MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 rating to Seattle, WA's 2015 electric revenue bonds; outlook stable

Global Credit Research - 09 Jun 2015

Approximately $2.3 billion of debt securities affected

SEATTLE (CITY OF) WA
Electric Generation
WA

Moody's Rating

ISSUE		RATING
Municipal Light and Power Improvement and Refunding Bonds, 2015		Aa2
Sale Amount	$290,000,000	
Expected Sale Date	06/13/15	
Rating Description	Revenue: Government Enterprise	
Municipal Light and Power Revenue Bonds, 2015 (SIFMA Index)		Aa2
Sale Amount	$100,000,000	
Expected Sale Date	06/13/15	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook STA

NEW YORK, June 09, 2015 --Moody's Investors Service has assigned Aa2 ratings to $390 million of City of Seattle, WA's (Seattle) Electric Enterprise's (Seattle City Light or SCL)'s revenue bonds consisting of $290 million of Municipal Light and Power Improvement and Refunding Revenue Bonds, 2015 and $100 million of Municipal Light and Power Revenue Bonds 2015 (SIFMA Index). Moody's also affirmed Seattle City Light's Aa2 rating on outstanding revenue bonds. The rating outlook is stable.

SUMMARY RATING RATIONALE

Seattle City Light's Aa2 rating considers SCL's strong historical willingness to raise rates when necessary, wealthy and diverse service area covering the City of Seattle (UTGO Aaa/stable) and surrounding communities, and credit supportive financial policies including the Rate Stabilization Account (RSA). Other credit supportive factors are SCL's ownership of low cost hydro generation, long-term power supply contract with Bonneville Power Administration (BPA, Aa1/stable), competitive retail rates, and SCL's participation in the City of Seattle's consolidated money pool.

However, the Aa2 rating also captures credit challenges including material wholesale price exposure, hydrology risk, and forecasted financial metrics in the 'A' category under Moody's US Public Power with Generation Ownership methodology. The rating further considers SCL's continued growth in debt to fund its $2.3 billion, 6-year capital improvement plan (CIP).

OUTLOOK

The stable outlook considers the benefit of the RSA mechanism, expected 'A' category financial metrics in 2016 and thereafter with 140 days cash on hand and adjusted debt service coverage ratio (DSCR) north of 1.5 times, and city council's demonstrated willingness to support credit quality. The stable outlook is also supported by the City of Seattle's strong economy and SCL's participation to the City of Seattle's consolidated money pool.

WHAT COULD MAKE THE RATING GO UP

The ratings could be upgrade if SCL is able to sustain financial metrics in the 'Aa' category including internal liquidity comfortably exceeding 150 days cash on hand and adjusted DSCR exceeding 2.0 times.

WHAT COULD MAKE THE RATING GO DOWN

SCL's ratings could be downgraded if the RSA mechanism is removed or weakened, the city council's willingness to increase rates diminishes or if financial metrics drop into the 'Baa' category including days cash on hand below 90 days or Moody's adjusted DSCR below 1.5 times. SCL's rating also can be downgraded if SCL does not have liquidity support through the City of Seattle's money pool, if SCL's financial policy targets were to be downwardly revised or if the underlying regional economy were to severely deteriorate.

STRENGTHS

-Strong and diverse service area anchored by the City of Seattle

-Demonstrated willingness to set rates including RSA mechanism

-Ownership of low cost hydro and contracted power from BPA

-Competitive retail rates

-Liquidity support through City of Seattle's consolidated money pool

CHALLENGES

-Hydrology and wholesale market risk

-Forecasted 'A' category financial metrics

-Very large capital spending program

RECENT DEVELOPMENTS

In May 2015, Washington State declared a statewide drought emergency due to substantial below average regional snowpack. Above average temperatures resulted in above average water flow early in the 2015 water year and National Oceanic and Atmospheric Administration (NOAA) forecasts 70% of average water flow for the April through September period. However, for the 2015 water year (October through September), NOAA forecasts that regional hydrology (Dalles Dam) will be around 87% of water which is not as severe as the April through September period. Below average hydrology lowers SCL's wholesale revenues and moderately weakens financial performance.

In May 2015, Jorge Carrasco retired as the general manager. James Baggs, previously the utility's chief compliance officer, is serving as the interim general manager until a permanent replacement can be found.

DETAILED RATING RATIONALE

REVENUE GENERATING BASE

Strong and Diversified Service Area in the Economic Heart of the Region

The utility derives more than 80% of its revenues from the sale of electricity to retail customers in the City of Seattle and surrounding communities, which has 776,000 residents as of 2014. Service in the surrounding communities is provided under franchise agreements and several are currently under negotiations for extension. SCL's rate process is governed by the city council and is not regulated by the state regulatory board.

The City of Seattle is located in King County, WA (UTGO Aaa/stable), which is the economic heart of the region. The City of Seattle's wealth levels are fairly high for a large city, with 2012 estimated median family income 145.5% of the U.S. Full value per capita, at $230,630 also remains very high for a major metropolitan city. The major economic activities in the greater Puget Sound region are technology, manufacturing, healthcare, military and education. The strong service area has also outperformed the US average with unemployment around 3.7% (preliminary) as of March 2015 compared to around 5.5% for the US. While the economy generally is strong, total electric demand has been generally flat over the last five years partly due to conservation efforts. Looking forward, the utility expects modest load growth over the next four years due to ongoing conservation efforts.

In conjunction with a robust service area, Seattle City Light's average system rates are well below the main investor owned utility in the area and remain modestly below Washington State's weighted average rate. The combination of competitive rates and a very strong service area further supports SCL's rate raising ability and willingness. The low rates also support Moody's assumption that the franchise agreements with neighboring communities currently under negotiation will be extended as planned.

Hydrology and Market Based Revenues

SCL derives approximately 10-20% of its revenue from non-retail sources such as wholesale revenue that can experience volatility owing to both hydrology and market prices. A severe drop of wholesale revenue resulted in adjusted DSCR dropping to below 1.0 times in 2009. Since then, SCL has implemented rates increases including a 13.8% base rate increase in 2010 and also installed the RSA mechanism (see Liquidity section). The rates increases have contributed to the growth in the more stable retail revenue from 62% of total revenue in 2008 to 81% of total revenue by 2014.

FINANCIAL OPERATIONS AND POSITION

Hydro Dependent Power Supplies

In 2014, SCL received approximately 48% of its power from owned generation, 35% from BPA, and the remainder from other sources such as the wholesale market, exchange agreements, and other various long-term contracts. Owned generation totals 1,872 MW of nameplate hydro dams and primarily consists of the 1,022 MW Boundary hydro project (Boundary Project) and the 802 MW Skagit hydro projects (Skagit Projects). The Boundary Project is located in Pend Oreille county in Washington State and its FERC license was recently renewed to 2055. The Skagit Projects comprise of three hydro projects that operate as one system since they are located on the same ten-mile section of the Skagit River. SCL also has smaller hydro facilities totaling 48 MW.

SCL also has a long-term contract with BPA that provides a 3.63% slice of the federal hydro system (265 aMW under critical water) and 269 aMW of firm power shaped through the year. BPA's contract is considered an attractive long-term source of power. SCL also has long-term agreements with other hydro projects such as the Priest Rapids project and long-term agreements with wind, landfill and biomass projects that contributes to Washington State's renewable portfolio standards through 2020. SCL plans to meet the 2016 increase in renewable requirements primarily through the purchase of RECs.

Over the longer term, SCL expects substantial investment in conservation to limit demand growth and ultimately the need for new power resources through at least 2020.

Large Capital Spending Plan

SCL's forecasted capital program remains sizeable at approximately $2.3 billion from 2015 to 2020 and continues to grow over time. The largest focus of the CIP is on the distribution system at $958 million, which include electric system related spending tied to the Alaskan Way Viaduct and seawall replacement and more typical expenditure like capacity additions. Forecasted generation related expenditures total $403 million and include environmental mitigation and plant improvements. Costs of conservation are also sizable at around $252 million.

SCL plans to fund these expenditures approximately 62% with debt, 29% from operations and the remaining from contributions. While the sizeable program and associated substantial increase in debt remain credit challenges for SCL, the risk remains manageable given the city council's demonstrated willingness to raise SCL's rates as necessary, the RSA, and SCL's forecast of at least 'A' category financial metrics. If any of these credit factors were to weaken, SCL's ratings will likely be negatively affected especially given the sizeable CIP.

Historical Volatility in Debt Service Coverage Ratios

Historically, SCL's DSCR have been volatile with a low of 1 times and a high of 2.1 times since 2009 with wholesale revenue as the biggest source of volatility. However, as SCL's retail revenues continue to grow and represent a larger share of total revenues, the volatility has decreased. For 2014, adjusted DSCR improved to 1.63 times from near 1.4 times in 2013 due to improving net revenues including higher wholesale revenue. Looking forward, adjusted DSCRs are forecasted to remain above 1.5 times assuming average water. SCL's reported DSCR in 2014 was 1.85 times which is calculated per SCL's bond resolution and thus excludes the subordinated city utility tax.

Liquidity

SCL's standalone liquidity consists of unrestricted funds and balances in the RSA account that equaled 166 days cash on hand at year end 2014. SCL's liquidity have been declining since 2011 and looking forward we expect the utility to maintain internal liquidity in the 'A' category (90-150 days cash on hand) with volatility primarily driven by wholesale revenue.

Anchoring SCL's minimum liquidity is the RSA mechanism. The RSA targets $100 million to $125 million in the RSA and an automatic surcharge is triggered if the cash balance drops below specific thresholds. The quarterly surcharge is 1.5% if the RSA is less than $90 million, 3.0% if the RSA is less than $80 million and 4.5% if the RSA is less than $70 million. If the RSA drops to $50 million or below, the city council must convene a rate review to try to bring the RSA up to $100 million within 12 months. If the RSA is above $125 million, excess funds could be used to refund ratepayers or be used for other purposes such as capital expenditures. Moody's views the RSA as a key risk management tool for SCL that supports minimum liquidity and financial metrics. If the RSA mechanism is weakened or eliminated, SCL's rating would likely be negatively impacted.

An additional source of liquidity is the City of Seattle's consolidated money pool, which totaled $1.6 billion ($791 million net of enterprise funds) at year-end 2014. Seattle's Director of Finance is authorized to make loans to Seattle's various enterprise funds including SCL for up to 90 days. For loans beyond the 90-day period, city council approval is required. Loans bear interest at the cash pool's rate of return. City of Seattle's liquidity support for SCL via the money pool was demonstrated during the 2001 power crisis when SCL borrowed up to $107 million from the money pool and again in 2010 when SCL borrowed $14 million.

DEBT AND OTHER LIABILITIES

Debt Structure

Nearly all of SCL's debts are traditional fixed rate obligations that fully amortize over time. The only exception is the $100 million of variable rate debt that is part of SCL's 2015 new issuance. While the variable rate obligation is expected to have a long dated maturity, these bonds have a 'soft put' feature after the initial floating rate period whereby the utility has to remarket or refund these obligations. An inability to meet the 'soft put' results in a penalty interest rate but it does not result in an event of default. There is no credit enhancement such as a letter of credit supporting the variable rate debt and the variable rate debt floats based on SIFMA. We anticipate the utility will issue more variable rate debt in the future.

Debt-Related Derivatives

SCL does not have any derivatives other than those for power hedging.

Pensions and OPEB

SCL participates in the City of Seattle's single-employer defined-benefit public employee retirement plan (SCERS). As of FY 2013, the three-year average of the city's gross adjusted net pension liability (ANPL) was $2.4 billion, or 2.14 times General Fund revenues. The city records an implicit subsidy for OPEB.

MANAGEMENT AND GOVERNANCE

Seattle's mayor and city council has ultimate authority over SCL and approves SCL's budget, sets rates, and approves any financing. A separate City Light Review Panel comprising of SCL's customers reviews and assesses SCL's strategic plan, financing policies and rates. SCL's rate process is not regulated by the state regulatory board.

Seattle's city council has shown a demonstrated willingness to use its authority to raise retail rates to support SCL's financial condition. For example, SCL raised rates 39% in 2001 and 13% in 2002 in response to extremely low hydro and high power prices during the 2001 power crisis. In January 2010, SCL implemented a 13.8% increase and also adopted the RSA mechanism. Since then, the city council has implemented steady base rate increases with the last increase of 4.2% for 2015 and 4.9% for 2016. Looking forward, the city council approved SCL's Strategic Plan calls for a 4.4% average annual increase from 2015 to 2020 for the base rate. A separate automatic rate adjustment mechanism exists for any BPA cost increases in addition to the RSA mechanism. The city council's continued willingness to implement rate increases, the BPA pass through adjustment, and the RSA mechanism are considered strong credit support factors. A material weakening of the willingness to raise rates, BPA cost pass through or the RSA mechanism would be credit negative.

General Fund Transfer

SCL pays a utility tax to the City of Seattle equal to 6% of gross revenues from retail sales, less certain adjustments. The utility tax is subordinate to debt service. SCL also pays a separate state public utility tax equal to 3.8734% of Gross Revenues from sales within the State, less certain adjustments.

OTHER CONSIDERATIONS: MAPPING TO THE GRID

Moody's evaluates Seattle City Light under the US Public Power Electric Utilities with Generation Ownership Exposure methodology, and, as depicted below, the grid indicated rating is Aa2, in line with its current Aa2 rating.

The grid is a reference tool that can be used to approximate credit profiles for public power with generation ownership in most cases. However, the grid is a summary that does not include every rating consideration. Please see US Public Power Electric Utilities with Generation Ownership Exposure for more information about the limitations inherent to grids.

METHODOLOGY SCORECARD FACTORS

1 Cost Recovery Framework in Service Area: (25% weight) (Aaa)

2. Willingness to Recover Costs and Maintain Sound Financial Metrics (25% weight) (Aa)

3. Management of Generation Risk- (10% weight) (A)

4. Rate Competitiveness: (10% weight) (A)

5. Financial Strength:

Sub factor a) Adjusted Days Liquidity on Hand: (10% weight) (192 3-yr avg) (Aa)

Sub factor b) Debt Ratio: (10% weight) (61% 3-yr avg) (A)

Sub factor c) Adjusted Debt Service Coverage: (10% weight) (1.50x 3-yr avg) (A)

Grid Indicated Rating: Aa3

Notching: +1 (liquidity support through Seattle's consolidated money pool)

Scorecard Indicated Rating: Aa2

KEY STATISTICS

Total Unrestricted Cash and Investments, 2014: $243 million

Boundary Project Hydro Capacity (Nameplate): 1,022 MW

Skagit Projects Hydro Capacity (Nameplate): 802 MW

Moody's Total Debt Service Coverage, 2014: 1.88 times (not adjusted) / 1.63 times (adjusted)

Senior Debt Service Coverage, 2014: 1.85 times (per resolution)

Cash to Debt Ratio, 2014: 13.4%

Debt Ratio, 2014: 59.4%

Consolidated Days Cash on Hand, 2014: 166 days

City of Seattle's Cash and Investment Pool, 2014: $1.6 billion ($791 million net of enterprise funds)

Average System Rate, 2014: Approximately 7.7 cents/kwh

Revenue Bonds, 2014: $1.9 billion

OBLIGOR PROFILE

Seattle City Light is a department of the City of Seattle, which operates a utility system that primarily generates and delivers electricity to approximately 415,056 customers in the City of Seattle and several surrounding communities under franchise agreements. The City of Seattle is located in the western part of Washington State and is commercial hub for the Pacific Northwest. SCL's service area comprises of 131 square miles and has a population of approximately 776,000.

LEGAL SECURITY

SCL's bonds are secured by a pledge of the gross revenues of Seattle City Light and covenants require that the City of Seattle set rates to fund debt service, operating costs and other costs to maintain the system. Moody's considers the rate covenant to be weaker than typical for similar issuers. For additional indebtedness, SCL is required to meet a 1.25 times DSCR based on net system revenues incorporating draws from and deposits into the RSA. Furthermore, the bonds have a debt service reserve for all parity bonds sized to the lesser of maximum annual debt service or reasonably required reserve or replacement fund per the tax code. The reserve is currently sized to 125% of average annual debt service (excluding variable rate debt). After debt issuance, the reserve is expected to be funded with a $77 million surety from Assured Guaranty Municipal Corp (insurance strength: A2-stable) and $64.4 million of cash.

USE OF PROCEEDS

Approximately $267 million of the issuance will fund a portion of SCL's capital spending plans, pay for transaction costs, and provide for incremental funding of the debt service reserve. The remaining funds are expected to refund a portion of 2008 series revenue bonds.

ISSUER CONTACT

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PRINCIPAL METHODOLOGY

The principal methodology used in this rating was U.S. Public Power Electric Utilities with Generation Ownership Exposure published in November 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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