

RatingsDirect®

Summary:

Seattle, Washington; Solid Waste/Resource Recovery

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Table Of Contents

Rating Action

Stable Outlook

Credit Opinion

Related Research

Summary:

Seattle, Washington; Solid Waste/Resource Recovery

Credit Profile		
Seattle solid waste <i>Long Term Rating</i>	AA+/Stable	Affirmed, Removed from CreditWatch
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Rating Action

S&P Global Ratings removed its long-term rating on Seattle, Wash.'s solid waste system improvement and refunding bonds from CreditWatch, where it had been placed with positive implications on Nov. 16, 2020, and affirmed the rating at 'AA+'. The outlook is stable.

The rating action reflects our determination that the model error described in our report (published Nov. 16, 2020, on RatingsDirect) did not impact the solid waste system's enterprise risk profile score, given that the economy score was already at our highest assessment. The rating continues to be supported by an extremely strong risk profile and very strong enterprise risk profile score.

We view the bond provisions as credit neutral. A pledge of net revenue of the city's solid waste system secures the bonds. A rate covenant requires the system to generate at least 1.25x debt service coverage. The additional bonds test requires that historical or projected net revenue provide at least 1.25x coverage of existing and proposed debt. As of Dec. 31, 2019, the solid waste system had \$187 million of solid waste revenue bonds outstanding.

Credit overview

The solid waste system is operated by Seattle Public Utilities (SPU), a department of the city. In our opinion, we view the diverse service area economy, strong income indicators, affordable rates, and recently renewed long-range collection service agreements supportive of our assessment of an extremely strong enterprise risk profile score, despite some economic challenges related to the pandemic. We continue to view the system's exposure to competition and revenue volatility as relatively low (given system's revenues are largely generated from rate revenue rather than tonnage-based tipping fees). Nevertheless, as surging COVID-19 cases take a toll on the health of the U.S. population, and gradual job recovery, there are concerns that the U.S. economic recovery is also facing a relapse, and possibly a double-dip recession, which we believe could pressure system affordability depending on the length and breadth of the economic contraction. (see "U.S. Biweekly Economic Roundup: Not Much To Be Cheerful About," published Dec. 4, 2020). One of the leading employers in the region, Boeing, Inc., plans to reduce its workforce Statewide. However, in recent years the city has experienced pronounced economic diversification, with an increase in information technology

and software industries, providing stability in the region. In addition, we view positively Seattle's continued drop in unemployment modestly below the national average for September 2020.

The financial risk profile is what we consider very strong and we expect financial metrics will remain sound given the preapproved rate increases, manageable pay-as-you-go capital plan and conservative forecasting. Due to the COVID-19 pandemic, commercial tonnage decreased but given the increase in residential tonnage there has not been a negative impact on total revenues. In our opinion, the solid waste system's very strong unrestricted cash position provides the system with cushion to deal with any short-term disruptions, delayed payments, or delinquencies because of the COVID-19 pandemic. While we continue to monitor events related to the COVID-19 pandemic, we do not currently expect it will affect the system's ability to pay debt service costs.

The extremely strong enterprise risk profile assessment further reflects:

- Strong and deep service area economy in the Seattle-Tacoma-Bellevue metropolitan statistical area (MSA), which is characterized by high incomes and declining unemployment compared with the nation;
- Monthly rates that we consider affordable as the 32-gallon monthly fee is only 0.8% of median household effective buying income (MHHEBI); and
- Strong Operational Management Assessment (OMA), represented by strong revenue collection mechanism where monthly fees appear on the water and sewer bill; regular rate increases through 2022, which the city plans to continue; and integrated solid waste system where the city has effectively contracted portions of the operations out to private vendors.

The very strong financial risk profile further reflects:

- A history of extremely strong coverage levels above 1.6x that we expect will continue given preapproved rate increases and renewed long-term contracts;
- Very strong liquidity position, with \$72 million, equivalent to 140 days of operating expenses as of Dec, 30 fiscal 2019 and no plans draw down cash;
- High debt burden, which is expected to decline over time given the system's lack of immediate plans to issue new debt; and
- A strong Financial Management Assessment (FMA), represented by conservative budgeting, monthly review of budget-to-actual results, long-range financial and capital planning, reserve policy of 45 days of operating expenses for the system and compliance with the city's debt management policy.

The stable outlook reflects our expectation for maintenance of all-in coverage at above 1.6x and very strong liquidity. Planned rate increases, coupled with the system's capital plan, should allow management to produce financial results in line with recent performance.

Environmental, social, and governance factors

In our opinion, Seattle's social risk is higher than that of peers given the recent civil unrest regarding the criminal justice system in early 2020; to date, these challenges have not had a meaningful financial impact to the system, although we believe the protests may have compounded the negative effects of the COVID-19 pandemic and

recession. The South Park Landfill is under a consent decree, which increases environmental risks above those of peers, however, SPU has taken steps to obtain ecology approval, a new scope, timing, and budget. Management emphasizes the importance of managing environmental issues and addressing regulatory requirements related to current and historic solid waste facilities while protecting employees' and customers' health and safety. Governance is strong and in line with that of peers, given the use of long-range demand and expense forecasts for SPU's recycling potential assessment model, long-range planning through the solid waste comprehensive plan, and strategic plan.

Stable Outlook

Downside scenario

We could lower the rating if project costs exceed expectations, resulting in the need to increase SPU's debt burden or materially draw down liquidity leading to an overall weaker financial risk profile.

Upside scenario

A higher rating is unlikely given S&P Global Economics projects a slow recovery from the economic contraction. However, we could raise the rating if the system pays down the significant amount of the debt it has issued and builds up reserves to levels that we consider comparable with those of higher-rated entities.

Credit Opinion

Enterprise risk

SPU provides solid waste collection and disposal to residents and businesses. We view positively the recently renewed collection agreements through 2029 with franchise collectors--Waste Management Inc. and Recology/Cleancescapes Inc.; which management indicated have similar cost structures to the prior agreements. The city owns and operates two transfer stations that receive refuse from the contract haulers and self-haulers. It contracts with Waste Management to haul refuse by rail and dispose of waste at Waste Management's landfill in Arlington, Ore. The city does not own an active landfill.

We continue to view the system's exposure to competition and revenue volatility as relatively low. Seattle residents are required by city ordinance to subscribe to the city's garbage collection services. For commercial refuse collection, the city faces little competition from independent haulers, according to management. The system's revenues are largely generated from rate revenue rather than tonnage-based tipping fees. In our view, this leads to lower revenue volatility.

Rates are affordable given strong income indicators and currently low county poverty rate giving SPU rate raising flexibility. However, our view of the system's market position score and affordability of rates could be pressured if income metrics deteriorate or the county poverty rate rises. Currently, a residential customer with a 32-gallon refuse can, a 96-gallon food and yard waste can, and a 96-gallon recycling can would pay about \$52 per month, which we view as affordable, at less than 1% of MHHEBI. Management reviews rates annually and preapproved rates through 2022.

Based on our OMA, we view SPU's solid waste system to be a '1' on a six-point scale, with '1' being the strongest. This

indicates, in our view, that operational and organizational goals are generally well aligned, even if some challenges exist. The OMA of strong includes the city's well-embedded asset adequacy identification program and a comprehensive operational risk-reduction plan. It also includes sufficient capacity for solid-waste disposal for the foreseeable future.

Financial risk

The solid waste system's all-in coverage has been extremely strong during the past three fiscal years. Under Seattle's charter, taxes paid to the general fund are subordinate to debt service. Based on our calculation, all-in coverage was extremely strong at above 1.6x the past three fiscal years (2017-2019) and we expect all-in coverage to remain at this level given preapproved rates through 2022 and lack of future debt plans. The system's liquidity position is very strong, in our view, and the system also has access to Seattle's \$1 billion pooled investments if needed, which mitigates the risk for increases in contract costs.

The solid waste system's capital plan is manageable over the next five years at \$85 million (2021-2026), which management plans to fund from rate revenue and cash. The largest projects include the cleanup of the historic South Park Landfill, and minimal operational improvement prior to the full redevelopment of the old South Transfer Station campus.

Finally, we view the SPU's management as strong, with strong financial policies and practices under our FMA methodology, indicating our view that financial practices are robust, transparent, well embedded, and likely sustainable.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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