

To: Erin Young, Water Resources Manager;  
City of Flagstaff Water Services

From: Carol Malesky, Principal  
Stantec Consulting Services Inc.

Date: February 8, 2024

**Reference: Pricing Objectives for Cost of Service-Based Rates and Fees**

As part of the Water, Reclaimed Water, & Wastewater Cost-of-Service Study (Rate Study), a discussion of pricing objectives or criteria used in rate-setting is useful for evaluating decisions made during the Rate Study. For the purposes of this discussion, the following pricing criteria are organized into five categories:

1. Revenue
2. Legal
3. Equity
4. Customer Impact
5. Administration

The table below summarizes the potential subcomponents of each major category.

Category	Pricing Criteria
Revenue	Revenue Sufficiency
	Revenue Stability
Legal	Legal Defensibility
Equity	Interclass (between classes) Equity
	Intraclass (within class) Equity
	Intergenerational (existing vs. new customer) Equity
Customer Impact	Affordability
	Conservation/ Demand Management
	Bill Stability
Administration	Administrative Burden
	Complexity/Customer Understanding
	Public and political acceptance

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## PRICING CRITERIA DEFINITIONS

### REVENUE

**Revenue sufficiency.** Rates and fees should be designed and set such that the full cost to provide service is recovered on an annual basis.

**Revenue stability.** The proposed alternative should minimize fluctuations in revenues due to changes in usage or other factors outside the control of the City.

### LEGAL

**Legal defensibility.** The rates and fees must be legally defensible if challenged.

### EQUITY

**Interclass equity.** This type of equity is improved if the alternative recovers the cost of serving each class. Each customer class pays its fair share and no class provides or receives a subsidy from another class. An example for the City is equity between residential and non-residential customers.

**Intraclass equity.** This type of equity is maximized when individual customers within a class pay their proportionate share for their contribution to the customer class revenue requirement. An example for the City is equity between low water/sewer users and large water/sewer users.

**Intergenerational equity.** Intergenerational equity is the relationship between new and existing customers. The addition of new customers should not burden existing rate payers. This is traditionally accomplished through the City's capacity fees to new customers for the cost of growth-related capital improvements.

### CUSTOMER IMPACT

**Affordability.** The ability of the alternative to provide a means for customers to influence their monthly bills by adjusting water consumption. Rate structures with higher base charges may present affordability challenges for lower income customers with low water use.

**Conservation/demand management.** The ability of the alternative to send the appropriate price signals to encourage efficient use of indoor and outdoor water use. Conservation rate structures are often used in combination with other non-price programs to achieve specific conservation reductions.

**Bill stability.** The implementation of an alternative may cause fluctuations in customers' bills due to the one-time structure change or on a monthly basis (winter vs summer). To minimize this, many utilities will transition, or phase-in, to a new rate/fee over a period of time. This criterion identifies the level of impact the City is willing to undertake with a new rate or fee change.

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## **ADMINISTRATION**

**Administrative burden.** The amount of administrative burden required to implement and maintain a new rate or fee. Billing system changes, changes to reporting requirements and staffing levels required to administer a rate structure may be affected with the administration of a new rate or fee.

**Complexity/customer understanding.** The public's ability to understand changes to a rate, fee, or structure.

**Public and political acceptance.** The rate study recommendations should be acceptable to the public and City Council. Acceptance of rates and fees is typically tied to community values and goals. This criterion typically requires gathering information on likely customer responses and the involvement of elected officials.

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