

FOR BOARD ACTION

Agenda Item #

5

Meeting Date:

7/27/10

SUBJECT:

Discussion of SMMPA Proposed Bond Issue

PREPARED BY:

Larry Koshire, General Manager

ITEM DESCRIPTION:

The current governmental stimulus program provides for incentives through a program called "Build America Bonds." These bonds, in addition to having low interest rates and flexibility in spending, have the advantage of a large discount. SMMPA is proposing to take advantage of the program that is now in place and may expire by the end of the year. SMMPA has identified two major areas for the appropriate use of these bonds. The first area is a refinancing of commercial paper, and the second is a project at the Fairmont generating plant whereby the Agency would acquire Fairmont's plant and assets and install a new gas fired generator up to 30 megawatts. This project would replace generating assets that were under member control and provide for the Agency's capacity needs.

I have attached a memo that responds to a SMMPA member request to explain the Build America Bond use, the Fairmont energy center project, and why the agency is recommending membership approval of these bonds. Also under separate cover is a presentation made at the last SMMPA board meeting on the Build America Bonds which further identifies the cost benefits and details of the capital projects these bonds would fund. The Agency has prepared a resolution for consideration by the SMMPA board and members at their August 2010 SMMPA board meeting which is also attached.

We believe the Agency has been responsive to our request to narrow the use of the bonds for the purposes identified only, provide for a levelized payment as these bonds are proposed for a 30 year issuance, and evaluate other alternatives such that this approach is in the economic interest of the majority of the members, including those that are not extending their contract beyond 2030. We also believe that the levelized approach for long term capital assets that are economically justified is an approach supportable and fair to all the members. The approach of levelized payments on new projects, and evaluating the economics on the lowest net present value can establish a future direction for other projects or bonds that may be presented to the members for approval.

FOR CAPITAL PURCHASES/BIDS/MAJOR PROJECTS:

Not Applicable

UTILITY BOARD ACTION REQUESTED:

No action is requested at this time.



General Manager

7-23-10
Date

ROCHESTER PUBLIC UTILITIES



SOUTHERN MINNESOTA
MUNICIPAL POWER AGENCY

Bringing power to your life.

July 19, 2010

RE: Fairmont Energy Center/Build America Bonds

Dear Member Representatives:

This letter responds to the request made at the July SMMPA board meeting for a summary of the merits of adding an Agency-owned, natural gas fired 25 MW (approximately) generating facility in Fairmont, and using Build America Bonds to be repaid on a level debt basis over a 30 year period (approximately) to finance that facility. For those interested in additional information, we have attached two presentations from that meeting as well as the July 7, 2010 letter you received electronically.

Due to the retirement of inefficient generation and two Power Purchase Agreements (PPAs) that will expire by 2013, the Agency has a need for 50 MWs of generation capacity beginning in 2013. To determine the most economic means of acquiring that generation, the Agency evaluated different generation technologies and different locations to site Agency-owned generation. We compared the economics of these options with various arrangements under which the Agency would contract for the capacity instead of owning any of the replacement generation.

Our analyses have led to the following conclusions:

1. Agency ownership of the 25 MW facility, combined with a 5 year 25 MW Power Purchase Agreement (PPA) is a lower cost option than a 50 MW PPA.
2. Issuing Build America Bonds in 2010 to finance the facility, to refund Commercial Paper, and to finance other improvements to the System results in lower overall costs than waiting until 2012 to issue long-term debt.
3. Compared to PPAs with no Agency ownership, combining points 1 and 2 above results in lower costs for the Agency and for all Members, including Members who have set a Contract Rate of Delivery; Members who have not extended their Power Sales Contracts past 2030; and full requirements Members who have extended their contracts. Owning the 25 MW plant and financing it with Build America Bonds helps to reduce upward pressure on rates for all Members.
4. If ownership of a generating facility in Fairmont (or elsewhere) is not pursued, to meet its capacity needs the Agency most likely would enter into PPAs to acquire the capacity and energy and incur the higher costs. Those added costs would be passed to all Members via the Agency's rates.

Member Representatives

Page 2

July 19, 2010

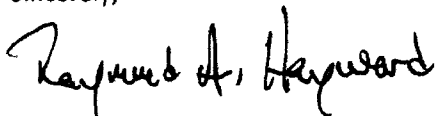
The recommended approach of adding a 25 MW Agency-owned facility combined with a 25 MW capacity purchase provides flexibility. It keeps approximately 25 MWs of the Agency's capacity portfolio in a relatively short-term contract (PPA or regulatory capacity). When the short-term contract nears expiration, the Agency will be able to determine how best to meet future needs (contract for the capacity; add Agency-owned generation; other?) based upon how the Agency's needs have evolved over that 5 year period, upon then-existing market conditions, and upon the forecasts at that time.

Other benefits of adding this 25 MW facility as an Agency owned asset include:

- Increasing the Agency's fuel diversity and thereby decreasing its reliance on coal as a fuel source;
- Adding operational flexibility with generation that can respond quickly to MISO prices, especially as those prices may be influenced by intermittent resources such as wind generation;
- Adding reliability for a Member community;
- Utilizing existing transmission rights currently allocated to the Agency;
- Reducing greenhouse gas emissions by adding efficient generation technology;
- Beginning to build a more diversified generation portfolio and a back-up plan for Sherco 3; and,
- The Agency will own the asset, contrasted with owning nothing at the end of a PPA.

Please let us know if you have any questions or would like additional information.

Sincerely,



Raymond A. Hayward
Executive Director & CEO

RAH:kbb
Attachments

RESOLUTIONS OF BOARD OF DIRECTORS OF SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY RELATING TO AUTHORIZING THE ISSUANCE OF THE AGENCY'S POWER SUPPLY SYSTEM REVENUE BONDS IN AN AGGREGATE PRINCIPAL AMOUNT OF NOT TO EXCEED \$[90] MILLION IN CONNECTION WITH THE PAY DOWN OF A PORTION OF THE AGENCY'S CURRENTLY OUTSTANDING COMMERCIAL PAPER NOTES, SERIES B, AND PROVIDING FOR THE PAYMENT OF COSTS OF ACQUISITION AND CONSTRUCTION OF THE POWER SUPPLY SYSTEM

WHEREAS, pursuant to the Power Supply System Revenue Bond Resolution adopted by the Board of Directors (the "Board") of Southern Minnesota Municipal Power Agency (the "Agency") on May 11, 1983 (as supplemented and amended from time to time, the "Resolution"), the Agency is authorized to issue one or more series of bonds designated as "Power Supply System Revenue Bonds" (the "Bonds") for the purpose of financing all or a portion of the Cost of Acquisition and Construction of the System (as such terms are defined in the Resolution); and

WHEREAS, the Agency currently has outstanding \$33 million in principal amount of its Power Supply System Commercial Paper Notes, Series B (the "Outstanding CP Notes") which constitute Subordinated Indebtedness under the Resolution; and

WHEREAS, the Agency has determined that it is in the best interests of the Agency and its Members to proceed with the acquisition of property comprising the Fairmont, Minnesota, Light Plant and the reciprocating engine generating units thereon (excluding that portion of the land comprising the City park, and the equipment comprising the City water tower, the low pressure steam boilers and other equipment used for district heating, the 69Kv transformer and interconnect switch and the equipment required for the City's electric distribution system) and to acquire and construct one or more additional reciprocating engine generating units, with such additional reciprocating engine generating units not exceeding in the aggregate 30 megawatts, all to be located on or near the Fairmont Light Plant (the "Fairmont Project"); and

WHEREAS, the Agency has determined that it is in the best interests of the Agency and its Members to finance (i) the pay down of not more than \$20 million in principal amount of the Outstanding CP Notes (the "Refunded CP Notes"), (ii) the Fairmont Project, (iii) certain other Costs of Acquisition and Construction of the System including, but not limited to, the costs of transmission projects; and (iv) the costs of issuance of the Agency's Power Supply System Revenue Bonds (the "Bonds"); and

WHEREAS, the aggregate principal amount of Bonds necessary to pay down the Refunded CP Notes, finance the Fairmont Project and finance certain other Costs of Acquisition and Construction of the System shall not exceed [\$90] million; and

WHEREAS, it is the intent of the Agency to structure the Bonds to be amortized on a level debt basis over a minimum of 30 years, with such 30 year amortization period

beginning after the period, if any, during which interest on the Bonds has been capitalized and paid by proceeds of the sale of the Bonds; and

WHEREAS, subject to the limitations set forth herein, the Agency has determined that it is in the best interests of the Agency and its Members to delegate to the Board certain determinations relating to the aggregate principal amount of Bonds issued for (i) through (iv) above; and

WHEREAS, pursuant to Section 9(B) of the Agency Agreement dated as of April 1, 1977 by and among the Agency's Members (the "Agency Agreement"), certain actions may be taken by the Agency only when authorized by a resolution of the Board of Directors approved by the Representatives of the Members, which approval of the Representatives may be given by resolution which is general in scope and continuous in nature and may delegate to the Board the power to take any and all action reasonably necessary or desirable to accomplish the purpose of such resolution.

NOW, THEREFORE, BE IT HEREBY

RESOLVED, that the issuance by the Agency of up to [\$90] million in aggregate principal amount of Power Supply System Revenue Bonds in one or more series on a taxable and/or a tax-exempt basis in order to finance the pay down of the Refunded CP Notes, the Fairmont Project, other costs of Acquisition and Construction of the System and the costs of issuance of the Bonds is hereby authorized; and be it further

RESOLVED, that the Agency shall direct its consultants and advisers to use reasonable, good-faith efforts to structure the Bonds to the extent practical to be amortized on a level debt basis over a minimum of 30 years, with such 30 year amortization period beginning after the period, if any, during which interest on the Bonds has been capitalized and paid by proceeds of the sale of the Bonds, so long as in the opinion of the Agency's Financial Adviser this approach does not unduly restrict the successful marketing and issuance of the Bonds; and be it further

RESOLVED, that there be and hereby is delegated to the Board of Directors the power and authority to determine, based on the best interests of the Agency and its Members, (i) the aggregate principal amount of the Refunded CP Notes to be paid down so long as that amount does not exceed \$20 million, (ii) if Bonds should be issued to finance the Costs of Acquisition and Construction of the Fairmont Project, (iii) if Bonds should be issued to finance certain other Costs of Acquisition and Construction of the System including, but not limited to, the costs of transmission projects, (iv) the amount of Bonds issued for the payment of costs of issuance of the Bonds and (v) if the Bonds will be issued on a taxable and/or a tax-exempt basis; and be it further

RESOLVED, that the foregoing delegation to the Board of Directors shall not permit, without the further approval of the Member Representatives, the issuance of CP Notes (which issuance is made possible by the pay down of the Refunded CP Notes) or the proceeds of

the Bonds hereby authorized to be used to add a generator to the System (other than costs in connection with the Fairmont Project); and be it further

RESOLVED, there be and hereby is delegated to the Board of Directors the power and authority to take any and all action reasonably necessary or desirable to accomplish the purpose of this resolution including, without limitation, the adoption of one or more supplemental resolutions authorizing the issuance of the Bonds and the execution and delivery of all documents reasonably necessary or desirable in connection with the issuance of the Bonds; and be it further

RESOLVED, that the officers of the Agency be and each of them hereby is authorized to execute or accept such further documents, to attest to and affix the seal of the Agency to documents authorized by these resolutions where necessary and to take any and all such further action as may be reasonably required on the part of the Agency to carry out, give effect to and consummate the transactions contemplated hereby; and be it further

RESOLVED, that, pursuant to Section 9(B) of the Agency Agreement, the Board seeks from the Representatives authority to take such actions as the Board shall from time to time deem necessary or desirable to accomplish the purposes of these resolutions.

ADOPTED, by the Board of Directors of the Agency this ____ day of August, 2010.

RESOLUTIONS OF THE REPRESENTATIVES OF THE MEMBERS OF SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY APPROVING THE RESOLUTION ADOPTED BY THE BOARD OF DIRECTORS AUTHORIZING THE ISSUANCE OF THE AGENCY'S POWER SUPPLY SYSTEM REVENUE BONDS IN AN AGGREGATE PRINCIPAL AMOUNT OF NOT TO EXCEED [\$90] MILLION IN CONNECTION WITH THE PAY DOWN OF A PORTION OF THE AGENCY'S CURRENTLY OUTSTANDING COMMERCIAL PAPER NOTES, SERIES B, AND PROVIDING FOR THE PAYMENT OF COSTS OF ACQUISITION AND CONSTRUCTION OF THE POWER SUPPLY SYSTEM

WHEREAS, on August ____, 2010 the Board of Directors (the "Board") of Southern Minnesota Municipal Power Agency (the "Agency") adopted a resolution authorizing the Agency to issue up to [\$90] million in aggregate principal amount of Power Supply System Revenue Bonds in one or more series on a taxable and/or a tax-exempt basis in order to finance (i) the pay down of not more than \$20 million in outstanding principal amount of the Agency's Power Supply System Commercial Paper Notes, Series B, subject to certain the limitations set forth in such resolution, (ii) the acquisition of property comprising the Fairmont, Minnesota, Light Plant and the reciprocating engine generating units thereon (excluding that portion of the land comprising the City park, and the equipment comprising the City water tower, the low pressure steam boilers and other equipment used for district heating, the 69Kv transformer and interconnect switch and the equipment required for the City's electric distribution system) and to acquire and construct one or more additional reciprocating engine generating units, with such additional reciprocating engine generating units not exceeding in the aggregate 30 megawatts, all to be located on or near the Fairmont Light Plant , (iii) certain other Costs of Acquisition and Construction of the System including, but not limited to, the costs of transmission projects and (iv) the costs of issuance of the Agency's Power Supply System Revenue Bonds, as described therein (the "Board Resolution"); and

WHEREAS, the Board authorized the President or Secretary of the Agency or the Executive Director and CEO to execute documents and to take all such further action as may be reasonably required or desirable on the part of the Agency to consummate the transactions contemplated by the Board Resolution; and

WHEREAS, pursuant to Section 9(B) of the Agency Agreement dated as of April 1, 1977 by and among the Agency's Members, certain actions may be taken by the Agency only when authorized by a resolution of the Board of the Agency approved by the Representatives of the Members (the "Representatives"), which approval of the Representatives may be given by resolution which is general in scope and continuous in nature and may delegate to the Board the power to take any and all action reasonably necessary or desirable to accomplish the purpose of said resolution.

NOW, THEREFORE, BE IT HEREBY RESOLVED, that the Board Resolution attached hereto as Exhibit A be and hereby is in all respects approved, and that there be and hereby is delegated to the Board of Directors the power and authority to take any and all action

reasonably necessary or desirable to accomplish the purposes of such resolutions and; be it further

RESOLVED, with the exception of the power and authority delegated herein to the Board to adopt a resolution which may be supplemental to the Bond Resolution, all power and authority delegated herein to the Board may be delegated to a Delegatee by the Board, until such time as the Board decides to rescind such delegation, at which time the Board may delegate such power and authority to another entity or may maintain such power and authority unto itself.

ADOPTED, by the Representatives of the Members of the Agency this ____ day of August, 2010.