May 29, 2024

Memorandum

To: Claudia Rasnick
Chief Financial Officer
Gainesville Regional Utilities

From: PFM Financial Advisors LLC
Chris Lover
Managing Director

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Subject: Cost of a Credit Rating Downgrade

Background Information

Gainesville Regional Utilities has three active, long-term ratings:

- Moody's Aa3
- Standard & Poor's A
- Fitch A+

On May 23, 2024, Fitch Ratings concluded a routine surveillance of GRU. While the rating was affirmed at the "A" level, the tone and content of the discussion about the surveillance process was of concern. Fitch noted a few areas that they would focus on in the coming 18-24 months:

Area	Fitch Commentary, May 23, 2024	Discussion
Leverage Metrics	- Leverage increased from 9.5x in 2022 to 11.9x primarily due to $150 million in debt issuance to fund capital needs - Factors that could individually or collectively lead to negative rating action/downgrade include: Failure to reduce leverage to near or below 10.0x on a sustained basis	Fitch standardizes financial metrics in its ratings criteria. For Fitch, a primary metric is "leverage" and generally measures the amount of total debt GRU has on the balance sheet compared to the funds available to service that debt on an annual basis. For Fitch, a leverage metric >10 is a concerning level while <10 is not as concerning.
Financial Plans and Policies	- Although leverage was elevated in FY23, Fitch believes the utility's financial plan, which includes base rate increases for the electric and wastewater businesses through 2027 and a significant reduction of the general fund transfer payment beginning in 2024, will result in near-term improvement in the utility's financial metrics. - GRU's forecast includes electric & wastewater base rate increases, that are subject to board approval, through 2027. Based on future rate increases, coupled with significantly reduced general fund transfers beginning in 2024, the utility expects to generate excess cashflow that will primarily be used to accelerate debt repayment. In Fitch's base and rating case scenarios, leverage is expected to remain below 10x through 2028.	Over the past several years, the financial plans and policies approved by GRU's governing body have been reviewed and discussed with Fitch and the other rating agencies. These plans and policies include the annual budget as well as the 5-year financial forecast, both of which typically have included the requisite rate increases to sustain each system. Other policies reviewed include the debt defeasance plan and cash balance study. These policies were generally viewed favorably given these help secure the financial foundation of the utility
Governance	- The rating also incorporates Fitch's expectation that the utility's transition in governance structure from City Commission oversight to that of a 5-member independent board should not preclude repayment of existing debt &contractual obligations, materially change the operational practices of the utility nor prevent the utility from executing its previously-established financial plan.	Fitch routinely comments on the willingness and ability of the governing body to approve the necessary rate increases required to sustain the safety and reliability of the systems as well as ensure the financial health of the utility.

In terms of Governance, GRU's operating environment is of concern to both investors and the rating agencies. Specifically, the recent efforts by the City Commission to bring to the November referendum, a resolution to dissolve the newly created GRUA and revert governance of GRU to the City (either the City Manager or the City Commission) is problematic. These concerns pertain to the City Commission's ability to:

- Control the level of the General Fund Transfer/Government Services Contribution. Recent changes materially reducing the GFT/GSC were viewed very favorably by the rating agencies and any action to reduce or eliminate this progress would result in quick ratings action, either through a change in GRU's current "stable" outlook to "negative" or a swift downgrade. PFM would expect the rating agencies to move quickly in response to this and other financial policy changes.

- Establish Rates and Charges. If rates increase materially to address the higher GFT/GSC, then the rating agencies would be concerned about rate affordability. If rate increases were not sufficient to address both a higher GFT/GSC *and* the financial footing of the utility, the rating agencies would also be concerned with weakening financial metrics.

To illustrate the rating agencies' focus on governance, PFM has informed the other two agencies about the dissolution of the initial Gainesville Regional Utilities Authority ("GRUA"), the reappointment of a new GRUA slate of directors as well as the recent City Commission approval to proceed with the referendum. The responses back from the agencies were a bit more concerning than expected, as both asked for follow-up calls with GRU's finance team to better understand the situation and implications on the credit ratings of GRU.

In the aggregate, it is PFM's opinion that GRU will likely be downgraded by Fitch in the coming 12-24 months and potentially Moody's given the large disparity between the Moody's rating and the other agencies' ratings. It is also PFM's opinion that the passage of the referendum to dissolve the GRUA and revert back to the historical governance structure would be quickly met with some type of ratings action from the agencies – either a change in outlook or downgrade. PFM has provided this analysis to illustrate the cost of a potential downgrade on GRU's current and planned debt portfolio and that financial impact starting on October 1, 2025.

Executive Summary

A credit ratings downgrade will impact the cost of GRU's debt portfolio. Fixed-rate bonds issued with a lower credit rating will have a higher interest expense as these will be viewed as riskier by investors. For variable rate debt, the credit facilities that support this particular form of debt will be more expensive and potentially GRU would have to look to other banks to provide these facilities. The same rational applies to GRU's direct purchases. Finally, future refundings that have not been previously hedged, will produce lower savings compared to GRU's current rating profile. PFM's analysis indicates that the total cost of these impacts will be, in the aggregate, ~$28.3 million, as detailed below:

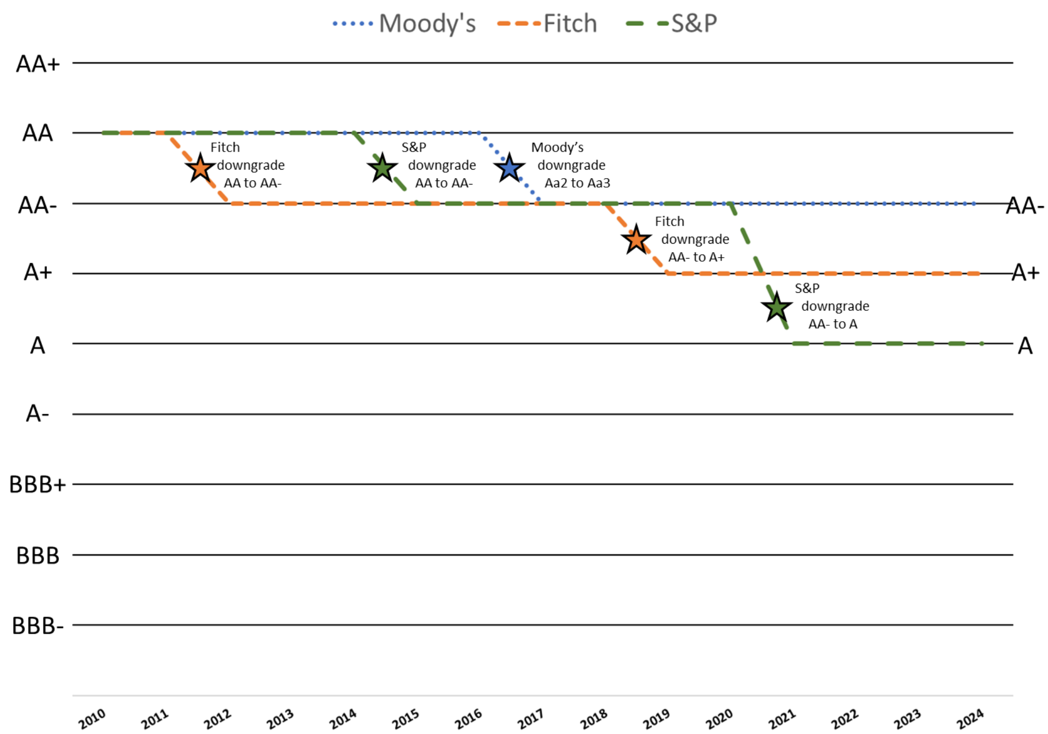
Area	Discussion	Average Annual Increase in Debt Service / Cost	Total Increase in Debt Service / Cost
Fixed Rate Debt (CIP)	Public market transactions requires higher yeild on GRU debt	$.2 million	$7.9 million
Variable Rate Debt	Credit support for variable rate debt has higher fees. Potential renewal risk.	$.4 million	$4.7 million
Direct Purchases and Letters/Lines of Credit	Private (bank) market transactions require additional fees when ratings drop. Potential renewal risk.	$.3 million	$9.3 million
Expected Refundings (lower savings)	Higher borrowing rates for future refunding transactions result in less savings	$.3 million	$6.4 million
	Total Expected Cost Impacts	**$1.2 million**	**$28.3 million**

On an annualized basis, the following table illustrates the cashflow impact to GRU across these 4 areas:

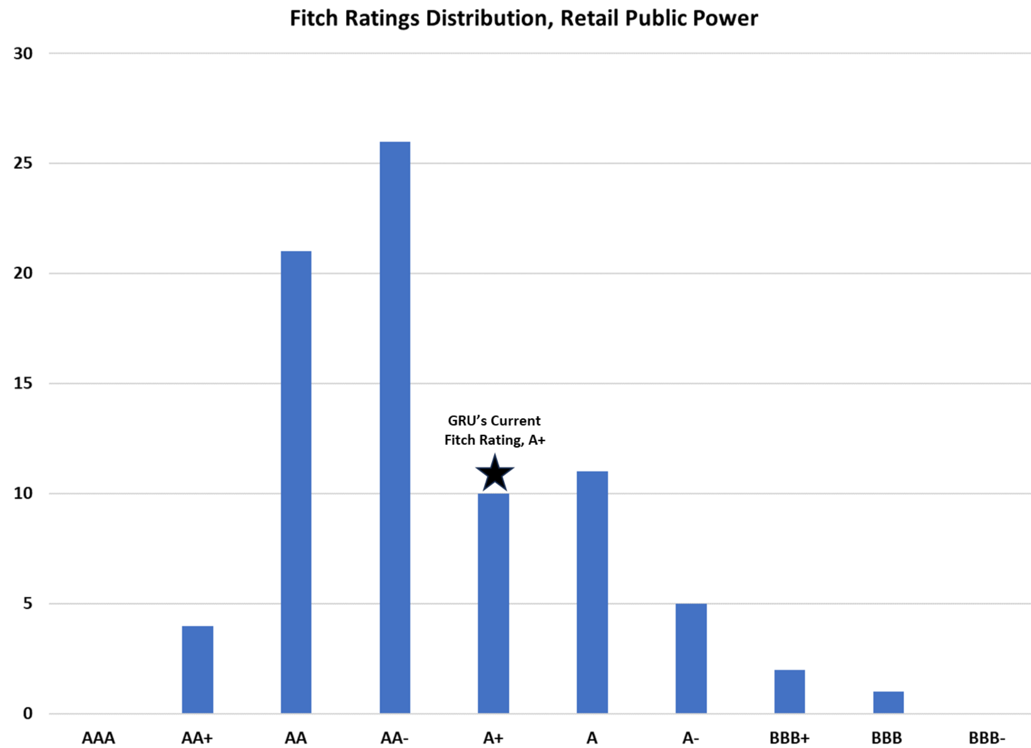
Implications of a Downgrade on Debt Costs					
	Fixed Rate Debt (CIP)	**Variable Rate Debt**	**Direct Purchases and Letters/Lines of Credit**	**Expected Refundings (lower savings)**	**Total**
10/1/2025		$.3 million	$.4 million		$.7 million
10/1/2026	$.0 million	$.3 million	$.4 million	$.0 million	$.7 million
10/1/2027	$.1 million	$.4 million	$.4 million	$.0 million	$.9 million
10/1/2028	$.1 million	$.4 million	$.4 million	$.3 million	$1.2 million
10/1/2029	$.1 million	$.4 million	$.4 million	$.3 million	$1.2 million
10/1/2030	$.2 million	$.4 million	$.4 million	$.3 million	$1.3 million
10/1/2031	$.2 million	$.4 million	$.4 million	$.3 million	$1.3 million
10/1/2032	$.2 million	$.4 million	$.4 million	$.4 million	$1.4 million
10/1/2033	$.3 million	$.4 million	$.4 million	$.4 million	$1.4 million
10/1/2034	$.3 million	$.4 million	$.4 million	$.4 million	$1.4 million
10/1/2035	$.3 million	$.1 million	$.4 million	$.4 million	$1.2 million
10/1/2036	$.3 million	$.1 million	$.4 million	$.4 million	$1.2 million
10/1/2037	$.3 million	$.1 million	$.4 million	$.4 million	$1.2 million
10/1/2038	$.3 million	$.1 million	$.4 million	$.4 million	$1.2 million
10/1/2039	$.3 million	$.1 million	$.4 million	$.4 million	$1.2 million
10/1/2040	$.3 million	$.1 million	$.4 million	$.4 million	$1.2 million
10/1/2041	$.3 million	$.1 million	$.4 million	$.1 million	$.8 million
10/1/2042	$.3 million	$.1 million	$.4 million	$.2 million	$.9 million
10/1/2043	$.3 million	$.0 million	$.3 million	$.2 million	$.8 million
10/1/2044	$.3 million	$.0 million	$.3 million	$.2 million	$.8 million
10/1/2045	$.3 million	$.0 million	$.3 million	$.2 million	$.7 million
10/1/2046	$.3 million		$.2 million	$.2 million	$.7 million
10/1/2047	$.3 million		$.2 million	$.2 million	$.6 million
10/1/2048	$.3 million		$.2 million	$.2 million	$.6 million
10/1/2049	$.3 million		$.1 million	$.2 million	$.6 million
10/1/2050	$.3 million		$.1 million	$.2 million	$.5 million
10/1/2051	$.3 million		$.1 million	$.2 million	$.5 million
10/1/2052	$.3 million		$.1 million		$.3 million
10/1/2053	$.3 million		$.0 million		$.3 million
10/1/2054	$.3 million				$.3 million
10/1/2055	$.3 million				$.3 million
10/1/2056	$.3 million				$.3 million
10/1/2057	$.2 million				$.2 million
10/1/2058	$.2 million				$.2 million
10/1/2059	$.2 million				$.2 million
10/1/2060	$.1 million				$.1 million
10/1/2061	$.1 million				$.1 million
10/1/2062	$.1 million				$.1 million
Total	**$7.9 million**	**$4.7 million**	**$9.3 million**	**$6.4 million**	**$28.3 million**

GRU’s Credit Ratings and the Retail Public Power Utilities

As detailed above, GRU has investment grade ratings. GRU also has split ratings, meaning each rating agency has a slightly different thought about GRU’s credit quality and financial security. Moody’s, with an “Aa3”, believes GRU’s credit is stronger than the other agencies. This has not always been the case. In 2010, for example, GRU was rated by all of the agencies as AA, Aa2 and AA by Standard & Poor's, Moody’s and Fitch, respectively. The following chart illustrates GRU’s credit ratings since 2010:



In context, GRU’s ratings are slightly below those of other public power issuers. The following information from Fitch’s 2023 Analytical Comparison Tool, illustrates GRU’s rating in relation to the other retail public power utilities that Fitch rates:



GRU’s Credit Ratings and Capital Improvement Program Cost Impacts

GRU’s projected capital spending plan is ~$1.1 billion through 2034. GRU expects to issue an additional $317 million in debt to finance the CIP with the remaining $800 million coming from internally generated resources:

	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030	FY 2031	FY 2032	FY 2033	FY 2034
CIP Total	$121.4 million	$142.5 million	$113.3 million	$103.8 million	$121.2 million	$123.4 million	$119.3 million	$88.3 million	$87.5 million	$88.9 million
Bond funded ($)			$85.0 million			$140.0 million			$92.0 million	

In the event of credit deterioration and credit rating downgrades, GRU’s projected new money borrowings and potential refunding issues would incur higher borrowing costs. The incremental interest rate impact would be a function of both the degree of any rating downgrade and the absolute level of interest rates at the time the prospective fixed-rate bonds are issued.

In the municipal marketplace, the “AAA” benchmark is the Bloomberg Valuation (“BVAL”) index. This represents the rate that a “AAA” rated entity could likely borrow. For each move downward in rating, investors demand a higher yield, a credit spread, to address the higher risk of the lower-rated entity. The following table illustrates the current spreads between different rating categories:

Maturity	AAA BVAL	Public Power AA BVAL	Difference from AAA BVAL	Public Power AA- BVAL	Difference from AAA BVAL	Public Power A BVAL	Difference from AAA BVAL	Difference from AA- BVAL
1	3.38	3.47	9 bps	3.45	7 bps	3.56	18 bps	11 bps
2	3.26	3.36	10 bps	3.34	8 bps	3.48	22 bps	14 bps
3	3.14	3.28	14 bps	3.25	11 bps	3.40	26 bps	15 bps
4	3.03	3.21	18 bps	3.17	14 bps	3.34	31 bps	17 bps
5	2.99	3.20	21 bps	3.16	17 bps	3.35	36 bps	19 bps
6	2.97	3.21	24 bps	3.16	19 bps	3.37	40 bps	21 bps
7	2.97	3.22	25 bps	3.18	21 bps	3.37	40 bps	19 bps
8	2.97	3.23	26 bps	3.19	22 bps	3.39	42 bps	20 bps
9	2.97	3.22	25 bps	3.19	22 bps	3.39	42 bps	20 bps
10	2.98	3.23	25 bps	3.21	23 bps	3.41	43 bps	20 bps
11	3.02	3.26	24 bps	3.26	24 bps	3.43	41 bps	17 bps
12	3.06	3.30	24 bps	3.31	25 bps	3.49	43 bps	18 bps
13	3.13	3.38	25 bps	3.39	26 bps	3.55	42 bps	16 bps
14	3.19	3.44	25 bps	3.45	26 bps	3.62	43 bps	17 bps
15	3.25	3.51	26 bps	3.53	28 bps	3.68	43 bps	15 bps
16	3.34	3.61	27 bps	3.62	28 bps	3.77	43 bps	15 bps
17	3.40	3.64	24 bps	3.65	25 bps	3.82	42 bps	17 bps
18	3.46	3.69	23 bps	3.70	24 bps	3.86	40 bps	16 bps
19	3.51	3.74	23 bps	3.74	23 bps	3.90	39 bps	16 bps
20	3.60	3.83	23 bps	3.84	24 bps	4.00	40 bps	16 bps
21	3.64	3.85	21 bps	3.87	23 bps	4.03	39 bps	16 bps
22	3.68	3.88	20 bps	3.91	23 bps	4.05	37 bps	14 bps
23	3.72	3.92	20 bps	3.95	23 bps	4.09	37 bps	14 bps
24	3.74	3.94	20 bps	3.97	23 bps	4.11	37 bps	14 bps
25	3.77	3.95	18 bps	3.99	22 bps	4.12	35 bps	13 bps
26	3.77	3.96	19 bps	4.01	24 bps	4.13	36 bps	12 bps
27	3.79	3.96	17 bps	4.01	22 bps	4.15	36 bps	14 bps
28	3.81	3.98	17 bps	4.03	22 bps	4.15	34 bps	12 bps
29	3.82	3.99	17 bps	4.04	22 bps	4.16	34 bps	12 bps
30	3.81	3.98	17 bps	4.04	23 bps	4.15	34 bps	11 bps

For this analysis, the sensitivity of fixed rate debt with an additional downgrade and the issues associated with the form of governance, **PFM assumed an ~15 to 20 basis point increase in yields compared to how GRU's bonds would price in the current market, in line with today's market conditions as well as the historical deviation.**

Applying higher yield to GRU's three planned CIP transactions, and assuming the CIP is funded a few months prior to the start of the Fiscal Year, PFM would expect the increase in debt service to be:

	Expected Increase in Debt Service: CIP Transactions			
	2027 CIP Needs	2030 CIP Needs	2033 CIP Needs	Total CIP Needs
10/1/2026	29,264			29,264
10/1/2027	68,750			68,750
10/1/2028	73,000			73,000
10/1/2029	67,000	48,183		115,183
10/1/2030	71,250	118,500		189,750
10/1/2031	70,250	112,000		182,250
10/1/2032	69,250	115,750	31,714	216,714
10/1/2033	68,250	119,250	78,250	265,750
10/1/2034	67,250	112,500	77,250	257,000
10/1/2035	71,250	116,000	76,250	263,500
10/1/2036	70,000	114,250	75,250	259,500
10/1/2037	68,750	117,500	74,250	260,500
10/1/2038	72,500	110,500	78,250	261,250
10/1/2038	71,000	113,750	77,000	261,750
10/1/2038	69,500	116,750	75,750	262,000
10/1/2038	68,000	114,500	74,500	257,000
10/1/2038	71,500	117,250	73,250	262,000
10/1/2038	69,750	114,750	77,000	261,500
10/1/2038	73,000	117,250	75,500	265,750
10/1/2038	71,000	114,500	74,000	259,500
10/1/2038	74,000	116,750	77,500	268,250
10/1/2038	71,750	113,750	75,750	261,250
10/1/2038	69,500	115,750	79,000	264,250
10/1/2038	72,250	112,500	77,000	261,750
10/1/2038	69,750	114,250	75,000	259,000
10/1/2038	67,250	115,750	73,000	256,000
10/1/2038	69,750	117,000	76,000	262,750
10/1/2038	67,000	118,000	73,750	258,750
10/1/2038	69,250	113,750	71,500	254,500
10/1/2038	66,250	114,500	74,250	255,000
10/1/2038	68,250	115,000	76,750	260,000
10/1/2038		115,250	74,000	189,250
10/1/2038		110,250	76,250	186,500
10/1/2038		110,250	73,250	183,500
10/1/2038			75,250	75,250
10/1/2038			77,000	77,000
10/1/2038			73,500	73,500
10/1/2038				-
Total	**2,125,514**	**3,495,933**	**2,296,964**	**7,889,147**

GRU's Credit Ratings and Variable Rate Debt Cost Impacts

GRU has $391 million in variable rate debt outstanding generally broken into two categories:

1. **Variable Rate Demand Bonds ("VRDBs").** These publicly traded variable rate bonds require a bank credit or liquidity facility. With VRDBs, an investor can elect to "put" the bonds back to GRU basically on any given business day. Given this characteristic, VRDBs require a bank-provided credit or liquidity facility. In the event an investor "puts" the bonds back to GRU, the bank facility can pay the tender price of the bonds, rather than GRU providing cash immediately. These credit and liquidity facilities have a fee and, in the event of a downgrade, this fee increases. Additionally, when VRDBs are assigned a lower rating, the form of the facility that investors require changes from a "standby" facility. The new form provides more security and certainty for an investor and is known as a Direct Pay Letter of Credit. Finally,

another factor to consider is the fact that GRU's current facilities are concentrated with a small number of banks. Given this concentration and potential higher risk that GRU poses at a lower rating, these banks might be less willing to renew their facilities and GRU would have to move to a more costly provider. PFM reviewed the fee letters and associated documents for these facilities and, where applicable, applied the downgrade pricing. In instances where there was no downgrade pricing impact, PFM assumed a 10 basis point adjustment in facility pricing at the expected renewal date to account for the both the expected higher fee for a lower-rated entity and the overall facility replacement risk given bank concentration.

2. **Letters of Credit and Revolving Credit Facilities.** Historically, GRU, like many issuers, has used these facilities as a means to finance the CIP projects between bond transactions. These facilities largely replaced GRU's prior commercial paper program. Additionally, these facilities serve as an emergency source of cash, a "rainy day fund", in the event of unexpected and severe expenses. Like VRDBs, the fee for these facilities will increase based on a rating downgrade and PFM used the same assumptions as with the VRDBs.

Based on some reasonable assumptions, PFM would expect the impact to GRU's variable rate debt would be as follows:

Variable Rate Debt and Letters/Lines of Credit Impacts						
Series	**Type**	**Amount Outstanding**	**Final Maturity**	**Average Annual Increase in Debt Service / Cost**	**Total Increase in Debt Service / Cost**	**Assumptions**
2012 Series B	VRDBs with Credit support	$98.6 million	2042	$.1 million	$1.1 million	Total represents 10 bps increase in cost of credit support reflecting renewal risk over the life of the bonds
2019 Series C	VRDBs with Credit support	$67.4 million	2047	$.1 million	$1.4 million	
2018 Series C, 2020 Series A and 2022 Series A&B	Letters/Lines of Credit and Revolving Facilities	$225.0 million	2034	$.2 million	$2.3 million	Total represents 10 bps increase in cost through 2034, representing renewal risk
Expected increase in Cost				**$.4 million**	**$4.7 million**	

GRU's Credit Ratings and Direct Purchase Cost Impacts

GRU has ~$700 million in multiple series of direct purchase debt with three banks. This debt is basically a non-public loan with that respective bank. Like the letters of credit and revolving credit agreements, a direct purchase would have a higher fee level if GRU is downgraded. Additionally, there is concentration risk in terms of renewing these facilities given the amount of GRU debt these banks hold on their respective balance sheets. PFM reviewed the fee letters and associated documents for these facilities and, where applicable, applied the downgrade pricing. In instances where there was no downgrade pricing impact, PFM assumed a 10 basis point adjustment in facility pricing, at the renewal date, to account for the facility renewal/replacement risk. The potential impacts are as follows:

Direct Purchase Debt Impacts						
Series	Type	Amount Outstanding	Final Maturity	Average Annual Increase in Debt Service / Cost	Total Increase in Debt Service / Cost	Assumptions
2020 Series A	Direct Purchase (fixed)	$10.6 million	1-Oct-34	Fixed rate direct purchased do not have a downgrade penalty		10 bps increase in cost of debt service over the life of the bonds. Represents renewal risk
2022 Series B	Direct Purchase (fixed)	$230.1 million	1-Oct-38			
2022 Series A	Direct Purchase (fixed)	$54.5 million	1-Oct-28			
2023 Series A	Direct Purchase	$160.0 million	1-Oct-47	$.1 million	$3.3 million	
2023 Series B	Direct Purchase	$105.0 million	1-Oct-44	$.1 million	$1.9 million	
2023 Series C	Direct Purchase	$151.2 million	1-Oct-53	$.1 million	$4.1 million	
Expected increase in Cost				**$.3 million**	**$9.3 million**	

GRU's Credit Ratings and Future Refunding Savings Impacts

Similar to refinancing a home mortgage, GRU has the ability to refinance their fixed rate debt periodically through a "optional redemption" or "call option". In the aggregate, GRU has ~$440 million in bonds that could be refunded in the future at the respective redemption date:

GRU's Refunding Opportunities					
Series	Par (Issued)	Par (Currently Outstanding)	Coupon	Maturities	Call Date
2017 Series A	$415.9 million	$343.4 million	4% - 5%	2025 - 2040	10/1/2027
2021 Series A	$95.8 million	$95.8 million	5%	2042 - 2051	10/1/2031

While savings would not accrue until that transaction is completed, usually within 90 days of the call date, savings can be meaningful, especially if the bonds have 5% coupons, are longer in maturity and have a sizable par amount (such as the 2017 Series A Bonds).

Assuming that, at the call date, this transaction is completed, the savings, given the credit downgrade, would be lower. The following table illustrates this lost savings:

Refuding Transactions, Opportunity Cost			
	2017As	2021A	Total
10/1/2026			
10/1/2027	36,483		36,483
10/1/2028	314,250		314,250
10/1/2029	321,000		321,000
10/1/2030	317,000		317,000
10/1/2031	317,750	15,033	332,783
10/1/2032	318,000	61,500	379,500
10/1/2033	317,750	61,500	379,250
10/1/2034	317,000	61,500	378,500
10/1/2035	315,750	61,500	377,250
10/1/2036	319,000	61,500	380,500
10/1/2037	316,500	61,500	378,000
10/1/2038	318,500	61,500	380,000
10/1/2039	319,750	61,500	381,250
10/1/2040	320,250	61,500	381,750
10/1/2041		61,500	61,500
10/1/2042		156,500	156,500
10/1/2043		156,750	156,750
10/1/2044		161,750	161,750
10/1/2045		156,250	156,250
10/1/2046		160,750	160,750
10/1/2047		164,750	164,750
10/1/2048		158,250	158,250
10/1/2049		156,750	156,750
10/1/2050		160,000	160,000
10/1/2051		162,750	162,750
Total	**4,168,983**	**2,224,533**	**6,393,517**