S&P Global
Ratings

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Summary:
Seattle, Washington; Water/Sewer

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Credit Profile		
US$107.475 mil wtr sys imp and rfdg rev bnds ser 2022 due 09/01/2052		
Long Term Rating	AA+/Stable	New
Seattle wtr		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Seattle, Wash.'s approximately $108 million series 2022 water system improvement and refunding revenue bonds. At the same time, S&P Global Ratings affirmed its 'AA+' rating on the city's existing water system parity debt. The outlook is stable.

Proceeds from series 2022 water system improvement and refunding revenue bonds will be used to fund $87.5 million of upcoming water system capital needs and refund all or a portion of the series 2012 bonds for debt service savings. The system presently has $645.4 million of parity water system bonds outstanding as well as $22.7 million of subordinate state loans.

The bonds are secured by a pledge of net revenues of the city's water system. A rate covenant requires the system to generate debt service coverage of 1.25x, though withdrawals from a rate stabilization fund can be included in this calculation. Additionally, securing all parity bonds is a reserve, funded at $56.1 million (funded with both cash and sureties), well above the DSRF requirement of approximately $40.4 million.

Credit overview

The rating is anchored by the Seattle's ample water supply and overall economic considerations of its large customer base, which also include many of the city's suburbs served under long-term wholesale contracts. The rating further reflects our opinion of Seattle's financial forecast, which we believe is achievable, given the system's manageable capital needs during the five-year forecast period as well as its proposed rate plan, which assumes relatively modest 3.4% per annum rate increases through 2026. The city's current forecasts assume relatively sizable cost escalations during the next two years, which drive operating expenses up about 30% between 2021 and 2023. While we recognize that there is some conservatism in the city's forecast, we understand that financial metrics (primarily coverage) could weaken to levels we consider just adequate should these cost pressures materialize.

While the size and scope of the upcoming capital improvement program (CIP) compare favorably to that of its peers at the current rating level, the system's upcoming five-year CIP is primarily debt-funded (78%) which we consider a potential credit stressor, given current inflationary pressures and overall negative economic headwinds. We understand the system is primarily addressing its aging distribution system infrastructure in its upcoming CIP.

The rating further reflects:

- The underlying economic strength, diversity, and wealth of the customer base. The city of Seattle (population: 734,000) sits at the center of the large, diverse Puget Sound regional economy. We view the service area's income levels as extremely strong based on the city's median household effective buying income (MHHEBI) at more than 145% of the national level in 2021. Unemployment is very low, and last stood at 2.1% as of March 2022;
- City council's demonstrated ability and willingness to increase service rates, with multiyear rate schedules that we believe promote cost recovery and revenue stability;
- Somewhat constrained rate affordability due to SPU's high combined bills for water, wastewater, and solid waste services. While water charges are generally affordable, on a combined basis, the city's typical monthly residential bill totals $232, which we consider sizable, at about 3.5% of median household effective buying income (MHHEBI). To address affordability risks, the city offers a rate program that provides a 50% discount to income-qualifying households, with an enrollment of about 30,000 households--but we believe SPU's higher service costs may induce political pressure to minimize future rate increases;
- Good projected financial metrics. The water system's historical all-in coverage has exceeded 1.6x during the past three years, as calculated by S&P Global Ratings, which we consider credit supportive but is conservatively projected to decline to about 1.3x based on management's forecast, which we consider reasonable but relatively weak compared to its peers at this rating level. Our calculation of all-in debt service coverage (DSC) nets out the payment of taxes ($46.0 million in fiscal 2021) to the city from revenues and expenditures.
- Strong liquidity, with $103 million (or 226 days' cash on hand) available as of Dec. 31, 2021. We expect SPU to deploy a portion of its cash reserves to defease existing debt later this year, but not draw cash down to less than $85 million (including both its operating fund and rate stabilization reserve. While unexpected, increased transfers (which would violate the Washington State Accountability Act) to the general fund would weaken the system's credit rating, potentially by several notches; and
- Moderate leverage with a 47.5% debt-to-capitalization as of Dec. 31, 2021, which we consider credit supportive. The upcoming CIP totals about $708 million through 2027 and is primarily focused on renewal and replacements to existing infrastructure. With additional planned debt during the next five years layered in, the system's financial capacity should not diminish to the point that metrics would become inconsistent with the current rating.

Environmental, social, and governance

Our credit rating analysis reflects both positive and negative considerations driven by ESG factors. Although the water system has an abundant water supply (the city's projections indicate that it has sufficient water resources through 2060), which we consider a key credit strength, we recognize that climate risks resulting in extreme weather events, sea-level rise, and drought could also pressure system operations over time. Pacific Northwest winters are projected to become warmer and wetter, and summers warmer and drier. That means more rain than snow falling on the Cascade Mountains and eventually more prolonged periods of drought; at the same time, recent years have presented some of the wettest winters on record, which could add costs related to flooding or mudslides. We recognize, however, that management has generally succeeded in executing its 10-year strategic plans, which focuses on future uncertainties and adaptive management and mitigates the influence of these environmental considerations on credit quality. We also recognize the city's robust drought management planning, comprehensive water conservation programs, as well as aggressive leak detection procedures. Should SPU's rates increase faster than wealth and income levels for the area, social risks for affordability could rise. Finally, we view the system's governance factors as credit supportive as they include full rate-setting autonomy; strong policies and planning; and robust interaction between management and the city council.

Stable Outlook

Upside scenario

A higher rating would be predicated mainly on an improved financial risk profile, specifically driven by our all-in DSC metric commensurate with its 'AAA' rated peers.

Downside scenario

We do not anticipate lowering the rating during the two-year outlook horizon. However, any unexpected economic or financial shocks, which could potentially significantly disrupt the system's operations, or any unanticipated and extraordinarily large change in the CIP that could alter related financial metrics or could present downward pressure on the rating or outlook at any time.

Credit Opinion

The water system serves a population of about 1.6 million, providing retail service to customers in Seattle and water on a wholesale basis to 17 suburban water districts and municipalities plus the Cascade Water Alliance. Although more than 50% of water is sold on a wholesale basis, only about 22% of system revenues come from this customer class, which may slightly understate coverage. The top two wholesale customers by revenue are Cascade (AAA/Stable; 7.9% of total operating revenue) and Northshore Utility District (2.0% of total operating revenue.) Most of the wholesale customers have entered into long-term agreements with Seattle through at least January 2062, requiring the city to meet the customers' water demands not met by local sources. Seattle's contract with its largest customer, Cascade Water Alliance, requires Seattle to provide 33.3 mgd annually through 2039, and thereafter at a declining annual volume.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of June 13, 2022)		
Seattle wtr (BHAC) (SEC MKT)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.