

WATER AND WASTEWATER UTILITIES FINANCIAL PLAN PROGRESS REPORT

EXECUTIVE SUMMARY

Utilities financial plan was established after a full review of utilities financial policies in 2011, with policies, targets and a timeline for compliance. Adhering to the plan ensures improved financial capacity and sustainability to meet the challenges of maintaining service and responding to growth. These policies are used on an ongoing basis to guide financial management decisions and their targets are used to measure performance within the financial plan.

This report provides an update on the Water and Wastewater Utilities (the Utilities) Financial Plan, in particular the progress towards achieving the financial targets and maintaining compliance with the financial policies set out in the Utilities Financial Plan. Additionally, this report also provides the results of a recent review of the continued relevance of the Utilities' financial policies and targets in relation to the goal of financial sustainability and utility industry best practices.

The Utilities remain on track to achieve compliance with the financial targets set out in the Utilities Financial Plan, thereby ensuring a financially sustainable future. Maintaining progress towards compliance is dependent on the utility rate increases approved in Action Plan 2015-2018.

A progress report (Attachment) is being provided for the purpose of:

- Demonstrating the Utilities' performance in accordance with the plan.
- Summarizing the impacts on the Utilities of the new off-site levy bylaw (C2016-0023, Bylaw 2M2016) approved by Council 2016 January 11.
- Providing an update on the assessment and recommendations resulting from the review of financial policies and targets that was undertaken by an external consultant.
- Completing necessary steps in advance of the Utilities Cost of Service study that will be undertaken in 2017.

ADMINISTRATION RECOMMENDATION:

That the SPC on Utilities and Corporate Services recommends that Council receive the Water and Wastewater Utilities Financial Plan Progress Report for information.

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 UCS 2014-0021 Water and Wastewater Utilities 2012-2017 Financial Plan update for information.

On 2014 May 05, Council approved 2015-2018 Utilities Indicative Rates (C2014-0103) directing 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. Administration was directed to report back

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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.

BACKGROUND

The Water Services and Water Resources business units operate the 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 do 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.

Utilities Financial Plan was established after a full review of utilities financial policies in 2011. Council approved Utilities financial policies and targets in advance of the 2012-2014 business cycle, with a six year timeline for compliance. In 2014, when the multi-year business plan and budget cycle became 4 years, the Utilities' timeline for compliance was increased to 7 years, to align with the end of the 2015-2018 business cycle. The policies and targets within the plan are used on an ongoing basis to guide financial management decisions and measure financial performance.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

Revenue

The Utilities are funded primarily by revenue, which is based on Council-approved rates for utility services, and Council-approved off-site levy rates that recover costs associated with new growth. The off-site levy bylaw (C2016-0023, Bylaw 2M2016) approved by Council 2016 January 11 included levy rates that will fund the full cost of infrastructure investments for development of new and existing areas. The full recovery of costs associated with growth results in an increase in forecasted off-site levy revenues in the Utilities.

In addition, off-site levy revenue is now being reported in the accounting system sooner than it has been in the past. Revenue is reported once costs are incurred by the utility; however, the actual revenue is received later, as per the payment schedule in the bylaw.

A net-zero budget adjustment, that will be presented to Council in 2016 June, has been approved to recognize changes from the 2016 off-site levy bylaw as well as the revised revenue recognition approach.

The increase in forecasted revenue from off-site levies in future years are still uncertain due to the current economic climate, and will not impact the approved utility rate increases for the remainder of this business cycle, but may decrease pressure on utility rates in 2019-2022.

Capital Investment

The water and wastewater Utilities manage long term capital requirements through their ten-year Water Infrastructure Investment Plan (WIIP). Investment is required to meet the increasing

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demands on the water and wastewater systems in response to regulatory and environmental protection requirements and Calgary's ongoing population growth. Optimum levels of service also require maintenance of the existing, and growing system. 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 Wastewater Operating Approval requires renewal in 2018 through negotiations with Alberta Environment and Parks.

The capital investments within the WIIP are categorized using four investment drivers as shown in the table below. Each driver addresses one of the factors identified as placing additional pressure on the infrastructure programs.

Investment Driver	Objective	Percentage of Water Infrastructure Investment Plan (WIIP)
Maintain assets	Maintaining, protecting and extending the life of infrastructure investments.	15% - 20%
Regulatory & Environmental Protection	Continuing to meet increasingly stringent regulatory and environmental protection requirements.	15% - 20%
Service	Continuing to provide reliable and high quality services to meet the needs of citizens.	25% - 30%
Growth	Providing infrastructure to meet the needs of a growing city.	35% - 40%

Operating Areas

As the pipe network grows, and the treatment plants expand, there is increased pressure on the Utilities' operating budget to operate and maintain the growing systems. Specific pressure areas in the Utilities include:

- Efficiency initiatives to reduce energy consumption and increase power generation.
- Development of a fleet optimization strategy between UEP business units and Fleet to manage costs associated with required vehicles and equipment.
- Efficiency opportunities identified through the Water Services Zero Based Review (ZBR).

The operating cost of Utilities' capital investment program will continue to be a significant consideration.

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Implementation of recommendations from the ZBRs is expected to have future benefit realized in the Utilities and will ultimately reduce some of these pressures on the operation budget. The Water Services ZBR is complete and the Water Resources ZBR is underway.

Progress on Utilities Financial Plan Targets

The policies and targets within the Utilities Financial Plan are used on an ongoing basis to guide financial management decisions and measure financial performance. A summary of performance as at the end of 2015 relative to established targets is provided in the table below.

Policy Area	Financial Plan Target	2015 Actual
Debt limit	Maximum \$2.0 billion	\$1.64 billion
Debt service	Maximum 40% of revenues	26.5%
Cash financing of capital maintenance	100%	100%
Sustainment reserve	10% of revenues	1.2%
Debt to equity ratio	60/40	66/34

The Utilities remain on track to achieve compliance with the financial targets set out in the Utilities Financial Plan, thereby ensuring a financially sustainable future. Achieving compliance is dependent on the Council-approved rate increases approved for the 2015-2018 Action Plan.

Next Steps

Along with ongoing focus on achieving the financial targets by 2018, the Utilities will concentrate on:

- Any required revisions to the financial policies including the return on equity policy and report back in Q1 2017 ahead of the Cost of Service Study that will inform 2019-2022 utility rates.
- A re-cast of the 2016-2018 capital budget for the Utilities.
- Aligning financial policy areas with recommendations to be implemented from Water Resources ZBR and leveraging any financial benefits from the Water Services ZBR.

Stakeholder Engagement, Research and Communication

The Utilities and Finance have undertaken the work to review progress on compliance with the financial plan. This work is overseen by a steering committee of operational, financial and strategic staff, and has been completed leveraging expertise across business units, as well as

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

Strategic Alignment

A focus on the financial capacity and sustainability of the Utilities enables 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 for and respond to natural disasters, and 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 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 have reviewed the progress made on the Utilities Financial Plan and remain on track to achieve compliance with the financial targets set out in the plan, thereby ensuring a financially sustainable future. Achieving compliance and delivering on commitments made in the 2015-2018 Action Plan is dependent on the Council-approved rate increases approved for the 2015-2018 timeframe.

The Utilities are managing operating pressures facing the business. Implementing ZBR recommendations and other efficiencies is expected to have future benefit in the Utilities and will ultimately reduce some of these pressures on the operating budget.

Current and Future Capital Budget:

Utility rate increases approved in the 2015-2018 business cycle are adequate to support the expected delivery of \$300M in capital projects annually. The capital budget approved in Action Plan was built based on the requirement to deliver this \$300M annually, and according to the split between capital investment drivers identified in the WIIP.

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Per the recommendation approved by Council on 2015 November 25, in the Proposed Adjustments to the 2016 Budget (C2015-0855) Water Resources 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 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, however compliance by the end of 2018 will require maintaining the approved rate increases from Action Plan.

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:

This report provides an update on the Utilities' progress within the plan for financial sustainability. The report demonstrates performance in accordance with the plan and summarizes the impacts on the Utilities of the new off-site levy bylaw. It also provides an update on the results of an external review of financial policies and targets.

Confirming any changes to financial policies in Q4 2016 will be an important step prior to undertaking a Utilities cost of service study that will inform the rates for 2019-2022.

ATTACHMENT

Water and Wastewater Utilities Financial Plan 2012-2018 Progress Report.