

Request for Decision

Water and Wastewater Operating and Capital Expenditures Allocation

Presented To: Finance and Administration Committee

Presented: Tuesday, Oct 04, 2016

Report Date Wednesday, Sep 21, 2016

Type: Managers' Reports

Resolution

THAT Council approves the transfer of \$1 million, representing the projected surplus in the 2016 watermain repairs budget to partially fund the City's share of the Clean Water and Wastewater Fund projects.

Background

Subsequent to the 2016 Water and Wastewater Budget deliberations, Council directed staff to prepare a report that would examine the allocation between operating and capital expenditures, specifically as it relates to distribution and collection (pipes, etc) infrastructure. Council approved \$1.5 million in additional operating funds for 2016 to deal with rising emergency repair costs to the City's aging infrastructure. This was based upon staff's estimate of the amount of annual work that is required to affect repairs to the City's distribution and collection infrastructure.

Capital versus Operating Expenditure

There have always been some gray areas when it comes to classifying expenditures as capital or operating.

It is generally agreed that capital expenditures include the following:

- Acquisition and construction of new buildings, structures, facilities, equipment, rolling stock, furnishings, studies, development and purchase of land and all associated items to bring the foregoing into operation
- Major rehabilitation of the above, sometimes referred to as betterment
- Normally has a useful life of more than one year

The following table lists some examples that may act as a guide when distinguishing capital budget items from operating budget items for water and sewer main infrastructure.

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Table 1 – Capital versus Operating Expenditures

	Capital	Operating
Water and Sewer Mains	<ul style="list-style-type: none"> • Large water and sewer mains (replacement and/or lining) • Other sewer or watermain replacement in conjunction with street paving • New construction • Gates and manholes to improve system flexibility 	Repair of isolated section of broken or collapsed sewer or water mains, catch basins, sewer outlets and repair fixtures as needed to maintain operations

It should be noted that since the introduction of PSAB accounting, the City has had to reclassify significant amounts of expenditures from capital to operating during the year end process because the expenditures, although funded from capital, have not met the criteria allowing it to be capitalized for accounting purposes. This confirms the notion that it is difficult it is to classify expenditures as operating or capital.

Unpredictability of Watermain Breaks (and other D&C infrastructure failures) and Related Repair Costs

The budgeting shortfalls in the operational costs for these expenditures over the past several years have been well documented. Budgeting for this type of repair work has been difficult from the standpoint that the severity of the break and location (arterial versus local) varies from year to year. 2016 is trending to a favourable variance in the watermain repair purchased contract services line.

Table 2 – Watermain Repairs Contract Services History (2013-2016)

Year	Budget	Actual	Variance
2013	\$1,000,000	\$1,622,651	\$(622,651)
2014	\$1,000,000	\$2,470,678	\$(1,470,678)
2015	\$1,000,000	\$2,506,547	\$(1,507,489)
2016 (projected)	\$2,500,000	\$1,500,000	\$1,000,000
Total	\$5,500,000	\$8,099,876	\$(2,600,818)

The projected actual spending for 2016 of \$1,500,000 is based upon the low amount of watermain breaks experienced in the first half of the year compared to previous years. As noted in the Water Wastewater June 30 Variance Report tabled at the September 20, 2016 Finance and Administration Committee meeting, there were 41 watermain breaks recorded in the first half of this year. This number is projected to be 80 for the calendar year using historical averages for the remaining months, compared to 184 breaks for 2015 and 141 for 2014. It is estimated that contracted repairs of watermains will be under budget by \$1.0 million, independent of any other over or under expenditures that may occur.

Options:

1. Transfer full amount of anticipated operating underexpenditure to capital to allow for capital spending in year of transfer.

This option would permit the work to get started during the current fiscal year. There is potential that the actual operating underexpenditure could be less than the amount transferred to capital. In that case the shortfall would be covered by a transfer from reserve funds if there are not sufficient

underexpenditures in other expenditures to offset it.

2. Transfer 50% of anticipated operating underexpenditure to capital to allow for a portion of capital spending in year of transfer.

This option would permit a portion some capital work to commence during the current fiscal year and would provide a cushion in the event that the projected underexpenditure does not materialize as projected. If the actual underexpenditure exceeds the amount transferred, the difference can be transferred to capital in 2017.

3. Wait until year end and transfer the underexpenditure to Reserve funds and then add that amount to the capital budget of the next year.

This option would be more conservative as the amount transferred would be based upon the actual underexpenditure. The amount will be known shortly prior to the commencement of the lining season and Council would be informed of that amount by way of an Information report during the spring of 2017.

4. Wait until year end and transfer the underexpenditure to Reserve funds. Any amounts to be transferred to capital subsequent to that will be at discretion of Council.

Staff would prepare a report with options for Council to consider prior to 2017 construction season.

5. The City has recently submitted a grant application to the Clean Water and Wastewater Fund. If approved, the City's share of eligible water and wastewater projects is estimated at \$ 2.3 million. The above mentioned surplus of \$1.0 million could be utilized to partially fund the City's share. This \$1.0 million effectively leverages an additional \$3.0 of capital projects that otherwise would be performed at this time or in the near future. A portion of these projects will commence prior to year end.

Conclusion

Option 5 is the recommended option from the perspective of achieving maximum capital spending. The opportunity to leverage this \$1.0 million into \$4.0 million of much needed watermain upgrades and replacements should be taken advantage of.