FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Seattle, WA's $75.8MM LTGOs and $35.5MM UTGOs 'AAA'; Affirms Outstanding Ratings

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Fitch Ratings - San Francisco - 16 May 2023: Fitch Ratings has assigned a 'AAA' rating to the following city of Seattle, WA general obligation (GO) bonds:

--$75,750,000 limited tax GO (LTGO) improvement and refunding bonds 2023A;

--$35,455,000 unlimited GO (ULTGO) refunding bonds 2023.

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

--$233 million outstanding ULTGO bonds;

--$727 million outstanding LTGO bonds.

Seattle's Issuer Default Rating is affirmed at 'AAA'.

The Rating Outlook is Stable.

RATING ACTIONS

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

VIEW ADDITIONAL RATING DETAILS

The series 2023A bond proceeds will be used to fund various capital improvement projects, as well as to refund the city's outstanding 2013A LTGO bonds. The new money portion of the 2023A bonds will be used for various capital improvements to city facilities, transportation infrastructure, and information technology projects. The series 2023 ULTGO bonds will be used to refund callable 2013 ULTGO improvement bonds. The bonds are scheduled to price via competitive sale on or about June 6, 2023.

SECURITY

The ULTGO and LTGO bonds are a general obligation of the city payable from its full faith and credit and an ad valorem property tax pledge subject to statutory limits.

ANALYTICAL CONCLUSION

Seattle's 'AAA' IDR and GO ratings are supported by expectations for strong economic and revenue growth over the long term, sustained by the highly educated workforce and the dynamic software and aerospace industries that dominate the regional economy. Long-term liabilities are low. The city's somewhat weak revenue raising ability is offset by solid expenditure flexibility and ample reserves relative to moderate expected revenue fluctuations during typical economic downturns. Fitch expects the city to maintain the highest level of gap closing capacity through the current environment and future economic cycles.

Economic Resource Base

Seattle is the largest city in the Pacific Northwest and the cultural and business center of the Puget Sound. Boeing had long been the largest regional employer, but while Boeing has reduced its Washington based workforce, Amazon has been expanding and is currently the largest regional employer followed by Boeing and Microsoft. Through the decade ending 2020, the city in particular experienced robust economic growth as Amazon and other technology companies expanded in downtown, fostering complementary multiuse development.

The workforce is highly educated, helping to sustain above average economic and revenue growth. The recessionary impact on the economy due to the pandemic is fairly modest at this point, and concentrated in the hospitality and entertainment sector. Both revenue per hotel room and diners at restaurants have trailed the national rates since the onset of the pandemic..

Regional job growth has been strong with the city regaining its pre-pandemic job levels. Seattle's March 2023 unemployment rate was 2.5%, 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. Offsetting some of this strength, the city's ability to independently raise its property tax levy is limited to 1% annually.

Expenditure Framework: 'aa'

Over time, expenditure growth is expected to be roughly in line with 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 other post-employment benefits (OPEBs) are moderately low.

Long-Term Liability Burden: 'aaa'

Seattle's low long-term liability burden totals less than 5% of personal income. The liability is 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 economic cycles 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.

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:

--Inability to manage expenditure pressure, especially if revenue growth slows or declines;

--Material decline in available reserves which limit the city's financial flexibility.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

Local Economy Continues to Recover

The regional economy is performing well while based on employment and retail sales figures. Based on unaudited 2022 estimates tax revenues have largely recovered relative to pandemic lows with property, retail sales, and business occupancy taxes. The positive trend is both a function of recovery and the city's new payroll expense tax. However, revenues closely tied to economic activity downtown -- parking meters, court fines, and admissions tax -- all remain below pre-pandemic levels as remote work continues to reduce the number of workers commuting to downtown offices.

For the sales and use tax, strength in trade and construction driven by both an uptick in construction activity and the increasing cost of construction materials. Sales and use tax revenue from leisure and hospitality was also up in 2022 relative to 2021.

Aiding in the economic recovery was a substantial amount of state and federal fiscal stimulus funds. The city received $187 million in 2020, and over $322 in 2021 and 2022, including a total of $232 million in American Recovery and Protection Act (ARPA) funds in two tranches, and other state and federal funds. The city used the ARPA funds for one-time allocations as follows : $67.6 million to maintain fire and other emergency staffing, $61.1 million for basic needs assistance, childcare access and other community, $34.5 million in small business and community grants, and $8.2 million for mental health and community safety programs.

2022 and 2021 Financial Operations

In 2021, the city reported a $202.6 million (or 11.4%) surplus and a general fund ending balance of $717.4 million, including $420 million of unrestricted general fund balance. Based on unaudited 2022 estimates, the city projects an operating surplus of $288.8 million. Total general fund expenditures are projected to be 6.0% higher in 2022 driven in part by higher public safety costs and health and social services expenditures. The higher spending was also tied to pandemic related programs. Property tax revenue growth was modest in 2022, up 2% from the prior year. Total general fund revenues are projected to increase by 2% in 2022 based on unaudited figures to $2.0 billion. Economically sensitive revenue such as sales and hotel taxes which dropped sharply in 2020 remain on a positive trajectory.

As revenues continue to recover in 2022, the city's estimated actuals for 2022 general fund revenues include approximately $130.3 million in payroll expense tax, that amount reflects a decline from the prior year's $248.2 million. However, the lower figure is due to the city's decision to deposit this tax into a separate fund, distinct from the general fund. Approximately $168.1 million was deposited outside of the general fund in 2022. In addition to the modest revenue recovery noted above and the new payroll expense tax helping to balance the budget, through the pandemic, the city also implemented budget reductions, enacted a hiring freeze, reduced professional services contracts, appropriated reserves as necessary and benefited from federal reimbursements of certain expenditures.

While spending increased, the city's 2022 estimates point to a $247.7 million increase to its unrestricted fund balance to $668.6 million, with the total general fund balance projected at $1.0 billion. A portion of this fund balance is also expected to be used on community-led investments.

2023 Budget

The 2023 general fund budget totals $1.6B up 1.3% from the prior year. The 2023 budget is balanced with targeted departmental expenditure reductions totaling 3%-6%. The budget includes a projected combined $10.1 million contribution to its emergency fund and revenue stabilization fund. (In 2022, the city's combined contribution to both reserves equaled $66 million.) The city expects its fiscal reserves to be fully funded (about $159 million) by the end of 2026 or earlier depending on revenue performance.

The city has closed a projected funding gaps with several balancing strategies, including redirecting real estate excise taxes and voter approved levies for allowable uses, use of federal stimulus, and temporarily redirecting a portion of the payroll expense tax to general purposes. In 2021 a portion of the payroll expense tax was redirected (from the intended housing and housing services focus) for the continuation of existing services and programs. As previously noted, in 2022, a portion of the payroll expense tax was directed to the general fund with the remainder being utilized as original planned.

Payroll Expense Tax Litigation Resolved in the city's favor

Employers began incurring liabilities under the new payroll expense tax in January 2021 but the tax was not collected until January 2022. Starting in 2022, the tax was collected quarterly. 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. In addition, the payroll expense tax's constitutionality was challenged. In July 2021 the tax was upheld by the King County Superior Court and the ruling was challenged to the Washington State Court of Appeals.

On June 21, 2022 the Washington State Court of Appeals affirmed the lower court's decision and the primary litigant against the city announced that it would not appeal its case further to the Washington State Supreme Court. While volatility risks remain with this new revenue, the city's solid unrestricted fund balance, expenditure control and strong management provide strong mitigation to revenue uncertainty.

CREDIT PROFILE

During the economic expansion leading to the beginning of the pandemic recession, Seattle had experienced very strong economic growth, benefiting from Amazon's rapid growth, increasing employment by other technology companies, and a strong construction industry. Seattle's tax structure captures this economic growth through property, business, sales, utility and real estate excise (transaction) taxes.

While Fitch views the city's transition towards a more broadly diversified economic base as a positive credit factor, Boeing, Microsoft, and Amazon, remain the most significant employers in the region, driving regional growth. Notwithstanding the recent layoff announcements by several firms in the technology sector, Amazon, Microsoft, and other information technology companies have grown, to the point that 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; 65% of residents have bachelor's degree, almost twice the average national rate of 33%, making it a desirable business location for expansion and new business formation.

The city's assessed value (AV) rose by over 8% on average annually between 2012 and 2022 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 14.6% from February 2021 to February 2022. However, Zillow currently projects the Seattle MSA to experience a decline of 1% by 2024.

Revenue Framework

Revenues are diversified among property taxes (about 21% of unaudited 2022 general fund revenues), sales taxes (19%), business taxes (excluding the payroll expense tax) (19%), and other revenues. The new payroll expense tax generated an additional 7%. 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 provide revenue growth in excess of GDP given the prospects for the region's economy.

Increases to property taxes beyond the levy limit require voter approval, which the city regularly seeks and receives in the form of temporary levy lid lifts for specific uses. The city has the ability to adjust charges for services, permit fees and fines but the combination makes up only about 10% of general fund revenues.

Expenditure Framework

Public safety comprises the bulk of city general fund spending at about 45%, followed by general government, culture and recreation and capital.

Given the nature of Seattle's revenue system and spending responsibilities, Fitch believes that growth in major spending areas is likely to be in line with, to marginally above, expected revenue growth (on average).

The city's fixed cost burden is low, with carrying costs for debt, pensions and OPEB equaling about 10.5% of 2021 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. The city is in negotiations with police officers and fire fighters to replace the contract that expired December 2020 and December of 2021, respectively. A new police management contract was settled in 2022 and runs through December 31, 2023. The unions continue to operate under the expired contracts until a new agreement is ratified. The parties reached tentative agreement in early 2022. The city often makes retroactive pay increases once new agreements have been made and have set aside funds for this possibility. Twenty-eight labor agreements, representing 61% of the city's represented employees, expired at the end of December 2022 and the city is currently negotiating with its bargaining units.

The city and its miscellaneous unions created a new pension tier for its non-uniformed employees effective Jan. 1, 2017, which has a lower benefit and expected lower contribution rate for the city and should slow the pace of growth of pension costs over time. The OPEB portion of carrying costs is very small.

Long-Term Liability Burden

The combination of the city's direct and overlapping bonded debt and its direct unfunded pension liability totals less than 5% of personal income, which Fitch considers a low burden on the city's resources. Bonded debt makes up about 40% of the total liability and the Fitch-adjusted net pension liability the remainder.

The city's debt issuance is exclusively for capital projects, with some use of pay-go for smaller projects. Given the city's practice of moderate, regular debt issuance, above-average pace of debt amortization and strong income growth, Fitch expects the city's debt burden to remain low relative to personal income. The city has its own pension system for miscellaneous employees (SCERS) and participates in the state-sponsored system for public safety workers (LEOFF). LEOFF is currently funded in excess of the liability, while SCERS has an unfunded liability the city is on track to fully pay off by 2042.

Operating Performance

The combination of the city's solid expenditure flexibility and sizeable reserves are expected to sustain its exceptional financial flexibility throughout economic downturns. The city's unaudited results for 2022 show a 15.5% operating surplus ($288.8 million) and an ending general fund balance totaling $1.0 billion including $668.6 million in unrestricted balance or 36% 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 rebuilt its reserves. In addition, the pension reforms noted above demonstrate commitment to financial flexibility.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

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

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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