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Ratings

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Summary:

Central Iowa Power Cooperative; Rural Electric Coop

Primary Credit Analyst:
Nicole Shen, New York (1) 332-323-4605; nicole.shen@spglobal.com

Secondary Contact:
Doug Snider, Centennial + 1 (303) 721 4709; doug.snider@spglobal.com

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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 utility does not have capital market debt. The ICR represents our view of CIPCO's general creditworthiness and does not apply to any specific financial obligation. Nevertheless, we incorporate our evaluation of the cooperative's debt and its debt service to our credit analysis. As of fiscal year-end 2021, CIPCO had about $457 million in debt outstanding.

Credit overview

CIPCO is a generation and transmission (G&T) cooperative with estimated operating revenue of $212 million in 2022. The cooperative had a 615-megawatt (MW) peak demand and a load factor of about 55% in 2021. Membership is composed of 12 rural electric distribution cooperatives (RECs) 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 consistently stable membership base provided by its long-term contracts that run through 2045. The utility is working on a contract extension and has reached a preliminary agreement with its members. The extended contract, if approved by all members, would provide enhanced credit protection that supports steady long-term revenue. CIPCO's fixed charge coverage (FCC) was approximately 1.3x in 2021, as a result of increased market exposure due to a timing gap between the early closure of the Duane Arnold Energy Center (DAEC) and replacement resources coming online, which was exacerbated by elevated energy and fuel costs associated with the February 2021 winter storm. Based on our analysis of management-provided projections, FCC is expected to weaken modestly in 2022, partially given power costs that are anticipated to remain elevated, coupled with increased debt service associated with the loan CIPCO recently entered with FFB. The board approved a member rate increase of 8% in December 2022, which along with management's robust cost planning, should result in FCC staying at about 1.2x over the next five years.

The rating also reflects our view of CIPCO's power supply that provides shaft and fuel diversity and ensures energy reliability. Somewhat offsetting this is CIPCO's considerable open position (about 20% in 2022), largely due to the retirement of DAEC in 2020. This market exposure introduces potential price volatility given uncertain market conditions. However, management has made strides in reducing market exposure over the past two years, as evidenced by its summer open position falling below 20% with newly added resources (including the 55 MW Summit Lake natural gas peaking units, 100 MW Wapello Solar LLC, and 56 MW Independence Wind). Moreover, as CIPCO plans to execute financial hedges against its natural gas fuel exposure beginning in 2023, we expect its winter-month exposure will be somewhat mitigated. Nevertheless, we do not expect market exposure to decrease significantly in the short term until additional planned resources come online in 2025.

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

- Robust cost pass-through, as reflected by its rate-setting autonomy, annual review of member rates, and frequent utilization of discretionary power cost adjustment (PCA) mechanism. In light of higher costs, CIPCO raised energy rates three times in 2022, resulting in a total increase of 12% or 9.5 mills per kilowatt-hour (kwh), which represents management's willingness and ability to fully recover costs.
- Sound financial and operational policies regarding debt service coverage (DSC), leverage ratios, and liquidity, coupled with robust power supply planning. Despite the $16 million loss recorded during the winter storm in 2021, management was able to quickly expand its line of credit facility to $150 million, raise rates by 1.5 mills per kwh, and draw down on various investments to mitigate the exposure and other expenses for the month.
- High liquidity level, including $105 million in available committed lines of credit with CoBank and $40 million with CFC in 2022, which we project will stay in line with recent trends as management continues to extend its credit facility upon maturity.

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

- Member retail rates are generally above the state average despite the cooperative's favorably priced wholesale power, due to lower density rates, which could constrain members' ratemaking flexibility. However, we note that CIPCO's wholesale rates are below average when compared with those of other G&T cooperatives across the nation.
- Coal-fired resources accounted for about 29% of total energy requirement in 2022, exposing the utility to potential indirect costs from carbon-related regulations.

Environmental, social, and governance

CIPCO's environmental risks are moderately negative within our credit analysis, given coal-fired generation accounted for about 29% of the 2022 fuel mix, exposing the utility to potential carbon-related regulation costs. However, the utility cut coal resources by more than 30% over the past decade, and management obtained new wind and solar power purchase agreements in 2021. We also note that CIPCO faces physical environmental risks, as evidenced by major derecho storms that took place in August 2020 and December 2021. Despite the severity of these events, we considered the financial and operational impact as manageable.

We also believe the cooperative's social factors are moderately negative within our credit analysis, given member retail rates that are above the state average based on the most recent available data from the Energy Information Administration (EIA). Governance factors are credit neutral in our opinion, given robust rate-setting authority and forecasting practices.

Outlook

The stable outlook reflects our expectation that the utility's track record of rate adjustments and cost management, coupled with the anticipated contract extension, will support healthy coverage metrics. The outlook further reflects our view that CIPCO's robust liquidity will provide financial flexibility to meet obligations and other contingencies.

Downside scenario

We could lower the rating if net margins and coverage metrics decline significantly, whether due to increased debt service payments associated with unplanned additional loans, inadequate rate adjustments to recover unbudgeted operating or capital costs, or extreme weather events that cause material financial damages beyond normal capacity.

Upside scenario

We do not anticipate raising the rating in the near term due to CIPCO's sparsely populated customer base, with member retail rates that are high compared with the state average, coupled with its sizable open market position. However, if finances materially improve to a level that offsets these risks, 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 EIA. However, the members' sparse service territories and the 55% load factor contribute to reduced efficiency in recovery of fixed costs for the member cooperatives, leading to higher rates. All members retain ratemaking autonomy.

The cooperative maintains a diverse fuel mix that consists of wind (36%), coal (29%), solar (7%), natural gas (2%), market purchases (20%), and other resources (3%). 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; 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. 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 its 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 managed to add additional renewable resources through power purchase agreements (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. Both projects enhance fuel mix diversity and avoid the risks associated with rising fuel costs given long-term stable pricing. With only two small PPAs terminating (about 3 MW wind and 6 MW solar) by 2027, the utility does not face meaningful short-term recontacting risks.

Looking forward, management will continue its commitment to securing replacement resources by adding about 90 MW solar, 75 MW of wind, and 120 MW of CIPCO-owned natural gas fired generation capacity in the next 10 years. However, before these resources fully come online, we believe market exposure will likely stay sizable, exposing the utility to price uncertainty during periods of high market volatility.

Financial performance is healthy, in our view. DSC (1.4x in 2021) and FCC (1.3x in 2021), which imputes the cooperative's minimal capacity payments as debt-like obligations, have been historically stable over the past five years. FCC is projected to decline to about 1.2x in 2022 in light of elevated fuel and purchased power costs, although we expect it will likely rebound in the following years given the board's recent member base rate increase, combined with management's robust track record of using PCA and sound financial planning. Overall, the projected financial trajectory suggests FCC ranging in a tight band of 1.20x-1.35x over the next five years. In our view, these metrics support the current, but not a higher, rating.

CIPCO maintains high liquidity, including $105 million in available committed lines of credit with CoBank and $40 million with CFC in 2022. We project liquidity will likely stay in line with recent trends as management continues to extend its credit facility upon maturity.

CIPCO is moderately leveraged, with a debt-to-capitalization ratio of about 68%, which is projected to stay relatively steady within the five-year horizon. CIPCO's long-term debt is amortizing with no significant bullet maturities. The cooperative has completed a significant cycle of capital expansion (including the Summit Lake Repowering project and high-voltage transmission projects) and therefore capital spending is projected to moderate through 2025. CIPCO previously assumed all debt would mature by 2045, the end date of the current contract. However, with the extension to 2062,management indicated that future debt issuances will reflect longer amortization schedules.

Related Research

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