Item #160807
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Blueprint to a Buyout

Although I have had the opportunity to talk with each one of you individually, I would like to inform you collectively, about how GRU has reached the point in which we have an MOU on the table with GREC, awaiting their response. It started with,

AN IDEA:

The impact of the Power Purchase Agreement with GREC is both financial and operational in addition to legal. The core of the PPA's financial impact is GRU's obligation to pay GREC $ 194,709 a day for what is termed "Available Energy". This cost represents GREC's cost of ownership and fixed cost of operations. Put simply, the cost of ownership is GREC's debt payment and the return to its investors. The fixed costs of GREC's operations are effectively GREC's costs of being available to generate (staff, rolling stock and other monthly bills, excluding fuel and consumables).

From this knowledge sprung an idea that for the right buyout price GRU could reduce the $ 194,709 a day to which it was already obligated. For example, GREC's cost of ownership was based on a double digit return on investment, while GRU's was based on tax-exempt bond rates, which are at historically low levels. GREC's fixed costs of operations were based on a stand-alone contract with an independent contractor, with investor rates of return, while GRU had multiple synergies within its own workforce staffing and management to handle GREC's operations.

I knew that a buyout of GREC's PPA would generate savings in the hundreds of millions of dollars if we could negotiate a reasonable buyout price.

On an operational perspective, GREC was designed to run between 70 megawatts and 102.5 megawatts, with long ramp-up times (up to 35 hours to reach load). From day 1 this operating profile was less than beneficial for GRU. In fact, a study was commissioned by GRU's Energy Supply Department which measured the impact of running GREC within these operating parameters on GRU's generating fleet. The results showed running GREC at these levels would require "thermal cycling" (turning our combustion turbines on and off) of our own units. The cost of this practice was expensive and damaging to our units.

The current environment has afforded GRU an opportunity to purchase less expensive gas-fired generation outside of our system and avoid the costly thermal cycling of its units. However, this won't last forever. As a utility we need to plan for higher gas prices and the impending retirement of older units.

The question for me became, "Could GREC generate power at lower operating levels and how could we facilitate that?" The answer to that question blended eloquently into the notion that a buyout of the PPA would save GRU hundreds of millions of dollars.

The engineers within GRU's Energy Supply have examined the possibility of modifying the GREC facility to operate as low as 25 megawatts so that we can fit the generation within our operating portfolio. We are confident that we can modify the facility for less than $ 15 million and make it a viable generating asset that could replace Unit 1 at Deerhaven as our load regulating facility. As a result, we believe GRU would avoid $ 150 to $ 200 million in replacement costs, already anticipated in 2022.

So the idea became, what if GRU could buyout the PPA, saving millions of dollars in financing and fixed costs, gain ownership control of the facility, manage the facility's operations within our system operating profiles with modest additional capital costs and in the end produce a substantial savings to our customers?

<u>AN UNDERSTANDING:</u>

In the midst of GRU's arbitration with GREC, a mediation process was accepted by GREC after our third attempt to facilitate it. It is my philosophy that as business-minded individuals there are always options in the process to better understand, facilitate and otherwise settle strongly held positions. Although our discussions during mediation did not result in a settlement, it did result in the acceptance of continuing to talk about issues. The one condition on the part of both GRU and GREC was that because of legal positions within the arbitration, as well as other sensitive issues a full vetting of the party's positions needed to be covered by a Non-disclosure Agreement ("NDA").

An NDA is customary and standard in these types of situations. I have used it in many situations during my career. In the situation with GREC it covered verbal conversations between a series of parties in both companies.

The bottom line is that before you can proceed with turning an idea into a contract which will be vetted by the public, it must first be reduced to an understanding. The overriding question is, "Are there conditions under which we can negotiate a buyout?"

<u>A Memorandum of Understanding (MOU):</u>

At some point it is imperative for the parties to reduce the understanding to writing, albeit in a non-binding fashion. That's the point of an MOU. In this case, based on the history of the GRU/GREC relationship I felt it was important to draft an MOU from GRU's perspective and deliver that MOU to GREC. The MOU sets a framework under which I would like both GRU and GREC to move towards a contract to buyout the PPA. It is not signed by either GREC or I and I anticipate that there will be further discussions between the parties over the conditions. Again this is typical.

What is not typical is the disclosure of a draft MOU to the media, public and elected officials. I am comfortable in this environment, although I must disclose that the other party may not feel the same way. It may result in making the execution of an MOU less likely. That would be unfortunate, given the savings which are at play here.

So what's in the MOU? Here's a primer:

- GRU is proposing to buy all the assets, contracts, property and rights of the GREC facility, in addition to terminating the PPA, in exchange for $ 750 million. This is important because there are folks in the public who are confusing the market value of the GREC facility with that of buying out the PPA, which has significant value to GREC. In fact, analysis of GREC's future cash stream under the PPA to be worth close to $ 1 billion in today's dollars.

- The price is subject to be reduced if interest rates go above 3.75%. This may not be acceptable to GREC and we may have ways to mitigate this risk in other ways, but the basic point is that I don't want to absorb the risk of a spike in municipal interest rates, to the point that it cuts into the savings of the transaction.
- GRU proposes no more than 4 months for execution of a contract and no later than 7 months for closing from execution of the contract.
- GRU proposes customary due diligence which will include, in our case the inspection by an independent engineer (which will be required through the issuance of bonds).
- GRU proposes an exclusivity period of up to ten months, which means that GRU and GREC will negotiate only with each other towards reaching an agreement.
- GRU will require compliance with Public Records and Confidentiality requirements, which means that other than the excluded verbal communications under the NDA all documents will be subject to the Sunshine Law.
- GRU proposes continuing in the arbitration unabated, unless the closing occurs prior to the arbitration decision.
- GRU proposes that each party reserves all rights under the PPA.
- The contract is proposed to be governed under Florida laws.
- The MOU is subject to City Commission approval.

I believe this MOU protects GRU and the City of Gainesville. Will it be negotiated? I believe so, but I will adhere to the basic principles of reducing risk and optimizing savings.

NEXT STEPS:

Public Vetting - I plan on establishing multiple public forums in which I will discuss the MOU and be available to answer questions. The still-unexecuted MOU has been delivered to the Commission and Utility Advisory Board. I expect further discussions in front of both of these bodies. My Communications Department, led by Magi Crawford is developing a communication plan through which I will meet with folks across the city and county.

Acceptance of an Executed MOU – If and when GRU and GREC execute an MOU, it will be subject to City Commission approval. Although it is still a non-binding agreement, I feel it's important to avoid the appearance of any "back-room dealing" or lack of transparency in the process. At the time of the acceptance of an executed MOU, it comes with the acceptance of allowing me and my executive team to negotiate a contract, subject to the City Commission's approval.

Bringing experts on board – Although we have established relationships with a host of bankers, lawyers and financing experts, we will line up the series of experts who will take the MOU to a final contract. These experts will include:

- **Transaction Counsel** – Working with our City attorney's office, GRU plans on using an organization of the caliber of Winston and Strawn to reduce a final deal to writing and closing the transaction.
- **Bond/Tax Counsel** – GRU has utilized a host of bond counsels over the years and is quite familiar with the process. For this transaction we will need to hire attorneys whose purpose is to write the bond documents.
- **Independent Engineer** – All of these types of bond transactions require an independent engineer, sometimes referred to as an IE to opine to the condition of the facility and to concur with the Financial Adviser's assessment.
- **Financial Adviser ("FA")**– GRU has a long history with Public Financial Management ("PFM") who we believe will be our FA in this transaction.
- **Underwriter's Counsel** – Typically, the Bond Underwriter retains Counsel who will opine along with our own Bond Counsel in regard to the Bond Documents and its covenants. Although they represent the Underwriter, GRU will be obligated for their fees as a condition of the overall underwriting of the Bond issuance.
- **Bond Underwriter** – Bond Issuances are facilitated by Bond Underwriters. Some of the bigger names include Goldman Sacks and JP Morgan. These firms typically will charge based on a percentage of the bond issuance costs. Their value is being able to facilitate the selling of the bonds to bond houses who either sell on a retail basis to individual investors or other financial institutions. It can be in the form of a day auction with or without the Underwriter willing to commit to buy any unsold issuances. I have found that the better underwriters can enhance an issuers' ability to gain a premium from bond investors which can save a company millions of dollars over the term of the bonds.
- **State Counsel** – Typically, GRU would retain Florida counsel to insure that we don't run afoul of state laws in the issuance and development of contract provisions.
- **City Attorney's office** – The City attorney's office will act as GRU's "general practitioner" in managing the aforementioned parties, making sure rates are proper and hours are reasonable.

Negotiation of Contract - The negotiation of the final contract between GREC and GRU will be in the Sunshine, except for any verbal communications between the parties to the NDA. This is no different than the current practice, which has led to the draft MOU.

Execution of Contract - Again, if and when GRU and GREC would execute a contract it would be subject to City Commission approval and the same public vetting process as will be seen and is occurring with the MOU.

Due Diligence – After the execution of the contract the experts would be green-lighted to proceed to the development of an Offering Memorandum ('OM") for the bond issuance, which will include the IE's report, confirming the FA's financial analysis. That development will include IE's inspection of the facility with a discussion of risks. Obviously the FA's report will do the same. The various attorneys' will hammer out bond documents and ancillary transaction documents. It should be noted that this will include very little participation from GREC, other than assisting in transferring titles, licenses, permits and other operating documents.

Closing – The closing of the transaction would occur simultaneously with the issuance of the bonds.

THE ECONOMICS:

It's important to understand that the proposed transaction through which GRU gains ownership of the GREC facility and terminates the PPA has virtually nothing to do with natural gas prices or other power prices. It has virtually nothing to do with operating risks or GREC's ability to generate power after the transaction. Although that sounds hard to believe, here's why:

The $ 194,709 a day which GRU is obligated to pay is based simply on GREC's ability to run, not the economics of running. Whether natural gas prices stay at $ 2.50 a million BTU or go to $ 100 dollars, the $ 194,709 is an obligation of GRU not matter if they are dispatched or not. My plan is to convert that current fixed payment, based on investor returns to a lesser amount based on tax-exempt, non-profit returns. For those who have moved from rental properties to owning their own home, or those who wish they could I compare it to a landlord offering a tenant with an 800 credit score a chance to terminate their over-priced lease at a price far below what they would have paid.

Finally, the economics of the MOU are based on future expenditures dropping from $ 2.1 billion to between $ 1.4 and $ 1.5 billion based on terminating the PPA and owning the GREC facility. That savings of between $ 600 and $ 700 million may be enhanced with modifications to the GREC facility which add close to $ 200 million in savings based on the difference between capital improvements and avoided costs and another $150 million in being able to run GREC as compared to Deerhaven's Unit 1.

This transaction could drive approximately $ 1 billion in savings as compared to the current PPA obligations of $ 2.1 billion. That is not insignificant and is relatively low in regard to a risk profile.

The most frequent question I hear is:

What if the GREC facility would fail the day after we purchase it and it had major internal failures?

My answer is this:

My analysis includes staffing the GREC facility for the next 30 years, without ever considering if it would run or not. In other words I have considered the added cost of being held in standby in my modeling. If the benefit under that scenario is between $ 600 and $ 700 million, than the alternate scenario of GREC having major component failures which would result in increasing the baseline economics to over $ 800 million in savings, because you'd no longer have to staff it.

Based on this fact, it means that GRU's operating risk is very small under this transaction.