Moody's Investors Service

Rating Action: Moody's assign Aa3 to Lakeland Electric (FL) Energy System Revenue Bonds, Series 2018; outlook stable

30 Aug 2018

New York, August 30, 2018 -- Moody's Investors Service assigned its Aa3 rating to the proposed issuance by the City of Lakeland, Florida of approximately $50 million of Energy System Revenue Bonds, Series 2018, which are obligations of Lakeland (City of) FL Electric Enterprise (Lakeland Electric or the system). The proposed offering will rank on par with Lakeland Electric's outstanding revenue and refunding bonds, also rated Aa3. The system's rating outlook is stable.

RATINGS RATIONALE

Lakeland Electric's Aa3 credit profile reflects its good prospects for sustaining sound financial performance consistent with the ample liquidity (207 days cash), debt service coverage (1.95x) and debt ratio (46.3%) achieved on average during 2015-2017 despite some negative effects from Hurricane Irma in 2017. The system effectively manages its diversified power supply portfolio to meet electricity demands from a diverse customer base which has shown modest growth during 2013-2017. Management and the City Commission willingly exercise base rate autonomy and routinely adjust for variable costs, including fuel, to achieve financial goals while maintaining a good competitive electric power cost structure versus peers in Florida. Lakeland Electric faces challenges to avoid further unplanned outages at its McIntosh natural gas-fired plant, which surfaced during 2017, and to integrate into its supply portfolio an existing combustion turbine being purchased from Calpine Corporation (Calpine) with proceeds from its impending revenue bond issuance, while sustaining credit metrics to support its existing credit profile.

RATING OUTLOOK

The stable outlook reflects Moody's view that the system can sustain its record of sound financial metrics through timely rate adjustments when necessary as it meets the electricity needs of its customers in a gradually improving economy throughout the service territory.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Effectively executing plans to maintain generation asset plant reliability and funding capital spending plans without compromising competitive position and sound metrics
- Economic activity improving at a faster than anticipated pace, leading to material increase in electricity sales
- In terms of specific credit metrics, maintaining an adjusted debt service coverage ratio of at least 2.0x combined with adjusted days liquidity of 200 days or better, respectively, for a sustained period of time
- Amending the bond resolution to establish a stronger debt service reserve requirement

FACTORS THAT COULD LEAD TO A DOWNGRADE

- A weakening of economic activity on a sustained basis
- Political interference unexpectedly surfacing during the rate setting process
- Any unexpected sustained increase in the debt ratio and sustained decline in adjusted debt service coverage or adjusted days liquidity on hand below FY 2017 levels

LEGAL SECURITY

Lakeland Electric's revenue bonds are secured by a senior lien pledge on the energy system's net revenues. Since 2012, the system's required rate covenant is guided by a 1.25x debt service coverage requirement and the additional bonds test is also 1.25x. This indenture change replaced a previously weaker rate covenant based on current annual revenues plus 20% of unrestricted system fund balance which were the requirements to achieve 100% coverage of debt service. Failure to meet the rate covenant is not an event of default but
requires a qualified independent consultant to develop a plan to comply. Notwithstanding the more standard rate covenants, the indenture has a springing debt service reserve requirement, which Moody's views as a credit negative, albeit partially offset by good internal liquidity and access to the City of Lakeland's investment pool. Under the bond ordinance, the system has no debt service reserve requirement so long as the debt service coverage (as calculated under the bond ordinance) exceeds 1.50x. The springing reserve is required to be funded in 10% increments (up to 50% of maximum annual debt service) for every 10 basis points drop below 1.50x debt service coverage.

USE OF PROCEEDS

The majority of the proceeds (approximately $36 million) of the proposed issuance will be used to acquire, install, and inspect the 125 megawatt dual-fuel (natural gas and oil) unit being acquired from Calpine. The remaining proceeds will be used to fund general capital improvements and pay the costs of issuance.

PROFILE

Lakeland Electric is one of twelve operating departments of the City of Lakeland. The system employs about 510 full time staff who collectively provide electric generation, transmission and distribution services to more than 128,000 customers, while also administratively handling load and financial forecasting and management, financial reporting and accounting and customer rate design.

METHODOLOGY


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