

RatingsDirect®

Summary:

Lafayette, Louisiana
Lafayette Public Power Authority;
Combined Utility; Retail Electric;
Wholesale Electric

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Credit Profile

US\$50.0 mil util rev bnds ser 2023 due 11/01/2048

Long Term Rating AA-/Stable New

Lafayette comb util (AGM)

Unenhanced Rating AA-(SPUR)/Stable Affirmed

Lafayette communications sys (AGM)

Unenhanced Rating A+(SPUR)/Stable Affirmed

Lafayette Public Power Authority, Louisiana

Lafayette, Louisiana

Lafayette Pub Pwr Auth (Lafayette) elec rev rfdg bnds

Long Term Rating AA-/Stable Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AA-' long-term rating to the City of Lafayette, La.'s approximately \$50 million utility revenue bonds, series 2023.
- At the same time, S&P Global Ratings 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's (LPPA) electric revenue bonds, issued for the city. The city's municipal electric, water, and wastewater system does business as Lafayette Utilities System (LUS).
- The outlook is stable.

Security

LPPA is a wholesale utility that sells power exclusively to LUS through a full-requirements, take-or-pay power sales contract, whereby LUS pays obligations to LPPA with its combined systems' operating revenues before paying its own direct debt service. Accordingly, we rate LPPA's debt based on the strength of the power sales contract and the quality of cash flows to LPPA from LUS. LUS consists of electric, water, and wastewater systems. Net revenues of LUS' combined utilities secure the senior-lien revenue bonds. LUS' electric system, which represented 77% of system net revenues in fiscal year 2022, is the focus of our credit analysis. We incorporate the credit attributes of the water and wastewater systems into our analysis and factor in the diversity provided by the three utility systems. LUS had about \$185.4 million of senior debt outstanding as of fiscal year-end 2022. Series 2023 bond proceeds will be used for replacement and upgrades of aging electric, water, and wastewater infrastructure and capacity expansion of utility systems. LPPA had about \$63 million of debt outstanding as of fiscal year-end 2022. In our fixed cost coverage (FCC)

calculation for LUS, we impute LPPA's debt service as debt-like.

The communications system's (LUS Fiber) revenue bonds are secured by LUS' subordinate-lien pledge. The bonds are payable first from net revenue of the communications system. However, if LUS Fiber's net revenues became insufficient, LUS would have to meet communications system obligations by using its capital additions fund. Bond covenants require that LUS carry a minimum in the capital additions fund equal to at least 7.5% of adjusted revenue (total revenue less cost of goods sold). The current minimum requirement in the fund exceeds maximum annual debt service for the communications system bonds. The 'A+' rating reflects the subordinate pledge of utility revenues to the telecommunications debt and the application of our "Assigning Issue Credit Ratings Of Operating Entities," criteria, published May 20, 2015, which result in a one-notch rating differential. We have included the telecommunication bond payments as direct debt service of the combined utility in our analysis. LUS had about \$75.8 million of communications system subordinate debt outstanding as of fiscal year-end 2022, representing about one-third of total LUS debt.

Credit overview

LUS' multiyear track record of sound financial performance, robust cost recovery through base-rate increases and its monthly power cost adjustment (PCA), and comprehensive long-term capital and financial planning support the rating. These factors are tempered by the near-term cost pressure from LUS' large capital needs, which total about \$470 million (inclusive of the new generation plant project) for fiscal years 2023-2027, combined with sizable debt plans that include the series 2023 bonds and an additional \$317 million that management could issue in fiscal years 2024 and 2026. Nevertheless, we view favorably the transition, as the anticipated decline in carbon emissions will meaningfully mitigate LUS' exposure to outsize environmental compliance costs. The new plant will also enhance system reliability and provide flexibility to accommodate future technologies. Project costs are sizable and rising debt will pressure financial metrics, but we believe management's proactive rate adjustments will ensure financial stability. These include approved base-rate increases across three utility systems (8.5% water, 9% wastewater, and 3% electric annually) through fiscal 2025, and base-rate increases (3.5% electric annually) in fiscal years 2026-2028 and (5% water and 5% wastewater annually) in fiscal years 2027-2028. However, in light of ongoing inflation and supply chain constraints, uncertainties remain over the next five years as to whether the new generation asset is completed on schedule without significant cost overruns.

The rating further reflects our view of LUS' credit strengths:

- Predominantly residential customer base (46% of total revenue in 2022), the presence of a large higher education institute (the University of Louisiana), and leading industrial and commercial customers provide revenue stability.
- Competitive rates, reflected by weighted average system rates that were 15% lower than the state average based on the most recent data from the U.S. Energy Information Administration, promote revenue-raising flexibility.
- FCC, averaging 1.4x from 2020-2022 (inclusive of LUS Fiber's debt service), is sound. Based on our view of LUS' financial forecast, FCC will likely stay above current levels over the next five years because future rate increases will offset rising debt service and provide additional financial flexibility.
- The utility's liquidity position is consistently solid measuring \$120 million in unrestricted reserves or 193 days of operating expenses as of fiscal year-end 2022 (inclusive of the capital additions and contingencies fund).

Tempering these credit strengths are the following factors:

- High reliance on market purchases (45% of energy requirements in 2022) exposes the utility to market price volatility, although partially offsetting this is LUS' access to diverse power supply from the MISO market that helps enhance reliability.
- Although we consider the debt-to-capitalization ratio (24% as of fiscal year-end 2022) low because LUS is a combined system, planned significant bond issues in the near term could bring the ratio to above 40%, which will moderately stress LUS' debt profile.
- Although LUS Fiber has been self-supporting with steady customer growth since 2012, we believe operational and financial risks exist largely due to the competitive nature of the telecommunications industry. LUS Fiber could face aggressive responses from commercial incumbents, including dropping prices or advancing technology, which might pressure LUS' FCC and liquidity.

Environmental, social, and governance

We view the utility's environmental risks as moderately elevated within our credit rating analysis, in part due to the exposure to costs related to carbon emission regulations given its reliance on coal-fired generation purchased through LPPA. Partially offsetting this risk in future years is the combination of the addition of a new natural gas combustion turbine, the decommissioning of Rodemacher unit 2 (RPS2) in late 2027, and new 100 MW solar power purchase agreements that are expected to come online by 2028. Nevertheless, LUS' fuel mix will remain highly reliant on fossil fuels, and future state or federal legislation could further restrict carbon dioxide emissions. LUS also faces heightened but manageable physical environmental risks given its location in an area prone to extreme tropical weather events. Hurricane Laura and Hurricane Delta in 2020 caused about \$9.6 million damage, although neither materially affected LUS' financial performance. LUS is investing significantly in system-hardening activities including replacing aging distribution and transmission poles and undergrounding distribution lines.

We believe the utility's social factors are credit neutral, given its weighted-average rate is 15% below the state average. LUS will raise electric rates moderately every year from fiscal 2024 to 2028. However, given the size of the rate increase, we do not expect LUS' competitive position will materially weaken in the short term. Following stronger-than-expected U.S. economic growth through the third quarter of 2023, S&P Global Economics believes that recent business and consumer activity are not sustainable and projects slowing economic activity in the fourth quarter of 2023, along with tepid economic growth of 1.3%-1.4%, respectively in 2024-2025 (See "Economic Outlook U.S. Q4 2023: Slowdown Delayed, Not Averted," published Sep. 25, 2023, on RatingsDirect). Although inflation is softening, S&P Global Economics projects elevated interest rates through 2024. Consequently, we continue to monitor the strength and stability of public power utilities' revenue streams for evidence of delinquent payments or other revenue erosion.

We believe the utility's governance factors are also credit neutral, as LUS has full rate-setting autonomy and maintains comprehensive long-term forecasts and capital plans, which in our view enhances financial and operational stability.

Outlook

The stable outlook reflects our view that LUS' diverse and primarily residential customer base, coupled with approved annual rate increases through fiscal 2025 and its monthly PCA, will support steady FCC. We also expect LUS' ample unrestricted reserves will provide sufficient cushion against extreme weather events, operational risks related to LUS Fiber, and uncertainties associated with the replacement generation project. Furthermore, despite anticipated significant debt issues in fiscal years 2024 and 2026, we view the size as manageable regardless of whether management decides to issue through LUS or LPPA.

Downside scenario

We could lower the rating if LUS' competitive position significantly worsens over an extended period, limiting rate-raising flexibility and causing delayed or insufficient cost pass-through; or if the cost for the new generation plant turns out to be substantially higher than the preliminary estimate, which could meaningfully impair financial performance either due to additional debt issues or an outsize cash drawdown.

Upside scenario

In our view, the possibility of a positive rating action is constrained by uncertainties associated with energy transition, the sizable capital improvement program, and rising debt burden.

Credit Opinion

LUS' electric system serves about 70,000 retail electric customers primarily from its partially owned coal-fired plant, RPS2, through LPPA (48% of energy in 2022), and two natural gas fired combustion turbines, T.J. Labbe and Hargis-Hebert (8% of energy). The remaining power supply consists of market purchases (45% of energy) from the Midcontinent Independent System Operator market and a negligible amount of hydroelectric power from Southwest Power Administration. LUS dispatches its power generation into the market and purchase all energy requirements from the market.

In July 2023, LUS (50% ownership share), Cleco Power (30% ownership share), and the Louisiana Energy & Power Authority (20% ownership share) announced the 42-year-old RPS2 would be retired in late 2027 due to ongoing maintenance expenses and high renovation costs required to meet federal environmental standards. To compensate for the loss of baseload power from RPS2, LUS will build a 240-megawatt natural gas fired combustion turbine at the Doc Bonin operations center, with an estimated operation date in early 2028. LUS will be the sole owner of the new generation plant and anticipates financing construction, which could cost \$317 million based on preliminary estimates, exclusively through bond issues. Future bonds are anticipated to be issued in conjunction with rate increases. When LUS plans to retire RPS2 by the end of 2027, we estimate LPPA will have approximately \$38 million Rodemacher debt outstanding, which would represent 8% of total LUS debt (inclusive of the new generation project debt), and be recovered through 2032.

Lafayette Utilities System, Louisiana--Key credit metrics

	--Fiscal year ended Oct. 31--		
	2022	2021	2020
Operational metrics			
Electric customer accounts	70,865	70,096	69,364
% of electric retail revenues from residential customers	46	45	45
Top 10 electric customers' revenues as % of total electric operating revenue	13	13	12
Service area median household effective buying income as % of U.S.	87	87	82
Weighted average retail electric rate as % of state	85	85	92
Financial metrics			
Gross revenues (\$000s)	281,947	233,667	218,589
Total operating expenses less depreciation and amortization (\$000s)	227,981	187,132	168,666
Debt service (\$000s)	33,281	34,527	34,805
Debt service coverage (x)	1.62	1.35	1.43
Fixed-charge coverage (x)	1.52	1.29	1.36
Total available liquidity (\$000s)*	120,408	122,766	131,800
Days' liquidity	193	240	285
Total on-balance-sheet debt (\$000s)	185,430	201,055	215,615
Debt-to-capitalization (%)	24	26	28

*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

Ratings Detail (As Of September 29, 2023)

Lafayette communications sys (BAM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
Lafayette communications sys (BAM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
Lafayette taxable retail elec (BAM)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Lafayette util (AGM)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Lafayette Public Power Authority, Louisiana		
Lafayette, Louisiana		
Lafayette Pub Pwr Auth (Lafayette) taxable retail elec (BAM)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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