

## CREDIT OPINION

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# Vermont Public Power Supply Authority

## Update to credit analysis

### Summary

Vermont Public Power Supply Authority's (VPPSA) Project 10 (Swanton Peaking Facility Project; Baa1 stable) credit profile reflects the legal security of the take-or-pay power sales agreements with 11 municipal electric utilities and 1 rural electric cooperative which have an estimated Baa weighted average credit quality. The credit profile also considers the requirement for Vermont municipal utilities to have their rates approved by the Vermont Public Utility Commission (though VPPSA itself is unregulated). The rating further considers the issuer's strong liquidity profile as well as the plant's value as a peaking facility, with the project participants benefiting from owning a local resource that can bid into the forward capacity and energy markets, and realize value from its ancillary services.

### Credit strengths

- » Take-or-pay power sales agreements are a strong source of cash flow security
- » The Swanton facility provides the participants with fast start reserve capacity, a market product highly valued by ISO-NE due to its ability to quickly help stabilize the NewEngland electrical grid
- » VPPSA has a track record of consistent financial management, and maintains an active role in its participants' electric systems by assisting in rate making and other management services

### Credit challenges

- » Estimated Baa weighted average participant credit quality reflects somewhat weak participant profiles securing the obligations under the power sales agreements
- » Though VPPSA is unregulated, the Vermont Public Utility Commission (PUC) regulates the Swanton participants' electric rates which could limit the scope of rate increases necessary to meet obligations under the power sales agreement
- » Single asset risk
- » Sum sufficient rate covenant is weak compared to peers

### Rating outlook

The stable outlook reflects our expectation for steady operating and financial performance at the project, and for no appreciable deterioration in participant credit quality

## Factors that could lead to an upgrade

- » Notable improvement in the project participants' weighted average credit quality

## Factors that could lead to a downgrade

- » Material deterioration in the project participants' weighted average credit quality
- » Unexpected major plant outages that impact financial performance

## Key indicators

Exhibit 1

	2016	2017	2018	2019	2020
Total Sales (mWh)	965	589	505	264	428
Debt Outstanding (\$'000)	18,815	17,055	15,590	14,450	13,280
Debt Ratio (%)	84.7	76.1	71.2	65.6	60.8
Adjusted Days Liquidity on Hand (incl. Bank Lines)(days)	1,085	1,566	1,696	2,415	1,853
Fixed Obligation Charge Coverage (if applicable)(x)	1.23	1.53	1.19	1.47	1.24

Source: Moody's Investor Service

## Profile

VPPSA is a joint action agency established in 1979. The authority is a self-supported agency providing a variety of centralized services to its 11 member municipal distribution utilities throughout the State of Vermont. The authority is organized as a public service corporation and the board of directors consists of 11 directors, with one director elected by the legislative body of each of the 11 municipal members.

The Swanton project participants include 11 municipal electric distribution utilities that are VPPSA members and one electric cooperative which is not a VPPSA member. The Swanton plant is a 48 MW dual-fuel peaking electric generation plant in Swanton, Vermont that achieved full commercial operations in June 2010. The plant has Fast-Start capabilities and is mostly utilized for reserve capacity purposes in the ISO-NE forward and real time markets.

## Detailed credit considerations

### Revenue Generating Base

The project debt is secured by the revenues derived under the take-or-pay power sales agreements with 11 municipal electric distribution utilities and one electric distribution cooperative. Of these participants, the entities with the largest shares include the Village of Lyndonville (19.6%), the Village of Northfield (12%), and the Village of Ludlow (10%), while all other participants' shares are below 10%. The participants are unconditionally obligated to make pro-rata payments based on their participant share to cover operating expenses and debt service costs, regardless of whether the Swanton plant is in operation or not. Should any of the participants default on their obligation, the step-up provisions in the agreements require transfer of a defaulting participant's share of costs and debt service to the remaining non-defaulting participants, subject to a 25% limit of each non-defaulting participant's original participation share. Each participant's obligation was approved by the Vermont PUC and then authorized by voter approval and subsequent board resolution in each of their respective jurisdictions. Similar take-or-pay contracts in Vermont have been previously court-validated by the Vermont Supreme Court, which also affirms the validity of municipalities to enter into take-or-pay contracts within the state, providing further legal strength to the contracts that underpin the Swanton debt.

While Moody's does not maintain ratings on any of the Swanton participants, their estimated weighted average credit quality is in the Baa rating category. Most of Swanton's participants are small utilities with under 6,000 customers and some with median family

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income below the national average, which would impact customers' ability to absorb higher electric bills, should they occur. Moody's views this as a rating constraint, as lower wealth levels of the population indicates lower tolerance for higher overall rates, since the electric bill is a larger part of their disposable income.

While VPPSA is free from regulation when setting its rates, municipal electric utilities across the state are subject to rate regulation and oversight by the Vermont PUC (unique in the municipal power sector), which we view as a weakness and potential constraint to full and timely cost recovery. Of the past rate increase requests made by the VPPSA members to the PUC, some have been granted full approval. However, some past rate increase requests have been granted approval of only part of the rate increase requested, resulting in a relatively varied track record for the PUC's regulatory decisions in terms of consistency, predictability and credit supportiveness. Effective July 2021, legislation was approved that now allows municipal utilities in Vermont to implement a rate increase without getting PUC approval provided that the municipal utility has had a rate increase approved by the PUC within the last 10 years. Also, the maximum allowable rate increase is 2.0% during any twelve-month period. For the Swanton participants (12 total), four members which have had rate increases approved by the PUC within the last 10 years would be eligible under this legislation, while the remaining eight participants would still be subject to PUC approval for their next rate request.

The Swanton plant continues to perform well, at 99-100% availability factor for the past seven years (2013-2019). Capacity factors during this same time frame were below 1% each year, reflecting the plant's role as a peaking facility. Insurance reviews continue to rate plant maintenance as "good" and the plant has successfully completed all rating tests required by ISO-NE. Borescope inspections are performed annually with the next one scheduled for fall 2021 during the scheduled shut down for maintenance. Because the Swanton facility is a peaker, it remains important for VPPSA to manage the major maintenance needs of the facility in order to meet the plant's capacity supply obligation in each year to earn capacity revenue from ISO-NE. Since 2012, VPPSA has had a dedicated plant operator at Swanton who is responsible for monitoring day-to-day operation and maintenance activities, which we view as credit positive to the plant's operational profile. The peaking plant's strategic value rests in the reliability it offers to both the project participants and the New England region as a whole and its ability to sell its capacity into the forward and real time markets.

Management bids the plant into the ISO-NE forward capacity market and forward reserve market. Swanton has fast-start capabilities, with the ability to produce maximum capable output of 48 MW within ten minutes of being called upon, and is compensated by ISO-NE for that service. Recent forward capacity market auctions resulted in progressively lower prices for the periods from 2019-2020 through 2023-2024, indicating surplus resources in the region. That said, the Swanton plant has continued to secure a capacity supply obligation of 38.653 MW each year through the 2023-2024 auction commitment period. For the 2024-2025 auction commitment period, VPPSA has elected to self supply its capacity in order to protect the self supply option as a choice in future auctions. The self supply designation for 2024-2025 has no financial impact on the Swanton project and thus the load-serving entity (LSE) owners of P10 are financially indifferent to the decision. Self supplying a generator reduces the LSE's obligation in the FCM and reduces its FCM charges from ISO. Although P10 will not receive capacity payments during this commitment period, P10's capacity payments to ISO-NE will be lower by an estimated \$1.15 million. VPPSA reports that although a decision will be made on an annual basis, it is likely that the self supply option will continue to be chosen for the 2025-2026 auction and going forward.

### Financial Operations and Position

Swanton's debt service coverage ratio (DSCR) for 2020 was 1.24x, resulting in a three-year (2018-2020) average DSCR of 1.3x. The higher coverage levels in the past five years are due primarily to increased project revenues, which were a result of additional amounts billed to project participants for building up a project reserve to fund future capital projects. However, due to the revenues earned by the Swanton plant in several regional markets, the project participants normally receive bill credits on an annual basis through the authority's power settlement process. Since 2013, Swanton plant revenues earned in the market each year have been in excess of the payments paid by the participants to VPPSA, thereby offsetting the higher invoices and demonstrating the value of the plant for its participants.

Due to the coronavirus pandemic, most VPPSA members experienced load reductions in 2020 through May 2020 year-to-date. However, VPPSA reports that since June 2020 members' retail sales had rebounded and have since been tracking in line with historical levels. VPPSA also has been monitoring all of its member operations during the COVID pandemic and reported that all members continue to make their monthly payments to VPPSA on time and in full.

The five-year capital improvement program for 2021-2025 includes a potential \$1.9 million of maintenance and improvement projects to the plant. The program is flexible in the timing of the projects and can be altered as necessary.

### Liquidity

Since 2016, the project's unrestricted liquidity has been at higher levels of over 1,000 days cash on hand, and at 2020 year-end reached 1,853 days cash or \$4.7 million. Liquidity at 2021 year-end is projected to be 1,344 days cash or \$4.3 million. Over the next several years, \$1.9 million of the current \$4.6 million total cash may be utilized for capital projects, which would moderate liquidity but to a level still within the 'Aaa' rating category as outlined under Moody's Rating Methodology for US Joint Action Agencies.

This liquidity helps mitigate any financial risk related to the plant's operating performance, and alleviates any potential timing mismatch between cost outlays and recovery from participants, particularly if any true-up would require a participant to file a 45-day rate case. While the project's liquidity will always appear more elevated due to the plant's low run time and low level of operating expenses, liquidity also has grown in part due to the extra participant billings to accumulate monies in the reserve fund for upcoming capital expenditures. VPPSA has no official policy on maintaining minimum liquidity, but the board considers the minimum reserve fund balance to be \$3.2 million (the likely cost to fully rebuild both generator units in the event of a major failure) plus the cost of any identified capital projects in each budget year.

The project also has access to VPPSA's \$10 million line of credit from KeyBank National Association, which is available for all VPPSA uses, including internal needs and other VPPSA projects. The line recently was renewed for a three year term to June 30, 2023 and currently, all of the \$10 million is available under the line. We note that this line of credit does contain a material adverse change clause, which could impair its use should VPPSA face material financial pressure.

### Debt and Other Liabilities

The project has one series of bonds, the Series 2017 A and B Bonds (\$13.28 million outstanding at 2020 year-end). There are currently no plans to issue debt.

### Debt structure

The authority's debt is fixed rate and fully amortizing. The amortization is level at \$1.8 million through final maturity, which is in 2029.

### Debt-related derivatives

No debt-related derivatives.

### Pensions and OPEB

The project has no pension liability, as it has only a defined contribution pension plan.

## ESG considerations

### Environmental

Increased concerns around climate change, combined with long standing efforts to improve air quality, will drive continued scrutiny in the US Municipal Joint Action Agency (JAA) utility sector around environmental-related considerations. The sector on average is heavily weighted towards fossil-fuels.

### Social

JAA's operate across a broad range of legal, political and economic frameworks and are often challenged to balance the needs of communities within the JAA's participant pool, with an ability to operate in a financially prudent and safe manner, and to provide the electric service at the most cost efficient price. The JAA sector faces moderate social risks, however the ongoing coronavirus pandemic has not materially impacted load demand for VPPSA participants.

### Governance

The authority is organized as a public service corporation and the board of directors consists of 11 directors, with one director elected by the legislative body of each of the 11 municipal members

## Rating methodology and scorecard factors

The principal methodology used in this rating was US Municipal Joint Action Agencies published in August 2020. Please see the Rating Methodologies page on [www.moody's.com](http://www.moody's.com) for a copy of this methodology.

Note: The grid is a reference tool that can be used to approximate credit profiles in most cases. However, the grid is a summary that does not include every rating consideration. Please see US Municipal Joint Action Agencies methodology for information about the limitations inherent to grids.

The assigned rating of Baa1 is one notch below the grid indicated outcome of A3 for the VPPSA Swanton project. The rating difference largely reflects rate regulation by the Vermont PUC that is present at the participant level.

Exhibit 2

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.	Baa	
2. Resource Risk Management	a) Resource Diversity. Asset quality and complexity. Resource supply contract terms and counterparty credit quality. Wholesale market purchase exposure	Baa	
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)	Aaa	1988
	b) Debt ratio (3-year avg) (%)	Aa	65.9
	c) Fixed obligation charge coverage ratio (3-year avg) (x)	Baa	1.3
Material Asset Event Risk	Does agency have event risk?	No	
<b>Notching Conventions</b>		<b>Notch</b>	
	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	
<b>Scorecard Indicated Rating:</b>		<b>A3</b>	

Source: Moody's Investor Service

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