

Ontario Sewer and Watermain Construction Association



2023 Pre-Budget Consultation – Full-Cost Recovery for Municipal Water and Wastewater Systems

January 2023



Summary of Recommendations to Provide Provincial Financial Relief to Aid in Other Priority Infrastructure Investments and Post-Pandemic Economic Recovery, Improve Environmental Outcomes, and Create Sustainable Employment Opportunities

1. Reinststitute the legislated definitions for “full-cost recovery”¹ and “wastewater services”² as defined in the *Sustainable Water and Sewage System Act, 2002*.³ Maintaining these definitions will ensure that those municipalities which voluntarily adopted full-cost recovery when it was previously legislated will not be unduly penalized due to a language change.
2. Require municipal water systems that serve at least 10,000 people to recover all costs through user fees.
3. Temporarily, make funding available to municipalities seeking to retrofit or rehabilitate water and wastewater infrastructure in order to accommodate a move towards system regionalization.
4. Require municipalities applying for provincial funding for a water or wastewater infrastructure project to demonstrate that amalgamation of their water and wastewater systems with a nearby municipal system would not resolve their funding issues and create greater economies of scale.
5. Maintain a long-term goal of eliminating provincial funding for municipal water and wastewater infrastructure projects for all municipalities with a population over 10,000.
6. Establish a regionalization fund that incentivizes larger system operators to assist smaller system operators with material purchasing and problem issues in cases of emergencies.
7. Allow small system operators the opportunity to remain independent, even when a regional option is available, on the condition that the users of the system are willing to pay for its operation and upkeep moving forward.

¹ Defined as costs associated with “source protection costs, operating costs, financing costs, renewal and replacement costs, and improvement costs associated with extracting, treating or distributing water to the public, and such other costs which may be specified by regulation.” Bill 175: Sustainable Water and Sewage System Act (2002), Royal Assent December 13, 2002, (37:3), Retrieved from Government of Ontario e-Laws website: <https://www.ontario.ca/laws/statute/s02029>.

² Defined as costs associated with “collecting, treating or discharging [of] wastewater.” *Ibid*.

³ This Bill (175) received Royal Assent but was never proclaimed.



January 2023

Submitted via e-mail: (submissions@ontario.ca)

The Honourable Peter Bethlenfalvy
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c/o Budget Secretariat
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Re: 2023 Pre-Budget Consultation – Mandating Full-Cost Recovery for Municipal Water and Wastewater Systems

The OSWCA represents over 800 member companies across the province. Our members construct, rehabilitate, and supply materials for water and wastewater systems throughout Ontario's 444 municipalities. This work is critical for the delivery of clean drinking water and maintenance of proper sanitation systems.

On behalf of our members, the Ontario Sewer and Watermain Construction Association (OSWCA) would like to provide the following recommendations for mandating full-cost recovery for municipal water and wastewater systems to ensure municipal infrastructure assets are being managed and invested in, in the most efficient and sustainable way possible.

As Ontario looks forward to the long-term recovery of its economy, employing measures to ensure the most efficient and strategic allocation of resources will be critical to sustainable economic development and job growth. The delivery and financing of critical water and wastewater infrastructure is one particularly area in which the Province will find considerable efficiencies which will aid in Ontario's post pandemic recovery.

The following proposal for the adoption of a utilities model used in other jurisdictions for the financing and delivery of critical water and wastewater infrastructure, is more crucial now than ever and includes the following:

1. An opportunity for significant provincial financial relief, and in turn, the ability to reallocate current municipal water and wastewater subsidies to provincial post pandemic recovery initiatives
2. The case for mandating full-cost recovery;
3. An overview of the current state of water and wastewater infrastructure in Ontario;
4. The case for regionalizing small municipal water and wastewater systems; and,
5. Subsidization models to accommodate low-and-fixed-income users.



Employing measures to ensure the most efficient and strategic allocation of resources will be critical, not only to sustainable infrastructure investment, but too, as Ontario moves through the post-pandemic economic recovery process. By requiring municipalities to operate their water and wastewater systems on a full-cost recovery basis, the province will: create consistent and sustainable jobs at the municipal level by ensuring stable and predictable annual investments in local infrastructure; ensure the sustainability of municipal operators to deliver clean drinking water and appropriately treat and dispose wastewater; and, perhaps entirely remove the need for provincial subsidization of municipal water and wastewater systems.

1. Opportunities for Provincial Financial Relief and Strategic Reallocation of Funds Currently Subsidizing Municipal Water and Wastewater Infrastructure

As Ontario seeks to accelerate its economic recovery post-COVID-19, it will be particularly prudent for the province to evaluate cost saving measures and reallocate resources to ensure monies are being directed to initiatives which will aid in the sustained economic development and job growth of the province. One area in which the province will find a restructuring of services will provide a significant cost savings, is its ongoing subsidization of municipal water and wastewater systems.

Since December of 2020, the Provincial government has allocated over \$1.7 billion dollars in funding to municipalities across Ontario through safe restart agreements (SRA). SRA's have provided relief funding in the short term to subsidize municipal budget shortfalls. Transit ridership decline has been responsible for the greatest share of municipal budget short falls. Ridership decline on the Toronto Transit Commission (TTC) resulted in a \$796.4 million loss in 2021.

The provincial governments ongoing subsidization of municipal transit operation is not sustainable, once subsidization ends municipalities will be forced to make funding cuts in other areas. These budget cuts are likely to include major road repairs, the upkeep of public park facilities, flood protection on the Toronto islands and public transit infrastructure are among the City of Toronto has publicly stated work the city has either already put on hold or will soon have to suspend if it doesn't receive more pandemic funding from other levels of government.

That's the conclusion of a city report details which capital projects are being affected as the city seeks as much as \$300 million in cuts to its capital budget, which it says will be necessary to bridge the budget shortfall caused by transit related deficits.

This investment will help address the key priorities, agreed to by Canada's First Ministers, for the safe restart of Canada's economy over the next six to eight months. It will support measures to increase testing and contact tracing of the virus to protect Canadians from a future outbreak, and support the capacity of our health care systems, including services for people facing mental health challenges. It will also assist with the



procurement of personal protective equipment to help our essential workers, and in protecting the most vulnerable, like our seniors.

The agreement will also help get funding quickly to municipalities so they can deliver essential services that Canadians rely on every day, such as public transit. In addition, it includes actions to help Canadian workers during this challenging time, such as ensuring the availability of safe child care to help parents returning to work, and providing income support for people who do not have paid sick leave so all Canadians can stay healthy.

Municipal water and wastewater infrastructure continue to be chronically underfunded. This is largely because, between the 1970s and the early-2000s, many municipalities across Ontario neglected their core infrastructure assets and left them to decay. During this time, municipal decision-makers were able to keep local water rates stagnant, or increases low, as infrastructure investments were not a priority issue for local taxpayers, particularly investments which were “out of sight, out of mind”. Unfortunately, it remains common practice for many small – and medium – sized municipalities to defer maintenance, rehabilitation, and expansion, as they do not have the necessary capital reserves or tax base to pay for needed work. Instead, often municipalities operate their water and wastewater systems below cost, compounded by the legacy-debt which accrued due to the lengthy period of underinvestment, and ultimately rely on development charges and billions of dollars of annual federal and provincial funding to supplement their system needs.

The unfettered discretion enjoyed by municipalities, with regard to the prioritization of their investments, has, too, contributed to the further neglected core infrastructure improvements, as there has traditionally been favouritism towards investment in politically appealing projects, rather than underground infrastructure. This choice allocation of funding may, additionally, lead to costly emergency repairs, where there was initially an opportunity to benefit from cost-effective maintenance and rehabilitation.

For water and wastewater infrastructure, chronic underfunding has resulted in a growing water/wastewater infrastructure deficit, with provincial estimates placing it at close to \$1 billion. The implications of such underfunding are not simply financial, too, this approach over the long term can be dire, placing public health at risk. Justice Dennis O’Connor, in the Report of the Walkerton Inquiry, noted why deferring necessary work on water infrastructure is a serious problem:

Over the long term, safety depends on stable and adequate financing to maintain the water system’s infrastructure and its operational capacity... Without adequate resources, corners will inevitably be cut, whether in the day-to-day operation of the facility, or in its long-term capital infrastructure. Ultimately, safety will be jeopardized.



Since the Walkerton water disaster in 2000, there have been many worthwhile provincial water policy initiatives, including: source water protection; training initiatives; the Walkerton Clean Water Centre; and the creation of WaterTap. However, these measures do not address the primary problem: financial sustainability. Undercharging for water and wastewater is a complex issue that most municipalities struggle with. More specifically, artificially suppressing rates operates counter to numerous infrastructure and environmental objectives; however, is a direct result of rising costs of living in the province and the political pressures to ensure rates remain low.

The province is in a unique position to realize decades-old objectives. By mandating municipalities operate their water and wastewater systems on a full-cost recovery model, the province will not only relieve the financial burden to subsidise municipal infrastructure, but too, create a sustainable funding source for water and wastewater infrastructure. Particularly during this time, the ability to save over a billion dollars in annual transfers to municipalities, and the flexibility to re-allocate these current investment dollars into areas of greater strategic importance, is critical. Similarly, the Standing Committee on Finance and Economic Affairs provided the recommendation that as part of the post pandemic recovery strategy, the Province should consult on the potential adoption of a utilities model used in other jurisdictions for the financing and delivery of critical water and wastewater infrastructure.

2. Why the Province Ought to Mandate Full-Cost Recovery

The financial sustainability of municipal water systems has been considered in numerous government and third-party reports⁴, as well as in at least two pieces of legislation over the last 15 years⁵. These expert reports have *consistently* identified the need for municipalities to operate their water systems at full-cost recovery to ensure the sustainability of such infrastructure. Interestingly, there, too, appears to be a consensus at both the provincial and municipal level regarding such necessity. However, despite these findings via government commissioned reports and subsequent proposed legislation, most municipal water systems in Ontario are being purposely operated at a loss. Obtaining approval from municipal councils to increase user rates to necessary levels is often identified as the most significant barrier to achieving financial sustainability.

While charging artificially depressed rates ensures the cost to the end user remains low, the subsequent underinvestment in the maintenance, rehabilitation and expansion of water and wastewater infrastructure that such depressed rates demand, results in a

⁴ For example: Fortin and Mitchell (1990); O'Connor (2002); Swain (2005); Drummond (2012); the ECO Annual Report (2014); Canadian Municipal Water Consortium (2015); Fenn and Kitchen (2016).

⁵ *Sustainable Water and Sewage Systems Act*, 2002; *Water Opportunities and Water Conservation Act*, 2010



growing infrastructure deficit and much greater reactive spending due to costly emergency repairs.

For example, in 2016 failing watermains caused a large sinkhole in Ottawa costing millions to repair and significantly more in lost business opportunities⁶, power outages to high rises in Toronto⁷, and service disruptions in almost every community in the province. Similarly, stormwater and sanitary sewer failures over the last ten years have caused billions of dollars in property and environmental damage⁸. Too, these tangible costs do not account for the more abstract and less-definable expenses associated with the dumping of billions of liters of untreated sewage into local watercourses every year because of antiquated combined sewer overflow systems (i.e. costs associated with clean-up, lost economic opportunities from recreational area closures, additional water treatment costs when using these watercourses for source water, etc.). Eventually, the necessity for rate increases must overcome the desire for artificially low rates.

When comparing the average cost of water across the country and across the developed world, Ontario's rates rank amongst the lowest for residential and commercial users. Of the six most populated provinces in Canada, Ontario rates rank fourth in average price, only higher than British Columbia and Quebec, and decidedly lower than Alberta, Manitoba, and Saskatchewan⁹. Concerningly, despite Ontario maintaining an infrastructure deficit estimated to be \$12.6 billion in 2012¹⁰, and with much of its municipal systems falling into disrepair, the Province maintains some of the lowest and artificially suppressed rates in the developed world and in the Country.

A provincial mandate requiring recovery for the total costs associated with the operation of municipal water systems is the most responsible and sustainable way to ensure core infrastructure is properly maintained, rehabilitated, and expanded. This system will ultimately create a transparent, accountable, and financially self-sufficient water systems which will minimize, and eventually eliminate, the need for provincial subsidization – saving the province hundreds-of-millions-of-dollars annually.

3. An Overview of the Financial Sustainability of Water Infrastructure in Ontario

⁶ Massive sinkhole closes Rideau Street in downtown Ottawa: Rideau Centre mall, businesses evacuated and tourists asked to avoid area," CBC News, Jun 08, 2016, <http://www.cbc.ca/news/canada/ottawa/sinkhole-rideau-street-downtown-ottawa-1.3621949>

⁷ "Third power outage plagues Minto condominiums residents," City News, September 17, 2016, <http://www.citynews.ca/2016/09/17/third-power-outage-plagues-minto-condominiums-residents/>

⁸ Toronto 2005 & 2013, Peterborough 2004, Burlington 2014, etc.; Insurance Bureau of Canada, "4 Ways to Prepare for Water Related Damage, Insurance Bureau of Canada, <http://www.ibc.ca/qc/disaster/water>.

⁹ Michael Fenn and Harry Kitchen, Bringing Sustainability to Ontario's Water Systems: A quarter-century of progress, with much left to do, OSWCA (May 2016), 52-53.

¹⁰ Association of Municipalities of Ontario, Towards a new Federal Long-term Infrastructure Plan: AMO's Submission to Infrastructure Canada, August 2012, p. 2.



Many municipalities defer the maintenance, rehabilitation, and expansion of their water and wastewater infrastructure because they do not have the necessary capital reserves to finance required works. As noted above, this approach has led to a growing water and wastewater infrastructure deficit, estimated at \$12.6 billion. Not only is the size of this deficit reaching unsustainable levels, but too, it is also placing public health at risk. Justice Dennis O'Connor, in the Walkerton Commission Report, discussed the reason deferring necessary work on water infrastructure is a serious problem, noting:

Over the long term, safety depends on stable and adequate financing to maintain the water system's infrastructure and its operational capacity... Without adequate resources, corners will inevitably be cut, whether in the day-to-day operation of the facility, or in its long-term capital infrastructure. Ultimately, safety will be jeopardized¹¹.

Although the case for full-cost recovery has been made numerous times over the last sixteen-years, only 59% of responding municipalities to a recent survey from the Environmental Commissioner of Ontario (ECO) believed that their systems were operating on a cost recovery basis. Interestingly, in the analysis of the survey results, the ECO noted:

[T]here seemed to be differing understandings amongst municipalities of what it means to have achieved full-cost recovery: some municipalities indicated that they do not rely on provincial/federal funding but use it if available; some stated that they had received provincial funding until recently, but this revenue stream had ended; and others explained that they still rely on senior-level funding for mid- and large-sized capital projects¹².

It is evident, from the result of this this survey is that there remains a lack of understanding of what it means to truly achieve full-cost recovery, as a standardized definition has never been provided. Provincial leadership is necessary to provide a clear definition of full-cost recovery and demonstrating the reasons it is necessary to achieve. Providing a standardized definition and requiring its achievement will force municipalities to accept what their standardized asset management plans and financial sustainability plans reveal about the degree of cost recovery they are presently maintaining, and the required investment to sustain their water and wastewater systems.

4. Regionalization for Economies of Scale in Small and Rural Water Systems

¹¹ The Honourable Justice Dennis O'Connor, Part Two – Report of the Walkerton Inquiry: A Strategy for Safe Drinking Water, Ontario Ministry of the Attorney General, (Queen's Printer for Ontario, 2002), 300

¹² Environmental Commissioner of Ontario Gord Miller, "Fourteen Years After Walkerton: Drinking Water Systems Not at Cost Recovery," Environmental Commissioner of Ontario, 2014,



One of the largest contributors to poorly managed infrastructure (i.e. deferred maintenance, rehabilitation and expansion) and ultimately, significant and necessary provincial subsidization, is that many municipal water systems maintain user bases that are too small to fully account for the necessary costs of operating and maintaining it. More than 80% of the 677 drinking water systems in the province serve populations of less than 10,000 people¹³, while 47% serve less than 1,000 people¹⁴. A great many of these small systems are facing increasing financial pressures due to deteriorating infrastructure, shrinking user bases, and escalating costs to maintain and operate their systems. Notwithstanding these pressures, there remains an obligation for local system operators to meet provincial regulations for water.

Considering the cost to operate and maintain these small systems has become prohibitive in many cases, alternative approaches to ensure adequate maintenance and expansion of core infrastructure assets must be considered. Regionalizing the management and/or operations of small water systems is an alternate solution that can significantly improve the economies of scale. There are numerous examples across the province of regionalized management of water and wastewater infrastructure, therefore making the general concept and potential barriers for implementation well understood.

In order to control the water and wastewater infrastructure debt and meet the growing demand for infrastructure maintenance and renewal, fundamental changes are needed with regards to how these critical assets are managed, particularly for municipalities outside the large urban centers. A significant body of research extols the benefits of, and paths to, regionalizing small and medium-sized water and wastewater systems¹⁵. It is often held as the answer to creating more financially sustainable and efficient water systems, when operating small systems becomes impractical. Larger systems simply have greater technical, managerial, and financial capacity, and can ensure that existing and future obligations are being met without creating significant financial hardships. Water and wastewater systems with larger operating capacities and serving a larger number of people are better positioned to adequately manage their assets and can more easily self-finance necessary improvements, which will require less provincial investment over the long-term.

When discussing a movement towards regionalized infrastructure management, it is important to acknowledge the common misconception of “price gouging”, thought to

¹³ For the purposes of this paper, a small water system is defined as serving fewer than 10,000 people. The US Environmental Protection Agency (EPA), however, defines small systems as serving fewer than 3,300 people. The United States Environmental Protection Agency, “Small Drinking Water Initiative,” https://www3.epa.gov/region1/eeco/drinkwater/small_dw_initiative.html.

¹⁴ Ministry of Infrastructure, *Building Together: Jobs & Prosperity for Ontarians*, Government of Ontario, (Queen’s Printer for Ontario, 2011), 55.

¹⁵ National Research Council, *Safe Water From Every Tap: Improving Water Service to Small Communities* (1997); the National Council for Public-Private Partnerships, “NCPPP Position on the Water Infrastructure Report,”; the US Environmental Protection Agency, *Much Effort and Resources Needed to Help Small Drinking Water Systems Overcome Challenges* (2006 – among numerous other papers); Rural Community Assistance Partnership,



occur when a smaller system amalgamates with a larger municipal system. In addressing this concern, one must know that there is not a one-size-fits-all approach, but rather a menu of options that can be considered by small system operators to create greater economies of scale in operations, management, infrastructure, or administration. While a full-scale amalgamation is the most ideal and cost-effective approach, there are opportunities to pool resources, administration responsibilities, and staff to improve efficiencies. Some of these opportunities may include:

- a larger system operator allowing for the bulk purchase of water at wholesale cost, allowing a small system operator to maintain control over distribution and billing;
- the bulk purchase and storage of needed treatment chemicals;
- the joint purchase of new technologies that will result in decreased administration costs over the long-term, such as automated meter reading and billing services;
- shared lab testing services by a regionalized group to provide more in-depth analysis for water quality problems;
- the bundling of small system debt with a larger system operator to create greater bonding capacity and better rating for a small operator;
- having a larger operator provide engineering and construction management services; and,
- having a larger system provide emergency assistance to a smaller system operator.

Whether incorporating one, all, or a combination of a select few of the above noted opportunities, municipalities will need assistance to help launch discussions and coordinate potential regionalization efforts. The success of such a system is contingent on a thoughtful coordinated effort of experts in the field and municipalities which may benefit from regionalized management. The province should consider reviewing where regionalized water and wastewater systems would be advantageous and subsequently work with those identified municipalities in a mentorship role to help them move towards regionalizing. Additionally, incentive programs or planning grants should be considered that encourage municipalities to study where economies of scale can be found in their current system. For instance, the state of Pennsylvania offers planning grants to municipalities to create comprehensive water supply plans or to conduct feasibility studies for regionalizing water systems with neighboring communities¹⁶.

A movement toward regionalization will allow participating municipalities to draw from a wider tax-base, reducing the potential cost increases necessary to assess, maintain, and expand their current system. Additionally, where increases in the water rates are necessary, there are a number of different subsidization options that local operators may consider in order to ensure it remains affordable for low- and fixed-income households.

¹⁶ National Research Council, *Safe Water from Every Tap: Improving Water Service to Small Communities*, (Washington, D.C., National Academy Press, 2002), 156-158.



Perhaps most importantly, the movement towards regional system management will eliminate the need for provincial subsidization of municipally owned water and wastewater systems, allowing for more than a billion dollars a year to be redirected to other priority infrastructure investments. As Ontario recovers from the economic effects of COVID-19, identifying and utilizing process changes which allow the province to reallocate funds towards necessary initiatives which serve better to promote job development and economic growth, are paramount.

5. Subsidization Models for Low-and-Fixed-Income Users

A common argument made against the move to full-cost recovery pricing is that many municipal residents are unable to absorb *any* cost increases for their water usage due to low- or fixed-incomes. While within this argument there is a legitimate concern, overall, the argument is based on a false premise. Simply because a sub-set of the population cannot afford cost-of-living increases does not mean that a subsidized system should remain in place for *all* users. As a full-cost recovery report from the European Environment Agency notes, "...keeping water prices at an artificially low level may not be the best way to ensure the affordability of water services to low-income households. It may result in a vicious cycle of underfunded service providers, insufficient investment, collapsing infrastructure and deteriorating services that further reduce the benefits that users receive from them."¹⁷

If full-cost recovery is mandated by the province, consumer pricing for water would be based on the condition of the local water and wastewater infrastructure and would therefore vary from municipality-to-municipality. Cost increases to the consumer may be necessary based on the level of neglect that the municipal system has experienced since it was installed; however, where systems have been properly maintained, increases would be minimal or not required at all. Where increases in the water rates are necessary, there are a number of different subsidization options that local operators may consider in order to ensure it remains affordable for low- and fixed-income households.

Examples of Existing Municipal Water Subsidization Programs:

- Guarantee a base quantity of water at a low fixed rate, with subsequent steep rate increases for anyone surpassing a set volumetric threshold that would be deemed for non-essential use (i.e. swimming pools, lawn-care maintenance, car washing, etc.).
- Increasing block tariffs (IBT), which implies stepwise price increases with increasing consumption. There are many possible versions of this approach (e.g. with uniform or variable block widths depending on household size, and combinations with a fixed charge). IBT systems provide a strong incentive for

¹⁷ European Environment Agency, *Assessment of cost recovery through water pricing*, EFA Technical Report, (no. 16, 2013), 23-24.

water conservation, especially in the 'luxury' part of water consumption (e.g. private swimming pools, garden watering, etc.).

- A fixed fee surcharge (e.g. City of London's "Customer Assistance Program") where a small charge is applied to each bill for all residential customers and used to discount low- and fixed-income consumer's bills if they fit within certain criteria for assistance.¹⁸
- Specific exemptions for low-income households from paying sewage and wastewater treatment charges. These reduce the cost-recovery rates but do not change incentives for water conservation.
- Additional low-/fixed-income subsidization strategies may include: lifeline rates; partnerships with social agencies; and pricing reforms, including seasonal surcharges, peak-load pricing, and tiered rates based on neighbourhood/zones.

6. Concluding Notes

In sum, keeping costs artificially low in municipalities due to a shrinking or insufficient tax-base, or to simply avoid the criticism of raising rates to the required level, may be doing more harm than good. In fact, it will likely result in a vicious cycle of underfunded service providers, insufficient investment, collapsing infrastructure and deteriorating services that further reduce the benefits that users receive from them. Cost increases to the consumer may be necessary based on the level of neglect that the municipal system has experienced since it was installed; however, where systems have been properly maintained, increases would be minimal or not required at all.

Mandating full-cost recovery for municipal water and wastewater systems was put in place by the Ernie Eves-led PC government in 2002, though it was never proclaimed following the 2003 election. By revisiting the *Sustainable Water and Sewage Systems Act, 2002* and updating it to reduce its scope to include only municipalities whose population base could reasonably self-finance its system upkeep (proposed at 10,000), the province will:

- most importantly, remove the need for provincial subsidization of municipal water and wastewater systems, allowing for more than a billion dollars a year to be redirected to other priority infrastructure investments. As Ontario recovers from the economic effects of COVID-19, identifying and utilizing process changes which allow the province to reallocate funds towards necessary initiatives which serve better to promote job development and economic growth, are paramount.

¹⁸ Any number of criteria may be applied to these types of programs, including: how often a household can apply for assistance funding, including a minimum threshold of usage volume, what type of usages are allowable (i.e. no pool or hot-tub filling, irrigation, car washing, or other discretionary uses)



- create a recession-proof employment industry with well-paid jobs at the municipal level by ensuring stable and predictable annual investments in local infrastructure; and,
- ensure that municipal operators are able to deliver clean drinking water and appropriately treat and dispose wastewater, which addresses the provincial Climate Change Action Plan goals around source water protection.