January 15, 2010

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

Primary Credit Analyst:
Jeffrey Panger, New York (1) 212-438-2076; jeff_panger@standardandpoors.com

Secondary Credit Analyst:
Judith Waite, New York (1) 212-438-7677; judith_waite@standardandpoors.com

Table Of Contents

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

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), Fla. At the same time, Standard & Poor's affirmed its 'A-' long-term rating on Seminole's series A, B, and C notes; and its 'A-' long-term rating on Putnam County Development Authority's pollution control revenue refunding bonds (Seminole Electric Cooperative Inc. project). The outlook is stable.

The affirmations reflect the Rural Utility Service's (RUS) approving and SECI's board adopting a new indenture in December 2009. Standard & Poor's has reviewed the indenture and in our opinion, it does not affect the rating.

Standard & Poor's previously revised its outlook on Seminole to stable from negative in July 2009. The outlook revision reflected our assessment of stabilized and modestly improved financial results in the past two years, and management's projections for further strengthening of coverage and liquidity. Projected improvement in financial metrics is based on the board-approved plan to build equity to enhance its access to capital markets.

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 credit profile for members, including their largely residential customer bases, competitive rates, their solid financial metrics;
- SECI's diverse power supply, with owned generation a source of low power costs;
- Its board-adopted equity development plan, which we expect will bolster coverage and liquidity while enhancing the cooperative's ability to access capital markets; and
- Favorable rate-setting practices, including annual and intrayear base rate reviews and automatic pass-through of fuel and power costs through a power cost adjustment mechanism that is reset at least every six months.

The ratings also reflect what we view as the following credit weaknesses:

- Although financial metrics have shown modest improvement over the past two years, we believe that debt service and fixed charge coverages are still weak.
- Liquidity remains marginal for the ratings, especially in light of collateral posted to support Seminole's gas hedging program. Including the hedged price in rates as recovered in member's power bills mitigates our concern.
- Seminole is seeking to replace expiring power purchase contracts with owned generation, and is considering two options--nuclear and natural gas--which we believe each carry unique challenges.
- We expect that debt levels will increase markedly, at 80%-120% from the current $1,500 per customer, depending on the generation option. However, mitigating our concern is an equity development plan that should enable SECI to build equity to 20% from the current 7%, which we consider to be weak.
- Seminole has a substantial carbon footprint in an increasingly carbon-constrained environment. However, we believe that the footprint is moderate when measured against that of other electric cooperatives, and management indicated it expects carbon intensity to decline under new nuclear or natural gas generation scenarios.
- While member contracts were recently extended to 2045 from 2020 with nine of 10 distribution members, the extension includes a provision for conversion to partial requirement membership, signaling that member interests are not necessarily aligned.

As of Dec. 31, 2008, the Tampa-based electric generation and transmission (G&T) cooperative had approximately $1.4 billion in debt outstanding.

Seminole 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 16,900 gigawatt-hours in 2008, which placed the utility among the nation's largest G&T cooperatives. While nine of 10 members extended their contracts, Seminole's second-largest member, Lee County Electric Cooperative, which accounted for 22% of total energy requirements in 2008, has received RUS approval to reduce its participation in SECI to 70% of its current load in 2010 and exit the cooperative at the end of 2013. Lee County will pay no exit fees. Management expects that a combination of load growth among remaining members and the expiration of power purchase contracts will enable Seminole to avoid a material impact related to excess power and member rates.

The contracts with the remaining members represent 78% of current member revenues. The extended contract enables members to find alternative energy suppliers for incremental energy needs after 2020 while still paying capacity charges under the existing take-and-pay contracts.

Seminole's members' 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 2,222 megawatts (MW) of efficient base and intermediate load capacity. It supplements its installed generation with higher cost power purchased to meet demand peaks and load shaping. In 2008, owned generation met 60% of energy needs, while long and short-term contracts supplied the rest. Although there is some recent easing in capacity margins in Florida, there has been a long-term narrowing trend, and import capability remains constrained. As such, the availability and costs of purchased power had been trending upward, although 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 $74.51 per megawatt-hour (MWh) in 2008. This rate is up significantly since 2004, when members paid an average of $56.16 per MWh. However, it still compares favorably with regional wholesale providers. We expect rates to rise in the near-to-medium term as power supply resources are added to the portfolio, but we also expect that SECI will be able to maintain its competitive position.

Even with Lee County's departure, Seminole has substantial debt financed capital needs. It had expected to build a third unit at its Seminole Generating Station (SGS3), a 750 MW coal fired unit. However, final certification challenges from the Florida Department of Environmental Protection delayed the project by more than two years, and while Florida's Fifth Circuit Court recently ruled in Seminole's favor, the combination of project delay, increasing cost, and potential for future environmental challenge has prompted management to scrap the plans and evaluate other power options.

SECI is evaluating nuclear and natural gas fired generation options. It is considering a share of up to 13.7% of Progress Energy Florida's proposed two-unit, 2,200 MW nuclear facility to be built in Levy County. Based on estimates from 2006, SECI's share would cost more than $2 billion ($7,000 per kilowatt [kW]), not including transmission costs. Seminole is also considering building an 835 MW 3x1 combined cycle generating turbine (CCGT) plus 217 MW of duct firing capability at a greenfield site in Gilchrist County for $1.6 billion (including interest during construction, but not transmission).

These substantial capital needs come at a time when the RUS has suspended loans for coal and nuclear generation. As such, RUS approval for Seminole's new indenture release the mortgage hold, and enables these G&Ts to access public debt markets.

SECI, 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 RUS and National Rural Utilities Cooperative Finance Corp. (CFC). As such, debt service coverage was thin at 1.05x in both 2005 and 2006, while fixed cost coverage was 1.02x in both years.

In the past two years, debt service coverage improved slightly, to 1.10x and 1.15x, respectively, while fixed cost coverage was marginally improved to 1.05x and 1.06x. The 2007 and 2008 results came despite a catastrophic outage at SECI's Midulla CCGT unit that resulted increased purchased power costs, although it passed the bulk of this to ratepayers. The unit has since been repaired and is operating at strong availability rates.

Seminole projects that its board-adopted equity development plan will bolster coverage levels. It has two sets of forecasts: one if it pursues nuclear generation (Levy), the other if it pursues gas-fired generation (Gilchrist). But in general, management projects fixed cost coverage ranging from 1.11x-1.29x through 2017, and 1.37x-1.58x from 2018-2024.

Liquidity has been a credit concern. At fiscal year-end 2008, only $90 million of its credit lines was undrawn, measuring 22 days of operating expenses, a level that we consider insufficient given SECI's operating profile. However, under the equity development plan, management expects to build on-balance-sheet cash to more than two months operating expenses. However, Seminole has recently increased its credit lines to $200 million from $155 million (general purposes and capital). Half of this is with CFC, and half with Co-Bank ACB. Both lines expire Dec. 31, 2010). Management expects to secure additional lines for capital, especially if it pursues nuclear generation.

Outlook

The stable outlook reflects our assessment of modest improvement in coverage levels and our expectation that coverages and liquidity will improve as a result of the equity development plan. As such, maintaining the rating will depend on Seminole actually achieving such coverage and liquidity. While we expect that debt levels will increase, we also expect SECI will build equity to a level in keeping with the rating.

Business Description

Tampa-based SECI is an electric G&T cooperative that sells energy under all-requirements contracts to 10 distribution cooperatives that serve 900,000 customers throughout Florida. Seminole 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 were due to expire in 2020. Nine members (providing 78% of the load) have approved 25-year extensions. Members can choose an alternate energy supplier for incremental growth after 2020.

Membership Profile And Markets

Seminole's membership profile exhibits both strengths and weaknesses relative to those of other G&T cooperatives in the 'A' category. Members tend to exhibit strong financial metrics, which suggest additional financial flexibility among the members 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, with the second-largest member, Lee County, accounting for 22% of member revenues.

To meet load growth and respond to the expiration of contracts for a substantial amount of purchased power capacity and energy, SECI is pursuing 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 those 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-and-pay contracts. The current contract with these nine members runs through 2045.

The nine members that extended represent 78% Seminole's total load requirements. Seminole's largest member, Lee County, whose contract was set to expire in 2020, opted not to extend, and will reduce it participation to 70% of the current load in 2010, exiting the cooperative entirely in 2013.

While the loss of Lee County reduces some of Seminole's revenue and load diversity, we don't project it will 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 proposed new generation projects would still be necessary to meet the remaining members' projected load growth.

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

Many of the customers' characteristics lend stability to Seminole and also make them less attractive to alternative energy suppliers, if the area were open to competition. Residential energy use is lower than that of other utilities in the region. Only a small portion of the energy sales are to commercial customers. The area has low customer density. The average number of customers per line mile (15) is less than that of most investor-owned and municipal utilities, but higher than for most rural cooperatives. Future growth is expected to be strong, but slightly lower than the historical average as economic concerns limit the region's housing market.

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%. In our opinion, the limited presence of industrial customers and the low load factors bode well for the revenue stream's stability and for credit quality, barring the departure of distribution cooperatives from the Seminole system.

The three largest distribution cooperatives--Withlacoochee River Electric Cooperative, Lee County Electric Cooperative, and Clay Electric Cooperative--account for about two-thirds of SECI's revenues in nearly equal shares.

Operations

Seminole owns about half of its capacity with the balance coming through purchased power agreements. The board favors the diversity of fuel source and providers, and the flexibility to adjust to members needs that a combination of owned generation and purchased power offers. However, more than half of the energy is from its owned capacity--Seminole Generating Station Units 1 and 2, twin 665 MW baseload coal units.

The cost of the purchased power is significantly higher than that of 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 three-to-seven years' notice before existing power purchase requirements can be reduced. In addition to the operational flexibility from the power purchase agreements, the company faces counterparty credit exposure. It has unit contingent contracts with Calpine Corp. B/Stable/--) and Centerpoint Energy Houston Electric LLC (BBB/Negative/--).

The Midulla Generating Station (formerly known as the Payne Creek Generating Station) includes 310 MW of peaking capacity and a 500MW CCGT unit. Since it started operation in 2002, the CCGT has been plagued with operational problems, most recently when it experienced a catastrophic failure in April 2007. The combustion turbine units returned to service (in simple cycle configuration) in relatively short order, in May 2007. 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 on SECI's rates. This was reaffirmed last year when the PSC determined and later the state 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 designed to recover fixed costs associated with owned and contracted capacity; and an energy charge that principally recovers variable costs, but also recovers a portion of 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 is $82.90 per MWh in 2009, up from $74.51 in 2008 and $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 to its customers price changes associated with fuel and fuel related purchased power costs. SECI has used this mechanism to offset increased gas costs and higher purchased power needed to supply the higher-than-expected growth and lower-than-budget availability of its own generation.

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

Debt And Capital

Debt to capitalization was 93% in 2008, reflecting Seminole's reliance on debt for capital projects. However, we consider the total debt per kW of installed capacity a low $562, offset by moderate ratio of debt per retail customer at about $1,550 per customer.

SECI expects future capital costs to be significant. If it pursues SG3, total capital costs will likely exceed $2.7 billion.

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

Related Research

USPF Criteria: Electric Utility Ratings, June 15, 2007