

FOR BOARD ACTION

Agenda Item #

5.a.

Meeting Date:

12/14/06

SUBJECT:

Emissions Reduction Project and Financing
SLP Unit 4

PREPARED BY:

Wally Schlink, Director of Power Resources

ITEM DESCRIPTION:

Beginning in 2003, a team of RPU staff and consultants have been working on an emission reduction program that would result in significantly reducing both the rate and the total amount of emissions from Silver Lake Power Plant Unit 4.

The Utility Board approved going forward with the permitting, engineering and design activities at the July 25, 2005 meeting. Since that time staff has refined the feasibility study and the related scope, cost estimates and schedule. More importantly, staff negotiated an agreement that would set the design parameters and other obligations that the utility must conform to in the implementation of the emissions reduction project. Staff reached an agreement and at the May 30, 2006 Utility Board meeting the Board approved the agreement.

At the June 2006 Board meeting an engineering services agreement with Utility Engineering was approved and they, along with staff have been working diligently to proceed with the significant activities that are required to make the emission reduction plan into a reality. Also at the June meeting staff presented a detailed scope, schedule and budget for the project.

We are now prepared to request that the Board formally approve the project and to also approve a financing plan that will allow the utility to issue electric revenue bonds to pay for the Emissions Reduction Project as well as other necessary infrastructure capital development.

Attached is a scope document that outlines the project, a letter from the financial advisor supporting the bonding plan as well as a memorandum from the RPU General Manager detailing the issues related to this financing and refunding of our 2000 bond issue. The total principal amount of the Electric Revenue Bonds to finance the emission reduction project, electric system improvements and the refunding, including costs of issuance and other related financing costs, will be approximately \$90,000,000.

Staff will be at the Board meeting to answer any questions on this request.

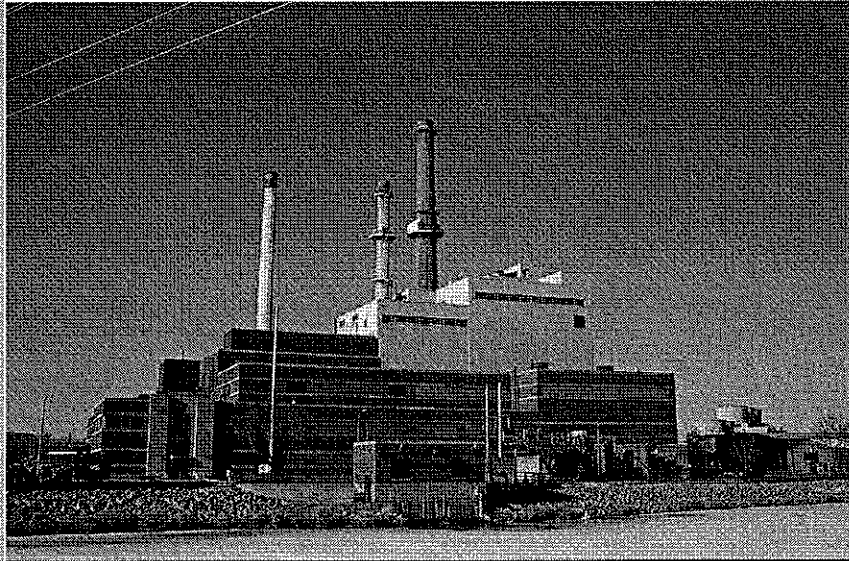
UTILITY BOARD ACTION REQUESTED:

Staff recommends that the Board approve and request the Common Council approve a resolution authorizing the SLP Unit 4 Emission Reduction Project. Staff also requests the same resolution approve financing of the Emission Reduction Project as well as other capital infrastructure improvements through issuance of electric revenue bonds and refunding of our 2000 bond issue.


General Manager


Date

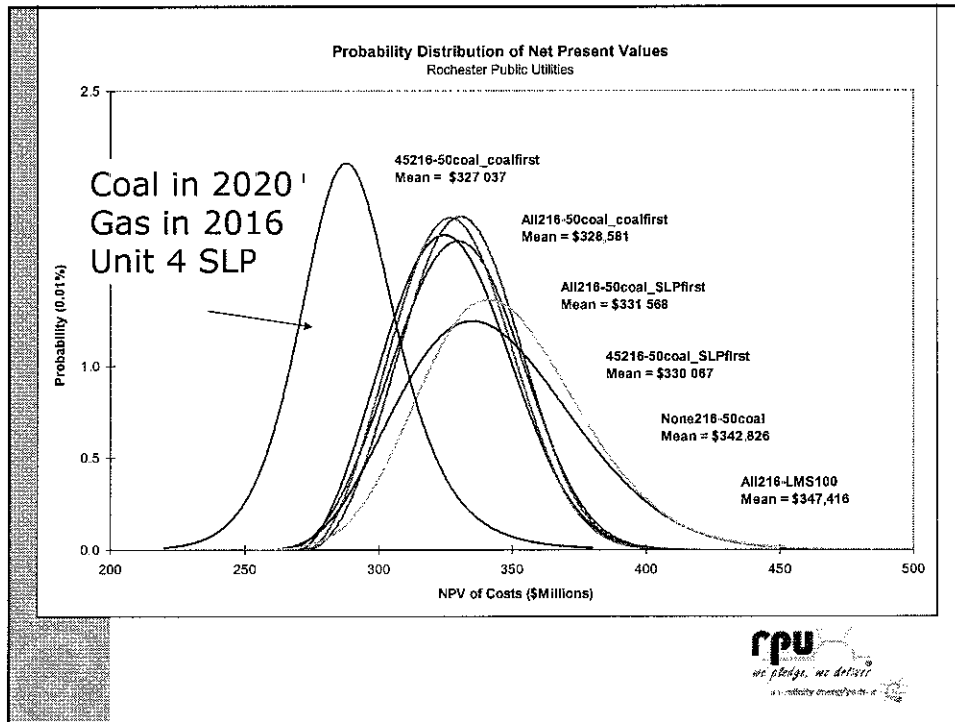
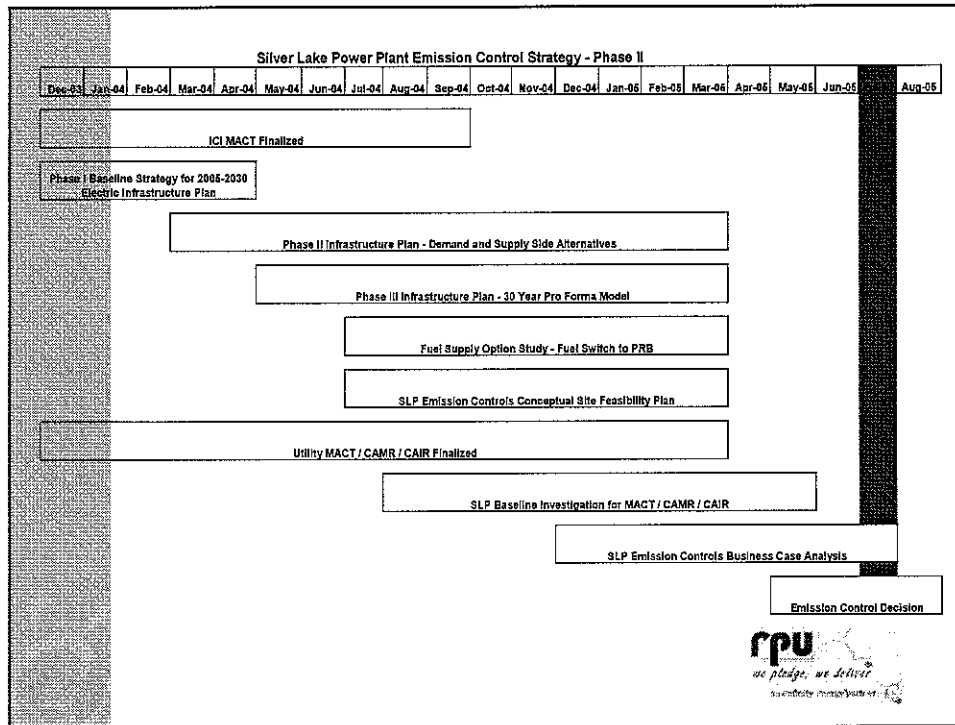
SLP Unit 4 Emission Reduction Project



Major Milestones

- July 2003 – Environmental Screening Study started by R.W. Beck based on RPU Utility Board & MPCA direction
- October 2003 – Presented results of Environmental Screening Study
- Developed an 18 month Environmental Planning Process
- April 2004 – Results of Electric Infrastructure Phase I Study were presented
- March 2005 – Results of Electric Infrastructure Phase II & III presented / Results of U.E. Emissions Feasibility Plan presented
- July 30, 2005 – Board approval to proceed with permitting, engineering & design of emissions reduction project
- January 2006 – Feasibility Study and Estimate Refinement
- May 30, 2006 – Board approval of Settlement Agreement w/ City & MCEA
- July 2006 – Board approval of engineering services agreement with Utility Engineering





Proposed Scope

- NOx Removal
 - Selective Non-Catalytic Reduction (SNCR), Separated Over Fire Air (SOFA), Low NOx Burners (LNB)
- SO2 Removal
 - Spray Dryer Atomization (SDA)
- Particulate Removal
 - Fabric Filter (FF)
- Mercury
 - Co-Benefit
 - Activated Carbon Injection (ACI)
- Fugitive Emissions
 - Dry Fly Ash System



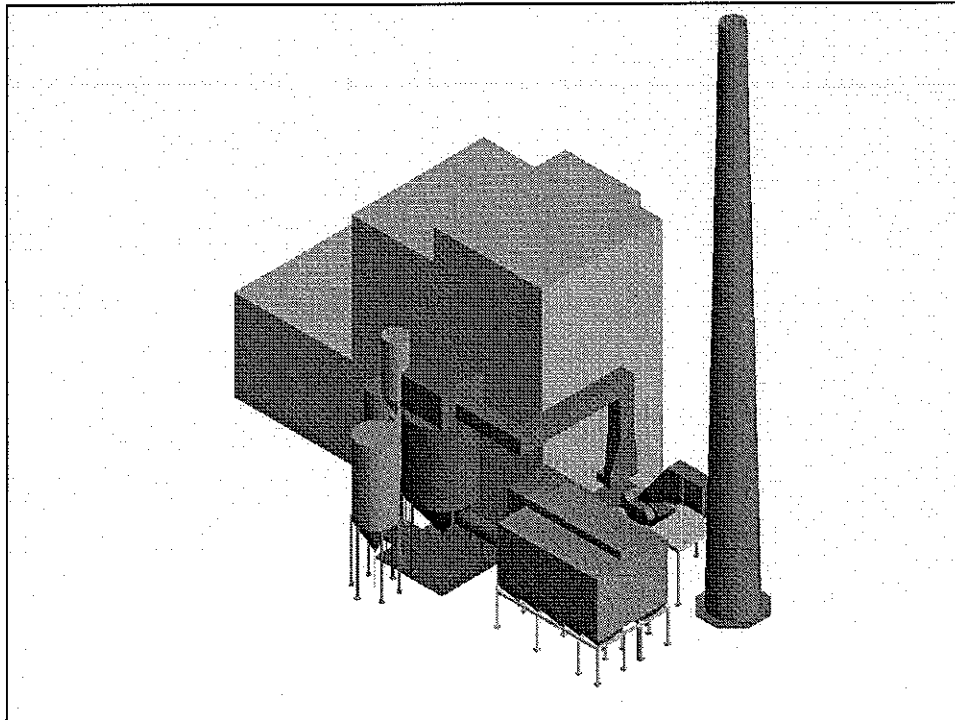
Projected Costs - \$M

- | | |
|-----------------------------|-----------------------------|
| • Most Probable | • High End Estimate |
| – Equipment \$10.48 | – Equipment \$12.21 |
| – Labor \$9.73 | – Labor \$9.76 |
| – Direct Contingency \$2.73 | – Direct Contingency \$3.84 |
| – Indirect \$5.8 | – Indirect \$6.75 |
| – Financing \$.63 | – Financing \$.72 |
| – Total \$29.37 | – Total \$33.28 |



Schedule

- 2006
 - Award Engineering Package
 - Spec Preparation & Bidding Award
- 2007
 - Release to Manufacture
 - Foundations & Utilities
- 2008
 - Install & Erect Equipment
 - Tie In Outage
- 2009
 - Start Up, Commission & Compliance





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December 11, 2006

Mr. Larry Koshire, General Manager
Rochester Public Utilities
4000 East River Road North East
Rochester, MN 55906-2813

Re: Financing of Electric System Capital Improvements and the Refunding of Certain Outstanding Issues

Dear Mr. Koshire:

The Rochester Public Utilities (the "Utility" or "RPU") is moving forward with a decision on the financing of electric system capital improvements which will include an emissions reduction system. This decision is, in part, affected by the determination of the ability to finance such a capital investment. We have been asked to provide the Utility with our opinion as to the ability to obtain financing at market interest rates.

In addition to financing capital improvements, we have reviewed with the RPU its outstanding debt to determine any advantages of refinancing those issues which would generate meaningful financial benefits. We have concluded that refinancing of the RPU's Electric Utility Revenue Bonds, Series 2000 could yield such benefits.

This letter covers both the financing of electric capital improvements (the "New Money Bonds") and the potential refunding of the 2000 Bonds (the "Refunding Bonds").

The Utility has provided us with an estimate of the total direct expenditure budget. This budget estimates total direct costs at \$48,000,000, of which \$34,000,000 will be used to finance the emission reduction project. The costs associated with this financing, including the funding of the debt service reserve fund are added to the direct costs for a total estimated bonding amount for the new improvements of \$52,170,000.

Preliminary Financing Plan

The financing would be secured by electric system revenues only and not secured by general property taxes. Security for the Bonds would be the same pledge of revenues as the RPU's outstanding electric revenue issues; therefore, issued on a "parity" basis. Investors in these Bonds would have equal access to pledged system revenues with current bondholders. The security terms for all of the RPU's outstanding bonds were negotiated pursuant to the issuance of the Electric Utility Revenue Bonds issued in 2000, which was the first in this series of financings.

The New Money Bonds will be repaid over a period from 2007 to 2030, the last date of payment for other outstanding bonds. The repayment will be structured with approximately even annual debt service payments.

The Refunding Bonds are estimated to produce net interest cost savings after consideration of all issuance costs on a present value basis of approximately \$2,300,000. On a net future value basis the estimated annual interest cost savings are \$187,000, in years 2007 through 2030. The percentage of the net present value savings to the present value of the refunded debt service is 6.07%.

Credit Rating/Security Conditions

The Utility has outstanding credit ratings of "Aa2" from Moody's Investors Service and "A+" from Fitch Investors. The Utility's Moody's rating was recently upgraded from "Aa3".

From both the Utility's and the bond investor's perspectives one primary indicator of the capacity to repay outstanding debt is debt service coverage. Coverage is the ratio of annual debt service to the net available revenues available to make debt payments. A one-to-one ratio indicates an issuer has just enough net revenues to fund annual debt service. We have estimated the coverage of future debt service with all outstanding bonds plus this proposed Issue. The estimate is based on historical actual net revenues for 2004 and 2005. The estimated coverage ranges from a low of 2.73 in 2007 to 3.68 in 2018. These estimated coverage levels are very favorable for the credit quality of the Utility.

Conclusion

We believe the Utility is well situated to successfully issue these Bonds. Today the tax-exempt municipal bond market is at a 40-year low which also presents a relatively favorable time to finance capital improvements and refund outstanding issues.

We would be glad to respond to any questions you may have on this financing.

Respectfully,

A handwritten signature in black ink that reads "David N. MacGillivray". The signature is written in a cursive style with a large, looping initial "D".

David N. MacGillivray
Principal

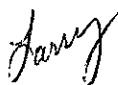
maj

cc: Mr. Dale Martinson, Finance Director, City of Rochester
Mrs. Mary Dyrseth, Briggs & Morgan



General Manager's Office
MEMORANDUM

(507) 280-1601
E-mail: lkoshire@rpu.org

DATE: December 7, 2006
TO: RPU Board
FROM: Larry Koshire 
SUBJECT: 2007 Electric Revenue Bonds

The installation of the emission reduction project (ERP) at the Silver Lake Power Plant unit 4 will necessitate the issuance of electric revenue bonds for project financing. As an action item on the December 14, 2006 board agenda, the Board will be asked to approve part of this project, the scrubber and baghouse. They will also be asked approve the entire project which is estimated at approximately \$34 million. The additional components that make up the entire ERP project will be bid out separately and brought back to the Board and Council for approval as part of the \$34 million material and equipment installation contract. The engineering services for this project were previously approved by the Board and Council in June

The 2007 budget reflects the continued growth of the City of Rochester and the capital investments needed to provide electrical capacity to serve this growing load. As the system has grown, we are reflecting in the five year forecast major one-time investments in new electrical distribution substations, transmission expansion, and distribution infrastructure to provide electrical service to the growing city. The budget reflects the need in the next three years for approximately \$7.1 million in 345 kV and 161 kV transmission projects, \$3.3 million in new substation and substation expansion projects, and approximately \$3.4 million in distribution feeder expansion and infrastructure. This is approximately \$14 million in one-time investments that will finance infrastructure that will be in service for the next 30 to 40 years serving future electric customers. Since continued capital investments have put pressure on reserves as the city expands, it would be prudent to finance these one-time investments as part of the financing for the ERP project. We are recommending this \$14 million be part of the bond issuance of \$34 million, or approximately \$48 million for system expansions and improvements.

We have been working with our financial advisor, Springsted Associates, to determine the best method of a bond sale for financing the above mentioned projects. We estimate the total bond sale would net us the \$48 million, as it does not include bond issuance costs, costs for the bond counsel, financial advisor, and other closing costs. In discussions with our financial advisor, we are apprised of the possibility of refunding the 2000 electric revenue bonds that would provide the Utility with a potential \$2 million savings. The market is attractive at this point to include this amount for a total financing. A letter from our financial advisor is included in this packet indicating their analysis and support of the issuance of the electric revenue bonds in consideration of a refunding of the outstanding bonds from 2000. This bond issue would allow

us to finance the needed emission reduction project, provide continued infrastructure improvements for electric customer growth, and potentially provide a significant savings through a refunding of outstanding bonds. We recommend the Board approve issuance of up to \$83 million in electric revenue bonds (not including debt service reserve or closing costs) subject to approval by the City Council and advice of our financial advisor on the final structure of the bond issuance.

As a final item, we discussed with the Board the use of a Clean Air Rider (CAR) on utility bills, which would cover the fixed costs (\$34 million bonds) of the ERP project. Once the details of the bonds, especially interest rates, are known, we will request the Board to approve the CAR at the time the approval for the bond sale is requested.

Attachment

LJK:kaw



RESOLUTION

BE IT RESOLVED by the Public Utility Board of the City of Rochester, Minnesota, that the Common Council of the said City is requested to approve, through issuance of Electric Revenue Bonds, the emission reduction project at Silver Lake Plant for approximately \$34,000,000, and

BE IT FURTHER RESOLVED that the Common Council approve, as part of the overall Electric Revenue Bond issue, financing of electric system improvements for approximately \$14,000,000, and

BE IT FURTHER RESOLVED that the Common Council authorize the issuance of revenue bonds to refund the Series 2000 RPU Electric Revenue Bonds of approximately \$35,000,000 due to positive market conditions. The total principal amount of the Electric Revenue Bonds to finance the improvements and the refunding, including costs of issuance and other related financing costs, will be approximately \$90,000,000. The Electric Revenue Bond sale will use a negotiated sale method.

Passed by the Public Utility Board of the City of Rochester, Minnesota, this 14th day of December, 2006.

President

Secretary