Fort Pierce Utilities Authority, Florida

New Issue Summary

Sale Date: May 26, 2022
Series: 2022A and 2022B
Purpose: Capex and refunding
Security: Utility system revenues

The downgrade to 'A' from 'A+' reflects Fort Pierce Utilities Authority's weaker financial profile due to an increase in expected leverage stemming from upcoming capex. FPUA is issuing approximately $145 million of debt to fund the relocation of its wastewater system's Island Water Reclamation Facility (IWRF) and other planned capex, in addition to refunding the series 2009 bonds, which will effectively triple the authority's outstanding debt.

Fitch Ratings expects planned capex and debt issuance to push the authority's leverage ratio, measured as net adjusted debt to adjusted funds available for debt service, to a peak above 6.5x in fiscal 2025 from a current low ratio of 4.4x. Adopted rate increases across all four systems — electric, water, wastewater and natural gas — will help absorb the new debt but still lead to expected leverage of over 6.0x in Fitch's Fitch Analytical Stress Test (FAST) analysis by fiscal 2026.

The weakening of the authority's financial profile assessment suggests the possibility of a rating lower than 'A'. However, Fitch considers the historically consistent revenue performance of FPUA's combined system of electric, water, wastewater and gas, in addition to the lower operating risk of the combined utility operations, the long-lived and one-time nature of the relocation project, and improving service area characteristics in its assessment.

Key Rating Drivers

Revenue Defensibility: 'bbb'; Weak but Improving Service Area Characteristics: The authority's 'bbb' revenue defensibility assessment reflects its very strong revenue source characteristics and strong rate flexibility. The assessment is constrained by FPUA's weak service area characteristics. However, considering the positive trends in income and unemployment coupled with continuing economic developments in the city, service area characteristics could be reassessed to stronger in the future with further improvement. FPUA has independent ability to set rates with a high affordability ratio.

Operating Risk: 'a'; Low Cost Burden and Stable Wholesale Power Supply: FPUA's operating risk assessments reflects its consistently low operating cost burden, which declined to a four-year low of 10.86 cents/kWh in fiscal 2021. Operating cost flexibility remains neutral given contracted power supplies provided through the authority's participation in Florida Municipal Power Agency's (FMPA) All-Requirements Power Supply Project (ARP) and in the St. Lucie Nuclear Project.

Financial Profile: 'bbb'; Leverage to Increase with Significant Capex and Debt Issuance: Fitch reassessed FPUA's financial profile to 'bbb' from 'a' due to an increased leverage ratio in Fitch's base and stress scenarios. Fitch expects the authority's debt issuance and planned capex to push its leverage above 6.0x despite the approved rate increases. Liquidity remains neutral as coverage of full obligations (COFO) consistently remains above 1.0x, with 97 days cash on hand (DCOH) for fiscal 2021.

Asymmetric Additional Risk Consideration: There are no asymmetric additional risk considerations influencing this rating.

Ratings

Standalone Credit Profile[a]	a

New Issues

$139,195,000 Utilities Refunding and Revenue Bonds, Series 2022A	A
$2,565,000 Utilities Revenue Bonds, Series 2022B	A

Outstanding Debt

Utility Capital Appreciation Bonds[b]	A
Utility Revenue Refunding Bonds[b]	A

[a]Downgraded from 'a+' on May 19, 2022.
[b]Downgraded from 'A+' on May 19, 2022.

Rating Outlook

Stable

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (September 2021)

U.S. Public Power Rating Criteria (April 2021)

Related Research

Fitch Ratings 2022 Outlook: U.S. Public Power and Electric Cooperatives (December 2021)

Public Power - Fitch Analytical Comparative Tool (FACT) - 2021 (June 2021)

U.S. Public Power — Peer Review (June 2021)

Analysts

John Choi
+1 212 908-0521
john.choi@fitchratings.com

Andrew DeStefano
+1 212 908-0284
andrew.destefano@fitchratings.com

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Improved revenue defensibility due to consistently stronger economics and demographics in the service area over time;
- A sustained decrease in the leverage ratio below 5.0x in Fitch's base and stress cases, which is not expected based on the capital plan.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- A sustained increase in the leverage ratio above 7.0x in Fitch's base and stress cases, driven by weaker operating performance, unanticipated borrowings or challenges to upcoming capital plans requiring greater than expected capex.

Credit Profile

FPUA provides retail electric, water, wastewater and gas service to the city of Fort Pierce, FL, and neighboring areas of St. Lucie County. FPUA's electric system serves roughly 28,870 customers and generates roughly two-thirds of the authority's combined revenue, making it the largest of the four systems. Water and wastewater operations account for roughly 30% of combined revenue and serve approximately 21,000 and 15,600 customers, respectively.

Fitch considers FPUA to be a related entity to the city of Fort Pierce for rating purposes given the city's ownership and authority of the system, including its authority to establish rates. The city's credit quality does not currently constrain the bond rating. However, as a result of being a related entity, FPUA's ratings could become constrained by a material decline in the city's general credit quality.

IWRF Relocation Project

The IWRF relocation project has been in discussion for several years. The new inland location will serve to limit potential environmental impacts from extreme weather and sewer overflows, given its current location on the Indian River Lagoon and proximity to the Atlantic Ocean. It will also provide for significant redevelopment of the current site, which is on the Indian River Lagoon close to downtown Fort Pierce. Relocation would naturally ameliorate these issues and would also prevent the authority from having to spend approximately $16 million in the near future to make necessary improvements to maintain IWRF in its location.

The board approved two rate increases, which were passed by the city commission in a 3-2 vote on May 16, 2022. FPUA expects construction to start in early 2023 and be finished in 2025. Once construction is finished, both the new and current facilities will run concurrently for a brief transition period. The current facility will be demolished in 2025.

Revenue Defensibility

The authority's revenues are derived nearly entirely from its monopolistic retail services. Electric revenue makes up roughly two-thirds of the combined utility's revenue, followed by water and wastewater at roughly 30%, natural gas revenues at 5%. The utility's competitive telecommunications business FPUAnet Communications Services accounts for less than 1% of revenue.

Fitch considers FPUA's service area and demand characteristics weak and as limiting factors in our revenue defensibility assessment. The area experiences consistent customer growth but is constrained by weaker median household income (MHI) and a weaker unemployment rate compared with national averages. The authority's annual customer growth averaged 0.5% over the past five years, reflecting steady growth. The MHI was consistently low at 56% and 58% of the national averages for 2019 and 2020, respectively. The service area's unemployment rate also lagged behind national averages at 165% and 125% for 2019 and 2020, respectively. However, both metrics steadily improved since 2017.

The unemployment rate is 125% of the national average and would typically merit a midrange assessment. However, the value is right on the cusp of midrange, and this is the first year the

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
A	Downgraded	Stable	5/19/22
A+	Revised	Stable	4/30/10
A–	Affirmed	Stable	10/3/08
A–	Affirmed	Stable	6/3/03
A–	Affirmed	Stable	12/6/01
A–	Assigned	—	9/14/99

IDR – Issuer Default Rating.
Source: Fitch Ratings.

metric reached 125%. Fitch will continue to observe the unemployment rate for consistent improvement prior to a potential reassessment of the service territory to midrange.

The authority's service area, which is set by state regulators, is largely built out and surrounded by investor-owned Florida Power & Light Company (FP&L, A/Stable), limiting customer growth potential. However, management expects some growth in the near future, as there has been an influx of migrants from other states and new boat manufacturers and businesses moving downtown. FPUA also expects some growth in water, wastewater and gas demand as new housing units were recently constructed in the western part of town. Analogous to many towns in Florida, Fort Pierce is home to many retirees and saw a recent increase.

FPUA's rate flexibility is strong, supported by its independent ability to set rates and high affordability ratio. Retail rates have historically been elevated at or above 110% of the state average, and rates have not been as competitive as neighboring utility FP&L. However, residential rates fared better and are near the state average.

Fitch expects retail electric rates to increase due to two upcoming rate increases to fund the relocation project. The first 1.4% increase will take effect near the end of fiscal 2022, followed closely by a second 1.3% increase to take effect at the beginning of fiscal 2023. FPUA expects water, wastewater and natural gas rates to increase by 21.2%, 20.9% and 7.9%, respectively, following the two rates increases. Rates will increase by 9.7% across all four systems.

The authority also expects higher wholesale rates from FMPA due to increased energy costs, which would be passed through to customers via power cost adjustments (PCAs). FPUA's affordability ratio — the percentage of MHI necessary to cover residential electric charges — is high at 3.3% and has been improving in recent years.

Management acknowledged some concerns from customers related to the expected rate increases and higher energy costs. However, there is a strong consensus within the community about relocating IWRF, despite the rate increases, as the area it occupies is considered prime real estate for future development. The authority took steps to publicly engage with ratepayers through town halls to explain and discuss rate changes resulting from higher energy costs and the PCA.

No Customer Concentration

FPUA has a diverse sales and revenue mix without sector or customer concentration. Residential sales accounted for approximately 45% of total retail revenue for fiscal 2021, while commercial sales accounted for 53%, with the water and wastewater systems exhibiting a comparable customer mix. The customer base is also diverse, as its top 10 customers accounted for approximately 19% of total revenues. The top customers primarily operate in stable sectors, such as education, government and healthcare.

Operating Risk

FPUA's electric operating cost burden is low at 10.86 cents/kWh in fiscal 2021. The authority's cost burden remained within the 10 cents/kWh–11 cents/kWh range in the past five fiscal years, exhibiting consistently low power costs. FPUA benefits from its long-term contracts with FMPA, which provide favorable wholesale rates due to a trend of low natural gas prices. The authority started to experience higher wholesale rates from FMPA starting in fiscal 2022, due to the overall increase in energy prices, particularly for natural gas. FPUA's operating cost is therefore anticipated to increase, but Fitch expects the cost burden to remain low.

The cost burden also includes the annual transfer to the city's general fund, which is set by formula in the city charter at 6% of prior-year utility revenues.

Fitch assesses FPUA's electric operating cost flexibility as neutral. The authority is among the largest participants in ARP and the St. Lucie Nuclear Project. FPUA and the balance of the ARP's 13 participants are bound by long-term evergreen (at least 30 years, absent participant notification) power supply contracts.

ARP has approximately 1,700MW of total resources in which more than 1,100MW are from fully or partially owned generation, more than 80% of which is natural-gas fired. The remainder of ARP's resources consists of member-contributed facilities and power entitlement shares in

several other FMPA projects, including Stanton, Tri-City and Stanton II, and purchased power contracts.

FPUA's participation in the St. Lucie Nuclear Project was not assigned to the ARP and remains a separately dispatched asset. The authority's contractual entitlement in St. Lucie consists of an 8.8% ownership interest in FMPA's 853MW St. Lucie Unit No. 2 nuclear generating facility, which is operated by FP&L. The ARP provides the balance of FPUA's energy needs in excess of FPUA's take-or-pay contract for St. Lucie power in any given year.

Water and Wastewater System

FPUA maintains water supply drawn from a mix of shallow and deep wells pursuant to a water use permit granted by the South Florida Water Management District. The permit allows the authority to withdraw a daily maximum of 23 million gallons daily (mgd) of ground water. FPUA's 20mgd conventional lime softening water treatment plant and a 10.3mgd reverse osmosis water treatment plant provide ample treatment capacity for the authority's 9.2mgd average daily demand. The wastewater collection system consists of a 17mgd treatment facility that operates under a permit issued by the Florida Department of Environmental Protection. Permitted treatment capacity of 10mgd is more than twice average daily flows of 4.5mgd treated by the system, which ensures sufficient long-term capacity. Effluent is disposed of through one on-site deep-injection well.

Capital Planning and Management

Fitch assessed FPUA's capital planning and management as strong based on its average age of plant of 20 years and adequate investment. The authority's average age of plant remained below 21 years in four of the last five years. The authority's five-year average capex-to-depreciation ratio is 106%, and its projected five-year capital spending total is approximately $220 million, significantly greater than the previous five-year capex total of approximately $71 million.

Management aims to complete approximately 75%–90% of the capital improvement plan in the next five years. Upcoming capex is primarily driven by the IWRF relocation project and the implementation of advanced metering infrastructure, storm hardening and service expansion projects for the natural gas system and FPUAnet. Capex will be largely funded through the 2022 Series A debt issuance, in addition to cash flow and grants.

Financial Profile

The authority's financial profile was revised to 'bbb' from 'a' based on the expected leverage increase to above 6.0x due to the 2022 Series A debt issuance. Leverage declined to 4.44x from 4.98x between fiscals 2019 and 2021 due to FPUA's strong operating performance through the height of the pandemic. FPUA maintained its electric sales at or above historical levels, which resulted in improved operating margins for fiscals 2020 and 2021. Debt outstanding at the end of fiscal 2021 was $47 million. Outstanding debt will increase to approximately $174 million following the $145 million debt issuance. Fitch expects leverage to increase to more than 6.0x throughout Fitch's base and stress scenarios.

FPUA's liquidity profile remains neutral, with sufficient DCOH and COFO consistently above 1.00x. The authority had 97 DCOH in fiscal 2021 and has historically maintained DCOH above 100 days. FPUA has an informal cash target of 90 DCOH, which includes the rate-stabilization fund established in fiscal 2018 at $1 million. The fund reached $1.8 million by the end of fiscal 2021. FPUA aims to keep $1 million–$4 million in the fund and can use the PCA in the rate structure (generally set at overcollection) to adjust rates before making draws on the fund.

Fitch Analytical Stress Test (FAST) — Base Case and Stress Case

Fitch's base case scenario is informed by management's revenue forecast for fiscals 2022–2026. Fitch expects leverage to increase to a high of 6.8x by fiscal 2025 due to debt issuances and higher capex. The two systemwide rate increases, which will come into effect for a full fiscal year starting in fiscal 2023, will improve margins and help fund the capex. However, leverage will continue to increase throughout fiscal 2025, as the authority plans to issuing another $18 million at that time to fund the IWRF relocation in the latter years of the project. Leverage will subsequently fall to 6.2x by fiscal 2026 as FPUA continues to benefit from the rate increases and as capex decreases to historical levels.

The authority could pursue an $18 million grant instead of borrowing, in which case leverage would increase to 6.4x in fiscal 2025 and decrease to 5.9x by fiscal 2026. Management stated it historically spent about 60% of planned capex in the past, but hopes to execute approximately 90% of its capital plan in the upcoming years. Fitch included 90% of FPUA's plans will be spent throughout the FAST.

FPUA performed unexpectedly well in fiscal 2021 despite the pandemic, driven by an increase in average monthly use per customer, which outpaced growth in overall customer accounts. Management believes this was potentially caused by a combination of lower rates driven by lower energy costs through the PCA and pandemic-related rebates implemented by the federal government. The authority expects fiscal 2022 sales to more reflect historical performance, and expects a slight decline in sales. Management subsequently projects an approximately 0.4% annual increase in sales.

Fitch's stress case was developed by using base case assumptions and imposing declines on retail sales based on the authority's own sales variability over time. The stress case assumes a 3.5% and a 1.1% decline for the first two years of the stress, respectively, followed by two years of sales growth. Under this scenario, FPUA's leverage ratio increases to 6.9x by fiscal 2025 while decreasing to 6.4x by fiscal 2026. Fitch performed a separate stress case, with the $18 million as a grant in fiscal 2025, in which case the leverage ratio increases to a high of 6.5x by fiscal 2025 while decreasing to 6.0x by fiscal 2026. Management indicated the authority could delay capex and raise rates during sales declines.

Fitch acknowledges FPUA budgets conservatively, and planned capex may be lower than 90%, resulting in better than expected financial performance. However, given the magnitude of the debt issuance and the planned capex, there is little flexibility in the stress case for the authority to maintain its current financial profile assessment, even in the best circumstances. Fitch expects leverage to increase in the next four years due to the debt issuance and capex. Leverage should gradually start to decrease as the authority continues to benefit from two rate increases and the relocation project concludes, returning capex to historical levels.

Debt Profile

FPUA's debt profile is neutral to the rating. As of Sept. 30, 2021, the authority had approximately $53.7 million in outstanding revenue bonds and direct placements as fixed rate, amortizing through 2030. The authority has no direct exposure to swaps or derivatives. The 2022 Series A and B issuance will be structured as fixed rate, long-term amortizing bonds.

Asymmetric Additional Risk Considerations

There are no asymmetric additional risks associated with this rating.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Financial Summary — Fort Pierce Utilities Authority, Florida

($000, Audited Fiscal Years Ended Sept. 30)	2017	2018	2019	2020	2021
Net Adjusted Debt to Adjusted FADS (x)	**4.97**	**4.87**	**4.98**	**4.78**	**4.44**
Net Adjusted Debt Calculation					
Total Current Maturities of Long-Term Debt	5,851	5,921	5,982	6,049	6,116
Total Long-Term Debt	66,851	62,516	57,813	52,863	47,652
Total Debt	**72,702**	**68,437**	**63,795**	**58,912**	**53,768**
+ Capitalized Fixed Charge — Purchased Power & Gas	109,109	103,726	104,909	100,428	103,898
+ Total Pension Obligation (GASB Fitch-Adjusted NPL + FASB PBO)	32,863	29,804	34,313	32,824	20,899
- Total Unrestricted Cash	26,661	28,616	30,506	24,808	20,786
- Restricted Funds for Debt Service	5,457	5,457	5,457	5,457	5,457
Net Adjusted Debt	**182,556**	**167,894**	**167,054**	**161,899**	**152,323**
Adjusted FADS for Leverage Calculation					
Total Operating Revenue	102,650	100,210	101,395	101,296	104,915
Total Operating Expenses	90,974	90,280	94,495	91,258	92,635
Operating Income	**11,676**	**9,930**	**6,900**	**10,038**	**12,280**
+ D&A	12,774	12,993	13,959	13,384	14,263
+ Interest Income	441	826	759	478	515
FADS	**24,891**	**23,749**	**21,618**	**23,900**	**27,058**
+ Adjustment for Purchased Power	13,107	12,421	12,577	12,144	12,396
- Total Transfers/Distributions	5,969	6,139	6,125	6,276	6,342
+ Pension Expense	4,183	3,868	4,921	3,694	640
Adjusted FADS for Leverage	**36,744**	**34,444**	**33,528**	**33,872**	**34,343**
Coverage of Full Obligations (x)	**1.34**	**1.50**	**1.37**	**1.41**	**1.56**
FADS	24,891	23,749	21,618	23,900	27,058
+ Adjustment for Purchased Power	13,107	12,421	12,577	12,144	12,396
- Total Transfers/Distributions	5,969	6,139	6,125	6,276	6,342
Adjusted FADS for Coverage	**32,561**	**30,576**	**28,607**	**30,178**	**33,703**
Full Obligations Calculation					
Cash Interest Paid	3,325	1,607	1,793	2,795	2,616
Prior-Year Current Maturities	7,405	5,851	5,921	5,982	6,049
Total Annual Debt Service	**10,730**	**7,458**	**7,714**	**8,777**	**8,665**
+ Adjustment for Purchased Power	13,107	12,421	12,577	12,144	12,396
Total Fixed Obligations	24,369	20,424	20,828	21,331	21,652
Liquidity Cushion (Days)	**124**	**135**	**138**	**116**	**97**
Unrestricted Cash (Days)	124	135	138	116	97
Liquidity Calculation					
+ Total Unrestricted Cash	26,661	28,616	30,506	24,808	20,786
Total Liquidity	**26,661**	**28,616**	**30,506**	**24,808**	**20,786**
Cash Operating Expense Calculation					
Total Operating Expense	90,974	90,280	94,495	91,258	92,635
- D&A	12,774	12,993	13,959	13,384	14,263
Cash Operating Expenses	**78,200**	**77,287**	**80,536**	**77,874**	**78,372**

FADS – Funds available for debt service. PBO – Pension benefit obligation. D&A – Depreciation and amortization.
Source: Fitch Ratings, Fitch Solutions, Lumesis, EIA, Fort Pierce Utilities Authority, Florida.

Key Definitions

Terms	Definition	Significance
Issuer Default Rating (IDR)	An expression of overall enterprise risk and relative vulnerability to default.	Provides an opinion of the relative ability of an entity to meet financial commitments, expressed as an ordinal measure of credit risk.
Standalone Credit Profile (SCP)	An expression of overall enterprise risk.	Provides an opinion of the credit quality of an entity on a standalone basis, irrespective of its relationship with, or the credit quality of, its related municipality.
Net Adjusted Debt	Adjusted debt – unrestricted cash – funds restricted for debt service	Provides an inclusive evaluation of long-term liabilities offset by funds available for debt service.
Adjusted FADS	EBITDA + interest income + 30% of purchase power expense + operating lease expense – transfers/distributions + pension expense	Provides an indication of cash flow available for the payment of debt service, adjusting for purchased power, operating lease and pension obligations.
Net Adjusted Debt to FADS	Net adjusted debt/adjusted FADS	Provides an indication of net total leverage position against available operating cash flow.
Full Obligations	Cash interest paid + scheduled long-term principal payments + 30% of purchase power expense	Provides an indication of inclusive fixed and debt service obligations.
Coverage of Full Obligations	(EBITDA + interest income + 30% of purchase power expense + operating lease expense – transfers/distributions)/full obligations	Provides an indication of the relative cushion of operating cash flow to fixed charges.
Base Case	The expected forward-looking case in the current macroeconomic environment.	Provides the analytical starting point in the forward-looking analysis, and also informs the stress case.
Stress Case	The potential performance under a common set of assumptions.	Illustrates how cycles affect individual issuers differently, and informs the level of rating stability and credit resiliency.

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