Long-term Financing and Out-Valley Project

Prepared by the Energy Finance Committee

This paper outlines possible strategies for completing the long-term financing for In-Valley due by May 2013 and financing for Out-Valley along with the process for deciding whether and when to construct the Out-Valley project.

Overview of Long-term financing

KMPUD might complete long-term financing either through the USDA Rural Utilities Service program (RUS - www.usda.gov/rus/electric) or the municipal bond market. There is a substantial difference on the electricity and propane rates. For **illustration purposes only**, we assume the following simplified comparison if the transaction were done at today's rates:

RUS financing – 3.145% (FFB 30 year rate plus 0.125%)
- see www.usda.gov/rus/electric/rates.shtml
Rated bond – 6% (per underwriters guidance)
Unrated bond – 7.5% (per underwriters guidance)
Taxable portions – 150 basis points higher (per underwriters guidance)
Total debt not to exceed $52M ($22M existing plus $30M for Out-Valley)
Debt not financed by RUS - $3.5M muni at 7.5%
Amortizing debt over 30 years for muni and 35 years for RUS

This translates into annual total debt service of

RUS at 3.145% + non RUS @7.5%	$2,601,000
Rated Bond at 6%	$3,817,000
Unrated Bond at 7.5%	$4,444,000

The actual debt service for RUS would be slightly more expensive because of the RUS loan would actually be multiple durations based on the "remaining useful life" of the assets. 35-year term applies to the transmission line and buildings but certain equipment may have a shorter lifetime.

Estimating the Impact on Electricity Rates

We assume that propane rates will pay $140,000 per year for its debt service and existing revenues from property taxes will cover $275,000/year. For each debt structure below, we first subtract $415,000 from the annual debt service and then divide by KWH/year. We then add estimated wholesale electricity and transmission costs of 12 cents/kwh and operations costs 6 cents/kwh:

Debt Structure	Assuming 6.8M KWH/year	Assuming 10M KWH/year
RUS	$.50	$.40
Rated Bond	$.68	$.52
Unrated Bond	$.77	$.58

The difference between the two columns is the amount of electricity sold. Since the debt is fixed and independent of power consumed, our 2012 assumption is annual sales of 6.8M KWH. At full valley build-out, we assume that consumption grows to 10M KWH.

Note that the rates above are sufficient to collect 100% of the debt service but underwriters have consistently told us that for muni bonds, we need rates sufficient to collect 120% of debt service (some have said we need 150%). Over time, the additional 20% that is collected can be refunded but in the first few years, it will raise rates in the muni bond cases by an additional 2 cents. We have not yet analyized the impact of maintaining margins sufficient to meet the RUS coverage ratios (TIER, OTIER, DSC, and ODSC) and would expect this to be an additional cost reflected in the rates.

In-valley costs are currently about $.50/kwh based on a diesel price of $3.21/gallon. Each dollar increase in the price per gallon of diesel adds $.08 to a kwh of electricity. Thus a "rated bond" price of $.68/kwh for Out-valley is equivalent to 2011 prices if diesel were $5.50/gallon. However, once we refinance the BAN, In-valley prices would also change to reflect the revised borrowing costs.

At some price, the cost of power is so high as to make operating the ski resort and living in Kirkwood not practical. We need to decide the upper limit of power prices we think the community can manage in the short term. Assuming growth, prices will decline over time (ignoring inflation and fluctuations in the costs of grid power).

For example, building the Out-Valley project and paying for it with un-rated bonds is probably an unaffordable decision. In fact, even using a rated bond for Out-Valley may be beyond what is affordable until demand is closer to 10M KWH or diesel approaches $5.70/gallon. (If someone can predict when that will happen, it would be useful to know!)

Please note that this simplified analysis does not yet include the cost of our legal obligation to comply with the California 33% Renewable Portfolio Standard. We currently have no estimate for the costs to purchase or generate renewable power.

Our current understanding of RUS financing is that we qualify as a candidate (small rural service with high costs for power) and that it is very likely that RUS will approve of our environmental impact statement upon completion of the Forest Service process and issuance of its finding, and our financing proposal overall. Since

there is no guarantee (e.g. Congress could take some unanticipated action) that we will be approved for financing, we want to proceed as if RUS financing will happen but be prepared with a fallback plan. While we were initially told that RUS was unlikely to finance all of In-Valley, recent conversations lead us to be somewhat optimistic that they would consider funding a significant portion of our entire debt, excluding propane facilities, as well as prior KMPUD long-term debt that was refinanced with the BAN.

Out-Valley Financing

RUS makes Out-Valley the most cost effective. The first step is to know if and when RUS financing would be guaranteed. The RUS decision timeframe is approximately

- KMPUD completes application to RUS by Feb 2012 (assumes completed EIR/EIS by January 2012)
- Approval (or denial) from RUS by Aug 2012
- Completed loan agreement by Feb 2013

Those dates might be accelerated or extended, depending upon the extent of RUS loan authority relative to the amount included in loan applications it would receive prior to the submission of KMPUD's loan application. We should be prepared in the event that things move faster but for initial planning purposes the dates are consistent with prior RUS experience from our consultant. Once we have RUS approval, there are several financial institutions that would provide construction financing prior to completion of a loan agreement with RUS.

Out-Valley Choices

Given the RUS timeline, the KMPUD Board should consider the following four choices:

1. BAN in Q1 2012 to finance construction in 2012/2013 replaced by RUS or Muni Bond.

   Under this plan, we prioritize construction over knowing firm financing costs. We start construction at the earliest date in 2012 and complete in 2013. KMPUD would issue a BAN to raise funds. Bond buyers would assess the risk of the BAN repayment assuming the worst case of an unrated bond since there would be no assurance of RUS financing. There is some chance that the BAN would not be possible or would be at very high interest rates.

2. Construction in 2013/2014 through RUS.

   Under this plan we do not start construction until the RUS loan is secured. Some short-term bank borrowing would be possible after approval and those funds could be used to bridge any timing issues if the completed loan

agreement took a few months longer. This plan has the advantage of knowing our long-term rates and eliminating all financial risks before incurring new debt. It does mean, however, that Out-Valley is completed a year later.

3. Construction in 2012/2013/2014 through construction loan replaced by RUS

   Assuming that a construction start in August 2012 provides some benefit (either by increasing the likelihood of completion in 2014 or maybe giving us a shot at finishing in 2013, KMPUD could do construction financing based on the approved RUS loan but prior to completion of loan agreement. This makes the most sense if construction could be completed by 2013. To explore this option, KMPUD should ask for construction bids based on funds being available beginning in August 2012.

4. Delay construction decision for up to five years

   The EIR/EIS allows KMPUD up to five years to start construction. A decision to delay would allow time to see if demand for power increases and more time to build an operating history. Delay could bring higher construction costs as economy improves and the cost of raw materials rises. It also exposes the Kirkwood community to the fluctuations in the price of diesel for a longer period of time.

In-Valley Long-term Financing

Since KMPUD has already incurred $22.3M in debt related to electricity and propane, the only costs under our control to reduce the price of power for In-valley are the long-term debt costs and the operating costs related to labor. Long-term financing must be secured no later than May 2013 and the current BAN can be called any time after June 2012. The cheapest cost of capital would be to replace the majority of the BAN with RUS financing and until that has been ruled out, we should do nothing to prevent that outcome. We would still need to re-finance the debt not related to electricity service (currently estimated at $3.5M) through a muni bond. Given the relative small amount of this loan, we could secure it through a pledge of existing property taxes already allocated to utility services (approximately $275,000).

The next lowest cost of financing would be a rated bond. This can only be achieved if we put a structure in place to use property taxes as a backup pledge to revenue pledges and reserve funds. There are three different structures that can be used for a back-up property tax. We need to decide which one is best for the Kirkwood community. “Best” is defined to mean that it has the maximum potential to reduce the cost of power for the community and fairly distributes the costs among utility customers. Once the structure has been selected, an election must be held to approve the tax structure. The election is determined either by registered voters or one vote per property (depending on the tax structure).

The tax structure needs to be completed at least two months before we start the rating process. Once the rating process is successfully completed, a bond could be priced within one to two months. To meet the earliest financing date of June 1, 2012, we would need to complete the election in February 2012.

During the BAN period, KMPUD is building up a reserve fund that will be necessary to secure any financing. The current rates set aside $832,000/year towards a reserve fund. The longer we utilize the BAN, the larger we will be able to build the reserve fund; however, the shorter the BAN period may reduce our overall interest costs.

Overlap During Out-Valley Construction

Once we raise capital for Out-valley, our costs immediately increase. It is only at completion of Out-valley that we can stop paying for diesel (currently 25 cents/kwh). To prevent a significant spike in power costs, we would most likely borrow the money needed to pay the interest costs during construction. In the absence of any firm data, this has been modeled at $1.8M capitalized interest plus $28M construction costs rounded up for a total of $30M). The actual amount may be considerably higher depending on the source of funds and whether we can draw down money on demand or must take it all at once. RUS financing allows an unlimited number of draw downs – each one establishes a borrowing rate based on the then current Federal Financing Bank interest rate.