
City of Kelowna

MEMORANDUM

DATE: August 19, 2004
FILE: 2240-20

TO: City Manager

FROM: Director of Financial Services

RE: Terasen Gas Inc. Legacy Opportunity – 2003 Additions

RECOMMENDATION:

THAT the City exercise its option to lease the Terasen Gas Inc. ("Terasen"), previously called BC Gas Utility Ltd., distribution system 2003 additions contained within the City of Kelowna boundary and having a declared capital cost of \$1,299,876.56 and a net book value at the City's option exercise date of \$1,272,055.46;

AND THAT the Director of Financial Services initiate all processes to obtain necessary approvals prior to October 20, 2004 as extended by agreement with Terasen from the October 10 annual completion of approvals 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 2003 additions, and any documents needed to reflect the extension described above, in the form presented to Council, subject to an alternative approval process open to all electors within the City of Kelowna, being initiated concurrently with this report and expiring on or about October 8, 2004 and followed by a determination and certification by the City Clerk that such alternative approval process has passed and elector approval has been obtained in accordance with Section 86 of the Community Charter;

AND THAT 4:00 p.m., Friday, October 8, 2004 be set as the deadline for receipt of alternative approval process response forms in the form attached to this report as Schedule "A", by the Acting City Clerk in relation to lease-in, lease-out of the Terasen Gas Inc. Gas Distribution System 2003 additions;

AND THAT the elector response form, attached as Schedule "A", be established as the form for this opportunity;

AND THAT Council approve the basis on which the number of electors is determined as a fair determination of the number of electors, that being the number indicated by the most recent census data for Kelowna, completed in 2001 (76,235).

AND FURTHER THAT costs associated with the acquisition of the 2003 additions in the amount of \$1,272,055.46 be financed from the Terasen Legacy Opportunity fund and the 2004 Financial Plan be amended to reflect this expenditure.

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.

2003 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 2003 totaling \$1,299,876.56. The entire capital lease must be prepaid and will be based on the net book value on the effective date being November 1, 2004. The payment from the City to Terasen will be:

2003 Additions	\$1,299,876.56
Less: Depreciation through October, 2004	<u>(27,821.10)</u>
Net Book Value at Close Date	\$1,272,055.46
Add: GST (recoverable through Input Tax Credit)	<u>89,043.88</u>
Payable to Terasen	<u>\$1,361,099.34</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 \$64,000 payable on April 30, 2005.

ECONOMIC BENEFITS:

The calculated net present value benefit to the City for the 2003 transaction is between \$200,000 and \$300,000 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 alternative approval process is open to all qualified electors in the City, which is estimated to be 76,235, based upon the most recent available census data for Kelowna (2001). Advertisements for the alternative approval process will be posted on the public notice board at City Hall, will run in the Kelowna Daily Courier on September 1st and 8th, 2004 and will be posted on the City's website. Approval of the electors will be obtained if the number of elector responses received by the end of the alternative approval process is less than 10% of the number of electors (7,624).

Paul Macklem, CMA

Schedule "A"

Proposed Lease-in, Lease-out Agreement of Gas Distribution System 2003 Additions between the City of Kelowna and Terasen Gas Inc.

ALTERNATIVE APPROVAL PROCESS ELECTOR RESPONSE FORM

I am **OPPOSED** to the City of Kelowna entering into Long Term Lease-in, Lease-out Agreements of gas distribution system 2003 additions with Terasen Gas Inc. without Council first obtaining the assent of a majority of the electors by vote before proceeding. The term of the Agreements is for a period of thirty-five (35) years with an early termination option on October 31, 2018.

I, the undersigned, hereby certify that:

- I am eighteen years of age or older; and
- I am a Canadian citizen; and
- I have resided in British Columbia for at least six months; and
- I have resided in, OR have been the registered owner of real property in, the City of Kelowna for at least thirty days; and
- I am not disqualified by the *Local Government Act* or any other enactment or otherwise disqualified by law from voting in local elections; and
- I am entitled to sign this alternative approval process elector response form and have not previously signed an alternative approval process elector response form for the proposed Agreement.

(see instructions on reverse)

ELECTOR'S FULL NAME (Print)	RESIDENTIAL ADDRESS * (AND mailing address if different from residential)	SIGNATURE OF ELECTOR

* Or property address for non-resident electors

You **MUST** reside or own property within the municipal boundaries of the City of Kelowna in order to sign this alternative approval process elector response form.

ALTERNATIVE APPROVAL PROCESS

Pursuant to section 86 of the *Community Charter*, the Council of the City of Kelowna is proposing to seek the assent of the electors of the City of Kelowna by an alternative approval process. The question before the electors is whether they are **opposed** to the City of Kelowna entering into Long Term Lease-in, Lease-out Agreements of gas distribution system 2003 additions with Terasen Gas Inc. The term of the Agreements is for a period of thirty-five (35) years with an early termination option on October 31, 2018.

INSTRUCTIONS

- If you are **opposed** to the Agreements outlined above, and you qualify as an elector of the City of Kelowna, you may sign an alternative approval process elector response form
- If you are not opposed to the Agreements outlined above, you need do nothing
- Alternative approval process elector response forms are available at the Office of the City Clerk, 3rd Floor, City Hall, 1435 Water Street, Kelowna, B.C. V1Y 1J4, from 8:00 a.m. to 4:00 p.m. business days, starting on September 1st, 2004
- Accurate copies of the alternative approval process elector response forms may be made and each alternative approval process elector response form, or accurate copy, may be signed by one or more electors
- To sign an alternative approval process elector response form you **MUST** meet the following criteria for either a Resident Elector OR a Non-resident (Property) Elector:

Resident Electors:

- Must be eighteen years of age or older; and
- Must be a Canadian citizen; and
- Must have been a resident of British Columbia for at least six months; and
- Must have been a resident of the City of Kelowna for at least thirty days; and
- Must not be disqualified by the *Local Government Act* or any other enactment from voting in an election or be otherwise disqualified by law.

Non-resident (Property) Electors:

- Must NOT qualify as a Resident Elector of the City of Kelowna; and
- Must be eighteen years of age or older; and
- Must be a Canadian citizen; and
- Must have been a resident of British Columbia for at least six months; and
- Must have been the registered owner of real property in the City of Kelowna for at least thirty days; and
- Must not be disqualified by the *Local Government Act* or any other enactment from voting in an election or be otherwise disqualified by law; and
- May only sign an alternative approval process elector response form once, no matter how many parcels the person might own within the City of Kelowna.

NOTE: A person must not sign any alternative approval process elector response form more than once and may not withdraw his or her name from the alternative approval process elector response form after the deadline for submission of the elector response forms has passed.

All alternative approval process elector response forms must be received by the City Clerk, 3rd Floor, City Hall, 1435 Water Street, Kelowna, B.C., V1Y 1J4 on or before 4:00 p.m. on Friday, October 8th, 2004.

The number of electors of the City of Kelowna is estimated to be 76,235. If 10% (7,624) of the estimated number of electors of the City of Kelowna sign an alternative approval process elector response form opposing the noted transactions, City Council will not be able to proceed without then receiving the assent of the electors by referendum.