



RATING ACTION COMMENTARY

Fitch Rates Seattle, WA's \$147.5MM LTGOs 'AAA'; Affirms Outstanding Ratings; Outlook Stable

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Fitch Ratings - San Francisco - 15 Apr 2022: Fitch Ratings has assigned a 'AAA' rating to the following city of Seattle, WA general obligation (GO) bonds:

--\$147,500,000 limited tax GO (LTGO) improvement and refunding bonds 2022A.

In addition, Fitch has affirmed the following Seattle ratings at 'AAA':

--\$251 million outstanding unlimited tax (ULT) GO bonds;

--\$753 million outstanding LTGO bonds;

--The city's Issuer Default Rating (IDR).

The Rating Outlook is Stable.

The series 2022A bond proceeds will be used to fund various capital improvement projects, including certain improvements to the city-owned aquarium, the repair of the West Seattle Bridge and other projects related to the central waterfront area, as well as to refund the

city's outstanding 2012 LTGO bonds The bonds are scheduled to price via competitive sale on May 3, 2022.

SECURITY

The LTGOs bonds are a general obligation of the city payable from its full faith and credit and an ad valorem property tax pledge subject to statutory limits.

ANALYTICAL CONCLUSION

Seattle's 'AAA' IDR and GO ratings are supported by expectations for strong economic and revenue growth over the long term, sustained by the highly educated workforce and the dynamic software and aerospace industries that dominate the regional economy. Long-term liabilities are low. The city's somewhat weak revenue raising ability is offset by solid expenditure flexibility and ample reserves relative to moderate expected revenue fluctuations during typical economic downturns. Fitch expects the city to maintain the highest level of gap closing capacity through the current environment and future economic cycles.

Economic Resource Base

Seattle is the largest city in the Pacific Northwest and the cultural and business center of the Puget Sound. Boeing had long been the largest regional employer, though it has reduced its Washington-based workforce in recent years. In contrast, Amazon has been expanding and is currently the largest regional employer followed by Boeing and Microsoft. Through the decade ending 2020, the city in particular experienced robust economic growth as Amazon and other technology companies expanded in downtown, fostering complementary multiuse development.

Seattle's workforce is highly educated, helping to sustain above average economic and revenue growth. The recessionary impact on the economy due to the pandemic is fairly modest at this point and concentrated in hospitality and entertainment. Both revenue per hotel room and diners at restaurants have trailed the national rates since the onset of the pandemic, and employment recovery (particularly in leisure and hospitality) remains weak. Fitch's U.S. Labor Market Tracker estimates that the Seattle-Tacoma-Bellevue MSA added back about 84% of the 12% of jobs lost at the start of the pandemic, which is modestly better than the 81% median among MSAs. Seattle's January 2022 unemployment rate was 3.1%, notably below the state and national rates.

KEY RATING DRIVERS

Revenue Framework: 'aa'

Revenue growth has been and is expected to remain above GDP growth over the long term, given the nature of the underlying economy. Offsetting some of this strength, the city's ability to independently raise its property tax levy is limited to 1% annually.

Expenditure Framework: 'aa'

Over time, expenditure growth is expected to be roughly in line with strong revenue growth as employee salaries and benefits track closely with increases in the city's revenue base. Carrying costs for debt service, pensions and OPEB are moderately low.

Long-Term Liability Burden: 'aaa'

Seattle's low long-term liability burden totals less than 5% of personal income. The liability is comprised of about 40% direct and overlapping debt and 60% adjusted net pension liabilities.

Operating Performance: 'aaa'

Seattle has exceptional gap-closing ability and is expected to manage through the economic uncertainty and recovery while retaining a high level of financial flexibility. Its strong revenue growth and conservative policies result in rapid rebuilding of reserves during periods of expansion while funding pay as you go capital outlays and actuarial funding of pension benefits.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--Not applicable.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--Inability to manage expenditure pressure, especially if revenue growth slows.

--Inability to adjust to cessation of payroll expense tax should it be ruled unconstitutional

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

CURRENT DEVELOPMENTS

Local Economy Continues to Recover

As noted, the regional economy continues to recover from the pandemic recession, with strong recoveries in most sectors save leisure and hospitality. Construction activity also remains below pre-pandemic levels based on construction taxable sales. Fitch expects this trend is to continue given that weakness in commercial building permits is only partially offset by strength in multifamily building permits.

Nonetheless, tax revenues largely recovered in 2021 relative to 2019 with property, retail sales, and business occupancy taxes all exceeding 2019 levels while revenues closely tied to economic activity downtown (parking meters, court fines, and admissions tax) all remain below pre-pandemic levels. For the business occupancy taxes (B&O), strength in information and financial activities sectors offset weakness in leisure and hospitality, construction, and professional and business services.

Aiding in the economic recovery was a substantial amount of state and federal fiscal stimulus funds. The city received \$187 million in 2020, and over \$322 in 2021 and 2022, including a total of \$232 million in American Recovery and Protection Act [ARPA] funds in two tranches, and other state and federal funds. The city plans to use the ARPA funds to maintain fire and other emergency staffing, basic needs assistance, childcare access, small business and community grants, and for mental health and community safety programs.

2020 and 2021 Financial Operations

The city's 2020 financial operations resulted in a \$70.5 million deficit, driven by unbudgeted expenditures related to the COVID-19 pandemic, as well as soft revenue

performance driven by pandemic mitigation efforts. Property taxes performed well, increasing almost 5% year over year; however, economically sensitive revenue such as sales and hotel dropped sharply in 2020 for a total revenue loss of about \$110.6 million, or 6.5%.

Revenues began to recover in 2021, and the city's estimated actuals for 2021 include total revenues \$167 million higher than budget. These higher than budgeted revenues include net taxes (\$120 million including sales, B&O, including the payroll expense (PET), property and utility taxes) as well as federal stimulus funds (\$46 million). Estimates also point to a revenue recovery compared to pre-pandemic 2019 revenues. Total taxes are estimated at \$311.5 million (21.67%) higher in 2021 compared to 2019. However, almost 80% (\$248.1 million) is attributed to the new payroll expense tax. Not including the new tax, general fund operating revenues in 2021 were about 4.4% higher than in 2019, with each major category of taxes higher in 2021.

While spending also increased, the city's 2021 estimates point to a \$203 million increase to its unrestricted fund balance. The city expects to use most of the increase in fund balance over the coming years on planned spending for community-led investments. In addition to revenue recovery and the new payroll tax helping to balance the 2021 budget, the city also made mid-year budget reductions, enacted a hiring freeze, reduced professional services contracts, appropriated reserves (\$44 million), and used FEMA reimbursements.

2022 Budget

The 2022 budget is \$42 million higher than the 2021 estimated actuals, and includes about \$131.5 million in one-time sources (\$70 million in ARPA funds and \$66.5 million from the sale of a large land sale). The budget includes the \$56 million required transfer to the revenue stabilization fund; the city expects reserves to be fully funded (about \$130 million) by the end of 2024.

The city closed its projected funding gap for the 2022 budget with several balancing strategies, including redirecting real property transfer taxes and voter approved levies for allowable uses, use of federal stimulus, and temporarily redirecting a portion of the PET to general purposes. In 2021 a portion of the payroll expense tax was redirected (from the intended housing and housing services focus) for the continuation of existing services and programs. For 2022, the PET will be directed largely to the original planned uses, though a portion could be redirected to existing general governmental purposes, as permitted by law, to the extent general fund revenue were forecast to perform below budget.

Payroll Expense Tax Litigation

Employers began incurring liabilities under the new payroll tax in January 2021, but payments were not due until January 31, 2022. Starting in 2022, the tax will be collected quarterly. While the tax is levied only on employees working within the city limits, the city believes that the large majority of employees subject to this tax live within the city limits, even if some continue to telecommute over the longer term. In addition, the PET is being challenged as unconstitutional. In July 2021 the tax was upheld by the King County Superior Court and the ruling was appealed to the Washington State Court of Appeals. While risks remain with this new revenue, the city's solid unrestricted fund balance, expenditure control and strong management provide ample mitigation to revenue uncertainty.

CREDIT PROFILE

During the economic expansion leading to the beginning of the pandemic recession, Seattle had experienced very strong economic growth, benefiting from Amazon's rapid expansion, increasing employment by other technology companies, and a strong construction industry. Seattle's tax structure captures this economic growth through property, business, sales, utility and real estate excise (transaction) taxes.

Fitch views the city's transition towards a more broadly diversified economic base as a positive credit factor. However, Boeing, Microsoft, and increasingly Amazon remain driving forces for the regional economy as the most significant employers in the region. As Amazon and Microsoft and other information technology companies have grown, the information sector now generates over three times the national average share of the regional employment and personal income. Fitch expects the performance of the information industry to continue to have an outsized impact on the economic fortunes of the city and region. The city's socioeconomic measures remain strong. Income levels are well above national averages as are educational attainment levels; 65% of residents have a bachelor's degree, almost twice the average national rate of 33%.

The city's assessed value (AV) rose by over 8% on average annually between 2012 and 2022 as increased employment, a growing population, and the significant development by Amazon and other companies led to a more active and higher priced real estate market. According to Zillow, home prices in Seattle increased 14.6% from Feb. 2021 to Feb. 2022.

Revenue Framework

Revenues are diversified among property taxes (about 21% of 2020 audited general fund revenues), sales taxes (22%), business taxes (18%), and other revenues. The new PET generates an additional 16%. Sales and business taxes tend to be more volatile and

responsive to changes in the economy while property and utility taxes tend to be very stable with more limited growth potential. The restriction of the city's real estate excise tax to capital spending reduces the exposure of financial operations to a volatile revenue source and provides an important source of pay-go capital throughout the economic cycle.

The city's revenue structure has provided a steady source of revenue growth despite a statutory limit of 1% annual property tax levy increases, due to ongoing additions to the tax base from new construction (which is excluded from the 1% limit) and economic growth benefiting other sources. As demonstrated in the Great Recession, the allowance for 1% levy growth provides solid downside risk mitigation in the event of AV declines as the tax rate can be increased to provide for the 1% annual levy increase.

Revenue growth has outpaced the rate of inflation and GDP by large margins. Fitch expects long-term economic growth to continue to provide revenue growth in excess of GDP given the prospects for the region's economy.

Increases to property taxes beyond the levy limit require voter approval, which the city regularly seeks and receives in the form of temporary levy lid lifts for specific uses. The city has the ability to adjust charges for services, permit fees and fines but the combination makes up only about 10% of general fund revenues.

Expenditure Framework

Public safety comprises the bulk of city general fund spending at about 48%, followed by general government, culture and recreation and capital.

Given the nature of Seattle's revenue system and spending responsibilities, Fitch believes that growth in major spending areas is likely to be in line with, to marginally above, expected revenue growth (on average).

The city's fixed cost burden is low, with carrying costs for debt, pensions and OPEB equaling about 10% of 2020 governmental expenditures. Pension costs represent about half of the total but are overstated because about one-third of those pension costs are attributable to and paid by various city utilities, including the power and water enterprises.

The collective bargaining framework in Washington State offers moderate flexibility to adjust personnel spending as needed. The city has a tentative agreement with police management and is negotiating with police officers to replace contracts that expired December 2019 and December 2020, respectively. The unions continue to operate under

the expired contracts until a new agreement is ratified. Twenty-eight labor agreements, representing 61% of the city's represented employees, expire at the end of December 2022.

Long-Term Liability Burden

The combination of the city's direct and overlapping bonded debt and its direct unfunded pension liability totals less than 5% of personal income, which Fitch considers a low burden on the city's resources. Bonded debt makes up about 40% of the total liability and the Fitch-adjusted net pension liability the remainder.

The city's debt issuance is exclusively for capital projects, with some use of pay-go for smaller projects. Given the city's practice of moderate, regular debt issuance, above-average pace of debt amortization and strong income growth, Fitch expects the city's debt burden to remain low relative to personal income. The city has its own pension system for miscellaneous employees (SCERS) and participates in the state-sponsored system for public safety workers (LEOFF). LEOFF is currently funded in excess of the liability, while SCERS has an unfunded liability the city will fully pay off by 2042.

Operating Performance

The combination of the city's solid expenditure flexibility and sizeable reserves are expected to sustain its exceptional financial flexibility throughout economic downturns. The city's unaudited results for 2021 show a \$202.6 million surplus, ending the year with \$419.7 million in unrestricted, equal to about 24% of spending, up from \$250 million and 15% of spending in 2020.

The city has demonstrated a strong commitment to financial flexibility through efforts to control costs, improve pension funding, maintain reserves, and utilize extensive and conservative financial forecasting. In addition, the city has a track record of funding key services such as public housing, library, transportation and families and education through voter-approved increases to property tax levy limits for specific purposes (levy lid lifts). During the extended economic recovery that followed the Great Recession, the city rebuilt its reserves. In addition, the pension reforms noted above demonstrate commitment to financial flexibility.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit

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ENTITY / DEBT ⇅	RATING ⇅		PRIOR ⇅
Seattle (WA) [General Government]	LT IDR	AAA Rating Outlook Stable	AAA Rating Outlook Stable
	Affirmed		
Seattle (WA) /General Obligation - Limited Tax/1 LT	LT	AAA Rating Outlook Stable	AAA Rating Outlook Stable
	Affirmed		
Seattle (WA) /General Obligation - Unlimited Tax/1 LT	LT	AAA Rating Outlook Stable	AAA Rating Outlook Stable
	Affirmed		

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APPLICABLE CRITERIA

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 04 May 2021\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 ([1](#))

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Seattle (WA)

EU Endorsed, UK Endorsed

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US Public Finance Infrastructure and Project Finance North America United States
