MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Aa2 to LADWP's (CA) Power System Revenue Bonds, 2022 Series B

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New York, March 18, 2022 -- Moody's Investors Service ("Moody's") has assigned an Aa2 rating to the City of Los Angeles Department of Water and Power's (CA) (LADWP or the utility) $360 million Power System Revenue Bonds, 2022 Series B. The rating outlook is stable.

RATINGS RATIONALE

The Aa2 rating reflects the underlying fundamental strengths of the LADWP Power System that self-regulates its monopolistic provision of essential electricity to a sizeable and diverse customer base in the City of Los Angeles (Aa2 stable) and has a track record of cost recovery supported by the city owner that has resulted in stable and resilient financial metrics. The rating also recognizes the rising financial and rate pressure stemming from capital investments related to the forecast transformation of LADWP's power supply to comply with local and state mandates for renewable and clean energy. To maintain overall credit quality, the expected higher costs and incremental leverage will have to be balanced with either higher debt amortization or higher revenues from increased rates which may pressure LADWP's rates competitiveness. Maintaining this credit relationship will be fundamental to the utility's future credit quality and if the balance of these factors change, credit pressure could increase. To date, LADWP has balanced this well as the utility's decoupled rate structure allows the recovery of uncollected budgeted costs in fiscal 2020 in future fiscal years. Higher revenues in fiscal 2021 resulted in a step up in financial metrics with a Moody's fixed obligation charge coverage ratio of about 2.12x compared to 1.59x in fiscal 2020 and days cash on hand increased to 289 days versus 240 days in fiscal 2020.

Almost 60% of the utility's rolling five-year $11 billion capital improvement plan will be debt funded. This incremental debt will add to LADWP's above-average total leverage profile, which includes significant direct debt, off-balance sheet debt issued through joint action agencies and high Moody's adjusted net pension and OPEB liabilities. The higher leverage could be manageable if more principal amortization, asset investment and increased revenues occur in tandem with increased borrowing for new capital investments.

The Aa2 rating also reflects our view that the LADWP Power System will be able to adequately manage the financial and rate pressure related to its power transformation plan over the next decade while also maintaining financial metrics in line with Moody's expectations. While local clean energy goals accelerated recently and are aggressively targeting 80% renewable energy by 2030 and zero carbon by 2035, LADWP has developed an industry leading LA 100 plan in partnership with the National Renewable Energy Lab (NREL) to outline how it will achieve these goals while maintaining reliability, a key focus for the utility since its inception. We expect effective management of the transition, including successfully adjusting rates with the next multi-year rate proposal to demonstrate support of the new Power Strategic Long-Term Resource Plan while maintaining the utility's financial profile. LADWP's rate structure allows for the pass-through recovery of energy and reliability costs as well as the procurement of renewables to comply with renewable portfolio standards, which when coupled with the decoupling mechanism in the base rates, ensures that rates will be sufficient to recover all costs.

Importantly, the rating also incorporates the utility's ownership and able stewardship of a transmission network that represents about 25% of the state's electric transmission grid as well as a share of transmission throughout the western US. The network presents opportunities and optionality for load balancing along with local control and management, coupled with the challenges related to large capital reinvestment requirements. LADWP's leverage is elevated as a result of the ownership and ongoing maintenance of this essential network. The value of this ownership has been demonstrated when wildfires resulted in rolling blackouts in portions of the state, while LADWP was able to meet its load requirements and sell excess power into the California Independent System Operator Corp. (CAISO: A1 stable) to aide in its shortfalls. Furthermore, the transmission assets also provide access to renewables outside the LA Basin and outside of California, which help the utility in its objective to meet the goals outlined in the LA 100 plan. This geographic diversity will be essential as the utility moves to majority wind and solar over time that are intermittent and vulnerable to adverse regional weather events.

RATING OUTLOOK

The stable outlook reflects our expectation that LADWP will adequately adjust its rates and operations to manage its rapid power transformation plan over the next decade to comply with aggressive local mandates for renewable and clean energy goals by 2030 and 2035, respectively. We expect LADWP to manage the rising financial and rate pressure related to the power transformation plan while maintaining financial metrics at or near a Moody's fixed obligation charge coverage (FOCC) of at least 1.60x, over 200 days cash on hand, and a total adjusted debt ratio below 125%.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATING

-Successful adoption of a multi-year rate forecast that shows adequate funding for the rising costs related to upcoming capital improvement plans and additional leverage.

- If the city owner's credit quality improves, LADWP successfully implements its power transformation plan, manages the risks of its large transmission system, remains cost competitive and materially improves its financial metrics with FOCC exceeding 2.0x and Moody's total adjusted debt ratio declining below 75% on a sustained basis.

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATING

- Lack of support for the next multi-year rate action or insufficient rate increases that do not adequately increase revenues to keep pace with rising operating and debt service costs

- Material increase in direct costs, leverage or unfunded adjusted net pension and OPEB liabilities

- Higher than expected costs related to power supply transformation to more renewable resources and the costs to transition the coal-fired Intermountain Power Project to run on a mix of natural gas and hydrogen

- Financial metrics weaken with FOCC below 1.5x, DCOH below 200 days, and Moody's adjusted debt ratio above 125% on a sustained basis

- Rates become externally regulated

- Multi-billion-dollar wildfire settlement

LEGAL SECURITY

The power system revenue bonds are secured by the net revenues of the power system. The bond covenants are relatively weak with a sum sufficient rate covenant and no debt service reserve requirement, while additional bonds can be issued if adjusted net income for 12 consecutive months in the preceding 18 months before the new debt is issued equals 1.25x the forecast maximum annual debt service including the new debt, subject to adjustments like the inclusion of already approved rate increases and expected new income from system expansions. While there is no indenture required reserves, LADWP maintains an unrestricted Debt Reduction Trust Fund that equaled $489.3 million as of January 31, 2022, restricted cash associated with the annual required debt service and PPA payments, as well as other significant liquidity sources including strong available cash on hand and a large amount of unused capacity under its bank revolving credit agreement.

USE OF PROCEEDS

Proceeds of the 2022 Series B bonds finance a portion of the capital improvement program and issuance costs.

PROFILE

LADWP is the nation's largest municipal electric utility that operates with self-regulated cost recovery. LADWP provides electric service to about four million residents in a 473 square mile service area, making it the third largest California electric utility in terms of customer demand. LADWP does not have dominant customers as its top 10 customers represent about 10% of total revenues. The utility has a major generation and transmission presence in the western region with net dependable generating capacity of 8,101 MW and ownership of 25% of the state's transmission assets.

METHODOLOGY

The principal methodology used in this rating was US Public Power Electric Utilities with Generation Ownership Exposure Methodology published in August 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1170209 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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The rating has been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

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