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Ratings

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Summary:

Central Iowa Power Cooperative; Rural Electric Coop

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Long Term Rating	A/Stable	Affirmed

Credit Highlights

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

Security

CIPCO borrows exclusively from the Federal Financing Bank (FFB), CoBank ACB, the U.S. Department of Agriculture's Rural Utilities Service (RUS), and the National Rural Utilities Cooperative Finance Corp. (CFC). The cooperative does not have capital market debt.

The ICR represents our view of CIPCO's overall creditworthiness and its capacity and willingness to meet its financial commitments in full as they come due. It does not apply to any specific financial obligation, as it does not consider the nature and provisions of those obligations, their standing in bankruptcy or liquidation, statutory preferences, or the legality and enforceability of the obligations.

As of fiscal year-end 2022, CIPCO had about $454 million in debt outstanding.

Credit overview

CIPCO is a generation and transmission (G&T) cooperative that supplies power to 12 rural electric distribution cooperatives plus the South Iowa Municipal Electric Cooperative Assn. (SIMECA), which combines the load of 15 small municipalities. The rating reflects our view of CIPCO's stable membership base, provided by its long-term all-requirements contract. The contract, which previously ran through 2045, was extended in late 2022 for all 13 members for another 40 years and amended to provide contractual flexibility that allows members to secure up to 10% of their energy requirements through member-owned distribution connected energy resources. The contract took effect in January 2023, providing enhanced credit protection that helps maintain steady long-term revenues.

In our view, CIPCO's power supply, which is primarily composed of long-term power purchase agreements (PPAs, 49.2% of total energy requirements in 2022) and owned generation assets (29.4% of energy requirements), provides shaft and fuel diversity that supports energy reliability. However, CIPCO maintains a considerable open position during both summer and winter months, largely due to substantially reduced energy and capacity following the early closure of the Duane Arnold Energy Center (DAEC) in August 2020, resulting in spot and day-ahead market purchases supplying about 16%-20% of annual energy requirements over the past three years. Management recognized that an open position could introduce sizable cost variability associated with market price fluctuations, especially during extreme weather events such as the winter storms in 2021 and 2022. Consequently, it secured additional PPAs (including the 100 megawatt [MW] Wapello Solar LLC and 56 MW Independence Wind), locked in short-term baseload purchases (10.8% of energy requirements) for around-the-clock firm power, and completed the Summit Lake repowering project that now assists the system during peak load periods and adds operational flexibility.

Based on CIPCO's five-year capital improvement plan (2024-2028), management plans to add a significant amount of wind and solar power resources, either through PPAs or owned generation (which might be supported by federal tax credits), as well as to build 200 MW of natural gas-fired generation capacity. We believe these capacity additions could substantially reduce the cooperative's market exposure and strengthen cost certainty. Nevertheless, in the short term, we expect CIPCO will continue to use market purchases to meet about 20% of energy supply needs. Weather volatility and unplanned operational events at power plants might also affect market purchases.

The rating further reflects our view of CIPCO's strengths, including:

- Dynamic cost pass-through, as reflected by its rate-setting autonomy, annual review of member rates, and frequent use of discretionary energy cost adjustments, and further proved by three rate increases totaling 9.5 mills per kilowatt-hour (kWh) in 2022 to compensate for elevated power costs;
- Competitive rates, given member retail rates were generally close to the state average in 2022 and CIPCO's wholesale rates compare favorably with those of other G&T cooperatives; In addition, rate reductions in 2023, including two energy charge reduction that amount to 7.5 mills per kWh and a $1/kilowatt-month reduction in the seasonal demand charge, can further strengthen the cooperative's rate competitiveness;
- Good risk management policies, as highlighted by management entering short-term financial hedges during winter months to mitigate about 50%-80% of the cooperative's indirect natural gas fuel cost exposure; and
- A track record of sound financial metrics, with fixed charge coverage (FCC) averaging 1.4x in 2020-2022 and reaching about 1.5x in 2023 based on unaudited financials. Our calculation of management's provided financial projections shows that FCC will likely decline modestly given the anticipated increase in annual debt service from 2024 to 2028 but remain largely within the healthy range of 1.2x-1.4x. We also view CIPCO as maintaining ample liquidity ($70 million in unrestricted cash and investments, $145 million in undrawn committed lines of credit, as of Dec. 31, 2022), although somewhat mitigating this is several members' very thin cash levels that could limit financial capacity to absorb cost variability passed through from CIPCO.

Tempering the preceding credit strengths are the following factors:

- Highly dispersed and rural customer base, as evidenced by about five customers on average per line mile, which results in relatively high fixed costs for the system incurred in serving each customer and could constrain distribution members' ratemaking flexibility, although somewhat tempering this are CIPCO's broad and diverse service area, average incomes, and below-average unemployment rate;
- Increasing, albeit currently manageable leverage, given we expect that the debt-to-capitalization ratio could reach about 80% in the next five years. Given the cooperative has decided to pursue sizable capital projects related to capacity additions, management will enter additional RUS loans (about $292 million from 2024-2028) for long-term financing and supplement it with new or expanded secured/unsecured lines of credit; and
- Moderate exposure to fossil fuel, as coal and natural gas-fired power sources provided 28.5% of total energy

requirements in 2023, which we consider low compared with that of peers in the Midwest. We expect CIPCO will remain exposed to carbon emission-related environmental regulations in the coming years, given it has no near-term coal unit retirement plan and the potential addition of natural gas capacity by 2028.

Environmental, social, and governance

In our opinion, CIPCO faces environmental risk exposure due to the presence of coal-fired generation in the cooperative's power supply portfolio that provided 25.5% of energy requirements in 2023. Although CIPCO has cut coal resources by more than 30% over the past decade, and new wind and solar resources are expected to come online in the near term (including the 100 MW Coggon Solar PPA), we believe the cooperative remains exposed to potentially more stringent greenhouse gas emission regulations. We also note that CIPCO faces physical environmental risks, as evidenced by major derecho storms that took place in August 2020 and December 2021, although the financial and operational impacts were manageable.

In our opinion, social risks are credit neutral given CIPCO's member rates were near the state average in 2022 and wholesale rates remain competitive with those of other G&T cooperatives in the region. Following stronger-than-expected U.S. economic growth through the third quarter of 2023, S&P Global Economics believes that recent business and consumer activity are not sustainable and projects slowing economic activity, along with tepid economic growth of 1.5% in 2024 and 1.4% in 2025. See "Economic Outlook U.S. Q1 2024: Cooling Off But Not Breaking," published Nov. 27, 2023, on RatingsDirect. Although inflation is softening, S&P Global Economics projects elevated interest rates through much of 2024. The amalgam of material increases in delinquent consumer, credit card, and auto loans, along with October's resumption of student loan payments and drawdowns of household savings garnered during the pandemic, will likely compound the financial pressures facing consumers. Consequently, we continue to monitor the strength and stability of cooperative electric utilities' revenue streams for evidence of delinquent payments or other revenue erosion.

Governance factors are credit neutral, in our opinion, as demonstrated by management's sound financial and operational policies, including a well-maintained target of at least 1.2x debt service coverage, leverage ratios (an equity-to-asset ratio that has exceeded the targeted 20%), level principal amortization that results in a declining trend of annual debt service requirements, coupled with long-term financial and power supply planning.

Outlook

The stable outlook reflects our expectation that the cooperative will continue to mitigate market exposure through a multi-pronged approach (including purchases of short-term baseload contracts, maintenance of financial hedges, and capacity additions through developing owned generation and procuring PPAs) and produce steady coverage metrics through dynamic rate adjustments and cost management. The outlook further reflects our view that CIPCO's robust liquidity will provide financial flexibility to meet its obligations and other contingencies.

Downside scenario

We could lower the rating within the next two years if the cooperative's coverage and liquidity decline significantly, whether due to meaningfully higher debt service payments associated with unplanned additional loans, inadequate rate adjustments to pass through unexpected costs to distribution members, or market disruptions (which could occur during extreme weather) causing material financial damages beyond normal capacity.

Upside scenario

We are unlikely to raise the rating over the next two years given CIPCO's projected financial metrics that show FCC at levels we consider just sufficient for the current rating, sizable market exposure in the near term, and low customer density. However, if coverage metrics improve to a level that offsets these risks while liquidity remains near current levels, we could raise the rating.

Credit Opinion

CIPCO members and SIMECA serve more than 133,000 electric accounts and a population of about 300,000 across much of southern and eastern Iowa. 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 five customers per line mile, and only two members serving more than five per line mile. No individual customer represents more than 2.5% 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 Energy Information Administration. However, the sparse service territories and the 54% load factor contribute to reduced efficiency in recovery of fixed costs for the member cooperatives, leading to higher rates.

The cooperative maintains a diverse fuel mix that consists of wind (34.8%), coal (25.5%), solar (7.1%), natural gas (2.7%), market purchases from the Midcontinent Independent System Operator (16%), and other resources (13.7%). The utility's generation portfolio provides about 1,017 MW of total generation resources, consisting of minority interests in coal plants; one wholly owned peaking facility (Summit Lake repowering project); and contractual resources from a mix of hydro, wind, solar, landfill gas, and diesel gas units. The arrangement has diversification benefits, with no reliance on a single plant or fuel, as well as economies of scale in operations. Operating availability of CIPCO's major resources is above industry averages in most years. In 2022, higher natural gas prices supported more coal generation; however, the total energy requirement supplied by the coal units modestly declined in 2023 to 25.5% from 29% in 2022 due to long-planned outages that took place during shoulder months.

Following the early closure of DAEC in 2020, management developed an integrated resource plan and obtained several new resources to replace energy and capacity lost from the early retirement. The $85 million Summit Lake repowering project commenced operations in 2021 and has the ability to produce 110 MW of power to assist during peak load periods. This project not only provides members with a low-cost natural gas peaking option that will run when demand is high, but also adds flexibility to the system when wind speeds are low at wind farms, or the sun is not shining for solar. CIPCO also added additional renewable resources through PPAs including Wapello Solar LLC, a 100 MWAC solar facility owned by Clenera; and Independence Wind Energy LLC, a 54 MW facility in Delaware County owned by BHE Renewables. With both projects coming online, CIPCO's summer open position has been reduced to less than 20%. In 2023, as part of its risk management approach and to address the winter short position for 2024, CIPCO made short-term, over-the-counter physical energy purchases for around-the-clock firm power.

The cooperative's five-year capital improvement program covering 2023-2028 totals about $760 million. Of this amount, $543 million is designated for capital additions to generating plants--predominantly focused on the addition of solar and wind generation as well as the development of 200 MW natural gas capacity. Another $147 million will fund transmission improvements to system reliability and facilitate growth. The plan indicates a considerable increase in long-term debt, as management expects to incrementally enter RUS loan funds (which could total $292 million) and supplement it with CoBank and CFC secured debt opportunistically.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022