Fitch Ratings

05 MAY 2021

Fitch Upgrades Alexandria's (MN) Elec Revs to 'AA-'; Outlook Revised to Stable from Positive

Fitch Ratings - Austin - 05 May 2021: Fitch has upgraded the following bonds issued by Alexandria, MN (dba Alexandria Light & Power [ALP]) to 'AA-' from 'A+':

--Approximately $4.27 million Electric Utility Revenue Bonds, Series 2015A;
--Approximately $2.37 million Electric Utility Revenue Bonds, Series 2019A.

Additionally, Fitch has assessed ALP's standalone credit profile (SCP) at 'aa-'. The SCP represents the credit profile of the utility on a stand-alone basis irrespective of its relationship with and the credit quality of, the city of Alexandria, MN.

The Rating Outlook has been revised to Stable from Positive.

ANALYTICAL CONCLUSION

The rating upgrade to 'AA-' from 'A+' reflects ALP's very strong financial profile, which continues to be bolstered by the utility's very low leverage, sound operating cash flow, and robust liquidity metrics. Fitch's analysis of ALP's leverage also considers the utility's proportionate share of borrowings at Western Minnesota Municipal Power Agency (WMMPA, AA-/Stable)/Missouri River Energy Services (MRES). ALP's long-term contracts with Western Area Power Administration (WAPA) and MRES provide the utility with a low-cost and well-diversified power supply.

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. Each of ALP's three utility systems is accounted for separately.

The electric utility revenue bonds issued by ALP are secured only by net revenues of the electric system, which compose approximately 90% of ALP's total revenue base on a consolidated basis. Accordingly, Fitch's analysis and metric calculations are based on the performance of the electric system.

Fitch considers the system to be a related entity to the city of Alexandria for rating purposes given the city's oversight of the system including the appointment of ALP board members and approval of bond issues. The credit quality of the city does not currently constrain the bond rating. However, as a result of being a related entity, the issue ratings could become constrained by a material decline in the general credit quality of the city.

The overall impact of the recent pandemic on ALP's financial performance remains limited. While ALP experienced some declines in industrial demand during the first half of 2020, energy sales rebounded in the later portion of the year and management expects energy sales to return to pre-pandemic levels by fiscal 2022.

Strong Revenue Defensibility; Some Customer Concentration

ALP's strong revenue defensibility is supported by an electric system that provides service within a single certified area. Demand characteristics throughout the service area support the assessment, but income levels are weaker than state and national averages. Fitch's assessment of revenue defensibility is further tempered by concentration among ALP's top 10 customers and a customer mix that is mostly commercial and industrial by energy sales and revenues, both of which represent asymmetric rating factors. Rate flexibility is very strong, and rates remain very affordable despite lower incomes.

Very Low Operating Cost Burden

ALP's operating risk assessment is well-supported by its very low operating cost burden, which remained below 9 cents/kWh for the past five years. ALP's long-term power supply contracts with both WAPA and MRES provide ALP with both an ample and diversified power supply. ALP's capital improvement plan is manageable, with modest spending through fiscal 2025.

Very Strong Financial Profile

ALP's financial profile assessment is very strong. The utility's leverage ratio, as measured by net adjusted debt to adjusted funds available for debt service, was a very low 3.6x at FYE 2020. While the ratio is somewhat understated given ALP's contractual obligations to WMMPA, the utility's overall leverage profile remains in line with the 'AA-' rating. Coverage of full obligations and liquidity remain very healthy and support the financial profile assessment.

Asymmetric Additional Risk Considerations

No asymmetric additional rating considerations were applied in the rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--An upgrade is unlikely absent a material decline in the concentration among ALP's largest customers.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Sustained weakening throughout ALP's service area and regional economy that challenges the utility's industrial and commercial customer base and employment base or reduces rate flexibility.

--Weakened operating cash flow that pressures the utility's liquidity;

--Sustained increases in leverage above 8.0x in Fitch's base and stress cases, resulting from either an increase in direct obligations, or an increase in off-balance obligations.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

SECURITY

The bonds are secured by the net operating revenues of the city's electric utility.

Revenue Defensibility

Very Strong Revenue Source Characteristics

ALP's revenue source characteristics are very strong, with revenues provided from the sale of retail electric to a single certified service area. ALP also provides water and communication services to retail customers. However, the revenue bonds are secured only by the net revenues of the electric system. Each of the utility systems is financially self-supporting, and the electric system accounted for approximately 90% of fiscal 2020 revenues (unaudited).

Service Area Characteristics

The city of Alexandria, MN, and the surrounding area serve as both a tourist destination and an important industrial center. The area's chain of lakes coupled with the city's retail and commercial presence attracts visitors throughout much of the year. The service area includes affluent lake homes and three large industrial parks that are home to several of the city's largest employers.

ALP's service area characteristics are generally viewed as strong. Customer growth remains fairly consistent, averaging around 0.9% annually over the past five years. Median household income levels remain below the state average, although the Douglas County unemployment rates generally outperformed state and national metrics in 2020.

Electric energy sales exhibited moderate declines of approximately 3% in 2020 compared to 2019, which was primarily attributable to declines in consumption among ALP's industrial customers. The state of Minnesota implemented a stay-at-home order from March 27 through May 17. Although certain industrial customers were deemed essential and remained in operation, industrial consumption declined by more than 5% yoy. However, stronger residential sales partially mitigated some of the industrial decline as demand grew by 3% over 2019 levels. Management projects energy sales to rebound in 2021, reaching pre-pandemic levels by 2022.

Rate Flexibility

Ample Rate Flexibility

Fitch views ALP's rate flexibility as very strong. ALP maintains the independent ability to set rates, and rates are not subject to oversight or approval by any political or regulatory body. ALP's board of directors, which consists of five members, can choose to adjust rates with a simple majority vote. ALP's rates consistently rank below the state average, providing additional flexibility to adjust rates. Residential electric costs remain very affordable despite lower than average income levels.

Customer Concentration Constrains Revenue Defensibility Assessment

Concentration among ALP's 10 largest end users (30.5% of energy sales in 2020) coupled with its above-average reliance on revenue derived from commercial and industrial customers are asymmetric risk factors and limit the utility's overall revenue defensibility assessment.

Operating Risk

Very Low Operating Cost Burden

Fitch assesses Alexandria's operating cost burden as very low. Multiple long-term contracts with stable wholesale power suppliers provide ALP a very low-cost power supply.

ALP meets its load requirements first with low-cost hydroelectric power purchased from WAPA under a long-term take-and-pay contract (2.2 cents/kWh in 2020 unaudited) that extends through December 2050. The WAPA allocation provides approximately one-third of ALP's power requirements.

The balance is satisfied with supplemental purchases from MRES, a power supply joint action agency. 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's agreement with MRES extends through January 2057.

Operating Cost Flexibility

ALP's long-term contracts with WAPA and MRES provide the utility with a stable and diverse power supply sufficient to meet its long-term needs, which Fitch assesses as neutral to the operating risk assessment. WMMPA maintains a sizable power portfolio and extensive transmission facilities sufficient to meet the power supply needs of the MRES members. Approximately 44% of energy supplied to members in 2020 was renewable, 34% purchased power, 14% coal, 6% from nuclear, and 2% gas and fuel oil.

WMMPA's most recent addition to its power supply - the 36.4MW Red Rock Hydro Project (RRHP) - was completed in September 2020. The new plant composes only a small portion of WMMPA's total energy, but it further diversifies the utility's resource mix and provides carbon-free, renewable power. The RRHP was subject to cost overruns (amounting to a manageable 6% over the original $379 million budget) and delays due to flooding and unanticipated site conditions and design modifications. However, the facility is expected to provide stable and low-cost power over the long-term.

WMMPA's coal-fired capacity is derived entirely from its 16.47% ownership interest in the Missouri Basin Power Project and its principal asset, Laramie River Station (LRS) Unit No. 1. Energy from LRS declined substantially in recent years, reflecting the WMMPA's entry of the plant into the Southwest Power Pool (SPP), an organized energy market serving portions of 14 states, in 2015.

Participation in the SPP market results in all generation assets being dispatched based on economics. LRS was previously dispatched as needed to cover member load/demand without regard to costs. The change reduced the amount of time LRS is dispatched, but as a benefit of being in an organized market, WMMPA is able to access lower priced energy to serve its load. Despite the more intermittent use, LRS remains a key resource and provides a physical hedge to changes in market prices. Most recently, LRS remained in operation during the February winter weather event, which mitigated the effect of higher prices within the SPP market.

Capital Planning and Management

Fitch considers ALP's capital planning and management as strong, primarily reflecting the utility's average age of plant of approximately 20 years. Fitch believes this suggests an elevated lifecycle investment need. However, ALP continues to invest in system improvements, with capex far exceeding depreciation and amortization. Future capital investments focus on the undergrounding of electric lines and management expects to fund the electric utility expenditures through operating cash flow.

Financial Profile

ALP continues to exhibit very strong financial metrics. Leverage steadily declined during the past five years to approximately 3.6x at FYE 2020 (unaudited) from 5.4x in fiscal 2015. The decline resulted from continued amortization of outstanding debt, and improving cash flow metrics bolstered by electric rate increases of 2% and 1% in fiscal years 2017 and 2019, respectively. Notably, operating cash flow improved in fiscal 2020 (unaudited) as the lower industrial energy demand was partially offset by declining purchased power costs.

Operating revenues also benefitted from the recent electric rate increases, in addition to the residential demand growth. Strong cash flow also contributed to a healthy liquidity cushion, as coverage of full obligations of 1.9x in fiscal 2020 (unaudited) led to an increase in days cash to 221 days at FYE 2020 (unaudited) compared to 182 days at FYE 2019.

Fitch also considered ALP's off-balance sheet debt, which is represented by ALP's proportional share of WMMPA's debt. While Fitch's calculation of ALP's leverage metrics is higher using the fiscal 2020 off-balance sheet debt, ALP's leverage metrics remain supportive of a very strong financial profile.

Fitch Analytical Stress Test (FAST) Scenarios

The FAST base case scenario represents Fitch's expectation of ALP's financial performance through the five-year period ending in 2025. Management expects energy sales will grow between 3% and 4% over the next two years as energy sales rebound to pre-pandemic levels before tapering to more moderate growth rates through 2025. Fitch's scenario analysis shows the utility's leverage ratio temporarily rising to 4.4x as operating cash flow narrows in 2021 before steadily declining to 3.9x by 2025 as debt slowly amortizes. Management does not expect to issue debt in the next five years.

ALP's capital improvement plan through fiscal 2025 appears manageable, with expenditures totaling approximately $13 million over the next five years. Low debt levels and a solid liquidity position the utility well to absorb additional leverage. Furthermore, planned rate increases 2024 (3%) and 2025 (2%) should provide additional operating cash flow to finance ALP's capital plan.

Fitch's stress case incorporates a demand stress illustrative of normal cyclical variations. The stress in energy sales is based on ALP's historical demand volatility and is overlaid on ALP's assumed annual load growth. Under the stress case, ALP's leverage ratio rises and plateaus at 4.6x in fiscals 2022 before resuming a steady decline.

Debt Profile

ALP's debt profile is neutral to the rating. Outstanding debt totaled $7.4 million at FYE 2020 (unaudited) and was comprised entirely of revenue bonds. Fitch's calculation of ALP's leverage also included $39 million of capitalized fixed charges for purchased power and $4 million for pension liabilities. Fitch's analysis of ALP's off-balance sheet debt considered approximately $45 million related to ALP's proportional share of MRES/WMMPA's obligations.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Fitch Ratings Analysts

Tim Morilla
Director
Primary Rating Analyst
+1 512 813 5702
Fitch Ratings, Inc. 2600 Via Fortuna, Suite 330 Austin, TX 78746

John Choi
Senior Analyst
Secondary Rating Analyst
+1 212 908 0521

Dennis Pidherny
Managing Director
Committee Chairperson
+1 212 908 0738

Media Contacts

Sandro Scenga
New York

+1 212 908 0278
sandro.scenga@thefitchgroup.com

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub.23 Feb 2021) (including rating assumption sensitivity)

U.S. Public Power Rating Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Alexandria (MN)	EU Endorsed, UK Endorsed

Disclaimer

ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

Copyright

 In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

Endorsement policy

Fitch’s international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch’s approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.