



BPA's Third-Party Program for Acquiring and Financing Transmission Assets Without Using Treasury Borrowing Authority

BPA currently is authorized to borrow up to \$4.45 billion from the U.S. Treasury to fund its capital investment program. BPA forecasts that its available Treasury borrowing authority will be adequate until FY 2012, assuming no further actions to conserve such borrowing authority. Thus, in order to assure that BPA is able, on a long-term basis, to meet the heavy demand for continued infrastructure investment in the Federal System and to assure that the Federal System operates safely, reliably and at low cost, it is essential that BPA identify methods of obtaining the needed assets and securing reliable means of funding them. As BPA is engaged in the electric power industry and functions on many levels like an electric utility, BPA also is concerned that its acquisition of transmission assets comport to a great extent with utility financing principles of intergenerational ratepayer equity where the costs of assets are recovered over time from beneficiaries thereof.

In 2000, after Congress encouraged BPA to use non-Federal financing to meet its capital needs, BPA began looking for means to acquire needed infrastructure assets on a long-term capitalized basis under existing authorities. As a result of this effort, BPA entered into a long-term capitalized lease agreement for the then-proposed Schultz-Wautoma transmission line.

Under the Schultz-Wautoma arrangement, BPA used its broad lease and lease purchase authority to enter into a 30 plus year agreement to lease the project from Northwest Infrastructure Financing Corporation (NIFC) (the Project Owner) as and after the project is constructed. NIFC is a bankruptcy remote subsidiary of JH Management, and a special purpose entity formed by JH Management solely to undertake the acquisition and financing of the Schultz-Wautoma transmission line.

Under the arrangement, BPA leased the line from NIFC and committed to make fixed rental payments regardless of whether or not the project is completed, operating, or operable. In utility slang, BPA's lease payment commitment is a "hell or high water" payment obligation. With BPA's payment obligation in hand, NIFC pledged BPA's payments to the payment of debt service on \$120 million in bonds issued by NIFC and sold into public debt markets. The proceeds of the bond sale were used by NIFC to cover the costs of constructing the project, funding capitalized interest during construction and paying costs related to the issuance of the bonds. BPA's rental payments are the sole security for the payment of the bonds and a substantial portion of the lease payments are directed to a special trust account established by NIFC to pay debt service on the project bonds.

Under the Schultz-Wautoma transaction, BPA has an option to purchase the project (or designated portions thereof) at any time by prepaying the lease. BPA also has an option to purchase the project at the end of the lease period upon payment of a nominal purchase charge. Coincident with the entry into the lease agreement, BPA entered into an additional agreement with NIFC under which BPA undertook to act as Construction Agent to construct the project on behalf of NIFC. The project was successfully energized in 2005 and after a prudent period of operation, BPA deemed construction complete in 2007.

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With the success and experiences of the Schultz-Wautoma transaction and in light of receiving further encouragement in the President's 2008 Budget to utilize non-Federal financing, BPA explored expanding the use of the Schultz-Wautoma model for further transmission asset acquisitions, thereby further conserving BPA's limited line of credit with the Treasury. A substantial portion of BPA's transmission infrastructure program involves replacements of and improvements to existing facilities rather than the construction of new, single, large scale projects such as the Schultz-Wautoma line. Indeed, BPA may have many of these smaller scale projects in various stages of development at any one time. Since these projects are not large scale single projects like the Schultz-Wautoma line, BPA explored using a lease model that would allow BPA to acquire a relatively large number of smaller transmission assets on a systematic and programmatic basis. As a result of these efforts BPA has initiated a Master Lease Program, which extends and modifies important features of the Schultz-Wautoma arrangement.

Under a master lease, BPA enters into an umbrella agreement (master lease) with an owner/lessor, which agreement governs a series of separate commitments that BPA and the owner may enter into from time to time. Each commitment is tied to a specific transmission project that the owner will lease to BPA. The separate commitments (one for each project) commit BPA to making rental payments to the owner. As with the Schultz-Wautoma transaction, BPA's rental payments are fixed and BPA's payment obligation is hell or high water, payable by BPA regardless of whether the related assets are operable or operating. Under a master lease, BPA also obtains full rights from the third-party owner to operate, manage and control the related assets until the leased projects are retired or acquired outright by BPA. To obtain funding for the projects, the owner pledges BPA's rental payments for the various assets as security for advances from a bank under a line of credit between the bank and the owner. As BPA and the owner enter each commitment, the owner draws against the bank line of credit to fund the purchase and or construction of the asset. As with the Schultz transaction, in addition to committing to lease the assets under the master lease and related individual rental payment commitments, BPA concurrently agrees under a separate contract with the owner to act as construction agent to build and install the related assets for the owner.

The initial terms for the lease commitments are relatively short term—about seven years. Eventually, once there are a substantial number of short-term commitments in place and construction concludes, BPA expects to renegotiate with the owner to extend the lease periods to reflect the remaining useful lives of the related assets. With these new terms and BPA's long-term commitment to make rental payments for the assets, the owner will issue long-term taxable debt and use the bond proceeds to pay off the draws made by the owner against the bank's line of credit.

Under the master lease, BPA has the option to acquire any or all related assets at any time during the term of the lease by making a purchase payment pursuant to a formula that would enable the owner to pay off related debt in full. BPA also has the option to pay a nominal purchase fee at the end of the lease and acquire any or all of the leased assets outright.

On June 12, 2007, Northwest Infrastructure Financing Corporation II (NIFC II) (a bankruptcy remote special purpose entity formed by JH Management) and BPA established the initial master lease, under which BPA agreed to lease four small, to-be-constructed transmission assets. At the same time, NIFC II entered into a \$90

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million one-year line of credit with Citibank. With the four lease commitments by BPA in hand, NIFC II drew \$5.4 million against the bank line of credit to pay for installation and construction of the projects (including cost of issuance and other expenses detailed below). BPA expects that NIFC II will utilize most if not all of the remaining capacity under line of credit during the next year on other transmission lease projects, at which point, NIFC II is expected to open one or more additional lines of credit on a rolling basis for future years' projects. The master lease with NIFC II does not in any way limit BPA from engaging with other possible project owners, nor do the master lease or the documents for the bank line of credit in any way limit NIFC II from engaging with other banks in the future.

The projects funded under the first draw consist of disconnect switches located in Oregon and steel transmission towers, circuit switchers, and relay house and circuit breakers located in Washington State, totaling \$4.3 million. The total BPA commitment was \$5.4 million, \$1.1 million greater than the anticipated construction costs. The \$1.1 million consists of costs of issuance and capitalized interest. Many of the costs of issuance are related to the start-up costs for the entire program and are non-recurring.

The short-term interest rate associated with the debt NIFC II incurred for these first four projects is 6.21% (approximately 0.60% higher than the Agency borrowing rate from the U.S Treasury for a 7-year bond). The rates on future short-term advances and eventual long-term take-out financings will reflect then-current market interest rates. BPA's payment obligations are effectively "triple net lease obligations" and require that BPA cover -- separate and apart from the lease payments -- the costs of any property or similar tax liability that the owner may have with respect to the projects. Thus, BPA lease payments are not an "all-in" cost of the related project.

The exact extent of potential property tax liability is uncertain at this time. The costs of the master lease program will also include BPA's internal administrative costs. BPA is establishing new accounting, asset tracking and inventory systems and processes to accommodate the master lease program and some additional administrative personnel will be required to implement the program. Thus, the administrative costs of the master lease program are expected to be somewhat greater than those incurred when BPA builds its own facilities using Treasury borrowing authority.

BPA estimates that its need for third-party financing and acquisition of transmission assets will exceed \$1 billion through FY 2018. BPA currently plans to enter into additional commitments in FY 2007 for an additional \$5-20million. BPA expects that on an ongoing basis, the master lease program will enable BPA to obtain the use of over \$100 million in transmission assets annually without using Treasury borrowing authority, although the exact amount will be dependent upon a wide variety of factors including construction schedules and project types.

The projects for which BPA will make master lease commitments will be subject to the identical capital program review that BPA uses for its own transmission assets. Similarly, all of the environmental review processes that attend BPA's transmission will apply to assets that BPA obtains under the master lease program. As with the Schultz Wautoma line, BPA's commitments under the master lease program will not be booked "off balance sheet," rather they will be identified on FCRPS balance sheets as "Non-Federal Debt." BPA's rental



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payment obligations are not general obligations of the U.S. Government, nor are they secured by the full faith and credit of the U.S. Government.

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