City of Red Deer Utility Governance Modernization – Public Business Plan

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Glossary and Abbreviations

Glossary

Amortization: The process of spreading out a cost over a period of time, often used for intangible assets.
Cost of Service (COS) Model: A rate-setting approach that ensures prices reflect the costs of providing service.
Depreciation: A reduction in the value of an asset over time due to wear and tear.
Municipally Controlled Corporation (MCC): A corporation that is owned or controlled by one or more municipalities. This means that the municipality that owns or controls the MCC can make major decisions about how the corporate is run, but the corporation operates at arm's length from the municipality.
Operating, Maintenance & Administrative (OM&A) Costs: Day-to-day costs of running a utility, including salaries and service-related expenses.
Rate Base: The value of property on which a utility is permitted to earn a specified rate of return.
Valuation: The process of determining the current worth of an asset or company.

List of Abbreviations

AESO – Alberta Electrical System Operator
AUC- Alberta Utilities Commission
CAD- Canadian Dollar
COS- Cost of Service
EU- Electric Utility
FTE- Full-Time Equivalent
kVA – kilovolt amps
MCC- Municipally Controlled Corporation
MGA – Municipal Government Act
OM&A- Operations, Maintenance & Administration
PPE- Property, Plant, and Equipment
REA- Rural Electrification Association

Municipally Controlled Corporation Business Plan: Overview

Introduction and Context

The City of Red Deer has provided essential electric utility services to its residents and businesses and has designed, built, and managed critical infrastructure through an internal City department since 1926. The electric utility has grown to manage the vast electric infrastructure, deliver electricity services and generate significant revenue for The City underscoring the importance of the electric utility not only as a critical service provider but also as a financial pillar that supports The City's borrowing capacity and overall fiscal health.

However, despite the rapid advancements in technology, growth of the electric utility infrastructure and service delivery, and increasing regulatory complexity, the governance and operational model of the electric utility has remained largely unchanged since its inception. The City has been investigating viable governance options as a means to address the evolving challenges and to position the electric utility in a way that will modernize and position it for long-term sustainability.

City Council has established the following guiding principles for the City's electricity services in Council Policy GP-F-2.8 Electric Utility Governance:

- **Reliable:** It provides high quality, dependable power and service to customers. It has the capacity to provide resilient, secure services and to respond to outages with minimal disruption or downtime.
- **Responsive:** It responds to customer needs.
- **Affordable:** The cost to provide electricity service considers customer accessibility.
- **Marketable:** It contributes to economic development.
- **Adaptable:** It enables citizens to adapt to emerging opportunities (e.g., energy technologies, environmental issues).
- **Financially Beneficial:** It provides a favourable revenue stream for The City.

Creating an electric utility MCC is the best way to fulfil these Council's principles for the electricity services. A qualitative and quantitative evaluation of the viable governance options was completed. With an MCC:

- **The City remains in control** – The City will maintain 100% ownership of the electric utility.
- **Stronger oversight and expertise** – A dedicated MCC board of directors will oversee the electric utility improving the efficiency and flexibility of decision making, while City Council continues to economically regulate and provide oversight to ensure reliable service for the community.
- **Stronger financial options** – The electric utility will have more flexibility to manage its finances, helping to reduce City debt and financial risk.
- **A stronger focus on service** – The City can prioritize delivering services while benefiting from specialized industry expertise.
- **More opportunities for innovation** – The electric utility will have greater potential to invest in new ideas and partnerships that benefit residents and the community.
- **Fairness across generations** – Future generations will continue to have access to high-quality, reliable, and affordable electricity.

Services Intended to be Provided

The MCC is being established to provide a service that is necessary or desirable for all or part of Red Deer. The MCC will provide the following electric utility services:

- Electricity distribution
- Electricity transmission

Names of Shareholders

The City will retain control of the MCC as its direct or indirect 100% shareholder. The shareholder will be represented by City Council. If a holding company is established, the holding company will be a direct subsidiary of The City, with the MCC established as a direct subsidiary of the holding company.

Geographic Location of Services

The geographic location of services for the MCC is intended to be within The City's AUC-approved service area, which will include any alternations to City or MCC service area boundaries as may be approved by the AUC from time to time. The MCC will continue the purpose of The City's electric utility, which is to provide electricity services to customers within Red Deer. The MCC will continue to provide transmission services in accordance with AUC approvals.

Transfer of Lands and Valuation

The City does not intend to transfer any land rights to the MCC at the time of its establishment, so there has been no land valuation conducted at this time. If The City is required, or has determined it is beneficial, to transfer any land rights to the MCC at a future date, a valuation will be conducted at that time. Any land valuation and transfer of land rights will not have an impact on the financial analysis done for this business plan as land is a non-depreciating asset and its value does not impact the electric utility revenue (which are based on capital investments and operational costs).

2. Municipally Controlled Corporation Business Plan: Analysis

Municipally Controlled Corporation Business Plan: Analysis

A detailed analysis was conducted to understand the impact and viability of the proposed MCC. This section provides:

- The projected rate structure for the MCC services;
- A market impact analysis in respect of competition with similar services provided by the private sector;
- Information demonstrating that the MCC will not be dependent on The City for its ongoing operations;
- The financial impact to The City of establishing and controlling the MCC;
- The costs related to establishing and controlling the MCC;
- A cash flow projection for the next three years of the MCC's operation;
- The value of any assets of The City that are to be transferred to the MCC and the book enterprise valuation of the MCC;
- Information on any potential environmental, financial, labour, or other liability risk in controlling the MCC; and
- The MCC's forecasted financial statements and operating and capital budgets for the first 5 years.

Projected Rate Structure

The regulatory regime for the MCC will remain unchanged for both transmission and distribution services, provided the MCC only provides electric distribution services within its service area. Under the current regulatory framework, transmission service rates are economically regulated by the AUC, and distribution service rates are economically regulated by City Council. Both services are regulated under cost-of-service rate setting mechanisms.

Transmission Rate Structure

Transmission services are economically regulated by the AUC using a cost-of-service rate setting mechanism. The City's transmission revenue requirement is recovered from a single customer, the AESO. The AESO subsequently recovers the costs of the transmission system (including amounts it is required to pay to transmission facility owners like The City) from all transmission customers in Alberta through its own tariff and AUC-approved rate structure. The regulatory regime for the MCC will remain unchanged for transmission services and as such, no further analysis has been developed for transmission rates.

Distribution Rate Structure

The City's electric distribution services are currently economically regulated by City Council under a cost-of-service rate setting mechanism. This will remain the same for the MCC, provided the MCC only provides electric distribution services within its AUC-approved service area.

The MCC will calculate the distribution rates charged to electricity consumers within its service area based on the costs associated with the development, construction, and ongoing operations and maintenance of the electric utility's assets. Distribution rates will be established by forecasting

service costs and incorporating a reasonable return on equity to determine the total revenue requirement that will be needed for the MCC to cover its expenses and earn a fair profit.

Once the revenue requirement is determined, a rate assessment and allocation study will be conducted by the MCC to determine how much of the total revenue requirement should be equitably recovered from each customer class (e.g. residential, commercial, and industrial.) Based on the results of this study, rates will be designed to ensure that each customer class pays its fair share of the costs associated with serving them and cross-subsidization among customer classes is minimized.

Currently, The City's distribution revenue requirement is allocated among specific customer classes based on their service type, size and load information, as will the MCC's distribution revenue requirement. The primary rate classes that cover most of the electricity consumers that are served by The City's electricity distribution system (and will be served by the MCC) include:

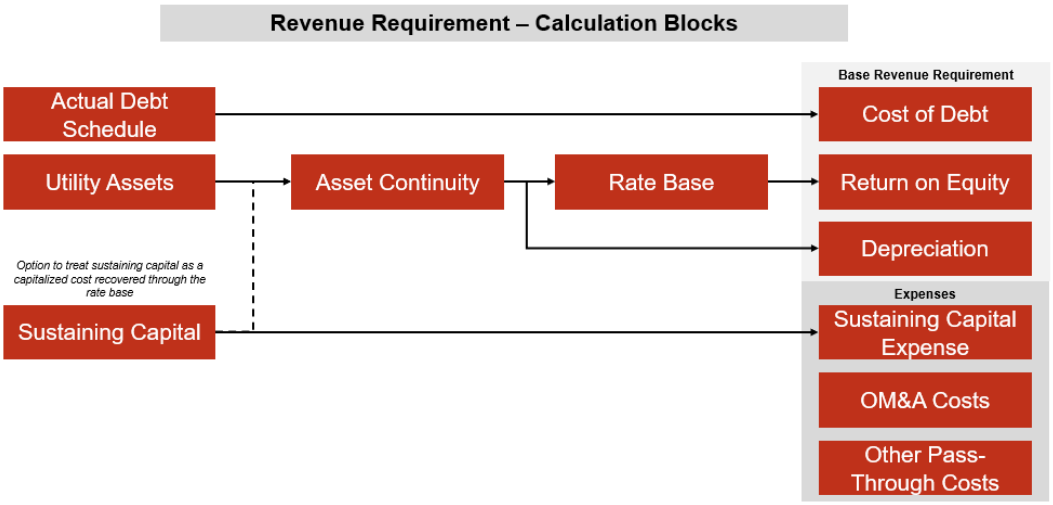
- **Residential:** This rate class is designated for residential premises that are measured by a single meter. It applies specifically to homes that do not have more than two dwelling units. This rate is offered for typical residential consumers who require standard electricity services without complex demands.
- **General Service:** This rate class is for customers with electricity demand below 50 kVA and who meet certain voltage requirements. It serves small businesses and other non-residential entities that have moderate electricity consumption.
- **Large General Service:** This rate class is intended for commercial and industrials sites that have an electricity demand that exceeds 50 kVA. This rate class caters to larger businesses that require more substantial electricity services due to their higher consumption levels.
- **Large General Service/Industrial:** This rate class is designed for large industrial operations that have significant energy needs, taking service at high voltage with demand exceeding 1,000 kVA.
- **Distribution Generation:** This rate class supports the integration of distributed generation into the electricity grid. Generators must meet specific criteria outlined by the AESO to qualify for this rate class.

By using the cost-of-service model, the MCC will have flexibility in setting rates and structuring them according to its operational realities. This model also allows for annual adjustments to rates, based on real time operational costs, changes in demand and other relevant factors, enabling the MCC to respond quickly to changing operational conditions, market dynamics, and customer needs. This adaptability will facilitate timely adjustments to distribution rates, ensuring that they accurately reflect the costs of providing reliable service.

Under the MCC, the regulatory framework governing electric utility distribution rates will remain unchanged. City Council will continue to regulate the MCC's electricity distribution rates, while the AUC will maintain its role in regulating the MCC's transmission rates. As a result, the structure of electric distribution rates under the MCC at startup will remain unchanged as described above and detailed through in The City's current electricity rates bylaw (for more details, see Electric Utility Bylaw 3273/2000 – Schedule 'A' Distribution Tariff, as may be amended or replaced from time to time). This means that electricity customers with The City's service area can anticipate that the MCC will use the same approach to rate structuring as The City has used.

The components that impact rate design under a cost-of-service model are outlined in the following figure: Cost of Service- Revenue Requirement Components.

Cost of Service - Revenue Requirement Components



Market Impact Analysis to Competitors

The City's electric utility operates within The City's AUC-approved service area. The electric distribution system function is economically regulated by City Council and its transmission function is economically regulated by the AUC. The electric utility demonstrates monopolistic characteristics, as it is the sole provider of electric distribution and transmission services in The City's service area, facing no competition. Given that the electric utility's services do not compete with any other entities within The City's approved service area, there will be no market impacts as a result of the transition to an MCC.

Demonstrating Independence

The MCC will be structured so that The City will retain ownership over the MCC as its sole shareholder, but the day-today operations and decision making will be managed by the MCC's Board of Directors and management, with limited direct control by The City. The City will maintain influence through its shareholder rights and City Council's appointments to the MCC's board of directors. City Council will also retain its role as the economic regulator for distribution services. The MCC will have a governance and operating model that enables autonomy for managing the long-term strategy of the MCC and its operations.

The MCC governance structure, illustrated in figure Governance structure of the EU MCC, has the following key components:

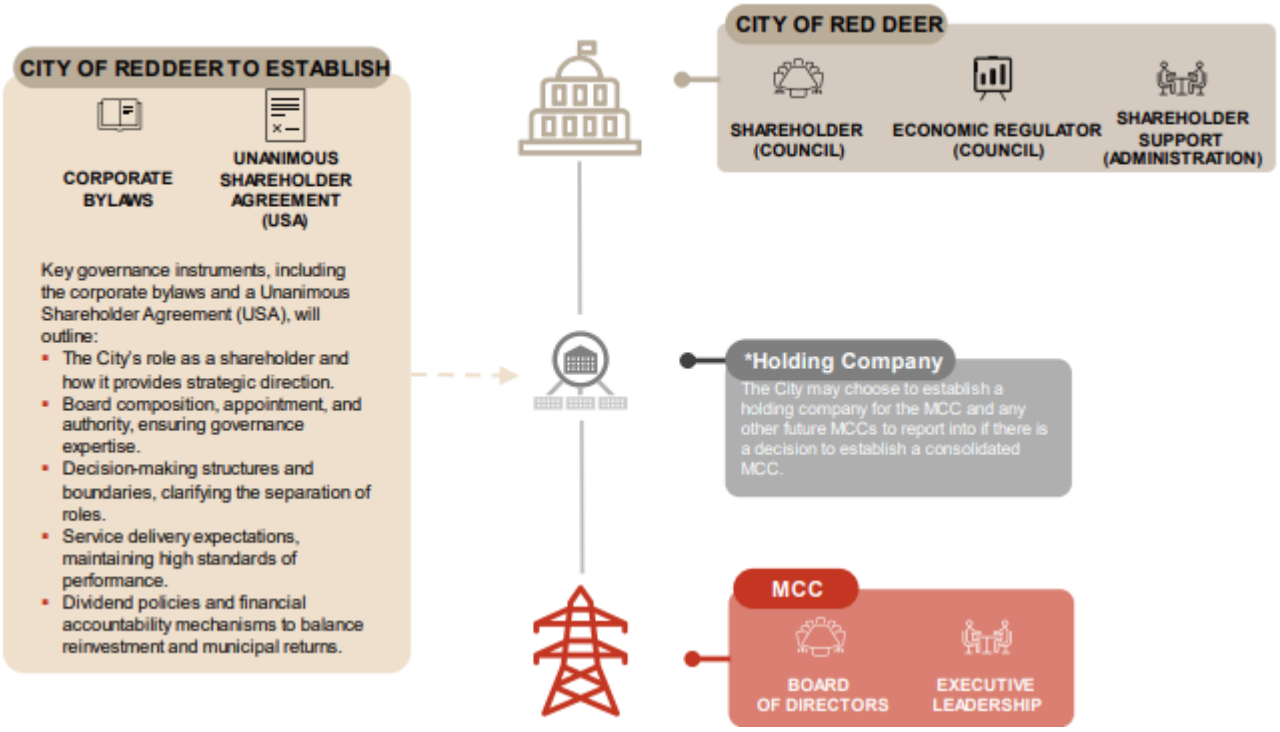
1) The City is the sole shareholder of the MCC and remains the economic regulator for the electric distribution service. Additionally, when establishing the MCC The City can identify decisions that require shareholder approval and, through the unanimous shareholder's agreement, ensure that such decisions are made by the shareholder (i.e. City Council).
2) The MCC will be a separate legally entity from The City. It will be a corporation created under Alberta's Business Corporations Act with its own board of directors and management, but owned and controlled by The City.
3) The relationship between The City and the MCC will be governed by a unanimous shareholders agreement, governance policies and corporate bylaws that ensure that the MCC will function independently from The City. In other words, instead of exercising direct operational control, The City will maintain influence over the MCC through defined governance levers and mechanisms, ensuring strategic alignment without The City having day-to-day involvement in MCC operations and management.
4) The City may decide to own the MCC through a multi-utility holding corporation, allowing for the addition of other utilities in the future.

Key governance instruments, including the corporate bylaws and a Unanimous Shareholder Agreement (USA), will outline:

- The City's role as a shareholder and how it provides strategic direction and oversight.
- Board composition, appointment, removal and authority, ensuring governance expertise. The board may include representatives from City Council and/or The City.
- Decision-making structures and boundaries, clarifying the separation of roles and identifying key decisions that require shareholder approval.

- Service delivery expectations, maintaining high standards of performance.
- Dividend policies and financial accountability mechanisms to balance reinvestment and municipal returns.
- Other expectations of the Board.

This governance framework will ensure that while the MCC remains accountable to The City, it will have the independence required to operate efficiently, respond to market dynamics, and drive long-term sustainability in Red Deer's electricity sector.



Governance structure of EU MCC

The subsections below demonstrate how the MCC will maintain financial and operational independence.

Financial Independence

The financial analysis covered in this business plan has been done on the assumption that The City will transfer the electric utility assets to the MCC in exchange for equity investment in the MCC, and that the MCC will assume any debt associated with the electric utility that is currently held by The City. However, a detailed transaction structuring and analysis will need to be done during the implementation planning phase, the results of which may alter how assets and liabilities are dealt with.

Additionally, the financial analysis has been done on the assumption that the MCC will remain as non-taxable entity. If this changes, further financial, legal and tax assessments will be required. However, this change is not contemplated at this time.

As an MCC, the electric utility will become an independent entity, capable of maintaining its financial stability. The MCC will continue to have the authority to recover costs that are fairly incurred and directly associated with providing electricity transmission and distribution services. As the only provider of electricity distribution service within its service area, the MCC will continue to benefit from a reliable stream of user fees linked to predictable consumption patterns.

The revenue model determines revenue requirements based on cost-of-service principles, and allows for the full recovery of operating costs and capital investments. Through the rate setting mechanism, the MCC will be able to pass on the costs incurred for developing, operating, and maintaining its assets to end consumers. A reasonable return on equity is built into the rate setting mechanism to ensure that the utility receives a return on its investment, thereby enabling predictable and stable cashflows. Based on this, the MCC will be capable of generating sustainable revenue that will covers its costs and generating a fair rate of return for The City. On that basis, the MCC will be a financially independent entity that does not rely on direct support from The City for its ongoing day-to-day activities.

As a separate entity from The City, the MCC will not be tied to the timelines, steps, and requirements of the municipal budgeting process, granting greater flexibility. This will enable the MCC to respond more effectively to operational needs, capital project demands, and emerging market opportunities. The MCC will also be able to engage in utility capital planning according to the accepted capital structure within the utility industry and approved by the AUC (i.e. approximately 60:40 debt to equity ratio), therefore not limited to the restrictions imposed by municipal policies regarding allowable dept capacity (i.e. borrowing capacity of 1.5 times revenues).

The MCC's capital project demands will be financed through a combination of debt and equity. The equity contribution required from The City can be sourced through net income generated by the MCC, while short-term cash requirements can be funded through various debt instruments backed by the assets and the revenue generating capacity of the MCC. Furthermore, the MCC's ability to maintain working capital reserves, access commercial debt markets, and participate in grant and funding programs further reinforces that it will have financial resilience. The MCC will be well-positioned to meet both short-term obligations and long-term infrastructure needs without depending on financial support from the City.

Operational Independence

The MCC will operate independently from The City, retaining autonomy over its operations and functions, including its personnel, processes, and technology. The chart presented below provides a high-level functional view of the operating model that the MCC will follow and lists core functions and contracted functions.

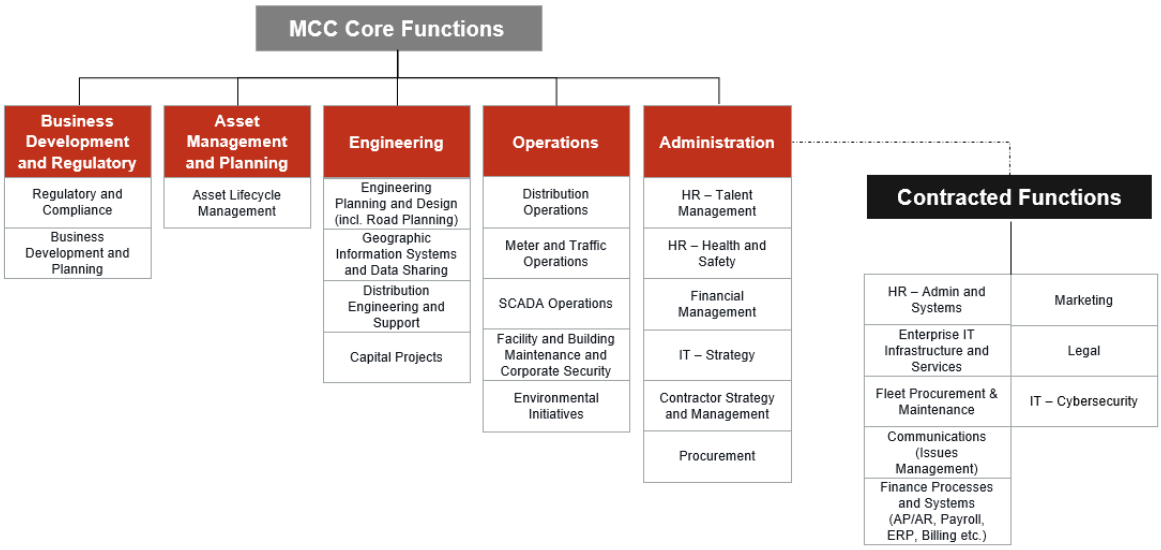
Core functions are functions that are fundamental to the MCC's business, functions that require high degrees of domain-specific technical expertise, and functions where the decision-making or operations require skills which are unique to the operating context (e.g., electrical utility regulations). Core functions will be internal to the MCC.

Contracted functions include functions that are standard, repeatable, and areas where the MCC will benefit from economies of scale due to the higher fixed and overhead costs of the functions (e.g., Fleet Procurement & Maintenance). Contracted functions do not require unique technical skills,

institutional knowledge or significant decision-making authority (e.g., Finance Processes and Systems as opposed to Financial Management). Contracted functions will be outsourced by the MCC on a temporary or permanent basis through services agreements with The City or third parties. Where a service agreement may be between The City (as the service provider) and the MCC, the service agreement will not give The City any additional decision-making powers if the decision-making power was already given to the MCC. For example, if the Unanimous Shareholders Agreement stated that decisions on financial strategy were to be made by the MCC, if the MCC contracts The City to provide Financial Processes and Systems services, neither the existence of the service agreement nor anything within it changes the decision-making authority that is set out in the USA.

The proposed functional organization structure is illustrated in figure Proposed Functional Organization Structure and is subject to change.

Proposed Functional Organization Structure



Impact of Controlling Corporation on The City's Finances

Transitioning the electric utility from a City department to an MCC signifies a fundamental shift in the governance of electric utility services and financing considerations for The City as the MCC's sole shareholder. Although the MCC will operate independently, it will be a subsidiary of The City, and its operations will continue to impact The City's financial statements in the following areas:

- **Balance sheet impacts:** Existing property, plant and equipment and the debt associated with those assets will be removed from City's balance sheet. The MCC's governance structure, as outlined in the previous section, means that the MCC will qualify as a government business enterprise, as defined in the CPA Canada Public Sector Accounting Handbook.[1] Government business enterprises should be accounted for using the modified equity method, which involves adjusting the investment in The City's consolidated statement of financial position to aggregate the MCC's net assets.
- **Income statement impacts:** The transition to an MCC means that The City will no longer be able to record electricity rate revenues as income. Instead, The City will be presenting the MCC's net income and franchise fee as a separate item on the City's consolidated statement of operations. The City will record new revenue if it contracts with the MCC to provide the MCC services for functions such as HR, Marketing, Communications, and Financial Process and Systems.
- **Cash flow impacts:** The dividend paid by the MCC will remain in the statement of cash flows under the cash flow from investing activities.

As a result of changes to the financial structure and reporting, The City's financial position will be impacted in two ways:

- Changes to the borrowing capacity resulting from revised financial consolidation rules outlined above.
- Alterations in cash flow distributions as The City moves from direct utility revenue to shareholder-based returns.

These metrics are relevant to City Council as they influence The City's ability to fund capital projects across various departments over the long term. There is concern that establishing the MCC may lead to a lower borrowing capacity for The City. Additionally, cash flow distribution from the electric utility is vital for funding various aspects of The City's operations, raising concerns that changes to these distributions may adversely affect different areas that the electric utility assisted in funding previously. The following sections provides an assessment of these impacts to The City and outlines how those potential risks will be mitigated under the MCC.

Overall, the transition to an MCC would have a mild impact on The City's finances. Borrowing capacity would be slightly diminished though not close to the MGA set borrowing limit of 1.5 times revenue. Cash flows would be reduced, potentially if the reduction in internal support cost transfers is not offset with reductions in The City's expenses.

The financial benefits of an MCC are:

- **Enhanced fiscal stability and greater clarity and discipline in financial management**. Through the establishment of the MCC, financial risk would be strategically shifted away from The City's budget, enabling The City to concentrate its debt and resources on tax supported services.

[1] Section PS 3070, investments in government business enterprises

- **Ability to restructure financing to follow industry best practices** and be able to better respond to the needs of aging infrastructure.
- **A balance between financial independence for the electric utility and benefit to The City**. The City will retain ownership and control of the electric utility as an MCC, while effectively managing The City's financial position through sustained capacity and reliable cash flow.

Borrowing Capacity of The City

In Alberta, a municipality's maximum debt limit is calculated as 1.5 times its eligible consolidated revenue[2]. The following components of The City's revenue will be impacted as a result of the transition of the electric utility to an MCC:

- With the establishment of the MCC, the electric utility will operate with standalone financial statements. Consequently, the net income generated by the electric utility will be reflected in The City's consolidated income statement, rather than its total utility revenue.
- The City currently receives a fee (a municipal consent and access fee) that is set by City Council and collected by the electric utility. The establishment of an MCC will result in The City receiving a similar fee (a franchise fee), that is set by City Council and needs AUC approval before being collected by the MCC. The franchise fee will be recorded as a new revenue source for The City.
- Currently, where a department within The City provides services to the electric utility, the department receives an internal transfer from the electric utility to fund the services provided (this arrangement is sometimes referred to as shared services). This will change with an MCC, the fee the MCC will pay The City to provide the MCC with services will need to be recorded as a new revenue source for The City.

Additionally, the electric utility related debt currently recorded on The City's balance sheet will be eliminated, as this responsibility will transition to the MCC.

As a result of the above noted changes, The City's overall debt utilization ratio will experience a modest increase. To illustrate the impact, 2023 financial results were assessed[3]. As presented in the table City of Red Deer debt utilization in 2023, The City generated $352 million revenue in 2022. This translates into a debt limit of $527 million for The City, and a debt utilization of 55%.

City of Red Deer debt utilization in 2023[4]

Line item	Variable	Value
Total Revenue for The City	A	$352 million
MGA debt Limit	B = 1.5 x A	$527 million
Total debt	C	$290 million
Debt limit utilized	D = C / B	55%

Based on the table: City of Red Deer debt utilization in 2023 with MCC, if the electric utility had transitioned to an MCC in 2023, the debt limit of The City would have been reduced to $449

[2] Debt Limit Regulation, Alberta Regulation 255/2000

[3] At the time this document was written The City's 2024 audited financial statements were not published, and the latest available financial statements were available for fiscal year 2023

[4] All values from The City's2023 audited financial statement

million. This reduction is the result of removing the electric utility's revenue contribution of $63 million and adding the MCC's net income of $4 million and franchise fee revenue of $7 million. This results in a reduction of debt limit by $78 million compared to what The City's debt limit actually was in 2023. Considering that The City had $290 million in outstanding debt in 2023, $11 million of which was associated with electric utility assets, The City's debt utilization would increase to 61%. The City would still have $170 million room to issue debt under the MGA prescribed debt limit.

City of Red Deer debt utilization in 2023 with MCC[5]

Line item	Variable	Value
Total Revenue for The City (including EU) - 2022	A	$352 million
Electric utility total revenue	B	$63 million
Electric utility net income	C	$4 million
MCAF revenue	D	$7 million
Total Revenue for The City (with MCC)	E= A – B + C + D	$299 million
Total debt (including EU)	F	$290 million
Electric utility debt	G	$11million
Total debt (with MCC)	H = F - G	$279 million
MGA debt Limit (with MCC)	I = 1.5 x E	$449 million
Debt limit utilized (with MCC)	J = H / I	61%

The current internal transfers from provision of shared services for the electric utility will be recorded as a new revenue source for The City after transition to an MCC. The addition of this revenue will impact the total debt limit and debt utilization for The City. According to recent estimates, the internal transfers range between $1-2 million per year, therefore it will not have a significant impact on the debt limit and debt utilization calculation presented above[6].

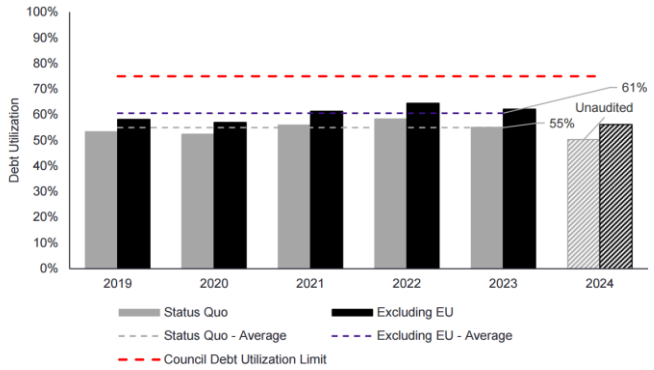
Historical financial data, illustrated in Historical Debt Utilization of The City- MCC vs Department indicates that The City retains substantial capacity to borrow and finance capital priorities without facing constraints if an MCC is established. and the MCC will not impact the integrity of The City's long-term financial capacity.

Historical Debt Utilization of The City – MCC vs Department[7]

[5] Values from City of Red Deer 2023 audited financial statement and EU 2025 financial model

[6] $1 million of additional revenues would translate into $1.5 million in increased debt limit for The City. Considering 2023 financial results, this will impact the debt utilization by 0.2%.

[7] Audited Financial Statements published by The City of Red Deer



Cash Flow Distribution to The City

Even though the electric utility as an MCC will operate as a standalone entity, The City will continue to receive regular cash flows from the MCC in its role as sole shareholder. Ongoing cash distribution from the MCC would include:

- **Franchise Fee:** The fee that will be collected by the MCC and provided to The City. Currently a similar fee (a municipal consent an access fee) is collected by the electric utility and provided to The City. The MCAF for the electric utility is set by City Council and is currently subject to a City Council policy that limits the fee up to 15% of the total electric utility revenue. The franchise fee that can be collected by the MCC and provided to The City will be set by City Council and will need to be approved by the AUC. The AUC allows a franchise fee for an electric utility to be up to 20%.
- **Payment of Dividends:** MCC receives revenues from rate payers, so the profits made by the MCC (i.e. remaining cash after payment of operating expenses, debt service, and capital expenditure) can be paid back to the shareholder as dividends. The dividend policy may include regular dividend payments and special dividends that can be declared by the MCC under certain conditions. On that basis, the MCC is expected to pay regular dividends to The City on an annual basis. The regular dividend amount is the greater of $3.7 million or 40% of electric utility net income. Considering the electric utility assets are currently funded mostly through reserves (i.e. capitalization ratio of approximately 10% debt and 90% reserves), the MCC has the potential to pay special dividend to The City in the short-term by fully funding the capital requirements through debt to align the capital structure with the deemed structure used in the rate making process (i.e. capitalization ratio of 60% debt and 40% equity).
- **Service Level Agreement revenue:** With an MCC, any services purchased from The City by the MCC would change from an internal transfer within The City to a revenue for services..

These cash flows replace the direct electric utility revenue currently reported within The City's budget. The MCC will formalize these payments through structured policies and agreements, reducing the risk of fluctuation and enhancing transparency. As the MCC becomes more efficient and financially mature, there is also potential for increased dividend capacity, creating a scalable benefit for The City.

Cost to Establish the Corporation

The costs required to establish the MCC can be broken into two major categories:

1. **One-Time Set Up Costs:** This process involves designing a future state organization and the necessary processes to support the MCC, as well as developing and implementing strategies to transition the entity from its current state to the desired MCC target state, including obtaining required regulatory approvals.
2. **Ongoing Operating, Maintenance, and Administrative (OM&A) Cost Adjustment:** As the current electric utility transitions to the MCC target state, the MCC's cost structure must be aligned to support its future processes and objectives. This shift will be integrated into the ongoing OM&A cost structure of the MCC, serving as the foundation for determining the revenue requirements for the MCC. Ultimately, adjustments made to the OM&A cost structure will influence the electricity rates charged to customers within the MCC's service area.

Further details about each cost category are provided in the following sections.

One-Time Set Up Costs

The cost estimates to determine the structuring and the execution costs to establish the utility MCC are $4.1M. These are primarily related to legal, project management and staffing to facilitate and execute the detailed set up and implementation of the MCC.

Ongoing OM&A Cost Adjustment

To assess the total OM&A costs of The City's electric utility and evaluate how these costs may change with its modernization, a benchmarking analysis was conducted. Five utility organizations were selected based on specific criteria to ensure that the entities that The City's electric utility costs are being benchmarked against accurately reflects the operational landscape. These findings are a strong indication of the OM&A investments that would be required to operate a sustainable electric utility and would be required if the electric utility remains a department of The City or if the electric utility becomes an MCC.

Comparator utilities were selected based on similar customer counts to the electric utility. Additionally, comparator utilities that were selected needed to have recently having submitted a cost-of-service rate filing to ensure that costs being included are up to date and best reflect the current landscape. Utilities included within the benchmarking list operate under a comparable model to how the MCC will operate, with the municipality retaining ownership while the utility operates as a separate entity.

Total OM&A costs across the five comparator utilities[8] were averaged and normalized per Full-Time Equivalent and per customer count. The total OM&A cost for The City was normalized based on the number of FTE's employed, and the total number of customers served by the electric utility. As presented in the table OM&A Benchmarking Results, the average OM&A per FTE is estimated at $184,000, and the average OM&A cost per customer is estimated at $375. Using these benchmarks,

[8] Comparator utilities include Greater Sudbury Hydro, Bluewater Power Distribution, Milton Hydro, Synergy North and PUC Distribution Inc.

the projected total OM&A for the electric utility (either as a City department or an MCC) could range between $13.6 million and $17.0 million.

OM&A Benchmarking Results

	Average Cost ($M)	$ / Average FTE	$ / Average Customer	CoRD Low End Scenario($M)[9]	CoRD High End Scenario ($M)[10]
Distribution Costs	7.0	78,000	158	5.7	7.2
Customer Costs	2.9	32,500	66	2.4	3.0
Administrative Costs	6.6	74,000	150	5.5	6.8
Total	**16.5**	**184,000**	**375**	**13.6**	**17.0**

Considering the cost ranges identified in the benchmarking study, the total OM&A costs for the electric utility have been formulated within the financial model. Administrative functional spends as a percentage and OM&A was determined across the various utility companies, these proportions were averaged and used as an input to determine the potential costs.

The cost increases for various departments have been estimated as presented in the table OM&A cost benchmark for electric utility. The administrative costs detailed in the "current cost" column reflect the ongoing support cost allocations that the electric utility is paying to The City for the services rendered. The forecasted cost increase column encompasses the cost of hiring FTEs and the necessary supporting infrastructure.

It is expected that the OM&A costs for the electric utility will increase to approximately $16.1 million per year. This investment would be required to modernize the electric utility whether it remains a department of The City or becomes an MCC. Finally, transition to the MCC may result in incremental cost savings or cost increases to a potential total of $1.1M annually on top of the $16.1M.

Incremental cost savings or cost increases do not provide a direct comparison to the current costs. They result from the cost of hiring FTEs, establishing functions directly under the MCC, or outsourcing to third-party providers, which may lead to costs savings or increases over time. The following assumptions were made in developing the estimated incremental costs:

- **Legal:** costs may increase in the event that specialized legal expertise is required.
- **MCC Executives and Board:** depending on the composition of the board responsible for overseeing the MCC utility operations and governance, salary costs may increase to accommodate the addition of enhanced technical supervision and expertise.
- **Information Technology:** ongoing costs may increase for ongoing IT operating costs to accommodate increased standalone access fees and technical expertise.

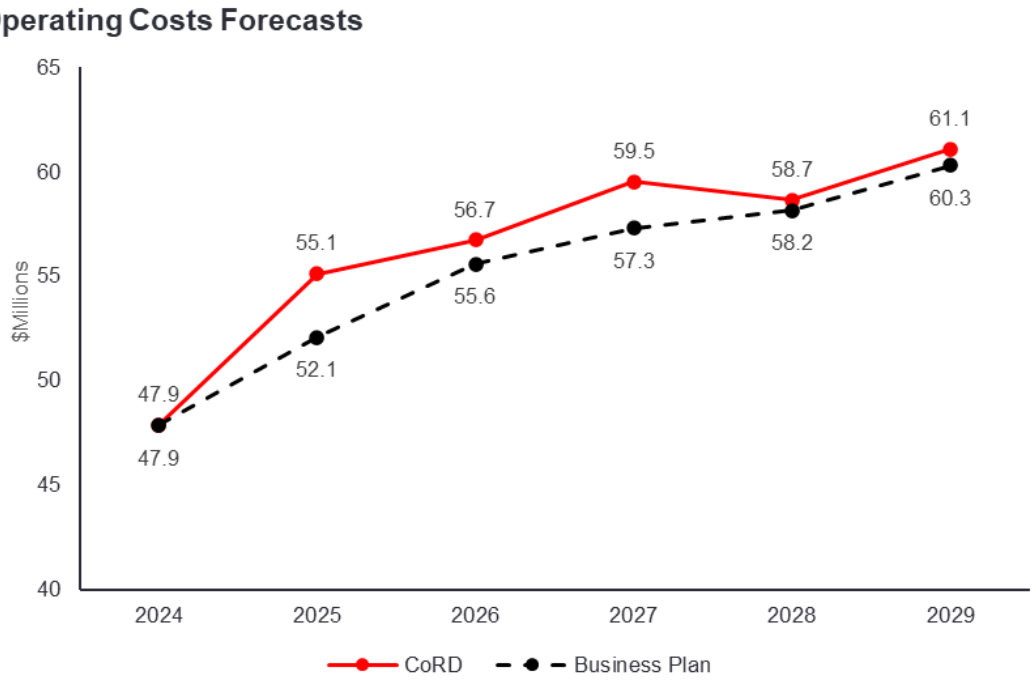
The Year-1 (2025) OM&A cost estimate presented in this business plan varies from The City's 2025 budgeted cost estimate. For the purpose of annual budget approval, The City has set aside a one-time total of $7 million for the MCC costs during the transition period from 2025 to 2027. In this

[9] Low end scenario costs were determined by multiplying $/average FTE costs by The City's anticipated FTE count under an MCC (74)
[10] High end scenario costs were determined by multiplying $/average customer costs by The City's current customer count (45,377)

document, the MCC OM&A costs were broken down and escalated using a more gradual, index-based approach. This allows for a smoother increase in costs over the transition period, including:

- **One-time costs for structuring and execution:** $4.1 million spread over three years.
- **Ongoing operational and maintenance costs:** A gradual increase of $3 million by the end of 2027, compared to the baseline in 2024.

As illustrated in figure Operating Cost Forecasts, the total cost impact over a 5-year period is almost identical between The City and the MCC (i.e. approximately $7 million). The cumulative average growth rate of OM&A is 5% per year in both models.



Electricity Rate Impact Analysis

Considering the capital expenditure and operating expense forecasts in 2024 and 2025, the total revenue requirements for the electric utility are expected to increase by approximately 11%. The direct impact of transitioning to the MCC is estimated to contribute 2% of the 11%. The increase in revenue requirement translates into 11% in electricity rates across all rate classes assuming the customer mix and demand for each customer class remains unchanged. This rate increase results from two contributing factors:

- **Capital Investment:** Impact of 2024 capital expenditure and planned capital for 2025. As a result of this expenditure, the total revenue requirement is forecasted to increase by 5%.
- **Operating Expenses:** Total OM&A costs are expected to increase in 2025 (by approximately $3 million) resulting in a revenue requirement forecasted to increase by 6%. This increase is a result of an increased volume of operating and maintenance activities, as well as the increase in The City's costs to modernize the electric utility. The direct impact of

transitioning to an MCC is estimated to contribute $1.1M to the overall cost of electric utility operations, which is approximately 2% of the total revenue requirement in 2025[11].

The Year-1 (2025) forecasted rate increase presented in this business plan varies from The City's 2025 budgeted rate projections. This is partly because the assumptions underpinning this business plan are based on the most up-to-date economic and business environment conditions, such as borrowing and equity costs. In contrast, The City's 2025 budget was prepared using 2024 data leading to variations between the two forecasts.

Additionally, this business plan was developed using a rate-recovery method as per the cost-of-service framework, where 100% of costs associated with delivering electric utility services are recovered through rates. The financial model does not include a detailed rate modelling exercise either and as such, changes in electricity rates may fluctuate significantly year-over-year. The City's 2025 budget was prepared based on The City's approach where a rate increase cap was used to smooth out the rate impacts using annual surplus or deficits as applicable. When the detailed rate modelling is completed for the MCC, it is expected that it will follow a similar rate smoothing process as The City currently follows to limit rate shock.

As a result, The City's 2025 budget presents a 6.5% increase whereas this business plan estimates an overall 11.4% increase based on the differing modelling assumptions and approach. The City's 2025 budget also shows an operating deficit as the full extent of the increase in the revenue requirements was not reflected in the rate design model.

If The City were to use the same cost-recovery modeling methods that were used in the development of this business plan, without the use of rate smoothing, the rate increase reflected in the 2025 Budget would likely be more consistent with the estimates provided in this document. Looking ahead, future iterations of the MCC rate forecast will incorporate a more detailed rate design exercise to gradually transition to the target operating model and implement a smoother rate increase over time.

[11] Assuming total revenue requirement of $58 million in 2024 and net cost increase of $1,100,000 resulting from transition to the MCC structure

Risk Analysis: Environmental, Financial, Labour or other Third-party Liability Risk in Controlling the Corporation

This section provides a summary of the analysis of the potential environmental, financial, labour or other liability risks associated with establishing, controlling and operating the proposed MCC, as well as potential mitigation strategies.[12]

Establishing an MCC may introduce some new risks for the electric utility while other identified risks are inherent to an electric utility and may be applicable regardless of the business model (e.g., department of The City or MCC). In some cases, risk exposure will be reduced in a move to an MCC.

These risks have been identified based on common risks faced across similar MCC and electric utility corporations in Alberta. Each risk is assessed based on its likelihood and scale of impact on the operations of the MCC in terms of low (1), medium (2), and high (3). Risk exposure of each risk has been assessed by multiplying the likelihood and impact of each risk for a scale ranging from 1 to 9. Appendix III provides a risk analysis – including a description of the risk and its impact, its exposure rating, potential risk mitigation strategies, and an assessment of whether it applies only in the MCC model.

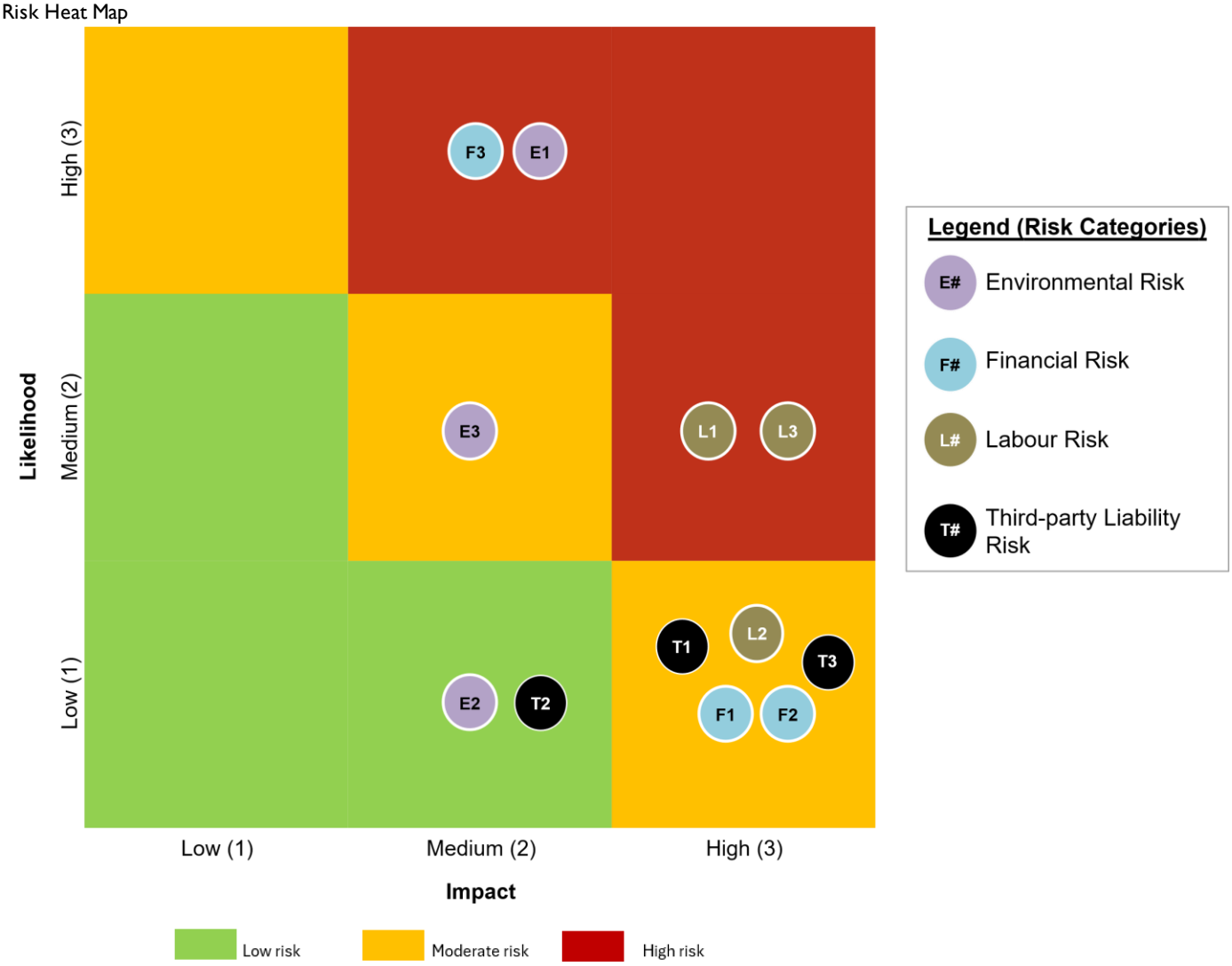
Summary of identified risks

Risk Category	Risks
Environmental	**E1. Climate change related:** The risk that extreme weather events and natural disasters, disrupt MCC operations, impact safety, and result in financial and reputational consequences. **E2. Environmental compliance:** The risk that environmental regulatory requirements (e.g., relating to hazardous materials) lead to operational delays, increased costs, and potential fines or sanctions for non-compliance. **E3. Decarbonization requirement:** The risk that evolving net-zero policies and emissions reduction targets increase compliance costs and energy prices, particularly due to Alberta's reliance on natural gas for energy.
Financial	**F1. Funding liquidity:** The risk that the MCC struggles to secure cost-effective financing for capital expenditures. **F2. Credit rating:** The risk that poor financial management and weak governance lower the MCC's credit rating, making financing more expensive or difficult to serve. **F3. Red Deer's economic conditions:** The risk that fluctuations in Red Deer's key industries impact energy demand affecting the MCC's operations and financial stability.

[12] Review of risk management plans, frameworks, and mitigation strategies of other comparable utility organizations was used, including ENMAX, EPCOR, ATCO, and FortisAlberta

Risk Category	Risks
Labour	**L1. Occupational health and safety:** The risk that electrical hazards, equipment failures or workplace accidents at MCC facilities lead to employee injury, service disruptions, or regulatory non-compliance. **L2. Talent attraction and retention:** The risk that inadequate HR policies, limited career development opportunities, or suboptimal working conditions lead to difficulties in attracting and retaining key personnel, especially during transition. **L3. Engagement with unions:** The risk that renegotiation of collective bargaining agreements during the transition increases labour costs, causes operational disruptions, or results in long-term commitments misaligned with MCC objective.
Third-party liability	**T1. Contractual non-compliance:** The risk that financial relationships with external stakeholders lead to cash flow issues if third parties fail to meet contractual obligations. **T2. Dispute resolution:** The risk that market partnerships, service agreements or joint ownership arrangements create disputes, causing project delays, operational disruptions, or financial strain on the MCC. **T3. Data security in outsourced services:** The risk that outsourcing services to third-party vendors leads to data breaches or unauthorized access, resulting in legal penalties, reputational damage, and regulatory non-compliance.

Risk Heat Map



Environmental

Three environmental risks have been identified, including risks related to climate change (e.g., wildfires, floods, storms), compliance with environmental regulations and guidelines, and decarbonization requirements (e.g., Net Zero Accountability Act, 2030 Emissions Reduction Plan). These are common environmental risks for electric utilities regardless of business model.

Climate change poses the highest risk exposure to the MCC. Proposed mitigations include investing in new technologies such as advanced decentralized grids and advanced warning radar, incorporating storm-resilient building materials, conducting periodic threat assessment. Preparedness exercises may also help to mitigate exposure. However, focus should be on preparing response plans, limiting liability, and maintaining appropriate coverage as extreme adverse weather and natural disaster events have limited recourse.

Financial

Red Deer's economy is highly reliant on the high energy consumption of industries including oil and gas and manufacturing, Given the current uncertainty of economic conditions, this leaves the MCC exposed, and proposed or alternate mitigation strategies should be considered. Proposed mitigation strategies include economic monitoring and load forecasting and establishing long-term industrial supply contracts.

While the impact of economic conditions is a risk regardless, the funding liquidity and credit rating risk will be different as an MCC. As a newly established MCC, the electric utility will be required to secure its own financing to fund its capital expenditures. Its ability to secure adequate funding will be influenced by debt-to-capital ratios that are accepted in the electric utility sector, market conditions, and MCC's credit rating. As an MCC, the electric utility will be able to optimise working capital and raise funds required for capital investment that is supported by the reliable cash flows generated through its market monopoly.

As such, proposed mitigation strategies include implementation of strong financial governance and oversight with a debt-equity ratio which provides the necessary liquidity while maintaining fiscal health, cash flow forecasting, financial exposure management, and regular audits. Additionally, robust governance structures (e.g., independent board members with adequate expertise) informed by leading practice will improve the credibility of the MCC to credit rating agencies.

Labour

Two important labour risks have been identified. The risks related to occupational health and safety are common for electric utilities and exist whether the utility remains a department or transitions to an MCC. Proposed mitigation measures include establishing training, policies, protocols and guidelines for electrical hazards, PPE use and emergency response, modernizing and maintaining the state of good repair of aging assets, and conducting regular safety audits and compliance checks.

Existing collective agreements would be ported over to a new MCC but could lead to new negotiations. There is a risk that those renegotiations may lead to increases in labour costs, cause operational disruptions, or result in long-term commitments misaligned with MCC objectives. Proposed mitigation strategies include early dialogue to allow sufficient time for discussions and consensus on potentially contentious items.
There is also a moderate risk to talent attraction and retention related to new HR policies, compensation, and hiring in moving to an MCC from The City. Additionally, the MCC may also risk losing key personnel during the transition. As such, the potential mitigation opportunities seek to tailor HR and hiring practices to meet the utility's needs in an MCC structure and remain competitive.

Third-party liability

While the electric utility may face third-party liability risks as a department of The City, these risks will be transferred directly to the MCC. If the electric utility is an MCC it will no longer fall under the protection of standard agreement terms included in municipal contracts which may provide protection against liability.

As an MCC, outsourcing and contracting certain functions such as finance and HR processes, as well as legal and cybersecurity will allow the organization to benefit from reduced investment in transition and start-up costs, and savings through economies of scale. In addition, the MCC model allows for more partnership opportunities with external parties. This may create moderate exposure to third-party credit risk resulting from vendor or partner defaults, and data security risk resulting from contracting/outsourcing of services which may result in access to sensitive data. Recommended mitigations include assessing vendor credibility, including creditworthiness, and robust agreements which consider liability impacts and confidentiality.