

Exhibit to Agenda Item #2

Accept the monitoring report for Strategic Direction SD-3, Access to Credit Markets

Board Policy Committee and Special SMUD Board of Directors Meeting
February 10, 2021, scheduled to begin at 5:30 p.m.
Virtual Meeting (online)

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 1.50x
- When making resource decisions, SMUD shall weigh the impacts of 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

1. Credit rating remains strong
 - “AA” Fitch – “Aa3” Moody’s – “AA” S&P
 - S&P and Moody's removed Negative Outlook
2. Fixed Charge coverage ratio exceeded minimum 1.50x target
 - 2.18x in 2020 and 2.09x in 2019
3. Successfully issued \$400 million in bonds at 3.26% cost of funds
 - Replenished cash for financially uncertain times due to COVID-19
 - Issued \$25 million Green Bonds for various qualifying projects
4. Locked in fixed rates for three upcoming bond refundings using Financial Contracts
 - NPV savings of \$110 million from 2022 – 2040
5. Terminated the RBC natural gas pre-pay resulting in a \$19 million payment to SMUD
 - Creates operational flexibility and removes the 20 yr. obligation to purchase natural gas, aligning with our carbon goals.

Why Do Credit Ratings Matter?

When credit markets freeze from events such as the 2007 Financial Crisis or Covid-19 last year, credit ratings matter

- In March 2020, credit markets froze
- SMUD was one of the first utilities able to enter the market because of our strong AA credit ratings
- Many “A” or lower rated utilities had to wait as investors were not lending to lower rated companies
- Higher credit ratings translate into lower borrowing costs.
 - If SMUD’s credit ratings were to fall from AA to A, the impact at today’s rates would be approximately \$200k/yr. for every \$100 million borrowed

Credit Strengths

- Strong financial metrics
- Governance structure – autonomous rate setting and no intra-government revenue transfers
- Management’s planning capability and measured approach to industry transition
- Proactive risk management practices
- Significant non-carbon resource portfolio and planned expansion
- Reduced reliance on debt for capital needs
- Diverse service territory, strong governmental presence

Credit Concerns

- Legal and financial risks from Inverse Condemnation statute interpretation as it relates to potential wildfire liability
- 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 potential for battery storage
- Impacts of CA environmental energy policy
- Significant net pension liability obligation
- Commodity price risk and exposure to collateral posting requirements

Rating Criteria and SMUD Report Card

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

Questions?