

Rating Action: Moody's downgrades Santee Cooper's (SC) to A3 from A2 rating and assigns A3 to 2022 Series C, D, E and F revenue bonds; Outlook remains negative

31 Oct 2022

Approximately \$7.4 billion of debt affected

New York, October 31, 2022 -- Moody's Investors Service (Moody's) has downgraded South Carolina Public Service Authority's (Santee Cooper) revenue bonds to A3 from A2. Moody's also assigned A3 to \$38.6 million of Revenue Obligations, 2022 Tax-Exempt Refunding Series C, \$136 million of 2022 Taxable Refunding Series D, \$390 million of 2022 Tax-Exempt Improvement Series E, and \$60 million of 2022 Taxable Improvement Series F. The outlook remains negative.

RATINGS RATIONALE

The downgrade of Santee Cooper's rating to A3 from A2 reflects weaker than anticipated financial metrics from 2022 through 2024 due to the combination of the utility's rate freeze through 2024 and further increases to the utility's fuel and purchased power costs. According to Santee Cooper's most recent forecast, the utility expects Moody's adjusted debt service coverage ratio (DSCR) for 2022 at around 0.50x and for 2023, DSCR is expected to improve to only around 1.15x, which are both below the downgrade threshold of 1.30x. Previously, Santee Cooper forecasted in July 2022 a swift return to 1.30x in 2023. Additionally, forecasted liquidity through 2024 is around 40% lower at around 190 adjusted days on hand while the higher costs overwhelm earlier plans for significant debt reduction that results in 20-30% higher sustained debt over the next four to five years compared to the utility's forecast in 2021.

While the utility cannot immediately recover these higher costs estimated at a revised \$496 million on a net basis for 2022 alone, we understand Santee Cooper's board has authorized regulatory accounting treatment for a portion of the costs that could qualify as rate freeze exceptions. The exceptions mostly relate to higher fuel and purchased power replacement costs incurred by the utility owing to a fire and temporary closure of a coal supplier's mine. Our understanding is that the utility will seek to recover these and other deferred costs after the rate freeze expires, which then exposes the utility to a material risk of dispute with parties to the Cook settlement, including Central Electric Power Cooperative Inc (Central), its largest customer. Parties to the Cook settlement have already contested expenses related to the mine outage and our understanding is that local court has declined to decide since the rate freeze is in effect, extending the uncertainty as to whether these deferred costs will be recovered. Additionally, to the extent the Cook settlement exceptions grow and fuel and purchased power costs stay elevated for a longer period, we see such costs needed to be funded by incremental debt and the increased potential for disputes between Santee Cooper and its customers as the possibility for rate shock in 2025 rises.

The negative outlook considers continuing uncertainty on the amount of excess fuel and purchase power costs that the utility will have to bear, the amount of debt funding to pay for the higher costs, and the extent that the current high natural gas and power prices will stretch into 2023 and 2024. Partially moderating this risk are fuel hedges which according to the utility represented 83% of 2023's needs and 75% of 2024's forecasted fuel usage. We understand, however, that the effectiveness of these hedges can decrease materially due to any natural gas basis differentials.

That said, A3 rating recognizes the utility's broad service area directly or indirectly serving approximately 2 million people in South Carolina, ownership by the state of South Carolina (Aaa stable), and competitive rates. Additional credit strengths include a long term, all requirements contract with Central maturing at the end of 2058, strong liquidity, and some generation diversity.

Further weighing on the issuer's credit quality are high leverage with its debt ratio exceeding 130% owing to the termination of the Summer nuclear project, counterparty concentration with Central, historically DSCRs falling in the 'Baa' category, carbon transition risk due to coal plant ownership, uncertainty surrounding the utility's future resource mix and the previously cited rate freeze through 2024. We note that Hurricane Ian had only a modest impact on the utility.

RATING OUTLOOK

The negative outlook further reflects continuing uncertainty on the amount of excess purchase power and fuel costs that Santee Cooper will have to manage, the possibility of further debt that the utility will have to bear to pay for higher fuel and purchased power costs, and the issuer's ability to improve its financial metrics over time.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

Given the negative outlook, an upgrade is unlikely. The utility's outlook could be revised to stable if excess purchased power and fuel costs do not exceed Santee Cooper's latest expectations while maintaining liquidity at around 200 adjusted days on hand and DSCR is above 1.20x on a sustained basis.

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

Santee Cooper's rating can be downgraded further if DSCR remains below 1.20x or if adjusted liquidity on hand falls below 150 days on a sustained basis; if the amount of excess costs is much greater than expected or leads to a significant increase to debt. The utility's

rating could also be downgraded if political influence weighs on Santee Cooper's operations, if major disputes arise with Central, particularly as it relates to the rate freeze, or if the borrower is not able to extend or increase its bank lines at beneficial terms.

LEGAL SECURITY

Santee Cooper's bonds benefit from a pledge of the electric and water system's gross revenues and a sum sufficient rate covenant. There is no debt service reserve account or additional bonds test.

USE OF PROCEEDS

Proceeds from 2022 Series C and D bonds will be used to refund \$175 million of 2016 Series D bonds maturing in December 2023. Proceeds from the 2022 Series E and F bonds will be used for capital spending and to pay transaction costs.

PROFILE

South Carolina Public Service Authority (Santee Cooper) was created by the South Carolina State Legislature in 1934 and provides both retail and wholesale electric service directly or indirectly to approximately two million people in all 46 counties of the state. Santee Cooper also has a water system serving over 200,000 people. The utility also operates an integrated transmission system which includes lines owned by the issuer as well as those owned by Central Electric Power Cooperative Inc, Santee Cooper's largest wholesale customer.

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.

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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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Clifford Kim
Lead Analyst

Project Finance
Moody's Investors Service, Inc.
7 World Trade Center
250 Greenwich Street
New York 10007
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Angelo Sabatelle
Additional Contact
Project Finance
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653



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