FITCH AFFIRMS BENTON COUNTY PUD NO. 1, WA'S ELECTRIC REV BONDS AT 'A+'; OUTLOOK STABLE

Fitch Ratings-San Francisco-28 August 2018: Fitch Ratings has affirmed the following bonds issued by Benton County Public Utility District No. 1, WA:

--Approximately $57.0 million electric revenue and refunding bonds, series 2010, 2011, and 2016.

The Rating Outlook is Stable.

SECURITY

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

KEY RATING DRIVERS

RETAIL DISTRIBUTION SYSTEM: Benton County Public Utility District No. 1 (the district) provides electric service to a growing region in southeastern Washington. The district's customer base is moderately concentrated with the single largest customer accounting for 10.1% and 7.8% of retail MWh sales and retail revenues, respectively, in 2017.

SOLID FINANCIAL METRICS: The district's financial metrics are sound for the rating. Fitch calculated coverage of full obligations improved to 1.38x in 2017 from 1.27x in fiscal 2016, the result of a rate increase and higher energy sales due to favorable weather conditions. Coverage levels are expected to remain stable over the medium term. Liquidity levels remain ample, with 158 days cash on hand at year-end 2017.

CASH-FUNDED CAPEX, ADEQUATE LEVERAGE: Liquidity levels are expected to be reduced temporarily as the district plans to cash-fund capex over the next few years. An expected reduction of fixed obligations in 2022 should bolster margins at that time and restore reserve levels over the longer term. The lack of debt issuance plans should continue to moderate the district's debt burden. Net adjusted debt to adjusted FADS of 4.8x in 2017 compared favorably to Fitch's June 2018 'A+' median of 5.9x.

WHOLESALE REVENUES: Regular retail rate increases over the past decade have greatly reduced but not eliminated the district's exposure to wholesale revenue variability. Consequently, the district's financial results remain modestly exposed to the amount of energy available for surplus sales and volatile market pricing. Wholesale revenues accounted for approximately 9.7% of total operating revenues in 2017.

HYDRO-BASED POWER SUPPLY: Power supply needs are largely met through a long-term contract with the Bonneville Power Administration (BPA) that exposes the district to hydrology risk and a variable energy supply. Purchase power contracts for wind and renewable energy credits (RECs) are in place to comply with the state's renewable portfolio standard.

COMPETITIVE RATES: The district's rates remain competitive following recent rate increases. Additional increases projected for three of the next four years to match rising BPA rates, system capital needs, and other cost pressures are expected to be modest.

RATING SENSITIVITIES

SUSTAINED IMPROVEMENT IN FINANCIAL MARGINS: Benton Public Utility District, WA expects a structural decline in operating costs to occur in 2022. Over time, the anticipated decline in operating costs, coupled with the declining debt burden and continued healthy liquidity, may lead to sustained improvement in financial margins which could result in positive rating action.

CREDIT PROFILE

The district provides retail electric services in a 939-square-mile service area of Benton County, Washington. Service area characteristics are favorable with 1.6% growth in average retail energy sales over the last five years and wealth and unemployment levels in line with state averages. The district also provides broadband services, which comprised 1.4% of 2017 revenues and presents limited revenue risk to combined utility operations. The majority of the district's customers are located within the cities of Kennewick, Prosser, and Benton.

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 of the U.S Department of Energy on the Hanford Reservation or the rural areas in the county which are served by the Benton Rural Electric Association.

The district's assets include 98 miles of 115 kV transmission lines, 1,675 miles of distribution lines, 37 substations, and contractual rights to purchase power and renewable energy credits (RECs) under various long-term agreements that exceed the district's power needs under average water conditions. Energy needs are predominately met with power purchased from BPA, with remaining requirements met through power purchase contracts and market purchases.

EXPOSURE TO WHOLESALE SALES

The district has continued its strategic shift towards a greater reliance on retail revenues following the sharp and persistent decline in wholesale market prices since 2008. While efforts have been successful, wholesale sales of surplus power continue to result in variability in the district's financial performance. Wholesale revenues contributed 9.7% of total operating revenues in 2017.

SOLID FINANCIAL PERFORMANCE

Fitch-calculated coverage of full obligations has narrowly ranged between 1.3x and 1.4x in four of the last five years, levels that are viewed as consistent with the rating. Coverage of full obligations rose to 1.4x in 2017, as favorable weather and water conditions drove improvement in margins and a 1.9% rate increase was implemented in the final months of fiscal 2017. Similarly healthy energy sales continue to support positive year-to-date results in 2018. Coverage levels are expected to remain stable in management's financial forecast until a portion of fixed obligations begin to roll off from 2022 onwards.

Liquidity levels remain solid for the rating. At the end of 2017, the district had $56.8 million in cash and investments or 158 days cash on hand. The district also maintains a $10 million revolving line of credit. Reserve levels are expected to decline with upcoming capital spending but should remain adequate for the rating.

MANAGABLE CAPEX; ADEQUATE LEVERAGE

The district has relatively heightened capital needs driven by reliability and growth objectives requiring substation and transmission investment. While the expectation is to fund the estimated $89 million spend from 2018 to 2022 with available reserves and operating cash flow, reserve levels are expected to be restored over the longer term.

The lack of debt issuance plans in the coming years improves the district's future debt capacity. While leverage, as measured by net adjusted debt to adjusted FADS, is expected to rise slightly in the short term due to reduced reserves related to capex, levels should begin to moderate thereafter.

PROPOSED CARBON REGULATION

Washington Initiative 1631, a proposed carbon fee, is on the Washington state ballot for November 2018. If passed, the district does not expect a material impact on its finances, with most of the adverse effects concentrated in its natural gas plant PPA that expires in 2022. Negative financial impacts are estimated to range between $1.0 million to $1.5 million annually from 2020 to 2022 and expected to be negligible thereafter.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Lumesis.

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Additional information is available on www.fitchratings.com

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. 18 May 2015)
https://www.fitchratings.com/site/re/864007