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TO:	CHAIR AND MEMBERS CIVIC WORKS COMMITTEE MEETING ON OCTOBER 22, 2012
FROM:	JOHN BRAAM, P. Eng. MANAGING DIRECTOR, ENGINEERING AND CITY ENGINEER
SUBJECT:	NEW "VALUE BASED" FUNDING MODEL FOR WATER AND WASTEWATER SERVICES

RECOMMENDATION

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.

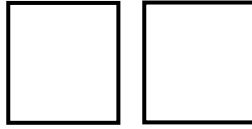
It **BEING NOTED**, a Public Participation Meeting will be held at the next meeting of CWC.

PREVIOUS REPORTS PERTINENT TO THIS MATTER
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The reports noted below can be found at:

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

- [Link to Julian Questions and Answers on the New Funding Model](#)
- Rate Structure Review – A New Funding Model for Water, Sanitary and Storm Drainage Charges , September 10, 2012, Agenda Item # 2
<http://sire.london.ca/cache/2/mldzlg551vek0l45dh0tau55/6062110122012023907561.PDF>
- [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](#)
- Council Proceedings 15th Meeting, July 27, 2009 – Item 285, 14th Report of the Board of Control, Clause #9, as amended;
- Water, Sanitary and Storm Rate Structure Review – Update on Implementation Timing, July 20, 2009, Environment and Transportation Committee, Agenda Item # 5;
- Sewer Surcharge of Water Used to Water Lawns, Flower Beds and Swimming Pools, January 12, 2009 – 2nd Report of the Environment and Transportation Committee, Item #19 and Agenda Item #17;
- Council Proceedings 15th Meeting, July 21, 2008 – Item 241, 22nd Report of the Board of Control, Clause #26, as amended;
- Water, Sanitary and Storm Rate Structure Review – Revisions to Current Structure, July 16, 2008 – 22nd Report of the Board of Control, Item #26 and Agenda Item #33;
- Water, Sanitary and Storm Rate Structure Review – Update on Concerns coming out of Consultation Process, May 28, 2008 – 17th Report of the Board of Control, Item #20 and Agenda Item #24;



- Water, Sanitary and Storm Rate Structure Review – Update Report, May 7, 2008, Board of Control, Agenda Item # 7;
- Water, Sanitary and Storm Rate Structure Review – Update on Concerns coming out of Consultation Process, November 14, 2007 – 31st Report of the Board of Control, Item #30 and Agenda Item #5;
- Water, Sanitary and Storm Rate Structure Review – Update on Consultation Process, August 8, 2007, Board of Control, Agenda Item # 25(a) and R. Jawniuk et al – Petition re: Storm Sewer Charges – Selkirk Street and Braesyde Avenue, Agenda Item # 25(b);
- Erosion and Sediment Control Requirements and Practices for Construction Sites to Ensure Water Quality Protection for Open Watercourses, June 18, 2007, Joint Environment and Transportation Committee and Planning Committee, Agenda Item #12;
- Several previous reports were referenced in the August 8, 2007 Board of Control Report.

BACKGROUND

PURPOSE

This report provides Committee and Council with an update of activities which occurred over the summer and fall, considerations for identifiable customer sub-groups, and a description of how the new funding model. The report will describe the process to be followed; re-iterate the objectives, goals and underlying principles; and detail past and upcoming input opportunities for Council and stakeholders.

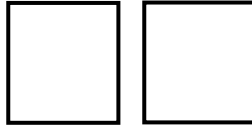
BACKGROUND

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 on a not-for-profit basis. 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 \$135,000,000 (2012 budget). 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.

Commencing December 31, 2012, Section 19 of the Safe Drinking Water Act will require that London’s Municipal Council be held to a statutory standard of care with respect to their oversight responsibilities toward the operation of the City of London’s drinking-water system. A companion report is provided to Civic Works Committee for the October 22, 2012 meeting which provides additional information. Financial aspects of the standard of care are described on pages 18 to 20 in the [Ministry of the Environment Guidance Document for Standard of Care](#)



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 (continuing)
- Assess the impact of changes to the rate structure on budget and financial plans for both utilities and seek direction from elected officials (underway)

The goal, objectives and principles are shown below and are further defined in Appendix “A” of the September CWC report. 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.

GOAL	To introduce and implement a “value based” funding model for water and wastewater services
OBJECTIVES	<ul style="list-style-type: none"> • To ensure financial stability • To promote conservation • To encourage and support economic development and jobs retention
OPERATING PRINCIPLES	<ul style="list-style-type: none"> • Fairness and equity • Sustainability • Affordability • Simplicity (added to address Council’s previous direction)

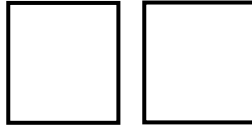
Introducing and implementing a new funding model for water and wastewater services will require a new understanding of the value of water; it is not about cost, it is not about price, it is about value – health and safety, quality of life, economic development and fire protection.

A Strategic Communications Plan has been prepared 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 mother receiving social assistance and raising four kids in a rented apartment; the retired couple spending six 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 giving services. There remain numerous fairness and equity issues as described in Appendix “B” of the September 10th CWC report 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 most loudly, while those customers who will see a lowering of what they currently pay, do not tend to voice their opinion. It is difficult for our elected officials to assess the



appropriateness of the proposed changes when we do not receive input from all customer groups.

As part of the new rate review, impact analysis of the proposed “value based” funding model is being undertaken as it relates to:

- our customers,
- the 20 year financial sustainability plans for the utilities, and
- how the 2013 budget is affected.

This report and subsequent presentation to CWC contains information on how sample customers would be affected by the new funding model. Individual customer impacts are being 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

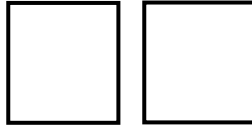
The basic structure of the new funding model will not be significantly different than what we have now, assisting our customers in understanding it. The changes necessary to promote equity among all customer groups are embedded in the details of the model. It is important at this time to suggest “considerations 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. A few of these considerations have been included in the model at this time, but a general indication of what might be considered is included in Schedules attached to this report. 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 small businesses – provide a one-time rebate based on demonstrated reduction in last 5 years on an application basis, provide additional incentive programs in future years, appropriately budgeted and collected from Development Charges or Rates.

In most cases, these sub-groups are not immediately identifiable (with the exception of high and low volume users), nor perhaps 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. Should it matter who our customers are or what they do in the delivery of these services and more importantly, should we discriminate on price between identifiable customer groups? We believe every one of our customers has a “right” to safe and sufficient water to meet their needs, but customers must be prepared to pay the appropriate price for delivery of these services. The owners of the system – our customers – pay for the service. The universal access to these services for our 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” (a representation of the true cost to deliver the service) is an effective way to distinguish the service needs and therefore costs that various customer groups are responsible for. This type of objective analysis ensures equity across customer groups.

If Council wishes to further benefit some sub-groups within the City, an appropriate allocation of funds from water and wastewater will have to be made and this amount will then have to be recovered from all customers or the remaining customers. Under the previously proposed rate structure, residential and ICI revenue streams were separate and any benefit to large ICI would be paid for by small ICI. Similarly if a benefit is provided to low volume users then this revenue reduction would have to be made up by medium or 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 therefore not a good indicator of whether customers are conserving or what their socio-economic status is. We can safely say that low volume users are currently not covering the cost of the infrastructure needed to provide water service to the building 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 Meter Charge	Capital Renewal Charge*	Flat Rate for small properties Area Rate for large properties

Note: * indicates a new flat rate charge dependent on the customer's cost responsibility within the system.
 + indicates a new additional flat rate charge dependent on the customer's cost responsibility within the system – water requirements for fire protection using surrogates such as meter, service, building or property size.

CUSTOMER CLASSES VERSUS VOLUMETRIC BLOCK RATES FOR ALL CUSTOMERS

The current model (see Appendix C or the Water and Wastewater Rates and Charges bylaws) has separate water rates for residential and ICI customers each with 3 blocks, while sanitary and storm are broken in 7 customer classes – 1 residential and 6 ICI, all as single blocks. Ideally, a new model would be consistent for water and wastewater to improve simplicity and understanding and provide the opportunity to combine them if this deemed to be desirable. Another potential model was presented in 2008 and 2010 that was similar to water's current structure applied to water and wastewater with only 2 blocks for residential and ICI.

Another potential model (used in a few municipalities in Ontario) does not distinguish between customer classes but uses several blocks to distinguish water customers and wastewater generators on the basis of how much volume they use. This type of model combines the notation of pipe value (true infrastructure cost) and a conservation incentive for small users. The main premise of the model is that:

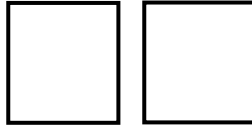
- fixed costs related to infrastructure renewal including fire protection are recovered as a fixed charge
- fixed costs related to operation and maintenance of the infrastructure will continue to be collected as a volumetric charge based on pipe value to encourage conservation
- volumetric charge related to variable operational costs for treatment and pumping of the water/wastewater equally between all customers with a different price for each block.

Essentially, this type of model combines the residential inclining block structure with the ICI declining block structure. The premise of this model is that the true cost of infrastructure is related to how much water flows through the pipes to service the customers. The fixed rate covers the basic hard infrastructure and part of the volumetric rate covers the fixed operating and maintenance costs, while the variable costs are covered by the remaining volumetric rate. The initial blocks then pay for the total infrastructure costs and very high industrial users pay an incremental rate for cost of pumping and treatment. The declining nature of the higher blocks reflects the proportionately lower cost to service larger volume users.

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 support / 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)
- One-on-one reviews with customers to assist them in understanding the impact to them
- Presentation of New Funding Model at CWC October 22, 2012 (this) meeting.



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. This report provides the draft structure 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 the cost of providing this benefit to our customers. Staff suggests that these improvements be included in the full rate structure review requested by Council. The fire protection charge is suggested to be a new revenue stream; but can also be revenue neutral as part of the fixed connection charge.

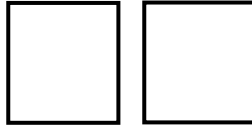
It is desirable to implement the new funding model separately from the annual budget discussion in October/November, while at the same time providing an indication of what changes may result to the budget for the proposed “value based” funding model. The budget should be viewed as defining the expenditure level for the utilities, continuing with the respective 20 year plans for water and wastewater to ensure proper “resourcing” of the utilities and achieve financial sustainability in the near term. The funding model is independent of the budget since it defines who of the 110,000 pays what to ensure fairness and equity. Changes to the funding model such as the increased fixed rate (and lower volumetric charges) should result in a more financially stable and sustainable utility with the potential for lower rate increases and a shorter time-frame to achieve sustainability. If a new revenue charge is included in the funding model, e.g. a fire protection charge, then this addition to the revenue stream would result in further lowering of future rate increases and a shorter time-frame to sustainability, recognizing that the 2013 budget year increase would be higher than currently stated.

To complete the implementation, following stakeholder consultation, it will be necessary to prepare a revised by-law and hold a public meeting at the Strategic Priorities and Policy Committee. The table below compares the timelines for the Rate Review (earliest) and Budget (planned) as they might progress through Committees and Council.

London Hydro requires approximately three months during which time they will modify the billing system to incorporate any revisions which may be made to the funding model.

The new funding model would be brought back in late 2012 or early 2013 for Council review with potential implementation by London Hydro tentatively scheduled for spring 2013.

Rate Review		Budget	
CWC Oct 22	Report for info – describe models and options		
		SPPC Oct 29	Tabling of budget and by-law – no discussion
CWC Nov 12	PPM and Draft By-law – recommendations with options		
		SPPC Nov 19	Presentation and PPM – possible vote
		Council Nov 20	Final vote –
SPPC Dec 3	PPM on by-law with firm recommendations		
Council Dec 11	Final vote		
SPPC Jan 14 & Council Jan 15	Contingency if directed to make changes		



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 and assist them with decision making imperative to arriving at a balanced funding model for the current and future generation of customers.

The main cost drivers of the fixed charges relate to infrastrucutre renewal, and thereby we are guaranting our investment in the sustainability, safety and reliability of the utilities to promote economic development and support quality of life in the City. Introduction of the proposed fixed rate charges for water and sanitary will improve revenue stability, achieve sustainability of the utilities more quickly - consistent with the City’s Strategic Plan; and improve fairness and equity from a user pay perspective. By changing the conservation rate premiums, the financial incentive to conserve will be maintained. Affordability is also maintained by tailoring fixed charges to usage and offering customers the first 7 cubic metres of water and sanitary service at no additional charge other than the fixed charge.

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.

PREPARED BY:	RECOMMENDED BY:
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October 15, 2012

- Attachment: Appendix A - BMA Water and Wastewater Fixed Rate Review, October 2012
 Appendix B – Schedules for Various Customer Benefits
- Schedule B1 – Low Income
 - Schedule B2 – Conservation Rebate
 - Schedule B3 – Industrial Incentive
 - Schedule B4 – Fire Protection Charge
 - Schedule B5 – Construction Water Charge
- Appendix C – Existing and Suggested Rate and Charges Tables
 Appendix D – Sample Customer Impact Table

- Cc: S. Glickman, London Economic Development
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