KBRA’S OUTLOOK: THE CREDIT LANDSCAPE FOR PUBLIC POWER COVID-19’S AND BEYOND

APPA

APRIL 24, 2020
KBRA BY THE NUMBERS

Certifications

KBRA
- Registered as an NRSRO with the SEC
- Designated as a DRO for Structured Finance products by the OSC
- Designated as a Credit Rating Provider by the NAIC
- Certified as a CRA with ESMA
- Recognized as an ECAI by the EBA and OSFI
- Recognized by the USDA’s Rural Utilities Service
- Accepted by the Department of Transportation (DOT) & TIFIA

KBRA Europe
- Registered as a CRA with ESMA
- Recognized as an ECAI by the EBA

Offices

KBRA has 400 employees in New York, Maryland, and Pennsylvania.
KBRA Europe has 17 employees in Dublin and London

Sector Coverage

- ABS
- CMBS
- Corporates
- Financial Guaranty
- Financial Institutions
- Funds
- Insurance
- Project Finance
- Public Finance
- REITs
- RMBS
- Single-Family Rental
- Sovereigns
- Structured Credit (CLOs)

PUBLIC FINANCE BY THE NUMBERS

As of 4/2020

$324.26 Bn
Total Rated Debt

$5.3 Bn
Notional Par Rated 2020 YTD

$327 Mn
Average Rated Deal Size

37,744
RATINGS ISSUED

2,492
RATED ENTITIES

$2.0 Tn
RATED ISSUANCE

65
METHODOLOGIES

1,000+
PUBLISHED RESEARCH
MACRO IMPACT OF COVID-19 ON CREDIT

- Passage of the CARES Act coupled with the Fed’s deep reach into its toolkit are bold and unprecedented attempts to offset some of COVID-19’s devastating economic effects.

- Direct aid to airports, airlines, transit systems, and others, has in some instances been the difference between collapse and survival.

- The Fed’s interventions into certain markets, including the short term muni market, and the IG corporate market, have helped these markets gain some much-needed footing.

- The new Municipal Liquidity Facility to help states, large cities, and counties with cash flow needs is helpful, but will likely not be enough to fill the large and growing void in governmental revenues.

- All of the above may help build a bridge to an improved environment, but it is difficult to build a bridge when you don’t know how long it needs to span. The most important credit questions are: When will the economy get back to normal? And what does that new normal look like?

- We believe economic recovery will begin in earnest only when the public becomes confident that the health crisis has been brought under control.

- Consumer and business behavior may be altered in significant ways which may temper economic rebound and trigger different behaviors in the immediate post-crisis period.

- Meanwhile, as always, KBRA is deploying the steady hands of experienced analysts who are using data rather than emotion and headlines when considering rating and outlook changes.
Crisis has proven, yet again, the essentiality of Public Power— a foundational credit strength of the sector, sometimes lost in the headlines.

Industrial / Commercial demand expected to be down – but reserves and lower fuel costs are among the things that should insulate the sector.

Local government owners may come knocking for help with their budgets.

Eventually, future will look like the past:

- Environmental / Regulatory pressure eventually will return, and could intensify if November elections bring change
- Grid Reliability and Cyber Security will also be top of mind
PUBLIC POWER KEY RATING CONSIDERATIONS

- Management, Governance, Regulatory Framework
- Service Area and Demand
- Operations and Capital
- Financial Profile and Debt

KBRA ratings and methodologies are intended to withstand economic cycles, not move with them.
Management, Governance, Regulatory Framework

- Assess the quality and experience of management team as well as the power entity’s relationship with the related governments
- Review management’s rate setting authority, revenue raising flexibility, and the rate implementation process
- Understand environment risk and renewable portfolio standards
- Review policies around capital and resource planning
LEGAL AND SECURITY CONSIDERATIONS

  
  - Review bond indenture and series resolution for legal mechanics governing debt issuance and the payment of debt service:
    
    - Revenue pledge
    - Rate covenant
    - Additional bonds test
    - Reserve requirements
    - Flow of funds
  
  - A strong security structure and relatively restrictive bond indenture provisions that prevent overleveraging of system revenues are generally characteristics of highly rated systems
Service Area and Demand

- Characteristics of a strong system include:
  - Strong and diversified customer base
  - Stable or improving trends in number of customers, system usage and sales revenues
  - Rate affordability – closely tied to level of economic prosperity within a service area

Rate Structure

- Review of rate structure in context of:
  - Utility’s ability to maintain competitive rates, ensuring flexibility for needed increases
  - Historical record of timely, consistent and reasonable rate adjustments which achieve full cost recovery amidst transition to new / changing power supply
  - Enforcement policies to support collections
  - Presence of a rate study to derive required level of future rates
Operations and Capital

- Maintaining both high quality infrastructure assets and rate affordability are key considerations.

- Capital plans and engineering reports are critical to our review of a utility’s operating profile.

- Fuel supply and diversity of fuel mix impact system reliability and cost.

- All-in cost of power influenced by:
  - The financing, capital and O&M costs of generation, transmission and distribution assets
  - Fuel costs
  - Regulatory environment and environmental considerations
  - Demand conditions

- Those utilities whose all-in cost of power is competitive can generally provide reliable service, recover costs and maintain rate setting flexibility.
Financial Profile and Debt

- Historical and pro-forma financial metrics are important measures of a utility’s overall financial profile and ability to manage through stress
  - Debt service coverage trends
  - Fixed charge coverage (for utilities with non-debt fixed liabilities)
  - Balance sheet trends and available resources relative to debt and other fixed obligations, including pensions
  - Reserves
  - Cash flow and liquidity (days cash on hand)
  - Revenue and expenditure performance trends
  - Operating margins
  - Accounts receivable
  - Leverage ratio (debt to net fixed assets)
  - Percentage of unhedged variable rate debt or derivatives exposure
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FURTHER INQUIRY

For any follow up questions regarding this presentation, please contact our credit team. For inquiries regarding our Public Finance ratings please contact:

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