

## **WATER AND WASTEWATER UTILITIES 2012-2017 FINANCIAL PLAN UPDATE**

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### **EXECUTIVE SUMMARY**

The water and wastewater Utilities established a Utilities Financial Plan in 2011 to provide improved financial capacity and sustainability to meet the challenges of maintaining service and responding to growth. The Utilities Financial Plan included financial policies and targets and options for a timeline to achieve compliance.

A six year timeline to achieve compliance to the financial targets was approved by Council in 2011. The six year timeline corresponded to two budget cycles. As the 2012-2014 budget cycle comes to a close, the Utilities have conducted a review of the progress made on the financial plan (Attachment). To plan for the upcoming 2015 -2018 budget cycle, the Utilities will be reviewing the capital and operating pressures facing the water and wastewater Utilities. The capital investments required to address the pressures will be considered within the 10-year Water Infrastructure Investment Plan (WIIP).

Indicative rates for the upcoming 2015 – 2018 budget cycle will be developed based on the investments required for the 10 year WIIP, operating budget requirements, and timeline for achieving the financial targets. Water Resources is also undertaking a Cost of Service study for water and wastewater services. The study will recommend equitable allocation of costs between customers, and rate designs that reflect the current and future state and support achieving the Utilities Financial Plan.

### **ADMINISTRATION RECOMMENDATION(S)**

That the SPC on Utilities and Corporate Services:

1. Receive this report for information;
2. Refer this report to the 2014 March 17 Special Strategic Planning Meeting of Council;
3. Direct Administration to report back to Council at the 2014 March 17 Special Strategic Planning Meeting with the Water Infrastructure Investment Plan and;
4. Direct Administration to report back to Council at the 2014 March 17 Special Strategic Planning Meeting with Utility rate impacts and recommendations for adjustments to the Utilities Financial Plan.

### **RECOMMENDATION OF THE SPC ON UTILITIES AND CORPORATE SERVICES, DATED 2014 FEBRUARY 26:**

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That Council receive Report UCS2014-0021 for information.

### **PREVIOUS COUNCIL DIRECTION / POLICY**

On 2009 December 2, Council approved UE2009-21 Wastewater Equity Requirements and Administration committed to undertaking a full review of the Utilities financial policies.

On 2011 February 15, Council directed Administration to report back to Council in 2011 June with recommended financial policies and practices for the Utilities (C2011-15), including a proposed timeline of compliance and the impact on Utility rates for 2012-2014.

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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.

### **BACKGROUND**

In 2011, the Utilities conducted a full review of the Utilities financial policies. The review concluded that the Utilities were not compliant with cash financing, and the debt to equity ratio policies. As a result, the Utilities prepared a Utilities Financial Plan that included financial policies, targets and management practices to improve the financial position of the Utilities. The policies and targets set out in Utilities Financial Plan were established within the context of The City of Calgary's Long Range Financial Plan.

A six-year timeline to achieve compliance to the financial targets was approved by Council in 2011. The six-year timeline corresponded to two budget cycles and was selected because it provided the increased financial capacity with more moderate impacts to rates.

The water and wastewater Utilities operate under a utility business model. Under this model, revenues must cover all the cost to provide the Utilities' services. The Utilities' revenue consists primarily of rate revenue which is based on the Council approved utility rates for water and wastewater.

In addition to the rate revenue, Water and Wastewater collect acreage assessments on new development. With the current Development Agreement in place, The City shares the costs of growth with the development industry by collecting fifty percent of the full costs of water and wastewater growth infrastructure through acreage assessments. In 2013, regional customers were invoiced growth capital charges for water and wastewater to recover appropriate infrastructure investments costs in lieu of acreage assessments.

The Utilities' expenses include all operations and maintenance costs for the infrastructure, all capital costs to maintain, upgrade and grow the system and payments to The City. The payment to The City includes a return on equity payment and a franchise fee.

### **INVESTIGATION: ALTERNATIVES AND ANALYSIS**

#### *Capital and Operating Pressure*

The increasing demand for water and wastewater services continues in response to population growth and regulatory and environmental protection requirements. The water and wastewater Utilities have reviewed the long term capital and operating pressures and will be updating the ten year WIIP.

To support growth, the water and wastewater Utilities target to have three to five years of serviced land supply and over five years of treatment plant capacity available. To achieve these targets, the Utilities need to continue to make investments in water and wastewater treatment plant upgrades and new infrastructure to support new development. Investments in capacity upgrades and the next planned wastewater treatment plant expansion at the Bonnybrook

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Wastewater Treatment Plant are being advanced to address higher than anticipated population growth in Calgary. The Utilities also have ongoing programs to evaluate, monitor and identify infrastructure in the water distribution and wastewater collection systems that is need of repair, replacement or upgrading. These programs ensure that levels of service to customers are maintained.

The City of Calgary has a Water Approval to Operate and a Wastewater Approval to Operate that specify regulatory requirements under the Environmental Protection and Enhancement Act. Ongoing investments will continue to be required to ensure continued compliance to regulations.

The capital investments within the WIIP are categorized using four investment drivers as shown in Table 1. These investment drivers are common to the Utilities and Waste & Recycling Services. Each driver addresses one of the factors identified as placing additional pressure on the infrastructure programs.

Table 1: WIIP Investment Drivers

INVESTMENT DRIVER	EXPLANATION
Maintain assets	Maintaining, protecting and extending the life of infrastructure investments.
Regulatory & Environmental Protection	Continuing to meet increasingly stringent regulatory and environmental protection requirements.
Service	Continuing to provide reliable and high quality services to meet the needs of citizens.
Growth	Investing in growth to meet the needs of a growing Calgary.

Although there have been significant capital investments made over the last ten years, there has been limited increases in the operating budgets. As the pipe network grows, and the treatment plants expand additional operating and maintenance is required. Historically, operating budget increases have been inflationary only and have not fully accounted for operating costs of new infrastructure or changing conditions. In particular, operating budgets for wastewater biosolids management, and electricity faced upward pressure resulting in budget shortfalls. In addition, the new agreement for billing and customer care services signed in 2013 resulted in a new fee structure. Over the 2012-2014 budget cycle, the Utilities have been managing these operating budget shortfalls by making reductions in other program areas such as maintenance. Over the short term, these reductions in the maintenance programs have minor impacts however, over the long term delaying maintenance activities can result in disruptions to service and higher repair/replacement costs at a later date.

The investments required to address the capital pressures will be incorporated into the 10-year WIIP. In parallel with the development of the WIIP, operating requirements will be reviewed. The capital requirements of the WIIP and operating requirements in 2015-2018 will have an impact on the Utilities' ability to achieve the financial targets within the six year timeline as outlined in the 2011 Utilities Financial Plan.

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### *Progress on Achieving the Utilities Financial Plan*

As part of the development of the 2015 – 2018 Action Plan, the Utilities have reviewed the progress made on the Utilities Financial Plan. Progress made on each of the targets identified in Table 2 has been reviewed against projections set out in the Utilities Financial Plan based on a six year timeline.

Table 2: Financial Targets

<b>Policy Area</b>	<b>6 Year Financial Plan Target</b>	<b>2013 Actual</b>
Debt Limit	Maximum \$2.0 billion	\$1.5B
Debt service	Maximum 40% of revenues	30%
Cash financing of capital maintenance	100%	35%
Sustainment reserve	10% of revenues	0.9%
Debt to equity ratio	60/40	70/30

The progress made on each of the financial targets is in line with projections made in 2011. The original six-year timeline to achieve financial compliance was based on two three-year budget cycles and assumed compliance by the end of 2017. To align with the new four year budget cycle The Utilities will consider compliance by the end of 2018. Based on the progress to date and with sufficient rate increases, the Utilities are in a position to achieve financial compliance by the end of 2018.

### *Impacts to Rates*

To develop the indicative rates for the 2015-2018 budget cycle, the Utilities will need to consider the investments required to address the capital and operating pressures, the timeline to achieve the financial targets and the impact to The Corporation's financial targets.

The Utilities will consider the rate impacts to achieve compliance to the financial targets by 2018. In addition, the Utilities will consider the impacts to rates and to The Corporate financial targets of extending the compliance of the financial targets.

The Utilities also recognize that the current Development Agreement will expire in 2015. Rate impacts of increasing acreage assessments to recover the full costs of growth will be evaluated.

### **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

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business units, as well as independent financial consultants. Financial benchmarking data was also reviewed which compared the Utilities against other municipalities across Canada.

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. 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 Utilities Financial Plan was established in 2011 and Council approved a timeline of six years to achieve the financial targets. As the 2012-2014 budget cycle comes to a close, the Utilities have reviewed the progress made on the Utilities Financial Plan.

To plan for the upcoming 2015-2018 budget cycle, the Utilities have reviewed the operating pressures facing the water and wastewater Utilities. Additional operating budget needs have been identified for programs such as biosolids management, energy costs and the new billing and customer care services agreement. These programs were under budgeted throughout the last budget cycle. To manage these operating budget shortfalls over the short term, the Utilities made reductions in other program areas such as maintenance. As the Utilities develop the operating budget for the next budget cycle, the Utilities will need to make adjustments to ensure that these programs are adequately funded moving forward.

An additional \$7 to \$9 million per year in operating will be required as the Utilities' contribution to the joint composting facility to manage biosolids. Preliminary estimates for rising energy costs, and additional energy needs for new facilities is in the range of \$8 to \$10 million per year. New operating needs related to new capital proposed in the WIIP are estimated to be around \$5 million per year.

Rate impacts of new operating needs will be evaluated with the timeline to achieve the financial targets. The operating budget needs and the timeline for compliance to the financial targets will guide the development of the indicative rates for the water and wastewater Utilities' 2015-2018 operating budget.

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### **Current and Future Capital Budget:**

The Utilities Financial Plan was established in 2011 and a timeline of six years to achieve the financial targets was approved by Council. As the 2012-2014 budget cycle comes to a close, the Utilities have reviewed the progress made on the Utilities Financial Plan.

To plan for the upcoming 2015-2018 budget cycle, the Utilities have reviewed the capital pressures facing the water and wastewater Utilities and are developing the 10 year Water Infrastructure Investment Plan (WIIP). Over the 2012-2014 budget cycle, the Utilities have delivered capital spending plans of \$200 million per year. Growth continues to put significant pressure on the Utilities' capital budget. The Utilities are recommending the advancement of the capacity upgrades and plant expansion at the Bonnybrook Wastewater Treatment Plant to ensure there is enough wastewater treatment capacity to keep pace with growth. The Bonnybrook Wastewater Treatment Plant Capacity Expansion Program is estimated to require \$690 million in capital investments starting in 2014 to delivery the necessary treatment capacity by 2020. In order to address the increasing capital pressures and particularly the rapid growth in population, the Utilities will likely need to increase the capital spending plans to \$300 million per year.

Rate impacts of new capital needs will be evaluated with the timeline to achieve the financial targets. The investments required for the WIIP and the timeline for compliance to the financial targets will guide the development of the indicative rates for the water and wastewater Utilities' 2015-2018 capital budget.

### **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. Originally, the six year timeline to achieve compliance was selected based on two budget cycles. Although the Utilities have made considerable progress towards compliance to the financial targets by 2018, there is a risk that financial compliance will not be achieved without the sufficient rate increases.

Although potential changes to acreage assessments could increase revenues, it may also introduce additional cash flow risks to the Utilities' revenue. The Utilities will assess the need to change the financial target for reserves to address this increased risk as part of the corporate growth funding and financing work.

The Utilities will evaluate the rate impacts to achieve compliance to the financial targets by the end of 2018 within the context of the capital and operating budget requirements.

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### **REASON(S) FOR RECOMMENDATION(S):**

The Utilities Financial Plan was established in 2011 and includes policies, targets and management practices. The plan was intended to provide the Utilities with improved financial capacity to meet the challenges of maintaining service and responding to growth and environmental objectives.

The Utilities are on track to achieve compliance with the financial targets by the end of the next budget cycle in 2018. The development of the indicative rates for the 2015-2018 budget cycle will need to consider the rate impacts to achieve financial plan compliance and the capital and operating budget requirements.

### **ATTACHMENT(S)**

Update on the Water and Wastewater Utilities Financial Plan