

RatingsDirect®

Wellesley Municipal Light Plant, Massachusetts; Retail Electric

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Wellesley Municipal Light Plant, Massachusetts; Retail Electric

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Wellesley Mun Light Plant ICR

Long Term Rating

AA/Stable

Affirmed

Rationale

S&P Global Ratings affirmed its 'AA' issuer credit rating (ICR) on Wellesley Municipal Light Plant (WMLP), Mass. The outlook is stable.

The rating reflects the application of our "U.S. Municipal Retail Electric And Gas Utilities: Methodology And Assumptions" criteria, published Sept. 27, 2018, on RatingsDirect.

WMLP is a distribution-only system that supported just \$979,000 in notes payable as of June 30, 2018.

The rating reflects our opinion of the electric system's very strong enterprise and financial risk profiles.

The enterprise risk profile reflects our view of the system's:

- Very strong service area economic fundamentals, as evidenced by its primarily residential customer base with extremely strong income levels and access to Boston's deep employment base;
- Extremely strong industry risk relative to other industries and sectors;
- Extremely strong market position, due to its weighted average system rate that was 14.1% below the state average in 2017, combined with extremely strong income levels in the service area, which provides further revenue-raising flexibility; and
- Very strong operational management assessment (OMA), reflecting its limited operating risk as a distribution system; well-managed power supply portfolio that limits exposure to fuel-price volatility; and management's robust financial policies and practices, including credit supportive rate-setting practices and annually updating its five-year financial forecasts and capital plans.

The financial risk profile reflects our view of the system's:

- Very strong coverage metrics, despite weak fixed-charge coverage in fiscal 2018 due to increased capacity market costs and we believe the system's rate adjustment in October 2017 will improve fixed-charge coverage to at least very strong levels beginning in fiscal 2020, which are likely sustainable;
- Strong liquidity and reserves for a distribution system, while we note liquidity is projected to decline to just adequate levels in fiscal 2019, we expect levels will improve and be maintained at strong levels; and,
- Extremely strong debt and liabilities profile, suggested by very little debt outstanding, coupled with plans to cash fund its capital improvement plan (CIP).

Outlook

The stable outlook reflects our view of the system's primarily residential and affluent customer base, coupled with highly competitive rates, which provides revenue-raising flexibility. In addition, the system does not have additional debt needs and we expect WMLP will maintain very strong financial metrics.

Upside scenario

We do not expect to raise the rating during the two-year outlook period because of the system's weak fixed-charge coverage for unaudited fiscal 2018 and as projected for fiscal 2019, which is not supportive of a higher rating.

Downside scenario

If higher-than-projected power costs cause WMLP's liquidity or fixed-charge coverage levels to remain thin or inadequate and actual financial performance does not improve as projected, we could lower the rating.

Utility Description

WMLP provides electric service to more than 10,110 mostly residential customer meters in the town of Wellesley and other unincorporated areas. WMLP purchases almost all of its power from Energy New England LLC (ENE) and has entered into firm energy purchase commitments through 2023 to reduce exposure to higher spot market prices during summer and winter peak periods. The system's electric rates remain highly competitive and provide revenue-raising flexibility to address unforeseen needs.

Enterprise Risk

Economic fundamentals: Very strong

We believe the electric system's customer base benefits from its convenient access to Boston's deep employment base, as evidenced by its extremely strong income levels. 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 25% of 2017 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, Wellesley Office Park Association, Sun Life Financial Inc., and Wellesley College.

Income levels in Wellesley are very high, in our view, at 214% of state and 259% of national median household effective buying income. The unemployment rates in the town are extremely low, well below the state and national averages. For 2017 the unemployment rate was 3.0%, lower than the nation's 4.4%.

Industry risk: Extremely strong

Consistent with "Methodology: Industry Risk" (published Nov. 19, 2013), we consider industry risk for municipal retail electric and gas utilities covered under these criteria as very low, and therefore extremely strong compared with other industries and sectors.

Market position: Extremely strong

We believe the system's rates are very competitive and its town's extremely strong income levels provide revenue-raising flexibility despite its small size. Based on the U.S. Energy Information Administration's latest available data from 2017, the system's weighted average system rate competitiveness (based on relative customer classes' revenue contributions) is 85.9% of the state average. Management reviews its discretionary power cost adjustment (PCA) mechanism monthly, and last raised its PCA in October 2017 to support higher forward capacity market costs. Officials do not have any future base rate increase plans.

Operational management assessment: Very strong

We consider the system's power supply well-managed by entering into fixed-price energy purchase commitments that limit exposure to fuel-price volatility. WMLP has no generation facilities of its own and purchases almost all of its power through ENE with capacity costs based on by ISO-New England policies. For 2017, it had contracts for 97% of its power requirements, purchasing the remaining 3% 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. Through these energy purchase commitments with ENE, WMLP has locked in energy prices at a fixed rate. As part of the strategy, the utility has contracted 104% of 2019 power requirements, 100% of 2020, 60.7% of 2021, 47.8% of 2022, and 35.7% of 2023. 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, and WMLP can extend for one or more five-year periods. In our view, the system's financial management policies and practices are very strong. Management has exceeded its \$5 million minimum liquidity policy since fiscal 2016, and annually makes a \$1 million payment in lieu of taxes (PILOT) to the town of Wellesley. In addition, management updates its five-year capital plan and financial forecast annually.

Financial Risk

Coverage metrics: Very strong

In our view, the system's fixed-charge metrics have been robust and despite a decline for unaudited fiscal 2018, we expect fixed-charge coverage metrics will improve as projected to at least very strong levels in fiscal 2020. Fixed-charge coverage, which compares net income minus the PILOT to the town plus the capacity charge included in purchased power costs, plus both on- and off-balance-sheet debt, was 1.7x in fiscal 2017, and has exceeded 1.8x over the past five years. Management projects fixed-charge coverage to just below 1.0x for unaudited fiscal 2018, because of increased capacity costs in 2018 due to capacity shortfalls in the northeast Massachusetts load zone. Following a PCA increase in 2017, combined with lower projected capacity charges, we expect fixed-charge coverage to improve to about 1.2x in fiscal 2019 and to 1.8x by fiscal 2020.

Liquidity and reserves: Strong

Given that the system is exposed to limited operational risks as a distribution utility, we consider these liquidity levels strong for a system this size. WMLP ended fiscal 2017 with \$9.4 million of unrestricted cash and investments, or a strong 116 days' cash on hand. While we note management intends to draw down cash to due to higher capacity costs to 69 days in fiscal 2019, we believe liquidity levels will rebound to strong levels in fiscal 2020.

Debt and liabilities: Extremely strong

We expect the system's very low debt burden will be maintained as it cash funds its CIPs. The system supported just \$979,000 in notes payable as of June 30, 2018. 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 \$22.5 million.

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