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Ratings

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Summary:

Transmission Agency of Northern California; Wholesale Electric

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Credit Profile		
Northern California Transmission Agy (California-Oregon transmission Proj) WHLELC		
Long Term Rating	A+/Stable	Outlook Revised

Rating Action

S&P Global Ratings revised the outlook to stable from negative, and affirmed its 'A+' long-term rating on the Transmission Agency of Northern California's (TANC) California-Oregon Transmission Project (COTP) $155.8 million project revenue bonds outstanding.

The outlook revision reflects our assessment of the agency's fire mitigation plan and fire mitigation activities that implement the plan and that we consider prudent. The rating action also reflects the topography of the areas surrounding TANC's transmission lines; the low population density surrounding the lines, which we believe limits the number of claimants; and the agency's liquidity and insurance coverage, which we believe provide additional lender protection. Tempering these strengths are wholesale contract provisions with members that limit the joint action agency's ability to recover liability assessments from member cities if the agency is deemed to have been negligent in the operation and management of its system.

Credit overview

The rating reflects our view of:

- A member-participant transmission service agreement (Project Agreement No. 3) with 13 public power or cooperative members that includes strong take-or-pay obligations for members to pay for transmission power services, including step-up provisions in the event of default by an individual member (services provided under this agreement constitute the bulk of revenue for TANC);
- The project participants' strong credit quality, with participants rated 'A+' or higher accounting for 111% of project operating and debt service costs, after the contractual 25% step-up is given effect;
- The uniqueness of the COTP transmission asset, its importance to California's power market to serve native load, and its diversification of TANC member resource portfolios through seasonal exchanges with utilities in the Pacific Northwest through the COTP;
- TANC and TANC members' covenant to establish and collect rates and charges necessary to pay operating expenses and debt service, with these payments senior to the members' direct debt service; and
- Strong liquidity at the agency level as of fiscal 2019, with more than $36 million, or 688 days' cash on hand, combined with a 90- to 120-day cash flow target.

Partially offsetting the above strengths, in our view, is the presence of TANC assets in regions vulnerable to wildfires;

California courts' approach to the doctrine of inverse condemnation, particularly as it would be applied for assigning liability for wildfire damage; and contractual provisions that might frustrate the agency's efforts to allocate liability costs among its members if the agency were to be found negligent in its mitigation measures.

TANC's business profile of '4', based on S&P Global Ratings' 10-point scale on which '1' is the highest, reflects our view of the agency's elevated wildfire risk, rate-setting authority, strong member credit quality, and adequate financial management.

The stable outlook reflects our view of the agency's strong wildfire mitigation strategy, coupled with the credit quality of the key members.

Environmental, social, and governance

We believe the district's direct environmental risks are low, given its role as a transmission-only provider. The district faces indirect social risk related to COVID-19 through its members, as efforts to protect the health and safety of the member communities may affect the members' financial metrics, albeit likely modestly, which could in turn affect their ability to pay TANC. There have been no member delinquencies to date. Finally, we view the agency's governance factors as credit supportive, as they include a strong wildfire risk mitigation toolkit, strong policies and planning, and a proactive and experienced management team.

Stable Outlook

Downside scenario

We could lower the rating by one or more notches if TANC's wildfire liability exposure materially increases or if the agency faces wildfire claims that could deplete or exhaust its financial reserves and insurance. We could also lower the rating if the credit quality of the key members erodes, whether due to impacts related to the pandemic or otherwise.

Upside scenario

We are unlikely to raise the rating given several factors, including uncertainty with regard to the financial impact of the ongoing COVID-19 pandemic and wildfire risk.

Credit Opinion

The COTP is a 339-mile-long, 1,600-megawatt, 500-kilovolt alternating current transmission project between southern Oregon and central California that went into service in 1993 at a cost of $430 million. The COTP is owned by TANC (87%) but also by Western, PG&E, the City of Redding, San Juan Water District, and Carmichael Water District. The project is interconnected with the Bonneville Power Administration transmission system in Oregon, as well as with Portland General Electric and PacifiCorp.

The five member-participants with the largest percentage shares in the project are Sacramento Municipal Utility District (27.6%; AA/Stable), Modesto (21.3%; A+/Stable), Santa Clara (20.5%; A+/Stable), Turlock (12.5%; AA-/Stable), and Redding (8.4%; not rated). Each participant is unconditionally obligated to pay its share of the project's debt service and operating expenses prior to the month of service, regardless of project operation. Each participant must also pay as much as 25% in addition to its percentage commitment in the event of a default by another participant, should that default not be cured within 45 days. In such a scenario, the nondefaulting member-participants may be required to accept a megawatt amount in excess of the original allocated share of the project. Additional financial flexibility exists at the agency level, with more than $36 million, or 688 days' cash on hand, as of fiscal 2019, combined with a 90- to 120-day cash flow target.

In our opinion, the transmission project's importance to each participant's overall resource portfolio is a key credit strength, because we believe the COTP is an essential element of the participants' ability to meet their individual native loads, sell wholesale power, and participate in economically beneficial seasonal exchanges with the Pacific Northwest. We anticipate that the project will remain an important component of the participants' resource portfolios. Should a participant have to make a step-up payment, we believe that the payment would constitute an insignificant portion of an individual member's overall operating expenditures. Members also have the ability to lay off (sell) transfer capability or transmission capacity to other members or third parties, should other members turn down such offers. And given the competitively priced transmission, we believe that such an outlay could generate high interest in the market, although we note wildfire risks could dampen this demand. No member has implemented a long-term layoff of its transmission capability to a nonmember, but minor layoffs of transmission capability to other TANC members have occasionally occurred--for example, when a member had surplus capacity.

If there is a wildfire claim related to the project that exceeds TANC's internal resources and insurance coverage, we generally believe the agency would be able to pass through the associated costs to its members. However, we believe the agency faces some exposure, although not immediately proximate, due to what we consider conflicting provisions of TANC's contract with the municipalities supporting the financial performance of the COTP. The Project Agreement No. 3 for the California-Oregon Transmission Project and California-Oregon Transmission Project Interim Participation Agreement simultaneously require project participants to support all project costs, but also absolves the municipalities of financial liability, in the event of TANC's negligence, if project assets, including transmission lines, cause property or personal damage, which we believe would likely include wildfire claims. Consequently, these provisions might preclude the agency from looking to its members to fund liability claims. In such a scenario, an inability to recover those costs might lead to bankruptcy and a default.

Mitigating this risk somewhat is the agency's wildfire management plan that includes semiannual aerial inspections, regular ground inspections, vegetation management, and a program for limiting crop and vegetation height in orchard areas. In addition, TANC and the Western Area Power Administration have collaboratively implemented a number of wildfire mitigation measures, with many more planned for the near future. Measures already implemented include enhanced maintenance patrol capabilities and structural and equipment inspection capabilities, while planned measures include further enhanced structural and equipment inspection capabilities, access road maintenance, vegetation inspections management, expanded inspection capacity, enhanced situational awareness, and enhanced recordkeeping. Finally, TANC maintains $35 million in wildfire insurance, or $26.25 million net of deducible and 25% coinsurance. Coupled with its $36 million in cash, the agency has a total cushion of about $62 million in the event of a wildfire claim. We view this liquidity cushion as relatively low versus that of other public power utilities in the state, although this is partially offset by our view of the limited number of structures near TANC's high-risk assets.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of July 2, 2020)		
Northern California Transmission Agy rev rfdg bnds (California-Oregon Transmission Proj) ser 2016A due 05/01/2039		
Long Term Rating	A+/Stable	Affirmed

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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.