FitchRatings

FITCH AFFIRMS OVERTON POWER DISTRICT NO. 5, NV'S REVS AT 'BBB+'; OUTLOOK NEGATIVE

Fitch Ratings-New York-06 May 2013: Fitch Ratings has affirmed the 'BBB+' rating on the following Overton Power District No. 5, Nevada (OPD5) revenue bonds:

--$15.4 million special obligation revenue bonds, series 2008.

The Rating Outlook remains Negative.

SECURITY

The bonds are secured by and payable from net revenues of the district electric system. In addition, the bonds share a mortgage and security interest in the district's facilities on parity with approximately $39.6 million of National Rural Utilities Cooperative Finance Corporation (CFC) notes.

KEY RATING DRIVERS

CHALLENGING SERVICE TERRITORY: OPD5 provides retail electric service to about 14,000 customers in a region northeast of Las Vegas that remains challenged by the most recent economic recession. Early signs of stabilization are emerging. However, the longer-term trend and extent of the district's financial decline warrant that the Outlook remain Negative.

TIGHT OPERATING CASH FLOW: Tight cash flows producing 1.0x debt service coverage for three consecutive years, coupled with declining cash balances, constrain OPD5's financial flexibility. Cash balances are near the district's $6 million minimum target as of March 31, 2013, which is down about one-fifth from the 2012 audited figure. However, a $5 million perpetual line of credit facility with CFC provides support.

PROJECTED CASH FLOW IMPROVEMENTS: Tentative signs of improvement emerged in the first quarter of 2013, given the effects of a recent rate increase, modest uptick in sales, and favorable weather conditions. Yearend debt service coverage and coverage through the 2017 projection period is forecasted at 1.25x, which is the district's covenanted level.

RATE ACTION PROVIDES MODEST BENEFIT: Rate increases in 2009, 2011, and 2012 demonstrate some willingness to stabilize financial operations. However, the increases have provided only modest support for bondholders, given weak kWh sales.

POWER SUPPLY CHANGE: A new wholesale contract with Arizona Public Service (APS) through 2017 adds medium-term clarity to OPD5's power supply. Longer-term power supply and related costs are budding concerns, absent improvement in the district's financial margins over the next few years.

RATING SENSITIVITIES

FINANCIALS RESULTS ARE FOREMOST: Financial metrics have become OPD5's primary rating driver. Sustained debt service coverage near 1.0x over the short term could lead to a rating downgrade. Conversely, coverage of closer to 1.25x could stabilize the district's rating at 'BBB+'.

RATE ACTION: Rate adjustments, as necessary to provide for covenanted levels of debt service coverage, are likewise important to the rating.

LONGER-TERM ECONOMIC GROWTH: A return to economic growth is a longer-term consideration that could ultimately help move the district back to the 'A' category.

CREDIT PROFILE

CHALLENGING SERVICE TERRITORY

Located approximately 65 miles northeast of Las Vegas, OPD5 provides retail electric service to about 14,000 customers in a relatively rural area of Clark County that was disproportionately affected by the most recent economic recession. Consequently, board-approved rate increases in 2009, 2011, and 2012 have merely offset a decrease in load to maintain 1.0x debt service coverage over the past three years. The rate increases had been intended to improve cash flow metrics to more in line with the district's 1.25x rate covenant.

Nascent signs of stabilization emerged in the first quarter of 2013. More specifically, revenues were $655,189 ahead of the same period in 2012 on account of the October 2012 rate increase (4.5%), modest load growth, and more favorable weather conditions. However, it is too early to suggest a shift in OPD5's operating environment, given (a) the duration and depth of the district's financial weakness over the past three years, and (b) similar projections of financial improvements made in prior years.

At a minimum, a stable load will be important to the financial recovery of the system. Load growth averaged nearly 5% annually for much of the prior decade but turned negative by an average of 4.1% annually from 2008-2011, underscoring the extent of economic contraction in the area. The decline in load eased to -0.6% in 2012.

MINIMUM LEVELS OF COVERAGE

Persistent weakness in debt service coverage was the principal reason for the 2012 downgrade to 'BBB+' from 'A-'. Additional weakness could ultimately cause downward rating pressure. Conversely, coverage of closer to 1.25x, as forecasted, could stabilize the district's rating at 'BBB+'.

Debt service coverage has averaged 1.01x over the past three years, including 1.04x in 2012. By contrast, Fitch's 'A-' and 'BBB+' rating category medians are 2.39x and 1.42x, respectively. Forecasted coverage in 2013, including $1 million of additional rate revenue that the district is on track to receive, improves to 1.25x. Moreover, projected coverage remains at similar levels through the 2017 term of the district's new power supply contract with APS.

LEGAL PROVISIONS ARE LENIENT

Lenient legal provisions, particularly with respect to the rate covenant, have provided the district with considerable latitude to run tight financial operations.

Per the indenture, the rate covenant requires the district to maintain net revenues reasonably expected to equal at least 1.25x the debt service requirement for the next year on the series 2008 bonds and all parity debt. In addition, the indenture permits the inclusion of available funds in net revenues to meet the 1.25x the debt service requirement for the current year.

Debt service coverage has fallen short of this calculation in recent years without causing an event of default under the indenture, as the district's attempts to improve coverage levels by raising rates and reducing expenses effectively satisfy the terms of the covenant.

CASH BALANCES AS A MEASURE OF CUSHION

Cash balances and a $5 million perpetual line of credit facility with CFC provide the district some cushion to manage slim debt service coverage levels. However, the trend in liquidity has been negative, and the extensive use of cash or a draw on the district's credit facility would signal additional financial stress that could weigh on the district's rating.

Cash balances were as high as $8.9 million in 2009, but fell to $4.5 million in 2012. Cash on hand went from 105 days to 55 days, respectively. Management notes that 2012 cash balances fell below the $6 million target - which would produce 73 days cash on hand using 2012 results - because of a one-month prepayment for power that was recouped through rate revenues in January 2013. Current cash balances (as of March 31) slightly exceed the targeted balance.

NEW POWER SUPPLY CONTRACT

The district's principal power supply contract with APS is relatively short-term when measured against similar systems, which exposes it to some degree of longer-term cost uncertainty. Tight financial operations heighten this risk. However, management intends to begin sourcing replacement power well in advance of the contract expiration.

Management negotiated the contract with APS to replace its contract with Shell Energy that expired on Dec. 31, 2012. The new fixed-price, take-or-pay contact with APS extends through Dec. 31, 2017 and is expected to satisfy the majority of the district's energy requirements with a modest increase in cost.

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This rating action was informed by information identified in Fitch's U.S. Public Power Rating Criteria and Revenue-Supported Rating Criteria.

Applicable Criteria and Related Research:
--'U.S. Public Power Rating Criteria' (Dec. 18, 2012);
--'Revenue-Supported Rating Criteria' (June 12, 2012).

Applicable Criteria and Related Research
U.S. Public Power Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=696027
Revenue-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=681015