

# RatingsDirect®

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**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\$78.04 mil taxable utils rev rfdg bnds ser 2021 due 11/01/2028             |            |     |
| <i>Long Term Rating</i>   | AA-/Stable | New |
| US\$38.625 mil taxable elec rev rfdg bnds (Lafayette) ser 2021 due 11/01/2032 |            |     |
| <i>Long Term Rating</i>   | AA-/Stable | New |
| US\$7.13 mil communications sys rev rfdg bnds ser 2021B due 11/01/2031        |            |     |
| <i>Long Term Rating</i>   | A+/Stable  | New |
| US\$6.705 mil communications sys rev rfdg bnds ser 2021A due 11/01/2031       |            |     |
| <i>Long Term Rating</i>   | A+/Stable  | New |

## Rating Action

S&P Global Ratings assigned its 'AA-' rating to Lafayette, La.'s \$78.04 million utilities revenue refunding bonds series 2021; its 'A+' rating to Lafayette's combined \$13.84 million subordinate-lien communication systems revenue refunding bonds series 2021; and its 'AA-' rating to the Lafayette Public Power Authority's (LPPA) \$38.63 million revenue refunding bonds series 2021, issued for the city. At the same time, S&P Global 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 LPPA's electric revenue refunding bonds, issued for the city. The outlook is stable.

Management anticipates using bond proceeds to refund various outstanding series for each system.

The ratings reflect a pledge of the Lafayette Utilities System's (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 related 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. The rating on LPPA's debt reflects that on 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 76% of the system's operating revenues are from the electric service. The rating further reflects the strength of the power sales contract and resulting cash flows to LPPA from LUS. The system's obligations to the authority are unconditional and take-or-pay; LUS is LPPA's only member. Obligations to the authority from LUS are operating expenses of the system, payable ahead of its own direct debt service.

## **Credit overview**

The utility does business as Lafayette Utilities System (LUS).

The ratings reflect our view of the following factors, including the utility's:

- Very strong service area economic fundamentals, reflecting a large, primarily residential and diverse customer base; however, we note incomes have declined in recent years due to the downturn in the oil and gas industry;
- Competitive rates, based on the utility's weighted-average electric system rates that were 7% below the state's average in 2019; LUS' low rates provide the utility with ratemaking flexibility;
- Robust financial metrics. Fixed-charge coverage metrics, after annual transfers to the city and adding telecommunications bond debt service, have averaged more than 1.4x over the past three years. Our calculations based on management's financial forecast indicate the maintenance of similar levels. Liquidity was similarly strong with \$131 million in total available liquidity, or about 285 days' cash, as of fiscal year-end 2020. These metrics provide the system with financial flexibility, in our view; and
- Credit-supportive operational and management assessment, as evidenced by the utility's participation in the Midcontinent Independent System Operator (MISO), which provides enhanced reliability and power supply diversity to the system. This is offset somewhat, in our view, by the system's carbon footprint, highlighted by its ownership in coal-fired generation, which could expose it to environmental regulation costs. We view the system's rate-setting practices and financial management policies positively, with a regularly updated financial and capital plan, as well as management's monthly review of system rates.

The stable outlook reflects our expectation that LUS will pass through escalating debt service costs, ensuring the system sustains fixed-charge coverage and liquidity metrics in line with historical levels.

## **Environmental, social, and governance factors**

We view the utility as having greater environmental risk than that of peers because of the system's ownership in the Rodemacher 2 coal plant. Coal has represented as much as 50% of LUS' energy portfolio in the past, although it accounted for about 33% in 2020. Management expects that the coal unit will potentially be retired in 2027, at which point LUS will need to source replacement power. The current engineer's report indicates the replacement power would likely be sourced through a new simple cycle gas turbine plant at the existing site. Ultimately, LUS could face additional cost pressures and/or a dramatically increased debt burden as it seeks a new power source in the future. While the projected elimination of coal from its portfolio is favorable from an environmental perspective, LUS' portfolio will remain heavily sourced from carbon-based assets.

In addition, the utility has elevated environmental risk due to its ongoing exposure to hurricanes. LUS experienced \$2.5 million in damage from Hurricane Laura and \$7.1 million in damage from Hurricane Delta in 2020 alone, highlighting this exposure. It was able to restore power in 1.5 days and four days, respectively, despite the destruction caused by each storm. Management reported it expects to recover 60%-70% of these costs from Federal Emergency Management Agency reimbursements over the next one-to-two years.

We view LUS' governance and social factors as being in line with those of peers, highlighted by affordable rates, sound long-term financial and capital planning, and proactive rate-setting practices. The operation of a competitive telecommunications enterprise does highlight a higher level of risk appetite; however, we believe management has

appropriately addressed this risk through staffing and risk management.

## **Stable Outlook**

### **Upside scenario**

We do not expect to raise the ratings in the next two years due to financial projections that indicate a largely flat financial profile, coupled with the utility's significant carbon footprint. However, if the utility can achieve and sustain both liquidity and coverage metrics at materially stronger levels, we could raise the rating.

### **Downside scenario**

If management fails to pass through costs, whether due to shifts in power supply expenses or capital spending, resulting in significantly weakened fixed-charge coverage or suppressed liquidity, we would likely lower the ratings.

## **Credit Opinion**

### **Enterprise risk**

We consider the combined utility's primarily residential customer base to be diverse, providing a predictable revenue stream that is credit supportive. In our opinion, the electric system customer base is very diverse, with the 10 leading customers accounting for about 12% of total system revenue in fiscal 2020. Residential customers accounted for 40% of retail electric revenue in fiscal 2020, which we believe further contributes to revenue stability.

Based on data from the U.S. Department of Energy's Energy Information Administration for 2019, LUS' weighted-average system-rate competitiveness (based on relative customer classes' revenue contributions) was 93.6% of the state average. Management reviews its rates monthly, and maintains a discretionary fuel cost adjustment mechanism that allows it to directly pass through fuel, purchased power, environmental, and various other costs to customers. LUS enacted this fuel cost adjustment to recover approximately \$4 million of unbudgeted power costs resulting from the February 2021 storm, with full recovery completed over an eight-month period. Management reported its fleet fared well throughout the storm, which helped the utility avoid \$4 million-\$5 million in additional power and fuel costs.

Lafayette's electric system, through 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. The joint ownership agreement is in effect through June 30, 2032. Lafayette's participation in the Rodemacher plant exposes it to potential costs through environmental regulation. LUS purchases all of its power supply requirements from MISO, with a portion of its expenses being offset by MISO's economic dispatch of the system's owned generation units. We believe Lafayette's participation in MISO provides significant power supply diversity to the utility, offsetting some of the risk associated with its participation in a large coal plant. LUS projects decommissioning unit 2 in 2027, replacing it with a similar-size simple cycle gas-fired plant. However, these plans could change based on economic and regulatory shifts. The utility will likely face additional costs associated with retiring the plant, as well as potential new

costs for its to-be-determined replacement power source.

We believe water and sewer operations are favorably situated. 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 tap into the Chicot aquifer and have not had any issues with long-term quality or quantity. Both the water and wastewater operations comply with all permit requirements.

Somewhat offsetting the combined utility's strengths noted above, in our view, is LUS' communications endeavor. LUS created a communications system in 2009, providing cable TV, internet, and phone services over a fiber optic network to residential and business customers. The fiber optic venture leverages an existing backbone used for operational and wholesale purposes. It is outside the bounds of the system's traditional monopoly practice, in that it competes for customers. According to bond covenants, under some conditions, the utilities system would have to meet communications system obligations with funds in its capital additions fund. Furthermore, bond covenants require that LUS carry a minimum in the capital additions fund equal to at least 7.5% of adjusted revenue. The current minimum requirement in the fund exceeds maximum annual debt service (MADS) for the communications system bonds. While the system has been cash flow-positive since 2012, there is some financial risk to the combined utility system given the enterprise's competitive nature.

We view the utility's financial management policies and practices as very strong. Management regularly engages consulting engineers to prepare engineer's reports, which provide a significant amount of information regarding Lafayette's combined utility, its telecommunications enterprise, and LPPA. Accompanying these reports are management's annually updated multiyear financial and capital forecasts. We also believe LUS' rate-setting practices are very strong. Management reviews its rates monthly, and maintains a credit-supportive fuel cost adjustment mechanism that allows it to directly pass through its variable costs to customers.

### **Financial risk**

The system's obligation to pay the debt service on LPPA debt is part of its fuel cost adjustment mechanism. Accordingly, we have imputed these costs as debt-like in our fixed-charge coverage calculation. Furthermore, we have included the telecommunication debt service as direct debt of the combined utility in our analysis, given the subordinate pledge of utility revenues to the telecommunications debt. Although telecommunications revenues have been pledged to the subordinate-lien debt, they are not pledged to the senior-lien debt. Accordingly, we have not included telecommunications revenues in our all-in fixed-charge coverage calculation, which has averaged 1.43x over the past three years. Management's projections indicate that fixed-charge coverage will generally meet or exceed historical performance. We believe the assumptions underpinning the forecast are reasonable.

Including the substantial \$123 million available in the capital additions fund, total available liquidity was very strong, equivalent to \$131 million, or 285 days' cash on hand, in fiscal 2020. We believe robust liquidity is especially important given the risks related to the utility's telecommunications utility.

We believe LUS' debt and liabilities capacity is solid for a combined utility, as evidenced by the system's 30% debt-to-capitalization ratio for fiscal 2020. The combined utility had \$215.6 million in total debt at fiscal year-end 2020. Management intends to fund its entire \$102 million five-year capital improvement program on a pay-as-you-go basis,

which we believe is reasonable given the system's strong margins.

## Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

| Ratings Detail (As Of October 11, 2021)               |                  |          |
|---|------------------|----------|
| Lafayette comb util                                   |                  |          |
| <i>Long Term Rating</i>                               | AA-/Stable       | Affirmed |
| Lafayette comb util                                   |                  |          |
| <i>Long Term Rating</i>                               | A+/Stable        | Affirmed |
| Lafayette comb util                                   |                  |          |
| <i>Long Term Rating</i>                               | A+/Stable        | Affirmed |
| Lafayette comb util (AGM)                             |                  |          |
| <i>Unenhanced Rating</i>                              | AA-(SPUR)/Stable | Affirmed |
| Lafayette communications sys (AGM)                    |                  |          |
| <i>Unenhanced Rating</i>                              | A+(SPUR)/Stable  | Affirmed |
| Lafayette util (AGM)                                  |                  |          |
| <i>Unenhanced Rating</i>                              | AA-(SPUR)/Stable | Affirmed |
| Lafayette Comb Util                                   |                  |          |
| <i>Long Term Rating</i>                               | AA-/Stable       | Affirmed |
| <b>Lafayette Pub Pwr Auth, Louisiana</b>              |                  |          |
| Lafayette, Louisiana                                  |                  |          |
| Lafayette Pub Pwr Auth (Lafayette) elec rev rfdg bnds |                  |          |
| <i>Long Term Rating</i>                               | AA-/Stable       | Affirmed |
| Lafayette Pub Pwr Auth (Lafayette) wholesale elec     |                  |          |
| <i>Long Term Rating</i>                               | 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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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