S&P Global Ratings

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Summary:

Tacoma, Washington; Retail Electric; Wholesale Electric

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Credit Profile		
Tacoma elec sys		
Long Term Rating	AA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'AA' rating on Tacoma, Wash.'s electric system revenue bonds.
- The outlook is stable.

Security

Tacoma pledges the electric system's net revenue to the bonds. At fiscal year-end 2021, the system had $540.2 million of electric system debt outstanding.

Credit overview

The rating reflects Tacoma's size, scale, and diverse customer base; and its ability to maintain healthy coverage and liquidity through various hydrological and economic conditions. This is tempered by concentration in hydroelectric generation; surplus sales risks in the wholesale power market; and economic challenges for the utility's residential customers, reflected by $20 million (5% of retail revenue) in delinquent accounts.

The rating further reflects our view of Tacoma's credit strengths:

- Stable retail demand from a sizable service area economy with diverse end markets and 184,000 customers, which provides flexibility and economies of scale;
- Management's willingness to increase rates in response to changes in power markets--the utility has built a rate stabilization account (RSA) to offset variability in power costs and in anticipation of future debt spikes, and uses hedging and risk management practices to navigate all circumstances;
- Liquidity position of $248 million in balance sheet cash, bolstered by a $50 million line of credit, which covers 241 days of operations without lines; and
- Debt-to-total-capitalization ratio of 38% reflecting a manageable debt load, and capital spending that will be 50% bond funded.

Partially offsetting factors include our view of the utility's:

- Dependence on the competitive wholesale power market for 10%-15% of revenue, which management budgets for and mitigates through policies and risk management practices during unfavorable hydrological conditions;
- Generation portfolio concentrated in hydroelectric dams, which carry risk of costs associated with fish-habitat

remediation; and

- Potential for Bonneville Power Administration (BPA) rate increases in years where hydrological conditions are not favorable.

Environmental, social and governance

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 the potentially substantial ongoing remediation costs for fish passage and fish habitats. In addition, we consider environmental risks as slightly elevated, given that the city is on 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 favorable electric rates, full rate-setting autonomy, and strong policies and planning.

Outlook

The stable outlook reflects historically strong coverage and liquidity levels that are expected to continue, and management's willingness to increase base rates in response to different cycles of hydrologic and power market conditions.

Downside scenario

We could lower the rating if poor hydrological conditions, rising power supply costs from BPA, or recessionary pressures result in materially higher retail rates or otherwise frustrate Tacoma's ability to maintain liquidity and achieve fixed cost coverage (FCC) above 1.4x.

Upside scenario

We do not expect to raise the rating over the next two years due to ongoing exposure to potentially volatile surplus energy sales related to concentration in hydroelectric generation.

Credit Opinion

Enterprise risk

With 184,000 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 stable customer base with 49% of retail revenues coming from residential customers. The local industries are broad and diverse and the Joint Base Lewis-McChord military installation provides stability in the region. The military base also likely suppresses income levels, and the lower cost of living compared with the neighboring Seattle-Tacoma metropolitan statistical area is also a stabilizing factor.

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. Tacoma's concentration in hydroelectric generation constrains our view of the utility's diversity in generating units.

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 compared with 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 2021 data from the Energy Information Administration, Tacoma's weighted-average overall rates are 105% of the state average, suggesting that there could be constraints to revenue-raising flexibility. However, we note that rates are still low overall and rate competitiveness in the region is skewed by a few ultra-low-cost providers in more rural areas. Compared with those in similarly urban areas, in our opinion, Tacoma's rates are competitive.

Financial risk

On a three-year average basis, Tacoma's FCC was 1.53x. S&P Global Ratings' FCC treats a portion of Tacoma's energy purchases as debt-like and while this figure is robust, FCC can vary from year to year, largely depending on the hydrology of the Columbia River. Projections are conservative and we view management as proactive in budgeting to less supportive hydrology conditions. Overall, although FCC can fluctuate, we do not view single-year aberrations as a material credit risk.

S&P Global Ratings' analysis of management's financial projections indicates coverage will significantly improve in fiscal 2022 due to continued favorable hydrological conditions and elevated wholesale power prices related to high natural gas prices.

Liquidity totals $361 million in unrestricted cash and is made up of $248 million in balance sheet cash, $63 million in an RSA, and $50 million from a line of credit. Balance sheet cash alone covers 241 days of operating expenses; with the RSA, the utility has 289 days covered and with the line of credit the utility has 350 days of liquidity total. Cash on hand, although robust, is necessary to maintain cushion to fund hydrological-related shortfalls and other unanticipated expenses. The utility contributed $25 million to the RSA in fiscal 2021. Furthermore, the utility received $10 million in rebates from BPA.

Tacoma has a modest debt burden, with a debt-to-capitalization ratio of 38%. The utility projects capital spending of about $400 million through 2026 and about $75 million-$85 million annually, which anticipates a modest issuance in 2023-2025. About half of the capital plan will be cash funded, which should result in steady leverage. The capital plan focuses on the generation assets of Tacoma and includes improvements to dams and fish habitats.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of November 16, 2022)		
Tacoma elec sys rev bnds ser 2021 due 01/01/2051		
Long Term Rating	AA/Stable	Affirmed
Tacoma elec (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.