FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Santee Cooper Series 2020 Revenue Bonds 'A-'; Outlook Stable

Thu 22 Oct, 2020 - 3:04 PM ET

Fitch Ratings - New York - 22 Oct 2020: Fitch Ratings has assigned an 'A-' rating to the following South Carolina Public Service Authority (Santee Cooper, or the authority) revenue obligations, series 2020, consisting of:

--$363,115,000 2020 tax-exempt refunding and improvement series A; and

--$300,450,000 2020 taxable refunding series B.

Proceeds from the 2020 obligations will be used primarily to refund outstanding parity obligations and pay costs of issuance. The bonds are expected to price the week of Oct. 26.

In addition, Fitch affirms the following Santee Cooper obligations and ratings at 'A-':

--approximately $6,424,000,000 tax-exempt and taxable revenue obligations; and

--Issuer Default Rating (IDR).

The Rating Outlook is revised to Stable from Negative.

ANALYTICAL CONCLUSION

The rating affirmation at 'A-' primarily reflects Santee Cooper's leverage ratio, measured as net adjusted debt to adjusted funds available for debt service (FADS), which has remained above 10.0x in recent years and is elevated for the current rating. While Santee Cooper's debt burden has steadily declined since 2016, balances still reflect the sizable burden incurred in connection with the cancelled Summer nuclear project. The authority's leverage and financial profile are supported by strong contractual underpinnings that support revenue collections, but also factor in the authority's recent agreement to lock rates through January 2025, as well as the credit quality of Central Electric Power Cooperative (Central), its largest wholesale customer. Very low operating risk, including very low operating costs and more moderate capital spending requirements, also supports the authority's profile.

The revision in Rating Outlook to Stable from Negative reflects Santee Cooper's recent agreement to settle the most significant aspects of outstanding litigation, the enactment of legislation that provides greater operating stability and progress related to stabilizing its management and governance structure. Collectively, these developments meaningfully address the asymmetric risk factors confronting the authority and weighing on its credit quality.

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The current rating and Rating Outlook further reflect Fitch's expectation that the authority's leverage ratio will improve to roughly 10.0x in 2022, following performance in 2020 and 2021 that will be strained by the effects of the coronavirus and economic contraction, $200 million in payments related to the settlement of litigation and the authority's agreement to lock rates.

CREDIT PROFILE

Santee Cooper is a state agency that provides wholesale power supply, as well as direct retail electric service to approximately 180,000 retail customer accounts and 27 large industrial customers. Including the retail base of Central, the largest of its five all-requirements wholesale customers, Santee Cooper supplies electricity to a population of approximately two million spanning much of the state of South Carolina. The authority also owns the Lake Moultrie and Lake Marion regional water systems, two drinking water treatment systems serving nearly 200,000 people.

Cancelled Nuclear Construction Strains Profile

Santee Cooper's decision to suspend construction of the Summer nuclear units 2 and 3 on July 31, 2017 following the bankruptcy of the project's lead contractor, Westinghouse Electric Company LLC, triggered a number of legal, political and financial challenges for the authority. At the time of the decision, Santee Cooper had spent $4.3 billion and construction of the nuclear plant expansion was 36% complete, with the engineering and procurement efforts both over 90% complete. While the decision may have been justified based on revised cost and timeline estimates considered in the context of revised load expectations, the halting of construction and prospects for recovering the stranded costs associated with the incomplete project ignited a series of controversies statewide.

Fervent customer and political opposition to the recovery of stranded costs related to the project ultimately drove state regulators and shareholders to approve the sale of co-owner South Carolina Electric & Gas and its parent company SCANA to Dominion Energy in January 2019, and led the governor to sign Act 95, which would allow the state to consider options to sell, manage or reform the authority. In early-2020, committees in the state senate and house of representatives rejected all three of the final proposals considered pursuant to Act 95, including the authority's own reform plan.

Also in early-2020, Santee Cooper took a major step forward toward stabilizing its operating profile by agreeing to resolve significant litigation challenging the authority's ability to recover costs related to the Summer project. The agreement - the Cook Settlement - provided for the release of major claims against the authority in exchange for payments for the benefit of utility customers totaling $200 million over three years, and an agreement by Santee Cooper to hold rates at levels consistent with its reform plan through Jan. 15, 2025.

Before concluding its regular two-year session in May 2020, the state Legislature passed a temporary resolution - Act 135 - that provides interim guidance for the authority's operation for up to a year, until the Legislature can return to consider other actions. Positively, the terms of Act 135 provide Santee Cooper with ample authority to operate the utility in a manner consistent with the principles of its reform plan and to adhere to the provisions of the Cook Settlement. In short, the terms of the Act will enable Santee Cooper to execute its proposed resource plan, hedge its variable-cost exposures, perform normal financing activities, resolve outstanding lawsuits and claims, and lock rates as provided in the Cook Settlement. The provisions of Act 135 will remain in effect through the earlier of May 31, 2021, or until superseded by an act of the General Assembly.

Finally, Act 135 addressed governance concerns at Santee Cooper by establishing an oversight committee and requiring that the Office of Regulatory Staff (ORS) conduct monthly reviews of the authority. The oversight committee, which consists of the governor and four members of the state government, is only expected to meet to consider certain long-term contracts and to clarify operational functions and matters identified by the ORS. Reviews by the ORS will focus on the authority's compliance with the terms of Act 135.

Coronavirus Impact Manageable

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The overall impact of the recent coronavirus outbreak on Santee Cooper appears manageable. The authority's annual load forecast has been updated to account for an 8% reduction in sales, but recent performance indicates declines closer to 5%. Retail delinquencies have returned to pre-COVID-19 levels and there are no expectations that bad debt expense will increase significantly compared to historical years. Overall, with anticipated reductions in operating costs, operating income for fiscal 2020 should approximate budget. Fitch's ratings remain forward-looking in nature, and we will continue to monitor developments related to the severity and duration of the virus outbreak, as well as revise expectations for future performance as appropriate.

Revenue Defensibility: 'a'

Statewide Wholesale and Retail Electric Provider

Santee Cooper's revenue defensibility assessment reflects the strong contractual underpinnings supporting revenue collections from both retail and wholesale customers, but is constrained by its agreement to lock rates through January 2025 and Central's credit quality.

Operating Risk: 'aa'

Very Low Operating Costs; Unlikely to Experience Upward Movement

Operating costs have averaged below six cents per kilowatt hour (kWh) over the past five years, which are considered low for its wholesale business line, but very low for the retail business line. Operating costs are not expected to experience upward pressure and could decline under the terms of its latest operating plan. Capital requirements for current and new generation are lower than historical levels and appear very manageable.

Financial Profile: 'a'

Leverage Remains Elevated

Santee Cooper's leverage ratio was high at 10.6x at the end of fiscal 2019. The ratio reflects substantial debt that was issued to fund the Summer nuclear expansion before the project was terminated. Financial margins have stabilized through 2019 with coverage of full obligations above 1.3x and cash on hand at 160 days, but weaker performance in 2020 and 2021 are expected to push leverage ratios higher before moderating thereafter.

ASYMMETRIC ADDITIONAL RISK CONSIDERATIONS

Asymmetric risk considerations related to management and governance no longer actively constrain or weigh on the rating and Rating Outlook.

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RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Significantly stronger than expected performance under the current rate lock that allows the authority to consistently reduce leverage ratios well below 10.0x in Fitch's base and stress scenarios.

--Increased stability related to the authority's board composition, operating parameters, and management and governance challenges.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Evidence of weaker than expected operating performance as a result of the current rate lock.

--Failure to reduce leverage ratios to levels approximating 10.0x by 2022 in Fitch's base and stress scenarios.

--Threatened or enacted changes in the authority's management and governance that could reduce operating flexibility or limit rate-setting authority further.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

SECURITY

The revenue obligations are payable from, and secured by a lien on, the net revenues of the authority.

REVENUE DEFENSIBILITY

Santee Cooper's very strong revenue source characteristics are rooted in the strong contractual underpinnings supporting revenue collections from both retail and wholesale customers. Wholesale revenues accounted for 63% of Santee Cooper's revenue in 2019, and are largely derived pursuant to a coordination agreement with Central. Santee Cooper provides the total power and energy requirements of Central and its member cooperatives under the agreement, which cannot be terminated.

Amendments to the agreement in 2013 extended the term from 2030 to 2058 to facilitate longer-term debt issuance to finance the Summer nuclear project and provided Central with greater flexibility as to participation in new generating resources constructed by the authority. Earlier revisions to the agreement allowed Central to transition roughly 900MWs of load from Santee Cooper to Duke Energy Carolinas, but no further load transitions are anticipated.

Nearly all of Santee Cooper's remaining wholesale revenues are similarly derived under long-term contracts that terminate between 2023 and 2033. These include all-requirements contracts with the cities of Georgetown, Bamberg and Seneca, as well

as agreements for capacity and energy with Piedmont Municipal Power Agency and Alabama Municipal Electric Authority.

The authority also provides direct service to approximately 190,000 retail customers throughout the Berkeley, Georgetown and Horry Counties of South Carolina, and an additional 27 large industrial customers located throughout the state. These customer classes provided roughly 24% and 13% of Santee Cooper's total revenue in 2019, respectively. The agency has the exclusive right under state law to provide retail electric service throughout these service areas and to serve the existing industrial customers outside its assigned territory. Demand throughout the areas served by the authority has been supported by very strong customer growth (8.7% since 2015) and regional demographics for income and unemployment that are consistent with, or narrowly below, national averages. Certain of the authority's large industrial customers are supplied under contract, including Nucor Corporation (4.8% of revenue) and Century Aluminum (1.4%). Contract durations are relatively short, but Nucor and Century have been customers of the authority since 1996 and 1977, respectively.

Santee Cooper's water operations account for less than 1% of total revenue.

Rate Flexibility

Santee Cooper's enabling legislation gives its board the autonomous power to set electric rates. Moreover, the terms of its revenue obligation resolution require that the authority set rates to provide revenue to meet all obligations, including principal and interest on indebtedness. These factors, together with the competitiveness of its rates and timely cost recovery, support very strong rate flexibility. While rate flexibility will be diminished somewhat through January 2025 as a result of the Cook Settlement Agreement, the authority's ability to manage its fuel and purchased power costs, as well as defer for later recovery a wide range of expenses including those related to changes in law, storm events, cyberattacks and certain changes in Central's load, support Fitch's assessment.

Rate-setting authority rests solely with the Santee Cooper board, which has historically exercised its authority to achieve financial targets of 1.4x debt service coverage and 90 days cash on hand. However, under the terms of the Cook Settlement, the board has agreed to impose a rate lock effective for all service after Aug. 16, 2020. The agreement applies to the vast majority of the authority's customers, suspending the rate adjustment mechanisms in place and locking rates at levels that are consistent with those proposed by the authority under its reform plan. Given its ability to hedge fuel costs, expectations for reducing operating costs (also consistent with the reform plan) and the allowance for deferring certain unanticipated expenses, Fitch expects that the authority's ability to produce cash flow sufficient to meet the its obligations and achieve its targets will not be compromised.

The rate lock should further support the competitiveness of the authority's retail rates, which have not been increased since 2017. According to U.S. Energy Information Administration data, Santee Cooper's total average retail revenue per kWh has consistently remained 15%-20% below the state average.

Purchaser Credit Quality

Purchaser credit quality is midrange, largely based on the credit quality of the authority's dominant purchaser, Central, as assessed by Fitch using publicly available information. Fitch's assessment reflects the cooperative's leverage ratio, measured as net adjusted debt to adjusted FADS, of roughly 8.0x and weaker liquidity as evidenced by historical cash on hand of roughly three days. Central's credit quality is supported by revenue derived pursuant to a very strong contractual framework that includes all-requirements wholesale power contracts with each of its 20 members, and legal authority to set rates to members.

Central's members, in turn, provide electric service to approximately 770,000 customers throughout South Carolina. The areas served by Central's largest members generally exhibit midrange demand characteristics including customer growth rates above 1.5% per annum, unemployment metrics consistent with the national average and income metrics that are weaker than

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the national average. Additionally, Central's operating risk profile and cost burden are low, reflecting the cost, terms and characteristics of its power supply arrangement with Santee Cooper.

Although the wholesale purchaser cities of Georgetown, Bamberg, Seneca, SC, and Waynesville, NC are not rated by Fitch, the credit quality of purchasers Piedmont Municipal Power Agency (A-/Stable) and Alabama Municipal Electric Authority (AA-/Stable) further support overall revenue defensibility.

OPERATING RISK

Santee Cooper's operating cost burden is assessed as very low, factoring its role as both a wholesale and retail supplier. While the authority's Fitch-calculated cost of power of 5.9 cents per kilowatt hour (kWh) over the past five years suggests a cost burden assessment of 'a' for wholesale systems, the burden is well below the 'aa' threshold for retail systems. The relative stability of the cost burden reflects the relative efficient operation of the authority's generating resources, and factors annual payments in lieu of taxes and distributions to the state totaling $28 million.

Operating Cost Flexibility

The authority's operating cost flexibility is neutral to the rating and driven by a power supply portfolio that is well diversified in terms of fuel sources and unit capacity. Summer peak capability, which includes a mix of owned (5,115MW) and purchased (474MW) resources, remains generally sufficient to meet peak demand, which declined to 4,507MW in 2019 from 5,869MW in 2015 due to lower Century load and declines in Central's purchases.

Coal-fired generation dominates the agency's portfolio of resources, accounting for nearly 63% of existing capacity, and supplied only 38% of energy needs in fiscal 2019. Natural gas-fired and nuclear generation accounted for about 21% and 11% of energy needs in 2019. Going forward, the diversity of the authority's portfolio should improve further, and its reliance on coal-fired capacity should decline. Current resource plans call for the retirement of nearly 600MW of capacity at the Winyah generating station by 2023, and a reduction of 153MW of purchased capacity in an effort to right-size resources against declining peak demand, and eliminate costly and inefficient generation. By 2024, the authority anticipates summer reserve margins will have declined to 21% from 28% in 2021, and coal will account for roughly 56% of total capacity. New added capacity will likely be limited to 76MW of new gas-fired combustion turbines and purchased solar capacity over the longer term.

Capital Planning and Management

Despite historical challenges related to Summer nuclear project, Santee Cooper's capital planning and management is assessed as strong, factoring in the authority's age of plant (18 years) and continued reinvestment in its system. Capex to deprecation ratios have averaged a lofty 324% over the past five years, reflecting very high capex in 2016 and 2017 related to the Summer expansion. However, capex has continued to exceed depreciation even in more recent years (129% in 2019) and is expected to do so on average over the next five years.

The authority's capital planning continues to evolve dramatically following the decision to abandon nuclear construction in 2017. Whereas spending approximated $3.39 billion over 2015-2019 and included substantial investment in the Summer project, Santee Cooper's current five-year plan contemplates total spending of roughly $1.6 billion through 2024 and will focus on general improvements ($898 million), environmental compliance ($274 million) and the addition of new combustion turbines ($115 million) to a lesser extent. Over the longer term, the authority expects to consider construction of a new gas-fired combined cycle facility and considerable new solar capacity.

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The majority of these more moderate expenditures are expected to be funded with internal funds and modest amounts of additional debt.

FINANCIAL PROFILE

Santee Cooper's leverage has declined since 2016, but remains stubbornly elevated for the current rating. Debt balances rose steadily beginning in 2008 when construction of the Summer nuclear project began, but declined modestly since peaking in 2016 at $8.7 billion to reach roughly $7.0 billion at year-end 2019. Similarly, the authority's leverage ratio trended down from a peak of 13.2x to 10.6x over the same period. Scheduled amortization and the use of funds from the authority's settlement with Westinghouse and its parent Toshiba to defease debt, together with steadily increasing FADS, have contributed to the improved metrics.

Liquidity is neutral to the rating. Cash balances have remained consistently strong ranging between 160 and 225 days over the past five years. At the end of fiscal 2019, unrestricted cash balances totaled approximately $481 million. Including available borrowing capacity under revolving credit agreements and available CP capacity, Santee Cooper's liquidity cushion totaled 332 days. Fitch-calculated coverage of full obligations has been healthy, above 1.3x since 2016.

Fitch Base Case and Stress Case Scenario Analysis

Fitch's scenario analysis suggests that the authority's leverage ratio will rise in 2020 and 2021 to over 11.0x before moderating closer to 10.0x in 2022 and thereafter. Base case assumptions are informed by Santee Cooper's own financial forecast and include reductions in energy sales of over 11% for retail customers and 3% for wholesale customers as both face lower demand brought on by the coronavirus pandemic. Energy sales are then expected to rebound in 2021 before stabilizing in 2022 through 2024. The scenario further incorporates the authority's current rate lock, expected payments related to the Cook Settlement, and moderated capital spending of approximately $285 million per annum through 2023. Liquidity through the scenario analysis is also expected to remain adequate and neutral to the rating with cash on hand of roughly 120 days and coverage of full obligations consistently above 1.3x.

Fitch's standard stress scenario produces weaker financial performance and leverage ratios that reach 12.8x before moderating to 11.3x in 2022, but have been given less consideration in Fitch's review as the base case fully incorporates a stress that is consistent with expectations related to the coronavirus pandemic and economic contraction.

Debt Profile

Santee Cooper's debt profile is neutral to the rating. Nearly all of the authority's approximately $7.0 billion of outstanding revenue obligations are fixed rate and scheduled amortization is manageable through final maturity. At year-end 2019, variable-rate debt was limited to 6% of total debt, or approximately $440 million including outstanding commercial paper ($142 million), borrowings under revolving credit agreements ($135 million) and a single series a variable-rate revenue obligations ($163 million). The authority's $300 million commercial paper program is supported by an irrevocable direct-pay letter of credit with Barclays Bank PLC, and additional borrowing capacity is available through separate revolving credit agreements with each of Bank of America, TD Bank, N.A. and J.P Morgan Chase bank, N.A totaling $550 million. The agreements expire at various dates in 2021, 2022 and 2023.

Total debt as calculated by Fitch further includes capitalized fixed charges related to purchased power ($462 million in 2019) and unfunded pension obligations as adjusted pursuant to Fitch's methodology ($430 million). Santee Cooper is a participant in the South Carolina Retirement System and contributes to the state's pension plan on behalf of its roughly 1,700 employees. Annual contributions are minimal, equal to less than 1% of total revenue.

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ASYMMETRIC ADDITIONAL RISK CONSIDERATIONS

The Cook Settlement and progress related to stabilizing Santee Cooper's management and governance structure have meaningfully addressed the asymmetric risk factors confronting the authority. While certain challenges and limitations remain, and are factored in the current rating, Fitch no longer believes that these factors actively constrain or weigh on the rating.

The Cook Settlement significantly reduces the authority's exposure to material and costly litigation, and the denial of its legal authority to recover costs related to the Summer nuclear project, including over $4.0 billion of outstanding debt. The settlement further appears to repair Santee Cooper's working relationship with its largest customer, Central.

Challenges remain related to governance as two of Santee Cooper's 12 board seats are vacant, including the chair, and five seats have expired. Appointments have been made for only three of the seven seats by the governor, with senate confirmation pending. Board members must be chosen from each of the state's seven congressional districts and the three counties being served on a retail basis - Berkeley, Horry and Georgetown Counties. Nonetheless, management's ability to flexibly operate the utility appears to be greatly improved. While the newly created oversight board and monitoring by the ORS are typical and could prove frustrating over time, the principles and guidelines established pursuant to Act 135 should support efficient and disciplined operations.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
South Carolina Public Service Authority (Santee Cooper) (SC)	LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Negative

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ENTITY/DEBT	RATING	PRIOR

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

U.S. Public Power Rating Criteria (pub. 30 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Public Power - Fitch Analytical Stress Test Model, v1.1.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

South Carolina Public Service Authority (Santee Cooper) (SC)	EU Endorsed

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Utilities and Power US Public Finance North America United States

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