

**New Issue: [Dover \(City of\) DE Electric Enterprise](#)**

**MOODY'S ASSIGNS A1 RTG TO CITY OF DOVER'S (DE) \$22.2M ELECTRIC REVENUE BONDS**

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**A1 RATING APPLIES TO \$41.2M IN PARITY BONDS, INCLUDING THE CURRENT ISSUE**

Dover (City of) DE Electric Enterprise  
Electric Utilities  
DE

**Moody's Rating**

<b>ISSUE</b>	<b>RATING</b>
Electric Revenue Bonds (Series 2008)	A1
<b>Sale Amount</b> \$22,220,000	
<b>Expected Sale Date</b> 04/15/08	
<b>Rating Description</b> Electric Revenue	

**Opinion**

NEW YORK, Apr 7, 2008 -- Moody's Investors Service has assigned an A1 rating to the City of Dover's (DE) \$22.2 million Electric Revenue Bonds, (Series 2008). Concurrently, Moody's has affirmed the A1 rating on \$19 million in previously-issued parity debt. The bonds are secured by a pledge of and first lien on the net revenues of the city's electric system, which serves the corporate limits of the city and surrounding territory. The A1 rating reflects the system's satisfactory financial position, characterized by healthy levels of liquidity and solid coverage ratios, and considers the recent transition of the system from a fixed-rated supply and operating contract to a market-rate environment. The rating further reflects the moderate growth of the system's mature customer base, anchored by a significant state and federal government presence, and a capital program and debt position that are expected to remain manageable. Proceeds of the Series 2008 bonds will finance the construction of two feeder lines from one substation and the replacement of another substation, in addition to other system improvements.

**SATISFACTORY LEGAL PROVISIONS FOR BONDHOLDERS**

The City of Dover has covenanted to charge and collect rates for services rendered by the system so that the sum of pledged net revenues will provide at least 1.25 times coverage of debt service for all senior lien bonds outstanding. Importantly, for the purpose of calculating net revenues, the Electric Revenue Bond Resolution, as amended and restated, permits current revenues to include any one-time funds budgeted for the payment of current expenses, including appropriations made from the system's rate stabilization reserve and other accounts. Further, the Bond Resolution requires any transfers to the city's General Fund or other funds to be treated as current expenses for the purpose of calculating debt service coverage. Moody's believes that this requirement provides additional bondholder protection given that the city annually transfers 6.5% of the electric system's gross operating revenues to the General Fund. The legal provisions also require net revenues to provide at least 1.25 times coverage of maximum annual debt service (MADS) upon the issuance of additional bonds and a reserve requirement equal to MADS, to be funded at closing with bond proceeds.

**FINANCIAL OPERATIONS EXPECTED TO STABILIZE FOLLOWING TRANSITION FROM FIXED-RATE TO MARKET-RATE ENVIRONMENT; HISTORICALLY STRONG COVERAGE RATIOS MAINTAINED**

During the 10-year period ending fiscal 2006, the city administered the electric system under a fixed-rate supply and operating contract; beginning in fiscal 2007, the city's power supply and plant operating costs increased substantially with the transition from a fixed-rate to market-rate environment. As a part of the transition, the city contracted with a power procurement manager and a plant asset manager during May 2006 - securing service agreements with both through June 2010 - and created a new utility services manager position to improve system oversight. The city also adopted a 24% rate increase, effective July 1, 2006, and appropriated \$5 million from the electric fund's rate stabilization reserve to moderate the immediate impact of higher power supply costs on the customer base during fiscal 2007. During the first quarter of the ensuing fiscal year, the system's preliminary financial results pointed to significant variances with the city's budgetary assumptions, placing negative pressure on the system's operating margins and debt service coverage. In addition, the rate model used to develop the fiscal 2007 budget assumed a 3% increase in customer demand, which the city subsequently corrected to reflect a 1% increase consistent with historical

trends.

Upon evaluating the drivers of the electric system's narrowed operating margins, city officials implemented a series of mid-year changes to improve the fund's financial position. Importantly, officials adopted a mid-year 6% rate increase, effective January 1, 2007, appropriated an additional \$1.1 million in one-time revenues to support electric system operations, and reduced the transfer to the General Fund by \$1 million (to \$4.7 million). When combined with a \$1.3 million gain in unanticipated investment income, the mid-year revenue enhancements increased the fund's gross revenues by \$6.6 million (7.5%). At the same time, the city effectively held operating costs at budgeted levels, allowing the revenue growth to directly increase net revenues to \$11.3 million at year end. While one-time revenues accounted for 54% (\$6.1 million) of net revenues, bond covenants permit the inclusion of these revenue sources in the calculation of debt service coverage. Accordingly, fiscal 2007 net revenues provided an ample 4.35 times debt service coverage before transfers. Debt service coverage decreased to a still satisfactory 2.54 times after the \$4.7 million transfer to the city's General Fund, well above the 1.25 times coverage requirement but below historical coverage levels, which averaged 3.3 times during the five-year period ending fiscal 2006. Moody's notes that the mid-year reduction to the General Fund transfer did not adversely impact its financial position; the General Fund recorded a \$400,000 operating surplus in fiscal 2007, boosting General Fund balance to a healthy \$9.1 million (32.1% of revenues). Moody's believes that the stability of the General Fund's financial position remains linked to the performance of the electric system, given that electric fund transfers comprise a significant 15% to 20% of General Fund operating expenditures annually.

Pro forma projections for the five years beginning fiscal 2008 estimate that net revenues of the electric fund will provide average annual debt service coverage of 4.25 times prior to General Fund transfers (2.4 times after transfers), notably below the historical 5.19 times average annual coverage (3.3 times after transfers) from fiscal 2002 to fiscal 2006. Projections include an average 86% operating ratio, above the 80% average of fiscal 2002 to fiscal 2006 but notably below the high 97% margin of fiscal 2007. Fiscal 2008 projections reflect the positive impact of a 9.75% rate increase implemented on July 1, 2007; revenue performance in subsequent fiscal years is based on the prospective passage of a July 1, 2008 rate increase of 3.5%, with no additional rate adjustments included through fiscal 2012. Importantly, revenue projections are based solely on recurring revenue sources and do not include any one-time appropriations. Projected system operating costs assume an annual 1% increase in customer demand, reflective of historical trends, and annual transfers to the General Fund are fixed at 6.5% of projected system operating revenues, consistent with city policy. Moody's notes that city officials amended the policy level for the inter-fund transfer from 8% to 6.5% of revenues as of July 1, 2006.

Moody's believes that the projected decline in debt service coverage and operating margins, when compared with historical levels, presents some future fiscal challenges; however, the electric fund's financial position is supported by a solid liquidity position that is buttressed by comprehensive reserve policy requirements. City policy requires that the electric fund maintain an operating reserve equal to 8% of annual revenues, a contingency reserve equal to 1% of annual revenues, and future capacity and depreciation reserves of a minimum \$10 million each (strengthened from \$5 million minimums in fiscal 2008). Moody's also notes that while the city has demonstrated the ability and willingness to address the fiscal imbalances of the electric system during the recent transition period, the city may continue to experience operating challenges as a result of future fluctuations in power procurement costs and competitive pressure resulting from electric utility deregulation. Favorably, the city began hedging on a multi-year, rather than annual, basis in fiscal 2008, providing some stability and predictability to future year costs.

#### SERVICE AREA ANCHORED BY INSTITUTIONAL PRESENCE; SYSTEM HAS ADEQUATE POWER RESOURCES

The electric system serves a 69 square-mile area that includes the City of Dover (G.O. rated A1) and surrounding portions of Kent County (G.O. rated A1). Steady, moderate population growth in both the city and the county have contributed to average customer account growth of 2.3% annually since fiscal 2002, and officials expect similar customer growth to continue for the foreseeable future as new development occurs within the service area. The local economy, which serves as an employment center to the greater region, is anchored by a sizeable government presence that includes the county seat, the State of Delaware (G.O. rated Aaa/stable) capital, and Dover Air Force Base, home to 25% of the nation's airlift capacity. Governmental and tax-exempt facilities account for nearly 20% of the city's total property base and also contribute to the significant concentration of the electric system's customer base. In fiscal 2007, the 10 largest customers of the electric system accounted for a substantial 44% of operating revenues; government and other public institutions account for nearly half of this concentration, including Dover AFB (9.7% of revenues), the State of Delaware (5.3%) and Delaware State University (3.1%). The balance of the largest customer group is comprised of large, reportedly stable manufacturing concerns, a regional health care facility, and the Dover Downs Hotel and Casino complex. Moody's believes that while the concentration of the electric system customer base is a vulnerability to long-term operating stability, risk is mitigated by the predominance of large, public institutions and the ability to reduce power procurement in line with customer contraction.

The electric system includes generation, transmission and distribution components. The system interconnects with the Delmarva Power and Light Company (DP&L) at a city-owned substation at 230 kilovolts (kV), which is transformed to 69 kV for distribution through the city's service area. The station is part of DP&L's transmission network and is governed by the rules and regulations of the PJM grid. The city owns

four oil and gas-fired generating units that are operated as peaking plants; together, these plants have a total rated capacity of 175 megawatts (MW). Officials report that the plants are in good condition and produced 2.9% of their combined rated production capacity during fiscal 2007. The city's current energy management agreement with Pace Global Asset Management, LLC is effective through June 2010 and includes asset, energy and risk management programs.

#### MANAGEABLE DEBT BURDEN WITH NO ADDITIONAL PLANNED BORROWING

The system's fiscal 2007 debt ratio of 13.4% is expected to increase to 26.6% with the current issue, still well below the roughly 50% median for similarly-rated credits. Approximately 57% of revenue bond principal will be retired within 10 years and all bonds will be repaid by 2033, within the useful life of the financed assets. Moody's expects the system's debt obligations to remain affordable, given the city's historically strong pay-go capital program and the absence of additional borrowing plans through 2012. The system's \$43.1 million, 5-year capital improvements program (CIP) includes the projects to be financed with the current issue; various additional upgrades and replacements will be funded from the system's depreciation reserve and future capacity reserve, in addition to annual operating fund contributions of \$2 million to \$3 million.

#### KEY STATISTICS

System: Electric generation, transmission, and distribution

Security: Senior lien on net revenues

Customer Base,

Number of customers (FY 2007): 22,437

Annual customer account growth (5-year average): 2.3%

Electric usage growth (5-year average): 1%

City of Dover population (2006): 34,735

1999 Per Capita Income: \$19,445 (83% of state and 90% of nation)

1999 Median Family Income: \$48,338 (87% of state and 97% of nation)

Kent County unemployment (12/2007): 3.4% (3.4% DE and 4.8% US)

Financial Ratios,

FY 2007 debt service coverage (before General Fund transfer): 4.35 times

FY 2007 debt service coverage (after transfer): 2.54 times

FY 2007 MADS coverage (before transfer): 2.8 times

FY 2007 MADS coverage (after transfer): 1.63 times

Debt Detail,

Fiscal 2007 debt ratio: 13.4%

Pro forma debt ratio: 26.6%

Post-sale parity debt outstanding: \$41.2 million

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