S&P Global Ratings

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Summary:

Wellesley Municipal Light Plant, Massachusetts; Retail Electric

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Credit Profile		
Wellesley Mun Light Plant ICR		
Long Term Rating	AA/Stable	Current

Credit Highlights

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

Security

The ICR represents our view of the utility's capacity and willingness to meet its financial commitments as they come due and does not apply to any specific financial obligation. We note that WMLP had $560,000 in debt outstanding as of June 30, 2023.

Credit overview

The rating reflects our view that WMLP's robust economic base and competitive rates provide ample rate-raising flexibility. We also incorporated in our analysis WMLP's recent track record of sound fixed charge coverage (FCC), which averaged 1.80x from fiscal 2021-2023 and which we believe will remain sustainable over the next five years. Our analysis also incorporates our view of WMLP's proactive risk management practices and financial planning, which mitigate cost uncertainty, and its lack of debt burden and no additional debt plans.

The rating further reflects our view of WMLP's following credit strengths:

- Stable customer base, primarily consisting of residential revenues (50% of total revenues in 2022) --although there is some customer base concentration, it is tempered by the presence of higher education institutes (including Babson College and Wellesley College), which we view as providing revenue stability;
- Exceptionally high income levels that are 165% above the national average, coupled with weighted average rates that are more than 20% below the state average, providing significant rate-raising flexibility;
- Robust fuel mix diversity provided by various power purchase agreements and sound hedging strategies, which reduce concentration in any individual unit, fuel source, or counterparty, and temper exposure to power cost volatility; and
- Sound management practices and policies, evidenced by annually updated long-range capital plans and financial forecasts, as well as regularly conducted cost-of-service studies.

Partially offsetting the above strengths, in our view, are WMLP's:

- Small number of customer accounts, somewhat limiting the utility's economies of scale; and
- Available unrestricted reserves of $8.3 million (inclusive of $1 million in a depreciation fund and $1 million in working capital deposits), equating to 97 days' operating expenses, as of June 30, 2023, which we view as just sufficient because its sizable capital improvement plan (CIP; $36 million for 2024-2028) could result in cash drawdown in future years, absent commensurate rate increases.

Environmental, social, and governance

We view environmental factors are credit neutral, as WMLP expects to exceed the state renewable portfolio standard (RPS) target of 50% noncarbon emission by 2030 and is progressing toward the goal of zero carbon emissions by 2050. The utility has a diverse power supply, almost entirely purchased through Energy New England (ENE) with Forward Capacity Market (FCM) costs based on ISO-New England policies. With no coal exposure, WMLP relies predominantly on natural gas (40% of power supply), as well as nuclear (33%), hydro (10%), wind (10%), and unidentified sources (7%), mitigating environmental risks. We also note that the utility is actively seeking new renewable contracts and has already executed four wind and solar contracts that will come into service over the next three years.

In our view, WMLP's social factors are credit-supportive, highlighted by electric rates well below the state average, combined with high-income levels that are significantly higher than the national average. We continue to monitor the strength and stability of electric utilities' revenue streams for evidence of delinquent payments or other revenue erosion. Inflation, as measured by the consumer price index, has remained above 3% in recent months, and S&P Global Market Intelligence forecasts elevated interest rates persisting through the first half of 2024, with moderate softening through the remainder of the year. (See "U.S. Economic Forecast Update: A Sturdy Job Market Keeps Growth Going," published Feb. 21, 2024, on RatingsDirect.) In addition, Bureau of Labor Statistics data shows that electricity price inflation continues to outpace the overall consumer price index. The amalgam of material increases in delinquent consumer, credit card, and auto loans, along with October's resumption of student loan payments and drawdowns of household savings garnered during the pandemic, will likely compound the financial pressures facing electricity consumers. Following stronger-than-expected U.S. economic growth through the fourth quarter of 2023, S&P Global Market Intelligence revised its 2024 real GDP growth forecast to 2.4%, from its November 2023 projection of 1.5%. S&P Global Market Intelligence believes that recent business and consumer activity are not sustainable, and projects slowing economic activity with growth of 1.5% in 2025.

We also view WMLP's governance risk factors as credit neutral, given its annually updated five-year capital plan and financial forecast, which establish both short-term and long-term priorities, along with a well-maintained liquidity target requiring a minimum of $5 million in unrestricted cash and a detailed power supply hedging policy. Despite the lack of a rate adjustment track record, management is willing to raise base rates or use its power cost adjustment mechanism, if needed, to ensure timely and sufficient cost recovery.

Outlook

The stable outlook is underpinned by our view that WMLP's robust economy, competitive rates, diverse power supply, and the lack of debt burden will continue to provide financial stability. The outlook further reflects our expectation that

WMLP will enact rate increases as needed to fund currently identified capital needs. We believe coverage metrics and liquidity will be sustainable over the next five years, based on management's financial forecast.

Downside scenario

We could lower the rating if WMLP experiences a significant and sustained deterioration in FCC and liquidity, which could occur if there is a lack of timely rate adjustments or if rate adjustments are insufficient to offset unbudgeted energy and/or capital costs.

Upside scenario

Given that we don't believe projected financial metrics will improve materially, and that the utility's small customer base could constrain flexibility to respond to net revenue volatility, we are unlikely to raise the rating within the next two years.

Credit Opinion

We believe WMLP's rate is competitive, highlighted by weighted average revenue about 27% below the state average in 2022, according to the most recent data from the U.S. Department of Energy's Energy Information Administration. Wellesley's significantly above-average incomes provide additional rate-raising flexibility on top of its already below-average rates, which we view positively. In January 2023, WMLP adopted a modest rate increase averaging 10% across all customer classes to offset rising power supply expenses and general operating costs. However, we do not expect rate competitiveness will materially weaken in the near future. WMLP also maintains a discretionary power cost adjustment (PCA) mechanism in place, which management actively monitors to maintain cash targets. PCA adjustments, which are reviewed several years at a time, provide accuracy to management's long-range financial forecasts.

In our opinion, WMLD's predominant use of purchased power contracts minimizes supply and price risk. ENE manages the light department's power purchases, with roughly 95% of electricity purchased through power purchase agreements. WMLD's power supply counterparties include entities such as NextEra, Shell, and smaller wind power providers. Wellesley also has a 10% entitlement (20-year agreement) in the Braintree Watson Peaking Plant (11 megawatts [MW]). WMLP is responsible for 10% of the payments associated with debt issued to build the plant ($875,000 per year). All of the energy purchases made in the spot or day-ahead market are passed through to Wellesley College and do not expose the utility to any market price volatility. Additionally, WMLD plans to install a 4.99 MW/15 megawatt-hour (MWh) battery storage facility behind one of its substations by fiscal year-end 2024 for peak shaving, toward reducing future needs for spot market purchases.

WMLP has exhibited robust coverage in recent years, given its average FCC of 1.80x over fiscal years 2021-2023. S&P Global Ratings treats the Watson Plant payments, 50% of purchased power expenses (excluding spot/day-ahead market purchases from ISO New England), and forward market capacity charges as part of the utility's fixed costs. We also treat PILOT as operating expenses in our calculation of fixed costs. Based on our analysis of management's forecasts, FCC will likely remain near current levels. Management's financial projections assume no rate increases, flat demand and retail revenues, and an annual 2.5% inflator applied to operating expenses, reflecting its generally conservative budgetary practices.

Wellesley Municipal Light Plant, Massachusetts--Key credit metrics			
	--Fiscal year ended June 30--		
	2023	**2022**	**2021**
Operational metrics			
Electric customer accounts	N.A.	10,444	10,202
% of electric retail revenues from residential customers	44	47	50
Top 10 electric customers' revenues as % of total electric operating revenue	19	19	22
Service area median household effective buying income as % of U.S.	265	265	258
Weighted average retail electric rate as % of state	73	73	81
Financial metrics			
Gross revenues ($000s)	40,582	39,134	37,754
Total operating expenses less depreciation and amortization ($000s)	31,128	30,642	30,461
Debt service ($000s)	85	87	101
Debt service coverage (x)	111.2	97.6	72.2
Fixed-charge coverage (x)	1.8	1.6	2.0
Total available liquidity ($000s)*	8,273	6,853	5,569
Days' liquidity	97	82	67
Total on-balance-sheet debt ($000s)	560	644	728
Debt-to-capitalization (%)	1	1	1

*Total available liquidity includes available committed credit line balances, where applicable. Debt service coverage--Revenues minus expenses divided by debt service. Fixed-charge coverage--Sum of revenues minus expenses minus total net transfers out plus capacity payments (or their proxy), divided by the sum of debt service plus capacity payments (or their proxy). N.A.--Not available.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022