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RATING ACTION COMMENTARY

# Fitch Downgrades Tri-State Generation & Transmission Debt to 'BBB+'/'F1'; Outlook Negative

Thu 28 Mar, 2024 - 5:06 PM ET

Fitch Ratings - New York - 28 Mar 2024: Fitch Ratings has downgraded the following Tri-State Generation & Transmission Association, Inc. (Tri-State) long-term debt obligations to 'BBB+' from 'A-':

--Long-Term Issuer Default Rating (IDR);

--$1.86 billion first mortgage bonds and notes, series 2010A, 2014B, 2014E and 2016A;

--$200.5 million Springerville pass-through certificates, series 2003B.

Fitch affirms Tri-State's $500 million CP program at 'F1', of which $184.2 million was outstanding at fiscal year-end 2023.

The Rating Outlook is Negative.

## RATING ACTIONS

| ENTITY / DEBT | RATING | | PRIOR |
|---|---|---|---|
| Tri-State Generation & Transmission Association, Inc. (CO) | LT IDR | BBB+ Rating Outlook Negative<br>Downgrade | A- Rating Outlook Stable |

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|---|---|---|---|---|
| Tri-State Generation & Transmission Association, Inc. (CO) /Senior Secured Obligation/1 LT | LT | BBB+ Rating Outlook Negative | Downgrade | A- Rating Outlook Stable |
| Tri-State Generation & Transmission Association, Inc. (CO) /Senior Unsecured Obligation/1 LT | LT | BBB+ Rating Outlook Negative | Downgrade | A- Rating Outlook Stable |
| Tri-State Generation & Transmission Association, Inc. (CO) /Self-Liquidity/1 ST | ST | F1 | Affirmed | F1 |

**VIEW ADDITIONAL RATING DETAILS**

The rating downgrade reflects Fitch's expectation of weaker rate flexibility and financial performance as a result of FERC's decision to reject Tri-State's proposed rate schedule, which included a formula rate and true-up mechanism, and would have resulted in a roughly 6% rate increase. Tri-State's inability to implement planned rate increases is expected to weaken operating income, funds available for debt service (FADS) and leverage metrics through 2024, and potentially beyond. Leverage (including deferred revenue) improved modestly in 2023 to 9.2x, after reaching a high of 9.7x in 2022, but given the uncertainty of rate relief and capital spending in the near term, leverage is expected to approximate 10x going forward. Liquidity remains adequate at 300 days, including 34 days of cash on hand, at year end 2023.

The Negative Outlook reflects the continued uncertainty surrounding the timing of the FERC rate filing and prospective rate increases, as well as the final contract termination payments (CTP) required pursuant to the FERC-approved methodology. United Power, Tri-State's largest member is expected to withdraw from membership on May 1, 2024. United Power accounted for 19.6% of utility member revenues and 16.2% of total operating revenues in 2023. Estimates have placed United Power's CTP at approximately $700 million, but a final figure has not yet been approved by FERC. Three other members, Northwest Rural Public Power District (NRPPD), Mountain Parks Electric, Inc. and La Plata Electric Association, Inc., have also provided notices for withdrawal on May 1, 2024, Feb. 1, 2025 and April 1, 2026, respectively. To the extent that the final approved CTPs are lower than anticipated and increase the likelihood of additional withdrawals, the negative effects of the delayed rate approval could be compounded.

The 'BBB+' IDR and 'BBB+' first mortgage bonds and Springerville certificate ratings continue to reflect Tri-State's weakened, but still very strong revenue defensibility characteristics including all requirements wholesale service contracts with its members, generally strong purchaser/member credit quality, a low operating cost burden and an evolving power supply resource mix that is expected to supply 70% of energy requirements from clean sources by 2030. Tri-State's 'F1' short-term rating, the higher of two possible ratings, is based on the cooperative's long-term credit quality and adequate liquidity. This includes a liquidity coverage ratio of 1.25x at year end 2023 that is expected to improve over the near term following receipt of the United CTP.

## SECURITY

Tri-State's first mortgage bonds are secured by a lien on substantially all of Tri-State's tangible assets and revenues, except for certain limited exceptions. The Springerville lease debt is secured by a lien solely on the Springerville Unit 3 generating facility and associated lease revenues. The CP notes are unsecured obligations of the cooperative, subordinate in payment to the senior secured obligations.

## KEY RATING DRIVERS

**Revenue Defensibility - 'aa'**

All-Requirements Contractual Framework; Strong Member Credit Quality but Departures Occurring

Tri-State's revenue defensibility reflects the cooperative's full requirements wholesale power sales contracts with its members, which provides an unconditional payment obligation and the ability to reallocate costs among the members. The revenue defensibility further reflects the generally strong credit quality of its largest members, with independent rate setting authority and modestly growing customer bases.

These strengths are somewhat offset by Tri-State's recent transition to rate regulation under FERC and the challenges related to new formula rate approval, a heavier industrial customer concentration for some of the members, the expected departure of the cooperative's largest member and the prospect for additional member departures. Rate flexibility has weakened in 2024 with the FERC rejection of the proposed rate structure. If the weakness persists, Fitch's Revenue Defensibility assessment may be reduced to 'a' from 'aa', which would also likely result in further rating deterioration as indicated by the Negative Outlook.

**Operating Risk - 'a'**

Tri-State's strong operating risk assessment is driven by its consistently low operating cost burden, as calculated by Fitch at 7.22 cents per kwh for 2023. The increase from 6.8 cents in 2020 reflects the inflationary cost environment affecting the sector broadly.

Power supply resources are sufficient to meet modestly growing member needs. Ongoing efforts to diversify generation (i.e. adding renewables and closing coal-fired generation), along with participation in regional energy imbalance markets should help Tri-State manage its long power supply position and meet the power supply transition targets outlined in its Responsible Energy Plan (REP), as well as state specific targets for its members located in New Mexico and Colorado. Resource planning is complicated by prospective changes to the membership base, but the additional risks should be manageable.

**Financial Profile - 'bbb'**

Fitch has lowered its Financial Profile assessment to 'bbb' from 'a'. Fiscal 2023 results were comparable to the prior year but are likely to weaken in 2024. Coverage of full obligations, as calculated by Fitch, came in at 1.17x in 2023, vs. the five-year average of 1.25x. Coverage ratios include previously deferred revenues of $47.1 million in 2023 and $95.6 million in 2022. Leverage improved modestly to 9.21x in 2023, down from the 9.7x in 2022, but in line with ratios over the last five years. These ratios also include the aforementioned deferred revenues. Leverage excluding deferred revenues totaled 10.23x in 2023 vs. 12.45x the prior year.

Performance through 2024 remains uncertain given the delay in rate relief, but financial ratios for 2024 are expected to be weaker than previously expected. Fitch's rating case scenario indicates that leverage will approximate 10x over the near term given the combination of lower earnings and cash flow, as well as current projections for capital spending.

Liquidity, which includes external bank lines, has remained strong, registering 300 days in 2023, versus 333 days the prior year. Liquidity should remain strong over the near term given the expected receipt of the United CTP.

**Asymmetric Additional Risk Considerations**

Tri-State continues to be challenged by material member dissatisfaction, as two smaller members have withdrawn from the G&T membership, United's withdraw is scheduled to occur on May 1, 2024, and three other members have submitted notice to withdraw. This ongoing member discontent and threat of further withdrawals represents an asymmetric management and governance risk that is factored into the overall rating determination.

## RATING SENSITIVITIES

### Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Approval of a final rate plan that further reduces rate flexibility and challenges the cooperative's ability to recover costs, support margins and true-up incurred costs;

--A weakening in the remaining purchaser credit quality which lowers Tri-State's revenue defensibility assessment;

--A sustained leverage ratio of greater than 11.0x in Fitch's base and stress cases;

--A continuing withdrawal of members from Tri-State, which negatively affects the cooperative's financial position or materially increases remaining members' average wholesale rate, and hampers resource planning activities;

--Failure to maintain a liquidity coverage ratio of 1.25x or higher, or a neutral liquidity profile, would result in a downgrade of the short-term rating to 'F2' from 'F1'.

### Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--A sustained leverage ratio below 10.0x in Fitch's base and stress cases;

--Exhibited stability in Tri-State's membership and its long-term support of the generation and transmission cooperative;

--Successful resolution to all member-related legal and regulatory disputes.

## PROFILE

Tri-State is one of the largest G&T cooperatives in the U.S., providing wholesale electricity service across four western states. As of fiscal year-end 2023, Tri-State provides power supply to 42 utility member electric cooperatives, of which, 38 are rural distribution cooperatives and four are Nebraskan municipal power districts. Tri-State's members are located in: Colorado (17 members), New Mexico (11), Wyoming (eight), and Nebraska (six).

The member systems provide exclusive retail electric service to approximately 628,000 users, or a population base of roughly 1 million. Tri-State also has three non-utility members.

Two utility members have withdrawn from Tri-State in recent years: Kit-Carson Electric Cooperative (2016) and Delta-Montrose Electric Association (2020), which in aggregate represented roughly 4.9% of total member MWh sales. The concern over departing members is captured as an overriding asymmetric governance and management risk consideration in Tri-State's rating determination. The asymmetric risk does not currently constrain the rating but has the potential to in the future.

Tri-State sold 18.22 million MWh in 2023, of which 90.7% was sold to members. Energy sales saw a greater fluctuation in 2020 due to a combination of weather and the withdrawal of Delta-Montrose Electric Association, and only minimally related to business curtailments due to the coronavirus pandemic. Member revenues represent the vast majority of Tri-State's operating revenues, accounting for 86.2% in fiscal 2023, which is fairly consistent for the past five years.

Tri-State's power supply mix is rapidly changing as it implements its Responsible Energy Plan (REP), which accelerates retirements of coal-fired generation and adds significant renewable energy resources. To date, Tri-State's capacity resources total 4,323MW, of which coal, renewables, natural gas, and power contracts accounted for 36%, 32%, 19% and 13%, respectively, as of December 2023. Tri-State's REP expects 70% of electricity used by members to come from clean energy sources and eliminating all emissions from coal-fired generating units in Colorado and New Mexico by 2030.

Members' contracts were revised in 2020 to allow for a partial requirement contract option, which was implemented in 2021 and six utility members have been aggregated 300 MW of self-supply. The partial requirement option includes a make-whole provision to buydown the member's full requirements obligation. The buy down methodology associated with the partial requirement members (Class B) was determined and accepted by FERC, but Tri-State subsequently filed and received FERC's acceptance of a notice of cancellation of the buy down payment methodology tariff. Tri-State continues to evaluate the partial requirements contract option.

### Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Tri-State's Environmental, Social and Governance (ESG) relevance score for Governance Structure is a '4', reflecting the current legal and regulatory disputes with certain members. The ongoing disputes with the members and the potential withdrawal of additional members represents an asymmetric risk. This has a negative impact on the credit profile and is relevant to the rating in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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## APPLICABLE CRITERIA

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub. 12 Jan 2024) (including rating assumption sensitivity)

U.S. Public Power Rating Criteria (pub. 08 Mar 2024) (including rating assumption sensitivity)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

## ADDITIONAL DISCLOSURES

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