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## Fitch Rtgs: Coronavirus Fallout to Lower Public Power Demand, Affordability

Fitch Ratings-New York/Austin-20 March 2020: US public power systems are expected to face limited immediate credit pressures related to the spread of the coronavirus, but an economic slowdown will weigh on longer-term performance, says Fitch Ratings. Significantly lower electric demand poses the most significant near-term risk for public power systems. While Fitch expects most systems to support revenue requirements and operating margins by raising retail rates, declining levels of employment and household income could strain affordability metrics over time and undermine rate-setting strategies, weakening credit quality.

Systems serving territories that rely heavily on travel and tourism, along with those subject to large shutdowns, are most likely to face immediate pressures as these regional economies suffer and electric demand falls precipitously. The effect of a sudden drop in energy sales on these issuers and their responses are expected to vary and will likely depend on the length of time demand is suppressed. Systems that rely heavily on purchased power, or those where fuel is a major expense, may be able to offset the effect of lower sales through lower purchases; whereas systems with higher fixed costs will experience the highest declines in margins and require the most pronounced increases in rates to preserve financial performance. Where economic weakness throughout the servicer territory limits an issuer's ability or willingness to increase rates, negative rating action may be warranted.

The effect on electric demand and prospective rate increases at other public power systems is expected to be more muted. Commercial and industrial sales will likely decline along with economic output but residential sales could rise reflecting increased isolation and changes in working habits. Fitch considers the effect of stressed demand on an issuer in its rating methodology and as part of each review. At this time, we expect that the resulting stress from the coronavirus will be in line with our applied stress for most issuers.

Declines in major operating expenses and more resilient rate structures could also lower revenue requirements, further limiting upward pressure on rates in the near term. Prices related to natural gas supplies have already reached levels consistent with Fitch's stress case and interest rates continue to test historical lows. Recent trends toward a higher component of fixed charges in retail rates should also lessen the effect of lower energy sales on revenue collection. Robust cash balances maintained by most issuers should further buffer the impact of any near-term disruption in cash flow.

Over the longer term, performance and credit quality could be negatively affected by sustained lower demand and pressures on household income, residential electric affordability and future rate setting. Improved affordability has helped to preserve demand and support rate-setting initiatives in recent years, bolstering financial performance. Residential electric costs consumed an estimated 2.2% of median household income (MHI) in 2019, well below the level of 2.8% in 2010.

Over the same period, financial performance throughout the sector has improved. Medians for Fitchcalculated coverage of full obligations and net adjusted debt/adjusted funds available for debt service (FADS) improved to 1.44x and 6.00x from 1.27x and 7.30x, respectively. To the extent lower MHI and weaker affordability result in more restrained rate-setting and demand declines, FADS will fall. This could weaken credit metrics and trigger rating actions for issuers on the cusp of a lower rating category.

Contacts:

Dennis Pidherny
Senior Director, US Public Power
+1 212 908-0738
Fitch Ratings, Inc.
Hearst Tower
300 W. 57th Street
New York, NY 10019

Sarah Repucci
Senior Director, Fitch Wire
+1 212 908-0726

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email:
sandro.scenga@thefitchgroup.com