

>> 2017 Budget



PUD

Approved Budget

December 6, 2016

Public Utility District #1 of Pend Oreille County
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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 \$79 million budget for 2017. The District continues to be a stable provider of electricity, broadband, and water services. Succession planning, compliance with increasing regulatory items, and implementation of Box Canyon license requirements will be a focus of the utility in 2017. In the midst of these and other utility industry changes, the District continues to be cost conscientious, evaluating positions and expenditures at all times and reducing costs if possible, while adapting to a changing environment. The District also continues to commit to the safety of our employees and customers, as well as a commitment to provide quality service to our customers in Pend Oreille County.

The budget includes many different projects and is based on several 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. All power generated by Box Canyon, except the amount allocated to the Kalispel Tribe, is sold to the Electric System. Therefore, the "Power from Box Canyon" item listed under the Electric System encompasses all costs to produce power at Box Canyon, including debt service payments, and is eliminated when the systems are consolidated so that the costs are not double-counted.

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, including water quality, recreation, fish passage, trout habitat restoration, erosion, and others.

The Box Canyon Turbine and Generator Upgrade was completed in 2015. The refurbished generators operated throughout the year, increasing maximum generation with increased efficiencies. With all four new units operating, Box Canyon's generation capacity will increase from 76 to 90 megawatts.

Construction of an upstream fish passage facility at Box Canyon began in 2016, with completion scheduled for October 2017.

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 1,600 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.

The Electric System

The Electric System distributes electricity to residential and other consumers in Pend Oreille County. The service area includes the entire County, which encompasses approximately 1,400 square miles. The District currently provides all of the retail electric service in its area.

Water System

The Water System consists of nine individual water distribution subdivisions. The District is contractually obligated to maintain separate and distinct rates for each water system which reflect the individual system's costs.

District Power Resources

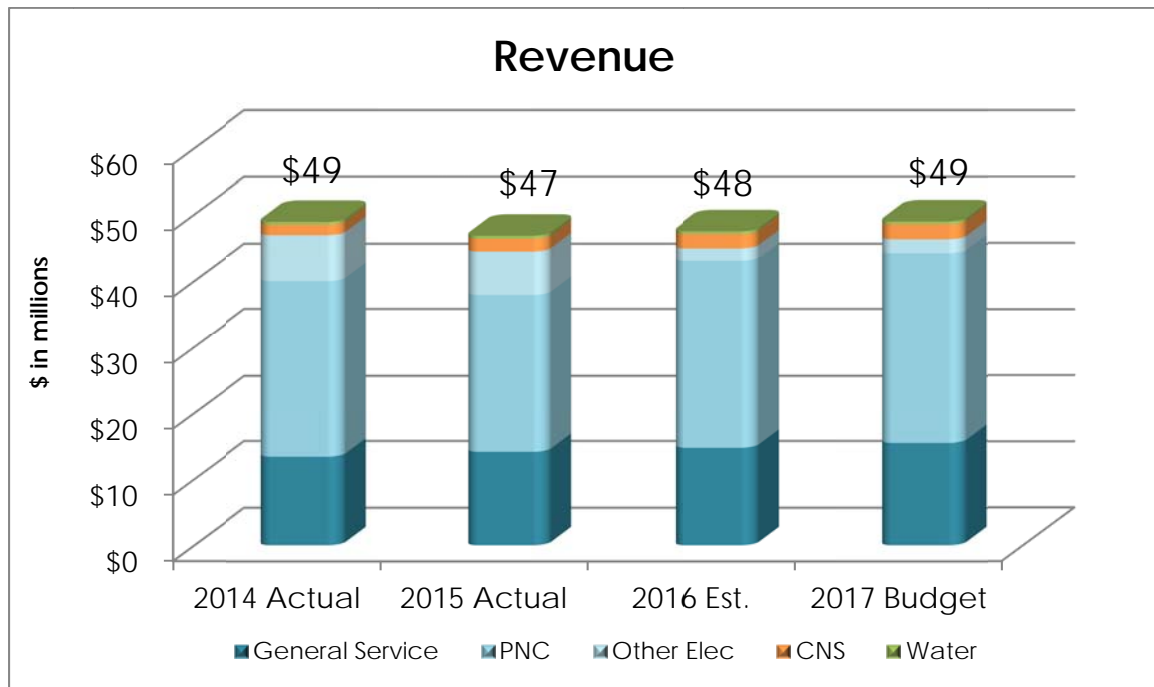
Energy resources are obtained from District-owned resources Box Canyon Dam and the Calispell Hydro Plant, and outside sources Boundary Dam owned by Seattle City Light, and Bonneville Power Administration (BPA).

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. The District's General Service customers are deemed to be served with lower-cost power from Boundary, and currently pay for only a small percentage of Box Canyon power.

Funding Sources

Ponderay Newsprint Corporation (PNC), which operates a paper machine and fiber mill in Usk, Washington, is the District's largest electric customer. Under current contracts with PNC, the cost of Box Canyon generation falls on PNC to the extent it is attributed to receiving Box Canyon power. Approximately 65% of the District's revenue is from PNC. General Service encompasses all remaining electric load outside of PNC and includes residential, commercial and industrial customers.

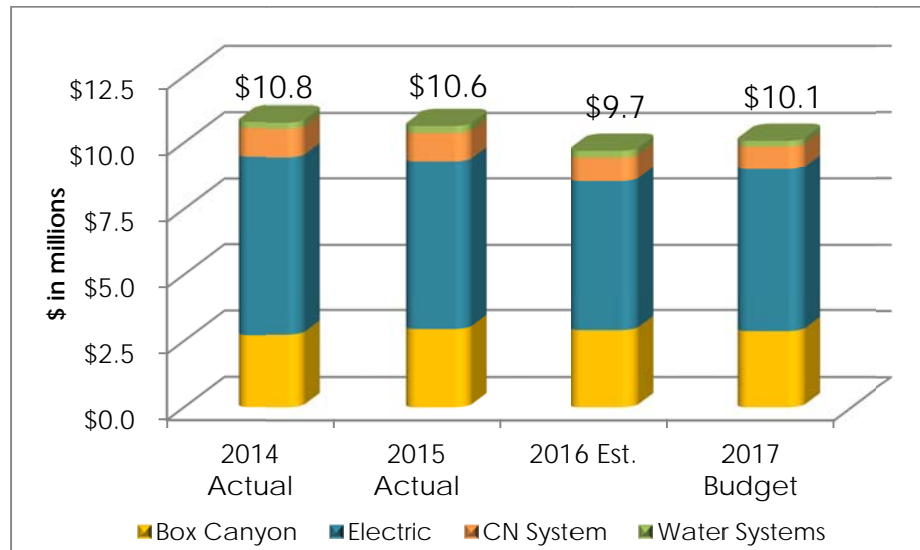
Community Network System revenue is increasing as more customers sign up for the service. The Budget assumes 1,700 standard class connections by the end of 2017.



Worst	Expected	Best
<p>The number of customers decreases.</p> <p>\$100,000 reduced revenue per 1% decrease</p>	<p><u># of Residential Customers</u></p> <p>The number of customers stays constant.</p>	<p>The number of customers increases</p> <p>\$100,000 additional revenue per 1% growth</p>
<p>Average usage decreases</p> <p>\$100,000 reduced revenue</p>	<p><u>Average Usage</u></p> <p>The average usage stays constant.</p>	<p>Average usage increases.</p> <p>\$100,000 additional revenue</p>

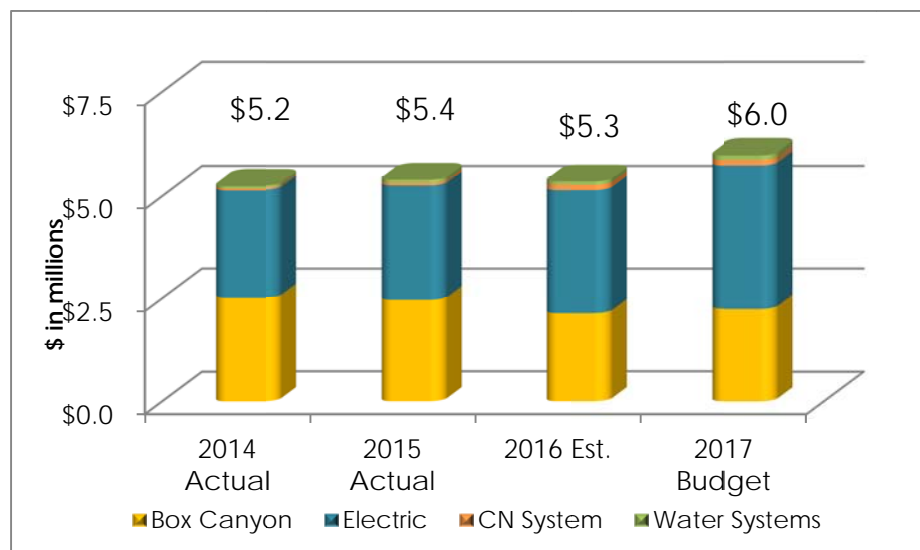
Operation & Maintenance Expenses

Operation and Maintenance expenses in 2014 and 2015 reflect costs due to the summer and winter storms. Expenses for 2016 are forecasted to be lower than prior years due primarily to reduced outages; 2016 labor hours related to outages has been well below average. The 2017 Budget forecasts increases due to a more average year for outages, inflation and regulatory requirements.



Administrative & General Expenses

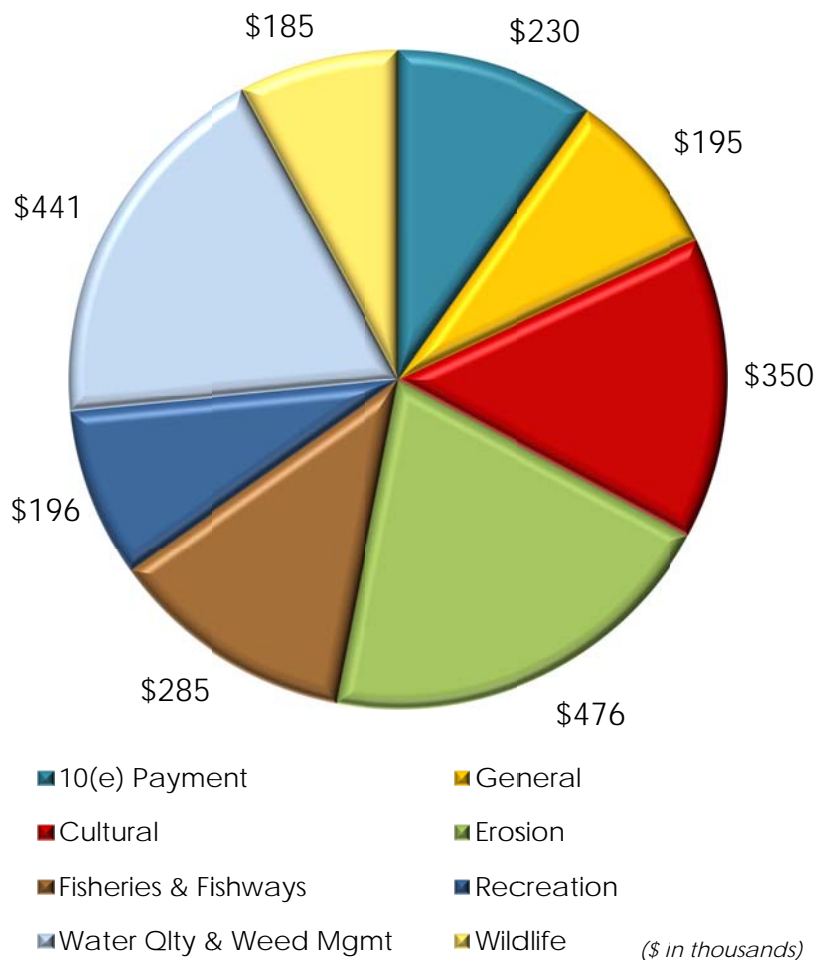
Administrative and General (A&G) expenditures are budgeted to increase due primarily to increased legal fees and additional personnel. Increased legal fees are due to ongoing litigation with Ponderay Newsprint. Per contract, legal fees are paid directly by Ponderay Newsprint, not General Service, and therefore these costs are offset by increased revenue from PNC. Increasing regulatory requirements related to the region's electric grid is the driving factor in increasing the number of employees.



Protection, Mitigation & Enhancement

In addition to required capital projects, the District has several regulatory and maintenance projects budgeted in 2017. The requirements for the Protection, Mitigation and Enhancement measures (PM&E,) per the Box Canyon FERC license, are estimated to be \$2.4 million in 2017. These projects include improvement of wildlife and fish habitat, water quality monitoring, erosion mitigation, and environmental studies.

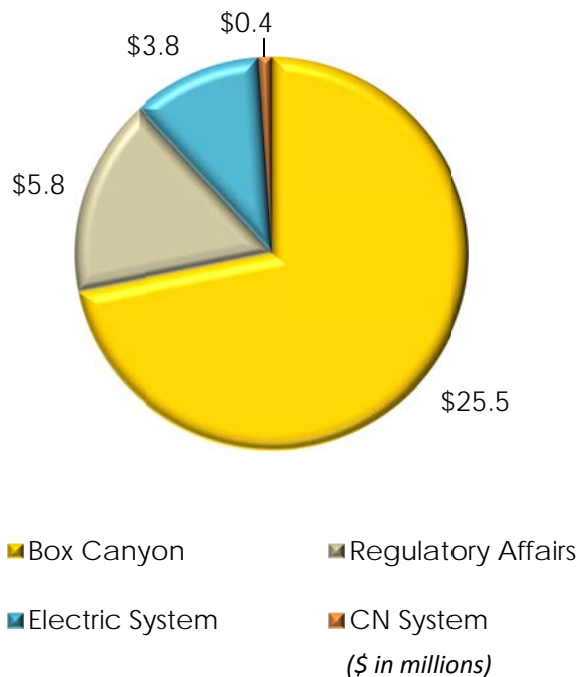
In 2014 the District entered into an agreement with the USDA Forest Service for an erosion monitoring plan required as part of the FERC license. The District will pay the Forest Service \$1.8 million over 5 years, and in exchange, the Forest Service will perform all necessary erosion work at these sites over the license period. The 2017 budget also includes a \$250,000 one-time study related to total dissolved gas and water quality issues created by Box Canyon Dam.



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 \$35.5 million for the year. Of the total expected spending, \$30.7 million will be debt financed.



Capital Expenditures Detail	
Production	\$31,258,100
Distribution	\$3,792,100
Community Network	\$391,100
Water	\$25,150
Total	\$35,466,450

Capital Expenditures Funding	
Debt Financed	\$30,700,000
Cash Reserves	\$4,766,450
Total	\$35,466,450

As part of its FERC license for Box Canyon Dam, the PUD is required to provide upstream fish passage for three target species: Bull Trout, Westslope Cutthroat Trout, and Mountain Whitefish. The upstream trap-and-haul type fishway will consist of a fish ladder, pre-sort holding pool, and a sorting facility. Target fish will be identified, measured, and tagged before being

transported upstream for release. Due to limited construction seasons associated with river flow conditions and water temperature, construction of the fish passage will require a two-year schedule. Completion is scheduled for October 2017. The 2017 Budget includes \$25 million for this project.

The District continues to focus on maintaining desired system reliability. 2017 will be the sixth year of a seven year Test and Treat program for the Electric System. 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 \$82,500 for test and treat expenses, and \$400,000 in capital expenditures for replacement of poles.

The District is in the last 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, 2015 and 2016 the District surveyed and documented all PUD equipment along Highway 211, Highway 2 and Highway 20 respectively. The District will then analyze the poles and guy wires identified in the surveys to determine if they need to be moved or can be left as is. The cost for each highway varies due to the number of miles, equipment, and remediation steps required. The 2016 Budget includes \$150,000 for this project.

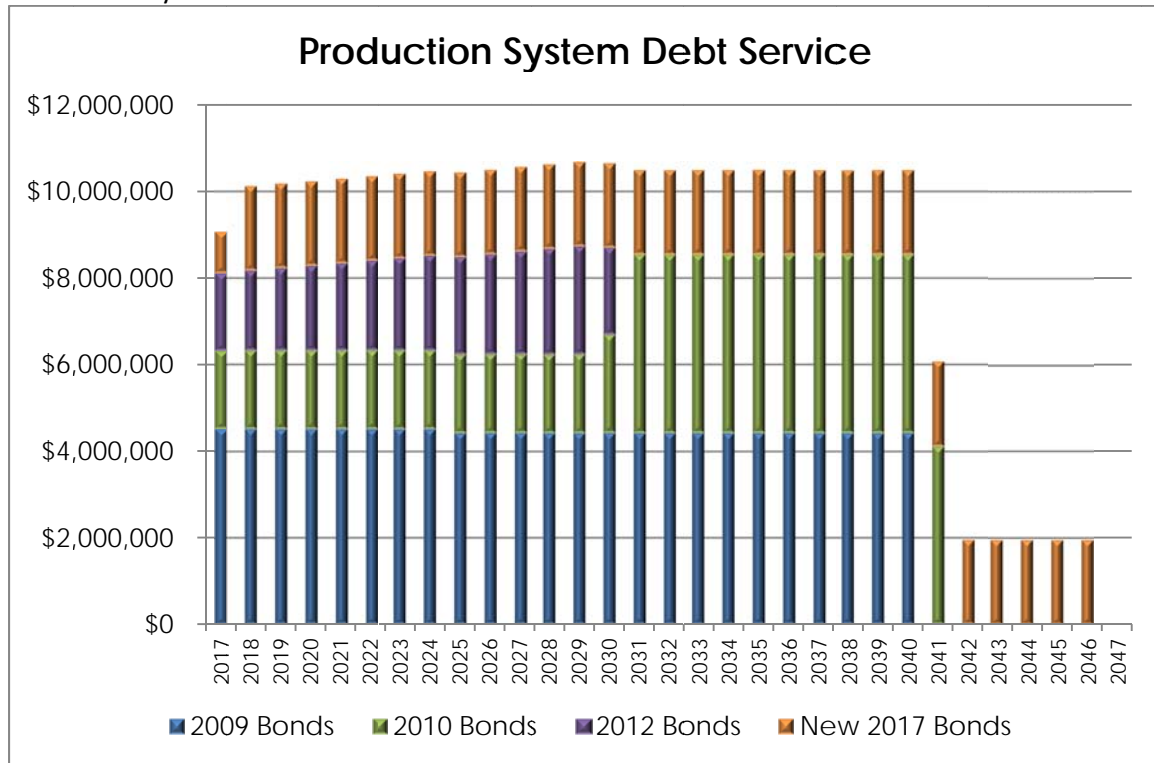
The Community Network System is budgeting \$391,100 in capital expenditures for the year. The majority of this budget is for new line extensions. \$126,000 of the line extension budget is assumed to be a District cost, those for customers with qualifying consent forms. The budget includes \$115,000 for line extensions paid for by the customer; this cost is offset through revenue.

The Water System capital expenditure budget is \$21,150. The system is budgeting \$12,000 to begin studies regarding undersized pipe at the Sunvale Acres subdivision. The Water System is also budgeting \$2,000 to begin a meter replacement project at all water systems.

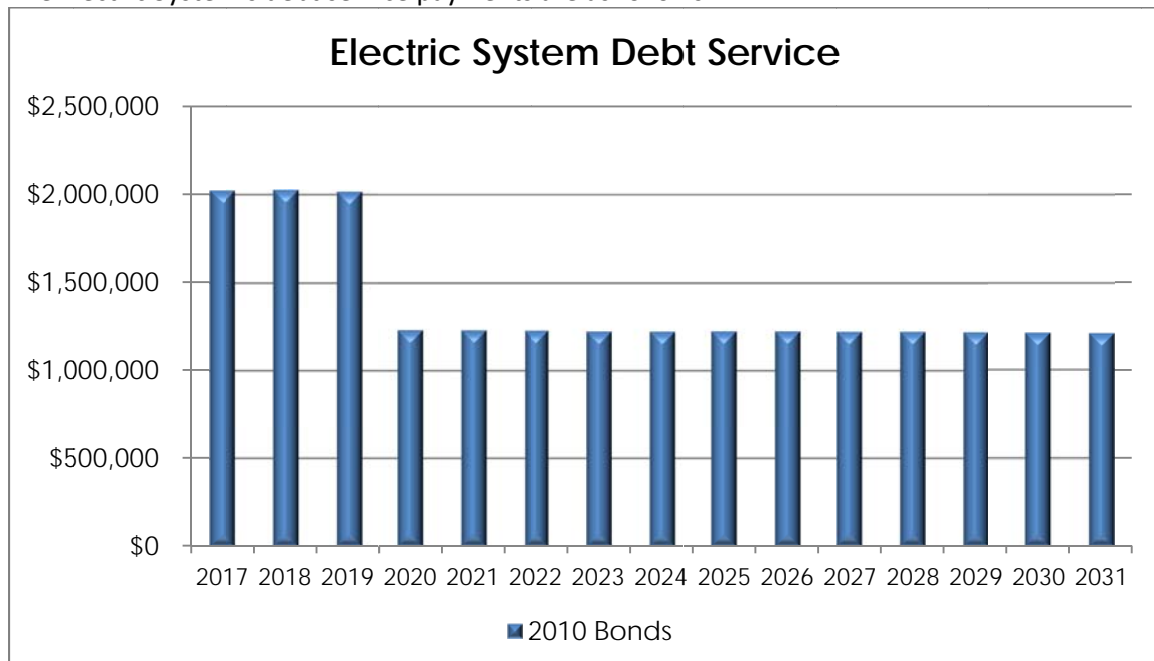
Debt Assumptions

The 2017 Budget assumes increased Box Canyon debt of \$30 million in 2017. The 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 contract, wage increases 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 2017 Budget includes \$13.0 million for District wages and benefits.

Personnel

In 2017 the District is requesting three additional Full-Time Employees. With the promotion of Colin Willenbrock to General Manager in 2015, the District did not fill the Legal Counsel position, but instead relied on outside counsel. This Budget assumes the position will be filled, bringing the expertise back in-house. With the ever increasing regulatory requirements, the Engineering department is requesting an additional engineer. This is a required position due to requirements set by NERC. The last position is a temporary position in Box Canyon Operations to train for an upcoming retirement.

Department	2014 Actual	2015 Actual	2016 Actual	2017 Budget
Administration	11	11	11	12
Electric Operations	31	31	31	31
Information Technology	7	8	5	4
Box Canyon Operations	20	19	17	18
Customer Service	9	10	10	10
Regulatory Affairs	9	7	6	6
Engineering	7	5	7	9
Water Systems	3	3	3	3
Community Network System	4	4	4	4
Full-Time Employees	101	98	94	97
On-Call Employees	5	4	4	4
Total Employees	106	102	98	101

Summary

The District is proposing a consolidated \$79 million balanced budget for 2017, 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	19,026,900	-	-	-	(19,026,900)	-
Power from Boundary	2,198,000	-	-	-	-	2,198,000
Power from BPA	938,795	-	-	-	-	938,795
Power from other sources	3,761,219	-	-	-	-	3,761,219
Wheeling and backup	701,707	110,000	-	-	-	811,707
Operation & Maintenance	6,159,718	2,844,261	871,376	215,057	-	10,090,412
PM&E costs	-	2,371,054	-	-	-	2,371,054
Customer accounting & information	781,995	-	44,800	18,500	-	845,295
Administrative and general	3,484,809	2,241,973	134,834	108,632	(171,600)	5,798,648
Taxes	2,441,062	102,040	7,510	21,252	-	2,571,864
Total Operating Expenditures	39,494,205	7,669,328	1,058,520	363,441	(19,198,500)	29,386,994
Interest on long-term debt	647,467	7,641,646	38,910	5,085	-	8,333,107
Less Federal Subsidy	-	(2,104,824)	-	-	-	(2,104,824)
Less amortization included in interest	44,283	77,242	-	-	-	121,525
Capital Project Payments	3,792,100	31,258,100	391,100	25,150	-	35,466,450
Renewal & License Funding	-	1,500,000	-	-	-	1,500,000
Capital Improvement Funding	295,000	-	-	-	-	295,000
Principal payments	2,040,000	4,020,714	211,209	-	-	6,271,923
Total Budgeted Expenditures	46,313,055	50,062,207	1,699,738	393,676	(19,198,500)	79,270,176
Funding Sources:						
Operating Revenues	46,276,875	19,256,900	2,250,079	431,198	(19,198,500)	49,016,552
Interest income	31,555	137,830	-	250	-	169,635
Debt Financed	-	30,700,000	-	-	-	30,700,000
Deferred and other income	9,456	(32,523)	(224,056)	-	-	(247,123)
Total Funding Sources	46,317,886	50,062,207	2,026,023	431,448	(19,198,500)	79,639,063

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 2017 budget is projecting a DSC of 3.31.