

RatingsDirect®

Summary:

**Gainesville, Florida
Gainesville Regional Utilities; CP;
Combined Utility**

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Summary:

Gainesville, Florida Gainesville Regional Utilities; CP; Combined Utility

Credit Profile

Gainesville, Florida

Gainesville Regl Utils, Florida

Gainesville (Gainesville Regl Utils) util sys

Long Term Rating

AA-/Stable

Affirmed

Rationale

S&P Global Ratings has affirmed its 'AA-' long-term rating on Gainesville, Fla.'s combined system revenue bonds, issued for Gainesville Regional Utilities (GRU). The outlook is stable.

At the same time, we affirmed our 'AA-/A-1' ratings on GRU's variable-rate demand bonds (VRDBs), series 2005C, 2006A, and 2008B. In addition, we affirmed our 'AA-/A-1+' ratings on the utility's series 2007A VRDBs. The ratings on GRU's variable-rate debt reflect our long- and short-term ratings on GRU's respective liquidity facility providers. Finally, S&P Global affirmed its 'A-1+' short-term rating on Gainesville's commercial paper (CP) program issued for the utility.

The 'AA-' long-term rating reflects our assessment of the following strengths:

- A stable customer base and economy, which the University of Florida anchors;
- Good coverage of fixed costs at the current rating level; and,
- Robust liquidity.

We believe the following represent credit weaknesses:

- An unfavorable power supply portfolio, highlighted by the Gainesville Renewable Energy Center (GREC), an uneconomical biomass plant, which we believe has resulted in very high rates, limiting financial flexibility and weakening fixed-cost coverage, and a coal-fired unit (Deerhaven 2) in an environment of increased regulation of emissions; and
- Rates that are among the highest in the state, resulting in reduced financial flexibility and lower coverage of fixed costs.

The business profile score is '5' on a scale of '1' to '10', with '1' being the strongest. The business profile reflects our assessment of the risks associated with GRU's generation portfolio and above-average rates, offset by a primarily residential service area with no significant concentration and an economic base that benefits from the University of Florida's stabilizing presence. The city commission governs the system.

GRU provides electric, natural gas, water, wastewater, and telecommunication services to customers in the Gainesville metropolitan statistical area (MSA). The electric utility accounts for 74% of combined revenue; the other four systems each account for 10% or less. We consider the user base stable. More than 40% of electric revenue comes from residential customers, and no single customer accounts for a significant share of the utility's operating revenue. Additional economic stability accrues from the University of Florida, which has more than 50,000 students, although this contributes to low median household incomes that are just 64% of the U.S. average.

We consider GRU's operating profile a credit weakness. To reduce reliance on fossil fuels and enhance fuel source diversity, GRU made a significant commitment in signing a power purchase agreement with a merchant biomass plant--GREC--which entered commercial operation in December 2013. However, low natural gas prices have rendered the biomass plant uneconomical, and GREC was largely idled in 2015 and 2016 in favor of other resources (owned and purchased) whose energy costs are more attractive. Nevertheless, as long as the unit is available, GRU makes substantial fixed payments to GREC, regardless of whether it dispatches energy. This has saddled the utility with a substantial fixed cost related to the agreement, which it passes through to ratepayers, putting upward pressure on rates. At about 14.9 cents per kilowatt hour (kWh) in 2015 (the most recent year of available comparative information), GRU's rates were among the highest in Florida (42% above the state average). We understand that GRU's rate, as of October 2016, was 13 cents/kWh. In our opinion, the utility's rates are extraordinarily high and especially burdensome given the low income levels.

Current projections for gas prices suggest that GREC will remain idled well into the future, unless needed for reliability purposes or to meet environmental regulatory requirements. As such, the goal of diversifying the utility's fuel mix remains unachieved. And with a significant component of energy coming from the coal-fired Deerhaven 2 unit, GRU continues to face risks related to environmental regulation, most prominently related to the Environmental Protection Agency's (EPA) Clean Power Plan. The plan's effects are unclear, and we have not factored them into the ratings. In 2016, GRU scaled back dispatch of Deerhaven 2 in favor of more economic market purchases, but here again it continues to shoulder related fixed costs.

We believe that these circumstances constrain GRU's revenue-raising flexibility. GRU's coverage of fixed costs was at 1.3x in 2014 and 1.33x in 2015, and is estimated to be 1.35x in 2016. Fixed-cost coverage treats the payments to GREC as a debt rather than an operating expense, and transfers to the city's general fund (\$34.9 million in 2015, a sizable 8.2% of utility revenue and one-third of the general fund budget) as an operating expense. Fixed-cost coverage levels are projected to be in the 1.33x-1.36x range over the next five years.

The utility maintains what we consider robust liquidity, with unrestricted cash and investments, plus restricted (but available) rate-stabilization and utility plant improvement funds measuring 243 days of operating expenses in fiscal 2015. GRU has two CP programs that provide \$110 million of short-term funding. Bank of America provides an \$85 million credit facility for the utility system that expires Nov. 30, 2018, and State Street Bank provides a \$25 million credit facility for the system that expires Aug. 28, 2017.

Management estimates capital spending for fiscal years 2017-2021 will be about \$332 million. With about 62% of the funding coming from internally generated funds, we expect only modest increases to leverage. About half of planned expenditures will be for the electric system. The gas system will spend about \$167 million for main and residential

extensions. GRU expects the water and wastewater system treatment capacity to be adequate for at least the next 10 years. During the next five years, the utility will invest about \$52 million in the water system and \$75 million in the wastewater system for expansion, maintenance, and system improvements. The system expects the telecommunications business to require about \$14 million to continue expanding its fiber-optic system throughout the MSA.

Outlook

The stable outlook reflect our view that GRU's fixed-cost coverage is likely to be adequate to support credit quality at the current level, and that robust liquidity will provide short-term support for unexpected budget variances that the utility's power cost adjustment mechanism will not otherwise recover.

Upside scenario

We do not expect to raise the rating over the next two years. In our view, GRU's limited revenue-raising flexibility, uncertainty regarding the effects of the EPA's Clean Power Plan, and the fact that the utility's financial forecast do not suggest strengthening of financial metrics would militate against credit improvement.

Downside scenario

We could lower the rating if fixed-cost coverage falls meaningfully short of projected levels, or if the Clean Power Plan's effects suggest significant additional operational and financial burden.

Ratings Detail (As Of December 12, 2016)		
Gainesville, Florida		
Gainesville Regl Utils, Florida		
Gainesville (Gainesville Regl Utils) VRDBs - 2008B		
<i>Long Term Rating</i>	AA-/A-1/Stable	Affirmed
Gainesville (Gainesville Regl Utils) util sys		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Gainesville (Gainesville Regl Utils) CP ser C		
<i>Short Term Rating</i>	A-1+	Affirmed
Gainesville (Gainesville Regl Utils) CP ser D		
<i>Short Term Rating</i>	A-1+	Affirmed
Gainesville (Gainesville Regl Utils) VRDBs - 2005C		
<i>Long Term Rating</i>	AA-/A-1/Stable	Affirmed
Gainesville (Gainesville Regl Utils) VRDBs - 2006A		
<i>Long Term Rating</i>	AA-/A-1/Stable	Affirmed
Gainesville (Gainesville Regl Utils) VRDBs - 2007A		
<i>Long Term Rating</i>	AA-/A-1+/Stable	Affirmed
Gainesville (Gainesville Regl Utils) VRDBs - 2012B		

Ratings Detail (As Of December 12, 2016) (cont.)

<i>Long Term Rating</i>	AA-/A-1/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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