S&P Global Ratings

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Tacoma, Washington; Retail Electric; Wholesale Electric

Primary Credit Analyst:
Doug Snider, Englewood + 1 (303) 721 4709; doug.snider@spglobal.com

Secondary Contact:
Stephanie Linnet, Englewood + 303-721-4393; Stephanie.Linnet@spglobal.com

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Credit Profile		
US$96.725 mil elec sys rev bnds (Green Bnds) ser 2024A due 01/01/2054		
Long Term Rating	AA/Stable	New
US$52.0 mil elec sys rev rfdg bnds ser 2024B due 01/01/2038		
Long Term Rating	AA/Stable	New
Tacoma elec sys		
Long Term Rating	AA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AA' long-term rating to Tacoma, Wash.'s anticipated $96.7 million series 2024A electric system revenue bonds (green bonds) and $52.0 million series 2024B electric system revenue refunding 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.

Security

The 2024A bonds will refinance the electric system subordinate revenue note series 2021, issued to evidence a $150 million revolving line of credit from Wells Fargo, that is routinely used for interim financing of various system improvements. The 2024B bonds will current-refund all or a portion of the series 2013 bonds outstanding for debt service savings, subject to market conditions.

We view the bond provisions as credit neutral. The bonds are secured by a pledge of net revenues of the city's electric system. A rate covenant requires the system to generate debt service coverage of at least 1.25x. The additional bonds test requires historical or projected revenues to provide 1.25x coverage. The utility had $469 million in electric revenue debt outstanding as of Jan. 1, 2024.

Credit overview

The rating reflects Tacoma's large service territory, proactive rate-setting practices, and diverse customer base, which together underpin its ability to maintain healthy coverage and liquidity through various hydrological and economic conditions. These strengths are tempered by the utility's concentration in hydroelectric generation and surplus sales risks in the wholesale power market, which could constrain financial flexibility during periods of prolonged adverse water conditions. The rating is also constrained by Tacoma's sizable future capital needs, largely related to its owned hydroelectric generating facilities.

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 almost 188,000 customers, which provides financial and operational flexibility as well as economies of scale;
- Management's track record of adjusting rates in response to changes in power markets—the utility maintains a rate stabilization account to offset variability in power costs and in anticipation of future expenses, and uses hedging and risk management practices to navigate varying circumstances;
- Liquidity position of $410 million in balance sheet cash, including a $50 million line of credit, equivalent to 401 days of operations in 2022; and
- Debt-to-total-capitalization ratio of 41% reflecting a manageable debt load, although this ratio could rise as the utility navigates through its capital program.

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

- Dependence on the competitive wholesale power market generally ranging from about 8% to 18% of revenue historically, which management budgets for and mitigates through policies and risk management practices when hydrological conditions are unfavorable;
- Generation portfolio concentrated in hydroelectric dams, which carry risk of costs associated with fish-habitat remediation; moreover, Tacoma anticipates it will face significant additional expenses associated with re-licensing three of its dams and seismic upgrades at two of its dams, respectively. Tacoma has incorporated these projects into its long-term planning.
- Tacoma's largest customer, WestRock Co., announced it will close its paper mill in the city, which historically accounted for about 4.3% of the electric utility's total operating revenue. However, management expects minimal financial impact from the departure of this customer, as the utility will purchase less power in response to the closure. WestRock was paying a negligible amount of distribution expense in its rates, so there will be minimal reallocation of fixed costs among Tacoma's remaining electric customers.

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, as well as potential seismic upgrades. 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 affordable electric rates, full rate-setting autonomy, and strong policies and planning. Following stronger-than-expected U.S. economic growth through the third quarter of 2023, S&P Global Economics believes that recent business and consumer activity are not sustainable and projects slowing economic activity, along with tepid economic growth of

1.5% in 2024 and 1.4% in 2025. (See "Economic Outlook U.S. Q1 2024: Cooling Off But Not Breaking," published Nov. 27, 2023, on RatingsDirect). Although inflation is softening, S&P Global Economics projects elevated interest rates through much of 2024. The amalgam of material increases in delinquent consumer, credit card, and auto loans, along with October's resumption of student loan payments and drawdowns of household savings garnered during the pandemic, will likely compound the financial pressures facing consumers. Consequently, we continue to monitor the strength and stability of electric utilities' revenue streams for evidence of delinquent payments or other revenue erosion.

Outlook

The stable outlook reflects our expectation that Tacoma will maintain coverage and liquidity in line with historical results based upon management's willingness to adjust base rates in response to different cycles of hydrologic and power market conditions.

Downside scenario

We could lower the rating if sustained adverse hydrological conditions, rising power supply costs from Bonneville Power Administration (BPA), or recessionary pressures result in materially higher retail rates or otherwise significantly erode Tacoma's liquidity and fixed cost coverage (FCC).

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 and ongoing capital costs related to the utility's owned generation portfolio.

Credit Opinion

Enterprise risk

With 188,000 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. The local industries are broad and diverse and the Joint Base Lewis-McChord military installation provides stability in the region. The lower cost of living compared with the neighboring Seattle-Tacoma metropolitan statistical area provides additional stability.

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. Revenue from wholesale sales has generally ranged from 8% to 18% of total revenues. Tacoma's concentration in hydroelectric generation constrains our view of the utility's diversity in generating units.

Tacoma is a cost-of-service utility with full rate-setting autonomy. Although it 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 2022 data from the Energy Information Administration, Tacoma's weighted-average overall rates are 105% of the state average, suggesting that there could be constraints on revenue-raising flexibility. However, 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 for adverse water conditions. S&P Global Ratings' analysis of management's financial projections indicates coverage will remain healthy.

Liquidity totals $410 million in unrestricted cash and is made up of $360 million in balance sheet cash and rate stabilization funds and an additional $50 million from a line of credit. Cash on hand, although robust, is necessary to maintain cushion to fund hydrological-related shortfalls and other unanticipated expenses.

Tacoma has a modest debt burden, with a debt-to-capitalization ratio of 41%. The utility projects capital spending of about $465 million through 2028, of which approximately half will be debt financed. The capital plan focuses on the generation, transmission, and distribution assets of the utility.

Tacoma Public Utilities, Washington--Key credit metrics

	--Fiscal year ending--		
	2022	**2021**	**2020**
Operational metrics			
Electric customer accounts	187,950	184,406	182,526
% of electric retail revenues from residential customers	52	50	51
Top 10 electric customers' revenues as % of total electric operating revenue	15	16	15
Service area median household effective buying income as % of U.S.	107	107	102
Weighted average retail electric rate as % of state	105	106	110
Financial metrics			
Gross revenues ($000s)	476,007	472,254	471,018
Total operating expenses less depreciation and amortization ($000s)	373,160	376,472	359,613
Debt service ($000s)	31,778	26,278	26,690
Debt service coverage (x)	3.2	3.6	4.2
Fixed-charge coverage (x)	1.5	1.5	1.7
Total available liquidity ($000s)*	410,161	298,356	332,706
Days' liquidity	401	289	338
Total on-balance-sheet debt ($000s)	601,804	550,200	524,942
Debt-to-capitalization (%)	41	39	37

*Total available liquidity includes available committed credit line balances, where applicable. Debt service coverage--Revenues minus expenses divided by debt service. Fixed-charge coverage--Sum of revenues minus expenses minus total net transfers out plus capacity payments (or their proxy), divided by the sum of debt service plus capacity payments (or their proxy). N.A.--Not available.

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 January 4, 2024)		
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.		