S&P Global
Ratings

RatingsDirect®

Summary:

Central Iowa Power Cooperative; Rural Electric Coop

Primary Credit Analyst:
Doug Snider, Centennial + 1 (303) 721 4709; doug.snider@spglobal.com

Secondary Contact:
Timothy P Meernik, Centennial + 1 (303) 721 4786; timothy.meernik@spglobal.com

Table Of Contents

Rating Action

Stable Outlook

Credit Opinion

Related Research

Summary:

Central Iowa Power Cooperative; Rural Electric Coop

Credit Profile		
Central Iowa Pwr Coop ICR		
Long Term Rating	A/Stable	Affirmed

Rating Action

S&P Global Ratings affirmed its 'A' issuer credit rating (ICR) on Central Iowa Power Cooperative (CIPCO). The outlook is stable.

The cooperative borrows exclusively from the Federal Financing Bank, CoBank ACB, the U.S. Department of Agriculture's Rural Utilities Service, and the National Rural Utilities Cooperative Finance Corp. Although we do not rate these borrowings, we evaluate the debt and its debt service in determining the ICR. The utility does not have capital market debt.

Credit overview

CIPCO is a generation and transmission (G&T) cooperative with total operating revenue of $188 million in 2019. The cooperative had a 636 megawatt (MW) peak demand and a load factor of about 56% in 2019. Membership is composed of 12 rural distribution cooperatives plus the South Iowa Municipal Electrical Cooperative Association (SIMECA), which combines the load of 15 small municipalities. CIPCO members and SIMECA serve more than 137,000 electric accounts and a population of about 300,000 across much of southern and eastern Iowa.

The rating reflects our view of the following factors:

- Long-term contracts with the 12 member cooperatives that extend through 2045, well beyond the term of debt outstanding, and little customer concentration at the distribution cooperative level;
- Good financial and operational policies regarding debt service coverage (DSC), leverage ratios, and liquidity, coupled with robust power supply planning; and
- A power supply that we believe is diverse by unit and fuel type, and reduces market exposure, with more than half of its energy coming from carbon-free resources; offset by the looming closure of the Duane Arnold Energy Center (DAEC) in 2020, which introduces some uncertainty to the cooperative's power supply. Management noted that all or some of the renewable energy credits associated with CIPCO's wind and solar generation projects may have been sold, or may be sold in the future, to other parties.

Tempering the preceding strengths and constraining the rating are CIPCO's:

- Member retail rates that are above the state average despite CIPCO's favorably priced wholesale power, due to a generally low density rate, which, in our view, could constrain members' ratemaking flexibility; and

- Moderate exposure to coal-fired generation, with about 32% of energy sourced from coal-fired resources.

The stable outlook reflects the utility's track record of rate adjustments and cost management that have supported sound DSC and fixed charge coverage (FCC) metrics, coupled with a forecast that we find to be feasible, suggesting this trend will continue.

Environmental, social, and governance factors

We believe that CIPCO's generation fleet presents moderate environmental exposures through its coal generation assets. Coal accounted for 32% of 2019's power supply, although management projects reducing coal exposure to about 30% by 2028 as the utility secures additional wind and solar resources. Energy Information Administration (EIA) data show that members' weighted-average retail rates were about 13% above state averages in 2018. We believe this level of rate disparity contributes to social risk that could limit financial flexibility, particularly as the nation experiences the recessionary impact of the COVID-19 pandemic. Furthermore, social distancing measures and stay-at-home orders could materially affect the utility's overall demand profile, especially in light of the potentially volatile ethanol and pipeline loads. Finally, the cooperative's governance factors, including its rate-setting authority and forecasting practices, are strong, which we view favorably relative to those of other rated electric cooperatives with less robust practices.

Stable Outlook

Downside scenario

We could lower the rating If net margins and coverage metrics decline significantly in light of COVID-19 and the resulting recessionary pressures, especially in regard to members' larger ethanol and pipeline loads. In addition, we could lower the rating if CIPCO fails to secure affordable and reliable replacement power following DAEC's closure.

Upside scenario

We do not anticipate raising the rating in the near term because of recessionary pressures flowing from the COVID-19 pandemic, coupled with CIPCO's sparsely populated customer base, with member retail rates that are high relative to the state average. However, if finances materially improve to a level that offsets these risks, we could raise the rating.

Credit Opinion

CIPCO's service area economy focuses heavily on agriculture. The cooperative's members serve an exceptionally rural and dispersed population, with the 12 member cooperatives averaging four customers per line mile, and only two members serving greater than five per line mile. No individual customer represents more than 2.75% of total energy sales. All but four members charge overall rates that are above the state average, according to the most recent available data from the EIA. However, the members' sparse service territories and the 56% load factor contribute to lessened efficiency in recovery of fixed costs for the member cooperatives, leading to higher rates. All members retain ratemaking autonomy.

While CIPCO's largest customer represents less than 3% of total system load, management reported that May energy

sales were about 11.3% below budget, although CIPCO's internal analysis suggests that only 1.7% of that decline was directly attributable to COVID-19-related economic impact, with suppressed oil prices and weather having a more pronounced effect. CIPCO members have seen demand softening among ethanol customers, casinos, pipeline loads, and, to a lesser extent, large industrial/manufacturing customers. Despite these declines, management has reported a slight uptick in delinquencies among members, with no concerns to date of member non-payment. Management reports that CIPCO's short position helped lessen the impacts of these demand declines, and ultimately does not expect material financial or operational degradation to the cooperative.

The cooperative's power supply consists mainly of coal and nuclear baseload resources, supplemented with hydroelectric power allocations from the Western Area Power Administration; and other sources, including wind, solar, and landfill gas purchase contracts. Power supply costs are low, in our view, with stable combined bus bar costs of $38.2 in 2019, and ranging from $38 to $45 for the past five years. Operating availability of CIPCO's major resources is above industry averages in most years.

The utility's generation portfolio provides about 740 MW of total generation resources, consisting of minority interests in large nuclear and coal plants; one wholly owned peaking facility; and contractual resources from a mix of hydro, wind, solar, landfill gas, and diesel gas units. The arrangement has the diversification benefit with no reliance on a single plant or fuel as well as economies of scale in operations.

NextEra Energy Inc. manages the 622 MW DAEC, of which CIPCO owns a 124 MW share. The plant's operating license extends to 2034. The plant provides about one-third of CIPCO's total energy needs; however, in July 2018, NextEra announced its plans to close the plant in 2020, 14 years before its Nuclear Regulatory Commission license expires, because Alliant Energy Corp. agreed to pay NextEra to shorten its power purchase agreement for the plant's output. The plant is scheduled to close in October 2020, having completed its final refueling in late 2018. Management reported plant performance will continue to wind-down as the plant burns through the existing fuel rods.

CIPCO developed a multi-pronged approach to address this unexpected announcement. First, it developed a plan to recognize the almost $80 million in stranded assets resulting from the plant closure. The cooperative was granted Rural Utilities Service approval to establish a $50.5 million regulatory asset for the plant, depreciated over 10 years, while recognizing a $15.1 million impairment loss in fiscal 2018. The remaining $12.2 million will remain on CIPCO's balance sheet as electric utility plant, depreciating the asset through 2020. Ultimately, management's goal was to establish a regulatory asset equal in amount to the unamortized debt associated with the plant, therefore linking amortization with member collections.

Second, the utility developed an integrated resource plan with a set of five objectives: Provide reliable and long-term cost-effective energy to members, support a flexible power supply portfolio that can respond to shifting market conditions and uncertainties, retain fuel diversity while managing environmental impacts, maintain competitive wholesale rates, and provide a framework to address enterprise risk. CIPCO identified that a combination of 150 MW of wind, 150 MW of solar, and 130 MW of owned reciprocating engines would best achieve these targets. The cooperative has already secured 100 MW of solar capacity through purchase power agreements. Looking forward, the cooperative may choose to layer in additional contracts for the remaining 50 MW of solar and 150 MW of wind capacity as well as a 55 MW expansion to its Summit Lake plant, and construct another 75 MW of distributed capacity

resources in 25 MW increments. However, management indicated it can and likely will defer a portion of this additional capacity to maintain a flexible portfolio in light of low market prices and demand uncertainty. Ultimately management reported it expects overall power costs to decline as a result of its proposed energy portfolio, in part due to DAEC's exceptionally high fixed costs and in part because of favorable contracted renewable prices.

We believe management has prudently addressed the early closure of DAEC; however, until it secures the necessary replacement resources, the uncertainty regarding the future power supply does introduce some credit risk. Management expects to maintain an approximately 20% open position, which, while favorable under current market conditions, could introduce price uncertainty should market prices rise.

Financial performance is moderately strong, in our view. DSC and FCC, which imputes the cooperative's minimal capacity payments as debt-like obligations, were both stable over the past seven years. DSC of 1.41x in fiscal 2019 and FCC of 1.41x (or 1.31x after a $3.8 million non-cash expense related to the DAEC regulatory asset) support the rating, in our view. Both metrics are projected to decline to about 1.3x in the long term, which we still believe supports the rating.

The cooperative has a number of financial policies, including a target DSC of at least 1.2x. CIPCO's long-range equity target is 25%, which it first attained as of fiscal year-end 2012 (Dec. 31). Liquidity levels are strong, in our opinion, with cash and available lines of credit totaling 252 days' expenditures as of Dec. 31, 2019.

CIPCO's long-term debt is amortizing with no significant bullet maturities. The cooperative's five-year capital improvement program covering 2010-2024 totals about $210 million. The plan designates $101 million for generation projects--predominantly focused on the incremental addition of smaller gas-fired peak shaving units, with an additional $57 million earmarked for the Summit Lake repowering project in 2020. Another $121 million will be used for transmission improvements to improve system reliability and facilitate growth. The plan indicates a modest increase in long-term debt, to $420 million by fiscal 2024 from about $318 million at fiscal year-end 2019.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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.

Copyright © 2020 by Standard & Poor’s Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor’s Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an “as is” basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT’S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P’s opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR’S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor’s Financial Services LLC.