# Summary:
# Wellesley Municipal Light Plant, Massachusetts; Retail Electric

| Credit Profile | | |
|---|---|---|
| Wellesley Mun Light Plant ICR | | |
| *Long Term Rating* | AA/Stable | Affirmed |

## Rationale

Standard & Poor's Ratings Services has affirmed its 'AA' issuer credit rating (ICR) on Wellesley Municipal Light Plant (WMLP), Mass. The outlook is stable.

The rating reflects our view of WMLP's:

- Very strong coverage of fixed costs;
- Well-managed power supply portfolio that limits exposure to fuel-price volatility;
- Very competitive electric rates; and
- Very strong economic service area, with high incomes and easy access to the broad and diverse Boston-Lawrence-Lowell-Brockton metropolitan statistical area.

Somewhat tempering these strengths, in our view, is the utility's liquidity, which we view as just adequate for the 'AA' rating level.

WMLP's business risk profile score of '3' reflects what we believe to be a prudent and proactive management team, sound operations, a supportive state regulatory environment, and a strong competitive position. We assign business risk profiles on a scale from '1' to '10', '1' being the strongest.

The utility provides electric service to more than 10,000 mostly residential customer meters in the town of Wellesley, Mass. and other unincorporated areas. Wellesley, in Norfolk County, is a 10.5 square mile, mostly residential community, approximately 13 miles west of Boston. Although the 10 leading customers accounted for about 27% of 2015 revenue, the stability of the leading customers, most of whom are educational or financial service establishments, mitigates our concern regarding concentration. Leading customers include Babson College, Sun Life Financial Inc., and Wellesley Office Park Association.

Wealth and income levels in Wellesley are very high, in our view, at 197% of state and 240% of national household effective buying income. The unemployment rates in the town are extremely low, well below the state and national averages. For 2015 the unemployment rate was 3.5%, lower than the state's 4.9% and nation's 5.3%.

WMLP has no generation facilities of its own and purchases the majority of its power through Energy New England (ENE). For fiscal 2015 (year ended June 30), it had contracts for 95% of its power requirements, purchasing the remaining 5% on the spot market through ENE. WMLP implemented a 100% fixed-block hedging strategy in fiscal

2016 to reduce its exposure to spot market volatility. As part of the new strategy, the utility has contracted 98% of fiscal 2016, 96% of fiscal 2017, 95% of fiscal 2018, 94% of fiscal 2019, and 71% of fiscal 2020 power requirements. We understand that WMLP has kept a 30% open position for fiscal 2020 while it continues to evaluate the requirements of the Massachusetts Global Warming Solutions Act legislation. Wellesley also has a 10% entitlement (11 megawatts) in the Braintree Watson Peaking Plant. It is responsible for 10% of the payments associated with debt issued to build the plant. The entitlement runs for 20 years, a WMLP can extend for one or more five-year periods.

The utility's distribution system is well-maintained; all but one of the nine supply lines are underground (with the one exception reserved for emergency use), and all are less than 20 years old. Two of its three substations have been completely rebuilt in the past 10 years, with the third scheduled to be replaced in 2020. In addition, the utility is on track to replace all of its 33 distribution circuits over a rolling 35-year period. Management's proactive maintenance has resulted in what we view as a manageable five-year capital program, totaling $17.45 million.

We believe Wellesley's retail electric rates are very competitive. According to 2014 Energy Information Administration data, the overall rate for customers was only 81% of the state average. WMLP is conducting a cost-of-service study in 2016. However, we understand that management does not expect to change rates as a result, nor does it have any rate changes planned in the next five years.

Although deregulation became law in Massachusetts in 1997, public power systems in the commonwealth operate in a very supportive regulatory environment. They have the option to prohibit retail choice in their service area as long as they are not selling generation service to customers outside of their territory. By 2003, however, the commonwealth required public power systems that have not offered retail choice to engage in a retail choice study. Under current law, municipal entities are required to do no more than engage in a study; they are not required to open up their service area. WMLP has not opened its service area for retail choice, but we believe it is well-positioned to compete in a retail access environment given its strong financial performance, rates that are currently competitive and likely to be even more so, and good relationships with its major customers.

Unrestricted cash plus the depreciation fund (designated for capital investment, but also available for working capital purposes) provided what we view as adequate liquidity, equaling approximately 70 days' worth of operating expenses in fiscal 2015. Management expects liquidity to remain above 80 days' operating expenses over the next five years, which we also view as adequate. Projected amounts include the funding and subsequent draw-down of a $5 million rate stabilization fund, which management plans to use to absorb increased capacity costs, in lieu of rate increases.

Fixed cost coverage, which compares net income minus the payment in lieu of taxes to the town plus the capacity charge included in purchased power costs, plus both on- and off-balance-sheet debt, was 1.82x in 2015, and has exceeded 1.8x over the past five years. Management projects fixed cost coverage to drop to a just-adequate 1.15x, or 1.40x after a transfer from a rate stabilization fund, due to increased capacity costs in 2018. We expect fixed cost coverage to rise to 1.96x by 2020.

## Outlook

The stable outlook indicates our expectation that WMLP will maintain strong financial metrics appropriate for the 'AA' rating.

### Upside scenario

We do not expect to raise the rating during the two-year outlook period because we expect the utility will maintain fixed cost coverage in line with historical levels.

### Downside scenario

If WMLP's liquidity or fixed charge coverage levels decline significantly, or if the utility does not make the rate stabilization fund transfers necessary to maintain fixed cost coverage levels, we could lower the rating.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Electric And Gas Utility Ratings, Dec. 16, 2014
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.