S&P Global Ratings

RatingsDirect®

Bryan Rural Electric System, Texas Bryan; Retail Electric

Primary Credit Analyst:
Scott W Sagen, New York (1) 212-438-0272; scott.sagen@spglobal.com

Secondary Contact:
Paul J Dyson, San Francisco (1) 415-371-5079; paul.dyson@spglobal.com

Table Of Contents

Bryan Rural Electric System, Texas
Bryan; Retail Electric

Credit Profile		
US$19.145 mil rural elec sys rev imp bnds ser 2018 dtd 11/15/2018 due 07/01/2043		
Long Term Rating	AA-/Stable	New
Bryan elec (rural)		
Long Term Rating	AA-/Stable	Upgraded

Rationale

S&P Global Ratings raised its rating on Bryan, Texas' rural electric system revenue debt to 'AA-' from 'A+'. At the same time, we assigned our 'AA-' rating to Bryan's series 2018 rural electric system revenue improvement bonds. The outlook is stable.

The upgrade is due to the application of our "U.S. Municipal Retail Electric And Gas Utilities: Methodology And Assumptions" criteria, published Sept. 27, 2018, on RatingsDirect.

Officials plan to use series 2018 bond proceeds to fund certain distribution capital projects and system modernization. The bonds are secured by a first-lien net revenue pledge of the city's rural electric system. The rural electric system had almost $16 million in total debt outstanding as of Oct. 1, 2018.

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

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, as a distributor of Bryan Texas Utilities (BTU) power and energy, which reduces direct operational and financial risk, and as evidenced by robust financial management policies and practices;

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

- Very strong coverage metrics, evidenced by maintaining 1.4x fixed-charge coverage over the past three years that could materially improve beginning in fiscal 2019 when fixed-costs related to Gibbons Creek decline;
- Strong liquidity and reserves for a distribution system, with about 60 days of total liquidity on hand; and,

- Strong debt and liabilities profile, suggested by a 27% debt-to-capitalization ratio that we expect to increase to about 40% in the near term.

Outlook

The outlook is stable because the utility is reducing its fixed costs in the near term, which will give it additional financial flexibility. We believe the system's very strong financial position is sustainable, given its historical willingness to pass along base-rate increases as necessary to generate good financial margins.

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

If actual fixed-cost coverage or liquidity weaken materially below historical levels or if debt issuance is materially higher than what is incorporated in the five-year CIP, we could lower the rating.

Utility Description

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.

Although the rural system is not directly responsible for any obligations to Texas Municipal Power Agency (TMPA), BTU's market-based rates are still structured to recover all costs of providing service to ensure the integrity of its financial position. All of TMPA's generation debt was paid on Sept. 1, 2018, and BTU's power sales contract with TMPA expired on Sept. 30, 2018. Therefore, we believe the rural system's financial performance will improve beginning in fiscal 2019 as a result of BTU's declining fixed-costs associated with Gibbons Creek.

Enterprise Risk

Economic fundamentals -- Very strong

The rural system provides electric services to the immediate rural area outside Bryan, extending to most of Brazos County. The customer base, which is mostly residential, has increased 15% since 2014. For 2017, the system served 21,120 customers and officials are projecting 3.6% annual customer growth. While customer growth projections are in line with historical growth trends, we believe it could be difficult to achieve projected growth levels consistently. We consider county median household effective buying income levels below average at 81% of the nation. The system's leading customer, Texas A&M University, provides a stabilizing economic presence and accounted for just 4.8% of total revenues in fiscal 2018.

Industry risk – Extremely strong

Consistent with "Methodology: Industry Risk" (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 as compared with other industries and sectors.

Market position – Adequate

We consider the rural system's rates above average, although the recent reduction in the base purchased power rate in October 2018 could improve the system's rate competitiveness in the near term. Because of BTU's decline in fixed-costs related to Gibbons Creek, BTU lowered the base purchased power rate 38% in October 2018.

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. Also, TMPA's Gibbons Creek coal plant accounted for just 11% of BTU's energy requirements in 2018, and only dispatched between May and September. Based on the U.S. Energy Information Administration's latest available data from 2016, the rural system's weighted average system rate competitiveness (based on relative customer classes' revenue contributions) is 105.6% of the state average.

Operational Management Assessment (OMA) – Very strong

As a distributor of BTU power and energy, the rural system's operating risks are reduced. 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, the most recent base-rate adjustment being 5.7% in 2016. 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 – Very strong

In our opinion, the system's financial position remains strong. Given its consistent customer growth trend and base-rate adjustments, total revenues have increased 23% since fiscal 2014. Fixed-charge coverage remains strong at about 1.4x in fiscal years 2017 and 2016, down from 1.5x in fiscal 2015. The system has had a very high level of reinvestment and pay-as-you-go funding for capital expenditures. Management's financial projections indicate maintaining 1.4x in fiscal 2018 before improving to 2.2x in fiscal 2019, even after accounting for additional debt issuance. The likely improvement in financial metrics in the near term reflects the decline in BTU's fixed costs associated with the Gibbons Creek plant and the related decline in the rural system's base purchased power costs. However, it remains to be seen whether the utility will establish a consistent track record of materially stronger fixed-charge coverage as projected.

Liquidity and reserves – Strong

The system's liquidity position has also remained stable, equal to $6.5 million, or a good 63 days' cash on hand in fiscal 2017, and above its 45-day minimum cash target. Management's financial projections indicate liquidity improving to over 90 days' cash on hand beginning in fiscal 2021, with cash funding roughly half of its capital improvement plan (CIP).

Debt and liabilities -- Strong

We consider the system's debt burden low with a debt-to-capitalization ratio equal to a modest 27% in fiscal 2017, but we anticipate it will increase following the series 2018 debt issuance. After that, the system's debt-to-capitalization ratio is projected by management to increase to 45% by fiscal 2019. Officials have identified $83 million in capital improvement needs over the next five years, and management plans to cash fund 50% of the capital plan. Officials intend to issue $19.4 million in additional debt in 2021.