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DRINKING WATER SYSTEM - FINANCIAL PLAN #013-301A

The Environmental Services Committee recommends:

- 1. Receipt of the presentation by Lucas Cugalj, Director, Strategy and Business Planning, Environmental Services; and**
- 2. Adoption of the recommendations contained in the following report dated May 13, 2010, from the Commissioner of Environmental Services and the Commissioner of Finance.**

1. RECOMMENDATIONS

It is recommended that:

1. Regional Council approve the Water Financial Plan prepared by Watson & Associates Economists Ltd., dated April 29, 2010.
2. Regional staff submit the Water Financial Plan to the Ministry of the Environment and the Ministry of Municipal Affairs and Housing in accordance with the *Safe Drinking Water Act*.
3. Regional staff publish notice of the availability of the Financial Plan, as prescribed by Ontario Regulation 453/07, in the local press and on the Region's website.

2. PURPOSE

The purpose of this report is to obtain approval of the Water Financial Plan, as required under the *Safe Drinking Water Act*.

3. BACKGROUND

Council approval of the Water Financial Plan required under the *Safe Drinking Water Act*

As part of the province's commitment to fulfill all of Justice O'Connor's Walkerton Inquiry recommendations, the Ministry of the Environment (MOE) is implementing a new approvals framework under the *Safe Drinking Water Act* for municipal residential drinking water systems called the Municipal Drinking Water Licence Program.

Justice O'Connor recommended that owners of municipal water systems obtain a licence for the operation of their drinking water systems. The licence will be issued to owners by the MOE under the *Safe Drinking Water Act* if the owner demonstrates it has the following five elements in place:

1. Drinking-water works permit
2. Accepted operational plan
3. Accredited operating authority
4. Financial Plan
5. Permit to take water

All these components, with the exception of item four, are now complete. Preparation of the financial plan is a key requirement for licensing and must be undertaken by all water providers.

Financial plan prepared in accordance with new statutory requirements

Watson & Associates Economists Ltd. (Watson) was retained in accordance with the Region's purchasing by-law to produce the financial plan. The detailed report completed by Watson has been included as Attachment 1 to this report.

Financial plan requirements regulated by the *Safe Drinking Water Act*

Ontario Regulation 453/07 details the following requirements with regards to s.30 (1) part b of the *Safe Drinking Water Act* for existing water systems:

- Financial plans must be approved by Council resolution (or governing body)
- Financial plans must include a statement that the financial impacts have been considered and apply for a minimum six year period
- Financial plans must include detail regarding proposed or projected financial operations itemized by total revenues, total expenses, annual surplus/deficit and accumulated surplus/deficit (i.e. the components of a "Statement of Operations" as per the Public Sector Accounting Board) for each year in which the financial plans apply
- Financial plans are to be made available to the public upon request at no charge
- If a website is maintained, financial plans are to be made available to the public through publication on the Internet at no charge, and
- Notice of the availability of the financial plans is to be given to the public

New regulations necessitate changes to financial reporting requirements

New regulations require municipalities to report financial statements on a full accrual accounting basis for 2009 and future years. The accrual accounting method recognizes revenues and expenses in the same period as the activities that give rise to them regardless of when they are actually paid. Historically, municipalities reported financial

results on a modified cash basis of accounting whereby revenues and expenses are recognized when cash is paid or received. The difference has impacted the presentation of the statements in that various accounts have been added or deleted to properly report transactions. Examples of changes in reporting are detailed in Attachment 1 (Figures 1-1 to 1-4).

The main differences in reporting include:

- Reporting tangible capital assets on the Statement of Financial Position
- Reporting accumulated surplus/deficit on the Statement of Financial Position
- Reporting amortization expense on the Statement of Operations
- Expensing any non-tangible capital assets on the Statement of Operations
- New report detailing the change in net financial assets/debt

Previously, capital assets were expensed; the new requirements stipulate that tangible capital assets must be capitalized and amortized as an expense over the estimated useful life of the asset.

***Safe Drinking Water Act* requires a declaration of the financial plan's sustainability**

The *Safe Drinking Water Act* requires a declaration of the financial plan's sustainability but it does not give a clear definition of what is considered sustainable. The Ministry of the Environment released a guideline ("Towards Financially Sustainable Drinking Water and Wastewater Systems") that provides possible approaches to achieving sustainability. Listed below are nine Principles of Financially Sustainable for Water and Wastewater Services developed by the Province:

1. Ongoing public engagement and transparency can build support for, and confidence in, financial plans and the system(s) to which they relate
2. An integrated approach to planning among water, wastewater, and storm water management is desirable given the inherent relationship among these services
3. Revenues collected for the provision of water and wastewater services should ultimately be used to meet the needs of those services
4. Life-cycle planning with mid-course corrections is preferable to planning over the short-term or not planning at all
5. An asset management plan is a key input to the development of a financial plan
6. A sustainable level of revenue allows for reliable service that meets or exceeds environmental protection standards, while providing sufficient resources for future rehabilitation and replacement needs
7. Ensuring users pay for the services they are provided leads to equitable outcomes and can improve conservation. In general, metering and the use of rates can help ensure users pay for services received.
8. Financial plans are "living" documents that require continuous improvement. Comparing the accuracy of financial projections with actual results can lead to improved planning in the future

9. Financial plans benefit from the close collaboration of various groups, including engineers, accountants, auditors, utility staff, and municipal council

The Region has included these principles of sustainability into the water financial plan as discussed in the following section.

4. ANALYSIS AND OPTIONS

Financial plan prepared in accordance with MOE Financial Plans Regulation

Municipalities have historically reported financial results on a modified cash basis of accounting. In 2009 and onwards, municipalities are required to report using full accrual accounting and capitalize assets that are owned and provide future benefits.

Accounting principles require York Region to expense yearly capital investments to the City of Toronto and the Region of Peel. As a result, the Statement of Operations in the financial plan shows yearly accounting deficits until 2017. The future water supply benefit received from these investments is not reflected in the financial statements of the financial plan.

Appendix B of the financial plan was completed for illustration purposes to capitalize investments with the City of Toronto and the Region of Peel. Under this scenario, the Region produces yearly accounting surpluses.

Financial plan was prepared using the Region's 2007 Development Charge By-law

On April 21, 2010, the Region issued a Development Charge By-law amendment draft background study. The financial plan was prepared using the existing 2007 Development Charge By-law and related rates. As a result, any future increase in development charge revenue will offset additional debt needed from 2013 onwards to cover development charge reserve shortfalls. This will also reduce additional interest expenses in the same years.

Financial plan was prepared using a preliminary draft rate study

In December 2009, Regional Council approved a water rate study that included increases of 10% in 2009 to 2011 and 5% in 2012 to 2013 and 2% thereafter. The financial plan for water was prepared using the approved rate study increases up to 2013 and for subsequent years assumed yearly rate increases of 3%. Going forward, a comprehensive draft water and wastewater rate study will be completed for Council review.

Water financial plan is due on July 29, 2010

York Region is required under the *Safe Drinking Water Act* to submit a Council endorsed water financial plan by July 29, 2010, six months after the first sets of licenses were issued to the Region.

Under the *Safe Drinking Water Act*, financial plans can be amended to reflect additional information

Regional Council's decisions regarding the Development Charge By-law amendment draft background study and the future water rate study will affect the water financial plan. Under the *Safe Drinking Water Act*, the water financial plan needs to be submitted every five years. However, the option exists to amend the financial plan to reflect Council direction. Staff will review the financial plan after approval of the Development Charge By-law amendment and revised rate study that is to be brought forward within the next twelve months. York Region staff are also currently working with external financial auditors to determine if cost-shared capital paid to the City of Toronto and the Region of Peel can be recorded as an asset on the balance sheet. An amended financial plan will be brought forward if there are material differences in the final calculations.

York Region's water financial plan built on MOE guideline for sustainability

The water financial plan is built on the principles of sustainability noted earlier in the report. The Region's current water rate strategy and draft rate strategy have been derived using the following processes:

- A detailed assessment of current and future capital needs including an analysis of potential funding sources
- An analysis of fixed and variable operating costs in order to determine how the costs will be impacted by evolving infrastructure needs and system growth
- A review and recommendation on rate structures that ensures revenues are equitable and sufficient to meet system needs
- A public process that involves consultation with stakeholders including Region staff, Council and the public.

York Region's water financial plan is viable over the long-term

The existing water rate strategy is designed to ensure the necessary funding is in place to meet operating costs and long-term rehabilitation and replacement needs. The strategy also includes a phase-in approach to rate increases over the long-term. As a result of phasing rate increases, the system is currently using all available revenue, including reserves to meet operating and capital obligations. The situation will improve as rates reach their full value and proportionately more of the rate is focused on contribution to reserves. Staff will be reviewing rates to ensure the existing strategy is meeting required

funding levels and will report back to Council when the updated rate study has been completed.

Net debt position rises from 2011 to 2016 and declines thereafter

Section 4 of Attachment 1 contains the detailed financial plan information. Due to the level of existing debt, anticipated issuance of new debt, and significant level of deferred revenue balances, the Region's water system will be in a net debt position of \$475.1 million in 2010. The Statement of Financial Position developed for the Region forecasts an increasing net financial debt position in the 2011 to 2016 forecast period as debt levels continue to rise. However, in 2017 to 2019, the estimated net financial debt position improves each year as debt levels decrease. The Statement of Financial Position is adversely affected by the treatment of the cost shared capital with Peel and Toronto. The new accounting rules require the amounts paid to Peel and Toronto be expensed as an operating expense and not recorded as an asset. Appendix A in Attachment 1 was prepared to illustrate the Region's financial position if the Peel and Toronto cost shared capital was recorded as an asset.

Toronto and Peel cost-shared capital now shown as operating expense

The Statement of Operations developed for the Region forecasts deficits until the end of 2017. The 2010 budget forecasted the water system would be in a surplus position by the end of 2011. The difference is primarily due to the unique agreements between the Region and the City of Toronto and the Region of Peel for cost shared capital works. The new accounting regulations require that the amounts paid to Peel and Toronto for capital works be expensed as an operating expense because the Region does not own a share of these assets. The Region does receive a future benefit from the capital works through capacity increase entitlements detailed in the previously approved agreements with Toronto and Peel.

Although the short-term forecast does not have annual surpluses, the Statement of Operations improves each year from 2011 to 2019 and proves to be financially viable over the long-term. The Region maintains an accumulated surplus throughout the financial plan.

Planned use of debt to construct capital and fund development charge shortfall

The Statement of Change in Net Financial Assets/Debt indicates whether revenue generated was sufficient to cover operating and non-financial asset costs (i.e. inventory supplies, prepaid expenses, tangible capital assets, etc.) and in so doing, explains the difference between the annual surplus/deficit and the change in net financial assets/debt for the period. Table 4-3 of Attachment 1 indicates that forecasted capital expenditures exceed forecasted net revenues in each year between 2010 and 2016, resulting in a decrease in net financial assets. However, in 2017 to 2019, forecasted revenues exceed

forecasted expenditures resulting in an increase in net financial assets. The overall net debt position is due to the planned use of debt to construct capital assets and fund development charge shortfalls.

The Statement of Cash Flow summarizes how the water system is expected to generate and use cash resources during the planning period. Transactions that provide/use cash are classified as operating, capital, investing, and financing activities as shown in Table 4-4 of Attachment 1. This statement focuses on the cash aspect of these transactions and thus is the link between cash and accrual based reporting. Table 4-4 of Attachment 1 indicates that debt, investment income, and cash on hand will be used to fund operating deficits and tangible capital asset acquisitions over the forecast period. The financial plan anticipates the cash position of the Region's water system improving from approximately \$153.5 million at the beginning of 2010, to \$257.6 million by the end of 2019.

5. FINANCIAL IMPLICATIONS

There is no financial impact directly associated with this report. By approving the financial plan, Regional Council is committing that the Region's drinking water system is financially viable.

6. LOCAL MUNICIPAL IMPACT

With Council approval of the water financial plan, York Region's Drinking Water System meets all regulatory compliance prescribed through applicable Federal and Provincial legislation, Certificates of Approval, and Permits to Take Water, enabling the Region to deliver safe drinking water to the local municipalities. Local municipalities will be required to submit water financial plans in accordance with the *Safe Drinking Water Act* regulations.

7. CONCLUSION

It is recommended that Regional Council endorse the water financial plan (*Attachment 1*) and authorize its submission to the Ministry of the Environment and the Ministry of Municipal Affairs and Housing as required under the *Safe Drinking Water Act* Ontario Regulation 453/07. Staff will advertise the availability of the financial plan in local newspapers and on the Region's website.

Report No. 6 of the Environmental Services Committee
Regional Council Meeting of June 24, 2010

For more information on this report, please contact Lucas Cugalj, Director of Strategy and Business Planning for Environmental Services at (905) 830-4444 Ext. 5041.

The Senior Management Group has reviewed this report.

(The attachment referred to in this clause is attached to this report.)