S&P Global Ratings

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South Carolina Public Service Authority; Retail Electric

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Credit Profile		
US$289.0 mil rev oblig ser 2021 B due 12/01/2051		
Long Term Rating	A/Stable	New
US$138.0 mil rev oblig ser 2021 A due 12/01/2036		
Long Term Rating	A/Stable	New
South Carolina Pub Svc Auth retail elec		
Long Term Rating	A/Stable	Affirmed

Rating Action

S&P Global Ratings revised the outlook to stable from negative and affirmed its 'A' rating on South Carolina Public Service Authority's (Santee Cooper) debt outstanding. At the same time, S&P Global Ratings assigned its 'A' rating to Santee Cooper's $138 million 2021 tax-exempt refunding bonds series A, and $289 million 2021 tax exempt improvement bonds series B.

The revised outlook reflects our view that:

- The settlement of outstanding litigation related to the cancelled V.C. Summer units 2 and 3 nuclear project resolves cost-recovery risk, under terms that are manageable within the context of the authority's financial profile, and that have led to improved relations and coordination between the authority and Central Electric Cooperative (Central), which accounts for 60% of Santee Cooper's electric revenue;
- Budgetary savings associated with renegotiated coal and rail contracts, fully hedged gas needs, and debt reduction provide the authority with financial headroom to operate under the settlement-imposed rate freeze through 2024;
- The expiration of Act 95 of 2019 (effectively ending the South Carolina Legislature's pursuit of a sale of, or third-party operator for, Santee Cooper) and the adoption of Act 135 enable the authority to continue to purse strategies that enhance flexibility and diversity of its power supply, reduce carbon intensity, reduce operating costs, and deleverage its balance sheet; and
- The adoption of South Carolina's Act 90 of 2021, which enhances governance oversight, preserves the authority's rate-setting autonomy, and does not unduly constrain operational and financial flexibility.

The 2021 series A bonds are being issued to refund currently callable debt, while the 2021 series B bonds will be issued to fund a combination of capital needs and pay down commercial paper outstanding and draws on the authority's revolving credit agreements. We also understand that later this year, the authority plans to refinance additional debt, callable in 2023 and after. The authority had $6.8 billion in debt outstanding at June 30, 2021.

Credit overview

The 'A' rating reflects our opinion of the utility's strong enterprise risk profile and financial profiles.

We base these views on the interplay among the following:

- A deep and diverse service area and customer base, spanning much of South Carolina. Santee Cooper serves about 1 million end-use customers--approximately 20% served directly, and 80% served indirectly, through its sales to Central;
- Competitive rates, but limited rate-raising flexibility while Santee operates under the Cook settlement-imposed rate freeze;
- In the wake of the stranded investment in the cancelled nuclear project, Santee Cooper's power supply plans are designed to preserve system reliability while transitioning its coal-dependent portfolio to a cleaner, more efficient, more flexible, and more diverse generating resource portfolio, while also reducing operating costs to create headroom under the Cook settlement-imposed rate freeze. We generally view these plans as credit supportive, but we also believe that there is a degree of execution risk in pursuing them;
- Strong coverage metrics, with fixed cost coverage (FCC) averaging 1.33x over fiscal years 2018-2020. While the authority's financial forecast suggests modest strengthening in FCC levels, we believe that the rate freeze and power supply plan execution risk makes uncertain the achievement of forecast improvement in metrics;
- Robust liquidity and reserves, which measured $984 million at fiscal year-end 2020 (353 days of operating expenses), although more than half is in the form of available lines of credit and revolving credit agreements supporting commercial paper that can be issued for either capital or operating purposes; and
- A moderately leveraged utility, with debt measuring 76% of total capitalization. We expect this ratio will improve to about 70% 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.

The stable outlook incorporates our view that the legal and political headwinds stemming from the cancellation of the V.C. Summer nuclear project have been largely resolved, without further significant sacrifice (beyond the rate freeze) of operational and financial flexibility, enabling the authority to pursue strategies to remake its power supply. Uncertainties resolved include the settlement of litigation that threatened cost recovery on the nuclear project; legislation that enhanced governance oversight but did not result in a change in authority ownership (under consideration prior to expiration of Act 95); and cost-cutting measures that have created headroom for the authority to operate under a rate freeze through 2024.

Environmental, social, and governance (ESG) factors

We believe that Santee Cooper faces heightened environmental risk. The authority anticipates closure of its 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 (37% of generation production in 2020) and natural gas plants (24% of energy). Nuclear (12% of energy), hydro (3%), and renewables (3%) 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 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.

Social risks primarily relate to the financial and operational effects of the COVID-19 pandemic and attendant recession as customers grapple with health and safety concerns, a situation exacerbated by below-average incomes. In our view, however, the pandemic and attendant recession have had a limited impact on Santee Cooper. Weather-adjusted sales were down about 5% in 2020, primarily among industrial and commercial customers, but are back to levels forecast prior to 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 a rate freeze through 2024.

We believe that governance risk has lessened with the expiration of Act 95 and the adoption of Act 90, which followed the cancellation of the V.C. Summer nuclear project. Nevertheless, we continue to believe that governance risk is elevated relative to that of the authority's peers, given significant turnover of its board and 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 (PSC) approval.

Stable Outlook

Downside scenario

Although we expect cost-saving measures to produce sufficient financial margins that can provide some resilience if the utility faces unforeseen expenses, we could lower the rating if the utility's ability to implement financial measures in response to rising costs are hampered by the rate freeze that extends through 2024 and/or the requirement that the authority obtain legislative approval as a precondition to accessing capital markets to fund unanticipated expenses.

Upside scenario

We do not anticipate raising the rating on the authority over the next two years given the financial constraints imposed by the rate freeze, and the execution risk in pursuing an aggressive plan to re-make its power supply.

Credit Opinion

Santee Cooper, based in Moncks Corner, S.C., is a state-owned electric and water utility. The electric system, which accounts for about 99% of revenue, derives 36% of its revenue from retail sales, and 64% from wholesale sales.

The electric system directly serves about 194,000 retail customers. Direct sales to residential, commercial, and industrial customers measure 11%, 13%, and 12% of total operating revenue, respectively. The utility indirectly serves another 800,000 electric customers, primarily through its largest wholesale customer, Central, under a coordination agreement that expires in 2058. Central serves 20 member-distribution cooperatives, and accounts for about 60% of Santee Cooper's total operating revenue.

V.C. Summer nuclear project abandonment: Litigation, political backlash, and legislation

In mid-2017, Santee Cooper cancelled the construction of the V.C. Summer nuclear units 2 and 3, after investing $4.5 billion. The utility cited the project's significant delays, substantial cost overruns, and uncertain completion costs in support of its abandonment decision. Although we view these positions as compelling, we believe that the project nevertheless contributed to almost doubling the utility's debt over a decade without delivering prospects for producing project revenues to defray the added debt burden. Cancelling the project also removed prospects for replacing carbon-laden coal-fired generation with zero-emission nuclear generation.

Cost overruns and project cancellation triggered customer and political backlash, contentious board and management changes, and litigation and legislation targeting the utility.

However, a court-approved settlement was reached in the most significant of the litigation, Cook, et al. v. Santee Cooper, et al., which had sought to preclude Santee Cooper from recovering investments in the abandoned project. Under the settlement, Santee Cooper is cash-funding $200 million in payments (spread over fiscal years 2020-2022), and has agreed to freeze rates through 2024. Importantly, the settlement allows Santee Cooper to include the debt costs associated with the nuclear project in its rates, irrespective of the rate freeze.

The project cancellation also resulted in political backlash and passage of Act 95 (2019), which directed exploration of a sale or restructuring of Santee Cooper. But after receiving bids and evaluating what it deemed to be the best sale and third-party operator proposals, the legislature rejected the proposals, and adopted Act 135 (2020), enabling the authority to proceed with its plans to remake its power supply, consistent with its previously submitted reform budget.

Act 95 expired in May 2021, effectively ending the legislature's effort to sell or find a third-party operator for Santee Cooper; we understand that after passing Act 90 in June 2021, the legislature has no plans to revisit the matter.

Key Act 90 provisions address governance reforms touching on the following areas:

- Board composition--including size, representation, terms, and qualifications;
- Debt reforms--creates a process whereby Santee Cooper must seek state Joint Bond Review Committee (JBRC) approval for new money, long-term debt or refundings that do not achieve savings;
- Resource oversight---requires PSC approval for generating facilities larger than 75 megawatts (MW), transmission facilities greater than 125 kV or greater, and power purchase agreements greater than 10 years for non-renewable resources; and
- Rate-making oversight--provides a process whereby intervenors may challenge proposed rate increases, and requires that proposed rate increases be submitted to the state Office of Regulatory Services (ORS).

In our view, Act 90 enhances oversight and provides clearer processes for rates, debt issuance, and resource planning. While it may limit nimbleness of action, it does not create extraordinary constraints relative to other issuers or states. In our view, it preserves Santee Cooper's rate-setting autonomy and should not unduly constrain operational and financial flexibility as long as the authority maintains good communication with the JBRC, the ORS, and the PSC.

Enterprise Risk

Economic fundamentals

The utility serves a broad footprint across South Carolina, with almost 1 million direct and indirect customers. Santee Cooper directly serves 194,000 residential, commercial, and industrial customers (36% of total electric revenue), with each class accounting for near-equal shares. About 60% of the authority's revenue is derived from sales to Central, which has 20 distribution cooperative members, serving about 800,000 end-use customers. Central's distribution members have largely residential bases, and it is a significant contributor to Santee Cooper's revenue stream; we believe that this contributes to stable demand patterns.

In our view, direct-serve industrial customers do not represent a significant percentage of authority revenue. Nevertheless, we note that Santee Cooper recently extended its contract to serve its second-largest direct-serve customer, Century Aluminum (1.3% of revenue) through 2023. We understand that the authority earns small margins on sales to Century, but we also note that these sales serve to support Santee Cooper's fixed costs.

Although South Carolina's unemployment rate is elevated (4.5% in June 2021) due to the pandemic and economic downturn, it is below the national rate. Incomes are below average at 88% of the nation, which we believe contributed to the backlash regarding the nuclear project and the imposition of the rate freeze. In our view, this serves to constrain our assessment of Santee Cooper's economic fundamentals.

Market position

According to the U.S. Department of Energy's Energy Information Administration (EIA), Santee Cooper's weighted-average rate was 87% of the state's average system rate in 2019, the most recent year of available comparative information. As Santee Cooper is a hybrid retail/wholesale entity, we believe that the EIA comparative is somewhat misleading because it includes wholesale rates to Central (but not distribution costs) as well as fully bundled rates to direct-serve retail customers. We also note that Santee Cooper's rates are below those of SCE&G/Dominion and Duke Carolinas across all customer classes, but slightly above Progress Energy's rates.

The authority's most recent base-rate increase, 2.1%, was in 2017. Proposed rate increases for 2018 and 2019 were withdrawn, as the authority cancelled plans to issue $2.5 billion in additional debt to complete financing of the V.C. Summer project. As part of the Cook litigation settlement, rates are frozen through 2024. During the rate freeze, Santee Cooper will not be able to pass along changes in its fuel and purchased power costs beyond what the authority projected in its reform plan. The settlement established monthly fuel-adjustment rates, for both retail customers and Central that will be used during the rate freeze in lieu of calculating monthly rates, as had been the practice.

While we believe the rate freeze places a potential constraint on Santee Cooper's financial flexibility, we nevertheless note that there are carve-outs allowing for rate increases in certain limited circumstances, including named storm events, cyberattacks, and plus or minus 4% deviations in Central's load.

We also understand that since development of the reform plan, coal and coal transportation contracts have been renegotiated and the authority has fully hedged gas costs through 2024, at prices below those contemplated under the reform plan. In our view, this has created headroom to operate under the rate freeze without compromising financial metrics or constraining power supply plans. Supporting this view is Santee Cooper's plan to adopt a modest rate increase in 2027, its first in a decade, which is well after the expiration of the rate freeze.

After the rate freeze, the Authority's fuel and power cost recovery mechanisms will revert to the pre-existing formula that we view as credit supportive: for retail sales, an automatic fuel-cost adjustor based on three-month rolling average, and an automatic adjustor for variance in the demand component of non-firm sales and off-system sales; together, the cost tracker covers about 75% of costs and minimizes budget variance. After the freeze, sales to Central will be adjusted monthly for fuel and annually for non-fuel variances.

Operational Management Assessment (OMA)

Although the authority has a diverse fleet of generation assets and fuels, it still has a $3.6 billion of debt outstanding (and a $3.7 billion regulatory asset) related to the cancelled nuclear project, , and this is captured in our assessment, despite the ameliorative effect of the Cook settlement. Also reflected in the OMA is our view of Santee Cooper's power supply plans, which are designed to preserve system reliability while transitioning its coal-dependent portfolio to a cleaner, more efficient, more flexible, and more diverse generating resource portfolio.

Santee Cooper's 4,830 MW of owned generation (and its allocation of hydroelectric energy from the Southeastern Power Administration) supplies about 80% of the utility's energy requirement, with the remainder coming from market economy purchases and long-term power purchase contracts. Santee Cooper has modest excess capacity, but this is expected to be largely eliminated over the intermediate term, as the authority's power supply plan envisions closure of its Winyah coal units by 2028.

Coal-fired generation accounts for about 37% of the authority's energy, down from about 60% several years ago, as natural gas (24%) has economically displaced coal as the fuel of choice.

Despite a challenging legal and political environment, we believe that management has successfully reduced operating costs and leverage, while driving toward settlement of the Cook litigation and improved relations with Central. We also believe that management has put together a credible plan to remake Santee Cooper's power supply, focusing on carbon reduction, fuel diversification, and reduced fuel costs.

Key elements of Santee Cooper's power supply plan (which are subject to change as the authority's load forecast is revised) include:

- The retirement of 1,150 MW of coal-fired generating capacity at Winyah by 2028, with the phase-out beginning in 2023;
- The installation of up to 200 MW dual-fuel (natural gas and oil) for reliability purposes;
- The purchase of 1,500 MW of solar capacity by 2031 (a greater than 800% increase over current levels);
- The addition of about 950 MW of natural gas-fired generating capacity, including approximately 550 MW to be built in the mid-2020s and approximately 450 MW to be purchased under tolling agreements during the 2030s;
- The addition of approximately 200 MW of battery storage, which may be purchased from the market by 2028; and
- In conjunction with partners, 150 MW of demand-side conservation by 2027, with an additional 50 MW to be achieved by 2037.

In our view, Santee Cooper's power supply plans, if executed, could help the utility achieve further carbon reduction. Management projects coal will account for 20% of energy by 2030 (down from 37% in 2020), largely supplanted by natural gas (31%, up from 24%) and renewables (18%, up from 3% in 2020). Nevertheless, we expect that Santee Cooper will still have a sizable carbon footprint that exposes it to a wide set of environmental regulations.

It is important to note that the costs associated with these plans were built into Santee Cooper's reform budget, upon which the rate freeze was predicated. We also note that Central is not bound to these plans, and has certain opt-out rights on future projects, which effectively forces Santee Cooper to give significant consideration to Central's needs and desires in formulating its power supply plans. Nevertheless, any decision by Central to opt-out of future projects would have no bearing on its obligation to serve then-existing load from Santee Cooper's then-existing resources. And from a practical standpoint, we also believe that there is minimal potential for the opt-out to affect Santee Cooper's power supply plans prior to 2030, when Central's contract with Duke Carolinas expires.

Financial Risk

Coverage metrics

The authority achieved debt service coverage averaging 1.48x over fiscal years 2018-2020. However, we calculate FCC at an average of 1.33x (including 1.29x in 2020). Our calculation of FCC treats payments to the state as an operating expense and a portion of payments to other energy suppliers as debt service rather than operating expenses because we view these payments as vehicles for funding the suppliers' recovery of their investments in generation assets serving the utility.

In 2019, the authority recorded a $200 million special item related to the settlement of the Cook litigation. As this was a non-cash expense, we do not factor it into our coverage calculations. We understand that the authority has used (and expects to continue to use) internally generated funds to pay down the settlement liability--$65 million in 2020 and 2021, and $70 million in 2022.

Based on Santee Cooper's projections for 2021-2025, we calculate FCC of 1.35x-1.45x. In our view, this would continue to support our current rating.

Liquidity and reserves

We view Santee Cooper's liquidity as robust in both absolute and relative terms. The utility recorded $442 million of unrestricted cash and investments at Dec. 31, 2020. In addition, the authority had $542 million of capacity available under revolving credit facilities and lines, which bolstered its liquidity position to 353 days of operating expenses.

While these levels are down from previous years, the decline was anticipated as the authority used Toshiba settlement money (related to the failed V.C. Summer nuclear project) to pay down debt and fund debt service requirements over fiscal years 2018 and 2019. We expect liquidity will remain above 237 days of operating expenses through 2025 and continue to support the current rating.

Debt and liabilities

S&P Global Ratings' leverage ratio calculation yielded a 76% debt-to-capitalization ratio for 2020, which we consider moderately leveraged for a vertically integrated utility. Santee Cooper's $2.3 billion capital plan for 2021-2028 calls for $1.3 billion in additional debt; nevertheless, the authority's debt-to-capitalization ratio is expected to decline to about 70%, as amortization and cash from operations offset the new money issuance.

The authority's debt service schedule is relatively flat, with the exception of a $175 million bullet maturity due in 2023. We understand that the authority has designated $85 million in reserves toward the repayment of the bullet, which would have the effect of levelizing debt service requirements from operation and reducing funding risk.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of August 12, 2021)		
South Carolina Pub Svc Auth retail elec		
Long Term Rating	A/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (AGM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (AMBAC)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (ASSURED GTY)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (BHAC) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (MBIA) (National)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth rev oblig (Taxable) ser 2016D due 12/01/2056		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.