S&P Global
Ratings

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Summary:

Seattle; General Obligation; General Obligation Equivalent Security

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US$37.455 mil ltd tax GO bnds (Imp Bnds) ser 2019A due 05/01/2049		
Long Term Rating	AAA/Stable	New
US$11.095 mil ltd tax GO bnds (Imp Bnds) ser 2019B due 05/01/2039		
Long Term Rating	AAA/Stable	New

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Seattle's series 2019A and 2019B (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, secures 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 2019 levy rate is $2.14.

Proceeds of the series 2019A will pay for a variety of capital projects, including transportation and information technology (IT) projects, consistent with a pattern of annual GO issuance that consolidates borrowing into annual issuances. The city will use proceeds of the series 2019B to provide grants, loans, and other contributions to affordable housing projects in the city, and a small portion will support waterfront amenity improvements--chiefly its Overlook Walk project, which will connect a prominent tourist attraction to the waterfront--following the removal of an elevated freeway that until recently separated the waterfront from the city's downtown.

Local ratings' 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, we would be unlikely to set ratings on the city's obligations more than two notches above the U.S. sovereign rating.

The city may have exposure to sovereign intervention as part of a now mostly quiet 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 understand that legal proceedings regarding this issue are continuing, with the timetable for resolution unclear. Regardless of the outcome, 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.) We view the revenue effects of Seattle's economic performance to have much larger implications for the city's budgetary performance and overall credit profile.

Credit Overview

Seattle's recent economic performance has belied our expectations of moderation from either moderating national economic performance, threats from international trade disputes, or difficulty among local employers in attracting qualified people as local housing prices rise. We still think that Seattle's economic performance--and with it revenue performance--will eventually slow down, but the property tax base keeps growing and voters appear willing and able to shoulder higher nominal property tax bills for specific services. The challenges of rising pension and other compensation costs remain, but the city has recently made a transition to a new accounting platform that offers improved management and budgeting tools that we think will help the city identify the next downturn when it occurs and start budget-balancing conversations earlier than it otherwise would.

The ratings reflect our assessment of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area;
- Very strong management, with strong financial policies and practices under our financial management assessment methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to 2018, which closed with a slight operating deficit in the general fund and an operating deficit at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in 2018 of 19% of operating expenditures;
- Very strong liquidity, with total government available cash at 70.5% of total governmental fund expenditures and 16.5x governmental debt service, and access to external liquidity we consider exceptional;
- Very strong debt and contingent liability position, with debt service carrying charges at 4.3% of expenditures and net direct debt that is 45.3% 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

Seattle continues to rank among the top large-city economic performers in the country, with key indicators showing little sign of slowing. At a time when the cost of housing threatens economic growth, we understand that a large share of the cranes dotting the skyline are supporting the construction of apartment buildings and that the city has been adding people at about 2% a year, to 747,300 for 2019. The city, as anchor for the broad and diverse Seattle-Tacoma-Bellevue metropolitan statistical area, continues to benefit from its ability to attract highly skilled workers, as evidenced by Apple recently announcing a downtown office space lease that would accommodate 2,000 workers and San Francisco-based cloud computing service giant Salesforce announcing the purchase of data visualization service provider Tableau, with a concurrent statement that the company sees Seattle as the locus for a second "headquarters." The city's property value growth is now in its sixth consecutive year of double-digit percentage increases, most recently by 14% to $244.9 billion.

Consistent with our expectation of continuing, if slowing, growth in the western U.S. states through 2021, we anticipate that the city will continue to show very strong income and wealth indicators, with our per capita effective buying income projection at 185% of the national level and per capita market value of $327,800. The dominant local employer, Amazon, has continued to pursue office space in downtown Seattle and more recently nearby Bellevue, but appears to also be interested in shifting growth to other metropolitan areas in the coming decade. We think this would be good for the city's credit quality, on balance, in that it would reduce economic concentration risk, and we see the city's diversity in information technology and life science employers needing people with high levels of education as a long-term strength. This diversity, we think, will help the city weather potential disruptions from Boeing, which has a large order backlog for aircraft built in the region but has suffered reputational damage from recent crashes.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our financial management assessment 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.

We understand that in 2018 the city revised its accounting structure as part of a shift to a new accounting platform. This allowed the city to track at a more granular level the match between funding and spending for particular initiatives and mostly eliminated transfers between the general fund and other funds and, management believes, has improved the city's ability to identify and respond to challenges and opportunities by improving the quality and speed of intrayear financial reporting.

Management reports that the city is aware of cybersecurity incidents affecting Atlanta and Baltimore and has been working to improve processes, training, and controls to manage such risks and improve the reliability of its systems generally. The city also performs incident exercises and brings in external feedback to identify and address potential vulnerabilities and is considering adding cybersecurity insurance in the coming year.

Adequate budgetary performance

Seattle's operating results swung to negative in 2018 based on unaudited actual results we consider reliable, with a slight deficit operating result in the general fund of 1.4% of expenditures, and a deficit result across all governmental funds of 1.8% in 2018. We understand that a retroactive labor settlement with the city's police bargaining group of $65 million, or 4% of expenditures, accounted for the divergence from what has been until recently a pattern of generally strong performance associated with economic-growth-driven rises in tax revenue. Although the local cost of living and scheduled increases in contributions to the city's pension liability point to medium- to long-term cost increases, we think the city's 2018 results were likely a blip and that performance will return to at least adequate in 2019.

A continuing strength of the city's general fund revenue structure, in our view, is the diversity of its tax sources, with taxes representing 84% of the general subfund's budgeted 2019 revenue, led by property taxes (23%) and followed closely by gross receipts taxes (21%), sales taxes (21%), and utility taxes (16%). The city's budget anticipates that its general subfund will see 6.3% tax revenue growth overall for 2019, which would be down slightly from a 7.1% increase in its final 2018 budget relative to 2017 actual results. We note that real estate development plays a particularly important role in revenue growth during economic expansions because new construction added to the property tax roll is exempt from a statutory limit on property tax revenue growth that generally translates into 1% per year and because new construction is subject to sales taxes. For 2018, for example, 37% of sales tax revenue came from building activity. Also potentially tied to the economic cycle is demand for hotel stays and the development of new hotels, with the city adding its largest hotel yet in 2018 and more in the pipeline through 2021.

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. The city most recently renewed its family, education, preschool, and promise levy for 2019-2026 in November 2018, and voters will consider a library levy renewal in August 2019. Although property tax bills have been rising rapidly in nominal terms (while falling relative to assessed value), we think the 69% approval rate for the most recent measure suggests that voters' willingness to approve such measures is not yet flagging. The city has also made small contributions to its revenue base through the inauguration of a sweetened beverage tax that took effect in 2018 and generated an unexpectedly high $22.3 million (equivalent to 1% of general fund expenditures) and a short-term rentals tax to capture lodging activity provided through platforms such as AirBnB that took effect for 2019. The latter technically comes in the form of a passthrough from the district that manages the local convention center and is projected by the city to generate $8.8 million this year.

Very strong budgetary flexibility

Seattle's budgetary flexibility is very strong, in our view, with an available fund balance in 2018 of 19% of operating expenditures, or $294.6 million, which was a step down from 23% in 2017 as a result of a one-time retroactive compensation payment. Our calculation of the city's budgetary flexibility includes an analytic adjustment to treat the city's committed general fund balances as practically available because they generally consist of set-asides for particular policy priorities or risks rather than for initiatives that are likely to require immediate spending. Based on our expectation that performance will strengthen for 2019, we anticipate that the city's budgetary flexibility will remain very strong in the medium term and may rise this year.

Very strong liquidity

In our opinion, Seattle's liquidity is very strong, with total government available cash at 70.5% of total governmental fund expenditures and 16.5x governmental debt service in 2017. In our view, the city has exceptional access to external liquidity if necessary, with a pattern of annual issuances of GO bonds 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 70% of the city's portfolio and repurchase agreements and commercial paper making up 9% as of December 2018.

The city has agreed to loan, on a contingent basis, sufficient and timely resources to enable two obligors to meet 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 $1.6 billion in primary government cash and investments as of the end of 2017 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 4.3% of total governmental fund expenditures, and net direct debt is 45.3% of total governmental fund revenue. Overall net debt is low at 0.6% 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 revenue from associated projects matched to new debt service. Also in the works is a local-improvement-district-funded capital program encompassing the city's downtown that could include about $160 million in property-assessment-secured debt, although we understand that the timing is contingent on the outcome of a legal challenge surrounding the creation of the district. 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. Likewise, the city's overlapping school district has generally pursued capital projects through voter-approved levies rather than GO bond authorizations.

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 will total $42 million at the end of 2019. Our calculation of the city's direct debt includes these obligations.

Seattle's required pension and actual other postemployment benefits (OPEB) contributions totaled 6.1% of total governmental fund expenditures in 2017, with 5.1% representing required contributions to pension obligations and 1.1% representing OPEB payments. The city makes its full annual required pension contributions each year.

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 64.4% as of Jan. 1, 2019. 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 (leaving 23 years after 2019). It has consistently met the ARC under its definition, although its payments can 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. For the 2019 valuation the city switched to a 7.25% discount rate from 7.50% and its valuation points to a slight increase in the city's contribution relative to payroll through 2025 to stay in compliance with its employer contribution policy. The city's amortization uses a generational mortality approach to account for likely improvements in life expectancy in out years, which we view as reducing risk.

The city's actuarial OPEB liability totaling $667.1 million as of Jan. 1, 2018 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. Likewise, we anticipate that net general fund performance will bounce back from 2018 without a repeat of the one-time payment affecting last year's results and with continuing tax revenue growth and voter support for property tax overrides. 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, Oct. 24, 2018
- 2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of July 17, 2019)		
Seattle GO		
Long Term Rating	AAA/Stable	Affirmed
Seattle GO		
Long Term Rating	AAA/Stable	Affirmed
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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Seattle GO		
Long Term Rating	AAA/Stable	Affirmed
Seattle GO		
Long Term Rating	AAA/Stable	Affirmed
Seattle GO		
Long Term Rating	AAA/Stable	Affirmed
Seattle Indian Svcs Comm, Washington		
Seattle, Washington		
Seattle Indian Svcs Comm (Seattle) GO		
Long Term Rating	AAA/Stable	Affirmed
Seattle Museum Dev Auth, Washington		
Seattle, Washington		
Seattle Museum Dev Auth (Seattle) GO equiv		
Long Term Rating	AAA/Stable	Affirmed

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