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South Carolina Public Service Authority; Retail Electric

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US$363.115 mil 2020 tax-exempt rfdg and imp bnds ser A due 12/01/2043		
Long Term Rating	A/Negative	New
US$300.45 mil 2020 taxable rfdg bnds ser B due 12/01/2032		
Long Term Rating	A/Negative	New
South Carolina Pub Svc Auth retail elec		
Long Term Rating	A/Negative	Affirmed

Rating Action

S&P Global Ratings assigned its 'A' rating to the South Carolina Public Service Authority's (Santee Cooper) $363.115 million tax-exempt refunding and improvement bonds, series 2020A; and $300.45 million taxable refunding bonds series 2020B. At the same time, S&P Global Ratings affirmed its 'A' rating on the authority's parity obligations, of which $6.6 billion was outstanding as of Oct. 1, 2020. The outlook is negative.

The authority anticipates that $92.38 million of the series 2020A bonds will be used to support a portion of Santee Cooper's $939 million 2021-2023 capital plan. The series 2020A and B refunding bonds are expected to produce about $140 million in net present value savings.

Credit overview

In mid-2017, Santee Cooper abandoned 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. Coal-fired generation represented 38% of energy supply in 2019, followed by natural gas at 23%, and nuclear at 11%.

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

In July 2020, 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 will cash-fund $200 million in payments spread over fiscal years 2020-2022 into a class benefit fund and will freeze rates, as specified in the agreement, through 2024. The authority had booked this as a $200 million non-cash special item in fiscal 2019.

Meanwhile, the political backlash resulted in legislative efforts that included directives to explore the sale or restructuring of Santee Cooper. Earlier this year, the legislature rejected the proposals, as well as a plan for "self-reform" put forth by Santee Cooper. Subsequently, legislation was introduced to negotiate with one of the bidders (NextEra), and another bill sought to impose governance reforms. However, further consideration as to Santee Cooper's fate was postponed due to the COVID-19 pandemic.

In our view, although the Cook settlement removes a key credit risk, the rate freeze constrains the utility's financial flexibility as it proceeds with plans to transform its power supply, and as it grapples with uncertainties posed by the pandemic and economic downturn. Importantly, the settlement allows Santee to include the debt costs associated with the nuclear project in future rates. However, it does not allow for recovery of additional costs (beyond limited carveouts). Meanwhile, political hurdles remain unresolved, and these factors combine to support the negative outlook.

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 63% from wholesale sales.

The electric system directly serves about 189,000 retail customers. Direct sales to residential, commercial, and industrial customers measure 11%, 13%, and 13% of total operating revenue, respectively. The utility indirectly serves another 775,000 electric customers, primarily through its largest wholesale customer, Central Electric Power Cooperative (Central), under a coordination agreement that expires in 2058. Central serves 20 member distribution cooperatives, and accounts for about 59% of Santee Cooper's total operating revenue.

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

We base our view of the strong enterprise risk profile on the interplay among the following:

- Very strong economic fundamentals, marked by about 960,000 retail customers consisting of the 189,000 retail customers Santee Cooper serves directly and the 771,000 retail customers it serves indirectly through its largest wholesale customer, Central;
- Adequate market position, reflecting the direct retail customers' favorable retail rates that are about 11% below the state average, but limited rate-raising flexibility while it operates under the Cook settlement-imposed rate freeze;
- Adequate operational management assessment, reflecting the political, managerial, and operational fallout the utility faces after abandoning plans to complete the construction of two additional nuclear units at the V.C. Summer nuclear plant. The assessment recognizes the ameliorative effects of the Cook settlement, as well as execution risk associated with the utility's plan to significantly remake its power supply to enhance flexibility and diversity, and to reduce its coal exposure; and
- The electric utility sector's extremely strong industry risk assessment, which assesses volatility relative to other industries and sectors.

We view Santee Cooper's financial profile as strong, reflecting the following:

- Strong coverage metrics, with fixed cost coverage (FCC) averaging 1.36x over fiscal years 2017-2019, and that are forecast to remain at a level that would continue to support this assessment;
- Very strong liquidity and reserves, which measured more than $1 billion at fiscal year-end 2019 (343 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

- Adequate debt and liabilities profile, as debt measured 78% of total capitalization, which we expect will decline to about 72%, despite about $460 million in additional debt in support of the authority's $939 million capital plan over fiscal years 2021-2023.

In our view, the pandemic and attendant recession have had a manageable impact on Santee Cooper. During March-July 2020, the authority experienced a 7% decline in weather-adjusted native energy sales (including sales to Central) versus budget; management conservatively projects a similar decline through the remainder of the fiscal year, and a 4% decline in fiscal 2021. The authority projects fiscal 2020 and 2021 operating income will be below its reform plan by $27 million and $23 million, respectively, having mitigated the revenue and expense gap via hedging of gas costs and entering into more favorable coal commodity and transportation contracts. Management has also reduced its capital budget by $59 million to mitigate the cash impact from the decline in operating income. A moratorium on shut-offs was imposed in March, but disconnections resumed in June. As of August 2020, about 200 customers faced service shut-off, although 3,000 customers are on payment plans (with recovery generally over a four-six month period).

The negative outlook reflects our view that cancelling the V.C. Summer nuclear plant expansion exposed the utility to many uncertainties. While we acknowledge that the Cook settlement has reduced the uncertainty of cost recovery from the project, we recognize that the legislature may seek further concessions on behalf of ratepayers as it revisits the Act 95 process in 2021. In our view, the state might impose conditions that could further limit Santee Cooper's operational and financial flexibility, at a time when it seeks to "remake" its power supply while grappling with the effects of the pandemic and economic downturn, which may extend and deepen. Finally, the outlook reflects uncertainty regarding the continued state ownership of the utility and the composition of its board, which we expect the legislature will address in 2021.

Environmental, social, and governance factors

We believe that Santee Cooper faces heightened environmental risk. Relative to current regulations, 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 (38% of generation production in 2019) and natural gas plants (23% of energy). Nuclear (11% of energy), hydro (2%), and renewables (2%), provide a modest amount of zero-emission energy; and 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 (13% of energy by 2027), and the closure of its Winyah coal units by 2027, but an increase in natural gas (33%). Therefore, we anticipate that Santee Cooper's carbon intensity will be relatively unchanged.

Social risks primarily relate to the financial and operational effects of the pandemic and attendant recession as customers grapple with health and safety concerns. So far, lower electric demand and bill payment delinquencies have not materially affected credit quality, but as the pandemic and economic downturn extends, Santee Cooper's operations or financial conditions could be pressured. We believe that Santee Cooper has limited financial flexibility to absorb this potential pressure, despite below-average rates, as the authority will be operating under a rate freeze through 2024, a situation exacerbated by below-average incomes and a heightened unemployment rate.

In the wake of political and legal fallout stemming from the cancellation of the V.C. Summer nuclear project, we believe that governance risk is also elevated. The legislature is expected to revisit the Act 95 process in spring 2021, and it is unclear whether it will proceed with an attempt to sell the authority, exact further governance reforms, or maintain the status quo.

Negative Outlook

Downside scenario

We could lower the rating if Santee Cooper's FCC and liquidity for 2020 and 2021 fall meaningfully below historical and/or projected levels, whether because the legislature seeks additional meaningful concessions from the authority on behalf of ratepayers, or for other operational reasons, which would be a risk given constraints on financial flexibility posed by the rate freeze.

Return to stable scenario

We could revise the outlook to stable if the completion of the Act 95 process does not result in additional constraints on the authority's financial flexibility, and in light of the rate freeze, if we view fiscal 2020 and 2021 financial metrics as approximating historical results and sustainable into the future.

Credit Opinion

Enterprise Risk

Economic fundamentals--Very strong

The utility serves a broad footprint across South Carolina, with 960,000 direct and indirect customers. Santee directly serves 189,000 residential, commercial, and industrial customers, (37% of total electric revenue), with each class accounting for near equal shares. About 59% of Santee's revenue is derived from sales to Central, which has 20 member distribution cooperatives serving 771,000 retail 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 there is uncertainty regarding Santee's second-largest direct serve customer, Century Aluminum (1.4% of Santee revenue), which has weak business prospects. The Federal Energy Regulatory Commission issued a proposed order enabling the city of Goose Creek to establish a municipal system that would serve Century. Earlier this month, a court ruled to affirm Santee Cooper's sole right to serve Century, but at this time, it is not clear whether an appeal will be forthcoming. We understand that the authority earns small margins on sales to Century, but we also note that these sales serve to support Santee's fixed costs.

Although South Carolina's unemployment rate is elevated (6.6% in August 2020) 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--Adequate

We view Santee's market position as adequate. According to the U.S. Department of Energy's Energy Information Administration (EIA), Santee's weighted-average rate was 89% of the state's average system rate in 2018, the most recent year of available comparative information. As a Santee is a hybrid retail/wholesale entity, the EIA comparative is somewhat misleading, as 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's rates are below those of Duke Energy Corp. and SCE&G across all customer classes, and below Progress Energy's rates for residential and commercial customers.

The authority's most recent base rate increase, 2.1%, was in 2017. Proposed 3.7% 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 will be frozen through 2024.

Although this should result in an improving market position, we do not expect it will improve to the extent that it changes our assessment of market position.

Moreover, we believe that the more prominent impact of the rate freeze is to reduce Santee's financial flexibility, which we view as the key issue in assessing a utility's market position. We note, however, 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.

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. We understand that since development of the reform plan, fuel costs have dropped, giving the authority a degree of cushion, and that Santee Cooper has taken advantage of the lower cost by hedging fuel as well as entering into new commodity and transportation contracts. Santee Cooper has hedged 100% of projected natural gas volumes for fiscal years 2020-22, 97% for 2023, and 72% for 2024; coal commitments range from 71%-97% of projected burn.

After the rate freeze, the authority's fuel and power cost recovery mechanisms will revert to the pre-existing formula: 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)--Adequate

Although the authority has a diverse fleet of generation assets and fuels, it still has a $4.5 billion, non-performing asset that accounts for more than half of its debt, and this is captured in our assessment, despite the ameliorative effect of the Cook settlement. Also reflected in the OMA assessment is our view of Santee Cooper's power supply plans, which are designed to preserve system reliability while transitioning its largely coal-dependent portfolio to a cleaner, more efficient, more flexible, and more diverse generating resource portfolio.

Santee's 5,110 megawatts (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 purchase power contracts. Santee has about 600 MW of excess capacity, but this is expected to be eliminated over the intermediate term, as the authority's power supply plan envisions closure of its Winyah coal units by 2027.

Coal-fired generation accounts for about 38% of the authority's energy, down from about 60% several years ago, as natural gas has economically displaced coal as the fuel of choice.

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 2027, 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);
- An addition of approximately 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 32% of energy by 2027, and expects the utility to achieve a 17% reduction in carbon dioxide emissions by 2030. Nevertheless, we expect that Santee will still have a carbon footprint that exposes it to a wide set of environmental regulations. Therefore, we believe that abandoning the nuclear project eliminated an important pathway for Santee Cooper to achieve additional carbon reduction.

The political fallout from the nuclear project cancellation resulted in significant turnover in senior management. We view the authority's newly hired CEO and deputy CEO as industry leaders, based on their previous experience at Arizona's Salt River Project. In a challenging legal and political environment, they have, in short order, put together what we believe is a credible plan to reform Santee Cooper--to reduce its carbon footprint, improve fuel diversity, reduce operating costs (through attrition), and reduce leverage--all while driving toward settlement of Cook litigation and working to improve relations with Central.

Over the past decade, Santee Cooper exercised its rate-setting autonomy, steadily raising rates to meet increasing fixed costs associated with the nuclear project, and maintaining sound financial metrics. As part of the Cook settlement, the authority agreed to freeze rates through 2024, which diminishes its financial flexibility. Moreover, despite the settlement, we believe that the political environment toward Santee remains hostile and could hamper financial flexibility.

Industry risk--Extremely strong

Consistent with "Methodology: Industry Risk," published Nov. 19, 2013, we consider industry risk for municipal retail electric and gas utilities covered under these criteria as very low, and therefore extremely strong compared with other industries and sectors.

Financial Risk

Coverage metrics--Strong

The authority achieved debt service coverage (DSC) averaging 1.43x over fiscal years 2017-2019. However, we calculate FCC at an average of 1.36x, (including 1.3x in 2019). Our calculation of FCC treats portions of payments to the state as an operating expense and 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 will 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 estimate for fiscal 2020, and projections for 2021-2025, we calculate FCC of 1.28x-1.37x. In our view, this would continue to support our current assessment.

Liquidity and reserves--Very strong

We view Santee Cooper's liquidity as robust in both absolute and relative terms. The utility recorded $481 million of unrestricted cash and investments at Dec. 31, 2019, representing the equivalent of 157 days of operating expenses. In addition, the authority had $572 million of capacity available under revolving credit facilities, which bolstered its liquidity position to 343 days of operating expenses.

While these levels are down from prior 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 decline further in 2020 and 2021 as the authority uses unrestricted cash to pay down its Cook settlement liability. Nevertheless, we expect total liquidity will continue to support the current assessment.

Debt and liabilities--Adequate

S&P Global Ratings' leverage ratio calculation yielded a 78% debt-to-capitalization ratio for 2019, which we consider adequate for a vertically integrated utility. Santee Cooper's $939 million capital plan for 2021-2023 calls for $460 million in additional debt; debt-to-nevertheless, the authority's debt to capitalization ratio is expected to decline to 72%, as amortization and cash from operations offset the new money issuance.

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 October 21, 2020)		
South Carolina Pub Svc Auth retail elec		
Long Term Rating	A/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (AGM)		
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) (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 (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 (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 (BHAC) (SEC MKT)		
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 rev oblig (Taxable) ser 2016D due 12/01/2056		
Unenhanced Rating	A(SPUR)/Negative	Affirmed

Many issues are enhanced by bond insurance.