

Exhibit to Agenda Item #2

Board Policy Committee and Special SMUD Board of Directors Meeting
Wednesday, February 12, 2020, scheduled to begin at 5:30 p.m.
Auditorium, SMUD Headquarters Building

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 revenue 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

Evidence of Compliance

- Credit ratings remain very strong Aa3 Moody's · AA S&P · AA Fitch
- Fixed Charge coverage exceeded minimum 1.50x target
 - 2.09 times 2019
 - 2.27 times 2018
- Increased the Commercial Paper program to \$400 million providing flexibility
- Raised Days Cash on Hand target to 150 days to strengthen liquidity
- Defeased the remaining CVFA and SCA outstanding debt totaling \$18 million one and two years early
- Successful \$392 million Refunding and New Money Transaction:
 - Refunded all outstanding Commercial Paper
 - **Issued \$75 million as SMUD's 1st Green Bonds for HQ Renovation**
 - Locked in all in debt service costs of 1.81 percent

Why Do Credit Ratings Matter? The ABCs

A Access to credit markets

- Ability to borrow and availability of Letters of Credit and other services with more competitive pricing and favorable terms

B Borrowing Costs

- Stronger credit = lower interest rates
 - Our AA ratings provide meaningful savings to SMUD and its customers

C Collateral Posting

- Commodity and interest rate hedging agreements receive better pricing, terms and conditions and collateral requirements supporting liquidity

Ratings Criteria and SMUD Report Card

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

Credit Strengths

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

Credit Weaknesses / Concerns

- Legal and financial risk from Inverse Condemnation statute interpretation as it relates to potential wildfire liability (new in 2019)
- Increased capital forecast and heavier reliance on cash could put pressure on key metrics leading to higher borrowing
- Lower demand growth due to energy efficiency, distributed generation and potentially, battery storage
- Impact of state environmental energy policies
- Significant adjusted net pension liability obligation
- Commodity price risk
- Exposure to collateral posting requirements

Requested Action

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