EXCERPTS FROM BOARD MEETING MINUTES
RE: CAPITAL CREDITS

SEPTEMBER 2017 BOARD MEETING MINUTES

Capital Credits Discussion – Capital Credits

The Board requested a general discussion on the topic of a general retirement of capital credits. To aid in this discussion the Board was provided a list of all of the general retirements and the assigned capital not yet retired.
Information regarding how we could fund a payout was discussed. Our options would be as follows: Operating fund cash flow would not be sufficient at the current time to fund a capital credit payout from general operating funds.

- We could utilize the cushion of credit to free up cash by using the cushion to make our September RUS/FFB debt payments of @ $1,200,000. (Will have a December payment as well)
- Could make a draw from work plan loan to fund payment.

A payout of capital credits would impact equity

Currently, we have 27.7% distribution equity and 44.4% overall equity.

Capital Credit Task Force recommends Equity Ratio level to between 30% and 50% for overall equity.

Lender Minimum Requirements are as follows:

- CFC- Cannot make a distribution of capital credits if total equity will be reduced below 20% of its Total Assets.
- RUS- Cannot make any distributions (exclusive of any distributions to the estates of deceased natural patrons) to its members except as follows:
    - Equity above 30%. Cant drop below 30% equity after the distribution or
    - Equity above 20%. Can't drop below 20% equity after the distribution and the aggregate of all Distributions made during the calendar year must be less than or equal to 25% of the prior year's margins.
    - Equity below 20%- Cannot distribute capital credits

Mrs. Herrman provided some information from the PSC's Order in our last rate case (2011-00096) - At that time, our equity was 21%. (This is our distribution equity. The Commission only recognizes equity without EKPC.)

"South Kentucky based its requested increase on an "equity growth and capital credit rotation" model. Using that model, South Kentucky set a goal to increase its equity ratio to 35 percent over a period of 15 years while restarting its past practice of making general rotations of capital credits. This approach produced a revenue increase resulting in a TIER of 2.43 and a return on net investment rate base of 9.03 percent.

South Kentucky's current policy is to not make general rotations of capital credits. This current policy took effect in January 2007 shortly after its previous general rate case, Case No. 2005-00450, in which the Commission's acceptance of a settlement between the utility and the Attorney General's Office relieved South Kentucky of the requirement that it make general rotations of capital credits for amounts earned above a 2.00 TIER.

Although it has made no general rotations of capital credits since that last rate case, South Kentucky's equity ratio has declined, from 23 percent in 2005, ranging between 18 and 21 percent from 2006 through the end of the test period.

South Kentucky's policy reflects a goal of maintaining an equity ratio between 30 and 40 percent, with the midpoint of that range, 35 percent, being the target used in this rate application. For distribution cooperatives, which can rely largely on RUS for financing and which are not required to seek capital from private markets, the Commission believes this to be a reasonable equity range. Of the 19 distribution cooperatives under Commission jurisdiction, 8 had equity ratios between 30 and 40 percent at the end of 2010, the latest year for which such data is available. Eight cooperatives had equity ratios below 30 percent at that time and three had equity ratios above 40 percent. South Kentucky and one other cooperative had equity ratios below 25 percent at the end of 2010.

Given how far South Kentucky is below the 35 percent equity ratio set as its goal, the Commission finds that it is reasonable to authorize a TIER greater than the 2.0 TIER typically granted in recent rate cases. However, under current economic conditions, we believe strongly that consumers are better served with a lesser increase in rates, without an explicit effort to rotate capital credits, than that which would result under South Kentucky's approach, which explicitly provides for the general rotation of capital credits.

The higher TIER awarded herein is intended for South Kentucky to increase its equity level until such time as it can pay capital credits without diminution of its cash flow or equity level. In this instance, the need for a stronger equity position is a major factor in the Commission's determination of South Kentucky's revenue requirement. However, other factors are of like importance in determining South Kentucky's revenue requirement, and ultimately, the amount of increase awarded. Those other factors are (1) the rate impacts on customers and (2) maintaining consistency in Commission rate decisions for electric distribution cooperatives.
The Commission finds, in this instance, that a 2.10 TIER is reasonable."
The Board requested the review of its capital credit and financial management policies. Counsel will provide the latest draft of the financial management policies and will work on a revised draft of the capital credits policy.

FEBRUARY 2018 BOARD MEETING MINUTES:

Capital Credits Discussion – Mrs. Herrman distributed a draft Capital Credit Policy and the list of those Capital Credits currently assigned. The years with outstanding capital credit assignments date back to 1986.

Mrs. Herrman noted the items in the Capital Credit Policy which require the Board's input and decision before the draft policy can be approved. Items noted were:

1. Method of retirement- FIFO or Hybrid
2. Disposition of G & T capital credits allocated
3. Amount eligible to be retired
4. Threshold for individual payout amount of retired capital credits and at what threshold will a paper check be issued versus a credit to the members account

Mrs. Herrman reviewed the possible sources of cash to fund a general retirement of capital credit payout and the funding source's effect on equity.

The Board of Directors requested a calculation be presented on what the calculated payout would be on the assigned capital credits for 1986. Mrs. Herrman advised that she would prepare the calculation.

The Board of Directors will review the Capital Credits Policy distributed for possible approval at the March 2018 Board of Directors Meeting.

Greg Redmon, Chairman

3/8/18
Date

Greg Beard, Secretary

3/8/18
Date