2015-2018 UTILITIES INDICATIVE RATES

EXECUTIVE SUMMARY

Most of the material presented in this report and attachments was already presented at the 2014 March 17 Special Meeting of Council. It is repeated here for completeness, to provide background and rationale for the recommendations in this report.

As part of the development of the 2015-2018 Action Plan, the Utilities have developed the proposed 2015-2018 water and wastewater Utilities indicative rates. The proposed indicative rates will enable the delivery of the capital investments outlined in the WIIP and the increased operating expenditures that are necessary for the Utilities to continue to deliver high quality services to Calgarians, while meeting regulatory requirements and providing the infrastructure necessary for a growing city. The proposed indicative rates will also ensure the long term financial health of the utilities.

Under the Utilities' business model, the Utilities must ensure that revenues can cover all expenditures. The proposed indicative rates have been built on the assumption that acreage assessments recover about half of the costs of water and wastewater infrastructure required to support growth as per the current Standard Development Agreement. Because the current Agreement is set to expire in 2015, the Utility rates will need to be reviewed once the new Standard Development Agreement is developed and the impacts on the Utilities' revenues can be evaluated.

ADMINISTRATION RECOMMENDATION(S)

That Council:

1. Direct Administration to prepare the 2015-2018 Action Plan based on:
   a. The Indicative Utility Rates in Attachment 2;
   b. The Utility financial targets for 2015-2018 in Attachment 2;
   c. An implementation plan for the cost allocation recommendations of the cost of service study;
2. Direct Administration to incorporate a cost of service study and an evaluation of financial policies and targets for 2019-2022 in the 2015-2018 Action Plan;
3. Direct Administration to report back no later than 2016 June with an update on the Utilities Financial Plan progress and any necessary Utility rate adjustments, including any adjustments required to reflect the new Standard Development Agreement; and
4. Direct that this report is kept confidential until rise and report; and that the in camera presentations and discussions remain confidential under Sections 23(1)(b), 24(1)(a) and (b) of the *Freedom of Information and Protection of Privacy Act or* until directed otherwise.

PREVIOUS COUNCIL DIRECTION / POLICY

At its 2014 February 26 meeting, SPC on UCS received the Water and Wastewater Utilities 2012-2017 Financial Plan Update (UCS2014-0021) for information and forwarded it to the 2014 March 17 Strategic Session of Council.

At the 2014 March 17 Strategic Session, Council adopted the 2015-2024 Water Infrastructure Investment Plan (WIIP) report (C2014-0095) and directed Administration to incorporate the Water Infrastructure Investment Plan into the 2015-2018 Action Plan.

In addition, Council adopted the 2015-2018 Utility Rate Scenarios report (C2014-0088) and directed Administration to return to the proposed 2014 May 5 Strategic Planning Meeting of Council with indicative rates for the 2015-2018 Action Plan based on:

a. The operating and capital budget requirements identified in the report;
b. Appropriate utility financial targets for 2015-2018 and for 2019 – 2024; and
c. The findings and recommendations of the Cost of Service Study regarding the Utility Financial Policies.

BACKGROUND

On February 26, Administration provided the SPC on Utilities and Corporate Services with a report on the progress made to date on the Utilities Financial Plan, which was established in 2011. As part of the process to develop indicative rates for the upcoming 2015-2018 budget cycle, the Utilities outlined the capital and operating pressures currently facing the water and wastewater Utilities.

The Utilities manage and operate infrastructure valued at approximately $38 billion across three lines of service: water, wastewater and drainage. This infrastructure is vital to the delivery of high quality drinking water, the collection and treatment of wastewater, and the management of stormwater. A capital investment plan is needed to ensure that capital expenditures optimize the value of services, minimize the risks to this capital-intensive business, and remain affordable to utility rate payers.

The Water Infrastructure Investment Plan (WIIP) presented to the 2014 March 17 Special Meeting of Council provides a prioritized perspective for long-term strategic investments in infrastructure. The plan balances the needs of citizens with business risks and the financial capacity of the Utilities. The result is a plan that provides a logical sequence of capital expenditures over the next ten years.

The Utilities are also undertaking a cost of service study. One of the outcomes of the study is a review the customer classes and the recommendation of the equitable allocation of costs. This includes rate design considerations for each of the customer classes that reflect the current and future state and support achieving the Utilities Financial Plan. The Study includes a review of the financial policies and targets within the context of rate designs.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

The utility rates are impacted by capital investments, operating expenditures, and the requirements to achieve compliance with financial policies and targets. The 2012-2017 Utilities Financial Plan was established in 2011 and included the requirement to achieve financial targets in six years (by 2017) which represented two budget cycles. After two years, the Utilities have made good progress towards the targets identified in the plan. To align with the new four year budget cycle, the Utilities have evaluated the rate impacts required to achieve the financial targets by 2018 (Attachment 1).

The Water and Wastewater Utilities allocate and record revenues and expenditures separately. Because the capital investment needs for infrastructure and operating costs are unique to each Utility, the amount of debt each Utility has is also different. Due to these variances, the water and wastewater utility rates are different. However, for simplicity the Utilities have developed a blended rate. The blended rate considers a weighted average of the water and wastewater rates. Rates discussed in this report are blended rates and the rate impacts discussed represent a combined impact.

Based on the review of the rate impacts, Administration has summarized the rate impacts in a proposed indicative rate scenario (Attachment 1, Table 2). This proposed rate scenario includes an average operating increase of $29 million, an average increase of $100 million in capital spend, and the achievement of financial compliance by 2018 to align with the new four year budget cycle. The total estimated rate impact is 8.3 percent per year. This translates into a $6.95 increase to the average monthly household bill for 2015. The separate water and wastewater rates that make up the blended rate are shown in Table 3 of Attachment 1, and in Attachment 2.

The proposed indicative rates are based on revenue projections that use the acreage assessment rates embedded in the current Standard Development Agreement. Because the new Standard Development Agreement will not come into effect until 2016, any increased revenues will not be realized until 2017 at the earliest. Changes to the percentage of cost recovery for growth related water and wastewater infrastructure in the next Standard Development Agreement would have a notable impact on the Utility rates.

Stakeholder Engagement, Research and Communication

Water Resources has established a policy review team that reports regularly to a steering committee of operational, financial and strategic staff. The team accesses expertise across business units, as well as independent financial consultants. Financial benchmarking data was also reviewed which compared the Utilities against other municipalities across North America.

Internal stakeholders were engaged in the review of capital and operating needs. Finance is a vital partner in the financial operations of the water and wastewater Utilities.

Strategic Alignment

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 Water and Wastewater Utilities provide fundamental services to the community and the larger watershed. Development of the 2015-2018 Action Plan and achieving the Utilities Financial Plan will ensure that the social, environmental and economic goals of the Utilities are delivered under sound and sustainable financial policies.

Financial Capacity

Current and Future Operating Budget:

The rate impacts of the operating budget requirements identified for biosolids management, energy costs, new operating requirements related to the WIIP and inflation have been reviewed and incorporated into the proposed indicative rate scenario for 2015-2018.

Current and Future Capital Budget:

Investments have been identified in the WIIP to address the capital pressures facing the water and wastewater Utilities. The Utilities have identified the need to increase the capital spending from the current $200 million per year to $300 million per year for water and wastewater to address those requirements. The rate impacts of this increased capital budget have been incorporated into the proposed indicative rate scenario for 2015-2018.

Risk Assessment

The Utility rates are impacted by the capital and operating requirements and the timeline to achieve financial compliance. Reductions in any of these components could reduce rates, but would also result in increased risk.

Reductions in the infrastructure investment plan would significantly impact the Utilities' ability to meet regulatory compliance, support growth and maintain infrastructure and service levels.

Over the 2012-2014 budget cycle, the Utilities have been managing operating budget shortfalls related to biosolids management, and energy costs by making reductions in other program areas such as maintenance. Reductions in the operating requirements identified would result in further reductions in maintenance activities. Over the short term, these reductions in the maintenance programs may not be noticeable, however, delaying maintenance activities increases the risk and likelihood of disruptions to service and higher repair/replacement costs at a later date and are not recommended.

Achieving compliance with the financial targets set out in the Utilities Financial Plan will ensure a financial sustainable future for the Water and Wastewater Utilities. The shift in one year, to achieve financial compliance by 2018 has minimal risk. The Utilities continue to focus on debt management and building up their sustainment reserves to address financial risk to the Utilities.

The results of the Water and Wastewater cost of service study could result in changes to the allocation of costs between customer classes. There is a risk that the re-allocation of costs between customer classes could result in further changes to the individual customer rates.

Water and wastewater infrastructure is considered to be leading infrastructure. The infrastructure needs to be installed before development can occur. The revenue generated from acreage assessments is dependent on the amount of land developed in any one year. As a result, the revenue from acreage assessments is collected after the infrastructure is completed and expenditures are incurred. In some cases, the recovery from acreage assessments can be years later. In the years that development is less than projected, rate revenues would be required to make up any shortfalls for growth related expenditures. Increases to the percentage of cost recovery in the next Standard Development Agreement for growth related water and wastewater infrastructure would result in an increased reliance on acreage assessment revenue for the Utilities. This would lead to an increased revenue cash flow risk which could be mitigated by increasing reserves.

REASON(S) FOR RECOMMENDATION(S):
The proposed Utilities indicative rates for the 2015-2018 budget cycle are based on the capital and operating requirements to meet the business objectives and achieve financial compliance by 2018. The proposed indicative rates will enable the delivery of the capital investments outlined in the WIIP and the increased operating expenditures that are necessary for the Utilities to continue to deliver high quality services to Calgarians. As well the proposed indicative rates will allow the Utilities to provide the infrastructure necessary for a growing city while continuing to meet regulatory requirements. The proposed indicative rates will also ensure the long term financial health of the utilities.

ATTACHMENT(S)

1. 2015-2018 Utilities Indicative Rates
2. Utilities Financial Targets and Indicative Rates