Fitch Ratings

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Fitch Affirms Kansas City (KS) BPU Bonds 'A'; Outlook Stable

Fitch Ratings - Austin - 25 Jul 2022: Fitch Ratings has affirmed the 'A' rating on the following issuances by the Unified Government (UG) of Wyandotte County/Kansas City Board of Public Utilities (BPU), KS:

--$592.81 million utility system improvement bonds.

In addition, Fitch has assessed BPU's standalone credit profile (SCP) at 'a'. The SCP represents the credit profile of the system on a stand-alone basis irrespective of its relationship with the credit quality of the UG of Wyandotte County/Kansas City.

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

BPU's rating reflects the combined utility's solid revenue defensibility, very low operating costs, and strong leverage profile. Leverage declined to 6.8x in fiscal 2021 from 8.3x in fiscal 2020 as operating margins improved and debt continued to amortize. Rising operating costs, mostly due to higher fuel and purchased power costs, could pressure Fitch's assessment of BPU's operating risk assessment, but Fitch expects the utility will continue to pass through costs to customers through its flexible rate structure.

Modest revenue growth from planned water rate increases are expected to partially finance planned water capex, in addition to maintaining BPU's net leverage at levels consistent with the rating. Liquidity, which has declined during the past couple years to 75 days at FYE 2021, is projected to increase over the next five years.

CREDIT PROFILE

The UG was formed on Oct. 1, 1997 through a consolidation of the city of Kansas City, KS, and Wyandotte County, KS. The BPU of the UG is responsible for the daily management of the utility system, which includes water and electric facilities. The combined utility serves approximately 65,000 electric and 53,000 water customers, although the electric system generates approximately 85% of total utility operating revenues. The utility's electric system is an integrated system consisting of generation, transmission and distribution assets.

BPU's payment in lieu of taxes (PILOT) payment accounts for a meaningful component of the UG's annual budget. While the PILOT amount is established annually by the UG, the range is no lower than 5% or more than 15% of gross operating revenues pursuant to local law. The PILOT remained at 11.9%

of gross revenues in 2021, in line with the five-year historical average.

BPU's board of directors consists of six members, serving staggered four-year terms. Three board members are elected by the voters within the limits of the former city at large, and the remaining three are elected by district.

Fitch considers the system to be a related entity to the UG for rating purposes given UG's oversight of the system. The credit quality of the city does not currently constrain the bond rating. However, as a result of being a related entity, BPU's bond ratings could become constrained by a material decline in the general credit quality of the city.

KEY RATING DRIVERS

Revenue Defensibility: 'a'

Solid Revenue Defensibility Supported by Independent Rate Setting Authority

BPU's revenue defensibility assessment reflects the combined utility's independent rate setting authority, strong revenue flexibility, and largely monopolistic revenue source characteristics. The service area's midrange characteristics, with relatively low median household income levels, are considered a limiting factor to the overall revenue defensibility assessment. The utility's predominately industrial rate base remains a concern in a declining economic environment, but is offset to some degree by the limited concentration in any particular industry or small group of customers.

Operating Risk: 'aa'

Very Low, Stable Operating Costs

BPU's operating risk assessment reflects the utility's very low electric operating costs. Rising purchased power and fuel costs are expected to increase the utility's operating cost burden, but BPU's diversified power supply mix should partially mitigate overall costs pressures. Capital needs are high but expected to be manageable.

Financial Profile: 'a'

Strong Financial Performance; Weaker Liquidity Projected to Improve

Leverage declined in fiscal 2021 to 6.8x from 8.3x in fiscal 2020 as the utility's operating cash flow improved and the utility's debt continued to amortize. Financial performance is projected to remain generally in line with the current financial profile assessment in Fitch's base and stress case scenarios.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations constrain BPU's rating.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustained declines in leverage below 8.0x in Fitch's base and stress case scenarios, in the context of stable revenue defensibility and operating risk assessments;

--Improved service territory metrics.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--An inability, or unwillingness, to implement planned rate increases which results in narrowing operating cash margins or further narrowing of liquidity levels;

--A sustained increase in BPU's electric operating costs above 10 cents/kWh, which would likely pressure the operating risk assessment;

--A sustained increase in BPU's leverage above 9.0x.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

SECURITY

The bonds are payable from net revenues of the combined electric and water system.

Revenue Defensibility

BPU derives the vast majority of its revenues from the retail sale of electric and water services. The receipt of wholesale electric revenues occurs from the opportunistic sale of energy into the market. A small portion of water revenues are generated from long-term wholesale contracts with other municipal entities and are not viewed by Fitch as being competitively sourced revenue.

Service Area Characteristics

BPU's service area is generally characterized as having midrange attributes with respect to customer growth trends and unemployment rates, while the area's income levels are considered a weaker attribute. Customer growth rates have been positive in each of the past five years, with the five-year compound annual growth rate reaching 0.6% in 2021.

The area's unemployment rate, which historically remained above state and national levels, dropped to pre-pandemic levels more quickly than most of the nation, with unemployment rates dropping to 89% of the national level in 2021. Median household income, however, has been persistently below national levels, remaining relatively stable at approximately 74% of the national average from 2017-2020.

Rate Flexibility

Fitch assesses BPU's rate flexibility as strong primarily based on BPU's independent ability to set and adjust rates, but remains somewhat limited by rate affordability. The utility's board approves rates based on a recommendation by staff and following a public hearing. The utility's electric rate structure consists of a base rate, an energy rate component and an environmental surcharge. PILOT payments made to the UG are also collected from the customers and shown as a separate line item in the monthly bill.

Fitch views BPU's rate structure as a credit positive, providing the utility with the ability to recapture costs in a full and timely manner. The energy rate component adjustment occurs quarterly and is not limited in its ability to recapture eligible costs. Over-collections in fiscal 2020 resulting from economic wholesale market sales allowed BPU to reduce the energy rate component in early 2021 to as low as 1.6 cents/kWh; however, the recent surge in commodity costs have led to a corresponding precipitous increase in BPU's energy rate component, which rose to 4.5 cents/kWh on July 1, 2022. BPU management projects the energy rate component could climb further as market prices remain high due to additional commodity price increases and surging demand through the summer months.

The environmental surcharge, which was established in 2011, is set annually and designed to pay for approved environmental upgrades to its power plants and other costs related to regulation. The environmental surcharge was modified in March 2017 to increase the coverage provided by the surcharge to 1.3x from the previous 1.0x and has since modestly bolstered margins.

BPU's retail electric rates remain competitive with the average Kansas state rates, with BPU's residential electric rates at 104% of the state average. However, rate affordability remains a concern as electric bills are increasingly impacted by BPU's energy rate component. Fitch-calculated rate affordability, which measures the percentage of median household income necessary to cover residential electric charges, was 2.7% in 2020. Fitch expects affordability metrics will weaken as rising electric rates outpace increases in income levels. No additional electric base rate increases are currently contemplated over the next five years, but management plans to complete its electric cost of service study in 2022 which could affect future rates.

BPU's scheduled May 2020 water rate hearing was delayed due to the recent coronavirus pandemic. The date of the rate hearing remains uncertain, but management plans to implement water rate increases of 5% and 4% at the start of fiscal years 2023 and 2024, respectively.

Asymmetric Rating Factor Considerations -- Revenue Defensibility

No asymmetric rating factor considerations constrain BPU's revenue defensibility assessment. The predominately industrial customer base is a potential credit risk, as residential electric and water customers account for a relatively low 33% of total 2021 operating revenues. However, this concentration in industrial customers is offset, to some degree, by both the diversity of those customers and the limited exposure to any individual or small group of those customers.

These customers include automotive manufacturing, hospital facilities, food processing, a water district, and other manufacturing and medical businesses. In addition, BPU's top electric customer and top 10 electric customers represent approximately 3.2% and 20.5%, respectively, of total operating revenues, below Fitch's thresholds for representing a material concern to the rating.

Proctor and Gamble (P&G), the eighth largest electric customer by revenue in 2021 (approximately 1.1% of total operating revenues), plans to close its plant at the end of 2023. P&G had initially planned to close the plant at the end of 2020, but extended the close to 2023 following a surge in demand for its products during the pandemic. Utility management is working with economic development officials to seek out potential industrial customers to take over P&G's site. Management does not expect that the loss of P&G on its own would result in the need for additional rate increases.

Operating Risk

Operating Cost Burden

Fitch's assessment of BPU's operating cost burden reflects the utility's ability to provide a very low-cost power supply, but also considers rising fuel and purchased power costs experienced by utilities across the country. Over the past five years, electric operating costs have remained relatively stable, averaging approximately 9.8 cents/kWh, including the utility's relatively high PILOT.

PILOT

BPU is exempt from federal and state income taxes and local property taxes, but is required to make a PILOT payment of 5%-15% of gross operating revenue to the UG. The PILOT payment has been increased during periods of economic weakness, including an increase to 9.9% from 7.9% in 2009 and a separate increase to 12.8% in January 2010. The PILOT was held at 11.9% from 2015 to 2021. Fitch views the PILOT's magnitude and its variability as a credit negative as it has the potential to shift operating costs to a significant degree. Management projects the PILOT to remain at current levels over the next five years in the financial forecast, although the UG is considering, as part of its annual budget review process, reducing the PILOT in 2023.

The PILOT payment is a separate line item on customers' bills and is made to the UG monthly, subordinate to debt service payments. Per the indenture, BPU accounts for the PILOT payment below operating expenses, and reported coverage under the indenture is correspondingly higher. Fitch views the PILOT payment as an operating expense due to the monthly nature of the payment, and looks at the adjusted coverage level as more reflective of the financial cushion available to protect bondholders.

The stated PILOT amount does not include the free services provided by BPU to the UG, which amounted to approximately $10.0 million or the equivalent of 3.2% of operating revenues in 2021.

Operating Cost Flexibility

Fitch views BPU's operating cost flexibility as neutral to the rating due to the utility's transitioning and increasingly diverse power supply and the water system's ample supply and treatment capacity.

Electric System

The BPU continues to execute on its 2019 integrated resources plan, which aimed to reduce the utility's dependence on coal and maintain a cost-effective power supply while also meeting required air quality standards. As a utility that derived 88% of its 2013 energy from coal-fired units, BPU historically was exposed to environmental regulations promulgated by the EPA, including Mercury and Air Toxics Standards (MATS). Since then, the utility has taken steps to transition away from its historical reliance on older coal facilities toward increased utilization of natural gas-fired and renewable resources. BPU intends reevaluate its integrated resources plan in 2024. The utility does not expect to need additional generation resources over the next five years given its current portfolio of resources which is long on generation.

BPU ceased operations at its Quindaro units 1 and 2 in October 2019. The units, which historically used coal, were switched to natural gas only in 2015 following BPU's determination that the environmental retrofits to comply with MATS would be too costly. The decision to terminate operations at the units in 2019 followed management's determination that the units were no longer viable, efficient or necessary to operate in the Southwest Power Pool (SPP) Integrated Marketplace. The retirements are expected to result in approximately $80 million in savings over a 10-year period ending in 2028. BPU recorded the $73.6 million loss on the units as a regulatory asset, which will be amortized through 2040.

BPU maintains a 17% ownership interest (110 MW) in the Dogwood Generating Facility. The Dogwood plant is an efficient combined-cycle gas-fired power plant with one of the lowest heat rates in the region. The plant became an important peaking resource for BPU and experienced a significant increase in dispatch since the SPP Integrated Marketplace began operations on March 1, 2014. The facility's ability to meet peak loads was most evident during Winter Storm Uri and led to a significant increase in wholesale sales in fiscal 2021. BPU received approximately $27.0 million in fiscal 2021, up from its three-year historical average of approximately $11.1 million during fiscal years 2018 through 2020. BPU nets the revenue from Dogwood's sales against purchased power costs.

BPU also continues to use one of its legacy coal units, the 246-MW Nearman Station (N1 unit), as a base load resource. While BPU's reliance on Nearman Station has declined in the past several years due to low market prices and the utility's various contracts for renewable energy, the facility has served as a physical hedge to the recent rises in natural gas prices. BPU's 2021 power supply mix was 22% coal, 16% gas, and 7% oil, with the remaining portion from net power purchases. Contracted renewable resources provided the utility with approximately 48% of its power supply in 2021.

Environmental Considerations and Clean Energy Transition

The state of Kansas maintains a voluntary renewable energy goal of 20% of peak demand capacity for investor-owned and cooperative electric utilities. However, BPU, as a municipally owned electric utility, is not required to comply with the state statute. Nonetheless, BPU's sizable renewable resources far exceeds the state's energy goal.

Water System

BPU serves approximately 53,000 water customers in an approximately 152-square mile area. The service area includes Kansas City, Edwardsville, and a small section of northern Johnson County, KS. BPU's daily water average during 2021 was approximately 30 million gallons per day (MGD), with a historical peak usage of about 49 MGD in 2012 (peak of 37 MGD in 2021). The utility also provides wholesale water service to three water districts in Leavenworth County and the cities of Bonner Springs and Tonganoxie, all in Kansas.

Raw water is sourced from the local aquifer, which is connected to the nearby Missouri River and has a naturally occurring filtration process. BPU operates a water treatment plant with a current capacity of up to 72 MGD. Treated water from this plant is distributed to retail and wholesale customers through a network of primary and secondary water mains.

Capital Planning and Management

BPU's average age of plant is viewed as presenting high life cycle investment needs. BPU's consolidated capital improvement plan (CIP) amounts to approximately $258.8 million from 2022 through 2026, and will address distribution and transmission needs, Nearman plant improvements, and substation investments, in addition to system improvements to BPU's water utility. Following the start of the coronavirus pandemic, BPU underwent a comprehensive review of its CIP and suspended certain non-essential projects, which resulted in material capex declines (up to 35%) in BPU's 2020 and 2021 capital spending. Management's five-year CIP plan returns spending to pre-pandemic levels, although the utility plans to prioritize projects that ensure system reliability.

BPU's management team expects to fund approximately 50%-55% of its CIP with debt financing over the next five years. Management plans on taking loans from the state revolving fund (SRF) program to finance water capex projects. The SRF loans will be structured to begin repayment once a project is completed.

Asymmetric Rating Factor Considerations -- Operating Risk

No asymmetric rating factor considerations constrain the utility's operating risk assessment.

Financial Profile

BPU's financial performance improved in 2021 as operating margins improved and debt continued to amortize. Fitch-calculated coverage of full obligations improved to 1.62x from 1.28x the year prior. The improved operating cash flow resulted from an increase in residential and commercial electric sales, following a period of lower demand during the pandemic. Wholesale sales also led to improved operating cash flows, primarily due to wholesale sales made during the February 2021 Winter Storm Uri event.

The utility's liquidity levels are relatively low but offset to some degree by the system's flexible rate structure. At the end of 2021, BPU maintained approximately 75 days liquidity on hand. Management plans to increase the utility's unrestricted cash over the next five years.

Fitch Analytical Stress Test (FAST) Scenarios

The FAST base case scenario represents Fitch's expectation of BPU's financial performance through the five-year forward look through fiscal 2026. Fitch analysis indicates that BPU's financial profile remains supportive of the rating. BPU conservatively projects retail electric demand will remain relatively flat over the next five years. The utility projects its generating resources will exceed customer demand over the next five years, resulting in wholesale sales contributing 10% to 15% of the utility's total energy sales.

Fitch believes any reliance on wholesale margins to recover costs is mitigated by the utility's ability to make timely adjustments to its energy rate component to the extent wholesale sales are not realized. The projections also include water rate increases of 5% and 4% in 2023 and 2024, respectively, but do not consider any electric base rate increases. Under the base case assumptions, leverage is expected to range from 7.0x to 8.2x.

Fitch's stress case scenario applies a demand stress to management's energy sales projections using the FAST model demand stress outputs, which are based on BPU's historical demand volatility. Historical energy sales have shown some volatility with recent fluctuations driven primarily by weather. The demand stress is applied in years one and two, followed by a modest recovery. Under the stress case, leverage is expected to moderate around the 7.5-8.5x over the medium to long term.

Debt Profile

BPU had approximately $658.1 million in outstanding debt at the end of 2021. Approximately $593 million of the debt is outstanding revenue bonds with fixed interest rates. Unamortized bond premiums and government loans make up the remainder of BPU's outstanding debt obligations.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations constrain BPU's rating.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Unified Government of Wyandotte County/ Kansas City (KS) [Electric]					
• Unified Government of Wyandotte	LT	A	Affirmed		A

ENTITY/DEBT	RATING	RECOVERY	PRIOR
County/ Kansas City (KS) /Electric System Revenues/ 1 LT			

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	⊙	

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub.01 Sep 2021) (including rating assumption sensitivity)

U.S. Public Power Rating Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Unified Government of Wyandotte County/Kansas City (KS)	EU Endorsed, UK Endorsed

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