Research

American Municipal Power Inc., Ohio; Wholesale Electric

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Credit Profile		
American Mun Pwr Inc. (Comb Hydroelec Pwr Proj) rev bnds		
Long Term Rating	A/Stable	Affirmed
American Mun Pwr Inc. (Comb Hydroelec Pwr Proj) (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services has affirmed its 'A' rating on American Municipal Power Inc. (AMP), Ohio's combined hydroelectric project revenue bonds. As of Dec. 31, 2013 $2.05 billion was outstanding. The outlook is stable.

The bonds mature in February 2050. Proceeds are funding construction of three hydroelectric projects (Cannelton, Smithland, and Willow Island), plus capitalized interest six months beyond commercial operation date. The trust estate, which consists primarily of payments from the participants under their power sales contacts, secures the bonds.

The rating reflects our view of the project's long-term creditworthiness. The three hydroelectric facilities, which will total 208 megawatts (MW) of generating capacity, are being built on three preexisting dams owned by the United States Army Corps of Engineers (USACE). The project is part of a larger power supply strategy that includes participation in other AMP projects.

We believe that the 'A' rating incorporates these credit strengths:

- A take-or-pay power sales contract (PSC) with 79 of AMP's 129 members with a 25% step up limit if any of the participants default on their payments. The contract, which expires in 2057, obligates the participants to pay their share of all power costs, including debt service, regardless of whether some or all of the three projects are finished or operating;
- The credit strength of the largest participating members, which we believe is medium-investment-grade, and the project's relatively small portion of each member's power supply;
- That the three hydroelectric facilities are on existing dams and employ conventional technology, and that AMP already operates a similar facility on the Ohio River; and
- Our view that the hydroelectric power enhances the project's attractiveness because it is a renewable energy resource in an increasingly carbon-constrained environment. We believe that the attractiveness would be further enhanced should Congress enact a carbon-reduction regime (such as cap-and-trade) or should a federal renewable portfolio standard apply to the project or other market participants.

The rating also incorporates our view that capital costs are high, projected to be about $9,700 per kilowatt (kW) including financing costs and capitalized interest. The utility projects that the project's all-in-power cost will be above-market, but the small percentage each participant takes helps mitigate the impact on retail rates.

We have assigned AMP a business profile of '4' on our scale from '1' to '10', '1' being the highest, reflecting our view of the membership base's diversity, the sophistication of the utility's management team, and its efforts to assist and monitor members' credit strength. The utility has 129 electric utility members serving more than 625,000 customers in Ohio, Michigan, Pennsylvania, Kentucky, Delaware, West Virginia, and Virginia.

The 79 participants in the combined hydroelectric project represent a large pool of retail customers, primarily in Ohio. The number of participants enables Standard & Poor's to decouple the rating from a weak-link analysis. Standard & Poor's believes that the likelihood that the step-up provision will be fully tested is minimal, so the rating reflects our view of the leading participating members' overall credit quality and, once the units begin commercial operation, on the credit metrics of the project itself.

The three power plants will have a combined generating capacity of about 208 MW. The Cannelton (three turbines, totaling 88 MW) and Smithland (three turbines, totaling 76 MW) facilities are in Kentucky. The Willow Island facility (two turbines, totaling 44 MW) is in West Virginia, 20 miles upriver from AMP's Belleville hydroelectric project. Management expects Cannelton to begin full operation in late fourth-quarter 2014 or early first-quarter 2015, Smithland by early third-quarter 2015 and Willow Island in by early third quarter of 2015. In 2009 and 2010, delayed receipt of the section 408 and 404 permits and poorer-than-expected geologic conditions at Smithland increased the original project cost estimate by about 10%. Since then, there have been no budgetary increases.

However, in our view, the increase had no credit impact because the power sales contract obligates full payment from the members. These billings represent operating expenses for most members, and the majority of them automatically pass the cost through to their retail customers. As run-of-the-river projects, generation is subject to Army Corps of Engineers interruption for various reasons, chiefly water derates. When completed, management expects the project to have a 55%-60% capacity factor, largely in keeping with other hydroelectric projects located on the Ohio River.

Management expects the generating capacity, including other hydroelectric plants, the coal-fired Prairie State Energy Center, and the Fremont combined cycle unit, to reduce its participants' exposure to market purchases to about 36% of total energy supply when all projects are in service, down from 75% in 2007. By 2015, the utility expects electricity will be 26% from coal-fired capacity, 17% from natural gas, 16% hydroelectric, and 5% from wind, solar and landfill gas in addition to the market purchases.

Members in this hydroelectric project have also invested in the additional projects. Although AMP secures these projects separately, they ultimately will be obligations of most of the same members. We expect that project financing will result in substantial increases in members' fixed costs, but our rating assumes that participating members will exercise their rate-setting autonomy, thereby maintaining adequate coverage of all fixed costs.

The Ohio members' current rates are generally competitive, based on 2012 data from the Energy Information Agency (EIA). Ohio's average residential rate was 11.76 cents per kW-hour (kWh), and the participants' rates, which the EIA's data include, are near or below that level.

A $750 million committed revolving credit facility that backs a $450 million commercial paper program provides what we view as strong liquidity for AMP's projects. The utility can use the facility to fund taxable project costs and working capital. The line can be expanded to $1 billion if needed, and expires Jan. 10, 2019. As of Oct. 31, 2013, $573.8 of the

$750 million facility was available.

Under the indenture, there is a 1.1x annual debt service rate covenant and a 1.1x additional bonds test two years after commercial operation. A parity common reserve is funded at lesser of maximum annual debt service, 125% average annual debt service, or 10% of principal, funded from bond proceeds. The Build America and clean renewable energy bonds each have a special reserve (funded with bond proceeds) with an amount equal to semiannual subsidy payment.

Outlook

The stable outlook reflects our view of the take-or-pay contracts that obligate what we believe is a broad pool of participants to make payments sufficient to meet AMP's revenue requirements, regardless of whether or not the project is in commercial operation. We do not expect to raise or lower the rating during the two-year outlook horizon.

The Participants

Seventy-nine of AMP's 129 members are participants in the combined hydroelectric project. The 10 participants with the largest shares account for 58%, or 72% including a 25% step up to cover defaulting members. The largest participant is Cleveland Public Power, with a 16.8% share. Other large-share members include Danville, Va. (10.6%) and Bowling Green, Ohio (9.6%), both of which we have assessed as medium-investment-grade. From there, participation levels decline, with participants having shares below 5%.

We believe that the top five participants (44% of capacity and energy) have credit profiles that are among the strongest of AMP's members. With some exceptions, in our view, they exhibit solid-to-strong coverage of fixed costs, strong liquidity, low customer concentration, and moderate exposure to industrial loads. Below the top five, loads tend to be more concentrated and industrial. Debt levels are what we consider low, but we expect those to increase with AMP project financing. Unemployment rates among the members' customers are generally above average.

Power Sales Contract

AMP has entered a PSC with the 79 participants, through 2057. The PSC covers entitlements of each participant for capacity and energy from the project (the three facilities) and related transmission. Obligations (including a 25% step-up) are take-or-pay, not subject to reduction, offset, counterclaim, or conditioned upon the utility's performance. Payments are mandatory regardless of the project's status. AMP is not responsible for supplying replacement power; however, the participating members may elect to require it later.

Under the PSC, rates must be sufficient to meet revenue requirements. Revenue requirements include transmission, operations and maintenance (including allocation of common costs), payments in lieu of taxes, fuel costs, taxes, the cost associated with any necessary pollution control equipment and emission requirements, and service fees. Also included are costs associated with decommissioning, debt service, swaps, liquidity or credit support, and money to fund additional reserves (contingencies, self-insurance, and rate stabilization).

Management reviews rates at least quarterly. Rates have demand and energy components, and a power-cost-adjustment mechanism to reflect monthly changes in fuel, environmental costs, purchased power, third-party sales, transmission fees, and service fees to AMP.

The utility can suspend service within 15 days' notice for delinquent payment, although suspension does not relieve defaulting participants of obligations. AMP can sell power into the market for up to two months. For defaults of more than 60 days, the utility can terminate the PSC (but the take-or-pay obligations remain in full force). Shares of defaulting members are offered first to the other participants, then to nonparticipating AMP members, then to other parties. To the extent that defaulting member's obligations are not met, nondefaulting participants agree to step up, shouldering the defaulters' variable and fixed costs, not to exceed 25% of their pro rata entitlement.

The contract has been court-validated in Ohio, and legislatively granted in Michigan, Virginia, and West Virginia. In Kentucky there is no specific statute that authorizes participants in that state to enter take-or-pay with out of state entities, or step up. Kentucky state counsel has issued an opinion that the participants there have the power to enter and perform under the PSC.

Participants make monthly payments, pursuant to the indenture, for fixed and variable costs, including debt service. Payments are operating expenses of participant electric system with two exceptions -- the cities of Coldwater and Marshall, both in Michigan. For these participants, the payments are subordinate to operating expenses and debt outstanding.

Related Criteria And Research

Related Criteria

USPF Criteria: Electric Utility Ratings, June 15, 2007