

FITCH RATES GAINESVILLE REGIONAL UTILITIES BONDS (FL) 'AA-' & AFFIRMS CP AT 'F1+'; OUTLOOK STABLE

Fitch Ratings-New York-03 December 2014: Fitch Ratings has assigned a 'AA-' rating to the following bonds for the city of Gainesville, Florida

- \$43 million utility system revenue bonds, series 2014 A;
- \$33 million utility system revenue bonds, series 2014 B.

The bonds are expected to price around Dec. 11 through negotiation.

In addition, Fitch has affirmed the following city of Gainesville, Florida securities:

- \$869.57 million utility system revenue bonds at 'AA-';
- \$85 million commercial paper (CP) notes, series C, at 'F1+'.

All bonds and CP notes have been issued for Gainesville Regional Utilities (GRU).

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a first lien on net revenues of the combined electric, gas, water, wastewater and telecom system (collectively, the systems).

The commercial paper notes are secured by an interest in GRU's net revenues that is subordinate to senior-lien indebtedness.

KEY RATING DRIVERS

COMBINED UTILITY SYSTEM: GRU is a combined utility system providing retail electric, gas, water, wastewater, and telecom services to the city of Gainesville, FL and surrounding areas. Electric is the largest system, accounting for about 59% of total revenues. Electric rates are at the upper level for state public power systems, with other GRU system rates generally more competitive. The systems are financially stable and have no customer concentration.

INITIAL IMPACT OF BIOMASS PROJECT: GRU's commitment to purchase the capacity and output of the costly Gainesville Regional Energy Center (GREC), a 102.5 megawatt (MW) biomass facility under a 30-year purchase power agreement, produced significant negative consequences for the combined utility. It put downward pressure on financial ratios, produced substantial excess capacity and contributed to a downgrade of the bonds to 'AA-' in 2012.

IMPROVED FINANCIAL FORECAST: A recent multi-faceted action plan, developed by management and the city commission, appear to be having a positive and stabilizing effect on financial results. Financial projections have turned more favorable, helped by cost saving programs, more aggressive rate adjustments and a return to positive sales growth. This is expected to result in debt service coverage (DSC) ratios solidly above 2.0x, which is more in line with historical norms. Financial liquidity and cash reserves are sufficient.

STRONG REGIONAL DEMOGRAPHICS: The systems provide utility services to and around the University of Florida (50,000 students), which helps to anchor the GRU service area. The service territory has a history of positive economic indicators, including steady population growth, new business development and per capita income and unemployment rates that compare favorably with state and national averages.

RATING SENSITIVITIES

CONTINUATION OF HEALTHY METRICS: Sustained improvement in financial performance would likely warrant consideration of a positive rating action.

CREDIT PROFILE

The city of Gainesville is located in north-central Florida and is the home of the University of Florida. As of April 1, 2014, the estimated population of Gainesville was about 125,661, including students, making it the largest city in Alachua County. Employment is well diversified among the healthcare, higher education, and light industrial and commercial sectors.

While Gainesville has been affected by the economic downturn, the impact appears to have been lessened by the resiliency of the university and healthcare jobs. GRU recently implemented a new economic development rate rider that is intended to retain and attract larger businesses. The city of Gainesville's general fund is highly dependent upon transfers from the utility system (equal to about 8% of GRU revenues), and accounting for 35% of total general fund revenues.

STATUS OF GREC

Renewable energy and carbon management strategies have become an important component of GRU's long-term power supply acquisition program. Under the purchase power agreement with GREC, GRU agreed to purchase all of the capacity and output and environmental benefits from the facility, which was developed by a private consortium. Although the terms of the purchase agreement, including the take-and-pay nature of the obligation and GRU's ability to dispatch the unit, are favorable, the addition of the costly new excess capacity during a period of slower growth and moderate natural gas prices has put a serious strain on electric system financial results.

GREC has now been fully integrated into GRU's generation mix and dispatch costs have been incorporated into its financial models. Although GRU's electric rates are at the upper level of public power utilities in the state of Florida, variable costs of the project appear competitive with alternative fuels and the biomass project adds fuel diversity.

POSITIVE STEPS IMPLEMENTED BY MANAGEMENT

Management and the city commission have taken several positive steps to stabilize financial performance at GRU including: the implementation of a system-wide cost reduction program, debt refinancing and the city commission's willingness to support larger, near-term electric rate adjustments, which should allow financial measures to return to more traditional levels. This strategy has also ameliorated the need to aggressively draw down cash reserves. As part of the utility's long-range plan, DSC is expected to again exceed 2.0x on a regular basis, liquidity should remain ample and general fund transfers should be stable.

AMPLE LIQUIDITY SUPPORTS SHORT-TERM REQUIREMENTS

GRU incorporates a risk management study for each of its utilities and sizes the cash reserves needed to support the levels of risk identified by the risk indicators. The utility has identified a liquidity target of \$76.5 million for fiscal 2015. The utility also maintains two CP programs totaling \$110 million;

with \$62 million tax-exempt CP regularly outstanding. Total fund reserve balances, together with credit facilities supporting the CP, are more than ample to meet any short-term requirements. GRU anticipates issuing \$8 million of taxable CP in December 2014.

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Applicable Criteria and Related Research:

- 'U.S. Public Power Peer Study -- June 2014' (June 13, 2014);
- 'U.S. Public Power Peer Study Addendum - June 2014' (June 13, 2014);
- 'U.S. Public Power Rating Criteria' (March 18, 2014);
- '2014 Outlook: U.S. Public Power and Electric Cooperative Sector' (Dec. 12, 2013).

Applicable Criteria and Related Research:

- U.S. Public Power Peer Study -- June 2014
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749789
- U.S. Public Power Peer Study Addendum - June 2014
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750283
- U.S. Public Power Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=740841
- 2014 Outlook: U.S. Public Power and Electric Cooperative Sector (Calm Under Pressure)
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=725447

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