
MEMORANDUM 24-13



TO: Princeton Public Utilities Commission
FROM: Keith R. Butcher, General Manager
SUBJECT: Annexation Feasibility Findings
DATE: May 22, 2024

ITEM SUMMARY

Report on DGR's analysis of the impacts of PPU annexing the South Princeton Industrial Park.

BACKGROUND

The Commission instructed staff to work with DGR Engineering on an evaluation of the feasibility of annexing the South Princeton Industrial Park. In particular, the Commission was interested in input on whether an annexation would be in the best interest of PPU, in the best interest of existing ratepayers, and in the best interest of the current businesses in the South Industrial Park.

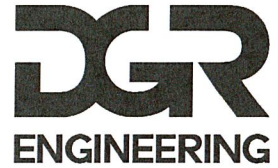
Based on data available, DGR's preliminary analysis indicates that PPU has the financial resources to acquire the area. It is estimated that the acquisition would have a "net positive outcome" meaning that the excess funds that would be generated could be used for investments in the system or rate reductions. Eventually, upon completion of the transition, it is expected that all ratepayers (current and new) would see a benefit.

More importantly, the new customers would benefit by taking advantage of PPU's enhanced reliability services and back-up generation. This would help minimize outages and lost revenue for these customers. The businesses would be able to immediately take advantage of PPU's energy efficiency programs and keep money in the local community. These businesses would also be able to take a more active role in how their utility is operated either by watching Commission meetings on PPU's YouTube channel, submitting comments at any public meeting, visiting our office on First Street, meeting one-on-one with any Commissioner or the General Manager, and/or chatting with staff while they are working to serve the community.

For the Princeton community, the transfer would help in the coordination of all city services to the area (roads, street lighting, water, and sewer) and better emergency response coordination between the electric utility and first responders thereby creating a more cohesive community.

RECOMMENDATION

Staff recommends that the Commission authorize staff to begin discussions regarding annexation.



Memo

TO: Keith Butcher, General Manager, Princeton Public Utilities – Princeton, MN

FROM: Blair Metzger, PE, DGR Engineering

DATE: May 22, 2024

DGR No.: 427607

RE: High Level Feasibility – Service Territory Acquisition (Industrial Park)

Introduction and Background:

In late 2023, Princeton Public Utilities (PPU) engaged the services of DGR Engineering to conduct a high-level review of the feasibility of acquiring a portion of electric service territory currently served by Connexus Energy (CE), located in the Industrial Park adjacent to U.S. Highway 169 in the southwest portion of the community, and within the city limits of Princeton. This memo is intended to inform the Public Utilities Commission of the initial findings of this review, so that a decision can be made regarding the advisability of continuing to study the concept of pursuing acquisition of this service territory more deeply.

The general area under consideration lies west of U. S. Highway 169; north of S. Rum River Drive; and east/southeast of the Princeton airport. The area is within the city limits of Princeton, and currently receives water utility service from PPU. The customer makeup in this area is primarily light industrial, with a smattering of commercial customers mixed in. The area is currently served electrically by CE through a 69kV transmission line owned by Great River Energy (the same transmission system that serves PPU substation facilities); a substation located in the industrial park; and two primary-voltage feeders that run throughout the industrial park and feed service transformers at customer facilities.

In approximately 2017, some preliminary discussions were conducted between PPU and CE regarding PPU's interest in acquiring the territory. From the information that has been provided so far, it appears that CE made an initial estimate of the cost for PPU to acquire the territory, and furnished this information to PPU. Since the effort so far in this work has been confined to high level analysis only, the CE information was used as a basis of the analysis to date; should this concept proceed further, independent analysis of the relevant transaction aspects should be made.

Relevant Financial Aspects:

In the state of Minnesota, it is possible for a municipal utility such as PPU to acquire the service territory of an incumbent investor-owned or cooperative utility, by arriving at a price to do so (along with fulfilling other requirements laid down by the Minnesota PUC). The financial aspects that are of most significance are as follows:

- **Cost of assets:** the acquiring utility needs to purchase the assets from the selling utility, at the depreciated value of the assets.
- **Reintegration cost:** the acquiring utility needs to "keep whole" the system of the utility selling the assets, by paying for infrastructure needed to connect the selling utility's system back together once the facilities sold are removed.

- **Loss of revenue compensation:** the final (and often largest) portion of the compensation due the selling utility is a 10-year present worth valuation that purports to represent the lost revenue over and above the drop in avoidable costs due to the loss of the customers in the acquired territory.

In addition to the payments that may be made to the selling utility by the acquiring utility, the acquiring utility may need to expend additional funds to connect the new customers to its system; provide necessary operations and maintenance services to the new service territory; and undertake all of the needed general and administrative function required to serve electrical utility customers.

From PPU's perspective, the "feasibility" of doing the deal rests on whether the additional revenue received by PPU serving the new customers is sufficient to overcome the cost of acquiring the territory and serving the customers in it. Ideally, the cost of acquiring the territory won't have a significant cost impact on existing PPU customers, nor will it significantly harm the customers acquired from CE. PPU serving all electrical customers within the city limits of Princeton, and serving electrically customers it already serves with water, would seem to be a positive thing, and which could also provide benefits to other City of Princeton funds. If the conditions are such, completing the acquisition can be a win all the way around for the citizens of Princeton.

Results of High-Level Review of Feasibility:

It was determined early on in this study that a step-by-step process would be used, and proceeding to the next step would only be done if the analysis completed in the earlier steps indicates sufficient potential feasibility to justify doing so. What that means practically at this point was that the initial effort so far was focused on applying limited analysis of the currently-available data as a first pass through, with the intent of making a go/no-go decision on further deeper analysis based on what the results of the initial work showed.

The work completed so far included the following:

- Review of the 2017 CE numbers relating to costs of acquisition, and making some adjustments to them to account for changes in cost during the intervening years.
- Estimate of the overall cost of acquiring the territory, including potential costs related to construction by PPU to connect the facilities to its system.
- Develop a ball-park estimate of the potential revenue that PPU would receive by serving the acquired customers, as well as the additional operating costs associated with serving them.
- Calculate what the cost of debt service payments needed to fund the purchase of the acquisition, and compare that figure to the estimated net revenues available to make those payments.

Obviously, much of the analysis described above involves both accepting some years-old values provided by CE relating to the cost of acquisition, plus determining some non-detailed figures relating to the financial operating performance of actually serving the new customers. **That said, for sake of this analysis, the initial ball-park calculations seem to indicate that there is a net positive outcome for PPU acquiring the CE service territory.**

Recommendations:

Based upon this initial high-level assessment, we recommend that the PPU Utilities Commission and staff begin conversations with CE with the intent of annexing the area in question. Moving forward with annexation and conducting a more detailed analysis of the potential acquisition as updated information becomes available is reasonable considering the favorable indications from the preliminary evaluation.

The next step would involve delving deeper into the numbers and assumptions, obtaining updated information from CE, and refining estimates for revenues, costs, and operational needs. Please be advised that annexation can be a long and complicated process. It is expected that as more details emerge that the PPU Utilities Commission would be able to refine the impacts, if any, of this acquisition on the Utility, its existing ratepayers, and any new customers.