SPECIAL CALL JOINT UTILITIES / FINANCE COMMISSION MINUTES
Monday, May 2, 2016 – 9:00 A.M.
City Hall, Council Chambers, Vero Beach, Florida

PRESENT: Finance Commission: Chairman, Peter Gorry; Vice Chairman, Glen Brovont; Members: Kathryn Barton, Nathan Polackwich, John Smith, Alternate Member #1, Daniel Stump and Alternate Member #2, Victor DeMattia **Utilities Commission:** Chairwoman, Laura Moss; Vice Chairman, Indian River Shores' Representative, Robert Auwaerter; Members: Chuck Mechling, Judy Orcutt, Stephen Lapointe, Bill Teston, J. Rock Tonkel and Alternate Member #1, George Baczynski **Also Present:** City Manager, James O'Connor and Deputy City Clerk, Sherri Philo

1. CALL TO ORDER

Today's meeting was called to order at 9:00 a.m.

Mrs. Moss read into the record the purpose of the Utilities Commission listed in the City's Code, *"The Utilities Commission is expressly charged with representing and considering all utility customers of the City in its activities, including City resident and non-resident customers alike."* She reported that tomorrow, immediately following Mr. Schef Wright's presentation to the City Council, Mr. Dylan Reingold, County Attorney, will be discussing the Florida Power & Light (FPL) electric utility sale. She read into the record Mr. Reingold's memorandum to the Board of County Commissioners dated April 5, 2016, *"The City of Vero Beach and FPL have entered into an agreement for the City to sell the City's electric utility to FPL. On two occasions, the voters of the City approved referenda supporting the sale of the City's electric utility to FPL. Since that time the negotiations between the Florida Municipal Power Agency (FMPA), Orlando utilities Commission (OUC), the City and FPL have stalled"* (memo attached to the original minutes). She said the purpose of Mr. Reingold coming before the City Council is to request that the City Council authorize the City's outside Counsel to join in discussions with FMPA, OUC, FPL, Indian River County, and the Town of Indian River Shores (IRS) to complete the sale.

Mr. Gorry said the Finance Commission is charged with the health and vitality in overseeing all finances of the City, which includes all customers, as well as City employees. He asked what is the expected outcome from each Commission as a result of today's presentation.

Mr. Jim O'Connor, City Manager, explained that staff is not requesting a recommendation. Today's meeting is for the Utilities/Finance Commissions to be briefed on what will be presented to the City Council pertaining to a partial sale of the utility.

2. PUBLIC COMMENT

None

3. PRESENTATION BY MR. SCHEF WRIGHT ON THE COST AND EXPOSURE FOR PARTIAL SALE OF THE ELECTRIC SYSTEM TO INDIAN RIVER SHORES

*Please note that questions and answers took place throughout the presentation (backup information on today's presentation attached to the original minutes).

Mrs. Moss asked Mr. Wright to introduce members of the audience who were with him today and to state their expertise so the Commission members can direct their questions to the appropriate person.

Mr. Schef Wright, Attorney, introduced Mr. Bill Herrington, stating that he has 40-years in the power industry almost all municipally related; Mr. Jerry Warren, stating that he also has about 40-years in utilities and is the past Utilities Director of Gainesville and the City of Winter Park; Mr. Henry Thomas, of Public Resources Management Group (PRMG), stating that he is the City's Rate Consultant. Not present today is Mr. Murry Hamilton, of PRMG, who is a key member of the Rate Study team for the City and a key member of the group who prepared the estimates that is included in their backup information.

Mr. Wright reported that in June, 2014, OUC and FMPA hit an impasse regarding OUC's ability to take assignment of the City's FMPA Power Purchase Agreements (PPA) and Project Support Contracts relative to bond covenants, which created the failure of a necessary condition for a total sale. When that happened IRS became very interested in a partial sale through various mitigation measures. In August, 2015, FPL made a formal offer in writing to purchase the IRS system for $13 million dollars and the City's team was asked to give an estimate of what a reasonable payment and transaction structure would be to keep the City and all electric customers, other than IRS, whole in the event of a partial sale to FPL. The team did a preliminary analysis last summer and the number in that analysis was $64.4 million. They then met with FPL in early September 2015, which did not go very far because FPL could not justify anything more than $13 million.

Mrs. Moss said that she has a question regarding IRS Resolution #414 (on file in the City Clerk's office) before they get into the numbers. She said IRS originally contracted with the City for 25 years in 1968. But, in 1986 the IRS Town Council passed Resolution #414. She read into the record the title of the Resolution, *"A Resolution granting to the City of Vero Beach, Florida, its successors and assigns, an electric franchise in the incorporated areas of the Town of Indian River Shores, Florida; imposing provisions and conditions relating thereto; and providing an effective date."* She then read into the record, in part, Section 14 of the Resolution, "*This* *franchise is subject to renewal upon the agreement of both parties. In the event the Grantee desires to renew this franchise, then a five year notice of that intention to the Grantor shall be required. Should the Grantor wish to renew this franchise, the same five year notice to the Grantee from the Grantor shall be required and in no event will the franchise be terminated prior to the initial thirty (30) year …"* She said this means that either party, the City of Vero Beach or IRS, needed to state five (5) years ago that they wished to continue this arrangement. She asked Mr. Wright was any notice furnished by either party.

Mr. Wright said that he did not agree with Mrs. Moss regarding notice being given, as a matter of law. He said somewhere close to February, 2014, IRS did give written notice to the City that they did not intend to renew the contact. He did not think notice was given five (5) years ago.

Mrs. Moss asked did the City give notice of their desire to renew five (5) years ago as required by this contract.

Mr. Wright said that he was not aware of any such notice having been given from either side in the five (5) year period contemplated by the franchise agreement. The only notice that he was aware of was the one that was given a few years ago from IRS to the City stating that they would not renew the franchise.

Mrs. Moss said then there is no argument that this expires.

Mr. Wright said that is correct. There is no argument that the franchise agreement is going to expire on November 6, 2016.

Mrs. Moss did not see where in this 30-year agreement that it extends beyond 30 years.

Mr. Wright said the franchise agreement is an agreement between the City and IRS as to the matters covered by the franchise agreement only. All that happens when the franchise agreement expires is that both sides are relieved of their obligations to each other as to the specific obligations under that agreement. There is no option to buy, no requirement that the City has to vacate, and there is nothing that states the City does not get to serve anymore. It simply states that the City doesn't collect the franchise agreement anymore and IRS doesn't have to maintain their rights-of-way for the City anymore.

At this time, Mr. Wright continued with his presentation. He said they met with representatives of IRS on January 27, 2016, and in the course of their conversation he was asked that they look at this from a revenue requirement respective. At that time, the City's team embarked on a process that led to the preparation of the spreadsheets in front of the Commission today. He said the reason it took until the middle of April was because they knew new information would be available from the FMPA regarding long term power cost projections from the three projects that the City participates in and they felt it would be best to wait until they had that information. He said they looked at all the components of the revenue requirements of the City and they broke them down into five (5) major components, which were: 1) General Fund transfer debt, 2) City electric costs, 3) non-departmental costs, 4) non-departmental costs paid by the electric system, and 5) bulk power supply costs. He said they also updated the natural gas price forecast and the latest bulk power supply costs. In front of the Commission is documentation of the revenue requirements, year by year, component by component analysis and the rate impacts of each.

Mrs. Moss asked Mr. Wright to go over the highlights of the difference between the $64 million number and the $42 million number.

Mr. Wright said they would cover that in their discussion. He said they were asked by the City to come up with the best estimate that they could come up with. They used the best information available, which produced the information presented today. In highlight, the principle that the City articulated all along is that they would consider selling IRS book of business to FPL or to IRS at a price and in a transaction structured so as to keep the City, their citizens, and all their customers whole in the event such a transaction were to occur. There are two components to that, which are: 1) a dollar amount sufficient to cover the fixed costs that would otherwise be shared by IRS over a period of time and 2) to address the City's contingent liabilities under the power supply contracts and project support contracts of the three (3) power supply contracts (Stanton I, Stanton II, and St. Lucie) in which the City participates.

Mrs. Moss said that she looked up the definition of "contingent liabilities" and what she found was the following, "*a contingent liability is recorded in the books of accounts only if the contingency is probable and the amount of the liability can be estimated.*" She asked Mr. Wright if he felt this was a fair definition.

Mr. Wright said in the disclosure requirements of the Financial Accounting Standards Board and the Government Accounting Standards Board, yes. In the practical reality of what the City of Vero Beach's liability would be if some unexpected significant cost arises with respect to one of the power supply contracts, the real impact could be different than that.

Mr. Auwaerter said that is where he is seeing inconsistency in a lot of the arguments that the City is making. He said a contingent liability is borne by the owner, not by the customers. He explained that if he was to do business with a company that he would not be responsible for the contingent liability. It would be the stockholders who bear that responsibility. On one hand the City argues that they are the sole equity owner of the utility in spite of the capital contributed by the utility by all the customers, with the majority living outside the City's incorporated limit and then it is argued that due to its ownership that they are entitled to a proper transfer of 6% of revenues to subsidize its General Fund and lower property taxes for its residents. He said if they are going to make the argument that the City solely owns the utility then the City is responsible for all the potential contingent liabilities. He said they can't have it both ways. They can't say the City gets to keep the good profits and any potentially bad contingent liabilities are the responsibility of its customers.

Mr. Wright said that he understood where Mr. Auwaerter was coming from. But, in this context if there is an event that results in unexpected costs, those costs have to be paid. The City is contractually on the hook to pay them.

Mrs. Moss asked is Stanton II considered one of the three (3) projects.

Mr. Wright answered yes. He said FMPA actually has five (5) power supply projects, which are: 1) Stanton I, 2) Stanton II, 3) St. Lucie, 4) the Tri-City Project, and 5) the All Requirements Project.

Mrs. Moss said that she was on FMPA's website and they show that Stanton II was formed in 1990, which is four (4) years after Resolution #414. She then read into the record some of the information that she pulled from the site, "*Thirty (30) years (1978) ago FMPA was formed with no staff, no office, no power generation projects, no revenues, and no assets. There was only the idea that FMPA could coordinate the wholesale power needs of its members in order to create economies of scale and power generation and related services. Three (3) decades later* (referring to 2008) *FMPA has grown to supply nearly 50% of its members total power needs. In 2008 FMPA had 30 members, a fulltime staff of nearly 70, a 25,000 square foot headquarters in Orlando, five (5) power generation projects, a pooled financing fund, approximately two (2) dozen member service initiatives, annual revenues of $707 million and total assets of $1.6 billion.*" She said it is a little hard to say that any of this could have been anticipated in any way, which is one of the reasons why Vero Beach has a problem with it.

Mr. Tonkel asked what is the major factors between the preliminary evaluation that was done and the current evaluation of $42.4 million. He asked what were the major factors that contributed to the difference.

Mr. Wright said that he has not analyzed them item by item, but there is an updated Bulk Power Supply Cost forecast that was estimated last summer based on a current cost per MWH number that was escalated forward. After receiving the information from FMPA in April it was actually done on a project by project basis for 20 years. He said the numbers shown today are the sums. Stanton I and Stanton II roll off in 2035 in the new analysis and St. Lucie II continues through 2046. That is a significant difference. There was a difference in the way the non-departmental costs were calculated that double counted against IRS, which they fixed. They also looked at every cost item on a component by component basis, year by year and projected those out. The General Fund transfer in the earlier analysis started at a value of $5.44 million and escalated out at 2 or 2 1/2 percent a year. When the calculations were done, they actually projected the four (4) other cost components year by year. He briefly explained how the formula worked to arrive at the numbers shown in their analysis.

Mr. Auwaerter said in looking at the spreadsheet with and without IRS every year the differential between the time with IRS and without IRS it is a standard haircut going way into the future of 7.1%. So, that is saying they are not right sizing their expenses and the same with the electric fund expenses. They decline by a set ratio of 3.8%. He asked if they know IRS is going away, why aren't they right sizing their expenses over time. He was lost in this analysis in that it is a straight line and does not reflect that they would be losing 3.8% of their customers.

Mr. Wright said they specifically asked the Finance Director and the Utilities Director what the cost difference would be with and without IRS. He asked Mr. Ted Fletcher if they really are not going to be able to shed a Lineman, for example. Mr. Fletcher said that he would not be able to maintain service with fewer linemen. Mr. Wright explained to Mr. Auwaerter that the best information they had was the information they received from City staff and that is the numbers that are reflected in the analysis. He said Mr. Auwaerter's position is plausible, but so is the City's position. He said these costs are going to decline, but beyond that the bulk of the costs or fixed costs aren't going to change and the cost components are going to stay the same and they escalated those at the rate that they agreed on in conference with PRMG representatives. He said essentially it is slightly less than the escalation rate they are using in the Rate Study.

Mr. Auwaerter said in looking at the numbers in the bulk power with and without IRS the numbers should be exactly the same because that is the base that they were billing from. Then down the line they would be shedding the OUC contract. In terms of the bulk power numbers for power the City is going to have to purchase upon the expiration of the OUC contract, the analysis still states there was an impact on the customers for that new supplier for a period of time if the IRS customers were shed. He asked if they know far in advance that they were going to shed those customers, why wouldn't they right size the power contract with the new bulk power. He said at that point they would know exactly what they were looking at in that they would have a utility system that is roughly 8% smaller. He asked why that should have any impact at all.

Mr. Wright thought the reason there is a continuing impact is because after the OUC contract rolls off, the City is still purchasing power from Stanton I, Stanton II, and St. Lucie. That power costs more than the market power supply costs for part of that time period. That is what causes the impact of losing IRS in the earlier years to be greater. If they look at years 2036 to 2046 they will see there is actually a benefit of not having IRS because St. Lucie II purchases represent a higher percentage of the City's bulk power supply purchases, which brings the average cost down.

Mr. Auwaerter said the FMPA numbers are exactly the same. He said when they no longer have OUC they are going to have to go out and purchase power and they can scale it precisely because they know what their power requirements are going to be if they didn't have IRS. These spreadsheets still show there is a detriment to the remaining customers with IRS leaving past 2024.

Mr. Herrington said that is correct. He said if they look at the market to purchase power they would see the amount they purchase does decline by the amount that IRS customers use so they have recognized that the load is smaller. He said the percentage of the City's take from two (2) different cost sources changes and when the percentage changes the City's net costs changes, which works against the IRS analysis for a certain number of years.

Mr. Auwaerter said that he went to an FMPA meeting last week and the CFO stated that FMPA costs were going to go down substantially because there will no longer be an entrance component and amortization of principle because St. Lucie, Stanton I, and Stanton II debts were coming off. Therefore, FMPA power costs are going down.

Mr. Herrington said their analysis shows FMPA costs going down, but not until the mid 2020's.

Mr. Auwaerter said that he was having trouble understanding what that has to do with the charge for a new power supply. To him, they are two (2) separate things and yet the analysis states somehow they can't figure out (x) number of years down the line.

Mr. Herrington said the analysis does not show that.

Mr. Gorry said when trying to project all of this multi-variable analysis over the years it becomes based on a series of variables that one has to begin to quantify. He said they could debate all the variables, but it is difficult when one is trying to project data over this time period.

Mr. Tonkel said another big variable is the debt retirement, which is built in to the financial exhibit. He asked have they seen a debt retirement schedule from FMPA. He said as he looked at the history of the accumulation of debt, it has been pretty consistently stable throughout the past 10 or 15 years. He asked Mr. Wright how realistic did he think FMPA's ability was to retire the debt according to their schedule.

Mr. Wright asked Mr. Tonkel if he was referring to the FMPA debt service component of the power supply costs for the three projects (Stanton I, Stanton II, and St. Lucie).

Mr. Tonkel said that is correct.

Mr. Wright said all cost projects they received from FMPA are rolled into their analysis, which includes FMPA's current projections of their debt retirement. He did think it was realistic to expect FMPA to retire the debt on the schedules they set. But, something could happen, for example there could be an event that causes a significant capital expenditure that is presently unforeseen. If something breaks FMPA is on the hook for their share of that expenditure and the City is on the hook for their share of that expenditure. If there is an environmentally regulatory mandated upgrade to a Plant, FMPA and the City have no choice but to pay for it. If FMPA, in their discretion, were to make an environmental upgrade the participating cities would have the option not to participate.

Mr. Wright reported that included in their backup material are spread sheets that shows the rate impact. If they look at it on a 30-year basis, the new number is $42.4 million and if they look at it on a 50-year basis the number is $59.6 million.

Mr. Auwaerter said if he remembers it correctly, the profit transfer has an escalator of two and one-half percent per year.

Mr. Wright said it is not a flat two and one-half percent per year. He explained that the transfer is a calculated number based on some of the other four (4) revenue requirement components. He briefly explained that the analysis takes the four (4) components, projects them out, adds them out year by year, and grosses them up so that the sum will yield a 6% return at the bottom line.

Mr. Auwaerter said that he is having a problem with this because in his background in utility analysis when an investor owned utility goes in front of the PSC, the PSC gives them a rate of return on equity. In those situations the PSC does not look forward over the years and state they are entitled to an escalator. He said that he conceptually has a problem with the idea that not only is the City entitled to this profit stream that the IRS customers would have to compensate for, but also that it increases over time. He also had an issue with going out as many years as they did. He referred to the arbitration between the City of Winter Park and Florida Power Corporation. He said there was a big discussion as to how stranded costs were going to be calculated, which referred back to FERC Order #888, which he read, *"FERC defined a period of time that a utility could reasonably expect to continue to serve the departed customer."* He said this is sort of in line with what they were discussing today. In two (2) cases FERC used the utility State mandated planning horizons as the duration of the "L" figure. At that time the State mandated planning horizon was 10 years, which he thought it still continues to be 10 years. He said it would seem to him that the maximum that they would be looking out is 10 years, but in this analysis they are looking out 30 years and 50 years.

Mr. Wright said that was a mandated arbitration that was pursuant to a provision in the franchise agreement between the City of Winter Park and Florida Power Corporation. That is not the context that the City of Vero Beach has. Here the City has a proposal from IRS and FPL to purchase part of the City's system for $13 million. The City has an asset and the proposition to the City is, and the charge they were given in conducting this analysis, was what would it take to keep the City and the rest of the City's customers whole if they were to sell the IRS book of business. In analytical terms, it has value beyond that. There are stranded costs beyond 10 years and the asset has value beyond 10 years.

Mr. Auwaerter briefly reviewed a hand out on the Electric Rate Comparison - Vero Beach vs. Ft. Pierce with the Commission members (attached to the original minutes).

Mr. Brovont referred to the 3% used for factoring the discount rate. He said that he did an analysis using a discount rate of 8%. He said that he did this because he thought the discount rate of 3% was thin. He said that it did not make sense for him to quibble over the figures that the City projected and he was not willing to spend hours second guessing this paperwork and he doesn't have any basis to do that. But, he does have basis for judging the 3% and asked Mr. Wright to defend it. He noted that he did not have a real problem with the 3%, but his point was that when he did the analysis using 8%, he was coming in close to the figures listed, but he did not go out as far. He felt that they did a great job on the analysis and didn't think they could ask for anything more.

Mr. Polackwich referred to the $42 million figure and how they came to that amount. He said they used a 30-year cash flow and discounted that back to present. He asked if they thought about using a terminal value at the end. He explained that is a formula where they project out indefinitely. They would have the final cash flow and the discount rate, subtract a growth rate from that and then discount that all the way back to the present, which would give them a terminal value on what it is worth indefinably. He asked if they thought about this from an evaluation standpoint.

Mr. Wright said they did not think about using a terminal value.

Mr. Tonkel asked Mr. Polackwich if this analysis was done as he just discussed, would that have had a material effect on the figure calculated.

Mr. Polackwich said that he agreed with the 3% figure. But, if they used the terminal value on the 30-year it would bump up the $42 million a little bit to maybe $44 million or $45 million.

Mr. Tonkel asked has this information been provided to IRS.

Mr. Wright thought the information was sent to IRS's after it was provided to the Finance Commission, Utilities Commission, and the City Council.

Mrs. Moss asked what happens when this franchise agreement with IRS expires in October.

Mr. Wright said all that happens is that IRS' obligation to the City terminates and the City's obligation to IRS terminates.

Mr. Tonkel said although he was troubled by the fact that there was a $20 million difference in the preliminary evaluation and what was given to them today, it seems to be a reasonable analysis to take to the interested parties for further negotiations.

Mrs. Moss agreed and noted that she was going to make a motion to a slightly different effect.

Mrs. Moss made a motion that in order to honor the will of the voters who approved referenda supporting the sale of the City's electric to FPL that the Utilities Commission advise the City Council to join in discussions with FMPA, OUC, FPL, Indian River County, and the Town of Indian River Shores regarding the sale of the entire system. Mr. Mechling seconded the motion.

Mr. Lapointe asked how would that vary from the process that would be occurring without that motion. He asked how does that change the process going forward.

Mrs. Moss said it would substantially change it because if they go forward in selling the entire system they could stop debating and IRS would not be an issue. It would become a mute point. The motion is strictly for the City to go to the table and discuss it.

Mr. Wright thought the big difference is that the motion includes the entire system and what they were discussing today was the informational presentation on just IRS.

Mrs. Moss said Mr. Wright would be presenting his information to the City Council at tomorrow's meeting and at the end of his presentation Mr. Dylan Reingold, of Indian River County, would be making a presentation that has something to do with FMPA.

Mr. Tonkel asked is this a replication of the prior Resolutions offered by the City to sell the entire system.

Mrs. Moss said if anything it could be a confirmation. She explained that all she was proposing was that they all gather in the same room to discuss this.

Mr. O'Connor said that Mr. Reingold has not shared with him what his plan is for tomorrow's City Council meeting. He is hoping that he would give them a name of someone from FMPA that they can talk to. FMPA has said all along if the City had a willing buyer that is qualified that they would sit down and negotiate.

Mrs. Moss said her motion is to encourage everyone to sit in the same room at the same time and review it.

Mr. Tonkel said that he would be voting against her motion. He felt they should allow the jurisdictions to continue their negotiations with the new information. He did not see the necessity or the value of the motion at this stage.

At this time, Mrs. Moss repeated her motion.

Mrs. Orcutt felt it was inappropriate to have that motion because they came together for today's meeting to hear this other information. She said they have not heard anything regarding Mr. Reingold's proposal. She did not think today's meeting was held for the Commissions to make a motion, but to have the opportunity to have a discussion and ask questions.

Mrs. Moss agreed in that they were not charged to make a recommendation today.

Mr. Auwaerter felt the motion might be premature. He suggested that they wait to see what Mr. Reingold would be presenting to the City Council.

Mrs. Moss withdrew her motion at this time stating that they would discuss this at a future meeting.

Mr. Gorry referred to the residential usage in the system listed in the City's CAFR. He reported that the total kilowatts for the entire system per month are about 1,060. The County and the City of Vero Beach, excluding IRS, are 939 kilowatt hours per month. Indian River Shores is 1,500 kilowatts per month, which is a 60% higher usage than Indian River County and the City of Vero Beach.

Mr. Brovont said they did a great job in doing the analysis. The only issue he has is that it would seem given the constraints the City is under, that they should have opportunities for reinvestment of funds that are above 3%. But, what they are looking at is marketable securities and what he is looking at is investment in the City's assets. He did not think they could do much better than 3% if they stay with marketable securities, but on the other hand they have major exposures. It would seem that somewhere in the capital expenditure program that they should do better than 3%.

4. ADJOURNMENT

Today's meeting adjourned at 11:11 a.m.

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