

Sewer Rate Application and Study

Town of Niverville

August, 2012

**Water and Sewer Utilities - Minimum Filing Requirements (MFR) for
Municipalities Filing Applications for Revised Rates with the Public Utilities Board
(Board)**

The Application shall include 3 paper copies and an electronic copy which can be forwarded by email.

Application and Financial:

- | | | |
|-----|--|-------------------------------------|
| 1. | Utility rates by-law, after first reading only, detailing rates, billing information, penalties, fees, etc. and rescinding past bylaw..... | <input checked="" type="checkbox"/> |
| 2. | Rate Study using Board Guidelines as applicable..... | <input checked="" type="checkbox"/> |
| 3. | Commentary on the reasons for the rate increase. <i>included in study</i> | <input checked="" type="checkbox"/> |
| 4. | Prior year's utility financial statements (audited, if available noting Schedule 9 prepared for the Board's purposes is unaudited), current year's utility budget (page 6*) ¹ , current year capital plan (page 13*), 5 year utility capital plan (page 14*), utility debenture schedules (page 12*) and operating forecast for the next 2 years..... | <input checked="" type="checkbox"/> |
| | *Pages from municipal Financial Plan template. | |
| 5. | Proposed method of financing 5 Year Capital Plan and details of any capital grant applications being considered or proposed or outstanding Municipal Board approvals..... <i>included in study</i> | <input checked="" type="checkbox"/> |
| 6. | Cost Allocation Policy with respect to shared services and equipment between the utility and general operations ² ... <i>included in study</i> | <input checked="" type="checkbox"/> |
| 7. | Management Representation Letter with respect allocated costs..... | <input checked="" type="checkbox"/> |
| 8. | Tangible Capital Asset (TCA) schedule for the utility..... | <input checked="" type="checkbox"/> |
| 9. | Any changes to the TCA with justification, noting all changes require the Board's approval ³ | <input type="checkbox"/> N/A |
| 10. | Details of other expenses capitalized and amortized with explanations... | <input type="checkbox"/> N/A |
| 11. | Statement on the need for contingency..... <i>included in study</i> | <input checked="" type="checkbox"/> |
| 12. | Statement on the need for reserves, if requested... <i>included in study</i> | <input checked="" type="checkbox"/> |
| 13. | Statement on adequacy of equity position and plans to address if insufficient (below the Board's 20% of prior year's operating expenses ⁴ target level)..... <i>included in study</i> | <input checked="" type="checkbox"/> |
| 14. | Summary of operating deficits in the last 5 years i.e. amount and approved method of recovery..... <i>included in study</i> | <input checked="" type="checkbox"/> |
| 15. | If accumulated deficit is being reported as a result of conversion to PSAB, a rate plan is to be submitted with respect to recovery of the deficit..... <i>included in study</i> | <input checked="" type="checkbox"/> |
| 16. | Details of any monies included in the rate proposal for continuing education of operators..... <i>included in study</i> | <input checked="" type="checkbox"/> |
| 17. | Details of any incentives or special rate treatment provided to large volume users with an explanation..... <i>included in study</i> | <input checked="" type="checkbox"/> |
| 18. | If rates are determined on a Residential Equivalent Unit basis, confirmation that the assessments have been reviewed and remain accurate. Comment on the potential use of meters. <i>included in study</i> | <input checked="" type="checkbox"/> |
| 19. | Details of connection charges and developer agreements related to the extension of service..... <i>included in study</i> | <input checked="" type="checkbox"/> |

**Water and Sewer Utilities - Minimum Filing Requirements (MFR) for
Municipalities Filing Applications for Revised Rates with the Public Utilities Board
(Board)**

Details of Operating System (s):

- 20. Description of the system(s) indicating age, condition and capacity to meet current and future needs of the ratepayers... *included in study*
- 21. Statement on compliance with drinking water standards including the most recent report form Water Stewardship and commentary on any recommendations therein..... *N/A*
- 22. Statement on compliance with Environmental License *N/A*
- 23. Statement as to whether there are any color and taste issues with respect to drinking water and plans to address, if any..... *N/A*
- 24. A description as to where discharges are made... *included in study*
- 25. File the Executive Summary and recommendations of the most recent engineering assessment and if not yet done, when it is expected to be done..... *N/A*
- 26. Details of operator certifications and whether they meet current requirements and if not, how is it to be addressed... *included in study*
- 27. Statement as to whether service is extended beyond the municipality or LID boundary and if so, details of any surcharges levied or proposed. *incl.*
- 28. Details of any plant being decommissioned and any resulting expenses set up as an environmental liability to be collected in rates. *incl. in study*
- 29. Commentary on unaccounted for water if the amount exceeds 10% and if related to a deteriorating system, provide a plan to address..... *N/A*
- 30. File a copy of the rules and regulations bylaw if existing.....

Other:

- 31. If a declining block rate is used, provide commentary on any consideration given to reducing or eliminating such blocks *incl. in study*
- 32. Commentary as to whether an increasing block rate has been considered *incl.*
- 33. Details of any notification of revised rates provided to customers and summary of response..... *none*
- 34. If utility rates are collected with taxes or on tax bills confirmation that utility operating costs are not being offset by the Education Property Tax Credit..... *included in study*
- 35. Report of disconnection for non-payment in the past years since the last rate study was filed..... *included in study*
- 36. If a Special Services Plan hearing is required, details of the hearing and if not held when it will be held..... *N/A*
- 37. Details of any advertising and/or promotions conducted related to water conservation and /or sewer discharges..... *N/A*

Notes:

- 1. All utility budgets prepared for the Board must be on a PSAB basis, modified in accordance with Board Order No. 93/09.
- 2. In the Board's Order No. 93/09, the Board referred to a suggested cost allocation matrix to be followed by municipalities noting that once a policy was developed any changes thereto required the Board's approval.
- 3. In the Board's Order No. 93/09, the Board adopted the TCA schedule for use by utilities with the understanding that any changes thereto will require the Board's approval.
- 4. Target equity position is determined as per Board Order 93/09

THE TOWN OF NIVERVILLE

BY-LAW NO. 711-12

BEING a By-law of the Town of Niverville to establish sewer rates within the limits of the said Town of Niverville;

WHEREAS the Town of Niverville owns and operates a sewer facility within the limits of the said Town of Niverville;

AND WHEREAS The Municipal Act, S.M. 1996, c. 58, provides in part:

“Section 232(1) A council may pass by-laws for municipal purposes respecting the following matters:

(l) public utilities;

Section 232(2) Without limiting the generality of subsection (1), a council may in a by-law passed under this Division

(d) establish fees or other charges for services, activities or things provided or done by the municipality or for the use of property under the ownership, direction, management or control of the municipality;”

NOW THEREFORE be it and it is hereby passed and enacted as a by-law of the Town of Niverville, in council duly assembled as follows:

- (1) THAT By-Law No. 335-89 enacted by the Town of Niverville on the 6th day of June, A.D., 1989 is hereby repealed.
- (2) THAT all accounts for sewer services as set forth in the schedule of quarterly rates shall be billed quarterly for sewer services for the preceding quarter. Consumers shall pay for sewer service supplied to them by the Town of Niverville at the rates and terms set out in Schedule “A” attached hereto and forming part of this By-law.
- (3) THAT this By-Law shall come into force and become effective on January 1st, 2013 from and after both approval of the Public Utilities Board and receipt of third and final reading thereof.

PASSED AND ENACTED by the Town of Niverville, in council duly assembled this day of , A.D., 2012.

Mayor

Chief Administrative Officer

SCHEDULE "A"
TOWN OF NIVERVILLE
BY-LAW NO. 711-12

SEWER RATES FOR THE TOWN OF NIVERVILLE

Effective January 1st, 2013 or upon approval by Public Utilities Board

1. Assignment of Residential Equivalent units (REU)

A residential equivalent Unit (REU) is the volume of sewage estimated to be emitted by an average single family residence. Units allocated to other customers are based on the estimated sewage they will emit compared to a residence. A residential unit is defined as a single family dwelling which includes the following: mobile home, single commercial business which includes offices, groceries, hardware, banks, credit unions, and garages without wash bays, halls with seating capacity of less than 230 seats, churches and drop-in centres. Apartments will be rated at one equivalent unit for each suite. Buildings with more than one sewer hook-up will be allocated a minimum of 1 unit per hook-up, additional units may be assigned dependant on the type of occupancy.

Description	REU for Sewer Connection/Annual Service Charge	REU for Operations & Maintenance
Residential Unit	1.0	1.0
Duplexes/Multi-plexes		
1 shared Sewer connection	.5 per unit	1 unit per residence
separate sewer connections	1.0	1 unit per residence
Apartment Blocks	1 Unit per hook-up	1 unit per suite
Apartment Blocks Converted to Condominiums	# sewer connections divided by number of units	1 unit per suite
Personal Care Homes		
Single units	1 Unit per hook-up	0.5
Double units		1.0
Office Type Business Buildings/Strip Malls	1 Unit per hook-up	1 unit per suite
Cafes, Bistros or Restaurants	1 Unit per hook-up	1 unit per 20 seats or fraction thereof
Halls/Banquet Facilities	1 Unit per hook-up	1 unit per 230 seats or fraction thereof
Car Wash	1 Unit per hook-up	1.5 units per wash bay
Elementary School	1 Unit per hook-up	.9 units per classroom
Secondary School	1 Unit per hook-up	1.2 units per classroom
Low Pressure System Customers		

2. Quarterly Charges:

Notwithstanding the REU schedule set forth in Section 1 above, all customers connected to or tipping to shall pay the applicable charge set out below:

<u>Year</u>	<u>Operations & Maintenance</u>	<u>Service Charge</u>	<u>Total Quarterly Billing</u>
2013	\$ 59.80	\$ 3.80	\$ 63.60
2014	\$ 60.95	\$ 3.90	\$ 64.85
2015	\$ 62.20	\$ 4.05	\$ 66.25

3. Surcharges for Services Beyond the Town Boundaries:

There are no customers served who are located outside the Town boundaries.

4. Billings and Penalties for Non-payment of Account:

All connected customers shall be billed quarterly and payment shall be due and payable within 21 days after the mailing of the bills. A late payment charge of 1.25% (1¼%) per month shall be charged on the dollar amount owing after the billing due date and a notice to this effect shall be clearly printed on the bills sent to the customers.

5. Disconnection of Service:

The Public Utilities Board has approved the Conditions Precedent to be followed by the municipality with respect to the disconnection of service for non-payment including, such matters, as notice and the right to appeal such action to the Public Utilities Board. A copy of the Conditions Precedent is available for inspection at the Municipality's office.

6. Reconnection of Service:

Any service disconnected, whether due to non-payment of account or for any other reason(s) mutually agreed to by the customer and the Town (i.e., repairs necessitated by negligence of the customer, changes in tenant, vacancy for an extended period of time, etc.) shall not be reconnected until all costs of disconnection and reconnection have been paid. Actual costs may vary depending upon the circumstances.

7. Liability for Charges:

Where charges and penalties pursuant to this by-law are not paid within sixty (60) days from the date when they were incurred said charges and penalties shall be added to the taxes on the property and collected in the same manner as other taxes as per authority of Section 252(2) of The Municipal Act of Manitoba.

Projected for the rate year(s)	with comparative numbers for current and past year				
			Inflation Rate:	3 %	
	Prior year	Current year	Budget forecasts		
	Actual	Projected	Next year	Next year+1	Next year+2
General					
<i>Expenses:</i>					
Administration (building, office, staff, etc.)	17,624.00	20,500.00	20,910.00	21,537.30	22,183.42
Billing and collection					
Total general expenses	17,624.00	20,500.00	20,910.00	21,537.30	22,183.42
Equity surcharge (1% of annual expenses)			4,433.10	4,508.62	4,585.32
Deficit Recovery for the year _____					
<i>Revenue:</i>					
Surcharges					
Service charges					
Other	6,063.00	700.00	714.00	715.00	715.00
Penalties					
Total general revenue	6,063.00	700.00	714.00	715.00	715.00
Net revenue general	11,561.00	19,800.00	24,629.10	25,331.12	26,053.73
Water					
<i>Expenses:</i>					
Staffing					
Purification and treatment					
Water purchases					
Service of Supply					
Transmission and Distribution					
Other Water Supply Costs					
Connections - Net Loss					
Amortization/ depreciation					
Interest on long term debt					
Reserves					
Minor capital upgrades					
Contingency					
Sub-total- water expenses	-	-	-	-	-
<i>Revenue:</i>					
Connection Revenue					
Hydrant rentals					
Investment income					
Amortization of capital grants					
Taxation revenues (1)					
Other revenue					
Total non-rate revenue - water	-	-	-	-	-
Net rate revenue - water	-	-	-	-	-
Sewer					
<i>Expenses:</i>					
Staffing					
Sewage Collection System	66,336.00	62,940.00	64,830.00	66,774.90	68,778.15
Sewage Lift Station					
Sewage Treatment and Disposal					
Other Sewage Collection & Disposal Costs					
Connection - Net Loss					
Amortization/ depreciation	77,720.00	77,720.00	216,228.00	216,228.00	216,228.00
Interest on long term debt	526.00				
Reserves					
Future Remediation			25,000.00	25,000.00	25,000.00
Capital upgrades - lagoon work			96,342.00	96,342.00	96,342.00
Contingency			20,000.00	25,000.00	30,000.00
Total sewer expenses	144,582.00	140,660.00	422,400.00	429,344.90	436,348.15
<i>Revenue</i>					
Connection Revenue					
Lagoon Tipping Fees					
Investment Income					
Amortization of capital grants	18,165.00	18,165.00	20,847.00	20,847.00	20,847.00
Taxation revenues (2)	6,995.00		41,700.00	41,700.00	41,700.00
Other Revenue					
Total non-rate revenue- sewer	25,160.00	18,165.00	62,547.00	62,547.00	62,547.00
Net rate revenue - sewer	119,422.00	122,495.00	359,853.00	366,797.90	373,801.15
(1) Water facility- debt servicing taxation revenues					
Principal					
Interest					
Total	-	-	-	-	-
(2) Sewer facility- debt servicing taxation revenues					
Principal	6,469.00		46,342.00	48,659.00	51,092.00
Interest	526.00		50,000.00	47,883.00	45,250.00

Town of Niverville
Sewer Utility Rate Study
2012

Prepared by: G. Barron, FCGA

Town of Niverville – Sewer Utility

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1.0 Introduction

The Town of Niverville (Town) provides water and sewer services via three (3) utilities operated and accounted for separately; two (2) utilities provide water services and one (1) provides only sewer service.

The central older part of Town is provided sewer service only as these customers are on private wells. The two (2) subdivisions known as Fifth Avenue Estates and Highlands (formerly known as Crow Wing) are provided both water and sewer services.

This rate study covers the Sewer Utility only. The Sewer Utility commenced service in the 1970's and serves currently approximately 1328 customers. All customers of the Sewer Utility pay an annual flat sewer rate using Residential Equivalent Units (REUs).

Customers located in the new developments are billed for water on a metered basis, but those readings are not used for billing sewer.

The Town plans to continue billing on a flat rate basis until consolidation of all utilities is considered. However, the Town is planning to move to quarterly billing

for all customers - both water and sewer customers and sewer only customers.

The sewer rates were last reviewed in 1989 (By-law No. 335-89 approved by the Public Utilities Board (PUB) in Order No. 105/89 dated May 25, 1989). A residential customer is charged \$61.60 annually including an \$11.60 annual service charge and a per REU charge of \$50.00.

Since rates were last reviewed there has been a major change in accounting rules requiring all municipalities to record amortization expense (depreciation) for the first time. Excluding amortization expense, the Sewer Utility has been able to operate with reasonable surpluses as noted below:

2008	\$18,470 (audited)
2009	\$12,708 (audited)
2010	\$ 2,085 (unaudited)
2011	\$ (269) (unaudited)
2012	\$ 0 (Budget)

However, clearly the surpluses have been declining to the point where issues of self-sustainability may arise.

Since the accounting rule changes in 2008, the Sewer Utility has been recording operating losses with the inclusion of approximately \$77,000 of new amortization expense per year rising to \$216,228 (estimated) in 2013 after the inclusion of amortization expense for the lagoon

(not included previously) and the planned lagoon bank stabilization work.

In 2009, the Town transferred \$60,738 from surplus to offset partially the amortization expense resulting in a net shortfall of \$6,036. In 2010, no transfer was made and the net shortfall was \$125,059 (unaudited). These results exclude the amortization expense related to the planned lagoon work.

It is clear that one of the fastest growing communities in Manitoba has been able to cover rising operating costs, since the rates last changed in 1989, by the accelerated growth in revenue due to expansion.

While there have been substantial increases in capital costs with the building of a new lagoon in 2006, these costs were recovered from other sources including taxes.

At current rates, the Town is concerned the operations of the Sewer Utility are no longer sustainable. Furthermore, the Town plans to operate the Utility more on a "user-pay" basis which means, to the extent possible, all capital costs should flow through the rate structure. This includes decommissioning costs of the retired lagoon and bank stabilization. The rates also include a provision for contingencies but not at the level recommended by the PUB of 1% of capital costs. No amount has been included to build the reserve fund in keeping with the PUB's view that

the recovery of amortization expense and the building of a reserve fund are one of the same.

When these matters are considered, a significant increase is required. Currently customers are paying \$15.40 per quarter (billed annually at \$61.60). The "indicated" rates are as follows:

2013: \$59.80

2014: \$60.95

2015: \$62.20

The revised rates include operational and capital costs and a surcharge as required by the PUB to meet the PUB's Working Capital Surplus minimum target.

Including such costs in rates reflects the "user-pay" principle. These costs are not avoidable costs and if not recovered in rates would be recovered by taxes or some other means which would not be transparent nor consistent with the user-pay approach.

For comparative purposes a customer using 35 cubic meters of water in the City of Winnipeg would pay a quarterly sewer bill of \$72.00.

2.0 Background

2.1 Financial Reporting and Public Sector Accounting Rule Changes

Since the Town last made an application to the PUB, the PUB has issued a number of pronouncements covering:

- the financial reporting for utilities including new requirements for reporting operating deficits whether they be budgeted, anticipated mid-year or actual,
- the reporting of transfers to utility operations from a reserve fund or the General Operating Fund,
- minimum utility surplus requirements,
- disconnection and reconnection of services for non-payment, and
- late payment charges.

In addition, the PUB has established reporting deadlines and penalties for failing to meet these deadlines.

Some of these pronouncements are set out in Order 151/08 dated November 7, 2008 and are ones municipalities will have to pay close attention to for reporting in the future.

In Order No. 93/09 dated June 9, 2009, the PUB set out its response to the adoption of the PSAB Accounting Standards for Local Governments. The accounting rule changes are significant and have major implications for the financial reporting of not only utilities but also the entire operations of a municipality. The PUB worked with the

Inter-Governmental Affairs Working Group in developing its response to PSAB.

The PUB noted that the 2009 financial statements are to be prepared in accordance with the new accounting rules and the 2008 financial statements are to be re-stated for comparative purposes.

Of particular note, one of the accounting rule changes requires that certain expenses be capitalized and amortized and if a capital asset, amortized over its useful life.

Municipalities are required to develop a Tangible Capital Asset (TCA) schedule listing the original capital cost of

the asset, the amortization period for each asset category and ultimately an annual amortization expense to be recorded in its financial statements. Depending on the age of the asset and whether it was financed by grants could have a significant impact on the utility financial statements as required by the PUB.

With respect to the rates of amortization, the PUB, in Order No. 93/09, stated that:

"During transition, the Board will accept TCA schedules developed in accordance with the manual (manual developed in conjunction with Inter-Governmental Affairs for all municipalities) for rate setting purposes."

Any changes to these rates require PUB approval. As noted above the PUB indicated that it would accept those rates

initially developed which are subject to review in the auditing process but if changes are made in the future, the municipality must obtain the PUB prior approval. This is because a change in this rate may have a significant impact on the rates charged for services.

The PUB noted that in the past the building of a utility reserve fund through rates might have been a surrogate for amortization expense. However, if the provision was not included in rates or if the ability to add monies to the reserve eroded over time by rising operating costs, amortization will be a new expense for the utility.

According to the new accounting rules, capital grants do not reduce amortization expense. However, for rate setting purposes, the PUB determined capital grants are to be amortized over the same period as the underlying asset.

Similarly, for donated assets, the PUB determined amortization expense is not to be included for ratemaking.

The PUB recognized that for some utilities the recording of amortization expense, even after adjusting for grants, might result in an operating deficit. The PUB stated that if such deficits are not manageable in the short term, municipalities are required to file a long-term rate plan to address the recovery of the operating deficits.

The PUB also required municipalities to develop a policy for the allocation of shared expenses between the utility and general operations of the municipality including personnel (including benefits) and equipment expenses.

This review addresses other PUB pronouncements regarding contingency allowances, future liabilities, reserves and surplus requirements.

3.0 Description of the Sewer System

3.1 General

The Town of Niverville owns and operates a sewer utility which commenced service in the early 1970s and which serves approximately 1328 customers. The Town also owns two (2) water utilities, which are operated separate from the sewer utility.

While all residents are connected to the sewer utility, not all residents are water customers. Residents in the older central part of Town have private wells. The Town bills all customers on a flat-rate basis and plans to continue this practice until the utilities are joined.

The Town provides a treated water supply to the residents of two (2) relatively new developments: known as Fifth Avenue Estates to the east and Highlands (formerly Crow Wing) to the west. The two (2) water utilities are not connected to each other and are treated as two separate utilities. The Town may consider, at some future time, the consolidation of these operations.

The Public Utilities Board regulates the rates charged by the three (3) utilities.

The rates charged by the sewer utility, the subject of this rate study, were last amended in 1989. The Town bills all sewer customers on a flat rate basis using Residential Equivalent Units (REU). Residential customers are assigned one (1) REU and larger users are assigned a multiple of REU based on an estimated use of utility services. The number of REUs assigned to the large customers has been determined using Guidelines adopted by the PUB. Currently, there are approximately 1,343 REUs and the Town is expecting this number will grow to 1,627 in 2013. The higher number has been used to calculate revised rates.

The Town bills for sewer services on an annual basis. The current annual charge is \$61.60 (approved by the Board in 1989).

Lagoon

With the rapid growth in the community, a new lagoon was constructed in 2006. The lagoon includes one primary cell and three (3) secondary cells.

The original lagoon was abandoned in place and the Town is in the final stages of decommissioning. Decommissioning costs are estimated at \$750,000 and the Town expects to pay this cost using surplus funds and/or grants and to some extent, through revised rates. The "indicated" revised rates include an amount of \$25,000 to cover in part the decommissioning costs. If the cost is paid by a borrowing debenture, the annual provision in rates could be used to cover the borrowing costs. Once the decommissioning costs are paid the rates should be examined to determine whether a rate reduction is required.

The new lagoon has a capacity to serve a population of 5,000 and based on the 2010 Census, the Town is nearing this capacity. Town advised it may need to add aeration to the primary cell in the next five (5) years.

The Town has an immediate need to stabilize the lagoon banks to prevent erosion. The Town has estimated this cost to be \$1.0 Million and in discussion with the Town's auditor, the Town advises this cost will be capitalized, as it is a "system betterment" and also, will be amortized over the remaining useful life of the lagoon. This is reviewed later in this report.

The Town expects to borrow the funds for bank stabilization and advised that it plans to recover the borrowing costs through revised rates. The only other alternative is to recover the borrowing costs through taxes but this approach deviates from the user pay principle.

The annual estimated borrowing cost is \$96,350 (\$1.0 Million over 15 years using a 5% interest cost). This cost has been included in the revenue requirements for the Utility as reflected in Appendix 1 attached.

As noted earlier, this cost will be capitalized and therefore, amortization expense for the lagoon will increase. The upgrade will be amortized over 24 years (the remaining useful life of the lagoon) and will increase the annual amortization expense by approximately \$41,700 ($\$1,000,000/24$).

Sewer Lines

The Town advised the sewer lines are in good shape although the Town believes provisions ought to be included in the rate proposal for unexpected repairs. This is often referred to as "contingency" and will be reviewed later in this report.

The sewer lines are mostly made of poly with the older part of Town serviced with concrete pipe.

The sewer system is mostly a gravity flow system with a small part being low-pressure. Customers on the low-pressure system are required to arrange pump-outs of their holding tanks with permission to dump in the lagoon. The customers on the low-pressure system pay the haulers directly and also, pay the Town the full annual sewer charge.

The Town has adopted a line-flushing program - all lines are cleaned once every three (3) years. The annual cost in 2011 was \$13,000. This expense has been included in the budgeting process followed by the Town.

Lift Stations

The Sewer Utility has four (4) lift stations. One (1) is called the Primary Lift Station, which has been fully upgraded recently and is in good shape.

There are two (2) lift stations known as the Hespeler Park and Fifth Avenue Estates lift stations. The latter lift

station is in good condition. However, the Hespeler Park lift station requires upgrading to stainless steel components to prevent corrosion. The estimated cost of the upgrading is \$5,110 plus PST.

The fourth (4) lift station is known as the Arena Road lift station. The Town plans to upgrade this lift station at the same time it installs a new force main to serve a new development. This work is in planning stages and the Town expects to recover, in whole or in part, the cost of this upgrade from a Capital Development Fund (developer) as the upgrade will serve approximately 400 new homes. In the 2012 budget, the Town has allocated \$106,529 for the Arena Road lift station work.

The Town advised that lift station repairs are not uncommon (\$15,200 in 2011) and the repairs are typically substantial (\$15,000 to replace one (1) pump). The Town believes some provision should be made to pay these costs through the rate structure as well. Again, such costs are typically recovered in a contingency allowance to be discussed later.

Operator Certification

The Town advises the Utility Operator is duly certified with a Level 1 certification in sewage treatment and Level 2 Collection. These certifications meet the assigned classification of the Town's sewer system. The Town also advised that employee-training allowances are included in its utility budget.

In accordance with the Town's Environmental License, and after testing, discharges from the Town's lagoon are made in the spring, summer and fall seasons into a local drain eventually draining into the Seine River and the Red River.

With the recently constructed reverse osmosis water treatment plant, backwater from the filter cleaning process is pumped into the lagoon increasing substantially the hydraulic loading on the lagoon. As a result, more frequent lagoon releases are required.

The Town is examining re-directing this water, which is "clean" water, to a nearby lake thereby eliminating the hydraulic loading on the lagoon.

4.0 Revenue Requirements

Section 4.0 reviews the financial requirements of the Utility upon which rates are based. Appendix 1 attached sets out the expenditure forecast as required by the PUB and includes the forecast reflected in the Town's 2012 Financial Plan, adjusted as required.

4.1 Current Financial Position

In 2009, all municipalities were required to prepare financial statements on a PSAB basis requiring the recognition of amortization expense for the first time.

In 2009, the Utility incurred an operating deficit (audited) of \$66,774 after recording \$76,999 in amortization expense. Without amortization expense and interest expense (collected by taxes), the Utility would have earned an operating surplus of approximately \$12,708.

In 2010, on an unaudited basis, the Utility incurred a \$76,648 loss after recording \$77,720 in amortization expense. Again excluding an amortization expense and debenture interest (paid by taxes but not recorded as revenue), a small operating surplus of \$2,085 would have been earned.

In 2011, the Utility recorded a small surplus of \$269 (obtained from management statements not reflected on a PSAB basis).

In 2012, again on a non-PSAB basis (not including amortization expense, the Utility is expected to breakeven.

The 2011 and 2012 operating costs as per management statements are as follows:

Expenditure	Budgeted	Actual
	2012	2011
Administration	\$20,500	\$17,624
Sewage Collection	\$62,940	\$66,336
Total	\$83,440	\$83,960

As of December 31, 2010 (again unaudited), the Utility reserve fund balance was \$34,079.

Three (3) Schedule 9's are attached reflecting operating results as required by the PUB. In effect, these schedules include taxation revenue (for debentures) to cover interest expense and the principal amount to cover part of the amortization expense. These schedules are attached as Appendix 2, 3 and 4.

Of note, these Schedules also allow for the amortization of grants to further the reduction of amortization expense, again consistent with the PUB requirements.

4.2 Capital Plans (2012 Financial Plan)

The Town's 5 Year Capital Plan reflects the \$1.0 Million bank stabilization work on the lagoon to be spent in 2013. The cost is to be paid using a debenture as reviewed earlier.

There is no sewer project planned for 2012.

4.3 Amortization

The Town has prepared its Tangible Capital Asset Continuity Schedule and the 2011 TCA Schedule used for the rate study is attached.

The Town has three (3) asset categories *being amortized*: Networks Sewer, Machinery & Equipment and Buildings, Wood Frame that includes the lift stations.

The total 2011 amortization expense and the amortization periods are as follows:

Buildings, Wood Frame:	\$43,430.18 (25 years)
Networks (Sewer):	\$30,903.10 (60 years) ¹
Machinery & Equipment:	<u>\$ 3,005.27 (15 years)</u>
Sub-total:	\$77,338.55 ²

Note 1: No differentiation between concrete or plastic pipe.

Note 2: \$76,999 in 2009 audited statements (last audited).

If the bank stabilization project proceeds in 2013 (to be capitalized), as noted earlier, this will have an amortization expense of \$41,700.

Further, the upgrading of the Hespeler Park Avenue lift station to stainless steel will expand the useful life of the lift station and therefore, may also be capitalized. However, this expense is only some \$5,000. If this costs is paid for by the developer it would be treated as a "donated asset" and the related amortization expense would not be required to be collected in rates, consistent with PUB requirements.

The Town advises that the operation of the lagoon in the past, was not accounted for as part of the Utility but this will be changed going forward.

Using the 2011 TCA Summary information provided by the Town adjusted as noted below, the total original capital cost of the assets related to the sewer utility is as follows:

Schedule:	\$2,530,807
Lagoon:	\$2,904,238
Lagoon Upgrade:	<u>\$1,000,000</u>
Total:	\$6,435,045

This capital cost will be used to determine the amount of contingency allowance to be collected in rates as per the PUB Guidelines.

Pursuant to the directives of the PUB, amortization expense is required to be reduced for those assets either being paid for by debentures (principal amount), paid for by grants (by percentage) or by developers (donated assets).

There are no outstanding debentures (the last being retired in 2011) and therefore there will be no reduction to amortization expense for outstanding debentures. However, the future debenture for the lagoon upgrade has been included.

The total amortization expense on a go forward basis will be approximately:

1. As per financial statements (2010 unaudited)	\$77,720
2. Lagoon	\$96,808
3. Lagoon upgrade	<u>\$41,700</u>
Total	\$216,228

With respect to grants, the 2009 audited statements (last audited) address this matter. Note 15 indicates for sewer services, the annual amortization amount for grants is \$18,165. In the 2010 unaudited statements, this amount is increased to \$20,847. The 2010 amount is used to reduce amortization expense in the rate study, as it is the most recent information.

Using these figures, the net amount of amortization expense to be collected in rates is \$195,381 (\$216,228 - \$20,847).

4.4 Contingency Allowance

A contingency allowance is a provision in rates to recognize that systems do breakdown unexpectedly. This provision is in addition to any amortization or reserve provision as these monies are generally intended to cover expected and normal wear and tear of a system. The amount of contingency included in rates is determined based on the PUB Guidelines and the Utility operating experience.

The PUB Guideline requires a contingency allowance approximating 1% of the historical capital cost of the system. The provision may be increased or decreased dependent on the operating experience of the utility. Newer operating systems tend to have a lower contingency allowance and older systems in a state of disrepair tend to have a higher contingency amount.

As noted earlier, the current rates do not include any amount for contingency and yet a repair can be quite costly.

Using the PUB Guidelines, the recommended contingency provision is 1% of the historical capital costs of the system or \$64,350. The Town believes that a lower amount of \$20,000 in 2013 and rising by \$5,000 in each of 2014 and 2015 is reasonable recognizing the new requirements to collect amortization expense. These amounts have been included in Appendix 1 attached.

4.5 Reserve Provision

Reserve funds typically pay for routine and planned capital expenses.

The PUB indicated that under normal circumstances the provision for amortization negates the need for such reserves. However, the PUB was prepared to consider an inclusion for reserves in rates if the need could be justified.

The Town supports the user-pay system and strongly believes funds should be available to cover planned and unexpected repair costs. However, as amortization expense provides for such costs and as this is the first rate study under the new accounting rules, it may be prudent to set aside such consideration at this time due to rate impacts. The need for the building of a reserve fund in addition to the collection of amortization expense can be re-visited at the

next rate review. Accordingly, with amortization expense, no amount has been included to build a reserve fund.

Of note, reserves are not intended to pay for new capital projects related to expansion, as it is expected that the newly connected customers will pay this cost. Further, reserves typically do not cover costs related to major capital, for example a new treatment plant, as the ability of the rates to support this cost would be difficult. Further, in some cases the cost of large capital projects are better recovered by tax assessment in fairness between small and large customers.

4.6 Allocation of Shared Services and Equipment

Where municipalities have dedicated staff and equipment to operate the utility, it is expected that these costs -will be assigned fully and directly to utility operations.

Where a sharing of staff time and equipment occurs between the utility and the general operations of the municipality or between utilities (in this case between the water and sewer utilities), the PUB determined that a municipality must establish how this cost is allocated in a Shared Cost Allocation Policy.

Further, in the future, a municipality must include a managerial statement confirming that the Policy has been adhered to in the preparation of the financial statements

filed with the PUB. The PUB must approve any change in the allocations.

The managerial statement is not required for the audited financial statements.

The concern is one of fairness. The allocation must reflect the utility's fair share of shared costs to ensure the utility operation is not being subsidized by general operations of the municipality.

The Town advised that this matter has been reviewed and it has been determined a 4% allocation of staff time including benefits, office space costs, utility costs and equipment costs is a reasonable allocation of these costs.

For 2011, this cost amounted to \$17,548 and has been included in Appendix 1 as part of the overall sewer operating expenses.

4.7 Working Capital Surplus

The PUB in Order Nos. 151/08 and 93/09, in its response to the new Public Sector Accounting Board rulemaking, determined new rules working the minimum capital surplus required to utilities. The PUB stated that utilities must carry a minimum of 20% of the prior year's operating expenses in surplus.

The working capital surplus (WCS) excluded capital related items but included reserves as determined as follows:

1. Fund Surplus/deficit (W)
- Minus:
2. TCA (X)
- Plus:
3. Long term debt (Y)
 4. Utility reserves (Z)

In summary, $WCS = W - X + Y + Z$. The figures are typically found in Schedules 6 and 8 of the audited financial statements.

For the Sewer Utility, for the period ending 2009 (last audited), the WCS is as follows:

$$\$2,518,355 - \$2,530,807 + \$12,452 + \$33,882 = \$33,882$$

The WCS for 2011 (unaudited) is \$34,079. This amount is in Appendix 1 (attached).

Appendix 1 (developed by the PUB), uses the existing WCS, and determines if the WCS is above or below the PUB target level) and if below, what if any surcharge is required to be collected in rates to build the WCS. In general, if the WCS falls below the PUB minimum, the PUB requires a minimum of 1% of operating expenses be added into rates until the WCS target is met.

As noted in Appendix 1 a surcharge is required as the existing WCS of \$34,079 falls below the current target level of approximately \$88,662. This is a shortfall of \$54,583. Appendix 1 determines a surcharge of approximately