Anchorage Municipality, Alaska
Anchorage Municipal Light & Power; Retail Electric

Credit Profile		
US$168.56 mil sr lien elec sys rev bnds ser 2014A due 12/01/2044		
Long Term Rating	A+/Stable	New
Anchorage Municipality elec rev & taxable Build America bnds ser 2009A&B		
Long Term Rating	A+/Stable	Affirmed
Anchorage Municipality elec		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Rationale

Standard & Poor's Ratings Services assigned its 'A+' long-term rating and stable outlook to Anchorage Municipality, Alaska's series 2014A senior-lien electric system revenue refunding bonds, issued for Anchorage Municipal Light & Power (ML&P), and affirmed its 'A+' long-term rating and underlying rating (SPUR), with a stable outlook, on ML&P's debt.

Credit strengths supporting the rating include, what we consider, ML&P's:

- Strong combined senior- and junior-lien debt service coverage (DSC) of at least 1.6x for fiscal years 2010-2013 and fixed-charges DSC of 1.3x over the same period;
- Adequate liquidity with unrestricted cash as of fiscal 2013, equivalent to 40 days' operating expenses;
- Substantial financial flexibility since rates are well below the average of neighboring utilities -- Recent and expected sizable rate increases to finance new gas-fired capacity, however, will nevertheless leave ML&P in a strong competitive position;
- Home city's position as the state's dominant economic and business center; and
- Stable operations, including a low cost gas supply, sufficient capacity, manageable load growth, and backup energy exchange agreements with neighboring utilities that somewhat mitigate the utility's remote location.

We believe somewhat offsetting credit concerns include, what we consider, ML&P's:

- Concentrated power supply portfolio with more than 88% of power resources derived from system-owned natural gas turbines -- Management, however, plans to complete the repowering of most of its fleet within the next two years, which it expects will greatly improve efficiency and reduce fuel costs;
- Remote location, which makes transmission and energy procurement somewhat challenging and necessitates excess capacity to ensure reliability;
- Some concern related to the depletion, over time, of the utility's gas supply at Beluga River Gas Field, a significant source of gas supply -- ML&P, however, has obtained additional contracted gas supply through 2019;
- Sizable capital improvement plan (CIP), totaling $209 million over the 2015-2020 period; and

- Lack of autonomous rate-setting ability since it must have rate increases approved by the Regulatory Commission of Alaska (RCA) – While there is a record of regulatory support for cost recovery for ML&P's rate filings, however, the requirement to have rates approved by a state regulator is atypical of municipal utilities; it creates the potential for regulatory lag or denial of requested rate increases.

Gross revenue of the municipality's utility fund secures the bonds after the payment of operating expenses. Officials intend to use series 2014A bond proceeds to refund commercial paper (CP) obligations and partially refund the series 2005A bonds. ML&P plans to continue to use its CP program to provide initial funding for its CIP and ultimately issue long-term bonds to retire CP borrowings. As of Aug. 31, 2014, ML&P had $140 million of CP outstanding.

The utility's business profile is '4' on a 10-point scale with '1' being the strongest and '10' the weakest, reflecting the risks inherent in the ownership of generation, an aging infrastructure, a somewhat concentrated power supply portfolio, a strong customer base with stable load patterns, the good financial performance and policies, and the competitive rates.

The utility's service area is 20 square miles, and it includes most of the downtown and high-density residential areas of Anchorage; the rest of the municipality, including most of the lower density outlying areas of the city, is served by Chugach Electric Assn. (CEA). Although the utility's service area is smaller physically than CEA's, ML&P estimates its service area accounts for approximately half of retail energy sales within the municipality.

Outlook

The stable outlook reflects Standard & Poor's opinion of ML&P's continued strong financial performance, including strong DSC and liquidity. The outlook further reflects our expectation that ML&P will repower its generation assets with more cost-efficient turbines. The outlook also reflects ML&P's competitive rates and recent additional load that should continue to produce strong DSC.

Markets

The Anchorage municipal utility provides electricity to 30,800 customers; residential customers account for 80%. The city's commercial and industrial base, which generated 67% of retail revenue in 2013, anchors energy sales. Management expects the number of customer accounts to increase by less than 1% annually over the next several years, and annual sales increase by about a half percent annually. The 10 leading customers accounted for 32% of annual energy sales in 2013 but just 26% of annual revenue. Elmendorf Air Force Base and Fort Richardson, both U.S. military installations, accounted for 10.1% of fiscal 2013 operating revenue combined after the bases' demand decreased following the installation of a landfill-gas-to-energy project. Almost all 10 leading customers are in the government or health care sectors, which we believe reduces the risk of customer concentration.

Anchorage is home to about 301,000 residents, or about 40% of the state's population. The municipality's economy is by far the largest in Alaska, and it serves as an economic hub for most of the state. Companies in key sectors such as petroleum and other natural resources, transportation, government and defense, health care, and tourism have headquarters in Anchorage. According to the U.S. Bureau of Labor Statistics, recent Anchorage unemployment was

5.6% as of August 2014, slightly below the national rate.

Operations

The utility's own generation consists of 425 megawatts (MW), mainly gas-fired units. In February 2013, ML&P's 30% share of Southcentral power project became commercially operable. This new plant is highly efficient, and management expects it will reduce annual fuel costs by up to $9 million. Additional system-owned resources include capacity from two hydroelectric projects. These combined resources provide ample capacity to meet existing peak demand. Despite a plentiful power supply, management plans to repower its existing fleet within the next two years, including the installation of two 60-MW gas-fired units by 2016. While likely to reduce fuel burn and, therefore, operating costs, this repowering is a significant factor for ML&P's CIP. The investment in new capacity will allow for the retirement of inefficient units, and it should provide wholesale sales opportunities because ML&P's resources will be well in excess of its native peak load.

Due to the utility's remote location, there is, in our opinion, moderate concern for power reliability, transmission, and resource adequacy. Somewhat mitigating these concerns are a plentiful power supply and the utility's existing Anchorage-Fairbanks intertie, a 70-MW high-voltage transmission line that electronically links Anchorage to Fairbanks and allows for the sharing of energy among five participants.

A key attribute of ML&P's operations is its one-third ownership in Beluga River Natural Gas Field, which it acquired in December 1996. The source of gas is the Beluga river gas field, on the west side of Cook Inlet, near Anchorage. The utility is permitted to pass on any gas cost increases or decreases directly through its quarterly cost-of-power adjustment to customers.

One key strength from ML&P's partial ownership in Beluga is the receipt of under-lift settlements. Whenever the field's total production is such that one-third of production is greater than ML&P's gas requirements, the other project participants must reimburse ML&P in the form of cash settlements of this under-lift position or bank it for future use. In 2006, ML&P received $22.9 million as part of an under-lift settlement.

Finances

In our opinion, financial performance has been strong with annual combined DSC of at least 1.7x over the past five fiscal years through fiscal year-end Dec 31, 2013. Fixed-charge DSC, which factors in off-balance-sheet obligations and annual transfers to the city government, was about 1.5x in fiscal 2013, up from about 1.3x the three previous fiscal years. Liquidity is, what we consider, adequate: The utility reported $7.1 million of unrestricted cash and investments as of fiscal year-end Dec. 31, 2013, or about 40 days' cash on hand, a decrease from $19 million in fiscal 2012.

The utility's CIP for fiscal years 2015-2020 includes $209 million of improvements. ML&P expects to issue approximately $200 million of revenue bonds in late 2016. The CIP's largest share consists of distribution investments. ML&P has focused on improving its capital structure with a goal, according to the equity management plan, to attain an equity-to-total-capitalization ratio of 40%. As of audited fiscal 2013, ML&P's equity position was 31%.

Regulation

The utility is subject to regulation as to which area it could serve, as well as to the RCA's economic regulation. Commission regulation covers service areas, service quality, tariff rules and regulations, monthly rates and charges, and some other utility charges. The RCA also reviews the utility's gas field under-lift settlements and approves how those funds are spent. Although rate changes are subject to the commission's approval, the utility indicates its recommended rate increases have been in-line with the final RCA-approved increases. Furthermore, the Alaska Supreme Court has ruled that a municipality could create a covenant for bond purchases regarding rates (rate covenant), with this covenant being valid, and that the RCA need not approve bond issues.

Competiveness

Despite recent rate increases due to ML&P's generation repowering plan, the utility's residential rates for typical monthly usage remain well below those of Chugach Electric Assn., which the municipality competes directly with on a wholesale basis; the advantage, however, decreases for commercial and industrial rates. Overall, ML&P's rates are well below the state's average, as well as other municipal utilities in the area. The utility most recently increased rates on an interim basis by 24% in late 2014 with final approval pending. We believe if RCA approves rate increases, ML&P will, nevertheless, retain its competitive position as a low-cost provider.

Management

The Anchorage Assembly has established a municipal light and power commission, which serves an advisory function. The mayor appoints commission members, who the Anchorage assembly confirms. Assembly approval is required for ML&P's operating budgets, ability to incur debt, and capability to make a rate filing to the RCA.

Related Criteria And Research

Related Criteria

USPF Criteria: Electric Utility Ratings, June 15, 2007

MLP1474

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