

**Rating Update: Moody's Affirms A1 Rating on American Municipal Power's Fremont Energy Center Revenue Bonds; Outlook Stable**

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Global Credit Research - 26 Mar 2014

**Rating Action Affects \$546.6 Million Revenue Bonds**

AMERICAN MUNICIPAL POWER, INC - FREMONT ENERGY CENTER PROJECT  
Joint Power/Action Agency (JPA)  
OH

**Opinion**

NEW YORK, March 26, 2014 --Moody's Investors Service has affirmed the A1 rating on the American Municipal Power, Inc.'s (AMP) \$546,585,000 AMP Fremont Energy Center Project Revenue Bonds Series 2012 A (Taxable) and Series 2012 B (Tax-Exempt). The outlook is stable.

**RATINGS RATIONALE**

The A1 rating takes into consideration the average weighted credit quality of A2 on the 87 project participants who are unregulated municipal electric utilities; the strong take-or-pay power sales contracts and the fully funded maximum annual debt service reserve; the tested and monitored cost recovery process; the Fremont Energy Center (Fremont)'s sound operating performance; AMP's sound liquidity profile and the effective power supply management for its members. Please refer to Moody's AMP's A1 issuer rating report dated February 28, 2014.

AMP's acquisition of Fremont, a two unit 675 MW natural gas fired combined cycle facility, has provided power resource diversity for its members from a highly efficient plant that went into commercial operation in January 2012. Fremont has demonstrated a very strong operating performance in its first two years of operation as measured by availability and capacity factors. Fremont generation is expected to supply on average 20-25% of the AFEC participants' peak load requirements in 2015.

The A1 rating on AFEC Project Revenue Bonds takes into consideration the significant increase in leverage that followed the Fremont acquisition, along with AMP's exposure to generation ownership risks. Specifically, for example, while there are limited water storage facilities for backup purposes at AFEC, we understand that AMP has a plan to expand storage.

AMP has an A1 issuer rating reflecting its key role in power supply management for numerous municipal electric systems in the Midwest; its strong cost recovery process and sound liquidity position. AMP has 129 members overall representing about 3,512 MW of peak demand located in seven states. AMP's management has a strong track record including access to ample liquidity, enhanced through sizeable lines of credit with highly rated banks. Each of AMP's project bonds stand alone, have indentured reserves and many participants are in more than one project. There is no cross default among the projects.

**Outlook:**

The stable credit outlook reflects continued expectations of solid operating performance and AFEC's value to AMP participants with a competitive power supply including notable fuel diversity. While the restructured wholesale energy marketplace presents challenges, the stable rating outlook factors in AMP's strong track record in managing generation risk for its members. Strong take-or-pay contracts that are monitored by AMP for compliance, Fremont's continued strong operating performance and AMP's favorable liquidity position are additional factors underlying our stable outlook.

**What Could Change the Rating Down:**

Any non-compliance with the take-or-pay contracts would cause the credit rating to be downgraded. Significant deterioration in the generation asset performance or in the credit quality of participants could also lead in a downgrade.

## What Could Change the Rating Up:

The rating could be upgraded should participant credit quality improve significantly.

## Fundamentals

### Strengths

\*Certainty in cost recovery due to sound AMP power supply contracts with its members; the unregulated rate setting authority of almost all AMP member municipal utilities; AMP's statutory authority to increase its wholesale power rates on a timely basis and members' ability to pass on purchased power costs to retail customers.

\*No material direct retail competition for municipal electric utilities in each state served (except for Cleveland Public Power)

\*Average weighted credit quality of the diverse group of AMP's participating members is A2

\*Strong contract enforcement provisions including AMP's credit monitoring system that provides an early warning of fiscal stress

\*The level and availability of internal and external financial liquidity with bank line agreements with satisfactory terms and conditions

\*Demonstrated record of success in managing power supply for AMP's member municipal electric utilities

\*Fully funded debt service reserves for individual separately-secured generation project debt including for AFEC Revenue bonds.

### Challenges

\*Single project risk

\*Commodity market risks in management of natural gas supplies for AFEC

\*Strategic plan to shift from market to generation ownership has increased debt leverage

\*Managing operations of a wholesale electric power utility in restructured wholesale electricity market

\*Some member utilities have customer dominance and above average retail rates

## DETAILED CREDIT DISCUSSION

### Project Description and Performance to Date

AMP's acquisition of Fremont a two-unit natural gas fired power plant, from FirstEnergy, has been positive for AMP and its members helping to diversify fuel mix. AMP and its 87 (65 from Ohio) Fremont project participants executed a 36 year take-or-pay power sales contracts for 90.69% of the aggregate capacity of the plant. The remaining ownership interest in Fremont includes a 4.15% undivided ownership interest of Central Virginia Electric Cooperative and a 5.16% undivided ownership interest of Michigan Public Power Agency (MPPA). MPPA share was financed by separate MPPA revenue bonds and are rated A2.

AFEC is a two-unit natural gas fired, combined cycle, electric power generation plant with capacity of 512 MW (unfired) 675 (duct fired) consisting of two Siemens-Westinghouse combustion turbines, two heat recovery steam generators and one steam turbine and condenser. As mentioned, Fremont went into commercial operation in January 2012 and has had a good operating record. Specifically, the plant heat rate has been in the 7300 Btu/kWh range; while plant availability during 2012 and 2013 was 78.8% and 84.2%, respectively, with 98% availability during the highest demand months. Fremont's capacity factor has averaged 50%; and we understand that engineering inspections have been sound.

AMP has established a plan to manage fuel risk. AMP has transportation agreements for gas on two interstate pipelines but will need to secure short-term interruptible transportation during peak periods.

AMP recently became an equity owner in The Energy Authority (TEA). AMP has a contractual relationship with TEA who handles fuel procurement and hedging on AMP's behalf as well as dispatching AFEC economically into

the MISO and PJM markets. TEA has a sound industry reputation for conservative and effective natural gas risk management. AMP has a Corporate Energy Risk Control Policy which sets limits for counterparties, and establishes other risk mitigation measures.

#### Legal Security for Fremont Energy Center Revenue Bonds:

The AFEC Project Revenue bonds are payable from and secured solely by the Trust Estate pledged under the Indenture that includes a net revenue pledge by AMP. Each AFEC participant has a fixed participant share and the participant is required to pay AMP on a monthly basis an amount equal to its proportionate share of AMP's revenue requirement. The payments are to be made as an O&M expense of the participant's electric system. The obligation to make payments are incorporated in the 36-year take-or-pay contract agreement such that the payments are not subject to any reduction, whether by offset, counterclaim, or for any other reason, nor shall they be conditioned on the performance of AMP, or any participant, and the payment shall be made whether the project is completed, operable, operating, or for any other reason. There is a 25% step-up provision. Delaware Municipal Electric Corporation (DEMEC), rated A2, also has a take-or-pay contract for its participant share and a 25% step-up provision.

The bond security covenants include a 1.10 times additional bonds test and 1.10 times rate covenant. The debt service reserve is equal to the least of maximum annual debts service, 125% of average annual debt service and 10% of original principal of parity obligations.

#### Flow of Funds:

AMP transfers monthly payments received from the participants to the Trustee and funds the waterfall under the Master Indenture Operating Account in the following way: the Fuel Reserve Account; Working Capital Account (estimated \$12.5 million); Derivatives Receipts Account, General Account; Fuel Hedge Reserve Account; Fuel Hedge Reserve Account (estimated \$5 million funded from bond proceeds); Capitalized Interest Account; Interest Account; Derivatives Payment Account; Principal Account; Sinking Fund Account; Redemption Account; Parity Common Reserve Account (estimated at \$34.5 million funded from bond proceeds); Subordinate Obligations Account; Reserve and Contingency Account; the Renewal and Replacement Account; the Overhaul Account; the Capital Improvement Account; the Rate Stabilization Account; the Environmental Improvement Account; and the Self-Insurance Account.

#### Strong Cost Recovery Protections

AMP's municipal utility members purchase non-project capacity and energy from AMP pursuant to take-and-pay contracts. The contracts are not secured by the full faith and credit of the respective cities. AMP members by their choice also participate on a take-or-pay basis in AMP-sponsored projects including AMP's share of the financing of Fremont. If there is a payment default, AMP has the power to suspend delivery, which we believe creates a significant incentive for the members to pay given the essential nature of the electric service. If nonpayment persists, AMP could bring litigation against the member and seek a judgment but AMP also has additional remedies which would be pursued prior to litigation. AMP has never experienced a payment default by a member.

Payment compliance is aided by AMP's credit monitoring program which produces early warning reports should a city be in fiscal distress. Moody's heavily weights this in the current credit rating.

#### AMP's Value Added Power Supply Role; Also a Rating Consideration

While AFEC Revenue Bonds are take-or-pay obligations of the 87 participants in the project, AMP credit strengths are also factored into our analysis. AMP was established by state statute (Ohio Revised Code Chapter 1702) as a non-profit corporation in 1971 to provide its members, which are municipal electric utilities, a reliable and competitive power supply. AMP is governed by a 20-member Board of Trustees made up of officials from 19 member municipalities and DEMEC. AMP operates like a joint powers agency and most of its members have home rule powers which permit retail rates to be set by the local governing boards with no external regulation. AMP has obtained a determination letter and qualifies as a Section 501(c) 12 corporation and has a private letter ruling that in effect permits it to issue tax-exempt bonds.

AMP has a master services agreement with all its members that provides a legal framework for the relationship of the municipal electric utility and AMP as it relates to power pools, energy products, power supply arrangements and individual services.

In 2011, non-coincident peak demand of AMP's 129 members was 3,512 MW, almost 50% higher than in 2005 primarily due to new members joining the agency and partly due to load growth. AMP electric revenues were \$831

million in 2013. AMP has supplied a part of that peak demand from 1,114 MW of generation that it owns and joint ventures of its members, with the balance coming from market purchases. Rate competitiveness has been maintained with AMP members averaging retail rates in the 20% range lower than region's investor-owned utilities. It is noted that several AMP participants retail rates are higher than the regional average.

AMP historically has been a wholesale power supplier using market purchases to resell to its members. AMP has undertaken a significant shift in its power resource strategy from mostly market purchases to moving towards generation ownership including AFEC. The main driver has been to mitigate the volatility that municipal electric utilities have had to face with the restructured wholesale power markets. AMP forecasts it will move to reliance on purchased power for about 36% from 73% of its energy today.

#### AMP Participants Credit Characteristics Weighted Heavily in the AFEC Credit Rating

Among the factors considered in the rating assigned on the AFEC Revenue Bonds are the general credit characteristics of AMP's AFEC participants. Moody's has determined the average weighted credit quality of AMP municipal participants is A2.

The fundamental credit strengths of AMP's members include near-monopoly status in their service areas and unregulated rate setting authority. Municipal electric utilities in Ohio are not subject to state regulation nor are they required to participate in retail choice programs.

#### AMP Financial Position: Financial Liquidity is Sound as AMP Begins to Change Its Operating Profile

AMP has historically operated on a breakeven basis as a non-profit wholesale power supplier with the bulk of its energy resources from market purchases resold to its municipal utility participants. AMP's move to be an owner of generation with operating risks has required a significant increase in liquidity. While AMP has an unregulated authority to set its rates to recover its costs, financial liquidity to manage changes in fuel prices and meet other immediate impacts on cash flow is required as it becomes more of a generation owner.

AMP negotiated a \$750 million revolving line of credit with 10 banks. The line was originally effective on January 9, 2012 it now has a maturity date of January 10, 2019. The revolving line of credit has an accordion feature to expand the line to \$1 billion. AMP has authorization to issue \$450 million of commercial paper notes (CP).

Prior to 2015, AMP will need to finance the acquisition of the 49% ownership interest in the Greenup hydro project from the City of Hamilton. No additional borrowing has been announced for any of the existing projects under development.

#### Key Facts:

KEY INDICATORS: Joint Action Agency-Take-or-pay Methodology Scorecard Factors:

Factor 1-Participant Credit Quality and Cost Recovery Framework: (45%) A2

Factor 2-Asset Quality: (15.0%) Baa

Factor 3-Cost competitiveness: (15%): Baa

Factor 4 (a) Three Year Average Days liquidity on hand: (10%): A (1)

Factor 4 (b) Three Year Average Debt Ratio (5%): Baa

Factor 4 (c) Three Year Average Fixed Charge coverage ratio (10.0%): Baa

Grid Indicated Rating: A2

Notching - Positive 0.5 Notch up for AMP cost recovery and monitoring program and positive 1.0 notch up for participant diversity.

(1)While internal liquidity is limited for Fremont Energy Center, AMP has a line of credit authorized at \$750 million.

Final Scorecard Indicated Rating: A1

AMP Issuer Rating: A1

Fremont Energy Center: 675 MW (duct fired)

Commercial Operation Start Date: January 2012

Average Participant Credit Quality: A2

AMP 2010 Power Supply Mix: 72.7% Purchased Power

AMP 2015 POWER SUPPLY MIX: 36% Purchased Power

23% Prairie State (coal)

15% Hydro

16% AFEC (Natural Gas)

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The principal methodology used in this rating was US Municipal Joint Action Agencies published in October 2012. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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