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Kansas Power Pool

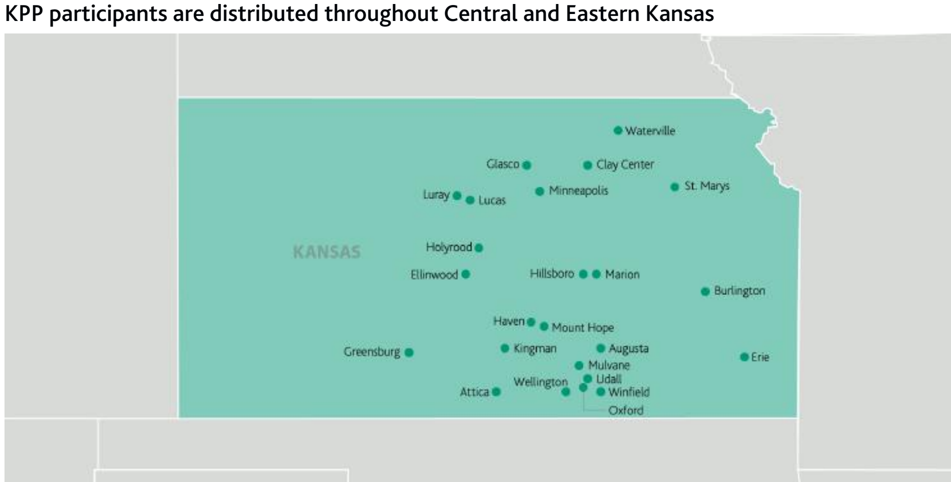
Update to credit analysis

Summary

Kansas Power Pool's (KPP; A3 stable) credit profile primarily reflects the A3 weighted average credit quality of its participants and the long-dated nature of the all-requirements, take-and-pay contracts. KPP serves 24 relatively small and rural cities that own and operate retail electric utility systems. In 2017, KPP members signed 20-year extensions to the power purchase contracts. The contracts are not subject to cancellation or termination prior to the end of the contract term or final maturity on the bonds, whichever is later.

The credit is additionally supported by KPP's trend of improving liquidity, reaching 152 days cash on hand in fiscal 2018 and significantly ahead of the original 2012 goal of 90 days by fiscal 2020. By policy, cash flow in excess of 1.30x coverage of debt service is diverted to a rate stabilization fund, and coverage is averaging over 1.7x. KPP's fuel mix is balanced and capacity consists of ownership in a large combined cycle unit and use of many of its members' small generating units. KPP's coal exposure will be materially reduced when the agency replaces its imminently terminating contracted coal capacity with gas-fired reciprocating engines. Lastly, while KPP's rates historically were under the jurisdiction of the Kansas Corporation Commission, recent legislation and a member election in 2018 allowed KPP to achieve unregulated rate setting authority.

Exhibit 1
KPP participants are distributed throughout Central and Eastern Kansas



Source: Kansas Power Pool

Credit strengths

» Weighted average credit quality of A3 of 24 member participants

» Participant power purchase contracts extend past the final maturity of the bonds

» Inability of participants to terminate the power contracts while KPP debt is outstanding

» Demonstrated ability by management to improve liquidity and financial metrics

» KPP maintains 10 year financial and operating projections, a requirement for SPP transmission owners

Credit challenges

» All of KPP's members are unrated by Moody's

» KPP serves smaller communities with below average socioeconomic indicators and susceptibility to economic pressures

Rating outlook

The stable outlook reflects our expectation that KPP will maintain DSCRs well-above KPP's internal target of 1.3x on a net revenue basis and liquidity around 150 days cash on hand over the next 12 - 18 months.

Factors that could lead to an upgrade

» The rating could face upward pressure after several years if the average credit quality of the all-requirements participants improves to at least A2

» The rating could also face upward pressure if projected coverage from net revenues averages above 1.4x and liquidity above 160 days cash on hand inclusive of new money issuance plans

Factors that could lead to a downgrade

» A material drop in liquidity from current levels to below 60 days cash on hand

» Revenue growth fails to materialize or operating expenses arise such that financial metrics decline below 1.2 times on a sustained basis

» A decline in the weighted average credit quality of participant members below A3 could result in downward rating pressure

Key indicators

Exhibit 2

Kansas Power Pool

	2014	2015	2016	2017	2018
Total Sales (mWh)	892,985	857,940	868,826	872,057	899,544
Debt Outstanding ($'000)	38,805	52,000	48,670	47,485	44,955
Debt Ratio (%)	83.2	90.3	78.0	74.3	66.7
Days Cash on Hand	67	67	67	67	67
Adjusted Days Liquidity on Hand (incl. Bank Lines)(days)	92	147	165	173	192
Fixed Obligation Charge Coverage (if applicable)(x)	1.72	1.19	1.78	1.60	1.85

Source: KPP Audited Financial Statements, Moody's Investors Service

Profile

KPP is a municipal energy agency created under the laws of the State of Kansas. The KPP was created by an areement executed by the original members in October and November of 2004. KPP provides electric power services under its operating agreement and a power purchase contract for wholesale electric energy, both of which are adopted by each member city.

KPP's 2018 membership includes 23 cities that are considered long-term members in that each has signed an exclusive 20-year power purchase contract with KPP, the term of which is the later of 20 years from the first supplemental power purchase contract date or the date upon which the principal, premium and interest on all bonds are paid in full and the bonds are retired. An additional member city has signed a 20-year power purchase contract with KPP; the term is from the first supplemental power purchase contract date.

Detailed credit considerations

Revenue generating base: A3 weighted average participant credit quality

KPP's 24 city and utility participants are billed under their all-requirements “take-and-pay” power purchase contracts which is designed to cover their proportionate shares of KPP's operating, capital and debt service costs, including KPPs share in other projects such as the Dogwood combined cycle generating facility in Pleasant Hill, MO and environmental upgrades made to its members' small Reciprocating Internal Combustion Engine (RICE) units. The overall weighted average credit quality of the 24 participants is internally estimated at an A3 and is expected to remain relatively stable at this level for several years.

The power purchase contracts are long-dated. All but one member are bound with a term for the later of twenty years from the First Supplemental Power Purchase Contract date or the date upon which KPP bonds are paid in full. The remaining member is still bound to the terms of the 2012 contract that will terminate in 2032.

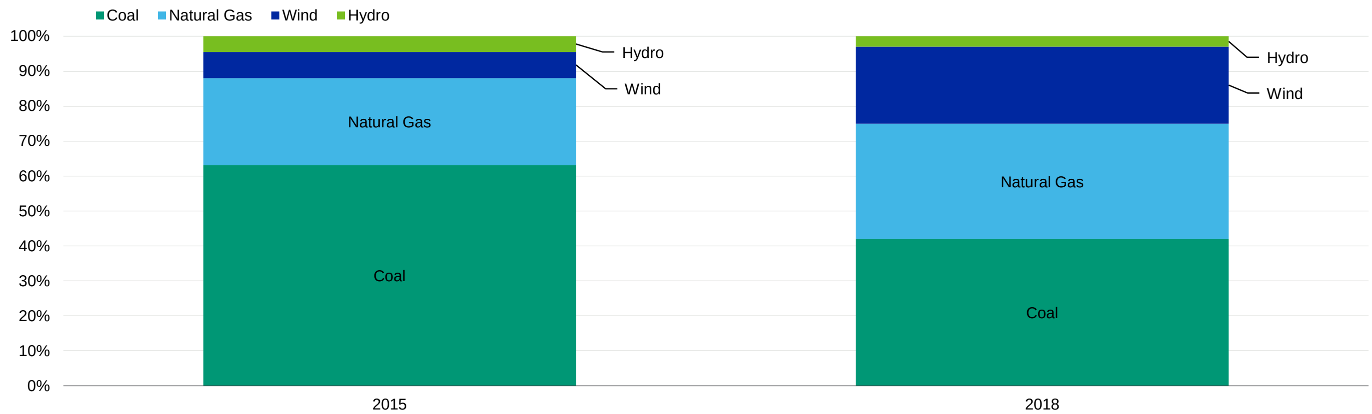
KPP's service territory is spread throughout the eastern two-thirds of the state. There are six members that each represent more than 5% of KPP peak demand: Winfield (29.7%), Wellington (14.1%), Augusta (10.8%), Clay Center (6.0%), and Mulvane (6.0%). Combined, they represent about two-thirds of demand. All but Clay Center are located In the Wichita metro area.

According to Moody's Analytics, the Wichita economy has relatively low employment diversity and above-average volatility. Defense and manufacturing are primary economic drivers. About one-fifth of manufacturing jobs are in fabricated metal and industrial machinery which may suffer from weaker overseas demand. Another one-fifth of factory workers are employed at Spirit AeroSystems and mostly work on the fuselages of Boeing 737 aircraft. The 737 MAX grounding has not affected Boeing's plans to ramp up production, but prolonged legal investigations could also be a downside risk. Overall, the Wichita economy is expected to maintain a slight lead over the state and Midwest this year.

KPP has a diverse capacity resource mix with ownership shares in multiple generation assets, including 95 MWs procured through long-term contracts; undivided ownership interests in the Dogwood facility as well as energy received through the SPP integrated market. Additionally, five members have a power purchase agreement with the Western Area Power Administration for hydro capacity that is not allowed to be pooled. KPP's power supply also includes 154.9 MWs of member owned capacity. When a member joins KPP and signs the operating agreement, it agrees to pool its generation resources to serve the entire membership. The only exceptions are members that have power purchase agreements with the Western Area Power Administration which does not allow its energy contracts to be pooled.

While still somewhat concentrated in coal, the fuel diversity has improved in recent years. Coal previously represented over half of generation, but the share dropped to 42% in fiscal 2018.

Exhibit 3
KPP has a balanced fuel mix
Coal dependency will drop significantly after the Jeffrey Energy Center contract expires in 2023



Source: Kansas Power Pool

KPP's contract with Westar Energy for 59 MW of baseload power from the Jeffrey Energy Center (JEC) will expire in 2023. Management plans to replace the lost capacity with KPP-owned generation. KPP will finance and build a new facility with gas-fired reciprocating engines that can ramp up and ramp down on very short notice. Currently, JEC has to run overnight which, due to rising wind capacity in the SPP market, results in a loss. The fast-start units, by contrast, would run when there is a premium on the intra-hour market. Preliminary KPP forecasts indicate a cost savings, inclusive of new debt and personnel, from the capacity change. The shift away from coal and shedding of related fixed payments will benefit KPP's credit profile.

Financial operations and position: Coverage and liquidity continue to improve

We expect KPP will maintain debt service coverage ratios well-above the Board's target of 1.30x. Fiscal 2018 ended with a net revenue debt service coverage ratio (DSCR) of 1.85x. We expect fiscal 2019 will end with coverage over 2.0x. Preliminary forecasts indicate that KPP will be able to maintain DSCRs at these levels over the next five years as it issues new debt for capacity requirements.

Rates are established annually and are finalized by a vote of the Membership Committee. KPP also imposes a monthly Energy Cost Adjustment charge to recover differences between actual and budgeted revenues. Financial policies and annual budgets are approved by the Board of Directors, which consists of nine members elected by the KPP Membership Committee. Each member city receiving wholesale electric service from KPP is represented by a voting delegate on the Membership Committee.

Historically, wholesale rates, including those of municipal energy agencies like KPP, were under the jurisdiction of the Kansas Corporate Commission (KCC). However, recent legislation clarified KCC jurisdiction and allowed KPP to become exempt from rate regulation provided that they have an election where members can vote on deregulation, which took place in 2018.

LIQUIDITY

KPP's liquidity profile has substantially improved after the Board implemented more favorable financial policies. KPP targets annual DSCR of at least 1.30x and diverts the excess cash flow to the rate stabilization fund. KPP transferred $2.4 million to the fund in fiscal 2018, which had a balance of $3.6 million by year end. Unrestricted liquidity and discretionary reserves totaled $23 million in fiscal 2018, or 152 days cash on hand.

KPP also has a $6 million bank line that provides supplemental liquidity. The bilateral credit line is with the Bank of the West (A2 stable). We do not include the credit facility in KPP's adjusted days cash on hand metric because of its short tenor. The bank line expires in March 2020. If we include the bank line, KPP's adjusted days cash on hand as of fiscal 2018 would be 192.

Debt and other liabilities: New debt plans potentially up to $97 million

KPP had $45 million of debt outstanding as of fiscal 2018 and a debt ratio of 66.7%. The debt was issued for the purpose of installing environmental upgrades for member owned RICE generating units, securing low cost generating capacity provided by KPP members, and generation ownership in the Dogwood generating facility.

KPP will issue debt to finance two projects over the next five years. The first will be about $5 million for a transmission project. The timing is uncertain due to ongoing litigation related to the project plans. For the new generation project, management estimates an additional issuance of up to $92 million.

DEBT STRUCTURE
All of KPP's debt consists of long-term, fixed rate bonds. Debt service is projected to be approximately $4.6 million through 2023 and then steps down to $4.1 million through maturity of the 2015 bonds in 2031.

DEBT-RELATED DERIVATIVES
None.

PENSIONS AND OPEB
KPP's full-time employees participate in Kansas Public Employee Retirement System Plan (KPERS), a cost-sharing multi-employer defined benefit pension plan. KPP's adjusted net pension liability (ANPL), under our methodology for adjusting reported pension information, totaled a modest $2 million in fiscal 2018. The reported unadjusted net pension liability was $711,822 in fiscal 2018. The adjusted debt ratio, including the ANPL as debt, was 70.1%.

Management and governance
KPP's management operates conservatively by financing with only traditional fixed rate, amortizing debt. KPP's management has several policies to ensure good liquidity and stable financial metrics. Also, the Southwest Power Pool has a 10-year budgeting process for its members, including KPP, which helps set annual budgets.

KPP is governed by a nine-member board elected by the membership as a whole, serving staggered terms.

Rating methodology and scorecard factors
The grid is a reference tool that can be used to approximate credit profiles in the public power electric utility sector in most cases. However, the grid is a summary that does not include every rating consideration. Please see Methodology on US Municipal Joint Action Agencies for more information about the limitations inherent to grids.

The assigned rating of A3 is below the grid indicated outcome of A2. The differential considers KPP's capital plan which has a significant new money debt component.

Exhibit 4

Kansas Power Pool Scorecard

Factor	Subfactor/Description	Score	Metric
1. Participant Credit Quality and Cost Recovery Framework	a) Weighted Average participant credit quality. Unregulated rate setting including participants. Cost recovery structure and governance.	A3	
2. Resource Risk Management	a) Resource Diversity. Asset quality and complexity. Resource supply contract terms and counterparty credit quality. Wholesale market purchase exposure	A	
3. Competitiveness	a) Cost competitiveness relative to regional peers	Baa	
4. Financial Strength and Liquidity	a) Adjusted days liquidity on hand (3-year avg) (days)	Aa	177
	b) Debt ratio (3-year avg) (%)	A	73.0
	c) Fixed obligation charge coverage ratio (3-year avg) (x)	Aa	1.74
5. Willingness to Recover Costs with Sound Financial Metrics	a) Rate Setting Record. Timeliness of rate recovery. Stability and strength of financial metrics	A	
Scorecard Indicated Outcome Before Notching:		**A2**	
Notching Conventions		**Notch**	
	1 - Contractual Structure and Legal Environment	0	
	2- Participant Diversity and Concentration	0	
	3 - Construction Risk	0	
	4 - Debt Service Reserve, Debt Structure and Financial Engineering	0	
	5 - Unmitigated Exposure to Wholesale Power Markets	0	
Scorecard Indicated Outcome:		**A2**	

Source: Moody's Investors Service

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