Moody's Investors Service

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New Issue: Gainesville (City of) FL

MOODY'S ASSIGN Aa2 RATING TO GAINESVILLE UTILITIES SYSTEM REVENUE BONDS, 2005 SERIES A AND 2005 SERIES B (TAXABLE)

Aa2 RATING AFFECTS $538.7 MILLION IN PARITY BONDS, INCLUDING THE CURRENT OFFERING

Combined Utilities
FL

Moody's Rating

ISSUE		RATING
Utilities System Revenue Bonds, 2005 Series A		Aa2
Sale Amount	$230,760,000	
Expected Sale Date	11/01/05	
Rating Description	Utilities System Revenue	
Utilities System Revenue Bonds, 2005 Series B (Taxable)		Aa2
Sale Amount	$16,420,000	
Expected Sale Date	11/01/05	
Rating Description	Utilities System Revenue	

Opinion

NEW YORK, Oct 21, 2005 -- Moody's Investors Service has assigned an Aa2 rating to Gainesville's (FL) sale of Utilities System Revenue Bonds, 2005 Series A ($230.8 million - fixed rate) and 2005 Series B ($16.4 million - taxable, fixed rate). A 2005 Series C bond ($53.1 million - variable rate) will be sold imminently and will be assigned a Moody's variable rate rating by our structured-finance group based on the bank's liquidity facility, as well an a underlying rating at that time. The bonds are secured by a senior lien pledge on the system's net revenues that include electric, water, sewer, gas and telecommunication components. The Aa2 rating is based on the system's relatively competitive electric power costs, well-managed financial operations with good debt service coverage and strong cash position, stable economic base, and good utility management. While diversity of services affords some credit strength, nearly 72% of operating revenues are derived from electric operations. There exists the potential for nearly doubling the current amount of system debt to fund construction of a 220 MW solid fuel facility, if approved, to meet the electric system's needs in the 2012 timeframe. Issuance of such a significant amount of debt (currently estimated upward of $491 million), would change the utility's debt profile, and could affect the electric system's relative competitive position given the status of deregulation at the time, increased rates with somewhat narrower debt service coverage, and exposure to a significant amount of generation debt. Moody's will review the financing plan and expected coverage ratios along with the impact on system rates at the time of the proposed issuance.

Moody's also affirms the Aa2 rating on $538.7 million in parity senior lien bonds, including these issues. The system also has $68.5 million in subordinate lien obligations (Series 2002A&B), which are variable rate obligations that have been synthetically swapped to fixed rate. Bond proceeds of the 2005 Series A will refund about $80 million of commercial paper (Series C) and provide $161.8 million in new money for the electric, gas, water and sewer systems capital program; the 2005 Series B bonds will be used to refund about $16 million in commercial paper notes (Series D); and proceeds of the 2005 Series C bonds (and a 2006 Series A bond expected to be issued in the spring of 2006) will be used to refund about $105.0 million in Series 1996 senior lien bonds to achieve an estimated $13.2 million net present value savings (12.6% of refunded par). The 2005 Series C (and 2006 Series A variable rate bonds, when issued) will be synthetically swapped to fixed rate.

LEGAL PROVISIONS MODIFIED; DEBT SERVICE RESERVE ELIMINATED

Senior lien legal provisions have been amended (effective March 9, 2004) to exclude the maximum debt service reserve, and include other obligations (commercial paper, medium-term notes, hedge payments, reimbursement bonds, etc.) as parity obligations (to senior lien). The 125% rate covenant and additional bonds test (historical basis) remained unchanged. Debt service reserve funds were reportedly disseminated to respective system components and used solely for construction purposes. Moody's believes that while the elimination of a debt service reserve weakens legal protections, this is balanced against the utility's history of maintenance of strong cash balances. Strong liquidity levels, especially for electric utilities, is a critical credit factor.

ELECTRIC STRATEGIES MEANT TO MODERATE COSTS; OTHER SYSTEM COMPONENTS ARE ADEQUATE

Moody's believes that the utility's focus on customer satisfaction and retention through competitive pricing and good service delivery has been beneficial in improving its competitive posture. With approximately 45% of the system's electric revenue derived from commercial/industrial entities, officials restructured rates, eliminated rate class differentials and pursued long-term large-user contracts. Currently, the electric system has roughly 34% of total electric revenue under long-term contracts. Power costs, which had shown competitive improvement, have increased appreciably, as have all utilities, with the spike in oil and gas prices nationwide. The utility has passed through fuel adjustments appropriately, utilizing a smoothing pattern to minimize monthly volatility. The electric system's major baseload and intermediate generating units are reported to be at or below market cost, with only some intermediate and all peaking units above market. Electric rates are very competitive within Florida, while natural gas and water and sewer are either the lowest or among the lowest in the state. The electric system's off system sales which reached double digit through 2002, due in part to surplus power, have since dropped dramatically due largely to the system's units that are above market costs. Fiscal 2005 generating capacity of 611.3 MW is compared to a peak of 465 MW in 2005. A gradual reduction in the system's surplus power, a generation inventory that includes higher-cost generating units, and steady customer growth necessitates new generation by 2012. Officials have a stated preference for being the sole owner of a potential 220 MW, $491 million, solid fuel facility. However, the city has selected three firms to interview to be retained to determine what role is best suited for the utility. Results of their study are due March 2006.

The system also has established strategic alliances with other utilities through it's participation in The Energy Authority (TEA), "Good Guys", and the Florida Municipal Power Agency's power pool, which have helped in fuel (natural gas) procurement, dispatching surplus power, and mitigating loss of the system's major unit (228 MW Deerhaven #2). Deerhaven #2 is the system's primary baseload and largest unit at 228 MW, over 37% of total potential generation resources. An extended outage for this unit provides some vulnerability which is balanced against the favorable operating and availability performance and the ability to purchase excess power from the members of the "Good Guys".

The five-year average fuel mix for 2000- 2004 included 67.9% coal, 23.9% natural gas, 5.0% nuclear (through ownership interest in Progress Energy Florida's Crystal River #3 plant), and 3.2% oil. Fuel contracts vary with coal beginning a new contract for 65% of system needs for the 2006 to 2008 timeframe, natural gas with only short-term contracts and spot market purchases, and oil with just spot market purchases. A $90 million required emissions control retrofit on Deerhaven 2 has been included in the capital plan. The retrofit project is expected to commence operations in the 2008-2009 timeframe.

The system is primarily residential and there are no major users in each utility component (e.g., top 10 electric customers 5.8% of electric revenues). Moody's also expects that deregulation in Florida will proceed at a slower pace than the rest of the nation due to transmission constraints, minimal large customer exposure, and retail rates that are below the national average. We believe that Gainesville will have sufficient transition time to implement measures to remain competitive, if necessary.

The water system reportedly has ample supply from the Floridan Aquifer, and water and sewer system treatment capacities are being expanded to provide for system needs through at least 2024. Currently the water system has 25.3 MGD of average demand compared to 54 MGD capacity, and the sewer system has average flow of 17.04 MGD in relation to capacity of 22.4 MGD. The water and sewer systems serve the City of Gainesville and the immediately surrounding area (approximately 74.0% and 66.4% of county population respectively), and are predominately residential in nature with no large customer dependency. Water and sewer operations generated 6.3% and 7.6% respectively of fiscal 2004 revenues. The natural gas system serves about 28.9% of the county residents (29,288 accounts) through 4 distribution points with Florida Gas Transmission. The Energy Authority has assumed procurement of gas for the city; natural gas revenues accounted for 11.0% of total system revenues in fiscal 2004. Finally, the system operates a telecommunications service (GRUCOM) with over 6,000 customers. GRUCOM accounted for 3.6% of fiscal 2004 total system revenue.

WELL-MANAGED FINANCIAL OPERATIONS WITH GOOD DEBT SERVICE COVERAGE AND CASH IN SYSTEM

Moody's believes that the utility maintains favorable operations with senior lien debt service coverage from 2.5 times in 1995 to 3.1 times in fiscal 2004 (from 1.4 times to 2.5 times on all debt). Coverage declines to 2.1 times on senior bonds (1.67 times on all debt) after sizable transfers in fiscal 2004. Projected debt service coverage before transfers is expected to decline to 1.92 times for senior bonds and 1.83 times for all debt by

2008 before increasing slightly to 1.99 times and 1.90 times respectively by 2011, not including potential funding for new generation. Unaudited and estimated fiscal 2005 results indicate an 8% decline in net revenues attributed to increased chemical and electric costs. Electric rates for general service and large power customers are among the lowest in the state, as well as water and sewer rates, while natural gas rates are the lowest among comparably-sized communities. In the five-year projections (FY 2006 to 2010), annual base rate increases are projected for all system components, with cumulative totals as follows: electric, 16%; gas, 11.75%; water, 44.0%; and wastewater, 48.0%. The 16% cumulative increase for electric does not include funding for a potential solid fuel facility, which would increase the electric's cumulative total increase to 40% from fiscal 2006 to 2011.

Also the system has about $62.7 million in system unrestricted cash at the end of fiscal 2005 (down from $113.5 million in 2002) just about 37% of operating expenses that year. Reserves are projected to be $66.7 million by 2011. Officials have adopted a change in philosophy related to maintenance of reserves by replacing traditional funds earmarked for rate stabilization and utility plant improvement, with reserves for categories of at-risk cash flows pursuant to a matrix. At-risk reserves (which include revenue, catastrophic events, construction and financial liability components) total $56.9 million for fiscal 2006 - which amount is $5.8 million less than fiscal 2005 reserves - and is reassessed annually. The utility has systematically lowered reserves since 2002. Maintenance of a favorable level of liquidity is critical for electric utilities, especially in light of a lack of debt service reserves and potential for a substantial borrowing program. The large General Fund transfer, dictated by a three-part formula which includes what an investor-owned utility would pay, influences retail rates and is an area of additional cost control. The $27.0 million fiscal 2004 transfer represents about one-third of the city's operating revenues and 11.0% of total utility gross revenues.

CAPITAL PROGRAM COULD BE EXPANDED WITH POTENTIAL CONSTRUCTION OF ADDITIONAL BASELOAD FACILITY

Moody's expects the utility to increase its debt levels and the proportion of electric system generation debt going forward. The combined utility has a rising debt ratio of 55.0% (61.8% on a pro forma basis including new money bonds). Electric generation debt, only about 19% of system total debt prior to the current offerings, could increase appreciably with funding of new baseload capacity within the next few years, although it is uncertain at this time how much will be debt-financed. The six-year $423 million capital program is expected to be 81.8% funded with bonds (including $162 million in the current offerings), and the remaining 18.2% with internally-generated funds. This symbolizes a shift in funding the capital program more with debt than equity to retain funds to apply towards new generation and other costs. Again, the current capital program excludes any funding of a potential new baseload unit. The system also has a sizable subordinate lien debt load comprised of about 36% of system debt ($164.5 million) composed of $68.5 in variable rate insured Series 2002 bonds (FSA insured - rated Aaa) and $96.0 million commercial paper (rated P-1). The current offerings are refunding all the outstanding commercial paper, and the Series 2002 variable rate bonds - along with the variable rate Series 2005 C bonds to be issued imminently and the variable rate 2006 A bonds to be issued in the spring of 2006 (to refund Series 1996 senior lien bonds) - are or will be swapped to a synthetic fixed rate. This will significantly reduce the system's variable rate exposure. The current offerings also slow overall debt payout.

MANAGEABLE CUSTOMER AND ENERGY GROWTH AND STABLE ECONOMY

The diverse customer base area encompasses the City of Gainesville and surrounding unincorporated areas. While the economy is dominated by the main campus of the University of Florida, it is not a utility customer. The area continues to expand with the creation of primarily government and service-oriented employment which has been a stabilizing force in the economy. Energy growth has averaged a manageable 2.9% annually while customer growth has averaged 2.4% (over the past decade) and forecasts through 2014 anticipate energy sales growth at 2.46% and growth in customer at 1.88% annually. There is no large customer dependency, and the system is primarily residentially-based.

KEY STATISTICS

FY 2004 Operations,

Operating ratio: 70.8%

Debt ratio: 55.0%

Debt Service Coverage (before transfers),

Senior debt: 3.11 times

All debt: 2.47 times

General Fund Transfers,

% system gross revenues: 11.0%

% system net revenues: 32.5%

% City operating fund: 32.7%

Post Sale Bonds Outstanding (including 2005 C),

Senior Lien: $538.7 million

All Debt: $607.2 million

Bond Payout (Senior Lien),

10 years: 38.0%

20 years: 69.1%

31 years: 100.0%

City Per Capita Income as % State (1999): 77.8%

City Median Family Income as % State (1999): 97.0%

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