FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Seattle, WA's $90.5MM LTGOs 'AAA'; Affirms Outstanding Ratings; Outlook Stable

Wed 15 Jul, 2020 - 4:29 PM ET

Fitch Ratings - San Francisco - 15 Jul 2020: Fitch Ratings has assigned an 'AAA' rating to the following city of Seattle, WA GO bonds:

--$79.1 million limited tax GO (LTGO) improvement and refunding bonds 2020A;

--$11.4 million LTGO improvement bonds 2020B (taxable).

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

--$262.8 million outstanding unlimited tax (ULT) GO bonds;

--$681.1 million outstanding LTGO bonds;

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

The Rating Outlook is Stable.

The series 2020A bond proceeds will be used to fund various capital improvement projects, as well as refund the city's outstanding 2010B bonds. The series 2020B bond proceeds will be used for certain costs associated with portions of the city's redevelopment of the central waterfront area as well as to help finance a portion of the city's affordable housing rental program. The bonds are scheduled to price via competitive sale on Aug. 11, 2020.

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 Puget Sound. The regional economy is still influenced by Boeing and Microsoft, though the city in particular experienced robust economic growth as Amazon and other technology companies expanded 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 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 revenue growth as employee salaries and benefits track closely with increases in the city's ad valorem and economically sensitive taxes. Carrying costs for debt service, pensions and OPEB are moderately low.

Long-Term Liability Burden: 'aaa'

Seattle's long-term liability burden is about 40% direct and overlapping debt and 60% adjusted 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 even the current downturn while retaining a high level of financial flexibility. Seattle's strong revenue growth and conservative policies result in rapid rebuilding of reserves while funding pay as you go capital 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:

--An inability to address the fiscal challenge triggered by the expected short-term but severe economic contraction, as evidenced by an inability to make sufficient budget adjustments, leaving the city less financially resilient at the end of the recovery period.

--Economic contraction extending well into 2H20 or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained and deep revenue declines and materially erodes the city's gap-closing capacity.

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

Sector-Wide Coronavirus Implications

The recent outbreak of the coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. As severe limitations on economic activity only began very recently, most governments' fiscal and economic data do not reflect any credit impairment. Material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward looking, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Recovery begins from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP remains below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the April 2020 report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Tax-Supported Issuers" on www.fitchratings.com.

Coronavirus - Liquidity Update

Under the Coronavirus Aid, Relief and Economic Security (CARES) Act enacted on March 27, the U.S. Treasury department distributed $150 billion to state and local governments using a population-based formula. The statute limits the use of funds to coronavirus expense reimbursement rather than to offset anticipated state tax revenue losses. Seattle received $152 million from the CARES Act which it expects to spend on costs consistent with federal guidelines, including budgeted payroll expenses for public health and public safety personnel whose services are dedicated to mitigating the impact of the coronavirus. Fitch notes the uncertainty surrounding which budget items will ultimately be reimbursable by CARES Act money. The city reports that is has sufficient liquidity to manage through the decline in revenues due to its high fund balance, CARES Act funding and internal other borrowable resources.

Coronavirus - City Budget Update

The city currently projects a $378 million budget gap for 2020, consisting of a $145 million revenue shortfall, mainly due to declines in sales (about 9% below budget) and business taxes (about 10% below budget), and $233 million in unbudgeted spending on its coronavirus response. The city expects to solve this gap through FEMA reimbursements, CARES Act funding and coronavirus relief for about $188 million, with the remaining $190 million gap solved through budget adjustments ($69 million), use of general fund-based rainy day and emergency funds ($29 million), other one time sources ($36 million) and other miscellaneous solutions ($56 million). The $145 million revenue loss represents about 9% of budgeted 2020 spending.

For fiscal 2021, the city estimates a revenue loss of $293 million, which totals about 18% of 2020 budgeted revenues. The city plans to address this shortfall through across the board spending reductions of 5% -10%, additional use of rainy day reserves, use of unspent department balances, reallocation of voted levies to cover 'base budgets', negotiate labor concessions, layoffs or new revenue proposals. This revenue impact is reasonable when compared to Fitch's Analytical Stress Test (FAST) which, while not a forecast, represents Fitch's assessment of possible revenue behavior in a downturn.

The city's unaudited 2019 results point to a $121 million net operating surplus (about 7.6% of 2019 spending), bringing the city's unrestricted fund balance to $334 million, equal to about 21% of fiscal 2019 expenditures and transfers out, and providing strong liquidity during the current crisis. Given the city's high available fund balance and its ability and willingness to make budget cuts, Fitch expects the city to maintain or quickly return to its superior gap closing capacity despite the challenging revenue environment.

CREDIT PROFILE

Until the beginning of the coronavirus recession, Seattle had experienced very strong economic growth, benefiting 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 employment and personal income. 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; 61% of residents have bachelor's degree, almost twice the average national rate of 31%.

The city's assessed value (AV) rose by over 12% on average annually between 2015 and 2020 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 2.2% in the last year and are projected to fall 1.7% in the next year.

REVENUE FRAMEWORK

Revenues are diversified among property taxes (about 23% of 2020 budgeted general fund revenues), sales taxes (20%), business taxes (20%), utility taxes (15%) 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. 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 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 44%, 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 11% of 2018 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 make adjustments to personnel spending as needed. Most of the city's labor agreements expire in December 2021, with a couple expiring in 2020 or 2022. The city settled with the police union in November 2018, replacing the contract that had expired in December 2014. In connection with the new contract, the city made a roughly $65 million payment for back pay with the police union. Given the size of the estimated budget gap in 2021, the city expects to negotiate furloughs or wage adjustments and/or utilize layoffs in order to make the necessary spending cuts.

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.

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 estimates it ended 2019 with about $334 million in unrestricted fund balance, equal to about 21% of spending.

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, the city built up its reserves, increasing unrestricted fund balance to an unaudited $334 million in 2019 from a low of $104 million in 2010. 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

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

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

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

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

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Seattle (WA)	EU Endorsed

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US Public Finance Infrastructure and Project Finance North America

United States
