Fitch Ratings

Fitch Rates Gainesville Regional Utilities Bonds (FL) 'AA-'; Outlook Stable

Fitch Ratings-New York-28 September 2017: Fitch Ratings has assigned a 'AA-' rating to the following bonds for the city of Gainesville, FL:

--Approximately $415 million utilities system revenue bonds, 2017 series A.

Bond proceeds will primarily be used to finance a portion of the costs of acquiring the Gainesville Renewable Energy Center (GREC), an existing 102 megawatt biomass power plant located in Gainesville, FL. The bonds are expected to sell via negotiation the week of Oct. 23.

The Rating Outlook is Stable.

In addition, Fitch affirms the following ratings:

--Approximately $850 million in outstanding utility system revenue bonds, multiple series at 'AA-';

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

SECURITY

The revenue 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. The CP notes are secured by an interest in GRU's net revenues that is subordinate to senior-lien indebtedness.

KEY RATING DRIVERS

COMBINED UTILITY SYSTEM: GRU is a combined utility system providing retail electric, gas, water, wastewater, and telecom services to the city of Gainesville, FL and surrounding areas. The electric utility is the largest system, accounting for 56% of combined revenue. Each individual utility is self-supporting and financially stable.

GREC PURCHASE: GRU is in the process of purchasing the privately-owned biomass facility (GREC) for $750 million. Fitch believes the purchase is credit neutral as it will replace fixed operating payments with lower, mostly fixed debt payments while adding an owned-asset to GRU's fleet. Most of the anticipated savings will be passed to GRU ratepayers, providing some rate relief.

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, and no customer concentration exists.

ELEVATED LEVERAGE: Leverage ratios, including adjusted debt to adjusted funds available for service (FADS) and equity to capitalization are weak for the rating category. The proposed buyout will reduce total debt obligations, but overall leverage should remain at similar levels. Adjusted debt to FADS is expected to remain above 8.0x initially, but gradually decline to roughly 7.0x by 2021.

STABLE FINANCIAL RESULTS: A combination of cost reductions, stabilized general fund transfers and rate increases have resulted in stable financial results despite GREC cost pressures over the past several years. Fitch-calculated debt service coverage (DSC) in fiscal 2016 was a solid 1.8x, which is similar to coverage levels over the prior two years.

LOWER ELECTRIC RATES EXPECTED: Electric rates are elevated compared to public power systems throughout the state, while the residential rates for GRU's other systems are generally more competitive. The GREC purchase is anticipated to lower electric rates, and expectations for additional rate increases to help fund capital spending are generally manageable.

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 PROFILE and LEVERAGE: Fitch expects Gainesville Regional Utilities will maintain consistent financial margins and gradually reduce leverage. Failure to reduce leverage to levels more consistent with 'AA' category medians, whether as a result of increases in transfer payments to the city, insufficient rate recovery or an increase in debt-funded capital expenditures could result in downward rating pressure.

MAPPING TO THE LONG-TERM RATING: A downgrade of GRU's long-term rating (AA-/Stable) could 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 128,000, making it the largest city in Alachua County. UF's fall 2017 enrollment exceeded 52,000 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.

GREC TRANSACTION

GRU has agreed to terms with the owners of GREC to purchase the existing 102 MW facility for $750 million. GRU will issue the 2017A fixed-rate bonds and two series of variable rate bonds, expected to be privately placed, for a total of approximately $680 million in total par. The GREC purchase price was determined using the estimated net present value of the future fixed PPA payments.

The existing PPA, which expires in 2043, requires GRU to pay certain minimum fixed costs regardless of whether any power is required and/or taken, and includes a variable component based on energy delivered. While GRU has discretion over dispatch, the fixed PPA payment totaled $76 million in 2016, and total payments are estimated to equal $1.7 billion over the remainder of the contract.

GRU's decision to purchase the plant is mainly economic. Under the current proposed financing structure, which assumes approximately $680 million of new debt, GRU will terminate the PPA and its large fixed annual payments and essentially replace the lease payment with annual debt service of roughly $38 million. Most of the annual expected savings will be returned to customers through lower electric rates.

Purchasing GREC will provide GRU with certain other advantages including the flexibility to operate/dispatch GREC at levels more economically advantageous than previously allowed under the contract (including control over scheduled outages) and reduced long-term balance sheet obligations, by eliminating the current capitalized lease associated with GREC and replacing it with long-term debt, by roughly $300 million.

ELEVATED LEVERAGE IS A CREDIT CONCERN

Including nearly $1 billion in capital lease obligations related to GREC, GRU's total leverage is high for the rating category. Total adjusted debt to FADS was 9.3x in 2016 and equity capitalization totaled just 19.85%. GRU's debt balance and capitalization should improve somewhat after the purchase of GREC. Total long-term obligations will decline by $300 million and expected additional bonding plans over the next five years should be manageable. However, since pro forma leverage will also be impacted by expected future cash flows and rate recovery, a decline in margins could lead to higher leverage (debt/FADS) even if total debt obligations are lower than current levels.

STABLE FINANCIAL PERFORMANCE

GRU's historical financial performance has been solid, although weaker metrics over the past few years resulted from the higher operating costs associated with GREC beginning in late 2013. Positive steps to stabilize financial performance were taken, including the implementation of a system-wide cost reduction program, debt refinancing and support for larger, near-term electric rate adjustments.

While weaker, financial metrics have stabilized at sound levels as evidenced by Fitch-calculated DSC at 1.9x in fiscals 2014 and 2015, and 1.8x in fiscal 2016. After general fund transfers, coverage of fixed obligations was lower, but still solid at 1.6x over the past three years.

In fiscal 2016, GRU had $62.6 million in current cash and investments plus $74.3 million in rate stabilization reserves. In addition, $58.8 million in cash was set aside for utility plant improvements. GRU's forecast shows reserves decreasing over time to about $94 million in total through 2022. Including rate stabilization funds, liquidity remained healthy with 228 days cash on hand in fiscal 2016.

AMPLE LIQUIDITY SUPPORTS SHORT-TERM RATING

GRU incorporates a risk management study for each of its utilities and sizes the cash reserves needed to support the levels of risk identified by the risk indicators. The utility has identified a cash reserve target of $59 million for fiscal 2017. GRU also maintains two commercial paper programs totaling $110 million which provide additional liquidity; $85 million of authorized tax-exempt commercial paper ($45 million outstanding) and $25 million of authorized taxable commercial paper ($8 million outstanding; not rated by Fitch).

The 'F1+' rating reflects GRU's solid long-term rating and ample internal liquidity, including monies in a rate stabilization fund, totaling approximately $170 million as of June 30, 2016. Credit facilities with Bank of America (rated A+/F1) provide support for the CP programs and expire on Nov. 30, 2018.

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Applicable Criteria
Fitch Internal Liquidity Worksheet (pub. 13 Jun 2013)
(https://www.fitchratings.com/site/re/710906)
Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017)
(https://www.fitchratings.com/site/re/898969)
Rating U.S. Public Finance Short-Term Debt (pub. 08 Feb 2017)
(https://www.fitchratings.com/site/re/893974)
U.S. Public Power Rating Criteria (pub. 18 May 2015)
(https://www.fitchratings.com/site/re/864007)

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