Fitch Rates Pasadena, CA's Electric System Rev Bonds 'AA'; Outlook Stable

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AUSTIN, Texas--(BUSINESS WIRE)--Fitch Ratings has assigned a 'AA' rating to the following bonds issued by Pasadena, CA on behalf of Pasadena Water and Power (PWP):

--Approximately $120 million electric revenue refunding bonds, 2016A series.

Bond proceeds will be used to fund approximately $30 million of the system's capital needs, refund an estimated $47 million in outstanding 2008 bonds for savings, refinance a $60 million line of credit and pay costs of issuance. Bonds are expected to price via competitive sale on Nov. 7, 2016.

In addition, Fitch affirms its 'AA' rating on the following outstanding parity bonds:

--$186.9 million electric revenue bonds (pre-refunding).

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a first lien on net revenues of the Pasadena electric system.

KEY RATING DRIVERS

MATURE SERVICE AREA: PWP provides retail electric service to 65,318 customers within the city of Pasadena. The service area is located within the greater Los Angeles region and exhibits strong economic indicators and ongoing in-fill development.

STRONG FINANCIAL PERFORMANCE: The electric system utility generates consistently strong financial metrics. Although debt service coverage (DSC) is expected to decline in fiscal 2018 related to a scheduled increase in debt service, DSC should remain above a healthy 2.5x coverage level.

ADAPTIVE RATE STRUCTURE: Retail rates include components to allow for the pass-through of energy and transmission costs (around 65% of electric revenue captures through adjustable mechanisms), which provides flexibility to adapt to unexpected cost pressures. In addition, the city council has shown support for base rate increases in fiscals 2015-2017.

REQUIRED POWER SUPPLY CONVERSION: PWP is well positioned to meet California's renewable mandate and greenhouse gas legislation that require PWP to shed its predominately coal-based power supply by 2026 and meet a 50% renewable portfolio supply by 2030. However, PWP will need replacement energy and/or capacity to replace its coal resource.

LIMITED CAPITAL; LOW DEBT: Following completion of the 71 MW GT5 repowering project in 2016, PWP's capital needs are moderate and limited to distribution system investments until a decision is made regarding the replacement of IPA capacity. PWP's low direct debt burden and robust reserves, including the stranded investment reserve, should provide financial flexibility to accommodate the next generation investment.

INCREASED TRANSFERS: Transfers to the city's general fund (GF) have been steadily increasing and reached 10% of revenue beginning in fiscal 2015, which is somewhat high compared to peers. City charter caps the transfer at 16%.

RATING SENSITIVITIES

MAINTENANCE OF FINANCIAL MARGINS: Pasadena Water and Power's ability to maintain strong financial margins and liquidity during fiscals 2018-2022 during a period of scheduled increases to debt service and city transfers totaling 10% of revenue will be key to maintain the rating.

CREDIT PROFILE

PWP is a retail electric system serving over 65,000 residential, commercial and industrial customers within the City of Pasadena's 23-square mile area. Located 10 miles northeast of downtown Los Angeles, Pasadena (IDR 'AA+') possesses a diverse employment base with above-average wealth and education levels.

The majority of PWP's energy sales are derived from residential (30%) and commercial and industrial customers (69%). Historical energy sales exhibit an average annual decline over the past five years of 1% as a result of industry advances in energy efficiency and well as the city's own programs to promote conservation.

POWER SUPPLY CONVERSION IN PROCESS

The electric system is fully integrated and includes generation, transmission and distribution facilities. In addition to its owned and operated generating units, PWP receives a majority of its total energy needs through ownership participation in various joint power agency agreements. Of 327 MW of non-renewable generation capacity, approximately half is local gas generation and the other half is long-term purchase arrangements from a variety of generation sources, including coal-fired, hydroelectric and nuclear-generating units. PWP also has 36 MW of renewable project capacity under contract in 2015 with additional solar projects coming on-line in 2016. PWP was an early adopter of renewable energy with a municipal renewable target that, until 2015, was more ambitious than the state target.

The Intermountain Power Project (IPP) is PWP's largest source of power (107 MW share), and accounted for approximately 36% of PWP's energy resources in 2015, but it is also the utility's largest source of carbon emissions. The IPP agreement is set to expire in 2027 and California mandate prohibits renewal if the resource continues to be coal-fired generation. The 35 project participants have agreed to a process by which the project will be repowered, or rebuilt, as a gas-fired generation project. PWP is evaluating its options as to whether it will participate in the repowering but has initially indicated its intent to participate for a maximum of 40 MW. PWP estimates that it will require a smaller share than its current 107 MW due to increased renewable purchases.

The GT5 Repowering Project will be completed in 2016, which provides PWP with a new, efficient 71 MW (68 MW net) combined cycle plant to replace the existing Broadway 3 steam plant. The $135 million project was built within budget, with commercial operation originally expected in May 2016 but now expected by the end of the calendar year. Construction is complete and final testing is in progress.

STRONG FINANCIAL PERFORMANCE

Financial metrics have been strong at PWP, albeit with some level of variability. Fitch calculated 7x and debt service coverage (DSC) has ranged between 2. 4.9x over the past five years. Fiscal 2015 DSC of 4.4x was up from 2.7x in fiscal 2014 as a result of the D&C charge increase implemented in 2015. The variation in coverage has resulted from higher power expenses in fiscals 2012 and 2013 and increased debt service. The variation is not a credit concern given the strong coverage provided in all years. PWP's large GF transfer of 10% brings coverage of full obligations down to a still strong 1.8x in 2015.

Projections show DSC remains relatively stable until 2018 when a large increase in direct debt service costs from around $18 million to $23 million is scheduled. Projected DSC in fiscal 2018 and beyond is projected to remain above 2.5x, or 1.7x after the general fund transfer. Projections assume continued minimal declines in energy sales and the final 2.2% base rate increase in fiscal 2017.

PWP maintains substantial liquidity, as shown through unrestricted funds totaling $179 million at year-end 2015, or 442 days cash on hand (DCOH). Unrestricted funds include the utility's stranded investment reserve (SIR), totaling $68 million, which is reserved for potential costs associated with IPP, and separate action of the City Council is required if the SIR is to be repurposed. Without the SIR, DCOH total a still strong 274 days. Unrestricted funds, not including the SIR, should remain strong and stay above $100 million.

The utility has limited capital needs until the potential IPP repowering and a moderate debt burden with around $203 million of direct debt at the end of fiscal 2015. Direct debt will increase with the approximately $30 million in new money debt in the 2016A bonds. Leverage, as calculated by debt/funds available for debt service (FADS), was 3.4x at the end of fiscal 2015, compared with Fitch's rating category median of 5.7x. Including off-balance sheet obligations, PWP's debt/FADS is still manageable at below 6.0x.

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

Applicable Criteria

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)

https://www.fitchratings.com/site/re/750012

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

https://www.fitchratings.com/site/re/864007

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1013463

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