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Update

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Tacoma Power, WA

Update to credit analysis

Summary

Tacoma Power's (Aa3 stable) credit profile is driven by its large and economically diverse service area within the Puget Sound region and a low-cost and zero-emission power supply portfolio comprised predominantly of hydroelectric resources.

The nature of Tacoma Power's service territory is a supportive credit factor, and includes a solid mix of residential, commercial/industrial and wholesale customers. Overall account growth over the past decade has averaged between 1% and 3% per year, reflective of the maturing nature of the service territory. Load growth overall in the past year was modestly higher for its residential and commercial customers, though wholesale power has been notably more volatile; in 2022, wholesale power billed increased by nearly 250,000 MWh, or 13.5% year-over-year.

Tacoma Power's credit profile also incorporates hydrology risk and the aforementioned exposure to wholesale market revenues that can sometimes result in financial volatility, particularly during drought conditions. Hydrological conditions to this point in the year have been below average, which may result in less generation from its own assets as well as higher market power purchase costs that negatively impact short-term cash and coverage; however, the utility is particularly well-positioned this year to manage through these conditions given its current liquidity position.

The electric utility has healthy financial metrics that include an adjusted debt service coverage ratio above 3.3x (3-year average, 2020-2022) and 271 days cash on hand (DCOH, 3-year average, 2020-2022), supported by a demonstrated willingness to raise rates as necessary. Tacoma's liquidity was bolstered in 2022 with a substantial transfer of $95 million into its rate stabilization fund, which increased DCOH to 336 from 239. The electric enterprise benefits from a $150 million line of credit with Wells Fargo (no repayment term that matures in October 2024) that it uses to manage cash flows for capital projects, as well as a $50 million note purchase agreement with KeyBank that additionally bolsters liquidity.

Debt levels are moderate and manageable at 64.5%. A small amount of additional long-term debt is expected toward the end of 2023 when Tacoma takes out the utilized portion of the Wells Fargo LOC. Tacoma Power's overall capital program appears manageable at less than $100 million annually, financed with a mix of bond funds and ongoing revenue.

Credit strengths

» Large and diverse service area in the Puget Sound region centered around Tacoma

» Ownership of low cost hydro and contracted power from Bonneville Power Administration (BPA)

» Competitive rates and typically strong financial metrics

Credit challenges

» Exposure to hydrological conditions

» Slightly below-average income measures in the service territory

Rating outlook

The rating outlook is stable with the expectation that adjusted debt service coverage ratios will exceed 2.0x in most years and that internal liquidity will exceed 200 DCOH. The stable outlook also incorporates our expectation that the utility will continue to make prudent decisions with respect to its approach to financing capital improvements and addressing the risks associated with sometimes volatile hydrological and power market conditions.

Factors that could lead to an upgrade

» Electric retail revenues representing more than 90% of total revenues on a sustained basis in conjunction with at least 2.0x adjusted debt service coverage ratio and at least 250 days cash on hand on a continuing basis

» Substantial improvement in the service area's underlying economy

Factors that could lead to a downgrade

» Debt service coverage falls below 2.0x (adjusted) and internal liquidity drops below 150 days cash on hand on a sustained basis

» Energy hedging program is not conservatively executed

» Substantial decline in service area's economic strength

Key indicators

Exhibit 1

	2018	2019	2020	2021	2022
Total mWh Sales ($'000)	6,774	6,104	6,937	6,502	6,892
Adjusted Debt Outstanding ($'000)	746,669	759,305	880,074	1,005,392	953,602
Adjusted Debt Ratio (%)	56.1	58.2	63.1	70.1	60.3
Adjusted Operating Revenues ($'000)	455,291	451,266	460,953	496,099	576,734
Adjusted Debt Service Coverage Ratio (x)	2.5	0.9	2.9	2.8	4.4

Adjusted debt outstanding and adjusted debt ratio reflect the debt of Tacoma Power plus the Moody's adjusted net pension liability of the enterprise. The adjusted operating revenues and adjusted debt service coverage reflect adjustments for transfers to the rate stabilization fund, as well as tax payments.
Source: Moody's Investors Service and Audited Financial Statements of Tacoma Power

Profile

Tacoma Power is an enterprise of the City of Tacoma that provides electric service to retail customers within the city's boundaries as well as to several wholesale customers in the metropolitan area, including Joint Base Lewis-McChord and the Town of Ruston. In 2022 the enterprise averaged 187,950 customer accounts and sold 4,797 GWh of retail electricity and 2,095 GWh of wholesale power. Tacoma Power's power portfolio is comprised almost entirely of hydroelectric generation, of most of which (56%) come from Bonneville Power Administration. The utility's board is nominated by the mayor and confirmed by the city council, with rates initiated by the board and adopted by the city council.

Detailed credit considerations

Revenue Generating Base

The electric enterprise benefits from a large and diverse service territory that includes the City of Tacoma as well as several wholesale customers in the metropolitan area, including Joint Base Lewis-McChord and the Town of Ruston. As measured in accounts, most of the enterprise's customers are residential (87%), which provides meaningful stability. Account growth has been fairly steady over the years across the two largest sectors (residential and small commercial), and overall customer account growth is typically between less than 1% and 3% annually, a trend we expect will continue. Energy sales (measured in GWh) can fluctuate meaningfully from year to year, with much of the change in load driven by wholesale activities, though the impact to total revenue from these fluctuations tends to be more limited; retail sales in 2022 accounted for 70% of sales by load, but represented more than 87% of sales by revenue, which is typical for the enterprise.

Tacoma Power's power portfolio is comprised almost entirely of hydroelectric generation, a credit positive given its low cost and lack of greenhouse gas emissions. Most of Tacoma's electricity is purchased from Bonneville Power Administration (BPA, 56%), with the remaining owned by the utility or purchased from Columbia Basin Hydro Power and Grant County Public Utility District No. 2. The BPA contract provides both firm power (block) and a portion (slice) of the federal hydro system output in the Pacific Northwest. Because of the utility's full dependence upon hydroelectric generation, its cost of power is substantially lower than the average in Washington as well as compared to nearby electricity providers, but also exposes the utility to drought risk. Tacoma's BPA contract expires in September 2028.

Financial Operations and Position

The utility's financial operations are a credit strength, though its exposure to hydrological risk can result in somewhat volatile financial results; adjusted net revenue since 2013 has been as high as $131 million (2022) and as low as $25 million (2019). For example, in 2019 dry weather conditions resulted in low amounts of hydroelectric generation from the utility's owned resources, forcing the utility to purchase five times more power than normal in the wholesale market; operating expenses increased year-over-year by more than $54 million. In these types of years, net revenue tends to compress, resulting in lower adjusted debt service coverage levels. In contrast, 2022 was an average hydrological year with high regional power prices resulting in a meaningful bump in wholesale sales and adjusted net revenue (which adds back the $95 million transfer to the rate stabilization account that is accounted for on a net basis in the audit).

Despite this volatility, fixed obligation charge coverage tends to be healthy in most years, averaging greater than 3.3x between 2020 and 2022. Audited 2022 financial results were reflective of near-normal hydrological conditions but high wholesale power market prices (driven by high natural gas prices in California) that boosted overall revenue, partially offset by a $15 million increase in non-operating expenses that included investment losses and COVID-related programs.

The utility uses a hedging program to manage its wholesale exposure and updated its policies and procedures in 2020 to meet industry standards and streamline processes. It also entered the Western Energy Imbalance Market in 2022 as part of its overall effort to better manage its power portfolio. Management estimates participating in the EIM added $5.9 million in value to its trading portfolio in 2022.

Hydrological conditions in 2023 appear weak, with below average inflows into both Tacoma and federal systems. Positively, California power market prices are expected to be more stable this year after a particularly wet winter, which may help mitigate the impact of weaker hydrologic conditions in the Pacific Northwest. Additionally, the utility is well positioned to withstand potentially stressed market conditions with a substantial cash buffer. Looking forward, we expect the utility's financial performance to remain close to recent historic performance - subject to hydrologic conditions.

Liquidity

Tacoma Power's liquidity position is generally strong, and ended 2022 with significantly higher than average days cash on hand (DCOH). The enterprise closed 2022 with $366.7 million in cash and investments, equal to about 336 DCOH. This was up from $248.4

million (239 DCOH) in 2021, and up substantially from the low of $189.9 million (160 DCOH) at the end of the 2019 drought year. Tacoma's formal policy threshold is to maintain at least 90 days of cash during normal hydrological conditions, but is building up cash reserves to address wholesale power market volatility and manage the utility's long-term debt portfolio.

Debt and Other Liabilities

Financial leverage for Tacoma Power is moderate. At the end of 2022, the electric utility had $562 million in debt outstanding, including $80 million used under the a $150 million line of credit with Wells Fargo. Total adjusted debt, which includes the utility's unfunded portion of the city's pension liabilities (as adjusted by Moody's), was $953.6 million, or an adjusted debt ratio of 60.3%. The utility plans to issue long-term debt to take out the currently utilized portion of the line of credit with Wells Fargo.

The utility's capital improvement program through 2028 is about $93 million annually, financed by a roughly even split of debt and ongoing revenue.

Legal security

The utility’s 2010 and 2013 bonds have a pledge of Tacoma Power’s net revenues and requires that the utility set rates to maintain 1.25x debt service coverage. The additional bonds test similarly requires rates be set to maintain 1.25x debt service coverage. Furthermore, the utility’s bonds (issued prior to 2017) have a pooled debt service reserve sized to the lesser of 125% of average annual debt service or one year of maximum debt service net of US government subsidy payments such as Build America Bond subsidies. Currently, the debt service reserve mostly consists of a $24.3 million surety from Assured Guaranty Municipal Corp. (A2 stable) with the remaining in cash ($5 million). The utility's 2017 and 2021 bonds do not have a debt service reserve.

Debt structure

The utility's debt consists of fixed rate obligations that mature in full in 2051.

Debt-related derivatives

Tacoma Power has no debt-related derivatives.

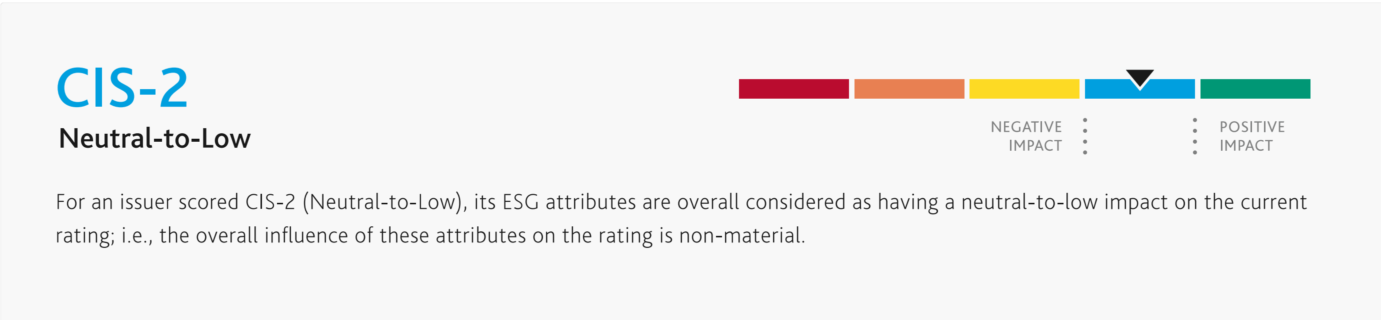
Pensions and OPEB

Tacoma Power participates in the City of Tacoma’s pension plan. Based on Moody's adjustments to reported pension data, we calculate the electric utility's share of the city's adjusted net pension liability was $391.6 million at the end of 2022 versus a reported net pension asset of $55.9 million. Moody's adjusts the reported pension liabilities of entities that report under governmental accounting standards in order to enhance comparability across rated issuers. Under governmental pension accounting, liabilities are discounted using an assumed rate of investment return on plan assets. Under Moody's adjustments, we value liabilities using a market-based discount rate for high quality taxable bonds. The difference between the utility's reported pension position and Moody's ANPL primarily reflects the different discount rates of 6.75% for the utility and 2.8% for the Moody's ANPL.

ESG considerations

Tacoma Power, WA's ESG Credit Impact Score is Neutral-to-Low CIS-2

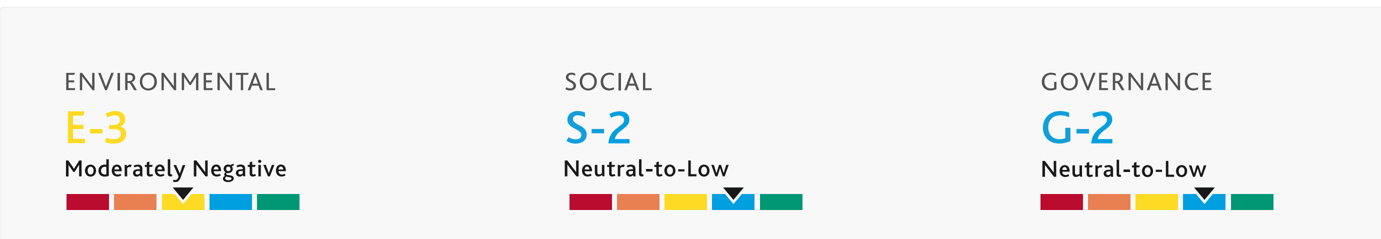
Exhibit 2
ESG Credit Impact Score



Source: Moody's Investors Service

Tacoma Power, WA's ESG credit impact score of **CIS-2** indicates that ESG considerations have a neutral-to-low impact on the enterprise's ratings. The score reflects moderately negative exposure to environmental considerations, neutral-to-low exposure to social risk and neutral-to-low governance risks.

Exhibit 3
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

Tacoma Power (**E-3**) is highly exposed to drought risks given its reliance on hydroelectric resources, though that same reliance also creates positive exposure to carbon transition. The service territory is vulnerable to wildfires and has moderate exposure to heat stress.

Social

Tacoma Power (**S-2**), like other publicly owned utilities, is exposed to broadly shared public concerns about environmental, social and affordability issues that could lead to adverse regulatory or political intervention, though these risks are well mitigated by its low-cost and zero-emissions power supply portfolio comprised almost exclusively of hydroelectric resources.

Governance

Governance risk is neutral-to-low (**G-2**). The city can recover service costs through a rate-setting mechanism that is not subject to state regulatory board approval, though intervention by local political leaders remains a risk.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

Moody's evaluates Tacoma Power under the US Public Power Electric Utilities with Generation Ownership Exposure methodology, and, as depicted below, the grid indicated outcome after notching is Aa3, in-line with its current Aa3 rating. The first -0.5 notch reflects the absence of a debt service reserve for the utility's 2017 and 2021 bonds, while the second -0.5 notch reflects the revenue volatility associated with its wholesale power sales.

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

Exhibit 4

Tacoma Power methodology grid

Factor	Subfactor	Score	Metric
1. Cost Recovery Framework Within Service Territory	Monopoly with unregulated rate setting. Service area characteristics- GO rating. Customer base stability	Aa	
2. Wllingness and Ability to Recover Costs with Sound Financial Metrics	Rate setting record. Timeliness of recovery. Political risk. Local Government Supportiveness. General fund transfer policy	Aa	
3. Generation and Power Procurement Risk Exposure	Diversity of Supply. Reliability and cost of supply & distribution	A	
4. Competitiveness	Rate Competitiveness (compared to state average)	Aa	
5. Financial Strength and Liquidity	a) Adjusted days liquidity on hand (3-year avg) (days)	Aaa	271
	b) Adjusted Debt ratio (3-year avg) (%)	A	64.50%
	c) Adjusted Debt Service Coverage or Fixed Obligation Charge Coverage (3-year avg) (x)	Aaa	3.37x
Preliminary Grid Indicated Outcome from Grid factors 1-5		Aa2	
		Notch	
6. Operational Considerations	Construction risk, whether the utility is a vital service provider	0	
7. Debt Structure and Reserves	Debt service reserves, special borrowing arrangements and debt structure	-0.5	
8. Revenue Stability and Diversity	Exposure to wholesale power markets, customer concentration, diversity from combined utility operations	-0.5	
Grid Indicated Outcome:		Aa3	

Source: Moody's Investors Service

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EMEA	44-20-7772-5454