

Municipality of Lakeshore – Report to Council

Finance

Financial Planning & Analysis



To: Mayor & Members of Council

From: Justin Rousseau, Corporate Leader-Finance/Chief Financial Officer

Date: August 2, 2022

Subject: Union Water Supply System- Restructuring

Recommendation

Approve and adopt the “Proposed Business Case Study for Restructuring Union Water Supply System (UWSS) into a Municipal Service Corporation” dated March 28, 2018 as presented at the August 9, 2022 Council meeting and as further described in the “Union Water Supply System Restructuring Project Financial Presentation” presented at the August 9, 2022 Council Meeting to establish a municipal services corporation pursuant to section 203 of the *Municipal Act, 2001* and which shall be known as Union Water Supply System Inc.;

Authorize the Mayor to act as a first director for Lakeshore as a shareholder in the incorporation of the municipal services corporation.;

Authorize and direct the Mayor and Treasurer, in consultation with Lakeshore legal counsel, to execute such agreements, documents and instruments as may be necessary or desirable including, but not limited to, a Unanimous Shareholder Agreement, a Water Services Agreement, an Asset Transfer Agreement, a Real Property Transfer Agreement, and a Municipal Access Agreement to restructure, establish and organize the municipal services corporation and arrange for the services to be continued in accordance with the Business Case; and

Direct Administration to develop a process for Council to select a Lakeshore representative on the Union Water Supply System Inc. Board of Directors.

Background

Since the late 1990's, the legal ownership of the Union Water Supply System (UWSS) was established by a transfer order issued by the Ministry of Environment. This legal ownership vested the four municipalities as tenants in common with ownership shares being proportionate to the volume of water that each municipality takes from the system. The Transfer Order provides that the ownership share is fixed for four years based on

the average supply to each municipality over the previous four years. Ownership percentages, updated January 1, 2021, are as follows:

Leamington	53.00%	Kingsville	38.72%
Essex	4.92%	Lakeshore	3.36%

The UWSS Joint Board of Management (UWSS Board) was also established in the transfer order. The UWSS Board is responsible for the oversight of UWSS notwithstanding the legal ownership of the system. The UWSS Board is responsible for regulatory compliance as well as the overall operation, maintenance, repair, construction and expansion of the system. The current UWSS Board is comprised of twelve members – 6 members from Leamington, 4 from Kingsville, 1 from Essex and 1 from Lakeshore.

The UWSS common asset listing, determined by the Provincial transfer order, includes the plant, various watermains, booster stations and water towers. Essentially all of the capital infrastructure projects built by the UWSS prior to the transfer order became assets of the UWSS. All other assets of the system are owned by the municipality in which the pipes are physically located.

UWSS is currently an unincorporated collection of assets owned as tenants in common and used collectively by the four Municipalities. There are limitations to the existing governance structure for the UWSS. Any borrowing on behalf of the UWSS must be done by the four municipalities instead of by the UWSS as a separate corporate entity. This also includes obtaining grant funding from senior levels of government. All UWSS debt must be carried on the municipal balance sheets in proportion to the system ownership share. This structure has significant limitations and as such, the four municipalities agreed to review a new structure.

Since 2017, the Administrations representing all four municipalities have been consulted in the development of this Financial Structuring Business Case as prepared by PricewaterhouseCoopers LLP's (PwC) and the UWSS General Manager.

The following resolution was passed by Lakeshore Council at the April 24, 2018 Council meeting:

That:

1. Council receive the presentation dated April 24, 2018 and report dated March 28, 2018 from the General Manager of the Union Water Supply System.
2. Council support in principle the proposed Business Case for Restructuring of the Union Water Supply System into a Municipal Service Corporation as outlined in the March 28, 2018 report.

3. Council direct Administration to proceed with an independent legal, financial and operational review on the merits of the Town of Lakeshore maintaining an ownership interest in the Union Water Supply System.

Comments

The Business Case

A newly formed corporate structure is anticipated to provide the UWSS with the ability to:

- Apply for grant funding separately from the Municipalities – no “competition” between UWSS and Municipal priorities;
- Borrow on its own to finance Board-approved capital expenditures;
- New UWSS debt is not attributed to the Municipalities, and does not affect Municipal debt capacity;
- Customers will see the UWSS portion of their water cost separately on their bill.
- Water rates will continue to be set by the Board, in accordance with Board policies and provisions of Board-approved lending agreement(s);
- UWSS, not the Municipalities, will bear the risk of volume fluctuations and uncollectible accounts;
- UWSS will pay a service fee to the Municipalities for work done by the Municipalities as agents of UWSS (billing and collection services);
- A corporate UWSS would be liable for itself and provide better liability protection to municipal shareholders; and

Section 203 of the *Municipal Act, 2001* authorizes a municipality to establish a corporation with other public entities. This is a municipal services corporation. O. Reg. 599/06 sets out how to create a municipal services corporation that regulation requires that, prior to doing so a municipality shall adopt a business case study. UWSS prepared the business case and documents needed to create and incorporate UWSS, in consultation with the various municipal administrations. The business case appears as attachment 2 to this report.

Administration has reviewed the business case and recommends establishing the new corporation for the benefits outlined in this report.

Composition of the Board

The new corporate structure, UWSS Inc., would be as follows:

- The current four municipalities which are acting jointly become shareholders of UWSS Inc. instead of operating under a joint management board structure.
- Ownership shares would be determined by water demand from each municipality. Ownership shares would consist of “tracking shares” that would be reviewed every 4 years based on water demand from each Municipality.

- UWSS Board of Directors would consist of 12 Board members. Each shareholder would appoint one Director to the UWSS Board. Shareholders would also appoint one additional Director to the UWSS Board for every 10 percent water demand for their respective municipalities.
- A maximum of two Directors appointed by each municipal shareholder would be either elected or employed municipal members. For example, the Municipality of Leamington, will be able to appoint six Directors to the UWSS Inc. Board since it is a shareholder and uses over 50% of UWSS water output. However, only two of the appointed directors may be a council member or municipal staff member. The other appointed directors would need to be independent of the municipal corporation and would be selected by a public appointment process. This is not an issue for Lakeshore as Lakeshore would only be entitled to have 1 member. If Council adopts the business case for the municipal services corporation, then Administration will prepare a further report regarding the appointment process for the Lakeshore director.
- When appointing Independent Directors, municipal shareholders shall consider the required competencies of prospective Board members including, but not limited to, legal, accounting, information technologies and engineering competencies.
- Existing UWSS “common” assets would be transferred from joint municipal ownership to UWSS Inc. ownership. All disputes on asset ownership will be reduced. A policy will be developed between UWSS Inc and municipal shareholders on any new future watermain/ transmission infrastructure in regard to finance and ownership.

The newly established corporation will not include private shareholders. The four current municipalities will remain owners however as Shareholders rather than as tenants in common.

Other Requirements

O. Reg. 599/06 also requires that the Municipality adopt and maintain a policy on asset transfers to corporations prior to transferring any assets to the corporation.

Administration will finalize its review of the draft policy (attachment 3) and present to Council at an upcoming meeting.

Others Consulted

UWSS, PWC, Willis Business Law (counsel for UWSS), Municipality of Leamington, Town of Essex, Town of Kingsville.

Financial Impacts

PwC has developed the financial model and plan for the UWSS Inc. for 50 years into the future. The financial model is founded on the principles of cost recovery rather than a return on equity model (that is similar to the electricity industry). This plan accommodates the proposed UWSS Inc. capital plan for 2023-2031 that is valued at over \$120 million and includes a new reservoir #3 at the plant, replacement of some

large watermains, expansion of Cottam Booster and construction of a new membrane “peaker” treatment plant. This plan is based on a lower annual base bulk water rate increase that is currently being used in the existing approved financial plan.

The financial benefits for the UWSS Inc. that are anticipated to be realized include:

- A corporation’s ability to independently obtain grants from senior governments;
- Become a credit worthy entity with the ability to secure its own debt;
- Become financially independent from the owner municipalities;
- Develop a financial planning structure that would address future capital requirements without creating “rate shock” to the end users customers; and
- As a Government Business Entity (GBE), the UWSS Inc. financials would be proportionately reported on the municipality’s financial statements as an investment, adjusted annually by dividends (if declared) and net income (loss).

The Municipality will continue to provide billing and collection services as agents on behalf of UWSS Inc. and remit those billings back to UWSS Inc.

The main risk, although satisfied through the discussions with the UWSS Restructuring Team, relates to bad debts of the UWSS Inc. treatment portion of the water charge. Currently, the Municipality is permitted to transfer all outstanding water (treatment and distribution) bad debts (uncollected charges) to property owners as a priority lien on the property to which the supply was made. Under the new corporate structure, only the Municipality’s portion of the outstanding distribution water debt will be transferrable to property taxes. The UWSS Inc. treatment portion of the bad debt will become the responsibility of the new corporation and will be recovered through a specific customer class bad debt provision within the UWSS rates along with system losses, specific to each Municipality. The importance of the bad debts being attributable to the specific customer class and each municipality is that the typical residential customer will not be required to pay for the bad debts of the large user customer classes (commercial, industrial and greenhouse) rather similar customer class types will share the bad debts and potentially recoveries of the new corporation.

Lakeshore’s collection efforts will continue on behalf of the Municipality and UWSS Inc. The uncollectible water treatment bad debts of the UWSS Inc. will be transferred back to UWSS Inc. and then ultimately recovered through water treatment rates charged by UWSS Inc. specific to Lakeshore for that entire customer class.

The PwC report details a financial structure for UWSS Inc. that can achieve the above criteria and outlines an implementation plan and schedule for the structure. It should be noted that the PwC report stipulates that the recommended financial structure and associated benefits can only be achieved if the UWSS legally restructures into a corporate entity first.

Lakeshore current valuation of its 3.36% stake in Union Water is \$1,329,000 based on 2020 audited financial statements.

Attachments

- 1) Draft – Policy on Asset Transfers to Municipal Service Corporation
- 2) Proposed Business Case Study for Restructuring Union Water Supply System (UWSS) into a Municipal Service Corporation dated March 28, 2018
- 3) Union Water Supply System Restructuring Project Financial Presentation dated August, 2022

Report Approval Details

Document Title:	Union Water Supply System - Restructuring Report.docx
Attachments:	<ul style="list-style-type: none"> - Asset Transfer Policy.docx - Attach I UWSS Financial Structure Business Case 2018 Municipal Public Consultation.pdf - Attach II UWSS Financial Structure Business Case August 2022.pdf
Final Approval Date:	Aug 4, 2022

This report and all of its attachments were approved and signed as outlined below:

Prepared by Justin Rousseau

Approved by Truper McBride