

CREDIT OPINION

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Seattle (City of) WA Water Enterprise

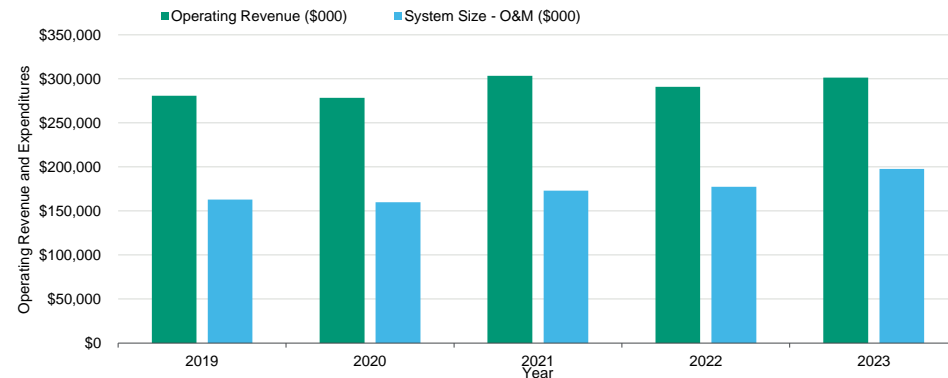
Update to Credit Analysis

Summary

The City of Seattle, Washington's Water Enterprise (Aaa stable) rating reflects the water enterprise's large and wealthy service area that includes the City of Seattle (Aaa stable) and surrounding communities. The rating is further supported by a healthy financial profile with good 1.64x debt service coverage and strong liquidity with 195 days cash on hand in FY23. The utility continues to benefit from access to the city's shared \$3.7B liquidity pool. Regulatory compliance and capital planning are overseen by a strong management staff and the rating also incorporates satisfactory legal provisions. Affordability will be a long-term challenge as water consumption remains stable and rates are increased to pay for system operations, maintenance and improvements.

Exhibit 1

Steady revenue growth and expenditure controls highlight proactive system management



Source: Seattle Public Utilities and Moody's Ratings

Credit strengths

- » A large and wealthy service area that includes the City of Seattle
- » Solid debt service coverage and healthy liquidity bolstered by access to the city's shared liquidity pool
- » Ample water supply
- » Strong management with good financial policies

Credit challenges

- » High customer combined utility bills relative to national peers
- » Long-term trend of declining water consumption
- » Significant additional debt expected in the next three to five years

Rating outlook

The stable outlook reflects sound debt service coverage that is expected to remain at satisfactory levels given regular rate increases. The utility has sufficient cash and ample access to additional liquidity that offers financial flexibility.

Factors that could lead to an upgrade

- » N/A

Factors that could lead to a downgrade

- » Debt Service coverage falling below 1.25x
- » Debt to operating revenues exceeding 4.0x
- » Days cash on hand falling below 150 days

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

City of Seattle Water System					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	24 years				
System Size - O&M (in \$000s)	\$197,698.78				
Service Area Wealth: MFI % of US median	183.36				
Legal Provisions					
Rate Covenant (x)	1.25x				
Debt Service Reserve Requirement	DSRF funded at the lesser of the standard 3-prong test (Aa)				
Management					
Rate Management	Aa				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2019	2020	2021	2022	2023
Operating Revenue (\$000)	\$281,008	\$278,578	\$303,499	\$290,869	\$301,496
System Size - O&M (\$000)	\$163,006	\$159,855	\$173,182	\$177,601	\$197,699
Net Revenues (\$000)	\$132,841	\$130,183	\$139,523	\$110,980	\$121,932
Net Funded Debt (\$000)	\$787,965	\$740,037	\$670,742	\$658,669	\$603,279
Annual Debt Service (\$000)	\$77,911	\$73,426	\$78,882	\$81,163	\$74,350
Annual Debt Service Coverage (x)	1.7x	1.8x	1.8x	1.4x	1.6x
Cash on Hand	291.17	321.41	217.13	182.88	196.25
Debt to Operating Revenues (x)	2.80	2.66	2.21	2.26	2.00

*Financial figures reflect non-cash adjustments for pension and OPEB

Sources: US Census Bureau, US Bureau of Economic Analysis, Seattle (City of) Water Enterprise, WA's financial statements and Moody's Ratings

Profile

The water enterprise provides retail and wholesale water services to a combined population of 1.6 million within the greater Seattle metropolitan area. Water is primarily sourced from two watersheds east of the city. Infrastructure includes 1,800 miles of pipelines and two treatment facilities, with high water quality supported by extensive watershed protection, advanced water treatment and ongoing monitoring.

Detailed credit considerations

The system is a key utility service provider to Seattle with ample supply

The utility system's robust service area economy is a significant credit strength. Seattle is the commercial and tourism hub of the Puget Sound region and the economic center of the [State of Washington](#) (Aaa stable). Software development and aircraft manufacturing are key components of the local economy, and the area serves as the headquarters or major operating base to some of the world's best known international corporations, including [Amazon](#) (A1 stable), [Boeing](#) (Baa3 negative), [Microsoft](#) (Aaa stable) and [Starbucks](#) (Baa1 stable). Positively, business and leisure travel to the region has begun to rebound following the pandemic and general economic activity has improved significantly. As of Feb 2024, the region's unemployment rate was lower than the national average at 4.0%.

Income measures are strong and will continue to be a positive component of the utility's credit profile. Median family income of 183% of the US level is among the highest for large urban areas. This will continue to be supported by the city's high educational attainment rate.

After falling over multiple decades, long-term water consumption is expected to remain flat as population growth is offset by declines in per capita usage driven by the implementation of water conservation efforts, improved efficiency in fixtures and increased residential density. Wholesale water represents slightly more than half of water demand (54% in 2023), followed by commercial (28%) and

residential (18%) use. In 2023 no single retail customer represented more than 2% of retail revenue, and the 10 largest retail customers represented just 8.3% of overall retail revenue.

Water supply comes primarily from the Cedar River and Tolt River Watersheds, providing an annual average yield of about 172 million gallons per day (MGD). The water system can also store a combined 327 million gallons (MG) of treated water within its distribution and transmission systems across its 13 reservoirs. In addition, the enterprise has access to more than 130,000 acre-feet of raw water stored in its watersheds. Given existing supply and demand forecasts, management has determined that no significant new water sources are necessary before 2060.

Debt service coverage is strong and stable, liquidity is bolstered by access to the city's consolidated cash pool

Coverage is solid and demonstrably stable. In 2023, debt service coverage on all debt, including low interest loans through the state's Drinking Water State Revolving Fund, was a strong 1.6x. Operating revenue for 2023 was \$301 million, a 3.6% increase from 2022 that was driven by a hotter than normal summer. Projected coverage through 2026 shows a coverage improving some but mostly stable at current levels.

Seattle Public Utilities (SPU) sets rates for Seattle Water, Seattle Drainage & Wastewater and the Seattle Solid Waste. The combined billing applies to solid waste first, then wastewater and then water. The SPU authority sends rate increases to the City Council & Mayor for approval after public input is sought; rate increases are adopted by ordinance. Currently, rates for the combined utility increases are approved for an average 4.2% through 2026. Water rates are elevated compared to national systems, however, more affordable when compared to other water systems in the region. Water bills tend to be progressive, with lower income households paying lower water bills.

Liquidity

Seattle's utilities have historically maintained lower levels of cash on their own balance sheets because of their access to liquidity in the city's \$3.7 billion consolidated cash pool. Short-term liquidity (up to 90 days) can be accessed with approval of the city's finance director. For long-term liquidity, the enterprise must receive approval of the City Council. The loans bear interest at the yield of the investment pool, which is low given the short-term investment nature.

The water system generates satisfactory operating cash flow. The enterprise ended 2023 with good 195 days of cash on hand. The forward projection for the enterprise shows flat to improving cash balances through 2026, though the city has historically outperformed similar projections by considerable margins.

Debt service coverage is strong and liquidity bolstered by access to the city's consolidated cash pool

Most of the water enterprise's debt consists of senior lien revenue bonds. The city has seven outstanding loans with the state that are junior to the senior lien revenue bonds. Although the state loans contain language permitting acceleration in the event of default, the enforcement of these provisions is unlikely. The water enterprise capital improvement program through 2029 is \$740 million, a large portion of which, \$366 million, is for improvements to distribution lines for seismic improvements and aging infrastructure. The CIP is expected to be funded largely by debt. An additional \$445 million in bonds are expected after the current transaction.

Legal security

The bonds are secured by a pledge of the net revenue of the water system. The city has covenanted to establish rates sufficient to generate debt service coverage of at least 1.25 times. The bonds are additionally secured by a common debt service reserve equal to the lesser of the standard three-prong test, funded by a combination of cash and sureties.

Debt structure

The water enterprise's debt consists of fixed rate obligations with declining debt service through final maturity in 2052.

Debt-related derivatives

The utility does not have any debt-related derivatives.

Pensions and OPEB

Pensions and other post-employment benefits (OPEB) are not a material driver for the water utility. As of 2021, the utility has an adjusted net pension liability (ANPL) of \$293 million based on a discount rate of 2.52%, which is manageable at 0.9x operating revenue. The enterprise uses a discount of 7.25% and therefore has a lower reported pension liability. Contributions have historically

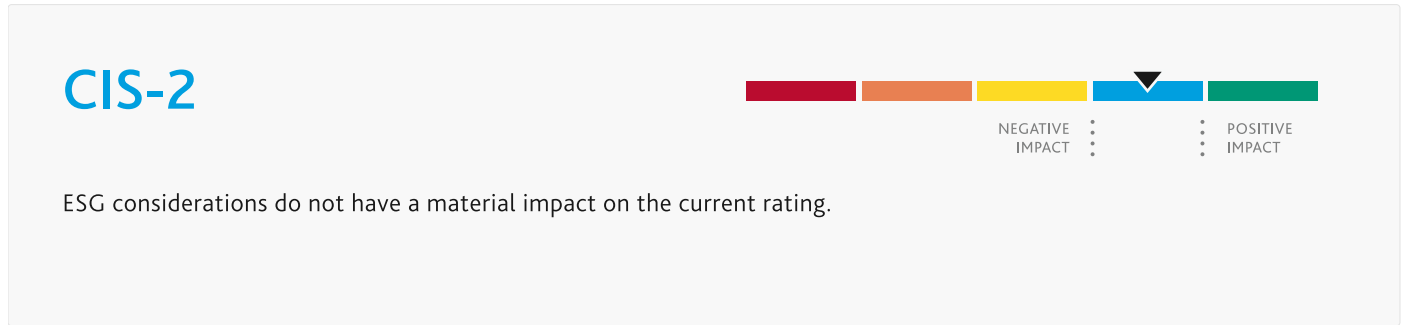
been modestly below its Moody's calculated "tread water" mark, or the contribution level required to keep pension liabilities from growing given plan assumptions.

Reported OPEB liabilities were a modest \$2.4 million at the end of 2023. The city funds its OPEB expenses on a pay-as-you-go basis and the utility's share is limited to the implicit subsidy associated with retiree healthcare.

ESG considerations

Seattle (City of) WA Water Enterprise's ESG credit impact score is CIS-2

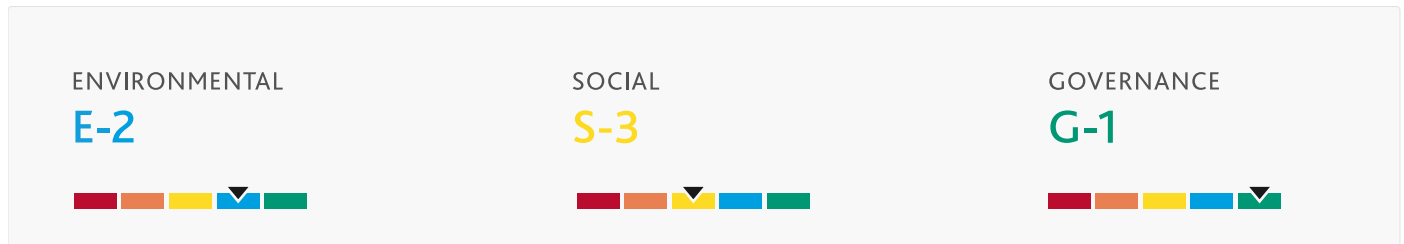
Exhibit 3
ESG credit impact score



Source: Moody's Ratings

Seattle Water, WA's ESG credit impact score of **CIS-2** indicates that ESG reflects neutral-to-low exposure to environmental risks, moderately negative exposure to social risks, and positive governance considerations.

Exhibit 4
ESG issuer profile scores



Source: Moody's Ratings

Environmental

The system's environmental risk score of (**E-2**), reflects low exposure to all environmental risk categories: carbon transition, natural capital, water management, waste and pollution, and physical climate risks. Long-term environmental challenges include sea level rise and the greater frequency of extreme rainfall. Positively, the system is not affected by the current drought conditions in the greater state of Washington.

Social

The system's social risk score is (**S-3**), primarily reflecting water utilities' exposure to responsible production risk, which we view as moderately negative across the environmental sector. Testing results reported to the Environmental Protection Agency indicate that most utilities provide clean and safe drinking water and Seattle Water notes they have no PFAS in the water supply. However, water utilities are at risk of health violations resulting from catastrophic events, changes in source water quality, failures in treatment or transmission processes or revised regulations. While rate affordability is a potential challenge, the enterprise benefits from positive exposure to demographic and societal trends, such as positive population trends and a highly educated workforce .

Governance

Seattle Water's governance score is (**G-1**). The system benefits from positive financial strategy and risk management considerations. Management credibility and track record considerations are also positive. Exposure to organizational structure and compliance and reporting considerations are neutral-to-low. Exposure to board structure, policies and procedures risk due to their lack of independent rate setting authority is a slight negative, reflecting the concentrated control of the system's operations by Seattle's city council.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moody's.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

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