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American Municipal Power Inc., Ohio; Wholesale Electric

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Table Of Contents

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Credit Profile		
American Mun Pwr Inc. meldahl hydroelec proj rev bnds Build America Bonds) ser 2010E due 02/15/2050		
Long Term Rating	A/Stable	Affirmed
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Long Term Rating	A/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has affirmed its 'A' rating on American Municipal Power Inc. (AMP), Ohio's electric revenue bonds (Meldahl hydroelectric project). As of Dec. 31, 2013, the project had $685.1 million of revenue bonds outstanding. The outlook is stable.

The bonds mature in February 2050. Proceeds are funding construction of the Meldahl hydroelectric project, plus capitalized interest six months beyond the commercial operation date.

Securing the bonds is the trust estate, which consists primarily of payments from the participants under their power sales contacts.

The rating reflects our view of the long-term creditworthiness of the project, a 105 MW hydroelectric plant on the Ohio River. The project is part of a larger power supply strategy that includes participation in other AMP power generation projects.

The rating incorporates what we believe to be these credit strengths:

- A take-or-pay power sales contract (PSC) with 48 of AMP's 129 members, with a 106% step up limit if any of the participants default on their payments. The contract, which expires in 2057, obligates participants to pay their share of all power costs, including debt service, regardless of whether the project is built or in operation;
- The medium-investment-grade credit profile of the largest participant, the City of Hamilton, Ohio, whose electric utility accounts for 51% of the project's revenue; and the project's relatively small portion of the other 47 participating members' power supply;
- The hydroelectric plant's location on an existing dam and use of conventional technology. 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 opinion that capital costs are high, at more than $6,000 per kilowatt (kW), including financing costs and capitalized interest expense, which contributes to power costs that management projects will be above-market levels through 2023. However, we believe that the benefit of low operating costs and the diversification of fuel sources, as well as the credit received for investment in renewable energy, will offset the higher costs.

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 48 participants in the Meldahl 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.

However, concentration is a factor in our assessment. Hamilton's electric utility accounts for 51.4% of the project's power sales revenue, and the utility's credit strength is, in our opinion, medium-investment-grade. We also believe that the credit strength of the other 47 participants is either medium- or low-investment-grade.

Management expects Meldahl to begin full operation during first-quarter 2015. The run-of-the-river project is being built at the pre-existing Army Corp. of Engineers' Captain Anthony Meldahl Locks and Dam, on the Ohio River, 36 miles upstream from Cincinnati. AMP management expects the project to cost $654 million, or what consider a high $6,232 per kW. The utility projects that the all-in-cost of energy will be about $80 per megawatt-hour in 2015, the first full year of commercial operation. However, because there are no fuel costs, AMP projects that by 2024, the project will produce power at an all-in cost that is under the market prices. As a run-of-the-river project, generation is subject to Army Corps of Engineers interruption for various reasons, chiefly high and low water de-rates. When completed, the utility 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 new 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, AMP 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 the utility 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. However, 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. Ohio's average residential rate was 11.76 cents per kW-hour (kWh), and the participant's rates, which the EIA's data include, are at about that level or below.

A $750 million committed revolving credit facility that backs a $450 million commercial paper program provides what we view as strong liquidity for AMP, which can use it 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 million 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 the lesser of maximum annual debt service, 125% average annual debt service, or 10% of principal, is 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 strength of the take-or-pay contracts coupled with participating members' rate-setting autonomy. We do not expect to raise or lower the rating during the two-year outlook horizon.

The Primary Participant

Accounting for 51.4% of the project, Hamilton's electric utility credit profile is a key component in our analysis. Standard & Poor's has assessed the utility's credit profile and believes that it is solidly medium-investment-grade. AMP and Hamilton have entered several agreements whereby the utility has committed to finance Meldahl's development and construction, and the city has committed to its operations.

Meldahl LLC, of which AMP is the sole member, owns the project, but Hamilton and AMP are co-holders of the Federal Energy Regulatory Commission (FERC) license necessary to construct and operate the project. The FERC license expires in 2058, eight years after the debt amortizes.

Hamilton is in Butler County, Ohio, about halfway between Dayton and Cincinnati. Historically manufacturing-dependent (paper, metalworking, automotive parts, and machine tools), the city has gained employment in education (Miami University-Hamilton), health care (Fort Hamilton Hospital), and technology (Cincinnati Bell). The unemployment rate in December 2013 was 6.8%, only slightly higher than the state's unemployment rate of 6.6%.

The city's electric system serves more than 29,000 customers. More than 40% of sales are residential, while industrial customers account for just 26% of total system revenue. Customer concentration is not significant, in our view, because the top five retail customers account for 10% of Hamilton's revenue. The electric system had a peak load of 186 MW in 2012, up from about 147 MW in 2009.

Hamilton electric utility's power is 71% owned generation and 29% purchased power, primarily spot and day-ahead market purchases. Fuel mix is diversified, in our view, with 41% of energy coming from hydro production and 30% from coal based resources. Management expects that by 2015, the resource mix will be 55% hydro, 39% coal, and 6% purchased power. The bulk of owned generation comes from Hamilton's Greenup Hydroelectric Plant, a run-of-the-river facility with a capacity of 70.2 MW. The FERC license for Greenup expires in 2026. Hamilton will make bilateral purchases of block power, selling capacity and energy from its Greenup project into the PJM market. The city also has a 35 MW participation share in the Prairie State Electric Center, and a 32 MW share of AMP's JV2 combustion turbine project.

Hamilton has a power cost adjustment (PCA) clause that passes through to customers all fluctuations in fuel, fuel transportation, purchased power, and transmission costs. However, management can adjust the PCA at its discretion, generally only annually, although it can do so more often; the true-up often takes place over extended periods so as to limit the impact on ratepayers. We view the PCA as comprehensive, but believe that its discretionary implementation allows for potential deferred recovery, which weakens the utility's credit profile.

We believe other financial provisions support credit. These include a rate-stabilization clause to replenish draws on the rate-stabilization fund, a 1.0% unfunded environmental mandate adjustment rider, and a 0.5% unfunded governmental and regulatory mandate charge.

Power Sales Contract

AMP has entered a PSC with the 48 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 206% step-up) are take-or-pay, not subject to reduction, offset, counterclaim, or conditioned upon AMP's performance. Payments are mandatory regardless of the project's status. The utility is not responsible for supplying replacement power; however, the participating members may elect to require it later.

Under the PSC, rates must be set 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 occurring 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, non-defaulting participants agree to step-up, shouldering the defaulters' variable and fixed costs, not to exceed 106% 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