S&P Global
Ratings

Research

Summary:

Lafayette, Louisiana; Combined Utility; Retail Electric; Wholesale Electric

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Summary:

Lafayette, Louisiana; Combined Utility; Retail Electric; Wholesale Electric

Credit Profile		
US$60.5 mil util rev rfdg bnds ser 2017 due 11/01/2035		
Long Term Rating	AA-/Stable	New
Lafayette comb util		
Long Term Rating	AA-/Stable	Affirmed
Lafayette comb util		
Long Term Rating	A+/Stable	Affirmed
Lafayette Pub Pwr Auth, Louisiana		
Lafayette, Louisiana		
Lafayette Pub Pwr Auth elec (Lafayette)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AA-' rating to Lafayette, La.'s utilities revenue refunding bonds series 2017. At the same time, S&P Global ratings has affirmed its 'AA-' rating on the city's senior-lien utility system revenue bonds, its 'A+' rating on Lafayette's subordinate-lien communications system revenue bonds, and its 'AA-' rating on Lafayette Public Power Authority (LPPA), La.'s electric revenue refunding bonds, issued for the city. The outlook is stable.

The ratings reflect our view of:

- The Lafayette Utility System's (LUS) combined utility system's sustained strong fixed charge coverage and liquidity levels; and
- The city's role as a regional economic center, providing stability to the employment and customer base, as well as the employment base's overall diversity.

We believe that the offsetting factors include the utility's sizable, predominately debt-funded, capital program, which will add leverage and potentially suppress fixed cost coverage (FCC). Also tempering our view are the underlying risks concerning the LUS' communications venture, which began serving customers in 2009. It competes directly with other providers, unlike the utility's traditional services, which are essentially monopolies. While the start-up venture's market penetration was in line with original projections, it was not until early 2012 that the system generated enough positive cash flow to fully support its operating and debt service expenses. Since then, the communications system has continued to increase market share and improve cash flow. We believe the LUS' financial performance remains strong and that it has ample capacity to support the telecom bonds, in the event that the communications system is unable to make annual debt service payments or even cease operation.

The ratings on Lafayette reflect a pledge of the LUS' combined water, sewer, and electric systems, which separately secures both the senior-lien and communications system revenue bonds. Communication system revenues also secure the communications system bonds, but the 'A+' rating reflects the LUS' subordinate-lien pledge to cover debt service obligations if net communication system revenues are insufficient. The subordinate lien results in a one-notch rating differential, which also reflects the application of our "Assigning Issue Credit Ratings Of Operating Entities" criteria (published May 20, 2015, on RatingsDirect). As of the time of publication, we did not expect any significant long-term credit impacts from Hurricane Harvey at the time of this publication.

Management anticipates using bond proceeds to refinance the majority of its utilities revenue bonds, series 2010.

The rating on LPPA reflects that of Lafayette's utility system senior-lien utility system revenue bonds. Revenues from a power sales contract with LUS secure the bonds. Payments from Lafayette come from LUS' combined electric, water, and sanitary sewer system; about 75% of all the system's operating revenues are from electric service. The rating further reflects the strength of the power sales contract and resulting cash flows to the LPPA from the LUS. The system's obligations to the authority are unconditional and take-or-pay; the LUS is the only member of the authority. Obligations to the LPPA from the LUS are operating expenses of the system, payable ahead of its own direct debt service.

We have assigned the system a business profile of '4', on a scale from '1' to '10', '1' being the lowest risk. The business profile reflects what we view as the system's rate-setting autonomy, diverse and growing customer base, adequate overall operations, and slightly above-average electric system rates.

The electric system has the most customers, at about 66,326, and typically provides about 75% of total operating revenues. The LUS primarily serves Lafayette, and a small number of customers outside city limits. Growth in metered accounts remains steady, because the Lafayette metropolitan area remains one of the highest performing in the state. Median household effective buying income is above the state average, and on par with the national average. Its growth rate is among the fastest in the U.S. Unemployment in 2016 was 6.1%. Given the depth and diversity of the regional economy, which anchors that of the five surrounding parishes as well, we believe LUS does not rely on any of its principal customers for annual operating revenues.

The system's financial and operational risk profiles have remained solid, in our view, even when stressing it for communication system contingent risks as well as off-balance sheet obligations to the LPPA for the authority's 50% interest (246 megawatts) in unit 2 of the Rodemacher plant for the bulk of the LUS' baseload energy requirements.

Lafayette's electric system, through the LPPA, is entitled to a 50% share of a 530 megawatt (MW) coal-fired power plant (Rodemacher Unit No. 2), which Cleco Power LLC operates. Cleco (30%) and the Louisiana Energy & Power Authority (20%) own the remaining 50%. Each of the partners' ownership is several, and there is no obligation to pay obligations for another partner. An agreement for joint ownership, construction, and operation governs the partners' obligations, and has an original termination date of 2017. The joint ownership agreement is in effect through June 30, 2032.

The LPPA was created in 1976 to acquire power projects and purchase electric power for Lafayette's utility system. The authority is a separate legal entity from the city, but is nevertheless governed and controlled by the consolidated city-parish government. It sells its share of the Rodemacher Unit 2 power to the LUS under a power sales contract that runs through 2047. A separate transmission service agreement covers transmission to Lafayette from the plant. The plant burns Powder River Basin coal, with both supply and rail contracts firmly in place for the near term. The three plant partners supply and manage their respective coal deliveries individually, not jointly, and the LPPA targets a 60-day reserve supply. Unit 2's cost profile is favorable, which we believe contributes to LUS' overall good competitive position and rate stability for retail service. Unit 2 has an estimated useful life of at least another 20 years. However, a conversion to gas-fired units is under consideration given low gas prices. Furthermore, a change in environmental regulations would spur consideration of additional large-scale reinvestments beyond the maintenance of efforts projects.

While LUS does have some purchased power agreements in place -- mainly federal hydropower -- the management preference is for local control and therefore to remain vertically integrated. Following the suspension and subsequent retirement the utility's Doc Bonin plant in 2017, LUS did not possess sufficient generation capacity to meet MISO requirements. As such, the utility contracted for 40 MW of capacity through May 2020, with an additional 20 MW in 2017 and 33 MW in 2018. To address capacity issues in the long term, management has set aside $120 million of its capital plan to install reciprocating engines at its Doc Bonin site.

The system's obligation to pay the service on LPPA debt is part of its fuel cost adjustment. Given the operational strengths, financial performance has remained high. Annual debt service coverage is typically 1.8x-2.1x, even when including an in-lieu-of-tax transfer payment to the consolidated city-parish general government. FCC, which factors in the transfers as well as off-balance-sheet debt the LPPA issued, but which we treat as debt-like, is what we view as strong, at about 1.6x in fiscal 2016 (audited). The LUS' financial forecast indicates similar FCC through 2019, followed by a dip in 2020 to about 1.4x because of increased debt service requirements. We still view projected levels as supporting the rating. However, high historical and projected margins have helped to offset the telecom venture's risks, and diminished FCC could amplify this credit exposure. Liquidity is what we view as strong, with unrestricted cash, including capital additions funds, equal to about seven months' of expenditures in fiscal 2016. We anticipate LUS will maintain similarly strong liquidity levels.

We believe water and sewer operations are also favorably situated. The LUS has already addressed, fully funded, and now closed previous regulatory mandates on its sanitary sewer system that many urban utilities are only now just beginning to deal with. Lafayette's raw-water supply comes from 18 wells, which are tapped into the Chicot aquifer and have not had any issues with long-term quality or quantity. Both the water and wastewater operations comply fully with all permit requirements.

The combined utility's capital improvement plan (CIP) through fiscal 2022 has $247 million in projects, most of which are in the electric and wastewater systems. Nearly half of the CIP is designated for the installation of new natural gas fired reciprocating engines at the Doc Bonin site. Other CIP projects will upgrade, renew, and expand the system to meet customer growth requirements. The LUS expects to fund 78% of the CIP with bonds, and the remainder with revenues and cash.

Outlook

The stable outlook reflects our expectation that the LUS will raise rates appropriately to achieve projected FCC that, while lower, still support the rating.

Upside scenario

We do not expect to raise the ratings in the next two years due to management's sizable capital improvement program and underlying risk with the utility's telecommunications venture.

Downside scenario

If management fails to pass through rising debt service requirements as new debt is added, resulting in significantly weakened FCC, we would likely lower the rating.

Ratings Detail (As Of August 30, 2017)		
Lafayette comb util		
Long Term Rating	A+/Stable	Affirmed
Lafayette communications sys (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Lafayette retail elec		
Long Term Rating	AA-/Stable	Affirmed
Lafayette communications sys		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Lafayette Pub Pwr Auth, Louisiana		
Lafayette, Louisiana		
Lafayette Pub Pwr Auth (Lafayette) elec rev rfdg bnds		
Long Term Rating	AA-/Stable	Affirmed
Lafayette Pub Pwr Auth (Lafayette) wholesale elec		
Long Term Rating	AA-/Stable	Affirmed

Many issues are enhanced by bond insurance.

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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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