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TO:	STRATEGIC PRIORITIES AND POLICY COMMITTEE MEETING ON NOVEMBER 24, 2014
FROM:	JOHN BRAAM, P.ENG. MANAGING DIRECTOR, ENVIRONMENTAL AND ENGINEERING SERVICES & CITY ENGINEER AND MARTIN HAYWARD MANAGING DIRECTOR, CORPORATE SERVICES & CITY TREASURER, CHIEF FINANCIAL OFFICER
SUBJECT:	2015 WATER AND WASTEWATER RATES

RECOMMENDATION

That, on the recommendation of the Managing Director, Environmental and Engineering Services & City Engineer, and the Managing Director, Corporate Services & City Treasurer, Chief Financial Officer:

- (a) all rates and charges related to the provision of Wastewater and Treatment Services, with the exception of charges related to the installation or replacement of Private Drain Connections, **BE INCREASED** by 7%, effective January 1, 2015;
- (b) all rates and charges related to the provision of Water Services, with the exception of the Customer Assistance charge, **BE INCREASED** by 7%, effective January 1, 2015;
- (c) the proposed by-law to amend the Wastewater and Treatment Rates and Charges By-law **BE INTRODUCED** at the Municipal Council meeting on November 25, 2014 to effect the rates and charges noted in (a), above; and
- (d) the proposed by-law to amend the Water Rates and Charges By-law **BE INTRODUCED** at the Municipal Council meeting on November 25, 2014 to effect the rates and charges noted in (b), above.
- (e) the Civic Administration **BE DIRECTED** to update the Water Service Area Financial Plan and report back to Council; it being noted that the 2015 rate increase is less than that presently included in the Financial Plan, and that the Financial Plan is due for an update in 2015 to coincide with Provincial Licensing requirements.

PREVIOUS REPORTS PERTINENT TO THIS MATTER
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None.

BACKGROUND

PURPOSE:

This report requests the approval of the Municipal Council to implementation changes to Water and Wastewater rates and charges effective January 1, 2015.

CONTEXT:

In recent years, the Municipal Council has combined the approval of Water and Wastewater budgets with the approval of changes to rates and charges. A fall schedule for budget approval had allowed for rates and charges to be changed effective on January 1 to coincide with the fiscal year. With 2014 being a municipal election year, Council will not be able to accomplish this combined approval on the normal schedule. Specifically, this Council cannot approve the 2015 Budgets prior to the inauguration of the new Council according to section 290 (1.1) of the Municipal Act, which states: "a budget for a year immediately following a year in which a regular

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election is held, may only be adopted in the year to which the budget applies.” The current Council can, however, approve changes to rates and charges. If changes to rates and charges are delayed, the forecasted full year revenues will not be realized as planned, which could in turn affect future rate increases.

DISCUSSION:

The usual schedule for Water and Wastewater Budget approval was challenged by the 2014 fall municipal elections. Delays in rate increases beyond January 1, 2015 will impact anticipated revenues built into forecasts by about \$850,000 per month. With the budget deliberations and subsequent rate change implementation schedule taking approximately 2 months, this would equate to approximately \$1.7M of reduced revenue which is required to fund utility operations and capital requirements.

Administration has contacted various Ontario municipalities to inquire about their preliminary plans for 2015 Water and Wastewater rate approvals:

Municipality	2015 Rates Effective	Additional Information
Cambridge	January 1, 2015	Rates to be approved by Council in Dec. 2014 and effective Jan. 1, 2015.
Hamilton	January 1, 2015	Rates to be approved by Council in Dec. 2014 and effective Jan. 1, 2015.
Kitchener	March/April, 2015	2015 budgets and rate changes to follow normal approval schedule.
Niagara Falls	March/April 2015	2015 budgets and rate changes to follow normal approval schedule.
Toronto	March 1, 2015	Rates to be approved in Jan. 2015, with a Mar. 1, 2015 effective date. Annual rate increase to be prorated over remaining months.
Waterloo	January 1, 2015	Rates to be approved by Council in Dec. 2014 and effective Jan. 1, 2015.

Generally speaking, all of these cities are not planning to reduce their 2015 revenues as a result of 2014 being an election year, either by approving rate changes in 2014, or because their budget schedule naturally accommodates it.

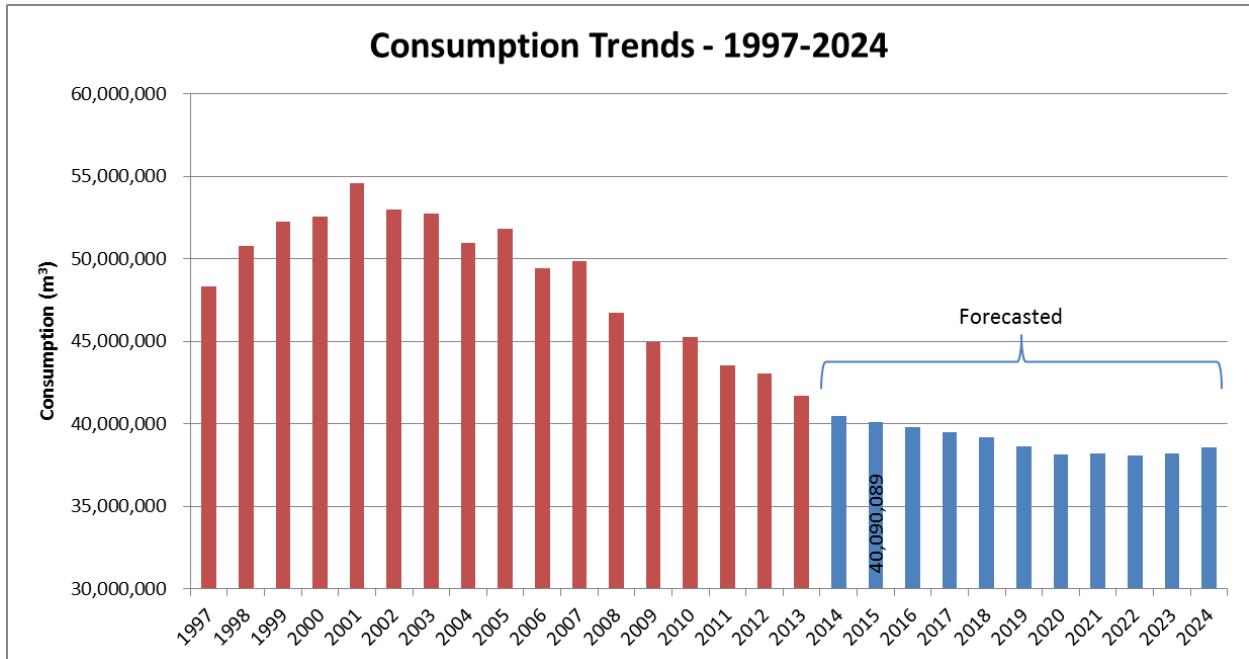
London’s rates and forecasts for rates are based on expenditure projections included in a 20 Year Plan, not just the forecasted expenditures for the upcoming year (i.e. the next year’s budget). Future rate increases (5 year forecasts) are updated each budget cycle, meaning the rates projected for 2015 were included in the 2014 Budget forecasts. The rate increases forecasted for 2015 of 7% for Water and 7% for Wastewater remain appropriate based on the preliminary 2015 Budgets and is less than what was forecasted in the Water Financial Plan. These rate increases continue to be necessary based on the following drivers.

Water Consumption:

Despite the implementation of the new water and wastewater rate structure in March, 2013, which shifted a greater proportion of total revenues to fixed charges, revenues continue to be heavily influenced by water consumption. Water conservation efforts, coupled with recent weather conditions that have not been conducive to water consumption, continue to drive water usage lower than Administration previously forecasted.

Average residential consumption has decreased 30% in the past 12 years, from a peak of approximately 253 m³/year in 2001 to approximately 176.3 m³/year in 2013. A significant reduction in forecasted consumption was made for the 2014 budget, reducing consumption forecasts from 43.2 million m³ in 2013 to 41.0 million m³ (5%) for 2014. A further anticipated reduction to 40.1 million m³ (2%) is the basis for the 2015 Budgets. The following graph illustrates the declining water consumption trend.

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If recent consumption trends are indicative of future water use patterns, the Water utility may be further challenged to generate sufficient revenues to support current and future infrastructure needs under the current rate plan.

Purchase of Water Costs:

The cost of purchasing water from the Lake Huron and Elgin Area Primary Water Supply Systems is a significant component of the Water budget, comprising approximately 30% of the total Water budget. The Water financial model includes the most up-to-date rate plans from the water boards, including the currently approved 5% and 9% rate increases for 2015 for the Huron and Elgin systems respectively.

Energy Prices:

Although inflation is a significant factor in current and future rate forecasts, price increases in energy commodities – specifically electricity and natural gas – could have a significant impact on future rate forecasts as they are a relatively large component (approximately 16%) of Wastewater operating expenditures, and are increasing at rates much higher than general inflation trends. Currently, electricity costs are forecasted to increase at an average of 6.2%/year from 2015 to 2019; natural gas costs are forecasted to increase at an average of 9.9%/year during the same time period. While further energy efficiency projects are planned for the near future, increases in energy prices greater than the general rate of inflation are putting significant pressure on current rates.

Infrastructure Gap:

The capital needs of the Water and Wastewater & Treatment systems continue to be significant drivers of current and future rate increases. The City of London’s State of the Infrastructure Report 2013 identified the following infrastructure gaps (as of 2013):

	Current Gap (\$000’s)	Gap in 10 Years (\$000’s)
Water	\$1,941	\$37,800
Sanitary	\$0	\$21,802
Stormwater	\$0	\$973

The updated 2015 Water and Wastewater 20 Year Plans, a significant portion of which are funded through Water and Wastewater rates, reflect the investment required to address the current and future infrastructure gap. The rate plan endorsed by Council during 2013 budget deliberations and confirmed during 2014 budget deliberations is critical to achieving infrastructure sustainability by providing the financing necessary to implement the 20 Year Plans.

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Maintaining Adequate Reserve Fund Balances:

It is estimated that the Water and Wastewater utilities have a combined asset replacement value of approximately \$6.7 billion - \$2.7 billion of Water assets and \$4 billion of Wastewater assets. It is critical that Water and Wastewater reserve fund balances are maintained at sufficient levels to support the renewal and enhancement needs of this significant asset base. Administration generally targets a minimum average reserve fund balance of 1% of the replacement value of these assets to be maintained to provide a funding source for future capital requirements. This would represent a target reserve fund balance of at least \$27 million for Water and \$40 million for Wastewater. The 7% rate increases proposed for 2015 are necessary to progress towards the target.

Maintaining adequate reserve fund balances is important to ensuring the financial flexibility to manage future strategic investments as well. In particular, there are a number of corporate and utility-specific initiatives which are anticipated in the near future, the costs of which are not fully quantified at this time:

- London’s Downtown Plan;
- Wastewater Optimization Strategy;
- Pollution Prevention and Control Plan; and,
- Water and Wastewater energy efficiency projects.

Water Financial Plan:

Ontario Regulation 453/07 *Financial Plans* under the *Safe Drinking Water Act, 2002* mandates the preparation of a Financial Plan as part of the Municipal Drinking Water License program. This regulation was designed by the Ministry of the Environment in response to Justice Dennis O’Connor’s Walkerton Inquiry recommendations. The intent is to ensure that municipalities plan for the long-term financial sustainability of their drinking water systems. The Financial Plan must be updated prior to the renewal of a municipal drinking water license every 5 years.

London’s Financial Plan was last updated in April, 2011. The implementation of the new water and wastewater rate structure in 2013 accelerated the achievement of inflationary-level rate increases. The following table outlines the rate increases forecasted in the Financial Plan as well as the revised rate forecast. The Financial Plan is recommended to be updated in 2015 based on a revised rate forecast.

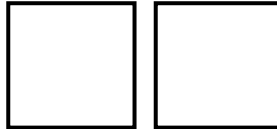
	2012	2013	2014	2015	2016	2017 and beyond
Forecast in Financial Plan	8%	8%	8%	8%	4.5%	3%
Revised Forecast	8%	8%	8%	7%	3%	3%

SUMMARY:

The 2015 rate changes are forecasted to be the last significant increase, leading to inflationary rate increases beyond 2015 (currently projected at approximately 3%), all in accordance with 20 Year Plans for both utilities. Implementing the 7% rate changes on January 1, 2015 will position the utilities to achieve Financial Sustainability, where future rate increases will be at or near inflationary levels based on a combination of the Consumer Price Index (CPI) and the Construction Price Index with the appropriate use of debt financing, adequate reserve funds and the appropriate investment in capital.

The proposed rate increases are consistent with that forecasted in the last budget cycle, with the Water rate increase being less than that included in its regulatory Financial Plan. The Water Financial Plan requires updating for this reason, as well as complying with a regular 5 year licensing cycle.

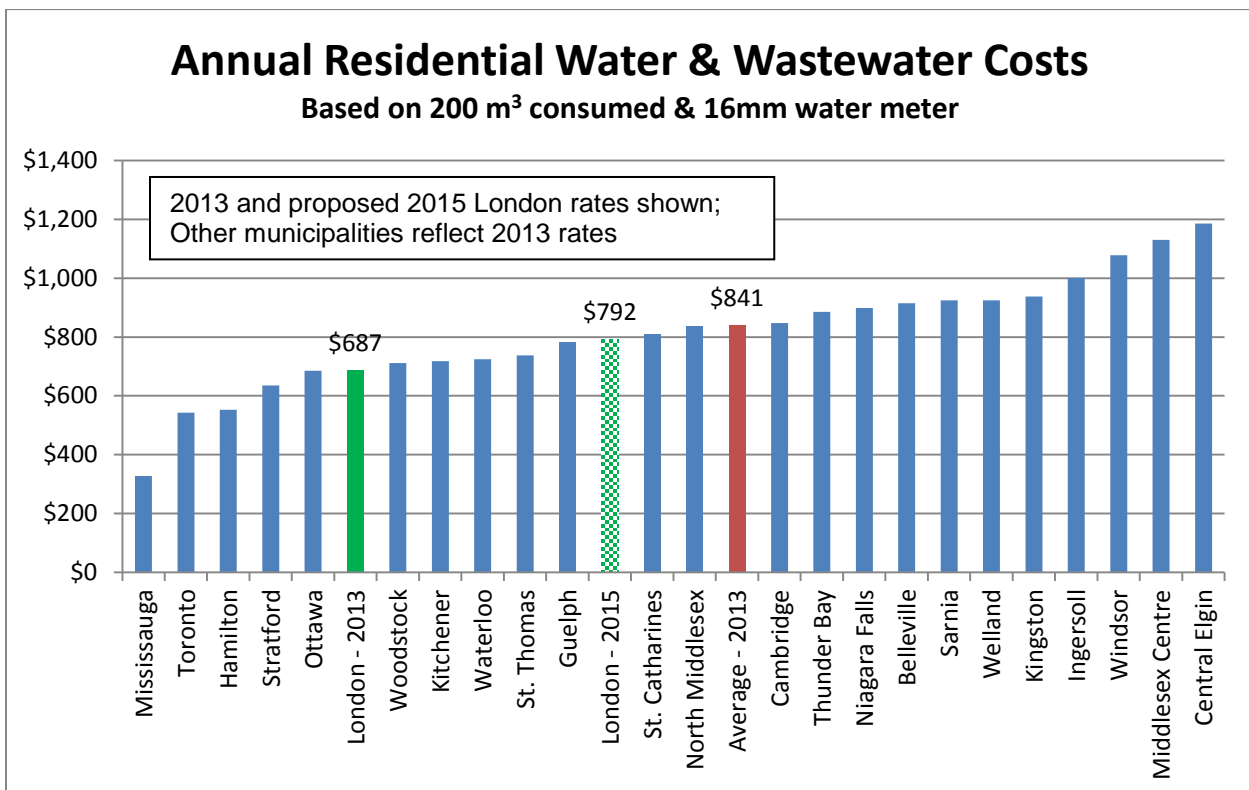
The impact to the average residential customer of a 7% increase in both Water and Wastewater rates is summarized below:



	Budgeted Residential Cost at 2014 Rates ⁽¹⁾	Forecasted Residential Cost at 2014 Rates ⁽²⁾	Proposed Increase (7%) ⁽³⁾	Forecasted Residential Cost at 2015 Rates ⁽⁴⁾
Water	\$363	\$343	\$24	\$367
Sanitary	\$299	\$281	\$20	\$301
Storm	\$165	\$165	\$9	\$174
	\$827	\$789	\$53	\$842

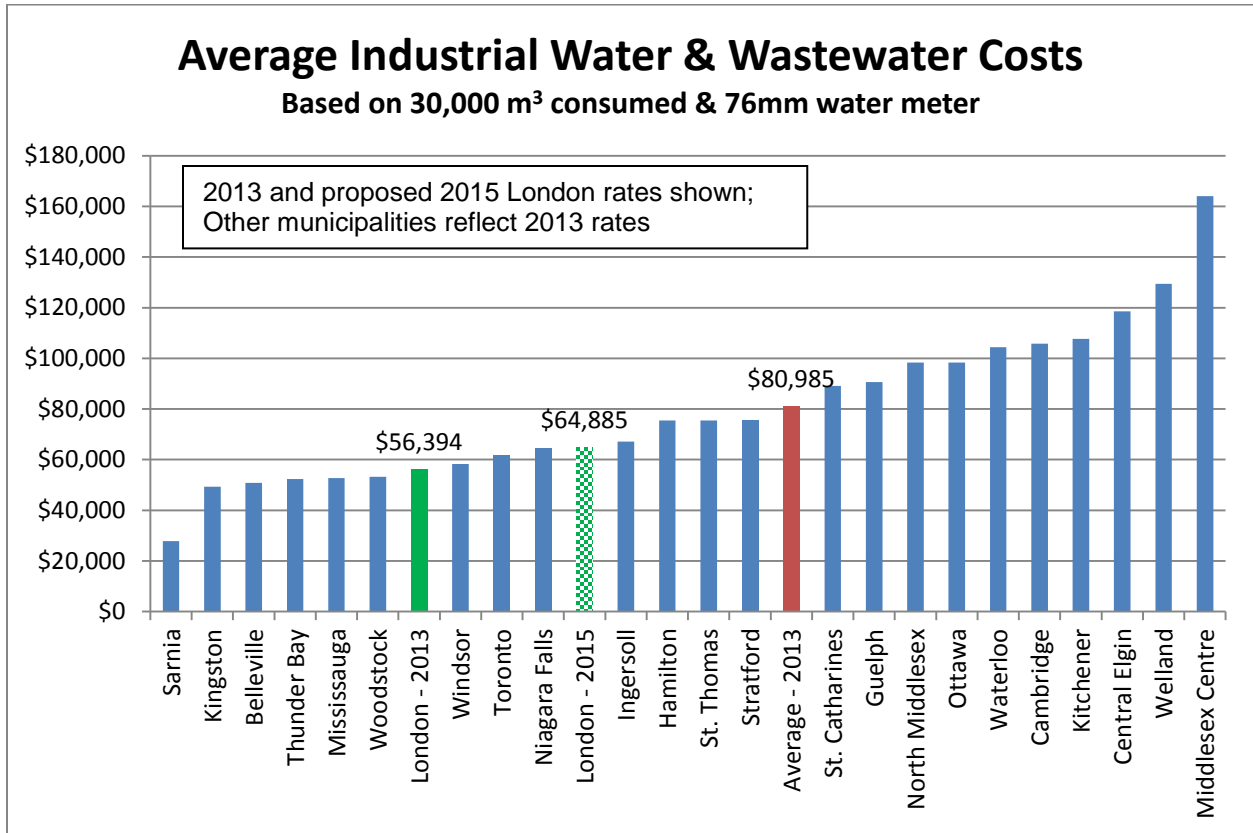
(1) The budgeted residential cost in 2014 was based on an average residential consumption of 181.2 m³.
 (2) The forecasted residential cost in 2014 has been restated using a revised average residential consumption estimate of 171.9 m³.
 (3) The forecasted average residential increase in Storm charges for 2015 is less than 7% due to the phase-in of the new Storm Drainage Charge.
 (4) The forecasted residential cost in 2014 is based on an average residential consumption of 171.9 m³.

By way of comparison, the following charts illustrate London's very competitive water and wastewater rates for both residential and industrial customers relative to other Ontario municipalities. Note that the data for other municipalities reflects 2013 rates, while London's 2013 and proposed 2015 figures are shown for comparison. It is likely that the rates for the other municipalities presented have since increased. These figures also exclude stormwater charges, as many municipalities incorporate these charges into their property tax rates.



Source: 2013 BMA Municipal Study

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Source: 2013 BMA Municipal Study

Although the Municipal Council cannot approve the 2015 Budgets for Water and Wastewater (noting that the 2015 Budgets will be deliberated after the inauguration of the new Council), it can elect to approve rate changes that would come into effect January 1, 2015. This report seeks the approval of Municipal Council for 7% Water and Wastewater rate increases for 2015 consistent with the financial sustainability plans endorsed by Council during 2013 budget deliberations and confirmed during 2014 budget deliberations. The implications of a reduction in the revenue stream will vary directly with the implementation date, but could include:

- Expenditure cuts to offset the reduced revenue; or
- Delay in the achievement of future rate increases at inflationary levels.

Acknowledgements:

This report was prepared with the assistance of Kyle Murray, Financial Business Administrator.

PREPARED BY:	
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