Fitch Ratings

RATING ACTION COMMENTARY

Fitch Rates King County, WA's $127MM LTGO Bonds 'AAA'; Outlook Stable

Thu 15 Oct, 2020 - 5:45 PM ET

Fitch Ratings - San Francisco - 15 Oct 2020: Fitch Ratings has assigned a 'AAA' rating to the following King County, WA new debt issuance:

--$53,415,000 limited tax general obligation (LTGO) bonds, 2020, series A; and

--$73,830,000 limited tax GO refunding bonds, 2020, series B.

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

The Rating Outlook is Stable.

The bonds are scheduled to sell via competitive sale on October 27. Proceeds of the 2020 series A bonds will be used to fund certain capital projects, and proceeds of the 2020 series B bonds will be used to refund certain outstanding county obligations for savings.

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 pandemic-related economic stresses and performs well in both baseline and downside 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 Boeing, Microsoft and Amazon. The regional economy is also supported by a substantial military presence.

Prior to the coronavirus-induced recession, economic growth in the county and region had been robust, with rapid expansion of information technology employment and ongoing construction activity. The aerospace industry had already been affected by Boeing's grounding and decision to cease manufacturing the 737 MAX, which continues to be an issue. As an early center of community spread of the novel coronavirus, the region experienced the economic effects of mitigation efforts, which shut down non-essential businesses. Recent infection rates have trended below the national average, allowing a gradual opening up of the regional economy.

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 is using a combination of spending cuts, revenue raising and use of reserves to mitigate sharp revenue losses due to the pandemic-induced recession. Given the strong reserve levels going into the current economic downturn and other tools available, Fitch expects the county to retain its superior gap-closing capacity. Once stronger economic growth resumes, Fitch expects the county to rebuild its financial cushion.

RATING SENSITIVITIES

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

--Not Applicable.

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

--An inability to address the fiscal challenges triggered by the severe economic contraction, as evidenced by insufficient budget adjustments, reducing the county's financial resiliency by the end of the recovery period.

--Over time, an inability to manage ongoing expenditure pressures in response to constitutional limits on 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

Sector-Wide Coronavirus Implications

The outbreak of coronavirus and related government containment measures worldwide has created an uncertain global environment for U.S. state and local governments and related entities. Fitch's ratings are forward-looking in nature, and Fitch will monitor the severity and duration of the budgetary impact on state and local governments and incorporate revised expectations for future performance and assessment of key risks.

While the initial phase of economic recovery has been faster than expected, GDP in the U.S. is projected to remain below its 4Q19 level until at least 4Q21. In its baseline scenario, Fitch assumes continued strong GDP growth in 3Q20 followed by a slower recovery trajectory from 4Q20 onward amid persisting social distancing behavior and restrictions, high unemployment and a further pullback in private-sector investment. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the reports titled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/research/sovereigns/fitch-ratings-coronavirus-scenarios-baseline-downside-cases-update-08-09-2020), published Sept. 8, 2020 and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Tax-Supported Issuers" (https://www.fitchratings.com/research/us-public-finance/fitch-ratings-updates-coronavirus-scenarios-for-us-state-local-tax-supported-issuers-01-10-2020), published on Oct. 1, 2020 on www.fitchratings.com.

King County Economy Under Coronavirus Pandemic

Public schools closed on March 16, and stay at home orders were in effect from March 23 through May 31. During June and July, as measured by consumer spending, the economy partially recovered and then was relatively flat in August. With the exception of the information sector, most employment sectors were sharply down starting in March but had recovered most of their losses by July. In August, the hospitality sector remained about 38% below its pre-pandemic peak, according to the county. King County's total employment was down 5.1% from a year earlier in August, which is about three-quarters of the 6.7% loss in the national job market, according to the Bureau of Labor Statistics.

Adequate Liquidity

Fitch considers liquidity to be the most significant and immediate risk to state and local government financial operations presented by the pandemic. The county received $262 million for pandemic expenses from the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and also expects to pursue FEMA reimbursement for an estimated $70 million. King County reports it had $8.1 billion in the county investment pool, of which 40% was attributable to county agencies. The county's estimated portion ($3.2 billion) is equal to about 485 days governmental spending based on 2019 expenditures. Fitch believes these borrowable resources provide sufficient liquidity for its near-term operating needs.

Budget Impact and Response

The county's budget and financial projections show a moderate amount of fund balance spending during the current downturn, which would not pressure the rating so long as management continues take steps to balance the budget as the economy recovers, as it has in past downturns. In its most recent forecast (August 2020), the county projects sales taxes to be about 11.6% lower in 2020 compared to 2019, and property taxes about 2.9%

higher than 2019. For the 2019-2020 biennium, sales taxes and charges for services are now forecast to come in about 3% and 4% lower than budget, respectively, with overall revenues modestly above budget for the biennium. In response to the decline in sales taxes, the county kept some positions vacant and began planning for spending reductions in the next biennial budget. The county estimates it will use about $43 million in fund balance in 2020, $15 million of which was for now settled labor agreements and other planned use of fund balance, and the remainder for other planned uses unrelated to the recession. The county forecast having an estimated $94 million in available fund balance at the end of 2020, equal to about 11% of 2019 spending.

The county is currently preparing its 2021-2022 biennial budget. The 2021-2022 general fund budget is estimated at about $1.9 billion, roughly the same as the current, revised biennial budget for 2019-2020, not including revenues and expenditures related to the pandemic. The decline in sales taxes along with some cost increases and new programs resulted in an estimated $143 million budget shortfall (about 8% of the biennial budget). The county's proposed budget closed the gap with $84 million in efficiencies and service reductions, such as in the sheriff's department where vacancies have been held open, and in other departments. Office space in downtown Seattle will be consolidated, saving rent. The proposed budget will also include $30 million in additional revenue by charging utilities rent on rights of way and appropriates about $29 million in reserves.

CREDIT PROFILE

King County has benefited from above-average population and employment growth during the past decade, and has an estimated 2019 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 historically but remains 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 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 growth has 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 taxing remote sellers. For 2020, the county is projecting a 11.6% decline in general fund sales taxes and a 2.9% growth in property taxes, which to date are unaffected by the downturn. In 2021, the county is forecasting 3.5% growth in sales taxes (still well below 2019) and 2.3% growth in property taxes.

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.

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 affordable housing and solid waste capital program. In addition, the county will have a $1.7 billion measure on the November 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. Most of the growth in the long-term liability burden is likely to come from debt issuances by overlapping jurisdictions, which account for the vast majority of overall long-term liabilities.

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, which relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria, has now been adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. 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 decisive 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 baseline 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 available fund balance of over $182 million, or 20% of general fund spending. The county estimates ending 2020 with lower reserves due to planned use of fund balance. Fitch's downside economic scenario would require the county to take policy action to align ongoing revenues and expenditures and to maintain reserves at a level that's consistent with the current rating. Fitch believes the county is well positioned to address such a downside scenario and would maintain (or promptly restore) reserves that are consistent with the highest financial resilience assessment, given 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 next biennium) of general fund revenues, as well as a rainy day reserve that exceeds $25 million at the end of 2020 (equal to about 3% of general fund spending). 2019 operations resulted in a surplus after transfers of almost $20 million, resulting in a total unrestricted fund balance of about $163 million, equal to 19% of general fund spending. At the end of 2019, the county also retained approximately $17 million in available balances outside the general fund. Approximately $15 million of the use of reserves in 2020 was appropriated from the county's risk reserve for salary increases pursuant to labor agreements.

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. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

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

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

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Endorsement Policy

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