

## RATING ACTION COMMENTARY

# Fitch Rates Santee Cooper Series 2024 A, B & C Revenue Bonds 'A-'; Outlook Stable

Mon 15 Jul, 2024 - 5:34 PM ET

Fitch Ratings - New York - 15 Jul 2024: Fitch Ratings has assigned an 'A-' rating to the following South Carolina Public Service Authority (Santee Cooper) revenue obligations consisting of:

--Approximately \$180.075 million 2024 tax-exempt improvement series A;

--Approximately \$669.925 million 2024 tax-exempt refunding series B;

--Approximately \$50.0 million 2024 taxable improvement series C.

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

--Approximately \$6.7 billion tax-exempt and taxable revenue obligations;

--Issuer Default Rating (IDR).

The Rating Outlook has been revised to Stable from Negative.

## RATING ACTIONS

ENTITY / DEBT ◆

RATING ◆

PRIOR ◆

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South Carolina Public Service Authority (Santee Cooper) (SC)	LT IDR	A- Rating Outlook Stable	A- Rating Outlook Negative
	Affirmed		

South Carolina Public Service Authority (Santee Cooper) (SC) /Electric System Revenues/1 LT	LT	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Negative
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#### [VIEW ADDITIONAL RATING DETAILS](#)

The 'A-' rating reflects the authority's financial profile and leverage ratio, measured as net adjusted debt to adjusted funds available for debt service (FADS), which improved to 10.4x in 2023, but remains elevated. The Outlook revision to Stable reflects Fitch's expectation that Santee Cooper's financial flexibility and revenue defensibility will improve following the expiration of its agreement to lock rates through January 2025.

The agreement was reached as part of a legal settlement to resolve significant litigation challenging the authority's ability to recover costs related to the Summer nuclear project (the Cook Settlement). The improved flexibility should allow the authority to support higher leverage. Moreover, with the expiration of the rate lock approaching, the effect of previously deferred costs appears to be manageable, even if these costs cannot be recovered in the future.

Beginning in 2025, leverage is expected to stabilize at approximately 10x in Fitch's rating case scenario as the authority implements a necessary base rate increase and begins to fully recover its operating costs in a timely manner. Unanticipated challenges related to coal supply, higher natural gas consumption, rising gas prices, and other circumstances led to operating costs during 2021 through 2024 that the authority was unable to recover as a result of the rate lock. As a result, through March 31, 2024, Santee Cooper deferred roughly \$637 million in costs. Santee Cooper expects to recover these costs after the expiration of the rate lock.

While the Cook Settlement provides for certain rate freeze exceptions and an ability to defer a range of expenses for later recovery, the authority's efforts are being challenged in court and the scope and extent of recovery is untested. Fitch's rating case scenario does not include recovery of any deferred costs.

The authority's financial profile and rating are further supported by strong economic and contractual underpinnings that support revenue collections, as well as the strong credit quality of Central Electric Power Cooperative (Central; rated A+/Stable), Santee Cooper's largest wholesale customer. Very low operating risk, including very low operating costs and higher, but manageable capital spending needs are also factored in the authority's rating.

## **SECURITY**

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

## **KEY RATING DRIVERS**

### **Revenue Defensibility - 'a'**

Statewide Electric Provider; Rate Flexibility Should Improve

Santee Cooper's revenue defensibility assessment reflects the authority's vibrant and growing service area and strong contractual underpinnings that support revenue collections from both retail (39% of total revenue) and wholesale customers (61% of total revenue). Santee Cooper's board maintains rating setting authority; however, revenue defensibility is presently constrained as a result of the board's agreement to lock rates.

Rate flexibility and revenue defensibility should improve following the expiration of the rate lock, paving the way for meaningful rate increases and cost recovery adjustments beginning in 2025. Despite the anticipated increases, wholesale costs should remain competitive and retail rates affordable given the multi-year rate freeze and strong service area characteristics. Revenue defensibility is further supported by the credit quality of Central, which accounts for roughly 58% of Santee Cooper's revenue.

### **Operating Risk - 'aa'**

Very Low Operating Costs; Evolving Resource Portfolio

Operating costs have averaged approximately 5.9 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. The operating cost burden reflects a diverse mix of generation resources with energy supplied predominately by coal-fired resources. Santee Cooper's integrated resource plan (IRP) outlines the authority's plan for further diversifying its

resource portfolio, and replacing 1,150 MWs of coal-fired capacity with new solar and natural gas-fired resources by 2030, and reducing its reliance of coal-fired generation.

Capital planning and management should remain strong as capital spending is expected to rise dramatically over the next five years, comfortably exceeding depreciation. Operating costs should similarly increase, but should remain in line with the assessment.

## **Financial Profile - 'a'**

### **Leverage Remains Elevated**

Santee Cooper's leverage ratio improved to 10.4x in 2023 from 12.2x in 2022, but remains elevated and volatile given swings in operating income and FADS as a result of the prevailing rate lock. Metrics are expected to stabilize around 10.0x beginning in 2025 in Fitch's rating case scenario when the authority's rate lock ends and full and timely cost recovery resumes. Meaningful improvement in leverage is expected to be limited given the authority's higher capital spending program of roughly \$700 million annually, and anticipated debt issuance. However, ratios should remain supportive of the rating even if deferred costs cannot be recovered.

Coverage of full obligations and total liquidity were also improved in 2023 at 1.7x and 281 days, respectively. Going forward, coverage should stabilize around 1.4x and liquidity should remain adequate and comfortably above 90 days. To the extent that the authority's effort to recover previously deferred costs is successful, incremental cash flow could lower prospective debt issuance to fund capex, and reduce to leverage ratios closer to 9.5 by 2027.

### **Asymmetric Additional Risk Considerations**

There are no asymmetric risk considerations factored in the rating.

## **RATING SENSITIVITIES**

### **Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade**

--Failure to adequately adjust base rates and cost recovery following the expiration of the current rate lock;

--Any agreement to limit or lock rates upon expiration of the current rate lock;

--Failure to reduce leverage ratios to levels approximating 10.0x in Fitch's rating case scenarios.

### **Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade**

--Timely collection of previously deferred operating costs that reduces borrowing requirements and/or improves liquidity;

--Leverage ratios approximating 9.0x in Fitch's rating case scenario;

--Improved revenue defensibility, supported by the expiration of the current rate lock.

### **PROFILE**

Santee Cooper is a state agency that provides wholesale power supply, as well as direct retail electric service to approximately 212,000 retail customer accounts and 27 large industrial customers. Including the retail base of Central, 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 over 210,000 people.

#### Cancelled Nuclear Construction Strains Credit Profile

Santee Cooper's decision to suspend construction of the Summer nuclear units 2 and 3 in 2017, 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.

Fervent customer and political opposition to the recovery of stranded costs related to the project led the governor to sign Act 95, which allowed the state to consider options to sell, manage or reform the authority. 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.

#### Legal and Legislative Resolution

In early-2020, Santee Cooper took a major step toward stabilizing its operating profile by agreeing to the Cook Settlement, which provided for the release of major claims against the authority in exchange for payments for the benefit of utility customers totaling \$200

million, and an agreement by Santee Cooper to hold rates at levels consistent with its reform plan.

During June 2021, the general assembly unanimously passed, and the governor signed, Act 90, which amended certain provisions related to the authority. Act 90 provided for manageable changes related to the authority's governance, broader state oversight over certain debt issuance, real estate transactions and resource planning, and establishment of a process for challenging rate adjustments approved by the board. Importantly, Act 90 did not include any provision to sell the authority, or undermine the board's sole rate-making authority.

### Fuel Supply Issues and Deferred Costs

The authority began incurring higher operating costs during 2021 that could not be immediately recovered as a result of the rate lock. Production and transportation challenges caused by the pandemic, storm costs and higher fuel costs as a result of business disruptions at the authority's largest coal supplier all contributed to operating costs that were higher than budgeted figures. The board of directors authorized the authority to create a regulatory asset in 2021 and begin deferring certain costs for future recovery after the rate lock period. The amounts deferred have been financed through a combination of commercial paper issuance and draws under the authority's revolving credit agreements.

The Cook Settlement authorizes the authority to defer certain just and reasonable costs incurred during the rate lock, but Central, among others, has challenged the exceptions. A September 2022 court ruling denied a motion to have the current exceptions reviewed at that time. A ruling on the applicability of the exceptions, as well as the request for an independent auditor, is expected to be made closer to the rate lock's expiration date.

### New EPA Power Plant Standards

In May 2024, the Environmental Protection Agency released final standards regarding the regulation of carbon emissions for existing coal and gas-fired power plants. The regulations require the closure or significant modification of existing coal-fired power plants by 2032. While Santee Cooper management plans to retire its Winyah coal-fired facilities (1,150MW) by 2030, the authority has no plans to decommission the Cross coal-fired units. The EPA carbon standards are facing legal challenges that could delay, alter or prevent their implementation. Should the EPA standards withstand the legal challenges, the potential mandate to close or repower the Cross units could dictate higher costs for the authority and its customers.

## Sources of Information

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.

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The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit

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## **APPLICABLE CRITERIA**

[U.S. Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 12 Jan 2024\) \(including rating assumption sensitivity\)](#)

[U.S. Public Power Rating Criteria \(pub. 08 Mar 2024\) \(including rating assumption sensitivity\)](#)

## **APPLICABLE MODELS**

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

[FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 \(1\)](#)

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