



Fitch Rates Santee Cooper's Series 2016 Bonds 'A+'; Outlook Stable

Fitch Ratings-New York-24 June 2016: Fitch Ratings has assigned an 'A+' rating to the following South Carolina Public Service Authority's (Santee Cooper or the authority) revenue obligations, series 2016 consisting of:

- \$400,000,000 tax-exempt series B;
- \$55,000,000 tax-exempt refunding series C;
- \$300,000,000 taxable series D.

The 2016 series D obligations will be used to retire certain commercial paper (CP) notes and, together with the series B bonds, fund a portion of the authority's ongoing capital improvement program. Series C bonds will be used to refund outstanding parity obligations (2006 series C).

The Rating Outlook is Stable.

SECURITY

The revenue bond obligations are secured by a lien upon and pledge of, the revenues and moneys in the revenue fund on parity with other revenue obligations, and prior to the payment of CP notes.

KEY RATING DRIVERS

STABLE CUSTOMER BASE: The authority is one of the nation's largest municipal wholesale systems, serving either directly or indirectly customers spanning all 46 counties within the state of South Carolina (Long-Term Issuer Default Rating 'AAA'/Outlook Stable). The state's improving economy provides stability to the authority's operations, as does a long-term (2058) power sales agreement with Central Electric Cooperative, which accounts for close to 60% of total annual revenue.

NUCLEAR CONSTRUCTION CHALLENGES: Recent construction delays and cost overruns related to the nuclear expansion project at V.C. Summer Nuclear Generating Station Units 2 and 3 (Summer Units 2 and 3) remain a growing concern. The authority's ability to exercise the fixed-price option in its engineering, procurement and construction (EPC) contract could prove a positive development as it will likely provide greater certainty of remaining nuclear construction costs. The fixed price option is under review by the authority's governing board with a final decision expected by the end of June 2016.

NUCLEAR CONTRACTOR CONCERNS: Although Fitch views the recent consolidation of the nuclear expansion project contractors (Westinghouse Electric Company LLC and Stone & Webster, Inc.) positively, the weakening credit profile of Toshiba Corporation (not rated by Fitch) is an increasing concern. Toshiba is the majority owner of Westinghouse and has guaranteed certain Westinghouse obligations.

COMPETITIVE ELECTRIC RATES: The authority's independent rate setting authority, competitive wholesale and retail rates, and ability to automatically recover in excess of 75% of costs from wholesale customers provides considerable flexibility. Manageable base rate increases needed to maintain acceptable financial metrics for fiscals 2016 and 2017 have already been approved.

SATISFACTORY FINANCIAL PERFORMANCE: The authority's major construction and financing program has pressured cash flow metrics and contributed to a previous downgrading of Santee Cooper bonds. Financial ratios remain well below historical levels, but appear to have stabilized, providing support for the 'A+' rating. The authority's long-term financial model ending in fiscal 2020 is predicated on senior-lien debt service coverage (DSC) remaining at a satisfactory level of no less than 1.41x.

RATING SENSITIVITIES

ADVERSE NUCLEAR DEVELOPMENTS: Further adverse developments related to the development of the Summer units 2 and 3, including sizable cost overruns, extensive delays or contractor insolvency, that result in rate pressures and ultimately lead to erosion in South Carolina Public Service Authority's financial metrics and the competitiveness of its power supply could result in negative rating action.

CREDIT PROFILE

Santee Cooper exists as a state-owned electric and water utility effectively serving a population of approximately 2 million spanning parts of all 46 counties within the state of South Carolina. The authority currently provides electric generation, transmission and distribution service directly to 175,000 retail customer accounts, and on a wholesale basis to 26 large industrial customers, Central Electric Power Cooperative Inc. (Central) and two municipally owned electric systems.

Wholesale customers, in turn, directly serve approximately 771,000 customers. Sales to Central, which account for nearly 60% of the authority's aggregate energy sales, are made pursuant to a wholesale power sales contract that extends through 2058, well beyond the scheduled maturity dates of the authority's existing debt obligations.

POWER SUPPLY RESOURCES TO DIVERSIFY

Santee Cooper's portfolio of resources remains heavily weighted towards coal-fired generation, which accounts for nearly two-thirds of existing capacity and almost half of energy supplied in fiscal 2015. The eventual completion of the Summer units will ultimately be a positive shift in the authority's resource base, resulting in a significantly more diverse energy supply led by non-carbon emitting nuclear capacity.

The authority's 5,104 MW of owned generation coupled with 296 MW of Southeastern Electric Power Authority hydroelectric capacity and a modest percentage of market purchases comfortably exceed peak demand. Ongoing compliance projects are positioning the authority well to meet existing environmental regulations. Remaining costs to do so should be manageable.

STATUS OF NUCLEAR CONSTRUCTION

The nuclear expansion project at V.C. Summer units 2 and 3 remains ongoing, slowed primarily by construction delays related to productivity and a longer than anticipated construction and operating license process. Santee Cooper maintains a 45% ownership interest in the project with South Carolina Electric & Gas (SCE&G) owning the remaining 55%. Units 2 and 3 are being developed pursuant to an engineering, procurement and construction (EPC) agreement with Westinghouse and Stone & Webster, using the Westinghouse AP1000 technology.

Originally expected to be completed April 2016 and January 2017, Units 2 and 3 are now scheduled to enter commercial operation in August 2019 and 2020 following significant construction delays and likely cost increases should the fixed price option be exercised. The authority's latest cost estimate as of May 2016 now stands at \$5.9 billion, up from initial estimates of \$4.9 billion in 2008.

On Dec. 31, 2015, Westinghouse acquired Stone & Webster, consolidating the related responsibilities and liabilities. Fitch views the acquisition of Stone & Webster and the recent settlement agreement between the co-owners and Westinghouse as positive developments for Santee Cooper as the agreement effectively resolves all outstanding claims between the project co-owners and the contractor and restricts the contractor's ability to seek further increases in the contract price. Moreover, with Westinghouse assuming the role of the primary contractor, concerns regarding inter-contractor disputes, which have plagued the project, should lessen.

Fitch has become increasingly concerned with the weakening credit profile of Toshiba, which is the majority owner of Westinghouse and has guaranteed certain Westinghouse obligations. Toshiba's credit rating has been lowered to well below investment grade by the other two rating agencies and prolonged financial weakness or insolvency could compromise project development and/or Toshiba's ability to perform under its guarantee.

SATISFACTORY FINANCIAL PERFORMANCE

Financial performance weakened in fiscal 2015 amid a decline in energy sales but remained supportive of the current rating category. Fitch-calculated debt service coverage declined to 1.29x after remaining at or above 1.45x over the prior two years. Coverage after incorporating annual distributions to the state and payments in lieu of taxes to local governments was satisfactory at 1.22x.

Cash reserves continued at a fairly robust level at fiscal year-end 2015, equal to about 180 days of cash on hand. Days of liquidity, which incorporates unused capacity under its revolving credit agreements and commercial paper program, totaled 279 days. The authority's latest financial forecast ending in fiscal 2020 shows debt service coverage averaging 1.37x after making annual distribution payments and factoring in interest charges associated with commercial paper notes.

The forecast incorporates recently approved annual base rate increases for its retail, industrial and municipal customers of 3.7% for the current and subsequent fiscal year. Importantly, the authority's board maintains autonomous rate setting authority, and slightly more than 75% of annual costs are subject to an automatic rate adjustment that ensures timely cost recovery. Despite the recent adoption of the increases, Santee Cooper's rates still approximate the state average and are considered competitive

relative to other regional providers.

Capital program spending is forecast to remain substantial between fiscals 2016-2019, approaching \$3.3 billion. The vast majority will be aimed at completing the Summer units; environmental compliance will account for slightly less than 15% of total projected spending. Fitch expects the authority will remain highly leveraged well beyond 2020 given plans to issue an additional \$1.4 billion in long-term debt over the next three fiscal years. Management, however, forecasts a significant decline in capital spending following the completion of the Summer expansion project, which should allow leverage ratios to ultimately begin moderating.

STABLE SERVICE TERRITORY

Since the most recent economic recession, the state has steadily added jobs at a pace that has mirrored or exceeded that of the nation, resulting in an unemployment rate that improved to 4.8% as of May 2016, about equal to the U.S. rate of 4.8%. South Carolina's wealth levels remain below average, with personal income per capita in 2015 ranking 47th among the states at 80% of the U.S.

The state's economic base continues to expand into the services industry, with the largest share of employment having moved into the trade, transportation, and utilities sectors. Renewed growth in the state's large manufacturing sector has aided in moderating unemployment rates despite strong labor force gains. AB Volvo's recently announced plan to build a \$500 million manufacturing plant within Santee Cooper's service area should bode well for the state's economy. The authority will serve the facility on an indirect basis through one of its wholesale customers.

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Date of Relevant Committee: Dec. 9, 2015

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)

(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiJlE0NjY4MjQ4MzYsInNlc3Npb25LZXkiOiJIRFFUN1BMMUE1V1RHUU9DUUFZRIQ1VVRBNzUzN0hJRTZEU1FYU1ZKIn0.YBI6DkCfET5qCaM7jqkb-Ov8KC9oRE3LzO2U9VO6ZE8)

U.S. Public Power Rating Criteria (pub. 18 May 2015)

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