FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Board of Public Utilities of Springfield, MO's COPs 'AA'; Outlook Stable

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Fitch Ratings - New York - 09 Sep 2021: Fitch Ratings has assigned an 'AA' rating to the approximately $130 million certificates of participation (COPs) series 2021 issued by the Board of Public Utilities of the City of Springfield, Missouri (City Utilities or the utility).

The bonds are expected to price on Sept. 28, 2021 via a competitive bid. Proceeds will be used to finance the costs for the expansion of the SpringNet fiber optic network, to paydown an existing facility with U.S. Bank National Association, and to pay for costs of issuance.

In addition, Fitch has affirmed the 'AA' rating on the following:

-- $449.0 million public utility revenue bonds, series 2015 issued by the city of behalf of City Utilities;

--$13.6 million Public Utility certificates of participation (COPs), series 2012;

--$25.2 million Public Utility COPs, series 2014;

--$6.4 million Public Utility COPs, series 2015.

Fitch has also assessed a Standalone Credit Profile (SCP) of 'aa'. The SCP represents the credit quality of City Utilities on a standalone basis, irrespective of its relationship with and the credit quality of the city of Springfield.

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The 'AA' rating reflects City Utilities very strong utility fundamentals and financial profile. The utility has ample rate flexibility, a captive customer base, a relatively strong service area, a very low electric system operating cost burden supported by a diverse power supply portfolio, and manageable capital requirements that will be funded primarily with cash from operations, reserves, and grants. Leverage was a very low 3.95x, coverage of full obligations (COFO) was 1.84x, and unrestricted cash equaled 331 days in fiscal 2020.

The utility's financial profile has been consistently solid. Fiscal 2021 unaudited results were enhanced by the utility's performance during the winter weather event (Winter Storm Uri) in February 2021. Although gas costs were approximately $40 million above budget, the electric system realized significant revenue from favorable off-system sales of activity of roughly $88 million (compared to $24 million the prior year). This resulted in improved financial performance compared with the budget for the utility in fiscal 2021, and obviated the need for electric base rate increases over the next five fiscal years.

The utility's leverage ratio is expected to increase slightly in fiscal 2022 as financial operations normalize, but ratios are expected to remain within 4.0x-5.0x in Fitch's base and stress case scenarios, which is consistent with the current rating.

City Utilities' strong financial profile and ample liquidity position it well to withstand a moderate stress scenario, which shows the preservation of strong financial metrics through a five-year horizon.

CREDIT PROFILE

The city of Springfield is located in Greene County in the southwest portion of the state of Missouri approximately 174 miles southeast of Kansas City. Springfield is the third largest city in Missouri and is a major center for trade and commerce.

City Utilities is a combined system that provides various essential services, including electric, gas, water, transit and broadband (the SpringNet system). The largest of the utility's services is the electric system, which accounted for approximately 67% of operating revenue in fiscal 2020. The electric system serves approximately 117,000 customers. The gas system (approximately 84,300 customers) and water system (approximately 82,800 customers) provided approximately 19% and 13%, respectively, of operating revenue.

SpringNet will complete its final phase of expansion with proceeds from this debt issuance. The project entails completing the construction of a network backbone between seven hut locations, and distribution and access fiber infrastructure reaching at least 115,000 demand points in seven different geographical areas within the utility's service territory. The utility leases the dark fiber to a third-party provider -- Lumen Technologies Inc. (previously known as CenturyLink Communications, LLC) -- pursuant to a 2019 lease agreement, for a 15-year lease term with three five-year automatic renewal periods.

The systems, with the exception of transit, are managed to be self-supporting based on their existing rates, charges and customer bases. The transportation system operates at a net loss and is not expected to be self-supporting in the future. In fiscal 2020, the transit system reported a $11.1 million operating loss. A transit subsidy is built into the rate structure of City Utilities other services.

Fitch considers City Utilities to be a related entity to the city of Springfield for rating purposes given the dependent relationship of the utility as a component unit of the city, and the requirement that rates be approved by the city council. The credit quality of the city does not currently constrain the bonds and COPS rating. However, as a result of the utility being a related entity, the ratings could become constrained by a material decline in the general credit quality of the city.

KEY RATING DRIVERS

Revenue Defensibility: 'a'

Strong Revenue Defensibility; Manageable Non-Monopolistic Revenue

City Utilities revenue defensibility is supported by healthy customer growth and the electric system's ample rate flexibility. The 'a' revenue defensibility assessment also incorporates weaker income levels in the service area and the non-monopolistic revenue the utility receives from the SpringNet System as well as uncontracted off-system energy sales, which together account for approximately 11% of operating revenue for the utility. Non-monopolistic revenue is expected to grow moderately, given the ongoing expansion of the fiber optic network.

Operating Risk: 'aa'

Very Low Operating Risk; Manageable Capital Needs

The operating risk of the electric system is very low, supported by an operating cost burden that was 5.48 cents per kilowatt hour (KWh) in fiscal 2020, a diverse power supply portfolio, and manageable capital needs. The electric utility is not subject to the state's renewable portfolio standard, but renewable energy sources accounted for 34% of energy in 2020.

Financial Profile: 'aa'

Low Leverage; Ample Financial Flexibility

City Utilities has a very strong financial profile, demonstrated by ample liquidity and very low leverage. Maintenance of a very strong profile through Fitch's stress case, which stresses electric and gas demand, underscores the utility's substantial financial flexibility and its ability to preserve strong financial metrics through-the-cycle. The utility's leverage reflects the combined nature of its service lines, including the gas, water, transportation and SpringNet operations.

Asymmetric Additional Risk Considerations

No asymmetric additional risk consideration affected the final rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Upward rating movement is unlikely given the utility's revenue characteristics and leverage that is expected to remain in the 4x to 5x range.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A sustained increase in leverage to more than 6.0x in Fitch's base or stress case scenarios;

--A sustained increase in the operating cost burden to higher than 10 cents per KWh.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

SECURITY

The COPs are subordinate to the revenue bonds and payable by a lien on combined excess revenues of the utility system, inclusive of the electric, natural gas, water, transportation and SpringNet systems, and a security interest in the assets financed with the leases.

The public utility revenue bonds are secured by a senior lien on combined net revenues of the utility system.

REVENUE DEFENSIBILITY

The utility's revenue source characteristics are strong, and its reliance on non-monopolistic revenue is manageable. SpringNet -- the utility's fiber optic network -- generated roughly $16.2 million in operating revenue in fiscal 2020 (about 3.8% of the utility's total operating revenue), compared with $15.0 million in fiscal 2018. Management's projections show this revenue source increasing to approximately $26.9 million by 2026, equal to about 5.4% of projected total operating revenue.

SpringNet revenue, combined with uncontracted off-system electric sales, accounted for approximately 11% of City Utilities total operating revenue in fiscal 2020. Non-monopolistic revenue is budgeted to grow moderately with the planned expansion of the fiber optic network, but Fitch expects it to remain controllable and consistent with the 'a' revenue source characteristics assessment.

City Utilities electric, gas, and water business lines exhibit monopolistic characteristics and provide a high degree of revenue stability.

Wholesale Sales

Wholesale off-system sales, which are factored into the revenue source characteristics assessment, have fluctuated historically, but are a manageable segment of the electric system's revenue base since the utility joined Southwest Power Pool's (SPP) Integrated Marketplace in 2014. The Energy Authority (TEA) assists the utility with its marketplace activities along with providing additional services.

Off-system sales into SPP have ranged from roughly $24 million to $41 million over the past five fiscal years. Off-system sales rose to a high $88 million in fiscal 2021 (unaudited) as a result of the storm event in February 2021 and sales into SPP in excess of the utility's native load requirements. In fiscal 2022, off-system sales are budgeted to drop to approximately $15 million, and range between $15 million to $20 million over the next several years, which is a return to historical levels.

Service Area Characteristics

Fitch considers City Utilities service area to exhibit strong demand characteristics, despite mixed demographic trends. The unemployment rate is strong and trends well-below the national average; the 5.9% unemployment rate in 2020 equaled 73% of the U.S. average. The five-year average annual customer growth is considered midrange, at 0.9%. Both of these metrics support strong electric demand. The service area has very weak wealth levels, as evidenced by median household income (MHI) of $36,856 equal to only 59% of the national average.

Rate Flexibility

The electric system has very strong rate flexibility that is reinforced by its unencumbered legal ability to set rates, its rate competitiveness, and rate affordability. Rates for each of the utility's services are set by the board and solely approved by the city council.

Electric rates are very competitive; the 2019 retail electric rate, as reported by the U.S. Energy Information Authority, was 8.56 cents per kWh, which compares very favorably with the state average retail electric rate, at approximately 88%. Electric affordability is also high, with residential electric bills accounting for 2.8% of MHI.

Rate Increases

No additional base electric rate increases are currently projected through fiscal 2026, largely due to favorable revenue performance the utility realized in fiscal 2021. Base rate increases are typically considered and set as part of the utility's annual budget process; however, if necessary, can be implemented at any time with the board and the city council's approval. The electric rate has an electric fuel adjustment clause, which fluctuates to capture under-recovery (or over-recovery) of fuel costs. The fuel adjustment factor changes each October and April, following approval by the board.

In 2016, the city council approved three successive natural gas and water system rate adjustments, with the last approved rate increase implemented in fiscal 2020. These rate increases supported capital needs and operation and maintenance costs. Proposed rate adjustments include a 2% annual gas rate increase in fiscals 2025-2026, and a 5% annual water rate increase in fiscals 2024-2026.

The natural gas rate has a purchased gas clause, which fluctuates monthly based on a recovery adjustment factor and passes changes in natural gas costs directly to the customer. This adjustor typically changes without board approval. The higher natural gas costs that resulted from the winter storm earlier in the year were paid by utilizing approximately $15 million in reserves and cash-on-hand. The recovery adjustment factor will be adjusted over a 24-month period (ending March 2023) to recover the funds while spreading out the impact on the customer base. This protracted recovery period required city council approval.

No Customer Concentration

Many of the top 10 electric customers are also in the top 10 customer list for the natural gas and water services. However, customer concentration risk appears to be manageable with no single customer accounting for more than 5% of the individual service revenue. The customer list includes a relatively diverse group of medical centers and hospitals, government and industry.

OPERATING RISK

The electric system's operating cost burden is very low and relatively stable, ranging from 5.48 cents per kWh to 6.87 cents per kWh over the past five fiscal years. The electric system operates and manages a diverse resource mix that is made up of owned generation, along with some contracted and market purchases.

Operating costs include payments in lieu of taxes (PILOT) to the city. Pursuant to city charter, the PILOT is equal to 3% of gross operating revenue of the electric system and 4% of gross operating revenue of the gas system and transportation system. In addition, City Utilities makes payments equal to 4% of the gross operating revenue of the water system, pursuant to a city ordinance.

Operating Cost Flexibility

Fitch views the electric system's operating cost flexibility as neutral, reflecting sufficient capacity and a fairly diverse power supply portfolio. The utility's combined gross generating capacity of 866.2 megawatts (MW) is more than sufficient to meet the utility's peak demand of 697 MW in fiscal 2020 and a 12% capacity reserve requirement.

The electric system has historically relied on owned, coal-fired generation for the majority of its supply like many utilities in the region; however, the electric system has been gradually diversifying its power supply and entering into renewable contracts. Owned coal-fired resources composed 39% of energy supply in fiscal 2020, down from 44% the prior year. Coal is followed by renewables (including landfill gas, wind, hydro and solar) at 34%; short-term market purchases (22%) and owned natural gas (5%).

Pursuant to a 2019 Integrated Resource Plan (IRP), City Utilities is planning to retire a 203 MW coal/natural gas turbine-generator (Unit 1) at the John Twitty Energy Center in 2027. This will serve to further reduce the utility's reliance on coal. Management will be evaluating options to replace this energy source in conjunction with an updated IRP in 2022, and the energy will possibly be replaced with a renewable long-term purchased power agreement.

Natural Gas System

In 2018, the utility entered into a 30-year prepaid gas supply contract with the Public Energy Authority of Kentucky, which expires in 2048. This prepaid contract supplies approximately 17% of the system's annual gas requirements. The prepay agreement provides the gas utility with cost savings, as gas purchases are at a discount to market prices. Remaining gas supply needs are met from various suppliers through short-term and long-term agreements.

The utility uses a diverse portfolio approach to manage its natural gas supply and limit its price risk, including physical storage, financial and physical options, long-term supply agreements, and market purchases. Winter is the peak season for gas sales and the gas system meets its supply needs with one-third from long-term contracts, one-third from storage, and one-third from monthly and daily gas purchases.

Water System

City Utilities' water resources are expected to be adequate to meet the system's needs through 2040. Raw water supply is primarily drawn from Fellows Lake, McDaniel Lake, James River, Fulbright Spring and two deep wells, supplemented by pumping from Stockton Lake as needed. Water is treated at the Blackman Water Treatment Plant and the Fullbright Water Treatment Plant with a combined treatment capacity of 74.6 million gallons per day (MGD). Together these sources and facilities provide sufficient capacity to meet average demand of 28.3 MGD, as well as peak demand of 43.7 MGD in fiscal 2020.

Capital Planning and Management

Fitch expects capital spending requirements to be manageable over the next five years. Capex has historically remained in excess of depreciation, averaging 131% over the past five fiscal years. The Fitch-calculated average age of plant of 15 years is indicative of a sufficiently-maintained system with some potential investment needs. Projected capex from 2022-2026 totals about $323 million or $65 million annually, which is fairly consistent with historical spending and approximates annual depreciation levels.

Projected capex reflects the final stage of the fiber backbone network expansion with SpringNet. Approximately $40 million of the Series 2021 COPs issuance will be used to complete the project. Total costs of the project are estimated at $145 million, slightly higher than the 2019 estimated costs of $120 million. Upon completion, the SpringNet fiber optic network will cover approximately 1,000 miles within City Utilities service area. City Utilities obtained a dedicated lending facility for prior SpringNet project costs, and approximately $90 million of the Series 2021 COPs will be used to take-out this facility.

Other capex includes construction of a new electric substation, electric transmission and distribution improvements, water infrastructure renewal and replacement, natural gas transmission and distribution improvements, and an advance metering infrastructure project to replace natural gas and water meters. City Utilities expects to fund remaining capex with operating cash flow, accumulated reserves, and grants. The utility is using the margin it received in off-systems sales to fund a capital reserve fund that will be used for several electric projects. There are no plans for additional debt.

FINANCIAL PROFILE

City Utilities has a strong financial profile. Leverage is low, and Fitch expects it to remain low. Liquidity is ample, and coverage of full obligations (COFO) is healthy. Leverage, as measured by net adjusted debt to adjusted funds available for debt service (FADS), has been very consistent at 4.0x since 2018.

Fitch views the utility's liquidity profile as neutral to the financial profile assessment. Total unrestricted cash has been very stable, averaging $249 million over the past five fiscal years. In fiscal 2020, the utility's unrestricted cash of $273 million equaled 331 days cash on hand. COFO has similarly been stable and strong, well in excess of 1.0x through fiscal 2020, reflecting level operating performance.

Fitch Analytical Stress Test (FAST) - Base and Stress Cases

The FAST base case scenario is informed by City Utilities pro forma expectations for fiscal 2021 (Sept. 30 year-end) as well as management's 2022-2026 operating plan. Fitch's base case incorporates key assumptions consistent with management's financial forecast, that include moderate growth in electric megawatt sales and gas Mcf sales, as well as proposed rate increases for the gas and water systems; no other rate increases are assumed over the five-year period. Capex are assumed according to the utility's projections. The base case also incorporates the current debt issuance to finance costs related to the final phase of the fiber optic network expansion.

Fiscal 2021 is expected to reflect positive financial performance compared to budget, primarily driven by the margin the utility received from off-system sales. Beyond that, the base case shows leverage potentially increasing to roughly 4.6x in fiscal 2022, as financial operations return to a normalized level, and the utility absorbs higher operating costs (particularly maintenance and administration and general operating cost increases) and the peak of capital spending of almost $96 million. Leverage trends lower for the final three years of the base case, to return to approximately 4.0x in fiscal 2025.

Other financial metrics, including COFO and liquidity, remain healthy and neutral to the financial profile assessment.

Fitch's stress case scenario applied a demand stress to management's electric and gas sales projections. Fitch did not stress the utility's water sales, but Fitch expects management will continue to ensure that this system is self-supporting.

The demand stress does not materially weaken City Utilities' leverage ratio relative to Fitch's base case. The rating case shows leverage peaking at 5.4x in fiscal 2023, followed by a decline to 4.9x by fiscal 2025. Management indicated that their respond to a downturn in sales would be first to reduce spending, followed by rate adjustments, if required. Fitch reduced capital spending by $5 million in the final three fiscal years to account for this.

Management has a history of implementing rate increases as well as meeting reserve and other financial targets, including a debt service coverage range of 2.0x-2.5x. The stress case demonstrates that City Utilities has ample financial flexibility to withstand a stress scenario.

Debt Profile

The utility's debt structures pose no additional risk. All of the utility's debt is fixed rate and fully amortizing.

ASYMMETRIC ADDITIONAL RISK CONSIDERATIONS

No asymmetric additional risk considerations were applied in this rating determination.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Power Rating Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (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

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Springfield Public Utilities Board (MO)	EU Endorsed, UK Endorsed

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