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CREDIT OPINION
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Contacts

Kathrin Heitmann +1.212.553.4694
Vice President - Senior Credit Officer
kathrin.heitmann@moodys.com

Kurt Krummenacker +1.212.553.7207
Associate Managing Director
kurt.krummenacker@moodys.com

A. J. Sabatelle +1.212.553.4136
Associate Managing Director
angelo.sabatelle@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Gainesville (City of) FL Combined Utility Enterprise

Update to credit analysis

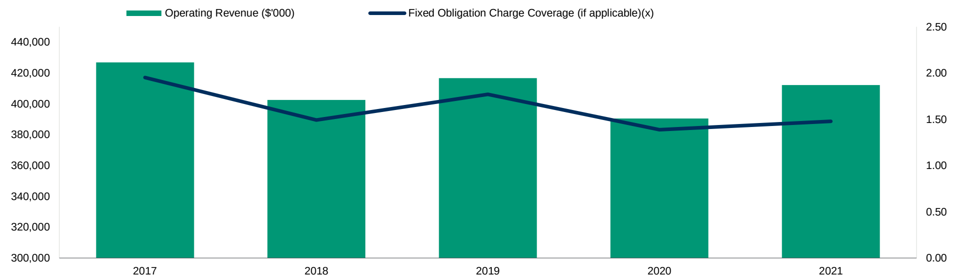
Summary

Gainesville (City of) FL Combined Utility Enterprise (GRU)'s credit profile (utility system revenue bonds, Aa3 stable) benefits from its resilient service territory, diversified operations and a track record of raising rates as necessary. A key future focus will be on developing a strategy to meet its 2045 net zero emission goal and renewing and diversifying its fuel sources.

GRU's credit profile is constrained by a high leverage (84.3% adjusted debt ratio in fiscal 2021), lack of a debt service reserve requirement, high electric rates and the age of some of its generation assets. High annual transfers to the city's general fund have limited the utility's ability to apply material amounts of free cash flow generation toward rate reductions or investments into new generating assets.

Modest annual reductions of $2 million in GRU's transfer to the city's general fund for fiscal years 2022-2027 and a debt defeasance plan will increase slightly financial flexibility going forward. However, cost pressures will remain, in particular in a high natural gas price and inflation environment. We expect that GRU will generate consistent but moderate fixed charge coverage ratios of 1.4x-1.5x per year after transfers to the city (1.5x in fiscal 2021).

Exhibit 1
Fixed charge coverage ratio will likely remain around 1.4-1.5x going forward



Moody's fixed charge coverage ratio includes annual transfers to the city's general fund. Operating revenue shown on left y-axis, fixed charge coverage shown on right y-axis.
Source: Moody's Investors Service

Credit strengths

» Resilient service territory and diversified operations as a combined utility enterprise

» Track record of raising rates when necessary

» Good liquidity profile

Credit challenges

» High natural gas price environment and high fixed cost base will put pressure on financial metrics if not passed through to customers

» High leverage and future investments to achieve city's zero net emission goal by 2045 will likely require additional debt

» High transfers to city's general fund

» No debt service reserve fund requirement

Rating outlook

The stable rating outlook reflects our expectation that GRU will maintain fixed charge coverage ratios in the 1.4-1.5x range and will maintain a good liquidity profile.

Factors that could lead to an upgrade

» A fixed charge coverage ratio maintained at or around 1.6x on a sustained basis

» Maintaining adjusted days cash on hand above 250 days

» Material and sustained reduction in leverage

Factors that could lead to a downgrade

» Cost pressures preventing timely future rate adjustments and fixed charge coverage ratios declining below 1.4x on a sustained basis and an inability to reduce leverage

» Deteriorating liquidity profile with adjusted days cash on hand materially below 175 days cash on hand

» More aggressive demands for transfers to the city's general fund

» Short-term: The VMIG1 ratings could be downgraded if Moody's were to downgrade the short-term rating of the banks providing standby purchase agreements to the variable rate debt

Key indicators

Exhibit 2

	2017	2018	2019	2020	2021
Operating Revenue ($'000)	426,980	402,554	416,693	390,570	412,187
Debt Outstanding ($'000)	1,871,709	1,627,340	1,687,270	1,664,970	1,733,640
Total Adjusted Debt ($000)	2,138,244	1,859,124	2,018,501	1,949,244	1,952,188
Adjusted Debt Ratio (%)	92.5	85.6	90.1	88.5	84.3
Total Days Cash on Hand (days)	162	146	150	178	163
Adjusted Days Liquidity on Hand (incl. Bank Lines)(days)	230	235	395	429	393
Debt Service Coverage (x) (Bond Ordinance Basis - Senior Lien)	2.50	1.88	1.89	1.85	1.96
Fixed Obligation Charge Coverage (if applicable)(x)	1.95	1.49	1.77	1.39	1.48

Fiscal year ends September 30. All ratios are as defined and as adjusted by Moody's Investors Service. Adjusted debt outstanding and adjusted debt ratio includes Moody's adjusted net pension liability for GRU.
Source: GRU's audited financial statements, Moody's Investors Service

Profile

Gainesville Regional Utilities (GRU) is a municipally-owned utility system in Gainesville, FL (issuer rating Aa2) with electric generation and transmission, natural gas, water, wastewater and telecommunication services. In fiscal 2021, GRU reported operating revenue of $412 million and had 101,672 electric customers.

The water and wastewater systems served an average of 74,861 and 68,566 customers, respectively, in fiscal 2021. The gas system served an average of 36,795 customers in fiscal 2021. GRU. Com served an average of 387 internet access customer connections in fiscal 2021.

Detailed credit considerations

Revenue Generating Base

Resilient service territory and diversified operations

The electric facilities of the system currently serve approximately 124.5 square miles of the County, and approximately 74% of the population of the County, including the entire City, with the exception of the University of Florida campus, which is served principally by Duke Energy Florida. Electric service is also provided in the unincorporated areas of the County by Duke, Clay Electric Cooperative ("Clay"), Florida Power & Light Company ("FPL"), and Central Florida Electric Cooperative, Inc.

The economic base of Gainesville consists primarily of light industrial, commercial, healthcare and educational activities. The University of Florida is the State's oldest university with approximately 56,500 students. Employment has recovered to near pre-pandemic levels.

The City of Gainesville's credit position is very high quality, and its Aa2 rating is slightly stronger than the median rating of Aa3 for cities nationwide. Notable credit factors include a healthy financial position and an adequate wealth and income profile. It also reflects a mid-ranged debt burden and a somewhat elevated pension liability.

The city's zero net emission target by 2045 will require additional investments in its generating assets

GRU will need to carefully manage the expected retirement of most of the Deerhaven Generating Station units in the next 10 years. GRU will also develop an initial Integrated Resource Plan (IRP) in the next 12 months to lay out an initial strategy to achieve the city's zero net emission target by 2045.

In 2022, GRU completed the conversion of the Deerhaven coal plant to dual fuel operations so that it can run on natural gas as well. Initial load testing indicates 232 MW net capability. GRU will also add by 2025 around 50 MW of solar power through a power purchase agreement with Origis Energy.

In fiscal 2021, GRU's power supply mix consisted of around 53% of natural gas, 16% coal, 25% biomass, 4% waste heat, 1% landfill gas and 1% solar.

GRU owns four generating facilities: J.R. Kelly Station (108 MW net summer capability), Deerhaven Renewable (biomass) plant (102.5 MW net summer capability), Deerhaven Generating Station (409 MW net capability coal/natural gas) and South Energy Center (10.9 MW). In total, GRU has access to around 635 MW of net summer capacity in excess of peak demand of around 422 MW in fiscal 2021.

Financial Operations and Position

High natural gas price volatility increases cost pressure

Similar to other utilities, GRU is highly exposed to the current volatility in natural gas prices. Higher than budgeted natural gas costs puts additional pressure on its operations and potentially on already high electric costs. GRU's gas requirements are around 60% hedged for the remainder of 2022 and around 50% for 2023.

The Deerhaven Renewable plant has become however, more cost competitive in a high natural gas price environment. As natural gas prices exceed $4MMBtu it is GRU's most cost competitive plant.

We expect that GRU will manage to maintain modest fixed charge coverage ratios around 1.4-1.5x (1.5x in fiscal 2021).

Labor cost pressure as a result of the high inflation environment is limited. GRU's labor union contracts foresee on average 2.5% annual wage increases and would be up for renewal only in 2.5 years.

Track record of raising rates but electric rates are high

GRU's residential and commercial electricity rates will likely exceed the state average in the foreseeable future given a high fixed costs base, transfers to the City's general fund, the current high natural gas price environment and future investment needs. GRU's rate competitiveness is more favorable when looking at the average customer bill for all services including water, waster water and other services.

GRU has demonstrated a willingness and ability to adjust rates as necessary. GRU is governed by the City Commission and the General Manager for Utilities serves at the will of the Commission. To date, the Utility Advisory Board (UAB), which advises the City Commission on policy and governance, has not restricted GRU's ability to implement future rate increases.

Electric and wastewater rate increases of 7% and 5%, respectively have been adopted for fiscal 2022. In addition, GRU plans to formally adopt a direction to increase rates in the electric and wastewater systems each year over the next 5 years of 3% and 5%, respectively, through a rate ordinance. A reduction in the general fund transfers by $2 million a year through fiscal 2027 will also help to ease cost pressures ($38 million in fiscal 2021). Nevertheless, general fund transfers will remain substantial.

Liquidity

Liquidity is solid with around $106 million of unrestricted and discretionary reserves as of September 30, 2021. Days cash on hand was 163 days and adjusted days liquidity on hand was 393 days including headroom under the commercial paper program.

GRU has recently replaced the commercial paper program with a $150 million revolving credit facility that provides both an ability to draw tax-exempt or taxable dollars. This facility expires in April 2025. Additional, GRU has a taxable line of credit totaling $25 million due April 2024.

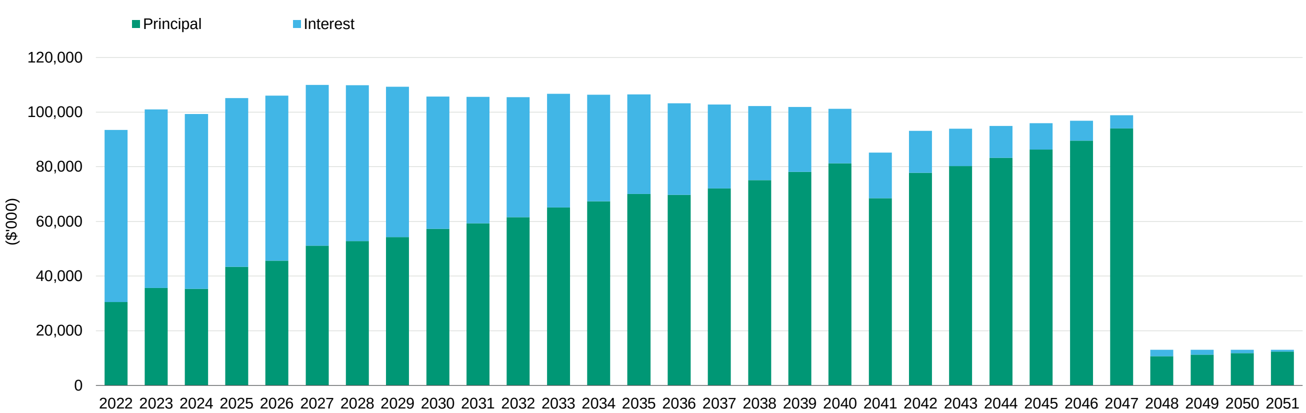
Debt and Other Liabilities

Debt structure

As of September 30, 2021 GRU had around $1.7 billion of utility system revenue bonds outstanding. The subordinated commercial paper program has currently no debt outstanding and has been terminated.

Exhibit 3

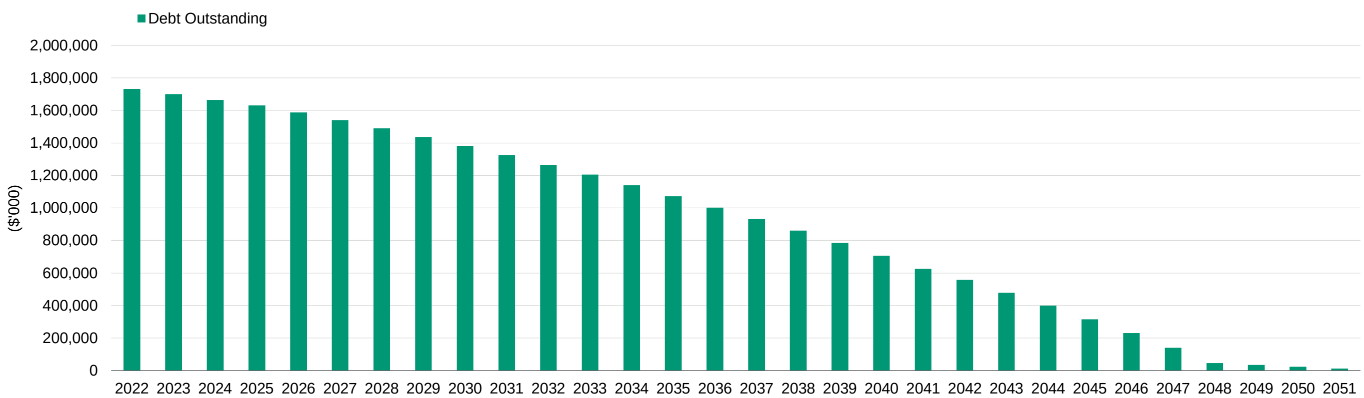
Expected annual debt service profile



Years are calendar years with principal due October 1 and interest due semiannually on each April 1 and October 1

Source: GRU

Exhibit 4
Expected scheduled debt amortization of outstanding debt



Years are calendar years with principal due October 1 and interest due semiannually on each April 1 and October 1
Source: GRU

GRU's debt ratio remains high (adjusted debt ratio 84.3% in fiscal 2021). We expect debt to gradually decline over time as debt amortizes. GRU also seeks to implement a debt defeasance plan as approved by the City Commission. As of their meeting June 17, 2021, the city authorized GRU to execute the first tranche of the debt defeasance program which will continue through September 2026. GRU's 5-year capital improvement plan for the period fiscal year 2021-25 foresees total investments of around $443 million. Most of the investments are geared toward improving the electric and wastewater systems.

However, future investments to achieve the city's net zero emission target by 2045 will likely require additional investments and debt to renew its fleet.

Structural Considerations
The utility system revenue bonds are secured by a senior lien pledge of net revenue of the combined utilities system of the City of Gainesville.

The rate covenant and additional bonds test requires that net revenue equal to at least 1.25x aggregate annual debt service. The utility is required to fund monthly deposits to the debt service account, so funds are available in advance of the principal and interest dates.

There has been no debt service reserve requirement since 2003, which is a credit weakness in GRU's bond resolution.

For its variable rate utility system revenue bonds, GRU has entered into separate standby bond purchase agreements with certain commercial banks to provide liquidity support in connections with tenders for purchase of the 2005 Series C, the 2006 Series A, and the 2012 Series B.

For the 2005 Series C, 2006 Series A, and the Series 2012 B, the VMIG-1 rating is derived from the credit quality of the Bank (Barclays Bank PLC) as provider of the SBPAs and Moody's assessment of the likelihood of an early termination or suspension of the SBPAs without a final mandatory tender. Events that would cause termination or suspension of the Bank's commitment under the SBPAs without a mandatory purchase funded by a draw on the SBPAs are directly related to the credit quality of GRU. Accordingly, the likelihood of any such event is reflected in the Aa3 long-term rating currently assigned to the Bonds. Moody's current short-term Counterparty Risk Assessment of Barclays Bank, PLC is P-1 (cr).

The 2019 Series C are supported by a letter of credit (LOC) provided by Bank of America, N. A. (the Bank).

Debt-related derivatives
GRU uses interest rate swaps to hedge its variable rate exposure. Around 90% of its debt is either fixed rated debt or synthetically fixed rate debt through the use of interest rate swaps.

The majority of GRU's swaps do not require the posting of collateral and are with creditworthy counterparties. However, some swaps require collateral posting at certain mark-to-market levels and include rating triggers. An unexpected termination of all or some swaps could require additional liquidity sources.

The $234 million 2022 fixed rate direct purchase agreement refinanced the 2007A and 2008B variable rate bonds as well as terminating the associated swaps and liquidity facilities.

Pensions and OPEB

The city of Gainesville has a defined benefit pension plan which includes permanent employees of GRU. GRU's share of the reported net pension asset was $43 million as of September 30, 2021 (excluding issued pension bond) based on a discount rate of 7.9%. Moody's adjusted net pension liability was around $219 million (including principal of pension bond (special obligation revenue bond) of $111 million issued in 2020), calculated based on a discount rate of 2.87%.

ESG considerations

GRU's ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 5

ESG Credit Impact Score

CIS-3

Moderately Negative

NEGATIVE IMPACT POSITIVE IMPACT

For an issuer scored CIS-3 (Moderately Negative), its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-2.

Source: Moody's Investors Service

GRU's ESG credit impact score of **CIS-3** indicates that ESG considerations have a moderately negative impact on the enterprise's rating. The score reflects highly negative exposure to environmental considerations, moderately negative exposure to social risk and neutral governance risks.

Exhibit 6

ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-4	S-3	G-2
Highly Negative	Moderately Negative	Neutral-to-Low

Source: Moody's Investors Service

Environmental

We assess GRU's exposure to environmental risks as highly negative (**E-4**), an outcome that considers its exposure to carbon transition and physical climate risks, as well as waste and pollution. As a utility located in Florida, GRU is highly exposed to extreme weather events such as hurricanes. In addition, reaching the City Commission's goal to achieve net zero community-wide greenhouse gas emissions by 2045 will be difficult and will require additional investments in future. This will require the City to retire and/or place in cold backup mode GRU's fossil fuel plants, many of which are at or near the end of their useful lives (GRU has five plants over 38 years of age), and develop replacement renewable energy generation capabilities which could come at a high cost. Approximately one-third of GRU's current electric generation comes from renewable resources including the biomass plant.

Social

Exposure to social considerations is moderately negative (**S-3**), reflective of GRU's residential and commercial electricity rates which remain well above the state average. When setting rates, GRU balances operating cost pressures with the need to maintain competitive electricity rates. To date, the Utility Advisory Board (UAB), which advises the City Commission on policy and governance, has not restricted GRU's ability to implement future rate increases. GRU has demonstrated a willingness and ability to adjust rates when necessary.

Governance

Governance risk is neutral (**G-2**). GRU has a high leverage and high transfers to the City's general fund. The City Commission and GRU are working on a solution to slowly reduce the burden on GRU as it faces cost pressures and high existing customer rates. GRU also seeks to implement a debt defeasance plan as approved by the City Commission. The city is reliant on the transfers from GRU as only 40% of the properties in Gainesville are taxable. GRU is governed by the Gainesville City Commission, in accordance with the City of Gainesville Charter Laws. As a Charter Officer of the City of Gainesville, the General Manager for Utilities serves at the will of the Commission. The Utility Advisory Board (UAB) advises the Gainesville City Commission on policy and governance decision regarding utility services. Members of the UAB are selected by the City Commission and serve for around 1-2 years. The UAB makes recommendations to the City Commission but has no authority to approve rate increases.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The principal methodology used in this rating was US Public Power Electric Utilities with Generation Ownership Exposure, published August 2019.

Credit metrics in the scorecard are based on the three year average for the period fiscal 2019-21. The scorecard-indicated outcome is A1, one notch below the assigned rating of Aa3.

The assigned Aa3 rating places more emphasis on the stability provided by GRU's diversity of operations and strong liquidity profile.

Exhibit 7

US Public Power with Generation Exposure Methodology Grid

Factor	Subfactor	Score	Metric
1. Cost Recovery Framework Within Service Territory		Aa	
2. Wllingness and Ability to Recover Costs with Sound Financial Metrics		Aa	
3. Generation and Power Procurement Risk Exposure		A	
4. Competitiveness		Baa	
5. Financial Strength and Liquidity	a) Adjusted Days Liquidity on Hand (3-year avg) (days)	Aaa	406
	b) Adjusted Debt Ratio (3-year avg) (%)	Baa	87.6%
	c) Adjusted Debt Service Coverage or Fixed Obligation Charge Coverage (3-year avg) (x)	A	1.55x
Preliminary Grid Indicated Outcome from Grid factors 1-5		**A1**	
		Notch	
6. Operational Considerations		0.0	
7. Debt Structure and Reserves		-0.5	
8. Revenue Stability and Diversity		0.5	
Grid Indicated Outcome:		**A1**	

Source: Moody's Investors Service

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