FitchRatings

Fitch Affirms M-S-R Public Power Agency's (CA) Electric Rev Bonds at 'A+'; Outlook Stable

Fitch Ratings-San Francisco-02 June 2017: Fitch Ratings has affirmed the following electric revenue bonds issued by M-S-R Public Power Agency (MSR), CA:

--$127,420,000 San Juan Project subordinate lien revenue bonds, series 2008L and 2011O at 'A+'.

The Rating Outlook is Stable.

SECURITY

Bondholders are secured revenues received pursuant to absolute and unconditional take-or-pay power sales agreements with the three project participants that extend for the life of the bonds. The agreements include a 25% step-up provision in the event of a participant default. Participant payments related to the project are made as operating expenses of their respective retail electric systems.

KEY RATING DRIVERS

JOINT POWERS AGENCY: MSR is a joint powers agency (JPA) established to acquire, construct, operate, and maintain any project for the purposes of providing electrical energy or other benefits to its three members. The San Juan Project includes MSR's 146 megawatt (MW), or 28.8% ownership interest, in San Juan Unit 4, a coal-fired generating unit located in New Mexico.

MEMBERS DRIVE PROJECT CREDIT QUALITY: The rating reflects the credit profiles of M-S-R's three member systems: Modesto Irrigation District (MID) (50%; 'A+'/Stable), City of Redding (15%; 'A+'/Stable), and Silicon Valley Power (SVP) (35;% 'A+'/Positive).

SOLID SECURITY FEATURES: Bondholders are secured by revenues received from absolute and unconditional take-or-pay power sales agreements with the three members that extend for the life of the bonds. Payments for the San Juan Project are made as operating expenses of the respective retail electric systems. The agreements include a 25% step-up provision in the event of a participant default. However, given the inability of the step-up to cover the sizable shares of MID and SVP, MSR's rating is constrained by the lower of the two ratings.

OBLIGATIONS UNAFFECTED BY PLANNED DIVESTITURE: MSR's planned divestiture of its interest in San Juan Unit 4 and the 2016 sale of the associated Southwest Transmission Project (STP) does not affect the obligations of the members under the take-or-pay power sales agreements and does not affect the rating on the bonds. Fitch expects that debt service on the outstanding bonds will continue to be paid by the participants as scheduled regardless of the asset sales and the related terms. The transfer of MSR's ownership interest in San Juan Unit 4 is expected to be completed by Dec. 31, 2017.

STABLE, THIN COVERAGE LEVELS: MSR's consolidated financial performance generally provides for stable but thin debt service coverage. However, in fiscal 2016, Fitch-calculated coverage fell below 1x as proceeds from the transmission asset sale, which are recorded as non-operating income, were used to pay a portion of debt service. Liquidity levels remain satisfactory with 108 days cash on hand at the end of 2016.

RATING SENSITIVITIES

CHANGES IN MEMBER CREDIT QUALITY: M-S-R Public Power Agency's credit rating is driven by the underlying credit quality of its members. Rating actions on the member systems - Modesto Irrigation District, the City of Redding, and Silicon Valley Power - are likely to impact MSR's credit rating, with the lower of the ratings of MID and SVP being the constraint.

CREDIT PROFILE

SAN JUAN PROJECT DIVESTITURE

The rating reflects MSR's agreement to fully divest its ownership interest in San Juan unit No. 4 effective Dec. 31, 2017. The transfer, which follows the May 2016 sale of associated transmission assets, will allow MSR members to reduce their exposure to coal and facilitate compliance with California's environmental mandates.

DEBT TO REMAIN OUTSTANDING

MSR's debt associated with San Juan is expected to remain outstanding following the ownership transfer. Importantly, the obligation of the participants to pay debt service on the bonds under the terms of the take-or-pay power sales agreements is not expected to be affected by the asset sale or MSR's exit from the project. Fitch expects that debt service will continue to be paid as originally scheduled. Fitch views the strength of the take-or-pay agreements supporting the debt and the credit quality of the member-participants as an important mitigant to concerns regarding the potential sale of the debt-financed assets.

ADEQUATE FINANCIAL PERFORMANCE

As a joint action agency, MSR collects only the amount of revenues from its members necessary to cover costs, including debt service. Debt service coverage levels are generally thin but stable, averaging 1.23x from 2011-2015. Fitch-calculated debt service coverage declined to 0.62x in fiscal 2016, reflecting the use of a proceeds from the transmission sale to pay a portion of debt service costs. Fitch expects coverage to return to adequate levels in the near term.

MSR retains satisfactory liquidity levels to help offset concerns regarding narrow coverage. At the end of 2016, MSR had 108 days cash on hand or approximately $35.5 million in unrestricted cash and investments. A portion of those reserves will be designated by the board to fund legacy liabilities from MSR's participation in San Juan, including decommissioning and mine reclamation liabilities.

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Applicable Criteria
Revenue-Supported Rating Criteria (pub. 16 Jun 2014) (https://www.fitchratings.com/site/re/750012)
U.S. Public Power Rating Criteria (pub. 18 May 2015) (https://www.fitchratings.com/site/re/864007)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/1024617)
Solicitation Status (https://www.fitchratings.com/site/pr/1024617#solicitation)
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Solicitation Status

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