STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:
Lubbock, Texas; Retail Electric

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Credit Profile		
US$7.675 mil elec light and pwr sys rev bnds ser 2016 dtd 04/15/2016 due 04/15/2046		
Long Term Rating	AA-/Stable	New
Lubbock retail elec		
Long Term Rating	AA-/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA-' rating to Lubbock, Texas' series 2016 electric light and power system revenue bonds. At the same time, we affirmed our 'AA-' rating on the system's parity electric system revenue bonds. The outlook is stable. The system does business as Lubbock Power & Light (LP&L).

The rating is based on our opinion of LP&L's general creditworthiness, and includes:

- The 2010 agreement that effectively ended the competitive situation between LP&L and an investor-owned utility that had been in place since 1942, making LP&L the sole retail electric provider to virtually the entire service area. This, in our opinion, not only removes competitive risks but also allows LP&L to have more certainty regarding long-term planning;
- The city's strong regional economy, anchored by higher education and health care;
- The low-risk operations of the city, which has essentially become a distribution-only system with a full-requirements purchased power agreement through 2019 with Southwestern Public Service Co. (SPS), a subsidiary of Xcel Energy, which is also LP&L's former competitor; and
- Possible integration to the Electric Reliability Council of Texas (ERCOT) power grid by 2019, which would likely reduce its wholesale power costs, and assure a diversified long-term power supply.

The rating is further stabilized by the city's implementation of a 2013 tweak to the rate schedule that has improved finances, following a dip in 2012. The adopted rate structure included:

- A 9.7% across-the-board rate adjustment (followed by a 5.75% annual base rate increase from 2014 through 2018);
- The creation of a rate-stabilization reserve, initially funded from $3.5 million of existing unrestricted reserves; and
- Seasonal rates, whereby the energy charge and purchased power cost recovery components of rates are fixed, albeit at different levels whether in the summer or nonsummer months. The rate stabilization reserve absorbs wholesale fluctuations up to a predetermined underrecovered threshold, at which time LP&L could still act to recoup costs more quickly.

The rate actions were, in our opinion, an important credit stabilizer to not only restore financial capacity in the immediate term, but likely to preserve it as the city evaluates future power supply options. Previously, LP&L's electric utility board had recommended a 7% rate increase in 2012 (twice) and in 2011--and each time, the city council rejected the rate increase, mainly choosing to await completion of a rate study and subsequent integrated resources plan. Those plans have since been completed and presented to council, which has ultimate rate-setting authority. We understand the city desires to become a member of ERCOT, and if approved, the majority of LP&L's future power supply (70%) could transition from the Southwest Power Pool (SPP) to ERCOT by 2019.

The bonds are secured by a first-lien pledge on the net revenues of LP&L's electric system. We understand series 2016 bond proceeds will fund system improvements. A debt service reserve fund in the amount of average annual debt service provides additional liquidity; however, a surety policy can be used to satisfy the reserve fund requirement, a new provision as of 2013. Also introduced in the 2013 master resolution was a revision to additional bonds language to a historical 1.1x maximum annual debt service coverage test. A rate increase implemented within 60 days of the bond issuance may be permitted to be applied to projected revenues to meet the additional bonds test. There is no change to the sufficiency rate covenant. The system has not entered into any direct purchase bank debt.

A business profile score of '4' on a '10'-point scale, with '1' being the strongest and '10' the weakest, reflects the system's position as a full-requirements purchased power agreement through 2019 with Southwestern Public Service Co. (SPS), a subsidiary of Xcel Energy, which we believe limits operational risk. However, the system's possible integration to ERCOT by 2019, if approved, will likely drive the capital program.

LP&L currently has 171 megawatts (MW) of dependable natural gas fired generation, with 114 MW anticipated to be available in 2019 for load requirements. Officials project the city will require an estimated 627 MW of total generation in 2019 for load requirements. LP&L will remain interconnected with SPP for 170 MW, and officials project an approximate need of 327 MW in 2019.

In September 2015, LP&L announced its intention to join ERCOT, which officials believed was significantly less expensive than self-build and all SPP-based proposals. The public utility commission (PUC) directed ERCOT to study the integration, and over the next four years additional infrastructure will be completed to convert to the ERCOT power grid, which serves most of the state's population, by 2019. LP&L will remain interconnected with SPP for a portion of electric load (30%) beginning in 2019. In the event the integration is not approved by the PUC or the ERCOT interconnection and transmission build-out is not completed until after June 2019, LP&L has contracted with a power marketing company to assist in identifying a short-term bridge of capacity and energy supply in SPP.

LP&L lies in the Southwest Power Pool, a regional transmission operator that serves all or portions of fourteen states, including the Texas Panhandle. Currently LP&L is a full-requirements customer of SPS by way of the city's participation in West Texas Municipal Power Agency (WTMPA), a joint action agency that derives 95% of its revenues from the city. LP&L has a bilateral agreement directly with SPS, beginning in 2019, to become a partial requirements customer through 2044.

Standard & Poor's had anticipated some decline in LP&L's financial profile following the 2010 acquisition of SPS' former assets, attributed to the associated bond sale that provided the acquisition's funding, as well as a significant equity contribution towards the final buyout. The decision to delay rate adjustments led to a larger decline than originally forecast and thin financial performance in fiscal 2012. However, the new rate schedule reduces the potential that net revenues available for debt service could further erode to the point that LP&L's coverage metrics become an outlier at the current rating level. The new rate schedule should also largely preserve LP&L's financial capacity for future debt plans, which total $167 million through 2019.

LP&L's financial performance is continuing to rebound from a period of unevenness in recent years, beyond even the anticipated decline in both cash reserves and coverage metrics in fiscal 2012. The decline in liquidity was a combination of a $20 million equity contribution to the SPS buyout as well as calling about $5.6 million in bonds in late 2012. From fiscal 2013 to fiscal 2015, the system increased its unrestricted cash and investments by $12 million to $64 million, or a strong 134 days' cash on hand, exceeding LP&L's statutory policy to maintain at least three months' operating reserves in cash. Annual debt service coverage (DSC) of LP&L's revenue bond debt and even its allocable portion of the city's general obligation (GO) debt remains above 2x. Fixed-charge coverage, which is Standard & Poor's internally adjusted DSC calculation that treats fixed demand charges as if they were on-balance-sheet debt and general fund transfers as if they were part of operating expenses, dropped to a thin 1.12x in fiscal 2012 but quickly bounced back to 1.25x in fiscal 2013. Fixed-charge DSC remained just below 1.2x in fiscal 2015 and fiscal 2014. We believe fixed-charge DSC will remain near 1.2x through fiscal 2017 after evaluating LP&L's financial projections.

We consider the system's debt burden moderate, with a debt-to-capitalization ratio equal to 51% in fiscal 2015. Following the series 2016 debt issue, the system will support $119.9 million in total debt including $42 million of GO debt. LP&L's five-year capital improvement plan (CIP) has identified about $305 million in total projects through fiscal 2021, not including anything that might be recommended from the PUC for ERCOT integration; the bulk of identified projects are transmission-related. LP&L intends to debt finance about 65% of its current CIP. Currently, officials intend to issue roughly $64 million in additional debt in 2017.

We will continue to monitor LP&L's possible integration to ERCOT; decisions supporting consistent financial performance, likely including rate adjustments, will also play a part. Management has in place, and regularly uses, a fuel/purchased power cost adjustor. The new rate schedule also creates summer and nonsummer fixed energy costs, with any power cost recovery to be absorbed by a newly created rate stabilization reserve. Management still reserves the right to implement a pass-through adjustment should LP&L become underrecovered beyond its target level.

LP&L currently serves 103,475 metered accounts. The city, home to approximately 241,300 people, is located in west Texas and acts as a regional trade and service center for a 25-county region with a population of about 600,000 people. The city's economy includes strong education and health care sectors. Lubbock's economy is anchored by the presence of Texas Tech University, which has an estimated enrollment of 35,000 and is the city's largest employer with approximately 9,000 employees. In our opinion, median household income levels are adequate at 87% of the national level, in part reflecting the large student population. LP&L is not reliant on any of its principal customers for operating revenues.

Outlook

The stable outlook reflects our expectation that LP&L's role as the sole retail provider to its service territory will allow it to maintain a financial risk profile commensurate with the current rating. In addition, we believe planned base rate adjustments through 2018 will help the system meet its financial metric projections.

Downside scenario

Conversely, any erosion in the financial health of LP&L, while not expected following the 2013 implementation of the new rate schedule, could be justification for a negative outlook or rating action.

Upside scenario

Given the possible integration with ERCOT, which will likely drive the system's capital program through 2019, we do not see any upward mobility for the rating within our two-year outlook horizon.

Related Criteria And Research

Related Criteria

- USPF Criteria: Electric And Gas Utility Ratings, Dec. 16, 2014
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of March 23, 2016)	
Lubbock retail elec	
Unenhanced Rating	NR(SPUR)
Many issues are enhanced by bond insurance.	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.