

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

GRAYSON RECC'S REQUEST TO CONVERT THE)
INTEREST RATES ON CFC NOTES #9014 AND) CASE NO. 94-087
#9015 FROM A FIXED INTEREST RATE TO A)
VARIABLE INTEREST RATE)

O R D E R

On March 10, 1994, Grayson Rural Electric Cooperative Corporation ("Grayson") filed a request that the Commission amend its prior Orders entered in Case No. 8394¹ and Case No. 9343² to authorize the conversion from a fixed to a variable interest rate for National Rural Utilities Cooperative Finance Corporation

¹ Case No. 8394, The Application of Grayson Rural Electric Cooperative Corporation for an Order Authorizing said Corporation to Borrow \$1,280,000 from the United States of America and to Borrow \$578,000 from the National Rural Utilities Cooperative Finance Corporation and to Execute Notes to the Government of the United States of America, and to the National Rural Utilities Cooperative Finance Corporation in the Aforesaid Sums of \$1,280,000 and \$578,000 to Provide Funds for the Construction of Distribution and Service Lines, Miscellaneous Construction including Transformers, System Improvements, Labor, Member Service Material and Other Expenses and Contingencies, Order dated December 23, 1981.

² Case No. 9343, The Application of Grayson Rural Electric Cooperative Corporation for an Order Authorizing said Corporation to Borrow \$1,050,000 from the United States of America and to Borrow \$463,918 from the National Rural Utilities Cooperative Finance Corporation and to Execute Notes to the Government of the United States of America, and to the National Rural Utilities Cooperative Finance Corporation in the Aforesaid Sums of \$1,050,000 and \$463,918 to Provide Funds for the Construction of Distribution and Service Lines, Miscellaneous Construction including Transformers, System Improvements, Labor, Member Service Material and Other Expenses and Contingencies, Order dated June 24, 1985.

("CFC") Loan Nos. 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 allowed borrowers to convert to a reduced variable interest rate. The current fixed interest rate on both of these loans is 9.375 percent. The variable rate applicable for these loans is 4.10 percent. On October 22, 1993, Grayson's Board of Directors voted to convert to the variable rate.

When converting from the fixed rate program to the variable rate program, CFC normally requires the payment of a conversion fee. However, the loans have been in force long enough that both are at the renegotiation period. Under the CFC loan conditions, a borrower may change interest rate options without paying a conversion fee.

Grayson 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. Grayson compared the fixed interest rate available as of January 1994 of 6.55 percent against the applicable variable interest rate. For each loan, Grayson provided an IRR value for the following 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 quarter after conversion, would result in an IRR value approximately equal to the IRR value resulting from the currently available fixed interest rate. Grayson considered this the break-even scenario.

Scenario I resulted in a net cumulative savings of \$117,104. Scenario II, which contained a constant increase in the variable interest rate, resulted in a net cost increase \$68,043. This is not a likely scenario because of the defined parameters. Many utilities view the assumptions in Scenario II to be a "worst case" scenario. Grayson, though, did not state this. Scenario III showed that the variable interest rate could reach 7.31 percent and Grayson would still be better off using the variable option than the fixed option.

Grayson plans to monitor the rates monthly and use CFC's "FXVAR" program to determine whether or not the loans should be locked into a fixed rate at some point in the future. Based upon Grayson's analyses and the conditions presented in this case, the conversions of the 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. 8394 and 9343 be and they hereby are modified to authorize the conversion from a fixed to a variable rate program for CFC Loan Nos. 9014 and 9015.

2. Grayson 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. Grayson shall file, along with its monthly financial report to the Commission, the current interest rate on its variable rate loans outstanding.

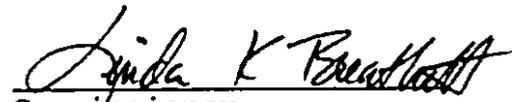
4. All other provisions of the Commission's Orders entered in Case Nos. 8394 and 9343 shall remain in full force and effect.

Done at Frankfort, Kentucky, this 9th day of May, 1994.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director