S&P Global
Ratings

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Summary:

Seattle; Solid Waste/Resource Recovery; Water/Sewer

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Table Of Contents

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Credit Profile		
US$35.485 mil solid waste sys imp and rfdg rev bnds ser 2016 due 06/01/2041		
Long Term Rating	AA/Stable	New

Rationale

S&P Global Ratings has assigned its 'AA' long-term rating to Seattle, Wash.'s series 2016 solid waste system improvement and refunding bonds. In addition, we affirmed our 'AA' long-term rating on the city's outstanding solid waste revenue bonds. The outlook is stable.

The rating is based on our view of the solid-waste system's strong enterprise risk profile assessment, reflected by its:

- Stable customer base that lies at the economic center of the Puget Sound region;
- Low industry risk assessment;
- Relatively low competition, with residential customers required to have solid-waste accounts with the city;
- Monthly rates that we consider affordable;
- Strong revenue collection mechanism where monthly fees appear on the water and sewer bill;
- Regular rate increases in recent years, 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 rating is also based on a strong financial risk profile assessment reflected by:

- A history of strong coverage levels;
- Higher-than-historical capital needs as the city replaces its two transfer stations and redevelops an old landfill site; and
- Relatively low fund liquidity, although this is partially offset by access to the city's large pooled cash accounts.

The 2016 bonds are being issued to provide about $19.3 million in capital funding for Seattle's solid-waste system. The current capital improvement program (CIP) largely focuses on two of the city's three transfer stations, including rebuilding one and redeveloping an old one into a recycling facility. In addition, bond proceeds will refund a portion of the series 2007 bonds. The bonds are secured by a pledge of net revenue of the city's solid-waste system, which is on parity with the system's series 2007, 2011, 2014, and 2015 bonds. The 2016 bonds also have a claim on the system's global reserve, funded at 1.25x average annual debt service on all outstanding parity bonds. A rate covenant requires the system to generate at least 1.25x debt service coverage (DSC). The additional bonds test requires that historical or projected net revenue provide at least 1.25x coverage of existing and proposed debt. Following this issuance, the system will support about $212.59 million of solid-waste revenue bonds outstanding.

Seattle is the largest city in the Pacific Northwest and the economic center of the Puget Sound regional economy. The city estimates it has a population of about 640,000. Its median household effective buying income is strong, in our view, at 121% of the national median.

The solid-waste system is operated by Seattle Public Utilities, a department of the city. It provides solid-waste collection and disposal to residents and businesses in the city. Collection services are provided by two franchise collectors--Waste Management Inc. and Recology/Cleanscapes Inc.--under contracts with the city. 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.

The city has raised rates annually in recent years, with a large 27% increase in 2009 to offset costs associated with new collections contracts. Currently, a residential customer with a 32-gallon refuse can, a 96-gallon organic waste can, and a 96-gallon yard waste can would pay about $34 per month, which we view as affordable. Management increased rates 3.4% on April 1, 2016. Residential customers are charged for solid-waste service on the same bill as water and sewer services. The city can shut off water for non-payment of any part of the bill, leading to low residential delinquencies. Commercial customer bills are collected by the contract haulers and remitted to the city. According to management, Seattle has not experienced significant delinquencies with commercial accounts.

The system has had strong DSC in recent years, although we believe future rate increases will likely be needed to maintain strong coverage of increasing debt service (through 2020). Operating revenue totaled $174.7 million in 2015 after depositing $2.5 million into the rate stabilization fund (RSF). Net of RSF deposits, total operating revenues have increased by about 14% since 2010. During that same period, operating expenses (excluding depreciation) were up about 16.0%, totaling $160.3 million in 2015. These expenses include $17.9 million paid as taxes to the city. Under Seattle's charter, taxes paid to the general fund are subordinate to debt service. Net revenues before taxes and after the deposit to the RSF provided DSC of more than 3.5x in 2014 and more than 3.46x in 2015. The decrease was due to the rise in debt service to $12.6 million from $9.7 million. When deducting the RSF deposit from revenues and including taxes as an operating expense, S&P Global calculates DSC of approximately 1.67x in 2014 and 2.0x in 2015.

With this issue, the annual debt service obligation will increase to $16.2 million in 2017 from $12.5 million in 2015. Under the city's projections, DSC incorporating deposits and withdrawals from the RSF stays above 2.7x through 2017 and coverage after deducting for taxes stays at or above 1.5x. Under its financial policies, the city targets coverage when including taxes as expenses of at least 1.5x. Ignoring RSF activity, coverage with the city tax credited back to available debt service stays above 2.7x. We view the projections as reasonable, with growing revenue based on planned rate increases and higher operating expenses.

The system's liquidity position remains adequate, in our view, although it is below average for the 'AA' rating level. Liquidity is also projected to weaken during the next three years due to cash funding of a portion of the system's CIP, though not as much as originally planned. As of Dec. 31, 2015, unrestricted cash and investments totaled $42.2 million based on the audited financial statement, representing about 95 days of cash on hand, not including city taxes in expenses. In our view, the system's currently only adequate liquidity is somewhat mitigated by its access to Seattle's $1.8 billion pooled investments if needed. Under the city's municipal code, the finance director is permitted to make interfund loans for up to 90 days. Longer term loans require city council approval.

From 2016 through 2021, management is projecting to spend about $80.3 million for the capital program. The largest elements of the capital program are the replacement of Seattle's two transfer stations (one of which is already complete) and the redevelopment of a historical landfill site. The transfer stations are the system's largest capital assets. Following this issuance, management is currently projecting that it will not need any debt issuances to complete the capital plan.

Outlook

The stable outlook reflects our expectation for maintenance of high coverage and adequate liquidity. Planned rate increases, coupled with the completion of the major capital projects, should allow management to produce financial results in line with recent performance. Based on these factors, we do not anticipate changing the rating during the two-year outlook period.

Upside scenario

A higher rating is possible as the system pays down the significant amount of the debt it issued over the last five years. This, coupled with building reserves up to comparable levels of higher rated entities, could also lead to an upgrade.

Downside scenario

A significant slip in coverage levels, whether caused by increased debt burden, failure to institute required rate increases, or the unfavorable renewal of current operating contracts, could lead to a lower rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Solid Waste System Financings, June 15, 2007
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- U.S. State And Local Government Credit Conditions Forecast, April 19, 2016
- A Mature Sector Means Stable Credit Quality For U.S. Municipal Solid Waste Systems, Sept. 10, 2013

Ratings Detail (As Of May 20, 2016)

Ratings Detail (As Of May 20, 2016) (cont.)		
Seattle Solid Wste rev & Rfgd bnds		
Long Term Rating	AA/Stable	Affirmed
Seattle solid waste		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.