santee cooper

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Delivered Via Email

October 30, 2020

The Honorable Henry D. McMaster
Governor, State of South Carolina

The Honorable Harvey S. Peeler, Jr.
President of the South Carolina Senate

The Honorable Hugh K. Leatherman, Sr.
Chairman, South Carolina Senate Finance Committee

The Honorable James H. Lucas
Speaker of the South Carolina House of Representatives

The Honorable G. Murrell Smith, Jr.
Chairman, South Carolina House Ways and Means Committee

Ms. Nanette Edwards
Executive Director, South Carolina Office of Regulatory Staff

Dear Santee Cooper Oversight Committee Members and Ms. Edwards:

We appreciate the opportunity to respond to questions and concerns raised in the letter dated October 29, 2020 from the Santee Cooper Oversight Committee (the "Committee") regarding the South Carolina Public Service Authority's ("Santee Cooper") plans to issue new debt as approved by the Board on October 28, 2020 (the "2020 AB Bond Transaction"). In the letter, the Committee requests additional information regarding the 2020 AB Bond Transaction. Specifically, it directs Santee Cooper to immediately furnish any and all pertinent information and documentation to ORS regarding the 2020 AB Bond Transaction and to also provide the Committee and ORS with a detailed explanation as to why, and how, Santee Cooper's actions are in keeping with both the letter and the spirit of the General Assembly's mandates in Act 135 (the "Act").

Summary

The 2020 AB Bond Transaction meets all applicable criteria set forth in Section 11E(8) of the Act and will save our customers millions of dollars as detailed below. It is consistent with normal business operations, it produces $330 million in gross savings, it finances a portion of capital expenditures as contemplated in the 2019 financing reviewed by the Department of Administration, it reduces the average life of refunded bonds by eight years, reduces the average life of all Santee Cooper debt, is supportive of the *Cook* settlement, and is issued under the 1999 bond resolution of Santee Cooper, which has not been changed.

We need to address one specific issue raised in the Committee's letter. The letter suggests that Santee Cooper violated the Act by not allowing ORS to complete a review of the Transaction prior to closing. While we clearly had conversations with ORS and legislative staff about the then-impending financing, a prior review requirement is not consistent with the process established by ORS under the Act. That process requires a post hoc review of Santee Cooper activities to determine whether any violations of Section 11(E) have occurred. Our understanding, confirmed by ORS this morning, is that ORS will not advise on proposed activities in advance. We have cooperated and complied fully with the process established by ORS.

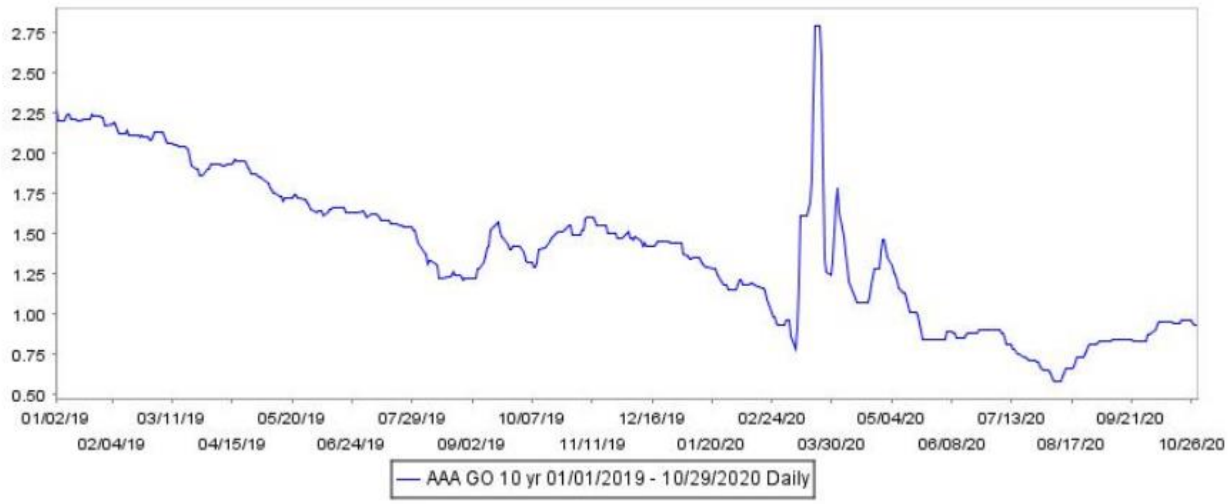
The 2020 AB Bond Transaction includes two distinct transactions. The 2020 Refunding and Improvement Tax-Exempt Series A bonds total $338.5 million and mature in the years 2021-2043. The 2020 Refunding Taxable Series B Bonds total $299.7 million and mature in the years 2025-2032. The 2020A proceeds will refund $292.4 million in currently callable tax-exempt bonds, and also provide $100 million in new money proceeds (which includes a premium of approximately $16 million above new money "par," which is approximately $84 million) to use towards capital projects. The 2020B Refunding is a taxable advanced refunding of bonds that are not eligible for tax-exempt refunding, and its proceeds will be held in escrow and used in 2021 and 2022 to refund $277.2 million in tax-exempt bonds which will then be callable. The all-in true interest cost for the 2020 AB Bond Transaction is 2.87%. Both series have a closing date of next Thursday, Nov. 5, 2020.

Technical Compliance

As background, this is a uniquely attractive time to issue fixed rate municipal debt as evidenced by the near record issuance by municipalities and public power entities in October 2020[1], and with total volume in 2020 expected to be the highest ever.

The following graph of the Municipal Market Data Index AAA-rated 10 year maturity for tax-exempt bonds shows both the very low level of interest rates, and the market's vulnerability to disruption. Earlier this year, rates shot upward and issuance came to a near standstill in reaction to the COVID-19 pandemic. However, rates have returned to historically low levels, and it would thus be irresponsible of us to let this opportunity pass. It is important to note that if we did not move expeditiously to execute this transaction, our customers would (i) continue to pay higher rates on $569.55 million of existing debt and (ii) bear future interest rate risk on the $100 million new money proceeds.

[1] Issuers have been pushing to complete their financings before the potential uncertainty that could occur just before and after the November 3rd elections.



In the context of these historically low interest rates, Santee Cooper was able to issue the 2020 Bonds to generate over ***$130 million of debt service savings*** on a present value basis. Generating additional bond proceeds to fund a portion of the Authority's ongoing capital improvement program was publicly discussed as a probability almost a year ago, and the size of this portion of the financing is <u>less</u> than the present value savings of the rest of the transaction. Subsection (E) of Section 11 of Act 135 authorizes Santee Cooper to continue operating in the ordinary course and, as provided in Section 11(E)(8), nothing in Act 135 prohibits Santee Cooper from "defeasing debt, ***issuing*** or ***refunding debt under existing bond resolutions and agreements***, and entering into financing arrangements consistent with existing bank facilities, ***all as necessary to manage day-to-day operations and financing needs***, including converting variable rate debt to fixed rate debt. ***Refunding of existing debt is permitted if it achieves present value savings*** or mitigates risk ***and does not extend the average life of the debt***…" (emphasis added).

As discussed above, Santee Cooper plans to finalize the sale of these two series of bonds on November 5, 2020, one series of tax-exempt bonds (2020A Bonds) and one series of taxable bonds (2020B Bonds), in accordance with the authority of and in full compliance with the existing bond resolution adopted by the Board of Directors on April 26, 1999, as amended and supplemented. As described in the Preliminary Official Statement, the proceeds of the 2020 Bonds will "***fund a portion of the Authority's ongoing capital improvement program***, ***refund a portion of the outstanding debt of the Authority***," and pay costs of issuance.

In connection with last year's $163,005,000 South Carolina Public Service Authority Variable Rate Revenue Obligations, 2019 Tax-Exempt Refunding Series A, the Official Statement, dated November 6, 2019, noted "Projections estimate the total cost of the capital improvement program for 2020 through 2022 at approximately $805 million, which includes approximately $150 million for environmental compliance expenditures, approximately $11 million for FERC relicensing expenses, approximately $70 million for the resource plan, and approximately $575 million for general improvements to the system. ***The cost of the capital improvement program will be paid from Revenues of the Authority***, ***additional Revenue Obligations***, and subordinated indebtedness, including Commercial Paper Notes and other short-term obligations of the Authority, as determined by the Authority. ***Based on current projections, the Authority anticipates issuing approximately $470 million of debt from 2020 through 2022 to fund capital projects and expenditures***" (emphasis added). This transaction was specifically reviewed and approved by the Department of Administration during the Act 95 process.

The 1999 Resolution authorizes Santee Cooper to issue bonds from time to time for any corporate purpose, which includes financing capital improvements of the Authority's System and refunding or refinancing outstanding indebtedness. The issuance of the 2020 Bonds is in compliance with existing bond covenants contained in the 1999 Resolution, pursuant to which Santee Cooper has issued bonds to fund capital projects and improvements to the system and refund bonds in the ordinary course of business since the adoption of the 1999 Resolution. Our most recent projections of the cost of the capital improvement program are in line with the 2019 projections.

The Spirit of the Act

In addressing compliance with the spirit of the General Assembly's mandates in the Act, we rely on both conversations we had with staff as well as the General Assembly's debate on the Act. We recognize the "spirit" of the Act may be more difficult to address than the "letter," given the inherent subjectivity in the assessment. The Act was structured to give Santee Cooper a degree of operating flexibility as needed to protect its financial integrity, take measures to save money to benefit customers, and concurrently fulfill its obligation to freeze rates under the Cook settlement. As it pertains to debt, we understood the General Assembly had two primary concerns, first that Santee Cooper might issue debt under new bond covenants that restricted the General Assembly's ability to enact reform (we have not and do not in this transaction), and second, that Santee Cooper would issue excessive debt, thereby unnecessarily prolonging the restrictions in the existing bond covenants and potentially dissuading a purchaser (discussed below). Accordingly, the Act provides that new debt can be issued only in amounts necessary to support operations and financing needs. The Act allows refunding of existing debt only if it achieves present value savings for customers and does not extend the average life of the debt. As described above, we have structured the Transaction to avoid running afoul of the expressed intent of the General Assembly, as we understood it.

We point to two examples of our efforts to comply with the spirit of the Act. First, we issued only a modest amount of "new money" debt in relation to our total capital financing needs. As described above, in 2019 we projected the need for approximately $805 million to fund capital improvements in 2020 – 2022. This issuance was sized at approximately $84 million par value in recognition of the General Assembly's expressed desire to moderate new debt issuance.

The second example is the use of an extraordinary call feature on the tax-exempt bonds which would, in fact, facilitate a sale or other privatization of Santee Cooper, not hinder it. Nearly every long-term tax-exempt bond is issued with an inability to retire those bonds for at least 10 years following their issuance. If bonds are issued with this type of 10-year call protection and the borrower or its facilities are sold, the federal tax rules require the issuer fund an escrow to defease those bonds to the call date (that is, an escrow containing investments that produce cash flow sufficient to pay interest on the bonds until the call date and then to pay the redemption price of those bonds). In an environment where investment rates are very low, this type of defeasance can be costly.

The 2020A Bonds were structured to include an "extraordinary" redemption provision under which, in the event of a sale or other privatization of Santee Cooper, the 2020A Bonds would be immediately retired at a price only slightly above their face amount (or amortized amount for bonds sold at a premium). This special provision avoids the need for a more costly funding of a defeasance escrow described above and instead results in the 2020A Bonds being retired at a cost only slightly above the amount which Santee Cooper borrowed. For each and every one of the tax-exempt bonds, using this extraordinary redemption feature is expected to provide a lower cost of debt retirement than using an escrow account to the call date. Thus, the 2020A Bonds were specifically structured in a manner which favorably addresses a potential sale or other privatization of Santee Cooper.

These two examples illustrate our actions to comply with the spirit, as well as the letter, of the Act.

Closing

Attachment A includes a list of all the information we have provided to ORS to date pursuant to your directive. We have made ourselves available to Director Edwards and her staff and stand ready to address any additional questions. This afternoon we received a request for additional information from ORS, and we will work over the weekend to respond. The Transaction is scheduled for closing on Thursday November 5th; accordingly, we ask the Committee and ORS to complete your inquiry promptly as a delay will likely result in increased costs to our customers and injure our, and perhaps others', credibility in the capital markets.

The Transaction is consistent with work Santee Cooper is accomplishing that reduces costs, improves operations and efficiency, and helps us comply with the terms of the *Cook* settlement. Our commitment beyond that remains to maintain rates for every customer class that are significantly lower than the state and national averages, and reliability that is among the best in the country, as it is today.

At every level, Santee Cooper employees are making solid progress on a leaner, greener energy mix and other vital initiatives that are already delivering benefits to our customers. Since the General Assembly approved the Act in May, we have hedged and renegotiated fuel agreements, worked with Central to add up to 500 megawatts of solar power (with contracts coming soon), and begun the process to idle a Winyah unit in December and close all Winyah units over the next few years. We are conducting joint resource planning and developing a new Integrated Resource Plan with Central. And we are working with neighboring utilities on joint operations that are already saving money. Santee Cooper is focused on progress that increases its benefit to customers and value to the state.

We very much appreciate the opportunity the General Assembly gave Santee Cooper in the Act, and have made Santee Cooper materially better as a result. We believe we have acted in complete good faith and compliance with the Act, and that remains our intent.

Sincerely,

Mark B. Bonsall

/srs

cc: Internal Santee Cooper Staff

Attachment A

List of Items sent to the ORS

<u>Special Board meeting Materials</u>

- IOC to the Board
- Agenda
- Letter from Chief Financial Officer
- Script for Chairman/Finance Committee Chairman
- Summary of transactions
- Forty-Eighth Series and Supplemental Resolution, Revenue Obligations, 2020 Tax-Exempt Refunding and Improvement Series A
    - Appendices
        - Exhibit A – 2020A Refunded Bonds
        - Exhibit B – Form of 2020A Bonds
        - Exhibit C – Form of Bond Purchase Agreement
            - Exhibit A – Issue Price Certificate
        - Exhibit D – Form of Continuing Disclosure Agreement
            - Exhibit A – Notice of Repositories of Failure to File Annual Report
        - Exhibit E – Form of Escrow Agreement
            - Exhibit A – Refunded Bonds
- Forty-Ninth Series and Supplemental Resolution, Revenue Obligations, 2020 Taxable Refunding Series B
    - Appendices
        - Exhibit A – 2020B Refunded Bonds
        - Exhibit B – Form of 2020B Bonds
        - Exhibit C – Form of Bond Purchase Agreement
            - Exhibit A – Issue Price Certificate
        - Exhibit D – Form of Continuing Disclosure Agreement
            - Exhibit A – Notice of Repositories of Failure to File Annual Report
        - Exhibit E – Form of Escrow Agreement
            - Exhibit A – Refunded Bonds
- Series 2020AB Chart

Additional Documents/Materials

- Form of Bond Counsel Opinion
- Notice of Conditional Redemption issued to the bond Trustee
- Preliminary Official Statement Dated October 20, 2020 and Supplement Dated October 23, 2020
  - Appendix A – Report of the Authority's Financial Statements
  - Appendix B – Summary of Certain Provisions of the Revenue Obligation Resolution
  - Appendix C – Provisions for Book-Entry Only System and Global Clearance Procedures
  - Appendix D – Certain Economic and Demographic Information
  - Appendix E – Proposed Form of Bond Counsel Opinion
  - Appendix F – Proposed Form of Continuing Disclosure Agreement
- Executed 2020A Bond Purchase Agreement
  - Schedule 1 – Principal Amounts, Interest Rates and Yields
  - Exhibit A – Issue Price Certificate
- Executed 2020B Bond Purchase Agreement
  - Schedule 1 – Principal Amounts, Interest Rates and Yields