

New Issue: Moody's assigns A1 to Grays Harbor PUD's revenue bonds

Global Credit Research - 29 Apr 2015

\$132 million of debt affected

GRAYS HARBOR COUNTY PUBLIC UTILITY DISTRICT 1, WA
Electric Distribution
WA

Moody's Rating

ISSUE	RATING
Electric Revenue and Refunding Bonds, Series 2015A	A1
Sale Amount	\$49,215,000
Expected Sale Date	05/06/15
Rating Description	Revenue: Government Enterprise

Electric Revenue and Refunding Bonds, Series 2015B (Taxable)	A1
Sale Amount	\$15,075,000
Expected Sale Date	05/06/15
Rating Description	Revenue: Government Enterprise

Moody's Outlook NOO

NEW YORK, April 29, 2015 --Moody's Investors Service has assigned an A1 rating to Grays Harbor County Public Utility District No. 1, Washington's Electric Revenue and Refunding Bonds, Series 2015. At this time, Moody's affirms the A1 rating on the district's parity debt outstanding in the estimated amount of \$67.7 million.

SUMMARY RATING RATIONALE

The A1 rating reflects the district's rural service area along the Washington State coast, a manageable debt burden, and satisfactory legal provisions. The rating also incorporates the PUD's historically healthy financial operations, and expectation of modest improvement in financial metrics.

OUTLOOK

Outlooks are usually not assigned to local government credits with this amount of debt outstanding.

WHAT COULD MAKE THE RATING GO UP

- Significant and sustained increase in available liquidity outside lines of credit
- Significant growth and diversification of local economy

WHAT COULD MAKE THE RATING GO DOWN

- Deterioration of financial position with depleted liquidity and lower debt service coverage
- Significant increase in outstanding debt

STRENGTHS

- Stable source of power through long-term contract with BPA

-Historically stable financial position and expectation of improvement

-Demonstrated willingness and ability to raise rates

CHALLENGES

-Rural service area with somewhat weak local economy and low resident wealth levels

-Power supply susceptible to hydrological conditions

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

SERVICE AREA AND SYSTEM CHARACTERISTICS: RURAL SERVICE TERRITORY IN WESTERN WASHINGTON WITH POWER SUPPLIED PRIMARILY BY BPA

The PUD provides electric service to residents and businesses within Grays Harbor County, with the exception of the small city of McCleary, and small portions of surrounding counties. The service area is largely rural, with an estimated population of 73,300. The largest city is Aberdeen with a population of 16,850. The area consists largely of land that will not likely ever be developable. Privately held timber land, Indian reservations, and state and national forest land make up a significant portion of the PUD's 1,959 square mile service territory. While there is some modest new development at the Port of Grays Harbor, unemployment remains high in the county at 10.6% as of December 2014. Resident wealth within the county is relatively low at 78.89% of the national level. A somewhat weak local economy has contributed to generally low to negative growth in the utility's load in recent years. However, given the region's low electric costs and abundant water, and combined with the legalization of marijuana farming, the PUD has seen increased load from these businesses and expects more in the near-term.

The electric system includes more than 1,800 miles of transmission and distribution lines and 36 substations, and serves approximately 41,450 customers. The PUD's peak load is roughly 215 average megawatts (MWs) during the winter. The vast majority of this load is served through a long-term contract with Bonneville Power Administration (BPA) that is in place through 2028. As a preference customer of the federal agency, this contract ensures the PUD has access to BPA's lowest cost tier of power. This certainty of low cost power supply is a credit strength that is somewhat mitigated by the hydrological risks that are associated with BPA's power. BPA markets the power generated at 31 federally-owned dams throughout the Northwest. Low water conditions could create the need for BPA to purchase power from the market to meet its obligations to its preference customers. The likely increase in costs of this circumstance would be passed along to the PUD through the rates it pays for BPA power.

While BPA provides roughly 89% of the PUD's power needs, the utility also has several other energy resources with which to manage its service provision. The PUD has the rights a 45 MW share of the 249 MW Frederickson combined cycle combustion turbine generating facility. The facility is primarily used to meet peak loads in winter months. The PUD also has power purchase agreements for stakes in the Nine Canyon Wind Project, a small wind facility called the Coastal Energy Wind Project, and a small biomass co-generation facility owned and operated by a timber company. These resources provide power at a level that in aggregate exceeds the current PUD load for the majority of the year. This allows the PUD to sell excess power in the market, which has historically been an important source of revenue. While volatility plays an important role in the wholesale power market, the district has typically estimated future revenues conservatively.

The PUD contracts with The Energy Authority (TEA) to provide it with scheduling and power management services. As part of this agreement, TEA enters into forward purchases and sales of power and natural gas as hedges to mitigate price risks that could cause shocks to the PUD's financial operations. TEA is not authorized to make speculative trades, and the PUD's conservative financial and investment policies govern the actions taken by TEA on its behalf.

DEBT SERVICE COVERAGE AND LIQUIDITY: STABLE FINANCIAL POSITION BENEFITS FROM REGULAR RATE INCREASES AND CONSERVATIVE MANAGEMENT

The PUD's financial position is stable, reserves are adequate, and debt service coverage is healthy. Coverage of annual debt service in 2014 is estimated to be approximately 1.8 times based on unaudited financial statements. This represents an increase compared to the previous year in which coverage was 1.7 times. Based on

projections for fiscal years 2015 through 2018, debt service coverage of the district's outstanding revenue bonds will gradually increase to 2.07 times in 2018.

These projections assume 3% annual rate increases, relatively low water conditions (equivalent to the 15th lowest water year out of the past hundred), and a modest 1% increase in load. Given the recent historical trend in load, we view the 1% growth assumption as reasonable, although somewhat optimistic. The PUD is governed by a three member commission that has shown the willingness in recent years to adopt regular rate increases. The assumption of 3% rate increases going forward is therefore very reasonable, and rates would likely be revised if the load forecasts prove too optimistic.

The PUD's customer base is not overly concentrated, but the top ten largest customers account for 14.4% of total annual revenues with the largest accounting for 4.9% by itself. This customer, Cosmo Specialty Fibers, provides wood pulp to various industries around the world, and represents modest longer-term revenue risk given the challenges of the timber industry and related products. This risk is mitigated somewhat by the fact that Cosmo is served power at a market rate, and therefore is not relied upon to meet the PUD's fixed costs.

Liquidity

The district's liquidity is adequate at approximately \$20.3 million, which is equivalent to 79 days worth of operating expenses. The district's liquidity policy is to maintain 90 days of cash on hand. Management has indicated that it will meet this policy by the end of the current fiscal year. The PUD also has access to a \$10 million line of credit with Bank of America, which provides additional liquidity. Currently there is no balance outstanding on this line.

DEBT AND LEGAL COVENANTS: MANAGEABLE DEBT PROFILE WITH STANDARD LEGAL PROVISIONS

The PUD has a very manageable amount of debt outstanding. This is due in part to its policy to finance no more than 60% of the cost of capital projects through the issuance of bonds. Notably, while this policy keeps the PUD's debt burden relatively low, it also makes building liquidity more difficult. As of fiscal 2013 the district's ratio of debt to operating revenues was just 1.13 times, which is quite strong. This ratio is not expected to increase notably with the current issuance of new money bonds given the small amount relative to total outstanding debt.

The current issuance is being issued both to provide \$8 million in funding for capital projects over the next two years, as well as to refund portions of the PUD's outstanding Series 2005 and Series 2006 revenue bonds for savings. The new bonds have standard legal provisions including a rate covenant and additional bonds test of 1.25 times annual debt service coverage. The bonds also have a debt service reserve requirement equal to the typical "lesser of" test, and the reserves will be funded in cash.

Debt Structure

All of the district's debt is fixed rate and amortizes over the long term.

Debt-Related Derivatives

The district has no derivatives.

OPERATING ENVIRONMENT AND GOVERNANCE

The PUD is managed primarily by administrative staff, but policy, electric rates, and budgets must be approved by the district's three member commission. The commission provides public oversight, and members serve six year terms, with one position being up for election every two years. The PUD has statutory authority to provide electric service within its service area, and electric rates are not subject to outside regulation.

KEY STATISTICS

Asset condition: 19 years

System size: \$94,145

Service area wealth: MFI is 78.98% of the US

Annual debt service coverage: 1.72x

Days cash on hand: 79 days

Debt to operating revenues: 1.13x

Rate management: Aa

Regulatory compliance and capital planning: Aa

Rate covenant: 1.25x

Debt service reserve requirement: Aa

OBLIGOR PROFILE

The Grays Harbor PUD provides electric service to Grays Harbor County in western Washington. The PUD is a preference customer of Bonneville Power Administration, and receives the majority of its energy from this agency.

LEGAL SECURITY

The bonds are secured by the net electric system revenues.

USE OF PROCEEDS

The current issuance will finance various capital projects throughout the district and refund portions of the PUD's outstanding Series 2005 and Series 2006 bonds.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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