

## CREDIT OPINION

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# Seattle (City of) WA

## Update to credit analysis

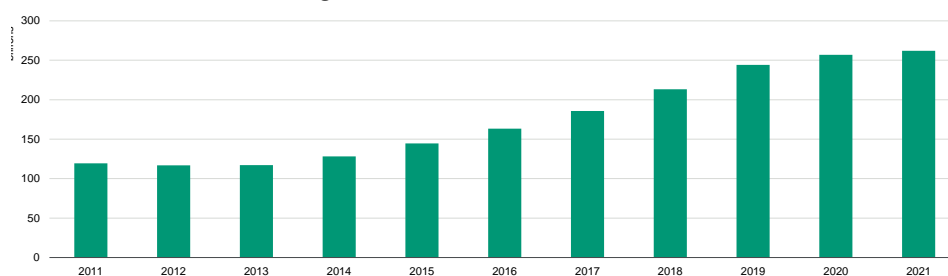
### Summary

The [City of Seattle, Washington](#) (Aaa stable) benefits from a large tax base that forms the economic center of the [State of Washington](#) (Aaa stable). The region includes some of the world's most well-known international corporations, including [Amazon](#) (A2 positive), [Microsoft](#) (Aaa stable) and [Boeing](#) (Baa2 negative). Although the coronavirus pandemic continues to have a significant impact on general economic conditions, particularly for the aerospace and leisure and hospitality sectors, strong underlying fundamentals will help to mitigate some of these challenges. High property values are driven by socioeconomic measures that are amongst the strongest in the country for a large city; residential property values have continued to rise through the pandemic because employment has generally remained strong for those at the upper end of the income scale, though some commercial valuations have likely softened with the rise of remote working.

The city will continue to experience COVID-driven revenue softness into the near future, though the addition of a payroll tax in 2021 and the influx of substantial federal aid will buttress the city's financial profile, which has historically been characterized by healthy reserve levels and liquidity. The ratings also incorporate a very strong management team with prudent institutionalized financial practices. The city's debt profile is manageable, consisting entirely of fixed-rate obligations, and pension and OPEB liabilities are moderate.

Exhibit 1

### Seattle's tax base continues to grow but has slowed



Source: Seattle (City of) WA's financial statements and Moody's Investors Service

### Credit strengths

- » Strong management team
- » City serves as the regional economic center of the Pacific Northwest
- » Strong socioeconomic measures for an urban area including high median family income

- » Healthy financial position that includes ample reserves and available liquidity
- » Favorable debt profile that includes only fixed-rate debt and relatively rapid amortization

### Credit challenges

- » Modest exposure to economically sensitive revenues
- » Somewhat dependent upon a small number of high profile private-sector firms for growth

### Rating outlook

The stable outlook reflects our expectation that the city's healthy financial profile, coupled with a sophisticated management team, strong economic fundamentals and substantial federal aid will provide adequate buffer from the effects of the coronavirus as vaccination rates increase and broader economic conditions improve.

### Factors that could lead to an upgrade

- » Not applicable

### Factors that could lead to a downgrade

- » Material weakening in the city's finances
- » Prolonged deterioration in the economy and tax base
- » Substantial growth in debt and/or pension liabilities

### Key indicators

Exhibit 2

#### Seattle (City of) WA

	2015	2016	2017	2018	2019
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$144,513,932	\$163,305,928	\$185,626,174	\$213,389,284	\$244,195,785
Population	653,017	668,849	688,245	708,823	724,305
Full Value Per Capita	\$221,302	\$244,160	\$269,709	\$301,047	\$337,145
Median Family Income (% of US Median)	155.8%	159.6%	162.9%	165.6%	169.1%
<b>Finances</b>					
Operating Revenue (\$000)	\$1,561,538	\$1,749,022	\$1,932,950	\$2,160,109	\$2,311,406
Fund Balance (\$000)	\$268,656	\$316,907	\$350,326	\$301,709	\$359,444
Cash Balance (\$000)	\$479,428	\$616,475	\$874,485	\$988,475	\$1,066,740
Fund Balance as a % of Revenues	17.2%	18.1%	18.1%	14.0%	15.6%
Cash Balance as a % of Revenues	30.7%	35.2%	45.2%	45.8%	46.2%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$1,040,474	\$1,027,503	\$1,028,140	\$990,550	\$954,445
3-Year Average of Moody's ANPL (\$000)	\$2,177,634	\$2,272,141	\$2,422,195	\$2,471,035	\$2,648,183
Net Direct Debt / Full Value (%)	0.7%	0.6%	0.6%	0.5%	0.4%
Net Direct Debt / Operating Revenues (x)	0.7x	0.6x	0.5x	0.5x	0.4x
Moody's - ANPL (3-yr average) to Full Value (%)	1.5%	1.4%	1.3%	1.2%	1.1%
Moody's - ANPL (3-yr average) to Revenues (x)	1.4x	1.3x	1.3x	1.1x	1.1x

Sources: US Census Bureau, Seattle (City of) WA's financial statements and Moody's Investors Service

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## Profile

Seattle is the economic center for the Pacific Northwest. The city is a full-service city, with a relatively affluent population of 761,100, a large and well-educated labor force, and ties to the broader metropolitan area including the cities of Bellevue and Everett.

## Detailed credit considerations

### Tax base and economy: coronavirus severely affecting leisure/hospitality, aerospace; strong underlying fundamentals will help tax base

The city's tax base and economy have historically been credit strengths that we expect will continue to support the city's strong overall credit profile as vaccination rates increase and broader economic activity returns to pre-pandemic levels. In addition to being the commercial and tourist hub of the Puget Sound region, the city is the economic center of the State of Washington, benefitting from the presence of some of the world's most well-known international corporations, including Amazon, Boeing, Microsoft, and [Starbucks](#) (Baa1 negative). Amazon and other technology firms have performed well during the pandemic by providing direct or enabling technologies that can capitalize on the broad "shelter in place" orders taking place across the country. On the opposite end of the spectrum, leisure and hospitality providers and brick and mortar retailers have struggled. Boeing, one of the world's leading aircraft manufacturers, struggled as global demand for air travel declined precipitously, compounding the company's pre-pandemic problems stemming from the company's 737MAX aircraft, though domestic and global air travel figures show improvement and the Federal Aviation Administration last fall [rescinded its emergency order](#) allowing the plane to resume flight, subject to certain conditions.

Both business and leisure travel to the region remain significantly depressed, and general economic activity remains below pre-pandemic levels, though conditions have improved significantly. Preliminary unemployment data for February show the rate declined to 5.5%, which is much higher than the 2.1% in November 2019 prior to the pandemic but well below the April 2020 peak of 16.2%.

Socioeconomic measures for the city are a credit strength, supporting extremely high property values. The city has one of the highest educational attainment rates in the country, along with some of the strongest income levels among large urban areas in the United States, with median family income at 165.5% of the US. Assessed values continue to climb, with the city's 2021 full value at \$262.1 billion, an increase of 2% from 2020. Residential real estate continues to climb in value, though expectations for commercial office space are more uncertain as the coronavirus pandemic has shifted expectations around remote work.

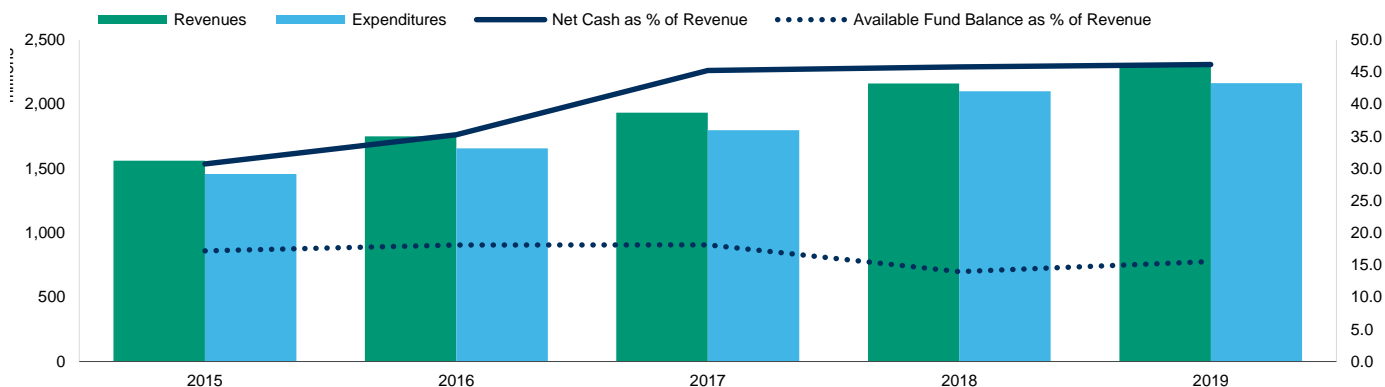
### Financial operations and reserves: coronavirus drives large revenue declines, expense increases; new payroll tax and federal aid provides buffer

The city's strong financial position will remain healthy in the near-term as economically sensitive revenue declines and increased outlays to address the effects of the pandemic are at least partially offset by new payroll tax revenue and additional federal aid. Despite revenue coming in 15% (\$231 million) lower than its adopted budget, the city's unaudited 2020 financial results showed a fairly moderate general fund reserve draw of \$39 million. The city was the beneficiary of \$84 million in federal coronavirus relief funds (reflective of general fund use only; the city received federal coronavirus relief funds used in other funds), and made nearly \$100 million of other budgetary adjustments including hiring freezes, the centralization of professional services, the suspension of capital work and temporary cost shifts between departments.

For 2021, the city's budget assumes a base built on 2020 actual revenue, with very modest increases in existing tax revenue streams, but does not assume the continuation of federal aid. However, the city is implementing a new payroll tax that it estimates will generate \$214 million, about half of which will be used to fund new investments in communities of black, indigenous and people of color (BIPOC). The city is also making significant reductions in its police department budget (-11%). The budget also includes another draw on reserves of \$39 million, but does not include the \$120 million it expects to receive in federal funding in 2021 or the additional \$119 million it expects to receive in 2022.

City managers expect to rebuild its emergency and rainy day fund reserves back to 2019 levels by 2024. The city's policies require portions of certain general fund revenue be deposited into reserves in the years following a drawdown, with the Emergency Fund replenished "as soon as practicable" following a drawdown. Notably, the city's reserve draws in 2020 did not exceed the surpluses generated in 2019, and the 2021 budget is likely extremely conservative, though a wide variance is possible because of uncertainties surrounding the payroll tax.

Exhibit 3

**The city's stable and healthy financial position provided a buffer to the effects of the pandemic**

Source: Seattle (City of) WA's financial statements and Moody's Investors Service

**Liquidity**

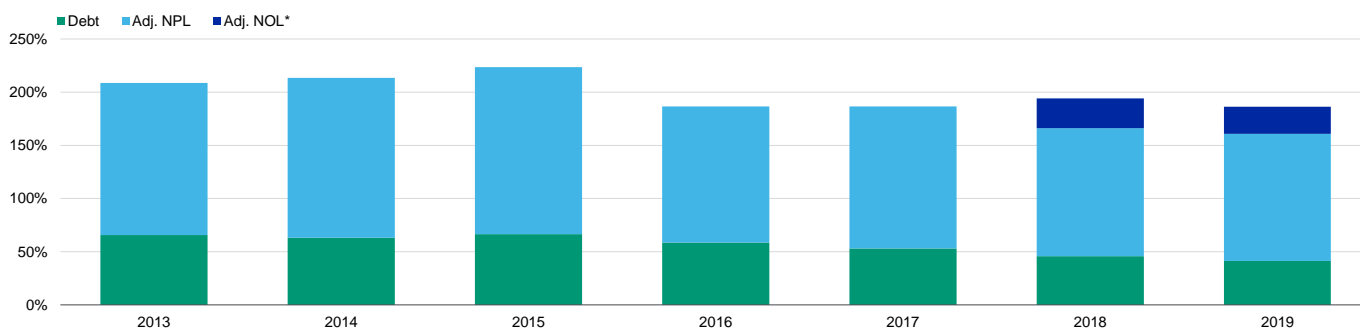
The city's liquidity position is healthy. The city's general fund cash and equity in pooled investments at the end of 2019 was \$502.2 million, or 29.6% of general fund revenue. On an operating funds basis, cash was even stronger at just under \$1.1 billion, or 46.2% of revenue.

Functionally, however, the city pools its cash and investments across funds. This consolidated pool held \$2.7 billion at the end of 2019. City funds may withdraw cash out of the pool without prior notice or penalty. City managers report the consolidated pool declined to \$2.5 billion at the end of 2020.

**Debt and pensions: moderate total liabilities, affordable fixed costs**

The city's financial leverage is moderate, with debt, pension and OPEB liabilities combined representing just 1.86x revenue and 1.8% of full value based on audited 2019 financial figures. This includes an adjusted net pension liability of \$2.77 billion and an adjusted net OPEB liability of \$585 million. Total fixed costs are affordable at just 10.7% of revenue, providing the city significant flexibility in adjusting in operating expenditures.

Exhibit 4

**Financial leverage relative to revenue is very manageable**

\*Adj. NOL not available pre-GASB 75

Source: Seattle (City of) WA's financial statements and Moody's Investors Service

**Legal security**

The city's unlimited tax general obligation bonds are secured by the city's full faith, credit, and resources and unlimited property tax pledge.

The city's limited tax general obligation bonds are secured by the city's full faith, credit, and resources and pledge to levy taxes annually within the constitutional and statutory tax limitation provided by law without a vote of the people.

### Debt structure

The city's debt consists of fixed-rate obligations with a declining debt service structure. Final maturity of the city's outstanding bonds is in 2049, though most of the city's debt is retired by 2030.

### Debt-related derivatives

The city has no debt-related derivatives.

### Pensions and OPEB

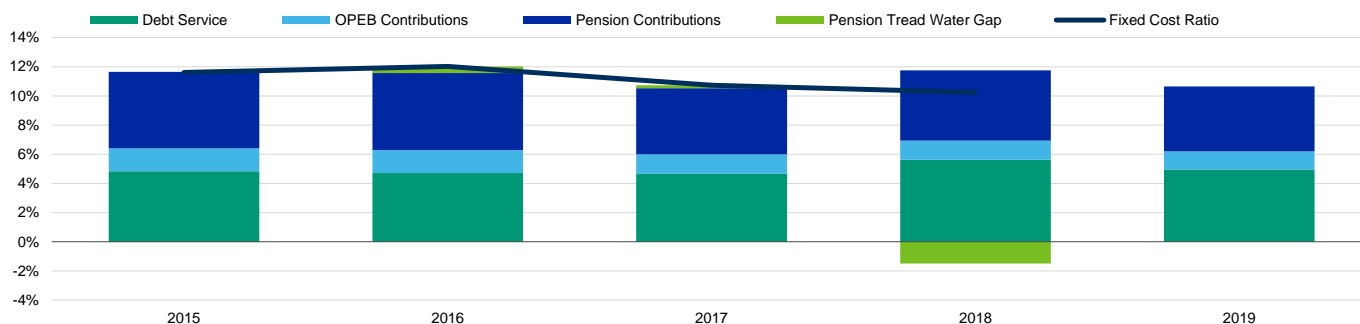
Pension and OPEB liabilities are manageable in comparison to the city's operating revenues and tax base. The city manages a single employer and defined-benefit public employee retirement plan (Seattle City Employees' Retirement System or SCERS), the Firefighter's Pension Fund, and the Police Relief and Pension Fund. The city's adjusted net pension liability (ANPL) based on a 3.93% discount rate is \$2.77 billion in 2019, equal to a manageable at 1.1% of full value and 1.2x times operating funds revenue.

Based on our calculations, the city's pension contributions in 2019 was above its "tread water" level; that is, contributions were sufficient to begin paying down the city's net pension liability under plan assumptions. We generally expect funding to improve given recently implemented pension reforms. On January 1, 2017, the city closed SCERS to new entrants, with new employees participating in a new system (SCERS 2). SCERS 2 has decreased benefit levels, increases the minimum retirement age, and defers retirement eligibility by increasing the age-plus-years-of-service requirement for retirement with full benefits. Additionally, the city may, under state law, levy a \$0.225 per \$1,000 property tax levy to cover the Firefighter's fund; the city does not levy this additional tax.

The city has three OPEB plans: the Health Care Blended Premium Subsidy, OPEB benefits under Firemen's Pension, and Police Relief and Pension. All OPEB plans are funded on a pay-as-you-go basis and there are no assets accumulated in a qualifying trust. The city's adjusted net OPEB liability at the end of 2019 was \$585 million, or 25% of revenue and 0.2% of full value.

Exhibit 5

#### Fixed costs are low



Source: Seattle (City of) WA's financial statements and Moody's Investors Service

## ESG considerations

### Environmental

Environmental considerations are not a key driver of the city's overall credit quality. The city has medium risk exposure to extreme rainfall, water stress and sea level rise, according to Moody's affiliate Four Twenty-Seven.

### Social

Social considerations are an important factor in the city's credit quality. Socioeconomic measures are strong, including above average levels of wealth and educational attainment. The coronavirus pandemic is also a factor under our ESG framework given its impact on public health and safety. The coronavirus is also having a significant impact on the city's financial profile, as discussed above.

### Governance

Moody's views the city's management team as strong. The strength of the management team is buttressed by codified practices that enhance the city's financial profile. Until 2017, the city appropriated sufficient money into the Emergency Subfund to the maximum amount allowed by state law (\$0.375 per \$1,000), but is now adding funds at a rate tied to inflation. Additionally, 0.5% of forecasted

tax revenues are automatically contributed to the city's "Rainy Day Fund," also known as the Revenue Stabilization Account, as are 50% of any unanticipated excess General Subfund balances at year end. Like the Emergency Subfund, the city is now adding to the "Rainy Day Fund" at a rate tied to inflation.

Washington cities have an institutional framework score <sup>1</sup> of "Aa," or strong. Although cities depend on economically sensitive taxes (sales, business and occupation) in addition to property taxes, revenue tend to be highly stable and predictable. Cities have a moderate ability to increase property taxes by 1% annually, subject to state statutory limits. Expenditures primarily consist of public safety costs, which are highly stable and predictable. Expenditure-reduction ability is moderate due to modest fixed costs. Cities can also make mid-year budgetary reductions not related to public safety.

## Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 6

### Seattle (City of) WA

Rating Factors	Measure	Score
<b>Economy/Tax Base (30%)[1]</b>		
Tax Base Size: Full Value (in 000s)	\$257,958,281	Aaa
Full Value Per Capita	\$356,146	Aaa
Median Family Income (% of US Median)	169.1%	Aaa
<b>Notching Factors:[2]</b>		
Regional Economic Center		Up
<b>Finances (30%)</b>		
Fund Balance as a % of Revenues	15.6%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	5.1%	A
Cash Balance as a % of Revenues	46.2%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	31.1%	Aaa
<b>Management (20%)</b>		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.1x	Aaa
<b>Debt and Pensions (20%)</b>		
Net Direct Debt / Full Value (%)	0.4%	Aaa
Net Direct Debt / Operating Revenues (x)	0.4x	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	1.0%	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.1x	A
Scorecard-Indicated Outcome		Aaa
Assigned Rating		Aaa

[1] Economy measures are based on data from the most recent year available.

[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.

Sources: US Census Bureau, City of Seattle's financial statements and Moody's Investors Service

## Endnotes

- 1 The institutional framework score assesses a municipality's legal ability to match revenues with expenditures based on its constitutionally and legislatively conferred powers and responsibilities. See [US Local Government General Obligation Debt \(July 2020\)](#) methodology report for more details.

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