Discussion of the Effects of the Administration's Proposal to Count Third-Party Debt under Bonneville's Borrowing Authorization

Introduction

Electric utilities are capital-intensive businesses and the Bonneville Power Administration is no exception. Bonneville depends on debt to finance its capital investments. Being a federal agency it does not have the option of issuing stock to help finance its investments. At the end of Fiscal Year 2004 Bonneville carried a total of $13.1 billion in debt. Bonneville expects that service of this debt will account for 40 percent of its $2.7 billion average revenue requirement during fiscal years 2007 to 2009.

Bonneville has a statutory cap on its debt to the U.S. Treasury. As a result, Bonneville's future capital borrowing capability is limited. In order to carry out its responsibilities, Bonneville must find ways to operate within its borrowing authority. One approach that Bonneville has used is to secure private, third-party financing for some of its investments. The Bush Administration's recent budget proposal includes a provision that requires new third-party debt to be included under the borrowing authority limitation, thus removing one of the paths Bonneville has to operate within its debt cap and still meet its obligations.

The implications of this proposal are explored in this paper. Evaluation of the potential effects requires an analysis of Bonneville's debt structure and its future borrowing needs compared to its remaining borrowing authority. Alternative approaches to reducing Bonneville's debt or finding new sources of borrowing are described. If the budget proposal becomes reality, its is important to understand how that might affect Bonneville's ability to meet its obligation to provide an adequate, efficient, economical and reliable power supply for the Pacific Northwest.

Bonneville's Current Debt

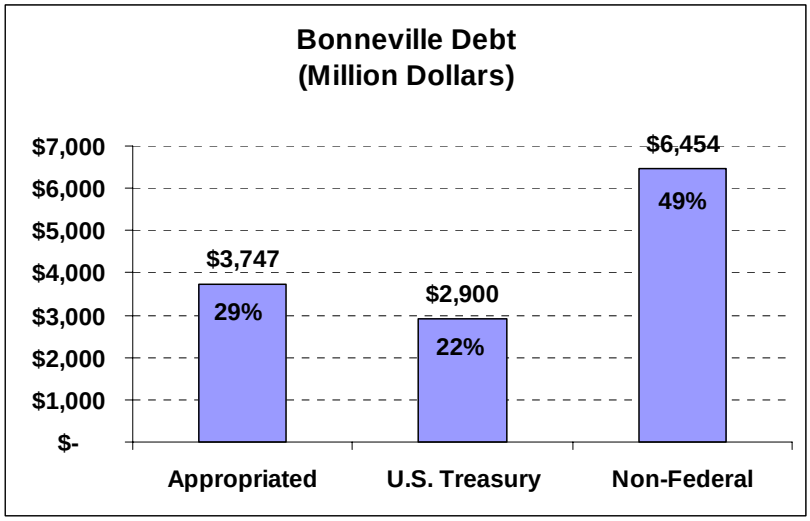
Bonneville carries three major kinds of debt: reimbursable appropriations, bonds issued to the U.S. Treasury, and nonfederal third-party debt. Figure 1 shows how Bonneville's $13.1 billion debt is allocated among these categories. The distinctions among these categories are important. The $2.9 billion U.S. Treasury debt is the only portion subject to the borrowing authority limit. However, it is also the primary avenue available to Bonneville for future capital borrowing.

Reimbursable appropriations are primarily the debt owed on early development of the dams and transmission system. Most reimbursable appropriations, 82 percent, are for power generation, and the rest are for transmission. In 1997 these reimbursable appropriations were refinanced and assigned market rates of interest under the BPA Appropriations Refinancing Act [16 U.S.C. 8381]. In addition the Act increased the present value of Bonneville's future debt payments by $100 million as a refinancing fee.

The Federal Columbia River Transmission System Act of 1974 changed the way capital investments in the Federal Columbia River Power System (FCRPS) were financed. Bonneville can issue bonds directly to the U.S. Treasury to finance investments in the power and

transmission systems. However, this Treasury borrowing authority is currently limited to $4.45 billion, of which $1.25 billion is reserved for conservation and renewable investments. Bonneville currently has $2.9 billion of this Treasury debt outstanding. About 70 percent of this debt is related to the transmission system; the rest is related to power.

Figure 1
Major Categories of Bonneville Debt
(September 30, 2004)



The third category of debt is nonfederal third-party debt. At $6.5 billion it is the largest of the three types of debt. The vast bulk of this debt was acquired during construction of nuclear power plants by the Washington Public Power Supply Syste (since renamed Energy Northwest). A total of $6.1 billion of this debt relates to nuclear plants, completed and abandoned, in the region. The remainder is for various small hydropower projects, and for conservation and renewable investments by utilities that were net-billed to Bonneville.

Most recently, Bonneville has used third-party financing to partially fund a new transmission investment, the Schultz-Wautoma line. This was a capital lease arrangement in which Bonneville will repay $119.6 million of capital costs that were financed by a private entity. At the end of the lease Bonneville may purchase the line for a nominal amount. Apparently, the Bush administration seeks to include future investments of this type under the Treasury borrowing cap.

Bonneville's Future Investment Needs

Most of Bonneville's future borrowing plans rely on U.S. Treasury financing, which falls under the borrowing cap. These capital requirements average $517 million a year from 2005 through 2010. Table 1 shows how the capital requirements are allocated among several purposes. Over half of the requirements are for expansion and maintenance of the transmission system. Another quarter of the requirements is for associated project costs, which are improvement and maintenance of the Corps of Engineers and Bureau of Reclamation hydroelectric facilities.

Conservation and fish and wildlife include capitalized components of those programs for projects such as construction of hatcheries and acquisition of habitat.

Table 1
Average Annual Bonneville Treasury Borrowing Needs, 2005 to 2010

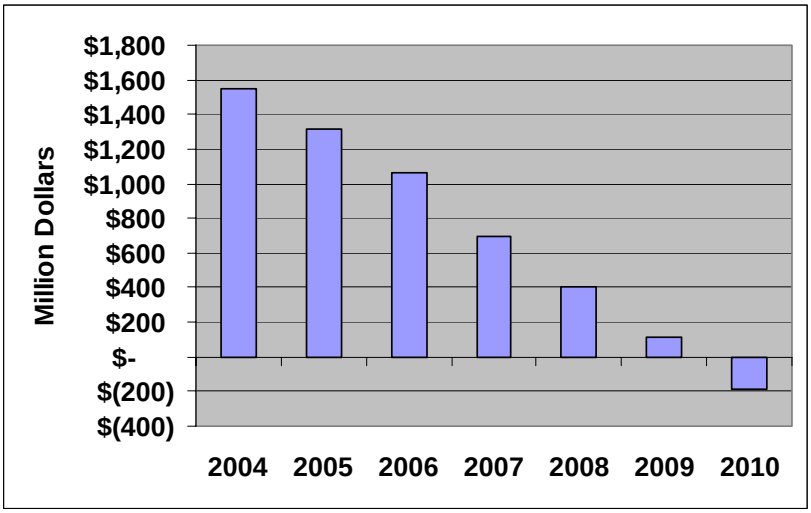
Category	Average Annual 2005 Through 2010 (Million $)
Transmission	$ 281
Associated Project Cost	$ 131
Conservation & Energy Efficiency	$ 32
Fish & Wildlife	$ 36
Capital Equipment	$ 35
Total	$ 517

Remaining Borrowing Allowed Under the Cap

Bonneville's current amount of U.S. Treasury debt is $2.9 billion. This means there is $1.55 billion still available under the $4.45 billion borrowing cap. The use of this additional borrowing authority is subject to the reservation of $1.25 billion of the authorization for conservation and renewable investments. The existing debt for conservation and renewables is $780 million, leaving $470 million under the cap for those investments. There is $1.03 billion left for other investments, primarily in the transmission system, but also including capitalized fish and wildlife costs and other capital equipment for Bonneville operations. Investments in fish-related improvements to the dams by the Corps of Engineers, such as removable spillway weirs or bypass and guidance systems, are funded through reimbursable appropriations and are not affected by Bonneville's limited borrowing authorization.

The effect of Bonneville's planned future borrowing in reducing the remaining room under the cap is partially offset by planned amortization of existing Treasury debt. The planned amortization averages $228 million per year from 2005 through 2010 compared to planned new borrowing averaging $517 million a year. Thus the available borrowing authority would be depleted by $289 million per year ($517 - $228). At that rate, Bonneville would use up the borrowing authority under the cap in five years and by 2010 would be about $200 million short of capital for ongoing upgrade and maintenance of the power and transmission systems, and for conservation and fish and wildlife capital investments. Figure 2 shows the projected depletion of the available borrowing authority on an annual basis from 2004 through 2010.

Figure 2
Remaining Bonneville Borrowing Authority, 2004 through 2010



Efforts to Extend the Remaining Borrowing Authority

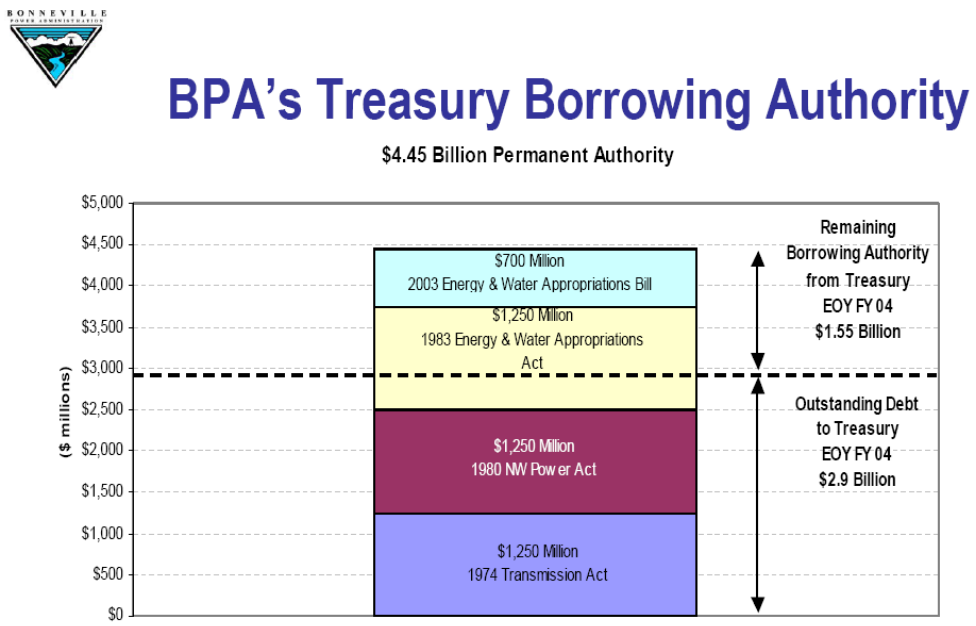
Bonneville has only a few options for dealing with the limited borrowing authority. These include accelerating the retirement of high-cost debt, utilizing other sources of borrowing, recovering more of the investment costs in current electricity or transmission rates, delaying needed capital investments, or obtaining increased borrowing authority from Congress.

Bonneville has been particularly focused on the first option, early debt retirement. Through its Debt Optimization Program, Bonneville achieved early retirement of $1.1 billion of its Treasury debt between 2000 and 2004. It has plans to retire another $461 million of Treasury debt early by 2012. The primary mechanism that permits early retirement of Treasury debt is the refinancing of maturing Energy Northwest bonds. Cash that would have been used to pay off the maturing bonds instead is used to pay off Treasury debt while the bonds are refinanced at recent low interest rates. In this way Bonneville reduces its interest expense and also reduces its Treasury debt, thus increasing room under the cap. It is our understanding that the Bush Administration's budget proposal is not intended to interfere with this refinancing of existing third-party debt.

More recently, Bonneville has used third-party debt for construction of the Schultz-Wautoma transmission line. The Northwest Infrastructure Financing Corporation issued $119.6 million in taxable bonds to finance the construction of the line. Bonneville took a 30-year lease on the line; lease revenues are used to back the bonds. It seems clear the administration's budget proposal would count such third-party arrangements under Bonneville's debt cap. Some transmission investments are financed by third parties under Bonneville's Open Access Transmission Tariff, which was developed under FERC guidelines. Many of these transmission investments are to connect new generation to the transmission grid, and they are paid by the generator. Bonneville's plan for these types of third-party financing are relatively modest at about $150 million in 2005 and 2006, decreasing to $118 million in 2007 and only $20 million per year thereafter.

The third and fourth strategies for increasing room under the borrowing cap are difficult for Bonneville to implement at this time. Increasing rates for power and transmission on top of the dramatic increases already being absorbed by customers is a difficult proposition. At the same time it is also difficult for Bonneville to delay necessary transmission investments because these investments have been delayed previously and now the need is urgent. In a related attempt to delay transmission investments, Bonneville has been studying the potential for reducing or delaying transmission expansions through targeted local conservation efforts or distributed generation in areas that would offset transmission constraints. The Non-Wires Solutions Roundtable has been working with Bonneville to advance this strategy, but to date the potential of this approach is unverified.

The final option, increasing Bonneville's borrowing authority, requires Congressional action. Since 1974 when the borrowing authority was established, it has been increased three times as shown in the figure below. The borrowing authority has increased from $1.25 billion in 1974 to its present $4.45 billion. However, just adjusting for inflation since 1974 would have increased the cap to $3.9 billion so the real increase has been quite modest in spite of the growth of loads and the aging of the system. The administration's budget proposal would add $200 million to the current borrowing authority. Additional increases would be difficult to achieve, especially with the current budget deficits and growing federal debt.



Source: Bonneville Power Administration, Power Function Review

The additional $200 million would push the date when remaining borrowing authority is exhausted out one year to 2011. Bonneville has estimated that full implementation of the debt optimization program would extend the room under the borrowing cap to 2013.

Potential Impacts of the Administration's Budget Proposal

The administration's budget proposal to include new third-party debt under Bonneville's borrowing authorization essentially would remove one tool that Bonneville has to limit the effect of its capital investments on the federal debt. It is difficult to predict how Bonneville will try to meet its goals and obligations as it approaches the point where its borrowing authority is exhausted,

Bonneville's options are limited. It is reasonable to expect that areas of investment that produce no revenue for the system are likely to be cut first. These include the areas of conservation and fish and wildlife mitigation. However, those are relatively small parts of the overall capital requirements. Other impacts of restricted access to capital such as decreased investment, capital project deferrals or revenue financing would all serve to reduce the adequacy and reliability, or increase the costs, of the transmission and generation assets that generate the revenues to repay Treasury debt. The resulting delays in investments to maintain and upgrade the transmission and hydroelectric systems could damage the reliability, adequacy and efficiency of the Northwest power supply and lead to higher costs and delayed debt repayment in the future.

The alternative of raising electricity rates to finance capital investments out of current revenues may be the only remaining alternative if Bonneville were to meet its obligations. However, this would burden current consumers with the cost of improvements that will create benefits for future consumers, a practice that is discouraged by the regulators of Bonneville's investor-owned competitors. The resulting increase in rates would put Bonneville in a difficult position to compete with alternative sources of power that its customers could access. If Bonneville's current costs rise above market prices it will not be able to recover its cost, and the U.S. Treasury would be liable for the losses ultimately. Bonneville has never missed a mandatory treasury or third-party debt payment, nor has Bonneville used its authority to reschedule debt payments since 1982. Removing an important tool that can help Bonneville reduce its reliance on federal debt only increases the risks that Bonneville already faces and increases the federal government's exposure to those risks.

The Administration's proposal ignores 30 years of history that began when Congress enacted the Federal Columbia River Transmission Act of 1974. The Act is responsible for Bonneville's ownership and operation of more than 15,000 miles of transmission lines in the Pacific Northwest, comprising more than three-fourths of the region's high voltage grid. Congress understood that financing expensive, multi-year construction projects with potentially unstable annual appropriations was not an efficient, business-like practice. Although the physical needs of the transmission system today are increasingly focused on upgrades and improvements to ease congestion and to ensure reliability, as well as expansion, the same financing concerns that moved Congress to pass the 1974 Act remain relevant. Any action that disregards Bonneville's ownership of such a large and significant regional asset, and diminishes its ability to maintain and finance improvements to it, threatens the long-term adequacy and reliability of the Northwest's electricity supply.