



New Issue: MOODY'S ASSIGNS A1 TO AMERICAN MUNICIPAL POWER PRAIRIE STATE REVENUE BONDS; OUTLOOK STABLE

Global Credit Research - 14 Sep 2010

AMP SELLS \$300 MILLION TO FUND CONSTRUCTION

Electric Utilities
OH

Moody's Rating

ISSUE	RATING
Prairie State Energy Campus Project Revenue Bonds, Series 2010 (Federally Taxable-Issuer Subsidy-Build America Bonds)	A1
Sale Amount	\$300,000,000
Expected Sale Date	09/20/10
Rating Description	REVENUE BONDS

Moody's Outlook Stable

Opinion

NEW YORK, Sep 14, 2010 -- Moody's Investors Service has assigned an A1 rating with a stable outlook to the American Municipal Power, Inc. (AMP) \$300 million Prairie State Energy Campus Project Revenue Bonds, Series 2010 (Federally Taxable-Issuer Subsidy-Build America Bonds). The bonds are expected to be priced in late September 2010.

RATINGS RATIONALE

The A1 rating assigned to the Prairie State bonds incorporates the A1 underlying credit strength of a diverse group of municipal electric utilities in Ohio and in several neighboring states participating in the Prairie State Project; the very strong legal security behind the bonds and AMP's strong cost recovery process; AMP's favorable power supply management record; the projected economics and value of the Prairie State Project to AMP members; and the unique project attributes, including advanced environmental controls and location adjacent to a coal reserve and mine.

The rating incorporates the recently announced cost overruns and the change to a fixed price EPC contract that is expected to mitigate further owner cost pressures.

USE OF PROCEEDS:

Completion financing of Prairie State Project.

LEGAL SECURITY:

Under the master trust indenture, AMP's pledges its net revenues, derived from take-or-pay power sales contracts with 68 municipal participants, payable regardless of whether the project is completed, operating, or operable.

The take-or-pay contracts have a 25% step-up provision. The master indenture includes a 1.10x rate covenant and a 1.10x additional bonds test after commercial operation. There is a fully funded maximum annual debt service reserve.

The member payments are payable as O&M expenses of their respective electric systems.

Legal opinions were issued that the contracts are valid and enforceable. On December 7, 2007, the Franklin County, Ohio Court of Common Pleas issued an order validating the power sales contract relating to the hydroelectric project between AMP-Ohio and the Ohio participants in that project, including the take-or-pay and step-up provisions included therein. Bond counsel references that order in its opinion as to the validity of the Prairie State Project take-or-pay contracts but separately the Prairie State Project power sales contracts have not been court-validated.

Several of the participants in AMP's Prairie State Project are located in Michigan, Virginia and West Virginia. Each of those states passed specific legislation authorizing take-or-pay contracts, including step-up provisions with out-of-state corporations.

Should the take-or-pay contract obligation ever be successfully challenged and ruled by a court as illegal or unconstitutional, the power sales contract obligations become take-and-pay obligations of the participants and the obligation shall not be subject to reduction for any reason and not conditioned upon the performance by any participants.

INTEREST RATE DERIVATIVES:

None related to Prairie State Project.

RECENT DEVELOPMENTS:

The Prairie State project is now almost 60% completed; 91% engineering is completed; and 90% procurement. In July 2010, an announcement

was made that the target EPC price budget was significantly exceeded. The project owners and the EPC contractor negotiated a change to a fixed price contract. The EPC target price was originally at \$2.95 billion and the agreed upon fixed price contract is now \$3.999 billion. The target completion date for Unit 1 was August 1, 2011. This was moved to December 6, 2011 and from May 1, 2012 to August 1, 2012 for Unit 2. Despite the cost increase, the project economics and value to participants remains sound.

STRENGTHS:

- *Take-or-pay contracts with municipalities with a weighted average credit quality, based on the global rating scale, in A1 to Aa3 range
- *Power supply contract extension for 50-years by members to join Prairie State Project indicates strong support for AMP's role as a regional power supplier
- *Prairie State Project has several unique advantages including prepaid coal supply that should be relatively stable in price; location of coal reserve and mine near coal-fired generation facility which eliminates rail transportation risk; and advanced environmental controls which meet current standards for pollution control and designed to emit less carbon.
- *Projected still competitively price power supply (after recently announced cost increases) (including carbon cost projections) for all-in bus bar cost of completed Prairie State Project relative to Midwest energy marketplace
- *Competitive current and projected member retail rates
- *AMP has a well-regarded fiscal monitoring system to provide ongoing assessment of members' credit profiles including evaluation of financial metrics
- *Limited deregulation risk at retail level for municipal electric utilities
- *Legal challenge to air permit rejected by the U.S. 7th Circuit Court of Appeals
- *Fixed price contract for balance of the construction project

CHALLENGES:

- *Significant cost overrun due to lower labor productivity on Unit 1. There is construction risk remaining as project is about 60% completed. Three-month project delay reported
- *The mine will be initially operated with only one portal
- *No assurances that environmental regulation will remain the same. Any federal legislation that addresses greenhouse gas emissions could have an adverse impact on the cost of coal-fired generation

OUTLOOK

Moody's has assigned a stable outlook given the expectation that the fixed price EPC contract will lessen the potential of future cost increases. The stable outlook has as its foundation the strong legal contracts with the AMP participants and still favorable economics of the project.

What Could Change the Rating UP:

The rating could be upgraded upon satisfactory completion of the project, improved financial metrics and continued strengthening of the underlying AMP participant's credit quality.

What Could Change the Rating DOWN:

The rating could be downgraded if the generation project faces further construction delays and cost overruns go above the current EPC fixed contract price and places pressure on contract compliance.

PROJECT DESCRIPTION: CURRENT OFFERING WILL PROVIDE COMPLETION FINANCING FOR AMP PARTICIPATION IN PROJECT

The current offering funds AMP's completion financing for its 23.26% ownership interest in the Prairie State Project, as well as, deposits made to construction and debt service reserves and for capitalized interest. AMP has issued \$1.697 billion of revenue bonds to finance its share of the project. The Prairie State Project includes the Prairie State Energy Campus, a two-unit 1,582 MW pulverized coal- supercritical coal-fired generating facility located in southern Illinois. The heat rate is projected to be 9,300 Btu/kWh. The project also includes coal reserves and mine facilities. AMP's share of the generating facility is about 368 MW of capacity and related energy.

Prairie State Generating Company (PSGC) is constructing and will operate the Prairie State Project. PSGC is a wholly owned company of Prairie State Energy Campus Management, Inc., an Indiana nonprofit corporation, which in turn is wholly owned by the PSEG Owners on a basis that is proportionate to their respective percentage interests in the PSEC. The other public power utility owners of the Prairie State Project are: Illinois Municipal Electric Agency (rated A1); Indiana Municipal Power Agency (rated A1); Missouri Joint Municipal Electric Utility Commission (rated A3); Kentucky Municipal Power Agency (rated A3); and Northern Illinois Municipal Power Agency (rated A2).

COST OVER-RUN Have led To A FIXED PRICE EPC CONTRACT FOR BALANCE OF PROJECT

PSGC had entered into an original \$2.95 billion target price engineer procure construct (EPC) contract with Bechtel Corp for the construction of the plant. The target price EPC contract locked up most costs but effectively shifted the risk of labor cost escalations from Bechtel to the owners.

Significant cost overruns reported in the mid- 2010 budget led to a change in the EPC contract to shift risks back to the EPC contractor through a fixed priced EPC contract. PSGC believes that recession brought about more labor availability but there was more unskilled labor that created issues for welding and other tasks.

The LDs in the new agreement are similar to LDs found in three other recent coal-fired generation construction projects in the Midwest. There

are new maximum warranty exposures, performance penalties and incentives and higher overall limits of liability. The overall scope of the project is the same.

Reportedly, the site now has over 4,000 workers and productivity metrics are improving.

The target completion date for Unit 1 was August 1, 2011 was moved to December 6, 2011 and from May 1, 2012 to August 1, 2012 for Unit 2.

VALUE OF THE PRAIRIE STATE PROJECT TO AMP REMAINS

Despite the cost increase, the all-in cost of Prairie State remains competitive versus regional power market prices. The value of the project includes the significant advantage the project has in that it is located adjacent to the fuel supply. Participants have financed the mine and have a stable source of fuel supply for 30 years. With level debt service on the Prairie State bonds and the relatively fixed fuel price, the long term value of the project is evident.

Since the project will represent about 20% of AMP participant's power supply on average, the impact of the cost increase on overall future retail rates is mitigated. Furthermore, AMP is in the process of decommissioning its 232 MW Gorsuch coal-fired power plant that has had a \$79/mwh all in price of generation. Prairie State at a projected \$62/mwh is expected to be competitive against the market and also the resource it is replacing.

DESCRIPTION OF AMP-ROLE: VALUE-ADDED SERVICE AND ECONOMIC BENEFITS TO MUNICIPAL ELECTRIC UTILITIES

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, to provide for a reliable and competitive power supply. AMP is governed by a Board of Trustees made up of officials from member municipalities. AMP operates like a joint powers agency and most of its members have home rule charters which permit retail rates to be set by the local governing boards with no external regulation. The Ohio members have their authorization to enter into power sales contracts derived from the state constitution. 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 2009, non-coincident peak demand of AMP's 128 members was 3,031 MW, almost 50% higher than in 2005 primarily due to new members joining the agency and partly due to load growth. AMP has supplied a part of that peak demand from 627 MW of generation that it owns, with the balance coming from market purchases.

Rate competitiveness has been maintained with AMP members averaging retail rates in the 20% range lower than the region's investor-owned utilities. It is noted that several AMP participants retail rates are higher than the regional average.

AMP has undertaken a significant shift in its power resource strategy from mostly market purchases to generation ownership. The main driver is 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 market power for under 15% of its energy by 2014. The base load power supply projects that AMP has participated in the financing of are projected to be competitive power sources and are secured by 50-year take-or-pay contracts with AMP members.

STRONG AMP COST RECOVERY

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 the Prairie State Project.

If there is a payment default, AMP has the power to suspend delivery, which in Moody's opinion creates a significant incentive to pay given the essential nature of the service. If nonpayment persists, AMP could bring litigation against the city and seek a judgment against the city's assets, including non-utility assets. AMP has never experienced a payment default. Should such a default occur, AMP would first offer the power to other AMP members and then exercise the 25% step-up provision that requires participants to be legally responsible for the costs for up to 25% of their original entitlement.

Payment compliance is aided by a credit monitoring program that AMP provides which produces early warning reports should a city be in fiscal distress. AMP management monthly evaluates its participant credit by monitoring a credit scorecard that includes fiscal metrics.

Importantly, a state statute also kicks in with the Ohio state auditor having fiscal emergency powers related to Ohio municipalities that could place a city on Fiscal Watch or Emergency to correct a fiscal stress problem. Moody's believes this structured process to catch any potential non-compliance with the take-or-pay contracts is a positive consideration in the rating. Ohio local governments also cannot be forced into involuntary Chapter 9 bankruptcy. Only the state auditor through a fiscal commission that is established can recommend such an action be taken.

AMP MEMBERS A1 CREDIT CHARACTERISTICS WEIGHTED HEAVILY IN CREDIT RATINGS

AMP's rating incorporates the general credit characteristics of AMP's participants. AMP has 128 members in six states (68 participants are in the Prairie State project) (Ohio, Kentucky, Pennsylvania, Michigan, Virginia and West Virginia). About 75% of AMP sales revenue comes from Ohio-based municipal electric utilities. Moody's has determined the average credit quality of AMP municipal participants is A1. Moody's uses its Q-rate methodology (recalibrated on the global scale) which is a statistical model based on several key rating factors to estimate credit standing of many of the non-rated AMP members. Moody's believes there is a close and direct relationship between the member cities' general credit and that of its municipal utility.

CAPITAL PROGRAM: NEW OWNED GENERATION TO REPLACE MARKET PURCHASES

AMP's capital plan primarily includes the implementation of its generation ownership expansion plan. The current offering is for the completion financing for Prairie State.

The next financing which will be project financings with AMP members subscribing for a portion of the project's output includes the Phase 2 of the AMP hydro expansion plan. That project is separately secured with a different mix of participants. AMP also plans to finance a 600MW natural

gas fired combined cycle generation facility in the next 24 months.

KEY FACTORS:

Prairie State Project: 1582 MW coal-fired generating facility with related equipment and coal mine

AMP's Ownership Interest in Prairie State: 23.26%

Completion date for Prairie State Unit 1: December 6, 2011

Unit 2: August 1, 2012

Outstanding AMP Prairie State Revenue Bonds: \$1. 697 billion

Issuer Contact: Robert Trippe, AMP CFO 614-540-0990

The principal methodology used in rating American Municipal Power, Inc., Ohio was U.S. Municipal Joint Power Agencies rating methodology published in September 2006. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found on Moody's website.

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