S&P Global Ratings

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Greenville, Texas; Retail Electric

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US$11.6 mil elec sys rev bnds ser 2022 dtd 09/15/2022 due 02/15/2052		
Long Term Rating	A/Stable	New
Greenville elec (BAM)		
Unenhanced Rating	A(SPUR)/Stable	Outlook Revised
Greenville retail elec		
Long Term Rating	A/Stable	Outlook Revised

Many issues are enhanced by bond insurance.

Credit Highlights

- S&P Global Ratings revised the outlook to stable from negative and affirmed its 'A' long-term rating and underlying rating (SPUR) on Greenville, Texas' electric system revenue bonds issued for the city's utility system (GEUS).
- At the same time, S&P Global Ratings assigned its 'A' long-term rating to Greenville's $11.6 million series 2022 electric system revenue bonds.
- The outlook revision reflects our view that the electric system is sufficiently positioned to manage its exposure to Electric Reliability Council of Texas (ERCOT) market price volatility based on its long power supply position, which enable it to meet demand spikes through its owned generation (including its dual-fuel capabilities) and other power supply contracts, most of which are, importantly, at fixed prices. We believe that, under certain stress scenarios, the utility's power supply and its significant and growing liquidity position moderate its exposure to unbudgeted power supply costs. The outlook revision is also based on GEUS' reduced exposure to volatile ancillary service costs, as ERCOT capped these costs at $5,000 per megawatt-hour (MWh). These costs, which were previously uncapped, comprised the majority of GEUS' $19.3 million costs stemming from February 2021's winter storm.

Security

A first-lien pledge of net revenues of the utility's system secures the bonds. As of Sept. 30, 2021, the electric system had $59.6 million in long-term debt outstanding.

GEUS will use the series 2022 bonds to fund various distribution and transmission improvements to the electric system. We consider bond provisions credit neutral. The bonds have a rate covenant that requires GEUS' net revenue to equal or exceed 1.25x annual debt service coverage and allows the utility to issue additional bonds if certain conditions are met. There is no reserve fund; however, GEUS' robust liquidity mitigates this risk.

Credit overview

We believe that GEUS' full rate-setting autonomy, robust margins, and ample liquidity provide the utility with operational and financial flexibility. This is particularly important because we believe there is additional operating risk related to extreme weather and price volatility in the ERCOT market. In anticipation of gas supply interruptions, prior to the 2021 February winter storm, GEUS secured additional energy hedges and prepared to run one of its gas-fired units on fuel oil. Management reports these actions provided significant cost savings during the storm, as the utility was able to curtail both gas purchases and ERCOT energy purchases. GEUS' unbudgeted net costs from the February 2021 winter storm were largely due to uncapped ancillary service charges, which are now capped at $5,000 per MWh. More recently, management reported minimal forced outages during heatwaves during the summer of 2022. Although GEUS has faced elevated costs, it successfully leveraged its generation fleet to make significant off-system sales to reduce the impact to the utility. In total, GEUS raised its fuel adjustment charge by 1 cent over the summer to cover the balance of elevated prices--a manageable adjustment, in our view.

The rating further reflects our view of GEUS':

- Sound service area economic fundamentals, reflecting a stable local service area economy that participates in Dallas-Fort Worth-Arlington metropolitan statistical area's deep employment base, although city income levels remain below average and the customer base is moderately concentrated;
- Fixed-charge coverage (FCC) projected to remain at or near 1.6x over the next five years, inclusive of the utility's additional borrowing plans; and
- Ample liquidity, with $44.6 million in liquidity at fiscal year-end 2021, and projections indicating cash will increase annually given strong system margins.

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

- Exposure to price spikes and volatility in the ERCOT market, as demonstrated by the February 2021 storm, although we note this exposure has been reduced due to the capped energy and ancillary services charges within ERCOT;
- Recontracting risk; 40 megawatts of the system's fixed-priced power purchase agreements (PPAs) will expire in 2023, requiring GEUS to either procure additional contractual power at unknown prices, or face elevated market exposure; and
- Above-average electric rates when compared with the state average, according to the most recent available information from the U.S. Energy Information Administration (2020) which could limit ratemaking flexibility, coupled with additional borrowing plans that will increase system leverage. However, we note that GEUS lowered base rates by 6% in October 2021, which, coupled with no plans to raise rates, will likely translate to an improved competitive position.

Environmental, social, and governance

The severe winter storm in February 2021 has brought into sharper focus a spectrum of environmental, social, and governance risks that may inform our credit analyses and ratings over the long term. In our view, the specter of climate change may weigh more heavily as a credit risk factor for Texas utilities in U.S. public finance. In particular, we evaluate 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 and cause a short energy position. Among these considerations are exposures related to the limits of power supply planning and hedging strategies. In our opinion, GEUS and many other Texas utilities face greater environmental risk than do most of their peers nationally, which results in a moderately negative influence in our credit rating analysis. Given wide fluctuations in temperatures in GEUS' territory, the utility, along with many of its Texas-based peers, faces heightened risk related to climate change. In fiscal 2021, GEUS' fuel mix was approximately 56.9% natural gas, 16.5% wind, 6.1% solar, and 20.4% unidentified.

In our view, governance risk in ERCOT is generally elevated because it increasingly requires stronger liquidity, proactive planning, hedging, and financial flexibility--all of which may be costly--versus most utilities in other regions where these risks are lower. ERCOT has relatively higher price volatility, heightened reliability risks, extreme temperature and demand fluctuations, and weaker grid interconnectivity compared with those of other states. However, we view governance as credit neutral in our analysis of GEUS because the utility has undertaken important planning and risk-mitigation processes. Management annually produces long-term financial forecasts and capital improvement plans. Moreover, GEUS' diverse power portfolio helps shield the utility from large swings in natural gas prices. While GEUS does not actively hedge against natural gas, it has the capability to transition several of its units to fuel oil, allowing it to avoid volatile fuel input pricing. The utility also faces price certainty for much of its power supply thanks to its fixed price power supply contracts.

We view GEUS' social attributes as neutral in our credit rating analysis. The utility's operations and finances have not been materially affected by the COVID-19 pandemic. However, we note that the utility's rates were above the state average in 2020, according to the most recent available U.S. Energy Information Administration data, indicating potential rate affordability challenges, especially against the backdrop of the city's lower median household effective buying income metrics. Even so, the utility reported a 6% overall rate decrease in October 2021 and does not have any plans to increase base rates, which should ease rate pressures.

Outlook

The stable outlook reflects our view that at the current rating level, GEUS' power supply resources and robust liquidity are sufficient to mitigate exposure to demand and power cost volatility that we view as endemic to utilities operating in ERCOT.

Downside scenario

We could lower the rating if additional volatility in the ERCOT market leads to price spikes that cause the utility's liquidity and/or coverage to fall below forecast levels for a longer period, or if these pressures burden ratepayers with unaffordable electric bills. In addition, we could lower the rating if GEUS is unable to replace its fixed-price energy contracts that expire in 2023 with similarly credit-protective arrangements, in turn increasing the utility's exposure to market volatility and price spikes that we believe could materially weaken its operational or financial profiles.

Upside scenario

Over the next two years, we do not anticipate raising our rating because projections do not indicate sustained improvements in FCC over the long term and because the inherent limitations of the ERCOT market limit the potential for a higher rating.

Credit Opinion

Greenville maintains a diverse supply of energy capacity, consisting of owned natural gas-fired assets, firm power PPAs, and wind and solar contracts that together exceed the utility's projected peak demand. Even if its renewable contracts experienced intermittency issues, GEUS would sustain a surplus energy position, mitigating exposure to the

ERCOT market.

GEUS' electric rates were 27.8% above the state average on a weighted-average basis in 2020, per data from the Energy Information Administration. The utility's competitive position will likely improve given no rate increases are planned, as we expect statewide rates will rise significantly as many utilities seek to recover similar--and in many cases more severe--costs incurred.

GEUS' pre-storm liquidity mitigated the effect on credit quality as costs of the storm came due. The utility paid all of its invoices for February 2021 with cash on hand, but issued short-term debt to preserve a healthy liquidity balance. GEUS pre-paid approximately $5 million of the short-term note and refunded the balance with a long-term private-placement borrowing. The bank placement issued in 2022 does not represent a contingent liquidity risk, as it does not afford the lender preferential rights relative to existing bondholders. At fiscal year-end 2021, GEUS' $44.69 million in liquidity equated to 131 days' cash on hand; however, we note this figure is suppressed given elevated expenses associated with the winter storm. Liquidity is projected to increase to more than $99 million (457 days) in 2026 from about $55 million (265 days) in 2022. We believe this exceptional liquidity is an important credit factor given the market exposures noted above.

FCC has historically averaged over 2.0x, with the exception of fiscal 2021 when coverage was suppressed due to exceptional storm costs. Management's current financial forecast indicates FCC will gradually decline to just below 1.6x, still supportive of the 'A' rating, in our view.

GEUS' leverage has increased in recent years, at more than 60% in fiscal 2021 and likely higher following recent and anticipated debt issuances. We could revisit our assessment of GEUS' debt and liabilities profile if additional debt materially limits the system's ability to progress through its capital plan. Current capital needs are manageable with about $43 million in planned spending over the next five years.

Related Research

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