Boulder Municipalization Study - Issue Paper #1

What you should know about Boulder's proposed rates.

In February, the City of Boulder released a study explaining how it can finance a takeover of Xcel Energy's electric utility system and business within the city as well as in certain areas of Boulder County. As part of that process, the city asked the community and Xcel Energy to provide detailed feedback. Although this has been somewhat challenging because the city would not make public all of its assumptions and modeling outputs, Xcel Energy is preparing a series of white papers to outline concerns. That study is being used as justification for Boulder to continue spending millions of dollars and city resources to determine whether, and if it should forcibly acquire the electric utility business from Xcel Energy, most likely through a condemnation (eminent domain) process expected to take years to complete.

To ensure those customers potentially affected by Boulder's decision have a more complete perspective on the issue and in response to the city's request for feedback, Xcel Energy is examining key assumptions and conclusions in Boulder's study.

Flawed assumptions

Boulder is using several assumptions to meet the city charter's requirement that electricity rates from a municipal utility must be the same or lower than that of Xcel Energy on the first day of the new utility's operations. Our analysis shows that Boulder is proposing a financing plan that artificially sets rates lower than Xcel Energy's on "Day 1" of operations and that creates its forecast of financial benefits which are backend-loaded more than 15 years into the future in an attempt to make a claim that customers will have lower average rates at some point by the end of the first two decades of operations.

Rates artificially set low for Day 1

One of Boulder's promises in the 2011 election, which narrowly gave the city authority to explore forming an electric utility, was that customers would have rates equal to or lower than Xcel Energy's rates on the first day of the municipal utility's operations. Xcel Energy and others cautioned there are many ways to artificially set initial rates low, including by borrowing money from the future to cover costs.

As expected, the Boulder plan indeed relies on delaying the city's financial obligations. In material provided to city council in a February 26 study session, city staff admits that its projected rates in the first few years of the start-up utility's operations do not include the cost to acquire the business from Xcel Energy because the city plans to make no payments on bonds sold to finance the creation of its utility. Boulder said:

"Since the debt for the municipal utility is capitalized over the first 18 months, as is standard with most municipal debt issues, debt payments are not made during that time, resulting in a lower revenue requirement than periods of time when debt payments are made."

"2017 rates do not vary by cost scenarios due to the capitalized debt in the first 18 months."

Making no debt payments is far from standard, and the city uses circular logic to rationalize its plan. Here's how: "Capitalized debt" means Boulder will borrow additional money to cover the first 18 months of bond payments. And, "lower revenue requirement" means the city will set rates artificially low since it will not need to collect money from customers in the first few years to cover bond payments Boulder thinks it will not need to pay.

As stated, the city plans to borrow additional money to cover its early bond commitments. This would be similar to you borrowing money to cover the first few years of your mortgage payment. Initially, your new home would be quite affordable, regardless of its purchase price. But the bill will ultimately come due, which is our next topic.

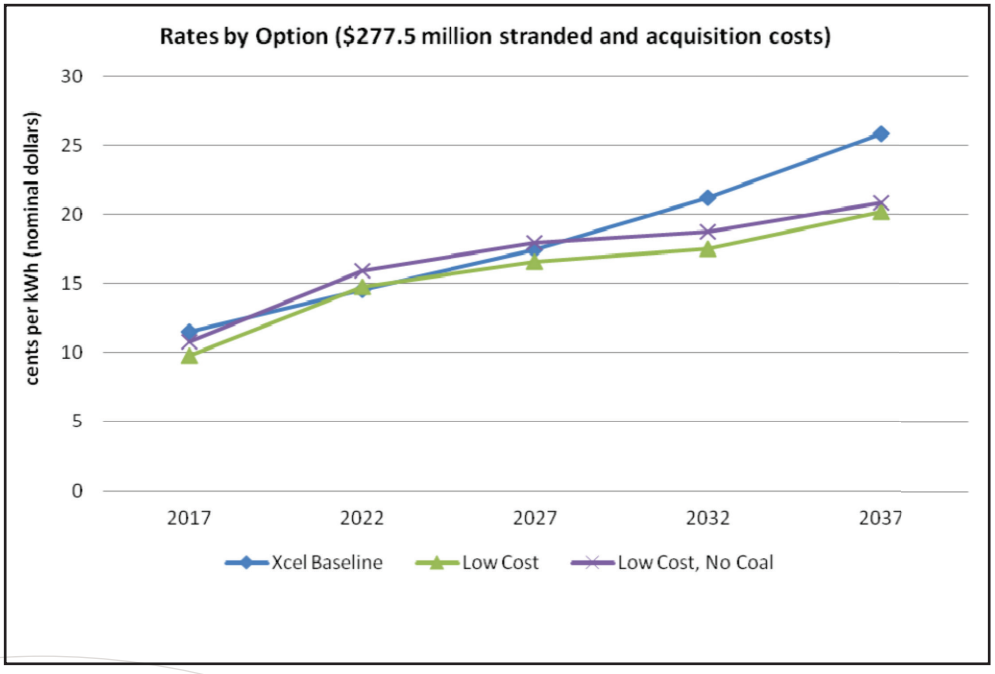
Backend-loaded financial forecast

Now that we have seen one of the ways Boulder plans to meet its Day 1 rates requirement artificially, it is important to look at how the city proposes to claim that its rates will be lower over time.

The chart below, included in Boulder's February 26 study session material, compares what the city assumes will be Xcel Energy's future rates (blue line with diamonds) to the city's two prominent scenarios for its own utility's rates: a so-called "Low Cost" option (green line with triangles), which includes some coal in the fuel mix, and a more expensive "Low Cost, No Coal" option (purple line with "x" marks).

The chart shows that, once Boulder finally begins making bond payments in 2019, its forecasted rate for the "Low Cost, No Coal" option quickly rises above its projected Xcel Energy rates and do not match the city's projected Xcel Energy rates until about 10 years later, in 2028.

And even in the "Low Cost" scenario, most of the purported Boulder rate savings are after 2028.



Boulder's projections for Xcel Energy and a city-run utility rates in its "norm" scenarios.

In fact, according to the city's own study, nearly all the predicted rate benefits would not be realized upon start-up of its electric utility until after 2030. The city's core assumptions of rate benefits are in question as well because of the study's flawed forecast of Xcel Energy's future rates and its overly optimistic cost assumptions. This will be the subject of another briefing paper.

Conclusions

When a thin margin of voters in 2011 supported Boulder's look at a takeover of Xcel Energy's electric distribution system in the city, it is unlikely they knew they were voting for initial lower rates artificially created by delaying bond payments, borrowing more money to cover those payments and borrowing again from the future. Most customers also probably did not assume they would have to wait 15 years to see any potential rate savings. In fact, the Boulder plan forecasts only single-digit percentage savings over the first 20 years of operations in most of its scenarios.

The essential, sobering lesson is that if it misses just one key assumption, such as the cost to generate and buy power or how much wind energy will be available and at what price, the savings in the forecast is eliminated. Other key assumptions found in Boulder's study will be addressed in future issue papers to provide a more complete picture of the potential costs and risks of forming a start-up utility.

The Boulder City Council is set to make a decision on August 6, 2013, to authorize the use of condemnation to form a city-run electric utility. Xcel Energy has served Boulder customers for more than 100 years, providing reliable, safe, and award-winning cleaner electricity at affordable prices. We look forward to continuing to serve you.

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