1
2012-2015 WATER AND WASTEWATER RATES

The Finance and Administration Committee recommends:

1. **Receipt of the presentation by Kelly Strueby, Director, Business Planning and Budgets, Finance Department and Lucas Cugalj, Director, Strategy and Business Planning, Environmental Services Department; and**

2. **Adoption of the recommendation contained in the following report dated April 20, 2011, from the Commissioner of Finance and the Commissioner of Environmental Services, as amended to read as follows:**

    1. **Council approve an annual blended rate increase of 10% for water and wastewater user rates for the four-year period from April 1, 2012 to March 31, 2016.**

1. RECOMMENDATION

It is recommended that:

1. Council approve an annual blended rate increase for water and wastewater user rates for the four-year period commencing April 1, 2012 to March 31, 2016 as indicated in Table 1.

2. PURPOSE

This report seeks Council approval for an annual blended rate increase of 9% for water and wastewater user rates for the four-year period of 2012 through 2015.

3. BACKGROUND

Water and Wastewater Reserves have been used to mitigate increases to the user rates

The Region provides water supply and sanitary sewage servicing capacity to the nine local municipalities within York Region. The operating costs associated with providing these services are recovered through a uniform region-wide water and wastewater user rate based on actual water flows per cubic metre. A fixed component of each user rate is contributed to a dedicated reserve which is used to fund the replacement and rehabilitation of water and wastewater infrastructure. In the 2011 budget, 5.37 cents per

cubic metre is contributed to a water capital replacement reserve and 12.06 cents per cubic metre is contributed to a wastewater capital replacement reserve. These reserves are also used to mitigate any large fluctuations in the water or wastewater user rates and fund any operating shortfalls.

Growth-related water and wastewater capital infrastructure is funded primarily from development charges. Regional Council has phased out discounting of the non-residential development charge rate to mitigate user rate pressures. However, a portion of the cost of new infrastructure continues to be funded from the water and wastewater capital reserves.

Council approved 10% annual rate increases for water and wastewater in December 2008

At its meeting of December 18, 2008, Council approved the 10% option for water and 10% option for wastewater rate increases. Specifically the water rate increased by 10% each year for the period from 2009 to 2011 and the wastewater rate increased by 10% each year from 2009 to 2011. At that time, water and wastewater reserve deficits were projected to be eliminated by 2009 and 2023 respectively and operating surpluses were anticipated by 2011 and 2018 respectively.

2011 Approved Water and Wastewater operating budget is $345.4 million

At its meeting of March 24, 2011, Council approved the 2011 water and wastewater gross operating expenditure budget of $345,372,000 (prior to allocations), of which $194,404,100 is to be recovered from user rates with no impact to tax levy. With the approved 10% rate increase, the actual 2011 rates effective April 1, 2011 are 69.73 cents per cubic metre and 79.00 cents per cubic metre for water and wastewater respectively.

An update to water and wastewater rates is required to ensure full cost user pay for these services

Since the last rate approval, several factors have changed that have had a significant impact on the Region's user rate and reserve requirements. These include continued aging of infrastructure, funding received from Infrastructure Canada (Building Canada Fund), and changes to the Region's Development Charge policies.

Furthermore, the cost of purchased water, which is a significant component of the operating budget, has increased. Specifically, in 2011 the cost of water purchased from Toronto and Peel is budgeted to increase by 6.45% and 9.8% respectively. Also, forecasted water and wastewater flows have decreased to reflect current usage trends since the rates were approved in 2008.

These circumstances have created a need to revisit the Region's user rate and reserve requirements.

A consultant was engaged in 2010 to review the water and wastewater rates

In 2010, Watson & Associates Economists Ltd. was engaged by the Region to prepare a study of future water and wastewater rates as part of the Safe Drinking Water Act's requirement for a Council approved Drinking Water Financial Plan. The study provided a long range projection of the Region's capital and operating budget along with a preliminary review of the infrastructure replacement needs. Regulations under the Safe Drinking Water Act encourage full cost recovery as a first step in developing a financially sustainable system. Regional staff has updated the model based on 2011 budget information to arrive at the recommended water and wastewater user rates for 2012 to 2015.

4. ANALYSIS AND OPTIONS

Rate increase options will support ongoing infrastructure requirements

The Region's uniform water and wastewater user rates provide for the following:

- Rehabilitation and replacement of existing assets
- Rehabilitation and replacement of assets built in the future
- Funding the non-growth component of new infrastructure (i.e. upgrades)
- Any portion of growth-related infrastructure not eligible to be recovered from development charges
- Costs associated with operating water and wastewater services

The recommended blended water and wastewater rates as effective April 1 for the four-year period of 2012 through 2015 are included in Table 1:

Table 1
Recommended Blended Water and Wastewater Rate Increases
for 2012 to 2015

Year	Percentage Increase
2012	9%
2013	9%
2014	9%
2015	9%

Increased contributions for asset replacement are required

The recent study carried out by Watson & Associates Economists Ltd. included a detailed inventory of all water and wastewater assets and contributions required to replace these assets at the end of their useful life. This study indicates that annual lifecycle replacement contributions of approximately $14 million for water and $19 million for wastewater are required to fund replacement needs.

In comparison, the 2011 budget includes replacement contributions of $6.7 million for water and $15.0 million for wastewater. However, the wastewater contribution is essentially offset by the 2011 budgeted operating shortfall of $15 million, as operating shortfalls have been funded through the reserve. The recommended annual rate increase of 9% over the next four years will help eliminate operating shortfalls, build reserve balances and provide greater contributions for asset replacement. Given the nature of water and wastewater assets, sufficient reserves are required in the event that it is necessary to replace these assets earlier than anticipated. A reserve balance equal to 20% of replacement costs is a reasonable target that would help to address both unanticipated and planned replacement of capital assets.

Building Canada Fund of $60 million has been approved which has alleviated debt and user rate pressures

The expansion of the Duffin Creek WPCP is a joint undertaking between York Region and Durham Region. Costs for implementing the plant expansion are shared between York and Durham Region at varying levels depending on the specific project element.

Both York Region and Durham Region submitted proposals to the Federal and Provincial Governments seeking funding for a portion of the upgrade and expansion of the Duffin Creek Water Pollution Control Plant. The Province of Ontario's contribution was paid out in full on June 9, 2010 through one-time grants of $29,766,700 for York Region. Funding from the Federal government of $29,766,700 is contingent on a funding agreement that has been finalized. Funding will follow payment terms outlined in the agreement.

As a result of receiving the Building Canada Fund commitment of $60 million, the Region has been able to alleviate debt and user rate pressures and this positive impact has been accounted for in the recommended wastewater rate increases for 2012 through 2015.

Increased recovery of growth-related infrastructure costs from Development Charges has alleviated future water and wastewater pressures

Before the 2007 Development Charge (DC) By-law came into force on June 18, 2007, non-residential rates were discounted and recovered only a portion of the growth-related costs allocated to that sector of growth. Council adopted a phase-in policy in May 2007

to gradually bring DC rates to full recovery of growth costs. Improvement in the cost recovery rates achieved with the 2007 by-law helped to ensure that growth-related capital costs are recovered from growth.

In addition, Regional Council authorized an amendment to the DC By-law in June 2010 for the Roads, Water and Wastewater components, to ensure that the development charge rate was sufficient to fund infrastructure requirements as per the updated Water and Wastewater, and Transportation Master Plans. Most major capital infrastructure is now 100% recovered from development charges.

Debt repayment associated with the phase-out of discounted non-residential DC rates and the 2010 DC By-law amendment has a favourable impact on future user rates. For example, while 79% or $140.5 million of the 2011 debt repayment is projected to be recovered from DC revenues, this is projected to increase to 95% or $299.9 million by 2020. Moving to high recovery of growth-related infrastructure costs will reduce future rate pressures from those previously forecast.

Proposed rate increase will significantly improve water and wastewater reserve balances through 2015

In December 2008, Council approved a 10% rate increase option for water and wastewater. At that time, wastewater reserve deficits were projected to be eliminated by 2023 and water and wastewater operating surpluses were anticipated by 2011 and 2018 respectively.

Based on the recommended rate increases, Table 2 provides a summary of actual and projected reserve balances together with the ratio of reserve fund balances as a percentage of the replacement value of system assets. For planning purposes, forecasted rate increases of 8%, 6%, 4%, 4%, and 3% for 2016 to 2020 respectively were used to help achieve the reserve levels identified by Watson & Associates.

With the recommended rate increase of 9% from 2012 to 2015, water will continue to have both a positive reserve balance and an operating surplus. It is expected that the wastewater operating deficit will be eliminated by 2013 and the reserve deficit will be eliminated by 2015.

Table 2
Water and Wastewater Reserves and
the Reserves to Replacement Cost Ratio

	Blended Rate Increase (%)	Water Reserve Balance ($Million)	Water Reserve to Replacement Costs (%)	Wastewater Reserve Balance ($Million)	Wastewater Reserve to Replacement Costs (%)
2009 Approved	10%	*29.9	4%	*(30.9)	-
2010 Approved	10%	*18.2	2%	*(39.4)	-
2011 Approved	10%	14.3	2%	(35.6)	-
2012 Proposed	9%	9.3	1%	(19.7)	-
2013 Proposed	9%	7.3	1%	(9.6)	-
2014 Proposed	9%	10.7	1%	(2.6)	-
2015 Proposed	9%	20.4	2%	17.0	1%
2016 Forecasted	8%	36.6	4%	35.0	2%
2017 Forecasted	6%	53.2	6%	95.2	5%
2018 Forecasted	4%	75.5	9%	177.8	10%
2019 Forecasted	4%	97.7	12%	261.7	15%
2020 Forecasted	3%	128.5	16%	354.8	20%

*Actual water and wastewater reserves balance.

As per the projection outlined in Table 2, the combined water and wastewater reserve balance of $483.3 million by the end of 2020 would be equivalent to 19% of the total replacement cost of $2.6 billion for water and wastewater assets. Currently greater than 50% of the Region's water and wastewater assets are past the midway point of their lifecycle and increased investment is required to reduce potential reliance on debt. The forecasted reserve balances are the best estimates available and will be reviewed annually as part of the budget process. Balances may vary from forecasted values depending on several factors including purchased water prices from Toronto and Peel, unanticipated major repairs (i.e. York-Peel feedermain), additional regulatory requirements, water conservation and total volume of water sold.

It should be noted that this estimated replacement cost is for the current asset inventory and does not include additional water and wastewater assets to be built in 2011 and beyond. Given the large water and wastewater capital program totalling $3.6 billion in the next 10 year period, further increases to capital asset replacement contributions may be required over and above the levels associated with the current asset inventory.

2011 Water and Wastewater rates for other GTA municipalities are increasing

Table 3 below illustrates the 2011 water and wastewater blended rate increases for the municipalities within the Greater Toronto Area:

Table 3
2011 Water and Wastewater Rate Increases
in GTA Regional Municipalities

Municipality	2011 Annual Increase
Halton	4.1%
Toronto*	9.0%
Durham	4.5%
Peel*	9.1%

* Retail rates

Future rate forecasts are also in line with York Region's recommendations. Toronto has forecasted a 9% increase in its water and wastewater rates for 9 years commencing in 2006.

5. FINANCIAL IMPLICATIONS

Annual blended rate increases of 9% for water and wastewater rates are recommended for 2012 to 2015. It is proposed that the first of four annual increases come into effect on April 1, 2012. There will be no impact on the 2012 tax levy budget. The recommended rate increases will help eliminate operating shortfalls, increase reserve balances and provide greater reserves for future capital replacement needs.

The proposed 9% rate increase will be reviewed annually and actual results will be monitored relative to budget assumptions. Staff will monitor water and wastewater reserves separately and make any adjustments that may be required between water and wastewater rates, maintaining a combined 9% rate increase.

If, upon review, a change to the recommended blended 9% rate increase is necessary, staff will report back to Committee and Council with revised rate recommendations as part of the annual budget process.

6. LOCAL MUNICIPAL IMPACT

The Region is a wholesaler of water and wastewater services to local municipalities. With the revised water and wastewater rates being reviewed in 2011 for implementation in 2012, local municipalities will have timely input to develop their 2012-2015 budgets.

7. CONCLUSION

This report provides the recommendations for an annual 9% increase in water and wastewater rates for the period of April 1, 2012 to March 31, 2016.

For more information on this report, please contact Kelly Strueby, Director, Business Planning and Budgets at Ext. 1611 or Lucas Cugalj, Director, Strategy and Business Planning, Environmental Services at Ext. 5041.

The Senior Management Group has reviewed this report.

Water & Wastewater Rate Recommendations

Finance & Administration Committee

Kelly Strueby & Lucas Cugalj

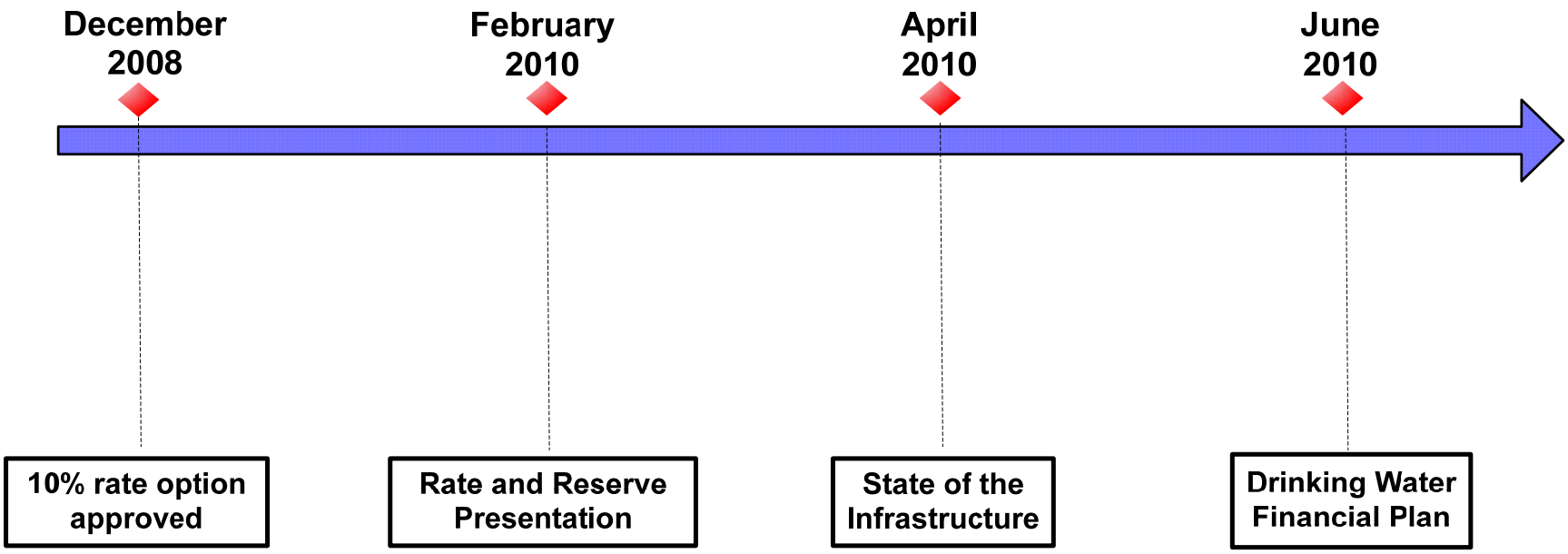
May 5, 2011

York Region

Agenda

1. Background
2. Recommended Rate Increases
3. State of Reserves
4. Benchmarking the Rate
5. Next Steps

Background



Rates reviewed annually as part of budget process and long-term planning activities

Blended Rate Increases

Recommended

- 9% annually 2012 to 2015

Forecast

- 8% in 2016
- 6% in 2017
- 4% in 2018 and 2019
- 3% in 2020

Recommended rates result in earlier elimination of operating and reserve deficits

Positive Results of Recommended Rate Model

- Wastewater operating surplus achieved five years earlier (2013 instead of 2018)
- Wastewater reserve deficit eliminated eight years earlier (2015 instead of 2023)

Wastewater achieves financial sustainability by 2020

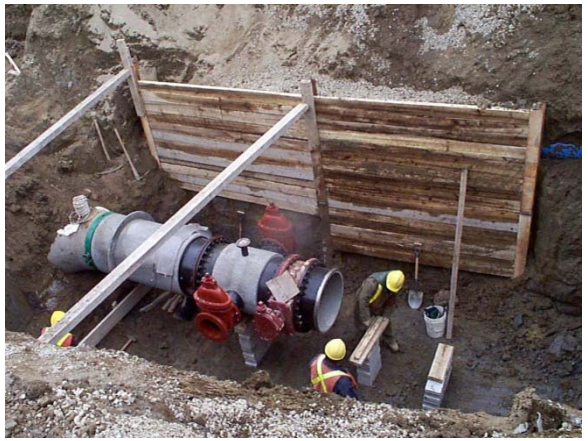
Changes Compared to 2008 Rate Structure

Favourable

- Increased Development Charge recovery
- $60 million from Building Canada Fund

Unfavourable

- Decreased consumption per capita
- Increased cost of purchased water

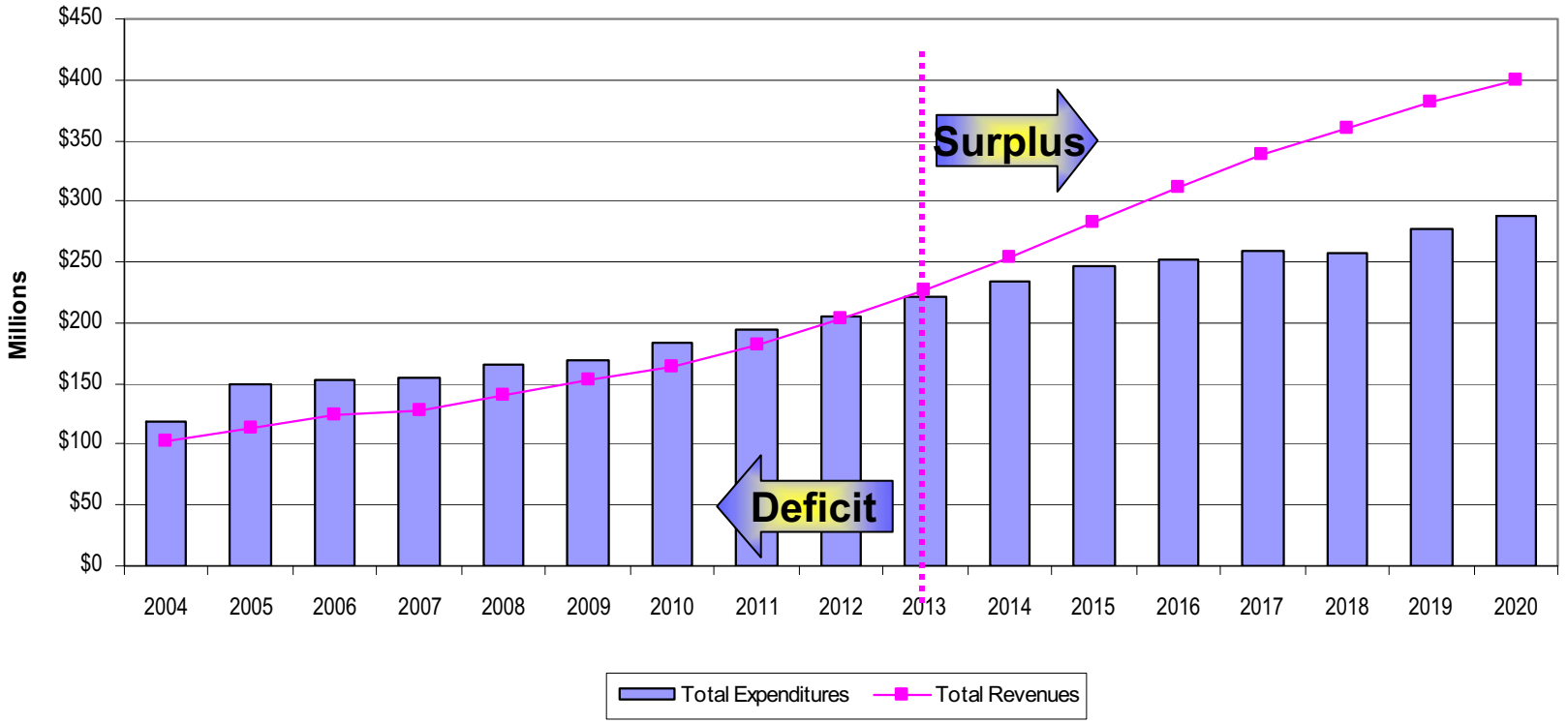


2011 Water & Wastewater Rates

	Water			Wastewater	
	2011 Amount ($ 000's)	Rate (cents/m3)		2011 Amount ($ 000's)	Rate (cents/m3)
EXPENDITURES					
Operating Expenditures	**59,153.4**			**53,296.2**	
Capital Related Expenditures	**23,721.8**			**58,232.7**	
TOTAL EXPENDITURES	**82,875.2**	**65.5**		**111,528.9**	**89.8**
TOTAL REVENUES	**86,376.0**	**68.3**		**96,212.3**	**77.4**
Contribution to/(from) Reserve - Surplus/(Shortfall)	**3,500.8**	**2.8**		**(15,316.6)**	**(12.4)**

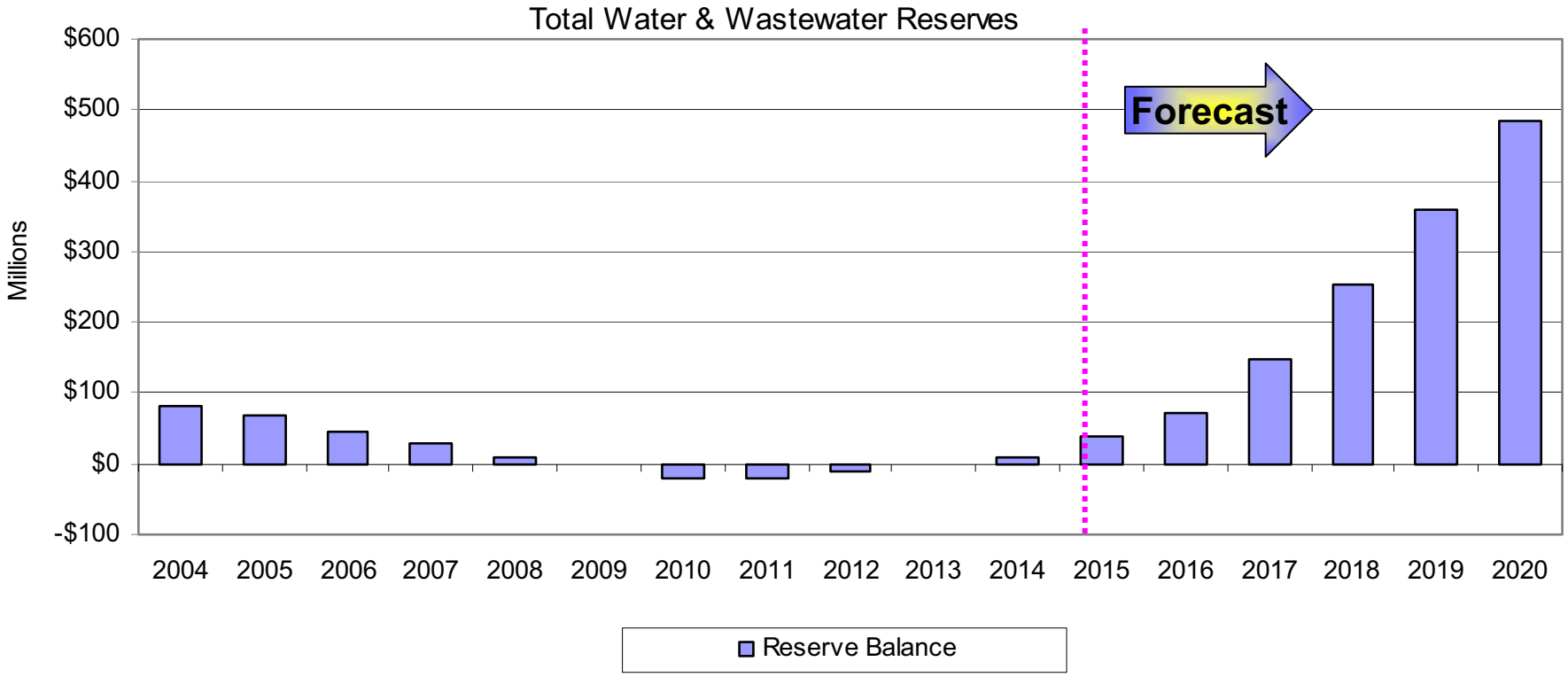
Current 2011 wastewater rate requires additional 16% increase to achieve full recovery of costs while the water rate is sufficient to cover expenditures

Water & Wastewater Financial Summary History & Forecast



Some level of surplus is both appropriate and required. Identifying the appropriate level of surplus must be done as a long-term forward looking planning process that takes into account future capital investment needs. (2010 BMA Benchmarking Study)

State of Water & Wastewater Reserves



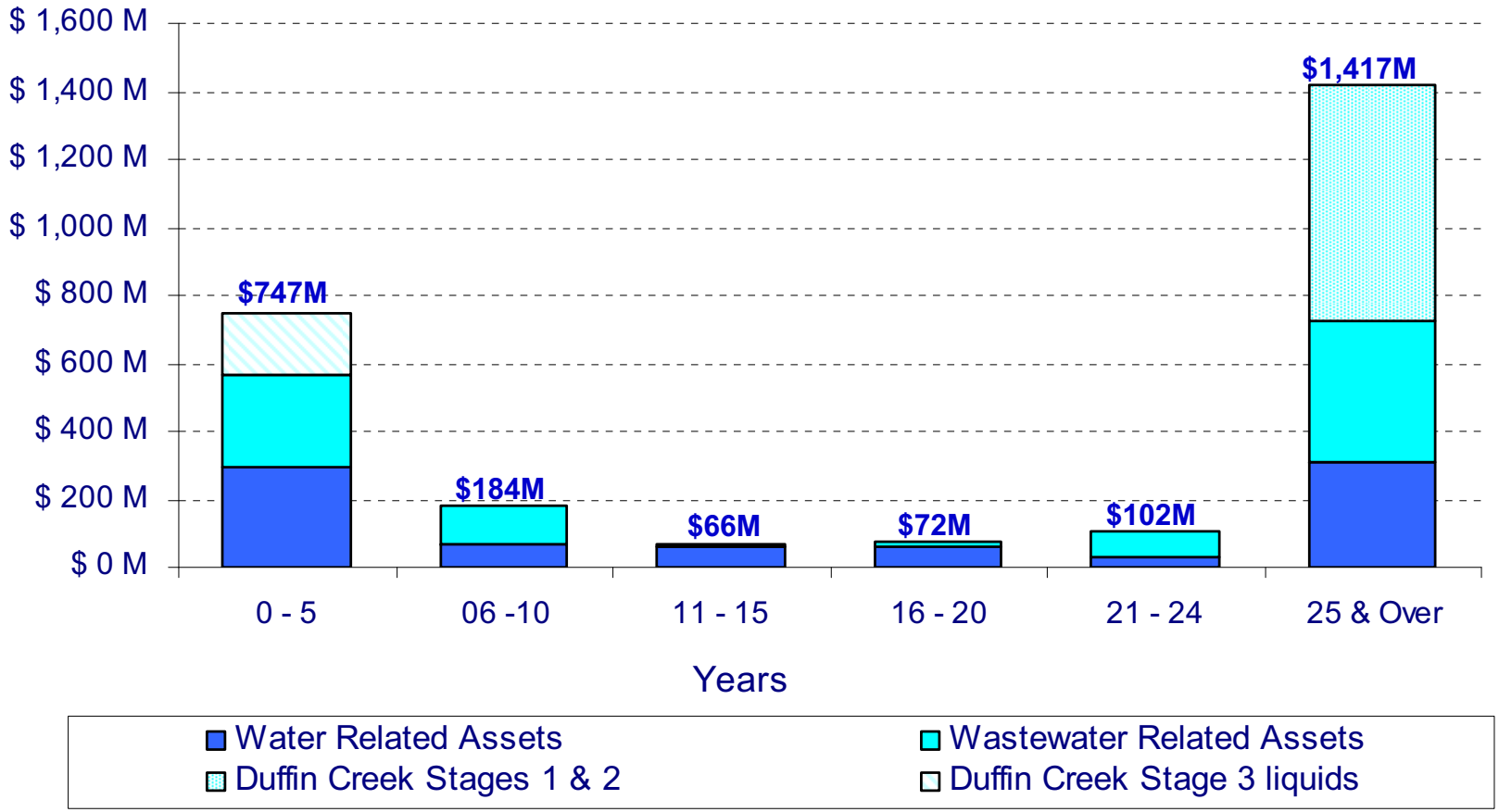
Building towards 2020 target reserve balance equal to 20% of replacement value to ensure sustainable asset management

Ongoing Rate Pressures

- Rehabilitation and replacement of aging infrastructure
- Increased Regulation/Legislation
- Market trend changes
- Operating and maintaining a more complex asset base
- Fixed operating costs

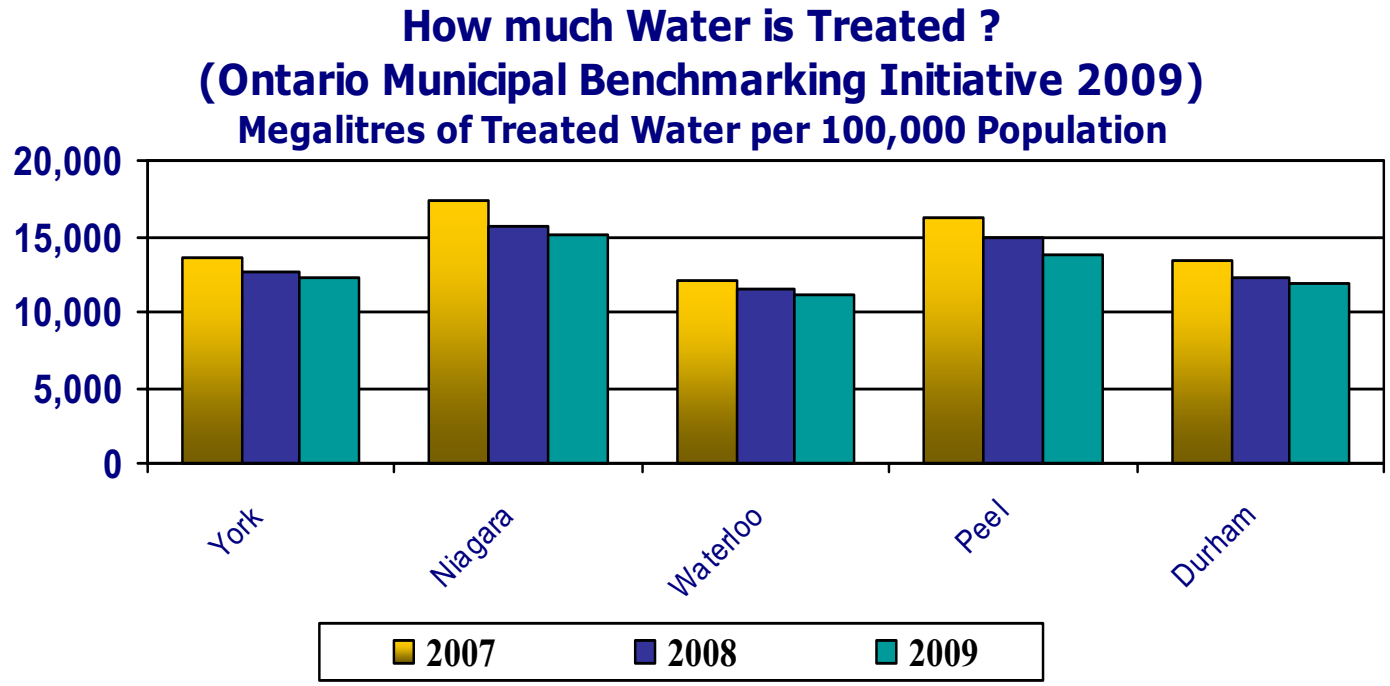
Recommended rate increases address the pressures and build towards financial sustainability

Age of Water & Wastewater Assets and Replacement Values



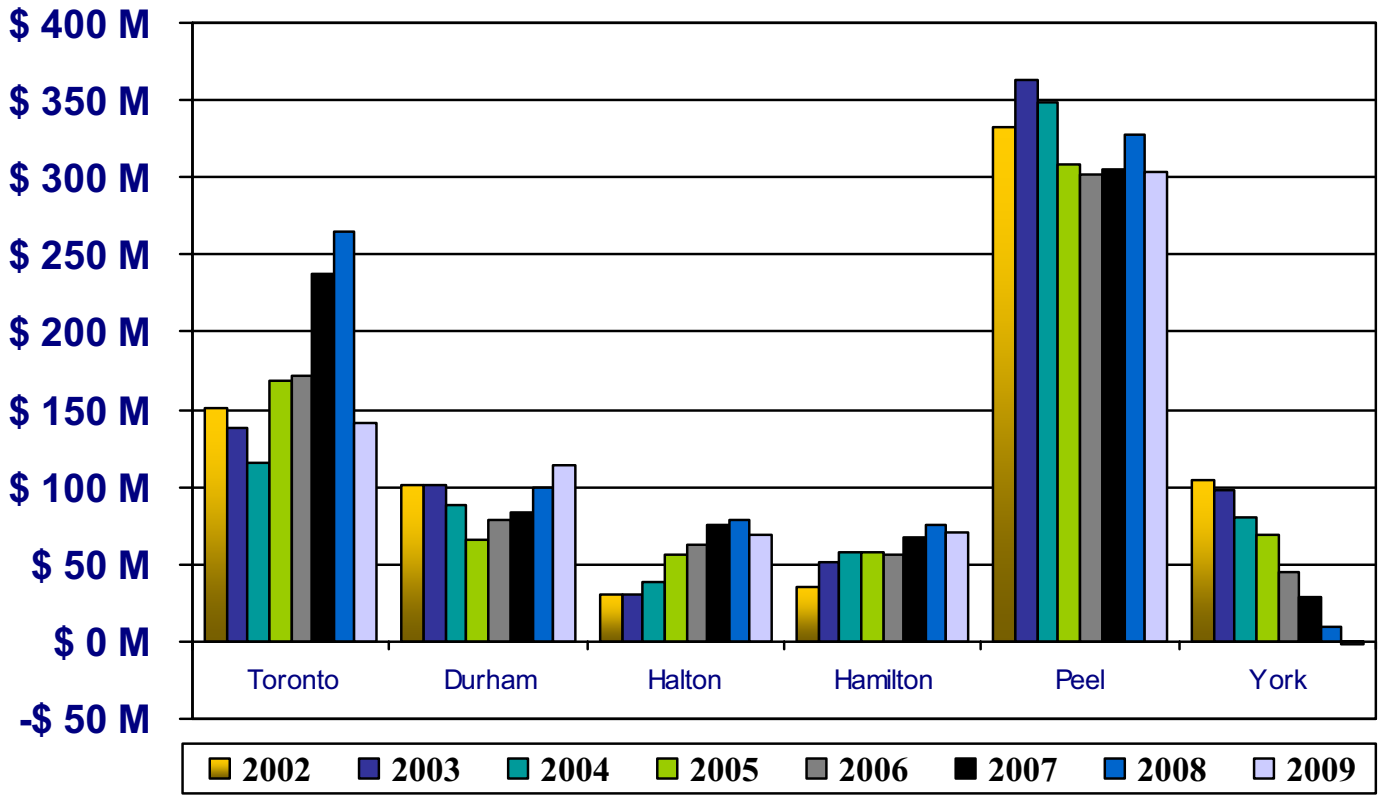
Total Replacement Value of Water & Wastewater Assets approximately $2.6B

Benchmarks with Other Municipalities Water Operating



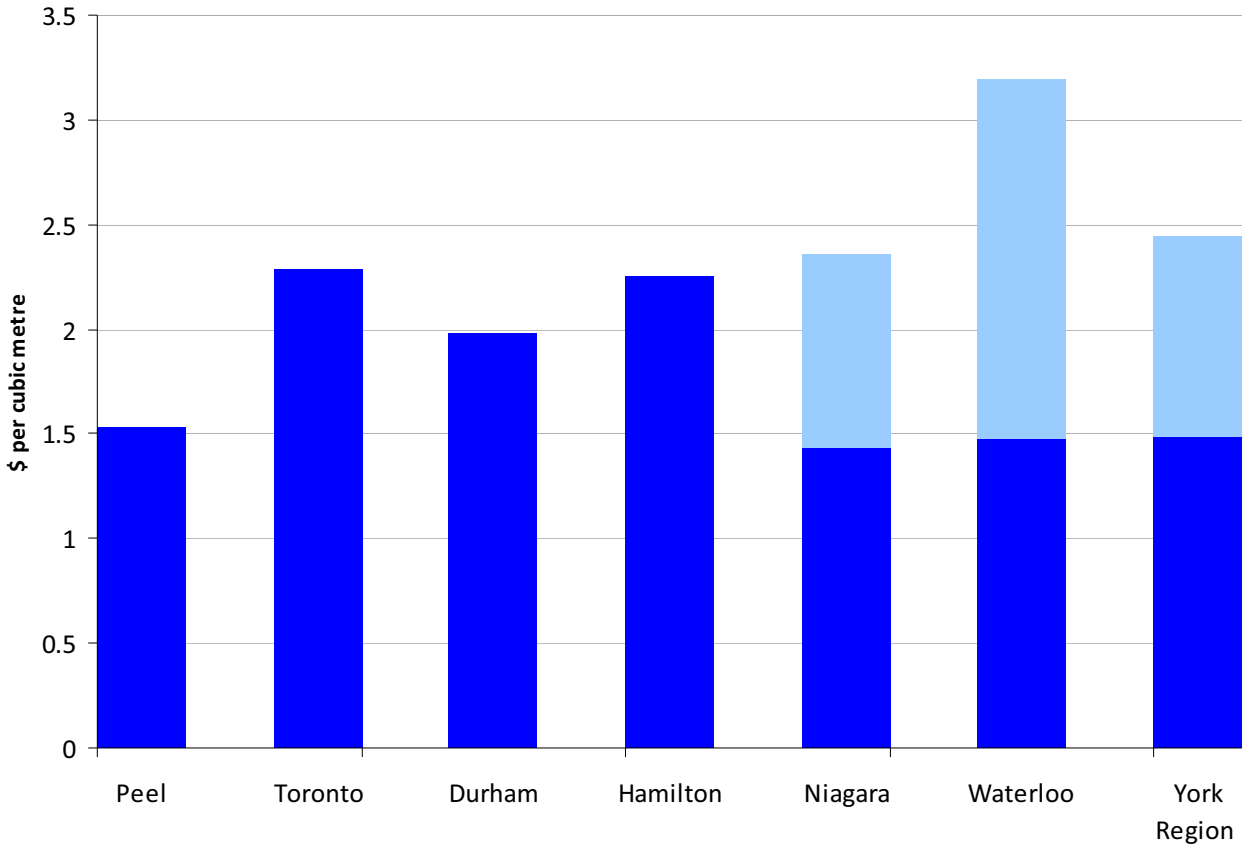
York is amongst the lowest per capita usage due to successful water conservation program

Water & Wastewater Reserve Balances



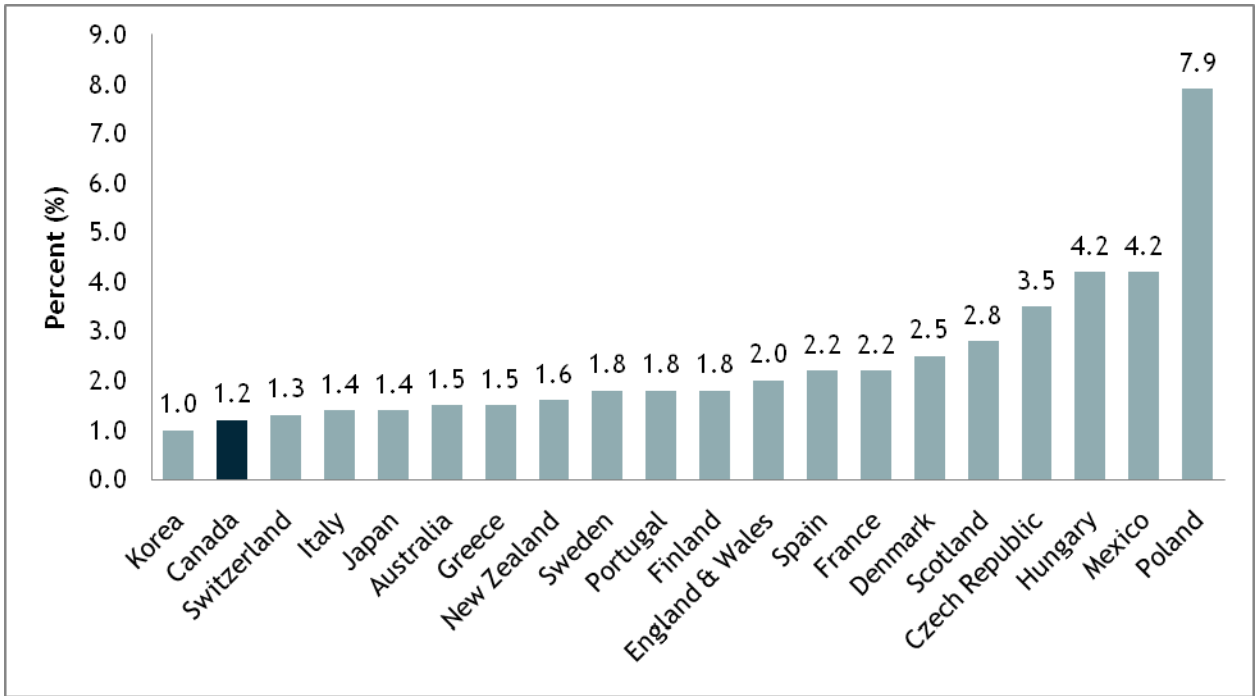
York Reserve balances lowest in GTA. Rate increases build reserves to sustainable levels in 2020 and beyond.

Water & Wastewater
Municipal Rate Comparison



Retail rate in York comparable to other GTA municipalities

Water & Wastewater Costs as a Percentage Share of Disposable Income



Source: OECD (2010). Percentage calculated based on the average income of the lowest decile of the population

Water & Wastewater costs as a percentage of household income is considered 'low' for each local municipality in York according to 2010 BMA Benchmarking Study

Summary

- Recommended annual blended rate increase of 9% to 2015
- Sustainable reserve balances achieved in 2020 and beyond
- Wastewater operating surplus in 2013 and reserve deficit eliminated in 2015

9% annual blended rate increases to 2015 moves towards financial sustainability of water & wastewater business

Next Steps

- Approve recommended rate increases 2012 to 2015
- Annual review of rate model as part of budget process
- Bring back revised rate recommendations if required

Thank You