

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
Wednesday, February 9, 2022, 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 ratings remains strong
 - “AA” Fitch – “Aa3” Moody’s – “AA” S&P
2. Fixed Charge Coverage ratio exceeded minimum 1.50x target
 - 2.42x in 2021 and 2.17x in 2020
3. Successfully issued \$107 million in refunding bonds at 1.16% cost of funds
 - Refunded 2011 Series X bonds
 - Transaction resulted in \$3 million annual savings through 2028
 - Total net present value savings of \$23 million
4. Received strong offers to restructure \$400 million Letter/Line of Credit Program
 - Lower fees than existing program will save SMUD \$500k annually through 2025
 - Increases program liquidity adding \$100 million emergency line of credit
5. Successfully renewed property and casualty insurance coverage programs
 - Maintained \$800 million property program and \$250 million wildfire program; and
 - Expanded cyber insurance program to \$60 million, at or below market rates & within budgets

Why Do Credit Ratings Matter?

- Higher credit ratings translate into lower borrowing costs, which will be critical as the Federal Reserve enters a tightening cycle
 - If SMUD's ratings were to fall from AA to A, the impact at today's rates would be approximately \$200k/yr. for every \$100 million borrowed
 - ✓ Impact grows in higher rate environments
- When credit markets freeze from events such as the 2007 Financial Crisis or Covid-19 in 2020, 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 them

Credit Strengths

- Strong financial performance
- Governance structure – autonomous rate setting and no intra-government revenue transfers
- Proactive planning and hedging strategies
- Diverse resource portfolio
- Favorable debt and liabilities profile
- Strong wildfire mitigation program
- 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
- Prioritizing environmental goals or rate affordability over preservation of the financial profile
- Significant net pension liability obligation

Rating Criteria and SMUD Report Card

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

Recommendation

Staff recommends accepting the SD-3 Report as evidence of compliance with Strategic Direction-3, Access to Credit Markets

Questions & Discussion?