STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Transmission Agency of Northern California; Wholesale Electric

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Summary:

Transmission Agency of Northern California; Wholesale Electric

Credit Profile		
US$175.0 mil rev rfdg bnds (California-oregon Transmission Proj) ser 2016A due 05/01/2039		
Long Term Rating	A+/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'A+' long-term rating to the Transmission Agency of Northern California's (TANC) $175 million series 2016A California-Oregon Transmission Project (COTP) revenue refunding bonds.

At the same time, we affirmed the following ratings on TANC's various bonds issued with regard to the COTP:

- Our 'A+' long-term rating and SPUR on the series 2002A variable-rate revenue refunding bonds (to be refunded by the 2016A bond proceeds),
- Our 'A+' SPUR on the series 2003A and 2003B auction-rate refunding bonds (to be refunded by the 2016A bond proceeds), and
- Our 'A+' long-term rating on the agency's series 2009A (a portion of which will be refunded by the 2016A bond proceeds) revenue refunding bonds and series 2009B taxable revenue refunding bonds.

The outlook on all ratings is stable.

The ratings reflect 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 and low-risk nature 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 2015, with more than $21 million, or 432 days' cash on hand, combined with a 90- to 120-day cash flow target.

Partly offsetting the above strengths, in our view, is TANC's relatively thin all-in debt service coverage (DSC) of 1.1x in fiscal 2015 when subordinate swap payments are included.

TANC's business profile of '3', based on Standard & Poor's 10-point scale on which '1' is the highest, reflects our view of the agency's rate-setting authority, strong member credit quality, and adequate financial management.

The 2016A fixed-rate bond proceeds will be used to refund TANC's series 2002 variable-rate direct purchase bonds outstanding, its 2003A and 2003B auction rate bonds, and a portion of TANC's callable series 2009A fixed-rate bonds outstanding. The series 2016A bond proceeds will also terminate swaps outstanding associated with TANC's series 2002A, 2003A, and 2003B bonds, which had an unfavorable mark-to-market of $21 million as of June 30, 2015. TANC's intention with the plan of finance is to eliminate the following risks:

- Interest rate exposure,
- Exposure to swap counterparty credit,
- Exposure to failed auction rate securities, and
- Liquidity renewal risk.

The bonds mentioned above are secured by TANC revenue, which is composed of payments received by 13 member-participants pursuant to Project Agreement No. 3, whereby TANC has agreed to provide each member with a share of TANC's entitlement of the COTP transfer capability in return for a corresponding percentage of operations-and-maintenance (O&M) and debt service costs associated with the project. Each member has severally agreed to make such payments from revenue of and as an operating expense of its electric system. TANC and all members covenant to establish rates and charges sufficient to pay O&M and debt service costs, with audited fiscal 2015 DSC at about 1.37x, or 1.10x when about $8.4 million in swap payments is included.

As of June 30, 2015, TANC had $284 million in debt outstanding.

TANC is a joint powers authority with 15 members. Its primary purpose is to provide electric transmission and other facilities for the use of its members. TANC is the manager of the COTP, which is TANC's major activity. TANC is governed by a commission consisting of one representative of each member, and its treasurer and controller is Sacramento Municipal Utilities District (SMUD), the member with the largest share (27.6%) of the project. Of the 15 members, 13 are member-participants: nine city electric systems, two irrigation districts, one municipal utilities district, and one cooperative. The rating on the project revenue bonds, therefore, reflects our view of the credit quality of the transmission project's participating members and the asset's importance to the members. After the contractual 25% step-up is given effect, participants rated 'A+' or higher account for 111% of project operating and debt service costs, while participants rated 'AA-' or higher account for 55%.

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 Suburban 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.

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 demand in the market. 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 certain member had surplus capacity.

The five member-participants with the largest percentage shares in the project are SMUD (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 $21 million, or 432 days' cash on hand, as of fiscal 2015, combined with a 90- to 120-day cash flow target.

As of June 30, 2015, TANC had three floating- to fixed-rate swaps for a total swap notional amount of $208 million, or what we consider a moderately high 73% of total debt. As of June 30, 2015, the swaps had a mark-to-market of negative $21 million (meaning they were "out of the money"). In our view, TANC's unrestricted cash on hand of more than $21 million acts as a prudent hedge against interest rate risk and swap risk. Swaps will be terminated with the proceeds of the series 2016A bonds.

Direct Purchase Bonds Will Be Refunded

The 'A+' long-term rating on the series 2002A bonds insured by Assured Guaranty Municipal Corp. (AA/Stable) reflects our tying the rating to the TANC unenhanced rating rather than to the bond insurer rating because the bonds were remarketed directly to Citibank N.A. under an agreement that heightens potential for acceleration, which the bond insurance policy does not cover. The bond insurer committed to pay regularly scheduled principal and interest, compared with accelerated principal payments. Tempering the heightened exposure to acceleration are provisions in the agreement with Citibank that permit TANC to repay accelerated debt balances in equal semiannual installments over a five-year term-out period. We performed stress analysis of an assumed acceleration, which indicates that TANC and its members would very likely be able to absorb the acceleration or principal under a five-year term-out without degrading their credit quality or that of the TANC bonds. In the event of term-out, the bond insurance policy itself will terminate 364 days after the term-out commencement date. But during that 364-day period, upon conversion from the index put-rate mode to another mode, subject to our review, the long-term rating on Assured could be applicable again. The bonds mature May 1, 2024.

According to the ninth supplemental indenture, should an event of default occur, the 2002A prepayment schedule will be adjusted such that the bonds will amortize in equal six-month installments over a five-year period. We understand that the first installment would be due sixth months after the trustee receives notice that an event of default has occurred. It is Standard & Poor's view that the events of default that could trigger such a term-out are permissive. In particular is a material adverse change clause, whereby the occurrence of any event or change that, in Citibank's sole reasonable discretion, results in a material and adverse change in TANC's business, condition (financial or otherwise), or operations that materially and adversely affects either the enforceability of the direct purchase agreement or any of the other related documents or TANC's ability to perform its obligations or the rights of, or benefits or remedies available to, Citibank under the indenture or the direct purchase agreement. Under the structure, the Assured Guaranty insurance policy expressly excludes the acceleration of principal repayment.

Notwithstanding the above, these bonds will be refunded with the series 2016A bond proceeds.

Outlook

The stable outlook reflects that on the ratings on relevant participants in each project.

Upside scenario

We could raise the rating if the credit quality of the relatively weaker members improves, assuming the credit quality of the higher rated members does not degrade.

Downside scenario

We could lower the rating if the credit quality of the weaker members weakens further, although we don't see this as likely over the next two years.

Related Criteria And Research

Related Criteria

- USPF Criteria: Electric And Gas Utility Ratings, Dec. 16, 2014
- USPF Criteria: Wholesale Utilities, May 24, 2005
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012
- 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

Ratings Detail (As Of February 16, 2016)		
Northern California Transmission Agy WHLELC		
Long Term Rating	A+/Stable	Affirmed
Northern California Transmission Agy WHLELC		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Northern California Transmission Agy (ARS) (California Oregon Transmission Proj) (MBIA) (National)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Ratings Detail (As Of February 16, 2016) (cont.)		
Northern California Transmission Agy (California-Oregon Transmission Proj) (AGM)		
Long Term Rating	A+/Stable	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.