

TO: GENERAL COMMITTEE

SUBJECT: WATER AND WASTEWATER FINANCIAL PLAN UPDATE

PREPARED BY AND KEY CONTACT: CRAIG MILLAR, CGA, ACTING DIRECTOR OF FINANCE, X. 4436

SUBMITTED BY: CRAIG MILLAR, CGA, ACTING DIRECTOR OF FINANCE *Craig Millar*
JOHN THOMPSON, P.ENG., DIRECTOR OF ENVIRONMENTAL SERVICES *John Thompson 12-04-12*

GENERAL MANAGER APPROVAL: E. ARCHER, CMA, GENERAL MANAGER OF CORPORATE SERVICES *E. Archer*
J. SALES, GENERAL MANAGER OF COMMUNITY OPERATIONS *J. Sales 12-04-12*

CHIEF ADMINISTRATIVE OFFICER APPROVAL: CARLA LADD, CHIEF ADMINISTRATIVE OFFICER *Carla Ladd*

RECOMMENDED MOTION

1. That Report FIN005-12, "Water and Wastewater Financial Plan Update" be received for information.

PURPOSE & BACKGROUND

Report Overview

2. The 2011 year-end financial results for water and wastewater services show a surplus that resulted from several one-time circumstances that will not recur in future periods. This report describes the approach staff are using to update the Financial Plan for water and wastewater services and the potential impact on rates for the 2013 business planning process.

Background

3. In January, Motion 12-G-010 provided the following direction to staff:

"That staff in the Finance Department investigate the feasibility of implementing a 10 year rate strategy for water and wastewater rates and services including the impact on the timing and financing of reserves, capital projects and rate structure, and report back to Finance and Corporate Services Committee in 2012 as part of the updated Drinking Water System Financial Plan".

Staff recognize the concerns expressed by customers about the cost of water and wastewater services and Council's desire to address them. It is important to note that while last year's one-time circumstances will be factored into staff's analysis, the financial plan and any decisions Council takes once it receives the updated plan needs to consider several years' worth of both historical trends and forward-looking information to ensure the plan remains viable in accordance with the province's Regulation 453/07.

4. The City of Barrie, like all Ontario municipalities, was required to produce a Drinking Water System Financial Plan under O.Reg. 453/07. Council approved this plan in 2010, following

consideration of Report CRP003-10 (see Appendix "A"). Prior to this plan's approval, Council approved several other policy changes that influenced the financial plan.

5. The province's objective in requiring a long range financial plan is to ensure municipalities have financially viable drinking water systems. While the determination of what constitutes a "financially viable" system is not specifically defined, it involves the use of full cost recovery calculations. This means rates should produce revenues sufficient for funding direct operating costs, indirect operating costs, financing costs and amortization charges. The plan must cover at least six years.
6. Council has been following the approved financial plan since its creation. The plan calls for annual rate increases of 13% for water and 19% for wastewater until 2014, with a continued 13% increase for water rates in 2015 but with wastewater rates increasing 5% in that year. These relatively sharp increases reflected Barrie's historically very low costs for water and wastewater services and information available at the time regarding planned operating costs, anticipated capital expenditures, forecast debt levels and consumption projections.
7. Notwithstanding these rate increases, costs for water and wastewater services remain well within the affordability threshold Council approved in the Financial Policies Framework. They also continue to be below the provincial average cost. In 2010 (the latest year for which comparisons are available), a typical residential home in Barrie that consumes 250 m³ paid 9% less for water and wastewater services than the provincial average.
8. It is also noteworthy, however, to recognize that Barrie residents have demonstrated a strong commitment to water conservation. Average water consumption in Barrie is approximately 25% lower than the provincial average. This influences revenue projections and rate forecasts.
9. Other standards established in the Financial Policies Framework for water and wastewater services have not yet been achieved. Specifically:
 - Stabilization Reserves for water and wastewater services were created in 2010 but have not yet been funded. Subject to the disposition of the 2011 surplus (see FIN001-12, also on this agenda), funds will be allocated to these reserves but their balances will still be well below target levels (i.e. no more than 10% of gross operating revenues)
 - Principal and interest charges for water rate supported debt exceeds 25% of the City's water revenues. By 2018, the corporation's policies call for debt charges not to exceed 25% of the City's water revenues.
 - Principal and interest charges for wastewater rate supported debt exceeds 25% of the City's wastewater revenues. By 2014, the corporation's policies call for debt charges not to exceed 25% of the City's wastewater revenues.

The Water and Wastewater Financial Plan needs to consider how, and when, the corporation can meet these standards.

10. Year-end 2011 financial results and variances associated with capital costs for both the Sunnidale Reservoir and Surface Water Treatment Plant projects introduce new elements to the financial plan update. Further to Council's direction regarding the development of a 10-year rate strategy, staff recognize the need to incorporate these recent financial results into the analysis.

ANALYSIS

Factors Influencing the Water and Wastewater Financial Plan Update

Operating Costs

11. As described in FIN001-12 ("2011 Year-end Financial Results"), both Water and Wastewater services generated a significant positive financial variance in 2011. Forecast year-end results, as reported in the 2012 Business Plan, were anticipated to be significantly below budget. Generally, this is attributable to delays in opening both the SWTP and the WPCC expansion, since the 2011 budget anticipated almost 12 months of costs associated with the SWTP and an earlier commissioning date for the WPCC expansion. These one-time experiences will not recur.
12. Similarly, the change in water and wastewater billing created an unusual, one-time circumstance in 2011 related to the timing of water and wastewater revenues. PowerStream, which provided meter reading and billing services until October 2011, typically had a two-month lag time in their consumption data. But the real-time data now available from the new automated meter reading infrastructure that went into operation in October eliminated the lag time. This means 14 months of revenue were recognized in 2011 and customers now have access to real-time, accurate billing data to help them manage their consumption levels.

Regulatory Requirements

13. As recently described in Council's March 21, 2012 education session about the *Safe Drinking Water Act*, provincial regulations introduce a variety of compliance requirements that drive process costs within Water Services. Similarly, other regulations associated with wastewater services (like those associated with the *Lake Simcoe Protection Act*, for example) have a similar effect. The effect of these regulations on the corporation's financial plan is to create some minimum and/or fixed costs that must be factored into any financing plans.

Capital Plan

14. The quality and completeness of the capital plan can have a significant impact on revenue requirements. Water and wastewater services must be self-funding – revenues need to be sufficient to recover capital, operating and financing costs. Changes in the value or timing of capital projects and/or changes in financing methods (for example, debt v. development charges) could influence annual revenue requirements.

Affordability

15. The Financial Plan not only needs to be sustainable, but it also needs to be affordable for customers. Currently, water and wastewater rates require 0.9% of household income, which is well below the 2.5% threshold established in the Financial Policies Framework. Provincially, the average household requires 1.0% of household income to pay for water and wastewater services based on the 2011 BMA Survey.

Water & Wastewater Rate Review Approach

16. The Financial Plan will be updated by Finance staff in collaboration with the Environmental Services Department and Corporate Asset Management (CAM). The objectives are to:
 - Assess the effect of smoothing rate increases over a longer time horizon (for example, 10 years) instead of the six years described in the 2010 financial plan. This will include, but

not be limited to, identifying the effect on affordability, reserve levels and compliance with applicable legislation.

- Reflect the latest information in the analysis including:
 - current reserve balances
 - current 2012 10-year capital plan and new capital requirements identified to remain in compliance with provincial regulations
 - current and projected annual debt servicing costs
 - consumption projections based on the corporation's new Automated Meter Infrastructure (AMI) data to increase accuracy of consumption forecasts
- Provide results of the analysis to Finance Committee and Council for implementation as part of the 2013 Business Plan

Potential Impact on 2013 Water and Wastewater Rates

15. The results of the analysis will include options that provide Council with an opportunity to reduce the planned 2013 increase for both water and wastewater rates. Staff will ensure information is provided to Council with sufficient lead time so that the implications of any changes in the financial plan can be discussed further, and budgets for 2013 can be established that reflect Council's decisions about the financial plan.

ALTERNATIVE

Alternative # 1

General Committee could choose to hire external consultants to complete the analysis.

This is not recommended as staff have sufficient understanding and capacity to address the analysis.

FINANCIAL

17. There is no direct financial impact associated with the recommendation in this report. Indirectly, the Financial Plan update will provide options for Council to consider that could reduce the planned 2013 increase for both water and wastewater rates.

LINKAGE TO COUNCIL STRATEGIC PRIORITIES

18. This is an operational matter with no direct relationship to Council's Strategic Priorities.

Appendix "A"

Report CRP003-10, "Drinking Water System Financial Plan"

Note: The appendix to Report CRP003-10 is not included with this report but is available for review in the Councillor's Lounge, or from the City's website.

TO: GENERAL COMMITTEE

SUBJECT: DRINKING WATER SYSTEM FINANCIAL PLAN

PREPARED BY AND KEY CONTACT: E. ARCHER, GENERAL MANAGER OF CORPORATE SERVICES X4419

SUBMITTED BY: E. ARCHER, GENERAL MANAGER OF CORPORATE SERVICES

GENERAL MANAGER APPROVAL: E. ARCHER, GENERAL MANAGER OF CORPORATE SERVICES

CHIEF ADMINISTRATIVE OFFICER APPROVAL: JON M. BABULIC, CHIEF ADMINISTRATIVE OFFICER

RECOMMENDED MOTION

1. That the Drinking Water System Financial Plan (the "Financial Plan"), presented as Appendix "A", be deemed to be viable and approved in accordance with Ontario Regulation 453/07.

PURPOSE & BACKGROUND

2. The purpose of this report is to present and obtain approval of the Financial Plan as required by the *Safe Drinking Water Act, 2002* ("SDWA"). Drinking water system owners are required to prepare a financial plan as part of the Municipal Drinking Water Licensing Program set out in Part V of the SDWA. A Municipal Drinking Water License is an approval issued by the Ontario Ministry of the Environment for the operation of a municipal drinking water system.
3. The Municipal Drinking Water Licensing Program reflects changes to the Ministry of the Environment's approvals process resulting from Justice O'Connor's *Report of the Walkerton Inquiry*. Part Two of Justice O'Connor's report stressed the importance of ensuring that municipalities plan for the long term financial sustainability of their drinking water systems to ensure that adequate finances are available to cover both day-to-day operational costs as well as the costs of maintaining and upgrading municipal water systems to ensure the safety of drinking water supplies now and in the future.
4. Ontario Regulation 453/07 describes the requirements of a Financial Plan that fulfils the licensing conditions set out in the SDWA. Financial Plans must:
 - a. be approved by a Council resolution that indicates the Financial Plan is financially viable
 - b. include a statement that financial impacts of the drinking water system have been considered and apply for a minimum six-year period
 - c. include details regarding proposed or projected financial operations using the Public Sector Accounting Board's "Statement of Operations" format for each year of the Financial Plan
 - d. be made available to the public who are served by the drinking water system upon request at no charge and online via publication to the corporation's website

Notice of the Financial Plan's availability must be provided to the public and a copy must be submitted to the Ministry of Municipal Affairs and Housing.

5. The Financial Plan, presented as Appendix "A", was prepared in accordance with Ontario Regulation 453/07. The City of Barrie received its Municipal Drinking Water License in November 2009. Therefore, under Regulation 453/07 the Financial Plan must be approved by July 1, 2010 and submitted to the province.

ANALYSIS

Report Objectives

6. The Financial Plan reflects the province's main objective – to require municipalities to develop a long-term strategy to ensure the financial sustainability of drinking water systems. This objective is consistent with Council's efforts to create policies and plans that help identify the long-term financial implications of current financing and service level decisions. In addition to complying with provincial legislation, it also represents the final step in the water/wastewater rate structure review Council started in 2009.
7. During this term of Council, the following policies and plans were approved that were instrumental in the preparation of the Financial Plan appended to this report:
 - a) The Annual Business Plan and 10-year capital plan
 - b) Development Charges Background Study and Policy
 - c) The Financial Policies Framework
 - d) The Long Range Financial Plan
 - e) The Capital Project Financial Control Policy
 - f) The Water and Wastewater Rate Structure
 - g) The Asset Management Strategy
8. The Financial Plan must cover a period of at least six years and be reviewed and re-submitted every five years as part of the renewal of the Municipal Drinking Water License. Updates to the attached plan can be made any time before the five-year reporting deadline. Considering the significant changes occurring now in water production and delivery processes within the corporation's water system, staff anticipate the attached plan will be updated prior to the next mandated reporting deadline.
9. The SDWA requires a declaration that the financial plan be "financially viable" but it does not give a clear definition of what is considered financially viable. The Ministry of the Environment released a Guideline ("Towards Financially Sustainable Drinking Water and Wastewater Systems") that includes nine principles that could be used to build sustainable financial plans:
 - h) Ongoing public engagement and transparency can build support for, and confidence in, financial plans and the system(s) to which they relate
 - i) An integrated approach to planning among water, wastewater, and storm water management is desirable given the inherent relationship among these services
 - j) Revenues collected for the provision of water and wastewater services should ultimately be used to meet the needs of those services

- k) Life-cycle planning with mid-course corrections is preferable to planning over the short-term or not planning at all
 - l) An asset management plan is a key input to the development of a financial plan
 - m) A sustainable level of revenue allows for reliable service that meets or exceeds environmental protection standards, while providing sufficient resources for future rehabilitation and replacement needs
 - n) Ensuring users pay for the services they are provided leads to equitable outcomes and can improve conservation. In general, metering and the use of rates can help ensure users pay for services received.
 - o) Financial plans are "living" documents that require continuous improvement. Comparing the accuracy of financial projections with actual results can lead to improved planning in the future
 - p) Financial plans benefit from the close collaboration of various groups, including engineers, accountants, auditors, utility staff, and municipal council
10. Sustainability, as defined by the Public Sector Accounting Board (PSAB) and used by staff during the annual business planning process to assess the corporation's financial condition, is the degree to which a [water owner] can maintain its current financial obligations and existing service commitments without increasing the debt or [rate] burden on the economy. As the plan in Appendix A shows, Barrie's water and wastewater services are not sustainable without debt financing and rate increases throughout the forecast period.
11. Staff recognize the need to manage both financial sustainability and affordability for customers. It is important to note that Council always retains the discretion to approve annual budgets and capital budgets that differ from the Financial Plan presented with this report. Annual budgets will continue to provide Council with opportunities to consider both financial sustainability and rate affordability.
12. Overall, the Financial Plan provokes consideration of the long-term financial implications of current service levels and financing decisions and provides a model to show how the water system's operational requirements could be fully funded over the forecast period. As presented in Appendix A, the corporation's water system is expected to operate with appropriate financial resources over the forecast period.

Report Overview

13. The Financial Plan consists of the following:
- a. Statement of Financial Position – this is the balance sheet in Municipal reporting and provides information about the assets, liabilities and accumulated surplus of the corporation's water system. As Appendix "A" shows, the corporation's water system will be in a net debt position of approximately \$16.8 million at the end of 2010. Net debt is expected to grow to \$141.0 million by 2012, then reduce annually until the net debt position reaches \$118.3 million in 2015;
 - b. Statement of Operations – this summarizes the revenues and operating expenses of the water system for a given period. "Net Revenues" measure whether the revenues generated were sufficient to cover the operating expenses incurred and are used to fund tangible capital asset acquisitions, reserve/reserve fund transfers and debt principal repayments. The Statement of Operations shows a cumulative net surplus over the

forecast period. This means the value of the resources used up to provide water and wastewater services (including asset amortization) will be lower than the revenues anticipated to be earned over the same period. The plan increases Council's flexibility to reduce its reliance on debt to finance asset renewals/replacements.

- c. Statement of Cash Flow – this summarizes how the water system is expected to generate and use cash during the forecast period. This statement shows positive ending cash balances in each year of the forecast period for water services; ending cash balances for wastewater services remain negative in each year of the forecast period.

To meet the Regulatory requirements certain budget and forecast figures needed to be restated to reflect consistency with the requirements for financial statement preparation as set out in PS1200 and PS3150 of the PSAB Handbook.

14. Most significantly, the PSAB requirements introduce the reporting of tangible capital assets on the Statement of Financial Position and the recognition of amortization expense on the Statement of Operations. The Financial Report also requires the allocation of asset and liability account balances that are maintained at a corporate level and not normally attributed to individual services.

Report Highlights

15. The report covers both water and wastewater services, although only the Water System is required reporting to the province. However, considering the initiatives already underway within the corporation to address long-term financial challenges staff felt it was prudent and appropriate to include the wastewater service in this analysis.
16. With respect to the Water System, the following reflect the critical few details of the plan:
- i. Interest charges on debt require, on average, 23% of annual revenue for each of the next six years. The range is 19% - 27%.
 - ii. Rate Revenue requirements need to increase, on average, 13% for each of the next six years.
 - iii. Capital spending is budgeted to be \$117.9 million over the next six years. The majority of spending occurs within the next three years, primarily related to the completion of the Surface Water Treatment Plant.
 - iv. Capital financing primarily comes from the Water Capital Reserve (48%) and debenture financing (33%). Development charges provide 15% of the capital plan's funding requirements.
 - v. Operating expenses average \$12.6M per year over the next six years. Generally, expenses are estimated to increase 3% per year.
17. With respect to the Wastewater System, the following reflect the critical few details of the plan:
- i. Interest charges on debt require, on average, 16% of annual revenue for each of the next six years. The range is 14% - 20%.
 - ii. Rate Revenue requirements need to increase, on average, 19% for each of the next five years, with a 5% increase required in the sixth year.

- iii. Capital spending is anticipated to be \$78.4 million over the next six years. The majority of spending occurs within the next three years as the Wastewater Pollution Control Centre construction is completed
- iv. Capital financing primarily comes from the Wastewater Capital Reserve (52%) and debenture financing (39%). Development charges provide 8% of the capital plan's funding requirements.
- v. Operating expenses average \$13.3M per year over the next six years. Generally, expenses are estimated to increase 3% per year.

Rate Revenue Requirements

18. As described earlier in this report, the Financial Plan was prepared in accordance with the province's regulatory requirements and the corporation's financial policies. The corporation's Financial Policies Framework establishes an affordability threshold for water and wastewater services. Specifically, it states that annual water/wastewater costs for a typical household will not exceed 2.5% of household income.
19. Currently, 0.8% of household income is required to pay for water and wastewater services. The Financial Plan assumes revenue increases from rates of 13% for water and 19% for wastewater throughout the forecast period. If these are the actual revenue increases approved by Council and consumption forecasts match those used as the basis for this plan, 1.4% of household income will be required to pay for water and wastewater services by 2015. This is within Council's affordability threshold established in the Financial Policies Framework.

Debt Charges

20. In addition to establishing an affordability threshold, the Financial Policies Framework also defines a limit for the amount of annual revenue that should be used to fund principal and interest payments on debt. For both water and wastewater services, principal and interest payments should not exceed 25% of annual revenue.
21. To comply with these policies, longer debt repayment terms were examined as part of the Financial Plan for portions of the debt yet to be issued for both water and wastewater services. As Council will recall, recently issued debt for the Wastewater Pollution Control Centre had a 20-year repayment term. At the time, rates for longer-term debt were higher than the 20-year rate and the incremental interest charges associated with longer payment terms prompted staff to conclude a 20-year term was appropriate. Work on the attached long-term financial plan was not yet complete, and staff noted then that longer payment terms for future debt issuance would need to be considered.
22. The reliance on debt financing for both water and wastewater systems' capital plans adds considerable pressure on annual revenue requirements. To alleviate this pressure, the plan assumes a 40-year repayment term for debt associated with the Surface Water Treatment Plant. While this increases total interest costs, it reduces annual cash requirements and reflects the long useful life of the asset. This helps manage affordability of rates and bring annual principal and interest costs closer to, but not within, the policy target that calls for these costs to be no more than 25% of annual revenue.

ENVIRONMENTAL MATTERS

23. There are no environmental matters related to the recommendation.

ALTERNATIVES

24. There are two alternatives available for consideration by General Committee:

Alternative #1

General Committee could amend Motion #1 by directing staff to revise certain assumptions regarding planned revenue and expense levels in a manner that strengthens the system's sustainability.

This alternative is not recommended as the Financial Plan was prepared in accordance with provincial regulations and using the corporation's existing policy framework, budget and capital plan/forecast. Strengthening sustainability would generally have a negative impact on affordability. While the Financial Plan is prescribed reporting by the province and may serve as a guide, Council will continue to determine annual water and wastewater rates through the annual budget process. Similarly, staff will continue seeking and, where appropriate, implementing process changes that reduce costs and/or improve service quality. These decisions will directly influence the systems' sustainability.

Alternative #2

General Committee could amend Motion #1 by directing staff to reduce the debt repayment term to 20 years for all outstanding debt before submitting the plan to the province.

This alternative is not recommended as it would prompt annual rate revenue increases greater than those currently included in the plan. Principal and interest payments would further exceed 25% of the City's water and wastewater revenues, which would be contrary to established policies in the Financial Policies Framework. Rate affordability, while not a consideration for provincial reporting purposes, would be negatively affected.

FINANCIAL

25. There are no direct financial implications for the Corporation resulting from the proposed recommendation. Although the Financial Plan may serve as a guide, water and wastewater rates, along with the related operating and capital budgets, will continue to be reviewed and approved by Council on an annual basis.

LINKAGE TO COUNCIL STRATEGIC PRIORITIES

26. The recommendation included in this Staff Report is not specifically related to any of City Council's Strategic Priorities.

APPENDIX "A"

Water and Wastewater Long-Range Financial Plan In Accordance with O.Reg. 453/07