

CREDIT OPINION

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Gainesville (City of) FL Combined Util. Ent.

Update following rating affirmation

Summary

Gainesville (City of) FL Combined Utility Enterprise (GRU)'s credit profile (utility system revenue bonds, Aa3 stable) recognizes positively the successful integration of the biomass plant facility into GRU's generation and dispatch profile following the completion of the buyout at the end of 2017. The biomass plant has achieved solid availability and capacity factors in 2018 and GRU has realized the projected cost savings.

In the near-term, GRU will focus on investments in technology upgrades across its system and will face higher debt service of around \$110 million on average per annum. This will put some pressure on management to contain cost inflation and, if necessary, increase rates.

Other credit factors include (1) a resilient service territory, (2) GRU's diversified operations as a combined utility enterprise, (3) a track record of maintaining solid financial metrics and raising rates when necessary, (4) high leverage (debt ratio 74.6% in fiscal year 2018) but expected debt reduction over time, (5) high rates, albeit modestly reduced after the recent rate reduction, (6) no debt service reserve requirement, (7) substantial variable rate and commercial paper (CP) exposure, (8) high transfers to the city's general fund (\$36.4 million in fiscal year 2018).

Credit Strengths

- » Successful integration of biomass plant and realization of expected cost savings
- » Resilient service territory and diversified operations as a combined utility enterprise
- » Track record of maintaining solid financial metrics and raising rates when necessary
- » Good liquidity profile

Credit Challenges

- » High fixed cost base will put pressure on fixed charge coverage ratios and customer rates
- » High leverage
- » No debt service reserve fund requirement
- » Exposure to variable rate debt and CP- notes
- » High transfers to city's general fund

Rating Outlook

The stable rating outlook reflects our expectation that GRU will maintain fixed charge coverage ratios in the 1.4-1.5x range and will maintain a good liquidity profile.

Factors that Could Lead to an Upgrade

- » A fixed charge coverage ratio maintained at around 1.6x on a sustained basis
- » Maintaining adjusted days cash on hand above 250 days (including unused capacity under the commercial paper program)

Factors that Could Lead to a Downgrade

- » Cost pressures preventing timely future rate adjustments and fixed charge coverage ratios declining below 1.4x on a sustained basis and inability to reduce leverage
- » Deteriorating liquidity profile with adjusted days cash on hand materially below 200 days cash on hand
- » More aggressive demands for transfers to the city's general funds
- » Short-term: The short-term P-1 rating on the commercial paper note and the VMIG-1 ratings could be downgraded if Moody's were to downgrade the short-term rating of the banks providing liquidity support to the commercial paper notes or providing standby purchase agreements to the variable rate debt

Key Indicators

Exhibit 1

Key Indicators - Gainesville (City of) FL Combined Utility Enterprise

Column1	2014	2015	2016	2017	2018
Operating Revenue (\$'000)	379,461	392,381	400,258	426,980	402,554
Debt Outstanding (\$'000)	1,942,058	1,948,060	1,908,254	1,871,709	1,627,340
Debt Ratio (%)	79.5	79.4	78.6	80.7	74.6
Total Days Cash on Hand (days)	196	182	192	162	146
Adjusted Days Liquidity on Hand (incl. Bank Lines)(days)	264	242	259	230	235
Debt Service Coverage (x) (Bond Ordinance Basis - Senior Lien)	2.38	2.48	2.52	2.50	1.88
Fixed Obligation Charge Coverage (if applicable)(x)	1.54	1.62	1.71	1.95	1.49

Source: Moody's Investors Service

Profile

Gainesville Regional Utilities is a municipally-owned utility system in Gainesville, FL with electric generation and transmission, natural gas, water, wastewater and telecommunication services. In 2018, GRU reported total revenues of around \$402.6 million and had 98,172 electric customers.

Detailed Credit Considerations

Revenue Generating Base

Electricity generation profile is more diversified following successful integration of biomass plant

GRU's power supply mix in 2018 consisted of around 41% of natural gas, 26% coal, 27% biomass, Solar FIT 1%, landfill gas 1%, and 4% covered through market resources (mostly gas). The successful integration of the biomass plant (102.5 MW net summer capability) in its dispatch profile reduced GRU's dependence on the Deerhaven Generating Station.

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The biomass plant has been running more than initially expected due to the ability to run it as low as 30 MW and as high as 102.5 MW. In 2018, the plant had an availability factor of 80.5% and a capacity factor of 73.5%. In addition, GRU was able to diversify the wood suppliers for the plant at a lower cost and realized the expected cost savings.

Besides the biomass plant, GRU owns three generating facilities: J.R. Kelly Station (108 MW net summer capability), Deerhaven Generating Station (228 MW coal, 181 MW natural gas) and South Energy Center (10.9 MW). In total, GRU has access to around 630 MW of net summer capacity in excess of peak demand of around 408 MW in FY 2018.

We note, however, that any major forced outage at the Deerhaven plant could significantly reduce the available excess capacity. As such, GRU will need to carefully manage the expected retirement of the Deerhaven Generating Station's Steam Units in 2022 (75 MW) and 2031 (228 MW).

GRU also has a 5-year agreement with Jacksonville Electric Authority (JEA), Florida (A2 negative) to coordinate the dispatch of up to 120 MW of generation within the combined GRU/JEA power generation portfolio. The agreement expires in December 2021. It can be terminated within 30 days after written notice and requires no additional personnel costs or capacity payments.

Resilient service territory and diversified operations

As a diversified municipally-owned utility system, GRU provides electric generation and transmission (71% of 2018 operating revenue), natural gas (5%), water (9%), wastewater (12%) and telecommunication service (3%). The utility serves the City of Gainesville except for the University of Florida, as well as additional customers beyond the city's limits. The city of Gainesville is the largest city in Alachua County (Aa2). Gainesville has a robust economy with an unemployment rate of around 3.4% in 2018 and a median household income growth of 5.4% from 2017 to 2018. Gainesville's robust economy is supported by the University of Florida and an aging population which drives strong demand for the healthcare sector, providing a high share of public sector employment, and stability to GRU's customer base.

In fiscal year 2018, GRU had 98,172 electric system customers, 35,389 natural gas customers, 73,043 water customers and 66,483 waste water customers. Annual operating revenues decreased to \$403 million in 2018 from \$427 million in 2017, primarily due to a rate reduction owing to the realized cost savings from the biomass plant facility.

Modest improvement in rate competitiveness but electric rates remain high

GRU passed on realized cost savings from the biomass plant to its customers through a 8% residential rate reduction, which modestly improved its rate competitiveness. Previously, GRU's residential and commercial electricity rates were well above the state average in fiscal year 2017. GRU's long-term strategy is to maintain electricity rates within ½ of one standard deviation of Florida mean per FMEA (\$120.9 for 1,000 kWh as of June 2017).

Going forward, GRU will be challenged to balance operating cost pressures with the need to maintain competitive electricity rates.

GRU has demonstrated a willingness and ability to adjust rates when necessary. GRU is governed by the City Commission and the General Manager for Utilities serves at the will of the Commission. To date, the Utility Advisory Board (UAB), which advises the City Commission on policy and governance, has not restricted GRU's ability to implement future rate increases.

Financial Operations and Position

High fixed cost base will put pressure on fixed charge coverage ratios and customer rates

GRU has a high fixed cost base with around 90% of operating costs being classified as fixed costs and debt service represents approximately one third of total operating costs. The implementation of the SAP HANA upgrade and other technology investments will lead to higher operating expenses in the short-term but should support long-term operating efficiencies.

However, GRU will need to carefully manage cost pressures, pressure to increase customer rates and maintain healthy fixed charge coverage ratios. We expect that GRU will maintain fixed charge coverage ratios (after transfers to the city's general fund) in the range of 1.4x-1.5x (1.49x in FY 2018) and senior debt service coverage ratios (before transfers) around 1.8x (1.88x in FY 2018) on average in the period 2019-2022.

High transfers to city's general fund

GRU projects transfers to the city's general fund to average approximately 9% of forecasted operating revenue. In FY 2018, transfers to the city's general fund totaled \$36.4 million. The current agreement of general fund transfers expires in 2019. The current transfer formula uses a base transfer amount that has increased each year by 1.5% since 2015. Management is currently renegotiating the transfer formula.

Capital improvement plan will require modest additional debt funding over the period 2021-2023

GRU's 5-year capital improvement plan for the period fiscal year 2019-2023 foresees on average around \$70 million of annual capital expenditures, which will be partially financed by operating cash flow generation and additional debt of around \$57 million in the years 2021-2023. Projected capital expenditures are higher in 2019 (\$84 million) and 2020 (\$100.3 million) and around \$90 million will be funded with the issuance of the 2019 Series.

LIQUIDITY

As of September 30, 2018, GRU had available cash and investments of around \$143 million including rate stabilization funds and utility plant improvement funds of which we consider \$94 million to be unrestricted and discretionary reserves.

Days cash on hand based on unrestricted reserves totaled 146 days and 235 days if one includes the headroom under existing credit lines/commercial paper notes. GRU has two commercial paper programs of in total around \$150 million of which around \$93 million are outstanding. GRU also has a rolling three-year \$25 million credit line with SunTrust Bank.

We expect GRU to maintain days cash on hand around current levels going forward.

Debt and Other Liabilities**DEBT STRUCTURE****High leverage but gradual debt reduction expected over next few years**

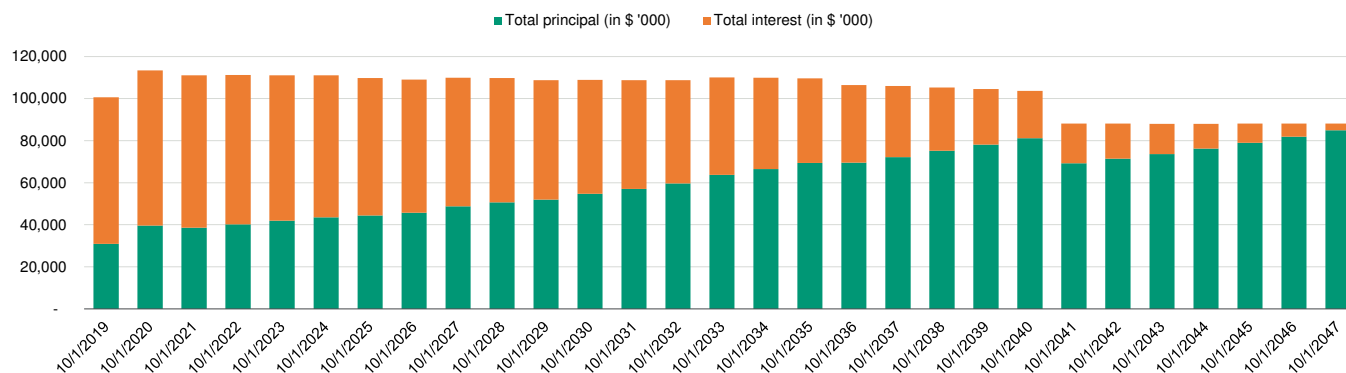
Before the 2019 Series A and B issuance, GRU had around \$1.6 billion of debt outstanding, consisting of \$1.5 billion in utility system revenue bonds and \$93 million subordinated commercial paper notes C and D. Based on the pro-forma of the 2019 Series A and B bonds we expect debt to increase to around \$1.7 billion.

The Aa3-rated utility system revenue bonds are secured by a senior lien pledge of net revenues of the combined utilities system of the City of Gainesville. The rate covenant and additional bonds test requires that net revenues equal at least 1.25x aggregate annual debt service. The utility is required to fund monthly deposits to the debt service account, so funds are available in advance of the principal and interest dates. There has been no debt service reserve requirement since 2003, which we view as a credit weakness in GRU's bond resolution.

The utility system commercial paper notes are rated A1/Prime-1 (P-1) and secured by a second lien pledge of net revenues of the combined utilities system of the City of Gainesville.

GRU's debt ratio remains high at around 75% in FY 2018. We expect debt to gradually decline over time as debt amortizes. Annual debt service will average around \$110 million going forward.

Exhibit 2

Debt service profile pro-forma of 2019 Series

Source: Moody's Investors Service

GRU has two credit facilities to backstop the commercial paper program. A credit facility with Bank of America (Bank of America, N.A., senior unsecured long-term debt rating Aa3, under review for possible upgrade) supports the \$125 million tax-exempt commercial paper program and a letter of credit with State Street Bank & Trust Company (long-term bank deposit rating of Aa1 stable) supports the \$25 million taxable commercial paper program. The credit facilities with Bank of America and State Street mature November 30, 2021 and August 28, 2020, respectively.

GRU expects to repay all outstanding amounts of the CP Series C and D with the Series 2019A and Series 2019B bonds.

For its variable rate utility system revenue bonds, GRU has entered into separate standby bond purchase agreements with certain commercial banks in order to provide liquidity support in connection with tenders for purchase of the 2005 Series C Bonds, the 2006 Series A Bonds, the 2007 Series A Bonds, the 2008 Series B Bonds and the 2012 Series B Bonds.

The following details the Liquidity Supported Bonds, the bank providing the liquidity support and the termination date of the current facility:

- » 2005C Landesbank Hessen Thüringen Girozentrale November 24, 2020
- » 2006A Landesbank Hessen Thüringen Girozentrale November 24, 2020
- » 2007A State Street Bank and Trust Company April 1, 2021
- » 2008B Barclays Bank PLC June 29, 2020
- » 2012B Citibank, N.A. June 29, 2020

DEBT-RELATED DERIVATIVES

GRU uses interest rate swaps to hedge its variable rate exposure. Currently around 55% of GRU's debt is fixed rate debt, 6% represents commercial paper notes, 13% is variable rate debt, and 26% is synthetic fixed rate debt through the use of swaps. Post the 2019 Series, this debt composition mix will change to be around 62% fixed, 13% variable, 25% synthetic fixed, and 0% commercial paper notes.

GRU has interest rate swap agreements with four different counterparties with respect to the 2005 Series B Bonds, the 2005 Series C Bonds, the 2006 Series A Bonds, the 2007 Series A Bonds, the 2008 Series B Bonds and the 2017 Series B Bonds. The current counterparties are Goldman Sachs Mitsui Marine Derivative Products, L.P., JPMorgan Chase Bank, N.A., Goldman Sachs Bank, USA and Citibank, N.A. The swaps mature in the period of October 2021 - October 2044 and as of January 30, 2019 have a negative fair value of \$48 million.

GRU is not required to post any collateral for any of these swap agreements. An unexpected termination of all swaps could require liquidity sources.

PENSIONS AND OPEB

The city of Gainesville has a defined benefit pension plan which includes permanent employees of GRU. The applicable reported net pension liability to GRU was around \$71 million as of September 30, 2018 based on a discount rate of 8.0%. Moody's adjusted net pension liability was around \$232 million, calculated based on a discount rate of 4.2%.

Management and Governance

The 2017 biomass plant buyout terminated the arbitration proceedings with the plant's previous owner and allowed management to focus on its core activities and operating initiatives, which is positive.

GRU is governed by the Gainesville City Commission, in accordance with the City of Gainesville Charter Laws. As a Charter Officer of the City of Gainesville, the General Manager for Utilities serves at the will of the Commission. The Utility Advisory Board (UAB) advises the Gainesville City Commission on policy and governance decision regarding utility services. Members of the UAB are selected by the City Commission and serve for around 1-2 years. The UAB makes recommendations to the City Commission but has no authority to approve rate increases.

Other Considerations - Mapping to the Grid

The principal methodology used in this rating was US Public Power Electric Utilities with Generation Ownership Exposure. Credit metrics in the scorecard are based on the latest available audited financial statements for fiscal year 2018 (ending September 30, 2018). The grid indicated rating is A1, one notch below the assigned rating of Aa3.

The assigned Aa3 rating places more emphasis on the stability of GRU's service territory and historical financial metrics. It also takes into account our expectation of gradual declining leverage and that GRU will be able to harvest the operating efficiencies associated with its investments in SAP HANA and other technology upgrades.

Exhibit 3

US Public Power with Generation Exposure Methodology Grid

Factor	Subfactor	Score	Metric
1. Cost Recovery Framework Within Service Territory		Aa	
2. Willingness and Ability to Recover Costs with Sound Financial Metrics		Aa	
3. Generation and Power Procurement Risk Exposure		A	
4. Competitiveness		Baa	
5. Financial Strength and Liquidity	a) Adjusted days liquidity on hand (3-year avg) (days)	Aa	241
	b) Debt ratio (3-year avg) (%)	Baa	78.0%
	c) Adjusted Debt Service Coverage or Fixed Obligation Charge Coverage (3-year avg) (x)	A	1.72x
Preliminary Grid Indicated rating from Grid factors 1-5		A1	
		Notch	
6. Operational Considerations		0.0	
7. Debt Structure and Reserves		-0.5	
8. Revenue Stability and Diversity		0.5	
Grid Indicated Rating:		A1	

Source: Moody's Investors Service

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