# FITCH AFFIRMS KANSAS POWER POOL'S REVENUE BONDS AT 'A-'; OUTLOOK STABLE

Fitch Ratings-Austin-14 October 2019: Fitch Ratings has affirmed the rating on the following bonds issued by the Kansas Power Pool (KPP or agency).

--Issuer Default Rating (IDR) at 'A-';
--$13.005 million electric utility revenue bonds series A, 2015 at 'A-'.

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The affirmation of KPP's 'A-' rating reflects the utility's strong financial profile and low net leverage, which have been bolstered by strong operating cash flow and amortizing debt, in the context of its strong revenue defensibility and low operating risk. KPP's revenue defensibility is supported by long-term purchased power contracts (PPCs) with its 24 full-requirements members, but also factors purchaser credit quality (PCQ) that is midrange. The KPP members generally exhibit weaker service territory metrics, including income levels that trail national levels. Members maintain autonomous rate-setting ability, which Fitch views favorably.

Fitch's rating also considers the impact of KPP's planned construction of a 55 MW natural gas-fired facility in 2023, which would replace capacity from expiring PPCs. Planned debt issuance of $92.3 million to finance the project will increase KPP's net leverage, but Fitch expects net leverage levels will remain supportive of KPP's rating.

CREDIT PROFILE

KPP is a municipal energy agency created under the laws of the State of Kansas in May 2005 to provide its members with a pooling of resources and collective resource planning for current asset operations and future resources to meet system growth. KPP has evolved over time to a membership base of 33 members, ranging in size from 151 meters to 7,651 meters. Of the 33 members, 24 cities have signed 20-year all-requirement PPCs with KPP. Wholesale rates are set by KPP at a level sufficient to generate a minimum target debt service coverage ratio of 1.3x.

KPP initially relied exclusively on market-based energy contracts and member-owned generation under contract to meet the energy requirements of its membership. However, since 2012, KPP has added a 10.3% undivided ownership interest in Dogwood, a natural gas plant located in Pleasant Hill, Missouri, in addition to purchased power agreements for baseload and wind generation.

KPP's membership remains largely unchanged since 2012, when 12 of its members elected not to sign long-term PPCs, which KPP requested in order to secure financing for the acquisition of the additional stake in the Dogwood facility. KPP has since added three full-requirements members, the City of Mulvane and the City of Waterville, in 2013, and the City of Glasco, in 2017. KPP continues to explore opportunities to add to its membership.

KEY RATING DRIVERS

Revenue Defensibility: 'a'; STONG LONG-TERM FULL-REQUIREMENTS CONTRACTS

Fitch assesses KPP's revenue defensibility as strong based on KPP's unconditional full-requirements contracts with its 24 members and the credit quality of the largest members. KPP's largest members exhibit aggregate credit quality of midrange. Certain member service territory metrics, including income levels, remain below national levels and rate affordability could become a challenge if member rates increased substantially.

Operating Risk: 'a'; LOW COST DIVERSIFIED POWER SUPPLY

KPP's operating risk assessment of strong reflects the utility's consistently low cost operating cost burden, which averaged 6.4 cents per KWh over the last five years. Fitch believes KPP's diversified portfolio of both owned generating assets and PPCs continues to support rate competitiveness and stability.

Financial Profile: 'a'; STRONG FINANCIAL PROFILE

KPP's financial profile assessment of strong reflects the utility's continued growth of its liquidity, which has increased to approximately 153 days cash on hand in fiscal 2018, and the resulting reduction in net leverage. While net leverage is expected to increase following KPP's planned debt financed construction of a 55 MW natural gas-fired facility in fiscal 2023, Fitch expects KPP's financial metrics will remain supportive of its strong financial profile assessment.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations were applied in this rating determination.

RATING SENSITIVITIES

CHANGES IN MEMBER CREDIT QUALITY: The credit quality exhibited by Kansas Power Pool's members going forward will be a key factor in future KPP rating actions, including the degree to which the full-requirements members are willing and able to increase rates to support KPP's debt and financial targets.

CHANGES IN POWER SUPPLY RESOURCES: Future power supply decisions, including the procurement of new generating resources, which result financial metrics that are weaker than anticipated or increase operating risk over the near term, could put pressure on the rating. Conversely, the ability to replace expired PPCs, while maintaining KPP's low net leverage and low operating risk, could result in a rating upgrade.

SECURITY

The bonds are secured by power supply system net revenues, including payments received by KPP pursuant to the PPCs with its full requirements members.

Revenue Defensibility

DE FACTO UNLIMITED CONTRACT STEP-UP PROVISION

Fitch assesses KPP's revenue source characteristics as very strong based on KPP's long-term unconditional take-and-pay PPCs with its 24 full-requirements members. The PPCs provide a de facto unlimited step-up among KPP's 24 full requirements members, whereby if one member defaults, other members are required to incur the reallocated costs, including debt service.

Pursuant to the PPCs, KPP's must set rates sufficient to meet its 1.1x rate covenant requirement. Similarly, each of the members is required to set rates sufficient to meet their obligations pursuant to the PPCs.

STRONG RATE SETTING ABILITY

KPP's rate flexibility is assessed as strong based on the limitations in its rate-setting ability, which technically falls under the jurisdiction of the Kansas Corporation Commission (KCC). Fitch notes however that KPP's rates have never been subject to the review of the KCC or any federal regulatory authority, and KPP has never been required to appear before the KCC in a rate case. The KPP wholesale rate is typically approved by KPP's membership committee, which is composed of a delegate from each of the 24 full requirements members.

Rates are established annually and include a monthly energy cost adjustment factor to recover all costs not covered in rates. KPP wholesale member rates were approximately $66.20/MWh in fiscal 2018.

MIDRANGE PURCHASER CREDIT QUALITY

Fitch assesses KPP's PCQ as midrange based on the credit quality of its largest members and a calculated purchaser credit index (PCI) of 2.7. The PCI is based on Fitch's evaluation of KPP's two largest members, the City of Winfield and the City of Wellington, which together, account for 46% of KPP's 2018 energy sales.

The City of Winfield and the City of Wellington exhibit weak to midrange service territory metrics as evidenced by median household income and unemployment levels that lag national averages. Both cities serve smaller populations of less than 15,000 and the economies focus on the manufacturing and retail sectors. Fitch notes that customer concentration exists at both utilities with the top ten customers representing nearly 40% of each utility's revenues, which presents additional revenue stability risk.

All KPP members maintain autonomous rate setting ability and are not subject to KCC oversight, which Fitch views favorably. Electric rates at the City of Wellington remain materially higher than state average rate, which limits the city's rate flexibility. The City of Winfield rates remain at levels commensurate with the state of Kansas. The residential rates of next five largest purchasers are also competitive with the state average.

The City of Winfield exhibits weak liquidity. Cash levels have declined in recent years primarily due to transfers that have averaged approximately 11% of the electric utility operating revenues during the past four years. Favorably, the City of Winfield electric utility has not issued any debt. The City of Wellington exhibits strong cash flow, low leverage, and healthy cash balances. In aggregate, the utilities are supportive a midrange PCQ assessment.

Operating Risk

DIVERSIFIED LOW COST POWER SUPPLY

Fitch assesses KPP's operating cost burden as low. Power supply costs have averaged 6.4 cents/KWh during the past five years, maintaining a fairly narrow range of 6.1 cents/KWh to 6.8 cents/KWh.

KPP maintains a diversified power supply of owned generation assets and purchased power resources. KPP's 2018 capacity sources include natural gas (65%), coal (18%), wind (11%), and other (6%). KPP's 10.3% ownership share (62MW) in the Dogwood natural gas-fired facility and its PPC with Westar Energy (59MW) remain important sources of baseload power. The Dogwood facility continues to benefit from low natural gas prices and its quick-start capabilities have allowed it to operate effectively in the SPP market where wind generation can fluctuate throughout the day. Additionally, recent coal and steam facility closures have increased its importance in the SPP market.

Management has added renewable energy resources in recent years to its power supply portfolio including a 20-year PPC with Marshall County Wind Farm for 25 MW of wind energy in May 2016. KPP's board also approved an engineering contract with ZEMAC in August 2018 to add six 25KW solar arrays located in six different KPP cities. Renewable energy resources represented approximately 13% of KPP's total energy capacity in fiscal 2018. Fitch views KPP's recent additions to its power supply favorably, as it further diversified its owned generating resources and provided more certain access to capacity. KPP also has the ability to supplement its power supply with economic market purchases through its agreement with Tenaska Power Services.

With the Westar Energy contract expiring in 2023 and its 15 MW contract with Grand River Dam Authority (GRDA) expiring in 2026, KPP management is currently reviewing its power supply resource plan. KPP's financial forecast considers the impact of adding a 55MW natural gas-fired generating facility to replace the expiring contracts. KPP also plans to incrementally add renewable resources to its power supply.

KPP provides transmission services for all of its members through the SPP. KPP has firm transmission and congestion rights for all paths necessary to serve its member city loads. KPP has also made the necessary arrangements with SPP to secure a firm transmission path for the additional Dogwood capacity.

Fitch assesses the capital planning and management as very strong based on an average age of plant of approximately four years. Following KPP's acquisition of an additional 3.3% stake in the Dogwood facility in 2015, capex has tempered in recent years. Construction of a new natural-gas fired plant, which management expects to cost approximately $92.3 million, is considered in KPP's financial forecast. KPP's capital plan also includes the construction of a substation, estimated at approximately $5.0 million, so one of KPP's members can connect directly to SPP. Fitch does not believe that the capital improvements present any material concerns that would affect KPP's strong operating risk assessment.

Financial Profile

CONTINUED STRONG FINANCIAL PERFORMANCE

KPP's net leverage has continued its steady decline in recent years due to debt amortization and increasing cash levels. Net adjusted debt to adjusted funds available for debt service has declined to 5.9x at fiscal year end 2018 from 8.4x at fiscal year end 2015. KPP issued the series A, 2015 revenue bonds to finance the acquisition of its additional stake in the Dogwood facility.

KPP continues to build liquidity in order to mitigate the risks associated with its reliance on purchased power and the Dogwood facility. Liquidity has accumulated by historically setting rates at 1.3x, above the 1.1x debt service coverage (DSC) requirement in the Resolution. KPP's unrestricted cash reserve balance at Dec. 31, 2018 was $23.2 million or 153 days cash on hand.

FITCH ANALYTICAL STRESS TEST (FAST) - BASE AND RATING CASE

Fitch used management's forecasted revenues and expenses to establish a base case in the Fitch Analytical Stress Test (FAST) scenario analysis. Under the base case, KPP forecasts rates to decline incrementally over the near term due to declining power costs. A substantial decline in rates is expected in 2023 following the expiration of the Westar Energy contract (59MW), which KPP does not expect to renew. KPP intends to replace the expiring Westar Energy contract with a newly constructed 55 MW natural gas-fired facility. Planned debt issuance of approximately $92.3 million to fund the cost of the construction is expected to increase KPP's net leverage to nearly 7.5x. However, Fitch believes management's policy of budgeting to 1.3x DSC will provide operating cash flow to support the additional debt.

Fitch's rating case applies a moderate stress to management's forecasted energy sales using the FAST model demand stress outputs, which are calculated based on KPP's historical demand volatility. Fitch notes that KPP's rates include a monthly energy cost adjustment factor, which ensures full recovery of the utility's costs. As a result, Fitch does not believe a moderate decline in energy sales would materially affect KPP's operating cash flow or net leverage metrics. .

KPP reported total debt of $45 million at Dec. 31, 2018, all of which is fixed rate. KPP also maintains a $6 million line of credit to finance accounts receivable, but the line of credit remains undrawn. Fitch's 2018 net leverage calculation also included a total of $94.4 million of obligations, which includes both capitalized fixed charges for purchased power and pension obligations.

Asymmetric Additional Risk Considerations
No asymmetric additional risk considerations were applied to this rating determination.

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ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Public Sector, Revenue-Supported Entities Rating Criteria (pub. 28 May 2019)
https://www.fitchratings.com/site/re/10064680
U.S. Public Power Rating Criteria (pub. 03 Apr 2019)
https://www.fitchratings.com/site/re/10066654