

To: Claudia Andrews, Acting Chief Financial Officer, BPA

From: John Saven and Geoff Carr

Re: Comments Regarding BPA Access to Capital

Date: December 9, 2011

Northwest Requirements Utilities is submitting the following comments concerning BPA's need to preserve access to borrowing authority for the next ten years. We recognize the value of the projects BPA has in its capital program, and that many of these initiatives are already underway, with contractual commitments already made for the FY 2012 – FY 2013 period. By suggesting alternative courses of action, we don't mean to ignore the hard work that has gone into each project, and the fact that there could well be a strong economic or operational case for them. However, the overriding question is how and whether the sum of these requests for capital funding can be met using financial mechanisms that represent sound business principles. We believe that a blend of alternatives should be employed in order to maintain sufficient borrowing authority over the long term.

Nature of the Problem

While BPA received \$3.25 B of additional borrowing authority through the ARRA in 2009, page 10 of the September 19 Strategic Capital Discussion handout shows BPA's remaining borrowing authority declining in FY 2016 to the minimum level needed to secure the \$750 million liquidity facility, and expiring in FY 2017. This assumes the "10% Capital Reduction" as described by Agency staff (but may not include certain currently unfunded projects that may represent additional capital obligations).

BPA's summary financial materials show future capital spending of \$1 billion per year over a 10 year period, a borrowing authority "gap" of \$428 million per year. \$100 million of that gap is closed by the 10% Capital Reduction. Various financial tools are then presented to close the remaining annual gap of about \$328 million for the 10 year period.

While no one can reliably predict if, or when, BPA's borrowing authority will be increased, most parties would argue that the region would be better off if BPA can extend the FY 2016 – FY 2017 crossover dates, as long as the financing approach represents sound business practices, and key components of the capital program can be addressed. We need to address both sides of the equation, as described in more detail below.

Need for a More Aggressive Examination of Capital Cost Reductions

For the most part, the BPA 10% capital reduction had a disproportionate amount of the reductions occurring not in the early years, but in the later years of the 10 year program. This gives the appearance of deferring hard choices. At the November 18 meeting BPA did provide an analysis of the consequences of a level application of the 10% capital reduction. Projects such as Central Ferry Lower Monumental and the I-5 corridor did exhibit some flexibility in terms of their timing. For other projects

such as Big Eddy-Knight, Celilo and System Replacements and Upgrades and Additions, the consequences of a capital reduction could be more significant. On the other hand, more potential for third party financing was described than in our initial meeting on this topic. Therefore, we believe that through a combination of continued budget scrutiny, delays of projects where timing is more flexible, and pursuing third party financing aggressively BPA's needs for capital can be reduced in tandem with the use of the financial tools discussed below.

We continue to believe that two areas are especially amenable to capital cost reduction. First, a number of entities have signed PTSAs and BPA is considering transmission builds to meet the demand of these PTSA holders. Now a number of these PTSA holders are asking to be released from these agreements for projects that may be in various stages of development. BPA should hold a workshop with its customers to address the interrelated issues of PTSAs and access to capital *together* in order to fully appreciate the implications of actions in one area or the other. For example, if customers are able to withdraw in part or whole from their PTSAs, this could have the result of reducing or delaying the number of planned transmission builds. We are not taking a position at this time in support or opposition to specific project terminations, but we are suggesting that this needs to be explored in relation to the level of capital needs.

Another example is the stated desire of some of BPA's customers, particularly the larger ones, to undertake their own financing for their own local energy efficiency programs. We found it illuminating that 40% of the forecast usage of BPA borrowing authority from 2012 to 2021 is related to borrowing for energy efficiency programs. If BPA were to accede to the stated requests of its larger customers, pressure will be taken off of BPA to borrow for these projects. While BPA has been disinclined to support this in the past, it may be an opportune time now to revisit that decision. A workshop that discusses the interrelated issues of its post-2011 energy efficiency program (including whether customers can opt to fully self-fund their own programs) and the implications that this would have on BPA's access to capital issues would be helpful.

The Access to Capital Tools

We appreciate all the work that the Finance staff and others put into researching and demonstrating the impact of various strategies and tools for accessing additional capital. Customer acceptance of various mechanisms will be influenced by: 1) their effect on the capital program, 2) their impact on current and future power and transmission rates and BPA's need for planned net revenues, and 3) an understanding of BPA's strategic approach to replenishing borrowing authority in the future. At the meeting on November 18th BPA staff noted that reliance on "revenue financing and the use of AAC could also require additional risk mitigation in BPA's revenue requirements in order to assure certain funding capability". If this turns out to be the case then adjustments to the base cost of Slice and the Slice true-up will have to be made to assure equitable treatment for both Slice and non-Slice customers. Also, we do need to ask whether customers will actually endorse the use of such a tool as the customer pre-pay, and whether it would be opposed by customers not participating in the program. Of the tools listed by BPA we believe that the following have the highest chance of success:

- Pursue Lease financing for transmission projects. Lease financing has a good track record so far and should be increased. We suggest moving the assumption from 25% to 30% of the

transmission capital budget. As BPA noted in the November 18 meeting this is an optimistic but possibly attainable goal.

- Use transmission financial reserves to fund a reasonable amount of transmission capital. These reserves have been accrued from those using the transmission system. It is reasonable to use a portion of these accrued revenues for transmission projects before selecting more potentially controversial tools, provided that the Agency retains sufficient liquidity and that the overall risk profile of the Agency is not negatively affected.
- As discussed above develop an option that would allow customer self funding of conservation measures rather than relying on BPA's borrowing authority. Customers have been asking for this for some time and should now be given the opportunity, provided that the Agency will continue to run viable energy efficiency programs for smaller utilities that do not elect self funding. If the region wants to pursue this, but it cannot be implemented for the FY 2012 – FY 2013 rate period because rates have already been set, then plan for this no later than FY 2014, and assume that at least 50% of energy efficiency will be financed in this manner.
- Use Anticipated Accumulation of Cash (AAC) on the Power side. These funds are generated via non-cash expenses in the rates and could be used as a source of capital financing. The use of these funds will have no upward rate pressure since they are already included in the power rates.
- Revenue financing and/or advance repayment of bonds (subject to call provisions) has been a controversial approach due to the rate pressure that results. Generally we do not believe that revenue financing of long lived assets is a sound business principle, and the NRU members would be reluctant to pursue this path unless there was a compelling reason to do so. However, the expectation here is that a small amount of rate pressure would be acceptable, particularly if it could be tied to projects that have a clearly demonstrated positive impact on future rates and have the strong support of customers. Also, as an alternative the advance repayment of outstanding debt should be examined if relatively high interest rate debt is available to be paid off. This could be used as a scalable tool as needed to help address the rolling ten year access to capital objective. Therefore, if all other options are exhausted, the revenue financing/advance repayment tool could be used, provided that there is an overall cap on its potential impact on rates. For purposes of continued discussion with the Agency, the NRU staff recommends that the cap be no more than a 5% upward pressure on transmission rates and 2% on power rates.

Based on what we have heard about the program to date, we do not believe that the concept of customer pre-pays will find sufficient general support within the public power community. On the surface it would appear as if BPA may have to offer an “incentive” for some utilities to tie up their own revenue in exchange for future credits. Such an incentive may be resisted by other customers not participating in the program, and cause concerns of further divisiveness within public power. From our perspective, an initial determination of serious interest among a sufficient number of customers should be made before much further work is put into this option. BPA has noted that this threshold of interest is \$500 million. While BPA should explore all possible tools, we suggest that the Agency not place an overreliance on this option. We are also concerned about the precedent this will set (of regional non-BPA funds being available from customers) when BPA ultimately has to go back to Congress to ask for additional

borrowing authority. It could make the task of increasing borrowing authority more difficult, particularly given current financial conditions.

Next Steps

We appreciate the Agency holding a special meeting with the Administrator on January 31st to discuss the policy issues and potential financial tools relating to BPA's access to capital. It is critically important to focus on these issues before delving into individual capital projects that will be discussed in the forthcoming Integrated Program Review process, which will be commencing shortly thereafter. While we have not made detailed comments regarding specific elements of the capital program here, we expect that will occur during the IPR process and the Agency will present capital spending levels that are in synch with the financial tools and the expectation for continued availability of borrowing authority.

Conclusion

NRU appreciates all of the work that the Agency has put into organizing materials and analyzing options the customers were interested in discussing. We believe that based on what we know today, through the use of the capital cost reductions and funding tools, a blend can be found that will extend the 5 year possible "cliff" of running out of authority, and come close to meeting the rolling ten year access to capital objective for a capital program that meets key needs. We look forward to working with you on this topic in the future.

CC: Members of NRU
Scott Corwin, Executive Director, PPC