FITCH AFFIRMS ALEXANDRIA'S (MN) ELECTRIC UTILITY REV BONDS AT 'A+'; OUTLOOK STABLE

Fitch Ratings-Austin-06 November 2017: Fitch Ratings has affirmed the 'A+' rating on the following Alexandria, MN bonds:

--Approximately $5,165,000 electric utility revenue bonds, series 2015A.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by net revenues of the city's electric utility. The bonds also carry a debt service reserve account.

KEY RATING DRIVERS

LOW-RISK DISTRIBUTION SYSTEM: Alexandria Light and Power (ALP) is a low-risk distribution provider serving a small but stable service territory located approximately 130 miles northwest of the Minneapolis metropolitan area. The utility ranks among the largest members of Western Minnesota Municipal Power Agency (WMMPA; power supply revenue bonds rated AA-/Stable), which, together with the Western Area Power Administration (WAPA), provide ALP with a low-cost, long-term power supply.

FAVORABLE DEBT PROFILE: Leverage ratios remain strong, providing capacity to absorb additional financing included in management's five year financial forecast. Leverage, measured by net adjusted debt to adjusted funds available for debt service (FADS), was 4.8x in fiscal 2016 and compared favorably to the 'A+' rating category median of 5.4x. A planned $5 million bond issuance in fiscal 2018 is not expected to have a material negative impact on the utility's leverage profile.

CONSISTENT FINANCIAL OPERATIONS: Sound cash flow metrics compare well to Fitch's median ratios with Fitch calculated debt service coverage staying comfortably above 4.0x over the prior five fiscals and coverage of full obligations averaging about 1.25x. Additional debt service following the utility's planned debt issuance is mitigated with planned rate increase included in the forecast. Liquidity also remains healthy with approximately 153 days cash on hand at the end of fiscal 2016.

LOW RETAIL RATES: Residential retail rates are competitive with area providers and noticeably lower compared to statewide averages. Commercial and industrial rates are above the statewide average rates, but still remain competitive. Rates are not subject to regulatory or political oversight and can be adjusted in a timely manner to recover changes in wholesale power costs, which Fitch views favorably.

CUSTOMER CONCENTRATION: Concentration among ALP's 10 largest end-users coupled with its above-average reliance on revenue derived from industrial customers poses some concern, although the take-and-pay nature of ALP's power supply contracts and the proven economic stability of the service area sufficiently lessen these risks.

RATING SENSITIVITIES

CONTINUED FINANCIAL PERFORMANCE: Sustained strong financial performance that is supported by continued system growth, constructive rate setting and robust liquidity, and offsets plans for higher direct and indirect debt issuance, could lead to positive rating action.

WEAKENING OF REGIONAL ECONOMY: Sustained weakening throughout ALP's service area and regional economy that challenges the utility's industrial and commercial customer base and employment base, reduces rate flexibility, and strains financial metrics could result in downward rating pressure.

CREDIT PROFILE

ALP is a relatively small city-owned utility providing electric distribution, water treatment and conveyance and communication services to a stable service territory located approximately 130 miles northwest of the Minneapolis metropolitan area. Outstanding electric utility revenue bonds issued by ALP are secured only by net revenues of the electric system. Accordingly, each of ALP's three utility systems is accounted for separately. Electric revenues comprise approximately 91% of ALP's total revenue base on a consolidated basis.

The utility serves a modestly growing, largely stable service territory that includes the city of Alexandria (the city) as well as smaller areas immediately east, north, and west of the city. The city, which serves as a tourism, retail and industrial center for the broader region, accounts for about half of the total service area, but includes slightly more than 80% of the total customer base. The region's exceptionally low unemployment and healthy median household income levels have contributed to consistently strong revenue collection for the utility.

The utility's 10 largest customers account for a fairly sizeable 32% and 27% of electric system sales and revenue, respectively, However, all are reportedly stable and well rooted with all but two having been a customer of ALP since at least 1984. Residential and commercial users dominate the entire customer base, but compose just 38% of the electric system's aggregate energy sales. Industrial end-users account for the balance.

LONG-TERM AND COMPETITIVELY-COST SUPPLIES THROUGH WAPA AND WMMPA

Multiple long-term contracts with stable wholesale power suppliers provide ALP with a diverse, low cost power supply sufficient to meet its longer term needs. ALP meets its load requirements first with low-cost hydroelectric power purchased from WAPA under a long-term take-and-pay contract ($31/MWh in 2016) that extends through 2051.

The WAPA allocation provides nearly one-third of ALP's power requirements while the balance is satisfied with supplemental purchases from Missouri River Energy Services (MRES), a power supply joint action agency that lacks financing authority. Power supplied by MRES is generated and/or procured by WMMPA, a municipal joint action agency created to finance and acquire resources on behalf of MRES. ALP recently extended its agreement with MRES through 2057.

WMMPA maintains a sizeable portfolio of competitively priced power ($58/MWh in 2016) as well as extensive transmission facilities sufficient to meet the power supply needs of its members. Owned generation is heavily weighted towards coal-fired capacity, although additional ownership of wind, nuclear, and natural-gas fired capacity provides some diversity. Completion of the ongoing 35MW Red Rock Hydro Project will further diversify the resource mix. ALP management expects the project to commence commercial operations in mid-2019.

WMMPA's coal-fired capacity is derived entirely from its 16.47% ownership interest in the Missouri Basin Power Project (MBPP) and its principal asset, Laramie River Station (Unit No. 1).

Energy supplied from WMMPA's share of LRS has diminished in recent years, decreasing to 23% of MRES members' power supply in 2016 from 29% and 37% in 2011 and 2006, respectively. The difference is primarily driven by increased purchased power, which has resulted from lower market prices.

LRS owners have historically benefited from the unit's consistently strong operating performance and low production costs. However, costs to comply with environmental regulations by further limiting emissions will affect LRS's future production costs. The owners of LRS reached an agreement with the EPA in 2016 that requires the installation of selective catalytic reduction NOx removal technology at all three of LRS's generating units. The agreement settles the pending appeal regarding the regional haze issues at LRS. MRES' portion of the costs is expected to be approximately $45 million, which is expected to be passed through to member rates.

SOUND FINANCIAL PROFILE AND LOW DEBT

Financial metrics currently compare well to Fitch's median ratios and should remain strong over the current forecast period given plans to raise electric rates. Fitch calculated debt service coverage was 4.07x in fiscal 2016 while coverage of full obligations, including a modest annual transfer to the city's general fund, averaged about 1.25x. Median ratios for the 'A+' rating category were 2.41x and 1.38x, respectively.

ALP's capital improvement plan through fiscal 2021 appears manageable with modest spending levels. Low debt levels, improved liquidity, and ample rate flexibility position the utility well to absorb additional leverage programmed into the current capital plan. Leverage, as measured by net adjusted debt to adjusted FADS, remained very healthy at 4.8x in fiscal 2016 and compared favorably to the 'A+' category median of 5.4x. The net adjusted debt to adjusted FADS considers the utility's proportionate share of WMMPA's outstanding debt as well as ALP's system debt.

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Applicable Criteria

Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017)
https://www.fitchratings.com/site/re/898969
U.S. Public Power Rating Criteria (pub. 18 May 2015)
https://www.fitchratings.com/site/re/864007