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Ratings

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Garland, Texas; Retail Electric

Primary Credit Analyst:
Scott W Sagen, New York (1) 212-438-0272; scott.sagen@spglobal.com

Secondary Contact:
Paul J Dyson, San Francisco (1) 415-371-5079; paul.dyson@spglobal.com

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Credit Profile		
US$139.795 mil elec util sys rev rfdg bnds ser 2019A dtd 12/01/2019 due 03/01/2050		
Long Term Rating	A+/Positive	New
Garland retail elec		
Long Term Rating	A+/Positive	Outlook Revised
Garland retail elec		
Long Term Rating	A+/Positive	Outlook Revised
Garland elec		
Unenhanced Rating	A+(SPUR)/Positive	Outlook Revised

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings revised its outlook to positive from stable on Garland, Texas' electric utility system revenue debt. At the same time, we assigned our 'A+' long-term rating to the city's new series 2019A electric utility system revenue refunding bonds. In addition, we affirmed our 'A+' long-term and underlying ratings on the city's outstanding first- and second-lien electric utility system revenue bonds. The city's electric utility system is known as Garland Power & Light (GP&L).

The positive outlook is based on our view of management's financial forecast, which suggests fixed-charge coverage metrics could improve to stronger levels due to lower fixed costs that reflect removing the Gibbons Creek coal plant from the resource mix, projections of additional transmission revenue, and the availability of substantial and strengthening rate stabilization account balances. We could raise the rating within two-years if fixed-charge coverage metrics improve based on recurring revenues to stronger levels and, in our view, are likely sustainable and debt levels do not increase more rapidly than expected, we could raise the rating over the next two years.

Proceeds from the $139.8 million new series 2019A revenue refunding bonds will be applied to refund the utility's series 2010 combination tax and electric utility system revenue bonds and series 2011A electric utility system revenue refunding bonds for interest cost savings, and take out $41.3 million in series 2018 CP notes. The bonds are secured by a subordinate-lien pledge of the city's net electric utility revenues. Following the new series 2019A debt issue, the utility will have roughly $480.8 million in total debt outstanding, including $21.3 million in general obligation (GO) debt. The first lien is legally closed and first-lien bonds, which make up only 3.1% of total debt outstanding, will mature in 2031, following the series 2019A issuance. Because the first-lien pledge is closed and represents a very small portion of total debt outstanding, we do not make a rating distinction between the two liens.

The rating reflects the application of our "U.S. Municipal Retail Electric And Gas Utilities: Methodology And Assumptions" criteria (published Sept. 27, 2018).

The rating further reflects our opinion of the system's very strong enterprise risk profile and strong financial risk profile.

The enterprise risk profile reflects our view of the system's:

- Strong service area economic fundamentals, reflecting its primarily residential and very diverse customer base that benefits from participation in the deep employment base of the Dallas-Fort Worth metropolitan statistical area (MSA);
- Extremely strong industry risk relative to other industries and sectors;
- Strong market position, based on the utility's weighted average electric system rate that is in line with the state average and maintaining its rate mitigation fund (RMF) at very strong levels, which provides financial flexibility while keeping base rates flat over the last decade; and
- Very strong operational and management assessment, as evidenced by its diverse power supply portfolio with a combination of owned assets and purchased power contracts, which contributes to GP&L's ability to maintain competitive rates for its retail customers. In our view, the utility's operational profile has improved with the replacement of capacity from the inefficient Gibbons Creek coal-fired power plant with lower-cost power purchase agreements (PPAs). Tempering this strength somewhat is the age of the city's owned facilities, though we understand the plants are in good working condition and face limited capital needs in the near-to-medium term.

The financial risk profile reflects our view of the system's:

- Strong coverage metrics, after annual transfers to the city, reflecting our forward-looking view that fixed-charge coverage metrics could improve to at least 1.2x over the next five years due to lower fixed costs and additional transmission revenue;
- Extremely strong liquidity and reserves, with $196 million in total available liquidity or about 322 days' cash for audited fiscal 2018 after including its $156 million RMF that provides financial flexibility; and
- Strong debt and liabilities profile, as suggested by its 60% debt-to-capitalization ratio in fiscal 2018 and our forward-looking view that its debt burden will likely increase over time as the system debt-finances roughly 75% of its capital improvement plan (CIP) over the next five years.

Outlook

The positive outlook anticipates that GP&L's fixed-charge coverage levels could improve to strong levels due to lower fixed costs that reflect removing the Gibbons Creek coal plant from the resource mix, projections of additional transmission revenue, and the availability of substantial and strengthening rate stabilization account balances. Due to potential nonrecurring Texas Municipal Power Agency (TMPA) refunds in the near term, we view future variability in fixed-charge coverage as an exposure that is tempered by a sizable RMF that management expects to build over the financial forecast period.

Upside scenario

We could raise the rating within two years if fixed-charge coverage metrics improve based on recurring revenues to stronger levels and, in our view, are likely sustainable and debt levels do not increase more rapidly than expected.

Downside scenario

If our view of the utility's competitive position weakens or if actual fixed-charge coverage metrics decline below our expectations, we could revise the outlook to stable.

Utility Description And Credit Overview

GP&L provides retail electric distribution service to 70,964 customers in Garland, and also sells wholesale power through firm bilateral agreements with four municipalities and three electric cooperatives. Garland is 14 miles northeast of Dallas in the Dallas-Fort Worth MSA. The electric system is a vertically integrated utility that is long on capacity which is used primarily for peaking purposes, and customers benefit from competitive retail rates by purchasing roughly 59% of its energy in fiscal 2019 from bilateral market purchases or from the spot or day-ahead market when economic.

Garland is one of four members of TMPA, and has approximately 47% share of the agency's Gibbons Creek coal-fired plant. That plant supplied 17% of the utility's energy needs in 2018, down from 48% in 2017, but Garland's power sales contract with TMPA expired on Sept. 30, 2018. TMPA is currently seeking to sell the plant. Under a joint operating agreement signed Sept. 1, 2016, any final sale of Gibbons Creek would result in TMPA's members recovering their proportionate shares of sales proceeds. All of TMPA's generation debt was paid on Sept. 1, 2018.

As outlined in the indenture, the flow of funds dictates that electric utility net revenue supports the utility's obligations in this order: first-lien revenue bonds, second-lien revenue bonds, CP notes, revenue notes (none are outstanding following the series 2019 issue), combination tax and electric system surplus revenue bonds, combination tax and electric system revenue bonds, and all other electric system-supported GO bonds.

Enterprise Risk

Economic fundamentals: Strong

GP&L's retail customer base is diverse and largely residential, with residential customers generating 53% of retail electric revenues in fiscal 2018. Service area demographic indicators are good, in our view, with city-level median household effective buying income (EBI) was 96% of the 2018 U.S. median level, while unemployment trends were just below the national rate in 2018. The system's 10 leading retail customers accounted for a very diverse 10.6% of total operating revenues in fiscal 2018.

Firm bilateral agreements with central and north Texas distribution systems have bolstered GP&L's off-system sales, which totaled about $71 million in fiscal 2018 (25% of total operating revenues). GP&L has no debt exposure related to its wholesale agreements, and it serves the wholesale loads with its wholesale power sales contracts, limiting the risk GP&L is left long on energy and thereby exposed to the market. We consider the intermediary supplier role GP&L has assumed under these contracts as an exposure, given the inherent counterparty risks present as a buyer and seller of wholesale power. This is mitigated, however, by the fact that GP&L's wholesale power supply contracts are either mirrored renewable contracts or load-following contracts that match load-forecasts, as well as by our expectation that wholesale sales as a percentage of total operating revenues will decline slightly over the next five years. Further mitigating these risks are the utility's practice of entering into PPAs with diversified suppliers to serve its wholesale loads.

Industry risk: Extremely strong

Consistent with our "Methodology: Industry Risk" criteria (published Nov. 19, 2013), we consider industry risk for municipal retail electric and gas utilities covered under these criteria as very low, and therefore extremely strong when compared with other industries and sectors.

Market position: Strong

We consider the system's electric rates competitive and there are no plans to raise base rates in the near term. Based on the U.S. Energy Information Administration's latest available data from 2017, the system's weighted average system rate competitiveness (based on relative customer classes' revenue contributions) is 100.7% of the state average.

Garland has not opted into rate regulation by the state public utility commission (PUC). In our view, rate-making autonomy is a credit positive that contributes to rate-making flexibility. GP&L's last base-rate increase occurred in January 2002. Since that time, the utility has decreased rates periodically, with an approximately 7% overall drop in 2016, reflecting lower power costs. A 2005 ordinance permitted a rate adjustment factor, which the utility general manager may implement discretionarily. Any adjustments take effect immediately--no board or council approval is required. We view the adjustment factor as a credit positive, enabling management to compensate for any potential fluctuations in power costs.

Operational management assessment: Very strong

We consider the GP&L's power supply diverse and it provides flexibility to purchase a large portion of its energy needs from the market, through spot or day-ahead market purchases (26.8% of its energy in fiscal 2019), which contributes to the utility's strong market position. In addition, its fuel mix has transitioned rapidly from its reliance on coal, via TMPA, at 18% of energy in 2018, to 0% in fiscal 2019, and its increased reliance on unidentified market fuel resources, followed by wind at 30%. In fiscal 2020 and for the next several years, we expect the fuel mix will skew more heavily toward natural gas-fired and renewable resources, reflecting the energy mix of the ERCOT market.

Though GP&L obtains the vast majority of its energy needs through long-term (62% in fiscal 2019) and short-term (4.9%) power purchase contracts, it owns approximately 522 megawatt (MW) of peaking capacity. GP&L is long on energy with a retail system peak of 479 MW in 2018. Its generation assets are for peaking purposes and only represented 5.5% of energy in fiscal 2019. GP&L owns and operates the Ray Olinger Power Plant, a natural gas-fired plant with capacity of 403 MW and its largest owned asset. All of the city-owned and operated generating facilities use natural gas as the primary boiler fuel, except for the 1.8 MW Lewisville Hydro Facility. Although several of the city's units are aging, all remain in service and are used primarily for peaking, and serve to enhance GP&L's overall reliability.

We consider the utility's financial management policies and practices very strong, including monthly review of its recovery adjustment factor based on changes in fuel and purchased power costs, liquidity targets that the utility has historically exceeded, and annually updating its formal multiyear capital planning and financial forecasts.

Financial Risk

Coverage metrics: Strong

Because its portion of TMPA generation debt was paid off in September 2018, GP&L's total actual and imputed fixed-costs are projected to decline by roughly $30 million in fiscal 2019 and will help contribute to stronger levels of fixed-charge coverage in the near term, even as the utility issues additional debt to fund its CIP. Higher fixed costs (including debt service, the 2016 rate decrease, and a lack of rate increases) have translated to thin fixed-charge coverage of almost 1.1x from fiscal years 2017 through 2015. For fiscal 2018, the utility transferred $25 million from its substantial RMF to provide almost 1.2x. In calculating fixed-charge coverage, we treat recurring transfers to the city general fund as operating expenses (these transfers are formulaic). Furthermore, we treat GP&L's historical share of TMPA's debt service and fixed costs as debt-like obligations, and we also impute a share of the utility's purchased power expenses from other sources as debt-like obligations.

In our view, management's updated financial projections indicate fixed-charge coverage could improve to stronger levels over the next five years due to lower imputed fixed-costs, and projections of additional transmission revenue (excluding any transfers from the RMF). We consider management's forecast reasonable, particularly in terms of its additional debt assumptions, and expense assumptions because management assumes recent wholesale power contract extensions over the forecast period. However, we note absent potential nonrecurring TMPA refunds from fiscal years 2019 through 2021 that fixed-charge coverage fluctuates from a robust 1.5x to 1.0x. We view this future variability in fixed-charge coverage as an exposure that is tempered by a sizable RMF that management expects to build over the financial forecast period. Including other potential nonrecurring revenue, fixed-charge coverage ranges from a robust 1.9x to 1.2x through fiscal 2024.

Liquidity and reserves: Extremely strong

Including the substantial RMF balance, total available liquidity was extremely strong, equivalent to over one year's cash on hand in fiscal years 2017 and 2016, respectively (376 and 390 days' cash on hand, respectively). GP&L maintained $196 million in total available liquidity in fiscal 2018 or a robust 322 days' cash. The utility has not projected RMF draws to support rising debt service costs, so we expect it to maintain robust levels. In addition, management projects building its $157 million RMF to over $190 million by fiscal 2021. RMF draws have only occurred in fiscal years 2018 and 2013. In addition, the 2018 CP program has an authorized capacity of $80 million, and CP note proceeds will primarily be used to finance transmission projects.

Debt and liabilities: Strong

We believe the utility's debt burden will continue to increase as it funds roughly 75% of its CIP over the next five years with additional debt. Following the series 2019 debt issue, GP&L will have $480 million in total debt outstanding, including $21 million in GO debt it supports. The electric utility's five-year CIP calls for about $278 million through fiscal 2023, with transmission investments accounting for roughly one-third of the capital program. Management plans to fund the CIP through CP, debt, and revenues from operations.

Over the past several years, GP&L's debt burden has risen, largely as a result of its investments in transmission assets. We note that the system's debt-to-capitalization ratio of 60% in fiscal 2018 has increased steadily over the past five years from 47% in fiscal 2013. Although the investments have led to higher leverage, because transmission in Texas is still regulated, these assets will benefit GP&L financially by way of a regulated rate of return based on filings with the state's PUC. While the commission regulates transmission operations, earnings from those operations are not restricted and GP&L can use them for any lawful purpose. For example, the utility's Limestone-to-Gibbons Creek transmission project was energized in April 2018. The city owns 38.9 miles of the Limestone-to-Gibbons Creek transmission line and a transmission cost of service rate of return from the Texas PUC will recover GP&L's transmission investment.