# FITCH RATES SEATTLE, WA'S $50.6MM LTGOS 'AAA'; AFFIRMS OUTSTANDING

Fitch Ratings-San Francisco-25 April 2018: Fitch Ratings has assigned a 'AAA' rating to the following city of Seattle, WA (the city) general obligation (GO) bonds:

--$24.1 million limited tax GO (LTGO) improvement bonds 2018A;
--$26.5 million LTGO improvement bonds 2018B (taxable).

In addition, Fitch has affirmed the following ratings at 'AAA':
$291.7 million outstanding unlimited tax (ULT) GO bonds;
$720.8 million outstanding LTGO bonds;
Issuer Default Rating (IDR).

The Rating Outlook is Stable.

The Series 2018A bond proceeds will be used to fund various capital improvement projects. The series 2018B bond proceeds will be used to fund capital improvements to the Overlook Walk project, which is related to its development of the central waterfront area as well as to fund a portion of the city's affordable rental housing program.

SECURITY
LTGOs bonds are payable from an ad valorem property tax pledge subject to statutory limits.

ANALYTICAL CONCLUSION

Seattle's 'AAA' IDR is supported by strong economic and revenue growth, sustained by the educated workforce and the dynamic software and aerospace industries that dominate the regional economy. Long-term liabilities are low. The somewhat weak revenue raising ability is offset by moderate expenditure flexibility and solid reserves relative to moderate expected revenue fluctuations. Fitch expects the city to maintain the highest level of gap closing capacity throughout the economic cycle.

Economic Resource Base
Seattle is the largest city in the Pacific Northwest and the cultural and business center of Puget Sound. The regional economy is still heavily influenced by Boeing and Microsoft. The city in particular is experiencing robust economic growth as Amazon and other technology companies expand in downtown, fostering complementary multiuse development. The workforce is highly educated, helping to sustain above average economic and revenue growth.

KEY RATING DRIVERS

Revenue Framework: 'aa'
Revenue growth has been and is expected to remain largely above GDP growth given the size of the healthy aerospace and growing software sectors. Offsetting 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 revenue growth as salaries and benefits grow in line with revenues. Carrying costs for debt service, pensions and OPEB are moderately low.

Long-Term Liability Burden: 'aaa'
Seattle's long-term liability burden is equally divided between bonded debt and net pension liabilities and is low relative to its resource base.

Operating Performance: 'aaa'
Seattle has exceptional gap-closing ability and is expected to manage through a downturn while retaining a high level of financial flexibility. Seattle's strong budget management and conservative policies result in rapid rebuilding of reserves while funding pay as you go capital and actuarial funding of pension benefits.

RATING SENSITIVITIES

BALANCED OPERATIONS; SOLID RESERVES: Material deviation from Fitch's expectation of the highest gap closing capacity through the economic cycle, while unexpected, would result in downward rating pressure.

CREDIT PROFILE

Seattle continues to experience very strong economic growth, benefitting from Amazon's recent and rapid growth, 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. While Fitch views the city's transition towards a more broadly diversified economic base as a positive credit factor, Boeing and Microsoft and increasingly Amazon, the most significant employers in the region, remain driving forces for the regional economy. 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 personal income. Employment in the information sector is more than double the national average. The performance of this industry is expected 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; city residents have over twice the national rate of advanced degrees.

The city's assessed value (AV) rose almost 60% between 2013 and 2017 as increased employment, a growing population, and the significant development plans by Amazon and other companies led to a more active and higher priced real estate market. Fitch expects additional growth, though likely at a slower pace, over the next few years as on-going and planned development projects are completed.

Revenue Framework
Revenues are diversified among property taxes (27% of general fund revenues), sales taxes (23%), business taxes (28%), utility taxes (14%) and other revenues. 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. This 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 benefitting other sources. As demonstrated in the Great Recession, the limitation on levy growth provides solid downside risk in the event of AV declines as the levy still increases by 1% annually.

Revenue growth has outpaced the rate of inflation and GDP by large margins. Ongoing economic growth appears likely to provide similarly paced revenue gains.

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 10% of general fund revenues.

Expenditure Framework
Public safety comprises the bulk of city general fund spending, 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 just over 10% of 2016 governmental expenditures. Pension costs represent about half of the total but are overstated as a significant portion of those pension costs are attributable to and paid by utilities, including the power and water enterprises. The collective bargaining framework in Washington State offers moderate flexibility to make adjustments to personnel spending as needed.

The city and its miscellaneous (non-public safety) unions agreed to create a new pension tier effective Jan. 1, 2017, which has a lower benefit and expected lower contribution rate for the city and should slow the pace of growth of pension costs over time. The OPEB portion of carrying costs is very small as the city only provides an implicit rate subsidy for retirees.

Long-Term Liability Burden
The combination of the city's direct and overlapping bonded debt and its direct unfunded pension liability totals about 6.3% 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 net pension liability the remainder.

The city's debt issuance is exclusively for capital projects, with some use of paygo 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's has its own pension system for miscellaneous employees (SCERS) and participates in the state-sponsored system for public safety workers (LEOFF). LEOFF is well funded, the annual pension payment consistently meets the ADC and actuarial assumptions are standard. SCERS has a weak funding ratio, with estimated assets equal to a low 61% of liabilities using a 6% return assumption.

The city council adopted changes to its SCERS pension funding in 2011. These changes require full funding of the actuarially required contribution (ARC) and adoption of five-year smoothing rather than the annual mark-to-market approach used prior to that which had resulted in a lower ratio of assets to liabilities. This is in contrast to the latest GASB guidelines, which now requires reporting on a mark to market basis rather than actuarial smoothing.

Operating Performance
The combination of the city's expenditure flexibility and sizeable reserves are expected to sustain its exceptional financial flexibility throughout economic downturns.

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 this extended economic recovery, the city has pro-actively built up its reserves, increasing unrestricted fund balance to an unaudited $392 million in 2017 from a low of $104 million in 2010. In addition, the pension reforms noted above demonstrate commitment to financial flexibility.

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 paygo capital throughout the economic cycle.

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

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Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)
https://www.fitchratings.com/site/re/10024656