MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa3 to Grant County Public Utility District 2, WA's 2015 revenue bonds; Outlook stable.

Global Credit Research - 16 Sep 2015

Approximately $1.38 billion of debt securities affected

GRANT COUNTY PUBLIC UTILITY DISTRICT 2, WA
Electric Distribution and Generation
WA

Moody's Rating

ISSUE		RATING
Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2015 Series A		Aa3
Sale Amount	$74,300,000	
Expected Sale Date	09/30/15	
Rating Description	Revenue: Government Enterprise	
Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2015 Series B (AMT)		Aa3
Sale Amount	$18,000,000	
Expected Sale Date	09/30/15	
Rating Description	Revenue: Government Enterprise	
Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2015 Series M (Taxable New Clean Renewable Energy Bonds)		Aa3
Sale Amount	$90,000,000	
Expected Sale Date	09/30/15	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook STA

NEW YORK, September 16, 2015 --Moody's Investor Service has assigned Aa3 rating to $182.3 million of Grant County Public Utility District 2, WA's (Grant PUD) revenue bonds, consisting of $74.3 million of Priest Rapids Hydroelectric Project (PRP) Revenue and Refunding Bonds, 2015 Series A; $18 million of Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2015 Series B (AMT); and $90 million of Priest Rapids Hydroelectric Project Revenue and Refunding Bonds, 2015 Series M (Taxable New Clean Renewable Energy Bonds). Concurrent with these rating assignments, Moody's has affirmed Grant PUD's Aa3 rating on its existing PRP and electric distribution system's (Electric System) revenue bonds. Grant PUD's rating outlook is stable.

SUMMARY RATING RATIONALE

Grant PUD's Aa3 rating is supported by the district's ownership of highly competitive hydro generation, extremely low retail rates, strong risk management, and strong 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. The district also forecasts resiliency to stress cases such as loss of industrial customers although the forecasted consolidated debt service coverage ratio (DSCR) would drop below their base case forecast of at least 1.7x DSCR. Investment grade electric utility counterparties for PRP under take or pay contracts for up to 37% of capacity are another benefit.

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. Grant PUD expects to enter into a new exchange contract (Pooling Agreement) in September 2015 that should substantially mitigate wholesale price and hydrology risk through September 2020 when taken together with the existing '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.

OUTLOOK

The stable rating outlook considers the district's forecasted financial performance and expectation that the district will enter into the Pooling Agreement. The outlook also incorporates successful execution of Grant PUD's capital expenditure program.

WHAT COULD MAKE THE RATING GO UP

The district's rating could improve if Grant PUD substantially completes PRP's major capital expenditure program, achieves consolidated DSCR in excess of 2.0x on a sustained basis, maintains liquidity greater than currently forecasted, and the district successfully demonstrates its risk mitigation measures largely reduce the district's wholesale and hydrology exposure over an extended period of time.

WHAT COULD MAKE THE RATING GO DOWN

The district's ratings could decline if Grant PUD does not implement rate changes to maintain forecasted financial performance over time, if the Pooling Agreement incurs material execution problems or if the district incurs major load loss on a sustained basis. Additional factors that could result in a negative rating action include major operating problems at PRP or major cost overruns at PRP's capital program.

STRENGTHS

Highly competitive retail rates

Strong liquidity

Ownership of low cost, hydro plants

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

CHALLENGES

Below average wealth in service area

Historical hydrology and wholesale market risk

Industrial load concentration

Large capital spending

RECENT DEVELOPMENTS

In May 2015, Washington State declared a statewide drought emergency due to substantially below average regional snowpack. The National Oceanic and Atmospheric Administration (NOAA) forecasts 75% of average water flow for the April through September period (at Grand Coulee). However, for the full 2015 water year (October through September), NOAA forecasts that regional hydrology will be around 94% of water given above average water flows early in the water year, which is not as severe as the April through September period.

Other recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

REVENUE GENERATING BASE

Retail Energy Sales (52% of revenues in 2014)

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 (2013) is $53K (82% of US) and poverty levels are at 20.3% (US average of 15.4%). Unemployment rate is also above the US at 8.6% average for the first five months of 2015 (5.5% for the US) albeit it is an improvement over 9% average for the first five months of 2014. However, the county's tax base has grown substantially since 2007 from $60K full value per capita to $94K full value per capita mostly due to new industrial development.

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 sales have grown 34% from 2005 to 2014 mostly due to power intensive businesses like data centers that are attracted to the district's low retail rates that are 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 with the ten largest customers providing around 38% of retail revenues in 2014 and industrial sales in total are 47% of total retail sales. The top ten customers primarily comprise of manufacturing, data centers and food processing and we view some as having weak credit quality such as the polysilicon plant. 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 and ability to sell into the wholesale market.

Wholesale Revenue Exposure (26% of revenues in 2014)

Grant PUD's financial results can be materially impacted by hydrology in the Columbia River Basin and wholesale power prices in the region since Grant PUD wholesale power sales has historically represented 20% to 30% of consolidated revenues and is a much more volatile source of revenues.

In September 2015, the district expects to enter into Pooling Agreement with Shell Energy North America (Shell: A2, stable) that should substantially reduce hydrology and market risk through the September 2020 term (see Financial Operations and Position section for further discussion). The district also has 'slice' contracts that shifts both hydrology, operating, and market price risk to contract counterparties. Existing slice contracts including sales to Iberdrola Renewables, LLC and Shell whose contracts mature in June 2018 and June 2016, respectively. As part of each slice transaction, Grant PUD also bought back power from the respective slice party for intra-year periods when the district might be short power.

Take-or-Pay Contracted Cash Flows (20% of revenues in 2014)

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. As of 2014, the largest third party off-takers are PacifiCorp (A3 stable) at 9.08% share (original nameplate), 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 decrease under the EUDL feature as Grant PUD's retail load grows.

FINANCIAL OPERATIONS AND POSITION

New Pooling Agreement Reduces Risk of Hydro Dependent Supplies

Grant PUD benefits from ownership of 2,104 MW of nameplate hydro generation capacity primarily comprising of the 1,148 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% 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% 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 new risk mitigation against hydrology and market risk is the expected Pooling Agreement. Under the 5-year Pooling Agreement, Shell is obligated to provide firm power that is pre-set in the contract to meet current forecasted load and various ancillary services. In exchange, the district provides to Shell its share of PRP's output starting at 43.3% rising to 53.3% after June 2016 thus effectively transferring a substantial amount of hydrology and market risk to Shell. The exchange contract should result in more stable financial metrics over the five-year contract term if it works as intended. However, we see the positive benefits of the exchange agreement tempered by heightened counterparty credit risk and the untested nature of the arrangement that could expose the district to unforeseen problems. The district also continues to largely retain operating risk.

Large Capital Program

From 2015 to 2020 the district expects to spend roughly $778 million on capital expenditures of which 33% 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 2018. Alstom Hydro US is performing the improvements to Wanapum's generators, which is expected to end in 2020. Generator and turbine upgrades at the separate Priest Rapids hydro dam is expected to start in 2016 and end in 2026. Other PRP expenditures include cultural resources and fish hatchery programs to meet requirements under the FERC license granted in 2008. These expenditures have been heavily debt funded resulting in $1.4 billion of debt expected by end of 2015 compared to around $787 million in 2009. However, the district intends to significantly 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 1.59x, which is commensurate with an 'A' scoring for this metric. However, for 2014, the district's DSCR was at 1.41x due to the costs associated with the Wanapum fracture and we view the outage as non-recurring event. On a look forward basis, we expect DSCR averaging above 1.7x times, which remains commensurate with an 'A' scoring for this metric.

An inability to meet forecasted financial metrics over time and maintain strong liquidity measures could lead to negative rating actions particularly if the district does not implement the rate increase required to achieve their forecast.

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 the Grant PUD during the recession when its unrestricted liquidity decreased by nearly $70 million from 2008 to 2010 and more recently, with 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 2014, the district had strong liquidity of 387 days cash on hand and cash to debt ratio of 16% although this was a significant drop relative to 2013's very robust levels. Looking forward, we expect Grant PUD to maintain liquidity between 400 to 500 days cash on hand and at around 15% cash to debt ratio, which is lower than the district's 2014 forecast. We recognize the days cash on hand metric benefits from lower purchased power expenses driven by the Pooling Agreement and not from higher absolute liquidity. That said, Pooling Agreement that should reduce volatility in operating expenses and substantially mitigate wholesale and market price risk.

DEBT AND OTHER LIABILITIES

Debt Structure

Most of the district's debt consist of traditional fixed rate, amortizing bonds except for $50 million of variable rate debt that was issued in 2014. While the variable rate obligation has a long dated maturity, these bonds have a 'soft put' feature after the initial floating rate period whereby the district has to remarket or refund these obligations. 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 the variable rate debt and the variable rate debt floats based on SIFMA. We anticipate the utility will issue more variable rate debt in the future.

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 employer contributions in 2014 to PERS totaled $5.7 million, which was 3.2% of operating expenses excluding depreciation.

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. Two of the commissioners' terms end in 2016.

Strong Risk Management Focus But Some Weakening of Historically Robust Willingness to Raise Rates

While Grant PUD's rates are very low, we view the district's willingness to raise rates to have weakened since 2013. In 2013, the district implemented a 6% increase as compared to a 8% increase anticipated in its earlier 2012-2015 budget. Since then, Grant PUD has implemented 2% annual rate increases in 2014 and 2015. We view the district's revision in 2013 as a sign of rate fatigue by retail customers given Grant PUD's previous 8% rate increases from 2010 through 2012. While this is a credit negative, we view positively Grant PUD's forecast of high liquidity, DSCR averaging above 1.7 times, and its resiliency to stress scenarios. Additionally, district has strengthened its risk management since the recession such as implementing and expanding upon its energy hedging program including the expected Pooling Agreement and adopting stronger financial objectives such as a $120 million minimum in the R&C fund and a 1.8 times consolidated debt service coverage ratio (per district's calculation).

OTHER CONSIDERATIONS

Moody's evaluates Grant PUD under the US Public Power Electric Utilities with Generation Ownership Exposure methodology, and, as depicted below, the grid indicated rating is A1, which is lower than the its Aa3 rating. Robust internal liquidity and low cost, carbon free generation are supportive considerations for the Aa3 rating as compared to the A1 grid indicated rating.

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

Methodology Factors

1 Cost Recovery Framework within Service Area: (25% weight) (A)

2. Willingness to Recover Costs with Sound Financial Metrics (25% weight) (Aa)

3. Management of Generation Risks- (10% weight) (A)

4. Competitiveness: (10% weight) (Aaa)

5. Financial Strength:

Sub factor a) Adjusted Days Liquidity on Hand: (10%weight) (486) (Aaa)

Sub factor b) Debt Ratio: (10% weight) (52%) (A)

Sub factor c) Adjusted Debt Service Coverage: (10% weight) (1.59x) (A)

Grid Indicated Rating: Aa3

Notching: -0.5 (merchant/customer concentration)

Scorecard Indicated Rating: A1

KEY STATISTICS

Total Restricted and Unrestricted Cash and Investments, 2014: $511 million

PRP Hydro Capacity (Nameplate): 2,104 MW

Electric System Debt Service Coverage, 2014 (per resolution): 5.0 times

Consolidated Debt Service Coverage Ratio, 2014 (Moody's): 1.41 times

Consolidated Cash to Debt Ratio, 2014: 16%

Consolidated Days Cash on Hand, 2014: 387 days

Consolidated Debt Ratio, 2014: 52%

Average Electric System Rate, 2014: Approximately 3.8 cents/kwh

Electric System Revenue Bonds, 2014: $196 million

Priest Rapids Development Bonds, 2014: $1.06 billion

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 2,681 square miles and has a population of almost 94,000 as of 2015.

LEGAL SECURITY

PRP bondholders benefit from a pledge of net revenues of the combined Wanapum and Priest Rapids hydro projects and a 1.15 times 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 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 $40.7 million of cash and $30.1 million of sureties. $13.9 million of the sureties are with unrated and PRP's exposure to sureties is considered a weakness. Separately, PRP must also maintain a minimum $12 million in the Renewal, Replacement, and Contingency fund.

Electric System's bonds have a pledge of net electric system revenues and a rate covenant of 1.25 times DSCR for senior debt and 1.0 times for junior lien debt. Draws and deposits from the Reserve and Contingency (R&C) fund can be used to smooth the DSCR rate covenant. The additional bonds test is 1.25 times 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 $17.6 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.

USE OF PROCEEDS

Approximately $90 million of PRP's debt issuance is new money to fund capital expenditures at PRP. The remaining funds will be used to refund a portion of 2005 and 2006 Series bonds, fund reserve requirements, and pay for transaction costs.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was U.S. Public Power Electric Utilities with Generation Ownership Exposure published in November 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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