S&P Global
Ratings

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Summary:

Public Service Authority of South Carolina; Retail Electric

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Public Service Authority of South Carolina; Retail Electric

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Unenhanced Rating	A+(SPUR)/Negative	Affirmed
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Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Long Term Rating	A+/Negative	Affirmed

Rationale

S&P Global Ratings has affirmed its 'A+' rating on the Public Service Authority of South Carolina (Santee Cooper). The outlook is negative.

The 'A+' rating reflects the following credit strengths:

- Good coverage of fixed costs at the current rating level (1.38x in 2017), with projections suggesting similar metrics over the next 10 years;
- Robust liquidity, bolstered by guarantee money from Toshiba Corp. after the cancellation of the V.C. Summer nuclear project. Santee Cooper has a 45% share in the project while investor-owned SCANA Corp. (parent company of South Carolina Electric and Gas [SCE&G]) has a 55% share. Total liquidity, which includes unrestricted cash and investments, and undrawn capacity under lines of credit and commercial paper, measured 764 days' operating expenses. While we expect Santee Cooper to use the money debt obligations, and expect it to reduce credit lines, the authority projects that total liquidity will measure roughly one year of operating expenses through 2027;
- A broad and diverse customer base. Santee Cooper serves 180,000 customers directly and nearly 771,000 indirectly, the latter chiefly via sales to wholesale customer Central Electric Power Cooperative Inc., which accounted for 59% of the authority's 2017 revenue;
- A responsive cost recovery mechanism. Santee Cooper's cost tracker covers about 75% of costs and minimizes budget variance. We view as credit supportive a board-approved 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; and
- Competitive rates. Santee Cooper's average revenue per kilowatt-hour (kWh) was 7.3 cents in 2017. In our view, rates are generally competitive. Residential, commercial, and industrial rates are, on balance, slightly higher than Progress Energy Inc. and Duke Energy Corp., but well below those of SCE&G. With the nuclear project's cancellation, the authority expects only modest rate increases through 2027, when average revenue per kWh is projected to reach 8.6 cents. If achieved, we believe that Santee Cooper would maintain its competitive positioning.

However, rate projections (and coverage metrics) rely on a new methodology for forecasting gas prices, producing lower operating costs and, as a result, revenue requirements. Should this methodology result in large gaps between budgeted and actual revenue, we would expect that average revenue per kWh would exceed management's projection.

We view the following as credit weaknesses:

- Legal fallout after the cancellation of the V.C. Summer nuclear project. The authority faces several lawsuits challenging its ability to recover costs related to the nuclear project. In our view, the litigation also puts at odds the interests of Santee Cooper and those of Central, which procures power from the authority under a coordination agreement;;
- Political and legislative fallout from the project's cancellation. Facing significant criticism, Santee Cooper's CEO and board chairman resigned in 2017, and we believe that the authority continue to face significant political issues. The legislature has approved a commission charged with studying Santee Cooper's possible sale. We also believe the authority could come under regulatory oversight, stripping it of rate setting autonomy and threatening its ability to recover costs associated with the nuclear project;
- The possibility that dealing with these political and legal issues could divert management attention and resources;
- High debt levels and substantial capital costs. Santee Cooper had about $7.9 billion in debt outstanding at Fiscal-year-end 2017, and a debt-to-capitalization ratio of 78%. The authority anticipates that over the next five years, capital spending will be significantly lower and largely funded internally; and
- A substantial carbon footprint. Santee Cooper relied on coal-fired generation to meet 42% of 2017 energy needs, and this could increase. We view costs of complying with existing regulations as manageable, but note that cancelling the nuclear project removes a tool from the authority's arsenal to reduce emissions in response to any future regulations.

Santee Cooper has pledged the gross revenue of its combined electric and water system to repayment of the bonds. Despite this pledge, we evaluate the authority's financial metrics on a net basis, because we believe this more accurately reflects the utility's ongoing nature.

The business profile score is '5' on a scale of '1' to '10', '1' being the strongest. In our opinion, the business profile reflects Santee Cooper's rate-setting autonomy, solid competitive position, and strong management, offset in part by the risks associated with litigation and political fallout resulting from the nuclear project.

We previously revised our outlook to negative from stable in March 2018, reflecting litigation that puts at odds the interests of Santee Cooper and those of Central. In our opinion, the litigation could impair Santee Cooper's ability to recover costs associated with the cancelled project, with $4.5 billion spent on the project and no asset to show for it. The authority is also facing intense criticism from elected officials, some of whom have advocated selling the utility (which we have previously said we believe is unlikely , while others have advocated restrictions on Santee Cooper's rate-setting autonomy. In our opinion, this heightens credit risk.

Santee Cooper, based in Moncks Corner, S.C., is a state-owned electric and water utility, although water sales have historically represented less than 1% of operating revenues.

We consider the service area to be broad and deep, serving nearly one million customers, directly (180.000 residential and large industrial customers) and indirectly (771,000 customers via wholesale contracts, chiefly through the Central contract). Demand growth has been stable and steady. The combined direct and indirect base of customers is weighted to residential, which adds to demand stability. There is some concentration among large industrial customers, most notably Nucor Corp. (5% of total revenue, 14% of retail revenue, and 19% of retail sales). Century Aluminum Co. accounts for less than 2% of total revenue, down from 9% in 2015, because the company has cut production. Finally, we view demographics as largely credit neutral, because median household effective buying incomes are on par with the U.S. average.

Santee sources power from a diverse set of generating assets--coal, gas, nuclear, hydro and landfill gas--and these assets have performed well, producing generally low-cost power at high availability factors. Capacity factors for coal units have been low, while gas units have been high, with dispatch reflecting and inverse to relative fuel commodity pricing.

Given flat demand growth, Santee Cooper does not project the need to add generating capacity within the next eight years, at least. The authority might return to service its idled Cross Unit 2 at that point (or sooner if economic), or they may add a 2x1 combined-cycle unit should the regulation of carbon emissions proceed. These costs have not been factored into the authority's financial forecast or capital plan.

While Santee Cooper still has a share of VC Summer nuclear unit 1, the backbone of the generating fleet is its coal-fired generation, which accounted for 42% of 2017 energy needs. In our view, reliance could increase if coal units are dispatched ahead of gas units in response to a change in relative commodity prices, or if the authority brings Cross 2 back into service. Santee Cooper faces about $330 million in costs to comply with existing environmental regulations, chiefly related to coal ash, but this does not include compliance costs associated with bringing Cross 2 back into service. Meanwhile, while the U.S. Supreme Court's stay and the Environmental Protection Agency's efforts to undo rulemaking of the Clean Power Plan has relieved some of the more immediate compliance pressures, we believe that future regulation of carbon emissions is inevitable. In our view, the cancellation of the nuclear project removes a tool from the authority's arsenal to reduce emissions in response to any regulations, and this exposure, along with other factors, constrains credit improvement.

Santee Cooper has full rate-setting autonomy and, despite being a state agency, has historically operated with political independence, both of which are standard for the public power sector and a key underpinning of our ratings on the authority. However, the consequent need to deal with legal and political headwinds is also placing a significant burden on the utility and management.

Santee Cooper is something of a hybrid utility. It is a retail utility that also provides wholesale power to members of Central under a long-term cost-plus based contract. As such, it is difficult to characterize its rates versus those of others. The authority's rates are generally competitive versus the state's major investor-owned utilities--higher than those of Duke Energy, but lower than those of SCANA.

Santee Cooper has a good record of raising rates as needed to maintain financial metrics that we view as adequate at the current rating level. Retail rates have automatic fuel-adjustment clauses--requiring no action by management or board--based on a three-month rolling average. Automatic rate adjustments cover over 75% of costs. Wholesale rates to Central are trued-up monthly for fuel costs, and annually for nonfuel costs. In our opinion, the cost adjustors support credit quality, although they do not apply to sales to Central, which mitigates this. Nevertheless, the authority controls for this risk adequately by maintaining solid liquidity.

Over the past decade, Santee Cooper steadily raised rates to meet increasing fixed costs associated with the nuclear project, and the average cost of power for the system measured 7.3 cents per kWh in 2016. A 2% rate increase took effect in April 2017.

The receipt of the $895 million settlement payment from Toshiba Corp. triggered by the Chapter 11 filing of subsidiary Westinghouse Corp.) and reduced debt plans ($2.5 billion lower, post-project cancellation) enabled the authority to rescind 3.7% rate increases it had proposed for 2018 and 2019. It now anticipates only modest rate increases in the 2020-2023 time-frame.

In our opinion, Santee Cooper's financial metrics support the rating. Fixed cost coverage was 1.38x in both 2016 and 2017. Fixed cost coverage is S&P Global Ratings' metric that treats distributions to the state as an operating expense, and treats as debt the authority's capacity payments and imputed costs, which are respectively associated with take-or-pay and take-and-pay power purchases. Based on management's projections, we would expect fixed cost coverage to remain at about this level over the next five years. However, Santee Cooper is using a new method for projecting gas commodity prices, a key driver of operating expenses. The new method, which uses the NYMEX settlement price, results in projected average annual growth in gas prices significantly lower than incorporated in the authority's prior forecast. As well, Santee Cooper's forecast for gas prices is well below the U.S. Department of Energy's Energy Information Administration Henry Hub forecast. The lower forecast suggests management's expectation of lower operating expenses, lower revenue requirements and lower projected rate increases than might otherwise be expected under the previous methodology. In our opinion, should gas prices rise faster than projections, Santee Cooper could find itself needing to pass through the increased costs to ratepayers via its fuel adjustment clause, raising overall rates.

We view liquidity as robust. At fiscal year-end 2017, Santee Cooper had $1.58 billion in unrestricted cash and investments, measuring 491 days of operating expenses. The unrestricted cash includes the Toshiba settlement. In addition, the authority had $1.2 billion in credit lines, $880 million of which was available at fiscal year-end 2017, which combined with unrestricted cash brought total days liquidity to about two years of operating expenses. We expect that Santee Cooper will spend down Toshiba settlement money to service debt, and reduce credit lines to $750 million from $1.2 billion. We expect days' liquidity will decline, but nevertheless remain robust at nearly one year's equivalent operating expenses through 2027.

Santee Cooper has substantial debt, and debt-to-capitalization is high at 78%. However, after the nuclear project's cancellation, debt levels are forecast to be lower as capital spending is expected to be funded internally. Management projects debt-to-capitalization decline to 65% by 2027. However, this expectation does not factor in possible capacity additions in the 2025 timeframe.

Outlook

The negative outlook reflects the nuclear project's litigation, which could impair Santee Cooper's ability to recover costs associated with the cancelled nuclear units. In our opinion, we believe that there is a one-in-three chance that the litigation and lack of aligned interests between Santee Cooper and Central will lead to diminished credit quality within the next two years.

Upside scenario

We could revise the outlook to stable if the courts rule that the utilities are entitled to cost recovery on the abandoned investments, without Central pursuing efforts that in our view would eviscerate the coordination agreement.

Downside scenario

We could lower the ratings if the court rules against Santee Cooper in either the existing case or the cross-claim, calling into question the scope of cost recovery that the authority is entitled to under the agreement. Litigation and political pressures leading to a diminution of rate-setting autonomy, or impairment of operational or financial flexibility, would also have a negative impact on the rating.

Ratings Detail (As Of August 21, 2018)		
South Carolina Pub Svc Auth retail elec (AGM) (SECMKT)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
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South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT)		
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 (BHAC) (SEC MKT)		
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 rev oblig (Taxable) ser 2016D due 12/01/2056		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed

Ratings Detail (As Of August 21, 2018) (cont.)		
South Carolina Pub Svc Auth rev oblig		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.