# Fitch Affirms Kissimmee Utility Authority (FL) at 'AA-'; Outlook Revised to Positive

Fitch Ratings-New York-20 March 2017: Fitch Ratings has affirmed the 'AA-' rating on the following Kissimmee Utility Authority, FL's (KUA, or the authority) bonds:

--$89.9 million electric system revenue bonds, series 2003 and 2011;

The Rating Outlook is revised to Positive from Stable.

SECURITY

The bonds are secured by a first lien on net revenues of KUA's electric system, including transfers from the rate stabilization fund (RSF) to the revenue fund.

KEY RATING DRIVERS

FLORIDA MUNICIPAL POWER AGENCY PARTICIPANT: KUA is the largest participant in Florida Municipal Power Agency's (FMPA) All-Requirements Power Supply Project (ARP, rated 'A+'/Stable), serving nearly 70,000 retail customers in central Florida, roughly 18 miles south of Orlando. The ARP provides KUA with a reliable long-term power supply sufficient to meet future load growth.

DECLINING LEVERAGE: The Outlook revision to Positive reflects Fitch's expectation that leverage at KUA will continue to decline as the utility's long-term debt fully amortizes in 2018 and the benefits of the growing service area are realized. KUA provides electric service to a diverse and stable customer base throughout the city of Kissimmee (IDR 'AA'/Stable) and Osceola county (IDR 'AA'/Stable), which continue to experience above-average growth.

SUSTAINED IMPROVEMENT IN FINANCIAL METRICS: KUA's financial profile demonstrates a sustained overall improvement, characterized by healthy financial margins, declining leverage and robust liquidity. Management projects declining reserve levels and tighter margins as debt levels decline, but metrics should remain acceptable for the rating category.

LIMITED CAPITAL NEEDS: Fitch views projected capital spending as manageable, at nearly $87 million through fiscal 2020. Moreover, FMPA will reimburse the majority of spending per its Capacity and Energy Sales contract with KUA. No additional borrowings are planned.

COMPETITIVE RATES PROVIDE FLEXIBILITY: KUA's rates are consistently lower than the statewide average for both municipal- and investor-owned utility systems due in part to lower fuel costs under the system's contract with FMPA. In addition, the authority employs a monthly cost of power adjustment that facilitates timely cost recovery.

RATING SENSITIVITIES

CONTINUED GROWTH AND CLARIFIED STRATEGIC GOALS: Resolution of the Kissimmee Utility Authority's Positive Outlook will be contingent upon successful deleveraging, continued strong growth and clarification of the authority's strategic and financial objectives beyond the full maturity of outstanding debt.

CREDIT SUMMARY

STABLE POWER SUPPLY

KUA's power supply is sufficient to meet its current needs as well as future load growth. Substantially all of KUA's power supply demands, as well as scheduling, transmission, and associated services, are satisfied through its participation in FMPA's ARP. KUA and the balance of the project's 14 participants are bound by 30-year power supply contracts that roll each year for one additional year, thereby keeping the length of the contracts at 30 years.

Subsequent to entering into the ARP, in October 2008 KUA leased the ownership share of its generating assets to FMPA and waived its right to exercise a contract rate of delivery (CROD) provision under the ARP. The provision allows participants who contribute generation to the ARP to cap their load from the project at the participant's peak demand during the preceding 12-month period with five years notice to FMPA.

In return for leasing its generating assets and foregoing the CROD provision, KUA cedes having to fund operation, maintenance and capital costs of the assets to FMPA and receives a fixed capacity credit that serves as a reliable revenue stream. Capacity payments, which are effectively secured by the contracts of the ARP members, totaled $11.4 million in fiscal 2016, equal to approximately 6% of total annual revenue.

Additional capacity is available to the authority through its participation in FMPA's St. Lucie Project (rated 'A'/Stable), consisting of FMPA's 8.8% ownership interest in St. Lucie Unit No. 2, a 984MW nuclear power plant operated by Florida Power & Light. KUA's participation in the St. Lucie Project provides up to 6.9MW of additional capacity.

ROBUST LIQUIDITY AND LOW RATES PROVIDE FLEXIBILITY

Fitch-calculated debt service coverage (DSC) improved in fiscal 2016 to 1.97x but remained well below Fitch's rating category median of 2.46x. Coverage of full obligations, which includes a transfer made to Kissimmee's general fund, remained in line with prior years at about 1.2x, also solidly below the median ratio of 1.4x. Fitch notes the transfer is subordinate to the payment of debt service obligations pursuant to the flow of funds outlined in the bond indenture.

The authority's unrestricted cash and available reserves, including a sizeable RSF, totaled $98.7 million at the close of fiscal 2016, equal to nearly 260 days of cash on hand compared to the rating category median of 216 days. The RSF was established in fiscal 2003 with an initial $5 million deposit and grew to a substantial $70 million by fiscal year-end 2014, declining to $56 million in 2016.

Fitch notes that the RSF is available for any operating purpose, although

KUA's internal policy requires a minimum balance of $5 million. Additional fiscal policies include preserving unrestricted cash at a minimum of 45 days of fixed operating costs, maintaining DSC of no less than 1.25x and retaining a $5 million minimum balance for future capital outlay.

FULLY AMORTIZING DEBT AND TIGHTENING MARGINS

All of KUA's outstanding revenue bonds fully amortize in 2018. KUA's ability and willingness to current fund its capital needs over the last several years has driven this favorable and ongoing decline in leverage ratios. The utility's ratios of debt to funds available for debt service (FADS) as well as debt as a percentage of capitalization have steadily declined, dropping to 1.8x and 30%, respectively, compared to the rating category medians of 4.7x and 47.7%.

Financial projections through fiscal 2020 show slightly tightening margins and lower reserves as debt obligations are retired -- based on what Fitch believes are reasonable assumptions, including annual growth of less than 2% in both customers and energy sales as well as no additional debt plans. Coverage of full obligations (inclusive of the annual general fund transfer and adjustments related to purchased power) is forecast to remain, on average, closer to 1.10x.

Fitch expects a modest decline in liquidity, given KUA's plan to fund annual capital spending from excess cash flow and existing reserves. Management's plan to keep base rates level through the current planning period is also reflected in the forecast.

Capital spending is forecast to continue at a very manageable level and will not require additional debt financing. KUA's 2017-2020 projected capital expenditures total $87.23 million, up modestly from the nearly $86.7 million prior plan that spanned fiscals 2015-2018.

GROWING SERVICE TERRITORY

The authority serves nearly 70,000 customers in a service territory that includes the city of Kissimmee (IDR 'AA'/Stable) and unincorporated areas of Osceola County (IDR 'AA'/Stable). Slightly more than one-half of KUA's customers are located in Kissimmee while the balance is located immediately outside the city limits. Kissimmee serves as the county seat and is located less than 20 miles south of Orlando, FL, and seven miles east of Walt Disney World. Customer growth has averaged 2.1% since 2006, and more recent growth has outpaced expectations at 2.3% year-over-year in 2016.

Despite steady improvement in unemployment levels since 2010 (halving from 12.2% to 5.6% in 2015), weak income levels persist, driven in large part by the prevalence of tourism-related jobs. The city's per capita and median household income equal just 66% and 79%, respectively, of the state indices and less than 70% of the national figures. Despite the weak income levels, utility bill collections have remained strong with annual write-offs remaining comfortably below 1%.

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**Applicable Criteria**

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
(https://www.fitchratings.com/site/re/750012)
U.S. Public Power Rating Criteria (pub. 18 May 2015)
(https://www.fitchratings.com/site/re/864007)

**Additional Disclosures**

Dodd-Frank Rating Information Disclosure Form
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