

Rating Action: Moody's downgrades South Carolina Public Service Authority revenue bonds; rating outlook negative

17 Aug 2018

Approximately \$7.4 billion of revenue bonds affected

New York, August 17, 2018 -- Moody's Investors Service has downgraded the rating on the South Carolina Public Service Authority (Santee Cooper) revenue bonds to A2 from A1, along with Santee Cooper bank bond rating to A3 from A2. Concurrent with this rating action, Moody's confirmed Santee Cooper's non-letter of credit backed commercial paper program rating at Prime-1.

The rating outlook is negative. Today's rating action concludes the rating review on Santee Cooper that was initiated on May 1, 2018.

RATINGS RATIONALE

Our rating action today takes into consideration continued unstable governance with uncertainty about future rate setting as Santee Cooper operates without a board chairman. The downgrade also reflects the very high leverage that will persist for many years owing to the termination of the Summer Nuclear project which has introduced cost recovery challenges to Santee Cooper, particularly in the near-to-medium term. Another consideration in the downgrade is the continued uncertainty about the ultimate outcome of the litigation brought by Central Power Electric Cooperative (Central), Santee Cooper's major wholesale customer that provides more than 60% of its revenues. While our rating action factors in our belief that the terms of the contract between Santee Cooper and Central will remain intact, the litigation, if it concludes with an adverse outcome for the utility, could affect Santee Cooper's financial strength and would lead to a further rating downgrade.

Despite the downgrade, factored into the assigned A2 rating are some important mitigating events including the fact that no legislative action was enacted in the 2018 session which curtails the Santee Cooper board's unregulated authority to establish rates and charges to meet bond covenants in a timely manner. We believe that these events were supported by an existing state statute that prohibits the state from doing anything including enacting new laws that would impact bond covenant compliance. The existence of this state statute is a credit positive feature for Santee Cooper's bondholders. We also observe that notwithstanding the governance challenges at Santee Cooper, the utility has implemented a financial recovery plan based upon management's schedule including using the Toshiba funds to mitigate any rate increases through 2020, while maintaining debt service coverage in the 1.40x range.

Santee Cooper's internal liquidity on hand remains very strong and the utility continues to have access to ample internal resources and low cost external liquidity through letter of credit backed CP and several revolving credit facilities. Moreover, the fact that Santee Cooper does not have to immediately replace the planned Summer addition with a new generation resource limits the potential for new borrowing in the intermediate term as Santee Cooper's debt ratio is one of the highest among US public power electric utilities. Implementation of its debt moderation plan through expenditure reductions, debt refinancing initiatives, and internal funding of capital improvements are expected to be future mitigating factors.

Santee Cooper still remains a competitive and reliable electric utility, even after an expected rate increase in 2020, that continues to provide services to a major portion of the state. The utility has an important and well established state role in economic development, flood control and water supply, and remains an important asset for the State of South Carolina (Aaa stable).

RATING OUTLOOK

The rating outlook is negative owing to the uncertainty relating to the Central litigation along with the political risks that Santee Cooper faces as it manages its plan to maintain targeted debt service coverage ratios.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Governance that provides certainty to cost recovery is re-established

- South Carolina Supreme Court affirms Santee Cooper's rate setting authority to meet bond covenants
- Further mitigation steps to moderate further nuclear debt leverage through combination of expenditure reductions; new revenues and customer growth

FACTORS THAT COULD LEAD TO A DOWNGRADE

- No carbon mitigation plan in 2019
- Adverse plan produced by the state study committee formed to evaluate Santee Cooper
- Three year average debt service coverage below 1.40x
- Adverse outcome of Central litigation that impacts cost recovery and financial metrics
- Lack of governance certainty and further political influence on Santee Cooper operations

LEGAL SECURITY

The bond resolution includes a sum-sufficient rate covenant and no debt service reserve account or additional bonds test but Santee Cooper must deposit annually into the Capital Improvement Fund an amount which, together with amounts deposited during the prior two years, equals 8% of required revenues (average \$180 million) in the preceding three fiscal years. These funds are required to be used for debt service or for capital. The amount Santee Cooper is required to transfer to the state is restricted to a maximum of 1% of Santee Cooper's projected operating revenues. There is no external rate regulation except for federal regulation on transmission rates.

PROFILE

South Carolina Public Service Authority (Santee Cooper) is a component unit of the State of South Carolina (GO bonds rated Aaa) and was created by the State Legislature in 1934. It is governed by a 12 member board of directors, 7 year staggered terms, appointed by the Governor with the advice and consent of the Senate. One board member has to come from each congressional district in the state. The authority provides electric service, retail and wholesale, and wholesale water supply in several regions of state. It also serves in other capacities including flood control; watersupply; real estate management; park management and economic development assistance for local communities. The authority's rates are not regulated by the state Public Utilities Commission and are set by the Santee Cooper board of directors. Rates can be established on an emergency basis but typically there is a process which includes public hearings.

METHODOLOGY

The principal methodology used in this rating was US Public Power Electric Utilities With Generation Ownership Exposure published in November 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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