

# RatingsDirect®

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## Summary:

# Mason County Public Utility District No. 3, Washington; Retail Electric

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### Credit Profile

Mason Cnty Pub Util Dist #3 elec rev & rfdg bnds

*Long Term Rating*

A+/Stable

Affirmed

**Mason Cnty Pub Util Dist #3 elec rev bnds ser 2001 dtd 03/01/2001 due 12/01/2005-2021**

*Unenhanced Rating*

A+(SPUR)/Stable

Affirmed

Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services affirmed its 'A+' long-term rating to Mason County Public Utility District (PUD) No. 3, Wash.'s electric revenue bonds. The outlook is stable.

Total debt outstanding as of Dec. 31, 2014 was \$79.9 million.

The rating reflects our view of the PUD's:

- Strong system liquidity, with unrestricted cash of \$18.5 million, or 142 days of operating expenses, as of fiscal 2014;
- Improved fixed-charge coverage from 2013 and 2014 levels, at an estimated 1.4x in 2015 due to multiple rate increases;
- Demonstrated willingness to adjust rates as needed, including increases in each of the past three years, and with a plan to increase rates annually through 2019;
- Good revenue stream diversity, with the utility's top 10 customers accounting for just 11.5% of total 2014 utility revenues;
- Largely residential customer base, which contributes to revenue stream predictability and stability; and
- Low-cost power supply because of its status as a preference customer of the Bonneville Power Administration (BPA), with a load following contract that extends through September 2028.

Partially offsetting the above strengths, in our view, are the district's:

- Relatively shallow local economy;
- Rates that are slightly above average for the region, combined with income levels that are good but below average for the state; and
- Reliance on BPA for almost 100% of power resources, although Bonneville's low cost somewhat mitigates this exposure.

We have assigned the PUD's electric system a business risk profile score of '4' on a 10-point scale, on which '1' is the strongest. The business risk profile score reflects our view of the district's limited operational risk as a distribution-only utility, stable low-cost power supply, and a relatively shallow economy.

A first-lien pledge of the electric system's net revenues secures the bonds.

Headquartered in Shelton and about 70 miles southwest of Seattle, the PUD provides service to approximately 32,750 customers within 567 square miles. It serves as a bedroom community to Olympia, 20 miles to the south, and to a nearby Naval base and shipyard to the north. The district's service territory extends into the nearby counties of Kitsap, Grays Harbor, and Pierce. The county's employment base, historically dominated by timber production, is diversifying somewhat. The leading employer is Little Creek Casino (840 employees), followed by the Washington Correction Center (685) and Shelton School District (591). Income levels in the county are slightly below average; median household effective buying income was 93% of the national and 82% of the state average, while unemployment was above average at 7.7%, versus the national average of 5.3% in 2015.

The PUD's customer base is stable. Residential accounts comprised 93% of total accounts and about two-thirds of revenue and energy usage in 2014, which we believe contributes to revenue stream predictability and stability. Energy sales for the district's native load totaled 635 megawatt-hours (MWh) in 2014, which represents a decline from earlier levels of 655-667 MWh. Forecast annual growth for fiscal years 2016-2019 is negative 3% to positive 1%. Recent declines are primarily attributable to the district's largest customer, Simpson Lumber Co., reducing operations in 2015 following its acquisition by Sierra Pacific Industries. The company expects to hire back about 200 employees in 2017. The PUD has good revenue stream diversity, with the top 10 customers accounting for just 11.5% of total revenues. The leading customer, Simpson Lumber, accounted for 5% of retail operating revenue in 2014.

The district receives approximately 98% of its power from BPA as a preference customer. It got the rest from a share of the Nine Canyon and White Creek Wind Projects, a 10% share of Packwood Lake generation, and a 5.2 MW owned peaking generating station. The PUD signed a new load following contract with Bonneville effective October 2011 that will run through September 2028.

Effective in 2011, BPA indicated its preference for customers to either assume the role of meeting their own load growth above actual 2010 net power requirements or pay a higher Tier 2 rate to assist it in recovering its own costs in meeting these increased loads. Due to low load growth, the PUD requested Tier 2 short-term service through 2019, although management does not anticipate purchasing any Tier 2 power until October of 2017. The district's reliance on BPA for power and its exposure to potentially higher Tier 2 rates represent a moderate credit weakness, in our view.

The PUD has secured various long-term renewable energy resources, as it is subject to the provisions of the state's Initiative 937 because it serves more than 25,000 customers. This initiative, passed by the state in 2006, requires that utilities with more than 25,000 customers achieve a renewable portfolio standard of 3% renewables by 2012, 9% by 2016, and 15% by 2020. The district has thus far met all standards, and expects to be in compliance through the 2020 requirement.

Although having BPA as its main provider offers the PUD stability, the district is also subject to administration rate adjustments, as with most PUDs in the region that receive BPA hydro power. The district increased base rates in each of the past four years, including two increases in 2015. The PUD has approved a 10 cent rate increase in 2016, with additional rate increases planned annually through 2019. Given the increases, rates are somewhat above average for

the region. According to the Energy Information Administration, residential rates were 4% above state average in 2014.

The district's debt-service coverage has been consistently strong, exceeding 1.45x in each of the past three years. The PUD's coverage of fixed charges, which includes fixed capacity payments related to BPA purchases and the district's share of the Nine Canyon Wind project's debt service, has recently declined, but it estimates this will rebound to levels in-line with 2011. Management estimates fixed-charge coverage will improve to 1.4x in 2015 from 1.24x in fiscal 2014 due to multiple rate increases, and projects similar coverage levels through 2019. Liquidity is strong, at \$18.5 million, or 142 days' cash. Management projects similarly strong cash levels through 2019. The district has an informal policy to maintain cash reserves of no less than 120 days.

The PUD's debt burden is moderate, as reflected in a debt-to-capitalization ratio of 44% as of 2014. The district is in the midst of a grid-modernization project worth \$7 million. In total, the district's five year capital plan will cost approximately \$34 million, a level we consider moderate. Management does not expect to issue any bonds during that time.

Bond provisions are adequate and feature a 1.25x rate covenant, a fully funded reserve fund funded at average annual debt service, and an additional bonds test of 1.25x coverage on parity debt service.

## Outlook

The stable outlook reflects our anticipation that the PUD will continue implementing rate increases as it deems necessary to avoid a material decline in coverage or liquidity. The outlook also reflects our expectation that the district will realize 2015 estimates, and continue to meet projected coverage and liquidity levels.

### Upside scenario

The utility's shallow economy and exposure to a power portfolio dominated by hydroelectric resources limit upward rating potential.

### Downside scenario

Should the PUD fail to make timely rate adjustments in the face of rising costs and debt service requirements, or should financial performance otherwise significantly weaken, we could lower the rating.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Electric And Gas Utility Ratings, Dec. 16, 2014
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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