

Rating Action: Moody's upgrades Chelan County Public Utility District 1, WA's revenue bonds to Aa2 from Aa3; Outlook is stable

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Approximately \$276 million of rated debt affected

New York, August 10, 2022 -- Moody's Investors Service has upgraded Chelan County Public Utility District 1, WA's (Chelan PUD) rating to Aa2 from Aa3 on its revenue bonds. Outlook is stable.

RATINGS RATIONALE

Chelan PUD's upgrade to Aa2 reflects new long-term contracts, demonstrated conservative risk management, and extensive deleveraging by the district resulting in 60% lower funded debt at year-end 2021 compared to 2009. In 2021, the district entered into a 20-year, 'cost plus' contractual arrangement with Avista Corp. (Avista: Baa2 stable) that starts in 2026. Under this contract, Avista initially receives 5% of the Rocky Reach and Rock Island's (RRR) hydro dams combined output that rises to 10% in 2031 in exchange for paying its pro-rata share of costs plus additional charges. Also in 2021, Chelan PUD executed a 10-year slice agreement with Avista and a 5-year slice agreement with Puget Sound Energy (PSE: Baa1 stable) whereby each offtaker receives 5% of RRR's combined output for a fixed fee. These contracts substantially increase the duration of the district's hedging program that transfers both hydrology and market price risk to creditworthy 3rd parties while ensuring greater predictability of cash flow over the long term. Furthermore, these contracts highlight the demand and value of proven hydropower power given the state of Washington and Oregon's mandate for 100% clean electricity by 2045 and 2040, respectively.

Further supporting the district's credit quality are low retail rates, major progress on its capital program for its key hydro dams and strong financial metrics in either the 'Aa' or 'Aaa' category. For 2021, the utility had Moody's adjusted debt service coverage ratio (DSCR) of 2.29x, adjusted debt ratio of 39%, and 379 days cash on hand. Cash to debt was also robust at around 77% as of year end 2021. Looking forward, we expect DSCR around 2.0x-2.5x, liquidity around 250-300 days cash on hand, and cash to debt exceeding 70%.

The utility's credit quality further considers its service area's relative weaker socio-economic characteristics for the utility's rating and exposure to volatile wholesale market and hydrology conditions, which remain the district's most significant long-term risk especially as the utility relies on non-retail revenue to subsidize its retail business. That said, the district has demonstrated its ability to manage market and hydrology risk through maintenance of strong liquidity, extensive deleveraging, strong financial metrics and execution of a medium to long term hedging program.

The rating upgrade also acknowledges the recent rating upgrade of Alcoa Nederland Holding B.V. (Alcoa: Baa3 stable), which is a wholly owned subsidiary guaranteed by Alcoa Corporation (Alcoa Corp). Alcoa Corp is a major offtaker to the district's RRR hydro dams with a 26% share of the output through 2028. Alcoa's upgrade considered its improved cash flow generation, competitiveness, strengthened balance sheet, excellent liquidity position and financial policy (see Moody's press release on Alcoa dated July 26, 2022).

RATING OUTLOOK

The stable outlook considers the district's forecast of maintaining 250-300 days cash on hand, expected debt service ratio in the 2.0x-2.50x range, and the continuation of its risk management policies including hedging.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- The district's rating could be upgraded if its service area's economic strength substantially improves and it sustains high liquidity and DSCR comfortably exceeding 3.0x.

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Chelan PUD's rating could be downgraded if its liquidity declines below 250 days cash on hand or debt service coverage is below 2.0x on a sustained basis. Additionally, the utility's rating could be downgraded if its

risk management weakens, its key assets have major operational problems, or if there is a significant decline to overall counterparty credit quality or termination of major, long-term contracts.

LEGAL SECURITY

The Consolidated System revenue bonds are secured by a lien on the net revenues of the Consolidated System, which consists of the electric distribution system, Lake Chelan hydro project, the water and waste water system, and the fiber optic system. The rate covenant and additional bonds test is 1.0x based net revenue and 1.25x including other available funds, respectively. The Consolidated System revenue bonds have a cash funded debt service reserve equal to maximum annual interest.

The Rock Island revenue bonds are secured by a pledge of the net revenues of the Rock Island system, which includes the district's electric distribution system. Chelan PUD is obligated to pay for its share of Rock Island's costs including debt service whether or not the dam is suspended or interrupted and the district is required to take any portion of the output not sold to others. The rate covenant requires 1.0x coverage and there is no additional bonds test. The debt service reserve requirement is sized to maximum annual interest and is cash funded.

PROFILE

Chelan County Public Utility District 1 is a public power utility that provides electric, water, wastewater and fiber-optic services in Chelan county (unrated), Washington. The combined electric and hydro systems represent nearly all of the revenues and assets of the consolidated enterprise. The utility owns three hydro projects totaling 1,988 MW.

METHODOLOGY

The principal methodology used in these ratings was US Public Power Electric Utilities with Generation Ownership Exposure Methodology published in August 2019 and available at <https://ratings.moodys.com/api/rmc-documents/63746>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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