

# Exhibit to Agenda Item #2a

Board Policy Committee and Special SMUD Board of Directors Meeting

Wednesday, January 17, 2018, scheduled to begin at 5:30 p.m.

Customer Service Center, Rubicon Room

# Strategic Direction (SD)-3

## Access to Credit Markets

Maintaining access to credit markets is a core value of SMUD.

Therefore:

- For SMUD's annual budgets, the Board establishes a minimum target of cash coverage of all debt service payments (fixed charge ratio) of 1.45 times
- When making resource decisions, SMUD shall weigh the impacts on long-term revenue requirements, debt, financial risk and flexibility
- SMUD's goal is to maintain at least an "A" rating with credit rating agencies.

# Evidence of Compliance

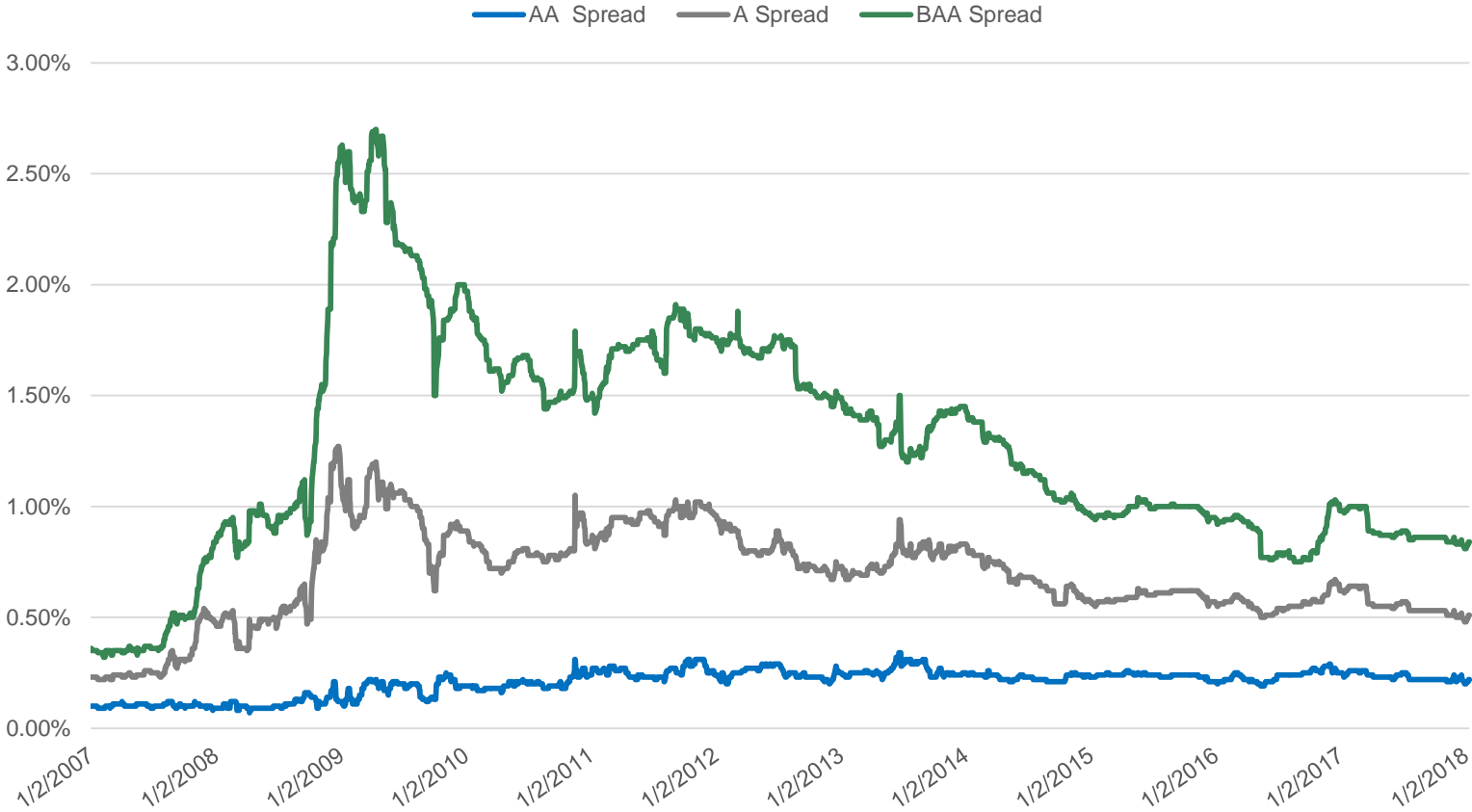
- Credit ratings (November, 2017)
  - AA3 Moody's
  - AA S&P (upgraded from AA-)
  - AA Fitch (upgraded from AA-)
- Fixed Charge cover exceeded minimum 1.45x target
  - 2.17 times in 2017
  - 2.23 times (as of Oct 31, 2017) for 2017
- Successful Refunding Transaction:
  - SMUD Refunding Bonds, 2017 Series E refunded \$250 million of variable rate debt
  - took advantage of lower interest rates in 2018-2028
  - locked in fixed rate of 1.81 percent as hedge against rising rates
- Successful Renewal of Property and Casualty Insurance at modest rate increases, despite high value claims

# Why do Credit Ratings Matter?

- Borrowing Costs:
  - Stronger credit = lower interest rates
  - Access to variable rate, short term debt market
    - Availability of LOC's, direct placement bonds and other short term products: more competitive pricing and favorable terms
- Commodity Hedging: Credit Ratings factor into contract terms for hedging agreements
  - Pricing and Collateral posting requirements
  - Termination triggers

# Municipal Credit Spread Trends

Spreads to "AAA" MMD, 20 Year (Since January 2007)



# General Ratings Criteria

- Financial Ratios and Metrics
- Governance Structure & Management
- Rate Competitiveness
- Resource Portfolio – cost of production
- Risk Management Practices
- Service Area Demographics
- Regulatory Factors

# SMUD's Report Card

- Financial Ratios ✓ Positive
- Governance ✓ Strong Positive
- Rate Competitiveness ✓ Strong Positive
- Resource Portfolio ✓ Neutral
- Risk Management ✓ Strong Positive
- Service Area ✓ Neutral
- Regulatory Factors ✓ Negative

# Credit Strengths

- Strong fixed charge coverage
- Very strong unrestricted cash reserves
- Governance Structure: autonomous rate setting; no general government revenue transfers
- Management's planning capability and measured approach to industry transition changes
- Proactive Risk Management practices
- Significant non-carbon resource portfolio
- Reduced reliance on debt for capital needs
- Diverse service territory, improving local economy



# Credit Weaknesses / Concerns

- Increased capital forecast and heavier reliance on cash could put pressure on key metrics
- Overall debt burden as a percentage of capitalization
- Lower demand growth due to:
  - Energy efficiency and distributed generation, and potentially battery storage
- Impact of state environmental energy policies
- Significant adjusted net pension liability obligation offset by self-regulated rate setting (Moody's new methodology)
- Commodity price risk
  - Somewhat mitigated by hedging
- Exposure to collateral posting requirements

# History of Credit Ratings (S&P)

1984	AA
4/22/86 - 8/27/86	AA-
8/27/86 - 6/4/87	A
6/4/87 - 5/6/92	BBB
5/6/92 - 3/29/93	BBB+
3/29/93 - 6/9/97	A-
6/9/97 – 4/28/09	A
4/28/09 – 4/11/13	A+
4/11/13 – 11/22/17	AA-
11/23/17 – present	AA

# Requested Action

- It is recommended that the Board accept the Monitoring Report for SD-3, Access to Credit Markets.