S&P Global
Ratings

Research

Summary:

Omaha Public Power District, Nebraska; CP; Retail Electric

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Summary:

Omaha Public Power District, Nebraska; CP; Retail Electric

Credit Profile		
US$219.087 mil elec sys rev bnds ser 2018A due 02/01/2039		
Long Term Rating	AA/Stable	New
Omaha Pub Pwr Dist elec		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' rating to Omaha Public Power District (OPPD), Neb.'s senior-lien revenue bonds, series 2018A. At the same time, S&P Global Ratings affirmed its 'AA' rating on parity obligations outstanding, and its 'AA-' rating on OPPD's subordinated revenue obligations. The outlook is stable. S&P Global Ratings also affirmed its 'A-1+' commercial paper rating on the utility.

The following credit factors support our assessment:

- A strong and diverse customer base, supported by an economically sound service area;
- OPPD's proven ability to maintain strong coverage of fixed charges and robust liquidity; and
- The utility's full rate-setting autonomy and a low-cost power supply that allows for competitive rates.

The following factors, in our view, partially offset the above credit strengths:

- A heavy reliance on coal-fired generation, making OPPD more susceptible to environmental regulation;
- Retail rates that are just average and income levels that are below average. While not a credit risk, this does place a constraint on further credit improvement; and
- The utility is moderately leveraged, but we anticipate that this will improve because the district expects to internally fund its capital needs over the next five years.

We rate OPPD's business profile as 4 on a scale from 1 to 10, 1 being the strongest. Despite a favorable regulatory environment, strong management, and a diverse service area, we believe the district is subject to operational risk, particularly related to exposure to fossil fuels.

A pledge of the net revenue of the electric system secures the bonds, and proceeds will be used to fund general capital expenditures. The district had about $2.1 billion of debt (including Nebraska City Unit 2 separate system debt) at Dec. 31, 2017.

We view the service area as very strong. Customer and demand growth has been modest in the past several years.

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Retail sales are evenly distributed among residential, commercial, and industrial classes. The top 10 customers are not concentrated. Median household effective buying income is adequate at 88% of the national average, and unemployment is well below the national average. Off-system sales account for about 35% of total sales, but with thin margins, they account for only 15% of revenue. The off-system sales enable OPPD to charge retail customers lower rates than would otherwise be the case. The district's off-system sales are off-peak sales of surplus power from base-load plants and sales to Nebraska City Unit 2 participants. Except for some market price exposure, the utility does not assume large business risks associated with these wholesale energy sales, because they are contingent upon plant and system availability, thereby avoiding the risk of having to source power elsewhere when the plants are not operating.

OPPD's owned generation accounts for about three-quarters of the district's total energy requirements, with power purchase agreements associated with renewable resources (largely wind) supplying the remaining energy needs. Owned baseload assets exhibit generally good availability factors and produce low-cost power. The district has significant surplus capacity, which it uses to make surplus sales when economical.

OPPD relies heavily on coal-fired generation, which accounted for 70% of 2017 energy needs. The district largely complies with existing regulations. However, its reliance on coal exposes it to future regulation of carbon emissions, which we believe is inevitable, despite the U.S. Supreme Court staying the Clean Power Plan and the Environmental Protection Agency working to undo its rulemaking. However, because the timetable and scope of any future regulation is unknowable, we have not factored its effect into our rating, although it constrains credit improvement.

To reduce reliance on its baseload coal units, OPPD has been restructuring its power supply portfolio over the past several years, adding significant wind capacity (with more expected to be added in 2019), retiring a nuclear unit (Fort Calhoun), while also implementing programs to help reduce demand. Management projects that by 2020, renewable resources will account for 47% of energy needs, up from 26% in 2017. We expect wind generation to displace coal-based generation, which we expect will drop to less than 50% by 2020. OPPD had planned to close its North Omaha natural gas peaking units 1-3, but will now use them to firm up energy delivery during periods of intermittency when power production from wind units that are under power purchase agreements declines.

In October 2016, OPPD ceased operating Fort Calhoun, one of the nation's smallest and least efficient nuclear power plants. The decision has helped the district produce significant operating cost savings. OPPD will not need to procure replacement power. The closure will result in almost $1 billion in savings, eliminating the need to increase rates over the next five years, while covering decommissioning costs. The plant is to be decommissioned by 2066, but with full funding expected by 2023, OPPD has the flexibility to accelerate the schedule. Fort Calhoun accounted for 21% of energy needs during the partial year of operation in 2016.

We view management as capable. OPPD has an automatic cost tracker, although it adjusts only annually, although it may be adjusted at any time with board approval. The district conducts integrated resource planning every five years, and produces annually updated five-year financial and capital plans. The district also has a robust risk-management process that we view as credit protective. Payments in lieu of taxes are manageable and stable at 4% of operating expenses net of depreciation.

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OPPD's competitive position is good, with rates slightly below the state average. As the district did not increase rates in 2017, and does not expect to increase base rates in 2018-2022, its competitive position should improve. The other large retail provider in the state, Lincoln Electric System (LES), projects moderate increases over the next five years, although LES' rates are about 13% below OPPD's.

In our opinion, the district's financial metrics are strong and support the rating. OPPD achieves a 2x coverage level for all debt. In our view, fixed charge coverage, which treats payments in lieu of taxes as an operating expense, and demand and capacity charges as debt, is robust, exceeding 1.75x in each of the past four years. The district's projections incorporate what we view to be credible assumptions (including flat load growth and no rate increases), and they inform our expectation that this trend will continue. Liquidity is also strong, in our view, with available reserves totaling $482 million, representing a strong 201 days of operating expenses. OPPD has a general line of credit from Bank of America N.A. for $250 million to provide liquidity for its commercial paper program and for other general expenditures. The line expires Oct. 1, 2019. Under a board-adopted resolution, the district is authorized to issue up to $150 million of commercial paper, and routinely issues the full amount. OPPD's commercial paper has a subordinate lien on the revenue of its electric system.

OPPD is moderately leveraged. Debt represents 66% of total capitalization, which we view as strong for a vertically integrated utility. This ratio increased from 54% in 2015, because the utility wrote off its investment in the Fort Calhoun nuclear plant. The district projects $748 million in capital spending over the next five years (slightly lower than the previous five years), but does not expect to use debt financing. Therefore, we anticipate a reduction in debt and improvement in the debt-to-capitalization ratio over the next five years.

Outlook

The stable outlook reflects our view of OPPD's financial metrics, with strong liquidity and fixed costs coverage that cushions against any near-term economic issues.

Upside scenario

We are unlikely to raise the rating over the two-year horizon, given income levels that are slightly below average and the district's reliance on coal-fired generation, which exposes OPPD to future environmental regulation.

Downside scenario

Although we do not anticipate lowering the rating, we could take a negative rating action if there is insufficient cost recovery, leading to fixed cost coverage and liquidity falling significantly below levels of the past several years.

Ratings Detail (As Of August 24, 2018)		
Omaha Pub Pwr Dist elec sys subord program		
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

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Ratings Detail (As Of August 24, 2018) (cont.)		
Omaha Pub Pwr Dist RETELEC		
Long Term Rating	AA/Stable	Affirmed

Many issues are enhanced by bond insurance.

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.

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