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Ratings

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Summary:

Snohomish County Public Utility District No.1, Washington; Retail Electric

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Credit Highlights

- S&P Global Ratings' long-term rating on Snohomish County Public Utility District No. 1 (SnoPUD), Wash.'s electric system and generation system bonds outstanding is 'AA'.
- The outlook is stable.

Security

Although debt service on the district's generating system obligations is paid as an operating expense of the electric system, we make no rating distinction between the two systems, and in calculating coverage metrics, we treat these obligations as electric system debt. A senior lien on net electric system revenue secures the electric system bonds. As of Dec. 31, 2022, SnoPUD had a combined $488 million of generation and electric system debt outstanding.

Credit overview

We believe the district's credit strengths include:

- Consistently robust liquidity (235 days in 2022) and coverage of fixed costs (averaging over 1.8x during the past three years) through varying hydrological conditions;
- Robust service area economic fundamentals, with a largely residential retail revenue base and good customer diversity, further supported by the area's above-average median household effective buying income, which we believe provide a high degree of stability;
- Low-cost, virtually non-carbon-emitting power supply, prudent rate-setting practices, and sound management, policies, and planning; and
- Moderate ratemaking flexibility, as evidenced by rates that are slightly below the state average coupled with above

average median household effective buying income.

We believe credit weaknesses include:

- Exposure to revenue volatility related to both hydrology risk (and its impact on wholesale sales) and reliance on economically sensitive developer contributions, although coverage without the contributions is still robust; and
- A sizable capital program, with more than $832 million in capital projects identified from 2024-2029, including funding for an automated metering infrastructure project and a new office building. Management anticipates financing approximately 22% of the program ($183 million) with debt, a manageable amount of additional leverage, in our view.

Environmental, social, and governance

We view regional environmental factors as slightly negative compared with those of peers on the national level. The district does own its own hydroelectric generation; however, it sources the majority of its supply from the Bonneville Power Administration (BPA). BPA's primary source of power is hydroelectric. In our view, the meteorological effects of climate change and subsequent drought could affect the generation capability of Bonneville to meet the loads of its off-takers, including the district. BPA's generating capacity is reliant on precipitation and snowpack, and in our view, climate change could affect the amount, timing, and availability of hydroelectric generation, which could result in increased costs to the electric utility. Furthermore, one potential longer-term risk is BPA's exposure to fish and wildlife regulations and potential seismic improvements, the costs of which are undetermined. In addition, the district is subject to an evolving regulatory environment in the State of Washington, including the Energy Independence Act and the Clean Energy Transformation Act. The district is in compliance with all regulations, but could face additional regulations in the future.

We believe the district's exposure to social factors is credit neutral. Given the district's slightly below-average rates and above-average incomes, the rates do not pose affordability risks, in our view. Following stronger-than-expected U.S. economic growth through the third quarter of 2023, S&P Global Economics believes that recent business and consumer activity are not sustainable and projects slowing economic activity, along with tepid economic growth of 1.5% in 2024 and 1.4% in 2025. (See "Economic Outlook U.S. Q1 2024: Cooling Off But Not Breaking," published Nov. 27, 2023, on RatingsDirect). Although inflation is softening, S&P Global Economics projects elevated interest rates through much of 2024. The amalgam of material increases in delinquent consumer, credit card, and auto loans, along with October's resumption of student loan payments and drawdowns of household savings garnered during the pandemic, will likely compound the financial pressures facing consumers. Consequently, we continue to monitor the strength and stability of electric utilities' revenue streams for evidence of delinquent payments or other revenue erosion.

We view the utility's governance factors as credit supportive, as they include full rate-setting autonomy, liquidity targets, a long-term capital plan, and long-term financial forecasting.

Outlook

The stable outlook reflects our view of management's projections, which indicate the maintenance of strong coverage metrics, while SnoPUD's robust liquidity provides a short-term cushion in the event of unfavorable hydrological or economic conditions. Further supporting the rating, in our view, are conservative forecast assumptions.

Downside scenario

We could lower the rating if sustained adverse hydrological conditions, rising power supply costs from BPA, or recessionary pressures significantly erode the district's liquidity and fixed cost coverage (FCC).

Upside scenario

We do not expect to raise the rating over the next two years due to ongoing exposure to potentially volatile surplus energy sales related to concentration in hydroelectric generation and sizable capital needs.

Credit Opinion

With more than 370,000 metered customers serving a population of about 850,000, SnoPUD is the second-largest municipal utility in the State of Washington. We believe the district's size and predominantly residential revenue base (about 61% of revenue), provide economies of scale and operational and financial flexibility. In addition, no single customer accounted for more than 3.3% of fiscal 2022 revenues, which provides additional stability.

SnoPUD benefits from a low-cost, predominantly hydroelectric-based energy portfolio. Purchased power accounts for the bulk of energy needs, with BPA supplying the majority under its block and slice products. On Oct. 1, 2011, the district began receiving its BPA power supply under an 18-year contract that is a mixture of slice (variable) and block (fixed) power allocations. In our view, this resource, combined with owned and renewable resources, provides ample energy to meet load demands and creates an opportunity for significant wholesale sales under average stream-flow conditions. We will continue to monitor the district's progress toward finalizing its post-2028 power supply.

The district does face some variability in its revenues from wholesale sales, which change with hydrological conditions. However, management generally budgets conservatively for these revenues, and robust cash balances provide a buffer in the event the district faces lower-than-anticipated sales.

Snohomish County Public Utility District No. 1, Washington--Key credit metrics

	Fiscal year ending		
	2022	**2021**	**2020**
Operational metrics			
Electric customer accounts	373,126	367,096	361,076
% of electric retail revenues from residential customers	61	61	62
Top 10 electric customers' revenues as % of total electric operating revenue	8	8	8
Service area median household effective buying income as % of U.S.	136	138	139
Weighted average retail electric rate as % of state	99	100	104

Snohomish County Public Utility District No. 1, Washington--Key credit metrics (cont.)			
	Fiscal year ending		
	2022	2021	2020
Financial metrics			
Gross revenues ($000s)	807,338	748,212	727,873
Total operating expenses less depreciation and amortization ($000s)	646,451	589,597	589,891
Debt service ($000s)	29,998	26,847	26,579
Debt service coverage (x)	5.4	5.9	5.2
Fixed-charge coverage (x)	1.9	1.9	1.7
Total available liquidity ($000s)*	416,580	380,398	310,943
Days' liquidity	235	235	192
Total on-balance-sheet debt ($000s)	465,383	414,793	324,598
Debt-to-capitalization (%)	24	22	19

*Total available liquidity includes available committed credit line balances, where applicable. Debt service coverage--Revenues minus expenses divided by debt service. Fixed-charge coverage--Sum of revenues minus expenses minus total net transfers out plus capacity payments (or their proxy), divided by the sum of debt service plus capacity payments (or their proxy). N.A.--Not available.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

This report does not constitute a rating action.