

**Loyalist Township Staff Report  
Draft Results of Water and Sewer  
Rates Study  
Special Council Meeting**



Report Number: SR- 1083

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**Meeting:** Special Council - 29 Jul 2019  
**Type:** Special Council  
**Department:** Finance  
**Report Date:** July 24, 2019  
**Author:** Brianne MacNevin

**Executive Summary:**

Through the Township's procurement process, an agreement was entered into with Hemson Consulting Ltd. ("Hemson") to complete a water financial plan in order to meet its drinking water license requirement under Ontario regulation 453/07. Additionally, Hemson will complete a wastewater financial plan and a detailed review of connection charges and user rates in correlation with the most up to date revenue requirements to fund growth capital, capital replacement and operating activities respectively.

This report provides an overview of the draft results of the connection charges and user rates study. A formal presentation of the findings will be made by Hemson, with a copy of the presentation material to be circulated in advance of the meeting as soon as it is available.

**Recommendation:**

That the report from the Senior Financial Analyst, July 24, 2019, re: Draft Results of Water and Sewer Rates Study, be received and the following be adopted:

1. That the findings of Hemson Consulting Ltd. be received and accepted in principle;
2. That staff be directed to coordinate a meeting with the development community to review the connection charge scenarios as directed by Council;
3. That staff be directed to coordinate an open house with the ratepayer community, to review the water and sewer user rate scenarios as directed by Council; and
4. That the outcome of the meeting with developers and public open house be reported back to Council for direction before preparing the by-laws to establish the connection charges and user rates.

**Background:**

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As required by the provincial regulation O.Reg 453/07, the Township's most current water financial plan has been in effect since 2014, as a condition of its drinking water license. Additionally, a detailed review of both connection charges and water and sewer user rates were undertaken by a third-party consultant, BMA Management Consulting Inc. ("BMA").

Water and sewer connection charges for new construction (may also be referred to as impost fees) are imposed through S. 391 of the *Municipal Act*, and are not included in the development charges study or by-law. The rates currently in effect were established as a result of the 2014 rate study and have been incremented annually by the Ottawa Construction Price Index (3rd quarter). Historically, connection charges have been calculated based on a combination of a recovery to existing or historic capital infrastructure and existing capacity to be used (referred to as the club fee), and a provision to cover the costs of growth. Currently, the proportion of the combined fee is approximately 43:57 for water and 47:53 for sewer of club fee and growth fee, respectively. Although these charges are imposed under the *Municipal Act*, the growth portion of the charge is calculated in the same way a development charge would be for residential development, whereas non-residential development is based on cubic meters in order to more accurately correlate with estimated capacity to be used.

Water and sewer user rates are also imposed through S.391 of the *Municipal Act*. The rates currently in effect were established as a result of the 2014 rate study and have been incremented annually, based on the schedule proposed in the study and by-law. User rates are billed bi-monthly as a combination of fixed and consumption rates that are currently 60:40, respectively.

In 2011, Council directed that each of the water and sewer user rates be harmonized across the three communities of Amherstview, Bath, and Odessa as well as the Harewood and Brooklands subdivisions. The adjustment to the user rate was phased in and fully harmonized by 2015.

Each of the water and sewer systems are intended to be self-sustaining, and aside from user rates, have minimal other sources of funding. The user rates billed for water services are used to fund Fairfield and Bath water systems, while the rates billed for sewer services are used to fund the Loyalist East and Bath sewer systems.

As authorized by by-law 2014-091 and subsequent by-laws, based on the review of the connection charges that took place in 2014, the following prior resolutions are reflected in the current connection charges:

- That connection fee changes proposed by BMA be approved and implemented as of January 1, 2015

As authorized by by-law 2014-090 and subsequent by-laws, based on the review of the rates that took place in 2014, the following prior resolutions are reflected in the current water and sewer rates:

- That water and sewer user rates increase as proposed by BMA, 8% in 2015, 8% in 2016, 8% in 2017 and 8% in 2018
- That the proportion of the flat rate versus metered rate remains at a split of 60% flat and 40% metered rate for the next four years

Furthermore, as authorized by by-law 2018-116, that user rate is increased by 8% as of January 1, 2019 with the intention that the rate study will be completed in 2019.

### **Status:**

There are three major components to the project deliverables:

1. Reviewing connection charges, including both a growth and existing capacity component (growth and club fee)
2. Reviewing user rates and impacts of various scenarios to update the fixed to consumption ratio or to implement a new structure
3. Establishing drinking water and wastewater financial plans

The presentation by Hemson will make a recommendation at a later meeting on the connection charges and user rates, subject to Council's direction, including input received as part of the public and developer consultation process. The financial plans will then be prepared, based on the approved assumptions for rate changes and submitted for Council's approval.

### **Analysis:**

The existing and proposed charges and rates are discussed below:

**Connection charges** (billed at the time of issuance of a building permit for a new connection) are structured to cover the historical cost of a unit of system capacity previously paid by the Township (also referred to as the club fee) prior to the commencement of the impost fee program. Connection charges cover the costs of growth based on prior costs incurred and future costs, both as reflected in the Township's growth capital budget capacity projections. The growth component of the charge is applied only to the growth component of costs incurred. The club fee component is used to provide funding for general capital as a method of recuperating past growth costs prior to amalgamation. It is anticipated that the club fee portion of the connection charge will be imposed under the *Municipal Act* until approximately 90% the related historical costs are recovered. Based on projections, and although not directly related, it is estimated to be at a time where capacity expansions will be required as outlined in the draft connection charge model. The combined fee is proposed to be comparable to the current combined residential connection charge. An overall reduction is proposed for the current combined non-residential charge. Only the growth portion of the connection charge is to be increased annually based on the Ottawa Construction Price Index. Hemson and Township staff are currently analyzing the impacts of removing the additional charge for a secondary unit upon permit issuance to provide comparability with neighboring municipalities and to correlate with proposed changes to

the *Development Charges Act* and the *Planning Act* from Bill 108, despite the fact that the charge is imposed under the *Municipal Act*.

**User rates** (billed to existing customers) are structured to cover the operating and capital replacement costs. Council's direction in 2014 was for rates to be set to achieve a 60:40 split for fixed versus consumption, however, BMA determined the revenue requirement was closer to 63.5:36.5%.

The preliminary scenarios for user rates that will be presented to Council are as follows:

**1. Remaining at status quo: 60:40 fixed/consumption ratio:**

This scenario will provide for annual reserve provisions for unexpected capital replacement and long-term capital planning, and will require current rates to increase for all users beginning at 6% in the early years of the forecast, before moderating at near inflationary adjustments towards the latter end of the planning period. It is imperative that reserve funds are not depleted over the 10-year forecast, given the fact that club fees, as noted above, will cease as a repayment to the user rate and will ultimately provide pressure by requiring an increase the Township's revenue requirement in due time.

**2. Changing the ratio more heavily to consumption at a 40:60 fixed/consumption ratio:**

This scenario bears some inherent risk to the Township in terms of revenue fluctuations; however, Hemson has conservatively forecasted consumption to be constant, despite a projected growth of ERUs per year, based on historical consumption trends to be decreasing annually. The draft calculations show that the burden shifts heavily onto high volume users. With that said, a residential user will need to consume approximately 18 cubic meters or less bi-monthly, in order to see no change or a reduction in their bill. As per 2018 consumption history, approximately 32% of service addresses achieve this volume level or below. or alternatively 68% of service addresses would see a bill increase. Residents would have more flexibility to reduce their bill by promoting conservation. Alternatively, the non-residential community using significant volume will see a shift to consumption at a higher rate, that outweighs the reduction in the fixed rate.

**3. Phasing-in 40:60 fixed/consumption ratio over 10 years beginning at 50:50:**

This scenario provides for similar savings in the reserve fund as the scenarios above, but moves to a 40:60 split, gradually over 10 years. This shifts the burden over time to high volume users, providing them the opportunity to adopt conservation measures in response to the shifting ratio.

**4. Minimum consumption charge after 20 cubic meters bi-monthly:**

Under this scenario, a consumption charge would only be levied for consumption greater than 20 cubic meters, bi-monthly. Therefore, only a fixed fee is levied for consumption less than this threshold. Overall, the burden will shift to high volume users

immensely and would require significant increases in both fixed and consumption rates to make up for the adjustment on the bill of low volume users.

Staff have proposed that the subsequent year over year increase be limited throughout all potential scenarios and Hemson will be providing recommendations on how to achieve that. As mentioned, the schedule of rates reflects declining annual volumes, which is offset by increased population in the next 10 years.

**Debt and reserves**

Hemson will be outlining the impact of the proposed rates on debt charges, including debt capacity for water and sewer service areas alone. The annual debt repayment limit determined by the Ministry of Municipal Affairs and Housing is calculated on a corporate-wide basis. As reported to Council previously, there is sufficient debt capacity corporately to handle capital projects approved in the future. With that said, a more meaningful measure of debt capacity for water and sewer service areas is as a percentage of own source utilities revenue only. Based on the current draft calculations, the required debt issuances are approximately \$5.9 million and \$2.8 million for water and sewer, respectively over 10 years, across all scenarios. This leaves the highest annual repayment limits at 13% in 2025 for water and 17% in 2021 for sewer (the limit being at 25%), and will be reduced as debt is paid down. Constant debt levels will result in fluctuations in the usage of reserve funds. Expenses required to service debt financing are treated as operational costs. The lower the overall debt servicing costs, the less impact to overall operations costs. The flip side to this discussion is that since most of the operating costs are fixed costs, the overall revenue of the systems can be negatively effected resulting in an operating deficit, should there be a year where water demand is significantly lower than expected.

**Implementation**

Subject to Council’s approval, the tentative proposed timelines for implementation of recommendations are as follows:

July 29	Council assuming acceptance of presented scenarios in charges and rates in principle for discussion purposes
August 5	Notice to development community re: upcoming consultative meeting on connection charges
August 12	Notice to public re: upcoming consultative meeting on user rates at Council meeting
August 26	Presentation to development community by Hemson
September 23	Presentation to public - open house by Hemson

October 14	Update to Council on outcome of consultative period and direction on updated charges and rates
November 12	Final recommendations to Council Receive and accept financial plans Adoption of user rates by-law to come into force for billing periods ending on or after December 15 Adoption of connection charge by-law to come into force, effective January 1, 2020
December 1	Submission by compliance supervisor of application for drinking water license renewal

**Financial Considerations:**

Due to the impending work to be completed prior to Council approval final rates, it is anticipated that rates would be adopted upon by-law passing in November 2019, that would come into effect for billing periods ending after December 15.

**Consultation:**

The contents of this report and presentation, in draft, have been reviewed with the Chief Engineer, the Utilities Manager, the Asset Management Manager, the acting Engineering Manager, the Deputy Treasurer, and the Chief Planner of Special Projects (on past developer input).

The proposed rates and connection charges will be communicated to the public by way of a meeting with the development community for the connection charges and an open house with ratepayers, as noted above.

Multi-residential water and sewer ratepayers have expressed concerns with the relationship between the number of fixed charges being billed and actual units, whereby a fixed charge is being imposed on certain units of which overall consumption is nominal. Township staff will be analyzing the consumption of various multi-residential units and providing the overall financial impacts to Council at the proposed public meeting date. It has been noted by Township staff that there are also instances of multi-residential units that consume well above the average ERU. If Council recommended to set the ratio more heavily on consumption, this would alleviate some of these concerns.

The Chief Planner has provided past concerns from developers on the connection charges with comments from staff:

- Residential connection charges are being charged for both single family dwellings and a secondary unit at the time of new build

- As noted above, Hemson will be calculating the financial impact of waiving the fees on secondary units and will be accompanied by a recommendation by staff at a later meeting to correlate with the changes laid out in the *Development Charges Act* and Bill 108
- Non-residential connection charges are being charged based on cubic meters, rather than square meters (as calculated in the *Development Charges Act*)
  - The rationale is that it places users on an equal footing on the basis that the cost to connect is a factor of anticipated use of the system. Residential users are charged based on average residential use. Commercial and industrial users are charged based on a projection of consumption. While this may create uncertainty for prospective new businesses, the Chief Engineer has assigned a capacity to the Loyalist East Business Park and this contribution could be recovered on a pro-rated basis using a per acre charge. This would give a purchaser a clear estimate of the potential investment. It is the Chief Engineer's opinion that non-residential connection fees should be calculated by cubic meter to ensure that all users of the system are paying their fair share for the service/allocated capacity. Calculating connection charges for new commercial and industrial users based on building size would penalize low volume water users and reward high volume water users, which will vary between industries.
  - The connection charge by-law allows for new consumers to provide estimates for subsequent adjustments, should the estimate be less than the actual. Staff have experience with smaller industrial, commercial, institutional ("ICI") units, and the fee charged is much less than a typical single-family home. The square meter approach has no relationship to the true cost of supplying water and sewer services.
- The industrial community should be exempt from both the growth portion of connection charge and development charges to encourage economic development
  - While the *Development Charges Act* allows for this exemption, along with other neighboring municipalities, it is imperative that an analysis be completed in the loss of growth revenue, as a result of this exemption, as the Act states that other rates cannot be increased to cover this loss. Hemson will be working on this analysis to provide an impact to the development community and Council, as to whether the Township can remain financially sustainable. In terms of the connection charge, this may result in a major fluctuation of revenue depending on the volume/capacity that this industry takes from existing uncommitted capacity. As a result, residual costs associated with growth would have to be paid by existing businesses and residents, in addition to the incremental operating costs, going forward.

### **Regulatory/Policy Compliance Implications:**

Completion of a drinking water financial plan is required under O.Reg 453/07.

**Link to Strategic Plan:**

Address the Township's Municipal Infrastructure Needs, Provide a Well-Managed and Effective Municipal Government, Strengthen the Township's Financial Position

**Approved By:**

Philip Reniers, Deputy Treasurer/Finance Supervisor  
Lorie McFarland, Utilities Manager  
Dave Thompson, Director of Infrastructure Services  
Kerry Rousselle, Executive Assistant  
Debbie Chapman, Township Clerk

**Status:**

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