City Electric System of Bryan, Texas

Revenue Bonds

New Issue Report

Ratings

New Issues

$43,830,000 Electric System Revenue Bonds, New Series 2018	AA–

Outstanding Debt

$185,475,000 Electric Revenue Bonds, New Series 2010, 2012, 2016 and 2017.	AA–

Rating Outlook

Stable

Key Utility Statistics

(As of Fiscal Year Ended 9/30/17)

System Type	Retail Electric
NERC Region	ERCOT
Number of Customers	36,819
Annual Revenue ($ Mil.)	190.1
Debt Service Coverage (x)	2.03
Days Operating Cash	157
Equity/Capitalization (%)	42.5

NERC – North American Electric Reliability Corporation. ERCOT – Electric Reliability Council of Texas.

Related Criteria

Rating Criteria for Public Sector, Revenue-Supported Debt (February 2018)

U.S. Public Power Rating Criteria (May 2015)

Related Research

Fitch Rates Bryan Texas Utilities, TX's City Electric System Revs 'AA–'; Outlook Revised to Stable (November 2018)

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New Issue Details

Sale Information: $43,830,000 Electric System Revenue Bonds, New Series 2018 via negotiated sale the week of Nov. 26, 2018.

Security: The bonds are secured by the net revenue of the city electric system.

Purpose: Proceeds will finance transmission projects, fund the debt service reserve and pay the costs of issuance.

Final Maturity: July 1, 2043.

Key Rating Drivers

City Electric System: The City of Bryan, TX's electric system is a vertically integrated electric utility serving a growing customer base within the City of Bryan's boundaries. The city system also provides all-requirements electric service to Bryan's rural electric system. Each system, while operated by a common staff, is maintained separately for accounting and reporting purposes.

Expected Improvement In Financial Metrics: Fitch Ratings' upgrade reflects the system's expected improvement in financial metrics and leverage. Obligations related to the Texas Municipal Power Agency (TMPA) are expected to be significantly reduced and direct debt related to TMPA's Gibbons Creek Station is expected to reach final maturity. Projected coverage of full obligations, days liquidity on hand, and net adjusted debt/adjusted funds available for debt service (FADS) are expected to become consistent with a 'AA–' rating beginning in fiscal 2020.

Flexible Rate Structure: The city system's competitive rates include two adjustable mechanisms to facilitate timely recovery of costs. The flexible rate structure is expected to offset projected costs and maintain relatively stable financial performance over the medium term.

Sufficient Power Supply: The system obtains its power supply through a combination of owned gas-fired resources and purchased power contracts. The city also owns a 21.7% share of the Gibbons Creek coal plant through the city's participation in TMPA. Bryan did not elect to extend the associated power supply contract and does not rely on the resource to meet its power needs.

Wholesale Revenue: Wholesale sales, not including sales to the rural electric system, accounted for approximately 32% of MWh sales and 18% of operating revenue in fiscal 2017. While wholesale sales are largely contracted, which Fitch views as less of a risk than reliance on solely ancillary sales, the system is still exposed to counterparty risk and potentially volatile market conditions for the portion of wholesale sales not contracted.

Rating Sensitivities

Weaker Than Expected Financial Performance: The inability to achieve the expected improvement in financial performance in fiscal 2020 and beyond, due to higher than expected operating costs, could result in a negative rating action.

Issuer Rating History

Rating	Action	Outlook/ Watch	Date
AA–	Upgrade	Stable	11/6/18
A+	Affirmed	Positive	6/6/18
A+	Affirmed	Stable	5/31/17
A+	Affirmed	Stable	7/1/16
A+	Affirmed	Stable	5/22/15
A+	Affirmed	Stable	6/4/13
A+	Affirmed	Stable	3/16/12
A+	Affirmed	Stable	1/25/12
A+	Affirmed	Stable	2/19/10
A+	Affirmed	Stable	10/22/09
A+	Affirmed	Stable	8/28/08
A+	Affirmed	Stable	8/22/07
A+	Upgrade	Stable	8/18/06
A	Affirmed	Positive	3/14/05

Credit Profile

The City of Bryan is located approximately 90 miles west of Houston, TX in Brazos County, TX and is considered a twin city of College Station, TX. Bryan owns and operates two electric systems: the City Electric System and the Rural Electric System. The combined systems are referred to as Bryan Texas Utilities (BTU). Each system, while operated by a common staff, is maintained separately for accounting and reporting purposes.

The city system has operated since 1909 and provides electric service within the city's boundaries. The rural system's service territory includes the area outside of the City of Bryan, adjacent to and including portions of the City of College Station, TX and parts of Burleson County, TX and Robertson County, TX in an approximately 20-mile radius from Bryan. BTU's rural system is an all-requirements customer of the city system.

The City of Bryan reserves the right, but has no current plans, to merge the city and rural electric systems. The net revenue from the rural electric system is not pledged as a repayment source for the bonds.

Governance and Management Strategy

BTU is managed by the Bryan Texas Utilities Board (the board), which was established by the city council in 2001. The board is charged with managing the city and rural electric systems and making recommendations to the city council regarding budgets, rates and rate changes, among other responsibilities. The board consists of seven members, each appointed to a staggered three-year term. Board members are drawn from diverse backgrounds and include customer representatives from the residential and commercial segment. The city council retains final authority in setting rates, issuing bonds and approving annual budgets.

Mr. Gary Miller became the permanent BTU general manager in February 2013 after serving as the interim manager since 2012. Mr. Miller has worked for BTU since 2005 and worked in the Electric Reliability Council of Texas (ERCOT) market for more than 20 years. Mr. Joe Hegwood, the CFO for both BTU and the City of Bryan, started at BTU in 2006 and has extensive experience in the industry, both within and outside BTU.

The utility's financial policies include a targeted debt service coverage level of 2.0x, a minimum of 1.1x, and an unrestricted cash balance of 110 days, with a minimum of 90 days. Fitch's expectation is the utility will outperform financial targets and this supports the rating.

Assets and Operations

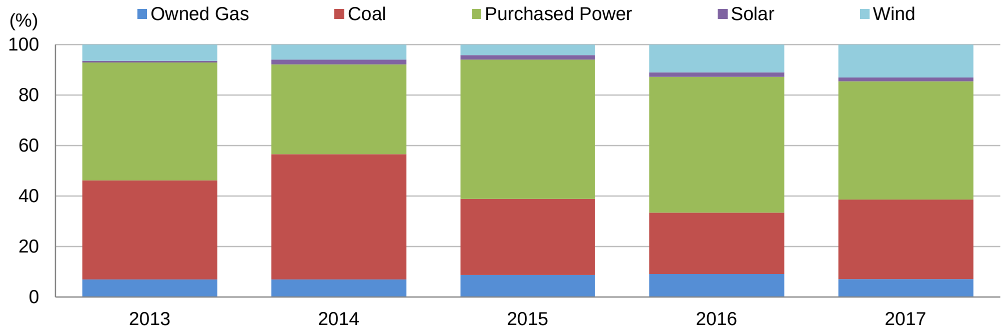
The city system's current power supply mix consists of owned gas-fired resources and purchased power contracts. While Bryan retains its ownership share in the Gibbons Creek Electric Station through TMPA, the city opted not to extend its purchase power contract at the end of fiscal 2018 and no longer expects to receive power from the facility. The transition away from its historical reliance on the aging, coal-fired power plant is expected to better position the utility financially, while also reducing exposure to potential future environmental regulations.

Texas Municipal Power Agency: Gibbons Creek

Bryan, along with the Cities of Denton, TX; Garland, TX; and Greenville, TX; created TMPA, a joint power agency, in 1975. Through TMPA, the cities developed Gibbons Creek, located in Grimes County, TX. The single-unit, coal-fired plant has a net capacity of 470MW and burns Powder River Basin coal. The city system has a 21.7%, or 102MW interest, in Gibbons Creek.

The city's reliance on Gibbons Creek to meet annual energy needs declined, as low natural gas prices and increased renewable generation in the ERCOT market made running the plant increasingly uneconomical. As shown in the chart below, Gibbons Creek provided approximately 32% of the system's energy, including Bryan's rural system, in fiscal 2017, compared with nearly 50% in fiscal 2014.

BTU Retail Power Supply for Fiscal 2013 to Fiscal 2017



BTU – Bryan Texas Utilities Board.
Source: City Electric System of Bryan, Texas

TMPA owns the coal plant and provided power to its four members under identical court-validated, take-or-pay power sales contracts (PSCs), which expired in September 2018. The PSCs financially obligated the members to pay certain expenses to TMPA, including debt service costs, regardless of actual plant operations. These costs are paid as operating expenses, and therefore, have priority over debt service payments. Bryan opted not to renew the PSC following its expiration in September 2018.

The four members approved a joint operating agreement (JOA), which became effective in September 2016. The JOA establishes the framework for how TMPA and its assets and liabilities are to be managed following the expiration of the PSCs. TMPA's assets and operations are divided into three business lines under the JOA: generation, transmission and mining.

The JOA allocates costs, ownership interests, decommissioning and remediation responsibilities to members based on participation share. Garland is the largest TMPA participant at 47.0%, followed by Bryan at 21.7%, Denton at 21.3% and Greenville at 10.0%.

TMPA is currently exploring the possibility of selling Gibbons Creek. If a sale were to occur, it would likely be viewed as credit neutral to positive for Bryan, as a sale would likely reduce the city's decommissioning liability. BTU replaced the portion of its power supply previously provided by Gibbons Creek at a lower cost through purchase power contracts.

Roland C. Dansby Power Plant

BTU's primary natural gas-fired resource is the Roland C. Dansby Power Plant. The Dansby power plant is a three-unit power plant consisting of a 110MW gas-fired steam turbine and two 48MW simple-cycle gas turbines with a total capacity of 206MW. The power plant acts as a physical hedge for BTU's power supply and is used as a peaking to intermediate resource.

Management reports Dansby's operations were not affected by the August 2015 discovery of a crack in the Lake Bryan Dam from which Dansby draws cooling water. The crack was stabilized in fiscal 2017 and management reports no additional degradation was found.

Natural gas for the Dansby facility is procured by BTU in the spot and forward markets. BTU follows a gas-hedging strategy, whereby approximately 50% of the anticipated gas needs for the future year are hedged as of January 1. The relatively limited hedging of BTU's gas supply exposes the utility to additional commodities pricing risk. However, the exposure is somewhat offset by BTU's sound liquidity levels and the relatively limited role of BTU's natural gas resources in meeting power supply needs.

Purchase Power Agreements

BTU entered into several purchase power agreements (PPAs) and forward market power purchases to meet the system's power needs. The forward market power purchases are with four separate counterparties for 2018 to 2022 and largely replace the output previously received from Gibbons Creek. The 2018 purchases were shaped to match the time periods when Gibbons Creek was not actively being run. The city also executed forward market purchases for projected power needs from 2023 to 2027.

BTU will also receive power from PPAs including a 15-year agreement signed in January 2011 for 30MW of wind energy from the Penascal 2 wind project and a 25-year agreement for 10MW of solar. BTU also receives 33% of the output from the 110MW Los Vientos V under a 25-year PPA that began in December 2015. BTU most recently signed a 15-year solar PPA beginning in 2022.

Cost Structure

The city system's rate structure consists of a base rate and two adjustable charges: a fuel-adjustment charge and a regulatory charge. Both of the adjustable charges can be modified at any time at the discretion of the board without council approval. The regulatory charge is intended to capture transmission costs plus any regulatory fines or fees imposed by agencies other than the city.

BTU recently completed a cost-of-service study in 2018 showing no need for rate increases over the next several years. The main finding from the study was a 38% wholesale rate reduction for the rural system implemented on Oct. 1, 2018. The significant rate reduction reflects the utility's much lower cost of power following the cost reduction from TMPA. City system rates are competitive for the state and with nearby electricity providers, particularly the City of College Station, TX.

Financial Performance

Bryan's financial performance is expected to strengthen considerably beginning in fiscal 2020 as it moves past the recent period of increased TMPA obligations, which ran through fiscal 2018, and makes a large scheduled debt payment in fiscal 2019. The significant decline in operating expenses is projected to boost margins, coverage metrics and build reserves to levels consistent with the rating.

Bryan outperformed its budget in fiscal 2018 based on unaudited actuals. NOI outpaced budgetary expectations by approximately $3.8 million due to higher than expected operating revenue derived from increased retail and wholesale sales.

Improved Operating Margin Expected

Fitch expects Bryan's operating margin to improve materially beginning in fiscal 2019 as financial obligations to TMPA are greatly reduced. Capacity payments to TMPA were approximately $26.3 million in fiscal 2017 and $17.1 million, unaudited, in fiscal 2018. These payments are expected to decline to approximately $300,000, beginning in fiscal 2019, reflecting the final payment on TMPA issued generation related debt on Sept. 1, 2018.

Bryan's coverage metrics are expected to be compressed in fiscal 2019, despite the improvement in operating margin, due to a large scheduled debt payment. Total debt service in fiscal 2019 is expected to increase to approximately $42.1 million from $17.3 million in fiscal 2018.

Post fiscal 2019, total debt service is expected to decline to historical levels of approximately $22 million to $24 million annually. The increased debt service in fiscal 2019 reflects the final payment on the debt issued by Bryan related to Gibbons Creek. Fitch views the increased debt service as manageable for the utility. This is due to the significant improvement in operating margin. The rating incorporates the expectation Bryan's coverage metrics will weaken in fiscal 2019 before improving significantly in fiscal 2020.

Liquidity Levels

The city's cash balance and liquidity position is adequate for the rating and expected to improve due to the stronger financial performance beginning in fiscal 2020. As of fiscal year-end 2017, the system's unrestricted cash balance increased to approximately $61.8 million, or 157 days cash on hand, compared to approximately $45.5 million, or 117 days, at fiscal year-end 2014.

Cash balances, including the rate stabilization fund, increased to approximately $74.6 million, unaudited, or 170 days cash on hand, in fiscal 2018. Reserves are expected to decline modestly in fiscal 2019. Thereafter, the system's projected improvement in financial performance is expected to increase cash reserves at a significant rate with management projecting a total of approximately $83.2 million in fiscal 2022.

General Fund Transfers

The city system makes a monthly transfer to the city's general fund in lieu of paying taxes. The annual transfer amount is modestly higher than similarly rated retail systems at 6.3% of fiscal 2017 operating revenue, compared with the peer group median of 5.7%. Positively, transfer amounts are capped by the city charter at a maximum 7% of gross system revenue.

Wholesale Sales

The city system is a member of ERCOT and is a qualified scheduling entity allowing for the scheduling of power and energy for BTU and the system's wholesale customers. The city system currently serves the rural electric system, two other municipal electric systems and Texas A&M University. The system also provides ancillary services to ERCOT and ERCOT participants.

Wholesale sales, not including sales to the rural system, generated $34.6 million in fiscal 2017, or 18.2% of the total operating revenue. Positively, most of the wholesale revenue was earned under contracted arrangements, which Fitch generally views as presenting a manageable level of risk for the utility. The contract presenting the highest level of financial risk expired at calendar year-end 2017, and management does not anticipate entering into similar contractual arrangements in the future.

Capital Plan

The city system's capital plan from fiscal 2018 through fiscal 2023 is a sizeable $264 million. Approximately 57% of the total amount is expected to be bond funded, with tentatively planned debt issuances of $40.0 million, $35.5 million and $31.4 million in fiscals 2020, 2021 and 2023, respectively.

A significant portion of the capital plan is driven by the system's ongoing investments in transmission, including the expected issuance of $40 million in fiscal 2020 to purchase the city's share of TMPA's transmission assets. Approximately 59% of Bryan's total capital improvement plan is dedicated to transmission projects. The transmission investments should benefit the system by improving system reliability, while also allowing the system to recover the costs along with a specified return from ERCOT participants.

Debt and Leverage Profile

The city system has a fairly conservative debt portfolio consisting entirely of fixed-rate debt. The portfolio had approximately $185.5 million parity revenue bonds, $31.0 million certificates of obligation (COs) and $5.5 million general obligation (GOs) bonds outstanding as of Sept. 30, 2018. The CO and GO bonds are issued by the City of Bryan but repaid by the system.

Bryan's GOs and COs carry a pledge of ad valorem tax revenue; however, in practice, debt related to the electric system is serviced by electric revenue. While Fitch views these obligations as effectively subordinate to third-lien debt, these obligations are included in our financial and debt metrics. We use the obligations to ascertain Bryan's ability to service the entirety of its financial obligations from the electric system's net revenue.

Following a decade of litigation, a Global Compromise Settlement Agreement (GCSA) was signed in 2009 between TMPA and member cities, including the City of Bryan, under which member cities refunded TMPA debt associated with Gibbons Creek at the member level. The GCSA also required any further issuance of debt related to Gibbons Creek to be at the member level. Bryan issued $64 million in 2010 to refund TMPA debt as part of the GCSA. These bonds amortized rapidly and are expected to be fully paid by 2019.

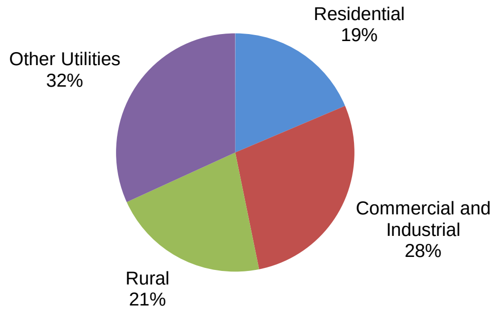
Leverage metrics are somewhat above average for the rating, with fiscal 2017 debt/FADS and net adjusted debt/FADS of 5.3x and 6.3x, respectively. However, the system's adjusted leverage is expected to moderate beginning in fiscal 2019 with the cessation of capacity payments to TMPA. The increased FADS is expected to result in net leverage metrics of around 5.0x over the next several years, which is consistent with the rating.

Customer Profile and Service Area

Wholesale and Retail Sales

The system served a largely residential customer base of approximately 36,800 in fiscal 2017. However, MWh sales extend well beyond its retail customer base to include wholesale sales to the city's rural electric system and other municipal entities. As shown in the *2017 MWh Sales* chart below, wholesale sales to other municipal entities accounted for the greatest single component of MWh sales in fiscal 2017, followed by commercial and industrial retail customers.

2017 MWh Sales



Source: City Electric System of Bryan, Texas

Wholesale contracts with other utilities and Texas A&M University expire between 2019 and 2038. The risks from serving the wholesale contracts are reduced by either fully hedged power supply arrangements or contractual provisions shifting the financial risk to the wholesale customer. Management stated additional wholesale customers would be added if economical and contractual arrangements met the utility's risk-management practices.

The system serves a non-concentrated retail customer base. The top-10 customers accounted for 18.1% of MWh sales to the city and rural electric systems in fiscal 2017. The top-10 customer list is dominated by local and county government, school districts, a public university and a couple of private enterprises, thereby lending stability and diversity to the customer base.

A large steel and pipe manufacturer continues to develop and expand operations within the city system's service territory. Initial MWh sales projections proved to be overly optimistic, as low oil and gas prices reduced exploration activities. At full capacity, the manufacturer is expected to account for approximately 3% of total MWh sales.

City Electric System of Bryan, Texas

($000, Audited Years Ended Sept. 30)	2013	2014	2015	2016	2017
DSC (x)					
DSC	1.57	2.17	1.99	1.95	2.03
Adjusted DSC (Including Transfer/PILOT/Dividend as O&M Expense)	1.10	1.63	1.48	1.41	1.52
Coverage of Full Obligations (PP as DS and Transfer/PILOT/Dividend as O&M Expense)	1.04	1.23	1.19	1.17	1.22
Liquidity Metrics					
Days Cash and Investments on Hand	101	117	125	135	157
Days Liquidity on Hand	101	117	125	135	157
Leverage Metrics (x)					
Debt/FADS	6.4	5.2	4.7	6.3	5.3
Adjusted Debt (Including PP Adjustment)/Adjusted FADS (Including PP Adjustment)	7.2	6.5	6.1	7.0	6.4
Net Debt/Net Capital Assets (%)	53.5	51.1	49.2	46.8	45.6
Equity/Capitalization (%)	46.6	44.9	46.2	40.5	42.5
Other Financial and Operating Metrics					
Operating Margin (%)	7.2	12.1	12.6	11.6	12.6
Wholesale Electric Revenue/MWh ($/MWh)	57.0	59.2	61.1	49.9	53.1
Retail Electric Revenue/kWh (Cents/kWh)	9.6	10.1	10.4	10.9	10.8
Transfer and PILOT and Tax/Total Operating Revenue	5.8	5.8	6.1	6.4	6.3
Capex/Depreciation and Amortization (%)	194.9	135.4	85.9	135.0	182.6
Debt Service/Cash Operating Expense (%)	13.4	12.2	13.6	13.2	14.0
Income Statement					
Total Operating Revenue	159,646	183,923	186,224	187,625	190,064
Total Operating Expense	148,139	161,614	162,698	165,939	166,211
Operating Income	11,507	22,309	23,525	21,686	23,853
Adjustment to Operating Income	19,685	20,415	21,075	21,454	23,511
Funds Available for DS	31,192	42,724	44,601	43,140	47,364
Total Annual DS	19,912	19,653	22,365	22,094	23,298
Balance Sheet					
Unrestricted Funds (Cash and Liquid Investments)	35,509	45,510	48,853	53,593	61,817
Restricted Funds	43,670	47,672	34,955	87,810	51,928
Total Net Assets/Member's Equity	174,089	181,552	180,574	183,168	187,408
Total Debt	199,311	223,056	209,980	269,696	253,116
Cash Flow Statement					
FCF (FADS – Transfer and PILOT – Total Annual DS)	2,083	12,473	10,825	9,137	12,148
Capex	37,564	27,084	17,445	28,091	41,503
FCF Less Capex	(35,480)	(14,611)	(6,621)	(18,953)	(29,355)

DSC – Debt service coverage. PILOT – Payment in lieu of taxes. PP – Purchased power. DS – Debt service. FADS – Funds available for debt service.
Source: Fitch Ratings, Fitch Solutions, City Electric System of Bryan, Texas.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.