S&P Global
Ratings

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Summary:

Oklahoma Municipal Power Authority; Retail Electric; Wholesale Electric

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Credit Profile		
US$325.755 mil pwr supply sys rev rfdg bnds ser 2021 dtd 07/01/2021 due 01/01/2047		
Long Term Rating	A/Stable	New
Oklahoma Mun Pwr Auth wholesale elec (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'A' long-term rating to the Oklahoma Municipal Power Authority's (OMPA) $51.65 million series 2021A and $265.45 million series 2021B power supply system revenue refunding bonds. At the same time, S&P Global Ratings affirmed its 'A' long-term and underlying ratings on OMPA's parity debt outstanding. The outlook is stable.

The rating reflects our view of the strength of OMPA's stable customer base, low wholesale rates, strong operational performance and reliability, and robust available liquidity. These factors provided a financial cushion that limited the financial effects of the February 2021 North American winter storm, which struck Texas and Oklahoma in mid-February 2021. The rating is also based on our view that management has identified key areas of risk management strategy as it pertains to gas procurement and pricing volatility, coupled with its proposed multipronged approach to mitigating the impact of a similar event in the future. The authority spent a net $59.6 million on natural gas purchases during the week of Feb. 14, 2021, versus a budgeted $1.9 million for that entire month, and the authority entered into a $60 million private placement to fund these unexpected fuel costs.

Additionally, the rating reflects our view of the quality of the revenue that the system receives from OMPA's 42 participants and its ability to adjust member rates upon 60 days' notice, essentially creating an unlimited step-up provision among nondefaulting members in the event of a member default.

Securing the bonds is a first lien on net revenue of OMPA's wholesale electric system. The authority derives its revenue primarily from the sale of electricity to its 42 member cities.

As of March 31, 2021, OMPA had $598.5 million in long-term debt outstanding, including the $60 million private placement issuance that the authority intends to refund with the proposed 2021A bonds. Management anticipates utilizing series 2021B proceeds, together with other funds available to refund its series 2013A and 2013B bonds, for interest expense savings, with a total expected savings of approximately $10.6 million based on interest rates as of April 16, 2021.

Credit overview

The rating further reflects our view of OMPA's:

- Long-term, take-and-pay full requirements contracts with municipal electric distribution systems with residential accounts constituting 87% of the total, which we believe helps stabilize demand;
- Diverse power portfolio, with 49% of energy sourced from natural gas, 12% from coal, 28% from renewables, and 11% from purchases estimated in 2021;
- Automatic monthly energy cost adjustment, which generally mitigates OMPA's exposure to fuel- or commodity-price risk (management includes in this adjustor a forward-looking estimate to go with the retroactive true-up)--however, due to the magnitude of the winter storm, this adjustment was not utilized to immediately pass through elevated gas procurement costs;
- Well-diversified portfolio of generating assets and purchased power contracts that provide excess system capacity through 2031; and
- Recently enhanced strategies to improve cash flow and other financial metrics, including an increase to the debt service coverage (DSC) target to 1.15x from 1.10x, and improved funding of reserve and contingency and rate-stabilization funds (RSF). These measures are especially important to help provide continued cushion against fuel price volatility. OMPA's liquidity grew to over 220 days in 2020, including an undrawn $15 million committed line of credit, up from just 112 days in 2017.

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

- Exposure to fluctuations in natural gas volatility, as highlighted by the February 2021 storm and demonstrating the need to reassess its hedging and risk management as it pertains to gas procurement;
- High debt burden, as demonstrated by a 94% debt-to-capitalization ratio, though total nominal debt increased by only about 7% as a result of the storm and associated financing; and
- Relatively weak economic and financial profiles of most of its members.

The stable outlook reflects our expectation that OMPA's revisions to its natural gas procurement strategy will sufficiently insulate the utility from experiencing severe financial damages in the event of another polar vortex or similar weather pattern. The outlook also reflects that the authority's power sales contracts and step-up provisions will allow it to maintain adequate DSC and liquidity in the face of additional system leverage.

Environmental, social, and governance (ESG) factors

The severe winter event in February 2021 has brought into sharper focus a spectrum of ESG-related risks that may inform our credit analyses and ratings over the longer term. In our view, the specter of climate change may weigh more heavily as a credit risk factor for many utilities in U.S. public finance. In particular, we expect to consider the adequacy of management's measures to mitigate, plan for, and adapt to risks associated with extreme weather conditions that have the potential to disrupt power supply or cause a short energy or fuel position. Among these considerations are exposures related to the limits of power supply planning and hedging strategies. Given wide fluctuations in temperatures throughout OMPA's territory, the authority faces heightened risk related to climate change, especially given both OMPA's and the Southwest Power Pool (SPP)'s reliance on natural gas-fired generation during these extreme weather patterns.

Regarding social factors, health and safety precautions that officials enacted in response to the COVID-19 pandemic did not result in any material operational or financial pressure for the authority. Management notes that some members have reported effects due to the pandemic and associated recessionary pressures, but also notes that no members have failed to pay their OMPA bills, nor have they needed financial assistance to do so. S&P Global Economics forecasts that U.S. GDP declined 3.5% in 2020 and estimates a rebound of 6.5% in 2021 (see "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, on RatingsDirect).

In our view, governance risk is heightened, given that the location in which the authority operates increasingly requires stronger liquidity, proactive planning, hedging, and financial flexibility, versus most utilities in other regions, where these risks are lower. OMPA's entire exposure from the winter storm were associated with elevated natural gas prices, reflecting the need to reassess risk mitigation practices related to gas procurement.

Stable Outlook

Downside scenario

If the authority does not take appropriate measures to mitigate fuel price risk, or if it cannot otherwise continue to pass through costs and financial metrics weaken, or capital needs escalate significantly, we could lower the rating. Any material weakening of the membership base and the quality of cash flows that they generate, absent offsetting adjustments, could also lead to a negative rating action.

Upside scenario

Over the next two years, a positive rating action is unlikely given the financial forecast, which indicates maintenance of financial metrics at or around historical levels. Additionally, the overall membership base's relatively shallow economies make for limited rating upside potential.

Credit Opinion

OMPA is a governmental agency of the State of Oklahoma that provides wholesale power under long-term, take-and-pay full-requirements contracts. These power sales contracts with municipal system offtakers lend stability to the revenue stream, as does the largely residential nature of customer accounts. All sales contracts extend through Dec. 31, 2033, and thereafter, until terminated by either party, and require 15 years' notice of termination.

The largest participant is Edmond Public Works Authority (AA-/Stable), which accounts for about 38% of the authority's total revenue, followed by the utilities of Ponca City, Altus, Duncan, Perry, and Blackwell, which together account for an additional 32% of total revenue. Edmond, a large city north of Oklahoma City, has what we view as very strong credit metrics and income, with median household effective buying income (MHHEBI) 36% higher than the U.S. average. The other participants are smaller and, in our opinion, have weaker financial and economic profiles.

Some member cities tend to rely heavily on transfers from the electric utility to their respective general governments, and transfers out to a general government can constrain the liquidity of those utility systems. Also, many members have retail rates above the state average, which could limit rate flexibility, in our view. However, most municipally owned public utility authorities in Oklahoma have a local option sales-and-use tax, the revenue from which is pledged to fund those systems' utility obligations. Unused sales tax revenue is typically transferred to the general government.

We view management's strategy of developing a well-diversified portfolio of assets as one of its key credit strengths. However, with approximately 50% of energy needs sourced from natural gas-fired units, the authority is also exposed to fuel price volatility. OMPA historically employed both financial and physical gas hedging strategies; however, due to various market factors, it did not have any hedges in place prior to the February storm. Management cited low natural gas prices, unpredictable and declining dispatch patterns from natural gas units, and mild weather forecasts as three primary factors. As a result of the storm, OMPA is exploring the possibility of intermonth financial hedge products, but notes that its best defense against future storms will likely be physical gas purchases and expanded gas storage. While the authority is still working out precise figures, at a minimum it currently expects to procure at least 50% of its expected gas needs in advance, between December and February. Management is also investigating increasing the volume and/or extending the months in which it procures physical gas strips. OMPA also reports it is expecting to increase its gas storage at its Charles D. Lamb Energy Center to match its firm capacity (about 6,200 dekatherms), which would insulate the authority somewhat from congestion and availability issues. We believe these measures, along with plans to continue increasing cash reserves, will sufficiently insulate the authority from extreme financial or operational pressures stemming from future extreme weather patterns.

Management reports that its generation fleet remained operational throughout the storm and it was able to help meet the SPP's multiday reliability unit commitments throughout the storm. Due to these commitments, OMPA's total gas costs were $76.47 million, offset by $16.87 million in market sale recoveries, for a net cost impact of $59.6 million, for which it issued a $60 million note with Bank of America. Management reports it will not need to raise rates to maintain its budgeted 1.15x debt service coverage ratio (DSC). Total debt burden will remain under $600 million, down from almost $660 million in fiscal year 2018. On a net basis, while monthly costs vastly exceeded the budget, OMPA's financial profile will not be unduly burdened by the additional leverage, nor will its members face elevated rates. Given manageable capital needs of approximately $32 million over the next five years, we believe OMPA should continue reducing its debt burden.

Our calculation of fixed charge coverage (FCC) includes purchased power capacity payments as a debt service equivalent, rather than as an operating expense. FCC has been near 1.1x the past three years, which is somewhat weak for the rating, in our view. As with most generation and transmission utilities, the authority sets rates to provide a small amount of surplus net revenue. The strength of OMPA's power sales contracts, which provide revenue reliability, largely supports our rating. The authority has recently revised its budgeted coverage target to 1.15x, from 1.10x, in an effort to improve metrics and fund a higher RSF balance, not to mention higher reserve and contingency balances. Accordingly, projections indicate FCC rising to around 1.14x through 2023.

OMPA's liquidity has grown in recent years--an especially important consideration, given the exposures noted above. Total liquidity grew to over 220 days in 2020, including an undrawn $15 million committed line of credit, up from just 112 days in 2017. Our view of liquidity is balanced against the authority's fuel procurement and risk mitigation strategies. If OMPA cannot effectively reduce its exposure to fuel price volatility, we believe current reserve levels would be insufficient at the current rating level.

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 May 14, 2021)		
Oklahoma Mun Pwr Auth pwr supp sys rev rfdg bnds		
Long Term Rating	A/Stable	Affirmed
Oklahoma Mun Pwr Auth wholesale elec		
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Many issues are enhanced by bond insurance.