

EPCOR Water Services Inc. Performance Based Rates

2013 Progress Report

Recommendation:

That Utility Committee recommend to City Council:

That the July 3, 2014, Financial Services and Utilities report CR_827, be received for information.

Report Summary

This report provides information with respect to the second year (April 1, 2013, through March 31, 2014,) of the five-year 2012-2016 Performance Based Rates regulation of water services and wastewater treatment with EPCOR Water Services Inc. (EPCOR).

Previous Council/Committee Action

At the July 4, 2006, City Council meeting, the following motion was passed:

That Administration provide annual reports to Council on how the EPCOR Water Services Inc. Performance Based Rates plan is progressing.

Report

In response to a September 1, 2011, motion from Utility Committee, a report to the April 3, 2012, meeting provided information and a new suggested format for annual progress reporting from EPCOR over the 2012-2016 Performance Based Rates regulation term.

This report provides a progress update on the second year (April 1, 2013, through March 31, 2014,) of the 2012-2016 Performance Based Rates regulation arrangement, as established under EPCOR Water Services and Wastewater Treatment Bylaw 15816. Although this is the third five-year Performance Based Rates term for water services, wastewater treatment was just introduced within the Performance Based Rates for the 2012-2016 term under Bylaw 15816.

Under the Performance Based Rates arrangement, rates are established for the first year of the term and are adjusted for subsequent years based upon a predefined formula. The formula is intended to provide predictable rates to the customer, while the utility has the opportunity to earn higher returns by finding efficiencies. Operating and financial performance targets are set, measured and reported.

**PLEASE RETAIN THIS REPORT FOR
FUTURE MEETINGS.**

EPCOR has prepared a 2013 Progress Report which has been included as Attachment 1 to this report. The 2013 Progress Report format generally follows the format discussed with Utility Committee at their April 3, 2012, meeting and the format utilized in the 2012 Progress Report. Performance measures and financial data within the report are reported on a calendar year basis. Appendices to the progress report provide annual data for each of the two years of the Performance Based Rates term to date and will be extended each year to track annual data over the Performance Based Rates term, intended to support analysis and provide a comparative basis for future Performance Based Rates reviews. The progress report integrates changes in response to feedback and questions from city Administration.

An executive summary has been provided as section 1 within the progress report. The following discussion highlights key items city Administration has identified within the 2013 progress report to raise to your attention.

Financial Performance and Consumption:

Overall, the combined water services and wastewater treatment 2013 net income of \$45.4 million compares to a Performance Based Rates forecast for the year of \$38.2 million. The annual combined return on equity of 11.88% exceeds the 2013 Performance Based Rates forecast rate of 9.56%. For the two years to date of the Performance Based Rates term (2012-2013) the rate of return on equity of 9.64% exceeds the Performance Based Rates forecast for the two years of 9.18%.

Water Services experienced a net income for 2013 of \$34.9 million compared to the Performance Based Rates forecast of \$31.2 million. Revenues were lower than the forecast primarily due to a more significant decline in consumption than was anticipated within the Performance Based Rates for the residential customer class. The revenue decline was more than offset by reduced operating costs in areas of corporate charges and chemicals, as described in section 3.2.2 of the progress report, as well as from reduced interest expense. The return on equity for 2013 of 12.66% exceeded the Performance Based Rates forecast of 10.88%, influenced by a lower rate base resulting from delays in capital projects going into service in addition to the increased net income. The return on equity approved in the Performance Based Rates for the five-year term with respect to water services is 10.875%.

Wastewater treatment reported a net income of \$10.5 million for 2013 relative to a Performance Based Rates forecast of \$7 million. The 2013 return on equity of 9.86% significantly exceeded the forecast of 6.2% resulting from the increased net income and reduced rate base arising from significant delays to capital projects. The average wastewater treatment return on equity over the five-year term approved in the Performance Based Rates is 7.8%, with returns ramping up to an annual return of 10.875% in 2016.

Sections 3.2 and 4.2 of the progress report provide additional information with respect to financial performance of water services and wastewater treatment respectively.

Non-Routine Adjustments:

In accordance with Bylaw 15816, significant and unusual events beyond the scope of control of EPCOR that exceed defined threshold levels may be considered non-routine adjustments. The Bylaw sets out a process and thresholds around the application and review of non-routine adjustments. The rate impact of non-routine events is calculated and allocated on a proportionate basis to customers. There were no non-routine adjustments requested in the 2013 Performance Based Rates period to either increase or decrease rates.

The progress report (section 5.1.2) identifies two matters that are being investigated further for potential future non-routine adjustments. One relates to additional water main replacement costs due to further clarification around the LRT expansion, bridge work and road paving. Offsetting that consideration would be an error identified in the water Performance Based Rates to overstate annual chemical costs, noted within section 3.2.2 of the progress report. These offsetting factors, along with the level of cost savings achieved result in a current projection to be above the approved water services ROE for the overall 2012-2016 Performance Based Rates. That being the case, no related non-routine adjustment would be requested for 2014 with respect to water services.

A wastewater treatment capital project relating to sanitary grit treatment which was not a part of the 2012-2016 approved Performance Based Rates plan has been identified as the second potential non-routine adjustment in the progress report. This project is being initiated by the City to treat effluent being hauled from the pump stations in vacuum trucks, currently being discharged directly in the bio-solids lagoon, and therefore bypassing treatment. Location and alignment with the Goldbar treatment facility is considered preferential to the City completing the project independently. Further discussions are ongoing and a potential non-routine adjustment may be requested relating to a sanitary grit treatment project in a future period.

Capital Expenditures:

Water capital expenditures for 2013 of \$85.9 million were managed overall to consistent levels with the Performance Based Rates forecast of \$85.8 million, with some increases in city-driven projects offset with timing and reductions across other projects.

As was raised with the 2012 progress report, a comprehensive review of the wastewater capital needs has identified additional requirements and the need to optimize costs across the 2012-2016 Performance Based Rates term. The review has resulted in the delays of certain projects and therefore reductions in actual expenditures for 2013 to \$25.0 million from the Performance Based Rates forecast of \$32.1 million. Over the two years of the Performance Based Rates to date, capital expenditures of \$36.9 million are well under the Performance Based Rates plan of \$50.7 million - however, a revised projection provided in the progress report for the five year Performance Based Rates of \$134.5 million would significantly exceed the approved Performance Based Rates forecast of \$111.7 million.

Additional details on capital expenditures are available in sections 3.2.6 (water services) and 4.2.6 (wastewater treatment) of the progress report in Attachment 1.

Performance Measures:

Operating performance for water services and wastewater treatment is measured by the results of a number of indices prescribed within Bylaw 15816. In 2013, water services and wastewater treatment operations exceeded performance measure targets in aggregate, resulting in no related customer rebates to be applied in the 2014 rates.

Water services met or exceeded all performance measures within the system reliability, water quality, customer service and environment indices. Within the seven measures for the safety index, performance met or exceeded the standards with the exception of the injury severity rate, primarily attributable to a single event. EPCOR has indicated that improvements to working alone processes have been made to help address this safety measure. Refer to section 3.4 of the progress report for more detailed information.

For 2013, wastewater treatment met or exceeded all performance measures within the system reliability, wastewater quality, customer service and safety indices. Within the environmental index, performance met or exceeded the standard with the exception of completeness and timeliness of reporting which incurred a score of 88.9% of the standard. Improvements to business processes have been subsequently implemented. Section 4.4 of the progress report provides more detailed information with respect to wastewater performance measures.

Future Plans and Challenges:

Section 5 of the progress report includes a discussion of the future plans and challenges EPCOR Water Services has identified and the approach being taken with respect to each. An update provided with respect to the ongoing cost of service and depreciation studies indicates that both studies are expected to be completed and inform the next Performance Based Rates regulation process for 2017-2021, for which the regulatory reviews will get underway in 2016.

No new provincial or federal legislation relating to water services or wastewater treatment was issued in 2013. There are no related matters awaiting decision with the Alberta Utilities Commission.

Policy

This report provides a 2013 progress report on EPCOR Water Services and Wastewater Treatment Bylaw 15816, covering the period of April 1, 2013, through March 31, 2014.

Corporate Outcomes

The information within this report:

- supports preserving and sustaining the City's environment by helping minimize the impact of City operations on water and wastewater systems

- contributes to ensuring the City's financial sustainability
- is consistent with Council's strategic vision in terms of its conditions of success, particularly related to sound management practices and processes.

Attachments

1. EPCOR Water Services Inc. 2013 Progress Report

Others Reviewing this Report

K. Rozmahel, General Manager, Corporate Services