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Utility sector's credit ratings weakened sharply in 2020: S&P Global Ratings

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HIGHLIGHTS

Downgrades exceed upgrades

ESG risks, regulatory issues were major factors

Vaccine may help recovery

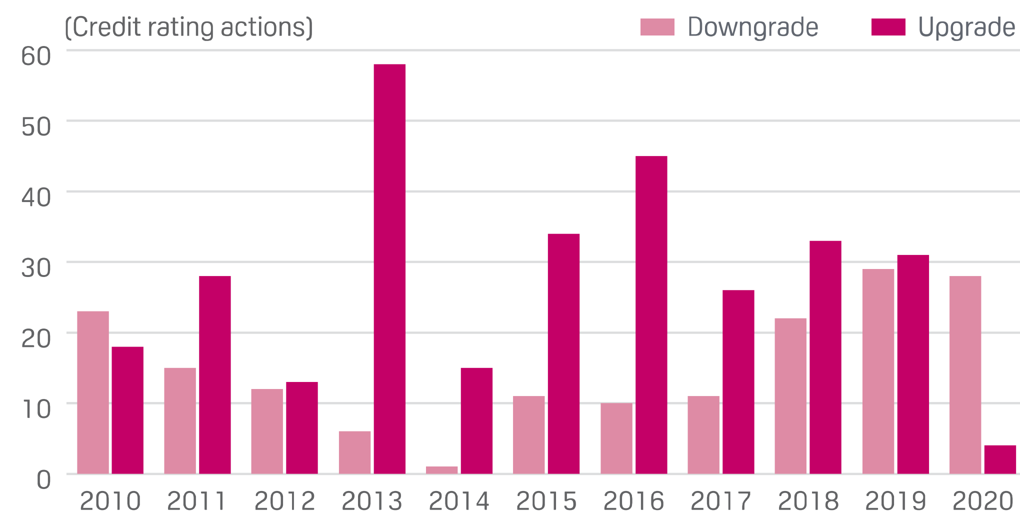
Houston — The percentage of North American regulated utilities with a negative outlook or on CreditWatch with negative implications surged from 18% in 2019 to 36% in 2020, a Jan. 21 S&P Global Ratings report states, which may cause power utilities to more strictly avoid risk in trading.

The report, entitled, "North American Regulated Utilities' Negative Outlook Could See Modest Improvement," also indicated that the number of downgrades exceeded the number of upgrades by a wide margin in 2020 for the first time since 2010.

"The main causes of weakening credit quality reflected environment, social, and governance (ESG) risks, regulatory issues, and companies' practice of strategically managing financial measures close to their downgrade threshold with little or no cushion," the report states.

The novel coronavirus pandemic "was not the culprit for weaker credit quality," the report states.

NORTH AMERICAN REGULATED UTILITIES UPGRADES AND DOWNGRADES



Source: S&P Global Ratings

"Lower electric and gas deliveries to [commercial and industrial] customers were mostly offset by higher residential deliveries, the industry generally worked well with regulators to defer COVID-19-related costs for future recovery, market returns improved, and the industry generally had consistent access to the capital markets," the report states.

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Rudy Tolentino, a Houston-based independent electric utility and power market analyst, speculated that the downgrades are likely more related to delayed rate filings and dispositions, "since fuel and purchased power costs are typically passed through to the customer."

"As far as the delayed rate filings, it's hard to ask for a rate increase when so many customers are struggling," Tolentino said in a Jan. 21 email. "The optics don't look good."

COVID-19 vaccine

S&P Global Ratings said, "We expect that as vaccines take hold and the pandemic dissipates, the economy will gradually recover, as will the industry's rate case performance."

Another factor that may enhance regulated utilities' may be an increase in corporate income tax that may result from the change in the makeup of the federal executive and legislative branches, the report states.

"While details of such a plan are limited, a key element of the proposal would likely call for an increase in the corporate tax rate to 28% from 21%," the report states. "We estimate that this higher tax rate would improve the industry's [ratio of] funds from operations to debt by about 100 basis points. The improving financial measures would likely boost credit quality, enhancing utilities' financial cushions from their downgrade thresholds."

In the interim, Jim Carson, CEO of RisQuant Energy, a St. Paul, Minnesota-based energy market consultancy, said electric utilities are likely to be more risk averse in their trading.

"They will be more inclined to fully hedge than before, and speculate less," Carson said in a Jan. 21 email. "Trading will be driven more by the need to hedge and less on value analysis and perception. I don't believe that price levels will be much affected. However, the day ahead to real time differentials should widen and the forward curve [should become] less efficient."