FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Tacoma, WA's Electric System Revenue and Refunding Bonds 'AA-'; Outlook Stable

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Fitch Ratings - New York - 03 Jan 2024: Fitch Ratings has assigned a 'AA-' rating to the following bonds issued by Tacoma, WA's electric system (Tacoma Power):

--Approximately $96.7 million revenue green bonds series 2024A.

--Approximately $52 million revenue refunding bonds series 2024B.

Series 2024A green bond proceeds will be used to refinance the Electric System Subordinate Revenue Note series 2021, issued to evidence a $150 million revolving line of credit with Wells Fargo, that is used to interim fund capital expenditures, and to pay costs of issuance. Series 2024B bond proceeds will be used to refund outstanding series 2013A and series 2013B bonds for debt service savings, and to pay the cost of issuance, subject to market conditions. The bonds are expected to price on Jan. 18, 2024, which is subject to change.

Fitch has also affirmed the following ratings at 'AA-':

--Approximately $469 million electric system revenue bonds and revenue refunding bonds outstanding as of Jan 1, 2024.

The Rating Outlook is Stable.

In addition, Fitch has assessed Tacoma Power's standalone credit profile (SCP) at 'aa-'. The SCP represents the credit profile of the utility on a stand-alone basis irrespective of its relationship with and the credit quality of the city of Tacoma (Issuer Default Rating AA/Stable).

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Tacoma (WA) [Electric]			
Tacoma (WA) /Electric System Revenues/1 LT	LT	AA- Rating Outlook Stable Affirmed	AA- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The 'AA-' rating and SCP reflect Tacoma Power's very strong but historically variable financial performance. Given the system's reliance on hydroelectric power resources for nearly all of its power supply, financial performance fluctuates depending on hydrology conditions, due to both variable costs and excess energy sales into the wholesale market. Fitch's rating incorporates our expectation that the electric system will experience temporary periods of weaker and stronger financial margins periodically.

Tacoma Power maintained its very low leverage though fiscal 2022 as higher wholesale market prices increased already robust wholesale revenues to over $153 million in fiscal 2022 from $85 million in fiscal 2021. While Tacoma Power deferred $95 million of wholesale revenues into its Rate Stabilization Fund (RSF) in fiscal 2022 and $25 million in fiscal 2021, Fitch's leverage calculation adds those revenues back into Funds Available for Debt Service (FADS), which translates to a very low leverage of just under 3x in fiscal 2022.

SECURITY

The bonds are payable from the net revenues of the electric system.

KEY RATING DRIVERS

Revenue Defensibility - 'a'

Variable Wholesale Sales and Midrange Service Area

The utility derives a majority of revenues from retail electric sales within the city of Tacoma, which Fitch considers monopolistic in nature. However, revenues derived from competitive wholesale market sales are significant, and serves to limit Fitch's revenue defensibility assessment to 'a'. Very high wholesale market energy prices, which began toward YE 2021, increased wholesale revenues to over $153 million in fiscal 2022 from $85 million in fiscal 2021, and from $59.6 million in fiscal 2020.

Fiscal 2022 wholesale revenues accounted for 31% of total operating revenues before the $95 million transfer to the RSF. Sustained wholesale revenues over 21% of total revenues could lead to a lower revenue source characteristics sub-assessment to midrange. However, given the variability in year-to-year wholesale performance, Fitch expects the sub-assessment to remain unchanged in the near term.

The assessment also incorporates the mixed service area characteristics, including midrange customer growth trends, median household income levels in line with the national average and unemployment levels notably above the national average. Total retail customers have grown between 0.7% and 1.2% per annum over the past five years. While median household income approximates the national average, unemployment numbers are systematically higher than the national average, coming in at 144% of the national average in fiscal 2022.

The assessment additionally reflects the utility's independent ability to adjust rates as necessary and very affordable rates, despite an ongoing commitment to annual rate increases in recent years.

There is no asymmetric credit factor for customer concentration with the top 10 customers accounting for approximately 15% of retail revenues. In August 2023, WestRock Company, Tacoma Power's largest customer at approximately 4.3% of retail revenues, announced the closure of its Tacoma plant. However, there is expected to be little to no disruption to Tacoma Power as a result of the plant closure.

Operating Risk - 'aa'

Very Low-Cost Hydroelectric Power Supply

Tacoma Power's very strong operating risk profile reflects its consistently very low operating cost burden despite a somewhat high age of plant and a weaker cost flexibility assessment. Tacoma Power's operating cost burden averaged just under 7 cents/kWh over the past five years, which is attributed to its owned and contracted hydroelectric power supply which provides approximately 80% of total generation.

Tacoma Power's power supply is primarily met through its long-term block and slice contract with the Bonneville Power Administration (BPA; IDR AA-/Stable), which provides approximately 56% of total generation needs. The BPA contract expires in 2028 and Tacoma Power expects to renew the contract under a similar product offering. Additionally, Tacoma Power owns seven hydroelectric facilities that are located across the western region of Washington state and provide approximately 38% of total generation.

Operating cost flexibility is weaker due to the concentration in a single fuel type, hydroelectric generation. However, this weakness does not outweigh the benefits of the very low-cost energy these resources provide. Given the carbon-free nature of its power supply, Tacoma Power is well positioned to comply with current renewable portfolio standards (RPS) in the state of Washington, as well as future mandates as part of the Clean Energy Transformation Act (CETA), which begins in 2030. Tacoma Power projects to meet all requirements through a combination of incremental hydro and purchased renewable energy credits (RECs).

Capital planning and management is midrange given its age of plant of 24 years, indicating high lifecycle investment needs. However, Tacoma Power has been investing in capital at a higher rate than depreciation over the past five years. The five-year capex plan totals approximately $466 million and focuses on advanced metering infrastructure, dam investments, and grid modernization.

Financial Profile - 'aa'

Variable Financial Performance Offset by Very Low Leverage Profile

Tacoma Power's financial profile is very strong and incorporates the expectation that financial performance will fluctuate based on hydrology. Tacoma Power's leverage ratio, as measured by net adjusted debt divided by net adjusted FADS, declined to a five-year low of just under 3x in fiscal 2022 (year-end Dec. 31), supported by very strong wholesale revenues of $153 million before a $95 million transfer into its rate stabilization fund (RSF).

Following poor hydrology conditions and weaker financial performance in fiscal 2019, when leverage increased to 9.7x and operating margins went to zero, strong wholesale market sales in subsequent years reduced leverage and restored operating margins to 12% in fiscal 2022. Coverage of full obligations (COFO) was similarly strong in fiscal 2022 at 2.95x.

Leverage is generally expected to remain below 7x over the next five years in Fitch's forward-looking stress case scenario, which considers the current 2024 series debt issuance. The additional debt will be supported by assumed annual rate increases of 2.5% throughout the five-year period. While leverage may periodically spike due to variable water conditions, this volatility in financial performance is captured in and supportive of the rating.

Tacoma Power's liquidity profile is neutral to the rating. Tacoma Power had 360 days unrestricted cash on hand at YE 2022. When including its $150 million line of credit with Wells Fargo and its $50 million line of credit with KeyBank, total liquidity is up to 480 days.

Asymmetric Additional Risk Considerations

There are no asymmetric additional risk considerations that affected this rating.

RATING SENSITIVITIES

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

--Sustained increase in the utility's reliance on wholesale revenue as a percentage of total revenues;

--Rate actions that do not support stability in the financial profile or the utility's own financial policies;

--Sustained leverage approximating 8.0x in Fitch's base or stress cases.

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

--Stronger than expected growth in cash flow from operations that drives the financial leverage ratio below 5.0x on a sustained basis in Fitch's base and stress cases.

PROFILE

Tacoma Power is a division of the city of Tacoma's Department of Public Utilities. The division provides vertically integrated electric services to roughly 188,000 customers. The electric utility serves approximately 180 square miles in the city and surrounding area of Pierce County with electricity primarily supplied from a long-term contract with Bonneville Power Administration and seven owned hydro resources across four rivers in the region.

Tacoma Power is governed by a Public Utility Board appointed by the mayor and confirmed by the city council. The board has approval authority for most department business, although the biennial budget, rates, and bond issues must also be approved by city council. Fitch considers Tacoma Power a related entity to the city of Tacoma (general government IDR AA/Stable) for rating purposes given the city's oversight of the system, including the authority to establish rates and operations.

The City of Tacoma's credit quality does not currently constrain the bond rating. However, as a related entity, the issue ratings could become constrained by a material decline in the general credit quality of the city.

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.

ESG CONSIDERATIONS

Tacoma Power's ESG Relevance Score of '2' for GHG Emissions & Air Quality varies from the public power sector guidance score of '3' since carbon-free systems (hydro, wind, nuclear, biomass and biowaste, geothermal) are not significantly exposed to the generation of GHG emissions from operations.

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 https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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APPLICABLE CRITERIA

U.S. Public Power Rating Criteria (pub. 03 Mar 2023) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Apr 2023) (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)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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