Long Term Debt Philosophy 2016 – 2027

June 6, 2016

Presentation Purpose

- No action requested today

✓ May 16, introduced draft Long Term Debt Philosophy and discussed key considerations

- Today, discuss various scenarios which have informed Long Term Debt Philosophy and Planning Strategies development

- June 20th, seek Board support for the Long Term Debt Philosophy and Planning Strategies

Review: Debt Leverage & Debt Coverage

Long term, target low leverage for flexibility and stability

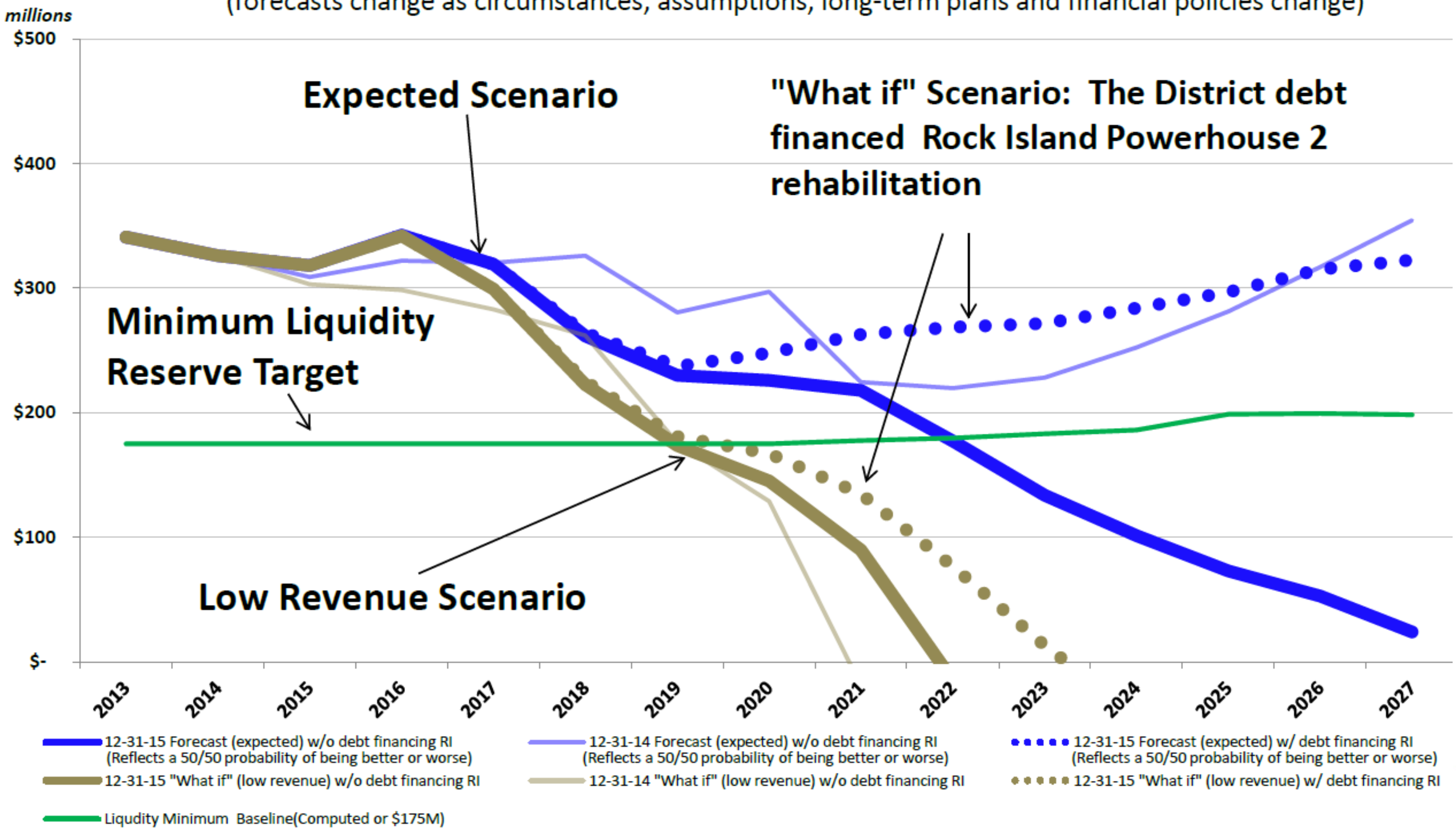
- Leverage target is <35% by 2019, anticipated to achieve <30%
- Lower debt leverage supports rate stability and cost savings:
  - Reduce revenue required by bond covenants to pay principal and interest every year (Debt Service Coverage (DSC))
  - High debt increases potential for large/sudden rate action in challenging years to meet debt service coverage

  - Rating agency considerations of leverage for high quality credits
  - Better aligns median retail debt per customer to peers
  - Lowers interest expense
  - Allows capacity to increase debt if needed and still meet financial and rate goals

Review: Liquidity – Long-Term Outlook

Liquidity Forecast: 2015 Update of Two Future Scenarios

(forecasts change as circumstances, assumptions, long-term plans and financial policies change)



Note: This Forecast assumes accelerated rehabilitation and financing of Rock Island Hydro for example purposes only. Eventual timing and financing actions will vary.

Scenario Analysis – Expected Case (50%)
Mid point of future estimates

Key Assumptions:

- Wholesale Prices as of Q4 2015 Forecast
- Accelerated debt reduction 2017 – 2019
- Debt issues early to mid 2020s for <50% of capital plan
- Average annual O&M Growth Rate ~3%
- No Electric Rate Increases (2027: 3.2¢/kwh, $50/month)

Projected Results 2020 - 2027

Liquidity (>$175M)	●	Maintaining above target
Debt Leverage (<35%)	●	Continue decline to <15%, ~$200M
Debt Service Coverage (>2.0x)	●	Average > 2.5x

Continued strong financial results forecast in the expected case, without electric rate action

Scenario Analysis – Unusual Case (5%)

If any single year is challenged, can we meet targets?

Key Assumptions:

- Wholesale Prices as of Q4 2015 Forecast
- Accelerated debt reduction 2017 – 2019
- Debt issues early to mid 2020s for <50% of capital plan
- Average annual O&M Growth Rate ~3%
- No Electric Rate Increases (2027: 3.2¢/kwh, $50/month)

Projected Results 2020 - 2027

Liquidity (>$175M)	● (green)	Maintaining above target
Debt Leverage (<35%)	● (green)	Continue decline, average ~20%, ~$250M
Debt Service Coverage unusual target (>1.25x)	◆ (yellow)	Tools: One time O&M growth rate decrease One time small rate increase, others

Continued strong financial results forecast in the unusual case, if incremental corrective action implemented

Scenario Analysis – Stress Case ("What-If")

Ongoing, cumulative low revenue and high costs

Key Assumptions:

- ***Sustained low water and price (73% water, $20/MWh)***
- Accelerated debt reduction 2017 ***only***
- Debt Issues early 2020s for ***>100% of capital plan (with 5% adder)***
- Average annual O&M Growth Rate ~3%, ***plus 5% adder***
- No Electric Rate increases (2027: 3.2¢/kwh, $50/month)

Projected Results 2020 - 2027

Liquidity (>$175M)	Only able to maintain through debt issuance
Debt Leverage (<35%)	Growing to >50%, ~$800M
Debt Service Coverage unusual target (>1.25x)	Too low in most years to issue new debt due to bond covenants

Strained financial results forecast in the stress case may be mitigated if future incremental corrective actions implemented

Scenario Analysis – Stress Case (“What-If”)
Holding Cost Growth to Base and No Rate Increases

Key Assumptions:

- Sustained low water and price (73% water, $20/MWh)
- Accelerated debt reduction 2017 only
- Debt Issues early 2020s for ***<100% of capital plan (no adder)***
- Average annual O&M Growth Rate ~3%, ***no adder***
- No Electric Rate increases (2027: 3.2¢/kwh, $50/month)

Projected Results 2020 - 2027

Liquidity (>$175M)	●	Capital mostly debt funded
Debt Leverage (<35%)	■	Gradual increase to >40%, ~$600M
Debt Service Coverage unusual case (>1.25x)	■	Too low in some years to issue new debt due to bond covenants

Cost containment actions will improve stress case results, but further incremental corrective actions may still be needed

Scenario Analysis – Stress Case (“What-If”)

Holding Cost Growth to Base and 3% Rate Increases

Key Assumptions:

- Sustained low water and price (73% water, $20/MWh)
- Accelerated debt reduction 2017 only
- Debt issues early 2020s for **>50% of capital plan** (no adder)
- Average annual O&M Growth Rate ~3%, no adder
- ***3% Annual Electric Rate increases*** *(2027: 4.1¢/kwh, $60/month)*

Projected Results 2020 - 2027

Liquidity (>$175M)	● (green)	Some pay-as-you-go capital
Debt Leverage (<35%)	◆ (yellow)	Rising to ~35%, ~$550M
Debt Service Coverage unusual case (>1.25x)	● (green)	Able to meet targets

A combination of cost containment and modest, incremental rate increases may mitigate stress case challenges

Scenario Analysis – Stress Case ("What-If")

Holding Cost Growth to Base and 5% Rate Increases

Key Assumptions:

- Sustained low water and price (73% water, $20/MWh)
- Accelerated debt reduction 2017 only
- Debt issues early 2020s for >50% of capital plan (no adder)
- Average annual O&M Growth Rate ~3%, no adder
- ***5% Annual Electric Rate increases*** *(2027: 4.7¢/kwh, $70/month)*

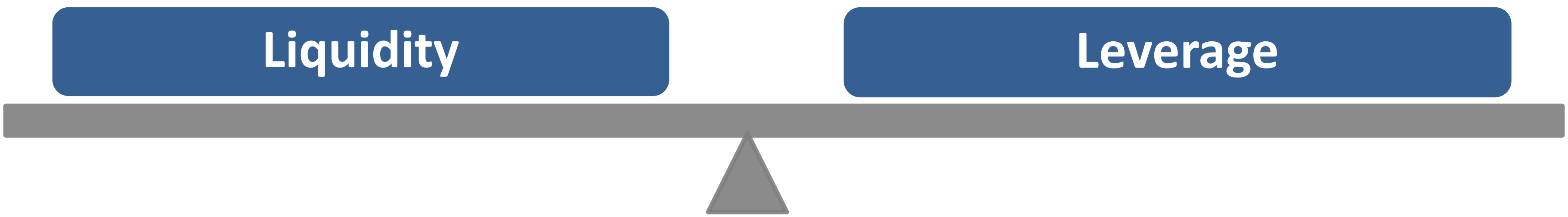
Projected Results 2020 - 2027

Liquidity (>$175M)	●	Some pay-as-you-go capital
Debt Leverage (<35%)	●	Managing under 35%, ~$500M
Debt Service Coverage unusual case (>1.25x)	●	Averaging ~1.5x

Cost containment and slightly larger incremental rate increases may produce financially sound results even in stress cases

Long Term Debt Philosophy and Strategy

Balancing Financial Health



Best supports doing the best, for the most, for the longest

Long Term Debt Philosophy and Strategy

Manage debt to create financial flexibility that supports low and stable electric rates even if lower than expected financial results are experienced

Long-Term Planning Strategies

- Maintain liquidity balance > $175M or policy minimum
- Target debt leverage < 35% by 2019 and remain below 35% thereafter
- Manage to lowest net interest (interest expense less interest income)
- Execute planned accelerated reductions through 2019 as long as liquidity allows
- Plan "pay-as-you-go" renewal/replacement capital as long as liquidity allows
- Consider debt financing for modernization/expansion capital, when needed
- Borrow for long-term sustainability, not temporary challenges
- Plan debt financings in 2 to 3-year intervals for cost-efficiency
- Tool box includes slowing cost growth, delaying discretionary capital, modest electric rate increases over time, etc.

Operational Plan of Finance: The "How"

Review and revise at least annually and communicate during the business planning process

Forecast Window	Debt Payments	Capital Funding	Stress Case Mitigation Tools
2016 Detailed Actions	As scheduled No early retirements	Pay-as-you-go No new issuances	N/A
2017 – 2020 General Steps	As scheduled Early retirements 2017 – 2019	Pay-as-you-go No new issuances	Scale back early retirements
2021 + Beyond Broad Path	As scheduled No early retirements	Mix of: Pay-as-you-go New issuances	Decrease cost growth Incremental rate increases

Key Considerations

- Should we continue our debt reduction strategy?
  - Yes, pay-as-we-go capital and accelerated reductions through 2019 support future financial flexibility, plan can be ramped up and down
- How low should our debt leverage ratio go post 2019?
  - Target < 35%, achieving lower levels as results allow to further support financial flexibility
- When might we reenter the bond market?
  - Plan for debt issuances in the early to mid 2020s when they support achieving strategic goals and maintaining financial health
- What is the likelihood of electric rate increases and by when?
  - Electric rate increases to support financial metrics not likely to be needed at least within 5 year forecast period or longer
- Should we continue the Public Power Benefit in the near term?
  - Yes, continue to make annual decisions on funding levels based on actual results and future requirements

Next Steps

Discuss

- June 6th: Discuss various scenarios which have informed Long Term Debt Philosophy development

Confirm

- June 20th: Confirm Board Support of Long Term Debt Philosophy and Planning Strategies

Update

- Fall 2016: As part of the business planning process, communicate Operational Plan of Finance, specific 2017 budget assumptions and general 2018 – 2021 plan