

Financial Plan Refresh: Debt & Borrowing Authority Grounding Workshop

October 19, 2021

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FINANCIAL HEALTH

Agenda

- Review and respond to comments received for the Sept. 15 kick-off workshop.
- Grounding session for debt and borrowing authority.
- Next Steps

Comments: Kick-off Workshop

- We have posted all of the comments and BPA's responses at a high level to bpa.gov.
- High-level discussion of comments and BPA's responses.

Debt and Borrowing Authority

Grounding Workshop

Background

- Revenue financing, whether to do it and the amount, was the single most controversial issue in BP-22.
- BPA committed to a review of long-term capital financing as part of a refresh of the 2018 Financial Plan.
- This process focuses on two different but related issues:
 - How BPA finances its capital program
 - How BPA addresses borrowing authority constraints when they exist
- Capital prioritization is related but will be addressed in a different series of workshops.

Objectives for Today

- Review BPA's current status
- Rating agency perspective
- Industry practice for financing capital investments
- BPA practice for financing capital investments

BPA's 2018 Financial Plan

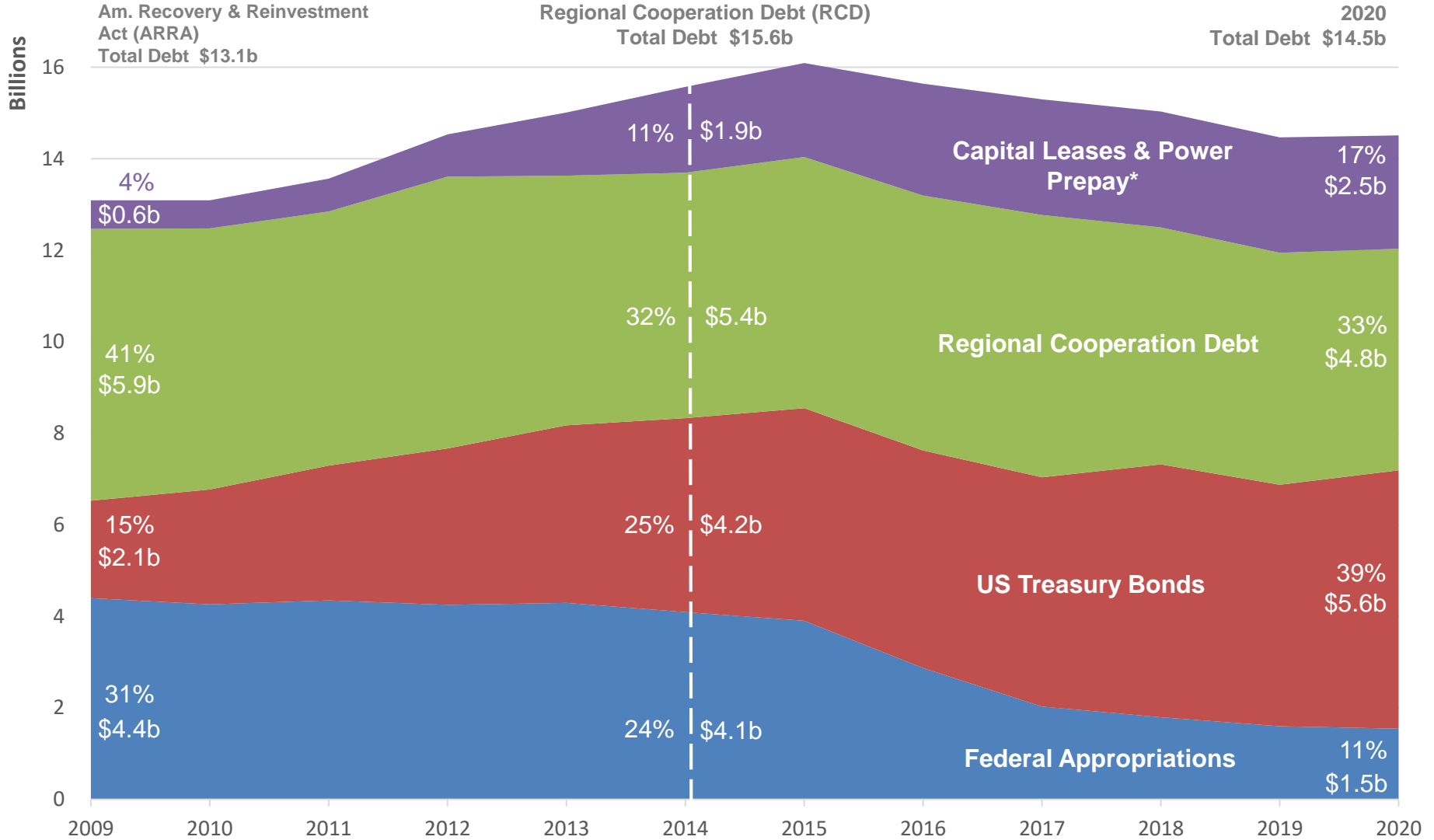


- The Financial Plan is organized in order of flexibility, beginning with the foundational and least flexible elements, followed by financial polices and practices, and ending with financial health objectives.
- The financial health objectives of debt utilization, debt capacity and liquidity relate to financial resiliency.
- Debt utilization and debt capacity are the prime focus of the “why” today.

2018 Financial Plan Details

Area	Financial Health Objective & Purpose	Metric	Target
Cost Management	Program Costs: Lowest possible rates	Rate-period change in program costs	Hold the sum of program costs, by business line, at or below the rate of inflation through 2028
	Capital Investments: Maintain value and reliability of assets	Leading industry-standard asset management	Manage the lifecycle cost and value of assets based on industry-leading standards
Financial Resiliency	Liquidity: Maintain financial reserves for solvency and stability	Days cash on hand and TPP	Maintain a minimum of 60 days cash on hand for each business line and a 97.5% annual TPP
	Debt Utilization: Reduce interest expense; maintain financial flexibility	Debt to asset ratio	Achieve a debt to asset ratio of 75% -85% within 10 years and 60% - 70% in the long term
	Debt Capacity: Maintain access to secure and low-cost debt financing	Remaining borrowing authority	Maintain ability to fund capital program on a rolling 10-year basis; preserve \$1.5B of available borrowing authority
Over-arching	Ind. Health Assessment: Maintain high investment-grade credit ratings	Credit rating	Maintain high investment-grade credit ratings from all three rating agencies

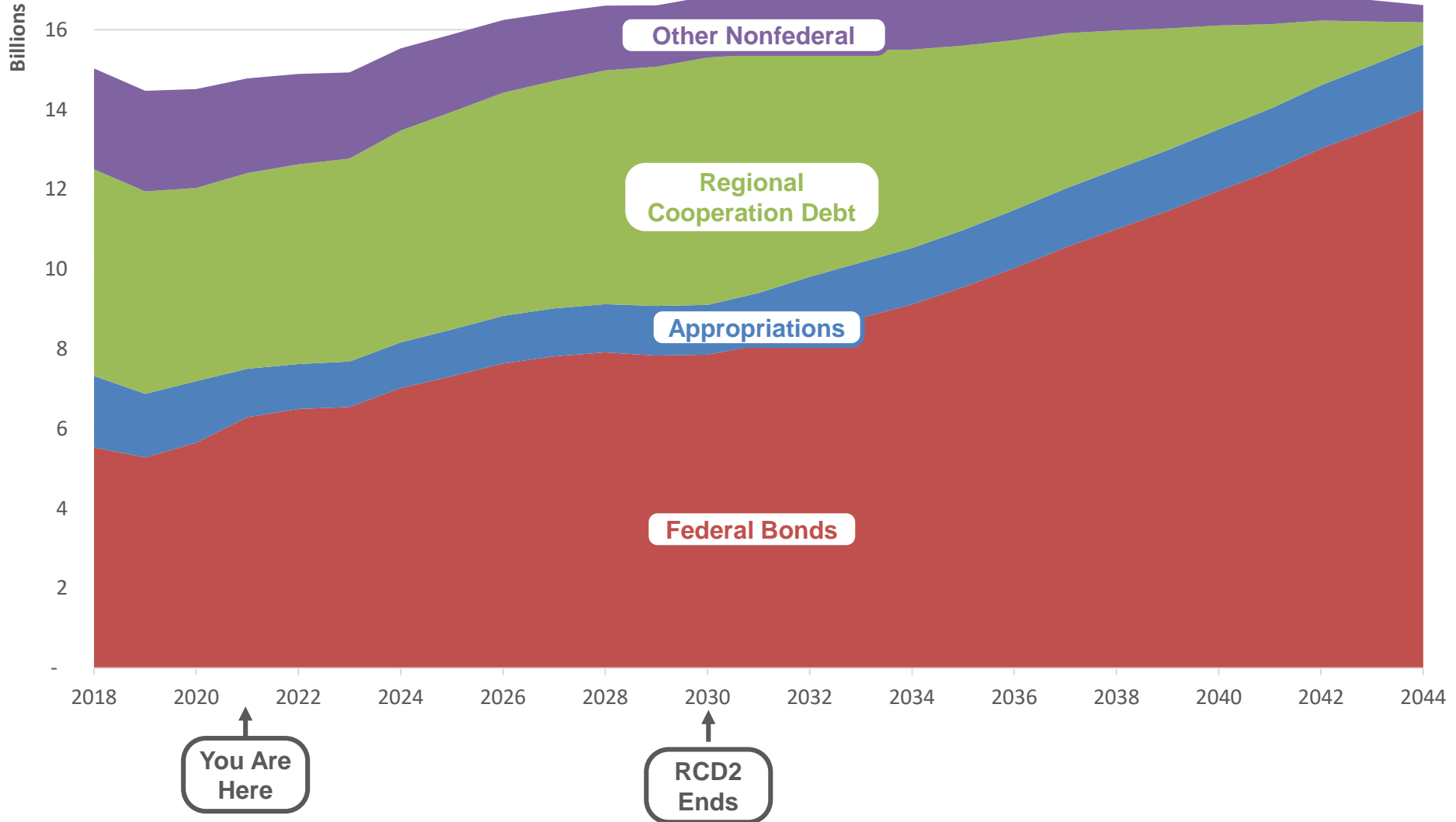
Outstanding Agency Debt at 9/30/20



Source: BPA Audited Financial Statements FY 2009-FY2020

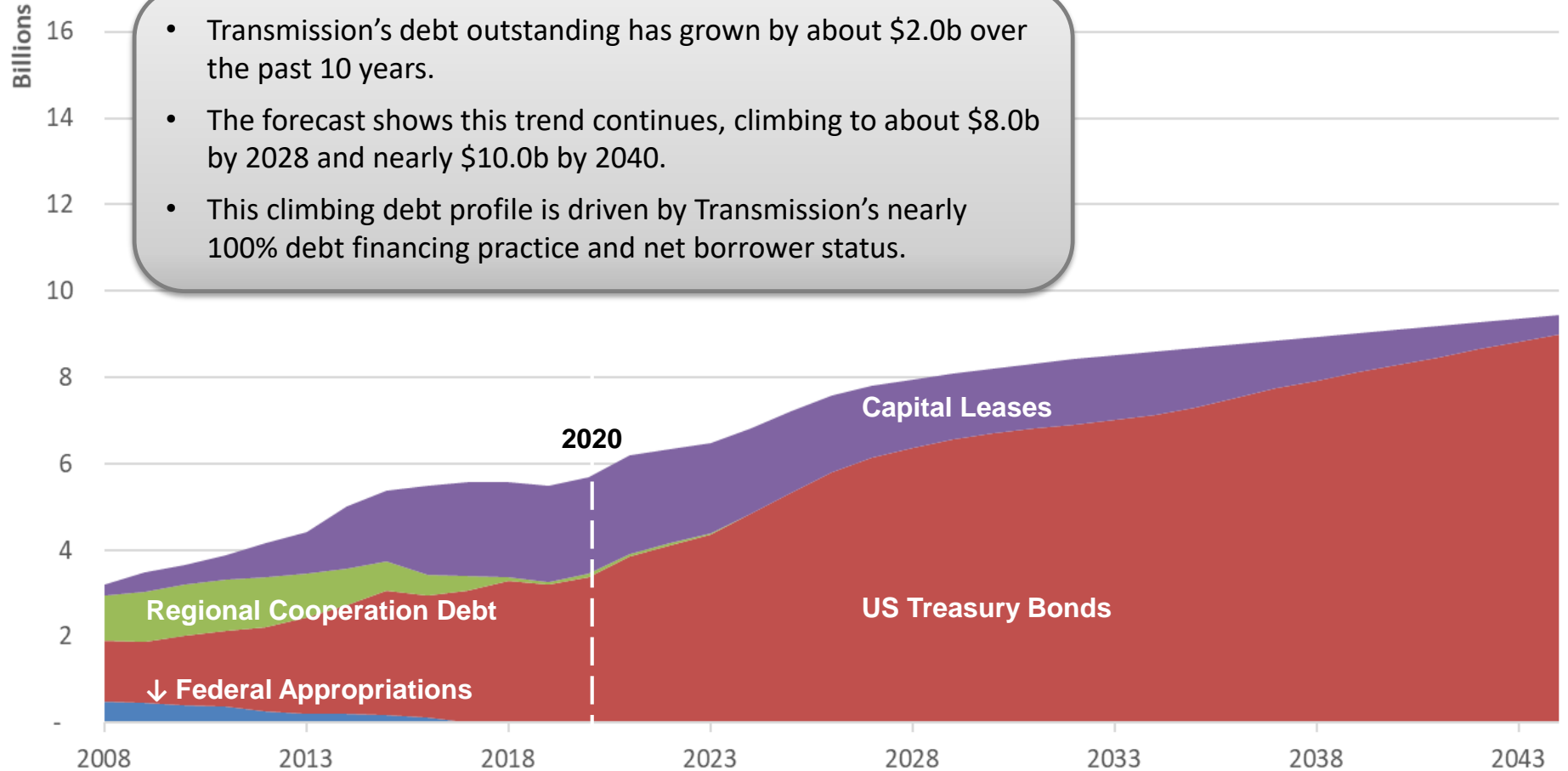
* FY14 and prior includes conservation bonds (Tacoma, CARES, and Emerald)

Debt Outstanding - Agency



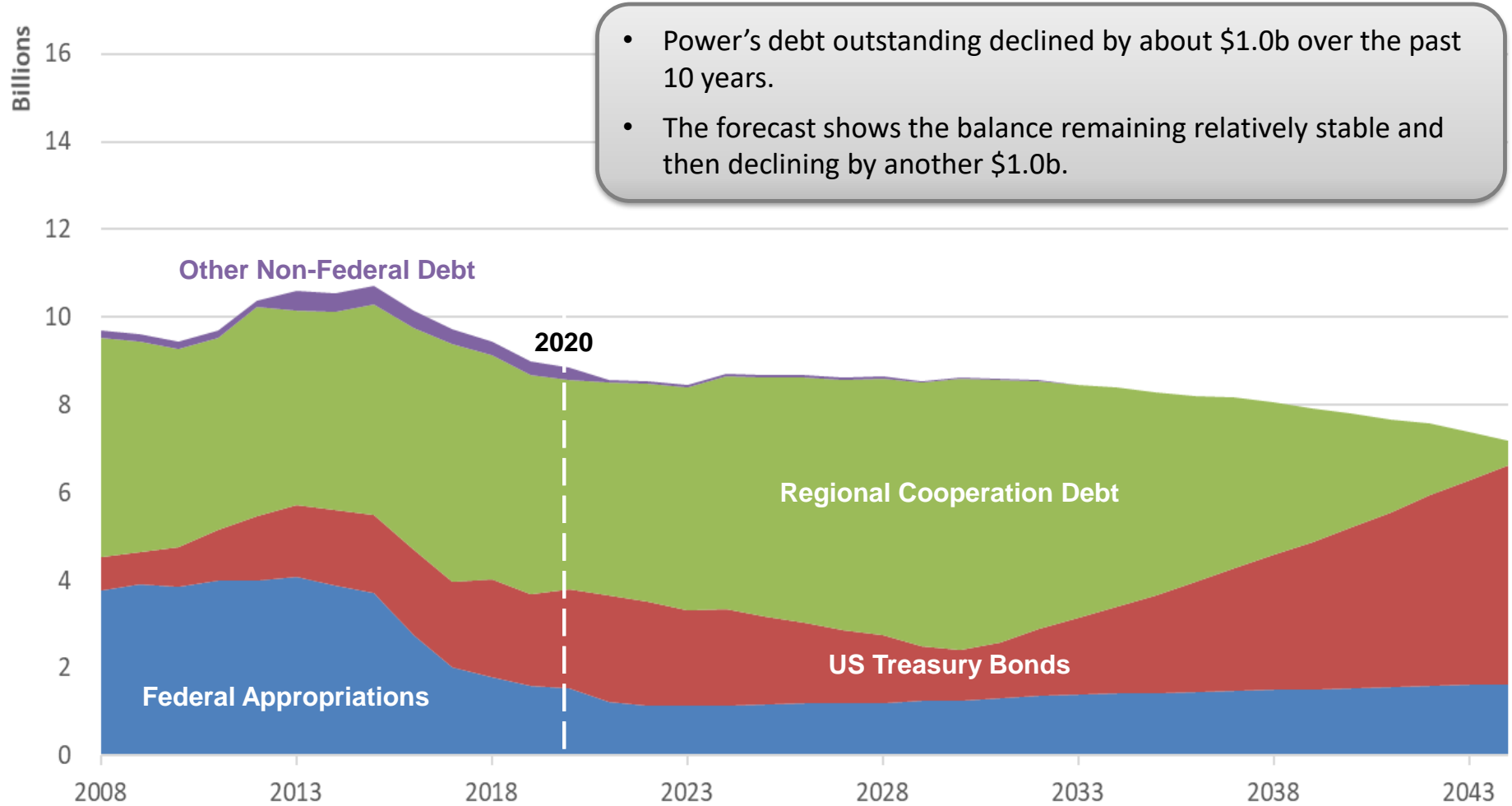
- Assumes unlimited Federal financing

Transmission's Increasing in Debt Profile



Source: BPA Audited Financial Statements FY 2008-FY2019

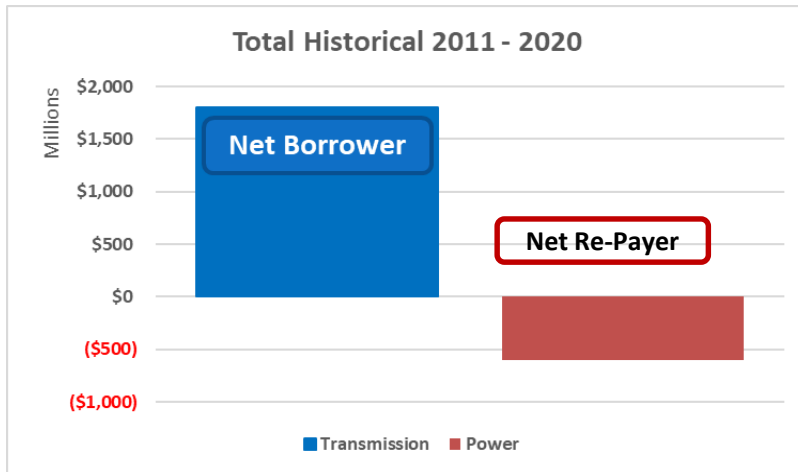
Power's Flat Debt Profile



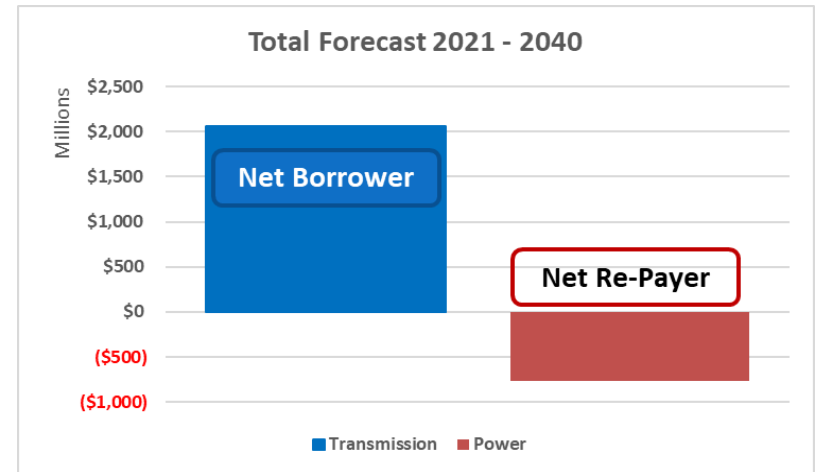
- Power's debt outstanding declined by about \$1.0b over the past 10 years.
- The forecast shows the balance remaining relatively stable and then declining by another \$1.0b.

Key Issue: Net Borrowing Position

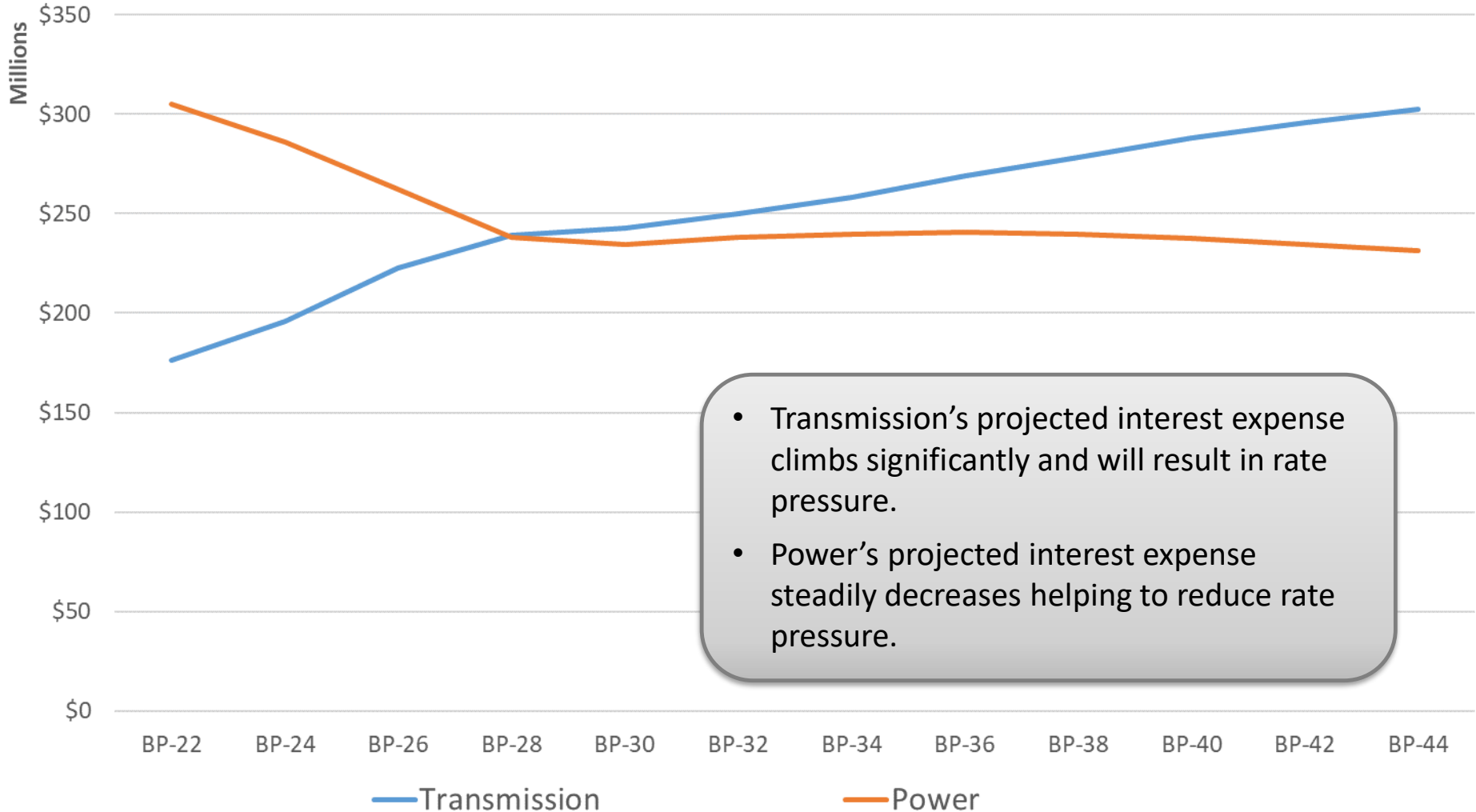
- Transmission is and has been a net debt borrower.
 - Net borrowed approximately \$1.8 billion since 2010.
 - Forecast to net borrow approximately \$2.97 billion in the next twenty years.
- Why is this important?
 - Net borrowing takes from BPA's limited borrowing authority that is jointly used by Power and Transmission Services.
 - Net borrowing adds significant future fixed costs (interest expense) that will be recovered through transmission rates.



Source: Based on BP-22 FP

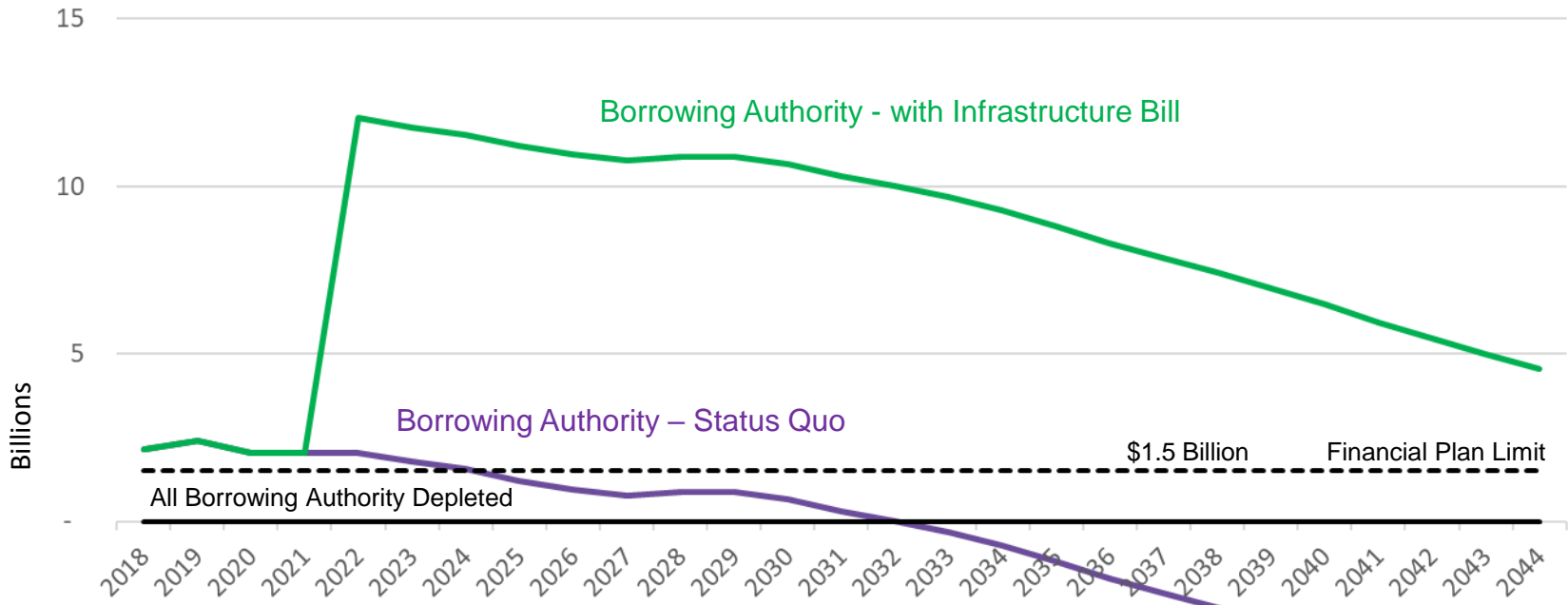


Total Projected Interest Expense



- Transmission’s projected interest expense climbs significantly and will result in rate pressure.
- Power’s projected interest expense steadily decreases helping to reduce rate pressure.

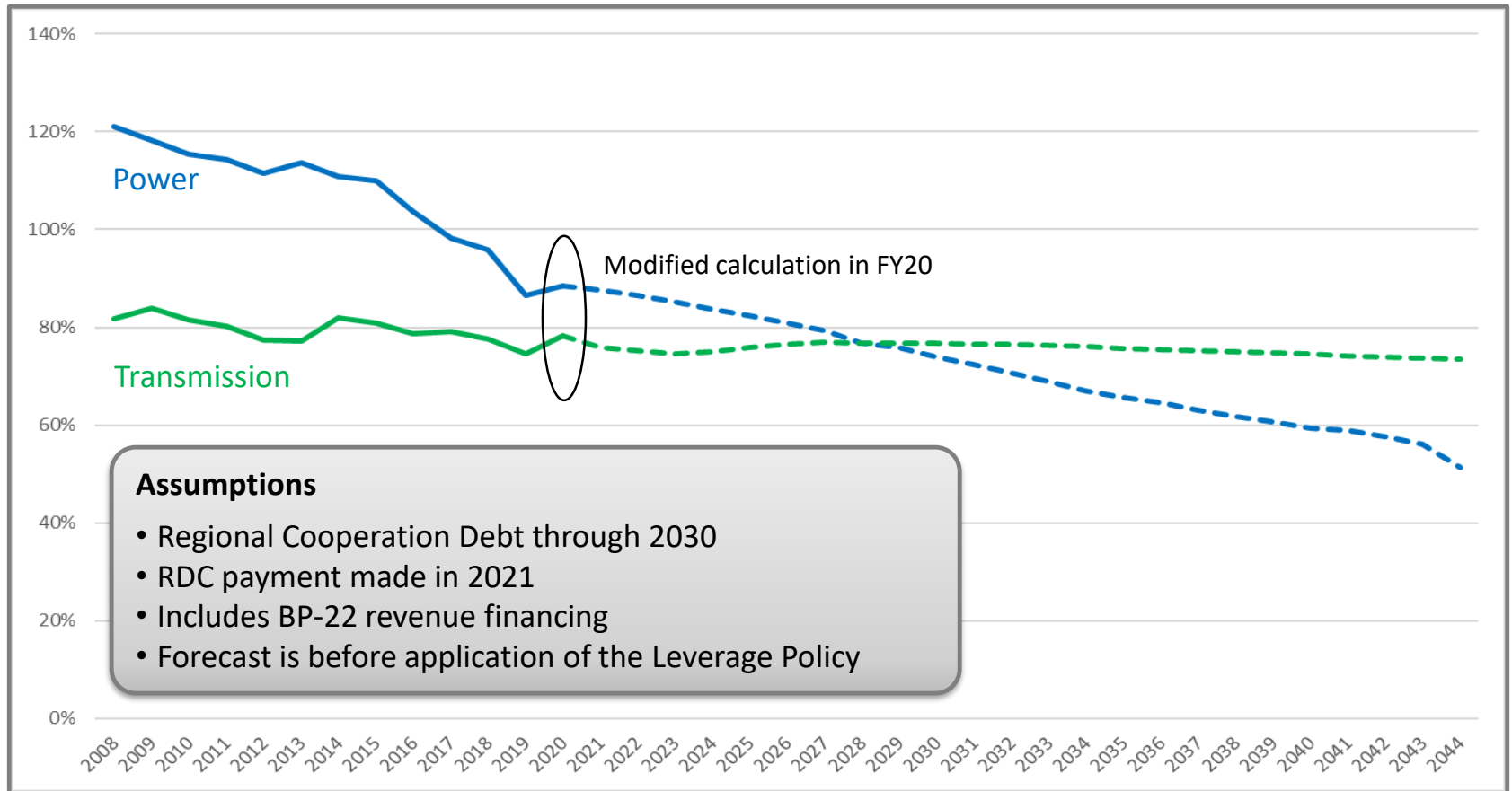
Forecasted Remaining Borrowing Authority



Assumptions

- Regional Cooperation Debt through 2030
- No additional Lease Purchase
- RDC payment made in 2021
- Includes BP-22 revenue financing
- No limit placed on Federal bond financing

Debt to Asset Ratio Historical & Projected



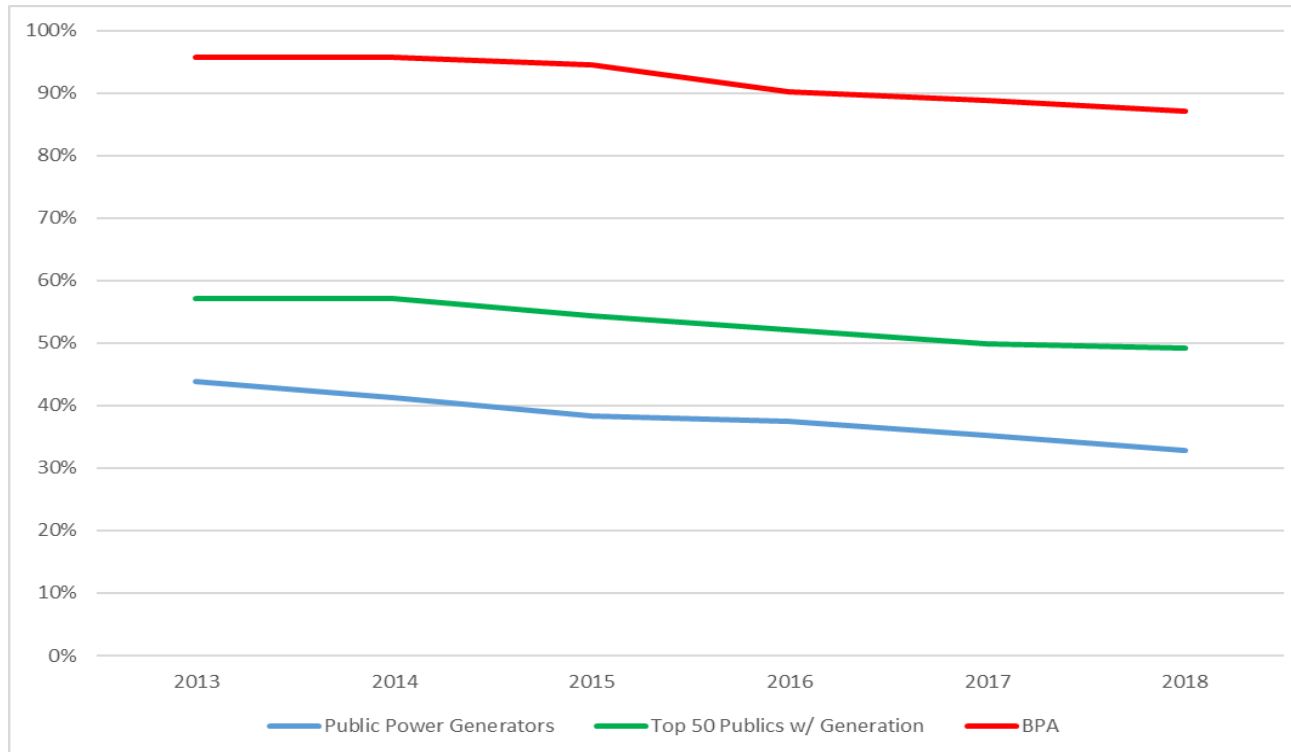
- Total debt (plus deferred borrowing) divided by total assets (plus construction work in progress)
- Modified formula to include deferred borrowing as debt starting in FY 2020

Rating Agency Leverage Perspective

- Moody's June 2021 rating: “**Positively, the proposed rates for both power and transmission customers incorporates increased revenue financing** totaling up to \$145 million per year for capital spending although the amount is still modest relative to BPA's consolidated capital spending requirements forecasted at an average of \$945 million per year over the FY2022-2023 period.”
- Moody's June 2021 rating: “... BPA's historical financial metrics range from the Ba to Baa category scoring under our methodology. Total DSCR has averaged around 1.12x over the last three years while BPA's 3-year average debt ratio is high at of [sic] 85%, which is with the 75% to 85% range target through 2028 under BPA's strategic plan. **Both the DSCR and debt ratio score at the 'Baa' category for those these two ratios.**”
- Fitch June 2020 rating, regarding the revision of BPA's Outlook to Negative from Stable: “**Bonneville's already high debt, together with its nearly 100% debt-financed capex plans** and weak liquidity profile could limit its financial flexibility to respond to increased economic uncertainty.”

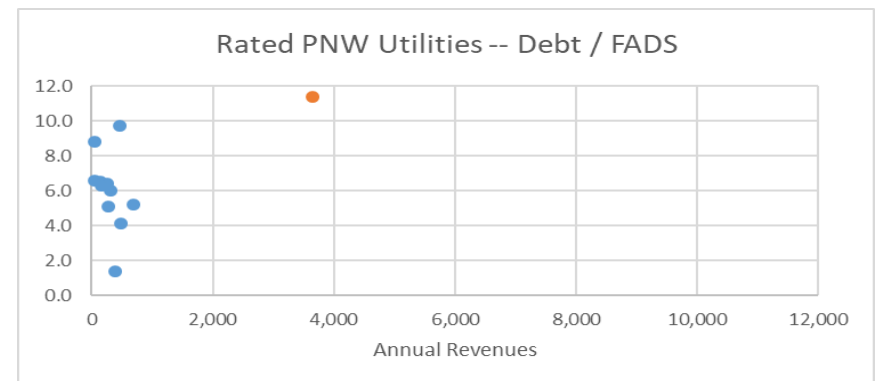
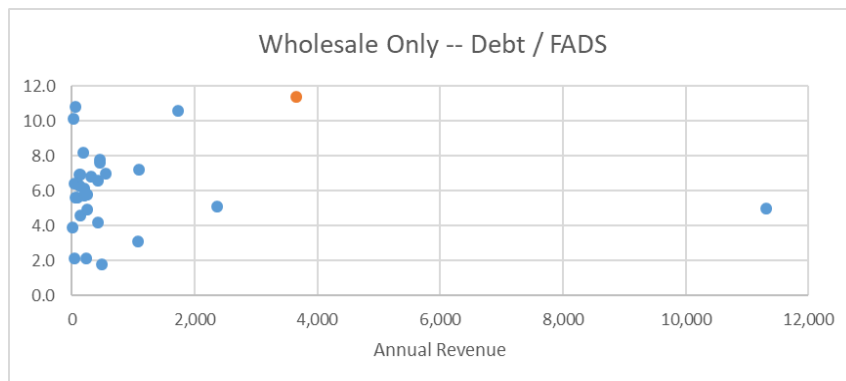
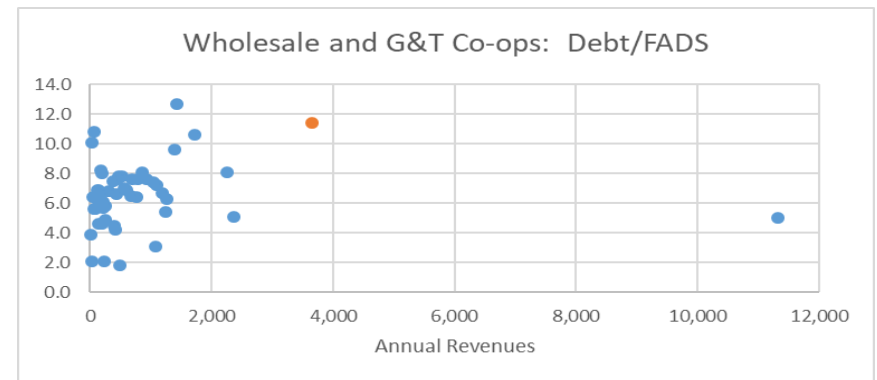
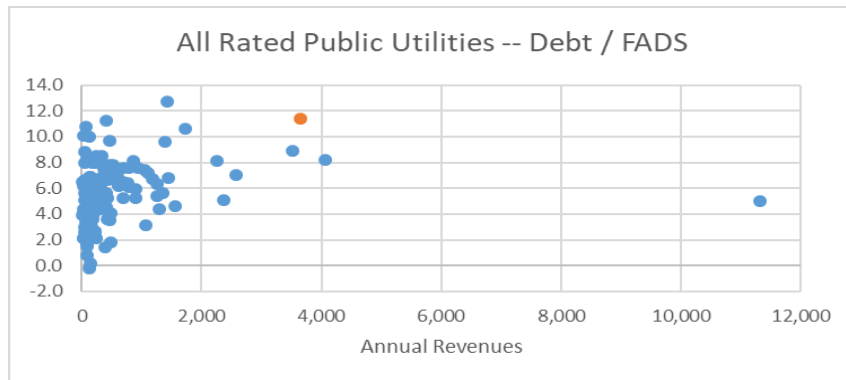
Rating Agency Perspective – Moody's

- Moody's uses a variation of the Debt to Asset ratio with a focus on industry medians. Lower is better.
- BPA is consistently above the medians.



Rating Agency Perspective – Fitch

- Fitch uses a custom metric: Adjusted Debt divided by Adjusted Funds Available for Debt Service (FADS). Lower is better.
- No matter the comparison, BPA (the orange dot) is an outlier.



Industry Practice for Capital Financing

- Regional utility practice = do not borrow for the entire capital program
 - “...utilities are commonly focusing cash contributions for capital programs on an annual basis in the range of 40-50%.”
- Some utilities rely on 100% financing through rates
- Utilities that issue bonds limit debt financing and explicitly use revenues from rates to finance capital projects.
- Use of debt can be limited to types or classes of assets
 - “financing on average no more than 40% of non-generation capital improvements through long-term financing”
 - “financing of approximately 50% of non-major capital projects with current revenue”
 - In practice, this may mean that a utility is only financing new, large projects rather than routine replacements.

Industry Practice -- Ratios

- Ratios are often tracked but generally not used as rate triggers
- Most common is a simple, direct statement of the percentage of capital spending that will be funded with new debt or with current revenues
- Some utilities measure Debt Service Coverage
 - Operating Income / Principal & Interest
 - Limits view of principal
- A few use a form of Leverage Ratio
 - Net assets / Total Debt or Debt to Capitalization
 - Commonly applied as a ratio for the use of debt
 - 60% Debt to Asset ratio target means that debt will be used to finance 60% of capital spending

Industry Practice – Application in Rates

- Simple approach -- Directly embed a dollar value in the revenue requirement or cost of service study
 - A fixed amount tied to capital financing ratio or other financial planning requirements
 - Depreciation may be used instead as it serves as a source of cash
- May be assessed with:
 - Debt Service Coverage ratio
 - Cash for principal, interest, and funding capital
 - Set the ratio at a point that satisfies bond holders and meets the capital financing policy (e.g. at least 40% paid for with current revenues)
 - Rate of Return
 - Operating income target -- Not the same as for an IOU
 - Ensures customers pay for their use of the assets, covers interest expense and funds replacement of assets

BPA Practice – Capital Financing

- Almost 100% debt financing of BPA's capital investments
- Limited use of reserve financing by Transmission
 - \$15 million/year during 2006-2019, \$210 million in total
- Limited use of revenue financing through 2021
 - Power: forecast \$34.9 million total, before BP-22 it was last done in 1996
 - Transmission: forecast \$187.4 million
 - In practice = a liquidity or risk mitigation tool in the operating year. About \$110 million of total revenue financing was used to offset poor financial performance.

BPA Practice – Debt Management

- Historically, BPA's focus has been on preserving access to Treasury borrowing authority not on total debt levels.
 - Expand the pot, i.e. get more borrowing authority
 - Get more pots, e.g. lease purchase, Power prepay
 - Shift between pots, e.g. Debt Optimization, Regional Cooperation Debt refinancing
 - Dates back to BPA's first financial plan
- The Leverage Policy in 2018 was the first effort to address debt as a whole.

BPA Practice – Repayment

- The repayment model is a regulatory tool. It provides key inputs to the revenue requirement study cost recovery and repayment demonstrations.
- The primary purpose of the repayment model is to determine a schedule of Federal principal payments that satisfy all statutory requirements and ensure timely repayment of the Federal investments.
- The model is not designed to produce results that factor in borrowing authority constraints, business unit leverage, total outstanding debt, or the optimization of financing choices.
- For the rate case, the results from the repayment model fix the total Federal repayment scheduled for each year of the rate period.
 - We consider this to be the base repayment.
 - Conditional repayment, dependent on non-Federal refinancing or other actions, may be layered on top.

BPA Practice – Repayment Modeling

- The model seeks to produce level total debt service – interest and principal for both Federal and non-Federal debt -- at the lowest possible cost given the variables provided starting with the study year and moving forward through the repayment period (50 years for Power and 35 years for Transmission). We call this “levelizing”.
- The repayment model studies a business unit’s debt portfolio year by year.
 - Using FY 2022 as an example, the model will look at all historical Federal and non-Federal debt through 2021 and all projected debt through 2022.
 - The model will shape the Federal principal payments around non-Federal debt to produce the lowest total debt service. Non-Federal debt is inflexible because BPA does not control it and it is higher on the priority of payments than Federal debt.
 - Consistent with RA 6120.2, the model will prioritize the repayment of discretionary amortization (i.e. pay debt earlier than originally planned) based on the highest interest rate first.
 - The model will repeat this process for each subsequent year for as long a period as is being studied.

Next Steps

- Please submit comments and feedback to communications@bpa.gov with the subject line “Financial Plan Refresh”.

Workshop Dates 2021	Proposed Topic
Sep 15	Project Kickoff
Oct 19	Grounding Session
Nov 16	Grounding Session
Workshop Dates 2022	Proposed Topic
Jan 12	Debt & Borrowing Authority; Capital Investment Prioritization
Jan 26	Debt & Borrowing Authority
Feb 9	Debt & Borrowing Authority; Capital Framework
Feb 23	Debt & Borrowing Authority
Mar 9	Debt & Borrowing Authority; Capital Metrics
Mar 23	Debt & Borrowing Authority
May 11/25	Draft Policy Proposal for ROD Development