RESOLUTION NO. 11 - 13616

A RESOLUTION TO AMEND THE LONG RANGE FINANCIAL POLICIES TO ADOPT A FINANCIAL LIQUIDITY METHODOLOGY AND TARGETS FOR 2011 AND BEYOND

FACTUAL BACKGROUND AND REASONS FOR ACTION

Pursuant to Resolution No. 10-13555, adopted by the Board of Commissioners (the "Commission") of Public Utility District No. 1 of Chelan County, Washington (the "District") on June 21, 2010, the Commission approved and adopted the District's Financial Policies, which included long-range targets for maintaining Rate of Return, Debt Ratio and Debt Service Coverage Ratio as well as establishing a minimum Financial Liquidity target for 2010 of $175 million. Liquidity needs for 2011 and beyond were to be analyzed by staff with a recommendation to be made to the Commission in a subsequent action. This Policy is in support of the Financial Management section of the District's Strategic Plan to develop policies to assure financial stability for the long term.

A Financial Liquidity Methodology is intended to provide a framework to ensure adequate liquidity to support operating reserves for normal business needs, contingency reserves for infrequent or unexpected events and planning reserves for future planned events. Staff has developed a methodology to identify levels of required liquidity over time that reasonably and prudently consider risks and risk mitigation efforts to protect the financial stability of the District in both the short and long term. A detailed example of the Financial Liquidity Methodology computation and the associated numbers is included as Exhibit A. A general descriptive summary of this methodology (below) includes the following components:

<u>Financial Liquidity Methodology</u>

1. Operating Reserves – amounts established for normal business needs including:
    a. three months average of operation and maintenance expense;
    b. revenue stabilization components to capture potential net revenue at risk associated with price and, or volume changes associated with the power portfolio and for interest rate sensitivity on the investment portfolio; and
    c. additional amounts as may be deemed prudent.
2. Contingency Reserves – amounts established for infrequent or unexpected events including:
    a. potential collateral requirements, termination events or counterparty defaults associated with energy or swap transactions;
    b. a general enterprise risk reserve component; and
    c. additional amounts as may be deemed prudent.
3. Planning Reserves – amounts established sufficient to meet future planned events or expenditures including:
    a. bond sinking fund amounts deposited three years in advance of any non-hydro bond maturity;

   b. amounts necessary to cover non-hydro capital funding requirements not already funded by other sources; and
   c. additional amounts as may be deemed prudent.
4. Portfolio Effect – a mathematical computation that reduces the sum of the Operating Reserves, Contingency Reserves and Planning Reserves to reflect that not all of the risks of each component are likely to happen at the noted magnitude at the same time.

The net of the Operating Reserves, Contingency Reserves, Planning Reserves, less the Portfolio Effect result in the computed Total Liquidity Requirements for which sources of liquidity should be secured. The Financial Liquidity Methodology and Exhibit A example computations have been reviewed by the General Manager and Executive Manager of Finance/Chief Financial and Risk Officer who concur that this methodology is a reasonable and prudent approach to determine adequate liquidity reserve levels.

The sources for the District's Financial Liquidity include Primary Liquidity, such as unrestricted cash and investments. The sources also include Secondary Liquidity, such as general bank lines or letters of credit or similar instruments and other internal sources, including certain Hydro system funds, if available, that could be used to meet the District's short-term liquidity needs. Both Primary Liquidity and Secondary Liquidity sources must provide adequate liquidity to support and supplement the Total Liquidity Requirements derived through application of the Financial Liquidity Methodology.

The District's staff has applied the Financial Liquidity Methodology to determine Total Liquidity Requirements and conducted financial modeling incorporating, among other things, current revenue and expense forecasts based on expected operations and market conditions and several additional probabilistic and "what if" scenarios. Staff has also considered several actions to enable the District to manage the requirements for liquidity and sources of liquidity. The financial analyses as well as risk evaluations, benchmarking results, customer and employee feedback and previous reserve targets were all taken into consideration to develop the following staff recommendations:

1. The District should utilize the Financial Liquidity Methodology described in this resolution to establish reasonable and prudent liquidity levels for 2011 and beyond. The Financial Liquidity Methodology calculation should be reviewed and updated on a quarterly basis or more frequently if conditions warrant.

2. A minimum Financial Liquidity target should be established for 2011 and beyond in the amount of $175 million that includes a minimum of $150 million of Primary Liquidity sources (unrestricted cash and investments).

3. Financial Liquidity reserves, including both Primary and Secondary liquidity sources, should be maintained or secured sufficient to manage to the greater of the Total Liquidity Requirements computed utilizing the Financial Liquidity Methodology or the established minimum Financial Liquidity target of $175 million.

The Executive Manager of Finance/Chief Financial and Risk Officer will monitor the District's Financial Liquidity reserve levels in relation to the Financial Policies, Financial Liquidity Methodology, minimum Financial Liquidity target and Liquidity Sources and the Executive Manager of Finance/Chief Financial and Risk Officer or designee will report compliance with these financial policies to the Commission on a quarterly basis or more frequently if conditions warrant.

The General Manager has reviewed staff's recommendation and recommends that they be approved and adopted by the Commission.

ACTION

IT IS RESOLVED BY THE COMMISSION OF PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON, as follows:

Section 1. Findings of the Commission. In order to comply with the District's Financial Policies, generally, and with the District's Financial Liquidity Policy, specifically, the Commission hereby recognizes the obligation to manage the District's liquidity sources and requirements to enable the District to provide stable, reliable, high quality services at a reasonable cost to its customers over the long-term. The Commission recognizes the need for rigorous financial planning to anticipate and respond to changes in the business climate and economic environment in order to maintain long term rate stability and adequate operating funds. This Policy is in support of the Financial Management section of the District's Strategic Plan to develop policies to assure financial stability for the long term.

Section 2. Amend Financial Liquidity targets. The Commission amends the Financial Policies to include:

1. The establishment of the Financial Liquidity Methodology as described in this resolution and illustrated by example in Exhibit A to determine reasonably prudent liquidity levels for 2011 and beyond. Refinements to the Financial Liquidity Methodology may be made by the General Manager and reported to the Board in the quarterly financial report but fundamental shifts or changes will be presented for Board consideration and approval.

2. Establish the minimum Financial Liquidity target for 2011 and beyond of $175 million that includes a minimum of $150 million of Primary Liquidity sources including unrestricted cash and investments.

3. The District will manage liquidity sources, including Primary and Secondary Liquidity, sufficient to manage to the greater of the Total Liquidity Requirements computed from the Financial Liquidity Methodology or the established minimum Financial Liquidity target of $175 million.

Section 3. Reporting. The District's Executive Manager of Finance/Chief Financial and Risk Officer or designee shall report compliance with these Financial Policies to the Commission on a quarterly basis. If projections reflect that future results will vary established targets and metrics, the recommended corrective action will be presented for Commission consideration and action.

Section 4. Amended Resolution No. 10-13555. Resolution No. 10-13555 is hereby amended to include the provisions of this Resolution.

Section 5. Effectiveness. This Resolution shall take effect upon its adoption.

DATED this 24th day of January 2011.

President

ATTEST:

Vice President

Secretary

Commissioner

Commissioner

SEAL

EXHIBIT A - CHELAN COUNTY PUD - AN EXAMPLE OF FINANCIAL LIQUIDITY METHODOLOGY ($Millions)

OPERATING RESERVES - Normal business needs	2011	2012	2013	2014	2015	Methodology / Comments
Working Capital	20	20	20	20	20	3 mo avg of 5 yr forecast non hydro operation maintenance & tax
Revenue Stabilization - Energy	48	57	65	65	65	3 year cumulative revenues at risk
Revenue Stabilization - Interest Rates	4	4	4	4	4	Interest rate sensitivity (1% shift/yr from budget)
Other	0	0	0	0	0	Additional amounts as may be deemed prudent
Subtotal (full dollar impact)	72	82	90	90	90	
CONTINGENCY RESERVES - Infrequent or unexpected events						
Power - Margin/Collateral Call/Termination	3	3	3	3	3	Physical Energy-not all parties will demand assurances
Swap - Termination	29	29	29	29	29	30% of -2% drop from 11/30/10 Mkt Value - rounded up to $1M
Power - Counterparty Default	10	10	10	10	10	Power - 50% Max Credit ($20M)
Swap - Counterparty Default	13	13	13	13	13	25% Uncollateralized Threshold at AAA rating ($50M)
Other Enterprise Risk Reserves	10	10	10	10	10	General Enterprise Risks
Other	0	0	0	0	0	Additional amounts as may be deemed prudent
Subtotal (full dollar impact)	65	65	65	65	65	
PLANNING RESERVES - Future planned events or expenditures						
Large Bond Repayments	100	152	180	139	1	Non Hydro Bond payment set aside, 25% 3 yr in advance of maturity
Future Capital Funding	0	2	14	20	32	Non Hydro Capital Requirements funded from cash 100%
Other	0	0	0	0	0	Additional amounts as may be deemed prudent
Subtotal (full dollar impact)	100	154	194	159	33	
LESS PORTFOLIO EFFECT	-57	-59	-60	-60	-60	Reflects that not all things are likely to happen at the same time
TOTAL REQUIRED LIQUIDITY	180	242	289	254	128	Amounts subject to rounding

SUMMARY OF REQUIRED LIQUIDITY	2011	2012	2013	2014	2015	
Operating Reserves	72	82	90	90	90	
Contingency Reserves	65	65	65	65	65	
Planning Reserves	100	154	194	159	33	
Less Portfolio Effect	-57	-59	-60	-60	-60	Reflects that not all things are likely to happen at the same time
TOTAL REQUIRED LIQUIDITY	180	242	289	254	128	Amounts subject to rounding

Shaded amounts subject to the Portfolio Effect that not all events are likely to happen at the stated magnitude at the same time.

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