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Fitch Rates Santee Cooper, SC's $1.7B Series 2013ABCD Bonds 'AA-'; Outlook Revised to Negative

NEW YORK--(BUSINESS WIRE)--Fitch Ratings has assigned an 'AA-' rating to the following $1,700,560,000 South Carolina Public Service Authority (Santee Cooper) bonds:

--$788,365,000 2013 tax-exempt series A bonds;

--$369,500,000 2013 tax-exempt refunding series B bonds;

--$212,940,000 2013 taxable series C bonds;

--$329,755,000 2013 taxable series D (LIBOR Index bonds).

The 2013 bond proceeds will be used to retire certain commercial paper notes, refinance a portion of outstanding debt and fund a portion of the authority's ongoing capital improvement program. The bonds are scheduled to price the last week of July via negotiated sale.

In addition, Fitch affirms the outstanding ratings as follows:

--$5,295,502,000 revenue obligations at 'AA-';

--$481,735,000 commercial paper notes at 'F1+'.

The Rating Outlook is Negative.

SECURITY

The revenue bond obligations are secured by a gross lien on system revenues and are paid prior to operating expenses and other outstanding obligations.

KEY RATING DRIVERS

SOLID LONG-TERM CUSTOMER BASE: Santee Cooper is one of the nation's largest municipal wholesale systems, serving either directly or indirectly nearly one-third of the state of South Carolina. The recent extension of the supply contract with its largest customer, Central Electric Cooperative (Central), to 2058 is viewed positively, in that it provides greater long-term revenue certainty and affords the authority greater flexibility in structuring debt.

RATING OUTLOOK REVISED TO NEGATIVE: The revision in Outlook reflects Fitch's view that although Santee Cooper will benefit from the Central contract extension, the authority faces a number of challenges over the next several years, including slower growth, a large capital program and the ability to manage its excess ownership share of the new Summer nuclear plant expansion project (units 2 and 3).

REALIGNMENT OF GENERATING CAPACITY: Santee Cooper is actively engaged in restructuring its power supply mix, by reducing its exposure to coal-fired generation and adding to its natural gas and nuclear facilities. However, because of slower demand growth and large capital requirements, the authority is also attempting to reduce its ownership interest in the Summer project from 45% to approximately 20%.

FINANCIAL METRICS EXPECTED TO STABILIZE: Financial ratios for the authority have drifted lower over the past five years, which was a factor in the rating downgrade from 'AA' to 'AA-' in January 2012. Fitch-calculated debt service coverage (DSC) stood at 1.24x in 2012, compared with 1.68x in 2009. The weaker metrics reflect participation in the capital-intensive Summer project, the slower economy and lower sales, and much higher coal stockpiles. The 10-year financial forecast assumes DSC stabilizing around 1.50x with debt to equity of around 70% to 75%.

DEBT RESTRUCTURING CONTEMPLATED: The recent extension of the earliest possible termination date of the Central agreement should enable the authority to reduce near-term debt service by extending the average life of its debt and better aligning its amortization schedule with the expected lives of its assets.

RATING SENSITIVITIES

INABILITY TO LESSEN INTEREST IN SUMMER NUCLEAR: The authority's 45% ownership interest in Summer leaves the utility with significant excess generating reserves for an extended period and potentially could weaken financial metrics below targeted levels. The authority's ability to address these challenges over the next 12 to 24 months will be instrumental in resolving the Negative Outlook.

SIGNIFICANT CONSTRUCTION DELAYS: Fitch will continue to evaluate any changes to the Summer project schedule, design and/or budget and evaluate the effect on the authority's rating and Outlook.

WEAKENED FINANCIAL POSITION: A primary factor in the current rating is the expectation that financial metrics will stabilize around the 1.50x DSC target established by the authority, supported by rate increases as warranted.

CREDIT PROFILE

Santee Cooper sells electricity directly and indirectly to approximately 2 million retail customers in 46 counties throughout South Carolina. The authority's direct customers currently include Central, 29 large industrial users and two municipal systems.

In 2012, sales to Central accounted for 59.6% of electric revenues. Large industrial customers represented 20.9% of 2012 sales revenues, and residential, commercial and small industrial customers accounted for about 17.9% of revenues. The authority also has long-term power agreements with Piedmont Municipal Power Agency (PMPA) and Alabama Municipal Electric Authority.

The authority has a long-term power contract with Alumax, providing 400 MW, which extends through Dec. 31, 2015. The contract contains a provision that Alumax must notify the authority by Dec. 31, 2013 if it intends to cease operations after Dec. 31, 2015. At this time, certain conditions have been met that would allow Alumax to terminate the contact with nine month's prior notice, but Alumax has not given the authority notice it intends to exercise its right to terminate. Santee Cooper believes that a termination of the Alumax contract would not have a material impact on the authority's future financial performance, but there could be a sizeable loss of area jobs.

The authority and Central adopted an amendment to their existing power supply agreement on May 20, 2013 that better aligns their future interest, formalizes how they will jointly plan for new resources and defers their rights to terminate the agreement prior to Dec. 31, 2058. Central has also entered into requirements agreements with all 20 of its member cooperatives that extend through Dec. 31, 2058.

DIVERSIFIED POWER SUPPLY

Santee Cooper has a wide range of generating resources and purchases, totaling 6,087 MW. Coal generation accounts for the largest component of the summer peak energy mix at 57.2%; natural gas and oil at 20.1%; nuclear 5.2%; owned hydro 2.1%; landfill methane gas 0.5%; and purchases 14.9%. The authority plans for firm power supply from its own generating capacity and firm power contracts to equal its firm load, including a 13% summer reserve margin.

As of May 31, 2012, the authority had 232 days of coal on hand. Coal inventory levels have remained high as a result of reduced usage of the utility's coal plants due to lower gas prices, the impact of the recession and mild weather conditions. The authority would like to see coal inventory closer to 50 days.

ATTEMPTING TO REDUCE INTEREST IN SUMMER NUCLEAR

In January 2008, the authority's board approved a generation resource plan that included a 45% ownership interest in the Summer nuclear units 2 and 3; SCE&G owns the remaining 55%. The plan was to acquire a 45% ownership interest (990Mw) in the proposed two-1,100 Mw nuclear units. The participation in the project continues to be a key component in the authority's strategy to address the potential for increasing costs associated with environmental regulation and carbon emissions.

These units are projected to increase the percentage of power generated from nuclear resources from approximately 8.86% to about 41.65% after both units are completed. The authority has evaluated its capital improvement program and long-term power supply plan in light of the economic downturn, the reduction in previously anticipated sales to Central and new environmental regulations. Santee Cooper has decided to retire six electric generating units and is also seeking to reduce its level of participation in Summer nuclear units below its current 45% to as low as 20% to better balance its nearer term capacity needs with the long-term benefits of nuclear power ownership.

The authority is engaged in negotiations with Duke Energy Carolinas, LLC to purchase a portion of its ownership share in the nuclear units (possibly 10%). Santee Cooper is also exploring other opportunities to market ownership interests to potential buyers. Continued 45% ownership of Summer units 2 and 3 would leave the authority with significant surplus reserves, if other ownership or power sales options were not effectuated. Preliminary estimates are that cumulative base rate increases over the 2015-2020 period would range from 6%-18% depending on the level of ownership in the nuclear project.

To date, approximately $1.8 billion has been financed for construction of Summer from bond issues sold beginning in 2008; and the authority plans to finance about $500 million of construction costs from proceeds of the 2013 bonds. The remaining requirements for construction equal $2.8 billion for a total of $5.1 billion. Absent the sale of a portion of its ownership interest in these two units, the authority intends to fund the remaining construction with the proceeds of additional bond sales projected in calendar years 2014 through 2018. Funding is expected to be accomplished with parity debt, but Santee Cooper also has a pending application with the Department of Energy for a loan guarantee to fund construction should it be advantageous to do so.

FINANCIAL RESULTS PRESSURED

Santee Cooper reported satisfactory financial performance for calendar year 2012; with Fitch calculated DSC at 1.24x, versus the authority's target of 1.50x, and equity to capitalization at 25%. The lower debt-service figure reflects pressures caused by electric industry-wide related issues, such as mild weather and slower economy, and increasing annual debt service requirements on the substantially greater debt. Results for the first six months of calendar year 2013 were tracking slightly below forecast, reflecting softer sales.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria and U.S. Public Power Rating Criteria, this action was informed by information from CreditScope.

Applicable Criteria and Related Research:

--'U.S. Public Power Peer Study -- June 2013' (June 13, 2013);

--'U.S. Public Power Peer Study Addendum -- June 2013', (June 13, 2013);

--'Criteria for Assigning Short-Term Ratings Based on Internal Liquidity' (June 13, 2013);

--'Revenue-Supported Rating Criteria' (June 3, 2013);

--'U.S. Public Power Rating Criteria' (Dec. 18, 2012).

Applicable Criteria and Related Research:

U.S. Public Power Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=696027

U.S. Public Power Peer Study Addendum -- June 2013

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=710641

U.S. Public Power Peer Study Addendum: January 2013

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=700013

Criteria for Assigning Short-Term Ratings Based on Internal Liquidity

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=708640

Revenue-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=709499

Additional Disclosure

Solicitation Status

http://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=796945

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