S&P Global
Ratings

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Grant County Public Utility District No. 2, Washington; Retail Electric; Wholesale Electric

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Grant County Public Utility District No. 2, Washington; Retail Electric; Wholesale Electric

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US$165.77 mil priest rapids hydroelec proj rev rfdg bnds ser 2024 B due 01/01/2044		
Long Term Rating	AA/Stable	New
Grant Cnty Pub Util Dist No. 2 priest rapids hydroelec proj rev rfdg bnds taxable		
Long Term Rating	AA/Stable	Affirmed
Grant Cnty Pub Util Dist No. 2 WHLELC		
Long Term Rating	AA/Stable	Affirmed
Grant County Public Utility District No.2 rev and rfdg bnds		
Long Term Rating	AA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AA' long-term rating to Grant County Public Utility District No. 2 (Grant PUD), Wash.'s proposed $165.77 million series 2024B Priest Rapids Hydroelectric Project revenue and refunding bonds.
- We also affirmed our 'AA' long-term rating and underlying rating (SPUR) on the district's previously issued revenue bonds for the Priest Rapids Project (PRP), and on Grant PUD's revenue bonds issued prior to 2010 separately for the Priest Rapids and Wanapum hydroelectric developments.
- The outlook is stable.

Security

A lien on net revenue of the consolidated PRP project secures the series 2024B bonds and bonds issued in 2010 or later. Bond provisions include a 1.15x rate covenant on both parity and junior-lien debt, and a 1.15x additional bonds test. Parity bonds issued prior to 2010 for each of the two hydro developments are also payable from net revenue of the combined PRP, pursuant to the resolution and prior resolutions. In 2010, the district consolidated the two developments into one system, the PRP. Revenue consists of all revenue received from the PRP, including that received under power sales contracts and payments from the electric system.

Grant's retail electric system (AA+/Stable) is obligated--regardless of whether the PRP is producing power or capable of doing so--to pay all project costs, including its share of debt service, not otherwise paid by other purchasers, and this obligation is payable as an operating expense prior to electric system direct debt service. The electric system covenants to set rates as it considers necessary to make such payments, to the extent that required payments are not otherwise made. Our rating on the electric system's debt is one notch higher than that on the PRP's debt for various reasons, including the electric system's significantly higher fixed-charge coverage, higher liquidity, and stronger rate-making flexibility. We also note that the electric system and PRP are rated under different rating methodology (retail electric criteria versus wholesale criteria).

Bond proceeds will be used to refund the PRP's series 2010 L Build America Bonds outstanding. Management also expects that that the proposed series 2024B bond tender will generate approximately $33.34 million in proceeds, which will be used to refund various bonds outstanding for savings purposes.

As of Dec. 31, 2023, the PRP had $1.37 billion in debt outstanding, including $810 million of outstanding revenue bonds and a $564 million intersystem loan from the electric system.

Credit overview

The ratings reflect our view of the utility's:

- Very low production costs of $27.50 per megawatt-hour (MWh) in 2023, and the PRP's noncarbon-emitting nature; we note that this represents an increase from the $20 average cost the project had exhibited from 2019-2022, largely due to poor hydrological conditions in 2023; management projects the 2024 water year will approximate 2023, which we anticipate will translate to similar production costs; nonetheless, we view the overall production costs as favorable;
- Unconditional power sales contracts with the project owner (Grant County PUD) as well as multiple other power purchasers for the entirety of the combined project output;
- Successful replacement of fish-friendly turbines and other measures that have resulted in reduced spill, generally enhanced project economics (during normal water conditions), and compliance with environmental regulations, with additional improvements ongoing;
- Generally solid operating performance, including a plant availability factor of 89% in 2023; and
- Continued adequate financial performance, with power purchasers, including the district, paying their share of project costs plus 15%, such that debt service coverage (DSC) is consistently about 1.15x.

Partly offsetting the above strengths, in our view, are the PRP's:

- High capital requirements associated mostly with turbine and generator restoration and powerhouse improvements, but also with regulatory compliance and license implementation, which could put pressure on the long-term competitiveness of the project's production costs, although per unit costs will likely remain below Bonneville's firm priority rate ($34.93 in 2023) over the next several years; and
- High project debt burden, with debt to capitalization of 68% when accounting solely for the system's revenue bonds, or 78% after incorporating S&P's adjustment, which includes intersystem borrowings from the retail system. However, we anticipate this ratio should improve as management anticipates funding the entirety of the PRP's five-year $459 million capital program with revenue and equity contributions directly from the electric system.

Environmental, social, and governance

The PRP faces elevated physical environmental risks through its exposure to drought conditions, which directly translates to variable--and hard to predict--hydrological conditions. Additionally, the district and PRP face considerable ongoing costs of remediating fish and wildlife habitats surrounding their hydroelectric facilities, along with the costs of related litigation and regulatory proceedings. However, from an energy transition risk standpoint, risks are limited as the project is noncarbon-emitting.

Social risks are neutral given the project's very low operating costs, which make the PRP one of the lowest-cost resources of the power purchasers' resource portfolios. However, prolonged hydrological challenges could gradually erode this advantage. We continue to monitor the strength and stability of electric utilities' revenue streams for evidence of delinquent payments or other revenue erosion. Inflation as measured by the Consumer Price Index (CPI) has remained above 3% in recent months, and S&P Global Economics forecasts elevated interest rates persisting at least until December (see "Economic Outlook U.S. Q3 2024: Milder Growth Ahead," published June 24, 2024 on RatingsDirect). In addition, Bureau of Labor Statistics data show that electricity price inflation continues to outpace the overall CPI. The amalgam of material increases in delinquent consumer, credit card, and auto loans, along with the resumption of student loan payments and drawdowns of household savings garnered during the pandemic, will likely compound the financial pressures facing electricity consumers.

We view the utility's governance factors as credit supportive, as they include full rate-setting autonomy as well as strong policies, forecasting, cyber security, physical security, and planning practices.

Outlook

The stable outlook reflects our anticipation that long-term contracts through 2052 will continue to provide a stable revenue stream. Strong project economics provide credit stability and mitigate credit risks regarding regulation, environmental mandates, and member credit quality. We anticipate that the project will remain competitive with other generators or resource options in the region despite the high capital investment required to comply with fish species protection requirements and other improvements.

Downside scenario

We do not anticipate lowering the ratings over the next two years given the competitive cost of power, but could do so if costs continue to rise such that the PRP's competitive advantage suffers material erosion on a sustained basis, or if other operating risks arise.

Upside scenario

Given high project debt and moderate capital needs, we do not anticipate raising the ratings during the next two years. Also limiting rating upside is our expectation that DSC is unlikely to materially improve.

Credit Opinion

The PRP consists of two hydroelectric generating facilities. The Priest Rapids development is a hydroelectric generating facility downstream from the Wanapum project on the Columbia River in Grant and Yakima counties. The generating plant has a nameplate capacity of 950 MW and began operations in 1961. The Wanapum development is a hydroelectric generating facility approximately 18 miles upstream of the Priest Rapids development on the Columbia River in Washington. The generating plant has a nameplate capacity of 1,222 MW and began commercial operation in 1963. The project owner and operator is Grant PUD, a vertically integrated public utility that operates its two utility systems as independent business units: the electric system and the PRP.

All power purchasers are either public or investor-owned utilities in the Pacific Northwest, and we believe that they are extremely unlikely to default on their payment obligations to the project given that the project represents one of the lowest-cost power resources in any of their supply portfolios and is a noncarbon-emitting resource. The take-or-pay power sales contracts extend to the expiration (April 1, 2052) of the project's 44-year license. Grant PUD has the ability to take a maximum of 93.3% of firm PRP power to meet its load (63.3% physical and 30.0% financial through the reasonable portion/estimated unmet district load). The Grant PUD electric system's share of project costs in 2023 was 86%.

Prior to 2010, the bonds whose proceeds secured each development relied on the net revenue from a single asset, but under the consolidated project this concentration risk is reduced. Furthermore, each development has 10 turbines that have typically achieved very favorable availability factors, with generally a maximum of one turbine or generator undergoing replacement or maintenance at any given time, reducing production risks. Also, the supply contracts require power purchasers to satisfy the cost of power production, irrespective of the amount of power produced, thus producing consistent annual DSC of around 1.15x (including excess funds available in the supplemental repair and renewal fund). These factors mitigate the risk that an outage or asset failure could hinder cash flows.

The project exhibits very strong credit fundamentals, primarily because of its very low cost of production and its ability to reassign or remarket power from any defaulting power purchaser. It sells power through power sales contracts to 18 public and private utilities in the Pacific Northwest, including the district's electric system. The PRP production cost increased to $27.50 in 2023 from $19.44 in 2022, reducing to 21% from 46% the PRP's cost advantage versus the comparable Bonneville Power Administration preference rate. Management estimates the average cost of power will decline to $24.35 through 2029. Given the continued advantage even under poor water conditions, we believe the district would likely be able to remarket any available power in the event of a default by a power purchaser, mitigating the lack of step-up provisions to project cash flows.

Production costs per unit are more favorable in very wet years. Streamflow can also vary considerably from year to year based on spill requirements and weather patterns. Streamflow was 74% of average in 2023, down from 111% in 2022, leading to a 23% decrease in gross PRP generation.

The PRP faces regulatory and environmental risks and uncertainties persist, though this is mitigated by the 44-year renewal of the district's Federal Energy Regulatory Commission license for the project in 2008. Nevertheless, the district must comply with state and federal regulations regarding dam operations and protection of endangered fish species. Fish habitat mitigation requirements, which include dam spill requirements, result in additional operating costs and loss of revenue.

Capital requirements remain relatively high at the PRP: The five-year capital budget calls for $459 million in capital expenditures from 2024 to 2028, all of which management intends to fund internally. The Wanapum development turbine replacement work has been completed, and the Priest Rapids development is also replacing its turbines with more efficient and fish-friendly advanced turbines. The district projects that the replacement of all Priest Rapids development turbines and generators will be complete by 2029, and anticipates that the useful life of the new equipment will be 50 years.

Power purchasers are billed monthly for their respective shares of project operating costs plus 115% of debt service, resulting in consistent DSC of around 1.15x. The project's financial performance is generally stable, and margins are slim because the project operates on a cost basis. Debt leverage at the project level was high, in our view.

S&P-adjusted debt-to-capitalization, which includes the PRP's intersystem borrowings from the retail system, approximated 78% as of Dec. 31, 2023, while debt to capitalization based solely on PRP's revenue bonds outstanding was 68%.

Liquidity has historically been only adequate or marginal at the PRP because of its ability to bill power purchasers monthly for their respective shares of project operating costs plus 115% of debt service. Most operating cash is held at the electric system level. According to the district, unrestricted cash at the PRP can fluctuate as a result of the timing of the power sales contracts' cash flows.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of August 2, 2024)		
Grant Cnty Pub Util Dist No. 2 WHLELC		
Long Term Rating	AA/Stable	Affirmed
Grant Cnty Pub Util Dist #2 rev rfdg bnds (Direct Payment)		
Long Term Rating	AA/Stable	Affirmed
Grant Cnty Pub Util Dist #2 rev & rev rfdg bnds (Priest Rapids Hydroelectric Proj)		
Long Term Rating	AA/Stable	Affirmed