

**CITY OF PENTICTON
UTILITY RATE REVIEW**

Submitted to:

City of Penticton

Prepared by:

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InterGroup

C O N S U L T A N T S

Executive Summary

The City of Penticton ("City") owns and operates electric, sanitary sewer and water utilities serving approximately 17,000 residential, commercial and industrial customers. InterGroup Consultants Ltd. ("InterGroup") was retained by the City to review and make recommendations for rate adjustments for the City's electric, water and sanitary sewer utilities for the period from 2016 through 2020. The City requested rate proposals that reflected an appropriate balance between return on investment, consumer affordability and business competitiveness.

The review of the City's electric, water and sewer rates provides the basis for the City to implement rates that will allow each utility to be financially sustainable. Proposed rate adjustments between customer classes will also help ensure rates reflect the costs to serve different types of customers. The five-year time horizon also provides customers with information on what they can expect for utility rate changes over the next several years. In particular, rate adjustments for electricity customers are proposed that will be lower than currently forecast rate increases for Fortis BC. Proposed changes to administration fees, the electric utility dividend to the City and revenue to cost coverage adjustments are phased in over time to avoid rate shock.

InterGroup reviewed City budgets for each utility in order to develop rate proposals. This review included reviewing the administration fees charged to each utility and the level of the dividend paid by the electric utility to the City. Based on a review of key cost drivers for the existing administration charges, it is recommended that the administration charges to the electric utility be reduced and the administration charges to the water and sewer utilities be increased. This would more properly reflect the true cost of support services required by the utilities. It is also recommended that the City change the method for calculating the dividend from the electric utility to align with common practice for other utilities.

Based on the review of the budgets it was determined that rate revenues would need to increase for each utility to maintain minimum reserve balances and ensure sufficient revenue to fund ongoing operating costs and an average annual capital program. Based on this review, the average annual rate increases proposed for each utility are:

- 3.19% each year from 2016 to 2020 for the electric utility
- 11.5% for 2016 and 2017 and 4.43% for 2018 to 2020 for the water utility
- 8.78% each year from 2016 to 2020 for the sewer utility

A cost of service analysis was also undertaken for each utility to determine the relative increases for each type of customer. The cost of service analysis indicated that residential customers were generally underpaying for electricity and water service and overpaying for sewer service. Commercial and industrial customers were generally overpaying for electricity and water service and under paying for sewer service.

A review of rates with other municipalities in Canada indicated in particular that Penticton's existing electricity rates are higher than similar sized communities in British Columbia. The review also indicated that the City's existing fixture charge rate structure for sewer service is not consistent with most other municipalities. Therefore it is recommended the City transition to a sewer rate structure based on a fixed charge and a variable charge based on water consumption. It is recommended the City delay this change in sewer rate structure until 2017 in order to effectively communicate the change in rate structure to customers.



Public consultation opportunities were provided during the course of the study, including:

- A small working group was established with some key stakeholders identified by the City. Presentations and discussions were held with members of this stakeholder group on April 15th, April 16th, July 27th and November 2, 2015.
- **Public open houses:** Public open houses were held August 24th at the City Council Chambers; August 25th at Cherry Lane Mall; and August 26th at the Penticton Library. The open houses included story boards with information about the rate study, surveys that participants could fill out and the opportunity to discuss results with City staff and the consultant.
- **City Website:** Information about the study was provided on the City's website and an online survey was available for interested parties to fill out.

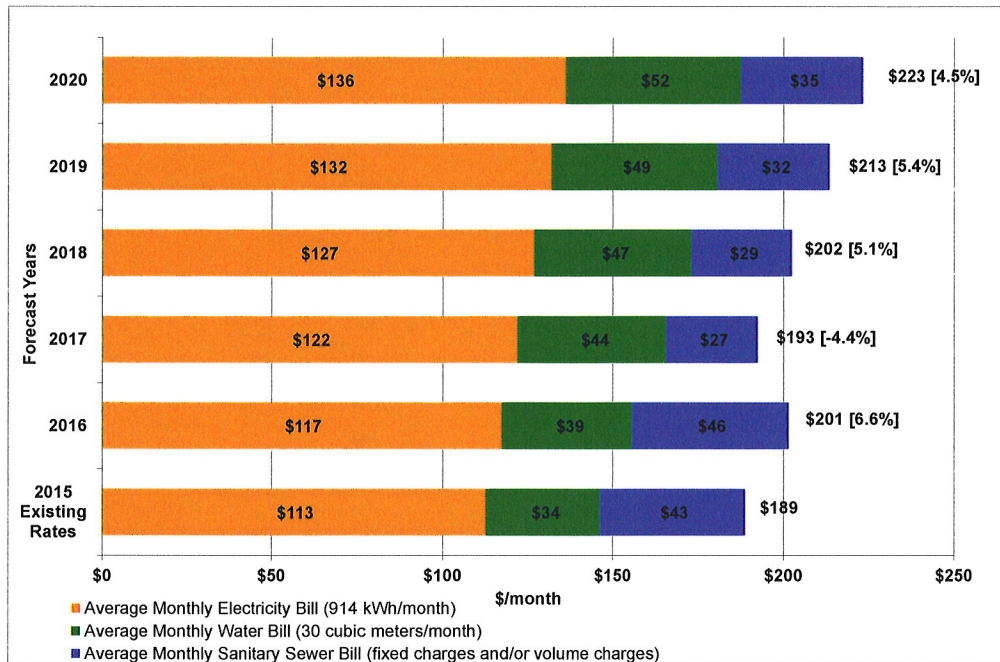
Rates were developed that would provide sufficient revenue to pay for operating costs and an average annual capital program and transition all customers toward full cost of service by 2020. Preliminary rate options were developed and presented at public open houses in August 2015. Final rate proposals were developed based on feedback from the City and residents. The combined effect of the rate proposals on electric, water and sewer bills for average customers are estimated as follows:

- Between 4.5% to 6.6% annual increases for residential customers. The transition to the new sewer rate structure is expected to reduce sewer bills for residential customers so these customers may see a small decrease in their overall utility bills when this new rate structure is implemented.
- Between 2.5% to 7.1% annual increases for small commercial customers. The transition to the new sewer rate structure is expected to slightly increase utility bills for these customers when the new rate structure is implemented.
- Between 1.9% to 5.4% annual increases for industrial customers. The transition to the new sewer rate structure is expected to slightly increase utility bills for these customers when the new rate structure is implemented.

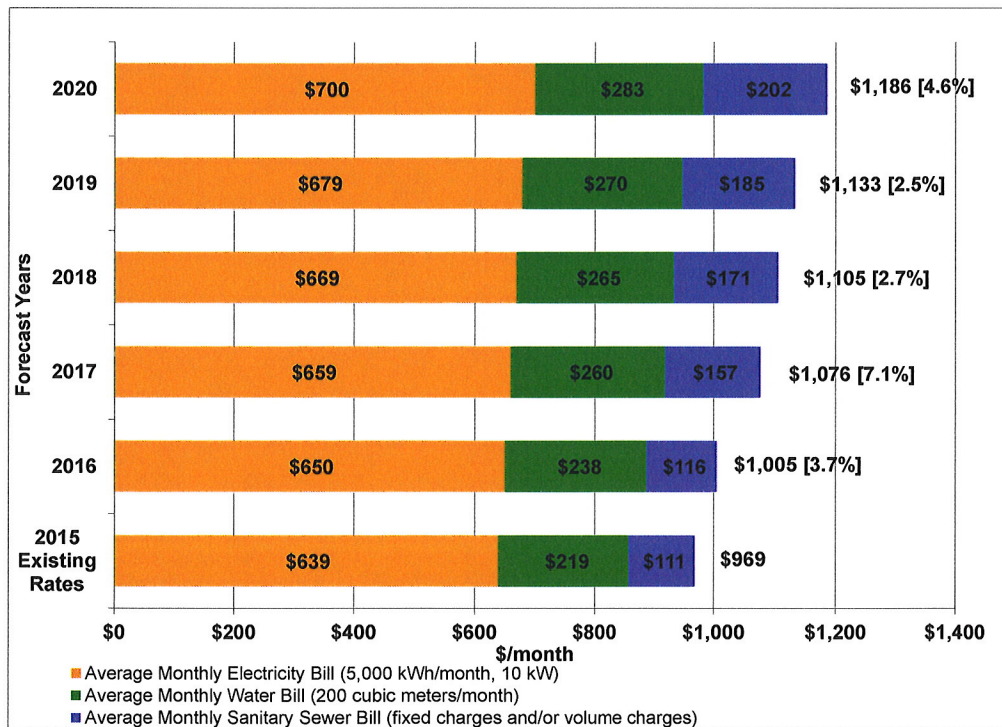
Electricity rates are generally the largest portion of each customer's total utility cost, therefore the average rate increases for each type of customer reflect a heavier weighting on the electricity portion of the total utility bill.

Figures 1-1 to 1-3 provide an illustration of the combined effects to the customers from proposed electric, water and sanitary sewer rate changes.

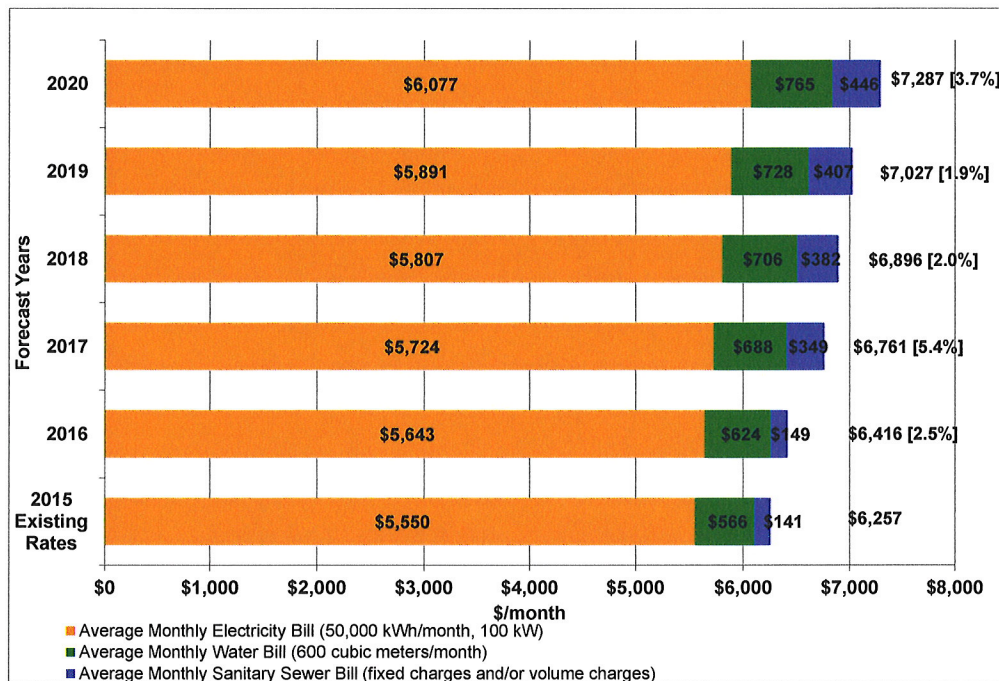
**Figure 1-1:
City of Penticton Residential Bill Comparison for 2015 through 2020**



**Figure 1-2:
City of Penticton Small Commercial Bill Comparison for 2015 through 2020**



**Figure 1-3:
City of Penticton Large Commercial/Industrial Bill Comparison for 2015 through 2020**



It is recommended the City adopt the following process for implementing the proposed rate changes:

1. City Council adopt the electrical, sewer and water rates schedules for the 2016 to 2020 as presented in Section 7 of this report. Rates were designed to reflect a balance of the following rate design criteria:
 - a. Ensure utility rates are sufficient to maintain at least minimum reserve balances in each year.
 - b. Ensure utility rates are sufficient to recover the full utility revenue requirements including an average annual capital program by 2020.
 - c. Finance a portion of major expansions and upgrades in capital programs for the water and sanitary sewer utilities in order to smooth out the required rate increases.
 - d. Phase in changes to Administration Fees and Electric Utility Dividend by 2020.
 - e. Target utility rates for each rate class equal to the cost of service by 2020.
 - f. Implement a new sanitary sewer rate structure based on treated water use in 2017.

2. Rescind the current Rate Setting Policy and review the proposed rates each year as part of the annual budget process to address any unexpected costs or changes in revenues. It is also anticipated that this alignment with the City’s annual budget process will enable residents to consider proposed changes to utility rates in the context of other City budget and revenue changes, such as property taxes.

3. The City undertake a detailed review of revenues and costs after three years, to ensure rates continue to fairly reflect the costs to serve each customer class. Future detailed rate studies should be prepared based on a three to five year forward looking basis to provide customers with some predictability about future rate changes.
4. It is recommended the City transition to monthly billing for water, sewer and electrical service.
5. It is recommended that the City not adopt an Institutional Utility Rate.
6. It is recommended that the City not implement an increasing block rate structure for residential electrical rates and water use.
7. It is recommended that for future capital planning, the City conduct an analysis of the replacement cost of its utility assets and ensure its capital budgets are sufficient to address ongoing requirements for infrastructure renewal, as well as any necessary expansion projects.

