S&P Global
Ratings

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Summary:

Springfield, Missouri Springfield Public Utilities Board; Combined Utility

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Credit Profile		
US$129.0 mil taxable certs of part ser 2021 due 11/01/2036		
Long Term Rating	AA/Stable	New
Springfield COMBUTIL		
Long Term Rating	AA+/Stable	Affirmed
Springfield Public Utilities Board, Missouri		
Springfield, Missouri		
Springfield COMBUTIL		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to the Board of Public Utilities of the City of Springfield, Mo.'s $129 million series 2021 taxable certificates of participation (COPs). At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the utility's revenue bonds outstanding and its 'AA' long-term rating on the utilities' COPs outstanding. We differentiate the revenue bond and COPs ratings by one notch given the certificates' subordinate-lien status to the revenue bonds. City Utilities (CU, or the utility) provides electric, natural gas, water, broadband, and mass transit (bus) services in Springfield and nearby areas of southwest Missouri. Net revenue of CU, after payment of revenue bond debt service, secures the lease payments. The outlook is stable.

As of Sept. 30, 2020, CU had $530 million of debt outstanding. The utility will use the series 2021 COPs proceeds for capital improvements on the broadband system and to prepay debt from a lease financing agreement.

In our opinion, bond provisions are credit neutral. The rate covenant on the 2021 lease payments is 1.0x and the 2021 lease payments are made on a parity lien with CU's 2012, 2014, and 2015 leases. The utility cannot enter any lease agreements on a more senior lien than the 2021 lease.

Our analysis considers the financial contributions from each of CU's utility systems to meet CU's financial obligations. We applied our retail electric and gas utilities criteria in performing the analysis because the electric and gas systems' net revenue represents a preponderance of net revenue available to service debt. In fiscal 2020, the electric system provided 69% of CU's net revenue and the gas system 11%.

Credit overview

The rating reflects our opinion of CU management's policies and procedures that have led to robust financial metrics and a solid operational profile. The utility's fixed-charge coverage (FCC) and liquidity are at exceptional levels, providing CU with financial flexibility. It has a large customer base, providing economies of scale, and more than 85% of electric system customers are residential, which we view as having stable demand profiles. CU's weighted average electric rates are below the Missouri state average, providing the utility with rate-raising flexibility. We note, however, that incomes in the service area are considerably below the national median. The mid-February 2021 North American winter storm (unofficially known as Uri) caused CU's natural gas purchases to be approximately $40 million greater than anticipated, while the utility earned about $40 million in off-system margins from its electric system. CU's reserves enabled the utility to pay its natural gas bills from the storm; the utility will recoup these expenses from its customers over the next two years. The electric system's earnings will be put towards planned capital system improvements.

The rating further reflects our opinion of CU's:

- Diverse power supply of owned generation, renewable power purchase agreements (PPAs), and spot market purchases from the Southwest Power Pool (SPP) Integrated Marketplace. The utility's owned generation provided substantial benefits during the winter storm as CU sold electricity at high prices into the SPP market;
- Production of long-term financial forecasts and capital improvement plans (CIPs), as well as written policies on natural gas hedging and rate policy standards. We believe these plans and policies guide the utility and can help identify problems, although we note that CU incurred considerable natural gas costs during the storm, indicating weaknesses in the hedging procedures;
- Rate-setting practices, including a willingness to increase base rates when necessary and adjustments on the electric and gas systems to pass through changes in fuel costs, that have resulted in more-than-sufficient cost recovery; and
- Debt-to-capitalization ratio of 30% at the end of fiscal 2020, which is manageable for a vertically integrated utility and we do not expect the ratio will change materially with the series 2021 issuance. The utility does not plan to issue additional debt over the next five years for its CIP.

The stable outlook reflects our view of CU's residential customer base, which provides a degree of revenue stability, a diverse resource portfolio given its owned generation as well as long-term PPAs, management that has developed credit-supportive policies and plans, and robust financial metrics.

Environmental, social, and governance (ESG) factors

We believe CU's high amount of electricity obtained from coal-fired generation exposes the utility to future carbon emission regulations. In fiscal 2020, CU's coal-fired generation on an energy basis was 39%. We recognize that the utility has significantly reduced the amount of electricity it obtains from coal-fired generation, from 77% in fiscal 2014. More than a third of CU's electricity came from renewables in fiscal 2020, which we view positively.

With regard to social factors, health and safety precautions that health officials enacted in response to the COVID-19 pandemic resulted in a 2% weather-adjusted decline in electric system sales in fiscal 2020. CU had a moratorium on customer shutoffs in the early months of the pandemic and saw delinquencies reach $5.7 million in June 2020. However, delinquencies declined to $2.7 million in June 2021, which is the typical level. S&P Global Economics forecasts that U.S. GDP declined 3.5% in 2020 and it estimates a rebound of 6.7% in 2021. (See "Economic Outlook U.S. Q3 2021: Sun, Sun, Sun, Here It Comes," published June 24, 2021, on RatingsDirect.) S&P Global Ratings believes that uncertainty remains high, albeit moderating, about the evolution of the pandemic and its economic effects.

For governance, CU has rate-setting autonomy, which is standard for the sector. CU's 11-member board of public utilities sets rates that the city council must approve. In our view, it is helpful that the utility has a written payment in lieu of taxes policy specifying transfer payments from each of the utility systems to the city.

Stable Outlook

Downside scenario

Although we are unlikely to do so, we could lower the rating if coverage declines from extremely strong levels.

Upside scenario

We do not expect to raise the rating over the next two years given the below-average income levels in the service area and significant generation from coal, which exposes CU to potential onerous future costs related to emissions.

Credit Opinion

CU has a diverse mix of power supply sources. In fiscal 2020, the utility obtained about 44% of its electricity from owned generation, 34% from renewable PPAs, and 22% from SPP spot market purchases. We do not believe that the utility's spot market purchases unduly expose CU to price risk. In our view, the utility's membership in The Energy Authority, a power marketing joint venture with six other municipal utilities, is beneficial to CU by pooling member resources and providing resource-management services.

We believe that CU's financial targets are valuable in keeping the utility operating at a healthy level. The utility has an internal target for working capital of 80-140 days, as well as an internal debt service coverage (DSC) target of 2.5x and a minimum of 2.0x. Actual results show that CU has stayed within its working capital range and has consistently exceeded its minimum 2.0x DSC target. The policy and planning that CU has undertaken show that management has thought seriously about operations. We expect the credit-supportive policies and plans will continue.

Springfield has mixed economic fundamental metrics. The unemployment rate was 4.3% in June 2021, matching the state rate, and lower than the national rate of 6.1%. However, incomes in the service area are just 64% of the country's median, which we view as a credit weakness. There is no concentration among CU's customers. The top 10 customers provided about 13% of CU's electric system revenue and the top customer, a hospital, provided 2%. Springfield is a regional economic center for the health care and retail sectors.

With the below-average income levels, we view CU's competitive rates as helping to provide a degree of rate-raising flexibility. CU's weighted average revenue per kilowatt-hour as a percentage of the state average is 90% according to 2019 data from the U.S. Energy Information Administration. Residential rates are 89% of the state average, commercial 89%, and industrial 98%. CU has not increased electric base rates since 2016 and it does not plan to do so over the next five years.

The utility has an automatic electric fuel adjustment clause and from a credit perspective, this is a helpful tool allowing CU to pass through fuel cost variability. Every six months, CU updates the fuel-adjustment factor to account for the upcoming six-month period as well as any under- or over-recovery from the previous six-month period. In case of a wide enough discrepancy in collection versus actual results within a six-month period, CU can undertake an emergency recalculation of the fuel-adjustment factor.

We view CU's FCC numbers as robust, and the consistency of coverage shows prudent financial management and operational stability. The utility's FCC was 1.88x in fiscal 2020, 1.88x in fiscal 2019, and 1.94x in fiscal 2018. The three-year average FCC was 1.90x. In calculating FCC, we treat transfers to the city as an operating expense and 50% of purchased power expenses as debtlike. We project CU's FCC will exceed 1.6x over the next five years.

CU's liquidity provides substantial cushion to meet financial obligations. The utility's unrestricted cash, funds in a designated improvement account, and funds in a working capital account totaled $273 million, or about 331 days of operating expenses, at the end of fiscal 2020. CU projects its unrestricted cash and investments will be slightly lower over the next five years, but still significant.

With the proceeds from the series 2021 issuance, CU will expand its fiber optic network, which will ultimately reach no less than 115,000 demand points in the next couple years. In fiscal 2020, the broadband system provided about 6% of the utility's net revenue; the broadband system revenue is part of the pledge to pay CU's revenue bonds and COPs. We do not expect the broadband system will be a drain on the utility's revenue in the coming years.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020