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Ratings

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Bryan, Texas; Retail Electric

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Credit Profile		
US$43.83 mil elec sys rev bnds ser 2018 dtd 11/15/2018 due 07/01/2043		
Long Term Rating	A+/Positive	New
Bryan retail elec (AGM)		
Unenhanced Rating	A+(SPUR)/Positive	Affirmed
Bryan elec		
Long Term Rating	A+/Positive	Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings revised the outlook to positive from stable on Bryan, Texas' outstanding electric system revenue bonds and affirmed its 'A+' long-term rating on the debt. At the same time, we assigned our 'A+' rating to the city's series 2018 electric system revenue bonds.

The outlook revision reflects the system's financial forecast that suggests fixed-charge coverage could improve materially over the next two years when fixed-costs related to Gibbons Creek, a coal-fired power plant, decline. If actual fixed-charge coverage exceeds historical levels and we believe very strong metrics are likely sustainable, we could raise the rating over the next two years. S&P Global Ratings' fixed-charge coverage calculation treats transfer payments to the city's general fund as an operating expense and treats imputed capacity costs included in the cost of power purchased from Texas Municipal Power Agency (TMPA), and other suppliers as debt-like obligations, reflecting, in our view, the utility's financial capacity to meet all of its obligations.

Officials plan to use series 2018 bond proceeds to fund certain new transmission projects. A first-lien net revenue pledge of Bryan Texas Utilities' (BTU) electric system secures the bonds. The electric system had $221.9 million in total debt outstanding as of Sept. 30, 2018.

The rating further reflects our opinion of the electric system's very strong enterprise risk profile and strong financial risk profile.

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

- Very strong service area economic fundamentals, reflecting a stable local service area economy--anchored by Texas A&M University in neighboring College Station--in a metropolitan area that continues to grow and has one of the lowest unemployment rates in the U.S.;
- Extremely strong industry risk relative to other industries and sectors;
- Adequate market position, due to its weighted average electric system rate that is just above the state average; and
- Very strong operational and management assessment, based on the system's robust financial management policies and practices, securing its long-term power supply until 2028, and the system has eliminated coal-fired generation

from its power supply when its power sales contract with TMPA expired on Sept. 30, 2018.

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

- Strong coverage metrics that we anticipate could improve to very strong levels beginning in fiscal 2020 when fixed-costs related to Gibbons Creek decline;
- Very strong liquidity and reserves, with 157 days of total liquidity on hand in fiscal 2017, which is projected to improve over the financial forecast and exceed its 110-day liquidity target; and,
- Strong debt and liabilities profile, suggested by a projected debt-to-capitalization ratio around 65% following the planned debt issues in 2019 and 2020.

Outlook

The positive outlook reflects our view of the system's financial forecast, that suggest fixed-charge coverage could improve materially when fixed-costs related to Gibbons Creek decline.

Upside scenario

We understand the utility's fixed costs are declining in the near term, and if the utility demonstrates a track record of materially stronger fixed-charge coverage while also maintaining liquidity at current levels, we could raise the rating.

Downside scenario

We could revise the outlook to stable if improvement in fixed-cost coverage fails to materialize.

Utility Description

BTU is a vertically integrated electric system serving 37,660 retail customers with more than half of the utility's electric revenue coming from retail customers living within Bryan's city limits. Revenue from off-system sales from the utility's owned generating capacity helps lower the fuel cost for retail customers, and about 53% of electric sales for unaudited fiscal 2018 were off-system wholesale sales. The system maintains wholesale power sales contracts with the cities of Bowie and Weatherford, as well as Texas A&M. BTU's wholesale customer, Bryan Rural Electric, which serves 21,630 customers outside the city, accounted for 22% of total sales in fiscal 2018.

The rural electric system is a component unit and all-requirements wholesale customer of BTU, which the city owns, with separate and discrete financial records. The rural system serves the remainder of Brazos County that BTU doesn't already serve, as well as several other outlying areas. The rural system and BTU otherwise share management and governance structures, although the rural system does not directly make any kind of transfer payment to the city's general fund.

BTU is one of four members of TMPA, and has approximately 102 megawatts (MW; 21.7% share) of TMPA's Gibbons Creek coal-fired plant. The Gibbons Creek plant supplied 11% of the utility's energy needs in 2018, but BTU's power sales contract with TMPA expired on Sept. 30, 2018. TMPA is currently seeking to sell the plant. Under a joint operating agreement signed Sept. 1, 2016, any final sale of Gibbons Creek would result in TMPA's members recovering their proportionate shares of sales proceeds. All of TMPA's generation debt was paid on Sept. 1, 2018. Therefore, we believe the electric system's financial performance will improve beginning in fiscal 2020 as a result of BTU's declining fixed-costs associated with Gibbons Creek.

Enterprise Risk

Economic fundamentals -- Very strong

BTU's customer base is mostly residential and accounted for 39% of total retail sales in fiscal 2018. The customer base has grown 8.8% since 2014 and officials are projecting 2% meter growth, which is in line with historical levels. We consider city median household effective buying income levels below average at 81% of the nation. We consider the customer base very diverse, with the 10 leading retail customer accounting for 10% of total operating revenues, and the system's leading customer, Bryan Independent School District, accounted for just 2% of revenues in fiscal 2018. BTU maintains power sales contracts with its wholesale customers. For example, the contract with Bowie is served from BTU's own resources and market purchases and extends to 2038. BTU's contract with Weatherford extends through 2020, and BTU expects to execute one-year extensions with Texas A&M.

Industry risk – Extremely strong

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

Market position – Adequate

We consider the system's rates above average and there are no plans to raise base rates in the near term. Based on the U.S. Energy Information Administration's latest available data from 2016, the system's weighted average system rate competitiveness (based on relative customer classes' revenue contributions) is 105.6% of the state average. BTU regularly passes through wholesale exposure to volatile fuel costs on to its customers; in turn, the rural electric system also recovers any purchased power costs from its retail customers. The utility, however, has a number of fuel supply contracts to control such costs as much as possible.

Operational Management Assessment (OMA) – Very strong

In our view, the system has secured its long-term power supply and will not need additional capacity until 2028. It is long on power with 471 MW of owned and purchased capacity in 2019 to meet its 340 MW peak demand. BTU purchased 81% of its energy in fiscal 2018 including spot or day ahead market purchases when economic (17% of energy in fiscal 2018). The system's 226 MW in owned gas-fired peaking generation will continue to firm up its wind and solar capacity (70 MW), and BTU has entered into bilateral contracts at various lengths with several counterparties (175 MW).

BTU eliminated coal-fired generation from its power supply when its power sales contract with TMPA expired on Sept. 30, 2018. Because TMPA's generation debt was fully paid in 2018, we expect the member cities to benefit from lower fixed costs in the short run, which would enhance the competitiveness of their respective retail electric systems. TMPA's Gibbons Creek coal plant accounted for just 11% of BTU's energy sales in 2018, but only dispatched between May and September 2018. Market conditions in ERCOT led to low plant capacity factors over the past four years. One result of the reduced dispatching of the plant, and the associated inefficiencies in its operations, is that TMPA is currently seeking to sell the plant. Under a joint operating agreement signed Sept. 1, 2016, any final sale of Gibbons Creek would result in TMPA's members recovering their proportionate shares of sales proceeds.

We consider management's financial policies and practices robust, including annually updating its five-year financial forecasts and capital plans, and establishing minimum and targeted debt service coverage and liquidity levels. Management has a track record of adjusting bases rates, and its discretionary purchased power cost adjustment mechanism is reviewed monthly. The BTU board of directors recently approved its energy risk management policy in August 2018, which details its natural gas hedging practices. BTU reviews its unhedged natural gas supply monthly and hedges roughly 50% of next year's gas supply. The board reviews its fuel under and over recovery quarterly and monitors forward pricing curves to take advantage of market purchases when economical.

Financial Risk

Coverage metrics – Strong

We believe the system's recent financial performance remains sufficient for the current rating level. Although fixed-charge coverage has been just adequate, ranging between 1.1x and 1.2x over the past three years, we believe coverage will improve to strong levels in fiscal year 2018 and could improve further to very strong levels in fiscal 2020 as projected capacity costs decline. Management's financial projections indicate fixed-charge coverage could improve to 1.5x in fiscal 2018 because of lower debt service costs in that year, and could improve further to 1.7x by fiscal 2020 once its Gibbons Creek plant debt is repaid. S&P Global Ratings' fixed-charge coverage includes transfers to the city's general fund as an operating expense. By policy, the amount of the transfer cannot exceed 7% of BTU's gross revenue. The fixed-charge coverage calculation adds capacity payments included in the cost of power purchased from TMPA, , and other suppliers back to the numerator and adds it to debt in the denominator. Management projects to provide 1.2x fixed-charge coverage in fiscal 2019, when a bullet payment increases total debt service to $42 million. All of TMPA's generation debt was paid on Sept. 1, 2018, resulting in BTU's lower capacity costs in fiscal 2019.

Liquidity and reserves – Very strong

In our opinion, liquidity is very strong, guided by management's policy of maintaining 110 days of unrestricted cash on hand as a target, including the rate-stabilization fund. Fuel and purchased power costs are passed on to retail and contracted wholesale customers as incurred, which limits the need for surplus cash. BTU improved its available liquidity equal to $61 million (equal to 157 days of operating expenses) in fiscal 2017, well above its 90-day liquidity policy. The forecast for fiscal year 2019-2023 projects maintaining over 200 days by fiscal 2019.

Debt and liabilities – Strong

We consider BTU's debt burden moderate with a debt-to-capitalization ratio equal to 57% in fiscal 2017, but debt levels are projected to increase with projected debt-to-capitalization ratios around 65% by 2020. Following the series 2018 debt issue, BTU will support about $266 million in total debt. Management expects the capital improvement plan (CIP) for fiscal years 2019-2023 to be about $237 million. The bulk of CIP relates to transmission construction that is recoverable statewide from load-serving entities through transmission rates via the Public Utility Commission of Texas' transmission cost-of-service rates. Management plans to fund about $148 million (62% of the CIP) through bond proceeds and the remaining $88 million through internal sources. Officials intend to issue $40 million in 2019 for certain transmission capital improvements.