Lubbock Power & Light, Texas

Revenue Bonds
New Issue Report

Ratings

New Issues

$7,675,000 Electric Light and Power System Revenue Bonds, Series 2016	A+

Outstanding Debt

$70,165,000 Electric Light and Power System Revenue Bonds	A+

Rating Outlook

Stable

Key Utility Statistics

Fiscal Year Ended 9/30/15

System Type	Retail Electric
NERC Region	SPP
No. of Customers	103,475
Annual Revenues ($ Mil.)	221.2
Peak Demand (MW)	584.5
Debt Service Coverage (x)	2.41
Days Operating Cash	134
Equity/Capitalization (%)	55.9

Related Criteria

U.S. Public Power Rating Criteria (May 2015)

Revenue-Supported Rating Criteria (June 2014)

Related Research

Fitch Rates Lubbock Power & Light, TX's $7.7MM Power System Rev Bonds 'A+'; Outlook Stable (March 2016)

U.S. Public Power (Peer Study) (July 2015)

Analysts

Matthew Reilly, CFA
+1 415 732-7572
matthew.reilly@fitchratings.com

Kathy Masterson
+1 512 215-3730
kathryn.masterson@fitchratings.com

New Issue Details

Sale Information: $7,675,000 Electric Light and Power System Revenue Bonds, Series 2016

Security: Bonds are payable from the net revenues of the electric system.

Purpose: Bond proceeds will fund various improvements to the city's distribution and transmission system. The bonds will be sold via negotiated sale the week of April 4, 2016.

Final Maturity: April 2046.

Key Rating Drivers

Retail Electric System: Lubbock Power & Light (LP&L) is a city-owned utility providing retail electricity to approximately 103,475 meters in and around the city of Lubbock, Texas. LP&L is the largest (95% of total revenues) of the four-member West Texas Municipal Power Authority (WTMPA), a joint powers agency established to coordinate and meet its members' power supply needs.

Power Supply Transition Underway: WTMPA supplies LP&L's power through an all-requirements wholesale contract with Xcel Energy Inc. (Xcel). The all-requirements contract expires in 2019, at which point LP&L plans on transitioning the majority of its load into the Electric Reliability Council of Texas (ERCOT) from the Southwest Power Pool (SPP) and managing its power needs through a combination of long- and medium-term contracts.

Favorable Debt Profile: Debt metrics compare favorably with similarly rated systems, but are likely to rise to still manageable levels with projected debt issuances of $210.5 million through fiscal 2021.

Stable Financial Metrics: Recent base rate increases have stabilized the system's financial metrics at levels generally in line with rating category medians. Liquidity levels are sound despite being somewhat below average for the rating at 134 days, while debt service coverage levels are solid at 2.41x in fiscal 2015.

Recent Rate Increases Approved: Rates are expected to remain competitive despite moderate increases projected over the next three years. While the service area is viewed as sensitive to rate increases, the demonstrated political support for recent rate increases helps anchor expectations that future increases will be adopted as projected.

Rating Sensitivities

City and Utility Tension: Fitch Ratings would view a return to the historically contentious relationship between LP&L, its board, and city political leaders with some caution as the utility undertakes a series of important changes over the near term. A lack of support for the utility's prospective rate increases and financial performance could negatively affect the rating.

Power Supply Transition: Prolonged delays in LP&L's transition into the ERCOT market or significantly higher than expected costs that are not offset by corresponding rate increases could also negatively affect the rating.

Rating History

Rating	Action	Outlook/ Watch	Date
A+	Affirm	Stable	3/16/16
A+	Affirm	Stable	3/19/15
A+	Affirm	Stable	4/10/14
A+	Affirm	Stable	4/16/13
A+	Affirm	Stable	2/1/13
A+	Upgrade	Stable	2/15/11
A–	Rating Watch	Positive	10/11/10
A–	Upgrade	Stable	3/10/09
BBB+	Affirm	Stable	10/3/06
BBB+	Affirm	Negative	10/19/04
BBB+	Downgrade	Negative	8/22/03
A+	Rating Watch	Negative	2/13/03
A+	Affirmed	Stable	6/28/02
A+	Rating Watch	Negative	7/5/01

Credit Profile

LP&L is the largest municipal electric utility in the West Texas region, serving approximately 103,475 meters in Lubbock, Texas, and some limited surrounding areas. LP&L's acquisition of Southwestern Public Service Company's (SPS) local distribution system in 2010 removed its largest competitor and transformed most of LP&L's service territory into a single-certificated area. In addition, the acquisition helped provide the electrical infrastructure necessary to split the electric distribution system between ERCOT and SPP, as the utility plans to do following the expiration of the all-requirements contract with Xcel in May 2019.

Governance and Management Strategy

The electric utility board (the board) consists of nine members appointed by the city council, with the council considering business/financial experience as its primary qualification for serving on the board. Board responsibilities include oversight of the electric fund's annual audit, management and operation of the electric system, and approval of annual budgets and electric rate schedules to be submitted to and approved by the city council. The board is also responsible for appointing LP&L's director, who reports directly to the electric board.

David McCalla has been the director of electric utilities (director) since June 2014. Mr. McCalla has stated that his primary focus as director is to effectively manage the 2019 power supply decision and process and rebuild ratepayer trust in LP&L.

The city council is composed of the mayor of Lubbock and six council members who serve four-year terms. Relations among the city council, mayor and LP&L have been contentious at times, including disagreements regarding an aborted request for proposal issued by LP&L, which led to the former director leaving his position, and division of authority issues for approving LP&L salary changes. In addition, the council voted against three separate rate increase proposals submitted by the board in 2011 and 2012, reflecting some disunity between the organizations. However, relationships between management and city officials have reportedly improved in recent years.

West Texas Municipal Power Agency

LP&L is the largest member of WTMPA and retains a majority interest in the agency. WTMPA generates and contractually sells power to LP&L and three other city systems; LP&L purchases about 95% of the electricity sold by WTMPA.

WTMPA is governed by an eight-member board of directors, with each city appointing two members to the board. An affirmative vote of the majority in interest is required to approve the budget, capital plan, debt issuance and amendments to WTMPA's rules and regulations. Lubbock retains the majority in interest vote based on its large share of energy purchases and payments.

Assets and Operations

Transitioning Power Supply

LP&L's power supply is fully secured through May 2019 under an all-requirements contract with Xcel, but is expected to change in several significant ways thereafter. The utility's plan, announced in September 2015, is to transition the majority of the system's load into the ERCOT market and secure medium-term power supply contracts of five to 10 years to meet its power needs. A smaller portion of the system, largely consisting of assets acquired from SPS, will be electrically isolated from the portion connected with ERCOT and will remain connected to SPP. Fitch views the plan as reasonable, particularly given the utility's other options that generally include building additional generation, but notes that it involves a significant change in the utility's business strategy, requires significant capital investment and has a relatively short implementation time frame.

Future Power Supply

Management projects LP&L's power supply needs at 627 MW in June 2019, which will be partially met through a combination of already-secured power purchase agreements (PPAs) and directly owned generation. The PPAs include a 25-year agreement with Xcel, secured as part of LP&L's acquisition of SPS, for 170 MW (plus 1.5% annually) beginning in June 2019. The other contract is a fixed-cost, 13-year agreement beginning in 2019 between WTMPA and Elk City II Wind, LLC (a subsidiary of NextEra Energy Resources) for 100 MW of wind generation. These contracts will be used as the primary power supply for the portion of LP&L's system that remains connected to SPP.

LP&L also owns approximately 171 MW of generally older-vintage natural gas-fired generation resources, which are projected to provide 114 MW of dependable net capacity in 2019. The capacity reduction prior to 2019 reflects management's proposed plan to mothball Cooke Steam 1 and Cooke Steam 2 for approximately $1 million in annual budgeted savings. LP&L's owned units are expected to be connected to the ERCOT portion of the electric system following the transition.

LP&L's Generation Assets

Manufacturer	Installed	Station	Prime Mover	Fuel	Generating Capacity (MW)	Dependable Capacity (MW)
Westinghouse	1957	J.R. Massengale No. 6	Steam Turbine	Gas	22	20
Westinghouse	1958	J.R. Massengale No. 7	Steam Turbine	Gas	22	17
Westinghouse	1964	Cooke GT 1	Gas Turbine	Gas	0	0
GeneralElectric	1965	Cooke Steam 1	Steam Turbine	Gas or Oil	46	43
Worthington	1971	Cooke GT 2	Gas Turbine	Gas	21	15
GeneralElectric	1974	Cooke GT 3	Gas Turbine	Gas	24	16
GeneralElectric	1978	Cooke Steam 2	Steam Turbine	Gas or Oil	54	0
GeneralElectric	1990	TX Tech (Brandon 1)	Gas Turbine	Gas	20	21
GeneralElectric	2000	J.R. Massengale No. 8	Gas Turbine	Gas	42	40
TOTAL	—	—	—	—	251	172

GT – Gas turbine.
Source: LP&L

The remainder of LP&L's power supply is expected to be met through five- to 10-year PPAs in the ERCOT market. None of the contracts have been secured at this point given the uncertainty of the ERCOT transition and its timing.

Entering ERCOT

Management's decision to enter the ERCOT market was made based on a multiyear process to determine the utility's future power supply. Guided by five basic goals, which included maintaining stable prices and limiting the issuance of additional debt, the management team found that joining ERCOT was more cost effective than either self-building generation or acquiring additional power supply and capacity contracts in SPP. Management estimates that the potential savings in 2015 would have been $20.9 million, or $7.67 per MWh, if the transition had already taken place.

Management also cited additional benefits to the transition, including access to a diversified energy portfolio from Texas-based power plants and greater integration with the state of Texas and its regulatory environment. If approved and interconnected, LP&L proposes to meet approximately 70% of its energy needs through the ERCOT market while keeping the remaining 30% interconnected to SPP during the life of the existing contracts with Xcel and WTMPA.

The formal process to join ERCOT has begun. LP&L has completed and submitted a full transmission study showing the feasibility and benefits of its membership as a transmission owner in the Texas state electric grid. ERCOT is currently completing its own integration study with an expected completion date of May or June 2016.

The time frame to receive approval and build the infrastructure to join ERCOT is relatively short. Management expects to be able to file a Certificate of Convenience and Necessity with the PUC by late 2016, which must be approved or denied within 12 months from the filing date. That would allow for approximately 18 months to complete the necessary transmission and substation infrastructure to allow the transition to happen.

Management expects to complete the transition in the allotted time, but has contracted with a power marketing company to purchase short-term capacity and energy in SPP to bridge any delays. This exposes the utility to potentially volatile short-term power markets, although this risk is partially mitigated by the utility's sound liquidity position and its rate structure, which includes a purchased power recovery factor that will allow for the recovery of purchased power costs for six months.

Owned Generation

LP&L had entered into three unit-contingent agreements with SPS, whereby LP&L is required to maintain and operate the units specified in the agreements, SPS is allowed to dispatch power from those facilities, and LP&L sells the output to SPS. The natural gas needed to run the units is provided by SPS. The agreements for the Brandon and Massengale plants expired in August 2014; the contract for the Cooke power plant continues until 2019.

Wholesale sales under this arrangement accounted for 16.4% of total system kWh sales in fiscal 2013, but fell to 12.4% and 2.3% in fiscal 2014 and 2015, respectively, due to the expiration of the Brandon and Massengale contracts and a significant unscheduled outage at the Cooke plant in 2015. The Cooke outage and subsequent derate led to a manageable $1.3 million reduction in capacity payments in fiscal 2015. The Cooke 2 unit remains inoperable due to a major boiler tube failure. As discussed above, management plans on mothballing Cooke 2 given the potential expense associated with the repair.

Management has entered into a two-year agreement with a power marketing company to dispatch the Massengale and Brandon units into the SPP integrated marketplace. Power sales are contingent on power prices in SPP; however, management has not included sales from the units in financial forecasts, providing some financial upside.

Cost and Rate Structure

Acquisition of Local Competition Changes Rate-Setting Practices

LP&L's acquisition of SPS's local distribution system brought about a number of changes in the utility's risk profile and business strategy. While in direct competition with SPS, LP&L's policy was to maintain rates approximately 2% below those of SPS. LP&L was able to do this by virtue of its advantageous power sales contract and full-requirements PPA with Xcel (obtained through WTMPA) along with lower cost of service.

LP&L and the city council approached rates differently following the acquisition, with the city council voting against LP&L's proposed rate increases on three separate occasions, once in 2011 and twice in 2012. The council requested and the electric board initiated a rate study to determine the utility's revenue requirements. The study was completed in December 2013.

The rate study proposed a number of changes to better align revenues with costs, including initially raising rates by an average of 9.5%, adopting a purchased power recovery factor that is reset semiannually (seasonally based) to replace the monthly fuel cost adjustor and other changes. The proposals were voted on and approved by the board and city council.

Subsequent average base rate increases of 5.75% were approved and implemented in fiscal 2015 and 2016. While earlier votes were more divided, the most recent rate increase was passed by the city council by a vote of six to one, providing some evidence of increased political support. Additional annual base rate increases of 5.75% are projected in LP&L's financial model through fiscal 2019.

Competitive Rates; Rate Sensitive

LP&L's rates are competitive and have benefited from the all-requirements contract with Xcel. Even with the recent rate increases, the utility's rates remain well below the Texas average and competitive with other Texas municipal utilities. Despite the relatively low rates, Fitch continues to view LP&L's customer base as being rate sensitive, based in part on political opposition to rate increases several years ago. However, rate increases have garnered more support and less reported ratepayer opposition over the past couple of years, helping to stabilize the utility financially.

Customer Profile and Service Area

The city of Lubbock (AA+/Stable) is located in northwest Texas. Lubbock has a stable economy based on agriculture, manufacturing and wholesale trade. Lubbock serves as the education and medical center for the area and is home to Texas Tech University (AA+/Stable), which is both the largest employer in the city and the largest customer of LP&L.

LP&L's customer base and sales saw a dramatic increase in fiscal 2011 as LP&L began providing service to SPS's customers. Since the acquisition, customer growth has averaged 1.3% annually while retail kWh sales have remained relatively stable. A recent, modest decline in retail sales in fiscal 2015 and 2014 was largely the result of mild summer weather.

LP&L's rate base is moderately concentrated, with the top 10 customers accounting for 20.3% and 15.4% of MWh sales and revenues, respectively. The largest customers, Texas Tech

Sales Information

	2015	2014	2013	2012
Peak Demand (MW)	584.5	533.2	612.3	615.3
Total Retail Electric Sales (MWh)	2,558,217	2,575,688	2,582,264	2,587,604
Retail Sales Growth (%)	(0.7)	(0.3)	(0.2)	0.0
Total Customers	103,475	102,079	101,165	99,720
Residential Sales (%)	38.5	38.7	38.4	39.0
Commercial and Industrial Sales (%)	53.9	55	55	45.4

Source: LP&L, Fitch Ratings.

University and the city of Lubbock, made up 9.2% and 6.9% of MWh sales and revenues, respectively, in fiscal 2015. The stability of the two largest customers offset rating concerns regarding the moderately concentrated rate base.

LP&L is currently engaged in a legal dispute with Texas Tech University. The university claims it overpaid for electricity, citing a provision in the power purchase agreement that calls for a refund to the university if it is charged a higher rate than LP&L's other industrial customers. The university has offered to settle the dispute for $3 million, which Fitch views as manageable for the utility. LP&L's contract with the university extends through July 1, 2019, and the university has continued to make full and timely payments despite the ongoing legal dispute.

Monsanto Company (A–/Stable) announced in January 2016 that it would build a cotton-seed processing facility in Lubbock. The plant, which is expected to require an estimated $140 million to build, is expected to become one of LP&L's top 10 customers once completed, with an expected energy demand of 7 MW and annual energy need of 30,660 MWh. The development is a positive for both the local economy and LP&L, which stands to benefit from the additional retail sales and the plant's expected high load factor.

Remaining Competition

LP&L remains in competition with South Plains Electric Cooperative and SPS in two relatively small overlapping service areas where LP&L does not have a significant presence. Fitch does not view the remaining competition as a significant credit concern, as the overlapping service areas are defined, limited in geographical size and customer base and of minimal importance to LP&L's operations.

Financial Performance and Legal Provisions

LP&L's financial metrics in fiscal 2015 and 2014 benefited from recent base rate increases. Fitch-calculated debt service coverage—which is not adjusted for debt legally defeased during the year but does include LP&L's portion of outstanding general obligation (GO) and certificate of obligation (CO) bonds issued by the city on LP&L's behalf—was at 2.41x and 2.37x in fiscal 2015 and 2014, respectively. Fitch-calculated coverage adjusted for transfers, primarily consisting of the franchise fee and payment in lieu of taxes (PILOT) paid to the city, was lower but still satisfactory for the rating at 1.61x and 1.56x in fiscals 2015 and 2014, respectively.

LP&L's transfer amounts to the general fund are formula driven. The franchise fee and PILOT are set at 5% and 1% of gross retail revenues, respectively, and are expected to remain at those levels in the future.

Management's financial forecast through fiscal 2021 shows generally stable financial performance, assuming not-yet-approved rate increases of 5.75% annually through fiscal 2019. Average debt service coverage through 2021 is projected at over 2.0x and, after adjusting for transfers, at around 1.4x.

Liquidity

Liquidity levels are sound, despite being somewhat below rating category medians, and supported by a reserve policy requiring a minimum level of three months gross metered revenue—approximately $65.0 million for fiscal 2016. LP&L retained unrestricted funds of $64.7 million, or 134 days cash on hand, at the end of fiscal 2015.

Debt and Capital Improvement Plan

Debt levels remain relatively low at $1,288 per customer. Outstanding revenue bonds amortize rapidly, with approximately 68% maturing before 2021, although outstanding GO and CO bonds issued by the city on LP&L's behalf ($47.4 million) amortize at a slower rate, with final maturity in 2034. Equity as a percentage of capitalization was 55.9% at the end of fiscal 2015 and remains consistent with the 'A' category median of 50.8%.

LP&L's $300.4 million, six-year capital improvement plan includes transmission system improvements and other system upgrades that will allow for the transition into the ERCOT market. The most significant series of projects relates to the completion of a 115 kV outer loop that will have four interconnections to the ERCOT grid. In total, management projects debt issuances of approximately $232.4 million through 2021, including issuances for $64.8 million and $51.3 million in fiscal 2017 and 2018, respectively.

Financial Summary — Lubbock Power & Light

($ 000, Audited Years Ended Sept. 30)	2011	2012	2013	2014	2015
Debt Service Coverage (x)					
Debt Service Coverage	2.1	2.0	1.9	2.4	2.4
Adjusted DSC (Including Purchased Power Adjustment as D/S)	1.3	1.3	1.3	1.4	1.4
Adjusted DSC (Including Transfer/PILOT/Dividend as O&M Expense)	1.4	1.3	1.3	1.6	1.6
Coverage of Full Obligations (PP as D/S and Transfer/PILOT/Dividend as O&M Expense)	1.1	1.1	1.1	1.2	1.2
Liquidity Metrics					
Days Cash on Hand	15	22	21	21	16
Days Cash and Investments on Hand	158	135	113	123	134
Days Liquidity on Hand	158	135	113	123	134
Leverage Metrics (%)					
Debt/FADS (x)	3.7	3.8	3.0	3.2	3.0
Adjusted Debt (Including PP Adj.)/Adjusted FADS (Including PP Adj.) (x)	5.9	6.0	5.4	5.7	5.5
Debt/Total Retail Customers ($)	1,438	1,305	1,277	1,311	1,288
Net Debt/Net Capital Assets	31.7	31.6	33.3	31.2	31.1
Equity/Capitalization	54.3	56.0	57.0	56.8	55.9
Debt/Capitalization	45.7	44.0	43.0	43.2	44.1
Adjusted Debt/Capitalization	73.1	72.1	72.7	74.0	74.3
Other Financial and Operating Metrics (%)					
Operating Margin	9.2	7.1	10.6	9.7	11.4
Retail Electric Revenue/kWh (Cents/kWh)	7.8	7.3	8.2	8.8	8.6
Transfer and PILOT and Tax/Total Operating Revenue	6.2	6.5	6.3	6.2	6.7
Capex/Depreciation and Amortization	475.1	122.4	85.5	83.1	61.3
Debt Service/Cash Operating Expenses	10.3	10.2	11.7	8.6	9.5
Income Statement					
Total Operating Revenue	201,459	189,209	212,656	227,245	221,215
Total Operating Expense	182,998	175,754	190,179	205,305	196,058
Operating Income	18,461	13,455	22,477	21,939	25,157
Adjustment to Operating Income for Deferred Revenue	20,218	21,484	20,595	19,444	19,487
Funds Available for Debt Service	38,695	34,939	43,082	41,393	44,653
Total Annual Debt Service	18,717	17,564	22,372	17,470	18,527
Balance Sheet					
Unrestricted Funds (Cash and Liquid Investments)	70,671	57,129	52,501	62,812	64,730
Restricted Funds	14,177	13,697	14,892	25,420	34,208
Total Net Assets/Member's Equity	170,555	167,312	171,536	175,993	168,713
Total Debt	143,327	131,233	129,467	133,800	133,250
Cash Flow Statement					
FCF (FADS - Transfer and PILOT - Total Annual Debt Service)	7,396	5,079	7,315	9,742	11,347
Capex	95,850	26,144	17,580	16,030	11,705
FCF Less Capex	(88,454)	(21,065)	(10,265)	(6,288)	(358)

FADS – Funds available for debt service. RSF – Rate stabilization fund. D/S – Debt service. PILOT – Payment in lieu of taxes. O&M – Operations and maintenance. PP – Purchased power.
Source: LP&L, Fitch Ratings.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.