Fact Sheet

September 2018

New Leverage Policy will improve financial strength and flexibility

The Leverage Policy creates a strategy to reduce BPA's total debt compared to its assets in an effort to strengthen financial health and flexibility. Reducing debt will help BPA lower its interest costs, support its strong credit rating, maintain access to borrowing from the U.S. Treasury, and improve financial strength and flexibility.

Why does BPA need a Leverage Policy?

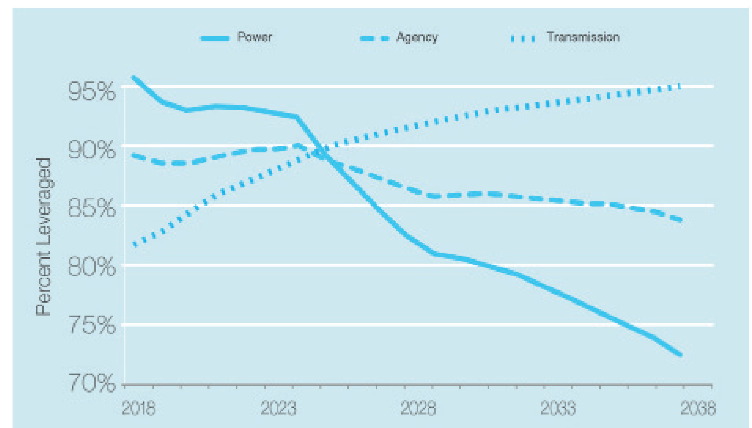
The BPA 2018-2023 Strategic Plan includes a debt utilization objective to achieve a debt-to-asset ratio of 75 to 85 percent within 10 years and 60 to 70 percent in the long term.

The term "debt utilization" describes how BPA uses debt to fund capital investments and how BPA repays that debt. A common measure of debt utilization is the debt-to-asset ratio, a comparison of total outstanding debt to the value of revenue-generating assets — the assets that are used to ultimately repay all debt. The comparison of outstanding debt to the value of assets is also known as leverage.

At the end of FY 2017, BPA's debt-to-asset ratios were at 90 percent for the agency, 98 percent for Power Services and 79 percent Transmission Services. This is high compared to an industry average of 54 percent.

Power Services anticipates a decrease over the coming years mainly due to expectations to pay down more debt than it plans to incur each year. Transmission Services, on the other hand, anticipates an increase in its debt-to-asset ratio as it incurs more debt than it repays.

DEBT-TO-ASSET RATIO FY 2018–2038



While the downward debt-to-asset ratio trajectory for Power Services is positive, the upward trajectory for Transmission Services is a significant risk to the future financial health of BPA.

What are the benefits of lowering BPA's debt-to-asset ratio?

BPA has not set targets for its debt-to-asset ratio in the past, but implementing such a policy now will help to strengthen BPA's financial health and flexibility for the future.

As the agency takes on more debt, the costs associated with debt repayment and interest expense increase. As BPA pays down its debt, the associated expenses also decline.

A higher debt-to-asset ratio limits financial flexibility because it results in higher fixed costs. Reducing the leveraged amount would provide BPA with more options should it face financial stress.

Finally, a high debt-to-asset ratio can impact BPA's credit rating. Ratings agencies are concerned that a high

amount of debt cannot be repaid quickly if needed and could create financial constraints on the agency. A downgrade could mean investors would require a higher interest rate for them to purchase Bonneville backed debt, which would make future borrowing more expensive.

HOW DOES BPA CALCULATE ITS DEBT-TO-ASSET RATIOS?

$$\frac{\text{Federal debt + nonfederal debt}}{\text{Net utility plant + nonfederal generation}}$$

What does the Leverage Policy do?

The Leverage Policy sets near-term, mid-term and long-term debt-to-asset ratio targets for each business line and the agency. It also outlines when BPA will take action to achieve those targets and how it may do so.

Leverage targets

BPA has a long-term goal to achieve debt-to-asset ratios, for the agency and each business line, of 60 to 70 percent. The policy also adopts near-term and mid-term targets due to the fact that it often takes some time to make significant progress in changing a company's leverage ratio.

In the near-term, BPA will not allow the agency or either business line's debt-to-asset ratio to increase from rate-period to rate-period. This will help to ensure that the debt-to-asset ratios do not get worse, pushing the agency and each business line further away from the mid and long-term targets. By 2028, BPA has set a target range of 75 to 85 percent for both the agency and business lines' debt-to-asset ratios.

Policy implementation

The policy implementation will occur prior to each rate period. BPA will evaluate current leverage ratios using actual financial statements. BPA will then forecast ratios for the next rate period using the best available information on the expected revenue requirements for the agency and each business line. Adjustments to capital spending levels will be considered during the Integrated Program Review process as an option to reduce the amount of capital that is debt financed. Use of other tools, such as additional debt repayment or revenue-financing capital investments, will be decided in each rate case.

If a ratio is increasing over the rate period or expected to be outside the acceptable mid-term target range, BPA will take action to reduce the ratio by one or a combination of actions that could include additional debt repayment or revenue-financing capital investments.

BPA will report its progress through the annual report and Quarterly Business Review.

What about rate impact?

The Leverage Policy is expected to create upward rate pressure for Transmission Services in order to prevent its leverage ratio from increasing from rate-period to rate-period. The administrator has the option to modify the policy to meet the changing needs of the operating environment.

Phase-in for Transmission customers

Based on current forecast, Transmission Services' leverage ratio is expected to increase in the BP-20 rate period. To lessen the upward rate impact of the policy on transmission rates, BPA is implementing a one-time phase-in of the policy for transmission customers. The phase-in allows a one-time increase to Transmission's leverage ratio over the BP-20 rate period. This increase, however, is only temporary. Transmission Services' leverage ratio must be at or below its fiscal year 2019 level by the end of the BP-22 rate period (i.e., FY 2023).

The administrator may choose to take action in BP-20 by revenue financing or paying additional debt to help offset the expected increase in Transmission's leverage ratio. If revenue financing or debt repayment is used, the amount will be determined during the rate case process. BPA is not currently considering a phase-in, for Power Services, as its anticipated leverage ratio is expected to decrease due to actions currently being taken to pay down existing debt.