S&P Global
Ratings

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Summary:

Rowley Municipal Lighting Plant, Massachusetts; Retail Electric

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Long Term Rating	A+/Stable	Affirmed

Rating Action

S&P Global Ratings affirmed its 'A+' issuer credit rating on Rowley Municipal Lighting Plant (RMLP), Mass. The outlook is stable.

RMLP does not have any long-term debt outstanding.

Credit overview

The rating reflects our favorable view of RMLP's improving fixed-charge coverage (FCC) to a three-year average of 1.39x, which includes unaudited 2021 figures. This is tempered, in our view, by RMLP's history of uneven coverage and S&P's expectations of sustained heightened gas prices. The utility maintains robust liquidity and reserves for a distribution system, with 341 days' cash on hand, including its rate stabilization fund and depreciation cash fund.

The rating is further supported by:

- A predominantly residential customer base that accounts for 52% of operational revenues on average and acts as an energy demand stabilizer;
- Low concentration in the top ten and top individual customers, which account for 14.5% and 7% of revenues, respectively; and
- Robust fuel mix diversity and strong hedging practices through power purchase agreements (PPAs), which temper exposure to any one fuel type or the spot market.

Offsetting these factors is:

- A small overall customer base of 3,100 customers in a town with 6,445 residents in 2020; and
- A concentration in natural gas energy resources in the near term through PPAs that are subject to gas-price volatility.

The stable outlook reflects our view that RMLP's strong residential customer base income levels, absence of debt, and a PPA portfolio that provides resource diversity of greenhouse gas-free resources will support the maintenance of financial metrics in line with recent historical levels.

Environmental, social, and governance

RMLP receives electricity from a broad variety of fuel sources. In 2021, 20.4% of the utility's electricity came from wind, hydroelectric, and solar. Additionally, 18.5% of its energy in 2021 was nuclear, and RMLP plans to increase its use of nuclear power to 38% by 2025. The utility maintains affordable rates according to current income levels, which were 52% above the national average in 2020.

In 2021, the governor of Massachusetts signed into law Bill S.9, also known as the Massachusetts 2050 Decarbonization Roadmap. The law sets standards for decarbonization that the municipal lighting plants (MLPs), including Rowley, must meet. Plants must achieve 50% renewable energy by 2030 and 100% by 2050, benchmarked to 1990 greenhouse gas levels. RMLP is well positioned to meet the first checkpoint, with nuclear, hydroelectric, wind, and solar PPAs expected to meet 62% of energy demand by 2026.

In our view, electric rates are affordable and do not present any social risks, especially considering the service territory's above-average income levels. We believe the utility's governance factors are in line with those of rated peers.

Stable Outlook

Downside Scenario

We could lower the rating if Rowley experiences a significant and sustained decline or material volatility in FCC levels or liquidity, which could occur given the current heightened energy costs due to higher fuel prices. If the utility does not respond with timely cost recovery measures in light of the recent sharp increases in fuel prices, leading to deterioration in financial metrics, we could lower the rating.

Upside Scenario

We do not expect to raise the rating in the near term given the lighting plant's history of uneven FCC, especially in light of ongoing elevated fuel and energy prices. However, we could raise the rating if we see a sustained trend of higher and stable coverage and liquidity through RMLP's decarbonization efforts.

Credit Opinion

RMLP is a distribution-only system with a primarily residential customer base of approximately 3,100 in the town of Rowley, MA. It has easy access to Boston, about 30 miles away via Interstate 95 and Route 1.

We believe RMLP's customer base provides stability to the utility's credit profile. Residential customers accounted for over 52% of revenue in 2020. Median household income is 52% above the national average, providing the utility with rate-raising flexibility, which we view as a credit positive. The risks associated with a concentrated customer base are minimal considering that the utility's top ten customers accounted for just 14.5% of revenue in 2020, with the largest customer accounting for a little over 7%. We do recognize that four of the top ten customers are manufacturing companies in glass, metals, and machine parts, which exposes RMLP to the larger economic environment. The utility's small size and exposure to the manufacturing industry tempers our view of its economic fundamentals.

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 one billion kilowatt-hours (kWh) in wholesale power transactions annually.

RMLP relies on a contracted power supply from a diverse mix of assets. In unaudited 2021, the utility obtained 31% of its power from NextEra Inc. In addition, 9.7% was derived from Shell Energy, and this will increase to 25.5% in 2023 before being phased out by 2025. The balance of power, about 20%, was purchased on the spot market. Management maintains a rolling hedge, with a tendency to keep exposure to the spot market at below 20%, which reduces its risk of volatility. In addition, gas accounts for a significant portion of the New England Independent System Operator from which Rowley purchases a portion of its energy. As the ISO continues to decommission gas- and coal-based generators, the costs of replacement renewable projects will be passed to participants indirectly through higher spot market energy costs.

The utility produces annually updated budgets (financial and capital) but no other forward-looking financial forecasts. We recognize its extensive planning to decarbonize and its procurement of future PPAs in renewable resources. We view management as generally capable stewards of a distribution electric system with limited operating issues. RMLP monitors budget-to-actual variances monthly, and management exercises its power cost adjustment (PCA) mechanism at its discretion, with costs generally recovered on a quarterly basis. The PCA is in line with practices of peer lighting plants and departments. The utility maintains a long-term capital improvement plan (CIP) and plans on an annual basis for improvement projects, both long and short term, through the budgeting process.

In our view, FCC, which includes RMLP's demand costs from power purchases, has been historically uneven but has shown steady improvement in the last three years. Coverage declined to 0.93x in 2018 due to an increase in purchased power expenses but improved to 1.41x in 2019 and 1.49x in 2020 before slightly declining to an unaudited 1.27x in 2021. 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 an operating expense. We have imputed 50% of RMLP's purchase power expense as a proxy for these charges. As the plant continues to devest from oil, gas, and coal, we expect power purchase costs to display less volatility.

Rowley's unrestricted cash totaled $6.4 million, or 341 days' worth of operating expenses, in fiscal 2020. Given that, as a distribution utility, the system is exposed to limited operational risks, we consider these liquidity levels robust for a system this size. We expect that management will continue to maintain sufficient liquidity to meet operations; however, if the utility were to draw on the cash reserves significantly, we would revisit this assessment and potentially lower the rating.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022