STANDARD & POOR'S RATINGS SERVICES
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Seattle, Washington; Retail Electric

Primary Credit Analyst:
Peter V Murphy, New York (1) 212-438-2065; peter.murphy@standardandpoors.com

Secondary Contact:
Paul J Dyson, San Francisco (1) 415-371-5079; paul.dyson@standardandpoors.com

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Credit Profile		
US$267.175 mil mun lt & pwr rev bnds ser 2014 due 09/01/2044		
Long Term Rating	AA/Stable	New
Seattle muni lt & pwr rev bnds		
Long Term Rating	AA/Stable	Affirmed
Seattle mun lt & pwr imp & rfdg rev bnds		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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 2014 (the utility does business as Seattle City Light [SCL]). At the same time, Standard & Poor's affirmed its underlying rating on 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 capital improvement program (CIP) that management expects will add about $1.25 billion of debt in the next six years.

Seattle pledges the light system's gross revenues to pay debt service on the 2014 bonds, and expects bond proceeds will fund improvements at the electric system's Boundary hydroelectric project. The city will use 2014 bond proceeds for capital improvements and conservation programs, and refund parity debt outstanding.

SCL is a municipally owned electric utility that provides service to approximately 408,000 customers in Seattle and surrounding areas within King County, Wash., covering a population of 776,000. Debt totaled about $1.78 billion as of Sept. 1, 2014.

We believe SCL's business position is satisfactory ('3' on our scale of '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 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 levels. Wholesale sales revenue has ranged from 9%-20% of total operating revenue in the past 10 years, although the number has been falling. Management intends to lower its reliance on wholesale sales to reduce volatility of financial performance. As part of its strategy, since 2010, city council has enacted a series of annual base rate increases. It also established a rate-stabilization account, which held $110 million as of fiscal 2013. A debt restructuring and a temporary rate surcharge in 2010 were significant components of the initial rate-stabilization account funding plan. In addition to the base-rate increases, Seattle most recently raised rates 5.6% in 2014, and recently adopted increases of 4.2% and 4.9%, respectively, for fiscals 2015 and 2016.

SCL management projects the rate-stabilization account balance to remain at or above $106 million through 2017, and as of October 2014, it expects it will not need any additional rate-stabilization fund surcharges from 2014-2020. 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. 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 sound, with strong DSC during fiscal years 2005-2013 (1.5x-2.0x), except for a drop in fiscal 2009 (year ended Dec 31) to about 1.2x. Standard & Poor's calculates coverage by including city taxes as an expense. Fixed charge coverage (of both debt service and purchase power obligations) has also typically been strong, in our view, exceeding 1.3x during the past two years. Bond provisions are what we consider adequate, and include a 1.25x additional bonds test, and a sufficiency rate covenant.

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. Rate stabilization, in conjunction with the automatic surcharge triggers, has contributed and should continue to contribute to credit stability, in our view. We could lower the rating if SCL fails to maintain consistently strong financial performance. We do not expect to raise 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 unincorporated areas that in total account for about 16% of energy sales. Management estimates the population of its service area at 776,000. Although the customer base is primarily residential, two-thirds of retail sales are to commercial and industrial customers. Although flat since 2006, 2013 retail sales of 9,506 gigawatt-hours reflect 1.4% overall growth since 2010. SCL forecasts modest annual growth, due in part to Seattle's increased conservation efforts. Peak demand of 1,837 megawatts (MW) in 2013 is just 3.3% below 2008's peak, reflecting a combination of conservation efforts and rebounding economic activity, although 2013's figure is up significantly from the 2011 levels. The customer base is what we consider diverse, with the 10 leading customers accounting for about one-sixth of revenues, with no single customer exceeding 3% of sales revenue.

Strong Hydrological Assets Provide Low-Cost Power

Low generating costs, a 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 include the Boundary project and the Skagit River projects, representing 24% and 17% of total resources, respectively. Additional resources include a maximum of 175 MW from the Stateline Wind Project. In fiscal 2013, SCL obtained 6.38 million megawatt-hours through several purchase contracts, at an average cost of $32.05, a price we view as contributing to SCL's overall low-cost portfolio, despite being higher than the unit cost of the system's owned resources. In 2013, the Federal Energy Regulatory Commission extended the Boundary project's license to 2055, which provides the utility with greater cost certainty regarding the project.

SCL's block-and-slice allocations under its current contract with the Bonneville Power Administration (BPA) contract are sized to bring the utility 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 BPA took effect October 2011 and provides SCL with BPA's block-and-slice products that are designed to more closely balance its firm resource requirements.

Nevertheless, this reliance introduces a measure of hydrological and wholesale power market risk to SCL in 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 expectation. Standard & Poor's also believes that the recent rate-stabilization account ordinance will offset much of the budgetary risk, because rate surcharges happen automatically should the account balance fall 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. The city has adopted modest retail rate increases in the past two fiscal years, and its forecast indicates a continuation of this trend through 2020.

Following strong operating results from 2011-2013, unrestricted cash and investments and other available reserves in the rate-stabilization account as of fiscal year-end 2013 totaled $303 million, or what we consider a sound six months of expenditures. Seattle also has access to interdepartment loans from a sizable common fund, which it estimates at $1.6 billion. We believe debt leverage is high but stable, and expect it to remain near management's target of 60%-61% through 2016. However, capital requirements are what we view as high, at about $2.10 billion for 2014-2019, of which $1.25 billion will require debt issuance. No specific project dominates, although 54% of the CIP's costs are distribution projects, including new substations and upgrades to existing services. City resolution specifies that capital funding contain not less than 40% from operations, which we expect will result in debt leverage consistent with Seattle's target. SCL has no floating-rate debt, although the city is considering a variable rate bond issue in 2015.

The system projects consistently strong coverage at slightly above recent levels. It also expects combined DSC of 1.9x for 2014, and at least 1.8x through 2015. Given the CIP's debt plans, ongoing financial performance will influence the extent to which SCL is able to generate sufficient net income to support its capital program and incorporate rate increases according to plan. The increased rates will support coverage levels that are consistent with ratings in the 'AA' category.

Related Criteria And Research

Related Criteria

USPF Criteria: Electric Utility Ratings, June 15, 2007