MOODY'S
INVESTORS SERVICE

Rating Update: Moody's changes City of Burlington's (VT) electric revenue bond outlook to stable from negative; Affirms Baa2 rating

Global Credit Research - 20 Dec 2013

Approximately $33 million of debt affected

BURLINGTON (CITY OF) VT ELECTRIC ENTERPRISE
Combined Utilities
VT

Opinion

NEW YORK, December 20, 2013 --Moody's Investors Service has changed the City of Burlington's (VT) Electric System Revenue Bond rating outlook to stable from negative and affirmed the Baa2 rating, impacting $33 million of outstanding parity debt. The Burlington Electric Department also has $45 million of outstanding general obligation bonds secured by the City of Burlington's (VT) general obligation pledge (GO rated Baa3, negative).

RATING RATIONALE

The change in the outlook to stable from negative reflects the Burlington Electric Department's (the department or BED) improved financial performance with stable debt service coverage ratios, coupled with reduced exposure to the wholesale power market volatility given the procurement of more certain medium to long-term power supply contracts.

The Baa2 rating is based on the department's stable customer base in the relatively strong economy of City of Burlington (VT) balanced against the fact that its rates are regulated by the state public service board (PSB), exposing the department to regulatory lag risk, which is unusual for public power utilities that generally benefit from local rate setting authority. While regulated, the PSB has approved all department rate requests for the last two decades, evidencing a supportive regulatory regime. The rating also reflects the department's improved power supply diversity and debt service coverage ratios (DSCR) in recent years. The department's liquidity, while improving, is still weak with approximately 50 days cash on hand.

Moody's recognizes that utility customers are subject to the same regional economic factors as the city, but there is a limited fiscal linkage between the local government and the Burlington Electric Department due to the indenture required closed loop flow of funds, therefore the department has not been impacted by the City of Burlington's telecom debt issue.

Outlook

The stable outlook reflects our belief that the department will continue to maintain a more predictable and diverse power supply profile, as well as financial metrics on par with 2013 results over the medium term and rates and costs will be timely adjusted to ensure margins are maintained.

What Could Change the Rating - UP

The rating could face upward pressure if the department improves its liquidity position, maintains stable coverage ratios, and successfully renews or replaces its power supply contracts as they expire to insulate the department from volatile spot market prices.

What Could Change the Rating - DOWN

The rating could face downward pressure if the debt service coverage ratio falls below the 1.25x rate covenant, if the department has difficulty managing the market exposure and if liquidity weakens.

DETAILED CREDIT DISCUSSION

LEGAL SECURITY: The bonds are secured by the net revenues of the electric system. There is a 1.25 times rate covenant and the debt service reserve requirement is equal to maximum annual debt service on the senior revenue bonds.

The department also has approximately $45 million of general obligation (GO) bonds that are expected to be repaid from electric department operating revenues. The rate covenant on the consolidated debt outstanding is 1.00 times. Per the General Bond Resolution, the claim on the revenues of the department by the revenue bondholders is prior to any claim of the GO bondholders.

INTEREST RATE DERIVATIVES AND VARIABLE RATE DEBT: None

RECENT DEVELOPMENTS

The department's financial position and its power supply management stabilized in 2013 with the addition of several long term power supply contracts that diversity the fuel mix while also increasing cost predictability. While the department's 50% ownership of the McNeil wood-fired plant provides 37% of its load capacity, the rest of the department's energy requirements are satisfied through the New England power market. In order to mitigate the exposure to increases in ISO NE costs for transmitting purchased power, management has fixed price contracts in place for nearly 100% of its capacity needs through 2017. The department is also replacing its short term bilateral contracts with long term contracts. In 2014, the department's short term purchases through bilateral contracts are expected to be 12%, notably down from a high of 44% in 2010. The department's new medium to long-term contracts are with Vermont Wind for 12% of capacity until 2021; Georgia Mountain Wind for 7% of supply until 2027; and Nextera Hydro for 24% of capacity until 2018. As Nextera's contract tapers down, additional contracts are expected to be signed to mitigate a drop in firm supply and the need for market purchases. The department is in the process of approving and executing contracts that will fully cover its annual energy requirements.

The department's revenue derived from the sale of Class I Renewable Energy Credits (REC) in Connecticut and Massachusetts has also increased to an expected $8.8 million in 2014. REC sales are contracted at fixed prices for more than 50% of production through 2016. In order to minimize the exposure in the renewable energy credit market, BED's budget assumptions for open positions are conservatively half of the present market prices. For the next three years, the department's cost variance will be related to the operation of its McNeil plant and the plant's production levels, REC sales, and variable demand under its power supply contracts.

Given the stability of the department's power supply, the DSCR in 2013 on a net revenue post city transfer basis was a strong 2.21 times for senior revenue bonds in 2013 and a solid 1.61 times for consolidated bonds (includes subordinate general obligation bonds). This was a notable improvement from a consolidated DSCR of 1.26 times in 2012. Per the power supply forecast until 2017, we expect the department to maintain financial metrics on par with 2013 results in the medium term. The department also continues to increase its liquidity position, which is relatively weak compared to its peer group and suppressed by its rate regulatory body. The department's days cash on hand in 2013 was approximately 50 days. Moreover, the department has secured a $5 million bank line of credit from Key Bank that has no outstanding draws, but also supports the liquidity profile moving forward.

Regarding the capital improvement projects, in 2013 the department continued to invest in the VELCO and Highgate Converter Station. Until 2017, the majority of the capital improvement plans will include distribution upgrades and other general plant upgrades that are likely to be cash funded. In 2016, the McNeil plant will have a scheduled major overhaul.

KEY STATISTICS:

Type of System: Electric generation and distribution

Total Debt Service Coverage Ratio, net revenue basis post city transfer, FY 2013 (3-YR AVG): 1.61x (1.45x)

Days Cash on hand, FY 2013 (3-YR AVG): 50 days (44 days)

Debt Ratio, FY 2013 (3-YR AVG): 60% (65%)

METHODOLOGY SCORECARD FACTORS:

Factor 1 - Cost Recovery Framework Within Service Territory (25% weight): Baa

Factor 2 - Willingness to Recover Costs and Maintain Sound Financial Metrics (25% weight): Baa

Factor 3 - Management of Generation Risk (10% weight): A

Factor 4 - Rate Competitiveness (10% weight): A

Factor 5 - Financial Strength (3 year historical averages) - (a) Liquidity (10% weight): 50 days (Baa)

Factor 5 - Financial Strength (3 year historical averages) - (b) Debt Ratio (10% weight): 60% (A)

Factor 5 - Financial Strength (3 year historical averages) - (c) Coverage (10% weight): 1.45 times (Baa)

Scorecard Indicated Rating: Baa1

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The principal methodology used in this rating was U.S. Public Power Electric Utilities with Generation Ownership Exposure published in November 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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