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Update

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Gainesville, FL Combined Utility Enterprise

Moody's maintains Aa2 rating on GRU's Utilities System Senior Lien Revenue Bonds, outlook stable

Summary Rating Rationale

GRU's Aa2 bond rating reflects the utility's sound financial metrics and our expectation that GRU can maintain a fixed charge coverage ratio around 2.0x going forward, its demonstrated willingness and ability to increase rates in order to manage cost pressures largely stemming from an above-market take-or-pay purchase power agreement (PPA) for a biomass facility, and the stability of its customer base in a robust service territory that benefits from a high share of stable public sector employment and the presence of the University of Florida.

The rating also takes positively into account the diversification benefits of its combined utility system with revenue streams derived from electric, gas, water/wastewater and telecom utility services. In addition, we recognize the utility's solid financial policies and management's recent initiatives to increase cost efficiencies.

However, the rating is constrained by GRU's high leverage (debt/operating revenue 4.6x, debt ratio 79% in fiscal year 2015) if one includes the capital lease obligations related to the Gainesville Renewable Energy Center (GREC) biomass facility. In addition, GRU faces high fixed capacity payments under the PPA. The relationship between the operator of GREC and GRU has been strained by several disputes around interpretation of certain terms in the PPA and arbitration is currently scheduled for June 2017.

GRU's liquidity profile is adequate and the utility's revenue transfers to the city government are expected to remain stable at around 26% of net revenue or 8% of total revenue.

Credit Strengths

- » Resilient service territory
- » Track record of raising rates when necessary
- » Combined utility enterprise with diverse revenue stream
- » Robust financial metrics

Credit Challenges

- » High rates could limit future ability to raise rates
- » High fixed capacity payments associated with GREC biomass PPA and pending arbitration
- » High leverage

» No debt service reserve fund

Rating Outlook

The stable rating outlook reflects our expectation that GRU will maintain fixed charge coverage ratios at around 2.0x and will maintain an adequate liquidity profile over the next 12-18 months. The rating also incorporates the expectation of no material impact on its liquidity profile from the pending arbitration with GREC's owner and operator.

Factors that Could Lead to an Upgrade

» DSCR above 2.0x on a sustained basis

» Reducing leverage to around 60%

» Maintaining a healthy liquidity profile

Factors that Could Lead to a Downgrade

» DSCR below 1.8x on a sustained basis

» Cost pressures preventing timely future rate adjustments

» Deteriorating liquidity profile

Key Indicators

Exhibit 1

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

GAINESVILLE (CITY OF) FL
COMBINED UTILITY ENTERPRISE

	2011	2012	2013	2014	2015
Operating Revenue ($'000)	368,471	348,858	348,776	405,895	425,941
Debt Outstanding ($'000)	1,025,180	1,006,695	974,795	1,942,058	1,948,060
Debt Ratio (%)	68.9	69.5	68.6	79.5	79.4
Total Days Cash on Hand (days)	175	182	196	196	182
Adjusted Days Liquidity on Hand (incl. Bank Lines)(days)	254	267	278	264	242
Fixed Obligation Charge Coverage (if applicable)(x)	1.7	1.6	1.6	2.0	2.2

Note: All ratios are based on adjusted financial data and as defined by Moody's Investors Service. Since 2014 debt includes capital lease obligations related to the GREC PPA.

Source: GRU financial statements, Moody's Investors Service.

Recent Developments

» **Deerhaven Generating Station Unit 2**

In September 2016, the Deerhaven coal unit 2 experienced issues with the circulating dry scrubber (CDS), which is used for pollution control. The CDS separated from the unit's baghouse. The costs for the repair have yet to be determined but are expected to be manageable and will likely be covered by insurance. The repair will likely require unit 2 to be down for around 4-5 months.

» **Dispatch agreement with JEA**

GRU has entered into a 5-year agreement with Jacksonville Electric Authority (JEA), Florida (Aa2 stable) to coordinate the dispatch of up to 120 MW of generation within the combined GRU/JEA power generation portfolio. The agreement began in May 2016 and is set to expire in December 2021. It can be terminated within 30 days after written notice and requires no additional personnel costs or capacity payments. GRU expects initial cost savings of around $3-$5 million annually from the agreement. According to GRU, the initial phase of this agreement has provided the expected cost benefits.

Detailed Rating Considerations

Revenue Generating Base

RESILIENT SERVICE TERRITORY

The utility serves the City of Gainesville except of 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 fairly robust economy with an unemployment rate of around 4.4% at October 2016 and real GDP growth of around 1.4% during the period 2004-2015. The unemployment rate is slightly lower than Florida's 4.8% and the US' unemployment rate as of October 2016 according to the Bureau of Labor Statistics.

Gainesville's robust economy is supported by the University of Florida and the healthcare sector which result in a fairly high share of public sector employment and which provides stability to GRU's customer base. Moody's Economy expects that an expanding population will help Gainesville outperform US GDP growth in the near term but that the metro area will not match the pace of Florida's economic growth due to its reliance on public sector employment.

The electric system has a stable customer base which generates around 56% of GRU's annual consolidated revenues. In fiscal year GRU had 94,795 electric system customers of which 10,726 commercial and industrial customers provided around 58% of electric system revenues. In addition, GRU had 34,496 natural gas customers, 71,545 water customers and 64,780 waste water customers.

TRACK RECORD OF RAISING RATES BUT HIGH RATES COULD LIMIT FUTURE WILLINGNESS TO RAISE RATES

GRU has demonstrated 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. In 2017, GRU will not raise electric rates for a second year in a row. However, the city has approved small rate increases for water, wastewater and gas. We do not anticipate at this stage that the city's newly created Utility Advisory Board (UAB) will materially restrict GRU's ability to implement future rate increases.

However, we caution of the risk that already high residential rates in Gainesville could result in higher resistance of the UAB to support future rate increases, which would be credit negative if not offset by improving operating efficiency. Residential rates in Gainesville ($130.4 electric for 1,000 kWh, $32.64 gas for 25 therms, $30.5 water for 7,000 gallons; $53.2 wastewater for 7,000 gallons) are among the highest in the region.

COMBINED UTILITY ENTERPRISE WITH DIVERSE REVENUE STREAM

GRU is a combined utility enterprise and provides electricity, natural gas, water/wastewater and telecom utility services (GRUCom). The diversity of its operations supports a diverse revenue stream: electric system (55.8% of total expected 2016 revenue), natural gas (6.2% of total revenue), water (15.2%), wastewater (17.6%), GRUCom (5.2%).

GRU's power supply mix in 2016 consisted of around 54% of natural gas, 21% coal, Solar FIT 1%, landfill gas 1%, biomass 1% and 22% covered through market resources (mostly gas). GRU owns three generating facilities: J.R. Kelly Station (112 MW net summer capability), Deerhaven Generating Station (232 MW coal, 185 MW natural gas) and South Energy Center (3.5 MW). GRU has a purchase price agreement with a biomass facility for 102.5 MW net summer capability. In total GRU has access to around 635 MW of dispatchable net summer capacity which provides substantial excess capacity given peak demand of around 421 MW. The Deerhaven unit 2 has demonstrated its ability to meet the Mercury Air Toxics Rule (MATS) according to GRU.

In addition to electric generating facilities, GRU owns a water treatment plant with capacity of 54 million gallons per day (Mgd), two major wastewater treatment plants totaling 22.4 Mgd average daily flow, and underground gas distribution and service lines.

HIGH FIXED CAPACITY PAYMENTS ASSOCIATED WITH GREC BIOMASS PPA AND PENDING ARBITRATION

GRU faces high fixed costs associated with a 30-year take-or-pay power purchase agreement (PPA) for all available and delivered energy with the 102.5 MW Gainesville Renewable Energy Center (GREC) biomass facility. The facility commenced commercial operations in December 2013. However, due to low natural gas prices and the above-market PPA, GRU has opted to keep the facility mostly in cold standby and has replaced the avoided cost per MW with own generation and generation through its dispatch agreement with JEA. However, GRU is still required under the contract to make fixed cost payments including non-fuel energy charges, fixed O&M costs and property tax costs. High fixed cost payments under the contract have resulted in rate pressure and high electricity rates for GRU's customers relative to other regions in Florida.

GRU is currently facing a dispute with the operator of GREC with respect to certain terms and conditions of the PPA related to shutdown charges, available energy payments during facility ramp up periods, and planned maintenance outages among others. Arbitration is currently scheduled for June 2017. GRU has withheld approximately $7 million for commercial disputes related to the PPA.

Financial Operations and Position

ROBUST FINANCIAL METRICS

Despite high fixed capacity payments under the GREC PPA, GRU has maintained robust bond ordinance DSCRs of around 2.2x on average over the last five years and a Moody's fixed charge coverage ratio of 1.8x on average over the last five years. We expect that GRU will be able to maintain coverage ratios at similar levels going forward, supported by continued modest revenue growth in a growing service area and effective cost containment. Total DSCR In the near-term GRU will face some operating cost pressure from the implementation of an SAP upgrade which however, should support long-term operating efficiencies following completion of the project after 3-5 years. GRU expects to benefit from around $3-5 million of annual cost savings through its coordinated dispatch initiative with JEA which should help to mitigate cost pressures.

GRU projects transfers to the city's general fund of around $37 million per annum going forward (around 26% of expected net revenue, around 8% of total revenue). The current agreement of general fund transfers expires in 2019 and was last renegotiated in 2015. We currently anticipate that GRU would extend its agreement with the city at similar terms beyond 2019.

CAPITAL IMPROVEMENT PLAN

GRU's five year capital improvement plan for the period 2017-2021 foresees capital expenditures of around $332 million (of which $85 million in fiscal year 2017) of which around 50% will be devoted to the electric system, 39% to water and wastewater projects, 7% to the gas utility infrastructure and the balance to the telecom services infrastructure. The program includes the SAP upgrade project which will cost around $30 million.

The majority of the capital plan will be financed from operating cash flow generation. However, GRU expects to finance around $78 million of the plan with additional debt in 2017 and 2018.

HIGH LEVERAGE

With a debt/operating revenue ratio of around 4.6x and a debt ratio of close to 80% in fiscal year 2015, GRU's leverage is fairly high if one includes around $977.3 million in lease obligations associated with the GREC PPA. Around 30% of bond principal will amortize over the next 10 years. Annual bond debt service requirements total around $44 million over the next five years. The GREC capital lease asset will be amortized over the life of the PPA. Minimum annual capital lease payments for the period 2016-2020 are around $61.2 million.

LIQUIDITY

As of September 30, 2015 GRU had available cash and investments of around $241 million including rate stabilization funds and utility plant improvement funds of which we consider $135 million ($148 million based on unaudited August 31, 2016 numbers) to be unrestricted and discretionary reserves. Days cash on hand based on unrestricted reserves totaled 182 days and based on available cash and investments including headroom under existing credit lines/commercial paper program around 242 days. GRU has two commercial paper programs of in total around $110 million of which around $64.9 million were outstanding at September 30, 2015.

GRU expects days liquidity on hand to gradually decline to around 200 days including headroom under its CP program over the next few years as some of the funds will be used to finance capital expenditures. A material erosion of its current healthy liquidity profile would be a credit negative. GRU has no debt service reserve fund.

Debt and Other Liabilities

DEBT STRUCTURE

As of September 30, 2015 GRU had total long-term debt of around $1.9 billion consisting of around $905.9 million utility system revenue bonds, around $64.9 million in outstanding commercial paper and around $977.3 million in lease obligations associated with the GREC PPA.

The outstanding commercial paper notes are subordinated to the utility system revenue bonds. GRU has two credit facilities to back-stop the commercial paper program. A credit facility with Bank of America (Bank of America, N.A., senior unsecured long-term debt rating A1 stable) supports the $85 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) support the $25 million taxable commercial paper program. The credit facilities with Bank of America mature October 1, 2017 and with State Street August 28, 2017.

GRU has relatively high share of variable rate debt but has hedged most of its variable rate exposure with interest rate swaps. Around 52% of its debt is fixed rate debt and an additional 29% has been converted to fixed rate through the usage of interest rate swap agreements. Unhedged variable rate debt amounts to around 13% of outstanding debt and commercial paper to around 6%.

DEBT-RELATED DERIVATIVES

GRU uses interest rate swaps to hedge its variable rate exposure. GRU has six swap agreements in place with investment grade rated financial institutions as counterparties. The 2008 tax-exempt CP swap will terminate October 1, 2017. The five remaining swaps mature in the period 2021-2038. As of September 30, 2016 the swap portfolio had a negative fair value of $93 million. GRU is not required to post any collateral any of these swap agreements. An unexpected termination of all swaps could require significant liquidity sources.

PENSIONS AND OPEB

The city of Gainesville has a defined benefit pension plan which includes permanent employees of GRU. The applicable net pension liability to GRU was around $76 million as of September 30, 2015 based on discount rate of 8.3%. Moody's adjusted net pension liabilities was around $205 million.

Management and Governance

Gainesville Regional Utilities 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.

In 2016 the city created the Utility Advisory Board (UAB), which 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. If managed successfully, the UAB could help to increase transparency of GRU's decision for the service area's community. However, while currently not expected, it could also limit GRU's ability to implement future rating increases if GRU faces higher resistance by the UAB.

We view GRU's management and governance practices as solid and GRU has been able to maintain robust credit metrics despite pending arbitration and high costs associated with GREC.

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 1.25x 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 Aa3 and secured by a pledge of net revenues of the combined utilities system of the City of Gainesville, which is subordinated to senior lien indebtedness.

Use of Proceeds

Not applicable.

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 2015, total energy supply was 1,340,066 MWh. Annual net revenues, as measured by Moody's, increased to $134 million in 2015 from $119 million in 2014.

Other Considerations - Mapping to the Grid

The principal methodology used in this rating was US Public Power Electric Utilities With Generation Ownership Exposure, published in March 2016. Credit metrics in the scorecard are based on the latest available audited financial statements for the fiscal year 2015, ending September 30, 2015. The grid indicated rating is an A1, two notches below the assigned rating. The lower grid indicated rating is constrained by GRU's high leverage and historical rate increase pressure in order to recover high fixed costs associated with the GREC PPA. The assigned rating of Aa2 benefits from the authority's sound financial policies and healthy liquidity profile.

Exhibit 2

Rating Factors - Gainesville, FL Combined Utility Enterprise

Rating Factors		
Gainesville, FL Combined Utility Enterprise		
U.S. Public Power Electric Utilities with Generation Ownership Exposure Industry Grid	**Current FY 09/30/2015**	
Factor 1 : Cost Recovery Framework Within Service Territory	**Measure**	**Score**
a) Cost Recovery Framework Within Service Territory	Aa	
Factor 2 : Willingness and Ability To Recover Costs With Sound Financial Metrics		
a) Willingness and Ability to Recover Costs with Sound Financial Metrics	Aa	
Factor 3 : Generation and Power Procurement Risk Exposure		
a) Generation and Power Procurement Risk Exposure	A	
Factor 4 : Competitiveness		
a) Competitiveness	Baa	
Factor 5 : Financial Strength and Liquidity		
a) Adjusted days liquidity on hand (3 Year Avg)	260.0	Aaa
b) Debt ratio (3 Year Avg)	79.0%	Baa
c) Adjusted Debt Service Coverage$_3$ OR Fixed Obligation Charge Coverage$_4$ (3 Year Avg)	1.9x	A
Factor 6 : Operational Considerations		
a) Operational		
Factor 7 : Debt Structure and Reserves		
a) Financial	-0.5	
Factor 8 : Revenue Stability and Diversity		
a) Revenue Stability/Diversity of Revenue	0.5	
Rating:		
Preliminary Grid Indicated Rating from Grid Factors 1-5		
a) Indicated Rating from Grid		**A1**
b) Actual Rating Assigned		**Aa2**

Note: All ratios are based on adjusted financial data and as defined by Moody's Investors Service.

Source: GRU financial statements, Moody's Investors Service.

Methodology

The principal methodology used in this rating was US Public Power Electric Utilities With Generation Ownership Exposure published in March 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

RATINGS

GAINESVILLE, FL COMBINED UTILITY ENTERPRISE	
Utilities System Revenue bonds	Aa2
Utility System Commercial Paper notes	Aa3
Rating Outlook	Stable

Source: Moody's Investors Service

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