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Research:
Summary: Gainesville Regl Utils, FL; Utility, CP; Utility, Combined Utility

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Credit Profile

AFFIRMED
Gainesville, Florida

$320.780 mil. Gainesville (Gainesville Regl Utils)	AA
$85.000 mil. Gainesville (Gainesville Regl Utils) 3(A)3 CP prog	A-1+
$25.000 mil. Gainesville (Gainesville Regl Utils) sys comm pap nts ser D dtd 05/01/2000 due 05/01/2030	A-1+
$77.300 mil. Gainesville (Gainesville Regl Utils) var rate sub util sys rev bnds ser 2002A&B (FSA)	AAA/AA(SPUR)
OUTLOOK:	NEGATIVE

AFFIRMED
Gainesville, Florida

$0,000 GAINESVILLE UTIL SYS COMM PPR NTS SER C	A-1+

Rationale

Standard & Poor's Ratings Services affirmed its 'AA' underlying rating on Gainesville Regional Utilities' (GRU) outstanding debt and its 'A-1+' rating on GRU's commercial paper program. At the same time, Standard & Poor's revised the outlook on the utility to negative from stable.

Standard & Poor's also assigned its 'AA' rating to GRU's $306.2 million series 2005 A-C bonds, which the utility will use to refund outstanding debt obligations and fund a portion of a sizable capital program.

GRU has applied for insurance for the bonds, and the bonds are expected to be assigned 'AAA' ratings once the insurance has been secured.

Based in Gainesville, Fla., GRU provides electric, natural gas, water, wastewater, and telecommunication services to customers in the Gainesville metropolitan area.

The revised outlook reflects our view that greater rate increases will be required to maintain the current rating, given the current debt amortization schedule.

GRU's electric system revenues ($159 million in fiscal 2004 from 88,165 customers) account for more than 70% of total operating revenues. As of Oct. 1, 2005, GRU's total long-term debt outstanding was $358 million and commercial paper outstanding was $96 million.

Net revenues from the combined utilities secure the outstanding revenue bonds and commercial paper notes. However, the commercial paper notes represent a subordinate-lien obligation on system revenues and, according to covenants in the subordinate revenue bond resolution, the utility must maintain a liquidity facility equal to the principal of all commercial paper notes outstanding. The $85 million backup bank facility was recently extended to Nov. 30, 2015 and the $25 million bank facility was recently extended to July 23, 2008.

Debt-financed capital spending over the next several years is expected to weaken GRU's financial profile. Total debt service coverage, which averaged 2.25x for fiscal 2000-2005, should average 1.85x over the forecast period due to higher capital spending in the absence of significant rate increases. The fixed charge coverage ratio, which measures debt service coverage after the general funds transfer to the City of Gainesville, averaged 1.5x during 2000-2005 and is likely to be 1.26x. This is weak compared with other 'AA' municipal utilities.

Moreover, GRU is contemplating constructing a 220 MW solid fuel generating plant to be brought on line around 2013. While this is its least-cost option given the price differential between coal and gas, the plant construction will require additional borrowing and would likely add risk to the utility's overall financial profile. However, Standard & Poor's will not incorporate the risks attendant to new plant construction and financing into the utility's overall profile until GRU establishes related terms and conditions.

Overall, the 'AA' rating reflects the following strengths:

- The combined utilities' solid operational profile and low production costs,
- Generally strong financial profile characterized by low debt-to-capacity level, and reasonably strong liquidity, despite the declining balance in the utility's rate stabilization fund,
- Experienced and proactive management team, and
- A stable economy with a growing customer base.

These strengths are somewhat offset by the following:

- Transfers to the general fund that are a large percentage of total revenues (11%), and
- A shift toward greater debt financing of the capital program since 2003, increasing to 62% from 30%.

Two-thirds of the estimated $415 million of capital spending will be for the electric utility and the rest will be used by the gas, water, and wastewater utilities and the telecommunications company. Total spending for the electric system is estimated to be around $275 million over the next five years, of which about $90 million will be used for the emission control equipment on Deerhaven Unit 2, a 220 MW coal-fired plant that supplies around 70% of the power required by GRU's customers. Another $50 million will be used for new and upgraded transmission and distribution systems. Estimated spending for the other utilities of about $140 million will include the cost of new gas system development, water system filter additions, plant rehabilitation, and well field expansion, reclaimed water-system and collection-system improvements, and rehabilitation for the wastewater system.

The dependence of GRU on the operation of Deerhaven 2 to supply low-cost power is a significant factor in the rating on the utility system. An agreement with surrounding municipal utilities to provide power in the event of an outage supports the current rating, but purchased power from the group of utilities would be at the higher cost of market-based gas rates. In this regard, the addition of a second solid fuel facility would provide the credit support of diversified supply. The cost, however, would require additional rate increases.

At present, GRU provides utility services at very low rates, so the rate increases needed to help fund a portion of the upfront cost of the system-upgrade capital spending program should not be burdensome. Even after the Oct. 1, 2005 increase for electric, water, and wastewater rates--the first increase for electricity customers in 11 years--rates are still the lowest, or among the lowest, of all utility systems in Florida. Furthermore, to help limit the overall cost of service, GRU has negotiated a new three-year very competitively priced contract for 65% of its coal requirements for the 2006-2008 period. GRU also has a rail contract through 2019 at rates made more favorable by the fact that GRU owns a fleet of rail cars. GRU expects to raise rates moderately for electric and gas customers over the next five years to cover the cost of operating the expanded system and assure minimal senior debt service coverage of 1.25x in accordance with the bond resolution.

However, greater rate increases will be required to maintain the current rating, given the current debt amortization schedule. Although GRU has always had the support of the City of Gainesville in implementing rate increases needed to avoid credit deterioration, we are concerned that the increases needed to provide adequate debt service coverage over the next several years may be unusually high, perhaps even higher than GRU's customers are willing to accept. GRU is using an increasing amount of debt to finance the upgrade of the system (almost two-thirds compared with around one-third prior to 2003), leading to an increased level of revenue requirement.

In support of the current rating, GRU intends to maintain reserve fund balances in excess of $60 million, which is greater than or equal to total annual debt service in 2006-2011. A risk analysis program used to determine the necessary reserve fund takes into account all risk associated with stability of revenue, commodity prices, a percentage of the value of the self-insured assets plus the deductible, 60 days of average annual nonfuel operating costs, and other potential liquidity needs including variable rate interest. This supports Standard & Poor's view that management of GRU has taken steps to support a strong credit profile.

While GRU's financial profile is expected to weaken, the financial profile is reasonably within the 'AA' metrics. At present, debt per electric customer is about $2,780 (55% of total debt is attributable to the electric supply business) and electric debt per kilowatt is about $400. Both measures are at the low end of the scale for municipal utilities.

Outlook

The negative outlook on GRU reflects Standard & Poor's view that greater rate increases will be required to maintain the current rating, given the current debt amortization schedule.

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.