

Report of the Expert Panel

on the feasibility of a water and
wastewater utility model
to be offered by LAS



Local Authority Services (LAS) land acknowledgement

We recognize that our work as LAS and the work of our members, takes place on traditional Indigenous territories across Ontario. We recognize and respect the history, languages, and cultures of the First Nations, Metis, Inuit and all Indigenous peoples whose presence continues to enrich our communities.

In addition and in line with their mandate, members of the expert panel recognize the special place that water holds in the cultures, practices and beliefs of Indigenous peoples.

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What this report contains

Given concerns in the sector, Local Authority Services (LAS), the business services arm of the Association of Municipalities of Ontario, convened an expert panel to assess the feasibility of a municipal utility model for water and wastewater in Ontario. This could be structured as a joint municipal services corporation or a joint municipal service board, both of which are permitted under the *Municipal Act*. A central goal was a solution that would be sector-led and potentially scalable while keeping water and wastewater assets in public hands.

This is the report of the panel. In line with our mandate, it:

- sets out, in Section 1, the background to the need for this study
- provides information in Section 2 on the current state of water and wastewater assets in Ontario, as well as the financial and other challenges facing the sector
- focuses in Section 3 on the feasibility of a utility business model that LAS might add to their offerings, and concludes that a joint municipal services corporation would be the most appropriate structure
- outlines in Section 4 our thoughts as to how best to structure and arrange the governance of a joint municipal services corporation for the water and wastewater sector
- discusses funding in Section 5 from user rates and other potential sources, as well as the use of debt and reserves, and touches on economic regulation

Risks and opportunities in each of the areas above are consolidated into Section 6, which outlines the conditions that we believe are needed for the feasibility of a joint municipal services corporation. In Section 7, we describe how LAS will move forward with a business case and explain why we believe municipalities should consider this initiative.

Our discussions with municipalities made clear to us that many smaller communities are deeply concerned about the sustainability of their present water and wastewater systems. While individual problems and circumstances vary widely across the province, in all cases we were struck by a strong appetite for change and genuine interest in exploring new solutions. We hope that our recommendations, which follow, help to set Ontario's water and wastewater systems on a clear path to financial sustainability.

Recommendations

The expert panel endorses the concept of an LAS offering of a water and wastewater municipal utility model as worthy of further development and makes the following recommendations should LAS decide to proceed:

1. LAS should consider offering a joint municipal services corporation rather than a joint municipal service board.
2. A joint municipal services corporation should be open to all Ontario municipalities.
3. Municipal participation in the water and wastewater joint municipal services corporation should be voluntary.
4. LAS should develop a detailed business case supported by additional financial modelling to further evaluate the financial and practical feasibility of offering a joint water and wastewater municipal services corporation.
5. The business case should include an assessment of whether it would be better to offer a single municipal services corporation with a regionalized service structure or a holding company with multiple regional corporations.
6. Shareholders of a joint municipal services corporation should be restricted to Ontario municipalities, other wholly public-sector entities, and First Nations. Private investment in the municipal services corporation should not be permitted.
7. LAS should work with the founding municipalities to appoint a skills-based board for the joint municipal services corporation.
8. The board should strictly adhere to principles of openness and transparency that are at a minimum consistent with the obligations of its municipal shareholders.
9. An economic regulator is not needed, at least in the initial phases. The Province, LAS and the joint municipal services corporation should reassess the need for an economic regulator as more experience is gained.
10. Municipalities joining the joint municipal services corporation would be expected to transfer all water- and wastewater-related assets and reserves to the corporation, except for reserves being held to service long-term debt.
11. Shareholder agreements should include provisions whereby the joint municipal services corporation provides payments to municipalities with long-term water and wastewater debt obligations sufficient to meet those debt obligations.
12. The use of reserves and the repayment of debt obligations should be restricted to the municipalities from which they originated.
13. The joint municipal services corporation should implement full cost pricing in all municipalities where this can be achieved without undue hardship to ratepayers.

14. LAS should enter into discussions with the Province to determine the potential for subsidies and other forms of financial support, including the use of existing provincial programming, for the joint municipal services corporation to address financially unsustainable municipalities.
15. The joint municipal services corporation should negotiate with participating municipalities to collect and transfer development charges on its behalf to fund growth-related infrastructure in municipalities where growth is planned or expected, or should enter into discussions with the Province on enabling the corporation to collect development charges directly. If development charges are not feasible, LAS or the municipal services corporation should talk to the Province about potential mechanisms to pay for growth-related infrastructure.
16. The joint municipal services corporation should encourage and enable participating municipalities with excess capacity to share their capacity on financially fair terms with neighbouring municipalities that have insufficient capacity.
17. The roles, responsibilities and protocols for the coordination of the infrastructure planning of the corporation and land use planning of the municipalities that it serves must be clearly and formally articulated.
18. LAS should develop a transition plan for establishing a municipal services corporation over a suitable time period, including engaging with potential founding municipalities and talking to the Province about transitional subsidies.
19. LAS should talk to potential operators for water and wastewater systems to get on-the-ground information needed to evaluate such aspects as successor rights, and should design an objective and appropriate process for selecting a system operator or operators.
20. LAS should consider engaging legal expertise, in line with the suggestions in this feasibility report, to:
 - inform the governance structure and the conditions under which municipalities could participate
 - advise on any issues arising from applicable legislation and regulations
 - advise on the allocation of shares
 - develop shareholder agreements and directions to the corporation
 - advise on other legal matters relevant to establishing a municipal services corporation for water and wastewater

1. Introduction

Safe and reliable water and wastewater systems are critical to the health of Ontario's growing and changing population.

But Ontario's municipalities, which own almost all of the province's water and wastewater systems, face major concerns in operating, maintaining and/or expanding them. These include:

- Capacity issues because systems are either too large or too small for the municipality's size and growth outlook
- Rapidly rising costs to build and operate systems
- Staffing challenges
- Difficulty achieving scale economies in small systems
- Keeping rates affordable
- Aging infrastructure, new asset management requirements, and in many cases inadequate investment in state-of-good-repair
- Declining water consumption
- Climate change impacts
- Complex intergovernmental considerations, including policy shifts at the provincial level such as changes to the development charge and land use planning frameworks
- The need to service a growing housing supply in light of both ambitious provincial targets and ongoing discussion on the use of development charges to fund growth

Given the number and complexity of concerns in the sector, the board of Local Authority Services (LAS) asked for a study on the feasibility of a municipal utility model for water and wastewater in Ontario. Created in 1992 by the Association of Municipalities of Ontario (AMO) as a not-for-profit corporation, LAS' offerings include cooperative procurement, asset management, and digital and financial management programs to municipalities and broader public-sector organizations. The goals are to lower their costs, increase revenues, and enhance staff capacity.

Acknowledgement

The expert panel would like to acknowledge the contributions of Justice Dennis O'Connor, who authored the historic *Report of the Walkerton Inquiry*, and the Water Strategy Expert Panel for its report *Watertight: The case for change in Ontario's water and wastewater sector*. Both provided compelling reasons to keep water and wastewater assets public and gave the expert panel a strong foundation from which to start its deliberations.

The motion directing LAS staff to develop the feasibility study specified that it be completed and submitted to the board by the end of 2024, and that it evaluate “the potential for LAS to create a municipal utility corporation for water/wastewater.”

To develop the feasibility study, LAS convened an expert panel comprising members with experience in water and wastewater, municipal finance, economics, legal issues and public-sector governance. Parallel to this work AMO also released a background paper on water and wastewater municipal services corporations in June 2024 that provided the panel with data and analysis and examined higher-level policy questions.

LAS asked the expert panel to focus on the potential creation of one or more joint municipal service board(s) or joint municipal services corporation(s) to function as the municipal utility, because these are existing structures under the provincial *Municipal Act, 2001*. The Act sets out governance arrangements for both structures, as well as their powers and restrictions.

This is the report of the expert panel. Appendix I provides panel members’ names and backgrounds. The full scope of our mandate is included as Appendix II.

LAS asked us to consider a solution that would be sector-led and potentially scalable to achieve economies of scale while keeping water and wastewater assets public.

We strongly agree with the need for Ontario municipalities’ water and wastewater assets to remain publicly owned. Britain’s privatized Thames Water serves as a cautionary tale: its investors “paid themselves billions in dividends ... despite Thames Water’s enormous capital spending needs”,¹ leaving in their wake polluted waterways and a massive financial crisis.

Both potential solutions we considered — a joint municipal service board and a joint municipal services corporation — would keep Ontario’s water and wastewater utilities in public hands. We also recognize that participation in a sector-led solution crafted by LAS must, by its very nature, be voluntary.

Ontario’s water and wastewater systems serve some 444 municipalities that range in size from a few hundred people to several million. The diversity and differing conditions across the sector are not just challenging to grasp; they call for recognition that for any solution to work, it must be carefully thought out and reflect a wide range of input.

Fortunately, we were greatly helped by people and organizations from across the sector. We were especially gratified that so many municipal officials and staff from almost every part of the province took part in an open house organized by LAS at the 2024 AMO conference in Ottawa. What we heard there provided a solid foundation for our understanding of the issues. We also heard from the interested parties listed in Appendix III. In our deliberations we were ably supported by LAS and AMO staff for research, analysis and logistics.

Our discussions made clear to us that many smaller communities are deeply concerned about the sustainability of their present water and wastewater systems. While individual problems and circumstances vary widely across the province, in all cases we were struck by a strong appetite for change and genuine interest in exploring new solutions. We hope that our recommendations help to set Ontario’s water and wastewater systems on a clear path to financial sustainability.

¹<https://oilprice.com/Energy/Energy-General/Thames-Water-Debate-A-Lesson-in-Regulation-and-Utility-Mismanagement.html>

In line with our mandate, the balance of this report covers:

Section 2. Ontario's current water and wastewater sector

- Provides information on the current state of water and wastewater assets in Ontario, as well as the financial and other challenges facing the sector

Section 3. A municipal utility model

- Focuses on the feasibility of a utility business model that LAS might add to their offerings, and concludes that a joint municipal services corporation would be the most appropriate structure

Section 4. Structure and governance of a joint MSC model

- Outlines our thoughts as to how best to structure and arrange the governance of a joint municipal services corporation for the water and wastewater sector

Section 5. Economics of the joint MSC model

- Discusses funding from user rates and other potential sources, as well as the use of debt and reserves, and implications for financing costs; also sets out conclusions about economic regulation

Section 6. Feasibility

- Outlines the conditions that we believe are needed for feasibility of a joint municipal services corporation

At the end of each of Sections 2 through 5, we set out what we see as related opportunities and risks for LAS. These are then rolled up in Section 6 to form a comprehensive foundation for our conclusions.

2. Ontario's current water and wastewater sector

Structure and governance

As the Introduction notes, Ontario's water and wastewater systems are almost all municipally owned. Despite uniform ownership, there are numerous arrangements across the province for structure, governance and operation:

- Arrangements vary across regional municipalities: Waterloo, Niagara and York have two-tier water and wastewater systems, whereas in other regions, the upper-tier municipality has sole responsibility.
- Counties also have differing arrangements, with their local municipalities managing water and wastewater directly in many instances.
- A number of area water systems serve multiple municipalities in southwestern Ontario under joint board arrangements.
- Some municipalities have set up municipal services corporations for water and wastewater services.
- Operations may be carried out by staff in a municipal department, joint board or corporation, or by a third-party contractor.

No matter what the arrangement, however, under the provincial *Safe Drinking Water Act, 2002*, system owners must “exercise the level of care, diligence and skill in respect of a municipal drinking water system that a reasonably prudent person would be expected to exercise in a similar situation; and ... act honestly, competently and with integrity, with a view to ensuring the protection and safety of the users...” This is generally referred to in the sector as the “duty of care.”

Given the varied governance arrangements and the involvement of both the provincial and federal governments in regulation and funding, the politics of water and wastewater can be complex and contentious. The spectrum of issues encompasses not just directives and legislation from the provincial and federal governments, but also tensions between upper-tier and local municipalities and neighbour-to-neighbour conflicts. In our deliberations we were always mindful of the elected official who, at the start of the project, strongly suggested “getting the politics out of the pipes.”

Costs and revenues of water and wastewater systems

Full costs and how they are recovered

The panel has adopted the following definition of full cost pricing:

- Operational and maintenance costs, including water quality and lab testing
- Overhead costs
- Capital costs, including costs to expand systems and long-term expansion and capacity planning
- Asset management costs, including contributions to reserves to rehabilitate and replace infrastructure
- Taxes and regulatory fees
- Financing costs
- Climate adaptation and mitigation costs
- Conservation and demand management costs

This definition includes both the costs of maintaining an existing system and expanding it as needed for growth. Where possible, funding for these needs comes — or should come — respectively from user rates paid by existing customers and charges levied on new development. We recognize,

however, that some systems in Ontario are not financially sustainable and require subsidies to cover full costs.

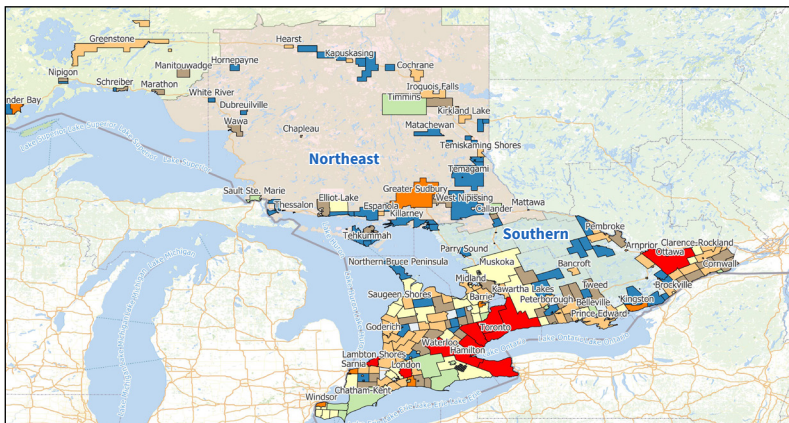
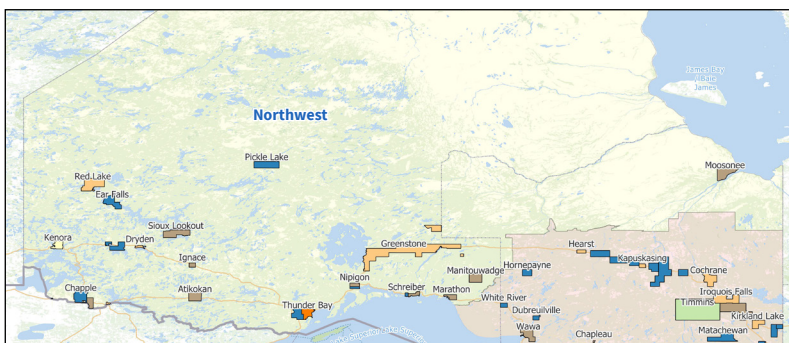
Funding from user rates

It is a best practice in Ontario’s municipal water and wastewater sector to charge user rates that are designed to recover all costs except those currently funded from development charges. This is because, unlike most municipal services, water and wastewater usage can be metered so customers pay for their individual usage.

There are strong environmental and financial reasons for full cost pricing for municipally owned systems. It is increasingly expensive to draw water from a lake, river or aquifer, treat and pump it to customers, and collect, treat and release wastewater while managing the burden on the natural environment. Pricing water appropriately encourages customers to limit their usage and reduce these costs and this burden.

Full cost pricing also ensures that water and wastewater services are not being subsidized by property taxes. This is especially important in rural areas where many residents are not able to access municipal water or wastewater services and must pay for their own systems.

Heat map of connections to municipal water systems



Note: Connections data was sourced from asset management plans, municipal websites, drinking water system operational plans, and/or conservation authorities. Where data was not directly available, number of connections was estimated based on population. Connections to the Lake Huron and Elgin Area supply systems were placed in the municipalities of South Huron and Central Elgin, respectively.



Typically, to determine full cost pricing, a municipality projects its costs and the size of its expected customer base (including expected consumption per capita and by businesses) over its forecast period. This exercise should allow costs to be balanced against revenues. We set out further thoughts on the right balance in Section 5, under the heading “Ensuring appropriate rates.”

As the maps to the left show, systems in rural and remote areas typically serve small communities that are often widely separated, with geography that makes physical connections between them impossible and efficient staffing difficult. This challenges the ability to recover full costs from a relatively small base of customers, especially as income levels are often lower in these communities than the provincial average. Appendix VII discusses regional differences in more detail.

We learned that some systems in Ontario do not meter all customers' use, leaving municipalities and residents in the dark as to usage patterns and volume being lost to leakage. Where flat rates are used instead of metering, rate payers are not as aware of the cost of providing the service based on their own usage. As well as discouraging conservation, this raises issues of fairness across the customer base.

Generally, however, most systems are fully metered and many of the larger ones have already moved toward recovering all related costs from user rates. For example, the cities of Hamilton and Toronto and Regional Municipality of York have achieved full cost pricing, and others — such as the City of Ottawa — are in the process of doing so.

Rate setting can be challenging, however, since it involves a number of factors that are inherently difficult to predict. For this reason, the rate structure can allow for creation of a rate stabilization reserve.

Funding growth

As noted above, the cost of system expansion is not generally recovered from user rates. In municipalities that collect development charges, these are used to fund growth-related infrastructure, including water and wastewater systems. Developers also construct local distribution systems (for example, in subdivisions) and convey them to municipalities at no cost.

The box on page 14 outlines that AMO expects municipalities across Ontario will spend roughly \$100 billion over the next 10 years on growth-related capital projects. Since water and wastewater assets account for more than one-third of the estimated replacement value of municipal assets, their share of growth-related spending is likely to be significant.

The outlook for population growth is driven to some extent by provincial direction. In pursuit of an ambitious goal of adding 1.5 million homes by 2031, the Province has assigned specific targets to Ontario's 50 largest municipalities. It also assumes that the remaining municipalities will together provide almost 12% of the goal. (This is in line with growth many smaller communities are seeing as younger people leave urban areas for affordable housing and baby boomers retire to more bucolic surroundings.²)

Lack of water supply and wastewater treatment capacity is a constraint on new development because, unlike most other municipal services, the infrastructure must be in place before development can occur. As *A Jump Start*, a 2024 Canadian Urban Institute report notes, "Many housing projects currently 'in the pipeline' can only proceed if certain essential infrastructure is provided. At the top of the list are potable water, wastewater, [and] stormwater drainage..."³

But making the best possible decisions about how much and where to invest is not always simple. Lead times to build the infrastructure are long and, for maximum efficiency, capacity is usually aligned with expected population at a point relatively far in the future. As noted above, if a system is too large for actual growth, there are financial consequences. Pipes that carry less water or wastewater than they are designed for are more costly to operate and maintain, as are oversized treatment plants, pumps and other infrastructure.

² Statistics Canada, Socioeconomic facts and data about rural Ontario; available at <https://www.ontario.ca/page/socioeconomic-facts-and-data-about-rural-ontario#section-2>. Accessed October 12, 2024.

³ We were asked to consider stormwater issues but determined that inconsistencies across the province in delivery and funding made an assessment beyond the scope of our work.

The value and state of Ontario's water and wastewater infrastructure

The *2021 Municipal Infrastructure Review*, carried out by Ontario's Financial Accountability Office, put the value of the province's municipal potable water and wastewater infrastructure at \$175.8 billion.

On average, 68.5% of potable water assets and 67.3% of wastewater assets were in a state of good repair compared to the provincial average of 54.7% across all assets.

The actual condition of assets could be significantly different. Information on the condition of many wastewater assets was missing, for example, making their state of repair uncertain. Many wastewater linear assets, such as sewers and water mains, are underground. The *2019 Canadian Infrastructure Report Card* highlighted the challenges in assessing underground assets. In addition, many sewers are more than 50 years old.

AMO estimates that Ontario municipalities are planning for \$250 to \$290 billion in total capital spending, including water and wastewater, over the next 10 years. About \$100 billion is expected to be growth-related, with the balance going to asset rehabilitation and replacement. As discussed on pages 14 to 15, there is a risk that municipalities are not building adequate reserves for these needs.

Just as important, municipalities typically borrow and/or build reserves to finance infrastructure investments. The next section looks at the impacts in more detail.

Debt and reserve management

Ontario municipalities are collectively servicing \$25.7 billion in outstanding debt for infrastructure, 24% of which is for water and wastewater assets. Debt instruments range from large public debenture issues to loans taken out from the local bank. Infrastructure Ontario also lends to municipalities, sometimes at better rates than those available to them in the marketplace.

Many small municipalities do not borrow at all, however, because they know they cannot service the debt. Instead, they apply for federal and provincial support and, if that is not available, must allow their infrastructure to deteriorate.

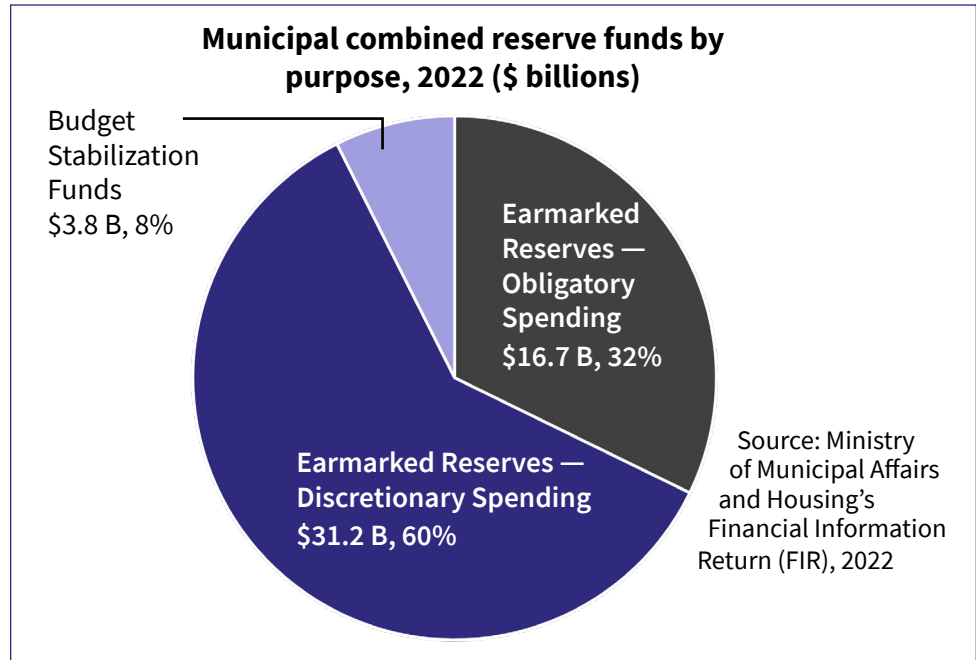
Some debt is growth-related. Municipalities that collect development charges typically borrow in advance of collecting the charges so that the needed infrastructure for growth is in place. In the meantime, the debt must be serviced until the related charges are collected. If development is slower than forecast, development charges will be collected later than expected, which creates a financial risk to municipalities because they must fund their debt servicing costs regardless of how much development charge revenue they've collected.

Municipalities also typically build reserve funds to pay for future capital spending for growth needs, existing asset renewal, or both. This is in part because of provincially mandated borrowing limits. As well, borrowing can be costly for smaller municipalities, which typically can't access the public debenture markets, and low revenues limit their ability to service debt. Borrowing related to growth investments is generally serviced from development charges, while renewal-related debt must be serviced from other sources.

In 2022, according to provincial Financial Information Return data, Ontario’s municipal reserves totalled \$51.7 billion, as shown in the chart below. Of the total, \$47.9 billion or 93% was earmarked for specific purposes such as asset renewal and growth to be funded by development charges. The balance was for budget stabilization.

As home prices have risen in Ontario, the level of reserve funds has come under criticism, with headlines suggesting municipalities have access to large amounts of cash that could be used to pay for housing-enabling infrastructure.

However, almost all earmarked funds will be used to service growth-related projects and renew assets.



Development charges collected for future growth are part of the obligatory spending component. They must be kept in segregated development charge reserve funds and reported as deferred revenue on municipal balance sheets. As noted above, municipalities often borrow in advance of related development and must service the debt in the meantime. Reserve fund balances thus might increase in a given year as more charges are collected, and conversely balances might also be partly drawn down to service outstanding debt and/or pay for projects as they go forward. In addition, municipalities issuing growth-related debt tend to keep balances at a level that would allow them to meet debt obligations should development charge collections be lower than expected for one or two years.

Asset management reserves are vital to municipalities. They are the largest component of reserves, making up almost all of the discretionary spending slice of the pie chart above. As an asset ages, increasingly higher spending is needed to keep it operating efficiently and ultimately replace it. In addition, asset management plans can disclose infrastructure deficits that require funding to address over time.

Many municipalities are building reserves to meet these present and future needs through annual contributions that, for fairness over time to all users, should be spread evenly over the infrastructure’s life cycle. As provincial regulations around asset management are phased in and municipalities carry out more assessments, the full costs asset renewal and related reserve needs are becoming clearer. Evidence suggests that current asset management reserves, at an estimated \$26 billion, are not large enough to meet needs: for example, as noted in the box on page 14, AMO estimates the spending needs on asset management at between \$150 and \$190 billion over the next ten years, with water and wastewater likely accounting for the largest single share. We considered this a key factor in assessing the long-term sustainability of many systems.

Asset management planning requirements

Ontario Regulation 588/17 under the *Infrastructure for Jobs and Prosperity Act, 2015*, categorizes water and wastewater systems as “core infrastructure assets.” The regulation specifies that Ontario’s municipalities must:

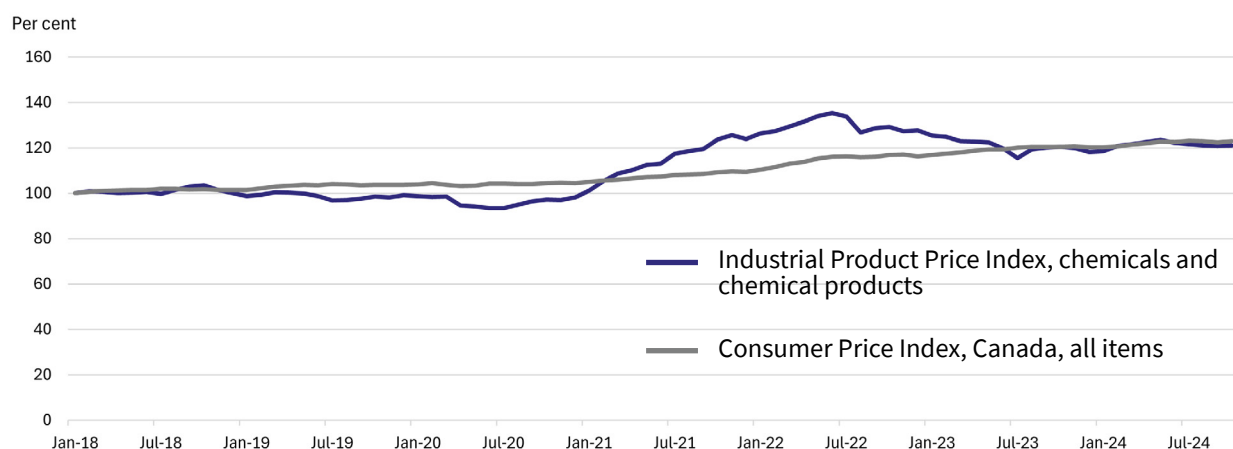
- Develop a strategic asset management policy by July 1, 2019
- Develop an asset management plan including core infrastructure assets with current levels of service by July 1, 2022
- Develop an asset management plan including all infrastructure assets with current levels of service by July 1, 2024
- Develop an asset management plan with proposed levels of service, and life cycle management and financial strategy by July 1, 2025

Additional challenges facing the sector

The exercise of determining full costs and recovering them from current and future customers is further complicated by several pressures the sector faces:

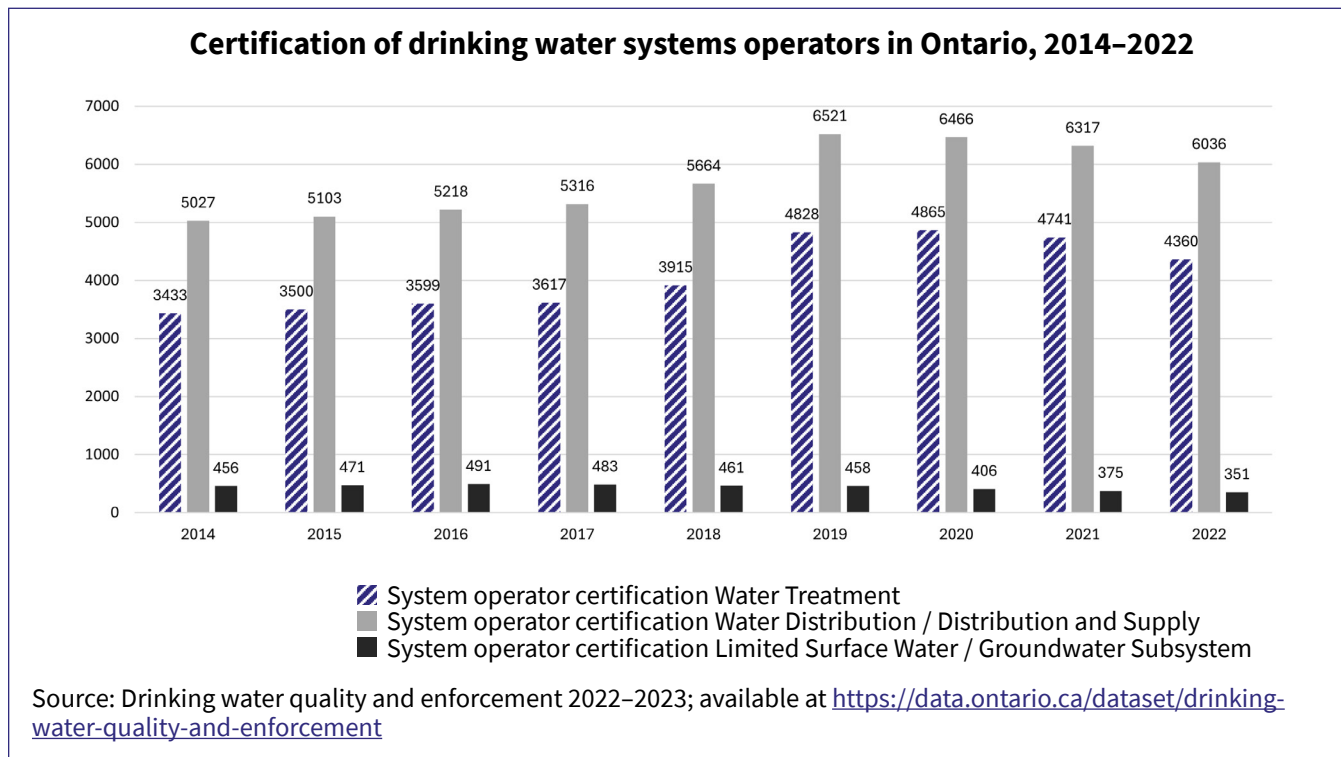
- Systems that are too large for the need. We heard many examples of systems built much larger than a community’s foreseeable population would demand, often for regulatory reasons. This adds to operating and financing costs and places an undue burden on actual rate payers.
- Unexpected escalation in operating costs. Higher costs for key inputs, particularly chemicals, as well as supply chain disruptions and more stringent regulatory requirements are all boosting operating costs. As the graph below shows, the prices of chemicals and chemical products rose by almost 25% from January 2021 to January 2022. Materials and contracted services rose by 7.4% and 10.1% respectively, over the same period.

Comparison of Industrial Product Price Index (chemicals and chemical products) and Consumer Price Index (all items)



Sources: Statistics Canada. Table 18-10-0265-01 Industrial product price index, by major product group, monthly; and Statistics Canada. Table 18-10-0004-01 Consumer Price Index, monthly, not seasonally adjusted

- Large increases in capital costs over the last few years. Prices for capital projects rose by more than 30% between 2020 and 2023 as a result of supply chain disruptions, higher material costs, rising interest rates and shortages of construction labour, and these pressures appear to be continuing.
- Staffing challenges. The supply of new operators appears to be seriously lagging needs. As the graph below shows, operator certifications fell during the Covid-19 pandemic and anecdotal evidence suggests they are not recovering. At the same time, many older workers are retiring. We heard that while finding and keeping qualified operators has long been difficult in more remote parts of the province, their situation is now critical and even bigger cities are facing the same challenge.



- Future rehabilitation and replacement needs (collectively called “renewal needs” in this report). Ontario requires municipalities to report on the state of their infrastructure and develop plans to manage their assets (details appear in the box on page 16). Because asset renewal costs are large, infrequent and often much higher than the initial investment, municipalities typically build reserves to pay for them through annual contributions from user rates. In some cases, improved data has shown that earlier estimates of renewal costs were too low. In addition, recent inflation in the construction industry is boosting all capital costs. Both factors are putting upward pressure on annual contributions to reserves, which were already estimated to be too low.
- Climate change cost impacts. A 2023 report by the provincial Financial Accountability Office⁴ noted that a changing climate is accelerating the deterioration of assets, boosting both renewal and operating costs. In the absence of adaptation and in a medium emissions scenario, this

⁴ Financial Accountability Office of Ontario, 2023. “CIPI: Summary Report — Estimating the budgetary impacts of changing climate hazards on public infrastructure in Ontario”; available at <https://www.fao-on.org/en/Blog/Publications/cipi-summary>. Accessed November 3, 2024.

is expected to add \$4.1 billion a year on average to the cost of maintaining the \$708 billion portfolio of existing public infrastructure, an increase of 16% over a stable climate base case. As owners of almost three-quarters of the province's infrastructure, municipalities will bear the brunt — especially related to the impacts on water and wastewater systems. While adaptation can reduce the financial costs, it would require major investment: for example, about \$8 billion a year from 2022 to 2030 under a proactive adaptation strategy.

Financial sustainability

To help determine the current financial state of smaller Ontario water and wastewater systems, LAS staff analyzed data from the 2022 Financial Information Return for municipalities with population of less than 25,000. For further details, refer to Appendix VII. This group was selected on the basis that smaller municipalities are most likely to have the greatest financial challenges.

LAS staff developed an aggregated statement that shows:

- Cash inflows and outflows for 2022, using Financial Information Return data and removing growth-related flows to give a “base case” scenario
- Estimated asset management needs, based on amortization figures adjusted for construction inflation between 2009 and 2022

To the second point, we believe this estimate is low compared to the actual need, for the following reasons:

- When municipalities adopted full accrual accounting in 2009, they had to estimate book values of tangible capital assets. These estimates may have been below replacement value and may not have been prepared consistently.
- Some assets are fully amortized and no longer appear on the balance sheet, but are still in service. They would not be captured in the adjusted amortization estimate, even though they must be replaced like any other asset.
- Technological and regulatory changes have increased the cost of replacing infrastructure, which our calculation does not reflect.
- Many municipalities have an existing infrastructure deficit and, depending on decisions about service levels, may need to invest over and above the adjusted amortization estimate.

These uncertainties around estimating the fiscal gap underscore the need for better data coordination in the municipal sector. The Financial Information Return is an excellent data source, but because it is based on financial reporting on a full accrual basis, it cannot provide information on the replacement value of assets (as opposed to the net book value) nor on asset management needs.

Ontario's asset management planning regulations are helping to fill in that picture, and as that data is collected it should be translated into realistic cost estimates to inform budgeting. Asset management spending and needs should also be coordinated with the Financial Information Return: for example, capital spending on asset renewal should be reported separately from growth-related investment.

Even with a spending estimate that is likely less than the need, the analysis strongly suggests that these municipalities collectively lack the capacity to fund full asset management needs, even with the current level of provincial and federal government grants:

Operating activities

Revenue

Water and wastewater user fees	639.8 M
Total revenues	639.8 M

Operating expenses

Operating costs (excluding amortization; Note 2)	-432.5 M
Interest on long-term debt	-20.3 M
Total expenses	-452.8 M

Cash from operations (revenues less expenses) 187.1 M

Financing activities

Contribute to asset management reserves	-52.0 M
Draw down asset management reserves (Note 3)	86.0 M
Repay long-term debt	-38.7 M
Grants (Note 4)	28.6 M
Net source (use) of cash for financing activities	23.9 M

Cash from operations and financing activities 211.0 M

Capital activities

Estimated asset management spending need (Note 5)	-220.0 M
Cash surplus/deficit after asset management spending	-9.0 M

Notes:

1. This base case scenario excludes both development charge revenues and capital spending supported by development charges
2. Amortization of \$161 million was not added back to cash inflows because the estimated need for asset management spending (under “Capital activities”) represents the actual spending need; see Note 5
3. The analysis assumes municipalities should be drawing down at a rate that would exhaust reserves at the end of 10 years if no new contributions were made
4. Grants spent in the year
5. Estimate was developed by inflating the book value of water and wastewater assets, including additions and betterments less asset disposals and write-downs, from 2009 to 2022 using the Non-Residential Building Construction Price Index to give an approximation of current replacement value; this figure was then multiplied by the ratio of reported amortization to book value in 2022

Without the \$28.6 million in grants, the collective fiscal gap across systems would be almost \$40 million.

We recognize that our data was aggregated and that not every municipality of less than 25,000 population has a fiscal gap with respect to water and wastewater. But a closer look at individual municipalities suggests that most do. The outcomes will be gradually deteriorating infrastructure and, possibly, increased health and environmental risks.

Policy instability

Municipal powers are determined by the provincial government through legislation including the *Municipal Act, 2001*, other acts and the related regulations. An unstable provincial policy environment adds to the challenges municipalities face in planning and delivering water and wastewater infrastructure. This has included, in recent years, unexpected expansions of urban boundaries, wider use of Minister's Zoning Orders (which can override municipalities' plans), and removal of official planning authority from all regional municipalities.

In addition, a provincial move to dissolve Peel Region, announced in 2023, was subsequently changed to a review of how service delivery might be better allocated between the region and its local municipalities. The review and the government's response to it may have impacts on how water and wastewater systems are governed not just in Peel but across Ontario.

Policy instability is especially challenging for water and wastewater systems, where infrastructure is costly and can take a decade or more to plan and build. Among other changes, the provincial *More Homes Built Faster Act, 2022*, which is widely known as Bill 23, amended the *Development Charges Act*. The changes had the effect of reducing and/or deferring collection of development charges. The *Cutting Red Tape to Build More Homes Act, 2024*, also known as Bill 185, reversed some provisions but left others in place. This reduced but did not eliminate revenue losses.

Municipalities are at risk as a result because they built water and wastewater systems in advance of growth in the belief they would collect the level of development charges determined by the framework in place at the time. With the changes, they might not be able to service the associated debt. Municipalities have also had to change their development charge forecasts twice since Bill 23 was enacted, impacting their capital plans and growth capacity. Meanwhile, the Province formalized its 1.5 million-home goal and in many cases assigned specific targets that require more infrastructure investment.

Opportunities and risks: Current state

	Opportunity	Risk
Structure and governance	Balance infrastructure and financial pressures beyond political boundaries.	Many small unsustainable systems.
Full cost pricing	More municipalities are moving ahead.	Unclear how many municipalities are at full cost pricing. Costs (especially asset management needs) may make rates unaffordable.
Debt and reserve management	Many municipalities are building reserves. Those that can't afford debt mostly don't take it on; some who could borrow are reluctant to.	Inadequate saving for asset management.
Policy instability	May foster innovation.	Development charges changes leave a funding gap for growth-related infrastructure. Municipalities may back away from growth due to funding constraints.

3. A municipal utility model

Our mandate

As panel members and in line with our mandate, we focused on the feasibility of a utility business model that LAS might add to their offerings.

Rationale for considering a municipal utility model

What is a municipal utility?

A utility is a public- or private-sector corporation responsible for delivering a service to the public. The nature of the service being provided determines if a utility model is appropriate. Typically:

- Service delivery requires a physical network (such as water mains) and other infrastructure
- Building competing networks to serve the same geographic area would not be practical or cost-effective
- Creating the network is costly, but in operation costs generally go down as output increases
- The service is usually strongly related to the public interest, requiring a high degree of certainty that it will be available when needed

A municipal utility, as the name implies, provides services with these characteristics using municipally owned assets. However, while water and wastewater delivery has the characteristics of a utility service, in most municipalities it is provided directly by the municipality, not through a separate organization.

As we note in the Introduction, the goal of the expert panel's work was to determine if shifting to a municipal utility model could address major concerns that municipalities face in operating, maintaining and/or expanding their water and wastewater systems. Some municipalities have already moved in this direction or are in the process of doing so.

Pros and cons

The aspects of a municipal utility model set out above — strong capital investment in public services, economic efficiency, and high degree of certainty of delivery — would appear to offer benefits to consumers and communities, at least in theory. The municipal utility model also offers other potential benefits that suggest it could help address current challenges:

- Either a joint municipal services corporation or a joint municipal service board, both of which are allowed under the *Municipal Act*, can function as a utility
- In either form, the utility can be governed by a board made up of experts who understand long-term business and other needs that support public health, asset maintenance and achieving service levels
- At a large enough scale, it can offer resources that an individual system could not afford on its own

- It can assess costs and benefits across an entire region instead of a single municipality
- Municipal participants can ensure basic protections through their initial involvement

Against these benefits, there are potential drawbacks:

- Based on Ontario’s experience with local distribution companies in the electricity sector, setting up a utility model is likely to be time-consuming and expensive
- Research into the cost impacts of creating larger water and wastewater utilities is inconclusive, with a recent study⁵ suggesting costs might go up with consolidation
- A utility is usually the only supplier in a given service area, so it faces no competitive pressures that would help ensure the rates it charges customers are at the right level
- The business interests of a utility might be at odds with the interests of one or more of the municipal participants
- Without appropriate safeguards, the involvement and control of municipal participants might decline over time

Two potential governance structures

The LAS mandate asked for a potential utility solution that would be scalable over several municipalities, so we focused on applying the utility model to an entity in which several municipalities would take part.

In Ontario, as noted above, such a utility could be either a joint municipal services corporation (JMSC) or joint municipal service board (JMSB). The table in Appendix IV provides a detailed comparison of the two options.

While both are separate legal entities from the municipality or municipalities that set them up, there are key differences:

- a joint municipal services corporation is able to borrow and own assets transferred to it by member municipalities
- a joint municipal service board generally relies on one or more of its member municipalities to borrow on its behalf, and its member municipalities frequently continue to own their assets

In addition, the impact on shareholders’ financial statements changes if a joint municipal services corporation meets accounting tests to be considered a government business enterprise. We discuss the impacts in more detail on page 28.

⁵ Klien, M., Michaud, D., 2019. “Water utility consolidation: Are economies of scale realized?” Utilities Policy, 61

Would a utility model deliver more benefits?

A key question for the panel was whether a utility model would be able to deliver greater benefits to consumers than the current approach of municipal ownership and operation.

We broke our assessment down into the three major categories of potential benefits: capital, operations, and certainty of delivery. We then assessed how well each potential option — the joint municipal services corporation or the joint municipal service board — could deliver benefits and minimize drawbacks.

Economies of scale: capital

Classic economic theory would suggest that in an industrial process such as water or wastewater treatment, economies of scale in capital reflect lower capital costs for each unit of output as plants increase in size. In other words, all other factors being equal, a plant serving 2,000 customers costs less than twice as much to build than one serving 1,000 customers. This assumes, however, that it is possible to easily increase the customer base. In that case, the only constraints on plant size are decisions about how big to make the service area and how much growth will happen over the facility's service life. (As the customer base grows, diseconomies of scale may emerge as facilities become very large. Since most concerns we heard were about small systems, this was not a major factor in our discussions.)

In much of Ontario, however, communities are small, remote and geographically scattered. In most cases little or no growth is expected, and the community might be facing population declines. We also heard from some AMO delegates at our open house that in some cases where growth is happening, new developments are being built outside the reach of existing service. We concluded that economies of scale in physical plants would be hard to achieve in many parts of Ontario.

Walkerton inquiry findings on regionalization

Justice O'Connor commented on the benefits of regional municipalities managing water systems:

The establishment of 12 regional governments in Ontario between 1969 and 1975 is another example of how the management of water systems has been consolidated across a wide service area. The Regional Municipality of Waterloo submitted to the Inquiry that the consolidation ... has provided for "better planning, a critical mass for staffing, expertise in operations, and the ability to finance major works." Also, it was submitted that regionalization has allowed for greater integration of the water system with other regional services, such as the public health programs of the Medical Officer of Health and his/her staff, who work within a regional department rather than a separate local health unit.

We agree and, for this reason, generally focused our efforts on areas without regionalization. We do, however, note the potential impacts of the recent removal of planning authority from regional municipalities.

Even if those economies were possible to achieve, they would very likely be offset by the costs of serving a larger customer base. Economies of scale do not universally hold for distribution and collection networks, even at relatively short distances from facilities, because of the costs of locating water mains and sewer lines underground. As a 2016 paper in the *Agricultural and Resource Economics Review* notes, “As water systems expand service territories, only in the most densely populated areas would remaining economies of size in treatment outweigh the diseconomies in distribution.”

Looking at both factors and conditions in Ontario, it becomes clear that any economies of scale in expanding, adding or linking plants and networks in most rural or remote areas will be very limited. Even with growth, any savings from building a larger facility are likely to be quickly offset by the cost of expanding the network because of distance and, in large parts of the province, rocky terrain. (The exception is southwestern Ontario, where relatively flat land and deep soil, combined with access to the Great Lakes, has enabled the creation and expansion of joint water systems.)

Innovating requires resources

Innovation in capital and operations across systems of all sizes abounds in the water and wastewater sector:

- Potential for generating revenue from wastewater, which has generally been seen as an output with high costs to process, has been identified. Possibilities include extracting heat to generate electricity or manage building temperatures, as well as the sale of treated sludge for agricultural use. While some of this work is in the early stages and the size of the revenue stream relative to overall costs not yet fully known, it does offer the potential to offset costs that are otherwise borne by ratepayers.
- Examples of cost savings from innovation include electronic logbooks, remote system monitoring and response to problems, digital twinning of systems to better model usage scenarios, and new approaches that don't require trenching to rehabilitate underground assets.

We heard from a number of sources that small and remote systems have very limited opportunities to take advantage of such innovations, for reasons of limited budget and/or access to the right resources to learn about and evaluate ideas. A larger utility would likely be better positioned to find, assess and apply innovation.

Nonetheless, the panel did identify a number of ways in which a larger entity might be able to reduce the cost per customer of providing infrastructure:

- Engineering and technical expertise. At present, every proposed new water or wastewater treatment facility in Ontario is treated as a “one-off” undertaking. By serving a wider geographic area, a larger entity should be able to determine instances where an existing design or approach could be largely replicated. Greater engineering and technical expertise should also allow for better assessment of bids and project management.

- More rational planning. There is a legacy in some Ontario municipalities of plants that had to be built because a neighbouring municipality with excess capacity would not agree to connect. During our deliberations we were encouraged by examples of municipalities overcoming this traditional attitude and recognizing that joining forces was a better option. Nonetheless, neighbour-to-neighbour tensions will no doubt continue. Municipalities with no growth inevitably compete to maintain population. Even where there is no risk of decline, municipalities generally have a strong interest in maximizing their share of expected growth. A larger entity could have the ability to balance competing interests and ensure infrastructure is located and built as efficiently as possible.
- Planning across regional municipalities. Regional municipalities have lost their official planning authority but must continue to provide infrastructure. This is likely to make efficient capital planning more challenging, especially where their local municipalities are working to achieve individual growth targets. Effective and seamless coordination of a corporation's infrastructure planning with the land use planning at the municipalities that it serves will be critical.
- More options to finance capital projects. A corporation might be able to use more sophisticated strategies and better leverage capital markets than its member municipalities, especially smaller ones. This would widen the potential pool of lenders and might allow longer-term borrowing. Operating savings related to borrowing are discussed in the next section.
- Assessing innovative approaches to physical capital. The box on page 25 provides examples.

Economies of scale: operations

A review of activity in the sector and our discussions at the AMO conference yielded thoughts about many potential operating savings from the utility model through:

- Bringing together operational/administrative services in such areas as joint procurement, human resources and billing. This is a special concern with escalating costs of chemicals, a key input. Some existing systems have already seen benefits from consolidating billing, either within a two-tier system or with a local distribution company in the electrical sector.
- Greater ability to attract qualified operators and other technical staff and deploy them more efficiently over a larger service area, which would also help address labour shortages.
- Better access to professional resources in such areas as legal advice, financial management, risk management, technology and innovation/modernization (the box on page 25 provides examples), contract management, regulatory compliance, and grant applications.
- Reducing financing costs. As we note above, a larger entity could potentially borrow for capital projects at better terms than its smaller member municipalities. This would likely be the case if the municipality could not access capital markets and must borrow from financial institutions. Smaller municipalities, however, already borrow from such government sources as Infrastructure Ontario at competitive rates. The ability of a corporation to provide equal or lower financing costs would depend on its ability to borrow from these sources as well. We look into this issue on page 34.

Evidence around cost impacts from consolidation is mixed

The evidence on economies of scale in the water sector is inconclusive, because systems and the geography in which they are located vary so widely. Even if it were possible to compare two identical plants, total costs would depend on the density of customer base, soils, climate, topography, and source water quality, among other variables. As we noted, in most of Ontario it appears difficult if not impossible to achieve economies of scale from linking physical assets.

A landmark study in 2004⁶ suggested modest cost reductions could be achieved by joining up small water systems, even if their physical assets could not be connected. The savings arose from scale economies because, the authors theorized, larger systems may be relatively better “at bargaining and receiving outside services and materials for a lower cost.” The paper’s authors cautioned, however, that they could not claim all theoretical benefits could be realized.

A more recent review from 2019⁷ looks at whether real-world data supports the notion that creating larger systems through consolidations achieves savings. It concluded that consolidations may or may not result in cost savings, finding evidence of one-off cost increases during consolidations, as well as a decrease in network density (which increases unit costs). The paper noted that outcomes appear to depend on design, the institutional setting, and technological and geographical circumstances.

Greater certainty in service delivery

Even with uncertainty about cost savings, many participants in the sector feel that a larger entity could improve the reliability of systems in the short and long term by:

- Providing faster and better emergency response
- Meeting increasingly stringent regulations and public health requirements
- Being able to attract qualified talent in an increasingly competitive employment market
- Helping to achieve long-term financial sustainability for groups of systems

Third-party operators help municipalities achieve some benefits

Many Ontario municipalities already leverage some of the benefits of larger scale in operations and service delivery by contracting with a third-party operator, such as the Ontario Clean Water Agency (OCWA) or one of the private-sector companies active in Ontario, with several municipal clients in the same geographic area. Benefits include, for example, more up-to-date technology, group purchasing power, and more coordinated emergency planning and response.

A utility model could provide added benefits in such areas as capital planning and delivery, financial management and management of contracts with a third-party service provider or providers. And as a utility owned by more than one municipality, with responsibility for infrastructure and insight into land use planning, it would be better able than a contracted operator or individual municipality to plan over a larger service area.

⁶ Pizer, B., Harrington, W., Shih, J.-S., Gillingham, K., 2004. “Economies of Scale and Technical Efficiency in Community Water Systems,” Resources for the Future.

⁷ Klien, M., Michaud, D., 2019. “Water utility consolidation: Are economies of scale realized?” Utilities Policy, 61

How well each option could deliver benefits

In general, either option we considered, a joint municipal services corporation or a joint municipal service board, could provide almost all the benefits outlined above.

The key difference is in the ability to borrow. When a municipal services corporation meets accounting tests to be considered a government business enterprise, as outlined in the box below, it is able to repay its debt from its own resources.

This means its municipal shareholders may record their investment in the corporation in a single line both in the statement of operations and on the balance sheet, a practice known as “one-line consolidation.” The level of debt related to water and wastewater on municipal balance sheets was a concern raised by some municipalities. In one-line consolidation, municipal shareholders do not add debt issued by a government business enterprise to their own debt. The box on page 33 looks in more detail at the impacts of removing water-related revenues and debt in differing municipal circumstances.

A Government Business Enterprise defined

Public Sector Accounting Standards (PSAS) for Canada define a government business enterprise as a government organization that has all of the following characteristics:

- It is a separate entity with the power to contract in its own name, and can sue and be sued.
- It has been delegated the financial and operational authority to carry on a business.
- It sells goods and services to individuals and organizations outside of the government reporting entity as its principal activity.
- 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 addition, a corporation that can borrow in its own name is not subject to restrictions on borrowing set out in the *Municipal Act*. This would potentially make it easier for projects constrained by municipal repayment limits to go ahead when needed. The corporation might also be able to borrow on more favourable terms than its shareholder municipalities, which could lower its operating costs compared to those of the individual shareholder municipalities.

Another issue that, in our minds, worked in favour of the corporation model is that there is clear provision in legislation for it to own the related assets. As noted, under the board structure, assets often remain in the hands of member municipalities. We feel that asset ownership would ensure the most rational planning of new infrastructure, and possibly the setting of optimal priorities for renewing existing assets.

Our conclusion and an overview of a utility model

An MSC offers greater benefits than a joint board

We have concluded that a joint municipal services corporation offers more benefits than a joint municipal service board. While both can operate on behalf of more than one municipality, we found that a corporation can potentially provide more financial and operational flexibility.

Experience in the sector would appear to support this conclusion. Appendix V provides examples of existing municipal services corporations, as well as joint boards for water supply. The ability of a corporation to borrow in its own name and/or service the resulting debt from its own revenues was cited specifically in two of the four examples of municipal services corporations. This includes one instance where a joint board was transitioned to a corporation.

We also looked at the outcomes of the Province’s creation of local distribution companies as municipally owned corporations, as discussed in Appendix VI.

Overview of an LAS-sponsored municipal utility model

In line with our mandate, we have considered a model that would be sector-led, multi-municipal and scalable as a municipal services corporation. Within that framework, the solution will need to be designed with:

- A structure that responds to the widely varying conditions and concerns of Ontario municipalities
- Strong governance and high standards of transparency and accountability
- Commitment to pricing designed to recover full costs, including asset renewal, to the greatest extent possible
- Flexibility in its approaches to funding and financing, guided by the principles of fiscal prudence and fairness to ratepayers over time
- Standards, practices and reporting that support the setting of appropriate rates without the need for external regulation

The following two sections examine these points in more detail. In Section 6 we then set out our views on the feasibility of the model. Section 7 concludes our report with suggested next steps toward our recommended solution.

Opportunities and risks: A joint municipal services corporation utility

	Opportunity	Risk
Joint municipal services corporation utility	<p>Possible scale economies, less risk, more shared resources, more objective planning.</p> <p>If MSC met accounting tests, its debt would not be included in shareholder balance sheets.</p>	<p>Several years of disruption and initial costs, large bureaucracy, uncertainty as to actual savings outcomes.</p> <p>Council concerns around loss of control over assets and revenues.</p>

4. Structure and governance of a joint MSC model

Options for structure: efficiency should be the guiding principle

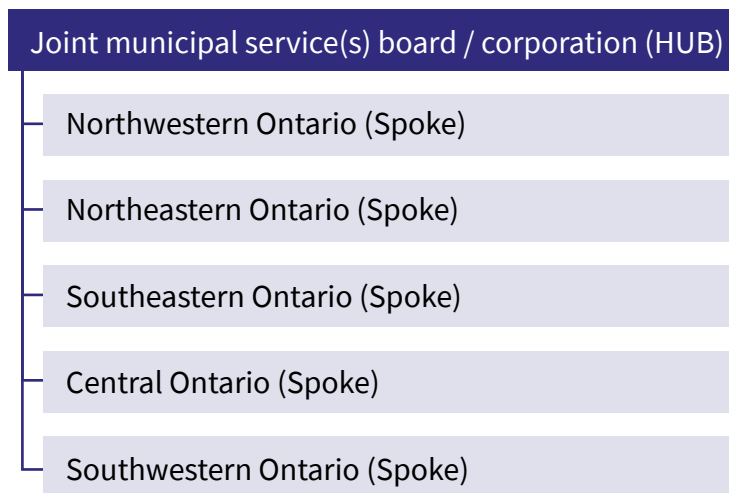
We considered several aspects of how an LAS administered utility set up as a joint municipal services corporation might be structured, taking into account the province’s geography, best practices in governance, and other factors.

How best to serve Ontario’s large and diverse geography?

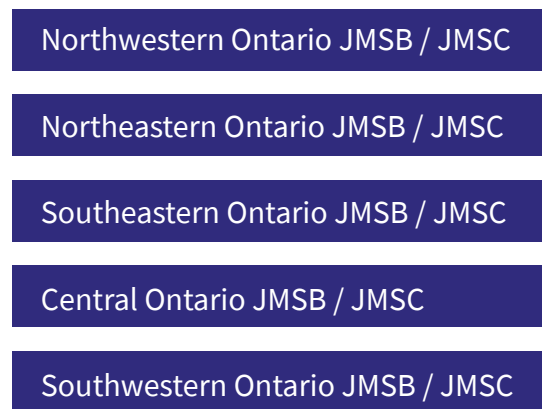
Any corporation created by LAS and member municipalities must take into account Ontario’s geography. At a minimum, the entity must recognize distinct differences in concerns and needs in northwest, northeast and eastern Ontario; the urban agglomeration centred on the City of Toronto; and southwestern Ontario (which might be further subdivided by areas that can potentially be served by linking systems and those that cannot).

A question is which corporate structure would best achieve that recognition — a single entity with regional branches/networks, or a holding company with separate corporations for each region:

Single utility (natural monopoly)



Multiple utilities



JMSB is joint municipal service board

JMSC is joint municipal services corporation

As the LAS Board has decided to further assess the idea of a water and wastewater utility model, this should be explored as part of the business case.

For the greatest efficiency, especially for operations and maintenance, member municipalities should ideally share borders with one another. However, because of the voluntary nature of participation, this can’t be guaranteed.

By watershed or by jurisdiction?

The next question is whether responsibilities, plans and systems within each region should be grouped by watershed or by jurisdiction. In our view, working across watersheds would strengthen protection of source water and rationalize water takings. When we posed this question at the AMO open house, however, the response was strongly in favour of jurisdictional divisions.

While that is understandable, in conversation we heard many municipalities acknowledge the need to plan by watershed. The preference for jurisdictions when the question was posed as a straight choice might arise from a concern that each municipality would have to plan in conjunction with all participating municipalities in each watershed. But this is not how the utility structure would work. The utility would plan and operate systems within each member municipality and have the same responsibilities across each watershed (excepting municipalities not participating in the utility). The benefits would be shared by all ratepayers in the participating municipalities (and by the natural environment), regardless of where they were located.

Corporate governance, shareholder agreements and directions, and corporate by-laws

A skills-based board

We believe a skills-based board of directors is essential, both because of the need for objective business, financial and technical advice and to manage priorities in a way that benefits ratepayers across the service area. We found widespread agreement with this approach in our discussions with municipalities at the AMO open house. We also note that most municipal services corporations set up for water and wastewater allow for independent directors or advisers with the requisite skills.

We believe LAS has both the experience and expertise to develop an appropriate governance framework for a water and wastewater utility. As an example, LAS gained relevant in-depth experience through the creation in 2020 of the ONE Joint Investment Board (ONE JIB), which invests on behalf of Ontario municipalities. Partnering with the Municipal Finance Officers Association, LAS worked with six municipalities to set up an effective governance structure and received legal assurance that the arrangements comply with the *Municipal Act* and related regulations. The experience and lessons learned can be applied in this work.

An important governance question in moving forward with any offering will be to determine how boards are initially appointed and how they are sustained over time. This is discussed below under “Shareholder agreements.”

Shareholders

We recommend that shareholders be limited to Ontario municipalities, First Nations and wholly public-sector entities in line with the LAS commitment to keeping water and wastewater assets in public hands.

Shareholder agreements and directions and corporate by-laws

Like the composition of the board of directors, several key principles can be reflected in the shareholders' agreement and directions to the corporation:

- Appointment, composition, and powers of the board (including ensuring that municipal interests remain paramount, prohibiting encumbering assets without the prior approval of the municipal shareholders, and giving shareholder municipalities the ability to appoint and discharge board members)
- Treatment of assets, reserves and debt, including transfer from participating municipalities
- Allocation of shares and voting powers attached to classes of shares
- Openness and transparency
- Performance information on water quality, costs, rate setting, and other parameters
- Regular consultation with participating municipality councils on rates and rate structure

The corporation's by-laws should set out mechanisms for ongoing connection to local public health boards. They should also provide for the same ability that municipalities have under the *Municipal Act* to enter into agreements with First Nations for water and wastewater. As we note above, First Nations would also be eligible to be shareholders, which the business case should consider in more detail.

Opportunities and risks: A joint municipal services corporation utility

	Opportunity	Risk
Structure	Align systems with geography.	Complex watershed planning issues.
Governance	Professional, skills-based board.	Municipal concern around less control over where resources are directed.
Shareholders	Keep assets in public hands.	Lost opportunity for equity investment from other sources.

5. Economics of the joint MSC model

Funding the utility

Funding from user rates

We identified in Section 2 the costs that municipalities should endeavor to recover from rates. This principle of full cost pricing must also apply to the utility. At least initially, full cost pricing might be broken out for the customer base and assets of each member municipality for transparency and to ensure fairness to ratepayers living in different member municipalities.

In the longer run, however, the utility will do its own work to move to full cost recovery pricing, including asset management contributions, based on costs and needs across its service area. This is likely to require rate increases where full costs were not being recovered before the joint municipal services corporation was set up.

We believe that over time, as grouped systems are better integrated, planning takes place over a larger geographic region, and operations are rationalized, better rate-setting mechanisms will evolve. Areas with higher rates might be able to benefit from relief as the utility matured and member municipalities gained a better understanding of its benefits. Ideally, this would go hand in hand with lower rates overall as the utility achieved increasing economies of scale.

Potential impacts on municipal borrowing limits

Every municipality in Ontario is subject to the provincial Annual Debt Repayment Limit, set out in *Ontario Regulation 403/02*. The limit each year is calculated by subtracting existing debt repayment obligations from 25% of a municipality's own-source revenue. The municipality may increase debt servicing costs without provincial approval as long as the limit is not reached.

In moving to a utility model, a municipality's debt servicing costs related to water and wastewater would be removed from the annual debt repayment limit if the utility met the criteria to be considered a Government Business Enterprise. But its own-source revenues would no longer include user rates. The impacts would vary depending on the municipality's circumstances:

- Where a municipality has relatively high water and wastewater-related debt servicing costs and user rate revenues are relatively low, removing both elements from the calculation tends to increase room for borrowing.
- Conversely, lower water and wastewater-related debt servicing costs and relatively high user rate revenues result in decreased borrowing capacity when both are removed from the calculation.

We concluded from our survey of municipal data that most municipalities in Ontario fall into the latter category. One concern is that some of these municipalities may be unable to borrow to fund asset management needs and are instead allowing assets to deteriorate.

Reserves and debt

Reserves to be transferred into the corporation were collected by specific municipalities and intended to benefit ratepayers within their service areas. While the corporation will build reserves as needed from its own revenues to benefit all of its ratepayers, initially it might be necessary to segregate reserves by municipality and report on benefits to ratepayers within each municipality as they are used. Similarly, arrangements would need to be made for the servicing of any debentures issued by a shareholder municipality that related to water and wastewater.

Funding growth

At present, development charges pay for most growth-related municipal capital projects. This funding source has come under increasing scrutiny as a factor in Ontario's housing crisis. There is criticism that charges for all municipal infrastructure, when passed on from developers to new home buyers, raise the initial sale price of a home by as much as \$100,000 or more. Water and wastewater tends to be one of the largest components of the total.

Development charges are a well-established mechanism for funding growth. Unless empowered by provincial legislation, however, a municipal utility for water and wastewater could not levy these charges directly. A joint municipal services corporation could negotiate with participating municipalities to collect and transfer development charges on its behalf to fund growth-related infrastructure in municipalities where growth is planned or expected.

If development charges are not an acceptable option, LAS and/or the joint municipal services corporation could assess other mechanisms to pay for growth-related infrastructure, such as debt repaid by all customers, or by connection charges, or by some combination of both. There is a large and growing body of research and analysis in this area in the Canadian context, and drawing from it should inform the business case and initial planning for the utility.

Financing costs

As we noted earlier, an important consideration in financing costs is the eligibility of a joint municipal services corporation to borrow from such provincial and federal government programs as Infrastructure Ontario and the Canada Infrastructure Bank. At present, some aspects of these programs may be available only to municipalities and not to municipal services corporations. We suggest that a water and wastewater municipal services corporation should be eligible for the same programs as municipalities would be for their water and wastewater systems.

The role of government grants

Although many water and wastewater systems in Ontario can set rates that are affordable while recovering full system costs, some will never be able to do so — even as a participant in a joint municipal services corporation.

This means that the joint municipal services corporation may well need to access grants, especially for capital projects. The model does not and should not preclude grant funding. Ongoing grants such as the Ontario Community Infrastructure Fund and the Canada Community Building Fund are formula based and should not be negatively impacted by the creation of a water utility.

In fact, it may be more efficient to provide grants to a utility as opposed to its individual municipality shareholders, given economies of scale in preparing grant applications and negotiating with other orders of government. Individual municipalities would still be able to apply for funding for other needs, such as roads, that do not generate user fees.

The ability of a municipal services corporation to have the same access as municipalities to grant and loan programs will become more important as provincial and federal programs shift increasingly toward greater emphasis on the loan component.

Ensuring appropriate rates

As we noted in Section 3, a drawback of a single service provider is that, as the only supplier in its service area, it is not subject to competitive pressures in setting its prices. This is true for the water and wastewater sector whether the service is delivered by the municipality directly or by a utility.

As a result, a major potential drawback is that prices might be set higher than needed to recover costs, allowing it to earn excess profits. This was historically seen as a concern with private-sector corporations. To manage this risk, governments typically regulate utility rates.

Examples of utilities in Ontario that are either federally or provincially regulated include land-line telephones, electricity transmission and distribution, and natural gas pipelines. As that list shows, rate regulation is not limited to private-sector utilities.

In Ontario, water and wastewater services are not subject to economic regulation. With municipal councils exercising direct control over rates in most communities, the concern in the past has been that rates would be set too low, not too high. This is evidenced, for example, by the gap between asset management needs and reserves — because when revenues aren't high enough, those future needs tend to be underfunded.

As we noted above, the goal of regulation is to ensure rates are fair. While this is a valid aim, it also imposes a financial burden on the utility that is passed along in rates, as well as potentially delaying badly needed investments.⁸

This makes regulation problematic for an LAS solution, where participation would be voluntary. If regulation were to be imposed, it would work only if applied to the entire sector. Otherwise, the regulatory burden on municipalities that joined the utility arrangement offered by LAS would put them at a disadvantage compared to those that did not.

We have concluded that while economic regulation is standard practice for most utilities, more work and analysis are required to determine if it would be needed — or even desirable — for the voluntary corporation we envision for Ontario's water and wastewater sector.

The alternative to regulation would be to rely on professional boards, well-thought-out shareholder agreements and a high degree of transparency on the part of the utility. There are any number of ratios that can be constructed to show whether rates are too low or too high. The initial shareholder agreement could require commitment to regular monitoring of these markers and to making the information readily available to residents in a form that is easy to understand. If the Province were

⁸ See, for example, "Credit FAQ: S&P Global Ratings' Evolving View of Ontario's Regulatory Construct," S&P Global Rating; available at <https://www.spglobal.com/ratings/en/research/articles/230607-credit-faq-s-p-global-ratings-evolving-view-of-ontario-s-regulatory-construct-12728137>. Accessed October 29, 2024.

not satisfied that these measures were adequate, it could then determine if a more formal approach to regulation would be better.

Mechanisms that ensure transparency and accountability in rate setting, no matter what form they take, will be important because of the very real possibility that rates will go up, at least in the short run and in some communities, as a result of joining a utility.

Opportunities and risks: A joint municipal services corporation utility

	Opportunity	Risk
Funding	Full-cost pricing; opportunity to assess a range of financing options.	Funding sources will not meet funding needs.
Role of government grants	Fewer individual applicants.	Municipal fear of unfair allocations.
Ensuring appropriate rates	Fairness without the full weight of regulation.	Province may step in and regulate across sector.

6. Feasibility

Roll-up of opportunities and risks to LAS:

Current state

	Opportunity	Risk
Structure and governance	Balance infrastructure and financial pressures beyond political boundaries.	Many small unsustainable systems.
Full-cost pricing	More municipalities are moving ahead.	Unclear how many municipalities are at full cost pricing. Costs (especially asset management needs) may make rates unaffordable.
Debt and reserve management	Many municipalities are building reserves. Those that can't afford debt mostly don't take it on; some who could borrow are reluctant to.	Inadequate saving for asset management.
Policy instability	May foster innovation.	Development charges changes leave a funding gap for growth-related infrastructure. Municipalities may back away from growth due to funding constraints.

Utility structured as a joint municipal services corporation

	Opportunity	Risk
Joint municipal services corporation utility	Possible scale economies, less risk, more shared resources, more objective planning. If MSC met accounting tests, its debt would not be included in shareholder balance sheets.	Several years of disruption and initial costs, large bureaucracy, uncertainty as to actual savings outcomes. Council concerns around loss of control over assets and revenues.
Structure	Align systems with geography.	Complex watershed planning issues.
Governance	Professional, skills-based board.	Municipal concern around less control over where resources are directed.

Continued...

	Opportunity	Risk
Shareholders	Keep assets in public hands.	Lost opportunity for equity investment from other sources.
Funding	Full-cost pricing; opportunity to assess a range of financing options.	Funding sources will not meet funding needs.
Role of government grants	Fewer individual applicants.	Municipal fear of unfair allocations.
Ensuring appropriate rates	Fairness without the full weight of regulation.	Province may step in and regulate across sector.

Financial feasibility of an LAS water and wastewater utility offering

Building on the work to analyze water and wastewater data outlined in Section 2, we worked with LAS staff on two additional scenarios:

- A full-cost pricing scenario assuming a 5% increase in operating costs and revenues
- A growth and full-cost pricing scenario assuming the same 5% increase in operating costs and revenues, plus population growth in line with regional rates calculated by Statistics Canada

In these scenarios, modelling excluded the potential costs of transition to a larger utility entity and assumed no subsidization from property taxation.

As we noted earlier, available data suggests many smaller systems are not financially sustainable and rely on grants. Even with grants, it's doubtful that they are spending enough on asset management to maintain their current asset base.

When we looked at costs related to climate impacts and other elements of our definition of full cost pricing, the fiscal gap grew. This was the case even with an increase in rates. Adding in assumptions about the costs of population growth further increased the fiscal gap.

We concluded that the feasibility of an LAS-sponsored joint municipal services corporation will depend on the mix of participating municipalities, the unique fiscal situation of each and the state of repair of their assets. Overall, however, the modeling strongly suggested that combining a group of smaller municipalities with a collective funding gap will not eliminate that gap.

Other considerations in feasibility

In addition to the financial sustainability dimension, there are a number of other high-level considerations to weigh in determining if a water and wastewater utility structured as a joint municipal services corporation is an appropriate LAS offering:

- Willingness of municipalities to deliver water and wastewater through a corporation owned by multiple municipalities
- The need for regulatory and legislative changes at the provincial level to deal with such issues as existing debt issued for water and wastewater systems and the potential transfer of asset management reserves and segregated development charge funds
- The time and resources needed to set up a joint municipal services corporation and the transition costs for its shareholders

At a more granular level, as LAS moves forward there are any number of practical considerations:

- Ultimate accountability and duty of care
- Transfer of existing municipal staff to the new corporation
- Collective agreements
- Ensuring the servicing of public market debt taken on for water and wastewater assets
- International agreements on the Great Lakes and their watersheds

Our conclusion: Key impacts of a utility model

What a utility model could achieve for many Ontario municipalities, especially smaller and more remote ones:

- More reliable operations and better response to emergencies
- More efficient regulatory compliance
- More rational planning, including across watersheds, and better-informed capital investment decisions
- Rate setting that identifies full costs and any gap between those and expected revenues
- Lower costs for some inputs through better procurement and sharing of internal resources
- Measured assessment of innovative approaches and ability to scale solutions up/down

What the model cannot do:

- Can't make a group of financially unsustainable systems collectively sustainable
- Can't by itself address affordability of rates (at least initially)
- Can't guarantee lower user rates (at least initially)
- Can't collect development charges unless empowered by the Province
- Can't require municipalities to join



7. Next steps

With approval from the LAS Board to further assess a utility model, LAS will develop a business case to consider in more detail:

- Determining the best structure to serve Ontario’s geography (whether through a single entity with regional branches/networks, or a holding company with separate corporations for each region)
- Carrying out further modelling on financial resources and needs
- Developing shareholder direction and arrangements, including provision for other public entity and First Nation participation
- Creating mechanisms to achieve fair and transparent rates without costly and time-consuming economic regulation
- Enabling the utility to take on shareholder obligations around debt
- Structuring the transfer of existing municipal reserves for water and wastewater
- Providing the utility with the ability to access development charges or similar mechanisms to fund growth
- Ensuring the utility is eligible for grants and loan programs offered by the provincial and federal governments

As LAS works through these points, the insights and experience of Ontario municipalities are essential. That is why a key next step for LAS is reaching out to municipalities across Ontario to involve them in shaping a utility model that truly helps to address their concerns.

As we have noted, a utility model cannot solve every problem in the water and wastewater sector on its own. We believe, however, that bringing systems together in a utility will help to make them more sustainable and more appropriately funded, and can better integrate services and operations across larger areas. Above all, a utility model can reduce operational and financial risks.

These are key considerations as costs and risks continue to mount in the water and wastewater sector and municipalities face many other competing demands for their limited resources. As LAS reaches out for partners to help structure such a utility, we urge municipalities and other potential participants to carefully consider how the model can help them, and to join with LAS in shaping a municipally led solution.

Appendix I: Panel members

Benjamin Dachis is Vice President of Research and Outreach at Clean Prosperity, a Canadian climate policy organization. An economist by training, he has contributed to public policy research, practice, and leadership across a broad range of Canadian policy sectors for nearly two decades. Before joining Clean Prosperity he was Associate Vice President, Public Affairs at the C.D. Howe Institute. As adviser to the Premier of Ontario in 2018-19, he helped to develop the Housing Supply Action Plan.

Heather Douglas is a partner at WeirFoulds LLP with extensive experience dealing with complex and sophisticated financial transactions involving municipalities in Ontario and other provinces, as well as provincial and territorial government bodies, and Crown corporations. She has been the legal advisor to the ONE Joint Investment Board since its inception.

Craig Dyer, who chaired the panel, brings 36 years of experience in the municipal finance sector to his current position as a member of the ONE Joint Investment Board. A Chartered Professional Accountant, he previously served for 12 years as Commissioner of Corporate Services and Chief Financial Officer for the Region of Waterloo, and before that was the Treasurer at Wellington County, and held finance positions at the City of Guelph and Halton Region. He has a particular interest in long-term municipal financial sustainability.

Bill Hughes is a Senior Fellow at the Institute on Municipal Finance and Governance at the University of Toronto and member of the ONE Joint Investment Board. He was previously Commissioner of Finance and Treasurer for the Regional Municipality of York and before that held senior positions in the Ontario government, including at the Ministry of Finance and the Ministry of Infrastructure. He worked closely with the expert panel that presented *Watertight: The case for change in Ontario's water and wastewater sector* to the Minister of Public Infrastructure Renewal in 2005.

Catharine Lyons-King is a writer and editor with expertise in drafting documents for non-technical readers on such topics as water and wastewater, asset management planning and public-sector finance. Her clients have ranged from global organizations to small Ontario municipalities.

An engineer by trade, **Ron Tripp** attended the University of Waterloo's Civil Engineering program. He has held a variety of increasingly senior positions throughout the region over the course of his career. Ron was the acting Chief Administrative Officer for the Town of Fort Erie, the Commissioner of Operations and Director of Transportation and Environmental Services for the City of St. Catharines, the Commissioner of Public Works for Niagara Region and most recently took on his current role as Chief Administrative Officer for Niagara Region. Under his leadership, Niagara Region is moving forward on numerous significant projects and initiatives aimed at improving infrastructure, the financial management of assets and preparing the region for future opportunities.

Appendix II: Mandate

The expert panel was asked to consider the following key questions:

- What is the current state of water and wastewater assets in Ontario?
- What are the financial challenges facing water and wastewater services?
- What are the pros and cons of a utility model?
- How would a water and wastewater utility system be structured?
- What legislative, regulatory and governance measures would be needed for LAS to offer a water and wastewater utility model to municipalities?
- Would an economic regulator be needed?
- How would utility funding and financing work?
- What would the key impacts of a utility model be?
- What practical considerations would be involved in implementing a utility model?
- Is the LAS water and wastewater utility offering financially feasible?

Appendix III: Discussions with sector participants

During its deliberations the panel met with representatives of the following organizations:

- Lake Huron & Elgin Area Primary Water Supply Systems
- Ontario Clean Water Agency
- Ontario Water Works Association
- Regional Municipality of York

We also drew on the insights and knowledge of the boards of the Rural Ontario Municipal Association, Federation of Northern Ontario Municipalities and Northern Ontario Municipal Association; Jim Pine, retired CAO of Hastings County and member of the Watertight expert panel; and Kelly Pender, retired CAO of Frontenac County and member of the technical advisory committee to the Frontenac County Municipal Services Corporation. In addition, the Eastern Ontario Wardens' Caucus provided a written submission.

The expert panel hosted an open house on Sunday, August 18, 2024, before the official start of the AMO Conference in Ottawa. Participants included 40 municipalities, as well as representatives of the Canadian Union of Public Employees, the Peel Region Transition Board, and Six Nations of the Grand River.

The municipalities that took part were:

- Cities of Cambridge, Kawartha Lakes, London, Markham, Pembroke, St. Catharines, Temiskaming Shores, Thunder Bay, Windsor and Welland
- Counties of Frontenac, Lambton, Prince Edward and Simcoe
- Region of Niagara
- Municipalities of Bayham, Brockton, Grey Highlands, Lambton Shores and Mississippi Mills
- Towns of Cobourg, Goderich, Ingersoll, Innisfil and Saugeen Shores
- Townships of Adelaide Metcalfe, Asphodel-Norwood, Black River-Matheson, Bonnechere Valley, Centre Wellington, Frontenac Islands, Greater Madawaska, Hornepayne, Leeds and the Thousand Islands, McNab/Braeside, Melancthon, North Dundas, Ramara, Severn, Tiny, and Whitewater Region

Appendix IV: Comparison of two potential structures

Pros	Joint municipal services corporation (JMSC)	Joint municipal service board (JMSB)
Establishment process	Can be created through section 203 of the <i>Municipal Act</i> .	Can be created through section 195 of the <i>Municipal Act</i> .
	Province may use regulation to streamline process (e.g., no business case requirement).	There is no legislative or regulatory requirement for a business case, it is best practice.
Corporate governance model	Recognized business model.	Widely used in the municipal sector for a variety of purposes.
	Flexible and expansive borrowing capabilities.	Could rely on a member municipality to borrow using the municipality's credit rating.
	Efficient corporate governance processes.	Efficient governance process is possible.
	Skills-based boards.	Skills-based JMSBs can be established.
	Nimble procedural processes.	Nimble procedural processes.
	Municipal shareholders can appoint directors.	Member municipalities would initially appoint board members and could then delegate the future appointment of board members to the JMSB.
	Municipal shareholders can ensure basic protection through shareholder direction.	The JMSB is a local board subject to the <i>Municipal Act</i> including the requirement for open meetings.
	Can emphasize transparency.	Open meetings are required.
	Boards of MSCs can be populated with industry experts and other required experts.	Boards of JMSBs can include industry experts and other required experts.

Continued...

Pros	Joint municipal services corporation (JMSC)	Joint municipal service board (JMSB)
Jointly owned entity	Economies of scale, efficiencies and economic power.	Economies of scale, efficiencies and economic power are possible.
	Properly drafted founding documents can mitigate cons/concerns.	Founding documents can mitigate cons/concerns.
Potential regulatory rate setting model	Setting rates by independent JMSC reduces political pressure on municipalities.	Setting rates by the JMSB could also reduce political pressure on municipalities.
Corporate borrowing powers	Financial assistance available from member municipalities.	Member municipalities provide financing under the <i>Municipal Act</i> .
	Can issue long-term debt in its own name and is not subject to financing restrictions contained in the <i>Municipal Act</i> .	Cannot issue long-term debt. Would need a member municipality willing to issue long-term debt on behalf of the JMSB.
	If MSC is properly structured, debt would not be included in the member municipalities' consolidated financial statements.	Debt would be included in the member municipalities' consolidated financial statements.
	If MSC is properly structured, member municipalities' annual repayment limits (ARLs) would not be adversely affected.	Member municipalities' ARLs would be impacted by debt issued by a member municipality on behalf of the JMSB.
Establishment process	Complex issues, costly and time-consuming process.	A complex issue that would require time and resources to establish.
	High degree of public and stakeholder engagement mandated.	High degree of public and stakeholder engagement possible but voluntary.
	Subject to compliance with several statutory and regulatory requirements.	Also subject to compliance with statutory and regulatory requirements.

Continued...

Pros	Joint municipal services corporation (JMSC)	Joint municipal service board (JMSB)
Corporate governance model	Directors have a fiduciary duty to the JMSC.	Directors have a fiduciary duty to the JMSB.
	Potential conflicts between interest of the JMSC and member municipalities.	Potential conflicts between interest of the JMSB and member municipalities.
	Progressively increasing difference between public policy focus of the member municipalities and the business orientation of the JMSC.	Public policy objectives would remain the focus.
	Potential jurisdictional battles and duplication between the member municipalities and the JMSC.	Less likelihood of jurisdictional conflicts and duplication.
	Progressive limitation and reduction of the member municipalities' control of the JMSC.	The JMSB is a local board of each member municipality and there is little likelihood of limitation or reduction of municipal control, although disputes could arise among the member municipalities.
	Debt borrowing in the capital markets is subject to securities legislation and higher financing costs.	Member municipalities are exempt from securities legislation and participation in a JMSB should not affect the cost of financing of member municipalities.
	Potential private sector involvement through purchase of shares in the future if there is a regulatory change.	No private ownership is possible as the assets remain in municipal hands.
	Federal insolvency legislation would apply in the event of an insolvency.	In the event of an insolvency, special provincial legislation would apply.

Continued...

Pros	Joint municipal services corporation (JMSC)	Joint municipal service board (JMSB)
Jointly owned entity	How to balance competing interests/objectives of member municipalities.	How to balance competing interests is also a challenge for a JMSB.
	Valuation principles — how are respective proportionate interests in JMSC’s assets fairly apportioned.	Member municipalities would retain ownership of assets, but there could be similar valuation issues in respect of each member municipalities’ assets.
	Each new member municipality dilutes the shareholding interests of existing member municipalities.	How to balance the interests of existing member municipalities would also be an issue for a JMSB. There are no shareholdings in a JMSB but the control and influence of existing member municipalities could be diluted.
	How to protect minority shareholders from majority shareholders.	Also potentially an issue for a JMSB. There are no shareholdings in a JMSB but a similar issue can arise in respect of the power of member municipalities to control or influence decisions of the JMSB.

Cons	Joint municipal services corporation (JMSC)	Joint municipal service board (JMSB)
	Splintering of share ownership increases the power of the JMSC and its board and can dilute the power of the member municipalities.	There are no shareholdings in a JMSB but a similar issue can arise in respect of the power of member municipalities to control or influence decisions of the JMSB.

Continued...

Cons	Joint municipal services corporation (JMSC)	Joint municipal service board (JMSB)
Potential regulatory rate setting model	How can a change in revenues from providing water and wastewater services be fair and appropriate and not worsen the financial situation of member municipalities.	Also potentially an issue for a JMSB.
	Public policy objectives of a third-party regulator and municipalities may be different.	Also potentially an issue for a JMSB.
	Councillors are still seen by the public as responsible for rates and service levels.	Also potentially an issue for a JMSB.
Corporate borrowing powers	Transfer of water and wastewater assets of member municipalities to the JMSC could have an adverse impact on municipal credit ratings.	No transfer of assets occurs. Member municipalities retain their assets and there should be no adverse impact on municipal credit ratings.
	Cost of borrowing likely higher than that of member municipalities.	Member municipalities can borrow through the member municipality that has the highest credit rating/ lowest cost of borrowing but the cost of borrowing could be adversely affected by the inclusion of member municipalities with no credit ratings and/or high borrowing costs.
	Not maintaining Government Business Enterprise status would jeopardize pros.	Not applicable, as the JMSB is a local board of each member municipality.

Appendix V: Examples of MSCs and joint water boards in Ontario

Water-related municipal services corporations

Union Water Supply System Inc.

In 2023, the Union Water Supply System Inc. (UWSS Inc.) was created as a municipal services corporation to replace a previous joint board of management. It supplies water to almost 70,000 residents in the Municipality of Leamington, Town of Kingsville, Town of Essex, and Municipality of Lakeshore, which are the corporation's four shareholders.

UWSS Inc. operates at arm's length from its shareholders. It is governed by a board of twelve directors, a maximum of six of whom may be elected officials. The rest of the directors have skills-based backgrounds in such areas as law, engineering, and business.

The corporation's government business entity status allows it to access credit markets directly. The ability to borrow on its own was important to the corporation's creation because its capital program for 2023–2032 is in the range of \$150 million and includes such major projects as a new reservoir and water treatment plant.

InnServices

In 2015, Innisfil Town Council approved a business case for setting up a municipal services corporation called InnServices as a water and wastewater utility. The purpose was to help enable strategic infrastructure investments, including expansion into Innisfil Heights, an employment area of about 650 hectares (or 1,600 acres).

The town is the sole shareholder and the corporation's five-member board includes the Mayor and Chief Administrative Officer, with the latter serving as chair. The town provides some corporate functions as set out in a shared-services agreement.

With roughly 60 employees, InnServices provides services to more than 12,000 customers in Innisfil and to a neighbouring municipality. It manages infrastructure and operates under a user-pay model, with rates set by council. Its current debt levels are low, and development charges collected by the municipality are still a significant revenue source for funding growth projects.

Frontenac County Municipal Services Corporation

The Frontenac Municipal Services Corporation business case was approved in 2021 and the corporation legally created in 2023. The county's four townships — Central Frontenac, Frontenac Islands, North Frontenac, and South Frontenac — are Class A voting shareholders, while the county holds Class B non-voting shares.

Many of Frontenac's communities are rural and remote, and a major aspect of the corporation's mandate is to facilitate the building and operation of decentralized communal water and wastewater systems. Another goal is to bring together and achieve economies of scale among existing municipal systems, most of which are very small.

The board is made up of one member from each township, and is supported by a skills-based technical committee that advises on standards and implementation.

The county is assuming 20% of the initial \$700,000 funding for the corporation's first five years, with the balance shared among the remaining members based on weighted assessment. Operations are expected to start in 2025, and work is underway on a full cost recovery model.

Township of Oro-Medonte

After council endorsement in 2018, two corporations were set up in Oro-Medonte in January 2020 to act respectively as a holding company (Oro-Medonte Holdings Corp.) and a utility (Oro-Medonte Utilities Corp). The corporations are intended to carry out the work of the former Environmental Services department, including responsibility for municipal water systems, communal tile beds, urban stormwater management ponds and future infrastructure needs. In 2023, township council approved a by-law transferring assets to the corporation.

The model is intended to respond to greater demand for services and resulting higher debt servicing needs, as well as to deliver a broader scope of services. Another goal is greater emphasis on rate setting to ensure fairness and sustainability and to avoid subsidization of services by residents who do not receive them.

Each board is made up of a combination of skills-based independent directors and township staff. There is also a municipal representative (either a current or former member of council) on the board of the utility.

The Chief Administrative Officer is the chief executive officer of both corporations and the Director of Environmental Services serves as chief operating officer of the utility. As the corporations have no staff themselves, township staff provide operational, technical and administrative support on a cost-recovery basis.

Joint boards for water supply

Lake Huron and Elgin area water supply systems

Two separate systems, the Lake Huron Primary Water Supply System and the Elgin Area Primary Water Supply System, together supply treated drinking water to fifteen municipalities (eight each, with the City of London supplied from both), serving an area of roughly 5,000 square kilometres in southwestern Ontario with a total estimated population of more than 550,000.

The systems draw water from Lake Huron and Lake Erie respectively, treat it, and deliver it on a wholesale basis to member municipalities that in turn distribute it to customers. Wholesale rates charged to the benefiting municipalities are set by the respective board, and retail rates by each member municipality.

Because both systems provide drinking water to the City of London, the largest single customer, the Boards have chosen to coordinate activities through a common administration and their governance is similar. Each is governed by a board of management that in many respects resembles the joint municipal services model set out in the Municipal Act. The boards, however, were established under different provincial legislation.

Member municipalities have an undivided interest in the respective system as tenants in common. The boards do not have access to development charges to fund growth-related projects. The board of management of each system determines debt needs through its Financial Plan updated every five years. The issuance of a debenture is approved by the respective Board. As is the case with a joint

board, neither system can borrow on its own, instead relying on the borrowing capacity of the City of London. Debt is then apportioned to the individual municipal members on an annual basis, which reduces the municipalities' capacity to borrow for other purposes.

It is not a requirement that board members appointed by the benefiting municipalities be elected officials of the municipalities, but in practice most are.

Lambton Area Water Supply System

This joint system, which draws water from Lake St. Clair, serves six municipalities in Lambton County. Total population served is roughly 100,000. It is governed by a joint board of management which consists of one political representative from each owner community, with the City of Sarnia representative having five votes, the Township of St. Clair representative two votes, and remaining representatives one vote each. Assets are owned as tenants in common by the member municipalities with ownership interests based on the share of water supplied to each municipality. The system had no outstanding debt at 2023 year-end.

Appendix VI: Lessons from Ontario’s electrical sector

In the late 1990s the Province undertook a sweeping restructuring of the electricity sector. Among other changes, local electrical distribution, which at the time was delivered through municipal public utility commissions, was moved into wholly owned municipal local distribution companies (LDCs). They are governed by the *Ontario Business Corporations Act* and regulated by the Ontario Energy Board, which sets performance standards and ensures transparency in rate setting.

The move to a corporate structure and the continuing evolution of the sector provide guidance in assessing solutions for the municipal water and wastewater sector.

Ownership and consolidation

LDCs remain almost entirely in public hands, largely through municipal ownership. What has changed — and dramatically — is the number of distributors, which fell from over 300 before restructuring to fewer than 55 by 2024 as a result of consolidations and mergers. The Province’s Hydro One initially bought up many distributors, but several small LDCs in rural and remote areas chose to merge instead. These LDCs tend to be regional with no single municipality dominating, and have been able to continue operating despite their relatively small size.⁹

Subsequent consolidations have brought together municipally owned LDCs serving mid-sized and even large markets, in some cases building on earlier consolidations. Examples include:¹⁰

- Alectra, made up of 17 former LDCs including those serving Mississauga, Brampton, Markham, Barrie, Richmond Hill, Vaughan, Guelph and St. Catharines. With over one million customers, it is the largest LDC in Ontario after Hydro One by customer count.
- Elexicon, which also consolidated 17 former LDCs, serves about 170,000 customers in Oshawa, Pickering, Ajax, Whitby, Belleville and Gravenhurst.

In addition, there is some LDC ownership apart from Ontario municipalities and Hydro One. Fortis, a publicly traded Canadian company, owns LDCs in five municipalities/areas. EPCOR, owned by the City of Edmonton, is the distributor for Collingwood and area. Through its previous stake in the Mississauga LDC, OMERS now owns a small share of Alectra.

Economies of scale

In response to the 2013 recommendation of a provincial panel that the province enforce further amalgamation of LDCs, a C.D. Howe Institute report noted that¹¹ “just as forced consolidations of municipalities have led to few clear savings, so too it is unclear that forced amalgamation of local electricity distributors would lower costs in the sector.” (The province did not act on the recommendation, instead promoting consolidation through tax breaks and other incentives.)

⁹ <https://www.notlhydro.com/ontario-electricity-distributors-consolidation/>

¹⁰ Ibid (also the paragraph after the bullets)

¹¹ https://www.cdhowe.org/wp-content/uploads/2024/12/Commentary_376_0-2.pdf

Further C.D. Howe work in 2021 concluded that, in the LDC sector, economies of scale through amalgamation accrue only to the smallest of LDCs, and there appears to be no significant benefit once the customer base reaches a few hundred thousand.¹²

Governance

The boards of municipally owned LDCs are appointed by the shareholder municipalities, and municipalities can appoint elected officials, independent directors, or both. An aim of moving LDCs into a corporate structure was to improve efficiency and decision-making by reducing political interference.

Three publications from the Ivey Business School at Western University analyze aspects of the current governance arrangements in the electrical distribution sector.

Board composition

A 2018 paper found that on average, elected officials made up about one-quarter of LDC boards.¹³ A 2020 paper by Ivey based on a survey of directors compared the behaviour of elected versus independent directors, forming two major conclusions:

- Elected official directors, after controlling for prior executive experience and professional qualifications, appear to be more risk-tolerant on average — for example, being more willing to diversify into unregulated business activities and/or acquire equity stakes in other LDCs. The paper posited that reasons might include “optimism bias” and/or a lack of previous business experience.
- Conversely, however, elected officials tended to favour higher dividend payments to the municipality over increased investment in the corporation, restricting potential for its growth. (A later study discussed below looked in more detail at this tendency.)

The paper noted that for small boards — for example, those with fewer than 10 directors — the overall mix of skills and experience can shift substantially with a minor change in board composition. It suggested, however, that “In mature industries where there is little or gradual change in competitive forces, ... the mix of political and independent directors may have less consequence for the performance of government-owned enterprises.”

Dividend payouts

Annual dividend payments from LDCs are an important source of revenue for some municipal shareholders. A 2022 Ivey analysis looked at dividend payout rates among municipally owned LDCs across a range of sizes and under differing board compositions.

It found that, all else being equal, LDCs with a smaller share of elected official directors tended to have a lower dividend rate. While this appears to be somewhat at odds with the 2020 conclusion, more detailed analysis showed that payout rates are higher in LDCs where the boards are larger and are dominated by elected officials. This is aligned with a further finding that the larger the service area, the higher the dividend payout.

¹² <https://www.cdhowe.org/publication/power-surge-causes-and-solutions-ontarios-electricity-price-rise-2006/>

¹³ Fremeth, A.R., Holburn, G.L.F., 2018. Improving Governance and Strategy in Ontario's LDC Sector. Retrieved from <https://www.ivey.uwo.ca/media/3780209/january-2018-improving-governance-and-strategy.pdf>.

Transparency

The third Ivey publication, in 2024, gave municipally owned LDCs an average grade of B- for transparency on corporate governance. It found that while most LDCs provide basic corporate information, few provide comprehensive information on their board, corporate governance practices and policies, or financial performance.

Again, the size of the LDC is a major factor in transparency. For example, the only LDC to achieve a perfect score on Ivey's corporate governance transparency index was Toronto Hydro.

- Twelve LDCs received an A grade, demonstrating an exceptionally high level of disclosure. Most LDCs in this group serve more than 50,000 customers.
- Eighteen LDCs received a B grade, seventeen a C, and seven (most of which serve fewer than 6,000 customers) a D grade.

Despite the strong correlation between the size of an LDC and the level of transparency, some small LDCs — such as Lakefront Utilities and Niagara-on-the-Lake Hydro — earned high scores, with the paper noting this as evidence that small corporations can implement best practice disclosure.

Appendix VII: Regional comparisons

Away from Ontario's major centres, many municipalities have no water or wastewater systems, population is growing slowly if at all, and the use of development charges to help pay for infrastructure is less common. Where water systems are in place, the average number of connections by municipality is small. This table highlights regional differences:

	Golden Horseshoe	Southwest Ontario	North-central Ontario*	Eastern Ontario	Northeast Ontario	Northwest Ontario
% of communities with population decline/no growth, 2016–2021	5%	10%	0%	9%	46%	56%
% of communities with no municipal drinking water systems	3%	3%	8%	28%	43%	35%
Avg # of water connections by municipality (est)	129,316	13,961	5,224	6,173	1,990	2,053
% of municipalities with fewer than 500 connections (est)	3%	21%	28%	49%	79%	59%
% of municipalities with fewer than 5,000 connections (est)	13%	63%	65%	87%	95%	94%
% of municipalities that collect development charges	100%	66%	85%	58%	4%	0%

*Comprising Barrie and Orillia, the counties of Dufferin, Haliburton and Simcoe, and District Municipality of Muskoka

Data sources: Statistics Canada, Census of Population, 2021 and 2016; Ministry of Municipal Affairs and Housing's Financial Information Return (FIR), 2022; connections data from various conservation authorities, asset management plans, municipal websites, drinking water system operational plans.

In the densely populated **Golden Horseshoe**, which wraps around the western end of Lake Ontario, water and wastewater systems are almost all large, sophisticated and well funded. Moving westward, **Southwestern Ontario** includes both rich farmland and some of Ontario's largest cities. Its southwestern half is home to all the province's joint water supply systems. Further north, however, its geography is more challenging. **North-central Ontario**, comprising the major city of Barrie and what's often called "cottage country," is fast-growing and increasingly urbanized. **Eastern Ontario** shares much of the same rugged terrain as Northern Ontario and a similar history of resource extraction. Communities near its larger cities of Ottawa and Kingston or close to central Ontario tend to see the greatest growth. Those that are more rural and remote often struggle to maintain population.

As a whole, **Northern Ontario** accounts for more than three-quarters of Ontario's land mass but only about 5% of its population. **Northeastern Ontario** extends northward from a point just west of Wawa on Lake Superior. Communities are generally clustered along provincial highways 60 and 17. Apart from its four cities of Sudbury, Sault Ste. Marie, Timmins and North Bay, communities are small and almost half are in decline. Similarly, almost all communities in **Northwestern Ontario**, which extends from Northeastern Ontario to the Manitoba border, are located along or near major east-west highways. It includes only one city of more than 10,000 residents, Thunder Bay. Population decline is widespread.



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