S&P Global Ratings

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**Summary:**

# King County, Washington; CP; Joint Criteria; Water/Sewer

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## Summary:

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| Credit Profile | | |
|---|---|---|
| US$174.245 mil swr imp and rfdg rev bnds ser 2020A dtd 08/04/2020 due 01/01/2052 | | |
| *Long Term Rating* | AA+/Stable | New |
| US$146.555 mil swr imp and rfdg rev bnds ser 2020B dtd 08/04/2020 due 01/01/2040 | | |
| *Long Term Rating* | AA+/Stable | New |
| US$100.275 mil junior lien swr rev rfdg bnds ser 2020B dtd 07/14/2020 due 07/01/2025 | | |
| *Long Term Rating* | AA/Stable | New |
| US$100.275 mil junior lien swr rev rfdg bnds ser 2020A dtd 07/14/2020 due 07/01/2025 | | |
| *Long Term Rating* | AA/Stable | New |
| 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 series 2020A sewer improvement and refunding revenue bonds and series 2020B (taxable) sewer refunding revenue bonds. At the same time, S&P Global Ratings assigned its 'AA' long-term rating to King County's junior-lien sewer revenue refunding bonds, series 2020A and 2020B (mandatory put bonds).

S&P Global Ratings also affirmed its various ratings on King County, Wash.'s outstanding debt, including its:

- 'AA+' long-term rating on the county's parity-lien sewer revenue bonds,
- 'AA' rating and underlying rating (SPUR) on the county's junior-lien sewer revenue bonds, and
- 'AA+/A-1' rating on the county's joint criteria bonds.

The outlook, where applicable, is stable.

The series 2020A bonds will have a par amount of approximately $174.2 million and provide funds to acquire and construct improvements to the county's sewer system, provide a deposit to the parity bond reserve account, and defease and refund (subject to market conditions) certain revenue bonds. The 2020B bonds will have a par amount of about $146.5 million and be used to defease and advance refund certain revenue bonds of the sewer system.

The series 2020A and B mandatory put bonds will have a par amount of approximately $200.5 million and provide funds to refund the county's series 2001 junior-lien variable-rate demand obligations and 2011 junior-lien bonds. Given the county's very strong credit quality, a failed remarketing would most likely be driven by a factor or event exogenous to the county. The put bonds will not have a credit enhancement or liquidity facility securing the payment of the purchase price of any bonds that are not remarketed. If remarketing is unsuccessful due to a lack of market access, then the county could fund the mandatory purchase with an interfund loan from the county's cash pool.

A rate covenant requires the system to generate debt service coverage (DSC) on parity bonds (senior-lien bonds) 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 the maximum annual parity debt service with respect to any calendar year

As of June 14, 2020, the county had the following outstanding debt supported by sewer system revenues:

- $2.2 billion in parity-lien sewer revenue bonds (first lien),
- $581 million in LTGO bonds (known as parity-lien obligations, second lien),
- $300.0 million in junior-lien obligations (third lien),
- $246 million in multi-modal LTGO/sewer revenue bonds (fourth lien),
- $226 million in state loans (fifth), and
- $134.5 million of undrawn loan commitments under the Water Infrastructure Finance Innovation Act (WIFIA) (first lien).

The county has parity-lien LTGO refunding bonds and multimodal LTGO bonds payable from sewer net revenue. These bonds, however, benefit from a full faith and credit pledge of the county. At this time, the GO rating on the county remains the stronger pledge. For more information on our rating on the county's LTGO bonds, please see our report published Nov. 12, 2019, on RatingsDirect.

### Credit overview

King County is a major regional wastewater treatment services provider to 34 municipal participants and three nonmunicipal participants. Given the large number of member participants, and the county's strong contracting provisions, we take a "system" approach when evaluating the county's credit quality. As a result, the ratings are not driven by any one participant and we look at the customer base, market position, and the system's financial position in aggregate. Although member credit quality has not been a constraining credit factor to date, we note that the Seattle wastewater rating was recently put on negative outlook. In 2019, Seattle represented 39.74% of total customers served and is the county's largest participant. While we continue to monitor Seattle's credit quality, we do not consider it to be a limiting credit factor for the county ratings. Nevertheless, a material erosion in Seattle's credit quality would affect our assessment of the county's credit quality, particularly if the city puts pressure on the county to delay or defer future rate plans or alter its capital funding plans. There is no indication that the city plans to do so at this time.

The ratings reflect our opinion of the system's creditworthiness, including its very strong financial risk profile and diverse economic base. The strength of the sewer system's financial metrics provides a strong cushion, in our view, to mitigate short-term disruptions from the COVID-19-related recession. S&P Global Economics acknowledges that the measures to contain COVID-19 have pushed the economy into recession. We believe the system's revenues may decline somewhat for fiscals 2020 and 2021, though ultimately our expectation is that management will continue to manage the system and maintain strong coverage levels. The wastewater system, as of fiscal 2019, also has over 380 days' cash on hand, which we believe provides sufficient cushion against short-term disruptions. While we continue to monitor events related to COVID-19, we do not anticipate them affecting the county's ability to maintain budgetary balance and pay debt service costs given the strong coverage and liquidity position. For more information, see our articles "COVID-19's Potential Effects In U.S. Public Finance Vary By Sector" (published March 5, 2020, on RatingsDirect), "All U.S. Public Finance Sector Outlooks Are Now Negative" (published April 1, 2020), and "An Already Historic U.S. Downturn Now Looks Even Worse" (published April 16, 2020).

The ratings reflect our view of:

- The county's role as a major regional provider of wastewater treatment services within the broad and diverse Seattle-Tacoma-Bellevue metropolitan statistical area;
- The county council's demonstrated ability and willingness to incrementally and regularly increase sewer rates and connection charges, resulting in financial stability in recent years; and
- The sewer system's consistent financial performance, with strong, stable and predictable DSC (across all liens and including its LTGO debt service), which we believe is sustainable based on the county's well-defined debt and reserve policies.

Partially offsetting the above strengths, in our view, is the sewer system's high outstanding leverage (as measured by the system's 96% debt-to-capitalization ratio, as of Dec. 31, 2019) and sizable upcoming capital improvement plan (CIP), which we understand will require approximately $1.2 billion of additional parity debt through 2026 (including draws on the WIFIA loan).

The stable outlook reflects the county's transparent and formalized financial management practices and policies that have resulted in consistently stable financial metrics during the past five fiscal years. Although we expect the sewer system to experience some adverse effects related to COVID-19 and the recession, management's conservative forecasting and long-term financial planning support our stable outlook and expectation that management will continue to manage expenses to maintain stable financial metrics.

### Environmental, social, and governance factors

In our opinion, environmental risk is heightened due to more stringent regulatory requirements, which could result in significant capital expenditures. In particular, the Department of Ecology is targeting mid-2021 for a general nutrient permit for 67 utilities that discharge into the Puget Sound, including the county. Studies in 2010 and 2011 indicated the compliance cost for the county are sizable and could exceed $2.9 billion, which could raise affordability challenges for communities served by the county. Additionally, addressing sanitary sewer overflows remains a challenge. Ecology is investigating two incidents from 2019, where untreated effluent was discharged from the county's West Point and South Plants into the Puget Sound. In our opinion, management has strong governance due to transparent communication with its communities and robust long-term strategic and financial planning. Specifically, management is developing a Clean Water Plan that it will submit to the county council at the end of 2021 as an amendment to the 1999 Regional Wastewater Service Plan that will inform the Wastewater Treatment Division which combined sewer overflow (CSO) and other investments will provide the best water quality outcomes. However, we believe the member agencies could look to King County for additional rate deferrals or reductions as the pandemic spreads and the recession deepens, which presents social risk.

## Stable Outlook

### Downside scenario

We could take a negative rating action if all-in coverage metrics underperform management's forecast or if the wastewater system substantially draws down the system's liquidity position for capital projects or other reasons. As the county formulates its future capital needs it is possible the financial costs associated with Ecology's general permit could result in a higher debt burden and affordability pressures that could pressure the rating downward; however, the timing of requirements and financial needs are unknown and, in our opinion, beyond the two-year outlook horizon.

### Upside scenario

S&P Global Economics projects it may be 2022 before credit conditions fully return to prepandemic levels. Therefore, due to the current recession, we do not anticipate raising the ratings during the two-year outlook horizon. Additionally further limiting consideration for upside potential are the sizable capital needs and the negative outlook on the city of Seattle wastewater rating.

## Credit Opinion

### Enterprise risk

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 39.74% of the county's customer base in fiscal 2019, followed by Bellevue (7.7% of the total) and Alderwood Water and Wastewater District (6.2%). 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 to be extremely strong, at 147% of the national average in 2018. As it relates to COVID-19, we expect the larger commercial centers in Seattle and Bellevue to experience more of a decline in wastewater flows compared to that of the other municipalities. The national unemployment rate for May of 2020 was 13.3%, and the preliminary May unemployment reported by the Bureau of Labor Statistics for King County was about 14.9%.

The county operates three regional secondary wastewater treatment plants, two local treatment plants, four CSO treatment plants, and 39 CSO outfall locations. In 2019, the average flow of the county's five wastewater treatment plants was 161 million gallons per day (mgd), with a peak daily flow of 752 mgd, including 145 mgd from the CSO treatment plants. Maximum system capacity was 865 mgd in 2019. In 2013, the U.S. District Court for the Western District of Washington approved a consent decree to control 14 uncontrolled over flow locations by 2030. Requests were made to initiate negotiations to modify the consent decree and to extend completion of bidding and construction for Chelan CSO beyond the current milestones at the end of 2020 and 2023. All other milestones are either on track for completion or will be completed after modifications are finalized. All five of the regional wastewater treatment plants, except the following incidents, have been in compliance with their permit effluent limits. In 2019, 3.43 million gallons of secondary treated effluent was discharged without disinfection from the South Plant when power was lost during a planned upgrade. Additionally, in 2019 the emergency bypass gate was opened at West Point, resulting in 2.1 million gallons of untreated stormwater and sewage flowing into Elliot Bay. Ecology is in the process of investigating both of these incidents.

Each participating agency is responsible for its own local collection and transmission system. Moreover, each participant, including Seattle, treats its proportionate share of the county's debt service and operations as operating expenses of their own systems, effectively subordinating participant debt to the county's sewer system debt. The agreements with 25 participating agencies (including Seattle) and the county to provide wholesale sewage treatment expire in 2036, although negotiations are underway to extend the agreements. Nine participants (including five cities) have signed extensions through 2056.

The county council has increased rates regularly, with recent increases every two years. The council recently adopted a 4.5% rate increase for 2021. The county sets a monthly flat per-residential customer equivalent (RCE) charge, which it levies on its participants. Rates were increased 2.5% on Jan. 1, 2019, to $45.33 per-RCE. Previously, rates were increased by 5.2% in 2017, 5.6% in 2015, 10.2% in 2013, and 13.2% in 2011. In addition to the financial flexibility provided by rate increases, the county has a rate stabilization fund (RSF), with a current balance of $46.25 million as of fiscal 2019. Retail customers' actual rates are higher since they also include charges to support the local collection system, and the average residential customer's monthly bill in King County is higher than those in the surrounding region. For example, the typical monthly bill in Seattle (including the county's charge) is currently $116 for 4.3 hundred cubic feet (HCF), versus $83 in Tacoma assuming 6 HCF.

### Financial risk

Even though fixed costs are sizable, the county's all-in coverage has been consistently strong, and we believe coverage will remain strong. In fiscal 2019, net revenue of $392 million provided very strong 1.58x coverage on $248 million of debt service (across all liens). Management indicated that the full COVID-19 impact is uncertain; however, 55% of sewer disposal charges are derived by a municipal fee on single-family residential customers and are not affected by changes in volume. The county has calculated, for the wastewater system, a 20% decrease in volume-based charges beginning in second-quarter 2020 to first-quarter 2021 would result in a 0.4% decrease in sewage disposal revenues for 2020 and a 7.8% decrease in 2021. In addition, management has assumed early payoffs for capacity charge revenues could decrease by approximately 50% in 2020 and 40% in 2021. With the impact of COVID-19, all-in coverage would be 1.41x (2020) and 1.37x (2021). Projected 2020 and 2021 all-in coverage is still what we consider strong.

Even under more extreme stress scenarios we believe the sewer system's financial metrics will remain sound in comparison with those of its peers. We have performed a stress-test scenario that assumes the future rate increases in 2023 are not adopted. Based on our stress-test scenario, by 2024 all-in coverage would drop to about 1.2x, a figure we still consider to be adequate.

The sewer system's liquidity position is very strong. Unrestricted cash and investments in the system's operating fund, construction funds, policy reserves, and RSF reserve totaled $162 million as of Dec. 31, 2019 (including $46.3 million in the RSF), representing 380 days of operating expenses on hand. The county has a reserve policy establishing an operating liquidity reserve, equal to $5.0 million plus 10% of annual operating expenses, and an emergency capital reserve equal to $15.0 million.

The sewer system has very high leverage outstanding (as measured by the system's 96% debt-to-capitalization ratio, as of Dec. 31, 2019) and sizable upcoming CIP, which we understand will require approximately $1.2 billion of additional parity debt through 2026 (including draws on the WIFIA loan). The sewer system's long-range capital plan from 2020 to 2026 is about $2.2 billion, and management plans to fund about 55% from debt and the remaining 45% from rates and annual pay-go. About 55% of the total CIP expenditures is to fund asset management and renewal and replacements of aging infrastructure, 28% to fund projects related to CSOs, and 17% for conveyance system improvements.

Overall, we believe that the county's financial practices are strong, comprehensive, and supportive of high credit quality. Management presents interim financial reports to the county council regularly as part of the county's budget monitoring process. The long-term planning process is rigorous, and the detailed multiyear forecast is annually updated. Management has indicated that it intends to maintain between 90 and 100 days of cash on hand (excluding the RSF balance) over the forecast period. In addition, the county water quality fund (wastewater treatment enterprise) has access to the county investment pool in which $2 billion in holdings are available to the sewer system for near-term liquidity purposes. The system has periodically borrowed from the county investment pool for interim financing pending the issuance of long-term debt; no loans remain outstanding.

## Related Research

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

| Ratings Detail (As Of June 18, 2020) | | |
|---|---|---|
| King Cnty jr ln VRD swr | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| King Cnty jr ln VRD 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 |
| King Cnty swr | | |
| *Unenhanced Rating* | NR(SPUR) | Current |
| King Cnty swr | | |
| *Long Term Rating* | NR | |
| King Cnty swr (FGIC) (National) | | |
| *Unenhanced Rating* | NR(SPUR) | Current |
| King Cnty CP swr | | |
| *Short Term Rating* | NR | Current |
| King Cnty JOINTCRIT | | |
| *Long Term Rating* | AA+/A-1 | Affirmed |

| Ratings Detail (As Of June 18, 2020) (cont.) | | |
|---|---|---|
| *Unenhanced Rating* | AA(SPUR)/Stable | Affirmed |
| King Cnty JOINTCRIT | | |
| *Long Term Rating* | AA+/A-1 | Affirmed |
| *Unenhanced Rating* | AA(SPUR)/Stable | Affirmed |
| Many issues are enhanced by bond insurance. | | |

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