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# South Carolina Public Service Authority; Retail Electric

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# South Carolina Public Service Authority; Retail Electric

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| US$137.355 mil rev oblig taxable rfdg ser D due 12/01/2042 | | |
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| *Long Term Rating* | A-/Negative | New |
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| *Long Term Rating* | A-/Negative | Affirmed |

## Credit Highlights

- S&P Global Ratings assigned its 'A-' rating to the South Carolina Public Service Authority's (Santee Cooper or the authority) $37.645 million 2022 tax-exempt refunding series C bonds; $137.355 million 2022 taxable refunding series D bonds; $390 million 2022 tax-exempt improvement series E bonds, and $60 million 2022 taxable improvement series F bonds.
- At the same time, we affirmed our 'A-' rating on Santee Cooper's parity obligations outstanding.
- The outlook is negative.

### Security

The bonds are secured by a net revenue pledge of the combined utility, which includes electric and water services. The electric system comprises 98% of pledged revenue. The authority had $6.8 billion in debt outstanding as of Dec. 31, 2021.

### Credit overview

The rating reflects:

- The authority's limited financial flexibility while operating under a rate freeze stemming from settlement of litigation (the "Cook settlement") related to its failed VC Summer nuclear project;
- A disruption to Santee Cooper's coal supply, which has led to significant unbudgeted power costs in fiscal 2022 ($621 million); and
- Our expectation that coverage of debt service requirements will be significantly below 1x in 2022, which the authority will bridge by drawing on $425 million of its $1 billion in lines of credit.

We have affirmed the 'A-' rating in consideration that there is a pathway, beginning in 2025, to recover a large portion of the unbudgeted costs, via exceptions to the Cook settlement rate freeze.

However, we have maintained our negative outlook reflecting:

- The possibility that this pathway could be eliminated, should litigation result in a court ruling that denies the applicability of the exceptions to the rate freeze, severely limiting Santee Cooper's ability to pass on to ratepayers the unbudgeted costs; and
- Because there is the possibility of further financial stress despite power costs being almost fully hedged for budgeted demand in 2022, and largely hedged for projected demand in 2023.

The 'A-' rating further reflects our opinion of the following:

- A deep and diverse service area and customer base spans much of South Carolina. Santee Cooper serves about 1 million end-use customers--approximately 20% directly, and 80% indirectly--through its sales to Central Electric Power Cooperative (Central).
- Rates are competitive, but the authority's rate-raising ability is limited while Santee Cooper operates under the Cook settlement-imposed rate freeze, which in our view constrains financial flexibility.
- In the wake of the stranded investment in the cancelled nuclear project, Santee Cooper's power supply plans are designed to maintain system reliability while transitioning its coal-dependent power supply to a cleaner, more efficient, more flexible, and more diverse resource portfolio. We generally view these plans as credit supportive, but we also believe that there is a degree of execution risk in pursuing them, and we view them as a key to Santee Cooper's effort to control costs.
- Fixed cost coverage (FCC) averaged 1.28x during fiscal years 2019-2021, and based on management's projections, we estimate that FCC will be 0.44x in fiscal 2022, which would put the three-year average at 1.0x, a level that only nominally continues to support the current rating.
- In our view, actions to mitigate the impact of the cost pressures are projected to help preserve $899 million in liquidity at fiscal year-end 2022 (down from $971 million projected in July 2022). Current liquidity includes $294 million in unrestricted cash and $605 million in undrawn capacity on $1 billion in credit lines and revolving credit agreements--covering about 189 days of operating expenses (down from 215 days projected in July 2022), a level that we still consider solid at the current rating. In our view, projected liquidity levels, although declining, are supportive of the rating based on peer comparisons.
- Santee Cooper is a moderately leveraged utility, with debt measuring 76% of total capitalization. We expect this ratio will improve to about 74% by 2026, despite about $1.3 billion in additional debt in support of the authority's $2.3 billion capital plan over fiscal years 2022-2028.

## Environmental, social, and governance

We believe that Santee Cooper faces environmental risks that are moderately credit negative. The authority anticipates closure of the coal ash ponds at its Cross and Winyah stations will cost $350 million. Santee Cooper also faces environmental risks related to potential future regulation of carbon emissions from its stakes in the coal-fired units (41% of generation production in 2021) and natural gas plants (20% of energy). About 27% of energy comes from purchased power. Nuclear (9% of energy), hydro (2%), and renewables (1%) provide a modest amount of zero-emission energy, but the authority's effort to reduce its carbon footprint was complicated by the cancellation of the V.C. Summer nuclear units 2&3 (VCS2&3) nuclear project. We note that the authority's current power supply plan envisions the addition of renewables (18% of energy by 2030) and the closure of its Winyah coal units by 2028--reducing energy from coal-fired units to 20% but increasing natural gas (31%). Therefore, we anticipate that Santee Cooper will be able to lower carbon intensity over the next decade. Although the authority is exposed to risk of hurricanes, its broad service area mitigates this risk, and we note that September 2022's Hurricane Ian resulted in less than $7 million in damages to Santee Cooper's assets, primarily related to transformers and pole replacements.

Social risks are credit neutral, primarily related to the financial and operational effects of the COVID-19 pandemic and attendant downturn as customers grapple with health and safety concerns, a situation exacerbated by below-average incomes. In our view, however, the pandemic and attendant downturn have had a limited impact on Santee Cooper. Weather-adjusted sales are back to levels forecast before the pandemic. Disconnections resumed in June 2020, after a three-month moratorium, and delinquencies have not been meaningful from a credit perspective. Nevertheless, we believe that Santee Cooper has limited financial flexibility to absorb future pressures, as the authority will be operating under the rate freeze through Jan. 15, 2025.

We believe that governance risk is a credit negative compared with that of peers, given significant turnover of executive management, the constraints of operating under a rate freeze, and the need to jointly conduct resource planning with Central--with such plans subject to public service commission approval.

## Outlook

The negative outlook reflects our expectation of weakened coverage metrics in fiscal 2022, stemming from the authority's inability to pass through unbudgeted fuel and purchased power costs due to a rate freeze, at a time when commodity costs are elevated. Although we note that commodity costs are almost fully hedged for projected demand for the remainder of 2022, there is potential that actual demand exceeds budgeted demand, and that cost pressures might extend into 2023.

The negative outlook also reflects the potential for disallowance of the Cook settlement exceptions, which would challenge the authority's ability to ultimately recover unbudgeted costs. This would have a negative effect on liquidity.

### Downside scenario

We could lower the rating if a constrained coal supply and elevated natural gas and power prices persist during the rate freeze, creating additional unbudgeted costs that challenges the authority's ability to effectively respond to further pressures on financial margins, coverage ratios, and liquidity, beyond levels currently estimated. We could also lower the rating, potentially by multiple notches, if there is an adverse ruling on the Cook settlement exceptions, challenging the authority's ability to recover a substantial portion of its unbudgeted costs. Finally, we could lower the rating if the authority is unable to execute on its plans to remake its power supply (which we view as key to controlling costs and flexibility), whether because of deferred capital spending, or the requirement that the authority obtain legislative approval as a precondition to accessing capital markets.

### Upside scenario

Given the authority's limited financial flexibility while operating under the rate freeze, and uncertainty related to the potential challenge to the Cook settlement exceptions, we do not anticipate raising the rating or revising the outlook to stable during the next two years.

## Credit Opinion

With the authority operating under the rate freeze, we believe that Santee Cooper has limited flexibility to absorb additional unbudgeted cost increases, which is reflected in our negative outlook. We do note that gas and coal commodity costs are now fully hedged for projected demand for the remainder of 2022, so there is substantial protection, but also continuing exposure, with 3% of total commodity costs remaining unhedged, attributable to projected power purchases.

In July 2022, we lowered our rating on Santee Cooper's debt to 'A-' from 'A' and maintained our negative outlook (which we had assigned in April 2022). The July 2022 rating action reflected our expectation of weakened coverage metrics in fiscal 2022, stemming from the authority's inability to pass through to wholesale and retail customers the vast majority of about $520 million in 2022 unbudgeted fuel and purchased power costs due to a rate freeze that will continue through Jan. 15, 2025 (imposed under terms of a litigation settlement agreement [the Cook settlement]), and at a time when coal supply from its largest and lowest-cost coal supplier had been cut in half.

Since July 2022, unbudgeted fuel costs have increased by an additional $100 million, as the authority has secured alternative (but higher-priced) coal supply, above-budgeted demand for natural gas has been hedged at higher prices, and purchased power expense remains elevated.

We understand that Santee Cooper is drawing on $425 million of its $1 billion in credit lines to meet the above-budgeted expenses.

The authority has identified substantial costs that it believes are exceptions to the rate freeze (as provided for in the Cook settlement), and that could provide a pathway for recovery of a large portion of the unbudgeted expenses and enable the authority to pay down the draw on its credit lines. The authority has filed for $91 million in exceptions related to 2020 and 2021, with about $38 million related to a fire at a mine belonging to the authority's primary and lowest-cost supplier of coal. As the mine fire disruption has continued through 2022 and is not expected to be resolved until 2024, Santee Cooper expects to file for hundreds of millions in additional exceptions.

However, these exceptions would not be recoverable until after the rate freeze ends, and then only if they survive legal challenge. Importantly, we note that the exceptions could be subject to an audit if requested by a party and granted by the court, and disallowance would pose a risk to ultimate recovery of these costs.

Indeed, on Sept. 9, 2022, Cook settlement class counsel filed a motion requesting the court rule on the applicability of the rate freeze exceptions. On Sept. 26, the court denied the motion, noting that insofar as the rate freeze is in effect, consideration at this time was premature. In the ruling, and in reference to the mine fire exceptions, the judge's ruling states that "Although the court will refrain from determining the applicability of this particular exception, I note that nothing in the language of the settlement agreement that limits the fire exception to Santee Cooper-owned property".

Although we take this as an indication of how the court might, in the future, interpret the applicability of the mine fire exceptions, the dismissal of the motion is not itself a ruling on the applicability of the mine fire exception. Therefore, we anticipate that the court may well revisit this at a later date.

Santee Cooper will be able to recover costs as the case makes its way through the legal process by billing its customers for the exceptions, but only after the rate freeze period ends, and then only if there is no adverse court ruling on the applicability of the rate exceptions. We believe that an adverse ruling at a later date that disallows a large portion of the exceptions would greatly hamper the authority's ability to recover these costs.

Santee Cooper is accounting for a portion of the exceptions as regulatory assets, which will result in projected 1.22x accrual-based debt service coverage (DSC) for 2022 based on current projections (down from 1.30x projected in July). However, the establishment of a regulatory asset is a noncash accounting treatment that defers recognition of the costs, but not the obligation to fund them. Consequently, our rating is more reflective of Santee Cooper's 0.42x cash-basis coverage of debt service requirements projected for 2022 (down from 0.59x projected in July 2022). We anticipate that in addition to expenditure reductions and deferral of planned defeasances, Santee Cooper will use approximately $255 million of available liquidity in 2022 (up from $170 million projected in July 2022) to bridge the remaining portion of the gap between the cash-basis coverage and debt service sufficiency. However, we believe that despite the planned use of liquidity, Santee Cooper will maintain ample unrestricted cash and available lines to support credit quality at the lower rating.

The authority's financial metrics are being adversely affected by coal supply and delivery disruption; rising gas and power costs; and an inability to pass through higher costs on a timely basis to ratepayers due to the rate freeze agreed upon in the Cook settlement, associated with the cancelled VCS2&3 project.

DSC was down sharply in 2021, declining to 1.24x from the three-year average of 1.36x over fiscal years 2018-2020, with FCC about two basis points lower.

A fire at the authority's largest and lowest-cost coal supplier cut Santee Cooper's expected coal deliveries from that complex in half. The fire occurred at a time when there has been a rapid shift in demand and newfound price competitiveness for the commodity compared with natural gas--the price of which has more than doubled year over year. The disruption prompted the authority to dispatch its higher-cost gas units and rely on more expensive power purchases to conserve its coal pile, which stood at about 26 days of average burn in July 2022, approximately half the minimum inventory that the utility uses for planning purposes. The authority has assumed that the mine does not return to production until the end of 2023. Santee Cooper has contracted with alternate coal suppliers for a portion of this at substantially higher prices than had been previously contracted and budgeted, and its coal pile, which stood at 47 days of average burn in October 2022, is now expected to reach the lower end of its minimum inventory used for planning purposes by year-end.

Rising gas prices have driven up day-ahead and real-time power purchases, which are not hedged. Although Santee Cooper has hedged all of its expected gas demand, the authority is unable to recover the higher fuel costs associated with above-budgeted demand, or largely unhedged and elevated power purchase costs, due to the Cook settlement-imposed rate freeze. We understand that as of October 2022, the authority's total commodity costs (coal, natural gas, and purchased power expense) for projected demand through the remainder of fiscal 2022 is 97% hedged.

Based on management's April 2022 estimate of $196 million in higher fuel costs (reflecting gas prices of about $5.50 per million British thermal units [mmBtu] with power purchases trending similarly, and plans for $100 million in cost reductions), we expected that DSC would be 1.16x in 2022, and this was reflected in our outlook revision earlier this year.

While subsequent volatility pushed gas prices above $8.50/mmBtu, we note that the authority had almost fully hedged its gas needs at levels well below this. However, purchased power prices, which were not fully hedged, did not fully follow the recent drop in gas prices.

As a result, management now projects about $621 million in above-budget fuel and power purchase expense for 2022.

Under terms of the Cook settlement, Santee Cooper can defer to rates charged in years after the rate freeze period just and reasonable costs and expenses incurred during the rate freeze period directly resulting from certain circumstances, referred to as permitted exceptions, or Cook exceptions, which generally include force majeure type events, changes in law, and deviations in Central's load of plus or minus 4%. The authority has identified $91 million of costs covering August 2020-December 2021, including $44 million in force majeure type events--primarily related to the fire at the mine, and to an equipment failure and fire at the authority's V.C. Summer nuclear unit 1--and $29 million in Central Electric load deviation. We understand that the authority has also estimated about $293 million of additional costs and adjustments, largely related to the mine fire exception that would apply to 2022 costs, with additional costs related to this exception possible for 2023.

The $621 million in above-budget fuel and power costs are mitigated by about $125 million in higher revenue. The authority has identified about $100 million in budget reductions, and about $65 million in savings from the deferral of planned debt defeasance and the refinancing of a $175 million bullet maturity due in 2023--effectuated through the issuance of the 2022 bonds.

Management expects to use a combination of unrestricted cash and draws on liquidity facilities to cover $425 million of the above-budget costs ($255 million in 2022 and $170 million in 2023), until it can collect these from ratepayers (as exceptions) after the rate freeze expires. The ultimate recovery of these exceptions is subject to audit and in our view remains uncertain. Indeed, in September 2022, class counsel for the Cook settlement plaintiffs initiated a motion challenging the 2021 Cook rate freeze exceptions.

Santee Cooper's board expects to reduce operations and maintenance expenses through regulatory accounting by $350 million due to the projected Cook exceptions in 2022, and on the strength of the regulatory asset accounting, the authority projects 1.22x DSC on an accrual basis in 2022. With the refinancing of a $175 million bullet maturity due in 2023 and defeasance of $85 million of additional 2023 maturities, debt service costs are expected to decline, and the authority projects higher accrual-based DSC in 2023 (1.68x) and 2024 (1.34x).

However, the authority expects 0.42x DSC on a cash basis for 2022, with cash-basis DSC improving closer to historical averages in 2023 (1.12x) and 2024 (1.34x). In our view, the projected improvement to both accrual- and cash-based

DSC is uncertain, given that power costs are not fully hedged and the rate freeze remains in place.

The authority, which had $1.2 billion in available liquidity, representing 355 days of operating expenses at fiscal year-end 2021, now projects that it will have 189 days of liquidity (down from 215 days projected in July 2022) at fiscal year-end 2022--with 62 days attributable to unrestricted cash (excluding collateral), and the remainder attributable to available capacity on revolving lines of credit and commercial paper that can be used for any operating purpose. Out-year projections suggest similar levels of liquidity.

However, we believe that the cost pressures might extend into 2023, presenting a continuing challenge to metrics until the rate freeze expires.

## Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

| Ratings Detail (As Of October 31, 2022) | | |
|---|---|---|
| South Carolina Pub Svc Auth retail elec | | |
| *Long Term Rating* | A-/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (AGM) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (AGM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (AGM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (AGM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (AGM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (AMBAC) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (ASSURED GTY) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |

| Ratings Detail (As Of October 31, 2022) (cont.) | | |
|---|---|---|
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (BHAC) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (MBIA) (National) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (National) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (National) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail elec (National) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth retail Elec (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |
| South Carolina Pub Svc Auth 2020 taxable rfdg bnds ser B due 12/01/2032 | | |
| *Unenhanced Rating* | A-(SPUR)/Negative | Affirmed |

## Ratings Detail (As Of October 31, 2022) (cont.)

Many issues are enhanced by bond insurance.