Union Water Supply System

Restructuring Project

Financial Presentation

August 2022

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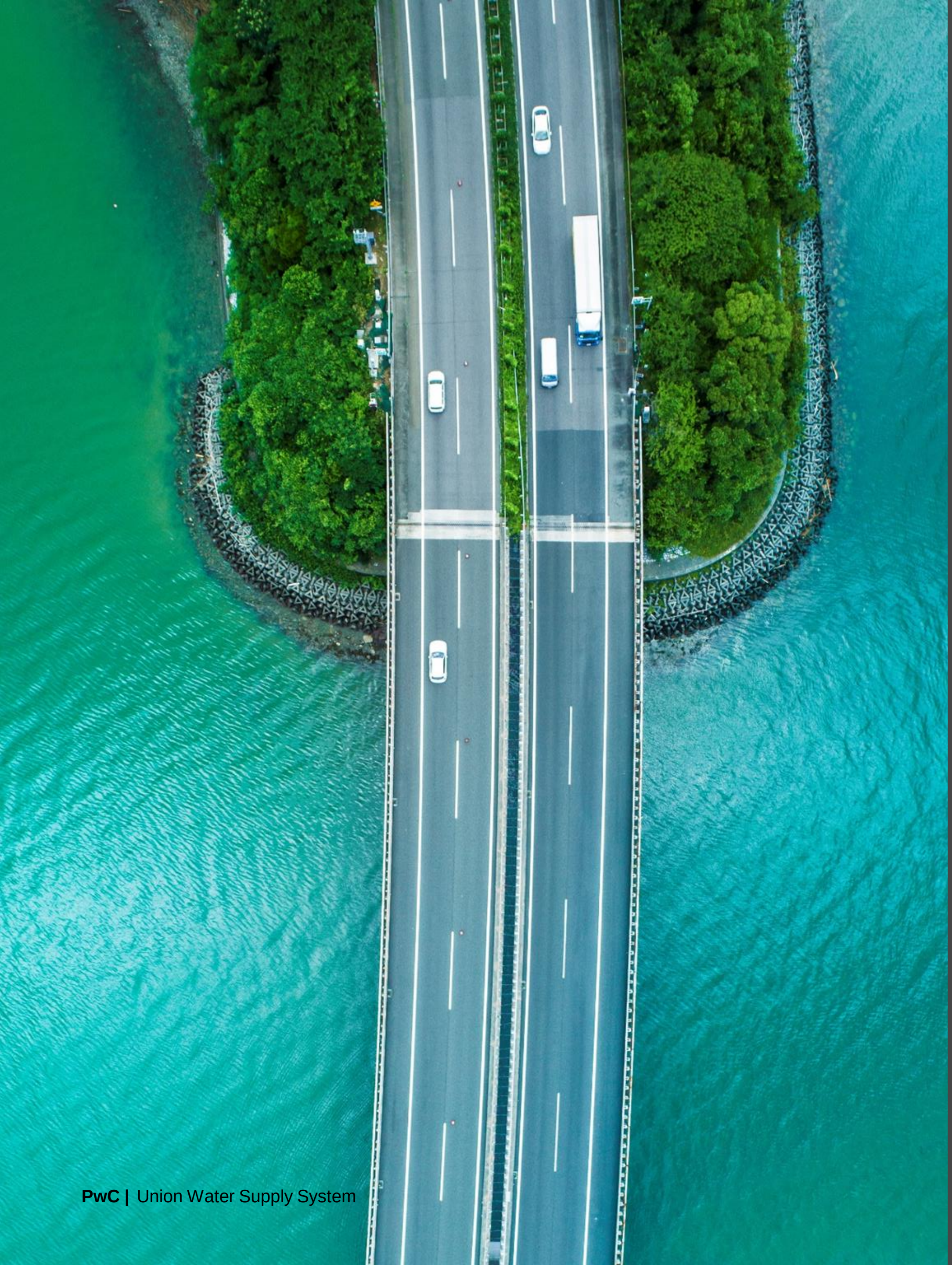


Content

Purpose of document

This document has been prepared to summarize the financial impacts of the proposed restructuring of Union Water and, in particular, to support the management of Union Water in discussions with municipalities.

This document should be considered in conjunction with:

- The draft legal documentation for the restructuring;
- The original business case for the restructuring of Union Water; and
- The detailed financial model that has been developed.

The document sets out the current position based on assumptions that have been developed and agreed with Union Water. These assumptions are subject to change.

Restructuring: Financial Objectives

Access to grant funding at the UWSS level

Access to debt capital at the UWSS level

Accounting for new UWSS debt as recourse only to UWSS and not to the owner municipalities

Ratepayer value and avoidance of “rate shock”

Summary of Proposed Financial Strategy

Objectives

Objectives	
Access to grant funding at UWSS level	• Establishment of a Municipal Services Corporation (MSC) • Municipal ownerships still allows potential grant applications to higher levels of government
Access to debt capital at the UWSS level	• The MSC structure allows UWSS to raise debt • Financial and rate structure designed to be attractive to lenders
Attribution of new debt only to UWSS	• Structure designed so debt is off balance sheet for the municipalities • To facilitate off balance sheet, UWSS will have commercial relationships with end customers – UWSS does not sell “wholesale” to Municipalities • Municipalities do not support UWSS financially, for example re bad debt expense
Ratepayer value, no rate shock	• Financial/rate structure provides lowered cost of capital • Reserves structure provides the UWSS Board with the ability to avoid rate volatility

Focus: Financial/ Rate Structure

- Rates will continue to be approved by the UWSS Board, in compliance with lending agreements
- The governance change above will be invisible to ratepayers
- Attractiveness of UWSS debt is supported by a market-standard DSCR (to be determined in financing competition)
- Both the current and proposed financial structures are low-cost-of-capital

Current	Restructured
Annual revenue requirement equals: • Operational costs (including OCWA contract) net of offsets • Debt service (currently limited to SunLife debt) • Cash-funded capital expenditures (portion not funded from cash reserves)	Annual revenue requirement each year is the **greater of** the value required to achieve accounting breakeven (the **"Breakeven Test"**): • Operational and maintenance costs (including OCWA contract) net of offsets • Depreciation • Interest cost net of interest earned **OR** the amount required to achieve a Debt Service Coverage Ratio (the **"DSCR Test"**): • Operational costs (including OCWA contract) • Debt service times a DSCR agreed with lenders • Required net additions to reserves End user rates will include provisions for system losses and bad debt
Actual revenues may vary from the core revenue requirement by varying the Rate Stabilization Fund	Actual revenues may vary from the core revenue requirement by varying the Rate Stabilization Fund
Larger capital expenditures are funded by Municipal borrowing	Capital expenditures are debt-funded at the UWSS level as required after capital reserves are exhausted

Focus: Attribution of Debt

Accounting Requirements for "Government Business Entities" to be equity-accounted (desired treatment)

- The GBE must be a legally incorporated entity
- The GBE must be delegated the responsibility to deliver the services that would otherwise be Municipal
- The Municipality(ies) must not be the dominant customer of the GBE
- The GBE must not receive financial assistance from the Municipality(ies)
- Normal-course payment for services delivered to Municipalities is OK

Changes for UWSS (no change to Municipal water business)

Features of the Restructuring

- UWSS will have a commercial relationship with end customers
  - Separate line on water bill
  - Accounts receivable ("AR") and collections tracked (and paid for by UWSS)
- UWSS responsible for AR management. Bad debt expense of UWSS will not go on tax roll, but be socialized across ratepayer base as in electrical utilities
  - Separate AR class for each municipality
  - Municipalities may want to consider separate treatment for commercial users (e.g. greenhouse industry)
- UWSS end user rates will incorporate system losses and a bad debt provision
- UWSS pays Municipalities for administrative costs borne re UWSS

Focus: Reserves in Restructured UWSS

Reserve	Characteristics
Operating and General Reserve ("OGR")	• The only reserve committed to lenders under the Common Terms and Intercreditor Agreement ("CTIA") • Minimum value (percentage of revenues specified in CTIA) • May be drawn on as needed to fund shortfalls in revenue or increases in costs versus approved budget • Must be replenished in the following rate year, by borrowing if necessary
Rate Stabilization Fund ("RSF")	• No minimum balance above zero (initial funding is contemplated) • Absorbs the difference between core revenue requirement and actual rates approved; cannot be debt-funded. This enables the Board to avoid rate volatility • Approved plan may call for draw from or increase in this reserve • Excess balances may be released to working capital on Board direction
Capital Reserve ("CR")	• Holds funds intended for approved or future capital expenditures • No minimum value above zero • May receive proceeds of debt financing and other cash balances at Board direction
Other reserves	• May be established by the Board as required • Financial analysis assumes a working capital reserve of $500,000 (2022 dollars)

Summary – UWSS Restructuring

What will not change	What will change
• UWSS operations (OCWA contract unaffected by the new structure) • Sufficient capital to meet volume and quality demands (although at present supported as needed by Municipal debt) • Water rates – no rate shock • Rate structure – essentially uniform underlying bulk water rates, although this could be modified in future at Board discretion • No privatization • Cost recovery model – not a Return on Equity/shareholder profit model like electrical utilities (this latter has a much higher cost of capital) • UWSS manages its cash reserves and investments on Board direction, although these will be to the account of UWSS as a corporate entity	• UWSS can apply for grant funding separately from the Municipalities – no "competition" between UWSS and Municipal priorities • UWSS can 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 • UWSS, not the Municipalities, will bear the initial risk of system losses, volume fluctuations and uncollectible accounts; these will be costs of doing business to be recovered in rates • UWSS will pay a service fee to the Municipalities for work done by the Municipalities as agents of UWSS (billing, collection, and associated accounting)

Financial Projection Highlights

In this section:

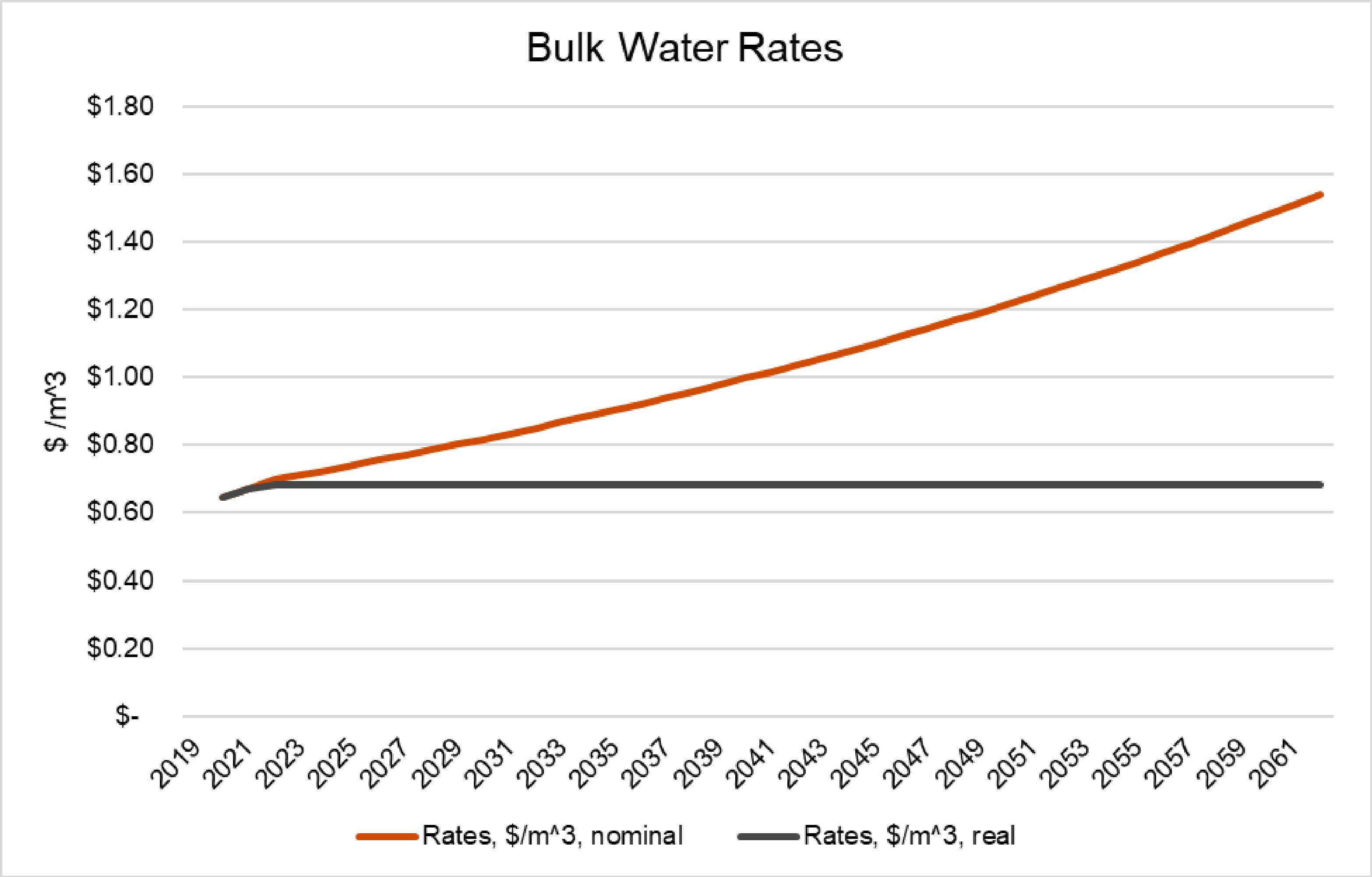
- Assumptions used in financial projections
- Revenue and rate projections
- RSF balances (using assumed rate growth and before any re-allocation)
- Additional financial projections – asset and debt metrics

Financial Projection – Selected Assumptions

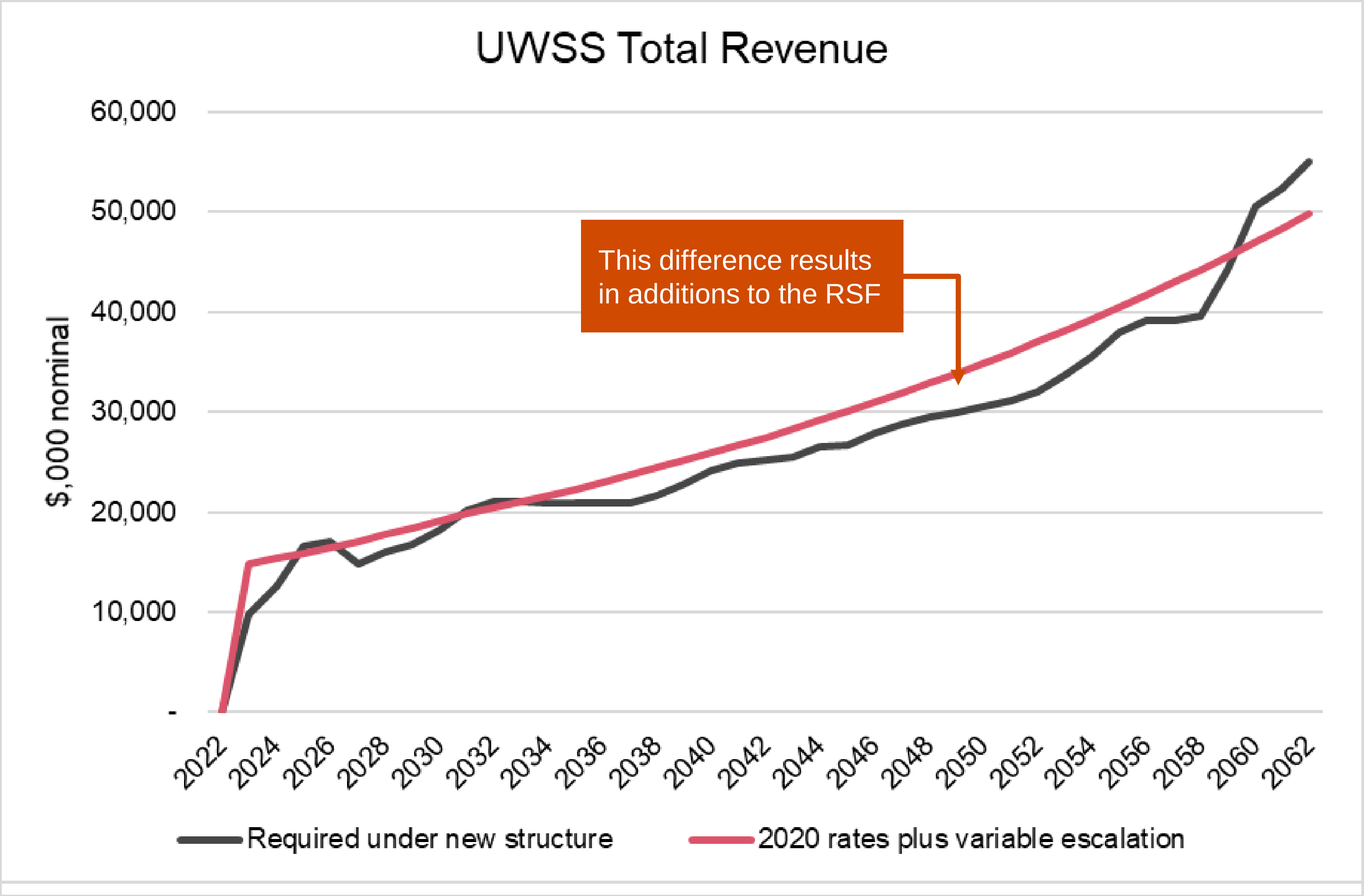
Item	Assumption
Inflation	• 2% long term
Rates (at bulk system level)	• Approved 2022 rates • Increase thereafter at 2% (that is, with inflation) through the end of the projection
Volume growth	• 1.5% through 2027 (2022 approved plan) • 1.75% 2028 through 2031 (AE engineering study) • 1% thereafter to end of projection • In all periods, lower than recent experience
Capital program	• Calculated replacement of assets at end of 2021 • Approved six-year capital plan, but with 2022 debt-funded expenditures moved to 2023 • Allowance for additional major capital works through 2031($48 million including new plant) • Allowance for $500,000 (2022 dollars) in supplementary capital works not foreseen in approved plan
Operating costs	• Per approved plan through 2027, then escalated at inflation
Grant funding	• None
Sun Life debt	• Retired on schedule in 2026
WFCU investment	• Retired to CR at the end of 2028

Financial Projections (1)

Note – end user rates will reflect prevailing system losses and a provision for bad debt, specific to each Municipality



Financial Projections (2)



Financial Projections (3)

Based on the current financial projections, if rates are kept constant in real terms the RSF Balance is projected to grow significantly.

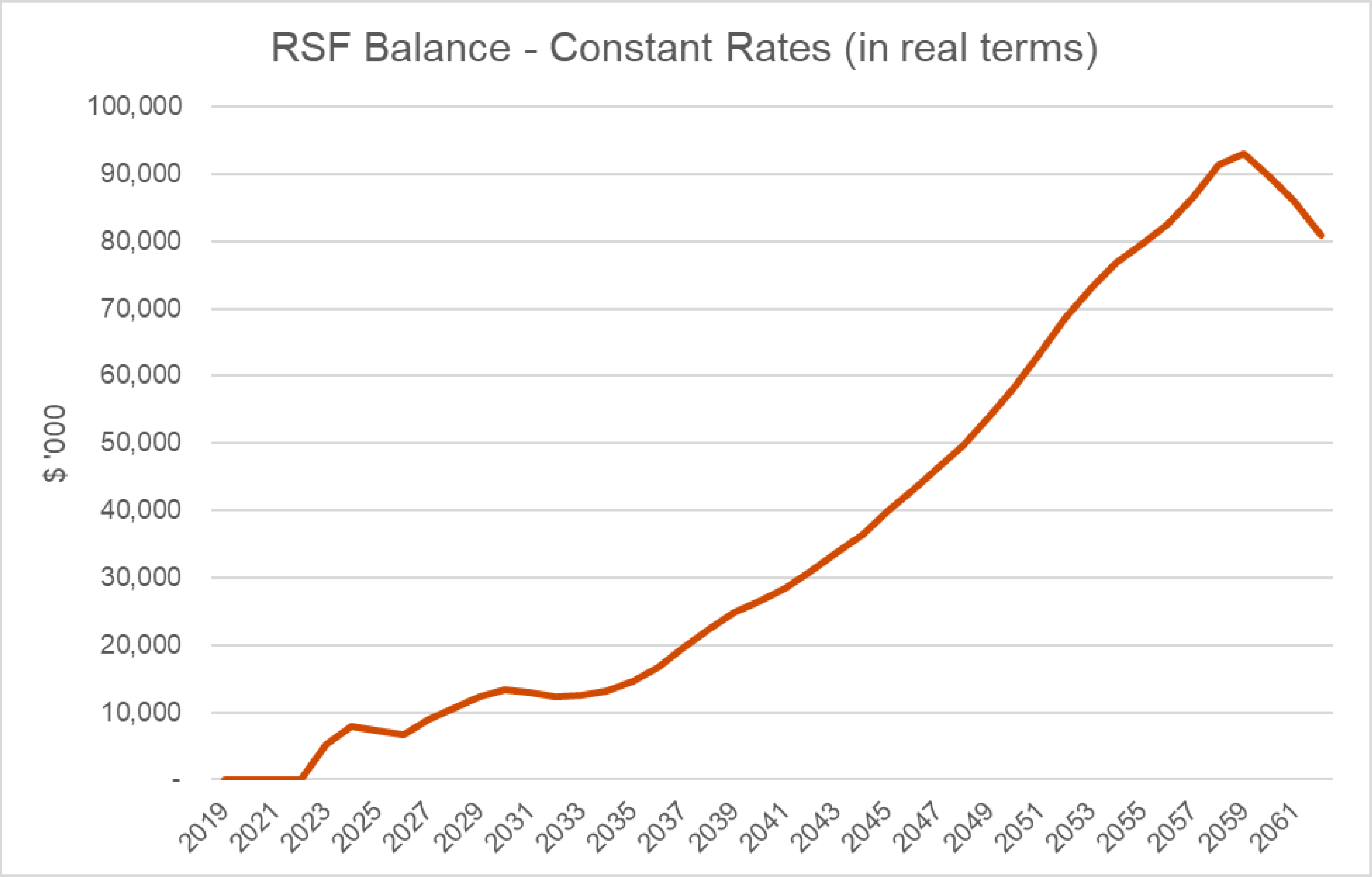
This largely reflects the projected volume growth in the business plan.

Rates are set annually by the Board (within provisions of the CTIA).

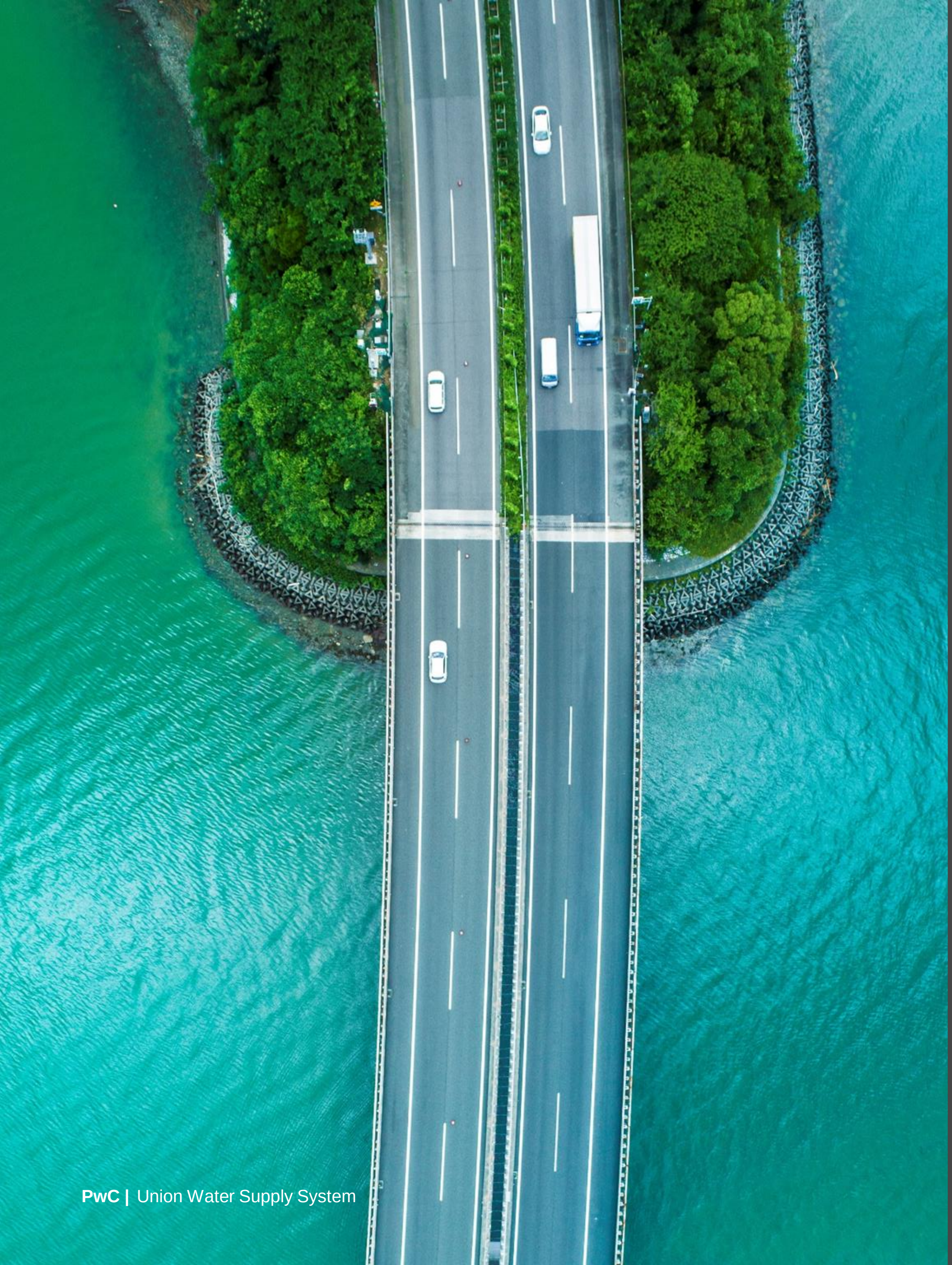
If the projected costs and growth materialises, it is expected that the Board would look to:

1. Reduce rates in real terms; and/or
2. Withdraw excess balances from the RSF.

UWSS would also want to consider its Treasury Management approach if it had cash balances of this level.



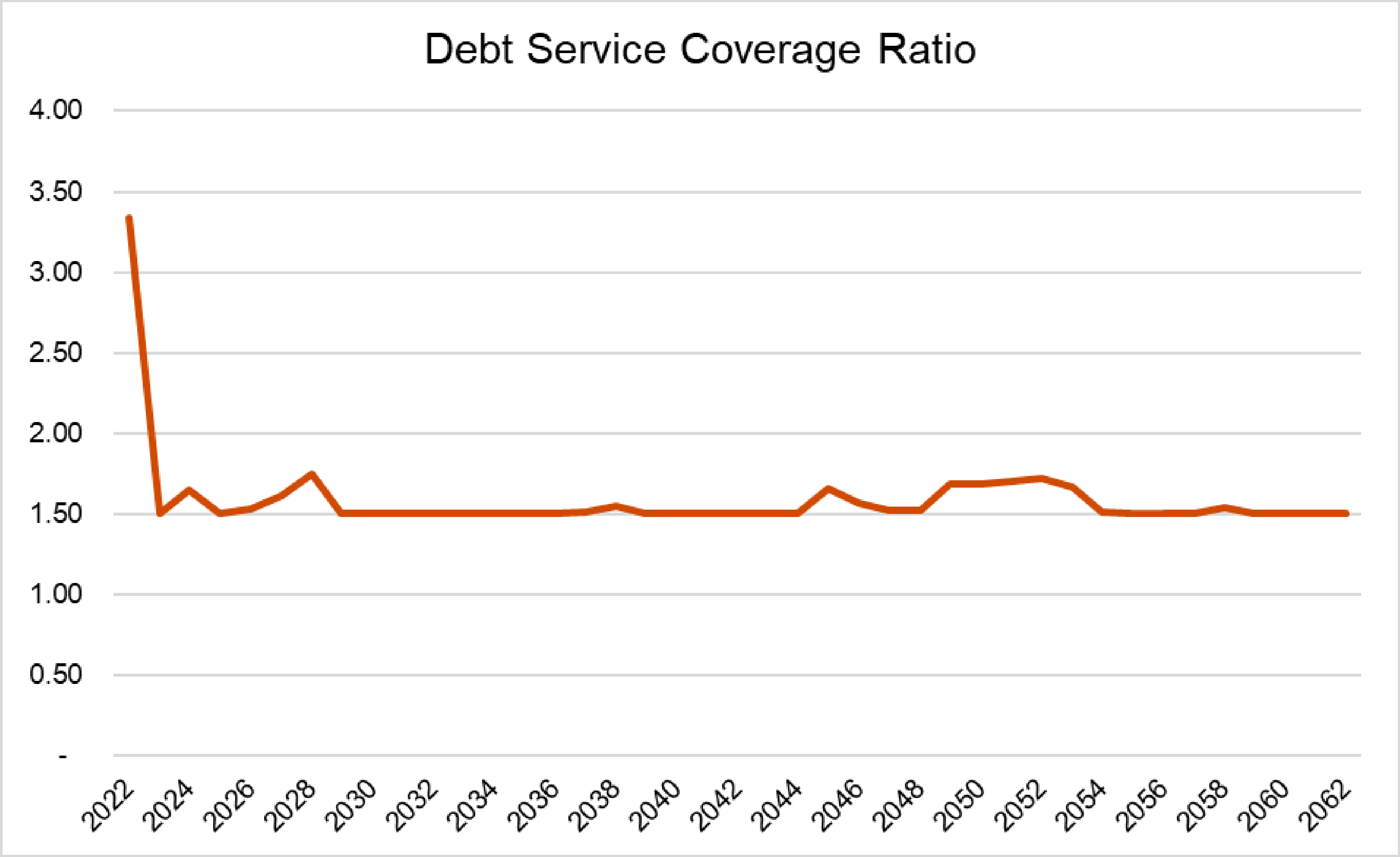
Questions



Appendix

Additional Financial Projections

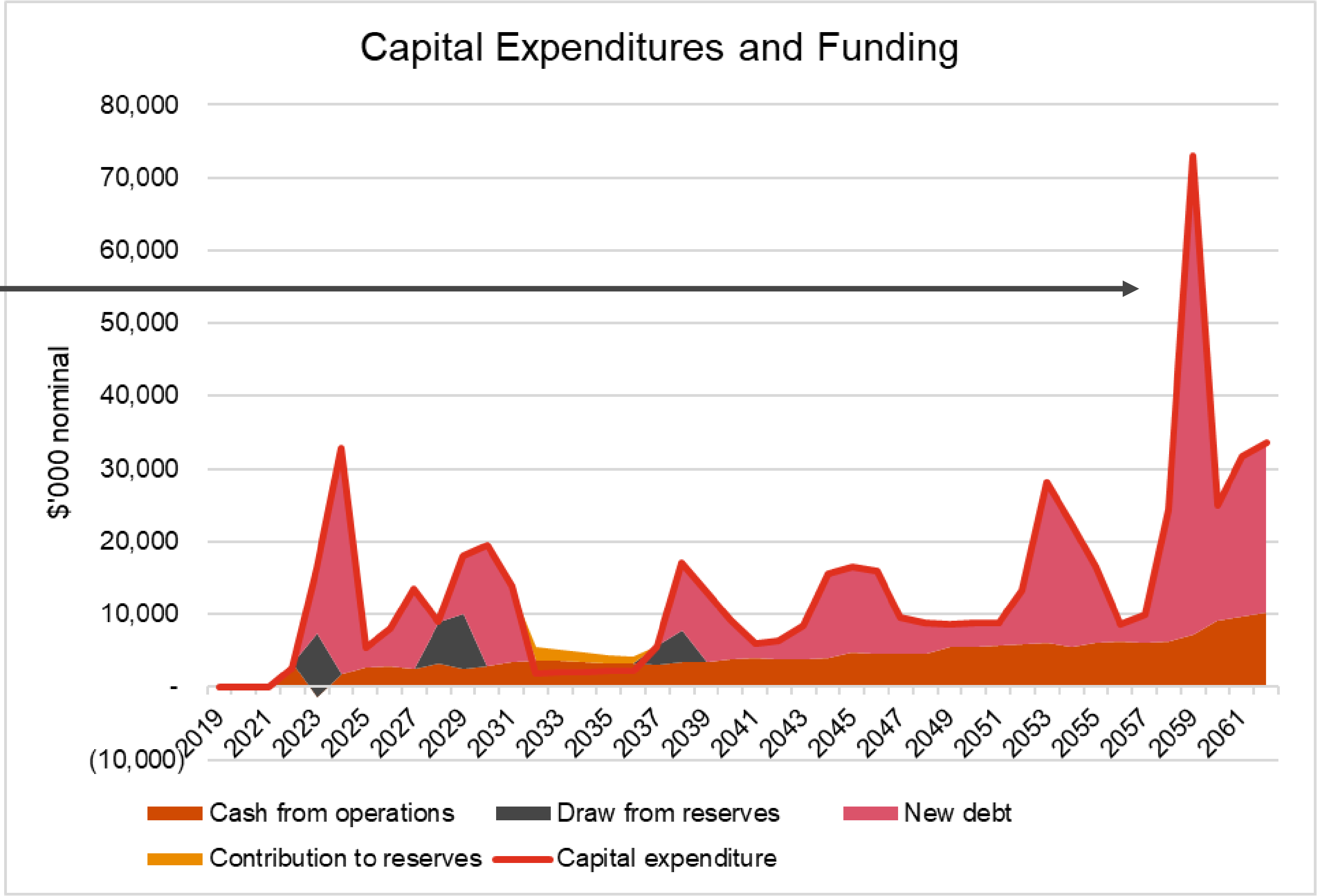
Additional Financial Projections (1)



Additional Financial Projections (2)

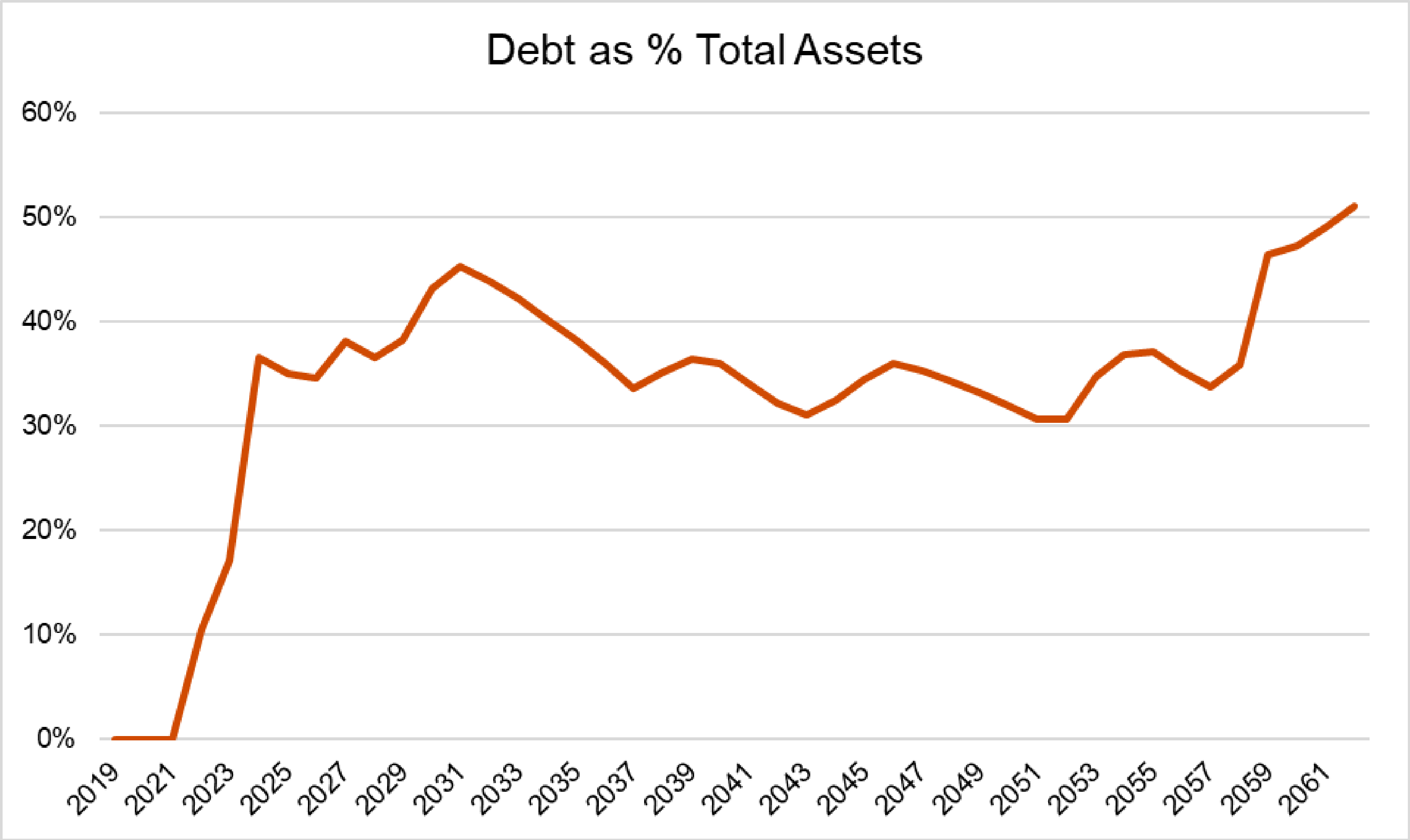
“Spike” in 2059 is calculated end of life replacement for assets in service in 2024 – reservoir and UV. Subsequent (lower) borrowing is also to fund calculated end of life replacement

Note – under the existing framework, new debt would be at the Municipal level



Additional Financial Projections (3)

Note – no defined capital structure has been “promised” to potential lenders. The integrity of the UWSS debt is provided by the rate structure, which is driven by DSCR



Thank you

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