Fitch Affirms Brazos Electric Power Cooperative, TX at 'A'; Outlook Stable

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AUSTIN, Texas--(BUSINESS WIRE)--Fitch Ratings has affirmed the 'A' rating on Brazos Electric Power Cooperative's (the cooperative) implied senior secured obligations.

The rating takes into account Brazos' $2.46 billion of outstanding debt on a consolidated basis as of Dec. 31, 2015, which consists primarily of mortgage notes payable to the Federal Financing Bank. The rating applies to implied senior secured obligations because the cooperative does not have any publically held debt.

The Rating Outlook is Stable.

SECURITY

Brazos' 2010 mortgage indenture grants senior secured bondholders a first lien on substantially all of its real and tangible personal property, including its member power sales contracts.

KEY RATING DRIVERS

LARGE TEXAS G&T COOPERATIVE: Brazos is a large generation and transmission (G&T) power cooperative serving 16 Texas distribution cooperative members across 68 counties pursuant to long-term, all-requirements power sales contracts through 2045. Strong financial margins are also provided by regulated transmission assets within the Electric Reliability Council of Texas (ERCOT).

GROWING MEMBER SYSTEMS: Sustained sales growth averaging 3.1% annually and a largely residential retail base provide stability to Brazos' member systems. System growth is projected to continue around this level. Brazos has limited concentration risk related to single, large retail customers, although some members have concentration within their own customer base.

FLEXIBLE RESOURCE PORTFOLIO: Brazos continues to add owned and contracted generation resources supplemented by heat rate call options, to meet its growing peak demand. Brazos plans to construct a 380 MW natural-gas plant within five years, but timing will depend on the continued availability of attractively-priced short-term energy options in ERCOT.

HEALTHY FINANCIAL PROFILE: Brazos's financial position is healthy, albeit with financial margins of around 1.2x that are slightly below Fitch sector medians. Equity ratios have increased in recent years and liquidity is robust. Rates are competitive and a monthly power cost recovery factor provides real-time pass through of fuel and variable costs.

RATING SENSITIVITIES

DECLIINES IN FINANCIAL PROFILE: The Stable Outlook reflects the expectation that Brazos Electric Power Cooperative's financial margins will remain consistently healthy and liquidity levels robust. Given the modest coverage levels, lower financial performance on a sustained basis could result in downward rating pressure.

CREDIT PROFILE

Brazos is a large G&T cooperative providing electric service to 16 Texas distribution cooperative members and one municipality pursuant to long-term, all-requirements contracts through 2045. The members, in turn, serve a growing retail customer base (593,434) in 68 counties principally to the west of the Dallas/Fort Worth metropolitan area and northwest of Houston. Highly residential member sales account for 56% of the total and add stability to the cooperative's overall revenue base.

RESOURCE SUPPLY STRATEGY TAKES ADVANTAGE OF LOW ERCOT PRICES

Brazos' power supply strategy has included the acquisition of additional generation resources, either owned or through long-term power purchase agreements, to continue serving its growing load demands. Recent additions in the past decade include 1200 MW at two units of natural gas generation (Jack County projects) and 388 MW from the Sandy Creek coal-fired plant. Brazos has a fuel mix that is primarily natural-gas dependent, which has provided favorable pricing in the current low natural gas price environment.

In addition to its 2,932 MW of owned and contracted resources, Brazos has adopted a strategy to take advantage of currently low energy prices in ERCOT to serve a portion of its load. Within the ERCOT market, low natural gas prices and the addition of substantial wind generation and transmission capacity have contributed to low energy prices. Low prices have provided an economic option for meeting load in the service area for utilities across ERCOT, not just Brazos. Brazos uses heat rate call options and forward energy purchases to limit risk associated with serving its peak load (3,407 MW in 2015).

Brazos plans to build a 380 MW natural-gas peaking unit in Hill County. Brazos own the property and air permits were received in 2016. However, plans to begin construction have been delayed given current market energy prices. The expected date of commercial operation has moved back from 2017 to 2019. Brazos instead signed a 300 MW firm energy three-year power purchase agreement from 2016 through 2018 in lieu of an earlier construction date in Hill County.

BRAZOS TERMINATES SAN MIGUEL ELECTRIC COOPERATIVE MEMBERSHIP

Brazos previously had rights to 50% (195 MW) of capacity at the San Miguel coal-fired power plant, owned and operated by San Miguel Electric Cooperative, TX (SMEC). The plant entered commercial operation in 1982 and includes a lignite coal-mine and a license to operate until 2037. Brazos and SMEC were in litigation in 2014 regarding Brazos' minimum scheduling requirements under its wholesale power contract. Brazos wanted to run the plant less than was desired by SMEC. The litigation was settled by Brazos, SMEC and the South Texas Electric Cooperative (STEC; the other 50% purchaser) in 2015.

The settlement allowed Brazos to assign its 50% rights to the project to STEC and exit SMEC by making a final payment designed to cover its remaining debt, plant and mine decommissioning costs. This occurred on Dec. 31, 2015. Brazos and its 16 electric distribution cooperative members have withdrawn their membership from SMEC and no longer have members on the Board of Directors. To replace the energy, Brazos entered into energy contracts totaling 160 MW through 2021.

COMPETITIVE WHOLESALE RATES

Brazos' resource strategy and low natural gas prices have benefitted its wholesale rates. The wholesale rate declined to $59.30 per MWh in 2015 from $69.99 as the average cost of gas declined. While exposure to a single fuel source and market conditions could ultimately introduce volatility, Brazos' active management of gas contracts and its competitive wholesale rate provide headroom to negotiate adverse conditions. In addition, the cooperative's monthly power cost recovery factor (PCRF) helps ensure the timely recapture of costs when gas prices move upward.

MODEST FINANCIAL MARGINS; IMPROVING DEBT RATIOS

Financial metrics have been stable during the past five years. This follows a period of considerable growth from 2008-2010, during which the cooperative added nearly $1 billion of debt. Consistent operating margins - including from its regulated transmission assets - are slightly below Fitch's 'A' category sector medians but are acceptable. Transmission operations now contribute the largest proportion of overall net margins.

Fitch calculated debt service coverage exceeded 1.2x in fiscals 2012-2014, compared to Fitch's wholesale system 'A' category median of 1.37x. Coverage in fiscal 2015 declined to 1.1x as a result of the non-cash write-off of patronage capital associated with Brazos' departure from SMEC. Without this adjustment, debt service coverage would have been above 1.2x.

Moreover, the ratios of (i) equity to capitalization and (ii) debt to funds available for debt service improved to 23.1% and 9.5x, respectively, from 15.7% and 15.1x in fiscal 2011. The rating category medians are 21.4% and 8.9x. Fitch expects more limited capital plans and corresponding deleveraging will continue to improve these metrics and provide an indicator of its longer-term financial strength.

ROBUST LIQUIDITY

Brazos has substantial liquidity, provided primarily by a $700 million syndicated credit facility expiring February 2019. The cooperative uses the facility for interim capital financing needs. Cash on hand and liquidity on hand were in line with the Fitch sector medians at 65 days and 301 days, respectively, at the end of fiscal 2015. These liquidity amounts do not include an additional $174.5 million on deposit at the end of fiscal 2015 with the Rural Utilities Service's cushion of credit program that receives a 5% rate of return but is legally restricted in that it can only be used to pay debt service on federal debt.

LIMITED CAPITAL SPENDING

Brazos' member costs benefit from the utility's favorable capital structure. The majority of its debt is through the Federal Financing Bank, which provides below-market borrowing rates. Currently outstanding debt of approximately $2.2 billion (consolidated) is financed by the federal government (76% from RUS and the Federal Financing Bank), National Rural Utilities Board Cooperative Finance Corporation (2%), Bank of America (3%) and the remaining amount in a private placement that matures in 2024, issued to fund Sandy Creek at Brazos Sandy Creek, a wholly owned subsidiary. Additional RUS loans are expected to fund the entirety of the cooperative's five-year capital plan totaling $676 million, which includes the potential $200 million for the Hill County project. A gradual deleveraging of the system is expected.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria

Revenue-Supported Rating Criteria (pub. 16 Jun 2014) https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012

U.S. Public Power Rating Criteria (pub. 18 May 2015)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=864007

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1005267

Solicitation Status

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