Leverage Policy

1. Background and Purpose

The Leverage Policy (Policy) establishes a policy framework to guide BPA in managing its leverage position, using the metric of the debt-to-asset ratio. This common business metric compares BPA's total debt against its revenue-producing assets that ultimately will repay its total debt. This Policy supports the debt utilization Financial Health Objectives identified in BPA's 2018-2023 Strategic Plan ("Strategic Plan") and Financial Plan 2018 ("Financial Plan").

BPA's debt-to-asset ratio significantly impacts its overall financial health. A high ratio increases BPA's future fixed costs (interest expense) which will either increase rates or require BPA to reduce costs in other areas of the business to maintain the same level of total costs despite a rise in fixed costs. Further, a high ratio may negatively impact BPA's credit ratings, which can result in higher interest rates. A high ratio may also indicate BPA has less available borrowing authority to fund its future capital investments. Broadly, a high ratio hampers BPA's ability to respond to times of financial stress and increased uncertainty by limiting its financial flexibility.

BPA currently has a high debt-to-asset ratio relative to similarly-situated utilities. At the end of fiscal year 2017, BPA's ratio was approximately 90 percent, compared to an industry average of 54 percent. By individual business line, Power Services' debt-to-asset ratio was 99 percent and Transmission Services' was 80 percent. Power Service's ratio is projected to decline to approximately 82 percent over the next decade primarily because it is expected to repay as much or more debt than it borrows each year. Transmission Services, on the other hand, is projected to borrow as much as $3.5 billion more debt than it will repay over the same timeframe, resulting in its debt-to-asset ratio growing to nearly 90 percent.

Prior to this Policy, BPA had no specific guidance setting leverage targets or directing certain actions be taken to achieve leverage-related financial objectives. Any actions to manage its leverage position would have been the result of indirect or *ad hoc* decision-making. Due to this lack of guidance—and BPA's historical heavy reliance on debt and method for planning debt repayment—BPA's debt-to-asset ratio has been high historically. This Policy provides crucial near-term and long-term guidance on the actions BPA can take to maintain its financial strength.

2. Scope

The Policy affects the leverage condition of the agency and each individual business line by establishing target ranges for leverage and providing guidance on actions BPA will take to achieve these targets.

The Policy is intended to provide a consistent framework within which BPA can manage its leverage position. To that end, the Policy will constitute precedent that BPA will adhere to in future rate cases absent a determination by the Administrator that the Policy must be modified to meet BPA's changing operating environment.

3. Targets

The Policy sets near-, mid-, and long-term targets.

3.1. Near-term: BPA will not allow an agency or individual business line debt-to-asset ratio to increase from rate-period to rate-period.

3.2. Mid-term: BPA as an agency and each individual business line will achieve a debt-to-asset ratio between 75-85% by 2028.

3.3. Long-term: BPA aspires to achieve agency and business line debt-to-asset ratios of 60-70%.

4. Implementation

4.1. The Policy will be implemented each rate period. BPA will monitor and annually report out its progress toward meeting the Policy's targets.

4.2. BPA will calculate the debt-to-asset ratios existing at the end of the preceding rate period for each business line ("base ratios"). BPA will compare the base ratios to forecast ratios to ensure that the ratios, at a minimum, are not forecast to increase by the end of the upcoming rate period.

4.3. BPA will take action(s) to reduce any agency and individual business line debt-to-asset ratio that is forecast to be higher at the end of the upcoming rate period than its base ratio. These actions may include, but are not limited to, one or more of the following:

4.3.1. reducing planned capital spending,

4.3.2. discontinuing regulatory treatment of certain investments,

4.3.3. additional debt repayment, and

4.3.4. revenue-financing capital investments.

4.4. Actions related to reducing planned capital spending and changes to regulatory treatment of certain investments will be addressed through Bonneville's capital review process, such as the Integrated Program Review or its successor.

4.5. Actions related to additional debt repayment above the minimum levels established by the repayment methodology and revenue-financing capital investments will be addressed in the applicable Power and Transmission rate proceeding.

4.6. BPA also plans to take additional action if it is necessary in order to achieve the mid- and long-term targets. These actions will be determined on a rate case by rate case basis.

5. Phase-in Provision for Transmission

Due to the potentially significant impacts of this Policy on Transmission's rates, BPA will implement a phase-in during BP-20 allowing an exception to the Leverage Policy's requirement to hold Transmission's debt-to-asset ratio flat (§3.1). The phase-in will allow Transmission's debt-to-asset ratio to rise from the end of BP-18 to the end of BP-20, but will require the ratio to drop back below the end of BP-18 ratio by the end of the next rate period, BP-22.

6. Calculations

6.1. BPA will calculate debt-to-asset ratios using the following formula:

(Federal debt + Nonfederal debt)/(Net Utility Plant + Nonfederal generation)

6.2. BPA will use audited financial statements to calculate base ratios for the agency and each business line.

6.3. BPA will use revenue requirements to calculate forecast ratios for the agency and each business line. When calculating forecast ratios, BPA will use its forecast of capital spending and investment as a proxy for new Plant in Service (an input into the Net Utility Plant component of the above debt-to-asset ratio formula). This is because actuals include Construction Work in Progress (CWIP) in the Net Utility Plant calculation. If BPA used a forecast of when plant goes into service in the future, it would double count investments that are currently in CWIP.