

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF HENDERSON-UNION)
RURAL ELECTRIC COOPERATIVE CORPORA-)
TION TO CONVERT NATIONAL RURAL) CASE No. 90-024
UTILITIES COOPERATIVE FINANCE)
CORPORATION'S NOTE FROM A VARIABLE)
RATE TO A FIXED RATE)

O R D E R

On January 31, 1990, Henderson-Union Rural Electric Cooperative Corporation ("Henderson-Union") filed a request that the Commission grant approval of the conversion of National Rural Utilities Cooperative Finance Corporation ("CFC") Loan No. 03-20-055-9014 ("9014") from a variable to a fixed interest rate. At the time Henderson-Union was advanced the funds on this loan, it elected to use CFC's variable interest rate program. The terms of the loan agreement give Henderson-Union the option to convert the loan to the fixed interest rate program in its next repricing year. The repricing year for this loan is 1990, and Henderson-Union has decided to exercise its option, securing a fixed interest rate of 9.5 percent. Henderson-Union's board of directors voted to exercise the option on February 22, 1990.

In its response to the Commission's March 6, 1990 Order, Henderson-Union indicated that it did not perform any financial analysis to evaluate the projected net savings resulting from the conversion of Loan No. 9014 from the variable to fixed rate program. In its April 6, 1990 Order, the Commission requested

Henderson-Union to provide a financial analysis of the interest rate program options using either a present value model approach or an internal rate of return approach. In its response to the April 6, 1990 Order, Henderson-Union provided a cash flow analysis which included a net present value calculation. However, the analysis did not adequately reflect the fluctuating nature of variable interest rates over a period of time.

In previous cases before the Commission involving loan conversions, the Commission has indicated that a present value based financial analysis is an integral part of the determination of whether to undertake the loan conversion. The use of a present value analysis requires that specific assumptions concerning changes in interest rates be made. While it is difficult to predict the interest rates of the future, reasonable assumptions can be made using historic trends, the current condition of the financial markets, and an evaluation of related economic factors.

The Commission has reviewed the interest rates available on CFC loans and believes that the conversion proposed by Henderson-Union is a reasonable action to take at this time. The availability of a fixed 9.5 percent interest rate over the next seven years should be beneficial to Henderson-Union and its ratepayers. However, the Commission advises Henderson-Union that in future cases where loan interest rate conversions are sought, Henderson-Union will be expected to present specific assumptions concerning the future of interest rates and prepare adequate present value based financial analyses.

Based on the evidence of record and being advised, the Commission hereby finds that the conversion of Loan No. 9014 from a variable to a fixed interest rate should be approved. Within 20 days of the finalization of the loan conversion, Henderson-Union should inform the Commission of the effective date of the fixed interest rate program.

IT IS THEREFORE ORDERED that:

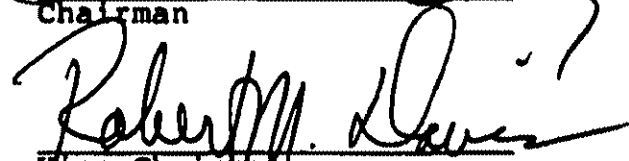
1. Henderson-Union's request to convert CFC Loan No. 9014 be and it hereby is granted.

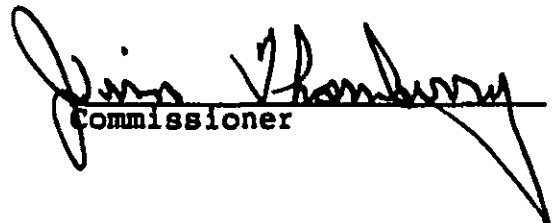
2. Within 20 days of the finalization of the loan conversion, Henderson-Union shall inform the Commission of the effective date of the fixed interest rate program.

Done at Frankfort, Kentucky, this 21st day of May, 1990.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director