

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF HENDERSON-UNION)
RURAL ELECTRIC COOPERATIVE)
CORPORATION FOR AN AMENDMENT TO) CASE NO 92-193
PRIOR ORDERS OF THE COMMISSION)
AUTHORIZING ISSUANCE OF EVIDENCE OF)
INDEBTEDNESS)

O R D E R

On April 29, 1992, Henderson-Union Rural Electric Cooperative Corporation ("Henderson-Union") filed a request that the Commission amend its prior Orders entered in Case No. 6270,¹ Case No. 6543,² Case No. 6788,³ Case No. 7762,⁴

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- ¹ Case No. 6270, The Application of Henderson-Union Rural Electric Cooperative Corporation for Permission to Borrow From the United States of America \$580,000.00 and From National Rural Utilities Cooperative Finance Corporation \$249,000.00 and to Issue Its Notes Therefor, Order dated May 21, 1975.
- ² Case No. 6543, The Application of Henderson-Union Rural Electric Cooperative Corporation for Permission to Borrow From the United States of America \$556,000.00 and From National Rural Utilities Cooperative Finance Corporation \$240,000.00 and to Issue Its Notes Therefor, Order dated May 18, 1976.
- ³ Case No. 6788, The Application of Henderson-Union Rural Electric Cooperative Corporation for Permission to Borrow From the United States of America \$556,000.00 and From National Rural Utilities Cooperative Finance Corporation \$240,000.00 and to Issue Its Notes Therefor, Order dated April 19, 1977.
- ⁴ Case No. 7762, The Application of Henderson-Union Rural Electric Cooperative Corporation for Permission to Borrow From United States of America \$2,771,000.00 and From National Rural Utilities Cooperative Finance Corporation \$1,250,000.00 and to Issue Its Notes Therefor and for a Certificate of Convenience and Necessity, Order dated March 28, 1980.

Case No. 9477,⁵ and Case No. 90-024⁶ to authorize the conversion from a fixed to a variable interest rate for National Rural Utilities Cooperative Finance Corporation ("CFC") Loan Nos. 9004, 9005, 9006, 9011, 9014, and 9015. The terms of these 35-year loans originally provided for a fixed interest rate for the first 7 years, after which, the rate would be renegotiated. Since the execution of these loans, interest rates have been substantially reduced and CFC has allowed borrowers to convert to a reduced variable interest rate. The current fixed interest rate for these loans was 9.5 percent, 9.5 percent, 8.5 percent, 8.75 percent, 9.5 percent, and 8.75 percent, respectively. The variable rate applicable for these loans is 5.375 percent. On April 24, 1992, Henderson-Union's Board of Directors voted to convert to the variable rate.

When converting from the fixed rate program to the variable rate program, CFC requires the payment of a conversion fee. The conversion fee for each loan is based on the difference in the interest rate on the note and CFC's long-term interest rate at the

⁵ Case No. 9477, The Application of the Henderson-Union RECC for Permission to Borrow From National Rural Utilities Cooperative Finance Corporation \$935,052.00 and to Issue Its Notes Therefor and for a Certificate of Convenience and Necessity, Order dated February 3, 1986.

⁶ Case No. 90-024, Henderson-Union Rural Electric Cooperative Corporation to Convert National Rural Utilities Cooperative Finance Corporation's Note From a Variable Rate to a Fixed Rate, Order dated May 21, 1990.

time the borrower elects to convert to the variable rate. The difference is applied to the outstanding loan balance at the start of the borrowers next first full quarterly billing cycle for the time remaining until a repricing option would have been allowed. A one-time, up-front fee of 25 basis points on the outstanding balance at the time of conversion is added to the conversion fee.⁷ The conversion fee could be paid either in quarterly payments or as a discounted up-front payment. The total conversion fee would be \$112,406 if paid quarterly and \$97,664 if paid up-front.

Henderson-Union provided a series of Internal Rate of Return ("IRR") analyses for each loan it proposed to convert. Under the IRR approach, the goal of the borrower would be to utilize the interest rate program which produces the lowest IRR. For each loan, Henderson-Union determined an IRR value for the following three different scenarios:

1. The current variable rate remained constant for the remainder of the pricing cycle ("Scenario I").
2. The current variable rate would begin increasing by .25 percent each quarter, beginning with the third quarter after conversion, for the remainder of the pricing cycle ("Scenario II").
3. The third scenario involved determining the variable interest rates which, when applied beginning with the third

⁷ Response to the Commission's Order dated May 12, 1992, Item 1(a).

quarter after conversion, would result in an IRR value approximately equal to the IRR value resulting from the current fixed interest rate. Henderson-Union considered this the break-even scenario.

Each scenario was run twice showing the impact on the IRR value of each payment option chosen for the conversion fee.

The analyses indicated that, under either Scenario I or II, the resulting IRRs for the variable interest rate were lower than the IRR for the fixed interest rate. The scenario results also indicate it is beneficial to Henderson-Union to pay the conversion fees up-front rather than quarterly. Scenario I resulted in a net cumulative savings of \$149,659 when the conversion fees were paid up-front and \$134,917 when the conversion fees were paid quarterly. Scenario II resulted in a net cumulative savings of \$32,078 when the conversion fees were paid up-front and \$17,335 when the conversion fees were paid quarterly. The net savings were lower in Scenario II because four of the six loans had 15 or more quarters remaining in the current pricing cycle. Under the assumptions incorporated in Scenario II, the increasing variable interest rate on individual loans resulted in significantly lower savings and in some instances a net increase in cost, when the conversion fee was paid quarterly.

Henderson-Union indicated that it would pay the conversion fees under the up-front payment option.⁸ Henderson-Union stated

⁸ Id., Item 1(b).

that while it did not see any indication of increases in the variable interest rate in the near future, it intended to constantly monitor the rates, and at whatever time indicators showed it to be advantageous, lock into a fixed rate.⁹ Based upon Henderson-Union's analyses and the conditions presented in this case, the conversions of the six loans should result in interest savings on an IRR basis and the loans should be converted as requested.

IT IS THEREFORE ORDERED that:

1. The Commission's Orders entered in Case Nos. 6270, 6543, 6788, 7762, 9477, and 90-024 be and they hereby are modified to authorize the conversion from a fixed to a variable rate program for CFC Loan Nos. 9004, 9005, 9006, 9011, 9014, and 9015.

2. Henderson-Union shall notify the Commission of the closing date of the conversions and shall file, within 30 days of the conversions, all documents pertaining thereto.

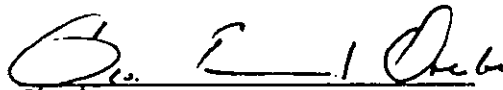
3. Henderson-Union shall file, along with its monthly financial report to the Commission, the current interest rate on its variable rate loans outstanding.

4. All provisions of the Commission's Orders entered in Case Nos. 6270, 6543, 6788, 7762, 9477, and 90-024 shall remain in full force and effect.

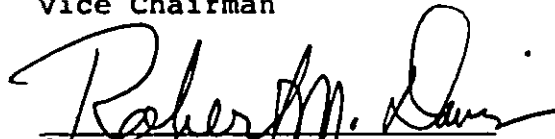
⁹ Id., Item 3.

Done at Frankfort, Kentucky, this 1st day of June, 1992.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director