

Report to Council



Date: October 28, 2024
To: Council
From: City Manager
Subject: Water Utility 2025 Budget
Department: Utility Services

Recommendation:

THAT Council receives, for information, the Report from the Utility Services Manager dated October 28th, 2024 pertaining to the city water utility, the proposed 2025 water operating and capital budgets and the 2025 water rates;

AND FURTHER THAT staff be directed to add the budget items referenced in the Report Attachment 1 to the draft 2025 Financial Plan - Preliminary Budget Volume.

Purpose:

To provide Council with information on the water utility and consider budget items for the 2025 capital and operation budget.

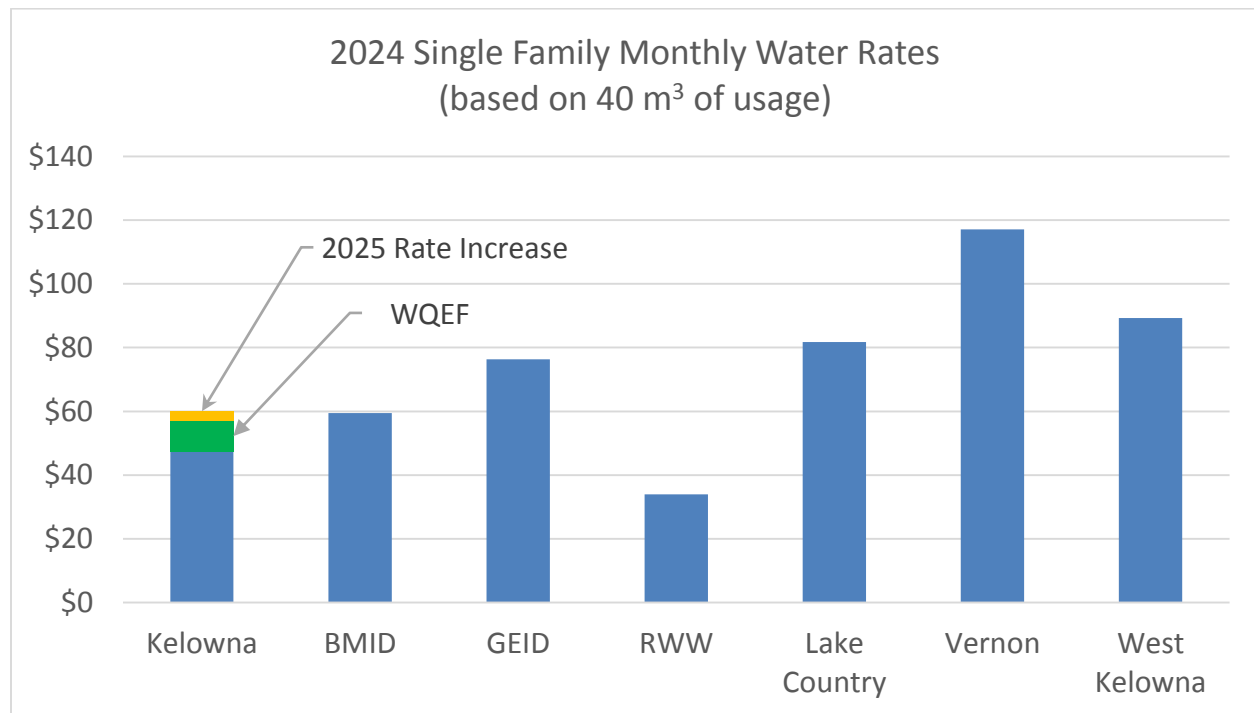
Background:

The City of Kelowna Water Utility is one of four major water providers operating within the municipal boundary. The Utility provides potable water to approximately 86,000 residents in addition to commercial and industrial customers. The potable system provides Okanagan Lake water from four sources located at Poplar Point, Eldorado Road, Cedar Creek beach and Swick Road. Each intake provides chlorine disinfection as well as ultraviolet light disinfection to ensure our potable water meets Canadian Drinking Water Quality Guidelines and Interior Health requirements. The potable water system is comprised of 20 booster pumping stations, 55 pressure-reduced valve stations and 24 water storage reservoirs. Additionally, the Utility owns and operates a non-potable system for irrigation that is in southeast Kelowna. That system is comprised of several lake reservoirs with 16 licensed dams, 5 diversion channels and 32 pressure-reducing valve stations.

The replacement value of the water distribution systems is well over \$1 billion. The total water distribution system is made up of 638 kilometers of watermains, 2,435 fire hydrants and over 20,000 metered service connections.

The City conducts annual reviews of water utility operations, maintenance, and capital expenditures required to support a sustainably funded utility. The analysis includes a pro-forma statement of revenues and expenditures over a 10-year projection based on current and anticipated capital and operating expenses.

Historically, water rates in Kelowna have been some of the lowest in the valley. In addition, Kelowna has the lowest water costs for a single family home of 35 Canadian cities that participate in a national benchmarking program. The water rate comparison in Figure 1 illustrates total water costs for an average single-family home using 2024 rates and an average monthly demand of 40 cubic metres of water. The cost of water includes the contribution to the Water Quality Enhancement Fund (WQEF). Water rates for both 2024 and 2025 were approved by Council in fall 2023.



Discussion:

Council should be aware of the following drivers that will have a significant impact on the Water Utility and water rates over the coming decade:

Infrastructure Renewal:

Water assets are depreciating faster than they are being renewed. The 2024 and 2025 capital renewal rate for the potable system is 0.62% of asset value which implies that, on average, potable system assets will be renewed every 160 years. Our current renewal rate is adequate given the relatively young age of our potable water assets.

The proposed 2025 capital budget sees the renewal rate for the non-potable system increase to 0.48% from the 2024 rate of 0.41%. This implies, on average, the non-potable system assets will be renewed

every 200 years. The non-potable system is over 50 years old on average and has seen very little renewal. This is the former South East Kelowna Irrigation District (SEKID) system that the City obtained in 2018.

While staff are developing a non-potable capital plan, it's clear that funding for asset renewal will need to increase significantly. Additionally, this system includes high value, high risk assets, such as reservoir dams and large distribution main. The Capital Plan sees significant renewal investment ramping up to over \$3 million per year by 2033. As this system was developed using agricultural grant funding in the 1960's and early 70's and continues to support agriculture in our community, staff will pursue agricultural grant opportunities for its renewal.

The renewal rate for Water Utility infrastructure will need to increase over time to a target of 1.33% (75-year average life) to ensure the sustainability of the utility and service to our customers. Staff are updating the water utility asset management plan which will clarify the necessary timing and rate of increase in renewal funding necessary for sustainable utility financing.

Over the next ten years, Infrastructure renewal will focus on reliability and asset preservation. An additional factor contributing to the costs of renewal is construction cost inflation, which has consistently exceeded general consumer inflation.

GEID, Growth and Expansion:

On June 17, 2024, the Province passed an Order-in-Council dissolving the Glenmore Ellison Improvement District (GEID) effective January 1, 2025. GEID assets and operations will be transferred to the City and continued as a local area service of the City. The GEID system will be operated as a branch of our Water Utility. Staff from both organizations are working together to ensure a smooth and effective transition. 2025 Water rates for the Glenmore Ellison water system will be set this fall by the current GEID board. Staff from both organizations are working to ensure the 2025 rates are appropriate. Council will first set rates for the Glenmore Ellison system in the fall of 2025 and the budget will be added to the City's Financial Plan as part of the 2025 Final Budget volume. It is anticipated that the Glenmore Ellison system will have separate rates through the transition period, with a goal of merging rates by 2028. GEID bylaws are inherited by the City and will continue to apply to that system until rescinded by Council. Rescinding and addressing GEID bylaws will be included in the transition activities between now and 2028.

As city operations increase to accommodate growing and aging utility infrastructure, organizational space for staff, fleet and equipment is not keeping up. Currently, water operations are split across two different locations that are struggling to accommodate growth in staff and equipment resources. The GEID merger will add one additional location to our dispersed operation. The need for a long-term consolidated location is one of the strategic goals for the Utility.

Water Quality:

The City of Kelowna applied for filtration treatment exclusion in 2010 and was approved in 2011, based on the provision that several treatment and water quality objectives be adopted, monitored, and reported to Interior Health on an annual basis. Since obtaining filtration exclusion, the City of Kelowna has continually met or exceeded the six requirements outlined by Interior Health and approved by the provincial Medical Health Officer.

While Okanagan Lake continues to have high water quality, there are changes and variations in water turbidity. Many factors such as lake use, source inputs and watershed management affect water quality but may not be in the City’s jurisdictional or practical ability to control.

City development and population growth will continue to put pressure on the lake and its creeks. Growth and activity in turbidity prone zones can permanently impact lake and drinking water quality. The consequences of not addressing these risks are significant. The largest is the loss of the filtration exemption from the Okanagan Lake source, resulting in expensive water treatment upgrades and a complete refocus on infrastructure priorities. The Utility is preparing for the long term by ensuring that land is available near our water sources for more advanced water treatment facilities.

2025 Budget

A summary of water utility accomplishments, highlights and proposed 2025 operating and capital budget adjustments are provided in Attachment 1. Upon support of Council, these requests will be presented for approval on December 5, 2024, as part of the 2025 Financial Plan – Preliminary Budget Volume.

Rate Projections:

Historically, infrastructure renewal was funded from revenues on a pay-as-you-go basis. Capital renewal was timed to reduce fluctuations in the annual capital funding required from Utility revenues and some balancing was accommodated from the Utility’s reserves. Debt has been used to fund large new infrastructure, such as the Cedar Creek water source and ultraviolet treatment upgrades at the Poplar Point water source.

Given the near-term need for capital investment as well as inflationary pressures on the Utility, the pay-as-you-go funding model would drive significant rate increases over a short period. Financially, current water utility debt will be substantially paid off in 2029 and fully eliminated in 2031. Financial analysis shows that using internally financed debt to help fund our ten-year capital plan will allow the Utility to be sustainably funded with ongoing annual rate increases in the realm of 6% to 7%. Financial health indicators suggest there is no substantial financial risk associated with this approach.

\$ thousands	2025	2026	2027	2028	2029
Operating revenues	18,985	20,245	21,765	23,411	25,193
Operating expenditures	(13,404)	(14,043)	(14,553)	(16,137)	(16,632)
Capital expenditures	(19,609)	(17,535)	(26,936)	(49,814)	(26,130)
Annual surplus / (deficit)	(14,028)	(11,333)	(19,724)	(42,540)	(17,569)
Other funding sources	5,525	3,848	8,025	19,348	13,250
Reserve use	8,603	7,485	11,876	23,622	5,009
Fund surplus / (deficit)	101	(0)	177	430	691
Recommended rate increase	6%	6%	7%	7%	7%

The table above shows the projected revenue and spending for the utility over the next five years. In all years, an annual deficit is expected but will be funded using the utility fund balance (reserves), DCC reserves, and developer contributions. This five-year plan will significantly reduce the utility fund balance but is expected to recover over the following five years. Based on planned capital expenditures, operating expenses and using some internally financed debt, water rates and the Water Quality Enhancement fee in 2024 and 2025 increased by 6%.

Conclusion:

The Water Utility continues to provide safe, high quality and cost-effective service for rate payers. With the current state of renewal, growth and inflationary pressures, water rates and charges should be expected to increase at 6% to 7% annually for the foreseeable future.

Internal Circulation:

Financial Planning Manager
Community Communications Manager

Considerations applicable to this report:***Financial/Budgetary Considerations:***

At the direction of Council staff will incorporate the proposed 2025 water budget adjustments into the draft 2025 Financial Plan – Preliminary Budget Volume that will be considered by Council in December 2024.

The approved 2025 water utility rates support the approved ten-year capital plan and the proposed 2025 operating budget adjustments.

Communications Comments:

A note on the utility bill will inform customers of the adjusted rates.

Considerations not applicable to this report:***Legal/Statutory Authority:******Legal/Statutory Procedural Requirements:******Existing Policy:******Consultation and Engagement:***

Submitted by: K. Van Vliet, Utility Services Department Manager

Approved for inclusion: M. Logan, General Manager, Infrastructure

Attachment(s):

Attachment A: Proposed Water Utility amendment of draft 2025 Preliminary Financial Plan

cc:

Financial Planning Manager, Corporate Services
Budget Supervisor, Corporate Services