

RESOLUTION NO. 12-13729

A RESOLUTION TO ESTABLISH LONG RANGE FINANCIAL POLICIES FOR THE WATER, WASTEWATER AND INTEGRATED ELECTRIC BUSINESS LINES AND ADOPT FINANCIAL TARGETS FOR 2012 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 Financials Policies, which included long-range targets for maintaining rate of return, debt ratio and debt service coverage ratio. Resolution No. 10-13555 also established a minimum financial liquidity target for 2010 and subsequently Resolution No. 11-13616, adopted by the Commission on January 24, 2011, established a financial liquidity methodology framework to be used to establish the 2011 and future financial liquidity minimum targets. All of the long-range targets are for the District as a whole on a combined basis.

The District's 2010 Strategic Plan adopted by the Commission incorporated the priorities and preferences expressed by our customers through customer outreach efforts. These preferences included maintaining low, stable electric rates and having the rates for our non-electric businesses (Water, Wastewater and Fiber & Telecom) cover the costs of those services. To help accomplish this, in 2012 an initiative was identified to establish financial and operational metrics for each major operational area that would include clear and concise expectations and measurement tools.

The major operational areas, or business lines, have been identified by staff as Water, Wastewater, Fiber & Telecom and Integrated Electric. Integrated Electric includes all activity associated with electric production, transmission and distribution which includes the Distribution, Transmission and Hydro Systems and other related accounting systems like the Financing Facility, Internal Services and Treasury Services.

A first step in establishing the individual business line financial metrics occurred May 21, 2012 when the Commission adopted Resolution No. 12-13722 setting specific financial policies for the Fiber & Telecom business line that includes the same types of long-range targets as the overall District's Financial Policies. The specific Fiber & Telecom business line financial policies include:

1. A minimum liquidity reserve target of \$4 million by the end of calendar year 2016, with a minimum of \$1 million to be accumulated prior to considering any expenditures for District-funded expansion of the fiber optic network outside of the existing areas currently served by District fiber.

2. A debt ratio target of zero,
3. A debt service coverage ratio target of zero, and
4. A rate of return target of break-even by the end of calendar year 2016.

District staff recommends that the Water, Wastewater and Integrated Electric business lines' specific financial policies utilize similar methodologies and types of long-range targets as the District's overall Financial Policies and the Fiber & Telecom business line's specific financial policies with the recognition that each business line has unique characteristics and risk profiles that warrant different financial metrics for each individual business line. Accordingly, some of the recommended or adopted targets for the Water, Wastewater and Fiber & Telecom business lines are below the District overall Financial Policy targets, and some of the Integrated Electric business line targets are higher. As a whole, the business line metrics combine to achieve the District's overall combined Financial Policy targets established in Resolutions No. 10-13555 and 11-13616.

District staff recommends that the existing financial liquidity methodology framework adopted by Resolution No. 11-13616 be consistently applied to the Water and Wastewater business lines, as individual components are applicable to those operations respectively, to determine the minimum level of reserves required. This 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 such as capital projects. Based on the liquidity framework, staff recommends:

1. For the Water business line, a minimum liquidity reserve target of \$2 million by the end of calendar year 2012,
2. For the Wastewater business line, a minimum liquidity reserve target of \$250,000 by the end of calendar year 2012, and

District staff further recommends that for the Integrated Electric business line, by calendar year end 2012, a minimum reserve target in the amount necessary to meet the combined District minimum target of \$150 million of primary unrestricted liquidity and combined District minimum target of total financial liquidity as determined by the existing financial liquidity methodology framework adopted by Resolution No. 11-13616.

District staff also recommends the following debt service coverage ratio and debt leverage targets:

1. For the Water business line, a debt coverage target of 1.25x by the end of calendar year 2016 and a debt leverage target of less than 60% by the end of calendar year 2012,

2. For the Wastewater business line, a debt coverage target of 1.25x by the end of calendar year 2016 and a debt leverage target of less than 60% by the end of calendar year 2012,
3. For the Integrated Electric business line, a debt coverage target in the amount necessary to meet the combined District target of 2.25x under expected conditions (50% confidence) with a minimum of 1.25x under unusual conditions (95% confidence), both by the end of calendar year 2012, and a debt ratio of less than 60% by the end of calendar year 2015.

Rate of return is one way to determine if a business will be self-sustaining in the long term. A positive rate of return indicates that the business is able to cover all of its costs, including depreciation. The Water and Wastewater business lines historically have had difficulty covering all of their operating and capital costs, but are moving towards covering the cost to provide those services. Based on staff analysis, the Integrated Electric business line is currently covering its operating and capital costs therefore a phased approach is not required. For rate of return metrics, District staff further recommends:

1. For the Water business line, a rate of return target of 1% by the end of calendar year 2016,
2. For the Wastewater business line, a rate of return target of break-even (greater than or equal to 0%) by the end of calendar year 2016, and
3. For the Integrated Electric business line, a rate of return target in the amount necessary to meet the combined District minimum target of 4-6% under expected conditions (50% confidence) with a minimum of 2% under unusual conditions (95% confidence) by the end of calendar year 2012.

Staff also recommends that after the initial phase-in period prior to the end of 2016, or earlier if warranted for strategic planning, these policies and targets be re-evaluated consistent with the District overall Financial Policies.

An illustrative summary of the combined District targets, the previously adopted Fiber & Telecom business line targets and the above recommended individual business line targets is included as Exhibit A to this resolution.

The Chief Financial/Risk Officer and General Manager concur with staff's recommendations.

#### ACTION

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

Section 1. The Commission recognizes the need for rigorous financial planning to anticipate and respond to changes in the business climate and economic environment and 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. These Financial Policies are 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. The Commission hereby adopts specific Water business line Financial Policies to include:

1. A minimum financial liquidity target of \$2 million by the end of calendar year 2012 based on the financial liquidity methodology framework adopted by Resolution No. 11-13616,
2. A debt ratio target of less than 60% by the end of calendar year 2012,
3. A debt service coverage ratio target of 1.25x by the end of calendar year 2016, and
4. A rate of return target of greater than or equal to 1% by the end of calendar year 2016.

Section 3. The Commission hereby adopts specific Wastewater business line Financial Policies to include:

1. A minimum financial liquidity target of \$250,000 by the end of calendar year 2012 based on the financial liquidity methodology framework adopted by Resolution No. 11-13616,
2. A debt ratio target of less than 60% by the end of calendar year 2012,
3. A debt service coverage ratio target of 1.25x by the end of calendar year 2016, and
4. A rate of return target of break-even (greater than or equal to 0%) by the end of calendar year 2016.

Section 4. The Commission hereby adopts specific Integrated Electric business line Financial Policies to include:

1. A minimum financial liquidity target sufficient to meet the combined District minimum target of \$150 million of primary unrestricted liquidity and combined District minimum target of total financial liquidity as determined by the existing financial liquidity methodology framework adopted by Resolution No. 11-13616 by the end of calendar year 2012,

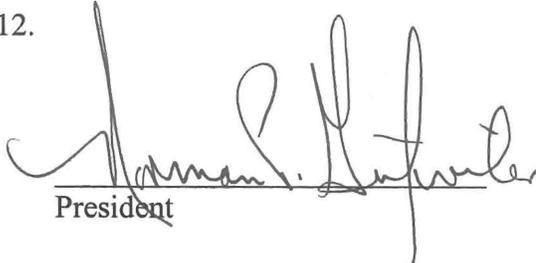
2. A debt ratio target of less than 60% by the end of calendar year 2015,
3. A debt service coverage ratio target in the amount necessary to meet the combined District target of 2.25x under expected conditions (50% confidence) with a minimum of 1.25x under unusual conditions (95% confidence) by the end of calendar year 2012, and
4. A rate of return target in the amount necessary to meet the combined District target of 4% - 6% under expected conditions (50% confidence) with a minimum of 2% under unusual conditions (95% confidence) by the end of calendar year 2012.

Section 5. The District's Chief Financial/Risk Officer or designee shall report compliance with the Water, Wastewater and Integrated Electric business lines' Financial Policies to the Commission on a quarterly basis. If projections reflect that future results will vary from established targets, the recommended corrective action will be presented for Commission consideration and action.

Section 6. This Resolution shall take effect upon its adoption.

Section 7. To the extent any prior resolutions of the District impose limitations or directions which are inconsistent with this Resolution, said prior resolutions are hereby amended and superseded to the extent they conflict with this Resolution.

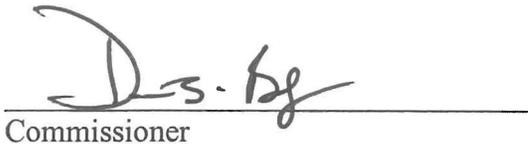
DATED this 13th day of June 2012.

  
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President

ATTEST:

  
\_\_\_\_\_  
Vice President

  
\_\_\_\_\_  
Secretary

  
\_\_\_\_\_  
Commissioner

  
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Commissioner

SEAL

**EXHIBIT A – Financial Policies Illustrative Summary – Year 2016**

2016 (expected conditions)	Water	Wastewater	Integrated Electric (3)	Fiber & Telecom (1)	Combined District (2)
Rate of Return	≥ 1.0%	≥ 0.0%	4.4%	≥ 0.0%	4.0%-6.0%
Unrestricted Cash	\$2 M	\$0.25 M	\$144 M	\$4 M	\$150 M (minimum)
Total Liquidity	\$2 M	\$0.25 M	\$178 M	\$4 M	\$184 M (minimum)
Debt Coverage	1.25	1.25	2.23	0.00	2.25
Debt Ratio	< 60%	< 60%	< 60%	0.0%	< 60%

1. Fiber & Telecom Financial Policy targets were adopted under Resolution 12-13727.
2. District combined Financial Policy targets were adopted under Resolutions 10-13555 and 11-13616.
3. Uses the most recent financial forecast and assumes Fiber, Water & Wastewater targets are achieved.