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CREDIT OPINION
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New Issue

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Seattle, WA Solid Waste Enterprise

New Issue - Moody's assigns Aa3 to Seattle's (WA) solid waste revenue bonds

Summary Rating Rationale

Moody's Investors Service has assigned a Aa3 rating to the City of Seattle, Washington's $35.5 million Solid Waste System Improvement and Refunding Revenue Bonds, 2016. Concurrently, Moody's affirms the Aa3 ratings on the solid waste system's outstanding parity revenue bonds. Post-issuance, the solid waste system will have $228.7 million in bonds outstanding.

The Aa3 revenue bond rating is based on the system's large and affluent service area; healthy financial profile that includes limited debt, satisfactory debt service coverage, and access to ample amounts of liquidity; very strong operating processes and management team; and solid legal provisions.

Credit Strengths

» Demonstrated willingness to raise rates

» Strong flow control provisions

» Large and wealthy service area

» Declining capital requirements

Credit Challenges

» Near-term declines of debt service coverage ratios

» Above average rates relative to peers

Rating Outlook

The outlook on the system's revenue bonds is stable, reflecting Moody's expectations that management will continue to adjust rates and charges to maintain satisfactory debt service coverage levels.

Factors that Could Lead to an Upgrade

» Higher debt service coverage ratios

» Strengthening of legal provisions

Factors that Could Lead to a Downgrade

- » Deterioration in financial metrics, particularly debt service coverage, materially below forecasted levels
- » Change in city ordinance that would weaken flow control

Key Indicators

Seattle Solid Waste Enterprise					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	10 years				
System Size - O&M (in $000s)	160,331				
Service Area Wealth: MFI % of US median	152.2%				
Legal Provisions					
Rate Covenant (x)	1.25				
Debt Service Reserve Requirement	DSRF funded at lesser of standard 3-prong test				
Financial Strength					
	2011	2012	2013	2014	2015
Operating Revenue ($000)	154,200	156,927	159,742	157,498	174,788
O&M ($000)	138,294	138,418	143,614	146,203	160,331
Long-Term Debt ($000)	125,142	121,556	117,805	177,522	210,310
Annual Debt Service Coverage (x)	5.47	3.79	3.74	3.50	3.46
Cash on Hand	49 days	56 days	53 days	81 days	96 days
Debt to Operating Revenues (x)	0.8x	0.8x	0.7x	1.1x	1.2x

Source: Moody's Investors Service

Recent Developments

Recent developments are incorporated in the detailed rating considerations below.

Detailed Rating Considerations

Service Area and System Characteristics: Seattle's Mandatory Garbage Service

The enterprise provides curbside waste collection for residential and commercial customers in Seattle through contracts with private haulers. City ordinance requires all residents to subscribe to solid waste collection and prohibits the collection of non-recyclable waste within the city by companies that are not under contract with the city. Commercial customers are required to use either the enterprise's contracted commercial haulers or self-haul. In 2015, the enterprise had nearly 170,000 residential customer accounts (including 5,200 multi-family dumpster accounts) and 8,145 commercial accounts. Despite strong local population growth, total account growth appears to have leveled off, driven by increasing urban density via multi-unit developments and overall declines in garbage tonnage.

The City of Seattle is the commercial and tourist hub of the Puget Sound region and the economic center of the State of Washington. Software development and aircraft manufacturing are key components of the local economy, and the area serves as the headquarters of or major operating base to some of the world's most well-known international corporations, including Amazon, Boeing, Microsoft, and Starbucks. Online retailer Amazon, in particular, continues to expand its footprint in Seattle, acquiring and developing substantial downtown office space to house its growing workforce. Median family income in the city is amongst the highest among large urban areas in the United States at 152.2% of the national average. Full value per capita, a proxy measure of wealth, is robust at $256,000. Price appreciation and new construction are continuing to drive the city's assessed value higher. In 2016, assessed value hit a new high of $163.3 billion, up 13% from 2015. Median home prices are up 24% year-overyear, and commercial office vacancy rates continues to decline. The city is forecasting a slowing of growth in 2017 back to 2014 levels, though Moody's notes that total housing permits are still projected to grow by 7.2%.

Financial and Operating Performance: Strong Revenue Generation With Limited Exposure to Operating Risks

With a near monopoly on service, a demonstrated willingness to increase rates, and strong collection mechanisms, Moody's views the solid waste enterprise's ability to generate revenue as strong. Solid waste rates have increased annually since 2007, including a large 27% increase in 2009 to correspond to more expensive waste collection contracts that started in April 2009. Under the city's current strategic plan adopted by the city council in 2014, the solid waste enterprise will raise rates by an average of 3.8% annually through 2020, including an expected 6.0% increase for 2017. As we've noted in past reports, while the willingness to raise rates is strong, the enterprise's average monthly bill is high relative to many of its regional peers. This is similarly the case with the city's water, drainage and sewer utilities, the result of which is a high composite utility rate for users and potentially constrained flexibility for individual utilities rates. For 2017, the projected combined monthly residential bill for a single family house is $178.33, growing to $207.02 by 2020. The city's ability to implement these rate increases will be an important credit factor that Moody's will continue to monitor moving forward.

The structure of Seattle's utility billing is a credit strength for the solid waste enterprise. Solid waste customers are billed on a combined utility statement, with partial payments applied first to solid waste, then wastewater, and lastly water. The city has the authority to shut off water to enforce collections, limiting delinquent or unpaid bills.

The enterprise has very little exposure to waste volumes, except to the extent that residential customers choose to downsize their collection containers. The city is able to adjust rates to derive necessary revenues from the smaller containers, but this approach may have its limits in the long-run, such as political challenges if users perceive they are being charged more for less. Notably, recyclable waste is not charged and the city earns only a minimal amount from the sale of processed materials. Thus, the growing recyclable waste volumes are subsidized by shrinking non-recyclable waste volumes, which is credit negative as the dynamic necessitates continued rate increases on the part of the enterprise to maintain targeted financial margins. Collection of organics is also subsidized.

Because collection, processing, and disposal are contracted through private haulers, the city has limited exposure to operational risks. The enterprise operates two transfer stations but zero active landfills. Landfill waste is transported from the transfer stations to a railhead by the solid waste enterprise, where it is hauled to a private landfill in Oregon. The provisions of the city's contract with its garbage hauler indemnifies the city against future risks associated with this disposal.

The city believes there is sufficient competition for its contracts that satisfactory fulfillment is not a significant operating risk for its solid waste enterprise. Residential and commercial solid waste collection and disposal activities are contracted to Recology/Cleanscapes and Waste Management, Inc. (Baa2 stable) under contracts that expire in 2017 and 2019, respectively, with city options to extend. The enterprise has contracts with third parties for handling recycling and processing organics. Long haul transportation service to landfills from the transfer stations is provided by Washington Waste Systems (WWS), a subsidiary of Waste Management under an existing contract that expires in 2028 but in which the enterprise has options to terminate in 2019 or 2021.

Debt Service Coverage: Declining But Satisfactory Coverage

Debt service coverage by the solid waste enterprise has declined over the past five years, driven principally increasing annual debt service for bond issuances to finance the demolition and reconstruction of the enterprise's two transfer stations. Top line revenue grew from $154.2 million in 2011 to $174.8 million in 2015, inclusive of the city utility tax. By ordinance, these city utility taxes are remitted to the city after the payment of debt service. Excluding non-operating revenues and expenses, the enterprise had $40.5 million in funds available for debt service in 2015 (including $18.0 million of city utility tax revenues and excluding depreciation and a one-time non-cash, extra-ordinary environmental liability cost of $9.3 million), resulting in solid coverage of 3.34 times debt service. This is down from 5.06 times debt service coverage in 2011. Despite projected revenue growth of 8.6% and 4.2% in 2016 and 2017, the city is projecting debt service coverage to decline as both operating expenses and debt service increase. The city is currently projecting debt service coverage of 2.74 times and 2.70 times in 2016 and 2017, respectively.

LIQUIDITY

Seattle's utilities have historically maintained low levels of cash on their own balance sheets. This is mitigated by their ability to access liquidity in the city's $1.8 billion consolidated cash pool. Short-term liquidity (up to 90 days) can be accessed with approval of the city's finance director. For long-term liquidity, the enterprise must receive approval of the city council. The loans bear interest at the yield of the investment pool, which is low given the short-term investment nature. This cash management approach has been tested and demonstrated successful, with the city's electric enterprise borrowing in excess of $100 million from the cash pool during the 2001 power crisis. The solid waste enterprise generates healthy operating cash flow, and while a considerable portion of this cash flow is contributed toward capital spending and therefore does not accumulate on the balance sheet, the enterprise would be able to quickly build cash reserves if it chose to limit the extent of cash-funded capital outlay. The enterprise ended FY 2015 with $42.2 million of cash in working capital, or more than 96 days of cash on hand, a level Moody's views as satisfactory.

Debt and Legal Security

With the current sale, the enterprise will have $228.7 million in debt outstanding. At just 1.31 times operating revenues, the existing debt burden is modest.

DEBT STRUCTURE

The solid waste enterprise has no plans to issue additional bonds after the current issuance. Peak debt service is expected to be approximately $16.3 million in 2017, after which debt service declines slightly before leveling off at $15.8 million through 2033, with final maturity in 2041.

DEBT-RELATED DERIVATIVES

The enterprise has no debt-related derivatives.

LEGAL SECURITY

The bonds are secured by a pledge of net revenues of the solid waste enterprise, which has a rate covenant that requires the enterprise to set rates to maintain at least 1.25 times annual debt service coverage on a pre-city tax basis. The additional bonds test similarly requires that rates be set to maintain at least 1.25 times annual debt service coverage on a pre city tax basis. Furthermore, the bonds are secured by a common debt service reserve sized at the lessor of the standard three-prong test. Currently, the debt service reserve is backed by a $5.9 million MBIA Insurance Corporation (Caa1 negative) surety policy (reinsured by National Public Finance Guarantee Corp (A3 negative) and $9.2 million of cash, with an additional $916,000 to be deposited from current bond proceeds.

Use of Proceeds

The bonds will be used to pay for the costs of various projects of the city's solid waste enterprise, and to refund for savings a portion of the outstanding Solid Waste Revenue and Refunding Bonds, 2007.

Obligor Profile

Seattle Public Utilities (SPU) was created in 1997 as a department of the City of Seattle (Aaa stable) and includes the city's water, drainage, sewer and solid waste utilities. The solid waste enterprise resides within SPU and is responsible for solid waste collection and disposal and owns and operates two transfer stations. Residential and commercial solid waste collection and disposal activities are contracted to Recology/Cleanscapes and Waste Management, Inc. (Baa2 stable) under contracts that expire in 2017 and 2019, respectively, with city options to extend. The enterprise has contracts with third parties for handling recycling and processing organics. Long haul transportation service to landfills from the transfer stations is provided by Washington Waste Systems (WWS), a subsidiary of Waste Management under an existing contract that expires in 2028 but in which the enterprise has options to terminate in 2019 or 2021.

Methodology

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

Seattle (City of) WA Solid Waste Enterprise

Issue	Rating
Solid Waste System Improvement and Refunding Revenue Bonds, 2016	Aa3
Rating Type	Underlying LT
Sale Amount	$35,485,000
Expected Sale Date	06/13/2016
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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