

New Issue: MOODY'S ASSIGNS Aa3 RATINGS TO THE CITY OF SEATTLE'S SOLID WASTE SYSTEM 2011 REVENUE BONDS

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Existing Revenue Bonds affirmed at Aa3

Seattle (City of) WA Solid Waste Enterprise
Solid Waste
WA

Moody's Rating

ISSUE	RATING
Solid Waste Revenue Bonds, Series 2011	Aa3
Sale Amount	\$47,075,000
Expected Sale Date	06/08/11
Rating Description	Revenue Bonds

Opinion

NEW YORK, May 27, 2011 -- Moody's has assigned Aa3 ratings to Seattle Solid Waste's (the Enterprise) Series 2011 revenue bonds. At the same time, the rating on existing revenue bonds has been affirmed at Aa3. The rating outlook is stable. The rating reflects the Enterprise's demonstrated willingness to raise rates, strong flow control provisions, robust service area and access to the City of Seattle's money pool.

The rating also incorporates the Enterprise's historically low standalone liquidity and weakening in financial profile which is expected to occur over the next few years as the Enterprise increases its leverage in order to fund capital expenditures. The rating further reflects declines in collected volumes and corresponding cost increases which have eroded its cost competitiveness.

Legal Security: The Enterprise's bonds have a pledge of net revenues, which requires that the Enterprise set rates to maintain 1.25 times debt service coverage. The additional bonds test similarly requires that rates be set to maintain 1.25 times debt service coverage. Furthermore, Enterprise's bonds have a pooled debt service reserve sized to maximum annual debt service.

Interest Rate Derivatives: None

Seattle Public Utilities (SPU) was created in 1997 as a department of the City of Seattle (Aaa/stable) and includes the City of Seattle's water (Aa1 / stable), drainage and wastewater (Aa1 / stable) and solid waste services. The City of Seattle owns and operates two transfer stations and in July 2007 the Mayor and City Council passed a resolution which authorized rebuilding the stations as well as completion of other smaller projects. The Enterprise was created to account for solid waste activities of the City of Seattle.

As of December 31, 2010, the Enterprise had total debt of approximately \$79 million.

KEY RATING FACTORS

FUNDAMENTALS OF SERVICE AREA SUGGEST STRONG ABILITY TO SUPPORT DEMAND

The service area of Seattle (Aaa / Stable) demonstrates stable economic indicators which underpin the Enterprise's rating. Despite the high unemployment rate of 9.2%, Moody's economy.com notes that "a well educated workforce, high incomes and strong population trends are supportive of favorable long term growth".

These fundamentals provide the Enterprise with a user base that has the capacity [i] to pay charges associated with the Enterprise and [ii] to remain fairly inelastic to rate increases, given the average residential monthly charge of \$34.75 relative to the average per capita income of \$53K recorded in 2009.

The Enterprise also serves commercial users, whose use will track the business cycle more closely than residential users. Whilst this exposes the Enterprise to greater changes in volumes and cost competitiveness relative to systems which serve only residential users, the low waste disposal cost relative to total operating costs is also expected to minimize commercial users' sensitivity to rate increases.

CITY ORDINANCES PROTECTION OF THE ENTERPRISE'S COMPETITIVE POSITION AND TRACK RECORD OF RAISING RATES WHEN REQUIRED ARE KEY RATING SUPPORTS

All city residents and businesses are required to obtain solid waste collection for non recyclable waste from the Enterprise, which underpins demand for its services.

The Enterprise 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 the solid waste system and enable it to secure residential collection fees, which are its largest revenue stream and accounted for 57% of total solid waste revenue in 2010. Additionally, the solid waste collection fee is included on each household's SPU bill, which combines water, wastewater and solid waste fees. In cases of partial payment, the money that is received is allocated to the solid waste fund first, since Seattle Municipal Code mandates that water services can be discontinued for non-payment but solid waste services may not.

For commercial customers, Seattle's ordinances and contract provisions require commercial customers to either use the Enterprise's contracted commercial haulers or self-haul to City owned transfer stations. While businesses may choose to self-haul their waste, most use the contracted commercial haulers. Commercial service represented about 30% of revenues in 2010.

The remaining revenue stream comprises of self haul fees for waste collected at the City owned transfer stations and tonnage fees collected from businesses engaged in operating transfer stations and collecting garbage.

The rates for residential and commercial solid waste collection are proposed by the Mayor, reviewed by the City Council and adopted by ordinance after public hearings. The Mayor and the City Council have exclusive authority to set rates and charges and are not subject to rate making jurisdiction of any state or federal agency.

The City has consistently raised rates when required, with increases passed in every year since 2007.

LESS OPERATING RISK RELATIVE TO OTHER RATED SOLID WASTE SYSTEMS

The operations of the Enterprise are lesser in scope relative to other rated solid waste systems. The Enterprise contracts most of its major functions such as collections, processing and disposal, under various contracts with expirations from 2016 - 2021. This is considered positive for the rating as it passes on certain operating risks, such as liabilities associated with landfills, to other parties.

The only retained operating function of the Enterprise relates to transfer stations - the city owns and operates two transfer stations which are to be upgraded under the capital expenditure program. The main function of the transfer stations are to weigh and compress collected waste, which Moody's considers to involve low amounts of operating risk relative to solid waste systems also responsible for collection and landfill.

Capital expenditures with respect to the first transfer station are currently on time and on budget. The second transfer station is yet to be constructed - expectations that these projects are completed on time and budget are incorporated into the Aa3 rating.

VOLUMES IN DECLINE AND COSTS INCREASING

The Enterprise has suffered declines in volumes of waste collected over the last few years, reflecting [i] declines in commercial haulage, reflecting output reductions from the recession and [ii] increased recycling efforts, which are collected by private operators and decrease the volume of non recyclable solid waste. Over the next few years, further volume declines are anticipated as recycling efforts increase.

Revenue losses associated with the above variables have been offset by implementation of rate increases, which have occurred every year since 2007. Further, contract expirations in 2009 were renegotiated at the higher prevailing market rates, leading to a roughly 28% cost increase in that period. Capital costs associated with the transfer stations are also to be recovered through rate increases in future years.

The above factors have led to a decline in the cost competitiveness of the Enterprise and increases the risk that residents or businesses to dispute future rate increases. This risk is considered to be low given the service cost relative to the incomes of the service area, however is incorporated into the Aa3 rating.

FINANCIAL PROFILE RECOVERED IN 2010 - EXPECTED TO WEAKEN OVER THE NEXT FEW YEARS

The Enterprise's financial profile has encountered volatility over the last few years resulting from timing differences associated with volume declines, contract renegotiations and rate increases. Over the next few years, the financial profile is expected to weaken relative to 2010, as a result of increases in debt service from the capital improvement plan. This will substantially increase leverage, adding 158M to the 79M of existing debt. The end result of this is that DSCRs achieved on a post tax basis are likely to decline into 1.5x - 1.7x over the next five years. DSCRs achieved on a pre tax basis are expected to be around 2.6x - 3.8x over this period.

Liquidity is aided by access to the city of Seattle's money pool - on a standalone basis liquidity is expected to be around 26 days over the next two years - this is considered low and below the average from the previous 5 years of 43 days.

The debt service reserve fund will be funded 51% with cash and 49% with a MBIA surety, following the 2011 bond issuance. As subsequent bond issuances are anticipated to feature cash funded debt service reserves also, this is expected to lead to increases in the cash funded portion of the debt service reserve over time.

Outlook

The rating outlook is stable, reflecting the stable economy of the service area as well as forecasts for financial performance.

What Could Change The Rating - Up

Improvements to the Enterprise's cost competitiveness or financial profile could place upwards pressure on the rating.

What Could Change The Rating - Down

Changes to flow control protections which protect the Enterprise's competitive position, failure to raise rates when required or deterioration in the Enterprise's financial profile below expectations could place downward pressure on the rating. The rating may also face downward pressure if the cash funded portion of the debt service reserve account does not increase in line with Moody's expectations over time.

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