STANDARD & POOR'S RATINGS SERVICES

Summary Analysis

May 22, 2012

Summary:
Seattle, Washington; Water/Sewer

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Table Of Contents

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(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
Seattle drainage & wastwtr bnds		
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)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Seattle drainage & wastewtr (AGM)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Seattle Drainage & Wastewater rev & rfdg bnds ser 2008 due 06/01/2038		
Long Term Rating	AA+/Stable	Affirmed
Seattle wtr/swr		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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