MOODY'S INVESTORS SERVICE

CREDIT OPINION
16 October 2020

Rate this Research

Contacts

Sam Feldman-Crough +1.415.274.1706
AVP-Analyst
samuel.feldman@moodys.com

Sam Krouse +1.214.979.6842
Associate Lead Analyst
sam.krouse@moodys.com

Tatiana Killen +1.212.553.2895
VP-Senior Analyst
tatiana.killen@moodys.com

Alderwood Water and Sewer District, WA

Update to credit analysis

Summary

Alderwood Water and Sewer District, Washington (Aa2) benefits from a well-maintained system that primarily distributes treated water and collects wastewater, with only portions of the wastewater treated by the enterprise itself, characteristics that will limit long-term debt needs. Debt service coverage will remain strong, supported by regular rate increases, and robust liquidity will be supported by sound financial policies. The coronavirus pandemic, which we view as a social consideration under our ESG framework, is only having limited financial effects on the system's demand and finances, due in part to a largely residential customer base with above-average income and no significant customer concentration. We do not expect slightly increased delinquencies to have a material impact on the system's finances. Though general facility charges (equivalent to connection fees) were weaker for the first half of calendar year 2020, the enterprise expects revenue to increase through the rest of the year to largely make up for the slower activity.

Credit strengths

» Consistently solid finances, including strong debt service coverage

» Leverage is limited with rapid payout providing room for manageable future debt to meet normal capital needs

Credit challenges

» Coverage is dependent, in part, on one-time revenue sources (in the form of general facility charges)

Rating outlook

Outlooks are not typically assigned to local governments with this amount of debt outstanding.

Factors that could lead to an upgrade

» Maintenance of strong coverage and solid liquidity

» Continued customer growth and system expansion

Factors that could lead to a downgrade

» Material and sustained decline in coverage

» Significant increase in long-term liabilities

Key indicators

Exhibit 1

Alderwood Water and Sewer District, WA					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	31 years				
System Size - O&M (in $000s)	$76,471				
Service Area Wealth: MFI % of US median	130.7%				
Legal Provisions					
Rate Covenant (x)	1.25				
Debt Service Reserve Requirement	No DSRF (Baa and Below)				
Management					
Rate Management	Aa				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2015	2016	2017	2018	2019
Operating Revenue ($000)	$76,628	$77,807	$83,862	$88,760	$89,568
System Size - O&M ($000)	$58,728	$63,916	$67,879	$73,294	$76,471
Net Revenues ($000)	$25,545	$21,810	$25,499	$25,297	$23,202
Net Funded Debt ($000)	$94,231	$89,309	$79,019	$81,830	$76,444
Annual Debt Service ($000)	$9,434	$9,102	$9,340	$9,060	$9,603
Annual Debt Service Coverage (x)	2.7x	2.4x	2.7x	2.8x	2.4x
Cash on Hand	661 days	622 days	599 days	488 days	456 days
Debt to Operating Revenues (x)	1.2x	1.1x	0.9x	0.9x	0.9x

Median family income is for Snohomish County. DSRF score of Baa is because the reserve will likely be phased out after full maturity of prior senior lien bonds.
Source: Moody's Investors Service; audited financials; US Census Bureau

Profile

Alderwood Water and Sewer District (also known as the Alderwood Water and Wastewater District), located in Snohomish County (Aa1 stable), serves an estimated population of 300,000 customers through retail and wholesale sales. The service area is approximately 44 square miles and includes unincorporated county area as well as portions of the cities of Bothell (Aa1), Lynnwood, Mountlake Terrace, Mill Creek, Mukilteo and Brier. The district purchases treated water from the city of Everett and distributes to retail and wholesale customers; wastewater is collected from customers and is mostly treated by the King County Sewer Enterprise (Aa1 senior revenue rating) through a long-term contract or at the district's own Picnic Point treatment facility.

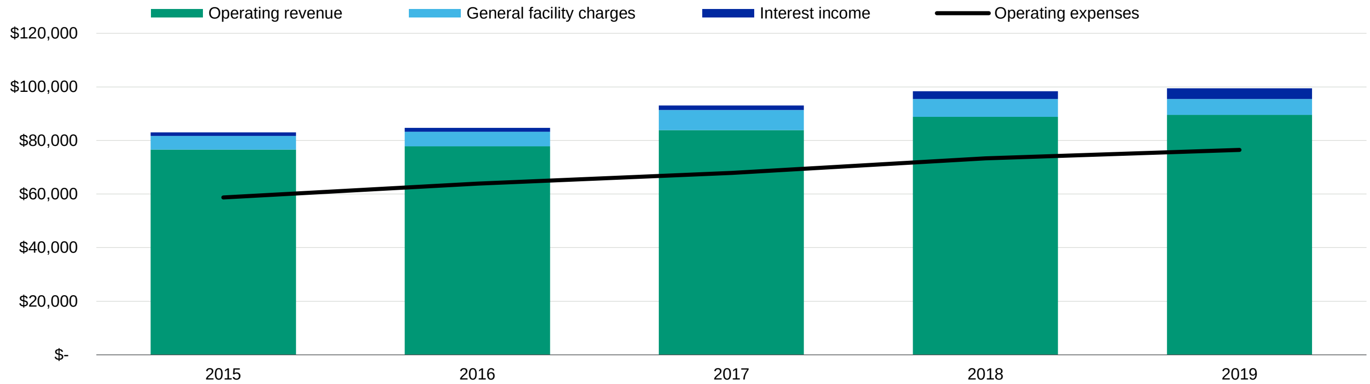
Credit considerations

Service area and system characteristics

Operating revenue will continue to grow, driven by solid population growth and consistent but manageable rate increases. Favorably, combined rates are affordable compared to regional peers, particularly in the water system. Capital plans remain manageable and we expect small new debt issuances every few years to pay for about $20 million in annual capital costs, which will also be paid using general facility charges (GFCs), general operating revenue and available liquidity.

Exhibit 2

Operating revenue lead the growth in gross revenue



Source: Moody's Investors Service

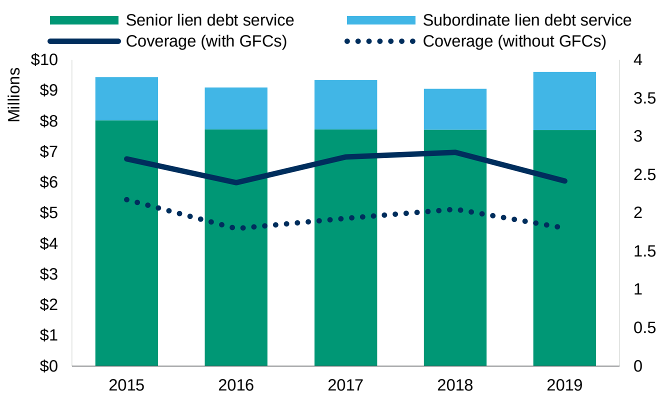
Retail customers are greater than 90% residential by number of customers and commercial customers are mostly single-site. Neither the water nor sewer system has a single retail customer that represents greater than 0.5% of 2019 retail revenue. Wholesale customers of the water system all have long-term contracts that extend to 2055, providing notable stability.

Debt service coverage and liquidity

Coverage is supported by general facility charges (GFCs), one-time connection fees, though even without this coverage would be strong (Exhibit 3). We expect coverage to remain strong based on the district's projections for net revenue (Exhibit 4), which are reasonable given planned rate increases. The district generally budgets conservatively for GFCs, which is favorable given the one-time nature of that revenue source, which has nevertheless remained relatively consistent.

Exhibit 3

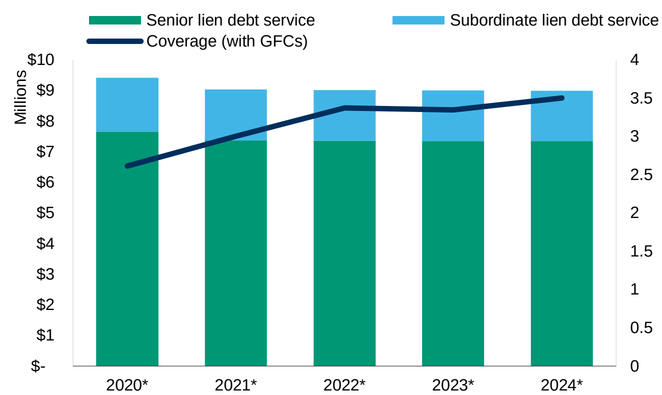
Coverage is strong, even without GFCs...



Source: Moody's Investors Service

Exhibit 4

...and is expected to improve under district projections for net revenue



Projections for net revenues not available without GFCs.

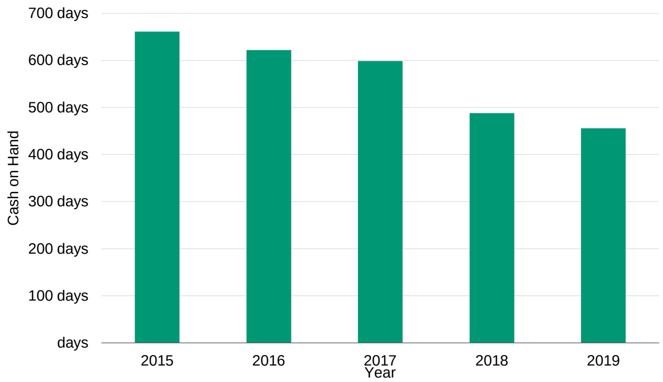
Source: Moody's Investors Service

Liquidity

Liquidity remains solid (Exhibit 5), though it has dipped in recent years compared to growing operating expenses (Exhibit 6).

Exhibit 5

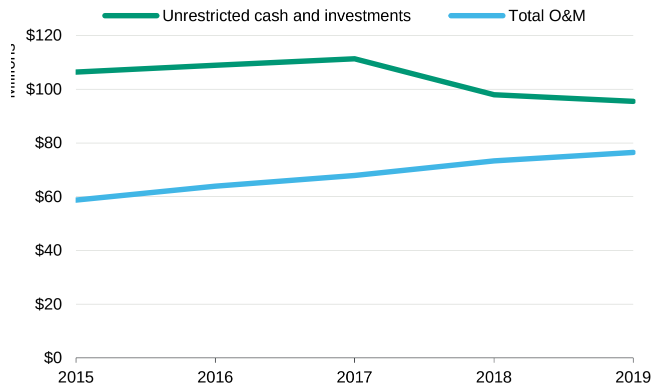
Days cash-on-hand is solid despite recent declines...



Source: Moody's Investors Service

Exhibit 6

...which are driven by both modest cash declines and growing O&M



Source: Moody's Investors Service

Debt and legal covenants

Debt-to-revenue is manageable at 105% (Exhibit 7), after the issuance of refunding and new money bonds expected in October 2020. Legal provisions include a solid 1.25x rate covenant. Pension liabilities are relatively modest, with total contributions at less than 2% of operating revenue.

Favorably, future debt has declining debt service (Exhibit 8) and amortizes rapidly, which provides ample room for the district to issue future debt as needed to maintain strong capital conditions.

Exhibit 7

Long-term liabilities are manageable

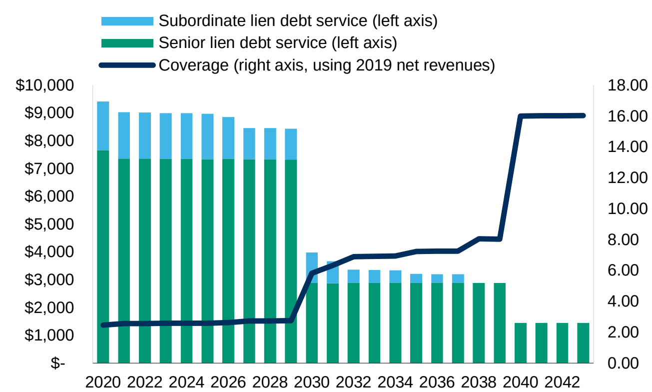
Leverage detail		Value ($000)
2020 bonds	$	74,970
Other senior lien debt (net of refunding)	$	2,350
Subordinate debt	$	16,982
Total debt	**$**	**94,302**
Reported net pension liability (2019)	$	4,266
Adjusted net pension liability (2019)	$	40,706
2019 operating revenue	$	89,568
Debt to operating revenue		**105%**
ANPL to operating revenue		43%

Adjusted net pension liability includes Moody's adjustments for a market-based discount rate.

Source: Moody's Investors Service

Exhibit 8

Declining debt service and rapid amortization are a strength



Source: Moody's Investors Service; debt service estimates for future debt

Legal security

The 2020 bonds are secured by a senior lien of net revenues of the district, inclusive of general facility charges (GFCs) as a pledged revenue source. The bonds will be backed by a debt service reserve fund, though the DSRF may be eliminated once unrefunded 2013 bonds reach their final maturity in 2023.

ESG considerations

Environmental

As a water and sewer utility, primary environmental risks are mostly related to water availability, water quality and regulations for treating both water and wastewater. Favorably, the district reports being current on all regulations and not subject to any pending rule changes. Additionally, water supply is exceptional. The district's water supply from the City of Everett is obtained primarily from the Spada Reservoir, which holds 50 billion gallons of water and is refilled by one of the wettest watersheds on the western side of the Cascades.

Social

The coronavirus pandemic, which we view as a social consideration under our ESG framework, is only having limited financial effects on the utility's finances. Further discussion appears in other sections.

Governance

Governance is a strength, despite some turnover in key appointed leadership positions over the last year. Favorably, the current management team brings decades of experience managing or advising other utilities in Washington and nationally. The elected board of five commissioners governs the district and has full power to modify rates and charges without oversight or approval from external bodies.

REPORT NUMBER 1250491

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454