

CHUGACH ELECTRIC ASSOCIATION, INC.
Anchorage, Alaska

REGULAR BOARD OF DIRECTORS' MEETING
AGENDA ITEM SUMMARY

June 25, 2008

ACTION REQUIRED

AGENDA ITEM NO. XIA.

Information Only
 Motion
 Resolution
 Executive Session
 Other

TOPIC

Motion to approve establishing an interim financing instrument in an amount up to \$300 million to meet future financing requirements for certain redeemed debt, future capital expansion and maturing long term debt.

DISCUSSION

Chugach's upcoming financing requirements include refinancing redeemed Auction Rate Securities, financing new capital expenditures, refinancing 2011 and 2012 long term debt maturities and making a provision for financing its' portion of a new generating unit. Over the next five years this will potentially amount to approximately \$600 million.

See discussion of alternatives, review of the request for proposal process and selection criteria and description of the proposed instrument and impacts in Exhibit I (attached) and the June 11, 2008 Finance Committee presentation.

MOTION:

Move that the Board of Directors approve the establishment of a Commercial Paper interim financing instrument up to \$300 million with N.R.U.C.F.C. and Key Bank. The Chugach Finance Committee recommended this to the Board of Directors at their June 11, 2008 meeting.

Chugach Electric Association, Inc. Interim Financing Instrument

Alternatives:

Chugach has three options at this time:

1. Do Nothing – wait for needs to arise and then borrow. This alternative is subject to the market conditions at the time of borrowing – interest rates, credit risk, and increased cost of issuance. This alternative continues the low liquidity coverage levels, which are a focus of the creditors and rating agencies.
2. Borrow all of the required long term debt now – current market rates (“spread” over Treasury Notes) are currently very high. This could result in higher interest rates and assumption of more Long Term Debt than is currently required to meet Chugach’s needs.
3. Establish an interim liquidity vehicle to finance needs as they arise – “All In” interest rates are lower than long term rates. Allows access to credit as needs arise. This alternative allows access to credit as needs arise and provides a timing platform from which to enter the long-term market and decreases overall financing risk.

Types of Liquidity Vehicles:

1. Commercial Paper Program – Short term instrument where Chugach issues commercial paper to many lenders in maturities up to one year. Interest rate is tied to the London Inter Bank Offering Rate (LIBOR) plus fees to establish and maintain the program. This is a highly liquid (versatile) financing vehicle that offers easy access to credit, an ability to set various maturities (up to one year) and issue required principal amounts. A “back stop” facility in case commercial market does not have sufficient purchasers is required.
2. Syndicated Facility – Similar to a Commercial Paper program in terms of interest rates, maturities and back stop requirement. Difference is the scope (number) of lenders (purchasers) is limited to banks that join the syndicate.
3. Revolving Line of Credit – Multi year short term line of credit established with one Lender.

The purpose of the liquidity vehicle is to gain access to low cost, short term debt financing to meet current needs. These funds will be “rolled over” into long term debt at appropriate times – when the amount of Commercial Paper outstanding reaches a level that makes economic sense for issuing long term bonds or other long term notes. The program also offers the flexibility to Chugach to finance current needs at an attractive interest rate with short term debt during times of high interest rates in the long term debt market.

Process:

Chugach solicited requests for Proposal for an interim financing vehicle from eight banking institutions. Seven responses were received and evaluated.

The respondents included:

1. N.R.U.C.F.C. (Commercial Paper & Syndicated Program)
2. Merrill Lynch (Long Term Fixed Rate Bond).
3. Bank of America (Revolving Line of Credit)
4. J.P. Morgan (Floating Rate Notes)
5. Co Bank (Revolving Line of Credit)
6. Goldman Sachs (Commercial Paper)
7. U.B.S. (Fixed/ Bullet)

The evaluation criteria included:

1. Pricing – “all in” cost.
2. Duration – 3 to 5 years.
3. Any Restrictions on use of the funds.
4. Ease of access to the facility’s funds.
5. Quality of “back stop” facility’s credit (credit rating of the back stop provider(s)).
6. Timeline to implement – 30 to 45 days.
7. Other Chugach required ratings or instrument establishment requirements.

Recommendation:

The N.R.U.C.F.C Commercial Paper program offered the lowest “all in” pricing (at LIBOR plus 72 basis points), met the facility length requirement of 3 to 5 years, did not restrict Chugach in how the funds could be used, provides “A” rated credit facilities as “back stop”, provided a workable implementation plan and training in the use of the commercial paper program. The N.R.U.C.F.C. program will require Chugach to obtain two “commercial paper” ratings from rating agencies. These should be easily obtained as the rating agencies will rely on our underlying “A2” and “A-“ratings.

Other Considerations and Information:

Impact on Key Ratios:

Days of Liquidity on Hand:

By adding the Commercial Paper program to our portfolio, we will improve “Days of Liquidity on Hand” from 49 to 228, assuming a first year usage of \$200 million. This brings us closer to the G&T norm of 246 and demonstrates our increased flexibility to fund projects and other requirements.

Current Ratio:

Commercial Paper is considered “short term” debt and will be classified as a Current Liability on Chugach’s Balance Sheet.

The “Current Ratio (a measure of ability to pay current obligations with current assets – cash and other liquid assets) is calculated as “Current Assets/ Current Liabilities”.

Addition of more short term debt on Chugach’s Balance Sheet may cause the Current ratio to fall below 1:1 (it is desirable to keep the ratio above 1:1 to demonstrate ability to pay current obligations).

Discussions with two of Chugach’s rating agencies indicate that since the Commercial Paper balances will vary and the program will ultimately either be extinguished or the balance converted to long term debt, a Current Ratio below 1:1 due to this program will have little or no impact on our ratings. The more important issue for one of the agencies revolved around the potential covenants contained in the “back stop” facility.

Margins for Interest/ Interest (“MFI”):

Short Term Interest Expense is included in the calculation of MFI, this ratio will need to be carefully watched to insure compliance with the 1.10 minimum Indenture of Trust covenant. Low interest rates for the Commercial Paper program will keep short term interest expense low. It is expected that the additional interest expense will be offset by Capitalized Interest entries for construction projects which will have a positive impact on the Income Statement.

Impact on Electric Rates:

Electric rates will not be impacted at this time. Short term interest expense will impact margins as it is an expense.

“Backstop Facility”:

The purpose of the “backstop” facility provided by N.R.U.C.F.C. and Key Bank is to insure the liquid nature of the program. The backstop is in place to insure there will be sufficient purchaser’s (N.R.U.C.F.C. and Key Bank) of our Commercial Paper at any given maturity date.

N.R.U.C.F.C. and Key Bank’s back stop facility is comprised of two “senior” unsecured liquidity guarantees. N.R.U.C.F.C. will provide \$150 million and Key Bank has committed to \$100 million.