S&P Global
Ratings

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Research Update:

Seattle, WA Series 2025 Drainage And Wastewater System Improvement And Refunding Revenue Bonds Assigned 'AA+' Rating

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Overview

- S&P Global Ratings assigned its 'AA+' long-term rating to Seattle, Wash.'s anticipated $157.1 million series 2025 drainage and wastewater system improvement and refunding revenue bonds. Seattle Public Utilities (SPU) is the city's utility system.
- At the same time, S&P Global Ratings affirmed its 'AA+' rating on Seattle's outstanding drainage and wastewater system parity debt.
- The outlook is stable.

Rationale

Security

Proceeds will be used to fund $66 million of upcoming drainage and wastewater system capital needs and to refund certain existing bonds. We consider the bond provisions to be standard. The series 2025 bonds are secured by a pledge of net revenues of the city's drainage and wastewater system. In addition, securing all parity bonds is a reserve funded at the lesser of maximum annual debt service (MADS), 125% of average annual debt service, or 10% of proceeds. A rate covenant requires the system to generate coverage of 1.25x average annual debt service, although withdrawals from a rate stabilization fund may be included in this calculation.

At fiscal year-end Dec. 31, 2024, the system had $767.3 million of drainage and wastewater revenue bonds, $194.5 million in subordinate state loans, and $86.8 million in borrowing under the Water Infrastructure Finance and Innovation Act (WIFIA) program with the Environmental Protection Agency.

Credit highlights

SPU's well-embedded management policies and financial practices have contributed to a healthy financial risk profile and stable drainage and wastewater operations in recent years. The rating is further supported by the overall favorable economic considerations of the customer base in Seattle, offsetting retail rates that are above average for the region, especially when adding utility taxes that SPU pays to the city and state.

We consider SPU's operational management comprehensive and forward-looking. Still, our assessment is tempered by the system's near-term capital spending, which focuses on regulatory compliance, environmental stewardship, emergency preparedness, and system reliability. While we consider the $1.4 billion six-year capital improvement plan (CIP) relatively substantial, about 40% will be funded with non-debt funding sources, which we consider credit-stabilizing. However, nearly all sewage within Seattle is treated on a wholesale basis by King County's regional wastewater treatment system (with about 1% treated by Southwest Suburban Sewer District). King County has approximately $3.5 billion of debt outstanding and an $8.2 billion 10-year CIP, approximately one-third of which will be passed through to the city, which adds social risk.

Fiscal 2024 financial performance was very strong, in our view, as operating revenues increased by $33.9 million (6.2%) year-over-year, due to an average rate increase of 3.8% for wastewater and 6.4% for drainage, resulting in additional revenues of $21 million and $12.1 million, respectively, while operating expenses increased $12.1 million (2.6%) from 2023. Cash on hand improved to $429.6 million as of Dec. 31, 2024, which we consider strong. The Fund also received a significant $160 million settlement from Monsanto for the Lower Duwamish Waterway Superfund cleanup, the proceeds of which will be used to fund a portion of the upcoming CIP. The settlement is held in a restricted account.

Our calculation of all-in debt service coverage considers SPU's imputed debt resulting from the city's participation in the county's regional wastewater treatment system and taxes paid to the general fund. It is weaker than SPU's calculation, given the sizeable amount of debt the regional wastewater treatment system has outstanding--we estimate that SPU is responsible for approximately 32% of King County's annual debt service, or about $85 million. We expect all-in coverage to decline modestly but remain at levels that we consider sound (more than 1.5x, as calculated by S&P Global Ratings).

About two-thirds of the drainage and wastewater system is a combined or partly combined storm water and wastewater system. This type of system leads to heavy flows and potential overflows during wet weather events. A significant portion of the drainage and wastewater system's CIP, including the Ship Canal Water Quality Project, is intended to address overflows and flooding. The Ship Canal project includes a 29-million-gallon offline storage tunnel, six diversion structures for diverting influent-combined sewage away from existing combined sewer overflow (CSO) outfalls to the tunnel, five drop structures to convey combined sewage into the storage tunnel, and odor-control systems. Because SPU owns four of the six existing CSO outfalls related to the Ship Canal project (King County owns the other two), per a joint agreement SPU is responsible for 65% of the project costs and King County for the remaining 35%.

The rating further reflects our view of the system's:

- City ordinance that allows SPU to pass through increases in King County's wastewater treatment charges based on adopted wholesale rates and projected billed consumption, which we consider a key credit strength.
- City council's demonstrated ability and willingness to increase service rates, with multiyear rate schedules that promote cost recovery and revenue stability. SPU's current plan assumes

a combined 4.7% average annual rate increases during 2025-2030 for all three SPU funds combined.

- Moderate leverage, with a 52% debt-to-capitalization ratio as of Dec. 31, 2024. SPU employees participate in the Seattle City Employees Retirement System (SCERS). The plan is only 76% funded, which we consider slightly below average (as a percentage of expenditures) but we expect it to be manageable in the near term for SPU.

Environmental, social, and governance

We believe Seattle's direct environmental risks are substantial and have factored them into the rating, given that SPU 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 the Puget Sound. It also faces social risk related to its sizeable CIP, which we expect will pressure rates that are already relatively high compared to those of its peer utilities. In our view, the service area's above-average income levels partially mitigate this risk. Because the city is concerned about affordability for low-income customers, it provides a 50% discount to income-qualifying households, with an enrollment of about 30,000 households.

In December 2021, the Washington Department of Ecology issued the Puget Sound Nutrient General Permit. The permit is on appeal and is the subject of litigation. However, the potential 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, and for one-third of which Seattle would likely be responsible. We will evaluate the potential credit implications, if any, as the timing and funding mechanisms are clarified during the next several years.

Finally, we view SPU’s governance factors as credit-neutral because they include full rate-setting autonomy, strong policies and planning, and robust interaction between management and the city council.

Outlook

The stable outlook reflects our anticipation that even with the additional planned debt during the next five years layered in, the system's financial capacity will not diminish to the point that metrics would become inconsistent with the current rating. We believe that any reluctance or inability to raise rates could result in erosion of financial margins and, in turn, diminished credit quality. Nevertheless, we believe the system's rate affordability could be challenged if household incomes do not keep pace with planned rate increases.

Downside scenario

We could take a negative rating action if liquidity is unexpectedly and substantially drawn down, or if project delays result in significantly more leverage than required to complete the CIP.

Upside scenario

Given the size of the CIP and the system's rising costs of service, we do not anticipate taking a positive rating action during the outlook period.

Credit Opinion

The city of Seattle (population: 797,700) sits at the center of the large, diverse Puget Sound regional economy. We view the service area's income levels as extremely strong based on the city's median household effective buying income (MHHEBI) of more than 153% of the national level in 2024. While the population served has grown by 41% in the past 25 years, per capita demand has been flat to declining due to conservation and the city forecasts stable demand, consistent with other large wastewater systems at this rating level.

We consider the city's annualized residential drainage and wastewater bill elevated on a nominal basis relative to those of its peers in the Pacific Northwest at an average of about $177 per month, including a public utility tax of about $20 charged by the city at a rate of 12.0% for wastewater revenues and 11.5% for drainage revenues, and a 3.85% public utility tax paid to the state of Washington on a certain portion of revenues identified as sewer collection revenues. Nevertheless, given the high income levels in Seattle, we believe the system's rates are somewhat more affordable at about 2.2% of MHHEBI.

Seattle, Washington--Economic and financial data

		Fiscal year-end			
	Most recent	2024	2023	2022	Median (AA+)
Economic data					
MHHEBI of the service area as % of the U.S.	153.0				112.0
Unemployment rate (%)	3.8				3.4
Poverty rate (%)	8.5				10.2
Water rate (6,000 gallons or actual) ($)	0.0				33.9
Sewer rate (6,000 gallons or actual) ($)	144.2				38.6
Annual utility bill as % of MHHEBI	1.7				1.0
Operational management assessment	Good				Good
Financial data					
Total operating revenues ($000s)		509,612	478,776	458,029	41,982
Total operating expenses less depreciation ($000s)		361,756	353,828	288,442	31,740
Net revenues available for debt service ($000s)		290,198	142,831	162,496	--
Debt service ($000s)		73,809	67,084	68,390	--
S&P Global Ratings-adjusted all-in DSC (x)		2.4	1.5	1.7	2.5
Unrestricted cash ($000s)		429,625	346,886	270,396	55,536
Days' cash of operating expenses		433	358	342	650
Total on-balance-sheet debt ($000s)		1,058,575	1,116,949	959,579	74,352
Debt-to-capitalization ratio (%)		52.3	59.1	56.6	25.0
Financial management assessment	Strong	--	--	--	Good

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

Ratings List
New Issue Ratings
US$157.14 mil drainage and wastewtr sys imp and rfdg rev bnds ser 2025 due 05/01/2055

Ratings List	
Long Term Rating	AA+/Stable
Ratings Affirmed	
Water & Sewer	
Seattle, WA Sewer and Stormwater System	AA+/Stable

The ratings appearing below the new issues represent an aggregation of debt issues (ASID) associated with related maturities. The maturities similarly reflect our opinion about the creditworthiness of the U.S. Public Finance obligor's legal pledge for payment of the financial obligation. Nevertheless, these maturities may have different credit ratings than the rating presented next to the ASID depending on whether or not additional legal pledge(s) support the specific maturity's payment obligation, such as credit enhancement, as a result of defeasance, or other factors.

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