S&P Global
Ratings

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Summary:

Seattle, Washington; General Obligation

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Credit Profile		
US$26.51 mil ltd tax GO imp bnds ser 2018B due 12/01/2038		
Long Term Rating	AAA/Stable	New
US$24.08 mil ltd tax GO imp bnds ser 2018A due 12/01/2038		
Long Term Rating	AAA/Stable	New

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Seattle, Wash.'s series 2018A and 2018B (taxable) limited-tax general obligation (GO) improvement bonds. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating on the city's previously issued unlimited-tax and limited-tax GO bonds. The outlook is stable.

Security and use of proceeds

The city's full faith and credit, including the obligation to levy ad valorem property taxes without limitation as to rate or amount, secure the city's unlimited-tax GO bonds. The city's limited-tax GO bonds are subject to statutory limitations that include a limit on annual property tax revenue growth without a voter override and a limit on the city's levy rate of $3.60 per $1,000 of assessed value (AV). The city's 2018 levy rate is $2.22.

Proceeds of the series 2018A and 2018B will pay for a variety of capital projects, including low-income housing grants (representing the bulk of the series 2018B) and information technology (IT) projects, consistent with a pattern of annual GO issuance that consolidates borrowing. Management estimates that designated revenue, such as commercial parking taxes and payments from other agencies, will support about 35% of debt service on these series, and that general revenue will support the balance.

Local rating's relationship with U.S. sovereign

Our issue ratings are based on our view that the city's general creditworthiness is above that of the U.S. sovereign. This reflects our view that the city would not default in a stress scenario likely to accompany a sovereign default given autonomy from sovereign intervention. We view the city as exhibiting relatively low funding interdependency with the federal government, as local taxes represent the vast majority of total governmental funds revenue. However, consistent with our view that U.S. state and local governments are moderately sensitive to country risk, should our view of the city's general creditworthiness deteriorate we would be unlikely to set GO issue ratings more than two notches above the U.S. sovereign rating.

The city's exposure to sovereign intervention could be tested in the medium term as part of a national debate on "sanctuary cities," a term generally used to refer to cities and other local governments that have policies that limit cooperation with federal immigration enforcement. We do not see an immediate credit risk to Seattle and other local governments with sanctuary city policies because federal revenue generally represents a small proportion of their revenue structures and because federal law may limit the White House's ability to impose cuts without Congressional action. (See "Federal Cuts To Sanctuary Jurisdictions Are Not An Immediate Credit Risk," published March 30, 2017 on RatingsDirect.) In March 2017, Seattle announced it had filed suit against the federal government regarding the executive actions; we understand that part of its challenge focuses on the lack of full alignment between the justice or public safety activities that are the focus of sanctuary city policies and a much broader array of federally supported city services. Management reports that the parties in its case have agreed to stay their case, which is on appeal, pending the result of a similar case filed by the County of Santa Clara, Calif. Given the predominantly local nature of the city's revenue structure, we consider the revenue effects of the economic performance to be much more relevant to the city's budgetary performance and overall credit profile.

The ratings reflect our assessment of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with an operating surplus in the general fund but an operating deficit at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 21% of operating expenditures;
- Very strong liquidity, with total government available cash at 61.7% of total governmental fund expenditures and 15.4x governmental debt service, and access to external liquidity we consider exceptional;
- Very strong debt and contingent liability position, with debt service carrying charges at 4.0% of expenditures and net direct debt that is 57.3% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value; and
- Adequate institutional framework score.

Very strong economy

We consider Seattle's economy very strong. The city, with an estimated population of 713,700, is located in King County in the Seattle-Tacoma-Bellevue MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 173% of the national level and per capita market value of $299,999. Overall, the city's market value, which is equal to AV in the state, grew by 14.9% over the past year to $214.1 billion in 2018. The county unemployment rate was 3.9% in 2016.

Seattle's strong economic growth from an already large base shows no signs of slowing after multiple years of increases across multiple metrics. We see this as a function of strong fundamental characteristics, including a deep reservoir of human capital, exposure to export markets, and large regional employers that are major players in their respective markets. The announcement in 2017 by its dominant local employer, Amazon, that the still rapidly-growing and multifaceted company is looking for another North American city for a second headquarters could be positive for the city's economic base in the long run, in our view, by lessening the risk of economic concentration.

Most remarkable at this stage of the economic expansion, in our view, is a continued acceleration in AV growth. After a three-year AV decline totaling 15% through 2012, the city's tax base stabilized for a year and subsequently increased by ever-larger double-digit percentages, including a 15% increase for fiscal 2018. The city's overlapping county's count of employed residents likewise continues to grow, albeit at a slower, 2% average for 2017, but the local unemployment rate has limited scope for further declines, with a preliminary 3.5% average for 2017. We anticipate that growth will continue in some form, consistent with our projection of real GDP growth in the Western U.S. states through 2019.

In the context of prominent regional employers, Microsoft and Boeing, keeping their local employee counts largely stable, Amazon, whose headquarters growth has effectively extended Seattle's downtown northward, continues to make waves within the city's office and housing markets. Real estate services firm Cushman and Wakefield's first-quarter 2018 report for Seattle estimates Amazon's office occupancy at 10 million square feet, relative to a total central business district office market size of 49.3 million square feet. The firm projects that Amazon will add another 4 million square feet through 2022. Amazon has signaled through its unique "request for proposals" process to North American cities that it envisions adding as many as 50,000 central-office employees outside Seattle in the coming decade--news reports estimate Seattle employment at 40,000--but given the company's growth trends and plans for absorption, we anticipate Amazon will be the largest single driver of employment growth in the city through 2020. We also think it will continue to have major indirect effects on the city's housing demand--real estate services firm Marcus & Millichap estimates the city will add 12,100 units in 2018, up from 11,900 in 2017--and transportation infrastructure needs for the foreseeable future.

Employment growth and housing development have intensified a public debate about strains on the city's transportation infrastructure and housing affordability. Partly mitigating these concerns, in our view, is progress in adding transit capacity, with the region's light rail operator, Sound Transit, opening the first two stations of its northern spur in March 2016 and with voters approving a tax increase in November 2016 to fund the next generation of rail and other infrastructure. City voters also have supported improvements recently in the form of a 10-year property tax increase for transportation infrastructure that the city estimated will total $930 million during 2016 to 2024 and an increase for low-income housing development with a projected total of $290 million during 2017 to 2023. The city's planning policies also appear to allow for the addition of housing units to at least partly address growing market-rate demand.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating our view that financial practices are strong, well embedded, and likely sustainable.

Elements of the city's financial policies and practices include:

- What we view as a consistent approach to budgeting, with the use of detailed, empirically based revenue and expenditure forecasts to build budgets;
- Management's provision of budget-to-actual updates to the council in May, September, and November and the council's practice of quarterly expenditure amendments;
- The use of a detailed financial forecasting model covering the current and subsequent three years to consider the long-term effects of current-year budgeting decisions;
- An annually updated rolling six-year capital improvement plan with funding sources identified;
- Quarterly reporting on investment holdings and returns under an internally guided investment policy;

- Formal and well-embedded comprehensive debt management policy including elements such as a maximum general fund carrying charge threshold relative to the budget (7%) and an annual debt portfolio report that coincides with the adoption of annual budget; and
- Compliance with automatic formula contributions to designated reserves for emergencies and economic downturns, although the city does not set reserve policy minimums.

Adequate budgetary performance

Seattle's budgetary performance is adequate, in our opinion. The city had surplus operating results in the general fund of 1.9% of expenditures but a deficit result across all governmental funds of 2.0% in fiscal 2016.

The city's general fund operations have been balanced-to-positive in the context of strong economic growth and upward pressure on salaries and benefits. General fund results for 2017 (unaudited), including our adjustments to treat recurring transfers-out as expenditures, stepped down from 2.9% in 2016 and a robust 4.1% in 2015. Although the city's budgeted figures suggest a positive general fund net result of just 0.5% (using a slightly different accounting framework), we anticipate based on our discussions with management and the city's record of past conservative assumptions that the general fund's performance will come in slightly stronger.

A continuing strength of the city's general fund revenue structure, in our view, is the diversity of its tax sources, with taxes representing 86% of the general subfund's budgeted 2018 revenue, led by property taxes (24%) and followed closely by gross receipts taxes (21%), sales taxes (20%), and utility taxes (17%). The city estimates that its general subfund will see 6.5% tax revenue growth overall for 2018, which is slightly higher than the estimated 5.1% increase in 2017.

We understand that the city plans to continue a pattern of using core revenue, the revenue or rates of which are restricted under state law, for basic services and to request that voters approve property tax increases for specific policy initiatives. Examples include a November 2015 approval for transportation capital improvements and an August 2016 approval for affordable housing programs. Management anticipates that the city will request in November that voters renew a families and pre-kindergarten education levy that expires in 2018.

We think that the November vote will be an important political test for local willingness to approve property taxes. Although the city's levy rate has been declining on the strength of AV growth, as part of the state's response to a state Supreme Court order to bring kindergarten through twelfth-grade funding into compliance with the state constitution, Seattle and many of its neighbors saw major property tax increases for 2018 as a result of a state levy hike. We see anecdotal evidence that property tax bills are increasingly part of local political conversations regarding housing affordability, particularly for long-term residents.

Very strong budgetary flexibility

Seattle's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 21% of operating expenditures, or $291.9 million. Over the past three years, the total available fund balance has remained consistent, totaling 21% of expenditures in 2016 and 21% in 2015.

Our calculation of the city's budgetary flexibility includes analytic adjustments that treat recurring transfers-out as expenditures given their recurring nature and committed general fund balances that we consider practically available.

Based on the city's 2018 proposed budget and expectation of adequate performance with at least nominally positive general fund operations, we anticipate that the city's financial flexibility will remain very strong.

Very strong liquidity

In our opinion, Seattle's liquidity is very strong, with total government available cash at 61.7% of total governmental fund expenditures and 15.4x governmental debt service in 2016.

In our view, the city has exceptional access to external liquidity if necessary, with a pattern of annual issuances of GO bonds in recent years and frequent issuances of debt secured by other revenue such as that from its electric and wastewater enterprises, during the past 15 years.

We do not consider the city's investments aggressive, with U.S. agency, government-sponsored enterprise, and U.S. Treasury obligations making up 61% of the city's portfolio and repurchase agreements and commercial paper making up 17% as of February 2018.

The city has agreed to loan, on a contingent basis, sufficient and timely resources to enable two obligors to meet their debt service obligations. We understand that city is already effectively making payments on one of the obligations through a real estate lease after the obligor stopped making payments, and should the other obligor stop making payments we don't believe this would constitute a material liquidity challenge, with the city's $1.3 billion in primary government cash and investments as of the end of 2016 dwarfing potential additional annual payments of $3.9 million.

Very strong debt and contingent liability profile

In our view, Seattle's debt and contingent liability profile is very strong. Total governmental fund debt service is 4.0% of total governmental fund expenditures, and net direct debt is 57.3% of total governmental fund revenue. Overall net debt is low at 0.8% of market value, which is, in our view, a positive credit factor.

We anticipate that the city will continue a pattern of annual limited-tax GO issuances in the spring of each year, with low-income housing grants and IT projects leading this year's slate of bond-funded projects. Also in the works is a local improvement-district-funded capital program encompassing the city's downtown that could include about $200 million in property-assessment-secured debt. We do not anticipate that the city's net direct debt will rise materially in the coming years, as the city continues to secure voter authorization for property tax increases for pay-as-you-go capital needs.

The city has agreed to loan, on a contingent basis, sufficient and timely resources to enable two obligors to meet their debt service obligations using the city's limited-tax GO authority. The principal of these loans totaled $42 million at the end of 2017. Our calculation of the city's direct debt includes these obligations.

Seattle's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 7.2% of total governmental fund expenditures in 2016, with 5.9% representing required contributions to pension obligations and 1.3% representing OPEB payments. The city made its full annual required pension contribution in 2016.

The city independently manages two defined benefit pension plans for most of its nonsworn employees and two small closed plans for public safety employees. Other public safety employees participate in the state-managed Law Enforcement Officers' and Firefighters' Retirement System. The city's required pension contribution is its actuarially determined contribution (ADC), which is calculated based on an actuary study. We view the largest plan's (Seattle City Employees Retirement System [SCERS] 1) funded ratio, which we estimate as the plan fiduciary net position as a percentage of the total pension liability, as low at 65.6%. In August 2016, the city and its bargaining groups agreed to create a second plan (SCERS 2) as a lower-cost tier for employees who joined the city starting in 2017.

In 2012, the city shifted its valuation of its pension assets to a five-year smoothing approach and formally declared its intention to fund its actuarially calculated annually required contribution (ARC) for the city-managed pension system based on a 30-year amortization. It has consistently met the ARC under its definition, although its payments fall slightly below the ARC under Governmental Accounting Standards Board guidelines because, as we understand, the guidelines do not allow an entity to assume growth in the number of employees.

The city's OPEB liability totaling $734.1 million as of 2016 consists of an implicit subsidy and, for certain public safety employees under a now closed plan, a direct subsidy. The city manages this cost on a pay-as-you-go basis.

Adequate institutional framework

The institutional framework score for Washington municipalities is adequate.

Outlook

The stable outlook reflects our view that Seattle's strong economic performance will likely continue in some form during our two-year outlook horizon, consistent with our expectation of GDP growth in the region, but that property value growth is likely to moderate. Likewise, we anticipate that net general fund performance will moderate but remain positive, with continuing negative total governmental funds results contributing to what we consider adequate performance overall. We view the chance of lowering the rating during the next two years as less than one in three.

Downside scenario

We do not anticipate lowering the rating during the outlook horizon unless the city experiences deterioration in multiple factors that we view as important to credit quality, such as a major economic reversal and rising costs that create a significant operating deficit that substantially erodes the city's liquidity position and available reserves.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Nov. 1, 2017
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of April 20, 2018)		
Seattle GO		
Long Term Rating	AAA/Stable	Affirmed

Ratings Detail (As Of April 20, 2018) (cont.)		
Seattle GO		
Long Term Rating	AAA/Stable	Affirmed
Seattle GO		
Long Term Rating	AAA/Stable	Affirmed
Seattle GO		
Long Term Rating	AAA/Stable	Affirmed
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Long Term Rating	AAA/Stable	Affirmed

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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.