S&P Global
Ratings

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Summary:

Washington Suburban Sanitary District, Maryland; General Obligation

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Table Of Contents

Summary:

Washington Suburban Sanitary District, Maryland; General Obligation

Credit Profile		
US$299.31 mil consolidated pub imp bnds ser 2024 due 06/01/2053		
Long Term Rating	AAA/Stable	New
US$29.93 mil consolidated pub imp bnds (Green Bnds) ser 2024 due 06/01/2053		
Long Term Rating	AAA/Stable	New
Washington Suburban San Dist GO		
Long Term Rating	AAA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AAA' rating to Washington Suburban Sanitary District (WSSD), Md.'s approximately $299 million series 2024 consolidated public improvement bonds and $29.9 million 2024 (second series) consolidated public improvement bonds (green bonds).
- At the same time, S&P Global Ratings affirmed its 'AAA' rating on the district's existing debt.
- Total debt outstanding (including the current issuance and Maryland Water Quality Bonds) is $4.0 billion.
- The outlook is stable.

Security

Debt service has been paid from revenues generated the from fees, charges, rates and assessments, and other available funds. In the event of a deficiency, the Montgomery and Prince George's county councils are required to impose ad valorem taxes on all the assessable property within the district. Proceeds of the bonds will fund capital projects, some of which are designated as "green projects," as well as the payment of costs of issuance related to the sale.

We consider the financial metrics supportive of the 'AAA' rating, with all-in coverage being just strong but extremely strong liquidity levels during the past three fiscal years. We view the unlimited ad valorem property taxes, which could be levied should district operating levels decline, as, in theory, supportive of the district's debt service; given the extremely strong liquidity levels, timing issues are mitigated, and therefore additional ratings uplift is given.

The issuer bonds are eligible to be rated above the sovereign because we believe the district can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), the district has full rate-setting authority, in addition to independent taxing authority and independent treasury management from the U.S. government.

Credit overview

WSSD's credit quality is anchored by the extremely strong management team that has historically demonstrated an ability and willingness to reduce expenditures and increase rates to maintain sufficient coverage and liquidity, as well as the large and mostly affluent tax base that ultimately secures the bonds if user fees are insufficient. Management has prudent financial, operational, and capital policies, which we view as critical to the 'AAA' rating. We recognize that coverage and cash is narrower than those of its commensurately rated peers; however, the additional security provided by the tax base and management's history of rate increases and cost containment offset this risk.

Environmental, social, and governance

Overall, we believe WSSD has above-average exposure to environmental risks given the existing consent decree and associated large capital improvement plan (CIP). However, management's strong practices and commitment to supportive environmental restorative and resiliency policies somewhat offset these risks. We believe WSSD has a better social and governance profile than its utility peers, which is reflected in the 'AAA' rating. However, implementing the increased levy requires approval from two governmental entities, which could increase the risk of delays. Liquidity is an important mitigant to this governance risk and management recently increased its liquidity target, which we view favorably. Social risk factors could become elevated if certain economic factors were to deepen, which could, in turn, could affect ratepayers' ability to pay water and sewer bills.

Outlook

The stable outlook reflects our view of the large, diverse, and mostly affluent service area which remains strong. Credit stability also rests with our view that management has a meaningful track record in managing volatility in revenues through significant expense reductions to maintain healthy coverage and liquidity. Despite substantial capital needs, we believe rates will remain affordable and financial metrics will meet forecasts.

Downside scenario

If management is unable to effectuate necessary rate increases or contain costs, which results in a reduction in reserves or a failure to meet forecast projections, we will lower the rating by one or more notches. While management has been prudent in reducing its expenditures historically, there is a point at which there will be fewer discretionary expenditures to reduce, which could necessitate greater rate increases and pressure rate affordability. Given income levels and affordability relative to peers, we believe this is unlikely but if political pressures or economic weakness results in willingness issues, we could also consider lowering the rating.

Credit Opinion

Enterprise profile

WSSD serves a population of about 1.9 million in the Washington-Baltimore metropolitan area, the fourth largest in the nation. The local economy's depth and diversity, in our opinion, contribute to the district's below-average unemployment and above-average income and wealth. Unemployment has declined considerably during the past six months to 4.1%. Montgomery and Prince George's county median household effective buying incomes were 152% and 122%, respectively, of the national average, which we view as extremely strong. Market value for the district is $351 billion or $194,900 per capita, which we consider extremely strong and supportive of the 'AAA' rating.

The six-member Washington Suburban Sanitary Commission governs the district. The commission has full rate-setting ability; it levies a variety of charges and fees, the most significant of which are consumption charges. It typically provides the counties with a consumption-rate forecast annually. Rates are affordable, relative to both incomes and regional peers. The six-year rate forecast includes a 7% increase in 2024, followed by a potential 8.5% rise in 2025 and 9% in 2026 and then falling to between 5.5%-4.2% from 2027-2030. In addition, the district is proposing to transition to a higher percentage of fixed charges, increasing the fixed charge by the same percentage as the volumetric rate. We believe a higher percentage of fixed charges would be beneficial since it would provide increased revenue stability. The main reason for the higher rates over the next couple of years when compared to previously reported plans is the transition of the commission to do more pay-as-you-go capital than in the past. The district has affordability program and customer assistance programs for lower income customers, which have been recently reviewed and adjusted given the pressures related to the recent pandemic and associated economic downturn. The approach to addressing affordability is extremely comprehensive relative to its peers, in our opinion. We believe the rate increases in the long-range financial plan are prudent and will support the substantial CIP and the increased liquidity and coverage targets.

Financial risk

Debt service coverage (DSC) is narrow relative to that of 'AAA' rated peers. However, management is sophisticated and has demonstrated an ongoing ability to recover costs and adjust expenditures as needed to meet revenue volatility. Through the pandemic, it has mitigated revenue losses through aggressive cost-containment "savings plans," which targeted reductions in operating expenses as well as pay-as-you-go and debt service savings. We believe management has demonstrated a willingness to raise rates and reduce costs to meet challenging operating and economic environments.

Debt service has always been paid by user fees, but the commission has the ability to levy an ad valorem property tax, which is a positive credit factor in our analysis. The commission sets the budget to ensure full cost recovery, including necessary infrastructure investment. Annual DSC, excluding capital contributions, has been at or slightly above sum sufficient and there is no rate covenant. Management recently increased the coverage target to a range of between 1.1x and 1.25x, which is what is expected each year through 2029.

The commission previously suspended all water turnoffs and late penalties due to the pandemic. As a result, payment delinquencies grew to $64 million as of June 30, 2021. As the economy improved in 2022 delinquencies fell to $47 million as of December 2023. Management has effectively employed several methods to reduce the delinquencies, including setting up payment plans. The percentage of accounts that were delinquent before the pandemic was about 17%, which is what it is currently.

WSSD's liquidity has remained healthy throughout the past decade, in our view. There have not been any draws on the reserve during fiscal years 2020-2023. If water or sewer operating revenues do not reach budgeted amounts, the commission first reduces expenditures, then draws on the reserve. If the reserve is inadequate, the commission may implement a midyear rate increase, although this has never been required. Finally, if all revenues are insufficient, the commission may levy a tax on the two-county area for debt service payment, which would be requested and effectuated annually. Liquidity is critical in a distressed scenario, given that there would be timing considerations associated with any tax levy. Management reports that cash on hand would be used as well as a line of credit, if needed. In fiscal 2023, liquidity was extremely strong with $381 million, or 272 days' cash on hand.

Overall net debt (including overlapping debt) remains low, in our view, at about 2.6% of market value at the end of fiscal 2022. Debt to capitalization is moderate at 45%. All of the commission's debt is self-supporting. Despite the commission's history of annual debt issuances to fund WSSD's sizable CIP, the commission's overall net debt levels have remained low given the size of the customer and tax base. The 2024-2029 CIP is $4.7 billion, 69% of which will be debt-financed. Capital needs consist primarily of rehabilitation or replacement of the older portion of water and sewer mains, as well as ensuring compliance with the Potomac Water Filtration Plant and Sanitary Sewer Overflow consent decrees, which are currently on target. In our view, the near-term capital needs are substantial, but the income levels and customer base are sufficient to keep rates relatively affordable in the near term (relative to income and peers).

Management has a very strong, institutionalized asset management plan, and it builds ongoing rehabilitation into the annual budget. Asset management is innovative and has improved operational performance and, in many cases, reduced costs, which we view favorably. Emergency response planning assesses enterprise-wide risk and plans for emergency response. Given the effects of climate change and the increased frequency of significant storms, we believe this level of planning is critical to credit quality. The commission continues to update cyber-security policies following a cyber attack in May 2021. The attack did not result in any financial or operational issues. Limited data on the commission's internal network were accessed and the commission is following the appropriate notification steps. There is no indication at this time that any information was publicly disclosed or subject to actual or attempted misuse as a result of this attack. Existing policies and protective measures are in place. We believe management has prudent cyber policies in place and in addition to cyber insurance, is taking sufficient steps to enhance its cyber-protective measures.

Related Research

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

Ratings Detail (As Of January 31, 2024)		
Washington Suburban Sanitary Dist consolidated pub imp bnds		
Long Term Rating	AAA/Stable	Affirmed
Washington Suburban Sanitary Dist consolidated pub imp bnds of 2023		
Long Term Rating	AAA/Stable	Affirmed
Washington Suburban Sanitary Dist cons pub imp rfdg bnds		
Long Term Rating	AAA/Stable	Affirmed
Washington Suburban Sanitary Dist cons pub imp rfdg bnds		
Long Term Rating	AAA/Stable	Affirmed
Washington Suburban San Dist GO		
Long Term Rating	AAA/Stable	Affirmed

Ratings Detail (As Of January 31, 2024) (cont.)		
Washington Suburban San Dist GO		
Long Term Rating	AAA/Stable	Affirmed