S&P Global
Ratings

RatingsDirect®

Summary:

Alabama Municipal Electric Authority; Wholesale Electric

Primary Credit Analyst:
Jeffrey M Panger, New York (1) 212-438-2076; jeff.panger@spglobal.com

Secondary Contact:
Andrew Bredeson, Centennial 303-721-4825; andrew.bredeson@spglobal.com

Table Of Contents

Summary:

Alabama Municipal Electric Authority; Wholesale Electric

Credit Profile		
Alabama Mun Elec Auth wholesale elec		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings has affirmed its 'A' rating on Alabama Municipal Electric Authority's (AMEA) power supply system revenue bonds. The outlook is stable.

These factors support our assessment:

- Full-requirements power sales contracts with 11 distribution utilities in Alabama that extend through 2035 and require monthly payments sufficient to cover the cost of electricity, system operating expense and debt service;
- A partial-requirements power supply contract with Alabama Power Co. (APCo) that extends through 2025 and allows the AMEA to charge very competitive wholesale rates;
- Flexibility in both power sales and power supply contracts to tailor power supply to match load requirements and adjust wholesale rates monthly to recover power supply costs;
- Solid and stable liquidity; and
- Low leverage and limited capital needs

We believe the following factors limit the potential for a higher rating:

- Net available revenue has historically been only sufficient to cover fix costs, which include debt service and capacity payments to APCo. We use this measure to better compare the financial risk profiles of electric utilities that purchase a substantial amount of their power with those that have issued debt to build power plants.
- Member credit profiles are adequate to support the rating. Members have service areas with below-average income levels and above average unemployment rates (constraining rate-raising flexibility) and generally adequate fixed cost coverage levels and generally solid liquidity; and
- A weak rate covenant, which includes available reserves in the calculation of rate sufficiency.

AMEA is a joint action agency in Montgomery, Ala., that provides electricity to 11 electric distribution utilities throughout Alabama. Six of the members account for 90% of AMEA sales. They include the Utilities Board of the City of Foley (accounting for 33% of the authority's energy sales); the electric utilities of Dothan (30%), Opelika (12%), and Fairhope (5%); the Sylacauga Utilities Board (5%); and the Utilities Board of Tuskegee (5%).

The power sales contracts with members are take-and-pay with an implicit full step up, and extend through 2035, and provide all requirements above the hydroelectric power supplied by the Southeastern Power Administration. The rates must be reviewed annually, but can be adjusted with 90 days' notice. Member billings include an energy cost adjustment charge that is revised monthly (if needed) to reflect actual energy costs. The contracts also include an adjustment to help offset lower demand due to mild weather or a slowing economy, and a further adjustment to assure adequate cash reserves.

Three-quarters of energy requirements are supplied by investor owned Alabama Power Co, under a contract that extends through 2025. Purchases in any given year are based on three year average peak demand, and are slice of system, giving power supply shaft diversity. The remainder of energy is through Southeastern Power Administration allocations, 50 megawatts of unit-contingent capacity and energy, energy from the South Carolina Public Service Authority (through 2023), and AMEA-owned peakers. The authority also has an evergreen contract with Tenaska Power Services Co. for power to replace the Sylacauga or Santee Cooper power when those units are unavailable. Fuel mix is fairly diversified -- 45% coal, 18% nuclear, and 15% gas. Because the bulk of energy is purchased, the AMEA is not directly exposed to carbon (and other) regulations impacting generation; however, they are indirectly exposed via purchases.

We believe the combined credit risk profiles of the authority's members provide support for the rating. The membership base exhibit the following credit characteristics:

- Generally stable customer base, with population growth slightly stronger for utilities near Mobile;
- Fairly stable revenue, with residential customers accounting for about half of the total, and no significant concentration among leading customers;
- Member rates range from slightly below the state average to significantly above;
- Consolidated member coverage of fixed costs ranging from a weak 1.05x (2013) to a solid 1.35x (2015);
- Consolidated member liquidity at 93 days of combined operating expenditures, which we consider adequate; and
- Consolidated member debt at 43% of total capitalization, which we consider moderate.

We view the municipalities' dependence on annual transfers from the utilities to the general fund as a weakness for the utilities' credit profile, although for most municipalities, the transfer is only 5%-8% of revenue.

Our rating reflects the AMEA's financial risk profile. In our opinion, coverage of the authority's fixed costs has been weak, ranging between 1.01x (2013) and 1.21x (2015), but only 1.06x in 2016. Unrestricted cash equaled about 108 days of cash operating expense in 2016, and a $5 million line of credit boosted liquidity to 117 days. In our view, the combination of the solid liquidity and the monthly true-up of purchased power costs are necessary to offset credit risks that might otherwise arise from such thin coverage of fixed costs.

The AMEA has a modest $33 million of debt outstanding, representing 57% of total capitalization. Because the authority only has modest capital needs that we expect it will fund internally, we anticipate debt ratios will continue improving.

Outlook

The stable outlook reflects a dynamic cost recovery mechanism and solid liquidity, which provides stability, despite weak coverage of fixed costs. In addition, we view the diversification of revenue across members, coupled with the implicit unlimited step as providing additional stability. We do not expect to raise or lower the rating over the next two years.

Upside scenario

While we don't expect it, we could raise the rating if the AMEA's fixed-cost coverage improves significantly or if our view of the composite credit profile improves.

Downside scenario

Downward rating pressure could occur if our view of member credit quality weakens, or if the authority's liquidity deteriorates, thereby heightening the risk from coverage of fixed costs.