MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa3 to Seattle (City of) WA Solid Waste Enterprise's new revenue bonds. Outlook is stable.

Global Credit Research - 15 May 2014

Approximately $212 million of debt affected

SEATTLE (CITY OF) WA SOLID WASTE ENTERPRISE
Solid Waste
WA

Moody's Rating

ISSUE	RATING
Solid Waste Revenue & Refunding Bonds, 2014	Aa3

Sale Amount	$96,190,000
Expected Sale Date	05/20/14
Rating Description	Revenue: Government Enterprise

Moody's Outlook STA

Opinion

NEW YORK, May 15, 2014 --Moody's Investors Service has assigned a Aa3 rating to Seattle (City of) WA Solid Waste Enterprise's (Seattle Solid Waste or SSW) $96.2 million of Solid Waste Revenue and Refunding Bonds, 2014. Concurrent with the rating assignment, we affirmed the Aa3 rating on the existing pari passu revenue bonds. The rating outlook is stable.

SUMMARY RATING RATIONALE

SSW's Aa3 rating is supported by its demonstrated historical willingness to raise rates, strong solid waste flow control provisions, and access to the Seattle (City of) WA's (City of Seattle, Aaa/stable) money pool. The rating is further supported by a solid service area and forecasted debt service coverage ratios (DSCR) of 1.5 times post 2016. The rating also reflects SSW's large capital expenditure program (CIP) over the next five years, SSW's plans to manage to extremely low levels of internal liquidity, and likely pressure on its financial metrics in 2015 and 2016. Declining waste volumes and above average rates compared to regional peers also are ongoing challenges.

OUTLOOK

The stable outlook considers SSW's strong service area, access to the City of Seattle's money pool, and our expectations of debt service coverage ratios (DSCR) averaging 1.3 times for 2015 and 2016 and 1.5 times thereafter.

WHAT COULD MAKE THE RATING GO UP

SSW's rating is unlikely to improve over the next several years in light of the large CIP and associated debt increase. However, the rating could be raised if SSW were to complete its CIP and demonstrate on a sustainable basis significantly higher liquidity levels and DSCR than compared to its long term historical performance.

WHAT COULD MAKE THE RATING GO DOWN

SSW's rating could be negatively impacted if the CIP incurs substantial cost overruns or if SSW's financial metrics materially drop below its forecasted levels.

STRENGTHS

- demonstrated historical willingness to raise rates

- strong flow control provisions

- healthy service area

- access to the city's money pool.

CHALLENGES

- large capital spending program and associated debt increase

- near term pressure on coverage ratios and expected decline in liquidity

- above average rates compared to peers

- declining non-recyclable waste volumes

DETAILED CREDIT DISCUSSION

Seattle Public Utilities (SPU) was created in 1997 as a department of the City of Seattle and includes the City of Seattle's water, drainage, wastewater and solid waste services. SSW 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 by SSW are contracted to Cleanscapes and Waste Management, Inc (Waste Management, Baa3/stable) under contracts that expire in 2017 and 2019, respectively, with extension options. Seattle Solid Waste also 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 SSW has an opt-out date in 2019.

USE OF PROCEEDS: Bond proceeds will be used to fund capital expenditures, refund up to $46 million of existing Series 2007 bonds, pay transaction costs, and fund any incremental debt service reserve requirements.

LEGAL SECURITY: The SSW's bonds have a pledge of net revenues of Seattle Solid Waste, which requires that SSW set rates to maintain 1.25 times debt service coverage on a pre city tax basis. The additional bonds test similarly requires that rates be set to maintain 1.25 times debt service coverage on a pre city tax basis. Furthermore, SSW's bonds have a pooled debt service reserve sized to maximum annual debt service. Currently, the debt service reserve is backed by a $5.9 million MBIA Insurance Corporation (B3, under review for possible upgrade) surety policy (reinsured by National Public Finance Guarantee Corp (Baa1, positive)) and $4.9 million in cash. We expect additional cash funding to come from for the new bond issuance.

INTEREST RATE DERIVATIVES: None

KEY RATING FACTORS

WILLINGNESS TO RAISE RATES IS A KEY STRENGTH BUT RATES ARE ABOVE SOME PEERS AND VOLUME DECLINES REPRESENT A CONCERN

The City of Seattle's demonstrated willingness to raise rates is an important credit strength. 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. We also view as credit positive the March 2014 approval of a stronger financial policy targeting 1.5 times debt service coverage ratio (post city tax). The strengthened financial policy demonstrates the Seattle Solid Waste's commitment to ensuring financial metrics commensurate with its past in the face of its large capital program that will necessitate future rate increases. Our rating incorporates the assumption that Seattle Solid Waste will continue to raise rates as necessary and will adhere to its financial policies.

While the willingness to raise rates is strong, SSW's average monthly bills is higher than some of its regional peers and SSW's transfer station rates are higher than the local county owned transfer stations.

Additionally, non-recyclable waste volumes have been declining since at least 2004 while recyclable waste streams continues to rise. While we understand SSW has aggressive targets for recycling, SSW charges and associated revenues are on the non-recyclable waste while recyclable waste is not charged. Thus, the growing recyclable waste volumes are subsidized by shrinking non-recyclable waste, which is a credit negative.

While above average rates and declining volumes are viewed as weaknesses, we view SSW's demonstrated willingness to raise rates in addition to the strong service area and flow control mechanism discussed further below as meaningful mitigations.

STRONG FLOW CONTROL AND SERVICE AREA REMAIN KEY CREDIT SUPPORTS

SSW provides curbside waste collection through private haulers for residential and commercial customers in Seattle. City ordinance prohibits collection of non-recyclable waste within the city by companies that are not under contract with it. Another city ordinance requires all citizens to subscribe to solid waste collection. Together, these two ordinances create a strong flow control mechanism for SSW and enable it to secure residential collection fees, which are its largest revenue stream and accounted for 63% of total solid waste revenue in 2013. For commercial customers, Seattle's ordinances and contract provisions require commercial customers to either use the SSW's contracted commercial haulers or self-haul. While businesses may choose to self-haul their waste, most use the contracted commercial haulers. Commercial service represented about 29% of revenues in 2013.

In addition to strong flow control, SSW benefits from strong residential bill collection since residential customers receive a combined bill for solid waste, water, and wastewater services. If a partial payment is made, the funds are first credited to the solid waste services and last to water services. SPU's internal prioritization of payments serves to incentivize residential customers to pay given the greater essentiality of water and waste water services. Commercial customers receive bills directly from private haulers and thus are not subject to a combined bill.

The City of Seattle also benefits from a strong regional economy supported by major companies in the technology and aircraft manufacturing fields. Wealth levels are fairly high for a large city with 2010 estimated median family income of $87,987, or 139.7% of the U.S. Employment growth has been steady over the last several years resulting in the city's seasonally unadjusted unemployment rate of 4.9% in December 2013. The combination of strong flow control and service area are considered a material strength for SSW.

STANDALONE LIQUIDITY REMAINS MODEST THOUGH ACCESSS TO CITY'S MONEY POOL IS A KEY EXTERNAL SOURCE OF LIQUIDITY

At year end 2013, unrestricted cash and investments at Seattle Solid Waste was on the low end with $21 million, which is equal to approximately 53 days cash on hand and an improvement from 10 days cash on hand in 2009. However, we understand SSW is looking to manage liquidity toward its minimum target liquidity sized to 20 days of contract payments, which we estimate is around 10 to 15 days cash on hand. While we view SSW's internal standalone target as very low for the rating, we also recognize Seattle Solid Waste's access to the City of Seattle's $1.4 billion money pool ($768 million net of enterprise funds), which continues to be an important source of external liquidity support. The City of Seattle pools and invests cash for all city departments. The cash pool operates like a demand deposit account in that all City departments, including SSW, may deposit cash at any time and can also withdraw cash out of the pool without penalty. The City's Director of Finance is also authorized to make loans for a period up to 90 days and these loans bear interest at the cash pool's rate of return. Loans longer than 90 days require approval from the city council. Seattle's electric system was able to access the money pool in 2001 and 2010 during periods of liquidity stress.

DEBT SERVICE COVERAGE RATIOS EXPECTED TO STABILIZE AFTER 2016

From 2010 through 2013, SSW achieved DSCR (post city tax) around 2.5 times under Moody's calculation, which treats city taxes as an operating expense consistent with other municipal infrastructure issuers. These financial metrics were a substantial improvement from a DSCR of 0.1 times (post city tax) in 2009 when SSW's costs substantially increased due to new waste collection contracts and SSW's internal liquidity dropped by over $10 million to $3.9 million. The recent four years are also stronger than the long-term average DSCR of around 1.6 to 1.7 times (post city tax) and the above average metrics were due to certain planned debt increases that were delayed. Excluding the sizeable city tax of around 10% of revenue that are subordinated to debt service on SSW's bonds, SSW's DSCR averaged 4.7 times over the last four years.

Looking forward, we expect SSW's debt service coverage ratios (post city tax) to weaken to around 1.6 times in 2014, 1.25 times in 2015, and 1.35 times in 2016. Key drivers of the drop include rising debt service, increased costs, and some revenue loss due to the demolition of the North Transfer Station. Post 2016, SSW forecasts achieving 1.5 times DSCR (post city tax) without using rate stabilization funds as planned rate increases take effect and the North Transfer Station is complete. Our rating incorporates the assumption that SSW will achieve 1.5 times over the longer term per Seattle Solid Waste's updated financial policy. Excluding the city tax, we anticipate DSCR (pre city tax) of at least 2.5 times from 2015 through 2018.

LARGE CAPITAL PROGRAM CONTINUES TO ADD SIGNIFICANT AMOUNT OF DEBT TO THE SYSTEM

SSW's CIP through 2019 totals approximately $160 million and is expected to be financed with a combination of current revenues and an estimated $106 million of new debt. Total debt is expected to peak at around $217 million, which is over 5 times the $41 million of debt outstanding in 2006. Most of SSW's capital expenditure funds spent since 2006 and the associated new debt relate to the building of two new transfer stations whose construction is staggered to allow for continuity of operations. The new South Transfer Station was completed in 2013. The demolition and new construction of the North Transfer Station has started and will be followed by the demolition of the old South Transfer Station, which is currently being used while the North Transfer Station is under construction. The North Transfer Station is expected to be completed in 2016 and SSW's capital spending ramps down significantly in 2018.

KEY STATISTICS:

Total Unrestricted Cash and Investments, 12/31/13: $21 million

Solid Waste Tonnage (2013): 716,560

2013 Debt Service Coverage (Moody's): 2.5 times (post city tax)

2013 Debt Service Coverage (Bond Covenant): 3.7 times (pre city tax)

Debt Ratio (2013): 75%

Days Cash on Hand (2013): 53

City of Seattle's Cash and Investment Pool, 2013: $1.44 billion ($768 million net of enterprise funds)

Solid Waste Revenue Bonds, 12/31/2013: $116 million

The last rating action was on May 27, 2011 when Moody's rating committee assigned Aa3 long-term ratings to $47 million of Solid Waste revenue bonds.

The Seattle Solid Waste's bond rating was assigned by evaluating factors believed to be relevant to the credit profile of the instrument such as i) the business risk and competitive position of the issuer versus others within its industry or sector, ii) the capital structure and financial risk of the issuer, iii) the projected performance of the issuer over the near to intermediate term, and iv) the issuer's history of achieving consistent operating performance and meeting budget or financial plan goals. These attributes were compared against other issues both within and outside of the authority's core peer group and their ratings are believed to be comparable to ratings assigned to other issuers of similar credit risk.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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