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City of Kelowna

MEMORANDUM

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DATE: July 16, 2003  
FILE: 2240-20  
  
TO: City Manager  
  
FROM: Director of Financial Services  
  
RE: Terasen Utility Services Inc. Legacy Opportunity – 2001/2 Additions

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**RECOMMENDATION:**

THAT the City exercise its option to lease the Terasen Utility Services Inc. ("Terasen"), previously called BC Gas Utility Ltd., distribution system 2002 additions contained within the City of Kelowna boundary and having a declared capital cost of \$673,705 and a net book value at the City's option exercise date of \$662,402;

AND THAT the Director of Financial Services initiate all processes to obtain necessary approvals prior to October 10, 2003 as required in the Additions Option portion of the Lease-in, Lease-out documents;

AND THAT Council authorize the Mayor and City Clerk to execute the Additions Capital Lease and Operating Lease Amendment for 2002 additions, and any further or other documents related to the re-exercise of the 2001 additions, subject to a counter petition opportunity open to all electors within the City of Kelowna, being initiated concurrently with this report and expiring on or about August 27, 2003 and followed by a determination and certification by the City Clerk that such counter petition opportunity has not defeated the City's initiative;

AND THAT the counter petition opportunity include the re-exercise of the option to lease the 2001 additions having a declared capital cost of \$605,089 and a net cost to the City on the option exercise date of \$592,483, to address a minor procedural error in advertising of the counter petition opportunity prior to the additions agreements dated November 1, 2002;

AND THAT 4:00 p.m., Wednesday, August 27, 2003 be set as the deadline for receipt of Counter Petitions in the form attached to the July 2, 2003 report of the Director of Financial Services as Schedule "A", by the City Clerk in relation to lease of the Terasen Utility Services Inc. Gas Distribution System 2001 and 2002 additions;

AND FURTHER THAT costs associated with the acquisition of the 2002 additions in the amount of \$662,402 be financed from the Terasen Legacy Opportunity fund and the 2003 Financial Plan be amended to reflect this expenditure.

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**BACKGROUND AND COMMENTS:**

On November 1, 2001, the City entered into various documents pursuant to an agreement to lease dated as of June 4, 2001 with Terasen that defined terms relative to a lease-in/lease-out transaction for natural gas distribution system assets within the City boundaries.

The Lease-In/Lease-Out documents included associated bylaws for entering into the transaction and the borrowing of \$49.3 million. While the capital lease has a term of 35 years, it is anticipated that an early termination option will be exercised by Terasen consistent with the Operating Lease expiry on October 31, 2018, which is 17 years from the Agreement to Lease closing date. The net present value benefit to the City of the original transaction has been estimated at \$6.7 Million.

### **2002 ADDITIONS:**

The Lease-in/Lease-out documents include an Additions Option that provides the City with an opportunity to lease, once each calendar year, Terasen's distribution system capital additions from the prior year under the same basic terms and conditions as the original lease. Terasen has reported additions for the year 2002 totaling \$673,705. The entire capital lease must be prepaid and will be based on the net book value on the effective date being November 1, 2003. The payment from the City to Terasen will be:

2002 Additions	\$673,705
Less: Depreciation through October, 2002	<u>(11,303)</u>
Net Book Value at Close Date	\$662,402
Add: GST (recoverable through Input Tax Credit)	<u>46,368</u>
Payable to Terasen	<u>\$708,770</u>

Terasen will add the value of these assets to the operating lease agreement amount currently in place. The first semi-annual rent payment from Terasen to the City is estimated to be approximately \$35,000 payable on April 30, 2004.

### **2001 ADDITIONS:**

As part of the contractual agreement, the City is obligated to provide Terasen with an unqualified opinion from our solicitor regarding the successful completion of approval procedures imposed by the Local Government Act or otherwise by law in relation to the Additions Agreements. While the counter petition advertisement invited the public to contact the Deputy Director of Finance or the Assistant City Clerk for more information, it did not specifically advise that the agreements could be inspected at City Hall. This oversight must be addressed by the proposed agreements and by including the 2001 additions in the proposed counter petition process. There were no signatures received when the counter petition process concluded in 2002.

### **ECONOMIC BENEFITS:**

The calculated net present value benefit to the City for each of the 2001 and 2002 transactions is between \$100,000 and \$200,000 over the 17-year period to the Operating

Lease expiry date. This range represents the anticipated excess funds after repayment of principal and benchmarked interest under current conditions. There are a number of variables that will impact the legacy payment over the term, therefore, a conservative approach to total economic benefit has been modeled. Benefits are shared on an 85%/15% basis between the City and Terasen.

The transaction is expected to have high positive cash flows in the early years that will reduce over time. Annual deficits in the later years of the agreement may require financing through either internal sources or from a combination of internal sources, borrowing and Terasen carrying of costs on the original agreement to the termination date. All modeling completed has contemplated the highest carrying cost option in order to reflect a conservative financial return.

### **RISK ASSESSMENT:**

A key objective of the original agreements was for the City to avoid the risks associated with outright ownership of the assets. Opinions were received from our consultants, Deloitte & Touche and Consolidated Management Consultants that together confirmed the City's risk exposure to financial and commodity market factors was either eliminated or minimized. This objective remains unchanged through the lease in/lease out of all capital additions. The combination of 'utility level risk' and the City's secured position with respect to gas distribution asset ownership in the event of default makes this transaction attractive for the City.

Funding for the additions is available in the Terasen Legacy Opportunity fund which has a current balance of approximately \$3.8 Million.

The counter petition opportunity is open to all qualified electors in the City, which is estimated to be 96,235, based upon the most recent available census data for Kelowna (2001). Advertisements for the counter petition opportunity will run in the Kelowna Daily Courier on July 23<sup>rd</sup> and 24<sup>th</sup>, 2003 and will be posted on the City's website.

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Paul Macklem, CMA  
Director of Financial Services