MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Gainesville, FL Combined Utility Enterprise utilities system revenue bonds; outlook stable

Global Credit Research - 25 Nov 2014

Approximately $69 million of debt securities rated

GAINESVILLE (CITY OF) FL COMBINED UTILITY ENTERPRISE
Combined Utilities
FL

Moody's Rating

ISSUE	RATING
Utilities System Revenue Bonds 2014 Series A Bonds	Aa2
Sale Amount $37,500,000	
Expected Sale Date 12/20/14	
Rating Description Revenue: Government Enterprise	
Utilities System Revenue Bonds 2014 Series B Bonds	Aa2
Sale Amount $31,600,000	
Expected Sale Date 12/20/14	
Rating Description Revenue: Government Enterprise	

Moody's Outlook STA

Opinion

NEW YORK, November 25, 2014 --Moody's Investors Service assigned a rating of Aa2 to the Gainesville Regional Utilities' (GRU or the Utility) planned issuance of approximately $37.5 million of Utilities System Revenue Bonds, 2014 Series A and approximately $31.6 million of Utilities System Revenue Bonds 2014 Series B. Moody's maintains Aa2 ratings on GRU's outstanding Utilities System Senior Lien Revenue Bonds. The rating outlook is stable.

RATING RATIONALE

Moody's Aa2 ratings for GRU's Utility System Revenue Bonds reflect its resilient service territory, sound risk and liquidity management, and the generally low business and operating risk profile that goes with a diverse revenue stream from providing electric, gas, water/wastewater and telecom utility services. The ratings also reflect some pressure on GRU's utility system blended rates compared to its peers in Florida resulting from the costs associated with a power purchase agreement (PPA) with the 102.5 MW Gainesville Renewable Energy Center (GREC) biomass facility which commenced commercial operations in December 2013. GRU has a history of timely rate adjustments across all its utility services which is a heavily weighted credit positive factor. Furthermore, the rating incorporates management's objective to keep GRU's financial profile reasonably in line with the current rating level through rate increases and other mitigating strategies as operating costs have increased since the GREC biomass facility began operations.

RATING OUTLOOK

The stable rating outlook is driven by GRU's timely risk mitigation strategies including a significant increase in the fuel component of its electric rates during 2013 when the 2014 budget was approved and prior to the GREC biomass plant reaching commercial operation along with similar actions in July 2014 when the 2015 budget was approved . The stable outlook factors in our belief that the utility will utilize all available tools to maintain its liquidity and financial strength, including maintaining adjusted debt service coverage at a minimum near 1.7 times or better on average, while also mitigating, to the extent possible, the upward cost pressures associated with GREC.

What Could Change the Rating - UP

We do not anticipate upward pressure on the rating over the medium term as GRU addresses cost pressures related to its supply diversification strategy. Over the long term, GRU's rating could be upgraded if it can achieve adjusted debt service coverage above 2.0 times and improve its debt ratio closer to 60% on a sustained basis, while also maintaining its sound approach to managing liquidity.

What Could Change the Rating - DOWN

Downward pressure on the ratings is likely to occur if adjusted debt service coverage as calculated by Moody's falls below 1.5 times for an extended period, if cost pressures prevent timely future rate adjustments from being implemented, or if there is a shift in the utility's strong liquidity profile.

Use of Proceeds:

The proceeds from issuance of the 2014 Series A bonds will be used to pay for costs of acquisition and construction of certain improvements to the Utilities System and to pay for the costs of issuance. The proceeds from issuance of the 2014 Series B bonds will be used for advanced refunding and current refunding of the 2005 Series A and 2008 Series A bonds, respectively, and to pay for the costs of issuance.

LEGAL SECURITY

GRU's Aa2-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 1.25 times 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.

INTEREST RATE DERIVATIVES

Upon issuance of the 2014 Series A and B bonds, GRU expects to have about 52% of its total debt in a fixed rate mode, with 28% synthetically fixed, 3% synthetic variable, and 17% variable. GRU currently has six swap agreements in place with investment grade rated counterparties. The six agreements had a combined notional value of about $367.2 million as of October 31, 2014 and termination payments that would apply as of that date were $55.9 million. Under existing thresholds, GRU is not currently required to post collateral under any of the swap agreements.

STRENGTHS

*Near monopoly of electric, gas, water/wastewater, and telecom utility services; GRU Serves about 77% of Alachua County (Aa2 Issuer Rating) and City of Gainesville (Aa3)

*Ability and willingness of board and management to raise rates promptly

*Historical and prospective stable economic base; service area supports steady demand for combined utility services with unemployment levels below U.S. and the State of Florida levels

*History of good relationship with City Commission; unregulated rate recovery with stable record of cost recovery

*Successful diversification of generating capacity via natural gas and renewables

*Experienced and proactive management

*Fuel and power risk management via The Energy Authority (TEA)

*Good liquidity levels, including unused capacity under bank lines

CHALLENGES

*Competitive impact of sizable rate increases to cover energy costs for GREC biomass PPA

* Somewhat lower equity funding of capital investments given planned use of the Utilities Plant & Improvement Fund (UPIF) to support debt service coverage

*GRU has excess capacity and energy that it may not be able to sell into the market due to economics

*No debt service reserve

DETAILED CREDIT DISCUSSION

RECENT DEVELOPMENTS

Under initial assumptions, management set a goal of holding the average monthly bill impact from costs associated with the purchase of power from the GREC plant to roughly $10.50 (based on 1,000 kWh of use) or about an 8.22% total bill increase. However, in approving the 2014 budget, the city commissioners approved an even larger rate increase, a credit positive factor for GRU. The 2014 budget allowed GRU to reduce its base rates by about 5.6% and increase its fuel rates by about 39% to address the fuel price increases under the GREC PPA for an estimated total bill increase of about $13.48 or 10.6%. The benefits of the 2014 rate increase are evident in unaudited September 30, 2014 fiscal year end financial statements, which reflect improvement as expected in adjusted debt service coverage metrics to about 1.9 times, a credit positive for GRU.

On July 23, 2014, the City Commission approved additional proposed rate increases that became effective October 1, 2014, which results in a total bill increase of slightly less than 1% for residential customers in fiscal year 2015. The fiscal year 2015 total bill increase for residential customers is considerably lower than originally expected owing to increased focus on containing O&M expenses, increasing non-retail revenues and controlling fuel costs. The approved residential rates for fiscal year 2015 are inclusive of an 8.5% lower residential base rate and a 13.5% higher fuel rate. Going forward, we anticipate relatively modest 2.7%-3.7% increases for 2016-2017 and substantially smaller increases of less than 1% for 2018-2020. The additional rate increases expected and other mitigating steps, including labor cost reductions and further O&M cost reduction strategies, are intended to mitigate cost pressures and keep the debt service coverage (DSC) ratio in line with GRU's historical performance. We also note that the utility plans to support the DSC ratio by using a modest portion of the UPIF, a discretionary fund, to pay a portion of its debt service instead of applying all of the funds to capital investments.

Since late 2013, GRU has been purchasing power under a take and pay PPA whereby it will be purchasing all the available energy and delivered energy from the 102.5 MW GREC biomass plant for 30 years. The utility currently has excess capacity and had initially planned to sell half of the GREC capacity into the market. Given the persistently low price for natural gas in the market, GRU will not be able to earn the energy margin from market sales initially assumed and will still be required to make GREC related payments (includes non-fuel energy charge, fixed O&M, and property taxes),creating cost recovery challenges. For the time being, these challenges have been addressed through rate increases and cost reduction strategies.

GRU currently expects to spend about $463 million on its capital improvement program between 2015-2020, with about 50% devoted to the electric utility system, about 34% relating to water and wastewater projects, about 7% relating to its gas utility infrastructure, and the balance for telecom. We note that GRU's budget is continually subject to review and some of the planned spending could be eliminated or be delayed into later years if projects are canceled or postponed. We expect that GRU's funding strategy for the 2015-2020 capital improvement program will allow for some directional improvement in the debt ratio; however, the directional shift is not likely to alter our view of leverage particularly when one factors in the above market long-term GREC PPA.

Please see our report dated August 26, 2014 for further details relating to GRU.

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RATING METHODOLOGY

The principal methodology used in this rating was U.S. Public Power Electric Utilities with Generation Ownership Exposure published in November 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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