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<b>TO:</b>	<b>CHAIR AND MEMBERS CIVIC WORKS COMMITTEE MEETING ON SEPTEMBER 10, 2012</b>
<b>FROM:</b>	<b>JOHN BRAAM, P. Eng. MANAGING DIRECTOR, ENGINEERING AND CITY ENGINEER</b>
<b>SUBJECT:</b>	<b>RATE STRUCTURE REVIEW – A NEW FUNDING MODEL FOR WATER, SANITARY AND STORM DRAINAGE CHARGES</b>

<b>RECOMMENDATION</b>
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That, on the recommendation of the Managing Director of Engineering and City Engineer, for the City of London the following the following report **BE RECEIVED** for information.

<b>PREVIOUS REPORTS PERTINENT TO THIS MATTER</b>
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The reports noted below can be found at:

<http://www.london.ca/d.aspx?s=/Meetings/Default/meetingpackages.htm>

- [Rate Structure Review - Water, Sanitary and Storm Drainage Charges, July 17, 2012, Civic Works Committee, Agenda Item #10](#)
- [Fixed Rate for Water and Sanitary Charges, April 2, 2012, Civic Works Committee, Agenda Item # 32](#)
- [Water, Sanitary and Storm Rate Structure Review - Fixed Rate for Water and Sanitary Charges, August 15, 2011, Built and Natural Environment Committee, Agenda Item # 7;](#)
- [Council Proceedings 14th Meeting, July 26, 2010 – page 30](#)
- [Presentation by Administration, London Economic Development Committee and Industry representatives from AB In Bev \(Labatt\) and Casco at July 19th meeting of ETC](#)
- [Water, Sanitary and Storm Rate Structure Review – Update on Implementation Timing and Consultation Process, July 19, 2010, Environment and Transportation Committee, Agenda Item # 26a, deferred from June 21, 2010](#)
- Several previous reports were referenced in the July 17, 2012 Civic Works Reports.

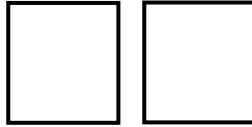
<b>BACKGROUND</b>
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**Purpose**

This report provides Committee and Council with an update of activities which occurred over the summer months, considerations for identifiable customer sub-groups, and an understanding of how the new funding model will be decided upon over the next several months. The report will describe the process to be followed; re-iterate the objectives, goals and underlying principles; and expand upon the input opportunities for Council and stakeholders.

**Background**

The water and wastewater systems are customer owned and supported utilities. Water and sewer rate charges provide the revenue streams needed to sustain these utilities. City staff undertake the stewardship roles to ensure the utilities are well managed and maintained for current and future generations. Total revenues for the two utilities are approximately \$130,000,000. Customer charges are based on formulae depending on the type of customer (aggregated into classes), their water consumption, sanitary sewage generated and land area of their property. The current rate structure was established more than 22 years ago for water and 15 years ago for sanitary rates. It has been identified as being one of the most complex rate structures in Ontario and contains inequities between customer classes and lacks consistency between the water and sewer customer classes and rate structures.



In 2004, Administration began a review of the water, sanitary and storm rate structures, in an effort to simplify the structure and improve fairness. Since then, the review has undergone several iterations in response to requests by the City’s elected officials and our stakeholders. While the process undertaken was well received and the most recently suggested rate structures ([July 2010 report](#)) are recognized as improving the fairness and equity, the current economic conditions have lead Council to avoid changes which might adversely affect employment retention and our competitive advantage to attract new businesses. In 2010, Council once again deferred the implementation of the proposed rate change and also requested whether simpler options might be available and to address the concerns of high volume industrial users.

In 2011, the priorities of the water and wastewater utilities switched to address revenue stability. In April 2012, Council requested that the full rate structure review be completed to determine longer term impacts on the customers and the sustainability of the utilities.

**Discussion**

In the July 2012 report to CWC, we identified a three step approach.

The three step approach is to:

- Re-focus the goal, objectives and principles for this review that is consistent with the City’s Strategic Plan – (done)
- Develop a communications plan that circulates the information widely to all stakeholder groups (done) and provides opportunity for input of both elected officials and customers (underway)
- Assess the impact of changes to the rate structure on budget and financial plans for both utilities (underway)

The goal, objectives and principles are shown below and are further defined in Appendix “A”. They have been abbreviated from the original 10 presented in past reports to focus on the most important issues and assist in the development of the new funding model.

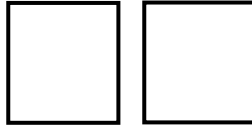
<b>GOAL</b>	<b>To introduce and implement a “value based” funding model for water and wastewater services</b>
<b>OBJECTIVES</b>	<ul style="list-style-type: none"> <li>• To ensure financial stability</li> <li>• To promote conservation</li> <li>• To encourage and support economic development and jobs retention</li> </ul>
<b>OPERATING PRINCIPLES</b>	<ul style="list-style-type: none"> <li>• Fairness and equity</li> <li>• Sustainability</li> <li>• Affordability</li> </ul>

Introducing and implementing a new funding model for water and wastewater services will require a new understanding of the value of water; it is not about cost, it is not about price, it is about value – health and safety is maintained through constant monitoring and testing of the system, quality of life is enhanced by providing service on demand to residents and businesses, promoting economic development through robust and reliable systems, and fire protection that keeps insurance rates low for all customers..

A Strategic Communications Plan has been prepared and will be rolled out over the coming weeks with the goal:

***To engage the citizens of London in a dialogue on the value of water.***

The communications plan identifies the strategy and tactics, key messages and delivery mechanisms required to reach and engage all audiences: the single parent receiving social



assistance and raising three kids in a rented apartment; the retired couple spending four months in sunny Florida (Snowbirds); the homeowner with a pool and a hot tub; London's business community; our world class healthcare organizations, universities and colleges; our large industries such as those in the business of producing food and beverages and the future businesses that will choose to set-up shop in London.

A properly designed funding model will balance the objectives and principles across all customer groups within the City and ensure that everyone pays their fair share for these life sustaining services. There remain numerous fairness and equity issues as described in Appendix "B" which need to be addressed. Invariably, modifications to the existing rate structures will see those who have been currently receiving a benefit at the expense of another customer group feeling disadvantaged. These customers will voice their concerns, while those customers who will see a lowering of what they currently pay, will not voice their opinion. It is difficult for our elected officials to assess the appropriateness of the proposed changes when there is not a more balanced response. To assist our elected officials, City staff are meeting with stakeholder and customer groups ahead of the final report to respond to their questions and concerns. The intent is to ensure that Council can make a decision knowing that their constituents have been consulted and understand the value and needs for the change.

As part of the new rate review, impact analysis of the proposed "value based" funding model will be undertaken as it relates to:

- our customers,
- the 20 year financial sustainability plans for the utilities, and
- budget impacts.

Future reporting will indicate the extent of these impacts on sample customers. Individual customer impacts can be assessed by our staff on a one-on-one basis to avoid concerns with confidentiality of business operations. Stakeholder meetings have been organized as deemed appropriate.

### **Suggested New Funding Model**

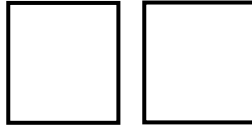
The basic structure of the new funding model will not be significantly different than what we have now. The changes necessary to promote equity among all customer groups are embedded in the details of the model which will be presented in future reports. It is important at this time to suggest "considerations or accommodations" that could be made to certain "identifiable" customer sub-groups and determine whether members of Committee and Council would support benefitting these sub-groups at the expense of other customers. These sub-groups and potential accommodation are listed below:

- low income customers – residential – reduce fixed charges based on a needs test
- low volume customers – residential – reduce fixed charges
- high volume customers – ICI – reduce volumetric charge to support attraction and retention of businesses
- conserving customers – residential and ICI – provide a one-time rebate based on demonstrated reduction in last 5 years on an application basis

In most cases, these sub-groups are not immediately identifiable (with the exception of high and low volume users), nor should they be in terms of privacy issues or the Water and Wastewater utilities' business objective of selling water and properly treating waste streams – both sanitary and stormwater. To deal with these issues of use, two additional considerations were made when developing the new rate model:

1. Who are our customers and how do they use our products (water, sanitary, storm);
2. Should one customer group receive a benefit on the price of the product over another?

We believe every one of our customers has a "right" to safe and sufficient water, storm, and sanitary service to meet their needs. Customers must be prepared to pay the appropriate price for the value and the delivery of these services. Our systems are publicly owned non-profit systems, that our customers pay for service and the City manages it on their behalf. The universality of these services to customers should be of paramount importance to all of us. Within this context, the financial principles on which the utilities are based (full cost pricing and user pay) will result in customers paying different rates as they have in the past. Past reports on



this topic have identified that “pipe value” is an effective way to distinguish the service needs and therefore costs that various customers groups are responsible for. This type of objective analysis ensures equity across customer groups.

In the current rate model, ICI customers use approximately 60% of the water but contribute approximately 40% of the total revenue. The new rate model will examine the splits and will rationalize and justify any future funding allocations. Should Council direct to further benefit the sub-groups within ICI and residential classes, an appropriate allocation of funds or subsidy from water and wastewater will then have to be recovered from the remaining customers. Under the previously proposed rate structure, residential and ICI revenue streams were separated and any benefit to low volume users would have to be made up by higher volume users. Water consumption in the residential sector is dependent on several factors, but indoor usage is primarily based on the number and age of people living in the home. Low volume consumption is not a good indicator of whether customers are conserving or what their socio-economic status is. Under the current structure, low volume users are not covering the cost of the infrastructure needed to provide services including fire protection. The infrastructure required to provide these services is therefore being paid disproportionately by higher volume users.

The suggested funding model would be structured in the following manner:

	Water	Sanitary	Storm Drainage
Volumetric Component	\$ per cubic metre	\$ per cubic metre	None
Fixed Component	Capital Renewal Charge* Fire Protection Charge* Water Billing Charge **	Capital Renewal Charge*	Flat Rate for small properties Area Rate for large properties

Note: \* indicates a new fixed rate charge dependent on the service cost to the customer's cost within the system.  
 \*\* Previously called the water meter charge and covered only the water meter replacement cost

In future reports, the details of the new proposed funding model will be illustrated, along with the options and elements available to achieve the “accommodations” noted above.

**Customer Engagement Activities**

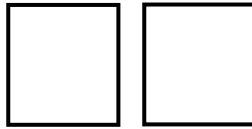
As part of the strategic communications plan, several engagement activities have already occurred or are planned in the near future including the following:

- Meeting with Community Services staff from Municipal Housing, Social and Community Support Services, and Ontario Works to review existing programs and opportunities for additional support with respect to crisis avoidance
- Focus group meetings with customers and advocacy groups, including:
  - Low income
  - Institutional sector
  - Business sector (Industrial and Commercial)
  - Neighbourhood groups
- Launch and roll out of branding for the “Value of Water” campaign: encourage dialogue and feedback, promote Town Hall meeting
- Contact with several media groups
- Town Hall Meeting on October 2, 2012 featuring Bob Macdonald (Quirks and Quarks)
- Presentation of New Funding Model at CWC October 22, 2012 meeting
- Public Meeting at CWC November 12, 2012 meeting with new rates and fees bylaw.

**Next Steps**

Over the next few months, further reports will be brought forward to provide additional opportunities for input, prior to finalization of the funding model. A draft structure will be brought forward for full discussion with Committee to attempt to address political issues as they relate to subsidization of businesses, those who conserve or the economically disadvantaged.

The internal audit undertaken by Pricewaterhouse Coopers recommended that a fire protection charge and a construction water charge be considered to more effectively recover costs of these services. In the late 1960’s, the PUC/City charged the Fire Department \$75 per hydrant



installed across London. This accounting practice was eliminated a few years ago to assist with tax budget targets. Staff suggests that these improvements be included in the full rate structure review requested by Council.

It is desirable to implement the new funding model separately from the annual budget discussion in October/November, while at the same time providing an indication of what changes may result to the budget for the proposed “value based” funding model.

To complete the implementation, following stakeholder consultation, it will be necessary to prepare a revised by-law and hold a public meeting before Council. London Hydro requires approximately three months modifying the billing system to incorporate these revisions.

The full rate structure review would be brought back in late 2012 for Council review with potential implementation by London Hydro tentatively scheduled for mid year 2013.

**Conclusion**

Council’s previous endorsement of the goal, objectives and operating principles provides the basis for the development of the new “value based” funding model. The objectives and operating principles are strongly aligned with the City’s strategic plan and will support economic development, health and safety, quality of life, and fire protection. A well developed communications plan will assist our customers and elected officials in understanding the value of the services provided by the utilities. The information provided as part of the communications plan will show why the new model is needed and assist with the decisions in providing a balanced funding model for the current and future generation of customers. Our customer and elected officials will also be given the opportunity to explore whether there is an interest in “benefitting” certain customer sub-groups at the expense of other customers.

**Acknowledgements**

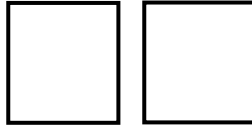
This report was prepared by Roland Welker, Division Manager of Water Engineering with input from Matt Feldberg, Water Demand Manager and Jason Senese, Manager Administrative Services.

<b>PREPARED BY:</b>	<b>RECOMMENDED BY:</b>
<b>ROLAND WELKER, P. ENG. DIVISION MANAGER WATER ENGINEERING</b>	<b>JOHN BRAAM, P.ENG. MANAGING DIRECTOR, ENVIRONMENTAL AND ENGINEERING SERVICES AND CITY ENGINEER</b>

August 31, 2012

Attachments: Appendix A - **Objectives and Operating Principles**  
 Appendix B – **Specific Concerns with the Current Rate Structure**  
**Appendix C – Communication Plan – Julian’s Brochure**

Cc: S. Glickman, London Economic Development  
 M. Henderson, Director of Business Liaison  
 M. Hayward, Managing Director, Corporate Services and City Treasurer, CFO  
 J. Fleming, Director of Planning  
 G. Macartney, London Chamber of Commerce  
 Jason Senese, Manager of Administrative Services, Finance/EES Support



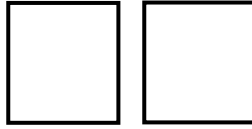
**APPENDIX A  
OBJECTIVES AND OPERATING PRINCIPLES**

<b>OBJECTIVES</b>	<b>DESCRIPTION</b>
Ensure Financial Stability	In the past seven of eight years the water system has operated in a deficit position. A predictable source of income (revenue) is required to avoid a deficit when meeting operating and capital obligations. Current fixed costs for water and wastewater range from 60%-80% of the total budget expenses while the current fixed charge recovers only 1% of total costs. A new funding model will reallocate how costs should be recovered from the fixed and volumetric fees and rates.
Promote Conservation	Continued support and promotion of water conservation efforts will benefit the wise consumer (increasing premiums charged to high volume residential customers), the operating system (may reduce operating costs and capital investment needs over time), and the natural environment (reduction of energy use, of residual wastes and chemicals).
Encourage and Support Economic Development and Jobs Retention	London's institutional, commercial and industrial (ICI) customers currently pay less for water and wastewater services than most other municipalities in Ontario. <sup>a</sup> The new funding model will be aligned with other economic development initiatives ensuring competitive positioning of London as place to do business thereby retaining current and attracting new businesses.

<b>OPERATING PRINCIPLES</b>	<b>DESCRIPTION</b>
Fairness and Equity	A new funding model - a reallocation of fixed and volumetric fees and rates to ensure that all customers are charged a fair price for the water and wastewater services they use and the infrastructure required to deliver it to their home and business.. Fixed costs make up 60%-80% of all operating costs and the current rate structure (or funding model) that has a 1% recovery rate. The result is that that high volume customers are paying a disproportionate share for water and wastewater services. <sup>b</sup>
Sustainability	A new funding model will ensure availability of funding for future capital investments for infrastructure maintenance and expansion. Life-cycle planning made possible with assured infrastructure financing will prove to be more efficient and cost effective and minimize social disruption associated with infrastructure failures.
Affordability	A new funding model (fixed and volumetric fees and rates) will offer affordable fees and rates for all customers while ensuring that the full cost of service is being recovered. Over the long term, customers will pay less as a result of sustainable infrastructure renewal and conservation efforts.

<sup>a</sup> Water and Wastewater Cost Recovery Review, BMA Management Consulting Inc., March 24, 2012

<sup>b</sup> Water and Wastewater Cost Recovery Review, BMA Management Consulting Inc., March 24, 2012



## APPENDIX B

### Specific Concerns with the Current Rate Structure

(excerpt from May 7, 2008 BOC Report, Agenda Item #7, page 36 – text edited in 2010 is in Italics)

Over the course of various meetings and discussions with customers in the last few years, many issues concerning the current rate structure. It is recognized that some of these issues may be purely technical, while others are more of a political nature, e.g. should rates be used as an economic development incentive or as a low income subsidy to promote better sanitation in poorer households. Appendix “B” of the May 7, 2008 BOC Report *provided* a summary of the issues and provided commentary and recommendations by Administration to set the context and assist in the decision making process.

While it is important to review our practices from time to time to ensure we are following the best practices and this is one of the key drivers for suggesting that current rate structures be changed, there are several examples of improvement opportunities which staff feel need to be addressed to make the rate structures more fair and equitable, *and achieve the principles which were established at the start of the rate review process* including:

- Increase difference between water block rates to further promote water efficiency in the residential sector
- *Fire protection costs are currently recovered based on the amount of water consumed, which is not reflective of actual costs, particularly in the ICI sector*
- Multi-family bulk metered properties currently are not subject to a conservation rate which can result in water wastage since the cost is distributed equally among all the residents – *the threshold for higher block rate charges for these buildings would be based on the single family residential threshold times the number of units in the building or development*
- Achieve a greater degree of consistency between water, sanitary and storm rates in terms of the rate structure and rationale for customer differentiation
- Demonstrate why there is a difference between residential and ICI
- Run the utilities more like a business, charging for what it costs to deliver the service versus pricing the service based solely on what the customer does, *thereby establishing a defensible cost basis versus what may appear to be a market pricing approach or worse favouritism of one customer over another*
- Water is charged on the basis of a metered account and meter volumes are not aggregated for ICI customers, while sanitary classifies customers based on the sum of all the customer’s *metered accounts* over the year, requiring annual updating to ensure customers are in the correct classification *based of thresholds of annual consumption*
- *Flat Rate* Charges for storm drainage service is based on the number of water meters a property has instead of the area of the property (currently only approximately 100 industries are charged based on area), examples:
  - a 130 unit townhouse development pays almost the same storm charge as a single family residential property
  - a commercial plaza or hospital campus of 30 ha may pay less than 6 single family homes equating to 0.6 ha , i.e. pay less for 50 times the area
- *Storm drainage servicing costs bear no relationship to water consumption, yet the current storm area charge offers a lower area rate to large water consumers*
- Some buildings with 5 or more units are classified as high rise and receive the commercial sanitary rate, whereas some buildings of 5 or more units are classified as multi-family and pay the residential sanitary rate – *buildings of up to 19 units are more reflective of residential pipe value costs and should be deemed as residential customers, whereas buildings of 20 units and 4 stories or more are defined as “high rise” and are more characteristic of larger commercial buildings with respect to pipe value and should therefore be classified as an ICI customer*
- Some customers pay storm drainage charges even though they do not see an obvious benefit.
- Some property owners do not pay any storm charge because they do not have a water meter, examples, lands under development and vacant parcels. If storm charges were part of the tax base, then these property owners would pay for storm servicing based on their assessment. *In subsequent discussions with these customer types, it was determined that achieving equity would disadvantage these customers, adding considerable cost to properties which are potentially developing which do not have a revenue source to support the new costs. This type of a charge will be reviewed in future updates.*