Approach to Review of Proposed Utility Fiscal Policies

Recommendation:
That the February 18, 2011, Finance and Treasury Department report 2011FS4994 be received for information.

Report Summary

This report provides information and considerations for discussion of elements of the Utilities' Fiscal Policies, in advance of proposed policies being revisited by Committee or Council.

Previous Council/Committee Action

At the December 10, 2010, City Council meeting, Bylaw 15478 – Amendment to the Procedures and Committees Bylaw 12300 to Create a Utility Committee, was given three readings.

At the September 7, 2010 Transportation Public Works Committee, the following motions were passed:

That the June 30, 2010, Asset Management and Public Works Department report 2010PW6508rev (Updated Utility Fiscal Policy for the Sanitary and Land Drainage Utilities) be referred back to Administration to return in the first quarter of 2011 with a revised policy.

That the June 30, 2010, Asset Management and Public Works report 2010PW6343rev (Waste Management Utility Fiscal Policy) be referred back to Administration to return in the first quarter of 2011 with a revised policy.

Report

Background

- In setting fiscal policy, Council can direct the approach for financial planning, budgeting and rate setting for the City managed utilities, and therefore provide for consistency in decision-making over time.
- In 2010, Administration presented a number of reports to the Transportation and Public Works (TPW) Committee with respect to an Updated Utility Fiscal Policy for the Sanitary and Land Drainage Utilities (2010PW6508; 2010PW6508REV; 2010PW7011).
- Administration also presented a series of reports for the development of a Utility Fiscal Policy for the Waste Management Utility, established in January 2009 (2010PW6343; 2010PW6343REV; 2010PW6963).
- The September 7, 2010, TPW Committee meeting was the first meeting where City Council's Utility Advisor (The Advisor) was able to participate in the discussion.
- Given the relatively short timeframe available to the Advisor to review the proposed policies in advance of September 7, 2010, along with the municipal election in October, and the need to move into Budget deliberations in November, TPW directed Administration to bring back these proposed policies for further discussion in the first quarter of 2011.
- Since that direction was provided, Council approved the creation of a Utility Committee, which will now review all items pertaining to the Drainage and Waste Management Utilities.

Establishment of the City Managed Utilities

- Attachment 1 provides a summary of considerations by City Council in establishing both the Land Drainage Utility in 2003 and the Waste Management Utility in 2009.
- The Sanitary Drainage Utility has been in existence since 1956. Administration does not have ready access to documentation related to the establishment of this Utility. However, research has revealed that the City of Edmonton has charged a Local Access Fee and taken a dividend from its Utilities (Edmonton Power, Edmonton Telephones, and Water and Sanitation) since at least 1977.

Policy Considerations

- During the 2011 Budget Process, City Council raised a number of questions related to the elements of Utilities' Fiscal Policies.
- Administration would benefit from Utility Committee discussion and direction prior to revisiting the proposed policies.
- Information and considerations on key policy elements are provided in Attachment 2.

Policy

- Policy C304C (under consideration) – Drainage Utilities Fiscal Policy
- Policy C558 (under consideration) – Waste Management Utility Fiscal Policy

Corporate Outcomes

- The establishment of Utilities Fiscal Policies primarily supports Council's goal to Ensure Edmonton's Financial Stability.

Budget/Financial Implications

- Updated fiscal policies for the Utilities, will have implications for the budget and rate setting process for those Utilities, and may have impacts on the budget for the City's tax supported operations.

Attachments

1. Establishment of the City Managed Utilities
2. Policy Considerations

Others Reviewing this Report

- M. Koziol, Acting General Manager, Asset Management and Public Works Department
- D. Edey, General Manager, Corporate Services Department

Establishment of the City Managed Utilities

Land Drainage Utility

- City Council gave approval for the establishment of Land Drainage as a Utility at its July 2, 2002 Council Meeting with an effective date of January 1, 2003.
- At that time, the primary reason for moving Land Drainage from Tax Levy to a Utility was to adopt an approach "… that provides adequate funding for current and future land drainage maintenance, rehabilitation, growth and environmental protection."
- The ability for Land Drainage to achieve this objective as a program under tax supported operations was limited because the City operated under a Debt Management Fiscal Policy that required capital to be funded under a "Pay-As-You-Go" scenario. This meant that the capital needs of the Land Drainage operations had to be financed by cash, raised through property tax levy.
- At that time, the City was attempting to address a growing infrastructure need and contemplated a suspension of the "Pay-As-You-Go" Program for a five-year period. On October 15, 2002, Council approved an amendment to the Debt Management Fiscal Policy that provided an annual financing source for capital projects of up to $50 million for tax-supported projects for five years.
- Operating as a utility allowed Land Drainage to meet its capital requirements by financing the debt servicing costs through customer rates, the benefactors of the capital investment.
- As a result, the Land Drainage Utility was established in January 2003, with that portion of property tax levy used to support the operations converted to user fees. Under this plan, moderate investment in capital infrastructure was made possible.
- Prior to the Land Drainage operations becoming a Utility, its 5-year Funded Capital Priorities Plan totalled $58 million. This increased to $64 million the following year under the Utility model to address storm sewer rehabilitation and upgrades. The longer term plan was to incrementally increase investment in these areas.
- In 2004, the City of Edmonton experienced a significant storm event in July that resulted in major flooding. This necessitated the acceleration of the capital investment to reduce risk.
- The Flood Prevention Program, formally approved by City Council in the 2006 Budget, saw the capital investment in this area increase from less than $2 million annually to a total expenditure of $43 million from 2007 to 2010, most of which was financed through debt. With the amount of work now completed, the Flood Prevention Program is being scaled back to the $8 million range in 2011; however, the increased requirements associated with the Neighbourhood Renewal Program is more significant than the reduction in Flood Prevention capital needs.
- City Council approved a 2% special property tax levy in 2009, an additional 2% in 2010, and a further 1.5% in 2011 for the Transportation Neighbourhood Renewal Program. This allows the City to increase the number of reconstructed neighbourhoods from two to five each year. To continue the practice of not cutting into newly reconstructed pavement for a 3-year period, Drainage Services also has to accelerate its Drainage Neighbourhood Renewal Program to match

Transportation's plans. This resulted in an increase in annual capital investments from $5 million in 2006 to $9 million in 2010.
- The Land Drainage Utility of 2011 is operating under different expectations than in 2003, when it was originally established.

Waste Management Utility
- City Council gave approval for the establishment of Waste Management as a Utility at its March 25, 2008, Council meeting with an effective date of January 1, 2009.
- At that time, there were a number of reasons for moving Waste Management from a partial user fee/tax levy operation to a full utility. These included:
  - As Edmonton's integrated waste system developed, the division between user fee and tax funded services became blurred.
  - To properly match the costs of providing the service to the users of the service since property tax from the non-residential sector supported 40% of the portion of the waste operations funded by tax levy, but did not receive the service.
  - To provide the ability to fund needed capital investments in a timely manner through self-liquidating debt without affecting the City's tax-supported debt limits and to improve the operations' ability to develop long-term capital plans and coordinate the operating impact of capital.
  - A waste management utility would ensure financial equity for Edmonton residents in any future regional initiative. Edmonton's waste management systems were to be transparent and easily defensible. It aligned the City with waste management financing approaches being taken by other Edmonton region municipalities.
- The Waste Management Utility is expected to face rate challenges over the next few years as the full financial impacts of bringing the integrated waste processing and disposal activities to full production are reflected in the operations. Over 2011 and 2012, the Utility will be absorbing new costs associated with shared services and central management charges, interest and depreciation expense from significantly increased capital requirements to put the new system in place, and the end of the landfill closure implementation plan that provided support of $6.5 million in 2011 and $3.4 million in 2012.

City of Edmonton's Historic Approach to Utility and Enterprises
- During the 2011 Budget process, the issue of the utility rates being the source of funds for dividends and Local Access Fees that reduce the requirement for the tax levy was raised by members of Council with an awareness that further discussion was likely warranted on the subject.
- The above summary provides information on the rationale for converting Land Drainage and Waste Management into utilities. While there was no mention of providing a funding source for City general revenues, the City's history (dating back prior to 1978) has been that all utilities and enterprises pay local access fees and dividends to the City.

Policy Considerations

This attachment provides background and information for consideration by the Utilities Committee in discussing the certain elements of the Utilities Fiscal Policies.

1. Local Access Fee

   A Local Access Fee (also called a Municipal Franchise Fee) is a permitted revenue source under the Municipal Government Act. It is an accepted flow-through cost when the Alberta Utilities Commission considers the revenue requirements of a privately or publicly owned utility. It is a fee billed on behalf of some municipalities arising from a franchise agreement with the distributing company, designed to reflect the use of public rights-of-way and the granting of exclusive rights to a local market.

   The Alberta Utilities Commission approves the rate for a Local Access Fee where the utility itself is subject to the governance of the Commission. In a publicly owned utility, the utility is simply required to report to the Commission the basis and the rate upon which Local Access Fee is applied.

   There are typically two bases upon which Local Access Fee may be calculated: revenue base or consumption base. A revenue base fee is calculated based upon total revenue (commodity and distribution) or a portion of the revenue (distribution only). Where a utility includes the provision of commodities which are subject to significant market price fluctuations, many municipalities have chosen to base their fees on distribution revenue. This provides greater certainty to both the consumers and the municipality on the annual amount of Local Access Fee to be collected. The use of total revenue as the basis for Local Access Fee calculation is typically found where the utility is mostly a service based utility (e.g. Drainage Services).

   Currently, the City of Edmonton charges an 8% Local Access Fee on the Sanitary Drainage Utility Rate Revenue. This is expected to generate roughly $10 million ($5.3 million from Collection and Transmission and $4.5 million from Wastewater Treatment) as general revenues to the Tax Levy, and represents 7.8% ($2 on the average monthly bill) of the total Sanitary Drainage Expenses (collection and treatment). There is no Local Access Fee charged to the Land Drainage Utility (pending a review of the financial situation in 2013) or to the Waste Management Utility (being a new utility).

   In looking at other municipal utilities, the City of St. Albert and the City of Leduc do not charge Local Access Fees to their municipal utilities. The City of Calgary's Local Access Fee is based upon 10% of Drainage Utility Revenue while the City of Regina's is based upon 7.5% of Drainage Utility Revenue plus a lump-sum of $675,000. The charging of a Local Access Fee for drainage services could be considered reasonable given that it uses the City's underground rights-of-way, similar to that of water infrastructure (where the norm is for Local Access Fee to be applied).

Administration is not aware of municipalities who charge a Local Access Fee to a Waste Management Utility. Waste Management operations use the municipal roadway network and do not require dedicated municipal rights-of-way; nor does the regulated service apply to the entire community (non-residential waste contractors do not pay a Local Access Fee to the City for their businesses).

Regardless of Committee's decision, the use of Local Access Fees will need to be taken into account when comparisons are made between municipalities on both utility rates and property taxes.

Considerations

- If the Committee directs that a Local Access Fee be charged at the current 8% for the Sanitary Drainage Utility, there would be no impact to the current customer rate. An increase in the fee will result in increased customer rate while a decrease in the fee will result in lower customer rate.
- If the Committee directs that a Local Access Fee be charged to the Land Drainage Utility, it would result in increased customer rates. Charging of a Local Access Fee for storm drainage varies from municipality to municipality.
- If the Committee directs that a Local Access Fee be charged to the Waste Management Utility, it would result in increased customer rates. Administration is not aware of any municipality that charges a Local Access Fee to municipally operated waste management operations.

2. Dividends

Administration has traced back to records available from 1978 and noted that various subsidiaries of the City of Edmonton (Edmonton Power, Edmonton Telephones, Edmonton Water, and Sanitary Sewer System) have historically paid a "Return on Equity Investment" to the City. The dividend amount has been budgeted based upon 30%-60% of budgeted net income from operations.

Corporate memory indicates that the City has historically viewed these activities as business operations, and as the "shareholder/owner", a return on the investment is expected. When a utility is newly established, the amount of dividend may initially be at a lower rate, with the expectation of increasing to 60% over time.

Having said that, the Sanitary Drainage Utility currently pays a 30% dividend. The Land Drainage Utility, established in 2003, is currently exempt from paying a dividend until 2014, when a review is to be conducted to determine its financial capacity to pay a dividend. The Waste Management Utility, being a newly created utility in 2009, is currently exempt pending Council's decisions on the fiscal policies.

The decisions regarding dividend payments are policy-based, as determined by City Council. *The effect of paying a dividend from the utilities operations is that customer utility rate is higher than if a dividend were not required; and that property tax levy is lower than would otherwise be required for the delivery of other municipal purposes*.

In reviewing the decision regarding dividends, the following points may be useful to consider:

- If the Utilities were owned and operated privately, there would be an expectation of dividends from the shareholders or investors.
- While dividends are not considered an expense of the utility from a technical perspective; the effects are that if a dividend were to be paid, the return to the utility (and therefore utility rates) must be higher than if a dividend were not required such that there is sufficient net income and cash to make the payment.
- The basis upon which property tax and utility fees are collected are different
  - Property taxation is a tax on wealth as determined by the assessed value of the property.
  - Where properties are exempt from taxation, the occupants of the property will still pay for utility services, particularly Drainage Services (commercial solid waste is not a regulated activity and is not necessarily provided by the City). Where a dividend is paid to the City for general municipal purposes the user fees collected contribute towards the dividend payment.
  - The customer rates for Drainage Services are based upon a fixed and a variable component, thereby tying the use of the service to the cost paid by the customers.
  - In contrast, Waste Management Utility rate is currently charged by a fixed monthly fee. Therefore, an increase in utility rate to pay a dividend to the City will have the following implications:
    - The financial impact will be the same for all waste customers, which are primarily residential customers while the benefit of the dividend is provided to both residential and non-residential property owners.
    - If an amount equivalent to the dividend were to be generated through property tax, property owners of a lower assessed property would pay a lower amount.
  - Council has requested a Cost of Service Study to be completed for all three utilities, and the process is currently underway, with the results expected for the June meeting.
- Financial impacts to the utility
  - Where a utility's financial position is such that there is already a high debt equity ratio, the payment of a dividend will have a negative impact on its cash balance, thereby further increasing the reliance on debt to finance capital investments and increasing pressure on the utility rate.
  - Where a utility is in an expansion phase, whether it is in capital investment or for the purpose of starting another line of activities, the non-availability of cash will increase the rate requirement.
  - When the Unappropriated Retained Earnings is supported by a positive cash balance and the debt structure is within set targets, a dividend payment will

not negatively impact the utility rate. However, this provides an opportunity to lower the rate increase if the dividend amount were used to pay for capital investment.

- Where a utility operation derives a large part of its revenue from non-regulated activities, it may be meaningful to link the payment of dividends to the net income from non-regulated activities. While this approach will still result in increased customer rates (when compared to using such revenue to offset rate revenue requirement), it may be argued that non-regulated activities should not be used to subsidize utility rates. Under this approach, it must be noted that if there were a net loss from such non-regulated activities, the loss should also not be borne by the rate customers.
- Different municipalities have chosen different approaches to the payment of dividends.

Considerations

- If the Committee directs that the existing 30% from the Sanitary Drainage Utility's net income continues to be paid to the City in the form of a dividend, there would be no direct impact to the existing customer rates. The longer term forecast of this Utility indicates that the debt to rate base ratio and the cash position are deteriorating; thus, ultimately, increases to rates will likely be required to support the dividend payment.
- If the Committee directs that a dividend be paid to the City from Land Drainage Utility's net income, it would result in increased customer rates.
- If the Committee directs that a dividend be paid to the City from Waste Management Utility's net income, it would result in increased customer rates.

3. Grant Eligibility

Over the years, other order of governments have traditionally provided capital grant funding for projects associated with transportation and utilities infrastructure. Grants that would have been eligible for wastewater and solid waste management included:

- Federal Infrastructure Program (FIP),
- Infrastructure Canada/Alberta Grants (ICAP),
- Alberta Municipal Infrastructure Program (AMIP),
- Canada-Alberta Municipal Rural Infrastructure Fund (CAMRIF),
- Federal Gas Tax Fund (formerly New Deals for Cities and Communities),
- Building Canada Fund (BCF), and
- Infrastructure Stimulus Fund (ISF).

In 2008, City Council approved financial principles for the 10-Year Capital Investment Agenda that included "funding utilities [capital] by utility rates". As existing projects with grant funding are completed, grant funding is no longer to be made available as a funding source.

In 2006 and prior, the Federal Infrastructure Program was accessed and grant funding was provided for capital investments in the Gold Bar Wastewater Treatment

Plant. Since that time, the grant is no longer available and with the transfer of the treatment plant, this information has been excluded from the details below.

An internal decision was made that all Drainage infrastructure grants were applied to the Land Drainage Utility as it was newly established in 2003, and compared to the Sanitary Drainage Utility, did not have the same financial capacity to carry out the needed capital investments. The following is a summary of the projects funded by grants prior to Council's approval of the financial principles in 2008.

Repairs made under the Alberta Disaster Relief Fund have also been excluded from the information below since this source of financing will remain available in the event of a disaster.

Grant Funding Applied to Land Drainage Utility Capital Projects

	Infrastructure Canada/Alberta Program (ICAP)	Alberta Municipal Infrastructure Program (AMIP)	Canada-Alberta Municipal Rural Infrastructure Fund (CAMRIF)	Infrastructure Stimulus Fund (ISF)	Total Grant Funding Applied
2003					
Storm Management Facilities	2,246,172				2,246,172
					2,246,172
2004					
Storm Management Facilities	718,976				718,976
					718,976
2005					
Storm Management Facilities	61,647				61,647
					61,647
2006					
Drainage Neighbourhood Renewal Program		3,823,414			3,823,414
Flood Prevention		849,488			849,488
					4,672,902
2007					
Drainage Neighbourhood Renewal Program		5,229,767			5,229,767
Flood Prevention		5,338,941			5,338,941
					10,568,708
2008					
Drainage Neighbourhood Renewal Program		9,653,688			9,653,688
Flood Prevention		11,835,777			11,835,777
Wetlands			2,855,105		2,855,105
					24,344,570
2009					
Drainage Neighbourhood Renewal Program		16,293,131			16,293,131
Flood Prevention		2,540,930			2,540,930
Wetlands			2,908,618		2,908,618
					21,742,679
2010 Budget					
Flood Prevention		9,434,864			9,434,864
Wetlands			222,000		222,000
Rehabilitation				1,000,000	1,000,000
					10,656,864
2011 Budget					
Wetlands			14,277		14,277
Rehabilitation				700,000	700,000
					714,277

- The Infrastructure Canada/Alberta Program (ICAP) has been fully subscribed and is no longer available to municipalities. This was replaced by the Municipal Infrastructure Program (AMIP) and the Municipal Rural Infrastructure Fund (CAMRIF).
- The Infrastructure Stimulus Fund (ISF) has since replaced the CAMRIF program.
- The ISF was made available to Drainage Services in late 2010 as a result of the need to meet grant eligibility for projects to be completed by March 2011. Going forward, based upon current Council directions, Drainage Services will not have further access to grant funding for capital requirements. This means that the capital investments will have to be fully funded by customer rates (whether it is through debt or cash financed through retained earnings).

Infrastructure capital grant funding is made available to municipalities by other orders of government typically on a formula basis such as an amount per capita per year. Other capital funding is provided on a project application basis. Programs often emphasize road and utility infrastructure in response to Canada's infrastructure deficit in its roadways, water, and wastewater systems. When funds are awarded on a formula basis municipal Councils are given the latitude to decide which projects to apply the grant funding towards, subject to an application process to the granting authority.

For illustration purposes, assume that for a 5-year period, instead of financing $7 million of annual infrastructure needs through grants, the utility replaces the financing source by taking out 5 consecutive debentures of $7 million each (25 year term). Using a constant rate of 4.6% (which is likely to increase in the future with the recovery of the economy), the cumulative impact of borrowing $35 million is an increase in debt servicing expense of $1.2 million annually by the end of the fifth year. This expense will continue until the retirement of the debentures. Using the current customer base, an additional increase of approximately 2% would be required ***each*** year to replace the lost financing source if the existing capital program cannot be reduced.

Having all eligible utility projects funded by grants is also not the best solution. In determining how available grant funding can be optimized, it is necessary to look at the whole of the City's capital needs. Therefore, the decision regarding whether or not Drainage or Waste Management Utilities should have access to grant funding should be based upon the capital requirements of the City as a whole, including both utilities and transportation needs. This is best carried out at the time of the 3-Year Capital Budget process.

Considerations

- That the Committee provides direction with respect to the use of grant funding for eligible utility capital projects.

4. City Council's Initiatives

Environmental, Occupational Health and Safety, and other legislation sets out various standards that govern the operations of the Utilities. In addition to meeting these legislated requirements, the City's Utilities also operate under Council approved Policies and Master Plans e.g. *The Ways*, with requirements that may exceed the legislated standards. A question was raised at City Council's deliberation on the 2011 Utility Budgets as to whether the incremental costs for such aspirations should be borne by the customers through rates, or by the general property tax levy.

The Alberta Utilities Commission allows "… a utility to recover its reasonable cost of providing the service, including a fair return on its investment, so that it will be financially viable and able to provide customers with adequate service now and into the future".

Privately owned and operated entities are increasingly addressing social responsibilities in the manner with which they carry out their business. These decisions are made by their Shareholders through the Board of Directors.

In a public utility, City Council acts as both governors and regulators of the utility operations. In its role as elected officials, Council constantly balances the competing needs of its constituents and that of the public good. In setting the Corporate Outcomes through the Sector Plans, Council has articulated their vision for the Utilities with respect to the desire to minimize the City's impacts on the environment, increase accessibility to all residents, protect public health, and to provide for proper maintenance of infrastructure. Where such decisions directly relate to the Utilities and the cost of implementation is reasonable, it can appropriately be applied to utility customer rates. Where the costs are such that they are not directly related to the business of the City's Utilities, or where the upfront cost is significant, funding from Tax Levy may be appropriate.

Considerations

- That the Committee provides direction with respect to the funding of Council's initiatives as they relate to the utilities.

5. Full Cost Allocation

The City of Edmonton has historically treated Utilities as self-sustaining operations, with no funding from Tax Levy. Shared Services and Central Management Charges have been allocated to these operations to represent the cost of centralized services provided to these operations.

Prior to 2009, the Waste Management Utility was not charged for Shared Services or Central Management as it was not operated as a full utility. Upon becoming a utility, an estimate was used in 2009 and 2010 for Shared Services and Central Management Charges. Drainage Services have paid for these costs historically.

Over the past 2 years, Administration has undertaken an internal review on the methodology used to move to full cost accounting. The premise for distributing Shared Services Costs and Central Management Charges is based upon using common principles in the calculation of the various charges across all operations. These charges are actually allocated to the Waste Management Utility, Drainage Services Utilities, Fleet Services, and Current Planning. For other Tax Levy Departments, the costs are provided as information.

Allocation Methodology

In arriving at a consistent allocation methodology used in the approved 2011 Utility Budgets, Administration applied the following principles:

a. The level of cost allocation accuracy is balanced against the cost of generating the information.

b. For simplicity, there will be no reciprocal charges between Shared Services providers (e.g. Finance and Treasury will not charge Corporate Services) where it cannot be demonstrated as being value-added to decision making.
c. The allocation method will be applied in the following order where possible:
    i. Where costs are directly traceable to a program, direct costing is used.
    ii. Where costs are pooled (indirect charges), a demonstrable cost driver that is tied to volume of services provided will be used.
    iii. Where services are centralized and clients cannot realistically impact the volume of work required from the service providers, a rational basis of allocation will be used.
d. Shared Services providers include: Communications, Transformation Services, Finance and Treasury, Information Technology, Human Resources, Corporate Information System, Legal Services, Materials Management, and Corporate Properties.
e. Central Management Charges represent the cost of governance for the City of Edmonton and includes Mayor and Council, Office of the City Manager, Office of the Deputy City Manager (excluding Communications and Transformation Services), and the Office of the City Auditor.

In moving forward with full cost accounting for the Utilities, Administration considered the following:

- The utility rate should reflect the full cost of service provision, including current operating and long term capital requirements of the utility. There should be no cross-subsidization between Tax Levy and Utility operations.
- In private utilities and the majority of public utilities, Shared Services costs (administrative costs) are commonly part of the cost of delivering services and included in the rate setting process.
- In a private utility, governance is provided by a Board of Directors, which may be akin to the City's Central Management Charges. The "cost" of governance may be lower in the private sector because for municipalities, there is a different expectation relating to "public good" discussion, transparency requirements for procurement, etc. The additional cost may be partially or fully offset by the lower cost of debt and/or the ability to receive contributed assets for the utility.
- Administration conducted a survey in 2010 regarding utility customer care, related services, and costing. Only 4 of the 8 municipalities surveyed responded. Based on the information collected, 50% of the municipalities allocate similar costs to the utilities. The other 50% provides only a partial allocation of specific costs.
- Administration provided the following comparison in response to Council's Budget question 11-109 "*Please provide what % of Epcor's Budget is allocated to Equivalent "Services" and compare to the City of Edmonton's calculations for shared services.",* demonstrating the reasonableness of resulting allocations. Full implementation refers to the systematic adjustment over a 2-3 year period to smooth out the impacts to customer rates.

Shared Services and Corporate Allocation as a % of Expenses

	Budget Page #	Included in Budget	Total Expenditure	%	Full Implementation	%
Waste Management	55	5,550	145,033	3.8%	7,400	5.1%
Drainage Services						
Sanitary Drainage	119	6,049	68,570	8.8%	5,417	7.9%
Land Drainage	154	1,828	21,429	8.5%	1,637	7.6%
Design & Construction	172	3,430	142,637	2.4%	4,253	3.0%
		11,307	232,636	4.9%	11,307	4.9%
EPCOR		5,343	61,278	8.7%	5,343	8.7%

- Council's Utility Advisor also reviewed the breakdown and application of the Shared Services/Central Management calculation. The Advisor provided the following comment in his report:

  > "In the UA's experience, this approach is quite detailed and sophisticated. The approach to allocating these costs seems quite reasonable." (page 184 in the 2011 Utility Budget)

  The Advisor's concern remained with the process for the methodology change without prior explicit approval of City Council.
- If a business case is made for seeking an external supplier for a service that is currently provided internally through the shared service model that would be considered as an option.
- Further directions may be needed if changes to the current approach are to be considered.

Considerations

- That the Committee provides direction regarding the continued transition of full cost allocation to the utilities.

6. Non-Regulated Activities

Non-regulated activities relates to business transactions that are not essential to the provision of the Utility's core services.

The purpose of segregating regulated from non-regulated services is to ensure that the utility rate only supports regulated services. In general, non-regulated services should be cost recovery such that there would be no subsidization by customer utility rates.

For Drainage Services, the collection and transmission of sanitary and storm water to the treatment plant and/or to outfalls are regulated services. Non-regulated activities such as lot grading and service connections represent less than 4% of total revenues. Design and Construction is a non-regulated activity that carries significant volume of work and potential business risks. This activity is being financially segregated from the utility.

For Waste Management, regulated services include the collection, processing, and disposal of residential wastes. In addition, processing and disposal of non-residential waste has historically been provided by the City at fees approved by City Council. Other privately owned and operated complementary activities such as processing of electronic and electrical waste and production of biofuels from solid waste are non-regulated services accessed by the Waste Management Utility. The Utility has started a new service to provide collection services to the commercial sector at large. While the primary purpose of this activity is to influence the diversion of specific commercial waste material away from the landfill, there is also future expectation of net revenue to the utility. Currently, these non-regulated activities form part of the utility rate calculation, providing an offset to the monthly residential utility rate requirement.

Considerations

- That the Committee provides direction regarding the treatment of revenues/losses generated from non-regulated activities of the utilities.