S&P Global
Ratings

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Gainesville, Florida; Combined Utility; Joint Criteria

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Table Of Contents

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Credit Profile		
Gainesville		
Long Term Rating	A/Stable	Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'A' long-term and underlying ratings on the City of Gainesville, Fla.'s combined utility system revenue bonds, issued for Gainesville Regional Utilities (GRU).
- At the same time, S&P Global Ratings affirmed its 'AA+/A-1' rating on the utility's variable-rate demand obligation, 2019 series C.
- The outlook, where applicable, is stable.

Security

The bonds are secured by a pledge of the net revenues of the combined utility, which provides electric (69% of net operating revenue), water (11%), wastewater (14%), gas (6%), and telecommunication (1%) services. Therefore, we base our rating on our retail electric criteria, while incorporating credit factors of the rest of the system. The 2019 series C bonds are also supported by Bank of America N.A., and reflect the application of our "Methodology And Assumptions For Rating Jointly Supported Financial Obligations," published May 23, 2016.

At fiscal year-end 2023, the utility, which does business as the Gainesville Regional Utilities (GRU), had about $1.8 billion of debt outstanding.

Credit overview

Gainesville is home to the University of Florida, one of the largest universities in the nation, with about 57,000 students. The city's economic base consists primarily of light industrial, commercial, health care, and educational activities. GRU serves about 102,000 electric customers, with about 60% in the city and almost 40% in Alachua County.

The 'A' rating reflects our view of the following credit strengths:

- The economy is anchored by the stabilizing presence of the University of Florida and several hospitals and a diverse, residential customer base that provides additional stability to financial operations.
- Gainesville has eliminated coal-fired generation; while natural gas accounts for about 85% of energy, renewables (primarily biomass) accounted for 16% of energy requirements in 2023, among the highest in the state and Southeast region.
- Fixed cost coverage (FCC) has been robust over the past three years, a trend that we anticipate will continue based on management's financial projections. In our view, the coverage of fixed costs provides operating cushion in the event of declining sales or increasing costs while also supporting current spending on capital needs, which we view

as important given GRU's high debt levels.

- Robust liquidity provides flexibility in the event of cash flow volatility, which we view as important given GRU's exposure to gas price volatility.

The rating also reflects the following credit risks:

- Although GRU has a significant level of renewables, this is the product of legacy investment in uncompetitive resources, including biomass and solar feed-in tariff (FIT).
- The combination of investment in uncompetitive resources, the associated high leverage and fixed costs, and the historically significant transfers to support the city's general fund contribute to electric rates that are among the highest in Florida (149% of the state average in 2022, the most recent year of comparative data). We anticipate that competitive positioning may have weakened further based on the adoption of a 3% electric rate increases in fiscal 2024, despite declining gas costs. We also note small water and wastewater rate increases are planned for 2026-2028.
- High rates, coupled with below-average incomes (68% of the state average) and high debt levels, have resulted in ratepayer backlash and unsettled governance that could frustrate Gainesville's strategic goals, cost recovery, and its ability to fund future capital improvements.

In our view, GRU has uneconomic generating assets and historically (until recently) had a high level of transfers to the city's general fund, both of which contributed to very high rates and a highly leveraged system. These longstanding credit risks formed the basis of our 2021 rating action, when we lowered GRU's rating to 'A' from 'AA-', despite robust liquidity and coverage of fixed costs.

We believe that recent events are creating governance and management uncertainty, leading to the potential for an inconsistent approach to addressing the credit risks that GRU faces.

These more recent events include:

- State legislation (2023) that removed GRU governance from the Gainesville City Commission, vesting it in a newly created GRU Authority (GRUA), appointed by Florida's governor;
- State and federal litigation (2024) challenging the validity of the GRUA, brought by the city commission; and
- A Nov. 5, 2024, local ballot initiative approved by Gainesville voters, reverting governance to the city commission, the implementation of which has been pre-emptively stayed by the 8th circuit court pending a hearing in January.

While S&P Global Ratings does not favor one governance structure over another--the Gainesville City Commission (GRU's former governing body) or the GRUA (its current governing body), we note the uncertainty of the changing governance structures could present credit risks. We believe this unsettled status has already resulted in an inability to gain validation for debt issuance and creates the potential for an inconsistent approach to rates, transfers to the city's general fund, power supply planning, decarbonization, and leverage reduction. However, at this time, we believe GRU's financial position supports the current rating.

Environmental, social, and governance

Given recently enacted legislation and litigation, and resultant uncertainty regarding GRU's approach to rates, leverage, general fund transfers, and decarbonization, we view governance risks as negative and until resolved, we believe these issues will continue to challenge the utility's strategic planning.

On balance, we believe that GRU's environmental risks are credit neutral. On the one hand, GRU has a power supply primarily focused on natural gas, and a sizable amount of renewable generation, relative to the state and region. We note that under GRUA governance, GRU has abandoned its goal of 100% renewable energy by 2045, and instead expects decarbonization efforts to hinge on project economics. We believe that GRU's very high rates and debt levels, inflationary pressures and fuel costs, Florida's constrained transmission system, and directives of the GRUA board will drive future decarbonization efforts. We also believe Gainesville's location in Florida exposes it to hurricane risk, although we note that the city and GRU incurred very limited damage and costs stemming from 2024's hurricanes Helene and Milton.

In consideration of the current high rates that pressures rate affordability and below-average incomes, we believe that social risks represent a credit weakness. We continue to monitor the strength and stability of electric utilities' revenue streams for evidence of delinquent payments or other revenue erosion. Although the rate of inflation as measured by the Consumer Price Index (CPI) has softened, Bureau of Labor Statistics data shows that electricity price inflation continued to outpace the broader CPI by 100 basis points (bps) to more than 200 bps during March-September 2024. The amalgam of increases in delinquent credit card, consumer, and auto loans, along with financial pressures associated with the resumption of student loan payments and weaker than historical household savings rates, will likely compound the financial pressures electricity consumers face. Potentially exacerbating issues of energy affordability are weak economic indicators, such as S&P Global Economics' forecast of a 25% recession risk within the next 12 months, which is elevated relative to the historical baseline. A cooling labor market, geopolitical risks, and the uncertainty surrounding whether and when the president-elect will implement economic initiatives proposed as a candidate, might add to recessionary pressures. (See "Economic Outlook U.S. Q4 2024: Growth And Rates Start Shifting To Neutral," published Sept. 24, 2024, on RatingsDirect; and "After Trump's Win, What's Next For The U.S. Economy?," Nov. 7, 2024).

Outlook

At the current rating level, the stable outlook reflects strong financial metrics, providing operating cushion that mitigates risk associated with an uncertain governance structure, as well as a highly strained relationship between the city of Gainesville, GRU, and its governing body (the GRUA), and the stakeholders that the utility serves.

Downside scenario

We could lower the rating if we believe that the lack of resolution to governance issues meaningfully compromises GRU's ability to access capital markets and threatens the utility's ability to address capital needs. We could also lower the rating if rate setting pressures compromise cost recovery, resulting in meaningfully lower FCC and liquidity.

Upside scenario

Given unsettled governance issues, very high rates, and high debt, we do not anticipate raising the rating over the next two years.

Credit Opinion

Uncertain strategic direction with unsettled governance

Despite actions and plans adopted by the city commission and GRU's management to reduce both leverage and the general fund transfer, state legislation (HB 1645) was enacted in 2023, amending the city's charter, removing GRU's governance from the city commission and vesting it with the newly created GRUA, with five members appointed by the governor--ostensibly to give greater representation to GRU customers residing outside of city limits (almost 40% of GRU customers reside in unincorporated areas of Alachua County). We note that a significant, but declining portion of the City of Gainesville's budget is funded with the transfer, and that the transfer had been reduced to $15 million, as budgeted for fiscal 2024, from a high of $38 million in 2021.

The newly appointed board subsequently fired GRU's CEO, replacing him with the authority's board chair, who had previously served as GRU's CEO, prior to being fired by the City Commission in 2022.

Under the current leadership, GRU's 2025 budget lowered the general fund transfer further, reducing it to $8.5 million, with some board members advocating its elimination and the clawback of legacy transfers from GRU to the city. Management plans to use the savings from the reduced transfer to fund rate relief, debt reduction, and/or capital investment. We note that despite these plans, GRU forecasts that debt to capitalization will remain above 80% over the next five years, and that its $460 million capital plan covering fiscal years 2025-2028 is expected to be 60% debt-financed.

GRU has also rolled back planned 3% annual electric rate increases for fiscal years 2025-2028 (but nevertheless projects improving liquidity and FCC through 2028), reduced capital expenditures, paused integrated resource planning, and announced that it will no longer strictly adhere to its adopted goal of net zero carbon by 2045--heretofore pursuing power supplies deemed affordable, economic, and opportunistic, suggesting a greater reliance on purchased power in the future.

Legal challenges to the constitutionality and validity of the GRUA have been filed in state and federal courts. Concurrently, the city commission placed a local measure on the Nov. 5, 2024, ballot that would return GRU governance to the city.

The referendum, which passed with 72.5% of the vote, deletes the article of the city's charter that created the GRUA.

However, prior to the election, the GRUA sought and received from the state circuit court, an injunction prohibiting dissolution of the authority until the legal challenges are resolved, despite the voter-approved measure, preserving (for now) the status quo. Hearings are scheduled for late January or early February 2025.

In addition to the uncertain strategic direction created by instances of the reassignment of oversight governance, we understand that the timing of GRU's access to capital markets could depend on the resolution of litigation challenging shifting oversight, which could create credit risk for this capital-intensive utility.

Deep and diverse service area, anchored by the University of Florida

Gainesville is home to the University of Florida, one of the largest universities in the U.S., with enrollment of about 57,000; and Santa Fe College, with about 15,000 students. These institutions, along with several major hospitals, stabilize the service-area economy.

GRU has a stable customer base and serves a primarily residential area of about 100,000 electric customers and 280,000 combined system customers. In our view, this affords the utility with scale efficiencies that benefit credit quality. Residential customers account for almost half of retail electric sales; in our opinion, these exhibit more stable demand patterns across economic cycles than do industrial customers, supporting credit quality. GRU's customer base is diverse and customer concentration is not a credit risk, as the leading customer accounts for just 3% of combined system revenue.

Median household effective buying incomes are just 63% of the U.S. average. However, while low-incomes signal a limitation to GRU's rate-raising flexibility, the extent to which the large student population contributes to the low metric mitigates the risk. In our opinion, this cohort both skews the income levels of actual ratepayers (that is, on-campus students are not ratepayers) and understates demand elasticity for off-campus students that receive financial support.

However, as a large portion of Gainesville is tax-exempt, the city's general fund has historically been dependent on transfers from its utility to support about 30% of its municipal operations. (For further information regarding the transfer, see "FCC and liquidity underpin credit quality, but leverage remains a weakness".)

Debt-laden resources contribute to high power costs and rates

The utility operates a vertically integrated electric system, with virtually all energy needs met through owned generation. GRU has excess capacity, giving it operational flexibility, and relies on three units for the bulk of its power needs--the 232 megawatt (MW) dual fuel (natural gas and coal) Deerhaven unit 2, the 103 MW Deerhaven Renewable Biomass Plant, and the 41 MW J.R. Kelly combined cycle unit.

In addition to the high level of transfers, two power supply decisions made more than a decade ago--a solar FIT paid to behind-the-meter generators and a power purchase agreement (PPA) for a biomass plant (the Gainesville Renewable Energy Center, or GREC)--are the source of GRU's high rates, in our opinion. The solar FIT required GRU to make fixed payments at well above market prices for solar energy for 20 years to participating customers. Although the GREC PPA was intended to reduce GRU's reliance on fossil fuels and enhance fuel-source diversity, the operational restrictions built into the PPA, coupled with low natural gas prices, rendered the biomass plant uneconomical, with substantial fixed costs that negatively affected rates.

In 2017, GRU purchased GREC for $750 million, renaming it Deerhaven Renewables (DHR). The price was significantly higher than the cost to construct, but ownership enabled GRU to significantly reduce associated fixed costs relative to those under the PPA, producing more than $500 million in net present value savings while eliminating the operational restrictions, making it a better fit as an intermediate resource in Gainesville's dispatch stack. Despite this, DHR accounted for just 23% of the utility's energy needs in 2023 and 15% in 2024, down from 28% in 2019, suggesting that this key asset remains uncompetitive.

GRU's fuel mix is diverse, with 65% of energy coming from natural gas units, 28% from renewable resources, primarily from DHR, and 5% from coal-fired generation. The utility's 644 MW of capacity is more than enough to meet the 408 MW peak load. In our opinion, the surplus capacity gives the utility some dispatch flexibility. However, despite the positive attributes, GRU's high all-in cost of power, which is largely attributable to the significant amount of debt associated with DHR, tempers our view of operations. So, despite the excess capacity, the utility's ability to recover fixed costs through surplus sales is very limited.

FCC and liquidity underpin credit quality, but leverage remains a weakness

FCC averaged 1.50x over fiscal years 2021-2023, including 1.34x in fiscal 2023, with the decline attributable to higher transfers to GRU's rate stabilization fund and inflationary pressures. Unaudited financial results for 2024 suggest net available revenue that we calculate as providing 1.60x FCC as gas prices declined. Our calculation of FCC treats capacity payments and a portion of purchased power expense related to renewables as debt-like while treating transfers to the city's general fund as an operating expense.

In 2021, GRU transferred $38 million to the city's general fund. The transfer was reduced by $2 million in 2022 and again in 2023. Nevertheless, we viewed this level of transfers as representing a substantial burden on the utility and, in our view, a significant contributor to its high rates. Facing political pressure, the city commission made a more significant reduction in the transfer for 2024, bringing it down to $15 million, while planning to use the savings to achieve $315 million in debt reduction. Now, under GRUA governance, GRU has cut the transfer further, to $8.5 million for fiscal 2025, a level that it expects to keep over the next 10 years. GRU projects operating results that we calculate as providing FCC in the 1.6x-1.7x range, despite the rollback of planned rate increases over fiscal years 2025-2028.

In our opinion, liquidity and reserves are solid. At fiscal year-end 2023, internal liquidity totaled $146 million, including operating cash, rate stabilization reserves, and unrestricted funds designated for capital improvements. At fiscal year-end 2023, external liquidity (undrawn capacity on lines of credit) measured $200 million. Total liquidity and available reserves measured a robust 395 days of operating expenses. The five-year forecast suggests strengthening in liquidity over the next five years.

GRU is highly leveraged, with about $1.8 billion in long- and short-term debt, representing more than 82% of total capitalization. The utility's current plan is to use savings from the reduction in transfers to the general fund, combined with current funds and expense-side saving by about $208 million through 2028.

The combined utility has about $790 million of privately placed debt, including $150 million of direct-placement debt issued at the end of June 2023. S&P Global Ratings does not rate the privately placed bonds. However, we understand that the termination events are consistent with those applying to GRU's capital market debt and that there are no acceleration provisions that would result in repayment of the privately placed debt ahead of the capital market debt.

Gainesville Regional Utilities, Florida--key credit metrics

	--Fiscal year ended Sept. 30--		
	2023	2022	2021
Operational metrics			
Electric customer accounts	102,200	101,718	100,944
% of electric retail sales from residential customers	47	45	44
Top 10 electric customers' revenues as % of total electric operating revenue	18	15	17
Service area median household effective buying income as % of U.S.	68	63	66
Weighted average retail electric rate as % of state	N.A.	149	133
Financial metrics			
Gross revenues ($000s)	468,724	527,238	413,319
Total operating expenses less depreciation and amortization ($000s)	286,149	313,542	230,997
Debt service ($000s)	109,678	107,118	92,207
Debt service coverage (x)	1.7	2.0	2.0
Fixed-charge coverage (x)	1.3	1.6	1.5
Total available liquidity ($000s)*	346,661	336,288	263,736
Days' liquidity	395	299	357
Total on-balance-sheet debt ($000s)	1,852,193	1,964,227	2,003,799
Debt-to-capitalization (%)	82	82	83

*Total available liquidity includes available committed credit line balances, where applicable. Debt service coverage--Revenues minus expenses divided by debt service. Fixed-charge coverage--Sum of revenues minus expenses minus total net transfers out plus capacity payments (or their proxy), divided by the sum of debt service plus capacity payments (or their proxy). N.A.--Not available.

Ratings Detail (As Of November 26, 2024)

Gainesville		
Long Term Rating	A/Stable	Affirmed
Gainesville		
Long Term Rating	A/Stable	Affirmed
Gainesville util sys rev bnds		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Gainesville util sys rev bnds ser 2019A due 10/01/2047		
Long Term Rating	A/Stable	Affirmed
Gainesville util sys rev bnds ser 2019B due 10/01/2047		
Long Term Rating	A/Stable	Affirmed