

Exhibit to Agenda Item #2a

Board Finance & Audit Committee Meeting and Special SMUD Board of Directors Meeting

Tuesday, February 19, 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 1.50 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.

Why Do Credit Ratings Matter?

- **Borrowing Costs:**
 - Stronger credit = lower interest rates
 - *AA vs. A rating lowers cost by \$200k per year for every \$100 million borrowed*
 - Access to credit, variable rate and short-term debt markets
 - *Availability of LOC's, direct placement bonds and other short term products at more competitive pricing and favorable terms*
- **Commodity Procurement and Hedging Agreements:**
 - Better pricing and terms
 - Lower collateral posting requirements
 - Contractual termination triggers minimized

SMUD Credit Strengths

- Strong fixed charge coverage and unrestricted cash reserves
- Prudent financial policies, including strong internal coverage and liquidity targets
- Reduced reliance on debt to finance capital needs
- *Demonstrated willingness and ability to adjust rates to recover costs and maintain margins*
- Diverse, low-cost, and relatively low greenhouse-gas-emitting power supply mix
- Strong risk management and hedging procedures particularly concerning gas supply procurement.

Credit Challenges / Concerns

- Increased forecast of capital spending over next five years could put pressure on key credit metrics
- Potential for less liquidity if SMUD relies less on debt and more heavily on cash on hand to fund capital projects in the future
- Moderate (although declining) debt burden as a percentage of capitalization, or Debt per customer
- Moderate long-term gas exposure and potential for collateral posting requirements requiring maintenance of strong liquidity

Ratings Criteria and SMUD Report Card

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

Evidence of Compliance

- Credit ratings
 - AA / AA / AA3 S&P / Fitch / Moody's
- Fixed Charge cover exceeded minimum 1.50x target
 - 2.21 times in 2018
 - 2.27 times in 2017
- Successful Bond Refunding Transaction
 - Issued \$165.5 million 2018 Series F Refunding Bonds providing \$39 million in NPV savings
- Successful Commercial Paper Program expansion and renewal of supporting credit facilities
 - Expanded capacity from \$200 million to \$288 million and renewed at lower rates than prior renewal
- Insurance Program Maintained
 - Successful renewal of Property and Casualty policies and maintained Cyber and Sacramento Power Academy coverage
 - Increased Wildfire coverage to \$300 million

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.