

RatingsDirect®

Summary:

Seattle; Retail Electric

Primary Credit Analyst:

Peter V Murphy, New York (1) 212-438-2065; peter.murphy@spglobal.com

Secondary Contact:

Paul J Dyson, San Francisco (1) 415-371-5079; paul.dyson@spglobal.com

Table Of Contents

Rationale

Outlook

Summary:

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Credit Profile

US\$151.15 mil mun lt and pwr imp and rfdg rev bnds ser 2016C due 10/01/2046

Long Term Rating AA/Stable New

Seattle muni lt & pwr rev bnds

Long Term Rating AA/Stable Affirmed

Rationale

S&P Global Ratings has assigned its 'AA' rating and stable outlook to Seattle's 2016C municipal light and power improvement refunding revenue bonds. The utility does business as Seattle City Light (SCL). At the same time, S&P Global Ratings affirmed its 'AA' underlying rating on about \$2 billion of SCL's parity debt. The outlook is stable.

We believe credit strengths include:

- A low-cost hydro-based generation portfolio that can meet demand under most water conditions, including less-than-normal water conditions;
- A strong and diverse customer base; and
- Competitive retail rates, despite significant increases in the past few years.

In our view, offsetting factors include some reliance on wholesale sales, and what we view as a large, \$2.3 billion capital improvement program covering 2016-2021, which management expects to issue about \$1.5 billion of debt to fund during that time.

Seattle pledges the light system's gross revenues to pay debt service on the 2016C bonds, and expects that bond proceeds will fund conservation programs, and refinance about \$32 million of series 2010B bonds outstanding.

SCL is a municipally owned electric utility that provides service to approximately 423,000 customers in Seattle and surrounding areas within King County, Wash., covering a population of 776,000. Debt totaled about \$2.0 billion as of the end of August 2016.

We believe SCL's business position is satisfactory ('3' on our scale of '1' to '10', '1' being excellent) due to the utility's ability and willingness to adjust rates to support financial health, a large and diverse customer base with low industrial concentration, and a supply of low-cost hydroelectric power that is sufficient to cover demand and wholesale sales. In our view, challenges include managing hydrology and market risks related to the system's high dependence on hydroelectric power generation for wholesale sales. Rates are about average for the state, but we believe they are very competitive relative to the national average and those of other large utilities in the region.

Historically, SCL has relied on wholesale sales for strong debt service coverage (DSC) levels. Wholesale sales revenue has ranged from 9%-20% of total operating revenue in the past 10 years, although the number has been declining due

to increases in native load demand and prevailing low prices in the wholesale market. Management has taken steps to lower its reliance on wholesale sales to reduce the volatility of financial performance, and intends to continue doing so. As part of its strategy, beginning in 2010, city council has enacted a series of annual base rate increases. It also established a rate-stabilization account, which has an estimated balance of about \$91 million as of fiscal year-end 2015. (Dec. 31). Seattle most recently raised base rates 4.9% in 2016, and has adopted twin increases of 5.6% for fiscal years 2017 and 2018. A 1.5% rate surcharge took effect Aug. 1, 2016, to replenish draws on SCL's rate stabilization fund, because balances had fallen below the \$90 million triggering threshold. Management projects that a 1.5% increase in revenues would generate \$12 million annually. The utility management projects surcharge revenues during 2016-2018 of about \$28 million, and that the rate-stabilization account balance will return to \$100 million by 2018. A portion of wholesale net revenues comes from forward sales of typically nine months or less, and SCL maintains strict limits on the portion of its surplus position made available for forward sales to avoid potentially high replacement power costs in low-water years. S&P Global Ratings believes the system's risk-management policies are conservative, and adequately reduces the risk related to its forward sales.

We believe SCL's overall financial performance is good, although mild weather that affected electricity sales contributed to a decline in DSC in fiscal 2015 to about 1.4x. S&P Global Ratings calculates fixed coverage by including city taxes as an expense, and imputes a portion of long-term purchased power expenses, mainly from Bonneville Power Administration, as debt-like. Fixed charge coverage has also typically been strong, in our view, but also declined in fiscal 2015 to about 1.27x, after transfers from SCL's rate-stabilization account. Given the utility's sizable debt plans, management forecasts that annual debt service will increase, although it has adopted 5.6% annual rate increases through fiscal 2018, which we expect will contribute to increase available net income. Liquidity is good, in our view. Including a rate stabilization account and unrestricted cash and investments, days' cash at fiscal year-end 2015 (Dec. 31) was 135 days, down slightly from fiscal year-end 2014 figures. Bond provisions are what we consider adequate; other provisions include a 1.25x additional bonds test

Outlook

The stable outlook reflects S&P Global Ratings' expectation that SCL will maintain adequate liquidity and DSC levels through rate-stabilization policies, and continued conservative wholesale revenue forecasting. Rate stabilization, in conjunction with the automatic surcharge triggers, has contributed and should continue to contribute to credit stability, in our view.

Upside scenario

Given SCL's large capital plan, and the system's dependence on hydro-electric power that is subject to hydrological variability, we do not expect to raise the rating in the next two years

Downside scenario

We could lower the rating if hydrological conditions or market prices have a negative impact on wholesale revenues, or if debt service and fixed charge coverage metrics do not rebound as forecast, given the utility's plans for additional debt.

Ratings Detail (As Of September 1, 2016)

Ratings Detail (As Of September 1, 2016) (cont.)

Seattle mun lt & pwr (BHAC) (SEC MKT)

Unenhanced Rating

AA(SPUR)/Stable

Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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