FitchRatings

Public Finance
Public Power
United States

Garland, Texas (Electric)

Texas Electric UtilitySystem Revenue Refunding Bonds

New Issue

Electric Utility System Revenue Refunding Bonds, New Series 2020	AA–

Outstanding Debt

Electric Utility System Revenue Bonds, Series 2011 and 2013	AA
Electric Utility System Revenue Refunding Bonds, New Series 2014, 2015, 2016A, 2016B, 2018, 2019 and 2019A	AA-
Electric Utility System CP Notes, Series 2018 (Bank Notes)	AA-
Standalone Credit Profille	aa–

Rating Outlook

Stable

Applicable Criteria

U.S. Public Power Rating Criteria (March 2020)

Public Sector, Revenue-Supported Entities Rating Criteria (March 2020)

Related Research

Fitch Ratings 2020 Outlook: U.S. Public Power and Electric Cooperatives (Strong Affordability and Deleveraging Support Stable Outlook) (December 2019)

U.S. Public Power Rating Criteria Update (Ratings Under Criteria Observation Resolved) (October 2019)

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New Issue Summary

Sale Date: May 19, 2020

Series: $39.5 million City of Garland, Texas Electric Utility System Revenue Refunding Bonds, New Series 2020

Purpose: Proceeds will be used to refund a portion of outstanding CP notes authorized in 2018

Security: The new series 2020 bonds are payable on a subordinate lien basis from net revenues of Garland, TX's electric utility system, known as Garland Power & Light (GP&L). Outstanding senior lien obligations are payable prior to outstanding subordinate lien obligations.

GP&L's ratings and standalone credit profile (SCP) reflect the improvement in its fiscal 2019 operating performance, which was anticipated and largely driven by the elimination of fixed demand charges that were made under the utility's power supply contract (PSC) with Texas Municipal Power Authority (TMPA).

GP&L enjoys very strong revenue defensibility that is enhanced by an expanding retail customer base and favorable service area characteristics, the independent ability to set its retail distribution and wholesale power supply rates, and by the stability of its transmission business. The system's very low operating risk reflects GP&L's diverse and economic power supply, as well as the benefit of low gas price trends.

GP&L's financial profile is very strong, evidenced by its very low leverage ratio, measured as net adjusted debt to adjusted funds available for debt service, of 4.7x in fiscal 2019. Expectations are that this ratio should remain at, or below, 6.3x, consistent with the current rating through Fitch Ratings' base case and stress case scenario analysis.

The recent outbreak of coronavirus and related government containment measures creates an uncertain environment for the public power sector in the near term. While performance through most recently available data has not indicated credit impairment, Fitch has reviewed a sensitized base case that considers the impact of a steep 12% decline in energy in year one, followed by recovery spanning four years thereafter.

The 12% energy decline is especially severe, considering that load loss attributed to the coronavirus pandemic was estimated to decline just 2% within the Electric Reliability Council of Texas (ERCOT) through mid-April. The stability of GP&L's financial profile under the high-sensitized base case coronavirus stress assumptions emphasizes the strength of its liquidity and financial position.

Fitch's ratings are forward-looking in nature, and the agency will monitor developments related to the severity and duration of the virus outbreak, and incorporate revised expectations for future performance and assessment of key rating drivers.

The 'AA' rating on GP&L's senior lien bonds further reflects the small amount of remaining debt outstanding, its closed lien and the added cushion against default afforded to this lien relative to subordinate obligations.

Key Rating Drivers

Revenue Defensibility: 'aa'; Competitive Power Provider with Rate Flexibility: GP&L provides competitive electricity and services to a largely residential customer base and to municipal and cooperative power companies under multiyear contracts. The utility has the independent ability to raise retail and wholesale electric rates, and its retail rates are highly affordable.

Rating History

Rating	Action	Outlook	Date
AA–	Affirmed	Stable	10/28/19
AA–	Assigned	Stable	12/14/12

Operating Risk: 'aa'; Very Low Operating Risk: Very low operating costs reflect a diversified and economic portfolio that has benefited from low gas price trends. GP&L's operating costs improved even further in fiscal 2019 due to the elimination of TMPA demand charges. Lifecycle investment spending is moderate based on 12-year estimated age of plant and planned capital spending is well in excess of deprecation over the next five years.

Financial Profile: 'aa'; Financial Profile Stable through Stress Scenario: GP&L's leverage ratio improved to 4.7x in 2019 from 7.1x in 2015, reflecting the elimination of TMPA demand charges and margin growth. Liquidity is also improved and is neutral to the rating. The utility's financial profile remains stable through Fitch's scenario analysis.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to a Positive Rating Action/Upgrade

- Maintenance of current financial margins and liquidity.
- Reduced exposure to more volatile wholesale energy sales and related-counterparty risk.

Factors that Could, Individually or Collectively, Lead to a Negative Rating Action/Downgrade

- Significant growth in wholesale sales that is not offset by strong liquidity levels and sufficient controls to reduce related market and credit risks.
- Sustained liquidity significantly below historical levels.

Credit Profile

GP&L is a municipally owned electric services provider serving a retail customer base of approximately 72,000 customers as of fiscal 2019. The city of Garland (AAA/Stable) resides in Dallas, Collin and Rockwall counties, approximately 14 miles northeast of downtown Dallas. In addition to its retail customer base, the electric system provides wholesale electric services to a small portfolio of municipalities and electric cooperative utilities, and provides ancillary services in the ERCOT market. GP&L is an integrated utility with generation, distribution and transmission assets, and is a qualified scheduling entity in ERCOT.

Revenue Defensibility

All of GP&L's business lines exhibit very strong, monopolistic characteristics. GP&L derives its revenues from the sale of electricity and related services to retail and wholesale customers, and from provision of transmission services. The utility provides retail electric service in a noncompetitive service territory that includes approximately 80% of all electric customers within the city of Garland. The remaining 20% of the city's electric customers are served by other retail providers.

GP&L's wholesale sales are made pursuant to multiyear contracts. These include full load requirement services to the city of Farmersville and partial load requirement services to the city of College Station, Fayette Electric Cooperative, San Bernard Electric Cooperative, the city of Weatherford and Central Texas Electric Cooperative. Contract terms are staggered between 2021 and 2027.

GP&L also sells renewable resources under long-term purchase power agreements (PPAs), extending to 2036 to several utilities under terms and conditions mirroring those between GP&L and the renewable project provider. While GP&L retains payment risk, the off-takers generally consist of stable municipal and cooperative retail systems with full rate-setting authority. GP&L structures its wholesale transactions consistent with International Swaps and Derivatives Association and Edison Electric Institute standards, and its contracts provide make-whole provisions to protect the utility in the event of early termination.

The magnitude of GP&L's wholesale sales exceeds that of a typical retail public power utility, but is not considered to detract from its very strong revenue defensibility due to the extent of GP&L's retail operations, the limited contribution from wholesale sales to margins, the multiyear term of wholesale contracts, high wholesale customer credit quality and risk mitigation provisions.

Service Area Characteristics

GP&L's service area exhibits strong demographic and demand characteristics, reflecting the city's inclusion in the Dallas-Fort Worth metroplex. The utility's total retail customer base realized a five-year CAGR of .7% through 2019. Favorably, median household income (MHI) represents 98% and unemployment 92% of the 2018 U.S. averages.

Garland (2018 population approximately 242,500) is the second-largest city in Dallas County, with access to a sizable regional labor force and multimodal transportation network, capable of supporting its long-standing manufacturing base. Top employers represented in Garland include Kraft Foods, US Food Service, Atlas Copco, SilverLine Window, Hatco (Resistol), L3 Communications, Arrow Fabricated Tubing, Valspar, KARLEE and General Dynamics. The city continues to realize growth in its diverse commercial and industrial bases, including an increasing number of data center businesses.

Notwithstanding Garland's presence in the regional economy, its largely residential customer base provides GP&L with further demand stability. The utility's residential customers account for 53% and 47% respectively of 2018 electric revenues and sales. Top 10 customers accounted for only 6.5% of GP&L's fiscal 2019 total revenues.

Rate Flexibility

GP&L has the independent ability to increase its distribution retail and its wholesale PSC rates without external approval. Its retail rate structure includes a base rate and a recovery adjustment factor (RAF). Changes to the base rate require approval from city council. However, the utility director can change the RAF on a monthly basis to support financial operations. The utility's retail rates approximate the state average and electric costs are highly affordable at 2.6% of Garland's MHI.

Garland has received timely and sufficient recovery of its transmission costs of service from the Texas Public Utility Commission. Newly activated transmission assets are included in the rate base through ongoing interim capital filings.

Operating Risk

Very low operating costs, averaging 6.9 cents per kWh over the past five years, have been heavily influenced by economic fuel and energy purchases, as well as fixed demand charges from GP&L's TMPA contract obligations. The demand charge contributed close to 15% of GP&L's cost burden in fiscal 2018. Effective Oct. 1, 2018, GP&L and the other TMPA member cities elected not to extend its PSC with TMPA, ending the required demand charge.

TMPA and Gibbons Creek Steam Electric Station

Garland, and the cities of Denton, Bryan and Greenville, created the TMPA in 1975. Through TMPA, the cities developed the Gibbons Creek Steam Electric Station (GCSES), located in Grimes County, TX. The single-unit, coal-fired plant has a net capacity of 470MW and burns Powder River Basin coal.

TMPA owns the baseload coal plant and had provided power to its four members under identical court-validated, take-or-pay PSCs. The PSCs financially obligated the members to pay certain expenses to TMPA, including its debt service costs, regardless of actual plant operations. This is notable, given GP&L's large proportionate share of the unit (47%).

After an operating cycle of seasonal use, the plant was retired in October 2018. TMPA and the member cities are negotiating the possible sale of GCSES. If a sale were to occur, it would be viewed as credit neutral to positive for GP&L, as a sale would likely reduce GP&L's decommissioning liability.

Operating Cost Flexibility

GP&L transitioned its power supply from a reliance on coal to one that benefits from competitively priced market purchases and renewable PPAs) The utility's fiscal 2019 power supply is well diversified and flexible consisting of owned (natural gas-fired) capacity of 523MW, firm capacity PPA (75MW), and renewable (wind/solar) PPAs (210MW available for retail/236MW for wholesale). GP&L's natural gas-fired units represent valuable capacity in the tightening ERCOT market, serve as a physical hedge against high market prices and provide GP&L with operational flexibility. The utility's power supply provided ample capacity in relation to its fiscal 2019 retail load of 462MW.

Capital Planning and Management

GP&L's lifecycle investment needs are moderate based on Fitch's estimated 12-year average age of the plant, and planned capital spending is well in excess of depreciation over the next five years. Capital projects total $204 million between fiscal 2020 and 2024, the majority of which represent transmission lines and substation upgrades, as well as distribution system projects.

Financial Profile

GP&L's leverage ratio improved to 4.7x at fiscal YE 2019 from 7.1x in 2015, reflecting the elimination of TMPA demand charges and system growth. Liquidity is neutral to the rating, as cash on hand remains robust, growing from 295 to 446 days between fiscal 2015 and fiscal 2019. These funds include GP&L's rate mitigation fund (RMF) equal to $173.9 million as of Sept. 30, 2019. GP&L historically has managed RMF monies for strategic and competitive purposes. Coverage of full obligations dipped below 1.0x over the past five years, but is not considered weak or risk additive based on the utility's robust unrestricted cash position in excess of 120 days.

Fitch Analytical Stress Test (FAST) — Sensitized Base Case for Coronavirus

Fitch's analysis considered GP&L's projections as a starting point for FAST. GP&L's financial forecast reflects generally flat retail, somewhat declining wholesale load growth and ongoing growth in the transmission system. The base case does not include base rate changes, although Fitch considers that a potential sizable build up in cash could possibly lead to rate discussions.

Fitch assumes the cost of power to grow at the same rate as energy sales. Variability in GP&L's other expenses largely reflect its anticipated Gibbons Creek decommissioning and mine closure cost obligations. Base case capital requirements and debt issuances are informed by the utility's forecast, which Fitch considers reasonable. The base case scenario indicates that GP&L's leverage ratio will peak at 5.5x over the five-year forward period before stabilizing at about 4.5x.

Fitch expects the utility's operations to support a stable financial profile through its sensitized base case that considers the impact of the most recent economic contraction and spread of the coronavirus on demand. The sensitized base case applies a sharp 12% decline in energy demand, followed by a four-year recovery, without any compensating mitigation. GP&L's financial profile remains stable through this scenario, highlighting the utility's financial resilience. Leverage peaks at 6.2x, before recovering to levels approximating the utility's fiscal 2019 performance by 2023.

GP&L's debt profile is neutral to the rating. Following this refunding, GP&L will have approximately $11.6 million in senior (closed lien) debt outstanding, approximately $474 million in subordinate lien debt and $34.7 million in CP outstanding under its $80 million electric utility system CP notes program. GP&L also has approximately $1.2 million outstanding in general obligation bonds, carrying a pledge of ad valorem tax revenues, but funded by the electric system, to whose benefit the proceeds were applied. These obligations are included in Fitch's financial and debt metrics to ascertain GP&L's ability to service the entirety of its financial obligations from net revenues.

Fitch's higher rating on the senior revenue bonds reflects the small amount of remaining debt outstanding, its closed lien and the added cushion against default afforded to this lien relative to subordinate obligations.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations were applied in this rating determination.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Financial Summary

($000, Audited Fiscal Years Ended Sept. 30)	2015	2016	2017	2018	2019
Net Adjusted Debt to Adjusted FADS (x)	**7.05**	**6.68**	**7.13**	**8.12**	**4.72**
Net Adjusted Debt Calculation					
Total Current Maturities of Long-Term Debt	25,505	26,605	28,880	30,305	34,335
Total Long-Term Debt	396,377	409,141	469,035	499,838	527,862
Total Debt	**421,882**	**435,746**	**497,915**	**530,143**	**562,197**
+ Capitalized Fixed Charge — Purchased Power	544,117	447,883	450,140	402,536	299,022
+ Total Pension Obligation (GASB Fitch-Adj. NPL + FASB PBO)	—	21,742	22,357	0	28,478
- Total Unrestricted Cash	228,376	231,281	222,563	195,857	225,861
- Restricted Funds for Debt Service	—	—	—	0	0
Adjusted FADS for Leverage Calculation					
Total Operating Revenue	339,179	278,970	280,453	288,523	301,684
Total Operating Expenses	303,682	267,791	268,063	246,326	210,581
Operating Income	**35,497**	**11,180**	**12,390**	**42,197**	**91,103**
+ Depreciation and Amortization	14,056	14,273	15,067	16,620	18,719
+ Interest Income	1,532	1,405	1,679	2,559	6,691
+ Other Noncash Charges	6,913	36,548	36,192	6,913	6,943
Funds Available for Debt Service	**57,997**	**63,405**	**65,328**	**68,289**	**123,456**
+ Adjustment for Purchased Power	68,015	55,985	56,267	50,317	37,378
- Total Transfers/Distributions	21,436	22,544	21,602	27,884	25,587
+ Pension Expense	—	4,028	4,847	0	5,462
Coverage of Full Obligations (x)	**1.07**	**0.98**	**0.98**	**0.91**	**1.50**
Funds Available for Debt Service	57,997	63,405	65,328	68,289	123,456
+ Adjustment for Purchased Power	68,015	55,985	56,267	50,317	37,378
- Total Transfers/Distributions	21,436	22,544	21,602	27,884	25,587
Full Obligations Calculation					
Cash Interest Paid	16,179	17,656	19,131	19,964	22,544
Prior Year Current Maturities	13,815	25,505	26,605	28,880	30,305
Total Annual Debt Service	**29,994**	**43,161**	**45,736**	**48,844**	**52,849**
+ Adjustment for Purchased Power	68,015	55,985	56,267	50,317	37,378
Liquidity Cushion (Days)	**340**	**607**	**402**	**321**	**470**
Unrestricted Cash (Days)	**295**	**389**	**375**	**321**	**446**
Liquidity Calculation ($000)					
+ Total Unrestricted Cash	228,376	231,281	222,563	195,857	225,861
+ Total Borrowing Capacity	60,000	199,245	139,245	159,440	80,000
- Amounts Unavailable	25,000	69,910	123,280	159,440	68,000
Cash Operating Expense Calculation					
Total Operating Expense	303,682	267,791	268,063	246,326	210,581
- Depreciation and Amortization	14,056	14,273	15,067	16,620	18,719
- Other Noncash Charges	6,913	36,548	36,192	6,913	6,943
Cash Operating Expenses	**289,626**	**253,518**	**252,995**	**229,706**	**191,861**

FADS – Funds available for debt service. FASB – Financial Accounting Standards Board. PBO – Pension benefit obligation.
Sources: Fitch Ratings; Fitch Solutions; Lumesis; EIA; Garland, Texas.

Key Definitions

Terms	Definition	Significance
Issuer Default Rating (IDR)	An expression of overall enterprise risk and relative vulnerability to default.	Provides an opinion of the relative ability of an entity to meet financial commitments, expressed as an ordinal measure of credit risk.
Net Adjusted Debt	Adjusted debt – unrestricted cash – funds restricted for debt service	Provides an inclusive evaluation of long-term liabilities offset by funds available for debt service.
Adjusted FADS	EBITDA + interest income + 30% of purchase power expense + operating lease expense – transfers/distributions + pension expense	Provides an indication of cash flow available for the payment of debt service, adjusting for purchased power, operating lease and pension obligations.
Net Adjusted Debt to Adjusted FADS	Net adjusted debt/adjusted FADS	Provides an indication of net total leverage position against available operating cash flow.
Full Obligations	Cash interest paid + scheduled long-term principal payments + 30% of purchase power expense	Provides an indication of inclusive fixed and debt service obligations.
Coverage of Full Obligations	(EBITDA + interest income + 30% of purchase power expense + operating lease expense – transfers/distributions)/full obligations	Provides an indication of the relative cushion of operating cash flow to fixed charges.
Base Case	The expected forward-looking case in the current macroeconomic environment.	Provides the analytical starting point in the forward-looking analysis, and also informs the rating case.
Rating Case	The potential performance under a common set of assumptions.	Illustrates how cycles affect individual issuers differently, and informs the level of rating stability and credit resiliency.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.