STANDARD & POOR'S

PUBLIC FINANCE

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Lodi, California

Credit Profile		
Lodi elec sys rev cur int certs of part ser 1999 A dtd 08/01/1999 due 01/15/2011-2019 2024 2027 2032		
Unenhanced Rating	BBB+(SPUR)/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services revised its outlook on Lodi, Calif.'s electric system certificates of participation (COPs) to stable from negative based on the implementation of a series of favorable financial and operational policies, resulting in reduced market exposure and an improved financial condition. Standard & Poor's also affirmed its 'BBB+' rating on the COPs, which are secured by net revenues of the electric system.

Credit factors supporting the 'BBB+' rating include:

- Low projected fixed-charge coverage;
- Limited revenue flexibility due to high rates, although Lodi's electric rates are lower than the area's investor-owned utility; and
- A high, although declining level of electric system transfers to support the general fund.

Factors that offset these concerns are:

- Management practices that have addressed concerns regarding market exposure and low liquidity levels, and increased oversight of system operations on the part of the city council;
- The system's stable economic base; and
- Positive relationships with large customers, and low load factors that mitigate near-term competitive risk.

The COPs are secured by net revenues of the electric system.

The system's business profile score of '5' is due to its high cost structure, which affects rate-making decisions; an operational profile that currently exposes Lodi to market price risk; stable, although somewhat concentrated, customer base; and improved management practices. Business profiles are ranked on a 10-point scale, with a best possible score of '1'.

Lodi is a member of the Northern California Power Agency (NCPA), and a participant in several NCPA projects. Additional power resources include Western Area Power Administration hydropower, and a seasonal exchange agreement with Seattle City Light. Short-term market purchases have historically provided the balance to serve Lodi's 140 MW peak load. Lodi has entered a three-year fixed-price purchase power agreement for 25 MW of base load power, significantly reducing its market exposure and the potential volatility of its net income. Unhedged market exposure in 2002 and again in the 2005 summer season, had lead to a significant rise in power costs for Lodi, causing the system's deteriorating financial performance in those years. Additionally, Lodi is expecting to acquire long-time base load power by way of participation in a new NCPA project that is expected to be operational by 2013, reducing its short position over the longer term, and accommodating growth in load demand.

The system's cash position and debt service coverage improved in fiscal 2006, as well as in fiscal 2007. Fiscal 2006 financial statements indicate weak coverage of about 1.04x of direct and off-balance-sheet debt service from net available after deducting transfers to the city, which is slightly improved over fiscal 2005. Liquidity, also improved marginally but remained weak at 47 days', up from 37 days' expenditures at the end of fiscal 2005. Preliminary figures for fiscal 2007 indicate continued improvement in cash levels.

In response to the losses incurred in the beginning of fiscal 2006 due to escalating energy purchase costs, the city council enacted a 17% increase in overall rates effective Dec. 1, 2005, including a 35% increase for large industrial customers. The impact of the rate increase on the 2006 fiscal year, which ended June 30, 2006, was to stem the losses, and stop the decline in working capital that had already occurred. The outlook for the city's rates will remain high due to a relatively high debt component related to direct and off-balance-sheet debt obligations, as well as transfers to the city's general fund of about 12% of revenues. Nevertheless, the city's rates compare favorably to those of Pacific Gas & Electric Co., the investor-owned utility in the area, especially for Lodi's industrial customers. Significantly, the city council adopted an ordinance effective in July 2007 (fiscal 2008) that implements an automatic energy cost adjustment that will enable full and timely recovery of power costs. Aside from this rate mechanism, other measures taken by the city to improve the electric system's financial operations include the adoption of a revised transfer policy, which has reduced the relative proportion of transfers from 12% of revenues to near 10%, and by increasing new connection charges so that new customers cover the cost of future capital improvements

Lodi, with a population of about 62,800, is in California's Central Valley, 35 miles south of the state capital, Sacramento. Lodi has experienced steady growth in customers and load. Although primarily residential, the customer base does exhibit some concentration among its largest users, although net revenue concentration is diminished as the city's largest customers are served at favorable rates with lower margins. In addition, Lodi has been very focused on large customers that also are key to the city's overall economic well-being, and has entered contracts with many of these customers, which should reduce competitive threats. The system serves about 26,000 customers and has good growth prospects due to annexations, especially in the residential sector, which will continue to diversify the base.

Outlook

The stable outlook reflects the expectation that management will continue to mitigate power and fuel market fluctuations through its power purchasing strategies in the short term and through the acquisition of firm power resources in the longer term. The outlook also assumes Lodi will recover costs fully and on a timely basis via the new power cost adjustment charge. Given the system's relatively weak financial condition, should actual financial results deteriorate, the rating could be pressured.

Legal Provisions

The COPs are secured by net revenues of the system. Covenants are standard, but are somewhat permissive to address deregulation issues. The rate covenant is 1.10x based on adjusted net revenues, which includes certain balances on hand in the calculation to meet the covenant. The legal provisions also contain the concept of adjusted annual net revenue and receipts pledged to above-market costs. The rate covenant and additional bonds test are based on adjusted annual net revenue. The adjusted component reflects the deduction from the net revenues of receipts pledged to above-market costs and any related adjusted operation and maintenance costs. The revenues are currently pledged to the certificates, but in the future could also be used for other purposes. Debt service reserve requirements are standard.