Garland Power & Light, Texas

Electric Utility System Revenue Bonds
New Issue Report

Ratings

New Issues

$15,000,000 City of Garland, Texas Electric Utility System Revenue Refunding Bonds, New Series 2015[a]	AA–

Outstanding Debt

$86,310,000 Electric Utility System Revenue Bonds, Series 2005, 2006, 2007, 2008, 2009, 2011, 2011A and 2013[b]	AA–
$90,485,000 Electric Utility System Revenue Refunding Bonds, New Series 2014[a]	AA–

[a]Subordinate lien. [b]Senior (prior), closed lien. Par amount as of March 1, 2014.

Rating Outlook

Stable

Key Utility Statistics

Fiscal Year Ended 9/30/13

System Type	Retail Electric
NERC Region	ERCOT
No. of Customers	69,126
Annual Operating Revs. ($ Mil.)	298
Fuel Dependency (%)	58
Primary Fuel Source	Coal
Peak Demand (MW)	474
Energy Growth (%)	(1.9)
Debt Service Coverage (x)	2.3
Days Operating Cash	336
Equity/Capitalization (%)	52.8
System Type	Retail Electric

Related Research

Fitch Rates Garland, TX's 2015 Electric Revs 'AA–'; Outlook Stable (January 2015)

U.S. Public Power Peer Study — June 2014 (June 2014)

Fitch Affirms Texas Muni Power Agency Revs at 'A+'; Outlook Stable (September 2013)

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New Issue Details

Sale Information: Approximately $15,000,000 Electric Utility System Revenue Refunding Bonds, New Series 2015, via competitive sale on Jan. 20, 2015.

Security: Subordinate lien on the net revenues of Garland, TX's, electric utility system, known as Garland Power & Light (GP&L).

Purpose: Refund outstanding Electric Utility System Revenue Bonds, Series 2006.

Final Maturity: March 1, 2026.

Key Rating Drivers

Texas Retail Utility: GP&L serves approximately 69,000 retail customers in a strong service territory located just outside the city of Dallas. The utility owns and operates various generating units, but its principal power source is the Texas Municipal Power Agency (TMPA, A+/Stable).

Robust Liquidity: A sizable rate-mitigation fund (RMF) will enable GP&L to offset increased obligations to TMPA in fiscal 2013–2018 with fewer rate increases. The RMF balance exceeded previous expectations, reaching a peak of $194 million in fiscal 2012 before declining to $175 million in fiscal 2013. GP&L retained 327 days cash on hand at the end of fiscal 2013.

Planned Use of Reserves: Projected cash flow and liquidity metrics remain satisfactory, despite significant draws on the RMF through fiscal 2018. The planned use of available cash is expected to reduce Fitch Ratings-calculated debt service coverage to below 1.0x for several years through fiscal 2018. However, rating concerns regarding the low coverage levels are offset to some degree by liquidity levels that are expected to remain sound and GP&L's other solid credit characteristics.

Good Power Supply: GP&L's 47% entitlement (220 MW) in TMPA's coal-fired Gibbons Creek Steam Electric Station (GCSES) provides a sound baseload power supply currently requiring minimal environmental modifications. The utility's typically high proportion (two-thirds) of energy from the facility poses some degree of single-site generation risk.

Financials Offset Legal Provisions: Healthy financial results offset concerns about the otherwise weak legal provisions on the bonds that allow for a sum sufficient rate covenant, including transfers from the RMF, and require a debt service reserve fund only under certain conditions.

Rating Sensitivities

Wholesale Business Adds Risk: An expansion of GP&L's wholesale business, absent the appropriate controls, could weigh on the rating. GP&L currently manages wholesale market and credit risk by entering into purchase arrangements with established counterparties.

Possible Prior Lien Uplift: A decreasing proportion of senior (prior) closed lien debt and improving lien-specific metrics, coupled with the successful realization of GP&L's overall financial strategy, could cause Fitch to upgrade the lien in the next several years.

Rating History

Rating	Action	Outlook/ Watch	Date
AA–	Affirmed	Stable	1/7/15
AA–	Affirmed	Stable	5/9/14
AA–	Affirmed	Stable	4/25/13
AA–	Affirmed	Stable	12/14/12
AA–	Upgrade	Stable	10/20/11
A+	Affirmed	Positive	5/20/11
A+	Affirmed	Stable	2/12/10
A+	Affirmed	Stable	4/29/09
A+	Upgrade	Stable	6/13/08
A	Affirmed	Positive	3/29/07
A	Affirmed	Stable	3/7/06
A	Affirmed	Stable	3/14/05
A	Affirmed	—	4/12/04
A	Assigned	—	8/1/03

Related Criteria

U.S. Public Power Rating Criteria (March 2014)

Credit Profile

The electric utility's principal source of power is a 220-MW (47%) share of GCSES, which it owns through its interest in TMPA. GP&L's financial operations are strong and its planning for increased fixed obligations over the next several years should benefit its longer term financial stability.

Governance and Management Strategy

Governance Structure

GP&L's governance and management structure is standard for city enterprises. The city uses a council-manager form of government consisting of the mayor and eight council members elected to staggered three-year terms. The city council has ultimate responsibility for GP&L.

The city council appoints the city manager, who is the chief administrative officer of the city. Garland's current city manager has been with the city for more than 42 years, and in this role since March 2003. The city's director of financial services has served the city for more than 36 years, and GP&L's new finance and accounting director since 2012 had previously been a consultant to the utility for a number of years.

Management Strategy

In a positive indication of its planning, GP&L's overall financial strategy has been to effectively prefund a large portion of its financial obligations to TMPA through fiscal 2018 by increasing reserves over a number of years. The proactive approach has enabled GP&L to maintain historical and forecast rate stability, as well as robust financial results.

Customer Profile and Service Area

GP&L provides retail electric service to 69,126 customers in the city of Garland. The depth and maturity of the surrounding Dallas metropolitan economy creates some stability for Garland that ultimately translates to GP&L. The largely built-out city's population is relatively stable, with a 2013 population of 234,566.

The city's income levels are modestly to moderately below average, but employment growth has been nearly two times the national rate over the past couple of years. Per capita income levels are approximately 77% of the national average. However, above average employment growth since 2012 has significantly reduced the city's unemployment rate to 4.9% (October 2014).

GP&L's relatively diverse customer base further lends itself to the utility's overall stability. Residential sales compose upwards of 46% of the total, which helps limit customer concentration. The 10 largest customers represented 18.7% of fiscal 2013 retail sales and 8.0% of operating revenues. Raytheon, the utility's third largest customer, is expected to leave at the end of calendar 2015. The loss, which amounted to approximately 2.2% of MWh sales and 1.1% of revenues, is expected to be manageable.

More recent declines in retail MWh sales, despite continued customer growth, are largely weather related. Retail sales are expected to increase by 3.4% in fiscal 2014, largely due to a colder than normal winter.

GP&L serves 85% of the city's electric customers; a different provider serves the remainder.

Garland Power & Light — Retail Energy Sales and Peak Demand

(Fiscal Year Ended Sept. 30)	MWh	% Change	Peak Demand (MW)	% Change
2013	1,923,610	(1.9)	474	(4.2)
2012	1,960,339	(5.9)	495	(3.9)
2011	2,083,263	1.7	515	4.7
2010	2,049,114	4.3	492	1.4
2009	1,964,073	(4.6)	485	(0.6)
2008	2,058,758	4.2	488	1.0
2007	1,976,683	(5.3)	483	(2.8)
2006	2,088,021	N.A.	497	N.A.

N.A. – Not applicable.
Source: Garland Power & Light.

The Texas Public Utility Commission certifies the boundaries of the respective service territories, and neither provider can serve customers in the other's singularly certified territory.

Wholesale Operations

As a qualified scheduling entity within the ERCOT market, GP&L measurably increased its wholesale sales to municipal and distribution cooperatives in fiscal 2013. GP&L currently provides full- or partial-requirements service to seven contracted customers for various terms through December 2021. Each customer contract has its own heat rate or fixed-rate price, depending on the nature and term of the provided services.

Fiscal 2013 wholesale sales of nearly 1,800,000 MWh rivaled GP&L's native load. Accordingly, the utility's overall enterprise risk is now higher than for a comparable retail utility serving a retail base. Any measurable expansion of this business without commensurate controls could ultimately lead to negative rating pressure.

Assets and Operations

GP&L meets its energy needs through a mix of purchased power and owned resources. Total requirements have grown substantially due to the addition of several new wholesale customers in fiscal 2013. Nevertheless, the ongoing successful implementation of its financial strategy, which began several years ago, is a good indicator of GP&L's overall asset operations.

Gibbons Creek Steam Electric Station

GP&L's primary source of power is TMPA's 470-MW GCSES, which typically supplies about two-thirds of its energy requirements. GCSES's historical operating metrics are in line with industry averages. However, low natural gas prices resulted in a 49% decrease in the unit's fiscal 2012 net generation. Output rebounded in fiscal 2013 with the more recent rise in natural gas prices. GP&L estimates a healthy 80%–85% capacity factor in future years.

The unit is well positioned to be a stable, low-cost resource through its estimated life of 2035. The final maturity of TMPA's generation debt in 2018 is forecast to cause a decline in the wholesale rate to its members. Management has modest expectations for additional environmental retrofits, and emissions credits provide additional cushion.

TMPA owns the baseload coal plant and provides power to its four members under identical court-validated, take-or-pay power sales contracts (PSCs) that expire in September 2018. The PSCs financially obligate the members to TMPA, regardless of actual plant operations. This is notable, given GP&L's large proportionate share of the unit (47%). However, satisfactory asset operations provide some comfort against outage risk.

Replacement operating agreements are under development for the period after the members' existing PSCs expire.

GP&L Owned Units

In addition to its interest in TMPA, the city owns several natural gas generating units and a small hydro facility. While the city has used these units in the past to supplement power from GCSES, they have been used less consistently in recent years due to their age and higher heat rates.

Management expects the utility's existing power supply to be sufficient to meet retail customers' needs for the foreseeable future due to the service territory's more limited forecast growth rate of 0.2% annually.

Wholesale Power Supply Risk Management

GP&L's extensive wholesale sales should provide additional benefit, but they require active management of counterparty credit risk and market risk. The utility appears to manage counterparty credit risk by engaging with highly rated suppliers, such as Shell Energy North America, J.P. Morgan (A+/Stable) and NextEra Energy, Inc. (A–/Stable) under industry standard master agreements, including Edison Electric Institute (EEI) and International Swaps and Derivatives Association. In addition, its wholesale purchasers enjoy full rate-setting authority.

Garland Power & Light — Retail Power Supply

Owned	Type	Capacity (MW)	Year in Service
Ray Olinger	Steam Turbine	78	1966
Ray Olinger	Steam Turbine	107	1971
Ray Olinger	Steam Turbine	146	1975
Ray Olinger	Combustion Turbine	75	2001
Spencer	Steam Turbine	61	1966
Spencer	Steam Turbine	61	1972
Spencer	Hydro	2	1991
Subtotal		**530**	
Firm Purchased[a]		221	
Total		**751**	

[a]Texas Municipal Power Agency (Gibbons Creek Steam Electric Station).
Source: Garland Power & Light.

GP&L principally enters into bilateral contracts with these large marketers to cover its wholesale customers' requirements. To a lesser extent, the utility will use its own resources or day-ahead markets where the economics are advantageous. For example, GP&L will purchase heat rate contracts and hedge its natural gas requirements to mitigate the price risk for wholesale customers with fixed-rate contracts.

Although there are no specific margin terms, GP&L can require collateral postings from its customers through adequate assurance provisions embedded in each EEI agreement. While all of the purchasers have full rate-setting authority, GP&L increased its fiscal 2013 working capital requirements to 75 days from 45 days to help manage receivables.

Cost and Rate Structure

GP&L's financial strategy should ultimately preserve its flexibility to generate additional revenues through rates. The utility plans to use its sizable RMF in lieu of rate increases to meet increased TMPA obligations through fiscal 2018. Existing retail rates are above the Texas average (114%), but the utility's limited forecast rate action and low-cost source of power in the GCSES will likely cause rates to become more competitive over time. Extensive wholesale sales should provide additional benefits, but present their own risks.

GP&L's 10-year financial forecast calls for 1.00 cent/kWh, 0.80 cent/kWh and 1.45 cent/kWh rate increases in fiscal 2016, 2022 and 2023, respectively. Better than expected cash flows principally from wholesale operations have pushed out a fiscal 2018 rate increase that had been planned during Fitch's 2013 review of the utility. GP&L's rates were last increased in January 2006; four rate decreases followed.

GP&L's rate structure includes a base rate and a rate adjustment factor (RAF). Changes to the base rate require approval from the city council. However, the utility director can change the RAF as necessary to ensure the system's balanced financial operations. The city has full rate-setting authority.

Financial Performance and Legal Provisions

Solid financial planning has positioned GP&L well to manage increased TMPA obligations through the duration of its PSC and a larger debt load. Robust operating margins and debt service coverage in recent years helped the utility establish a healthy financial position, including its sizable RMF.

GP&L's average debt service coverage ratio over the past five years (3.9x) was nearly double Fitch's 'AA–' rating category median of 2.2x. The utility began augmenting cash flows with draws on its RMF in fiscal 2013. Debt service coverage consequently began to moderate to still-strong levels of 2.3x that year, as expected. Likewise, cash on hand fell to 336 days from 647 days in fiscal 2012.

GP&L's projected debt service and TMPA obligations rose to an average of $124 million in fiscal 2013–2018, or by about one-fifth more than the average of fiscal 2008–2010. Garland nearly doubled its existing debt in February 2010 with $127 million of bonds to refund its portion of three TMPA bonds. The city's bonds effectively brought those TMPA obligations onto GP&L's balance sheet and extended its debt maturities to 2030 from 2018 to better match the useful life of GCSES (now 2035).

The refunding provided a respite in fiscal 2011–2012 TMPA demand charges to continue building balances in the RMF. GP&L's total obligations will fall slightly below historical norms after TMPA's currently remaining power supply bonds fully mature in fiscal 2018.

Debt service payments are made after Garland's considerable off-balance sheet obligation to TMPA for purchased power, which is paid as an operating expense of GP&L (i.e. before the electric utility's own debt service). The obligation to TMPA is unconditional and not dependent on the receipt of power from the GCSES.

Rate-Mitigation Fund

GP&L's outsized RMF provides exceptional liquidity and flexibility to manage increased financial obligations through fiscal 2018 while preserving rate-raising flexibility, as noted. The RMF grew to a peak of $194 million in fiscal 2012, which is considerably higher than early projections of $143 million in 2011. Moreover, planned draws totaling $164 million are well below the $191 million forecast as recently as 2013.

Additional margins from contracted wholesale sales have materially contributed to the stronger RMF balances, and enabled GP&L to limit planned draws from its RMF and maintain retail rate stability.

Financial Projections

Augmenting cash flows with draws on the RMF has naturally limited the high operating margins and debt service coverage ratios that GP&L has produced to generate additional cash flows in recent years. However, projected coverage ratios remain satisfactory, given the utility's overall financial strategy.

By Fitch's calculations, GP&L's forecast debt service coverage averages 2.0x through fiscal 2023, including transfers from the RMF, or 1.41x excluding the transfers. This includes the next proposed issuance of debt in fiscal 2017 ($60 million). Fitch's 'AA–' median for debt service coverage is 2.35x.

Projected retail sales revenue increases by an average of 2.6% through fiscal 2023, including 1.00 cent/kWh, 0.80 cent/kWh and 1.45 cent/kWh rate increases planned for fiscal 2016, 2022, and 2023, respectively. Forecast retail sales tick up by a modest 0.2% annually, as noted. Forecast wholesale revenues trend steadily downwards given the current expiration dates of GP&L's wholesale contracts. Pursuit of additional wholesale contracts to replace expiring agreements may alter forecasts in future years.

Of note, a large portion of the utility's outstanding debt carries a pledge of ad valorem revenues. However, in practice, debt related to the electric system is serviced by electric revenues. Accordingly, Fitch measures the entity's ability to service the entirety of its financial obligations from the electric system's net revenues.

General Fund Support

Transfers to the city's general fund are above average but have not limited GP&L's ability to build liquidity or equity levels. GP&L does not make a formal general fund transfer. Instead, the city council uses a return on investment methodology that represents a percentage of gross electric revenues. The transfer, adjusted annually, has averaged 8.4% of total electric revenues, or $20.2 million annually over the past five years. Fitch's 'AA–' median is 6.8%. GP&L's 52.8% ratio of equity to capitalization is in line with the median.

Legal Provisions

GP&L's healthy financial position mitigates its otherwise weaker legal provisions that require a sum sufficient rate requirement, including transfers from the RMF, and the establishment of a reserve fund only under certain limited circumstances.

Security

The new series 2015 revenue bonds are secured by a subordinate lien on GP&L's net revenues. GP&L currently has $85.2 million in outstanding senior lien bonds.

Rate Covenant

The city has covenanted in the ordinance to maintain rates and charges such that net revenues, coupled with transfers into the system fund, equal at least the aggregate annual debt service requirement, plus any amounts owed to the reserve funds and for other system indebtedness.

Net revenues are calculated after provision for operation and maintenance expenses, as well as depreciation expense.

Additional Bonds Test

Additional bonds may be issued if historical debt service coverage in any 12 consecutive months within the 15 months preceding the passage of an ordinance authorizing the issuance of additional bonds equaled at least:

- 1.25x average annual debt service for the then-outstanding bonds (both liens) and the proposed bonds, and;
- 1.00x the maximum annual debt service for the then-outstanding bonds (both liens) and the proposed bonds.

The calculations are subject to certain adjustments for rate adjustments that would increase coverage calculations to the stated levels.

Debt Service Reserve Fund

The ordinance does not require a reserve fund, as long as annual debt service coverage on the series 2014 and any parity (subordinate lien) bonds equals at least 1.5x. A reserve fund must be established within 60 months (equal payments) at increasing percentages of average annual debt service if coverage falls below 1.5x at fiscal year end, peaking at 50% of average annual debt service if coverage falls below 1.1x.

GP&L is not required to maintain a reserve fund if subsequent calculations of debt service coverage equal at least 1.5x in two consecutive fiscal years.

Financial Summary — Garland Power & Light, Texas

($000, Audited Years Ended Sept. 30)	2013	2012	2011	2010	2009
Debt Service Coverage (x)					
Debt Service Coverage (DSC)	2.33	4.11	4.12	3.84	5.09
Adjusted DSC (Including Purchased Power Adjustment as D/S)	1.63	2.93	2.75	2.14	2.45
Adjusted DSC (Including Transfer/PILOT/Dividend as O&M Expense)	1.43	3.20	3.22	2.66	3.69
Coverage of Full Obligations (PP as D/S and Transfer/PILOT/Dividend as O&M Expense)	1.20	2.37	2.24	1.67	1.96
Liquidity Metrics					
Days Cash on Hand	38	196	204	160	214
Days Funds on Hand	336	647	549	350	310
Days Liquidity on Hand	525	988	549	350	310
Leverage Metrics					
Debt/FADS (x)	6.3	3.2	3.2	4.5	2.5
Adjusted Debt (Including PP Adjusted)/Adjusted FADS (Including PP Adjusted) (x)	6.8	3.9	4.0	5.5	3.9
Debt/Total Retail Customers ($)	5,093.4	4,307.9	4,356.6	4,412.7	2,440.7
Debt/Electric Customers ($)	5,093.4	4,307.9	4,356.6	4,412.7	2,440.7
Net Debt/Net Capital Assets (%)	30.3	14.1	28.8	44.5	(2.9)
Equity/Capitalization (%)	52.8	56.9	54.1	50.5	63.3
Debt/Capitalization (%)	47.2	43.2	45.9	49.5	36.7
Adjusted Debt/Capitalization (%)	59.0	50.9	55.7	62.4	55.5
Other Financial and Operating Metrics					
Operating Margin (%)	12.7	31.4	32.7	21.0	22.8
Retail Electric Revenue/kWh (Cents/kWh)	10.7	11.3	10.7	11.3	11.7
Transfer and PILOT/Total Operating Revenues (%)	7.3	9.0	9.1	8.8	8.0
Capex/Depreciation and Amortization (%)	391.0	85.7	114.2	127.0	265.9
Debt Service/Cash Operating Expenses (%)	9.1	14.2	14.6	9.5	7.3
Income Statement					
Total Operating Revenue	297,758	223,701	223,505	232,469	231,131
Total Operating Expense	260,103	153,421	150,327	183,585	178,383
Operating Income	37,655	70,280	73,178	48,884	52,749
Adjustments to Operating Income	18,396	20,874	19,377	18,051	14,288
Funds Available for Debt Service	56,051	91,155	92,555	66,934	67,037
Total Annual Debt Service	24,052	22,157	22,450	17,431	13,167
Balance Sheet					
Unrestricted Funds (Cash and Liquid Investments)	222,718	237,424	198,025	159,642	141,804
Restricted Funds	25,104	20,080	22,250	24,660	31,518
Total Net Assets/Member's Equity	394,007	388,126	348,840	306,298	286,423
Total Debt	352,089	294,642	296,396	300,066	165,861
Cash Flow Statement					
FCF (FADS – Transfer and PILOT – Total Annual Debt Service)	10,340	48,814	49,792	28,994	35,472
Capex	72,050	16,701	21,220	21,734	30,237
FCF Less Capex	(61,710)	32,113	28,571	7,260	5,235

D/S – Debt service. PILOT – Payment in lieu of taxes. O&M – Operations and maintenance. PP – Purchased power. FADS – Funds available for debt service.
Source: Garland Power & Light, Fitch.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.