Bond Case Briefs

Municipal Finance Law Since 1971

Moody's: Outlook for US Regulated Utilities is Stable.

New York, February 20, 2014 — The outlook for the US regulated electric and gas utilities in 2014 is stable, says Moody's Investors Service in the industry outlook "Regulation Will Keep Cash Flow Stable As Major Tax Break Ends." Regulatory support will help the utilities maintain stable credit profiles in 2014, even as customer demand remains stagnant and the utilities lose the cash flow boost they have been receiving from bonus depreciation, a tax break that expired in 2013.

Cost recovery mechanisms, coupled with annual base rate increases, will keep the ratio of industry-wide cash flow to debt at about 18% in 2014, within Moody's range for a stable outlook.

"Fundamentally, the regulatory environment is the most important driver of our outlook because it sets the pace for cost-recovery," says Moody's Assistant Vice President — Analyst Ryan Wobbrock. "Favorable rate orders, even in states where utilities have had contentious regulatory relationships in the past, are part of what we view as a broader shift toward stronger regulatory support for the industry."

Moody's sees signs of improved regulatory support in some of the historically less supportive and more challenging states, such as Connecticut and Illinois. Stronger recovery mechanisms introduced last year will lead to utilities in those states having more predictable cash flows.

Moody's notes that over the last five years the predictability and stability of utility cash flows has generally increased as ratemaking mechanisms become more commonplace. These include revenue decoupling and riders to regulatory agreements, which help utilities recover costs faster.

The improved regulatory environment is helpful this year because bonus depreciation ended on December 31, 2013. Moody's takes the view that this temporary tax break will not be extended, although various corporate sectors are currently lobbying for extensions.

One potential negative on the horizon is the trend among utility holding companies towards restructuring through creating a master limited partnerships and a "yieldco" to defend historically high equity multiples at a time of stagnant demand. For now, Moody's says the credit risks from this trend are limited, but so are the benefits for bondholders, and these structures may weaken sponsor credit quality over time.

Moody's research subscribers can access the full report HERE.

Global Credit Research – 20 Feb 2014