

2015 Budget

PUD No. 1 of Pend Oreille County

Public Utility District #1 of Pend Oreille County
2015 Budget

Approved December 2, 2014

Public Utility District No. 1 of Pend Oreille County, Washington (the PUD, or the District) is a municipal corporation governed by an elected three-person board of commissioners. The District consists of four primary systems: Box Canyon Production, Community Network, Electric, and Water.

The District is proposing a consolidated \$74 million balanced budget for 2015. The budget includes many different projects and is based on several different assumptions all of which are discussed in full detail below. Financial projections are developed using expected, worst and best case scenarios. The budget is a plan, and, despite best intentions, plans can change. For that reason, the summary below provides a look at different scenarios and the impact on the budget.

Generation

The Box Canyon Production System produces power from the Box Canyon Hydroelectric Project. The PUD was issued a license by the Federal Energy Regulatory Commission (FERC) in 2005 that allows the District to operate Box Canyon Dam. The license has many different requirements that relate to wildlife and wildlife habitats in the project area, water quality, recreation, fish passage, trout habitat restoration, just to name a few.

The fourth and final turbine runner was lowered into the turbine pit on September 15, 2014. Upgrade of this final turbine generator unit is scheduled for completion in December of this year. With all four new units operating, Box Canyon's generation capacity will increase from 76 to 90 megawatts.

Communication Services

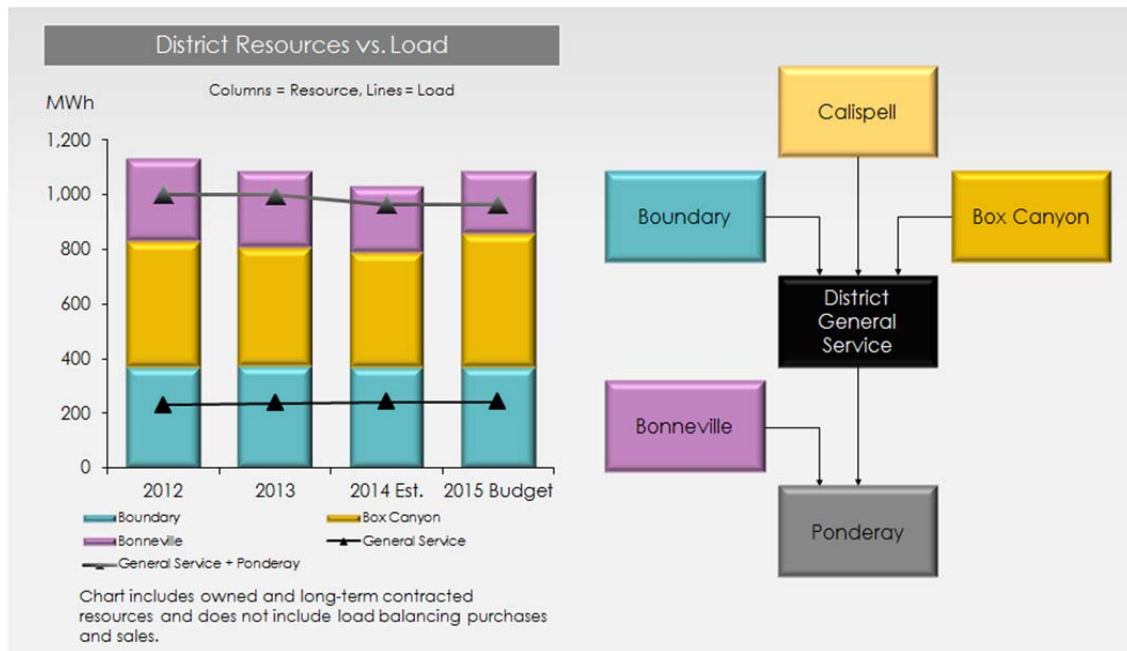
The Community Network System (CNS) supplies wholesale broadband communication services. CNS was created in 2010 and became fully operational in 2014. Fiber optic lines are installed to approximately 4,000 homes in the County and over 1,150 customers have been connected to fiber.

The Washington State legislators facilitated PUD's telecommunication infrastructure capacity sharing, but strictly in a wholesale role. Plainly saying, the District can only sell fiber on a wholesale basis, not directly to the customer. Therefore, the District charges Retail Service Providers (RSP's) for use of the fiber. The RSPs are the link to the consumer; customers purchase fiber connection through the RSP of their choosing.

District Power Resources

The Electric System distributes electricity to residential and other consumers in Pend Oreille County. Energy resources are obtained from District-owned resources Box Canyon Dam and the Calispell Hydro Plant, and outside sources Boundary Dam owned by Seattle City Light, and Bonneville Power Administration (BPA).

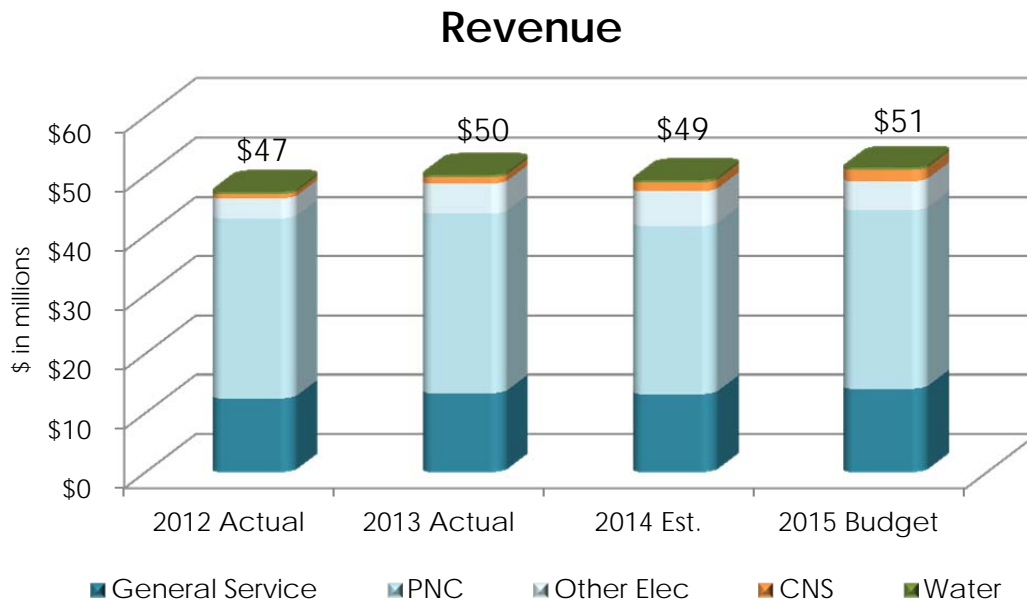
The District receives 48 megawatts of power capacity from the City of Seattle's Boundary Hydroelectric Project. Power received from Boundary is the District's most inexpensive power source and a key component of the District's low customer rates.



Funding Sources

Ponderay Newsprint Corporation (PNC), which operates a paper machine and fiber mill in Usk, Washington, is the District's largest electric customer. Approximately 60% of the District's revenue is from PNC. General Service includes residential, commercial and industrial customers. Industrial revenue is expected to increase in 2015 due to the reopening of Teck American's Pend Oreille Mine. The budget assumes a ramp-up year, which generates an additional \$450,000 in revenue for the District.

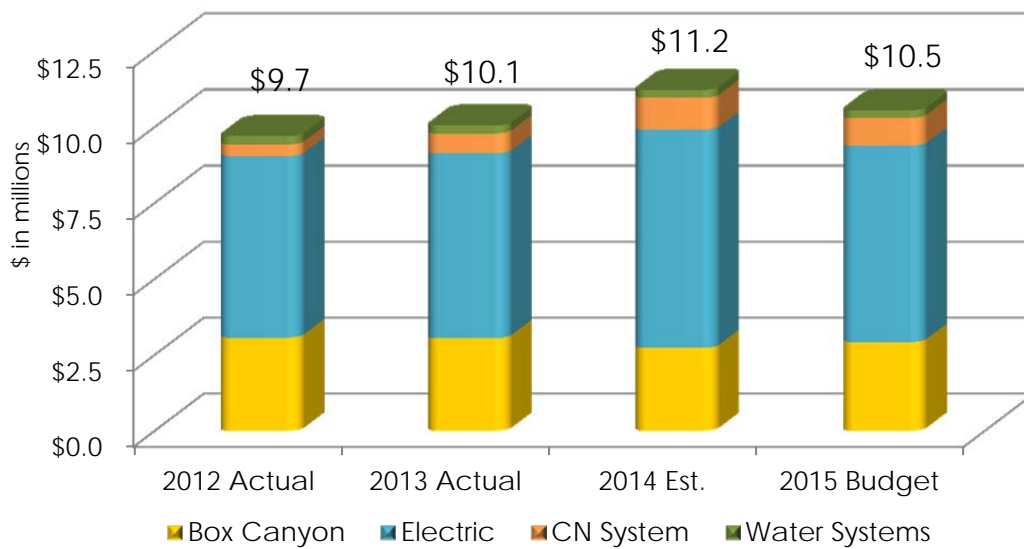
Community Network System revenue is increasing as more customers sign up for the service. The Budget assumes 1,395 standard class connections by the end of 2015.



Worst	Expected	Best
<p>The number of customers, and/or usage, decreases.</p> <p>\$100,000 reduced revenue</p>	<p># of Residential Customers</p> <p>The number of customers increases slightly, with average usage.</p>	<p>The number of customers and/or average usage, increases by more than expected.</p> <p>\$100,000 additional revenue</p>
<p>Pend Oreille Mine ramps up slower than anticipated, thus reducing usage from expectations.</p> <p>\$125,000 reduced revenue</p>	<p>Pend Oreille Mine</p> <p>Pend Oreille Mine usage increases slowly, as it ramps up to full production.</p>	<p>Pend Oreille Mine reaches full production sooner than expected, thus increasing usage.</p> <p>\$180,000 additional revenue</p>

Operation & Maintenance Expenses

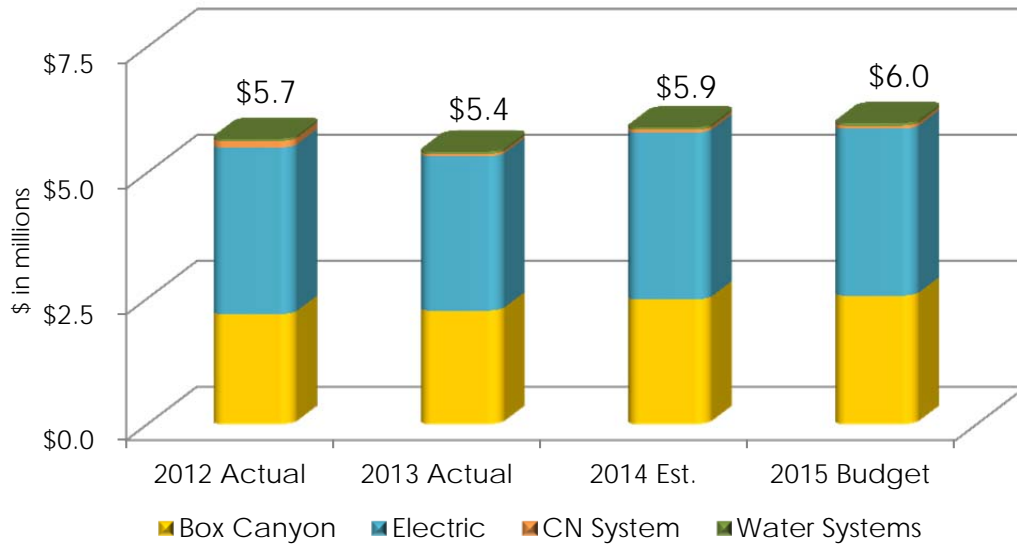
Maintenance expenses were higher in 2014 due to the summer storms. Summer storms tore through the region on July 23 and August 2, 2014, both of which left thousands of customers without power and fiber service. District costs to repair damage were over \$1 million. Operation and Maintenance expenses for 2015 are forecasted to be slightly higher than prior years (excluding 2014) due primarily to inflation, regulatory requirements, and the District's increased focus on system safety and reliability. The District has put a renewed focus on maintaining vegetation around service lines. As we saw earlier this year, high winds can uproot trees and send branches into power lines. Power outages, while inconvenient, also pose a threat to public safety. Downed wires can cause serious injuries and spark fires.



Worst	Expected	Best
The District experiences another severe storm.	Expenses rise at 2% inflationary rate.	Expenses do not rise at inflationary rates and remain at 2013 levels.
\$1.0 million in additional expenses		Expenses reduce by \$0.4 million

Administrative & General Expenses

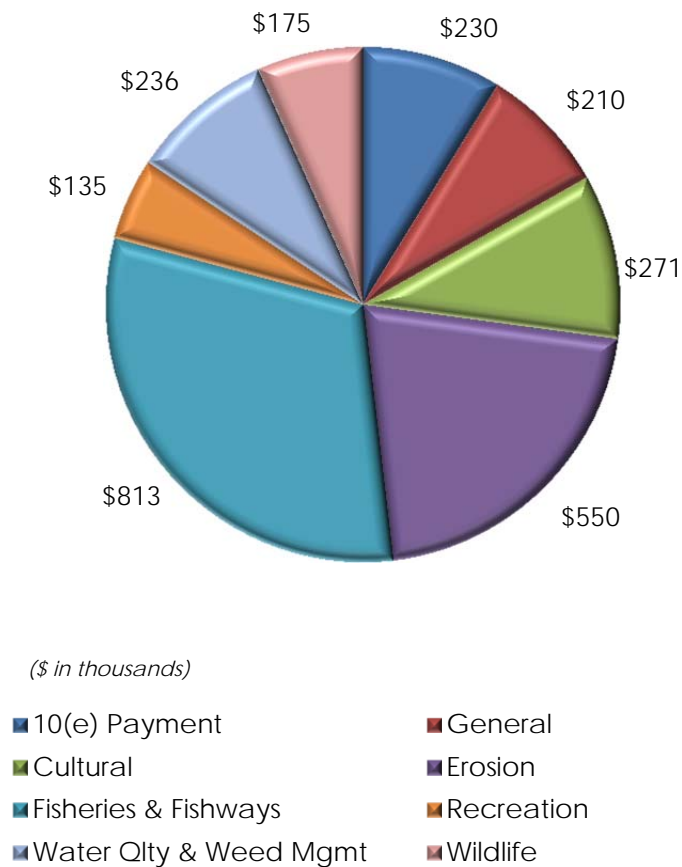
Administrative and General (A&G) expenditures have risen faster than inflation over the past few years due primarily to required additional personnel. Ever increasing regulatory requirements is the driving factor in increasing the number of employees. Some employees have been transferred from other departments, in accordance with the District's effort to keep total headcount down.



Protection, Mitigation & Enhancement

In addition to required capital projects, the District has several regulatory and maintenance projects budgeted in 2015. The requirements for the Protection, Mitigation and Enhancement measures (PM&E,) per the Box Canyon FERC license, are estimated to be \$2.6 million in 2015. These projects include improvement of wildlife and fish habitat, water quality monitoring, erosion mitigation, and environmental studies.

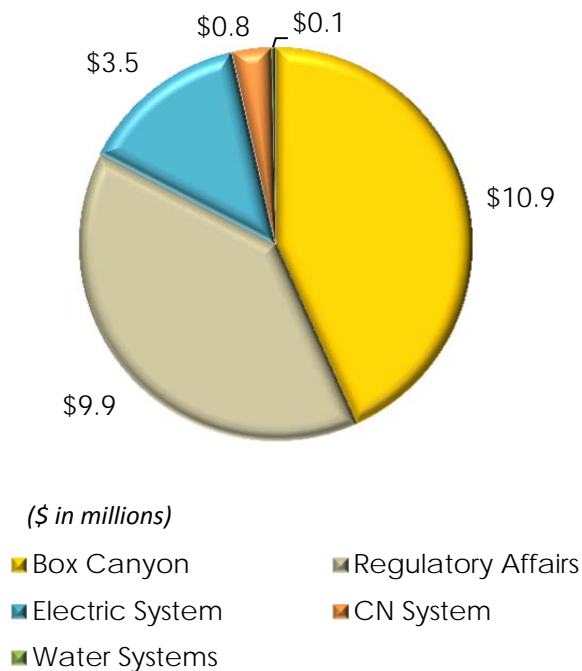
In 2014 the District entered into an agreement with the USDA Forest Service for the erosion monitoring plan required as part of the FERC license. The District will pay the Forest Service \$1.8 million over 5 years, and in exchange, the Forest Service will perform all necessary erosion work at these sites over the license period.



Capital Expenditures

Capital Expenditures are defined as items of tangible business property of a relatively permanent nature, having an acquisition cost of \$2,000 or more. This includes, but is not limited to: land, new purchases of machinery and equipment, replacement and major rebuild of plant and equipment, construction projects, major spare parts, office furniture and fixtures and computer hardware and software.

Total District capital expenditures are budgeted to be \$25.2 million for the year. Of the total expected spending, \$20.5 million will be debt financed.



Capital Expenditures Detail	
Production	\$20,817,500
Distribution	\$3,487,100
Community Network	\$814,900
Water	\$85,000
Total	\$25,204,500

Capital Expenditures Funding	
Debt Financed	\$20,475,000
Cash Reserves	\$4,729,500
Total	\$25,204,500

The District is continuing work on the projects required as part of the 2005 license renewal. The PUD is in the final stages of the turbine upgrade project. Although the project will be finalized in 2014, the 2015 budget does include \$10 million for final invoices and contract closeouts for the project.

Work is ramping up on the upstream fish passage, another FERC requirement, for the Box Canyon Project. In 2015 the District will be spending approximately \$9 million for the final engineering and design of the project along with the beginning stages of construction of the upstream passage. The project is expected to be completed in 2016, with a total project cost estimated to be \$23 million.

Total capital expenditure spending budgeted for the Production System is \$20.8 million.

The District continues to focus on maintaining desired system reliability. 2015 will be the fourth year of a seven year Test and Treat program. Distribution poles are tested, and then either treated to increase the lifespan or replaced if found to be aging or unsafe. This work is enhancing the safety and reliability of poles. The budget includes \$50,000 for test and treat, and \$400,000 in capital expenditures for replacement of poles.

The District is in the second year of a four year project to meet Washington State Department of Transportation's (WSDOT) franchise update requirements. The franchise, or permit, issued by the WSDOT allows the District to put equipment in the state highway right-of-ways. In 2014 the District surveyed and documented all PUD equipment along Highway 211. The District will analyze approximately 50 poles and guy wires identified in the survey to determine if they need to be moved or can be left as is. The District will perform the same work on Highway 2, Highway 20 and Highway 31 in the years 2015, 2016 and 2017 respectively. The cost for each highway varies due to the number of miles, equipment, and remediation steps required. The 2015 Budget includes \$330,000 for this project.

Capital expenditure spending budgeted for the Distribution System is \$3.5 million.

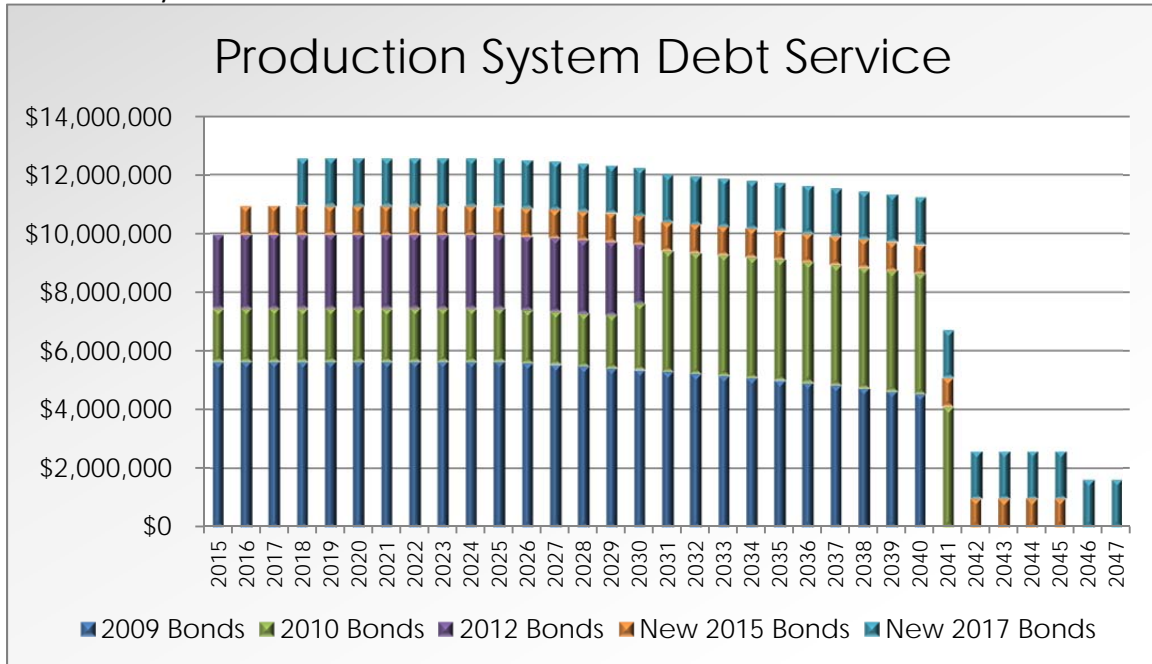
The Community Network System is budgeting \$814,900 in capital expenditures for the year. The majority of this budget is for new line extensions. \$699,100 of the line extension budget is assumed to be a District cost, those for customers with qualifying consent forms, and for new customers with the \$1,500 credit. The budget includes \$90,000 for line extensions paid for by the customer; this cost is offset through revenue. District capital spending, net of the customer payments, will be limited to \$725,000. Line extensions for those customers with qualifying consent forms will be limited to \$200,000 in 2015.

The Water System capital expenditure budget is \$85,000. The system is budgeting \$40,000 to replace undersized pipe at the Sunvale Acres subdivision. This is a three year project, estimated to cost \$90,000, which will improve low water pressure. The Water System is also budgeting \$45,000 for an emergency generator at Sandy Shores, to operate pumps in an emergency situation.

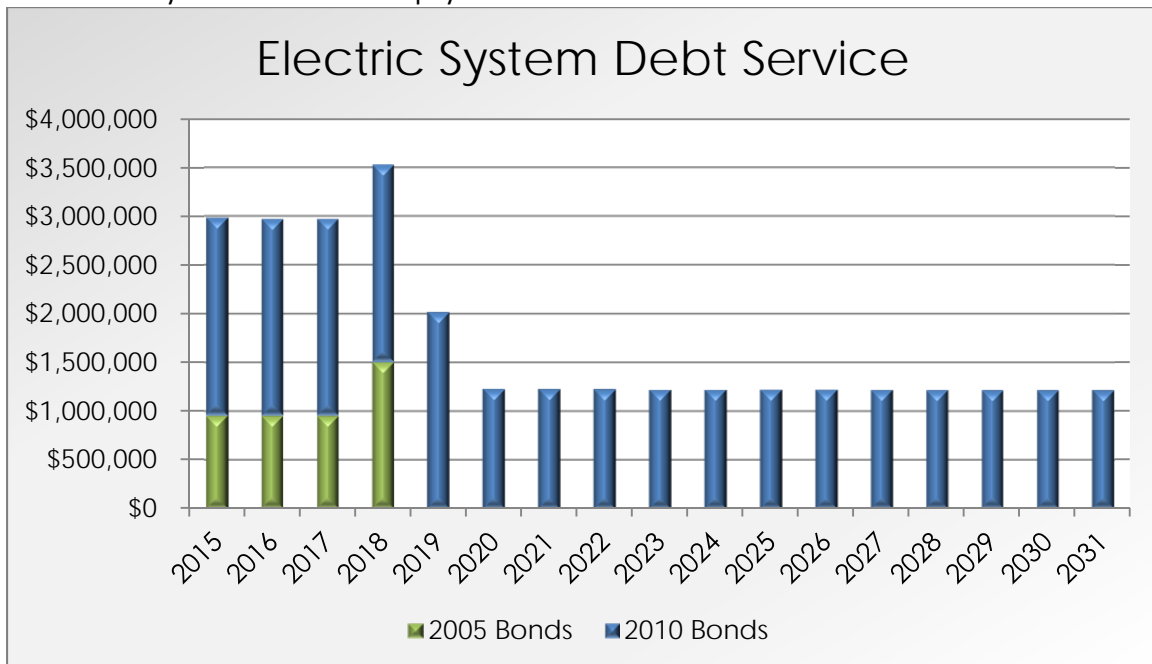
Debt Assumptions

The 2015 Budget assumes increased Box Canyon debt of \$15 million in 2015, and assumes approximately \$25 million will be borrowed in 2017, or later, dependent upon the construction timing of Box Canyon downstream fish passage. The 2015 proceeds will be spent on the Box Canyon upstream fish passage project, which is currently underway.

The following graph shows an estimate of debt service (principal and interest) payments for the Production System bonds.



The Electric System's debt service payments are as follows:



Labor Costs

Linemen, Hydro Mechanics, Electricians, Technicians, System Operators, and many other positions are part of the International Brotherhood of Electric Workers (IBEW) union. Union personnel increases are dictated by contract, which was negotiated in 2014 for a new three year term. Under the new contract, union employees received a 3% wage increase effective April 1, 2014. Wage increases in 2015 and 2016 are based on CPI-W, with a minimum increase of 2% and a maximum increase of 3.5%.

Non-union increases are at the discretion of District management, and affect roughly 50% of personnel. Management will continue to review industry and economic factors affecting wages through the first part of the year. The budget assumes a 2.75% increase for all employees. The average wage increase over the past five years has been 2.8% for union employees and 2.2% for non-union employees.

The 2015 Budget includes \$15.0 million for District wages and benefits. \$3.6 million of these costs are expected to be capitalized as employees work on various projects, and therefore, included in the Capital Expenditures number discussed above. The remaining \$11.4 million in labor costs are expensed.

Worst	Expected	Best
Wage increase is 3.5%.	Wage increases are estimated to be 2.75% (based on CPI-W), effective April 1, 2015 for Union employees and July 1, 2015 for non-union employees.	Wage increase is 2%.
\$66,000 in additional labor costs for the year.		Labor costs reduced by \$48,000 for the year.

Personnel

In 2015 the District is requesting three additional Full-Time Employees, offset by a reduction due to attrition and on-call personnel. With the ever increasing regulatory requirements, both the Compliance and the Information Technology departments are requesting additional staff. The District is obligated to maintain compliance with over 900 reliability standard compliance requirements. Additional staffing is necessary to assist with processing incoming operating evidence, standards tracking and reporting obligations. The new Information Technology position will assist with increased work load necessary to become compliant with the North American Electric Reliability Corporation (NERC) required Critical Infrastructure Protection (CIP) standard.

In addition, the Customer Service Department is requesting to turn the on-call position into a full-time employee. This person will be assuming duties of the front desk area. Installs, disconnects and billing are requiring more time to process for the CN System than originally anticipated. In addition, processing of locates takes a considerable amount of time with the new 'call before you dig' program.

Department	2012	2013	2014	2015
	Actual	Actual	Actual	Budget
Administration	12	13	11	12
Electric Operations	29	28	31	31
Information Technology	4	5	7	8
Box Canyon Operations	21	21	20	20
Customer Service	10	9	9	10
Regulatory Affairs	9	9	9	9
Engineering	5	5	7	6
Water Systems	3	3	3	3
Community Network System	6	5	4	4
Full-Time Employees	99	98	101	103
On-Call Employees	4	6	5	4
Total Employees	103	104	106	107

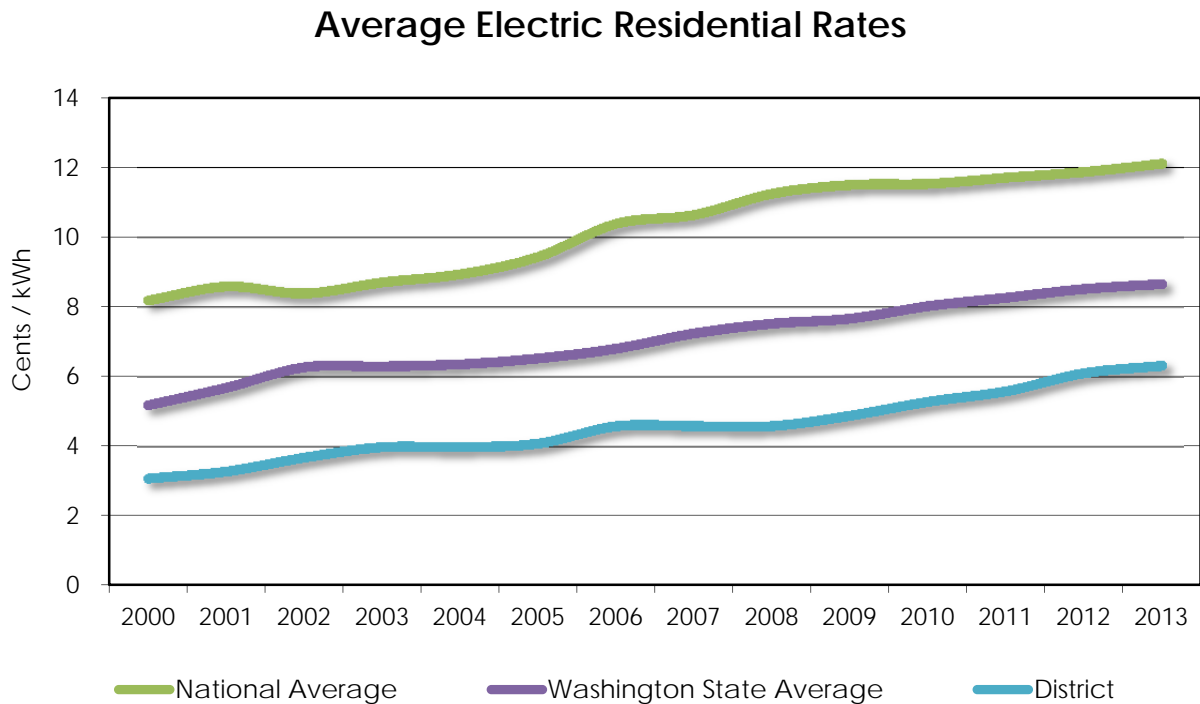
Compared to 2014, these movements will net in two additional Full-Time Employees (FTEs), and one fewer on-call employee. The District anticipates ending 2015 with 103 Full-Time Employees, and 4 on-call employees.

Rate Adjustments

The 2015 Budget includes a projected 1.5% electric rate increase. Electrical rates are decided upon by the Commissioners during the spring of each year, and if adjustments are approved, they become effective July 1. The process always includes a public rate hearing. The District budget was compiled in accordance with the philosophy of managing finances toward small more frequent rate increases rather than larger periodic rate increases. CPI-U, a measure of general inflation, is up 2.0% from September of last year to September of this year. In addition, the District is experiencing cost increases, beyond inflation, due to regulatory requirements. Despite rising costs, many out of the District's control, such as NERC regulation, the District is forecasting an increase even less than inflation.

Additionally, the budget includes a projected 1.0% electric rate increase related to the cost of power the District receives from Seattle City Light's Boundary Dam. Boundary provides most of the power used by the District's residential and commercial customers and contributes to the District's low cost power rates. Seattle City Light recently relicensed Boundary Dam, and the District is expecting the cost to produce Boundary power to increase significantly over the next few years. Because the District has no control over this increase in cost, the District will analyze the change in Boundary cost each year to address the affect and adjust rates as necessary.

The District's current residential electric rates are in the lowest 3% of the nation. The following chart shows the District's retail rate increases compared to other utilities across the state and nation.



The District introduced the fiber standard class with a monthly rate of \$35.00, which was slated to increase to \$50.00 on January 1, 2015. In September 2014 the PUD Commissioners approved a gradual increase, with the standard class monthly rate increasing to \$40.00 effective January 1, 2015 and \$45.00 effective January 1, 2016.

Both Sunvale and Sandy Shores Water system customers should expect a rate increase in the coming year to cover the cost of the capital projects proposed for the year.

Summary

The District is proposing a consolidated \$74 million balanced budget for 2015, the details of which were discussed in the document above, and shown numerically in the table below.

	Electric System	Production System	Community Network System	Water System	Eliminations	Total District
Budgeted Expenditures:						
Power from Box Canyon	17,863,224	-	-	-	(17,863,224)	-
Power from Boundary	1,885,524	-	-	-	-	1,885,524
Power from BPA	8,555,657	-	-	-	-	8,555,657
Power from other sources	625,505	110,057	-	-	-	735,563
Wheeling and backup	1,017,674	-	-	-	-	1,017,674
Operation & Maintenance	6,462,760	2,922,724	913,410	249,735	-	10,548,629
PM&E costs	-	2,619,000	-	-	-	2,619,000
Customer accounting & information	722,864	-	8,000	-	-	730,864
Administrative and general	2,658,455	2,585,054	51,070	54,032	(390,000)	4,958,611
Taxes	2,405,438	110,347	6,171	20,233	-	2,542,189
Total Operating Expenditures	42,197,102	8,347,182	978,651	324,000	(18,253,224)	33,593,711
Interest on long-term debt	883,819	7,804,802	7,900	6,382	-	8,702,903
Less amortization included in interest	81,314	(278,878)	-	-	-	(197,564)
Capital Project Payments	3,487,100	20,817,500	814,900	85,000	-	25,204,500
Renewal & Replacement Funding	-	250,000	-	-	-	250,000
Capital Improvement Funding	547,981	-	-	-	-	547,981
Principal payments	1,965,000	3,673,343	182,687	37,590	-	5,858,620
Total Budgeted Expenditures	49,162,315	40,613,949	1,984,138	452,972	(18,253,224)	73,960,150
Funding Sources:						
Operating Revenues	49,144,065	18,093,224	1,900,500	410,532	(18,253,224)	51,295,097
Interest income	18,250	2,066,125	200	87	-	2,084,662
Debt Financed	-	20,475,000	-	-	-	20,475,000
Grant/Third Party Funds	-	-	-	-	-	-
Deferred and other income	-	(20,400)	(49,588)	-	-	(69,988)
Total Funding Sources	49,162,315	40,613,949	1,851,112	410,619	(18,253,224)	73,784,771

The Debt Service Coverage (DSC) Ratio measures the District's ability to pay the year's debt service (interest and principal payments) through net revenues. Debt covenants dictate the PUD maintain a DSC ratio of at least 1.25, although the District goal is 1.75. The 2015 budget is projecting a DSC of 2.32.