

RatingsDirect®

Summary:

Middleton Municipal Electric Department, Massachusetts; Retail Electric

Primary Credit Analyst:

Georgina Rovirosa, New York (1) 212-438-7983; georgina.rovirosa@standardandpoors.com

Secondary Contact:

Judith G Waite, New York (1) 212-438-7677; judith.waite@standardandpoors.com

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Summary:

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Credit Profile

Middleton Mun Elec Dept ICR

Long Term Rating

A/Stable

Affirmed

Rationale

Standard & Poor's Rating Services has affirmed its 'A' issuer credit rating on Middleton Municipal Electric Department (MELD), Mass. The outlook is stable.

MELD has no direct debt, but contingent liabilities include \$5.6 million of debt (MMWEC) issued for generating units that provide electricity to MELD.

The rating reflects these factors, which we view as credit positive:

- Strong liquidity, which helps offset weak fixed charge coverage (FCC);
- Low business risk associated with the electric distribution system;
- Competitive rates; and
- The town's proximity to Boston and a vibrant local economy with a strong demographic profile.

We view MELD's adequate level of FCC of about 1.22x as a credit weakness. We also view its dependence on one customer, Bostik Inc., for about 10% of revenue as a risk, although Bostik, the world's fourth-largest manufacturer and supplier of adhesives and sealants, is headquartered in Middleton. We also note that MELD has the flexibility to reduce purchased power to match load requirements.

Middleton enjoys easy access to Boston, 19 miles to the south, as well as a strong local area economy. The town is small (population 7,744 in 2013) but affluent, where the median household effective buying income is about 68% above the national median. Unemployment in the area was 5.6% average in 2013, well below the state and national averages.

MELD's business profile of '4' reflects our view of the strong demographic profile as well as the supportive state regulatory environment, which excludes municipal utilities from statewide electric service competition. We assign business profiles on a scale of '1'-'10', '1' being the strongest.

Although the utility is protected from open competition in the retail market for electricity, it provides competitive rates. Management raised base rates about 4% in May 2009 to cover increased transmission and capacity costs, but for the past few years and probably the next several years, it will use the \$5.7 million rate-stabilization fund to supplement revenue if purchased power costs increase. Even with the rate increase, the town has comparatively low rates. Based on 2012 data from the Energy Information Agency, MELD's retail residential rate was 90% of the state average, and its industrial average rate was 102%. Residential customers account for 38% of revenue; commercial and industrial

customers account for 62%, Bostik being the largest. The remainder is from municipal entities and street lights.

The rates are a blend of power costs from the nuclear, gas and oil-fired generating units owned through MMWEC (about 40% of power) and a block of power contracted through 2013 from Macquarie Holdings Inc.'s energy markets division (also about 40% of power), as well as low-cost hydropower through the New York Power Authority and a hydropower dam in Maine, some wind power and purchases from the New England power pool. This blend of power also provides flexibility to cut back purchases when power demand decreases. The average cost of all purchased power, including transmission and other energy-related charges, in 2013 was 14.3 cents per kilowatt-hour. Macquarie has purchased the electricity required to fulfill its power supply contract through 2013, which eliminates unexpected cost increases. Management has also signed a fixed-price contract with for 2014 and 2015 at 5.7 cents per kilowatt-hour, for blocks of power that are different at peak and off-peak times.

Management maintains what we consider fairly healthy liquidity, but the coverage ratio is consistently weak, at slightly more than 1x. Our FCC calculation compares net cash from operations after the transfer of funds to the city. Middleton has repaid its direct debt, but has about \$7.3 million of fixed charges included in power purchased from MMWEC. This amount includes the debt service associated with the generating units built to supply electricity to Middleton's retail customers, and so represents its share of that cost. We expect this measure to strengthen as MMWEC's debt service declines. MELD will repay almost all of the MMWEC debt in 2017; the final maturity is 2019. We also include in the FCC calculation half of the annual cost of power purchased through the Macquarie contract, representing imputed debt service.

Unrestricted cash of \$8.7 million provides what we view as a strong level of liquidity equal to about 258 days of operating expense. These funds include a \$5.7 million rate-stabilization reserve at MMWEC and a \$2.3 million depreciation fund at Wells Fargo Bank N.A. MELD limits cash requirements by adjusting the purchased power cost recovery calculation as needed to recover those costs. In addition, Energy New England, which MELD engages to procure power from sources other than MMWEC, holds \$190,000 to cover liquidity requirements related to purchases from the New England power pool and others.

Outlook

The stable outlook reflects our expectations that the utility's business profile will continue to be low-risk and financial metrics will be at least as strong as they are now. We believe the slim FCC margins limit the potential for a higher rating during the two-year outlook horizon. We also do not expect to lower the rating during that period.

Related Criteria And Research

Related Criteria

USPF Criteria: Electric And Gas Utility Ratings, Dec. 16, 2014

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