

Utilities Financial Sustainability Strategy

Presented to Priorities Committee
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Objectives

- Ensure Utilities continues to operate as a self-sustaining entity
- Update and reinforce the applicable policy framework
- Discuss principles and options that underpin this undertaking
- Enable a more deliberate approach to long-term planning and fiscal management of utility services

Strategic plan



Goal 2

Manage, invest and plan for sustainable municipal infrastructure

Long-term financial sustainability framework

Current strategies

- Utilities is financially self-sufficient through the use of a utility rate model:
 - Does not use municipal property taxes to support operational or capital requirements
 - Exceptions are recycling stations and the Enviroservice Station

Future strategies

- Future policy is to be developed to support components of this methodology

Capital funding

Best practice

- Based on response to two key questions:
 - Who pays?
 - When do they pay?

Current County strategies

- The utility is typically not eligible for per capita grants
- Capital is typically funded through either debt or reserves

Capital funding

Recommended strategies

- Narrow-based funding sources (e.g. dedicated grants)
 - Ideal for targeted projects
- Reserves and current-year rate revenue
 - Ideal for reinvestment in existing assets
- Debt financing primarily for growth, while monitoring future-year impacts on debt capacity and annual debt service burdens
 - Ideal for expanding capacity or servicing new customers

Implementation

- These strategies are consistent with current practice
- Consider as inputs to capital funding guidelines

Utilities debt

Category	Recommended strategies	Rationale	Current
Limits on debt			
Total debt to annual revenue ratio	Maximum 1.5	Alberta Capital Finance Authority (ACFA) limit	0.8 \$46,456,000 (December 31, 2017)
Limits on debt service			
Annual debt payment as a percentage of annual revenue	Maximum 25% of annual operating revenue	Defer to corporate debt management policy	4.9% \$2,789,000 (December 31, 2017)

Implementation

- These strategies are consistent with the current debt policy

Utilities reserves

	Current strategies	Recommended strategies
Reserve RU1	Stabilize rates from operating or capital impacts	Risk reserve for operating and capital
Reserve RU4	Capital reserve	<u>Planned</u> expansion, replacement, refurbishment and maintenance of tangible capital assets

Risk reserve

Purpose

- To manage unforeseen circumstances
 - Mid-year rate adjustments are undesirable, a risk reserve mitigates against this potential
 - Sufficient risk allows for more realistic budgeting

Benchmark

- Customize to individual risk profile
- Utilities generally are low-risk enterprises, but water faces more risk of revenue variability due to weather

Current County strategy

- 5% of prior year's utility operations expense

Risk reserve

Recommended strategies

- Separate by individual utility (administrative change)
- Water: 16% of prior year operating expense
- Other utilities: 12% of prior year operating expense

Implementation

- Update reserve policy – optimal balance formula

Risk reserve

Utility		Current balance (December 31, 2017)	Optimal balance (based on 2018 budget)
Water	16%		\$3,500,000
Wastewater	12%		\$2,000,000
Stormwater	12%		\$250,000
Community Energy	12%		\$150,000
Waste	12%		\$1,000,000
		\$2,036,795	\$6,900,000

Implementation – options

- Use Utilities year end surplus
- One time transfer from infrastructure reserve

Infrastructure reserve

Purpose

- To have dedicated funds to support growth and replacement
 - Already have some funding (\$46.1M as of December 31, 2017)

Benchmark

- No standard is published but a higher figure indicates more capacity for reserve funding projects, which means more flexibility in capital planning and implementation

Current County strategy

- 5% of Utilities current asset replacement value

Infrastructure reserve

Recommended strategies

- Set optimum balance based on long-term (90 year) capital forecast
 - No single or static target balance for a capital reserve. Target balance in any year depends on the long-term forecast of need.
- Assumes each current asset is replaced at the end of its useful life at its current year replacement cost

Implementation

- Update Reserve Policy - optimal balance formula

Continuum of choices



- Reliable service is most important
- We need to plan for the future
- If we start now rate increases will be gradual



- Put aside a portion in the bank and take some debt when needed
- Willing to be proactive to a point but not willing to pay for all an asset that may exceed my lifetime



- Wait until expenditure is required
- Concerned about intergenerational equity
- Avoid big balances in reserve

PAY NOW

BLEND

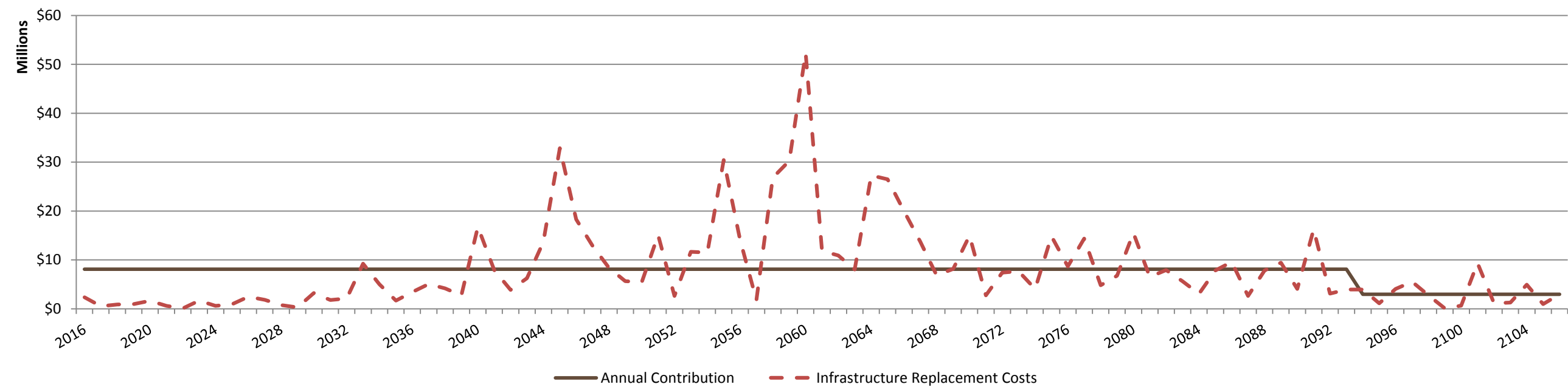
PAY LATER

Consequence

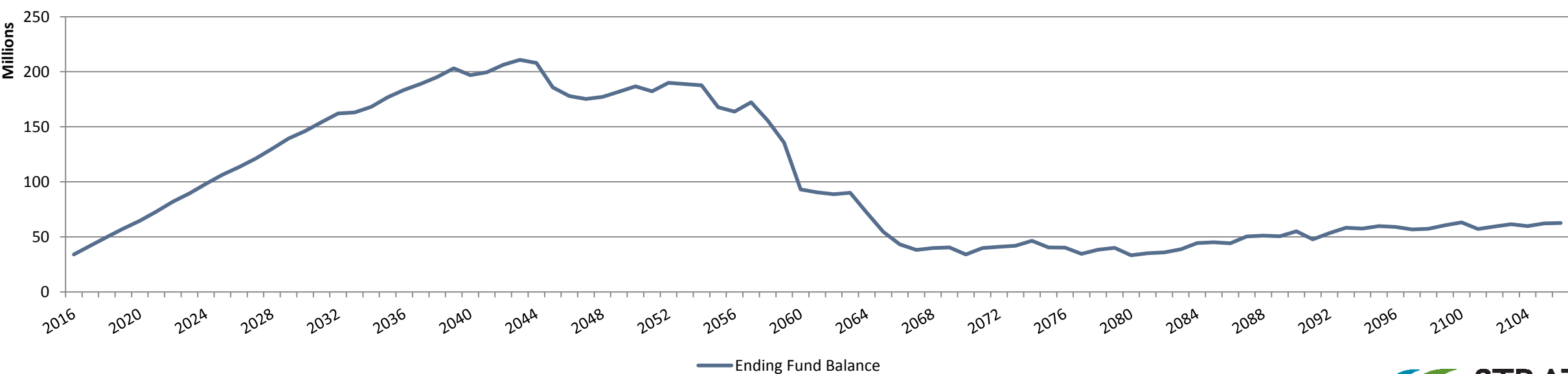
Approach	Pro	Con
Pay now - rely on reserves	• Funding will be in place for replacement • Gradual rate increases	• Intergenerational equity • High reserve balances
Pay later - rely on debt	• Funding will be in place for replacement • Defers rate increases	• Impact on debt capacity and debt servicing • Will deliver rate shock in future year
Defer the decision/status quo	• Defers rate increases	• Risks sustainability of infrastructure • Assumes that grants or debt capacity will be available in the future

Cumulative balance

Summary infrastructure replacement



Summary ending replacement fund balance



Assumptions

What's included in the graph?

- Annual asset maintenance program funding
- Reserve contributions related to historical cost of owned capital
- Estimated useful life is based on accounting life – over time estimated useful life will become adjusted based on asset management evidence

What's not included in the graph?

- Reserve contributions for donated assets
- Replacement costs have not been calculated – this will be accomplished through asset management efforts
- Capital for growth

Implementation – options

Potential rate impact

- Based on current estimates, need an extra \$6.5M per year
- Equates to the equivalent of a 16% rate increase
- Currently project to have rate increases for water and wastewater treatment in the 3 to 5% range due strictly to flow through costs
- Also need some allowance for annual inflation

Options

- Use Utilities year end surplus
- Develop an annual rate increase strategy to achieve optimum balance

Next steps

- Return to Council with an update to Reserve Policy
- Prepare an implementation plan for Council to consider as part of budget deliberations
- Bring forward a report on the utility rate setting methodology

Discussion