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Ratings

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Summary:

Snoqualmie, Washington; Water/Sewer

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Table Of Contents

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Credit Profile		
US$32.0 mil wtr & swr util rev bnds ser 2018 dtd 07/25/2018 due 12/01/2048		
Long Term Rating	AA/Stable	New

Rationale

S&P Global Ratings assigned its 'AA' rating to Snoqualmie, Wash.'s series 2018 water and sewer revenue bonds. The rating reflects an extremely strong enterprise risk profile and a very strong financial risk profile. The outlook is stable.

The enterprise risk profile reflects our view of the combined system's:

- Service area participation in the broad and diverse Seattle-Tacoma-Bellevue, Wash., metropolitan statistical area economy;
- Affordable rates, given very strong income metrics and an average county poverty rate;
- Very low industry risk as a monopolistic service provider of an essential public utility; and
- Good operational management practices and policies focused on adequate water supply and treatment capacity to meet near-term demand.

The financial risk profile reflects our view of the combined system's:

- Historically extremely strong all-in coverage metrics that we expect will stay sustainable given preapproved rates through 2020 and planned rate increases through 2022;
- Unrestricted liquidity position for fiscal 2016--approximately $4.9 million, equivalent to 305 days' of operating expenditures--that we consider very strong;
- Large but manageable capital improvement plan (CIP); and
- Good financial management practices and policies, which we believe are meaningful.

We have used a one notch peer adjustment down from the initial indicative rating of 'AA+' to land at the final rating based on the system's liquidity position, which we believe is in line with that of peers at the current rating level.

We view the combined system's bond provisions as credit neutral. The bonds are secured by a pledge of net revenue of the city's water, sewer, and stormwater system. The rate covenant requires the system to generate debt service coverage of at least 1.20x less utility local improvement district assessments (ULIDs) due in that year and not delinquent. The additional bonds test requires 125% of maximum annual debt service (MADS) excluding ULIDs due in that year and not delinquent. The city has no ULIDs with assessments currently outstanding. The bonds also have a reserve, funded at the lowest of MADS, 125% of average annual debt service, or 10% of proceeds.

Enterprise risk

Snoqualmie has a population of about 13,700, and is located on the western edge of the Cascade Mountains, about 29 miles east of Seattle. The adjacent cities of North Bend and Carnation, along with the city, comprise an area known as the Snoqualmie Valley; this area encompasses many job opportunities given its close proximity to the Puget Sound regional job centers. The King County local economy consists of various high-tech clusters, including biotech and telecommunications, as well as the aviation and manufacturing sectors. The Snoqualmie population has grown approximately 46% since 2012, which we consider significant.

We believe that residents participate in the broad and diverse Seattle-Tacoma-Bellevue metropolitan area economy, and that income levels are very strong. The median household effective buying income (MHHEBI) for the city was 227% of the national median in 2017. Unemployment rates continue to decline in King County; the county annual unemployment rate was 3.0% for April 2017; this is below both the state's rate and the nation's rates April 2017 of 4.8% and 3.9%, respectively.

The combined system is primarily residential and diverse. In 2017, the system served about 4,400, 4,200, and 1,900 water, sewer, and stormwater customers, of which more than 70% were residential. During the past five years, average annual customer growth has been about 2%, and we expect growth to continue at that pace. We consider the water customer base to be diverse based on the leading 10 customers contributing about 11% of total operating revenues for unaudited fiscal 2017. In addition, we view the sewer and stormwater customer base as slightly less diverse, with the leading 10 customers contributing 21% and 36% of total operating revenue, respectively, for unaudited 2017. It is our understanding that the leading sewer customer, Snoqualmie Casino, has a contract with the city through 2020, which we view as a credit positive as it stabilizes the revenue stream. However, we understand that Snoqualmie Casino may disconnect and move to its own wastewater treatment after the contract expires, and that management expects the Salish Lodge and Spa expansion will offset the potential loss.

We view the combined system's market position as good given the affordable service rates in the context of the service area's very strong income metrics and average county poverty rate. The city's rate structure for residential customers consists of a water base fee plus a consumption fee and a fixed sewer and stormwater fee. The current combined bill represents about 1.6% of MHHEBI when annualized using the city's average water usage of about 700 hundred cubic feet. The most recent rate increase was effective Jan. 1, 2018. The city had a rate study performed in 2016, which recommended rate increases for 2017 through 2022. In 2017, council approved rate increases for 2017 through 2020. Water, sewer, and stormwater rate increases are 5.00%, 17.00%, and 5.65% annually through 2020 and become effective Jan. 1 of each year. Additionally, management has planned rate increases for each system for 2021 and 2022. The city has a rate study performed on the systems every three years. In the future, we expect management to continue to review rates annually and implement rate increases as needed to support future debt obligations.

Based on our operational management assessment, we view the city to be a '3' on a six-point scale with '1' being the strongest. The system provides water, sewer, and stormwater services to its customers. The primary source of water supply is Canyon Spring; its full capacity is used throughout the year. When demand exceeds Canyon Spring's capacity, the North Wellfield is activated; this water is pumped to the reservoirs on Snoqualmie ridge. If demand exceeds both Canyon Spring and the North Wellfield, then the South Wellfield is activated and mixed with Canyon Spring water. The water from Canyon Spring is treated with chlorine, and the water from the Snoqualmie ridge system is treated through iron and manganese removal, filtration, and chlorination. The water system has a capacity to produce up to 4.5 million gallons per day (mgd). In 2017, the average demand was 1.5 mgd with a peak of 4.2 mgd. The system additionally has about 4.5 million gallons of storage capacity at its reservoirs. We understand that management expects current water supply to meet demand through 2025. In addition, the city will continue to pursue additional water rights for future growth of the service area with enough capacity to meet demand of customers in the current service area.

The city has a wastewater treatment plant with a capacity of 2.2 mgd, which includes secondary treatment for advanced nutrient removal and ultraviolet disinfection. The effluent disposal is based on discharging effluent into the Snoqualmie River outfall in the winter and Eagle Lake Golf Course and other irrigated landscape strips for irrigation in the summer. For fiscal 2017, average flow was 1.2 mgd. The stormwater system provides stormwater drainage, treatment, and discharge. There have been no changes to the stormwater system, and the city continues to add new facilities as it grows. We understand that the sewer system has not experienced any sewer system overflows to date for 2018. Furthermore, all of the city's systems are in compliance with all regulations and permits.

Consistent with "Methodology: Industry Risk," published Nov. 19, 2013, we consider industry risk for the system to be very low, the most favorable assessment possible on a six-point scale, with '1' being the best.

Financial risk

We view the combined system's all-in coverage to be extremely strong, and given preapproved rate increases through 2020, we expect coverage metrics will be sustained at this level. We understand that management could potentially issue additional debt in 2020 and 2022, and once total debt service ramps up, we expect coverage to decline to a strong level contingent on future rate increases to offset the rising debt. For our all-in coverage metric, we have included the portion of city general obligation bond debt service associated with utility improvements. We calculate all-in coverage was about 2.4x, 3.1x, and 3.9x for fiscal years 2014 through 2016, a range that we consider extremely strong. Based on our analysis of management-provided projections, we expect coverage to decline to about 1.57x in fiscal 2022, which we consider strong. The decline in coverage is related to the series 2018 debt obligations and management's expected two following debt issuances. The projections assume water, sewer, and stormwater rate increases annually through 2022. Furthermore, the city's financial statements are prepared on a cash basis. We view the city's decision to request audits on a cash basis of accounting as providing less transparency than annual accrual-based audits.

The combined system has historically maintained a strong cash position, and we anticipate it will likely remain strong despite management's plan to fund a portion of its CIP from cash (16%, based on the most recent rate study). At the end of fiscal year 2016, the combined system held unrestricted cash and investments of about $4.9 million, or about 305 days of operating expenses. This is an improvement from fiscal 2013's unrestricted cash and investments totaling $2 million, or 142 days of operating expenses. Based on our analysis of management-provided projections, which assume rate increases through 2022, we expect cash to stay above $3 million, or 156 days, during the next four years. However, we would expect cash to drop below our projections absent continued timely rate increases.

The combined system's capital plan is large but manageable at about $47 million during the next five years. We believe the CIP is manageable given planned rate increases and a mixture of funding sources such as debt, cash, and pay-go.

The CIP consists of about 35.7% water projects, 47.1% sewer projects, and 17.2% stormwater projects. The majority of the CIP is focused on sewer projects that consist of UV disinfection system upgrades, standby generator system upgrades, additional solids treatment, and existing clarifier improvements. Some of the large water projects consist of pressure zone modifications, source-of-supply improvements, and water treatment plant improvements. In addition, stormwater projects consist of renewal and replacement projects. As mentioned, we understand about 16% of the CIP will be cash-funded and the remaining from new debt.

Based on our financial management assessment, we view the combined system to be a '2' on a six-point scale, with '1' being the strongest. We believe that the city's practices and policies are good and mostly comprehensive in nature. The city's areas of strength include quarterly budget monitoring to the city council in addition to monthly monitoring of revenues and expenses. The city has a rate study performed by an outside consultant every three years. We understand that the city has a formal investment and debt policy and a reserve target of 90 days (water), 60 days (sewer), and 45 days (stormwater). In addition, the city updates the combined system's long-term CIP every two years and reviews long-term financial planning annually. Furthermore, as mentioned above, we view cash-basis accounting as less transparent than accrual-based accounting.

Outlook

The stable outlook reflects our expectation that management will continue to increase rates annually to post stable margins in order to support rising debt obligations during the next five years.

Upside scenario

We could raise the rating if management sustains financial metrics as debt service obligations rise or if unrestricted cash materially strengthens to a level consistent with the higher rating level.

Downside scenario

We could lower the rating if cash is spent down more than management indicated or if the service area economy deteriorates. We could also lower the rating if all-in coverage drops below levels we believe are consistent with the current rating level.