S&P Global
Ratings

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Seattle; Retail Electric

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Seattle; Retail Electric

Credit Profile		
US$203.995 mil mun lt and pwr imp rev bnds ser 2020 A dtd 08/05/2020 due 07/01/2050		
Long Term Rating	AA/Stable	New
Seattle mun lt & pwr rev bnds		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' rating to Seattle's $203.99 million 2020 series A municipal light and power improvement revenue bonds. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating (SPUR) on Seattle's electric system revenue bonds outstanding. The utility does business as Seattle City Light (SCL). The outlook is stable.

Seattle pledges the light system's net revenues to the bonds. The city will use bond proceeds to finance capital improvements and conservation programs for the system, fund a reserve fund, and pay the costs of issuance. Later in the year, the city plans to defease $100 million of high-coupon debt outstanding with operating cash that was previously identified to be used for capital purposes. This reduction in capital funding will be offset by bond proceeds.

Credit overview

The rating reflects the application of our "U.S. Municipal Retail Electric And Gas Utilities" criteria (published Sept. 27, 2018).

The 'AA' rating further reflects SCL's ability to produce stable coverage and liquidity through various hydrological and economic conditions, especially in light of recessionary pressures stemming from the COVID-19 pandemic. Concentration in hydroelectric generation, from both owned assets and power purchases, exposes the city to some surplus sales risks, although it budgets conservatively to minimize the potential effects of this variability. The maturity and diversity of the underlying service area and stable customer base contribute to credit stability, in our view. The rating further reflects our view of the utility's very strong enterprise and financial risk profiles.

The very strong enterprise risk profile reflects our view of the utility's:

- Very strong operational and management assessment, highlighted by primarily hydroelectric assets that are high quality and low cost, with assets and purchased power supply through the Bonneville Power Administration (BPA) offering relatively low-cost supply; the concentration in hydroelectric resources exposes the city to above-average price volatility with respect to surplus sales, although we note it budgets conservatively for wholesale revenues, offsetting this risk somewhat; the operational and management assessment also reflects management's credit-supportive practices and policies, coupled with its sound rate-setting track record;
- Very strong service area economy, highlighted by a large and diverse customer base with low industrial concentration and stable economic fundamentals. However, like many American cities, Seattle has experienced a recent surge in unemployment stemming from the COVID-19 pandemic. Preliminary unemployment figures for April 2020 show an increase to 13.4%;

- Adequate market position, with retail electric rates above the state average following several recent rate increases, although we believe SCL's rates are very competitive with those of other large utilities in the region relative to the national average; and
- Extremely strong industry risk assessment relative to other industries and sectors.

The very strong financial risk profile reflects our view of the department's:

- Very strong fixed charge coverage (FCC) with conservative budget practices, which suggest ongoing maintenance of coverage near historical levels with only modest declines following COVID-19-related load loss;
- Very strong liquidity that, when including a $74.1 rate stabilization account (RSA), totaled $264 million as of Dec. 31, 2019; and
- Strong debt and liabilities profile, characterized by 60% debt to capitalization. The utility's five-year capital improvement plan (CIP) totals $1.84 billion, with about 53% ($972 billion) to be funded with debt. Based on management's projections, we calculate debt to capitalization will improve to about 57% by 2021 as debt amortizes more rapidly than it is added.

The stable outlook reflects S&P Global Ratings' expectation that SCL will maintain its current liquidity levels through rate-stabilization policies, and continued conservative wholesale revenue forecasting. The outlook further reflects our view that average FCC will remain at or above levels we consider very strong, despite projected load loss of about 5% compared to the prior retail sales outlook. Rate stabilization, in conjunction with the automatic surcharge triggers, should continue to contribute to credit stability, in our view.

Environmental, social, and governance

SCL predominantly sources its power through non-carbon emitting hydroelectric and nuclear resources, which limits the utility's exposure to the costs and operational challenges of legislative and regulatory initiatives to reduce greenhouse gas emissions. However, SCL's reliance on a network of hydroelectric dams exposes the utility to substantial ongoing remediation costs for fish passage and fish habitats.

Seattle received early publicity for having a large number of COVID-19 cases in the region and the city was an early adopter of social distancing rules that quickly wound down large gatherings, cut business and tourism travel, and forced restaurants to close or convert to take-out operations. Management has taken several measures to minimize the spread and impact of the coronavirus on staff. Nevertheless, we believe the system faces social risk related to COVID-19, as efforts to protect the health and safety of the community may affect the system's financial metrics.

Further, we believe social risks for SCL are currently elevated as a result of recent significant social unrest. In our view, the associated community unrest could have cost implications stemming from existing lawsuits and public safety cost implications at the city level. Further, continued unrest could lead to property damage or business closures that may compound the issues already facing the utility's commercial customer base. This could result in potential consumption or revenue impacts or unforeseen expenditures in a year when health and safety social risks have already created budget gaps due to stay-at-home orders to contain the community spread of COVID-19. We believe the utility's diverse revenue stream and robust liquidity mitigate these elevated social risks.

Finally, the utility faces social risk related to its relatively high rates compared with those of its peer utilities in the state. In our view, the service area's above-average income levels partially mitigate this risk.

We view the utility's governance factors as credit supportive, as they include full rate-setting autonomy; and robust policies, forecasting, and planning.

Stable Outlook

Downside scenario

We could lower the rating if the city's additional leverage, rising power supply costs from BPA, or recessionary pressures or demand loss related to the pandemic result in materially higher retail rates or a weakened competitive position that frustrates SCL's ability to maintain liquidity and achieve FCC commensurate with recent years' levels.

Upside scenario

We remain uncertain as to the final magnitude and duration of the global recession and the specific effect on any individual utility's operations and financial profile, limiting any upside for the rating or outlook until credit conditions demonstrate sustained improvement and stability. In addition, given SCL's financial forecast that indicates financial metrics in line with historical levels, increasing rates, declining retail sales, and its large CIP and additional anticipated debt, we do not expect to raise the rating in the next two years.

Credit Opinion

With more than 470,000 customers, SCL is the largest municipal utility in the state of Washington. It provides service within Seattle and surrounding areas of King County, covering a population of about 940,000. The utility's predominantly hydroelectric power supply portfolio is low-cost and carbon-free. It provides power to a stable customer base with access to a broad and diverse economy.

Enterprise Risk Profile: Very Strong

Operational management assessment (OMA): Very strong

In our opinion, SCL's operational management is very strong, highlighted by very strong operational assets; very strong rate setting; extremely strong management, policies, and planning; and strong environmental compliance. Management activated its incident command system (ICS) on March 4, following the state of emergency declaration in the state of Washington on February 29. The utility had in place a continuity of operations plan that was then enacted on March 25. The utility benefited from advance emergency planning, strong coordination with the city, regular monitoring of electric utility finances and operations, and a successful migration to telecommuting. Looking forward, SCL anticipates reducing its workforce to facilitate more agile operations.

Low generating costs, very high reliance on hydroelectric generation, and surplus generation capacity in most months characterize SCL operations. The system's hydroelectric generating assets are distributed among the Columbia River-based Federal System and two other independent river systems. Owned generating assets include the Boundary and Skagit river projects, representing 26% and 16% of energy needs in 2019, respectively. Additional resources include a maximum of 175 megawatts from the Stateline Wind Project and a number of smaller renewable contracts. In our view, SCL's owned assets combined with BPA purchases provide ample energy to meet load demands. Management reported 10% and 8% energy consumption declines, respectively, in April and May 2020 on a weather-adjusted basis, due to pandemic-response measures. The utility has experienced generally stable residential loads, with the brunt of the losses attributable to SCL's commercial and industrial customers. Management projects a 5% decrease in load from 2019-2021 relative to the previous budget; a figure that has been incorporated in SCL's financial projections. We believe SCL's diverse load profile and broad customer base should allow the utility to meet these projections.

SCL's block allocation under its current contract with the BPA is sized to bring the utility into load-resource balance under critical water conditions, with the goal of considerably reducing supply risk for its retail operations. The system's block product is designed to more closely balance its firm resource requirements. Nevertheless, the city's reliance on owned hydroelectric assets introduces a measure of hydrological and wholesale power market risk to SCL in achieving its financial targets.

Management has taken steps to lower its reliance on wholesale sales to reduce financial performance volatility, and intends to continue doing so. 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. Furthermore, as part of its strategy, beginning in 2010, city council enacted a series of annual base-rate increases. It also established an RSA to further offset potential revenue volatility. In our view, management has established an excellent track record of rate setting, as evidenced by SCL's historically robust and stable financial metrics, further supported by the utility's two automatic pass-through mechanisms.

The utility updates its long-term strategic plan every two years, and updates its five-year financial and capital forecasts annually. Management also maintains a robust 1.8x debt service coverage policy. Given these policies, coupled with the utility's conservative forecasting practices noted above, we believe SCL's management, policies, and planning procedures are very strong.

SCL's renewable resources comply with Washington's Renewable Portfolio Standard (known as I-937). The utility is required to obtain "eligible" renewable resources equal to at least 9% of its load through 2019 and 15% thereafter to comply with I-937. Management reported that current power contracts will be sufficient to meet the state's renewable mandate under a no-load growth scenario for the next decade. Prior to the pandemic and recession, the city forecast slightly declining load annually because of conservation efforts and energy-efficiency advancements, with expectations that electrification will reverse the trend by the early 2030s. We believe the costs of complying with I-937 will be manageable given the city's existing power portfolio and management's proactive approach.

The Washington State Legislature passed E2SSB 5116 in May 2019, designed to transition the electricity sector to 100% clean power. The Clean Energy Transition Act establishes three standards for Washington State utilities, which include eliminating all coal, requiring utilities to provide 100% carbon-neutral electric service to retail load, and a 100% Clean Electricity Standard by 2045. Utilities will be required to demonstrate compliance with this policy on an annual basis. SCL is evaluating compliance strategies, but believes it is well positioned to satisfy the 2030 requirement.

Economic fundamentals: Very strong

The city of Seattle sits at the center of the large, diverse Puget Sound regional economy. SCL's service area consists principally of Seattle, but it also has franchise agreements with several cities in King County and some unincorporated areas. The city's median household effective buying income was 141% of the U.S. in 2019. Although the customer base is primarily residential, about two-thirds of retail sales are to commercial and industrial customers. Total 2019 retail sales of 9,122 gigawatt-hours reflect a 0.5% increase from 2018 figures. The customer base is what we consider diverse, with the 10 leading customers accounting for just 15.5% of total revenues, and no single customer exceeding 3.3% of sales revenue. The city's large size, high incomes, and stable customer base provide the utility a high degree of revenue stability and operational flexibility, and provide cushion in light of the COVID-19 pandemic.

Market position: Adequate

Seattle's average overall rates are slightly above the state average, suggesting that despite solid demographics, there are some constraints to revenue-raising flexibility. According to the Department of Energy's Energy Information Administration, the city's weighted-average revenue per kilowatt-hour was 113% of the state average in 2018 (the most recent year for available comparative information). Seattle has adopted regular base-rate increases, between 5.5% and 5.8%in each of the past three years. The city also automatically passes through cost fluctuations from BPA, and maintains an RSA surcharge that is automatically applied if the balance of its RSA drops below a certain level. While these mechanisms have supported very stable financial metrics, Seattle's competitive position has also eroded somewhat in recent years. However, the city's high income levels and relatively favorable rates compared with those of other large U.S. cities mitigate this somewhat, in our view. Seattle's projected 2021 rate action has been delayed pending the city's recovery planning process.

Industry risk: Extremely strong

Consistent with our criteria "Methodology: Industry Risk" (published Nov. 19, 2013), we consider industry risk for municipal retail electric and gas utilities covered under these criteria very low, and therefore extremely strong compared with that of other industries and sectors.

Financial Risk Profile: Very Strong

Coverage metrics: Very strong

Seattle's coverage of fixed costs, which include BPA power purchases, has averaged 1.56x over the past three years. Our calculations suggest coverage will decline to about 1.35x in 2020 before rebounding to about 1.4x through 2021. We believe these projections are reasonable, as they have taken into account pandemic-related load losses and delayed rate increases.

Surplus sales accounted for approximately 4.5% of operating revenue in 2019, and have historically ranged from 4.5%-11% of operating revenues. While the exposure to surplus sales introduces greater potential revenue volatility, management has prudent policies in place to mitigate surplus sales risk, as demonstrated by the city's strong coverage and liquidity through various hydrologic and market conditions. As a result, we believe this risk is mitigated and we did not adjust the coverage metric downward.

Liquidity and reserves: Very strong

Seattle ended fiscal 2019 with $264 million of available reserves, or 139 days' worth of operating reserves, including a $74.1 million RSA. SCL draws on its RSA when net wholesale revenue is lower than budgeted amounts, as it did in 2019 when wholesale revenues were $39.5 million short of budgeted levels. The utility targets a $100 million balance and automatically enacts a surcharge on its rates to achieve this amount.

Debt and liabilities: Strong

The debt and liabilities score is strong, characterized by a 60% debt-to–capitalization ratio. The utility's five-year (2020-2024) CIP totals $1.84 billion. SCL has reported it may delay or defer certain projects to provide cushion against COVID-19-related pressures. Specifically, it may delay its pole-replacement project by about one year. We do not expect these deferrals will materially affect SCL's operational health or flexibility. The utility anticipates funding its CIP with about $972 million of debt, and the balance with cash and available revenues. We have taken a forward-looking view in our analysis given projections that indicate leverage easing as debt is paid off faster than it is added.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of July 9, 2020)		
Seattle muni lt & pwr rfdg rev bnds		
Long Term Rating	AA/Stable	Affirmed
Seattle muni lt & pwr rfdg rev bnds		
Long Term Rating	AA/Stable	Affirmed
Seattle muni lt & pwr rfdg rev bnds		
Long Term Rating	AA/Stable	Affirmed
Seattle muni lt & pwr rfdg rev bnds		
Long Term Rating	AA/Stable	Affirmed
Seattle mun lt & pwr imp rev bnds ser 2019A dtd 2//20/08/2 due 04/01/2049		
Long Term Rating	AA/Stable	Affirmed
Seattle mun lt & pwr rfdg rev bnds ser 2019B dtd 08/22/2019 due 02/01/2026		
Long Term Rating	AA/Stable	Affirmed
Seattle mun lt & pwr (BHAC) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.