

RatingsDirect®

Summary:

Middleton Municipal Electric Department, Massachusetts; Retail Electric

Primary Credit Analyst:

Valentina Protasenko, Chicago +1 3122337085; valentina.protasenko@spglobal.com

Secondary Contact:

Scott W Sagen, New York + 1 (212) 438 0272; scott.sagen@spglobal.com

Table Of Contents

Rating Action

Stable Outlook

Credit Opinion

Related Research

Summary:

Middleton Municipal Electric Department, Massachusetts; Retail Electric

Credit Profile

Middleton Mun Elec Dept ICR

Long Term Rating

A+/Stable

Affirmed

Rating Action

S&P Global Ratings affirmed its 'A+' issuer credit rating (ICR) on Middleton Municipal Electric Department, Mass. The outlook is stable. MELD had no revenue debt as of Dec. 31, 2020.

Credit overview

MELD is a small electric distribution utility located north of Boston, MA. The utility services about 3,900 customers and sources power through project ownership of nuclear facilities partially owned by the Massachusetts Municipal Wholesale Electric Company (MMWEC), several bilateral contracts, and market purchases from the New England Independent System Operator (NEISO).

Credit strengths of MELD include:

- Deep service area economy that supports revenue-raising flexibility;
- Competitive electric rates that are 14.6% below state average; and
- Robust financial metrics evidenced by a three-year average of 1.6x fixed charge coverage (FCC), unrestricted cash and investments equal to 438 days' of operating expenses, and no outstanding debt.

Partly offsetting the above credit strengths are the utility's;

- Moderate revenue concentration of 37% in the top ten customers and 10% in the top individual customer, which exposes MELD to potential load loss;
- Small operating budget, which suggests limited financial flexibility to meet unforeseen risks compared to larger utilities with greater economies of scale; and
- Exposure to market price volatility due to ongoing significant natural gas-price increases and greater reliance on spot purchases.

The stable outlook reflects our view that FCC will continue to support the current rating. MELD has no outstanding debt in relation to its MMWEC project ownership share and management is not currently planning for further near-term ownership participation. This will maintain fixed charges associated with MMWEC at steady levels. While we acknowledge the improvement in FCC, we also recognize that MELD has chosen not to renew several gas- and coal-powered purchase power agreements (PPAs). While a credit positive from the standpoint of decarbonization

initiative (see below), it heightens MELD's exposure to volatile ISO market power prices. We expect that management will continue to pass on any increased energy costs to customers on a quarterly basis to sustain recent historic coverage levels.

Environmental, social and governance

Overall, we believe that environmental, social and governance factors are in line with those of peers. We consider MELD's fuel mix to be diverse. In 2020, about 28% of its energy came from wind, hydroelectric, and solar resources, and the utility no longer relies on any coal-fired generation after removing Dynegy from its fuel portfolio, which we view as a credit positive.

In 2021, the governor of Massachusetts signed into law Bill S.9, also known as the Massachusetts 2050 Decarbonization Roadmap. The law sets standards for decarbonization that municipal lighting plants and departments, including MELD, must meet. Plants and departments must achieve 50% renewable energy by 2030 and 100% by 2050, benchmarked to 1990 greenhouse gas levels. MELD is well positioned to meet the first checkpoint, with nuclear, hydroelectric, wind, and solar PPAs accounting for 65% of the current fuel mix.

The utility maintains very affordable rates in the context of current income levels, which help to insulate it from potential operational and financial challenges. We additionally recognize that governance factors have improved in line with those of peers, as evidenced by improvement in multi-annual budgeting and financial forecasting.

Stable Outlook

Downside scenario

We could lower the rating if Middleton experiences a significant and sustained decline or material volatility in FCC levels or liquidity, which could occur given the current heightened energy costs due to higher fuel prices in the New England ISO, or if we see a material decline in top customer revenue in a way that substantially affects MELD's financial performance. If the utility does not respond with timely cost-recovery measures, leading to deterioration in financial metrics, we could lower the rating.

Upside scenario

We could raise the rating if we see a sustained trend of higher and stable coverage and liquidity through MELD's decarbonization efforts and improved customer revenue diversity.

Credit Opinion

MELD relies on a contracted power supply, albeit from a diverse mix of assets. The counterparties providing purchased power include NextEra (which we view as having extraordinarily diverse assets) and MMWEC. MELD holds partial ownership in the Millstone Unit 3 and Seabrook Unit No. 1 nuclear facilities, as well as in Stonybrook's intermediate and peaking facilities. The remaining energy comes primarily from several bilateral agreements and purchases from ISO New England on the spot market, which accounted for 14% of purchased power in fiscal 2020. In the current fiscal year 2022, this is expected to increase to 26% as the gap from non-renewal of the Dynegy PPA is stop-gapped by ISO market purchases.

We view management as generally capable stewards of a distribution electric system with limited operating issues and recognize an improvement in financial reporting. MELD monitors budget-to-actual variances monthly and management exercises its power cost adjustment mechanism at its discretion, with costs generally recovered quarterly.

We believe MELD's service area, which has an affluent and primarily residential base, provides stability to the utility's credit profile. Median household effective buying incomes are 67% above the U.S. average as of 2020, providing the utility with rate-raising flexibility. Though we believe the customer base is stable, there is concentration, with the 10 largest users accounting for 37% of utility revenues, which we believe leaves the utility at risk for load loss. The top customer, Bostik, is a large manufacturer and supplier of adhesives and sealants and represented approximately 10% of system revenues in fiscal 2020.

FCC, which includes MELD's portion of total MMWEC debt service and capacity payments, has improved in the last three years to an average of 1.6x and an unaudited 1.9x in 2021. This robust coverage metric is facilitated by simultaneous amortization of MMWEC-related debt and decreasing energy purchase costs stemming from a low-cost renewable energy portfolio. In the near term, we expect that FCC will remain at recent historic levels given the heightened energy cost expectations. FCC is our internally adjusted debt service coverage metric that tracks the use of total utility operating revenues. We use fixed-cost coverage that treats capacity charges that MELD pays to power suppliers as debt service rather than as operating expenses. We view this portion of operating expenses as funding the suppliers' recovery of capital investments in generation assets.

MELD's unrestricted cash and depreciation fund (which we consider to be available liquidity) totaled \$14 million, or a healthy 438 days' cash on hand, according to the 2020 audit. Because MELD is a distribution-only operation, its liquidity provides a cushion to meet unbudgeted costs. Given that the system is exposed to limited operational risks as a distribution utility, we consider these liquidity levels robust for a system this size.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

Copyright © 2022 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.