S&P Global
Ratings

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Summary:

Tacoma, Washington; Retail Electric

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Summary:

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Credit Profile		
US$69.905 mil elec sys rev bnds ser 2017 due 01/01/2046		
Long Term Rating	AA/Stable	New
Tacoma elec sys		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' rating to the city of Tacoma, Wash.'s series 2017 electric system (Tacoma Power) revenue bonds, and affirmed its 'AA' rating on the electric system's parity obligations. The outlook is stable.

The rating reflects what we view as the electric system's:

- Favorable power supply position with surplus capacity in nearly all months, even under low stream flow conditions and below-average power supply costs;
- Solid coverage of fixed costs and strong liquidity at the current rating level, which we project will continue over the next five years; and
- Manageable debt levels, although capital needs are expected to add moderate leverage.

Credit concerns include the following:

- Tacoma Power's residential rates were 7% below-average, but industrial rates are 27% above-average in 2015, the most recent year of available comparative information. However, with a large industrial component, Tacoma Power's weighted average system rate is 9% higher than the state average. Since the electric system raised rates 5.9% for 2017 and again in 2018 (and anticipates more modest increases thereafter), we anticipate competitive position will weaken over the next eight years;
- Tacoma Power is exposed to revenue volatility and budget variance related to wholesale sales (37% of 2016 total sales), which are highly influenced by hydrological conditions and market prices. However, we believe that management's conservative budgeting practices help to mitigate (although not eliminate) this risk; and
- Exposure to economic downturns because industrial customers account for 53% of retail sales and 33% of total sales.

Tacoma Power's business profile score of '4', on a '10' point scale with '1' representing the least risk and '10' the highest risk, reflects the utility's low-cost power supply and competitive rates. The bonds are secured by a pledge of net electric system revenues.

Tacoma Power has a deep and generally diverse service area with somewhat below-average demographics (slightly below-average income levels and above-average unemployment rates). Sales are somewhat skewed toward industrial customers, exposing the utility to potential volatility should economic conditions result in lower industrial production. Load growth has tapered off during the recession and ensuing recovery, though we note a healthy increase in population in 2016, both within the city and in the surrounding county. Sales to industrial customers are a substantial 53% of retail sales (33% of total sales), exposing the utility to potential demand fluctuation. Although there is industrial concentration, the base is generally broad, with the top 10 customers accounting for 17% of retail revenue. Reflective of a large military presence (Fort Lewis and McChord Air Force Base), median household effective buying incomes are only 95% of the U.S. average.

We view the electric system's power supply as a credit strength. About 90% of Tacoma Power's energy comes from hydropower resources. Power from Bonneville Power Administration (BPA) accounts for about half of power needs, under BPA's block and slice products. But the BPA slice power is variable, based on hydrological conditions; in years when conditions are unfavorable, Tacoma Power receives less energy.

Because the electric system is long on power, this can have the effect of reducing the amount of energy available for Tacoma to resell, creating a potential for revenue volatility. During fiscals 2015 and 2016, hydrological conditions have been close to average. However, margins on off-system sales have thinned in recent years as market prices have declined in response to the falling price of natural gas.

With conservation driving down energy demand, we anticipate that Tacoma's allocation of block power will decline in the future, with slice power comprising a larger share. In our view this may expose Tacoma to greater future volatility. This places a premium on conservative budgeting of wholesale sales revenue, and in our opinion Tacoma Power has exhibited reasonable practices by budgeting for adverse hydrological conditions, and has maintained solid financial metrics by raising rates to address revenue shortfalls stemming from wholesale sales variances.

According to the Dept. of Energy's Energy Information Administration, Tacoma Power's weighted average revenue per kilowatt hour was 9% above-average for utilities in the State of Washington during 2015, the most recent year of available comparative information. However, we expect Tacoma's competitive position will weaken over the next eight years as management has recommended 5.9% rate increases over fiscals 2017 and 2018, and anticipates more modest increases over the ensuing five years. Nevertheless, the rate increases will likely help the utility absorb increasing power costs from BPA, lower wholesale sales, and capital spending requirements while still maintaining solid financial metrics.

Tacoma Power's financial profile has historically been strong and stable, with 1.39x-1.55x fixed cost coverage over fiscals 2013 and 2016, and projections suggest it will remain in that range or stronger over the next five years. In our opinion, liquidity is strong, measuring $239 million, or 272 days of 2016 operating expenses. We believe that maintenance of strong liquidity is essential given the utility's exposure to revenue volatility due to hydrological conditions and power prices on off-system sales. Further necessitating robust liquidity is the potential exposure that Tacoma Power has to a mandatory tender under certain events of default related to $100 million of subordinate-lien privately placed debt. In our opinion, Tacoma Power has adequate liquidity to address the contingent liability should the tender be triggered, giving the utility adequate time to gain market access to refinance the obligation. Tacoma's electric system is not unduly leveraged. Debt to capitalization is healthy at 36%. The utility's five-year capital plan totals $445 million, with 59% ($261 million) to be funded with debt, so we expect this ratio to increase, but remain in the moderate range.

Outlook

The stable outlook reflects a track record of exercising rate setting authority in a fashion that produces strong coverage of fixed costs and liquidity. Based upon a financial forecast that in our opinion is plausible and conservative based on stressed conditions, we believe that the utility will be successful in maintaining financial metrics supportive of the current rating.

Upside scenario

Given its exposure to revenue volatility related to wholesale sales and adverse hydrological conditions, upside potential is unlikely.

Downside scenario

If weak wholesale markets or poor hydrological conditions lead to financial metrics that are materially short of recent results, we could lower the rating.

Ratings Detail (As Of August 7, 2017)		
Tacoma elec		
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.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.