

Order No. 62/17

**AN ORDER RESPECTING THE TOWN OF LAC DU BONNET
WATER AND WASTEWATER UTILITY
SYSTEM DEVELOPMENT CHARGE**

June 13, 2017

BEFORE: The Hon. Anita Neville, P.C., B.A. (Hons.), Acting Chair
Carol Hainsworth, C.B.A., Member
Shawn McCutcheon, Member

Table of Contents

1.0	Executive Summary.....	3
2.0	Background	4
3.0	Current Application and Board Findings.....	7
4.0	Backbone components valuation and depreciation	8
5.0	System components – Present debt.....	10
6.0	System components - Grants	11
7.0	Reserves and operating surplus.....	12
8.0	Town residents and out of boundary customers.....	13
9.0	Allocating a portion of SDCs – Schedule “B” to Bylaw No 09-2014.....	15
10.0	Board Findings on the Issues.....	17
11.0	System development charges.....	19
12.0	IT IS THEREFORE ORDERED THAT:	20

1.0 Executive Summary

By this Order, the Manitoba Public Utilities Board (Board or PUB) varies the system development charge applied for by the Town of Lac du Bonnet for its water and wastewater utility, and authorizes the Town to charge it only to those customers connecting from out of the Town's boundaries. This approval does not include or revise the current connection inspection fees approved in Board Order No. 36/16.

The SDCs for water and wastewater are approved as follows:

Water system development charge - out of boundaries	\$2,500.00
Wastewater system development charge - out of boundaries	\$1,500.00
Water and wastewater system development charge - within Town boundaries	\$ -

Rationale for the PUB's decisions may be found under "Board Findings".

2.0 Background

The Town of Lac du Bonnet's application for a system development charge dates back to the submission of a rate application in 2010, which was subsequently revised by the Town in December 2011. The Town later submitted Council resolution No. 218/11, which amended the existing rate application again, this time to include a proposed \$5,000 charge for connection to the water utility from outside of Town limits. During the review of that application, the Town advised the PUB that the intention of the \$5,000 charge was to create a balance between non-residents and Town residents, who are required to make capital contributions through their taxes. When asked to provide supporting calculations for the \$5,000 charge, the Town advised that it was based on a "reasonable amount", rather than a quantifiable calculation. It did not provide any further information.

The Board issued its decision May 1, 2013 denying the \$5,000 charge for non-residents. Board Order No. 46/13 stated "The Board supports charging connection or "system development charge" for non-residents who are connecting to a distribution system. However, it is important that a quantitative basis be used for setting the appropriate charge in order to ensure its fairness." The Board encouraged the Town to reapply with a properly supported charge at its earliest opportunity.

The Town filed a full rate application in December 2013 which included a request for a “one time capital charge fee” of \$4,500. This fee was calculated by the Town’s consultant, who provided three examples of the various means to arrive at a capital charge:

Undepreciated value of the plant	
Net book value from audit	5,507,460
Less 2/3 funded by grants	- 3,689,998
Subtotal	1,817,462
Total number of customers	525
Per lot charge (rounded)	\$ 3,500
Original value of the plant	
Original value of the plant	6,567,151
Less 2/3 funded by grants	- 4,399,991
Subtotal	2,167,160
Total number of customers	525
Per lot charge (rounded up)	\$ 4,200
Future value of the cost of the plant	
\$6.6M in 20 years at 5%	17,500,000
Less 2/3 funded by grants	-11,725,000
Subtotal	5,775,000
Total number of customers	525
Per lot charge (rounded)	\$ 11,000

The rate study indicated that the \$4,500 was determined to be a reasonable charge after reviewing the three examples and calculating the average of the three being \$6,200.

In a letter dated October 17, 2014 the Board requested follow up information regarding the \$4,500 charge. In its December 5, 2014 response to the Board’s request for information, the Town advised the PUB that it was in the process of developing a new ‘System Development Charge’ (SDC) and would be withdrawing its request for the \$4,500 one time capital charge.

Upon further request, the Town provided By-law 09-2014, which had been given third reading December 18, 2014, approving the SDC, under the authority of the Manitoba Planning Act section 142. This effectively by-passed the requirement to obtain the approval of the PUB to introduce a new fee or charge.

In response, the Board issued Order No. 80/15 on August 6, 2015, which disputed the Town's authority to set the rates as proposed without PUB approval. The Board's interpretation of section 142 of the Manitoba Planning Act was that it applied to costs that may be chargeable to applications relating to the subdivision of land. The Board understood By-law 09-2014 intended to charge the sewer and water development charges to customers in existing developments, both within and beyond the boundaries of the Town.

Board Order No. 80/15 directed the Town of Lac du Bonnet to refund any sewer and water development charges collected under By-law 09-2014 and to submit to the PUB a proposal for sewer and water development charges.

On August 12, 2015 Mayor Gordon V. Peters sent an email to the PUB asking for the Board's authority in legislation, as it related to "equity one time charges". The response from the PUB was sent September 21, 2015 advising that the PUB's authority can be found in the Public Utilities Board Act, sections 74(1), 64(1), 64(2), 77, 84(1) and 84(2).

3.0 Current Application and Board Findings

On October 20, 2015 the RM submitted a letter to the PUB officially withdrawing the \$4,500 one time capital charge fee that had been part of the December 2013 rate application, and declared its intention to replace it with System Development Charges for water and wastewater, as per its By-law No. 09-2014.

The Town provided a copy of the By-law and its Schedules “A” and “B”. Schedule “A” showed the Town’s calculations and Schedule “B” provided for specific development charges for different types of dwellings. No further explanation or supporting information was included with the submission.

The Board reviewed the submission and on April 5, 2017 sent the Town a list of information requests regarding the rationale and methodology used to calculate the SDCs for water and wastewater. The Town responded on May 2, 2017 and May 9, 2017. This response included a revised copy of Schedule “A” calculated with updated financial information. There was no amended Schedule “B” submitted, therefore the Board will consider Schedule “B” from the October 20, 2015 submission in its decision.

The Town’s calculations for the SDCs are based on five distinct valuations:

1. Backbone components (tangible capital assets)
2. Depreciation
3. Present debt on tangible capital assets
4. Grants received for tangible capital assets
5. Reserves and operating surplus

4.0 Backbone components valuation and depreciation

Rather than using historical costs, the Town proposed that its “backbone components”, the tangible capital assets (TCA) of the utility, be valued using an engineer’s assessment of what it would likely cost to replace the assets. This valuation was prepared in 2008. The Town then adjusted this amount using “ENR-CCI indexes”. The Board requested further information regarding the “ENR-CCI index”, and the Town submitted what appears to be a page from a website or magazine. The Town offered no explanation of how the information on this page was used by the Town in calculating the SDC, nor did it provide source information allowing the PUB to verify it. The PUB decided to refrain from issuing another round of information requests to avoid delaying the decision further.

The Town calculated depreciation on the Utility’s TCA by assuming a rate of 25% depreciation on the water treatment system and distribution system, and 65% on the sewage treatment system and sewage collection system. The Town did not state how these estimates were made, except to say that the water systems are relatively new.

Board findings – Backbone components valuation and depreciation

The Board does not accept the Town’s use of the ENR-CCI index when calculating the present value of the TCA of the Utility. The values on the website cannot be accessed without a fee, and the Construction Cost Index from the Engineering News Record website is based on the average of 20 cities, all of them large urban centres located in the United States. The Town failed to convince the Board of the relevance of using this approach, which focuses on large cities in the United States, instead of applying a historical cost analysis to the TCA valuation.

The Town applied the mark up to the valuation prior to adjusting for the present debt and grants received, which overstates the valuation. The Town has not presented evidence for the Board to accept the methodology of indexing the historical costs in setting the value of the SDC.

The Town has advised that it has used the system buy-in method of calculating SDCs, as defined in the AWWA M1 Manual (American Water Works Association; Principles of Water Rates, Fees and Charges, 5th Edition). The goal of the system buy-in method, as stated in the manual, “is to achieve an equity position between new and existing customers of the system” (page 201). The Board is not persuaded that the goal of equity in existing infrastructure is achieved by charging based on the cost of replacing the assets today. The Board finds that this goal is better achieved by using the historical cost of the existing TCA.

The 2015 audited financial statements for the Town of Lac du Bonnet indicate that the net book value of the utility’s tangible capital assets total \$5,573,117 as of December 31, 2015. The 2016 audited statements are not available. In its submission to the PUB, the Town had separated its component costs by four functions, as shown below. The PUB used that information to calculate a percentage of total assets to each of the four categories of utility functions, used in assumptions outlined in section 11 of this Order:

Water treatment system	3,200,000	30%
Water distribution system	3,500,000	33%
Sewage treatment system	1,200,000	11%
Sewage collection system	2,800,000	26%
Total	10,700,000	

The PUB then used those percentages to allocate the net book value from the 2015 audited financial statements:

Water treatment system	1,666,727	30%
Water distribution system	1,822,983	33%
Sewage treatment system	625,023	11%
Sewage collection system	1,458,386	26%
Total	5,573,118	

5.0 System components – Present debt

The Town's figures used in the May 2017 submission for present debt are verifiable in the notes to the audited financial statements for 2015.

Board findings – Present debt

In order to adjust for the present debt, it needs to be removed from the gross historical cost, which is not available.

The Board's understanding of the methodology of adjusting for present debt, as set out in the M1, is to refrain from double charging new customers who will now be contributing, either through utility rates or taxes, to the repayment of outstanding debt. Out of boundary customers will not be contributing through taxes or utility rates to the repayment of the remaining debt.

The Town submitted that its intention is to charge the same SDC to both in and out of boundary customers; therefore the Board does not find that this adjustment is reasonable for all users and does not align with the goal of the system buy-in method. The Board finds that the Town taxpayers are not subject to the SDC, as they have already contributed to the existing equity and will continue to contribute through their taxes. The Board also finds that the Town's proposed method of calculating the SDC, which removes the value of current debt, is not appropriate in calculating an SDC for those customers who do not contribute to the debenture recovery through taxes.

6.0 System components - Grants

The Town provided updated information regarding the grants received for the Utility's TCA on the May 2017 submission. The submission indicated the Town had \$3,771,906 in grants to adjust the valuation of the TCA.

When reviewing the May 2017 submission, the percentage of capital grant contribution is 59% for water treatment, 46% for water distribution, 17% for sewage treatment and 3% for sewage collection.

The Town's December 2013 rate study estimated the value of the capital grants at a flat rate of 66% (2/3) applied to all components.

Board findings – Grants

The overall percentage of TCA paid for by capital grants is impossible to calculate without the TCA historical cost information that the Town has not provided as evidence to the PUB. This information should be included in the notes to the audited financial statements, but is not found in the Town's 2015 audited financial statements and cannot be verified by the PUB with the evidence provided.

The percentages calculated from the May 2017 submission are impacted by the Town's use of its 2008 engineering assessment replacement values, rather than actual historical cost information. It is not possible to determine how significant the difference is without the historical cost information for comparison.

7.0 Reserves and operating surplus

The Town's May 2017 submission included a valuation of \$1,240,529 in "Reserves and Operating Surplus December 31, 2016". This amount, along with the Town's net valuation of the TCA, was used in calculating the proposed SDCs. The Town calculated the value of the reserves and operating surplus at December 31, 2016 as follows:

Water Reserve #4	236,986.54
Utility Op Reserve #14	740,167.16
Sewer Reserve #15	195,469.62
Chequing Account	67,905.82
Total	1,240,529.14

The Town's 2015 audited financial statements show only one utility reserve account, labelled "Utility equipment reserve" and the value at December 31, 2015 was \$250,879.

Board findings – Reserves and operating surplus

The Board needs the best evidence that should be available to make its decisions. The Board does not accept as evidence a reserve valuation that is approximately \$1M higher than the most recent audited figures available. M1 states, "The financial goal is to achieve a level of equity from new customers by collecting an SDC representative of the average equity attributable to existing customers" (page 199). The Town did not provide any financial statement evidence supporting its valuation.

The Board cannot make decisions based on representation without support in valuations.

8.0 Town residents and out of boundary customers

The PUB asked the Town to provide its rationale for charging the same SDC regardless of whether the new customer was located within the Town or outside of the Town's boundaries. The Town advised that it determined this was appropriate because, "Property owners of vacant land only pay the utility surcharge based on the Provincial Assessments Services value. Some properties pay very little towards the debt, hence an 'equity buy-in process'... The annual levy on empty lots do not come close to what the levy will be on the properties with homes or a business will pay. The amount of levy each year to be paid by the property owner has nothing to do with the consumption of water... The Town is trying to achieve an understanding of equality with new utility customers in the Town and new utility customers outside the Town's boundaries by paying the same SDC."

Board findings – Town residents and out of boundary customers

The Board finds that the Town's proposal to charge the same SDC for in and out of boundary customers does not align with the goal of the system buy-in method, nor the Town's own statement of wanting to achieve equality between the two groups of customers.

The Town's calculations do not take into account the amounts contributed through taxes by the customers located in the Town. The Town's concerns about the tax levy having no connection to the amount of water being consumed by the taxpayer are not relevant to the SDC. The Board has long been a proponent of the user-pay principle in rate setting for utilities in Manitoba; however, taxation is predicated upon the ability to pay principle. The Board has approved debenture recovery through utility rates in the past and will consider such applications as they are submitted. In the case of the Town of Lac du Bonnet, the debentures are recovered through taxation, as was the decision of the Town Council of the day.

For this reason, the Board finds that the SDCs should not be charged to Town residents, who are already contributing through taxes, only to out of boundary customers who do not pay taxes to the Town.

9.0 Allocating a portion of SDCs – Schedule “B” to Bylaw No 09-2014

The Town’s proposal in October 2015 included Schedule “B”, which provided a schedule of specific development charges based on dwelling type. This allocated a percentage of one SDC to two or more bedroom apartments, bachelor and one bedroom apartments, and other multiples. It proposes non-residential customers be charged based on the square meters of floor area. It also noted that industrial buildings are exempt.

In a letter dated April 5, 2017, the PUB asked the Town to explain the methodology and rationale behind Schedule “B” and how it aligns with Schedule “A”, which uses residential equivalency units (REUs) to calculate the SDC. One REU represents the volume of water and/or wastewater estimated to be produced by the average single family residence. Units allocated to other customers are based on estimated consumption, as compared with a single family residence. REUs are used in communities with unmetered distribution and collection systems, where information regarding actual consumption is unavailable.

The Town’s response May 2, 2017 stated, “The methodology used to create a value on apartments or other multi-residential units is one of recognizing that the standard 3 bedroom bungalow in the suburbs on a 7,000 square foot lot is not the only type of dwelling that we have in our communities today. Our communities are made up today of 1-3 bedroom condos, 1-3 bedroom apartments, 2-3 bedroom row housing with some ground that will support vegetation of sorts... to try and use a meter size for the building could be a 1 ½ inch at 10 times the value of 1 REU or even worse a 2 inch meter at 25 times. Therefore some new methodology based on the individual suites has to be used. This brings into play that a study of multi-residential units needs to be conducted so that a fair price levied against each size suite or condo would be possible.”

The Town did not explain how it calculated the per square meter charge for non-residential customers, nor the methodology and rationale behind that decision.

In response to the PUB's question about the note stating that industrial buildings would be exempt, the Town replied, "In hindsight, rather than exempt, a notation should have been that larger meters for industrial purpose will be dealt with differently as an SDC will ultimately be assessed." The Town did not propose any alternative for PUB approval.

Board findings – Allocating a portion of SDCs – Schedule "B" to Bylaw No 09-2014

The Board finds the Town's methodology is inconsistent. If the Town uses REUs in calculating the value of the SDC, then that is how the charge should be applied to new customers. If a multi family dwelling is added with a two inch connection, it should be paying the equivalent of 25 REUs. The Town indicated this places an unfair burden on these customers; therefore it should not have used this methodology in calculating or assigning the SDCs.

The number of REUs calculated is 789 and the number of customer connections is 528. This leads to a material difference when calculating and applying the SDCs.

The Town first suggested that industrial customers would be exempt, and then acknowledged they should be charged an SDC, but did not include any revised proposal. This reflects to the Board that further consideration and thought was required for this application.

The Town failed to provide any evidence at all supporting the use of a per square meter charge for non-residential customers.

The Town's submission used REUs to calculate the SDCs but only for certain dwelling types. The methodology a utility chooses to adopt must be applied consistently and fairly, and the utility must also be able to defend its rationale for making this choice, to both the PUB and its customers. The Board found the Town's evidence fell short in this regard.

10.0 Board Findings on the Issues

The Board does not find that there is adequate evidence to support the application. The Board made information requests of the Town in an attempt to gather the evidence required, but finds the final information the Town submitted was deficient. Upon reviewing the file, the Board determined that it would vary the rate, rather than deny the charge or send further rounds of information requests which would delay the final decision even further. The evidence used to calculate the varied rate is provided below.

The application has been in queue for processing since October 21, 2015 and the Town has criticized the length of time taken to process it, both in meetings with Board staff and in writing. The May 2, 2017 response from the Town to the PUB stated: “The Town has had the ability to build equity by collecting the debenture debt based on property assessments but feels that it has been stymied by the PUB while other municipalities in the Province impose SDC’s without PUB involvement.”

The Board feels it must respond to this allegation. The Board has historically regulated the majority of these types of fees using a complaint based model; a request for information regarding the charge being levied is included in the Minimum Filing Requirements for a rate application. If a municipality asks the Board for approval of its charge or if the Board determines that their processes/charges require closer scrutiny, the Board has the authority to request a full application from the Utility in question. In addition, if any complaints are received about the charges or processes involved, the Board has the authority to investigate. In the case of the Town of Lac du Bonnet, the Town initiated this process by requesting Board approval of the charge in 2010/2011.

The Town’s inability to respond to questions regarding the calculation of that proposed charge is what led to the PUB requesting a full application to determine if the charges are just and reasonable.

The PUB supports the concept of charging new customers to connect to an existing system. The PUB is aware that there is no current written process and guideline to assist municipalities in gaining Board approval for these types of fees and charges. The PUB is now drafting a policy and, once completed, it will be seeking out the input of the Association of Manitoba Municipalities in this process.

The Board finds the Town's submission was unnecessarily complicated and inconsistent. Further, much of the information was unverifiable, including crucial financial information. The PUB's role is to establish just and reasonable rates; determining whether or not the proposed rates submitted by the Town of Lac du Bonnet met that criteria was not possible with the evidence provided by the Town. The Board allows the municipalities in its jurisdiction flexibility and latitude in determining the best course of action for their utilities; however the methodology chosen by a municipality should be consistent, fair and defensible.

11.0 System development charges

The Board will use the methodology provided in the Town's December 2013 submission to calculate the net book value (NBV), free of grants, of the utility's assets at December 31, 2105. The Board does accept the Town's proposal that the utility's reserves be included in the valuation of utility assets; however, this will be based on the actual reserve amount, as per the December 31, 2015 audited financial statements.

This methodology uses the number of customers to calculate a single connection charge for both water and wastewater. This charge does not include or revise the current connection inspection fees, which were approved by the PUB on Board Order No. 36/16.

Net book value of TCA from 2015 audit	5,573,118
Utility equipment reserve from 2015 audit	250,879
Less 2/3 funded by grants	-3,733,989
Subtotal	2,090,008
Total number of customers	528
Per lot charge (water and wastewater)	3,958

Information regarding the split of the NBV between water and wastewater assets was not available. The Board will therefore calculate a split using the percentages derived from the May 2017 submission, outlined above in the "Backbone components valuation and depreciation" section of this Order, and has rounded the final charges to \$2,500 and \$1,500.

Water treatment system	30%	
Water distribution system	33%	
Total - water	63%	2,494
Sewage treatment system	11%	
Sewage collection system	26%	
Total - wastewater	37%	1,464

12.0 IT IS THEREFORE ORDERED THAT:

- 1) The Town of Lac du Bonnet water system development charge for customers outside of the Town's boundaries is HEREBY APPROVED in the amount of \$2,500.00, effective January 1, 2016.
- 2) The Town of Lac du Bonnet wastewater system development charge for customers outside of the Town's boundaries is HEREBY APPROVED in the amount of \$1,500.00, effective January 1, 2016.
- 3) The Town of Lac du Bonnet water and wastewater system development charge for customers located within the Town's boundaries is HEREBY DENIED.

Fees payable upon this Order - \$500

Board decisions may be appealed in accordance with the provisions of Section 58 of *The Public Utilities Board Act*, or reviewed in accordance with Section 36 of the Board's Rules of Practice and Procedure. The Board's Rules may be viewed on the Board's website at www.pubmanitoba.ca.

THE PUBLIC UTILITIES BOARD

"The Hon. Anita Neville, P.C., B.A. (Hons.)"
Acting Chair

"Jennifer Dubois, CPA, CMA"
Acting Secretary

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by The Public Utilities Board

Acting Secretary