

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 8, 2023, 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
 - **SMUD received a "Positive Outlook" from Moody's**
2. Fixed Charge Coverage ratio exceeded minimum 1.50x target
 - 1.64x in 2022 and 2.42x in 2021
3. Successfully issued \$133 million in refunding bonds at 2.31% cost of funds
 - Refunded 2012 Series Y bonds
 - Resulted in \$31 million of cash flow savings - \$2.8 million annual savings through 2033
4. Successfully renewed and restructured \$400 million Letter/Line of Credit Program
 - Lower fees than existing program will save SMUD \$500k annually through 2025
 - Utilized the Letter/Line of Credit program by issuing \$150 million of commercial paper in 2022
5. Successfully renewed property and casualty insurance coverage programs
 - Maintained \$800 million property program and \$255 million wildfire program; and
 - Obtained a \$50 million advance on the Cosumnes Power Plant claim outage.

Why Do Credit Ratings Matter?

- Higher ratings = lower borrowing costs
 - If SMUD's ratings were to fall from AA to A, the impact at today's rates would be approximately \$400k/yr. for every \$100 million borrowed.
 - ✓ Impact grows in higher rate environments as Federal Reserve tightens
- 2022 events make access to credit and financial risk mitigation imperative
 - SMUD reserves and commercial paper provide liquidity
 - Business interruption insurance provides recovery from higher costs.
 - ✓ Both support and enhance SMUD financial strength and our AA ratings
- Enhances our position as a strong counterparty
 - ✓ Lower costs for Commodity procurement function
 - ✓ Higher collateral thresholds allow for headroom with volatile commodity prices

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 growth in 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?