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CREDIT OPINION
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New Issue

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# Benton County Public Utility District 1, WA

## New Issue - Moody's Assigns Aa3 to Benton County Public Utility District 1, WA's Electric Revenue and Refunding Bonds

### Summary Rating Rationale

Moody's Investors Service has assigned a Aa3 rating to Benton County Public Utility District 1, Washington's $22.7 million Electric Revenue and Refunding Bonds, Series 2016. Moody's also affirmed the Aa3 rating on the district's parity debt outstanding. Post-issuance, the district is expected to have $63.1 million in debt outstanding.

The Aa3 rating reflects the district's sizeable service area, generally strong financial operations and healthy debt service coverage, and an excellent rate-setting record demonstrating a strong willingness to adjust rates as needed. The rating also incorporates the district's reliance on contracted power from the Bonneville Power Administration's reliable hydrological system for a substantial portion of their supply.

### Credit Strengths

» Vast majority of power supply is from relatively low-cost federal Bonneville Power Administration (BPA)

» Rate increases do not require external approval, and district has proven record of increases

### Credit Challenges

» Moderate customer concentration in agriculture and related industries

» Power supply levels from BPA susceptible to fluctuations in hydrological conditions

### Rating Outlook

Outlooks are not usually assigned to issuers with this amount of debt outstanding.

## Factors that Could Lead to an Upgrade

» Material increase in liquidity

» Reduced customer concentration and further diversification of the district's service area

## Factors that Could Lead to a Downgrade

» Deterioration of liquidity levels

» Significant increase in debt profile

» Power supply levels from BPA susceptible to fluctuations in hydrological conditions

## Key Indicators

Exhibit 1

| Benton County Public Utility District 1, WA | | | | | |
|---|---|---|---|---|---|
| System Characteristics | | | | | |
| Asset Condition (Net Fixed Assets / Annual Depreciation) | 9 years | | | | |
| System Size - O&M (in $000s) | 116,753 | | | | |
| Service Area Wealth: MFI % of US median | 110.88% | | | | |
| Legal Provisions | | | | | |
| Rate Covenant (x) | 1.25 | | | | |
| Debt Service Reserve Requirement | DSRF funded at lesser of standard 3-prong test | | | | |
| Financial Strength | | | | | |
| | 2011 | 2012 | 2013 | 2014 | 2015 |
| Operating Revenue ($000) | 134,441 | 129,147 | 137,319 | 145,264 | 138,885 |
| O&M ($000) | 103,525 | 99,450 | 110,407 | 118,278 | 116,753 |
| Long-Term Debt ($000) | 62,330 | 59,575 | 56,635 | 53,600 | 49,735 |
| Annual Debt Service Coverage (x) | 4.03 | 3.60 | 3.14 | 3.38 | 2.93 |
| Cash on Hand | 153 days | 207 days | 160 days | 153 days | 142 days |
| Debt to Operating Revenues (x) | 0.5x | 0.5x | 0.4x | 0.4x | 0.4x |

*Source: Moody's Investors Service*

## Recent Developments

Recent developments are incorporated into the Detailed Rating Considerations.

## Detailed Rating Considerations

### Service Area and System Characteristics: Sizeable Service Area, Somewhat Concentrated in Agriculture; Power Source is Stable and Low-Cost

The district, located in southeastern Washington, serves much of Benton County (Aa2 Issuer Rating) with the exception of the City of Richland, which owns and operates its own electric utility. The county comprises the bulk of the Tri-Cities area in south central Washington along the Yakima and Columbia Rivers. Historically, the Tri-Cities economy was largely supported by the federally funded cleanup and conversion of the Hanford Nuclear Reservation, however the local economy and employment have recently been less reliant on Hanford-related employment. Agriculture and related food processing remain important components of the local economy and a substantial portion of the district's revenues are derived from manufacturing firms and from agricultural interests with large

power needs for irrigation. The top 10 customers, representing 24% of revenues and 32% of MWhs sold, are somewhat concentrated, with farms representing six of the top 10.

The district has been a statutory preference customer of the Bonneville Power Administration (BPA) since 1946 and currently purchases nearly all of its power from BPA. Like many of its peers in the Northwest, the district's Block and Slice Power Sales Agreement with BPA is in effect through September 2028. The district has a block (guaranteed power delivery) of 103 aMW. During critical water years, when power generation is lowest, the district expects to receive an additional 96.3 aMW as part of their slice; in average water years, they expect to receive 125.3 aMW. The district's projected 2017 load requirement is 207.6 aMW, which can be met by BPA power alone during average water years. The district's remaining power supply requirements, if any, are supplied by contract purchases. The district achieved its 2016 Renewable Portfolio Standard target of 9% due to its participation in the Nine Canyon Wind Project and the purchase of capacity from the White Creek Wind Project. The district sells into the market any surplus it has from these sources. We expect the district to continue to perform well against future renewable energy standards given their advance planning and access to renewable resources if needed.

Similar to many public utilities in the Northwest, the district has a Resource Management Agreement (RMA) with The Energy Authority (TEA) to provide scheduling, dispatching, fuel management and other power management services. The arrangement allows the district to operate more efficiently during peak-power needs due to the larger base and diversity of customers across the other proximal public utilities that are also members. This provides significant benefit to the district as it is a "double-peaker," with peak demand in both summer months (due to irrigation needs and weather-related demand) and winter months (largely due to weather-related demand).

### Debt Service Coverage and Liquidity: Strong Coverage and Adequate Liquidity

The district's debt service coverage has consistently outperformed projections, even in 2015, which presented the district with several challenges. Debt service coverage exceeded 3-times from 2011 to 2014, and dropped to a still-strong 2.93 in fiscal 2015. The drop in coverage was largely due to the warmest year on record in the Tri-Cities area, which reduced sales significantly, especially during the winter months. Additionally, net power costs were slightly higher than budgeted due to the third-worst water year on record, which reduced the supply from BPA. In 2016, warm winter weather in the first few months of the year continued to reduce demand, however net power costs were lower than projected as water flows are near average for the year. Debt service coverage is expected to be 2.84-times, with 134 days cash on hand, by year-end.

Most of the district's operating revenue is from retail energy sales (84%), however the district also receives 12% of operating revenue from wholesale activity from surplus power supplies. Wholesale market prices have been volatile, and the amount of surplus power changes based on weather, water flows, and other factors. Positively, wholesale activity represents a smaller portion of the district's revenues than in previous years, and the district has effectively managed with lower wholesale revenues.

The district's projections are driven by conservative assumptions. Even with the most conservative assumptions used by the district, debt service coverage is expected to exceed 2.8-times with moderate rate increases of 4.9% in 2017 and 2019. (The district is not projecting a rate increase in 2018 as they will be moving the timing of rate increases from September to April in order to better capture revenue from increased summer demand.)

#### LIQUIDITY

The district's liquidity is strong at 142 days in fiscal 2015. The district is projecting cash to be roughly equal in future years, with a moderate decline in the most conservative scenarios. The board requires unrestricted reserves at least equivalent to 90 days of cash-on-hand, not including designated funds, and management's target is 120 days by the same measure. Moody's measures cash including most designated funds, so our calculation is somewhat higher.

### Debt and Legal Covenants: Debt Profile is Low; Standard Legal Provisions

The district's debt profile is low at 0.45-times operating revenues. Post-issuance, the district is expected to have $63.1 million in debt outstanding, all of it on parity with the current issuance.

Satisfactory legal provisions include a rate covenant which requires 1.25 times coverage of annual debt service requirements, a 1.25 times additional bonds test, and a standard cash- or surety-funded reserve requirement employing the lesser of the standard three-prong test.

#### DEBT STRUCTURE

All of the district's debt is fixed-rate. Annual debt service is roughly equal at $6.5 million through 2021, when debt service decreases in steps to $5.5 million in 2022, $4.5 million in 2023 through 2030, and finally to $1.6 million in 2031 before final maturity in 2041.

#### DEBT-RELATED DERIVATIVES

The district has no debt-related derivatives.

#### PENSIONS AND OPEB

The district provides pension benefits through the state's defined benefit and cost-sharing plans of the Washington Department of Retirement Systems. The district fully funds its actuarially required contributions annually to the state system, including a modest contribution expense of $1.3 million in FY2015 (equivalent to 1% of operating revenues). The district has no Other Post-Employment Benefit (OPEB) plans.

### Management and Governance: Solid Policies and Practices Maintain Healthy Finances

The PUD benefits from local rate-setting authority that does not require external approval. The district's board has increased rates five times since 2010 and currently plans to increase rates twice in the next three years. The district is expecting to adjust the rate structure to better align fixed and variable costs with fixed and variable rate revenue.

The district's board has set several policy targets that demonstrate a healthy focus on stable financial management. For example, the legal covenants for the bonds require rates that collect net revenues at least 1.25-times debt service, however the commission has set a policy to maintain coverage that is at least 1.75-times debt service, excluding capital contributions. Additionally, the board requires unrestricted reserves at least equivalent to 90 days cash-on-hand, not including designated funds, and management's target is 120 days including designated funds.

## Legal Security

The bonds are secured by the net revenues of the electric system.

## Use of Proceeds

Proceeds will be used to fund various capital projects of the district. The district may also use a portion of the proceeds to refund outstanding parity bonds.

## Obligor Profile

The Benton County Public Utility District provides electric service to approximately 51,000 customers in a service area in Benton County, located in southeastern Washington. The district serves the cities of Kennewick (population 79,120), Prosser (5,940), and Benton City (3,325) as well as portions of the surrounding area. The district does not provide power to the U.S. Department of Energy's operations on the Hanford Reservation, nor to the cities of Richland and West Richland, which are served by other providers. The PUD is a preference customer of BPA and reserves the majority of its energy from this agency.

## Methodology

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

## Ratings

Exhibit 2

### Benton County Public Utility District 1, WA

| Issue | Rating |
|---|---|
| Electric Revenue and Refunding Bonds, Series 2016 | Aa3 |
| Rating Type | Underlying LT |
| Sale Amount | $22,705,000 |
| Expected Sale Date | 09/16/2016 |
| Rating Description | Revenue: Government Enterprise |

*Source: Moody's Investors Service*

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