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**Summary:**

# Seattle; Solid Waste/Resource Recovery


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## Rationale

S&P Global Ratings has raised its long-term rating on Seattle, Wash.'s outstanding solid-waste system improvement and refunding bonds to 'AA+' from 'AA'. The outlook is stable.

The upgrade reflects a strong conservative management team, which has strived to keep solid-waste fees affordable while dealing with increasing contract costs and capital requirements. The rising capital requirement reflect management's efforts to become more efficient at its solid-waste facilities, with one of two transfer stations completely rebuilt and construction on the other expected to start soon. Management has also indicated that it will be funding a larger part of the capital program from operations, thereby reducing future expected debt burden levels.

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

- Strong and deep service area economy in the Seattle-Tacoma-Bellevue metropolitan statistical area (MSA) which is characterized by high incomes and below-average unemployment;
- Low industry risk as a contractual monopolistic service provider of an essential public utility;
- Monthly rates that we consider affordable as the 32-gallon monthly fee is only 0.7% of median household effective buying income (MHHEBI); and
- Strong Operational Management Assessment (OMA, where we view the system as a '1' on a six-point scale with '1' being the strongest and '6' the weakest), which, in our opinion, implies overall alignment among the system's operational characteristics and that its management strategies are sufficient and well embedded as well as very conservative. Highlights include a 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 very strong financial risk profile assessment reflected by:

- A history of strong coverage levels;
- Strong liquidity position with available cash and investments totaling $55 million or 117 days' cash on hand, well above the policy of maintaining 45 days of operations;

- An above-average debt burden with a debt-to-capitalization ratio of 85.9%, which is expected to come down as debt rolls off quicker than the city plans to issue new debt; and
- A strong Financial Management Assessment (FMA), which indicates that the finance department maintains adequate policies in some, but not all, key areas. We view the system as a '1' on a six point scale with '1' being the strongest and '6' the weakest.

The bonds are secured by a pledge of net revenue of the city's solid-waste system. 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 $201 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. Management estimates it has a population of about 640,000. Its MHHEBI is strong, in our view, at 134% 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. 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.

Consistent with our criteria, titled "Methodology: Industry Risk" (published Nov. 19, 2013), we consider industry risk for the system very low, the most favorable assessment possible on a '1' to '6' scale, with '1' being the best.

The city has raised rates annually in recent years, with a large 27% increase in 2009 to offset costs associated with new collection contracts. Currently, a residential customer with a 32-gallon refuse can, a 96-gallon organic waste can, and a 96-gallon yard waste would pay $37.15 per month, which we view as affordable. Residential customers are charged for solid-waste service on the same bill as water and sewer services. The city can shut off water for nonpayment 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. Rates are expected to increase by 4% effective April 1, 2019.

Based on our OMA, we view Seattle Solid Waste System to be a '1' on a scale of '1' to '6', with '1' being the strongest. This indicates, in our view, that operational and organizational goals are generally well aligned, even if some challenges exist. The OMA of strong includes the city's well-embedded asset adequacy identification program and a comprehensive operational risk-reduction plan. It also includes sufficient capacity for solid-waste disposal for the foreseeable future.

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 $209.6 million in 2017. Total operating revenues have increased by about 33.6% since 2012. During that same period, operating expenses (excluding depreciation) were up about 30%, totaling $180.2 million in 2017. These expenses include $26.4 million paid as taxes to the city. Under Seattle's charter, taxes paid to the general fund are subordinate to debt service. S&P Global Ratings calculates DSC of approximately 2.17x in 2017.

The system's liquidity position remains adequate, in our view, although it is below average for the 'AA' rating level. As of Dec. 31, 2017, unrestricted cash and investments totaled $55.7 million based on the audited financial statement, representing about 117 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 $1.0 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.

We view the city's management as strong, with strong financial policies and practices under our FMA methodology, indicating our view that financial practices are strong, well embedded, and likely sustainable.

Elements of the city's financial policies and practices include:

- What we view as a consistent approach to budgeting, with the use of detailed, empirically based revenue and expenditure forecasts to build budgets;
- Management's provision of budget-to-actual updates to the council in May, September, and November and the council's practice of quarterly expenditure amendments;
- The use of a detailed financial forecasting model covering the current and subsequent three years to consider the long-term effects of current-year budgeting decisions;
- An annually updated rolling six-year capital improvement plan with funding sources identified;
- Quarterly reporting on investment holdings and returns under an internally guided investment policy;
- Formal and well-embedded comprehensive debt management policy including elements such as a maximum general fund carrying charge threshold relative to the budget (7%) and an annual debt portfolio report that coincides with the adoption of annual budget; and
- Compliance with automatic formula contributions to designated reserves for emergencies and economic downturns, although the city does not set reserve policy minimums.

### Pensions

Seattle's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 7.2% of total governmental fund expenditures in 2016, with 5.9% representing required contributions to pension obligations and 1.3% representing OPEB payments. The city made its full annual required pension contribution in 2016.

The city independently manages two defined-benefit pension plans for most of its nonsworn employees and two small closed plans for public safety employees. Other public safety employees participate in the state-managed Law Enforcement Officers' and Firefighters' Retirement System. The city's required pension contribution is its actuarially determined contribution, which is calculated based on an actuary study. We view the largest plan's (Seattle City Employees Retirement System [SCERS] 1) funded ratio, which we estimate as the plan fiduciary net position as a percentage of the total pension liability, as low at 65.6%. In August 2016, the city and its bargaining groups agreed to create a second plan (SCERS 2) as a lower cost tier for employees who joined the city starting in 2017.

In 2012, the city shifted its valuation of its pension assets to a five-year smoothing approach and formally declared its intention to fund its actuarially calculated annually required contribution (ARC) for the city-managed pension system based on a 30-year amortization. It has consistently met the ARC under its definition, although its payments fall slightly below the ARC under Governmental Accounting Standards Board guidelines because, as we understand, the guidelines do not allow an entity to assume growth in the number of employees.

The city's OPEB liability totaling $734.1 million as of 2016 consists of an implicit subsidy and, for certain public safety employees under a now closed plan, a direct subsidy. The city manages this cost on a pay-as-you-go basis.

## 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 an increased debt burden, failure to institute required rate increases, or the unfavorable renewal of current operating contracts, could lead to a lower rating.

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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.