

CREDIT OPINION

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Send Your Feedback

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Kentucky Municipal Energy Agency

New Issuer Report

Summary

[Kentucky Municipal Energy Agency's](#) (KYMEA: A3 stable) credit profile reflects the long-term, all-requirements, take-and-pay contracts with its nine Generation Project Participants with a weighted average credit quality of A3 and KYMEA's ability and willingness to maintain financial health which is supported by an additional bonds test of 1.2x debt service coverage ratio (DSCR) and a separate bond covenant requiring 1.1x DSCR. KYMEA also benefits from an adequate liquidity position, which as of fiscal year end 2024 (6/30), reached 169 days cash on hand.

The credit profile also considers KYMEA's adequate resource risk management and construction risk associated with a new gas fired generation asset. Presently, KYMEA's largest energy resource is coal, primarily sourced through a power purchase agreement (PPA) with [Big Rivers Electric Corporation](#) (Baa2 stable), which accounts for 51% of KYMEA's resource portfolio that contributes to carbon transition risk. However, KYMEA's resource mix is expected to shift towards natural gas once KYMEA's own 75 MW Energy Center I (ECI) reciprocating internal combustion engines (RICE) plant is completed in 2027. ECI's construction is expected to start in 2025 and we understand KYMEA has entered into subcontracts for a substantial portion of the construction including fixed price arrangements for the cost of equipment. That said, KYMEA will retain some cost risk including labor.

Credit strengths

- » Participants' unregulated local retail rate-setting and governance and KYMEA can adjust rates without external regulation
- » Each of KYMEA's Generation Project participants operates independently from the general government of its respective city, and has control over their electric service territory with no competition
- » The construction of new asset is straight-forward and not complex

Credit challenges

- » FY2025 resource mix is 65% coal
- » Vague termination language included in the ECI PPA
- » Region served by JAA members provides modest service territory growth

Rating outlook

The stable outlook reflects our view that KYMEA will adequately adjust rates in line with its projections to ensure financial metrics remain healthy during the construction of the Energy Center I Project.

Factors that could lead to an upgrade

- » Participants weighted average quality materially improves
- » Consistent demonstration of sustained annual full cost recovery with debt service coverage ratio (DSCR) in excess of 2x
- » Liquidity well above 250 days cash on hand on a sustained basis
- » Completion of the Energy Center I Project on time and within budget

Factors that could lead to a downgrade

- » Participants weighted average credit quality materially deteriorates
- » Significant cost overruns related to the Energy Center I Project that requires a material increase in future borrowings needed to complete the project
- » Significant revenue reduction or increased operating expenses such that DSCR declines below 1.1x
- » Liquidity position materially drops to below 60 days cash on hand on a sustained basis

Key indicators

Exhibit 1

	2020	2021	2022	2023	2024
Operating Revenue (\$'000)	80,074	76,549	109,408	107,330	85,518
Total Sales (mWh)	1,215,116	1,215,733	1,216,411	1,191,059	1,238,841
Total Days Cash on Hand (days)	47	71	75	51	169

KYMEA did not have any long term debt prior to the Series 2025 bonds, thus, no debt related metrics are shown.

Fiscal 2021 revenues increased by 43% due to change in accounting treatment where sales of electricity to non-KYMEA members became recognized as operating revenue.

Source: Moody's Ratings

Profile

Kentucky Municipal Energy Agency's ("KYMEA") is a joint agency organized under the Interlocal Cooperation Act of the Commonwealth of Kentucky, created in 2015. KYMEA was created to allow its members to collaborate effectively to do all things necessary or convenient to serve the current and future electric power and energy requirements of the members and to provide assistance to the members related to their electric power and energy utility systems. KYMEA began supplying power to its members beginning on May 1, 2019. The agency's members currently consist of the following Kentucky municipalities: Barbourville, Bardwell, Benham, Berea, Corbin, Falmouth, Frankfort, Madisonville, Owensboro, Paris, and Providence.

Detailed credit considerations

Revenue Generating Base

KYMEA's resource mix is structured to reduce coal fire exposure in the future

KYMEA's resource portfolio is predominantly coal fire generation which accounted for 65% of KYMEA's resource mix in fiscal 2025. KYMEA has several power purchase agreements in place, structured to reduce its coal exposure in the future. In 2018, KYMEA signed a 20-year PPA with the Ashwood Solar 1 project for 86 MW of capacity. The solar project completion date has been delayed due to supply chain constraints and is expected to come online in 2025. In 2019, KYMEA signed ten-year PPAs with Southeastern Power Administration (SEPA) for 32 MW of capacity, Big Rivers Electric Corporation for 100 MW in base capacity, Paducah Power System ([Paducah \(City of\) KY Electric Enterprise](#), Baa1 stable) for 90 MW of capacity, and the City of Paris Power Plant for 11 MW of capacity. In

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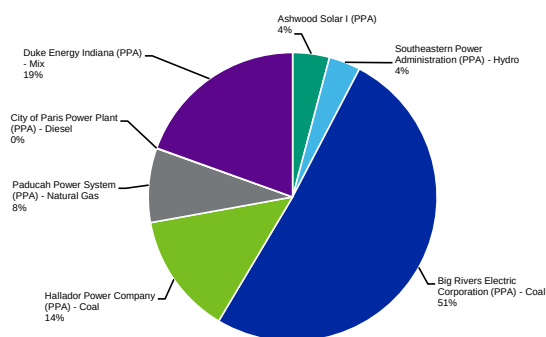
2022, KYMEA signed a five-year PPA with Duke Energy Indiana for 30-60 MW of capacity. In 2024, KYMEA signed a five-year PPA with the Hallador Power Company for 35-100 MW capacity. The end dates of most of aforementioned PPAs are around the completion date for the ECI project and some of which are expected to be renewed at less capacity.

KYMEA will be building a 75 MW natural gas power plant, the "Energy Center I Project," located in Madisonville, Kentucky. The plant will consist of four reciprocating internal combustion engines (RICE), the world's largest four-stroke gas engines, supplied by Wartsila and is expected to be complete in fiscal 2029. The project will be located on a 10-15 acre site and anticipates approximately seven acres of site development. The intention behind pursuing RICE engines is to help KYMEA rapidly respond to fluctuations inherent to the Ashwood Solar I intermittent generation as well as reduce its coal fire generation exposure.

Exhibit 2

While KYMEA's resource mix is predominantly coal fire generation...

Fiscal 2025 resource mix

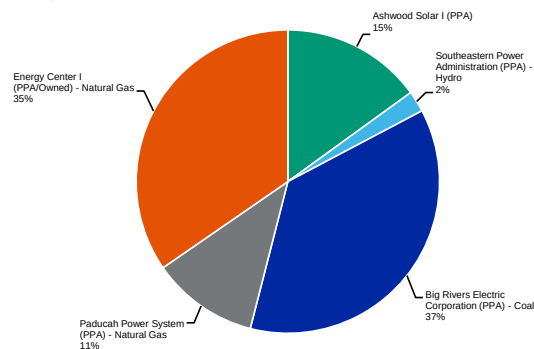


Source: Kentucky Municipal Energy Agency

Exhibit 3

...natural gas is expected to be the largest resource in fiscal 2030 once the ECI project is complete

Fiscal 2030 projected resource mix



Source: Kentucky Municipal Energy Agency

While the construction of the ECI project is not complex, KYMEA is exposed to labor costs at this time

Currently, approximately 55% of ECI's construction costs are fixed, with the Wartila equipment and the Christman Company engineering management contracts being signed. The remaining costs that will undergo a competitive bid process are largely subcontracted labor work and electrical and natural gas interconnection. KYMEA expects to enter into subcontracts that will be responsible for labor. While the subcontracts will fix labor costs in the future, not all of the subcontracts have been signed at this time. Management notes that they will seek to secure performance and payment bonds or parent guarantees in the subcontracts for construction work.

Strong participants but PPA contains weak termination provisions

The ECI project benefits from a take-and-pay PPA with its public power participants of high credit quality of A3. There are a total of nine participants that have signed the Generation Project agreement and are contractually obligated to pay for the debt service on the Series 2025 bonds for 30 years. Frankfort, KYMEA's largest participant, has provided notice that it will be leaving the Agency effective June 1, 2029. While Frankfort did not sign the Generation Project agreement, they will effectively be making payments on ECI up until their departure date, barring any extensions, as the Series 2025 bonds are secured by revenues from the all requirement contracts KYMEA has in place, not just the ECI PPA. Moody's has conducted an analysis on Frankfort's departure from KYMEA and does not believe it poses an adverse effect on KYMEA or the remaining participants.

Exhibit 4

Energy Center I Generation Project Participants

Energy Center I Project Participants	Percentage Share
City of Madisonville, Electric Department	39.6%
City of Berea Municipal Utilities	18.8%
Barbourville Utilities	12.5%
City Utilities Commission of Corbin	11.9%
City of Paris Combined Utilities	8.3%
City of Providence Utility Office	4.2%
City of Falmouth Utilities	2.7%
Bardwell City Utilities	1.2%
Benham Power Board	0.9%

Participation share is expected to slightly fluctuate depending on energy usage.

Source: Kentucky Municipal Energy Agency

The ECI PPA contains features such as requiring the participants to pay for their respective share of debt service and operating costs via their energy usage; defining coverage needed to maintain as DSCR of 1.35x from ECI revenues; and does not contain specific project performance requirements. Participants are required to pay debt service irrespective of performance on the project, even if the project never becomes operational. However, the PPA does contain some weak features compared to a typical take-and-pay arrangement as it has no clear obligation by the participants to pay its share of costs or debt service even after the PPA is terminated. The PPA does outline two main termination provisions – event of defaults by way of 1) the entire participation pool filing for bankruptcy and 2) failure to pay any amount due to KYMEA.

Financial Operations and Position

Fiscal 2024's operating revenues were \$85.5 million, a 20% decline from fiscal 2023, due to KYMEA's decreased long position where it was able to sell electricity through its PPAs in excess of its load to the MISO market. Management is projecting for operating revenues to rebound upwards to \$117 million, supported by the Ashwood Solar I project coming online in fiscal 2025. Going forward, we expect KYMEA to maintain adequate DSCR of around 1.2x, supported by ECI's PPA that requires rates to be adjusted accordingly.

Liquidity

As of fiscal year end 2024, KYMEA had \$37.4 million in unrestricted cash available or 169 days cash on hand. The three-year days cash on hand average was 98 days. Management is projecting to remain above 100 days cash on hand until the completion of the ECI project.

KYMEA maintains a \$45 million line of credit from PNC and a rate stabilization fund with an approximate balance of \$12.5 million, both available to cover any cost overruns from the construction of the ECI Project. Once Energy Center I is complete and operational, a separate rate stabilization fund will be available to generation project participants as well.

Debt and Other Liabilities**Legal security**

The bonds are secured by the Trust Estate, which includes all revenues, payments, and AR revenues received by KYMEA from its power purchase agreements for the sale of capacity and energy to the all-requirements members, which includes the energy and capacity from the ECI Project. The bonds will also be secured by a cash-funded debt service reserve fund sized at 12-months. The AR revenues also secure on a parity basis the PNC line of credit and Bank of American line of credit described below.

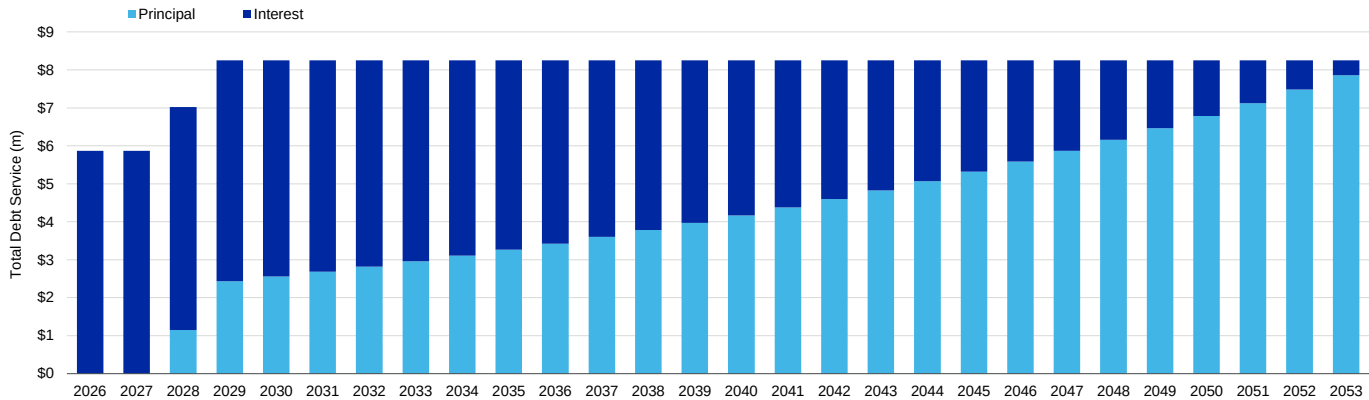
Debt structure

As of fiscal year end 2024, KYMEA did not have any debt outstanding. The \$120 million Series 2025 bonds, which will be closed in February, will be fixed rate. The Series 2025 bonds debt service steadily ramp ups from \$6 million in 2026 to \$8 million in 2030 and is flat thereafter.

In conjunction with this transaction, KYMEA will be obtaining a \$50 million line of credit with Bank of America, which is intended to provide timing flexibility with regard to payments not covered by the Series 2025 issuance. KYMEA is planning to issue approximately

\$25 million in completion bonds in fiscal 2026 to cover the remaining costs of the ECI project. The completion bonds are anticipated to take out any outstanding balance on the Bank of America line of credit.

Exhibit 5

Series 2025 Debt Service Profile

Source: Kentucky Municipal Energy Agency

Debt-related derivatives

The agency has no debt related derivatives.

Pensions and OPEB

The agency does not currently hold unfunded pension and OPEB liabilities.

ESG considerations

Kentucky Municipal Energy Agency's ESG credit impact score is CIS-3

Exhibit 6

ESG credit impact score

CIS-3

Score



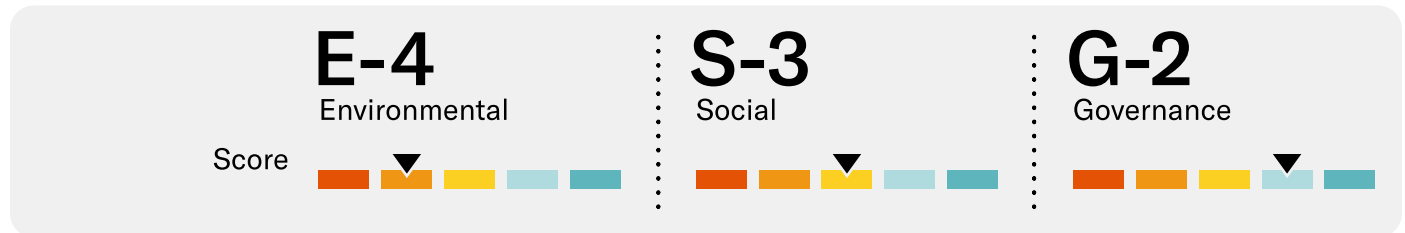
ESG considerations have a limited impact on the current rating, with potential for greater negative impact over time.

Source: Moody's Ratings

KYMEA's credit impact score of **CIS-3** indicates that ESG considerations have a limited impact on the current credit with potential for greater negative impact over time given carbon transition risks, driven by coal-fired generation being the primary energy source which is as well as health and safety risk as KYMEA undergoes the construction of the Energy Center I project.

Exhibit 7

ESG issuer profile scores



Source: Moody's Ratings

Environmental

KYMEA's **E-4** issuer profile score reflects its carbon transition risk through its exposure to coal fire generation. In fiscal 2024, KYMEA sourced 74% of its energy needs through PPA agreements supplying coal fire generation. However, these agreements are not long term, expiring in 2027 and 2029 respectively. It is KYMEA's intention to reduce its coal exposure over the next five years and shift over to natural gas as its primary source for energy once the Energy Center I Project is complete. Risk exposure to waste and pollution is also elevated due to coal fire generation being the primary energy resource in KYMEA portfolio.

Social

KYMEA's **S-3** issuer profile score reflects elevated health and safety risks due to the construction of the Energy Center I Project.

Governance

KYMEA's **G-2** issuer profile score reflects management credibility and track record, as well as compliance and reporting risk factors. Kentucky Municipal Energy Agency's is a joint agency organized under the Interlocal Cooperation Act of the Commonwealth of Kentucky, created in 2015.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moody's.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The principal methodology used in this rating was US Municipal Joint Action Agencies published in December 2022. Please see the Rating Methodologies page on www.moody's.com for a copy of this methodology.

The A3 scorecard indicated outcome is in line with the assigned rating.

Exhibit 8

US Municipal Joint Action Agency with Take-and-Pay Contracts

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 and Exposure to Environmental Regulation	a) Resource Diversity. Asset quality and complexity. Resource supply contract terms and counterparty credit quality. Wholesale market purchase exposure. Exposure to environmental compliance costs	Baa	
3. Competitiveness	a) Cost competitiveness relative to regional peers	A	
3. Liquidity	a) Adjusted Days Liquidity on Hand (3-year average)	A	98 days
4. Leverage and Coverage	a) Adjusted Debt ratio (3-year avg) (%)	A	95.00%
	b) Fixed obligation charge coverage ratio (3-year avg) (x)	Baa	1.19x
5. Willingness to Recover Costs with Sound Financial Metrics	a) Rate Setting Record. Timeliness of rate recovery. Stability and strength of financial metrics	A	
Notching Factors		Notch	
	1 - Contractual Structure and Legal Environment	0	
	2- Participant Diversity and Concentration	0	
	3 - Construction Risk	-0.5	
	4 - Financing Structure	0	
	5 - Unmitigated Exposure to Wholesale Power Markets	0	
Scorecard Indicated Outcome:		A3	

This scorecard features projections for metrics in the future following the issuance of the Series 2025 bonds.

Source: Moody's Ratings

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