Fitch Upgrades Lodi Electric Utility's (California) COPs to 'A-'; Outlook Revised to Stable

Ratings
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Fitch Ratings-New York-08 December 2010: Fitch Ratings has upgraded the following bonds issued by the City of Lodi, CA on behalf of its electric system:

--$80.5 million Certificates of Participation (COP) to 'A-' from 'BBB+'.

The Rating Outlook is revised to Stable from Positive.

RATING RATIONALE:
--The upgrade reflects an improvement in financial performance as evidenced by higher debt service coverage in fiscal 2010 (unaudited) along with a marked increase in liquidity to 149 days cash on hand.
--The resource mix remains diverse, and the utility has already met the state's renewable requirement of 20% by 2010, with 31% renewables.
--Upon completion in June 2012 the Lodi Energy Center (LEC) is expected to supply approximately 50% of the utility's energy needs thereby reducing Lodi's exposure to market volatility.
--While operating performance has strengthened, forecasted coverage ratios provided by management are slim after including city transfers. However, this is mitigated by the reduction in exposure to market volatility due to LEC and a forecasted liquidity level of nearly 160 days unrestricted cash on hand.
--While transfers to the city remain high at about 10% of the utility's revenue, the recent adoption of a formula based transfer policy places a ceiling on the transfer amount which is not expected to increase during the forecast period.
--Lodi's electric rates are below those of Pacific Gas & Electric (PG&E) but are higher than area municipalities' rates thereby limiting the rate flexibility for Lodi Electric Utility (LEU). However, LEU retains limited rate flexibility through the automatic monthly energy cost adjustment (ECA) charge.
--The customer base is relatively stable but somewhat concentrated, with the top nine customers accounting for 22.5% of revenue and 28.6% of kWh sales. The single largest customer accounted for 6.8% of kWh sales and 4.6% of revenue in fiscal 2010. However, the diversity of the top customers partially mitigates the concentration risk.
--City demographics are weak as compared to the state and county average.

KEY RATING DRIVERS:
--Continued maintenance of financial metrics adequate for the rating category and adherence to the transfer policy.
--Timely completion and commercial operation of the Lodi Energy Center (LEC) within the budgeted cost given the large share of LEC in LEU's resource mix.

SECURITY:
The bonds are secured by net revenues of the electric system.

CREDIT SUMMARY:
Lodi's electric utility provides retail service to approximately 25,400 customers in and around the city of Lodi. The city encompasses approximately 14 square miles, with a population estimated at 63,549 and is located in the San Joaquin Valley of California, approximately 35 miles south of Sacramento. The revenue stream is generated by residential, commercial and industrial customers, contributing 39%, 36% and 22% of revenues, respectively.

The utility does not own any generation assets, but rather purchases power through its membership in the Northern California Power Agency (NCPA), from the Western Area Power Administration (WAPA) and from various short and long-term power purchase contracts. Lodi is one of 10 NCPA power pool members, whereby each member provides its resources to NCPA for combined operations, and NCPA dispatches all resources to provide total requirements to the pool members at the lowest reasonable cost. In addition, Lodi is a member of the Transmission Agency of Northern California (TANC), and participates in the California-Oregon Transmission Program (COTP). The utility is also participating in the NCPA Lodi Energy Center, which is a 280 MW combined cycle natural gas plant that is currently under construction. LEU's share is 11.7% or about 32 MW. This plant is expected to be the most efficient plant in the region with a planned commissioning date of June 2012. It is expected to provide the utility with 50% of its power needs, mitigating the risks associated with exposure to the spot market.

In fiscal 2010, energy sales totaled 434,020,987 MWH, reflecting a 4% decline over the prior year. Although the decline in fiscal 2010 is high the trend over the last four years has been that of declining sales mainly due to milder weather and energy efficiency programs.

Financial performance has improved over the last three years largely due to changes in management practices. Debt service coverage has ranged from 1.71 times (x) to 3.13x in the most recent three-year period. When adjusted for general fund transfer, coverage equals 1.76x in 2010 which exceeds the rating category median. Management's projections through fiscal 2015 indicate a coverage that is fairly strong at 2.0x (excluding transfers to the city) and 1.12x (average) after including city transfers. While forecasted coverage ratio is slim after including city transfers, the weakness is mitigated by the reduction in exposure to market volatility due to LEC, the automatic monthly energy cost adjuster in the rate structure and a forecasted liquidity level of nearly 160 days unrestricted cash on hand. Additionally LEU's debt profile is conservative, as there is no variable rate debt or interest rate swap outstanding.

The city's median household income is below the state and county average. The unemployment rate in the city, as of September 2010, closely tracked the state average of 12.4%. While high, this rate is lower than San Joaquin County's unemployment rate of 16.6%. Due to recent reductions in shut-off cycle time and increase in customer deposits the utility has experienced a significant reduction in delinquencies from the historical number of 0.6% of revenue.

Contact:

Primary Analyst
Bhala Mehendale
Director
+1-212-908-0520
Fitch, Inc.
One State Street Plaza
New York, NY 10004

Secondary Analyst
Kathy Masterson
Senior Director
+1-415-732-5622

Committee Chairperson
Lina Santoro
Senior Director
+1-212-908-0522

Media Relations: Cindy Stoller, New York, Tel: +1 212 908 0526, Email: cindy.stoller@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria and Related Research:
--'Revenue-Supported Rating Criteria', Aug. 16, 2010.
--'Public Power Rating Guidelines', June 11, 2009.

For information on Build America Bonds, visit 'www.fitchratings.com/BABs'.

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Public Power Rating Guidelines