FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Puget Energy and Puget Sound Energy; Outlook Stable

Fri 26 Apr, 2024 - 1:30 PM ET

Fitch Ratings - New York - 26 Apr 2024: Fitch Ratings has affirmed Puget Energy Inc.'s (PE) Long-Term Issuer Default Rating (IDR) at 'BBB-' and Puget Sound Energy, Inc.'s (PSE) Long-Term IDR at 'BBB+'. The Rating Outlook for both entities is Stable. Fitch has also affirmed PSE's Short-Term IDR at 'F2'.

PE and PSE's rating affirmations and Stable Outlooks assumes a reasonable outcome for the pending rate case, on-budget and on-time execution of the increased capex program, and sufficient equity contributions to maintain expected credit metrics. Fitch forecasts PSE's 2024-2028 FFO leverage to average 4.1x; significantly lower than its downgrade threshold. PE has limited headroom in its credit metrics, with FFO leverage expected to average 5.3x between 2024-2028.

Wildfire is a notable risk factor in parts of PSE's service territory. While PSE has taken significant measures to reduce wildfire risk, there can be no assurance the utility will not experience a serious wildfire event and associated large liabilities and other costs. Fitch's expectation of an improved regulatory environment, could support a loosening of downgrade thresholds for PE and PSE.

However, given the continuing and increasing risk of wildfires, Fitch is not loosening PE's or PSE's FFO downgrade rating thresholds at this time. Any significant retrenchment in Washington's improved regulatory environment will likely result in the tightening of thresholds and additional negative rating action.

KEY RATING DRIVERS

Majority Regulated Business: PE's consolidated revenue is largely attributed to its ownership in PSE, contributing to approximately 99% of consolidated revenue. PSE is a fully regulated integrated electric and gas utility in western Washington predominately regulated by the Washington Utilities and Transportation Commission (WUTC). Puget Energy's only significant unregulated business is its 57% allocation of the Tacoma liquefied natural gas facility, which comprises of approximately 1% of consolidated EBITDA.

Ambitious Emission Reduction Goals: Washington State enacted the Clean Energy Transformation Act (CETA) in 2019 and the Washington Climate Commitment Act (CCA) in 2021. The CETA requires PSE to eliminate coal-fired generation from the company's supply mix by Dec. 31, 2025; to be carbon neutral by Jan. 1, 2030; and by 2045 renewable resources supply 100% of all sales of electricity to Washington retail electric customers. CETA will requiring significant operating and capital costs, that if not recovered through ratepayers will result in a degradation of PSE and PE's credit metrics. The CCA establishes a greenhouse gas (GHG) emissions cap and invest program, administered by the Washington Department of Ecology (WDOE). Fitch notes that PSE could be subject to swings in cash flow due to CCA compliance costs.

Improving Regulatory Outcomes: WUTC has historically been considered a restrictive commission owing to authorized ROEs and equity capitalizations below industry averages. WUTC's prior practice of using historic test years and uncertain or delayed pass throughs of some costs resulted in regulatory lag and reduced credit metrics. The 2021 Senate Bill 5295 significantly improved utility regulation allowing for (but not mandating) the use of multiyear rate plans and forecast test years.

PSE benefits from revenue decoupling, along with other trackers and riders; however, often with some regulatory lag. Fitch assumes a durable improvement in the Washington regulatory environment. Any significant retrenchment in Washington's improved regulatory environment could result in negative rating action.

Second Multiyear Rate Case Filed: During December 2022 and January 2023, The WUTC approved PSE's first multiyear (two-year) general rate case (GRC) settlement, authorizing a ROE and equity ratio of 9.40% and 49%, respectively. Electric and natural gas base rate increased $280.1 million and $90.3 million over the two years, respectively.

PSE filed its second multiyear rate case on Feb. 15, 2024. The two-year plan requests an overall increase in electric and natural gas rates of 6.7% and 19.0%, respectively, effective in 2025 and 9.3% and 2.1% effective in 2026. The company is proposing 2025 rates be established on 9.95% ROE and 50% equity capitalization and 2026 rates set on 10.50% ROE and 51% capitalization. The rate filing also includes new trackers for wildfire prevention, insurance and related costs, eligible clean energy, and aspirational gas decarbonization efforts. A final order from the WUTC is expected by January 2025 with rates effective mid-January 2025. Fitch expects a reasonable outcome.

Capex Plan Growth: As a result of the CETA mandate to eliminate coal from its resource mix and procure cleaner energy sources, PSE electric supply mix is dramatically changing. The shift will require significant resource additions either through new PSE owned generation or long-term power supply contracts. Fitch's capex forecast for PSE has increased meaningfully by over 50% compared to the prior three-year capital expenditure projections, thereby exposing the company to higher construction risk. While PSE can make a Power Cost Only Rate Case (PCORC) filing of the new assets if between rate cases, there is no guarantees that the commission will find the resource acquisitions as prudent and/or allow their full and timely recovery in rates.

Bill Affordability a Concern: As filed, rate plans coupled with tracker revenue is expected to result in significant rate increases. While the overall utility cost burden for Washington rate payers is low compared to the rest of the country, Fitch expects PSE electric bills to be among the highest in the state. Fitch is concerned that an increased focus on affordability could potentially result in unfavorable rate case outcomes and pressure on credit metrics, as was the case in the 2020 GRC.

Wildfire Risk Exposure: In the last 10 years, PSE had had only one wildfire incident that resulted in claims brought against PSE. PSE's limited wildfire experience can be attributed in part to its service territory's favorable topography and wildfire mitigation planning. While PSE has taken significant measures to reduce wildfire risk, there can be no assurances that PSE will not experience a serious wildfire event.

PSE has adequate headroom in its credit metrics at the 'BBB+' rating level to absorb the financial impact from a significant fire. However, Fitch forecasts PE having limited-to-no room over the next few years in its downgrade threshold of 5.5x. Additionally, in the event of a fire, PSE may not be able to pay dividends further constraining PE's liquidity and creditworthiness. If PE were to be downgraded, PSE would be downgraded due to parent subsidiary linkage considerations.

Credit Metrics Improving: In recent years, PE and PSE's credit metrics have improved with 2023 FFO leverage at 5.5x and 4.0x respectively. The improvement in credit metrics can be attributable to approval of the company's first multiyear plan with the WUTC in 2022, lower natural gas costs in 2023 coupled with an increase in allowable purchased gas cost adjustment, and net recovery of regulated assets and liabilities in 2023. Fitch considers the purchased gas cost adjustment to be a timing difference and excludes the cash flow impact from FFO, but includes the debt impact in FFO leverage.

Fitch expects that PE and PSE will maintain credit metrics that are commensurate with their respective rating thresholds, projecting an average FFO leverage of 5.3x and 4.1x over the forecast horizon. Historically, PE parent level debt averaged 30%, however Fitch expects a decrease to 20% driven by a reasonable 2024 rate case outcome and growth in PSE's capex plan funded partially with debt at the subsidiary level.

Parent-Subsidiary Linkage: There is parent-subsidiary linkage between PE and PSE. Fitch determines PE's standalone credit profile (SCP) based on consolidated metrics. Fitch considers PSE to have stronger SCP due to its lower leverage and lower operating risks as a regulated utility. A high level of parent-level debt results in weaker consolidated credit metrics at PE. As such, Fitch has followed the stronger subsidiary path. Legal ring-fencing is porous given the general protections afforded by economic regulation, and access and control are also porous. Due to the linkage considerations, Fitch will limit the difference between PE and PSE to two notches.

DERIVATION SUMMARY

PE's peers include Cleco Corporate Holdings, LLC (BBB-/Stable), IPALCO Enterprises, Inc. (BBB-/Stable) and DPL Inc. (BB/Stable), all of which are holding companies operating one primary utility. All four companies have sizable parent-only debt. PE currently has approximately 30% parent-only debt which is similar to IPALCO and lower than Cleco's and DPL's 60%. Historically, PE parent level debt averaged 30%, however Fitch expects a decrease to 20% driven by a reasonable 2024 rate case outcome and growth in PSE's capex plan funded partially with debt at the subsidiary level.

PSE operates an electric and gas utility with a larger customer base and higher gross revenue than Cleco Power LLC (BBB/Stable), The Dayton Power & Light Company (BBB-/Stable) and Indianapolis Power & Light Co. (BBB+/Stable). However, PSE's service territory is less favorable than its peers', as it is subject to restrictive regulation and progressive energy goals in Washington.

PE's credit metrics have improved in recent years attributable its approved rate case outcome in 2022. Fitch assumes a reasonable rate case outcome for its most recent 2024 general rate case filing in line with historical outcomes and expects both PSE and PE FFO leverage metrics to remain commensurate with its current ratings. PE's FFO Leverage metrics are similar to Cleco Corporate and stronger than DPL. and IPALCO.

KEY ASSUMPTIONS

--$5.9 billion capex from 2024 to 2026;

--New rates starting in January 2025 and 2026;

--Electrical load growth of 0.8% CAGR and gas load decrease of 0.5% CAGAR from 2024 to 2028;

--General rate case outcomes in line with historical filings;

--6% interest rate on incremental debt issuance in the forecast period.

RATING SENSITIVITIES

Puget Energy, Inc.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--FFO leverage sustained below 4.5x.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--FFO leverage exceeding 5.5x on a sustained basis;

--A downgrade at PSE could lead to one at PE.

Puget Sound Energy, Inc.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--A positive rating action is not likely at this time, given PSE's potential wildfire risk.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-- A downgrade at PE would lead to a downgrade at PSE;

-- FFO leverage sustained above 4.8x;

-- Wildfire activity that gives rise to significant financial liability.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: PSE and PE have separate and reasonable liquidity access. PSE has an unsecured $800 million revolving credit facility maturing on May 14, 2027. The facility has a swing-line feature allowing same day availability on borrowings up to $75 million. Subject to bank approval, PSE can increase the size of the facilities up to $1.4 billion. The credit agreement requires that PSE maintain maximum debt/total capitalization of 65%. PSE is in compliance with the covenant. As of Dec. 31, 2023, PSE had no draw under the facility and $336.6 million outstanding under the commercial paper program.

PE provides PSE with a $200 million revolving facility in the form of a credit agreement and a demand note. PSE had no outstanding balance under the note as of Dec. 31, 2023.

PE maintains an $800 million senior secured revolving credit facility that matures on May 14, 2027. The revolver also has an accordion feature that could increase the size up to $1.3 billion. As of Dec. 31, 2023, $261.5 million was outstanding under the facility. The primary financial covenant under the credit agreement is maximum total debt/total capitalization of 65%. PE complies with all applicable covenants.

Debt maturities are very manageable across the forecast period for both PE and PSE. The earliest maturities include a $400 million maturity in 2025 for PE and $300 million maturity in 2027 for PSE.

ISSUER PROFILE

Puget Energy is an energy services holding company incorporated in the state of Washington. Substantially all of its operations are conducted through its regulated subsidiary, Puget Sound Energy (PSE). PSE is a fully regulated integrated electric and natural gas utility serving approximately 6,000 square miles of the pacific northwest in the Puget Sound region with 1.23 million electric and 877,000 natural gas customers as of Dec. 31, 2023.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Puget Sound Energy, Inc.	LT IDR	BBB+ Rating Outlook Stable	Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2	Affirmed	F2
senior secured	LT	A	Affirmed	A
senior unsecured	ST	F2	Affirmed	F2
Puget Energy Inc.	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
senior secured	LT	BBB	Affirmed	BBB

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria - Effective from 3 November 2023 to 21 June 2024 (pub. 03 Nov 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Puget Energy Inc.	EU Endorsed, UK Endorsed
Puget Sound Energy, Inc.	EU Endorsed, UK Endorsed

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