FitchRatings

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Fitch Affirms Central Iowa Power Cooperative's IDR at 'A'; Outlook Stable

Fitch Ratings - Austin - 29 Dec 2021: Fitch Ratings has affirmed Central Iowa Power Cooperative's (CIPCO) Issuer Default Rating (IDR) at 'A'.

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The affirmation reflects CIPCO's strong revenue defensibility and Fitch's expectation that CIPCO's leverage ratio will remain below 8.0x over the medium to long term. Financial metrics are likely to weaken in fiscal 2021 due to elevated purchased power expenses related to the February 2021 winter storm event; however, Fitch believes metrics should improve in 2022 as the utility's operating cash flow returns to historical levels. Additionally, CIPCO has taken steps to reduce its risk exposure to market prices with recent additions to its power supply including solar, wind and natural gas-fired generation. Fitch expects CIPCO will continue to provide a low cost and diversified power supply.

The 'A' rating also considers the aggregate credit quality of CIPCO's members, which generally exhibit strong economic metrics and midrange financial performance.

CREDIT PROFILE

CIPCO is Iowa's largest cooperative energy provider, supplying power to a membership of 12 rural electric cooperatives and one association of municipal utilities. The members, in turn, provide power through a service territory that spans 300 miles diagonally across central and southern Iowa and encompasses 58 of Iowa's 99 counties. The members serve over 125,000 retail customers and a population of approximately 300,000 residents.

A 13-member board of directors governs CIPCO and is comprised of one appointed board member from each of the member systems. CIPCO's board members also provide active oversight by approving CIPCO's 20-year financial forecast and its annual operating and capital budgets, which consist mainly of generation and transmission construction workplans.

Winter Storm Event

CIPCO's incremental power supply costs due to the Winter Storm Uri were approximately $16.4 million over the utility's budgeted costs for the month of February. The costs were due to materially higher market energy prices and natural gas prices experienced during the week of Feb. 14, 2021. Like many utilities across the central and southern regions of the United States, CIPCO experienced elevated energy market prices and fuel costs prompted by unprecedented and prolonged below freezing temperatures.

CIPCO management took several steps in the immediate aftermath of the storm to mitigate its financial impact. CIPCO implemented a 1.5 mills/kWh rate increase in April 2021, which generated approximately $4 million in additional revenues in fiscal 2021. The utility also liquidated approximately $8 million of investments to settle storm-related expenses. The drawdown did not materially weaken the utility's liquidity as the liquidated investments represented approximately 10% of the utility's investment fund balance. CIPCO management also expanded its CoBank line of credit to $150 million from $105 million to further mitigate liquidity concerns.

The financial impact from the storm event was exacerbated by the utility's increased reliance on market purchases. CIPCO maintained an outsized open market position for several months following the closure of the Duane Arnold Energy Center (DAEC) in August 2020 as the utility awaited the completion of several planned generation projects during 2021. Diminished performance at CIPCO's wind facilities during the storm, in addition to a mechanical issue at one of CIPCO's coal-fired facilities midway through the storm event, both contributed to the utility's reliance on higher priced market purchases. CIPCO management estimated market purchases represented up to 40% of energy supplied at certain points during the storm event.

While CIPCO still maintains an open market position going into 2022, Fitch believes recent power supply additions and enhancements reduce the utility's risk exposure to market prices. Since the event, the utility added 100MW of solar generation, 54MW of wind generation, and repowered its Summit Lake facility to provide 110MW of natural-gas fired capacity. Each of the projects were part of CIPCO's broader power supply plan to replace the lost capacity at DAEC, but the projects had not reached commercial operation by February 2021. The utility also increased its bilateral baseload purchases, and secured additional short-term physical hedges for the 2021-2022 winter. Management projects market purchases will account for approximately 9% of the utility's 2022 energy requirements.

Limited Coronavirus Impact

The impact of the of the outbreak of the coronavirus on CIPCO's credit profile remains limited. While overall electric sales declined by approximately 5% in 2020 due to lower commercial and industrial consumption, 2021 energy sales (unaudited) are nearly back to pre-pandemic levels. Reduced consumption was most pronounced among CIPCO's pipeline customers in the early months of 2020, but consumption levels have since rebounded. The largely residential customer base among CIPCO's participants provided additional stability in energy sales.

The state of Iowa issued a moratorium on electric cooperative utility disconnections from March 27, 2020 through May 28, 2020. However, CIPCO participants did not report material increases in customer non-payments during 2020.

KEY RATING DRIVERS

Revenue Defensibility: 'a'

Long-Term Power Contracts; Midrange Member Credit Quality

CIPCO's revenue defensibility assessment reflects the very strong revenue source characteristics of its long-term take-and-pay, all-requirements contracts with 12 rural electric distribution cooperatives (RECs) and South Iowa Municipal Electric Cooperative Association (SIMECA). Aggregate member credit quality, however, is midrange, reflecting adequate financial performance but high leverage and mixed liquidity metrics. Although CIPCO members maintain autonomous rate-setting ability, member retail rates generally remain higher than neighboring utilities due to the rural nature of the service territory. Some customer concentration exists among CIPCO's largest members.

Operating Risk: 'a'

Low Cost Power; Transitioning Power Supply

CIPCO's operating risk assessment of strong is based on the utility's history of providing a consistently low cost and diversified power supply to its members. CIPCO is expected to maintain low operating costs as it transitions its power supply following the closure of the DAEC nuclear facility in August 2020, one of CIPCO's baseload generation resources. Since the closure, CIPCO has added solar (100 MW), wind (54 MW), and natural gas-fired (110 MW) generation. An additional 100 MW of solar is expected to be added to CIPCO's power supply before 2023. Planned capex during the five years ending in 2025 are very manageable at $170.1 million and will focus on the planned transmission investments.

Financial Profile: 'a'

Strong Financial Profile Despite Recent Challenges

CIPCO's financial profile assessment is based on the utility's historically strong financial performance. Fitch expects CIPCO's financial metrics will weaken in fiscal 2021 due to the utility's elevated purchased power expenses during the winter storm. However, operating cash flow and leverage metrics should rebound over the medium to long term to levels consistent with the 'a' profile assessment as purchased power expenses normalize. The cooperative's leverage ratio is expected to approach 9x in Fitch's base case in 2021 before declining below 7x through fiscal 2025. Fitch expects the recent power supply additions better positions the utility against rising market prices.

A sizable portion of CIPCO's unrestricted assets are held in riskier asset classes, which creates uncertainty in regards to investment returns and market volatility. CIPCO's strong liquidity position is somewhat tempered by this increased risk.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustained declines in leverage below 6.5x in Fitch's base and stress cases;

--Meaningful improvement in the aggregate credit quality of the CIPCO members, which results in an improvement in the utility's revenue defensibility assessment.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Sustained increase in leverage above 8.0x in Fitch's base and stress cases;

--A sustained weakness in financial markets and a resulting sizable decrease in the value of CIPCO's unrestricted assets.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

SECURITY

CIPCO's IDR reflects Fitch's assessment of the cooperative's relative vulnerability to default on its financial obligations.

Revenue Defensibility

CIPCO's revenue source characteristics are very strong based on the cooperative's take-and-pay all-requirements contracts with 12 RECs and SIMECA. The RECs and SIMECA have long-term contracts extending through 2045 and 2053, respectively.

Rate Flexibility

Fitch assesses CIPCO's rate flexibility as very strong, reflecting the cooperative's autonomous rate-setting ability. The board approves rates annually, but management can adjust the rates throughout the year in order to ensure recovery of costs and that the cooperative's financial obligations are met. Rates can be adjusted based on a demand charge, which covers fixed and operating costs, or the energy charge, which is primarily related to fuel costs.

CIPCO is nearing completion of its cost of service rate study. While CIPCO wholesale rates should remain relatively stable through the five-year forecast, the cooperative anticipates the rate structure will be adjusted to better align overall system costs with wholesale rates, while ensuring a full recovery of costs. Future rate changes will depend on CIPCO's ability to access low-cost power through their generation portfolio or purchased power contracts, and any rate increases will likely be driven by the proposed layering in of additional natural gas-fired generation and recovery for the stranded costs related to the DAEC facility. A revised rate structure is not expected to be implemented before 2023.

Purchaser Credit Quality

Fitch assesses CIPCO's Purchaser Credit Quality (PCQ) as midrange based on the aggregate credit quality of its members and a calculated purchaser credit index that has remained at approximately 2.4 to 2.5 during the past three years. Fitch evaluated the credit quality of CIPCO's three largest members, which represent nearly half of the cooperative's revenues. Overall, these members exhibited strong to midrange credit quality, characterized by median household income levels that remain in line with the national level and unemployment that remains well below the national level.

The customer base served by members is relatively diverse and primarily residential, save for a handful of larger retail users that include two ethanol producers, a crude oil pumping station, and an anhydrous ammonia producer. Three of CIPCO's top 10 load customers are served by one CIPCO member exposing it to customer concentration. Sales to these large customers are tracked separately by CIPCO as contract sales.

The contract sales, which are primarily with pipeline customers, present some volatility risk with respect to CIPCO's power supply requirements; however, each customer is served pursuant to staggered multiyear contracts that include clauses to collect fluctuating energy costs on a monthly basis, and, in some cases, provide for minimum volumetric thresholds. Additionally, while 2020 demand for these customers declined in the immediate aftermath of the pandemic, CIPCO management reports contract sales demand has nearly returned to pre-pandemic levels.

Each of CIPCO's members maintains autonomous rate-setting ability. However, the retail rates of CIPCO member cooperatives vary, with some member rates well above the state average. This is partially attributable to the rural nature of member service territories. Retail rates at the top three utilities ranged from 12% to 22% above the state average retail rate and affordability, as measured by total residential electric cost of service divided by median household income, ranged from 2.0% to 3.0%.

The financial profiles of the three largest members span from midrange to strong, characterized by midrange to high leverage levels, and adequate cash flow and liquidity. Fitch believes the member financial profiles, in conjunction with each member utility's ability to absorb rate increases, support the midrange PCQ assessment.

Operating Risk

Fitch assesses CIPCO's operating risk profile as strong reflecting the utility's consistently low operating cost burden, which has averaged approximately 5.5 cents/KWh during the past five years. CIPCO has historically benefited from a relatively low-cost power supply derived from primarily coal and nuclear generation.

Operating Cost Flexibility

Fitch believes CIPCO's operating cost flexibility is neutral to the utility's operating risk profile. CIPCO maintains a diversified power supply, albeit one that is in the midst of transitioning following the closure of DAEC in August 2020. DAEC provided the utility with approximately 124MW of nuclear capacity and supplied nearly a third of the utility's power supply in 2019. CIPCO underwent a full review of their integrated resource plan prior to the DAEC closure to ensure the cooperative maintained an adequate and diversified power supply, minimized rate impacts to members, and ensured sufficient cash flows to service DAEC debt maturing through 2034. Since then, CIPCO management has taken steps to replace the capacity by layering in long-term wind and solar contracts and adding gas-fired generation capacity.

CIPCO entered into a long-term PPA for the purchase of 100% of the energy and capacity output from the 100 MW Wapello Solar facility, which began commercial operations in March 2021. Additionally, CIPCO completed the repowering of its Summit Lake Generating Station (Summit Lake), replacing the steam generation units with natural gas-fired reciprocating engines. The project, which cost approximately $85 million, reached commercial operation in April 2021 and will provide CIPCO with 110 MW of regulatory capacity.

CIPCO also entered into a 20-year PPA with BHE Renewables LLC for the purchase of the capacity and energy from the 54MW wind facility. The facility began commercial operations in December 2021. Management also plans to add 100 MW of additional solar generation through a long-term PPA executed in April 2021. The project, which is currently in development, is projected to be completed before 2023.

Despite the transitioning power supply, CIPCO continues to offer a balance between fuel types, in addition to a mix of both owned resources and long-term PPAs. CIPCO's projected 2022 sources of energy include coal (36%), wind (36%), and solar (7%), with the remaining power coming predominantly from market purchases and other contracted purchases. Long-term PPAs and owned generation are expected to account for approximately 46% and 39% of CIPCO's 2022 energy supply, respectively, with market purchases fulfilling the utility's remaining energy requirements.

Fitch views CIPCO's power supply strategy favorably, as it further diversifies its energy supply and provides some flexibility by allowing the utility to slowly add generation capacity to accommodate the cooperative's forecasted load growth. Additionally, contract purchases, which accounted for more than one-third of CIPCO's regulatory capacity in 2021, are expected to account for less than 20% of the utility's 2022 regulatory capacity. Fitch believes this should mitigate some of the market price exposure and therefore, limit the financial impact of rising market prices during storm events similar to the one CIPCO experienced during February 2021. The planned addition of the PPAs and the expectation of continued lower energy market prices mitigate longer-term concerns.

Capital Planning and Management

Fitch assesses CIPCO's capital planning and management as very strong reflecting the utility's average age of 10 years. Recent capital expenditures in fiscals 2019 and 2020 have been elevated as CIPCO completed the repowering of its Summit Lake generation facility. However, projected capital expenditures are expected to be much more manageable, averaging less than $30 million during fiscals 2022 through 2025. Expenditures will primarily focus on planned transmission investments to improve system reliability.

Financial Profile

CIPCO continues to demonstrate strong financial performance despite confronting some recent headwinds. The coronavirus pandemic led to lower commercial and industrial customer demand, both of which contributed to lower operating revenues in fiscal 2020. However, coverage of full obligations (COFO) remained strong at 1.7x in fiscal 2020 as the utility offset its lower electric sales with lower purchased power expenses. Partial debt-financing of the utility's expanded capital improvement plan due to the Summit Lake repowering project caused the utility's leverage to increase to 5.9x at FYE 2020 from 4.6x at FYE 2019, but the leverage metric remained supportive of the rating.

Liquidity, as measured by unrestricted funds on hand, remained robust at 287 days as of FYE 2020. However, approximately 92% of these unrestricted assets are invested in equities, real estate investment trusts and hedge funds, which creates some uncertainty in regards to the amount of, and return on, investments. Fitch views CIPCO's investment strategy as somewhat risky, given the impact unpredictable income can have on financial metrics including debt service coverage, leverage and liquidity ratios. The cooperative's margin policy that excludes investment income partially mitigates this risk. CIPCO management liquidated approximately $8 million of its investments, representing approximately 10% of the investment fund balance, to offset storm-related costs following the February 2021 winter weather event.

CIPCO also maintains two lines of credit, one with CoBank ($150 million) and one with the CFC ($40 million). The cooperative uses these lines primarily for working capital purposes but may also use them to fund capital expenditures prior to long-term financing. CIPCO expanded its CoBank line of credit to $150 million from $105 million in 2021 to further mitigate liquidity concerns following the February winter storm event. Management plans to reduce the CoBank facility down to $105 million before the end of 2021.

Fitch Analytical Stress Test (FAST) - Base and Stress Cases

Fitch used management's projections for energy sales, revenues, and expenses, in addition to CIPCO's planned capital expenditures and debt issuances, to inform the base case in Fitch's scenario analysis. The projections also include CIPCO's additional purchased power costs resulting from the February 2021 winter storm event.

Factoring in the elevated purchased power expenses, Fitch expects CIPCO's operating cash flow to materially weaken in fiscal 2021 with COFO expected to drop to 1.1x, well below CIPCO's five-year historical average of 1.6x. Leverage is also expected to weaken, rising to nearly 9x at FYE 2021. However, CIPCO's cash flow and leverage metrics should recover in subsequent years as projected purchased power expenses normalize and capex levels decline. COFO and leverage metrics are expected to average 1.2x and 6.7x, respectively, over the four-year period ending 2025. Fitch believes CIPCO has substantially reduced its risk exposure to market power prices with the recent enhancements to its power supply, including new generation, bilateral baseload purchases, and short-term physical hedges.

Fitch's stress case applies a moderate stress to management's forecasted energy sales using the FAST model demand stress outputs, which are calculated based on CIPCO's historical demand volatility. Under the stress case, the cooperative's leverage ratio approximates 7.7x during the four-year period ending 2025. However, Fitch believes CIPCO has ample flexibility to respond to deteriorating financial metrics through timely rate adjustments, reducing market power purchases, or delaying planned capital investments, all of which would likely improve the projected leverage metric.

Debt Profile

CIPCO's debt profile is neutral to the rating. Total debt outstanding on Dec. 31, 2020 was approximately $434.5 million, all long term, with the exception of current debt maturities. The majority of CIPCO's long-term debt has been funded through the RUS loan program at conservatively fixed interest rates. The remaining long-term debt includes CoBank notes, a small amount of notes issued by the CFC, and outstanding borrowings on CIPCO's credit facilities with CoBank and the CFC.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Central Iowa Power Cooperative (IA)	LT IDR	A	Affirmed		A
• Central Iowa Power Cooperative (IA) /Issuer Default Rating - Electric/ 1 LT	LT	A	Affirmed		A

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub.01 Sep 2021) (including rating assumption sensitivity)

U.S. Public Power Rating Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Central Iowa Power Cooperative (IA)	EU Endorsed, UK Endorsed

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