The Regional Municipality of York

Committee of the Whole
Environmental Services
September 9, 2021

Report of the
Commissioner of Environmental Services and Commissioner of Finance

2022 – 2027 Water and Wastewater Rates

1. Recommendations

1. Council approve transfers of $13.95 million from the water rate stabilization reserve to the water asset management reserve and $14.29 million from the wastewater rate stabilization reserve to the wastewater asset management reserve, for a total of $28.24 million, to offset the impact of rate increases that were deferred in 2020 and 2021.

2. Council approve the annual water and wastewater user rates shown below for the period April 1, 2022 to March 31, 2028, equivalent to 3.3% increases each year, to maintain full cost recovery.

Recommended Water and Wastewater Rates

Year Starting	Combined Wholesale Rate ($/m^3)
April 1, 2022	$3.18
April 1, 2023	$3.28
April 1, 2024	$3.39
April 1, 2025	$3.50
April 1, 2026	$3.62
April 1, 2027	$3.74

3. The Regional Clerk circulate this report to Clerks of the local municipalities.

2. Summary

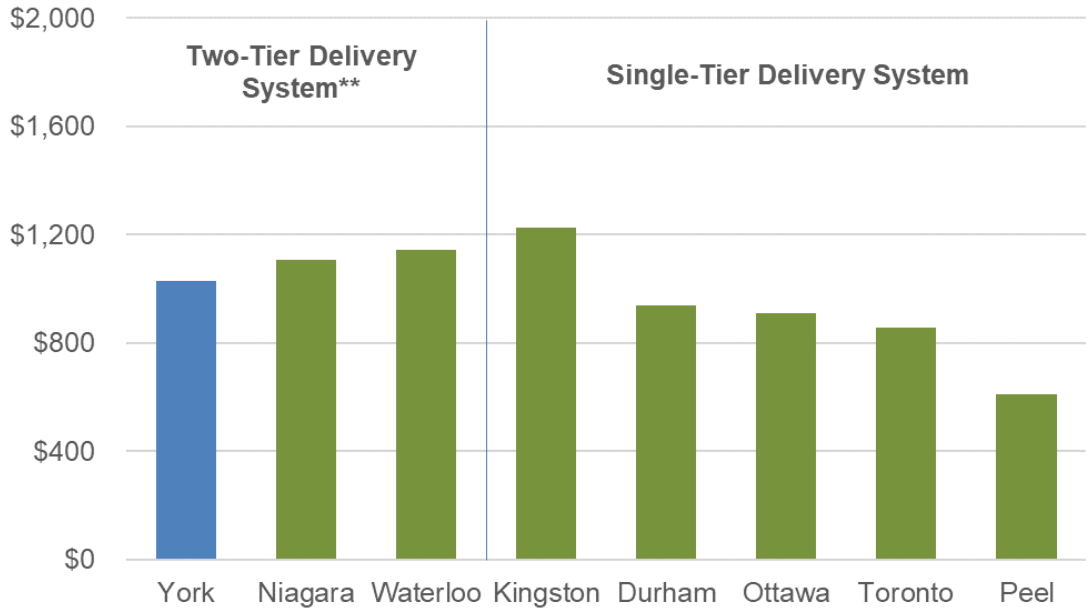
Regional Council periodically reviews and sets annual wholesale rates for water and wastewater. Proposed rates are developed through a rate study. The 2021 rate study is summarized in the Financial Sustainability Plan for water and wastewater (Attachment 1).

Key points:

- York Region's average water bill is the lowest among regional municipalities with a two-tier delivery system, as the following figure shows. The change at the Regional level taking effect April 1, 2022, is expected to add $21 a year, or $1.75 a month, to an average water bill.

Figure 1

Average 2021 water bills in large Ontario municipalities*

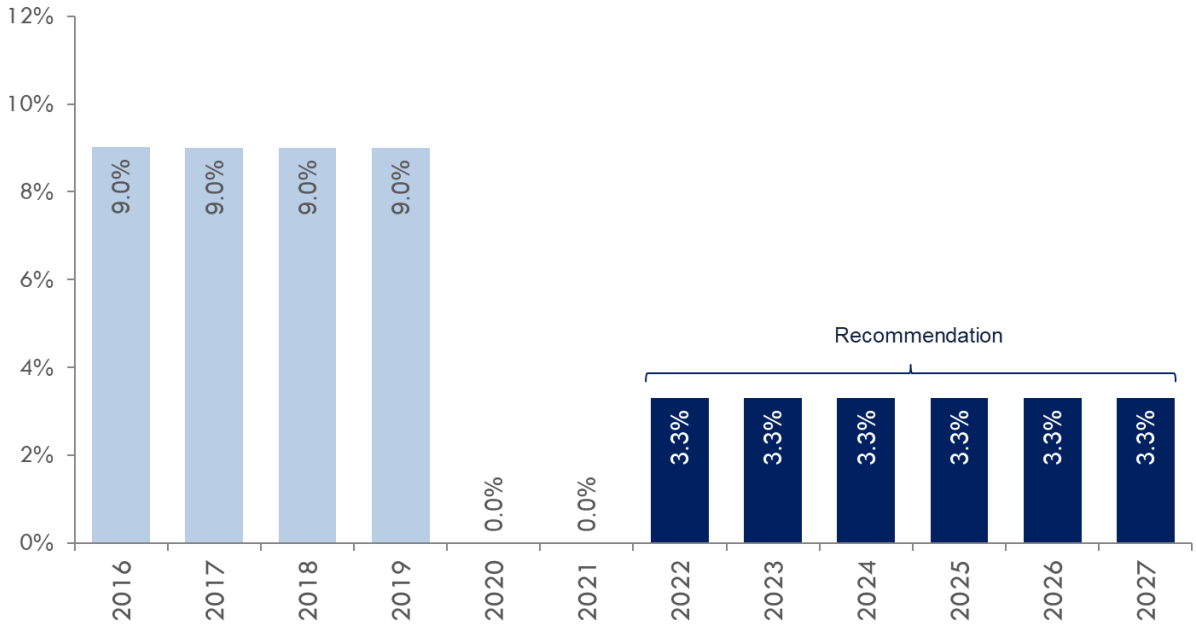


* Bill based on published 2021 retail rates and water consumption of 207 m^3 per year, which is the average for all residential property types in York Region
**Weighted average bill across lower-tier municipalities by population

- York Region implemented annual rate increases of 9% or 10% between 2009 and 2019 to improve the financial sustainability of the water and wastewater system, as Figure 2 shows.

Figure 2

Trend in water and wastewater rate increases



- The recommendation to rebalance reserves would address a $28.24 million funding gap in asset management reserves resulting from rate relief in 2020 and 2021.
- The proposed rates would then allow York Region to maintain full cost recovery while promoting intergenerational equity and reducing reliance on debt.
- Current social programs are available to address concerns about affordability of water and wastewater services among households with low income.

3. Background

The Region and local municipalities are partners in water and wastewater services

York Region acts as a wholesale provider of water and wastewater services to its local municipalities, which in turn set retail rates and provide services to end users.

Without direct access to Lake Ontario, the Region has entered into long-term agreements with the Region of Peel and the City of Toronto for 85% of its drinking water supply. These agreements describe the basis for the rates charged to York Region and provide for annual increases. Over the last 5 years the rates from Peel have increased by an average of 2.9% annually while the Toronto rates have increased by 4.1% annually. The balance of our

drinking water is sourced within the Region and comes from Lake Simcoe and several groundwater wells.

The Region collects wastewater from the local municipalities and conveys it to treatment plants through a system of trunk sewer pipes and pumping stations. The Duffin Creek Water Pollution Control Plant, which is co-owned with Durham Region, treats about 85% of the Region's wastewater. Peel Region treats a further 10%, and the balance goes to seven York Region-owned facilities.

The *Safe Drinking Water Act, 2002* requires Municipal Council members to meet a standard of care to protect the people in their communities by ensuring financial sustainability, asset management, risk mitigation and continual improvement of the water system. In the Chief Drinking Water Inspector's Annual Report Card for the province's 2019-2020 fiscal year, the Region achieved an inspection score of 100% and 99.98% of its water samples met drinking water quality standards. Similarly, York Region met 100% of quality measures for treated wastewater returned to the environment, while meeting all regulatory obligations and performance limits.

Full cost recovery is a long-standing Regional commitment

Water and wastewater rate-setting is guided by goals and principles that recognize the importance of both operational excellence and long-term financial sustainability.

For financial sustainability, the goal is to set prices that cover the full costs of providing services, a goal to which York Region has been committed for more than a decade. Full costs include both day-to-day operating expenses and contributions to reserves to cover current and future rehabilitation and replacement costs.

In 2015, analysis found that revenues did not cover all costs, mainly those related to asset management needs. To address this, Regional Council approved a Financial Sustainability Plan for 2016 to 2021 that was designed to ensure adequate contributions to asset management reserves.

The Region's economy is expected to fully recover by 2022

In response to concerns about the impact of the COVID-19 pandemic on customers, Regional Council voted in 2020 to forego scheduled rate increases of 9.0% for the year starting April 1, 2020 and 2.9% for the following year.

As more information became available, a fuller picture of the pandemic's economic impacts emerged. An April 2021 report by the Conference Board of Canada estimated that overall, disposable income in the Region rose by an average of 7.8% in 2020. In addition to benefiting from government support programs, households saw savings because of restrictions on retail shopping, dining out, travel and commuting.

The Conference Board of Canada also forecasts that the Region's real Gross Domestic Product would expand by 5.9% in 2021 and a further 5.5% in 2022, making up for a loss in 2020 and outperforming the provincial government forecast for Ontario as a whole.

A 2021 survey of Regional residents found that roughly half considered water rates to be fair, which is in line with earlier results from 2015 and previous surveys on attitudes elsewhere in Canada.

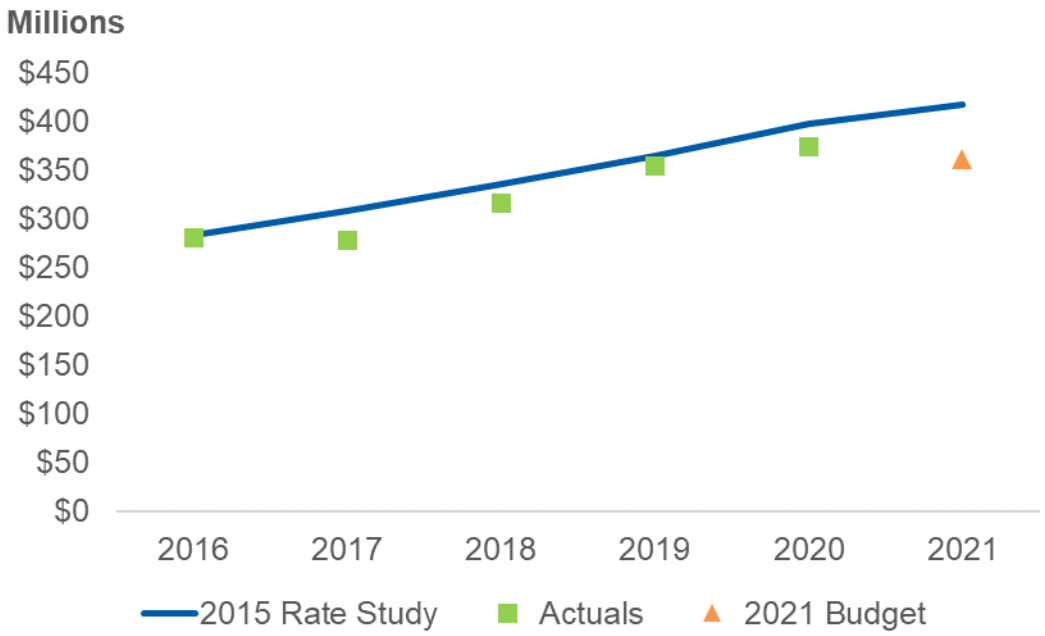
4. Analysis

Between 2016 and 2020, water demand was generally close to prediction

For the 2015 rate study, the Region developed a user rate model that forecasts water flows and annual costs. Between 2016 and 2020, actual consumption of water was generally close to the model's predictions. As Figure 3 shows, resulting revenues were also largely in line with the model's predictions.

Figure 3

Comparison of forecast revenue in 2015 plan to actuals/budget



In 2020, revenues fell below forecast because a planned rate increase of 9% on April 1 was not implemented as Council responded proactively to provide financial relief to customers due to changing economic conditions related to the COVID-19 pandemic. The impact of the rate deferral was largely offset by hot, dry summer weather, which helped boost water consumption, and a revenue shortfall of $9.1 million was managed by reducing expenditures through finding internal operating savings.

Demand for water reflects growth, pricing and summer weather

The forecast model for water demand combines two elements: a base component reflecting year-round uses that accounts for about 90% of demand, and a seasonal component that

mainly reflects demand for water in the warmer months and accounts for about 10% of demand.

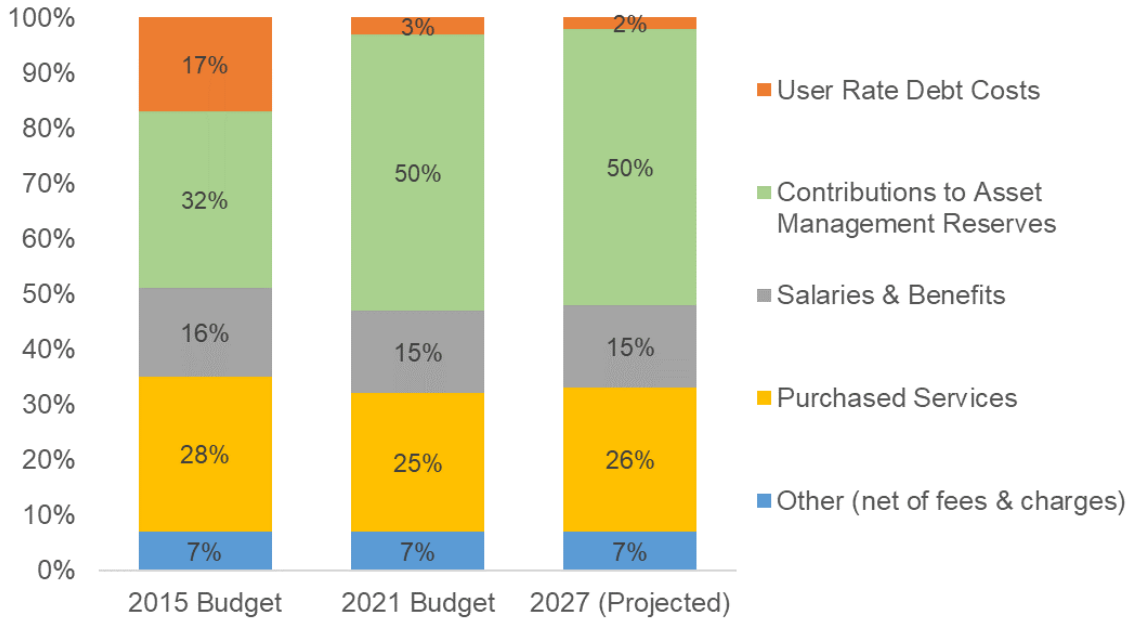
The model uses three factors to determine future water demand: population growth, response to prices, and average summer weather. Population and price have an impact on year-round water use, while average summer weather underlies the seasonal component. A review of the model for the 2021 user rate study confirmed that these factors remain valid for forecasting demand. The 2021 study also updated population projections using provincial government forecasts and other inputs.

Long-term supply agreements, inflation, and reserve contributions drive costs

The annual water and wastewater budget comprise day-to-day operational costs, such as salaries and benefits and purchased services, as well as contributions to rate stabilization and asset management reserves.

Figure 4

Components of York Region's User Rates



As Figure 4 indicates, the cost components are expected to be more stable out to 2027 than between 2015 and 2021, as the Region is now essentially at full cost recovery.

Contributions to asset management reserves are the largest component in the annual budget. The share has grown since 2015, largely reflecting more detailed information about asset management needs. The current and projected level of contributions is in line with other municipalities in the Greater Toronto and Hamilton Area. Asset management reserves are used to fund renewal of a growing capital asset base, with more than $1.1 billion to be spent over the next decade.

Rate stabilization reserves are available to help offset unexpected changes in revenues and/or costs. A review for the rate study concluded that contributions of $800,000 a year would maintain required balances in these reserves.

The largest day-to-day operating costs are for water supply and wastewater treatment services provided by neighbouring municipalities, and the co-ownership agreement with Durham Region for the Duffin Creek Water Pollution Control Plant. The forecast for these items is based on details of the agreements, historic experience and the flow forecast.

Debt service costs have decreased sharply since 2015 and are expected to fall from 3% in the current budget to 2% by 2027, reflecting the increased use of asset management reserves in place of user rate debt for asset renewal. With planned growth in asset management reserves, the Region would be able to avoid issuing new user-rate debt and existing debt would be fully paid off by 2040.

Other costs, including salaries and occupancy, are assumed to increase in line with the value of the asset base, plus roughly 2% a year in inflation.

One-time transfer from rate stabilization reserves would close asset management gap

Late in 2020, during the second wave of COVID-19 cases and continued constraints on working outside the home, Regional Council made the decision to forego a planned rate increase of 2.9% for 2021. With the earlier deferral of a scheduled rate increase on April 1, 2020, rates are now about 12% below the level expected in the 2015 rate plan.

Lower rate revenue has been addressed in large part by reducing planned contributions to asset management reserves by $28.24 million in the 2021 budget. This change in direction would put the reserves at 95% of full funding at the end of 2021, instead of the 100% level projected and committed to by Council in the 2015 rate study.

Since significant annual rate increases would be needed to close this gap in 2022 and beyond, a rebalancing of reserves is recommended. There are sufficient funds in the rate stabilization reserves, due largely to lower-than-expected costs, to cover the shortfall while maintaining those reserves at an adequate level. The recommended transfer would comprise $13.95 million from the water rate stabilization reserve and $14.29 million from the reserve for wastewater rates to the respective asset management reserves.

Proposed rate structure would achieve and maintain full cost recovery

Approval of the reserve transfers outlined above would address the gap in asset management reserves resulting from rate deferrals, but a small gap would remain in the operating budget. If not addressed, this would trigger higher rate increases in future.

Closing the gap and maintaining full cost recovery can be achieved with annual rate increases of 3.3% for the next six years. Beyond 2027, modelling suggests that annual increases of 2.9%, outlined in the 2015 study and confirmed by 2021 study, should be sufficient to maintain full cost recovery.

An alternative would be a one-time rate increase of 4.9% in 2022, which would allow for expected annual increases of 2.9% starting April 1, 2023, to maintain full cost recovery.

Staff recommends 3.3% annual increases to 2027 because it is based on uniform annual increases that are only slightly above the “steady state” of 2.9%. This is expected to add $21 to the average household water bill over the first year.

Proposed rates meet standard tests for affordability

With an average household income in the Region of more than $120,000, current and proposed rates meet all standard tests of affordability for water and wastewater. However, given the general high cost of shelter in the Region, paying for water and wastewater services may be a challenge for some households with low income.

Recommended best practice for water and wastewater utilities is to consider affordability support programs for low income households, rather than keep water and wastewater rates low for all customers. When rates are uniformly low, it may be difficult to generate enough revenue for long-term financial sustainability. Low rates also encourage over-consumption of water, which puts an unnecessary burden on the environment and infrastructure.

The Region provides two ongoing programs to assist households with rental and/or utility arrears. Between 80% and 90% of requests for help relate to rent arrears. On average, over 2019 and 2020, the programs received about 17 applications a month for assistance with utility bills of any type.

On Council direction, staff in Finance, Environmental Services and Community and Health Services would be prepared to investigate a specific support program for water and wastewater, including looking at such issues as costs to administer, overlap with existing programs, eligibility criteria, support amounts and coordination with local municipalities.

Full cost recovery rates support Vision 2051 and 2019-2023 Strategic Plan

Full cost recovery water and wastewater rates for 2022 to 2027 that promote intergenerational equity support the Vision 2051 goal of Open and Responsive Governance and the Good Government priority of the 2019-2023 Strategic Plan, particularly the objective of managing the Region’s assets for current and future generations.

5. Financial

The recommended rates would have no impact on the tax levy budget because water and wastewater operations are funded from user rates.

The 2021 rate study introduced a new target range for the rate stabilization reserve of 10-15% of the annual user rate budget. This recognizes that risks to the plan include both year-to-year operating fluctuations and less predictable longer-term risks. Also, in recognition of uncertainty in long-term projections, full cost recovery is now defined as being achieved when balances in the asset management reserves are within 2% above or below target.

In line with the Regional fiscal strategy, which has the principle of intergenerational equity as a core pillar, water and wastewater rates are designed so that current and future customers make equalized contributions to asset management reserves. Maintaining investments in water and wastewater assets ensures they remain in a state of good repair for the health and safety of all residents, businesses and the environment in York Region. As reported to Council in June 2021, 94% of water and 96% of wastewater assets are in fair or better condition, with over $110 million being spent each year to rehabilitate water and wastewater assets in poor condition.

6. Local Impact

The Region is a wholesaler of water and wastewater services to local municipalities. The proposed wholesale rates will help ensure that the Region can continue providing these essential services in a safe and reliable manner for many years to come. In turn, this will enable local municipalities to provide quality services to end users.

Consultation with local municipal staff throughout 2020 was key to developing the proposed rate structure. In addition, opportunities to strengthen the two-tier delivery system were identified and implemented, such as aligning information on anticipated water and wastewater flow volumes for budget and rate planning purposes.

With approval of new water and wastewater rates in fall 2021, local municipalities will have timely information for developing their 2022 budgets.

7. Conclusion

The proposed water and wastewater rates and related reserve adjustments outlined in this report would bring the Region to full cost recovery while supporting intergenerational equity and continuing to reduce debt. This will help ensure long-term financial sustainability of the Region and its water and wastewater services, adequacy of key reserves, and fairness to water and wastewater customers now and in the future.

Full cost recovery has been a long-standing commitment of the Region and achieving this goal demonstrates sector best practices.

For more information on this report, please contact Kelly Strueby, Director, Office of the Budget, Finance, at Ext. 71611 or Michelle Swan, Director, Business Planning and Operations Support, Environmental Services, at Ext. 73040.

Accessible formats or communication supports are available upon request.

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Chief Administrative Officer

August 12, 2021
Attachment (1)
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