FITCH DOWNGRADES OGLETHORPE POWER CORP., GA FMBS TO 'BBB+'; NEGATIVE WATCH REMOVED; OUTLOOK NEGATIVE

Fitch Ratings-Austin-12 October 2018: Fitch Ratings has downgraded the following Oglethorpe Power Corp., GA (OPC) ratings to 'BBB+' from 'A-':

--$980.8 million pollution control bonds issued by the Development Authorities of Appling, Burke, Heard and Monroe Counties;
--$3.05 billion first mortgage bonds issued by OPC.

Fitch has affirmed its 'F2' rating on the $1 billion CP program.

The long-term ratings have been removed from Rating Watch Negative and assigned a Negative Outlook.

SECURITY

OPC's long-term debt is secured by a first mortgage lien on substantially all of OPC's owned tangible and certain intangible assets. The pollution control bonds are secured by loan payments from OPC that are secured by a parity lien. The CP notes are unsecured obligations of OPC that are subordinate to the outstanding pollution control revenue bonds and first mortgage bonds.

KEY RATING DRIVERS

DOWNGRADE RESULT OF NUCLEAR COST ESCLATION: The downgrade reflects higher leverage and ultimately, higher rates to members, that will result from OPC's revised budget for its 30% (660 MW) share of Vogtle Units 3&4. The $7.5 billion budget, up from $7.0 billion announced less than one year ago, includes an $800 million project level reserve and OPC's financing costs and its own contingency reserve, which provides some protection from further project increases beyond the approximate $27 billion total project cost.

NEGATIVE OUTLOOK REFLECTS POTENTIAL FURTHER COST INCREASES: The Negative Outlook reflects Fitch's opinion that significant additional cost increases and potential schedule delays are possible at Vogtle 3&4 given the ongoing nuclear construction risk, lengthy timeline for completion and historically unreliable cost estimates. While new cost-sharing mechanisms and a one-time tender option are designed to reduce OPC's share of any additional cost increases, higher leverage and potentially reduced ownership in the asset for the sake of project completion could still materialize.

WHOLESALE PROVIDER; UNCONDITIONAL CONTRACTS: OPC is one of the largest generation electric cooperative in the nation, providing wholesale power supply to 38 members who collectively serve 1.9 million customer meters and approximately 4.1 million people. Power is supplied pursuant to joint and several, take-or-pay wholesale power contracts that extend to Dec. 31, 2050, beyond the life of all outstanding debt. The contracts are not all-requirements but OPC's generation resources are allocated to members on a subscription basis, with the obligation to secure supplemental power supply remaining with the individual members. Not all members are obligated for each OPC project, including Vogtle 3&4.

DIVERSE GENERATION; DEMAND FOR VOGTLE EXPANSION: OPC has a large and diverse generation portfolio of approximately 8,400 MW of generation capacity and member owned resources and federal hydropower allocations. The portfolio provides a balanced mix of nuclear, natural gas and coal-fired resources to meet a portion of total member load requirements that have grown at an average of 0.7% per year over the past five years. OPC's 30% share of Vogtle Units 3&4, currently under construction, will be used to serve a greater share of member load; load that is presently being purchased from other suppliers.

COMPETITIVE RATES BUT DECLINING HEADROOM: OPC's rates will increase significantly in 2021 and 2022 to those members participating in Vogtle Units 3&4. While there is a wide range of residential retail rates among OPC's members, average member retail rates are below those of GPC. Given GPC's announcement in 2018 that it will not seek to recover its share of the most recent cost increase in rates, the headroom between OPC's average member rates and GPC's retail rates will decline. The potential for GPC to make similar decisions regarding any future potential cost increases is a concern regarding OPC's rate competitiveness.

HEALTHY FINANCIAL MARGINS; HIGH LEVERAGE: OPC's financial margins and liquidity position are stable and management's commitment to achieving margins for interest coverage of 1.14x through the final year of Vogtle construction should continue to produce healthy margins during construction. However, the nuclear expansion has resulted in high leverage, which reduces OPC's financial flexibility. Another roughly $5 billion in new debt is expected over the next five years, which will elevate leverage further until large rate increase, anticipated in 2021 and 2022, bring the leverage ratio back below 11.0x.

SHORT-TERM RATING: The 'F2' on the CP note program reflects OPC's long-term credit rating and adequate internal liquidity sources.

RATING SENSITIVITIES

DELAYS AND FURTHER COST INCREASES: A delay in the Vogtle project completion dates beyond November 2022 and project cost increases exceeding the existing project contingency funds would likely result in a downgrade.

PROJECT CANCELLATION: Project cancellation does not appear likely at this time. However, cancellation prior to completion could prompt a rapid decline in credit quality, potentially more than one-notch, given the acceleration of the Department of Energy loans and the potential for political and legal backlash in that scenario.

CREDIT PROFILE

OPC provides partial wholesale electric service to 38 member cooperatives located throughout Georgia. Collectively the OPC members serve a vast region covering approximately 38,000 square miles (65% of the state's land area) and encompassing 151 of the state's 159 counties. The member service territory exhibits considerable size, breadth and diversity, which Fitch views very favorably. Average load growth in the member service area has averaged 0.7% annually over the last five years.

OPC is participating in the Vogtle nuclear expansion project with current co-owners GPC (45.7%), the Municipal Electric Authority of Georgia (22.7%) and the city of Dalton Utilities (1.6%). OPC's 30% share will provide OPC with 660 MW of additional capacity when completed.

Bechtel took over in late 2017 as the general contractor on a time and materials contract basis, following the bankruptcy filing of the Westinghouse Electric Company. GPC, along with Southern Nuclear Operating Company, is acting as the construction manager. Around the time of the change in construction management, the co-owners each adopted sizable budget increases in recognition of the higher cost to complete without a fixed-price contract. OPC adopted a new budget of $7.0 billion for its 30% share, up from its previous $5.0 billion budget.

DOWNGRADE REFLECTS VOGTLE NUCLEAR PROJECT COST INCREASE

The downgrade reflects higher costs related to Vogtle construction resulting from the unexpected announcement in August 2018 that the cost of the total project increased by approximately $2.3 billion. OPC announced that its budget, in turn, has increased to $7.5 billion. The rapid timing and magnitude of the cost increase is concerning, given that the prior budget was so recently developed and represented a very large cost increase at that time. The continued cost increases reflect the difficulty associated with nuclear construction. Vogtle 3&4 are the first new nuclear units to be built in the U.S. in over 30 years. As a minority owner, OPC has limited control over construction and the ultimate cost of the project.

OPC's decision to include additional Oglethorpe-level contingency funds within its $7.5 billion budget estimate, as was done in the prior budget as well, mitigates the potential for future cost increases. Further cost increases that can be absorbed by either the project level or OPC's own contingency reserve are factored into the 'BBB+' rating level. Fitch views OPC's inclusion of contingency funds as prudent and protective against continued cost uncertainty at this stage of construction.

The Negative Outlook reflects the potential for further credit decline if further cost increases are sizable and exceed contingency reserves. The Negative Outlook indicates our skepticism about the resilience of the revised project estimate, the ongoing need to attract and retain sufficient numbers of craft labor to the project site to remain on schedule, and the stage of project completion. Construction was approximately 55% complete and the overall project, including engineering and design, was around 70% complete at the end of July 2018.

CO-OWNERS VOTE TO PROCEED; REVISED TERMS

Revisions to the co-owners agreement made in November 2017 required an affirmative vote by 90% of the co-owners in order to proceed with construction in certain events - two of which were triggered by the approximately $2.3 billion total project cost increase and GPC's announcement that it would not seek rate recovery from the Georgia Public Service Commission for their share of the $1.5 billion construction cost increase.

In late September, all four co-owners voted to continue construction but approved binding term sheets that materially amend the co-owners agreement. The agreed upon changes require GPC to pay for a portion of the other co-owners costs if the total project budget increases from the current budget plus $800 million and a total $2.1 billion cost increase. After a project cost increase of $2.1 billion, each co-owner would have the one-time option to tender a portion of its ownership share in the project in return for GPC paying that co-owner's remaining costs to complete. Any future cost overruns no longer require a co-owner affirmative vote for construction to continue, although a 90% vote is still required if the schedule change exceeds one year. GPC now has the authority to cancel construction at any time. Finally, the revised terms include price options at which GPC will purchase the production tax-credits from the owners.

Fitch views the cost sharing mechanism as favorable for OPC in that it provides some relief in the event of future cost overruns in excess of the current budget and $800 million project level contingency. However, the relief is modest in relation to the additional construction costs OPC will incur in that event. The one-time option for OPC to reduce its project ownership share in order to fund construction costs that exceed the $2.1 billion cost increase threshold is viewed as neutral. While it favorably provides OPC and its members with some optionality, the only choices are to fund the cost increase with additional debt or freeze its investment, stop further funding of the project and accept a reduced ownership share at commercial operation. Finally, the new production tax credit option provides a floor value to the benefit once construction is complete but this term change is viewed as neutral.

SIZEABLE CONSTRUCTION COSTS OVER NEXT FIVE YEARS

OPC's capital improvement plan (CIP) is immense, dominated by the completion of Vogtle. The current five-year plan is cumulatively sized at $5.2 billion for period 2018-2022 with $4.4 billion in Vogtle-related expenditures. This is an increase from last year's 2018-2022 CIP forecast of $4.7 billion and $3.9 billion for Vogtle. The non-Vogtle expenditures include additions and replacements to the existing fleet and environmental projects at the coal-fired Wansley and Scherer units. Although both Wansley and Scherer are compliant with most prevailing regulations, expenditures related to coal ash disposal and water treatment are required.

HIGH LEVERAGE

OPC's debt portfolio increased substantially after nuclear construction began in earnest in 2012. Debt outstanding at the end of 2017 was approximately $8.3 billion, up from $5.6 billion at the end of 2012. The increase is primarily the result of OPC's investment in Vogtle 3&4. Leverage as measured by Fitch's net adjusted debt/adjusted funds available for debt service (FADS) is elevated. The leverage ratio was 10.1x at the end of fiscal 2017.

Leverage is forecast to increase through the completion of Vogtle to a maximum of between 13x to 14x, at which time an increase in rates to recover Vogtle costs would increase FADS and reduce Fitch's projected leverage ratio. Leverage is projected to decline back down below 11x in 2022, but remain high in comparison to other utilities.

HEALTHY FINANCIAL MARGINS AND LIQUIDITY

Financial margins improved in fiscal 2016 as a result of increased sales of energy to members, as expected from the Smith and Hawk Road generation resources. Fitch calculated coverage of full obligations was over 1.6x in fiscals 2016 and 2017; however, debt service costs do not include any costs related to Vogtle construction yet. The strong margins and cash flow are the result of OPC's 1.14x MFI target being used to set rates during Vogtle 3&4 construction, estimated through fiscal 2022. Initial but unaudited indications for year-end fiscal 2018 show performance in line with recent years.

Liquidity ratios also remained strong and relatively stable at year-end 2017. Cash on hand was reported at 185 days ($398 million) and available borrowing capacity, including available lines of credit totaled 780 days. These robust ratios reflect OPC's strategy of maintaining borrowing capacity sufficient to complete its planned construction program. Although down from its peak of nearly $2.0 billion in 2014, the cooperative maintains access to $1.61 billion of committed credit facilities, including a $1.21 billion multibank syndicated facility that extends into 2020, and is available to support CP issuance and provide short-term funding. Fitch views capital access as important due to the magnitude of the construction program and the uncertainty of timing associated with approvals and funding under the government-administered loan programs.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Lumesis.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Fitch Internal Liquidity Worksheet (pub. 13 Jun 2013)
https://www.fitchratings.com/site/re/710906
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)
https://www.fitchratings.com/site/re/10020113
U.S. Public Finance Short-Term Debt Rating Criteria (pub. 01 Nov 2017)
https://www.fitchratings.com/site/re/905637
U.S. Public Power Rating Criteria (pub. 18 May 2015)
https://www.fitchratings.com/site/re/864007