

ISSUER COMMENT

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Gainesville, FL Combined Utility Enterprise

GRU's offer for GREC's biomass facility is credit negative

On 22 March 2017, Gainesville, FL Combined Utility Enterprise ("Gainesville Regional Utilities", "GRU", Aa2 stable) announced that it had entered into a non-binding Memorandum of Understanding (MOU) with Gainesville Renewable Energy Center, LLC regarding an offer by GRU to purchase the 102.5 MW Gainesville Renewable Energy Center (GREC) biomass facility for \$750 million. The purchase price would be financed with 30-year utility system revenue bonds.

While the MOU has been signed by representatives from GRU and GREC, the Gainesville City Commission must agree to the MOU in order for the MOU to be effective. The Commission currently seeks to review and deliberate the MOU in April.

We view the entirely debt-financed transaction as credit negative because the deal may lead to a deterioration in GRU's debt service coverage ratios (DSCR), and will introduce higher plant operating risk for GRU to manage.

The announcement of the non-binding MOU has no immediate rating impact. However, we seek to gain more clarity on the following factors as GRU negotiates from the non-binding MOU to a binding purchase and sale agreement with GREC: (1) GRU's future operating costs for the plant and if GRU will operate the facility itself or if it will be contracted out to a third party; (2) potential cost savings from the transaction, the risk that these will not be realized and possibility for additional transition costs; (3) the future dispatch profile of the plant which had been operated mostly in cold stand-by mode since the start of operations and (4) potential impact on electricity rates charged to customers.

GRU's leverage is currently high for its rating category. Debt/operating revenue was around 4.6x and GRU had a debt ratio of 80% in fiscal year 2015. However, we do not expect that the transaction will result in an increase of Moody's adjusted debt which already included the long-term portion of the \$977.3 million in lease obligations associated with the existing GREC purchase price agreement (PPA) at the end of fiscal year 2015. The PPA would be terminated upon the purchase of GREC by GRU.

Downward rating pressure would arise if GRU's fixed charge coverage ratio fell below 1.8x for a sustained period of time. This could occur if additional debt service and operating costs after the GREC purchase exceed the current minimum annual capital lease payments under the PPA that have been included in operating expense.

GRU's fixed charge coverage ratios are solid and averaged around 1.8x over the last five years (2.2x in fiscal year 2015). Moody's coverage metrics do not include any payments under the GREC PPA as debt service. However, payments related to GREC reported as operating expense would be included in the coverage metrics. Minimum annual capital lease payments

under the GREC PPA are forecasted to be around \$61.2 million for the period 2016-2020 including depreciation expense.

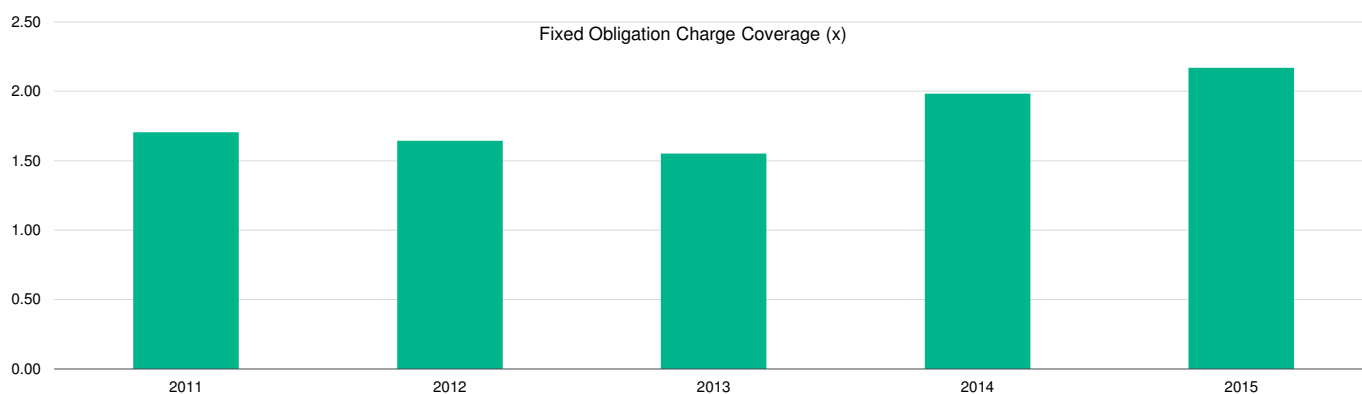
The purchase offer is costly for GRU but provides a long-term solution to GRU's strained relationship with the operator and owner of GREC, which is positive. The relationship has been characterized by several disputes around interpretation of certain terms in the PPA and the high fixed costs associated with the 30-year take-or-pay PPA. Arbitration is currently scheduled for June 2017. The facility commenced commercial operations in December 2013. However, due to low natural gas prices and the above-market PPA, GRU has opted to keep the facility in cold stand-by most of the time.

The deal will be subject to the negotiation and execution of a purchase and sale agreement to be negotiated within the next four months, with closing of the transaction to be reached within the next seven months.

Gainesville Regional Utilities (GRU) (Aa2 stable) is a municipally-owned utility system in Gainesville, FL with electric generation and transmission, natural gas, water, wastewater and telecommunication services. In 2015, total energy supply was 1,340,066 MWh. Annual net revenues, as measured by Moody's, increased to \$134 million in 2015 from \$119 million in 2014.

Exhibit 1

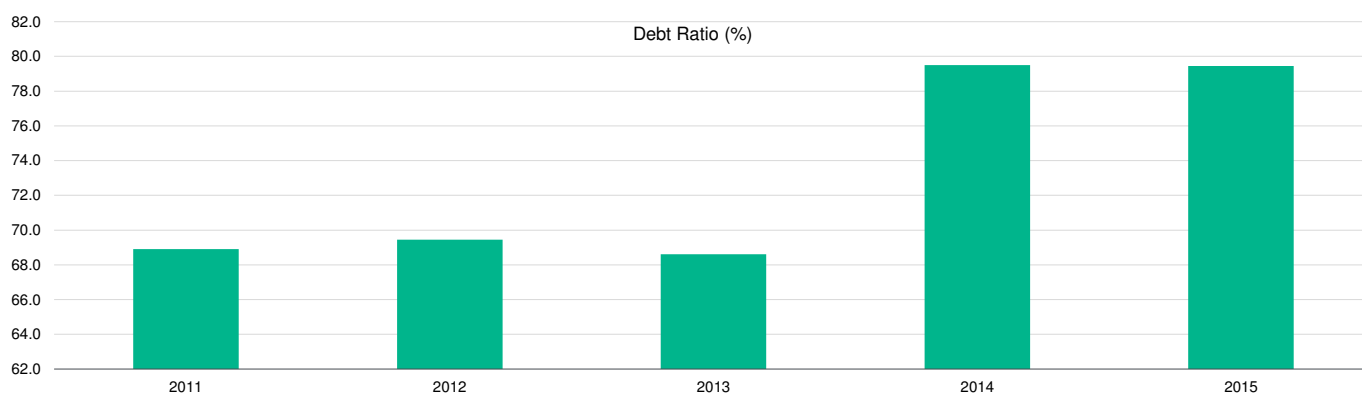
Fixed obligation charge coverage will be pressured if additional debt service and operating costs exceed current minimum annual capital lease payments included in operating expenses



Source: Audited financial statements GRU, Moody's Investors Service

Exhibit 2

High leverage reflects GREC lease obligation since fiscal year 2014



Source: Audited financial statements GRU, Moody's Investors Service

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