MOODY'S
INVESTORS SERVICE

Rating Action: Moody's revises South Carolina Public Service Authority's outlook to negative from stable; A2 rating affirmed

26 Jul 2022

Approximately $6.7 billion of rated debt affected

New York, July 26, 2022 -- Moody's Investors Service has affirmed South Carolina Public Service Authority's (Santee Cooper) A2 rating on its revenue bonds and changed the outlook to negative from stable.

RATINGS RATIONALE

"Santee Cooper's revised outlook to negative from stable reflects our expectation that the utility will have weaker financial metrics in 2022 due to significantly higher purchased power and fuel costs that cannot be immediately passed onto customers", said Clifford Kim, Vice President - Senior Credit Officer. "Unlike most electric utilities, the Santee Cooper's Cook settlement materially limits the utility's ability to pass through cost increases to customers through 2024." For 2022, we expect these factors will result in debt service coverage ratios (DSCR) well below 1.0x and Moody's adjusted internal liquidity declining by almost 50%. The circumstances that caused the rate freeze which can be traced to the suspension of the V.C. Summer nuclear project negatively impacts our view of Santee Cooper's financial strategy and overall governance, a key component under our ESG framework and a driver of the rating action. Santee Cooper's financial strategy and risk management score has been revised to a '4' leading to a G-4 score for governance and a credit impact score of CIS-4 instead of CIS-3.

While the utility cannot immediately recover these higher costs estimated at a net $430 million for 2022 alone, we understand Santee Cooper's board has authorized regulatory accounting treatment for a portion of the costs that could qualify as rate freeze exceptions. The exceptions mostly relate to higher fuel and purchased power replacement costs incurred by the utility due to a fire and temporary closure of a coal supplier's mine. Our understanding is that the utility will seek to recover these and other deferred costs after the rate freeze expires, which then exposes the utility to a material risk of dispute with Central Electric Power Cooperative Inc. (Central), its largest customer, as well as any other parties to the Cook settlement. Central has already indicated its opposition to treat some of these costs as a rate freeze exceptions.

Additionally, the negative outlook considers uncertainty on the amount of excess fuel and purchase power costs that the utility will have to bear, the amount of debt funding to pay for the higher costs, and the extent that the current high natural gas and power prices will stretch into 2023 and 2024. While the utility has utilized conservative assumptions to arrive at its forecast, US natural gas and power prices remain at high levels and influenced by external factors. As such these prices could exceed Santee Cooper's assumptions and lead to higher than expected costs for the remainder of the price freeze. Partially moderating this risk are fuel hedges which according to the utility represented 87% of the 2022's second half requirements, 78% of 2023's needs and 70% of 2024's forecasted fuel usage.

That said, the affirmation of Santee Cooper's A2 rating recognizes expected cash management actions to conserve internal liquidity such as reducing expenditures in 2022 by $100 million and the utility's expectations that financial performance will improve in 2023 and onward resulting in at least 1.30x DSCR for future years. We view the forecast as plausible given the steep backwardation of forward natural gas prices. The rating affirmation also considers the improved quality of the utility's external liquidity. Net availability under its $600 million of bank lines now qualify for inclusion in Moody's adjusted liquidity on hand ratio in addition to net availability under Santee Cooper's backed CP program. Incorporating external liquidity, the utility expects to maintain adjusted liquidity on hand at above 200 days through 2024, a key rating consideration.

Further supporting Santee Cooper's rating is the utility's broad service area directly or indirectly serving approximately 2 million people in South Carolina, ownership by the state of South Carolina (Aaa stable), and competitive rates. Additional credit strengths include a long term, all requirements contract with Central maturing at the end of 2058, strong liquidity in the 'Aa' category, and some generation diversity.

Further weighing on the issuer's credit quality are high leverage with its debt ratio exceeding 130%, counterparty concentration with Central, historically weak DSCRs falling in the 'Baa' category, carbon transition risk due to coal plant ownership, uncertainty surrounding the utility's future resource mix and the previously cited rate freeze through 2024.

RATING OUTLOOK

The negative outlook considers likely weakening of financial metrics in 2022 and the potential for major disputes with Central regarding the rate freeze exceptions. The negative outlook further reflects uncertainty on the amount of excess purchase power and fuel costs that Santee Cooper will have to manage, the extent of additional debt that the utility will have to bear to pay for higher fuel and purchased power costs, and the issuer's ability to improve its financial metrics starting in 2023.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Given the negative outlook, an upgrade is unlikely. The utility's outlook could be revised to stable if excess purchased power and fuel costs are substantially below expectations and Santee Cooper is able to improve financial metrics with DSCR well over 1.30x and adjusted liquidity on hand remaining above 200 days on a sustained basis.

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Santee Cooper's rating can be downgraded if DSCR remains below 1.30x or if adjusted liquidity on hand falls below 150 days on a sustained basis; if the amount of excess costs is greater than expected or leads to a significant increase to debt. The utility's rating could also be downgraded if political influence weighs on Santee Cooper's operations, if major disputes arise with Central or if the borrower is not able to extend or increase its bank lines at beneficial terms.

LEGAL SECURITY

Santee Cooper's bonds benefit from a pledge of the electric and water system's gross revenues and a sum-sufficient rate covenant. There is no debt service reserve account or additional bonds test.

PROFILE

South Carolina Public Service Authority (Santee Cooper) was created by the South Carolina State Legislature in 1934 and provides both retail and wholesale electric service directly or indirectly to approximately two million people in all 46 counties of the state. Santee Cooper also has a water system serving over 200,000 people. The utility also operates an integrated transmission system which includes lines owned by the issuer as well as those owned by Central Electric Power Cooperative Inc, Santee Cooper's largest wholesale customer.

METHODOLOGY

The principal methodology used in these ratings was US Public Power Electric Utilities with Generation Ownership Exposure Methodology published in August 2019 and available at https://ratings.moodys.com/api/rmc-documents/63746 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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Clifford Kim
Lead Analyst
Project Finance
Moody's Investors Service, Inc.
7 World Trade Center
250 Greenwich Street
New York 10007
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Angelo Sabatelle
MANAGING DIRECTOR
Project Finance
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

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