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Summary:

Seattle, Washington; Water/Sewer

Primary Credit Analyst:
Chloe S Weil, San Francisco + 1 (415) 371 5026; chloe.weil@spglobal.com

Secondary Contact:
Malcolm N D'Silva, Englewood + 1 (303) 721 4526; malcolm.dsilva@spglobal.com

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Credit Profile		
US$69.215 mil wtr sys imp rev bnds ser 2024 due 10/01/2054		
Long Term Rating	AA+/Stable	New
Seattle wtr		
Long Term Rating	AA+/Stable	Affirmed
Seattle wtr (BHAC) (SEC MKT)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Credit Highlights

- S&P Global Ratings assigned its 'AA+' long-term rating to Seattle, Wash.'s approximately $68 million series 2024 water system revenue bonds.
- At the same time, S&P Global Ratings affirmed its 'AA+' rating on the city's outstanding water system parity debt.
- The outlook is stable.

Security

Proceeds from series 2024 issuance will be used to fund $70 million of upcoming water system capital needs.

The bonds are secured by a pledge of net revenue 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 $61.5 million (funded with both cash and sureties), well above the debt service reserve fund requirement of approximately $38.3 million.

The system presently has $583.4 million of parity water system bonds outstanding as well as $18.6 million of subordinate state loans.

Credit overview

As a result of Seattle Public Utilities' (SPU's) proactive water resources management, Seattle is exempt from the drought emergency, which was declared for most of the state of Washington in April 2024. SPU monitors reservoir, weather, and precipitation conditions daily; makes frequent real-time and dynamic operational adjustments; and models future scenarios out several months to ensure it can meet downstream river conditions and have sufficient water for its customers. During the last 30 years, the city has not needed to implement mandatory water curtailments, and it forecasts that it has sufficient water supply through at least 2060. While system-wide consumption fell slightly in 2020 due to COVID-related restrictions, it rebounded to its pre-2020 average in 2021, which we consider credit supportive, and regional water conservation programs and other water-use reductions are expected to continue offsetting the effects of population and employment growth on water demand.

Beyond Seattle's plentiful water supply and storage, the rating is further supported by its broad customer base, which includes many of the city's suburbs served under long-term wholesale contracts, as well as comprehensive financial policies, conservative forecasting, and modest rate plans, which together indicate that the water system's financial metrics should remain consistent with historical trends despite escalating capital spending during the five-year forecast period.

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 151% of the national level in 2023, and the projected local gross product growth rate exceeds that of the U.S. as a whole by 1%, according to IHS Markit. Unemployment is very low, and last stood at 2.1% as of March 2024;
- City Council's demonstrated ability and willingness to increase service rates, with multiyear rate schedules that we believe promote cost recovery and revenue stability;
- Modest adopted rate increases through 2024 which average 2% per annum through 2026, however, we consider SPU to have somewhat constrained rate affordability due to the 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 $245, which we consider sizable, at about 3.5% of 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 encounter political pressure to minimize future rate increases;
- Slight decline in all-in debt service coverage (DSC) in fiscal 2023 primarily as a result of pension liability accruals as well as other inflationary cost pressures.
- Sound pro forma financial metrics, based on our assessment of SPU's proactive debt management practices, conservative budgeting based on known increases and localized CPI escalators, and current plans to fund approximately 24% of the upcoming capital improvement plan (CIP) on a pay-as-you-go basis. The city levies a relatively sizable tax of 15.54% upon gross retail revenue, therefore our calculation of all-in debt service coverage (DSC) differs from the city's as we net out the payment of taxes to the city from revenue.
- Strong liquidity, with $106 million (or 226 days' cash on hand) available as of Dec. 31, 2023. We do not expect SPU to draw cash down materially during the next five years. While unexpected, increased general fund transfers in addition to the existing tax (which would violate the Washington State Accountancy Act) would weaken the system's credit rating, potentially by several notches; and
- Favorable debt capacity, due to flat to declining debt service, having defeased approximately $100 million of high-interest bond debt in 2021 and 2022. While the upcoming CIP totals about $742 million through 2029, with additional planned debt during the next five years layered in, we do not expect the system's financial profile to diminish to the point that metrics 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, which we consider a key credit strength, we recognize that climate risks resulting in extreme weather events, sea-level rise, and drought could pressure system operations over time. Pacific

Northwest winters are projected to become warmer and wetter, with 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. Management does not expect material costs for it to comply with the evolving PFAS national primary drinking water regulation or the revised lead and copper rule.

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.

Outlook

Downside scenario

We do not anticipate lowering the rating during the two-year outlook horizon given SPU's approved rate plans and financial policies. While unexpected, a significant increase in capital spending would negatively pressure the rating.

Upside scenario

Although elements of SPU's credit quality could support a higher rating, a positive rating action would require improvement in SPU's market position assessment and overall financial metrics to levels commensurate with its 'AAA' rated peers.

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 19% of system revenue come from this customer class, which may slightly understate coverage. The top two wholesale customers by revenue are Cascade Water Alliance (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 a declining annual volume thereafter.

Seattle, Washington--economic and financial data

		Fiscal year-end			
	Most recent	**2023**	**2022**	**2021**	**Median (AA+)**
Economic data					
Water customers	201,847				34,150
Sewer customers	--				34,070
MHHEBI of the service area as % of the U.S.	151.0				110.0
Unemployment rate (%)	3.9				3.4
Poverty rate (%)	8.5				9.9
Water rate (6,000 gallons or actual) ($)	55.0				36.0
Sewer rate (6,000 gallons or actual) ($)	183.0				43.0
Annual utility bill as % of MHHEBI	0.7				1.0
Operational Management Assessment	Good				Good
Financial data					
Gross revenues ($000s)		301,496	290,869	303,499	41,079
Total operating expenses less depreciation ($000s)		199,444	169,474	166,402	29,720
Net revenues available for debt service ($000s)		120,186	119,102	146,303	--
Debt service ($000s)		83,632	80,719	82,527	--
S&P Global Ratings-adjusted all-in DSC (x)		1.4	1.5	1.8	2.4
Unrestricted cash ($000s)		106,297	88,984	103,020	47,258
Days' cash of operating expenses		195	192	226	588
Total on-balance-sheet debt ($000s)		624,223	759,489	687,182	73,325
Debt-to-capitalization ratio (%)		43.2	49.6	49.0	24.5
Financial Management Assessment	Strong	--	--	--	Good

Note: Most recent economic data available from our vendors. MHHEBI--Median household effective buying income. DSC--Debt service coverage.

Related Research

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