



REPORT OF INDEPENDENT AUDITORS AND FINANCIAL  
STATEMENTS WITH REQUIRED SUPPLEMENTARY  
INFORMATION AND OTHER INFORMATION

**KING COUNTY WATER QUALITY ENTERPRISE FUND  
(AN ENTERPRISE FUND OF KING COUNTY, WASHINGTON)**

January 1 – December 31, 2020

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## Report of Independent Auditors

The Metropolitan King County Council  
Seattle, Washington

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the King County Water Quality Enterprise Fund (the Fund), which comprise the statement of net position as of December 31, 2020, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the King County Water Quality Enterprise Fund as of December 31, 2020, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, the Schedule of the County's Proportionate Share of the Net Pension Liability, Schedule of the County's Contributions, and Schedule of the County's Changes in total OPEB Liability and Related Ratios be presented to supplement the basic financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other Information*

Our audit was conducted for the purpose of forming an opinion on the Fund's financial statements. The Supplemental Schedule of Debt Service Coverage Ratios and Supplemental Schedule of Historical Debt Service are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The other information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

## **Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated April 30, 2021, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

*Moss Adams LLP*

Seattle, Washington  
April 30, 2021

# King County Water Quality Enterprise Fund Management's Discussion and Analysis

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The management of King County Water Quality Enterprise Fund (Water Quality) presents to readers of its financial statements this narrative overview and analysis of its activities and financial performance for the fiscal year ended December 31, 2020 with comparative information to 2019.

## The Sewer System

Water Quality provides regional wastewater treatment services to Western Washington in King County, part of Snohomish County, and part of Pierce County with a service area encompassing over 424 square miles. The major wastewater treatment facilities include three secondary treatment plants at West Point in Seattle, South Plant in Renton and the Brightwater Treatment Plant located near Woodinville and two smaller secondary treatment plants at Vashon Island and Carnation, 397 miles of conveyance lines, 48 pump stations, and 25 regulator stations. Other facilities include four combined sewer overflow (CSO) treatment plants and 39 CSO control locations. The sewer system collected and treated an average of 178 million gallons per day (MGD) in 2020 from approximately 2.0 million residents.

## Financial Highlights

During 2020, Water Quality provided sewage treatment services to 767,265 residential customer equivalents (RCE) compared to 763,436 in 2019. An RCE is one single-family residence or an equivalent unit of 750 cubic feet of monthly water consumption for all other customers such as multifamily residential, commercial, and industrial properties. The capacity charge program added 6,522 new connections to its customer billing base in 2020 compared to 12,513 new connections in 2019. In 2020, the average flow of the five treatment plants was 178 MGD with a peak daily flow of 596 MGD compared with a 2019 average flow of 161 MGD and peak daily flow of 752 MGD. Maximum system capacity remained unchanged at 868 MGD in 2020. The annual fluctuation in flows largely depends on the amount of annual precipitation.

In 2020, resource recovery delivered 117,092 tons compared to 124,958 tons in 2019 of Loop® biosolids to customers for use in forest management, agriculture, and composting. Approximately 74.1 million gallons of Class A reclaimed water was distributed for irrigation, urinals/toilets, municipal purposes, and wetland enhancement compared to 82.3 million gallons in 2019 and about 724 million gallons of filtered, treated wastewater were used for internal treatment plant processes compared to 719 million gallons in 2019. The permitted capacity for the South Plant reclaimed water facility is a filter feed loading of 1.3 MGD and the Brightwater permitted reclaimed water treatment capacity is 12 MGD.

Water Quality sold 2.8 million therms of natural gas to Puget Sound Energy from the South Treatment Plant in 2020 and 2.7 million therms in 2019. Congressional action under the Energy Independence Security Act and subsequent rulemaking by the Environmental Protection Agency (EPA) created an opportunity for Water Quality to monetize the environmental benefit of its biofuel through the generation and sale of environmental attributes called RINS (Renewable Identification Numbers). In November 2016, King County entered an agreement with IGI Resources, Inc., for the sale of bio-methane from South Plant and the corresponding RINS. In 2020, RINS revenues were \$3.9 million from which \$1.1 million was paid for operational costs to fulfill the administrative and operations requirements of the contract and to improve the operation of the biogas system. In 2019, RINS revenue totaled \$2.8 million from which \$800 thousand was paid for operational and administrative costs and improvement of the operation of the biogas system. The 45 percent increase in 2020 costs associated with maximizing RINS revenue relates to damage of a natural gas pipeline in early 2019. West Point Treatment Plant sold Seattle City Light 16.9 million kilowatt hours of electricity generated from digester gas in 2020 and 15.3 million kilowatt hours in 2019.

# King County Water Quality Enterprise Fund Management's Discussion and Analysis

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## Financial Highlights (continued)

The Industrial Pretreatment Program conducted 213 inspections and took 1,540 compliance samples in 2020 compared to 244 inspections and 1,712 compliance samples taken in 2019. The program currently tracks 558 facilities with discharge authorization permits and 102 significant industrial users compared to 545 facilities with discharge authorization permits and 104 significant industrial users in 2019.

In 1999, the Metropolitan King County Council adopted the Regional Wastewater Services Plan (RWSP) to construct additional capacity, protect public health and provide for future projected population growth in its service area through 2030. Major RWSP projects include improvements to the regional Conveyance system and CSO control projects. Total capital program expenditures were \$199.6 million in 2020.

Water Quality currently has 39 CSO locations plus four CSO treatment facilities. Past investments conducted in concert with the City of Seattle have resulted in a significant reduction in combined sewer overflows from a baseline of 2.3 billion gallons per year in years 1980–1983 to an average of 1 billion gallons per year at present.

In 2012, the EPA entered a consent decree (CD) with Water Quality to reduce CSO overflows to meet the regulator's standards for discharges or treatment by 2030. The consent decree is based on Water Quality's 2012 Amended Long-term CSO Control Plan (the Plan). The Plan amended the original total of 21 CSO projects to 13 projects that will control 18 CSO locations. By 2018, five projects were either completed or operational and under monitoring for compliance. At present, four of the remaining eight projects are underway, including a joint project with the City of Seattle to control two King County CSO locations.

In October 2019, King County formally requested, and subsequently has begun negotiations to modify King County's CD with EPA and Ecology to address changed conditions since the CD was signed. These changed conditions include substantially higher cost estimates for planned CSO control projects, climate change impacts, anticipated future increases in regulatory requirements for nutrient discharges to Puget Sound and rate affordability. Any potential modification agreed to by EPA, Ecology and the U.S. District Court would also need King County Council approval.

The EPA and Washington State Department of Ecology (DOE) will monitor Water Quality's progress with CSO control and work closely with the enterprise going forward to meet CSO control requirements. In accordance with the county's National Pollutant Discharge Elimination System (NPDES) permit for the West Point Treatment Plant and the consent decree, a review of the CSO Program was submitted to the DOE as part of the West Point permit renewal, stating no changes to the Plan. The next update to the Plan is due to the DOE and EPA in 2024 as part of the next West Point NPDES permit renewal.

Water Quality operating revenues fell by 1.2 percent, or \$6.5 million, to \$529.9 million in 2020 from \$536.4 million in 2019 while operating expenses before depreciation and amortization increased by 7.4 percent, or \$10.7 million, to \$154.5 million in 2020 from \$143.8 million in 2019. The main driver of the operating revenue reduction was a 9.3 percent decrease in capacity charge revenue. The increase in operating expenses before depreciation and amortization is reflected in IT services, labor costs, and actuarial changes in the estimation of pension expense.

# King County Water Quality Enterprise Fund Management's Discussion and Analysis

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## Financial Highlights (continued)

The RCE's billed for sewer treatment services increased to 767,265 in 2020 from 766,436 (based on sewer revenues that include sewer agency prior year adjustments) in 2019. Capacity charge revenues decreased 9.3 percent, or \$9.5 million, to \$92.6 million in 2020 from \$102.1 million in 2019. The capacity charge rate increased to \$66.35 per RCE in 2020 from \$64.50 per RCE in 2019, however, the number of new sewer connections decreased by 47.9 percent and early capacity charge payoffs decreased by 41.0 percent. The County allows the capacity charge to be prepaid on a discounted basis at the customer's option. The discount rate reflects the 15-year mortgage and 10- and 20-year Treasury rates and was 2.6 percent in 2020 and 3.6 percent in 2019. In June of 2020, the County Council adopted a capacity charge of \$68.34, a 3.0 percent increase, along with a 4.5 percent sewer rate increase to \$47.37 for 2021.

The rate stabilization reserve, as mandated by the Metropolitan King County Council as part of its rate setting activities, permits Water Quality to set aside a portion of current revenue for future periods in order to moderate the impact of rate increases over time. The rate stabilization reserve was unchanged at \$46.3 million in 2020. Future deposits to the rate stabilization reserve will decrease operating revenues and debt service coverage in the year of the deposit. Withdrawals will have the opposite effect of increasing operating revenues and debt service coverage in the year the rate stabilization reserve is reduced.

In 2020 Water Quality issued debt to refund existing bonds and fund its capital program, and voluntarily redeemed and defeased existing debt using funding from operations and excess bond reserves. Water Quality received \$36.6 million in low interest state loans at rates between 2.6 and 2.7 percent. More detail can be found in the Debt Administration section of this analysis and in Note 5 of the financial statements.

## Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to Water Quality's basic financial statements. The basic financial statements are comprised of the statement of net position; statement of revenues, expenses and changes in net position; statement of cash flows; and the notes to the financial statements, which explain certain elements of the financial statements in greater detail.

Water Quality's financial statements provide information with respect to all its activities using accounting methods like those used by private-sector companies. The statements provide both long-term and short-term information about Water Quality's financial status.

The statement of net position presents information on all of Water Quality's assets, liabilities, and deferred inflows/outflows of resources, with the difference presented as net position as of yearend. Over time, the statements demonstrate Water Quality's financial health by providing a basis for the reader to evaluate capital structure, liquidity, and financial flexibility.

# King County Water Quality Enterprise Fund Management's Discussion and Analysis

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## Overview of the Financial Statements (continued)

The most recent year's operating, and non-operating revenues and expenses of Water Quality are accounted for in the statement of revenues, expenses, and changes in net position. The statement illustrates the current period results of operations and recovery of costs by receipt of fees and are instrumental in demonstrating Water Quality's continued creditworthiness. All changes in net position are reported as soon as the underlying event occurs, irrespective of the timing of related cash flows. The receipt of monthly sewage treatment charges provides the principal support for Water Quality's activities. Sewage treatment charges of \$417.3 million provided 78.7 percent of operating revenues in 2020. Water Quality is a wholesale provider of sewage treatment services to 34 municipal and 3 non-municipal participants in King, Pierce, and Snohomish counties. The receipt of the monthly payments is governed by service agreements, the majority of which expire in July 2036.

The statement of cash flows reports cash receipts, cash payments, and net changes in cash derived from operations, financing, and investment activities. From the statement, the reader can discern Water Quality's sources and applications of cash during 2020, reasons for differences between operating cash flows and operating income, and the effect on the statement of net position from investing, capital, and financing activities.

The notes to financial statements provide additional information essential to obtain a full understanding of the data provided in the basic statements.

In the following analysis of the financial statements, percentages and ratios were calculated and rounded using the actual detail from the financial statements.

## King County Water Quality Enterprise Fund Management's Discussion and Analysis

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### Financial Analysis of the Statement of Net Position

Comparative data, stated in millions of dollars:

|   | <u>Years Ended December 31,</u> |                 |
|---|---------------------------------|-----------------|
|   | <u>2020</u>                     | <u>2019</u>     |
| Current assets                                      | \$ 404.5                        | \$ 381.1        |
| Noncurrent restricted assets                        | 335.9                           | 289.1           |
| Capital assets                                      | 4,093.7                         | 4,112.8         |
| Other   | <u>150.6</u>                    | <u>124.8</u>    |
| Total assets  | 4,984.7                         | 4,907.8         |
| Deferred outflows of resources                      | <u>175.4</u>                    | <u>188.9</u>    |
| Total assets and deferred outflows of resources     | <u>5,160.1</u>                  | <u>5,096.7</u>  |
| Current liabilities                                 | 221.1                           | 216.2           |
| Noncurrent liabilities                              | <u>3,989.5</u>                  | <u>3,994.3</u>  |
| Total liabilities                                   | 4,210.6                         | 4,210.5         |
| Deferred inflows of resources                       | <u>55.9</u>                     | <u>59.5</u>     |
| Total liabilities and deferred inflows of resources | <u>4,266.5</u>                  | <u>4,270.0</u>  |
| Net position - net investment in capital assets     | 431.8                           | 405.1           |
| Net position - restricted                           | 238.7                           | 230.6           |
| Net position - unrestricted                         | <u>223.1</u>                    | <u>191.0</u>    |
| Total net position                                  | <u>\$ 893.6</u>                 | <u>\$ 826.7</u> |

Net position serves as a useful indicator of Water Quality's financial position. As of December 31, 2020, assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by \$893.6 million.

Of the total Water Quality assets and deferred outflows of resources, 79.3 percent or \$4,093.7 million were invested in capital assets such as treatment plants, pumping and regulator stations, interceptors, and other equipment at year-end 2020. For the year-end 2019, 80.7 percent or \$4,112.8 million were invested in capital assets. Water Quality uses its capital assets to provide wholesale wastewater collection and treatment services in King, Pierce, and Snohomish counties. Current operating and debt service requirements are met by operating and non-operating revenues composed of monthly sewage treatment charges, a capacity charge for new customers, other special-handling charges, miscellaneous operating revenues, and investment earnings.

# King County Water Quality Enterprise Fund Management's Discussion and Analysis

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## Financial Analysis of the Statement of Net Position (continued)

The net position increased by 8.1 percent or \$66.9 million in 2020 to \$893.6 million from \$826.7 million in 2019. Restricted net position increased by 3.5 percent or \$8.1 million in 2020 to \$238.7 million from \$230.6 million in 2019. The unrestricted net position increased by \$32.1 million in 2020 to \$223.1 million from \$191.0 million in 2019.

## Financial Analysis of the Statement of Revenues, Expenses, and Changes in Net Position

Comparative data, stated in millions of dollars:

|                                  | Years Ended December 31, |                 |
|----------------------------------|--------------------------|-----------------|
|                                  | 2020                     | 2019            |
| Sewage treatment fees            | \$ 417.3                 | \$ 415.3        |
| Capacity charge revenue          | 92.6                     | 102.1           |
| Other revenue                    | 20.0                     | 19.0            |
| Operating revenues               | 529.9                    | 536.4           |
| Operating expenses               | 344.4                    | 323.3           |
| Operating income                 | 185.5                    | 213.1           |
| Nonoperating revenues (expenses) | (118.7)                  | (132.1)         |
| Grant revenues                   | 0.1                      | -               |
| Change in net position           | 66.9                     | 81.0            |
| Net position beginning of year   | 826.7                    | 745.7           |
| Net position end of year         | <u>\$ 893.6</u>          | <u>\$ 826.7</u> |

While the statement of net position show changes in assets, liabilities, deferred inflows/outflows of resources and net position, the statement of revenues, expenses and changes in net position provide insight into the source of these changes.

In late March of 2020, Washington's Governor issued a stay-at-home order and the closing of all non-essential businesses in response to the COVID-19 pandemic. Despite the challenges brought by COVID-19, Water Quality continued to protect public health by treating our region's sewage and ensuring its infrastructure's resiliency. Water Quality has developed mitigation strategies to lessen the impact of any revenue loss with debt service savings in the form of low bond market interest rates and operating cost controls. During 2020, operating revenues decreased by 1.2 percent or \$6.5 million to \$529.9 million from \$536.4 million in 2019. Operating expenses increased by 6.5 percent, or \$21.1 million to \$344.4 million in 2020 from \$323.3 million in 2019.

# King County Water Quality Enterprise Fund Management's Discussion and Analysis

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## Financial Analysis of the Statement of Revenues, Expenses, and Changes in Net Position (continued)

### Operating Revenues

In 2020, sewage disposal fee revenue increased by 0.5 percent, or \$2.0 million to \$417.3 million from \$415.3 million in 2019. This increase in sewage disposal fee revenue reflects a portion of reported usage prior to the pandemic. Water Quality charged a monthly sewage treatment rate of \$45.33 per RCE in both 2020 and 2019.

Capacity charge revenue fell 9.3 percent, or \$9.5 million to \$92.6 million in 2020 compared to \$102.1 million in 2019. New sewer connections dropped 47.9 percent to 6,522 in 2020 from 12,513 in 2019 and early payoffs revenues fell 41.0 percent to \$18.5 million in 2020 from \$31.3 million in 2019. These reductions in growth reflect the pandemic's effect on the local economy.

Other operating revenues totaling \$20.0 million in 2020 increased \$1.0 million, or 5.3 percent, compared to \$19.0 million in 2019. The increase was due to a 39.3 percent increase in RINS revenue from \$2.8 million in 2019 to \$3.9 million in 2020.

### Operating Expenses

In 2020, operating expenses, excluding depreciation, rose 7.4 percent or \$10.7 million to \$154.5 million compared to a 3.1 percent increase, or \$143.8 million in 2019. This change is due primarily to changes in pension expense and to increased accrued vacation leave expense associated with the COVID-19 pandemic.

Utility and Service costs increased 1.7 percent, or \$600 thousand from \$35.6 million in 2019 to \$36.2 million in 2020. Electricity costs in 2020 rose by 3.3 percent, or \$500 thousand, to \$15.6 million from \$15.1 million in 2019. Natural gas and water utility costs decreased 32.0 percent from \$2.5 million in 2019 to \$1.7 million in 2020. Chemical costs increased less than \$100 thousand or 0.3 percent in 2020 to \$9.5 million. These essential operational costs are subject to market price fluctuation.

Intragovernmental expenses rose 3.3 percent, to \$40.8 million in 2020 from \$39.5 million in 2019 due to increased technology services.

### Non-operating Revenues and Expenses

Non-operating expenses (net) decreased by \$13.5 million to \$118.6 million in 2020 from \$132.1 million in 2019. Lower interest rates and receipt of an insurance settlement contributed to the greater portion of this decrease.

# King County Water Quality Enterprise Fund Management's Discussion and Analysis

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## Capital Assets

At December 31, 2020, Water Quality's investment in capital assets, net of accumulated depreciation, was \$4,093.7 million, reflecting a decrease of \$19.1 million or 0.5 percent less than the balance of \$4,112.8 million at December 31, 2019.

Large 2020 construction project expenditures include:

- \$48.5 million for Georgetown Wet Weather Treatment Station
- \$22.6 million for Joint Ship Canal CSO Control
- \$ 7.5 million for Sunset and Heathfield Pump Stations and Force Main Upgrade
- \$ 5.4 million for West Point Treatment Plan OGADS replacement
- \$ 5.3 million for Ovation Control Systems upgrade

Large 2019 construction project expenditures include:

- \$44.3 million for Georgetown Wet Weather Treatment Station
- \$23.6 million for Eastside Interceptor Phase 11
- \$15.8 million for Sunset and Heathfield Pump Stations and Force Main Upgrade
- \$ 7.8 million for North Mercer Island and Enatai Interceptor upgrade
- \$ 7.1 million for Ovation Control Systems upgrade

For more information on capital assets, refer to Note 7 in the financial statements.

# King County Water Quality Enterprise Fund Management's Discussion and Analysis

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## Debt Administration

In January of 2020, Water Quality voluntarily redeemed \$1.8 million of principal on its Junior Lien Multi-Modal Limited Tax General Obligation Refunding Bonds, Series 2017A and B. This is part of a financial practice whereby variable rate debt will be amortized so that each issue will be retired by its stated maturity date. In July of 2020, Water Quality voluntarily redeemed \$2.7 million of principal on its Sewer Revenue and Refunding Bonds, Series 2010.

On July 14, 2020, Water Quality issued \$200.6 million in Junior Lien Sewer Revenue Refunding Bonds, Series 2020A and Series 2020B to refund \$200.0 million of Junior Lien Sewer Revenue Bonds, Series 2001A, Series 2001B and Series 2011. These term bonds bear fixed interest rates of 0.6 and 0.9 percent, respectively, and are subject to mandatory repurchase in January 2024 and January 2026, respectively.

On August 4, 2020, Water Quality issued \$179.5 million in Sewer Improvement and Refunding Revenue Bonds, Series 2020A with an effective interest rate of 2.6 percent and an average life of 20.4 years to refund \$28.3 million of Sewer Revenue and Refunding Bonds, Series 2010, with an average coupon interest rate of 4.3 percent. This debt issue provided \$180.2 million of proceeds for the capital program. On August 4, 2020, Water Quality also issued \$186.7 million in Sewer Refunding Revenue Bonds, Series 2020B with an effective interest rate of 1.9 percent and an average life of 11.1 years to refund \$167.0 million in Sewer Refunding Revenue Bonds, Series 2012B, Series 2012C, Series 2013A and Series 2016B, with an average coupon interest rate of 5.0 percent.

On December 11, 2020, Water Quality purchased and deposited U.S. Treasury securities in an escrow to pay interest and redeem at their earliest redemption dates \$80.0 million of outstanding Sewer Revenue and Refunding Bonds, Series 2012. Funding for the escrow came from operations and excess bond reserves.

Water Quality has \$2.6 billion of sewer revenue bonds and variable rate revenue bonds outstanding at the end of 2020 and had \$2.6 billion of sewer revenue bonds and variable rate revenue bonds outstanding at the end of 2019. Revenue bonds are repaid from and secured by a pledge of earnings, revenues and money received by Water Quality from or on account of operation of the sewer system, including receipts from sewage treatment fees, and other income of Water Quality. Revenue bonds are not guaranteed by the full faith and credit of King County.

At the end of 2020, Water Quality has \$814.7 million of general obligation bonds and variable rate general obligation bonds outstanding and had \$839.4 million of general obligation bonds and variable rate general obligation bonds outstanding at the end of 2019. While the full faith and credit of King County guarantees repayment of principal and interest on general obligation bonds, they are paid from sewage treatment fees and other income.

King County Sewer Enterprise parity revenue bonds ratings of Aa1 from Moody's Investors Services (Moody's) and AA+ from Standard and Poor's (S&P) Global Ratings were affirmed in June 2020 and December 2020, respectively. Water Quality's ratings on its limited tax general obligation bonds of Aaa from Moody's and AAA from S&P were both affirmed in October 2019.

# King County Water Quality Enterprise Fund Management's Discussion and Analysis

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## Debt Administration (continued)

As required by bond covenant, Water Quality maintains a bond reserve account, which is funded by cash, Treasury securities investment and surety bond policies. At December 31, 2020, the cash and investment balance in the reserve account was \$128.8 million and with a surety bond balance of \$29.6 million, totaling \$158.4 million. This balance exceeded the reserve account requirement of maximum annual debt service on the parity bonds by \$294 thousand. In 2020, excess funds in the reserve account of \$11.6 million were contributed to the refunding and defeasance of outstanding debt. At December 31, 2020 and 2019, respectively, the rate stabilization, liquidity, and asset management financial policy reserves totaled \$82.0 million.

For more detailed information on debt, refer to Note 5 in the financial statements.

## Debt Service Coverage Ratios

|                             | Year Ended December 31, |      |
|-----------------------------|-------------------------|------|
|                             | 2020                    | 2019 |
| Parity and parity lien debt | 1.78                    | 1.85 |
| Total debt                  | 1.56                    | 1.58 |

Two debt service coverage ratios closely monitored by bond rating agencies are coverage on parity debt and coverage on total debt. By bond ordinance, Water Quality sets sewer rates at a level adequate to provide net revenue equal to at least 1.15 times the annual debt service requirement on parity debt. Water Quality has an adopted policy to equal or exceed a ratio of at least 1.25 on parity debt or 0.10 above the ratio required by bond ordinance. Since 2001, Water Quality established a minimum coverage policy of 1.15 on total debt to further strengthen coverage performance.

## Requests for Information

This financial report is designed to provide an overview of Water Quality's financial condition as of the year ended December 31, 2020. Questions concerning this report or requests for additional information should be addressed to Cheryl Lee, Chief Accountant for King County, 500 Fourth Avenue, Room 653, Seattle, WA 98104.

# King County Water Quality Enterprise Fund

## Statement of Net Position (in thousands)

|  | December 31,<br>2020       |
|--|----------------------------|
| <b>CURRENT ASSETS</b>                                  |                            |
| Cash and cash equivalents                              | \$ 353,058                 |
| Restricted cash and cash equivalents                   | 1,463                      |
| Accounts receivable, net                               | 37,749                     |
| Due from other funds                                   | 2,524                      |
| Due from other governments, net                        | 133                        |
| Inventory of supplies                                  | 9,543                      |
| Prepayments  | 29                         |
|  | <u>404,499</u>             |
| <b>NONCURRENT ASSETS</b>                               |                            |
| Restricted assets                                      |                            |
| Cash and cash equivalents                              | 319,416                    |
| Investments  | 16,473                     |
|  | <u>335,889</u>             |
| Capital assets   |                            |
| Building and land improvements                         | 2,190,369                  |
| Infrastructure and right of way                        | 2,513,249                  |
| Plant in service and other equipment                   | 1,212,096                  |
| Less accumulated depreciation                          | <u>(2,584,290)</u>         |
|  | 3,331,424                  |
| Land and easements                                     | 264,775                    |
| Artwork  | 1,023                      |
| Construction work in progress                          | 496,428                    |
|  | <u>4,093,650</u>           |
| Other noncurrent                                       |                            |
| Regulatory assets, net of amortization                 | 142,864                    |
| Other assets   | 7,797                      |
|  | <u>150,661</u>             |
| Total assets   | <u>4,984,699</u>           |
| <b>DEFERRED OUTFLOWS OF RESOURCES</b>                  |                            |
| Deferred outflows on refunding                         | 167,499                    |
| Deferred outflows on other postemployment benefits     | 84                         |
| Deferred outflows on pension                           | 7,205                      |
| Deferred outflows on asset retirement obligations      | 662                        |
|  | <u>175,450</u>             |
| <b>TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</b> | <u><u>\$ 5,160,149</u></u> |

**King County Water Quality Enterprise Fund**  
**Statement of Net Position (continued) (in thousands)**

|  | December 31,<br>2020 |
|--|----------------------|
| <b>CURRENT LIABILITIES</b>                                 |                      |
| Accounts payable   | \$ 30,849            |
| Retainage payable  | 1,463                |
| Due to other funds   | 12                   |
| Interest payable   | 65,015               |
| Wages and benefits payable                                 | 5,632                |
| Compensated absences, current portion                      | 783                  |
| Other postemployment benefits, current portion             | 102                  |
| Taxes payable  | 12                   |
| Unearned revenue   | 3,173                |
| State loans payable, current portion                       | 17,610               |
| General obligation bonds payable, current portion          | 17,670               |
| Revenue bonds payable, current portion                     | 71,950               |
| Environmental remediation liability, current portion       | 6,751                |
| Other liabilities, current portion                         | 71                   |
|  | 221,093              |
| <b>NONCURRENT LIABILITIES</b>                              |                      |
| Compensated absences                                       | 12,015               |
| Other postemployment benefits                              | 1,612                |
| Net pension liability                                      | 8,074                |
| State loans payable, net                                   | 227,861              |
| General obligation bonds payable, net                      | 871,935              |
| Revenue bonds payable, net                                 | 2,745,449            |
| Environmental remediation liability                        | 42,567               |
| Asset retirement obligation                                | 1,350                |
| Other liabilities  | 78,691               |
|  | 3,989,554            |
| Total liabilities  | 4,210,647            |
| <b>DEFERRED INFLOWS OF RESOURCES</b>                       |                      |
| Regulatory credits - rate stabilization                    | 46,250               |
| Deferred inflows on refunding                              | 1,693                |
| Deferred inflows on other postemployment benefits          | 229                  |
| Deferred inflows on pension                                | 7,685                |
|  | 55,857               |
| Total deferred inflows of resources                        | 55,857               |
| <b>TOTAL LIABILITIES AND DEFERRED INFLOWS OF RESOURCES</b> | <b>4,266,504</b>     |
| <b>NET POSITION</b>  |                      |
| Net investments in capital assets                          | 431,793              |
| Restricted for   |                      |
| Debt service   | 142,429              |
| Regulatory assets and environmental liabilities            | 96,322               |
| Unrestricted   | 223,101              |
|  | 893,645              |
| Total net position   | <b>\$ 893,645</b>    |

**King County Water Quality Enterprise Fund**  
**Statement of Revenues, Expenses, and Changes in Net Position (in thousands)**

|   | Year Ended<br>December 31,<br>2020 |
|---|------------------------------------|
| OPERATING REVENUES                                |                                    |
| Sewage disposal fees                              | \$ 417,361                         |
| Capacity charge revenues                          | 92,622                             |
| Miscellaneous revenues                            | 19,956                             |
| Total operating revenues                          | <u>529,939</u>                     |
| OPERATING EXPENSES                                |                                    |
| Personnel services                                | 59,039                             |
| Materials and supplies                            | 18,474                             |
| Contract service and other charges                | 18,869                             |
| Utilities   | 17,345                             |
| Internal services                                 | 40,786                             |
| Depreciation and amortization                     | 171,844                            |
| Miscellaneous expenses                            | 18,098                             |
| Total operating expenses                          | <u>344,455</u>                     |
| OPERATING INCOME                                  | <u>185,484</u>                     |
| NONOPERATING REVENUES (EXPENSES)                  |                                    |
| Investment earnings                               | 11,443                             |
| Interest expense                                  | (129,592)                          |
| Federal, state, and other operating subsidies     | 138                                |
| Loss on disposal and impairment of capital assets | (2,372)                            |
| Loss on extinguishment of debt                    | (1,266)                            |
| Other   | 3,092                              |
| Total nonoperating revenues (expenses), net       | <u>(118,557)</u>                   |
| CHANGE IN NET POSITION                            | 66,927                             |
| NET POSITION                                      |                                    |
| Beginning of year                                 | <u>826,718</u>                     |
| End of year                                       | <u>\$ 893,645</u>                  |

## King County Water Quality Enterprise Fund Statement of Cash Flows (in thousands)

|   | Year Ended<br>December 31,<br>2020 |
|---|------------------------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                     |                                    |
| Cash received from customers                                    | \$ 529,183                         |
| Cash received from other funds - internal services              | 1,911                              |
| Cash payments to suppliers for goods and services               | (55,466)                           |
| Cash payments to other funds - internal services                | (40,798)                           |
| Cash payments for employee services                             | (61,768)                           |
| Other receipts  | 12,292                             |
| Other payments  | (37,220)                           |
| Net cash provided by operating activities                       | 348,134                            |
| <b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>          |                                    |
| Operating grants and subsidies                                  | 4                                  |
| Transfers in  | 150                                |
| Transfers out   | (894)                              |
| Assistance to others  | (2,249)                            |
| Net cash used in noncapital financing activities                | (2,989)                            |
| <b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b> |                                    |
| Acquisition of capital and other utility assets                 | (157,953)                          |
| Principal paid on capital debt                                  | (107,444)                          |
| Interest paid on capital debt                                   | (150,315)                          |
| Proceeds of new bond issuance                                   | 180,736                            |
| Proceeds of state loans   | 36,634                             |
| Cash payments for bond defeasance                               | (85,920)                           |
| Subsidies and other receipts                                    | 63                                 |
| Net cash used in capital and related financing activities       | (284,199)                          |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                     |                                    |
| Purchase of investments   | (1,500)                            |
| Proceeds from sale and maturity of investments                  | 1,518                              |
| Interest on investments   | 11,279                             |
| Net cash provided by investing activities                       | 11,297                             |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>                | 72,243                             |
| <b>CASH AND CASH EQUIVALENTS</b>                                |                                    |
| Beginning of year   | 601,694                            |
| End of year   | \$ 673,937                         |

# King County Water Quality Enterprise Fund

## Statement of Cash Flows (in thousands)

|  | Year Ended<br>December 31,<br>2020 |
|--|------------------------------------|
| <b>RECONCILIATION OF OPERATING INCOME TO NET<br/>CASH PROVIDED BY OPERATING ACTIVITIES</b> |                                    |
| Operating income   | <u>\$ 185,484</u>                  |
| Adjustments to reconcile operating income to net cash<br>provided by operating activities  |                                    |
| Depreciation and amortization  | 171,844                            |
| Other nonoperating revenue   | 10,465                             |
| Changes in assets  |                                    |
| Accounts receivable  | 2,396                              |
| Due from other funds   | 1                                  |
| Inventory of supplies  | 82                                 |
| Prepayments  | (18)                               |
| Other assets   | (25,817)                           |
| Changes in deferred outflows of resources  |                                    |
| Deferred outflows on other postemployment benefits   | (48)                               |
| Deferred outflows on pension   | (2,035)                            |
| Deferred outflows on asset retirement obligations  | 588                                |
| Changes in liabilities   |                                    |
| Accounts payable   | (689)                              |
| Retainage payable  | (152)                              |
| Due to other funds   | (12)                               |
| Taxes payable  | (3)                                |
| Unearned revenue   | 207                                |
| Wages and benefits payable   | 730                                |
| Compensated absences   | 1,681                              |
| Other postemployment benefits  | 188                                |
| Net pension liability  | 2,112                              |
| Other liabilities  | 6,488                              |
| Changes in deferred inflows of resources   |                                    |
| Deferred inflows on other postemployment benefits  | 125                                |
| Deferred inflows on pension  | <u>(5,483)</u>                     |
| Total adjustments  | <u>162,650</u>                     |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>   | <u><u>\$ 348,134</u></u>           |

### NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Water Quality issued bonds in 2020 to refund debt issued from 2010 to 2016. The \$414.8 million of bond proceeds and \$4.6 million of cash payments by Water Quality were placed in escrow for the defeasance of \$395.3 million of outstanding bond principal and \$20.2 million of interest.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 1 – Operations and Accounting Policies

**Summary of operations** – The King County Water Quality Enterprise Fund (Water Quality) is an enterprise fund operated by the King County Department of Natural Resources and Parks in accordance with Chapter 35.58 of the Revised Code of Washington (RCW) to provide sewage treatment and water pollution abatement services to the urbanized areas of King County, Washington (the County).

Water Quality is an integral part of the County reporting entity and is included, as an enterprise fund, in the County's comprehensive annual financial report. As an enterprise fund, Water Quality is funded and operated separately from other operations of the County. Revenues, bond proceeds, and grants are restricted by purpose. Accordingly, Water Quality maintains separate accounting records and issues stand-alone financial statements.

Water Quality has long-term sewage disposal agreements with the cities and sewer districts that operate sewage collection systems within its service area. The monthly sewage disposal charge to the contracting cities and districts is based on Water Quality's estimated annual monetary requirements, including operating costs and debt service. Revenues from Water Quality's largest customer, the City of Seattle (Seattle Public Utilities), represent approximately 39.3 percent of total sewage disposal fees in 2020.

Water Quality purchases goods and services from other County agencies, including reimbursement of the County's general fund for a share of general government. Expenses incurred in doing business with other County agencies amounted to \$40.8 million in 2020.

**Significant accounting policies** – Water Quality is accounted for using the flow of economic resources measurement focus similar to that of a private enterprise organized for profit. Water Quality's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units using the accrual basis of accounting. Under this method, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred. Water Quality, regardless of the timing of cash flows, applies all applicable Governmental Accounting Standards Board (GASB) pronouncements.

- a. **Cash and cash equivalents** – Water Quality considers as cash and cash equivalents demand deposits, cash with escrow agent, and all balances held with the King County Treasurer in the King County Investment Pool (the Pool) except the amounts invested through the Pool-Plus program. Water Quality records its investments in the Pool-Plus program at fair value. Unrealized gain or loss on Water Quality's proportionate share of the pooled investments and individual investments is reported as a component of investment earnings.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 1 – Operations and Accounting Policies (continued)

b. **Receivables and allowance for doubtful accounts** – Receivables include charges for services rendered by Water Quality or intergovernmental grants. All unbilled service receivables are recorded at year-end. The provisions for estimated uncollectible receivables are reviewed and updated at year-end. These provisions are estimated based on actual historical write-off trends and knowledge of specific circumstances that indicate collection of an account may be unlikely. Water Quality has the ability to place a lien on properties owned by customers for uncollected capacity charges. Water Quality reported notes receivable of \$5.0 million at 2020 year-end for capacity charge account balances over 365 days old.

c. **Due from and to other funds, interfund loans, and advances** – Due from and to other funds consists of current receivables and payables from or to other funds within the County. They typically arise from interfund goods and service transactions and reimbursements.

Interfund loans receivable and payable or advances from and to other funds represent authorized short-term and long-term, respectively, lending and borrowing arrangements within the County.

d. **Inventory of supplies** – Inventory is recorded at the lower of cost or market using the weighted-average cost method. Materials and supplies are expensed as consumed. Inventory is written off in the year that it is determined obsolete.

e. **Restricted assets** – In accordance with Water Quality’s bond resolutions, state law, King County codes, or other agreements, separate restricted assets have been established. These assets are restricted for specific purposes, including bond and state loan reserves.

f. **Capital assets** – Capital assets are stated at cost, less accumulated depreciation and amortization. Water Quality’s capitalization threshold is: equipment at \$5 thousand; software and intangible assets at \$500 thousand, and buildings and improvements at \$100 thousand. Provision for depreciation and amortization is made on a straight-line basis over the estimated useful lives of Water Quality’s capital assets as follows:

| Description                                     | Estimated Useful Life |
|---|-----------------------|
| Buildings and improvements other than buildings | 10–75 years           |
| Cars, vans, and trucks                          | 5–10 years            |
| Data processing equipment                       | 3–10 years            |
| Heavy equipment                                 | 5–25 years            |
| Sewer lines                                     | 20–50 years           |
| Shop equipment                                  | 5–20 years            |
| Software  | 3–10 years            |
| Intangibles                                     | 35 years              |

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 1 – Operations and Accounting Policies (continued)

Repairs and maintenance are expensed as incurred; major renewals, replacements, and betterments are capitalized.

Water Quality annually reviews long-lived assets for impairment to determine whether any events or circumstances indicate the carrying value of the assets may not be recoverable. No impairment was identified in 2020.

- g. **Compensated absences** – Employees earn vacation based upon their date of hire and years of service. Employees hired prior to January 1, 2018, have a maximum vacation accrual of 480 hours, while those hired January 1, 2018, or after have a maximum vacation accrual of 320 hours unless the employee’s collective bargaining unit agreement specifies a different maximum. Unused vacation at retirement or normal termination is considered vested and payable to the employee, up to the employee’s maximum accrual. Employees also earn up to 12 days of sick leave per year and may accumulate sick leave balances without limit. If the employee is leaving their employment due to death or retirement, they are paid for 35 percent of the value of unused sick leave with no maximum. Vacation pay, a portion of sick leave liabilities, and compensatory time in lieu of overtime pay, including payroll taxes, are accrued.

Water Quality accrues estimated excess compensation liabilities to the Washington State Department of Retirement Systems based on an employee’s accrued vacation and sick leave. An excess compensation liability is incurred when an employee whose retirement benefits are based in part on excess compensation receives a termination or severance payment defined by the State as excess compensation. This includes, but is not limited to, a cash-out of unused annual leave in excess of 240 hours and a cash-out of any other form of leave.

- h. **Rebatable arbitrage** – Water Quality’s tax-exempt debt is subject to arbitrage restrictions as defined by the Internal Revenue Code. Arbitrage occurs when the funds borrowed at tax-exempt rates of interest are invested in higher yielding taxable securities. These interest earnings in excess of interest expense must be remitted to the federal government except when spending exception rules are met. The liability is recognized during the period the excess interest is earned. Water Quality has no liability as of December 31, 2020.
- i. **Deferred outflows and inflows of resources** – Deferred outflows of resources represent consumption of resources that is applicable to future reporting periods and deferred inflows of resources represent acquisition of resources that is applicable to future reporting periods. Deferred outflows of resources include deferred losses on refunding of bonds and certain amounts related to pension, postemployment benefits other than pensions (OPEB) and asset retirement obligations. Deferred inflows of resources include rate stabilization, deferred gains on refunding of bonds, and certain amounts related to pension and OPEB.
- j. **Unearned revenues** - Unearned revenues are obligations of Water Quality to perform services or provide goods. This account offsets reported assets for revenues that have not met recognition requirements, including prepayments for capacity charges.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 1 – Operations and Accounting Policies (continued)

- k. **Operating and nonoperating revenues and expenses** – Operating revenues result from exchange transactions of Water Quality’s activities. Expenses associated with providing wastewater treatment services and operating Water Quality’s treatment facilities are considered operating. Nonoperating revenues result from nonexchange transactions such as operating subsidies and investment earnings.

Water Quality provides water treatment services to cities and sewer districts and recognizes revenue when such service is provided. Additionally, the capacity charge revenue is generated from new connections to the sewer system. Both water treatment service and capacity charge rates are authorized by ordinances passed by the King County Council. Water treatment service and capacity charge revenues are recorded through cycle billings rendered to customers monthly. Water Quality accrues and records unbilled water service and capacity charge revenues in the financial statements for services provided from the date of the last billing to year-end.

- l. **Debt-related amortization** – Bond premiums, discounts and refunding losses and gains are amortized over the life of the bonds using the outstanding principal balance method.
- m. **Capital grant revenues** – Pursuant to GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, grant revenues for capital purposes are reported separately from operating and nonoperating revenues as capital grant revenues.
- n. **Net position** – Resources set aside for debt service and other obligations, net of related liabilities, are classified as restricted net position on the statements of net position as their use is limited by externally-imposed restrictions. Net investments in capital assets are reported as a separate component of net position and consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, notes, or other liabilities attributable to the acquisition, construction, or improvement of those assets. Any net position not subject to classification as restricted or invested in capital assets is reported as unrestricted.
- o. **Net position flow assumption** – Sometimes Water Quality will fund outlays for a particular purpose from both restricted (e.g., restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to be reported as restricted net position and unrestricted net position, a flow assumption must be made about the order in which the resources are considered to be applied. It’s the County’s policy to consider restricted net position to have been depleted before unrestricted net position is applied.
- p. **Use of estimates** – The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Specific estimates have been made in the areas of allowance for uncollectible accounts, environmental remediation costs, useful lives of capital assets, asset retirement obligations, pension and other postemployment benefits liabilities and related deferred outflows and inflows of resources, and future interest rates. Actual results could differ from these estimates.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 1 – Operations and Accounting Policies (continued)

**New accounting standards** – The following GASB pronouncement was implemented during 2020.

GASB Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, was issued in May 2020. This statement is aimed to provide temporary relief to governments and other stakeholders in light of the COVID-19 pandemic by postponing the effective dates of certain provisions in Statements and Implementation Guides that first became effective or are scheduled to become effective for periods beginning after June 15, 2018, and later. As a result, Water Quality will implement GASB Statement No. 87, *Leases*, in 2021 instead of 2020.

### Note 2 – Deposits and Investments in King County Investment Pool

The King County Treasurer is the custodian of Water Quality's cash. Water Quality's cash on deposit with the King County Treasurer is pooled with cash from other County funds and other jurisdictions and are either deposited in the County's bank account or invested by the County. The King County Investment Pool (the Pool) functions essentially as a demand deposit account where Water Quality receives an allocation of its proportionate share of pooled earnings as interest.

The Pool is administered by the King County Treasury Operations Section and is not registered with the Securities and Exchange Commission (SEC) as an investment company. Oversight is provided by the King County Executive Finance Committee (EFC), which serves the role of the County Finance Committee as defined in RCW 36.48.070.

The County has deposit and investment policies addressing risks that have the potential to result in losses of deposits and investments. The deposits that are not covered by the Federal Deposit Insurance Corporation (FDIC) are collateralized by the Public Deposit Protection Commission of the State of Washington (PDPC) at no less than fifty percent. Effective June 7, 2018, resolution 2018-1 adopted by Commission on June 1, 2018, allowed "all well capitalized public depositories may collateralize uninsured public deposits at no less than fifty percent." The PDPC is a statutory authority established under Chapter 39.58 RCW that governs public depositories and provides that "all public funds deposited in public depositories, including investment deposits and accrued interest thereon, shall be protected against loss, as provided in the chapter." It constitutes a multiple financial institution collateral pool that can make *pro rata* assessments to all public depositories within the state for their public deposits. PDPC protection is of the nature of collateral, not of insurance.

The custodial credit risk for deposits is the risk that Water Quality's deposits may not be returned to it in the event of a bank failure. State statutes require that certificates of deposit be placed in qualified public depositories in the State of Washington and total deposits cannot exceed the net worth of the financial institution. Those institutions not meeting 100 percent collateralization or the minimum credit rating requirements may receive deposits up to the FDIC or federally guaranteed amounts. The County's diversification policy limits the maximum amount of investment in certificates of deposit to 25 percent of the total amount of the portfolio and five percent from a single issuer.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 2 – Deposits and Investments in King County Investment Pool (continued)

Assessing Water Quality’s risk exposure, Water Quality’s cash and cash equivalents balance of \$673.9 million were fully invested in the Pool as of December 31, 2020. The County had demand deposits of \$24.9 million as of December 31, 2020, of which \$9.5 million was exposed to custodial credit risk as uninsured and uncollateralized.

The EFC adopted the Pool-Plus program which allows County agencies or junior taxing districts to invest funds beyond the maximum maturity limit established for the Pool. This policy provides an investment option that allows a participant in the Pool to combine a portfolio of individual long-term securities in the same fund that is invested in the Pool. The pooling of the long-term portfolio with the Pool provides the ability to invest at durations longer than the Pool while maintaining access to the liquidity of the Pool. The Pool-Plus program allows qualifying funds to invest over longer durations recognizing there are: (1) potential risks such as increased price volatility and the possibility of selling securities before maturity to pay unexpected expenditures could result in a loss of principal; (2) benefits from reducing reinvestment risk which improves the predictability of future budget revenue; (3) and potential rewards such as increased earnings.

The Pool is used for the liquidity portion of the portfolio while the following investment types are used for the longer-term investments:

- U.S. treasuries or securities with full faith and credit of the U.S. government backing them.
- Senior debt obligations issued by U.S. agencies, instrumentalities, or government-sponsored enterprises such as Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB), Federal Farm Credit Bank (FFCB), and Federal Home Loan Mortgage Corporation (FHLMC). While these agencies have credit ratings equivalent to the U.S. government, they are not explicitly guaranteed by the U.S. government. Financial market participants view them as having an “implied guarantee” because these agencies were chartered by Congress.

Water Quality participated in the Pool-Plus program starting in 2018 and reported individual investments at \$16.5 million as of December 31, 2020, which comprises fair value of \$16.4 million and interest accrual of \$90 thousand on its investments. The following schedule shows the types of investments, the average interest rate, and the effective duration limits of the Pool-Plus program at December 31, 2020 (dollars in thousands):

|                     | <u>Fair Value</u> | <u>Principal</u> | <u>Average<br/>Interest Rate</u> | <u>Effective<br/>Duration (Yrs)</u> |
|---------------------|-------------------|------------------|----------------------------------|-------------------------------------|
| Investment type     |                   |                  |                                  |                                     |
| U.S. Treasury notes | \$ 16,383         | \$ 15,228        | 2.47%                            | 4.280                               |

The U.S. Treasury notes are valued using quoted prices in active markets. The U.S. Treasury notes with AA credit rating are backed by full faith and credit of the U.S. government.

## King County Water Quality Enterprise Fund Notes to Financial Statements

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### Note 2 – Deposits and Investments in King County Investment Pool (continued)

**Credit risk – investments** – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. As of December 31, 2020, the Pool was not rated by a Nationally Recognized Statistical Rating Organization (NRSRO). In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. federal agency securities and mortgage-backed securities, municipal securities and corporate notes (rated at least “A” by two NRSROs), commercial paper (rated at least the equivalent of “A-1” by two NRSROs), certificates of deposit issued by qualified public depositories, repurchase agreements, and the Local Government Investment Pool managed by the Washington State Treasurer’s office.

The Pool’s policies limit the maximum amount that can be invested in various securities. At 2020 year-end the Pool was in compliance with these policies. The Pool’s actual composition, as of December 31, 2020, is as follows (in thousands):

| Investment type                                    | Total        | Allocation<br>Percentage |
|--|--------------|--------------------------|
| Repurchase agreements                              | \$ 366,000   | 4.54%                    |
| Commercial paper                                   | 449,859      | 5.58%                    |
| U.S. Agency discount notes                         | 424,851      | 5.27%                    |
| Corporate notes                                    | 423,828      | 5.26%                    |
| Corporate notes floating rate                      | 32,559       | 0.40%                    |
| U.S. Treasury notes                                | 1,125,620    | 13.98%                   |
| U.S. Agency notes                                  | 2,394,289    | 29.73%                   |
| U.S. Agency collateralized<br>mortgage obligations | 2,565        | 0.03%                    |
| Supranational coupon notes                         | 1,854,671    | 23.03%                   |
| State treasurer's investment pool                  | 981,309      | 12.18%                   |
|  | \$ 8,055,551 | 100.00%                  |

**Custodial credit risk – investments** – Custodial credit risk is the risk that in the event of the failure of the counterparty, the County will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. County policy mandates that all security transactions, including repurchase agreements, are settled “delivery versus payment (DVP).” This means that payment is made simultaneously with the receipt of the security. These securities are delivered to the County’s safekeeping bank or its tri-party custodian banks. Exempt from the DVP policy are Certificates of Deposits (CDs) and funds placed with the State of Washington Local Government Investment Pool.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 2 – Deposits and Investments in King County Investment Pool (continued)

**Concentration of credit risk – investments** – Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issue. At 2020 year-end, the Pool had concentrations greater than 5.0 percent of the total investment pool portfolio in the following issuers: Federal Home Loan and Mortgage Corporation, 13.5 percent; International Bank Reconstruction and Development, 9.0 percent; Federal National Mortgage Association, 8.2 percent; Federal Farm Credit Banks, 7.3 percent; Federal Home Loan Banks, 6.0 percent; Bank of Montreal, 5.8 percent; Inter-American Development Bank, 5.7 percent.

**Interest rate risk – investments** – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Through its investment policy, the County manages its exposure to fair value losses arising from increasing interest rates by setting maturity and effective duration limits for the Pool. The policy limit for the Pool's maximum effective duration is 1.5 years, and 40 percent of the Pool's total value in securities must have a maturity of 12 months or fewer. Securities in the portfolio cannot have an average life greater than five years at purchase. The combined effective duration of the liquidity and core portfolios was 1.198 years at December 31, 2020.

All securities are reported at fair value. Fair value reports are prepared monthly and distributed to all Pool participants. The Pool values participants' shares using an amortized cost basis. Monthly income is distributed to participants based on their relative participation during the period.

**Fair value hierarchy** – The County categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure fair value of the assets. Level 1 inputs are quoted prices in an active market for identical assets; Level 2 inputs are significant other observable inputs; and Level 3 inputs are significant unobservable inputs.

## King County Water Quality Enterprise Fund Notes to Financial Statements

### Note 2 – Deposits and Investments in King County Investment Pool (continued)

The following is a summary of inputs in valuing the County's investments as of December 31, 2020 (in thousands):

| Investments by Fair Value Level  | Fair Value<br>12/31/2020 | Fair Value Measurement Using   |   |                                     |
|--|--------------------------|--|---|-------------------------------------|
|  |                          | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Unobservable<br>Inputs<br>(Level 3) |
| Commercial paper   | \$ 449,859               | \$ -   | \$ 449,859  | \$ -                                |
| U.S. agency discount notes   | 424,851                  | -  | 424,851   | -                                   |
| Corporate notes  | 423,828                  | -  | 423,828   | -                                   |
| Corporate notes floating rate  | 32,559                   | -  | 32,559  | -                                   |
| U.S. treasury notes  | 1,125,620                | 1,125,620  | -   | -                                   |
| U.S. agency notes  | 2,394,289                | -  | 2,394,289   | -                                   |
| U.S. agency collateralized<br>mortgage obligations                           | 2,565                    | -  | 2,565   | -                                   |
| Supranational coupon notes   | 1,854,671                | -  | 1,854,671   | -                                   |
| <b>Subtotal</b>  | <b>6,708,242</b>         | <b>\$ 1,125,620</b>  | <b>\$ 5,582,622</b>                                       | <b>\$ -</b>                         |
| Investments Measured at Amortized Cost (Not Subject to Fair Value Hierarchy) |                          |  |   |                                     |
| Repurchase agreements  | 366,000                  |  |   |                                     |
| State treasurer's investment pool  | 981,309                  |  |   |                                     |
| <b>Subtotal</b>  | <b>1,347,309</b>         |  |   |                                     |
| <b>Total investments in Investment Pool</b>                                  | <b>\$ 8,055,551</b>      |  |   |                                     |

U.S. Treasury notes are valued using quoted prices in active markets and classified in Level 1 of the fair value hierarchy.

Commercial Paper, U.S. Agency Discount Notes, Corporate Notes, U.S. Agency Notes, U.S. Agency Collateralized Mortgage Obligations and Supranational Coupon Notes are valued using standard inputs including benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications. Interactive Data also monitors market indicators, industry and economic events and corroborating market data and are classified in Level 2 of the fair value hierarchy.

State Treasurer's Investment Pool and Repurchase Agreement are overnight securities and are recorded at amortized cost.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 3 –Restricted Assets

A significant portion of Water Quality’s assets are restricted to use by legal and contractual provisions and by fiscal management policy. Restricted assets comprise cash and cash equivalents of \$320.9 million and investments of \$16.5 million at December 31, 2020, to comply with bond covenants and other requirements.

Liability amounts payable from restricted assets primarily consist of escrow and in-house retainage payables. These amounted to \$1.5 million at December 31, 2020. The details of cash and cash equivalents and restricted assets as of December 31, 2020, are as follows (in thousands):

|   |                          |
|---|--------------------------|
| Unrestricted cash and cash equivalents                              |                          |
| Operating funds   | \$ 81,142                |
| Construction funds  | 18,314                   |
| Bond funds  | 139,803                  |
| Unallocated insurance recoveries                                    | 78,004                   |
| Policy reserves   | <u>35,795</u>            |
| Total unrestricted cash and cash equivalents                        | <u>353,058</u>           |
| Restricted cash and cash equivalents                                |                          |
| Bond reserves   | 112,290                  |
| SRF loan reserves   | 13,666                   |
| Bond proceeds committed to construction                             | 147,205                  |
| Retainage and deposits  | 1,468                    |
| Rate stabilization reserve  | <u>46,250</u>            |
| Total restricted cash and cash equivalents                          | <u>320,879</u>           |
| Total cash and cash equivalents                                     | <u>673,937</u>           |
| Restricted investments  |                          |
| Bond reserves   | <u>16,473</u>            |
| Total restricted assets - cash and cash equivalents and investments | <u><u>\$ 337,352</u></u> |

## King County Water Quality Enterprise Fund Notes to Financial Statements

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### Note 4 – Risk Management

Water Quality is exposed to a wide range of risks of loss, including those related to tort; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters.

Water Quality participates in three County internal service funds to account for and finance its (1) property/casualty, (2) workers' compensation, and (3) employee medical and dental benefits, through self-insurance programs. The County contracts with a plan administrator to process medical and dental claims. County fund/claims managers, together with the Civil Division of the King County Prosecuting Attorney's Office, are responsible for processing all tort and workers' compensation claims.

Water Quality claims paid by the Insurance Fund of King County were \$51 thousand during 2020. In the past three years there was no occurrence that resulted in payment in excess of the self-insured retention of \$6.5 million.

Claims settlements and loss expenses are accrued in the three internal service funds for the estimated settlement value of both reported and unreported claims. These funds are responsible for collecting interfund premiums from insured funds and departments, for paying claim settlements, and for purchasing certain policies. The County's internal service funds assess premiums attributable to Water Quality on the basis of claims experience, actuarial evaluation of future claims risk, and adequacy of available reserves. Premiums are recorded as an expense in the year paid or accrued.

Water Quality retains all risk associated with environmental claims.

### Note 5 – Long-Term Liabilities

**Sewer revenue bonds** – As of December 31, 2020, bonds outstanding include \$2,598.9 million of serial and term bonds maturing from January 1, 2021, through January 1, 2052, bearing interest at stated rates of 0.3 percent to 5.0 percent per annum.

In July of 2020, the County voluntarily redeemed \$2.7 million of principal on its Sewer Revenue and Refunding Bonds, Series 2010, to reduce future debt service.

On July 14, 2020, the County issued \$200.6 million of Junior Lien Sewer Revenue Refunding Bonds, Series 2020A (\$100.3 million) and Series 2020B (\$100.3 million) to refund \$100.0 million of the County's Junior Lien Sewer Revenue Bonds, Series 2001A and Series 2001B, the letter of credit support for which was scheduled to expire on September 30, 2020, and \$100.0 million of the County's Junior Lien Sewer Revenue Bonds, Series 2011, which became callable on June 1, 2020. The 2020A and 2020B term bonds bear fixed interest rates of 0.6 and 0.9 percent, respectively, and are subject to mandatory repurchase in January 2024 and January 2026, respectively. The bond maturity dates of January 1, 2032 and January 1, 2042 remain the same. The refunding of the Series 2011 bonds was undertaken to reduce total debt service payments by \$590 thousand through the mandatory put date of December 1, 2020, resulting in an economic gain (difference between the present values of the old and new debt service payments) of \$590 thousand.

## King County Water Quality Enterprise Fund

### Notes to Financial Statements

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#### Note 5 – Long-Term Liabilities (continued)

On August 4, 2020, the County issued \$179.5 million in Sewer Improvement and Refunding Revenue Bonds, Series A, with an effective interest rate of 2.6 percent. The proceeds were used to fund the Water Quality capital program and refund \$28.3 million of outstanding Sewer Revenue and Refunding Bonds, Series 2010, with an average coupon interest rate of 4.3 percent. The net carrying amount of the refunded debt exceeded the reacquisition price by \$1.7 million. This refunding was undertaken to reduce total debt service payments by \$15.3 million over the life of the bonds, resulting in an economic gain (difference between the present values of the old and new debt service payments) of \$9.0 million.

On August 4, 2020, the county also issued \$186.7 million in Sewer Refunding Revenue Bonds, Series B, with an effective rate of 1.9 percent to refund \$167.0 million of outstanding Sewer Revenue Refunding Bonds Series 2012B, 2012C, 2013A and Sewer Improvement and Refunding Revenue Bonds, Series 2016B with an average coupon interest rate of 5.0 percent. The reacquisition price exceeded the net carrying amount of the refunded debt by \$11.3 million. This refunding was undertaken to reduce total debt service payments by \$43.7 million over the life of the bonds, resulting in an economic gain (difference between the present values of the old and new debt service payments) of \$36.5 million.

On December 11, 2020, the County purchased Treasury securities at a cost of \$85.9 million and placed them in an escrow to pay interest and redeem at their earliest redemption dates \$80.0 million of outstanding Sewer Revenue and Refunding Bonds, Series 2012. Funding for the escrow came from operations and excess in bond reserves. Water Quality undertook the defeasance to reduce future debt service.

Bond issues provide funding for Water Quality's construction plan. Certain serial bonds may not be redeemed prior to maturity; other bonds may be redeemed after the lapse of specific periods of time. Amounts from the sewer revenue bond fund may be used to purchase term bonds prior to maturity.

The bonds are secured by a pledge of the revenue of the sewer system subject to payment of all operating and maintenance expenses of the sewer system. Payments from revenues of Water Quality are required to be made to the sewer revenue bond fund to pay interest and retire serial or term bonds on or before maturity. The amount required in the cash reserves and surety policies are based on the highest year of debt service over the life of all outstanding revenue bonds.

## King County Water Quality Enterprise Fund

### Notes to Financial Statements

#### Note 5 – Long-Term Liabilities (continued)

The following table summarizes Water Quality's revenue bonds (in thousands):

|                                      | Final<br>Maturity | Interest<br>Rates | Original<br>Issue<br>Amount | Outstanding at<br>December 31,<br>2020 |
|--------------------------------------|-------------------|-------------------|-----------------------------|--|
| 2011 Sewer Revenue                   | 1/1/41            | 5.00%             | 175,000                     | 4,175                                  |
| 2011 Series B                        | 1/1/41            | 1.00-5.00%        | 494,270                     | 29,445                                 |
| 2011 Series C                        | 1/1/35            | 3.00-5.00%        | 32,445                      | 7,885                                  |
| 2012A Refunding                      | 1/1/52            | 5.00%             | 104,445                     | 9,785                                  |
| 2012B Refunding                      | 1/1/35            | 4.00-5.00%        | 64,260                      | 13,640                                 |
| 2012C Refunding                      | 1/4/33            | 2.50-5.00%        | 65,415                      | 14,345                                 |
| 2012 Sewer Junior Lien Variable      | 1/1/43            | (variable)        | 100,000                     | 100,000                                |
| 2013A Refunding                      | 1/1/35            | 2.00-5.00%        | 122,895                     | 45,930                                 |
| 2013B Revenue and Refunding          | 1/1/44            | 2.00-5.00%        | 74,930                      | 54,680                                 |
| 2014A Refunding                      | 1/1/47            | 5.00%             | 75,000                      | 75,000                                 |
| 2014B Refunding                      | 7/1/35            | 1.00-5.00%        | 192,460                     | 175,500                                |
| 2015A Refunding                      | 7/1/47            | 3.00-5.00%        | 474,025                     | 467,735                                |
| 2015B Refunding                      | 1/1/46            | 4.00-5.00%        | 93,345                      | 70,895                                 |
| 2016A Refunding                      | 7/1/41            | 4.00-5.00%        | 281,535                     | 269,175                                |
| 2016B Refunding                      | 7/1/49            | 4.00-5.00%        | 499,655                     | 447,070                                |
| 2017A Refunding                      | 7/1/49            | 5.00%             | 149,485                     | 122,305                                |
| 2018B Sewer Revenue                  | 7/1/32            | 5.00%             | 124,455                     | 124,455                                |
| 2020A Refunding                      | 1/1/52            | 1.63-5.00%        | 179,530                     | 179,530                                |
| 2020B Refunding                      | 1/1/40            | 0.27-2.48%        | 186,745                     | 186,745                                |
| 2020A Refunding Junior Lien Variable | 1/1/32            | (variable)        | 100,295                     | 100,295                                |
| 2020B Refunding Junior Lien Variable | 1/1/42            | (variable)        | 100,295                     | 100,295                                |
|                                      |                   |                   | <u>\$ 3,690,485</u>         | <u>\$ 2,598,885</u>                    |

**General obligation bonds** – As of December 31, 2020, bonds outstanding include \$814.7 million of serial and term bonds maturing January 1, 2021, through January 1, 2046, bearing interest at stated rates of 2.0 percent to 5.3 percent per annum.

Certain serial bonds cannot be redeemed prior to maturity; other bonds may be redeemed after the lapse of specific periods of time.

In January of 2020, the County voluntarily redeemed \$1.8 million of principal on its Junior Lien Multi-Modal Limited Tax General Obligation Refunding bonds, Series 2017A and B, to reduce future debt service.

## King County Water Quality Enterprise Fund

### Notes to Financial Statements

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#### Note 5 – Long-Term Liabilities (continued)

The following table summarizes Water Quality's general obligation bonds (in thousands):

|                          | Final<br>Maturity | Interest<br>Rates | Original<br>Issue<br>Amount | Outstanding at<br>December 31,<br>2020 |
|--------------------------|-------------------|-------------------|-----------------------------|--|
| 2008 LTGO                | 1/1/34            | 5.25%             | \$ 236,950                  | \$ 21,020                              |
| 2012A LTGO               | 1/1/25            | 2.00-5.00%        | 68,395                      | 41,360                                 |
| 2012B LTGO               | 1/1/29            | 5.00%             | 41,725                      | 30,500                                 |
| 2012F LTGO               | 12/1/22           | 2.20%             | 3,010                       | 3,010                                  |
| 2015A LTGO               | 7/1/38            | 2.00-5.00%        | 247,825                     | 239,465                                |
| 2017A LTGO               | 1/1/34            | 4.00-5.00%        | 154,560                     | 131,970                                |
| 2017A-B Multi-Modal LTGO | 1/1/40            | (variable)        | 100,000                     | 98,225                                 |
| 2019A LTGO               | 1/1/38            | 5.00%             | 101,035                     | 101,035                                |
| 2019A Multi-Modal LTGO   | 1/1/46            | (variable)        | 100,000                     | 100,000                                |
| 2019B Multi-Modal LTGO   | 1/1/46            | (variable)        | 48,095                      | 48,095                                 |
|                          |                   |                   | <u>\$ 1,101,595</u>         | <u>\$ 814,680</u>                      |

**Prior year refunded and defeasance of debt** – As of December 31, 2020, Water Quality had outstanding refunded and defeased general obligation bonds and sewer revenue bonds in the amount of \$802.6 million, of which \$556.0 million were for the bonds defeased prior to 2020. Water Quality defeased these bonds by placing proceeds of the refunding bonds and/or existing cash from Water Quality in irrevocable trust accounts to provide for future debt service payments on the defeased bonds. The liability for the defeased bonds has been removed from Water Quality's financial statements.

**State loans** – Water Quality has received loans from the Washington State Department of Ecology under the Water Pollution Control State Revolving Fund Loan Program and the Washington Public Works Trust Fund. The loans require either semi-annual or annual payments of principal and interest from 2021 through 2053 and bear interest at stated rates from 0.0 percent to 3.1 percent. As of December 31, 2020, the balance due on all state loans is \$245.5 million and the unused portion of state loan agreements is \$19.8 million. Water Quality maintains separate cash reserves of \$13.7 million as of December 31, 2020. These reserves are treated as restricted, being required under the Revolving Fund Loan Program.

## King County Water Quality Enterprise Fund Notes to Financial Statements

### Note 5 – Long-Term Liabilities (continued)

State loans are secured by a subordinate lien on the net revenues of the system. Events of default under the loan agreements with the Department of Ecology include nonpayment of amounts due, failure to commence the project for which the loan was granted and unjustified failure to perform loan agreement obligations. Remedies include suspending any undisbursed loan proceeds and acceleration of the outstanding balance, provided that the loan is not subject to acceleration if any sewer revenue bonds are outstanding. Any state funds owed to the County may also be withheld. Events of default under the loan agreements with the Public Works Trust Fund include nonpayment of amounts due and failure to use loan proceeds for permitted activities. Remedies include withholding of any undisbursed loan proceeds, assessment of additional interest and notification to creditors.

**Water Infrastructure Finance and Innovation Act (WIFIA) loan** – Water Quality has a \$134.5 million WIFIA loan agreement with the U.S. Environmental Protection Agency. No draws have been taken on this loan as of December 31, 2020. The WIFIA loan, after draws are made, will be secured by a pledge of revenue of the sewer system subject to payment of all operating and maintenance expenses of the sewer system.

At December 31, 2020, the required principal and interest payments for all classes of long-term debt are as follows (in thousands):

| Year(s) Beginning    | Revenue Bonds       |                     | General Obligation Bonds |                   | State Loans       |                  | Total               |
|----------------------|---------------------|---------------------|--------------------------|-------------------|-------------------|------------------|---------------------|
|                      | Principal           | Interest            | Principal                | Interest          | Principal         | Interest         |                     |
| January 1, 2021      | \$ 71,950           | \$ 99,785           | \$ 17,670                | \$ 40,375         | \$ 17,610         | 5,579            | \$ 252,969          |
| January 1, 2022      | 64,025              | 97,881              | 29,885                   | 39,313            | 16,990            | 5,239            | 253,333             |
| January 1, 2023      | 74,255              | 94,938              | 37,485                   | 37,865            | 16,325            | 4,902            | 265,770             |
| January 1, 2024      | 73,410              | 91,552              | 28,055                   | 36,239            | 17,086            | 4,554            | 250,896             |
| January 1, 2025      | 65,575              | 88,103              | 29,445                   | 34,830            | 16,264            | 4,190            | 238,407             |
| January 1, 2026-2030 | 397,120             | 389,930             | 188,215                  | 150,631           | 64,922            | 16,058           | 1,206,876           |
| January 1, 2031-2035 | 574,860             | 302,184             | 155,700                  | 105,148           | 56,436            | 8,474            | 1,202,802           |
| January 1, 2036-2040 | 499,620             | 207,405             | 180,130                  | 68,440            | 17,001            | 3,786            | 976,382             |
| January 1, 2041-2045 | 551,270             | 102,426             | -                        | 39,988            | 8,056             | 2,582            | 704,322             |
| January 1, 2046-2050 | 207,995             | 22,870              | 148,095                  | 7,995             | 9,201             | 1,449            | 397,605             |
| January 1, 2051-2053 | 18,805              | 666                 | -                        | -                 | 5,580             | 224              | 25,275              |
|                      | <u>\$ 2,598,885</u> | <u>\$ 1,497,740</u> | <u>\$ 814,680</u>        | <u>\$ 560,824</u> | <u>\$ 245,471</u> | <u>\$ 57,037</u> | <u>\$ 5,774,637</u> |

The future annualized interest payments for the variable rate bonds are based on an interest rate of 3.5 percent, which represents 70 percent of the long-term interest rate of 5.0 percent assumed by the County for financial planning purposes. Interest payments on the Junior Lien Variable Sewer Revenue Bonds, Series 2012, Series 2020A and Series 2020B, are based on the stated interest rates of 2.6 percent, 0.6 percent, and 0.9 percent, respectively, that will be paid through their mandatory purchase dates.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 5 – Long-Term Liabilities (continued)

**Variable rate general obligation and revenue bonds** – The County's \$98.2 million Limited Tax General Obligation Refunding Bonds (Payable from Sewer Revenues), Series 2017A and B, are in a direct placement mode and are secured by a subordinate lien on the net revenues of the system. Events of default under the continuing covenant agreement for the bonds include nonpayment of amounts due and ratings downgrades below BBB/Baa2. The continuing covenant agreement expires on April 5, 2021.

The 2019 Series A and Series B Multi-Modal Variable Rate Bonds in the amount of \$148.1 million are supported by a periodically renewable standby bond purchase agreement that expires on June 26, 2024.

The agreements related to the County's variable rate bonds, Series 2017A and B and Series 2019A and B, have acceleration clauses (declaring outstanding balances immediately due). The variable rate bonds, Series 2012, Series 2017A and B and Series 2020A and B, do not have liquidity facilities.

**Financial policy reserves** – In addition to bond reserves related to Sewer Revenue Bonds, Water Quality maintains liquidity and asset management reserves totaling \$35.8 million at December 31, 2020.

**Compliance with bond resolutions** – With respect to the year ended December 31, 2020, Water Quality complied with all financial covenants stipulated by its bond resolutions.

**Changes in long-term liabilities** – Long-term liability activity for the years ended December 31, 2020 was as follows (in thousands):

|                                    | Balance<br>January 1,<br>2020 | Additions         | Reductions          | Balance<br>December 31,<br>2020 | Due Within<br>One Year |
|------------------------------------|-------------------------------|-------------------|---------------------|---------------------------------|------------------------|
| Bonds payable                      | \$ 3,312,100                  | \$ 566,865        | \$ (563,625)        | \$ 3,315,340                    | \$ 89,620              |
| Direct placements-bonds payable    | 100,000                       |                   | (1,775)             | 98,225                          | -                      |
| Bond premiums and discounts        | 322,654                       | 26,020            | (55,235)            | 293,439                         | -                      |
| <b>Total bonds payable</b>         | <b>3,734,754</b>              | <b>592,885</b>    | <b>(620,635)</b>    | <b>3,707,004</b>                | <b>89,620</b>          |
| Direct borrowings-state loans      | 226,221                       | 36,634            | (17,384)            | 245,471                         | 17,610                 |
| Compensated absences               | 11,117                        | 11,837            | (10,156)            | 12,798                          | 783                    |
| Other post-employment benefits     | 1,526                         | 279               | (91)                | 1,714                           | 102                    |
| Net pension liability              | 5,962                         | 24,745            | (22,633)            | 8,074                           | -                      |
| Environmental remediation          | 44,508                        | 8,624             | (3,814)             | 49,318                          | 6,751                  |
| Asset retirement obligations       | 1,500                         | -                 | (150)               | 1,350                           | -                      |
| Other liabilities                  | 77,302                        | 1,827             | (367)               | 78,762                          | 71                     |
| <b>Total long-term liabilities</b> | <b>\$ 4,102,890</b>           | <b>\$ 676,831</b> | <b>\$ (675,230)</b> | <b>\$ 4,104,491</b>             | <b>\$ 114,937</b>      |

## King County Water Quality Enterprise Fund

### Notes to Financial Statements

#### Note 6 – Asset Retirement Obligations

In 2020, Water Quality reported the ARO of \$1.4 million in accordance with GASB Statement No. 83, *Certain Asset Retirement Obligations*. The liability is measured at its current value and based on professional judgment, experience, and historical cost data.

Water Quality's ARO relates to the disposition of underground storage tanks (USTs) due to applicable regulations and requirements. The estimated remaining useful life of the USTs ranges from one to nine years.

The liability could change over time as new information becomes available as a result of changes in technology, legal or regulatory requirements, and types of equipment, facilities or services that will be used to meet the obligation to dispose of the USTs.

#### Note 7 – Changes in Capital Assets

Changes in capital assets for the years ended December 31, 2020, are shown in the following table (in thousands):

|   | Balance<br>January 1,<br>2020 | Increases         | Decreases           | Balance<br>December 31,<br>2020 |
|---|-------------------------------|-------------------|---------------------|---------------------------------|
| Land                                      | \$ 248,766                    | \$ -              | \$ -                | \$ 248,766                      |
| Easements                                 | 15,569                        | 440               | -                   | 16,009                          |
| Artwork                                   | 4,349                         | -                 | (3,326)             | 1,023                           |
| Construction work in progress             | 438,160                       | 191,333           | (133,065)           | 496,428                         |
| Total nondepreciable assets               | <u>706,844</u>                | <u>191,773</u>    | <u>(136,391)</u>    | <u>762,226</u>                  |
| Buildings                                 | 2,034,935                     | 7,863             | (862)               | 2,041,936                       |
| Improvements other than buildings         | 141,422                       | 7,011             | -                   | 148,433                         |
| Right of way                              | 7,635                         | -                 | -                   | 7,635                           |
| Infrastructure                            | 2,465,628                     | 42,823            | (2,837)             | 2,505,614                       |
| Equipment                                 | 1,150,241                     | 42,059            | (17,486)            | 1,174,814                       |
| Software development                      | 35,631                        | 1,651             | -                   | 37,282                          |
| Total depreciable assets                  | <u>5,835,492</u>              | <u>101,407</u>    | <u>(21,185)</u>     | <u>5,915,714</u>                |
| Accumulated depreciation and amortization |                               |                   |                     |                                 |
| Building                                  | (857,861)                     | (53,208)          | 553                 | (910,516)                       |
| Improvements other than building          | (41,031)                      | (5,765)           | (1,696)             | (48,492)                        |
| Right of way                              | (1,799)                       | (218)             | -                   | (2,017)                         |
| Infrastructure                            | (719,459)                     | (51,749)          | 1,200               | (770,008)                       |
| Equipment                                 | (773,782)                     | (60,216)          | 17,060              | (816,938)                       |
| Software development                      | (35,631)                      | (688)             | -                   | (36,319)                        |
| Total depreciation and amortization       | <u>(2,429,563)</u>            | <u>(171,844)</u>  | <u>17,117</u>       | <u>(2,584,290)</u>              |
| Depreciable assets - net                  | <u>3,405,929</u>              | <u>(70,437)</u>   | <u>(4,068)</u>      | <u>3,331,424</u>                |
| Total capital assets - net                | <u>\$ 4,112,773</u>           | <u>\$ 121,336</u> | <u>\$ (140,459)</u> | <u>\$ 4,093,650</u>             |

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 8 – Environmental Remediation

Water Quality operations are subject to rules and regulations enacted by the Washington State Department of Ecology (DOE) and the U.S. Environmental Protection Agency (EPA).

Water Quality follows GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB 49), which mandates the disclosure of “obligations to address current or potential detrimental effects of existing pollution by participating in pollution remediation activities.” GASB 49 establishes five events, any one of which obligates Water Quality to record a liability for pollution remediation expenditures. Liabilities are related to ongoing projects, which include the sediment management of aquatic habitats along Elliott Bay and the clean-up of certain sites along the Lower Duwamish Waterway (LDW). Environmental remediation costs are capitalized and amortized over 30 years.

The Sediment Management Project was obligated when the Metropolitan King County Council approved the pollution remediation program. The LDW project became a Water Quality obligation when King County entered into an Administrative Order on Consent (AOC) with the DOE and EPA. This AOC also includes The Boeing Company, the City of Seattle and the Port of Seattle as parties conduct the studies on which to base the cleanup decision. Each party has agreed to pay one fourth of the costs under the AOC.

Both projects may result in additional cleanup efforts as a result of future regulatory orders. These potential cleanup liabilities cannot be currently estimated. Ongoing, regulatory action has identified and may identify other Potentially Responsible Parties (PRP) for the LDW cleanup.

There are no estimated recoveries at this time that will reduce the amount of Water Quality’s pollution remediation obligations. The total environmental remediation liability at December 31, 2020, stands at \$49.3 million.

The pollution remediation obligation is an estimate and subject to changes resulting from price increases or reductions, technology, or changes in applicable laws or regulations.

The methodology for estimating liabilities continues to be based on Water Quality engineering analysis, program experience and cost estimates for the remediation activities scheduled to be undertaken in future years as programmed under Water Quality’s Regional Wastewater Services Plan. Certain costs were developed by consulting engineers. Costs were estimated using the expected cash flow method set out by GASB 49. For the LDW project, a weighted average method is used to calculate the liability. The Sediment Management Plan does not employ weighted average cost estimation because the remaining work is well-defined and negates the utility of multiple estimates. The cost estimates continue to be re-measured as succeeding benchmarks are reached or when cost assumptions are modified. All pollution remediation costs are being deferred and amortized over 30 years as permitted by regulatory accounting standards (see Note 9 – Regulatory Assets and Credits).

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 9 – Regulatory Assets and Credits

The King County Council has taken various regulatory actions resulting in differences between the recognition of revenues for rate-making purposes and their treatment under generally accepted accounting principles for nonregulated entities. Changes to these balances and their inclusion in rates may occur only at the direction of the Council.

**Rate stabilization** – In 2005, the Council established a Rate Stabilization Reserve. This action created a deferred inflow of resource which deferred operating revenue to be set aside in a reserve and recognized in subsequent years to maintain stable sewer rates. The reserve was \$46.3 million in 2020.

**Pollution remediation** – In 2006, the Council approved the application of regulatory accounting to treat pollution remediation obligations as regulatory assets to allow for cost recovery through future rate increases. The portion of regulatory asset costs that have been accrued is being amortized over a recovery period of 30 years.

**Rainwise program** – In 2013, the Council approved the application of regulatory accounting to treat program payments to Rainwise participants as regulatory assets to allow for cost recovery through future rate increases. The portion of regulatory asset costs that have been accrued is being amortized over a recovery period of 7 years.

**Strategic planning costs** – In 2016, the Council approved the application of regulatory accounting to treat strategic planning costs as regulatory assets to allow for cost recovery through future rate increases. The portion of regulatory asset costs that have been accrued is amortized over a 7 to 10-year recovery period.

### Note 10 – Employee Benefit Plans

In accordance with GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, the County elected to use June 30, 2020, as the measurement date for reporting net pension liability at 2020 year-end.

The following table represents the aggregate pension amounts allocated to Water Quality for all pension plans subject to the requirements of GASB Statement No. 68 for the year 2020 (in thousands):

|                                | <u>Aggregate Pension<br/>Amounts—All Plans</u> |       |
|--------------------------------|--|-------|
| Pension liabilities            | \$   | 8,074 |
| Deferred outflows of resources |  | 7,205 |
| Deferred inflows of resources  |  | 7,685 |
| Pension expense                |  | 3,903 |

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 10 – Employee Benefit Plans (continued)

**Pension plans** –Substantially all full-time and qualifying part-time employees of Water Quality participate in Public Employees’ Retirement System (PERS) Plan 2 or Plan 3.

PERS is administered by the Washington State Department of Retirement Systems (DRS) under cost-sharing, multiple-employer public employee defined benefit and defined contribution retirement plans. The state Legislature establishes, and amends, laws pertaining to the creation and administration of all statewide public retirement systems.

The DRS, a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for each plan.

The DRS financial report may be obtained by writing to:

Department of Retirement Systems  
Communications Unit  
P.O. Box 48380  
Olympia, WA 98540-8380

Or the DRS financial report may be downloaded from the DRS website at [www.drs.wa.gov](http://www.drs.wa.gov).

**Public Employees Retirement System** – PERS members include elected officials; state employees; employees of the Supreme, Appeals and Superior Courts; employees of the legislature; employees of district and municipal courts; employees of local governments; and higher education employees not participating in higher education retirement programs. PERS is comprised of three separate pension plans for membership purposes. PERS Plans 1 and 2 are defined benefit plans, and PERS Plan 3 is a defined benefit plan with a defined contribution component.

PERS Plan 1 provides retirement, disability, and death benefits. Retirement benefits are determined as two percent of the member’s average final compensation (AFC) times the member’s years of service. The AFC is the average of the member’s 24 highest consecutive service months. Members are eligible for retirement from active status at any age with at least 30 years of service, at age 55 with at least 25 years of service, or at age 60 with at least five years of service. Members retiring from active status prior to the age of 65 may receive actuarially reduced benefits. Retirement benefits are actuarially reduced to reflect the choice of a survivor benefit. Other benefits include duty and non-duty disability payments, an optional cost-of-living adjustment (COLA), and a one-time duty-related death benefit, if found eligible by the Department of Labor and Industries. PERS 1 members were vested after the completion of five years of eligible service. The PERS Plan 1-member contribution rate is established by State statute at 6 percent. Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates. The plan was closed to new entrants on September 30, 1977.

## King County Water Quality Enterprise Fund Notes to Financial Statements

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### Note 10 – Employee Benefit Plans (continued)

**PERS Plan 2/3** provides retirement, disability, and death benefits. Retirement benefits are determined as two percent of the member's average final compensation (AFC) times the member's years of service for Plan 2 and 1 percent of AFC for Plan 3. The AFC is the average of the member's 60 highest-paid consecutive service months. There is no cap on years of service credit. Members are eligible for retirement with a full benefit at 65 with at least five years of service credit. Retirement before age 65 is considered an early retirement. PERS Plan 2/3 members who have at least 20 years of service credit and are 55 years of age or older, are eligible for early retirement with a benefit that is reduced by a factor that varies according to age for each year before age 65. PERS Plan 2/3 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions:

- With a benefit that is reduced by three percent for each year before age 65; or
- With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2/3 members hired on or after May 1, 2013, have the option to retire early by accepting a reduction of five percent for each year of retirement before age 65. This option is available only to those who are age 55 or older and have at least 30 years of service credit. PERS Plan 2/3 retirement benefits are also actuarially reduced to reflect the choice of a survivor benefit. Other PERS Plan 2/3 benefits include duty and non-duty disability payments, a cost-of-living allowance (based on the CPI), capped at three percent annually and a one-time duty related death benefit, if found eligible by the Department of Labor and Industries. PERS 2 members are vested after completing five years of eligible service. Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service if 12 months of that service are earned after age 44.

PERS Plan 3 defined contribution benefits are totally dependent on employee contributions and investment earnings on those contributions. PERS Plan 3 members choose their contribution rate upon joining membership and have a chance to change rates upon changing employers. As established by statute, Plan 3 required defined contribution rates are set at a minimum of 5 percent and escalate to 15 percent with a choice of six options. Employers do not contribute to the defined contribution benefits. PERS Plan 3 members are immediately vested in the defined contribution portion of their plan.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 10 – Employee Benefit Plans (continued)

The PERS Plan 2/3 employer and employee contribution rates are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. The Plan 2/3 employer rates include a component to address the PERS Plan 1 UAAL and an administrative expense that is currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 2 employer and employee contribution rates and Plan 3 contribution rates. The PERS Plan 2/3 required contribution rates (expressed as a percentage of covered payroll) for 2020 were as follows:

| Actual Contribution Rates | PERS Plan 2/3 |            |
|---------------------------|---------------|------------|
|                           | Employer 2/3  | Employee 2 |
| January – August 2020     |               |            |
| PERS Plan 2/3             | 7.92%         | 7.90%      |
| PERS Plan 1 UAAL          | 4.76%         |            |
| Administrative Fee        | 0.18%         |            |
| Employee PERS Plan 3      |               | Varies     |
| Total                     | 12.86%        | 7.90%      |
| September – December 2020 |               |            |
| PERS Plan 2/3             | 7.92%         | 7.90%      |
| PERS Plan 1 UAAL          | 4.87%         |            |
| Administrative Fee        | 0.18%         |            |
| Employee PERS Plan 3      |               | Varies     |
| Total                     | 12.97%        | 7.90%      |

Water Quality's actual contributions to the PERS plan 2/3 were \$9.3 million for the year ended December 31, 2020.

**Actuarial assumptions** – The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed in 2020 with a valuation date of June 30, 2019. The actuarial assumptions used in the valuation were based on the results of the Office of the State Actuary's (OSA) *2013-2018 Experience Study* and the *2019 Economic Experience Study*.

Additional assumptions for subsequent events and law changes are current as of the 2019 actuarial valuation report. The TPL was calculated as of the valuation date and rolled forward to the measurement date of June 30, 2020. Plan liabilities were rolled forward from June 30, 2019, to June 30, 2020, reflecting each plan's normal cost (using the entry-age cost method), assumed interest and actual benefit payments.

- Inflation: 2.75 percent total economic inflation; 3.5 percent salary inflation.
- Salary increases: In addition to the base 3.5 percent salary inflation assumption, salaries are also expected to grow by promotions and longevity.
- Investment rate of return: 7.4 percent

## King County Water Quality Enterprise Fund Notes to Financial Statements

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### Note 10 – Employee Benefit Plans (continued)

Mortality rates were developed using the Society of Actuaries' Pub. H-2010 mortality rates, which vary by member status, as the base table. The OSA applied age offsets for each system, as appropriate, to better tailor the mortality rates to the demographics of each plan. OSA applied the long-term MP-2017 generational improvement scale, also developed by the Society of Actuaries, to project mortality rates for every year after the 2010 base table. Mortality rates are applied on a generational basis; meaning, each member is assumed to receive additional mortality improvements in each future year throughout his or her lifetime.

There were changes in methods and assumptions since the last valuation.

- OSA updated its demographic assumptions based on the results of its latest demographic experience study. See OSA's 2013-2018 Demographic Experience Study at [leg.wa.gov/osa](http://leg.wa.gov/osa).
- OSA updated the Early Retirement Factors and Joint-and-Survivor factors used in its model to match the ones implemented by DRS on October 1, 2020. These factors are used to value benefits for members who elect to retire early and for survivors of members that die prior to retirement.
- The valuation includes liabilities and assets for Plan 3 members purchasing Total Allocation Portfolio annuities when determining contribution rates and funded status.
- OSA simplified its modeling of medical premium reimbursements for survivors of duty-related deaths in LEOFF 2.
- OSA changed its method of updating certain data items that change annually, including the public safety duty-related death lump sum and Washington state average wage. OSA set these values at 2018 and will project them into the future using assumptions until the next Demographic Experience Study in 2025. See [leg.wa.gov/osa](http://leg.wa.gov/osa) for more information on this method change.

**Discount rate** – The discount rate used to measure the total pension liability for all DRS plans was 7.4 percent.

To determine that rate, an asset sufficiency test was completed to test whether each pension plan's fiduciary net position was sufficient to make all projected future benefit payments for current plan members. Based on OSA's assumptions, the pension plans' fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 7.4 percent was used to determine the total liability.

**Long-term expected rate of return** – The long-term expected rate of return on the DRS pension plan investments of 7.4 percent was determined using a building-block-method. In selecting this assumption, the OSA reviewed the historical experience data, considered the historical conditions that produced past annual investment returns, and considered Capital Market Assumptions (CMA's) and simulated expected investment returns provided by the Washington State Investment Board (WSIB). The WSIB uses the CMA's and their target asset allocation to simulate future investment returns at various future times.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 10 – Employee Benefit Plans (continued)

**Estimated rates of return by asset class** – Best estimates of arithmetic real rates of return for each major asset class included in the pension plan’s target asset allocation as of June 30, 2020, are summarized in the table below. The inflation component used to create the table is 2.2 percent and represents the WSIB’s most recent long-term estimate of broad economic inflation.

| Asset Class     | Target Allocation | % Long-Term<br>Expected Real Rate of<br>Return Arithmetic |
|-----------------|-------------------|---|
| Fixed income    | 20.00%            | 2.20%   |
| Tangible assets | 7.00%             | 5.10%   |
| Real estate     | 18.00%            | 5.80%   |
| Global equity   | 32.00%            | 6.30%   |
| Private equity  | 23.00%            | 9.30%   |
|                 | <u>100.00%</u>    |   |

**Sensitivity of NPL** – The table below presents Water Quality’s proportionate share of the net pension liability calculated using the discount rate of 7.4 percent, as well as what Water Quality’s proportionate share of the net pension liability/(asset) would be if it were calculated using a discount rate that is 1-percentage point lower (6.4 percent) or 1-percentage point higher (8.4 percent) than the current rate (in thousands).

| Pension Plan | 1% Decrease<br>(6.40%) | Current<br>Discount Rate<br>(7.40%) | 1% Increase<br>(8.40%) |
|--------------|------------------------|-------------------------------------|------------------------|
| PERS 2/3     | \$ 50,241              | \$ 8,074                            | \$ (26,650)            |

**Pension plan fiduciary net position** – Detailed information about the fiduciary net position of the State’s pension plans is available in the separately issued DRS financial report.

**Pension liabilities, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions** – At December 31, 2020, Water Quality reported a total pension liability of \$8.1 million for its proportionate share of the net pension liabilities of PERS Plan 2/3.

Water Quality’s proportionate share of the collective net pension liabilities was as follows:

|          | Proportionate<br>Share 6/30/19 | Proportionate<br>Share 6/30/20 | Change in<br>Proportion |
|----------|--------------------------------|--------------------------------|-------------------------|
| PERS 2/3 | 0.60%                          | 0.63%                          | 0.03%                   |

## King County Water Quality Enterprise Fund Notes to Financial Statements

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### Note 10 – Employee Benefit Plans (continued)

Employer contribution transmittals received and processed by the DRS for its fiscal year ended June 30 are used as the basis for determining each employer's proportionate share of the collective pension amounts reported by the DRS in the Schedules of Employer and Nonemployer Allocations for all plans except Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) Plan 1.

The collective net pension liability was measured as of June 30, 2020, and the actuarial valuation date on which the total pension liability is based was as of June 30, 2019, with update procedures used to roll forward the total pension liability to the measurement date.

**Pension expense** – For the year ended December 31, 2020, Water Quality recognized pension expense in the amount of \$3.9 million.

**Deferred outflows of resources and deferred inflows of resources** – At December 31, 2020, Water Quality reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in thousands):

| PERS 2/3  | Deferred<br>Outflows of<br>Resources | Deferred<br>Inflows of<br>Resources |
|---|--------------------------------------|-------------------------------------|
| Difference between expected and actual experience.  | \$ 2,891                             | \$ 1,012                            |
| Net difference between projected and actual investment earnings on pension plan investments.          | -                                    | 410                                 |
| Changes of assumptions  | 115                                  | 5,515                               |
| Changes in proportion and differences between contributions and proportionate share of contributions. | 1,274                                | 748                                 |
| Contributions subsequent to the measurement date.   | <u>2,925</u>                         | <u>-</u>                            |
| Total   | <u>\$ 7,205</u>                      | <u>\$ 7,685</u>                     |

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 10 – Employee Benefit Plans (continued)

Deferred outflows of resources related to pensions resulting from Water Quality’s contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2020. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows (in thousands):

| <u>Year Ending December 31,</u> | <u>PERS 2/3</u> |
|---------------------------------|-----------------|
| 2021                            | \$ (3,320)      |
| 2022                            | (771)           |
| 2023                            | 174             |
| 2024                            | 847             |
| 2025                            | (173)           |
| Thereafter                      | (162)           |

### Note 11 – Other Post-Employment Benefits

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, establishes standards for recognizing and measuring other postemployment benefits (OPEB) liabilities, deferred outflows of resources, deferred inflows of resources, and expenses. The following table represents Water Quality’s allocated OPEB amounts subject to the requirements of GASB Statement No. 75 for the year 2020 (in thousands):

|                                | <u>OPEB Amounts</u> |
|--------------------------------|---------------------|
| OPEB liabilities               | \$ 1,714            |
| Deferred outflows of resources | 84                  |
| Deferred inflows of resources  | 229                 |
| OPEB expense                   | 264                 |

**Plan description** – The County administers a single-employer defined-benefit postemployment healthcare plan (the Plan). The Plan provides healthcare insurance for eligible retirees and their spouses and children through the County’s health insurance plan, which covers retired members. The plan provides healthcare insurance benefits and prescription coverage. The plan offers dental and vision benefits, but the retiree premiums are assumed to cover the full cost of those benefits.

As a self-insurer, the County establishes a monthly premium rate for insurance benefits each budget year. Eligible retirees may continue to receive insurance benefits by contributing 100 percent of the Consolidated Omnibus Budget Reconciliation Act or COBRA rate for these benefits. The program provides the same level of healthcare benefits to retirees as the active group plan. LEOFF1 retirees are not required to contribute as the County pays 100 percent of their medical costs. The County pays benefits as they come due.

## King County Water Quality Enterprise Fund Notes to Financial Statements

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### Note 11 – Other Post-Employment Benefits (continued)

**Employees covered by benefit terms** – At December 31, 2020, the benefit terms covered the following employees:

| Category   | Count                |
|--|----------------------|
| Inactive employees, spouses, or beneficiaries currently receiving benefit payments | 517                  |
| Active employees   | <u>14,746</u>        |
| Total  | <u><u>15,263</u></u> |

**Net OPEB liability** – The County's total OPEB liability was valued as of December 31, 2020 and used to calculate the net OPEB liability measured as of December 31, 2020.

**Actuarial assumptions** – The total OPEB liability in the December 31, 2020 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

|                             |   |          |
|-----------------------------|---|----------|
| Measurement Date:           | <u>December 31, 2020</u>                                |          |
| Discount rate               |   | 2.00%    |
| Inflation                   |   | 2.75%    |
| Healthcare Cost Trend Rates |   |          |
| Pre-Medicare                |   | 5.40% *  |
| Medicare                    |   | 0.00% *  |
| Salary Increases            |   | 3.50% ** |
| Mortality Rates             | Public Employer Mortality Tables - Society of Actuaries |          |

\* Trending down to 4.04% over 54 years. Applies to calendar years.

\*\* Additional merit-based increases based on CalPERS merit salary increase tables.

- Projections of the sharing of benefit-related costs are based on an established pattern of practice.
- Experience studies come from the State of Washington 2018 reports.
- Inactive employees (retirees) pay 100 percent of the cost of benefits, except for LEOFF1 which pays zero percent.
- There were no ad hoc postemployment benefit changes (including ad hoc COLAs) to the plan.

The discount rate used to measure the total OPEB liability is 2.0 percent. The County's OPEB Plan is an unfunded plan, therefore the discount rate was set to the rate of tax-exempt, high-quality 20-year municipal bonds, as of the valuation date.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 11 – Other Post-Employment Benefits (continued)

**Changes in total OPEB liability** – Water Quality’s allocated changes in the total OPEB liability for the year ended December 31, 2020, were as follows (in thousands):

|   |                        |
|---|------------------------|
| Total OPEB liability - 1/1/2020                   | <u>\$ 1,526</u>        |
| Changes for the year:                             |                        |
| Service cost                                      | 36                     |
| Interest  | 67                     |
| Difference between expected and actual experience | (139)                  |
| Change of assumptions                             | 53                     |
| Benefit payments                                  | (63)                   |
| Implicit subsidy credit                           | (28)                   |
| Other changes                                     | 262                    |
| Net changes                                       | <u>188</u>             |
| Total OPEB liability - 12/31/2020                 | <u><u>\$ 1,714</u></u> |

**Sensitivity of the net OPEB liability to changes in the discount rate** – The table below presents Water Quality’s proportionate share of the net OPEB liability as well as what Water Quality’s proportionate share of the net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower (1.0 percent) or one percentage point higher (3.0 percent) than the current rate (in thousands).

|                      | <u>1% Decrease<br/>(1.00%)</u> | <u>Current<br/>Discount Rate<br/>(2.00%)</u> | <u>1% Increase<br/>(3.00%)</u> |
|----------------------|--------------------------------|--|--------------------------------|
| Total OPEB liability | \$ 1,858                       | \$ 1,714                                     | \$ 1,585                       |
| Increase (Decrease)  | 144                            |  | (129)                          |
| % change             | 8.40%                          |  | -7.54%                         |

**Sensitivity of the net OPEB liability to changes in the healthcare cost trend rates** – The healthcare trend for this valuation started at 5.4 percent and decreased to 4.0 percent over 54 years. The table below presents Water Quality’s proportionate share of the net OPEB liability as well as what Water Quality’s proportionate share of the net OPEB liability would be if it were calculated using healthcare cost trend rates that are one percentage point lower (4.4 percent) or one percentage point higher (6.4 percent) than current healthcare cost trend rates (in thousands).

|                      | <u>1% Decrease<br/>(4.40%)</u> | <u>Trend Rate<br/>(5.40%)</u> | <u>1% Increase<br/>(6.40%)</u> |
|----------------------|--------------------------------|-------------------------------|--------------------------------|
| Total OPEB liability | \$ 1,562                       | \$ 1,714                      | \$ 1,888                       |
| Increase (Decrease)  | (152)                          |                               | 174                            |
| % change             | -8.85%                         |                               | 10.17%                         |

## King County Water Quality Enterprise Fund Notes to Financial Statements

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### Note 11 – Other Post-Employment Benefits (continued)

**Deferred outflows of resources and deferred inflows of resources** – At December 31, 2020, Water Quality reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources (in thousands):

|   | Deferred<br>Outflows of<br>Resources | Deferred<br>Inflows of<br>Resources |
|---|--------------------------------------|-------------------------------------|
| Difference between expected and actual experience | \$ 37                                | \$ 123                              |
| Changes of assumptions                            | 47                                   | 106                                 |
| Total   | \$ 84                                | \$ 229                              |

Amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB in the year ended December 31, 2020, will be recognized as OPEB expense as follows (in thousands):

| Year Ending December 31, | Amount  |
|--------------------------|---------|
| 2021                     | \$ (21) |
| 2022                     | (21)    |
| 2023                     | (21)    |
| 2024                     | (20)    |
| 2025                     | (20)    |
| Thereafter               | (42)    |

**Expected average remaining service lives (EARSL)** – The effects on the total OPEB liability of (1) changes of economic and demographic assumptions or of other inputs and (2) differences between expected and actual experience are required to be included in OPEB expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all employees that are provided with benefits through the OPEB plan (active employees and inactive employees), beginning in the current period. The EARSL for the current period is 8.8 years.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 12 – Interfund Balances and Transfers

Water Quality is an enterprise fund of the County and reports in its financial statements interfund balances and transfers as a result of intra-county activity with other County agencies.

**Interfund balances** – The balances result from the time lag between the dates when interfund goods and services were provided or reimbursable expenditures incurred and when interfund payments were made, Water Quality reported total due from other funds of \$2.5 million and due to other funds of \$12 thousand at December 31, 2020.

**Interfund transfers** – The King County Council approves ordinances and/or motions authorizing Water Quality to contribute and receive amounts to and from various County funds. During 2020, the transfers from Water Quality to other funds were \$894 thousand and transfers from other funds were \$150 thousand.

### Note 13 – Commitments and Contingencies

**Construction and maintenance programs** – To ensure the continued operation, reliability, and compliance with regulatory standards of existing wastewater treatment facilities, Water Quality has active construction and contractual commitments of approximately \$153.1 million on active construction contracts as of December 31, 2020.

**Contingencies and claims** – The following litigation, or potential litigation, may involve claims for material damages against the King County Water Quality Enterprise Fund for which Water Quality is unable to provide an opinion as to the ultimate outcome or the amount of damages that may be found:

- *Lower Duwamish Waterway* - The Environmental Protection Agency (EPA) issued an administrative order that required King County, the City of Seattle, Boeing, and the Port of Seattle to conduct studies to determine the nature and extent of contamination in the Lower Duwamish Waterway. The County and the other three parties have agreed with EPA to amend the administrative order on a number of occasions to conduct additional. A new amendment is currently being negotiated for the next phase of remedy design. EPA issued a Record of Decision (ROD) in the latter part of 2014. The ROD contains EPA's final plan for cleanup of the Lower Duwamish Waterway. The County and a number of other parties are participating in an alternative dispute resolution process, called an allocation, to determine shares of liability for the costs of the cleanup. If parties that participate in the allocation accept their allotted shares, they then expect to enter into a settlement agreement and to negotiate a consent decree with EPA to implement the cleanup. Due to the fact that the parties do not yet know their respective shares of cleanup costs and no consent decree has been negotiated with EPA, the County is unable to determine the schedule or cost of any required remediation. In addition, the County is unable to determine the extent to which the County and Water Quality will be responsible for the cost of such remediation.

## King County Water Quality Enterprise Fund Notes to Financial Statements

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### Note 13 – Commitments and Contingencies (continued)

- *Denny Way CSO Model Toxic Control Act Cleanup* – There was a potential requirement for more cleanup in the area contaminated when the Denny Way combined sewer outflow was replaced in 2005. Water Quality signed an Agreed Order with the Washington State Department of Ecology (DOE) under the Model Toxics Control Act for an interim cleanup action in November 2007 and subsequently performed the interim cleanup at a cost of \$3.6 million. Water Quality has recently engaged in negotiations with DOE to prepare a remedial investigation, feasibility study and draft cleanup action plan, and to implement what may be an interim or final cleanup action. It is unclear what final remedy DOE may select. The County is unable to determine an amount, if any, for which Water Quality may be responsible.
- *East Waterway Operable Unit of the Harbor Island Superfund Site* – There were potential claims for past and future cleanup costs at the Harbor Island Superfund Site. The Port of Seattle has completed a significant removal action in the East Waterway. The City of Seattle, Port of Seattle and the County may subsequently negotiate the amount, if any, that the City and the County will contribute to defray the Port of Seattle's past cleanup costs at the site. The County is unable to determine an amount that Water Quality may be responsible for, if any.

In addition, EPA determined that a supplemental remedial Investigation/Feasibility study (RI/FS) is necessary. The supplemental RI/FS is now complete and has been approved by EPA though one additional study is being completed at EPA's request to further finalize it. A three-way agreement with the Port of Seattle, the City of Seattle and King County covers the participation of the City, the Port of Seattle, and the County in the supplemental RI/FS governing the East Waterway Operable Unit. The agreement allocates to Water Quality a one-third pro-rata share of the study costs as defined in the agreement although these costs may be reallocated among the parties or with other potentially responsible parties (PRP) who may agree to participate in the study. The parties may also seek contribution from other PRP's for the cost of the study. EPA is now contemplating issuance of a proposed plan that would select the site remedy. The County and three other PRP's have negotiated a memorandum of agreements to implement a search for other responsible parties.

- *North Creek Interceptor Sewer Improvement Project* - A claim was submitted by the County against a contractor and its performance bond surety over the project to repair and replace two miles of pipeline serving the rapidly developing area in the vicinity of Canyon Park. Pursuant to an agreement with DOE, Water Quality had to install a bypass system because the capital project was not completed by the onset of the 2016 wet season. The contractor submitted a request for change order of approximately \$1.5 million based on its assertion that the contract dewatering and open-faced shield tunneling specifications were defective. The contractor also asserted that it was constructively suspended and stopped tunneling. Water Quality found the contractor in default, terminated the contract, made demand upon the performance bond surety, and procured a \$20.0 million completion contract. Water Quality's additional costs to complete the project and to repair consequential damages amounted to approximately \$28.0 million. In December 2016, the County initiated a suit in King County Superior Court to recover the additional costs to complete the project from the contractor and its insurance company. The trial date is set for August 30, 2021. The contractor is counterclaiming for approximately \$10.0 million based on a wrongful termination.

# King County Water Quality Enterprise Fund

## Notes to Financial Statements

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### Note 13 – Commitments and Contingencies (continued)

*Lower Duwamish Waterway - Possible Natural Resource Damages* - The County has participated in discussions with National Oceanic and Atmospheric Administration (NOAA) regarding alleged natural resource damages (NRD) in the Lower Duwamish Waterway and around Harbor Island. These discussions have included NOAA's determination that the County may be a potentially liable party that has contributed to the release of hazardous substances that have injured natural resources. NOAA notified the County in February 2016 that the Natural Resources Trustees will proceed with a NRD assessment and invited the County to participate in the development of the assessment. The County notified NOAA in March 2016 and again in December 2019 that the County desires to conduct settlement discussions with NOAA regarding the NRD liability that NOAA attributes to the County. The County's intent in past discussions with NOAA has been to minimize the County's alleged liability relative to other liable parties. The County is currently in the process of negotiating a settlement with NOAA but cannot predict the amount or likelihood of settlement.

*Ronald Wastewater District v. Olympic View Water & Sewer District* – Ronald Wastewater District (Ronald) sought a declaratory judgment that it is the exclusive wastewater service provider to the Point Wells area in unincorporated Snohomish County. Olympic View Water & Sewer District (OVWSD) claimed that the Point Wells area is located within its corporate boundaries, was not properly annexed to Ronald, and that OVWSD is the exclusive service provider. Woodway, Snohomish County, and Edmonds were also parties to the action, supporting OVWSD's legal position. Shoreline and King County were defendants, supporting Ronald's position. The Superior Court ruled in favor of Ronald finding that King County properly transferred the Richmond Beach Sewer System to Ronald in 1985 and that the court's approval in 1985 of that transfer lawfully annexed the Point Wells service area to Ronald's corporate boundary. The Court of Appeals reversed the superior court and decided that the 1985 transfer from King County to Ronald was void. Ronald and King County both filed petitions for review to the Supreme Court, which accepted review. Late in 2020 the Supreme Court upheld the appellate court's ruling, agreeing that Ronald could not have unilaterally annexed Point Wells into Ronald's service area because Point Wells was already within OVWSD's boundary, and neither OVWSD nor Snohomish County consented to Ronald's annexation of Point Wells. This ruling will resolve most of the remaining litigation amongst the parties. However, OVWSD indicates that it plans to pursue other causes of action, including breach of contract, against Shoreline, as successor to Ronald, and against King County. The County intends to vigorously defend itself against such causes of action.

*Suquamish Tribe Notice of Intent to Sue* - In July 2020, the Suquamish Tribe (Tribe) submitted a Notice of Intent (NOI) to sue under the Clean Water Act for the County's discharges of untreated wastewater in violation of the County's discharge permits. In March 2021, the Tribe submitted a supplemental NOI for additional County discharges. Civil penalties available under the Clean Water Act are a maximum of \$57 thousand, per violation per day. The County has met with the Tribe in an effort to settle the NOI. If settlement efforts are not successful, the County believes that it has some available defenses to a potential Clean Water Act lawsuit related to these discharges and would vigorously defend against such an action.

## King County Water Quality Enterprise Fund Notes to Financial Statements

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### **Note 13 – Commitments and Contingencies (continued)**

*Georgetown Wet Weather Treatment Station* - This project involves construction of a new 70.0 million gallon per day capacity wet weather treatment station for treating combined sewer overflow wastewater. The contract was awarded to a contractor in the amount of \$96.2 million. The contractor seeks approximately \$4.3 million in additional compensation for claims including for contaminated soil, schedule delays in obtaining a shoring and dewatering permit, addressing a sinkhole and water intrusion that occurred while driving secant pile shaft, and additional costs associated with electrical work. The County has disputed the contractor's request for entitlement. A date for mandatory mediation has not yet been set. Mediation is a condition precedent to litigation.

*Sunset and Heathfield Pump Stations and Force Main Upgrade Project* - The project involves installation of eight new raw sewage pumps, four at the Sunset Pump Station and four at the Heathfield Pump Station, and related improvements to these facilities, including upgrades to electrical systems, mechanical systems and conveyance system piping. The contract was awarded to a contractor for \$36.6 million. The contractor has submitted a \$6.4 million request for change order from the County for work to address ongoing vibration issues and mechanical failures in the installed pumps. The County is evaluating this request.

### **Note 14 – Subsequent Events**

On December 15, 2020, the County authorized issuance of up to \$250.0 million in Limited Tax General Obligation Notes (Commercial Paper) that will be issued from time to time to finance or refinance certain capital projects of the County's sewer system. Water Quality issued \$44.2 million of commercial paper notes on January 7, 2021.

On January 19, 2021, Water Quality closed on a \$96.8 million loan commitment with the Environmental Protection Agency for the Ship Canal Water Quality project. Draws on the loan commitment was evidenced by the sewer revenue bond, 2021 (WIFIA – N19128WA), authorized by King County Council on June 23, 2020.

On January 29, 2021, the continuing covenant agreement related to the County's Limited Tax General Obligation Refunding Bonds (Payable from Sewer Revenues), Series 2017A and B, was extended beyond the prior expiration date of April 5, 2021. The continuing covenant agreement, which governs the direct bank loan arrangement in which form the bonds are currently held, now expires on January 28, 2022.

On February 25, 2021, the County issued \$100.0 million in commercial paper notes and placed the proceeds in escrow to refund and defease the Junior Lien Variable Rate Demand Sewer Revenue Bonds, Series 2012, at their earliest redemption date. Water Quality undertook the refunding to reduce interest costs.

## **Required Supplementary Information**

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## King County Water Quality Enterprise Fund Required Supplementary Information Pension Plan Information

Schedule of the County's Proportionate Share of the Net Pension Liability  
Public Employees' Retirement System (PERS) Plan 1  
Measurement Date of June 30\*  
(dollars in thousands)

|  | 2020         | 2019         | 2018         | 2017         | 2016            |
|--|--------------|--------------|--------------|--------------|-----------------|
| County's proportion of the net pension liability   | 8.85%        | 8.25%        | 8.56%        | 8.45%        | 8.90%           |
| County's proportionate share of the net pension liability                                    | \$ 312,368   | \$ 317,333   | \$ 382,129   | \$ 400,803   | \$ 477,872      |
| Covered payroll  | \$ 1,283,745 | \$ 1,196,465 | \$ 1,124,434 | \$ 1,031,025 | \$ 1,007,624 ** |
| County's proportionate share of the net pension liability as a percentage of covered payroll | 24.33%       | 26.52%       | 33.98%       | 38.87%       | 47.43% **       |
| Plan fiduciary net position as a percentage of the total pension liability                   | 68.64%       | 67.12%       | 63.22%       | 61.24%       | 57.03%          |
|  | <u>2015</u>  |              |              |              |                 |
| County's proportion of the net pension liability   | 8.76%        |              |              |              |                 |
| County's proportionate share of the net pension liability                                    | \$ 458,477   |              |              |              |                 |
| Covered payroll  | \$ 1,000,211 | **           |              |              |                 |
| County's proportionate share of the net pension liability as a percentage of covered payroll | 45.84%       | **           |              |              |                 |
| Plan fiduciary net position as a percentage of the total pension liability                   | 59.10%       |              |              |              |                 |

\* This schedule is to be built prospectively until it contains ten years of data.

\*\* 2015-2019 numbers are restated to include PERS 2/3 and PSERS 2 covered payroll on which portions of PERS 1 UAAL contributions are based.

# King County Water Quality Enterprise Fund

## Required Supplementary Information

### Pension Plan Information (continued)

Schedule of the County's Proportionate Share of the Net Pension Liability  
Public Employees' Retirement System (PERS) Plan 2/3  
Measurement Date of June 30\*  
(dollars in thousands)

|  | 2020         | 2019         | 2018         | 2017       | 2016       |
|--|--------------|--------------|--------------|------------|------------|
| County's proportion of the net pension liability   | 10.85%       | 10.06%       | 10.29%       | 10.14%     | 10.52%     |
| County's proportionate share of the net pension liability                                    | \$ 138,736   | \$ 97,735    | \$ 175,728   | \$ 352,361 | \$ 529,855 |
| Covered payroll  | \$ 1,219,052 | \$ 1,144,724 | \$ 1,072,968 | \$ 995,800 | \$ 953,254 |
| County's proportionate share of the net pension liability as a percentage of covered payroll | 11.38%       | 8.54%        | 16.38%       | 35.38%     | 55.58%     |
| Plan fiduciary net position as a percentage of the total pension liability                   | 97.22%       | 97.77%       | 95.77%       | 90.97%     | 85.82%     |
|  | <u>2015</u>  |              |              |            |            |
| County's proportion of the net pension liability   | 10.36%       |              |              |            |            |
| County's proportionate share of the net pension liability                                    | \$ 370,294   |              |              |            |            |
| Covered payroll  | \$ 949,860   |              |              |            |            |
| County's proportionate share of the net pension liability as a percentage of covered payroll | 38.98%       | **           |              |            |            |
| Plan fiduciary net position as a percentage of the total pension liability                   | 89.20%       |              |              |            |            |

\* This schedule is to be built prospectively until it contains ten years of data.

\*\* Amount restated to reflect correction in calculation.

## King County Water Quality Enterprise Fund Required Supplementary Information Pension Plan Information (continued)

Schedule of the County's Contributions  
Public Employees' Retirement System (PERS) Plan 1  
For the Year Ended December 31\*  
(dollars in thousands)

|   | 2020         | 2019         | 2018         | 2017         | 2016            |
|---|--------------|--------------|--------------|--------------|-----------------|
| Contractually required contributions                                  | \$ 60,884    | \$ 62,240    | \$ 59,366    | \$ 54,111    | \$ 50,154 **    |
| Contributions in relation to the contractually required contributions | 60,884       | 62,240       | 59,366       | 54,111       | 50,154 **       |
| Contribution deficiency (excess)                                      | \$ -         | \$ -         | \$ -         | \$ -         | \$ -            |
| Covered payroll   | \$ 1,306,676 | \$ 1,245,598 | \$ 1,154,804 | \$ 1,082,715 | \$ 1,028,598 ** |
| Contributions as a percentage of covered payroll                      | 4.66%        | 5.00%        | 5.14%        | 5.00%        | 4.88% **        |
| <hr style="width: 20%; margin-left: 0;"/>                             |              |              |              |              |                 |
|   | 2015         |              |              |              |                 |
| Contractually required contributions                                  | \$ 25,283    | **           |              |              |                 |
| Contributions in relation to the contractually required contributions | 25,283       | **           |              |              |                 |
| Contribution deficiency (excess)                                      | \$ -         |              |              |              |                 |
| Covered payroll   | \$ 507,206   | **           |              |              |                 |
| Contributions as a percentage of covered payroll                      | 4.98%        | **           |              |              |                 |

\* This schedule is to be built prospectively until it contains ten years of data.

\*\* 2015-2019 numbers are restated to include portions of PERS 1 UAAL from PERS 2/3 and PSERS 2 contributions.

# King County Water Quality Enterprise Fund

## Required Supplementary Information

### Pension Plan Information (continued)

Schedule of the County's Contributions  
Public Employees' Retirement System (PERS) Plan 2/3  
For the Year Ended December 31\*  
(dollars in thousands)

|   | 2020           | 2019          | 2018          | 2017          | 2016             |
|---|----------------|---------------|---------------|---------------|------------------|
| Contractually required contributions                                  | \$ 101,390     | \$ 93,935     | \$ 84,792     | \$ 72,763     | \$ 62,650 **     |
| Contributions in relation to the contractually required contributions | <u>101,390</u> | <u>93,935</u> | <u>84,792</u> | <u>72,763</u> | <u>62,650 **</u> |
| Contribution deficiency (excess)                                      | <u>\$ -</u>    | <u>\$ -</u>   | <u>\$ -</u>   | <u>\$ -</u>   | <u>\$ -</u>      |
| Covered payroll   | \$ 1,251,724   | \$ 1,188,641  | \$ 1,103,984  | \$ 1,031,418  | \$ 977,342       |
| Contributions as a percentage of covered payroll                      | 8.10%          | 7.90%         | 7.68%         | 7.05%         | 6.41% **         |
|   | <u>2015</u>    |               |               |               |                  |
| Contractually required contributions                                  | \$ 72,853      | **            |               |               |                  |
| Contributions in relation to the contractually required contributions | <u>72,853</u>  | **            |               |               |                  |
| Contribution deficiency (excess)                                      | <u>\$ -</u>    |               |               |               |                  |
| Covered payroll   | \$ 933,304     |               |               |               |                  |
| Contributions as a percentage of covered payroll                      | 7.81%          | **            |               |               |                  |

\* This schedule is to be built prospectively until it contains ten years of data.

\*\* 2015-2019 numbers are restated to exclude portions of PERS 1 UAAL from PERS 2/3 contributions.

## **King County Water Quality Enterprise Fund Required Supplementary Information Pension Plan Information (continued)**

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### **Notes to Pension Required Supplementary Information**

For PERS, the Office of the State Actuary (OSA) calculates the actuarially determined contributions (ADC) based on the results of an actuarial valuation consistent with the state's funding policy defined in Chapter 41.45 the Revised Code of Washington (RCW).

Consistent with the state's contribution-rate adoption process, the results of an actuarial valuation with an odd-numbered year valuation date determine the ADC for the biennium that ensues two years later. The actuarial valuation with a June 30, 2017, valuation date, completed in the fall of 2018, plus any supplemental contribution rates from the preceding legislative session, determined the ADC for the period beginning July 1, 2019, and ending June 30, 2021.

OSA calculates the ADC consistent with the methods described above. Adopted contribution rates could be different pending the actions of the governing bodies.

For cost-sharing plans, OSA calculates the contractually required contributions (CRC) using the same assumptions and methods as the ADC except the CRC reflect the adopted contribution rates for the time period shown, which might differ from the contribution rates produced for the ADC.

For fiscal years 2015 - 2020, the annual money-weighted rate of return on plan investments for each PERS pension plan is disclosed in the 2020 Washington State Department of Retirement Systems Annual Financial Report (AFR). The AFR is available online at <https://www.drs.wa.gov/administration/annual-report/>.

# King County Water Quality Enterprise Fund

## Required Supplementary Information

### Postemployment Health Care Plan

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Schedule of the County's Changes in Total OPEB Liability and Related Ratios  
For the Year Ended December 31\*  
(dollars in thousands)

|   | 2020              | 2019              | 2018              |
|---|-------------------|-------------------|-------------------|
| Total OPEB liability - beginning of year                | \$ 111,272        | \$ 111,412        | \$ 118,120        |
| Service cost  | 2,220             | 2,155             | 2,092             |
| Interest  | 4,149             | 4,138             | 4,147             |
| Changes of benefit terms                                | -                 | -                 | -                 |
| Differences between expected and actual experience      | (8,646)           | -                 | 3,332             |
| Changes of assumptions                                  | 3,310             | (4,953)           | (9,652)           |
| Benefit payments  | (3,922)           | (1,480)           | (5,244)           |
| Implicit rate subsidy fulfilled                         | (1,764)           | -                 | (1,383)           |
| Other changes   | -                 | -                 | -                 |
| Net change in total OPEB liability                      | (4,653)           | (140)             | (6,708)           |
| Total OPEB liability - end of year                      | <u>\$ 106,619</u> | <u>\$ 111,272</u> | <u>\$ 111,412</u> |
| Covered-employee payroll                                | \$ 1,324,116      | \$ 1,219,237      | \$ 1,217,867      |
| Total OPEB liability as a percentage of covered payroll | 8.05%             | 9.13%             | 9.15%             |

\* This schedule is to be built until it contains ten years of data.

#### Notes to OPEB Required Supplementary Information

The plan does not have assets in trusts or equivalent arrangements and is funded on a pay-as-you-go basis. Potential factors that may significantly affect trends in amounts reported include changes to the discount rate, health care trend rates, salary projections, benefit terms, and participation percentages.

## **Other Information**

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**King County Water Quality Enterprise Fund  
Supplemental Information  
Supplemental Schedule of Debt Service Coverage Ratios (Unaudited)  
Year Ended December 31, 2020**

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Water Quality is obligated by applicable bond ordinances to set sewage disposal rates at a level adequate to provide net revenue equal to at least 1.15 times the annual debt service requirements for sewer revenue and general obligation bonds payable from revenues of Water Quality. It is an adopted policy of Water Quality to achieve a debt service coverage ratio of 1.25.

Coverage (1.15 required by covenant, adopted policy 1.25) 1.78

In 2001, Water Quality adopted a new debt service target of 1.15 times the annual debt service for bonds, obligations, notes, and loans of Water Quality.

Coverage (1.15 adopted target) 1.56

Water Quality is required to generate revenues sufficient to pay all costs of operation of the sewage treatment system and debt service on obligations of Water Quality.

Coverage (1.00 required by covenant) 1.42

In 2001, Water Quality issued an additional tier of revenue bonds. The bond covenants of the Junior Lien Variable Rate Demand Sewer Revenue Bonds, Series 2001A and Series 2001B, require that sewage disposal rates provide net revenue equal to at least 1.10 times the annual debt service requirements for all junior lien obligations after payment of senior lien requirements. All of Water Quality Junior Lien Variable Rate Sewer Revenue Bonds and Multi-Modal Limited Tax General Obligation Revenue Bonds incorporate the identical requirement stated in the 2001 bond covenant requirements. In 2020, short-term interest rates fell to 1.22 percent from 2.11 percent in 2019.

Coverage (1.10 required by covenant) 21.88

**King County Water Quality Enterprise Fund  
Supplemental Information  
Supplemental Schedule of Historical Debt Service  
Coverage Ratios (Unaudited)**

**DEBT SERVICE COVERAGE FOR THE WATER QUALITY ENTERPRISE  
LAST TEN FISCAL YEARS**  
(dollars in thousands)

|   | <u>2011</u>       | <u>2012</u>       | <u>2013</u>       | <u>2014</u>       | <u>2015</u>       | <u>2016</u>       | <u>2017</u>       | <u>2018</u>       | <u>2019</u>       | <u>2020</u>       |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Residential customer and residential customer<br>Equivalents (RCEs) (annual average, rounded) | 707,300           | 708,900           | 718,160           | 725,844           | 736,090           | 756,430           | 756,916           | 760,571           | 763,436           | 767,265           |
| Percentage annual change  | 0.41%             | 0.23%             | 1.31%             | 1.07%             | 1.41%             | 2.76%             | 0.06%             | 0.48%             | 0.38%             | 0.50%             |
| Operating revenues  |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| Sewage disposal fees  | \$ 306,430        | \$ 307,143        | \$ 342,850        | \$ 346,591        | \$ 371,253        | \$ 381,513        | \$ 401,650        | \$ 403,589        | \$ 415,279        | \$ 417,361        |
| Rate stabilization  | (25,523)          | 13,923            | 10,350            | 18,000            | (12,000)          | -                 | -                 | -                 | -                 | -                 |
| Capacity charge revenues  | 48,693            | 51,411            | 58,660            | 59,522            | 62,479            | 71,200            | 82,615            | 86,836            | 102,146           | 92,622            |
| Other operating revenues  | 7,830             | 9,398             | 10,126            | 11,675            | 11,674            | 11,828            | 18,308            | 19,125            | 19,024            | 19,956            |
| <b>Total Operating Revenues</b>   | <b>337,430</b>    | <b>381,875</b>    | <b>421,986</b>    | <b>435,788</b>    | <b>433,406</b>    | <b>464,541</b>    | <b>502,573</b>    | <b>509,550</b>    | <b>536,449</b>    | <b>529,939</b>    |
| Operating and maintenance expenses <sup>1)</sup>  | 103,995           | 114,939           | 117,183           | 122,014           | 127,211           | 138,698           | 142,263           | 139,585           | 143,834           | 154,513           |
| Add: GAAP adjustment <sup>2)</sup>  | -                 | -                 | -                 | 2,187             | 1,715             | (2,377)           | 5,936             | 13,004            | 10,438            | 3,505             |
| <b>Net operating and maintenance expenses</b>   | <b>103,995</b>    | <b>114,939</b>    | <b>117,183</b>    | <b>124,201</b>    | <b>128,926</b>    | <b>136,321</b>    | <b>148,199</b>    | <b>152,589</b>    | <b>154,272</b>    | <b>158,018</b>    |
| Net operating revenue   | 233,435           | 266,936           | 304,803           | 311,587           | 304,480           | 328,220           | 354,374           | 356,961           | 382,177           | 371,921           |
| Interest income <sup>3)</sup>   | 2,725             | 1,697             | 2,682             | 2,822             | 2,863             | 4,549             | 6,055             | 8,956             | 10,765            | 7,971             |
| <b>Net revenue available for debt service</b>   | <b>236,160</b>    | <b>268,633</b>    | <b>307,485</b>    | <b>314,409</b>    | <b>307,343</b>    | <b>332,769</b>    | <b>360,429</b>    | <b>365,917</b>    | <b>392,942</b>    | <b>379,892</b>    |
| Debt service  |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| Parity bonds  | 132,664           | 157,117           | 172,959           | 175,463           | 167,694           | 160,957           | 159,761           | 163,967           | 171,321           | 162,385           |
| Parity lien obligations   | 32,910            | 38,626            | 43,064            | 42,876            | 40,348            | 53,164            | 52,650            | 49,121            | 41,529            | 50,755            |
| Subordinate debt service  | 12,769            | 14,087            | 15,039            | 17,477            | 18,318            | 21,316            | 26,277            | 33,139            | 35,174            | 30,367            |
| <b>Total debt service</b>   | <b>\$ 178,343</b> | <b>\$ 209,830</b> | <b>\$ 231,062</b> | <b>\$ 235,816</b> | <b>\$ 226,360</b> | <b>\$ 235,437</b> | <b>\$ 238,688</b> | <b>\$ 246,227</b> | <b>\$ 248,024</b> | <b>\$ 243,507</b> |
| Debt service coverage   |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| On parity bonds   | 1.78              | 1.71              | 1.78              | 1.79              | 1.83              | 2.07              | 2.26              | 2.23              | 2.29              | 2.34              |
| On parity bonds and parity lien obligations   | 1.43              | 1.42              | 1.36              | 1.44              | 1.48              | 1.55              | 1.70              | 1.72              | 1.85              | 1.78              |
| On all sewer system obligations   | 1.32              | 1.28              | 1.33              | 1.33              | 1.36              | 1.41              | 1.51              | 1.49              | 1.58              | 1.56              |

1) 2014 operating expenses were restated as part of GASB Statements 68 and 71 implementation.

2) Non-cash GAAP adjustments consist of pension, other post-employment benefits and compensated absence accruals.

3) Interest Income excludes unrealized gains in the GASB Statement 31 market valuation adjustment.

## **Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards***

The Metropolitan King County Council  
Seattle, Washington

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the King County Water Quality Enterprise Fund, which comprise the statement of net position as of December 31, 2020, and the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 30, 2021.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the King County Water Quality Enterprise Fund's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the King County Water Quality Enterprise Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the King County Water Quality Enterprise Fund's internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the King County Water Quality Enterprise Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose

*Moss Adams LLP*

Seattle, Washington  
April 30, 2021



MOSSADAMS