

FITCH AFFIRMS DELAWARE MUNI ELECTRIC CORP'S ELECTRIC REVS AT 'A-'; OUTLOOK POSITIVE

Fitch Ratings-New York-02 October 2013: Fitch Ratings affirms the 'A-' rating on the following Delaware Municipal Electric Corporation's (DEMEC) bonds:

--\$55.5 million electric utility revenue bonds, series 2011.

The Rating Outlook is revised to Positive from Stable.

SECURITY

The bonds are secured by a first lien on net revenues, which are principally derived from power sales contracts (PSC) between DEMEC and its seven participants related to the Beasley Power Station. Other net revenues include administrative charges derived from full requirements' contracts with the same seven participants, but annual amounts are nominal.

KEY RATING DRIVERS

DELAWARE JOINT ACTION AGENCY: DEMEC is a project-based joint-action agency that provides power to seven member cities located in Delaware pursuant to take-or-pay power sales contracts that remain in effect as long as the bonds are outstanding. The agency's lone generating asset is the Beasley Power Station, which consists of two natural gas-fired simple-cycle combustion turbine generation units (Units 1 and 2), each with 45 MW of capacity.

POSITIVE TREND IN MEMBER PERFORMANCE: DEMEC's rating is based primarily on the sound credit quality of the seven participants, the largest of which are Newark (GOs rated 'AA+', Stable Outlook) and Milford, which account for nearly 65% of the ownership interest in the Beasley Units. The Positive Outlook reflects the improving trends in the participants' financial metrics and service territory characteristics occurring in recent years.

STANDARD CONTRACT STEP-UP PROVISION: A 25% step-up provision provides additional bondholder protection from a default of one or more participants with the exception of Newark, which maintains a 42.1% entitlement share and whose obligations would not be covered by the other participants. However, Fitch believes the direct exposure to Newark is mitigated by its solid credit quality.

LARGE GENERAL FUND TRANSFERS: Generally strong cash flows at the member level are offset by the sizeable general fund transfers to the host city, which prevents the accumulation of more acceptable levels of liquidity and net assets.

INCREASING CONTROL OVER POWER COSTS: The recent construction of the second unit at Beasley coupled with DEMEC's participation in American Municipal Power's (AMP) Fremont Energy Center (AFEC) project (project revenue bonds rated 'A', Stable Outlook) provide DEMEC and its members with a more reliable and competitively priced energy supply.

RATING SENSITIVITY

CHANGE IN MEMBER CREDIT QUALITY: The resolution of the Rating Outlook will likely be determined by the ability of the agency and its members to sustain the recent improvement in financial and economic metrics.

CREDIT PROFILE

DEMEC is a joint action agency serving nine municipal electric utilities located in the state of Delaware (GO bonds rated 'AAA', Stable Outlook). Members include Newark, New Castle, Middletown, Dover (electric revenue bonds rated 'AA-', Stable Outlook), Smyrna, Seaford, Lewes, Clayton and Milford. The member utilities make up seven of the 10 largest cities in the state and on

a combined basis serve nearly 60,000 customer accounts and a total population of about 114,000.

Seven of the agency's nine members participate in DEMEC's Beasley Power Station project pursuant to long-term, take-or-pay power sales contracts that secure the agency's outstanding electric revenue bonds. The power sales contracts require each participant to purchase up to 125% of its original ownership interest if another participant were to default on its obligations.

Fitch notes that the step-up would not cover a default by the single largest member, Newark, which maintains a 42.1% entitlement share of the project. The remaining six participants would provide only 72.4% of required revenues, leaving bondholders directly exposed to the largest participant.

SOUND AND IMPROVING CREDITWORTHINESS OF MEMBERS

The credit quality of the Beasley project's participants continues to sufficiently support the current rating, and has improved, prompting the revision in Outlook to Positive. The participants in general exhibit healthy cash flow, minimal leverage and satisfactory cash balances that offset sizeable general fund transfers.

Newark's utility system routinely generates strong operating margins in excess of 20%, providing positive cash flow after covering its full obligations, including purchase power costs and a sizeable below the line transfer to the city's general fund. The system ended fiscal 2012 with an acceptable 46 days cash on hand.

Financial metrics of the remaining participants are also sound. Milford, the second largest member, ended fiscal 2012 with strong debt service of 3.0x and nearly 200 days of unrestricted cash on hand. Middletown's practice of transferring all of its excess operating cash flow to the city's general fund poses some concern, but operating margins have averaged a strong 23% over the prior three years and the system has no long-term debt obligations. Fitch notes that only four of the seven participants have long-term debt obligations, and the total obligations are nominal.

STABLE SERVICE TERRITORY

Economic and demographic indicators vary somewhat for each member city, but metrics in general appear stable. The state's economy is relatively diverse due principally to deliberate policies that created a climate attractive to banking and related business services and pharmaceuticals. The July 2013 unemployment rate of 6.9% ranks comfortably below that of the U.S. average of 7.3%.

Newark, DEMEC's largest participant, benefits economically from the presence of the Christiana Care Health System and the University of Delaware, which together employ almost 15,000 workers. The city's July 2013 unemployment rate of 7.5% remains slightly elevated compared to the state (6.9%) and nation (7.3%), and income levels are somewhat low, although the city's large student population contributes to the weaker figures. Both Milford and Middletown exhibit stronger wealth and employment indicators.

Aggregate energy sales among the three largest participants are reasonably balanced. Sales to Newark's largest customer, the University of Delaware, typically account for slightly more than one-third of the distribution system's total energy sales. Industrial customers make up a manageable 27% of Newark's remaining sales while residential and commercial users account for the balance at 23% and 17%, respectively. The high proportion of sales to the University of Delaware is viewed positively by Fitch given its longstanding role as a reliable and stable customer.

The balance of the project's participants all exhibit varying degrees of customer concentration, although sales to the 10 largest end-users served indirectly by DEMEC, including the University of Delaware, are less concentrated, accounting for a manageable 28% of DEMEC's total revenues in fiscal 2012. In addition, the members' exclusive control over their service territories provides a degree of stability by limiting retail competition. Favorably, the 10 largest participants' customers have been customers of their respective systems for a minimum of 20 years.

SATISFACTORY FINANCIAL PERFORMANCE AT THE AGENCY LEVEL

DEMEC's financial metrics compare well to other similarly rated joint action agencies. Fiscal 2012 was particularly strong as sales increased by nearly 8% and DEMEC profited from selling excess

power into to the PJM energy market. Consequently, annual debt service coverage increased to nearly 7.0x and available liquidity grew to 57 days cash on hand.

The outstanding bonds are secured by revenues from the power sales contracts for the Beasley project, and participants are required to make debt service payments equal to 1.1x of annual debt service. Project debt service coverage has historically been in excess of 2.0x due to increased energy sales and significantly higher capacity market revenues.

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Applicable Criteria and Related Research:

- 'U.S. Public Power Peer Study -- June 2013' (June 13, 2013);
- 'U.S. Public Power Peer Study Addendum -- June 2013' (June 13, 2013);
- 'U.S. Public Power Rating Criteria' (Dec. 18, 2012).

Applicable Criteria and Related Research:

- U.S. Public Power Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=696027
- U.S. Public Power Peer Study -- June 2012
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=681449
- U.S. Public Power Peer Study Addendum -- June 2013
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=710641

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