SPECIAL MEETING OF COUNCIL
AGENDA

Tuesday, March 23, 2021, 6:00 PM

Council Chambers

2021 Division Road N

Kingsville, Ontario N9Y 2Y9

Pages

A. CALL TO ORDER

In light of the ongoing COVID-19 pandemic, this Special Meeting of Council is being held electronically. Members will meet via electronic participation. Members of the public can view the meeting at www.kingsville.ca/meetings and select the VIDEO icon.

B. DISCLOSURE OF PECUNIARY INTEREST

When a member of Council has any pecuniary interest, direct or indirect, in any matter which is the subject of consideration at this Meeting of Council (or that was the subject of consideration at the previous Meeting of Council at which the member was not in attendance), the member shall disclose the pecuniary interest and its general nature, prior to any consideration of the matter.

C. BUSINESS CORRESPONDENCE--ACTION

1. **Union Water Supply System Joint Board of Management--Correspondence dated March 9, 2021 RE: Town of Kingsville Appointees to the Union Water Supply System Joint Board of Management** 1

2. **Selection of Four (4) Members to the UWSS Board**

   J. Astrologo, Director of Legislative Services

D. STAFF REPORTS

1. **Union Water System Treatment Capacity & Governance Discussion** 4

   John Norton, Chief Administrative Officer

   G. A. Plancke, Director of Infrastructure and Engineering

   Rodney Bouchard, General Manager, Union Water Supply System will also be in attendance.

Recommended Action
That Council receive the covering report and,

That Council receive the verbal information provided by the Union Water Supply System Manager, and Chair of the Joint Board of Management as a sufficient update to the recent Moratorium and ongoing governance discussions.

E. CONFIRMATORY BY-LAW

1. By-law 31-2021 112

Being a By-law to confirm the proceedings of the Council of The Corporation of the Town of Kingsville at its March 23, 2021 Special Meeting of Council

To be read a first, second and third and final time

F. ADJOURNMENT

Union Water Supply System

P.O. Box 340, 1615 Union Avenue, Ruthven, Ontario, N0P 2G0
Tele: 519-326-1668 Fax: 519-326-3490
Email: rbouchard@unionwater.ca
www.unionwater.ca

SENT BY: email
March 9, 2021

Town of Kingsville
2021 Division Road North
Kingsville, Ontario
N9Y 2Y9

Attention: Mr. John Norton, Chief Administrative Officer

Dear Mr. Norton,

RE: Town of Kingsville Appointees to the Union Water Supply System Joint Board of Management

As per the *Transfer Order for the Union Water Supply System, Transfer Order Union W1/1999 dated January 8, 2001* (Transfer Order) the appointment of municipal representatives on the UWSS Joint Board of Management is governed by the following section of Schedule "B" to the Transfer Order:

Joint Board of Management

1. *(a) Each Municipality may appoint one (1) Representative to the Management Board, such appointment to be made at the effective date of this order and on an annual basis thereafter by January 31st of each year. Commencing with the effective date of this order, and on annual basis thereafter, by January 31st of each year each Municipality may appoint one (1) additional Representative to the Management Board for every ten (10) percent of the total water consumption of the System apportioned to that Municipality in the previous year.*

   (b) Notwithstanding paragraph (a), a Municipality may not have more than fifty (50) percent of the total number of Representatives, nor more than fifty (50) percent of the total vote, of the Management Board.

Thus, as per Schedule "B" of the Transfer Order, each municipality can appoint 1 member to the UWSS Board as the municipal representative and additional member for every 10 percent of the total UWSS water consumption.

The proportion of the UWSS that each municipality owns is governed by Schedule C of the UWSS Transfer Order and is based on water consumption for each municipality.

Schedule C provides that the system interest is to be updated every four years on the basis of the previous four years' flows.

At its meeting on February 17, 2021 the UWSS Board passed the following resolution:

No. UW-14-21

Moved by: *Deputy Mayor Verbeke*

Seconded by: *Councillor Tiessen*

That UWSS system interests in Schedule C of the Transfer Order are updated as follows:

Municipality	*Average Water Consumption (ML/year)*	*Proportional System Interest*
The Corporation of the Municipality of Leamington	*8,909.0*	*53.00%*
The Corporation of the Town of Kingsville	*6,509.1*	*38.72%*
The Corporation of the Town of Essex	*827.8*	*4.92%*
The Corporation of the Town of Lakeshore	*564.8*	*3.36%*

That the municipalities of Leamington, Kingsville, Essex and Lakeshore be informed of this update to Schedule C of the UWSS Transfer Order. This update will apply from January 1, 2021 to December 31, 2024.

Carried (UW/10/21)

In accordance with Schedule "B" of the Transfer Order, Table 1 below identifies the number of UWSS Board representatives that can be appointed by each municipality:

Table 1

Municipality	No. of Municipal Representatives	Percentage of Total UWSS Water Consumption	Additional Appointees Based on Water Consumption	Total No. of Municipal Appointees to UWSS Board
Leamington	1	53.00%	5	6
Kingsville	1	38.72%	3	4
Essex	1	4.92%	0	1
Lakeshore	1	3.36%	0	1

The UWSS Board currently includes the following number of municipal representatives: Leamington – 6; Kingsville – 5; Essex – 1; Lakeshore – 1. In keeping with Schedule "B" of the Transfer Order, the Town of Kingsville will need revise its number of appointees to the UWSS Board from five (5) to four (4).

It is anticipated that the adjustment to the Town of Kingsville's appointees to the UWSS Board will take place prior to the March 17th, 2021 UWSS Board meeting.

Please do not hesitate to contact me if you have any questions or comments.

Yours truly,

Rodney Bouchard, General Manager
Union Water Supply System Joint Board of Management
kmj
Filename: e:\khristine\projects\system interest\03-03-21 ltr to town of kingsville- appointees to uwss board member.docx

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Date: **March 18, 2021**

To: **Mayor and Council**

Author: **G.A. Plancke / Director of Infrastructure & Engineering**

RE: **Union Water System Treatment Capacity & Governance Discussion**

Report No.: **IED 2021-16**

AIM

To provide Council with an update with respect to Union Water Supply System treatment capacity limitations, and provide additional information regarding the historical and current governance discussions.

BACKGROUND

The Union Water Supply System (UWSS) Joint Board of Management recently unanimously approved a Moratorium, which limits applications for large water service connections due to treatment production capacity limitations until such time as treatment capacity upgrades can be completed and or other investigations completed. The moratorium is not intended to restrict residential, commercial, and light industrial growth, and is limited to any requests for more than 50,000 liters/day for a period of up to twelve (12) months.

The legal ownership of the UWSS is vested in the four (4) partner municipalities as tenants in common with ownership share being in proportion to the volume of water they take from the system and operates under a Joint Board of Management (Board).The Transfer Order provides that the ownership share is fixed for four (4) years based on the average supply to each municipality over the previous four (4) years.

DISCUSSION

The Transfer Order set the initial proportional ownership in January 2001 and it has been revised in 2005, 2009, 2013, 2017 and again this year (2021). This proportional ownership has consequences for the financial administration of the system and the municipalities. The Board is exclusively responsible for the oversight of the UWSS notwithstanding the legal ownership of the system. It does so on behalf of the municipalities but has the autonomy to make decisions without requiring municipal approval. The UWSS Board is ultimately responsible for operating, maintaining, repairing, constructing and expanding the system.

One very important area in which the UWSS does not have any authority is for borrowing/incurring debt. The UWSS cannot borrow on its own authority. Any borrowing on behalf of the UWSS must be done by the four municipalities. This also includes obtaining grant funding from senior levels of government. Any UWSS debt must be carried on the municipal balance sheets in proportion to the system ownership share described above.
In order to streamline governance of the UWSS, several Governance reviews have been completed including the 2008-2009 Governance Review, 2012 Governance Review, 2014-2015 Governance Work – Legal Review of UWSS Structure, and the 2017 – 2018 Governance Work – Financial and Legal Business Case for Restructuring with the intention of developing a platform to restructure appropriately and provide some autonomy to UWSS.

The proposed solution as identified in the March 28, 2018 report recommended a UWSS Municipal Services Corporation be created wherein UWSS Inc. would be owned by the Municipalities as shareholders and governed by an unanimous shareholders agreement.

A new corporate structure as proposed could consist of the following:

- Four owner municipalities become shareholders of UWSS Inc. instead of tenants in common. Ownership shares will be determined by water demand from each municipality.
- Ownership shares will be reviewed every 4 years based on water demand from each municipality
- Board of Directors will initially consist of municipal elected councillors from the four municipal shareholders. The process to appoint Board members will remain the same as it is currently; 1) Each municipality will appoint 1 Board member as a shareholder member; 2) Additional members will be appointed based on water consumption with each municipality appointing one member for every 10 percent water demand; and 3) No municipality will have more than half of the Board representation. Thus with a Board of 12 directors, no municipality will have more than 6 Board representatives.
- Existing UWSS assets will be transferred from municipal ownership to UWSS Inc ownership through an agreed upon Asset Transfer Policy. A New Asset Policy will be developed between UWSS Inc and municipal shareholders on any new future watermain/ transmission infrastructure in regards to finance and ownership.

If created, the new corporate structure of UWSS Inc. could also include the following changes to the existing commercial and financial structure:

- 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 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

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- UWSS will pay a service fee to the Municipalities for work done by the Municipalities as agents of UWSS (billing, collection, and associated accounting)
- A corporate UWSS would be liable for itself and provide better liability protection to municipal shareholders

LINK TO STRATEGIC PLAN

Effectively manage corporate resources and maximize performance in day-to-day operations.

To become a leader in sustainable infrastructure renewal and development.

FINANCIAL CONSIDERATIONS

None at this time

CONSULTATIONS

Rodney Bouchard – Union Water Supply System Manager
John Norton C.A.O – Town of Kingsville

RECOMMENDATION

That Council receive the covering report and,

That Council receive the verbal information provided by the Union Water Supply System Manager, and Chair of the Joint Board of Management as a sufficient update to the recent Moratorium and ongoing governance discussions.

G.A. Plancke
G.A. Plancke Civil Eng. Tech (Env)
Director of Infrastructure & Engineering

John Norton
John Norton
C.A.O.

UW/16/21

Report

To: Chair and Members of the Union Water Supply System Joint Board of Management

From: Rodney Bouchard, Union Water Manager

Date: March 11, 2021

Re: Moratorium on Applications for UWSS Treated Water Allocations

Recommendation:

That the Union Water Supply Joint Board of Management (UWSS Board) implements a moratorium to take effect immediately on new requests for treated water allocations from new or existing entities that use more than 50,000 litres per day;

And further, that the moratorium would not apply to any type of residential development;

And further, that the moratorium will be in effect for up to 12 months;

And further, that the UWSS Board directs the UWSS General Manager, with support from the UWSS-Municipal Treatment Capacity Allocation Working Group (Working Group), to undertake an evaluation of all approved treated water allocations to identify any discrepancies between approved allocations versus actual water usage;

And further, that the UWSS Board directs the UWSS General Manager to deliver a report to the UWSS Board by October 31st, 2021 that provides the Working Group's conclusions and recommendations in regards to the evaluation of approved treated water allocations.

Background:

The Union Water Supply System Board of Management is responsible under Transfer Order Union W1/1999 for considering any application by a municipality within its service area for adding a large water service.

New applicants for large water services (i.e. large water users) in the UWSS service area are required to seek approval from the UWSS for treatment capacity allocation and from the local municipality for water distribution capacity. Review of large service applications for water treatment capacity allocation is completed by a consultant on behalf of the UWSS. Upon completion of an application review, the consultant issues a letter to UWSS and the local municipality that provides a recommendation in regards to treatment capacity allocation for the proposed development.

A review of available records indicates that since the creation of the UWSS in 2001, almost all large service applications have been for greenhouse expansions and new greenhouse developments. It should also be noted that records indicate that most large service applications for UWSS treatment capacity have been reviewed and addressed on a "first come, first served" basis.

At the January 20th, 2021 meeting of the UWSS Board, the UWSS General Manager presented report *UW06-21 UWSS Water Treatment Capacity Allocation* (copy attached). The report highlighted the following:

- Potable water demand from the UWSS has been on a steady increase since 2015. Water demand in 2020 was 32.8% greater than 2015 demand. Most of this increase (approx. 21%) occurred between 2018 and 2020.

- The recent significant increase in water demand is attributed to moderate increase in residential growth but mainly due to significant greenhouse growth in Kingsville and Leamington. Further, some of the water demand increase is likely related to greenhouse crop switchover from food crop to cannabis, which appears to be a more water intensive crop.

- Of the UWSS' approved 24.7 million imperial gallons per day (IGPD) treatment capacity for the UWSS, approximately 2 million IGPD remains "unallocated" and is available to support growth in the UWSS service area. This remaining "unallocated" treatment capacity has been apportioned to each owner municipality based on UWSS ownership share.

Report UW06-21 also recommended the formation of a working group consisting of UWSS and municipal administration representatives to address the issue of treatment capacity allocation and to develop a more robust and equitable application process for allocation of UWSS treatment capacity. This was supported by the UWSS Board.

The UWSS-Municipal Treatment Capacity Allocation Working Group (Working Group) was created in January 2021 with support from the UWSS' 4 owner municipalities. The Working Group held its first meeting on February 24, 2021.

Discussion:

The introductory meeting of the Working Group was held on February 24th, 2020 via Zoom. The meeting included 13 participants: 2 from UWSS and 11 from the municipalities of Leamington, Kingsville, Essex and Lakeshore. Discussions at the meeting were related to various items relating to existing treatment capacity allocations, planned and projected growth in various sectors within municipalities and projected water demands.

The main item of discussion was the existing situation with greenhouse industry growth and the limited remaining treatment capacity at UWSS. This discussion resulted in

agreement by Working Group participants that a moratorium should be imposed on new applications from Large Water Users, including greenhouse developments, due to the limited remaining treatment capacity. This moratorium would be in place to ensure that residential and commercial developments that are already in the planning/approval process can move ahead from a water requirement perspective. The proposed moratorium would be temporary until additional UWSS treatment capacity is made available.

Based on the comments and feedback received from municipal representatives at the February 24th, 2021 meeting of the Working Group and from subsequent consultations with staff from owner municipalities, the UWSS General Manager proposes that a temporary moratorium be implemented immediately on new applications for UWSS treated water allocations for large water users. The temporary moratorium is proposed as follows:

- Applications for new requests for treated water allocations from new or existing operation that use more than 50,000 litres per day would no longer be reviewed for approval;

- All types of residential developments would be exempt from the moratorium;

- The moratorium would extend for a period of up to 12 months and may be rescinded or extended at the discretion of the UWSS Board based on review of supporting information.

The proposed upper threshold limit of 50,000 litres/day for new applications is based on the Permit to Take Water (PTTW) application under Ontario Regulation 387/04 (Water Taking and Transfer) made under the *Ontario Water Resources Act, 1990.* By law, a person/entity must have a permit from the Ministry of Environment, Conservation and Parks (MECP) if that person/entity plans to take greater than 50,000 litres of water in a day from the environment. The UWSS General Manager stipulates that this value provides a good basis for establishing what could be considered a “large water user”.

Also, as per the feedback received from the Working Group, the UWSS General Manager proposes that an evaluation of existing approved treatment capacity allocations be completed. The purpose of the evaluation would be as follows:

- <u>Identify historical approved allocations that may never have been used</u>. It has been recently noted during an application review that some historical allocation approvals for greenhouses have not been used. These allocations should be cancelled so that the associated treated water capacity is available for future use.

- <u>Identify discrepancies between approved allocations and actual water usage for each operation</u>. It should be noted that for greenhouse allocations, some historical allocations were based on 10,000 IGPD/ acre. However, based on technological improvements and conservation measures in the greenhouse industry, water

usage per acre has decreased. As such, through the years, allocations were decreased to 8,000 IGPD/acre and now the standard for new applications is 6,000 IGPD/acre. Actual water usage for all allocations should be reviewed so that historical higher allocations can be reassessed to lower allocations thus freeing up treatment capacity for future growth.

- Provide recommendations for water allocation that would identify proposed volume rates for future applications.

- Provide recommendations for a revised application process that is more comprehensive and based on actual needed treated water volumes.

This evaluation would be led by UWSS with support and advice from the Working Group. The consultant that currently reviews applications for treated water allocations would also be retained to assist with this evaluation. The UWSS General Manager anticipates that a report would be provided to the UWSS Board no later than the October 20th, 2021 UWSS Board meeting.

It should be noted that support for the moratorium has been received by Working Group participants. Owner municipalities have been consulted in regards to this proposed moratorium.

Closing Comments and Recommendations:

Current treatment capacity allocation methodology has been mostly focused on the growth in the greenhouse industry and has not really taken into consideration other types of growth in the UWSS service area.

The proposed moratorium on new applications by large water users for treated water is intended to allow for continued residential development (and commercial/industrial developments that are not treated water intensive) while restricting non-residential developments that are dependent on large volumes of UWSS treated water.

This will allow the UWSS (in consultation with its owner municipalities) time to complete the required evaluations of existing and proposed future treatment capacity allocations so as to identify “unused” treatment capacity that is already allocated and to develop a more effective process for allocating future treated water requests..

Respectfully submitted,

Rodney Bouchard, General Manager
Union Water Supply System Joint Board of Management
rb/kmj
Filename: t:\union wtr\reports to board\2021\uw16-21 moratorium on applications for uwss treatment capacity allocations.docx

Attachments

S-UW/01/18

Report

To: Mayor and Members of Council

From: Rodney Bouchard, General Manager Union Water Supply System

Date: March 28th, 2018

Re: Proposed Business Case for Restructuring UWSS into a Municipal Service Corporation

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Recommendation:

That the Councils of the Municipality of Leamington, Town of Kingsville, Town of Essex and Town of Lakeshore, as owners of the Union Water Supply System receive this report;

That the Councils of the Municipality of Leamington, Town of Kingsville, Town of Essex and Town of Lakeshore, as owners of the Union Water Supply System endorse and adopt the Business Case for Restructuring of the Union Water Supply System into a Municipal Services Corporation as set out in Exhibit "A" of this report.

Overview of Union Water Supply System

The following provides an overview of the Union Water Supply System (UWSS) in regards to its history, ownership, management, and operation.

History

Any discussion of the Union Water Supply System (UWSS) needs to begin with the system's history. The history is important because it explains why the system has its present governance structure and its throws light on a number of issues that the UWSS currently faces.

The UWSS was created in the late 1950s by the Ontario Water Resources Commission (OWRC), a provincial body. The OWRC was created to assist municipalities with funding,

building and operating drinking water and waste water systems. The OWRC operated the treatment plant on behalf of the municipalities. It functions were absorbed into the new Ministry of the Environment in 1972 and were transferred to the new Ontario Clean Water Agency (OCWA) in 1993.

The UWSS's original participants were the old municipalities of Leamington, Mersea, Gosfield South, Gosfield North, Essex and Maidstone along with H.J. Heinz. Kingsville and Rochester joined around 1970. Over time the service area expanded as watermains were built in the rural areas and the current service area occupies the southeast quarter of Essex County.

In the 1990s the Province did two (2) things which resulted in the current structure of the UWSS. First was the amalgamation of municipalities which reduced the number supplied by the UWSS from eight (8) to four (4). Second was the transfer of ownership of provincially operated drinking water and wastewater systems to the municipalities they served. In most such cases amalgamation meant that transfer was to a single municipal owner. Examples in Essex County are the Colchester South-Harrow water system which is now owned by Essex or the Lakeshore West wastewater system which is now owned by Kingsville. The UWSS was one of four (4) provincially operated systems that still served several municipalities even after amalgamations. In these cases ownership was transferred to the municipalities and governance to a Joint Board of Management.

Ownership

The legal ownership of the UWSS is vested in the four (4) municipalities as tenants in common with ownership share being in proportion to the volume of water they take from the system. The Transfer Order provides that the ownership share is fixed for four (4) years based on the average supply to each municipality over the previous four (4) years. The Transfer Order set the initial proportional ownership in January 2001 and it has been revised in 2005, 2009, 2013 and 2017. The next revision is scheduled for 2021, unless the Board decides to undertake and earlier review. The following table shows the ownership percentages since 2001:

	2001	2005	2009	2013	2017
Leamington	63%	59.9%	58.1%	56.11%	50.55%
Kingsville	27%	30.7%	33.4%	34.83%	40.33%
Essex	7%	6.5%	5.8%	6.04%	5.97%
Lakeshore	3%	2.9%	2.7%	3.02%	3.15%

This proportional ownership has consequences for the financial administration of the system and the municipalities.

In total, there are approximately nine hundred (900) kilometres of water mains in UWSS' service area indirectly servicing approximately sixty five thousand (65,000) residents and a substantial number of commercial, industrial, and agricultural customers. UWSS'

assets include a low lift pumping plant, a water treatment plant, a booster pumping station, in-ground reservoir at 2 locations, four elevated water towers, and approximately 130 kilometers of central ("transmission") water mains. UWSS wholesales its water directly to the Municipalities. The Municipalities handle local billing and distribution.

Management

A Joint Board of Management (UWSS Board) was established under the Transfer Order to govern the management of UWSS. The UWSS Board meets once per month. The UWSS Board is composed of members appointed by the Municipalities in accordance with the Transfer Order. Each Municipality appoints at least one member, with additional members granted according to its ownership interest (i.e. 1 additional member for every 10% ownership to a maximum of 6 for any municipality). These members are generally, but need not be, municipal counsellors. There is no requirement for any professionals to sit on the Board.

At present there are twelve (12) members on the Board as follows:

Leamington 6	Kingsville 4
Essex 1	Lakeshore 1

The UWSS Board is exclusively responsible for the oversight of the UWSS notwithstanding the legal ownership of the system. It does so on behalf of the municipalities but has the autonomy to make decisions without requiring municipal approval. The UWSS Board is ultimately responsible for operating, maintaining, repairing, constructing and expanding the system. In particular it alone is responsible for regulatory compliance of the system.

In 2002, the UWSS Board created the position of UWSS General Manager to oversee the day to day duties and obligations of the UWSS. The UWSS Manager reports solely to the UWSS Board. However, since the UWSS is not a legal entity per say, it does not have the ability to conduct its own financial administration (i.e. accounts receivable and accounts payable) nor directly hire employees. Thus, the UWSS Board has retained the Municipality of Leamington, as the system's largest "owner", to carry out financial and human resources related administration purposes on its behalf. The UWSS' finances are separate from those of the municipalities. The UWSS maintains its own bank accounts for this purpose. The UWSS' revenue source is mainly from wholesale of treated water to

the four owner municipalities. A small revenue source is also generated from the lease of antennae space on the UWSS water towers to telecommunications providers.

One very important area in which the UWSS does not have any authority is for borrowing/incurring debt. The UWSS cannot borrow on its own authority. Any borrowing on behalf of the UWSS must be done by the four municipalities. This also includes obtaining grant funding from senior levels of government. Any UWSS debt must be carried on the municipal balance sheets in proportion to the system ownership share described above. The UWSS currently carries a debt of $13.76 M (as of December 31, 2017) that consists of a loan (aka "Sun Life debt") that was secured by the four owner municipalities to "purchase" the UWSS assets from the Province of Ontario at the time when the UWSS was transferred to the municipalities. The UWSS is responsible for repayment of this debt but this debt is registered on the municipalities' balance sheets.

Operations

The Board currently contracts with the Ontario Clean Water Agency (OCWA) operations and maintenance of the UWSS. As an accredited operator, OCWA assumes most of the legislative obligations regarding UWSS, including such things as implementing a Drinking Water Quality Management System (DWQMS). OCWA's services do not extend to the four distinct distribution systems providing water to each Municipality. OCWA was the system's owner and operator before 2001 and has been retained as the operator since then. The current operating is a 5-year fixed-fee agreement that came into effect on January 1, 2014 and will expire on December 31, 2018.

UWSS Governance – A Review of What's Been Done

The following provides a chronology of the steps that have been undertaken since a review of UWSS governance was initiated in 2008.

2008-2009 Governance Review

The initial UWSS governance review was initiated in February 2008 and a Terms of Reference was developed to outline the purpose and anticipated goals of the governance review. As part of the Governance Review, external governance "experts" were retained by UWSS to facilitate the undertaking of the review. These included the following experts:

> Dr. Karen Bakker – University of British Columbia: Dr. Bakker was retained based on her academic and published experience on water system governance with particular reference to Ontario. Dr. Bakker was assisted by a post-doctoral student, Dr. Karen Furlong.
>
> Maria Kelleher – Kelleher Environmental: Mrs. Kelleher was retained based on her work experience with the Essex Windsor Solid Waste Authority on facilitating a discussion on governance

The work undertaken as part of this governance review included the following tasks:

- Governance Questionnaires - these were distributed to UWSS Board members, municipal councillors and municipal administration.
- Interviews – these were conducted with UWSS Board members and key municipal administration staff.
- Governance Review Workshops – these consisted of a "visioning" workshop and a "Governance Review" workshop that included UWSS Board members and key municipal administrative staff.
- Reports on Governance Review – The reports identified the main concerns and issues with the existing governance structure and identified next steps for resolving these issues.

The Governance Review reports by Maria Kelleher in 2009 following the workshops indicated a number of issues with the existing UWSS Governance. These included:

- Lack of Board authority for UWSS system. Municipalities need secure any debt and apply for government grants on behalf of UWSS.
- Lack of legal standing of the UWSS.
- Common asset issues; who owns what? Who is responsible for UWSS assets?

Although significant issues were identified and recommendations were provided to address these issues, a key takeaway from the 2008-2009 Governance review work was that there appeared to be very little appetite by many Board members and municipalities to undertake changes to the UWSS Governance.

2012 Governance Review

At the December 21, 2011 UWSS Board meeting, the Board agreed to undertake a review of the existing UWSS governance structure in 2012 to identify whether an alternative governance model/structure would be more suitable for the UWSS. This 2012 governance review was to build upon an earlier governance review that was initiated in 2008-2009 but never brought to closure.

At the May 16, 2012 UWSS Board meeting, the Manager presented report No. UWSS-19-12 Governance Review, which summarized the information, workshop reports, and documents that were generated as part of the 2008-2009 governance review. The intent of the report was to provide background information to newer UWSS Board members and a refresher to long standing Board members of the work undertaken as part of the 2008-2009 Governance Review.

On July 5, 2012, a special meeting of the Board was held at the Essex County Civic Centre to present and discuss possible alternative governance structures for UWSS. At this meeting, the Manager provided a presentation to the Board on possible alternative

ownership and governance structures for the UWSS that would address the main issues and drawbacks with the existing governance structure such as:

- Lack of legal standing for the UWSS;
- Inability to take on debt or financing;
- Inability to directly own UWSS assets;
- Ineligibility to receive senior government grants;
- Lack of authority and decision making powers of the UWSS Board over the entire UWSS system;

The identification of alternative ownership/governance structures for UWSS required that different ownership models and corporate structure model be considered. As part of this presentation, the Manager considered and evaluated the following ownership and corporate structure models:

Ownership Models:

- As-Is: - UWSS plus 4 (or less) owner municipalities
- Source to Tap: - All one system; treatment and distribution combined into one utility
- Single municipality/County Ownership: - Common system purchased and operated by a single municipality. This option also discussed the potential of the County taking over the system

Corporate Structure Options:

- Local Joint Board – this is the current structure
- Municipal Services Board (MSB)
- Municipal Services Corporation (MSC)
- New "wish" list option – Special Legislation by Province

The evaluation of the various Ownership Models, Corporate Structure Options, and Expansion of Service Area resulted in the identification of 12 alternative governance structures for UWSS and the benefits and drawback of each alternative. The restructuring of UWSS into a Municipal Service Corporation (MSC) was identified as the governance structure that provided the most benefit for UWSS.

Following the UWSS Manager's presentation on *UWSS Ownership and Corporate Structure Options* the UWSS Board endorsed the recommendations to:

- Undertake a financial feasibility evaluation of the alternative governance structure options;

- Discuss and share the UWSS governance review information with senior administration and Council of the municipalities of Leamington, Kingsville, Essex, and Lakeshore;
- Discuss and share the UWSS governance review information with staff from MMAH, MOE, and any other provincial government entity as needed to the undertaking of a feasibility evaluation of any potential UWSS restructuring;
- Retain a financial consultant to assist with the undertaking of the financial feasibility evaluation of any potential UWSS restructuring.

2014-2015 Governance Work – Legal Review of UWSS Structure

In the Spring of 2014, The UWSS consulted with its solicitor, Deborah Rollier of Ricci, Enns, Rollier & Setterington LLP to initiate a legal review of the existing structure of the UWSS in regards to governance and possible restructuring. A legal team with expertise in corporate and business law, real estate law, and water and wastewater related laws was assembled. The legal team included the UWSS Board Solicitor, Mr. William Willis of Willis Business Law (formerly with McTague Law Firm LLP at the time of review) of Windsor, Ontario and Mr. Andrew Roman of Roman Law Corp of Toronto, Ontario.

The legal team prepared a preliminary report in May 2015 that provided a legal review of the existing UWSS Governance Structure. This report included legal opinion and recommendation for improvements to the UWSS organizational structure in regards to its existing governance, legal identity and status, liability protection, and capacity for self-financing, issuance of debt, etc. The main recommendation of the report proposed that the restructuring of UWSS into a Municipal Services Corporation under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001 would addressed the identified issues.

A Special Meeting of the UWSS Board was held on May 7, 2015 to present the legal team's preliminary report on UWSS Restructuring. The Chief Administrative Officers (CAOs) and/or senior municipal water department staff from the municipalities of Leamington, Kingsville, Essex and Lakeshore were also present at this meeting. The preliminary report on UWSS Restructuring was presented for information and discussion purposes.

The legal team's report on UWSS Restructuring was summarized in UWSS Report *UW19-15 UWSS Restructuring* that was presented at the UWSS Board meeting of May 20, 2015. The following report recommendation was endorsed by the UWSS Board:

That the UWSS Board investigates the necessary process to re-structure the Union Water Supply System (UWSS) and associated assets into a Municipal Services Corporation under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001;

2017-2018 Governance Work – Financial and Legal Business Case for Restructuring

At the June 21st, 2017 UWSS Board meeting, the UWSS Board approved a budget of to complete a financial analysis and development of a Business Case for the restructuring of Union Water Supply System (UWSS) and associated assets into a Municipal Services Corporation under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001. UWSS retained PricewaterhouseCoopers (PwC) to complete this work.

UWSS also retained Willis Business Law of Windsor, ON to revise the May 2015 legal review on the existing UWSS Governance Structure and proposed restructuring. The revised legal report also serves as a legal business case for UWSS Restructuring purposes.

Financial Restructuring Business Case

PwC initiated the development of the UWSS Restructuring Financial Business case in July 2017. On October 19th, 2017, UWSS and PwC held a workshop with senior administrative staff from the municipalities of Essex, Kingsville, Lakeshore and Leamington. The purpose of the workshop was to obtain information from the municipalities on financial administration/ cooperation with UWSS, proposed options for restructuring UWSS in regards to financial systems, etc.

A similar workshop was held on October 20th, 2017 with the UWSS Board members. The focus of this workshop was to obtain Board members opinions, thoughts, concerns, etc. in regards to financial restructuring of UWSS.

PwC provide its draft report titled “Union Water Supply System Financial Structure Business Case” to the UWSS General Manager on November 14, 2017, which had been revised to include comments by UWSS and Willis Business Law. The PwC report concluded that a financial restructuring of UWSS was possible to achieve the following:

- Have the 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

The PwC report details a financial structure for UWSS 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.

Legal Advice on UWSS Restructuring

Willis Business Law provided their Legal Advice on UWSS Restructuring in a letter report dated October 26, 2017. This legal advice report revised the original opinion provided by William Willis in May 2015. The Legal advice recommends the restructuring of UWSS into a Municipal Services Corporation under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001.

The UWSS General Manager provided a copy of the PwC Financial Restructuring Business Case and Willis Business Law Legal Advice on UWSS Restructuring report to the CAOs of the four owner municipalities in an email dated November 20th, 2017. The email indicated that these documents were being provided for review and comment by senior administration at each of the four owner municipalities.

The Legal Opinion and the draft UWSS Restructuring Financial Business Case reports were presented to the UWSS Board at the February 21, 2018 UWSS Board meeting. As an action item from this meeting, the UWSS Board provided direction to form an executive committee including the UWSS Board Chair, the UWSS Board Vice Chair and the UWSS General Manager to present the proposed UWSS restructuring materials to the Councils of the Municipalities of Leamington, Kingsville, Essex and Lakeshore (i.e. the UWSS owner municipalities).

UWSS Restructuring - What Problems are We Trying to Solve?

The restructuring of the Union Water Supply System into a Municipal Services Corporation is being proposed to solve a number of problems including the following:

Access to grant funding

- UWSS cannot apply on its own; Municipalities must apply for grants on behalf of UWSS;
- If done via the Municipalities, UWSS applications may “compete” with other Municipal priorities for grant funding

UWSS Capital Works Program Funding

- UWSS has significant capital requirements in the coming years (i.e. $30 million + in next 10 years);
- Wholesale water revenue to owner municipalities is basically the only revenue source for UWSS;

- Annual revenue includes capital expenditure as an item to be recovered in rates
- UWSS has cash reserves, but once these are depleted there is no source for replenishment;
- Without direct access to debt financing, funding of large scale capital works are difficult to fund without significant water rate increases.

UWSS Debt

- If debt is used to fund capital, this debt is attributed to the Municipalities and registered on municipal balance sheets;
- UWSS has no corporate existence, so it cannot borrow on its own;
- All new debt is attributed to the Municipalities and reduces capacity to borrow for other uses
- The existing Sun Life debt is attributed to the Municipalities

Proposed Solution – UWSS Municipal Services Corporation

The proposed solution to address existing issues associated with the existing UWSS Governance Structure is to establish UWSS as an incorporated entity that would consist of a Municipal Services Corporation under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001. For the sake of this report, the hypothetical corporation will be called UWSS Inc.

UWSS Inc. would be owned by the Municipalities as shareholders and governed by a unanimous shareholders agreement. The new corporate structure would consist of the following:

- Four owner municipalities become shareholders of UWSS Inc. instead of tenants in common. Ownership shares will be determined by water demand from each municipality.
- Ownership shares will be reviewed every 4 years based on water demand from each municipality
- Board of Directors will initially consist of municipal elected councillors from the four municipal shareholders. The process to appoint Board members will remain the same as it is currently; 1) Each municipality will appoint 1 Board member as a shareholder member; 2) Additional members will be appointed based on water consumption with each municipality appointing one member for every 10 percent water demand; and 3) No municipality will have more than half of the Board representation. Thus with a Board of 12 directors, no municipality will have more than 6 Board representatives.
- Existing UWSS assets will be transferred from municipal ownership to UWSS Inc ownership through an agreed upon Asset Transfer Policy. A New Asset Policy will

be developed between UWSS Inc and municipal shareholders on any new future watermain/ transmission infrastructure in regards to finance and ownership.

The new corporate structure of UWSS Inc. would also include the following changes to the existing commercial and financial structure:

- 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
- 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, collection, and associated accounting)
- A corporate UWSS would be liable for itself and provide better liability protection to municipal shareholders

Concluding Remarks:

The legal review of the UWSS governance structure completed by Willis Business Law, LLP in October 2017 provides sound reasoning from a legal perspective that the UWSS and its owner municipalities would benefit from a governance restructuring of UWSS into a corporate entity such as a Municipal Services Corporation. Should that occur, the PwC Financial Restructuring Business case recommends a financial structure that appears to be financially sound and would provide future financial stability to UWSS, its ratepayers, and its municipal shareholders. The result would be a resilient and sustainable corporate water utility that is municipally owned, able to self-finance and incur debt; can obtain senior government grants for water related works; and provides increased liability protection to its shareholder municipalities, Board directors, and UWSS staff.

Respectfully submitted,

Rodney Bouchard, General Manager
Union Water Supply System Joint Board of Management
rb/kmj

Filename: c:\users\kjohnson\documents\projects\restructing (municipal service corporation)\report to municipal councils on uwss restructuring.docx

Union Water Supply System Restructuring Business Case

March 28, 2018

Rodney R. Bouchard
UWSS Manager

UNION WATER SUPPLY SYSTEM

UWSS Draft Mission/Vision Statement

The UWSS strives to provide safe, reliable and sustainable water supply that always exceeds applicable water quality standards to all current and future customers in a manner that is cost effective, environmentally friendly and fair among the municipal partners

What Works Well At UWSS?

- People think service is good
- Current Board members are forward thinking and collaborative
- Operational part works well (OCWA)
- Projects that can be revenue funded internally go forward well
- Good relationship with local municipalities
- Water supply is great

What Are the Main Issues?

- **Legal Status** – UWSS has no legal status; it is not a corporate body, municipal board or department.
- **Debt/Financing** – UWSS debt is carried by owner municipalities; UWSS cannot obtain financing on its own
- **Government Grants** – UWSS cannot apply or receive government grants directly; must be done through owner municipalities
- **Common Assets** – Who owns what? Specifically, in regards to common asset watermains.
- **Priorities** – Each municipality has its own priorities in regards to water and has no obligation to put UWSS interests before its own
- **Authority** – UWSS has very little authority/decision making power over its own operations.

Ownership and Corporate Structure Options

- Two things to consider if UWSS to be re-structured in any way:
  - Ownership of UWSS (who owns it) and
  - Corporate Structure (how is it governed)
- Ownership preferences should be addressed first
- Then can look at corporate structure and governance options

What is UWSS?

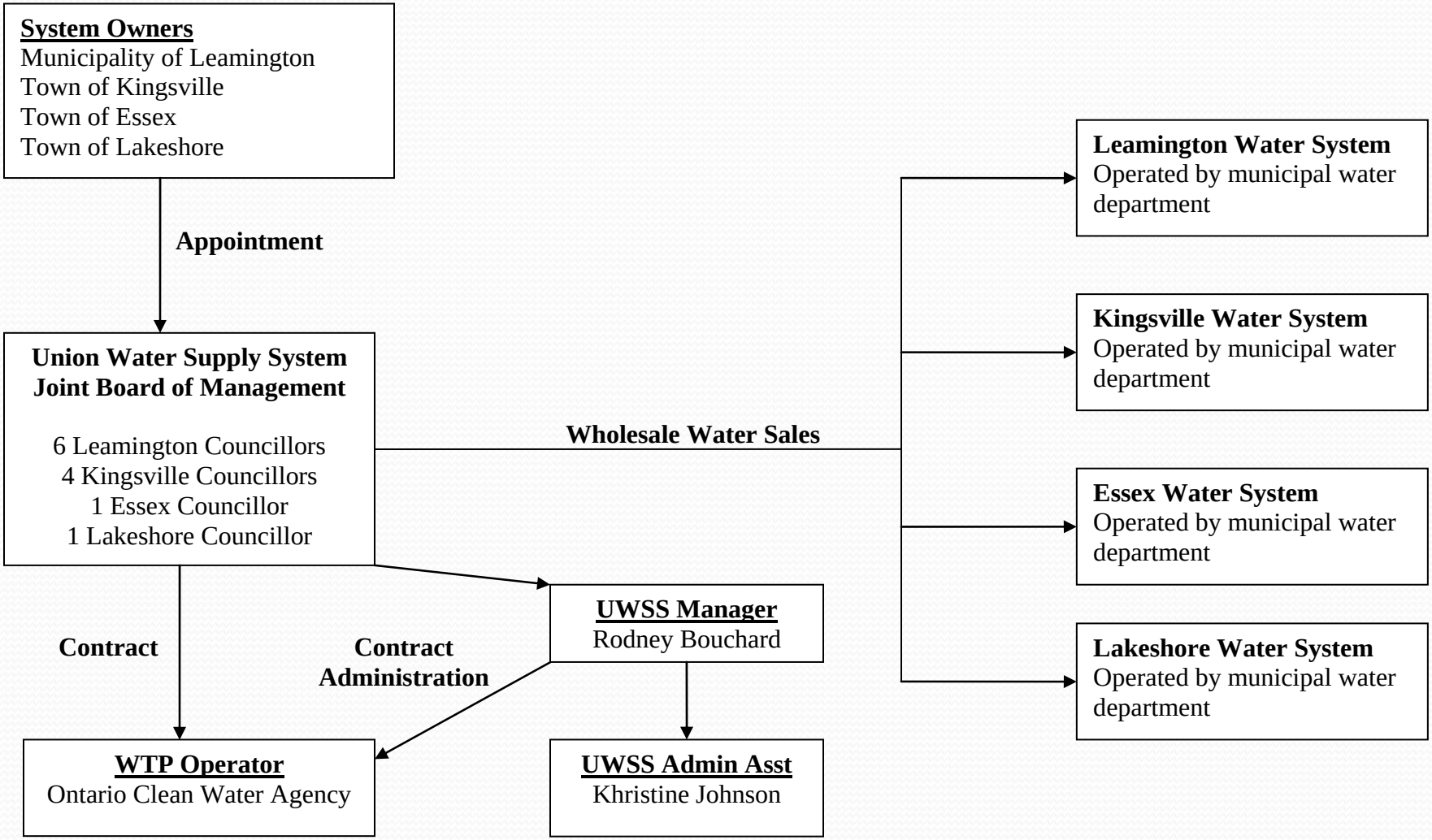
History

- The Union Water System (UWS) was commissioned in 1960 by the Ontario Water Resources Commission (OWRC)
- Original participants served by the UWS included the Town of Leamington, Town of Essex, Township of Maidstone, Township of Gosfield North, Township of Gosfield South, Township of Mersea and H.J Heinz in Leamington
- The Town of Kingsville and Township of Rochester joined the UWS around 1970
- In 1972 OWRC operations, including the UWS were absorbed into the newly created Ministry of Environment

History

- In 1993, ownership and operation of the UWS was transferred to the newly created Ontario Clean Water Agency (OCWA).
- The *Municipal Water and Sewer Transfer Act, 1997* required transfer of ownership of water and sewer systems from OCWA to municipalities;
- In 2001 the *Transfer Order for the Union Water Supply System* was completed and the Municipalities of Leamington, Kingsville, Lakeshore and Essex became the owners of the system.
- The 2001 Transfer Order stipulated the creation of a Joint Board of Management that would oversee the management of the UWSS on behalf of the 4 owner municipalities.
- OCWA was retained by the UWSS Joint Board of Management to operate the system on its behalf.

UWSS – Governance/Structure



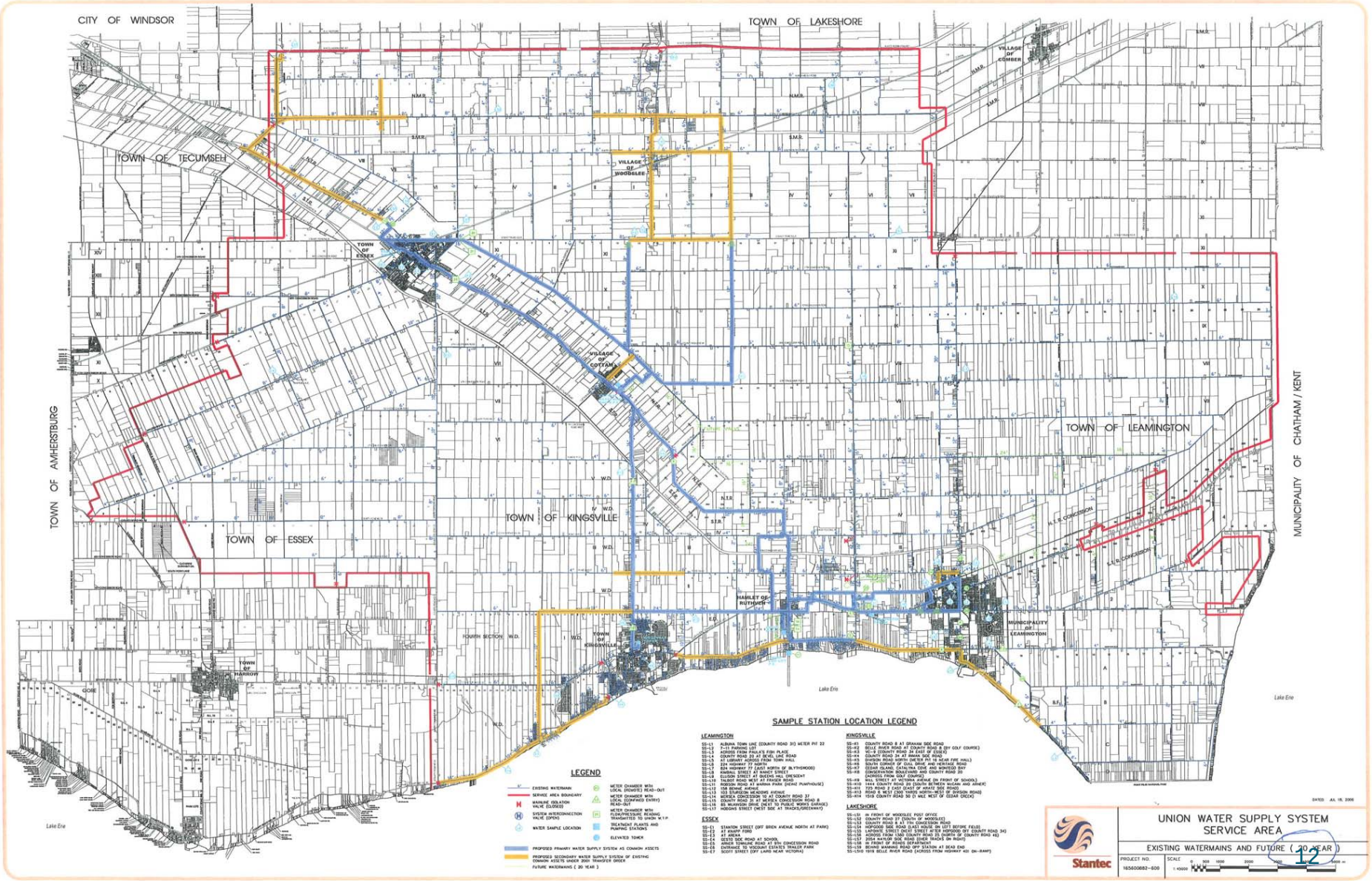
UWSS - Ownership

- As per Transfer Order, the interests of the Municipalities in UWSS shall be as tenants-in-common
- Ownership of the common system is based on each municipality's proportional consumption of the total flows of the system;
- The ownership interests were last set January 1, 2017 as:
  - Leamington – 50.55%
  - Kingsville – 40.33%
  - Essex – 6.97%
  - Lakeshore – 3.15%.
- The ownership interest is to be updated every four years.

UWSS – Common Assets

- Low Lift Pumping Plant
- Ruthven Water Treatment Plant
- Cottam Reservoir and Booster Station
- 4 Elevated Water Towers
  - Albuna WT
  - Leamington WT
  - Kingsville WT
  - Essex WT
- Approximately 140km of "common" transmission watermains as per 2008 Agreement

UWSS Service Area



UWSS Governance - Review History

- **2008-2009 Governance Review**
  - Governance Experts (M. Kelleher, Dr. K. Furlong, Dr. K. Bakker) were retained to facilitate review of UWSS Governance
  - Questionnaires were sent and interviews and workshops conducted with UWSS, Board members, and municipal administrative staff
  - Results of governance review identified governance and structure issues (i.e. lack of authority, inability to directly obtain financing and grants, etc)
  - Consensus on modifications to governance and structure not achieved. No changes were made

- **2012 Governance Review**
  - Internal governance review undertaken by UWSS Manager
  - Consultations conducted with water utilities, municipalities in various provinces and in US in regards to governance/structure models for drinking water serving
  - Governance model/ structure alternatives evaluation conducted and presented to UWSS Board. Municipal Services Corporation (MSC) identified as best alternative.
  - UWSS Board direction to undertake further review of MSC options, including financial viability

Evaluation of Ownership and Corporate Structure Options

Ownership Options

- **As Is** – 4 Municipalities as Tenants in Common
- **Municipal Owners + Preferred Customers** – 3 or less Municipalities as tenants in common with others as Preferred Customers
- **Single Municipality Ownership**– Pumping plant, treatment plant and Cottam PS owned by one Municipality (County owernship also considered)
- **Lake to Tap Option**– all one system; one entity responsible for water including treatment and distribution

Corporate Structure Options

- Local Joint Board of Management – *Current Structure*
- Municipal Service Board (MSB)
- Municipal Service Corporation (MSC)
- New "Wish List" Option – Special Legislation by Province

Municipal Services Board (MSB)

- Similar to local services board but in-line with Municipal Act, 2001 as amended
- Can own land
- Can issue debt – but reflected on municipal books
- Maintains financial clarity and reporting under Municipal Act
- Meetings must be public
- Can have mix of elected and non-elected Board members
- MSB is basically an "agency" of a municipality

Municipal Services Corporation (MSC)

- Section 203 of Municipal Act allows creation of Joint MSCs
- Must do a business case to justify creation of MSC
- Can be incorporated as share capital or non-share capital corporation
- For drinking water, MSC must be publicly owned
- MSCs have same investment authority as municipalities
- MSCs may borrow and secure it with corporate assets (revenue bonds)

MSC's (*continued*)

- Meetings not required to be public but can be
- Can have non-elected officials
- Shareholder Declaration(s) can be used to limit MSC's authority,
- Asset transfer policy is required from the Municipality(ies) prior to transfer of any assets to MSC
- MSC directors and officers deemed "members" for purposes of Municipal Conflict of Interest Act, EA Act, and MFIPPA

“Wish List” Option

Special Act of Provincial Legislation to create new entity that addresses existing issues;

- May not be much interest for this at provincial level since existing legislation (e.g. Section 203 of Municipal Act; O. Reg 599 – Municipal Services Corporations) can address most existing UWSS issues

How were Alternatives Considered?

Ownership Options

- As-Is
- Owner Municipalities + Preferred Customers
- Single Municipality Ownership
- Lake to Tap Option

Corporate Structure Options

- Joint Board (local board)
- Municipal Services Board (MSB)
- Municipal Services Corp. (MSC)
- "Wish List" – Special Legislation

Resulted in numerous Ownership/Corporate Structure Alternatives

Results of Alternatives Evaluation – Preferred Solution(s)

- A Joint Municipal Services Corporation (eg. UWSS, Inc.) of the 4 existing municipal owners with Lake to Tap option was identified as the preferred option through the alternatives evaluation.
- However, the Lake to Tap option would require that the UWSS take over local distribution services and possibly customer billing. This was not considered feasible at this time.
- Thus, the alternate preferred solution was identified as a Joint Municipal Services Corporation of the 4 existing municipal owners with only the existing "common assets" that are considered part of UWSS.

Legal and Financial Review

- **2014-2015 – Legal Review of Existing UWSS Governance**
  - Legal team with expertise in corporate/business law and drinking water/ wastewater laws retained to undertake a review of existing UWSS Governance.
  - UWSS Governance legal review report prepared and presented to UWSS Board in May 2015
  - Report highlights indicate restructuring to MSC is possible and would benefit UWSS;
  - UWSS Board resolution to investigate necessary processes required in regards to restructuring UWSS into a Municipal Services Corporation under Section 203 and O.Reg. 599/06 of the Municipal Act

- **2017-2018 – Financial and Legal Business Case for Restructuring**
  - PricewaterhouseCoopers ("PwC") retained to undertake a Financial review and Business Case for UWSS Restructuring into an MSC
  - Willis Business Law retained to revise 2015 UWSS Legal Review Report and prepare Legal Business Case for UWSS Restructuring into an MSC
  - Consultations undertaken with UWSS Board members, municipal administration and senior staff, OCWA, and other government entities
  - Draft Financial and Legal Business Case presented to UWSS Board and shared with senior administrators at owner municipalities
  - UWSS Board directs UWSS Manager to present restructuring business case with Councils of municipal owners.

UWSS Restructuring Business Case

Recommendations

- The Legal Review by Willis Business Law indicates that UWSS can readily be restructured into an MSC and recommends that an incorporated UWSS would provide substantial governance and legal benefit over the existing tenant in common ownership structure.
- The Financial Review and Business Case by PWC stipulates that a restructuring of UWSS into an incorporated entity would allow for substantial financial related benefits (i.e. self-financing, credit-worthiness, future capital planning and funding, etc.) that are currently not readily available to the current UWSS structure.
- The Legal and Financial reviews also indicate that the owner municipalities would also benefit from the restructure of UWSS into an incorporated entity (i.e. MSC), Example – new UWSS Inc. debt would not be registered on municipal ledgers thus no effect of <u>new</u> UWSS debt on municipal debt capacity

UWSS Ownership

- UWSS would be incorporated into a Municipal Services Corporation under O. Reg. 599/06 of the Municipal Act
- Shareholders would consist of existing municipalities; Municipality of Leamington, Town of Lakeshore, Town of Kingsville and Town of Essex
- Ownership shares/ percentage would be based on UWSS water consumption.
- Ownership shares would be reviewed every 4 years;
- UWSS existing assets would be transferred to UWSS, Inc. under an Asset Transfer Policy

Governance

- UWSS, Inc. would be governed by a Board of Directors
- Board of Directors will consist of municipal elected councillors from the 4 municipal shareholders
- Each shareholder will appoint 1 Board director as a shareholder member
- Each shareholder municipality will also appoint an additional director for each 10% of total UWSS water demand.
- Stipend could be provided to Board directors;

Governance

- Day to day operations of UWSS would be undertaken by UWSS executives/ officers appointed by the Board;
- Board meetings would be open to public
- UWSS, its Board directors and UWSS officers/ staff would be subject to MFIPPA and transparency requirements under the Municipal Act
- UWSS Board would retain the ability to set water rates subject to Board policies and Board approved agreement(s) with UWSS lenders.

Operations

- Water Treatment operations at Ruthven Plant would continue under a contract operations agreement. Currently this contract is with OCWA;
- Local distribution of treated water would be the responsibility of each municipality
- An agreement would be set out between UWSS Inc. and each municipality for repair of UWSS Inc. "transmission" watermains
- An agreement would be set out between UWSS Inc, OCWA and each municipality for distribution regulatory monitoring requirements

Admin/Finance Matter

- Financial administration for UWSS, Inc. would initially be under a formal agreement with Municipality of Leamington
- A direct relationship between UWSS Inc and end user customer would need to be established. However, customer billing would remain the responsibility of each municipality under formal agreements with the municipalities.
- Water Bills to customers would show portion of fees attributed to UWSS Inc.
- Under formal agreement, Municipalities would act as agents on behalf of UWSS. Liability for UWSS related services would remain with UWSS (i.e. uncollectible accounts).

Benefits of Restructuring

- An incorporated UWSS would be a legal entity and have the legal powers to procure, contract, buy property, etc.
- UWSS Inc. would constitute a municipally owned corporation; there is <u>no privatization of the UWSS</u> involved
- An incorporated UWSS would be able to apply for grant funding separately from the Municipalities – no "competition" between UWSS and Municipal priorities
- An incorporated UWSS would borrow on its own to finance Board-approved capital expenditures
- New UWSS Inc. debt would not attributed to the Municipalities, and would not affect Municipal debt capacity

Benefits (cont'd)

- An incorporated UWSS that can borrow and incur debt would avoid "rate shock" that could occur with financing a large capital plan on rate revenue alone
- An incorporated UWSS would grant the UWSS Board with the authority needed to adequately plan and finance future capital upgrades, asset replacement, and growth.
- An incorporated UWSS would own its own assets, including transmission water main, and thus address current "common asset" watermain ownership issues.
- An incorporated UWSS would be liable for itself and thus provide better liability protection to municipal shareholders.

QUESTIONS?

EXHIBIT “A”

Union Water Supply System

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RE: Business Case – UWSS Incorporation

I. Purpose

This document (the "**Business Case**") was prepared in satisfaction of certain obligations requiring a municipality to adopt a business case study before it establishes a corporation either alone or with one or more other public sector entities.[1]

II. Background

Union Water Supply System ("**UWSS**") was established by the Ontario Water Resources Commission (the predecessor of the Ontario Clean Water Agency ("**OCWA**")) in 1959, and supplies treated potable water to the municipalities of Leamington, Kingsville, Essex, and Lakeshore (collectively, the "**Municipalities**"). As evidenced by Transfer Order Union W1/1999, issued by the Ministry of Environment on January 8, 2001 (the "**Transfer Order**"), the Municipalities own UWSS as tenants in common, with each municipality owning an interest proportionate to its water consumption.

UWSS is an unincorporated collection of assets owned in common and used collectively by the Municipalities. The owners have agreed to share their joint property by voting on decisions through a group of appointed representatives (the "**Board**"). Neither UWSS nor the Board is a legal entity with all the rights and protections that come with that status. Although the Board has the power to budget, plan expenditures, and collect revenue, ultimately all decision-making authority comes from the Municipalities.

Recently, the legal structure of UWSS has been the subject of examination by the Municipalities. For the reasons that follow, the Municipalities have determined that it is advantageous to incorporate UWSS, and prepare this Business Case in support of such decision.

III. Key Legal Justifications

1. Separate Legal Entity

As indicated above, UWSS is presently unincorporated. In law, neither UWSS nor the Board is a legal entity, and lack the rights and protections that come with that status. As an unincorporated entity, UWSS is unable to issue or assume debt, and lacks the standing to sue and/or be sued in its own name. Due to these restraints, the substantial legal powers that UWSS has – such as

[1] See *O. Reg. 599/06: Municipal Services Corporations* at s. 6, made pursuant to the *Municipal Act, 2001,* SO 2001, c. 25.

contracting, buying property, and determining capital projects – are severely restricted, since UWSS cannot itself finance its own plans.

The practical impact is that the Board itself is very limited in the independent decisions it can make and implement. The essential decision-making power resides with the Municipalities, either directly through the need for financing or indirectly through the Board members appointed from their respective councils.

2. Liability

When a municipal water system is owned by a corporation other than a municipality, liability for a breach of section 19 of the *Safe Drinking Water Act* should (in theory at least) fall to the corporation as the owner of the system and its officers and directors. This should (in theory at least) protect the municipalities and their councillors from liability, except for those councilors actually on the Board of the corporation.

3. Ownership of Assets

Under the current structure, the Municipalities have a collection of assets that are used collectively, creating a number of municipal interests and financial obligations that reoccur on a regular basis, every time a financial decision must be made. Under the current structure, it is often unclear who owns and is responsible for which assets.

If UWSS were to incorporate, all assets would be owned and managed by UWSS Inc. The myriad of current municipal interests and financial obligations will need to be dealt with only once, to transfer the assets, rather than recurring every time a financial decision must be made. Thereafter the assets will be repaired, renovated, or replaced using UWSS Inc. funds and according to the priorities of the water system as determined by its officers and directors. This addresses the complex ownership issues.

Same Governance Structure

It is contemplated that the governance structure of UWSS Inc. would, to the extent that it is both legally possible and logical to do so, be modeled largely after the Transfer Order currently in place today.

The contemplated governance structure would be premised upon the following:

- "Tracking Shares" would be used to provide for each municipality ownership interest to be equal to its percentage of total water consumption as determined every four (4) years;

- Each municipality will be entitled to appoint one (1) representative to the Board, and a municipality will be able to appoint an additional representative for every 10% of the total water consumption (a municipality cannot have more than 50% of the Board positions regardless of its water consumption).

IV. Financial Justifications

Under the current structure, UWSS faces several financial challenges including:

- The inability to access grants and other types of funding available for water infrastructure from senior levels of government independent of the Municipalities;

- The inability to raise its own debt independent of the Municipalities;

- A revenue model which, absent additional Municipal debt, does not accommodate large-scale capital programs; and

- The attribution of UWSS debt to the Municipalities.

Many of the above captioned financial challenges are likely to be resolved by incorporating UWSS. By incorporating, UWSS Inc. would, among other things:

- Shift volume and credit risk to UWSS's account, not that of the Municipalities;

- With the agreement of Municipal auditors, attract Government Business Entity treatment and not be fully consolidated on the Municipal accounts;

- Have capital expenditures funded by capital reserves, funds from operations and new (not the existing Sun Life) debt; and

- Set rate revenue at the greater of:

    - that which results in zero net income – no loss – for UWSS according to Generally Accepted Accounting Principles; and

    - that which enables UWSS to meet the Debt Service Coverage Ratio as agreed upon with UWSS's lenders.

Further, financial analysis indicates that:

- The proposed financial structure offers potential rate savings to municipal ratepayers, compared to rates approved for 2017 and 2018 (adjusted for inflation);
- UWSS financial metrics – in particular, those related to new debt – are projected to be robust over a 50-year projection period under the proposed financial structure; and

- Obtaining stand-alone credit-worthiness is achievable for UWSS Inc. – something critical for the success of UWSS on a go-forward basis.

V. <u>Conclusion</u>

For all of the reasons given above, there is a strong business case to be made in favour of incorporating UWSS. Incorporating UWSS is arguably the most effective way to mitigate the associated legal and financial risks associated with the current unincorporated structure. For these reasons, it is recommended that each municipality adopt this business case study in order to establish UWSS as a corporation.

www.pwc.com/ca

Union Water Supply System

Financial Structuring Business Case

April 2018

For Municipal Consultation With The Public

pwc

Note to readers:

This confidential report is not to be used for any purposes other than those detailed in the terms of engagement dated June 22, 2017 and is not intended for general circulation, nor is it to be published or made available to other parties in whole or in part without PricewaterhouseCoopers LLP's ("PwC") written consent. PwC will not assume any responsibility or liability for losses suffered by the or by any other party as a result of the circulation, publication, reproduction or use of this report contrary to the provisions of this paragraph.

This report as well as the analyses and conclusions that are presented are based on information provided by Union Water Supply System as well as industry benchmarks and data available to PwC. We did not audit the accuracy or completeness of the above financial information. PwC reserves the right, without any obligation on our part, to revise the calculations contained herein or those to which we refer and, if we judge it necessary, to revise our conclusion in light of information which existed at the date of issuance, but which is brought to our attention subsequent to the issuance of this report.

In accordance with the conditions of our mandate, our findings cannot be interpreted as estimation or as an opinion on the fair market value of Union Water Supply System. This report must be considered as a whole. Selecting portions of the report or factors considered in it without considering all factors together could create a misleading view of the process underlying our conclusions.

The individuals who prepared the report did so to the best of their knowledge, acting independently and objectively. PwC's compensation is not contingent on an action or event resulting from the use of the report.

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This proposal to provide services is contingent on successful completion of PwC's client and engagement acceptance process.

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1. Executive summary

Summary of Conclusions

Union Water Supply System ("UWSS") has operated as a bulk water supply utility owned on a "tenants in common" basis by the Towns of Leamington, Kingsville, Essex, and Lakeshore (the "Municipalities") since a 2001 Transfer Order was issued by the Ontario Ministry of the Environment (now the Ministry of Environment and Climate Change). UWSS has no corporate existence; it cannot conduct business independent of the Municipalities. This structure gives rise to several financial challenges including:

- The inability to access grants and other types of funding available for water infrastructure from senior levels of government independent of the Municipalities;
- The inability to raise its own debt independent of the Municipalities;
- A revenue model which, absent additional Municipal debt, does not accommodate large-scale capital programs; and
- Attribution of UWSS debt to the Municipalities.

This Business Case addresses the financial challenges and proposes a new financial structure for UWSS. Legal analysis and other matters not discussed in this report are outside the scope of this Business Case. The Business Case is premised on the Municipalities establishing UWSS as a corporate entity.

In order for a new financial structure to be successful for UWSS and the Municipalities, UWSS must be credit-worthy on a stand-alone basis. Our analysis of potential credit-worthiness indicates that such stand-alone credit-worthiness is achievable for UWSS.

Also, in order for a new financial structure to be successful for UWSS and the Municipalities, UWSS and the Municipalities must achieve a commercial structure under which UWSS debt is properly accounted for as non-recourse to the Municipalities. Our accounting analysis indicates that this too is achievable.

The proposed commercial structure has the following features:

- The essential commercial relationship would be between UWSS and end-use water customers in the Municipalities (who receive UWSS bulk water);
- The Municipalities would act as agents of UWSS in facilitating this relationship;
- The Municipalities would provide billing services as agreed upon with UWSS;
- Volume and credit risk would be to UWSS's account, not that of the Municipalities; and
- UWSS would, with the agreement of Municipal auditors, attract "Government Business Entity" ("GBE") treatment and not be fully consolidated on the Municipal accounts.

The proposed financial structure has the following features:

- Initial capitalization: The Municipalities would convey the UWSS assets to an incorporated UWSS in return for shares in UWSS. UWSS is contemplating a share structure whereby each Municipality's ownership will continue to be based on its consumption through the use of tracking shares. To preserve the existing UWSS ownership model under this structure, tracking shares can be incorporated into the corporate framework, and provide for each Municipality's ownership interest to be equal to its percentage of total water consumption, adjusted every 4 years, much like the current framework;
- Approved capital expenditures would be funded by capital reserves, funds from operations and new (not the existing Sun Life) debt;
- The UWSS revenue model would set rate revenue at the greater of:
    - That which results in zero net income – no loss – for UWSS according to Generally Accepted Accounting Principles; and

- That which enables UWSS to meet the Debt Service Coverage Ratio (DSCR") as agreed upon with UWSS's lenders;
- UWSS operations would continue as at present, or otherwise as determined by the UWSS Board; and
- Both "source to tap" (integration of UWSS bulk water services with Municipal water distribution) and rate structures other than a uniform rate per unit volume are achievable under the proposed financial structure at the discretion of the Municipalities.

Financial analysis indicates that the proposed financial structure offers potential rate savings to Municipal ratepayers, compared to rates approved for 2017 and 2018 (adjusted for inflation). This financial analysis also indicates that UWSS financial metrics – in particular, those related to new debt – are projected to be robust over a 50-year projection period under the proposed financial structure.

Recommendations

This Business Case recommends that, if the Municipalities establish UWSS as a corporate entity, UWSS and the Municipalities:

- Adopt the proposed financial structure as set out in Sections 6 and 9;
- Adopt the proposed commercial structure as set out in Section 5; and
- Proceed to implementation as set out in Section 10.

Task or Milestone	Preliminary Timing
Financial market sounding – gauging lender interest and most likely lenders; and gaining detailed insight into the required/available provisions of key agreements	• Q1-Q2 2018
Discussion and agreement with Municipal auditors concerning commercial structure and GBE treatment; adjust commercial model if required	• Q1-Q2 2018
Development of the agreement between UWSS and the Municipalities	• Q1-Q2 2018
Development of a Master Trust Indenture, a document which will govern all new debt upon implementation. This will likely involve negotiations with key prospective lenders	• Q2-Q3 2018
Exploration (and potentially negotiation) with Sun Life concerning transfer of obligation to UWSS	• Q2-Q3 2018
Design and organization of new billing and other administrative measures required for new commercial structure	• Q2 – Q4 2018
Decision on management of Windsor Family Credit Union funds – leave invested to maturity or redeem early (possibly with an interest penalty)	• Q3 2018 or after
Updating of UWSS financial projections based on latest information (including volume outlook, investment, and debt requirements)	• Q3 2018
Development and negotiation of lending agreements for initial new debt to be issued	• Q3 2018
Execution of agreements: • UWSS agreement with Municipalities	• Q4 2018

• Supporting service agreements between UWSS and Municipalities (as determined by final commercial structure) • Master Trust Indenture • Initial lending agreements • (Possibly) agreement concerning existing Sun Life debt	
Funds available – new debt	• January 2019
Go-live for new commercial structure including billing and other administration	• January 2019 or before
New revenue and rate model active	• 2019 fiscal year

2. Background and Current Situation

This section reviews the history of Union Water Supply System ("UWSS"), and highlights the challenges faced by UWSS and its owner municipalities (Leamington, Kingsville, Essex, and Lakeshore, collectively the "Municipalities").

Historical and Early 1990's

Historically, the Province of Ontario (the "Province") constructed, owned and operated selected municipal water systems, directly through the Ontario Water Resources Commission (OWRC). The Union Water System (now the Union Water Supply System, "UWSS") was originated by the OWRC in 1960. In 1974 the Province of Ontario created the Ministry of the Environment ("MOE", now the Ministry of the Environment and Climate Change). All assets owned and operated by the OWRC, including UWSS, were transferred to the MOE and the OWRC was subsequently dissolved.

In 1993, the Province created the Ontario Clean Water Agency ("OCWA") to assume its water and wastewater responsibilities. In 1994, OCWA signed an agreement with the then municipalities of Essex, Gosfield North, Gosfield South, Leamington, Maidstone, Mersea, Kingsville, and Rochester; and with H. J. Heinz Company of Canada Ltd ("Heinz"). This agreement provides for matters including:

- An expansion to the shared water supply system (identified as the Union Water System);
- Ownership by OWCA and OCWA's water supply responsibilities; and
- Rate-setting and rate payment by the signatory municipalities.

The agreement provided for an initial five year term with three optional renewals taking effect absent termination by the signatories.

The Transfer Order

The Province elected to exit ownership (but not operation) of water and wastewater systems according to a policy adopted in the late 1990's.

Ownership of UWSS was conveyed to the Municipalities on January 8, 2001. UWSS ownership was on a "tenants in common" basis; UWSS did not and does not have a corporate existence. OCWA operates the UWSS system under contract to the Municipalities; rate-setting and budgeting for capital and operations are the responsibility of UWSS subject to Board approval.

Supply to Heinz continued according to the 1994 agreement described above.

The framework for governance of UWSS was set out in this order, and continues to the present. Ownership of UWSS was and is according to respective shares of UWSS consumption, and is reset every four years. A 12-person Board structure was established, with Board seats allocated according to ownership (with a 6-seat cap for any individual Municipality).

The UWSS rates were and are set (and approved by the UWSS Board) based on:

- Operating costs;
- Capital costs and contributions to capital reserves;
- Debt service (interest and principal); and
- Other Board-approved costs.

A special Heinz rate and area-specific rates were provided for.

Initial Financing

Ownership of UWSS was not free to the Municipalities. In order to pay OCWA for the UWSS assets, the Municipalities incurred debt of approximately $18.5 million. This debt was arranged by MFP Structured Finance Ltd. ("MFP"), and purchased by Mutual Life Assurance of Canada (now part of Sun Life).

MFP was later found to have misrepresented the cost of this debt. In a 2006 settlement, the Municipalities received approximately $10 million. This amount is still held for UWSS in a deposit instrument at the Windsor Family Credit Union. Debt service payments were renegotiated with Sun Life; these payments are approximately $2.5 million per annum and the debt matures in 2026. UWSS funds the debt service.

The Municipalities have, since 2001, issued debt on behalf of UWSS, and UWSS has funded debt service. As at the end of 2016, approximately $14.5 million of Sun Life debt is outstanding; the Municipalities have no other debt or cash related to UWSS.

Portrait of UWSS in 2016

At the end of 2016, UWSS had the following characteristics:

Characteristic	UWSS as at the end of 2016
People served	• Approximately 65,000 across the four Municipalities
System connections	• The Municipal water systems of Leamington, Kingsville, Essex, and Lakeshore
Principal assets	• Non-linear assets: water treatment plant, low-lift pumping station, booster pumping station, in-ground reservoir, four water towers • Linear assets: approximately 125 km of "transmission" water main
Board seats[1]	• Leamington: 6 • Kingsville: 4 • Essex: 1 • Lakeshore: 1
Staff	• Two full time (General Manager and Executive Assistant) • Legally, these staff are employed by the Town of Leamington
Operations and maintenance	• OCWA, under contract
Asset value	• Net book value $41 million • Replacement cost: $112 million
System Flow	• Approximately 3.3 billion gallons
Sector share of flow (2013, most recent available)	• Residential: 33% • Commercial: 13%

[1] We understand that, as of January 1, 2017, Kingsville obtained one additional Board seat, for a total of five.

	• Greenhouses: 37% • Canneries and other: 17%
Revenues	• Rate revenue: $8.9 million • Interest income: $0.4 million • Ancillary revenue: <$0.1 million
Capital accounts	• Depreciation: $1.2 million • Capital expenditure: $0.6 million
Debt service	• Interest expense: $1.6 million • Principal repayment: $0.7 million • Total debt service: $2.3 million
Rate revenue model	• Operations, maintenance and administrative costs; plus • Debt service (principal and interest); plus • Approved capital expenditures

Challenges

UWSS and the Municipalities face a number of challenges going forward.

The Capital Program

The UWSS approved 6-Year Capital Plan calls for over $26 million in expenditures. This amount is thought by UWSS to exceed available cash reserves, plus the amount that could be included in annual revenue without causing "rate shock" (a sharp increase in rates from one year to the next).

Longer Term Capital Replacement and Reserves

In a water utility, assets are long-lived – a "short" life may be 15 years, while a "long" life may be 75 years. UWSS's linear assets have an assigned life of 75 years.

At some point, all assets require replacement or renewal. If a utility has cash reserves –in Ontario, some municipal water systems do and some do not – these reserves may be used to fund renewal or replacement. If reserves are nil or insufficient, funds must be provided from another source, such as grant funding (which may not be available when needed) or municipal borrowing (recovered in rates over a period of time).

UWSS does have cash reserves:

- $10 million in a deposit instrument maturing in 2021;
- An operating fund of $1.7 million; and
- Approximately $4 million in other cash capital reserves.

However, given the UWSS short-term capital plan described above, UWSS cash capital reserves will be fully depleted by the early 2030s.[2]

Grant Funding

As UWSS does not have a corporate existence, it cannot apply for grant funding from senior levels of government. The Municipalities must apply on UWSS's behalf. This can be a cumbersome process, and UWSS requirements would compete with other Municipal projects for available grant funding.

While this Business Case does not assume the availability of any grant funding (in the interests of conservatism, and as the availability of grant funding is unpredictable), the ability of UWSS to access available grant funding in the future is an important objective.

It is important to note that UWSS, if incorporated, could access grant funding with no change to the financial structure.

Required Revenue Determination and Rates

The revenue model of UWSS directly includes capital expenditure. This is in contrast to, for example, electrical Local Distribution Companies ("LDCs") which recover capital costs in arrears (in the case of LDCs, with a return to debt and equity).

In years in which cash reserves are not available, this model is not compatible with a large capital program in a single year – this would result in a sharp increase in required revenue and therefore rates (this is commonly referred to as "rate shock"). The nature of UWSS's business is that such large capital expenditures are required on occasion; for example, the UWSS 6-Year Capital Plan calls for expenditures of approximately $7 million in 2019, and the same amount again in 2021.

From a rate-making standpoint, UWSS currently has a largely uniform rate per unit volume (measured at the perimeter of the UWSS system). In the past, there have been rate structures under which different users bore different costs, depending in part on what assets served each user.

Debt and Debt Attribution

As UWSS does not have a separate corporate existence, its debt is consolidated on the accounts of the Municipalities (in proportion to ownership). As Ontario municipalities have a provincially-mandated maximum debt amount (relative to receipts), debt capacity has value to municipalities.

Our consultations indicate that the existing UWSS debt is not an immediate concern for the Municipalities; however, having the existing UWSS debt attributed solely to UWSS would be desirable.

With respect to debt which may be required in the future (projections indicate this could be as early as 2019), the existing process among UWSS and the Municipalities calls for:

- Approval of the UWSS capital plan and resulting requirement for new debt;
- Approval for the new debt by each Municipality, for the applicable proportional share;
- Issuing the new debt; and
- Servicing the debt by UWSS, with cash flow to each Municipality according to its proportional share.

[2] A working capital and operating cash reserve of approximately $2 million is maintained.

Consultations indicate that the potential new debt in the short term is feasible from the standpoint of the Municipalities (from a debt capacity standpoint); however, UWSS having the ability to issue new debt with recourse only to UWSS would be desirable.

Potential complexities may arise should a capital project not benefit all Municipalities equally (or at all); in this case, reaching agreement to undertake new debt may be challenging under the existing model.

"Source to Tap"

As described above, UWSS is a bulk water system with no responsibility for distribution of water to end customers. UWSS and the Municipalities have considered and rejected the potential for UWSS to assume responsibility for the Municipal water distribution systems as well as bulk supply. This is known as the "source to tap" option. UWSS and the Municipalities have required that any change to the UWSS financial structure not impede development and implementation of "source to tap" should this option be considered in the future.

The Legal Analysis

In 2015, UWSS had a legal analysis undertaken by William Willis, now the founding partner at Willis Law in Windsor. This analysis examined the option of an incorporated legal structure for UWSS and addressed such matters as:

- Liability of the Municipalities and UWSS Board members;
- Feasibility of an incorporated UWSS from a licencing standpoint;
- UWSS's inability to issue debt and therefore finance its own operations;
- Governance and decision-making;
- Potential risks associated with separate ownership and operation of UWSS and the Municipal water systems; and
- How an incorporated Municipal Services Corporation (MSC) which would succeed UWSS – potentially "UWSS Inc." – may be established, including the initial capitalization by conveyance of existing UWSS assets to the successor in return for shares in the new corporation.

The recommendations of this analysis were that the Municipalities:

- Establish UWSS as a Municipal Services Corporation as this is defined in Ontario legislation;
- Transfer the UWSS assets held on a "tenants in common" basis by the Municipalities to the UWSS corporate entity in return for shares;
- Consider the inclusion on the Board of industry experts as well as Municipal appointees;
- Establish UWSS's mandate, and its delegated authority to conduct its business under Board supervision and within the Ontario legislated and regulatory environment; and
- Consider the "source to tap" option as described above.

Premise for This Business Case

The premise for this Business Case is:

- IF the UWSS shareholders undertake the adoption of a corporate structure for UWSS, broadly as set out in the legal analysis of 2015 as modified by the UWSS Board and Municipalities;
- AND if UWSS shareholders wish to explore financial structuring options to address the financial challenges described above;

- THEN this Business Case may be considered as a potential path forward with respect to financial structure.

3. Financial Structuring Objectives

This section describes the objectives we set in designing the proposed financial structure for UWSS.

Objectives

Given the background and challenges set out in Section 2, we set the following objectives for design of a potential new financial structure for UWSS[3].

Ability to Issue New Debt

UWSS must, under a proposed financial structure, be able to issue debt to finance its operations (according to plans and budgets approved by its Board). This in turn requires that UWSS be credit-worthy – that is, its debt is attractive to lenders in the financial markets, so that UWSS may borrow as needed on reasonable terms (notably interest rates and principal repayment term).

Attribution of Debt Solely to UWSS

A proposed financial structure must support the attribution of UWSS debt solely to UWSS and not to the Municipalities:

- New debt; and if possible
- The Sun Life debt as well.

Ability to Accept Grant Funding

A proposed financial structure must be able to access grant funding if it is available. UWSS indicates that infrastructure grants from senior levels of government are available to municipalities directly, and to Municipal Services Corporations, but not to UWSS as an entity without corporate existence. At present, a grant application for UWSS would have to come from the Municipalities; this s complex and may put UWSS priorities in conflict with Municipal infrastructure grant priorities.

"Source to Tap"

A proposed structure must be compatible with "source to tap" should the Municipalities elect to take up this option in the future.

No "Rate Shock"

A proposed financial structure must minimize required rates, and avoid "rate shock" to the extent possible given the costs to be borne by UWSS in the future.

Non-Uniform Rate Structures

For purposes of this Business Case analysis, a uniform rate per unit water volume is assumed. However, a proposed financial structure must be compatible with non-uniform rate structures should UWSS and the Municipalities elect to go this route.

[3] For the balance of this Business Case, UWSS will refer to an incorporated entity succeeding the existing UWSS.

Summary

The objectives described above formed the basis for design of the proposed financial structure. Achieving these objectives requires the support of two principal attributes for UWSS:

- Credit-worthiness on a stand-alone basis (as described in Section 4); and
- Commercial structuring to achieve accounting treatment as a Government Business Entity (as described in Section 5).

One potential objective is notable by its absence – a profit flow for the Municipalities. The Municipalities have never earned a return on their share of UWSS, and consultations indicate that earning a return (funds from ratepayers that would accrue to the tax base) is not an objective for a new financial structure. Accordingly, Municipal profit is not an objective driving the design of the proposed financial structure.

4. Credit-Worthiness

This section defines credit-worthiness for the purpose of this Business Case, and sets out the requirements for credit-worthiness which the financial markets will likely apply to UWSS.

What Is Credit-Worthiness for UWSS?

An entity may be considered credit-worthy if:

- It can borrow as it needs to, in order to finance its operations (and specifically its approved capital plans), under most market conditions[4];
- The terms and conditions (notably the interest rate and principal repayment provisions) are reasonable – broadly equivalent to terms and conditions available in to comparable borrowers, and stable over time in most financial market conditions.

At present, lenders for UWSS look directly to the Municipalities for assurance that debt principal and interest (together, debt service) will be paid according to the lending agreements. Municipalities are credit-worthy to the extent that their ability to realize tax and other revenue is sufficient to fund all municipal obligations including debt service, with a safety factor. Ontario legislation caps municipal borrowing at levels viewed as prudent by the financial markets.

In order for the objectives described in Section 3 to be achieved, UWSS must be credit-worthy on a stand-alone basis. For lending to utilities such as UWSS, lenders can only look to the sufficiency and reliability of revenues for assurance of debt service – in a default situation, the assets (unlike, say a vehicle) cannot be seized and sold to other buyers.

Credit Positives for UWSS

It is reasonable for UWSS to expect a positive reception from the financial markets as a stand-alone borrower, if properly structured and operated.

A Utility with Monopoly Access to Customers

Utilities are generally attractive to lenders as they have monopoly access to their customers – they do not face competition (although they are constrained by regulation or other means). Although actual consumption (in UWSS's case, bulk water) may vary, utilities generally recover their costs in the form of a required revenue (that is, the revenue that achieves the regulatory or otherwise agreed-to conditions), which is then converted into rate(s) per unit volume – ratepayers bear the risk of volume variations over time.

Defined Pricing Power

Utilities have defined pricing power – that is, the power to recover costs and set rates constrained by a predictable set of rules, at a level sufficient to meet all obligations, without the prospect of external interference (but of course subject to Board oversight).

UWSS at present recovers costs as described in Section 2:

- Operations, maintenance and administrative costs; plus

[4] During periods of financial market turmoil, such as experienced in 2007 – 2009, many borrowers had difficulty accessing new debt.

- Debt service (principal and interest); plus
- Approved capital expenditures

As set out in Section 6, the proposed financial structure will incorporate a different, but equally defined, required revenue model. The proposed revenue model would be established contractually as described in Section 9.

LDCs recover costs according to a different formula:

- Operations, maintenance and administrative costs; plus
- Depreciation expense; plus
- Interest expense; plus
- A return to equity calculated according to regulated parameters; plus (if applicable)
- An allowance for cash taxes paid

The formula is different, but it is defined and reliable over time. In the case of LDCs, credit ratings (DBRS in this case) range from A (low) to A (high) for major bond-issuer LDCs[5].

Conservative Capital Structure

UWSS had, at the end of 2016, a debt : equity ratio of 25% debt : 75% equity. The regulated debt : equity ratio for Ontario LDCs is 60% debt: 40% equity.

As described in Section 6, the proposed financial structure does not include a covenant concerning capital structure. However, long-term financial projections described in Section 7 indicate a UWSS capital structure with less debt than specified for Ontario LDCs.

Strong Debt Service Coverage

As described above, lenders require a "safety factor" between a borrower's debt service obligations, and the borrower's means to make debt service payments. This safety factor is "debt service coverage", and it expressed as a ratio referred to as the Debt Service Coverage Ratio ("DSCR").

In 2016, UWSS (having only the Sun Life debt to service) had a DSCR of approximately 1.9x. This is calculated as:

- "Cash Available for Debt Service":
    - Revenues; less
    - Operations, maintenance and administrative costs; divided by
- Debt service:
    - Interest; and
    - Required principal repayment.

[5] DBRS, May 2017

This level of DSCR is more than the market requires, in PwC experience. DSCR of 1.25 to 1.50 will support investment-grade treatment in the financial markets; we have used 1.50 in our analysis in the interest of conservatism.

Priorities for Credit-Worthiness

In designing the proposed financial structure, we have considered two principal attributes:

- UWSS must, in all periods, be able to earn required revenue which enables it to at least break even on a "Generally Accepted Accounting Principles" ("GAAP") basis – this includes recovery of depreciation expense (which the current UWSS revenue model does not); and
- UWSS must, in all periods, be able to earn required revenue which enables UWSS to achieve a market-appropriate DSCR (for which we have used 1.50 in our analysis).

These conditions respond to lenders' most pressing requirements:

- High-quality borrowers do not lose money; and
- Borrowers always have the capability to pay debt service – interest and required principal repayment – with a safety factor.

The manner in which these requirements are incorporated into the proposed financial structure is set out in Sections 6 and 9.

5. Accounting Considerations

An important objective of UWSS's for the Municipalities is that UWSS debt be considered an obligation solely of UWSS, and not be consolidated on the accounts of the Municipalities.

This section addresses the requirements for achieving this accounting treatment and discusses the commercial structure of UWSS, and its relationship with the Municipalities and with end customers is such that UWSS debt is properly accounted for as recourse only to UWSS and not consolidated (on a line-by-line basis) in Municipal accounts.

Accounting Principles

Canadian accounting principles contain guidance in the areas of consolidation, reporting relationships and government entity types which can assist in determining the accounting treatment with respect to the attribution of debt in circumstances similar to those of UWSS. In particular, guidance is provided concerning:

- "Government Business Entity" (or "GBE") treatment and the requirements to achieve this treatment; and
- "Agent versus principal" relationships

Government Business Entity

A Government Business Entity (or "GBE") is a business owned by government which is financially self-supporting. GBEs are accounted for by its government owner(s) on an "equity" basis – that is, the value of the equity ownership (i.e. net assets) stake in the GBE is recorded as an asset in the balance sheet. As a result, the debt of the GBE is not classified as debt in the government owner(s) balance sheet but rather is included as part of the governments net investment of the GBE (reducing the net asset value). Therefore, GBE treatment would achieve the objective of the Municipalities with respect to accounting treatment/classification of UWSS debt.

Guidance for qualification as a GBE is set out (in part) below:

28 A government business enterprise is an organization that has all of the following characteristics:

(a) it is a separate legal entity with the power to contract in its own name and that can sue and be sued;

(b) it has been delegated the financial and operational authority to carry on a business;

(c) it sells goods and services to individuals and organizations outside of the government reporting entity as its principal activity; and

(d) it can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.

In the electricity market, municipally-owned local distribution companies ("LDCs") are commonly treated as GBEs.

Agent versus Principal

In assessing the relationship for financial reporting purposes between UWSS and the Municipalities (i.e. whether or not UWSS is a GBE to the Municipalities) an important consideration is the relationship among UWSS, the Municipalities, and the end customers using UWSS-supplied water. Specifically, are the Municipalities customers of UWSS, or agents of UWSS in a commercial relationship essentially between UWSS and end water customers?

If the Municipalities are agents of UWSS, then they may qualify for "Net Revenue Reporting", and would record only the net revenue (if any) from sales of UWSS water to end customers. UWSS would be considered a supplier to end customers, not the Municipalities.

Key requirements[6] for the Municipalities to be considered for treatment as an agent of UWSS include:

- UWSS (not a Municipality) is the "obligor" – that is, responsible for providing the product or service (in the case of UWSS, bulk water);
- The Municipalities earn a fixed amount (not mandatory) – a fixed amount per account, per year, or other unit of measure in exchange for acting as agent of UWSS. The municipalities do not bear the risks of profit and loss related to the product or service being provided; and
- Credit risk related to the provision of bulk water is not borne by the Municipalities. Bad debt risk is ultimately borne by UWSS.

Conversely, UWSS would be considered the principal provider (as desired) if it has:

- The primary responsibility for providing bulk water to its customers (local delivery being considered a separately billed service);
- Inventory risk – the risk that end customers may or may not order or use a given volume of product;
- Latitude in setting prices (and not be directed concerning pricing by the Municipalities[7]); and
- Exposure to credit and collection risk.

Options for Commercial Structure

UWSS and the Municipalities may structure their affairs in several different ways, with varying potential accounting treatment.

Option #1: Current Structure

In this structure:

- UWSS sells bulk water to the Municipalities according to the existing bulk metered volume measurements;
- The municipalities take title to the bulk water, and resell to their end water customers according to residential and business metered volume measurements. UWSS charges are not shown as a separate billed item to end customers;
- Credit and collection risk is borne by the Municipalities; UWSS is paid according to the bulk metered measurements and has no commercial relationship with end water customers.

Option #2: "LDC" Structure

In this option:

- UWSS has a direct relationship with individual metered end customers. A supply agreement with these customers may be required;
- UWSS bills each end customer according to residential and business meters (rather than the existing bulk meters);

[7] Municipal representation on the UWSS Board would not compromise UWSS's latitude in setting prices; an established revenue determination mechanism as set out in Sections 6 and 8 would reinforce UWSS pricing authority

- Accounts Receivable ledgers are maintained (perhaps by Municipalities as a service to UWSS);
- Billing may be done (for a fee which would be a recoverable cost for UWSS) by Municipalities on behalf of UWSS. UWSS charges would show separately from other Municipal billed items (such as water distribution or perhaps electricity if this is billed with water);
- As UWSS charges are collected, collected funds are remitted to UWSS. The Municipalities do not guarantee UWSS collections.

Option #3: Municipalities as Agents of UWSS

In this option:

- UWSS has a direct relationship with individual metered end customers. A supply agreement with these customers may be required (potentially a significant challenge given the number of customers);
- End customer volumes (which will be different than bulk water metered volumes due to system losses) are the basis for billing based on end user metered volumes. These volumes are shared between UWSS and the Municipalities;
- The Municipalities bill individual end users according these end user metered volumes, with UWSS charges being an item separate from other billed charges;
- UWSS invoices the Municipalities for bulk water according to end user metered volumes, and the Municipalities pay such invoices;
- Municipalities charge back UWSS for any UWSS end customer charges which prove to be uncollectible according to Municipal policy;
- Municipalities charge UWSS for services provided including:
    - Billing;
    - Administration of collections;
    - The time value of money between the UWSS billing date and the anticipated date of collection from end customers; and
    - Other items as agreed upon by UWSS and the Municipalities;
- UWSS includes these charges in its cost base to be recovered from its end customers.

Potential Qualification for GBE Treatment

The potential for these options to qualify for GBE treatment is as follows:

Scenario	Separate Corporate Entity	Delegated Financial and Operational Authority	Goods and Services Provided Principally to Customers Other Than Government	Maintain Operations and Meet Liabilities from Revenues Other Than Government	Comments and Cautions
Option #1: Current Structure	OK	OK	Fail – Municipalities are only customers	Fail – revenue source is only from Municipalities	Easiest implementation but does not achieve a key objective

Scenario	Separate Corporate Entity	Delegated Financial and Operational Authority	Goods and Services Provided Principally to Customers Other Than Government	Maintain Operations and Meet Liabilities from Revenues Other Than Government	Comments and Cautions
Option # 2: "LDC" Structure	OK	OK	OK: UWSS bills to and collects from end customers directly	OK: No direct financial relationship with Municipalities, other than as normal course billed customers	Greatest available assurance of GBE treatment; however, potentially significant administrative load on UWSS (and possibly Municipalities as service providers)
Option #3: Municipalities as agents of UWSS	OK	OK	OK: Essential commercial relationship is with end customers	OK: Key risks are to the account of UWSS	Some administrative changes, but less than in Option #2.

Other Considerations

Under any structure, if UWSS requires investment of Municipal equity it may fail the test of "Maintain Operations and Meet Liabilities from Revenues Other Than Government". The financial structure and financial projections in this Business Case (see Sections 6 - 9) do not anticipate this need for equity investment; however, the Municipalities should keep this consideration in mind going forward.

Summary

At this Business Case stage, it appears that Option #3 is a leading candidate for investigation and adoption. As a practical matter, one option should be implemented for all Municipalities.

Both Options #2 and #3 will require socialization of the new structure with end customers, and (potentially) the execution of connection agreements between UWSS and end customers.

Requirements to Achieve Proposed Commercial Structure

In the end, the determination of whether or not a structure meets the requirement for GBE treatment will be that of the Municipalities' auditors. Therefore, if the Municipalities elect to proceed on a course indicated by this Business Case, the following will be required:

- The Municipalities engage their auditors concerning the selected structural option and GBE treatment;
- The need for a connection agreement between UWSS and end customers be determined, and (if required) the form of this agreement be developed;
- Planning be undertaken to socialize the new commercial structure with end customers, and (ultimately if required) achieve execution of these agreements; and
- UWSS maintain a forward financial plan that will highlight the potential need for Municipal equity investment in advance, with a view to advance planning to avoid a situation in which GBE qualification fails.

6. Financial Structure

This section develops the financial structure recommended in this Business Case.

It is assumed that UWSS and the Municipalities will obtain advice concerning legal structure, ownership, governance, liability and related matters from counsel. This Business Case and this section address only financial structuring.

Drivers of the Financial Structure

The proposed financial structure is designed to achieve objectives in two areas:

- Credit-worthiness (Section 4); and
- GBE treatment (Section 5).

Recommended Financial Structure

The financial structure proposed in this Business Case is as follows:

Opening Assets

Upon the establishment of UWSS under a corporate structure, the Municipalities will transfer all UWSS-related assets to UWSS in return for shares. UWSS is contemplating a share structure whereby each Municipality's ownership will continue to be based on its consumption through the use of tracking shares. To preserve the existing UWSS ownership model under this structure, tracking shares can be incorporated into the corporate framework, and provide for each Municipality's ownership interest to be equal to its percentage of total water consumption, adjusted every 4 years, much like the current framework.

Opening Liabilities

If achievable, UWSS will assume legal liability for the Sun Life debt; this will require negotiation with Sun Life and may or may not be achievable.

Other (current) liabilities such as accounts payable would also be assumed by UWSS.

Other Undertakings

UWSS would assume legal responsibility for the OCWA contract and other undertakings.

The existing two employees of OWSS (who are currently formally employed by Leamington) would be employed by UWSS directly.

UWSS and the Municipalities would enter into an agreement as set out in Section 9.

Revenue and Rate Model

The required revenue to which UWSS will be entitled according to its agreement with the Municipalities would be the greater of that which results in:

- A break-even net income under GAAP (the "break-even test"); and
- A DSCR equal to that agreed to with UWSS lenders (the "DSCR test").

A uniform rate would be constructed as at present – required revenue divided by flow – however, the flow would be at the end user point, not the UWSS-Municipality billing points as at present. This is to facilitate the commercial structure according to Option #3 in Section 5.

The UWSS Board may, at its option, also set rates higher than those described above, in the interests of avoiding fluctuating rates. An example may be rates which are equal to the prior year plus inflation. In the proposed structure, UWSS would not have the latitude to set rates lower than those which meet both the "break-even test" and the "DSCR test" without explicit permission of its lenders.

Funding of Capital Expenditures

The capital program will at all times be approved by the UWSS Board, as at present.

Funding of the capital program would be:

- First from cash from operations;
- Then from available capital reserves;
- Then by issuance of new debt.

Capital investment gives rise to depreciation expense regardless of how the investment is financed (reserves or debt). This depreciation expense is recovered in revenue (according to the "break-even" test) over the life of the asset.

New debt gives rise to debt service – interest and principal. This debt service, multiplied by the applicable DSCR, gives rise to a recoverable cost according to the "DSCR test".

Ongoing Operations

The principal operating relationship with OCWA would continue essentially unchanged, but the OCWA contract would be with UWSS as a stand-alone contracting entity.

Any services provided by the Municipalities to UWSS would continue (until changed by agreement if at all), but would be articulated in formal agreements.

Summary

We have conducted our financial analysis in Section 7 based on the proposed financial structure described above; Section 8 evaluates assesses the achievement of the objectives set out in Section 3 by the proposed financial structure.

7. Financial Analysis

This section sets out the projected financial results should the recommended financial structure be implemented.

Methodology Highlights

A financial modeling analysis was undertaken in support of this Business Case, addressing the following items and incorporating information provided by UWSS:

Category	Specific Items

Capital Items	• Capital expenditure:
	  o 2017 and 6-year approved Capital Plans
	  o Replacement of assets as at the end of 2016
	  o Water treatment plant expansion ~2034
	• Depreciation

Other Costs	• Operations, maintenance and administrative costs

Financial Items	• The Windsor Family Credit Union deposit instrument
	• Sun Life debt
	• New debt:
	  o Interest rates
	  o Principal repayment
	• Interest earned on reserves

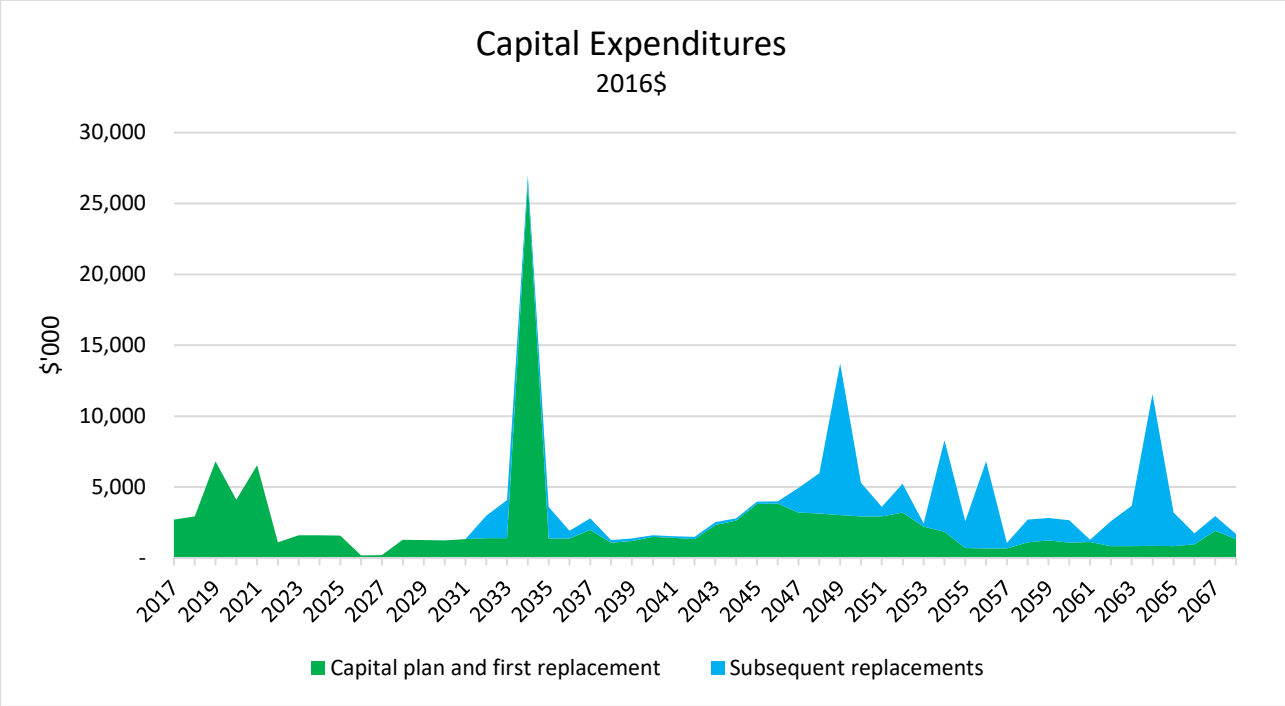
Rates and Revenue	• Rates for 2017 and 2018 as per approved plans • Rate-making thereafter according to the proposed financial structure
Volume	• Volume growth assumption, consistent with planning the water treatment plant expansion

Results

The results from the financial analysis are set out below.

Capital Expenditure

Capital expenditure over time, here shown in 2016 dollars, are projected as follows:



Looking ahead, there are clearly some years of very high capital expenditures – "spikes". These are driven by:

- The 2017 and 6-year capital plans;
- The water treatment plant expansion projected for 2034; and
- Replacement of these major expenditures at the end of useful life.

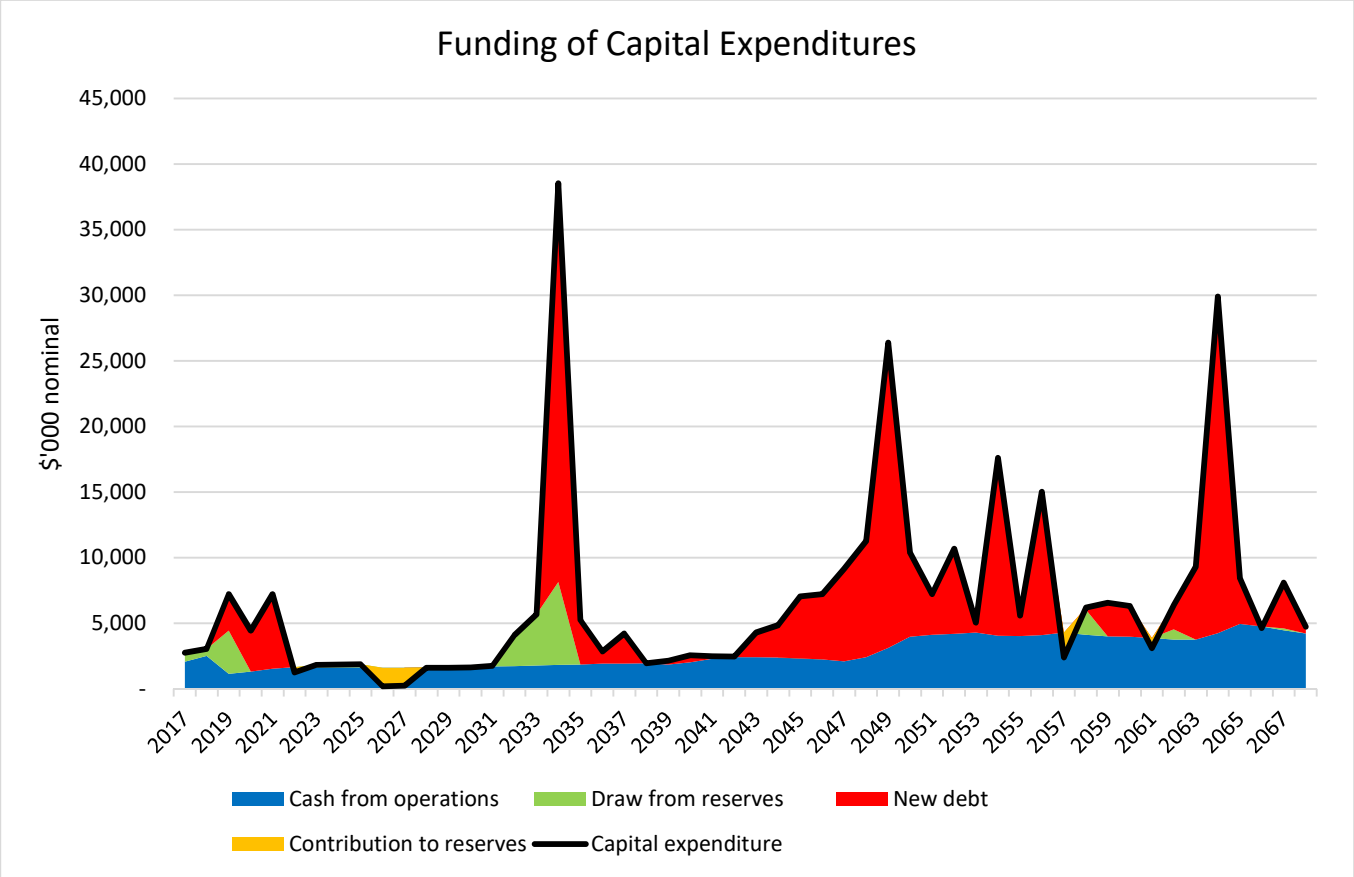
The total capital expenditure, in 2016$, over a 52-year projection period (2017 and 2018, plus 50 years of the proposed financial structure) is nearly $200 million.

Funding of Capital Expenditures

How are these capital expenditures funded? The chart below shows funding of capital expenditures (here in nominal, inflated dollars) by:

- Reserves;
- Funds from operations; and
- New debt.

In some years, funds from operations contribute to reserves.

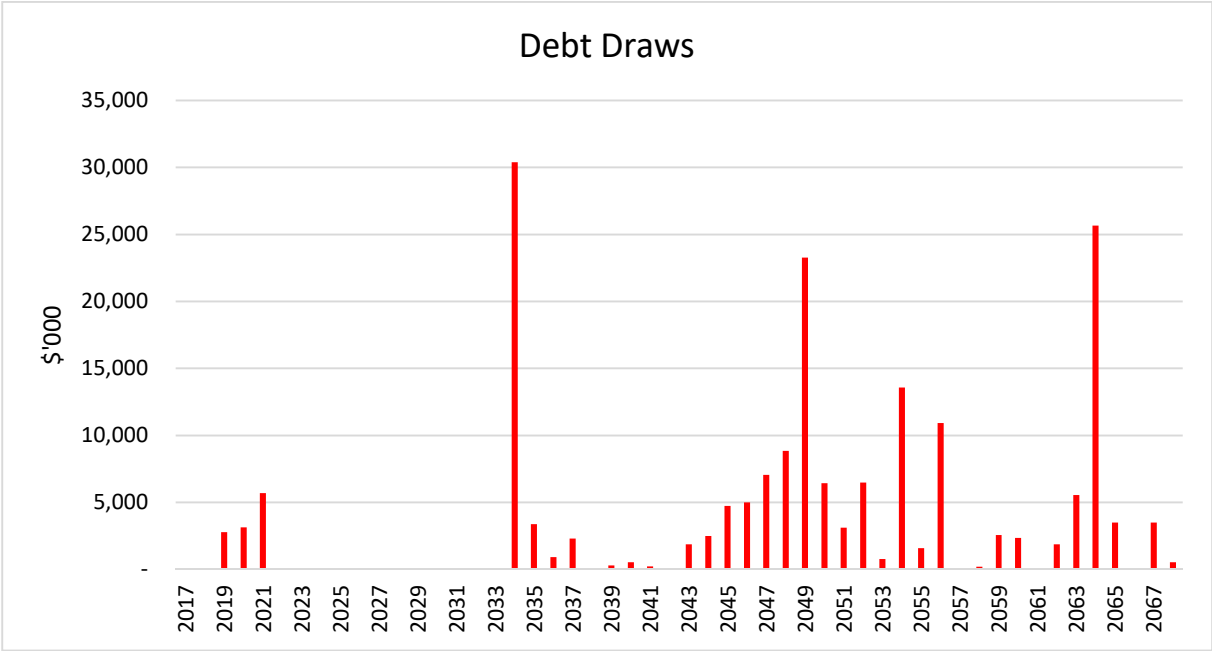


Over time, funding is provided from a variety of UWSS sources (in this chart, dollars are nominal including inflation):

- Operations provide some funding, as is the case at present. Even in years in which the "break-even test" prevails for revenue, UWSS recovers depreciation expense. This is a non-cash expense, and therefore provides UWSS with cash which may be deployed to fund capital expenditures;
- Reserves – both the Windsor Family Credit Union funds and other capital funds (but not the operating reserves) are available in some years. Further, in some years of low capital expenditure capital reserves are increased;
- New debt provides roughly 55% of funding for capital expenditures over time.

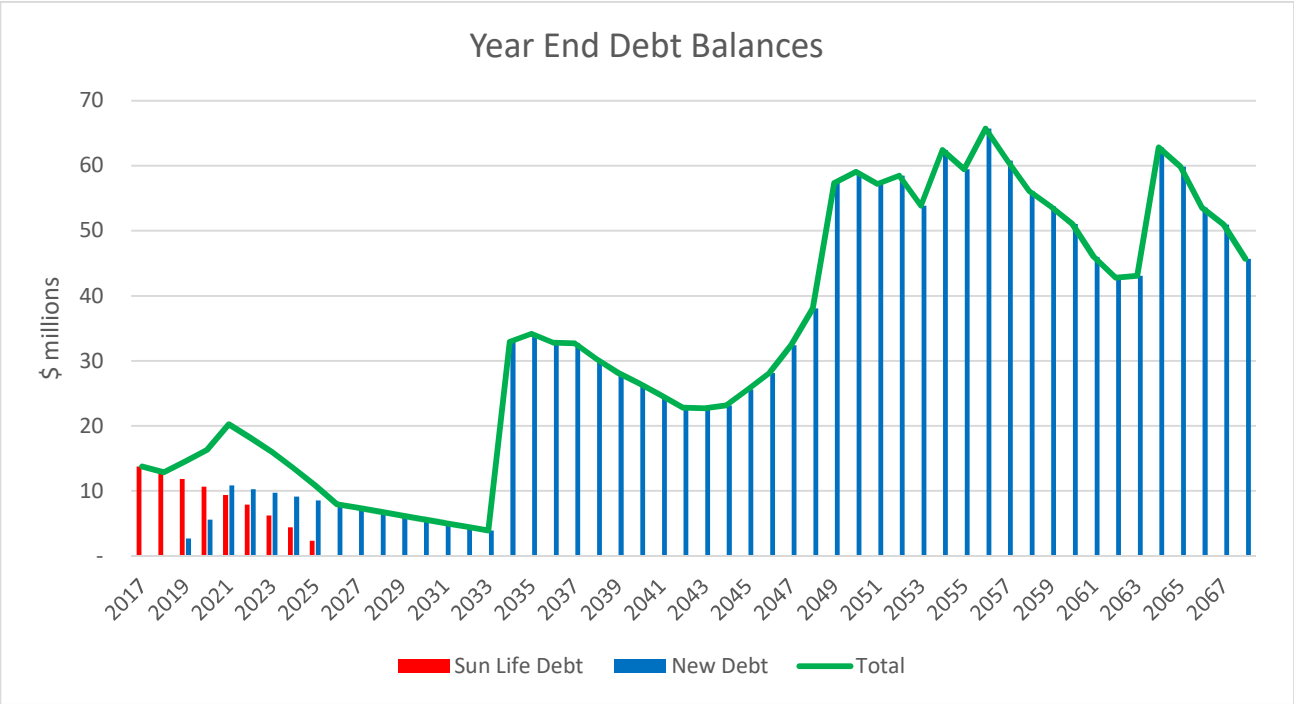
New Debt

New debt (that is, not Sun Life) is drawn as follows:

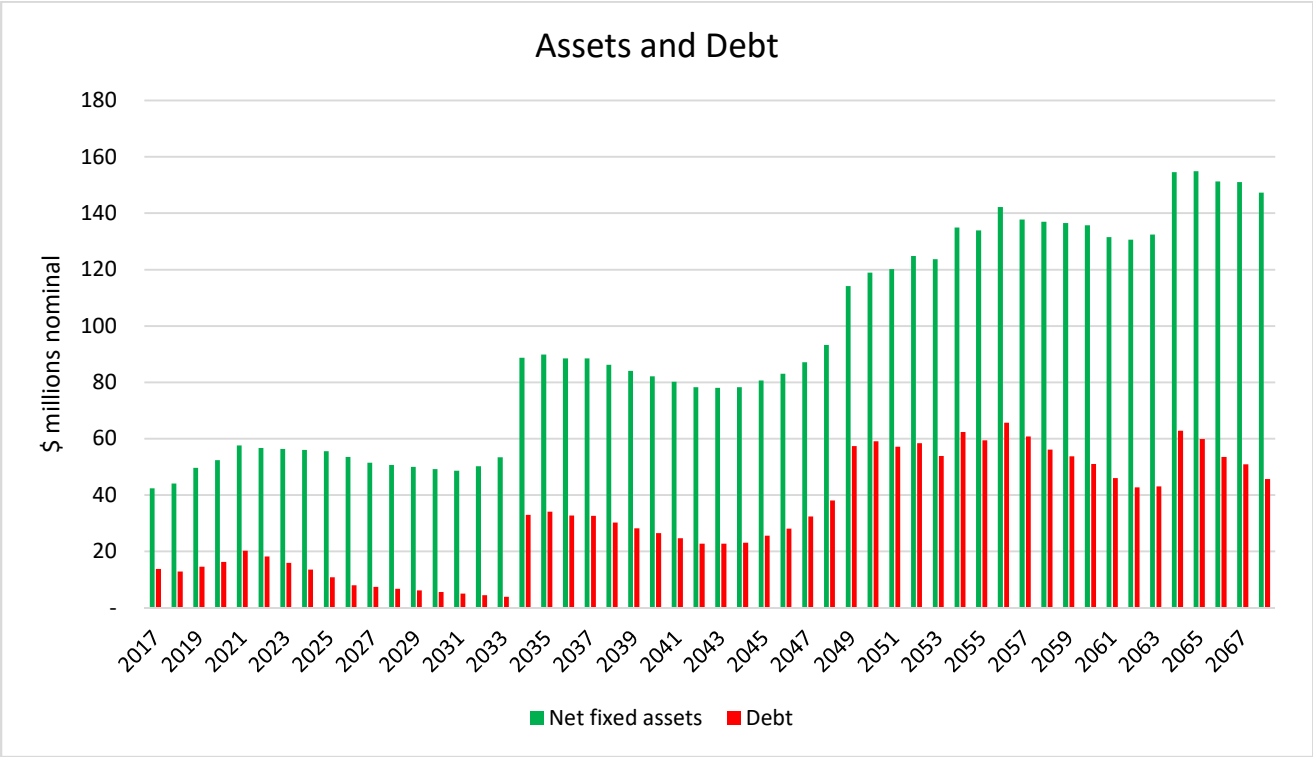


The requirement for new debt, like that of capital expenditures that causes it, is highly uneven. New debt is only drawn if needed. For some expenditures reserves are available to fund capital requirements in part, and in all years cash from operations is available.

The debt balance over time is projected as follows:

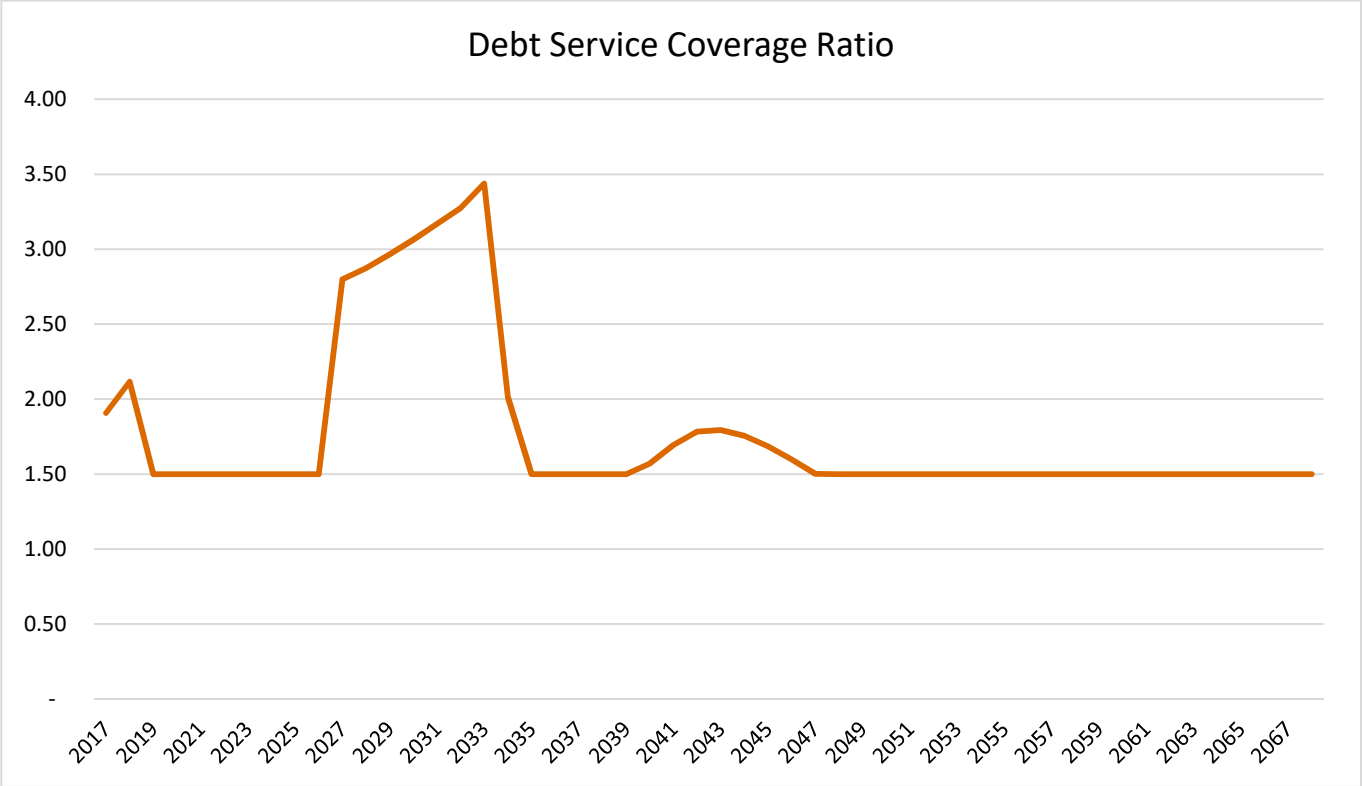


In dollars of the day (including inflation), UWSS debt is projected to exceed $60 million during the projection period. Debt and total assets broadly move together over time:



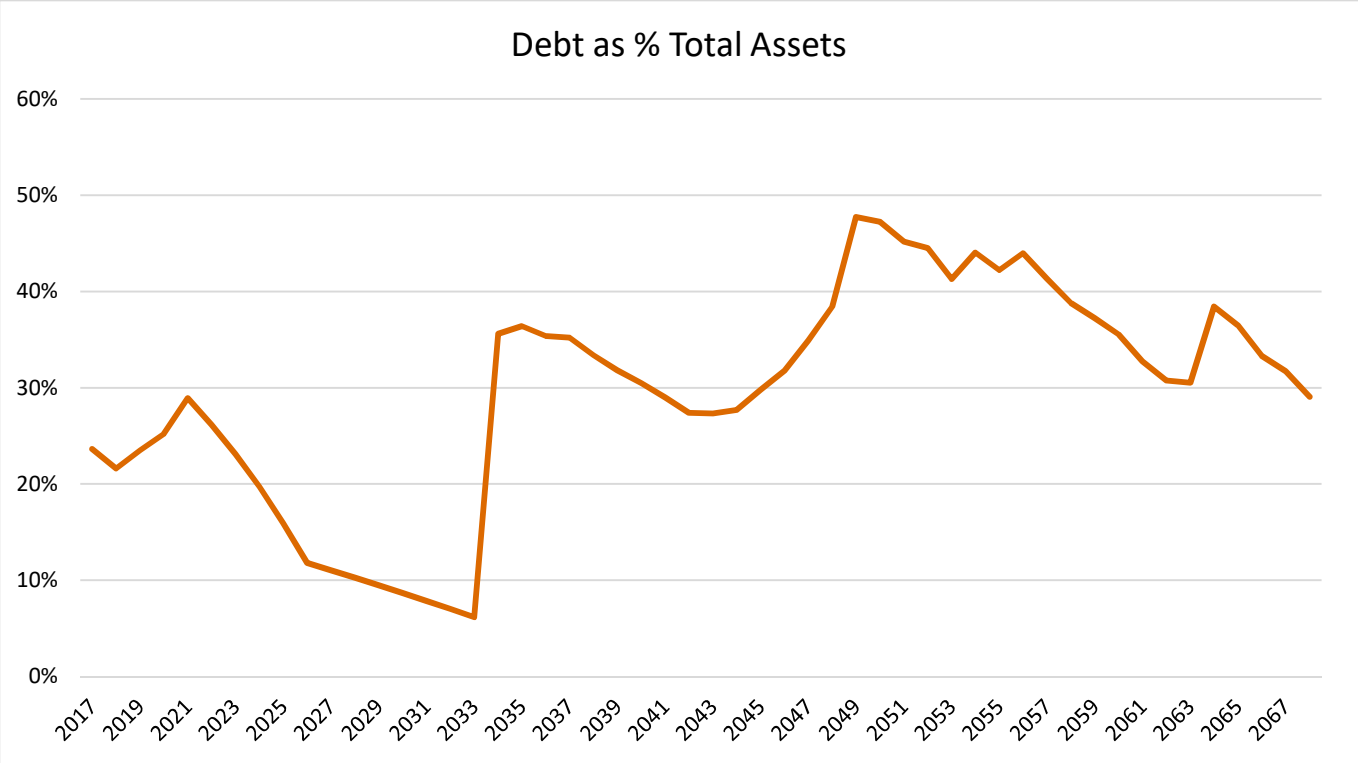
Can UWSS carry this much debt? There are two key measures.

DSCR – a measure of the safety factor enjoyed by lenders – is projected as follows:



In many years, a DSCR of 1.5x is forecast. This is the DSCR built into the revenue model for purposes of this Business Case; UWSS may be able to improve on this through negotiations with lenders. In years for which this DSCR is forecast, revenue is determined according to the "DSCR test".

Another metric is the debt : equity ratio:



Debt as a percentage of total assets is projected not to exceed 50%. By way of reference, LDCs in Ontario are mandated a 60% debt : 40% equity ratio.

Revenue and Rates

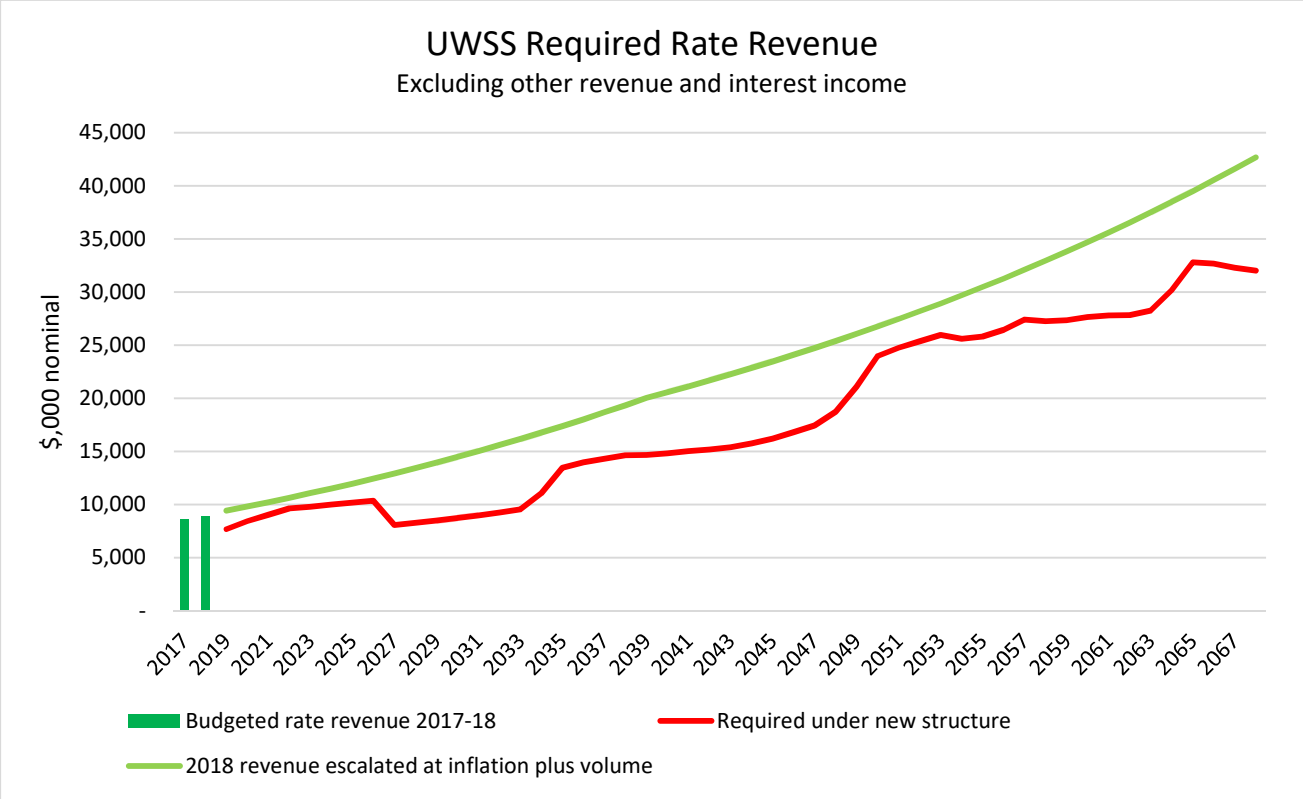
Does the proposed financial structure result in affordable rates, or is there a prospect of "rate shock"?

Comparison to Current Rates

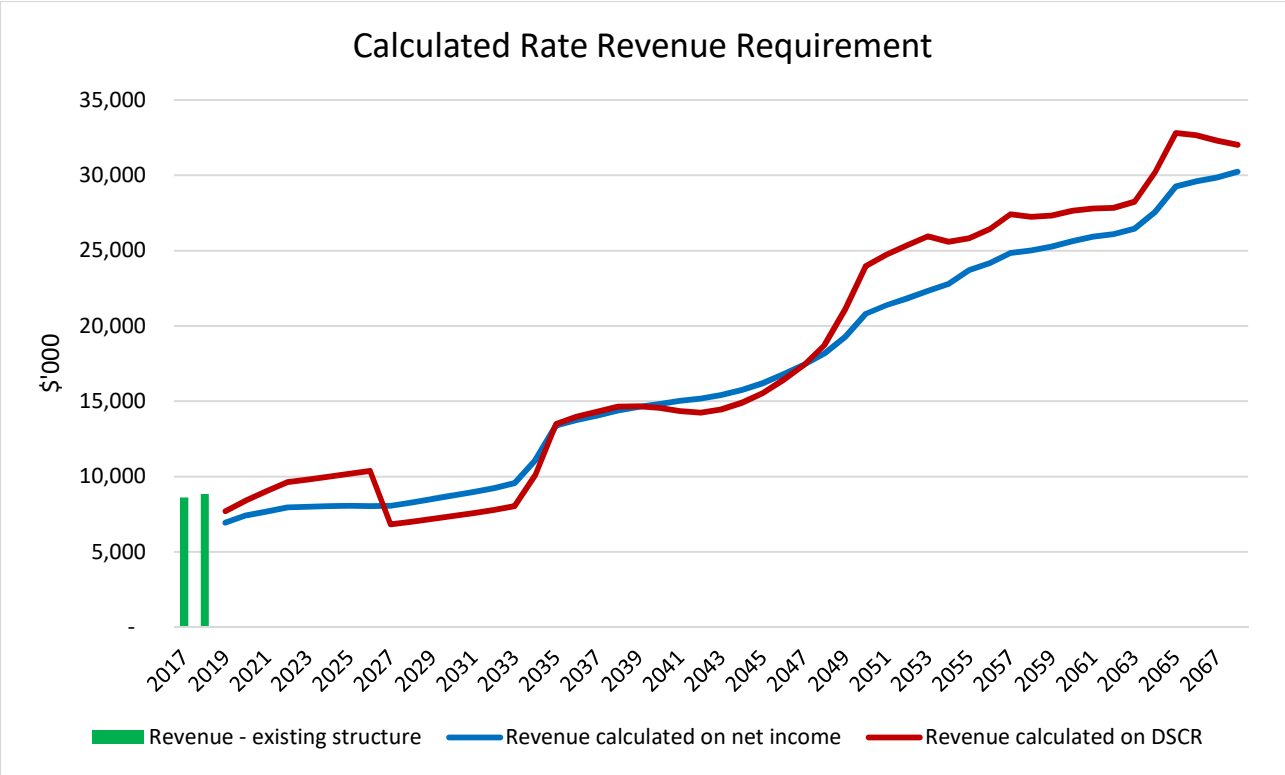
Compared to existing rates (2017 and 2018 approved UWSS plans), the proposed financial structure offers a potential savings:

- The green bars show UWSS rate revenues from the 2017 and 2018 approved plans;
- The green line shows how these rates would translate into rate revenues if rate revenues reflected only:
- General inflation at 2%; and
- Changes in volume over time;
- Resulting in stable real-dollar rates over time;
- The red line shows the projected required rate revenue according to the proposed financial structure.

The proposed financial structure is projected to offer a savings, compared to 2018, in real dollar rates in all years of the projection.



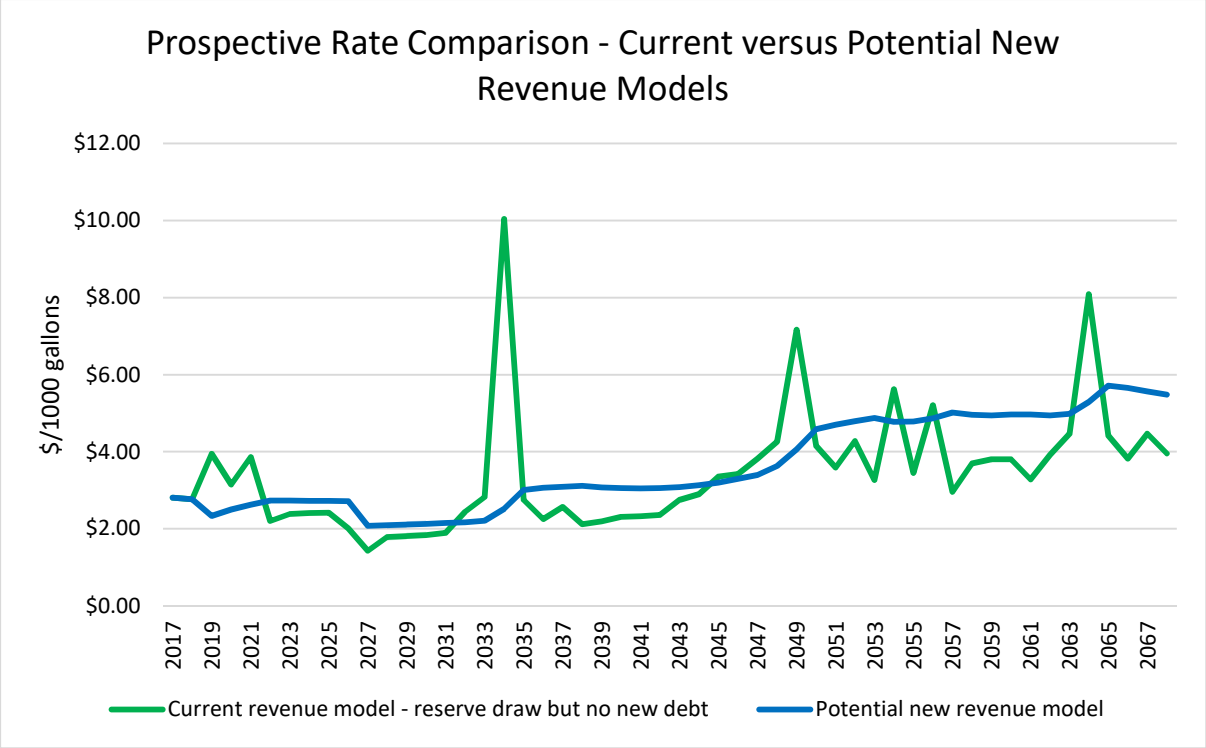
As set out in Section 6, revenue must meet two tests – "break-even test" and the "DSCR test". The graph below shows which test prevails in each year of the projection:



The two "tests" require very similar revenues in all years of the projection; the "DSCR test" prevails in most years. This assumes that the required DSCR is 1.5x; as noted above, UWSS may negotiate a more favourable (less conservative) DSCR in implementation.

Comparison to the Current Model – No New Debt

Leaving aside the existing rates, how would the proposed financial structure compare to the current model if there is no new debt?



The above chart shows this comparison. In most years, the current model and proposed financial structure are close in required rates, with the current model slightly lower (and quite volatile). This makes sense in years with moderate capital expenditure – the current model would need to recover neither depreciation nor debt service.

However, in years of high capital expenditure, the current model calls for rates sharply higher than the proposed financial structure. In practice, UWSS would likely seek some means to provide relief to ratepayers.

Comparison to the Current Model – New Municipal Debt

One means to accomplish this could be to issue new Municipal debt, which is part of the current model.

In this case, as UWSS takes debt service responsibility for Municipal debt issued on its behalf, the projections for required revenue and rates under the current model with Municipal debt would be similar to those for the proposed financial structure as shown above. The difference is that the debt would be consolidated on Municipal accounts.

What About Grant Funding?

Although not reflected in the financial projections, grant funding (as available) may be applied to required capital expenditures, decreasing the need for funding from operations, reserves, or new debt.

Implications

The analysis of the proposed financial structure, and comparing it to the current model with and without new Municipal debt, indicates the following:

- The proposed financial structure offers a potential rate saving (in real dollar terms) compared with prevailing rates in 2017, and those planned for 2018;
- This structure also provides rate stability even in periods of large capital expenditure, as costs are recovered over time in depreciation and debt service rather than giving rise to potential “rate shock”; and
- If grant funding is available, the proposed financial structure will accommodate it and ratepayers will benefit.

8. Assessing the Proposed Financial Structure

This section:

- Assesses the way in which the proposed financial structure achieves the objectives set out in Section 3;
- Describes other options considered and their relative attractiveness;
- Describes the use of the design features of the proposed financial structure by other utilities; and
- Confirms that the proposed financial structure is not a privatization.

How Financial Structure Meets Objectives

This financial structure meets the objectives set out in Section 3 as follows:

Ability to Issue New Debt on a Stand Alone Basis

The proposed financial structure is designed specifically with stand-alone UWSS credit-worthiness in mind. UWSS can realize revenues to at least break even on a GAAP basis, and achieve DSCR as required by lenders.

Debt Attributed to UWSS, not to Municipalities

If the commercial structure is implemented as set out in Section 5, UWSS and the Municipalities can expect to achieve GBE treatment for UWSS. In this case, the debt of UWSS would properly be accounted for on a non-recourse basis, and the Municipal interest in UWSS would properly be accounted for on an equity consolidation basis.

Ability to Accept Grant Funding

The proposed financial structure readily incorporates accessibility to grant funding from senior levels of government. Grant funding, if available, would act as a supplement to cash capital reserves, and would have the effect of avoiding the need for additional debt, and/or augmenting capital reserves.

"Source to Tap"

The proposed financial structure could readily be extended to support the "source to tap" should this be undertaken by one or more Municipalities.

If one Municipality wishes to operate on a "source to tap" basis, this could be accomplished by:

- Keeping separate records for the Municipal water distribution assets and operating costs;
- Determining the required revenue and associated water distribution rates for the Municipality. The Municipality and UWSS would have the option to bill bulk water charges separately from distribution charges (as set out in Section 5), or to combine these two charges; and
- The commercial structure would be as described in Section 5, Option #3.

This structure would have the same financial attributes as described for the UWSS bulk water business, and so should attract the same terms and conditions from lenders. It is likely unnecessary to have separate debt instruments for the bulk water system and a Municipal distribution system (the distribution system would bear its pro rata share of debt-related costs), but this is an option available to UWSS.

Essex and Lakeshore have bulk water supply other than UWSS for the geographic area not served by UWSS; how "source to tap" might be implemented in light of this would require further study.

A rate impact analysis would be undertaken in advance.

There would be other non-financial considerations, including the status and transfer of employees and contracts. These would be the subject of analyses outside the financial structure.

If all Municipalities wish to undertake "source to tap", the Municipalities and UWSS have the option to establish (immediately or over time) a uniform rate structure across all Municipalities.

In sum, the priorities for implementing "source to tap" via UWSS are:

- Maintaining the revenue model such that credit-worthiness is maintained; and
- Maintaining the commercial structure so that GBE treatment is achieved.

No "Rate Shock"

Based on the financial modeling undertaken for this Business Case, the proposed financial structure can accommodate funding for future UWSS capital expenditures – even years with heavy expenditures – without causing "rate shock". Please refer to Section 7.

Non-Uniform Rate Structures

As long as the UWSS required revenue model is maintained, the proposed financial structure can accommodate non-uniform rate structures. The essence of this is that the allocation of the UWSS required revenue may be borne differentially (on a unit of measure basis) by various consumers of UWSS bulk water.

Other Options Considered

Two other financial structures are worth reviewing as alternatives.

The Current Structure

The current financial structure has been in operation since the 2001 Transfer Order (see Section 2), and UWSS has operated to date on this basis.

The current financial structure could be maintained for the short term, if the Municipalities wish to undertake the transition to a corporate legal structure for UWSS before changing UWSS's financial structure.

The current financial structure could be maintained for the long term if:

- The Municipalities (unanimously) are able to implement issuance of new UWSS-related debt as required to undertake the required UWSS capital programs over time;
- Differences (by Municipality) in the usage of capital assets to be funded can be accommodated in the raising of new debt;
- The Municipalities can continue to accommodate the consolidation of UWSS debt on Municipal accounts; and
- The Municipalities can create a streamlined process to enable to UWSS to apply for available grant funding through the Municipalities – including a process to reconcile Municipal and UWSS funding needs if there are limits imposed by granting authorities that call for such a reconciliation.

The LDC Model

The LDC financial structure, as regulated by the Ontario Energy Board ("OEB") has the following characteristics[8]:

- A fixed regulated debt : equity ratio which is 60% debt and 40% equity;
- Cost recovery, subject to regulatory approval:
  - Recovery on a pass-through basis of operations, maintenance, and administrative costs and depreciation expense;
  - Recovery of the actual cost of debt; and
  - An allowance for cash tax expense (not applicable to UWSS); and
- A return to equity based on an OEB-stipulated Return on Equity percentage, which is also recovered from ratepayers.

In the water sector, the LDC model is used by EPCOR[9] in Edmonton and surrounding municipalities; it is also seen in some U. S. water systems (including those owned by EPCOR).

This financial structure could be implemented, but has the following potential drawbacks:

- This is, compared to the proposed financial structure, a high-cost option for ratepayers. The Municipal equity investment under the proposed financial structure earns no systematic return[10]. In the LDC model, it does earn a return, and this return is part of the required revenue to be paid by ratepayers. PwC experience in confidential engagements confirms that inclusion of most or all of existing assets in the base on which a return is earned (debt and equity) results in a sharp increase in rates; and
- With a fixed debt : equity ratio, there may arise circumstances in which a large capital program could result in a call for cash equity investment on the part of the Municipalities. As described in Section 5, this could threaten GBE treatment and result in the requirement for the Municipalities to consolidate all UWSS debt.

How Different is This Structure?

How different is the proposed financial structure from existing precedents in the market? Four examples are worth considering.

The Current UWSS Financial Structure

This structure is described in Section 2 and above in this Section. It is similar to the proposed UWSS financial structure in several important ways:

- UWSS has significant equity under either framework (although it is notional in the current legal structure as UWSS has no corporate existence);
- The revenue model is defined, and recovers all defined costs;

[8] The OEB's Incentive Rate Mechanism sets out rate-setting rules for years between detailed rate filings – this is not described above.

[9] EPCOR is wholly owned by the City of Edmonton

[10] As set out in Section 3, earning a return from UWSS is not a Municipal objective.

- Incremental capital which cannot be funded from available reserves must be debt-funded (no Municipal equity investment is contemplated).

There are differences, which are driven by the objectives set out in Section 3:

- The revenue model is different as described above in order to support stand-alone credit-worthiness;
- Capital costs are ultimately recovered mainly "in arrears" via depreciation and debt service, rather than in-year ratepayer revenue;
- The commercial structure is as set out in Section 5 in order to achieve GBE treatment; and
- Additional debt is provided by the Municipalities rather than being issued by UWSS as a stand-alone entity; this is to be avoided in the proposed financial structure.

Nav Canada

Nav Canada is the entity that controls air space in Canada. It provides air traffic control, flight information, air flight communication services and other services to aviation customers.

Nav Canada is a private non-share capital corporation. It realizes revenues from the aviation industry; it receives no government funding. Its balance sheet shows negligible equity.

Financially, Nav Canada is 100% debt-funded; it has approximately $2 billion in publicly traded bonds outstanding. Revenue is defined according to governing legislation, specifically the Civil Air Navigation Services Commercialization Act, which "prevents [Nav Canada] from setting customer service charges higher than what is needed to meet [Nav Canada's] financial requirements for the provision of air navigation services"[11].

Nav Canada maintains reserves to ensure that it will have the ability to meet its debt-related obligations in the face of fluctuating demand for its services (and therefore its service charge revenue). Nav Canada's debt rating is AA/AA (low)[12].

The Nav Canada model is similar to the proposed UWSS model in that:

- Nav Canada enjoys a monopoly on an essential service;
- Capital costs are recovered "in arrears" via depreciation and debt service;
- It has a defined revenue model (in Nav Canada's case, legislated by Canada);
- Additional capital, as required, is funded entirely by debt; and
- Break-even results are a parameter in determining required revenue.

This model also differs from the proposed UWSS model:

- UWSS has significant equity. The proposed financial structure calls for the Municipalities to convey UWSS-related assets to UWSS in return for shares, while Nav Canada issued debt to purchase its assets from Canada[13];

[11] Nav Canada Management Discussion and Analysis, December 2016
[12] DBRS, September 2017
[13] The cost of this debt is recovered from its customers

- Nav Canada maintains significant debt-related reserves, which we do not believe will be required in UWSS's situation (given the proposed UWSS revenue model and equity position);
- Nav Canada is an "industry-led entity". Industry stakeholders (of which there are relatively few) provide governance and oversight. The proposed UWSS model, serving a large number of end water customers, relies on the UWSS Board to represent customers. This is analogous to the current situation in most municipalities, where Council represents water customer interests; and
- The proposed legal and financial structure calls for share capital held by the Municipalities, while Nav Canada is a non-share capital entity.

Greater Toronto Airport Authority

The Greater Toronto Airports Authority ("GTAA") is the entity that manages and operates the Toronto Pearson Airport under a ground lease with the Government of Canada; its mandate includes the responsibility to "develop and improve"[14] its facilities. The GTAA is a non-share capital corporation established in 1993.

While the GTAA realizes significant revenue from commercial activities (such as parking and concessions, roughly 30% of total revenues), its principal revenues are aeronautical (landing fees and terminal charges, collected from airlines) and airport improvement fees (collected as surcharges paid by passengers).

A key feature of the GTAA's financial structure is its revenue model, according to which "… the GTAA [must] establish and maintain rates, rentals, charges, fees and services so that, among other things, Net Revenues … in each Fiscal Year will be at least equal to 125 percent of the Annual Debt Service for each Fiscal year…."[15] The GTAA calculates its debt service including a notional 30-year amortization of debt (even if the actual debt instruments do not require such annual amortization).

At the end of 2016, the GTAA recorded over $6.2 billion in debt. Its debt rating is Aa3 (Moody's)[16].

The GTAA's financial structure is similar to that proposed for UWSS as follows:

- The GTAA has a monopoly on its services at Toronto Pearson Airport, an essential service;
- Capital costs are recovered "in arrears" via depreciation and debt service; and
- Its revenue model includes a provision explicitly based on DSCR.

The GTAA's financial structure also differs from that proposed for UWSS:

- The GTAA has a deficit of liabilities over assets of almost $600 million, in contrast to the positive equity position of UWSS;
- The GTAA realizes a significant proportion of its revenues from what, for UWSS, would be non-rate revenue.

Hydro One Remote Communities Inc.

Hydro One Remote Communities Inc. ("HORCI") is wholly owned by Hydro One, Ontario's largest (and until recently 100% publicly owned) electrical transmission and distribution utility. HORCI's business is serving remote

[14] GTAA Management and Discussion and Analysis and Financial Statements, 2016
[15] Ibid.
[16] Moody's, 2016

northern Ontario communities which are not grid-connected, using diesel generation to energize the local distribution system.

HORCI operates on a break-even basis, in that it is 100% debt-financed (and therefore has no equity). It recovers its costs from a combination of rate revenue and a ratepayer-supported subsidy program (the Rural or Remote Rate Protection program), according to OEB regulation.

HORCI's framework is similar to the proposed UWSS financial structure as follows:

- Incremental capital is 100% debt financed;
- Capital costs are recovered "in arrears" via depreciation and debt service; and
- HORCI operates to a defined revenue model which includes break-even as a parameter.

This framework also differs from the proposed UWSS financial structure:

- HORCI debt is guaranteed by Hydro One, which would be counter to the Municipalities' objectives if applied to UWSS; and
- HORCI, like Nav Canada and the GTAA, has negligible equity.

Summary

To summarize, the proposed UWSS financial structure applies several proven design features – including features of the current UWSS model – and adapts them to achieve the objectives set out in Section 3 given UWSS's specific circumstances.

Proposed Financial Structure – Is It Privatization?

The proposed financial structure is not a privatization option – in fact this structure is incompatible with privatization:

- The initial capitalization – assets and liabilities – calls for the Municipalities to convey UWSS-related assets to a UWSS incorporated entity in return for all the shares of UWSS. Ownership of UWSS would be entirely in the hands of the Municipalities. The Municipalities could at their option, advised by counsel, incorporate rules governing transfer of shares which would explicitly preclude ownership other than by the Municipalities; and
- The revenue model is incompatible with private investment. Under the proposed revenue model, UWSS would not realize a reliable income accruing to equity:
    - The viability of any privatization is based on the earning power accruing to the equity shareholders;
    - In years in which the "break-even test" prevails, net income is zero; and
    - In years in which the "DSCR test" prevails, incidental net income would result; however, the Municipalities could, with counsel's advice, specify that any such net income be contributed to capital reserves to be allocated only to future approved capital projects.

In summary, privatization is not viable under the proposed financial structure.

9. The UWSS-Municipal Agreement

The following table sets out some of the provisions for an agreement between UWSS and the Municipalities, through which the proposed financial structure may be implemented.

Please note that this section deals solely with provisions related to the financial structure; counsel may advise on other matters such as establishment, asset transfer, shareholding, liability, contracting (including the OCWA contract) and governance.

Item	High-Level Provision
Parties	• UWSS • The Municipalities
Effective date	• TBD 2018
Term	• Evergreen, unless terminated as agreed by the Parties
Termination	• As agreed by the parties • A provision would call for the Municipalities to assume UWSS liabilities upon termination, or if the provisions related to credit-worthiness are compromised
Scope	• Provision of bulk water • Quality levels – meet all Provincial requirements • Reliability of supply • Baseline volume year of and prior to Effective Date; UWSS and Municipalities to cooperate on volume projections
Served Area	• Defined for each of the Municipalities
Monopoly provider	• UWSS as exclusive provider of bulk water to the Served Area
Operating and capital budgeting	• Subject to Board approval
Recoverable costs	• Operations, maintenance and administration; including OCWA and other contracts • Depreciation expense • Interest cost • Bad debt expense • All according to approved budget
Revenue model	• Rates set such that UWSS will realize revenue which is at least the greater of: o That which enables UWSS to achieve zero net income; and o That which enables UWSS to achieve a Debt Service Coverage Ratio as agreed with UWSS's lenders under applicable lending agreements [definition of DSCR to be included in the agreement]
Rates	• Required rate revenue divided by aggregate volume at end user meters • Non-uniform rates are acceptable provided that the required rate revenue is achieved
Essential commercial relationship	• UWSS; and • End-use metered water customers

Item	High-Level Provision
Municipalities agents of UWSS	• Municipal undertaking to act as agents of UWSS in billing and normal-course collection of UWSS water charges • UWSS charges to be separately identified in billing • Billing services to be facilitated by Municipalities • UWSS responsible for uncollectible accounts; Municipalities may back-charge • Other provisions as required to achieve appropriate agency treatment

This agreement, once executed, is the principal document on which UWSS will secure financing for new debt (and, potentially, assume responsibility for the Sun Life debt). As such, it will be difficult to change once debt has been raised on its strength.

10. Implementation

This section sets out the prospective implementation tasks and potential timing. The assumed target transition date to the recommended financial structure is January 1, 2019.

This preliminary implementation schedule assumes adoption of a corporate structure for UWSS, and the proposed financial model, circa year-end 2017.

This table addresses only matters related to the proposed financial structure; legal, operational and other matters are not addressed.

Task or Milestone	Preliminary Timing
Financial market sounding – gauging lender interest and most likely lenders; and gaining detailed insight into the required/available provisions of key agreements	• Q1-Q2 2018
Discussion and agreement with Municipal auditors concerning commercial structure and GBE treatment; adjust commercial model if required	• Q1-Q2 2018
Development of the agreement between UWSS and the Municipalities	• Q1-Q2 2018
Development of a Master Trust Indenture, a document which will govern all new debt upon implementation. This will likely involve negotiations with key prospective lenders	• Q2-Q3 2018
Exploration (and potentially negotiation) with Sun Life concerning transfer of obligation to UWSS	• Q2-Q3 2018
Design and organization of new billing and other administrative measures required for new commercial structure	• Q2 – Q4 2018
Decision on management of Windsor Family Credit Union funds – leave invested to maturity or redeem early (possibly with an interest penalty)	• Q3 2018 or after
Updating of UWSS financial projections based on latest information (including volume outlook, investment, and debt requirements)	• Q3 2018
Development and negotiation of lending agreements for initial new debt to be issued	• Q3 2018
Execution of agreements: • UWSS agreement with Municipalities • Supporting service agreements between UWSS and Municipalities (as determined by final commercial structure) • Master Trust Indenture • Initial lending agreements • (Possibly) agreement concerning existing Sun Life debt	• Q4 2018
Funds available – new debt	• January 2019
Go-live for new commercial structure including billing and other administration	• January 2019 or before
New revenue and rate model active	• 2019 fiscal year

11. Summary

Summary of Conclusions

Union Water Supply System ("UWSS") has operated as a bulk water supply utility owned on a "tenants in common" basis by the Towns of Leamington, Kingsville, Essex, and Lakeshore (the "Municipalities") since a 2001 Transfer Order was issued by the Ontario Ministry of the Environment (now the Ministry of Environment and Climate Change). UWSS has no corporate existence; it cannot conduct business independent of the Municipalities. This structure gives rise to several financial challenges including:

- The inability to access grants and other types of funding available for water infrastructure from senior levels of government independent of the Municipalities;
- The inability to raise its own debt independent of the Municipalities;
- A revenue model which, absent additional Municipal debt, does not accommodate large-scale capital programs; and
- Attribution of UWSS debt to the Municipalities.

This Business Case addresses the financial challenges and proposes a new financial structure for UWSS. Legal analysis and other matters not discussed in this report are outside the scope of this Business Case. The Business Case is premised on the Municipalities establishing UWSS as a corporate entity.

In order for a new financial structure to be successful for UWSS and the Municipalities, UWSS must be credit-worthy on a stand-alone basis. Our analysis of potential credit-worthiness indicates that such stand-alone credit-worthiness is achievable for UWSS.

Also, in order for a new financial structure to be successful for UWSS and the Municipalities, UWSS and the Municipalities must achieve a commercial structure under which UWSS debt is properly accounted for as non-recourse to the Municipalities. Our accounting analysis indicates that this too is achievable.

The proposed commercial structure has the following features:

- The essential commercial relationship would be between UWSS and end-use water customers in the Municipalities (who receive UWSS bulk water);
- The Municipalities would act as agents of UWSS in facilitating this relationship;
- The Municipalities would provide billing services as agreed upon with UWSS;
- Volume and credit risk would be to UWSS's account, not that of the Municipalities; and
- UWSS would, with the agreement of Municipal auditors, attract "Government Business Entity" ("GBE") treatment and not be fully consolidated on the Municipal accounts.

The proposed financial structure has the following features:

- Initial capitalization: The Municipalities would convey the UWSS assets to an incorporated UWSS in return for shares in UWSS. UWSS is contemplating a share structure whereby each Municipality's ownership will continue to be based on its consumption through the use of tracking shares. To preserve the existing UWSS ownership model under this structure, tracking shares can be incorporated into the corporate framework, and provide for each Municipality's ownership interest to be equal to its percentage of total water consumption, adjusted every 4 years, much like the current framework;

- Approved capital expenditures would be funded by capital reserves, funds from operations and new (not the existing Sun Life) debt;
- The UWSS revenue model would set rate revenue at the greater of:
    - That which results in zero net income – no loss – for UWSS according to Generally Accepted Accounting Principles; and
    - That which enables UWSS to meet the Debt Service Coverage Ratio (DSCR") as agreed upon with UWSS's lenders;
- UWSS operations would continue as at present, or otherwise as determined by the UWSS Board; and
- Both "source to tap" (integration of UWSS bulk water services with Municipal water distribution) and rate structures other than a uniform rate per unit volume are achievable under the proposed financial structure at the discretion of the Municipalities.

Financial analysis indicates that the proposed financial structure offers potential rate savings to Municipal ratepayers, compared to rates approved for 2017 and 2018 (adjusted for inflation). This financial analysis also indicates that UWSS financial metrics – in particular, those related to new debt – are projected to be robust over a 50-year projection period under the proposed financial structure.

Recommendations

This Business Case recommends that, if the Municipalities establish UWSS as a corporate entity, UWSS and the Municipalities:

- Adopt the proposed financial structure as set out in Sections 6 and 9;
- Adopt the proposed commercial structure as set out in Section 5; and
- Proceed to implementation as set out in Section 10.

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THE CORPORATION OF THE TOWN OF KINGSVILLE

BY-LAW 31 - 2021

Being a By-law to confirm the proceedings of the Council of The Corporation of the Town of Kingsville at its March 23, 2021 Special Meeting

WHEREAS sections 8 and 9 of the *Municipal Act, 2001* S.O. 2001 c. 25, as amended, (the "Act") provides that a municipality has the capacity, rights, powers and privileges of a natural person for the purpose of exercising the authority conferred upon a municipality to govern its affairs as it considers appropriate.

AND WHEREAS section 5(3) of the Act provides that such power shall be exercised by by-law, unless the municipality is specifically authorized to do so otherwise.

AND WHEREAS it is deemed expedient that the proceedings of the Council of The Corporation of the Town of Kingsville (the "Town") be confirmed and adopted by by-law.

NOW THEREFORE THE COUNCIL OF THE CORPORATION OF THE TOWN OF KINGSVILLE ENACTS AS FOLLOWS:

1. The actions of the Council at its March 23, 2021 Special Meeting in respect of each report, motion, resolution or other action taken or direction given by the Council at its meeting, is hereby adopted, ratified and confirmed, as if each resolution or other action was adopted, ratified and confirmed by its separate by-law.

2. The Chief Administrative Officer and/or the appropriate officers of the Town are hereby authorized and directed to do all things necessary to give effect to the actions set out in paragraph 1, or obtain approvals, where required, and, except where otherwise provided, the Mayor and the Clerk are hereby directed to execute all documents necessary and to affix the corporate seal to all such documents.

3. This By-Law comes into force and takes effect on the day of the final passing thereof.

READ A FIRST, SECOND AND THIRD TIME AND FINALLY PASSED this 23rd day of March, 2021.

MAYOR, Nelson Santos

CLERK, Jennifer Astrologo