COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF INTER-COUNTY RURAL ELECTRIC COOPERATIVE CORPORATION TO CONVERT ITS CFC LOANS FROM STANDARD FIXED RATE TO A VARIABLE RATE	)	CASE NO. 92-366

O R D E R

On August 20, 1992, Inter-County Rural Electric Cooperative Corporation ("Inter-County") filed a request that the Commission amend its prior Orders entered in Case No. 6453,[1] Case No. 6621,[2]

[1] Case No. 6453, The Application of Inter-County Rural Electric Cooperative Corporation for an Order Authorizing it to Borrow From the United States of America $612,000 and From the National Rural Utilities Cooperative Finance Corporation $262,000 for the Purpose of Improving Existing Lines and Facilities and for Constructing Additional Lines and Facilities; and to Execute a Mortgage Note for $612,000 Payable to the United States of America and a Mortgage Note for $262,000 Payable to the National Rural Utilities Cooperative Finance Corporation, Order dated January 20, 1976.

[2] Case No. 6621, The Application of Inter-County Rural Electric Cooperative Corporation for an Order Authorizing it to Borrow from the United States of America $610,000 and from the National Rural Utilities Cooperative Finance Corporation $262,000 for the Purpose of Improving Existing Lines and Facilities and for Constructing Additional Lines and Facilities; and to Execute a Mortgage Note for $610,000 Payable to the United States of America and a Mortgage Note for $262,000 Payable to the National Rural Utilities Cooperative Finance Corporation, Order dated September 15, 1976.

Case No. 7339,[3] Case No. 8382,[4] and Case No. 10227[5] to authorize the conversion from a fixed to a variable interest rate for National Rural Utilities Cooperative Finance Corporation ("CFC") Loan Nos. 9010, 9012, 9017, 9021, and 9023. 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

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[3] Case No. 7339, The Application of Inter-County Rural Electric Cooperative Corporation for an Order Authorizing it to Borrow from the United States of America $2,243,000 and from the National Rural Utilities Cooperative Finance Corporation $1,012,000 for the Purpose of Improving Existing Lines and Facilities and for Constructing Additional Lines and Facilities; and to Execute a Mortgage Note for $2,243,000 Payable to the United States of America and a Mortgage Note for $1,012,000 Payable to the National Rural Utilities Cooperative Finance Corporation, Order dated March 19, 1979.

[4] Case No. 8382, The Application of Inter-County Rural Electric Cooperative Corporation for an Order Authorizing it to Borrow from the United States of America $1,619,000 and from the National Rural Utilities Cooperative Finance Corporation $730,000 for the Purpose of Improving Existing Lines and Facilities and for Constructing Additional Lines and Facilities; and to Execute a Mortgage Note for $1,619,000 Payable to the United States of America and a Mortgage Note for $730,000 Payable to the National Rural Utilities Cooperative Finance Corporation, Order dated November 25, 1981.

[5] Case No. 10227, The Application of Inter-County Rural Electric Cooperative Corporation for an Order Authorizing it to Borrow from the United States of America $2,030,000 and from the National Rural Utilities Cooperative Finance Corporation $896,907 for the Purpose of Improving Existing Lines and Facilities and for Constructing Additional Lines and Facilities; and to Execute a Mortgage Note for $2,030,000 Payable to the United States of America and a Loan Agreement and Mortgage Note for $896,907 Payable to the National Rural Utilities Cooperative Finance Corporation secured by a Restated Mortgage and Security Agreement, Order dated May 24, 1988.

substantially reduced and CFC has allowed borrowers to convert to a reduced variable interest rate. The current fixed interest rate for these loans is 9.5 percent, 9.5 percent, 9.0 percent, 9.25 percent, and 9.50 percent, respectively. The variable rate applicable for these loans is 5.375 percent. On August 14, 1992, Inter-County'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 time the borrower elects to convert to the variable rate. The difference is applied to the outstanding loan balance at the start of the borrower's 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. The conversion fee could be paid either in quarterly payments or as a discounted up-front payment. The total conversion fee would be $158,167 if paid quarterly and $138,556 if paid up-front.

Inter-County 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, Inter-County 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 quarter after conversion, would result in an IRR value approximately equal to the IRR value resulting from the current fixed interest rate. Inter-County 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 Inter-County to pay the conversion fees up-front rather than quarterly. Scenario I resulted in a net cumulative savings of $110,282 when the conversion fees were paid up-front and $90,672 when the conversion fees were paid quarterly. Scenario II resulted in a net increase cost of $17,465 when the conversion fees were paid up-front and $51,065 when the conversion fees were paid quarterly. There were no net savings in Scenario II because three of the five loans had 14 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 a significant increase in cost, when the conversion fee was paid quarterly.

In its request, Inter-County indicated that it would pay the conversion fees up-front. Inter-County stated that it viewed the assumptions in Scenario II to be a "worst case" scenario. While stating that it did not see variable interest rates increasing or decreasing dramatically in the next few months, Inter-County would continue to monitor interest rates and whenever indicators showed it to be advantageous, it would lock into a fixed rate. Based upon Inter-County's analyses and the conditions presented in this case, the conversions of the five 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. 6453, 6621, 7339, 8382, and 10227 be and they hereby are modified to authorize the conversion from a fixed to a variable rate program for CFC Loan Nos. 9010, 9012, 9017, 9021, and 9023.

2. Inter-County 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. Inter-County 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. 6453, 6621, 7339, 8382, and 10227 shall remain in full force and effect.

Done at Frankfort, Kentucky, this 8th day of October, 1992.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director