
LCRA TRANSMISSION SERVICES CORPORATION BOARD POLICY

T301 – FINANCE

Dec. 15, 2020

T301.10 PURPOSE

This policy provides a framework from which the LCRA Transmission Services Corporation (LCRA TSC), an affiliated corporation of LCRA, will maintain financial integrity while serving the long-term interests of ratepayers and other constituencies. LCRA TSC recognizes that maintaining financial integrity is critical to accomplishing its goals and discharging its responsibilities. This policy establishes processes to be used by the LCRA TSC Board of Directors (Board) to define the strategic plan for LCRA TSC and to approve specific program goals, objectives and associated budgets.

T301.20 DEFINITIONS

Business Plan – The business plan is the document approved by the LCRA TSC Board annually that establishes the Board’s goals and priorities. The business plan includes operating and capital budgets, as well as projections of LCRA TSC’s overall financial performance and capital financing plans. It describes the categories of projects, products and services that support the associated revenues and expenditures over a five-year period.

Debt Service Coverage (Coverage) – Debt service coverage is the ratio of that fiscal year’s ending total revenues minus total operating and maintenance expenses (net of depreciation, amortization, and other revenue and expense exclusions resulting from prior period funding), divided by scheduled debt service on all obligations as approved in the business plan.

Equity Ratio (Ratio) – The calculation is the ratio of total equity divided by total assets.

Fixed-Rate Debt – Fixed-rate debt consists of coupon securities that have a scheduled maturity or mandatory sinking fund redemption date. Fixed-rate debt that has been synthetically converted to variable-rate debt via a derivative instrument will be classified as variable-rate debt for the term of the derivative instrument.

Operating and Maintenance Expenses – Operating and maintenance expenses consist of all reasonable and necessary costs and expenses incurred in the operation and maintenance of the LCRA TSC system.

Variable-Rate Debt – Variable-rate debt consists of securities on which the interest rate varies over time (a) based on an index or formula such as variable-rate demand notes or auction rate bonds, or (b) because the securities are sold in the short-term market (with a maturity not exceeding 270 days), such as commercial paper.

T301.30 FINANCIAL OBJECTIVES

In seeking to fulfill its commitment to ratepayers and public service objectives, LCRA TSC will maintain a high level of financial stability and will not compromise long-term financial integrity to achieve short-term benefits.

The chief executive officer (CEO) is authorized to engage financial service providers and other related professional service providers if deemed necessary and appropriate by the CEO in consultation with the chief financial officer, considering the expertise and cost of any such service provider. The CEO will provide an annual report to the Board listing all contracts into which LCRA TSC entered pursuant to this paragraph.

T301.301 Debt Service Coverage. To provide a margin of safety in LCRA TSC's financial affairs, revenue levels will be set in accordance with rules and regulations of the Public Utility Commission of Texas to provide necessary funding of operating reserves and the capital program and to ensure that debt service coverage exceeds the minimum level of 1.25x required in the bond resolution. Higher levels of coverage will be appropriate in periods of rapid growth and capital investment and to mitigate possible regulatory lag. In the event that overall debt service coverage is projected to be below 1.25x for any fiscal year, the Board will promptly implement a plan, to be recommended by staff, which could include rate proceedings, cost reductions or other means to achieve a debt service coverage ratio of 1.25x.

This policy level of debt service coverage shall be reviewed each year in conjunction with the preparation of the business plan. Revenue levels will be evaluated in consideration of, but not limited to, bond ratings, capital funding requirements, current business conditions, economic projections and load-growth assumptions, delays inherent in the regulatory process, operating reserve requirements, and the projected size and frequency of necessary rate adjustments. Rates will be established to produce appropriate revenue levels commensurate with specific economic, regulatory, contractual and other risk factors that are adequate to cover operating and maintenance expenses, debt service, covenanted debt service reserves, liquidity requirements, and equity funding for the capital program.

T301.302 Rates. LCRA TSC will use commercially reasonable efforts to obtain regulatory approval of rates and prices that cover the cost of specific services, allow it to be self-supporting, and provide a stable and predictable flow of revenues. Rate adjustments, as needed to maintain appropriate levels of revenue, will be reasonably structured to achieve these goals. These revenues will be adequate to cover operating and maintenance expenses (including funding statutory requirements of LCRA), debt service, equity funding for the capital program, and operating reserve requirements.

Rates for electric transmission and transformation services are regulated by the Public Utility Commission of Texas.

T301.303 Sources of Financing. LCRA TSC will use a combination of equity and debt to finance capital additions such that both current and future ratepayers are allocated an equitable portion of the costs. LCRA TSC may borrow for capital projects when it is appropriate to spread the cost of capital assets over their useful lives.

The issuance of debt requires an affirmative vote of a majority of the Board. LCRA TSC will not issue debt for working capital items. Pursuant to state law, the LCRA Board of Directors must approve any financing or other obligations.

As appropriate, LCRA TSC will evaluate mechanisms to restructure or refinance debt. LCRA TSC will continually evaluate alternatives to conventional financing to lower the overall cost of capital for ratepayers.

LCRA TSC may structure debt such that the average maturity of the debt approximates the average life of the assets financed; however, debt issues may be structured with a shorter average maturity if economically justified. LCRA TSC will build equity that will maintain appropriate access to capital markets and is consistent with regulatory guidance. While LCRA TSC may be highly leveraged during periods of rapid growth, LCRA TSC business plans will specifically address the accumulation of equity to achieve and maintain a minimum long-term equity position of 20%.

T301.304 Variable-Rate Financing. LCRA TSC may use variable-rate debt to provide flexibility in its overall capital program and to manage its overall interest rate exposure.

The variable-rate limit is 25% of total capitalization, long-term debt plus total equity as presented periodically in LCRA TSC's financial statements.

T301.305 Operating Reserves. In addition to any debt service reserve funds required by bond resolutions governing LCRA TSC's debt, LCRA TSC will build and maintain appropriate target levels of operating reserves as follows:

Six months of average debt service on all outstanding LCRA TSC debt and other obligations to LCRA, and two months of average operating and maintenance expenses, including those billed by LCRA.

The portion of operating reserves relating to debt service on LCRA TSC's contractual obligation to LCRA will be maintained on LCRA's books of record, and may be changed from time to time as the contractual commitment changes. The portion of operating reserves relating to stand-alone financing by LCRA TSC may be funded with excess revenues or substituting such reserves with surety bonds or other insurance.

If at any time the level of reserves are less than the target levels set forth in this policy, the Board will promptly implement a plan, to be recommended by staff, to increase rates,

reduce costs, or otherwise cause there to be sufficient revenues to replenish the level of reserves to such target levels within 12 months.

To the extent that:

- a) payments pursuant to contractual commitments are current;
- b) debt service payments are current; and
- c) operating and debt service reserves are funded,

the Board may declare and distribute remaining revenues to LCRA, subject to conditions and limitations agreed to by LCRA TSC in connection with regulatory proceedings of the Public Utility Commission of Texas.

T301.306 Alternative Financing. As appropriate, LCRA TSC will evaluate mechanisms to restructure or refinance debt. LCRA TSC will continually evaluate alternatives to conventional financing to obtain the lowest overall cost of capital for ratepayers.

T301.307 Investment Policy. LCRA TSC hereby adopts and incorporates by reference the Banking and Investments policy of LCRA with respect to all investments of LCRA TSC.

T301.308 Insurance. LCRA TSC acknowledges that property and casualty insurance may be unavailable for the facilities and operations of the transmission and transformation business. In this regard, LCRA TSC will use operating reserves held from time to time by LCRA TSC to provide self-insurance against these types of property and casualty risks. Additionally, LCRA TSC may use the proceeds of short-term borrowings to fund any such losses.

T301.40 PLANNING

Business Plan: LCRA TSC will prepare a business plan to be submitted for LCRA TSC Board and LCRA Board approval before the start of each fiscal year. The business plan will include the organization's goals and objectives and will describe the project categories, products and services that comprise a five-year forecast for:

- Operating and maintenance expenses.
- Capital expenditures.
- Capital funding sources.
- Debt service requirements.

Adoption of the business plan authorizes the CEO to complete work plans and make associated expenditures within the budget as provided for in accordance with Board policies. The resolution adopting the business plan will authorize the capital and operating budgets for the upcoming fiscal year. The Board will approve lifetime budgets for individual projects throughout the fiscal year. The resolution adopting the business plan also will include guidelines for authorizing capital spending and reporting requirements for business plan results.

If annual expenditures for operations or capital are expected to exceed Board-authorized levels, additional approval from the Board will be required, except as otherwise provided below. Staff will provide sufficient support for the additional funding request and provide analysis for impacts on current and future rates.

For any project not previously authorized by the Board, authority is delegated to the CEO to approve any capital project with a lifetime budget not to exceed \$1.5 million. The CEO also is delegated authority to approve all capital projects associated with generation interconnection projects not previously authorized by the Board, in each case only after the generator has provided appropriate financial security to LCRA TSC for its expenses. Prior to the approval of any generation interconnection capital project, the CEO shall consult with the chief financial officer and chief operating officer. Such approval by the CEO will meet the official intent requirements set forth in Section 1.150-2 of the IRS Treasury Regulations. These delegations will apply only when such approval does not cause total capital expenditures to exceed the approved capital plan or materially adversely impact business planning assumptions. In such a situation, Board approval will be required. Staff will communicate any CEO-approved projects to the Board on a quarterly basis. If Board approval is required, staff will communicate to the Board the funding source and rate impact of any new project when Board approval is requested. A new project may require an amendment to the existing capital plan or be managed within the previously authorized annual spending limits.

The CEO may approve additional funding for an approved capital project that is expected to exceed its lifetime budget, so long as such additional funding does not cause total capital expenditures to exceed the approved capital plan or materially adversely impact business planning assumptions.

Quarterly Business Plan Update: The CEO will provide quarterly updates that include indicators of year-to-date operational and financial performance, progress toward key goals, CEO-approved additional capital project funding, and financial performance projections.

EFFECTIVE: Aug. 22, 2001. Amended Oct. 16, 2001; June 12, 2002; March 19, 2003; Oct. 21, 2003; Feb. 15, 2017; Feb. 19, 2020; and Dec. 15, 2020.