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Ratings

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Summary:

Rowley Municipal Lighting Plant, Massachusetts; Retail Electric

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Summary:

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Long Term Rating	A+/Stable	Current

Rationale

The long-term rating on Rowley Municipal Lighting Plant (RMLP), Mass. is 'A+'. The outlook is stable.

The rating reflects our view of RMLP's very strong enterprise risk profile and strong financial risk profile. Key credit strengths are the utility's mainly residential customer base with high-income levels, robust liquidity, and no debt.

Credit overview

RMLP is a distribution only system. The utility serves a primarily residential customer base of approximately 3,100 in the Town of Rowley (population 6,500), with easy access to Boston about 30 miles away via Interstate 95 and Route 1.

The rating reflects our opinion of the system's very strong enterprise risk profile, including:

- Strong operational and management assessment, highlighted by the utility's diverse mix of power purchase agreements;
- Very strong service area economic fundamentals, highlighted by its primarily residential customer base with above-average income levels and little customer concentration;
- Very strong market position, due to its weighted average electric system rate that is slightly below the state average and very high income levels; and
- Extremely strong industry risk relative to other industries and sectors.

The rating also reflects our view of the combined system's strong financial risk profile, including:

- Adequate fixed-charge coverage (FCC) metrics, evidenced by fixed-charge coverage ranging between 0.93x and 1.20x over the past three years;
- Very strong liquidity and reserves for a distribution system, with 290 days' cash on hand in fiscal 2019, including its rate stabilization fund; and
- Extremely strong debt and liabilities profile, as the utility has no debt.

The stable outlook reflects our view that financial metrics will remain at levels consistent with the rating even as they have contended with effects of the pandemic and the subsequent recession. Given the system's healthy financial metrics and no plans to issue debt over the next five years, we believe the utility could sustain a short-term decline due to economic effects associated with COVID-19, and maintain budgetary balance.

Environmental, social and governance (ESG) factors

Overall, we believe environmental, social and governance factors are in line with peers. RMLP receives electricity from a wide variety of fuels. In 2018, 35% of the utility's electricity tied to specific generating sources came from wind, hydroelectric, and solar resources, and the utility does not rely on any coal-fired generation, which we view as a credit positive. We believe the utility's social factors including health and safety issues related to COVID-19 do not present a significant financial risk at this time. The utility serves a mostly residential community, and according to management demand decline has been marginal and none of the utility's major customers have shut down. Management has also indicated that there have been no significant cutbacks by any of the utility's top 10 customers. The utility will continue to watch for other leading economic indicators in the coming months and plans to make appropriate changes to its balance of resources if necessary. In our view, if rates were needed to be increased in order to account for ramifications related to the pandemic, we view the ratepayers as being able to afford higher rates. The utility maintains affordable rates in context of current income levels, which help to insulate the utility from operational and financial challenges. However, we do believe governance factors are elevated as the utility does not perform long-term financial forecasting.

Stable Outlook

Upside scenario

Although we do not expect to raise the rating over the next two years, a trend of higher and sustained coverage could lead to a higher rating. Due to the utility's historically uneven fixed-cost coverage, we believe that higher coverage levels need to be sustained over a period of time in order for us to raise the rating.

Downside scenario

Although we are unlikely to do so, we could lower the rating if the light department experiences a significant and sustained decline in fixed-cost coverage levels or liquidity. In addition, if the current economic ramifications of the COVID-19 pandemic deepen and were to materially impair the utility's financial performance, we could lower the rating.

Credit Opinion

Enterprise Risk Profile

Operational Management Assessment (OMA): Strong

The utility purchases all of its power through Energy New England (ENE), with ENE performing the forecasting for RMLP's power supply. ENE manages the power supplies of over 20 municipal electric systems in New England, serving more than 1,100 megawatts of load and conducting more than 1 billion kilowatt-hours (kWh) in wholesale power transactions annually.

RMLP relies on a contracted power supply, albeit from system power from a diverse mix of assets. In 2018, the utility obtained 38% of its power from Nextera Inc., 25% from Shell Energy, and 17% from a variety of short to mid-term renewable purchase power contracts. The balance of power was purchased on the spot market. Management maintains a rolling hedge, which reduces its risk to potential volatility in the spot market. Nonetheless, the plant's power supply suggests a controllable carbon footprint, so environmental costs should be manageable, borne by power suppliers and passed through to the utility via cost of purchased power. The system is not exposed to coal generation; therefore, the utility is not exposed to any future environmental risks such as regulation of carbon emissions, which we view as a credit positive.

The utility does not produce formal strategic plans or five-year financial forecasts, which we view as a credit limitation. The utility produces annually updated budgets (financial and capital), but no other forward-looking forecasts. However, the scope of the utility is limited, and we view management as generally capable stewards of a distribution electric system with limited operating issues. RMLP is a very small utility with eight full-time employees. Although RMLP monitors budget-to-actual variances monthly, management exercises its power cost adjustment (PCA) mechanism at its discretion, with costs generally recovered quarterly. In our opinion, the PCA is just adequate in this regard. The utility maintains a long-term capital improvement plan (CIP), and on an annual basis, and the utility plans for improvement projects, both long and short term, through the budgeting process.

Economic fundamentals: Very strong

We believe RMLP's customer base provides stability to the utility's credit profile. Residential customers accounted for over 50% of revenue in 2019. The risks associated with a concentrated customer base are minimal when considering the utility's leading customers, which accounted for just 13% of revenue in 2019 with the largest customer accounting for 9% of revenue. Median household effective buying incomes are 57% above the U.S. average as of 2019, providing the utility with rate-raising flexibility, which we view as a credit positive. The utility's small size, serving approximately 3,100 customers in 2019, tempers our view of its economic fundamentals.

Market position: Very strong

Based on the U.S. Energy Information Administration's latest available data from 2018, the utility's average electricity rate was 98% of other electricity providers in Massachusetts. The town's above-average incomes provides RMLP with additional rate-raising flexibility, in our view. Management does not anticipate raising rates in the next three years, so we expect the utility to maintain its relatively competitive advantage.

The utility utilizes a discretionary pass-through mechanism to pass along power costs, which are recovered in the following month. The pass-through mechanism is reviewed monthly and the amounts can be changed, at management's discretion, when the utility is faced with increased costs in purchased power costs. From a credit perspective, the PCA mechanism is a credit positive, though discretionary, as it allows the light department to pass through purchased power cost variability.

Financial Risk Profile

Coverage metrics: Adequate

In our view, fixed-cost coverage, which includes RMLP's demand costs from power purchases, has been historically uneven. Fixed-cost coverage has ranged from 0.93x-1.20 for the past three years. Coverage declined to 0.93x in 2018 due to an increase in purchased power expenses. According to the utility's most recent DPU report, which we consider as unaudited financials, coverage was 1.37x for fiscal 2019, as the purchased power costs haves returned to historical levels. Fixed-cost coverage is our internally adjusted debt service coverage metric that tracks the use of total utility operating revenues. It also incorporates our recognition of fixed costs associated with demand costs from power purchases, which we define as a long-term recurring item that is debt-like, even if legally treated as operating expense.

The light department has no debt, and based on management's budget, which we view as reasonable, we calculate fixed-cost coverage will achieve 1.25x for fiscal 2020, which we view as strong. The system intends to cash fund the majority of its capital plan over the next five years; therefore, we do view the budgeted coverage as attainable, unless there is a material, unexpected rise in operating expenses. Budgeted purchased power for fiscal 2020 is slightly increased at 4% higher than the purchased power expense for fiscal 2019.

Liquidity and reserves: Extremely strong

Rowley's unrestricted cash and depreciation fund (which we consider to be available liquidity) totaled $5.6 million, or 290 days' cash according to the utility's most recent DPU report, which we consider as unaudited financials. Days' cash has been an average of approximately 276 days since 2017. As a distribution-only operation, the light department's liquidity provides a substantial cushion, which we view as extremely strong. Given that the system is exposed to limited operational risks as a distribution utility, we consider these liquidity levels robust for a system this size. Based on management's plan to fund a portion of its capital needs with cash, we anticipate draws on internal operating cash to fund future capital projects, but we expect management will continue to maintain sufficient liquidity to meet operations; however, if the utility were to draw on the cash reserves significantly, this could pressure the rating.

Debt and liabilities profile: Extremely strong

The utility does not have any debt outstanding, nor does it expect to issue any debt in the next five years. Capital improvements total approximately $2.7 million over the next five years. Given its modest capital requirements and lack of debt, we view RMLP's debt and liabilities profile as extremely strong.