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Summary:

Snohomish County Public Utility District No. 1, Washington; Water/Sewer

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Credit Profile		
US$17.07 mil wtr sys rev bnds ser 2023 due 12/01/2043		
Long Term Rating	AA/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'AA' long-term rating to Snohomish County Public Utility District No. 1, Wash.'s $17 million 2023 water system revenue bonds.
- The outlook is stable.
- The rating reflects the district's strong economic base and solid financial metrics, tempered slightly by likely cost pressure from imported water and operations.

Security

We consider the bond provisions to be credit neutral. The net water revenue, inclusive of general facilities charges, secures the bonds as well as utility local improvement district assessments, if available. Key bond provisions include an additional bonds test with a rate covenant that permits additional debt if net revenues of the system (including assessments) cover annual debt service payments by 1.25x.

Proceeds of the series 2023A bonds will be used to finance costs associated with the district's water plan and advanced metering infrastructure, as well as the design, construction, and improvement of other system facilities and a deposit into the reserve account.

The district also has a publicly issued parity debt series 2019 with $5.26 million outstanding. This series is unrated by S&P Global Ratings.

Credit overview

The rating reflects the district's historically strong financial position and our expectation that the district's finances will remain good when including general facilities charges, as it absorbs the 2023 debt service. However, constraining the district slightly is a reliance on imported water for 75% of its supply, which leaves it vulnerable to increases in its water supply costs, with anticipated rate increases from its wholesaler. However, the area's strong economic indicators tied to the broader Seattle-Tacoma area and regionally comparative rates provide the district with financial flexibility if rate increases are needed.

The rating further reflects the water system's:

- Service area with access to the broad and diverse Seattle-Tacoma-Bellevue metropolitan area economy, with consistent service population growth of 2% annually over the last five years;

- Competitive service rates, bolstered by the strong income levels and a low county poverty rate that provide management with revenue-raising flexibility;
- Good operational management, with adequate water supply to meet future growth with a combination of imported water, active wells, and water treatment plants;
- Good liquidity position, with approximately 200 days' operating expenses on hand and a policy of maintaining 90 days of working capital reserve (excluding imported water costs);
- Low debt-to-capitalization ratio that we expect will remain low, inclusive of this issuance; and
- Financial projections that forecast four years beyond the budget year and support ongoing discussions regarding rate increases and liquidity. In addition, the district has a history of raising rates annually at moderate rate of 2%-3%, which may not always match the increase in costs but has provided for strong historical financial performance.

Environmental, social, and governance

We believe that the district has elevated exposure to acute physical risks, with earthquakes the most prominent, but also wildfires in its large mountainous area and flooding among its several rivers. Additionally, Pacific Northwest winters are projected to become warmer and wetter, and summers warmer and drier. At the same time, recent years have been some of the wettest winters on record for the region, which could result in operating costs from flooding or mudslides. Hydrological volatility underpinned by climate hazards can challenge water supply and operations, but the district has developed emergency plans to address its exposure. The district also complies with all lead and copper rule revisions (LCRR) and has tested negative for polyfluoroalkyl substances (PFAS), mitigating some of these more costly environmental exposures. Customers have incomes higher than the national average, and rates are competitive regionally, which mitigates affordability challenges and social risk. We consider the county's social and governance risk in line with our view of the sector standard. For more information, see "Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors," published March 2, 2022, on RatingsDirect.

Outlook

The stable outlook reflects our view of the system's strong local economy, good water supply, and strong financial performance. We anticipate that, during the two-year outlook horizon, the district will continue to adopt multiyear rate increases.

Downside scenario

We could take a negative rating action if the district does not raise rates sufficiently to address rising debt service and operational expenditures, including potentially higher imported water costs, such that coverage is at levels no longer commensurate with those of its peers.

Upside scenario

We could take a positive rating action if the district's financial policies are codified and align with operations, combined with robust coverage but excluding growth-related fees, and unrestricted reserves are maintained at stronger levels.

Credit Opinion

The district's water system has a diverse customer base that serves a growing primarily suburban and rural residential population. The 10 largest retail customers for the 12 months ended Dec. 31, 2022, accounted for approximately $1,353,000, or 8.7%, of the water system's operating revenues. The district also provides wholesale water to cities in the area, with the two largest, Granite Falls and Arlington, accounting for $688,000, or 4.4%, of operating revenues in 2022.

The district is reliant on imported water and is responsible for running its own wells, pumps, storage, and treatment plants. This covers both an integrated system as well as satellite areas that are impractical to connect to the rest of the system. The facilities include nine well sites with 12 active wells, 17 supply and booster pump stations, 17 reservoirs with approximately 15.5 million gallons of storage, and four treatment plants. All drinking water meets state and federal drinking water standards, with imported water treated at Everett's filtration plant and the water from the district's sources treated for iron and manganese in the district's local treatment plants.

The district receives 75% of its water supply from the City of Everett, with which it has a longstanding relationship. For the local supply, the district's groundwater comes from Lake Stevens, May Creek, Skylite Tracts, Sunday Lake, and Warm Beach. These sources can meet approximately 25% of the district's need. The treatment plant can produce 1,000 gallons per minute at full production, and groundwater rights allow for up to 1,400 acre-ft. per year.

In our view, the district has affordable service rates that provide it with revenue-raising flexibility. The water bill represents about 0.73% of median household effective buying income, and the county poverty rate is low at 7.2%. Rates are $53.20 for 6,000 gallons. We understand the district has a practice of instituting annual rate increases of roughly 2%-3%. However, purchased water rates adopted for 2023 and 2024 included 7.9% and 8.1% increases, which will outpace the district's traditional rate increase, perhaps putting some pressure on net revenues in the medium term. The district does not have a direct rate pass-through.

The district's finances have been very strong over the past three years, with adjusted all-in coverage above 1.8x, based on net revenues. The adjusted coverage includes our calculation of coverage for obligations regardless of lien position and incorporates our long-term recurring items that we view as debt-like in nature, even if legally treated as an operating expense. Including all pledged revenues, coverage on the senior lien shows above 4x for the past several years. Projections show good all-in adjusted coverage, but falling below 2x when excluding one-time revenues. Expenditures for operations are projected to grow due to the rise in costs to operate, and operating revenues show relatively modest increases. The balance of expenditures and rate increases will be key to the ongoing financial health of the system. The system has held good days' cash on hand over the past several years, and maintains a policy of 90 days, excluding imported water costs. The district holds several different reserves, including a project reserve, an operating reserve, and a contingency reserve. It forecasts roughly $50 million in capital projects through 2026. The district's debt-to-capitalization ratio will rise to approximately 18% with the issuance of this $17 million, but will still remain comparatively strong.

Snohomish County Public Utility District No. 1, Washington--Economic and financial data

		Fiscal year-end			
	Most recent	**2022**	**2021**	**2020**	**Median (AA)**
Economic data					
Water customers	22,774				19,445
Sewer customers	--				19,829
MHHEBI of the service area as % of the U.S.	136.0				110.0
Unemployment rate (%)	3.2				4.3
Poverty rate (%)	7.2				10.5
Water rate (6,000 gallons or actual) ($)	53.2				35.0
Sewer rate (6,000 gallons or actual) ($)	--				45.0
Annual utility bill as % of MHHEBI	0.7				0.9
Operational Management Assessment	Good				Good
Financial data					
Operating revenues ($000s)		15,506	14,989	14,123	21,711
Total operating expenses less depreciation ($000s)		11,016	9,448	9,443	13,767
S&P Global Ratings-adjusted all-in DSC (x)		1.8	2.1	1.9	2.2
Unrestricted cash ($000s)		7,077	8,355	7,995	22,334
Days' cash of operating expenses		234	323	309	566
Total on-balance-sheet debt ($000s)		11,440	14,481	13,129	33,692
Financial Management Assessment		Standard	--	--	Good

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

Related Research

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