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CREDIT OPINION

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King (County of) WA

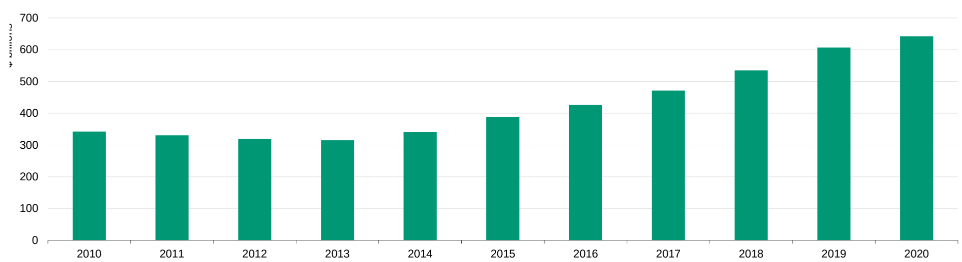
Update to credit analysis

Summary

King County, Washington (Aaa stable) benefits from a large and wealthy tax base that includes the City of Seattle (Aaa stable). The coronavirus pandemic has significantly disrupted economic activity in the region, but the Puget Sound remains the economic engine for the State of Washington (Aaa stable) and is supported by multi-national businesses in technology, aviation, retail, and consumer goods. The county is experiencing revenue declines as well as increased costs for measures to address the pandemic's health and economic effects, some of which will be offset by substantial federal government support, primarily through the CARES Act. Given the county's historically strong financial management team, we anticipate the county's financial profile will recover and its long-term financial results will remain solid. The county's debt and pension liabilities are manageable and supportive of its overall strong credit position.

Exhibit 1

King County's tax base has grown quickly over the past decade



Source: King County, WA

Credit strengths

» A large and wealthy tax base with a highly educated population

» Strong financial management team

» Manageable debt and pension liabilities

Credit challenges

» Moderate exposure to economically sensitive revenue that are currently weak due to the coronavirus pandemic

» Pre-pandemic maturation of the service area leading to slower revenue growth and increasing service costs

Rating outlook

Although the coronavirus pandemic has had a significantly negative economic impact on the region, the county maintains strong underlying fundamentals, including a highly educated population and solid infrastructure, that we expect will endure beyond the current outbreak. We expect the county's tax base to remain strong and that the county's financial management team will ensure the county's financial profile remains healthy.

Factors that could lead to an upgrade

» Not applicable

Factors that could lead to a downgrade

» Significant, protracted downturn in the local economy and tax base

» Sustained deterioration of the county's financial position

» Material growth in the county's fixed costs, including pension, OPEB, and debt service

Key indicators

Exhibit 2

King (County of) WA	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$388,118,856	$426,335,606	$471,456,288	$534,662,435	$606,623,698
Population	2,045,756	2,079,550	2,118,119	2,163,257	2,163,257
Full Value Per Capita	$189,719	$205,013	$222,583	$247,156	$280,421
Median Family Income (% of US Median)	146.7%	148.3%	148.9%	150.7%	150.7%
Finances					
Operating Revenue ($000)	$1,942,490	$2,113,754	$2,128,222	$2,233,002	$2,290,744
Fund Balance ($000)	$217,526	$130,685	$167,579	$199,481	$201,226
Cash Balance ($000)	$538,013	$594,658	$676,537	$761,048	$805,369
Fund Balance as a % of Revenues	11.2%	6.2%	7.9%	8.9%	8.8%
Cash Balance as a % of Revenues	27.7%	28.1%	31.8%	34.1%	35.2%
Debt/Pensions					
Net Direct Debt ($000)	$1,099,823	$1,028,567	$1,001,938	$932,038	$1,041,738
3-Year Average of Moody's ANPL ($000)	$2,198,792	$2,467,035	$2,430,519	$2,266,810	$2,276,073
Net Direct Debt / Full Value (%)	0.3%	0.2%	0.2%	0.2%	0.2%
Net Direct Debt / Operating Revenues (x)	0.6x	0.5x	0.5x	0.4x	0.5x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.6%	0.6%	0.5%	0.4%	0.4%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.1x	1.2x	1.1x	1.0x	1.0x

Net direct debt includes the county's debt less bonds paid from self-supporting essential enterprises (sewer).
Source: US Census Bureau, Moody's Investors Service and King County, WA

Profile

King County spans Seattle, a major city and economic hub of the Northwest, and a large share of the Puget Sound area. The county serves a large population approaching 2.2 million residents which amounts to almost one-third of the State of Washington's population.

Detailed credit considerations

Economy and tax base: coronavirus has slowed strong regional growth, but solid fundamentals remain

Although the coronavirus pandemic has significantly slowed the Puget Sound's regional economy, solid underlying fundamentals are expected to sustain the county's long-term credit strength. Prior to the pandemic, the county's economy and tax base, which encompass much of the larger Seattle metropolitan area, was amongst the fastest growing in the nation. Software development and aircraft manufacturing are key sectors, and the area serves as the headquarters or major operating bases to some of the most well-known corporations, including Amazon.com Inc. (A2 positive), The Boeing Co. (Baa2 negative), and Microsoft Corp. (Aaa stable). Struggles at Boeing surrounding the 737 MAX and its decision to move other aircraft manufacturing away from the region to South Carolina (Aaa stable) have added to the pandemic-driven employment stress in the region, and the region also has a disproportionately high number of jobs that both pay well and can be done remotely, though evidence of economic out-migration has thus far been limited. The area is also home to the University of Washington (Aaa negative) system's flagship campus, which is additive to the already highly-educated workforce in the region.

Median family income is affluent, especially for a large urban area, at 150.7% of the US 2018 estimates from the American Community Survey. Full value per capita, a proxy measure of wealth, is uncommonly high at $297,001 for a tax base that lacks any material taxpayer concentration. The county's unemployment rate is high at 7.2% as of August 2020, but better than both the state and nation. As the county begins gradual re-opening of its economy, we anticipate this rate to improve, though leisure and hospitality, which have been a growing part of the area economy, are likely to lag.

The county's tax base is immense with an assessed value (AV) of $642.5 billion as of 2020. Despite elevated unemployment rates, property values appear to show continued increases through the pandemic, though we would anticipate a protracted period of high unemployment rates will slow that growth. Prior to the pandemic, the county had expected a slowing of AV given the length and strength of the economic expansion.

Financial operations and reserves: softening expected in the near-term; CARES Act funding to support revenue weakness, added expenses from the coronavirus pandemic

The county's financial profile is expected to soften into the 2021-2022 biennium as a result of the coronavirus pandemic. Nonetheless, given the county's strong financial management team and generally conservative approach to budgeting, we expect the county's long-term financial profile to remain strong. The county closed 2019 with general fund reserves of $183.8 million, or a healthy 19.7% of revenue and the fourth consecutive year of substantial surpluses. On an operating funds basis, which includes the county's general fund, health fund, special revenue fund and debt service fund, total reserves equaled $785.9 million, or 34.3% of revenue. Available reserves, or those designated as unassigned, assigned, committed or restricted for debt service, were more modest at $201.2 million (8.8% of revenue), though much of the restricted fund balance are for key public services including flood control, parks and housing and have their own dedicated property tax levies.

Because of the coronavirus pandemic, the county's sales taxes in 2020 are expected to see a decline of -11.6%, with a full recovery to 2019 levels not until 2023. Beneficially for the county its largest source of revenue is property taxes (39.2% of general fund revenue and 38.3% of operating funds revenue), which under state law can grow by 1% annually plus new growth, providing substantial stability. Other core revenue, including charges for services and other economically sensitive revenue are expected to remain flat. The county will receive a significant revenue boost from the state and federal governments totaling more than $309 million (excluding dollars specifically geared towards public transportation and the airport), though these dollars will be spent by the end of 2020 and will not fully offset the additional appropriations for the response to the coronavirus pandemic.

The county anticipates drawing down overall general fund reserves in 2020, with continued planned draws into the 2021-2022 biennium given $200 million in new expenditures and assuming that economic conditions remain weak and additional federal assistance is not forthcoming. To regain structural balance, the county anticipates making headcount adjustments through early retirements as well as a modest number of layoffs, shifting more expensive public safety activities (jail) to lower cost ones (community programs and other diversion options) and making some per-agency funding reductions. The county is also adding new revenue, such as charging utilities rent for “right of way” usage. The county has adopted an ordinance to dip into its rainy day reserve fund, but has yet to appropriate those funds. Undesignated general fund reserves are budgeted to fall to 6%, which is fairly weak on a relative basis but remains nominally large. Given the county's historic performance relative to budget and management's responsiveness to rapidly changing conditions, we expect the county to meet or exceed these figures in the short-term and maintain a strong financial profile over the longer-term.

Liquidity

Cash in operating funds was a strong 35.2% of operating revenues as of fiscal 2019, aligning with total fund balance in operating funds. In addition, the countywide investment pool is available to all of the county on a borrowable basis, and any such loans are not required to be repaid within the same fiscal year. The pool's assets were $7.5 billion as of fiscal 2019 and largely comprises low-risk and relatively liquid US government and agency securities. The county's own portion averages more than 40% of the pool's assets.

Debt and pensions: manageable leverage and low fixed costs

King County's net direct debt burden remains very modest and declined to the equivalent of only 0.2% of 2020 full value and 0.5x fiscal 2019 operating revenues, including the current offering. The debt burden is net of GOLT bonds issued for King County Sewer Enterprise (Aa1 stable), which are self-supported by the enterprise's net revenues.

Fixed costs were low at the equivalent of 7.0% of operating revenues in fiscal 2019, which is favorable compared to norms for local governments and implies strong financial flexibility. Fixed costs include net direct debt service as well as pension and OPEB contributions.

The county's debt plans include additional GOLT issuances in the fiscal 2021-2022 biennium of up to $1 billion for various bridge replacements, land purchases, facility improvements, solid waste and affordable housing. A measure is on the November ballot seeking voter approval for $1.7 billion in unlimited tax general obligation bonds to finance improvements at Harborview Medical Center that would be issued over 6-7 years.

The county is also looking at establishing a commercial paper program with a maximum authorization of approximately $250 million for the sewer enterprise, with liquidity support provided internally via the county's investment pool.

Legal security

The county's general obligation limited tax bonds are secured by the county's full faith, credit, and any legally available resources and its pledge to levy taxes annually within the constitutional and statutory tax limitations for non-voted debt.

Debt structure

The county's debt load is comprised primarily by $1.8 billion of GOLT obligations for various purposes, including $811.7 million issued for sewer purposes. The county also has $49.8 million GOULT bonds, and $8.2 million of lease obligations backed by its GOLT pledge. The county also has $311.9 million committed for contingent loan agreements related to financing housing projects, and below the $400 million limit on such guarantees.

The county assigned its GOLT pledge to a relatively small amount of variable rate obligations related to the sewer enterprise, which are funded from the junior lien on sewer net revenues. These are the Series 2017A and B bonds ($98.2 million outstanding) and the Series 2019A and B bonds ($148.1 million). The 2017 bonds are supported by a continuing covenant agreement with State Street Lending Corporation that expires in April 2021 and the 2019 bonds have a standby bond purchase agreement with TD Bank, NA that expires in June 2024.

Debt-related derivatives

The county does not have derivative agreements.

Pensions and OPEB

The county's retirement liabilities are favorably low burdens. The three-year average of Moody's adjusted net pension liabilities (ANPL) for fiscal years through 2019 was modest at the equivalent of 1x fiscal 2019 operating revenues or 0.4% of 2020 full value. The county participates in various plans of Washington's multi-employer, cost-sharing, and predominantly defined-benefit programs. ANPL is net of contributions made by self-supporting enterprises, such as the sewer utility. The county contributes above its “tread water” amount, or the amount necessary to keep pension liabilities from growing under plan assumptions.

The county's Moody's adjusted net OPEB liability is modest at $116.5 million, or less than 0.1x operating revenue. The county provides OPEB to qualified retirees through a single-employer, defined-benefit plan that provides various medical benefits like insurance coverage. The county's contributions are made on a pay-go basis and totaled a small $5.0 million in fiscal 2019.

ESG considerations

Environmental

Environmental considerations are not a key driver of the county's credit profile. The county does have exposure to extreme rainfall events, but other climate risks are more limited, including heat or water stress and sea level rise.

Social

Social considerations are incorporated in our credit view of the county, as reflected in the strong wealth measures and high levels of educational attainment. The coronavirus pandemic is a social risk under our ESG framework, and has had a substantial impact on the county's financial operations, though we expect strong management to act as a mitigant to the credit risks from the pandemic.

Governance

Washington Counties have an Institutional Framework score of “Aa”, which is strong. The sector's major revenue source is property taxes. Counties can increase collections 1% over the prior year, subject to state statutory limits on property tax rates. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. Fixed costs are driven primarily by debt service and pension costs. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

The county operates under a Home Rule Charter with an executive-council form of government. The county executive is the chief executive officer of the county and is elected to a four-year term. The county council is made up of nine members elected to staggered four-year terms.

The county's financial position is driven partly by management policies, including a narrow 6% undesignated general fund balance target for its fiscal years 2021-2022 biennial budget, relative to estimated annual revenues. This target conforms to the county's policy to maintain that balance at 6-8%, along with rainy day reserves in supplemental funds. Nevertheless, the county's total reserves in operating funds surpass these levels, and not including borrowable funds from the countywide investment pool that bolster financial flexibility.

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 3

King (County of) WA

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$642,490,492	Aaa
Full Value Per Capita	$297,001	Aaa
Median Family Income (% of US Median)	150.7%	Aaa
Notching Factors:[2]		
Regional Economic Center		Up
Other Scorecard Adjustment Related to Economy/Tax Base: Massive tax base far exceeds parameters of scorecard		Up
Finances (30%)		
Fund Balance as a % of Revenues	8.8%	A
5-Year Dollar Change in Fund Balance as % of Revenues	-10.4%	Ba
Cash Balance as a % of Revenues	35.2%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	11.8%	Aa
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Notching Factors:[2]		
Unusually Strong or Weak Budgetary Management and Planning		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	0.2%	Aaa
Net Direct Debt / Operating Revenues (x)	0.5x	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	0.4%	Aaa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.0x	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.
Source: US Census Bureau, Moody's Investors Service and King County, WA

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