



# Power Net Revenue Improvement Sounding Board

## Net Interest Expense

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# The Drivers of Power Interest Expense

Controllable

Not Controllable



① New capital programs  $\pm$

② Additional federal payment using Debt Optimization proceeds –

④ Capital programs in progress  $\pm$

⑧ Direct-funded COE/BOR plant into service  $\pm$

③ Terms and conditions  $\pm$  (maturity & call provisions)

⑤ Earnings rate on the BPA fund  $\pm$

⑨ Delayed Columbia River Fish Mitigation (CRFM) investment schedule –

⑥ Reserves  $\pm$

⑩ Interest rates  $\pm$

⑦ Issuance date  $\pm$

**Note:** ‘+’ equals upward pressure on net interest expense, ‘-’ equals downward pressure on net interest expense.



# Power Net Interest Expense Cross Walk FY04

PBL FY04 Aug 28th Workshop vs. FY 04 First Quarter Review	August 28th Base	1st Quarter Review	Delta	Major Drivers	
	FY 2004	FY 2004	FY 2004		
1 INTEREST EXPENSE:					
2 INTEREST ON FEDERAL INVESTMENT-					
3 ON APPROPRIATED FUNDS	234,187	214,299	(19,888)	The revised forecast for interest on appropriated funds is due in part to the delay in the service date for a large CRFM project that was originally scheduled to be in service in 2003.	⑨
4 ON LONG-TERM DEBT	59,388	46,301	(13,087)	The revised forecast reflects FY 03 and FY 04 actual short-term borrowing at lower interest rates than expected.	② ③ ⑦ ⑩
5 INTEREST CREDIT ON CASH RESERVES	(21,990)	(19,820)	2,170	The revised forecast for interest credit is based on FY 2004 actuals (three months of actuals). The calculation also reflects a reduced earnings rate on the BPA fund, based on lower weighted average interest costs on outstanding bonds.	⑤ ⑥
6 AMORTIZATION OF CAPITALIZED BOND PREMIUMS	613	615	2	N/A	
7 CAPITALIZATION ADJUSTMENT	(47,836)	(47,836)	0	N/A	
8 ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION	(6,578)	(11,500)	(4,922)	Transfers of plant into service for direct funded Corp and Bureau investments are not occurring as fast as originally forecasted, which results in increased AFUDC estimates and reduced interest expense from plan.	⑧
9 NET INTEREST EXPENSE	217,784	182,059	(35,725)		



# Power Net Interest Expense FY05 Potential Improvements

- Based on our knowledge of FY05, we expect net interest expense in FY05 to decrease by about \$30 million (from \$235.1 million) due to:
  - A revised forecast of interest on appropriated funds that incorporates a delay in the service date for a large CRFM project that was originally scheduled to be in service in 2003, as well as an updated CRFM investment schedule for FY04 and FY05.
  - A revised borrowing and amortization schedule that reflects actual FY03 borrowings at lower interest rates.



# Power Net Interest Expense

# Appendix



# The Net Interest Expense Formula

$$\begin{aligned} &+ \text{Interest on Appropriated Funds} \\ &\quad + \text{Interest on Long-Term Debt} \\ &\quad\quad (\text{includes expensed bond premiums}) \\ &- \text{Interest Credit on Cash Reserves} \\ &+ \text{Amortization of Capitalized Bond Premiums} \\ &\quad - \text{Capitalization Adjustment} \\ &\quad\quad - \text{AFUDC} \end{aligned}$$

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Net Interest Expense



# Components of Power Net Interest Expense

**Interest on Appropriated Funds** - Interest on Appropriated Funds includes interest on Corps of Engineers (COE) and Bureau of Reclamation (BOR) appropriations as determined in the generation repayment studies.

**Interest on Long-Term Debt** - Includes interest on the bonds that BPA issues to the U.S. Treasury to fund investments in capital equipment, conservation, fish and wildlife, and to fund COE/BOR investments under the Energy Policy Act of 1992, and any call premium expense incurred when a bond issued to the Treasury is repaid through an early call. A call premium requires a cash outlay.

**Interest Credit on Cash Reserves** - An interest income credit is computed on the average monthly cash balance in the BPA fund attributable to the Power Marketing function. It is credited against bond interest payments.



# Components of Power Net Interest Expense (continued)

**Amortization of Capitalized Bond Premiums** - When a bond issued to the Treasury is refinanced, the call premium is capitalized and included in the principal of the new bond. The capitalized call premium is then amortized annually over the term of the new bond. This is a non-cash component of interest expense.

**Capitalization Adjustment** - The BPA Refinancing Act of 1996 reduced outstanding appropriations in the generation function by \$2.142 billion. The capitalization adjustment is the annual recognition of this reduction required by our auditors. The adjustment is amortized over the remaining repayment period of the refinanced appropriations. It is included on the income statement as a non-cash, contra-expense.

**Allowance for Funds Used During Construction (AFUDC)** - AFUDC represents the cost of funds used during the construction period before plant goes into service. It is capitalized and is recovered through rates over the expected service life of the related plant once the plant is put into service through depreciation expense. AFUDC is a credit against interest costs on long-term debt.





# Drivers that can Increase or Decrease Power Projected FY05 Net Interest Expense

↓ Interest Expense	↑ Interest Expense
<p>Persistent lower than expected interest rates for bonds remaining to be issued in 2004.</p>	<p>Short-term interest rates increase in FY04/05 to more normal levels.</p>
<p>COE/BOR transfer of plant into service at a slowed rate. Results in: increased AFUDC, decrease interest expense in FY05.</p>	<p>COE/BOR transfer of plant into service at an accelerated rate. Results in: decreased AFUDC, increased interest expense in FY05.</p>
<p>The Debt Optimization proceeds applied as planned in 2004, paying off more federal obligations.</p>	
<p>Potential for Power (including Conservation) and Fish and Wildlife to spend less on capital in FY04 than budgeted.</p>	