

Rating Update: [Delaware Municipal Electric Corporation](#)

MOODY'S AFFIRMS DELAWARE MUNICIPAL ELECTRIC CORPORATION'S A2 DEBT RATING; OUTLOOK IS STABLE

DELAWARE MUNICIPAL ELECTRIC CORPORATION HAS A TOTAL OF \$31 MILLION OF RATED DEBT OUTSTANDING

Electric Utilities
DE

Opinion

NEW YORK, May 10, 2006 -- Moody's Investors Service has affirmed the A2 underlying rating on the Delaware Municipal Electric Corporation's ("DEMEC") \$31 million of outstanding debt. The outlook is stable.

LEGAL SECURITY: Net revenues for DEMEC, derived from "take-or-pay" contractual obligations with seven municipal members.

INTEREST RATE DERIVATIVES: None

STRENGTHS

*The Series 2001 bonds are secured by "take-or-pay" power supply contracts matching bond maturity. The contracts obligate seven DEMEC members to pay rates sufficient to cover debt service and operating contingencies;

*Members have exclusive control over their respective service areas;

*Members are unregulated on the federal and state level and have the ability to pass through monthly fuel cost increases to customers;

CHALLENGES

*DEMEC may double its base load over next 12 months, creating a long-term challenge to identify economic power supplies. Possible solutions include participation in construction of a new generating asset;

*The power supply contracts between DEMEC and the seven members participating in the Smyrna project include a 25% step agreement. The step-up is insufficient to cover a total default by the City of Newark (G.O. rated Aa3), which contracts for 47% of the output. This risk is offset by the stability and essentiality of Newark's electric utility.

RECENT DEVELOPMENTS: LOAD GROWTH EXPECTED TO DOUBLE

DEMEC, a joint power agency ("JPA") in Delaware that provides electricity and other services to nine local municipally owned utilities, may double its load serving requirement within the next 12 months if the City of Dover (electric revenue bonds rated A1) and the Town of Lewes elect to become full requirements members. The addition of these members to the full requirements project group would increase DEMEC's total load served to 380 megawatts ("MW") from 215 MW in 2005. Dover would represent the vast majority of the increase at 170 MW and would become DEMEC's largest full requirements member, followed by City of Newark, with 90 MW.

The seven other DEMEC members, including the cities of Newark, New Castle, and Seaford (G.O. rated Baa1), and the towns of Clayton, Middleton, Milford, and Smyrna, will continue as full requirements members. These seven municipal utilities participate in DEMEC's only generating asset, a natural gas-fired 45 MW turbine generator located in Smyrna, DE, which began operations in 2002. DEMEC financed construction of the generator with the Series 2001 bonds, which carry an A2 rating based on the fundamental credit characteristics of DEMEC and the combined credit quality of the seven members whose "take-or-pay" contracts with DEMEC secure the bonds. The payments under each contract are operating and maintenance

("O&M") expenses of each member.

DEMEC negotiates and manages short- and medium-term power supply contracts and buys energy on the spot market on behalf of its members. Volatile markets for electricity driven by rising natural gas prices, which have increased more than 200% since October 2003, and transmission constraints in the Delmarva Peninsula, where DEMEC members are located, have driven up the cost of power. Price per MW increased 35% between 2005 and 2003, to \$74.69 from \$55.22. Wholesale prices to members increased 51% between 2005 and 2004. DEMEC has maintained stable financial operations in an environment of rising fuel costs by charging higher wholesale prices to the member utilities, which automatically pass through the rising fuel costs to their retail customers.

Managing the full requirements load service to members will remain a challenge. DEMEC has entered into a one-year fixed-price power supply contract beginning on June 1, 2006 to provide 90% of DEMEC's total load, and will enter into additional power supply contracts to serve new members when they join. Longer term, DEMEC is exploring options to invest in new generating assets that would cover 100% of DEMEC's base load, which is projected to increase by about 5% annually over the next five years exclusive of the new members. The timeframe during which a new asset using coal, nuclear, or coal gasification would be available is about four to ten years. DEMEC's generator in Smyrna was built as a peaking plant, but the rising prices of the two fuels the generator uses, natural gas and coal, have made running the plant less economical during the last year.

DEMEC maintains limited liquidity (net working capital averaged 3.25% of operations and maintenance ("O&M") over the last five years) but can receive cash within three days from members for unforeseen contingencies pursuant to the power supply contracts. DEMEC's operating ratio, a measure of O&M expenses compared to operating revenues, has averaged 96.8% over the past five years. DEMEC's debt service coverage levels were 1.76 times in fiscal 2004 and 2.28 times in fiscal 2005, compared to a covenant of 1.1 times.

DEMEC's members have exclusive control over their service territories and establish their own rates and charges. The 1999 legislation that authorized retail competition in Delaware exempted municipal electric utilities from competition. The "take-or-pay" contracts between DEMEC and the seven members participating in the Smyrna generator are authorized under Delaware statutes (Chapter 496, Volume 61 in Section 1306) and under the DEMEC's Articles of Incorporation. The contracts provide that if a participant defaults in its payment obligation, the remaining participants must pay their respective pro rata share of the defaulted amount, provided that a participant's liability not exceed 125% of its initially contracted pro rata share. A default by Newark, which has a 47% share in the Smyrna project, could not be covered by the remaining six members. This risk is offset by the stability and essentiality of Newark's electric utility.

Outlook

The stable outlook is based upon our expectation that DEMEC will continue to manage prudently its load requirements while pursuing a long-term strategy to ensure a reliable power supply for its members.

What could change the rating -- UP

A demonstrated long-term energy supply strategy that lowers wholesale costs and provides reliable and competitively priced energy to members, coupled with an increase in liquidity.

What could change the rating -- DOWN

Continued load growth and price pressure absent an effective strategy to hedge costs, putting pressure on members to seek alternate power supplies.

KEY INDICATORS

Debt Ratio, FY 2005 (Unaudited): 87.3% (Moody's JPA Median: 131.5%)

Operating Ratio, FY 2005 (Unaudited) (5 YR AVG): 97.3% (96.8%)

Debt Service Coverage, FY 2005 (Unaudited): 2.28

Average Wholesale Rate/Kilowatt Hour, 2005 (2004): \$0.075 (\$0.050)

RATED DEBT

Electric Revenue Bonds Series 2001, \$31 million

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