

BLATCHFORD RENEWABLE ENERGY

Funding Opportunity

RECOMMENDATION

That Utility Committee recommend to City Council:

That the adjustments to the 2023-2026 Blatchford Renewable Energy Utility capital budget, as outlined in Attachment 2 of the May 9, 2023, Integrated Infrastructure Services report IIS01821, be approved.

Requested Council Action	Decision required		
ConnectEdmonton's Guiding Principle	ConnectEdmonton Strategic Goals		
CONNECTED This unifies our work to achieve our strategic goals.	Climate Resilience		
City Plan Values	BELONG. LIVE. THRIVE. ACCESS. PRESERVE. CREATE.		
City Plan Big City Move(s)	Greener as we grow	Relationship to Council's Strategic Priorities	Climate adaptation and energy transition
Corporate Business Plan	Transforming for the future		
Council Policy, Program or Project Relationships	<ul style="list-style-type: none"> Blatchford Vision Energy Transition Strategy District Energy Strategy 		
Related Council Discussions	<ul style="list-style-type: none"> FCS01479, Proposed 2023-2026 Blatchford Renewable Energy Utility Budget, Utility Committee, November 25, 2022 		

Executive Summary

- Blatchford Renewable Energy has secured \$23.7 million in funding support from National Resources Canada's (NRCan) Smart Renewables and Electrification Pathways Program (SREPs).
- Total project costs of \$79.2 million were included as a part of the grant submission.

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- The federal grant requires matching funding from the Blatchford Utility of \$55.5 million (70 per cent of total project costs).
- The capital expenditures included as a part of the grant submission and related funding sources, including the matching funding contribution from the utility, require approval from City Council.
- The report also provides a summary of the overall funding approach for the utility as well as a summary of capital expenditures and funding as of December 31, 2022.

REPORT

Blatchford Renewable Energy (BRE) was established in 2016 to help achieve the City's long-term goal of 100 per cent renewable energy and carbon neutrality for the community of Blatchford. The City-owned utility owns and operates the neighbourhood's District Energy Sharing System. BRE's goals align with City Council's strategic goal of climate resilience; its operations support The City Plan and the Community Energy Transition Strategy by significantly reducing greenhouse gas emissions and increasing energy resilience in the heart of Edmonton. Since the inception of BRE, one of City Council's priorities was to attract grant funding for initial capital investment in the utility.

Grant Funding Overview

On January 24, 2023, the City was approved for federal grant funding of \$23.7 million from National Resource Canada's (NRCan) Smart Renewables and Electrification Pathways (SREPs) program for BRE, subject to the successful negotiation and signing of a funding agreement. The SREPs, announced in 2021, is a non-competitive grant program that aims to significantly reduce greenhouse gas emissions by encouraging the replacement of fossil fuel-generated electricity with renewables that can provide essential grid services, while supporting Canada's transition to an electrified economy.

The program originally provided up to \$1.42 billion over four years for smart renewable energy and electrical grid modernization projects. In the 2022 budget, the federal government recapitalized the program with an additional \$600 million over seven years starting in 2022-23, for a total investment of \$2 billion. Projects approved under the SREPs must be completed by the program's end date of March 31, 2029. SREPs is currently fully committed and no longer accepting applications.

The \$23.7 million was granted to undertake the following components of the BRE:

- Energy Centre 1 Expansion;
- Growth of the distribution piping network, including energy meters; and
- Planning, design, and construction of the Sewer Heat Exchange Energy Centre.

As the next step, the City needs to enter into a funding agreement with the federal government, which will outline all the terms, conditions, and obligations assigned to the City for receipt of the grant. The agreement allows the City to claim reimbursement for incurred eligible expenditures. Before this can happen, NRCan needs confirmation from the City that all non-federal sources of funding have been secured. In the case of the SREPs program, the federal government will contribute up to a maximum of 30 per cent of eligible project costs towards capital investment and some limited operating dollars, with the applicant being responsible for the 70 per cent balance.

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The \$23.7 million grant, based on total submitted project costs of \$79.2 million, requires City Council to commit to the full project submission by approving a municipal contribution of \$55.5 million. Only project costs incurred after April 1, 2023 are considered eligible for grant funding.

Capital Funding Strategy - Background and Overview

Prior to considering further capital commitments for BRE, it is important to understand the capital funding challenges and expenditures to date.

Non-Refundable Cash Infusion

The business case for developing the District Energy Sharing System at Blatchford identified the need for a \$93.3 million non-refundable cash infusion to support the initial capital investment required to establish BRE. The business case and assumptions were presented to City Council on April 10, 2018 (CR_5452 - Blatchford Utility Fiscal Policy).

Projected cash flows from the utility on its own are not sufficient to cover the required capital cost to operate the Utility. The non-refundable cash infusion is key in enabling the achievement of two principles in City Policy C597A - Blatchford District Energy Utility Fiscal Policy:

- (1) ensure that the utility becomes financially sustainable in the long run without any ongoing subsidy and
- (2) ensure customers pay a comparable fee to what they would elsewhere in the City ("Business as Usual" or BAU) through their energy utility bills and annual maintenance costs.

One of City Council's early priorities was to attract grant funding to support the initial required capital investment. The strategy was outlined and was re-emphasized in various reports to City Council, including most recently on June 4, 2019 (CR 6640 - Blatchford Utility - Updated Strategy and Financial Options). That report discussed potential options to fund the non-refundable cash infusion, including:

- federal and provincial grant funding;
- self-liquidating debt (utility debt funded through customer utility rates or BRE retained earnings);
- Blatchford Land Development retained earnings;
- tax-supported debt;
- and partnerships with other utility providers.

The optimal method to fund the non-refundable cash infusion was federal and provincial grant funding, which would allow the utility to reach a positive cash position and achieve long-term financial sustainability, with no major impact to future utility rates.

Self-liquidating debt would need to be eventually repaid through utility rates. As per Policy C597A, utility rates should be based on BAU, and therefore the utility may be limited in the amount of additional debt it can borrow. Additionally, use of the BRE retained earnings may delay the timing of the utility achieving long-term financial sustainability as originally anticipated (2028/2029).

Consideration could be given to increase utility rates beyond BAU to pay for the debt servicing cost, however, this would need to be explored further through revisiting Policy C597A.

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Use of tax-supported debt to finance the non-refundable cash infusion would result in BRE being subsidized through the tax-levy. Council/Utility committee did not prefer tax-levy subsidization of BRE and tax-levy subsidization would not align with Policy C597A.

Blatchford Land Development retained earnings is not a viable option at this time as the retained earnings are required to keep the land development operations financially sustainable.

The last option was to explore potential partnerships with other utility providers. At this time, there are no potential opportunities available, as BRE is still in the early stages of operation. A more detailed process to partner with other utility providers is set to commence in 2024, as identified in the 2023-2026 Blatchford Renewable Energy Utility Budget and Plans.

Capital Expenditures to Date and Funding

As of December 31, 2022, \$23.0 million of the initial \$93.3 million in capital infrastructure required for BRE has been spent. This included expenditures relating to the geo-exchange field, Energy Centre 1, the distribution piping system, energy meters and design work on the Sewer Heat Recovery Energy Centre. By the end of the 2022 calendar year, federal and/or provincial grant funding had not yet been secured to fund the non-refundable cash infusion.

As there was a need to proceed with building utility infrastructure, the initial capital expenditures (Attachment 1) were funded through self-supported tax guaranteed debt. Self-supported tax guaranteed debt is issued to finance capital expenditures that ordinarily generate sufficient cash to fund all obligations or have a dedicated source of revenues. Any funding shortfall to repay the debt, however, would eventually need to be funded through tax-levy revenues if the identified source does not generate enough cash flow. In this case, the intention was to repay the debt servicing costs through future federal and/or provincial grant funding.

However, if future grant funding is not secured, then the debt servicing would need to be repaid by tax-levy. Consideration could also be given to repay the debt servicing through utility rate revenues and utility retained earnings. As discussed above these funding options do not align with the objectives and principles in Policy C597A.

Short-Term Financing from Working Capital

As BRE is currently not in a financial position to generate sufficient rate revenues to cover day-to-day operations, the City of Edmonton has been using its working capital to cover annual operating shortfalls to date, including debt servicing on the \$23.0 million debt borrowed as of December 31, 2022. The amount of working capital funding used by the utility as of December 31, 2022 is \$7.7 million. The intention is for this working capital funding to be eventually recovered through utility retained earnings when BRE is able to generate positive net income/cash flows and become financially self-sufficient.

Budget/Financial Implications

Smart Renewables and Electrification Pathways Grant and Recommended Budget Adjustment

To secure the \$23.7 million SREPs grant, City Council needs to approve a matching contribution of \$55.5 million (70 per cent of the submitted \$79.2 million of total eligible project costs).

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Of the \$79.2 million, \$16.5 million in capital expenditures have already been approved through the 2023-2026 capital budget for the extension of Energy Centre #1, the growth of the distribution piping network including the energy meters, and initial costs for the sewer heat exchange. These costs will be funded through \$11.6 million of self-supported tax guaranteed debt and \$4.9 million of SREPs grant funding.

The remaining \$62.7 million in capital expenditures (\$61.8 million in capital costs and \$0.9 million in salaries and benefits) need to be approved by Council and are related to expenditures for the distribution piping network including the energy meters, and costs for the sewer heat exchange from 2026 to 2029. The proposed funding source for these costs is \$43.3 million in self-supported tax guaranteed debt and the remainder of the SREPs grant of \$19.4 million.

The resulting matching municipal contribution of \$55.5 million will be funded by \$54.9 million of debt financing (\$43.3 million in new debt financing and \$11.6 million in self-supported tax guaranteed debt previously approved in the 2023-2026 Blatchford Renewable Energy Utility Budget and Plans) and \$0.6 million by retained earnings for related operating costs.

The table below summarizes the project costs submitted as a part of the SREPs grant submission, the portion of those costs previously approved as a part of the 2023-2026 Blatchford Renewable Energy Utility Budget and Plans, and the proposed expenditures and related funding sources. Operating costs (salaries and benefits) submitted as a part of the grant application were approved in the 2023-2026 budget.

Project Costs (Submission) (\$ millions)	Capital Expenditures (Approved 2023-2026)		Capital Expenditures (Proposed 2026-2029)			Operating Expenditures (Approved 2023-2026)			Total	
	Debt	Grant	Debt	Grant		Retained Earnings	Grant			
Geo-Exchange Field/EC1	2.3	0.9	3.2						3.2	
Distribution Piping System/Energy Meters	8.3	3.6	11.9	1.4	0.5	1.9			13.8	
Sewer Heat Exchange (SHX)	1.0	0.4	1.4	41.9	18.0	59.9			61.3	
Salaries & Benefits (Operating Costs)							0.6	0.3	0.9	
Total	11.6	4.9	16.5	43.3	18.5	61.8	0.6	0.3	0.9	79.2
Total Debt/Retained Earnings (Matching Contribution - 70% of Project Costs)									55.5	
Total NRCan Grant (30% of Project Costs)									23.7	

Refer to Attachment 2 for a summary schedule of the supplemental capital budget adjustments and Attachment 3 for the associated capital profiles.

Interest Related to Long-Term Debt

The non-refundable cash infusion was originally intended to be funded through federal/provincial grants. Prior to the \$23.7 million grant currently being discussed, no other external funding had yet been received, and as such to proceed with initial utility infrastructure development, BRE has had to borrow (self-supported tax guaranteed debt). Borrowing to finance these costs comes at an additional cost reflected as the annual interest expense on the borrowing.

The debt has been classified as self-supported tax guaranteed debt because ultimately it will need to be repaid through utility rates and retained earnings. To the extent that those funding sources are unable to fully fund the shortfall the remaining balance would most likely need to be borne by tax-ley

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revenues. The debt servicing paid to the end of the 2022 related to the utilities borrowings have been paid through the City's working capital and are accumulating as a part of the short-term borrowing balance eventually to be paid back to the City.

The table below summarizes as of December 31, 2022 the debt borrowed to date, forecasted debt borrowing, and the estimated interest expense on forecasted debt based on an average interest rate of six per cent:

Debt Servicing Costs (25 Year Debt) (\$millions)	Principal	Forecasted Interest Expense	Total Estimated Debt Servicing
Debt as of December 31, 2022 (Borrowed to Date)	23.0	10.9	33.9
Approved in 2023-2026 Budget (Forecasted)	28.0	25.6	53.6
Proposed 2023-2029 (Forecasted) <i>Required for SREPs grant matching purposes</i>	43.3	39.6	82.9
Total	\$94.3	\$76.1	\$170.4

Administration will continue to pursue grant funding opportunities to minimize the amount of borrowing for BRE, though no known current options are available. If grant funding is not secured and the utility continues to borrow to fund the initial infrastructure costs, the debt servicing on the borrowing will need to be repaid by the utility or the tax-levy. Administration continues to actively scan any possible federal and provincial grant funding opportunities available to the utility.

To the extent BRE is required to borrow to fund a portion or all of the \$93 million required infusion, the long-term financial sustainability of the utility would likely be negatively impacted and based on the current Policy C597A the utility rates can at most be comparable to what customers pay elsewhere in the City of Edmonton, therefore BRE may be limited in the amount of additional debt it can issue or may need to consider increasing utility rates beyond BAU.

Next Steps

To qualify for the \$23.7 million grant, Administration's recommendation is to approve the matching funding through self-supported tax guaranteed debt to fund eligible project expenditures. The majority of the debt will not be borrowed until 2027, at the earliest, and as such will not have an immediate financial impact as the majority of the project costs are anticipated to be incurred from 2027 to 2029, after planning and design for the sewer heat exchange system is completed.

Administration will return in December 2023 with a review of the Blatchford Utility Fiscal Policy C597A, as its review with Utility Committee and City Council is required every three years. Through that review, the original utility principles of capping rates at BAU, to be self-sustaining with no tax-levy subsidization, and other key objectives and targets can be revisited to help address any funding shortfalls and determine BRE's financial position.

COMMUNITY INSIGHT

Since the Blatchford redevelopment started in 2008, Administration has engaged in extensive discussions, public consultations, and expert analysis to inform the development of the community, including the concept of BRE. Regular updates are provided to City Council’s Energy Transition Climate Resilience Committee.

GBA+

The cost of providing utility service for Blatchford Renewable Energy is equitably allocated to customers. Customer rates are guided by the policy statements and applicable industry best practice, and utility rate design principles in Blatchford District Energy Utility Fiscal Policy C597A. Utility rates and fees are based on a cost of service methodology whereby rates are designed to fairly apportion the cost of providing utility service to individual customer classes based on the cost of providing service among customers.

RISK ASSESSMENT

Risk Category	Risk Description	Likelihood	Impact	Risk Score (with current mitigations)	Current Mitigations	Potential Future Mitigations
If recommendation is approved						
No risk higher than 12 identified						
If recommendation is not approved						
Financial	SREPs grant is not received	5 - Almost certain	3 - Major	15 - high	Project continues to be funded 100% by self-supported tax guaranteed debt	Administration will continue to look for grant opportunities from other level of governments

ATTACHMENTS

1. Blatchford Renewable Energy Utility Capital Expenditures to Date
2. Recommended Blatchford Renewable Energy Utility Capital Budget Adjustments
3. Blatchford Renewable Energy Utility Capital Profiles