



Memo

To: Gordon Heitke, City of Baxter
From: Nick Anhut and Rebecca Kurtz, Ehlers
Date: January 12, 2016
Subject: Gas and Electric Franchise Fee Public Informational Meeting

The City of Baxter is holding a public informational meeting on the proposed establishment of utility franchise fees on Tuesday, January 19, 2016. Ehlers has been working with the City to provide information on steps and best practices for implementing gas and electric franchise fees and propose a fee structure to fund a portion of the City's street maintenance and street lighting programs. This memo is intended to revisit the process to date and provide an update on the proposed franchise fee structure published for the informational meeting.

Why Establish a Franchise Fee?

Cities in Minnesota charge franchise fees to utility service providers as an alternative means to raise revenues for the City's general fund or for a specific project. This authority is granted under Minnesota Statutes 216B.36. Franchise fees have become a more common and desirable alternative to taxes for funding street maintenance in the absence of other funding mechanisms. Currently over 65 cities in Minnesota have implemented franchise fees to assist with raising revenues. The franchise fees are usually a fixed amount charged per month in most communities, but in some cases they are based on a percentage of gross revenues or at a rate per kilowatt hour or therm. The fees may also factor in the provider's pricing tiers. Generally, fees will vary by type of customer – whether it be residential or commercial – and they may be capped per customer.

There are several benefits to establishing franchise fees:

- Not subject to loss of revenue as a result of State budget issues.
- Reliable and stable source of revenue irrespective of economic conditions and State budgets.
- Growth in revenues is proportional to the growth in business activity and population.
- New residents immediately begin contributing to the cost of city services. There is approximately a 2-year lag between a new building being built and the city realizing the tax benefit.
- Tax-exempt properties, including State, county and school facilities along with churches and other non-profits, contribute their respective share to the revenue stream.
- Opportunity to balance the financial obligations between payer classes (commercial and residential) without being based on property valuation.

While there are several benefits, we recognize that there are also disadvantages:

- May be viewed as another form of taxes.
- May be perceived as a means of generating new revenues without annual notification and approval, as with taxes.
- May be unpopular with certain property or user classes.

- May be strongly opposed by non-profits that do not believe their benefits equal their costs.
- May need to be adjusted periodically for inflationary and other factors.

Implementation Process

Ehlers and the City have communicated with the four utility providers in the Baxter area regarding the process of implementing a franchise fee. Empowered by each provider's franchise agreement, the City must adopt an ordinance for each service provider enacting the fee. The ordinance will contain the terms of the fees imposed, along with setting effective and expiration dates.

The state regulated providers (Northern States Power - Xcel and CenterPoint Energy) request that the City send a certified copy of the council action to pass the ordinance 90 days in advance of the first fee collection. These providers must furnish a 60 day notice to the Minnesota Public Utilities Commission of the intention to change fees collected. Both Xcel and Centerpoint have model ordinances that they can provide the City as well. Crow Wing Power and Brainerd Public Utilities have a less stringent process for implementing the franchise fee.

Fees are collected on a monthly basis from service provider customers. Service providers then remit said fees to the City. For the larger providers, this typically occurs on a quarterly basis. Both Crow Wing Power and Brainerd Public Utilities identified that the remittance could be monthly, but there may be a 60-day lag between collection and remittance. Both local providers will need to undergo changes to their billing and collections procedures to accommodate the fees.

Utility Classifications

Each service provider has unique customer classifications to differentiate pricing for residential and various commercial entities. These classifications are based on the usage and peak demand each account places on the utility system. Customers are charged monthly fixed fees by customer type as well as usage rates. Schools, churches, hospitals, and other similar institutions are classified as commercial.

Proposed Fee Structure

Most franchise fees imposed in Minnesota are fixed, but are initially developed under review as a percent of the utilities' gross revenues. Fixed fees are generally preferable to both cities and their utility providers because they will not change monthly based on energy price and usage fluctuations, only by the number of customer accounts. A fixed fee can be applied across all users, however most cities use a tiered approach because residential, commercial and industrial customers' consumptions vary greatly; making it difficult to implement a flat fee with equitable impact.

In developing its fee structure, the City projected a 10-year funding need and reviewed average monthly gross revenue information for each utility provider by customer classification. For pavement management funding, an initial 2.5% target of average monthly gross revenues by customer classification was used to set the fixed fee level. The City then adjusted the fee structure with the intent to try to alleviate disparities between the utility providers' customer classifications at the bequest of the utility providers. The City underwent a similar exercise for street lighting using only the electric utilities.

The tiered fee structure system has been using new information from each utility provider for 2015:

		Proposed Monthly Fee
Electric - Brainerd Public Utilities and Crow Wing Power		
Residential		\$ 3.00
Small Commercial	(less than 2,500 kWh's per month)	\$ 13.00
Commercial-Demand	(greater than 2,500 kWh's per month, but less than 250 kW Demand)	\$ 52.00
Large Commercial	(greater than 250 kW Demand per month)	\$ 138.00

Natural Gas - CenterPoint Energy		
Residential		\$ 2.00
Commercial/Industrial - A		\$ 7.00
Commercial/Industrial - B & C		\$ 22.00

Natural Gas - Xcel Energy		
Residential		\$ 2.00
Commercial Firm - Non-Demand		\$ 7.00
Commercial Demand and Interruptible		\$ 65.00

It is anticipated that this fee structure will deliver annual revenues to offset local property taxes of \$390,000 for the pavement management program and \$115,000 for the street lighting program.