S&P Global Ratings

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Summary:

Tacoma, Washington; Retail Electric; Wholesale Electric

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Credit Profile		
US$115.0 mil elec sys rev bnds ser 2021 due 01/01/2051		
Long Term Rating	AA/Stable	New
Tacoma elec sys		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' rating to Tacoma, Wash.'s approximately $115 million electric system revenue bonds, series 2021 (green bonds). The bonds have been verified by a third-party provider as green bonds based on the climate adaption and/or mitigation benefits of the projects financed and refinanced by the 2021 bonds. At the same time, S&P Global Ratings affirmed its 'AA' rating on Tacoma's electric system revenue bonds outstanding. The outlook is stable.

Tacoma pledges the electric system's net revenue to the bonds. The utility will use bond proceeds to pay down a $145 million draw on its note purchase agreement with Wells Fargo.

Credit overview

The rating reflects Tacoma's ability to maintain healthy coverage and liquidity through various hydrological and economic conditions. Concentration in hydroelectric generation, from both owned assets and power purchases, exposes the city to some surplus sales risks, although the utility has built a rate-stabilization account (RSA) to offset some variability. In addition, management has prudent risk-management policies and a history of successful rate management, which mitigates this ongoing exposure. Furthermore, the maturity and diversity of the underlying service area and stable customer base contribute to the city's credit quality.

The stable outlook reflects our view of management's projections that indicate historically strong coverage and liquidity levels will continue. Given management's demonstrated willingness to increase base rates in response to unfavorable hydrologic years and/or adverse market conditions, coupled with conservative budgeting and planning practices, we believe the projections are credible. The long-range financial plan and the recent rate study further support the stability of the 'AA' rating, since prudent contingency planning contributes to Tacoma's ability to weather different cycles with predictably strong outcomes.

Environmental, social, and governance (ESG) factors

Tacoma predominantly sources its power through non-carbon-emitting hydroelectric resources, which limits the utility's exposure to the costs and operational challenges of legislative and regulatory initiatives to reduce greenhouse gas emissions. However, Tacoma's reliance on a network of hydroelectric dams exposes the utility to potentially substantial ongoing remediation costs for fish passage and fish habitats. In addition, we consider environmental risk as slightly elevated, given that the city is adjacent to Puget Sound and is exposed to storm surges and other extreme events related to sea-level rise.

Tacoma is compliant with Washington's renewable portfolio standard (I-937) and well positioned to comply with its decarbonization bill, the Clean Energy Transition Act through its existing low-carbon portfolio, eligible energy purchases, and the acquisition of renewable energy credits. We believe the continued costs of complying with mandates will be manageable, given management's proactive approach and the existing portfolio of assets.

We believe Tacoma's social and governance factors are in line with those of peers, highlighted by generally affordable electric rates, full rate-setting autonomy, and strong policies and planning.

Stable Outlook

Downside scenario

We could lower the rating if poor hydrological conditions, rising power supply costs from Bonneville Power Administration (BPA), or recessionary pressures or demand loss result in materially higher retail rates or a weakened competitive position that frustrates Tacoma's ability to maintain liquidity and achieve fixed charge coverage (FCC) commensurate with recent years' levels.

Upside scenario

Although unlikely, given our view of the city's forecast that indicates financial metrics in line with historical results, coupled with ongoing exposure to potentially volatile surplus energy sales, we could raise the rating if Tacoma materially outpaces projections, and we believe these trends are sustainable.

Credit Opinion

With more than 180,000 retail customers as well as wholesale customers, Tacoma is the fourth-largest public power utility in the state of Washington. Tacoma provides power to a predominantly residential, stable customer base with access to a broad and diverse economy. The city has access to the greater Seattle-Tacoma metropolitan statistical employment area and while income levels are significantly lower than Seattle-Bellevue and slightly below the national average, Tacoma has a significantly lower cost of living, which should contribute to continued incremental growth in the area. Furthermore, the Joint Base Lewis–McChord military installation provides stability in the region and, in our view, likely results in understated income levels. The city's large size, lower cost of living, and stabilizing military presence provide Tacoma with a high degree of revenue stability and operational flexibility.

In our view, Tacoma's owned assets combined with BPA purchases provide ample energy to meet load demands; however, the concentration in hydroelectric resources exposes the city to above-average price volatility with respect to surplus sales. The city's revenue from wholesale sales has varied in recent years, due to fluctuating hydrological conditions and low natural gas prices that set the margin for wholesale electricity prices. We view positively management's ability to maintain healthy margins, on average, in a challenging market environment.

Managing Tacoma's financial position and power supply is more complex, given the exposure to surplus sales volatility and the industrial customer mix, but we believe policies and planning are robust relative to those of peers and credit supportive with respect to financial, budgeting, planning, and risk management guidelines.

Tacoma is a cost-of-service utility with full rate-setting autonomy. Although Tacoma does not use a power cost adjustment mechanism, the city has a strong track record of frequent base rate changes, which has supported solid financial metrics and contributes to our favorable view of its rate-setting practices. According to our calculations based on 2019 data from the Energy Administration Information (EIA), Tacoma's weighted-average overall rates are slightly above the state average, suggesting that despite solid demographics, there are some constraints to revenue-raising flexibility. Residential rates are slightly below average but when accounting for the industrial customer base, rates exceed state levels. Despite recent and projected rate adjustments, we expect the city will maintain its competitive position, as several utilities in the state will similarly need to pass through BPA's rate increases.

Tacoma has exhibited consistently stable and generally robust financial performance. FCC, which treats a portion of Tacoma's energy purchases as debt-like, averaged almost 1.6x over the past three years, suppressed by a decline in fiscal 2019 due to poor hydrological conditions. Projections indicate ongoing maintenance of coverage slightly below historical levels, but still in keeping with the 'AA' rating.

The utility's liquidity has been similarly strong: When including the $38 million RSF and $100 million unrestricted note purchase agreement with KeyBank, liquidity totaled more than 338 days' operating expenses as of Dec. 31, 2020. Projections indicate liquidity will remain well above 200 days over the forecast period, providing the utility ample liquidity to fund hydrological-related shortfalls or other unanticipated expenses.

Finally, Tacoma has a modest debt burden, as evidenced by a 37% debt-to-capitalization ratio. The utility projects biennial capital spending of about $150 million through 2024, approximately half of which will be cash funded, which should result in a steady leverage profile as existing debt amortizes as new debt is added. Together, these factors indicate Tacoma has good flexibility to debt-fund additional capital needs.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of August 10, 2021)		
Tacoma elec (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.