Non-Regulated Loan Repayment Recommendation

Recommendation

That Utility Committee recommend to City Council:

That Option 3 - Full Notional Loan Forgiveness for the non-regulated loan repayment, as outlined in the June 25, 2021, City Operations report CO00582, be approved.

Executive Summary

Waste Services operated a commercial waste collection and processing program as part of its non-regulated lines of business that accumulated a $7.6 million deficit. Major program changes have been implemented as a result of the City's Program and Service Review and the 25-year Waste Strategy.

To address non-regulated program losses and achieve target cash balances, the Waste Services Utility was given authorization to draw on a notional short-term loan from the City of Edmonton from 2015 to 2019. This report outlines various options for repayment of the notional short-term loan to the City and recommends Option 3 - utilize funding appropriated within the Financial Stabilization Reserve from the 2020 tax-supported surplus to write-off the outstanding notional loan.

Report

Waste Services is legislated to provide services for single unit and multi-unit residential properties within city limits, which are the regulated activities of the Utility. The City of Edmonton is not required to offer non-regulated waste services, but has been active in this space since 2008, seeking to improve diversion rates in the non-regulated sectors.

As part of the 25-year Waste Strategy, an assessment of the City's non-regulated business lines was conducted to determine whether participation in non-regulated business activities is the most effective way to influence diversion in these sectors. An extensive preliminary review of the business lines was also conducted by the City's Program and Service Review in 2018, which assessed the City's four non-regulated business lines:

1. Commercial Collections
2. Commercial Self-Haul

3. Construction and Demolition Processing
4. Aggregate Recycling

Building on the work from the Program and Service Review, public engagement was conducted as part of the strategy to seek clarification from a variety of organizations on the ways the City can best impact waste reduction and diversion in the non-residential sectors.

It was determined that the City's involvement in direct collection of waste from the Industrial, Commercial and Institutional sector has been ineffective in its efforts to impact waste diversion in the non-regulated sectors. While the business line has successfully grown a modest client base, its impacts are only felt on approximately four percent of the industry. Only a small number of City clients have been able to fully participate in waste diversion programming, which was challenged further with the closure of the Edmonton Composting Facility.

The 25-year Waste Strategy recommended changes to the City's current non-regulated business lines, including a wind-down of the Commercial Collections business and securing an operational partner for the Construction and Demolition Recycling business. The City's involvement in these business lines was assessed as ineffective in terms of achieving both diversion and financial results. More information and details are provided in Attachment 4 of the August 29, 2019 City Operations report CR_5829. Council approved the recommendation to exit and wind down these two lines of business in September 2019.

After Council's approval, Waste Services proceeded with securing an operational partner for the Construction and Demolition business. The Construction and Demolition Recycling Facility has been managed and operated by an independent contractor since April 2020. The Commercial Collections business is expected to fully wind down by the end of 2021, with the exception of City of Edmonton facilities and some mixed-use sites.

Non-Regulated Program Plan

To address non-regulated program losses and achieve target cash balances, the Waste Services Utility was given authorization through the Waste Services Utility 2015 Operating Budget process to draw on a notional short-term loan from the City of Edmonton. The notional short-term loan was available from 2015 to 2019. The notional loan was to cover non-regulated losses related to the commercial business lines including closure of the Construction and Demolition Recycling Facility and the wind-down of Commercial Collections. Access to this notional short-term loan ensured that losses from the non-regulated lines of business were financed by the notional loan, did not impact regulated rate revenue and assisted in reducing non-regulated rate increases.

As of December 31, 2020, the outstanding notional short-term loan balance was $7.6 million which has provided financing for the cumulative losses generated by the non-regulated lines of business, and no further losses are forecast at this time. The notional loan needs to be repaid by 2025. Waste Services conducted a financial review of five potential notional loan repayment options. The options are described in detail below.

1. Repayment utilizing non-regulated profits
2. Transfer of stranded assets to tax-supported operations
3. Utilize funding appropriated within the Financial Stabilization Reserve from the 2020 tax-supported surplus to write-off the outstanding loan
4. Repayment utilizing unappropriated retained earnings of the utility
5. Interest only payments for five years starting in 2021 and re-evaluate the repayment options in 2026 based on financial sustainability of the non-regulated business lines

Option 1 - Repayment Utilizing Non-regulated Profits

Modest profits are anticipated to be generated by the remaining two non-regulated lines of business. These profits could be used to pay down the balance of the notional loan starting in 2021. Future profits expected from the remaining non-regulated business lines are approximately $0.5 million annually. The notional loan will be fully repaid by 2036 using these profits. Interest on the outstanding notional loan balance will accrue annually at 1.5 percent until the notional loan is fully repaid.

Option 2 - Transfer of Stranded Assets to Tax-Supported Operations

Under the stranded asset transfer option, the stranded capital assets primarily associated with the non-regulated construction and demolition and Commercial Collections lines of business that received approval to wind down in 2019 would be transferred to the tax levy at the end of 2021. This would reduce the amount of amortization and interest expense covered by the non-regulated business (approximately $500,000 annually), resulting in higher overall profits generated by the remaining non-regulated lines of business, and would allow the notional loan to be repaid sooner.

It is estimated that the notional loan will be fully repaid in approximately seven years under this option with repayment starting in 2021. Net profit from non-regulated lines of business would transfer over to the tax levy until the notional loan is fully repaid.

Option 3 - Utilize Funding Appropriated within the Financial Stabilization Reserve from the 2020 tax-supported surplus to write-off the outstanding loan

Write-off the full amount of the notional short-term loan utilizing funding of $7.6 million appropriated within the Financial Stabilization Reserve from the 2020 tax-supported surplus. Revenue from non-regulated operations, less an amount to fund the Industrial, Commercial and Institutional program, would transfer over to the tax levy. Operational authority for the program will remain with Waste Services. This transfer of revenue would be indefinite.

Option 4 - Repayment Utilizing Unappropriated Retained Earnings of the Utility

The notional loan would be repaid using unappropriated retained earnings of the Utility over a period of five years. The non-regulated business lines have not contributed to the unappropriated retained earnings of the Utility due to the losses experienced by the business lines in the past and have an outstanding loan balance of $7.6 million as of December 31, 2020. Repayment of the notional loan using retained earnings generated by the regulated lines of business would result in regulated customers subsidizing the non-regulated lines of business.

Option 5 - Interest Only Payments; Re-evaluate Repayment Options at Later Date

A fixed amount would be paid by the Utility equal to the interest accrued on the notional loan. The expected interest rate is 1.5 percent per annum, and the balance is approximately $7.6 million. The amount of interest payment would be $114,000 per year. This payment would begin in 2021 and end at the end of 2025. Repayment options would be re-evaluated at that time based on the financial sustainability of the non-regulated business lines.

The table below shows a summary of each option.

Repayment Options	1	2*	3*	4	5
Notional Loan Amount	$7,600,000	$7,600,000	$0	$7,600,000	$7,600,000
Estimated Annual Notional Loan Payment	$500,000	$1,076,000	N/A	$1,520,000	$114,000
Payback Period (Years)	15	7	N/A	5	5 years + TBD

*Assumes $250,000 in annual funding is retained by the Utility from the remaining non-regulated activities to support the engagement and development of the Industrial, Commercial and Institutional program.

Corporate Outcomes and Performance Management

Corporate Outcome(s): The City of Edmonton has a resilient financial position.

Outcome(s)	Measure(s)	Result(s)	Target(s)
Edmonton’s waste service rates are fair, equitable and value driven.	Stable Rates	0.3% (2020)	0% (2021)

Risk Assessment

Risk Element	Risk Description	Likelihood	Impact	Risk Score (with current mitigations)	Current Mitigations	Potential Future Mitigations
Customers / Citizens	Higher cost to residents to provide waste services if the notional loan repayment is required from regulated Utility funds	3 - possible	2 - moderate	6 - low	Proposal of loan repayment options	Continue to look for financial efficiencies in the Utility to hold rates low and stable
Public Perception	To repay the non-reg.notional loan by 2025 prices charged to provide services from remaining non-regulated programs would need to increase in a short time frame which may impact waste diversion goals and further extend the non-regulated losses compromising the non-reg programs long-term sustainability	3 - possible	3 -major	9 - low	Holding rate increases low and stable	Continue to hold rate increases low and stable

Others Reviewing this Report

- M. Persson, Chief Financial Officer and Deputy City Manager, Financial and Corporate Services
- C. Owen, Deputy City Manager, Communications and Engagement
- K. Fallis-Howell, Acting City Solicitor