Fitch Rates Anaheim Public Utilities, CA's Electric Sys Rev Bonds 'AA-'; Outlook Stable

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AUSTIN, Texas--(BUSINESS WIRE)--Fitch Ratings has assigned an 'AA-' rating to the following qualified obligation bonds, issued by the Anaheim Housing and Public Improvements Authority, CA (AHPIA) on behalf of Anaheim Public Utilities (APU):

--$93.5 million revenue bonds, series 2016A;

--$199.2 million revenue bonds, series 2016B;

--$70.2 million revenue bonds, series 2016C (taxable).

The bonds are scheduled to price Sept. 28, 2016. Proceeds will be used to: i) finance a portion of the utility's capital improvement plan, ii) refund all or a portion of the outstanding series 2007A, 2009A and 2011A revenue bonds, iii) fund the debt service reserve fund for the bonds, and iv) pay cost of issuance.

In addition, Fitch has affirmed the 'AA-' ratings on the following bonds:

--$201.4 million qualified obligation revenue refunding bonds, series 2014 and 2015B, issued by the California Municipal Finance Authority, CA (CMFA) on behalf of APU;

--$50.0 million qualified obligation variable rate SIFMA index mode, second lien revenue refunding bonds, series 2015A, issued by the CMFA on behalf of APU;

--$400.2 million (pre-refunding amount) qualified obligation revenue refunding bonds series 2007A, 2009A, 2011A and 2012A, issued by the Anaheim Public Financing Authority, CA (APFA) on behalf of APU;

--$22.0 million Canyon power project revenue bonds, series 2010A issued by the Southern California Public Power Authority (SCPPA);

--$191.0 million Canyon power project revenue bonds, series 2010B issued by SCPPA.

The Rating Outlook on all bonds is Stable.

SECURITY

The 2016 bonds will be issued by AHPIA and secured by purchase payments made by APU, an enterprise fund of the city of Anaheim, in accordance with the installment purchase agreement. Payments from the city to AHPIA are absolute and unconditional and are made from surplus revenues of the city's electric utility system. The rating reflects the payment obligation of the city's electric system.

KEY RATING DRIVERS

MATURE SERVICE AREA: APU provides retail electric service to 115,682 customers within the city of Anaheim. The service area benefits from the tourism-driven local economy and labor market of the greater Los Angeles area. The customer base is relatively stable, with limited growth.

REQUIRED POWER SUPPLY CONVERSION: The state's renewable mandate and greenhouse legislation require APU to implement changes to its predominately coal-based power supply in favor of renewable generation to meet a 50% renewable portfolio supply by 2030. APU is on schedule to meet the state requirements, although similar to other southern California municipally owned utilities, the utility will need replacement energy and/or capacity after 2027.

RATE ADJUSTERS PROVIDE FLEXIBILITY: APU's rate structure includes periodic adjustment mechanisms that recover escalating power supply and environmental and regulatory costs, the two areas of cost uncertainty in the California power markets. The cost increases are periodically rolled into base rates, as occurred in fiscal 2016. There has been strong support from city council for the base rate increases, when needed.

HEALTHY FINANCIAL PERFORMANCE: Financial margins and debt service coverage (DSC) have been healthy the past three years. DSC is still low compared to the rating category median, but is expected to remain within an acceptable range of 2.0x. Liquidity levels are robust.

HIGH DEBT LEVELS: APU's debt levels are high compared with similarly rated utilities, especially after including off-balance sheet debt issued by joint action agencies. Leverage is expected to remain at an elevated level due to the use of debt financing for a majority of capital needs.

SCPPA RATING SUPPORTED BY ANAHEIM: The rating on the SCPPA bonds reflects the credit profile of the sole participant in the project, APU, and its unconditional take-or-pay obligation on the bonds as defined in the power purchase contract between APU and SCPPA.

RATING SENSITIVITIES

HIGH LEVERAGE: Downward rating action could result should Anaheim Public Utility's continued reliance on debt to fund its capital program begin to pressure financial margins.

CREDIT PROFILE

APU is an enterprise system of the city that provides retail electric service within the city limits of Anaheim. While residential customers make up the largest class, residential energy sales only accounted for 21% of total energy sales in fiscal 2016. There is some customer concentration, with the 10 largest customers accounting for 20% of MWh sales.

The city's service area is largely dependent on tourism, dominated by the Walt Disney World Company (Disney; IDR 'A'/Outlook Stable). Given Disney's credit quality and its ongoing investment in its Anaheim location, Fitch does not view the city's dependence on Disney as a credit concern. Anaheim's retail electric sales have grown by an average of 1.1% annually since 2011, which incorporates weather-related fluctuations.

POWER SUPPLY RESOURCE CONVERSION

APU's resource mix consists primarily of jointly-owned resources. The resources are predominately coal-based, which accounted for 48% of total energy supplies, including wholesale sales, in fiscal 2015. The remainder of fiscal 2015 total energy supply was natural gas (23%), renewable (22%), large hydro (1%) and market purchases (6%). When only retail sales are considered, APU generated 33% of its energy from renewable resources in calendar 2015.

Combined generation capacity of 811 MW is more than sufficient to serve APU's system peak demand of 549 MW, although the 811 MW of capacity includes 246 MW of peaking capacity (including the Canyon power project owned by SCPPA) that is only used to generate during short peak load time periods each summer and 63 MW in purchased power wind contracts. APU also owns 118 MW of the Magnolia Power Project, a combined cycle natural gas plant owned and operated by the Southern California Public Power Authority (SCPPA). Magnolia provided 19% of APU's energy requirements in 2015. APU has no nuclear generation and very limited large hydroelectric generation.

California state legislation enacted in 2006 limits new long-term contracts for coal-fired resources. APU is working towards replacing its coal-fired generation resources with renewable energy and gas-fired generation. APU negotiated an early termination in 2017 from its 50 MW ownership position in the San Juan coal-fired power plant in New Mexico. The 50 MW will be replaced by renewable contracts already in place. Since 2014, APU has entered into long-term contracts for 46 MW of landfill gas and biomass renewable energy.

APU's largest single-generation resource is its entitlement share in the two-unit, coal-fired Intermountain Power Project (IPP), operated by Intermountain Power Agency (IPA). Anaheim is the second largest project participant (after LADWP) with a 13.2259% entitlement (237 MW), pursuant to a power sales contract that terminates in 2027. IPP remains APU's largest source of power, accounting for almost 40% of fiscal 2015's total energy supply.

The IPP participants are exploring options to repower the project as a gas-fired resource near the end of the contract to comply with California legislation prohibiting coal resources. Although APU does not expect to participant in the repowering, it will continue to receive its 13.2259% share in the plant through the termination date of its power sales agreement through 2027, whether or not the plant is repowered. APU expects to replace the baseload capacity from IPP after 2027 with a purchase contract although land is owned within the service area to construct additional generation capacity, if that option is deemed more economic closer to 2027.

HEALTHY FINANCIAL PERFORMANCE; BASE RATE INCREASE IN 2016

Fitch-calculated debt service coverage was over 2.0x in fiscals 2013-2015 and based on preliminary information for fiscal 2016 (unaudited), appears to continue at that level. Fitch-calculated debt service coverage includes rates collected through APU's RSA adjustments, although these receipts are placed in a deferred account for future recognition as revenues. Fitch's calculation also includes repayment of $11.2 million of an outstanding Wells Fargo RCA loan. Fitch calculated coverage of full obligations has ranged from 1.3x-1.35x in fiscals 2013-2015.

APU's financial profile and metrics, while stronger than historical performance, are still below the median levels for the 'AA-' rating category. The somewhat weaker financial metrics are partially mitigated by APU's rate flexibility supported by two adjustable components in the rate structure that allow for timely recovery of additional cost components. These adjustment factors, in addition to the use of regular base rate increases (with the most recent base rate increase in fiscal 2016), provide timely rate recovery, which Fitch believes is critical as APU implements changes to its power supply.

HIGH DEBT LEVELS

The utility has a sizeable debt burden with approximately $735 million of direct debt at the end of fiscal 2015. This will increase with the approximately $100 million in new money debt in the 2016A bonds, which will be included in the fiscal 2017 year-end debt ratios. The $100 million increase in debt is in addition to the issuance of $85 million in new money debt included with the 2015A&B bonds. The proceeds are being used to fund distribution-related capital needs in fiscals 2015 through 2019.

Leverage, as measured by debt to funds available for debt service (FADS), was 6.8x at the end of fiscal 2015, compared to the rating category median of 4.7x. APU expects to issue $85 million in additional debt in the next five years to finance its 2017-2021 five-year capital plan, estimated at $377 million.

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=1011581

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