

# **Credit Ratings and GRU's Current Credit Profile**

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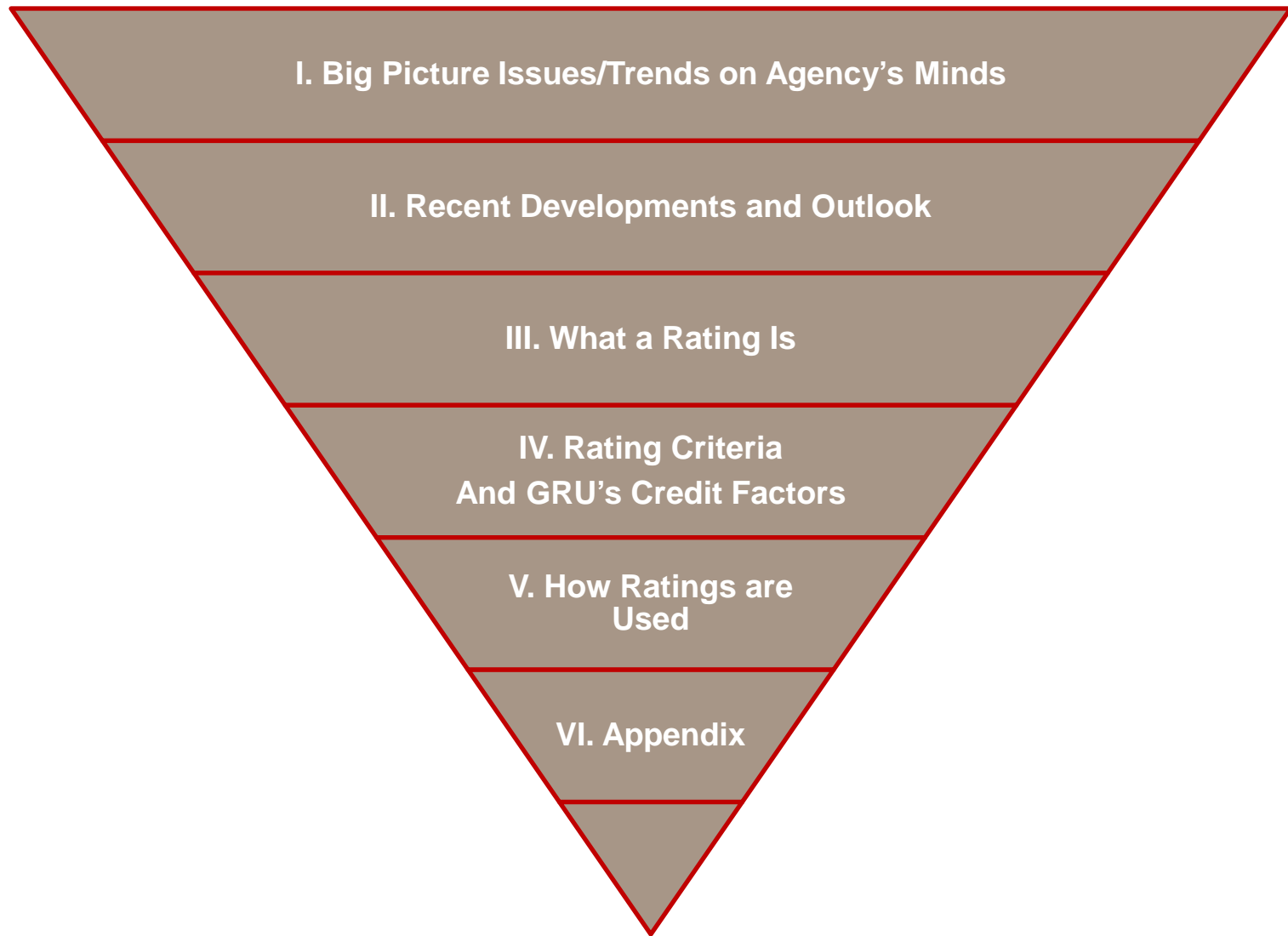
# Context: what angle am I coming from?

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- Wells Fargo Bank's National Head of Public Power (including municipal and cooperative utilities)
  - Developed underwriting criteria for utilities
- Wells Fargo looks at 1-5 yr credit facilities and provides credit advice to clients by helping with rating agency and investor presentations
- 15 years of Rating Agency experience:
  - Previously Head of Public Power at Fitch Ratings
  - Today, continued relations and discussions of utility credit with all major credit agencies

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# Big Picture

# Rating agency views reflect recent events

2000				Present	
▪ Enron	▪ Natural gas price volatility	▪ Financial market turmoil	▪ Fukushima	▪ Lower power and gas pricing	
▪ Western energy crisis	▪ JAA member contract renewals	▪ Recession	▪ Increased natural gas supply	▪ Wind – negative pricing	
▪ Retail competition and industry restructuring	▪ Developing wholesale market	▪ Slowdown of coal unit construction	▪ Flat to declining energy sales	▪ Distributive generation	
	▪ Changing management and governance personnel	▪ Nuclear renaissance	▪ New EPA regulations	▪ Nuclear station closings	
		▪ Renewable mandates	▪ New generation decisions	▪ Stay of CPP and the EPA's continued push	
		▪ Variable rate debt disruption	▪ Decreased wholesale market prices	▪ Cyber terrorism	
		▪ Carbon tax legislation		▪ Battery storage	
				▪ Management succession planning	

# Sector's current capital needs



## **Aging Infrastructure**

- System Upgrades
- Repair and Replacement
- New Technology
- Cyber Security

## **Pension Obligations**

- Unfunded Liability
- OPEB

## **Environmental/ Renewable Requirements**

- MATS
- CSAPR
- Carbon Regulations
- RPS
- Clean Power Plan

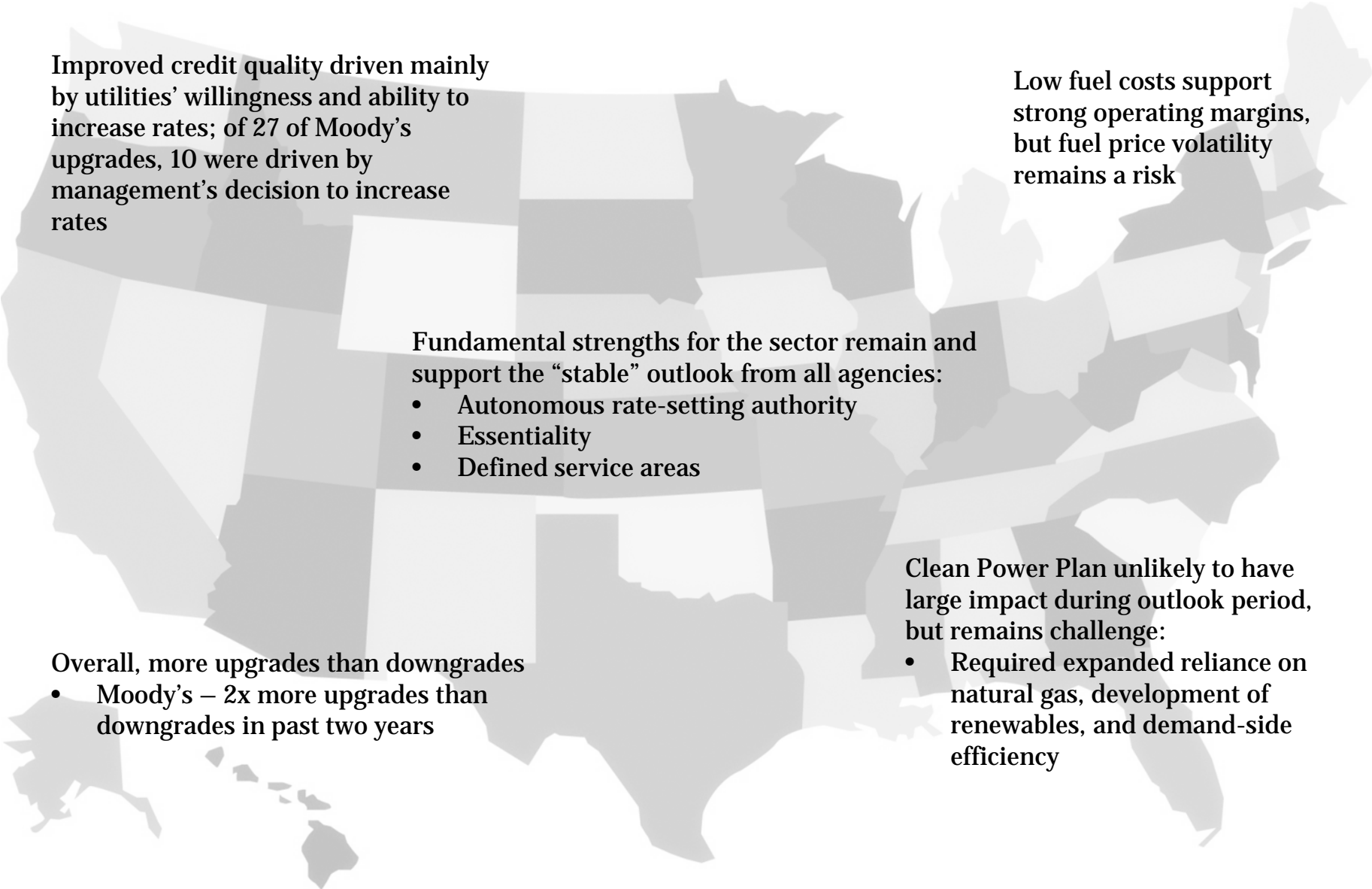
## **Growth?**

- Transmission
- Distribution
- New Generation

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# Recent Developments and Outlook

# Agency outlook takeaways and future drivers



Improved credit quality driven mainly by utilities' willingness and ability to increase rates; of 27 of Moody's upgrades, 10 were driven by management's decision to increase rates

Low fuel costs support strong operating margins, but fuel price volatility remains a risk

Fundamental strengths for the sector remain and support the "stable" outlook from all agencies:

- Autonomous rate-setting authority
- Essentiality
- Defined service areas

Overall, more upgrades than downgrades

- Moody's – 2x more upgrades than downgrades in past two years

Clean Power Plan unlikely to have large impact during outlook period, but remains challenge:

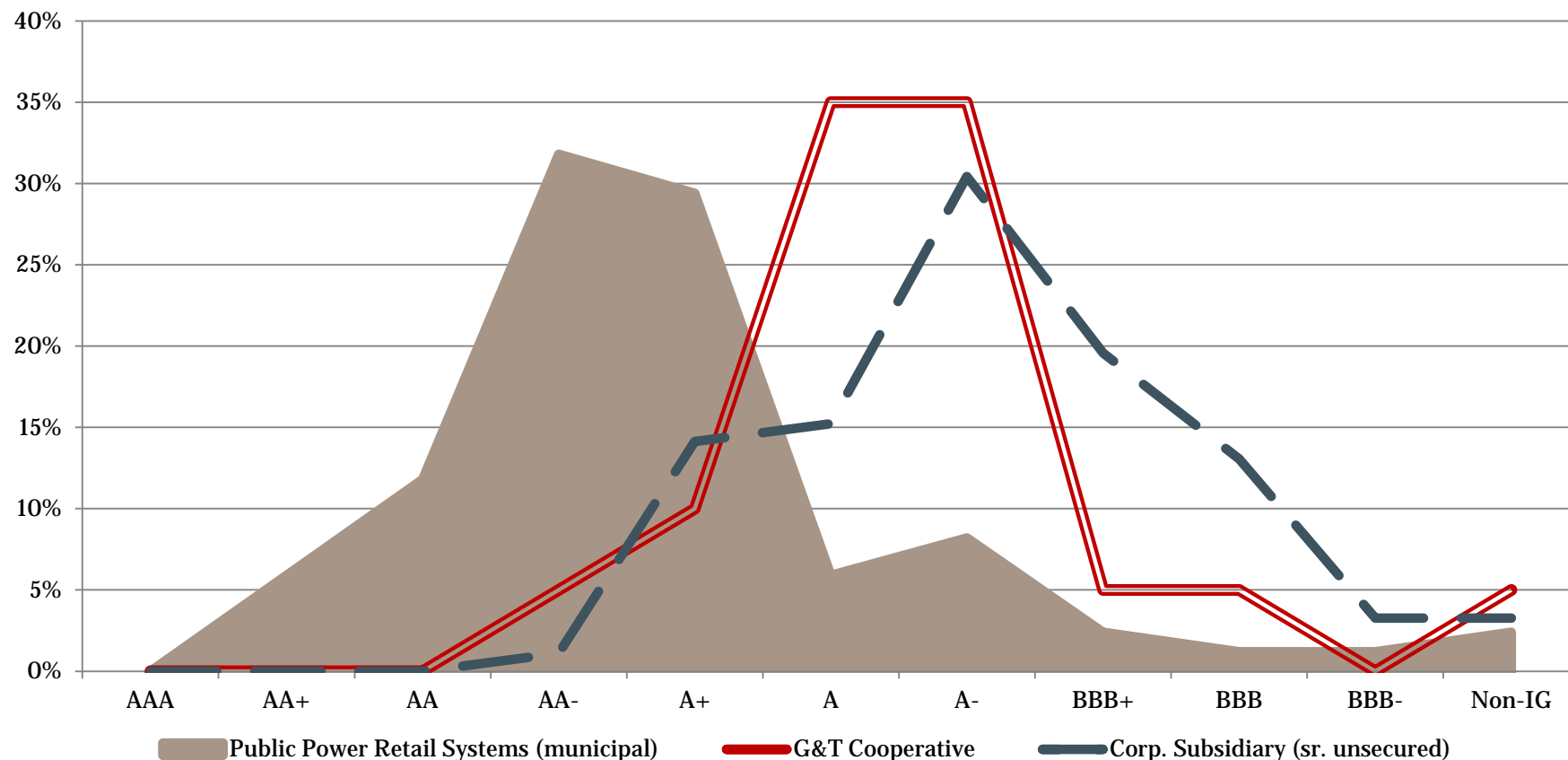
- Required expanded reliance on natural gas, development of renewables, and demand-side efficiency



# Fitch ratings distribution and outlook

Retail Outlook	
Negative	8.1%
Stable	88.4%
Positive	3.5%

Wholesale Outlook (excluding G&T)	
Negative	3.6%
Stable	92.9%
Positive	3.6%



Source: Fitch Ratings, U.S. Public Power Peer Study (June 2016); US Utilities Power & Gas First Quarter 2016 Rating Actions (April 2016)

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# **What is a Credit Rating?**

# A credit rating is NOT:

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- Buy, sell, or pricing recommendation
- Political statement in favor of or against a particular person, management, or administration
- Judgment or statement regarding any aspect of public policy
- A measure of what should be done or how a matter should be handled

# A credit rating IS:

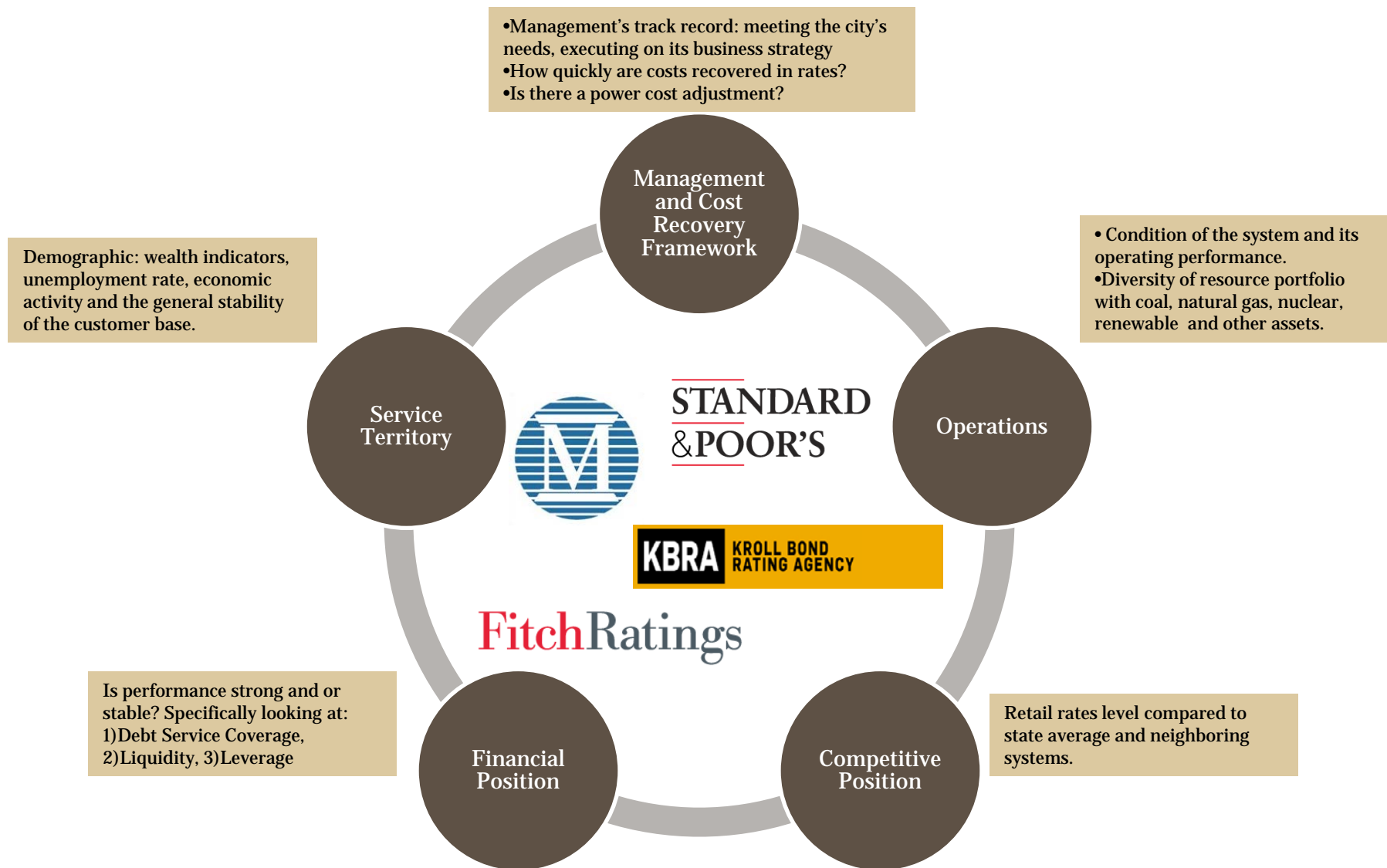
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- An independent, forward-looking assessment of credit quality
- Letter representation of the likelihood of full and timely repayment over the life of a specific financial obligation
- Includes a “+” and a “-” to modify, in addition to Rating Outlooks
- Based on an issuer’s ability and willingness to pay on time
- One input to a fuller understanding of risk

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# Rating Criteria

# Core credit factors



# GRU credit factors

<u>Concerns</u>	<u>Fitch</u> AA-	<u>Moody's</u> Aa2	<u>S&amp;P</u> AA-	<u>Strengths</u>
<ul style="list-style-type: none"><li>• High fixed costs associated with concentrated power resource</li><li>• Above average rates</li><li>• Customers' willingness to support utility</li><li>• High debt levels with 81% debt to capitalization</li><li>• Reliance on coal in current regulatory environment</li></ul>				<ul style="list-style-type: none"><li>• Willingness to provide rates sufficient to meet targeted financial metrics</li><li>• Strong debt service coverage at 2.14x and healthy liquidity at 169 DCOH</li><li>• Stable revenue base with no customer concentration and a strong economy (supported by U of Florida)</li><li>• Diverse operational profile of five utility systems</li><li>• Prudent capital improvement program with good equity funding targets</li></ul>



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# How Ratings are Used



# Why do ratings and rating agencies matter?

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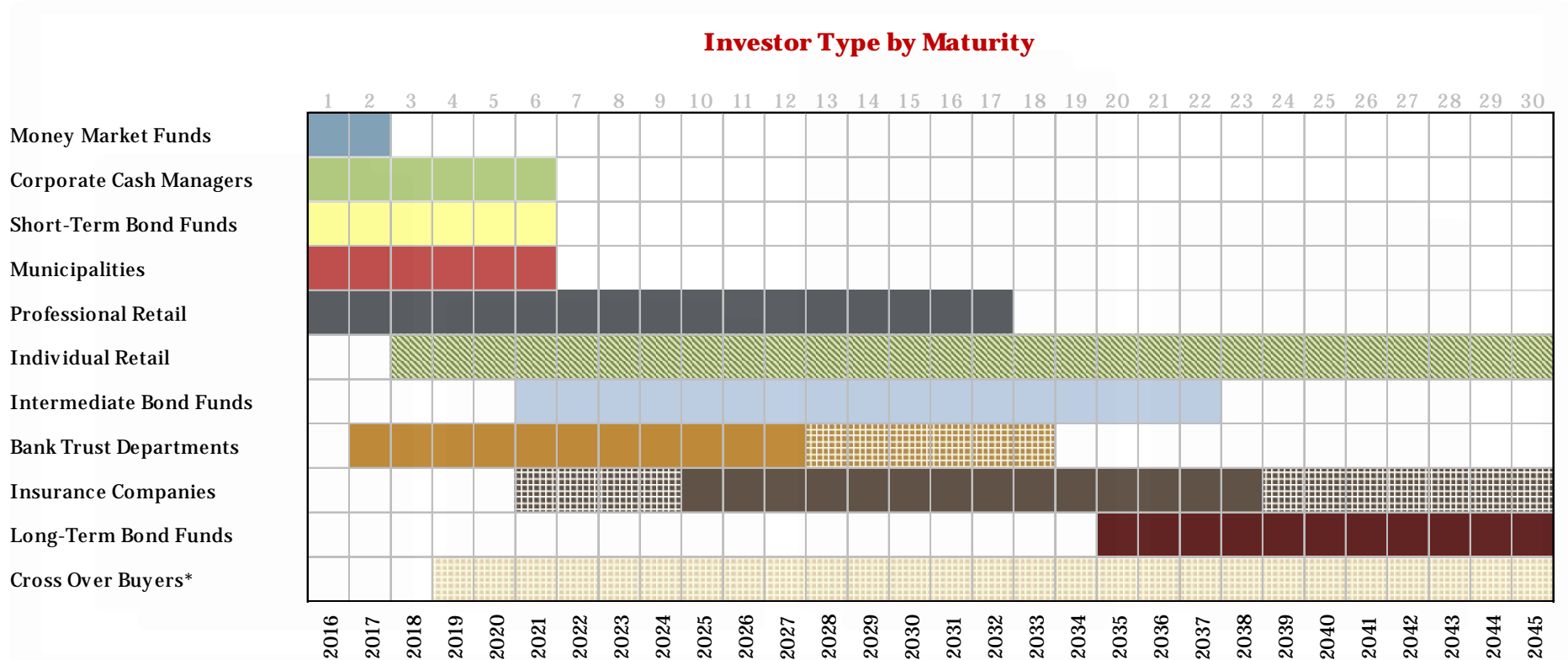
- A bridge between issuer, investor and other counterparties
- Continuing oversight and surveillance
- Published Research
- Increased investor knowledge
- Higher ratings typically equate to lower interest costs and greater market access

# Agency ratings - used differently by each investor

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- A utility rating is used for multiple credit purposes:
  - Debt
  - Derivatives
  - Operations
  - Liquidity
- Same rating for multiple tenors
- Viewed as a barometer for market access

# Investors, creditors, and counterparties all use ratings in different ways



Note: Limited interest in hashed areas, interest is highly dependent on current tax-exempt and taxable ratios

- **One rating for all bond tenors**
- **As the table above illustrates, many investors exist in the market, but their interest in bonds of particular maturities are different**
- **Other types of creditors not shown include banks, and fuel and power counterparties**

Source: Company data 2015

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# **Appendix**

# Rating agency key credit factors

Rating Agency Criteria					
	Fitch	Kroll (for a Rural G&T)	Moody's	Wt. (%)	S&P
<b>Management:</b> track record, ability to achieve strategic goals, resource planning, risk management, etc.	<i>Emphasis on:</i> - Measuring prior strategic/financial plans vs. actual outcomes - Extent of risk management	<i>Additional factors:</i> - Experience and philosophy of management - History in dealing with regulators	<i>Emphasis on:</i> - Cost recovery framework, which includes strength of monopoly control, rate rising ability, and strength of the service area economy	25%	<i>Additional factors:</i> - Extent to which plans are supported by local councils or boards of directors - Extent to which governing body's actions are supportive of credit quality
<b>Operations:</b> examining operational efficiency and reliability, power and fuel resource mix, environmental compliance, and capital needs	<i>Additional factors:</i> - Resource portfolio benchmarking to industry standards (fuel mix, plant capacity factors, load factor) - Integrated resource planning - Environmental considerations - Review of D&T assets	<i>Additional factors:</i> - History of fuel and purchased power hedging strategy and open market spot purchases	<i>Emphasis on:</i> - Generation and power procurement risk exposure, assessed through mix of power supply and cost of power	10%	<i>Emphasis on:</i> - Efficiency measures such as frequency and duration of unplanned outages, line losses, plant heat rates
<b>Competitive position:</b> analyzing a utility's cost structure, rate flexibility, and rate affordability	<i>Additional factors:</i> - Fitch's perception of high or volatile rates, lack of future rate flexibility, or difficulty in obtaining timely rate relief.	<i>Additional factors:</i> - Tenure and type of long-term contracts with members and suppliers - Importance of the growing essentiality and monopolist status of utilities	<i>Emphasis on:</i> - Utility's willingness to recover costs through rate-setting as well as its ability to obtain the necessary regulatory approvals. Moody's analyzes the rate-setting process. - Competitiveness of retail rates	25%  10%	<i>Emphasis on:</i> - System average rates and rates on a customer class
<b>Service territory:</b> demographics include wealth indicators, unemployment rate, population trends, customer diversity, and economic stability	<i>Additional factors:</i> - Breakdown of residential, commercial, and industrial customers a. by kWh sales b. by no. of customers	<i>Additional factors:</i> - Relationships with distribution members - Wealth measures for retail systems	<i>Additional factors:</i> - Local economic diversity - Customer concentration - Revenue stability and diversity		<i>Additional factors:</i> - Revenues, sales volumes, margins, and load factors per customer - Terms and time-frames of long-term contracts
<b>Financials:</b> primary metrics are debt service coverage, liquidity ratios, capital structure, debt profile, and future financing needs	<i>Additional factors:</i> - Legal provisions on security, revenue pledge, lien position, rate covenant, debt service reserve, flow of funds	<i>Emphasis on:</i> - Capex program, current planned capex, future capital needs and impact on performance	<i>Emphasis on:</i> - Adj. days liquidity on hand - Debt ratio - Adj. debt service or fixed obligation charge coverage - Debt structure and debt service	10% 10% 10%	<i>Additional factors:</i> - Fixed-charge coverage; unrestricted cash as a % of total expenditures - Legal provisions and regulatory risk also analyzed