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## Summary:

# Wellesley Municipal Light Plant, Massachusetts; Retail Electric

### Primary Credit Analyst:

Judith G Waite, New York (1) 212-438-7677; [judith\\_waite@standardandpoors.com](mailto:judith_waite@standardandpoors.com)

### Secondary Contact:

David N Bodek, New York (1) 212-438-7969; [david\\_bodek@standardandpoors.com](mailto:david_bodek@standardandpoors.com)

### Research Contributor:

Sunita S Nair, Mumbai; [sunita\\_nair@standardandpoors.com](mailto:sunita_nair@standardandpoors.com)

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### 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 assessment of various credit factors we view as strengths:

- A strong financial risk profile;
- A well-maintained electric distribution system;
- A well-managed power supply portfolio;
- Competitive electric rates;
- An affluent service area that allows for rate flexibility; and
- No debt outstanding, with a manageable \$18.7 million, five-year capital improvement program that the utility intends to fund with cash.

Although WMLP's board has adopted a conservative strategy for power supply procurement, the bilateral contracts could require the utility to post collateral under certain circumstances. We believe WMLP's strong financial risk profile mitigates this potential credit risk.

The business risk profile score of '2' 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.

WMLP provides electric service to more than 10,000 mostly residential customer meters in the town of Wellesley, Mass. and other unincorporated areas. Although the 10 leading customers account for about 23% of revenue, the stability of the leading customers, most of whom are educational and financial service establishments, mitigates our concern regarding concentration. The town has indicated that it maintains extremely good relationships with its major customers, who are pleased with both the cost and reliability of service. Further strengthening this is that WMLP had 11.4% of its customers participating in the voluntary renewable energy program, at the end of fiscal 2012. 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, 203% of state and 235% of national household effective buying income. The unemployment rates in the town are extremely low, well below the state and national

averages. For 2012 the unemployment rate was at 4.0%, lower than the state's 6.5% and nation's 8.1%.

WMLP has no generation facilities of its own and purchases most of its power through Energy New England (ENE), a power broker in which Wellesley has a 5% ownership share. For fiscal 2012 (year ended June 30), it had contracts for 84% of its power requirements, purchasing the remaining 16% on the spot market through ENE. The utility has contracts for 92% of fiscal 2013, 71% of fiscal 2014, 53% of fiscal 2015, 43% of fiscal 2016, and 22% of fiscal 2017 power requirements. We understand that the utility is locking-in its remaining energy purchases for fiscal years 2013-2017. Wellesley also has a 10% entitlement (11 megawatts) in the Braintree Watson Peaking Plant. WMLP is responsible for 10% of the payments associated with debt issued to build the plant. The entitlement runs for a 20-year period, with WMLP option to extend for one or more five-year periods.

We believe Wellesley's retail electric rates are competitive. Using 2011 Energy Information Administration data, the rate for residential customers was 14.09, lower than the state's average of 14.67. Based on a comparison with 43 municipal and investor-owned electric utilities in eastern Massachusetts, the town's residential rate is ninth from the lowest, based on 500 kilowatt-hour monthly usage. The utility had increased its rates from 2006-2010, but in October 2012 the rates for residential, commercial, municipal and primary customers fell 5%. We understand that the management does not have any rate changes planned. WMLP maintains modest open positions for near-term power that can result in deviation from these costs, but any variance should be manageable. The requirement to post collateral under the terms of purchased power contracts is minimal, according to a summary of contract terms from ENE.

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 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 the utility's strong financial performance, zero debt position, rates that are currently competitive and likely to be even more so, current cost-cutting initiatives, and good relationships with its major customers.

We believe the utility has a track record of strong financial performance, and the forecast indicates that financial metrics will continue to reflect that strength. In fiscal years 2008-2009, financial metrics weakened since rate increases lagged behind the increased cost of purchased power. However, higher electricity rates and electric sales, combined with a conservative 1.5% increase in annual power usage, have enabled the utility to improve its financial performance. Fixed charge coverage, which compares net operating cash to the purchased power capacity charge (and debt service, if any), had slipped to 1.4x in 2008 and 1.0x in 2009, but improved to 1.7x in fiscal 2010, 2.3x in fiscal 2011 and 2.6x in fiscal 2012. The forecast for fiscal years 2013-2017 projects the fixed charge coverage to exceed 1.9x.

Days' cash on hand had been more than 400 in 2007, but declined to 60 in 2010. For fiscal years 2011 and 2012, the unrestricted cash levels were about \$5 million, equal to about 70 days of cash operating expense. We understand that the management has been building its reserves to pay for the 8,400 square foot administrative building addition, which

will cost about \$2.9 million and is to be complete by June 2013. The forecast for fiscal years 2013-2017 projects the unrestricted cash to remain at about \$5 million, which we believe provides adequate liquidity. Since purchased power costs are passed along to retail customers every month, the need for surplus cash is limited. However, WMLP would need cash if it required collateral to support a purchased power contract. Wellesley does not maintain lines of credit.

## **Outlook**

The stable outlook reflects our view that management will maintain a strong financial risk profile with credit metrics that are appropriate for the 'AA' rating. Management does not expect to issue debt to fund capital investment, and fixed charges associated with purchased power are moderate. We do not expect to raise or lower the rating during our two-year outlook horizon.

## **Related Criteria And Research**

USPF Criteria: Electric Utility Ratings, June 15, 2007

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