Access to Capital Tools

September 20, 2011
9:00am – 12:00pm

Rates Hearing Room
911 N.E. 11th Ave, Portland, OR 97232

Participants may participate via phone by dialing 503-230-5566, after the double beep enter 0124#

Topics for Discussion

- Overview
- Lease Financing
- Cash Tools
  - Use of Existing Reserves
  - Cash From Rates
  - Anticipated Accumulation of Cash
- Third Party Conservation Financing
- Prepayment of Customer Revenues
- Summary

Overview

- Today's objective is discuss individual capital tools that may be available to BPA to help preserve scarce borrowing authority.
- Each tool is different and has different implications for customers.
- Some tools are already in use, some are being actively pursued, and others are still being evaluated.
- BPA must balance the competing goals of ensuring capital financing over a rolling 10-year period vs. having minimal impact to rates.

Recap - History of Funding Sources and Debt Management Actions

- 1974 – Transmission Act (initial $1.25 billion Treasury Borrowing Authority)
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- 2006 – CGS Debt Extension ($350 million for rate relief and $100 million for Debt Optimization)
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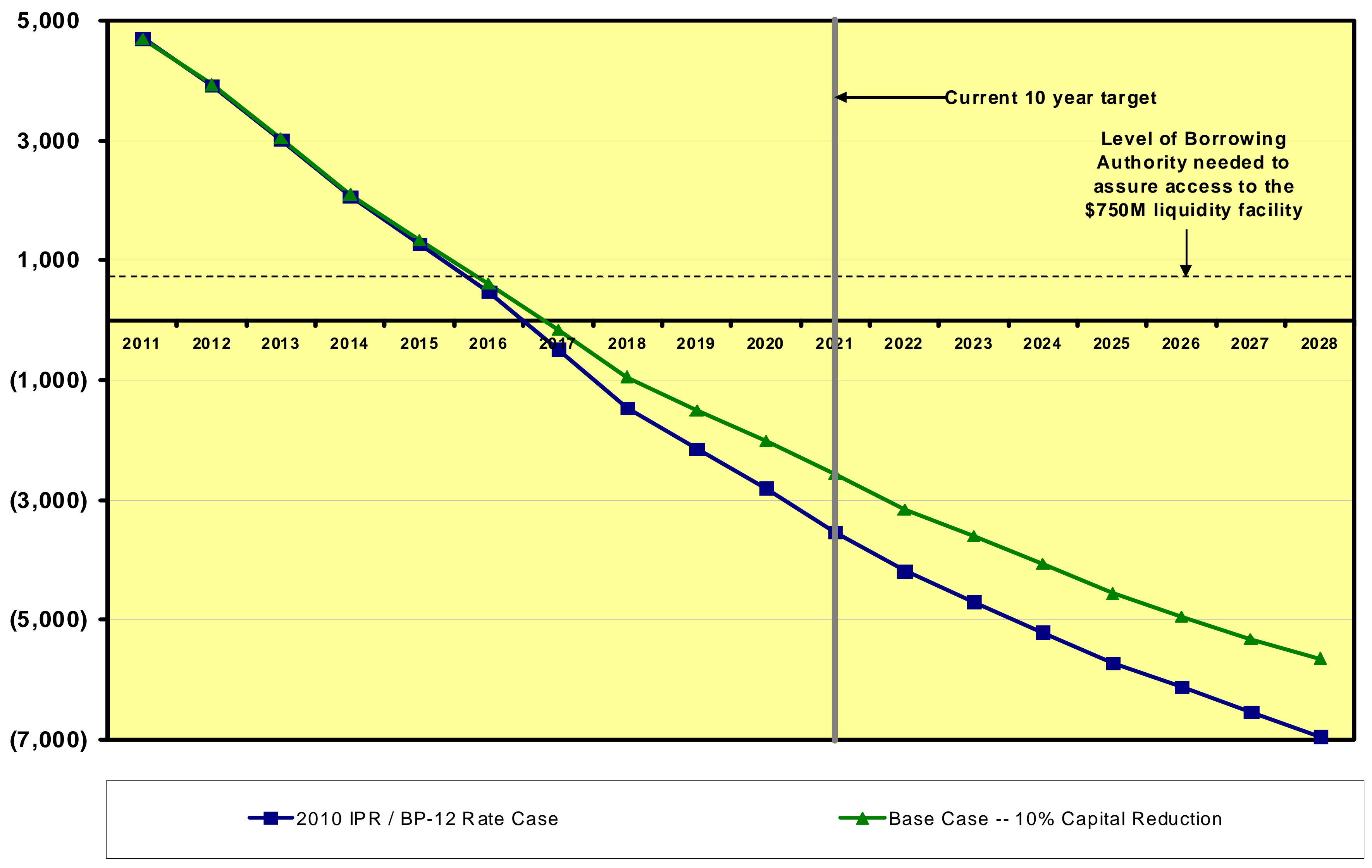
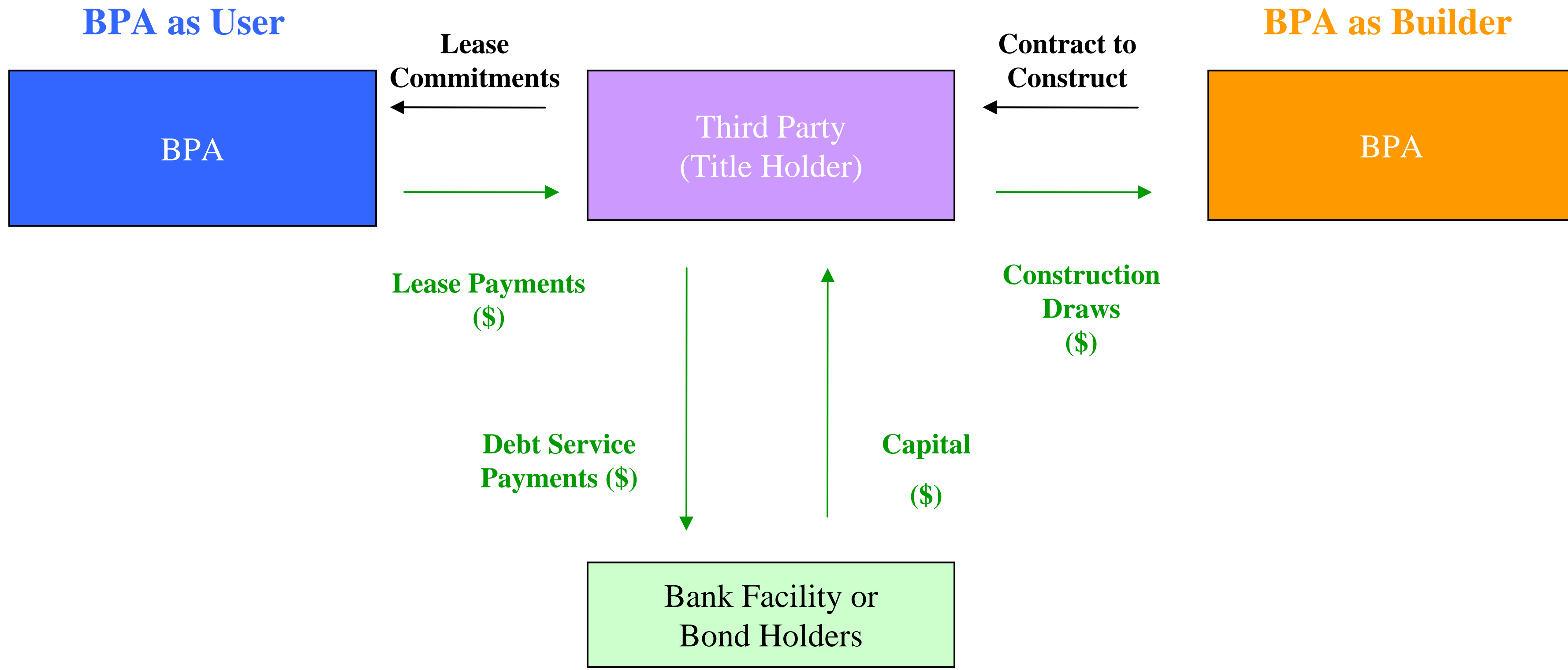
- 2008 – $300 Million Short-Term Liquidity Facility from Treasury (Increased to $750 million in 2009)
- 2009 – American Recovery and Reinvestment Act ($3.25 billion in additional Borrowing Authority)
- 2011 – EN Debt Restructuring / CGS Debt Extension ($1 billion for rate relief)

Remaining Agency Treasury Borrowing Authority



Lease Financing

Lease Financing Structure



BPA has implemented two types of lease financing:

- The third party can issue long term bonds to finance the construction of the asset. This method is used primarily to finance stand alone, large projects such as the Schultz-Wautoma line. In this situation, BPA enters into a long term lease with the third party to match the terms of the financing.
- The third party may use funds from a short term line of credit to finance the construction. This structure is also used to finance multiple smaller projects. BPA enters into a short-term lease with the third party (seven years) to match the terms of the financing. After the construction of the assets is complete, the third party issues long-term bonds and renegotiates the term of the lease.

Lease Financing Structure

- BPA enters into a series of individual lease commitments with one or more bankruptcy remote special purpose entities.
- BPA's lease payment commitments are made regardless of whether the related facility is completed, operable or operating.
- The third party irrevocably pledges BPA lease payments to the payment of bank loans or other debt.
- The related project assets are not pledged as collateral.
- The third party initially holds title to the assets, but BPA obtains full benefit and use of the assets.
- BPA pays all costs to operate and maintain the assets.
- At the end of the lease, BPA will acquire title to the assets for a nominal charge.
- BPA has only used this mechanism to finance Transmission capital projects.
  - BPA does not own the Corps of Engineers and Bureau of Reclamation assets
  - Conservation and Fish & Wildlife capital are intangible assets and BPA typically doesn't hold title.
- Lease financing cannot be used for all Transmission capital projects. Land and access roads are some examples of projects that are excluded from the program.
- Assets not leased initially become a permanent lost opportunity for preserving borrowing authority.

Lease Financing Program Status

- Since the start of the Lease Financing program in 2004, BPA has entered into roughly $556M leases for projects located in three different states with five different third parties:
- BPA has lease agreements with the Northwest Infrastructure Financing Corporation (NIFC), NIFC II, NIFC III, NIFC IV, and NIFC V. All of these third parties are bankruptcy remote, special purpose entities under Global Securitization Services.

Lease Commitment Amount by Entity	
NIFC I	$120
NIFC II	$90
NIFC III	$200
NIFC IV	$77
NIFC V	$69
	$556

Lease Commitment Amount by Fiscal Year *	
2004	$120
2007	$51
2008	$148
2009	$126
2010	$5
2011	$106
	$556

Lease Financing Rate Comparison**	Weighted Average All In Rate	Comparable Treasury Financing Rate	Delta
NIFC	5.52%	5.23%	0.29%
NIFC II	5.54%	4.63%	0.91%
NIFC III	3.97%	3.73%	0.24%
NIFC IV	4.77%	3.08%	1.69%
NIFC V	3.25%	1.88%	1.37%

Numbers in millions
*Lease commitment refers to the dollar amount of leases signed in a year, not annual spending.
**Weighted Average All in Rate does not include property taxes.

Lease Financing Program Status

Target Levels (in Millions)				
	2008	2009	2010	2011*
BPA Transmission Capital Expenditures	185	313	365	241
Lease Financed Capital	55	120	53	38
Lease Financing Level	30%	38%	15%	16%
Average	25%			

* 2011 information as of Q3

- At the peak of the program, BPA was able to lease finance over 30% of transmission capital projects.
- We expect to increase the use of the Lease Financing program, striking a balance with use of ARRA borrowing authority.

Property Taxes

- Property tax expense is a concern to the overall program costs.
- In order to mitigate the potential property tax expense, BPA is engaged in an ongoing effort to obtain property tax exemptions for the program.

Property Taxes cont.

Montana:

- Due to high property tax rates and low levels of investment, BPA has chosen not to lease finance projects in Montana at this time.

Washington:

- Lease financed assets are exempt from property taxes.
- In connection with the Schultz-Wautoma project, the Washington Department of Revenue issued a ruling granting a property tax exemption on the ground that BPA is the beneficial owner of the assets.

Idaho:

- Lease financed assets are exempt from property taxes.
- The Idaho State Tax Commission has determined that BPA is beneficial owner of the assets for property tax purposes and has granted a property tax exemption.
- Based on the Commission's determination, NIFC II has requested a refund of the $70,000 in property tax it paid to two counties. One county has made a refund and NIFC II/BPA are working to secure a refund from the other county.

Property Taxes cont.

Oregon:

- In April 2008, BPA began discussions with the Oregon Department of Revenue (DOR) regarding potential grounds for exemption.
- BPA asked the DOR for "informal advice" in order to assess the likelihood of property tax exemption. In response, the DOR indicated that the exemption would be denied (October 2008).
- From November 2008 through March 2009, legislation in Oregon granting an exemption was under consideration, but did not materialize.
- On May 15, 2009, BPA submitted a request to the DOR for a formal Declaratory Ruling On January 20, 2010, the DOR issued a Declaratory Ruling, declaring that because NIFC holds legal title, the assets are subject to property tax.
- Since an exemption was not granted through the administrative process, the United States/BPA have filed three separate complaints against the State of Oregon and Clackamas County:
  - US District Court 3-Count Complaint (filed May 6, 2010): This case was dismissed in January 2011 and the dismissal is on appeal in the Ninth Circuit. The US/BPA filed its opening brief on July 2011. The State/County answering briefs are due September 14, 2011.
  - US District Court Single-Count Complaint (filed April 13, 2011): This case was dismissed in June 2011 and the US/BPA are considering whether to appeal the dismissal.
  - Oregon Tax Court (filed April 14, 2011): The US/BPA have requested a stay pending resolution of the appeal being heard in the Ninth Circuit.
- The DOR/counties have agreed to delay assessment of tax pending the final outcome of litigation.

Lease Financing Program Costs

Estimated All-In Costs Above BPA's Treasury Borrowing Rate (in basis points)		
	30 years	**7 years**
Lease Financing (taxable)		
Non-Oregon (no property tax)	95	110-165
Oregon (property tax)	150-220	165-290
Conservation		
Taxable		
Tax-Exempt		
Prepays		
Taxable		
Tax Exempt		

Based on interest rates as of June 23, 2011
Costs will vary depending on interest rate environments
Comparison based on assumed 7 year maturity of the debt to be issued

Challenges for the Lease Financing Program

Property Taxes

- BPA's lease financing is a low-cost financing alternative to ensure adequate access to capital over the long-term. Potential property tax liability on top of the financing costs could make this alternative less attractive in some states.
- BPA is managing this challenge by actively pursuing property tax exemptions and has successfully secured exemption in Washington and Idaho.

Access to Lines of Credit – this issue only effects the lease financing program whereby the third party uses a line of credit to finance the initial investment.

- A seven year repayment term on the short term line of credit is a requirement for the lease financing program. During the financial crisis, it was difficult to obtain lines of credit sufficient to provide enough capital for the duration of the term. There continues to be a risk to the availability of credit.

- We manage this challenge by continually communicating BPA's needs to banks and determining which ones are viable business partners.

Third Party Costs

- BPA is receptive to alternative third-parties and third-party financing models but ultimately the cost effectiveness of the program is a key criterion.

Lease Financing Summary

- BPA has only used this mechanism to finance Transmission capital projects.
- Lease financing cannot be used for all Transmission capital projects.
- Assets not leased initially become a permanent lost opportunity for preserving borrowing authority.
- The availability of the ARRA funds has decreased reliance on the Lease Financing Program.
- We expect to increase the use of the Lease Financing program, striking a balance with use of ARRA borrowing authority.
- Potential property tax expenses in Oregon could increase the cost of the program but BPA is actively trying to mitigate this risk.

Cash Financing Tools

Use of Existing Reserves

- Reserves attributed to Transmission have grown over the last decade. Transmission is forecast to have $561 million of reserves available for risk at the end of FY 2011 and $465 million at the end of FY 2013.
  - Reserves available for risk is a subset of total reserves. It excludes “funds held for others” such as customer PFIA and LGIA deposits. For the purposes of this presentation, all references to reserves are to reserves available for risk.
- BPA has used reserves attributed to Transmission for three primary purposes.
  - Risk mitigation: Sufficient reserves to ensure 95% Treasury Payment Probability.
  - Source of funds for capital investment: In the last four rate case settlement agreements, BPA has committed $15 million per year of reserves attributed to Transmission to be used for financing capital investments.
  - Rate relief: In the last two rate periods, BPA has offset portions of Transmission expenses with reserves, $40 million in 2010-2011 and $67 million in 2012-2013, to support settlement agreements.
- BPA could commit additional reserves attributed to Transmission to be used to finance capital investments.
- BPA has not recently considered reserve financing for Power.

Cash Through Rates

- BPA can explicitly or implicitly generate cash for capital investments through rates.
- Revenue financing is when a specific cash requirement for funding capital investments is incorporated in a business unit's revenue requirement.
- BPA has used revenue financing in the past:
  - WP-82 included 5% of transmission and conservation annual capital expenditures as a cash requirement.
  - Transmission revenue requirements since the mid-1990's included $15 million per year to fund investments (except TR-02).
  - Power revenue requirement for 1996 included $15 million to fund conservation investments.

Cash Financing

($thousands)	1984	1985	1996	1997	1998	1999	2000	2001	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
Put In Rates																			
Conservation	9,400	10,500	15,000																34,900
Transmission	8,754	5,822	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000									134,576
	5% of capital																		169,476
From Reserves																			
Transmission											15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	120,000
																			289,476
Implemented			30,000						15,000	15,000	15,000	15,000	15,000	15,000		30,000			150,000

Cash Through Rates

- Cash can also be generated implicitly when the revenue requirement would naturally lead to the accumulation of cash. This occurs when the forecast of non-cash expenses (primarily depreciation/amortization and the capitalization adjustment) exceed scheduled Federal cash requirements (debt repayment and/or irrigation assistance).
- The repayment study schedules Federal amortization payments around non-Federal debt service to achieve the lowest levelized debt service possible.
- Previously, the shaping of Energy Northwest debt service created circumstances between FYs 1992 and 2004 in which Power's revenue requirements provided $554 million of cash. However, in each of the rate periods during that time this cash was used to supplement risk mitigation measures.
- Because of the new Treasury agreement and the ability to borrow for expenses, the last two rate cases have not required cash for risk mitigation to be included in revenue requirements. In addition, the Slice true-up provides cost-recovery risk mitigation.

AFES Period

($thousands)

	WP-91		WP-93		WP-95	WP-96					WP-02			
	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**Total**
Cash Flow	28,091	21,579	1,218	25,078	2,548 *	1,420	31,984	108,125	114,519	106,135	21,578	57,689	33,624	553,588

revenue financing	15,000
total cash flow	17,548

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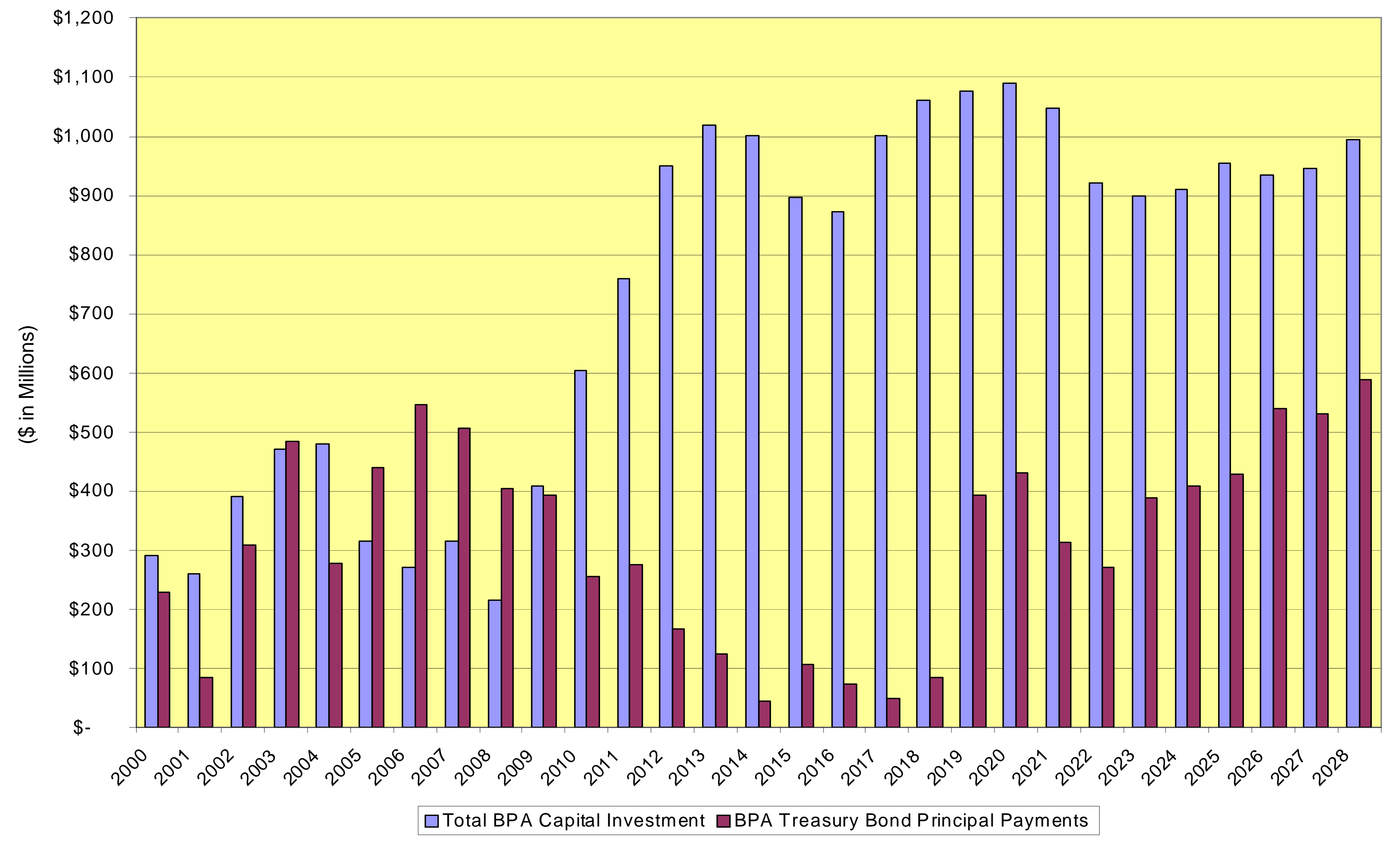
Repayment Studies

- Repayment studies establish a schedule of planned amortization payments and resulting interest expense by determining the lowest levelized debt service stream necessary to repay all Power obligations within the required repayment period.
- Included in the studies as fixed inputs are the annual debt service payments associated with BPA's non-Federal debt service obligations.
- Irrigation assistance is also generally regarded as fixed payments according to when they become due because of their lack of associated interest expense (no financial incentive to pay them early).
- To achieve the levelization of the total debt service, Federal principal is scheduled by the repayment study in opposition to non-Federal debt service – when non-Federal debt service is high, Federal principal repayment is low and vice versa.

Capital Spending and Treasury Bond Principal Payments



Power's Anticipated Accumulation of Cash

- Since the 1987 general rate case, BPA policy has been to determine revenue requirements based on total accrued expenses (income statement). When this is inadequate to cover cash requirements, Minimum Required Net Revenues are added to the expenses to provide sufficient cash flows.
- Current forecasts show Power Services revenue requirements could accumulate significant cash in the 2014-2024 period.
- This period is when most Energy Northwest debt is repaid, which means that the Federal amortization payments scheduled for Power will be relatively small.
- The potential difference between non-cash elements and cash requirements could be over $1 billion.

($000s)	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	
Non-Cash Elements	178,674	183,385	184,133	201,104	218,921	236,912	260,908	279,609	297,816	309,871	319,703	
Cash Requirements	100,470	124,487	74,815	51,277	52,276	228,836	214,058	198,398	189,278	178,085	148,324	
Cash Flow	78,204	58,898	109,318	149,827	166,645	8,076	46,850	81,211	108,538	131,786	171,379	1,110,731

Uses for the Anticipated Accumulation of Cash

- The use of cash generated by the revenue requirement to augment risk mitigation, as had been done in the 1990s, might be viewed as inequitable to Slice customers.

- What options are available?

1. Rate relief: If realized, the funds could be returned to customers by reducing revenue requirements, as in the last two transmission rate cases. Without additional modifications, however, this could present GAAP problems by planning for negative net revenues (asset impairment).
2. Reinvest in the system: BPA would be able to preserve borrowing authority by using cash the to fund capital investments. This would also immediately reduce financing costs as well as future repayment requirements.
3. Repay debt: These funds could also be used to repay additional Treasury bonds, thereby restoring borrowing authority.

Cash Tools Summary

- As shown in the charts, the attempts to revenue finance by including cash requirements in revenue requirements have been far less successful than using existing reserves to finance capital investments.
- This may be significant in regards to any planned actions toward the AAC in Power revenue requirements.
- Any strategy may best be served from after-the-fact actions rather than to depend on cash flows materializing during a given rate period.

Third-Party Conservation Financing

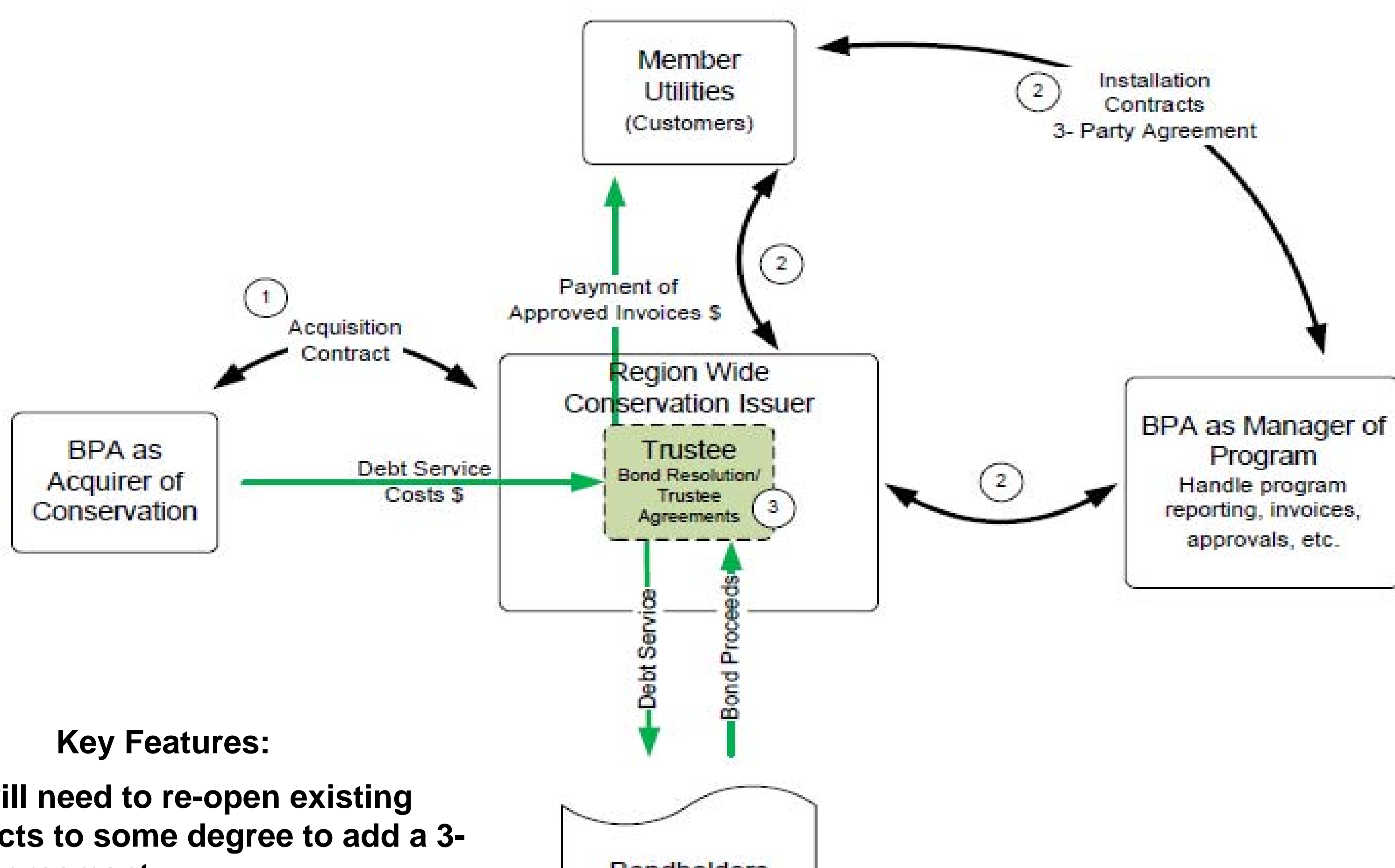
Introduction to Third-Party Conservation Financing

- Third-Party conservation non-federal financing can be a significant funding tool to help with BPA's access to capital situation (estimate about $50 -75M/year).
- Conservation 3rd-party financing is a viable, effective funding source either through taxable or ideally, tax-exempt bond issuance.
- Changing the conservation amortization period policy from 5 to 12 years makes bond financing efficient and cost-effective.
- The size of the multi-year conservation program for BPA is substantial enough to warrant a permanent, long-term funding tool.
- BPA is familiar with non-federal financing and its requirements and previously completed several 3rd party financings in the mid-90's.
- The NW Power Act gives BPA clear authority to secure bonds issued by others for conservation projects (third-party financing).
- BPA is actively pursuing implementation of this funding tool.

How Third-Party Conservation Financing Works

- To use a third party as a source of financing, BPA would need to contract with the third party to acquire conservation.
- The third party would then issue debt secured by BPA's acquisition payments.
- The third party would also contract with BPA and BPA's customers to implement conservation in the customer's utility service area.
- The new agreement will be to assure the third party that the proceeds from the issuance of its debt are being used for implementation of the program.
- BPA would continue to be responsible for management of the conservation program.

Financing Construct Envisioned: Taxable/Tax-Exempt Financing



Key Features:

- **BPA will need to re-open existing contracts to some degree to add a 3-party agreement.**
- **BPA maintains customer relationship.**

Supporting Contracts

1. **Resource Acquisition Contract (2-Party Agreement):**
   - Between BPA and Issuer
   - BPA, as obligor, makes hell-or-high water payment commitments
   - Program specifics regarding installation of conservation measures

2. **3-Party Conservation Contracts:**
   - Between Issuer, BPA customers, and BPA
   - Customers install conservation measures
   - Customers report through BPA and BPA approves – payments are paid through Trustee
   - BPA serves as Program Manager
     - Designs program specifics (Implementation Manual)
     - Reporting (EE Central)
     - Invoice Approval
   - Understanding and knowledge of the conservation measures we are purchasing will be key to obtaining 9(f) tax-exemption *(further explained on next page)*

3. **Bond Resolution/Trustee Agreement:**
   - Between Issuer and Trustee
   - Outlines flow of funds/pledge of revenue
   - Trustee duties assigned
   - Debt service commitment of Issuer
   - Miscellaneous rights and obligations of parties

Section 9(f) of Northwest Power Act

(Tax-Exempt Bonds)

- Section 9(f) of the Northwest Power Act allows BPA to “acquire” conservation resources financed by a third party with tax-exempt bonds where otherwise applicable tax law would cause the bonds to be taxable.
- Complex conditions and limitations apply and the 9(f) exemption involves an IRS approval process that was last used in the mid-1990’s.
- The maximum potential portion of the conservation program that could be financed tax-exempt would be tied to measures installed by or for municipalities and PUDs. Co-op/federal agency conservation may not be financed tax-exempt.

Conservation Contract Overview - Current

- BPA has provided bilateral, capital funding for energy efficiency since 1999.
- BPA's capital budget is set during the IPR process at a level sufficient to achieve the Northwest Power and Conservation Council's programmatic energy efficiency targets.
- The Energy Conservation Agreement (ECA) is the current contract providing bilateral funding to BPA’s utility customers.
- ECAs currently have a BPA fiscal year term of 2010-2014.
- BPA’s customer utilities operate conservation programs in their service areas and report accomplishments to BPA via a centralized reporting system.
- BPA reviews reports/invoices submitted and makes determinations of acceptability for payment.
- BPA conducts oversight reviews to verify claims made to BPA.

FY 2012 Changes to Conservation

- BPA issued the final Energy Efficiency Post-implementation Proposal (Proposal) in January 2011.
- The Proposal changes the capital allocation method to an equity-based model which takes effect on October 1, 2011.
- The Energy Efficiency Incentive (EEI), or budget amount added to each BPA's Customer's ECA, is determined based upon their Tier One Cost Allocation.
- At the beginning of the rate period BPA will update each customer's ECA budget, with the EEI amount calculated from the Tier One Cost Allocation percentage.

Contract Changes to Include Third-Party Financing

- BPA, the issuer and BPA utility customers will need to replace the existing ECA with a new 3-party agreement.
- The new three party agreement will be developed with a goal of minimizing the revisions to the existing contract and existing implementation and reporting procedures.
- Discussions on the new 3-party agreement are anticipated for next spring 2012; with a goal to have all customer contracts signed by June 30, 2012.
- Contracts signed by June 30 enable implementation of the bond financed acquisition beginning Oct. 1, 2012.

Expected Operational Changes to Current Conservation Contracts

- Operations between utilities and BPA will remain largely unchanged
  - Utilities will continue to:
    - Report savings into EE Central (replacing the PTR reporting system in October 2011).
    - Follow the requirements of the EE Implementation Manual.
  - Changes include:
    - Conservation payments to utilities changed from BPA to 3rd-party issuer.
    - BPA will provide invoice information to the 3rd-party, yet still approve invoices in its role as program manager.
    - Real time data about payments will be synched with BPA, the Trustee, and 3rd-party in a structure that supports ongoing reporting systems.
    - New 3-Party agreements will be signed between utilities, BPA and the issuer (3rd-party.)

Differences from Past Third-Party Financing Models

- The amount of financing will tie to BPA's annual capital budget and not an individual customer's specific project/program.
- Program management will reside at BPA and not be assigned to the issuer/3rd-party.
- The role of the 3rd-party/issuer will be limited – hybrid between the NIFC transmission model and the previous CARES model.
- This tool is envisioned as a long-term/multi-year funding program and not a one-time EE project financing.
- Tighter controls and processes for Finance and Energy Efficiency (EE) for financing arrangements are now in place to govern 3rd-party financings.
  - Finance and EE have greatly increased communication and have quarterly meetings.
  - Finance and EE are implementing changes:
    - Third party issuers must have a long-term relationship with BPA.
    - BPA will use its own outside tax counsel for bond financings.
    - Finance and Energy Efficiency have forged a stronger internal partnership for ongoing management of the overall conservation program.

Cost

Estimated All-In Costs Above BPA's Treasury Borrowing Rate (in basis points)		
	30 years	7 years
Lease Financing (taxable)		
Non-Oregon (no property tax)	95	110-165
Oregon (property tax)	150-220	165-290
Conservation		
Taxable		100-125
Tax-Exempt		10-35
Prepays		
Taxable		
Tax Exempt		

Based on interest rates as of June 23, 2011
Costs will vary depending on interest rate environments
Comparison based on assumed 7 year maturity of the debt to be issued

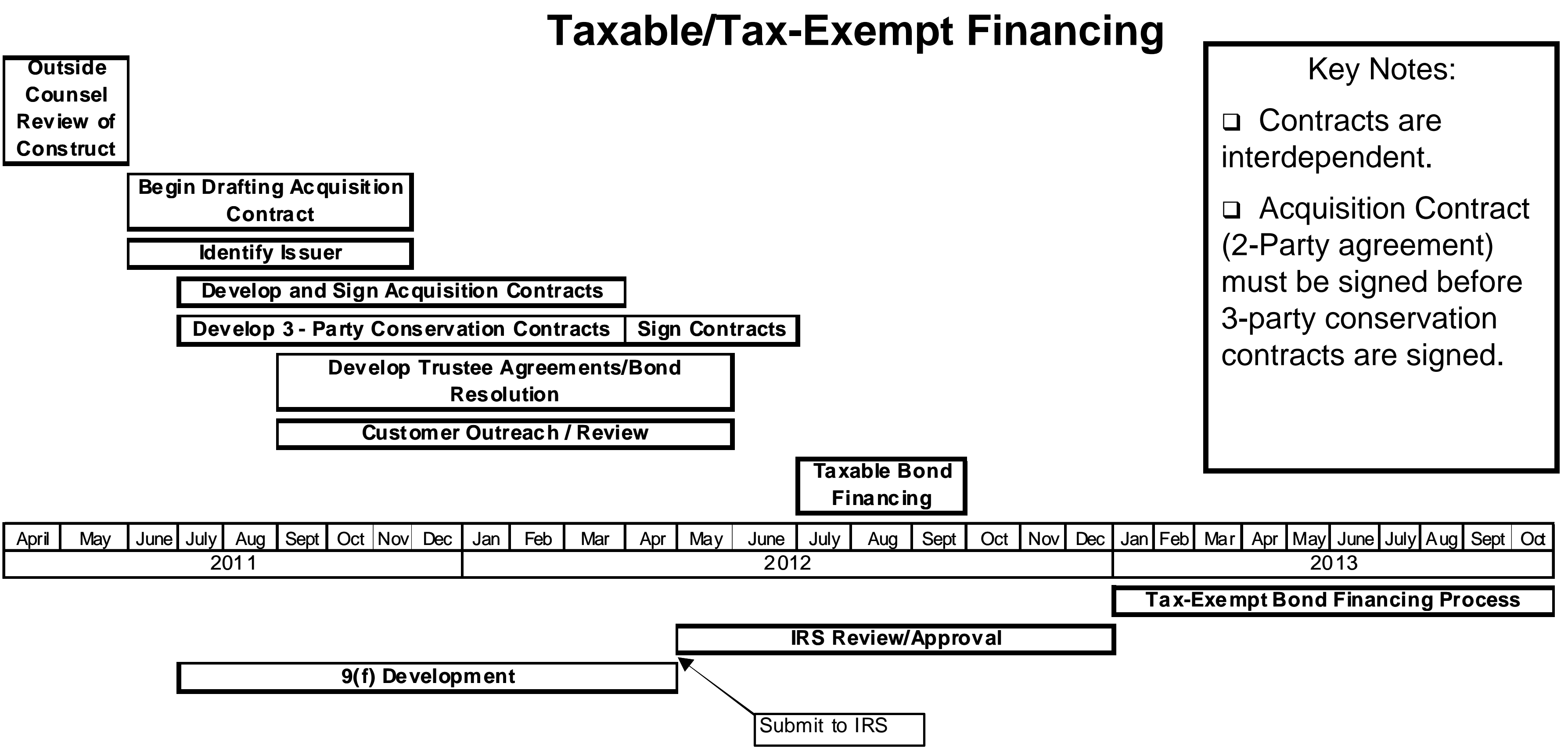
Third-Party Entity Issuer Requirements

- Legal
- The third-party entity should be authorized to:
  - Issue debt, including tax-exempt debt
  - Provide installation agreements outside its service territory/geographic boundary
  - Provide agreements to co-ops, federal agencies
  - Assign program management to BPA

- Business
  - Be a going concern
  - Possess the staff resources/staff skill-set to ensure efficient and effective administrative processing as well as internal control for disbursements
  - Strong governance structure (perhaps independent Board)
  - Robust Treasury function/management
  - Have a working relationship with BPA
  - Be willing to perform for a limited incentive or none at all

- Currently BPA is evaluating potential issuers and would like to have an issuer selected by calendar year end 2011.

Third-Party Conservation Estimated Timeline



Key Notes:

- Contracts are interdependent.
- Acquisition Contract (2-Party agreement) must be signed before 3-party conservation contracts are signed.

Third Party Conservation Summary

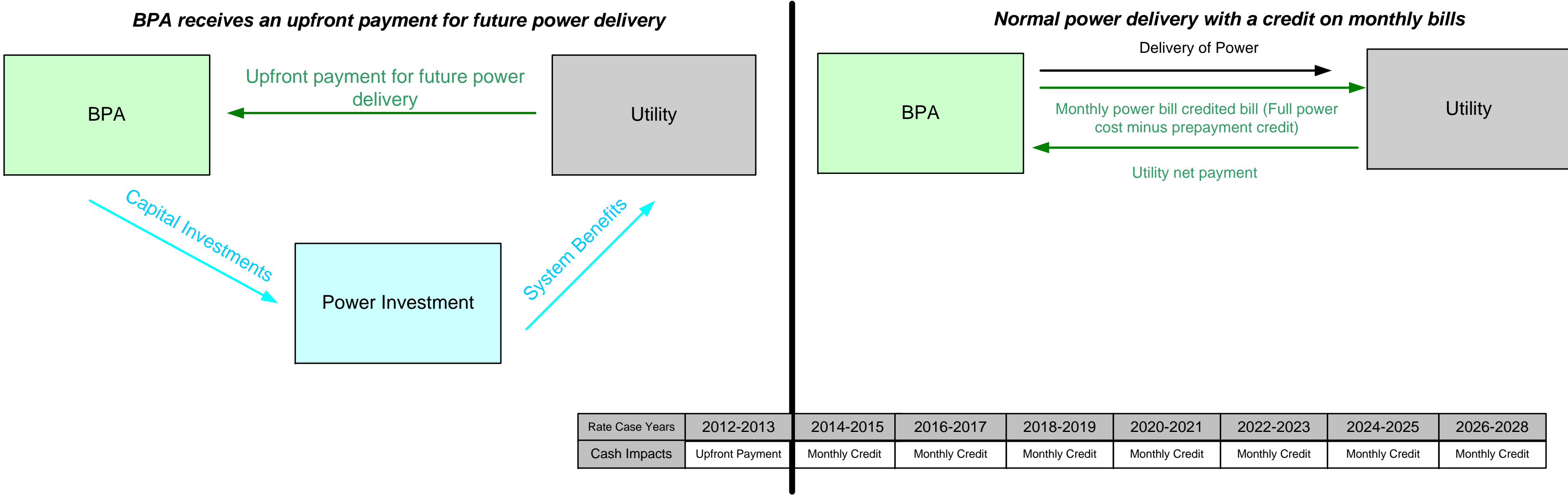
- BPA anticipates implementation of this funding tool by start of fiscal year 2013.
- Prior to that date, in the spring of 2012, customers will be asked to review and subsequently sign new 3-party agreements which will replace existing conservation contracts. We are planning for completion and signing of new contracts by end of June 2012.
- Changes to existing practices on invoicing and payment procedures are expected to be minimal.
- We will keep customers informed on progress and current timing for implementation.
- The financing process will begin as soon as contracts are signed; anticipated for late summer or early fall of 2012.

Prepayment of Customer Revenues for Power Services

General Description of a Prepayment Program

- BPA is internally exploring the feasibility of a revenue prepayment program for Power customers, but no decision has been made to proceed with offers.
- We are gauging the level of interest for participation as well as seeking input from customers on whether we should develop this program.
- BPA is interested in hearing from customers who would consider participation if such a program was offered.
- A utility would pre-purchase power through 2028 and in return receive corresponding reductions in its future bills through 2028. The utility may fund the upfront prepayment from its financial reserves and/or from the proceeds of bonds it issues for the pre-purchase.
- After the prepayment is made to BPA, subsequent power bills would show reductions (under a fixed, agreed-to schedule) that in aggregate equal the amount of the prepayment plus an imputed interest component. The shape over time of the offsetting power bill reductions may not reflect a level debt service schedule.
- The amount of power that a customer may pre-purchase would be limited to a portion (under 50%) of its total purchase obligation from BPA. The prepayment envisioned would not involve a prepayment for a fixed block of power at a fixed rate/price. Rather, the scheduled reductions in future power bills would be calculated based on the amounts that would otherwise be due to BPA at then-current power rates. This would assure that BPA’s ability to change power rates, including the power rates applicable to pre-paying customers, would not be affected.
- Prepay financing could be a cost-effective means of financing needed power related investments.

Diagram of a Prepay



Rate Case Years	2012-2013	2014-2015	2016-2017	2018-2019	2020-2021	2022-2023	2024-2025	2026-2028
Cash Impacts	Upfront Payment	Monthly Credit	Monthly Credit	Monthly Credit	Monthly Credit	Monthly Credit	Monthly Credit	Monthly Credit

- A utility uses cash or issues bonds and uses the proceeds to pre-purchase energy through 2028 and in return receives a credit on future bills that reflects the prepayment.
- BPA uses the prepayment for capital investments which would otherwise be funded with Treasury borrowing authority.
- Customers would prepay BPA for future delivery of power consistent with existing regional dialogue contracts.
- BPA would bill monthly for the power delivery with a credit on the portion of power that is prepaid.

Use of Proceeds

- BPA would use the prepayment proceeds to fund Power capital investments, although a portion of proceeds could be used for Power-related bond repayment.

- BPA is not considering a prepay program for the Transmission Services:
  - Transmission Services does not have sufficiently long contracts.
  - Transmission prepays are not eligible for tax-exempt financing.
  - Transmission Services is already incurring customer prepay credits for LGIA and COI.

- In order to maximize the potential of the program, BPA sized the program so there would be no adverse impact to the total revenue requirement. To a great extent, this was done by taking into account the AAC.

- Through an iterative process, the desired credit stream over the period was tested in the revenue requirement against reductions in interest and repayment requirements from removing annual increments of borrowing.

- The prepayment funds were then used to offset capital spending funded by Treasury borrowing authority for each respective year.

Certainty of Future Customer Bills

- BPA has put in place a Tiered Rate Methodology which goes into effect in FY 2012 that establishes the rate structure BPA intends to follow through FY 2028 to ensure the costs of BPA's current power system (Tier 1 System) are recovered through the public utility customers eligible to purchase the power.

- Most of BPA's Tier 1 costs will be common to all customers and will be allocated to each customer based on its rights to access Tier 1 energy and will be recovered through a rate called the Composite Customer Charge. Load Following and Block customers also have monthly adjustment to their bill based on their proportion of a Non-Slice Composite pool which accounts for risks not included in Slice and provides a credit for expected secondary revenues from the FBS. The annual amount of dollars associated with these customer charges are divided by 12 and assessed on a monthly basis with no connection to how much power the customer actually purchases from BPA during that month. Once rates are set and the record of decision issued, customers will know what their Customer Charge bill will be for each month of the 2-year rate period.

- This approach is much like the approach BPA used for the Slice product from FY 2002-11 but now applies to both Slice and Load Following. In addition both Load Following and Block customers receive monthly credits and charges to account for power amounts that are higher or lower than what the power system was forecast to produce that month.

- All BPA customers are required to purchase the full amount of Tier 1 power available to them to meet their loads.

- ***This means that unless they have a catastrophic load loss it is almost certain they will receive a bill from BPA for power.***

Rates/Equity Between Slice and Non-Slice Customers

- As earlier stated, the way that prepayment revenue credits would affect rates through the revenue requirement is in the MRNR calculation. Non-cash revenues are an offset to non-cash expenses in the calculation.
- This new element in the revenue requirement would be introduced in the composite cost pool table.
- Both Slice and non-Slice customers, then, would bear the “cost” of the credits in the MRNR calculation.
- Since the AAC would be eliminated by the size of the program suggested on the previous slide, neither Slice nor non-Slice customers would be contributing to reserves through this mechanism, but would be providing funds for capital programs or for additional debt repayment.
- Both Slice and non-Slice customers would see immediate reductions in interest expense and in future repayment requirements over the contract period and in subsequent years.

Customer Credit For Future Bills

- BPA is indifferent as to whether the prepayment from customers is funded by bond issuance or cash: BPA is primarily concerned with the amount of the discount for prepayment.

- The customer’s power bill “credits” for the prepayment will be established upfront and will be fixed upon the deposit of the prepayment into the BPA Fund.

- Credits will not be able to be accelerated for non-performance by Bonneville in delivering the prepaid power. In other words if BPA fails to meet a prepaid power sales obligation, the full amount of the remaining prepayment will not become immediately due and payable by BPA. If BPA does not meet a monthly prepaid power delivery, the credits will roll forward and BPA will periodically become obligated to pay in cash to the customer any accumulated-but-unapplied “credits.”

  - BPA’s future cash requirement: Any acceleration of credits would negatively affect BPA’s cash flows.

  - Legal: BPA may accept prepayments from customers for future power purchases that are to be made under the existing power sales contracts. Non-acceleration of credits is a key provision to assure that the transaction is a power prepayment .

  - Accounting: Initial review of the prepayment concept led BPA to conclude that the accounting treatment would be a discount sale approach (i.e., initially recorded as deferred revenue with an offset to revenue for the discount when revenue is recognized). Any acceleration of credits may result in a different accounting treatment.

- If a customer decides to fund the prepayment from cash-on-hand and not with the proceeds of bonds, the customer will receive above market rates for such “investment” but the investment will be illiquid (not readily reducible to cash).

Program Cost Considerations

- The all-in-cost of the program will be dependent on two main factors:
  1. Taxable versus tax-exempt bond rates
  2. Customer participation

- Taxable versus tax-exempt rates:
  1. The IRS prepay regulations do not explicitly require a fixed price schedule for the amount prepaid. However, former IRS and Treasury employees have suggested that a fixed price schedule may be required for bonds to qualify for tax-exempt status.
  2. BPA believes that there is a decent chance that a utility may be able to issue tax-exempt bonds for a power prepay to BPA, but that an IRS ruling will be required. BPA believes that seeking such a ruling would be in the best interests of the region by lowering the cost of this possible program. BPA also believes that such a ruling request should be prepared so that a favorable ruling can be relied on for future prepayment bonds issued by other customers as part of the program.
  3. Currently with the low interest rate environment, the benefit between taxable and tax-exempt rates is compressed but BPA expects that over time, tax-exempt financing would be a benefit.

- Customer participation:
  - A prepay program centers around customer participation and therefore customers may require some sort of financial incentive.
  - Customers will have to evaluate applicable state law, municipal ordinances, master bond resolutions and other materials to determine their authority to proceed and to determine any required contract terms. They should also be prepared to provide timelines and important steps to complete the prepayment, including validation proceedings, board actions and other procedures.

Cost Analysis of Customer Incentive

- There is a high certainty that BPA will fulfill its power obligation to deliver power to customers, thereby creating a long term expense for the utility.
- This long term expense could be considered similar to long-term debt service.
- One method to determine the appropriate ‘incentive rate” to offer customers would be to look at traditional “refinancing for savings” thresholds for utilities contemplating refinancing transactions.
- BPA uses a 5% threshold, meaning that the refinancing for savings is undertaken if the net present value of the savings is at least 5% of the bonds refunded. This threshold is consistent with most municipalities who use a 3-5% threshold.
- If a utility assumes its long-term power costs are similar to debt service (a long-term obligation), then it may consider prepaying a portion of the cost if it can receive a 3-5% NPV savings. This would be similar to BPA giving participating utilities 45-85 bps over their cost of financing.*
- BPA’s cost of capital is shared among its customers and recovered through rates, regardless of the source of capital (bondholders, investment banks or customers).
- Therefore, from an economic perspective, BPA’s non-participating customers should be indifferent to the incentive paid to participating customers as long as the all-in-rate to BPA is competitive with other sources of capital.

Impacts to BPA's All-in Cost

	Prepay vs. Treasury
Customer Incentive	↑
Tax Exempt	
Amortization Period (Yield Curve)	

*RATES AS OF 6.23.11

Cost Analysis of Yield Curves

Taxable versus Tax-Exempt

- Currently there is an approximate110 bps spread between taxable and tax-exempt interest rates, for a AA- credit rating .*

Amortization Periods

- When using Treasury borrowing authority or entering into long-term lease purchase contracts under its Lease Financing program, BPA would typically finance those capital investments for 30 years or more.
- BPA's prepay program would be tied to the Regional Dialogue contracts that end in 2028, therefore, BPA's financing period would be 15 years or less.
- Therefore since the average life of the bonds are 7 years or less, the interest rate compared to a Treasury rate is less due to the shorter maturity period.

Impacts to BPA's All-in Cost

	Prepay vs. Treasury
Customer Incentive	↑
Tax Exempt	↓
Amortization Period (Yield Curve)	↓

*RATES AS OF 6.23.11

Key Features of BPA's Potential Prepay Program

1. **Fixed Price Schedule:** To ensure future equity between customers, BPA is not offering a long-term fixed rate for the portion of the customer power bill that is prepaid. A fixed power rate would not allow BPA to increase rates on the portion of purchased power identified in the contract for the term of the contract.

2. **Customer Participation**: Any prepayment model depends on customer participation.
   - Any direct bond issuance by customers may be reflected on their balance sheet and could have an adverse impact on their financial metrics (debt service coverage ratios, additional bonds tests, other debt ratios), and hence their credit rating.
   - BPA does not currently think its is feasible for customers to set up a Joint Operating Agency (JOA) for a prepay program in order to have the transaction not included on the customers balance sheet because this would require opening up the Regional Dialogue contracts so participating customers could assign their high water marks to the JOA.
   - The benefits of using a JOA in order to get a bond transaction off the balance sheet of a participating utility may be minimal if Moody's Rating Investor Service implements their "Adjusted Debt Service Coverage Ratio" proposed on July 17, 2011. It is unclear where Fitch Ratings and Standard and Poor's stands on this issue.

3. **Credit Shape:** In order to have no adverse impacts to revenue requirements, BPA will determine the shape of the credits the customers will receive (credits may not be level from year to year).

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	Total
Yearly Credits	116,585	105,916	173,438	226,264	243,349	80,677	114,606	146,094	169,147	186,966	219,745	65,966	60,366	54,666	51,487	**2,015,272**

$000's

Draft Prepayment Policies

- BPA will only consider a power prepay program if it has customer interest in excess of and aggregate $500 million during 2013-2018.
- The prepayment program will focus on funding Federal System power investments, although a portion of proceeds may be used for power related debt reduction.
- The prepayment program will not be used as a means to condition Bonneville’s decision on power capital investments.
- The need for capital will drive when BPA offers a power prepayment program.
- BPA will seek participation in the prepayment program widely; however, participation by any or all interested customers is not assured and selection will be in accordance with the selection criteria.
- Each customer’s request for a prepayment will be evaluated based on direct negotiations with BPA.
- The maximum monthly customer credits will be no greater than 50**%** of their historical monthly bill.
- Risks associated with credits given to customers will be appropriately managed.
- BPA will value the program based on marginal costs of capital.
- BPA’s prepay amortization period will be factored into the existing repayment methodology.

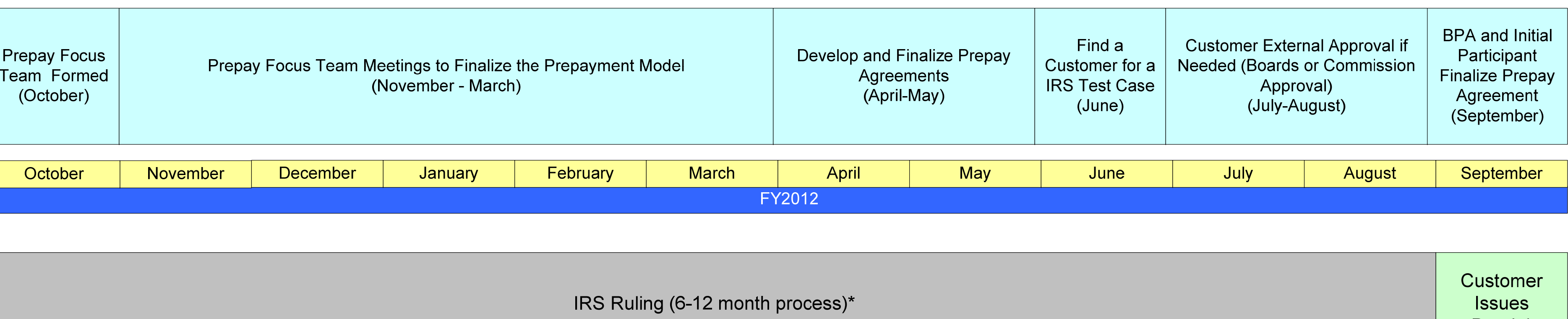
Draft Prepay Participant Selection Criteria

BPA will select participants based on:

- Past business experience with BPA
- Transaction cost (all in rate) to BPA
- The amount of prepayment they can offer BPA
- The timing of a prepayment to BPA
- Administrative ease for BPA
- Customer's requested terms
- Customers must be willing to have BPA involved in the debt transaction including selecting underwriters, tax counsel and preparing information to obtain any necessary IRS rulings.

Prepay Timeline

- BPA recommends that we form a “Regional Focus Team” to evaluate if a prepay program is right for the region.
- The objective of this team would be to provide transparency as we evaluate the merits of a prepay program and give BPA feedback on the region’s level of interest.
- This team would consist of BPA finance staff and a sub-set of interested customers and other stakeholders to ensure that regional equity is maintained.
- If BPA offers a prepay program, we believe that we should have the offer starting in 2013 because the regional dialogue contracts necessitate a short amortization period.
- In order to meet that timeline, BPA would need to move forward with the evaluation and implementation planning in FY2012 and start the IRS process to get tax-exempt financing.



* Assumes that a customer issues bonds to fund the power prepayment

Costs

Estimated All-In Costs Above BPA's Treasury Borrowing Rate (in basis points)		
	30 years	**7 years**
Lease Financing (taxable)		
Non-Oregon (no property tax)	95	110-165
Oregon (property tax)	150-220	165-290
Conservation		
Taxable		100-125
Tax-Exempt		10-35
Prepays		
Taxable		195-230
Tax Exempt		85-120

Based on interest rates as of June 23, 2011
Costs will vary depending on interest rate environments
Comparison based on assumed 7 year maturity of the debt to be issued

Prepay Summary

- BPA is exploring offering a prepay program to customers but has not made a decision.
- A prepay program centers around customer participation.
- BPA can offer a $1.7 billion prepay program with no adverse revenue requirement impacts.
- Assuming we have adequate interest from customers after the public meetings, BPA recommends that we form a “regional prepay team” made up of BPA staff and customers to finalize and implement the prepay model.
- This team would consist of BPA finance staff, a handful of interested customers and potential participants, as well as one or two customer representatives who are not interested in participating in the program but can represent the viewpoints of that customer subset.
- The objective of the team would to get regional buy-in on the prepay program by educating potential participants and explaining the benefits of the program.
- BPA is seeking volunteers for this regional prepay team by November 1st.
- Please submit volunteer contact information to:

  Name: Don Carbonari, Debt and Investment Manager

  Email: dwcarbonari@bpa.gov

  Phone: 503-230-3798

Prepay Appendix- Power Prepay Versus the Flexible PF Rate

- BPA's potential Power Prepay program would be different than the Flexible PF Rate offered in the 2007 - 2009 rate case.
- The Flexible PF rate's objective was to lower rates and was used as a liquidity tool. It enabled BPA to adjust BPA's power rate upward for the 33 utilities participating in the program if BPA's cash requirement increased.
- The utilities would prepay their power bills and BPA would hold the prepayment for 120 days and then start paying it back with credits on their power bills that would zero out the eligible charges until repayment was achieved.
- The participants' annualized interest rate would not exceed the LOC of the utilities annualized interest rate, plus 50 basis points.

Power Prepay Versus the Flexible PF Rate

Power Prepay	Flexible PF Rate
▪ Designed to fund Power related capital investments ▪ Multiple year program ▪ Certainty of use if customers are willing to participate	▪ Designed to lower base rates by approximately $.30/MWhr. ▪ 120 day liquidity tool ▪ The probability of triggering depended on the reserves balance at SOY and how the agency cash flow played out over the year. The probability was very low on a par with the 2.5% Treasury Payment Probability (TPP) standard requirement.

Prepay Appendix- Credit Example

$100 Million Example Assuming a 5% Savings

DS Rate	**2.65%**
Issuance Costs at 1%	0.21%
Pre-incentive Cost	**2.86%**
Incentive Cost	0.78%
BPA Cost	**3.64%**

	Principal	Interest	Debt Service	Incentive	Total Credits	PV
1/1/2012						
1/1/2013	7,185,000	2,650,000	9,835,000	491,750	10,326,750	9,964,084
1/1/2014	7,380,000	2,459,598	9,839,598	491,980	10,331,577	9,618,649
1/1/2015	7,575,000	2,264,028	9,839,028	491,951	10,330,979	9,280,313
1/1/2016	7,775,000	2,063,290	9,838,290	491,915	10,330,205	8,953,725
1/1/2017	7,980,000	1,857,253	9,837,253	491,863	10,329,115	8,638,368
1/1/2018	8,190,000	1,645,783	9,835,783	491,789	10,327,572	8,333,750
1/1/2019	8,410,000	1,428,748	9,838,748	491,937	10,330,685	8,043,501
1/1/2020	8,630,000	1,205,883	9,835,883	491,794	10,327,677	7,758,760
1/1/2021	8,860,000	977,188	9,837,188	491,859	10,329,047	7,487,273
1/1/2022	9,095,000	742,398	9,837,398	491,870	10,329,267	7,224,481
1/1/2023	9,335,000	501,380	9,836,380	491,819	10,328,199	6,970,043
1/1/2024	9,585,000	254002.5	9,839,003	491,950	10,330,953	6,727,054
Total	100,000,000	18,049,548	118,049,548	5,902,477	123,952,025	99,000,000

Assumed tax-exempt financing
Rates as of 6.23.11

Summary

- Utility issues tax-exempt bonds at 2.65%
- The all-in-rate to the utility is 2.86% after cost of issuance
- Assuming a 5% incentive, BPA incentive is $5.9 million and the all-in-rate to BPA is 3.64%
- BPA pays the utility 78 bps above their cost of borrow

Overall Summary

- There is no perfect funding tool to solve the Treasury borrowing authority/access to capital problem; a diversified portfolio of capital sources is necessary and prudent.
- Some of the financing tools can only be used specifically for Power or for Transmission.
- Achieving the rolling 10 year objective will be compromised the longer it takes to implement the tools.
- It is in BPA’s and customers’ best interest to develop permanent long term funding tools for capital investments, rather than relying solely on debt management actions.
- Access to capital is a multi-year problem that will not go away soon.
- The next topic area will address the interplay between the tools and the potential impact on rates and borrowing authority as well as present results of some combination scenarios.

Financial Disclosure

This information has been made publicly available by BPA on September 13, 2011 and contains information not reported in agency financial statements.