

**Utilities & Environmental Protection Report to
Strategic Meeting of Council
2018 June 18**

**ISC: UNRESTRICTED
C2018-0787
Page 1 of 8**

Utilities Indicative Rates and Funding New Growth

EXECUTIVE SUMMARY

At the 2018 April 25 Strategic Meeting of Council, Council referred Administration's recommendations for 2019-22 Water Utility indicative rates to the 2018 June 18 Strategic Council Meeting. Council directed Administration to explore mechanisms other than the utility rates to fund the developers' share of infrastructure in new growth areas not included in the current Off-site Levy (OSL) Bylaw (2M2016).

Administration reviewed options for addressing the developer portion of the costs with Building Industry and Land Development Association (BILD), Calgary Region, and is recommending an amendment to the OSL bylaw. The bylaw captures 100 per cent of the proportionate share of the utility cost attributable to new growth (developers' share) through levies. This amendment would include only linear utility infrastructure necessary to enable development for the communities that Council approves as part of the New Community Growth Strategy report going to Priorities and Finance Committee on 2018 June 28.

ADMINISTRATION RECOMMENDATION:

That Council:

1. File Recommendation 2 from C2018-0489.
2. Approve the 2019-2022 range of indicative rate increases for Water, Wastewater and Stormwater services as shown in Table 3 of this report.
3. Direct Administration, in consultation with stakeholders, to incorporate the proportionate share of the cost of off-site utility infrastructure attributable to new growth that provides servicing to communities approved by Council in the New Community Growth Strategy report (PFC2018-0678) into the off-site levy rates, through a proposed amendment to the water, sanitary sewer and storm sewer levy rates in Bylaw 2M2016, and report back to the Priorities and Finance Committee by no later than 2018 Q4.

PREVIOUS COUNCIL DIRECTION / POLICY

On 2018 April 25, Council considered recommendation 2 of C2018-0489 (One Calgary: Setting Indicative Rates for 2019-2022) as follows: "approve 2019-2022 indicative rates for Water, Wastewater and Stormwater services including new growth as outlined on slide 52 of the presentation, as distributed at today's Meeting". Council directed that recommendation 2 be referred to the 2018 June 18 Strategic Meeting of Council.

On 2018 March 19, Council approved UCS2018-0223 financial plans for the water and wastewater lines of service, as well as UCS2018-0230 financial plan for the stormwater line of service for the 2019-2022 timeframe.

On 2018 March 19, PFC2018-0200, Council directed that Administration report back to Council, through the Priorities and Finance Committee (PFC), in Q2 2018 with strategic growth recommendations that increase the level of City commitment and investment in new communities, beginning with the 2019 – 2022 budget cycle, as identified in option 1(b) of the Report, and prioritize future growth areas outlined in Attachment 1, including financial implications for the 2019-2022 budget cycle, future budget cycles, and how any funding gaps for operating and capital would be funded using the property tax.

Utilities Indicative Rates and Funding New Growth

On 2016 January 11 C2016-0023 Council gave three reading to Bylaw 2M2016, the OSL bylaw, that included OSL rates that were calculated based on capturing 100% of the proportionate share of the utility costs attributable to new growth through levies.

BACKGROUND

The Water Utility has defined three lines of service – Water, Wastewater, and Stormwater. The Water Treatment and Supply line of service treats and delivers water to customers. It protects public health and ensures long-term sustainability of water resources. The Wastewater Collection and Treatment line of service collects wastewater from customers, treats it, and returns it to the river. This service protects public health, property and the environment. The Stormwater Management line of service collects and manages stormwater and surface water that originates during periods of rain or snow / ice melt to protect public safety, reduce damage to property and ensure our watersheds are healthy.

These lines of service are provided under a self-sustaining, public utility model. All costs are recovered through user rates, levies, fees and sources other than the municipal tax base. The self-supported utility business model relies on:

- Rate revenue for water and wastewater being primarily generated through basic, fixed service charges and variable charges based upon the volume of water used and a rate, which is determined by customer class. The rates are calculated to reflect the cost of providing services to customers.
- Rate revenue for the Stormwater line of service that is generated from a uniform stormwater drainage service charge.
- Off-site levy revenue from levies on development of new and existing areas that are charged based on water, wastewater and stormwater system investments required for growth. Current levies are collected in accordance with Bylaw 2M2016. As identified in the report supporting the bylaw (C2016-0023), the OSL rates will result "...in capturing 100% of the proportionate share of costs attributable to growth in the Greenfield Areas. If this share is not captured through off-site levies an alternative funding source such as utility rates or property taxes would need to be used." The report highlighted the potential financial risk of a shortfall if growth patterns change significantly, and identified internal corporate borrowing as a potential source through which the risk could be managed.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

Utility indicative rates based upon OSL Bylaw growth – no new community growth

In development of the 2019-2022 indicative rates, the Water Utility considered drivers and priorities related to operating and capital expenditures, expectations of customers around availability, quality, reliability and responsiveness of services, requirements to meet financial plan compliance to improve financial sustainability.

The indicative rates presented can accommodate the primary requirements to provide Water Utility services, as described below:

Utilities Indicative Rates and Funding New Growth

Table 1: Drivers and requirements for operating and capital expenditures.

Factor	Description
Compliance with Financial plans	Services have financial plans approved by that include measures, targets and a timeframe for compliance with financial policies that focus on managing debt and mitigation of financial risk.
Growth and development	Growth and development drives investments required to service new communities and drives OSL revenue. OSL revenues are intended to fund the developers' share of the utility costs attributable to new growth. Utility indicative rates include The City's share of utility costs, as identified in the OSL bylaw, as well as any short-term cash flow shortfall of OSL revenue over cost. Although the developer portion of the utility infrastructure will be completely funded through OSL, the rate of development will affect the cash flow, which creates the risk of a short-term OSL revenue shortfall.
Capital	Investment plans address 4 drivers: Regulatory/environmental requirements; growth; service level and maintenance. Analysis is based on the typical annual investment of \$350 million per year split between the three services and funded largely from rates and off-site levy revenue.
Operating	Efficiencies and reductions will help offset inflationary pressures and 2019-22 priorities. Service priorities that cross all lines of service in the water utility include meeting the demands of changes in regulatory and environmental expectations, increased opportunities to integrate customer input into service planning, acting on climate change.

Considering the above factors, as well customer expectations, and supporting the needs of a growing city, the indicative rate increases for 2019-2022 required to support OSL bylaw growth are defined in Table 2 and were presented to Council on 2018 April 25. In consideration of the new community growth strategy, the rate impacts in Table 2 are no longer recommended.

Utilities Indicative Rates and Funding New Growth

Table 2: Indicative Rates 2019-2022 – April 25, 2018

Line of Service	Indicative Rates 2019-2022
Water Treatment and Supply	0% per year
Wastewater Collection and Treatment	4.5% - 5.5% per year
Stormwater Management	3.5% - 5.0% per year

The Water Utility is conducting a Cost of Service Study to ensure costs are being recovered appropriately and equitably through rates from each customer class according to their specific demands on the system. Implementing Cost of Service Study recommendations will mean that different customer classes will be impacted differently within the water and wastewater lines of service. However, the overall utility revenue will change according to the rate increases indicated above.

Detailed background for the proposed 2019-22 indicative rates for Water, Wastewater and Stormwater are included as Attachment 1 to this report, the same attachment as presented to Council on 2018 April 25 (C2018-0489).

Mechanisms for funding the New Community Growth Strategy (NCGS)

The OSL bylaw rates (2016 January C2016-0023) were calculated based on capturing 100% of the developers' share of the utility costs attributable to new growth through levies. As outlined in the report supporting the OSL Bylaw, population forecasts, the anticipated distribution of the projected population, Departmental long-range planning documents and stakeholder consultation formed the basis of the infrastructure list and cost estimates contained in the OSL Bylaw.

Since the rate of actual development is lower than forecasted in 2016, the risk of a temporary financial shortfall has materialized, and a source is required to cover it until the OSL are collected in the fullness of time. Presently when short-term cash flow shortfalls occur, they are buffered by utility rates until the development happens.

OSL revenue varies based on two factors:

- hectares of development and
- timing and magnitude of capital investment to support growth.

Based on the above factors, it is anticipated that the cumulative short-term cash flow shortfall absorbed in the utility rates could be approximately \$80 million by the end of 2022.

The NCGS envisions 6-12 additional new growth communities, which would require additional investments by the Water Utility that are not included in the OSL bylaw. Specific investments are subject to Council's decision in 2018 July following the 2018 June 28 meeting of PFC.

Utilities Indicative Rates and Funding New Growth

The total new investment in utilities servicing required for all the business cases submitted by developers is in the range of \$210-220 million. Of this, \$200 million is the developers' share and is currently unfunded. The City's share, up to \$10-20 million will be funded through utility rates and in line with the communities that Council approves in 2018 July.

To address the unfunded portion of the utility infrastructure, Administration has developed the following three options, and consulted with BILD - Calgary Region:

- Amend the sections of the bylaw related only to water, sanitary and stormwater linear services now to accommodate new growth areas and incorporate the developers' proportional share of utility infrastructure costs in the bylaw levy calculations.
- Amend the entire bylaw as anticipated in 2021. Discuss options for an interim measure that will allow for infrastructure construction to start before the bylaw is amended.
- Amend the entire bylaw as anticipated in 2021. Explore opportunities for developers to finance infrastructure and share the risk of repayment tied to the rate of development. The City would guarantee its proportional cost contribution.

The option to amend the sections of the bylaw related only to water, sanitary sewer and storm sewer linear services now to accommodate new growth areas is aligned to the principles and approach that was determined as part of the off-site levy report C2016-0023 in 2016 January. Proposing an amendment to the OSL bylaw adheres to the principles of benefit allocation, accountability, transparency and efficiency that were the foundation of the off-site levy objectives and recommendations in 2016.

It was the expectation of BILD, Calgary Region that the OSL bylaw would be in effect for five years. It was stated in the 2016 January OSL report that the overall methodology would not be reviewed for five years to provide cost certainty to the land development industry. The OSL report also identified that amendments to the OSL bylaw may be required from time to time to keep the calculations current. This included adjusting numbers to support changes to facilitate developer funding arrangements and to correct errors that may be identified. It is anticipated that the next off-site levy methodology review will start in 2020 and propose an updated off-site levy bylaw to be implemented in 2021.

The OSL calculations in the bylaw are correct and the proposed amendment would seek to incorporate the developers' proportionate share of the cost of off-site utility infrastructure attributable to new growth that provides servicing to communities approved by Council in the New Community Growth Strategy report (PFC2018-0678). Including this infrastructure in the OSL bylaw now may facilitate funding arrangements with developers to deliver infrastructure at a time that best meets their development plans.

Administration's recommendation is that the water, sanitary sewer and storm sewer linear services sections of the OSL Bylaw be amended now to accommodate the NCGS and the developers' proportionate costs for the associated Water Utility infrastructure. The City's proportionate costs for this infrastructure would require a range of investments dependent upon the growth scenario selected. Of note is that the approval of twelve business cases for growth would result in an incremental increase in the range of water indicative rates by an additional 0.5% per year (Table 3).

Utilities Indicative Rates and Funding New Growth

Table 3: Indicative Rates 2019-2022 – New Growth Community Strategy

Line of Service	Range of Indicative Rate increase 2019-2022
Water Treatment and Supply	0 – 0.5% per year
Wastewater Collection and Treatment	4.5% - 5.5% per year
Stormwater Management	3.5% - 5.0% per year

Stakeholder Engagement, Research and Communication

Customers place high value on the services that they pay for. Based on the 2017 Citizens Perspective Survey result, 94 per cent of citizens are satisfied with the quality of drinking water, about 95 per cent of Calgarians are in favour of user pays when it comes to water and wastewater, and the majority of customers believe that those who use more should pay more.

Strategic Alignment

It is crucial for the Water Utility to ensure an adequate supply of water for a growing city, and maintain river water quality downstream of Calgary. The Water Utility's lines of service align with The City's 2020 Sustainability Direction. Service line rates will strengthen the financial capacity that enables delivery on its commitment on three Council Priorities:

1. To support a city of inspiring neighbourhoods, the Water Utility provides the infrastructure needs of a growing city, enhances The City's ability to prepare for and respond to natural disasters, and builds resiliency to flooding.
2. 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.
3. The financial discipline demonstrated through the Water and Wastewater Lines of Service's performance within their financial plan is an example of commitment to a well-run city.

Social, Environmental, Economic (External)

Establishing indicative rates requires a balanced approach to rate setting that considers the social, environmental, and economic implications of rates and rate structures. Recommendations reflect fairness and equity to customers balanced with recovering the Water Utility's costs of providing services and continuing to meet regulatory requirements, achieve financial targets and timelines for compliance, and support reaching The City's environmental goals.

Utilities Indicative Rates and Funding New Growth

Financial Capacity

Current and Future Operating Budget:

To ensure a financially sustainable future and to manage operating pressures facing the business, financial plans 2019-2022 for the Water and Wastewater Lines of Service (UCS 2018-0223) and the Stormwater Line of Service (UCS 2018-0230) have been reported to and approved by Council in 2018 Q1.

Current and Future Capital Budget:

Recommended utility rate increases for 2019-2022 will accommodate an investment plan that address four key drivers: Regulatory/environmental requirements; growth; service level and maintenance. This is consistent with the typical annual investment of \$350 million per year split between the three services and funded largely from rates and off-site levy revenue.

Water has participated in the Infrastructure Calgary capital prioritization process. Business cases were submitted for capital investments that are funded through the utility rates, as well as for the unfunded projects required for the NCGS. If the recommendation is approved to amend the OSL bylaw to include the projects to support the communities that Council approves, then of the up to \$210-220 million required for NCGS, up to \$200 million will be funded from OSL and up to \$10-20 million would be funded from utility rates, for the City share.

Risk Assessment

Various solutions have unique risks associated with them

- Servicing for additional growth communities will require managing a larger capital delivery program, potentially requiring an alternative delivery mechanism, adding complexity.
- There is potential financial risk to The City resulting from changing growth patterns, and a funding source will be required to manage potential shortfalls.
- Significant administrative resources will be required to consult and prepare the amendment to the bylaw.
- Additional investment is required to provide servicing, however there is no projected increase to land absorption forecast.

REASON(S) FOR RECOMMENDATION(S):

Previously recommended indicative utilities rates (C2018-0849) included 100 per cent of the developers' share of costs for funding new growth communities and should be filed. Discussions between The City and BILD Calgary Region confirmed that this is not Administration's recommended approach, and as such the recommendation can be filed.

The recommended rates in Table 3 are estimated to be sufficient to accommodate The City's cost share for new community growth (included within the OSL bylaw) in alignment with the new community growth strategy and the forecasted short term OSL cash flow shortfall.

Administration recommends incorporating the developers' cost share of utility infrastructure for new community growth into the OSL bylaw in consultation with stakeholders. This will maintain one transparent and accountable system that provides a funding source to enable new community development. A proposed OSL bylaw amendment no later than 2018 Q4 will ensure

**Utilities & Environmental Protection Report to
Strategic Meeting of Council
2018 June 18**

**ISC: UNRESTRICTED
C2018-0787
Page 8 of 8**

Utilities Indicative Rates and Funding New Growth

that communities approved by Council as part of the new community growth strategy have a secured infrastructure funding source for inclusion in the 2019-2022 capital investment plan.
--

ATTACHMENT(S)

1. C2018-0489 Attachment 1 “2019-2022 Indicative Rates: Water, Wastewater and Stormwater Lines of Service”