Lafayette, Louisiana; Combined Utility; Wholesale Electric

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Credit Profile		
US$60.22 mil util rev bnds ser 2019 due 11/01/2044		
Long Term Rating	AA-/Stable	New
Lafayette communications sys (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Lafayette Pub Pwr Auth, Louisiana		
Lafayette, Louisiana		
Lafayette Pub Pwr Auth (Lafayette) elec rev rfdg bnds		
Long Term Rating	AA-/Stable	Affirmed
Lafayette Pub Pwr Auth (Lafayette) wholesale elec		
Long Term Rating	AA-/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AA-' rating to Lafayette, La.'s utilities revenue bonds series 2019. At the same time, S&P Global ratings affirmed its 'AA-' rating on the city's senior-lien utility system revenue bonds, its 'A+' rating on Lafayette's subordinate-lien communications system revenue bonds, and its 'AA-' rating on Lafayette Public Power Authority (LPPA), La.'s electric revenue refunding bonds, issued for the city. The outlook is stable.

The utility does business as Lafayette Utilities System (LUS).

Management anticipates using bond proceeds to fund system improvements and upgrades, and finance a debt service reserve fund. The combined utility had about $195.92 million in total debt outstanding at fiscal year-end 2018.

The ratings on Lafayette reflect a pledge of the LUS' combined water, sewer, and electric systems, which separately secures both the senior-lien and communications system revenue bonds. Communication system revenues also secure the related bonds, but the 'A+' rating reflects the LUS' subordinate-lien pledge to cover debt service obligations if net communication system revenues are insufficient. The subordinate lien results in a one-notch rating differential, which also reflects the application of our "Assigning Issue Credit Ratings Of Operating Entities" criteria (published May 20, 2015). The rating on LPPA reflects that of Lafayette's utility system senior-lien utility system revenue bonds. Revenues from a power sales contract with LUS secure the bonds. Payments from Lafayette come from LUS' combined electric, water, and sanitary sewer system; about 76% of all the system's operating revenues are from electric service. The rating further reflects the strength of the power sales contract and resulting cash flows to the LPPA from the LUS. The system's obligations to the authority are unconditional and take-or-pay; the LUS is the LPPA's only member. Obligations to the authority from the LUS are operating expenses of the system, payable ahead of its own direct debt service.

The ratings further reflect the application of our "U.S. Municipal Retail Electric And Gas Utilities" criteria (published

Sept. 27, 2018), supported by our opinion of the system's very strong enterprise and financial risk profiles.

The enterprise risk profile reflects our view of the system's:

- Very strong service area economic fundamentals, reflecting a large, primarily residential and diverse customer base with strong income levels;
- Extremely strong industry risk relative to that of other industries and sectors;
- Strong market position, based the utility's weighted average electric system rates that were 7% below the state's average in 2017; and
- Very strong operational and management assessment, as evidenced by the utility's participation in the Midcontinent Independent System Operator (MISO), which provides enhanced reliability and power supply diversity to the system. This is offset somewhat, in our view, by the LUS' owned coal-heavy generation, which could expose it to environmental regulation costs. We view the system's rate-setting practices and financial management policies positively, with a regularly updated financial and capital plan, as well as management's monthly review of system rates.

The financial risk profile reflects our view of the system's:

- Very strong fixed charge coverage (FCC) metrics, after annual transfers to the city and adding telecommunications bond debt service. FCC averaged 1.43x over the past three years. Our calculations based on management's financial forecast indicate the maintenance of similar levels;
- Very strong liquidity and reserves, with $113 million in total available liquidity or about 220 days' cash for unaudited fiscal 2018 after including amounts in its capital additions fund, that provides financial flexibility; and
- Strong debt and liabilities profile, reflecting our view of the utility's 30% debt-to-capitalization ratio.

Outlook

The stable outlook reflects our expectation that the LUS will pass through escalating debt service cost, ensuring the system sustains FCC and liquidity metrics in line with historical levels.

Upside scenario

We do not expect to raise the ratings in the next two years due to management's sizable capital improvement program and financial projections, which indicate a largely flat financial profile, coupled with the enhanced operating risk associated with running a telecommunications enterprise. However, if the utility can achieve and sustain both liquidity and coverage metrics at materially stronger levels, we could raise the rating.

Downside scenario

If management fails to pass through rising debt service requirements while adding new debt, resulting in significantly weakened FCC or suppressed liquidity, we would likely lower the rating.

Utility Description And Credit Overview

The electric system has the most customers, at about 67,243 and typically provides about 75% of total operating revenues. The LUS primarily serves Lafayette, and a small number of customers outside city limits. Growth in metered accounts is steady because the Lafayette metropolitan area remains one of the highest performing in the state.

Enterprise Risk

Economic fundamentals: Very strong

We consider the combined utility's primarily residential customer base to be diverse, providing a predictable revenue stream that is credit supportive. Lafayette's combined utility served 67,243 electric, 56,564 water, and 45,019 sewer customers in 2018. In our opinion, the electric customer base is very diverse, with the 10 leading customers accounting for about 10% of total system revenue in fiscal 2018. Residential customers accounted for 40% of retail electric revenue in fiscal 2018, which we believe further contributes to revenue stability. We consider city income levels strong, with median household effective buying incomes at 99% of the national level.

Industry risk: Extremely strong

Consistent with our "Methodology: Industry Risk" criteria (published Nov. 19, 2013), we consider industry risk for municipal retail electric and gas utilities covered under these criteria as very low, and therefore extremely strong when compared with other industries and sectors.

Market position: Strong

Based on data from the U.S. Department of Energy's Energy Information Administration for 2017, the LUS' weighted-average system-rate competitiveness (based on relative customer classes' revenue contributions) was 93.5% of the state average. Management reviews its rates monthly, and most recently raised base rates 2.8% November of 2017. The utility also maintains a discretionary fuel cost adjustment mechanism that allows it to directly pass through fuel, purchased power, environmental, and various other costs to customers. Management does not anticipate raising base rates in the next five years given its continued use of its fuel cost adjustment mechanism.

Operational management assessment: Very strong

Lafayette's electric system, through the LPPA, is entitled to a 50% share of a 530 megawatt (MW) coal-fired power plant (Rodemacher Unit No. 2), which Cleco Power LLC operates. Cleco (30%) and the Louisiana Energy & Power Authority (20%) own the remaining 50%. Each of the partners' ownership is several, and there is no obligation to pay obligations for another partner. An agreement for joint ownership, construction, and operation governs the partners' obligations. The joint ownership agreement is in effect through June 30, 2032. Lafayette's participation in the Rodemacher plant exposes it to potential costs through environmental regulation. LUS purchases all of its power supply requirements from MISO, with a portion of its expenses being offset by MISO's economic dispatch of the system's owned generation units. We believe Lafayette's participation in MISO provides significant power supply diversity to the utility, offsetting some of the risk associated with its participation in a large coal plant.

The LPPA was created in 1976 to acquire power projects and purchase electric power for Lafayette's utility system.

The authority is a separate legal entity from the city, but is nevertheless governed and controlled by the city. It sells its share of the Rodemacher 2 power to the LUS under a power sales contract that runs through 2047. A separate transmission service agreement covers transmission to Lafayette from the plant. The plant burns Powder River Basin coal, with both supply and rail contracts in place for the near term. The three plant partners supply and manage their respective coal deliveries individually, not jointly, and the LPPA targets a 60-day reserve supply. Unit 2 has an estimated useful life of at least another 20 years. However, a conversion to gas-fired units is under consideration given low gas prices. Furthermore, a change in environmental regulations would spur consideration of additional large-scale reinvestments beyond the maintenance of efforts projects.

We believe water and sewer operations are also favorably situated. The LUS has already addressed, fully funded, and now closed previous regulatory mandates on its sanitary sewer system that many urban utilities are only now just beginning to deal with. Lafayette's raw-water supply comes from 18 wells, which tap into the Chicot aquifer and have not had any issues with long-term quality or quantity. Both the water and wastewater operations comply with all permit requirements.

Somewhat offsetting the combined utility's strengths noted above, in our view, is LUS's communications endeavor. The LUS created a communications system in 2009, providing cable TV, internet, and phone services over a fiber optic network to residential and business customers. The fiber optic venture leverages an existing backbone used for operational and wholesale purposes. It is outside the bounds of the system's traditional monopoly practice, in that it competes for customers. According to bond covenants, under some conditions, the utilities system would have to meet communications system obligations with funds in its capital additions fund. Furthermore, bond covenants require that the LUS carry a minimum in the capital additions fund equal to at least 7.5% of adjusted revenue. The current minimum requirement in the fund exceeds maximum annual debt service for the communications system bonds. While the system has been cash flow-positive since 2012, there is some financial risk to the combined utility system given the enterprise's competitive nature.

We view the utility's financial management policies and practices as very strong. Management regularly engages NewGen Strategies & Solutions LLC to provide engineer's reports, which provide a significant amount of information regarding Lafayette's combined utility, its telecommunications enterprise, and LPPA. Accompanying these reports are management's annually updated multiyear financial and capital forecasts. We also believe the LUS' rate-setting practices are very strong. Management reviews its rates monthly, and maintains a credit-supportive fuel cost adjustment mechanism that allow it to directly pass through its variable costs to customers.

Financial Risk

Coverage metrics: Very strong

The system's obligation to pay the debt service on LPPA debt is part of its fuel cost adjustment mechanism. Accordingly we have imputed these costs as debt-like in our FCC calculation. Furthermore, we have included the telecommunication debt service as direct-debt of the combined utility in our analysis given the subordinate pledge of utility revenues to the telecommunications debt. Although telecommunications revenues have been pledged to the subordinate-lien debt, they are not pledged to the senior-lien debt. Accordingly, we have not included telecommunications revenues in our all-in FCC calculations, which has averaged 1.43x over the past three years. Management's projections indicate FCC ranging from 1.45x to 1.67x through 2023. We believe the assumptions underpinning the forecast are reasonable.

Liquidity and reserves: Very strong

Including the substantial $103 million available in the capital additions fund, total available liquidity was very strong, equivalent to $113 million or 220 days' cash on hand in fiscal year 2018. We expect projected total available liquidity to continue at very strong levels, equal to at least 223 days' cash through the financial forecast.

Debt and liabilities: Strong

We believe the LUS' debt and liabilities capacity is strong for a combined utility, evidenced by the system's 30% debt-to-capitalization ratio for fiscal 2017. The combined utility had $195.92 million in total debt at fiscal year-end 2018. Management intends to fund a portion of its $143 million five-year capital improvement program with the 2019 bonds, funding the balance on a pay-as-you-go basis.

Ratings Detail (As Of April 8, 2019)		
Lafayette comb util		
Long Term Rating	AA-/Stable	Affirmed
Lafayette comb util		
Long Term Rating	A+/Stable	Affirmed
Lafayette comb util		
Long Term Rating	A+/Stable	Affirmed
Lafayette util (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Lafayette Comb Util		
Long Term Rating	AA-/Stable	Affirmed

Many issues are enhanced by bond insurance.