FITCH RATES GAINESVILLE REGIONAL UTILITIES BONDS (FL) 'A+'; OUTLOOK STABLE

Fitch Ratings-New York-13 March 2019: Fitch Ratings has assigned a 'A+' rating to the following bonds for the city of Gainesville, FL:

--$159 million utilities system revenue bonds, 2019 series A;
--$27 million utilities system revenue bonds (federally taxable), 2019 series B;
--$68 million utilities system revenue bonds, 2019 series C.

Bond proceeds will be used primarily to finance the costs of acquisition and construction of capital improvements, reimburse GRU for funds previously used for capital spending, refund and restructure outstanding variable rate bonds and the Commercial Paper Notes, Series C, and pay issuance costs. The bonds are expected to sell via negotiation the week of April 2.

In addition, Fitch has downgraded the following ratings to 'A+' from 'AA-':

--Approximately $1.5 billion in outstanding utility system revenue bonds.

Fitch has also affirmed $85 million utilities system tax-exempt commercial paper (CP) notes program series 2010C at 'F1+'

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a first lien on the net revenues of Gainesville Regional Utilities (GRU), which is the combined electric, gas, water, wastewater and telecom systems (collectively, the system) supporting the city of Gainesville, FL.

KEY RATING DRIVERS

HIGH SYSTEM LEVERAGE: The downgrade of GRU's outstanding debt reflects a weakening of the system's already high leverage profile. While leverage is expected to decline gradually over time, net adjusted debt to adjusted funds available for debt service (FADS) is now expected to remain above 9.0x through 2021, a level that Fitch believes is not supportive of a 'AA' category rating.

COMBINED UTILITY SYSTEM: GRU is a combined utility system providing electric, gas, water, wastewater and telecom services to the city of Gainesville, FL and surrounding areas. Electric rates are elevated compared with peer public power systems, but comparability improved in 2018 following a decrease in rates. GRU's other utilities are generally more competitive. Each utility is self-supporting and financially stable.

HEALTHY SERVICE AREA: Service is provided to and around the city and certain locations of the University of Florida, which helps anchor the service area. Steady population growth and new development continue to be viewed favorably, offsetting demographics that are weakened by a high student population. No customer concentration exists.

STABLE FINANCIAL RESULTS: GRU's coverage metrics have remained stable in recent years as changes in rates have been balanced against cost reductions and stabilized general fund transfers. Fitch-calculated debt service coverage (DSC) in fiscal 2018 was 1.9x, which is slightly better than results recorded in the prior two years. Coverage of full obligations, which incorporates the GF transfer, was 1.5x in 2018. Liquidity remains solid but has declined in recent years.

DIVERSE RESOURCE BASE: GRU's portfolio of owned generation is diverse by number of assets and by fuel type. Total available capacity is comfortably in excess of peak demand and in 2018, energy dispatched by fuel source was led by natural gas (42%), followed by biomass (27%) and coal (26%).

POTENTIAL LIQUIDITY DEMANDS WELL COVERED: GRU's 'F1+' rating reflects the utility's solid long-term rating and ample internal liquidity, which provides coverage of maximum potential short term requirements in excess of Fitch's 125% threshold for an 'F1+' rating.

RATING SENSITIVITIES

FINANCIAL PERFORMANCE AND LEVERAGE: Fitch expects GRU will maintain consistent financial margins and gradually reduce leverage as projected over time. Failure to reduce leverage to levels more consistent with 'A' category medians could result in further downward rating pressure.

MAPPING TO THE LONG-TERM RATING: A further downgrade of GRU's long-term rating would result in a corresponding reduction of its short-term rating, pursuant to Fitch's short-term rating criteria.

CREDIT PROFILE

The city of Gainesville is located in north-central Florida and is the home of the University of Florida (UF). Including the large student population, the city has an estimated population of about 132,000, making it the largest city in Alachua County. UF's enrollment exceeds 57,000 and the university remains the largest employer in the county with more than 27,500 employees. Overall, the city's employment base is well diversified among the healthcare, higher education, and light industrial and commercial sectors.

GRU provides retail electric, gas, water, wastewater and telecommunications services to approximately 279,000 customers across the five utility systems. The electric system is the largest, accounting for over half of total system revenues. The water, wastewater and gas systems serve territories that are similar to, and overlap, the electric system. Each of the systems is self-supporting and stable, exhibiting no customer concentration. Rates are above average for the electric system but more competitive for the others.

VERY HIGH LEVERAGE BASIS FOR DOWNGRADE

Despite a gradual decline in total debt over the past few years, GRU's leverage profile is very high and a main credit weakness for the utility. As of fiscal-end 2018, GRU had about $1.6 billion of total debt outstanding and $93 million of outstanding commercial paper. A portion of the 2019 bond proceeds will be used to repay outstanding CP with long term debt, leaving total debt outstanding relatively unchanged.

Nevertheless, leverage, as measured by net adjusted debt to adjusted FADS, has been elevated for many years before rising to a very high 11.0x in fiscal 2018. A combination of factors in 2018 led to the higher levels, including a decline in cash for capital spending and lower residential and commercial rates in 2018, which are well above the median for systems rated even in the 'A' category.

Fitch anticipates a decline in leverage over the next five years based on financial projections provided by GRU, which include expectations for meaningful pay-go capital spending, additional rate increases and scheduled debt amortization. In addition, as a combined system with significant water and sewer operations, Fitch believes GRU can maintain a slightly larger amount of financial leverage relative to its solely electric service providing peers.

STABLE FINANCIAL PERFORMANCE

GRU's historical operating performance has been solid, although the somewhat weaker metrics over the past few years resulted from higher operating costs associated with GRU's agreement to buy power from the biomass plant (previously known as GREC, prior to its purchase by GRU in 2017) beginning in late 2013. Results have stabilized at sound levels as evidenced by Fitch-calculated DSC at 1.9x in three of the past five fiscal years, including fiscal 2018. After transfers to the general fund, coverage of all fixed obligations was lower, but still good at 1.5x in 2018.

In fiscal 2018, GRU had $26.8 million in current cash and investments plus $57.7 million in rate stabilization reserves. In addition, $14.7 million in cash was set aside for utility plant improvements. A portion of the 2019 proceeds will be used to reimburse the utility plant improvement fund for previous capital spending of about $23 million. Including rate stabilization funds and other cash and investments, liquidity remained healthy with 135 days cash on hand in fiscal 2018. GRU forecasts reserves remaining near these levels as a sizable portion of its excess cash flow is used for pay-go capital spending.

AMPLE LIQUIDITY SUPPORTS SHORT-TERM RATING

The 'F1+' rating reflects GRU's solid long-term rating and ample internal liquidity, including monies in the rate stabilization fund. Credit facilities with Bank of America (A+/F1) provide support for the CP programs and expire on Nov. 30, 2021.

DIVERSE RESOURCES

GRU maintains access to a well-diversified portfolio of power supply resources that include coal, natural-gas and waste wood capacity, totaling about 634MW. Peak demand for 2018 was 408MW, which was comfortably below total available capacity even when including a 15% reserve margin. Management believes the system's resources are adequate through at least 2022, which coincides with the scheduled retirement of the 75MW Deerhaven Station #1.

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A January 2018 district court ruling that dismissed claims regarding payment of Puerto Rico Highways and Transportation Authority debt has raised questions about the scope of protections provided by Chapter 9 of the U.S. bankruptcy code to bonds secured by pledged special revenues. Fitch's rating criteria treat special revenue obligations as independent from the related municipality's general credit quality. The outcome of the litigation could result in modifications to Fitch's approach. For more information, see "What Investors Want to Know: The Impact of the Puerto Rico Ruling on Special Revenue Debt" available at www.fitchratings.com.

In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed from Lumesis.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Fitch Internal Liquidity Worksheet (pub. 15 Feb 2019)
https://www.fitchratings.com/site/re/10063363
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)
https://www.fitchratings.com/site/re/10020113
U.S. Public Finance Short-Term Debt Rating Criteria (pub. 01 Nov 2017)
https://www.fitchratings.com/site/re/905637
U.S. Public Power Rating Criteria (pub. 18 May 2015)
https://www.fitchratings.com/site/re/864007