Attachment 1

Sustainable Capital Financing Policy

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July 2022

1. Background and Purpose

The Sustainable Capital Financing Policy (Policy) guides BPA's use of debt and revenue financing to finance its capital investments. Responsibly managing our outstanding debt, as well as controlling its growth in relation to the value of the underlying Federal assets, is vital to ensuring the sustained financial strength and viability of the Federal Columbia River Power System (FCRPS) for BPA's customers and their communities, and will help to ensure a more consistent cost of service over time.

BPA has a large capital program, generally spending between $500 million to $1 billion per year to reinvest in aging infrastructure and expand the existing system and capabilities. Over the years, the vast majority of the program has been funded with debt, which is not a common utility practice. It is common for some funding of the current capital program to come from current rates. Power has relied almost entirely on debt, primarily U.S. Treasury bonds with smaller amounts coming from the one-time Power Prepay Program and Congressional appropriations to the U.S. Army Corps of Engineers and Bureau of Reclamation. Transmission also relied on U.S. Treasury bonds, although a significant amount of investment was also funded through the lease-purchase program. Transmission also has investments built to meet the needs of specific customers who also finance the construction. These investments are generally described as Projects Funded in Advance (PFIA) and are liabilities BPA must repay with interest.

BPA's use of debt has a significant impact on its long-term financial strength and flexibility. High debt levels increase BPA's future fixed costs (interest expense), which will either increase rates or require BPA to reduce costs in other areas of the business to maintain the same level of total costs despite higher fixed costs. Further, debt levels have a direct impact on debt-to-asset ratios. A high ratio hampers BPA's ability to respond in times of financial stress and volatility by limiting its financial flexibility. Limited flexibility in times of financial stress or volatility can result in an unstable cost of BPA service. Furthermore, an entity's debt ratio, along with liquidity position and debt-service coverage ratio, is a key financial indicator. A high ratio, while one of many factors considered, could negatively impact BPA's credit ratings, which can result in higher interest rates.

This Policy establishes a predictable and consistent approach for determining amounts of revenue financing each rate period that is anchored to achieving our long-term debt-to-asset ratio target. Revenue financing will reduce BPA's use of debt, which will reduce future fixed costs, allowing for financial flexibility and a more stable cost of service over time. However, the revenue financing amounts are limited and debt will still play a major role in financing BPA's capital investments.

2. Definitions

Revenue financing: Raising funds through rates to recover the cost of directly paying for capital investments. In lieu of directly paying capital investments, funds could also be used to repay existing debt above the scheduled amounts if conditions warrant, such as to achieve greater interest savings by paying off existing debt rather than avoiding new debt.

BPA-funded capital investments: The portion of the BPA's total capital program that it would fund with debt (bonds, appropriations, lease purchase or power prepay), financial reserves, or revenue financing. It excludes commercial, customer-funded projects, which are generally categorized as PFIA, including those funded through Large Generator Interconnection Agreements (LGIA), Small Generator Interconnection Agreements (SGIA), and Line Load Interconnection Protocols (LLIP).

3. Scope

The Policy affects BPA's use of debt to finance the capital investment program for each individual business unit. It is intended to provide a consistent, long-term framework within which BPA can manage its capital funding practices.

4. Goals

The Policy goals are to establish a capital financing method that:

1. Moves BPA away from 100% debt financing by revenue financing a portion of capital, and
2. Achieves agency and business unit debt-to-asset ratios of no greater than 60% by 2040.

5. Policy

The default amount of revenue financing will be calculated for each business unit prior to each rate case as follows:

3. The default amount of revenue financing for each business unit will be 10% of the Integrated Program Review[407] loaded capital spending forecast of BPA-funded capital investments that are functionalized to each business unit.
4. However, if 10% revenue financing in step 1 results in a business unit debt-to-asset ratio that is greater than 60% by 2040 on a forecast basis, the default amount of revenue financing for that business unit will be increased to the lower of:

   (a) 20% of the IPR capital spending forecast of BPA-funded capital investment, or

   (b) Incremental revenue financing (compared to the amount of revenue financing included in the prior rate case) of $15 million per year for Transmission Services or $25 million per year for Power Services.[408]

BPA may propose or adopt an amount of revenue financing for a given rate period that is greater than or less than the default amount, in response to circumstances including, but not limited to: changes in BPA's capital program, prior or forecast triggering of risk adjustment mechanisms, rate pressure, settlement, likelihood of achieving the debt-to-

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[407] Or its successor.
[408] The amounts in subsection (b) are based on incremental rate impacts of approximately 1% for each business unit, on a net-cost basis, which considers savings from avoided interest expense.

asset ratio policy goal, or whether an amount of revenue financing greater or less than the default amount occurred in a prior rate period.

Such circumstances do not require BPA to deviate from the default amount of revenue financing. This Policy and accompanying Record of Decision will be relevant evidence in making such decisions.

6. Implementation

The Policy will be implemented each rate period. The Administrator retains the discretion to use revenue financing to support business-line liquidity needs. BPA will propose to retain, within its calculations for risk adjustment mechanisms such as the Power and Transmission Financial Reserves Policy (FRP) surcharges and cost recovery adjustment clause rate adjustments, the requirement to repurpose revenue financing to support business unit liquidity needs in lieu of, or to reduce the magnitude of, these rate-increasing risk adjustment mechanism amounts. Additionally, when a business unit's start-of-year reserves for risk are between 60 and 120 days cash on hand, BPA intends that revenue financing will be reduced to the extent that a business unit's end-of-year reserves for risk are expected to be lower than the start-of-year. The reduction is limited to the amount needed to retain the start-of-year reserves for risk.

7. Periodic Review

The intent of this Policy is to provide durable guidance on capital financing decisions for long-term debt management. BPA intends to periodically review this Policy to consider its progress toward achieving the goals set forth in Section 4, to ensure the Policy is operating effectively, and ensure the Policy continues to align with BPA's strategic direction. BPA will request stakeholder input as part of this review. BPA expects to review the Policy approximately every five years.

BPA will also monitor and annually report its progress toward meeting the Policy goals.

8. Calculations

The following calculations are pertinent to the Policy:

1. BPA will calculate debt-to-asset ratios using the following formula: (Federal debt + Nonfederal debt + Deferred borrowing)/(Net Utility Plant + Nonfederal generation)
2. BPA will use audited financial statements to calculate actual debt-to-asset ratios for the last complete fiscal year to serve as the starting point for the forecast for each business unit.
3. BPA will use revenue requirements to calculate forecast ratios for each business unit. When calculating forecast ratios, BPA will use its forecast of capital spending as a proxy for new Plant in Service (an input into the Net Utility Plant component of the above debt-to-asset ratio formula) and for new debt. This is because actuals include Construction Work in Progress (CWIP) in the Net Utility Plant calculation. If BPA used a forecast of when plant goes into service in the future, it could double-count investments that are currently in CWIP. In addition, actuals include deferred

borrowing as debt. If BPA used a forecast of new borrowing, it could double-count existing deferred borrowing.

4. BPA will use end-of-year actual reserves for risk compared to the start-of-year reserves for risk balances to determine whether revenue financing is to be repurposed to support business unit reserves for risk.