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Ratings

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Summary:

Central Iowa Power Cooperative; Rural Electric Coop

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Central Iowa Pwr Coop ICR		
Long Term Rating	A/Stable	Affirmed

Rating Action

S&P Global Ratings affirmed its 'A' issuer credit rating (ICR) on Central Iowa Power Cooperative (CIPCO). The outlook is stable.

The cooperative borrows exclusively from the Federal Financing Bank, CoBank ACB, the U.S. Department of Agriculture's Rural Utilities Service, and the National Rural Utilities Cooperative Finance Corp. Although we do not rate these borrowings, we evaluate the debt and its debt service in determining the ICR. The utility does not have capital market debt.

Credit overview

CIPCO is a generation and transmission (G&T) cooperative with total operating revenue of $179 million in 2021. The cooperative had a 605 megawatt (MW) peak demand and a load factor of about 55% in 2020. Membership is composed of 12 rural distribution cooperatives plus the South Iowa Municipal Electric Cooperative Assn. (SIMECA), which combines the load of 15 small municipalities. CIPCO members and SIMECA serve more than 132,000 electric accounts and a population of about 300,000 across much of southern and eastern Iowa.

The rating reflects our view of the following factors:

- CIPCO's long-term contracts with the 12 member cooperatives extend through 2045, beyond the term of debt outstanding, and there is little customer concentration at the distribution cooperative level.
- The cooperative has a power supply that we believe is reliable, and diverse by unit and fuel type. This diversity is offset by CIPCO's open position, with about 22% of power purchased from the market. This in turn exposes the cooperative to potentially volatile market prices. This exposure was highlighted by the February winter storm event, which caused market prices to increase rapidly, resulting in a $16 million gross loss for CIPCO. However, management reports its open position was approximately double the normal exposure due to a timing gap between closure of the Duane Arnold Energy Center (DAEC) and new resources coming online. CIPCO reported no material operational disruptions as a result of the storm.
- CIPCO has good 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 in February, management was able to quickly expand its line of credit facility to $150 million, raise rates by 1.5 mills per kilowatt-hour, and draw down on various investments to mitigate the exposure and other expenses for the month. In total, we believe the impact of the storm was manageable within the scope of CIPCO's budget. However, we will

continue to monitor the cooperative's market exposure and potential related pressures.

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

- Member retail rates that are above the state average despite the cooperative's favorably priced wholesale power, due to a generally low density rate, which, in our view, could constrain members' ratemaking flexibility; and
- Moderate exposure to coal-fired generation, with about 20% of energy sourced from coal-fired resources.

The stable outlook reflects the utility's track record of rate adjustments and cost management that have supported sound DSC and fixed charge coverage (FCC) metrics, coupled with a forecast that we find to be feasible, suggesting this trend will continue.

Environmental, social, and governance (ESG) factors

We believe that CIPCO's generation fleet presents moderate environmental exposures through its coal generation assets. However, coal accounted for 20% of 2020's power supply, down from more than 50% 10 years ago as the cooperative has added several renewable resources to its portfolio. Management projects it will source about 30% of its energy needs from coal fired assets in the future.

We believe the cooperative's social factors are in line with those of rated peers, as management reports impacts of the COVID-19 pandemic were generally muted on the cooperative's customer base.

Finally, the cooperative's governance factors, including its rate-setting authority and forecasting practices, are strong, which we view favorably relative to those of other rated electric cooperatives with less-robust practices.

Stable Outlook

Downside scenario

We could lower the rating if net margins and coverage metrics decline significantly whether due to unanticipated market power costs or recessionary pressures associated with the COVID-19 pandemic.

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 relative to 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'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 four customers per line mile, and only two members serving more than five per line mile. No individual customer represents more than 2.75% 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 Energy Information Administration. However, the members' sparse service territories and the

55% load factor contribute to lessened efficiency in recovery of fixed costs for the member cooperatives, leading to higher rates. All members retain ratemaking autonomy.

CIPCO experienced a major derecho storm in August 2020 that resulted in $5.3 million in direct damages to the system, although the cooperative anticipates receiving about $4.5 million in Federal Emergency Management Agency reimbursements and state support. Management reports the storm caused devastation through the heart of CIPCO's load center, and that the cooperative saw about 40% of its load dropped in a two-hour period. Despite the severity of the storm, CIPCO fully restored power on its system within one week. Ultimately, management indicated the storm did not materially impair the cooperative's operational or financial health.

The cooperative's power supply consists mainly of coal, wind, and market purchases. Power supply costs are low, in our view, with stable combined bus bar costs of $38 in 2020, and ranging from $38 to $45 for the past five years. Operating availability of CIPCO's major resources is above industry averages in most years.

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 the diversification benefit with no reliance on a single plant or fuel as well as economies of scale in operations.

NextEra Energy Inc. manages the 622 MW DAEC, of which CIPCO owns a 124 MW share. In July 2018, NextEra announced its plans to close the plant in 2020, 14 years before its Nuclear Regulatory Commission license expires, because Alliant Energy Corp. agreed to pay NextEra to shorten its power purchase agreement for the plant's output. The plant closed in August 2020.

CIPCO developed a multi-pronged approach to address this unexpected announcement. First, it developed a plan to recognize the almost $80 million in stranded assets resulting from the plant closure. The cooperative was granted Rural Utilities Service approval to establish a $50.5 million regulatory asset for the plant, depreciated over 10 years, while recognizing a $15.1 million impairment loss in fiscal 2018, with the balance depreciated through 2020.

Second, the utility developed an integrated resource plan with a set of five objectives: provide reliable and long-term cost-effective energy to members, support a flexible power supply portfolio that can respond to shifting market conditions and uncertainties, retain fuel diversity while managing environmental impacts, maintain competitive wholesale rates, and provide a framework to address enterprise risk. CIPCO identified that a combination of wind, solar, and owned reciprocating natural gas-fired engines would best achieve these targets.

The cooperative has already secured 100 MW of solar capacity through purchase power agreements and 55M W of reciprocating engines, which are both online with an additional 54 MW of wind capacity under construction and 100 MW of solar capacity in development. Looking forward, the cooperative may choose to layer in additional contracts and/or construction of owned capacity. However, management indicated it can and likely will defer a portion of this additional capacity to maintain a flexible portfolio in light of low market prices and demand uncertainty. Ultimately management reported it expects overall power costs will decline as a result of its proposed energy portfolio, in part due to DAEC's exceptionally high fixed costs and in part because of favorable contracted renewable prices.

We believe management has prudently addressed the early closure of DAEC; however, until it secures the necessary replacement resources, the uncertainty regarding the future power supply does introduce some credit risk. Management expects to maintain an approximately 20% open position, which, while favorable under current market conditions, could introduce price uncertainty should market prices rise, as seen during the February 2021 winter storm.

Financial performance is moderately strong, in our view. DSC and FCC, which imputes the cooperative's minimal capacity payments as debt-like obligations, were both stable over the past seven years. DSC of 1.58x in fiscal 2020 and FCC of 1.5x (or 1.4x after a $4.1 million non-cash expense related to the DAEC regulatory asset) support the rating, in our view. Both metrics are projected to decline to about 1.2x in the long term, which we still believe supports the rating.

The cooperative has a number of financial policies, including a target DSC of at least 1.2x. CIPCO's long-range equity target is 25%, which it first attained as of fiscal year-end 2012 (Dec. 31). Liquidity levels are strong, in our opinion, with cash and available lines of credit totaling 190 days' expenditures as of Dec. 31, 2020.

CIPCO's long-term debt is amortizing with no significant bullet maturities. The cooperative's five-year capital improvement program covering 2022-2026 totals about $144 million, which we view as manageable.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020