Chelan County PUD

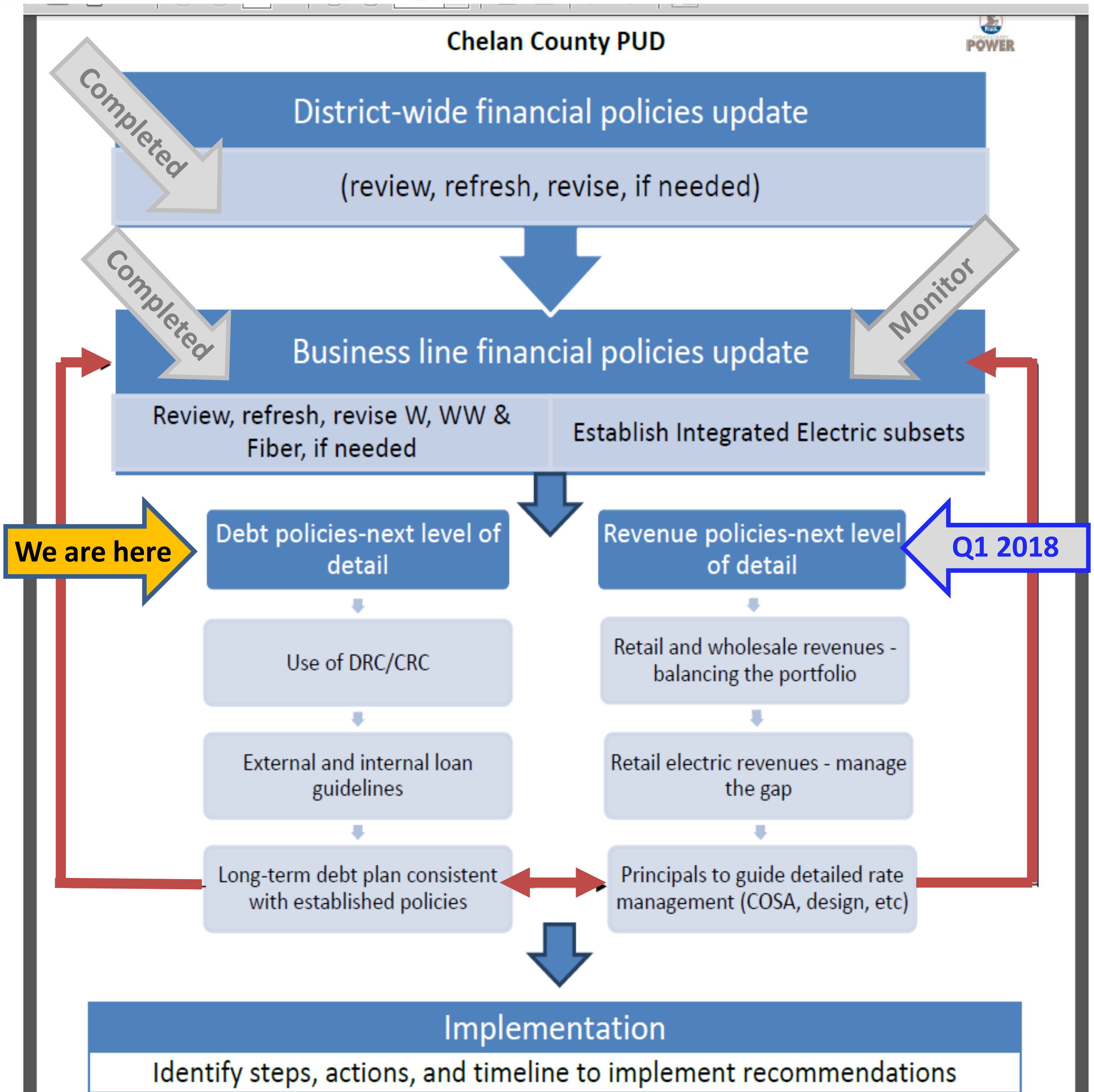
Financial Strategy Sessions
Debt Policy Guidelines

Board Presentation
November 20, 2017

CHELAN COUNTY POWER
www.chelanpud.org

Financial Strategy Next Steps

Goal: Conduct series of Board strategy sessions to refresh long-term financial policies, establish Integrated Electric business line metrics, set next level of detail for debt funding philosophies and develop additional principles to guide revenue policies



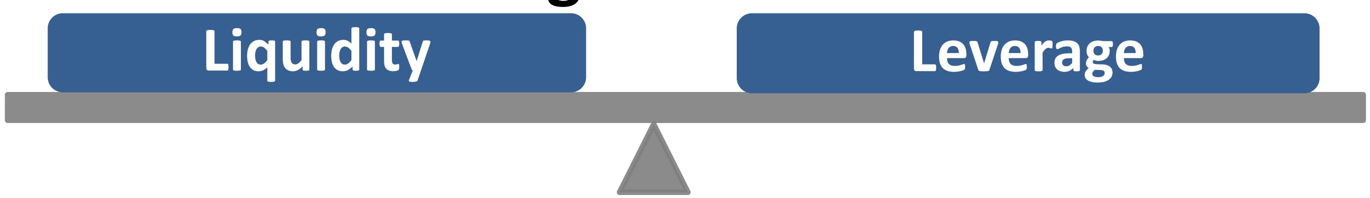
No Action Today, Review Only

- Review current debt philosophy and planning strategies
- What’s changed since last Board strategy session
- Updated plan of finance
- Review Hydro funding tools and guidelines
- Updated Hydro funding guidelines
- Return Dec. 4 to seek affirmation of updated philosophies, guidelines and plans

Long Term Debt Philosophy

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

Balancing Financial Health



Supports doing the best, for the most, for the longest

Long Term Debt Planning Strategies

- Maintain liquidity balance > $175M or policy minimum
- Target debt leverage < 35% by 2019 and then remain below 35%
- Execute planned accelerated reductions through 2020 as long as liquidity allows
- Plan "pay-as-you-go" renewal/replacement capital as long as liquidity allows
- Manage to lowest net interest (interest expense less interest income)
- 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
- Refinancing opportunities continually monitored

2017 Operational Plan of Finance: The "How"

Forecast Window	Activity	Action	"Lower Results" Mitigation Tools
2017 Detailed Actions	Net Scheduled Principal Early Retirements Net New Debt Refinancing Actions	\$23M \$29M None None Done	Scale back early retirements Decrease cost growth Delay discretionary capital Incremental rate increases
2018 – 2021 General Steps	Net Scheduled Principal Early Retirements Net New Debt* Refinancing Actions	\$100M \$133M \$2M Monitor	
2022 – 2027 Broad Path	Net Scheduled Principal Early Retirements Net New Debt** Refinancing Actions	\$241M None \$171M Monitor	

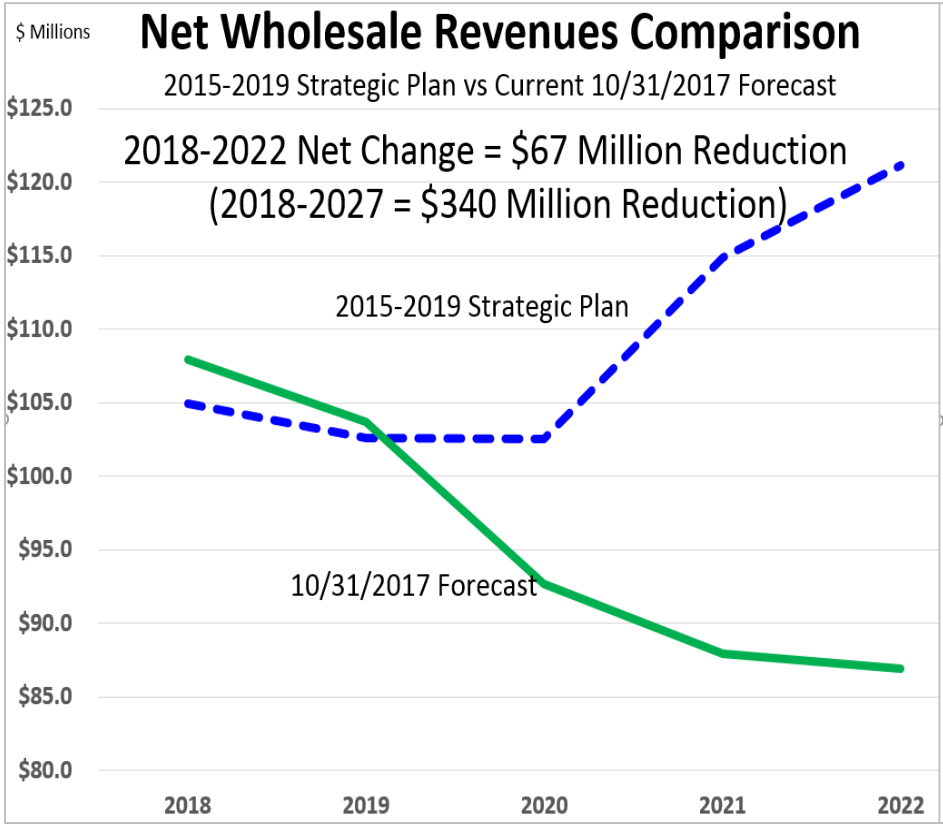
Net reduction in debt 2018-2027 of \$301M

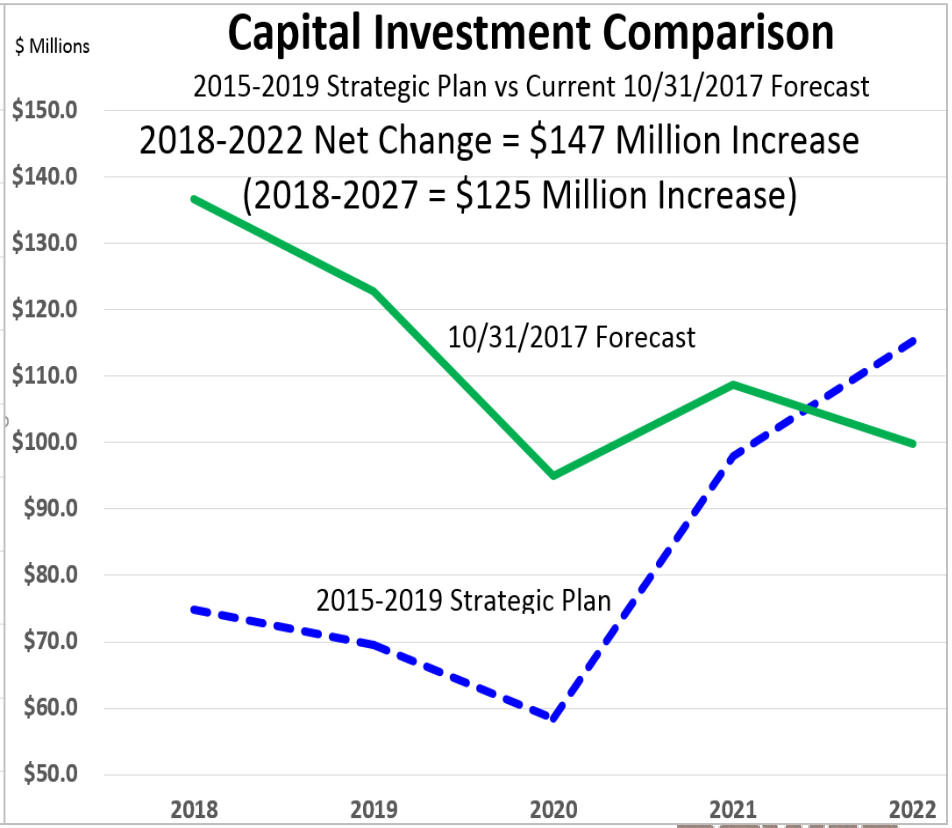
* \$2M related to SRF Loan: Wastewater-Peshastin/Dryden in 2019

** Next new bond issuance forecast in 2022

What's Changed?

- Financial results are good for 5-year horizon but challenges are forecasted beyond 2020
- Major changes compared to the 2015-2019 Strategic Plan
  - — $67M reduction in wholesale revenue forecast from decline in market prices through 2022
  - — $147M increased capital investment in plant and facilities through 2022





Mitigation Tools

Debt Planning Modifications

- Scale back on early debt retirements
  - **2018, scale back $61** million accelerated, going from $85 million to $24 million
  - **2019, scale back $44** million accelerated, going from $86 million to $42 million
  - Expected case = 31.6% debt ratio in 2019 (achieves target of <35% by 2019)
- Implement certain debt payments 6 months in advance for coverage support and net savings
- Renewed use of borrowing on the planning horizon (2022), consistent with long term debt philosophy with focus on managing liquidity
  - Update guidance philosophy to borrow for electric modernization/expansion capital while continuing to fund electric replacement capital through electric revenues. This will be continued discussion as part of the Q1 2018 Revenue Policy efforts.
- Continue annual debt plan review to ensure right balance of liquidity and leverage

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2018 Operational Plan of Finance: The "How"

Forecast Window	Activity	Action		"Lower Results" Mitigation Tools
2018 Detailed Actions	Net Scheduled Principal **Early Retirements** Net New Debt Refinancing Actions	$24M **None** None Monitor	Overall debt continues to decline	Scale back early retirements Decrease cost growth Delay discretionary capital Incremental rate increases
2019 – 2022 General Steps	Net Scheduled Principal **Early Retirements*** **Net New Debt**** Refinancing Actions	$114M **$51M** **$40M** Monitor		
2023 – 2027 Broad Path	Net Scheduled Principal **Early Retirements*** **Net New Debt** Refinancing Actions	$167M **$44M** **$231M** Monitor	Overall debt begins to grow slightly	

Net debt reduction 2018-2027, $129M, down from $301M reduction forecast from last year

*** Early retirements 6 months in advance for savings and coverage support**

**** $1M SRF loan forecast in 2019 for WW; new bond issuance of $39M forecast for 2022**

Financial Policies

District Combined	2017	2018	2019	2020	2021	2022
Liquidity - $175M Min (Expected)	$402M	$350M	$289M	$250M	$193M	$178M*
Liquidity - $175M Min (Unusual)	$401M	$343M	$276M	$231M	$179M*	$177M*
Debt Ratio (Expected <35% by 2019)	37.6%	34.8%	31.6%	28.8%	26.0%	25.1%
Debt Ratio (Unusual <35% by 2019)	37.7%	35.0%	31.9%	29.2%	27.2%	27.7%
Days Cash on Hand (Expected >250)	623	587	475	410	320	288
Days Cash on Hand (Unusual > 250)	622	576	454	378	297	286
Combined Debt Cover (Expected > 2.00x)	3.32	2.80	2.70	2.47	2.39	2.25
Combined Debt Cover (Unusual >1.25x)	3.31	2.69	2.58	2.34	2.17	1.93
Rate of Return (Expected > 4% thru 2019)	9.2%	6.0%	4.8%	Sunset		
Rate of Return (Unusual > 2% thru 2019)	9.1%	5.5%	4.3%			
Bottom Line Results (Expected)	*$103M*	*$72M*	*$61M*	*$49M*	*$46M*	*$40M*
Bottom Line Results (Unusual)	*$102M*	*$66M*	*$55M*	*$43M*	*$37M*	*$28M*
Outstanding Debt (Expected)	*$537M*	*$514M*	*$473M*	*$434M*	*$393M*	*$388M**
Outstanding Debt (Unusual)	*$537M*	*$514M*	*$473M*	*$434M*	*$408M**	*$428M**

* Assumes external debt issuances to maintain adequate liquidity.

Includes revised debt strategy and facilities plan

The information in this schedule contains forward-looking information and projections. Such projections are necessarily subject to various risks and uncertainties. Actual results could, and likely will, differ materially from those projected, in part as a result of differences between assumptions utilized in making such projections and actual outcomes and certain other risks.

Hydro Funding Tools and Guidelines

- The Debt Reduction Charge (DRC) and Capital Recovery Charge (CRC) are components of the long-term "cost-plus" power contracts used to pay for capital and/or reduce debt
- Utilization has been for capital expenditures pay-as-you-go
- In 2014, guidelines were established to assist with planning and expectations on the DRC and CRC percentages charged
- The objective was to accumulate sufficient funds to cover hydro capital and the DRC and CRC funds were forecast to be sufficient to cover capital through our planning horizon
- Increased investments at the hydro plants and facilities are now forecast to fully utilize the DRC/CRC funds and prompt the need for additional funding for hydro capital in ~2019

DRC/CRC Guidelines

Guidelines: When the combined DRC and CRC fund balance reaches predetermined levels, charges may be adjusted as follows:

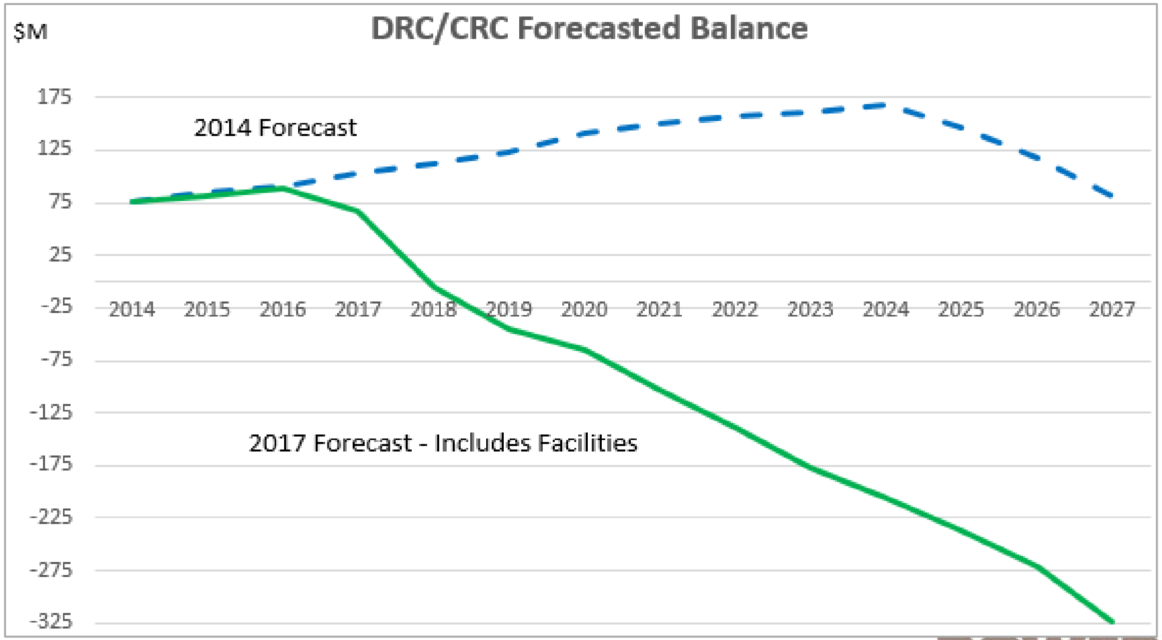
Guideline - Fund Level Criteria	Fund Estimate	DRC %	CRC %
Fund Level	\$0 - \$90 million	3.00%	50%
5.0% Contractual Debt Balance & 2.0 Years Capital Recovery Charge Base	\$90 million	**2.75%**	50%
7.5% Contractual Debt Balance & 2.5 Years Capital Recovery Charge Base	\$115 million	**2.50%**	50%
10.0% Contractual Debt Balance & 3.0 Years Capital Recovery Charge Base	\$140 million	2.50%	**40%**
12.5% Contractual Debt Balance & 3.5 Years Capital Recovery Charge Base	\$165 million	2.50%	**30%**
15.0% Contractual Debt Balance & 4.0 Years Capital Recovery Charge Base	\$185 million	2.50%	**25%**

Changes to established percentages will follow the contractual provisions & Board approval
Contract limits fund balances to 5 times capital recovery charge base amount

What's Changed?

DRC/CRC Expectations	2014 Forecast		2017 Forecast	
Charge assumptions	Default % reduced as balance increases		Maximum (3%/50%)	
Balances through contract period	Growing to 2024, then decline		Depletion by 2019	
Average annual DRC/CRC contribution*	$29M	Net **+$2M** average/year	$29M	Net **-$24M** average/year
Average annual capital expense	$27M		$53M	
2018 year end balance forecast	$113M		$0M	

Even with max charges, the DRC/CRC funds will be depleted and require contractual debt financing (either internal loans or external debt) for RR/RI ~2019



*District contributes 49%, LT Purchasers 51%

Forecast: 2014: Apr 30, 2014, 2017: Oct 31, 2017

Updated Hydro Funding Guidelines

- Utilize DRC/CRC balances to the extent available
- New Contractual Debt Obligations for Rocky Reach and Rock Island when DRC/CRC funds are insufficient
  - —Loans from internal unrestricted funds, if available
  - —External borrowings, if internal funds not available
- Plans included in the annual Operational Plan of Finance update
- Follow stated guidelines should future DRC/CRC balances meet fund level criteria

Debt Planning Modifications Summary

- Scale back on early debt retirements while still achieving debt ratio target of <35% by 2019
- Implement certain debt payments 6 months in advance for coverage support and net savings
- When needed, borrow for electric modernization/expansion capital and continue to fund electric replacement capital through revenue
- Utilize DRC/CRC funding for hydros to the extent available
- If DRC/CRC funds are insufficient, establish hydro Debt Obligations first from internal unrestricted funds, if available, otherwise from external borrowings
- Continue ongoing debt plan review to ensure right balance of liquidity and leverage

Next Steps

Q&A

- Nov 20th through Dec 3rd
- Follow-up questions and answers

Affirm

- Dec. 4th
- Affirm Board support of debt planning modifications
- 2018 Operational Plan of Finance will also be approved through Budget adoption

Appendix

(Additional descriptions of DRC/CRC)

Debt Reduction & Capital Recovery Charges

- The Debt Reduction Charge (DRC) and Capital Recovery Charge (CRC) are components of the long-term “cost-plus” power contracts
- Based on contract percentage
  - Chelan PUD 49%, Alcoa 26%, Puget 25%, Douglas is not included
  - Douglas PUD has separate contract terms and does not pay DRC/CRC
- The purpose of the charges is to forego additional debt by paying for capital “as-you-go” <u>OR</u> reduce outstanding contractual debt associated with the Hydros
- Utilization has been for capital expenditures pay-as-you-go
- If used for contractual debt reduction, purchasers receive a credit

Debt Reduction & Capital Recovery Charges

- DRC range is 0-3%
  - Applies to outstanding contractual debt balance
  - Default rate is 2.5% (currently Board set at maximum of 3.0%)
- CRC range is 0-50%
  - Applies to the CRC base ($25 million in 2004 $'s w/escalation)
  - Default rate is 25% (currently Board set at maximum of 50%)
- Percentage changes require Board approval
- There are limits to the amount that can be accumulated and a phase down during the last five years of the contract
- The District retains any remaining balance at contract end