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

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Rationale

S&P Global Ratings affirmed its 'A+' long-term rating on Benton County Public Utility District No. 1 (BCPUD, or the district), Wash.'s electric revenue bonds. The outlook is stable.

The rating reflects the application of our criteria "U.S. Municipal Retail Electric And Gas Utilities: Methodology And Assumptions," published Sept. 27, 2018 on RatingsDirect.

The rating reflects our opinion of BCPUD's very strong enterprise risk profile and strong financial risk profile. The very strong enterprise risk profile reflects our view of BCPUD's slice/block power sales agreement with the Bonneville Power Administration (BPA) and a management team that produces detailed policies and plans. The strong financial risk profile reflects our view of robust fixed-charge coverage (FCC) and a low debt-to-capitalization ratio.

The very strong enterprise risk profile reflects our view of BCPUD's:

• Very strong operational management assessment, highlighted by a clean power supply with the BPA power sales agreement through 2028 and power purchase agreements (PPAs) with several other entities, as well as a management team that has financial policies and annually produces five-year financial forecasts and capital improvement plans (although we note that the district's slice/block contract with BPA can also result in year-to-year volatility as a result of hydrological variability);

• Strong service area economic fundamentals, reflected by BCPUD's collecting approximately 46% of its retail electric revenue from residential customers, moderate customer concentration in the service area, and income levels in the service area markedly above the national median;

• Very strong market position, with the weighted average electric rate less than 90% of the state average in 2017; and

• Extremely strong industry risk assessment relative to that of other industries and sectors.

The strong financial risk profile reflects our view of BCPUD's:

• Strong coverage metrics, with FCC that averaged 1.44x over fiscal years 2016 through 2018, though we note weaker projected coverage in fiscal 2019;

• Very strong liquidity and reserves, reflecting BCPUD's ability to meet expenses for about six months with about $67 million in unrestricted reserves in fiscal 2018; and

• Very strong debt and liabilities profile, evidenced by a debt-to-capitalization ratio of less than 30% in fiscal 2018 and no additional debt plans over the next five years.
Outlook

The stable outlook reflects our view of BCPUD's growing customer base and a management team that has developed detailed policy and planning procedures while assuming conservative financial forecasts. The district's power supply is largely carbon-free, putting BCPUD in a good position to meet state environmental mandates. While BCPUD's financial performance has been largely stable, we note some volatility in 2018 and projected volatility in 2019. However, based on expectation of average water flows during the out-years, we anticipate a return to stable financial metrics over fiscal years 2020 to 2023.

Upside scenario

Although we are unlikely to do so, we could raise the rating over the next two years if BCPUD's coverage, liquidity, or debt profile improve beyond levels projected by management and that we believe are sustainable.

Downside scenario

We could lower the rating if the district's rate setting practices do not result in sufficient cost recovery, particularly in years with adverse hydrological conditions.

Utility Description And Credit Overview

Benton County is located in southeastern Washington along the Columbia River, 160 miles southwest of Spokane. The county has seen steady population growth in recent decades, growing to about 200,000 people in 2018 from 113,000 in 1990. BCPUD's service territory includes the cities of Kennewick, Finley, Benton City, and Prosser, and other nearby areas. The district had 54,136 customer accounts in 2018. BCPUD began serving electricity in 1946.

Enterprise Risk

Operational Management Assessment: Very strong

BCPUD is a distribution-only utility that purchases the majority of its electricity from long-term contracts. The district has a slice/block power sales agreement with BPA through 2028. The block portion of the contract provides a consistent amount of electricity each month (ranging between 70 megawatts, or MW, and 156 MW, depending on the month), while BCPUD receives 1.37% of the total Federal Columbia River Power System slice. The slice amount varies by month, depending on water conditions; there are risks and benefits to the slice component. Of all the electricity purchased by BCPUD in 2018, about 85% was from BPA. BPA markets wholesale power from 31 federal hydroelectric projects, one nonfederal nuclear plant, and several small nonfederal power plants. We view positively the district's contract with BPA because of the size and sophistication of the organization.

BCPUD has PPAs with the Frederickson 1 Generating Station combined-cycle natural-gas-fired combustion turbine plant (50 MW; 6% of the district's purchased electricity in 2018), the Nine Canyon Wind Project (9 MW; 1% of the district's purchased electricity in 2018), and the White Creek Wind Project (9 MW; 1% of the district's purchased electricity in 2018). BCPUD also obtains about 4 MW from Packwood hydro (less than 1% of the district's purchased electricity in 2018) and wholesale market purchases (about 7% of the district's purchased electricity in 2018). 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.

BCPUD is compliant with all environmental regulations. In 2017, BCPUD's fuel mix was 82% hydro, 8% nuclear, 7% wind, 1% natural gas, 1% other, and less than 1% coal. As a utility that serves more than 25,000 customers, the district is subject to the provisions of the Energy Independence Act (Initiative 937), passed by Washington voters in 2006. The Energy Independence Act requires that the district purchase renewable energy as a percentage of its electricity needs (3% in 2012, 9% in 2016, and 15% in 2020). With the contracts it has in place and the purchase of renewable energy credits, BCPUD will meet the 15% requirement in 2020.

In 2019, Washington passed legislation designed to transition the electricity sector to 100% clean power. The Clean Energy Transition Act establishes three standards for Washington State utilities: elimination of all coal, a requirement that utilities provide 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 on an annual basis. In our view, given that BPA hydro and federal incremental hydro qualify, BCPUD is well positioned to meet the requirements of the act. One potential longer-term risk is BPA's exposure to fish and wildlife regulations and potential new seismic improvements, of which costs are undetermined. BPA is codeveloping the Columbia River System Operations Environmental Impact Statement with the U.S. Army Corps of Engineers and Bureau of Reclamation. The final report will be released in 2020 and may include significant mitigation measures that could increase costs over the longer horizon.

BCPUD's management team has produced documents concerning rate strategy, enterprise risk management policy, 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 of 2x, including capital contributions. BCPUD annually produces five-year financial forecasts and five-year capital improvement plans. The financial forecast is based on a stochastic model, and to be conservative, the district has chosen a forecast that assumes a net power budget at the 25th percentile of the model. We view these policies, financial targets, and planning documents favorably because they provide guidance, can help identify problems, and require a forward-looking view.

**Economic fundamentals: Strong**

In 2018, residential customers made up about 83% of BCPUD's electric customers. Total customer numbers grew by about 1.9% each year on average over years 2015 to 2018, while retail sales grew by about 0.1% each year on average. Residential customers account for about 46% of BCPUD's retail revenue and 40% of retail sales. We view the amount of residential revenue and sales as providing substantial stability. General service and irrigation customers, whose demand is more generally more volatile than that of residential customers, make up most of the other retail customers in terms of revenue and sales.

Customer concentration is moderate in the service area: BCPUD's top 10 customers provide about 25% of electric revenue, while the top customer provides 8%. Of the top 10 customers, six are in the large irrigation customer class. Among other agricultural products, Benton County produces potatoes, apples, sweet corn, onions, grapes, cherries, wheat, and hay. The top four BCPUD customers have remained the same over the past 10 years. Income levels in the service area are 112% of the national median, benefiting the rating. However, the unemployment rate in Benton County averaged 5.2% in 2018, above the state rate of 4.5% and the national rate of 3.9%.
In most months of the year, BCPUD is long on electricity and sells the excess into the market. With the district's slice/block BPA power sales agreement, the volume of secondary market sales depends on hydrological conditions. Over 2015 through 2018, secondary market sales ranged from 24% to 28% of BCPUD's total sales; the revenue from these sales ranged from 10% to 17% of the district's total revenue. We do not see the secondary market sales as a credit risk because of BCPUD's conservative budgeting process.

Market position: Very strong
In 2017, BCPUD's weighted average electricity rate was slightly below 90% of the state's average of other electricity providers. Specifically, residential rates were 86% of the state's average, commercial rates were 78%, and industrial 113%. The district increased its rates by about 3.9% in 2015, 4.9% in 2016, and 1.9% in 2017. The rate increases show the willingness of BCPUD to raise rates when needed, and we view this positively. The district will likely increase rates by 2.9% in October 2019. Even with the rate increase later this year, we expect BCPUD's weighted average rate to remain below 90% of the state average, providing rate-raising flexibility if needed. Although BCPUD lacks a power cost recovery mechanism, the combination of conservative budgeting of wholesale sales and BCPUD's advance knowledge of BPA costs mitigates concern regarding rate flexibility.

Industry risk: Extremely strong
Consistent with our "Methodology: Industry Risk" criteria, published Nov. 19, 2013, we consider industry risk for municipal retail electric and gas utilities covered under these criteria very low, and therefore extremely strong compared with that of other industries and sectors.

Financial Risk
Coverage metrics: Strong
BCPUD's FCC, which treats a percentage of BPA costs, Frederickson fixed costs, the district's portion of Nine Canyon Wind Project debt service, and a percentage of White Creek Wind Project costs as debtlke rather than as an operating cost, was 1.67x in fiscal 2018, 1.38x in fiscal 2017, and 1.28x in fiscal 2016. Over the past three audited years, FCC averaged 1.44x. Hydrological conditions in 2017 and 2018 were both significantly above average. Using projections provided by BCPUD, we calculate that FCC will drop in fiscal 2019 to 1.14x before rebounding to 1.36x to 1.39x in fiscal years 2020 through 2023. Projected coverage in fiscal 2019 is lower because of unfavorable hydrological conditions and extreme winter weather with Benton County's coldest February and March on record. In addition, on one weekend in early March 2019 power prices spiked because of extremely cold weather and lack of transmission on the Pacific DC Intertie as a result of maintenance. The projected 1.14x coverage in fiscal 2019 would not be viewed as strong, although FCC between 1.36x and 1.39x for the later projected years would be.

Liquidity and reserves: Very strong
BCPUD had 189 days of liquidity in fiscal 2018, providing a considerable cushion to meet financial obligations. The district's unrestricted reserves totaled $67 million, including $7.5 million in a rate stabilization fund and a $10 million line of credit. Projections show a decline in liquidity and reserves over the next five years. At a minimum, these metrics reach 128 days' liquidity and $50 million in reserves. The line of credit expires in 2021. As a distribution-only utility, BCPUD does not require reserves as large as those of a vertically integrated utility.
Debt and liabilities profile: Very strong
As of December 2018, BCPUD had $57.2 million in debt outstanding: $22.5 million in series 2016 revenue and refunding bonds, $17.3 million in series 2010 Build America Bonds, $13.5 million in series 2011 revenue and refunding bonds, and $3.9 million in unamortized premium. The district's debt-to-capitalization ratio was less than 30% in fiscal 2018. The ratio has strengthened over the past three years and is expected to further improve, as BCPUD amortized debt and has no plans to issue additional debt. We view a debt-to-capitalization ratio of less than 30% as manageable for a distribution-only utility. BCPUD employees participate in retirement plans administered by the Washington State Department of Retirement Systems. In 2018, the PERS Plan 2/3 was 96% funded; we do not consider the pension liability a credit risk.