S&P Global
Ratings

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Summary:

King County, Washington; Water/Sewer

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

Secondary Contact:
Alexandra Rozgonyi, Centennial + 1 (303) 721 4824; alexandra.rozgonyi@spglobal.com

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Credit Profile		
US$226.94 mil swr rev rfdg bnds ser 2021A due 07/01/2040		
Long Term Rating	AA+/Stable	New
King Cnty junior lien swr rev rfdg bnds		
Long Term Rating	AA/Stable	Affirmed
King Cnty junior lien swr rev rfdg bnds		
Long Term Rating	AA/Stable	Affirmed
King Cnty swr		
Long Term Rating	AA+/Stable	Affirmed
King Cnty swr		
Long Term Rating	AA+/Stable	Affirmed
King Cnty swr		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to King County, Wash.'s $226.9 million series 2021A sewer revenue refunding bonds, issued for the county's wastewater treatment division's (WTD).

S&P Global Ratings also affirmed its various ratings, including its:

- 'AA+' long-term rating on the county's parity lien sewer revenue bonds; and
- 'AA' long-term rating and underlying rating (SPUR) on the county's junior-lien sewer revenue bonds.

The outlook, where applicable, is stable.

A rate covenant requires the system to generate debt service coverage (DSC) on parity bonds (senior-lien bonds) and parity lien obligations of at least 1.15x and on junior-lien and multimodal limited-tax general obligation (LTGO)/sewer bonds at 1.10x. The county can issue additional parity debt if projected net revenue provides at least 1.25x DSC. The bond ordinance provides that the county will pay into and maintain in the parity bond reserve account an amount that, together with other funds in the parity bond reserve account, will be at least equal to maximum annual debt service with respect to any calendar year.

The county has previously issued debt payable from wastewater net revenue that also benefits from a full faith and credit pledge of the county. Currently, the GO rating on the county remains the stronger pledge, therefore, the ratings on these obligations reflect our opinion of the county's overall credit quality rather than the sewer pledge.

As of July 1, 2021, the county had the following debt outstanding supported by sewer system revenues:

- $2.2 billion in parity lien sewer revenue bonds (first lien);
- $231.3 million of undrawn Water Infrastructure Finance and Innovation Act loans (first lien);
- $549.64 million in LTGO bonds (known as parity lien obligations, second lien);
- $300.6 million in junior-lien obligations (including $165.7 million in commercial paper draws, third lien);
- $310.2 million in multi-modal LTGO/sewer revenue bonds (fourth lien); and
- $246.9 million in state loans (fifth lien).

Credit overview

King County's WTD provides wholesale wastewater treatment to over 30 cities and communities in the Puget Sound area. Despite the WTD's already sizable debt burden (over $3.8 billion) and plans to add $1.5 billion of debt within the next six years, our rating reflects our assessment of its capacity to perpetuate consistently strong financial metrics over this period, despite the additional leverage. While we consider the WTD's sewage treatment rates to be somewhat elevated, relative to those of peer utilities, we believe the use of fees based on residential equivalent units, in lieu of volumetric charges, shields the utility's financial performance from the Pacific Northwest's variable hydrological conditions and economic shocks.

Credit risks center on the WTD's largely regulatory driven capital improvement plan (CIP; which will be approximately 60% debt funded) and its ability to meet critical milestones as required under a consent decree between the county, the U.S. Department of Justice, the United States Environmental Protection Agency, and Washington Department of Ecology (WDOE) which requires the WTD to undertake and construct nine capital projects to control 14 uncontrolled overflow locations by 2030.

The rating also takes into consideration the WDOE's draft nutrient removal permit (announced June 15, 2021), which could require compliance by 2036. We understand that the proposed nutrient removal limits could compel the county to construct an additional wastewater treatment plant and finance significant upgrades to existing facilities with current cost estimates in the multi-billion-dollar range. We will evaluate the potential credit impacts, if any, as the timing and funding mechanisms are clarified over the next several years.

Although household incomes in King County, are on average, higher than those in most other major metropolitan statistical areas (MSAs) nationwide, we note that the average residential customer's monthly bill in the county is typically higher than those in the surrounding region. For example, the typical monthly bill in Seattle (including the county's charge) is currently $119.05 for 4.3 hundred cubic feet (HCF), versus $58.22 in Tacoma assuming 6.0 HCF. The county's current projections assume 4%-6% annual rate increases through 2027. While we believe the county's rising cost of service could adversely affect overall affordability in the communities it serves, including Seattle (which has planned wastewater rate increases that average 5.8% per annum and drainage rate increases 8.7% per annum through 2026), we recognize that the WTD's costs are effectively paid on a senior basis to its participants' own costs, which we consider a stabilizing credit factor for the county. With many jobs able to happen remotely and the region's largest employer, Amazon, surging on robust demand for online retail and cloud computing services, we think a significant portion of the county's economic life has adapted to the pandemic with minimal disruption.

The rating further reflects our view of:

- The underlying economic strength, diversity, and wealth of the WTD's customer base;
- The county council's demonstrated ability and willingness to increase service rates, with projected rate schedules that promote cost recovery and revenue stability;
- Sound historical all-in coverage that we believe will remain at levels that we consider credit supportive (exceeding 1.44x through 2027). In fiscal 2020, net revenue of $379.9 million provided very strong 1.56x coverage on $243.5 million of debt service (across all liens);
- Strong liquidity that is supported by an adopted reserve policy. Unrestricted cash and investments totaled $162 million as of Dec. 31, 2020 (including $46.3 million in the rate stabilization fund [RSF]), representing 380 days of operating expenses on hand. The county has a reserve policy establishing a liquidity reserve, equal to $5.0 million plus 10% of annual operating expenses, and an emergency capital reserve equal to $15.0 million. Management intends to maintain between 90-100 days of cash on hand (excluding the RSF balance) over the forecast period, which we consider credit supportive;
- Extremely high existing leverage (as measured by the system's 96% debt-to-capitalization ratio, as of Dec. 31, 2020) further tempered by the WTD's $2.3 billion CIP, which we understand will require approximately $1.5 billion of additional debt through 2027 (and does not include any potential costs related to the proposed nutrient removal permit); and
- Transparent and well-defined financial management practices, with planned capital spending built into current financial projections.

The stable outlook reflects our anticipation that the WTD's strong liquidity position--including its access to the county investment pool, if needed--mitigates the potential effects of the COVID-19 pandemic and that, even with the significant additional planned debt over the next several years layered in, the system's financial capacity will not diminish to the point that metrics would become inconsistent with the existing ratings. The outlook further reflects our assessment of the county's historical and future willingness to adjust rates to meet rising debt service requirements. We believe that any reluctance or inability by the county council to raise rates could result in erosion of financial margins and liquidity and, in turn, diminished credit quality.

Environmental, social, and governance (ESG) factors

We think King County's direct environmental risks are substantial, given that it is subject to deadline-certain regulatory mandates to reduce the number of sewage backups and untreated sewage overflows that enter the Duwamish River, Lake Washington, and Puget Sound. Like many others, the WTD is also engaged in an ongoing plan to modernize and rehabilitate the system, offsetting significant aging infrastructure. The WTD has been in the news periodically due to sewage overflows from its treatment plants into Puget Sound due to flooding, equipment failings or operating errors; this has resulted in short-term public advisories to avoid contact with the water in the area. As a matter of practice, the WTD collaborates with the county's department of public health and the state department of ecology in these instances to publicize and mitigate any effects from these spills.

We believe the system continues to face ongoing social risk related to COVID-19 as the county does not anticipate a return to prepandemic customer use (based on flows) until the beginning of 2023. To date, however, the pandemic has not had a meaningful impact on the WTD's financial position. The WTD's billing structure provides some lead time to adapt to reduced flows (due to both hydrology or economic factors) as rates are based on historical average usage (over the previous four quarters) rather than on a projection of future volumes, which we consider credit supportive. Furthermore, revenue losses in fiscal 2020 (and forecasted for fiscal 2021 and 2022) are largely offset by operating efficiencies and debt service savings. While not currently a credit risk, in our view, persistent negative public sentiment or rising political pressure--given the rising cost of service environment--would adversely affect our view of the WTD's governance practices. On June 1, 2021, the county council unanimously approved the 2022 sewer rate increase, which in our view indicates a strong working relationship between the council and management.

Stable Outlook

Downside scenario

While unexpected, we could take a negative rating action if financial metrics decline from current projections due to an unanticipated loss of revenue attributable to the economic contraction, increased operating expenses or capital needs, or a delay in planned rate increases.

Upside scenario

Given the size of the CIP and the WTD's projected debt service requirements, we do not anticipate taking a positive rating action during the outlook period.

Credit Opinion

King County (population 2.2 million) provides wholesale wastewater treatment services to customers in 34 municipalities and three nonmunicipal participants within or near the county. The City of Seattle provides 38.5% of the county's customer base in fiscal 2020, followed by Bellevue (8.16% of the total) and Alderwood Water and Wastewater District (6.85%). The local economy is broad, diverse, and growing, and is largely derived from various high-tech clusters, including biotech and telecommunications, as well as the aviation and manufacturing sectors. We consider the county's median household effective buying income will be extremely strong, at 147% of the national average in 2020. Unemployment peaked at 14.9% in April 2020, but it has since declined to 4.8% as of May 2021.

While the WTD is principally responsible for sewage treatment and disposal, each participating agency is responsible for its own local collection and transmission. Each participant pays a monthly sewer charge to the county for its proportionate operating and capital costs associated with the system, and treats its proportionate share of the county's debt service and operations as operating expenses of its own systems, effectively subordinating participant debt to the county's sewer system debt, which we consider credit supportive for the WTD. The agreement between the county and 25 participants (including Seattle) for wholesale sewage treatment expires in 2036, although negotiations are underway to extend the agreement. Nine participants (including five cities) have signed extensions through 2056.

The county has regularly increased its wholesale treatment rates to recover its rising costs and has historically increased its wholesale treatment rate every two years. Going forward, the county council intends to adopt annualized rate increase to provide a more stable rate path. We believe rate affordability could become challenged if household incomes do not keep pace with planned rate increases.

The sewer system's long-range capital plan from 2021-2027 is sizable, at about $2.3 billion, and management plans to fund about 60% from debt and the remaining 40% from rates and annual pay-as-you-go payments, which we consider credit supportive. About 42% of the total CIP expenditures is to fund asset management and renewal and replacements of aging infrastructure, 19% to fund projects related to combined sewer overflows, and the remainder for other purposes.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020