Government of the District of Columbia
Office of the Chief Financial Officer

Natwar M. Gandhi
Chief Financial Officer

MEMORANDUM

TO:	**The Honorable Phil Mendelson** **Chairman, Council of the District of Columbia**
FROM:	**Natwar M. Gandhi** **Chief Financial Officer**
DATE:	**December 9, 2013**
SUBJECT:	**Fiscal Impact Statement – "Electric Company Infrastructure Improvement Financing Act of 2013"**
REFERENCE:	**Bill 20-387, Committee Print shared with the Office of Revenue Analysis on December 5, 2013**

Conclusion

Funds are not sufficient in the proposed FY 2014 through FY 2017 budget and financial plan to implement the bill.

The bill, which proposes to bury underground power lines in the District and pay for the cost of this project through surcharges on electricity consumers in the city, will increase District utility expenditures by approximately $800,000 in FY 2014, $3.4 million in 2015, $4.1 million in FY2016, and $4.9 million in FY2017. The implementation of the surcharges that would finance the undergrounding project is subject to inclusion of these costs in an approved budget and financial plan. The Mayor has already asked to reprogram $800,000 in Department of General Services' budget to cover the FY 2014 costs. The Mayor plans to fund the out-year costs in his proposed FY 2015 through FY 2018 budget and financial plan. It should be noted that the Public Services Commission must take at least 120 days from the effective day of the bill to approve a capital plan before determining the surcharge rates and implementing them.

Background

In the District, the Potomac Electric Power Company (PEPCO) is the regulated utility responsible for the electricity distribution network. The District has 1,433 miles of overhead electrical wires, which serve approximately 40 percent of PEPCO customers.

The bill creates the legal and administrative processes for approving and financing $875 million of an estimated $1 billion[1] project allowing PEPCO, in partnership with the District, to bury the

[1] Mayor's Press Release of May 15, 2013.

highest priority above-ground electric company feeders and power lines to improve the reliability of electric power in the District. The bill outlines a financing and construction structure as follows:

1. The Public Service Commission (PSC) will issue a financing order that allows PEPCO to impose surcharges on electric company customers sufficient to pay debt service on up to $375 million of District-issued revenue bonds. After issuance, the District's Department of Transportation (DDOT) would utilize the bond proceeds to construct underground ducts, conduits, and manholes to accommodate the power line undergrounding. Because they are financed by customer surcharges, and not District imposed fees or taxes, these bonds would be considered revenue bonds, and would not be considered District debt under the District's statutory debt cap.
2. The PSC will also review and approve a PEPCO investment of up to $500 million, which PEPCO will use to put the feeders and electric wires into the ducts and conduits that have been built by DDOT. The PSC will approve a surcharge on customer bills to repay PEPCO's debt and equity at their regulated rate of return.

The Mayor's Underground Powerline Taskforce has separately recommended that the District support the cost of construction with a capital contribution of up to $125 million from the DDOT budget, since a significant portion of the underground conduits built by DDOT would be completed concurrently with DDOT's road reconstruction projects. This part of the funding plan is not addressed in this bill.

The bill also provides for the prioritization of and approval process for the undergrounding work, which will be prepared by DDOT and PEPCO, and be approved by the PSC. PEPCO and DDOT will develop three-year work plans allowing PEPCO to move some of the District's electrical infrastructure underground. The legislation does not provide any specific authority to support the undergrounding of lower secondary wires nor service lines that go directly into homes and buildings. However, the legislation provides for two subsequent analyses, in 2019 and 2027, on the efficacy of undergrounding additional feeders, wires, and eventually the secondary and service lines.

Pursuant to the legislation, DDOT's portion of the overall project will include excavating the roads, installing manholes, duct banks and conduits, and refinishing the roads. After the DDOT project is completed, the District will transfer the constructed conduit infrastructure to PEPCO for a sum of $1. PEPCO will install the wires, feeders, and other distribution equipment in the conduits.

The infrastructure investment is supported by two separate surcharges on ratepayers' electricity bills, imposed by the PSC. The surcharge to support the District's bonds will coincide with the term of the bonds, currently estimated to be 15 years. The surcharge to support PEPCO's debt and equity financing is expected to be in place for up to 60 years.

The amount of the surcharges will depend on (a) market conditions at the time of bond issuance; (b) the structure and subsequent credit rating of the District bonds, (c) and the rate of return PSC will approve for PEPCO. The surcharge structure this fiscal impact analysis uses to estimate the District costs assumes that the District could achieve AAA ratings on the bond issue, keeping the cost of debt financing low. It also assumes that the PSC will approve customer rate increases commensurate with PEPCO's blended debt and equity cost of financing of 8.08 percent (including approximately 9.5 percent on PEPCO's equity investments). Changes in these assumptions could result in higher or lower surcharges for customers, including the District government.[2]

In addition, the bill requires periodic adjustments of the surcharge supporting the District bonds, to assure there is sufficient revenue to meet the debt and equity requirements. These adjustments could increase or decrease the monthly surcharges to customers, again, including the District government.

Lastly, it is common for larger conduits to be installed to accommodate additional future uses, such as telecommunications and cable lines, but DDOT has indicated that it does not plan to install conduits with this additional space.

Financial Plan Impact

Funds are not sufficient in the proposed FY 2014 through FY 2017 budget and financial plan to implement the proposed legislation.

The proposed legislation will lead to an increase in District expenditures of approximately $800,000 in FY 2014 and by $13.2 million over the four-year financial plan period through increased electricity billings. This amount does not include any additional cost to UMC, which may have to be absorbed by the District. The Mayor has already asked to reprogram $800,000 in Department of General Services' budget to cover the FY 2014 costs. The Mayor plans to fund the out-year costs in his proposed FY 2015 through FY 2018 budget and financial plan.

The District government spends approximately $47 million on electricity consumption in its buildings, and another $10 million on the operation of streetlights. Given the projected surcharge percentages, the District's annual surcharge amount could be up to $6.9 million, when the surcharge reaches its maximum level in approximately 2020. In addition, the United Medical Center (UMC) spends approximately $11.8 million per year on electricity; any increase would have to be absorbed by UMC directly, or by the District indirectly through additional subsidy.

In addition, the surcharges are estimated to add to the District's electricity bills between $32 million and $65 million between FY 2018 and FY 2027. After that time, surcharges are expected to continue, but decline annually, for 60 years.

The chart below outlines the projected path of the surcharge costs:

[2] The bill also allows Washington Gas to request rate increases from the Public Services Commission should it be required to relocate some of its infrastructure due to the construction work for the undergrounding project.

Estimated Fiscal Impact of Electric Company Infrastructure Improvement Financing Act of 2013 FY 2014 through FY 2017, in millions of dollars					
	FY 2014	FY 2015	FY 2016	FY 2017	Four Year Total
Estimated surcharge expense	$0.8	$3.4	$4.1	$4.9	$13.2

Sources: Office of Revenue Analysis estimate based upon data from PEPCO and the Department of General Services.

Council should be aware of two issues related to the Mayor's Underground Powerline Taskforce's plan.

First, the bill authorizes a financing structure for an expected six-year $1 billion project that includes a PEPCO expenditure of $500 million and a District bond issuance of $375 million. Funding PEPCO's $500 million portion of the project over a 60-year period will shift to future customers a greater portion of the cost; but because PEPCO financing costs are higher than the District's and the District would finance the project over 15 years rather than 62 years, customers will pay more, in total and on a net present value basis, for the undergrounding project than they would have paid if the project were funded entirely through a District securitized financing. The magnitude of the difference between the proposed structure and the District issuing the full $875 million could be between $550 million and $670 million (in nominal terms) over a 60-year period.

Second, the bill only identifies funding for $875 million of the planned $1 billion project. The remainder will be supported by leveraging the District's capital funds. DDOT plans to align their planned resurfacing and reconstruction program with the undergrounding project to help reduce overall costs. Further, DDOT has some flexibility within their Federal Highway funds and their local road reconstruction funds to move capital funds from other projects to support this project. Thus far, DDOT has identified $62 million of local and Federal Highway funds for the project. If the reprioritization exercise requires funds to be diverted from other transportation projects, then the Mayor must seek Council's approval before diverting the funds.[3] Funds needed beyond the current DDOT capital plan, if needed, could require additional Council approval of funding.

[3] The reallocation of funds among Federal Highway Administration approved capital sub-projects does not require Council approval so long as the losing and gaining sub-projects are within the same project as categorized in the District's Highway Trust Fund spending plan.