## UTILITIES INDICATIVE RATES – REVISED FOR 2017 AND 2018

### EXECUTIVE SUMMARY

This report presents Administration's analysis and recommendations regarding opportunities to reduce the Utilities approved rate increases for 2017 and 2018. Through the process leading up to the presentation of the Action Plan budget and business plan, Utilities received Council approval for indicative rate increases for the water and wastewater lines of service. These rate increases were approved by Council in support of the Utilities achieving compliance with their overall financial plan.

In response to the financial impacts felt by the Calgary community related to the current economic conditions, Administration has undertaken a review of all opportunities to reduce the magnitude of annual rate increases for 2017 and 2018. After reviewing the factors and drivers in Utility rates, Administration presents two options for reducing the currently approved 8.3 per cent per year utility rate increases.

Administration recommends that the Action Plan approved 2017 and 2018 utility rate increases be revised to reflect a 2.5 per cent per year increase in 2017 and 2018. This proposed rates scenario leverages efficiencies and service reductions while maintaining capital investment required to build, upgrade, and maintain infrastructure to provide high quality services to customers. It results in a moderate impact on the indicative rates for the 2019-2022 timeframe. Compliance with financial policies is maintained with the exception of the requirement to build the 10 per cent of revenues sustainment reserve balance by 2018, which will be delayed until 2022. In comparison to a zero per cent increase scenario, a 2.5 per cent per year increase offsets some risk of off-site levy revenue not materializing due to the uncertainty of growth and development, and will have less impact on rates in 2019-2022.

### ADMINISTRATION RECOMMENDATIONS:

That Council direct Administration to:

1. Present an operating budget adjustment for 2017 and 2018 and related bylaw amendments based on the reduced utility rate increases in Attachment 2 as part of Mid Cycle Adjustments; and
2. Report back in Q1 2017 with revisions to the Utilities Financial Plan that integrate utility industry best practice and the change to the timeframe of building the sustainment reserve balance.

### PREVIOUS COUNCIL DIRECTION / POLICY

At its 2011 June 28 meeting, Council adopted Report C2011-66 (Utilities Financial Plan and Indicative Rates) and approved the recommended Utility financial policies. Council also directed Administration to incorporate a cost of service study for the Utilities and Drainage in the 2012-2014 business plan.

2014 March 17 Council received UCS2014-0021 Water and Wastewater Utilities 2012-2017 Financial Plan update for information.

On 2014 May 05, Council approved C2014-0103 directing Administration to develop 2015-2018 Action Plan based on a blended utility rate increase of 8.3 per cent per year, which would enable meeting the targets set out in the Utilities Financial Plan by the end of the business cycle.

At the 2014 November 24 Special Meeting of Council, Council approved Action Plan 2015-2018 with Utilities' operating and capital budgets that had been developed based on the approved annual rate increases of 8.3 per cent for 2015-2018.

## BACKGROUND

The Water Services and Water Resources business units operate the Water and Wastewater Utilities under a utility business model. In this model, the Utilities are self-supported – requiring revenues to cover all the costs of providing services. In addition to operating within relevant Council and Administrative policies, the Utilities maintain financial policies specific to their operations. These policies, their associated targets and an established timeline for compliance, comprise the Water and Wastewater Utilities Financial Plan.

In 2014 May (C2014-0103) Council directed Administration to develop 2015-2018 Action Plan based on a blended utility rate increase of 8.3 per cent per year, which would enable meeting the targets set out in the Utilities Financial Plan by the end of the business cycle.
Table 1 below shows the breakdown of water and wastewater rate increases that make up a blended utility rate increase of 8.3 per cent per year, which was approved as part of Action Plan.

**Table 1. Action Plan Approved Water and Wastewater Rate Increases**

| | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|
| Blended | 8.3% | 8.3% | 8.3% | 8.3% |
| Water | 2.0% | 2.0% | 2.0% | 2.0% |
| Wastewater | 16.9% | 15.8% | 14.9% | 14.2% |

## INVESTIGATION: ALTERNATIVES AND ANALYSIS

In response to the current economic conditions Administration has undertaken a review of all opportunities to reduce the magnitude of annual rate increases for 2017 and 2018. Based on ability to vary factors and drivers in Utility rates, Administration has examined options for reducing the currently approved 8.3 per cent per year utility rate increases.

The self supported and capital intensive nature of the utility business is a driver of utility rates, in addition to the requirement to comply with the Utilities Financial plan. These drivers, and the financial performance of the Utilities to date, do present an opportunity to reduce the magnitude of the rate increase in the short term. However, reducing rate increases in the short term will have an impact on utility rates in the next business cycle.

Based on ability to vary factors and drivers in Utility rates, Administration presents the following two options for reducing the currently approved 8.3 per cent per year utility rate increases:

- Zero% Increase: Reduces the currently approved 8.3 per cent per year increase in 2017 and 2018 to zero per cent in 2017 and 2018, with a higher rate increase forecast for 2019-2022; and

- 2.5% Increase: Reduces the currently approved 8.3 per cent per year increase in 2017 and 2018 to 2.5 per cent in 2017 and 2018, with a similar rate increase forecast for 2019-2022.

Scenarios are shown in Figure 1 and summarized in Table 2 below. The key difference between these scenarios is their impact to the rate increases predicted for the 2019-2022 timeframe.

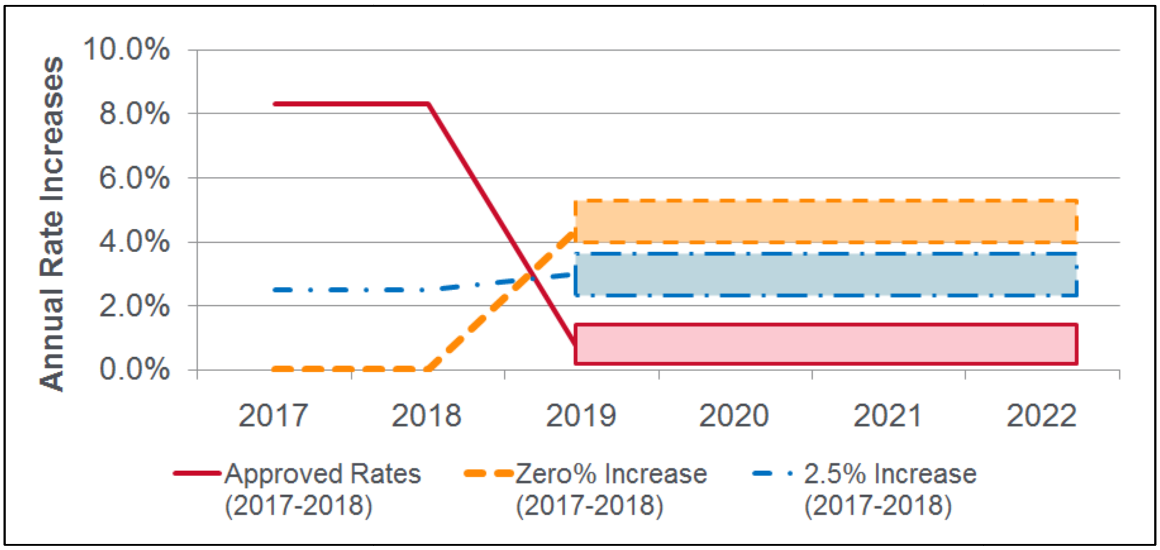


**Figure 1. Scenarios for Rate Increases in 2017 and 2018, and Impact on Future Rates**

**Table 2. Impact of Scenarios on Utilities Financial Policies**

| 2017 and 2018 increases | Operating Budget | Capital Priorities | Cash for Capital Maint. | Maximum Debt $B (Year) | Max Debt Service % (Year) | 10% of Revenue Reserve Balance | Indicative Annual Increase (2019-22) |
|---|---|---|---|---|---|---|---|
| Zero % | 98% of Action Plan | 100% | 100% | $1.975 (2021) | 26.3% (2022) | 2022 | 4 to 5% |
| 2.5 % | 98% of Action Plan | 100% | 100% | $1.919 (2020) | 26.1% (2022) | 2022 | 2.5 to 3.5% |

To mitigate the impact of the reduced rate increases, Administration identified efficiencies and service reductions that can be achieved to reduce operating expenditures by two per cent. No capital related mitigations are recommended on the basis that the capital priorities identified in Action Plan are still required, and that investment according to the recast budget will provide stimulus in this economic downturn.

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Also key to mitigating the rate reductions, is leveraging the funds in the utilities sustainment reserve, and delaying achieving the 10 per cent of revenues sustainment reserve balance from 2018 to 2022.

Administration recommends that the Action Plan approved 2017 and 2018 utility rate increases be revised to reflect a 2.5 per cent per year increase in 2017 and 2018. This proposed rates scenario leverages efficiencies and service reductions, while maintaining capital investment required to build, upgrade, and maintain infrastructure to provide high quality services to customers. It is projected that, for utilities, off-site levy revenue will be $15.1 million unfavourable in 2016. In comparison to a zero per cent increase scenario, a 2.5 per cent per year increase offsets some risk of off-site levy revenue not materializing due to the uncertainty of growth and development, and will have less impact on rates in 2019-2022.

The recommended rate increase offers the savings in Table 3 on the typical residential metered bill, relative to the Action Plan approved rate increases.

**Table 3. Customer Savings – 2.5% Rate Increases in 2017 and 2018 Scenario**

| | 2017 | 2018 |
|---|---|---|
| **Annual customer savings relative to Action Plan approved rates**<br><br>**Typical Bill – Residential metered** | $70 | $148 |

Consistent with the rates that were approved as part of Action Plan, the revised rates for 2017 and 2018 will also incorporate Cost of Service adjustments, to continue closing 50 per cent of the cost allocation gap by 2018. These adjustments mean that customers in distinct classes will see annual rate changes that vary from the overall utility rate increase.

The services provided to the outside city customer class are agreed upon through Master Servicing Agreements between The City and regional customers. The rates charged to these customers are based on the amount and type of service that has been contracted for, and the specific capital required for those services. The service required by regional customers, and the costs associated with the services have not been revised, and as such there will be no change to the outside city customers' rate increases.

**Stakeholder Engagement, Research and Communication**

The Water Utility, in partnership with Finance, manages expenditures within the operating and capital budgets approved by Council, forecasts the future requirements to deliver services to Calgarians that drive utility rates, and reviews progress on compliance with the financial plan. This work is overseen by a steering committee of operational, financial and strategic staff. Financial benchmarking is also performed annually to compare the Utilities against other municipalities across Canada.

**Strategic Alignment**

A focus on the financial capacity and sustainability of the Utilities enables Utilities & Environmental Protection (UEP) to deliver its commitment on three Council Priorities:

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

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

**Social, Environmental, Economic (External)**

The current economic downturn has affected the Calgary community. With reduced rate increases for 2017 and 2018, the Utilities can still ensure that the social, environmental and economic goals are delivered under sound and sustainable financial policies, while reducing the magnitude of water and wastewater bill increases for Calgarians.

**Financial Capacity**

**Current and Future Operating Budget:**

The Utilities have made considerable progress on the Utilities Financial Plan; however remaining on track to achieve compliance with the financial targets set out in the Utilities Financial Plan would require maintaining the Council approved rate increases for the 2015-2018 budget cycle.

A two per cent reduction in expenditures for operating the Utilities can be achieved through efficiencies and service reductions that have been identified. Combined with a delay in the building of the sustainment reserve balance from 2018 to 2022, these create the financial capacity required to absorb the impact of reduced rate increases in 2017 and 2018.

The recommended 2.5 per cent per year rate increase for 2017 and 2018 will result in less revenue for Utilities ($34 million in 2017 and $72 million in 2018) relative to the currently approved rate increases. This will need to be offset by reducing operating expenditures and deferring the building of the 10 per cent of revenues balance in the sustainment reserve. Franchise fees paid to the corporation will be lower by a total of $10.6 million. This is a reduction of corporate revenue by $3.4 million in 2017 and $7.2 million in 2018.

Overall outstanding debt required to support capital investment, and the Utilities' debt service ratio, are forecast to be minimally higher under the reduced scenario than with approved rate increases. These can be accommodated within the overall debt and debt servicing limits of the corporation.

**Current and Future Capital Budget:**
The recommended Utility rate increases for 2017 and 2018 are adequate to support the expected delivery of approximately $325M in capital projects annually over the remainder of this business cycle. The capital budget approved in Action Plan was built according to the split between capital investment drivers identified in the Water Infrastructure Investment Plan (WIIP).

Per the recommendation approved by Council on 2015 November 25, in report C2015-0855, Utilities is undertaking a recast of the capital budget for Water and Wastewater. The recast process will result in a Utilities capital budget more closely aligned with anticipated capital spend, and will still ensure that the investment commitments made in Action Plan are fulfilled. Once the budget is recast, Utilities will deliver capital through a process with additional controls to ensure that budget is allocated to highest priority projects, when they are ready to proceed and with the most accurate cost estimates available.

**Risk Assessment**
Achieving compliance with the financial targets set out in the Utilities Financial Plan will ensure a financially sustainable future for the water and wastewater Utilities. The Utilities have made considerable progress towards targets, and compliance by the end of 2018 would require maintaining the approved rate increases from Action Plan. Delaying building the sustainment reserve balance to 2022 from 2018 extends the period of time in which the utilities do not have reserve funds to provide cash flow for minor fluctuations in operating and capital budget expenditures, or to mitigate the risk of periodic shortfalls in projected revenue.

The approved off-site levy rates increase forecasted revenues in future years, and this may decrease pressure on utility rates in 2019-2022. However, these revenues are still uncertain due to the current economic environment.

**REASONS FOR RECOMMENDATIONS:**
In response to the impact the current economic downturn is having on the Calgary community, Council is requested to direct Administration to reduce the Action Plan approved 2017 and 2018 utility rate increases to reflect a 2.5 per cent per year increase in 2017 and 2018. This proposed rates scenario leverages efficiencies and service reductions, while maintaining capital investment required to build, upgrade, and maintain infrastructure to provide high quality services to customers. In comparison to a zero per cent increase scenario, a 2.5 per cent per year increase offsets some risk of off-site levy revenue not materializing due to the uncertainty of growth and development, and will have less impact on rates in 2019-2022.

**ATTACHMENTS**
1. Utilities Indicative Rates – Revised for 2017 and 2018
2. Recommended 2017 and 2018 Utilities Rate Increases
3. Presentation: Utilities Indicative Rates – Revised for 2017 and 2018