

# EPCOR Water Services Inc. 2022-2026 Rates Application - Fire Hydrant Service Costs

## Recommendation

That the February 5, 2021, Financial and Corporate Services report FCS00307, be received for information.

## Executive Summary

Public fire protection services are provided by EPCOR Water Services Inc. to the City of Edmonton through the fire hydrant service agreement. The annual costs included in the agreement for the period April 1, 2017 to March 31, 2022 range from \$10.8 million for 2017 to \$12.4 million for 2021. The cost of these services are currently included in the operating budget of Fire Rescue Services and funded by the City of Edmonton through the property tax levy. City Council previously reviewed the options for funding public fire protection costs as part of its approval of EPCOR Water Services Inc.'s performance based rates application for the five year period April 1, 2012 to March 31, 2017. At that time, Council concluded that fire protection services should continue to be funded through the property tax levy as a municipal service.

This report provides Administration's justification for public fire protection costs to be funded through water utility rates rather than the property tax levy effective April 1, 2022, as part of EPCOR Water Services Inc.'s performance based rates application to set customer rates for the five year period April 1, 2022 to March 31, 2027. This funding approach is guided by City Policy C624, Fiscal Policy for Revenue Generation, which provides a governing framework for allocating service and infrastructure costs. It is also supported by the American Water Works Association Principles of Water Rates, Fees, and Charges, and a comparative analysis of the funding approaches used by other Canadian municipalities.

Depending on the feedback provided by Utility Committee on February 5, 2021, EPCOR Water Services Inc. would amend the performance based rates application to include the recovery of public fire protection services in water utility rates for April 1, 2022 to March 31, 2027. EPCOR Water Services Inc. is expected to be revenue neutral over time based on either option for funding the public fire protection services. Should the funding approach through water utility rates not be accepted, the current model for funding public fire protection services would continue with the costs being included in the operating budget of Fire Rescue Services and funded by the City of Edmonton through the property tax levy.

## Report

### Background

EPCOR Water Services Inc. (“EWSI”) owns and operates water, wastewater treatment and drainage services utilities. Through its water services utility, EWSI provides potable water to residents of the City of Edmonton (“in-city customers”) and regional customers in communities surrounding Edmonton, as well as fire protection services to the City of Edmonton’s Fire Rescue Services department (“public fire protection”) and other commercial customers (“private fire protection”).

Edmontonians and Fire Rescue Services depend upon the proper operation of fire hydrants across the city and availability of water supply and infrastructure for firefighting purposes on demand. The public fire protection services provided by EWSI include standby services (e.g., fire storage volumes in reservoirs), hydrant inspections, infrastructure maintenance, hydrant flushing, and other fire hydrant services. Fire hydrants and the associated waterworks infrastructure are owned by EPCOR. The infrastructure supports a readiness-to-service capacity for public fire protection water services.

The same water services infrastructure is used in part to provide both potable water and fire protection services. Accordingly, the methodology used by EWSI in its performance based rates applications to set customer rates first calculates the total forecast cost of providing water services for both potable water and fire protection. The costs are allocated between in-city customers (approximately 81 percent for 2020), regional customers (approximately 13 percent for 2020) and fire protection services (approximately six percent for 2020). The cost of providing service to in-city customers is recovered by EWSI through utility customer rates (as prescribed by EPCOR Water Services and Wastewater Treatment Bylaw 17698 for April 1, 2017 to March 31, 2022), with the cost for regional customers being recovered by EWSI through bulk sales agreements with water services commissions and communities surrounding Edmonton.

The cost of providing public fire protection services is recovered annually by EWSI through a fixed charge under a five year fire hydrant service agreement with the City of Edmonton. In accordance with the terms of the fire hydrant service agreement, the annual costs include the operation and maintenance of fire hydrants, as well as the depreciation, debt interest and cost of equity financing of the direct and common waterworks infrastructure owned by EWSI and used to provide public fire protection water services. The annual costs included in the fire hydrant service agreement for the period April 1, 2017 to March 31, 2022 range from \$10.8 million for 2017 to \$12.4 million for 2021.

### **Funding Options Previously Considered for Fire Protection Services**

As part of City Council's review and approval of EWSI's performance based rates application for the five year period April 1, 2012 to March 31, 2017, Administration presented the rationale and implications of shifting the cost of public fire protection water service fees and infrastructure from municipal property taxes to water rates (Financial Services report 2011CF5667). Historically, the fee charged by EWSI for fire protection services has been included as part of the City's municipal property taxes. Municipal property taxes are determined based on property value. This method assumes public fire protection water services provide safety and are for the public good, similar to other municipal services provided by the City of Edmonton.

However, given that a waterworks system provides both basic water service and a readiness-to-serve infrastructure capacity for fire protection that is available on demand, the costs associated with providing standby water services and infrastructure may be more appropriately charged to water customers through water rates. Incorporating public fire protection costs within water utility rates would result in a more appropriate allocation of costs, including the recovery of these costs from entities that currently rely on the fire protection services but are exempt from municipal taxes. Residential owners would also be allocated a more appropriate portion of the overall costs through utility water rates. In 2012 it was estimated that residential water customers accounted for 72 percent of the total cost of annual public fire protection water services and infrastructure but only represented 45 percent (single family residential property owners) of the total fee collected by the City through municipal property taxes.

After considering the merits and implications of each option during the September 14, 2011 meeting, City Council approved public fire protection costs to continue to be included in the fire hydrant service agreement and funded through municipal property taxes.

### **Further Considerations for Funding Fire Protection Services**

Best practices for the management, operations, accounting and regulation of municipally owned utilities throughout North America, including the City of Edmonton, have evolved over the past number of years.

- The American Water Works Association Principles of Water Rates, Fees, and Charges (Seventh Edition Updated in 2017) provides guidance on the regulatory approach for funding fire protection costs. The manual states that while the traditional approach to charge fire protection costs to a municipal government where it is recovered through the property taxes is still a common and generally accepted practice, limitations on property taxes (e.g. tax exempt properties) have caused municipalities to seek different cost recovery methods

that do not burden the general fund. An alternative and contemporary approach develops fire protection costs that can be passed on directly to customers through charges based on the respective demands for fire flow by user class or to individual retail customers. The traditional fire hydrant charge approach is still presented in the manual because it may reflect local policy preferences, may be required by state law, or it could be the preferred method stipulated by a state regulatory commission.

- The City of Edmonton has also continued to refine its accounting policies and practices, including those applicable to municipally owned utilities. On November 2, 2020, City Council approved Policy C624 Fiscal Policy for Revenue Generation, as in the October 16, 2020, Financial and Corporate Services report CR\_8018. The Fiscal Policy provides a principle based governing framework for allocating service and infrastructure costs throughout the community, and to guide fiscal decisions on the fundamental question of who pays for what, in what amount, and why.

The Fiscal Policy provides specific guidance for the recovery of costs for utility services, with the third policy statement stating “where a regulated utility service is provided, revenues are raised from customers and other non-tax sources to recover the whole cost of the service.” As discussed in report CR\_8018, for many services and infrastructure assets, allocating costs entirely to the overall tax levy is appropriate, particularly if the service provides broad benefits to the community at large. However, the City also provides services and infrastructure that give direct or greater benefit to certain parties. Especially during times of financial stress, it is important to ensure that allocation of public costs is equitable and reasonable to reduce strain on the property tax levy.

- The Canadian Tax Foundation, in its 2016 publication *User Fees in Canada: A Municipal Design and Implementation Guide* noted that municipalities that are home to federal or provincial governments are considering moving charges for goods and services provided by the municipality (such as water services charges) from property taxes to users fees. This is being considered as some governments have reduced their payments of grants in lieu of taxes to municipalities. This effectively reduces payments for municipal public services relied upon by these orders of government.
- Effective September 1, 2017, drainage services were transferred from the City of Edmonton to EWSI. The transfer was completed in part to consolidate the four major components of the water system (wastewater and stormwater collection, water treatment, wastewater treatment, and water distribution) to achieve capital and operational efficiencies and to qualify for new drainage-related business development opportunities.

During deliberations on September 14, 2011, members of City Council noted that the recovery of fire protection costs is a difficult issue since it is a blend of public versus private benefit. Council should not address this one issue in isolation, but with a larger view on how to fairly address and recover costs for other similar services. In light of the governing framework provided by the City Policy C624 Fiscal Policy for Revenue Generation and the additional guidance provided by the American Water Works Association Principles of Water Rates, Fees, and Charges, Administration is in support of public fire protection costs being funded through water utility rates rather than municipal property taxes. This change in funding methodology would be incorporated into EWSI's water services performance based rates application to set customer rates for the five year period April 1, 2022 to March 31, 2027.

Administration considers this change in funding approach to water utility rates will result in fairer allocation of public fire protection costs in proportion to the benefits received from the services, for both residential water customers and tax exempt properties. The Province of Alberta provides grants in lieu of tax to compensate the City of Edmonton for provincially owned tax exempt properties (that receive fire protection and other municipal services). Of note in the 2019 Provincial budget, grants in lieu of taxes were reduced by 50 percent over 2019 and 2020, an \$11 million decrease in grants for the City.

Edmonton Fire Rescue Services reached out to the fire chiefs of a number of other major cities in Canada for a comparative analysis of how their respective cities manage expenditures for fire hydrant maintenance, repairs and infrastructure investment. Based on the cities that participated in the jurisdictional review, fire hydrant maintenance, repairs and infrastructure investment expenditures tend not to be allocated within the budgets of other major metropolitan Canadian fire departments. Ottawa, Winnipeg, Calgary and Vancouver all fund public fire protection services through water user paid rates. Edmonton Fire Rescue Services did not receive any responses from other municipalities indicating they fund public fire protection services through the property tax levy.

### **Next Steps**

EWSI will be submitting its performance based rates application to set customer rates for water services effective April 1, 2022 with the City of Edmonton in mid-February 2021. The rates application will reflect public fire protection services being included in the fire hydrant service agreement and funded through property taxes.

Depending on the feedback provided by Utility Committee on February 5, 2021, EWSI would amend the rates application to include the recovery of public fire protection services in water utility rates. EWSI is expected to be revenue neutral over time based on either option for funding the public fire protection services. If public fire protection

costs were to be recovered through water rates, these costs could either be included in the water consumption utility rates or treated as a separate fixed charge by customer class or by water meter size. Should the funding approach through water utility rates not be accepted, the current method for funding public fire protection services would continue with the costs being included in the operating budget of Fire Rescue Services and funded by the City of Edmonton through the property tax levy.

Administration and EWSI continue to work together to address outstanding matters related to the transfer of drainage services from the City of Edmonton to EWSI. Included in this are drainage expenditures paid for by the City as part of the Neighborhood Renewal Program, including manhole covers and catch basins, that are subsequently contributed to EWSI at no cost. In accordance with Policy C624 Fiscal Policy for Revenue Generation, it may be appropriate for these drainage expenditures to be paid for by EWSI and incorporated into utility rates as part of the April 1, 2022 to March 31, 2025 drainage services rates application. Administration will continue to work with EWSI to evaluate and quantify these expenditures and will provide an update at the next Utility Committee meeting.

### **Financial/Budget Implications**

The annual costs included in the fire hydrant service agreement for the period April 1, 2017 to March 31, 2022 range from \$10.8 million for 2017 to \$12.4 million for 2021. Approval of public fire protection costs to be funded through water utility rates effective April 1, 2022 would reduce the operating budget requirements for Fire Rescue Services and the resulting impact on the property tax levy. If the change in funding is approved by Council as part of EWSI's rates application to set water utility rates for the period April 1, 2022 to March 31, 2027, Administration will bring forward the corresponding amendments to the Fire Rescue Services operating budget as part of the 2022 supplemental operating budget adjustment.

### **Legal Implications**

Public utilities owned or operated by municipalities providing service within that municipality are generally regulated by their municipal councils, as they are exempt from Alberta Utilities Commission regulation pursuant to s. 78(2) of the *Public Utilities Act*, RSA 2000, H-16. Public utilities that are not owned or operated by municipalities that supply water, heat, light or power are regulated by the Alberta Utilities Commission. Public utilities that are owned or operated by a municipally controlled corporation and that provide a utility service within the boundaries of the municipality are exempt from regulation by the Alberta Utilities Commission pursuant to s. 75.4 of the *Municipal Government Act*.

EPCOR Water Services and Wastewater Treatment Revised Bylaw 17698 sets out a mechanism for setting and adjusting fees, rates and charges for water and wastewater

treatment services for the five year period April 1, 2017 to March 31, 2022. The fire hydrant service agreement between EWSI and the City of Edmonton sets out the fixed charge for public fire protection services provided by EWSI for the five year period April 1, 2017 to March 31, 2022. Therefore, a new EWSI water services bylaw is required to set fees, rates and charges effective April 1, 2022 with a new fire hydrant service agreement required to set public fire protection service costs effective April 1, 2022. Alternatively, if public fire protection services are funded through water utility rates effective April 1, 2022, the fire hydrant service fees would need to be incorporated into the new EWSI water services bylaw.

**Public Engagement**

A Utility Committee meeting will be held in June 2021 to review the EWSI performance based rates applications, including submissions from Administration and the public regarding the applications.

**Corporate Outcomes and Performance Management**

<b>Corporate Outcome(s): The City of Edmonton has a resilient financial position.</b>			
<b>Outcome(s)</b>	<b>Measure(s)</b>	<b>Result(s)</b>	<b>Target(s)</b>
The City of Edmonton has a resilient financial position.	Adjustments to the approved Operating Budget result in the same or lower approved tax rate increase.	TBD (2022)	1.6% (2022)

**Others Reviewing this Report**

- R. Smyth, Deputy City Manager, Citizen Services
- S. McCabe, Deputy City Manager, Urban Form and Corporate Strategic Development
- B. Andriachuk, City Solicitor