

# MOODY'S INVESTORS SERVICE

## Rating Action: Moody's assigns Aa3 rating to GRU's Utilities System Revenue Bonds, Series 2017A, outlook stable

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New York, September 26, 2017 -- Issue: Utilities System Revenue Bonds, 2017 Series A; Rating: Aa3; Rating Type: Underlying LT; Sale Amount: \$757,000,000; Expected Sale Date: 09/28/2017; Rating Description: Revenue: Government Enterprise;

### Summary Rating Rationale

Moody's Investors Service has assigned an Aa3 rating to Gainesville (City of) FL Combined Utilities Enterprise's (Gainesville Regional Utilities (GRU)) proposed Utilities System Revenue Bonds, Series 2017A. At the same time, Moody's has downgraded the existing Senior Lien Utilities System Revenue Bonds rating to Aa3 from Aa2 and the ratings on the second lien Utilities System Commercial Paper Notes, Series C (Bank Bonds) and Utilities System Commercial Paper Notes, Series D (Bank Bonds) to A1 from Aa3.

Moody's also affirmed the existing Prime-1 (P-1) ratings on the Commercial Paper Notes Series C and Series D as well as the short-term VMIG 1 ratings of the City of Gainesville, Florida (the City) Variable Rate Utilities System Revenue Bonds.

The rating outlook is stable.

The rating action follows GRU's announced asset purchase agreement to buyout the GREC biomass facility for an expected consideration of around \$750 million and terminate the existing power purchase agreement (PPA) with the owner Gainesville Renewable Energy Center, LLC. The transaction has been approved by the City Commission and the Mayor of the City of Gainesville after it was supported by the Utility Advisory Board (UAB) and is expected to close in calendar year 2017.

Even though the transaction will provide GRU with ownership of the GREC facility, terminate a costly above-market PPA, lower costs for GRU's customers, and allow management to refocus on its core activities, the expected additional annual debt service burden associated with the debt-financed transaction will result in bond ordinance total debt service coverage ratios of around 1.8x (2.27x in 2016) and Moody's fixed charge coverage ratios (after transfers to the city's general fund) of around 1.4x (1.7x in 2016, 1.5x on a pro-forma basis post the GREC buyout) over the next few years. Coverage ratios at these levels position GRU more solidly in the Aa3 rating category.

In addition, the rating action considers that GRU faces some operating cost pressure from a SAP upgrade over the next three years before it can harvest long-term operating efficiencies with the new enterprise IT system. GRU intends to pass through all expected annual cost savings from the GREC buyout transaction of around \$27 million to electric rate payers through a one-time 8% rate reduction. This one-time rate reduction will improve modestly GRU's rate competitiveness but leaves GRU also with less cushion to withstand operating cost pressure without raising rates to customers and lowers financial metrics.

Uncertainty remains around the long-term benefits of owning the GREC plant and how GRU will integrate the GREC facility in its generation fleet and dispatch profile, particularly given the operating challenges associated with a biomass facility. GRU estimates annual operating expense of just \$5 million if the facility continues to be maintained in standby mode.

GRU's credit profile remains supported by the (i) diversity of its revenues and operations as a combined utility enterprise, (ii) the stability of its customer base which has supported a solid track record of maintaining stable financial metrics, (iii) the utility's demonstrated willingness and ability to increase rates in order to manage cost pressures, (iv) the utility's solid financial policies and (v) management's recent initiatives to increase cost efficiencies.

The rating remains constrained by GRU's high leverage (debt ratio 79% in fiscal year 2016) which we expect to decline modestly to 68% post the GREC buyout transaction once the capital lease obligation related to the PPA is no longer included in Moody's debt ratio.

GRU's liquidity profile is adequate and the utility's revenue transfers to the city government are expected to remain stable at around \$37 million or 9% of total revenue.

The A1 rating on the second lien Utilities System Commercial Paper Notes, Series C (Bank Bonds) and Utilities System Commercial Paper Notes, Series D (Bank Bonds) reflects the subordinate pledge of the net system revenues to the utility's outstanding long-term revenue bonds rated Aa3.

#### Rating Outlook

The stable rating outlook reflects our expectation that GRU will maintain fixed charge coverage ratios at 1.4x and will maintain an adequate liquidity profile.

#### Factors that Could Lead to an Upgrade

Moody's 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)

Successful integration of GREC in GRU's generation profile

#### Factors that Could Lead to a Downgrade

Cost pressures preventing timely future rate adjustments and fixed charge coverage ratio declining below 1.4x on a sustained basis

Deteriorating liquidity profile with adjusted days cash on hand materially below 200 days cash on hand

More aggressive demands for transfer's to the city's general funds

#### Legal Security

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.

#### Use of Proceeds

Please see section Recent Developments for expected sources and uses of the GREC buyout transaction. The proposed Utilities System Revenue Bonds 2017 Series A will used to finance a portion of the approximately \$750 million transaction price.

#### Obligor Profile

Gainesville Regional Utilities (GRU) is a municipally-owned utility system in Gainesville, FL with electric generation and transmission, natural gas, water, wastewater and telecommunication services. In 2016 GRU reported total revenues of around \$420 million and had close to 95 thousand electric customers.

#### Methodology

The principal methodology used in the long term rating was US Public Power Electric Utilities With Generation Ownership Exposure published in March 2016. The principal methodology used in the short term revenue rating was Variable Rate Instruments Supported by Conditional Liquidity Facilities published in March 2017. The principal methodology used in rating the commercial paper was Rating Methodology for Municipal Bonds and Commercial Paper Supported by a Borrower's Self-Liquidity published in January 2012. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of these methodologies.

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