FitchRatings

RATING ACTION COMMENTARY

Fitch Rates King County, WA's $53.6MM LTGO Bonds 'AAA'; Outlook Stable

Thu 27 May, 2021 - 4:32 PM ET

Fitch Ratings - San Francisco - 27 May 2021: Fitch Ratings has assigned a 'AAA' rating to the following King County, WA new debt issuance:

--$53,575,000 limited tax general obligation (LTGO) bonds, 2021, series A.

In addition, Fitch has affirmed the county's Issuer Default Rating (IDR) and its various outstanding ULTGO and LTGO bonds at 'AAA'.

The Rating Outlook is Stable.

Feedback

The bonds are scheduled to sell via competitive sale on June 9. Proceeds of the 2021 series A bonds will be used to fund certain capital projects.

SECURITY

The bonds are general obligations of the county, supported by an irrevocable full faith, credit and resources pledge to levy an ad valorem tax sufficient (together with all other legally available monies) to pay debt service. The county's pledge on LTGO bonds is constrained by property tax levy growth of 1% per year, plus new construction, and a rate cap of $1.80 per $1,000 of taxable assessed value (TAV).

ANALYTICAL CONCLUSION

The 'AAA' IDR and GO rating reflect the county's strong economic underpinnings, superior gap-closing capacity and low liability levels. The county is well positioned to withstand economic weakness and fiscal challenges, performing well in both Fitch's moderate (-1% GDP) and baseline (-3.5% GDP) economic scenarios. A history of steady revenue growth and sound financial cushion offset constraints on the county's independent ability to increase the property tax levy.

ECONOMIC RESOURCE BASE

King County benefits from a diverse economy and tax base that encompasses nearly 30% of the state's population including Seattle, the Pacific Northwest's largest city. Major private employers include Microsoft, Amazon, and Boeing. The regional economy is also supported by a substantial military presence.

Prior to the coronavirus-induced recession, economic growth in the county and region was robust, with rapid expansion of information technology employment and ongoing construction activity. The aerospace industry had already been affected by Boeing's grounding in 2019 of the 737 MAX. In 2020, Boeing decided to consolidate the 787 Dreamliner aircraft production in South Carolina, which will result in job losses in the region over the next several months.

The coronavirus recession was sharp but brief in King County, with employment falling about 10% in the spring of 2020 and improving gradually since then. According to the county, information sector employment remained fairly stable while construction dropped and then recovered; manufacturing remains more than 10% below pre-pandemic levels, due in part to the changes at Boeing mentioned above. The leisure and hospitality sector employment remains about 30% below its pre-pandemic level.

KEY RATING DRIVERS

Revenue Framework: 'aa'

Over the last 10 years, general fund revenues have lagged behind overall U.S. economic performance, but have exceeded inflation. Fitch expects that trend to continue over the long term given constraints on the revenue system that keep the county from fully benefitting from economic growth. The county's independent legal ability to raise revenues is satisfactory.

Expenditure Framework: 'aa'

Constraints on revenue increases have challenged the county's ability to address inflationary and population-based expenditure growth; however, management has a strong track record of closing budget gaps and aligning expenditures with revenues. Carrying costs for debt service and retiree benefits are low to moderate.

Long-Term Liability Burden: 'aaa'

Long-term liabilities, primarily in the form of overlapping debt, are a low burden on the resource base. The county participates in several state pension plans and has a minimal OPEB liability.

Operating Performance: 'aaa'

The county used a combination of spending cuts, revenue raising and use of reserves to balance the 2021 budget assuming continued weak performance due to pandemic mitigation efforts. Given strong reserve levels and other tools available, Fitch expects the county to retain its superior gap-closing capacity.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Upgrades are not possible as the ratings are currently at the highest level.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--An inability to address the fiscal challenges triggered by a slower than expected economic recovery, as evidenced by insufficient budget management, reducing the county's financial resiliency by the end of the recovery period.

--An inability to manage ongoing expenditure pressures in response to statutory limits on revenue growth, coupled with salary and benefit costs that outpace revenue growth.

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

The recently-enacted the American Rescue Plan Act (ARPA) will provide $350 billion in direct aid to state and local governments and additional funding for 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 should bridge near-term fiscal gaps (https://www.fitchratings.com/research/us-public-finance/american-rescue-plan-boosts-state-local-government-budgets-11-03-2021).

Budget Impact and Response

Feedback

The county's fiscal year coincides with the calendar year so almost the entire 2020 fiscal year was affected by the economic weakness from coronavirus mitigation efforts. Performance was better than earlier forecast, with sales and property taxes and ending fund balance all higher than in the county's August 2020 forecast. The county estimates sales taxes totaled about $132 million in 2020, down about 4% compared to 2019 ($5.5 million), and that property taxes were about $380 million, an increase of 2.9% ($10.5 million) over 2019. Early in the 2020 budget year, in response to the decline in sales taxes, the county kept some positions vacant and made other spending adjustments in preparation for the development of the 2021-2022 budget. The county estimates it ended 2020 with roughly break-even operations.

The 2021-2022 biennial budget assumes a gradual return of normal of economic activity, with hospitality - such as cruises and conventions - not likely to return to normal levels for another year or two. The county's most recent economic and revenue forecast (March 2021) estimates an 8% gain in sales taxes in 2021 and 5.25% in 2022 and estimates that property taxes will increase by about 2.4% to 2.5% each year. The budget assumes no 2021 salary increases for open contracts, including for the coalition of unions which is currently negotiating its contract potentially through 2024.

The 2021-2022 general fund biennial budget totals about $1.9 billion, roughly the same as the 2019-2020 budget, not including revenues and expenditures related to the pandemic. The lower than previously forecasted sales taxes along with some cost increases and new programs resulted in an estimated $143 million budget gap (about 8% of the biennial budget) that the county closed through improving efficiencies in service delivery, eliminating positions (including 14 filled positions) and reducing or eliminating services. The county also increased general fund revenue by charging utilities for the use of right-of-way on county-owned land (estimated at $30 million annually) and eliminating the use of a downtown office building, saving $5 million in operating costs and $40 million in deferred maintenance. The budget also appropriates about $29 million in undesignated fund balance and some of the rainy day reserve; however, given ARPA funding and improved prospects for tax revenues, the county now expects it will not use the rainy day reserve in 2021.

CREDIT PROFILE

King County has benefited from above-average population and employment growth during the past decade, and has an estimated 2020 population of 2.3 million. Educational attainment levels are well above the national average and annual personal income growth has been close to 6% in recent years. The county continues to attract new residents drawn by high-paying jobs in the information technology sector, which Fitch expects to support sustained economic growth.

REVENUE FRAMEWORK

For the 10 years through 2019, revenue growth outpaced inflation but remained below overall U.S. economic performance. Fitch expects county revenues to continue to exceed inflation based on population gains and ongoing economic development, but to lag behind U.S. GDP over the long term due to the statutory limit.

Property taxes accounted for approximately 40% of general fund revenues in 2019 and have provided a steady source of revenue growth due to ongoing additions to the tax base from new construction, which are not considered in the 1% statutory limit on property tax levy growth. Charges for services, which include revenues received for services provided on behalf of other local governments, accounted for 31% of general fund revenue in 2019, while sales taxes provided an additional 17%.

Prior to 2020, sales tax revenue growth had been strong, benefitting from higher than usual sales in unincorporated areas (which garner the county a larger share of the taxable sales value), as well as newly instituted taxing of remote sellers. The 1% statutory limit on increases to the property tax levy also provides downside protection by allowing the tax rate to increase to result in the 1% levy increase should property tax values decline.

Feedback

Property and sales tax increases require voter approval. The county's chief area of independent revenue flexibility is in charges for services. In aggregate, these tools provide the county with satisfactory independent legal ability to raise operating revenues in relation to expected normal cyclical declines.

EXPENDITURE FRAMEWORK

Law, safety and justice is the county's primary responsibility and accounts for about three-quarters of general fund expenditures in 2019. In 2019, the county settled with two of its larger unions with a 4% wage increase for 2019 and 1.5% each on January 2020 and July 2020. A majority of the other unions agreed to similar terms. The 2021-2022 biennial budget assumes no wage increases in 2021 and 2% for 2022.

Based on current spending practices, Fitch expects expenditure growth to be marginally above revenue growth over time in the absence of policy action.

Expenditure-cutting flexibility is solid. The county's carrying costs for debt service and retiree benefits were equal to about 10% of spending in 2019, but approximately 40% of pension costs (about two thirds of the total carrying costs) were paid from county enterprise funds. In addition, the county has incorporated ongoing expenditure controls into its biennial budget process, providing a strong starting point for potential cuts that may be required in a downturn or in order to align revenues with expenditures given terms of recent labor contracts.

LONG-TERM LIABILITY BURDEN

The county's long-term liability burden, including direct and overlapping debt and the Fitch-adjusted net pension liabilities, totals about $9.9 billion, which is low relative to the county's resource base at about 5% of personal income. The county plans to issue about $1 billion in new money limited tax GO bonds over the next biennium for bridge replacements, land purchases, facility improvements and the affordable housing and solid waste capital programs. In addition, the voters approved a $1.7 billion GO bond measure on the November 2020 ballot to finance needed improvements to the county's Harborview Medical Center, including seismic improvements. The county amortizes its debt rapidly with almost 80% of its outstanding GO bonds paid off in 10 years.

Feedback

The county participates in several state-sponsored pension plans that are adequately funded under Fitch's assumption of 6% investment returns. OPEB liabilities are low at approximately 0.1% of personal income.

OPERATING PERFORMANCE

The Fitch Analytical Stress Test (FAST) scenario analysis tool relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria. The FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn based on historical revenue performance. Hence, actual revenue declines will vary from the FAST results, and Fitch expects that the county will implement necessary corrective actions to offset them. The FAST does provide a relative sense of the risk exposure of a particular local government entity compared to other local government entities.

The county's FAST results under the moderate decline scenario, which assumes no policy action, show the county maintaining unrestricted general fund reserves well above the level required to maintain a 'aaa' financial resilience assessment. The county ended 2019 with an unrestricted general fund balance of over $182 million, or 20% of general fund spending. As noted, the county estimates ending 2020 with break-even operations and roughly the same level of reserves. Fitch believes the county is well positioned to address the current fiscal challenges associated with slower revenue growth as the recovery takes hold and will maintain reserves that are consistent with the highest financial resilience assessment. This expectation is based on strong past performance, a healthy starting point for reserves, solid control over spending and a relatively manageable gap that would open in the downside scenario.

Financial resilience is supported by a policy that targets unassigned reserves at 8% (lowered to 6% in the 2021-2022 biennium) of general fund revenues, as well as a rainy day reserve that exceeded $25 million at the end of 2020 (equal to about 3% of general fund spending). At the end of 2020, the county also retained approximately $17 million in available balances outside the general fund.

Feedback

The county has demonstrated a strong commitment to financial flexibility through the maintenance of reserves at targeted levels, extensive and conservative financial forecasting and monitoring, and regular closure of budget gaps without the use of reserves. In addition, the county has a track record of moving expenditure responsibilities outside of the general fund through voter-approved increases to property tax levy limits for specific purposes.

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.

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

RATING ACTIONS

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

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

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

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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

ENDORSEMENT STATUS

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US Public Finance Infrastructure and Project Finance North America United States

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