S&P Global
Ratings

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Seattle; General Obligation; General Obligation Equivalent Security

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Credit Profile		
US$76.83 mil ltd tax GO imp and rfdg bnds ser 2020A due 08/01/2040		
Long Term Rating	AAA/Stable	New
US$11.395 mil ltd tax GO imp bnds ser 2020B due 08/01/2040		
Long Term Rating	AAA/Stable	New

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Seattle's $76.8 million series 2020A limited-tax general obligation (GO) improvement and refunding bonds and $11.4 million series 2020B taxable limited-tax 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.

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, including the series 2020A and 2020B, 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 2020 levy rate is $2.13.

Proceeds of the series 2020A will pay for a variety of projects, the largest of which are streetway improvements to a stretch of the city's downtown waterfront and technology and telecommunication upgrades. Proceeds of the series 2020B will support the city's affordable rental housing program, which includes grants, loans, and other contributions to multiple projects within the city, and for a walkway that connects the city's Pike Place Market area to the waterfront. Inclusive of these issuances, the city will have about $905 million in governmental debt outstanding at the end of 2020.

These issue ratings are based on our view that the city's general creditworthiness is above that of the U.S. sovereign. We do not expect the city to 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.

Credit overview

Seattle came into the COVID-19 pandemic and the rapid onset of the recession with very strong budgetary flexibility and considerable economic momentum in the form of residential and commercial real estate development and job growth in highly compensated professions in information technology and life sciences. With much of this work able to happen remotely, we think a significant portion of the city's economic life has adapted to the pandemic with minimal disruption, but the pandemic also has severely curtailed employment in hospitality and tourism industries, which often pay low wages in a region with a high cost of living. We expect the social component of environmental, social, and governance factors affecting credit quality to be prominent in the intermediate term, with city policymakers seeking to enhance services that reduce and mitigate homelessness and to find policy responses to a national debate over the criminal justice system and local clashes between police and protesters. Our outlook is generally for two years, but we see credit quality as potentially changing more quickly, with the performance of economically sensitive revenue from sales taxes and gross receipts taxes important to budgetary performance and with uncertainty regarding the yield of a novel tax slated to take effect in 2021.

The ratings further reflect our assessment of the city's:

- Unusually strong income and wealth indicators for a service area with a comparably large population;
- Very strong management, with strong financial policies and practices under our financial management assessment methodology;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 21% of operating expenditures; and
- Very strong debt and contingent liability position, with debt service carrying charges at 5% of expenditures, net direct debt that is 36% of total governmental fund revenue, and overall net debt at less than 1% of market value, but a low funded ratio of 71% for its largest pension liability.

Environmental, social, and governance factors

We believe that the city has elevated exposure to environmental risks, with earthquakes and sea level rise the most prominent. The city has managed seismic risk through revisions to building codes and through the funding of an emergency management office. The city is managing sea level rise through an assessment of vulnerable areas and capital improvements that have included debt-financed improvements to its downtown sea wall.

Social risks appear to be rising, with the most visible related to civil unrest regarding the criminal justice system. In our view, recent prolonged and often violent interactions between law enforcement officers and protestors in the context of a consent decree with a federal court dating back to 2012 regarding police use of force raises the prospect of increased costs to the city in the intermediate term, with the most prominent the potential for increased legal liability and overtime costs. Protests also may have compounded the negative effects of the COVID-19 pandemic and recession for businesses in specific districts in the form of lost revenue and/or property damage. Finally, the recession has increased the number of households at risk of or experiencing homelessness, which has spurred the city to revise its budget this year to use a portion of reserves to elevate affordable rental housing support, among other recession- and pandemic-related responses.

We consider the city's governance risk to be in line with our view of the sector standard, with robust political debate but a functional decision-making process and what we find is timely and public document disclosure regarding policy and budgetary challenges.

Stable Outlook

Downside scenario

Although our outlook incorporates the likelihood that the city's available reserves will decline in 2020 as a result of midyear budget revisions, we could lower the rating if new data or a legal challenge called into question the city's ability to collect revenue in 2021 that is slated to replenish the city's two main designated reserves along with enhancing services. We could also lower the rating if we saw signs that the city was struggling to find sustainable solutions to balance its budget in a weaker revenue environment, particularly if our forward-looking view of economic performance weakened.

Credit Opinion

Very strong economy

Seattle and its region had one of the early clusters of identified COVID-19 infections in 2020 and is going through a period of economic pain that is likely being felt unevenly. Continued controls on gatherings--the area is in Phase 2, which permits restaurants to operate at half capacity--has severely curtailed its hospitality and tourism industry, which has a high proportion of jobs at the low end of the compensation spectrum. The pandemic's negative effect on global trade also poses a risk to the city and its region, in our view, although we understand that much of the contraction is related to aircraft (manufactured just outside the city) and agricultural products, rather than services, much of which can be delivered online. Overall, we think the increasing prominence of jobs in the region that require high levels of human capital, such as in information technology and life science, means that a substantial portion of the local activity has been able to adapt to a remote work environment with minimal friction. Similar to its peers, the city's overlapping county enjoyed a prolonged period of low unemployment rates below 5%, but the rapid onset of the recession has disrupted this, with a doubling to 6% in March and a peak of 15% in April.

With infections continuing to climb nationwide, we don't expect Seattle to be an exception to our expectation of a recession turning to a weak recovery this year. There is also a risk that public health measures associated with the pandemic could reduce demand for urban real estate, but anecdotal evidence of office investments and leases and the resiliency of owner-occupied residential real estate prices suggest that the city's property values are holding up even if momentum slows from what has until recently been a period of rising prices and real estate development throughout the city. Average annual market value growth has averaged a robust 12% from an already large base during the past five years, and stands at $258 billion. The city also entered the recession with some of the strongest metrics of its peers of comparable size, with per capita market value of $338,900, and we project its 2023 per capita effective buying income at 186% of the national level.

The performance of major regional employers during the recession appears likely to have countervailing effects on Seattle's economic performance. Aircraft manufacturer Boeing, which has major operations to the north and south of the city, remains a major regional employer and has seen its sales damaged by both quality problems that caused the worldwide grounding of its 737-Max model and now from a severe downturn in global travel. Recent announcements from company leadership point to the potential for additional job cuts in the coming year. By contrast, the pandemic's acceleration of a shift to remote working and online collaboration tools seems to have bolstered the fortunes of Amazon (headquartered within the city) and Microsoft, which is headquartered outside the city but to which many residents commute. Amazon has instructed its office employees to expect to work remotely through the end of 2020, and remote work could have a centrifugal force on jobs that could be done remotely given the city's high housing costs, but we are not seeing signs that either of these prominent employers or local ones in the industry are decentralizing or relocating core operations.

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 and an external economic forecaster to model revenue assumptions;
- 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;
- Monthly 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 and is slated to nearly fully tap these reserves in 2020 before replenishing them with an adopted new tax taking effect in 2021.

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, 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. However, amid debates regarding budget-balancing options and changing spending priorities, the city has not updated its long-term financial forecast to provide context for the long-term implications of shifts in the city budget.

The city has a formal information security policy that addresses such issues as controls and training and provides for continuing threat assessments, including external penetration tests to identify gaps. The city has recently purchased cybersecurity insurance.

Strong budgetary performance

We view Seattle's budgetary performance as strong despite this weakened economic environment given a combination of likely resiliency in a portion of a diverse tax revenue structure and given the recent adoption of a new employer tax taking effect in 2021 to help pay for increased service needs. Property taxes and utility taxes, which tend to hold up in recessions, made up 36% of general fund revenue in 2019 (unaudited), while gross receipts taxes from businesses and sales taxes, the latter of which are at risk of a downturn, made up 38%, although under the state's point-of-delivery allocation system the city will continue to realize sales tax revenue that occur in person or online within the city. Performance during the recent expansion has generally been strong, with 3% general fund net results during 2016 and 2017 and a negative 1% result in 2018 (reflecting, in part a retroactive salary settlement) followed by a swing to what we consider a very strong 6% positive general fund result in 2019 (unaudited) when considered in combination with a 1% total government fund result. Our calculation of the city's budgetary performance includes an analytic adjustment to treat recurring transfers out as expenditures.

For 2020, the city has been trying to get a handle on its operating gap, with the optimistic scenario from a spring analysis anticipating that general fund revenue will come in the equivalent of 10%-of-expenditures below budget and the pessimistic scenario at 12% below. On the spending side, the city estimated that the pandemic has fueled net new spending of the equivalent of 11% of expenditures in areas such as emergency response, homelessness services, and mitigation for household hunger. In the city's June 2020 synthesis of the effects of the pandemic and recession on the general fund, including redirections of already-budgeted spending, the city estimated its net budgetary gap at $233 million, or the equivalent of 16% of expenditures in the adopted budget. In response, the city has frozen hiring, taken actions to maximize eligibility for federal grants for pandemic response, and directed department heads to identify nonessential spending in advance of proposals to cut expenditures by 5% to 10% of baseline in 2021.

We see a negative net result for 2020 as very likely in this environment, with the council deciding in July 2020 to tap the city's emergency and "rainy day" reserves to absorb approximately four-fifths of the city's general fund operating gap. (We understand that the mayor has vetoed the proposal, but public statements suggest that the council is likely to override that veto.) In addition, the council is slated in August 2020 to consider a proposal by the mayor for additional spending to address the pandemic and recession. At the same time, the city has set itself up to replenish its two main reserves in 2021 through a new tax on employers with highly compensated employees. The tax applies to marginal compensation above set levels on a graduating scale tied to the size of qualifying employers by size of sales. The city estimates that the tax, which takes effect in January 2021 but for which the city likely won't receive receipts until January 2022, will generate $214 million, or about 2.5x the amount needed to replenish the reserves. The ordinance provides for the city to allocate the residual of the proceeds to pandemic- and recession-related services in 2021 and beyond.

Although the pandemic and the recession represent the city's most pressing budgetary challenge, longer-range costs for infrastructure maintenance appear likely to compete with the likelihood of rising pension contribution requirements in the 2020s as a risk to budgetary performance. The discovery of cracks in the main bridge that connects the city center to its southwestern neighborhoods forced its closure just as traffic fell in response to public health measures, partly obscuring the negative effects on the city's transportation network. We understand that engineering complexity and cost have complicated discussions regarding the bridge's replacement, and the city's inventory of other aging bridges points to significant capital needs that would be difficult to address without voter-approved tax increases or GO authorizations.

Very strong budgetary flexibility

Seattle's budgetary flexibility was very strong going into the recession, in our view, with an available fund balance in fiscal 2019 of 21% of operating expenditures, or $334.3 million. 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 and we have adjusted expenditures to include recurring transfers out. This year probably will see a substantial portion of this base erode, which we think will be common among the city's peers, but the city is unusual in that it is also adopting a significant tax to replenish its emergency and revenue stabilization reserves next year, while funding spending on programs targeted at mitigating the effects of the recession and the pandemic.

Very strong liquidity

In our opinion, Seattle's liquidity is very strong, with total government available cash at 71% of total governmental fund expenditures and 14x governmental debt service in 2018. 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. Management has confirmed that the city has no alternative financing obligations outstanding.

We do not consider the city's investments aggressive, with U.S. agency, government-sponsored enterprise, and U.S. Treasury obligations making up 55% of the city's portfolio as of June 2020, followed by the state investment pool (18%), municipal bonds (16%) and repurchase agreements, corporate bonds, and commercial paper (9%).

The city has agreed to loan, on a contingent basis, sufficient and timely resources to enable two obligors to meet debt service obligations, one of which the city has already assumed. Should the other obligor stop making payments, we don't believe this would constitute a material liquidity challenge, with the city's $1.7 billion in primary government cash and investments as of the end of 2018 dwarfing potential additional annual payments of $3.9 million.

Very strong debt and contingent liability profile

Total governmental fund debt service is 5% of total governmental fund expenditures, and net direct debt is 36% of total governmental fund revenue. Overall net debt is low at 0.5% of market value.

We anticipate that the city will continue a pattern of annual limited-tax GO issuances to address a mix of capital needs, with the list for 2021 pointing to $50 million to 60 million, according to management. 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, with the trial scheduled to begin in November 2020. 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. Of the current five overrides, the most proximate expiration, for low-income housing, happens in 2023. 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 $37 million at the end of 2020. Our calculation of the city's direct debt includes these obligations.

Pension and other postemployment benefit (OPEB) highlights

- We do not consider the city's pension and OPEB liabilities an immediate source of credit pressure given low carrying charges relative to total governmental expenditures in the intermediate term.

- However, we anticipate that the city will take several years to achieve our calculation of minimum funding progress associated with its largest net pension liability even if it adheres to its policy of meeting or exceeding the annual required contribution using a closed amortization approach, and we think the actuarial assumptions underlying the annual required contribution could lead to volatility in contributions.
- We consider the city's OPEBs, which it funds on a pay-as-you-go basis, manageable.

The city's major plans consisted of:

- Seattle City Employees' Retirement System: 71.5% funded with the city's proportionate net pension liability of $1.2 billion (as of Dec. 31, 2019)
- Law Enforcement Officers and Fire Fighters (LEOFF) 1: 144.2% funded (as of Dec. 31, 2018)
- LEOFF 2: 118.5% funded (as of Dec. 31, 2018)

The city separately tracks two closed single-employer plans using Government Accounting Standards Board Statement No. 73 guidelines as of Jan. 1, 2018:

- Firefighters' Pension Fund: 24.9% funded with the city's unfunded actuarially accrued liability of $57.2 million
- Police Relief and Pension Fund: 9.3% funded with the city's unfunded actuarially accrued liability of $85.1 million

The city's OPEB liabilities as of Dec. 31, 2018 consisted of:

- City of Seattle Blended Health Care Premium Subsidy Plan: $61.1 million total OPEB liability
- LEOFF 1 Fire Employees: $268.8 million total OPEB liability
- LEOFF 1 and Escalator Employees: $297.4 million total OPEB liability

The city's pension and actual OPEB contributions totaled 6.2% of total governmental fund expenditures in 2018, with 5.1% consisting of pension contributions and 1.1% OPEB payments.

The city has shifted its approach to funding its Seattle Employees' Retirement System liability during the past decade, and made contributions slightly in excess of the annually required contribution (ARC) in 2018 and 2019 to start to smooth out the curve of future payments. In 2012, the city shifted its asset valuation to a five-year smoothing approach and formally declared its intention to fund its actuarially calculated ARC for the city-managed pension system based on a 30-year amortization (leaving 22 years after 2019). It has consistently met or exceeded 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. In 2019 city switched to a 7.25% discount rate from 7.50%, but this still exceeds our baseline assumption of 6.0% for realistic asset performance and, combined with a level-percentage basis approach, the city's path to fully funding its liability could meander. Of significance to long-term costs, in our view, was the city's adoption of a new, lower-cost tier for employees hired beginning in 2017.

The contractually required contributions (CRCs) of the city's LEOFF liabilities exceeded both static funding and minimum funding progress, indicating our view of timely progress in reducing pension liabilities. The CRCs, which are developed using the same approach as the actuarially determined contributions (ADCs), are not updated following passage into law biennially and so can diverge from the annually updated ADCs. However, because CRCs determine funding requirements using an approach that approximates 10- to 15-year level percent open amortization, timely progress on reducing liabilities is still made even when ADCs surpass CRCs, so we believe costs will likely remain stable. However, the plans' 7.4%-7.5% discount rates increase contribution volatility relative to our 6.0% national baselines.

The city's actuarial OPEB liabilities totaling $627.3 million consist of an implicit subsidy and, for LEOFF 1 employees, 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, partly as a result of discretion over the quality and frequency of financial reporting.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- U.S. Real-Time Economic Data Suggests Hopeful Signs Of A Recovery Could Be Short-Lived, July 16, 2020
- The U.S. Faces A Longer And Slower Climb From The Bottom, June 25, 2020
- U.S. Local Government Mid-Year Sector View: Unprecedented And Unpredictable, July 29, 2020
- Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of August 4, 2020)		
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
Seattle GO		
Long Term Rating	AAA/Stable	Affirmed

Ratings Detail (As Of August 4, 2020) (cont.)		
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 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