Moody's Modifies Credit Metrics for G&T Cooperatives

Amid a sea of change in the utility industry, modifications to credit ratings methodologies may go largely unnoticed by many distribution managers. However, it is worth a review as the impact on generation and transmission (G&T) cooperative ratings resulting from one agency's methodology may influence the way we think of the relationship between the distribution member's financial management and the assigned credit risk of its G&T.

In December 2009, Moody's Investors Service published updates to its 2006 methodology framework in providing credit ratings to U.S. Electric Generation & Transmission Cooperatives. While based on the 2006 metrics, the new framework includes methods that focus on the challenges that G&T cooperatives currently face. Moody's published its procedures of analyzing the creditworthiness of G&T cooperatives with the aim of providing more transparency to help issuers, investors and other interested parties assess credit risk for the sector.

Moody's five key factors utilized in examining the credit risk of a G&T are:

- Long-term wholesale power supply contracts and regulatory status
- Rate flexibility
- Member profile
- Financial metrics
- Size

Power Supply Contracts and Regulatory Status

Moody's regards long term wholesale power contracts between G&T cooperatives and their members as reducing the G&T's credit risk. Such contracts promote assurance that rates and sales will recover costs and capital investment. Moody's gives a preference for full requirements contracts. The regulatory environment in the G&Ts service territory has strong bearing on this factor. An unsupportive jurisdiction is a credit negative while the absence of regulation positively impacts the rating.

Rate Flexibility

Rate flexibility is the next broad factor Moody's considers when assessing credit risk. First, a board of directors' involvement in rate adjustments is critical as the timely adoption of costs into rates is the fiduciary responsibility of the board. The second element of this factor is the degree of reliance of the G&T on purchased power where market purchases increase financial uncertainty, hence risk. The third element is the G&T capital investment exposure relative to the existing asset base. Last, the potential for rate shock can reduce the competitive position of the G&T rates relative to the market.

Member Profile

The third factor Moody's evaluates is the member profile of the G&T. The rating agency considers two elements. The first element is the portion of the members' load composed of residential load with the higher the percentage earning a more positive risk impact. The second element is the member cooperatives' consolidated equity as a ratio to total capitalization with a higher equity ratio reducing the G&T's risk exposure.

Financial Metrics

Moody's analyzes five financial metrics as the fourth step in risk evaluation process. The first element is the Times Interest Earned Ratio (TIER). The second financial metric is the Debt Service Coverage (DSC) ratio. Both the TIER and DSC metrics are familiar to cooperatives as part of their filings with the RUS. In addition to these measures, Moody's goes further by examining the Funds From Operations (FFO) to Interest Expense Coverage. Fourth, it also gauges the FFO to Total Debt of the G&T with a lower measure contributing negatively to the the risk profile. Fifth, in order to foster comparison to investor owned utilities with whom G&Ts and member cooperatives compete for capital, Moody's calculates the Equity to Total Capitalization ratio of the G&T.

Size

The last factor in assessing credit quality that Moody's considers is the size of the G&T. Moody's focuses on two elements of G&T size that it considers reflective of credit quality. The first is Megawatt sales which represents the economies of scale with a higher number indicating lower risk. The second is the net value of plant, property and equipment. A larger value of net plant usually indicates a more diverse pool of assets hence more diversification of risk.

For more information, contact David Hedrick at 405.416.8157 or david.hedrick@chguernsey.com.