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CREDIT OPINION
30 October 2017

New Issue

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Grant County Public Utility District No 2's (WA)

New Issue - Moody's assigns Aa3 to Grant County Public Utility District No 2's (WA) 2017-N bonds. Outlook is stable

Summary Rating Rationale

Moody's Investors Service has assigned a Aa3 rating to Grant County Public Utility District No. 2's (WA) $50 million of Electric System Revenue Refunding Bonds, Series 2017-N. The rating outlook is stable.

Grant PUD's credit profile is supported by the district's ownership of highly competitive hydro generation, extremely low retail rates, strong risk management, and robust liquidity well in excess of the 'Aaa' category for this metric. The district forecasts maintaining liquidity equivalent to 400 to 500 days cash on hand starting around 2018 after using some its liquidity for capital expenditures. The rating recognizes the benefits of having up to 37% of the 2,123 MW Priest Rapids Project (PRP) contracted under take-or-pay arrangements with investment grade electric utility counterparties. The rating also considers the district's resiliency to stress cases such as the loss of industrial customers although the forecasted consolidated debt service coverage ratio (DSCR) under this scenario would drop to below their base case forecast of at least 1.7x DSCR.

The rating also considers exposure to wholesale power price and hydrology risk over the longer term, a large capital program, below average wealth levels in the service territory, and concentration of retail sales to industrial customers. Through September 2020, hydrology and wholesale power price risk is largely reduced by an exchange contract (Pooling Agreement) with Shell Energy North America (US), L.P. (Shell: A3, stable) and 'slice' sales. Separately, the Estimated Unmet District Load (EUDL) feature in the third party off-take contracts continues to substantially protect Grant PUD from a net generation shortage caused by extremely low water flows or high load growth.

Credit Strengths

» Ownership of low cost, hydro plants

» Strong liquidity

» Ability to withstand stress given risk mitigation measures such as the EUDL

» Take-or-pay contracts with investment grade utilities for up to 36.7% of PRP's output

» Highly competitive retail rates

Credit Challenges

» Below average wealth in service area

» Industrial load concentration

» Hydrology and wholesale market risk starting in October 2020

» Large capital spending

Rating Outlook

The stable rating outlook considers the district's forecasted financial performance with DSCR above 1.70x and liquidity trending to 400 to 500 days cash on hand over the next five years. The outlook also incorporates successful execution of Grant PUD's capital expenditure program.

Factors that Could Lead to an Upgrade

» Consolidated DSCR in excess of 2.5x on a sustained basis, maintenance of robust liquidity, and debt ratio below 35%

» Extension of Pooling Agreement or similar wholesale and hydrology risk mitigation over the long term while maintaining strong financial metrics

Factors that Could Lead to a Downgrade

» Consolidated DSCR drops below 1.50x or unrestricted liquidity drops materially below $200 million on a sustained basis

» Major load loss on a sustained basis

» Pooling Agreement incurs material execution problems

» Significant operating problems at PRP

» Large cost overruns at PRP's capital program

Key Indicators

Exhibit 1

GRANT COUNTY PUBLIC UTILITY DISTRICT 2, WA	2012	2013	2014	2015	2016
Debt Outstanding ($'000)	1,080,675	1,152,740	1,251,775	1,306,020	1,325,105
Debt Ratio (%)	52.3	51.6	52.7	51.8	49.9
Adjusted Days Liquidity on Hand (incl. Bank Lines)(days)	470	563	368	490	761
Adjusted Debt Service Coverage (x) (Post Transfers/PILOTs - All Debt)	1.6	1.5	1.4	1.8	1.8

Source: Moody's Investors Service and Audited Financial Statements

Recent Developments

Recent developments are incorporated in the Detailed Rating Consideration

Detailed Rating Considerations

Revenue Generating Base

Retail Energy Sales (Approximately 55-60% of revenues)

Retail electric sales represent Grant PUD's largest revenue stream and its service area in Grant County, WA (Issuer Rating: Aa3/no outlook) has a socio-economic indicators that are weaker than the national average. Grant County, WA's median family income was $54K (83% of US) in 2015 and poverty levels are at 17.9% (US average of 15.5%). The unemployment rate is also slightly above the US at 4.7% average for the first seven months of 2017 (4.4% for the US).The major economic activities in the county were historically agriculture and food processing but in the last ten years, data centers and manufacturing has expanded substantially. Industrial/commercial sales has more than doubled since 2006 owing mostly to power intensive businesses like data centers that are attracted to the region by the district's low retail rates that are around 50% below the state average. Grant PUD forecasts strong continued growth to industrial customers. However, the large growth of industrial load has led to customer concentration as industrial/commercial sales represent almost 40% of total revenue in 2016. The top ten customers primarily comprise manufacturing, data centers and food processing and we view some as having low credit quality such as the polysilicon plant that experienced periods of limited operations over the last several years. Grant PUD's high industrial load concentration exposes the district to sudden load declines if a customer leaves or shuts down although this is partially mitigated by the district's low cost power, ability to sell into the wholesale market, and strong liquidity position.

Strong Risk Management Focus Takes Pressure Off Significant Rate Increases

Over the last five years, Grant PUD has implemented risk mitigation actions that has improved the utility's financial performance including stronger DSCR and improved liquidity which are supported by financial objectives such as a $120 million minimum in the Reserve and Contingency (R&C) and a 1.8x consolidated DSCR (per the district's calculation). Continuation of strong risk management remains a key foundation that allows the district to maintain its steady 2% per year rate increase objective, which the utility has done since 2014.

Wholesale Revenue Exposure (Approximately 20-25% of revenues)

Historically, Grant PUD's financial results were materially impacted by hydrology in the Columbia River Basin and wholesale power prices in the region since Grant PUD wholesale power sales have historically represented 20% to 25% of consolidated revenues and was a much more volatile source of revenues.

In September 2015, the district entered into the Pooling Agreement with Shell that has substantially reduced hydrology and market risk through the September 2020 term (see Financial Operations and Position section for further discussion). The district also has a 'slice' contract that shifts both hydrology, operating, and market price risk to Avangrid Renewables (NR), via a contract that matures in June 2018. As part of the slice transaction, Grant PUD also bought back power for intra-year periods when the district might be short power. However, as these contracts expire, the district will again face heightened exposure to market and hydrology risk unless Grant PUD implements additional risk mitigation.

Take-or-Pay Contracted Cash Flows (Approximately 15% of revenues)

Grant PUD sells up to 36.7% of PRP's original nameplate output to a collection of seventeen load serving utilities and public power entities (PPA Purchasers) under cost based, take-or-pay contracts maturing in April 1, 2052. The largest third party off-takers are PacifiCorp (A3 stable) at 9.08% share (prior to EUDL adjustment), Portland General Electric Company (A3 stable) at 9.08%, and Puget Sound Energy, Inc (Baa1 stable) at 5.24%. The PPA Purchasers' effective share of PRP decreases under the EUDL feature as Grant PUD's retail load grows.

Operational and Financial Performance

Pooling Agreement Reduces Risk of Hydro Dependent Supplies

Grant PUD benefits from ownership of 2,123 MW of nameplate hydro generation capacity primarily comprising of the 1,167 MW Wanapum hydroelectric plant (Wanapum) and the 956 MW Priest Rapids plant (together with Wanapum, PRP). PRP's all-in-costs including debt service attributable to PRP are highly competitive and substantially below market prices. Grant PUD's Electric System retains 63.3% of PRP's output and the remaining output is sold to the PPA Purchasers. The district has the ability to effectively benefit from up to 93.3% of PRP's generating capacity through physical and financial settlements to meet the Electric System's load requirements and be responsible for 93% of PRP's costs under the EUDL feature. The district also has various, small long-term contracts for less than 2% of power supply and also purchases power in the market to balance supply.

A weakness to the district's reliance on hydro is the concentration in two large plants. This risk was highlighted in February 2014, when the district discovered a fracture at the Wanapum dam that resulted in reduced power generation and repair work. Wanapum reached normal operations in March 2015 and the direct and indirect cost of the fracture totaled approximately $78 million.

A major risk mitigation against hydrology and market risk is the Pooling Agreement that expires in September 2020. Under the Pooling Agreement, Shell is obligated to provide firm power that is scheduled in the contract and various ancillary services. In exchange, the district provides to Shell its share of 53.3% of PRP's output through September 2020 thus effectively transferring a substantial amount of hydrology and market risk to Shell. The district continues to largely retain operating risk.

Large Capital Program

From 2017 to 2022, the district expects to spend roughly $756 million on capital expenditures of which 35% will be for the Electric System and the remaining for PRP. The Electric System's capital system is mostly on the distribution and transmission system. For PRP, its capital expenditures include turbine and generator upgrades at Wanapum, which will increase generation capacity, and these expenditures start to ramp down starting in 2019. Alstom Hydro US is performing the improvements to Wanapum's generators, which is expected to end in 2020. As of 2017, eight of Wanapum's ten generators have been replaced. Grant PUD plan is to replace one generator per year.

Generator and turbine upgrades at the separate Priest Rapids hydro dam started in 2016 and is expected to end in 2026. Other PRP expenditures include cultural resources and fish hatchery programs to meet requirements under the FERC license granted in 2008. While previous capital projects have been heavily debt funded, the district will increase revenue funding of these expenditures in the future.

'A' category DSCR

Over the last three years, Grant PUD has also achieved consolidated DSCR of 1.67x and in 2016, the district had DSCR of around 1.81x. These metrics are commensurate with an 'A' scoring. On a look forward basis, we expect the district will continue its historical performance with DSCR averaging above 1.7x times.

LIQUIDITY

An important mitigant to Grant PUD's exposure to key risks like industrial load concentration and wholesale market risk is its strong liquidity. The district's strong liquidity served to cushion Grant PUD during the recession when its unrestricted liquidity decreased by nearly $70 million from 2008 to 2010 and the Wanapum fracture event that contributed to a $40 million use of liquidity in 2014. The district's policies include maintaining $120 million in the Electric System's R&C fund and a minimum $35 million of working capital cash. For 2016, the district had strong liquidity of 794 days cash on hand and cash to debt ratio of 21%. The high days cash on hand ratio reflects the accounting treatment of the Pooling Agreement that has substantially reduced purchased power costs.

Looking forward, we expect Grant PUD to maintain liquidity between 400 to 500 days cash on hand which suggests a cash to debt ratio of around 15% to 20%. The decline reflects the district's plans to use some of its liquidity to fund capital spending.

Debt and Other Liabilities

DEBT STRUCTURE

Most of the district's debt consist of traditional fixed rate, amortizing bonds except for $150 million of variable rate debt including a recent $50 million private bank loan. For the private bank loan issued in September 2017, we note it contains a rating trigger whereby a rating downgraded to or below Baa1/BBB+/BBB+ results in an event of default. Such a rating trigger is credit negative although we acknowledge the trigger level is at least 4 notches away from its current rating. For the new series 2017 variable rate issuance, these bonds have a 'soft put' feature after the initial floating rate period whereby the district has to remarket or refund these obligations even though its legal maturity is long dated maturity. An inability to meet the 'soft put' results in a penalty interest rate but it does not result in an event of default. There is no credit enhancement such as a letter of credit supporting any of variable rate debt.

DEBT-RELATED DERIVATIVES

The district does not have debt-related derivative exposure.

PENSIONS AND OPEB

The district participates in Washington State's statewide, multiple employer Public Employees Retirement System (PERS) pension plan. Grant PUD's reported net pension liability in 2016 totaled $60.9 million and employer contributions in 2016 to PERS totaled $6.7 million, which was 2.4% of operating revenues.

Management and Governance

The district's governing body is comprised of a five-member board of commissioners. Two commissioners-at-large each serve four-year terms and the remaining three commissioners serve six-year terms. The terms are staggered so that two members of the board are elected every two years.

Legal Security

Electric System's bonds have a pledge of net electric system revenues and a rate covenant of 1.25x DSCR for senior debt and 1.10x for junior lien debt. Draws and deposits from the R&C fund can be used to smooth the DSCR rate covenant. The additional bonds test is 1.25x DSCR. The debt service reserve is sized to the lower of 125% of average annual debt service, maximum annual debt service or 10% of initial principal. Funding of the reserve consists of a surety from Assured Guaranty Municipal Corp (Assured; A2 stable) totaling $6.5 million and around $18 million in cash. On a fully consolidated basis with PRP, Grant PUD's debt service reserve after incorporating cash and sureties from investment grade monolines approximates ten months of total debt service.

PRP bondholders benefit from a pledge of net revenues of the combined Wanapum and Priest Rapids hydro projects and a 1.15x rate covenant. The Electric System has also covenanted to pay for all of PRP's costs including debt service whether or not PRP produced or is capable of producing power and energy. The Electric System's payment obligation to PRP is senior to the Electric System's debt service if PRP produces power and on parity if PRP no longer produces power. The PRP bonds have a debt service reserve account sized to twelve months maximum interest net of any federal interest subsidy. These provisions are weaker than typical issuers in the rating category. PRP's debt service reserve is funded by a combination of around $42 million of cash and $30.1 million of sureties. Around half of the sureties are provided by non-rated sureties. Separately, PRP must also maintain a minimum $12 million in the Renewal, Replacement, and Contingency fund.

Use of Proceeds

Proceeds from the issuance will be used to refund $50 million of maturing debt and pay transaction costs.

Obligor Profile

Grant PUD operates a utility system that primarily generates and delivers electricity to approximately almost 47,000 retail customers in Grant County, which is located in central Washington State. The district also provides wholesale fiber-optic services and PRP generates electricity for sale to a number of investor owned utilities and municipal public power entities. The district's service area comprises of 2,777 square miles and has a population of around 93,000 as of 2016.

Scorecard Factors and Other Considerations

Moody's evaluates Grant PUD under the US Public Power Electric Utilities with Generation Ownership Exposure methodology and the grid indicated rating is Aa3, in line with its current Aa3 rating.

The grid is a reference tool that can be used to approximate credit profiles in the US public power industry in most cases. However, the grid is a summary that does not include every rating consideration. Please see U.S. Public Power Electric Utilities with Generation Ownership Exposure for more information about the limitations inherent to grids.

Exhibit 2

Factor	Subfactor	Score	Metric
1. Cost Recovery Framework Within Service Territory		A	
2. Willingness and Ability to Recover Costs with Sound Financial Metrics		Aa	
3. Generation and Power Procurement Risk Exposure		A	
4. Competitiveness	Rate Competitiveness	Aaa	
5. Financial Strength and Liquidity	a) Adjusted days liquidity on hand (3-year avg) (days)	Aaa	540
	b) Debt ratio (3-year avg) (%)	Aa	51.5%
	c) Adjusted Debt Service Coverage or Fixed Obligation Charge Coverage (3-year avg) (x)	Baa	1.67
Preliminary Grid Indicated rating from Grid factors 1-5		**Aa3**	
		Notch	
6. Operational Considerations		0.0	
7. Debt Structure and Reserves		0.0	
8. Revenue Stability and Diversity		-0.5	
Grid Indicated Rating:		**Aa3**	

Source: Moody's Investors Service

Methodology

The principal methodology used in this rating was US Public Power Electric Utilities With Generation Ownership Exposure published in March 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 3

Grant County Public Utility District 2, WA

Issue	Rating
Electric System Revenue Refunding Bonds, Series 2017-N	Aa3
Rating Type	Underlying LT
Sale Amount	$50,000,000
Expected Sale Date	11/15/2017
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

REPORT NUMBER 1095721

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