

# RatingsDirect®

---

## Summary:

# Seattle; Retail Electric

### **Primary Credit Analyst:**

Doug Snider, Centennial 303-721-4709; doug.snider@spglobal.com

### **Secondary Contact:**

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

## Table Of Contents

---

Rationale

Outlook

## Summary:

# Seattle; Retail Electric

Credit Profile		
US\$373.885 mil mun lt & pwr imp & rfdg rev bnds ser 2017C due 09/01/2047		
<i>Long Term Rating</i>	AA/Stable	New
Seattle mun lt & pwr (BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<b>Seattle muni lt &amp; pwr rev bnds</b>		
<i>Long Term Rating</i>	AA/Stable	Affirmed

Many issues are enhanced by bond insurance.

## Rationale

S&P Global Ratings has assigned its 'AA' rating and stable outlook to Seattle's 2017C 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 \$2.1 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 below-normal water levels;
- 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, \$2.4 billion capital improvement program covering 2017-2022, which management expects to issue about \$1.6 billion of debt to fund.

Seattle pledges the light system's gross revenues to pay debt service on the 2017C bonds, and expects that approximately \$270 million of bond proceeds will fund the utility's capital program and conservation programs, with the remainder refunding a portion of the series 2011A bonds outstanding.

SCL is a municipally owned electric utility that provides service to approximately 447,000 customers in Seattle and surrounding areas within King County, Wash., covering a population of 874,000. Debt totaled about \$2.1 billion at the end of August 2017.

We believe SCL's business position is satisfactory ('3' on our scale of '1' to '10', '1' being excellent), reflecting 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 7%-13% of total operating revenue in the past five years. This has been declining due to increases in native load demand and low prices in the wholesale market. Management has taken steps to lower its reliance on wholesale sales to reduce the volatility in financial performance, and intends to continue doing so. As part of its strategy, beginning in 2010, city council 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 2016 (Dec. 31). Seattle most recently raised base rates 5.6% in 2017, and has adopted a similar 5.6% increase for fiscal year 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 will determine its rate increases for the 2019-2021 period based upon its next strategic plan, which is currently under discussion. The utility management projects surcharge revenues during 2017-2022 of about \$25 million, and that the rate-stabilization account balance will return to \$100 million in 2017. 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 reduce the risk related to its forward sales.

We believe SCL's overall financial performance is good, with DSC ranging from 1.4x-1.6x over the past five years. 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, rebounding to 1.4x in 2016 after a decline to around 1.3x in 2015. Given the utility's sizable debt plans, management forecasts that annual debt service will increase, although it has adopted a 5.6% annual rate increase for fiscal 2018, which we expect will contribute to increased 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 2016 (Dec. 31) was 94 days, down slightly from fiscal year-end 2015 figures. Bond provisions are what we consider adequate; other provisions include a 1.25x additional bonds test.

Seattle entered a direct purchase with State Street Public Lending Corp. in January 2017 that consisted of \$100 million in revenue bonds, which a pledge of SCL's gross revenues secures. The agreement includes what we consider nonstandard events of default under our "Standby Bond Purchase Agreement Automatic Termination Events" criteria (published April 11, 2008, on RatingsDirect) along with an acceleration clause that could require the utility to pay all outstanding principal and accrued interest at the lender's discretion, subject to certain provisions. We view the scope of these provisions as very broad and inherently vague, which makes it difficult to gauge SCL's proximity to the contingent claims on liquidity that the provision presents. Nevertheless, at the current rating, with the utility's strong financial management practices and policies, and based on its financial performance, we view the likelihood of the bank availing itself of these provisions to be remote in most cases. If we lower the ratings significantly, it would amplify the exposure to these provisions. However, in the event of an acceleration of the direct purchase debt, we believe SCL's current cash balances of \$164 million, as of fiscal year-end 2016, as well as the \$1.8 billion of liquidity available from the citywide cash pool, could be called upon if needed.

## 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 additional anticipated debt, and the system's dependence on hydroelectric 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 DSC and fixed charge coverage metrics fall materially short of forecast levels, given the utility's plans for additional debt.

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://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](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

Copyright © 2017 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.