

Funding Strategy for Water Treatment Long Term Capital Strategy

ISSUE

As the City of Saskatoon (City) and surrounding region continues to grow, a strategy is required to increase the water treatment capacity to 450million Litres per day (MLD), which will provide safe and reliable drinking water for approximately 500,000 people. To date, the Water Treatment Long Term Capital Strategy (the Strategy) has been reaffirmed and now a funding strategy is required.

The Administration runs a long-term (30 years) forecast for water rates to avoid rate shock and ensure capital replacement and expansion are planned effectively. As outlined in the long-term strategy report recently presented to this Committee, commencement of the work on the new Water Treatment Plant site has been moved ahead by five years compared to the original 2009 plan. This approach will save \$255 million over the 30-year time frame compared with the original 2009 plan.

A funding strategy is required to spread out the longer-term utility revenues to smooth utility rates over several years.

RECOMMENDATION

That the Environment Utilities and Corporate Services Committee recommend to City Council that the Administration be directed to build a detailed funding strategy for the Water Treatment Long Term Capital Strategy and this funding strategy be reported back and incorporated into the 2024/2025 water utility rate recommendations.

BACKGROUND

As outlined in the Administrative Report [Water Treatment Long Term Capital Strategy](#) presented to the Environment Utilities and Corporate Services Committee on August 8, 2022, the City's Water Treatment Plant (WTP) has been a cornerstone of the community since 1906, providing reliable and safe drinking water to support growth in the city and the surrounding region. The current WTP, as of 2021, has a firm treatment capacity of approximately 250 MLD and has two remote reservoirs with pump stations which service the city and region, with a third reservoir currently under construction.

The Administration uses a long-term rate forecast to avoid rate shock and ensure that capital rehabilitation programs are funded. The 2009 capital development plan identified an investment of \$907 million (2022 dollars) for the long-term capital strategy with the new WTP planned for design starting in 2029. In 2019, an update to the Strategy was undertaken to inform project and financial planning including capital expenditures, cash flows, borrowing, and customer utility rates.

The Strategy was completed in 2022 and the results summarized in a report to the Standing Policy Committee on Environment, Utilities and Corporate Services on August 8, 2022. The reviews since 2009 have re-affirmed that the overall logic and

approach of that comprehensive strategy remains the optimal solution for Saskatoon. The subsequent work has helped the Administration refine the details of the approach.

As outlined in the August 8, 2022 report to this Committee, an estimated \$651 million investment over an 18-year period is planned, with design of the new WTP starting in 2024. While the new strategy provides lower overall cost to the City, in the short term it creates a funding gap of up to \$74.3 million in the next five years.

DISCUSSION/ANALYSIS

Current State

The Administration continues to work through refining estimates for the Water Treatment Long Term Capital Strategy including project costs, potential rates, and reserve balances. Currently water rates are set in alignment with the two-year budget cycle with consideration of the long-term rate forecast. Historically, capital work for the water utility has been 100% self sufficient on Water Utility Rates for capital funding and debt repayments. The long-term capital strategy is utilizing the same approach and projected to rely on a combination of rate increases and debt to fund the strategy. A variety of options outside of rate increases and debt have been preliminarily reviewed but require further exploration prior to being included in future rate models. An overview of the options can be found in the remainder of this report.

Government Funding

There are typically Government Funding Programs that are available to the City that include Saskatoon Water projects as eligible. However, the City has historically only applied for Water projects where a reallocation strategy is utilized. That is, Government Funding is applied to Water Utility Projects and an equivalent dividend is provided to the City from the Water Utility Reserves to fund other non-eligible priority projects. Through this process Saskatoon Water receives no direct benefit from Government Funding Programs and continues to be 100% reliant on utility rates for funding.

There may be an option to change the way the City utilizes Government Funding by allowing the Water Utility to retain some government funding for this project. However, it is important to note that this would be a significant shift and would put additional pressure on property taxes to fund projects that have been historically funded through dividends described above. Two examples are as follows:

- the City's 2024-2035 Major Capital Prioritization Process currently includes \$79 million of Community Building Funds (formally known as the Gas Tax Funding) which could be allocated to this Saskatoon Water project; however, there would be a corresponding impact on the City's ability to undertake other mill-rate funded capital such as Fire Halls, Transit Fleet Replacement, Transportation, and other projects. Every dollar allocated to the WTP would be one less dollar for the 2024-2035 Major Capital Prioritization Process; and
- The Investing in Canada Infrastructure Program (ICIP) is an example of where Saskatoon Water Projects would have been eligible; however, the City applied for several non-utility related projects such as Bus Rapid Transit, Transit Fleet Replacement and a Northeast Leisure Centre. Allocation of ICIP or a program

similar to ICIP would have a corresponding impact on the mill-rate projects that could be completed.

Based on the above noted risks, the rate model that will be presented in future reports will not assume any senior government funding in the funding strategy. The City will retain the ability to allocate funding from other levels of government on a case-by-case basis, and any such funding retained in the Utilities would result in reduced utility rates compared to those planned.

Debt

Currently Saskatoon Water utilizes debt to complete a variety of capital projects. Based on the scale of this strategy, debt will be a key source of funding which will be repaid through future utility revenues. While the borrowing related to Saskatoon Water is included in the City's overall debt limit calculations, historically, the Water Utility has operated under an internally imposed borrowing limit of 20% of budgeted revenues to ensure the utility's debt burden remained manageable as part of the City's overall debt limit. To reduce rate-shock and spread revenues over a longer period of time, the Administration will explore temporarily increasing the internal borrowing limit to 25% of budgeted revenues. This increase will result in approximately \$10 million in additional borrowing by Saskatoon Water. Impacts on the City's overall debt capacity and limits will be evaluated in future reports as the funding plan is further defined.

Reserve Allocations

Construction of a new Water Treatment Plant is a significant capital investment which will rely on the Waterworks Capital Projects Reserve. Under the Reserves for Future Expenditures Policy C03-003, excess funds from the Stabilization Reserve are applied to the Waterworks and Wastewater Treatment Capital Reserve, and if required, to the Infrastructure Replacement Reserve. As the Infrastructure Replacement Reserve has only been funded through this mechanism once in the last ten years and as the linear water and sewer systems have a fully funded asset management program, the Administration will explore retaining additional funding in the Waterworks Capital Projects Reserve for the construction of the new WTP.

Other Potential Options

Further options for City Council's consideration could include the introduction of a Growth Pays for Growth levy to support the Long-Term Capital Strategy or a decrease in the Return on Investment transfer from the Water Utility which offsets general revenues. The introduction of a new levy is not recommended at this time as the City is currently awaiting the results of a development levy audit. The Administration will report back on this option in more detail when the audit is complete. However, because treatment capacity is directly related to city growth, charging newly developed properties a levy to partially fund this work is a viable and defensible approach. A decrease in the Return on Investment is also not recommended at this time due to the mill-rate reliance on this source of funding for other priorities. While a decrease in the Return on Investment would reduce future utility rates, there would be a corresponding negative impact on the mill-rate.

FINANCIAL IMPLICATIONS

This report provides an overview of the options and strategic direction Saskatoon Water will utilize to develop the 2024/2025 and beyond rate recommendations. As outlined in the report ([Administrative Report Water Treatment Long Term Capital Strategy](#)), further work is required to refine the capital plan, rate projections and timing in order to finalize the detailed funding strategy and corresponding rate recommendations. It is important to note that the original plan from 2009 totaled \$907 million over the next 18 years. Based on refinements outlined in the [Administrative Report Water Treatment Long Term Capital Strategy](#), a revised investment of \$651 million is now required over the next 18 years. Future reporting will provide a detailed analysis of the overall project costs and funding sources which will be submitted for approval as part of the utility rate setting during the 2024/2025 Business Plan and Budget Deliberations.

Preliminary financial modelling of the utility rate impacts of the Status Quo Funding Strategy (relying solely on rates and debt) and the Potential Adjusted Funding Strategy (utilizing other options as outlined in this report) was completed. Outlined below are the possible utility rate outcomes over a 10-year period:

1. Status Quo Funding Strategy – 3-9%
2. Potential Adjusted Funding Strategy – 3-5%

The rates shown above are for comparative purposes only based on the information known to date. Detailed financial modeling will be completed as part of future budgets based on the components of the Adjusted Funding Strategy that are deemed feasible following further investigation.

OTHER IMPLICATIONS

Legal, social, and environmental implications of the capital work included within the Strategy will be reviewed and addressed as each project is brought forward for implementation.

NEXT STEPS

The Administration will undertake detailed financial modelling and report on the water utility rates during the 2024/ 2025 City Council Business Plan and Budget Deliberations.

The Administration will report on the detailed funding plan for the Water Treatment Long Term Capital Strategy in Q3 2023.

The Administration will report back on the possibility of introducing a Growth Pays for Growth levy to offset Waterworks Capital once the development levy audit is complete.

Report Approval

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