S&P Global
Ratings

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Summary:

Seattle, Washington; Solid Waste/Resource Recovery

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Credit Profile		
US$25.55 mil solid waste sys rfdg rev bnds ser 2021 due 08/01/2036		
Long Term Rating	AA+/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Seattle, Wash.'s $25.55 million solid waste system refunding revenue bonds, series 2021. The outlook is stable.

The series 2021 bonds will be issued to refund certain outstanding obligations of the solid waste system. We view the bond provisions as credit neutral. A pledge of net revenue of the city's solid waste system secures the bonds. A rate covenant requires the system to generate at least 1.25x debt service coverage. The additional bonds test requires that historical or projected net revenue provide at least 1.25x coverage of existing and proposed debt. As of June 4, 2021, the solid waste system had $174.2 million of solid waste revenue bonds outstanding.

Credit overview

The solid waste system is operated by Seattle Public Utilities (SPU), a department of the city. We view the diverse service area economy, above-average income indicators, affordable rates, and recently renewed long-range collection service agreements as credit supportive. We continue to view the system's exposure to competition and revenue volatility as relatively low (given system's revenues are largely generated from rate revenue rather than tonnage-based tipping fees). The rating reflects the solid waste system's history of strong financial performance represented by robust all-in coverage metrics. However, we note that the system's current debt-to-capitalization ratio is high at 67% and coverage is projected to decline due to higher operations and maintenance expenses. Nevertheless, council approved the strategic business plan and approved rate increases, and we understand that all-in coverage is projected to stay above 1.6x, a figure consistent with the current rating level.

The pandemic has had a relatively modest effect on the solid waste utility's operating margins to date. With many jobs able to happen remotely and the city's largest employer, Amazon, surging on robust demand for online retail and cloud computing services, we think a significant portion of the city's economic life has adapted to the pandemic with minimal disruption. However, commercial tonnage decreased by 20% for 2020, but given the increase in residential tonnage by 9.5%, all-in coverage for fiscal 2020 was still robust at about 2.9x.

The solid waste credit strengths include:

- Underlying economic strength, diversity, and wealth of the customer base in the Seattle-Tacoma-Bellevue metropolitan statistical area, which is characterized by high incomes and declining unemployment compared with the nation;

- Monthly solid waste rates that we consider affordable as the 32-gallon monthly fee is only 0.8% of median household effective buying income (MHHEBI);
- Robust all-in coverage at 2.9x and unrestricted cash at $98 million, equivalent to 195 days of operating expenses, which is sufficient to deal with any long-term re-contracting risk;
- Operational management represented by strong revenue collection mechanism where monthly fees appear on the water and sewer bill; regular rate increases through 2022, 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; and
- Robust financial management represented by conservative budgeting, monthly review of budget-to-actual results, long-range financial and capital planning, reserve policy of 45 days of operating expenses for the system, and compliance with the city's debt management policy.

Somewhat offsetting the credit strengths are the solid waste system's currently high debt-to-capitalization ratio at 67% and the long-term re-contracting risk; however, we note this risk is beyond 2029 given the recently renewed collection agreements.

The stable outlook reflects our expectation for maintenance of all-in coverage at above 1.6x and very strong liquidity. Planned rate increases, coupled with the system's capital plan, should allow management to produce financial results in line with recent performance.

Environmental, social, and governance (ESG) factors

The South Park Landfill is under a consent decree, which increases environmental risks above those of peers, however, SPU has taken steps to obtain ecology approval, a new scope, timing, and budget. Management emphasizes the importance of managing environmental issues and addressing regulatory requirements related to current and historic solid waste facilities and the system has sufficient capacity for solid waste disposal for the foreseeable future. Governance is a credit strength and in line with that of peers, given the use of long-range demand and expense forecasts for SPU's recycling potential assessment model, long-range planning through the solid waste comprehensive plan, asset adequacy identification program, and comprehensive operational risk reduction program in addition to the solid waste system's long-range strategic plan. Absent the implications of COVID-19, we consider the utility's social risks to be in line with those of the sector.

Stable Outlook

Downside scenario

We could lower the rating if project costs exceed expectations, resulting in the need to increase SPU's debt burden or materially draw down liquidity leading to an overall weaker financial risk profile.

Upside scenario

We could raise the rating if the system pays down the significant amount of the debt it has issued resulting in a lower debt-to-capitalization, consistently robust all-in coverage, and a buildup in reserves to levels that we consider comparable with those of higher-rated entities.

Credit Opinion

Enterprise risk

SPU provides solid waste collection and disposal to residents and businesses. We view positively the recently renewed collection agreements through 2029 with franchise collectors--Waste Management Inc. and Recology/Cleanscapes Inc., which management indicated have similar cost structures to the prior agreements. 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.

Solid waste rates are affordable given the strong income indicators and currently low county poverty rate allow for SPU rate-raising flexibility. Solid waste charges are combined with water and wastewater on the city's combined monthly bill. When looking at the total customer bill, combined rates are higher because wastewater rates are elevated compared with those of regional peers, but given the high income levels in Seattle, we believe the total bill is still affordable. Currently, a residential customer with a 32-gallon refuse can, a 96-gallon food and yard waste can, and a 96-gallon recycling can would pay about $54 per month, which we view as affordable, at less than 1% of MHHEBI. Management reviews rates annually and preapproved rates through 2022.

Financial risk

Financial performance remains a credit strength. Under Seattle's charter, taxes paid to the general fund are subordinate to debt service. Based on our calculation of all-in coverage, we believe the metric is strong at 2.9x in fiscal 2020, modestly down from 3.17x in fiscal 2019 due to the decrease in commercial tonnage. Based on our analysis, we expect all-in coverage to remain above 1.6x, given the preapproved rates through 2022 and lack of future debt plans. The solid waste liquidity position, at $98 million, equivalent to 195 days of operating expenses, is sufficient to deal with any short-term disruptions or increase in contract costs. Additionally, the system also has access to Seattle's $2.5 billion pooled investments if needed, which mitigates the risk for increases in contract costs.

The solid waste system's capital plan is manageable over the next five years at $85 million (2021-2026), which management plans to fund from rate revenue and cash. The largest projects include the cleanup of the historic South Park Landfill, and minimal operational improvement prior to the full redevelopment of the old South Transfer Station campus.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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.