01 AUG 2022

Fitch Rates Lubbock Power & Light, TX's Power System Rev Bonds 'A+'; Outlook Stable

Fitch Ratings - Austin - 01 Aug 2022: Fitch Ratings has assigned an 'A+' rating to the following bonds issued by the city of Lubbock, TX (the city), on behalf of its municipally owned electric utility system known as Lubbock Power & Light (LP&L):

--$60.54 million electric light and power system revenue bonds, series 2022.

Bond proceeds will fund certain capital projects, fund the series 2022 bond reserve requirement, and pay costs of issuance. Bonds are expected to price during the week of Aug. 11 via a negotiated sale.

Additionally, Fitch has affirmed the following LP&L outstanding bonds at 'A+':

--$378.785 million outstanding electric light and power system revenue bonds, series 2013, 2014, 2015, 2016, 2017, 2018 and 2021.

Fitch has assessed LP&L's standalone credit profile (SCP) at 'a+'. The SCP represents the credit profile of the utility on a standalone basis irrespective of its relationship with and the credit quality of the city of Lubbock (Issuer Default Rating AA+/Stable).

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The rating reflects both LP&L's very strong revenue sources and the hurdles remaining before it completes the transition of all of its customers into the Electric Reliability Council of Texas (ERCOT) organized market and opts into retail competition.

These hurdles include the selection of the provider of last resort (POLR) and the completion of certain transmission and distribution (T&D) capital projects, in addition to receiving the requisite regulatory approvals. As a result, Fitch views the planned transition as a limiting factor to the rating over the near- to-medium term, given the significant uncertainty around the costs, operational changes and potential system impacts. LP&L's issuance of long-term debt with this transaction is part of LP&L's plan to finance its remaining ERCOT integration and transmission upgrade projects.

While the transition into ERCOT marketplace increases the utility's overall operating risks over the near-term given the inherent pricing and resiliency weaknesses in the ERCOT market exposed by February 2021 winter storm event, these risks should be alleviated as LP&L plans to cease power supply services following the utility's plan to opt in to retail competition by June 2023. LP&L plans to operate solely as a T&D utility following its transition to a competitive retail electric market.

LP&L's leverage increased in fiscal 2021 as the utility partially debt-financed significant capital investments related to the ERCOT transition. Increases in leverage following LP&L's successful transition to retail

competition will be somewhat mitigated by the declining operating risks associated with operating a T&D utility.

CREDIT PROFILE

LP&L is the largest municipal electric utility in the West Texas region, serving approximately 107,000 meters in Lubbock and limited surrounding areas. LP&L's acquisition of Southwestern Public Service Company's (SPS) local distribution system in 2010 removed its largest competitor and transformed most of LP&L's service territory into a single-certified area. The utility successfully interconnected to the ERCOT marketplace on May 30, 2021, and plans to opt in to retail competition by June 1, 2023.

Fitch considers the system a related entity to the city for rating purposes given the city's oversight of the system, including the authority to establish rates. The credit quality of the city does not currently constrain the bond rating. However, as a result of being a related entity, the issue rating could become constrained by a material decline in the general credit quality of the city.

Winter Storm Uri

LP&L's net purchased power costs during February 2021 increased to $23.5 million from a pre-storm projection of $11.3 million for the month due primarily to the surge in natural gas prices. The price spikes were prompted by unprecedented and prolonged below freezing temperatures across the state of Texas and much of the south-central U.S. region.

At the time of the event, LP&L had not yet interconnected to ERCOT, but the utility still experienced exorbitant power and fuel costs. However, LP&L benefited from certain energy purchase hedges (heat rate call option), which mitigated the vast majority of the storm-related costs. LP&L's generation assets remained operational during most of the winter storm event, with only its Massengale and Cooke GT2 units experiencing short outages due to gas curtailments.

The overall financial impact of the winter storm event was limited. LP&L used excess funds in its power cost recovery factor (PCRF) balancing account to mitigate much of the costs. The PCRF balancing account, which was in an over-recovered position prior to the storm, is used by LP&L to match pass-through revenues with purchased power costs and provide an offset to seasonal fluctuations in load and power prices.

Additionally, LP&L does not expect to be affected by any potential ERCOT uplift charges related to the winter storm event. According to House Bill 4492, which was signed on June 16, 2021, any utility interconnecting to the ERCOT market from May 29, 2021 through Dec. 30, 2021 will not be responsible for any uplift or default charges related to the February winter weather event. LP&L interconnected to the ERCOT market on May 30, 2021.

KEY RATING DRIVERS

Revenue Defensibility: 'aa'

Very Strong Revenue Defensibility

LP&L's revenue defensibility assessment is supported by the system's independent rate-setting authority and strong service area characteristics, as well as the utility's competitive rates. Rate affordability metrics remain strong despite median household income metrics that trail the national median.

Operating Risk: 'a'

Very Low Operating Costs

Fitch's assessment of LP&L's operating risk profile at 'a' reflects the utility's very low operating costs, but also considers Fitch's view of the elevated risks associated with supplying power in the ERCOT market. These risks became evident during the February 2021 winter storm event in the form of extreme price volatility and counterparty risks, both of which weaken Fitch's view of LP&L's operating cost flexibility.

LP&L historically maintained very low operating costs, averaging 7.8 cents/kWh during the four years prior to fiscal 2021. Rising commodity and market prices are expected to increase operating costs over the next two years but will decline substantially in fiscal 2024 once LP&L opts into retail competition and ceases its power supply operations. Execution of LP&L's planned transition into ERCOT will likely improve Fitch's assessment of the utility's operating risk.

Capex levels will remain somewhat elevated at approximately $51 million per year as the utility completes transmission projects related to its ERCOT integration.

Financial Profile: 'a'

Increased Leverage

LP&L's financial profile remains strong despite some weakening in fiscal 2021. Leverage increased to 9.3x in fiscal 2021 from 5.8x in fiscal 2020 as the utility continued to partially debt finance certain integration and transmission upgrade projects. The current long-term financing will finance certain remaining ERCOT integration capital projects. Additional increases in leverage following LP&L full transition into the ERCOT market in 2023 are expected to be mitigated by declining operating risks as the utility shifts to a T&D utility. Fitch expects leverage will continue to remain supportive the financial profile assessment.

Asymmetric Additional Risk Considerations

Fitch views LP&L's ERCOT integration plan as a potential longer-term credit positive as the plan assumes LP&L would only provide T&D services and no longer provide generation services. However, there are hurdles over the near-to-medium term, including completion of an expanded capex plan and the selection of a POLR, both of which would need to occur before LP&L opts in to retail competition before June 2023. These factors represent an asymmetric risk at this time.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--LP&L's completion of its planned transition into ERCOT and a sustained record of successfully managing retail competition could lead to positive rating action;

--Sustained leverage below 8.0x in Fitch's base and stress cases.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Higher than expected capex leading to increased debt issuances and higher leverage;

--The inability to manage its ERCOT integration due to ratepayer or political pushback, or direct transition-related issues;

--A weakening in revenue source characteristics caused by a competitive supplier market if LP&L continues to provide power to the affected load following a transition to the retail choice market;

--Legislative or regulatory changes that impose material new capex or operating costs for utilities;

--Inflationary cost pressures that weaken LP&L's financial profile on a sustained basis.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

SECURITY

Bonds are payable from the net revenue of the electric system.

Revenue Defensibility

LP&L's revenue source characteristics remain very strong with electric revenues provided almost entirely from the sale of retail electric service to a predominately single-certified service area. LP&L remains in competition with South Plains Electric Cooperative and SPS in two relatively small overlapping service areas in which LP&L does not have a significant presence.

Fitch does not view the remaining competition as a significant credit concern, as the overlapping service areas are defined, limited in geographical size and customer base, and represent less than 5% of LP&L's revenue. Fitch expects the revenue source characteristics to remain very strong following LP&L's transition into the competitive retail electric market as LP&L would remain the sole provider of T&D services.

Service Area Characteristics

LP&L's service area demand characteristics are consistent with the 'a' assessment, indicating strong electric demand and capacity for revenue generation to support the repayment of utility obligations. Customers have increased at a CAGR of 0.8% over the past five years ended in 2021, while socioeconomic indicators point to modestly below average income levels and a better than average unemployment rate. Residential sales account for a high 51% of electric revenues, providing for strong, stable demand and support for additional revenue generation.

LP&L maintains a moderately concentrated customer base, with the utility's top 10 customers accounting for 26.7% and 17.4% of fiscal 2021 energy sales and revenues, respectively. However, Fitch does not believe this rises to a level that would indicate an asymmetric risk. The stability of LP&L's two largest customers, Texas Tech University and the city, offset any rating concern.

Rate Flexibility

Fitch views LP&L's rate flexibility as very strong. The city council maintains the authority to approve rates as recommended by LP&L's electric utility board, but no outside regulatory approval is needed to adjust rates.

The system's rates drifted lower in fiscals 2019 and 2020 as utility customers continued to benefit from lower natural gas prices. Retail rates were in line with the state average in 2020 and residential rates were slightly more competitive at 87% of the state average, according to the U.S. Energy Information Administration. Affordability metrics for LP&L are very high, with the average monthly bill averaging only 2.3% of median household income.

LP&L's rate structure consists of a base rate and the PCRF. The PCRF generally passes through purchased power and fuel costs to customers and can be adjusted at least semiannually to ensure the full cost recovery. LP&L tracks PCRF revenues compared to actual costs and any excess funds, or shortfalls, are tracked in the PCRF balancing account. In recent years, LP&L has been able to use excess funds in the PCRF balancing account to stabilize its rates in times of unexpected fluctuations in load and power prices. LP&L used excess funds in the PCRF fund, which had increased to $10.8 million at FYE 2020 due to low commodity prices, to partially mitigate the increased purchased power costs from the Texas winter weather event in February 2021.

As of FYE 2021 (Sept. 30), the PCRF fund had an under-recovered balance of $3.2 million, primarily due to the rise in market energy prices. LP&L maintains a policy to adjust the PCRF rates to replenish the PCRF stabilization fund if the PCRF balancing account is approaching, or less than zero. As a result, LP&L's board approved an adjustment to the PCRF in May 2022 to increase the PCRF (for commercial customers only) to ensure the full recovery of costs. LP&L also used the PCRF in fiscals 2018 and 2019 to collect funds required for the $24 million SPS hold harmless payment, which was paid on June 1, 2021 as part of LP&L's transition into ERCOT.

No base rate increases are budgeted in LP&L's five-year forecast. However, LP&L is in the process of undergoing a cost of service study that could result in changes to the utility's base rates, or rate structure. The cost of service study is expected to be completed by December 2022.

Operating Risk

Very Low Operating Cost Burden

LP&L's operating cost burden assessment reflects the utility's historically very low operating cost burden, which averaged 7.8 cents/kWh in the four years prior to fiscal 2021. Operating costs increased substantially in fiscal 2021 to 9.7 cent/kWh due, in large part, to the February 2021 winter storm event costs. Still, costs could have been materially higher had LP&L not benefited from certain energy purchase hedges (heat rate call option), which effectively provided a ceiling on the utility's power costs during the winter storm event.

Notwithstanding the extraordinary winter storm costs in fiscal 2021, power supply costs are expected to rise in fiscals 2022 and 2023 due to projected increases in purchased power and fuel costs, in addition to inflationary pressures on other operating costs. However, LP&L's operating costs are expected to decline substantially after a complete transition to retail competition and the utility ceases its power supply operations.

LP&L also approved a settlement agreement on May 27, 2021 to terminate its Partial Requirements Agreement (PR agreement) with SPS following the full integration of LP&L's load into ERCOT. As part of the agreement, LP&L will pay $77.5 million to compensate SPS for power and transmission incremental costs resulting from

the early termination of the agreement. LP&L expects to use long-term debt to finance the payment, and management expects the incremental annual debt service costs related to the financing will be more than offset by the termination of its annual capacity charge paid to SPS.

The agreement will not become effective unless approved by both the Texas Public Utilities Commission (PUC) and the Federal Energy Regulatory Commission (FERC). The agreement identified May 31, 2023 as the termination date, which coincides with LP&L's projected date of full integration into ERCOT.

Operating Cost Flexibility

Transition to ERCOT Elevates Operating Risk Over Near-Term

LP&L's operating cost flexibility is assessed at weaker and reflects Fitch's view of LP&L's increased operating risk following the utility's integration into the ERCOT market for 70%, or approximately 83,000, of its customers on May 30, 2021. The February winter event in Texas exposed weaknesses in the ERCOT market that precipitated in the form of acute energy shortages and market dislocation. Fitch remains concerned about material pricing and reliability risks that remain in the ERCOT marketplace. Participation in ERCOT also exposes utilities to counterparty risk, including the potential to share in costs associated with any future counterparty defaults.

In February 2022, LP&L's board voted in favor of transitioning into retail competition, making LP&L the first municipally owned utility to choose to voluntarily deregulate since the Texas legislature passed Senate Bill 7 to deregulate the Texas electricity energy market in 1999. LP&L anticipates remaining as the T&D utility, while ceasing to act as the power provider.

Customers would contract directly with power suppliers and LP&L would provide access to their distribution and transmission system on a nondiscriminatory basis to qualified power providers. Fitch views the potential elimination of LP&L's power supply responsibilities for the majority of its load as a credit positive over the longer term, reducing the system's overall operating risk profile following the transition.

While LP&L's transition to a T&D utility would improve the utility's operating risk profile, certain hurdles remain over the next 18 months. LP&L is in the process of soliciting potential retail electric providers and LP&L has not yet determined the POLR, which would need to occur before LP&L fully transitions into retail competition (expected in the summer of 2023). LP&L also needs to complete certain transmission projects in order to migrate the remaining 30%, approximately 24,000 customers, of its customers to ERCOT (also expected in the summer of 2023). Execution of the utility's plan to transition to retail competition, including the receipt of the requisite PUC and FERC approvals, would reduce the utility's operating risks over the medium-to-long term.

Environmental Considerations and Clean Energy Transition

The state of Texas established a renewable generation goal in 1999 that required an additional 5,880 MW of renewable generation by 2015 and 10,000 MW of renewable generation by 2025 on a state-wide basis. These goals have been achieved, and there has been no further expansion of this legislation or any indication of a state-mandated requirement to increase renewable energy supply within the state.

LP&L maintains approximately 106 MW of dependable natural gas-fired generation and is entitled to 85% of the output from its 107 MW Elk City II Wind, LLC purchased power agreement, which extends through May 31, 2032. LP&L also agreed to purchase 170MW from SPS under its PR agreement.

Remaining power needs are supplied by the ERCOT market and SPP market (until LP&L's remaining customers transition to ERCOT in 2023). ERCOT's 2021 generation portfolio included natural gas (42%), wind (24%), coal (19%), and nuclear (10%), with remaining amounts composed of solar, hydro and biomass. SPP's 2021 generation portfolio was composed of coal (36%), wind (35%), natural gas (20%), and nuclear (6%), with remaining amounts composed of hydro, solar, and fuel oil.

Capital Planning and Management

LP&L's average age of plant of approximately 15 years indicates elevated investment needs. LP&L made significant capital investments in fiscal 2021, with annual capex climbing to a five-year high of $173 million, as the system continued the buildout of the utility's transmission, advanced metering and distribution assets necessary to make the integration with ERCOT possible.

Transmission projects to migrate the remaining customer load to ERCOT by 2023 are expected to average approximately $51 million over the next two years, before declining to an average annual spend of approximately $25 million through fiscal 2026 as the utility focuses on less capital-intensive system maintenance. LP&L intends to use debt-financing, including proceeds from the current sale, to fund approximately 35% of capex over the next six years.

Financial Profile

LP&L's financial profile is assessed at 'a', reflecting LP&L's elevated leverage, which climbed to 9.3x in fiscal 2021 as the utility partially debt-financed its expanded capex program. Liquidity, which declined to 107 days at FYE 2021 from 281 days at FYE 2020, was also impacted by the significant capex in fiscal 2021 as LP&L used cash reserves to partially fund capital projects. The decline in liquidity levels was not entirely unexpected as LP&L had intentionally spent down cash reserves after increasing its liquidity in recent years to meet expected, and potentially unexpected, costs related to the ERCOT transition.

Rising purchased power costs in addition to the utility's use of its over-recovered PCRF balancing account to cover a portion of the February 2021 winter storm costs, also contributed to a lower liquidity position at FYE 2021. Despite the declining liquidity and rising leverage metrics, LP&L maintained healthy operating cash flows in fiscal 2021, as Fitch-calculated coverage of full obligations was at a five-year historical high of 1.29x.

Fitch Analytical Stress Test (FAST) Scenarios

The FAST base case scenario represents Fitch's expectation of LP&L's financial performance through the five-year forecast ending in 2026. Fitch's scenario analysis focuses on LP&L's financial resiliency as the utility continues to execute its plan to transition all its customers to the ERCOT marketplace by the summer of 2023. LP&L's 2022 budget conservatively assumes 0.12% annual load growth over the next five years.

LP&L's leverage is expected to plateau over the next two years at around 8.5x to 9.0x, in Fitch's base case, as debt is issued to support the buildout of the transmission and distribution infrastructure to allow LP&L to fully transition into ERCOT. LP&L also plans to use long-term debt to finance the $77.5 million payment to SPS for any power or transmission shifted costs following the termination of its PR agreement. Liquidity levels are expected to remain adequate and neutral to the rating. LP&L's budget assumes its general reserve is at least equal to three months of electric revenue.

Leverage is expected climb further in the three years following LP&L's full transition into ERCOT, ranging from 10.5x to 10.8x through 2026 in the base case. Increased debt levels following debt issuances in fiscals 2022 and

2023, in addition to declining operating cash flows as LP&L transitions to a T&D utility, contribute to the rising leverage. Operating cash flows are also impacted by the utility's planned $22 million annual payments to ERCOT through fiscal 2027, which the PUC ordered LP&L to make to mitigate any future integration costs.

While the rising leverage is a concern, Fitch believes LP&L's planned shift to a T&D utility alleviates certain power supply operating risks, and therefore, could provide additional headroom in the utility's leverage metrics at LP&L's current rating. Additionally, Fitch expects LP&L's operating cash flows will improve following the termination of the ERCOT integration payments in fiscal 2027.

Fitch's stress case scenario applies a demand stress to management's energy sales projections using the FAST model demand stress outputs, which are based on the utility's historical demand volatility. Leverage could increase above 11x in the stress case scenario, but Fitch expects LP&L could implement additional rate increases or defer certain capital projects, which would likely moderate leverage.

Debt Profile

LP&L's debt profile is neutral to the rating. Debt at FYE 2021 totaled $496.6 million and includes $413.1 million in revenue bonds, $21.8 million in certificates of obligation and $61.7 million in bond premiums. All debt is amortizing and fixed-rate.

Asymmetric Additional Risk Considerations

Fitch views LP&L's plan to integrate its load into ERCOT as a potential long-term credit positive but one that presents significant uncertainty in the short term and is therefore an asymmetric risk. The plan involves a significant buildout of infrastructure, changes in operations, and the involvement of yet to be determined retail electric providers as service providers and billing and collection agents. Completion of the transition on time and on budget along with a proven record of successfully implementing retail competition would likely lead to the elimination of this asymmetric rating factor.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Lubbock Power & Light (TX) has an ESG Relevance Score of '4' for Exposure to Environmental Impacts due to the effects of recent severe winter weather, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Lubbock Power & Light (TX)					
• Lubbock Power & Light (TX) /Electric System Revenues/1 LT	LT	A+ ●	Affirmed		A+ ●

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	◆
NEGATIVE	⊖	◆
EVOLVING	◎	◆

RATINGS KEY	OUTLOOK	WATCH
STABLE		⊙

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub.01 Sep 2021) (including rating assumption sensitivity)

U.S. Public Power Rating Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Lubbock	EU Endorsed, UK Endorsed

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