Fact Sheet

September 2011

Strategic Capital Discussion

BPA has long relied on the agency's authority to borrow from the U.S. Treasury, which is limited by statute, and on third-party financing to address capital funding requirements.

However, an increasing demand for capital investments may exceed what is available through those means. BPA, with the help of all interested regional parties, is now seeking to develop new approaches to accessing capital. The Strategic Capital Discussion slated for Sept. 19 and 20, 2011 is intended to expand our collective thinking on those issues.

Access to capital objectives

When BPA updated its 10-year financial plan in 2008, it emphasized the importance of access to capital. The plan established three objectives relevant to this process:

- Ensure that capital financing needs are covered over a rolling 10-year period.
- Develop strategies and tools that will extend BPA's Treasury borrowing authority availability over a rolling 20-year period.
- Ensure BPA is able to meet its capital requirements at least cost.

Those strategic objectives provide the backdrop for the upcoming strategic discussions.

Evolving capital requirements

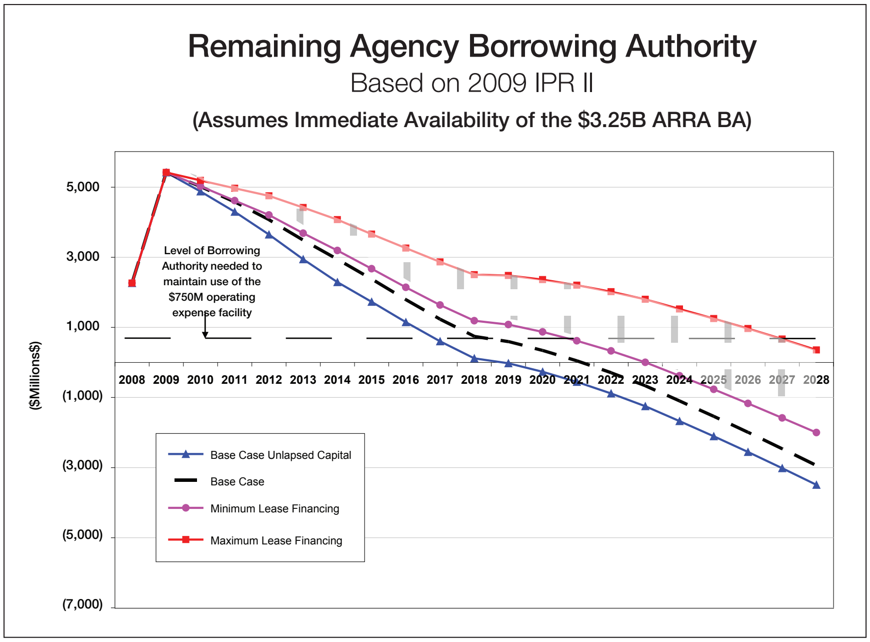
When BPA conducted its 2008 Integrated Program Review, we forecast that we would run out of borrowing authority in about 2014 if we relied solely on borrowing authority for capital investments and in about 2016 if we used extensive lease financing.

At the same time, we were also addressing liquidity issues. In 2008 we formalized an agreement with the U.S. Treasury that provides BPA with a more flexible banking relationship that allows BPA to borrow up to $750 million from the Treasury in the short term to cover operating expenses. This liquidity source is currently being assumed in rate setting, complementing reserves for risk. The $750 million liquidity option counts against the borrowing authority limit.

We appeared to meet our financial plan objectives in 2009 when, as part of the American Reinvestment and Recovery Act, we received a $3.25 billion addition to the available borrowing authority limit, bringing the total from $4.45 billion to $7.7 billion.

With the additional borrowing authority, analysis from the February 2009 IPR2 update showed BPA potentially running out of borrowing authority in 2018 if relying on Treasury borrowing for capital investments while retaining the $750 million of borrowing authority for short-term liquidity needs. The same analysis indicated we could run out of borrowing authority in 2021 with minimum reliance on lease financing and in 2027 with maximum reliance on lease financing. (SEE GRAPHS ON PAGE 2.)

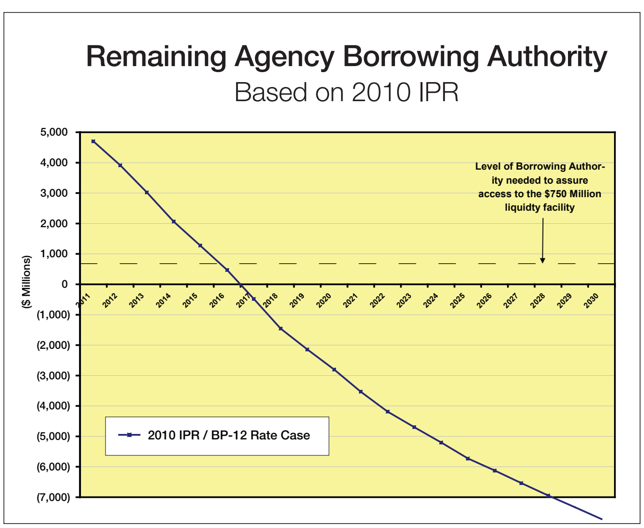
By the September 2010 final IPR report, the forecast of remaining borrowing authority had changed for the worse. We then anticipated running out of borrowing authority as early as



2016 if we relied solely on Treasury borrowing for capital investment. We forecast running out of borrowing authority by 2017 if we obtained 10 percent of our capital investment through lease financing and by 2018 with 40 percent funded through lease financing.

Magnitude of the problem

It may seem surprising that we now expect to run out of borrowing authority in 2016, two years sooner than we did before receiving the increase. That's because our expected capital spending has



increased as we have evaluated long-term capital needs in the asset plans and made other changes in the IPR that increased capital spending projections.

The increases in the capital forecast come primarily from major transmission network reinforcement projects; major rehabilitation of the Grand Coulee Third Powerhouse; investment in three major hatchery projects and in other Environment, Fish and Wildlife programs; and the effort to meet aggressive energy efficiency targets set by the Northwest Power and Conservation Council.

The situation is clear — we have roughly $6.4 billion in forecast capital needs from fiscal years 2011 through 2017 based on the 2010 IPR but only $5.2 billion in remaining borrowing authority as of the 2010 fiscal year.

Tools

We have identified tools to help us reduce the gap between the borrowing authority cap and the capital requirements. Some are familiar; some are not.

Spending reductions

The bluntest tool for reducing the gap between the borrowing authority limit and the capital requirement is simply to reduce capital spending. At the September meetings, we will present a scenario in which the agency assumes a 10 percent reduction to capital spending over the next 10 years. This is a yearly reduction, not an across the board reduction, so we retain some flexibility. Program managers believe this reduction produces a manageable level of risk without jeopardizing their ability to accomplish their mission.

Reductions beyond 10 percent would require very difficult decisions to identify which programs would be reduced with the least harm to the agency mission.

Lease financing

Lease financing is BPA's ongoing alternative to Treasury borrowing. While lease financing preserves borrowing authority, it has limits. Lease financing can be used to fund only the Transmission capital program, and not all Transmission capital projects qualify.

Lease financing is more expensive than Treasury borrowing. Not only is the financing interest rate higher for lease financed projects, but other costs also apply.

Third-party Energy Efficiency financing

BPA used third-party financing in the mid-1990s to fund conservation projects for individual utilities and is, therefore, familiar with the concept. It is a viable, efficient and cost-effective source of capital for qualifying conservation investments.

Third-party financing could begin as early as fiscal year 2013. It would be nonfederal financing employing BPA-backed bonds similar to the way BPA backs Energy Northwest bonds. The third-party would issue municipal bonds (tax exempt to the extent possible) and proceeds would be used for BPA's annual conservation investments. This funding tool may be used to finance 50 percent or more of BPA's conservation per year.

Customer prepayment

We are exploring a potential customer power prepayment program that could begin as early as the 2012 fiscal year and run through the 2028 fiscal year consistent with Regional Dialogue contract terms. A utility may prepurchase power, funding the upfront prepayment from its financial reserves and/or from the proceeds of bonds it issues for the 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 amount of power that a customer may prepurchase would be limited to a portion (probably under 50 percent) 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 taken off 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 prepaying customers, would not be affected.

Use of available cash

BPA can use cash reserves that have accumulated over time as a source of funds for capital investments. Transmission Services, for example, has used reserves to fund capital investments since the TR-06 rate case. The BP-12 rate case contained $30 million in reserve funding of capital for the 2012–2013 fiscal years.

Given that Transmission Services has reserves available for risk as of the end of fiscal year 2011, BPA could increase the amount of reserves used to fund capital projects, although the amount of cash available would be limited by the business unit's risk requirements.

Revenue financing

BPA can also fund capital investments through cash generated through rates. This is known as revenue financing and can be done explicitly by adding a specific cash requirement to the business unit's revenue requirement. Revenue financing has been included on occasion in Transmission rates. BPA can also generate cash implicitly when the revenue requirement would naturally lead to the accumulation of cash. This condition will very likely occur for Power Services in the 2014–2024 fiscal year period as the bulk of Energy Northwest debt is repaid and federal debt payments are low.

The strategic discussion

At the meetings, we will seek stakeholder views on the relative merits of the competing demands for capital and the proper sequencing of capital projects. We also invite vigorous discussion over the desirability and effectiveness of the tools we have identified and on their impact on rates. We welcome the discussion and hope that you have additional suggestions for financing tools.

Additional information for the meeting will be made available at *www.bpa.gov/corporate/Finance/FinancePublicProcesses/2011CapitalStratDisc.cfm*.