

## RATING ACTION COMMENTARY

### Fitch Affirms Chelan County PUD, WA's Consolidated Sys and Rock Island Revs at 'AA+'; Outlook Stable

Tue 27 Feb, 2024 - 2:52 PM ET

Fitch Ratings - Austin - 27 Feb 2024: Fitch Ratings has affirmed the following ratings for Chelan County Public Utility District No. 1 (the district), WA at 'AA+':

--\$147.8 million consolidated system revenue and refunding bonds series 2011C, 2020A, 2020B, and 2020C);

--\$40.2 million consolidated system revenue bonds, series 2008B (underlying and bank bond rating);

--\$130.9 million Rock Island Hydroelectric project revenue bonds, series 1997A (separately secured by project revenues);

--Long-Term Issuer Default Rating (IDR).

The Rating Outlook is Stable.

## RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕
Chelan County Public Utility District No. 1 (WA)	LT IDR AA+	Affirmed
		AA+

Chelan County Public  
Utility District No. 1  
(WA) /Electric  
System Revenues -  
Consolidated  
System/1 LT

LT    AA+    Affirmed    AA+

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Chelan County Public  
Utility District No. 1  
(WA) /Electric  
System Revenues -  
Rock Island System/1  
LT

LT    AA+    Affirmed    AA+

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Chelan County Public  
Utility District No. 1  
(WA) /Electric  
System Revenues -  
Subordinated/2 LT

LT    AA+    Affirmed    AA+

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PREVIOUS

Page

1

of 1

10 rows



NEXT

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The 'AA+' rating reflects the district's very strong financial profile in the context of its 'a' revenue defensibility assessment and 'aa' operating risk assessment. The 'aa' financial profile assessment is very strong with high coverage and liquidity levels and very low leverage under 2.0x, calculated by Fitch as net adjusted debt/adjusted funds available for debt service. The financial profile is expected to remain very strong with continued debt amortization and full cash funding of substantial capex needs expected over Fitch's five-year forward look.

The district benefits from its sizable owned portfolio of very low-cost hydroelectric generating resources, which easily meets the needs of the county's retail electric demand and provides the district with the opportunity to sell surplus capacity and carbon-free energy on a wholesale basis. The district's strategic risk management practices hedge district revenues (and retail rates) from hydrology-based and operational risk.

The rolling hedging strategy on a portion of the wholesale sales does expose the district to medium-term price risk on that portion of sales, although this has been beneficial in the past two years, given the overall escalation of market prices in the northwest and across

U.S. energy markets. The wholesale business line does have exposure to counterparty risk, but the counterparties are typically investment-grade and contractual provisions provide some protections, including collateral posting requirements.

Large load growth is occurring in the service area, including construction that began in 2023 on a new Microsoft datacenter in Malaga, WA on parcels totaling just over 100 acres. Microsoft anticipates that construction could be completed in early 2026. The district received prepayment from Microsoft to make the capital infrastructure investments needed to serve the new load and energy supply is to be determined.

## **SECURITY**

The consolidated system revenue and refunding bonds are secured by a net revenue pledge of the consolidated system, which includes the electric distribution, water, wastewater, fiber and telecommunications systems, and the Lake Chelan hydroelectric project. The Rocky Reach and Rock Island systems are not part of the consolidated system. Revenues of the Rocky Reach and Rock Island systems are used to pay costs of those systems and include revenues paid by the consolidated systems to those projects for the retail share of project generation.

Rock Island project-specific bonds are secured by a separate senior lien net revenue pledge from the project with a credit backstop provided by the distribution system.

## **KEY RATING DRIVERS**

### **Revenue Defensibility - 'a'**

Significant Wholesale Sales Under Medium and Long-term Contracts; Very Low Retail Rates

Revenue defensibility is strong, but exposure to counterparty risk remains a concern. Currently, Fitch believes much of the risk is mitigated through contractual provisions, collateral postings and the ability to remarket the very low-cost power in the unlikely event of a counterparty default. Of the district's ample 2,037 MW in hydroelectric generation capacity, less than a quarter is necessary to meet the needs of its retail customers. The vast majority of excess power is sold to third parties through long- or medium-term contracts designed to largely insulate the district from price and hydro-variability risks. The reliance on the remaining relatively modest amount of revenue from competitive sources (between 5% and 10% on average) is considered manageable.

Retail rates are independently set by the district's board of commissioners and rate flexibility is considered very strong. Service area demographics and demand characteristics are favorable, but mixed. Unemployment is above the national average, the county median household income is just below the national average, and customer growth is flat. Coupled with the asymmetric credit factor considerations associated with the excess power supply and counterparty risk, these factors constrain the revenue defensibility assessment to 'a'.

### **Operating Risk - 'aa'**

**Exceptionally Low-Cost and Robust Hydroelectric Resources; Robust Capex Planned**

The district's operating risk assessment reflects its valuable hydropower generation resources at the Rocky Reach, Rock Island and Lake Chelan projects that provide exceptionally low-cost electric power. Chelan's hydro assets remain in demand as the need for carbon-free hydropower products remains solid. Fitch's operating cost burden metric is very low at 3.6 cents per KWh on average over the last five years, with some variability in the metric due to hydrology. Operating cost flexibility is considered weaker given the concentration in a single fuel type, but the assets provide significant benefits, and concentration risk does not constrain the operating risk assessment.

The district's consolidated five-year capital improvement plan (CIP) is estimated at \$920.7 million between 2024 and 2028. The CIP includes the continuation of major spending for Rock Island project to modernize certain of the 19 units (\$426.7 million). Rock Island's existing 50-year Federal Energy Regulatory Commission (FERC) operating license will expire in 2028. The district began the formal relicensing process in 2023 and will seek another 50-year operating license. Although the relicensing process is lengthy, with numerous interested parties, there are no competing applicants for the operating license.

The district did agree with FERC in 2019 on the need for over \$600 million in investments at Rock Island, including rehabilitation of the powerhouses, improvements to the spillway, and implementation of a habitat conservation plan. This spending is included in the current CIP and will be incorporated by FERC during the relicensing process and considered when establishing the maximum term of the district's next operating license. The CIP is expected to be funded with cash from operations; no additional debt is expected.

### **Financial Profile - 'aa'**

**Very Strong Financial Profile; Very Low Leverage**

The district's combined financial metrics remain very strong with coverage of full obligations at a consistently robust 2.5x or better and unrestricted cash at the end of 2023 (unaudited) of \$359 million, or over 350 days cash on hand (DCOH). These levels exceed the district's financial policies of 2.0x debt service coverage and 250 DCOH.

The district has proactively used above-budget margins produced by higher wholesale market energy prices in recent years to rapidly decrease leverage through optional and scheduled debt payments while preparing for a period of increased capital spending. This has positioned the district well to address the upcoming larger capital plan with no anticipated new debt over the next five years.

In Fitch's five-year forward look and stress scenario, leverage ratios should remain exceptionally low, below 2.0x. Liquidity and coverage levels should remain very healthy through the forward look. Assumptions include the district's planned capex funded from cash flow from operations with no additional debt issuance. The district assumes that the relatively modest overall unhedged portions of their excess supply will be hedged within each year, but the limited reliance on the forward price curve is not expected to disrupt Fitch's financial profile assessment.

### **Asymmetric Additional Risk Considerations**

There are no asymmetric additional risk considerations associated with this rating.

### **RATING SENSITIVITIES**

#### **Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade**

--Reduced demand for the district's wholesale products for any reason, or persistently low wholesale market prices, which result in lower operating margins and sustained leverage above 4x.

#### **Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade**

--An upgrade to 'AAA' is unlikely given the counterparty considerations and risk associated with managing the district's excess power supply.

### **PROFILE**

The district provides electric, water, wastewater and wholesale telecommunications service throughout Chelan County, WA (aka, the consolidated system) and wholesale power supply to a variety of regional electric customers. The integrated electric system,

which includes the retail electric utility and the hydro-generating projects, accounts for over 90% of the combined systems' revenues, and serves as the primary driver of the rating. Additionally, modest revenues are derived from the water and wastewater utility and the fiber telecom network, which combined account for less than 4% of the combined systems' revenues. The district's retail electric system serves approximately 52,850 retail customers in the county.

Fitch views the district and its separately secured Rock Island project debt as a combined, integrated system. While the distribution system and the individual hydro-generating projects are accounted for and can be financed separately, they are managed and operated as an integrated system, with the same management team and loans flowing between the systems. As such, Fitch rates all the outstanding bonds in line with the district's 'AA+' IDR.

### **Sources of Information**

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

### **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

### **ESG CONSIDERATIONS**

Chelan CountyPUD's ESG Relevance Score of '2' for GHG Emissions & Air Quality varies from the public power sector guidance score of '3' because carbon-free systems (hydro, wind, nuclear, biomass and biowaste, and geothermal) are not significantly exposed to the generation of GHG emissions from operations.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit

<https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

## **PARTICIPATION STATUS**

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

## **APPLICABLE CRITERIA**

[U.S. Public Power Rating Criteria \(pub. 03 Mar 2023\) \(including rating assumption sensitivity\)](#)

[U.S. Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 12 Jan 2024\) \(including rating assumption sensitivity\)](#)

## **APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

[FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 \(1\)](#)

## **ADDITIONAL DISCLOSURES**

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

[Endorsement Policy](#)

## **ENDORSEMENT STATUS**

Chelan County Public Utility District No. 1 (WA)

EU Endorsed, UK Endorsed

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