FitchRatings

Public Finance
Public Power
United States

Energy Northwest, Washington

Rating

Long-Term Revenue Bond Rating and Stand Alone Credit Profile (SCP)	A

Outlook

Stable

Outstanding Debt

Nine Canyon Wind Project Revenue Refunding Bonds	A

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (April 2023)

U.S. Public Power Rating Criteria (March 2023)

Related Research

Public Power - Fitch Analytical Comparative Tool (FACT) - 2023 (June 2023)

U.S. Public Power – Peer Review (June 2023)

U.S. Public Power and Electric Cooperatives Outlook 2023 (December 2022)

Analysts

Kathy Masterson
+1 512 215-3730
kathryn.masterson@fitchratings.com

Geneho Park
+1 646 582-3754
geneho.park@fitchratings.com

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

The 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 Ratings' purchaser credit quality (PCQ) assessment of 'a'. Given the limited 25% permitted step-up reallocation of costs among the project participants in the PPAs, the bond rating is capped and constrained by the credit quality of the largest Phase III participant, Grays Harbor County Public Utility District (PUD) No. 1 (A/Positive; 37.52% of Phase III).

The Positive Outlook on the bonds reflects the Positive Outlook on Fitch's Issuer Default Rating for Grays Harbor County PUD. Other Phase III participants include Franklin County PUD (25.00%), Benton County PUD (AA–/Stable; 18.63%), Lewis County PUD (15.71%) and Mason County PUD (3.14%).

Debt related to Phase I and Phase II of the Nine Canyon Wind Project was repaid at the final maturity date of July 1, 2023. The five project participants involved in Phase I and Phase II — but not Phase III — still make payments to ENW to pay the operating costs of those earlier two phases, but have no responsibility to make debt payments related to the outstanding series 2015 bonds used to finance Phase III of the project.

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 PUD power purchasers. However, certain purchasers are involved in multiple phases.

Key Rating Drivers

Revenue Defensibility — 'a'

Strong Contractual Framework; Strong Purchaser Credit Quality

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 ENW's independent rate-setting ability and the PCQ assessment of 'a.' Fitch considers the rating capped based on the credit quality of the two largest of the five project participants in Phase III, given the direct bondholder exposure to those two participants for repayment of the debt.

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. The take-or-pay structure of the contract requires payment by the participants regardless of whether the project is operating or operable. The operating cost flexibility is assessed as weaker given the single-asset nature of the project, but does not constrain the operating risk assessment or the rating.

Financial Profile — 'aa'

Financial Profile Less of a Rating Factor

Financial operations are balanced and sufficient revenue is collected from the project participants to pay operating costs, capex and debt service on the bonds. The project's leverage and financial profile 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.

Sensitivities

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

- A decline in the overall credit quality of the largest Phase III project participants, specifically Grays Harbor County PUD and Franklin County PUD.

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

- Improvement in the credit quality of the largest Phase III project participants, specifically Grays Harbor County PUD and Franklin County PUD.

Profile

ENW has 28 members, consisting of 23 PUDs 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 project 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

ENW developed the Nine Canyon Wind Project to provide renewable energy to 10 PUDs in Washington. The project consists of 63 wind turbines totaling 95.9MW of capacity completed in three phases between 2002 and 2008. The turbines are in Benton County, WA, on land leased beyond the final repayment of the bonds. Production has been healthy, with an average capacity factor over 29% during four of the last five fiscal years.

Revenue Defensibility

Revenue Source Characteristics

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, despite the debt maturing sooner — in 2023 — for Phase I and II. 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 if a participant defaults. If a purchaser fails to pay its obligation, ENW may reallocate the defaulting participant's share of the phase to each other nondefaulting 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 or combination of purchasers having a share in a particular phase exceeding 20%.

Bondholders have exposure to project participants over 20% of any of the three phases, which includes: Grays Harbor County PUD, and Franklin County PUD in Phase III. Bondholders are also subject to the risk in the event of nonpayment of operating expenses by participants not involved in their respective phase of the project given the net revenue pledge of the three phases on a combined basis. However, a default by the Phase III five participants on the operational costs of those phases is considered highly unlikely given the improved economics of the project cost for Phase I and II after the repayment of all debt.

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 an 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 ENW'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 assessed the PCQ at 'a' based on the credit characteristics of the largest project participants. The power purchasers and their entitlement shares of Phase III are as follows:

- Grays Harbor County PUD No. 1 (37.52%; A/Positive);
- Franklin County PUD No. 1 (25.00%; not rated);
- Benton County PUD No. 1 (18.63%; AA–/Stable);
- Lewis County PUD No. 1 (15.71%; not rated);
- Mason County PUD No. 3 (3.14%; not rated).

Grays Harbor County PUD and Franklin County PUD are weighted most heavily in Fitch's assessment of purchaser credit quality, given that bondholders have direct exposure to them. The ratings are capped by the rating of Grays Harbor County PUD and will continue to be constrained by the weakest credit quality of these two participants.

Asymmetric Factor Considerations

No asymmetric rating factor considerations affect the revenue defensibility assessment.

Operating Risk

Operating Cost Burden

The Fitch-calculated cost of energy produced by all three phases of the project is assessed as low, averaging 5.7 cents/kWh over the last five years. Project costs are above market energy prices in the region, but participants are obligated to pay project costs regardless of operations and market alternatives. The average project costs for Phase I and Phase II will decline in fiscal 2024, the first year that will include operating costs only and no fixed-debt costs. Phase III debt costs will continue to result in a higher cost for that phase through fiscal 2029.

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 and clean energy requirements. The capacity factor of all three phases of the project was 24%–31% over the last five years due to wind condition variability.

Operating Cost Flexibility

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 Planning and Management

The project capital needs are limited, and Fitch expects them to be recovered as part of the annual billing process. No additional debt is anticipated for the project.

Asymmetric Factor Considerations

No asymmetric rating factor considerations affect the operating risk assessment.

Financial Profile

Financial Profile and FAST Analysis

ENW operates the project on a cost basis, collecting rates sufficient to pay costs, including debt service. Coverage of full obligations is slim at approximately 1.0x. Unrestricted cash totaled approximately $14.6 million, or 799 days' operating cash, at fiscal YE 2022. Fitch's calculates the project leverage ratio at 1.6x in fiscal 2022, a steady decline from 4.8x in fiscal 2018 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 project participants' credit quality.

Debt Profile

Outstanding debt totals $32.0 million for Phase III (series 2015). Phase I and II debt matured on July 1, 2023, while Phase III debt matures on July 1, 2030. Debt continues to exceed the net value of the project, resulting in negative equity. This is common for single-asset public finance projects financed entirely with debt.

Asymmetric Additive Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

ESG Considerations

The ESG Relevance Score of '2' for GHG Emissions & Air Quality for the ENW Nine Canyon Wind Project varies from the public power sector guidance score of '3' because the largest purchasers have carbon-free power supplies. Carbon-free systems (hydro, wind, nuclear, biomass and biowaste, geothermal) are not significantly exposed to the generation of greenhouse gas emissions from operations.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Financial Summary

($000, Audited Fiscal Years Ended June 30)	2018	2019	2020	2021	2022
Net Adjusted Debt to Adjusted FADS (x)	**4.82**	**3.67**	**3.21**	**2.45**	**1.60**
Net Adjusted Debt Calculation					
Total Short-Term Debt	—	—	—	—	—
Total Current Maturities of Long-Term Debt	8,010	8,425	8,835	9,295	9,755
Total Long-Term Debt	85,343	75,625	65,647	55,367	44,792
Total Debt	**93,353**	**84,050**	**74,482**	**64,662**	**54,547**
+ Total Pension Obligation (GASB Fitch-Adjusted NPL + FASB PBO)	2,181	1,780	1,562	1,384	41
- Total Unrestricted Cash	13,192	14,840	14,820	15,081	14,545
- Restricted Funds for Debt Service	21,121	21,523	21,910	22,148	21,997
Net Adjusted Debt	**61,221**	**49,467**	**39,314**	**28,817**	**18,046**
Adjusted FADS for Leverage Calculation					
Total Operating Revenue	18,540	18,293	18,368	18,397	17,904
Total Operating Expenses	12,855	12,600	13,625	13,493	13,516
Operating Income	5,685	5,693	4,743	4,904	4,388
+ Depreciation and Amortization	6,831	6,822	6,820	6,835	6,871
+ Interest Income	90	963	676	51	—
FADS	**12,606**	**13,478**	**12,239**	**11,790**	**11,259**
+ Pension Expense	99	-6	-2	-31	-1
Adjusted FADS for Leverage	12,705	13,472	12,237	11,759	11,258
Coverage of Full Obligations (x)	1.06	1.13	1.03	0.99	0.94
FADS	**12,606**	**13,478**	**12,239**	**11,790**	**11,259**
Adjusted FADS for Coverage	12,606	13,478	12,239	11,790	11,259
Full Obligations Calculation					
Cash Interest Paid	4,288	3,905	3,500	3,075	2,629
Prior-Year Current Maturities	7,640	8,010	8,425	8,835	9,295
Total Annual Debt Service	**11,928**	**11,915**	**11,925**	**11,910**	**11,924**
Total Fixed Obligations	11,928	11,915	11,925	11,910	11,924
Liquidity Cushion (Days)	799	937	795	827	799
Unrestricted Cash (Days)	799	937	795	827	799
Liquidity Calculation					
+ Total Unrestricted Cash	13,192	14,840	14,820	15,081	14,545
Total Liquidity	**13,192**	**14,840**	**14,820**	**15,081**	**14,545**
Cash Operating Expense Calculation					
Total Operating Expense	12,855	12,600	13,625	13,493	13,516
- Depreciation and Amortization	6,831	6,822	6,820	6,835	6,871
Cash Operating Expenses	**6,024**	**5,778**	**6,805**	**6,658**	**6,645**

FADS – Funds available for debt service. PBO – Projected benefit obligation
Source: Fitch Ratings; Fitch Solutions; Energy Northwest, Washington

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.