

RESEARCH

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Summary:

Wellesley Municipal Light Plant, Massachusetts; Retail Electric

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Rationale

Standard & Poor's Ratings Services has affirmed its 'AA' issuer credit rating on Wellesley Municipal Light Plant (WMLP), Mass. The outlook is stable.

In our opinion, the 'AA' rating reflects:

- A business profile of '2' on Standard & Poor's 10-point scale where '1' is the highest;
- WMLP's strong financial performance;
- An affluent service area that allows for rate flexibility;
- No debt outstanding and a manageable \$17.7 million capital improvement program from fiscals 2010-2014 that we expect to be largely cash-funded; and
- The expectation that WMLP's rates will continue to be highly competitive despite significant increases, as management proactively responds to the expiration of favorable power supply contracts.

We believe that tempering these strengths are:

- Modest concentration in the customer base, with the 10 leading customers accounting for 25% of revenues; and
- Increased-but-manageable fixed costs associated with power supply and entitlement contracts.

The business profile score of '2' reflects a prudent and proactive management team, sound operations, a supportive state regulatory environment, and a strong competitive position--the latter partially due to WMLP's favorable rates and zero debt position.

WMLP provides electric service to more than 9,970 mostly residential customer meters in Wellesley, Mass. (GO rating AAA/Stable), and other unincorporated areas. Although the 10 leading customers are concentrated, the stability of the leading customers, many of whom would be unlikely to relocate, mitigates this. The town has indicated that it maintains

Credit Profile		
Wellesley Mun Light Plant ICR		
<i>Long</i>	AA/	
<i>Term</i>	Stable	Affirmed
<i>Rating</i>		

extremely good relationships with its major customers, who are pleased with both the cost and reliability of service. Leading customers include Wellesley Office Park Assn. and Sun Life Financial Inc.

Wealth and income levels in the town are a very high 181% of state levels and 218% of national levels as measured on a median household effective buying income basis. Unemployment rates are extremely low, well below the state and national averages.

The utility has no generation facilities of its own and purchased the bulk of its power. From June 1, 2002 through Sept. 30, 2007, WMLP purchased power from Constellation Energy Commodities Group Inc. (CEC) through an all requirements take-and-pay contract. Under the CEC contract, WLMP enjoyed favorable power costs, and as a result, ratepayers paid some of the lowest rates in the state, less than half of those that neighboring municipal utilities charged. Expecting the CEC contract's expiration and the resulting rising rates, WMLP began a program of phased-in rate increases to reduce rate shock. These increases included a 5% increase in January 2006, a 10% increase in January 2007. In February 2007, WMLP began a program of monthly 1% increases, which we expect to continue through February 2010. While these increases have resulted in a substantial 36% rate hike to-date (with additional increases into 2010), Standard & Poor's views this phased-in approach as supporting WMLP's credit quality, the strong rating, and bondholder interests.

Yet despite these rate increases, WLMP maintains a strong competitive position, with average rates for the year ending June 2008 that are in the bottom quartile for Massachusetts municipal lights and well below those of investor-owned utilities. In the face of the large rate increases, maintaining the strong competitive positioning has been a function of WLMP's previously low rates and the rising cost environment that has resulted in rate increases for most electric providers in the state.

Since September 2007, WLMP has entered a series of layered and staggered market contracts through its participation in Energy New England (ENE). WMLP's hedging program has secured reasonably priced power and reduced exposure to market volatility. About 89% of fiscal 2009 energy needs were hedged at \$82 per megawatt-hour (mWh), as of Nov. 18, 2008. Hedging of out-years ranges from 77% in 2010 to 50% in 2012 (currently at \$75 per mWh, and \$74 per mWh, respectively). WLMP maintains modest open positions for near-term power that can result in deviation from these costs, but such variance should be manageable. ENE's hedging activity on WLMP's behalf has given the light plant greater budgetary predictability.

WMLP has also purchased a 10% entitlement on Braintree Electric Light Department's new Watson unit, a 116 MW dual-fired oil and gas unit that we expect to be into service in March 2009. The entitlement runs for 20 years, with WLMP having the option to extend for one or more five-year periods.

Although Massachusetts deregulated the industry in 1997, public power systems operate in a very supportive regulatory environment. The systems have the option, under Massachusetts' legislation, to prohibit retail choice in their service area as long as they are not selling generation service to customers outside their territory. By 2003, however, the

commonwealth required public power systems that have not offered retail choice to engage in a retail choice study. Under current law, municipal entities must do no more than engage in the study; they do not have to open up their service area. WMLP has not opened its service area for retail choice but is well-positioned to compete in a retail access environment, given the utility's strong financial performance; zero debt position; rates that are competitive and expected to be even more so; current cost-cutting initiatives; and good relationships with its major customers.

WMLP has a track record of strong financial performance, in our opinion. The utility generated net available revenue of \$10 million in fiscal 2007 before depreciation and payments in lieu of taxes of \$1 million to the town. The coverage level of estimated capacity payments associated with purchased power after the pilot payment was strong, in our opinion, at 2.6x. Liquidity is robust, we believe, at 430 days' worth of operating cash available at fiscal year-end 2007. WMLP management has projected diminished coverage of fixed costs (1.09x) in fiscal 2009 as rate increases are phased in, but expects coverages to return to levels in excess of 1.8 in 2010-2013.

Outlook

The stable outlook reflects phased-in rate increases to cushion financial effects of transitioning to a higher energy cost environment. Standard & Poor's expects that WMLP will nevertheless maintain competitive rates, and after narrowing of margins in 2009, continue to generate strong financial performance in the following three-year period.

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