

Summary Analysis

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Summary: Seattle, Washington; Water/Sewer

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Summary:

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Credit Profile		
US\$229.445 mil wtr rev bnds ser 2012 due 09/01/2033		
<i>Long Term Rating</i>	AA+/Stable	New
Seattle wtr rev		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Seattle wtr sys and rfdg rev bnds ser 2003 dtd 05/12/2003 due 09/01/2003-2025 2028 2033		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Seattle wtr sys rev bnds ser 2004 dtd 10/25/2004 due 09/01/2005-2029 2034		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Seattle wtr		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Seattle wtr sys		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' rating to Seattle, Wash.'s series 2012 water system revenue refunding bonds. At the same time, we affirmed the 'AA+' rating on Seattle's existing water system parity debt. The outlook is stable.

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

- Role as a major regional water supplier to retail customers within Seattle and to wholesale customers in the Puget Sound area;
- Deep and diverse service area economic base; and
- History of adopting rate increases to support stable financial performance.

These strengths are partially offset by our view of the water fund's maintenance of a low unrestricted cash position. 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 \$229 million series 2012 bonds are being issued to refund certain outstanding water revenue bonds for debt service savings. The bonds are secured by a pledge of net revenues of the city's water system. Additionally securing all parity bonds is a reserve, funded at \$70.9 million, with 76% of this requirement funded with surety bonds. A rate covenant requires the system to generate debt service coverage of 1.25 times (x) though withdrawals from a rate stabilization fund can be included in this calculation. As of May 1, 2012, the system had \$968 million in parity bonds outstanding plus \$18 million in subordinate lien state loans.

The water system is operated by Seattle Public Utilities, a department of the city. The water system provides retail

service to customers in Seattle and in portions of the cities of Shoreline, Burien, and Lake Forest Park, as well as in unincorporated King County. The system additionally provides wholesale water service to 21 suburban water districts and municipalities plus the Cascade Water Alliance. The wholesale customers cover a population of about 634,193. 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 system primarily derives its water supply from surface water diversions on the Cedar River and on the South Fork of the Tolt River, each about 25 miles east of Seattle. The system also operates two wellfields under temporary state permits with a combined capacity of 10 million gallons per day (mgd). The city estimates it has a firm supply yield of 171 mgd compared with average demand of 130 mgd. The system also has substantial storage in eight reservoirs. Although the population in the service area has steadily risen, increased conservation has actually lowered water demand during the past 20 years.

About 23% of operating revenue in 2011 was derived from sales to the system's wholesale customers. Most of the customers, representing about 56% of wholesale consumption, have entered into long term agreements with Seattle through at least December 2060 requiring Seattle to meet the customers' water demands not met by local sources. Seattle's contract with its largest customer, Cascade Water Alliance (AA+ revenue bond rating), requires Seattle to provide 33.3 mgd annually through 2017, 35.3 mgd through 2023, and thereafter at a declining annual volume. Cascade represents about 44% of wholesale consumption. The top three wholesale customers by revenue are Cascade (9.3% of 2011 total operating revenue), Northshore Utility District ('AAA'; 2.4% of 2011 operating revenue), and Soos Creek Water and Sewer District ('AA'; 1.7% of 2011 operating revenue).

The city has a history of annually implementing water rate increases. Retail customers are charged a flat rate plus a volume-based rate that is higher and tiered during summer months. We view current rates as relatively high. A monthly bill for 10 hundred-cubic feet (ccf) of summer water use would be \$60.70 for a single-family residential customer. The city uses 5 ccf for its representative water bill, which would be \$34.95 monthly in the summer. The city has adopted rate increases of 7.2% and 7.0% for each of the next two years.

The system's financial performance has been relatively stable, with past rate increases helping to boost operating revenue. In 2011, operating revenue totaled \$194.6 million, down 0.3% from 2010 but up from previous years. Operating expenses excluding depreciation were down 6.6% in 2011, at \$108.4 million. In the city's debt service coverage calculations under its rate covenant, it excludes taxes paid to the city from operating expenses. City taxes were \$23.3 million in 2011, and under city charter are paid only after provisions have been made to pay debt service. Based on the city's calculation, senior lien debt service coverage was 1.49x in 2011, down from 1.59x in 2010. If city taxes are included in operating expenses, debt service coverage was at 1.19x in 2011. In the city's projections, debt service coverage, as calculated according to the rate covenant, rises to levels above 1.6x in years 2012 through 2017.

We view the water fund's unrestricted liquidity position as low. As of Dec. 31, 2011, unrestricted cash and investments totaled \$7.3 million, representing 25 days of operating expenses on hand. The system has additional liquidity in a rate stabilization account of \$9.0 million, bringing total combined liquidity to 55 days. We view provisions in the city's municipal code allowing the finance director to make interfund loans for up to 90 days as partially mitigating the system's relatively low liquidity. Longer-term loans require city council approval. According to management, the city's investment pool balance is currently about \$1.2 billion.

The water system's capital program covers about \$380 million in projects during the next six years (through 2017), which we view as manageable relative to the size of the system. These include distribution, habitat conservation, transmission, water treatment, and water resources projects. The city currently plans to issue about \$112 million in additional debt to finance a portion of this and to fund the remainder with existing bond proceeds, internally generated funds, and grants.

Outlook

The stable outlook reflects that we anticipate that the system will continue to set rates to provide good debt service coverage and sufficient capital funding. With the system's low 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

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