



City of Grand Island

Tuesday, October 05, 2004

Study Session

Item -3

Electric Utility Economic Study

Staff Contact: Gary R. Mader

Council Agenda Memo

From: Gary R. Mader, Utilities Director
Meeting: October 5, 2004
Subject: Electric Utility Economic Study
Item #'s: 3
Presenter(s): Gary R. Mader, Utilities Director
Mary Garrison, Stanley Group

Background

The last rate increase in the Electric Department was in 1980. In that intervening period the City has enjoyed an unusually stable period of electric costs due to a number of factors including steady city load growth, low inflation rates, and stable fuel prices nationally, particularly coal and natural gas. But over the last few years, that stable environment has changed.

Discussion

As was discussed at last year's Electric Budget hearings and more recently by the Utility Auditors, the Electric Utility financial reports have shown a general down trend in the financial position of that utility for over a year. From December '02 to December '03, the department's reserves have been reduced by 26%.

The reduction occurred during a period of relatively normal operations and capital improvements. Department staff began analyzing the source of the decline and now believes that it is directly attributable to increased energy costs for production; fuel costs and purchase power costs. The following indicate the state of these factors;

- Delivered coal costs have increased 14% since December '02 and are expected to firm up at that or a higher level.
- Natural gas prices are extremely volatile but on average, have approximately tripled in the last two years.
- Oil prices have increased sharply and OPEC continues production limits.

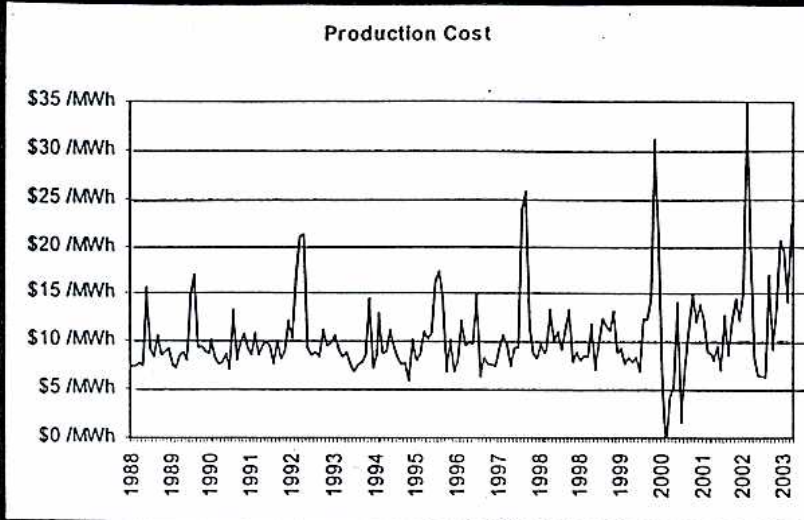
Electric energy markets have reflected the aforementioned source fuel price increases.

The attached graphs illustrate the history of the department's energy costs. For most of the last 15 years (Graph #1), production costs, while very variable on a month to month basis, did, on average, remain fairly steady through 1999 (Graph #2). The historical high peaks are periods when PGS has been down for maintenance and the old gas fired steam units and power purchases were used to meet City electric demand. But in 2000, the volatility of pricing increased and there began a general uptrend in the average costs (Graph #3), with average production costs ramping up approximately 40% from 2000 to 2003. Department staff believes that this is a trend in the industry rather than a "blip" on the radar. This view is shared by other of the state's electric utilities who have had rate increases in the last two years; including OPPD, NPPD, Lincoln, Hastings and others.

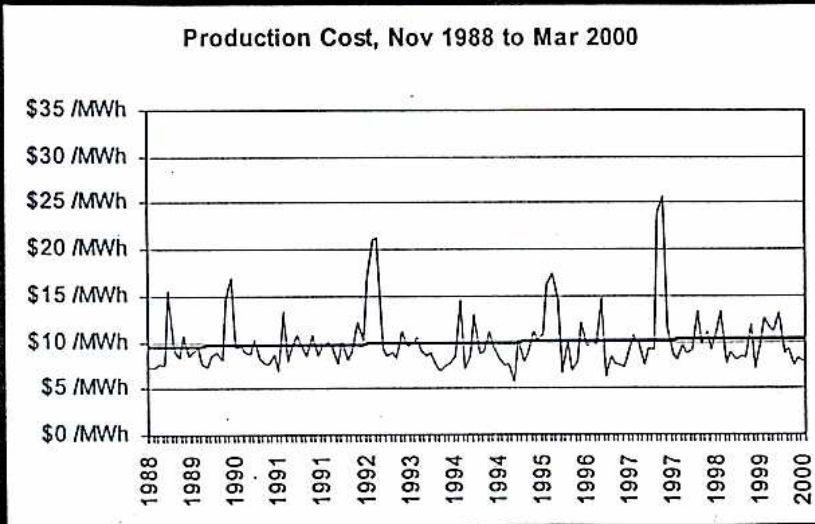
Economic Evaluation

As a result of the declining financial condition of the Electric Utility, an economic evaluation was begun in May, 2004. The firm of Stanley Consultants was commissioned to conduct the study working closely with Electric Department Staff. The Study concludes that it is necessary to increase Electric Department revenue to maintain that Department.

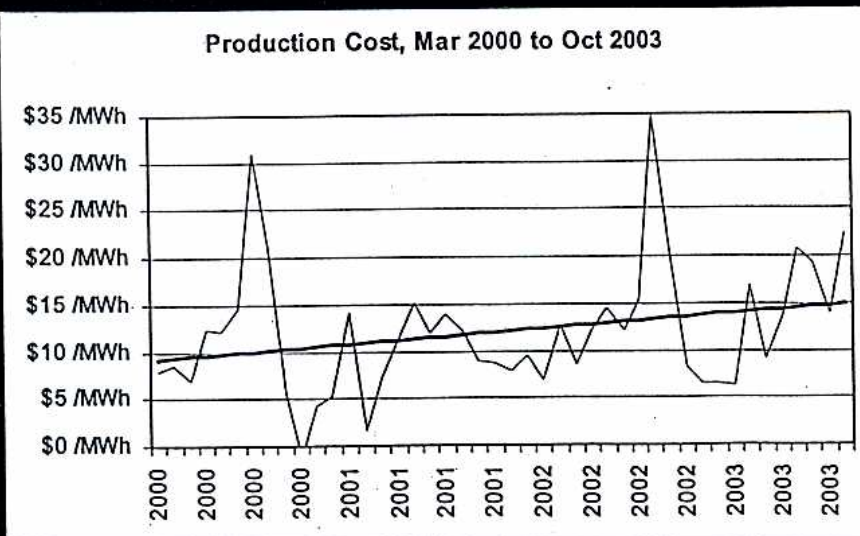
The results of that Economic Evaluation are scheduled for presentation to Council at the October 5, 2004 Study Session.



Graph #1



Graph #2



Graph #3