

11 Jun 2018 | New Issue

# Fitch Rates Puget Sound Energy's Senior Secured Notes 'A'

---

Fitch Ratings-New York-11 June 2018: Fitch Ratings has assigned an 'A' rating to Puget Sound Energy Inc.'s (PSE; Issuer Default Rating 'BBB+') offering of \$600 million senior secured notes due 2048. The Rating Outlook is Stable. The proceeds will be used to pay at maturity \$200 million 6.74% due June 15, 2018, pay down a portion of outstanding commercial paper, and for general corporate purposes.

## KEY RATING DRIVERS

**Low-Risk Business Profile:** PSE is a fully regulated integrated electric and gas utility in western Washington State, serving 1.1 million electric customers and 822,000 natural gas customers. Approximately 70% of the company's revenue is derived from electric service and 30% from natural gas service. The company is regulated by the Washington Utilities and Transportation Commission (WUTC).

**Somewhat Restrictive Regulation:** Fitch views certain aspects of WUTC's regulations as restrictive. Revenue requirements in rate case proceedings are largely based on historical test years (partially mitigated by expedited rate filings in between general rate cases for certain investments). Authorized returns on equity (ROEs) and equity ratios are relatively low. PSE benefits from full revenue decoupling for both electric and gas operations that mitigates revenue fluctuation from weather, conservation, and changes in energy usage patterns. PSE also benefits from trackers and recovery mechanisms for power costs, conservation, property taxes, pipeline replacement, purchased gas and low income.

**Rate Settlement Implemented:** On Dec. 5, 2017, the WUTC approved a multi-party settlement reached in PSE's 2017 general rate case (GRC). As a result, the company was authorized an electric increase of \$20.2 million (0.9%) and a net natural gas decrease of \$35.5 million (-3.8%). Both awards were based upon an ROE of 9.5% and equity ratio of 48.5%. The company's last rate decision in 2012 was based upon an ROE of 9.8% and equity ratio of 48.0%. The settlement also included modifications to the depreciation schedule for the Colstrip units, mitigating the risk of stranded investment from the planned shut-down of coal units 1 and 2 in 2022. Coal units 3 and 4 will be fully depreciated in 2027.

Impacts of Tax Reform: As a result of the Tax Cuts and Jobs Act of 2017, PSE will flow \$132 million in benefits to customers. The effect of the change in tax rate from 35% to 21% will be passed back to customers beginning May 1, 2018 via a \$73 million cut in base rates for electric and a \$24 million cut in base rates for natural gas. The \$35 million benefit from the first four months of this year has been deferred until the next GRC.

Tacoma Liquefied Natural Gas Facility: PSE's parent, Puget Energy, Inc. (PE, BBB-/Stable) is developing a liquefied natural gas (LNG) facility at the Port of Tacoma Washington (Tacoma LNG). The facility, along with an 8 million gallon storage tank is planned to provide peak-shaving service to PSE's natural gas customers. As per WUTC order, 43% of the project's capital and operating costs are allocated to PSE, with the balance allocated to PE. The plant, which is currently under construction, was expected to be operational in 2019; however an additional environmental study was requested by the Puget Sound Clean Air Agency before issuing the final permit, which will delay the in-service date. As of Dec. 31, 2017, PSE has incurred construction work in progress of \$87.2 million related to Tacoma LNG.

Credit Metrics: PSE's capex has been ramping up since 2017, which, along with the impact of tax reform, will pressure credit metrics in the next two to three years. PSE's FFO adjusted leverage is expected to average in the mid-3x and FFO fixed-charge coverage around high-4x. In the next three years, PE plans to spend \$2.6 billion in capex (mostly in PSE), an average of \$861 million annually compared to \$595 million average during the past four years. PSE will fund most of the capex from internal cash flow and the remaining using debt financing.

Notching: The two-notch IDR differential between PSE and PE reflects the substantial parent-level debt at PE (approximately 40%), the ring-fencing mechanism, and to a lesser degree, the companies' ownership by a group of long-term infrastructure investors. PSE benefits from various ring-fencing measures put in place by the WUTC at the time of the 2009 buyout. However, PSE's ratings are upwardly constrained by PE. Fitch believes that the ring-fencing restrictions are not sufficient to justify notching wider than two categories as PSE is PE's sole funding source to service its parent-only debt. The private equity ownership is less favorable than public equity ownership from a credit perspective. However, Fitch considers the investor group's large and highly diversified portfolios, long-term investment horizon, and demonstrated behavior supporting the maintenance of PE and PSE long-term financial health as mitigating factors.

DERIVATION SUMMARY

PSE and Cleco Power (BBB/Stable) are similar in that they are both owned by private equity investors, have substantial parent level debt and are exposed to coal generation. PSE's FFO-adjusted leverage is expected to average in the mid-3x range. It compares favorably with Cleco Power, which has FFO-adjusted leverage of 3.9x. However, PSE's service territory in Washington is considered a less favorable jurisdiction than Cleco Power's Louisiana. PSE and Cleco's ratings are both upwardly constrained by their parent holding companies. However, PSE's IDR is two notches higher than PE, while Cleco Power is only one notch higher than its parent, Cleco Corporation (Cleco, BBB-/Stable) as Cleco has much higher parent-only debt of nearly 60% compared with PE's approximately 40%.

## KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Electric load growth on average 0.5% and gas load growth 0.4%;
- O&M escalates at an average of 1.5% per year from 2018 to 2021;
- Net book value of Colstrip 1 and 2 recovered through 2022 per prior precedent; decommissioning cost and remediation costs are recovered through offsetting production tax credits and treasury grants per Washington state legislation;
- Cash shortfall is funded by debt.

## RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action

- Absent an upgrade at PE, it is unlikely that PSE's ratings will be upgraded in the foreseeable future.

Developments that May, Individually or Collectively, Lead to Negative Rating Action

- A downgrade at PE could lead to a downgrade at PSE;
- After the heavy capex period, if FFO adjusted leverage sustains above 4.8x, negative rating pressure could mount;
- If PSE is not able to recover the majority of the stranded and remediation costs associated with Colstrip unit 1 and 2, if the outcome of future rating proceedings is materially unfavorable, or if Washington's regulatory environment deteriorates materially, negative rating action could occur.

## LIQUIDITY

Fitch deems PSE's liquidity adequate. In October 2017, the company entered into a new \$800 million credit facility, which matures in October 2022. With the banks approval, the facility can be increased to up to \$1.4 billion. Under the terms of the credit agreement PSE is required to

maintain a total debt to total capitalization of less than 65%. As of March 31, 2018, PSE had no outstanding borrowings on the facilities and \$371 million in commercial paper. Absent the \$200 million June 2018 maturity, PSE does not have any significant maturities over the forecast period.

Contact:

Primary Analyst

Julie Jiang

Director

+1-212-908-0708

Fitch Ratings, Inc.

33 Whitehall St.

New York, NY, 10004

Secondary Analyst

Barbara Chapman

Senior Director

+1-646-582-4886

Committee Chairperson

Shalini Mahajan, CFA

Managing Director

+1-212-908-0351

Date of Relevant Rating Committee: May 26, 2017

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email:

elizabeth.fogerty@fitchratings.com

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com). For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

**Applicable Criteria**

[Criteria for Rating Non-Financial Corporates - Effective from 10 March 2017 to 7 August 2017 \(pub. 10 Mar 2017\)](#)

[Non-Financial Corporates Hybrids Treatment and Notching Criteria - Effective from 27 April 2017 to 27 March 2018 \(pub. 27 Apr 2017\)](#)

## **Additional Disclosures**

[Solicitation Status](#)

[Endorsement Policy](#)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT [WWW.FITCHRATINGS.COM](http://WWW.FITCHRATINGS.COM). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the

accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit

ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001. Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

---

**ENDORSEMENT POLICY** - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the [EU Regulatory Disclosures](#) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.