# Moody's INVESTORS SERVICE

# **CREDIT OPINION**

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# Seattle, WA

Update to credit analysis

### Summary

Seattle (Aaa stable) benefits from a strong economy and growing tax base with socioeconomic measures that are amongst the strongest in the country. The city also has solid finances that include healthy reserves and liquidity, a manageable debt profile that consists of fixed-rate debt, and moderate pension and OPEB liabilities.

#### Exhibit 1

#### Seattle has experienced strong tax base growth since the recession \$ billions



Source: City of Seattle, WA

# **Credit strengths**

- » A large and growing tax base and a regional economic center
- Strong socioeconomic measures for an urban area including high median family income, » full value per capita, and low unemployment
- Healthy financial position that includes ample reserves and available liquidity »
- Favorable debt profile that includes only fixed-rate debt and relatively rapid amortization »
- Strong management team »

# **Credit challenges**

- » Modest exposure to economically sensitive revenues
- » Somewhat dependent upon a small number of high profile private-sector firms for growth

## **Rating outlook**

The outlook is stable, reflecting our view that the city is well positioned financially and that the local economy will continue to be amongst the nation's strongest.

# Factors that could lead to an upgrade

» Not applicable

# Factors that could lead to a downgrade

- » Material weakening in the city's finances
- » Prolonged deterioration in the economy and tax base
- » Substantial growth in debt and/or pension liabilities

# **Key indicators**

Exhibit 2

Seattle (City of) WA	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value (\$000)	\$116,995,513	\$128,205,754	\$144,513,932	\$163,305,928	\$185,626,174
Population	624,681	637,850	653,017	668,849	688,245
Full Value Per Capita	\$187,288	\$200,997	\$221,302	\$244,160	\$269,709
Median Family Income (% of US Median)	149.5%	152.2%	155.8%	159.7%	162.9%
Finances					
Operating Revenue (\$000)	\$1,364,050	\$1,419,507	\$1,561,538	\$1,749,022	\$1,932,950
Fund Balance (\$000)	\$217,821	\$241,883	\$268,656	\$316,907	\$350,326
Cash Balance (\$000)	\$359,796	\$348,782	\$479,428	\$616,475	\$874,485
Fund Balance as a % of Revenues	16.0%	17.0%	17.2%	18.1%	18.1%
Cash Balance as a % of Revenues	26.4%	24.6%	30.7%	35.2%	45.2%
Debt/Pensions					
Net Direct Debt (\$000)	\$897,025	\$897,610	\$1,040,474	\$1,027,503	\$1,028,140
3-Year Average of Moody's ANPL (\$000)	\$1,648,620	\$1,880,940	\$2,177,634	\$2,272,141	\$2,422,195
Net Direct Debt / Full Value (%)	0.8%	0.7%	0.7%	0.6%	0.6%
Net Direct Debt / Operating Revenues (x)	0.7x	0.6x	0.7x	0.6x	0.5x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.4%	1.5%	1.5%	1.4%	1.3%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.2x	1.3x	1.4x	1.3x	1.3x

Source: City of Seattle, WA

# Profile

Seattle is the economic center for the Pacific Northwest. The full-service city has a relatively affluent population of 747,300, a large and well-educated labor force, and ties to the broader metropolitan area including the cities of <u>Bellevue</u> (Aaa stable), <u>Tacoma</u> (Aa2 stable), and Everett.

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# **Detailed credit considerations**

### Economy and tax base: Seattle is the economic center of the Pacific Northwest

The City of Seattle is the commercial and tourist hub of the Puget Sound region and the economic center of the <u>State of Washington</u> (Aa1 stable). Software development and aircraft manufacturing are key components of the local economy, and the area serves as the headquarters of or major operating base to some of the world's most well-known international corporations, including <u>Amazon</u> (A3 positive), <u>Boeing</u> (A2 stable), <u>Microsoft</u> (Aaa stable), and <u>Starbucks</u> (Baa1 stable). At just 2.6% as of May 2019 (according to data from the Bureau of Labor Statistics), the city's unemployment rate continues to outpace the state and the nation, even as the local labor force grew by 3.6% year over year. Despite <u>issues with the 737 Max</u>, demand for Boeing aircraft remains high, with a sizeable order backlog that is estimated to take several years to fulfill. Online retailer Amazon continues to expand its footprint in Seattle, acquiring and developing substantial downtown office space to house its growing workforce. The city is forecasting continued economic growth in 2019 and 2020, albeit at slower rates than in recent years.

Median family income in the city is amongst the highest among large urban areas in the United States at 162.9% of the national average. Full value per capita, a proxy measure of wealth, is robust at \$355,889. New construction is continuing to drive the city's assessed value higher, though median home prices appear to be softening. In 2019, assessed value grew by 14.8%, the seventh consecutive year of growth and hit a new high of \$244.9 billion. Median home prices declined 2.4% year-over-year, but remains high at \$729,000. Commercial office vacancy is low at 5.6%, and is projected to decline over the next several years as Amazon and other technology companies occupy additional space.

#### Financial operations and reserves: structurally balanced with healthy reserves supported by diverse revenue streams

The city's finances are healthy and a credit strength, driven by strong growth amongst the city's diversified revenue streams. On a governmental activities basis, property taxes make up the largest portion of the city's revenues (26.4% in 2017), followed by business taxes (23.4%), sales taxes (12.7%), and excise taxes (5.2%). The city's property tax rate is subject to a \$3.60 per \$1,000 cap, not including the rate for voted bonds; the city's current rate (2019) subject to the rate limit is \$2.14. Outside of new growth and voter-approved levy lid lifts, operating property tax revenues are limited to 1% annual growth. Preliminary figures for 2018 indicate governmental revenues increased by 8.2%, supported by strong growth and a new sweetened beverage tax. City managers report year-to-date 2019 revenue growth remains healthy; the city updates its revenue projections three times per year.

The city's largest expense in 2017 was for public safety (27.7% of 2017 governmental activities revenues), followed by general government (14.6%) and culture and recreation (14.4%). Expenditures in 2018 increased by 10%, with a substantial portion of that increase attributable to a one-time retroactive payment of \$65 million for a contract settlement with the Seattle Police Officer's Guild (SPOG).

The city's 2019-2020 biennal budget continues to focus on public safety (including the addition of police officers), homelessness, and information technology. State law requires that the city balance its budget, and the city uses a quarterly supplemental budget process to consistently deliver structurally balanced financial operations. Revenues are expected to increase more moderately than in years past, particularly as new construction appears to be slowing.

Since 2011, the city's revenues have exceeded its expenditures, allowing the city to build up its total operating funds balance (which includes reserves in the city's General Fund, Special Revenue Fund, and Debt Service Fund) increased from \$262.1 million to \$938.0 million (48.5% of revenues), while available reserves (those not designated as nonspendable or restricted) increased from \$161.5 million in 2011 to \$350.3 million (18.1%) in 2017. On a General Fund basis, the city is anticipating a very modest \$20 million decline in reserves due to the one-time payment to the SPOG. We anticipate 2019 financial results will continue to show the city maintaining a healthy financial position.

#### LIQUIDITY

The city's liquidity position is healthy. The city's General Fund cash and equity in pooled investments at the end of 2017 was \$406.8 million, or 28.2% of General Fund revenues. Functionally, however, the city pools its cash and investments across funds. This consolidated pool held \$2.5 billion at the end of 2018. City funds may withdraw cash out of the pool without prior notice or penalty.

#### Debt and pensions: modest debt and manageable pension liabilities

The city's fixed costs are moderate and give the city significant financial flexibility. Total fixed costs for the city, including pension, other post-employment benefits (OPEB), and debt service, was moderate at 10.5% of operating funds revenues in 2017.

The city maintains a very moderate level of debt that amortizes quickly. Net direct debt is just 0.4% of full value and 0.5 times operating funds revenues. The ten-year amortization rate of the city's debt is average at 63.9%, with 79.0% of the city's limited tax general obligation bonds being retired within ten years. Potential future bond issuances include up to \$160 million for the city's waterfront (backed by assessments within the local improvement district), as well as annual bond issuances of \$50-\$60 million annually for general government projects.

### DEBT STRUCTURE

The city's governmental debt consists of fixed-rate unlimited tax general obligation bonds (\$273.9 million) and limited tax general obligation bonds (\$752.1 million). In 2019, approximately 35% of the city's LTGO debt is expected to be paid by dedicated revenues outside the General Fund.

### DEBT-RELATED DERIVATIVES

The city has no debt-related derivatives.

#### PENSIONS AND OPEB

Pension and OPEB liabilities are not a driving credit factor for the city. The city manages a single-employer and defined-benefit public employee retirement plan (Seattle City Employees' Retirement System), the Firefighter's Pension Fund, and the Police Relief and Pension Fund. The city's adjusted net pension liability (ANPL) based on a 4.04% discount rate, is \$2.58 billion in 2017, equal to a manageable at 1.39% of full value and 1.34 times operating funds revenues.

Based on our calculations, the city's pension contributions in 2017 were modestly below the "tread water" level; that is, contributions were not sufficient to prevent the city's net pension liability from growing under plan assumptions. However, the "tread water" gap was modest at \$4.0 million, or less than 0.2% of operating funds revenues.

We expect the "tread water" gap to be eliminated moving forward. On January 1, 2017, the city closed SCERS to new entrants, with new employees participating in a new system (SCERS 2). SCERS 2 has decreased benefit levels, increases the minimum retirement age, and defers retirement eligibility by increasing the age-plus-years-of-service requirement for retirement with full benefits.

Additionally, the city may, under state law, levy a \$0.225 per \$1,000 property tax levy to cover the Firefighter's fund; the city does not levy this additional tax.

The city records an implicit subsidy for OPEB and funds these benefits on a pay-as-you-go basis. The city made \$25.8 million in contributions in 2017 with a net OPEB obligation at the end of the year of \$171.1 million.

#### Management and governance: strong management team with codified practices

Moody's views the city's management team as strong. The strength of the management team is buttressed by codified practices that enhance the city's financial profile. Until 2017, the city appropriated sufficient money into the Emergency Subfund to the maximum amount allowed by state law (\$0.375 per \$1,000), but is now adding funds at a rate tied to inflation. Additionally, 0.5% of forecasted tax revenues are automatically contributed to the city's "Rainy Day Fund," also known as the Revenue Stabilization Account, as are 50% of any unanticipated excess General Subfund balances at year end. Like the Emergency Subfund, the city is now adding to the "Rainy Day Fund" at a rate tied to inflation.

Washington Cities have an Institutional Framework score of "Aa", which is strong. The sector's major revenue sources are economicallysensitive sales taxes and property taxes. Cities can increase property tax collections 1% over the prior year, subject to state statutory limits on property tax rates. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

# **Rating methodology and scorecard factors**

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 3

Seattle (City of) WA

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	\$244,938,709	Aaa
Full Value Per Capita	\$355,889	Aaa
Median Family Income (% of US Median)	162.9%	Aaa
Notching Factors: <sup>[2]</sup>		
Regional Economic Center		Up
Finances (30%)		
Fund Balance as a % of Revenues	18.1%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	7.2%	Α
Cash Balance as a % of Revenues	45.2%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	30.2%	Aaa
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.1x	Aaa
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	0.4%	Aaa
Net Direct Debt / Operating Revenues (x)	0.5x	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	1.0%	Aa
	1.3x	Α
	Scorecard-Indicated Outcome	Aaa
	Assigned Rating	Aaa

[1] Economy measures are based on data from the most recent year available.

[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology dated December 16, 2016.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs Updated for 2019 publication *Sources: US Census Bureau, Moody's Investors Service* 

Source: City of Seattle, WA, US Census Bureau, Moody's Investors Service

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