

SOLID

Why tremors on Wall St. don't crack the cooperative model

By Andrea Blowers

A candid conversation with Basin Electric CFO Buzz Hudgins and Dave Raatz, manager of marketing and power supply planning, reveals how Basin Electric remains stable in the current financial and economic crisis.

How has the current financial crisis affected Basin Electric?

Hudgins: This financial crisis has affected all segments of the American economy including utilities and Basin Electric. First, some of the financial entities we have worked closely with in the past are themselves

experiencing difficulties, prompting us to put more effort into communications and development of additional avenues of

capital. Second, the cost of capital has risen substantially. Third, the economic health of our service territory and its projected load growth is a concern.

Why has Basin Electric been able to remain financially stable when other businesses are struggling?

Hudgins: Basin entered this financial crisis with exceptionally strong financial metrics and bond ratings. Basin also is providing an essential service at a very favorable price compared to the marketplace.

How does the cooperative business model differ from other business models?

Hudgins: It's a very interesting question. From a purely financial perspective, the main difference lies in the fact that cooperatives are unable to raise equity quickly, like an investor-owned utility does.

We can't go out and issue stock. We have to grow our equity through our membership. So, as we prepare for growth at

Basin, and in order to preserve the correct capitalization ratio, we have to take a very long view. That is the main difference, financially, between our model and the investor-owned utility model. It's not necessarily a negative by any means, it's just that we have to be prepared to grow equity from a long-term perspective.

Raatz: From a power supply planning perspective, when developing generation we try to develop resources that have the lowest power supply costs spread over a long period of time. In other words, we tend to develop more capital-intensive resources with more stable fuel costs. These types of baseload resources ensure less fluctuation in costs to the membership and lower long-term member rates. From an IOU (investor-owned utility) perspective, they tend to be less concerned about fuel cost risk, as these costs can generally be passed on to the consumer and, as a result, they tend to develop less capital-intensive resources that have more fuel cost variability.



Dave Raatz, Basin Electric manager of marketing and power supply planning

So, in general, would you say cooperatives are a little more conservative in managing their financial affairs?

Hudgins: I would. The rural electric cooperatives tend to focus almost exclusively on their core mission – providing reliable, cost-effective power to their members. They avoided the temptation to diversify into other lines of business that the investor-owned utility community fell into in the early part of the decade – with disastrous results for some. Cooperatives also do not have to focus on short-term share price moves, as stock-held companies do. There is no pressure upon cooperative boards and management for short-term performance, freeing them to make decisions for the long-term benefit of the cooperative.

Basin Electric completes a load forecast, which weighs heavily on the financial forecast. Can you explain the relationship between the two?

Hudgins: The origins of the financial forecast begin in marketing. They prepare the power requirement study or load forecast. Once that power requirement study has been prepared, Dave (Raatz) and his people develop a resource plan to meet those requirements, which includes things like the cost of generation, fuel expense and all the expenses associated with the growth in our generation portfolio. These and other inputs then go into the financial forecast.

So it's really a three-stage process that begins with the power requirement study of our members, then it goes into the resource plan to meet those power requirements. Thirdly, all of that goes into the financial forecast, which then comes down to a bottom line, and that bottom line is what the mill rate will be to the members, forecasted over the next 10 years.

Dave, can you explain exactly what goes into completing the load forecast and how often it's done?

Raatz: Every utility needs to do load forecasting because it's the foundation for resource and financial planning.

Basin Electric is currently on a schedule with the RUS (Rural Utilities Service) to do a new official load forecast every two years. We did one in 2007, and we just finished another in 2009, and we'll do another forecast in 2011.

We used to do it about every four years. When Basin had 1,000 megawatts of surplus, we weren't having to borrow money; we weren't in resource expansion. Today, we're in a building phase, so now we're developing new load forecasts on a two-year cycle. This allows Basin Electric to continually monitor future load growth expectations so we can develop the lowest resource alternates to meet our member power supply obligations.

Essentially, we gather historical and forecasted information from different databases and independent sources for the foundational assumptions. We then use the historical information to develop what they call econometric models that mathematically calculate historical load levels that can be trended over time, like residential growth. We then apply the forecasted information into the econometric models to forecast a portion of our member power needs.

We also develop specific load forecasts for different segments of our member power needs like coal-bed methane and oil-related load growth upon interviews with the end-use consumer. And we work closely with our membership to forecast specific load growth opportunities in their service territories.

This load forecasting process is a collaborative effort between Basin Electric staff and our members.

Buzz, because the financial forecast relies heavily on the cooperative's load forecast, can you explain how Basin Electric's financial forecast has changed in the last five years?

Hudgins: The recent information we've gotten from our members contained in the power requirement study shows a less rapid member growth projected over the next 10 years, which translates into less new generation, less cap-ex (capital expenditures), less debt required and frankly, a lower mill rate.

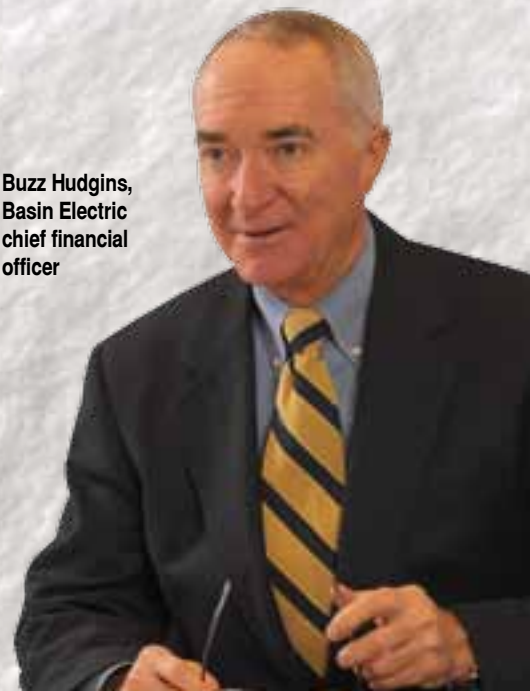
The good news is we are still projecting growth throughout the membership, which shows that our territory is healthy, at least as we understand it today. We are just not growing as rapidly as we had originally predicted.

How have these changes impacted the membership?

Hudgins: We believe that these changes will show a slower increase in the member mill rate from what was originally projected over the last couple of years.

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Buzz Hudgins,
Basin Electric
chief financial
officer



Dave, from your perspective, what are the most significant factors driving the changes in the load forecast?

Raatz: As the energy industry, such as oil, gas and coal development, is so prevalent in the Basin Electric membership area, energy prices are probably the biggest driver. We are also seeing a significant falloff of residential growth – a direct impact of the stall in construction of new homes in developments served by co-ops.

For Basin Electric, what areas have been affected the most by the current economy?

Raatz: In our 2007 load forecast we saw significant load growth in the PRECorp (Powder River Energy Corporation) area in Wyoming related to coal-bed methane development and coal mining. We also saw tremendous oil-related load growth in western North Dakota. In eastern South Dakota, Minnesota and Iowa, there was tremendous residential growth because of the I-29 corridor and all the ethanol plants. The result of the new load forecast shows the same areas of load growth, but at a reduced rate. Basically, the price of oil and gas has come down, so we’re seeing reduced growth.

From the 2007 to 2009 load forecasts, there’s about a 200-megawatt drop in our member loads by the year 2016. Most of this reduction can be directly attributed to reduced energy development. We are also seeing a reduction in residential load growth throughout the whole region. So, the state of the economy is having an impact on us. However, it’s not as significant in our general area as in other parts of the United States.

Residential growth in our service area is forecasted to be 1.42 percent compared to a national average of 0.73 percent. The same is true in commercial growth – 2.48 percent within Basin Electric’s membership; 1.10 percent on a national average.

We also have the potential for the development of a new TransCanada Pipeline that will run through eastern Montana and western South Dakota. If this new pipeline is constructed, it will require additional electrical power supply. The first phase of the pipeline is expected to require 130 megawatts of power by 2013.

Based upon our new 2009 load forecast and the expectation that at least the first phase of the TransCanada Pipeline will be constructed, we are forecasting our members will experience about 1,600 megawatts of new load growth by 2023. With this magnitude of load growth, Basin Electric will need to make commitments for additional amounts of generation capacity.

Going forward, what will be the most significant challenge Basin Electric and its membership will face?

Hudgins: Without a doubt, the carbon emissions uncertainty is the biggest challenge we face. This has the potential, given what we know today, to have a huge impact upon our mill rate to our membership. Behind that I would list the economic downturn and how long it will continue.

Raatz: I agree, a carbon dioxide tax is going to have a huge impact on what happens to the economy and what happens to resource development. Electricity prices will certainly go up,

but so will other commodity prices. If the price of energy goes up in this country, it will have an impact on the price of food in the grocery stores, the price of products sold by Wal-mart, and everything else.

Carbon dioxide tax legislation will change resource development significantly.

So, knowing legislation is coming, how do you deal with that?

Raatz: It makes it very difficult.

There’s also the impact of the country’s future energy policy. What’s that going to look like? Is this country going to have a mandated renewable portfolio standard? If a tremendous amount of wind resources is constructed, it will change the price of power in the market and resource development strategies. We’ll need to expand transmission significantly if large amounts of wind are developed in the Dakotas, and who is going to pay for that transmission expansion? All of these factors have yet to be defined, but play major roles in Basin Electric’s forecasting and resource development.

What have been Basin Electric’s greatest strengths since the financial crisis began?

Hudgins: Basin’s strength is that of its membership – we should never lose sight of that. This was the case before the financial crisis and will continue well beyond it. Specifically with regard to the last nine months, I would say the greatest strength from a financial perspective is the fact that for a long time we’ve maintained an active communications program with the financial community. They understand and appreciate the Basin story, as you can see from our very strong bond ratings and our reception by the financial community.

“Basin’s strength is that of its membership – we should never lose sight of that.”
Buzz Hudgins, Basin Electric