Northwest Power and Conservation Council

February 20, 2007

Staff Analysis:

Proposed Application of BPA's Secondary Revenues for Advance Federal Debt Payments As Proposed in the President's FY 2008 Budget

The staff of the Northwest Power and Conservation Council prepared the following analysis of the Administration's FY 2008 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 when 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.

Description of the Proposal

BPA's FY 2008 budget estimates net secondary revenues of $630 million in FY 2008, $628 million in FY 2009 and $630 million in FY 2010. This would result in an advance payment for debt amortization in FY 2008 of $130 million, which would reduce BPA's probability of Treasury repayment and result in a rate increase for BPA's customers. Because the proposal likely would not be implemented until FY 2008, it is possible that Bonneville's preference customers would not feel the impact of an advance amortization payment made at the end of FY 2008 until FY 2009. (At this point in time, the Council understands that BPA has not made a decision when a rate increase would be implemented.)

The Administration argues that the proposal is a sound business practice that will help BPA better manage its access to capital for its construction programs. Through the use of this proposal, and combined with its ongoing *debt optimization* program, the budget estimates that BPA will be able to make advance amortization payments of $906 million to the Treasury by 2012. These two tools, combined with continued access to third-party financing (unlike last year's budget, the FY 2008 budget encourages BPA to use third-party financing), will allow BPA to remain beneath its federal Treasury borrowing cap of $4.45 billion for an additional four years, or until 2016.

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Effects on Electricity Rates and other Economic Impacts

The following is our analysis of the economic impacts of a projected rate increase: [1]

Change in Average Annual Regional Electricity Costs for FY 2008-10

- $130 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 Consumers' Monthly Bills

- $2.17 increase in the monthly electricity bill for a customer of a consumer-owned utility
- Increased annual cost to consumer: $26.00
- Approximate rate increase caused by proposal: 7.0 percent

Effect on the Regional Economy

- $128 million decrease in regional personal income
- 1,800 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

- $22.0 million decrease in federal personal income tax revenues
- Additional loss in federal revenues corporate profits taxes
- $6.0 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 drawbacks that this proposal represents to the Pacific Northwest. The following issues were raised by the Council a year ago and are still deemed to be important to the region.

First, 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 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.

[1] See appendix for notes on methodology of calculations

Second, the proposal also appears to ignore the fact that BPA has used its debt optimization program over the last six years to voluntarily retire $1.675 billion of its federal debt. While BPA's motive for initiating this program was to improve its access to capital by replenishing its federal Treasury borrowing authority, the Federal Government has benefited from these advance amortizations, as well. To require BPA to make advance debt payments without consideration of any other relevant factors appears to be an oddly punitive response to a program that has reaped benefits for the Treasury.

Third, the proposal is counterproductive to BPA's efforts to reassure its customers of its long-term intentions as it continues working on its Record of Decision pertaining to the *Regional Dialogue.* The Council, along with regional utilities, public purpose entities and others, has been urging BPA to make several difficult long-term decisions that will affect the way BPA markets power in the future. This has been a long and laborious process for the region, and the Administration's proposal on mandatory advance amortization continues to inject distrust and uncertainty into the discussion at a critical time. The Administration should be more interested in the long-term financial stability that can result from a Record of Decision that sanctions long-term contracts and requires individual utilities to be responsible for their own load growth, instead of demanding mandatory debt payments that alarm BPA's customer base.

Finally, we are concerned that the 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 2001 West Coast energy crisis provides a 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, the region would be wise to demand consideration from Treasury for the advance amortization payments made in preceding years.

APPENDIX

Estimation Methods

Rate impacts:

The Administration's budget proposal includes a provision that any BPA secondary revenues in excess of $500 million would go to pay down BPA debt. The proposal estimates that these early debt payments would amount to $130 million a year over the next several years. This would take $130 million a year out of the Pacific Northwest economy because BPA would have to recover this additional money from its customers in order to maintain the target level of repayment probability.

There are two simple ways to estimate the impact on BPA's power rates of recovering an additional $130 million in revenues. One is a simple rule of thumb used by BPA that $59 million in increased revenues equates to a $1 per megawatt-hour increase in rates.

Using this rule of thumb, the rate increase necessary to increase revenues by $130 million would be $2.20 per megawatt-hour ($130/$59 = $2.20).

A second approach would be to divide the additional $130 million by the total megawatt-hours of BPA sales. We assumed that BPA would sell about 8,000 average megawatts of energy per year, or 70.1 million megawatt-hours. The average BPA rate increase equals the increase in revenue divided by the megawatt-hour sales:

= $130,000,000 / 70,080,000 MWh = $1.86 per MWh

For further analysis we assumed that the rate impact would be $2.00 per megawatt-hour.

Consumer Electric Bill Increases:

To estimate the monthly bill increase for a residential customer of a BPA-served public utility that would result from a $2.00 per megawatt-hour rate increase, we multiplied the typical residential annual consumption in megawatt-hours by the $2.00 rate increase and then divided by 12 to get an average monthly bill increase.

= $2.00 * 13 / 12 = $2.17 per month ($26.00 per year)

Residential and small farm customers of investor-owned utilities in the Northwest could also experience a rate increase through the residential exchange program, but we have not tried to estimate that effect.

Effects on the Regional Economy:

Removal of $130 million from the regional economy will have an effect on income and jobs in the Pacific Northwest. A quick way to estimate the impact was to extend the results of a regional impact analysis done by Joel Hamilton and Henry Robison for the evaluation of the impacts of providing financial benefits to aluminum companies.[2] In this study, using an input-output model for the Pacific Northwest region, including Oregon, Washington, Idaho and the western portion of Montana, they found the value-added losses from a $150 million BPA rate increase to be $182 million. Using the estimated $130 million revenue increase from the Administration's budget proposal, we estimate the impact on regional value-added (or gross state product) to be about $158 million ($182/$150*$130 = $158).

To convert the $158 million reduction in gross state product into lost personal income we simply used the ratio of regional personal income to gross state product, which was .81, to estimate personal income loss of $128 million (.81 * $158 = $128).

Another finding of the Hamilton and Robison study was that for every $1 increase in BPA's Priority Firm rates there can be 900 jobs lost. Based on that finding, the estimated $2.00 per megawatt-hour increase from the Administration's budget proposal could cost the region 1,800 jobs ($2 * 900 = 1,800 jobs).

Effects on Tax Revenues:

Federal Personal Taxes - including personal income tax and employment tax

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

= - $ 128 million * (58,061,063 / 341,448,219) = - $ 21.8 million

State Personal Taxes - including income tax, sales tax, gross receipts tax

We used a similar method as for federal personal taxes, above.

= - $ 128 million * (15,812,770 / 341,448,219) = - $ 5.9 million

[2] " Economic Impacts from Rate Increases to non-DSI Federal Power Customers Resulting from Concessional Rates to the DSIs," Joel Hamilton and Henry Robison. Submitted to the Public Power Council, May 31, 2006.