# S&P Global
## Ratings

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**Summary:**

# Seattle; General Obligation; General Obligation Equivalent Security

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# Seattle; General Obligation; General Obligation Equivalent Security

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| US$147.495 mil ltd tax GO imp and rfdg bnds ser 2021A due 12/01/2041 | | |
| *Long Term Rating* | AAA/Stable | New |
| US$21.46 mil ltd tax GO imp bnds (taxable) ser 2021 due 12/01/2041 | | |
| *Long Term Rating* | AAA/Stable | New |

## Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Seattle's expected $147.5 million series 2021A limited-tax general obligation (GO) improvement and refunding bonds and $21.5 million series 2021B 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 2021A and 2021B, 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 2021 operating levy rate is $2.16.

Proceeds of the series 2021A will pay for a variety of capital projects, the largest of which are repairs to the bridge that connects the city's southwestern neighborhoods to its industrial district and the city as a whole, and to refund a portion of the city's limited-tax GO debt outstanding for interest expense savings estimated at about 17% of refunded principal on a net present value basis. Proceeds of the series 2021B will support capital improvements to city facilities with commercial aspects, including the aquarium and civic events center. Inclusive of these issuances, the city will have about $985 million in governmental debt outstanding at the end of 2021.

### Credit overview

We see Seattle's long-term credit fundamentals during the COVID-19 pandemic as largely enduring, with strengths in the form of clusters of highly compensated professions in information technology and life sciences; a diverse revenue structure and willing voter base that allows the city to tap the city's economic strengths; and formal reserve-filling mechanisms that the city has been able to draw on as revenue fell during the past 12 months. With many jobs able to happen remotely and its largest employer, Amazon, surging on robust demand for online retail and cloud computing services, 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 the 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.

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

- Very strong economy in the center of a broad and diverse metropolitan statistical area;
- Very strong management, with strong financial policies and practices under our financial management assessment methodology;
- Strong budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2020 (unaudited), which closed with operating deficits in the general fund and at the total governmental fund level;
- Strong budgetary flexibility, with an available fund balance of 16% of operating expenditures in fiscal 2020 that could fall to less than 15% in 2021;
- Very strong liquidity, with total government available cash at 81% of total governmental fund expenditures and 17x governmental debt service, and access to external liquidity we consider exceptional;
- Very strong debt and contingent liability profile, with debt service carrying charges at 5% of expenditures and net direct debt that is 38% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Adequate institutional framework score.

### 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 are elevated, in our view, with the most visible related to civil unrest regarding the criminal justice system. The city saw prolonged and often violent interactions between law enforcement officers and protestors in 2020, and 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 if incidents recur. 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, with a statewide eviction moratorium that runs through June 2021 in response to the pandemic potentially masking economic stress for a substantial portion of the city's residents.

We consider the city's governance risk 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

Our outlook incorporates the potential for the city's available reserves to weaken further in 2021 depending on the accuracy of the city's tax projections and the classification of American Rescue Plan grant proceeds. However, we could lower the rating if a weak economic recovery or complications from the new employer tax lead the city to draw on reserves through 2022 without a credible recovery plan, particularly if they fell below our "strong" threshold of 8% of adjusted expenditures.

## Credit Opinion

### Very strong economy

Seattle's economic experience during the recent recession and pandemic have been uneven, with controls on gatherings severely damaging its hospitality and tourism industry but in some cases benefiting industries that were able to quickly transition to remote work and see revenue soar, such as cloud computing and online retail. The company that leads in these two businesses, Amazon, has told employees to expect to be required come back to the office by July 2021, partly as a result of its executive team's view that in-person work is essential to the company's culture. As the region seems to be deploying vaccines effectively, we expect that long-dormant downtown office employers will make similar decisions to bring staff into the office again in the second half of 2021, but that changes in remote work policies and office cultures could prolong the recovery in the city's downtown population. The pandemic's downside risks to global trade appear to have mostly gone unrealized locally, and the most important influence on aircraft manufacturing in the intermediate term has been regulatory approval for airlines to resume flying the Boeing's 737-Max model, a popular model that was grounded as a result of deadly crashes.

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, has meant that a substantial portion of the city's households have thrived economically during the past 12 months, with climbing ownership residential values and less spending on travel only partly redeployed to home improvement. At the same time, we think that a large portion of the city's households with members working in lower-paid industries such as hospitality and tourism are likely under economic strain, with a likely lifting of the state's eviction moratorium potentially exacerbating the city's homelessness challenges by the end of 2021. We understand that hotel stays associated with regional travel are starting to return, but we don't anticipate substantial intercity tourism or business travel to come back in substantial form until 2022, suggesting that a hiring recovery in these industries will be slow. The city's overlapping county's unemployment rate spiked to 15% in April 2020 (compared with 2% in April 2019) as the most recent recession took hold, but has mostly eased in the succeeding months, with preliminary data showing an 8% unemployment rate for 2020 and preliminary January 2021 figures pointing to 6%.

Values for owner-occupied residential prices continue to climb, while hotel and office properties have likely weakened in the wake of the pandemic, suggesting that the city's already slowing market value growth trend has come to an end and might reverse slightly in 2022 as revised assessments start to show up on the tax rolls. The city's market value

stands at $262 billion after 10% average annual growth during the past five years, and its metrics are among the strongest among peers of comparable size, with per capita market value of $345,500, and we project its 2024 per capita effective buying income at 189% of the national level. Boosting long-term growth potential, in our view, are sustained resources available for transportation infrastructure, with recurring voter support for multiyear city property tax overrides dedicated to transportation and multiyear authorizations for the regional transit agency's capital program, which includes the opening of three stations in the city's North End in fall of 2021.

## 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 draw on a portion of these reserves through 2021 before rebuilding them during 2022 to 2024.

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 in mid-2020, the city did not perform a supplemental long-term financial forecast to provide context for the long-term implications of shifts in the city budget prior to its annual scheduled update.

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 cybersecurity insurance.

## Strong budgetary performance

We view Seattle's budgetary performance as strong, reflecting our view that a new employer tax and resiliency in its largest revenue stream, property taxes, will translate into balanced operations in 2021 and positive operations in 2022 after a negative 2020 (unaudited).

The pandemic and rapid recession onset dented the city's 2020 revenue, with the general fund losing 6% overall in 2020, resulting in negative general fund net results of 4% of expenditures (adjusted to include recurring transfers out) and negative total governmental fund results of 6% of expenditures, following positive net results of 6% and 1% in the prior year. Among the city's most prominent revenue streams, business gross receipts (making up 18% of 2020 total general fund revenue) took the largest hit with a loss of 18%, but sales tax revenue (16%) also fell by a substantial 13%, and utility taxes (16%), which we find tend to be resilient during recessions, grew by 1%. At the same time, property tax revenue, which made up 22% of 2020 total revenue, was a bright spot, with 10% growth. The city amended its budget midyear using a variety of measures, including some redeployment of spending to absorb pandemic costs, a hiring freeze, and suspension of some capital projects. These changes appear to have substantially narrowed last year's general fund losses, with what management estimated was a 16%-of-expenditures baseline gap.

A new tax on employers with highly compensated employees, a slow recovery in economically sensitive revenue, and the likelihood of federal grants under the American Rescue Plan point to a rebound in net results by 2022. The new tax, which applies to marginal compensation above set levels on a graduating scale tied to the size of qualifying employers by size of sales, has a nexus with where the employee works, so the city is positioned to realize revenue in cases where city residents normally work in offices outside of the city--many Microsoft employees, for example, commute to nearby Redmond to work--but the most important influence is likely to be how fast employers reopen their offices. The city estimates that the tax, which took effect in January 2021 but which the city likely won't receive receipts for until January 2022, will generate $214 million, or the equivalent of about 13% of general fund expenditures. The city expects a much smaller aggregate $33 million increase from ongoing tax revenue this year, and initial calculations suggest the first payment under the American Rescue Plan in mid-2021 will be about $120 million.

Although the revenue effects and service demands associated with the pandemic represent the city's most pressing budgetary challenge, longer-range costs for infrastructure appear likely to compete with the likelihood of rising pension contribution requirements in the 2020s as a risk to budgetary performance. In particular, there are also looming bills to repair or replace the city's aging bridges--some of which could be funded with federal grants if existing proposals proceed--and we think that the scope of the challenge could represent drag on general fund performance.

## 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, but hits to revenue associated with the recent recession and the pandemic lowered this ratio to 16% for 2020, and we think the ratio may drop more modestly for 2021.

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. Relative to what we understood in mid-2020, the city's draws on reserves were both milder in 2020 but likely to extend into 2021, despite the presence of a significant new employer tax. Under the city's planning model, the city will draw down its emergency and "rainy day" funds to about one-third of their size at the end of 2019 and then restore them incrementally during 2022 to 2024. Accordingly, our assessment takes into account the potential that the city's available general fund balance could dip slightly below our "very strong" threshold of 15% of expenditures for 2021, but we also see elements in place that will enable this ratio to start to grow again by 2022.

## Very strong liquidity

In our opinion, Seattle's liquidity is very strong, with total government available cash at 81% of total governmental fund expenditures and 17x governmental debt service in 2019. 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 58% of the city's portfolio as of December 2020, followed by the state investment pool (21%), municipal bonds (12%), 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 $2 billion in primary government cash and investments as of the end of 2019 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 38% 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 approximately $50 million to $60 million for general projects and potentially another $60 million to $70 million for further bridge repairs and waterfront projects, 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. 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.

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: 64.1% funded with the city's proportionate net pension liability of $1.5 billion (as of Dec. 31, 2019)
- Law Enforcement Officers and Fire Fighters (LEOFF) 1: 148.8% funded (as of June 30, 2019)
- LEOFF 2: 119.4% funded (as of June 30, 2019)

The city separately tracks two closed single-employer plans using Government Accounting Standards Board Statement No. 73 guidelines as of Dec. 31, 2019:

- Firefighters' Pension Fund: 29.4% funded with the city's unfunded actuarially accrued liability of $90.7 million
- Police Relief and Pension Fund: unfunded with the city's unfunded actuarially accrued liability of $92.9 million

The city's OPEB liabilities as of Dec. 31, 2019, consisted of:

- City of Seattle Blended Health Care Premium Subsidy Plan: $60.9 million total OPEB liability
- LEOFF 1 Fire Employees: $269.9 million total OPEB liability
- LEOFF 1 and Escalator Employees: $287.1 million total OPEB liability

The city's pension and actual OPEB contributions totaled 6.0% of total governmental fund expenditures in 2019, with 4.9% consisting of pension contributions and 1.0% OPEB payments.

The city 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 consistent with a plan to fund its actuarially calculated ARC 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.

### Issue rating's relationship with U.S. sovereign rating

Our issue ratings reflect 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.

# 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

- Economic Outlook U.S. Q2 2021: Let The Good Times Roll, March 24, 2021

- Across U.S. Public Finance, All Sectors Stand To Benefit From The American Rescue Plan, March 18, 2021

- State, Local Government, School District, And Charter School Sector Views Revised Back To Stable, March 24, 2021

- 2020 Update Of Institutional Framework For U.S. Local Governments

| Ratings Detail (As Of April 15, 2021) | | |
|---|---|---|
| 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 April 15, 2021) (cont.)

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|---|---|---|
| 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 |
| **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 |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.