

Financial Plan 2019-2022 – Stormwater Management Line of Service

EXECUTIVE SUMMARY

In 2013, Council approved financial policies for The City of Calgary's (The City's) Stormwater Management (Stormwater) line of service to strengthen the operational management of the service and to secure its long term financial outlook. This line of service was historically termed Drainage. A Stormwater financial plan that integrates financial targets with the approved financial policies has been developed. The establishment of financial targets allows Water Services and Water Resources (the Water Utility) to monitor progress towards long term goals and provide the flexibility to respond to changing circumstances.

This report provides revisions to the financial plan based on the results of a review of the current financial policies, measures, targets and timelines in relation to the goal of financial sustainability and resiliency to economic circumstance changes. This revised financial plan for the Stormwater line of service is aligned with the planning for One Calgary, and the development of stormwater charge (approved in the Bylaw as stormwater drainage service charge) for the 2019-2022 timeframe.

The City's Water Utility, operating the Stormwater line of service, remains on track to achieve compliance with the financial targets set out in this financial plan, thereby mitigating financial risks and ensuring a financially sustainable future. Maintaining progress towards compliance is contingent on the stormwater charge increases that will be presented to Council as part of the One Calgary Program for 2019-2022.

A Stormwater line of service financial plan for 2019-2022 (Attachment 1) provides an update on the assessment of financial risks and recommendations for the Stormwater line of service financial plan 2019-2022, and the specific changes recommended to policies, measures and targets are included in Attachment 2.

ADMINISTRATION RECOMMENDATION:

That the Standing Policy Committee on Utilities and Corporate Services recommends that Council approve the recommended financial plan policies, measures and targets for the Stormwater line of service for 2019-2022 as shown in Attachment 2.

And further, that Report UCS2018-0230 be forwarded as an item of Urgent Business to the 2018 March 19 Combined Meeting of Council.

RECOMMENDATION OF THE SPC ON UTILITIES AND CORPORATE SERVICES, DATED 2018 MARCH 14:

That Council approve the recommended financial plan policies, measures and targets for the Stormwater line of service for 2019-2022 as shown in Attachment 2

PREVIOUS COUNCIL DIRECTION / POLICY

2013 April 22, Council approved Drainage Financial Policies (UCS2013-0044), which included financial policies specific to the Drainage line of service.

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2014 March 17 Council received Drainage Financial Plan 2015-2018 (UCS2014-0022) for information, which included recommended financial targets and levels of service.

2014 May 05, Council approved 2015-2018 Drainage Indicative Rates (C2014-0103) directing Administration to incorporate a Cost of Service Study and a review of the Drainage Financial Plan, including program areas for potential acceleration in 2019-2022, into the 2015-2018 Action Plan; and to report back no later than 2016 June with an update on Drainage Financial Plan progress.

2016 May 25, Council received UCS2016-0414 Drainage Financial Plan Progress Report with updates on Drainage Financial Plan progress towards achieving the financial targets and maintaining compliance with the financial policies set out in Drainage Financial Plan.

2016 September 19, Council received C2016-0689 Drainage Indicative Rate-Revised for 2017 and 2018. Council directed decreasing the rate increases for the Drainage charge from 19.1 per cent per year to 7.4 per cent per year for 2017 and 2018. Council also directed Administration to report back in 2017 Q1 with revisions to Drainage Financial Plan that integrate industry best practice and the change to the timeframe in building the sustainment reserve balance.

2017 February 22, UCS2017-0175, Council further directed Administration to report back with revisions to the Drainage Financial Plan no later than 2018 June.

BACKGROUND

The City's Water Utility operates the Stormwater line of service under a utility business model. In this model, the business is self-funded, requiring revenues to cover all the costs of providing services. In addition to operating within relevant Council and Administrative policies, the Stormwater line of service also maintains financial policies specific to its operations. These policies, their associated measures, targets and the established timelines for compliance are the focus of the financial plan for this line of service.

The annual increases in the charge for the Stormwater line of service were approved in Action Plan 2015-2018 at 19.1 per cent increase per year, and they were reduced to 7.4 per cent per year for 2017 and 2018. This reduction in the increase required deferring the timeframe for compliance with financial policies and targets. Specifically, the target of achieving the 10 per cent of revenues sustainment reserve balance by 2018 deferred to 2022.

With rising capital investment required to maintain a highly reliable Stormwater line of service, meet regulatory requirements, protect the watershed and environment, and be resilient to environmental and economic changes, a revision for existing financial plan and financial policies is necessary.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

The structure of the financial plan includes policy statements, measures, targets, and the timeline for achieving those targets. Review of Stormwater financial plan is necessary to ensure it is current and relevant in terms of utilizing industry best practices to retain resiliency under

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changing environmental and economic conditions, while also meeting Council and citizen expectations.

Self-funded Activity

The Stormwater line of service operates under a self-funded, public utility model, where stormwater charge revenues, off-site levy (OSL) and sources other than the municipal tax shall cover all the operating and capital costs incurred to provide the service, as well as comply with the financial targets set out in the financial plan and achieve financial sustainability.

Revenue

The Stormwater line of service is funded by revenue based on the Council-approved stormwater charge and is supported through Council-approved OSL rates that recover costs associated with new growth. The OSL bylaw (C2016-0023, Bylaw 2M2016) approved by Council on 2016 January 11 included levy rates that will fund the full cost of infrastructure investments for new development.

Cost of Service

Since 2012, the Water Utility has committed that a Cost of Service Study shall be carried out in each of The City's multi-year business cycle to ensure costs are being recovered appropriately by each customer class and that the right mix of fixed and volumetric charges are in place to support long term sustainability. The goal of the Cost of Service Study is to balance fairness and equity to customers, financial sustainability of Stormwater and water resource management. A Cost of Service Study is currently underway to inform the 2019-2022 charges and provide recommendations on the potential for variable charges within this line of service for future business cycle.

Capital Investment

The Water Utility manages the long-term capital requirements through the ten-year Water Infrastructure Investment Plan (WIIP). Investment is required to meet the increasing demands on the stormwater system in response to regulatory and environmental protection requirements and Calgary's population growth. Optimum levels of service also require maintenance of the existing and growing system. There are ongoing programs to evaluate, monitor and identify infrastructure in the stormwater system that requires repair, replacement or upgrading. These programs are intended to migrate towards consistent and desired levels of service to customers.

The City of Calgary has a Wastewater Approval to Operate that specifies regulatory requirements under the Government of Alberta's Environmental Protection and Enhancement Act and requires renewals periodically. A renewal application was submitted in 2017 November, and is pending review by and discussion with Alberta Environment and Parks. Changes to targets, such as sediment loadings to the rivers, within the Wastewater Approval to Operate may impact the degree of investment required in the Stormwater line of service to ensure continued regulatory compliance.

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A driver of investment within the Stormwater line of service is the Community Drainage Improvement (CDI) program that delivers stormwater infrastructure upgrades in older communities, where the historical level of service during floods or storm events does not meet current service standards. The planning and delivery of the CDI program is proceeding according to plan, and opportunities to accelerate projects in the CDI stream of work are evaluated on an ongoing basis.

In addition to flood resiliency, capital investments within the WIIP are categorized using four investment drivers as shown in the table below.

Investment Driver	Objective	Percentage of WIIP
Maintain assets	Maintaining, protecting and extending the life of infrastructure investments.	20% - 25%
Regulatory & Environmental Protection	Continuing to meet increasingly stringent regulatory and environmental protection requirements.	15% - 20%
Service	Continuing to provide reliable and high-quality services to meet the needs of citizens.	10% - 20%
Growth	Providing infrastructure to meet the needs of a growing city.	45% - 60%

Financial Plan Revisions

A review of the financial plan for the Stormwater line of service was completed by a utility sector financial consultant in 2016 March and examined the magnitude of financial risk in the business as well as the adequacy and consistency of policies, measures and targets with industry best practice. The work done by this consultant has been considered, and informs the recommended revisions in this financial plan for 2019-2022.

The recommended changes include removing the debt limit of \$300 million as well as the debt servicing limit of a maximum of 40 per cent of revenues, but continuing to effectively manage the level of debt in the business by introducing a Debt Service Coverage Ratio and associated target to apply to this line of service. It also recommended using 120 days of annual operating expenditures as the target for sustainment reserve.

Except for a revision to the debt term policy statement, the financial plan 2019-2022 aligns with historical financial policy statements. Revisions to the financial plan for the Stormwater line of service for the 2019-2022 timeframe are summarized below and provided in Attachment 2.

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Policy Area	Measure	Revision
Debt and Cash Financing	Debt limit	Remove Maximum \$300 million Debt limit
Debt and Cash Financing	Debt Service to Revenue Ratio	Remove Maximum debt servicing 40% of revenues
Debt and Cash Financing	Debt Service Coverage Ratio	Minimum 1.75 times in Debt Service Coverage Ratio in Stormwater line of service for 2019-2022
Debt to Equity	Debt to equity ratio	Debt to equity ratio will be monitored annually and reported on periodically
Debt term	Length of debt term	Stormwater line of service will employ up to a 25-year debt term on major projects.
Sustainment reserve	Sustainment reserve balance	120 days of annual operating expenditures

Management of Stormwater line of service debt

Debt Service Coverage Ratio is a measure of the Water Utility's ability to pay debt service obligations. The Debt Service Coverage Ratio, recommended replacing the current \$300 million debt ceiling and the maximum 40 per cent of revenues for debt servicing, can better measure the ability to meet debt servicing requirements. A minimum target of 1.75 times will be maintained for the Debt Service Coverage Ratio. This represents how many times the principal and interest payments can be made, once operating expenses and payments to The City have been made. In the case of the Stormwater line of service, there are no payments to The City, so it is measured after operating obligations are met. Further, for 2023-2026, it is recommended that the Debt Service Coverage Ratio target be increased to 1.80 times. This will function as capital contingency to ensure some debt capacity is maintained for unexpected capital requirement. This new mechanism for managing the level of debt will maintain Stormwater debt levels within the historical \$300 million debt ceiling.

It is recommended to change the wording of the debt term policy from "25 year" to "up to 25 year" in the Stormwater line of service financial plan 2019-2022 to provide greater flexibility to match debt terms to specific asset.

Reserve

The sustainment reserve has the purpose of serving both operating and capital, which has a current target of 10 per cent of revenue. Industry best practice indicates the reserve target should be tied to operating expenditures. As such, a target of 120 days of annual operating

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expenditure, is recommended and will be achieved by the line of service by the end of 2022. In terms of the sustainment reserve balance to be achieved and maintained, the 120 days operating expenditures is slightly higher than the previous 10 per cent of revenues target.

Stakeholder Engagement, Research and Communication

The Water Utility and Finance have undertaken the work to review progress on compliance with the financial plan. This work is overseen by a combination of operational, financial and strategic staff, and has been completed leveraging expertise across business units, as well as independent financial consultants. Financial benchmarking data was also reviewed, which compared the Stormwater line of service to that in other municipalities across Canada.

Strategic Alignment

A focus on the financial capacity and sustainability of the Stormwater line of service enables The City's Utilities & Environmental Protection (UEP) Department to deliver its commitment on three Council Priorities:

- To support a city of inspiring neighbourhoods, the Water Utility provides stormwater management infrastructure needs of a growing city, enhances The City's ability to prepare/respond to natural disasters, and builds resiliency to flooding.
- Contributing to a healthy and green city, the Water Utility, and UEP, lead by example to protect public health and the environment, and ensure regulatory compliance.
- The financial discipline demonstrated through Stormwater line of service's performance within its financial plan is an example of commitment to a well-run city.

Strengthening the financial capacity and sustainability of Stormwater line of service aligns with The City's Long Range Financial Plan and the Municipal Development Plan. Ensuring that there is sufficient funding available to support growth, and operate and maintain the systems also aligns with The City's 2020 Sustainability Direction, and the Corporate Growth Management Framework.

Social, Environmental, Economic (External)

The Stormwater line of service is fundamental to the community and the larger watershed. Compliance to the business' financial plan policies and targets will ensure that the social, environmental and economic goals of UEP are delivered under sound and sustainable financial policies.

Financial Capacity

Current and Future Operating Budget:

The Water Utility has reviewed progress on the current financial plan with the financial targets set out in the plan, to ensure a financially sustainable future and to manage operating pressures facing the business. A course of revision of financial policies statements, measures, targets and timelines for compliance is required to ensure a sustainable future and to manage operating pressures facing the business.

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Current and Future Capital Budget:

In response to the continuously changing economic situations, the Stormwater line of service has adjusted the capital budgets 2016-2018 through the corporate capital budget recast. The Stage Gating process implemented in 2016 also provides additional controls to ensure that budget is allocated to the highest priority projects at the time when projects are ready to proceed and with the most accurate cost projections.

Risk Assessment

Achieving compliance with the financial targets set out in Stormwater lines of service financial plan will ensure a financially sustainable future for the Stormwater line of service and mitigate financial risk due to environmental or economic changes and uncertainty of OSL revenue.

REASON(S) FOR RECOMMENDATION(S):

This report provides updates on the Stormwater line of service financial plan and summarises proposed financial policies for financial sustainability.

Confirming any changes to financial policies in 2018 March will be an important step prior to establishing the next four years' operating and capital budgets as is completing the Cost of Service Study to inform the stormwater charges for 2019-2022.

ATTACHMENT(S)

1. Attachment 1 – Financial Plan for 2019-2022 Stormwater Management Line of Service
2. Attachment 2 – Revisions to Stormwater Management line of service financial plan for 2019-2022