STANDARD & POOR'S
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Summary:

Garland, Texas; Retail Electric

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Summary:

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Credit Profile		
US$14.975 mil Elec Rev Rfdg Bnds ser 2015 dtd 02/01/2015 due 03/01/2025		
Long Term Rating	A+/Stable	New
Garland retail elec		
Long Term Rating	AA-/Stable	Affirmed
Garland elec		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'A+' long-term rating, and stable outlook, to Garland, Texas' series 2015 electric utility system revenue refunding bonds. At the same time, Standard & Poor's affirmed its 'AA-' underlying rating on the prior-lien revenue bonds of the system, doing business as Garland Power & Light (GP&L). The outlook is stable.

The 2015 bonds are secured by a subordinate-lien net revenue pledge of the electric system secures the bonds, and are rated one notch below the prior lien bonds. The prior lien is closed to new debt issuance.

Factors that support the rating include:

- A solid financial profile, which includes a sizable rate-mitigation fund balance of slightly more than $176 million as of Nov. 30, 2014. This provides the system with significant liquidity support even with expected draws on that fund through fiscal 2018 to smooth the impact of high demand charges;
- The system's willingness to adjust base rates and implement a regular fuel-cost adjustment, although operating results have allowed management to maintain the 1-cent rate reduction since 2010; and
- A strong and diverse economy, with above-average wealth in the customer base, boosted by its participation in the Dallas-Fort Worth metropolitan statistical area.

We believe that offsetting credit weaknesses include the system's off-balance-sheet obligation of a 47% share of, as of the beginning of fiscal 2015, about $695 million to Texas Municipal Power Agency (TMPA) . The GP&L system's cash flow also supports about $162 million of general obligation (GO) indebtedness issued for electric system purposes. In addition, the U.S. Environmental Protection Agency's (EPA) recent and pending actions regarding power plant emissions could contribute to rising power production costs, particularly for GP&L's coal-fired resources, although the regulations, which are not final, will not be implemented fully for many years.

Bond proceeds will refund the series 2006 revenue bonds. The 2015 bonds will be issued under an ordinance enacted in 2014. The prior lien is effectively closed, and the prior-lien bonds outstanding ($68 million, following the proposed refunding transaction) are to mature by 2031.

TMPA's key asset is the Gibbons Creek coal-fired power plant. It installed scrubbers in 2011 to the single unit, 470 megawatt (MW) plant, but might still have to add pollution controls by 2016 for other EPA-identified air emissions. Gibbons Creek also saw diminished use in 2012 given current low prices for natural gas, which also prompted TMPA to reduce the volume of coal deliveries to the plant. The plant's usage, however, increased in fiscal 2013, with a capacity factor of 58%, up from just 42% in 2012; the reduced coal deliveries ultimately led to a revision in the coal supply contract, as the result of a settlement from TMPA to the supplier. The coal contract settlement came at a time when TMPA was revisiting a complaint against the railroad that transports the coal, alleging captive customer pricing. While the federal Surface Transportation Board ultimately upheld the railroad's rates, TMPA reached a settlement that lowered the minimum delivery threshold as well as a reduction on the future delivery rate. We believe these coal supply and rail contract developments are favorable for the plant's operating costs. GP&L management expects that the plant's capacity factor will increase to about 65% for the next three years, which we believe will increase its cost-effectiveness.

Since a 2005 ordinance permitted a fuel-cost adjustment, which includes costs associated with Garland's power contract with TMPA, DSC and cash levels have remained what we consider strong; for fiscal 2013, this included DSC of GP&L's revenue-secured debt of more than 5x, and coverage of all debt -- including the self-supporting GO debt -- of 2.4x. While the fiscal 2013 figures are down from those of fiscal years 2011 and 2012, when TMPA demand charges were unusually low due to a debt restructuring, they are nearer to, albeit lower than historical norms. For fiscal 2013, when accounting for fixed demand charges to TMPA as well as transfers to the city's general fund, fixed charge coverage was 1.15x, compared with 1.44x in fiscal 2010. Including the substantial rate-stabilization fund balance, total available liquidity was about 337 days' cash on hand in 2013, well above its 45-day working capital policy, but down from fiscal 2012's 648 days. The decline is more representative of the increase in power cost expenses in 2013 than a decline in liquid assets. Management has long represented that the rate-stabilization reserve provides it the cushion to offset TMPA demand charges that will peak at about $77 million in 2018, before plummeting thereafter. In fiscal 2014, budgeted drawdowns from the electric system's rate-mitigation fund of $8 million were not necessary based on strong operating performance during the year. The estimated balance in the rate mitigation fund as of November 30, 2014 remains a sizable $176 million.

GP&L's five-year, $173 million capital improvement program (CIP) is manageable. It calls for about $88 million of debt-financed non-transmission projects, which we expect the utility to fund initially with commercial paper, and later with long-term bonds. Garland's share of a joint transmission project (the Houston Import Project) is $100 million. GP&L has partnered with South Texas Electric Cooperative on two new 345 kilovolt lines that will bring west Texas wind energy to central Texas, as part of the state's Competitive Renewable Energy Zone program. Because transmission in Texas is still regulated, these assets, which were energized in January 2014, will benefit GP&L financially by way of a regulated rate-of-return based on filings with the state's public utility commission. Management expects to receive final approval on its most recent transmission cost filing in early 2015. While the PUC regulates transmission operations, earnings form transmission operations are not restricted, and GP&L can use them for any lawful purpose. Management expects that, based on interim rulings, its annual transmission revenues will rise to about $32 million annually from $25 million in 2014.

Firm bilateral agreements with several central Texas distribution systems have bolstered GP&L's off-system sales, which totaled about $106 million in fiscal 2013. Many of these public power and cooperative systems are former customers of the Lower Colorado River Authority (LCRA) who left LCRA in 2012 and 2013 under breach of contract allegations against the authority. While the former LCRA customers who have not settled litigation, the authority could, under court order, be compelled to honor their existing respective power purchase contracts that last through June 2016. GP&L has no debt exposure related to these wholesale agreements.

Outlook

The stable outlook reflects our expectation of continued use of the fuel-cost adjustor as needed, as well as its conservative risk management in operations and off-system sales. We believe this will allow GP&L to maintain financial metrics, including DSC and liquidity appropriate to this rating. While we expect large use of the rate-mitigation fund and have incorporated this into the rating, a faster-than-expected drawdown of this designated reserve due to open-ended transfers, or what we view as aggressive risk-taking or other unplanned fixed-cost obligations (absent an offsetting revenue increase), could be a reason to revisit the rating. In addition, we are not able to predict the impact of EPA rulemaking, if any, on greenhouse gas emissions in general and to TMPA in specific. Should regulations not affect credit quality, a higher rating could be justified, even if outside our two-year outlook horizon.

Related Criteria And Research

Related Criteria

USPF Criteria: Electric And Gas Utility Ratings, Dec. 16, 2014

Ratings Detail (As Of January 15, 2015)		
Garland retail elec		
Long Term Rating	A+/Stable	Affirmed
Garland retail elec (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Garland elec		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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