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Ratings

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Summary:

Middleton Municipal Electric Department, Massachusetts; Retail Electric

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Long Term Rating	A+/Stable	Current

Rating Action

The long-term rating on Middleton Municipal Electric Department (MELD), Mass. is 'A+'. The outlook is stable.

The rating reflects our view of MELD's strong enterprise risk profile and very strong financial risk profile. Key credit strengths are the utility's mainly residential customer base with high-income levels, robust liquidity, and no debt.

Credit overview

MELD serves 3,800 electric customers throughout its primarily residential customer base that remains concentrated among its leading customers. The Town of Middleton (population 9,800) is in Essex County, 19 miles north of Boston in northern Massachusetts. Middleton participates in several MMWEC nuclear projects, providing it with about 40% of its power needs, but also requiring it to share in operation and maintenance costs as well as debt service of the generation projects. However, its power cost structure has improved recently because its off-system MMWEC project debt service was paid off at the end of fiscal 2019. The system's significant revenue concentration and limited customer base inherently limit its financial and operational flexibility.

S&P Global Ratings acknowledges a high degree of uncertainty related to the impacts of the COVID-19 pandemic, including the rate of spread and peak of the pandemic. It has become increasingly clear to us that COVID-19 will be a major headwind to U.S. growth in the near term, though the inevitable impact on the U.S. economy depends largely on how long the COVID-19-related challenges last in the U.S. The system has 352 days' cash on hand as of fiscal 2019 and strong fixed-cost coverage, which we believe supports financial flexibility if short-term disruptions were to occur.

The rating reflects our opinion of the system's strong enterprise risk profile, including:

- Adequate operational and management assessment, highlighted by the utility's diverse mix of power purchase agreements and reflecting its participation in the Massachusetts Municipal Wholesale Electric Co.'s (MMWEC) Seabrook and Millstone nuclear power projects that accounted for about 40% of its energy in fiscal 2019 and contributed to the system's competitive rates, although management does not perform multiyear financial forecasts or capital plans;
- Strong service area economic fundamentals, highlighted by its primarily residential customer base with above-average income levels with access to Boston's deep employment base;
- Very strong market position, due to its weighted average electric system rate that is below the state average and extremely high income levels; and

- Extremely strong industry risk relative to other industries and sectors.

The rating also reflects our view of the combined system's very strong financial risk profile, including:

- Strong fixed-cost coverage (FCC) metrics, evidenced by FCC ranging between 1.50x and 1.70x over the past three years;
- Extremely strong liquidity and reserves for a distribution system, with 352 days' cash on hand in fiscal 2019 (unaudited), including its rate stabilization fund; and
- Extremely strong debt and liabilities profile, as the utility has no debt.

The stable outlook reflects our view that financial metrics will remain at levels consistent with the rating even as they have contended with effects of the pandemic and the subsequent recession. Given the system's healthy financial metrics and no plans to issue debt over the next five years, we believe the utility could sustain a short-term decline due to economic effects associated with COVID-19, and maintain budgetary balance.

Environmental, social and governance (ESG) factors

Overall, we believe environmental, social and governance factors are in line with peers. MELD receives electricity from a wide variety of fuels. In 2019, about 38% of the utility's electricity tied to specific generating sources came from wind, hydroelectric, and solar resources, and the utility does not rely on any coal-fired generation, which we view as a credit positive. We believe the utility's social factors including health and safety issues related to COVID-19 do not present a significant financial risk at this time. The utility serves a mostly residential community and, according to management, demand decline has been marginal and none of the utility's major customers have shut down. Management has also indicated that there have been no significant cutbacks by any of the utility's top 10 customers. The utility will continue to watch for other leading economic indicators in the coming months and plans to make appropriate changes to its balance of resources if necessary. In our view, if rates were needed to be increased in order to account for ramifications related to the pandemic, we view the ratepayers as being able to afford higher rates. The utility maintains affordable rates in context of current income levels, which help to insulate the utility from operational and financial challenges. However, we do believe governance factors are elevated, as the utility does not perform long-term financial forecasting. For more information, see our articles "COVID-19's Potential Effects In U.S. Public Finance Vary By Sector" (published March 5, 2020, on RatingsDirect), "All U.S. Public Finance Sector Outlooks Are Now Negative" (published April 1, 2020), and "The U.S. Faces A Longer and Slower Climb From The Bottom" (published June 25, 2020).

Stable Outlook

Upside scenario

We do not expect to raise the rating over the next two years, as we believe MELD's revenue concentration among its top customers and its limited service area population preclude a higher rating.

Downside scenario

Although we are unlikely to do so, we could lower the rating if the light department experiences a significant and sustained decline in fixed-cost coverage levels or liquidity. In addition, if the current economic ramifications of the COVID-19 pandemic deepen and were to materially impair the utility's financial performance, we could lower the rating.

Credit Opinion

Enterprise Risk Profile

Operational Management Assessment (OMA): Adequate

MELD relies on a contracted power supply, albeit from system power from a diverse mix of assets. The counterparties providing purchased power include entities such as NextEra (which we view as having extraordinarily diverse assets), MMWEC, and Shell Energy. MELD participates in the Millstone Unit 3 and Seabrook Unit No. 1 nuclear facilities, as well as Stonybrook intermediate and peaking facilities. The remaining energy comes primarily from several bilateral agreements and purchases at Independent System Operator (ISO) New England on the spot market, which accounted for 11% of purchased power in fiscal 2019. We consider the system's fuel mix relatively diverse and centered on nuclear (40%) and unidentified (28%) purchased power, followed by natural gas (4%), hydro (10%), and renewable resources (18%). The utility's power supply suggests a controllable carbon footprint, so environmental costs should be manageable, borne by power suppliers and passed through to the utility via cost of purchased power. The system is not exposed to coal generation; therefore, the utility is not exposed to any future environmental risks such as regulation of carbon emissions, which we view as a credit positive.

The utility does not produce formal capital plans or multi-year financial forecasts, which we view as a credit limitation. The utility produces annually updated budgets (financial and capital), but no other forward-looking forecasts. However, the scope of the utility is limited, and we view management as generally capable stewards of a distribution electric system with limited operating issues. MELD monitors budget-to-actual variances monthly, management exercises its power cost adjustment (PCA) mechanism at its discretion, with costs generally recovered quarterly. In our opinion, the PCA is just adequate in this regard.

Economic fundamentals: Strong

We believe MELD's service area, which is evidenced by an affluent primarily residential base, provides stability to the utility's credit profile. Residential customers accounted for about 38% of revenue in 2019. Median household effective buying incomes (MHHEB) are 71% above the U.S. average as of 2019, providing the utility with rate-raising flexibility, which we view as a credit positive. Though we believe the customer base is stable, there is concentration, with the 10 largest users accounting for 35% of utility revenues, which we believe leaves the utility at risk for load loss. The top customer, Bostik, is a large manufacturer and supplier of adhesives and sealants, which is headquartered in Middleton, and represented approximately 10.5% of system revenues in fiscal 2019.

Market position: Very strong

Based on the U.S. Energy Information Administration's latest available data from 2018, the utility's average electricity rate was 85% of other electricity providers in Massachusetts. The town's above-average incomes provides MELD with additional rate-raising flexibility, in our view. Management does not anticipate raising rates in the next three years, so we expect the utility to maintain its competitive advantage.

The utility utilizes a discretionary pass-through mechanism to pass along power costs. The pass-through mechanism is reviewed quarterly and the amounts can be changed, at management's discretion, when the utility is faced with increased costs in purchased power costs. From a credit perspective, the PCA mechanism is a credit positive, though discretionary, as it allows the light department to pass through purchased power cost variability.

Financial Risk Profile

Coverage metrics: Strong

In our view, fixed-cost coverage, which includes MELD's portion of total MMWEC debt service and actual demand costs from power purchases, has been historically strong. Fixed-cost coverage has ranged from 1.50x-1.70x for the past three years. According to the utility's most recent DPU report, which we consider as unaudited financials, coverage was 1.70x for fiscal 2019, as purchased power costs haves returned to historical levels. Fixed-cost coverage is our internally adjusted debt service coverage metric that tracks the use of total utility operating revenues. We use fixed-cost coverage that treats capacity charges MELD pays to power suppliers as debt service rather than operating expenses. We view this portion of operating expenses as funding the suppliers' recovery of capital investments in generation assets. While we think the system's fixed-cost coverage metrics are likely sustainable as the system's MMWEC capacity costs will decline in fiscal 2020, officials have not produced financial projections.

Liquidity and reserves: Extremely strong

MELD's unrestricted cash and depreciation fund (which we consider to be available liquidity) totaled $12.2 million, or 352 days' cash according to the utility's most recent DPU report, which we consider as unaudited financials. Days' cash has been an average of approximately 343 days since 2017. As a distribution-only operation, the light department's liquidity provides a substantial cushion, which we view as extremely strong. Given that the system is exposed to limited operational risks as a distribution utility, we consider these liquidity levels robust for a system this size. In addition, officials project to increase total liquidity to about $13.7 million by the end of fiscal 2020.

Debt and liabilities profile: Extremely strong

MELD expects to finance its $4.5 million in capital needs internally over the next five years. There is no direct bonded debt outstanding. Given its modest capital requirements and lack of debt, we expect the system's debt profile to remain at extremely strong levels.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.