WAPA's Unobligated Balances Strategy

FY 2016 – FY 2020

Background

Western Area Power Administration's (WAPA) budgetary operations exceed $1 billion annually. More than 90% of the annual budgetary operations are financed from WAPA's offsetting collections and alternative financing arrangements with customers. Less than 10% of WAPA's annual budgetary requirements are provided by direct appropriations. In addition, WAPA also conducts a substantial work-for-others program on a cash advance or reimbursable basis.

WAPA markets power in 15 central and western states generated from Federally-owned power plants operated primarily by the U.S. Army Corps of Engineers, U.S. Bureau of Reclamation, and the Department of State's International Boundary and Water Commission. WAPA owns, operates and maintains a 17K mile integrated, high-voltage transmission system to deliver the firm electric power resource to its customers. WAPA has long term contractual obligations with customers to operate and deliver electric power every hour of the day, every day of the year. If sufficient power is not generated from the Federally-owned sources to fulfill the contractual obligations, WAPA is required to purchase power at market rates to fulfill the obligations.

To ensure programs are financially sustainable, within the context of WAPA's legislative authorities and the Federal appropriation and administrative control of funds procedures, WAPA recognizes that unobligated balances are a necessary financial resource that requires both management and oversight.

WAPA has managed its unobligated balances informally over the years. Since WAPAs inception in 1977, management of unobligated balances has included the Colorado River Basins Power Marketing Fund, a revolving fund, to ensure WAPA and generating agency operation and maintenance (O&M) and purchase power and wheeling (PPW) requirements for revolving fund projects are sustainable. In FY 2001, new legislation provided WAPA use of receipt authority to better manage the variability in the Construction, Operation and Maintenance (CROM) account Purchase Power and Wheeling (PPW) program. Additionally, new legislation was enacted for FY10 to finance CROM annual O&M expenses from receipts as well. With the changes in legislation, the CROM annual O&M and PPW expenses have many of the same cash management requirements as the revolving fund program balances. To further complicate financial sustainability, WAPA and its respective generating agencies are being requested to finance much of their power-related capital programs through alternative financing methods rather than direct appropriations. Unlike Bonneville Power Administration, WAPA does not have borrowing authority for its mission related capital financing requirements within its CROM account. The alternative financing required for capital investments, the purchase power and wheeling expenses, and the annual O&M expenses all rely on WAPAs cash flow and contingency balances.

Over the past five years, WAPA's fiscal year-end (FYE) unobligated balance has ranged from $550 million in FY12 to a high of $793 million in FY15. Most recently, FY16 year-end position was $767 million.

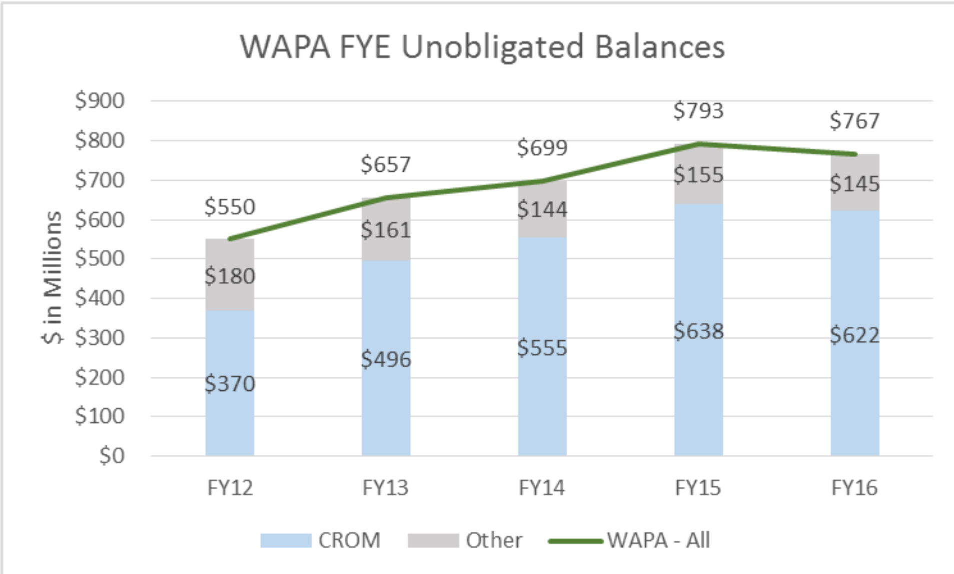

Exhibit 1

The majority of WAPA's balances are derived from offsetting collections and nonfederal cash advances. Excluding Congressional directed funding, only 1%, or $11 million of the unobligated balance at the end of FY16 was appropriated.

This document updates the WAPA strategies for unobligated balances, and provides options and recommendations to maintain alignment with the strategy objectives.

Methodology

WAPA initiated a process to identify a comprehensive WAPA-wide unobligated funding strategy that aligns with overall sustainable funding plans in support of WAPA's mission. Early on it was evident that the risks and contingency needs varied by purpose. A WAPA-wide cross-functional team was set up to address contingency requirements for the following major purpose categories:

- Annual O&M Expenses
- Capital Funding
- Purchase Power and Wheeling (PPW)
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In addition, there are a number of activities that WAPA is involved in that do not fit within the three primary purpose categories. The 'Other Resources' are Reimbursable Work-for-Others, Congressional Directed activities, Transmission Infrastructure Program, and Other Revolving Fund requirements. The level of the unobligated balances for these 'Other Resources' are independent of WAPA's unobligated strategies.

Since the initial steps to formalize a WAPA-wide strategy, significant effort has taken place to refine the categories and thresholds, and communicate our approach and progress to stakeholders including GAO and DOE IG. This current document refines the strategy further, particularly with respect to PPW. First, summaries follow illustrating the FYE15 unobligated balances, the WAPA Strategy, and the FYE16 unobligated results. Following the summaries, detail descriptions are provided for the strategy behind each purpose category.

WAPA-wide Summary by Purpose

Primary Purpose Categories

- O&M Annual Expenses (Annual)
- Capital Funding (Capital)
- Purchase Power and Wheeling (PPW)

Other Resources

- Reimbursable Work for Others
- Congressional Directed - Earmarks
- Transmission Infrastructure Program
- Other Revolving Fund

At the end of FY15, WAPA's unobligated balances were $793 million. $689 million was identified to the three specific Unobligated Strategy purposes: Annual, Capital, and PPW. In addition, WAPA had $104 million in unobligated balances supporting other activities; $49 million reimbursable work for others, $27 million Congressional directed funding, $10 million Transmission Infrastructure Program, and $18 million additional revolving fund requirements.

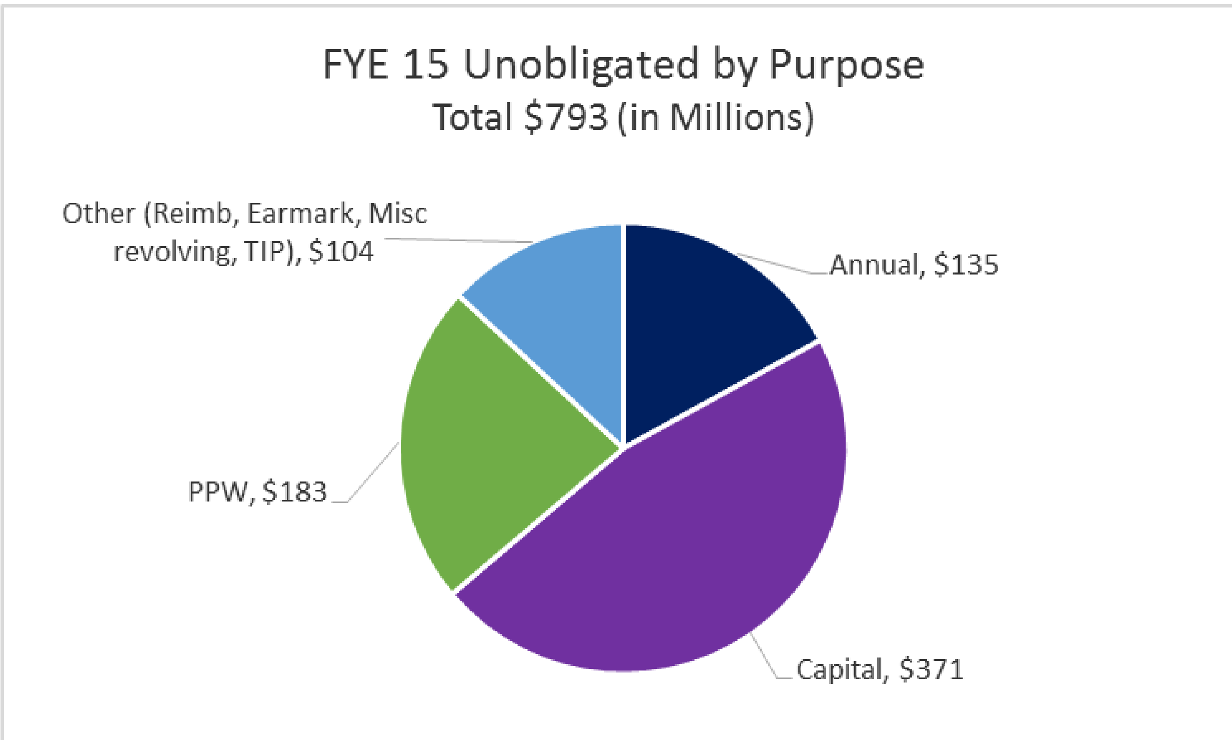

Exhibit 2

As illustrated in the following chart, WAPAs minimum unobligated strategy contingency levels total $818 million. At the beginning of FY16, WAPA's FYE 15 balances were slightly less than the minimum strategy, however the mix of balances by purpose were not optimal. By purpose, WAPA had more than sufficient contingency for Annual and Capital requirements, but needed to raise PPW unobligated balances to align with the strategy.

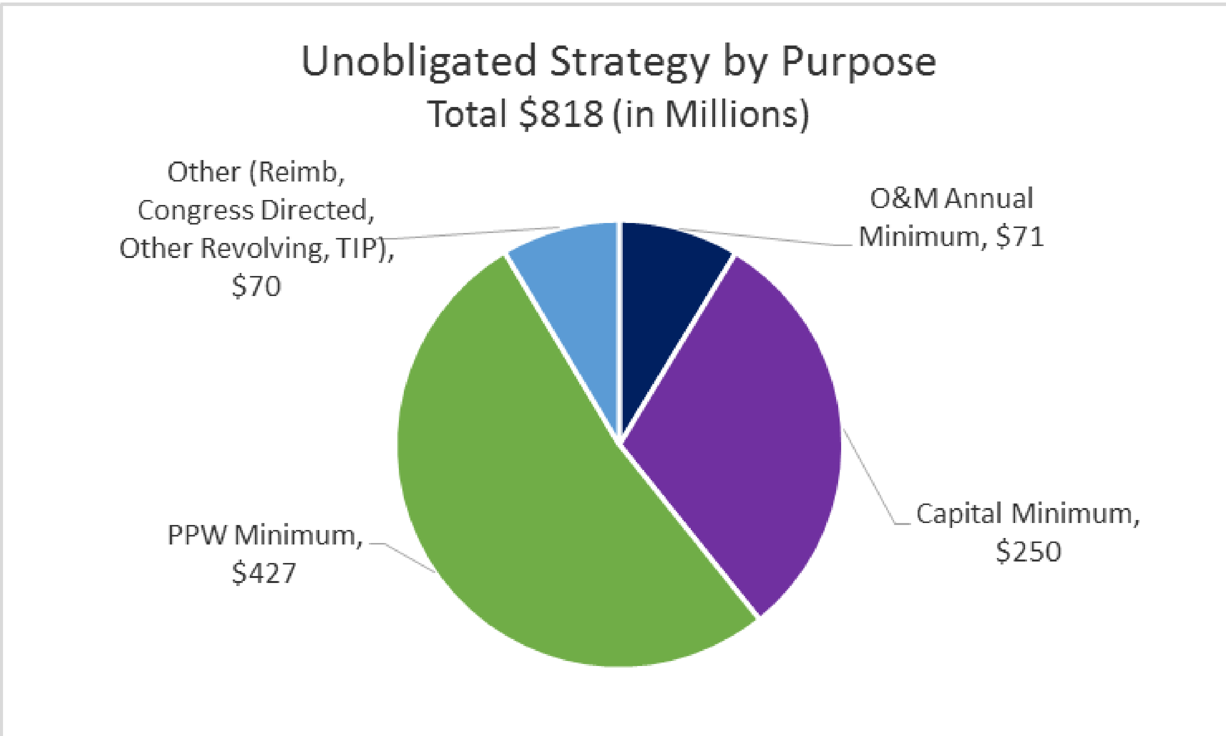

Exhibit 3

Significant progress toward the strategy can be seen in the chart below illustrating the FYE16 balances by type. While overall balances drop roughly $36 million, the mix of balances by purpose have shifted toward the strategy objectives. Unobligated balances for Capital have been reduced substantially, and now align closely with the strategy. Unobligated PPW balances have increased toward contingency level, improving alignment. While annual O&M carryover continues to exceed the minimum contingency level, WAPA, DOE, and OMB are collaborating on approaches which will reduce annual O&M carryover, aligning it more closely to the strategy level over time. 'Other' purpose has grown reflecting increase in WAPAs reimbursable work for others and identification of balances for other revolving fund requirements.

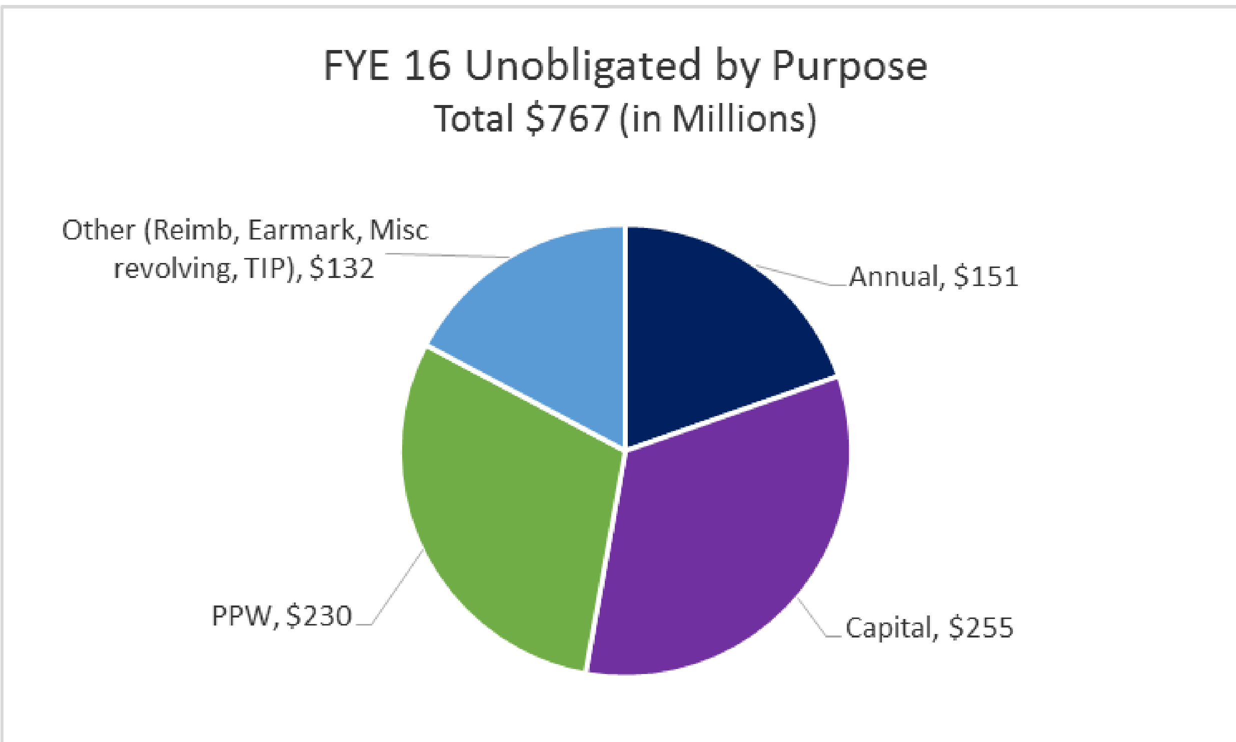

Exhibit 4

Detailed Strategy by Purpose Categories

O&M Strategy

The O&M Strategy is to retain at least one quarter's annual budget plus 21 days requirement as a contingency for the annual O&M program in the event of a Continuing Resolution (CR) and/or Government shutdown. This length of time was determined by referencing the timeframe of recent CRs, and applying the majority to WAPA's strategy. WAPA also searched historical data from 1997 – 2015 and recognized the longest lapse in Federal appropriations continued for a period of 21 days. Should a lapse of appropriations occur at the end of a CR period, WAPA would be required to reverse the Net Zero treasury warrant and replace that warrant with cash from the Reclamation Fund. Using the CR and subsequent lapse of appropriations scenario, WAPA calculated a minimum 31% required contingency rate for its annual O&M funded activities. The O&M contingent funds will be accounted for in the Net Zero balances with the exception of the revolving fund balances. Applying the aforementioned strategy, the calculated contingency threshold for FY16 into FY17 is $70.6 million WAPA-wide, made up of $54.4 million of Net Zero and $16.2 million of revolving funding.

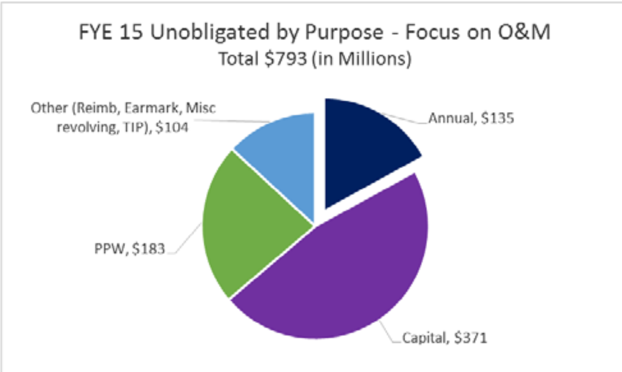

Exhibit 5

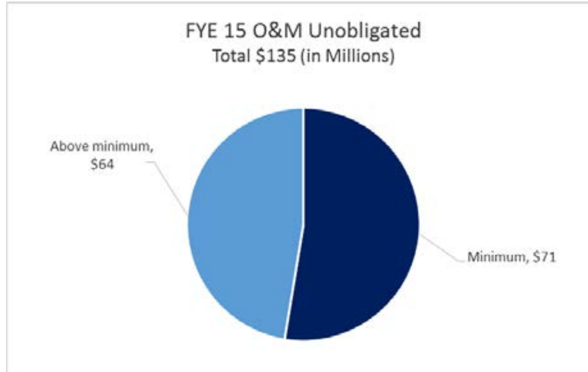

Exhibit 6

Summary: Exhibit 5 reflects that the total balance purposed for O&M funding is derived from the Net Zero balances of $119M, and the portion of the multi-purpose revolving fund targeted for O&M, about $16 million. In total, $135 million of the $793 million is purposed for O&M.

Summary: Exhibit 6, $71 million of the $135 million is the minimum carryover level to meet the 31% contingency for O&M. WAPA's current FYE15 balances meet that contingency requirement with $64 million above the minimum.

As of FYE15, WAPA had a Net Zero unobligated balance of $119 million. These funds can only be used for annual expense and, as WAPA fully budgets for actual need each year, the balance will not decrease without an authorized strategy.

As of FYE16, the Net Zero unobligated balance rose to $135 million. To manage this category at the optimal level, WAPA is seeking alternative methods in concert with the Department of Energy to decrease the Net Zero authority. WAPA is pursuing the following:

- **Transitional Strategy:** WAPA will request full program level for Net Zero, but this request will be offset by the use of prior year balances within WAPA's budget documents. In order to mitigate its risk, WAPA will decrease the amount of Net Zero above the strategic target gradually over a three year period. The use of prior year balances as an offset in the budget request will be required annually to achieve the strategic target amount without a change in our legislative authority.

- **Optimal Strategy:** a revision of the current Net Zero appropriation language to allow matching receipt authority for annual expenses only to the level required to meet program requirements for the fiscal year. The balance of authority not matched by year-end would not carry over into the new fiscal year. This is different than the current Net Zero authorities; there would be no up-front appropriation. This would require WAPA utilize a portion of the carryover contingency balances at the beginning of each fiscal year in lieu of the current use of the up-front appropriated funds. Each year, WAPA would replenish the contingency balance back to the optimal level to begin the new fiscal year. No negative warrant would be required as this fund would no longer use appropriated funds. There should be no scoring implication because net budget authority will continue to be $0. More specifically, the budget authority required for annual O&M and annual Program Direction expenses would continue to be entirely offset by the same Reclamation Fund cash collections.

Capital Strategy

WAPA's Ten Year Capital Investment Plan (TYP) illustrates the significant hydropower capital investment requirements across the 15-state service territory. The plan supporting the FY17 President's Budget, Exhibit 7, forecasts $1.5 billion in capital investments to the transmission systems over the ten-year period, or $150 million/year on average.

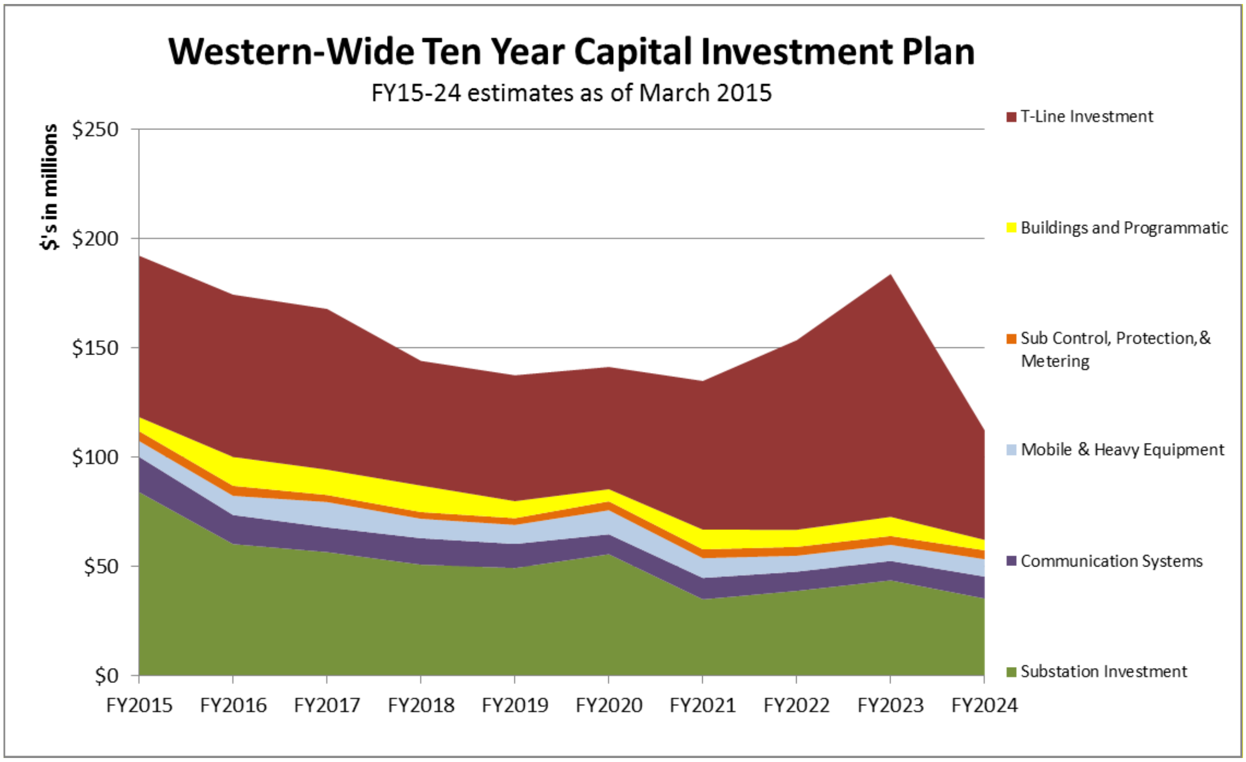

Exhibit 7

The ten-year plan includes capital O&M investments relying on appropriations, as well as investments relying on offsetting collections and alternative financing. The current strategy targets the variability in this latter group. The majority of offsetting collections and alternative financing for capital is based on WAPA's cash flow. The cash flow is highly variable due to purchase power costs; and it also fluctuates due to intensive capital reinvestments at the generating agencies.

In order to ensure WAPA's financial capability to initiate and complete necessary multi-year capital replacements and investments timely given the variable nature of the cash flow, WAPA will deploy a strategy to collect and retain nonfederal resources for as much as three years in advance of the planned capital investment.

A 3-year unobligated strategy for capital meets the minimum requirement to have resources on hand before initiating multi-year capital investments using non-Federal resources. In addition, the strategy provides for greater certainty in the extensive planning process that near-term projects have a funding resource available or under way, and recognizes the high potential for short term delay in priority projects. The strategy also recognizes that the majority of WAPA balances on hand for capital are related to projects planned, approved, and funded by nonfederal customers, but that for a number of reasons have been delayed for even longer periods. Examples are the nonfederal funds advanced for the Keystone related upgrades in Upper Great Plains Region, Estes-Flatiron transmission line rebuild in the Rocky Mountain Region, and several Desert-Southwest transmission line and substation projects. Typically, these projects have not been cancelled, but are pending action outside of WAPA's control. If the delays are significant, WAPA may return or propose shifting to other active projects subject to the advancing customer(s) approval.

For the limited appropriations WAPA receives for capital, it seeks to execute at a high level and does not expect significant unobligated balances at year-end with the exception of OMB or DOE direction to retain funding for potential lapse in appropriation. On occasion, delay in the procurement award, environmental, land or legal review processes for a particular project could lead to unobligated balances at year-end.

In summary, the unobligated balance recommended at FYE are the amounts needed to support the near-term (within three years) alternatively financed capital and construction program projects, and the revolving program capital projects. For the appropriated capital O&M replacements, retirements and additions (RRADs) activities, WAPA continues to rely on appropriations and does not recommend contingency unobligated balances at this time.

The recommended FYE unobligated balance is not static, but moves with each years update to the TYP. Based on the TYP supporting WAPA's FY17 Congressional Budget request, the recommended FYE unobligated balance is $250 million; comprised of $176 million alternative financing, and $74 million revolving fund. At the beginning of FY15, WAPA met the unobligated balance recommendation of $250 million, and had an additional $120 million in nonfederal advances.

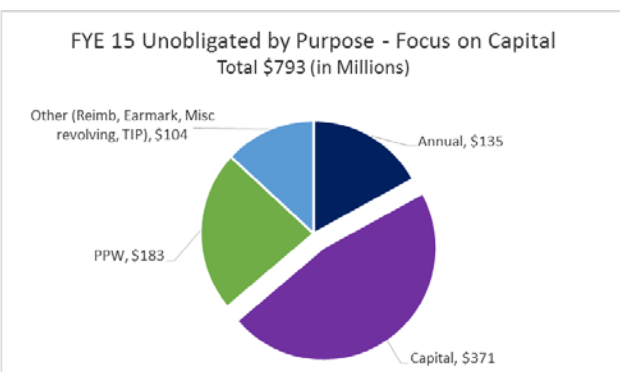

Exhibit 8

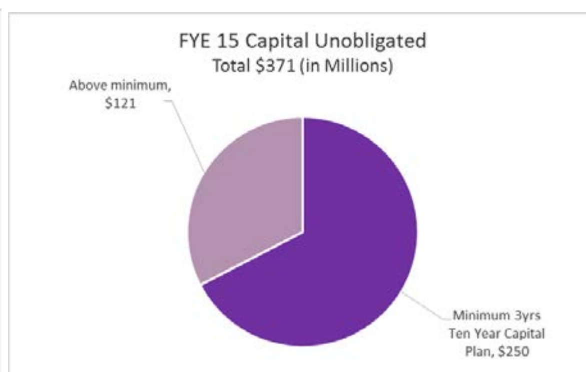

Exhibit 9

<u>Summary</u>: Exhibit 8 shows approximately 47% or $371 million of the FYE15 unobligated balances are for the Capital Program. The majority of these funds are derived from alternative financing methods; customer advance and customer prepay arrangements. Also providing capital funding for WAPA mission is a $74 million portion of the Revolving Fund unobligated balances.

<u>Summary</u>: Exhibit 9, $250 million of the $371 million is the minimum carryover level to meet the contingency strategy for Capital purposes. WAPA's current FYE15 balances meet that contingency requirement with $120 million above the minimum. The unobligated balance will be reviewed annually

by OCFO and the Regions to determine whether the balances are appropriate given fluctuations in construction activities and procurements during the year of execution.

To manage the unobligated balance in Capital funding, toward the optimal level, WAPA will execute out-year project activities where feasible; realign balances for delayed or completed projects; and/or return balances to the advancing non-Federal customer, the Reclamation Fund, or the General Fund as appropriate.

FYE16 Results - By the end of FY16, through project execution and returns to Treasury, WAPA has reduced the capital unobligated balance to $255 million, aligning very closely with the strategy.

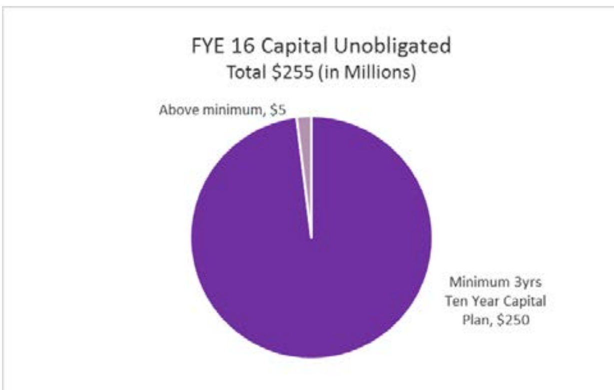

Exhibit 10

Purchase Power and Wheeling Strategy

WAPA's PPW program is highly variable and subject to a number of factors beyond WAPAs control. Exhibit 10 below illustrates the significant variation in WAPA's PPW costs over the last 10 years.

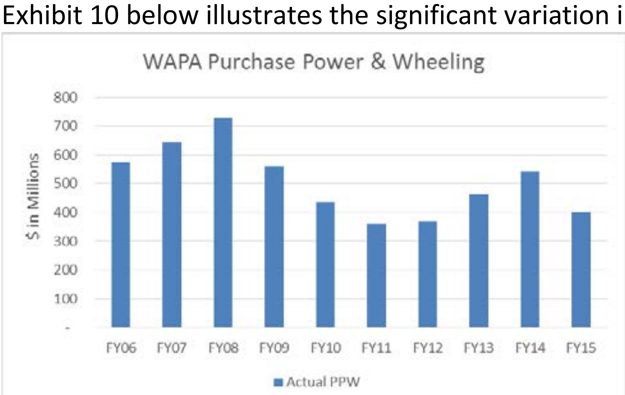

Exhibit 11

In considering a contingency strategy to support the PPW program at WAPA, it was recognized that not all of WAPA's power systems would be at risk simultaneously due to the geographic and market diversity seen in WAPA's broad 15-state footprint. As such, WAPA focused on the Power System with the highest hydro variability; the Pick-Sloan Missouri River Basin Program (Pick-Sloan Program). As a result, by addressing the Pick-Sloan PPW contingency requirement and selecting portable contingency tools that can be shared among most power systems, a smaller contingency can cover the material portion of WAPA's PPW program.

For CROM PPW, the strategy is to use unobligated Use of Receipt Authority for PPW balances which provide portable contingency capability among the CROM power systems. The unobligated contingency level is set to cover a three year shortfall caused by a drought as it could take approximately three years for WAPA to fully identify a drought in the Pick-Sloan Program, administer a public rate process to adjust the rate and implement the new rate, and to receive increased Congressional PPW funding authority. While these actions are underway, WAPA would need sufficient contingency resources to cover the additional PPW costs in the interim.

The specific CROM PPW contingency is determined based on the highest 3-year cumulative actual amount of net energy needed to meet Pick-Sloan Program's contractual energy obligations and a net energy price/MWh set at a mid-point energy price between the price of energy paid for purchasing energy during the actual drought period, and the current on-peak energy prices. An estimated offset is calculated for the amount the Pick-Sloan drought rate adder would likely recover in the first three years of the future drought. These increased drought adder collections are deducted from the recommended minimum contingency level.

Based on the above criteria, the amount of contingency funding for the Pick-Sloan Program is approximately $393 million. This amount was arrived at by using the highest 3-year cumulative amount of net energy purchased which were during the drought years 2005-2007. The price/MWh is set at a mid-point energy price between the price of energy paid for purchasing energy during the actual drought period (~$46/MWh), and the current on-peak energy prices (~$20/MWh) which is $33/MWh. This sets the initial level at $453 million, however after including $60 million of drought adder credits, the final targeted CROM PPW carry-over is $393M.

The Revolving Fund, or CRBPMF, purchase power and wheeling requirements are not mitigated by balances in the CROM account. As such, additional contingency in the Revolving Fund account is recommended at 25% of the peak annual purchase requirement seen in the most recent 10-year period; that amount is $34 million.

Combining CROM and the Revolving Fund, the recommended unobligated strategy contingency balance for PPW is $427 million; comprised of $393 million CROM and $34 million Revolving Fund.

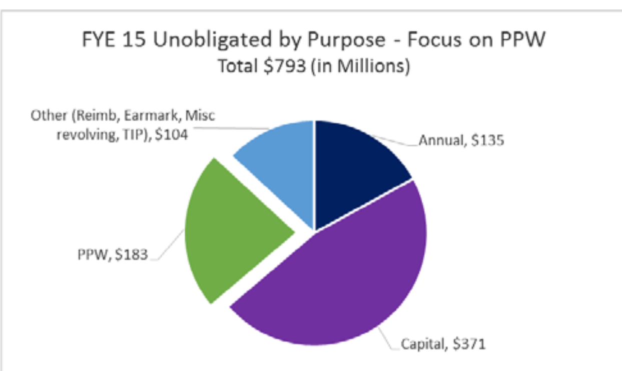

Exhibit 12

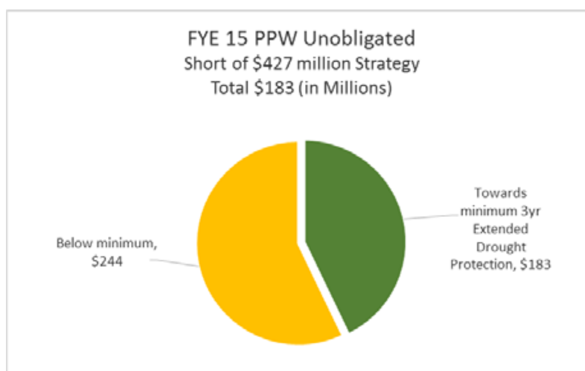

Exhibit 13

Summary: Exhibit 12 reflects PPW which makes up approximately 23% or $183 million of the FYE15 Unobligated balances. The $183 million balance is comprised of $149 million CROM account receipt authority, and $34 million Revolving Fund.

Summary: Exhibit 13, the $183 million FYE15 balance is $244 million short of the $427 million unobligated strategy contingency recommendation.

To manage the unobligated balance in PPW funding toward the optimum level, WAPA may adjust PPW balances as needed during the execution year. When both authority and receipts are sufficient, WAPA, in collaboration with its customers, will increase PPW balances toward the optimum level over a four year period.

Other Categories

Reimbursable Work for Others

The Unobligated Balance for Reimbursable work for others is required for nonfederal entities in advance of work to be performed and in all cases is reviewed and tracked by contract, customer and project at the regional level. At the end of FY16, WAPA had $61 million supporting reimbursable work-for-others. WAPA monitors the age of the reimbursable funds to identify balances that may no longer need to be retained.

Congressional Directed Activities

Unobligated balances that support Congressional directed activities as provided specifically by law will be reviewed and managed consistent with the status of the individual projects within those programs. At the end of FY16, WAPA had $24 million in balances for Congressional Directed Activities; the majority of which supports the Spectrum Relocation effort. At the final close of each specific directed activity, WAPA will return or request reprogramming as appropriate.

Transmission Infrastructure Program

WAPAs Transmission Infrastructure Program (TIP) retains unobligated balances from borrowing, non-Federal reimbursable cash advances, and from revenue collections for ongoing revolving fund operations and maintenance. These balances are reviewed and adjusted annually to ensure optimum levels to support the TIP mission needs that may fluctuate based on project development. WAPA had $12 million in balances for TIP at the end of FY16.

Other Revolving Funds

In addition to contingency for the Annual, Capital, and PPW purposes, the revolving fund is also tapped to finance the operations of the generation agencies, the non-reimbursable environmental program requirements, and legislated State program activities. WAPA ended FY16 with $35 million in balances available for other revolving fund contingencies.

Implementation & Monitoring

Consistent with WAPA’s formalized unobligated balance strategy, the WAPA OCFO will continue to refine minimum contingency requirements for its primary purposes. WAPA senior management will review and approve action plans to address changes needed to meet those requirements.

Monthly
WAPA OCFO and regional Financial Managers will consolidate unobligated balances and forecast changes to unobligated balances based on Region spend plans, cash management planning, and specific approved action plans.

Quarterly/Periodically
WAPA senior management will review unobligated balance forecasts against the unobligated strategy contingency requirements and review recommendations. WAPA senior management will approve changes to strategy or action plans as necessary.

Annually
WAPA will report final balances at the end of each Fiscal Year, and assess those against the subsequent Fiscal Year's unobligated strategies' contingency requirements by Purpose. WAPA will develop the upcoming years unobligated contingency amounts based on these strategies along with action plans to achieve the next years unobligated contingency. For 'major' proposed actions, WAPA will coordinate with DOE and OMB as necessary.