FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Grant County PUD, WA Electric System Rev Rfdg Bonds 'AA'; Outlook Stable

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Fitch Ratings - Austin - 01 Nov 2023: Fitch Ratings has assigned a 'AA' rating to the following bonds issued by the Public Utility District No. 2 of Grant County, WA (the district):

--Approximately $47.3 million electric system revenue refunding bonds, series 2023-V.

Bond proceeds will refinance outstanding 2020S put bonds as 20-year amortizing debt and pay issuance costs. The bonds will be sold via negotiated sale on Nov. 15, 2023 subject to market conditions.

Fitch also affirmed the following district ratings at 'AA':

--$272.7 million electric system senior lien revenue and refunding bonds (prior to refunding);

--$834.4 million Priest Rapids Project (PRP) revenue and refunding bonds;

--The district's Issuer Default Rating (IDR).

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR

Grant County Public Utility District No. 2 (WA)	LT IDR	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Grant County Public Utility District No. 2 (WA) /Electric System Revenues/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Grant County Public Utility District No. 2 (WA) /Priest Rapids - Project Revs/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The 'AA' rating reflects Grant County Public Utility District No. 2's (Grant PUD) very strong financial profile assessment in the context of its 'a' revenue defensibility assessment and 'aa' operating risk assessment. The 'aa' financial profile is expected to remain stable over the next five years, with leverage, calculated as net adjusted debt/adjusted funds available for debt service, remaining at or below 6.0x and supportive of the rating. The district continues to maintain healthy liquidity and very low retail rates.

The district benefits from its sizable hydroelectric generating resources, which produce very low-cost power sufficient to meet the district's retail needs and provide the opportunity to sell surplus energy on a wholesale basis. The district's risk management strategies largely hedge revenue from hydrology-based volume risk, but the portion of wholesale energy sold under market-based pricing exposes the district to somewhat elevated revenue volatility on a meaningful portion of revenue (roughly 24% in 2022), which Fitch believes constrains the district's revenue defensibility at 'a'.

Under current load projections, significant new large-load industrial development in the district's service territory will require the procurement of additional energy resources after 2025. The addition of new resources will require compliance with state mandates requiring

District resource planning documents project the addition of up to 1.2 gigawatts of solar, wind, solar plus battery storage and natural gas procurement through purchase agreements or district development. Management expects the costs associated with building or procuring additional resources will largely be borne by the new industrial customers driving the growth.

SECURITY

Grant PUD's electric system bonds are payable from the revenue of the electric system after payment of distribution system operating expenses, inclusive of PRP resource costs.

The PRP bonds are payable from revenue received under unconditional power sales contracts that extend through 2052, coterminous with the expiration of the Federal Energy Regulatory Commission (FERC) license for the PRP.

KEY RATING DRIVERS

Revenue Defensibility - 'a'

Significant Wholesale Sales Supported by Various Contracts; Very Low Retail Rates

The 'a' assessment factors in the revenue risks and benefits of a growing but concentrated retail load and significant surplus wholesale energy sales that are exposed to market-based price risk. The assessment also reflects Grant PUD's strategy to hedge these risks, including slice contracts that largely mitigate hydrology-based volume risk. Anticipated district load growth stemming from industrial sector expansion will reduce energy available for wholesale sales and reduce revenue subject to competitive pressure over the next five years.

Retail rates are independently set by the district's board of commissioners, and rate affordability is considered very strong. Service area demographics are mixed. Unemployment is well above the national average, and the median household income is below average, but the area was bolstered by strong customer growth of 1.4% over the last five years.

Operating Risk - 'aa'

Ample, Very Low-Cost Hydroelectric Resources

upward pressure, although the district's capital spending has increased as modernization investments are made and FERC-required relicensing requirements are determined.

Operating cost flexibility is considered weaker given the concentration in hydro assets, but in Fitch's view, the assets provide significant benefits, and concentration risk does not reach a level that constrains the operating risk assessment.

The district's consolidated five-year capital improvement plan (CIP) is estimated at $811 million, with spending on electric system improvements (59% of total) marginally higher than on PRP capital projects (41% of total). Approximately 70% of the CIP is expected to be funded with rate revenue.

Financial Profile - 'aa'

Very Strong Financial Profile

The district's financial profile is very strong, with coverage of full obligations (COFO) consistently above 1.5x, which includes multiple years of $50 million cash defeasances of outstanding maturities. Operating margins were consistently above 26% over the past five years. Leverage remains very low for the risk profile, declining to a five-year low of 3.6x at YE 2022. Liquidity remains healthy, well in excess of the district's 250 days cash on hand (DCOH) target.

Fitch's forward-looking scenario indicates an increase in leverage as a result of reduced wholesale sales revenue and increased capital spending. However, leverage is expected to remain adequate for the rating at below 6.0x throughout Fitch's base and stress cases.

Asymmetric Additional Risk Considerations

There are no asymmetric additional risk considerations affecting this rating.

RATING SENSITIVITIES

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

--Inability to effectively manage the various hedging agreements while maintaining a strong

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

--Consistently higher funding in rates to support capex that produces a materially lower leverage profile could result in upward rating movement.

PROFILE

The district is a vertically integrated electric utility serving retail customers throughout Grant County, WA, with a retail customer base of approximately 54,000. The district maintains and accounts for two operating systems: the electric distribution system, comprising 4,427 miles of transmission and distribution lines, and the PRP generating assets, which include assets from Priest Rapids and Wanapum. The Priest Rapids assets consist of a dam and hydroelectric generating station with a nameplate capacity of 950MW, while the Wanapum assets consist of a dam and hydroelectric generation station with a nameplate capacity of 1,222MW, for total combined generating capacity of 2,172MW.

The district issues debt payable from the electric system and the net revenues of the consolidated generation system, called the PRP. The PRP hydroelectric generation assets were combined under a new power sales contract, with all energy output sold to the electric system, effective Nov. 1, 2009, that extends through the life of the FERC license expiring April 1, 2052. Fitch rates the district and its debt as a single, integrated system, which includes the debt of the electric distribution system and the PRP and does not distinguish the district's ratings based on security given the consolidated view of the obligations. Fitch's financial analysis and calculated metrics are based on the consolidated system.

PRP debt is secured entirely by unconditional payments from the electric system, reduced by any revenue the PRP collects from other wholesale counterparties, making the electric distribution system the ultimate obligor on the PRP bonds. The electric system makes payments to the PRP as an operating expense, prior to payments on the electric system debt. However, if the PRP were to become inoperable or not provide any energy, the electric system payments to the PRP would become subordinate to the electric system bonds.

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

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

ESG CONSIDERATIONS

Grant PUD'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.

FITCH RATINGS ANALYSTS

Kathy Masterson
Senior Director
Primary Rating Analyst
+1 512 215 3730
kathryn.masterson@fitchratings.com
Fitch Ratings, Inc.
2600 Via Fortuna, Suite 330 Austin, TX 78746

Geneho Park
Analyst
Secondary Rating Analyst
+1 646 582 3754
geneho.park@fitchratings.com

Andrew DeStefano
Director

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

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

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Apr 2023) (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

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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