Northwest Power and Conservation Council

February 1, 2007

MEMORANDUM

TO: **Council members**

FROM: **Mark Walker, Director of Public Affairs**

SUBJECT: **Bonneville Power Administration's Fiscal Year 2008 Budget**

President Bush's Fiscal Year 2008 budget will be submitted to Congress on Monday, February 5. At the February Council meeting I will be prepared to provide a brief summary of any major budget provisions proposed for the Bonneville Power Administration.

The President's budget routinely includes provisions relating to the repayment of Bonneville's federal debt. Last year, the Administration included a unique proposal that would have required Bonneville to pay to the U.S. Treasury its secondary revenues in excess of $500 million for advance payment of Bonneville's bonded debt. Unlike previous debt-related budget proposals, however, this one could be implemented <u>without</u> specific authorization by Congress.

The Administration's stated purpose for the provision was that it would free-up needed Treasury borrowing authority that would assist Bonneville in its quest to improve and expand its high voltage transmission system. The provision would have resulted in an estimated additional $924 million in revenue to the U.S. Treasury over 10 years.

In early February 2006, the Council's staff was asked by the Northwest congressional delegation to undertake an economic analysis of the proposal. The analysis showed that the proposal would increase the region's annual power costs by about $145 million and cause Bonneville to increase its rates by almost 7 percent (see attached staff analysis).

The Northwest congressional delegation, in unified opposition to the proposal, passed an amendment to one of last year's supplemental appropriations bills that prohibited the Administration from implementing the provision prior to April 1, 2007. The delegation was able to pass the amendment because they could show that there would be no negative revenue impact prior to April 1, 2007 if the provision were not implemented, thus obviating the need to find

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budgetary offsets that otherwise would have been required to avoid a budgetary point of order against the amendment.

Unfortunately, it is expected that the Administration will include the same or a similar proposal again in the FY 2008 Bonneville budget. If so, the congressional delegation will be searching for opportunities to defeat or delay its implementation once again. It is also possible that other, new proposals could appear in the President's FY 2008 budget.

Northwest Power and Conservation Council

February 8, 2006

Preliminary Staff Analysis:

Proposed Application of BPA's Secondary Revenues for Advance Federal Debt Payments as Proposed in the President's FY 2007 Budget

In response to a request by Senator Gordon Smith's office, the staff of the Northwest Power and Conservation Council prepared the following preliminary analysis of the Administration's FY 2007 budget proposal pertaining to the Bonneville Power Administration's use of net secondary revenues for accelerated debt reduction purposes. The proposal would require BPA, in those years it earns more than $500 million in net secondary revenues, to use the amount in excess of $500 million for advance amortization payments to the federal Treasury on BPA's bonded federal debt.

Effects on Electricity Rates and other Economic Impacts

BPA's FY 2007 budget estimates net secondary revenues of $669 million in FY 2007, $605 million in FY 2008 and $660 million in FY 2009. While this would result in advance payments for debt amortization in FY 2007 of $169 million, we do not believe it would result in a rate increase for BPA's customers in FY 2007. (BPA did propose a rate increase for FY 2007 in its initial proposal for the FY 2007-2009 rate case, but not for reasons pertaining to this new advance amortization proposal.) Because the proposal would not be implemented until FY 2007, Bonneville's preference customers would not feel the impact of an advance amortization payment made at the end of FY 2007 until FY 2008.

Due to the inability to forecast BPA's reserve levels beyond FY 2007 with any degree of accuracy, and considering that the advance amortization payment in FY 2007 will have an impact on BPA's financial reserves, we assume the Administration's proposal will result in a rate increase beginning in FY 2008. The following is our analysis of the economic impacts of a projected rate increase: [1]

[1] See appendix for notes on methodology of calculations

Change in Average Annual Regional Electricity Costs for FY 2007-09[2]

- $145 million average increase in the annual cost of power from Bonneville based on budget proposal estimate of secondary revenues over $500 million.
- An increase in BPA's cost of power could cause a corresponding increase in the cost of power to residential and small farm customers of investor-owned utilities through the residential exchange provision of the Northwest Power Act.

Effect on Utility Rates and Consumer's Monthly Bills

- $2.18 increase in the monthly electricity bill for a customer of a consumer-owned utility
- Increased annual cost to consumer: $26.13
- Percentage rate increase caused by proposal: 6.6 percent

Effect on the Regional Economy

- $109 million decrease in regional personal income
- 1,120 decrease in regional jobs
- Additional effects on aluminum and other energy-intensive industries
- Decreased income and jobs in other regions that do business with the Northwest

Effect on Tax Revenues

- $18.5 million decrease in federal personal income tax revenues
- Additional loss in federal revenues corporate profits taxes

- $5.1 million decrease in state personal tax revenues
- Additional loss in state revenues from corporate taxes

Other Staff Concerns

While our analysis illustrates real economic impacts to the region, it does not reveal all the dangers that this proposal represents to the Pacific Northwest.

The proposal sets an alarming precedent by administratively imposing a mechanism on BPA that collects funds for national deficit reduction purposes. While the impacts we analyzed are

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[2] Although we based our calculations on the net secondary revenue projections in BPA's FY 2007 budget, these estimates were based on mark-to-market natural gas market prices in early January 2006. These prices, which were used to estimate electricity prices for secondary sales revenues, overstate likely future natural gas prices. They reflect futures prices as of early January. For example, prices on January 4, 2006 averaged $10.14 per million Btu. Since early January, natural gas prices and futures prices have been falling as the market recovers from hurricanes in the Gulf of Mexico last summer. Currently, natural gas futures prices for FY 2007 average $9.553. This could reduce the estimate of the amount of money that would be used for early debt repayment. Use of Bonneville's rate case forecasts based on natural gas market fundamentals would reduce the estimate even more. Using rate case numbers, the early repayment amount would be reduced from $169 million in FY 2007 to only $35 million. And in FY 2008 and FY 2009 secondary revenues would remain below $500 million so no early repayment would result.

relatively small in the first years of implementation, it appears that the Administration has the ability to further increase the dollar amounts in future budget proposals without the need for authorizing legislation.

Our concerns are further heightened by the Administration's related FY 2007 budget proposal (repeated from the FY 2006 budget) that would restrict BPA's access to non-federal, third-party debt arrangements. These two proposals appear to be inconsistent with one another. On the one hand, with the advance amortization proposal, the Administration seems to want to assist BPA by improving its access to capital by making more federal borrowing authority available. On the other hand, the third-party debt proposal appears to blatantly restrict Bonneville's access to capital in the non-federal markets. This inconsistency leads us to conclude that the primary purpose of the advance amortization proposal has less to do with access to capital for infrastructure improvements, and more to do with increasing cash flows into the Treasury for deficit-reduction purposes.

The proposal also appears to ignore the fact that BPA has used its debt optimization program over the last few years to voluntarily retire $1.46 billion of its federal debt. While BPA's motive for initiating this program was to improve its access to capital by taking advantage of low interest rates, the federal Treasury has benefited from these advance amortizations, as well. To require BPA to persist in making advance debt payments appears to be an oddly punitive response to a program that has reaped benefits for the federal Treasury.

From the perspective of the region's efforts over the last several years to revise BPA's future power supply role in the region, the timing of this proposal is especially unfortunate. The Council, along with regional utilities, public purpose entities and others have been urging BPA to make several difficult long-term decisions that will affect the way BPA markets its power. This has been a long and laborious process for many of BPA's stakeholders, and the Administration's new proposal on advance amortization of debt injects more distrust and uncertainty into the region at a delicate time in the regional process. BPA's announcement earlier this week that it will initiate a new rate case in July to implement the new budget proposal seems to be particularly ill-timed, especially if it proceeds before BPA issues its draft Record of Decision on these much-anticipated long-term decisions.

Finally, we are concerned that the advance amortization proposal has the potential of increasing risk to the Treasury during years of poor water conditions and/or low electricity market prices. While it can be argued that as long as BPA's net secondary revenues remain healthy, BPA should have sufficient reserves to meet all its obligations, there can be no denying that the imposed policy of forced advance amortization payments may, at some point, reduce BPA's reserves to the point that a Treasury repayment could not be made in full. The events of the 2001 West Coast energy crisis are a recent and harsh example of how quickly BPA can exhaust several hundred million dollars of reserves in a matter of months. If such a scenario were to recur, we wonder whether BPA would receive "credit" from the Administration for the advance amortization payments it had made in the preceding years?

Appendix

Methodology

Rate impacts:

Bonneville forecasts average annual secondary revenues of $645 million for FY 2007-09 in their budget proposal. Under the Administration's budget proposal an average of $145 million a year would be used to pay down debt. In order for Bonneville to maintain its probability of Treasury payment it would have to replace these revenues from rates. This would take $145 million dollars out of the Pacific Northwest economy.

Average Bonneville rate increase equals increase in revenue collected divided by the megawatt-hour sales.

= $145,000,000 / 72,278,760 MWh = $2.01 per MWh (6.6% increase)

Public utility residential monthly bill increase equals the rate increase ($/MWhr) times the annual electricity consumption of a household (MWhr) divided by 12 months.

= $2.01 x 13 / 12 = $2.18 per month ($26.13 per year)

An increase in BPA's cost of power could also cause a corresponding increase in the cost of power to residential and small farm customers of investor-owned utilities through the residential exchange program.

Effects on Regional Economy:

Estimates are based on an extension of the regional impact analysis done for the Lower Snake River Juvenile Migration Feasibility Report/EIS. In that analysis, a net increase in power costs of $308.38 million a year was estimated, using an input/output analysis to cause a decrease in regional personal income of $232.07 and a decrease in jobs of 2,383. We used the ratio of personal income and job change to energy expenditures change to estimate the effects of the $145 million increase in power costs.

Personal income effects: $145 million x (-232.07 / 308.38) = - $109 million personal income

Job effects: $145 million x (-2,383 / 308.38) = - 1,120 jobs

Effects on Tax Revenues:

Federal personal taxes - including personal income tax and employment tax

We used the ratio of total income and employment tax revenues for WA, OR and ID to the total personal income for the 3 states in 2003, times the change in personal income estimated due to charging market prices.

= - \$ 109 million x (58,061,063 / 341,448,219) = - \$ 18.5 million

State personal taxes - including income tax, sales tax, gross receipts tax

We used similar methods as for federal personal taxes, above.

= - \$ 109 million x (15,812,770 / 341,448,219) = - \$ 5.1 million