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New Issue

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Contacts

Clifford J Kim 212-553-7880
VP-Senior Analyst
clifford.kim@moodys.com

A.J. Sabatelle 212-553-4136
Associate Managing Director
angelo.sabatelle@moodys.com

Maria Matesanz 212-553-7241
Senior Vice President
maria.matesanz@moodys.com

Kurt Krummenacker 212-553-7207
Senior Vice President
kurt.krummenacker@moodys.com

Seattle (City of) WA Electric Enterprise

New Issue:Moody's assigns Aa2 rating to Seattle, WA's 2016C electric revenue bonds; outlook stable

Summary Rating Rationale

Moody's Investors Service has assigned Aa2 ratings to $151.2 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, 2016C. 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 SCL's strong historical willingness to raise rates when necessary, wealthy and diverse service area covering the City of Seattle (UTGO Aaa/stable) and surrounding communities, 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, hydrology risk, and somewhat volatile financial metrics that have ranged from the 'Baa' to 'Aa' category under Moody's US Public Power with Generation Ownership methodology. The rating further considers SCL's continued growth in debt to fund its large $2.3 billion, 6-year capital improvement plan (CIP).

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

» Large, ongoing capital spending program

Rating Outlook

The stable outlook considers the benefit of the RSA mechanism, expected 'A' category financial metrics in 2017 and thereafter with over 90 days cash on hand and adjusted debt service coverage ratio (DSCR) of at least 1.5 times, and city council's demonstrated 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

» Days cash on hand below 90 days or Moody's adjusted DSCR below 1.5 times on a sustained basis.

» Liquidity support through the City of Seattle's money pool is weakened

» Severe deterioration of underlying regional economy

Key Indicators

Exhibit 1

	2011	2012	2013	2014	2015
Total Sales (mWh)	15,653,490	15,091,730	13,360,752	13,423,975	12,706,001
Debt Outstanding ($'000)	1,680,000	1,778,600	1,863,300	1,903,800	2,070,800
Debt Ratio (%)	67.1	62.6	61.6	59.4	60.0
Total Days Cash on Hand (days)	218	205	204	158	152
Adjusted Debt Service Coverage (x) (Post Transfers/PILOTs - All Debt)	2.11	1.46	1.39	1.63	1.24

Source:

Recent Developments

Recent developments are incorporated in the Detailed Rating Consideration.

Detailed Rating Considerations

Revenue Generating Base

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 776,000 residents as of 2015. 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 152.2% 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 4.4% as of July 2016. While the economy generally is strong, total electric demand has been generally flat partly due to conservation efforts and unusually mild winter weather. Looking forward, the utility expects modest load growth over the next five years.

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 also support Moody's assumption that the franchise agreements with neighboring communities currently under negotiation will be extended as planned.

Demonstrated Willingness to Raise Rates

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 last increase of 4.2% for 2015 and 4.9% for 2016. Looking forward, SCL's Strategic Plan, which was approved by the city council, calls for a 4.3% average annual increase from 2017 to 2022 for the base rate. A separate automatic rate adjustment mechanism exists for any BPA cost increases in addition to the RSA mechanism. 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. A material weakening of these factors would be credit negative.

Hydrology and Market Based Revenues

SCL derives 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 the more stable retail revenue, the volatility of non-retail revenue continues to affect the utility's financial performance such as in 2015 and 2016.

Operational and Financial Performance

Hydro Dependent Power Supplies

In 2015, SCL received approximately 42% of its power from owned generation, 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. The utility has requested to BPA to 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 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 $2.3 billion for the 2016 to 2021. The largest focus of the CIP is on the distribution system at over $1 billion, which include electric system related spending tied to the Alaskan Way Viaduct and seawall replacement and more typical expenditures like capacity additions. Forecasted generation related expenditures total $432 million and include environmental mitigation and plant improvements. Forecasted spending on conservation is also sizable at around $215 million.

SCL plans to fund these expenditures approximately 64% with debt, 26% from operations and the remainder from capital contributions. While the sizeable program and associated substantial increase in debt remain credit challenges for SCL, the risk remains manageable given the city council's demonstrated willingness to raise SCL's rates as necessary, the RSA, and SCL's forecast of at least 'A' category financial metrics. If any of these credit factors were to weaken, SCL's ratings will likely be negatively affected especially given the sizeable CIP.

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 wholesale revenue and weather related demand fluctuations as the biggest sources of volatility. For 2015, SCL's adjusted DSCR declined to 1.24 times from 1.63 times in 2014 due to below average hydrology, low power prices, and lower demand from an unusually warm winter. For 2016, we expect the utility will also underperform with adjusted DSCR of around 1.3 times given the mild winter and low power prices. Looking forward past 2016, the utility expects adjusted DSCRs should improve to 1.5 times assuming average water and weather. Also supporting improving financial metrics are expected retail rate increases and the RSA surcharge that took effect in August 2016. SCL's reported DSCR in 2015 was 1.62 times and is calculated per SCL's bond resolution which excludes the subordinated city utility tax but includes RSA draws and deposits. We note SCL's covenant derived DSCR is below the 1.8 times DSCR target per the utility's financial policy.

LIQUIDITY

SCL's standalone liquidity consists of unrestricted funds and balances in the RSA account that equaled 152 days cash on hand at year-end 2015. SCL's liquidity has been declining since 2011 and looking forward we expect the utility to maintain internal liquidity in the 'A' category (90-149 days cash on hand) with volatility primarily driven by wholesale revenue and weather driven demand.

Anchoring SCL's minimum liquidity is the RSA mechanism. The RSA targets $100 million to $125 million in the RSA and an automatic surcharge is triggered if the cash balance drops below specific thresholds. The quarterly surcharge is 1.5% if the RSA 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 for SCL that supports minimum liquidity and financial metrics. If the RSA mechanism is weakened or eliminated, SCL's rating would likely be negatively impacted.

An additional source of liquidity is the City of Seattle's consolidated money pool, which totaled $1.8 billion ($1.1 billion net of enterprise funds) at July 2016. 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 Other Liabilities

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 intends to borrow privately in October 2016. There is no credit enhancement such as a letter of credit supporting the variable rate debt. Based on draft terms, we understand the private variable note could have more restrictive covenants than the previous 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, we recognize the event of default trigger is expected to be 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 2015, the utility reported a net pension liability of $272 million and its 2015 pension contribution was 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 $71.4 million of cash.

Use of Proceeds
Approximately $148 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 2010B 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 423,000 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 776,000.

Exhibit 2

Factor	Subfactor	Score	Metric
1. Cost Recovery Framework Within Service Territory		Aaa	
2. Wllingness 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)	Aa	171
	b) Debt ratio (3-year avg) (%)	A	60
	c) Adjusted Debt Service Coverage or Fixed Obligation Charge Coverage (3-year avg) (x)	Baa	1.42
Preliminary Grid Indicated rating from Grid factors 1-5			
		Notch	
6. Operational Considerations		0	
7. Debt Structure and Reserves		1	
8. Revenue Stability and Diversity		0	
Grid Indicated Rating:		**Aa2**	

Source: Moody's Investor 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 Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 3

Seattle (City of) WA

Issue	Rating
Municipal Light and Power Improvement and Refunding Revenue Bonds, 2016C	Aa2
Rating Type	Underlying LT
Sale Amount	$151,150,000
Expected Sale Date	09/09/2016
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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Contacts

Clifford J Kim 212-553-7880
VP-Senior Analyst
clifford.kim@moodys.com

Begaiym Sabyrbekova +1 212 553 1482
Associate Analyst
becca.sabyrbekova@moodys.com

A.J. Sabatelle 212-553-4136
Associate Managing Director
angelo.sabatelle@moodys.com

Jamal Mtshali 212-553-1486
Associate Analyst
jamal.mtshali@moodys.com

Kurt Krummenacker 212-553-7207
Senior Vice President
kurt.krummenacker@moodys.com

Maria Matesanz 212-553-7241
Senior Vice President
maria.matesanz@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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