

NCEMPA 2008 Wholesale Rate Increase Fact Sheet

Factors causing the increase:

The factors causing the rate increase are the same factors that affect all products and services: supply and demand, regulations, cost of materials and labor.

Specifically for NCEMPA:

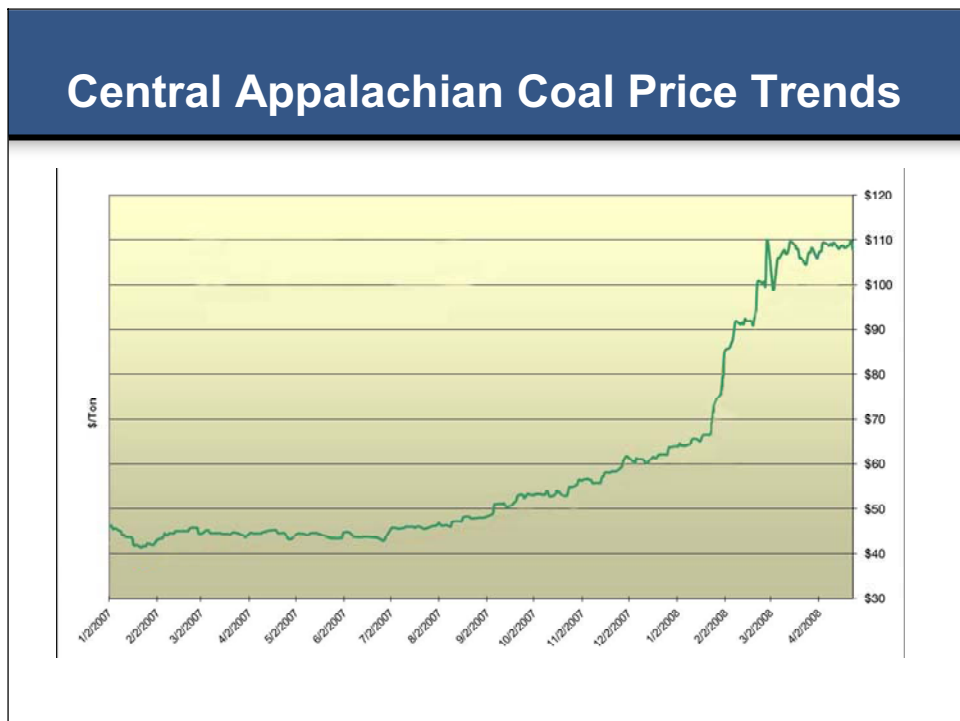
- Coal cost
- Cost to produce nuclear power
- Financing costs
- Transmission costs
- Operations/maintenance costs

Coal Costs:

Both domestic and global demand has contributed to the cost increases. China and India are in a period of rapid growth and modernization. They are continuing to build coal plants and are willing to pay a premium to import coal from the US. In areas served by Appalachian coal, supplies are very tight as inventories are lower than usual and production continues to be affected by labor shortages. Currently, the price of coal is not affecting demand for coal.

The NCEMPA-owned coal plants (Roxboro and Mayo Plants) use Central Appalachia (CAP) coal. Spot Market Prices in 2002 were approximately \$30/ton. A significant increase occurred in 2004-2005 when prices jumped to \$60/ton. Now, as a result of increased demand, along with limited production versus supply, CAP coal has jumped to over \$100/ton.

In addition to the global demand for coal, transportation costs (rail) associated with coal have increased. Transportation costs are tied to oil prices, and we have seen oil prices at an all time high, reaching \$132/barrel.



Nuclear Fuel Costs:

Increases in raw uranium prices have also contributed to overall increases in nuclear fuel costs.

The cost of uranium material is about 25-30 percent of the total cost of nuclear fuel. All other phases of nuclear fuel production have seen some increases; however, the cost of the raw material has increased significantly. Canada and Australia account for almost half of worldwide uranium mining. Floods at several mines in 2006 and 2007, along with an increased market speculation as a result of new nuclear plant announcements, drove spot market prices up to all time highs at \$135/lb. Prior to this sudden increase, these prices had been below \$20/lb. for the last decade. Even though Progress Energy has long-term contracts that lock in the supply of uranium, these contracts have escalation clauses. As a result, increases in the spot market price for uranium will cause overall nuclear fuel costs to increase.



Financing Costs:

NCEMPA has outstanding debt from the purchase of ownership interests in a number of coal and nuclear plants that are operated by Progress Energy. Historically, NCEMPA has maintained a portion of its debt in variable rate debt securities to manage exposure to interest rates on both its investment and debt portfolio as well as to minimize debt service costs. Recent events in the credit markets, and specifically the subprime mortgage crisis, have adversely impacted the variable rate debt programs of NCEMPA and hundreds of other issuers.

Prior to the recent bond refundings, variable rate debt accounted for approximately 15 percent of the Agency's total outstanding debt and was delivering savings to the Power Agency. It was standard industry practice to have this type of variable rate debt as part of a prudent financing strategy. Numerous North Carolina entities, such as the airport authorities, healthcare systems and publicly traded corporations used these same strategies. Most of them are now digging out from the damage the subprime mortgage crisis caused.

Interest rates on the Agency's variable rate debt, which were insured by MBIA Inc., rose significantly as a result of the subprime mortgage crisis. The impact of the subprime mortgage crisis on MBIA's perceived and actual credit rating has inflicted significant collateral damage on sound borrowers, including NCEMPA. Failing subprime mortgages have significantly eroded the capital base of the bond insurers, including MBIA, due to significant write-downs of their subprime portfolios. While MBIA was just recently downgraded by Standard & Poors from AAA to AA credit rating, the market's perception of the value of their AAA ratings deteriorated in mid-February, adversely affecting all types of municipal and other debt insured by them.

NCEMPA moved quickly to take action to move the existing variable rate debt into fixed rate securities and completed the sale of the fixed rate bonds on April 29. According to an April 21 *Bloomberg* article, approximately 25 percent of outstanding auction rate securities had been, or were in the process of, being redeemed or converted as of the date of the article, which placed NCEMPA in the first quartile of issuers to address the issue. Even though NCEMPA moved quickly, incremental costs were incurred due to increased interest rates and the one-time costs associated with refunding the variable rate debt. Now all of NCEMPA's outstanding debt is at fixed interest rates. The weighted average interest rate of the Power Agency debt is 5.8 percent.

NCEMPA has two remaining commitments that may be adversely impacted by the current market turmoil. As part of a forward refunding plan for debt service savings the Agency entered into forward starting interest rate swaps in anticipation of refunding the 1999 A, B and C bond series in the fall of 2008 and the 1999 D bond series in the fall of 2009. Depending upon the prevalent market conditions, the Agency may incur additional debt service costs, or generate debt service savings, once the refundings are completed. Staff will continue to keep the Board of Directors and the Board of Commissioner's informed of the status of this issue.

Transmission Costs:

The transmission system carries power from power plants to substations located in cities and towns. Progress Energy has determined that additional projects and expenditures are necessary to maintain adequate and reliable transmission service. Progress Energy filed for an increase in their transmission rate paid by all customers that use the transmission system. NCEMPA is a wholesale customer of Progress Energy and pays for transmission service per the Open Access Transmission Tariff (OATT). The projected increase is approximately \$3 million per year.

Progress Energy notified the Power Agency of this change and their plans to file at the Federal Energy Regulatory Commission in late November 2007, after the 2008 budget was already approved.

Operations and Maintenance Costs:

The plants that NCEMPA jointly owns were all constructed before 1987. While they continue to operate efficiently and Progress Energy maintains the facilities well, their age necessitates an increasing cost to keep them operational and to ensure compliance with new federal standards, including emissions standards.

Higher material and labor costs are also contributing to the increased capital and operating and maintenance cost increases. The increased operations and maintenance activities, material and labor costs, and capital additions are causing additional increases in NCEMPA expenses.