

TACOMA POWER

TACOMA POWER
ELECTRIC RATE & FINANCIAL POLICY

2024

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EXECUTIVE SUMMARY

The Electric Rate & Financial Policy gives direction to future short-term and long-term planning decisions and endeavors to ensure that reliable service is provided to all customers at the lowest possible cost consistent with prudent utility management.

This booklet contains the Electric Rate & Financial Policy which results from review and revision of the Electric Rate Policy adopted in 1984 and revised in 1989, 1991, 1993, 1994, 1996, 2003, 2005, 2007, 2013, 2015, 2017, 2019, 2022, and 2023. The 1996 changes were extensive and incorporated language which provided Tacoma Power flexibility to compete in a rapidly changing economic environment. The 2005 change modified the projected cash balances from 45 to 63 days. The 2007 changes modified the projected cash balances from 63 to 90 days and modified the language concerning planned debt service coverage. The 2013 changes added a language pertaining to the Rate Stabilization Fund. The 2015 changes added guidance for using long and short-term debt to finance capital projects, additional clarification pertaining to financial metrics, and additional language pertaining to the Rate Stabilization Fund. The 2017 changes modified the New Large Load policy. The 2019 changes modified the description of low-income customers, added a rate setting objective to maintain rate stability, and added a description of a phased-in approach for rate adjustments. The 2022 changes added language for operationalizing equity, added language around climate change, provided additional emphasis on affordability for customers, modified the description of low-income customers to include customer programs, and modified the description of rate stability to emphasize gradual rate adjustments through long-term financial planning. The 2023 changes added new very large loads of 10 average megawatts or more to the exceptions from embedded cost-of-service study and eliminated the previous language regarding New Large Load policy in Section IV.B.2.c. "Rates for New Large Loads." The 2023 changes also removed certain terms and definitions in the Glossary section that were no longer referenced in the Policy. The 2024 changes updated load forecasting language to include assumptions around electrification, modified minimum financial ratios and projected cash balances to align with business practices, added language pertaining to resource planning and adequacy, and added language to establish a core balance target in the Rate Stabilization Fund. The 2024 changes modified the minimum Debt Service Coverage Ratio from 1.8 to 2.0 and median to average hydro conditions for net revenues from surplus sales.

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ELECTRIC RATE & FINANCIAL POLICY

MISSION STATEMENT: Tacoma Power is an innovative, citizen-owned electric utility that generates, transmits and distributes electricity and provides energy services in an increasingly competitive marketplace.

We are committed to provide high-value, competitively priced products and services to our customers through the quality of our employees and the responsiveness that results from local ownership.

We will continue to serve our customers in Tacoma and neighboring communities and serve new markets to benefit both existing and new customers.

PURPOSE: The Electric Rate & Financial Policy provides direction and guidance in the development of the rates and prices for Tacoma Power services as well as the structure of financing to support sound financial planning and practices. The policy guides prudent decision-making and planning on matters that affect the quality, cost and competitiveness of Tacoma Power services. It is the intent of this policy to provide an enhanced level of service to our customers and demonstrate to credit rating agencies, investors, and capital markets that Tacoma Power is well-managed and prepared to meet all financial and rate-related obligations.

I. Rate Setting Objectives

A. Serving Customer Needs in a Competitive Electric Industry

Tacoma Power services, including rates and prices for those services, will be designed to meet customer needs and respond to increasing competition in the electric utility industry. Tacoma Power will seek to both unbundle and offer a greater variety of services to its customers who desire to make more of their own choices. Services or rates designed to meet the needs of one group of customers will be accomplished without negative impacts to other Tacoma Power customers. Tacoma Power's financial planning and rate-setting process aims to deliver to all households safe, reliable, and affordable electric services and provide equitable access to information.

B. Recovery of Tacoma Power Costs

Costs that Tacoma Power incurs to provide services will be recovered through the rates and charges collected from its customers.

C. Cost Analysis for Tacoma Power Services

Regular reviews will be performed to determine the adequacy of rates, and a full revenue requirements study will be performed every two years.

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To the extent practicable, short-run and long-run costs will be identified for all Tacoma Power services, including services provided at cost-based rates and services sold at flexible or market-based prices.

D. Review of Major Commitments

Capital investments and other commitments that would significantly affect costs, rates or charges for Tacoma Power services will be evaluated and documented before commitments are made. Such evaluations will address known, as well as potential or uncertain, incremental impacts on costs and revenues. Impacts on Tacoma Power competitiveness will also be assessed. Tacoma Power will plan for, and consider ways of mitigating, the impacts of climate change on our electric system in an affordable manner.

E. Cost-Based Rates

Rates charged to each class of customer will generally be set to reflect the costs of providing their service. This includes any taxes levied by the various jurisdictions that Tacoma Power serves.

F. Exceptions to Cost-Based Rates

Exceptions to cost-based rates for Tacoma Power services will be made only in circumstances where customers have access to competing providers for the service, or as otherwise authorized by the Public Utility Board.

G. Low-Income Customers

The needs of low-income, senior, and disabled electric customers will be considered when establishing rates, providing bill assistance, developing and implementing customer programs, and offering financial education. As rate adjustments are made, we will monitor the affordability of our rates and assess ways to mitigate impact on customers.

H. Electric Rate & Financial Policy Revisions

Any decision to revise electric rate or financial policies will be done in an orderly fashion and formalized by resolution.

I. Public Involvement

Tacoma Power will provide information and gather citizen input to its rate setting process.

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J. Rate Stability

To the extent possible, rate adjustments should be stable and consistent, adjusted gradually through long-term financial planning, and not exceed general inflationary trends.

II. Rate Review Process

A. Traditional Retail Electric Services

The rate review process shall consist of the following four interrelated, yet distinct, steps for traditional retail electric services.

1. Review of Electric Rate & Financial Policy

The Public Utility Board will review the existing Electric Rate & Financial Policy well in advance of consideration of each general rate adjustment. Any required changes must be formalized by Board and Council resolutions.

2. Revenue Requirements Analysis

A Revenue Requirements Analysis will be accomplished to study the projected revenue, expenses and capital improvements for the period to be covered by the rate change.

3. Cost-Of-Service and Cost Allocation

A cost-of-service study will be accomplished to determine the cost of serving each customer class and will be used to allocate class responsibility for the projected expenses of the system.

4. Rate Design

Rate schedules will be developed for each customer class to recover the revenue requirements determined in the cost-of-service procedure.

B. Non-Traditional Retail Electric Services

The rate review process will include estimates of costs and revenues associated with non-traditional services that may be offered during the general rate period and will reflect the policies incorporated in Section III.C. Rates for new non-traditional energy-related services, including unbundled

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and non-portfolio services, may be set at times other than the general rate setting process.

III. Rate Setting Policies

A. Policies Applicable to All Tacoma Power Services

All Tacoma Power services, including rates and prices, will be designed to:

1. Meet a broadening range of customer needs;
2. Enhance competitiveness of Tacoma Power services;
3. Recover all costs of service;
4. Satisfy statutory and regulatory requirements; and
5. Maintain Tacoma Power's financial strength as illustrated in the rating criteria for AA-category utilities.

B. Policies Applicable to Traditional Electric Services

Traditional Tacoma Power retail electric utility services (e.g., transmission, distribution, portfolio power supply), including rates and prices, will be designed to:

1. Unbundle and set rates or prices for services to facilitate increased customer choice;
2. Set rates or prices for each service at actual cost, except where specifically authorized;
3. Minimize cross-subsidies between services or between classes of customers, except where specifically authorized; and
4. Identify and mitigate cost shifts, stranded costs, or other negative impacts that may result from increased customer choice.

C. Policies Applicable to Non-Traditional Energy-Related Services

Non-traditional Tacoma Power services (e.g., retail energy services, non-portfolio and ancillary power supply services) will be offered with pricing flexibility, subject to the following guidelines. Non-traditional services must:

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1. Return positive net benefits to Tacoma Power's traditional retail electric customers;
2. Maximize productive, cost-effective use of Tacoma Power assets and capabilities;
3. Offer lower prices and/or better quality than competing providers;
4. For existing assets or capabilities, seek to recover the fully allocated cost-of-service; and
5. Recover the fully allocated cost of new assets or capabilities added to provide the service.

IV. Financial Targets and Rate Setting Practices

Tacoma Power will endeavor to maintain sound financial metrics that support current and future financing needs, support maintenance or improvement of credit ratings, and minimize the cost of funds and risks associated with borrowing. While this policy includes minimum requirements for liquidity and debt service coverage, it is the goal of Tacoma Power to maintain or improve current debt ratings, and the utility will maintain higher levels of coverage and liquidity as required to achieve this goal.

A. Assumptions and Criteria for Rate Setting

1. Rates will be set at levels to provide projected cash balances of more than 90 days of current budgeted expenditures. It is recognized, however, that seasonal fluctuations may cause cash balances to be below recommended levels, but rates should be set such that the minimum cash balance in any month does not drop more than 40 percent below the recommended level.
2. Tacoma Power will maintain sufficient liquidity to support Tacoma Power's operational objectives, preserve financial and management flexibility, and plan for maintaining or improving credit ratings. Liquidity measures may include cash, the unused portion of dedicated bank lines, the Rate Stabilization Fund, and other short-term debt agreements.
3. The Utility will maintain a minimum Debt Service Coverage Ratio of approximately 1.5 based on net revenues including surplus power sales consistent with water supply planning noted in subsection 5 below or at higher levels consistent with sound financial practice in the electric industry. The Utility will plan to a minimum Debt Service

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Coverage Ratio of 2.0 based on net revenues including surplus sales estimated using average water availability or at higher levels consistent with sound financial practice in the electric industry.

4. In order to maintain an appropriate Debt to Equity Ratio, the Utility, over time, will finance its capital program in a manner which strives for a balance in the use of revenue and debt. Under normal circumstances, major capital projects will be financed primarily with debt and fifty percent of all other capital requirements will be financed through rate revenues. Any debt financing will not be used for longer than the useful life of the capital project.
5. Water supply planning for surplus power available during the rate adjustment period will be based on water conditions that have historically been exceeded 75 percent of the time.

B. Rate Setting for Traditional Retail Electric Services

1. Revenue Requirements

- a. The projected load forecast for the rate review process shall include the consumption effects of price, local economic and demographic conditions, and other projected impacts to future consumption. Projected retail revenues will be based on average weather assumptions.
- b. The level of annual funding for low-income assistance will be determined by the Public Utility Board.
- c. Both the short-term and long-term rate impacts of conservation programs, electrification assumptions, and generating resource development will be considered when establishing current funding levels.
- d. Power rates will be designed to ensure sufficient and reliable power supply and transmission. This includes the procurement and maintenance of sources of supply, infrastructure, facilities, and personnel to meet or exceed regulatory requirements.

2. Cost-of-Service

- a. An embedded cost-of-service study will be the basis for allocating the cost of providing electricity to the rate classes. Below are listed the only exceptions to cost-of-service principles that will be considered in the rate-making process:

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- i. A modified electric rate will be considered to help low-income senior or low-income disabled electric customers pay their bills.
 - ii. A rate surcharge may be considered for new construction and conversions not conforming to existing model conservation standards.
 - iii. New very large loads of 10 average megawatts (aMW) or more over any consecutive 12-month period.
- b. Resource cost classifications between demand and energy will be reflected in the rates in the following ways:
- i. Energy and demand classification factors for Tacoma's existing hydro resources will be determined by operating characteristics of the resources.
 - ii. Power purchases from the Bonneville Power Administration (BPA) will be classified between demand and energy based on the new resource rate for BPA.
 - iii. Demand and energy classification will reflect the incremental value to the Utility at the time of purchase of all new resources and existing resources not covered in 1 or 2 above.

3. Rate Design

- a. Consideration will be given to simplifying and reducing the number of rate schedules by combining customers of similar usage and cost-of-service characteristics.
- b. Rates should maintain a seasonal differential that reflects any significant differences in cost-of-service between the seasons.
- c. A flat seasonal demand rate will be maintained for all non-residential customer classes.
- d. Each rate schedule will contain a monthly customer charge which will reflect, at a minimum, the administrative and billing costs.

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- e. Consideration will be given to rate designs that encourage conservation.
- f. Consideration may be given to rate designs which will reflect existing costs of providing electric service at different times of the day.
- g. The costs and benefits of the current discounted rate for the low-income/senior and low-income/disabled, together with other low-income programs, will be evaluated, along with an analysis of other utility programs that provide assistance to the low-income customer. The low-income rate may be discontinued at the discretion of the Public Utility Board if it is determined that the rate discount is not an effective method of providing assistance to the low-income customers.
- h. Rate adjustments may be phased-in over a limited time period and may be used if a disproportionate change in rate levels is expected for certain classes. Inter-class revenue requirement adjustments significantly in excess of the system average may be allocated proportionally to the remaining customer classes. A gradual approach may be used for the subsidized class to set subsequent rate increases until cost-of-service rates are reestablished.

V. Rate Stabilization Fund

A. Description

Tacoma Power will maintain a Rate Stabilization Fund as a means of managing potential volatility in Rates and augmenting reserve policies. Funds are intended to mitigate the need for large changes in rates from one year to the next.

The Fund also may be used as a rate stabilization account for purposes of the ordinances authorizing Tacoma Power debt and provides that amounts withdrawn from the Fund are deducted from revenues in the year they are deposited into the Fund and counted as revenues in the year withdrawn from the Fund. Amounts withdrawn can only be used for purposes mandated in Ordinance #21862 as amended.

B. Guidelines

General Guidelines for use of the Fund are as follows:

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1. Upon the availability of excess wholesale revenues, Tacoma Power will target a core balance of \$100 million in the Fund. Core balance is defined as the revenues set aside to mitigate the variability in hydro supply and wholesale market prices only. The Fund total balance can be higher to reserve revenues for other operational purposes. In addition, at the conclusion of each fiscal year, Tacoma Power will evaluate the adequacy of the core balance amount in the Fund for meeting the forecast difference between critical and adverse water conditions over the next two fiscal years. The core balance target threshold will be re-evaluated on a periodic basis, at a minimum upon significant operational or market changes that impact wholesale revenues.
2. To the extent the Fund is determined to be inadequate, Tacoma Power will take steps to return the Fund to adequate levels over a period of up to four years, including establishing budgets designed to generate sufficient net revenue to meet all requirements as described below and provide for deposits to the Fund.
3. Prior to depositing amounts into the Fund in a given fiscal year, all obligations related to Operating and Maintenance Expense, Bond Parity Obligations or other debt, and Gross Earnings Tax must first be met.
4. Deposit must not cause the Current Fund Balance to go below 90 days of expenditures for the fiscal year of deposit.
5. Deposit must not cause the Debt Service Coverage ratio to go below 1.5x for the fiscal year of deposit.
6. Deposit should allow for achievement of metrics for liquidity and debt service coverage consistent with achieving the policy goal of maintaining or improving debt ratings.

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GLOSSARY

ANCILLARY SERVICES – Those services, other than power itself, necessary for the transmission and delivery of power.

AVERAGE COST – See EMBEDDED COST.

AVERAGE COST PRICING – A method of pricing electrical service to recover total costs that have been identified with such service, thereby making total revenue equal to total cost.

CHARGE

CUSTOMER CHARGE – An amount to be paid periodically by a customer for electric service that reflects specific customer-related costs incurred for metering, meter reading, billings, etc., exclusive of demand or energy consumption, traceable to the type and number of customers, and not varying with the volume of metered sales.

DEMAND CHARGE – That portion of the charge for electric service based upon the customer's use of the system's electric capacity consumed at the time of the system peak or at the time of the customer's maximum demand and billed on the basis of billing demand under an applicable rate schedule or contract.

ENERGY CHARGE – That portion of the charge for electric service based upon the customer's electric energy (kWh) consumed and billed under an applicable rate schedule or contract.

CUSTOMER CHARGE – An amount to be paid by the customer in a lump sum, or in installments, for connecting the customer's facilities to the supplier's facilities.

CLASSIFICATION – The process of classifying functionalized costs to demand, energy and customer-related components for allocation to the various customer classes by examining the nature of the investment or expense with respect to the manner in which it was incurred.

CONSERVATION – A reduction in energy usage for the purpose of reducing energy consumption.

CONTROL AREA – A (usually contiguous) region within the system with metering at all its boundaries, intended to be used as the basis for frequency regulation and balancing of supply and demand in real time.

COST-OF-SERVICE STUDY (COS) – A study of the costs incurred by the utility in producing, transmitting and distributing electricity to its customers, by customer class, in

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relation to revenues collected from each class or projected to be collected under existing or proposed rates.

CUSTOMER CLASS – A distinction between users of electrical energy. Customer class is usually defined by usage patterns, usage levels, and conditions of service. Classes are usually categorized generically by customer activity, i.e., residential, commercial, industrial, etc.

EMBEDDED COSTS – Embedded costs represent monies already spent for investment in plant and in operating expenses. The terms embedded and fully allocated embedded are synonymous.

FREQUENCY REGULATION – The automatic changing of supply (and, in some cases, demand) as the frequency of a system changes.

FULLY ALLOCATED COSTS – Costs assigned to a product or service such that no cross-subsidy exists for that product or service.

INCREMENTAL VALUE – The avoided cost of acquiring a megawatt-hour of energy and a megawatt of demand.

NON-PORTFOLIO RESOURCES – One or a combination of non-utility owned resources.

NON-TRADITIONAL SERVICE – Goods and services which have normally not been offered by electric utilities. These may include, but are not limited to, ancillary, control area and other power supply services, as well as energy brokering and energy service consulting.

PORTFOLIO RESOURCES – A combination of owned or contractual resources controlled by Tacoma Power.

REGULATION – The process of following moment-to-moment variations in load and, thereby, maintaining power system frequency.

REVENUE REQUIREMENT – The amount of revenue a utility must receive to cover the sum of the estimated operation and maintenance expenses, debt service, taxes and, in the case of a publicly-owned, non-profit utility, sufficient additional revenues to provide for the portion of the projected capital budget not provided by long- or short-term borrowing of funds.

UNBUNDLED SERVICES – Packaged services that do not include all fundamental services.