FITCH UPGRADES ENERGY NORTHWEST WIND PROJECT REV BONDS TO 'A'; OUTLOOK REVISED TO STABLE

Fitch Ratings-Austin-25 November 2019: Fitch Ratings has upgraded the following bonds issued by Energy Northwest, WA (ENW) to 'A' from 'A-':

--Approximately $70.1 million nine canyon wind project revenue and refunding bonds series 2012, 2014 and 2015.

The Rating Outlook has been revised to Stable from Positive.

ANALYTICAL CONCLUSION

The rating upgrade is based on the strengthened credit quality of the Energy Northwest Nine Canyon Wind Project participants, whose payments are ultimately used to pay operating expenses and debt service on the bonds used to finance all three phases of the project. Payments from 10 project participants are made pursuant to identical take-or-pay power purchase agreements (PPAs) with Energy Northwest that extend to 2030, the date of the final bond maturity for any debt related to the project. The obligations of the project participants are absolute and unconditional and are not dependent on operations of the wind project.

The very strong credit quality of the largest project participants is supported by their monopolistic utility operations, autonomous rate setting authority, very high rate affordability and very low operating costs. These credit characteristics of the largest project participants are reflected in Fitch's purchaser credit quality assessment of 'a'. Moreover, given the limited 25% reallocation of costs among the project participants, the ratings are capped and currently constrained by the credit quality of the largest participants across all three phases of the project, including Grays Harbor Public Utility District No. 1 ('A'/Stable), whose individual project shares exceed the protection afforded by the step-up provision and who shares in the project operating cost.

Fitch rates all three series of bonds the same despite the different mix of project participants as the pledge of net revenues of the project, follows the payment of operating expenses, exposing each project to non-payment by participants not involved in their separate phase of the project.

CREDIT PROFILE

ENW has 27 members, consisting of 22 public utility districts and the cities of Richland, Seattle, Tacoma, Centralia, and Port Angeles, WA. ENW owns and operates a nuclear generating station, Columbia Generating Station, the Packwood Lake Hydroelectric Project, the Nine Canyon Wind Project, and the White Bluffs Solar Station. Each of the projects is separately financed. ENW members participate in various projects for specific percentages of the capacity and energy, resulting in differing credit quality for each of the projects, depending on the underlying members, power sales contract terms, and project economics

The Nine Canyon Wind Project was developed by ENW to provide renewable energy to ten public utility districts in the state of Washington. The project consists of 63 wind turbines totaling 95.9 MW of capacity that were completed in three phases between 2002 and 2008. The turbines are located in Benton County, WA on land that is leased beyond the final repayment of the bonds. Production has been healthy with an average capacity factor of 27% over the last five fiscal years.

KEY RATING DRIVERS

Revenue Defensibility: 'a'; Strong Contractual Framework; Very Strong Purchaser

Strong revenue defensibility reflects the contractual obligations underpinning the project, which are absolute and unconditional but only provide for a limited reallocation of costs through the 25 % step-up provision in the PPAs. The 'a' assessment also reflects the purchaser credit quality (PCQ) assessment of 'a' and considers a rating cap based on the credit quality of the five largest project participants, given the direct bondholder exposure to the project overall and within each of the three phases.

Operating Risk: 'a'; Low Cost Wind Power

The operating risk assessment is driven by the low operating cost of the wind project and the relatively small magnitude of the project costs as a percentage of each project participant's total costs. Importantly, the take or pay structure of the contract requires payment by the participants regardless of whether the project is operating or operable.

Financial Profile: 'aa'; Financial Profile Less of a Rating Factor

Financial operations are balanced and sufficient revenues are collected from the project participants to pay operating costs, capex and debt service on the bonds. The leverage profile and financial profile of the project are less of a consideration in Fitch's determination of the overall rating given the pass-through nature of the project and the contractual obligation of the project participants.

Asymmetric Additional Risk Considerations

There are no asymmetric risk considerations that affect the overall rating.

RATING SENSITIVITIES

Change in Participant Credit Quality: The long-term rating of the Energy Northwest (ENW) nine canyon wind project bonds will continue to be determined by Fitch's assessment of the credit quality of the largest project participants in each phase of the project. Therefore, material shifts in the rating or credit quality of purchasing utilities below the current rating on the bonds could result in a downgrade. Conversely, shifts in the rating or credit quality of all of the utilities above the current rating on the bonds would result in an upgrade.

SECURITY

Bonds are secured by a net revenue pledge of the entire nine canyon wind project, which consists of three phases. However, each phase (and bond series) is separately secured by a unique group of public utility district power purchasers, although certain purchasers are involved in multiple phases.

Revenue Defensibility

ENW receives revenues from the project participants in accordance with the absolute and unconditional PPAs that obligate each purchaser for its share of debt service and operating costs for the phases of the project in which it participates. The PPAs terminate in 2030 for each of the three phases, even though the debt matures sooner (2023) for two of the phases. Operating costs of the project are spread across the three phases.

Participant obligations are several, not joint, but a 25% step-up provision allows for a limited reallocation of debt service costs across each phase in the event of a default by a participant. If a purchaser fails to pay its obligation, Energy Northwest may reallocate the defaulting participant's share of the phase to each other non-defaulting purchaser in that phase, up to an additional 25% of its original share of that phase. The reallocated share includes O&M and debt service. The step up is not sufficient to cover a default by a single purchaser (or combination of purchasers) having a share in a particular phase in excess of 20%.

Bondholders have exposure to project participants over 20% of any of the three phases, which includes: Okanogan PUD, Grant PUD, Douglas PUD, Grays Harbor PUD, and Franklin PUD. Given the net revenue pledge of the three phases on a combined basis, bondholders are also subject to the risk in the event of non-payment of operating expenses by participants not involved in their respective phase of the project.

The PPAs define specific events that allow for the project to be terminated in the event of large cost increases (payment cap) or failure of the project to operate for over one year and agreement by the majority of the project participants to terminate. However, purchasers remain obligated to pay debt service in the event of project termination.

Rate Flexibility

Rate flexibility is assessed at very strong given Energy Northwest's ability under the PPAs to establish rates at the discretion of the Board of Directors to recover full costs of the project. Similarly, each of the project participants has local control over its own rates and rate setting processes

Purchaser Credit Quality

Fitch has assessed the purchaser credit quality at 'a', based on the credit characteristics of the largest project participants. The power purchasers and their overall shares of the project in aggregate are as follows:

--Grays Harbor County PUD No. 1 (20.9%; A/Stable);
--Okanogan County PUD No. 1 (16.6%; not rated);
--Grant County PUD No. 2 (12.5%; AA/Stable);
--Franklin County PUD No. 1 (10.5%; not rated);
--Douglas County PUD No. 1 (10.2%; not rated);
--Benton County PUD No. 1 (9.4%; AA-/Stable);
--Chelan County PUD No. 1 (8.3%; AA+/Stable);
--Lewis County PUD No. 1 (6.3%; not rated);
--Mason County PUD No. 3 (3.2%; not rated);
--Cowlitz County PUD No. 1 (2.1%; A/Stable).

Because bondholders have direct exposure to Okanogan PUD, Grant PUD, Douglas PUD, Grays Harbor PUD, and Franklin PUD, these five participants are weighted most heavily in Fitch's assessment of purchaser credit quality. The ratings are currently capped by the rating of Grays Harbor County PUD No. 1 but will continue to be constrained by the weakest credit quality of these five participants.

Operating Risk

The Fitch calculated cost of energy produced by the project is assessed as low, averaging 5.8 cents per kilowatt hour (kWh) over the last five years. While project costs are above market energy prices in the region, participants are obligated to pay project costs regardless of operations and market alternatives. The project accounts for a relatively small share of most of the participants' total energy supply and the renewable aspect of the project provides additional value to certain purchasers subject to Washington's renewable portfolio standard requirements. Overall costs are expected to remain level while cost per kWh will vary with annual wind conditions. With wind condition variability, the capacity factor of the project (all three phases) has ranged between 24% and 31% over the last five years.

Fitch assesses operating cost flexibility as weaker given the single source of energy supplied by the wind project, albeit through three phases of development. However, it does not constrain the overall operating risk assessment of 'a'.

Capital needs of the project are limited and expected to be recovered as part of the annual billing process. No additional debt is anticipated for the project.

Financial Profile

ENW operates the project on a cost basis, collecting rates that are sufficient to pay costs (including debt service). Given very strong cash reserves at the project, it has been ENW's intention to use modest amounts of this cash to pay a portion of costs. Successful cost management has allowed the delay of the planned spend down of reserves. At fiscal year-end 2019, unrestricted cash totaled approximately $14.8 million, or 937 days operating cash. Fitch calculated debt service coverage was 1.13x.

Fitch's calculates the project leverage ratio at 3.7x in fiscal 2019, a steady decline from 8.6x in fiscal 2014 as debt amortizes as scheduled. The leverage profile and financial profile are less of a consideration in Fitch's determination of the rating, as the rating is more heavily influenced by the credit quality of the project participants.

Outstanding debt totaled $18.3 million for Phase I (series 2014), $5.8 million for Phase II (series 2012), and $46.0 million for Phase III (series 2015). The Phase I and II debt matures on July 1, 2023 while the Phase III debt matures on July 1, 2030. Debt levels continue to exceed the net value of the project, resulting in negative equity levels. This is common for single asset public finance projects financed entirely with debt.

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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.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - 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.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

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Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 07 Nov 2019)
https://www.fitchratings.com/site/re/10099396
U.S. Public Power Rating Criteria (pub. 03 Apr 2019)
https://www.fitchratings.com/site/re/10066654