City of Northfield, Minnesota
Electric and Gas Utility Franchise Fees

Prepared for

Ben Martig, City Administrator
Brenda Angelstad, Finance Director

Prepared by

Doug Green, Director
Baker Tilly

380 Jackson Street, Suite 300
Saint Paul, MN 55101
T: +1 651 223 3086

October 20, 2020

bakertilly

INTRODUCTION

The City of Northfield requested Baker Tilly assist the City conduct research and analysis on the use of utility franchise fees as a replacement to property assessments to fund the City's street and utility repair and replacement projects. Street and utility projects are currently paid for with a combination of property tax levies, assessments, state aid and utility revenues. Those sources are used to pay for both construction costs and debt service (principal and interest) on municipal bonds.

Part 1 of this report provides background information on franchise fees in Minnesota, City special assessments and the various statutory authorities the City can utilize to finance street improvement projects. Part 2 of the report describes the analysis the City conducted, the estimated franchise fee revenue and next steps.

Part 1: BACKGROUND

I. Franchise Fees

Under Minnesota Statute (216B.36), cities can impose a fee on utility companies that use the public rights-of-way to deliver service. Per state law, a city may impose a franchise fee on a gas or electric utility for the use of the public right-of-way by adopting an ordinance that establishes fee terms, including structure, collection, schedule and effective dates. There is no cap on the fees and the revenues can be used for any public purpose. Many communities opt to dedicate the franchise fees for specific purposes, such as infrastructure management, road maintenance, sidewalks or trails.

a. Implementation Options

Cities in Minnesota generally have the option to structure the franchise fee four ways:

1. Flat fee per utility account (e.g. $4 per month)
2. Percentage of consumption used by each utility account (e.g. $0.0050 per KWh for electric and $0.040 per therm for gas)
3. Percent of revenue (e.g. 3.0% of monthly bill)
4. Hybrid of flat fee and percent of usage or revenue (e.g. flat fee for residential and percentage of usage or revenue for commercial and industrial)

These fees can vary between residential customers and various commercial customer types. For example, cities can impose a $4 flat fee on residential customers and an $8 flat fee on commercial and industrial customers who are larger users. By statute, the utility companies pass the franchise fees on to their customers. Utility customers in the designated franchise fee area would see a line item on their bills titled "City Franchise Fee." Utility companies collect the franchise fees and remit the money to the City on a quarterly basis.

The primary implementation considerations are outlined below:

- *Xcel Energy's policy is to only implement a flat fee structure based on customer classes as defined by Xcel Energy.*
- The flat rate fee structure provides a stable revenue stream, rather than one based on consumption, which would vary each month.
- If customers are charged the same flat fee across all customer classes, smaller utility users (e.g., most residential and small business customers) pay a higher fee as a percentage of their total bill compared to large consumption users.
- An increasing flat fee for the various customer classes mitigates the inequities described above.
- A percentage fee provides a more equitable fee across all users as it ensures the largest users pay a proportionally higher fee.
- A percentage fee can have a significant financial impact on certain commercial and industrial users that may also be one of the largest taxpayers and employers.

b. Advantages and Disadvantages of Franchise Fees

Advantages of franchise fees include the following:

- Franchise fees are paid by all properties within the City, including tax-exempt properties.
- Diversifies the City's revenue sources, potentially reducing reliance on property taxes, local government aid and assessments.
- Provides a reliable source of revenue.
- Easy for the City to administer and no administrative costs are charged by the utility companies.

Disadvantages of franchise fees include the following:

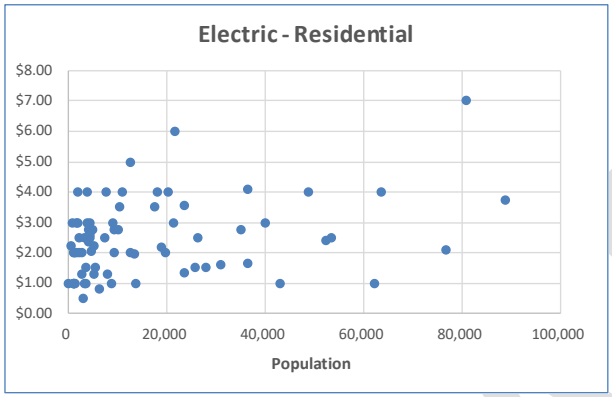
- Everyone pays the franchise fee when they pay their gas and electric bills.
- A flat-rate franchise fee would be the same for all residential homes, regardless of the value of their property or utility usage.
- A flat rate franchise fee can be burdensome on households with lower incomes because they pay the fee regardless of utility usage.
- Like property taxes, franchise fees may make a city less desirable than surrounding communities that do not impose franchise fees.
- Depending on various circumstances (type of business, utility usage, amount of fee, etc.), franchise fees can be a financial hardship on commercial businesses.

c. Sample of Existing Franchise Fees

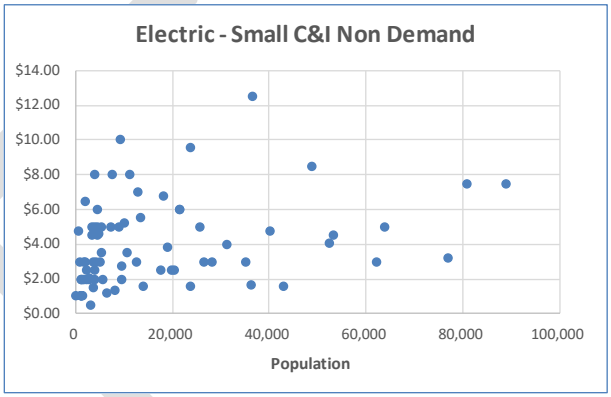
Tables 1 and 2 along with the corresponding charts provide information on existing electric and gas franchise fees *that implement a flat rate* by customer class. This list does not include all franchise fees imposed by cities throughout the state. The full list of cities included in the summary tables below are included in **Appendix A**. Appendix A also provides the fees for cities that impose franchise fees based on a percent of revenue or percent of usage.

Table 1: Electric Franchise Fee Summary Table

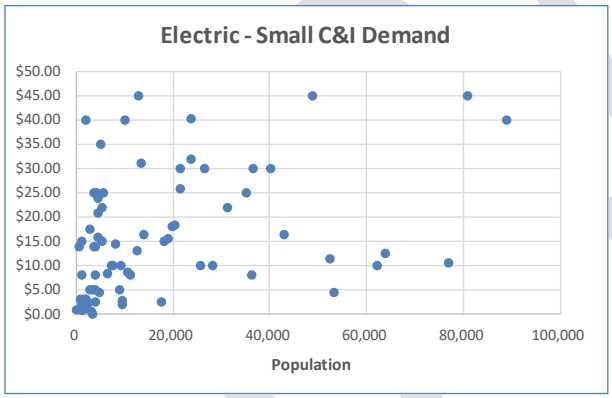
Electric Fees	Residential	Small C&I Non-Demand	Small C&I Demand	Large C&I	Public Street Lighting
Number of Cities*	78	78	78	77	35
Mean	$2.43	$3.89	$15.05	$76.03	$6.95
Median	$2.30	$3.00	$11.95	$50.00	$4.00
Minimum	$0.50	$0.50	$0.50	$0.50	$1.00
Maximum	$7.00	$12.50	$45.00	$335.00	$25.00
**69 cities served by Xcel Energy, 7 by Minnesota Power and 3 by Ottertail Power.*					



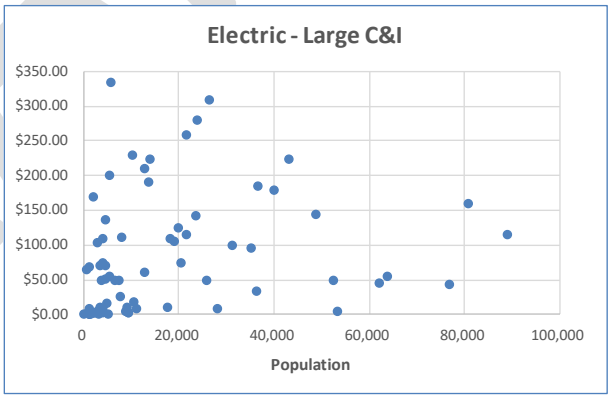
N= 78 Minimum $0.50
Mean $2.43 Maximum $7.00
Median $2.30



N= 78 Minimum $0.50
Mean $3.89 Maximum $12.50
Median $3.00



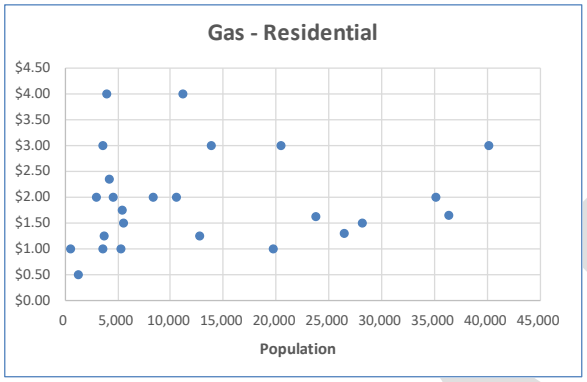
N= 78 Minimum $0.50
Mean $15.19 Maximum $45.00
Median $12.50



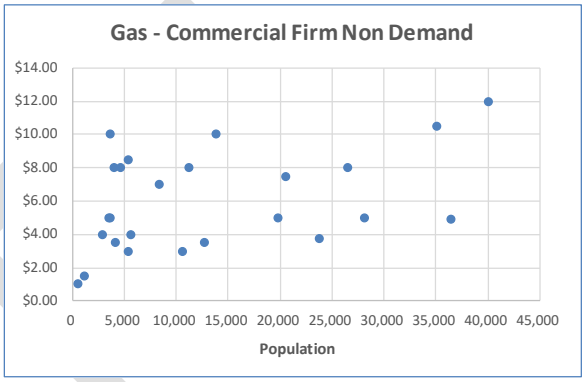
N= 78 Minimum $0.50
Mean $76.03 Maximum $335.00
Median $50.00

Table 2: Gas Franchise Fee Summary Table

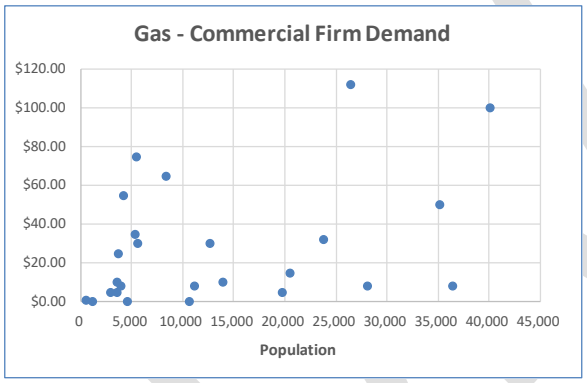
Gas Fees	Residential	Commercial Non-Demand	Commercial Demand	Small Interruptible	Med & Large Interruptible
Number of Cities*	25	25	22	22	21
Mean	$1.95	$5.99	$31.48	$35.79	$63.51
Median	$1.75	$5.00	$20.00	$16.75	$24.75
Minimum	$0.50	$1.00	$1.00	$1.00	$1.00
Maximum	$4.00	$12.00	$112.00	$100.00	$335.00
**All cities served by Xcel Energy.*					



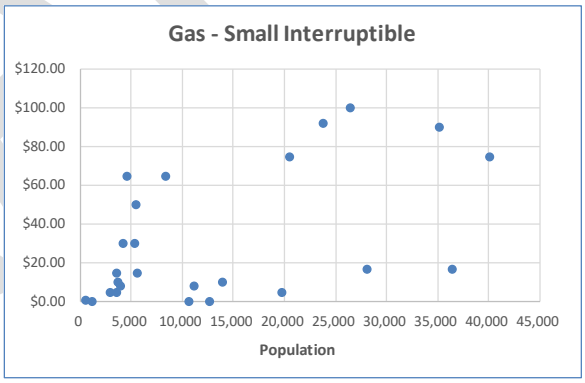
N=	25	Minimum	$0.50
Mean	$1.95	Maximum	$4.00
Median	$1.75		



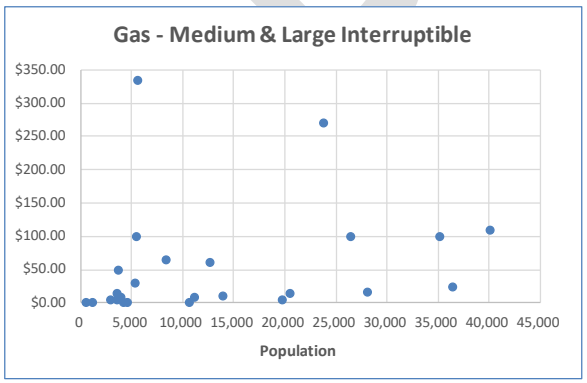
N=	25	Minimum	$1.00
Mean	$5.99	Maximum	$12.00
Median	$5.00		



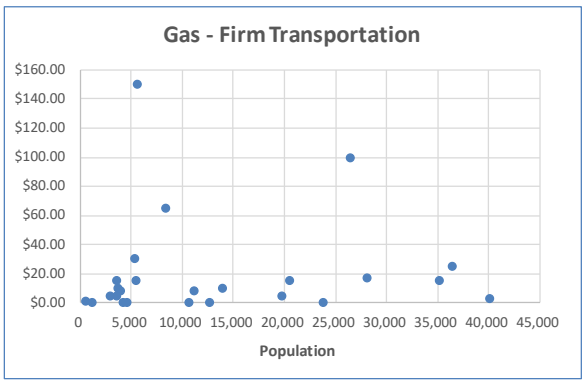
N=	25	Minimum	$1.00
Mean	$31.48	Maximum	$112.00
Median	$20.00		



N=	25	Minimum	$1.00
Mean	$35.79	Maximum	$100.00
Median	$16.75		



N=	25	Minimum	$1.00
Mean	$63.51	Maximum	$335.00
Median	$24.75		



N=	25	Minimum	$1.00
Mean	$26.38	Maximum	$150.00
Median	$15.00		

II. Special Assessments

One of the primary considerations for exploring franchise fees is to move away from the special assessment process, which is time-consuming and costly. Like many cities, the City has utilized the authority granted in state statutes to issue general obligation improvement bonds as long as special assessments account for at least 20 percent of the overall project cost. This bonding authority allows cities to issue general obligations bonds without a referendum or a petition requiring a referendum ("reverse referendum"). In addition, general obligation improvement bonds do not count against the City's statutory debt limit.

a. Historical and Projected Assessment Revenue

Special assessment revenue is legally pledged to repay outstanding general obligation improvement bonds. Table 3 below shows the total special assessment revenue over the past five years.

Table 3: Historical Special Assessment Revenue

2015	2016	2017	2018	2019
$394,368	$531, 487	$531,687	$416,685	$658,364

The principal amount of assessments in the City's 2020-2024 Capital Improvement Plan (CIP) is shown in the Table 4 below. The projected assessment revenue (principal and interest) assumes the assessment charges are amortized over 10 years at 4.0%. By 2024 the total assessment revenue is expected to be approximately $907,000.

Table 4: Estimated Assessment Revenue

Estimated Assessments (Principal)	**2020**	**2021**	**2022**	**2023**	**2024**
2020 Mill and Overlay	848,559				
2021 Mayflower Hill Reclamation		744,030			
TH 3 Frontage Road Mill and Overlay		368,725			
NW Area Mill and Overlay			1,225,533		
Southwest Area Reclamation				492,345	
2023 Mill and Overlay Project				976,203	
2024 College & Winona Street Recon					293,440
2024 Water Street South Reconstruction					119,420
Wall Street Road Reconstruction					367,004
Total	848,559	1,112,755	1,225,533	1,468,548	779,864
Estimated Annual Assessment Revenue	**2021**	**2022**	**2023**	**2024**	**2025**
from Outstanding and Future Assessments	*439,431*	*563,405*	*690,650*	*861,467*	*906,611*

III. Bonding Authority Options

State statute allows cities to issue general obligation bonds for street and utility projects under another authority called General Obligation Street Reconstruction Plan Bonds. The authorized uses under this authority are very similar to General Obligation Improvement Bonds and most often allows cities to perform necessary repairs. Most importantly, bonds issued under the street reconstruction plan authority do not require that assessments account for at least 20% of the overall project cost.

A third statutory authority exists called General Obligation Abatement Bonds. However, the primary purpose for bonds sold under this authority involve economic development initiatives. Abatement Bonds are also used to finance park and trail projects. For reasons outside the scope of this report, the City should avoid financing street improvements under this statutory authority.

Table 5 below compares the authorized uses for each bonding authority.

Table 5: Statutory Authorities

Authorized Uses	G.O. Improvement Bonds	G.O. Street Reconstruction Plan Bonds	G.O. Abatement Bonds
Repair & Replace Utilities*			
Water Lines	●	●	●
Sanitary Sewer Lines	●	●	●
Storm and Gutters	●	●	●
Repair & Replace Streets			
Reconstruct and Overlays	●	●	●
Adding Turn Lanes	●	●	●
Widening Streets	●		●
Installing New Streets	●		●
Installing New Curbs and Gutters	●		●
Improving Sidewalks	●		●
Exception: Public Safety Function		●	
Parks and Trails			●
Payment & Process			
Payment Source	Min 20% Assess	Any	Any
Subject to Reverse Referendum	No	Yes	No
Subject to Debt Limit	No	Yes	No

*Cities can repair and replace utilities under the Street Reconstruction Plan authority if it is in conjuntion with a street project.

Part 2: FRANCHISE FEE ANALYSIS

I. Background

City staff and Baker Tilly conducted a thorough analysis of the data provided by Xcel Energy to project potential franchise fee revenue, determine the best implementation method and understand the impact on the residents, businesses and institutions within the City.

While state statute authorizes cities to impose franchise fees, each utility provider sets their own policies. Background information unique to Xcel Energy's policies and the franchise fee analysis is provided below.

1. Customer Class – Xcel Energy's electric and gas rate books define dozens of different types of customers based on usage and the type of energy consumer, e.g. time of day, interruptible service, demand, etc. However, for the purposes of implementing franchise fees, Xcel Energy uses consolidated customer classes. Table 6 below shows the non-residential customer classes and how they are defined for the purposes of implementing franchise fees.

Table 6: Franchise Fee Customer Classes

Electric Customer Class	General Usage	Max Demand Usage
Small C&I: Non-Demand	Less than 100 kWh per day	Less than 25 kWh
Small C&I: Demand	Less than 100 kWh per day	Greater than 25 kWh
Large C&I	Great than 100 kWh per day	N/A

Gas Customer Class	General Usage	Max Demand Usage
Commercial Firm: Non-Demand	Not defined	Less than 500 Therms
Commercial Firm: Demand	Not defined	Greater than 500 Therms
Small Interruptible	Not defined	Less than 2,000 Therms
Medium & Large Interruptible	Not defined	Greater than 2,000 Therms

2. Premise – Xcel Energy bills their customers by "premise". A customer may have one or multiple premises. Additionally, there may be more than one meter per premise.

3. 15/15 Privacy Rule – For privacy reasons, Xcel Energy will not release usage information if there are less than 15 customers within a customer class or if a customer accounts for 15 percent of the total usage in a particular customer class.

II. Xcel Energy Data

Xcel Energy provided data for a recent twelve-month period for the number of premises, revenues and uses by customer class. The data originally excluded those premises that fell under their privacy policies. In order to more accurately estimate the potential franchise fee revenue and the financial impact on the largest users, city staff obtained waivers from Carlton College, St Olaf College, the Northfield School District, Northfield Hospital and Clinics and MOM Brands to release usage information.

Table 7 on the following page includes premise and usage data for the entities listed above with the exception of MOM Brands. Additionally, Xcel Energy indicated other premise and usage data is still not

included due to their privacy policy. City staff does not know who these customers are and Xcel Energy will not provide the information to seek waivers.

Table 7: Premise and Usage Data for a Recent Twelve-Month Period

ELECTRIC CUSTOMER CLASS	NUMBER OF PREMISES	% OF PREMISES	12 MONTHS ELECTRIC REVENUES	% OF REVENUES	kWh USAGE	% OF USAGE
Residential	6,532	89.6%	$ 7,022,987	40.7%	50,147,466	31.3%
Small C&I – Non-Demand	486	6.7%	$ 674,014	3.9%	5,263,410	3.3%
Small C&I – Demand	214	2.9%	$ 2,335,944	13.5%	20,812,192	13.0%
Large C&I*	49	0.7%	$ 6,999,931	40.6%	83,144,136	52.0%
Public Street Lighting	11	0.2%	$ 226,238	1.3%	661,089	0.4%
Municipal Pumping – Non-Demand	1	0.0%	$ 1,944	0.0%	15,334	0.0%
Total	7,293	100.0%	$ 17,261,058	100.0%	160,043,627	100.0%

* Affected by company's Privacy Policy.

GAS CUSTOMER CLASS	NUMBER OF PREMISES	% OF PREMISES	12 MONTHS GAS REVENUES	% OF REVENUES	THERMS USAGE	% OF USAGE
Residential	5,273	91.1%	$ 3,515,009	52.1%	4,879,233	42.5%
Commercial Firm – Non-Demand	510	8.8%	$ 1,876,034	27.8%	3,138,997	27.4%
Commercial Firm – Demand*	1	0.0%	$ 22,726	0.3%	41,929	0.4%
Small Interruptible*	3	0.1%	$ 126,166	1.9%	251,697	2.2%
Medium & Large Interruptible*	2	0.0%	$ 1,211,372	17.9%	3,157,042	27.5%
Total	5,789	100.0%	$ 6,751,306	100.0%	11,468,898	100.0%

* Affected by company's Privacy Policy.

III. City Staff Analysis and Xcel Energy Discussions

After analyzing the data provided by Xcel Energy, City Staff concluded the most equitable franchise fee implementation method is one based on a percent of revenue and/or usage. For example, the Large Commercial and Industrial electric customer class makes up less than 1% of total premises and approximately 52% of usage. Additionally, the usage within the customer class could vary significantly as the category includes all users over 100 kWh per day.

Within the Gas Customer Class, the general usage for Commercial Firm Demand and Non-Demand is not defined for the purposes of franchise fees, although Xcel Energy's rate book further breaks down the Commercial Firm category in to small (less than 6,000 Therms per year) and large (greater than 6,000 Therms per year).

As a result, it was the desire of City Staff to recommend a franchise fee based on a percent of revenue or usage. While it was understood Xcel Energy's policy is to only implement a flat monthly fee by the consolidated customer classes, state statute does not specifically prescribe a specific implementation method and other cities served by Xcel Energy currently charge franchise fees on a percentage basis.

However, the City obtained a legal opinion from Flaherty Hood P.A. that the existing franchise agreement negotiated from December 2012 stated that any future franchise fee *"shall be a flat fee per customer based on metered service to retail customers within the City or on some other similar basis."* The result is the City cannot impose a fee based on a percent of usage without the consent of Xcel Energy, which the City determined was unlikely and could possibly result in expensive legal action.

IV. Franchise Fee Projections

Because the City is relegated to implementing a flat monthly franchise fee by customer class, city staff requested Xcel Energy provide monthly fees based on an equivalent percentage increase for each customer class. Please note that this does not mean that each customer would see a specific percent increase in their monthly electric and gas bills. As stated earlier, there are likely significant differences in electric and gas usage within Xcel's customer classes, particularly the Large C&I electric customer class and the Commercial Firm: Non-Demand gas customer class.

Tables 8 and 9 shows the estimated franchise fee revenue based on each customer classes' average monthly and annual electric and gas bill increasing by various percentages.

Table 8: Monthly Franchise Fee

		Equivalent Increase in Monthly Bill by Customer Class				
Electric Customer Classes	**Approx # of Premises**	**3.0%**	**3.5%**	**4.0%**	**4.5%**	**5.0%**
Residential	6,532	$2.50	$2.75	$3.25	$3.75	$4.00
Small C&I: Non-Demand	486	$3.00	$3.50	$4.00	$4.50	$5.00
Small C&I: Demand	214	$24.25	$28.50	$32.50	$36.25	$40.25
Large C&I	49	$740.00	$867.00	$990.00	$1,112.50	$1,235.00
Estimated Annual Revenue	**7,281**	**$724,000**	**$834,000**	**$960,000**	**$1,094,000**	**$1,193,000**

Gas Customer Classes	**Approx # of Premises**	**3.0%**	**3.5%**	**4.0%**	**4.5%**	**5.0%**
Residential	5,237	$1.25	$1.50	$1.75	$2.00	$2.25
Commercial Firm: Non-Demand	510	$7.50	$8.75	$10.00	$11.25	$12.50
Commercial Firm: Demand	1	$292.00	$341.00	$390.00	$437.50	$485.00
Small Interruptible	3	$59.75	$70.00	$80.00	$89.75	$99.50
Medium & Large Interruptible	2	$1,126.00	$1,313.00	$1,500.00	$1,690.00	$1,880.00
Estimated Annual Revenue	**5,753**	**$172,000**	**$203,000**	**$235,000**	**$265,000**	**$298,000**

Table 9: Annual Franchise Fee

		Equivalent Increase in Annual Bill by Customer Class				
Electric Customer Classes	**Approx # of Premises**	**3.0%**	**3.5%**	**4.0%**	**4.5%**	**5.0%**
Residential	6,532	$30	$33	$39	$45	$48
Small C&I: Non-Demand	486	$36	$42	$48	$54	$60
Small C&I: Demand	214	$291	$342	$390	$435	$483
Large C&I	49	$8,880	$10,404	$11,880	$13,350	$14,820
Estimated Annual Revenue	**7,281**	**$724,000**	**$834,000**	**$960,000**	**$1,094,000**	**$1,193,000**

Gas Customer Classes	**Approx # of Premises**	**3.0%**	**3.5%**	**4.0%**	**4.5%**	**5.0%**
Residential	5,237	$15	$18	$21	$24	$27
Commercial Firm: Non-Demand	510	$90	$105	$120	$135	$150
Commercial Firm: Demand	1	$3,504	$4,092	$4,680	$5,250	$5,820
Small Interruptible	3	$717	$840	$960	$1,077	$1,194
Medium & Large Interruptible	2	$13,512	$15,756	$18,000	$20,280	$22,560
Estimated Annual Revenue	**5,753**	**$172,000**	**$203,000**	**$235,000**	**$265,000**	**$298,000**