

<b>TO:</b>	<b>STRATEGIC PRIORITIES AND POLICY COMMITTEE MEETING ON DECEMBER 7, 2015</b>
<b>FROM:</b>	<b>JOHN BRAAM, P.ENG. MANAGING DIRECTOR, ENVIRONMENTAL AND ENGINEERING SERVICES &amp; CITY ENGINEER AND MARTIN HAYWARD MANAGING DIRECTOR, CORPORATE SERVICES &amp; CITY TREASURER, CHIEF FINANCIAL OFFICER</b>
<b>SUBJECT:</b>	<b>2016 WATER AND WASTEWATER RATES</b>

<b>RECOMMENDATION</b>
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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 3%, effective January 1, 2016;
- (b) all rates and charges related to the provision of Water Services, with the exception of the Customer Assistance charge, **BE INCREASED** by 3%, effective January 1, 2016;
- (c) the proposed by-law to amend the Wastewater and Treatment Rates and Charges By-law **BE INTRODUCED** at the Municipal Council meeting on December 8, 2015 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 December 8, 2015 to effect the rates and charges noted in (b), above.
- (e) the Civic Administration **BE DIRECTED** to review factors affecting revenue forecasts and report back to Council.

<b>PREVIOUS REPORTS PERTINENT TO THIS MATTER</b>
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- Updated Water Service Area Financial Plan, May 5, 2015, Civic Works Committee, Agenda Item # 8,  
<http://sire.london.ca/cache/2/oeddya45yta2ut45ds5yax45/18483111202015121148970.PDF>

<b>BACKGROUND</b>
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**PURPOSE**

This report requests the approval of the Municipal Council to implement changes to Water and Wastewater rates and charges effective January 1, 2016.

**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. Last year, rate changes were approved in advance of the budget because the Council of the day could not approve the budget due to the municipal election. This year rate changes are recommended in advance of the 2016-2019 Water and Wastewater Budgets, as budget review is now aligned with the multi-year Property Tax Supported budget process. If these changes are delayed, the forecasted full year revenues will not be realized as planned, which could in turn affect future rate increases. Next year it is proposed that rate changes be aligned with other City rate changes. The proposed 2016 rates and charges are consistent with that forecasted last year.

## **DISCUSSION**

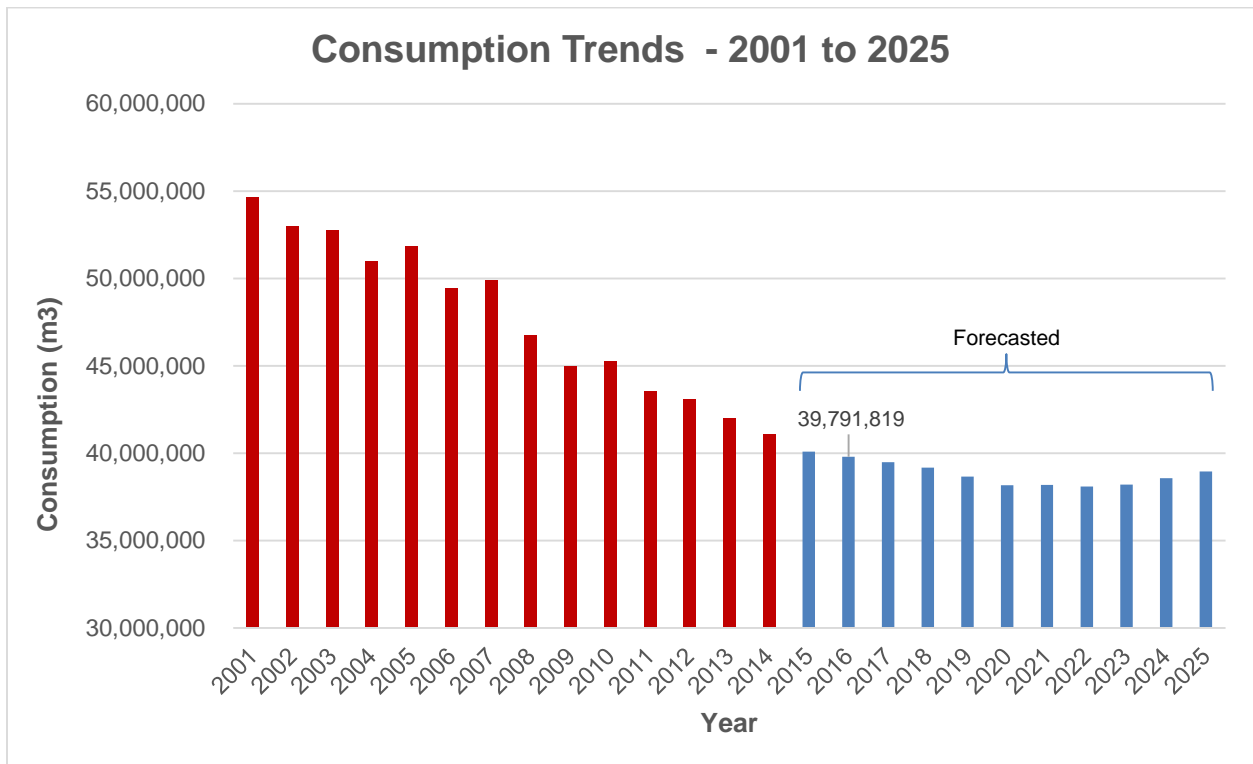
Delays in rate increases beyond January 1, 2016 will impact anticipated revenues built into forecasts by about \$400,000 per month. With the budget deliberations and subsequent rate change implementation schedule taking approximately 3 months, this would equate to approximately \$1.2M of reduced revenue which is required to fund utility operations and capital requirements.

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 2016 were included in the 2015 Budget forecasts. The rate increases forecasted for 2016 of 3% for Water and 3% for Wastewater remain appropriate based on the preliminary 2016 - 2019 Budgets and is consistent with the approved Water Financial Plan that was updated and submitted to the Ministry of Environment and Climate Change earlier this year. 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 have not been conducive to water consumption. Growth in the number of customers has not resulted in linear and proportional increases in water revenues. Subject to the approval of recommendation (e), above, staff will investigate cold weather impacts, water demands per person, customer growth and other revenue factors to strengthen our understanding of their future impact.

Average residential consumption has decreased 32.2% in the past 13 years, from a peak of approximately 253.4 m<sup>3</sup>/year in 2001 to approximately 171.9 m<sup>3</sup>/year in 2015. Another reduction in forecasted consumption was made for the 2015 budget, reducing consumption forecasts from 41.1 million m<sup>3</sup> in 2014 to 40.1 million m<sup>3</sup> (2.4%) for 2015. A further anticipated reduction to 39.8 million m<sup>3</sup> (0.7%) is the basis for the 2016 Budgets. The following graph illustrates the declining water consumption trend.



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 4% and 9% rate increases for 2016 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 18%) 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 6.8%/year from 2016 to 2019; natural gas costs are forecasted to increase at an average of 9.1%/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)
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Water	\$1,941	\$37,800
Sanitary	\$0	\$21,802
Stormwater	\$0	\$973

The updated 2016 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. Continuing the rate plan is critical to achieving infrastructure sustainability by providing the financing necessary to implement the 20 Year Plans.

### **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 3% rate increases proposed for 2016 are necessary to progress towards these targets.

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;
- New Regulations to target a 40% phosphorus reduction in the Thames River watershed; 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 Water Financial Plan was last updated in May 2015. The implementation of the new water and wastewater rate structure in 2013 accelerated the achievement of inflationary-level rate increases. The following table outlines prior year approved rate increases, along with proposed rate increases which are consistent with the Water Financial Plan.

<b>Approved Rate Increases</b>	<b>Proposed Rate Increases</b>
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	2011	2012	2013	2014	2015	2016	2017	2018	2019
Budgets	0%	8%	8%	8%	7%	3%	3%	3%	3%

## Financial Sustainability

The 2016 rate changes are the first inflationary rate increase in accordance with the 20 Year Plans for both utilities. Implementing the 3% rate changes on January 1, 2016 will position the utilities to achieve financial sustainability, with future rate increases 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.

### SUMMARY:

The proposed 3% increase in Water and Wastewater rates and charges represent a financial sustainability achievement. Maintaining the projected annual 3% rate increases throughout the four year budget will be challenged by a number of factors affecting revenues. These are proposed for detailed examination. Challenges to the expenditure side of the budget are recognized and continue to be evaluated as better information becomes available.

The proposed rate increases are consistent with that forecasted in the last budget cycle, with the Water rate increase being consistent with its regulatory Financial Plan.

The impact to the average residential customer of a 3% increase in both Water and Wastewater rates is summarized below:

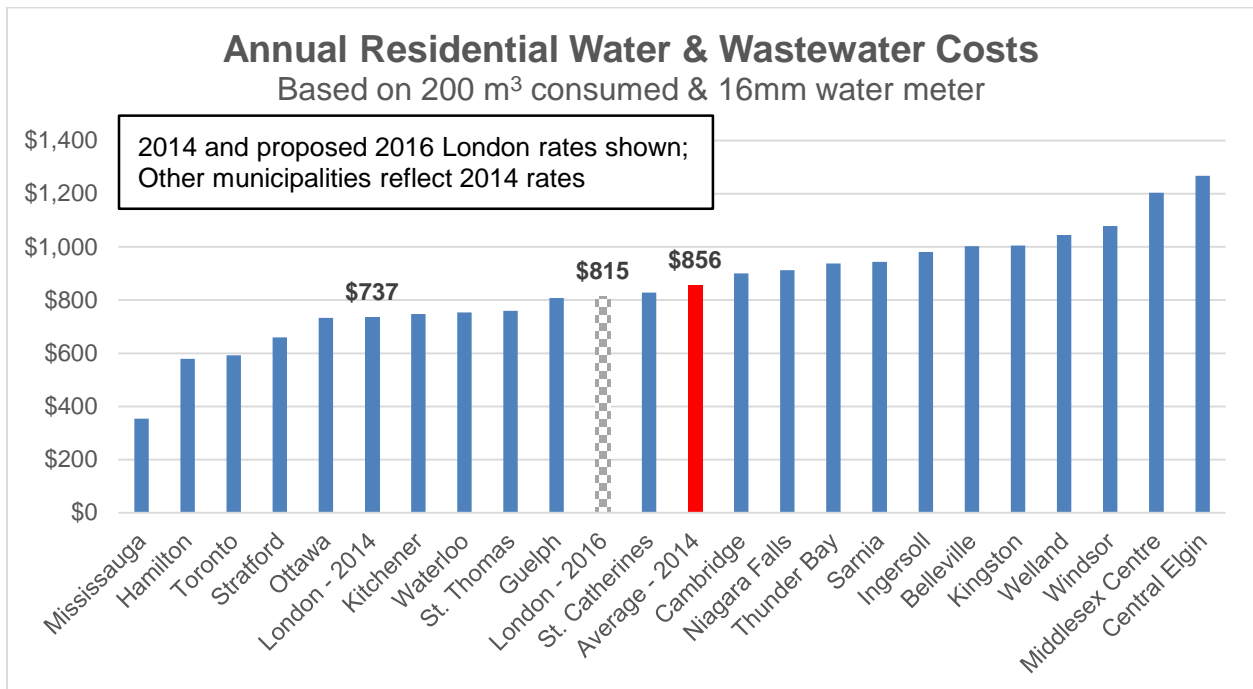
	Budgeted Residential Cost at 2015 Rates <sup>(1)</sup>	Forecasted Residential Cost at 2015 Rates <sup>(2)</sup>	2016 Increase (3%)	Forecasted Residential Cost at 2016 Rates <sup>(3)</sup>
Water	\$367	\$353	\$10	\$363
Sanitary	\$301	\$288	\$9	\$297
Storm	\$174	\$174	\$5	\$179
	\$842	\$815	\$24	\$840

(1) The budgeted residential cost in 2015 was based on an average residential consumption of 171.9 m<sup>3</sup>.

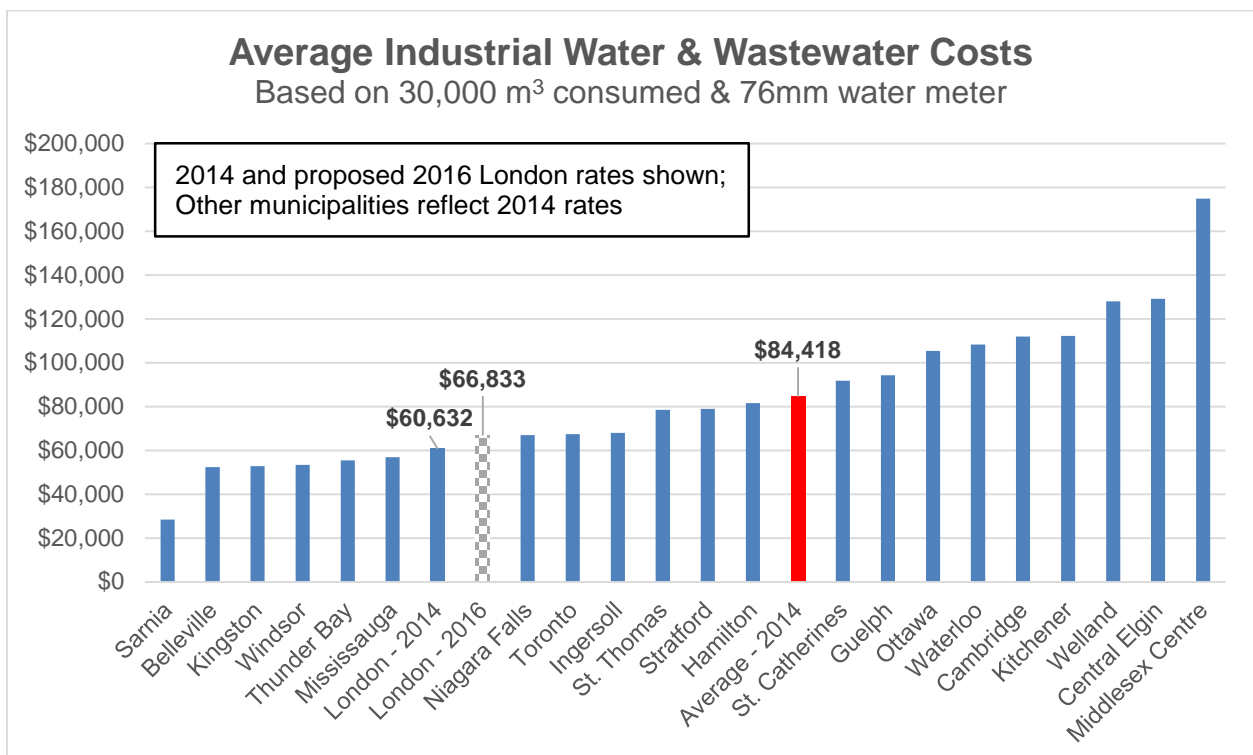
(2) The forecasted residential cost in 2015 was based restated using a revised average residential consumption estimate of 165.4 m<sup>3</sup>.

(3) The forecasted residential cost in 2016 is based on an average residential consumption of 165.4 m<sup>3</sup>.

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 2014 rates, while London's 2014 and proposed 2016 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: 2014 BMA Municipal Study



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Approving rate increases now will allow the Water and Wastewater Budgets to be aligned with the City Property Tax Supported Budget, while not reducing revenues by \$400,000 per month.

**Acknowledgements:**

This report was prepared with the assistance of Debbie Gibson, Financial Business Administrator.

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CC. Larry Palarchio, Director of Financial Planning and Policy