S&P Global
Ratings

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Summary:

South Carolina Public Service Authority; CP; Wholesale Electric

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Summary:

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Credit Profile		
US$400.0 mil rev oblig ser 2016B due 12/01/2056		
Long Term Rating	AA-/Stable	New
US$300.0 mil rev oblig (Taxable) ser 2016D due 12/01/2056		
Long Term Rating	AA-/Stable	New
US$55.0 mil rfdg rev oblig ser 2016C due 12/01/2056		
Long Term Rating	AA-/Stable	New
South Carolina Pub Svc Auth rev oblig		
Long Term Rating	AA-/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AA-' rating to South Carolina Public Service Authority's (Santee Cooper) proposed $755 million revenue obligations, series 2016B, C & D. The outlook is stable.

At the same time, S&P Global Ratings affirmed its 'AA-' rating on Santee Cooper's $6.8 billion of existing long-term revenue bonds. In addition, S&P Global Ratings affirmed its 'A-1' short-term rating on the utility's subordinate-lien commercial paper (CP). About $597 million of CP was outstanding as of Dec. 31, 2015.

The proceeds from the 2016B, C, and D bonds will retire CP notes issued to finance Summer Nuclear units 2 and 3, fund a portion of the ongoing capital improvement program, and refund a portion of debt outstanding. The bonds are payable from net revenues of the authority's electric system.

The ratings reflect what we consider to be the following credit strengths:

- Adequate coverage of debt service and fixed costs at the current rating. We calculate debt service coverage of revenue bonds, lease obligations, and CP interest of 1.39x in 2015, 1.51x in 2014, and 1.43x in 2013. We calculate coverage of fixed costs, which treats transfers to the state as an operating expense, at 1.34x in 2015, 1.45x in 2014, and 1.37x in 2013. Also, management projects that coverage levels through 2018 will be consistent with 2015 results;
- Solid liquidity. Unrestricted cash and investments measured nearly $644 million, or a robust 177 days of operating expenses at fiscal year end Dec. 31, 2015. An additional $152 million in liquidity was is available through unissued CP capacity; while technically available, we anticipate that this will be drawn on for capital purposes over the next several years. We would still consider liquidity to be robust absent this money;
- A broad and diverse customer base. Santee serves 175,000 customers directly and nearly 771,000 indirectly, the latter chiefly via sales to wholesale customer Central Electric Cooperative, which accounted for 57% of the authority's 2015 revenue;

- A responsive cost recovery mechanism. The authority'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 a three-month rolling average), and an automatic adjustor for variance in the demand component of non-firm sales and off-system sales;
- A strong and sophisticated management team, and a governance structure that appears to be insulated from politicization despite the board's gubernatorial appointment. Despite the recent retirement of a number of senior executives, we believe that the management team continues to demonstrate a commitment to a robust enterprise risk management program, and continued focus on generating asset diversification, expense reduction and the adoption of credit protective policies; and
- Competitive rates. Santee Cooper's retail rates are generally competitive. Residential, commercial, and industrial rates are, on balance, slightly higher than those of Progress Energy Inc. and Duke Energy Corp., but well below those of South Carolina Electric & Gas (SCE&G). While cost pressures are expected to result in moderate rate increases, we believe Santee will maintain its competitive positioning.

In our opinion, the following factors represent credit risks:

- Nuclear risk. Nuclear generation accounts for 9% of the total, and Santee is participating in the construction of two new nuclear units, which we expect to boost nuclear to 34% by 2020. The construction of VC Summer units 2 and 3 has experienced significant delays (29 months, not including an additional 11-month delay associated with obtaining the construction and operating license) and cost overruns. We understand that Santee's board is considering an option to fix the costs related to its engineer, procure, and construct (EPC) contract. If the option is exercised, it would add roughly $1 billion to the Santee's share of the project cost, which we expect management to debt-finance, but ultimately recovered through a rate increase of less than 5%. The board expects to decide as early as the end of June. We continue to believe that Santee's power costs will remain competitive despite this and additional projected rate increases. Moreover, we continue to view the project as adding diversity to Santee Cooper's generating fleet and providing a source of zero emission energy in an increasingly carbon constrained environment;
- High debt levels and substantial capital costs. Santee has about $8 billion in long-term debt and CP, or roughly $8,500 per customer (direct and indirect). We anticipate that debt levels will increase to $8.5 billion by 2020, as the authority has a substantial $3.2 billion capital plan (2016-2019), the bulk of which is related to the nuclear units; and
- A substantial carbon footprint. Santee Cooper relied on coal-fired generation to meet a little less than half of its 2015 energy needs. Although coal units generally comply with existing Environmental Protection Agency (EPA) regulations (and we view the capital costs of additional controls as manageable), Santee Cooper is exposed to financial and operational risks associated with regulation targeting greenhouse gas emissions at existing units. The fate of the EPA's Clean Power Plan (CPP), which has been stayed by the U.S. Supreme Court, is uncertain, but we believe that carbon regulation is inevitable, posing challenges to many carbon-intensive utilities. Insofar as the associated costs and timing of such regulation are uncertain, we have not factored in the potential negative impact into the rating. However, in Santee's case, the utility's investment in the VC Summer units 2 and 3, which will help to reduce carbon dioxide emissions, reduces the risk.

The business profile score is '4' on a scale of '1' to '10', one being the strongest. The business profile reflects our opinion of Santee Cooper's rate-setting autonomy, solid competitive position, and strong management, although the risks associated with building new nuclear generation and exposure to environmental regulation given the utility's substantial carbon footprint partially offsets these strengths.

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. The utility serves about 175,000 residential, commercial, and industrial electric customers directly, and another 771,000 customers indirectly through wholesale electric supply arrangements with cooperative and municipal utilities. Central serves most of the latter group.

In May 2013, Santee extended its wholesale power sales contract with Central to 2058. In our opinion, this enhances the predictability of the authority's revenue stream, and enables it to better align the amortization of existing and proposed debt with its assets' useful lives. Based on the Central contract extension, the utility has been using refunding transactions to extend the maturities of some of its existing debt beyond the contract's previous 2030 expiration. We believe that longer amortization should better enable Santee Cooper to achieve stable debt service coverage metrics as it increases long-term. The utility's capital plan through 2020 totals $3.2 billion, with 66% dedicated to the Summer nuclear project.

The contract with Santee's largest industrial customer, Alumax of South Carolina Inc. (a subsidiary of Century Aluminum), accounts for almost 9% of operating revenues and expired at the end of 2015. After previously announcing its intent to close its plant, Century entered into a contract with Santee, effective Feb. 1, 2016 through 2018, for 200 megawatts (MW) of capacity and energy, roughly half the level under the previous contract. The new contract allows for early termination by Century with 60 days' notice. While Santee derives little net margin on these sales, they shoulder a portion of the utility's fixed costs.

However, mitigating this risk is the recent announcement that Volvo will build its first U.S. facility, on land that is directly or indirectly (via coops that are part of Central Electric) served by Santee. The $500 million plant is expected to be in service in 2018, and create thousands of direct and indirect jobs. Santee expects the plant will add 17-20 MW of load. As inducement, Santee has agreed to purchase 6,800 acres of land on behalf of Volvo, and make economic development loans to Berkeley County, as well as grants for transmission and water rights. We expect Santee will debt-finance its $60 million outlay, with about $21 million to be repaid under the loan. As part of the deal, the utility will retain ownership of 3,900 acres; Santee expects that state funded and other utility improvements to the property state funded projects (which are part of the overall economic development project will enhance the value of the property, which the authority expects to sell to potential Volvo suppliers.

Santee Cooper is diversifying its fuel mix to reduce its high coal reliance. Although coal accounted for nearly 78% of generation in 2010, its contribution dropped to 47% in 2015, as gas prices have declined.

The utility views investments in proposed nuclear capacity additions and investments in or purchases from renewable resources as tools for diversifying its fuel mix. It committed to purchase a 45% interest in each unit, but revisited the size of its interest due to the recession's impact on demand and Central's decision to contract with Duke Energy for a portion of its energy needs. After several failed attempts to sell a 20% share in the plant, Santee was successful in selling a 5% share (111 MW) to majority owner SCE&G -- 1% upon unit 2's commercial operation, 2% one year thereafter, and 2% one year after that. Given this schedule, Santee is retaining the construction risk for the share being sold. We note that the utility still projects fairly significant excess capacity when the nuclear units are scheduled to come on line.

On Oct. 27, 2015, Santee, SCE&G, and Westinghouse reached a settlement to amend the EPC contract effective upon Westinghouse's acquisition of Stone and Webster from Chicago Bridge and Iron (CB&I). Under the settlement, Santee will pay Westinghouse $112.5 million to settle substantially all prior and existing disputes regarding costs and timing. Concurrently, the guaranteed substantial completion dates for units 2 and 3 were revised to Aug. 31, 2019 and 2020, respectively, two months later than previously announced. Finally, SCE&G was given the option, which it has since exercised, to fix the total amount to be paid to the consortium for work done after June 30, 2015. Santee's share of the total project cost has been fixed at roughly $6.1 billion, about $1 billion above previous projections. Santee expects that it will debt-finance the additional cost, and estimates that it will need to raise rates less than 5% to accommodate the cost increase. In our opinion, the increased costs are manageable at the current rating and considering Santee's competitive rates, and we continue to believe that the benefits of exercising the fixed-price option removes significant uncertainty regarding the potential for cost overruns. However, liquidated damage provisions only cover a two year delay to the current schedule, so Santee does still face some construction risk exposure.

Santee's rates are generally competitive -- slightly above that of Duke Energy Carolinas and Duke Energy Progress, but well below that of SCE&G. The utility has adopted a 5% increase for 2017. We expect additional rate increases over fiscal years 2018-2022 as Santee embeds into rates its capital costs associated with the nuclear units. So we anticipate that competitive positioning will be pressured relative to Duke Carolinas and Duke Progress, but remain solid versus SCE&G, which is also participating in the VC Summer project.

Roughly 47% of the utility's energy is coal-fired. When VC Summer units 2&3 come online, they are expected to displace coal-based generation and purchased power, making for a somewhat more diverse fuel mix. As such, we expect coal-fired generation to decline to about 44% by 2020. With the retirement of its Grainger and Jefferies coal units, we further expect the cost of complying with the EPA's Mercury and Air Toxics Standard and Cross State Air Pollution Rule to be manageable. Costs associated with complying with coal combustion residuals (ash) are estimated at $604 million.

Of greater credit concern is the regulation of carbon dioxide (CO_2) emissions at existing power plants, which would most significantly affect 3,525 MW of coal-based capacity at Santee's Cross and Winyah stations. On Aug. 3, 2015, the EPA released its CPP, calling for a 32% cut in CO_2 emissions from the nation's existing power plants by 2030, with interim reductions covering the 2022-2029 timeframe. South Carolina expects to cut its CO_2 emission level by 36%. Santee's reduction burden will not be known until the state submits to the EPA its initial implementation plan, which it had expected to do by September 2016. However, in February 2016, the U.S. Supreme Court stayed the regulation, returning the case to the Court of Appeals, to rule on its legality. The Court of Appeals expects to hear arguments in September.

We believe it is too early to determine the impact of the regulation on credit quality. The regulation needs to work its way through the courts. In addition, states need to develop implementation plans, the details of which will be a key in framing the challenges that utilities will face. Moreover, utilities will have an opportunity to formulate response strategies. As these issues come into focus, S&P Global Ratings will evaluate the challenges and assess the extent to which the response erodes credit quality.

We believe that Santee's financial metrics support the rating. In 2015, coverage of debt service requirements (which includes principal and interest payments on commercial paper paid from revenue) before payments in lieu of taxes was 1.39x, and 1.34x after -- down from 2014's metrics of 1.51x and 1.45x, respectively. Coverage after transfers is projected to range from 1.35x to 1.45x from 2016-2020. We believe that Santee's liquidity is robust, but necessary given the scale of its capital program and exposure to nuclear generation. The utility had $644 million of unrestricted cash at fiscal year-end Dec. 31, 2015, representing 177 days of operating expenses. In addition, the authority has a $200 million revolving credit agreement that provides additional liquidity, boosting total liquidity to 232 days of fiscal 2015 operating expenses.

Santee Cooper uses CP to fund a portion of its investment in the Summer nuclear station because CP provides debt retirement flexibility as the utility sought to sell some of its interest in the plant. It pledged through a board resolution to maintain liquidity facilities sufficient to cover the principal of the CP so long as CP is outstanding. It has revolving credit agreements with five banks that total $750 million. The banks' support obligations could terminate before expiration as there are default events tied to the utility's creditworthiness. Consequently, the short-term CP rating reflects our view of Santee Cooper's capacity to service short-term obligations, rather than the banks' credit quality. In the event of an authority insolvency proceeding, the liquidity facilities will terminate automatically. The board's Aug. 23, 2010, resolution caps the utility's CP balances. Santee Cooper can issue CP in amounts that do not exceed the lesser of 20% of its total debt or the unused balance available under the revolving credit agreements that provide the liquidity that backstops the CP program.

Outlook

The stable outlook reflects our view that that extending the Central contract by 28 years and re-amortizing a portion of existing debt and matching debt maturities to the lives of the assets the utility is financing bolsters capacity to service existing debt and the substantial debt it plans to issue. We view the ability to exercise of the option to convert the EPC contract to a fixed cost contract as supportive of credit stability. However, Santee still faces risks related to nuclear generation and addressing remediation of its coal fleet.

Upside scenario

Upside potential for the rating is limited by financial projections that suggest coverage metrics that are just adequate at the current rating level, ongoing exposure to risks associated with nuclear generation, and by uncertainties related to the CPP's effects. We do not expect to raise the rating in the next two years.

Downside scenario

Downside ratings pressure could result if coverage of fixed costs falls significantly short of levels contained in its financial projections (1.35x to 1.45x), or if there are further significant delays or costs associated with nuclear generation, or if there is greater clarity regarding the impact of the CPP that suggests significant operational or financial burden.

Related Criteria And Research

Related Criteria

- USPF Criteria: Electric And Gas Utility Ratings, Dec. 16, 2014
- USPF Criteria: Commercial Paper, VRDO, And Self-Liquidity, July 3, 2007
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In

U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of June 27, 2016)		
South Carolina Pub Svc Auth rev oblig bnds tax-exempt		
Long Term Rating	AA-/Stable	Affirmed
South Carolina Pub Svc Auth rev oblig (BHAC) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth CP		
Short Term Rating	A-1	Affirmed
South Carolina Pub Svc Auth rev oblig		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
South Carolina Pub Svc Auth CP prog		
Short Term Rating	A-1	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.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.