



T 206.245.1700
1191 2nd Avenue, Suite 2000
Seattle, WA 98101-3404
pacificallawgroup.com

MEMORANDUM

TO: Christie True, Director, King County Department of Natural Resources and Parks

FROM: Stacey Lewis, Pacifica Law Group LLP

DATE: January 13, 2023

SUBJECT: Bond Counsel review of King County Regional Wastewater Governance Study

I. Introduction.

We serve as bond counsel to King County, including in connection with the issuance of bonds to finance or refinance wastewater (“WTD”) facilities. We have reviewed portions of the King County Regional Wastewater Governance Study prepared by Portland State’s Center for Public Service. Specifically, we have reviewed Project Report 2: Description of the Existing System, and Project Report 4: Evaluation of Governance Options (together the “Report”). We offer the following observations from our perspective as bond counsel, noting in particular bond covenants that (1) restrict the ability of the County to transfer wastewater system (“System”) assets or debt, (2) require the County to set rates, and (3) obligate the County to enforce a requirement that municipalities discharge to the System all sewage collected by that entity from any portion of the Seattle metropolitan area that can drain by gravity flow into facilities of the System.

These bond covenants prevent the County from implementing any of the options that would transfer System debt or assets to a new entity without first setting aside sufficient funds to pay all (or a proportionate share, in the case of a partial transfer of System assets) of the principal and interest on outstanding WTD debt. The debt cannot be transferred or assigned to another entity. In addition, System assets cannot be transferred to another entity without defeasing a proportionate amount of the debt (e.g. providing for the payment of principal and interest on the debt until and on the first available optional call date). As a result, the Report options that provide for an intergovernmental agency to govern or assume the System, and the options that provide for partial separation of the System, are not compatible with the County’s bond covenants and would require defeasance of the bonds. The first part of this memo outlines these bond covenants, to provide a roadmap to be available in the event these options are considered in the future. If these options are considered in the future, an important consideration to be added to the discussion would be a calculation of the cost of defeasing the WTD bonds, which are currently outstanding in the aggregate principal amount of approximately \$3.4 billion.

The second part of the memo focuses on the Report option that may be compatible with existing bond covenants and would not, therefore, require defeasance of the bonds: option 1 (Current System, Modified Advisory Board(s)). Although this option may be compatible with existing bond covenants, we note that the County has limited ability under state law and bond covenants to delegate its authority to set rates and charges for the System, and to approve the plan and budget for System expenditures. The County has flexibility to receive recommendations and other input, and to add

procedural steps to enhance transparency and to ensure consideration of these recommendations and other input, so long as these steps do not prevent, or unduly defer, the County's responsibility to set rates, adopt plans and approve expenditures for System improvements.

II. Background regarding WTD Bond Portfolio.

a. Outstanding WTD Bonds. As noted in the Report, the County has issued bonds to fund WTD projects.

- *Parity Bonds.* The County has issued and currently has outstanding approximately \$2.1 billion of "parity bonds" paid from a pledge of, and secured by a statutory lien on, net revenues of the System. WTD also has outstanding a federal WIFIA loan, which is treated as (and secured as) a parity bond.
- *Parity Lien Obligations.* The County also has issued and currently has outstanding approximately \$700 million of "parity lien obligations," which are double-barreled obligations secured by both a statutory lien on net revenues of the System and a County "limited tax general obligation" (or "LTGO") pledge. Pursuant to its LTGO pledge, the County has covenanted to levy nonvoted property taxes as necessary to pay the debt, and has pledged the County's full faith, credit and resources for prompt payment of the debt.
- *Junior Lien Obligations.* The County has issued and currently has outstanding approximately \$341 million of "junior lien obligations" paid from a subordinate pledge of, and secured by a statutory lien on, net revenues of the System.
- *Multi-Modal LTGO/Sewer Revenue Bonds.* The County has issued and currently has outstanding approximately \$277 million of multi-modal LTGO/sewer revenue bonds, which also are double barreled bonds secured by both a subordinate pledge of and statutory lien on net revenues of the System and an LTGO pledge.
- *State Loans.* Finally, the County has received loans from the State (administered by various State agencies) that are secured by a further subordinated pledge of net System revenues.

Collectively, the County has outstanding approximately \$3.4 billion in bonds issued to finance or refinance System projects, including almost \$1 billion in bonds that are secured by the County's LTGO pledge in addition to a pledge of and lien on net revenues of the System.¹ The County also provides liquidity for WTD's commercial paper program, through an interfund loan agreement that permits WTD to borrow available County funds to pay maturing commercial paper.

b. Refinancing Opportunities. The vast majority of the County's bonds issued for WTD purposes are tax-exempt, fixed-rate, long-term bonds that are subject to optional redemption on and

¹ The County's LTGO pledge provides a County credit backstop to these particular WTD obligations. The County charges WTD a credit enhancement fee in return for providing the credit backstop, but the value of the backstop exceeds the fee, resulting in a lower net cost of capital to the System.

after a 10-year par call date. The bonds also can be “defeased” prior to the 10-year par call date by placing, in an irrevocable escrow account, cash or certain U.S. government securities in an amount sufficient to pay scheduled principal of and interest on the bonds until the 10-year par call date, and then redeem the remaining bonds on that date. The cost to defease approximately \$3.4 billion in WTD bonds (issued in a lower interest rate environment) to their first par call date would be quite significantly in excess of the outstanding \$3.4 billion principal amount of the debt. An important consideration to be added to any future discussion would be a calculation of the cost of defeasing the bonds.

c. Bond Covenants. The County has made a number of covenants for the benefit of bond owners of WTD bonds, including the following key covenants:

- *Rate covenant:* The County has covenanted that, for so long as WTD bonds are outstanding, the County will at all times establish, maintain and collect rates and charges for sewage disposal service that will be fair and nondiscriminatory and that will be adequate to provide in each calendar year net revenue in an amount that will exceed debt service in that year by a required coverage factor. In addition, the County has covenanted to set rates and charges in an amount sufficient to operate and maintain the System, to maintain all reserves required by its bond ordinances, and to pay costs incurred in the construction or acquisition of any portion of the Comprehensive Plan that may be ordered by the County.
- *Covenant to maintain in good order.* The County has covenanted to cause the System to be operated in a safe, sound, efficient, and economic manner in compliance with all health, safety, and environmental laws, regulatory body rules, regulatory body orders and court orders applicable to the County's operation of the System. The County also has covenanted from time to time to cause to be made, without undue deferral, all necessary or proper repairs, replacements and renewals, so that at all times the operation of the System will be properly and advantageously conducted.
- *Covenant to collect revenue.* The County has covenanted to operate and maintain the System and conduct its affairs so as to entitle it at all times to receive and enforce payment to it of sewage disposal charges payable: (a) pursuant to the ordinance or ordinances establishing a tariff of rates and charges for sewage disposal services; and (b) under any Service Agreement that the County has now or may hereafter enter into and to entitle the County to collect all revenues derived from the operation of the System. The County has covenanted not to release the obligations of any person, corporation or political subdivision under such tariff of rates and charges or the Service Agreements and at all times, to the extent permitted by law, to defend, enforce, preserve and protect the rights and privileges of the County under or with respect thereto. In accordance with RCW 35.58.200(3), the County has covenanted to require any county, city, special district or other political subdivision to discharge to the System all sewage collected by that entity from any portion of the Seattle metropolitan area that can drain by gravity flow into facilities of the System that serve such areas.
- *Covenant to defease bonds upon sale or disposition of the System.* The County has covenanted not to sell or voluntarily dispose of all of the operating properties of the System unless provision is made for payment of a sum sufficient to pay the principal of and interest on all outstanding

bonds. The County has covenanted not to sell or voluntarily dispose of any part of the operating properties of the System unless provision is made for the payment of a sum sufficient to pay the principal of and interest on a proportionate share of the outstanding bonds, calculated as provided in the bond ordinances. The County has preserved the flexibility to sell or dispose of a minor portion (less than 5% of the net utility plant) of the System or to sell or dispose of obsolete portions of the System, without making this defeasance deposit.

III. Rate Setting and Other Budget Authority

By statute, the County has authority to set rates and charges for use of the System, to expend System funds, and to adopt System plans. The County has promised to exercise this authority for the benefit of WTD bondowners. Specifically, the County has covenanted to set rates, operate the System, and invest in System improvements without undue deferral.

a. Rate Setting. RCW 35.58.200(4) authorizes the County, exercising its assumed Metro powers, to fix rates and charges for the use of the metropolitan water pollution abatement facilities. Likewise, pursuant to RCW 39.46.150 and RCW 35.58.460, the County may covenant to establish and maintain rates and charges sufficient to pay and secure WTD bonds. The County has covenanted with its bondowners to establish, maintain and collect rates and charges that are fair and nondiscriminatory as well as adequate to meet the System's obligations. During the term of the Service Agreements, municipal participants agree to pay rates and charges as provided in the agreements. The County's WTD bonds extend, however, beyond the term of the existing Service Agreements. To provide security for WTD bonds over the long term, the County has covenanted for the benefit of its bondowners that it will enforce RCW 35.58.200(3)'s statutory requirement that municipal participants discharge to the System all sewage collected by that entity from any portion of the Seattle metropolitan area that can drain by gravity flow into facilities of the System that serve such areas if the Council declares that the health, safety or welfare of the people within the metropolitan area require such action. Consistent with this covenant, the County has adopted Ordinance 15757, passed on May 7, 2007, to provide rates and charges for use of the System, including for municipal participants within the County that are required to connect to the System, and others that do not contract with the County for the service.² In other words, the County has express statutory authority to set rates and charges, the County has covenanted for the benefit of bondowners to exercise this rate-setting authority and, to provide security for bonds that mature after expiration of the current Service Agreements, the County has exercised this authority to impose the rates and charges that would apply in the absence of a contract.

b. Budget; Capital Plan Approval.

RCW 35.58.200(4) authorizes the County, exercising its assumed Metro powers, to fix System rates and charges and to "expend the moneys so collected for authorized water pollution abatement activities." Likewise, RCW 35.58.200(1) authorizes the County to "prepare a comprehensive water pollution abatement plan including provisions for waterborne pollutant removal, water quality improvement, sewage disposal, and stormwater drainage for the metropolitan area." Consistent with this statutory authority, the County has covenanted with WTD bondowners to "pay costs incurred in the

² The County Council has invoked its authority under RCW 35.58.200(3) to require that each current Municipal Participant within the County continue as an "Agency Customer" (a wholesale customer of the Sewer System not subject to a Service Agreement) following expiration of its Service Agreement.

construction or acquisition of any portion of the Comprehensive Plan that may be ordered by the County” and to “cause to be made, without undue deferral, all necessary or proper repairs, replacements and renewals, so that at all times the operation of the System will be properly and advantageously conducted.” In other words, the County has express statutory authority to approve System expenditures and the comprehensive plan, and has covenanted for the benefit of bondowners to make such expenditures, and to make necessary improvements.

IV. Potential Modifications

As discussed above, the County has responsibility for rate setting and for approving System expenditures and the comprehensive plan, and has covenanted to exercise this authority to meet specific bond covenants. Option 1: Current System, Modified Advisory Board(s) set forth in the Report may be compatible with these responsibilities so long as the County retains final authority to approve rates, budget and plan, and meet these specific covenants. The County has flexibility to receive recommendations and other input, and to add procedural steps to enhance transparency and to ensure consideration of these recommendations and other input, so long as these steps do not prevent, or unduly defer, the County’s responsibility to set rates, adopt plans and approve expenditures for System improvements.

The County and the Municipal Participants could agree to processes changes and to changes in the role of advisory committees, without overriding the County’s final decision-making authority over these matters. As the Report notes “contract agencies could have more influence in decisions affecting the regional system. There is, however, a limit to how much King County can share decision-making authority.”³ The Report notes that there could be changes to the Service Agreements specifying approval processes and the authority of advisory committees.⁴ The following considers the four more specific recommendations for option 1 identified in the Report, taking into consideration applicable covenant and state law constraints.

a. More effective use of the Regional Water Quality Committee (RWQC) as a sounding board for staff. The Report’s characterization of the RWQC as a “sounding board for staff” is inaccurate. The RWQC is a King County council committee designated by charter with a scope that includes review and approval of regional countywide plans and policies. Its decisions can only be overridden by a supermajority of the Council. Plans and policies can fundamentally influence budgets and rates but the authority for the actual budget and rate adoption resides solely with the Council.

b. Empower the RWQC with decision-making over the total operating and capital budgets. The Report states “King County could, by ordinance, provide that RWQC must approve the total amount of the annual budget and the amount to be recovered by rates...As an ultimate circuit breaker, the County Council could repeal the ordinance granting RWQC this authority.”⁵ As discussed above, the County has statutory authority to approve expenditures for the System, and has covenanted to exercise its spending authority for the benefit of the System. Section 220.20 of the County Charter requires that the County Council adopt budgets for the County and comprehensive plans. Section 405 of

³ Project Report 4: Evaluation of Governance Options, p. 3.

⁴ Consistent with this general approach, the County and participants have explored formation of an “operating board” through amendments to the existing Service Agreement.

⁵ Report at p. 37.

the Charter further details the County biennial budget process, including the responsibility of the County Executive to present proposed current expense and capital budget appropriation ordinances. Providing the RWQC with decision-making authority over the System total operating and capital budgets is inconsistent with the County's responsibility to approve expenditures for System improvements, its covenant to do so, and these Charter provisions. The County has flexibility to make process changes to provide additional transparency, or to provide more or different opportunities for input, but ultimate budget authority resides with the County legislative authority.

c. Amend the Basic Agreements to remove the rate allocation method from the agreement, and add approval of the comprehensive waste management plan similar to the language used in the solid waste interlocal agreements. The agreements could be amended to remove the rate allocation method. The County is required to establish and collect rates and charges as needed to operate and maintain the System, maintain reserves, pay debt service and meet required debt service coverage ratios. The County has covenanted with its bondowners to establish, maintain and collect rates and charges for each calendar year that are "fair and nondiscriminatory." The County could change the classifications for its various rates and charges so long as the rates and charges meet these requirements.

RCW 35.58.200(1) authorizes the County to prepare the comprehensive waste management plan. Consistent with this statutory authority, the County has covenanted with WTD bondowners to pay costs of the plan "ordered by the County." Section 220.20 of the County Charter requires that the County Council adopt comprehensive plans. Delegating final approval of the plan is inconsistent with the County's responsibility to approve the plan. An amendment to the agreements that provides an additional role for input in the development of a proposed plan for approval by the County legislative authority may be consistent with this responsibility.

d. Empower the Metropolitan Water Pollution Abatement Advisory Committee with decision-making power over the rate allocation formula as well as contract language. Remove from the agenda all issues over which the member jurisdictions are unlikely to have significant influence. The County is required to establish and collect rates and charges as needed to operate and maintain the System, maintain reserves, pay debt service and meet required debt service coverage ratios. The County could change the rate allocation so long as the rates and charges collectively meet these requirements (and meet other legal requirements). The County legislative authority cannot, however, cede its final authority over rates and charges, including the basis for the rate or charge. MWPAAC could recommend a rate allocation for final approval by the County, and MWPAAC could negotiate, on behalf of member jurisdictions (subject to their final approval), amendments to the agreements.