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Fitch: Texas Public Power Utilities Ratings Pressured Amid Cost Surge

Fitch Ratings-New York-25 February 2021: Operating challenges and significantly higher prices for power and natural gas triggered by severe winter weather has led to a surge in costs for public power utilities in Texas. Early indications are that cost increases for utilities forced to rely on market purchases could be in the hundreds of millions of dollars, potentially straining liquidity and margins, Fitch Ratings says. Fitch has placed all Electric Reliability Council of Texas (ERCOT)-based municipal and cooperative utility ratings on Rating Watch Negative.

Texas's municipal and cooperative utilities are usually able to maintain sufficient resources to meet customer demand and are generally exempt from the state's competitive supply market. However, the unprecedented winter weather that swept through Texas earlier this month led to electricity demand well beyond what the state's utilities and grid operator, ERCOT, anticipated.

Extreme cold weather conditions froze generating equipment and limited gas supplies, rendering some units inoperable. Public utilities were then forced to purchase power and gas on the market at an exorbitant cost, as energy prices reached ERCOT's market price cap of $9,000/MWh and spot gas at the Houston Ship Channel pricing point averaging more than $200 per million British Thermal Units (MMBTU). Prices for those commodities hovered around $20/MWh and $3/MMBTU, respectively, earlier this year and have since returned to similar levels.

Public power issuers typically maintain robust cash balances and enjoy local rate autonomy. However, the unprecedented costs threaten liquidity and timely cost recovery. Utilities may need to increase borrowings over the medium term to support operations, increasing leverage and weakening credit quality. If funds are borrowed from local governments, other municipal utility systems or affiliated cooperatives, credit pressures could also mount for these related entities.

It remains to be seen if the state legislature will reform the Texas power grid and marketplace, and therefore the effect of any potential changes on public power and cooperative utilities is uncertain. Changes requiring infrastructure to store energy in reserve, reserves/excess capacity, and greater interconnectivity with other parts of the national grid to provide support in an emergency are all possible, but could prove challenging given the complexity and disaggregated nature of the Texas marketplace.

Fitch previously noted the risks associated with declining reserve margins in ERCOT and a reliance on purchased power. ERCOT targets a system-wide planning reserve margin of 13.75%, although utilities are not required to provide capacity or reserve margins on an individual basis, as is the case in other organized US electric markets.

Public power systems in the states surrounding Texas, including Oklahoma and Missouri, are also reporting higher costs, but the amounts are lower and appear more manageable. In cases where the cost burden strains financial performance and liquidity, and timely recovery is unlikely, credit metrics and ratings for public utilities in these surrounding states could also be pressured.

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