FitchRatings

Seattle, Washington

New Issue Summary

Sale Date: May 5, 2021	
Series: Limited Tax General Obligation (LTGO), Series 2021A; LTGO, Series 2021B (Taxable)	
Purpose: Various capital projects	
Security: Limited tax	

Seattle's 'AAA' Issuer Default Rating (IDR) and GO bond rating 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 Ratings 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. While Boeing has long been the largest regional employer, it is believed that, with recent layoffs at Boeing, Amazon is now the largest regional employer followed by Boeing and Microsoft. The city in particular experienced robust economic growth as Amazon and other technology companies expanded downtown, fostering complementary multiuse development. The workforce is highly educated, helping sustain above-average economic and revenue growth. The recessionary impact of the pandemic-related economic disruption on employment has been fairly modest, with total employment down about 2.3% yoy in February 2021. The February unemployment rate was 4.6%, 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. The limit of 1% annually in the city's ability to independently raise the property tax levy offsets some of this strength.

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 ad valorem and economically sensitive taxes. 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 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. Seattle's strong revenue growth and conservative policies result in rapid rebuilding of reserves during periods of expansion while funding pay as you go capital and actuarial funding of pension benefits.

Public Finance
Tax-Supported
U.S.A.

Ratings

Long Term Issuer Default Rating	AAA

New Issues

$165,360,000 General Obligation Limited Tax Improvement & Refunding Bonds, Series 2021A	AAA
$21,460,000 General Obligation Limited Tax Improvement Bonds (Taxable), Series 2021B	AAA

Outstanding Debt

General Obligation Limited Tax Improvement & Refunding Bonds	AAA
General Obligation Limited Tax Improvement & Refunding Bonds (Taxable)	AAA
General Obligation Limited Tax Improvement Bonds	AAA
General Obligation Limited Tax Improvement Bonds (Taxable Build America Bonds-Direct Payment)	AAA
General Obligation Limited Tax Improvement Bonds (Taxable)	AAA
General Obligation Unlimited Tax Improvement Bonds	AAA
General Obligation Unlimited Tax Refunding Bonds	AAA

Rating Outlook

Stable

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (March 2020)

Related Research

Fitch Rates Seattle, WA's $169MM LTGOs 'AAA'; Affirms Outstanding Ratings; Outlook Stable (April 2021)

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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:

- Given uncertainties, ability to match revenues and expenditures once recovery takes hold.
- If sustained, slower revenue growth could weaken the city's revenue framework.

Current Developments

Near-Term Budget Relief

The recently enacted the American Rescue Plan Act (ARPA) will provide $350 billion in direct aid to state and local governments, transit systems and school districts (through the states) as well as a significant amount of economic stimulus that should have a positive near-term impact on state and local government revenues. Fitch does not expect the stimulus aid to alter the long-term credit fundamentals of state and local governments, but it should bridge near-term fiscal gaps (for more information, see "ARP Boosts State and Local Government Budgets," dated March 2021). The city's allocation from the ARPA is about $239 million, or almost 30% above fiscal 2021 budgeted general fund revenues. The city expects to receive and spend about half in 2021 and the other half in 2022.

Due to the shelter in place orders enacted in March 2020 and related coronavirus mitigation efforts, 2020 general fund revenues declined 6% compared to 2019, led by business & occupancy (B&O) taxes, down 17.7% yoy, and sales taxes that were down almost 13% yoy. In addition, other revenues were below budget by about $129 million compared to budget. Parking and license and permit revenues were below budget by about $40 million, and the sale of a large city-owned parcel expected to bring in $66.5 million was delayed to 2021. In response to declining revenues and additional expenses related to coronavirus mitigation, the city made some spending adjustments (paused contracts, enacted a hiring freeze) and appropriated a portion of its rainy day and emergency reserves ($39 million) and utilized $65 million in coronavirus relief funds to support eligible spending. The city's unaudited results for 2020 show a net deficit after transfers of $61.6 million, reducing unrestricted fund balance to a still sound $259.7 million (15.7% of spending) from $334.4 million (21% of spending).

2021 Budget Update

The city closed a projected 2021 funding gap with a new payroll tax, adopted by city council in July 2020, which is projected to generate $214 million in new revenues in 2021, as well as additional use of reserves of about $44 million. The budget, which was adopted in November 2020, assumes some recovery in sales and B&O taxes and increased property tax delinquencies but does not include receipt of $120 million in ARPA funding for 2021. Another $119 million in ARPA funds is expected in 2022. The city reduced its police department budget by 11%, including a 4.6% reduction in force realized through elimination of vacant positions/attrition.

Although employers began incurring liabilities under the new payroll tax in January 2021, the tax will not begin to be collected until the end of the year, delaying somewhat the understanding of how this new tax will perform. 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. While there are risks associated with this new revenue in its first year, the unbudgeted ARPA funds and the city's solid unrestricted fund balance significantly mitigate revenue uncertainty.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	4/22/21
AAA	Affirmed	Stable	4/15/04
AAA	Assigned	—	2/12/99

Credit Profile

During the economic expansion leading to the beginning of the coronavirus-related 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 toward 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. 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; 64% of residents have bachelor's degree, almost twice the national average of 32%.

The city's assessed value (AV) rose by over 8% on average annually between 2011 and 2021 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 8.2% in the last year, after dipping slightly in late 2019.

Revenue Framework

Revenues are diversified among property taxes (about 22% of 2020 unaudited general fund revenues), sales taxes (16%, though closer to 20% in normal years), business taxes (18%), 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 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 boost revenues 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 with temporary lifts on the levy 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 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 2019 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. Twenty-one of the city's 24 collective bargaining units, including with the coalition of city unions or similar, have contracts that expire Dec. 31, 2021. The remaining three are in negotiations, including for the police officers’ guild, which had been delayed due to the pandemic.

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, with the Fitch-adjusted net pension liability representing the remainder.

The city's debt issuance is exclusively for capital projects, with some use of pay-go for smaller projects. Fitch expects the city's debt burden to remain low relative to personal income given its practice of moderate, regular debt issuance, above-average pace of debt amortization and strong income growth. The city has its own pension system for miscellaneous employees Seattle City Employees' Retirement System (SCERS) and participates in the state-sponsored system for public safety workers Law Enforcement Officers' and Firefighters' Retirement System (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 sizable reserves are expected to sustain its exceptional financial flexibility throughout economic downturns. The city's unaudited results for 2020 show a moderate use of unrestricted fund balance ($74.6 million, $39 million of which was from emergency and stabilization reserves), ending the year with a $259.7 million unavailable fund balance, equal to about 16% of spending.

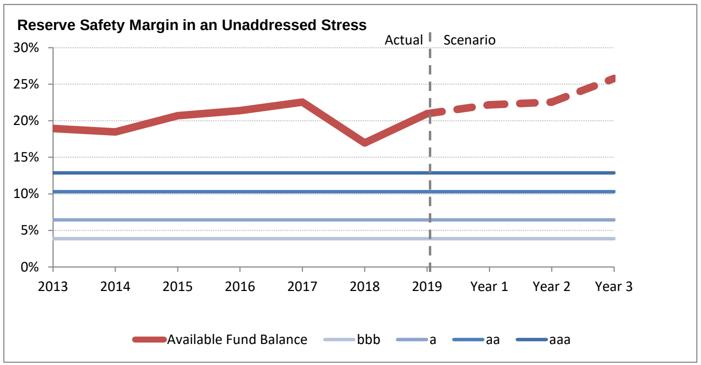
The city has demonstrated a strong commitment to financial flexibility through efforts to control costs, improve pension funding, maintain reserves, and utilize extensive and conservative financial forecasting. In addition, the city has a track record of funding key services such as public housing, library, 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 that followed the Great Recession, the city built up its reserves, increasing the unrestricted fund balance to a peak of $334 million in 2019 from a low of $104 million in 2010. In addition, the aforementioned pension reforms demonstrate the city’s commitment to financial flexibility.

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 www.fitchratings.com/esg.

Seattle (WA)

Scenario Analysis



Analyst Interpretation of Scenario Results:

The combination of the city's solid expenditure flexibility and sizable reserves are expected to sustain its exceptional financial flexibility throughout economic downturns. The city's unaudited results for 2020 show a moderate use of unrestricted fund balance ($74.6 million, $39 million of which was from emergency and stabilization reserves), ending the year with $259.7 million unavailable fund balance, equal to about 16% of spending.

Scenario Parameters:			Year 1	Year 2	Year 3
GDP Assumption (% Change)			(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)			2.0%	2.0%	2.0%
Revenue Output (% Change)	*Min Y1 Stress:* **-1%**	*Case Used:* **Moderate**	(2.6%)	1.2%	4.9%
Inherent Budget Flexibility				Midrange	

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2013	2014	2015	2016	2017	2018	2019	Year 1	Year 2	Year 3
Total Revenues	1,098,175	1,160,753	1,218,733	1,330,045	1,404,724	1,541,640	1,685,569	1,642,199	1,661,479	1,743,257
% Change in Revenues	-	5.7%	5.0%	9.1%	5.6%	9.7%	9.3%	(2.6%)	1.2%	4.9%
Total Expenditures	855,584	897,493	902,662	1,021,753	1,083,903	1,548,449	1,564,503	1,595,793	1,627,709	1,660,263
% Change in Expenditures	-	4.9%	0.6%	13.2%	6.1%	42.9%	1.0%	2.0%	2.0%	2.0%
Transfers In and Other Sources	39,510	20,027	40,199	48,867	35,248	16,370	10,406	10,138	10,257	10,762
Transfers Out and Other Uses	248,133	275,112	289,603	318,299	303,516	27,951	29,656	30,249	30,854	31,471
Net Transfers	(208,623)	(255,085)	(249,404)	(269,432)	(268,268)	(11,581)	(19,250)	(20,111)	(20,597)	(20,709)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	33,968	8,175	66,667	38,860	52,553	(18,390)	101,816	26,295	13,173	62,285
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	3.1%	0.7%	5.6%	2.9%	3.8%	(1.2%)	6.4%	1.6%	0.8%	3.7%
Unrestricted/Unreserved Fund Balance (General Fund)	208,926	216,670	246,826	286,457	312,781	267,553	334,350	360,645	373,818	436,103
Other Available Funds (GF + Non-GF)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Other Available Funds)	208,926	216,670	246,826	286,457	312,781	267,553	334,350	360,645	373,818	436,103
Combined Available Fund Bal. (% of Expend. and Transfers Out)	18.9%	18.5%	20.7%	21.4%	22.5%	17.0%	21.0%	22.2%	22.5%	25.8%

Reserve Safety Margins	Inherent Budget Flexibility				
Moderate	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	41.2%	20.6%	12.9%	7.7%	5.1%
Reserve Safety Margin (aa)	30.9%	15.4%	10.3%	6.4%	3.9%
Reserve Safety Margin (a)	20.6%	10.3%	6.4%	3.9%	2.6%
Reserve Safety Margin (bbb)	7.7%	5.1%	3.9%	2.6%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.