BONNEVILLE
POWER ADMINISTRATION

2004 PROGRAMS IN REVIEW
DEBT OPTIMIZATION TECHNICAL WORKSHOP
Questions and Answers
AUGUST 5, 2004

OVERVIEW: The primary purpose of debt optimization and debt service reassignment is to maintain continued access to Treasury borrowing authority. BPA has used other means to fund capital programs through a third party lease transaction.

Q1: On your bullet on page 4 of the presentation are you saying that Transmission is taking on both Energy Northwest (EN) and Treasury debt?
A1: Transmission is assigned the debt service on the extended EN bonds when Federal debt is paid earlier than planned. Transmission remains obligated to pay Treasury debt service on Treasury bonds that haven't been retired early issued for Transmission capital.

Q2: Is the Associated Project Cost on page 6 Corps of Engineers and Bureau of Reclamation capital?
A2: Yes

Q3: Are Associated Project costs in the FY05 Congressional budget assigned to PBL?
Q3: Yes.

Q4: What are you assuming in page 7's chart about revenue and 3rd party financing?
A4: We are not assuming any future revenue financing, 3rd party financing, or debt optimization. Right now only federal financing is assumed in this chart and the overall PIR process.

Q5: I am confused - you are assuming no more EN debt refinancing on page 7?
A5: Yes, it means all sources of capital are assumed to be Treasury. Our agreement with the EN board is that we will go back annually to discuss the debt optimization program.

Q6: Is there any other EN debt extension assumed beyond this chart?
Q6: No.

Q7: Does this assume all future capital financing comes from Treasury?
Q7: Yes.

Q8: What time of year do you go to EN? When are your discussions with EN?
A8: After September 30, generally in November or December, we report what we have done. In January of each year we start discussions with them on upcoming debt extension.

Q9: For your $435M in capital outlays your one chart goes down by that amount but the other chart on page 7 goes down less. Why aren't they the same?
A9: The difference is amortization. Projected repayment of Treasury debt offsets the use of Treasury borrowing so the reduction shows the net effect.

Q10: Is the chart on page 7 all BPA and not just TBL?
A10:Yes.

Q11: Is it also true that you have to pay a penalty on calling Treasury bonds?
A11: No, we pay call premiums on some bonds. These are not penalties, but the price of exercising the call option. Not all bonds have a call option. Call premiums are considered part of debt service.

Q12: Do you mean you are taking all EN proceeds and paying down only PBL bonds?
A12: We are paying down both PBL and TBL bonds.

Q13: The costs of this debt are functionalized to TBL? Which debt are you talking about? (See chart on pg. 8)
A13: When EN issues new 2013 to 2018 debt as part of debt service reassignment, the cost of this new debt/new bonds passes through the TBL revenue requirement.

Q14: Do you only use the term "debt service reassignment" when you transfer debt to TBL?"
A14: Yes, debt service reassignment is about TBL.

Q15: I was confused as to what was meant by Past, Present, and Future on page 10.
A15: Past- what happened previously (rates got set for 5 years in PBL), Present (what happens now when EN issues new bonds), and Future (how it is reflected after the transaction takes place)

Q16: For the $315M of savings that showed up from EN refinancing- is there also an inter-business line loan because PBL's savings are used to pay down TBL debt?
A16: No. The $315M is not savings. It represents the principal due on EN debt.

Q17: Over time do you show savings?
Q17: This is not savings.

Q18: The power rates were set to recover X amount of EN principal and interest – the actual was Y- so the difference between X and Y was $315M?
A18: The $315 million was the amount of EN principal due. PBL's rates were designed to pay the original interest and the original principal. The PBL costs for the year, when the debt optimization program is utilized to prepay federal transmission bonds through debt service reassignment, include a charge to relieve the business line of responsibility for that debt in the future, generally equivalent to the expected EN principal payment.

Q19: Is Power still paying on EN debt?
A19: No, Power is not paying new EN debt service that has been reassigned to TBL.

Q20: Which (PBL or TBL) revenue stream caused that $315M to be there?
A20: You are mixing cash and accrual accounting.

Q21: So there is no reimbursement by TBL to PBL?
A21: No.

Q22: Where did the $315 million come from?
A22: It came from the Bonneville Fund.

Q23: Who backs the EN bonds?
A23: EN bonds are system bonds, backed by the Bonneville Fund, not TBL or PBL alone. BPA is the security for the bonds.

Q24: When do you realize those savings in the form of a reduction in rates?
A24: In subsequent years, total BPA interest expense is lower.

Q25: Who benefits from the savings?
A25: Both business lines experience overall interest expense savings (pages 14 and 15)

Q26: Does BPA believe there is a future obligation for the two business lines to square up on these EN transactions?
A26: No.

Q27: It feels to me that the $315 million was generated by PBL and they are owed money. I am a PBL ratepayer.
A27: PBL customers were charged through rates for the original $315 M of maturing principal. PBL's obligation for future debt service on those new bonds is extinguished through the debt service reassignment charge, and PBL ratepayers are not responsible for the debt service on the new EN bonds in the future (see page 10).

Q28: Who enjoys the savings of the actual transactions? So there was a reduction in EN in FY2003, where does that show up?
A28: The reduction in EN principal is not savings. The savings from the program are realized in reduced interest expense in subsequent years.

Q29: Let me see if I understand this. Come July 1 PBL had an obligation that came due- the theory was that it extinguishes PBL's obligation, instead you refinanced and assigned debt service to TBL. So past then we should not see any obligation for PBL – what is not clear- is what we discussed here and what shows up in rates- where is that money showing up in the PBL rate structure?
A29: PBL's original obligation was extinguished on July 1 as envisioned in the rate case. The debt service on the new EN bonds was assigned to TBL and is no longer a future PBL obligation.

Q30: Does that 0.9% reduced weighted average interest rate include the call premiums you paid?
A30: No, just the interest rate difference.

Q31: Does the interest rate savings include the call premium?
A31: No, however, the interest rate reduction results in savings over time.

Q32: So we don't know whether we actually saved any money? All I want to know is what happened in '01, '02, and '03. Did it save us money or cost money?
A32: Probably by 2003 you will see a cost reduction. Remember this is an overall portfolio look over time, not just a one-year look.

Q33: If the original bonds were $2.7 billion, and $1.3 billion were for extension, and you stated that $600M was paid on federal debt, this does not seem to add up.
A33: From 9/30/00 through 9/30/03, a total of $2.7 billion of non-federal debt was refinanced, with $1.2 billion being EN debt extension related to the debt optimization program. Of the debt optimization amount, about $700 million was used on federal debt that was paid off earlier than planned during this period. The remaining $500 million was EN advance refunded bonds with original due dates between 2004 and 2012. Corresponding federal prepayments for about $500 million are anticipated in these years.

Q34: If you are not advance funding now, are you holding the money?
A34: The money is held in an escrow account to pay interest until those bonds are due. The money is then used to pay off the bonds.

Q35: How much money is in escrow now for this?
A35: I don't have that number now. If we take an average of about $40-50 million a year between now and 2012 of advance refundings, that is our commitment to EN for future federal debt prepayments.

Q36: You make it sound like a closed account and Corporate doesn't have a rate case. So where does that interest from the escrow account go?
A36: A trustee holds the funds and they are exactly the amount necessary (including interest earnings), to pay future semi-annual interest and principal when due.

Q37: What does that mean for the business line rate case? I have not seen revenue requirements with escrows?
A37: The debt service will be about the same, or somewhat less due to the lower interest rate on the extended bonds.

Q38: Is the escrow account visible?
A38: The EN 2003 annual report refers to the accounts on pages 58-59. The values of the accounts do not appear in the annual report because of GASB standards.

Q39: When you do an EN debt extension and you get a lower interest rate, if TBL had federal debt that came due in 2006, 2007, and 2008, presumably it would line up with the life of an asset. Doesn't that mean that TBL is paying longer for the debt?
A39: First, the maturities on debt often don't line up with specific assets lives. Second, the TBL bonds paid down in FY03 matured, on average, in FY32. The non-federal debt that replaced those federal bonds matures in FY13 – FY18. Maturities will vary and are consistent with the principle of not raising revenue requirements.

Q40: How is the $315 million handled on page 15?
A40: From July through September 2003 the money is in the Corporate account. The reassignment took place on October 1, 2003 when the debt service requirement became a TBL obligation. So if you see this same chart next year it will be different.

Q41: On the PBL side you are saving 90 basis points on the debt. How are they getting the savings?
A41: In the case of the CRACs, directly through reduction in federal interest. For savings in Energy Northwest debt service, since the modified net revenue calculation resets to 2002 Rate Case debt service levels, Treasury Payment Probability (TPP) takes into account current and projected reserve levels which do not adjust for debt service. Also resetting the thresholds for FB CRAC and SN CRAC in the SN CRAC process implicitly adjusts for realized debt service savings as of the time of the threshold recalculation. This is an excellent question for the SN CRAC workshop.

Q42: Was this an entity created especially for sole purpose of the Schultz-Wautoma?
A42: Yes, it is a subsidiary of J.H. Management. NIFC owns this line throughout the term of the lease.

Q43: We have the option to buy the line at what price at the end of the lease?
A43: $10.

Q44: What were the net proceeds you received? S&P said it was $128 million. Was it $12 million less?
A44: The S&P report referred to information prior to pricing. Pricing resulted in the following: The bond amount of $119.6 million made up of $110.0 million construction fund, $8.1 million capitalized interest, and $1.5million underwriters discount and cost of issuance.

Q45: Your BPA authority lets you lease land. Why are you saying you can't 3rd party finance land?
A45: With Schultz-Wautoma the decision was made not to lease the land portion for various reasons. The reasons included right-of-way issues and leasing land rights back that had already been purchased by BPA.

Q46:: What causes the BPA agency rate to be higher than Treasury?
A46: Risk. The Treasury rate is the risk free rate. The BPA borrowing rate is consistent with the Government Agency rate, which will be higher than the Treasury rate because of an adder for risk. The adder for risk isn't set by Treasury, but by the marketplace, when Fannie Mae, Freddie Mac, and TVA bonds are bought and sold.

Q47: Does Treasury determine the rate?
Q47: Yes.

Q48: Is that (agency adder for risk) determined every time by Treasury?
A48: Let's clarify. Treasury sets the BPA borrowing rate at every bond issuance. However, that rate is consistent with the rate available for Government Agency bonds. The market determines the Government Agency spread above Treasury. BPA's rates depend on the market at the time of pricing.

Q49: Are these sold as BPA bonds on the market?
A49: No. Treasury holds our bonds, but they have the right to sell them. They have not sold them in the past.

Q50: Is the spread over Treasury bonds fixed?
A50: No. The spread can go up or down; it fluctuates with the market and it also varies at any given time with the expected maturity of the bond.

Q51: What is the agency rate similar to?
A51: Similar to Fannie Mae, TVA, Freddie Mac and other agency bond rates.

Q52: This third party transaction was based on the credit of BPA. What did JH Management bring to the table?
A52: BPA doesn't have statutory authority to accept loans from other than the U. S. Treasury. They served as the third party to own the assets, issue bonds to finance the project, and lease the assets to Bonneville.

Q53: Why can't a customer do this for you? Like a co-op or a city?
A53: The entity would have to hold assets outside of its jurisdiction. In addition we had a tight construction timeline, which ruled out entities that had to secure approvals in order to proceed.

Q54: Wouldn't it be better to keep benefits in the region rather than send them out of the area?
A54: JH Management is the least cost alternative that was able to meet the schedule and other requirements. We believe that ultimately the entire region benefits from lower costs.

Q55: This isn't new for you though. Haven't you done this before?
A55: It's somewhat similar to the Goshen-Drummond line.

Q56: Does the lease payment include debt service and something else?
A56: The lease payment includes debt service (only interest for the first 30 years). It also includes the annual auditing and management fees and an estimate for other potential legal expenses.

Q57: Is the lease payment annual?
A57: It is semi-annual. We pay $3.2 million in July and January. There is an inflation factor added for future years for some of the leasing costs.

Q58: Since we are talking about PIR issues, are you going to do any more 3rd party financing in '06 and '07?
A58: PIR revenue requirement projections do not currently assume future 3rd party financing.

Q59: Does this count as part of borrowing authority?
A59: No.

Q60: So the whole flap with OMB about scoring 3rd party financing is over?
A60: No.

Q61: Did this transaction (Schultz-Wautoma) count against borrowing authority, or did you convince OMB that it was an exception-based transaction? Did they ask you to come back every time when you do these types of transactions?
A61: No, the 2005 Congressional budget said that the Administration would consider proposing legislation that other debt instruments (outside of Treasury borrowing) may count against borrowing authority in the future.

Q62: Could Schultz-Wautoma count against borrowing authority in the future?
A62: No. It is our understanding that any change through proposed legislation would only be effective for transactions after the date the legislation is approved.

Q63: Do you have an outlook for sources and uses of funds for the capital program for the agency?
A63: It changes a lot. We don't have specifics at this time. The folks you see at the table here are working on these issues.

Q64: It is incumbent on you to give us an idea of what you are looking at.
A64: We are looking at capital programs on Aug. 25th but that is not intended to look at sources and uses of capital.

Q65: If EN debt had been all moved to PBL instead of TBL, would it (PBL) have lower rates?
A65: There are several principles for debt optimization. The main reason is to restore borrowing authority. Paying off appropriations does not restore borrowing authority. Another issue is how much debt optimization proceeds each business line can absorb in the repayment study. Remember, for every dollar of Federal debt that is paid down, there is a dollar of non-federal debt in FY13 – FY18. One of our principles is that debt optimization not cause rates to increase. Placing too much debt in a given year or period will cause debt service requirements (and then most likely rates) to increase. We know that PBL can't handle the whole amount, which is over $2 billion.

Q66: What is the process to decide which business line is benefiting?
A66: Recall, the main purpose of debt optimization IS to restore borrowing authority. We prefer to pay down federal bonds with debt optimization proceeds, rather than appropriations. That means, after determining the rate case Treasury principal payment amounts, we look at what obligations are available to pay down in each business line. While each business line has sufficient federal obligations, bonds plus appropriations, available for retirement in any given year, neither has sufficient additional bonds available to absorb all the additional Treasury principal payment associated with debt optimization in a given year. That is definitely the case on the PBL side. We've been issuing short-term bonds for both business lines for the last several years. Still, the PBL will not have enough bonds available to pay down to absorb all the debt optimization proceeds in any given year of the program. Second, we look at how much debt each business line can handle in FY13-18 without creating a critical year or making an existing critical year worse.

Q67: You run the analysis for Transmission and Power as you run the process with EN? Do you do an ongoing rate impact assessment? Is this ongoing?
A67: Each year we determine what we will do with the proceeds.

Q68: Does that take into account advance refundings?
A68: Determining which business line will have debt paid off early is a separate decision from the economic decision of whether or not to do an advance refunding.

Q69: At the beginning of the presentation, when EN pays off debt it shows up as an expense for BPA?
A69: The annual EN budget which BPA uses as a basis for net billing and for accruing debt service expenses includes all projects' debt service, both principal and interest. That debt service is an expense to BPA. An EN principal payment is an expense on BPA's books because of the contractual relationship with BPA.

Q70: So as it gets paid off, it becomes an expense?
A70: The year it gets paid off, it shows up as an expense.

Q71: What happens if interest rates go above municipal rates? Does that stop the debt optimization program?
A71: So, if rates were above by 2-3%, we would have to remember that the fundamental reason of debt optimization is to restore borrowing authority. The taxable rates (Treasury rates) are generally higher than tax-exempt municipal rates at any given time. There are very few times in history where tax-exempt rates have been higher than taxable rates. We don't see higher rates as a reason to stop the debt optimization program because it still represents our least cost financing alternative to Treasury borrowing.

Q72: I thought you said you had a $4.5 billion borrowing authority limit, I don't see that on page 15.
A72: The chart shows $2.697 billion, which are the total outstanding bonds to Treasury. If you look on page 7 you can see the remaining borrowing authority of $1.752 billion. If you add those together you get to $4.45 billion.

Q73: Where does the borrowing authority limit stop?
A73: We still have about $1.3 billion remaining.

Q74: If you hadn't done the debt optimization program, what would pages 14 and 15 have looked like?

A74: You may likely see Treasury borrowing maxed out in FY2004.

Q75: How did you pay for the $17 million call premium?
A75: When we call federal bonds and repay them in full, the call premium shows up as an expense in that year. When a federal bond is refinanced, the call premium is rolled into the new bond and amortized over the life of the bond. In FY03, the call premium was an expense charge to the Transmission business line.

Q76: Are Transmission customers paying more for the assets?
A76: No. We are just paying down bonds that are not due and replacing them with a bond with a similar life.

Q77: Is this interest rate savings maximized for PBL? Would you, barring constraints, always pick PBL bonds?
A77: This program was intended to extend borrowing authority for the agency. A number of criteria are used. The highest criterion is to extend borrowing authority. Power first is a criterion but a bit lower on the list. However, we haven't been in that situation. PBL just doesn't have the future capital program with the big need for Treasury borrowing authority.

Q78: How is the debt service reassignment interest rate calculated?
A78: It is composed of three parts -- the actual debt service on the newly extended EN bonds plus transaction costs for the EN bond deal, plus a carrying charge to cover interest until federal Transmission bonds are paid off.

Q79: How is the carrying interest cost calculated?
A79: It is calculated for the 3-month period from July 1 - October 1.

Q80: When you are doing debt refinancing are you extending out TBL debt beyond when it is due?
A80: The bonds we paid down in FY03 had 30 years remaining (going to 2025 and 2034) However, those bonds were not necessarily scheduled to be paid at their maximum maturity. EN issued new bonds with maturities of FY13 through FY18. These maturities are not going to match specifically but we could roll these over into longer bonds.

Q81: Does shortening of the bond affect the transmission revenue requirement? Does it affect repayment levels?
A81: We avoid creating new critical years in the repayment study or increase existing critical years. That would drive up the debt service requirement, so EN issues the bonds with new maturities that meet repayment study criteria.

Q82: Did you shorten the maturity of the bonds?
A82: The repayment study probably would have showed those bonds being called earlier than their maximum maturity. Even if debt optimization were not in place last year, it is likely that we would have repaid some or refinanced all those bonds anyway. Remember, the rate case only sets the level of amortization, not the specific individual obligations that are to be paid. That's something we decide on a year-by-year basis. Those bonds had interest rates in the 7% range, so we would have taken advantage of the low interest rates last year.

Q83: Where does the $17 million call premium show up on the income statement?
A83: On page 58 of the main PIR presentation, you will see that the $17 million is embedded in the 2003 net interest expense and then flowed through to reduce net revenue.

Q84: Would you need to use debt service reassignment in the future?
A84: Yes.

Q85: How are these proceeds going to be allocated in the future between the business lines?
A85: Slide 6 shows that TBL has the lion's share of the capital. It will give you an idea of how refinancing will play out, PBL needs vs. TBL needs.

Q86: So basically it is a 3:1 or 2:1 on TBL vs. PBL capital needs?
A86: Yes.

Q87: On page 6 are these all Treasury bonds and not appropriations?
A87: Everything on page 6 is Treasury bonds.

Q88: Do the PIR materials include debt optimization for FY06 and FY07?
A88: No. Only through FY04.

Q89: Why was the refinancing of EN bonds harder this time?
A89: A number of the underwriters left our main banking firm (the "book runner"). We had a former bond counsel with whom we had built up a relationship for years. It took weeks to explain the Bonneville credit to the new bond counsel. Keep in mind that bond counsel has to issue a clean opinion on these bonds, that the security is as represented.

Q90: Should it be better next year?
A90: Hopefully. You can never predict these things.

Q91: Are the call premiums on federal debt formula-driven?
A91: Yes.