S&P Global
Ratings

RatingsDirect®

South Carolina Public Service Authority; Retail Electric

Primary Credit Analyst:
Jeffrey M Panger, New York + 1 (212) 438 2076; jeff.panger@spglobal.com

Secondary Contact:
David N Bodek, New York + 1 (212) 438 7969; david.bodek@spglobal.com

Table Of Contents

South Carolina Public Service Authority; Retail Electric

Credit Profile		
South Carolina Pub Svc Auth retail elec		
Long Term Rating	A/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (BAM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised

Rating Action

S&P Global Ratings revised the outlook to negative from stable and affirmed its 'A' rating on the South Carolina Public Service Authority's (Santee Cooper, or the authority) revenue debt.

The outlook revision reflects an extended disruption to Santee Cooper's coal deliveries resulting in an increased reliance on natural gas and power purchases (in a high price environment). The authority is unable to pass these expenses on to ratepayers while operating under a rate freeze through 2024, and we anticipate that coverage metrics will be pressured until that time.

The bonds are secured by net revenue of Santee Cooper's electric and water systems. The authority had $6.8 billion in debt outstanding as of Dec. 31, 2021.

Credit overview

The authority's financial metrics are adversely affected by coal delivery disruption; rising gas and power costs; and an inability to pass through higher costs on a timely basis to ratepayers due to a rate freeze agreed upon in settlement of litigation (the "Cook Settlement"), associated with the cancelled V.C. Summer nuclear project.

Santee Cooper has experienced higher-than-budgeted electric demand, and fuel and purchased power expense in 2021 and 2022. Santee Cooper's primary supplier of coal experienced a fire in one of the two mines located at its complex, and coal deliveries from that supplier have been cut about in half at a time when there has been a rapid shift in demand and newfound price competitiveness for the commodity relative to natural gas--the price of which has more than doubled year over year. Rising gas prices have driven up day-ahead and real-time power purchases, only a small percentage of which the authority has hedged.

The disrupted coal deliveries have also prompted the authority to dispatch its higher-cost gas units and rely on more expensive power purchases to conserve its coal pile, which stands at about 29 days of average burn, about 60% of the minimum inventory that the utility uses for planning purposes. Although Santee Cooper has hedged most of its budgeted 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. As a result, management now projects $196 million in above-budget fuel and power purchase expense for 2022. Management has identified about $30 million in operations and maintenance cuts and $70 million in capital spending deferrals to mitigate the impact, leaving $96 million in above-budget net expenses (significantly higher than $45 million projected at the time of our last review in January 2022).

Fixed cost coverage (FCC) was down sharply in 2021, declining to 1.22x from the three-year average of 1.33x over fiscal years 2018-2020. However, based on the revised estimate of fuel costs as incorporated in management's April estimate, we now expect that FCC will be 1.14x in 2022.

However, we note that this projection is based on natural gas prices averaging $5.50/million British thermal units (mmBtu). We also note that recent natural gas prices have been volatile, bouncing around the $6.50/mmBtu-$8.50/mmBtu range, while the NYMEX forward pricing suggests the expectation of natural gas prices remaining at about $8.50 through February 2023 (and declining to about $5.00 by April 2023).

Management has estimated that if gas prices average $7.50 in 2022, the authority would incur an additional $100 million in fuel and power expenses, and we estimate that 2022 coverage would decline further, to about 1.0x.

Management's previous financial projections suggested the expectation that FCC would improve in 2023 and beyond. We understand that revised projections will not be available until June 2022. However, we believe that the cost pressures might extend into 2023, presenting a continuing challenge to metrics until the rate freeze expires. Although the authority has filed for certain exceptions to the rate freeze (as outlined in the Cook litigation settlement)--potentially enabling it to ultimately recover about $90 million in costs incurred in fiscal years 2020 and 2021--we note such recovery cannot occur before the rate freeze expires and depends on the board approving such recovery.

The 'A' rating reflects our opinion of the interplay 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% served directly, and 80% served 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.
- FCC averaged 1.28x during fiscal years 2019-2021, and based on management's projections, we estimate that FCC will be 1.14x in fiscal 2022, which would put the three-year average at 1.22x, a level that nominally continues to support the current rating.
- In our view, actions to mitigate the impact of the cost pressures are projected to help preserve about $1 billion in liquidity at fiscal year-end 2022--about $320 million in unrestricted cash and $700 million in undrawn capacity on credit lines and revolving credit agreements--covering about 300 days of operating expenses, a level that we consider robust.
- Santee Cooper is a moderately leveraged utility, with debt measuring 76% of total capitalization. We expect this

ratio will improve to about 71% 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 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 (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 units 2 and 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.

Social risks primarily relate 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 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 the 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 VCS2&3 nuclear project. Nevertheless, we continue to believe that governance risk is elevated relative to 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 (PSC) approval.

Negative Outlook

Downside scenario

We could lower the rating if a constrained coal supply and elevated natural gas and power prices persist during the rate freeze, challenging the authority's ability to effectively respond to further pressures to financial margins and coverage ratios, beyond levels currently estimated. We could also 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.

Return to stable scenario

Over the next two years, we could revise the outlook to stable if cost pressures abate and if, in our opinion, coverage levels sustainably improve.

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 units 2&3 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), while agreeing 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; the general assembly subsequently passed Act 90 in June 2021. There is no current legislation proposed related to the sale of Santee Cooper.

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 of 125 kilovolts 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 199,000 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. South Carolina's unemployment rate (3.4% in March 2022) is below the national rate (3.6%). 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 88% of the state's average system rate in 2020, 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 Dominion and Duke Carolinas across all customer classes, but slightly above Duke Progress' 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 for the majority of Santee Cooper's customers through 2024, at levels established in Santee Cooper's reform plan. During the rate freeze, Santee Cooper will not be able to pass along changes in its fuel and purchased power costs beyond what is reflected in the frozen rates. 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 force majeure events, cyberattacks, changes in law, and plus-or-minus 4% deviations in Central's load. We understand that the authority has filed for exceptions totaling about $90 million over fiscal years 2020 and 2021, primarily related to force majeure events, and related changes in law at the mine of the authority's primary coal supplier ($39 million) and a fire at the V.C. Summer unit 1 ($6 million); a decline in Central's load of more than 4% ($29 million); and changes in law ($12 million). We also understand that these exceptions may become subject to audit (and therefore possibly disallowed), and even if allowed, Santee would be unable to recover these costs until the end of the rate freeze.

Since development of Santee Cooper's reform plan, coal and coal transportation contracts were renegotiated and the authority has largely hedged gas costs for projected demand through 2026, at prices below those contemplated under the reform plan. While we believe that this created headroom to operate under the rate freeze without compromising financial metrics or constraining power supply plans, we also believe that increased power costs have since depleted this headroom.

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 a 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 $6.8 billion of debt outstanding (including $3.7 billion booked as a 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 an allocation of hydroelectric energy from the Southeastern Power Administration), which together supplies about 80% of the utility's energy requirement; the remainder comes 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 displaced coal as the fuel of choice--until recently on an economic basis, and currently due to the disruption in coal deliveries.

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;
- The purchase of 1,500 MW of solar capacity by 2031 (a greater than 800% increase over current levels);
- The addition of about 1,100 MW of natural gas-fired generating capacity by the late 2020s, s;
- Phased implementation approximately 200 MW of battery storage, which may be purchased from the market in the mid-2020s depending on capacity needs; 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 17% of energy by the 2030s (down from 37% in 2020), largely supplanted by natural gas (41%, up from 24%) and renewables (17%, 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. On April 28, 2022, Central exercised its option to opt out of the proposed natural gas resource with a proposed commercial operating date at the beginning of 2029. Per the terms of the contract between Central and Santee Cooper, each party has 180 days (October 2022) to provide details regarding their non-shared resources. Each entity may jointly pursue and develop the same resource(s) or bring their own independent resources, which will satisfy their obligations. The decision by Central to opt out of this, or any future resources, would not reduce its responsibility to bear the cost of existing resources. 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 or when the Winyah coal units are retired.

Financial Risk

We calculate FCC at an average of 1.28x (including 1.22x in 2021). 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.

Operating revenue for 2021 was up 9% year over year, due to higher energy sales and demand usage coming out of the pandemic, and as a result of increased production at the authority's two leading direct-serve customers--Century Aluminum and Nucor. Operating expenses for 2021 were up 18% year over year, due largely to higher fuel and purchased power expense resulting from higher sales, increased purchased power (at higher prices) in response to plant outage (VCS1) and in an effort to preserve coal stockpiles.

Disrupted coal deliveries and high natural gas prices continue to drive high fuel and power purchase costs in fiscal

2022. Based on management's April 2022 projections, we anticipate 1.14x FCC for 2022.

We note that this projection is based on natural gas prices averaging $5.50/mmBtu. We also note that recent natural gas prices have been volatile, bouncing around the $6.50-$8.50 range, while the NYMEX forward pricing suggests the expectation of natural gas prices remaining in the $8.50 area through February 2023 (declining to about $5.00 by April 2023).

Management has estimated that if gas prices average $7.50 in 2022, the authority would incur an additional $100 million in fuel and power expenses, and we estimate that 2022 coverage would decline further, to about 1.0x.

Given the constraints of the rate freeze, we anticipate that coverage metrics will continue to be challenged in the intermediate term.

Liquidity and reserves

We view Santee Cooper's liquidity as robust in both absolute and relative terms. At fiscal year-end 2021, the authority $1.26 billion of total liquidity ($603 million of unrestricted cash and investments, and $657 million in undrawn capacity on credit agreements) represented 372 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, and to pay down Cook settlement requirements over fiscal years 2020 and 2021. With the final Cook settlement payment due in 2022, we expect that Santee Cooper will have about $1 billion in liquidity at fiscal year-end 2022, representing 300 days of operating expenses. We expect liquidity will remain above 237 days of operating expenses through 2025 and continue to support the current rating, but we also acknowledge that elevated fuel and gas prices could result in further erosion

Debt and liabilities

S&P Global Ratings' leverage ratio calculation yielded a 76% debt-to-capitalization ratio for 2021, which we consider moderately leveraged for a vertically integrated utility. Santee Cooper's $2.3 billion capital plan calls for $1.3 billion in additional debt; nevertheless, the authority's debt-to-capitalization ratio is expected to decline to about 71%, 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 leveling debt service requirements from operations and reducing funding risk.

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 May 6, 2022)		
South Carolina Pub Svc Auth retail elec		
Long Term Rating	A/Negative	Outlook Revised

Ratings Detail (As Of May 6, 2022) (cont.)		
South Carolina Pub Svc Auth retail elec		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (AGM)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (AGM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (AGM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (AGM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (AGM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (AMBAC)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (ASSURED GTY)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (BAM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (BHAC) (SECMKT)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (MBIA) (National)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A(SPUR)/Negative	Outlook Revised

Many issues are enhanced by bond insurance.