



# CITY POLICY

**Policy Number: C558**

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**REFERENCE:**

**ADOPTED BY:**

City Council – Date

**SUPERCEDES:**

New

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**PREPARED BY:** Asset Management and Public Works

**DATE:** May 6, 2011

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**TITLE: WASTE MANAGEMENT UTILITY FISCAL POLICY**

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**Policy Statement:**

1. The Utility is to be operated in a manner that balances the desire to provide the best service at the lowest cost (public utility) while employing private sector approaches to encourage innovation and using a cost structure that sends the proper price signal to the customers (private utility).
2. The Utility is exempt from a Local Access Fee as the Utility does not have exclusive rights to the waste collection and disposal market, nor does it have exclusive use of the roadways.
3. The Utility is exempt from Dividend payment to the City of Edmonton.
4. Similar to private utilities, the Utility will account for the cost of service under a full cost accounting approach.
5. Where government transfers are not provided for the exclusive use of the Utility, access to government transfers is dependent upon the completion of a business case that takes into account the overall needs of the community. The goal is to ensure that any government transfers have been best leveraged to achieve the City's overall priorities.
6. Where the Utility is contemplating the provision of non-regulated services and such services require significant capital investment and/or net operating costs, a business case is to be prepared such that the Utility Committee may make recommendations to City Council regarding the initial and/or ongoing funding of such activities from sources other than Rate Revenue.
7. The Utility is to contribute towards achieving the City's Strategic Plan.



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Attachment 1

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**The purpose of this policy is to:**

- 1.0** Ensure that the Waste Management Utility is operated in a manner that reflects City Council's overall vision and philosophical objectives for the Utilities.
- 2.0** Ensure that there is a consistent approach year over year for the financial planning, budgeting, and rate setting for the City managed Utilities.
- 3.0** Ensure that the Utility is financially sustainable over the long term.



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## 1.0 Definitions

- 1.1 *Appropriated Retained Earnings*** – past accumulated surplus of the Utility that has been set aside for specific purposes.
- 1.2 *Debt Coverage Ratio*** – is a measure of the ability of each utility to meet both interest and principal payment obligations.
- 1.3 *Debt to Net Assets Ratio*** – is a measure of the extent to which the net book value of non-contributed assets is being financed by debt.
- 1.4 *Dividend*** – an amount that is payable to the City of Edmonton from the actual net income of the Utility, payable in the following year.
- 1.5 *Financial Indicators*** – a set of financial measures that provide signals on the financial health of the Utility.
- 1.6 *Financial Sustainability*** – financial sustainability is achieved when all targets set for the Financial Indicators (as recommended by the Utility Committee and approved by City Council) are attained.
- 1.7 *Full Cost Accounting*** – shall include cost allocation from services provided by the Corporation and may include administration costs, and other shared services such as Communication, Personnel, Information Technology, Law, Materials Management, Customer Information System, Fleet Services, Financial Services, Building Maintenance, Custodial, Space Rent, and general Corporate Overhead.
- 1.8 *Local Access Fee*** - an amount recommended by the Utility Committee and approved by City Council that would otherwise be equivalent to property taxes, and compensation for the exclusive rights afforded each utility for as long as such property is deemed by the relevant legislation of the Province of Alberta to be non-assessable and non-taxable for property taxes.
- 1.9 *Non-regulated Activities*** – are activities that are not essential to the provision of services by the Utility.
- 1.10 *Rate Revenue*** – revenues generated through monthly customer rates.
- 1.11 *Regulated Activities*** – are activities that are core to the services provided by the Utility. The collection, processing, and disposal of residential waste are considered regulated activities.
- 1.12 *Unappropriated Retained Earnings*** – past accumulated surplus of the Utility that is available for other uses.
- 1.13 *Utility*** – refers to the Waste Management Utility, which is a self-funded operation providing collection, processing, and/or disposal services to



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customers on a fee for service basis, including a return on rate base, at rates regulated by City Council.

**1.14 *Weighted Cost of Capital*** – the total interest paid on outstanding debt.

**1.15 *Working Capital*** – amount of cash required to enable the operations to meet its obligations in the short term.

What follows are additional policy statements and targets the City of Edmonton aims to reach for the Waste Management Utility Fiscal Policy. An update to this policy will be attached to this policy annually. This update will advise on the City's progress in achieving the targets.

## **2.0 *Financial Indicators***

Policy Statement: Financial indicators are measures that provide information on the financial health of the Utility. The selection of indicators will be based upon best practices identified by the Government Finance Officers Association, adapted for Utility operations. Taken collectively, these indicators provide the long-term viability of the Utilities assuming that there are no significant price fluctuations in the system.

### **2.1 *Rate sufficient to meet expenses***

Policy Statement: As a minimum, projected total revenue generated will be equal to projected expenses for the year. This will provide a balanced budget. Otherwise, customer rates are not sufficient to pay for the current cost of service and the Utility is not self-sufficient.

### **2.2 *Return on Rate Base***

Target: The Alberta Utilities Commission typically allows a Return on Equity of between 6% - 12% (assuming a 65% debt financing of capital) to be earned as profit to ensure that customers receive safe and reliable service at just and reasonable rates. Return on Rate Base is the total return before applying assumptions on debt load. The components to be used in the calculation of the return are defined by the Commission. City Council, as Regulator, will aim to achieve a targeted Return on Rate Base between 4% and 10%, subject to City Council decision making during the budget process. The lower limit of 4% reflects the lowest expectation for average cost of debt. The return should cover the cost of debt used to finance capital investment. The upper limit at 10% provides for a reasonable return for a public utility.

### **2.3 *Debt Financing of Capital – Policy Statements***

- a. The Utilities will not utilize Short-Term Debt or Long-Term Debt obligations to finance current operating expenditures.



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- b. Long-Term Debt will be considered for Capital Expenditures in:
  - i. projects with benefits that extend 10 years or longer;
  - ii. major rehabilitation or upgrade of existing assets; and
  - iii. emerging requirements to support corporate priorities and strategic plans.
- c. The Utility will follow the City of Edmonton's process for debt issuance, including the term of the debt and the legislated debt limits.
- d. When making a decision about the use of debt, alternative capital financing sources will be considered first, including a review of the Debt Coverage Ratio and the Debt to Net Assets Ratio.

## 2.4 **Debt Financing of Capital – Targets**

- a. The **Debt Coverage Ratio** is a measure of the Utility's ability to meet both interest and principal payment obligations. It is calculated as follows:

$$\begin{aligned} & \text{Net income before interest and depreciation} \\ & \div \text{Current year's principal and interest payments} \\ & = \text{Debt Coverage Ratio} \end{aligned}$$

The targeted Debt Coverage Ratio is 1.3 or higher.

- b. The **Debt to Net Assets Ratio** is a measure of the extent of capital investment that is financed through debt. It is calculated as follows:

$$\begin{aligned} & \text{Total Long Term Debt} \\ & \div \text{Net book value of Non-Contributed Assets} \\ & = \text{Debt to Net Assets Ratio} \end{aligned}$$

The targeted Debt to Net Assets Ratio is less than 60%.

## 2.5 **Financial Stabilization Reserve**

Financial Stabilization Reserve is established from Unappropriated Retained Earnings to manage operational variability (revenue shortfall or one-time expenses) and to provide flexibility in the financing mix of capital investments. To the extent possible, it should be supported by Cash.

## 2.6 **Capital Replacement Reserve**

Capital Replacement Reserve is established from Unappropriated Retained Earnings to ensure that the Capital Investment Program that is to be financed through Retained Earnings has been set aside and is supported by Cash for capital purposes.



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## **2.7 Cash Balance - Target**

To be financially sustainable, the Utility must have sufficient access to cash to meet obligations as they become due. Furthermore, it is important that Capital Investments that are planned to be financed by Cash (based upon the Debt Ratios) are achievable. Post Closure care is a new area to the City and while the amount provided is expected to be drawn over a 25-year period, the actual timing of the draws is uncertain. Providing a 10% cash balance will help mitigate the risks associated with potential timing differences. Accordingly, the targeted Cash Balance is as follows:

$$\begin{array}{r} 100\% \text{ of the targeted Capital Replacement Reserve} \\ + 60\%-120\% \text{ of the targeted Financial Stabilization Reserve} \\ + 10\% \text{ of the Post Closure liability} \\ \hline = \text{targeted Cash Balance} \end{array}$$

## **3.0 Financial Planning – Policy Statements**

Budget and financial planning follow the general principles of budget, long range planning, and management of capital assets as established by the City of Edmonton and in accordance with Generally Accepted Accounting Principles defined by the Public Sector Accounting Board.

The Utility will prepare 3-year Business Plans, to be presented annually to the Utility Committee prior to the preparation of the annual operating budget and 3-year Capital Program.

The Utility Committee shall recommend annually to City Council the customer rates for the following year, based on a 10-year planning horizon with budgets that are prepared based upon current year forecast, business plan implementation, and directions regarding the desired Return on Rate Base.