ITEM # 27
DATE: 12-8-15

COUNCIL ACTION FORM

SUBJECT: SALE AND ISSUANCE OF ELECTRIC REVENUE BONDS SERIES 2015B IN AN AMOUNT NOT TO EXCEED $10,360,000

BACKGROUND:

The FY 2015/16 budget includes electric revenue bond-funded capital improvement projects in the amount of $18,875,000 for fuel conversion from coal to natural gas and cooling tower repairs. Favorable bids allowed for reduction of the issuance amount to $10,360,000. The City Council held a public hearing on issuance of these bonds on November 10, 2015. Council action is now required to authorize the sale. The bonds were assigned an Aa2 credit rating from Moody's Investor Services. **This is a very strong credit rating especially for revenue debt and is only one step down from the City's Aa1 general obligation rating. With this rating the bonds are classified as "high quality and very low credit risk."** A copy of the published credit report is attached to this Council Action Form.

On the morning of December 8, 2015, the City will accept bids for the bonds per the terms of our offering statement. The bids will be evaluated by our financial advisor, Public Financial Management, by the City's Bond Counsel, and by City staff to recommend award to the bidder with the lowest cost. A report of bids will be provided to Council at the December 8 meeting. The City Council will then be asked to adopt a resolution accepting bids and authorizing the sale of bonds to be awarded to the chosen bidder.

ALTERNATIVES:

1. The City Council can adopt a resolution accepting bids and authorizing the sale and issuance of Electric Revenue Bonds in an amount not to exceed $10,360,000.

2. The Council can reject the bond sale resolution and delay the capital projects.

MANAGER'S RECOMMENDED ACTION:

Issuance of these bonds is necessary in order to accomplish the City's approved capital improvements during this fiscal year and complete the fuel conversion for the primary electric generating units.

Therefore, it is the recommendation of the City Manager that the City Council accept Alternative No. 1, thereby adopting a resolution accepting bids and authorizing the sale and issuance of Electric Revenue Bonds in an amount not to exceed $10,360,000.

MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns initial Aa2 to Ames, IA's $10.4M Electric Rev. Bonds, Ser. 2015B

Global Credit Research - 01 Dec 2015

Current issuance comprises all of enterprise's outstanding debt

AMES (CITY OF) IA ELECTRIC ENTERPRISE
Electric Distribution
IA

Moody's Rating

ISSUE		RATING
Electric Revenue Bonds, Series 2015B		Aa2
Sale Amount	$10,350,000	
Expected Sale Date	12/09/15	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook NOO

NEW YORK, December 01, 2015 --Moody's Investors Service has assigned an initial Aa2 rating to Ames Electric Enterprise, IA's $10.4 million Electric Revenue Bonds, Series 2015B. The current offering represents the utility's only outstanding debt.

SUMMARY RATING RATIONALE

The Aa2 rating reflects the utility's stable service area and growing customer base; sound financial operations resulting in projected strong coverage levels well above covenanted levels and very healthy reserves; modest debt burden and satisfactory legal covenants; and unlimited local rate setting authority subject to city council approval.

OUTLOOK

Outlooks are not usually assigned to local government credits with this amount of debt outstanding.

WHAT COULD MAKE THE RATING GO UP

-Expansion and diversification of the customer base

WHAT COULD MAKE THE RATING GO DOWN

-Significant increases in customer concentration

-Material narrowing of annual debt service coverage and/or liquidity

STRENGTHS

-Modest debt burden

-Strong liquidity and sound debt service coverage

CHALLENGES

-Small system size for the rating category

-Elevated customer concentration

RECENT DEVELOPMENTS

Recent developments are incorporated into the detailed rating rationale.

DETAILED RATING RATIONALE

REVENUE GENERATING BASE: MODERATE, GROWING SERVICE AREA BOLSTERED BY INSTITUTIONAL PRESENCE OF IOWA STATE UNIVERSITY

We expect the continued stability of the region's residential and commercial sectors as well as the institutional presence of Iowa State University of Science & Tech. (ISU; Aa2 stable) will contribute to long-term service area health. The customer base has grown moderately in recent years from 24,500 customers in 2010 to 25,600 customers in 2015. The top ten users comprised an elevated 30% of kWh billed in fiscal 2015, but concentration risk is partially mitigated by the stable presence of the industrial users, particularly AMCOR Rigid Plastics USA (9.6% of fiscal 2015 kWh billed), Danfoss Power Solutions (4.5%), and 3M Company (Aa3 negative; 3.8%), as well as the ISU FP&M Utilities (3.8%), the ISU Athletic Department (1.5%), and the ISU Ames Lab (1.1%). Ames' socioeconomic profile is above the nation with median family income at 123% of the US.

The utility owns 143,000 kilowatts (kW) of generating capacity, in excess of 130,700 kW peak demand (in 2013), but satisfies 55% to 60% of its energy requirements via a long term purchase power agreement with the Midcontinent Independent System Operator (MISO) (A1 stable). Generating capacity includes the utility's ownership and operation of two coal/gas/refuse fired steam generation units as well as two diesel gas turbine units used to meet peak demand. The two main coal fired units are presently being converted from burning coal to natural gas and the project is scheduled to be completed by April 2016. The completion of this project will remove any coal generation risks and will eliminate the utility's potential for additional capital investment required by environmental regulations. Management reports that its local generation capacity is utilized primarily for refuse requirements (the city has an obligation to burn city refuse given the lack of a county-wide landfill), peaking purposes, as well as a back-up source of energy.

The utility also has a 20-year purchase power agreement to purchase 36 megawatts (MW) from a nearby wind farm that expires in 2030. Management indicates that current total capacity is expected to serve their projected load growth needs through 2022.

OPERATIONAL AND FINANCIAL PERFORMANCE: SOUND FINANCIAL OPERATIONS DEMONSTRATED BY STRONG LIQUIDITY

Moody's expects the system's financial operations will remain sound due to the operational stability and sound financial management of the utility. While the current issuance represents the utility's only outstanding series of debt, projected maximum annual debt service (MADS) coverage based on unaudited fiscal 2015 net revenues is very strong at 7.6 times over the last three years. Coverage is projected to maintain strong levels and current projections do not incorporate any rate increases or changes in the power cost adjustment. While the utility does not have a defined schedule for reviewing its rate structure and the last rate increase was in 2012, the utility's strong operations have not necessitated a need for additional rate increases and there are no planned increases at this time. When evaluating debt service coverage, we include as an expense the payment in lieu of taxes (PILOT) to the city's General Fund. The utility's PILOT payment to the city is set by the city council and is disbursed only after all operational and debt service requirements have been met. The PILOT was approximately $1.96 million in fiscal 2014 and $1.93 million in fiscal 2013.

Liquidity

In fiscal 2014, the utility's unrestricted cash and investments totaled $41.2 million, or a strong 303 days cash on hand. The utility's liquidity has historically been maintained at these levels.

DEBT AND OTHER LIABILITIES: MODEST DEBT AND SATISFACTORY LEGAL COVENANTS

The utility's debt profile is expected to remain modest as the current issuance represents the utility's only outstanding obligations. The utility's debt ratio will increase to 9.7% in fiscal 2016. Management has no plans to issue any debt for at least the next two years, if not longer.

Debt Structure

All of the utility's debt is fixed rate. Principal repayment is rapid with 90% retired in ten years and 100% retired by 2027. The legal provisions outlined in the bond ordinance specify a rate covenant of 1.25 times the principal and interest due each fiscal year. The additional bonds test is set at 1.25 times. The flow of funds specifies that the bonds have a first claim on the system's net revenues, defined as gross revenues less operational expenses. A bond reserve is to be cash funded and equivalent to the lesser of 1) MADS, including the current bonds and any future parity bonds; 2) 10% of stated par and future parity debt; or 3) 125% of average annual debt service on the bonds and future parity debt.

Debt-Related Derivatives

The utility has no exposure to debt-related derivatives.

MANAGEMENT AND GOVERNANCE: UNLIMITED RATE SETTING AUTHORITY SUBJECT TO CITY COUNCIL APPROVAL

Management maintains a 5-year financial plan and benefits from an unlimited local rate setting authority subject to approval by the city council. The utility is advised by the Electric Utility Operations Review and Advisory Board (EUORAB), which is comprised of five members who are appointed by the Mayor, subject to city council approval, for up to two three-year terms. The EUORAB provides the city council with a critique of management practices, planning and proposals, including recommended rate structures and power sales contracts. We note that that while the utility does not have ultimate rate setting authority, historically there has been minimal friction between the utility and city council on rate structures.

The utility's last rate increase was in November 2012 and the utility does not have a set schedule for rate studies. While this is considered a weak practice, we note that the utility's strong liquidity and projected debt service coverage are reflective of overall strong management.

KEY STATISTICS

System type: Municipal-owned electric generation

Electric system customer base (FY2014): 25,600 customers

Factor 1 - Cost Recovery Framework within Service Territory (25% weight): Aa

Factor 2 - Willingness to Recover Costs with Sound Financial Metrics (25% weight): A

Factor 3 - Management of Generation Risks (10% weight): A

Factor 4 - Rate Competitiveness (10% weight): 2.31%

Factor 5 - Financial Strength - Days liquidity on hand (10% weight; 3-year average): 311 days

Factor 5 - Financial Strength - Debt Ratio (10% weight): 9.7%

Factor 5 - Financial Strength - Debt Service Coverage (10% weight): 7.6x

Grid indicated rating: Aa3

Notching factors: 0.5 notch down for reliance on purchased energy

Scorecard Indicated rating: Aa3

Other Considerations:

Moody's evaluates Ames Municipal Electric Utility relative to the U.S. Public Power Electric Utilities with Generation Ownership Exposure methodology and, as depicted above, the scorecard indicated rating for the utility is Aa3, which is one notch below the assigned public rating of Aa2. We note that while the utility's rate management practices are not clearly defined, the utility's strong debt service coverage and liquidity levels are indicative of overall strong management.

OBLIGOR PROFILE

Ames Municipal Electric Utility is a moderately sized electric utility in north central Iowa that serves an estimated

25,600 customers in the City of Ames and at Iowa State University.

LEGAL SECURITY

The bonds are secured by a first lien on net revenues of the city's electric utility.

USE OF PROCEEDS

The proceeds from the Series 2015B Bonds will finance improvements to the municipal electric light and power plant and system, which includes the conversion of the utility's two coal fired power plants to natural gas.

RATING METHODOLOGY

The principal methodology used in this rating was U.S. Public Power Electric Utilities with Generation Ownership Exposure published in November 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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