

2019 PROPOSED OPERATING AND CAPITAL BUDGET FOR VT TRANSCO LLC

September 13, 2018

TABLE OF CONTENTS

	Page
I. 2019 Budget Highlights	1
II. VT Transco LLC Statement of Income (Budget 2019 vs. Budget 2018)	2
III. O&M and A&G Budget Summary	3
IV. Capital Budget	4 - 5
Appendices:	
2019 Equity, Debt and Operating Assumptions	6
VT Transco LLC Statement of Income (Budget 2018 vs. Projection 2018)	7

2019 Budget Highlights

Overview – We have had a flat nominal budget since 2014 and the proposed 2019 budget is consistent with that trend when comparing budget composition year on year with the exception of \$1.0M increase to administrative overhead primarily due to the elimination of costs related to telecommunication services for radio, fiber and microwave since these costs directly support transmission assets. We have otherwise been able to manage within the existing budget, despite considerable burdens associated with rising medical costs, the increasing compliance requirements spurred by the growing threat of cyber-attack, securing new opportunities and asset management.

The 2017 tax reform has provided a respite from the rising costs of transmission service by reducing income tax expense included in both the New England Open Access Transmission Tariff and the 1991 Vermont Transmission Agreement (VTA) revenue requirement. Conversely, tax reform reduces the earnings before tax realizable to VT Transco LLC members (\$12M), coupled with additional costs in 2019 due to 2018 asset growth (e.g., property taxes, insurance and depreciation expense), the net cost of the transmission services we deliver our customers will increase in 2019 by \$13.1 million from the 2018 budget.

Vermont Transmission Costs				
	Budget 2019	Budget 2018	Variance	
New England Open Access Transmission Tariff	88,500	93,800	(5,300)	
1991 Vermont Transmission Agreement	31,700	29,000	2,700	} 13,100
Specific Facility	9,400	11,000	(1,600)	
Earnings before tax	(93,900)	(105,900)	12,000	
Net Cost of Transmission	35,700	27,900	7,800	

The following pages provide more detail and greater context for our proposed budget.

VT Transco LLC
2019 Budget vs. 2018 Budget

	2019 Budget	2018 Budget	Variance	% Change	Description
Operating Revenues					
Transmission Service Revenues:					
RNS	\$ 164,407,000	\$ 170,525,000	\$ (6,118,000)	-3.59%	Change in RNS rate, includes effects of tax reform
VTA: Common	31,692,000	28,968,000	2,724,000	9.40%	
Specific facilities	9,350,000	10,962,000	(1,612,000)	-14.71%	
Other transmission revenue	309,000	734,000	(425,000)	-57.90%	
Rent of transmission facilities to others	1,868,000	1,683,000	185,000	10.99%	
Total Operating Revenues	207,626,000	212,872,000	(5,246,000)	-2.46%	
Operating Expenses					
(1) Transmission O&M expenses	13,870,000	14,070,000	(200,000)	-1.42%	
(2) A&G expenses	11,620,000	10,395,000	1,225,000	11.78%	
Depreciation and amortization	44,535,000	41,156,000	3,379,000	8.21%	Additional assets placed in service (\$146M)
Taxes other than income taxes	27,598,000	25,432,000	2,166,000	8.52%	Additional assets placed in service (\$146M)
Total Operating Expenses	97,623,000	91,053,000	6,570,000	7.22%	
Operating Income	110,003,000	121,819,000	(11,816,000)	-9.70%	
Interest (income) expense and other deductions					
Interest Expense & amortization of debt expense	21,146,000	21,040,000	106,000	0.50%	
Interest Income	(96,000)	(96,000)	0	0.00%	
AFUDC	(2,948,000)	(5,036,000)	2,088,000	-41.46%	Lower avg CWIP (\$32M vs \$58M)
Non utility revenue	(2,045,000)	0	(2,045,000)		Release of Utopus escrowed funds
Non utility expense	0	0	0		
Total interest and other deductions	16,057,000	15,908,000	149,000	1%	
(3) Earnings Before Tax	\$ 93,946,000	\$ 105,911,000	\$ (11,965,000)	-11%	Savings from tax reform reducing effective tax rate partially offset by \$5M equity issuance in 2018 and non utility revenues
(1) Transmission O&M expenses					
Payroll for operations and maintenance	\$ 7,208,000	\$ 7,145,000	63,000	0.88%	
Performance based compensation	800,000	775,000	25,000	3.23%	
Planning studies	122,000	127,000	(5,000)	-3.94%	
SCADA - Maintenance & Operations	846,000	857,000	(11,000)	-1.28%	
Maintenance and operation of substations	831,000	748,000	83,000	11.10%	Increase in station electric service
Maintenance and operation of structures	470,000	497,000	(27,000)	-5.43%	
Vegetation management	1,506,000	1,420,000	86,000	6.06%	Increase in scope of work plan
NERC work	361,000	187,000	174,000	93.05%	Increase in contracted support for upcoming CIP IT security audit
Leased lines	257,000	303,000	(46,000)	-15.18%	Elimination of leased lines utilizing Transco fiber
Safety expenses	166,000	167,000	(1,000)	-0.60%	
Environmental and ROW services	378,000	367,000	11,000	3.00%	
Vehicle maintenance, gas and insurance	27,000	117,000	(90,000)	-76.92%	Revised vehicle allocation methodology
Emergency response plan	10,000	65,000	(55,000)	-84.62%	
Inventory	40,000	70,000	(30,000)	-42.86%	
Training	124,000	159,000	(35,000)	-22.01%	
Highgate Converter	175,000	435,000	(260,000)	-59.77%	Replacement of equipment is yielding lower operating costs and fewer outages
Other	549,000	631,000	(82,000)	-13.00%	Reduction of Vermont Weather Analytics consulting and engineering support for EPRI study and PRC Software analysis
	\$ 13,870,000	\$ 14,070,000	\$ (200,000)	-1.42%	
(2) A&G Expenses					
Administrative Overhead	\$ (7,031,000)	\$ (8,056,000)	1,025,000	-12.72%	2019 Administrative overhead costs exclude telecommunication support costs
Benefits (Medical, 401k, SERP, Pension)	5,641,000	5,426,000	215,000	3.96%	\$250K increase in medical, \$45K addition of employee 401k fees, partially offset by revised pension census data and slight change in pension discount rate from 3.76% to 4.05%
Payroll	4,958,000	4,983,000	(25,000)	-0.50%	
Payroll overhead	(3,686,000)	(3,470,000)	(216,000)	6.22%	Increase in payroll overhead rate from 75% to 80%
Performance based comp / long term incentive	1,150,000	1,030,000	120,000	11.65%	Includes additional officer in long term incentive plan
Insurance	1,945,000	1,908,000	37,000	1.94%	
External Affairs and communication	271,000	241,000	30,000	12.45%	
IT support services	88,000	76,000	12,000	15.79%	
Software agreements	1,977,000	1,997,000	(20,000)	-1.00%	
Telecommunication services	2,507,000	2,627,000	(120,000)	-4.57%	Lower radio maintenance costs and lower internet and cell phone fees
Legal matters and strategic planning	426,000	321,000	105,000	32.71%	Increase in FERC legal support for ROE case and additional compliance matters
FERC annual charge	315,000	300,000	15,000	5.00%	
Financial audit and tax services	362,000	325,000	37,000	11.38%	
Amortization of LLC costs	146,000	146,000	0	0.00%	
Memberships	183,000	183,000	0	0.00%	
Directors expenses	310,000	309,000	1,000	0.32%	
Maintenance of Pinnacle Ridge	482,000	468,000	14,000	2.99%	
Cash surrender value of life insurance	0	0	0		
Amortization of Floyd study	155,000	154,000	1,000	0.65%	
Training	305,000	322,000	(17,000)	-5.28%	
Highgate Converter	303,000	283,000	20,000	7.07%	
Other	813,000	822,000	(9,000)	-1.09%	
	\$ 11,620,000	\$ 10,395,000	\$ 1,225,000	11.78%	
(3) Earnings Before Tax					
Muni's	\$ 16,607,000	\$ 17,767,000	\$ (1,160,000)	-6.53%	Return on the \$5M in equity issued in 2018
IOU's	54,777,000	53,238,000	1,539,000	2.89%	
IOU's Income Tax	20,517,000	34,906,000	(14,389,000)	-41.22%	Savings from tax reform reducing effective tax rate partially offset by applicable taxes on the additional return
Net non utility revenue	2,045,000	0	2,045,000		Release of Utopus escrowed funds
	\$ 93,946,000	\$ 105,911,000	\$ (11,965,000)	-11.30%	

O&M and A&G BUDGET SUMMARY

	Budget 2019	Budget 2018	Variance	% Change
Administrative Overhead ¹	(7,030,649)	(8,055,649)	1,025,000	13%
Support Services ²	6,514,227	6,141,678	372,549	6%
Employee Related Benefits (Non-Labor)	4,559,494	4,466,817	92,677	2%
Insurance (Non labor)	2,248,039	2,171,762	76,277	2%
Compliance	1,299,898	1,234,699	65,199	5%
Operations (EMS/Operations)	2,564,002	2,524,911	39,091	2%
Design and Construction	1,722,691	1,702,843	19,848	1%
Planning – VT Long-Range Transmission Plan Update and Vermont System Planning Committee Non-transmission Alternative Work	426,717	426,687	30	0%
Maintenance and Support of Pinnacle Ridge	576,516	580,811	(4,295)	(1%)
Software and Hardware Support (Non-labor)	2,531,673	2,583,626	(51,953)	(2%)
Maintenance of Substation and Lines ³	6,554,564	6,752,962	(198,398)	(2%)
Communication (Radio and Fiber) ⁴	3,522,828	3,933,853	(411,025)	(10%)
Total	25,490,000	24,465,000	1,025,000	4%

1. **Administrative Overhead** – Reduced administrative overhead assumptions to exclude telecom support services.
2. **Support Services** – Additional FERC legal support for ongoing ROE complaint and discovery of additional compliance matters and merit increases.
3. **Maintenance of Substation and Lines** – Recent Highgate refurbishment is reducing the required number of outages yielding lower operating costs for the facility despite acquiring the remaining assets. In addition, we have revised the vehicle allocation methodology to align cost allocation with utilization on capital versus expense efforts. These savings are partially offset by rising electrical facility charges as additional meters are installed by DU's and increase of vegetation management work scope.
4. **Communication (Radio and Fiber)** – Fewer leased lines, lower maintenance costs due to capital investment of equipment, reductions in cellphone and internet fees, and shift in labor resources to support construction of the data center.

Vermont Transco LLC Capital Expenditures 2019 - 2022

(000's omitted)

Capital Project	Pre '19	2019	2020	2021	2022	2023	TOTAL PROJECT
Connecticut River Valley	74,200	36	-	-	-	-	74,236
Fiber Project	2,412	775	-	-	-	-	3,187
Structure Reliability Upgrade	156,197	313	-	-	-	-	156,510
Transmission Line Refurbishment	1,075	20,605	20,881	22,227	23,129	24,785	112,702
Statewide Radio Project/Enhancements	50,903	2,867	351	5,332	6,544	1,522	67,519
PV20	36,002	335	-	-	-	-	36,337
Barre SCAP	2,706	8,475	271	-	-	-	11,452
Berlin SCAP	476	1,409	7,327	1,017	40	-	10,269
East Fairfax Substation SCAP	-	-	-	-	-	2,203	2,203
Florence SCAP	331	804	1,350	7,254	-	-	9,739
Highgate SCAP	-	-	798	2,296	9,703	7	12,804
Irasburg SCAP	36	1,154	1,654	10,138	-	-	12,982
Middlebury SCAP	20	2	1,082	967	8,898	7	10,976
North Rutland SCAP	20	2	2	1,270	1,398	6,218	8,910
Sandbar SCAP	506	2,585	6,815	148	-	-	10,054
South Hero SCAP	-	-	-	2,058	893	7,733	10,684
St. Albans SCAP	6,384	189	5	-	-	-	6,578
SCAP St. Johnsbury	-	-	-	-	2,031	1,096	3,127
SCAP Windsor	210	21	23	27	463	795	1,539
Essex Statcom Refurbishment Project	24,028	631	-	-	-	-	24,659
Pinnacle Building Renovations	75	1,581	1,411	-	-	-	3,067
Easement Acquisitions	2,486	613	555	462	465	457	5,038
Vermont Weather Analytic Center	36,419	190	-	-	-	-	36,609
Data Integration and Analytics	2,813	1,662	1,481	-	-	-	5,956
Pinnacle Solar Project	2	1,812	-	-	-	-	1,814
Backup Data Center & Backup Control Room Upgrade	1,120	1,869	24,849	462	-	-	28,300
Pinnacle Data Center	22,476	466	-	-	-	-	22,942
SONET TDM multiplexer replacement	6,640	108	-	-	-	-	6,748
Spare Transformer	1,798	721	-	-	-	-	2,519
Microwave Upgrade	2,375	1,734	-	-	-	-	4,109
Other Projects	-	9,077	4,457	6,675	6,192	5,490	31,891
Total	431,710	60,036	73,312	60,333	59,756	50,313	

Vermont Transco LLC 2019 Capital Projects

Other Projects, by Category

2019

Substations

Various substation improvements (Capacitor replacements, Transformer DGA Monitors, St. Albans RTU installation, Relay, Battery bank and PMU replacements, GMP DWDM node, Highgate P&C servers and HVAC/heat pump replacements	1,817,000
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Computer Hardware and Software

iTOA Upgrade	316,000
Telecom Ethernet Edge	1,813,000
CES Network Enhancements	1,743,000
Client hardware (PC's), PBX software upgrade, Cyber security, Inguardians, IO Loss Meter Report, Network Management upgrade	1,594,000
EMS situational awareness tool	84,000
Power Accounting system modifications	104,000

Building Renovations

Pinnacle Ridge office repairs	178,000
Pinnacle Ridge furniture	47,000

Transmission Lines

Improperly treated pole	278,000
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Tools & Test / Facilities / Equipment (vehicles)

Parking Lot	344,000
Wells Mtn building	155,000
Tools and test/ Equipment	604,000

Total	<hr/> 9,077,000
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APPENDICES

2019 EQUITY, DEBT & OPERATING PLANNING ASSUMPTIONS:

- Equity & Debt Assumptions
 - \$50 million additions to long-term debt in December 2019
 - Redistribution of maturing \$8.7 and \$2.7 million specific member equity in November and December 2019 respectively
 - Line of credit interest at 3.0 % and AFUDC at 8.50%
- Revenues
 - The 12-month average coincident peak is assumed to be level with 2017 and 2018 peaks
 - ROE rate is 10.57%
 - FERC ROE Complaint #1, #2, #3 and #4 refunds are not reflected in the 2019 RNS revenues
- Operating Expenses
 - Salary plan at 3% merit increase
 - Headcount is 150
 - Pension discount rate assumed at 4.05%
 - Held overall amount at 2018 level with the exception of the reduced shift of administrative overhead allocated to capital projects
- Capital and Billable Projects
 - Possible effects of Utopus strategic partnership are not included

VT Transco, LLC
2018 Forecast vs. 2018 Budget

	Forecast	Budget	Variance	Change	Description
Operating Revenues					
Transmission Service Revenues:					
RNS	\$ 162,507,000	\$ 170,525,000	\$ (8,018,000)	-4.70%	Reduction due to income tax reform (July - Dec)
VTA: Common	22,628,000	28,968,000	(6,340,000)	-21.89%	
Specific facilities	10,205,000	10,962,000	(757,000)	-6.91%	
Other transmission revenue	303,000	734,000	(431,000)	-58.72%	Reduction due to income tax reform (Jan-Dec)
Rent of transmission facilities to others	1,884,000	1,683,000	201,000	11.94%	
Total Operating Revenues	197,527,000	212,872,000	(15,345,000)	-7.21%	
Operating Expenses					
(1) Transmission O&M expenses	14,040,000	14,070,000	(30,000)	-0.21%	
(2) A&G expenses	10,150,000	10,395,000	(245,000)	-2.36%	
Depreciation and amortization	41,110,000	41,156,000	(46,000)	-0.11%	
Taxes other than income taxes	24,919,000	25,432,000	(513,000)	-2.02%	
Total Operating Expenses	90,219,000	91,053,000	(834,000)	-0.92%	
Operating Income	107,308,000	121,819,000	(14,511,000)	-11.91%	
Interest (income) expense and other deductions					
Interest expense & amortization of debt expense	20,661,000	21,040,000	(379,000)	-1.80%	Lower borrowing partially offset by higher avg interest rate (2.4% vs 2.0%)
Interest income	(156,000)	(96,000)	(60,000)	62.50%	
AFUDC	(5,755,000)	(5,036,000)	(719,000)	14.28%	Lower avg CWIP (\$64M vs \$58M)
Non utility revenue	(9,448,000)	0	(9,448,000)		Primarily gain on sale of Utopus shares partially offset by non utility expenses
Non utility expense	800,000	0	800,000		
Total interest and other deductions	6,102,000	15,908,000	(9,806,000)	75%	
Earnings Before Tax	\$ 101,206,000	\$ 105,911,000	\$ (4,705,000)	-4%	Increase due to additional non-operating net income of \$8.6M offset with income tax savings due to tax reform
(1) Transmission O&M					
Payroll for operations and maintenance	\$ 6,977,000	7,145,000	(168,000)	-2.35%	Permanent savings attributed to timing of filling open positions
Performance based compensation	850,000	775,000	75,000	9.68%	Includes 2017 reclass to A&G
Planning studies	127,000	127,000	0	0.00%	
SCADA - Maintenance & Operations	815,000	857,000	(42,000)	-4.90%	
Maintenance and operation of substations	842,000	748,000	94,000	12.57%	Increase in station electric service
Maintenance and operation of structures	523,000	497,000	26,000	5.23%	
Vegetation management	1,421,000	1,420,000	1,000	0.07%	
NERC work	154,000	187,000	(33,000)	-17.65%	
Leased lines	291,000	303,000	(12,000)	-3.96%	
Safety expenses	167,000	167,000	0	0.00%	
Environmental and ROW services	355,000	367,000	(12,000)	-3.27%	
Vehicle maintenance, gas and insurance	104,000	117,000	(13,000)	-11.11%	
Emergency response plan	68,000	65,000	3,000	4.62%	
Inventory adjustments	469,000	70,000	399,000	570.00%	Write down of obsolete telecom, relay, and substation materials
Training	139,000	159,000	(20,000)	-12.58%	
Highgate Converter	177,000	435,000	(258,000)	-59.31%	Replacement of equipment is resulting lower operating costs and elimination of fall outage
Other	561,000	631,000	(70,000)	-11.09%	Reduction in engineering consulting support
	<u>\$ 14,040,000</u>	<u>\$ 14,070,000</u>	<u>\$ (30,000)</u>	<u>-0.21%</u>	
(2) A&G Expenses					
Administrative overhead	\$ (7,715,000)	(8,078,000)	363,000	-4.49%	Revise administrative overhead to exclude telecom support charges partially offset by additional billable opportunities.
Benefits (Medical, 401k, SERP, Pension)	5,554,000	5,426,000	128,000	2.36%	Increase of \$200K medical partially offset by reductions in pension expense for updated census information
Payroll	4,667,000	4,983,000	(316,000)	-6.34%	Permanent savings attributed to timing of filling open positions and shift of telecom to capital efforts
Payroll overhead	(3,978,000)	(3,466,000)	(512,000)	14.77%	Increase payroll overhead rate from 75% to 80% and additional capital and billable labor
Performance based comp / long term incentive plan	1,150,000	1,030,000	120,000	11.65%	Includes increase for anticipated performance results
Insurance	1,881,000	1,908,000	(27,000)	-1.42%	
External affairs and communication	251,000	241,000	10,000	4.15%	
IT support services	73,000	76,000	(3,000)	-3.95%	
Software agreements	2,006,000	1,997,000	9,000	0.45%	
Telecommunication services	2,298,000	2,627,000	(329,000)	-12.52%	Lower radio operating and maintenance
Legal matters and strategic planning	415,000	321,000	94,000	29.28%	Increase in FERC legal support for ROE case and additional compliance matters
FERC annual charge	306,000	300,000	6,000	2.00%	
Financial audit and tax services	501,000	325,000	176,000	54.15%	Increase in consulting support for tax reform, new revenue accounting implementation, and revision of operating agreement.
Amortization of LLC costs	146,000	146,000	0	0.00%	
Memberships	185,000	183,000	2,000	1.09%	
Directors expenses	326,000	309,000	17,000	5.50%	
Maintenance of Pinnacle Ridge	488,000	468,000	20,000	4.27%	
Cash surrender value of life insurance	(93,000)	0	(93,000)		Favorable changes in FMV of market investments
Amortization of Floyd study	154,000	154,000	0	0.00%	
Training	291,000	322,000	(31,000)	-9.63%	
Highgate Converter	326,000	283,000	43,000	15.19%	
Other	918,000	840,000	78,000	9.29%	
	<u>\$ 10,150,000</u>	<u>\$ 10,395,000</u>	<u>\$ (245,000)</u>	<u>-2.36%</u>	
(3) Earnings Before Tax					
Muni's	\$ 17,897,000	17,767,000	\$ 130,000	0.73%	Return on additional equity in 2017
IOU's	52,927,000	53,238,000	(311,000)	-0.58%	
IOU's Income Tax	21,734,000	34,906,000	(13,172,000)	-37.74%	Applicable taxes on return plus tax reform savings
Net non utility revenue	8,648,000	0	8,648,000		Primarily gain on sale of Utopus investment
	<u>\$ 101,206,000</u>	<u>\$ 105,911,000</u>	<u>\$ (4,705,000)</u>	<u>-4.44%</u>	