MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Aa2 to Seattle (City of), WA Electric Enterprise's electric revenue bonds, 2022 and affirms Aa2 on parity bonds; outlook remains stable

15 Jun 2022

Approximately $2.8 billion of debt affected

New York, June 15, 2022 -- Moody's Investors Service (Moody's) has assigned Aa2 to Seattle (City of), WA's Electric Enterprise's (Seattle City Light or SCL) $310.7 million of Municipal Light and Power Improvement and Refunding Revenue Bonds, 2022. At the same time, Moody's affirmed SCL's Aa2 rating on its parity municipal light and power revenue bonds. The utility's rating outlook is stable.

RATINGS RATIONALE

The affirmation of Seattle City Light's Aa2 rating considers the wealthy and diverse service area covering the City of Seattle (UTGO Aaa/stable) and surrounding communities, SCL's historical willingness to raise rates when necessary, and credit supportive financial policies. Other credit supportive factors are SCL's ownership of low-cost hydro generation, long-term power supply contract with Bonneville Power Administration (BPA, Aa2/positive) and SCL's participation in the City of Seattle's consolidated cash pool.

The Aa2 rating also captures long term credit challenges including declining electric load growth relative to the service area's historically strong economic growth, system average rates above the regional investor owned utility and state average, and SCL's rising debt burden that funded its historically large capital improvement plan (CIP). Also considered in the rating are hydrology risk, wholesale price exposure, and financial metrics historically in the 'A' category with Moody's adjusted debt service coverage ratio (DSCR) averaging at 1.64x and days cash on hand averaging at 141 days over the last year 3 years.

For 2021, Moody's adjusted DSCR for SCL improved to 1.71x compared to 1.51x in 2020 given a 5.1% increase to electricity demand. The unexpectedly large increase in demand is attributed to a combination of a stronger regional economy and a cold winter. As of April 2022, Seattle's unemployment rate declined to 1.6% compared 3.8% a year prior and is well below the US average of 3.6%. Given the improved economy and expiration in April 2022 of the citywide executive order preventing disconnects, the utility plans to resume its full collection process in August 2022. We expect this will help address the elevated amount of overdue receivables totaling around $63 million as of year-end 2021, which is around double the amount in 2019.

Also, in 2021, SCL revised its Rate Stabilization Account (RSA) policy, a material credit negative. SCL moved $60 million from the overfunded DSRA to the operating account that was a key driver of 2021's improved days cash on hand. SCL plans to contribute additional funds into the DSRA to ensure sufficient funding when the surety policy expires in 2029. The RSA policy revisions include lower required thresholds of $75 million ($90 million originally) before a retail rate surcharge is implemented, lower threshold of less than $25 million ($50 million originally) before city council action is required to replenish the reserve over a 24-month period (12 months originally), and lower frequency of possible rate surcharges with any implementation limited to a semiannual basis instead of quarterly. While the weakening of the RSA is credit negative, we also understand that SCL's latest draft strategic plan incorporates a target to have 130 days cash on hand, which is slightly lower than its five-year historical average of 138 days cash on hand and within our expected range for the utility. Thus, the weakening of the RSA is somewhat moderated by the utility's target to maintain liquidity generally commensurate with its past.

Looking forward, SCL expects to have above average financial performance in 2022. Moody's calculates an adjusted DSCR at around 1.90x and 190 days cash on hand, thanks to better hydrology conditions and higher wholesale power prices. As a result, net wholesale revenues in 2022 should double compared to 2021. That said, SCL's near-term financial boost will be temporary. Longer term, the utility is expected to maintain financial metrics consistent with historical financial performance and commensurate with its financial policies and goals, including a DSCR averaging at least 1.50x and liquidity averaging around 130 days cash on hand.

RATING OUTLOOK

The stable outlook considers the strong local economy and our expectation that the utility will maintain liquidity averaging around 130 days cash on hand and adjusted DSCR averaging of 1.50x or higher over the long term.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- SCL's rating could improve if Internal liquidity comfortably exceeds 200 days cash on hand and adjusted DSCR exceeds 2.0x on a sustained basis.

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- SCL's rating could be downgraded if its financial policies are materially weakened, willingness to increase rates diminishes, the underlying regional economy sustains a severe and sustained deterioration or liquidity support through the City of Seattle's cash pool is restricted. Furthermore, the utility's rating could also be downgraded if internal liquidity drops below 90 days cash on hand or Moody's adjusted DSCR drops below 1.50x on a sustained basis.

LEGAL SECURITY

SCL's bonds benefit from a pledge of the net revenues of SCL and covenants require that the City of Seattle set rates to fund debt service, operating costs and other costs to maintain the system. Moody's considers the rate covenant to be weaker than typical for similar issuers. For additional indebtedness, SCL is required to meet a 1.25x DSCR based on net system revenues incorporating draws from and deposits into the RSA. Furthermore, the bonds have a debt service reserve for all parity bonds sized to the lesser of maximum annual debt service or reasonably required reserve or replacement fund per the tax code. The reserve is currently sized to 125% of average annual debt service (excluding variable rate debt). Post issuance, the reserve is expected to be funded with a $71.5 million surety from Assured Guaranty Municipal Corp (insurance strength: A1-stable) and $101.5 million of cash. The previous overfunded balance was distributed to the utility's operating fund in 2021.

USE OF PROCEEDS

Bond proceeds from the 2022 bonds will be used to refund all or portion of the Series 2012A bonds, fund capital spending, incremental funding of the debt service reserve, and pay transaction costs.

PROFILE

Seattle City Light is a department of the City of Seattle, which operates a utility system that primarily generates and delivers electricity to approximately 485,155 customers in the City of Seattle and several surrounding communities under franchise agreements. The City of Seattle is in the western part of Washington State and is a commercial hub for the Pacific Northwest. SCL's service area is comprised of 131 square miles and has a population of approximately 941,000.

METHODOLOGY

The principal methodology used in these ratings was US Public Power Electric Utilities with Generation Ownership Exposure Methodology published in August 2019 and available at https://ratings.moodys.com/api/rmc-documents/63746 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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