Policy Type:	Finance Policy
Policy No:	203
Title:	Equity Management Policy
Date Reviewed:	February 25, 2020
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SUBJECT: EQUITY MANAGEMENT POLICY

I. OBJECTIVE: To establish the Cooperative's policy for the acquisition, allocation, use and retirement of debt and equity capital by balancing the requirements and expectations of the Members, Cooperative, Lenders and Government Bodies. In so doing, the Cooperative will ensure compliance with:

A. IRS Code Section 501 (c) (12).
B. Colorado Statutes
C. Mortgage requirements set forth by the Rural Utilities Service (RUS) and National Rural Utilities Cooperative Finance Corporation (CFC)
D. Accounting rules and regulations
E. Article VIII of the Cooperative's Bylaws

It is the responsibility of the Board of Directors and CEO to remain cognizant of and devote appropriate consideration to the various issues and developments that may affect the Cooperative's acquisition, use and retirement of debt and equity capital, whether the sources of those issues and developments are internal or external to the Cooperative.

II. POLICY: Acquisition of Debt and Equity Capital

A. The acquisition of debt and equity capital is necessary in order to finance the cooperative's investment in plants, meet lender requirements, manage risk, support the achievement of the Cooperative's business philosophies and ensure the long-term financial soundness of the Cooperative. To meet these objectives, the Cooperative shall:
    1. Acquire equity capital through margins included in its rates to electric members, interest income from invested funds, capital credit allocations from affiliated cooperatives, and other non-operating margins.
    2. Acquire needed amounts of debt capital in a manner that manages risk by taking advantage of secure sources of industry debt (i.e., RUS, FFB, Co-Bank and CFC), loan maturity options and interest rate options.
    3. Achieve a targeted modified or distribution equity to asset ratio of approximately 35%.
    4. Plan, report and monitor equity both on a total equity to assets and on a modified equity to assets basis.
    5. To support the achievement of a targeted 35% modified or distribution equity ratio, and generally budget for an annual Operating TIER of 1.60. When the targeted modified or distribution equity has been achieved, considerations for Operating TIER of less than 1.60 may be accommodated via a

revenue deferral plan or associated measures which will allow the cooperative to address future margin needs.

6. Ensure that minimum lender Times Interest Earned Ratios (TIER) and Debt Service Coverage (DSC) ratios are met.

B. Revenue Credit
   1. In the event the financial condition of the Cooperative in a particular year warrants, the Cooperative may implement a revenue credit to members' bills in certain special situations. Guidelines for the revenue credit include:
      a. Revenue credits may be implemented when actual Operating Margins exceed budgeted Operating Margins by 25% or more.
      b. Revenue credits shall be based on year-to-date patronage.
      c. Revenue credits may be made to November or December members' bills.

C. Assignment of Costs and Margins to Rate Class
   1. To adhere to applicable tax and cooperative principles, the Cooperative shall:
      a. Ensure that investments and costs are fairly and equitably allocated to all rate classes.
      b. Minimize subsidies between and within rate classes.

D. Allocation of Margins as Patronage Capital
   1. To fulfill the legal and tax requirements associated with the allocation of margins as capital credits, the Cooperative shall:
      a. Allocate all margins using the appropriate industry-accepted method(s) based on the cost of service study analysis.
      b. Classify operating margins, interest income, affiliated organization patronage capital allocations (except from Tri-State G&T) and other non-operating margins as Patronage Type #1. Tri-State G&T allocations shall be classified as Patronage Type #2. Capital credit retirement gains shall be classified as Patronage Type #3.
      c. Follow RUS rules regarding the handling of losses. The Cooperative will not allocate operating or non-operating losses but will accumulate and offset losses against current and future non-operating margins.

E. General Retirements of Patronage Capital
   1. To adhere to applicable tax laws and cooperative principles, the following guidelines have been established for the general retirement of capital credits.
      a. The Board of Directors shall approve the amount, method, basis, priority, and order of retirement on an annual basis per this policy. This decision will be based on or reflect:
         i. The financial condition of the Cooperative
         ii. Current and forecasted equity levels
         iii. The rate impact of the retirement
         iv. The economic impact on the patrons receiving a retirement
         v. Previous amounts of general retirements
         vi. Mortgage requirements
      b. The Cooperative shall retire approximately between 3.5% and 4.5% of outstanding Type #1 patronage annually (approximately $1,000,000) on a FIFO basis. OR The Cooperative shall retire

approximately between 3.5% and 4.5% of outstanding Type #1 patronage annually (approximately $1,000,000), with approximately half of any general retirement being devoted to the retirement of the oldest patronage outstanding (FIFO) and the remaining amount being used to retire outstanding allocations from more recent years (LIFO).

c. General retirements shall be made after audited financials have been completed and targeted within 6 months of completion of the audited results.
d. The minimum refund amount to be issued shall be $10.00, whether for active or inactive members. When the refund is less than $10.00, the amount will accumulate for future retirement when the total refund exceeds the minimum amount.
e. If, after calculating the effect of the retirement, an inactive patron's patronage capital balance is less than $10.00, the remaining balance shall also be included in the current retirement.
f. All retirements of previously allocated patronage from Tri-State G&T (Type #2 Patronage) shall be targeted to be retired to SMPA members who received the original allocation in the year (or immediately following year) in which the retirement is received from Tri-State G&T. The cooperative may adapt this practice dependent upon its current retirement schedule, or dependent upon changes in practice of Tri-State G&T's policy and procedures for the distribution, allocation and retirement of Tri-State equity.
g. The Board of Directors will separately budget amounts for general retirements and special retirements of capital credits.
h. Any general retirement of capital credits shall be applied against an inactive patron's outstanding bad debt.
i. Should the Board decide not to approve the general retirement of capital credits for a particular year, the Board shall document the reasons for the decision in a resolution.

F. Special Retirements of Patronage Capitals
   1. To adhere to applicable tax laws and cooperative principles, the following guidelines have been established for the special retirement of capital credits.
      a. Special retirements of outstanding patronage will be made upon the death of a natural person based on receiving proper notification (as defined in 7b below) from the appropriate legal representative of the estate.
      b. In these cases, the legal representative of the estate shall be allowed to elect whether to receive a one-time discounted settlement of outstanding patronage or receive the full settlement of outstanding patronage when the Board of Directors authorizes the general retirement of the type(s) and year(s) allocated.
      c. Discounted settlements shall be based on outstanding Type #1 Patronage and any Type #2 that has been received in cash by the Cooperative but not yet retired to SMPA members or former members for the most recently completed fiscal year.
      d. The discount rate will be established from time to time by the Board of Directors and shall be based on a calculation of the Cooperative's weighted average cost of capital. The discount period will be the rotation cycle created by the general retirement of Type #1 patronage capital. The portion of capital credits discounted will be retained as permanent equity of the

cooperative and shall remain in the name of the patron to minimize the impact on the calculation of the Cooperative's IRS 501 (C) (12) 85/15 test.

e. Special retirements to estates will be limited to $30,000 annually.
f. Special retirements in which the cash portion of retirement is less than $10.00 will forfeit retirement into permanent equity for associated administrative costs.

G. Estate Eligibility
   1. Joint membership. If the form of membership is joint, then no payment shall be made to the survivor. The surviving tenant shall become the sole owner of the capital credit account and shall receive refunds in accordance with the General Retirement as previously stated.
   2. Individual membership. Payment to estates shall be supported by a death certificate and a signed Election and Agreement.

H. Any special retirement of capital credits shall be applied against an inactive patron's outstanding bad debt.

I. No fee shall be charged to change the name on an account to reflect the death of a member.

J. Communication Plan
   1. The Cooperative shall ensure that its communications plan places a high priority on informing and educating members, employees and other individuals about the cooperative business model and the accumulation, allocation and retirement of patronage capital on a general and special basis.

III. RESPONSIBILITY: It shall be the responsibility of the General Manager/CEO to see that this policy is implemented and followed.