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Seminole Electric Cooperative Inc., Florida Putnam County Development Authority; Rural Electric Coop

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Credit Profile		
Seminole Elec Coop ICR		
Long Term Rating	A-/Stable	Affirmed
Seminole Elec Coop sr nts		
Long Term Rating	A-/Stable	Affirmed
Putnam Cnty Dev Auth, Florida		
Seminole Elec Coop, Florida		
Putnam Cnty Dev Auth (Seminole Elec Coop) poll cntl		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services has affirmed its 'A-' issuer credit rating on Seminole Electric Cooperative Inc. (Seminole or SECI). At the same time, Standard & Poor's affirmed its 'A-' rating on SECI's series A, B, and C notes, and its 'A-' rating on Putnam County Development Authority's pollution control revenue refunding bonds (Seminole Electric Cooperative Inc. project). The outlook is stable.

In our opinion, Seminole's credit strengths include:

- A captive retail market and the ability to set rates through take-and-pay all-requirements wholesale power agreements with nine of 10 members through 2045;
- A favorable profile for members, including their largely residential customer bases, competitive rates, and solid financial metrics;
- A diverse power supply, with owned generation a source of low-power costs;
- A board-adopted equity development plan (to build equity to 20% from the current 14%), which we expect will bolster coverage and liquidity while enhancing the cooperative's ability to access capital markets after successfully obtaining U.S. Rural Utilities Service (RUS) approval of an indenture; and
- Favorable rate-setting practices, including annual and intrayear base rate review and automatic pass-through of fuel and power costs through a power cost-adjustment mechanism that is reset at least every six months.

The rating also reflects our assessment of the following credit weaknesses:

- Fixed cost coverage levels have historically been weak, measuring less than 1.10x.from fiscals 2004-2008, although an adequate 1.12x in 2009. Strong 1.32x fixed cost coverage for 2010 was largely a product of favorable weather conditions. The cooperative's projections indicate a return to fixed cost coverage levels that are adequate for the rating--1.10x-1.18x in the next five years.
- Liquidity is just adequate. At fiscal year-end 2010 (Dec. 31), cash and investments measured only 10 days of operating expenses, but was supplemented by a $200 million committed credit line, boosting overall liquidity to

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68 days. The inclusion of the hedged price in rates as recovered in member's power bills mitigates our concern.
- Seminole has a substantial carbon footprint in an increasingly carbon-constrained environment. However, we note that although the footprint is high compared with those of investor-owned utilities (IOUs) in Florida (Progress Energy Inc. and Florida Power & Light Co.), the footprint is more moderate when measured against those of other electric cooperatives.
- While member contracts were recently extended to 2045 from 2020 with nine of 10 distribution members, the extension includes a provision for converting to partial requirement membership, signaling that member interests are not necessarily aligned. The approved withdrawal of the second-largest member (Lee County Electric Cooperative) bears this out. While this relieves Seminole of the need to provide additional power supply, it nevertheless diminishes the overall diversity of the membership base.

As of Dec. 31, 2010 (unaudited), the Tampa-based electric generation and transmission (G&T) cooperative had approximately $1.31 billion in total debt outstanding.

SECI sells energy under all-requirements contracts to 10 distribution cooperatives that serve about 900,000 retail customers in 46 counties throughout Florida. Its electric energy sales totaled approximately 17,436 gigawatt-hours in 2010, which placed it among the nation's largest G&T cooperatives. Seminole's second largest member, Lee County, which accounted for 22% of total energy requirements in 2009, negotiated the right to reduce its participation in Seminole to 70% of its current load in 2010, and exit at the end of 2013. Lee County will pay no exit fees. Management expects that a combination of load growth among remaining members and expiring power purchase contracts will enable SECI to avoid material adverse impacts related to excess power and member rates.

The contracts with the remaining members represent about 85% of current member revenues. The extended contract gives members the choice to find alternative energy suppliers for incremental energy needs after 2020 while still paying capacity charges under the existing take-or-pay contracts.

Seminole's member's retail markets are strong, in our view, and have several attributes that are generally favorable to credit quality, including a high concentration of residential customers (which account for about 72% of its member revenues), generally competitive rates, and strong financial metrics.

SECI owns 2,125 megawatts (MW) of efficient base and intermediate load capacity. The cooperative supplements its installed generation with power purchased to meet demand peaks and load shaping. In 2010, owned generation met 66% of energy needs, while long- and short-term contracts supplied the rest. Although there is some recent easing in Florida capacity margins, there has been a long-term narrowing trend, and import capability remains constrained. As such, the availability and costs of purchased power had been rising, although we note that recent declines in natural gas prices have had an ameliorative effect. The cost of self-generation and purchased power blended into a competitive average wholesale rate of $83.83 per megawatt-hour (MWh) in 2010. This is up significantly since 2004, when members paid an average of $56.16 per MWh. However, it is still middle of the pack compared with those of wholesale providers in Florida. We expect current rates to remain stable in the next several years, increasing thereafter as the utility pursues baseload needs by 2020; however, we expect that SECI will maintain its competitive position.

Lee County's departure and the effects of the weak economy has prompted Seminole to reduce its load forecast, and the utility no longer expects needing to add baseload or intermediate resources until 2020. In 2010, the cooperative wrote off about $1.9 million in costs related to its evaluation of nuclear and natural gas fired generation options.

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Seminole, which sets its own rates, historically budgeted for narrow excess financial margins. Until recently, its policy was to set rates to provide 1.05x debt service coverage, slightly above the level required under the mortgage granted to the RUS and National Rural Utilities Cooperative Finance Corp. (CFC). Fixed cost coverage was historically thin, in our view, ranging from 1.01x in 2004 to 1.06x in 2008. In 2009, fixed cost coverage improved slightly, to 1.12x. and a cold winter and warm summer contributed to what we consider a strong 1.34x coverage in 2010. While management projects similar strong results for 2011, the utility's forecasts indicates fixed cost coverage levels returning to the 1.1x vicinity in the ensuing 10 years.

Additional lines of credit have bolstered liquidity, which remains just adequate. Unrestricted cash measured a thin 10 days of operating expenses at Dec. 31, 2010 (unaudited). SECI has three committed credit lines that expire in December 2013. The lines total $200 million--$75 million with CFC, $75 million with CoBank ACB, and $50 million with Bank of America N.A. Together with cash, the lines bring total liquidity to 68 days of operating expenses. Management expects to secure additional lines for capital, especially if it pursues nuclear generation. However, we note that under the equity development plan, management expects to build on-balance-sheet cash to more than one month's operating expenses.

Outlook

The stable outlook reflects our view of modest improvement in fixed cost coverage levels. Based on the utility's projections, we expect that they will diminish somewhat but remain in the range that supports the current rating. Should fixed cost coverage levels decline below these levels, the rating could face pressure.

Business Description

SECI is an electric G&T that sells energy under all-requirements contracts to 10 distribution cooperatives that serve 900,000 retail customers in 46 counties throughout Florida. It charges its members cost-based rates for electric service and also sells surplus generation to buyers in the wholesale market at market prices. Member revenues accounted for 98% of total revenues.

Contractual Agreements

The contractual agreements supporting Seminole's creditworthiness is its members' wholesale power contracts. The original 45-year contracts with the 10 members were due to expire in 2020. Nine members (providing 85% of the load) have approved 25-year extensions. Members have the flexibility to choose an alternate energy supplier for incremental growth after 2020.

Membership Profile And Markets

SECI's membership profile exhibits both strengths and weaknesses relative to those of other G&T cooperatives in the 'A' category. Members tend to exhibit what we view as strong financial metrics, which suggest additional financial flexibility to absorb rate shock in the event of significant operating or capital cost overruns. However, with only 10 members, there is significant concentration among members.

To meet load growth and respond to the expiration of contracts for a substantial amount of purchased power

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capacity and energy, Seminole is pursuing the addition of new generation, which required the extension of member contracts. Seven of 10 members extended, but three held out, including two of Seminole's largest members. Two of the three ultimately decided to extend after SECI offered the choice to find alternative energy suppliers for incremental energy needs after 2020 while still paying capacity charges under the existing take-or-pay contracts. The current contract with these nine members runs through 2045.

The nine members that extended represent 85% Seminole's total load requirements. Lee County, whose contract was set to expire in 2020, opted not to extend, and reduced its participation to 70% of the load in 2010, exiting Seminole in 2013.

While losing Lee County reduces some of Seminole's revenue and load diversity, management does not project that it will have to increase costs for remaining members. Significant reliance on purchased power tempers the exposure to increased fixed costs because purchased power can be reduced should load be lost. Furthermore, the cooperative would still need the proposed generation projects to meet projected load growth.

SECI's members provide retail electric service to customers in the north central and southwest portion of Florida, serving two of the fastest-growing regions in the state. In the past five years, the customer growth rates have exceeded those of the investor-owned and municipal utilities. The areas, while primarily residential, are economically diverse, in our view, serving some more densely populated areas outside of Tampa and Fort Myers and rural farm areas in central Florida.

We believe many of the customers' characteristics lend stability to SECI and also make them less attractive to alternative energy suppliers, if the area were open to competition. Residential energy usage is lower than that of other utilities in the region. Only a small portion of the energy sales are to small and large commercial customers. The area has what we consider low customer density. The average number of customers per line mile (15) is less than typically seen for IOUs and municipal utilities, but higher than for most rural cooperatives.

The member systems' low load factors reflect a relatively small industrial presence. Even those cooperatives with the greatest industrial presence have load factors below 50%. The limited industrial presence and low load factors bode well for revenue-stream stability and credit quality, barring the departure of more distribution cooperatives. The two largest remaining distribution cooperatives, Withlacoochee River Electric Cooperative and Clay Electric Cooperative, account for about half of Seminole's revenues in nearly equal shares.

Operations

SECI owns about half of its capacity, with the balance coming through purchased power agreements. The board favors the diversity of fuel source, provider, and flexibility to adjust to members needs provided by a combination of owned generation and purchased power. However, the majority of energy is from SECI's owned units (Seminole Generating Station units 1 and 2), which are twin 650 MW baseload coal units.

The cost of the purchased power is significantly higher than the cooperative's own generation. SECI purchases a mix of full- and partial-requirement system power and unit contingent block power to meet a portion of its intermediate and peaking needs. This portfolio approach provides flexibility if a member were to leave the system. However, some contracts require 3-7 years' notice before existing power purchase requirements can be reduced. The Midulla Generating Station includes 310 MW of peaking capacity and a 500 MW combined-cycle gas turbine (CCGT) unit.

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Since opening in 2002, the CCGT has faced operational problems, most recently when it experienced a catastrophic failure in April 2007. The combustion turbine units returned service (in simple cycle configuration) in relatively short order, a month later. However, the steam unit required $43 million in repairs and returned to service in 2008.

Regulation

Seminole sets its own wholesale rates. The Florida Public Service Commission (PSC) lacks jurisdiction over the level of rates Seminole sets, which was reaffirmed last year when the commission determined and later the Florida Supreme Court concurred, that the PSC lacks jurisdiction over cooperative wholesale energy providers.

Competitive Position

Seminole's wholesale rates consist of two components: a demand charge that is designed to recover fixed costs associated with owned and contracted capacity; and an energy charge that principally recovers variable costs, but that also recovers a portion of Seminole's fixed costs. While all members purchase electricity under the same tariff, there is variation in the actual wholesale rates paid by members due to varying usage patterns. Systemwide, SECI's average cost of power to members was $83.83 per MWh in 2010, up from $56.16 in 2004. Rates are competitive with wholesale providers within the southeast.

Finances

Seminole has a semiannual fuel and purchased-power-adjustment mechanism that permits it to pass through price changes associated with fuel and fuel-related purchased power costs, shifting the burdens of price volatility to the members. SECI has used this mechanism to offset higher gas costs and purchased power needed to supply the greater-than-expected growth and lower-than-budgeted availability of its own generation.

Seminole historically operated under a traditional RUS mortgage that established financial benchmarks that SECI must meet as an RUS borrower. The mortgage required that rates provide debt service and interest earned coverage of not less than 1.00x and 1.05x in two of every three years, respectively. Under the new indenture, Seminole is required to set rates to achieve annually achieve 1.1x margin for interest coverage.

Debt And Capital

Debt-to-capitalization was 86% in 2010 (unaudited), reflecting Seminole's reliance on debt for capital projects. However, the total debt per retail customer was moderate, in our view, at about $1,460.

Approval of the new indenture potentially enhances SECI's access to public debt markets, bolstering financial flexibility. Under the RUS mortgage, financial flexibility was a significant concern in light of Seminole's substantial capital needs and the RUS' suspension of loans for coal and nuclear generation.

Related Criteria And Research

USPF Criteria: Applying Key Rating Factors To U.S. Cooperative Utilities, Nov. 21, 2007

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