S&P Global Ratings

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Research Update:

Seattle, WA Water System Revenue Bonds Assigned 'AA+' Rating; Outlook Is Stable

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Overview

- S&P Global Ratings assigned its 'AA+' long-term rating to Seattle, Wash.'s anticipated $257.7 million series 2025 water system revenue bonds.
- At the same time, S&P Global Ratings affirmed its 'AA+' rating on the city's outstanding water system parity debt.
- The outlook is stable.

Rationale

Security

Proceeds from the series 2025 issuance will fund $77 million of upcoming water system capital needs and refund up to $244 million of outstanding bonds for interest rate savings.

The bonds are secured by a pledge of net revenue of the city's water system. A rate covenant requires the system to generate debt service coverage of 1.25x, though withdrawals from a rate stabilization fund can be included in this calculation. Additionally, securing all parity bonds is a reserve, funded at $61.5 million (funded with both cash and sureties).

As of Dec. 31, 2024, the water system had $629.2 million of parity water system bonds outstanding and $14.5 million of subordinate state loans.

Credit highlights

The rating is anchored by Seattle's plentiful water supply and storage, broad customer base that includes many of the city's suburbs (served under long-term wholesale contracts), and well-embedded management policies and financial practices. Approved rate increases have averaged 2% annually through 2026, which we consider low. However, we consider Seattle Public Utility's (SPU) rate affordability somewhat constrained due to the high combined bills for its water, wastewater, and solid waste services. While water charges are generally affordable at

$50.12, assuming 5 hundred-cubic-feet (HCF) demand, or 0.7% of median household effective buying income (MHHEBI), the city's typical monthly residential bill totals $245 for utility services.

We consider SPU's pro forma financial metrics sound, with conservative budgeting based on known increases and localized consumer price index (CPI) escalators, and plans to fund approximately 24% of its upcoming capital improvement plan (CIP) on a pay-as-you-go basis. The city levies a relatively sizable 15.54% tax upon gross retail revenue. Therefore, our calculation of all-in debt service coverage (DSC) differs from the city's, as we net out the payment of taxes to the city from revenue. Incorporating future debt issuance plans, annual debt service is expected to rise from approximately $78 million in 2025 to roughly $91 million by 2030, which we consider manageable.

The rating further reflects our view of:

- The city's strong economic fundamentals. 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 MHHEBI at more than 153% of the national level in 2024. Unemployment is below both the state and federal average, at 3.8% as of February 2025;
- The City Council's demonstrated ability and willingness to increase service rates, with multi-year rate increases scheduled that we believe promote cost recovery and revenue stability;
- Robust water supply management, the city monitors reservoir, weather, and precipitation conditions daily; makes frequent real-time and dynamic operational adjustments; and models future scenarios for several months to ensure it can meet downstream river conditions and have sufficient water for its customers. During the last 30 years, the city has not needed to implement mandatory water curtailments, unlike peers in the region, and it forecasts that its water supply will be sufficient through at least 2060;
- Stable liquidity, with $109 million (or 197 days' cash on hand) available as of Dec. 31, 2024. We do not expect SPU to draw cash down materially during the next five years; and
- Favorable debt capacity, due to the system's flat to declining debt service, after it defeased approximately $100 million of high-interest bond debt in 2021 and 2022. While the upcoming CIP totals about $826 million through 2030 and anticipates additional planned debt during the next five years, we do not expect the system's financial profile to diminish to the point that its metrics become inconsistent with the current rating.

Environmental, social, and governance

Our credit rating analysis reflects both positive and negative considerations driven by various environmental, social, and governance (ESG) factors. Although the water system has an abundant supply, which we consider a key credit strength, we recognize that climate risks resulting in extreme weather events, sea-level rise, and drought could pressure the system's operations over time. Pacific Northwest winters are projected to become warmer and wetter, with warmer and drier summers. That means more rain than snow falling on the Cascade Mountains and eventually more prolonged periods of drought; at the same time, recent years have presented some of the wettest winters on record, which could add costs related to flooding or mudslides.

We recognize, however, that management has generally succeeded in executing its 10-year strategic plans, which focuses on future uncertainties and adaptive management and mitigates the influence of these environmental considerations on credit quality. We also recognize the city's robust drought management planning, comprehensive water conservation programs, as well as its aggressive leak detection procedures. Management does not expect material costs for it to comply with the evolving water regulations regarding per- and polyfluoroalkyl substances (PFAS) or the revised lead and copper rule.

To address affordability risks, the city offers a rate program that provides a 50% discount to income-qualifying households, with about 30,000 households currently enrolled--but we believe SPU's higher service costs may encounter political pressure to minimize future rate increases.

Finally, we view the system's governance factors as credit supportive, as they include full rate-setting autonomy; strong policies and planning; and robust interaction between management and the city council.

Outlook

The stable outlook reflects our expectation that we will not change the rating during the outlook period.

Downside scenario

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

Upside scenario

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

Credit Opinion

The water system serves a population of about 1.7 million, providing retail service to customers in Seattle and water on a wholesale basis to 17 suburban water districts and municipalities plus the Cascade Water Alliance. Although more than 50% of water is sold on a wholesale basis, only about 21% of system revenue come from this customer class, which may slightly understate coverage. The top two wholesale customers by revenue are Cascade Water Alliance (AAA/Stable; 7.9% of total operating revenue) and Northshore Utility District (2.0% of total operating revenue.)

Most of SPU's wholesale customers have entered into long-term agreements with Seattle through at least January 2062, requiring the city to meet the customers' water demands not met by local sources. Seattle's contract with its largest customer, Cascade Water Alliance, requires Seattle to provide 33.3 mgd annually through 2040, and declining annual volume thereafter. In May 2024, Cascade indicated that it will obtain the majority of its water from Tacoma Public Utilities, rather than SPU, once the current contract with SPU expires. While this could modestly pressure SPU's future revenue, we understand that SPU and Cascade Water Alliance are discussing a potential contract amendment that could extend the date and change the rate of decline in the volume it sends past the contractual date of 2040.

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) ($)	50.12				33.9
Sewer rate (6,000 gallons or actual) ($)	--				38.6
Annual utility bill as % of MHHEBI	0.9				1.0
Operational management assessment	Strong				Good
Financial data					
Total operating revenues ($000s)		307,820	301,496	290,869	41,982
Total operating expenses less depreciation ($000s)		202,905	199,444	169,474	31,740
Net revenues available for debt service ($000s)		115,926	120,186	119,102	--
Debt service ($000s)		74,301	83,632	80,719	--
S&P Global Ratings-adjusted all-in DSC (x)		1.6	1.4	1.3	2.5
Unrestricted cash ($000s)		109,255	106,297	88,984	55,536
Days' cash of operating expenses		197	195	192	650
Total on-balance-sheet debt ($000s)		484,115	624,223	759,489	74,352
Debt-to-capitalization ratio (%)		35.8	43.2	49.6	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$257.7 mil wtr sys imp and rfdg rev bnds ser 2025 due 05/01/2045	
Long Term Rating	AA+/Stable
Ratings Affirmed	
Water & Sewer	
Seattle, WA Water 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.