

CREDIT OPINION

30 August 2017

New Issue

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Seattle (City of) WA Electric Enterprise

New Issue - Moody's assigns Aa2 rating to Seattle, WA's 2017C electric revenue bonds; outlook stable

Summary Rating Rationale

Moody's Investors Service has assigned Aa2 ratings to \$373.9 million of City of Seattle, WA's (Seattle) Electric Enterprise's (Seattle City Light or SCL) Municipal Light and Power Improvement and Refunding Revenue Bonds, 2017C. Moody's also affirmed the Aa2 ratings on SCL's outstanding parity bonds. The rating outlook is stable.

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 strong historical willingness to raise rates when necessary, and credit supportive financial policies including the Rate Stabilization Account (RSA). Other credit supportive factors are SCL's ownership of low cost hydro generation, long-term power supply contract with Bonneville Power Administration (BPA, Aa1/stable), competitive retail rates, and SCL's participation in the City of Seattle's consolidated money pool.

The Aa2 rating also captures credit challenges including material wholesale price exposure, low electric load growth relative to the service area's economic growth, hydrology risk, and SCL's continued growth in debt to fund its large \$2.5 billion, 6-year capital improvement plan (CIP). The rating further considers volatile historical financial metrics that have ranged from the 'Baa' to 'Aa' category under Moody's US Public Power with Generation Ownership methodology owing in part to regional hydrology levels. On a look forward basis, SCL expects to have debt service coverage ratios (DSCR) around 1.33x in 2018 and standalone liquidity below 90 days cash on hand from 2017 through 2019, which is below our quantitative guidance of 1.5x DSCR and 90 days cash on hand for a negative rating action. We currently incorporate the view that the utility's new strategic plan covering the 2019 -2024 period will result in changes that will address the utility's volatile financial metrics and weakening internal liquidity.

Credit Strengths

- » Strong and diverse service area anchored by the City of Seattle
- » Demonstrated willingness to set rates including RSA mechanism
- » Ownership of low cost hydro and contracted power from BPA
- » Competitive retail rates
- » Liquidity support through City of Seattle's consolidated money pool

Credit Challenges

- » Hydrology and wholesale market risk
- » Somewhat low and volatile financial metrics and financial underperformance in recent years
- » Large, ongoing capital spending program
- » Decoupling of retail electricity demand from economic growth

Rating Outlook

The stable outlook considers the benefit of the RSA mechanism, our assumption that the utility will develop and implement plans to sustain over 90 days cash on hand and adjusted DSCR of at least 1.5 times, and city council's historic willingness to support credit quality. The stable outlook is also supported by the City of Seattle's strong and growing economy and SCL's participation in the City of Seattle's consolidated money pool.

Factors that Could Lead to an Upgrade

- » Internal liquidity comfortably exceeding 150 days cash on hand and adjusted DSCR exceeding 2.0 times on a sustained basis.

Factors that Could Lead to a Downgrade

- » Weakening of financial policies including RSA mechanism
- » Willingness to increase rates diminishes
- » Inability to sustain at least 90 days cash on hand or Moody's adjusted DSCR of at least 1.5 times over time
- » Liquidity support through the City of Seattle's money pool is weakened
- » Severe deterioration of underlying regional economy

Key Indicators

Exhibit 1

SEATTLE (CITY OF) WA ELECTRIC ENTERPRISE					
	2012	2013	2014	2015	2016
Total Sales (mWh)	15,091,730	13,360,752	13,423,975	12,706,001	13,224,890
Debt Outstanding (\$'000)	1,778,600	1,863,300	1,903,800	2,070,800	2,118,100
Debt Ratio (%)	62.6	61.6	59.4	60.1	58.3
Total Days Cash on Hand (days)	205	204	158	152	104
Adjusted Days Liquidity on Hand (incl. Bank Lines)(days)	205	204	158	152	104
Adjusted Debt Service Coverage (x) (Post Transfers/PILOTs - All Debt)	1.46	1.39	1.63	1.24	1.50
Fixed Obligation Charge Coverage (if applicable)(x)	1.46	1.39	1.63	1.24	1.50

Source: Moody's Investors Service and Audited Financial Statements

Recent Developments

Recent developments are incorporated in the Detailed Rating Consideration.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Detailed Rating Considerations

Service Area and System Characteristics

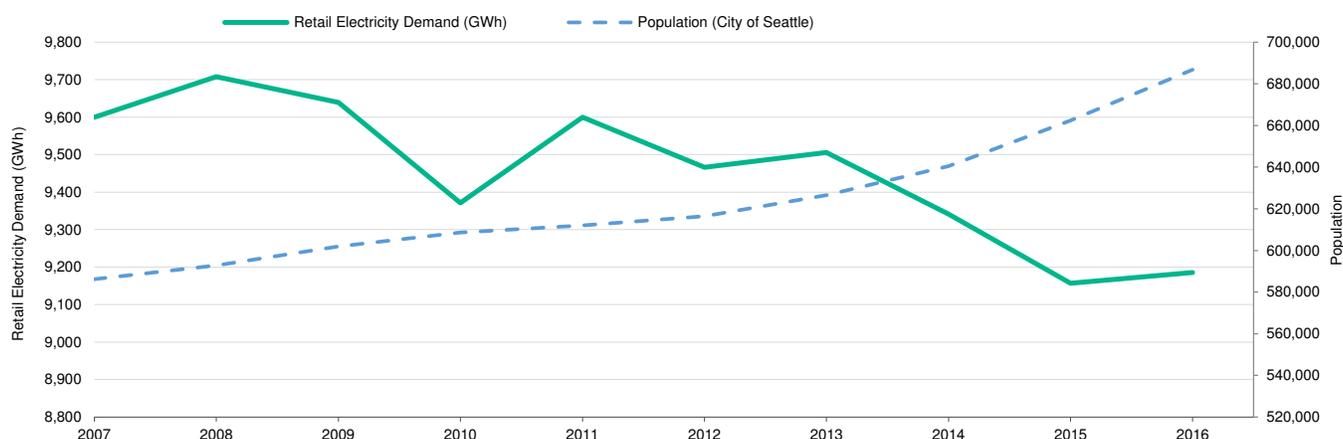
Strong and Diversified Service Area in the Economic Heart of the Region

The utility derives more than 85% of its revenues from the sale of electricity to retail customers in the City of Seattle and surrounding communities, which has 874,000 residents. Service in the surrounding communities is provided under franchise agreements and several are currently under negotiation for extension. SCL's rate process is governed by the city council and is not regulated by the state regulatory board.

The City of Seattle is located in King County, WA (UTGO Aaa/stable), which is the economic heart of the Pacific Northwest region. The City of Seattle's wealth levels are fairly high for a large city, with estimated median family income at 155.8% of the U.S. The major economic activities in the greater Puget Sound region are technology, manufacturing, healthcare, military and education. The strong service area has also outperformed the US average with unemployment around 3.5% as of July 2017. While the economy has been strong and growing, total electric demand has declined from 2008 through 2016 owing in large part to energy efficiency initiatives which contributed to revenues materially below forecasts. For 2017, the 2016/2017 cold winter contributed to improved electricity demand in 2017 which should lead to stronger financial performance for 2017.

Exhibit 2

Seattle's Electricity Demand Has Decoupled From Economic and Population Growth



Source: Census Bureau and Moody's Investors Service

In conjunction with a robust and affluent service area, Seattle City Light's average system rates are well below the main investor owned utility in the area and are around the state weighted average. The combination of competitive rates and a very strong service area further supports SCL's rate raising ability and willingness. The low rates helps to support Moody's assumption that the franchise agreements with neighboring communities currently under negotiation will be extended as planned.

Demonstrated Willingness to Raise Rates But Financial Metrics Are Under Pressure

Seattle's city council has shown a demonstrated willingness to use its authority to raise retail rates to support SCL's financial condition. For example, SCL raised rates 39% in 2001 and 13% in 2002 in response to extremely low hydro and high power prices during the 2001 power crisis. In January 2010, SCL implemented a 13.8% increase and also adopted the RSA mechanism. Since then, the city council has implemented steady base rate increases with the most recent comprising of 5.6% base rate increases implemented for 2017 and another 5.6% approved for 2018. A separate automatic rate adjustment mechanism exists for any BPA cost increases in addition to the RSA mechanism. While the city council's continued willingness to implement rate increases, the BPA pass through adjustment, and the RSA mechanism are considered strong credit support factors, the utility's historical financial metrics have been volatile and the utility's DSCR is likely to come under pressure in 2018 with internal liquidity forecasted at below 90 days cash on hand from 2017

through 2019. We currently incorporate the assumption that the utility's new strategic plan covering the 2019 -2024 period will result in changes that will address the utility's volatile financial metrics and weakening internal liquidity.

Hydrology and Market Based Revenues

SCL has historically derived approximately 10-20% of its revenue from non-retail sources such as wholesale revenue that can experience volatility owing to both hydrology and market prices. A severe drop of wholesale revenue resulted in adjusted DSCR dropping to below 1.0 times in 2009. Since then, SCL has implemented rates increases including a 13.8% base rate increase in 2010 and also installed the RSA mechanism (see Liquidity section). While the rate increases have contributed to the growth of retail revenue, the volatility of non-retail revenue continues to affect the utility's financial performance such as in 2015 and 2016.

Hydro Dependent Power Supplies

Typically, SCL receives approximately 40% to 45% of its power from owned generation, 30% to 35% from BPA, and the remainder from other sources such as the wholesale market, exchange agreements, and other various long-term contracts. Owned generation totals 1,872 MW of nameplate hydro dams and primarily consists of the 1,022 MW Boundary hydro project (Boundary Project) and the 802 MW Skagit hydro projects (Skagit Projects). The Boundary Project is located in Pend Oreille County in Washington State and its FERC license expires in 2055. The Skagit Projects consist of three hydro projects that operate as one system since they are located on the same ten-mile section of the Skagit River. The Skagit projects' FERC license expires in 2025. SCL also has smaller hydro facilities totaling 48 MW.

SCL also has a long-term contract with BPA that provides a 3.63% slice of the federal hydro system (265 aMW under critical water) and 269 aMW of firm power (Block) shaped through the year. Starting October 1, 2017, the utility will switch to a Block-only arrangement that should reduce the utility's direct exposure to hydrology risk. SCL also has long-term agreements with other hydro projects such as the Priest Rapids project and long-term agreements with wind, landfill and biomass projects that contribute to Washington State's renewable portfolio standards through 2020. SCL has met the 2016 increase in renewable requirements primarily through the purchase of renewable energy credits (RECs).

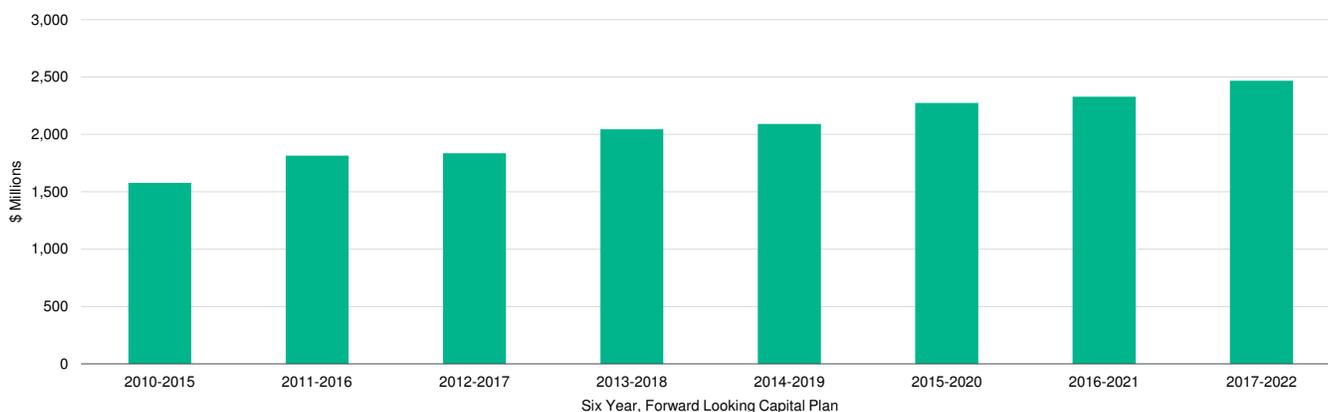
Over the longer term, SCL's substantial investment in energy conservation has contributed to limited demand growth and has ultimately deferred the need for new power resources well past 2020.

Large Capital Spending Plan

SCL's 6-year forecasted capital program has grown steadily from \$1.6 billion for the 2010-2015 period to approximately \$2.5 billion for the 2017 to 2022. The largest focus of the CIP is on the distribution system at over \$1 billion, which includes electric system related spending tied to the Alaskan Way Viaduct and seawall replacement and more typical expenditures like capacity additions. Forecasted power supply related expenditures total \$487 million and include environmental mitigation and plant improvements. Forecasted spending on conservation is also sizable at around \$217 million.

Exhibit 3

The Utility's Rolling 6-Year Capital Program Has Steadily Grown Over Time



Source: Official Statements

SCL plans to fund these expenditures approximately 65% with debt, 26% from operations and the remainder from capital contributions. The sizeable program and associated increase in debt remain credit challenges for SCL especially as electricity demand has decoupled from economic growth. Looking forward, the utility's new strategic plan covering the 2019 -2024 should provide greater clarity around how SCL will provide for cost recovery and improved financial performance especially as electricity demand has decoupled from economic growth.

Debt Service Coverage and Liquidity

Historical Volatility in Debt Service Coverage Ratios

Historically, SCL's adjusted DSCRs have been volatile with a low of 1.0 times and a high of 2.1 times since 2009, with rising costs, volatility of wholesale revenue, and the decoupling of retail sales from economic as key sources of volatility and financial underperformance. We also note that the utility's reported DSCR (per bond resolution) for 2015 and 2016 are below its financial target of 1.80x and the utility would not have met its 1.80x DSCR financial target for four out of the last five years excluding draws on the RSA.

That said, SCL's adjusted DSCR improved to around 1.50x in 2016 supported by a higher retail revenue and for 2017, we expect the utility will achieve adjusted DSCR 1.5 times given strong retail energy demand during the 2016/2017 winter period. Looking forward, the utility expects adjusted DSCRs in 2018 will drop to around 1.33x due to increasing O&M expenses and debt service costs outpacing revenue increases. After 2018, SCL's DSCRs are forecasted to improve to around 1.50x in 2019 and thereafter mostly due to forecasted increases in retail revenue.

LIQUIDITY

SCL's standalone liquidity consists of unrestricted funds and balances in the RSA account that equaled 104 days cash on hand at year-end 2016, which was a substantial drop from 152 days cash on hand in 2015. SCL's liquidity has declined since 2011 and looking forward we expect the utility will have liquidity drop below 90 days cash on hand starting in 2017 and lasting through 2019, which is below our quantitative guidance of 90 days cash on hand for a negative rating action. We currently take the view that the utility's new strategic plan covering the 2019 -2024 period will result in changes that will address the utility's volatile financial metrics and weakening internal liquidity.

While the utility's liquidity has been weakening over time, we see the RSA mechanism as providing a soft floor. The RSA targets \$100 million to \$125 million balance and an automatic surcharge is triggered if the cash balance drops below specific thresholds. The quarterly surcharge is 1.5% if the RSA is at \$90 million or less, 3.0% if the RSA is at \$80 million or less, and 4.5% if the RSA is at \$70 million or less. If the RSA drops to \$50 million or below, the city council must convene a rate review to try to bring the RSA up to \$100 million within 12 months. If the RSA is above \$125 million, excess funds could be used to refund ratepayers or be used for other purposes such as capital expenditures. Moody's views the RSA as a key risk management tool that supports minimum liquidity and financial metrics. That said, the RSA mechanism itself is insufficient to ensure at least 90 days of liquidity or adjusted DSCR of 1.5x.

An additional source of liquidity is the City of Seattle's consolidated money pool, which totaled \$2.24 billion (\$1.27 billion net of enterprise funds) at July 2017. Seattle's Director of Finance is authorized to make loans to Seattle's various enterprise funds including SCL for up to 90 days. For loans beyond the 90-day period, city council approval is required. Loans bear interest at the cash pool's rate of return. City of Seattle's willingness to provide liquidity support to SCL via the money pool has been demonstrated on several occasions, including during the 2001 power crisis when SCL borrowed up to \$107 million from the money pool and again in 2010 when SCL borrowed \$14 million.

Debt and Legal Covenants

DEBT STRUCTURE

Most of SCL's debts are traditional fixed rate obligations that fully amortize over time. The only exceptions are the \$100 million of variable rate debt that SCL issued in 2015 and another \$100 million the utility borrowed privately in 2017. There is no credit enhancement such as a letter of credit supporting the variable rate debt. The private variable note has more restrictive covenants than the 2015 public variable rate issuance including rating triggers tied to both pricing and an event of default. We view the rating trigger resulting in an event of default as a negative since it would create a liquidity demand most likely when the utility's performance is severely strained. However, the event of default trigger is set multiple notches away from the utility's current rating and the utility benefits from additional liquidity via the City of Seattle's consolidated money pool as previously described in the 'Liquidity' section.

DEBT-RELATED DERIVATIVES

SCL does not have any debt related derivatives.

PENSIONS AND OPEB

SCL participates in the City of Seattle's single-employer defined-benefit public employee retirement plan (SCERS). As of year-end 2016, the utility reported a net pension liability of \$318 million which increased from \$272 million in 2015. 2016 pension contribution was unchanged and around 3% of adjusted revenues.

Management and Governance

Seattle's mayor and city council has ultimate authority over SCL and approves SCL's budget, sets rates, and approves any financing. A separate City Light Review Panel comprised of SCL's customers reviews and assesses SCL's strategic plan, financing policies and rates. SCL's rate process is not regulated by the state regulatory board.

General Fund Transfer

SCL pays a utility tax to the City of Seattle equal to 6% of gross revenues from retail sales, less certain adjustments. The utility tax is subordinate to debt service. SCL also pays a separate state public utility tax equal to 3.8734% of gross revenues from sales within the State, less certain adjustments.

Legal Security

SCL's bonds are secured by a pledge of the gross 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 1.25 times 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). After the debt issuance, the reserve is expected to be funded with a \$75 million surety from Assured Guaranty Municipal Corp (insurance strength: A2-stable) and \$94.1 million of cash.

Use of Proceeds

Approximately \$270 million of the issuance will fund a portion of SCL's capital spending plans. The remaining funds are expected to refund all or portion of the 2011A series revenue bonds, pay transaction costs, and provide for incremental funding of the debt service reserve.

Obligor 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 447,332 customers in the City of Seattle and several surrounding communities under franchise agreements. The City of Seattle is located in the western part of Washington State and is commercial hub for the Pacific Northwest. SCL's service area comprises of 131 square miles and has a population of approximately 874,000.

Scorecard Factors and Other Considerations

Moody's evaluates Seattle City Light under the US Public Power Electric Utilities with Generation Ownership Exposure methodology and the grid indicated rating is Aa2, in line with its current Aa2 rating.

The grid is a reference tool that can be used to approximate credit profiles for public power with generation ownership in most cases. However, the grid is a summary that does not include every rating consideration. Please see US Public Power Electric Utilities with Generation Ownership Exposure for more information about the limitations inherent to grids.

Exhibit 4

Factor	Subfactor	Score	Metric
1. Cost Recovery Framework Within Service Territory		Aaa	
2. Willingness and Ability to Recover Costs with Sound Financial Metrics		Aa	
3. Generation and Power Procurement Risk Exposure		A	
4. Competitiveness	Rate Competitiveness	A	
5. Financial Strength and Liquidity	a) Adjusted days liquidity on hand (3-year avg) (days)	A	138
	b) Debt ratio (3-year avg) (%)	Aa	59.3%
	c) Adjusted Debt Service Coverage or Fixed Obligation Charge Coverage (3-year avg) (x)	Baa	1.46
Preliminary Grid Indicated rating from Grid factors 1-5		Aa3	
		Notch	
6. Operational Considerations		0.0	
7. Debt Structure and Reserves		1.0	
8. Revenue Stability and Diversity		0.0	
Grid Indicated Rating:		Aa2	

Source: Moody's Investors Service

Methodology

The principal methodology used in this rating was US Public Power Electric Utilities With Generation Ownership Exposure published in March 2016. Please see the Rating Methodologies page on www.moody's.com for a copy of this methodology.

Ratings

Exhibit 5

Seattle (City of) WA Electric Enterprise

<u>Issue</u>	<u>Rating</u>
Municipal Light and Power Improvement and Refunding Revenue Bonds, 2017C	Aa2
Rating Type	Underlying LT
Sale Amount	\$373,885,000
Expected Sale Date	09/13/2017
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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