

# RatingsDirect®

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## Summary:

# Duvall, Washington; Water/Sewer

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### Credit Profile

Duvall wtr & swr rev rfdg bnds ser 2011 due 12/01/2018

*Long Term Rating*

AA/Stable

Affirmed

## Rationale

Standard & Poor's Ratings Services affirmed its 'AA' long-term rating on Duvall, Wash.'s series 2011 water and sewer revenue bonds. The outlook is stable.

The rating reflects our view of the system's:

- Service area fundamentals based on the city's strong income levels and its participation in the Seattle-Bellevue-Everett metropolitan area economy,
- Strong senior-lien and total debt service coverage (DSC) during the past three years, and
- Historically strong liquidity position.

Partly offsetting these strengths is our view of the system's:

- Exposure to wholesale water rate increases from Seattle Public Utilities, the city's primary water provider;
- Cash-basis financial reporting combined with a two-year interval between releases of audited financial statements; and
- Reliance on connection fees to maintain strong total DSC.

The bonds are secured by a pledge of net revenues of the city's water and sewer systems and any utility local improvement district (ULID) assessments. There are currently no ULID assessment revenues. In our view, the bond provisions are adequate. The bonds are additionally secured by a debt service reserve, funded at the lesser of 10% of purchase price, maximum annual debt service (MADS), or 125% of average annual debt service. Under the rate covenant, the city must generate pledged revenue to provide debt service coverage of at least 1.20x. The additional bonds test also requires 1.20x coverage.

The water service area includes 1,580 acres within the city limits and 2,620 acres outside the city limits. The city's primary source of water supply is imported water from Seattle through the Seattle Public Utilities (SPU). The city also has one groundwater well, which it currently uses for irrigation. Storage facilities include two reservoirs totaling 2.7 million gallons. The city does not have to treat the water received from SPU. The sewer service area is the city limits, with about 99% of the city's population served by the sewer system. The city owns a wastewater treatment plant, which received a major overhaul in 2005. The plant's capacity is 1.3 million gallons per day (mgd) with an average daily flow of about 0.6 mgd and peak daily flow of 0.9 mgd in 2013. According to the city, the plant could be expanded to up to 1.75 mgd with minor improvements.

In our view, the customer base is growing, primarily residential, and very diverse. Account growth for the water and

sewer system has averaged about 3.3% and 2.3%, respectively, during the past three years to about 2,560 and 2,392 accounts at the end of 2013. We view the overall customer base as generally very diverse, with the leading customers for the water and sewer systems providing 9% and 5.5% of total operating revenue in 2013, respectively.

We calculate the monthly water and sewer residential rate at \$132.68, or 2.0% of the median household effective buying income (MHEBI), assuming monthly usage of 8,000 gallons. The city last increased rates at the beginning of 2014, when both systems had 1.4% rate increases. We consider the rates to be affordable relative to the service area's high income levels. We understand that the city plans to implement future water and sewer rate increases based on changes in the local consumer price index.

We consider the district's financial performance to be strong although the city maintains its financial statements on a cash basis of accounting. Based on the city's unaudited financial statements for fiscal years 2012 and 2013, we calculate senior-lien DSC at 4.0x and 4.6x, respectively. After including the subordinate-lien state loans, we calculate the total DSC of between 1.6x and 2.4x during fiscal years 2011 through 2013. These results reflect growth in operating revenues driven by implemented rate increases combined with increases in connection fees (general facilities charge). Excluding the connection fees, we calculate the senior lien DSC and total DSC at 2.6x and 1.3x, respectively. Based on management's projection, senior lien DSC and total DSC are anticipated to be at least 3.8x and 2.0x through fiscal year 2018.

The system has maintained strong liquidity levels in the past three years, and we expect liquidity to remain strong over next few years. According to unaudited fiscal-year 2013 results, the system closed the year with \$2.9 million of unrestricted cash and investments, equivalent to 374 days of operating expenses. This represents an improvement from \$2.3 million, or 314 days, of unrestricted liquidity at the end of fiscal 2011. Management reported an unrestricted cash balance of \$2.9 million as of Sept. 30, 2014. The city has an adopted reserve policy that established a reserve balance for both water and sewer. The reserve amount increases annually based on inflation.

The city's capital facilities plan includes \$2.8 million in water system projects and \$1.2 million in sewer projects for 2016 through 2018. Management projects that these capital expenses will be funded through ongoing revenues and available reserves. It reports that no additional debt is planned at this time.

Duvall is located in northeastern King County and, as of 2013, had a population of about 7,240. The city is about 37 miles from Seattle, 18 miles from Bellevue, 25 miles from Everett and nine miles from Redmond. The city is increasingly becoming a bedroom community and has experienced strong population growth during the past 20 years. Household income levels in Duvall are very strong in our view. Median household effective buying income was 199% of the national median in 2013.

## Outlook

The stable outlook reflects our anticipation that past rate increases and the city's planned future inflation-based increases will lead to continued strong debt service coverage and maintenance of at-least good liquidity. We could take a negative rating action if coverage or liquidity were to decline substantially. If total debt service coverage, excluding connection fees, is strong over the next two years, and if liquidity remains strong, we could raise the rating.

## **Related Criteria And Research**

### **Related Criteria**

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011

### **Related Research**

- U.S. State And Local Government Credit Conditions Forecast, Dec. 10, 2014 U.S. Municipal Water And Sewer Utilities 2014 Sector Outlook: Learning To Do More With Less, Jan. 9, 2014
- 2014 Review Of U.S. Municipal Water And Sewer Ratings: How They Correlate With Key Economic And Financial Ratios, May 12, 2014

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