



August 2021

Made in California: Prop 218 and Water Rate Studies

California is known to be a “dry” state, where water is scarce and expensive. Californians pay the third-highest price for water in the United States, after West Virginia and Connecticut.¹ In California, local water districts typically reassess rates every five years.² Behind every water rate hike by a water district stands a water rate study and, in the shadow, Proposition 218.

Proposition 218 is a constitutional initiative, approved by California voters in November 1996, that significantly restricts local governments’ ability to raise revenue. It applies to nearly 7,000 cities, counties, school districts, special districts, including water districts, and other agencies. In essence, Proposition 218 requires that water districts set water rates on a cost-of-service basis, provide written notice of proposed changes, and hold at least one public hearing. To ensure compliance with Proposition 218, water districts seeking to update water rates often engage consulting firms to perform a water rate study.

Consistent with the cost-of-service principle, a typical water rate study calculates the amount of revenue the water district needs to collect through charges to its customers to cover its anticipated costs including operating costs, capital improvement costs, and debt servicing costs. A water rate structure is then designed to ensure that all costs are recovered fairly and equitably and that the rates will provide fiscal stability to the water district.

Water rate structures typically include a meter charge (or a fixed monthly fee) and a volumetric charge (uniform or tiered) and may also have other components specific to the water district such as peak-demand charges, energy charges, and other miscellaneous fees. Tiered water rate structures—those that charge progressively higher marginal rates as water use increases—can both encourage conservation and ensure that those users who place higher demands on the

¹ “Water Prices by State 2021.” *World Population Review* <<https://worldpopulationreview.com/state-rankings/water-prices-by-state>> (accessed June 22, 2021).

² See, for example, the most recent rate hike announced by the East Bay Water District. Rendell, Bob. “East Bay MUD to Vote on 4% Water Rate Increase.” *NBC Bay Area* (June 8, 2021) <<https://www.nbcbayarea.com/news/local/east-bay/east-bay-mud-to-vote-on-4-price-raise/2564520>> (accessed June 22, 2021).

system pay a larger portion of the costs. For a water rate study's proposed tiered rates to comply with Proposition 218, the proposed rates must correspond to the costs of providing service at each usage level.

Vega Economics has the expertise and resources to assist California public utilities by conducting water rate studies. Our director, Dr. Wenbiao Cai, has both research and consulting experience in utility management. Vega also has a partnership with Lechowicz & Tseng founders Alison Lechowicz and Catherine Tseng who have over 25 years combined experience in municipal consulting and public finance.

And our team has significant experience working with water allocation issues. We have been engaged to provide analysis related to water demand projection, water shortage estimation, water accounting, and economic analysis of a water transfer.

For any additional inquiries, please contact info@vegaeconomics.com.