Fitch Ratings-San Francisco-17 May 2019: Fitch Ratings has upgraded the rating on the following bonds issued by Benton County Public Utility District No. 1, WA to 'AA-' from 'A+':

--Approximately $53.3 million electric revenue and refunding bonds, series 2010, 2011 and 2016.

Fitch had designated the above ratings as 'Under Criteria Observation', or 'UCO' on April 9, 2019 following the publication of Fitch's revised rating criteria. Fitch has removed and resolved the UCO designation on all the ratings.

Fitch has also assigned a 'AA-' Issuer Default Rating (IDR) to Benton PUD.

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The rating upgrade is based on the application of Fitch's new criteria and reflects Benton PUD's strong financial profile, the district's very low operating cost burden and ample rate flexibility. The district's low net leverage is expected to persist at levels adequate for the rating despite cash funding of relatively heightened short-term capital needs, partially due to an expected structural decline in costs beginning in 2022.

CREDIT PROFILE

Benton PUD provides retail electric and broadband services in a 939 square-mile service area of Benton County, Washington, with the majority of its customer base located within the cities of Kennewick, Prosser and Benton City.

The district does not serve certain other areas within Benton County including the cities of West Richland and Richland; it also does not serve the significant operations by the U.S Department of Energy on the Hanford Reservation or the rural areas in the county that are served by the Benton Rural Electric Association.

Energy needs are predominately met with power purchased from the Bonneville Power Administration (BPA), with remaining requirements met through power purchased contracts and market purchases. Contractual rights to purchase power under long-term agreements exceed the district's power needs under average water conditions.

KEY RATING DRIVERS

Revenue Defensibility: 'a'; Manageable Wholesale Exposure, Competitive Rates

Benton PUD's revenue defensibility is driven by the district's continued efforts to reduce its exposure to wholesale revenue variability combined with its very strong rate flexibility. The district serves a diverse, growing customer base in Benton County, which is supportive of the revenue defensibility assessment.

Operating Risk: 'aa'; Low Operating Cost, Solid Flexibility
Benton PUD's operating risk is driven by its very low operating cost burden. Operating costs remain well below 10 cents/kWh and the district's power supply should be supportive of similarly low levels going forward. Relatively heightened short-term capital spending related to reliability and growth objectives is viewed as manageable.

Financial Profile: 'aa'; Strong, Resilient Financial Profile

Benton PUD's financial profile is very strong, supported by low leverage, which is expected to persist following a structural decline in costs. Coverage and liquidity metrics are healthy and neutral to the rating assessment.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations affected this rating determination.

RATING SENSITIVITIES

MARGIN PRESERVATION: The Stable Outlook reflects Fitch's expectations that Benton PUD will take appropriate action to preserve the district's financial profile following a structural decline in costs expected to occur in 2022.

SECURITY

The bonds are payable from the net revenues of the electric system.

Revenue Defensibility

Benton PUD derives a significant portion of its total revenues from the sale of retail electricity throughout its exclusive service territory, a business line that exhibits monopoly characteristics and underpins revenue defensibility. The remainder is primarily derived from wholesale sales of surplus power, which are subject to more competitive pressures.

The district has continued its strategic shift toward a greater reliance on retail revenues, evidenced by regular retail rate increases over the last decade. While efforts have been successful, wholesale sales of surplus power still have some influence in the district's financial performance comprising approximately 15% of total operating revenues in 2018.

Benton PUD's service area characteristics are viewed as favorable. The area has seen employment growth in a broad range of industries as well as greater agriculture and wine production activity, which has contributed to the rise in irrigation load. As a result, the district has seen continued steady customer growth among most rate classes.

Demographic and economic indicators for Benton County are solid, with 2017 median household income of $63,001 finishing at 109% of the national average. However, Benton County's unemployment rate of 5.5% remained structurally higher than national levels (4.4%) reflecting the breadth of the service area that includes a large portion of agricultural and irrigation activity.

The Board of Commissioners has the exclusive authority to set rates and charges for the district's services. No outside regulatory approval is required.

Benton's average retail revenue per kilowatt hour (7.03 cents/kWh) as reported by the EIA in 2017 was solidly below the state average (87% of the average). Rate affordability is similarly solid, with an affordability ratio (a measure of annual energy cost against median household income) of 2.2%. Collectively, these factors suggest very strong rate flexibility, which is expected to be preserved
Despite an expected average annual rate increase of 2.4% in October 2019. The increase is designed to meet system capital needs and to match rising BPA costs.

The district's the top 10 electric customers accounted for approximately 31% of retail energy sales in 2018, indicating some concentration. A majority of the system's concentration risk resides in a long-time irrigation customer, which comprised 10% of retail sales in 2018. Fitch views this concentration as manageable and consistent with the district's overall revenue defensibility.

Operating Risk
Low Operating Cost, Solid Flexibility

Benton PUD has a very low operating cost burden, with a Fitch-calculated cost of power of 6.6 cents in 2018. Despite projected BPA rate increases, upward pressure to the district's costs is expected to be moderated by the expiration of a contract for 50 MW of the 249 MW Frederickson combined-cycle natural-gas fired combustion turbine project in 2022.

The district's power supply is predominately met with power purchased from BPA, with remaining requirements met through power purchase contracts and market purchases. The district is fully resourced to meet its power supply needs through 2022 under critical water conditions and through 2032 under average water conditions. The Energy Authority (TEA) is responsible for shaping and balancing Benton's power supply resources with load requirements. The reliance on hydroelectric power for over 80% of power supply reflects a weak operating cost flexibility, given the dominance of a single fuel type, but does not constrain the district's operating risk assessment.

Benton PUD's power supply contract with BPA is in the form of both a block fixed component and a variable slice component, which fluctuates based on water conditions. Primarily supplementing the district's BPA contract is 50 MW of contracted capacity from the 249 MW Frederickson project. Under the agreement that expires in 2022, the district is obligated to pay regardless of energy production from the project. The district does not anticipate renewing its contract after its expiration, but instead plans to fill the consequent capacity gap with market products for summer deficits and potentially purchasing longer-term call options to cover winter deficits. Exact strategies will continue to be evaluated as the contract's expiration date approaches.

The district is fully resourced to meet the state's renewable portfolio standard (RPS) through 2019 via contracted renewable resources and renewable energy credit (RECs) purchase agreements. The district expects to meet the 15% requirement in 2020 with contracted REC purchases that are expected to be procured in 2019.

Benton PUD's age of plant is 20 years, which may indicate high capital requirements though system investment has been adequate with a five year capex to depreciation average of 105%. The district has an elevated CIP relative to historical levels, driven by reliability and growth objectives requiring greater substation and transmission investment. The estimated $81 million spend from 2019 to 2023 is expected to be primarily funded from cash reserves and operating cash flow.

Financial Profile
The district's recent strong financial performance continued through 2018, with Fitch-calculated coverage of full obligations remaining unchanged at 1.4x. Key drivers included incorporating effects of the first full year of the 2017 rate increase as well as favorable weather and water conditions. Strong performance is expected to moderate in 2019 due to extreme weather conditions combined with weaker slice output that forced the district to purchase power at higher market prices; however, margins are still projected to be at levels adequate for the rating.

Liquidity levels remain solid, though reserves are expected to be utilized to fund relatively heightened short-term capital needs. Reserve levels are expected to be restored over the longer
term, as the district projects continued solid margins supported by reduced debt obligations, the
expiration of the Frederickson contract, and future rate increases. Additionally, the district has a
proven track record of managing to its reserve target range of 108 to 132 days cash on hand.

The lack of debt issuance plans in the coming years supports the district's future debt capacity.
While leverage, as measured by net adjusted debt to adjusted FADS, is expected to rise in the short
term due to aforementioned reduced reserves related to capex, levels should begin to moderate
thereafter. Leverage is not expected to be materially increase after a moderate decline in energy
sales to levels that would be viewed as inconsistent with the rating, as the issuer has solid capacity
to raise rates under a stress scenario.

Asymmetric Additional Risk Considerations
Outstanding debt is entirely fixed-rate, with final maturity in 2041, presenting no additional risks to
the district’s financial profile.

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In addition to the sources of information identified in Fitch's applicable criteria specified below,
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Applicable Criteria
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)
https://www.fitchratings.com/site/re/10020113
U.S. Public Power Rating Criteria (pub. 03 Apr 2019)
https://www.fitchratings.com/site/re/10066654

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