

Rating Action: Moody's upgrades to A1 Delaware Municipal Electric Corporation's Beasley project outstanding revenue bonds; outlook stable

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New York, February 14, 2020 -- Moody's Investors Service has upgraded Delaware Municipal Electric Corporation's (DEMEC) Beasley Peaking Power Station (Beasley) \$46.6 million outstanding Electric Revenue Bonds, Series 2011 to A1 from A2. The outlook is stable.

RATINGS RATIONALE

The upgrade to A1 from A2 primarily reflects Beasley's demonstrated strong financial performance owing to the incremental revenues and cash flow it receives from the PJM capacity auction which supplements the stable cash flow received from its members. Over the last three years, Beasley's fixed obligation charge coverage (FOCC) ratio averaged above 4.0x and liquidity restricted to the project has been preserved at comfortable levels, with cash and cash equivalents above \$6 million, which is equivalent to approximately 1,200 Days Cash on Hand. DEMEC clears almost the entire generating capacity of the project in past PJM capacity auctions, providing it with contract visibility through May 2021. These incremental payments, which represent about 43% of Beasley's total revenues in recent years, comfortably exceed the costs to operate the plant and to pay debt service on the bonds.

Notwithstanding the potential for future changes in the PJM capacity auction, the rating upgrade anticipates that above average credit metrics will continue prospectively for the project given Beasley's location in the Delmarva Peninsula, a transmission constrained region. The A1 rating is also supported by the A2 weighted average credit quality of the seven municipal electric systems whose 2001 and 2011 take-or-pay power sales contracts with DEMEC secure the outstanding Beasley project bonds. Sound legal structure, including take-or-pay power sales contracts extending through bond maturity and a 125% step-up provision, also supports the rating. The A1 rating is somewhat tempered by the high participant concentration in the project, with Newark (City of) DE (Aa2, no outlook) representing 42.1% of the Beasley Project, followed by Milford (City of) DE (unrated) and Middletown (Town of) DE (A1, no outlook), that owns 20.3% and 11%, respectively, through July 2026. Despite the 125% step-up provision, the mechanism is still insufficient to cover a possible default by the largest participant, a remote risk that is mitigated by city of Newark's strong credit quality.

OUTLOOK

The stable outlook is based on Moody's expectations that Beasley will continue to be an essential component of DEMEC's power supply strategy within Delmarva and PJM transmission constrained regions. The outlook also incorporates our anticipation for continued healthy operational and financial performance of both DEMEC and Beasley, in addition to their collective municipal utility participants.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Improved weighted average credit quality of Beasley participants
- Continued ability for Beasley to provide reliable and competitively priced peak energy to its seven members
- Sustained increase in Beasley's PJM capacity payments that improve both annual debt service coverage ratio and days cash on hand at above 4.0x and 1,200 days, respectively, on a sustained basis

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Deterioration in Beasley participants' weighted average credit quality
- Inability of Beasley to provide members with reliable and competitively priced peak energy, putting pressure on members to seek alternate peak power supplies
- Material reduction in Beasley's PJM capacity payments that impact both annual debt service coverage levels to below 1.5x and liquidity position at the project level to less than 200 days cash on hand on a sustained basis
- Material and extended operational problems with either or both of the Beasley peaking units

PROFILE

Delaware Municipal Electric Corporation (DEMEC) is a public corporation constituted as a joint action agency and a wholesale electric utility. DEMEC represents and provides power supply and related services to nine municipal electric distribution utilities located in Delaware. DEMEC was incorporated in July 1979 and its members comprise all the major towns in Delaware except Wilmington. The nine DEMEC member utilities combined serve about 70,300 end-use meters and a population of about 137,200.

Seven of DEMEC's nine members, including the cities of Newark, Milford, Seaford, the towns of Clayton, Middletown, Smyrna, and the Municipal Services Commission of the City of New Castle are the participants in the Beasley take-or-pay project to finance DEMEC's 2 Beasley Peaking Power Station generating assets, Beasley CT Units I & II, located in Smyrna, Delaware. Participant members are obligated to establish, maintain, and collect rates, fees, and charges from its customers in order to provide sufficient revenues to make payments for Beasley Project's fixed and variable costs. The take-or-pay participants have a weighted average participant credit quality of A2 and the contracts are authorized under Delaware statutes.

LEGAL SECURITY

The Electric Revenue Bonds Series 2011 are secured by a pledge of the net revenues from both the 2001 and 2011 take-or-pay power sales contracts with the seven participants. The security package also includes a pledge of the administrative charges from DEMEC's full requirements' contracts. The power sales agreements terminates on the later of (i) the Bonds Series 2011 matures in 2041 or (ii) the date DEMEC disposes any of the facilities.

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. Per the Beasley Project's indenture, participants are required to comply with a rate covenant of 1.10 times the participant's portion of the project's annual debt service costs. Members are also required to pay all O&M costs associated with the project.

The bonds also require a debt service reserve fully funded at the minimum of [i] maximum annual debt service, [ii] 1.25x average annual debt service, or [iii] 10% of the original principal amount of the bonds.

METHODOLOGY

The principal methodology used in this rating was US Municipal Joint Action Agencies Methodology published in August 2019. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

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