

Memo

To: Honorable Mayor and City Commission
From: John Lawton
Date: February 28, 2008
Re: Highwood Generating Station Financing

The purpose of this memorandum is to provide an update regarding RUS Funding for Southern Montana Electric's Highwood Generation Station. Southern Montana Electric does not anticipate receiving RUS financing, which will change the nature of the City's ownership and participation from what had been earlier anticipated.

Southern Montana Electric G & T ("SME") began the process of securing financing from the Rural Utilities Administration of the U.S. Department of Agriculture ("RUS") for the construction of Highwood Generation Station in 2004. SME was required to submit a detailed loan application, fund an environmental impact statement conducted by an RUS contractor and provide various studies of alternative sites, alternative technologies and system load demands for the five member coops.

The City of Great Falls is a member of SME but is ineligible for RUS funding because it is not a rural coop. Therefore the City was pursuing private financing for its share of the project. Under that scenario, the City would have had a separate ownership interest in the project.

RUS along with the Montana Department of Environmental Quality completed an environmental impact statement in February, 2007 and issued a joint record of decision with the Montana Department of Environmental Quality in May 2007 that concluded that the project would have no significant environmental impacts to air, water or land. RUS held that the project was eligible for funding and DEQ issued a final air quality permit for the project. SME has also received other necessary permits from the State and federal governments. On January 11, 2008 the Board of Environmental Review rejected one of the claims filed by CCE and MEIC-- that DEQ should have required an analysis of CO2 emissions in the air permit for the plant. On January 31, 2008 the Cascade County Commissioners voted to recommend approval of rezoning for the site at which Highwood Station would be built. Therefore, the project has received all of the major approvals necessary to commence construction.

However, RUS informed SME in the fall of 2007 that because of a prohibition in the FY 2007 Budget on RUS' funding of base load generation and likely legislative restrictions on future funding, that SME would not be considered for funding, if at all, until the end of 2008 at the earliest. In February, 2008 RUS informed SME that it would not be able to finance the Highwood plant at all. Some of the reasons cited by RUS were the unavailability of funds in the Fiscal Years 2008 and likely 2009 budgets and the risk of increasing material costs and thus higher rates caused by the RUS funding delays.

This RUS decision was not unexpected and in view of problems with RUS funding, SME had already begun actively pursuing alternative sources of funding for construction of the project. That funding would include funding for the City's portion of the project. SME hopes to know shortly whether and under what conditions it will receive alternative financing for the project. Under this new scenario, Great Falls would not have a separate ownership interest in the project but would have the same interest as the five coop members. Great Falls will continue to be a member of SME and will receive electricity and other services for its customers from the proposed plant.