CITY OF BATAVIA

DATE: **February 14, 2013**
TO: **Public Utilities Committee**
FROM: **Gary Holm**
SUBJECT: **Prairie State Basic Concepts and Utility Financial Projections**

Several aldermen have requested that we update our presentation of the basic concepts associated with Batavia's involvement in the Prairie State project. We've also received requests to update our five-year financial projections as they relate to the Utility and Prairie State.

Please find attached a PDF entitled "Prairie State Basic Concepts 2_19_13". This document summarizes many of the basic concepts that we have discussed over the past few years. We plan to review the slides in detail at the Committee meeting and answer any questions you may have.

Also attached please find a PDF entitled "Five Year Financial Projections 2013-2017". This document will also be reviewed in detail at the meeting.

If upon your initial review you have questions, then please contact me so that I can be sure to address them at the meeting.

Guide to understanding Slide #1:

- This slide is for illustrative purposes only. The cost values shown are theoretical only.

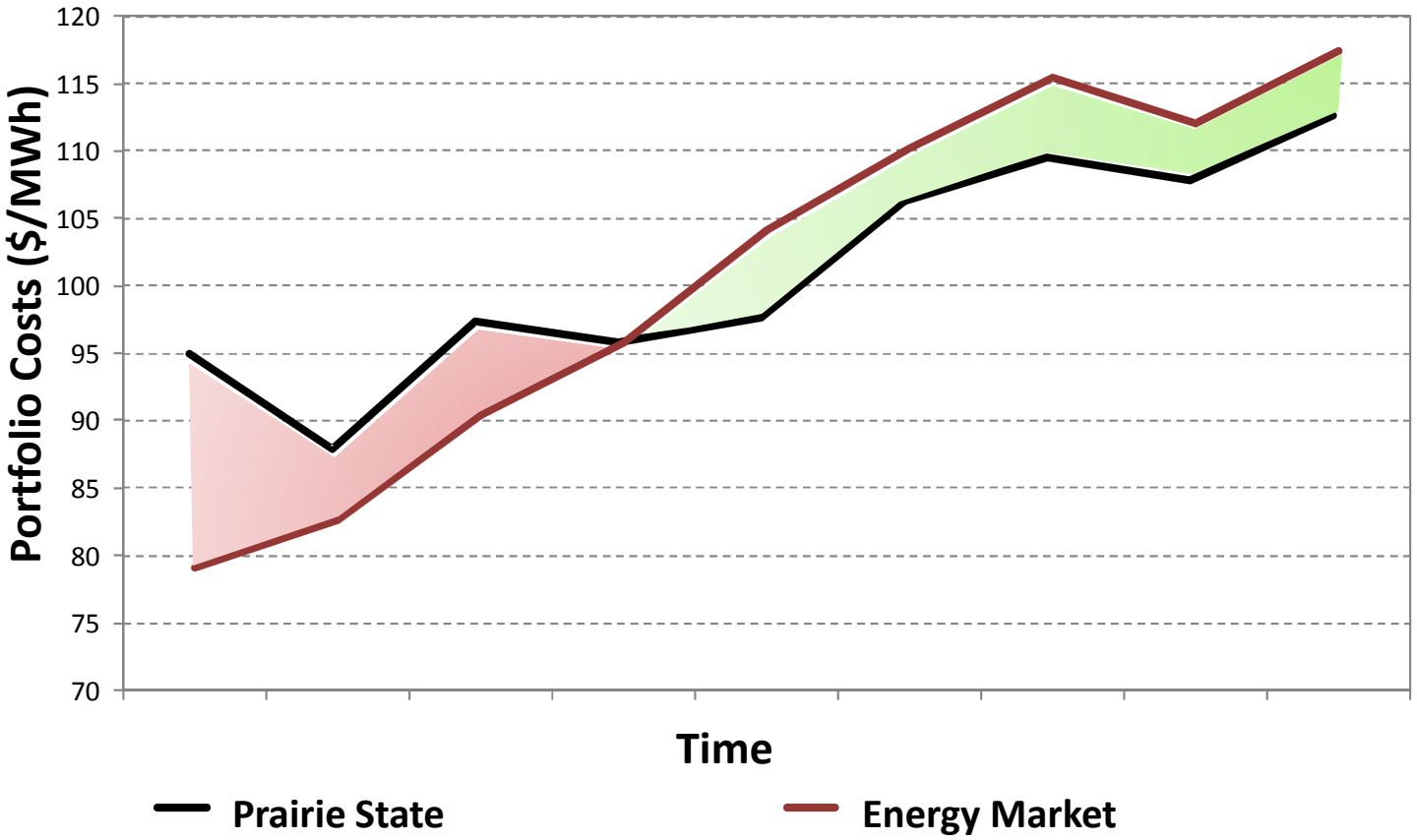
- The black line is a theoretical representation of costs associated with Prairie State

- The red line is a theoretical representation of the price of energy market purchases

- The point at which the black line crosses the red line is commonly referred to as the "crossover" and is discussed in more detail on the next slides

- The red shaded area represents that period of time in which the cost of Prairie State exceeds the cost of energy on the market. During this time period:
    - The City is paying more for energy from Prairie State then it could otherwise purchase it from the market
    - The City is losing money on the sale of any excess power purchased from Prairie State and sold back into the market

- The green shaded area represents that period of time in which the cost of Prairie State is below the cost of energy on the market. During this time period:
    - The City is benefiting from ownership by receiving power at a lower cost then it could otherwise purchase on the market
    - The sale of any excess power purchased from Prairie State results in increased revenues for the utility

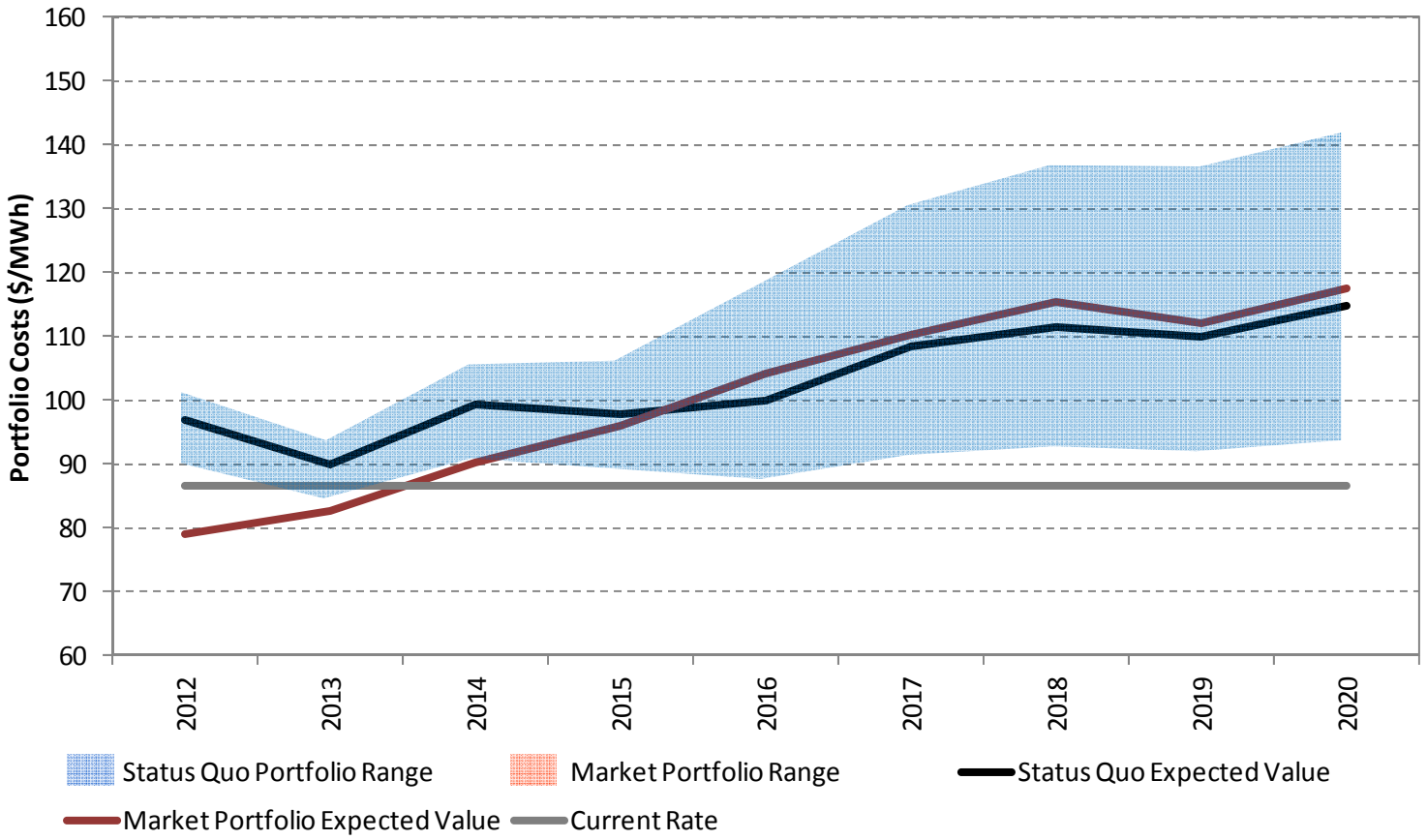

120
115
110
105
100
95
90
85
80
75
70
Portfolio Costs ($/MWh)
Time
Prairie State
Energy Market

Guide to understanding Slide #2

- This slide comes from data out of the Pace Global study which was completed in 2011

- A statistical analysis was performed to project the future cost of Batavia's portfolio, which consists primarily of Prairie State.

- The black line represents the expected cost of Batavia's portfolio and the shaded blue area represents the possible range within it may fall over time.


Portfolio Costs ($/MWh)
160
150
140
130
120
110
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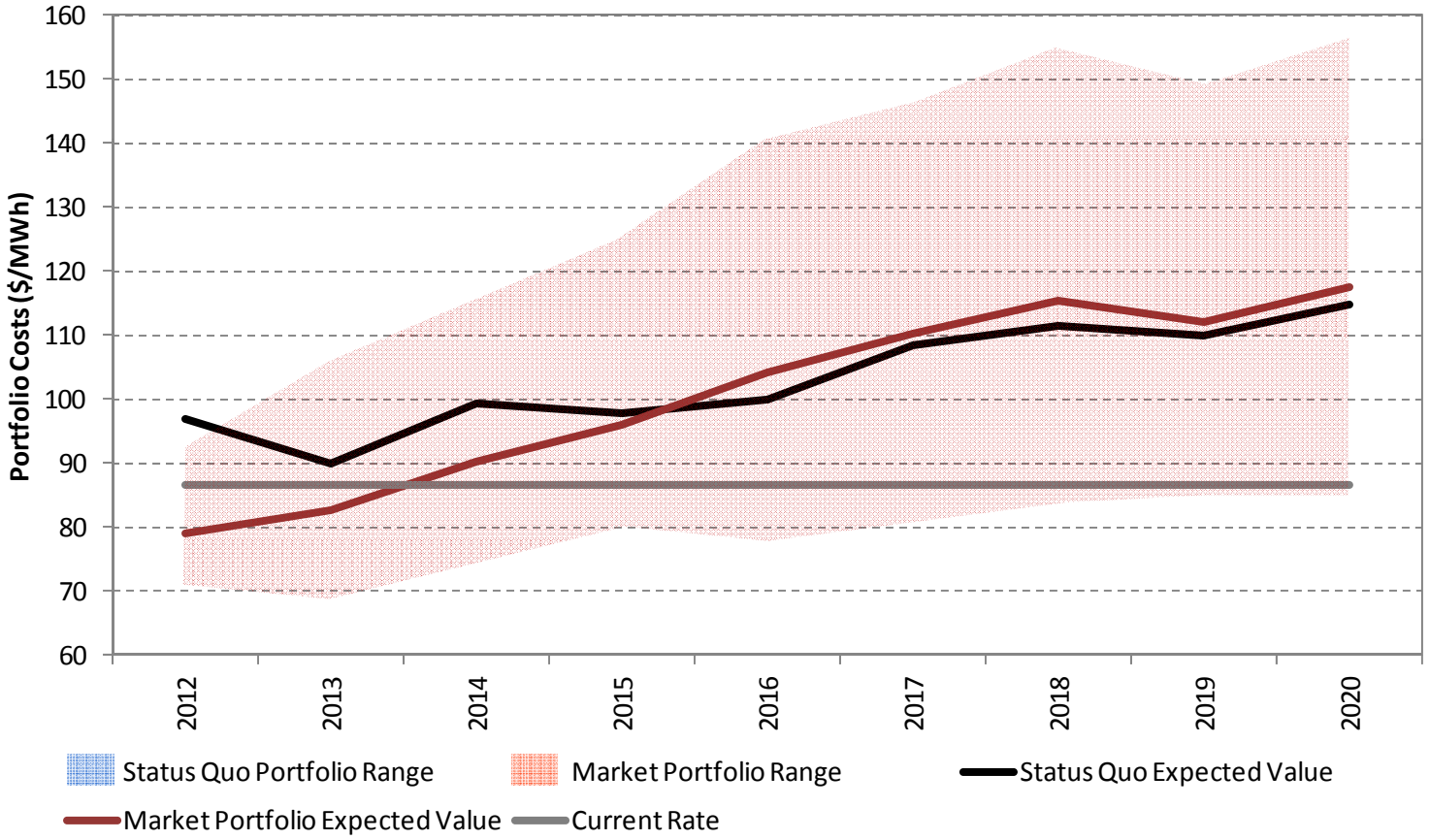
90
80
70
60
2012
2013
2014
2015
2016
2017
2018
2019
2020
Status Quo Portfolio Range
Market Portfolio Range
Status Quo Expected Value
Market Portfolio Expected Value
Current Rate

Guide to understanding Slide #3

- This slide comes from data out of the Pace Global study which was completed in 2011

- A statistical analysis was performed to project the cost of future energy market purchases

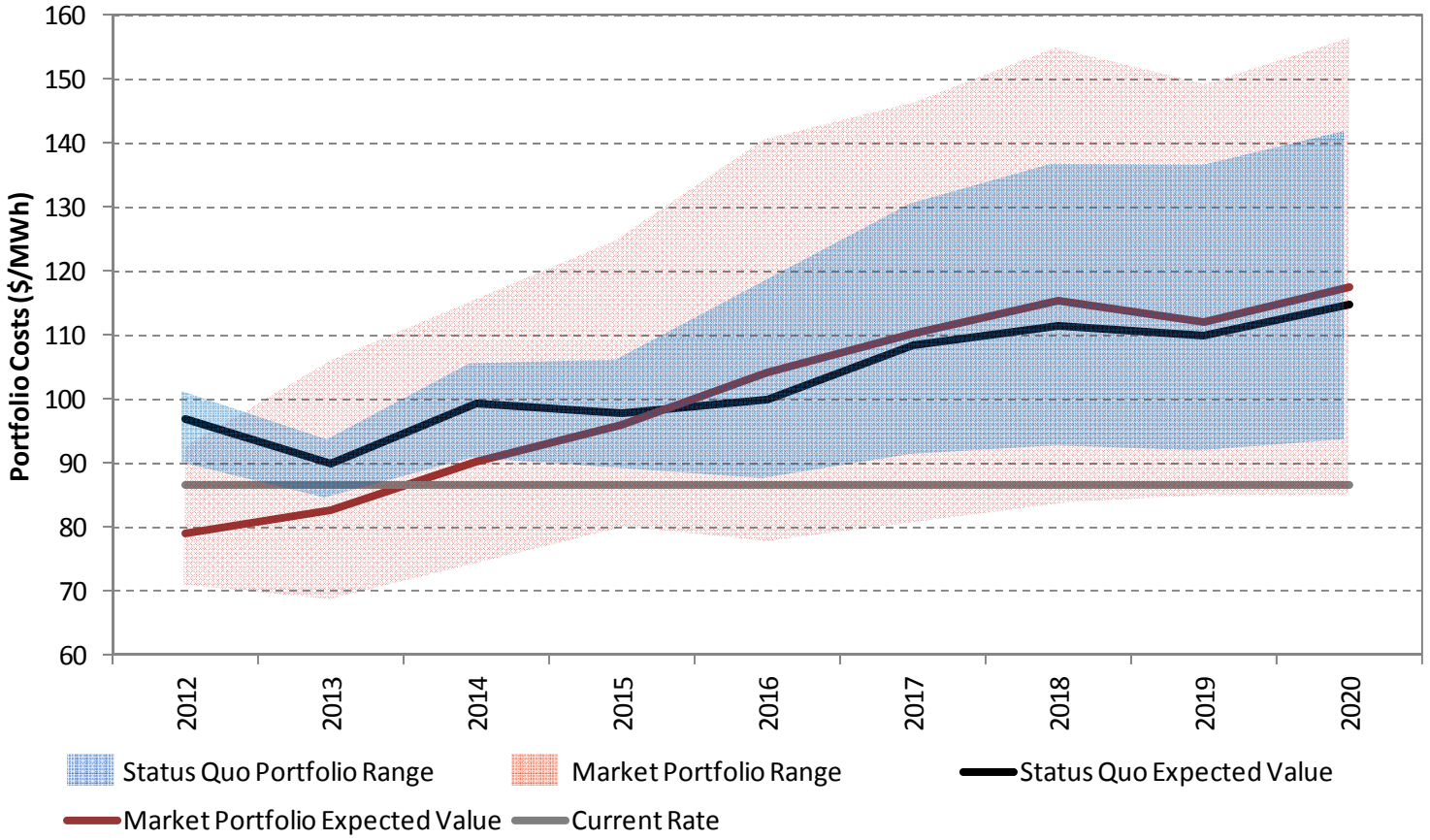
- The red line represents the expected cost of market purchases and the shaded pink area represents the possible range within the costs may fall over time.


Portfolio Costs ($/MWh)
160
150
140
130
120
110
100
90
80
70
60
2012
2013
2014
2015
2016
2017
2018
2019
2020
Status Quo Portfolio Range
Market Portfolio Range
Status Quo Expected Value
Market Portfolio Expected Value
Current Rate

Guide to understanding Slide #4

- This slide comes from data out of the Pace Global study which was completed in 2011

- The keys to this slide are the black line (Prairie State cost) and the shaded pink area. Note that in the year 2020 it is projected that the black line will fall approximately in the center of the pink shaded area. This means that there's approximately a 50/50 chance that the cost of energy market purchases will be either more or less expensive than the cost of Prairie State.


Portfolio Costs ($/MWh)
160
150
140
130
120
110
100
90
80
70
60
2012
2013
2014
2015
2016
2017
2018
2019
2020
Status Quo Portfolio Range
Market Portfolio Range
Status Quo Expected Value
Market Portfolio Expected Value
Current Rate

Guide to understanding Slide #5

- This slide comes from the Brattle sale process using 1/9/2013 through 1/16/2013 market data.

- The Y axis is the cost of energy in $/MWh. The X axis is time in years from 2013 to 2024.

- General market wisdom is that futures energy prices and natural gas prices tend to track together during peak times.

- The two parallel black lines create a range of plus or minus one dollar around the Henry Hub futures price for natural gas.

- Henry Hub is the physical location tied to natural gas futures contracts that are traded on the NYSE. Henry Hub is typically referenced when analyzing the price of natural gas.

- The blue line represents a combination of known market forward prices for peak and off-peak energy and Brattle's projections for peak and off-peak energy. Peak energy is indexed to natural gas generation which generally controls during peak times. Off-peak energy is indexed to coal generation which generally controls during off-peak times.

- NIMPA has provided us with the 2013 cost for Prairie State power. This cost includes an Energy Cost Adjustment (ECA) factor which could vary throughout the year. This cost includes all power components, not just energy.

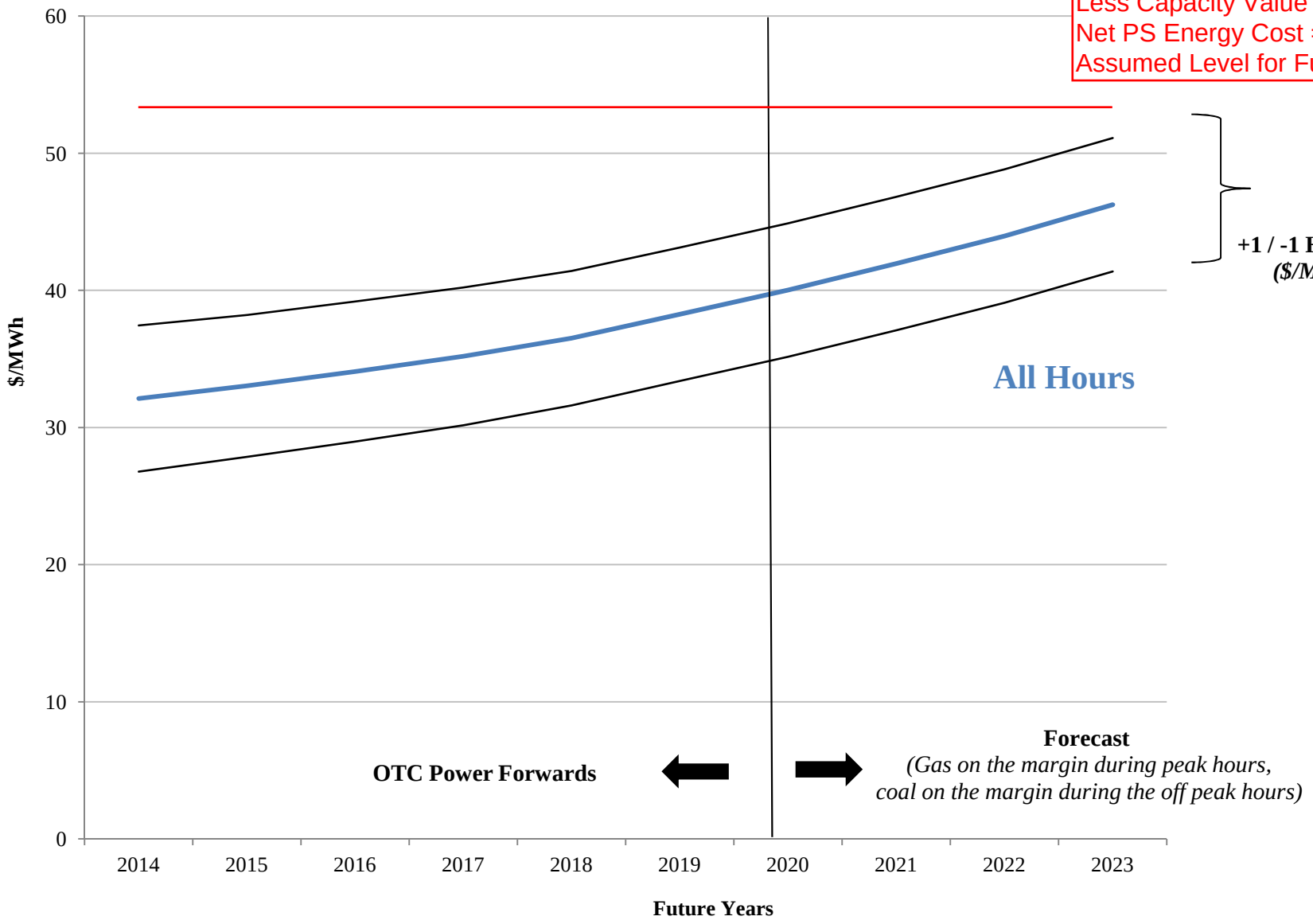
- In an effort to more accurately compare the red line to the blue line, the value of capacity from Prairie State was estimated. This value was estimated using known auction results and Brattle future projections.

- The value of capacity was subtracted from NIMPA's 2013 cost to create an estimated Prairie State energy cost and is plotted as the red line on the graph. For simplicity, the red line was plotted flat (no increase) for future years.

- Assuming no increase in Prairie State costs and using Brattle's future energy projections, the "crossover" is estimated to occur beyond 2024. This means that for the foreseeable future:
    - The City is paying more for energy from Prairie State then it could otherwise purchase it from the market
    - The City is losing money on the sale of any excess power purchased from Prairie State and sold back into the market

Northern Illinois Hub Forecast [All Hours]
($/MWh)

NIMPA 2013 Rate w/ECA = $59.955/ MWh
Less Capacity Value = +/-$7.1/MWh
Net PS Energy Cost = +/-$52.85/MWh
Assumed Level for Future Years



Attached is a summary of 5-year financial projections for the Electric Utility. Some items of note:

Expenses

- Expenses excluding purchase power are expected to rise modestly, or in some cases remain level, over the next five years. These expenses include items such as personnel, operations & maintenance, equipment, facilities, etc.

- Expenses for short-term summer peak purchase power are projected to remain relatively constant throughout the five-year period.

- Batavia was notified at the January NIMPA meeting that insufficient funds were collected by the agency in 2012. An additional $1.2M needs to be collected during the first six months of 2013 in order to make up the shortfall. This information was not accounted for in Batavia's 2013 budget.

- According to the most recent information provided by NIMPA, costs associated with Prairie State are projected to be level over the next five years.

Revenues

- Revenues excluding the sale of energy are expected to rise modestly over the next five years. These revenues include items such as interfund transfers, permit fees, reimbursements, investment revenues, etc.

- The amount of energy sold to our customers is expected to rise 1-2% annually over the next five years.

- The utility's Purchase Power Adjustment Factor (PPAF), which was established by Ordinance as part of the 138 KV bonds, will automatically adjust to cover the cost of purchase power. City Council has previously authorized the use of up to $2M in reserve funds to stabilize the PPAF and reduce impacts on our customers. It is anticipated that the PPAF will rise in 2013 despite the anticipated use of the entire $2M in stabilization funds.

Summary

- The future financial impact to rate payers is most clearly seen by looking back in time. The utility's annual cost of purchase power has increased approximately $6M from 2010 to the present. It is this increased cost that will continue to impact rate payers going forward.

- It is difficult to project best & worst case scenarios. Our long position in Prairie State means that we are exposed to variations of the power market. We are selling excess power back into the market on an almost daily basis. The result of these sales has a direct impact on the utility's financial performance. In the near term it appears that we will be selling back into the market at a loss. We've been advised by our consultants that over the long-term market costs will rise and there will be a "crossover". After that time we will be selling back excess power for a profit. The exact timing of the "crossover" is unknown.

- Additional revenues may be needed for 2013 and beyond. These revenues could come in the form of a higher PPAF and/or rate/fee increases. Based on information we already know, we are projecting the PPAF throughout the first half of 2013 to range between $0.01 and $0.02. This assumes utilization of the entire $2M in rate stabilization funds. For reference, the PPAF throughout 2012 was in the range of $0.00 to $0.01.

	2010 Actuals	2011 Actuals	2012 Estimated	2013	2014	2015	2016	2017
EXPENSES								
#21-61 Electric Improvements	$3,848,954	$1,556,307	$1,843,034	$3,470,000^	$3,500,000	$3,500,000	$3,500,000	$3,500,000
#21-62 Meter Reading / Locating	$386,958	$413,757	$426,700	$444,210	$450,000	$475,000	$475,000	$500,000
#21-64 Transmission & Distribution **Excluding** Purchase Power	$8,720,764	$8,141,820	$7,538,811	$8,097,608	$8,300,000	$8,600,000	$8,900,000	$9,200,000
#21-64 Purchase Power	$24,925,589	$24,197,197	$29,394,653	$32,400,000	$31,200,000	$31,200,000	$31,200,000	$31,200,000
#21-90 Interfund Transfer	$679,146	$661,904	$718,734	$721,582	$725,000	$725,000	$725,000	$725,000
#21-98 Revenue Bond Payments	$1,424,480	$1,423,805	$1,702,806	$1,703,606	$1,700,000	$1,700,000	$1,700,000	$1,700,000
Total Expenses	$39,985,891	$36,394,790	$41,624,738	$46,837,006	$45,875,000	$46,200,000	$46,500,000	$46,825,000
REVENUES								
Revenue **Excluding** Sale of Electricity	---	---	---	$550,000^	$600,000	$650,000	$700,000	$750,000
Revenue from Sale of Electricity	---	---	---	The cost of purchase power is automatically passed through to customers via the PPAF. Revenue increases proportionally with expenses per the PPAF formula. **The true impact on rate payers is more accurately determined by looking at the increase in expenses for purchase power**. The PPAF automatically collects more revenue as necessary to cover costs.				

^ - 2013 revenues/expenditures do not include Rubicon improvements