Summary Analysis

Summary:

Omaha Public Power District, Nebraska; CP; Retail Electric

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Credit Profile		
Omaha Pub Pwr Dist elec		
Long Term Rating	AA/Stable	Affirmed
Omaha Pub Pwr Dist elec (MBIA) (National)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Omaha Pub Pwr Dist CP Program		
Short Term Rating	A-1+	Affirmed
Omaha Pub Pwr Dist elec sys		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has affirmed its 'AA' rating on Omaha Public Power District (OPPD), Neb.'s senior lien electric system revenue bonds. At the same time, Standard & Poor's affirmed its 'AA-' rating on OPPD's subordinate-lien bonds and periodically issued bonds, and its 'A-1+' commercial paper rating on the utility. The outlook is stable.

Factors supporting our assessment of the ratings include:

- A diversified customer base, with low customer concentration, and a service area with good economic characteristics;
- Historically reliable and low cost power supply;
- Unregulated rate-setting ability with no expected retail-level competition;
- Strong financial ratios, including coverage of debt service and fixed charges, and solid liquidity; and
- A moderate debt burden.

Despite these credit strengths, we believe the district faces exposure to the following risks:

- Challenges and costs associated with bringing back on-line its Fort Calhoun Station (FCS) nuclear unit, which has been out of service since an April 2011 refueling that was followed by a flood, an electrical fire, and several adverse findings by the Nuclear Regulatory Commission (NRC);
- OPPD's reliance on FCS for about one-quarter of its energy needs. The prolonged outage demonstrates the risks that utilities with significant nuclear generation face;
- Uncertainty regarding the costs and operational challenges that might arise if regulation of coal-fired generation is adopted. These costs could prove onerous given the district's dependence on coal-fired generation, although many other utilities in the region would face similar challenges; and
- A sizable capital program.

OPPD's business position is '4' on Standard & Poor's scale from '1' to '10', '1' being the least vulnerable. Although we believe the business position is solid, the score reflects our assessment of difficulties the utility is having in bringing FCS back online, as well as the expected loss of competitive advantage. Despite this, Nebraska's favorable regulatory environment, the district's strong management team, and the depth and diversity of the utility's service area continues to support the business position, in our view.

One of the key credit risks OPPD faces is managing increased operating and capital costs associated with a prolonged outage at FCS, as well as meeting the challenge of bringing the unit back online.

In June 2011, the Missouri River crested, causing widespread flooding in the Omaha area, impacting both FCS and Nebraska City coal station. Fort Calhoun, which at the time had been in the midst of a refueling outage, has been offline since. Following the flood, a fire in an electrical switch room and several adverse findings prompted the NRC to place FCS under its "Multiple/Repetitive Degraded Cornerstone". The commission has moved FCS to its NRC 0350 process, under which OPPD must satisfy a list of actions that the commission will review before the unit returns to service.

Management now expects that the plant will receive these approvals and resume operations in September 2013, but we note that this is uncertain, as a number of delays over the past couple of years demonstrate.

OPPD estimates it will recover $89 million in replacement power costs through insurance proceeds and the utility's fuel and purchased power adjustment mechanism over the next two years. It is funding an additional $143 million in nonfuel expenses through general rates, and $55 million in increased capital expenditures with debt. Despite these costs, Standard & Poor's believes that the district still maintains solid coverage and liquidity.

OPPD recently entered a 20-year agreement with Exelon Corp. to provide management services and operational responsibility for FCS. The district will maintain ownership of the plant and oversight of Exelon. It will pay Exelon up to $26.5 million (plus certain reimbursable costs) in 2013, with cost escalators thereafter. According to OPPD management, Exelon reviewed the NRC's 0350 checklist and initially believed that it would be able to bring FCS back online by February 2013, but has revised the expected date to the third quarter.

With this agreement, OPPD expects that Exelon, the nation's largest nuclear operator, will be able to produce savings through economies of scale and shortened refueling outages. While we cannot assess whether Exelon will ultimately be able to produce these savings, we acknowledge that refueling outages at the company's nuclear fleet have been, on average, shorter than OPPD's. We believe that a reduction in the length of FCS refueling outages would result in a combination of reduced replacement power costs and additional energy that could be sold off-system. As important, we believe that the agreement with Exelon contains adequate termination provisions (although at a cost) to protect OPPD's interests should savings fail to materialize, or should the plant fail to be back in service.

Fort Calhoun's license expires in 2033. Additional upgrades (replacement of high pressure turbine and main generator) originally scheduled for 2013 will be deferred, and management now expects that it will not achieve a 75 megawatt (MW) uprate for FCS until 2019. However, we note that the utility has no baseload needs over the next 15 years, so the delay does not present a credit concern.

With FCS out of service, coal fired generation accounted for about 79% of OPPD's energy needs, so its substantial carbon footprint exposes the utility to significant costs related to environmental regulation.

The district has received a new source review information request from the Environmental Protection Agency (EPA) regarding capital projects undertaken since 1987 at its Nebraska City 1 and North Omaha Station. Should the EPA issue an adverse ruling, OPPD could be subject to substantial retrofit costs.

The district is evaluating strategies to comply with the EPA's Mercury and Air Toxics Standard (MATS), which would apply to both of these facilities. It estimates that the costs could range from what we consider to be modest levels, if dry sorbent injection adequately reduces defined hazardous air pollutants, to what we would consider a more significant but still manageable level if scrubbers are needed. The utility must comply with MATS by April 16, 2016.

Nebraska's utilities, which faced potential costs under the Cross State Air Pollution Rule before it was vacated by the courts, are not subject to requirements under the Clean Air Interstate Rule, but we believe that further regulation is inevitable. Given its dependence on coal-fired generation, OPPD would likely face significant costs and credit risk exposure should greenhouse gas regulation of existing units be imposed.

Historically, the delivered cost of fuel has represented one of the district's most significant cost pressures as both the commodity price of Powder River Basin coal and the cost to transport it from mine to plant has escalated over the past several years. However, OPPD has recently entered into new contracts for coal and coal transportation at significantly lower rates than under the prior contract, with savings over time of a magnitude that largely offsets increased O&M costs associated with the FCS outage. In addition, we believe that adoption of a fuel and purchased power cost tracker with an annual true-up mechanism (and recovery in the subsequent year) supports the current rating. Although the tracker is not the strongest that we have seen, we feel that it is adequate given the utility's solid margins and liquidity.

In our opinion, OPPD's service area and customer base are credit strengths. The district provides retail service to about 350,000 customers in Omaha and the surrounding area in a state served exclusively by public power entities. The regional economy has fared well through the recession, and Omaha's unemployment rate stands well below the national rate. Per capita personal income levels are good, in our opinion, at 105% of the national average, and population growth has approximated the national average. The utility's user base is what we view as diverse, with the top 10 customers accounting for 14% of retail revenue, and with all industrial customers accounting for 19% of retail revenue. The three largest industries in the service area--food and grain processing, medical-educational institutions, and insurance and other services--are relatively stable businesses.

OPPD's off-system sales have been a significant and long-term source of revenues, accounting for 19% of operating revenue in 2010, but only 12% in 2012 because the utility had less energy for resale with FCS offline. Given its favorable cost profile, the utility has continued to produce solid margins on market sales, which we note has not been the case for many utilities in the region as low natural gas prices and surplus energy have depressed electricity prices. OPPD's off-system sales are primarily off-peak sales of surplus power from base-load plants. Except for some market price exposure, the district does not assume large business risks associated with these wholesale energy sales, because the sales are contingent upon plant and system availability, avoiding the risk of having to source power elsewhere when the plants are not operating.

OPPD's competitive positioning is favorable, but we expect that it will weaken in the near term. We believe that the management's demonstrated willingness to raise rates when necessary to preserve both solid liquidity and a healthy coverage of fixed costs continue to support the ratings, and we do not believe that the change in competitive position will be significant enough to produce a change in credit quality. According to the Department of Energy's Energy Information Administration, OPPD's average revenue per kilowatt-hour (kWh) was 6% below the state average in 2011, the most recent year of available comparative information, providing the district with modest rate-setting flexibility. We expect that the costs associated with the FCS outage will have a modest impact on rates, but that additional capital needs and operating costs will necessitate additional rate hikes that will boost average revenue per kWh slightly above the state average instead of slightly below it.

We believe the utility financial risk profile is a credit strength, with strong and steady coverage of both debt service and imputed debt costs associated with power purchases. The district manages a 2x coverage target for all debt. Actual coverage levels were above these targets in 2009-2011, but fell slightly below in 2012, at 1.94x. Meanwhile coverage of fixed obligations, which includes imputed debt service associated with power purchases, has exceeded 1.65x in each of the past three years, supporting the strong rating. The utility projects coverage levels to remain near or above these levels over the next five years.

OPPD maintains what we view as solid liquidity. At fiscal year-end 2012 (Dec. 31), total liquidity measured about $540 million, representing about 250 days of operating expenses. The five-year financial forecast anticipates maintaining liquidity at or above 100 days of operating expenses, which we consider solid and supporting the current rating.

Our short-term debt rating on the district is 'A-1+', reflecting the strong long-term rating, the utility's adequate liquidity, and access to the capital markets. Under a board adopted resolution, OPPD is authorized to have outstanding, at any time, up to $150 million of commercial paper. It has obtained a general line of credit from Bank of America N.A. for $250 million to provide liquidity in support of its commercial paper program, and provide liquidity for other general expenditures. OPPD has covenanted to maintain sufficient undrawn on capacity on the line to cover all outstanding commercial paper. The line expires Oct. 1, 2015. The district's commercial paper has a subordinate lien on the revenue of its electric system.

Debt levels have edged upward over the past few years due to improvements at Fort Calhoun and the construction of the 682 MW Nebraska City 2 (NC2) unit, in which OPPD has a 50% share of the output. Seven public power entities in Nebraska, Missouri, and Minnesota take the remaining output under 40-year, take-or-pay, purchased power agreements (PPAs). Net of issuance for participant shares of NC2 debt, debt to assets is a forecast 50% in fiscal years 2013-2017, despite a sizable $1.6 billion capital expenditure program. Capital projects include $582 million for fossil fuel-fired generation, $373 million for nuclear generation, and $455 million for transmission and distribution work. Capital costs could be about $450 million lower if scrubbers are not required on Nebraska City 1 and North Omaha Station to meet regulatory requirements.

Outlook

The stable outlook reflects Standard & Poor's expectations that financial performance will remain strong, and that wholesale sales will continue to be structured in a way that limits OPPD's financial exposure to volatile markets. The outlook also reflects our expectations that the costs associated with the outage at FCS will not increase significantly and that the unit will return to service in the third quarter. Standard & Poor's expects that the district will raise rates as necessary in order to maintain its sound financial performance as it addresses increasing operating costs associated with FCS. Further problems with FCS or a failure to make timely and sufficient rate increases may place downward pressure on the ratings. We are unlikely to raise the ratings in the next two years given the risks from OPPD's operating profile, highlighted by coal and nuclear generation.

Related Criteria And Research

USPF Criteria: Electric Utility Ratings, June 15, 2007

Ratings Detail (As Of July 19, 2013)		
Omaha Pub Pwr Dist elec sys subord program		
Long Term Rating	AA-/Stable	Affirmed
Omaha Pub Pwr Dist elec sys subord (wrap of insured) (FGIC & BHAC) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Omaha Pub Pwr Dist elec (PIBs) ser 2005A (wrap of insured) (FGIC) (National) (BHAC) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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