

EPCOR Water Services Inc. Performance Based Rates

2012 Progress Report

Recommendation:

That Utility Committee recommend to City Council:

That the June 18, 2013, Financial Services and Utilities report CR_69, be received for information.

Report Summary

This report provides information on the first year (April 1, 2012, to March 31, 2013) of the five-year 2012 - 2016 Performance Based Rates regulation with EPCOR Water Services Inc. (EPCOR).

Previous Council/Committee Action

At the July 4, 2006, City Council meeting, Council passed a motion requiring Administration to provide an annual report to City Council on progress with respect to the EPCOR Water Services Inc. Performance Based Rates.

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

Report

This report provides a progress update on the first year (April 1, 2012 to March 31, 2013) of the 2012 - 2016 Performance Based Rates arrangement, as established under EPCOR Water Services and Wastewater Treatment Bylaw 15816.

Under the Performance Based Rates arrangement, rates are established for the first year of the Performance Based Rates term and are adjusted for each subsequent year 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.

EPCOR has prepared a 2012 Performance Based Rates Progress Report, which has been included as Attachment 1 to this report, utilizing the new format reviewed with the Utility Committee on April 3, 2012. The progress report has integrated changes in response to questions and feedback from Administration.

Since the 2012 - 2016 Performance Based Rates term is the first to include wastewater treatment services, this is the first year wastewater treatment services are discussed as a part of the annual progress report.

An executive summary has been provided as page 1 to Attachment 1. The following discussion highlights key items City Administration has identified

in the 2012 Performance Based Rates progress report, as well as an update on certain other matters for Council and Committee information.

Financial Performance and Consumption

Water services net income of \$22.2 million was \$7.6 million less than the 2012 forecast, largely due to the decrease in residential customer consumption which was more significant than anticipated. This resulted in a return on equity of 8.46% compared to the rate of 10.875% approved for the Performance Based Rates.

Wastewater services net income of \$4.4 million was also negatively impacted by lower residential customer consumption. However, operating cost savings and lower interest costs resulted in a \$0.7 million greater than forecast net income for 2012. The increased net income, combined with a lower rate base, corresponded to an actual return on equity of 4.07% compared to the approved Performance Based Rates rate of 3.45%.

On a combined basis, the return on equity was 7.20% compared to a combined approved Performance Based Rates return on equity of 8.77%.

More details on financial performance are provided in Attachment 1, Section 4. Consumption details are in Section 1.2 and future plans and challenges are discussed in Section 6 of the attachment.

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 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 2012 Performance Based Rates period to either increase or decrease rates.

Capital Expenditures

Combined water and wastewater treatment services capital expenditures were \$11.8 million less than forecast for 2012; wastewater treatment services being \$6.8 million and water services being \$5.0 million under forecast.

Wastewater treatment services capital expenditures were lower than forecast due to project delays and cost reductions arising from a review and re-optimization of its capital plan undertaken in 2012.

Water services capital expenditures were under budget due to changes in project timing, unexpected project delays and further need for engineering cost analysis. These cost reductions were partially offset by other projects advancing ahead of schedule.

EPCOR expects combined capital expenditures to be close to forecast over the 5-year Performance Based Rates term.

Additional details on capital expenditures are available in Attachment 1, Sections 1.4 and 4.3.

Performance Measures

2012 saw the introduction of new water system reliability indices - planned construction factor and water loss factor. The water environmental index of vehicle fuel efficiency was replaced with watershed program activity. This was the first year wastewater treatment operations performance measures were formally set, measured and reported.

In 2012, water and wastewater treatment operations exceeded all performance measure targets in aggregate. The safety index measure for water was below the standard level. Certain other specific measures did not meet the standards, as outlined on pages 10 through 18 of the progress report. Areas of improvement have been identified.

As targets were exceeded in aggregate for water and wastewater treatment services in 2012, no customer rebates are to be applied to the 2013 rates. Further details on performance measures are available in Attachment 1, Section 3.

Other Related Matters

The following items have not been specifically addressed in the 2012 Performance Based Rates Progress Report. However, updates are being provided for Council and Committee information.

Alberta Utilities Commission:

An Alberta Utilities Commission ruling on August 3, 2012 finalized the review of regional water rates for 2004 - 2007. A subsequent agreement has been

reached directly by EPCOR with the regional water group for 2008 - 2011 rates, with support for utilizing the same approach for 2012.

There was an Alberta Utilities Commission hearing on May 14, 2013 for a complaint relating to the in-City water rates, on which the Alberta Utilities Commission decision is expected within 90 days. A summary of the issues of this complaint was provided to Utility Committee on March 14, 2013 through the in-private Financial Services and Utilities report 2013CA1861.

Cost of Service Study:

A Cost of Service Study is being completed by EPCOR, utilizing an external consultant, to update the methodology for allocation of EPCOR's water system costs across customer segments and classes. Work is on track to finalize the Cost of Service Study in 2014, prior to the next Performance Based Rates application.

Policy

This report provides a 2012 progress report on EPCOR Water Services and Wastewater Treatment Bylaw 15816 covering the period of April 1, 2012, to March 31, 2017.

Corporate Outcomes

The information contained in this report:

- supports preserving and sustaining the City's environment by helping minimize 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 the sound management practices and processes.

Attachment

1. 2012 Progress Report - EPCOR Water Services Inc. 2012-2016 Performance Based Regulations

Others Reviewing this Report

- D. H. Edey, General Manager, Corporate Services