

MOODY'S INVESTORS SERVICE

Rating Action: Moody's affirms Aa1 on Arizona Power Authority's Revenue Bonds; outlook stable

08 Dec 2022

New York, December 08, 2022 -- Moody's Investors Service ("Moody's") has affirmed the Aa1 rating of Arizona Power Authority's Revenue Bonds. Outlook is stable. Arizona Power Authority currently has \$24.9 million in revenue bonds outstanding.

RATING RATIONALE

The affirmation of Arizona Power Authority's (APA) Aa1 rating reflects the predictability of cash flows from long term take-or-pay contracts with a diverse group of 63 wholesale customers that are mandated to pay for all of APA's operating and capital costs and that expire well beyond APA's outstanding debt. The creditworthiness of Arizona-based Salt River Agricultural Improvement and Power District (SRP, Aa1 stable) and Central Arizona Water Conservation District (CAWCD, Aa2 stable), which comprise approximately 40% of the APA's take-or-pay demand allocation obligation, underpins APA's credit profile.

The Aa1 rating incorporates that APA benefits from its strategic position as the sole entity responsible for acquiring and marketing Arizona's allocation of power generated from the Hoover Dam and from a low-cost structure, both factors that help retain customers and incentivize regulatory support. In addition, APA's rating also reflects the authority's strong rate setting record, low carbon transition exposure, consistently adequate financial performance and the quick ramp-up ability of the Hoover Dam's power generation, which is important to a regional power grid that is more reliant on intermittent renewable resources.

Moody's views that these credit positive factors are balanced by severe drought conditions that constrain power generation and raise customer costs, partially offset by APA's take-or-pay contractual structure that provides for full cost recovery from its customers and government's ongoing support measures. Notably, we have a positive view on the dedicated funding from the Inflation Reduction Act and Bipartisan Infrastructure Law to improve water conservation and devise long-term solutions for drought-stricken areas.

RATING OUTLOOK

The stable outlook reflects our view that the authority will maintain steady financial performance, consistent with its historical track record, while continuing to provide competitively priced power to its wholesale customers.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATING

- Limited prospects exist for further upward rating pressure given the Aa1 rating.

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATING

- Severe curtailment of Hoover hydroelectric production due to drought or other conditions.
- Material increase in APA's leverage or the price of Hoover Power.
- A fundamental downturn in the Arizona agribusiness sector.
- Decline in the credit quality of either SRP or CAWCD.

LEGAL SECURITY

The authority's outstanding bonds are payable solely from net revenues derived from APA's sale of power generated by the Hoover power plant. Those sales are made under take-or-pay power sales contracts (which are authorized under Arizona law) with 63 Arizona irrigation districts and municipal utilities, which constitute APA's contract customers until contract expiration in 2067. The revenue pledge extends to replacement contracts as well as any other revenue generated from the sale of Hoover Power. APA has a cash funded debt

service reserve fund equal to maximum annual debt service, and an additional bonds test of one times historical (12 out of the past 24 months) and future (five years) debt service coverage.

APA's obligation to pay WAPA for the costs associated with the Hoover Dam is on a take-or-pay basis. In the event the revenues generated by WAPA's sale of power was insufficient to cover the federal Bureau of Reclamation's costs of operating the dam, APA and the other Hoover contractors would remain obligated to pay their proportionate share of these costs. This risk is mitigated by both the take-or-pay contractual structure and the engineering and construction of the dam, which includes 17 separate generation units relying on the natural flow of water through the Colorado River basin for the production of power. The Hoover Dam power plant has been in continuous operation since the first generating units were installed over 80 years ago.

USE OF PROCEEDS

Not applicable.

PROFILE

Arizona Power Authority is a state agency responsible for the acquisition and marketing of Arizona's approximately 19% share of the electrical output from the federally owned and operated Hoover Dam power plant. The authority has been acting in this capacity since 1952. The Hoover Power Allocation Act of 2011 extended APA's entitlement to capacity and energy produced by the Hoover Dam through September 2067. APA is a not-for-profit entity with no taxing authority, however per state statutes, APA is required to set rates at levels sufficient to recover its total costs. The authority currently has 63 customers.

METHODOLOGY

The principal methodology used in this rating was US Public Power Electric Utilities with Generation Ownership Exposure Methodology published in August 2019 and available at <https://ratings.moodys.com/api/rmc-documents/63746>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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