MOODY'S
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CREDIT OPINION
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New Issue

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Seattle (City of) WA Water Enterprise

New Issue: Moody's assigns Aa1 to Seattle, WA's water revenue bonds

Summary Rating Rationale

Moody's Investors Service has assigned an Aa1 rating to Seattle, Washington's $195.8 million Water System Improvement and Refunding Revenue Bonds, 2017. Moody's maintains an Aa1 rating on the water enterprise's parity revenue bonds. The outlook is stable.

The Aa1 rating reflects the water enterprise's broad and economically diverse service area, ample water supply and capacity margin, satisfactory and stable debt service coverage, liquidity that is buttressed by access to the city's $1.9 billion investment pool, and manageable debt burden. The rating also incorporates satisfactory legal provisions providing bondholder protections, as well as a strong management team and culture as demonstrated by strong capital planning and prudent historical rate adjustments.

Credit Strengths

» Strong service area that is economically diverse, relatively affluent, and growing

» Ample water supply

» Strong management team and culture

Credit Challenges

» Long-term trend of declining water consumption

» High combined utility cost to consumers may limit future rate increases

Rating Outlook

The stable outlook reflects Moody's view that debt service coverage will remain healthy, supported by a strong service area and prudent management actions, including regular rate increases. Moody's also expects capital projects and the use of leverage will be manageable.

Factors that Could Lead to an Upgrade

» Significant increase in debt service coverage

» Material decline in outstanding debt

Factors that Could Lead to a Downgrade

» Decline in debt service coverage

» Weakening in the enterprise's ability to access additional liquidity

Key Indicators

Exhibit 1

Seattle (City of) WA Water Enterprise					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	28 years				
System Size - O&M (in $000s)	143,563				
Service Area Wealth: MFI % of US median	144.5%				
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)	194,573	213,474	235,594	242,947	251,977
O&M ($000)	108,435	114,983	126,622	132,979	143,563
Long-Term Debt ($000)	977,160	919,640	887,010	853,465	851,565
Annual Debt Service Coverage (x)	1.46	1.70	1.86	1.93	1.87
Cash on Hand	25 days	40 days	83 days	120 days	108 days
Debt to Operating Revenues (x)	5.0x	4.3x	3.8x	3.5x	3.4x

Source: Moody's Investors Service

Detailed Rating Considerations

Service Area and System Characteristics: Retail and Wholesale Water Provider to Seattle Metro Area

The enterprise provides retail and wholesale water service to a population of more than 1.4 million in the greater Seattle metropolitan area. Retail service is provided to the City of Seattle, portions of the cities of Shoreline, Burien, and Lake Forest Park, and a portion of unincorporated King County. The number of retail accounts have grown by just over 2% between 2011 and 2015 (to 192,633), though much of that growth has come in the last three years as the region began rapidly recovering from the recession. Wholesale water is provided to 21 suburban water districts and municipalities, and the Cascade Water Alliance.

Wholesale water represents slightly more than half of water demand, followed by commercial use (28%), and residential (19%). No single retail customer represents more than 2.46% of total revenues, and the ten largest retail customers represent just 10.67% of total revenue. 13 wholesale customers receive water under full-requirements contracts that extend through 2060. Four wholesale customers purchase water under partial-requirements contracts, in which the purchased water supplements their own supplies. These contracts carry the same terms and duration as the full-requirements ones. The enterprise also provides water under block contracts with Cascade Water Alliance (CWA) and Northshore Utility District, which have been established on a take or pay basis. The enterprise provides CWA a specified minimum block (base block) and supplemental water (supplemental block) through 2039, at which point the block volume begins to decline.

Total annual billed water consumption has fallen over multiple decades, driven by the implementation of water conservation efforts, improved efficiency in fixtures, and increased residential density. However, enterprise managers expect per capita consumption to level out moving forward, with some variability driven by year-to-year changes in hydrological conditions. In 2015, for example, drought conditions resulted in a 4.5% increased in total billed water use (to 43,415 million gallons).

Water supply comes from two surface sources (the Cedar River and the Tolt River) and one well field (Seattle Well Fields). Currently, these sources provide an average annual yield 172 million gallons per day (MGD). The water system can store 105 million gallons within its distribution system, predominantly in its six reservoirs, and the enterprise also has access to more than 130,000 acre-feet of raw water stored in the Cedar River and South Fork Tolt Watersheds (equal to roughly 42,345 MG, or about one year of water consumption). Given existing supply and demand forecasts, managers have determined that no significant new sources of water are necessary before 2060.

The transmission and distribution system is comprised of three main transmission lines, 1,690 miles of pipeline, and 16 pumping stations. The city estimates water loss at about 6.2 MGD, with total non-revenue producing water at 6.6 MGD. The current capital improvement plan (CIP) through 2022 includes $556.9 million in projects, primarily for shared cost projects (such as the Alaskan Way Viaduct and Seawall Replacement Program) and improvements to the distribution system. This total is expected to decline as system managers look for less costly alternatives to a $44 million project to bypass the Tolt 2 transmission line, which is suffering from deflection caused by slope movement.

Debt Service Coverage and Liquidity: Satisfactory Coverage With Thin Liquidity Buttressed by Access to City's Investment Pool

After some weakness in coverage in 2010 and 2011, the water enterprise has generated satisfactory debt service coverage levels above its target policy of 1.70x. In 2015, coverage was 1.87 times, a slight decrease from 1.93 times in 2014 but on par with 2013 (1.86 times). Top-line revenue growth has been strong, with operating revenues increasing by 3.7% in 2015 (to $252.0 million), driven by strong drought-driven retail demand and despite no change in statutory rates. Retail operations in 2015 generated 74.2% of operating revenues, marginally higher than in recent years. Although wholesale water service represents 53% of consumption, it represented just 20.7% of operating revenues in 2015.

Operating expenses, including the city's 15.54% utility tax and the state's public utility tax (5.029%), have kept pace with revenue growth, leading to relatively flat net operating income between 2013 and 2015. Absent adjustments for city taxes and other non-operating revenues, 2015 financial performance resulted in a more modest 1.3 times debt service coverage, similar to the average of the prior five year period.

The enterprise is projecting debt service coverage through 2018 to average 1.78 times (after adjustments for city taxes and other non-operating revenues), reflecting rate increases of 2.1% and 2.7% in 2016 and 2017, as well as some one-time money from the Cascade Water Alliance in 2018. Despite the 2.1% rate increase, revenue for 2016 is projected to grow just 1.7%, reflecting a small decline in retail water service revenues resulting from normal hydrological conditions. Under the city's strategic plan for its public utilities, water rates were projected to increase by an average of 3.6% annually between 2015 and 2020, including increases of 5.2% in each of 2016 and 2017. However, given high combined utility costs, projected to increase to $207 per month by 2020 from $161 in 2015, large increases by the water utility may be difficult to implement without smaller adjustments by the other enterprises. Positively, management reports low delinquency rates and reasonable affordability given Seattle's strong socioeconomic profile.

LIQUIDITY

Like the city's other utility enterprises, the water enterprise had historically held low levels of cash. The water enterprise has a target year-end operating cash balance equal to 1/12 of the current year's operating expense, with an informal target of 45 days of expenses. At the end of 2015, the water enterprise held $42.3 million in unrestricted cash and investments, or 108 days of cash on hand. Although satisfactory, this is substantially lower than than that of similarly-rated water enterprises nationally. Positively, the enterprise has access to the city's investment pool, which at the end of 2015 held $1.76 billion in cash and investments. The investment pool could provide a loan for up to 90 days with approval from the city's finance director, and longer loans with approval from the city council.

Debt and Other Liabilities

In addition to its revenue bonds, the water enterprise has $24.7 million in outstanding loans from the Drinking Water State Revolving Fund program. These loans are subordinate to the current bonds and other parity obligations.

At the end of 2015, the water enterprise reported a net pension liability of $82.7 million as part of the Seattle City Employees' Retirement System and a unfunded OPEB (other post retirement benefit) liability of $2.7 million. The enterprise made a pension contribution of $7.3 million and an OPEB contribution of $1.1 million.

DEBT STRUCTURE

All of the enterprise's debt is fixed rate and fully amortizes by 2046. Currently, peak debt service is estimated to occur in 2020 at $83 million, with principal and interest declining rapidly thereafter. The city anticipates layering in an additional $263.3 million as part of its capital improvement plan over the next six years, which would increase debt service to approximately $99 million in 2022.

DEBT-RELATED DERIVATIVES

The enterprise has no debt-related derivatives.

Management and Governance

The water enterprise is one of three utilities managed under Seattle Public Utilities (SPU), a department within the City of Seattle. The general manager of SPU reports to the city's mayor, with rates approved by the city council. SPU operates under a strategic plan adopted by the city council, with capital and operating budgets planned over a multi-year horizon.

Legal Security

The bonds are secured by a pledge of the net revenues of the water system. The city has covenanted to establish rates sufficient to generate debt service coverage of at least 1.25 times. The bonds are additionally secured by a common debt service reserve equal to the lesser of the standard three-prong test, funded by a combination of cash and sureties.

Use of Proceeds

About $100.7 million of the bond proceeds will be used to pay for a portion of enterprise's ongoing capital program. The remainder ($95.2 million) will be used to refund for savings some or all of the enterprise's 2006 bonds.

Obligor Profile

The water enterprise provides retail and wholesale water services to a population of 1.4 million within the greater Seattle metropolitan area.

Methodology

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

Ratings

Exhibit 2

Seattle (City of) WA Water Enterprise

Issue	Rating
Water System Improvement and Refunding Revenue Bonds, 2017	Aa1
Rating Type	Underlying LT
Sale Amount	$195,800,000
Expected Sale Date	01/11/2017
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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