S&P Global
Ratings

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Summary:

Benton County Public Utility District No.1, Washington; Retail Electric

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Credit Profile		
US$24.1 mil rev bnds ser 2023 due 11/01/2048		
Long Term Rating	A+/Positive	New
Benton Cnty Pub Util Dist #1 elec		
Long Term Rating	A+/Positive	Outlook Revised

Credit Highlights

- S&P Global Ratings revised its outlook to positive from stable and affirmed its 'A+' rating on Benton County Public Utility District No. 1 (BCPUD), Wash.'s outstanding electric revenue bonds.
- At the same time, S&P Global Ratings assigned its 'A+' long-term rating to the district's approximately $24.1 million series 2023 electric revenue bonds.
- The positive outlook reflects our opinion of the district's improved financial performance trend, as reflected by its improved fixed-cost coverage (FCC) during the past three years and its healthy liquidity position. In addition, management projects improved coverage metrics in the medium term due to planned rate increases and a change to a load-following contract versus a block/slice contract, which we believe will stabilize power costs and decrease volatility.

Security

Net revenue derived from the electric system's operations secure the bonds. The bonds call for a rate covenant of 1.25x, and as of the end of fiscal 2022, the district had $57 million of outstanding long-term debt. The bond proceeds are being used to finance or reimburse the district's costs of improving or replacing the electric system.

Credit overview

The rating reflects our opinion of the district's stable financial performance and comprehensive management practices and policies, which have resulted in good financial performance historically. The rating further reflects our opinion of the district's affordable electric rates given its low-cost power portfolio and history of increasing its base rate when needed. These factors led to the district's strong financial performance, highlighted by FCC that has averaged 1.4x during the past three fiscal years and is projected to remain at a higher, sustained level during the next five years.

The district is focused on managing its system to uphold its proactive regulatory posture around renewables, environmental compliance, emergency preparedness, and system reliability. In the near term, we consider credit risks to be relatively manageable, given the system's stable customer base, and change to a load-following power sales agreement with the Bonneville Power Administration (BPA). We believe that the district will maintain the capacity to make rate and other budgetary adjustments to support its capital needs without diluting the system's unrestricted liquidity or FCC to levels we consider inconsistent with the current rating level.

This contract change means the district will no longer be in the business of transacting directly in wholesale electricity markets to meet customer loads, which are becoming more volatile and uncertain in terms of price and availability of dependable generating supplies. In December 2022, Mid-Columbia (Mid-C) market power prices were as high as $700/megawatt (MW) and sustained market prices were above $100/MW for several weeks. Under a load-following contract, Benton PUD's power costs will be more certain, as BPA sets its tier 1 and tier 2 rates for a two-year period (BP24 rate period: October 2023-September 2025) in the preceding July. This will allow the district to estimate its future power costs with a fair amount of certainty and adjust retail rates as needed. The district's rate period high water mark (RHWM) is currently 201 aMW, which is served at tier 1 rates. Any district loads above the RHWM will be served by BPA's tier 2 rates. For the BP24 rate period, 10 aMW will be served at tier 2. We note that the district's previous block/slice contract meant year-to-year volatility was common due to hydrological variability. With the change to the load following product, the district will not need to manage its volumetric or price risk. However, in the event of a new large single load, the district may investigate products previously used to manage power supply to serve the new load.

Benton County is in southeastern Washington along the Columbia River, 160 miles southwest of Spokane. BCPUD's service territory includes the cities of Kennewick, Finley, Benton City, and Prosser, and other nearby areas. The district had 56,900 customer accounts in 2022, and residential customers comprise about half of BCPUD's retail revenue. We view the residential revenue as providing substantial stability.

The rating further reflects our view of the following:

- The district has a clean power supply and power purchase agreements (PPA) with several other entities. BPUD has no immediate plan to enter into any new PPAs.
- We consider the district's current rates competitive: Its average revenue per kilowatt-hour (kWh) was 16% below the state average in 2022. Management plans to increase rates by 3.5% in 2025 and 2026 or by 4.0% as overall BPA rates increase.
- The district has good FCC metrics, good liquidity and reserves, and a low debt position. FCC averaged 1.4x between fiscals 2020 and 2022 despite increased purchased power expenses, and management projects it will improve through 2028, with a 1.6x five-year projected average, a level we consider healthy. The district's $53.7 million in unrestricted reserves (in fiscal 2022) would be able to cover its expenses for about four months. The fiscal 2022 debt-to-capitalization ratio was 28% and management does not plan to issue debt in the near term.
- Operations are favorably aligned with management's strategic goals, in our view. The district maintains well-defined and comprehensive financial management practices and policies that we consider sustainable, especially because of the ongoing volatility in hydrological conditions and the district's significant exposure to wildfires within its service area. Management's robust fire mitigation plan partly offsets this risk, in our view.

Environmental, social, and governance

In our view, environmental risks facing the district, such as wildfires, drought, and earthquakes, are negative to credit quality. The district sources about 95% of its power through non-carbon-emitting hydroelectric, nuclear, and wind resources, largely insulating it from the uncertainty, costs, and operational challenges of legislative and regulatory initiatives to reduce greenhouse gas emissions. Nevertheless, the district is still subject to an evolving regulatory environment in the state of Washington, including the Energy Independence Act (EIA) and the Clean Energy

Transformation Act (CETA). In our view, given that BPA's hydroelectric and federal incremental hydroelectric qualify in the state's renewable energy targets, and the district is well positioned to meet the requirements of the various acts and will use its integrated resource plan to guide its decisions to comply with CETA. S&P Global Ratings will monitor the regulatory landscape, the district's compliance, as well as additional operational or budgetary pressures it might face.

The district experiences less social risk because current electric rates remain affordable due to the economic power sources coupled with above average incomes. Following stronger-than-expected U.S. economic growth through the third quarter of 2023, S&P Global Economics believes that recent business and consumer activity are not sustainable and projects slowing economic activity in the fourth quarter of 2023, along with tepid economic growth of 1.3%-1.4%, respectively in 2024-2025. (See "Economic Outlook U.S. Q4 2023: Slowdown Delayed, Not Averted," published Sept. 25, 2023). Although inflation is softening, S&P Global Economics projects elevated interest rates through 2024. Consequently, we continue to monitor the strength and stability of public power utilities' revenue streams for evidence of delinquent payments or other revenue erosion.

Governance risk factors are in line with its peers, as the district has been able to manage hydrologic risk, maintain coverage and reserve targets, and sustain long-range capital and financial plans that are updated annually, which we consider a credit positive, as forward-looking planning can help illuminate potential future challenges. The district also maintains a robust formal cyber security policy, which we view favorably.

Outlook

The positive outlook reflects our view of the system's largely residential customer base, low rates, and good FCC at the current rating level. We anticipate that, during the outlook period, management will address future rate adjustments to preserve the system's financial profile and meet any pay-as-you-go capital requirements, ultimately improving the district's overall FCC metrics in the medium term.

Downside scenario

We believe the rating could be pressured if the system experiences higher-than-expected capital improvement needs without sufficient cost recovery causing FCC metrics and liquidity to deteriorate. Furthermore, if insufficient cost recovery results in a significant drawdown in liquidity, we could lower the rating.

Upside scenario

If the district is able to improve its financial metrics while maintaining credit-supportive operational, financial, and risk management policies, we could raise the rating.

Credit Opinion

Customer concentration is moderate in the service area: BCPUD's top 10 customers provide about 24% of electric revenue, while the top customer provides 10%. Of the top 10 customers, six are classified as large irrigation customers. Among other agricultural products, Benton County produces potatoes, apples, sweet corn, onions, grapes, cherries, wheat, and hay. General service and irrigation customers, whose demand is generally more volatile than that of residential customers, comprise most of the other retail customers in terms of revenue and sales.

In 2022, BCPUD obtained power from the following:

- Nine Canyon Wind Project (9 MW PPA; 0.8% of purchased electricity);
- White Creek Wind Project (9 MW PPA; 1% of purchased electricity);
- Packwood hydroelectric (about 4 MW; less than 1% of purchased electricity); and
- Wholesale market purchases (about 5.5% of purchased electricity).

The district works with The Energy Authority to manage its electricity needs. These non-BPA electricity sources diversify BCPUD's supply, and we view this favorably.

In 2022, BCPUD's fuel mix was 75% hydroelectric, 10% nuclear, 7% wind, and 4% other renewables. As a utility that serves more than 25,000 customers, the district is subject to the provisions of the EIA (Initiative 937), which was passed by Washington state voters in 2006. The EIA requires that the district purchase renewable energy as a percent of its electricity needs. With the contracts it has in place and the purchase of renewable energy credits (REC), BCPUD met the 15% requirement in 2023, and management expects it will maintain compliance through the use of RECs.

In 2019, the state of Washington passed legislation designed to transition the electricity sector to 100% clean power. CETA establishes three standards for Washington State utilities: elimination of all coal; provision of 100% carbon neutral electric service to retail load; and a 100% clean electricity standard by 2045. Utilities will be required to demonstrate compliance with this policy annually. In our view, given that BPA hydroelectric and federal incremental hydroelectric qualify, the district is well positioned to meet the requirements of the act.

BCPUD's management team has produced documents concerning rate strategy, enterprise risk management policy, wildfire mitigation, and power risk management and trading policy. In addition, the district has financial targets of no less than 90 days' cash on hand and debt service coverage (DSC) of 2.0x, including capital contributions. Under the load-following contract, the district is using the current tier 2 rate of $80/MWh (the forward Mid-C price) in two different scenarios, which we view as conservative. Actual tier 2 prices are developed by BPA as a mix of Mid-C and BPA's own modelling, which is generally lower. We view these policies, financial targets, and planning documents favorably, because they provide guidance, can help identify problems, and require a forward-looking view.

In 2022, BCPUD's weighted average electricity rate was 84% of the state's average. Specifically, residential rates were 85% of the state's average, commercial rates were 74%, and industrial 94%. The district's rate increases in 2015 (3.9%), 2016 (4.9%), 2017 (1.9%), and 2019 (2.9%) demonstrate BPCUD's willingness to raise rates when needed, which we view positively. Although BCPUD lacks a power cost recovery mechanism, the combination of conservative budgeting and the district's new contract with BPA mitigates rate flexibility risk. Management plans to increase rates by 3.5% in 2025 and 2026 or by 4.0% as overall BPA rates increase.

BCPUD's FCC, which treats a percent of BPA costs, the district's portion of Nine Canyon Wind Project debt service, and a percent of White Creek Wind Project costs as debt-like rather than as an operating cost, averaged 1.4x from 2020 through 2022 with FCC at 1.4x at fiscal year-end 2022. Using projections provided by BCPUD, we calculate that

FCC will remain at levels that we consider very strong--increasing to 1.5x in 2023 and reaching 1.6x by 2027.

The district's forecast assumes BPA will increase costs by 3% (power) and 10% (transmission) beginning Oct. 1, 2025 and built the increases into its forecasts. Management runs various scenarios to see the influence on each financial metric, including cash projections. This allows the district to identify trends ahead of time and develop an appropriate course of action (i.e. rate increases, bond issuance, reduction in expenses (capital or operations and management), or a combination thereof).

BCPUD had $53.7 million (excluding lines), or 120 days' liquidity in fiscal 2022, providing a robust cushion to meet financial obligations. Projections indicate drawing down reserves to $41 million by 2028 for planned capital projects. In our view, as a distribution-only utility, BCPUD does not require reserves as large as those of a vertically integrated utility, but the additional cushion is still meaningful in light of potentially volatile hydrological conditions, which can influence surplus sales revenues. The district maintains a $10 million line of credit that is undrawn. It will expire in 2024.

We consider the district's debt position moderate. We view a debt-to-capitalization ratio of less than 30% as manageable for a distribution-only utility, and there are no additional debt plans in the near term. The six-year (2023-2028) capital improvement plan totals $135 million, and a majority of the projects will be funded with surplus revenue. The district typically issues bonds every four to six years.

Benton Public Utility District No.1, Washington--Key Credit Metrics

	--Fiscal year ended Dec. 31--		
	2022	**2021**	**2020**
Operational metrics			
Electric customer accounts	56,895	56,072	55,342
% of electric retail revenues from residential customers	48	45	46
Top 10 electric customers' revenues as % of total electric operating revenue	24	27	26
Service area median household effective buying income as % of U.S.	111	111	109
Weighted average retail electric rate as % of state	84	86	91
Financial metrics			
Gross revenues ($000s)	184,152	177,840	158,163
Total operating expenses less depreciation and amortization ($000s)	163,252	155,712	136,111
Debt service ($000s)	5,999	5,995	6,155
Debt service coverage (x)	3.5	3.7	3.5
Fixed-charge coverage (x)	1.4	1.4	1.4
Total available liquidity ($000s)*	63,723	69,727	61,461
Days' liquidity	143	164	164
Total on-balance-sheet debt ($000s)	62,327	65,957	69,536
Debt-to-capitalization (%)	28	30	33

*Total available liquidity includes available committed credit line balances, where applicable. Debt service coverage--Revenues minus expenses divided by debt service. Fixed-charge coverage--Sum of revenues minus expenses minus total net transfers out plus capacity payments (or their proxy), divided by the sum of debt service plus capacity payments (or their proxy). N.A.--Not available.

Related Research

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