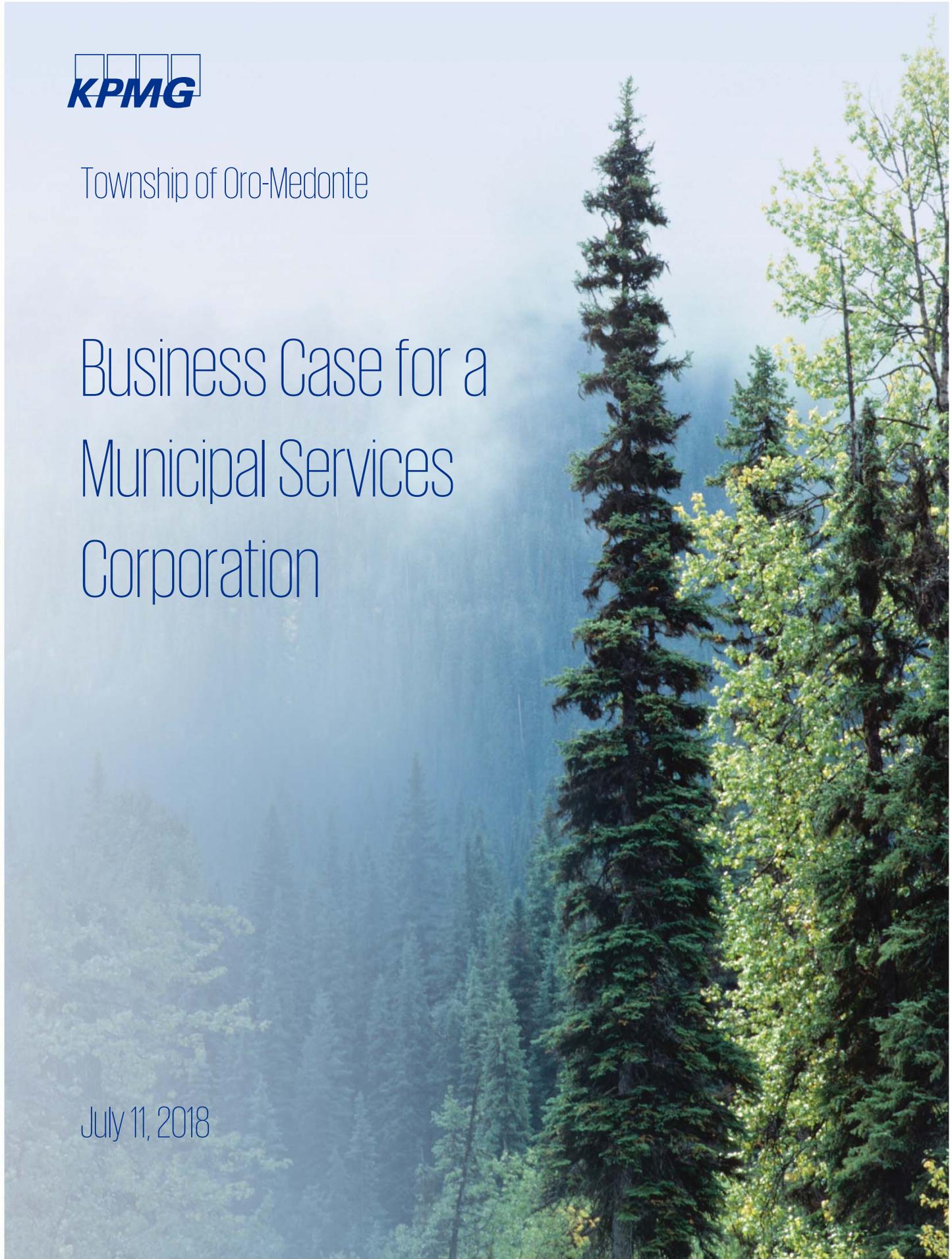




Township of Oro-Medonte

Business Case for a Municipal Services Corporation

July 11, 2018



Executive Summary

The Township of Oro-Medonte (the “**Township**”) is proposing the development of a municipal services corporation (“**MSC**”) for the delivery of the following municipal services: potable water, communal tile beds, urban stormwater management, streetlighting and wastewater (collectively, the “**environmental services**”). This document presents the business case study for the MSC and identifies the framework for its establishment and ongoing governance and operation.

Overview of the Current State

The Township is a lower-tier municipality located in Simcoe County that provides a range of services to more than 21,000 full-time and seasonal residents. During the 2018 fiscal year, the Township budgeted a total of \$7.1 million in operating and capital expenditures for those environmental services directly delivered by the Township, specifically, potable water, communal tile beds, urban stormwater management and streetlighting. In addition to these services, the Township administers approximately \$1.5 million in annual billings for water and wastewater services, which are delivered by a third party.

Included within the scope of services provided by the Township are the following:

- The treatment and distribution of potable water, within 14 water systems¹ providing service to approximately 2,500 households at an annual cost of \$2.2 million (operating and capital/infrastructure renewal charges);
- The maintenance of seven communal tile beds that provide septic systems to 94 properties;
- The maintenance of urban stormwater management infrastructure in selected residential neighbourhoods (i.e. urban storm ponds);
- The maintenance of the Township’s streetlighting network; and
- The collection and treatment of wastewater services to approximately 731 households through a Ministry of the Environment Municipal Responsibility and Capital Facility Transfer Agreement with Skyline Utility Services (“**Skyline**”), a private sector provider, of which approximately 400 households also receive water services from the Township.

The scope and scale of the Township’s environmental services and supporting infrastructure has changed over time in response to aging, changing and growing servicing needs. In addition, while wastewater services are being delivered by a private sector organization to certain households, at the request of a local homeowner’s association the Township has become involved in the oversight and billing administration of such services.

¹ There are currently 11 municipal water systems in operation plus private systems providing water service to Braestone (to be assumed by the Municipality) , Lake Simcoe Regional Airport and Big Cedar Estates

Overview of the Anticipated Future State

With the expectation of continued growth and development and aging infrastructure, it is anticipated that the Township will see demand for environment services, including the construction of new infrastructure, the assumption of infrastructure and services from private owners and the expansion of services through the use of existing infrastructure. Specifically, future investments anticipated include:

- The future acquisition of private water systems such as Horseshoe Valley Zone 1 and Braestone;
- Increased maintenance demands of communal tile beds and future wastewater systems in Craighurst, Edgar Centre and Horseshoe Valley;
- Expanded maintenance of the Township's urban stormwater management infrastructure as a result of implementation of the new stormwater master plan.

Currently, there is considerable interest from residents receiving water and wastewater services from Skyline for the delivery of these services to be provided by a 'Township owned and operated' system. We understand these residents believe this form of delivery model would be more cost-effective and provide enhanced monitoring.

Where infrastructure investments are made, the Township will pursue a combination of senior government grants and debt to fund these investments, with debt servicing costs recovered through user fees.

While the cost of new infrastructure investments is contingent upon future development levels, the strategy adopted for delivering the environmental services and the state of the infrastructure currently supporting same (capacity and condition), is expected to exceed \$15 million over the next 10 years.

In addition to the Township's own activities relating to the provision of the environmental services, it is also involved in discussions with the County of Simcoe with respect to possible shared service arrangements which may result in the Township participating in county-wide delivery of environmental services to reduce costs.

Overall, it is expected that in the next few years the Township will be faced with a future state for environmental services that:

- Is characterized by increased infrastructure demands and associated debt servicing requirements;
- Involves a broader scope of services and operations; and
- Requires a greater emphasis on rate setting so as to ensure fairness, sustainability and the avoidance of subsidization of environmental services by residents that do not receive them.

The Concept

In light of the expected impending changes to environmental services, the Township is investigating alternative governance and ownership structures, specifically the establishment of a municipal services corporation for environmental services (specifically water, communal tile beds, urban stormwater management, streetlighting, and future wastewater services) through the use of MSCs. Permitted under Ontario Regulation 599/06, the establishment of MSCs requires a municipality to:

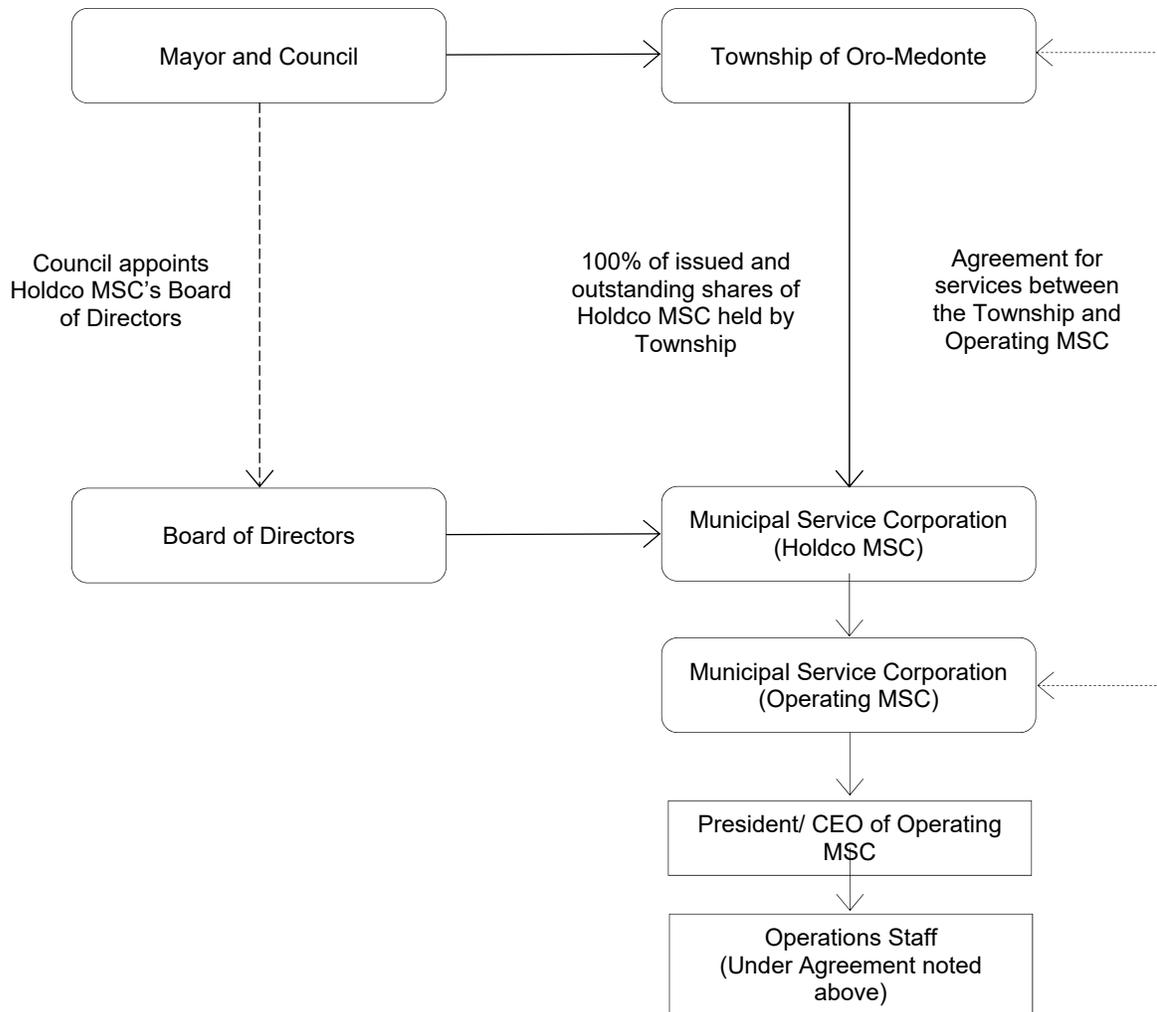
- Develop a business case study for the proposed MSC;
- Consult with the community about the plan to create the proposed MSC;
- Adopt and maintain policies with respect to the transfer of assets.

As outlined in more detail in the following sections of this business case study, the contemplated structure for the Township's utilization of a MSC in the delivery of the environmental services involves the establishment of two MSCs:

- One MSC to act as a holding company ("**Holdco MSC**") to hold the Township's equity ownership interest in the Operating MSC (as hereinafter defined). The issued and outstanding shares of Holdco MSC would be owned by the Township. The establishment of Holdco MSC is intended to facilitate (i) potential initiatives involving other municipalities; and/or (ii) the creation and organization of additional MSCs in the future.
- Another MSC to act as an operating company (the "**Operating MSC**") for delivery of the environmental services. The issued and outstanding shares of Operating MSC would be owned by Holdco MSC.

Governance of Holdco MSC would rest with an appointed skills-based Board of Directors and while consideration could be given to appointing elected officials of the Township to the Board of Directors of Holdco MSC, such elected officials would not represent a majority of the directors. Governance of the Operating MSC would rest with an appointed skills-based Board of Directors, appointed by Holdco MSC, and day-to-day operations of the Operating MSC would be the responsibility of a President/CEO ("**CEO**"), who would be responsible for the management of the Operating MSC. In addition to internal resources owned and operated by the Operating MSC, the Operating MSC would contract for administrative, engineering and other supporting services from the Township.

A graphical depiction of the proposed MSC structure is as follows.



While conditional upon the wishes of the Township, we suggest that the following be considered with respect to the governance of the MSCs:

- The use of a common board membership for both MSCs, whereby directors of the Holdco MSC would also serve as the directors of the Operating MSC;
- The establishment of a skills-based board, with the Township identifying the requisite knowledge base for board members (e.g. engineering, legal, finance)
- Board of Directors would be composed of five or seven directors, two of which should be selected from Township Council; and
- Five year staggered terms, with no limitation on reappointments.

In addition to the above, the Township may wish to consider appointing the Chief Administrative Officer and/or Chief Financial Officer as ex-officio members of the Board so as to provide additional linkages between the MSCs and the Township.

The Case for Support

The establishment of a separate organizational structure for environmental services in the form of a MSC is intended to provide a range of benefits to the Township and its residents:

- *Skills-based governance that extends beyond the term of Council* – Governance of the Operating MSC would rest with a Board of Directors appointed by the Holdco MSC. The Township can enter into long term agreement(s) with the Holdco MSC and the Operating MSC to ensure that the Board of Directors of the Operating MSC has skill-based expertise, e.g., legal, engineering, finance, etc. In addition to a dedicated focus on environmental services governance/decision-making, the use of a MSC in the provision of the environmental services allows for a longer-term vision for such services, including the adoption of sustainable user fee and other revenue models.

The Township would exercise control over the Operating MSC, through contractual agreements in favour of the Township, including a shareholder agreement for the Operating MSC among the Township, Holdco MSC and the Operating MSC, which would include protective provisions requiring the prior written consent of the Township for any material change in the business, operations, organization or structure of both Holdco MSC and the Operating MSC.

- *Increased debt financing capability for the Township* – Under Ontario Regulation 403/02, Ontario municipalities are limited in the amount of long-term debt that a municipality can incur based on a formula that caps debt servicing payments at 25% of net revenue. For the 2017 fiscal year, the Township's debt servicing costs amounted to approximately 7% of net revenue, or approximately one-third of its allowable level. With the expectation of increased capital investments for environmental services infrastructure, which may exceed \$15 million over the next 10 years, it is possible that the Township's debt servicing costs will increase, which may (i) approach the upper limit of debt servicing costs allowed under Ontario Regulation 403/02; and/or (ii) impact borrowing costs due to the overall credit position of the Township. Through the use of a MSC, it may be possible for the Township (contingent on the terms of the borrowing agreement and other considerations) to separate debt relating to water and wastewater operations, thereby structuring the debt as non-municipal.
- *Potential for shared service arrangements* – The proposed MSC structure can facilitate the establishment of shared service arrangements with other municipalities by providing a corporate structure for joint ownership of municipal assets and operations. In the case of water services for example, a MSC could allow for the sharing of management personnel as well as enhanced efficiencies through the use of remote monitoring of supervisory control and data acquisition (SCADA) systems. The proposed MSC structure could also facilitate the Township's involvement in Simcoe County initiated shared service activities.
- *Avoidance of subsidization of water and wastewater services* – At the present time, approximately 27% of households within the Township receive municipal water services, with approximately only 7% of households receiving wastewater services through the Township (i.e., through communal tile beds and the Township's management services agreement with a private sector provider). While the Township has adopted a strategy of full cost recovery for water and wastewater services and streetlighting, the potential does exist for some form of cross-subsidization (i.e., taxation revenues being used to fund these services) in the event of operating losses or major capital investment requirements. The use of an MSC for the provision of water and wastewater services to the Township, would reduce the risk that residents who do not receive water and wastewater services from the MSC/Township will fund such services. In addition, the use of an MSC would contribute towards transparency in the allocation of costs to environmental services by structuring these separate from the Township's remaining operations.

- *Enhanced focus on sustainability* – As part of the Township’s broader corporate structure, the Township’s Environmental Services Department is required to compete with other departments for infrastructure funding necessary to both sustain and expand water and wastewater networks. Through the proposed MSC structure, the Township will establish a separate governance and management structure that will be solely focused on the operating and management of the environmental services. This will provide a decision-making framework that will contribute towards longer-term sustainability by (i) ensuring that the environmental services rates provide an appropriate level of funding for both operating and capital requirements; (ii) capital planning decisions for the environmental services are not influenced by the needs of other municipal departments; and (iii) a focus on safety, compliance and innovation with quality management standards engrained throughout the organization.

Implementation Strategy

In connection with the implementation of the MSC structure for the operation and management of the environmental services, the Township is proposing the following work steps:

1. **Completion of public consultation** with respect to the proposed MSC structure as required under Ontario Regulation 599/06, which we suggest include the following components:
 - a. Open House to communicate the salient points of the proposed reorganization of environmental services, including the rationale for the use of a MSC.
 - b. Communication materials included on the Township’s website.
 - c. Request and receive feedback from Township residents.
2. **Incorporation of the Holdco MSC and Operating MSC** for the purposes of holding and operating the infrastructure relating to the Township’s water, communal tile beds, urban storm water management, and streetlights. In doing so, the Township should:
 - a. Ensure that the organization of the MSCs are structured so as to meet the definition of a Government Business Enterprise for financial reporting purposes², which would allow the Township to not consolidate the MSC’s for financial reporting purposes, thereby excluding its debt from the determination of the Township’s allowable debt servicing limit.
 - b. Ensure that the organization of the MSCs are structured so as to meet the requirements for tax exempt status under Section 148.1(c) of the Income Tax Act.
3. **Adoption of an asset transfer policy** as required under Ontario Regulation 599/06 that would establish the framework for the transfer of environmental services assets from the Township to the MSC. While contingent upon the wishes of the Township, we suggest that the asset transfer policy:
 - a. Ensure that the Township retain some form of residual control over the assets, which could potentially be accomplished through (i) the use of debt as consideration for the transfer of assets from the Township to the MSC; and/or (ii) the granting of a right of first refusal to the Township to acquire the assets in the event of a business failure by the MSC.

² A government business enterprise is an organization that has all of the following characteristics:

- (a) it is a separate legal entity with the power to contract in its own name and that can sue and be sued;
- (b) it has been delegated the financial and operational authority to carry on a business;
- (c) it sells goods and services to individuals and organizations outside of the government reporting entity as its principal activity; and
- (d) it can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.

- b. Require the transfer of all assets and liabilities associated with the MSC services, including (i) tangible capital assets; (ii) reserve and reserve fund balances; (iii) deferred revenue balances; (iv) customer lists, marketing material, historical financial information and other intangible assets; and (v) the cumulative operating deficit for environmental services. We understand that the Township does not have development charge deferred revenue relating to the services to be delivered by the MSC.
 - c. Assets and debts are transferred with no expectation of financial return to the Township.
4. **Development of appropriate governance and operating policies** for the MSC, including terms of reference for the MSCs' Board of Directors and a formal dividend policy outlining the requirement for the MSC to pay dividends to the Township and the formula for calculating the dividends. Specifically, we would suggest that the dividend policy indicate that no dividends will be paid by the MSC as this would result in a situation where MSC customers are providing a financial return to all taxpayers of the Township, including those that do not receive water services.
 5. **Establish a Master Services Contract** between the Township and the MSC, the purpose of which will be to define the roles and responsibilities of the MSC with respect to the services being provided, which should include, but not be limited to:
 - a. Ownership and management of assets;
 - b. Annual establishment of rates;
 - c. Regulatory and legislative reporting;
 - d. Strategic and operational planning, including asset management planning; and
 - e. Decisions that require consent of the Township.
 6. **Establish a Personnel Services Contract** between the Township and the MSC for the provision of services by the Township's employees involved in the transferred environmental services. The Township intends to employ environmental services staff directly, with the MSC purchasing these services pursuant to the Personnel Services Contract on a fee-for-service basis. Accordingly, the implementation strategy does not anticipate the transfer of employees from the Township to the MSC.
 7. **Establish an Administrative Services Contract** between the Township and the MSC for the delivery by the Township of certain administrative functions, including finance, billing and collections, information technology, human resources, engineering and procurement.
 8. **Consider the implementation of additional development charges** to fund services delivered by the MSC. Currently, the Township's development charges do not fund future growth for water, wastewater or stormwater infrastructure and consideration could be given to these categories as part of the Township's upcoming development charges review.

Introduction

KPMG LLP (“**KPMG**”) has been retained by the Township of Oro-Medonte (the “**Township**”) to assist with the development of a business case relating to the establishment of a municipal services corporation (“**MSC**”) pursuant to the provisions on Ontario Regulation 599/06 (the “**Regulation**”). The terms of reference for our engagement are defined in our engagement letter with the Township dated August 31, 2017.

Background to the Business Case

The Township is a lower-tier municipality located in the Simcoe County that provides a range of services to more than 21,000 full-time and seasonal residents. During the 2018 fiscal year, the Township budgeted a total of \$7.1 million in operating and capital expenditures for those municipal services directly delivered by the Township, i.e., potable water, communal tile beds, urban stormwater management, streetlighting (collectively, the “**environmental services**”). In addition to these services, the Township administers approximately \$1.5 million in annual billings for water and wastewater services, which are delivered by a third party.

The Township’s Environmental Services department is responsible for the delivery of a number of services to Township residents, including:

- The treatment and distribution of potable water, within 14 water systems³ providing service to approximately 2,500 households at a cost of \$2.2 million (operating and capital/infrastructure renewal charges);
- The maintenance of seven communal tile beds that provide septic systems to 94 properties;
- The maintenance of urban stormwater management infrastructure in selected residential neighbourhoods (i.e. urban storm ponds);
- The maintenance of the Township’s streetlighting network; and
- The collection and treatment of wastewater services to approximately 731 households through a Ministry of the Environment Municipal Responsibility and Capital Facility Transfer Agreement with Skyline Utility Services (“**Skyline**”), a private sector provider, of which approximately 400 households also receive water services from the Township.

The scope and scale of the Township’s environmental services and supporting infrastructure has changed over time in response to aging, changing and growing servicing needs. In the future, the scale of environmental services is expected to increase further as a result of:

- The acquisition of private water systems such as Horseshoe Valley Zone 1 and Braestone;
- Increased maintenance demands of communal tile beds and future wastewater systems in Craighurst, Edgar Centre and Horseshoe Valley;
- Expanded maintenance of the Township’s urban stormwater management infrastructure as a result of its implementation of the new stormwater master plan;

³ There are currently 11 municipal water systems in operation plus private systems providing water service to Braestone (to be assumed by the Municipality), Lake Simcoe Regional Airport and Big Cedar Estates

- Continued reinvestment in the Township's existing infrastructure as assets reach end of useful life.

Currently, there is considerable interest from residents receiving water and wastewater services from Skyline for the delivery of these services to be provided by a 'Township owned and operated' system. We understand these residents believe this form of delivery model would be more cost-effective and provide enhanced monitoring.

As a result of the expected expansion of environmental services, the Township is investigating alternative governance and ownership structures, specifically the establishment of a public utility for a variety of municipal services (water, communal tile beds, urban stormwater management, streetlighting and eventually wastewater services) through the use of one or more MSC's.

About Municipal Service Corporations

An MSC is defined under the Regulation as a corporation, all of whose shares are owned by a municipality or by a municipality and one or more other public sector entities, where the shareholders have an entitlement to all the voting shares allocated to the members of the corporation, and which provides a system, service or thing that the municipality itself could provide. As noted in the definition, MSCs are not required to be wholly-owned by a single municipality but rather can be used to structure the governance of shared service initiatives between municipalities. MSCs can only operate within the geographic boundaries of a municipality with the permission of the municipality in question.

Pursuant to Section 11(1) of the Regulation, MSCs are not permitted to provide services that are mandated by the following acts:

- *Ambulance Act.*
- *Child and Family Services Act.*
- *Fire Protection and Prevention Act, 1997.*
- *Health Protection and Promotion Act.*
- *Long-Term Care Homes Act, 2007* in respect of long-term care homes under Part VIII of that Act.
- *Police Services Act.*
- *Provincial Offences Act.*
- *Public Libraries Act.*
- *Ontario Works Act, 1997.*

In addition to delivering the services of an individual municipality, an MSC can also facilitate the creation of shared service agreements between multiple municipalities by providing a corporate structure that allows for the joint ownership and operation of assets. In addition to the Lake Simcoe Regional Airport, a shared service arrangement between the Township, City of Barrie and the County of Simcoe, we understand that other potential shared service arrangements are under consideration in Simcoe County, including the potential for the shared operation of water and wastewater services.

Prior to establishing an MSC, the Regulation requires municipalities to undertake the following prior to the establishment of a MSC:

- Develop a business case study for the proposed MSC;
- Consult with the community about the plan to create the proposed MSC;
- Adopt and maintain policies with respect to the transfer of assets.

This document represents the business case study for the proposed MSCs.

Restrictions

This report is based on information and documentation that was made available to KPMG at the date of this report. KPMG has not audited nor otherwise attempted to independently verify the information provided unless otherwise indicated. Should additional information be provided to KPMG after the issuance of this report, KPMG reserves the right (but is under no obligation) to review such information and adjust its comments accordingly.

Pursuant to the terms of our engagement, it is understood and agreed that all decisions in connection with the implementation of advice and recommendations as provided by KPMG during the course of this engagement shall be the responsibility of, and made by, the Township. This report includes or makes reference to future oriented financial information. Readers are cautioned that since these financial projections are based on assumptions regarding future events, actual results will vary from the information presented even if the hypotheses occur, and the variations may be material.

Comments in this report are not intended, nor should they be interpreted to be, legal advice or opinion.

KPMG has no present or contemplated interest in the Township nor are we an insider or associate of the Township or its management team. Our fees for this engagement are not contingent upon our findings or any other event. Accordingly, we believe we are independent of the Township and are acting objectively.

The Proposed Municipal Services Corporation

Services Provided

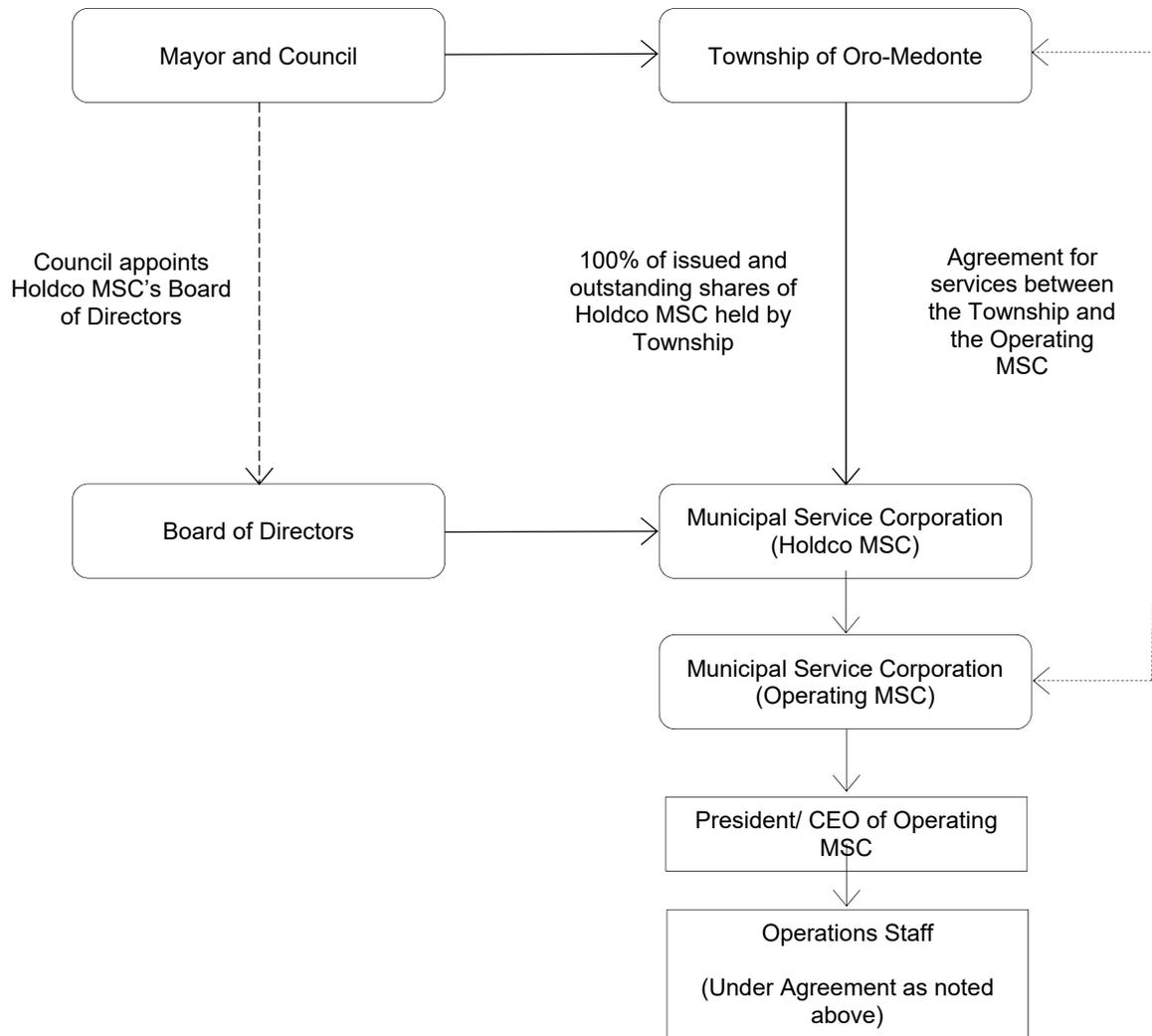
The Township is proposing to utilize a MSC structure for the ownership, operation, maintenance and funding of the following municipal services:

- Potable water;
- Communal tile beds;
- Urban stormwater management;
- Streetlighting;
- Administration for wastewater services provided by third parties; and
- Future infrastructure related to water and wastewater, urban stormwater and streetlighting.

Corporate Structure

As depicted on the following page, the proposed structure would involve the establishment of two MSCs:

- One MSC to act as a holding company (“**Holdco MSC**”) to hold the Township’s equity ownership interest in Operating MSC (as hereinafter defined). The issued and outstanding shares of Holdco MSC would be owned by the Township. The use of a Holdco MSC as holding company is intended to:
 - a) Allow the Township to establish additional MSCs in the future while providing for a common governance structure; and
 - b) Provide a means for the Township to participate in MSC arrangements with other municipalities or public sector bodies, with the Holdco MSC owning the Township’s equity interest in other MSCs; and
- Another MSC to act as an operating company (the “**Operating MSC**”) for delivery of the environmental services. The issued and outstanding shares of Operating MSC would be owned by the Holdco MSC.



While conditional upon the wishes of the Township, we suggest that the following be considered with respect to the governance of the MSCs:

- The use of a common board membership for both MSCs, whereby directors of the Holdco MSC would also serve as the directors of the Operating MSC;
- The establishment of a skills-based board, with the Township identifying the requisite knowledge base for board members (e.g. engineering, legal, finance)
- Board of Directors would be composed of five or seven directors, two of which should be selected from Township Council; and
- Five year staggered terms, with no limitation on reappointments.

In addition to the above, the Township may wish to consider appointing the Chief Administrative Officer and/or Chief Financial Officer as ex-officio members of the Board so as to provide additional linkages between the MSCs and the Township.

Management and Personnel Structure

Day-to-day operations of the Operating MSC would be the responsibility of its President/CEO, who would be responsible for the management and supervision of employees of the Operating MSC. For the initial start-up period of the Operating MSC, we suggest that consideration be given to appointing the Township's Chief Administrative Officer (the "**Township's CAO**") as the President/CEO of the Operating MSC and Holdco MSC, based on the following:

- The overall size of Holdco MSC's and the Operating MSC's operations are not expected to be sufficient to justify a full-time President and CEO;
- The appointment of the Township's CAO will ensure coordination between the Township, Holdco MSC and the Operating MSC during and following the transfer of infrastructure, employees and financial assets from the Township to the Operating MSC; and
- The potential for the Township's CAO to enter into discussions with other municipalities with respect to shared service arrangements delivered through the Operating MSC.

As discussed later in this report, aspects of the relationship between the Township and the Operating MSC will provide the Township with ongoing control over Holdco MSC and the Operating MSC regarding decisions that may be contrary to the best interests of the Township and its residents.

The operational delivery of services by the MSC would be undertaken through a combination of:

- **Township employees** – The Township intends to continue to employ the current employees of the Township's Environmental Services department (the "**Township Personnel**"), with these employees providing services to the Operating MSC pursuant to the terms of a contract between the Township and the Operating MSC. Specific employees that would be contracted to the Operating MSC would include the following:

Management	Operations
<ul style="list-style-type: none"> • President/CEO (cross-appointment of CAO) • Managing Director/Manager of Environmental Services • Environmental Services Coordinator • Environmental Services Technologist 	<ul style="list-style-type: none"> • Environmental services operators

- **External service providers** – In addition to the Township's Personnel, the Operating MSC may engage certain third parties as external contractors to perform services on its behalf. The current collective bargaining agreement between the Township and CUPE limits the use of contracting-out arrangements. However, the anticipated assumption of wastewater services could allow the Operating MSC to augment service delivery by contracting with other parties.
- **Township resources** – Certain services, including but not limited to finance (including billings and collections), information technology, human resources and engineering, may be contracted from the Township by the Operating MSC, as this represents the most efficient approach of meeting the needs of the Operating MSC given its relatively small scope of operations.

Rate Structure

It is anticipated that the Operating MSC would continue the rate structures currently established by the Township, recognizing that future rate setting undertaken as part of the Operating MSC’s budgeting processes may result in changes.

A summary of the initial rate structures for environmental services to be delivered by the MSC is provided below.

Water	Wastewater (proposed)	Communal tile bed	Stormwater management	Streetlighting
Combined fixed and variable rate	Percentage of water billings	Fixed rate per household	Fixed rate per household	Fixed rate per household

The Case for Support

The establishment of a separate organizational structure for environmental services in the form of a MSC is intended to provide a range of benefits to the Township and its residents:

- *Skills-based governance that extends beyond the term of Council* – Governance of the Operating MSC would rest with a Board of Directors appointed by the Holdco MSC. The Township can enter into long term agreement(s) with the Holdco MSC and the Operating MSC to ensure that the Board of Directors of the Operating MSC has skill-based expertise, e.g., legal, engineering, finance, etc. In addition to reducing political influences over governance decision-making, the use of a MSC in the provision of the environmental services allows for a longer-term vision for such services, including the adoption of sustainable user fee and other revenue models.

The Township would exercise control over the Operating MSC, through contractual agreements in favour of the Township, including through a shareholder agreement for the Operating MSC among the Township, Holdco MSC and the Operating MSC, which would include protective provisions requiring the prior written consent of the Township for any material change in the business, operations, organization or structure of both Holdco MSC and the Operating MSC.

- *Increased debt financing capability for the Township* – Under Ontario Regulation 403/02, Ontario municipalities are limited with respect to the amount of long-term debt that can be issued based on a formula that caps debt servicing payments at 25% of net revenue. For the 2017 fiscal year, the Township's debt servicing costs amounted to approximately 7% of net revenue, or approximately one-third of its allowable level, as summarized below.

Total net revenue (i.e. total revenues less grants and donated capital assets)	\$22,881,955
Allowable debt servicing repayment limit	25%
<hr/>	
Allowable debt servicing costs (interest and principal)	\$5,720,489
Actual debt servicing costs (interest and principal)	\$1,563,594

With the expectation of increased capital investments relating to water, wastewater and other infrastructure, it is possible that the Township's debt servicing costs will increase, which may (i) approach the upper limit of debt servicing costs allowed under Ontario Regulation 403/02; and/or (ii) impact borrowing costs due to the overall credit position of the Township. Through the use of a MSC, it may be possible for the Township (contingent on the terms of the borrowing agreement and other considerations) to separate debt relating to environmental services operations, thereby not impacting the Township's debt servicing limits.

- Potential for shared service arrangements* – The use of an MSC can facilitate the establishment of shared service arrangements with other municipalities by providing a corporate structure for joint ownership of municipal assets and operations. A survey by the Ministry of Municipal Affairs identified a number of municipal services that are delivered, to varying degrees, on a shared basis, and which could be incorporated into future MSCs.



We understand that potential shared service arrangements have been identified by the County of Simcoe, with the potential for shared water systems also identified with respect to adjacent municipalities.

- Avoidance of subsidization of water and wastewater services* – At the present time, approximately 27% of households within the Township receive municipal water services, with approximately only 7% of households receiving wastewater services through the Township (i.e., through communal tile beds and the Township’s management services agreement with a private sector provider). While the Township has adopted a strategy of full cost recovery for water and wastewater services, the potential does exist for some form of cross-subsidization (i.e., taxation revenues being used to fund water and wastewater costs) in the event of operating losses or major capital investment requirements. The use of an MSC for the provision of water and wastewater services to the Township, would reduce the risk that residents who do not receive water and wastewater services from the MSC/Township will fund such services. In addition, the use of an MSC would contribute towards transparency in the allocation of costs to environmental services by structuring these separate from the Township’s remaining operations.
- Enhanced focus on sustainability* – As part of the Township’s broader corporate structure, the Environmental Services Department is required to compete with other departments for infrastructure funding necessary to both sustain and expand water and wastewater networks. Through the proposed MSC, the Township will establish a separate governance and management structure that will be focused on potable water and wastewater services. This will provide a decision-making framework that will contribute towards longer-term sustainability by (i) ensuring rates for environmental services provide an appropriate level of funding for both operating and capital requirements; (ii) capital planning decisions are not influenced by the needs of other municipal departments; and (iii) a focus on compliance and innovation with quality management standards can be engrained throughout the organization.

Implementation Strategy

In connection with the implementation of a MSC for the operation and management environmental services, the Township should consider the following work steps:

1. **Completion of public consultation** with respect to the proposed MSC model as required under Ontario Regulation 599/06, which we suggest include the following components:
 - a. Open House to communicate the salient points of the proposed reorganization of environmental services, including the rationale for the use of a MSC.
 - b. Communication materials included on the Township's website.
 - c. Request and receive feedback from Township residents.

With respect to the consultation and communication process, we suggest that the key themes include the following:

- The proposed MSC model is not expected to result in significant incremental costs for residents. Any future cost increases for the services to be delivered by the MSC (i) reflect operational and capital requirements; and (ii) would have occurred even if the services were delivered by the Township as opposed to the MSC.
 - The proposed MSC model is intended to enhance governance and operational efficiencies, particularly through the potential use of shared service arrangements. To the extent that these result in cost reductions, these will be used to defray future cost increases, thereby providing a financial benefit to customers.
 - The proposed MSC model ensures fairness by segregating services that are received by only some residents from general municipal operations, thereby avoiding potential cross-subsidization issues.
2. **Incorporation of the Holdco MSC and Operating MSC** for the purposes of holding and operating the infrastructure relating to the Township's water, stormwater management, communal tile beds and streetlights. In doing so, the Township should:
 - a. Ensure that the articles of incorporation of the MSC's are structured so as to meet the definition of a Government Business Enterprise ("**GBE**") for financial reporting purposes. Under Generally Accepted Accounting Standards for Public Sector organizations, GBE's are not consolidated for financial reporting purposes but rather are accounted for using the modified equity basis of accounting⁴. As such, long-term debt held by a GBE is not reflected in the financial statements of the municipality and as such, is not considered in the determination of the allowable debt servicing limit⁵. In order to qualify for GBE status, the MSC must meet the following criteria:
 - it is a separate legal entity with the power to contract in its own name and that 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; and

⁴ Under the modified basis of accounting, the Township would reflect its investment in the MSC as a single line item on its Statement of Financial Position, with the amount of the investment increasing to reflect the MSC's net income (if any) and decreasing to reflect any dividends received (if any). The net income of the MSC would also be recorded as a single line item on the Township's Statement of Operations.

⁵ The allowable repayment limit is calculated based on information reported in the Township's Financial Information Return, which in turn reflects information contained in the Township's financial statements.

- 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.

The last requirement relates to financial self-sufficiency and as such, the quality of the MSC's rate setting process will significantly impact its ability to meet the conditions for recognition as a GBE.

- Ensure that the articles of incorporation are structured so as to meet the requirements for tax exempt status under Section 148.1(c) of the Income Tax Act.

3. **Adoption of an asset transfer policy** as required under Ontario Regulation 599/06 that would establish the framework for the transfer of assets relating to the environmental services from the Township to the MSC. We recommend that the asset transfer policy:

- Require the transfer of all assets and liabilities associated with the environmental services, including (i) tangible capital assets; (ii) reserve and reserve fund balances; (iii) deferred revenue balances; (iv) customer lists, marketing material, historical financial information and other intangible assets; and (v) the cumulative operating deficit for environmental services. We understand that the Township does not have development charge deferred revenue relating to the services to be delivered by the MSC.

As at December 31, 2017, the net book value of the assets to be transferred was \$19.4 million, as follows:

(in millions)	Water	Wastewater	Stormwater	Streetlights	Total
Tangible capital assets	\$14.622	\$0.057	–	\$1.159	\$15.838
Work in progress	\$0.162	–	–	-	\$0.162
Reserves and reserve funds	\$3.382	\$0.276	–	-	\$3.658
Accumulated deficits	(\$0.170)	-	(\$0.034)	(\$0.046)	(\$0.250)
Long-term debt	–	–	–	–	–
Total net assets	\$17.996	\$0.333	(\$0.034)	\$1.113	\$19.408

- Assets and debts are transferred with no expectation of financial return to the Township; and
- Ensure that the Township retain residual right to acquire the assets, which could potentially be accomplished through (i) the use of debt as consideration for the transfer of assets from the Township to the MSC; and/or (ii) the granting of a right of first refusal to the Township to acquire the assets in the event of a business failure by the MSC. The issue of the form of financial consideration for the transfer of assets to the MSC is discussed in further detail below.

4. **Development of appropriate governance and operating policies** for the MSCs, including terms of reference for the Board of Directors of the MSCs and a formal dividend policy outlining the requirement for the MSCs to pay dividends and the formula for calculating the dividends. Specifically, we would suggest that the dividend policy indicate that no dividends will be paid by the Township as this would result in a situation where MSC customers are providing a financial return to all taxpayers of the Township, including those that do not receive the environmental services.

5. **Establish a Master Services Contract** between the Township and the MSC, the purpose of which will be to define the roles and responsibilities of the MSC with respect to the services being provided, which should include, but not be limited to:

- Ownership and management of assets;
- Annual establishment of rates;

- c. Regulatory and legislative reporting;
 - d. Strategic and operational planning, including asset management planning; and
 - e. Decisions that require consent of the Township.
6. **Establish a Personnel Services Contract** between the Township and the Operating MSC for the provision of services by the Township's employees involved in the transferred environmental services. The Township expects to continue to employ environmental services staff, with the Operating MSC contracting for these services from the Township.
 7. **Establish an Administrative Services Contract** between the Township and the Operating MSC for the delivery by the Township of certain administrative functions, including finance, billing and collections, information technology, human resources, engineering and procurement.
 8. **Consider the implementation of additional development charges** to fund services delivered by the Operating MSC. Currently, the Township's development charges do not fund future growth for water, wastewater or urban stormwater infrastructure and consideration could be given to these categories as part of the Township's upcoming development charges review.

Financial Analysis

As noted in the analysis, the implementation of the MSC is not anticipated to result in a significant changes in costs to customers in comparison to the costs if the environmental services continued to be provided by the Township directly, with incremental costs limited to liability insurance, board meetings and professional fees. However, the analysis demonstrates that the Township's borrowing capacity would be significantly impacted (reduced) if environmental services were retained and provided by the Township as opposed to being transferred and provided by the MSC.

In developing the financial analysis, we have considered the following key assumptions:

- The general rate of inflation will be in the order of 2% per year;
- The MSC is not subject to third-party regulatory oversight and as such, has full discretion with respect to rate setting;
- The MSC will be exempt from income taxes. This differs from the situation of Electrical Local Distribution Companies, which are subject to payments-in-lieu of taxes that are equivalent to Federal and Provincial corporate income taxes; and
- Assets and debts will be transferred with no expectation of financial return to the Township. It is envisioned that the transfer would include 100 common shares with a fair market value of \$100.

While the proposed structure for the MSC appears similar to that used for municipal electrical utilities ("LDC"), there are some significant differences between the two models:

- LDCs are subject to payments-in-lieu of taxes, which are equivalent to Federal and Provincial corporate income taxes. Under the provisions of the Income Tax Act (Section 149.1(c)), MSCs are exempt from income taxes and payments-in-lieu of taxes. As a result, **customers will not be required to bear the cost of income taxes with respect to the proposed structure.**
- LDCs are subject to regulatory oversight by the Ontario Electrical Board ("OEB"), which includes (i) rates of return on the LDC's equity; (ii) required debt-to-equity ratios, which will sometimes result in the LDC paying dividends in order to comply with the mandated ratio; (iii) OEB approval for rate increases. None of these factors are expected to be applicable to MSCs, which are currently outside of a third party regulatory framework (except for MSCs involved in the delivery of natural gas or telephone services). As a result, **customers will not pay user fees that provide a profit or other form of return on investment to the Township.**

Next Steps

Given the case for support, it is the recommendation of KPMG that an MSC is a viable business model to support the delivery of environmental services. Should Staff and Council elect to proceed, we would anticipate next steps to be as follows:

- Consideration by Council of MSC business model July 2018
- Preparation of required documentation August - December 2018
- Presentation to Council and incorporation of MSCs December 2018
- Asset and operations transfer January – June 2019
- MSC operational July 2019