

## **FITCH RATES AMERICAN MUNI POWER MELDAHL PROJECT BONDS 'A'; OUTLOOK STABLE**

Fitch Ratings-New York-11 July 2016: Fitch Ratings has assigned an 'A' rating to the following American Municipal Power, Inc. (AMP) revenue bonds:

--Approximately \$80.2 million Meldahl Hydroelectric Project revenue bonds, series 2016A (Green Bonds).

The bonds are expected to sell via negotiation during the week of July 11. Proceeds will be used to repay draws on a line of credit related to Meldahl construction, fund additional projects, if any, make a deposit into the debt service reserve and pay issuance costs.

In addition, Fitch affirms the following outstanding parity bonds:

--Approximately \$620 million Meldahl hydroelectric project revenue bonds at 'A'.

The Rating Outlook is Stable.

### **SECURITY**

The bonds are secured and payable solely from gross receipts including payments made by the Meldahl participants under the power sales contracts and other funds established pursuant to the indenture. AMP has covenanted under the indenture to set participant rates at a level sufficient to generate 1.1x debt service coverage on the Meldahl project bonds.

### **KEY RATING DRIVERS**

**CONTINUED RESOURCE DIVERSIFICATION:** The Meldahl Project (Meldahl) is a 105 MW run-of-the river hydroelectric generating facility located on the Ohio River. The project, one of several recently constructed or acquired AMP projects was recently completed and is expected to provide power that is above current market prices (approximately \$90/MWh). However, the project adds an environmentally-friendly resource to a region dominated by fossil-fuel fired generation.

**STRONG TAKE-OR-PAY CONTRACTS:** Take-or-pay power sales contracts (PSCs) obligate the 48 participating municipally-owned electric systems to pay for their respective shares of all project costs, including debt service on the bonds, whether or not the project is completed, operating or operable. All of the participating systems are members of AMP.

**RATING REFLECTS PARTICIPANT CREDIT QUALITY:** The rating reflects the credit quality of the project participants, particularly the largest -- Hamilton, OH, which holds a 51.4% entitlement share of the project. Hamilton's relatively weak financial results of late are expected to improve following the receipt of a sizeable one-time payment related to a recent sale of its partial ownership interest in an existing hydro facility to AMP.

**SIZABLE CONTRACT STEP-UP PROVISIONS:** The PSCs include sizable step-up provisions that require each participant to purchase up to 106% of its original allocation of the output in the event that another participant defaults. This step-up is sufficient to absorb the loss of the largest participant's share in the event of a default.

### **RATING SENSITIVITIES**

**CHANGES IN PARTICIPANT CREDIT METRICS:** The rating on the American Municipal Power, Inc. Meldahl Project bonds is sensitive to shifts in the credit quality of the project participants, particularly the city of Hamilton, OH which is the largest participant with a 51.4% share of the project.

## CREDIT PROFILE

AMP is a nonprofit wholesale power supplier and services provider organized in 1971 for the benefit of its members. As of June 1, 2016, AMP reported 133 members located throughout nine states (Delaware, Kentucky, Michigan, Ohio, Pennsylvania, Indiana, Maryland, Virginia, and West Virginia). Together, the AMP members served approximately 645,000 retail electric customers.

## RESOURCE DIVERSIFICATION CONTINUES

AMP has assisted its membership in procuring reliable and competitively priced wholesale power since its inception. AMP has worked with the membership over the last decade to adopt strategic long-term power resource plans for each member, which ultimately led to the development of a wide range of new resources to meet power requirements.

In this regard, AMP and its members have continued to shift from market purchases to owners of a diverse array of generating assets, including Meldahl and several additional hydroelectric facilities, Fremont Energy Center, a 675 MW natural gas combined-cycle facility and a 23.26% ownership interest in Prairie State Energy Campus (coal), among others. Over roughly the past decade, AMP has successfully reduced its power purchases from 75% of its energy resource mix in 2007 to around 40%, while integrating greater sustainable/renewable resources including building/acquiring various discreet hydroelectric projects.

## STAND-ALONE PROJECT, CONSTRUCTION COMPLETED

Meldahl is a run-of-the-river hydroelectric generating facility constructed on the Captain Anthony Meldahl Locks and Dam, operated by the Army Corps of Engineers, on the Ohio River about 36 miles upstream from Cincinnati, OH. AMP and the city of Hamilton, a member of AMP and a project participant, are co-licensees of the project. Meldahl's FERC operating license is valid through June of 2058, approximately eight years beyond the maturity of all project related debt, including the 2016A bonds.

Meldahl, which has an aggregate generating capacity of 105 MWs, consists of three bulb-type turbine-generating units and is forecast to achieve an annual net capacity factor (60%) consistent with AMP's other hydro projects. Annual output is projected to be approximately 555,000 MWh. Outages will be planned and scheduled in conjunction with AMP's other hydroelectric projects on a unit basis to minimize production loss. Meldahl, which entered commercial operation on April 12, 2016, is operated by Hamilton pursuant to an operating agreement with AMP.

## ELEVATED COST OF POWER

Meldahl's gross cost of power to the participants is expected to be high. Projections indicate gross power costs will range between \$90-\$94/MWh through 2025 before rising modestly to around \$100/MWh by 2033. Power costs will be influenced somewhat by revenues obtained from offering some Meldahl capacity into the PJM reliability pricing model and the sale of renewable energy certificates. Net power costs are projected to be closer to \$80-\$84/MWh, which is still high but similar to costs at one of AMP's other hydroelectric facilities (Greenup).

Fitch also believes the higher project costs are at least partially mitigated by the fuel diversity offered by the addition of Meldahl, particularly given the participants' reliance on fossil fuel generation, and the potential for climate change legislation or renewable energy standards to regain traction over the next few years.

## TAKE-OR-PAY POWER SALES CONTRACTS

Under the PSCs, each participant is entitled to receive its share of output from the project. Each participant's obligation under the PSCs is made on a take-or-pay basis, and each is required to make monthly payments to AMP equal to its proportionate share of AMP's revenue requirements associated with the project.

The strength of a take-or-pay agreement lies in the participant's requirement to make payment regardless of the unit operation and as long as the bonds remain outstanding. Contract payments are considered an operating expense for all but three small participants, the cities of Coldwater, Marshall and Wyandotte, MI, where payments may be subordinated to their own utility system debt.

Additionally, the PSCs feature a step-up provision that would require non-defaulting participants to purchase a pro-rata share of any defaulting participants' allocation up to 106% of their original allocation. This provision typically serves to mitigate participant default risk, particularly for the weakest and smallest participants. In this case, the required step-up is sufficient to cover a default of the largest project share held by the city of Hamilton, OH.

## PROJECT PARTICIPANT CREDIT QUALITY

The project rating will continue to primarily reflect the creditworthiness of the underlying participants, which historically have exhibited satisfactory cash flow, modest leverage, and healthy cash balances. The participants collectively serve a wide variety of cities and towns dispersed over a broad geographic area.

Financial metrics and the blended credit quality of the six largest participants (equivalent to 76% of Meldahl participation) weakened somewhat in fiscal 2014, but remain supportive of the project rating. None of the participants are publicly rated by Fitch, with the exception of Paducah ('BBB'/ Outlook Stable).

The relationship between Hamilton and the Meldahl project is somewhat symbiotic. Not only is Hamilton the largest participant, but its share of the project will account for roughly 36% of Hamilton's total resource capacity.

Hamilton's debt service coverage was weak compared with 'A' rated retail systems and exhibited significant deterioration through fiscal years 2014 and 2015. DSC dropped to below 1.0x versus a historical average of about 1.3x as higher purchased power costs were not offset by needed rate increases. Hamilton intentionally left rates unchanged in 2014 and 2015 due to the pending sale of its ownership interest in the Greenup hydroelectric facility to AMP and an anticipated \$139 million in proceeds.

The Greenup project sale was completed in April 2016 and the related proceeds received by Hamilton shortly thereafter. According to AMP, and consistent with Fitch's expectations, Hamilton utilized approximately \$104 million of the Greenup bond proceeds to retire outstanding electric revenue bonds, with the balance used to bolster the utility's liquidity position (about \$35 million). After the redemption, Hamilton's remaining balance of outstanding debt is approximately \$30 million.

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#### Applicable Criteria

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)

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U.S. Public Power Rating Criteria (pub. 18 May 2015)

[https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=864007](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=864007)

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