

# Summary Analysis

---

May 22, 2012

## **Summary:** Seattle, Washington; Water/Sewer

### **Primary Credit Analyst:**

Robert Hannay, San Francisco (1) 415-371-5038; robert\_hannay@standardandpoors.com

### **Secondary Contact:**

Chris Morgan, San Francisco (1) 415-371-5032; chris\_morgan@standardandpoors.com

## Table Of Contents

---

Rationale

Outlook

Related Criteria And Research

## Summary:

# Seattle, Washington; Water/Sewer

*(Editor's Note: Debt service coverage numbers and their characterization have been corrected. A revised version follows.)*

Credit Profile		
US\$203.38 mil drainage wastewtr rev bnds ser 2012A due 09/01/2042		
Long Term Rating	AA+/Stable	New
<b>Seattle drainage &amp; wastwtr bnds</b>		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

## Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating to Seattle, Wash.'s approximately \$203.38 million series 2012 drainage and wastewater improvement and refunding revenue bonds. At the same time, Standard & Poor's affirmed its 'AA+' long-term and underlying rating (SPUR) on Seattle's existing drainage and wastewater system parity debt. The outlook on all ratings is stable.

The rating is based on our view of the drainage and wastewater system's:

- Stable customer base, which anchors the deep and diverse Seattle-area economy;
- Good debt service coverage in 2011, and
- History of adopting rate increases to support stable financial performance and to offset increases in wholesale treatment rates.

These strengths are partially offset by our view of the drainage and wastewater fund's maintenance of an unrestricted cash position that we consider adequate but low for the rating category. However, in our view, access to loans from the city's large investment pool under the city's municipal code partially mitigates the low liquidity.

The approximately \$203 million series 2012 bonds are being issued to provide about \$91 million in capital funding and to refund a portion of the system's series 2001, 2002, and 2004 bonds. The bonds are secured by a pledge of net revenues of the city's drainage and wastewater system. Additionally securing all parity bonds is a reserve, funded at the lesser of maximum annual debt service (MADS), 125% of average annual debt service, and 10% of proceeds. The reserve requirement prior to this issuance is \$36.3 million, with \$23.6 million funded with surety bonds. A rate covenant requires the system to generate coverage of 1.25 times (x) average annual debt service, although withdrawals from a rate stabilization fund can be included in this calculation. As of May 1, 2012, the system had \$483 million in parity bonds outstanding and \$18.6 million in junior lien state loans.

The drainage and wastewater system is operated by Seattle Public Utilities, a department of the city. The system provides wastewater services to about 166,000 accounts within Seattle. The drainage system serves about 213,000 accounts. The city sits at the center of the large, diverse Puget Sound regional economy. Income levels within the city are above average, with the median effective household buying income at 111% of the national average.

The wastewater system is primarily a collection system, with all sewage treated on a wholesale basis by King County's regional wastewater treatment system. The agreement between Seattle and the county to provide wholesale sewage treatment expires in 2036, although we understand that negotiations are underway to extend the agreement. The system pays a monthly sewer charge to the county based on the number of residential customer equivalents (RCEs). Seattle is the largest customer of the regional system, representing 40% of total regional system RCEs. The county has periodically increased its wholesale rate, and the city has historically passed the increase on to its retail customers. Wholesale treatment expenses represented 54% of drainage and wastewater system operating expenses in 2011.

Most sewer customers are billed bi-monthly based on water consumption (winter water consumption for residential customers). The city uses a 4.3-hundred cubic feet (ccf) per month measure for a typical residential bill, leading to \$45.92 per month. The city has increased wastewater rates in each of the past six years.

The drainage system consists of facilities to handle stormwater runoff. About two-thirds of the system is a combined or partially combined stormwater and wastewater system. Annual stormwater charges are based on parcel size and, for larger parcels, the proportion that is impervious surface. The charge is billed on the county property tax statement. For 2012, a typical residential customer's annual charge is \$261.66.

The drainage and wastewater system financial performance has been relatively stable during the past three years. Regular rate increases have helped increase operating revenue and offset increasing wholesale treatment expenses. In 2011, operating revenue totaled \$279.0 million, up 11.7% from 2010. Operating expenses excluding depreciation were up 11.1% in 2011, at \$233.2 million, partly due to a wholesale rate increase. In the city's debt service coverage calculation under its rate covenant, it excludes taxes paid to the city and claims expenses from operating expenses. In 2011, city taxes and claims expenses were \$32.4 million and \$1.5 million, respectively. Under the city's charter, city taxes are paid only after provisions have been made to pay debt service. Based on this calculation, senior-lien debt service coverage was 2.21x in 2011, up from 2.03x in 2010. Including all operating expenses other than depreciation and amortization, senior-lien debt service coverage was good at 1.30x in 2011 and total debt service coverage was good at 1.26x. In the city's projections, debt service coverage, as calculated by the city, is at or above 1.8x during the next six years. These projections do not incorporate increases in wastewater treatment expenses, although it is the city's policy to offset wholesale increases with higher retail wastewater rates. We anticipate that King County will increase wholesale rates and Seattle will pass these increases through to its customers.

We view the drainage and wastewater fund's unrestricted liquidity position as adequate but low for the 'AA+' rating. As of Dec. 31, 2011, unrestricted cash and investments totaled \$29.1 million, representing 46 days of operating expenses on hand. In our view, provisions in the city's municipal code allowing the finance director to make interfund loans for up to 90 days partly mitigate the system's low liquidity. Longer-term loans require city council approval. According to management, the city's investment pool balance is currently about \$1.2 billion.

About two-thirds of the city is served by a combined or partially combined sewer and stormwater system. The city has invested heavily during the past 40 years in projects to control combined sewer overflows. Under an agreement between the city and state Department of Ecology, the city is required to continue reducing overflows. Combined sewer overflow projects represent about 40% of the system's capital program during the next six years.

The system's total six-year capital improvement program covers \$585 million in projects. In addition to projects to reduce combined sewer overflows, the CIP includes rehabilitation projects, flooding and sewer-backup prevention,

and other projects. The city currently plans to issue another \$265 million in drainage and wastewater system-backed debt during the next six years to finance a portion of the capital plan. Other sources include the series 2012 bonds, prior bond proceeds, grants, and internally generated funds.

## Outlook

The stable outlook reflects our anticipation that the system will continue to provide good debt service coverage, generate sufficient capital funding, and pass-through wholesale treatment rate increases to its customers. With the system's only-adequate unrestricted cash position, we do not anticipate raising the rating during the next two years. If cash levels or debt service coverage were to fall, we could lower the rating.

## Related Criteria And Research

- 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

Ratings Detail (As Of May 22, 2012)		
Seattle drainage and wastewtr rev bnds ser 2001 dtd 06/01/2001 due 11/01/2002-2021 2025 2031 (MBIA) (MBIA of Illinois)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Seattle drainage & wastewtr (AGM)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Seattle Drainage & Wastewater rev & rfdg bnds ser 2008 due 06/01/2038		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
<b>Seattle wtr/swr</b>		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

Copyright © 2013 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).