

FITCH RATES GRAYS HARBOR COUNTY PUD NO. 1, WA'S ELECTRIC REV BONDS 'A'; OUTLOOK STABLE

Fitch Ratings-Austin-29 April 2015: Fitch Ratings assigns an 'A' rating to the following Grays Harbor County Public Utility District (PUD or the district) No. 1, WA electric revenue bonds:

- Approximately \$50 million electric revenue and refunding bonds, series 2015A;
- Approximately \$15 million electric revenue and refunding bonds, series 2015B (taxable).

Bond proceeds will current refund series 2005 outstanding bonds for savings, advance refund a portion of the 2006 bonds for savings, and approximately \$8 million will fund a portion of the district's capital needs over the next two years. The bonds will be sold via negotiation the week of May 11.

In addition, Fitch affirms the following Grays Harbor County PUD electric revenue bonds at 'A' although portions of this amount will be current and advance refunded by the 2015 bonds upon closing:

- \$126.8 million electric revenue bonds, series 2005, 2006, 2010 and 2013.

The Rating Outlook is Stable.

SECURITY

The bonds are payable from a pledge of net revenues of the electric system.

KEY RATING DRIVERS

RETAIL DISTRIBUTION SYSTEM: The district is a retail electric system serving a largely residential customer base of 41,625. Power supply needs are largely met through a contract with the Bonneville Power Administration that includes hydrology risk and variable energy supply from hydro-electric generation.

IMPROVED REVENUE MIX: Low regional power-market prices have reduced revenues provided by wholesale sales available to support financial margins and metrics. In response, the district has increased retail rates significantly over the past four years. Moderate future increases are also expected.

ADEQUATE FINANCIAL MARGINS: Financial metrics are improving as the new management team and commission have recommitted the district to achieving financial targets, including 1.75x debt service coverage and rebuilding cash reserves to a minimum \$30 million (90 days).

WEAK SERVICE AREA ECONOMY: Economic indicators for the district's service area are weak, with an elevated unemployment rate of 11.2% and below-average wealth levels. The local economy is concentrated in lumber and wood products, which has been subject to some volatility over the past several years with several mills closing and opening.

MANAGABLE DEBT: Debt levels for the district are expected to increase but remain satisfactory for the rating. Debt-to-funds available for debt service (FADs) is currently 7.9x and equity as a percentage of capitalization is 50.9%. Additional debt issuance, including the new money portion of the 2015A bonds, is expected to fund 40% of ongoing capital needs.

RATING SENSITIVITIES

FAILURE TO IMPLEMENT RATE INCREASES: Ongoing rate increases appear to be needed to keep pace with increasing power supply costs and infrastructure reinvestment. Given the district's above-average rates, any further customer loss or weakening of the economy that erodes support for annual rate increases and weakens financial margins could put downward pressure on the rating.

CREDIT PROFILE

Grays Harbor provides electric service to nearly all of Grays Harbor County, which is located on the Washington state coast about 110 miles southwest of Seattle. The relatively limited economy is primarily supported by the lumber and wood products industries, fishing, and tourism. The service territory is viewed as weak with an above-average unemployment rate and below-average wealth levels.

Customer concentration is moderate with the top 10 customers accounting for 25% of energy sales and 14% of revenues.

HYDROELECTRIC, COST-BASED POWER SUPPLY

The district's advantageous power supply contract with Bonneville Power Administration provides most of the energy needed to serve retail customers at cost-based rates. A portion of the district's power supply is provided under Bonneville's 'slice' product, which gives the district a percentage share of the federal hydroelectric output. The product provides the benefits and risks to the district of hydroelectric generation ownership. The contract generally provides excess energy for resale into the market to the district at varying amounts by year, depending on hydrology in the region.

REVENUE-BASE TRANSITION

In the past years, the district was able to subsidize its retail ratepayers through off-system sales of surplus Bonneville power. However, revenues from off-system sales decreased between 2008 and 2010 and have remained at low levels since, driven largely by low wholesale power-market prices. A slight increase occurred in fiscal 2014 as a result of stronger hydrology conditions and more energy to sell. Similar to other slice customers, the district continues to adjust its business strategy and rates as it increasingly relies on retail sales to fully support operations.

The district implemented three sizable rate increases (7%-8% each) during this same timeframe to restore revenues. The relatively higher retail rates are designed to offset diminished revenues from wholesale sales and to address rising costs from Bonneville, renewable requirements, and conservation mandates. Recent rate actions have been more moderate at 5.25% in 2014 and 3.0% in 2015. Management projects that future rate increases will occur regularly to keep pace with increasing costs but will likely be in the more modest range.

The district's rates are at the upper end of other public utility districts and municipally owned utilities. Consistent with Washington law, the district does not serve an exclusive service territory, but to date, competition for customers has not been an issue.

IMPROVED FINANCIAL PERFORMANCE EXPECTED

Financial metrics are gradually strengthening with Fitch-calculated coverage at 1.67x in fiscal 2013 (most recent audited financials available) and \$22.3 million in cash on hand, or 83 days. When the district's \$10 million line of credit is included, available liquidity increases to 120 days. The improved margins are up from debt service coverage levels of between 1.4x-1.6x in the prior four years.

Financial performance is projected to continue to strengthen as the district's renewed commitment to achieving its financial targets is incorporated into the budgeting and rate setting processes. While the district previously had financial policies that identified the targets of debt service coverage at 1.75x and cash reserves of \$30 million, the district had not achieved these levels for the past five

years. Recent management and board planning efforts reviewed the policies and affirmed them as firm targets. Rates have been adopted to achieve revenues and cash reserves consistent with these policies by fiscal 2015.

MODERATE CAPITAL NEEDS AND DEBT PROFILE

The district also has a policy of funding 40% of its non-generation-related capital needs from debt with the remaining amount debt financed. The district has around \$10 million annually in capital needs, primarily related to distribution system and substation reinvestment. Approximately \$8 million of the series 2015A proceeds will be used to fund a portion of capital spending during the next two years.

The district's debt profile consists of fixed rate debt structured with level debt service through 2033 before declining with a final maturity of 2043. The district has capacity for new debt in the later years without resulting in a material increase to debt service.

Contact:

Primary Analyst
Kathy Masterson
Senior Director
+1-512-215-3730
Fitch Ratings, Inc.
111 Congress Avenue, Suite 2010
Austin, TX 78701

Secondary Analyst
Matthew Reilly, CFA
Director
+1-415-732-7572

Committee Chairperson
Dennis Pidherny
Managing Director
+1-212-908-0738

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

This rating action was informed by information identified in Fitch's U.S. Public Power Rating Criteria and Revenue-Supported Rating Criteria.

Applicable Criteria and Related Research:

- 'U.S. Public Power Rating Criteria' (March 18, 2014);
- 'Revenue-Supported Rating Criteria' (June 16, 2014);
- 'U.S. Public Power Peer Study Addendum - February 2015' (Feb. 9, 2015);
- 'Fitch Rates Energy Northwest, WA Electric Rev Ref Bonds' (April 8, 2015);
- 'Energy Northwest, Washington and Bonneville Power Administration, Oregon New Issue Report' (April, 7, 2014).

Applicable Criteria and Related Research:

Energy Northwest, Washington and Bonneville Power Administration, Oregon (Electric Revenue Bonds)

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=743117
U.S. Public Power Peer Study Addendum -- February 2015
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=861490
Revenue-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012
U.S. Public Power Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=740841

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.