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Jeffrey Johnson, Chairman  
Guam Public Utilities Commission  
Suite 207, GCIC Building  
Hagåtña, Guam 96932

Re: GPA Petition for Contract Review: Application of the Guam Power Authority  
Requesting Approval of a Bond Issuance for Refinancing and Restructuring —PUC  
Docket GPA 12-03

Dear Chairman Johnson,

This letter report is in response to the request of the Public Utilities Commission ("PUC") for Georgetown Consulting Group, Inc. ("GCG") to review the June 14, 2012 petition of the Guam Power Authority ("GPA") to approve the Series 2012 Bonds for Refinancing and Restructuring portions of GPA's existing debt ("Series 2012 Bonds") and to approve the buyout of the Lehman Brothers Forward Delivery Agreement ("FDA") for which GPA had previously petitioned the PUC for approval on March 9, 2012. GPA is proposing the Series 2012 Bonds as a vehicle to allow it to capture projected interest cost savings and to restructure a portion of its existing debt service payments to lower its annual revenue requirements for the period FY 2013 through FY 2018. GPA asserts in their petition that the potential reduction in annual cash flow and net present value<sup>1</sup> ("NPV") savings resulting from the Series 2012 Bonds would be beneficial to consumers and is reasonable, prudent, and necessary.

Crucial in undertaking any review of GPA's proposed Series 2012 Bonds is the identification and establishment of objective evaluation criteria for debt refinancing and restructuring analysis. The Government Finance Officers Association (the "GFOA") has developed "Best

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<sup>1</sup> NPV compares the value of a dollar today to the value of that same dollar in the future, taking inflation and returns into account.

Practices” criteria<sup>2</sup> for issuers like GPA considering municipal debt refinancing. The best practices criteria consist of:

- Meeting a Minimum Savings Threshold<sup>3</sup>;
- Cash Flow Smoothing / Restructuring;
- Consolidation of Debt;
- Removal of Restrictive Covenants<sup>4</sup>; or
- Combination of the above

Principal among the objective measures used in the financial industry to determine the economic efficiency of pursuing the refinancing and restructuring of existing debt is the attainment of a minimum and acceptable level of NPV savings. A common savings threshold objective (net of all transaction costs attributable to the new bond issue), as measured as a percentage of the total principal of the new bonds, should be attained. While the GFOA recommends a threshold of 3% to 5%, GCG has historically in these types of analyses used a NPV savings threshold of 2.0%. This savings test should be applied to the entire issue. GCG also has reviewed GPA’s proposed Series 2012 Bonds from a policy perspective. Specifically, the restructuring portion of the Series 2012 Bonds is designed to smooth (i.e., normalize or level) GPA’s annual debt service in early years which will allow for significant consumer savings in the early years. This is certainly a worthy objective that, if it can be accomplished without increasing overall consumer cost on a NPV basis over the period of the refinanced bonds, should be appropriately considered by the PUC. This is particularly true given that interest rates are at historically low levels.

In undertaking this engagement we issued informal discovery and participated in several teleconferences with GPA and its financial advisors. We express our appreciation to GPA and its advisors for the quick turnaround of responses and the open cooperation we received.

## **Overall Summary**

GPA is requesting PUC authorization to refinance and restructure a portion of its Series 1993 and Series 1999 Bonds. In addition, GPA is requesting PUC approval of additional long-term debt of “up to” \$20 million for the purpose of providing it the flexibility to terminate two separate FDAs, one with Lehman Brothers and another with Bank of America (“BoA”). The FDA matter will be discussed in more detail later in this report. No action on the remaining debt of GPA, the Series 2010 A, Series B or the fixed cost related to GPA’s

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<sup>2</sup> Government Finance Officers Association Best Practices, Analyzing and Issuing Refunding Bonds, February 2011—[http://www.gfoa.org/index.php?option=com\\_content&task=view&id=1572](http://www.gfoa.org/index.php?option=com_content&task=view&id=1572).

<sup>3</sup> GFOA recommends as a rule a net present value (NPV) threshold savings level of at least 3-5 percent as a percentage of the refinancing bonds. GCG in past refinancing proceedings has supported a lower NPV savings level of 2 percent.

<sup>4</sup> GPA’s senior debt is structured so that all debt issued under its master trust indenture is at parity making it impossible to change any restrictive covenants as part of a partial refinancing and restructuring.

independent power producer (“IPP”) contracts is currently under consideration. GPA previously considered and evaluated the possibility of refinancing a portion of the fixed costs related to the IPPs, but found obstacles to such transactions resulting in no savings. Specifically, GPA reviewed the fixed cost being paid to the Marianas Energy Corporation (“MEC”) as a possible candidate for restructure or refinance. At the present time, the payment schedule for repayment of the fixed costs of the MEC units only extends over a period of about one-half of the useful life of the plant. As a result, repayment of the fixed costs is front-end loaded and then drops to zero. Consumers could obtain some near-term relief if it were possible to extend or smooth out the remaining MEC debt. GPA determined that doing this directly was not economically feasible and has proposed in its petition a surrogate approach that involves the restructuring of a portion of its existing outstanding debt. Further explained herein is that the restructuring and refinancing mechanisms which GPA proposes for issuance of the Series 2012 Bonds will only involve a portion of the Series 1993 and Series 1999 Bonds as well as the termination of the FDAs.

At the current time, GPA carries approximately \$650 million of long-term debt net of original issue discounts as shown on Table 1 below.

**Table 1**  
**GPA Debt Instruments**

	<b>Jul 31, 2012 Balance</b>	<b>Original Issue Discount</b>	<b>Loss on Def./ Current Balance-Net</b>	<b>Proposed</b>
	<b>(Dollars in 1000s)</b>			
Series 1993	\$ 60,090	\$ 594	\$ 59,496	\$ -
Series 1999	304,595	13,933	290,662	
Series 2010A	150,440	3,815	146,625	146,625
Series 2010B	51,680		51,680	51,680
IPP's	99,675		99,675	99,675
Series 2012A				57,660
Series 2012B				293,890
Series 2012C				20,000
Total Debt	\$ 666,480	\$ 18,342	\$ 648,138	\$ 669,530

Note (1) Ties in with the July 31, 2012 Balance Sheet

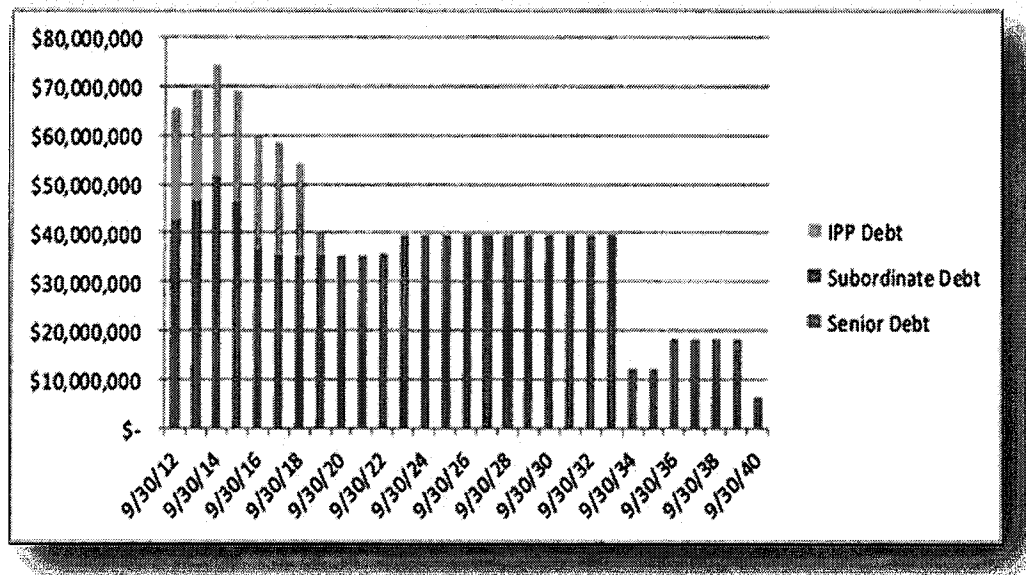
Note (2) Excluded the \$4.5M Lehman buyout from total restructured amount.

Note (3) Amounts based on September 5, 2012 MS update

The justification supporting GPA’s proposed Series 2012 Bonds is summarized by the GPA General Manager, Joaquin Flores, in his testimony as follows:

*The debt service requirement of GPA under the current debt profile reaches a peak of \$74.7 million in 2014 and then decreases to \$35.5 million in 2020 after the short-term taxable bonds and the IPP contracts such as the MEC contract are paid off. While there are many unknowns regarding GPA's future borrowing needs at this time, GPA is concerned that the nature of the debt profile could lead to rate actions that are inconsistent with rate smoothing and would cause more financial pressure on ratepayers (emphasis added).*

**Figure 1**  
**Existing GPA Debt Service Profile**  
**FY 2012-2040**



*GPA started looking at alternative solutions to levelize its debt profile in order to avoid a situation where GPA would have to ask for even higher rates to cover the debt service peak between now and 2019. GPA further recognized that leveling its debt service requirements over the 1999 Bonds term had a similar ratepayer impact as would a refinancing of the MEC obligation, coincidentally matching the long-term payoff of the plants' cost over the service life of the IPP plant.*

*Today, GPA has an excellent opportunity to restructure its outstanding bond debt service during the near term, resulting in lower principal and interest payments in the very near term and allowing GPA and the PUC to render significant cash flow savings to ratepayers. Additionally, substantial present value savings for ratepayers also can be achieved by refinancing GPA's outstanding bond debt service in future years, because mid-to long-term interest rates are at an all-time low. **With this combined strategy, GPA and the PUC would be able to use these savings to help offset the recent base rate increase and prevent potential future rate hikes, all of which will benefit ratepayers. These savings would offset the need for \$8 million in***

*annual rate relief through 2019 (emphasis added). Combining the restructuring with the refinancing for savings benefits ratepayers over the long term relative to a restructuring alone, because any increase in rates over the mid-to long-term resulting from the restructuring will be minimized by offsetting interest savings from the refinancing.*

*This strategy could have the impact of resulting in decreased debt service payments of approximately \$8 million per year through 2018 followed by increased debt service payments of approximately \$5 million per year from 2019 to 2031. These figures are based on interest rates as of May 14, 2012. Small changes in interest rates can have a large impact on the level of present value savings and the par amount of the final bond issuance. However, municipal bond interest rates are currently at near historic lows as a result of turmoil related to European economic issues and a slowing U.S. economy. GPA would like to issue refunding bonds in the next few months in order to allow ratepayers to benefit from these low interest rates. If done quickly, ratepayers also could receive rate relief sooner.*

Based upon the justification outlined in the excerpt and highlighted in Mr. Flores testimony supporting GPA's proposed Series 2012 Bonds, GPA has indicated it anticipates achieving multiple restructuring and refinancing objectives including those of a policy and financial nature, as well as achieving near-term consumer rate relief. Most notably, GPA believes its proposed bond refinancing and restructuring will exceed what GPA considers an adequate "minimum savings threshold" as measured by NPV savings. In addition, the Series 2012 Bonds will allow GPA to accomplish favorable "smoothing or leveling" of its annual debt service cash flow which will result in a lower annual revenue requirements and consumer rates. As presented in GPA's petition and associated filings, the proposed GPA restructuring and refinancing will meet many of the critical GFOA best practices objectives.

The remainder of our report will present our analysis of GPA's proposed Series 2012 Bonds as well as its proposal to provide flexibility to terminate the two FDAs with the objective to achieve specific policy, financial, and debt service (cash flow) smoothing objectives beneficial to GPA and Guam consumers. We also present our analysis and review the GPA's proposal with regard to how the Series 2012 Bonds will impact consumer rates.

### **GPA's Proposed Restructuring Component**

The proposed Series 2012 Bonds and associated financial and economic impacts are related to the (i) restructure and (ii) refinance of a portion of the embedded debt (Series 1993 and 1999 Bonds), and not the Series 2012A and Series 2012B Bonds and IPP debt as previously mentioned. The restructuring component of the proposed Series 2012 Bonds involves buying back a portion of the Series 1993 and 1999 Bonds and issuing new bonds replacing the original bonds with interest only bonds through FY 2018 and full principal and interest on

the new bond debt service thereafter. The theory behind GPA's proposal is that the bond restructuring component of its overall financing program will allow GPA to refinance a portion of the Series 1993 and 1999 bonds to realize debt service (cash flow) savings in the early years and then fold the additional principal from those earlier years into later years. By doing this GPA will provide cash flow and rate relief in the early years without interjecting volatility in later year cash flow—in fact, later year cash flow is relatively normalized. The restructuring component of the Series 2012 Bonds is more of a policy decision based upon reducing the early year volatility in GPA's cash flow, normalizing later year cash flow, and achieving a favorable impact on consumer rates in the near-term. GPA views the proposed restructuring as a win-win for the Authority and consumers.

To assist the PUC in its review and analysis of the restructuring component of GPA's proposed Series 2012 Bonds Table 2 presents its total Series 1993 and 1999 debt service.

**Table 2**  
**Existing Annual Debt Service**

<b>Bond Year</b>	<b>Original 1993 Debt Service</b>	<b>Original 1999 Debt Service</b>
1-Oct-13	\$6,874,425	\$20,610,050
1-Oct-14	\$6,873,888	\$20,608,363
1-Oct-15	\$6,877,588	\$20,607,500
1-Oct-16	\$6,874,738	\$20,606,675
1-Oct-17	\$6,875,075	\$20,605,175
1-Oct-18	\$6,877,813	\$20,603,675
1-Oct-19	\$6,877,163	\$20,606,425
1-Oct-20	\$6,877,600	\$20,602,425
1-Oct-21	\$6,873,338	\$20,611,175
1-Oct-22	\$6,873,850	\$20,606,175
1-Oct-23	\$6,878,088	\$20,602,175
1-Oct-24		\$27,483,175
1-Oct-25		\$27,483,925
1-Oct-26		\$27,484,456
1-Oct-27		\$27,481,425
1-Oct-28		\$27,482,781
1-Oct-29		\$27,480,963
1-Oct-30		\$27,483,663
1-Oct-31		\$27,481,463
1-Oct-32		\$27,480,725
1-Oct-33		\$27,483,300
1-Oct-34		\$27,480,775
<b>Total</b>	<b>\$75,633,563</b>	<b>\$528,976,463</b>

Source: GPA Response to GCG Set 1, 4.a, 4.b & 4.d.

As noted above, the PUC should understand that the restructuring component of the Series 2012 Bonds involves only a portion of the Series 1993 and 1999 Bonds. Under the proposed financing structure the restructuring component of the Series 2012 Bonds will be fully amortized by 2034—the same year as the current Series 1999 Bonds are fully amortized.

GPA’s proposed restructuring component of the Series 2012 Bonds involves the buy-back of a portion of the Series 1993 and 1999 Bonds and the structuring of the new debt service in a manner to improve (reduce) near-term cash flow. Starting with the total debt service for the Series 1993 and 1999 Bonds as shown in Table 2, the restructuring component of the Series 2012 Bonds replaces portions of such debt presented in Table 3 below.

**Table 3**  
**Restructured Debt Service: Pre-and Post-2012 Financing**

<b>Bond Year Ending</b>	<b>Portion of Series Restructured</b>		<b>Bond Fund Contribution</b>	<b>2012 Restructuring Debt Service</b>	<b>Cash Flow Differential</b>	<b>Present Value of CF Differential</b>
	<b>1993 Debt Service</b>	<b>1999 Debt Service</b>				
Oct-13	\$5,322,263	\$6,983,625	\$35,732	\$3,994,454	\$8,275,702	\$7,895,435
Oct-14	\$5,321,725	\$6,981,938		\$3,982,776	\$8,320,887	\$7,566,825
Oct-15	\$5,325,425	\$6,981,075		\$3,876,824	\$8,429,676	\$7,306,895
Oct-16	\$5,322,575	\$6,980,250		\$3,758,561	\$8,544,264	\$7,059,613
Oct-17	\$5,322,913	\$6,978,750		\$3,644,391	\$8,657,271	\$6,818,295
Oct-18	\$5,325,650	\$6,977,250		\$3,569,314	\$8,733,586	\$6,556,327
Oct-19				\$5,265,281	(\$5,265,281)	(\$3,809,847)
Oct-20				\$9,079,592	(\$9,079,592)	(\$6,246,767)
Oct-21				\$9,060,874	(\$9,060,874)	(\$5,943,389)
Oct-22				\$8,807,462	(\$8,807,462)	(\$5,508,208)
Oct-23				\$5,183,840	(\$5,183,840)	(\$3,096,296)
Oct-24				\$5,184,466	(\$5,184,466)	(\$2,952,314)
Oct-25				\$5,193,483	(\$5,193,483)	(\$2,819,535)
Oct-26				\$5,200,487	(\$5,200,487)	(\$2,691,630)
Oct-27				\$5,214,759	(\$5,214,759)	(\$2,573,046)
Oct-28				\$5,227,342	(\$5,227,342)	(\$2,458,824)
Oct-29				\$5,235,912	(\$5,235,912)	(\$2,347,802)
Oct-30				\$5,245,087	(\$5,245,087)	(\$2,241,984)
Oct-31				\$235,344	(\$235,344)	(\$96,428)
Oct-32				(\$442,882)	\$442,882	\$172,073
Oct-33				(\$441,448)	\$441,448	\$163,592
Oct-34				(\$441,040)	\$441,040	\$155,891
Total	\$31,940,550	\$41,882,888		\$95,634,878	(\$21,847,172)	\$911,474

Source: Morgan Stanley Sep. 5, 2012 Update

For the next fiscal year—the bond year ending October 1, 2013—existing debt service of \$5,322,263 and \$6,983,625 for the Series 1993 and 1999 Bonds is replaced in the analysis

with debt service of \$3,994,454, resulting in a cash flow savings of \$8,275,702. These savings will be used by GPA to reduce consumer rates in FY 2013. The impact on a year-by-year basis can be seen in Table 3. The restructured component of the Series 2012 Bonds have debt service through the bond year ending October 1, 2034 which is the same end date for the original Series 1999 Bonds. This produces significant cash flow savings for the period FY 2013 through FY 2018 and negative savings from FY 2019 through FY 2034. On a nominal basis<sup>5</sup> there are negative savings of \$21,847,172 resulting from the restructured component of GPA's proposed Series 2012 Bonds; however, on a real basis the restructuring proposal results in a cumulative NPV savings of \$911,474 or 1.47% savings based upon the restructuring principal amount inclusive of the additional \$5 million of debt related to the Lehman FDA buyout. In sum, the impact of GPA's restructuring proposal is to reduce cash flow requirements for debt service in the early-years allowing consumer rates to be reduced from FY 2013 through FY 2018 as compared to the rates that otherwise would have to be put in effect. In the post FY 2018 period through FY 2034, while cash flow for debt service for the restructured component of the Series 2012 Bonds would be greater than the current bonds, the difference or "delta" between the debt service cash flow requirement for FY 2018 and the post FY 2018 period would be relatively normalized as compared to the pre FY 2018 period without the restructuring component. From a policy perspective consumers would benefit from having less volatility in GPA rates associated with the cash flow requirement for debt service. At the same time, following the industry accepted NPV method for evaluating future cash flows, consumers should be indifferent from a financial perspective over the entire period—based on a discount rate of approximately 4.7%—which we believe is reasonable for these purposes.<sup>6</sup>

As mentioned above, GPA's and the CCU's policy position, as reflected in its proposal in this proceeding, is to use the cash flow savings as a rate offset directly benefiting consumers in the near-term. This is discussed in more detail in a later section. We will mention here that although the GPA petition requests the flexibility for the inclusion of a full \$20 million in subordinate bonds for the full repurchase of the FDA's, the analysis provided by GPA of the proposed restructured component of the Series 2012 Bonds only has an allowance for approximately \$5 million to provide for the buyout of the Lehman Brothers FDA, but no impact of the full \$20 million of additional subordinate bonds, if required. Both our prior analysis of the Lehman buy-out as well as GPA's integrated analysis of its proposed refinancing and restructuring analysis in this proceeding indicate that the buyout will approximately provide for investment income equal to the price of the buyout. The cash flow

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<sup>5</sup> An unadjusted value or change in value. A nominal measure reflects the then current situation, and doesn't make adjustments to reflect factors such as inflation or the cost of money, which when considered provides a more accurate measure and is referred to as a "real" basis.

<sup>6</sup> Generally, the cost of credit to the average consumer would be higher than the discount rate used. It could be argued that a higher discount rate would be appropriate. Such would produce a higher NPV consumer benefit.



savings used as a rate reduction includes the investment income GPA projects it will earn after it controls the bond reserve funds.

### **GPA's Proposed Refinancing Component**

The refinancing component of the proposed Series 2012 Bonds buys out most<sup>7</sup> of the remaining Series 1993 and 1999 Bonds (those not restructured) by advance funding the purchase of the existing bonds and issuing new bonds at a lower interest rate (reducing the average rate of 5.18% to 4.75%). After a full buy-back of the Series 1993 and 1999 Bonds the restructuring and refinancing components of the Series 2012 Bonds GPA estimates new debt service payments will be lower than what would be experienced through FY 2018. The current annual debt service amounts related to the restructured and refinanced bonds is shown in Table 4 below.

**Table 4**  
**Future Debt Service following Restructuring / Refinancing**

<b>Bond Year Ending</b>	<b>Restructuring Debt Service</b>	<b>Refinancing Debt Service</b>
Oct-13	\$3,994,454	\$14,272,881
Oct-14	\$3,982,776	\$14,433,250
Oct-15	\$3,876,824	\$14,433,250
Oct-16	\$3,758,561	\$14,433,250
Oct-17	\$3,644,391	\$14,433,250
Oct-18	\$3,569,314	\$14,433,250
Oct-19	\$5,265,281	\$26,638,250
Oct-20	\$9,079,592	\$26,633,000
Oct-21	\$9,060,874	\$26,637,500
Oct-22	\$8,807,462	\$26,634,750
Oct-23	\$5,183,840	\$26,633,500
Oct-24	\$5,184,466	\$26,637,000
Oct-25	\$5,193,483	\$26,638,250
Oct-26	\$5,200,487	\$26,635,500
Oct-27	\$5,214,759	\$26,632,000
Oct-28	\$5,227,342	\$26,635,750
Oct-29	\$5,235,912	\$26,634,250
Oct-30	\$5,245,087	\$26,635,500
Oct-31	\$235,344	\$26,632,000
Oct-32	(\$442,882)	\$26,631,500
Oct-33	(\$441,448)	\$26,636,250
Oct-34	(\$441,040)	\$26,633,250
<b>Total</b>	<b>\$95,634,878</b>	<b>\$512,597,381</b>

Source: Morgan Stanley Sep. 5, 2012 Update

<sup>7</sup> There remains \$23,646,682 after the proposed restructure and refinance.

The debt service for the refinancing component alone compared with the current debt service is shown in Table 5 below.

**Table 5**  
**Annual Debt Service—Refinancing Component**

Bond Year Ending	Refinanced Portion		Bond Fund Contribution	2012 Refinancing Debt Service	Cash Flow Differential	PV of Cash Flow Differential
	1993 Debt Service	1999 Debt Service				
FY 2013	\$1,552,163	\$13,626,425	\$168,651	\$14,272,881	\$737,056	\$711,699
FY 2014	\$1,552,163	\$13,626,425		\$14,433,250	\$745,338	\$686,541
FY 2015	\$1,552,163	\$13,626,425		\$14,433,250	\$745,338	\$654,826
FY 2016	\$1,552,163	\$13,626,425		\$14,433,250	\$745,338	\$624,577
FY 2017	\$1,552,163	\$13,626,425		\$14,433,250	\$745,338	\$595,725
FY 2018	\$1,552,163	\$13,626,425		\$14,433,250	\$745,338	\$568,205
FY 2019	\$6,877,163	\$20,606,425		\$26,638,250	\$845,338	\$613,811
FY 2020	\$6,877,600	\$20,602,425		\$26,633,000	\$847,025	\$586,462
FY 2021	\$6,873,338	\$20,611,175		\$26,637,500	\$847,013	\$559,206
FY 2022	\$6,873,850	\$20,606,175		\$26,634,750	\$845,275	\$532,128
FY 2023	\$6,878,088	\$20,602,175		\$26,633,500	\$846,763	\$508,264
FY 2024		\$27,483,175		\$26,637,000	\$846,175	\$484,278
FY 2025		\$27,483,925		\$26,638,250	\$845,675	\$461,569
FY 2026		\$27,484,456		\$26,635,500	\$848,956	\$441,744
FY 2027		\$27,481,425		\$26,632,000	\$849,425	\$421,365
FY 2028		\$27,482,781		\$26,635,750	\$847,031	\$400,567
FY 2029		\$27,480,963		\$26,634,250	\$846,713	\$381,704
FY 2030		\$27,483,663		\$26,635,500	\$848,163	\$364,468
FY 2031		\$27,481,463		\$26,632,000	\$849,463	\$347,802
FY 2032		\$27,480,725		\$26,631,500	\$849,225	\$331,270
FY 2033		\$27,483,300		\$26,636,250	\$847,050	\$314,775
FY 2034		\$27,480,775		\$26,633,250	\$847,525	\$300,002
Total	\$43,693,013	\$487,093,575	\$168,651	\$512,597,381	\$18,020,556	\$10,894,523

Source: Morgan Stanley Sep. 5, 2012 Update

Based on the above, the FY 2013 annual cash flow savings attributable to the refinancing component of the Series 2012 Bonds is \$737,056.<sup>8</sup> This is a portion of the total cash flow savings (refinancing component) in debt service for FY 2013 that can be applied to a reduction in consumer rates. Meanwhile, over the longer-term the nominal value of the cash flow savings over the entire time frame through FY 2034 is \$18,020,556 while the cumulative NPV savings associated with the refinancing component of the Series 2012 Bonds are \$10,894,523 or 3.71 % of the outstanding refinanced principal balance. This NPV savings exceeds the recommended GFOA threshold as well as the threshold previously employed by GCG in refinancing proceedings.

<sup>8</sup> Likewise there is a difference to the amount in GPA's original petition.

## Combined Restructuring and Refinancing

Table 6, based on the current restructuring and refinancing proposal from GPA, presents the combined results for restructuring and refinancing:

**Table 6**  
**Combined Restructuring & Refinancing Cash Flow Savings**

<b>Bond Year</b>	<b>Cash Flow Differential</b>	<b>PV of Cash Flow Differential</b>
Oct-13	\$9,012,758	\$8,607,133
Oct-14	\$9,066,224	\$8,253,365
Oct-15	\$9,175,014	\$7,961,721
Oct-16	\$9,289,601	\$7,684,190
Oct-17	\$9,402,609	\$7,414,019
Oct-18	\$9,478,924	\$7,124,533
Oct-19	(\$4,419,943)	(\$3,196,036)
Oct-20	(\$8,232,567)	(\$5,660,305)
Oct-21	(\$8,213,861)	(\$5,384,183)
Oct-22	(\$7,962,187)	(\$4,976,080)
Oct-23	(\$4,337,078)	(\$2,588,032)
Oct-24	(\$4,338,291)	(\$2,468,036)
Oct-25	(\$4,347,808)	(\$2,357,966)
Oct-26	(\$4,351,531)	(\$2,249,886)
Oct-27	(\$4,365,334)	(\$2,151,681)
Oct-28	(\$4,380,311)	(\$2,058,257)
Oct-29	(\$4,389,200)	(\$1,966,098)
Oct-30	(\$4,396,924)	(\$1,877,516)
Oct-31	\$614,118	\$251,374
Oct-32	\$1,292,107	\$503,343
Oct-33	\$1,288,498	\$478,367
Oct-34	\$1,288,565	\$455,893
<b>Total</b>	<b>(\$3,826,616)</b>	<b>\$11,805,997</b>

Source: Morgan Stanley Sep. 5, 2012 Update

The combined FY 2013 annual cash flow benefit of both restructuring and refinancing as proposed in the September 5, 2012 updated data supplied by Morgan Stanley is \$9,012,758<sup>9</sup> versus \$8,275,702 for restructuring alone. The annual cash flow benefit of the refinancing alone is \$737,056.

<sup>9</sup> As originally proposed in GPA's petition this value was \$9,623,413. See GPA response Set 1, 5a.

Combining the restructuring and refinancing debt components associated with the proposed Series 2012 Bonds results in the following cash flow and consumer benefits:

1. Annual cash flow savings for the years FY 2013 through FY 2018 can be used to directly offset and reduce consumer rates or otherwise needed rate increases.
2. Cumulative NPV savings in annual cash flow resulting from the combined benefits of the debt restructuring and refinancing of \$11,805,997. This is equivalent to a NPV saving of 3.32 % on the basis of the total principal amount for both the restructuring and refinancing components of the Series 2012 Bonds indicating a healthy net benefit to consumers.
3. The smoothing or stabilization of annual cash flow for debt service payments which removes the current volatility in GPA's annual debt service payments, stabilizes the cash flow required from consumers to make debt service payments and serves as a surrogate for better matching future system debt service to the life of the IPP plants—one of the objectives GPA hoped to attain when it earlier attempted to restructure the MEC debt related costs.

Table 7 summarizes the individual restructuring and refinancing components of NPV savings for each of the two components of the Series 2012 Bonds. The information is presented in terms of NPV cash savings and as a percentage of bonds issued for both refinancing and restructuring.

**Table 7**  
**Net Present Value Savings**

	<b>Restructuring</b>	<b>Refinancing</b>	<b>Combined</b>
Par Value of Bonds	\$62,160,000	\$293,890,000	\$356,050,000
NPV Savings-\$	\$911,474	\$10,894,523	\$11,805,997
NPV Savings-%	1.47%	3.71%	3.32%

Calculation based upon Morgan Stanley September 5, 2012 analysis

### **Refinancing of MEC (and other IPPs)**

Currently GPA has three contracts with IPPs: Marianas Energy Corporation (MEC), Pruvient Energy, and Taiwan Electrical and Mechanical Engineering Services (TEMES). The annual payments for power purchases from the IPPs made by GPA under the terms of each agreement include fixed charges which current accounting rules require be booked as debt service (principal and interest) related to the generators covered by each agreement. In simple terms these payments are similar to a mortgage payment. At the end of the term, GPA will own the units. The Pruvient contract will cease in 2017; the MEC contract will cease in 2019 and the TEMES contract will cease in 2018. The annual “debt service” is

\$23,084,204 through FY 2017, with lower payments for FY 2019 and FY 2020 when the contracts expire. The majority of that debt is MEC related as shown in Table 8.

**Table 8**  
**IPP Debt Service FY2013**  
**(\$000)**

Pruvient	\$2,295
MEC	\$18,250
TEMES	\$2,540
Annual Debt Service	<u>\$23,085</u>

As stated earlier, GPA is not proposing to refinance any portion of the debt service payments to the IPPs, including MEC, and no action is being requested of the PUC. GPA came to that conclusion in May 2012 as discussed in the cover letter of June 12, 2012 that accompanied this filing. GPA concluded that the economics of refinancing the balances of the remaining portion of IPP debt service was not cost effective. GPA informed GCG in discussions that the reason that it was not economic was the fact that MEC would have tax consequences should the debt be paid off and refinanced. If MEC were to be compensated for those taxes, the new debt service would not be justifiable. The proposed restructuring component of the Series 2012 Bonds can be viewed as a surrogate for accomplishing the same objective had GPA been able to implement the refinancing of MEC debt.

#### **Bond Forward Delivery Agreements Repurchase**

In its petition GPA has also requested the PUC to authorize the issuance of up to \$20 million in taxable subordinate lien bonds as a funding source for the FDA termination payments, if required. The bond proceeds would be used to make termination payments to Lehman Brothers and/or BoA, pay costs of issuance of the bonds, and fund any necessary reserves for the bonds if events change from the situation currently expected. In 2000, GPA signed agreements with both Lehman Brothers and BoA that permitted investment and return on the combined debt service reserve funds required by both the Series 1993 and 1999 Bonds by the financial institutions in exchange for up-front payments to GPA. The amount of funds that are available in the debt service reserve fund is \$27.5 million. The management of these funds through the FDAs was evenly split between BoA and Lehman Brothers. The debt service reserve fund was purchased in equal amounts by both BoA and Lehman Brothers. The PUC was not involved in reviewing or approving this decision as GCG has previously indicated was required.<sup>10</sup> When the FDA's were executed, GPA received a net sum of \$13.5 million which it deposited into the Working Capital Fund ("WCF") to partially meet the

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<sup>10</sup> GCG provided a report on these transactions to the PUC dated February 11, 2004.

requirements of its bond covenants. The amounts related to the transaction for the \$13.5 million received are as shown in Table 9.

**Table 9**  
**Bond Forward Delivery Agreement Details**  
**(\$000s)**

Cash BOA	\$8,765
Cash Lehman	\$8,756
Gross Payment	<u>\$17,522</u>
Less:	
Closing Costs	(\$1,251)
Termination Fee	<u>(\$3,530)</u>
Net Cash Received	\$12,741
Accrued Interest	<u>\$759</u>
Deposit to WCF	\$13,500

As the PUC is aware, the WCF fund was later depleted by GPA and several measures to replenish and fully fund the WCF subsequently have been approved by the PUC. The current estimated WCF was established in GPA Docket 09-03 and a surcharge to civilians and the Navy has been established to fully fund the WCF requirement, which has greatly increased due primarily to increasing fuel oil prices and other operating costs.

In this proceeding, GPA has presented financial and economic analyses based upon an allowance of \$5 million for the repurchase of the Lehman contract only. Meanwhile, in its petition GPA is proposing that the PUC approve the flexibility to sell of up to \$20 million in short term securities for the purpose of repurchasing both the Lehman and BoA FDAs in the event that BoA does not grant a waiver assertedly needed for GPA to issue the restructuring and refinancing bonds and Lehman requests the full payment for its buyout as well. In that case GPA will need the flexibility to buy-out both the BoA and Lehman FDAs. GPA states that \$17.8 million of the \$20 million petitioned for could be used to buy out both of the FDAs and the remaining funds would be used to pay bond related requirements, all as summarized in Table 10.

GCG was provided a copy of the following email from its Bond Counsel (“Orrick”), with regard to certain time deadlines of the Lehman buyback. This could impact the price of the Lehman buyout:

*As you know, GPA has an existing Forward Delivery Agreement, dated as of September 28, 2000 (the “FDA”), with Lehman Brothers Special Financing, Inc. (“LBSF”), for the investment of a portion of the debt service reserve fund related to the outstanding 1993 and 1999 GPA senior lien bonds. Under the FDA, as a condition precedent to GPA’s issuance of its proposed refunding*

*bonds, the FDA must be transferred to the debt service reserve for the refunding bonds or terminated.*

*At GPA's request, we have approached the Lehman bankruptcy estate (the "Lehman Estate"), which is the business decision maker for LBSF now that it is part of the Lehman bankruptcy, to see if it would consent to transfer the FDA to the proposed GPA refunding bonds. The Lehman Estate has refused this request. Further, because GPA received an up-front payment upon execution of the FDA, in order to terminate the FDA under current market conditions, GPA must make a termination payment to the Lehman Estate. The Lehman Estate has agreed to allow GPA to terminate the FDA at 55% of the so-called "mark-to-market" termination value of the FDA; provided that GPA must finalize and execute the termination agreement with the Lehman Estate on or before September 30, 2012. If the termination value is set and the termination agreement executed after September 30, 2012, the termination price will increase to 65% of the mark-to-market termination value. For a variety of reasons, the most important being certainty of having a source of funds to pay the termination payment to the Lehman Estate, we have advised GPA to set the termination value and execute the termination agreement with the Lehman Estate on the same day it signs the bond purchase contract for its refunding bonds.*

*Because of the time-sensitive nature of the Lehman Estate's offer, there is a financial cost to GPA if the bonds are not sold, and the termination not priced, by September 30, 2012. Based on an estimated mark-to-market termination value as of late February 2012 of \$7.7 million, pricing the bonds and termination after September 30, 2012 would cost GPA approximately \$770,000. (Please note that the \$7.7 million estimated termination value was provided to us by the Lehman Estate in late February, and was reviewed by Morgan Stanley (the senior managing underwriter) on the basis of what they believe to be reasonable assumptions. The value fluctuates with the market and may increase or decrease by the time the termination occurs, depending on market conditions at that time. If the termination value increases, the cost of delay would increase accordingly, and vice versa.)*

*Please let us know if we can provide any further information about this matter.*

In response to discovery, in the event that GPA will need to buyout both FDAs at full price, GPA indicated that the \$20 million in subordinate bonds would be for a proposed nine-year term with the current assumption of an interest rate of 5.6%. The 5.6% is somewhat higher than interest rates would be if this debt would be tax exempt. While GPA is not exactly sure of what the actual borrowed amount may be, it seeks a PUC decision to be flexible enough to permit financing.

The debt service associated with the full \$20 million of borrowing if issued is projected as shown in Table 10.

**Table 10—Annual Debt Service**

**GPA \$20M Subordinate Bond**

Principal Amount	\$20,000,000
Interest rate	5.60%
Term-yrs.	9
Annual Debt Service	(\$2,889,467)
Capitalized Interest	\$0
Debt Service Reserve Fund	\$2,000,000
Underwriter's Discount	\$140,000
Project Fund	<u>\$17,860,000</u>
Bond Size	\$20,000,000

In the event that BoA does grant a waiver, GPA will be required only to pay Lehman approximately \$4.5 million. Approval for this buyout was petitioned for previously by GPA, on a stand-alone basis, and such approval was not granted by the PUC. In this proceeding, the buy-out is integrated into GPA's overall restructuring and refinancing bond issue proposal.

The analysis with regard to the benefit cost ratio was previously presented and has again been provided below in this proceeding. On a present value basis there is a slight cost to the transaction at current interest rates. We do not disagree with the results of the analysis undertaken and the resulting data presented in Table 11.<sup>11</sup>

**Table 11**

**Lehman Buyout Justification**

	Base Case	High Case	Low Case
NPV of Income	\$3,985,461	\$4,429,024	\$3,541,898
Payment to Lehman – Est.	(\$4,500,000)	(\$4,500,000)	(\$4,500,000)
Net Loss	(\$514,539)	(\$70,976)	(\$958,102)

The NPV of the interest income GPA expects to accrue on the \$13.7 million of the debt service reserve fund that it would control is shown in Table 9 under various interest rate assumptions. GPA in presenting the NPV has discounted the flow of income by 7.5% per

<sup>11</sup> In the prior proceeding we used slightly different interest rates than presented here. We also indicated that if a higher discount rate was used the end result would be neutral or positive to the consumer.



annum for each of the income streams that it has calculated over a period of twenty-two years at which time the debt is scheduled to be extinguished.<sup>12</sup>

Our findings with regard to the FDAs are as follows:

- First, as previously discussed, the refinancing component of the proposed Series 2012 Bonds included in the analysis a \$5.0 million allowance for the buy-out of the Lehman FDA. That buy-out amount was integrated into that analysis which demonstrated a NPV benefit of 1.47% and a significant near-term reduction in debt service cash flow that could be used to offset consumer rates through FY 2018.
- If viewed from an optimistic perspective, if the PUC were to approve the proposed restructuring and the refinancing and if BoA permits a one-time waiver as promised, then the buyout of the Lehman FDA makes imminent sense and should be approved. While the Lehman buyout has a small negative value NPV when viewed from a stand-alone perspective, when integrated with the restructuring it has a positive NPV and, from a policy perspective, provides substantial near-term cash flow flexibility.
- We are not aware of any potential reason that Lehman Brothers or BoA would change their positions; however, as a contingency, if the PUC were to approve the restructuring and the refinancing and for whatever reason both Lehman and BoA changed their minds and required a full buyout it is critical the PUC understand the implications. In this case the costs of a buy-out of both FDAs would be approximately \$15.4 million or \$10.9 million more than currently included in the analyses. The NPV of the interest income would be approximately \$8 million based on the Table 9 above or \$4 million greater than currently included in the analysis as a result of controlling the Bond Reserve fund associated with the BoA buyout. This would leave a net cost of approximately \$6.9 million that it not currently in the analysis. This would translate into a reduction in the NPV of the cash flow savings from \$11.8 million to approximately \$5.0 million and a NPV percentage savings of approximately 1.4%—somewhat less than the NPV threshold value GCG has recommended in previously refinancing proceedings. This analysis is based on the September 5, 2012 analysis of Morgan Stanley and while a reduction from the original projected savings there is still both cash flow and NPV savings and the ability to provide a reversal of the rate increase just approved would remain intact. We would still recommend approval of the FDA buyouts; however, if this situation were to arise the GPA should provide notice to the PUC of the change in either the Lehman and BoA positions. As discussed below changes in the interest rates outlook will impact on the analysis.

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<sup>12</sup> This discount rate is higher than the 4.7% used for the NPV on the cash flows of the restructuring and refinancing bonds.

## **Sensitivity of the Restructuring and Refinancing Analysis**

The analysis undertaken by GPA's proposed restructuring and refinancing Series 2012 Bonds is sensitive to interest rates. There have been four analyses provided by Morgan Stanley over the past 5 months:

- May 29, 2012;
- July 3, 2012;
- August 2, 2012; and
- September 5, 2012

The results of the analyses show that for the aggregate restructuring and refinancing financing the NPV of cash flow savings is as follows:

- May 29, 2012; NPV savings of \$12.8 million.
- July 3, 2012; NPV savings of \$6.9 million.
- August 2, 2012; NPV savings of \$14.4 million.
- September 5, 2012; NPV savings of \$11.8 million.

All four analyses demonstrate a NPV that is positive for consumers. We recommend; however, that prior to the issuance of the Series 2012 Bonds, if the PUC were to approve the transaction, GPA should provide verification to the PUC that the NPV is still positive and indicate that the agreements for the FDAs are as indicated in this filing – i.e. that the Lehman purchase is \$4.5 million and that BoA has provided the one time waiver.

## **Rate Impact**

There are several rate issues that we comment on and we believe need clarification. In its petition GPA's General Manager states:

*...substantial present value savings for ratepayers also can be achieved by refinancing GPA's outstanding bond debt service in future years, because mid-to long-term interest rates are at an all-time low. With this combined strategy, GPA and the PUC would be able to use these savings to help offset the recent base rate increase and prevent potential future rate hikes, all of which will benefit ratepayers. These savings would offset the need for \$8 million in annual rate relief through 2019. Combining the restructuring with the refinancing for savings benefits ratepayers over the long term relative to a restructuring alone, because any increase in rates over the mid-to long-term resulting from the restructuring will be minimized by offsetting interest savings from the refinancing.*

This statement was based on the May 2012 Morgan Stanley analysis in which the average annual cash flow savings for the period FY 2012 to FY 2108 was projected to be \$8.4 million. In a further clarification requested by GCG we received the following response to our question:

- c. *Provide the calculations for the \$8 million in annual rate relief stated above. If the \$8 million represents the reduction in annual debt service would not the reduction in rate relief at the PUC authorized coverage rate of 1.75x be approximately \$14 million? If not, why not?*

*Response: If GPA's rates were set solely on debt service coverage needs without regards to the needs of the utility, then the statement would be correct. However, in the recently completed rate proceeding, we believe the PUC has adopted an approach where more than one factor will be utilized for the purpose of setting rates for the utility. Since no other cash requirements of the utility will be going away, GPA maintains that the ratepayer burden can be reduced by \$8 million.*

*.. GPA is anticipating rates would be reduced by \$8 million per year over what they would have been if the financing were not completed. GPA is only forecasting that its revenue requirement would decrease by \$8 million.*

In a response to a question from Shaw Consultants, GPA provided the following response:

9. *In reference to RFI 07, is it now GPA's position that the expected savings from this refinancing will not reduce current levels of rates, but will only offset the level of increase needed to compensate for other factors (such as conservation, lower than expected revenue increases, the addition of demand charges, etc.)?*

*Response: There are a lot of moving parts that make this difficult to answer. GPA has recently filed an emergency petition with the PUC which would pull back on the amount of demand charges that were implemented in May 2012. It would also increase the rates in the tail blocks of our demand tariffs that would enable us to recover the lost revenue from the fallout of the implementation of the demand charges. If this petition is approved by the PUC, then GPA would expect most of the savings to be used to lower rates. When GPA petitions for the rate decrease, the amount of the savings will be known, the FY14 budget will be known and we will be able to give the PUC a forecast of the impacts of the rollback on debt service coverage and compliance with GPA's rate covenants. GPA is not expecting to give back the full benefit of the refinancing/restructuring if it would cause compliance problems with GPA's coverage levels. But GPA is planning to give back as much of*

*the refinancing as is consistent with prudent management of the utility.*

In this last statement GPA seems to take the position that any rate decrease that flows from the restructuring and refinancing will be in the context of some rate proceeding while other statements indicate that GPA would make the change as soon as the restructuring and refinancing were completed.

We offer the following observations with regard to this issue:

1. GPA has recently completed the first step of a multi-year rate plan. It is expected that there will be annual filings for the next several years. The basis of rate determination in those future years will be based both on the debt service coverage ratios (the PUC has set a target standard of 1.75x coverage) and cash balances (a firm standard has not been set by the PUC). Therefore the impact of the restructuring and refinancing approved in this proceeding by the PUC will impact each of the future filings in that the debt service will change from the current schedule of payments to the debt service finally associated with the new restructured and refinanced bonds.
2. The rate impact from this proceeding should focus on the changes to FY 2013. Using the numbers as filed in this proceeding the reduction in debt service for FY 2013 is \$9.012 million. These figures are based on the Morgan Stanley Report dated September 5, 2012.
3. It would be our position that the rate impact of this change to debt service and cash flow of \$9.012 million would at a minimum be to lower rates by \$9.012 million upon GPA successfully issuing the Series 2012 Bonds in Phase II of the still open rate proceeding GPA Docket 11-09 or in this proceeding, if the PUC so desires. The rate increase just implemented was designed to produce additional revenues for GPA of \$9.1 million. This would provide the basis to immediately almost completely offset the recent revenue requirement increase. The revenue requirement offset of the recent revenue requirement increase should be implemented by reducing the debt service component of the cost of service by \$9.012 million and using the same billing determinants as were agreed to in the just completed Emergency Rate proceeding. Since there is a change in the cost of service, the impact on Navy will also have to be considered.
4. While we believe that a case could be made to reduce revenue requirements by 1.75x of the reduction in debt service of \$9.012 million, or \$15.771 million, we are not recommending such a reduction in this proceeding or in the still open GPA Docket 11-09 proceeding. When the new debt is issued the related debt service will automatically make its way into the next step of the 5-year rate plan and will impact the results based on the coverage in that proceeding taking into account current data.

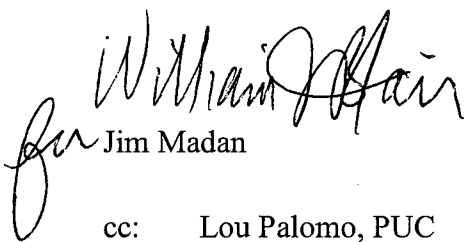
## **Summary of Recommendations**

Based on the data provided and analyzed it is our recommendation that:

1. GPA's request to restructure and refinance its existing debt to produce both cash flow savings and NPV savings and to levelize the near-term variability in debt service cash flow between FY 2013-2018 should be approved. GPA should provide to the PUC for review actual figures for the cash flow and NPV savings based on interest rates at the time just prior to bond issuance.
2. Following financial close of the Series 2012 Bonds, the PUC should reduce GPA retail rates by the amount of reduction in debt service resulting from the financial transaction (i.e., somewhere on the order of \$9 million). GPA should provide a summary of the debt service achieved and revised tariffs for review so that that the rate reduction can take effect on the first day of the month following financial close.
3. GPA's request to buy out the Lehman FDA as currently offered should be approved.
4. In the event that there is a change of mind by BoA not to offer the waiver and to require a buyout at the contract rate we would still recommend approval as long as there remain cash flow and NPV positive benefits taking into account the buyout requirements. In the event that this happens, GPA should immediately file documentation with the PUC showing continued benefits.

If you wish to discuss any and all of the above, please do not hesitate to call.

Respectfully,

  
for Jim Madan

cc: Lou Palomo, PUC  
Fred Horecky, Esq.  
Graham Botha, Esq. (GPA)  
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