Full Analysis

June 14, 2012

Seattle, Washington; Retail Electric

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Credit Profile		
US$298.0 mil mun lt & pwr imp rfdg rev bnds ser 2012A due 06/01/2041		
Long Term Rating	AA-/Stable	New
US$43.0 mil mun lt & pwr imp rev bnds (Taxable Renewable Energy Bnds) ser 2012C due 06/01/2033		
Long Term Rating	AA-/Stable	New
US$9.0 mil mun lt & pwr rfdg revn bnds (Taxable) ser 2012B due 12/01/2014		
Long Term Rating	AA-/Stable	New

Rationale

Standard & Poor's Ratings Services has assigned its 'AA-' rating to Seattle, Wash.'s municipal light and power improvement and refunding revenue bonds, series 2012A and 2012B; and improvement revenue bonds, series 2012C. At the same time, Standard & Poor's affirmed its 'AA-' rating on the system's parity lien debt and its 'AA-' underlying rating on the debt. The outlook is stable. The 2012C bonds will be sold as New Clean Renewable Energy Bonds (CREBs). The system does business as Seattle City Light (SCL).

The rating reflects our opinion of the following strengths:

- A low-cost hydro-based generation portfolio that can meet demand even under below -normal water conditions;
- A strong and diverse customer base;
- Good financial management; and
- Competitive retail rates, despite significant rate increases in the past few years.

In our view, offsetting factors include reliance on wholesale sales, which affected fiscal years 2009 and 2010 (year ended Dec. 31) net income, although SCL proactively addressed much of the potential volatility through the funding of a rate stabilization account. We also believe the system's debt leverage and a large capital improvement program that will add $1.16 billion of debt in the next six years offset these strengths.

Seattle (general obligation rating: AAA/Stable) plans to issue the 2012C bonds as CREBs. As such, the city will be allowed a tax credit, which management expects will approximate 70% of the interest due on the bonds, and will account for the tax credit as gross revenues in debt service coverage (DSC) calculations. Seattle pledges the light system's gross revenues to pay debt service on the 2012C bonds, and expects bond proceeds will fund improvements at the electric system's Boundary hydroelectric project. The city will use the 2012A bonds for various capital improvements and conservation programs, and some of the proceeds of the 2012A and 2012B issues to refund parity debt outstanding.

SCL is a municipally owned electric utility that provides service to approximately 400,000 customers in Seattle and surrounding areas within King County, Wash., covering a population of 785,000. Debt outstanding totaled about $1.6 billion as of April 30, 2012.

We believe SCL's business position is satisfactory ('3' on our scale from '1' to '10', '1' being excellent) due to its ability and willingness to adjust rates to support the utility's 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 native demand as well as energy for wholesale sales. In our view, challenges include managing hydrology and market risks related to its 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 compared with those of other large utilities in the region.

Historically, SCL relies on wholesale sales for strong DSC levels. Wholesale sales revenue as a percent of total operating revenues has ranged from 10% to 21% over the past ten years, although in fiscals 2009-2011, low prevailing market prices and below average stream flows, especially in 2009 and 2010, resulted in reduced revenues from wholesale activity (10% to 13% of total operating revenues). The decline dramatically affected financial performance in 2009 and 2010. In Standard & Poor's view, Seattle's response in late 2009 and early 2010 led to a rebound in 2011, will positively affect its long-term financial performance, and will reduce the financial impacts of variability in wholesale revenues. The city council approved a 13.8% base rate increase effective Jan. 1, 2010, and a temporary surcharge of 4.5% effective May 1 that year as part of a plan to rebuild reserves. In addition, we believe the rate-stabilization account, which was well above the targeted balance of $100 million as of Dec. 31, 2011, will address variances in wholesale sales levels. A debt restructuring and a temporary rate surcharge were significant components of the initial rate-stabilization account funding plan. SCL management projects that the rate-stabilization account balance will remain at or above $70 million through 2014, and the surcharge has already been eliminated, although management indicates that surcharges are likely to be implemented in 2013. In addition, SCL's management forecasts projected annual wholesale net revenues of $51 million-$95 million through 2014. A significant 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. Standard & Poor's 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, with strong DSC during fiscal years 2005-2011 (1.5x-2.0x), the exception being a drop in fiscal 2009 to about 1.2x. Standard & Poor's calculates coverage including city taxes as an expense. Fixed charge coverage (of both debt service and purchase power obligations) has also been strong, typically, in our view, exceeding 1.4x during the same period, again with 2009 excepted.

Outlook

The stable outlook reflects Standard & Poor's expectation that SCL will maintain adequate liquidity and DSC levels through rate-stabilization policies, and continued conservative wholesale revenue forecasting. We believe these improved financial practices will contribute to credit stability. We could raise the rating if SCL maintains consistently strong financial performance while executing its sizable capital plan. We do not expect to lower the rating in the next two years.

Diverse Customer Base

SCL's service area consists principally of Seattle, but it also has franchise agreements with several cities within King County and some incorporated areas that in total account for about 15% of energy sales. Management estimates the population of its service area at 788,500. While the customer base is primarily residential, two-thirds of retail sales are to commercial and industrial customers. While flat since 2006 levels, 2011 retail sales of 9,600 gigawatt-hours reflect 1% compound annual growth since 2003. SCL forecasts continued modest annual growth, due in part to

Seattle's increased conservation efforts. Peak demand of 1,748 megawatts (MW) in 2011 is about 8% below 2008's peak, reflecting a combination of conservation and slowed economic activity. The customer base is diverse, in our view, exhibiting little concentration, with the 10 leading customers accounting for about one-sixth of revenues.

Strong Hydrological Assets Provide Low-Cost Power

Low generating costs, very high reliance on hydroelectric generation, and large surplus generation capacity in most months characterize SCL operations. The system's hydroelectric generating assets are distributed between the Columbia River-based Federal System and two other independent river systems. Owned-generating assets, with an average production cost of under $10 per megawatt-hour, include the Boundary project and the Skagit River projects, representing 26% and 16% of total resources, respectively. Additional resources include a maximum of 175 MW from the Stateline Wind Project.

SCL's block and slice allocations under its BPA contract are sized to bring it into load-resource balance under critical water conditions, with the goal of considerably reducing its supply risk for its retail operations. The system's 17-year contract with Bonneville Power Administration (BPA) took effect October 2011, and provides it with BPA's block and slice products, which are designed to more closely balance the utility's firm resource requirements.

Nevertheless, this reliance introduces a measure of hydrological and wholesale power market risk to SCL achieving its financial targets. A significant portion of wholesale net revenues comes from forward sales of typically nine months or less. The system has adopted risk-management policies and forward sales guidelines, which establish limitations on the timing and quantity of forward sales to avoid potentially high replacement power costs when hydroelectric power supplies fall short of expectations. Standard & Poor's also believes that the recent rate-stabilization account ordinance will offset much of the budgetary risk, since rate surcharges are triggered automatically in the event that the account balance falls below $90 million.

Finances

Financial flexibility is adequate, in our view, given the city council's ability and willingness to set rates to support SCL's financial position. Seattle has adopted modest retail rate increases in each of the past two fiscal years, and a proposed six-year financial plan assumes 4.7% annual rate increases to support rising operating costs and a sizable capital program. Increases in power supply costs from SCL's contract with BPA are passed through automatically in the utility's retail rates, a mechanism that we view favorably from a cost-recovery standpoint. The city is developing a long-range strategic plan that addresses operating and capital costs, and would include modest annual rate increases, and significant cuts in nonpurchased power expenses.

Following a strong operating year in 2011, unrestricted cash and investments and other available reserves as of fiscal year-end 2011 totaled $171 million, or what we consider a sound 110 days' expenditures. Seattle also has access to interdepartment loans from a sizable common fund, which is estimated at $1.27 billion. We believe debt leverage is high but stable, at about 64%; the city projects it to decline gradually toward SCL's target of 61% by 2014. However, capital requirements are high, in our view, totaling about $1.8 billion in 2012-2017, with $1.16 billion to be debt-funded. No specific project dominates, although 42% of the plan's costs are distribution projects, including new substations and upgrades to existing services. A city resolution specifies that capital funding must contain not less than 40% from operations, which we expect will result in debt leverage levels consistent with the city's target.

SCL has no floating-rate debt.

SCL projects that it will achieve consistently strong coverage, slightly above recent levels, and also expects combined DSC of at least 1.75x through 2014. Given the system's debt plans, ongoing financial performance will be influenced by the extent to which on whether Seattle generates sufficient net income to support its capital program, and incorporates rate increases as assumed in its financial plan. These rates will likely support superior coverage levels that are consistent with ratings in the 'AA' category.

Related Criteria And Research

USPF Criteria: Electric Utility Ratings, June 15, 2007

Ratings Detail (As Of June 14, 2012)		
Seattle muni lt & pwr rev bnds		
Long Term Rating	AA-/Stable	Affirmed
Seattle mun light & pwr rfdg rev bnds ser 2002 dtd 12/01/2002 due 12/01/2003-2014		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Seattle mun lt & pwr imp & rfdg rev bnds		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.