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RATINGS SERVICES
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Summary:

Seattle, Washington; Solid Waste/Resource Recovery

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Summary:

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Credit Profile		
US$96.0 mil solid waste rev bnds ser 2014		
Long Term Rating	AA/Negative	New
Seattle Solid Wste rev & Rfgd bnds		
Long Term Rating	AA/Negative	Outlook Revised
Seattle solid waste		
Unenhanced Rating	AA(SPUR)/Negative	Outlook Revised

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services revised its outlook to negative from stable and affirmed its 'AA' long-term rating on Seattle, Wash.'s existing solid waste revenue bonds. At the same time, Standard & Poor's assigned its 'AA' long-term rating to the city's series 2014 solid waste revenue bonds.

The negative outlook reflects our view of the city's planned drawdown in liquidity of the solid waste system to pay for capital projects. At year-end 2013, the system had about 60 days of operating expenses on hand, a level we view as adequate but below-average for the 'AA' rating level. Under the city's projections, liquidity is anticipated to fall to a level we consider low by 2016. The city's currently only adequate liquidity is somewhat mitigated by the system's stable revenues and expenses and access to loans from the city's pooled investment account, if needed. However, if liquidity within the fund falls to a low level during the next two years, we could lower the rating.

The rating is based on our view of the solid waste system's:

- Stable customer base that lies at the economic center of the Puget Sound region;
- Relatively low competition, with residential customers required to have solid waste accounts with the city;
- Regular rate increases in recent years, which the city plans to continue; and
- Strong debt service coverage during the past three years.

These strengths are partly offset by our view of the system's:

- Higher-than-historic capital needs as the city replaces its two transfer stations and redevelops an old landfill site; and
- Projected decline in liquidity as cash is used to cover a portion of the capital program.

The bonds are being issued to provide about $58.7 million in capital funding for the city's solid waste system. The current capital improvement program is largely focused on rebuilding the city's two transfer stations and redeveloping an old landfill. Depending on market conditions, the city may also refund a portion of its outstanding series 2007 debt with the issue.

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 and 2011 bonds. The bonds also have a reserve, funded at maximum annual debt service (MADS). A rate covenant requires the system to generate at least 1.25x debt service coverage. The additional bonds test requires that historic or projected net revenue provide at least 1.25x coverage of existing and proposed debt. As of Dec. 31, 2013, the system had $115.9 million in solid waste revenue bonds outstanding. The series 2014 bonds will add approximately $55 million in new debt.

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 627,000. The city's 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. The system provides solid waste collection and disposal to residents and businesses within 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. The city 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 its own active landfill.

We view the system's exposure to competition and revenue volatility as relatively low. Residents within Seattle 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. We understand that the system does face significant competition for commercial recycling and organics hauling from private, independent haulers. But according to management, the system's relatively low market share in these categories has been an ongoing trend that is not expected to change. 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 the impact of the recession. Currently, a residential customer with a 32-gallon refuse can and 96-gallon yard waste can would pay about $41 per month, which we view as moderate. The city has adopted a 4.3% increase for 2015 and a 3.4% increase for 2016, although management is recommending larger rate increases of 5.7% and 5.8%, respectively, in those years as part of its budget proposal. 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 cities. According to management, the city has not experienced significant delinquencies with commercial accounts.

The system has had strong debt service coverage in recent years, although we believe future rate increases will likely be needed to maintain strong coverage of increasing debt service. Operating revenue totaled $159.7 million in 2013 after depositing $5.2 million in a rate stabilization fund, up 1.8% from 2012. Including the $5.2 million, operating revenue grew 5.1%. Operating expenses excluding depreciation were up 3.8% in 2013, totaling $143.6 million. These expenses include $16.8 million paid as taxes to the city. Under the city's charter, taxes paid to the general fund are subordinate to debt service. Net revenues before taxes and after the deposit to the rate stabilization fund provided debt service coverage of 3.74x in 2013, down slightly from 3.85x in 2012, as calculated by Standard & Poor's. Without the rate stabilization fund deposit, debt service coverage would have been 4.32x in 2013. With taxes deducted from net revenues, Standard & Poor's calculates debt service coverage of 1.88x in 2013 and 2.13x in 2012.

With this issue and a future planned issue, debt service will increase from $9.0 million in 2013 to $16.3 million in 2016. Under the city's projections, debt service coverage incorporating deposits and withdrawals from the rate stabilization fund stays above 2.6x through 2016 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 rate stabilization fund activity, coverage without the tax stays above 2.5x and coverage after deducting taxes stays above 1.2x. We view the projections as reasonable, with growing revenue based on planned, but not yet adopted, rate increases and increasing operating expenses.

The system's liquidity position is 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 capital improvement plan. As of Dec. 31, 2013, unrestricted cash and investments totaled $20.9 million based on the audited financial statement, representing about 60 days of cash on hand (53 days when including taxes in expenses). Under the city's projections, cash falls to $6.5 million or about 17 days, by 2016. In our view, the system's currently only adequate liquidity is somewhat mitigated by its access to the city's $1.4 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.

The city is planning higher than historic levels of capital funding during the next six years, with capital needs decreasing thereafter. The largest elements of the capital program are the replacement of the city's two transfer stations (one of which is already complete) and the redevelopment of a historic landfill site. The transfer stations are the system's largest capital assets. The six-year capital plan covers $144 million in expenses through 2019. This issue is providing $58.7 million in funding for the program. The city is planning another $46.9 million in debt to complete the plan.

Outlook

The negative outlook reflects our view of the city's planned drawdown in cash to pay for capital expenses. If liquidity is drawn down to a level we view as low, we could lower the rating. If the drawdown in liquidity is limited, debt service coverage remains strong, and in our view the capital plan can be completed without significant further cash drawdown, we could revise the outlook to stable.

Related Criteria And Research

Related Criteria

USPF Criteria: Solid Waste System Financings, June 15, 2007

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