

# RatingsDirect®

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**Summary:**

## Snoqualmie, Washington; Water/Sewer

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## Summary:

# Snoqualmie, Washington; Water/Sewer

### Credit Profile

#### Snoqualmie wtr & swr

*Unenhanced Rating*

AA-(SPUR)/Stable

Upgraded

Many issues are enhanced by bond insurance.

## Rationale

S&P Global Ratings raised its underlying rating (SPUR) to 'AA-' from 'A' on Snoqualmie, Wash.'s existing water and sewer utility revenue bonds based on the application of our revised criteria "Rating Methodology And Assumptions For U.S. Municipal Waterworks And Sanitary Sewer Utility Revenue Bonds," published Jan. 19, 2016, on RatingsDirect. The outlook is stable.

The raised rating reflects, in our opinion, the combination of the water, sewer and stormwater systems extremely strong enterprise risk profile and strong financial risk profile. The raised rating further encompasses the strong service area economy in addition to historically strong financial metrics that we believe are sustainable given management's planning for future capital improvements.

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

- Service area participation in the broad and diverse Seattle-Tacoma-Bellevue, WA metropolitan statistical area (MSA) economy; that has had a population growth of 38% since 2012;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Affordable rates, given very strong income metrics and an average county poverty rate; and
- Good operational management practices and policies.

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

- Historically strong financial performance that we anticipate will be sustainable;
- Unrestricted liquidity position for fiscal 2015--approximately \$3.6 million, equivalent to 221 days' of operating expenditures--that we consider very strong;
- Large anticipated debt funded capital improvement plan (CIP), given the size of the system; we consider this to be manageable, given its historical rate increases and strong all-in coverage metrics; and
- Good financial management practices and policies.

The bonds are secured by a pledge of net revenue of the city's water, sewer, and stormwater system. The bonds also have a reserve, funded at the lesser of maximum annual debt service (MADS), 125% of average annual debt service, or 10% of proceeds. The rate covenant requires the system to generate debt service coverage of at least 1.20x.

## **Enterprise Risk**

Snoqualmie has a population of about 13,048, 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 38% 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 is 231% of the national median. Since 2010, unemployment rates in King County have been decreasing; the county annual unemployment rate is 4.4% for fiscal 2015; this is below both the state's rate and the nation's rate of 5.7% and 5.3% respectively. The city's water, sewer, and stormwater customers are approximately 90% residential with a total of 4,662 water, 4,214 sewer and reclaimed water, and 7,803 stormwater customers. For fiscal 2015, the leading water, sewer, and stormwater customers comprise approximately 14% of operating revenues, which we consider very diverse. A few of the leading water, sewer, and stormwater customers include Snoqualmie School District, Salish Lodge and Spa, and the Washington State Department of Social and Health Services.

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 source of water depends on the location in Snoqualmie and either comes from the Canyon Spring, which supplies water to the historic Snoqualmie area, or the Snoqualmie ridge system, which consists of three deep wells. 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 well fields have a total capacity of approximately 3.23 million gallons per day (mgd) with an average flow of the water system was approximately 1.42 mgd in fiscal 2015 with a peak day of 3.61 mgd. According to management, the city continues 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 3.0 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 2015, peak flow was 4.66 million gallons, with an average flow of 1.71 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. All of the city's systems are in compliance with all regulations and permits.

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. Non-residential sewer customers pay based on flow. The city uses an outside consultant for three-year rate studies, which is currently underway. The city has historically increased rates annually as needed and in 2014 pre-approved rates through 2016. Water rates were \$32.97 based on 800 cubic feet (cf) for 2016, with sewer rates at \$55.57 based on a fixed monthly rate. The stormwater rates for 2016 are \$19.30. The combined water and sewer bill is 1.1% of MHHEBI, which we consider affordable given the city's very strong income metrics. We understand the city is currently undertaking a rate study to determine future rate increases.

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**

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. All-in coverage has been consistently strong over the past three fiscal years, with coverage above 1.88x. For fiscal 2015, all-in coverage rose to 3.09x, which we consider an extremely strong coverage metric; the growth in revenues for fiscal 2015 was due to drier weather. All-in coverage is our internally adjusted debt service coverage metric that we believe best tracks the use of every dollar of utility operating revenues, regardless of lien position, accounting treatment or ultimate purpose. It also incorporates recognition of fixed charges or costs, which we define as certain long-term recurring items that are debt-like in nature, even if legally treated as an operating expense. For our all-in coverage metric, we have included the portion of city general obligation bond debt service associated with utility improvements. Our assumption is that the city will maintain strong all-in coverage from rate increases and city growth despite future debt borrowing within the next three years. The utility fund's liquidity position is strong, in our view. Unrestricted cash and investments totaled approximately \$3.6 million as of Dec. 31, 2015, representing about 223 days' of operating expenses on hand. Currently, management reports higher cash and investments of \$5.5 million through November 2016.

The city currently has outstanding 2008 water, sewer, and stormwater revenue bonds in addition to Public Works Trust Fund Loans and a Drinking Water State Revolving Loan. The city of Snoqualmie was approved for bond anticipation notes (BANs) with the Washington Federal Bank in 2015 and borrowed \$475,000 from the \$8 million BANs. Pursuant to Ordinance No. 1157, the city was also authorized \$7.5 million for water and sewer BANs in 2016 through the Washington Federal Bank. These notes will provide interim financing for the city's capital improvement plan. The city plans to issue long-term debt to finance the BANs within the next year.

We consider the city's large anticipated debt funded capital improvement plan, given the size of the system; we consider this to be manageable, given historical rate increases and strong all-in coverage metrics. Currently planned capital expenses through fiscal 2020 total an approximate \$18.00 million of unfunded capital improvements; which consist of approximately \$5.5 million of unfunded water projects, \$7.06 million of unfunded sewer projects, and \$5.60 million of unfunded stormwater projects. Wastewater, water, and stormwater projects consist of: construction on the aerobic digester; construction on the third, secondary clarifier; standby generator construction at three sites; aerobic digester construction; and renewal and replacements for the water, sewer, and stormwater system. The city plans to use the BANs for interim financing of capital improvements with the expectation that long-term debt will be used in the medium term to finance capital improvements. In addition to debt financing the city plans to increase utility rates to help fund the unfunded capital improvements.

Based on our financial management assessment, we view the city to be a '3' 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 annually updates and budgets through 2018; in addition to utilizing forecasts provided by an outside consultant. We believe that management's revenue and expense assumptions are reasonable and financial performance is not dependent on one-time revenues. We understand that the city has a formal investment policy and

an informal working capital target for the water fund of 90 days' and a 60-day target for sewer and stormwater. The city's debt management policy establishes reasonable policies and procedures for the issuance and administration of debt obligations. The formalized debt policy focuses on state guidelines on the acquisition of debt. Financial planning and operational data are easily obtained, as the budget and financial statements are readily available on the city's Web site.

## **Outlook**

The stable outlook reflects our expectation that the system's strong financial metrics will continue, that the system will use timely rate adjustments, and that the economic stability of the Seattle-Tacoma metro area will remain supportive of the system's strong credit quality.

### **Upside scenario**

If the city was able to strengthen both the nominal liquidity and continue to demonstrate very strong all-in debt service coverage, through the additional debt issuances and capital needs we could raise the rating.

### **Downside scenario**

We could take a negative rating action if financial metrics trend downward due to capital needs.

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