S&P Global
Ratings

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Summary:

Seattle; General Obligation; General Obligation Equivalent Security

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Credit Profile		
US$147.495 mil ltd tax GO imp and rfdg bnds ser 2022A due 09/01/2042		
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 2022A limited-tax general obligation (GO) improvement and refunding 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 2022A, 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. The city's 2022 operating levy rate is $2.17.

Proceeds of the series 2022A 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. Proceeds will also refund a portion of the city's limited-tax GO debt outstanding for interest expense savings estimated at about 8% of refunded principal on a net present value basis. Inclusive of this issuance, the city will have about $1.1 billion in governmental debt outstanding at the end of 2022.

Credit overview

We think Seattle's credit profile has weathered the recent recession and COVID-19 pandemic well, with a recent relaxation of most public health controls helping a battered local hospitality industry build on nascent growth in the second half of 2021 and federal grants and a pre-pandemic decision to impose a new employer tax contributing to a bounceback in the city's general fund performance and available reserves in 2021.

Notwithstanding a substantial emptying of activity in its downtown and a national narrative regarding dispersal of highly compensated remote workers to the edges of metropolitan areas nationwide, we don't think the city's economic fundamentals have changed in a material way. The city's life sciences cluster likely has benefited from increased policymaker and investor attention as a result of the pandemic and resilient residential real estate prices that continue to attract households with means. Less clear is the future of office occupancy, with a shift to partial remote work potentially allowing workers to live further away and reduce spending downtown but with the local dominant employer, Amazon, appearing to be keeping to its plans to add office capacity. Pandemic conditions continue to suppress the hospitality industry, with travel from Asia curtailed, but we think that growth in domestic leisure travel in 2021 has likely set the stage for a partial recovery in business travel in 2022 and that it will add to sales and lodging tax revenue this year.

We expect the social component of environmental, social, and governance factors affecting credit quality to continue to be prominent, with housing affordability a key concern, but the new employer tax is being deployed for priorities such as affordable housing development and equitable community development in 2022 after helping shore up the budget in 2021.

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

- Very strong economic profile, including a projected per capita effective buying income of nearly 2x the national level, which is unusually strong for a city of its size;
- Very strong management, with strong financial policies and practices under our financial management assessment methodology;
- Very strong budgetary performance in 2021 that boosted the adjusted available general fund balance to what we consider a very strong 24% of expenditures from a more than five-year low of a still very strong 15% at the end of 2020; and
- Very strong debt and contingent liability profile, which is unusual for a city of its size, with debt service carrying charges at just 4% of governmental expenditures and pension and other postemployment benefits (OPEB) carrying charges of 6% of expenditures.

Environmental, social, and governance

In our view, the city has elevated exposure to sea level rise, which we consider a form of chronic physical risk, and is addressing the implications through an assessment of vulnerable areas and through capital improvements that have included debt-financed improvements to its downtown seawall. The city has managed the risk of natural disasters, particularly earthquakes, through revisions to building codes and through the funding of an emergency management office.

Social capital risks also are elevated, in our view, with a substantial number of households at risk of or experiencing homelessness and a continuation of a pattern of rising ownership and rental prices likely exacerbating the problem and planning policies in the region seemingly not providing the conditions for additions to supply to match demand growth. The city is responding to this challenge in multiple ways, including generating resources for affordable housing development through a recently adopted employer tax and a voter-approved property tax override. In abeyance after 2020 have been major protests regarding the criminal justice system, but a consent decree with a federal court dating back to 2012 regarding police use of force remains in effect and we think this topic will remain an area of focus for management and policymakers.

We consider governance risk neutral within our criteria framework, 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

We see the risk of a negative rating action receding given a bounceback in budgetary performance in 2021 and our expectation of sustainable operations during the next two years. The most likely scenario that could lead to a lower rating is a combination of factors such as a weak economic recovery and sustained elevated inflation leading to negative general fund net results without a credible recovery plan, particularly if the adjusted available general fund balance fell below our strong threshold of 8% of adjusted expenditures.

Credit Opinion

Residential real estate continues to soar, hospitality is finding its legs but office occupancy remains a question

By at least temporarily degrading urban quality of life, the pandemic has probably dented Seattle's ability to attract workers but we see no evidence of an exodus during the past two years and the lifting of public health controls in March 2022 has improved the economic prospects of activities associated with city living, such as dining and concerts. During the pandemic the life sciences and information technology sectors, which have outsized presences in the city, appear to have thrived. Among the eight-industry classification the city tracks for its gross receipts tax revenue, the information sector saw the largest percentage and nominal increase in 2021 relative to 2019, and monthly data from residential real estate data providers Zillow and Apartment List reinforce the story suggested by the assessed valuation pattern, with a slowdown in 2020 followed by a resumption in price growth in 2021.

A recovery of the hospitality sector appears to have started in the second half of 2021 amid a highly vaccinated local population but has further to go. Industry tracker STR reports that the main hotel industry metric, revenue per available room, rose 117% for a period roughly corresponding to March 2021 to March 2022. Similarly, the city's main airport reports its count of screened passengers was up 46% from 2021 for the first week of April 2022. Both metrics seem likely to rise in the coming months as cruise ships began docking in Seattle again in April 2022 and the convention center ramps up trade shows and professional conferences this year. However, with public health controls suppressing travel from Asia and what we understand has been a tepid recovery in business travel so far, we don't think activity or revenue are likely to approximate those of 2019 until 2023.

Another issue surrounds changes in office culture, which has implications for spending by workers nominally based in the city and for a new employer tax based on the time a worker does their work within city limits. We think the city has probably been subject to a national phenomenon of a partial dispersal of workers to the edges of metropolitan areas from city centers, and surveys point to remote work being more prevalent but not pervasive in the coming years. These forces seem likely to slow a recovery in office occupancy and downtown vitality, but we don't think the office occupancy downturn will prove permanent as long as the region continues to attract highly skilled workers whom employers need.

Robust array of institutionalized policies and practices, with recent enhancement in the form of the creation of an independent revenue forecasting role

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, in 2021, a shift of the revenue forecasting role to a position outside the budget office to improve independence and reduce the risk of political conflicts over 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, with the mechanism operating as designed in 2020 and 2021, although the city does not set reserve policy minimums.

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.

Core revenue recovery, new tax appear to have helped the city bounce back in 2021

Seattle substantially restructured its general fund revenue mix for 2021 with the adoption of a tax on employers with highly compensated employees, which has elevated business taxes to its largest single general fund revenue source. The new tax, which generated 13% of general fund revenue in 2021, applies to marginal compensation above set levels on a graduating scale tied to the size of qualifying employers by size of sales, and has a nexus with where the employee works. This means that city realizes revenue in cases where someone works from home but has an office outside of the city--many Microsoft employees, for example, commuted to nearby Redmond to work before the pandemic--but we think the most important influence on revenue performance is likely to be how fast employers reopen their offices. In 2021, new tax generated revenue 16% above estimates at the beginning of the year and was temporarily used for pandemic-related budgetary stresses, but for 2022 is being deployed primarily for housing and housing services (62% of proceeds) but also for economic revitalization (15%), equitable community development (9%), and climate change adaptation (9%).

This new employer tax and federal grants under the American Rescue Plan Act, coupled with a resurgence in sales tax revenue and spending freezes imposed in 2020, helped Seattle post a strong rebound in budgetary performance in 2021. The pandemic and rapid recession onset, plus a one-time factor boosting 2019 excise taxes, led to a 6% general fund revenue decline in 2020 on the weight of a 13% drop in sales tax revenue. But consistent with a pattern we have seen elsewhere, households continued to spend and business gross receipts tax revenue growth was probably the largest single contributor to a rebound in general fund and governmental fund performance for 2021. Management reports that 2021 actual results came in ahead of assumptions at 2022 budget adoption, and we understand that federal grants are likely to be fully encumbered by this year, with the ending 2022 available balance likely to be comparable to that of 2021.

Our calculation of budgetary flexibility includes an analytic adjustment to treat 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. The city drew on its "rainy day" fund (included in the general fund) in 2020 and 2021 but will substantially refill it in 2022, and under current projections, automatic, if small, contributions under the funding mechanism are slated to restore the reserve in 2024.

We anticipate that the liquidity profile will remain very strong for the foreseeable future given the recent recovery in governmental reserves and the availability of cash associated with the city's utility enterprises.

Voter support for multiyear tax overrides that can be used for capital have reduced the need for governmental debt issuance

We anticipate that the city will continue a pattern of annual limited-tax GO issuances to address a mix of capital needs, with management anticipating an issuance in 2023 of similar size or larger than the series 2022A. However, we do not anticipate that 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.

We don't consider the city's pension and OPEB burden large, and the creation of a new tier for its main plan in 2017 and investment gain in 2021 point to slower contribution rate growth

The city's major plans consist of:

- Seattle City Employees' Retirement System: 71.5% funded with the city's proportionate net pension liability of $1.3 billion (as of Dec. 31, 2020)
- Law Enforcement Officers and Fire Fighters (LEOFF) 1: 146.9% funded (as of June 30, 2020)
- LEOFF 2: 115.8% funded (as of June 30, 2020)

The city separately tracks two closed single-employer plans using Government Accounting Standards Board Statement No. 73 guidelines as of Dec. 31, 2020:

- Firefighters' Pension Fund: 25.8% funded with the city's unfunded actuarially accrued liability of $85 million
- Police Relief and Pension Fund: unfunded with the city's unfunded actuarially accrued liability of $100.5 million

The city's OPEB liabilities as of Dec. 31, 2020, consisted of:

- City of Seattle Blended Health Care Premium Subsidy Plan: $63.6 million total OPEB liability
- Firefighters' Pension Fund: $300.9 million total OPEB liability

- Police Relief and Pension Fund: $308.6 million total OPEB liability

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 20 years after 2021). 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 March 2022 the city moved its discount rate to 6.75% 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 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 consist of an implicit subsidy for the smaller single-employer plan for public safety employees qualifying for LEOFF 2 and, for LEOFF 1 employees, a direct subsidy. The city manages this cost on a pay-as-you-go basis, and management thinks the latter has likely peaked as a result of LEOFF 1 eligibility ending for employees hired starting October 1977.

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.

Seattle Key Credit Metrics				
	Most recent	**Historical information**		
		2020	**2019**	**2018**
Very strong economy				
Projected per capita EBI as % of U.S.	195			
Market value per capita ($)	372,163			
Population		737,015	718,564	699,391
County unemployment rate (%)		7.5		
Market value ($000s)	276,293,453	257,958,280	244,938,709	214,109,064
Ten largest taxpayers as % of taxable value	3.5			
Strong budgetary performance				
Operating fund result as % of expenditures		(4.8)	6.4	(1.2)
Total governmental funds result as % of expenditures		(5.9)	1.3	(1.6)
Very strong budgetary flexibility				
Available reserves as % of operating expenditures		15.1	21.0	17.0
Total available reserves ($000s)		250,764	334,350	267,555
Very strong liquidity				
Total government cash as % of governmental funds expenditures		70	81	71
Total government cash as % of governmental funds debt service		1,659	1,724	1,382
Very strong management				
Financial management assessment	Strong			
Very strong debt and long-term liabilities				
Debt service as % of governmental funds expenditures		4.2	4.7	5.1
Net direct debt as % of governmental funds revenue	36			
Overall net debt as % of market value	0.6			
Direct debt 10-year amortization (%)	52			
Required pension contribution as % of governmental funds expenditures		4.6		
OPEB actual contribution as % of governmental funds expenditures		1		
Adequate institutional framework				

Note: Data points and ratios may reflect analytical adjustments. EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022
- 2021 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of April 20, 2022)		
Seattle GO		
Long Term Rating	AAA/Stable	Affirmed

Ratings Detail (As Of April 20, 2022) (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
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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.