

Financial Plan, Policies and Targets

Updates to Financial Policies and Targets

The structure of the financial plan includes policy statements, measures, targets, and the timeline for achieving targets. Review of the financial plan for The Water Utility lines of service is necessary to ensure it is current and relevant in terms of reflecting industry best practices to retain resiliency under changing environmental and economic conditions, while also meeting Council and citizen expectations.

In keeping with Administration's vision to modernize government and introduce or update financial mechanisms, and in light of ongoing pressures to utility rates, service commitments to Calgarians, continued focus on financial sustainability in the current economic conditions and utility industry best practice, Administration has reviewed the current policies, measures and targets, and recommend the following two updates:

Payment to the Corporation

The Water and Wastewater lines of service currently remit payment to the Corporation in the form of franchise fees and dividends. The franchise fee is calculated as 10 per cent of utility rate revenue collected from inside City customers. The dividend is a fixed annual amount dating back to 2004. Both the existing franchise fee and dividend will be replaced with an annual payment in the form of a return on equity.

The calculation of a return on equity uses a widely accepted and standardised method by applying a reasonable and agreed upon return percentage on the value of equity. The proposed 8.5% rate of return is in general alignment with industry standards and The City will continue to scan the utility environment for consideration of rates in the future. The City proposes that the rate of 8.5 per cent will be in effect for the duration of the current budget cycle for 2021 and 2022 and will review and update as needed for future budget cycles.

The calculation of utility rate base equity is based on utility assets net of non-rate base funding sources such as off-site levies and government grants. To calculate projected utility rate base equity, forecasted capital spend will be considered additions to utility assets.

Debt Financing and Servicing

Debt servicing limits are established to ensure debts and related interest costs are repaid in a timely manner. The debt service coverage ratio states operating income as a multiple of debt, and the target is stated in terms of how many times debt servicing obligations could be paid after other obligations are met. It reflects the line of service's ability to pay debt service after first paying for critical operations and maintenance expenditures and required transfers to The City.

The minimum target for each line of service is currently 1.75 times, increasing to 1.8 times from 2023 onward. The future increase was to function as capital contingency to ensure some debt capacity for unexpected capital requirements.

These targets are very conservative relative to the Standard & Poor's Global ratings criteria for US Public Finance Waterworks, Sanitary Sewer and Drainage Utility Systems that aligns a debt service coverage ratio of 1.4 to 1.6 times to a very strong AA+ profile, and 1.6 times or above to an extremely strong AA+ profile.

Administration recommends revising the debt service coverage ratio minimum target for each line of service to 1.6 times. This new target continues to maintain overall debt for The Water Utility at a level consistent with The City's internal financial planning standards while still providing each line of service with additional debt funding capacity. The revised debt service coverage ratio target has been incorporated into the revised Water Utility rates analysis.

Financial Policy Matrix

Policy Area	Policy Statement	Financial Measure	Financial Target
Self -Sustaining Utility	Water, Wastewater, and Stormwater Management services are provided under a self-sustaining, public utility model and all costs shall be recovered through user rates, levies, fees and sources other than the municipal tax base.	N/A	Meet all financial policies and not require tax support
Debt and Cash Financing	The Water, Wastewater, and Stormwater lines of service shall debt finance capital projects that are substantial in cost and size and where the benefits will extend over a relatively long period. Subject to funding availability, the Water and Wastewater lines of service shall cash finance capital projects that are part of an on-going improvement program, or will reduce the operation and maintenance costs.	Debt Service Coverage Ratio	Maintain a Debt Service Coverage Ratio to a minimum of 1.6 times
		Cash financing of Maintenance Capital	100%
Debt to equity ratio	The Water, Wastewater, and Stormwater lines of service monitor annually and report periodically on the debt to equity ratio.	Debt to equity ratio	60/40
Debt Term	The Water, Wastewater, and Stormwater lines of service will employ up to a 25 year debt term on major projects.	Length of debt term	N/A
Sustainment reserve	The Water, Wastewater, and Stormwater lines of service will maintain sufficient reserves to mitigate risks.	Number of days of Annual operating expenditures	Equal to 120 days of annual operating expenditures
Return on Equity	The Water, and Wastewater lines of service will pay a return on equity (formerly referred to as dividend) to The City of Calgary.	N/A	N/A
Franchise Fee	In lieu of property taxes, the Water and Wastewater lines of service will pay The City of Calgary a 10 per cent tax on revenue. This tax on revenue, referred to as the franchise fee, is based on the total of sales and service charges and excludes developer fees and acreage assessments.	N/A	-N/A
Depreciation	The Water, Wastewater, and Stormwater lines of service will maintain depreciation rates that are aligned with generally accepted accounting practices. Depreciation on donated assets is not charged as an operating expense for the purpose of rates setting.	N/A	N/A

Note: Revisions to financial plan formatted in **Bold**.

