S&P Global Ratings

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Summary:

King County, Washington; General Obligation

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US$525.9 mil ltd tax GO bnds 2021 (Taxable) ser C due 12/01/2041		
Long Term Rating	AAA/Stable	New
US$29.945 mil ltd tax GO and rfdg bnds 2021 ser B due 12/01/2029		
Long Term Rating	AAA/Stable	New
US$18.43 mil unltd tax GO bnds ser 2021 due 06/01/2041		
Long Term Rating	AAA/Stable	New

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to King County, Wash.'s expected $18.4 million series 2021 unlimited-tax general obligation (GO) bonds, expected $29.9 million series 2021B limited-tax GO refunding bonds, and expected $525.9 million series 2021C taxable GO bonds. The outlook is stable.

The county will have about $5.4 billion in direct debt outstanding at the end of 2021 excluding planned-but-unissued debt, and after our adjustments for revenue-supported debt and GO debt we consider self-supporting we calculate the county's net direct governmental debt at $1.4 billion.

Proceeds of the series 2021 will fund capital improvements to the county's main public medical facility. Proceeds of the series 2021B will refund for interest expense savings previously issued GO bonds that funded capital improvements. Series 2021C will fund a variety of county capital projects, with a focus on affordable housing and transit-oriented development.

The series 2021, series 2021B, and series 2021C are full faith and credit obligations of the county, including ad valorem property taxes. The series 2021B and series 2021C are subject to statutory limitations that include a maximum levy rate and a maximum annual property tax revenue increase. Given the fungibility of the county's resources and because pledged revenue is not measurably narrower or subject to disproportionate risks relative to the county's overall revenue, we rate the county's limited-tax GO debt, including the limited-tax series, on par with our view of the county's general creditworthiness.

Credit overview

We see King County as showing resiliency in the face of the 2020 COVID-19-driven recession, with a dynamic and diverse economic base that includes Seattle and most of the region's high-income job centers. The county's leisure and hospitality industry is likely to continue to struggle to predict demand and manage staffing as a rise COVID-19 infections in the second half of 2021 makes personal decisions to go out more fraught, but the information technology and biotech industries have seen stronger demand during the pandemic and house values are continuing their climb from an already high base, suggesting that remote workers have mostly been staying put. The county has a management culture with what we see as a strong long-term record of conservative, arm's-length economic and revenue assumptions and a sustained record of voter support to fund specific services and capital needs. For this reason, we anticipate that its budgetary flexibility will remain very strong in the intermediate term even if available general fund reserves are low relative to those of similarly rated peers with limited ability to increase revenue without a public vote.

The ratings further reflect our assessment of the county's:

- Very strong economy, with participation in a broad and diverse metropolitan statistical area;
- Very strong management, with strong financial policies and practices under our financial management assessment methodology;
- Adequate budgetary performance, with an operating surplus in the general fund but an operating deficit at the total governmental fund level in 2020;
- Very strong budgetary flexibility, with an available fund balance of 20% of adjusted operating expenditures in fiscal 2020, down only slightly from 22% in 2019;
- Very strong liquidity, with total government available cash at 126% of total governmental fund expenditures and 37x governmental debt service at the end of 2020, and access to external liquidity we consider exceptional;
- Very strong debt and contingent liability profile, with debt service carrying charges at 3% of expenditures in 2020 and net direct debt that is 56% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Adequate institutional framework score.

Environmental, social, and governance (ESG) factors

We consider the county to have elevated exposure to environmental risks, with earthquakes and wildfires the most prominent. We believe the county's maintenance of an emergency management office, which handled the county's pandemic response, and robust state building codes largely mitigate these risks. We consider the county's social and governance risk in line with our view of the sector standard.

The county manages cybersecurity in its information technology department, with a chief of security role, and has risk management strategies in place such as cybersecurity insurance and remote backups of records.

Stable Outlook

Downside scenario

We could lower the ratings if the county's budgetary flexibility as measured by its available general fund balance deteriorates to a level approaching our adequate threshold of 8% of expenditures, which we think could occur if the post-pandemic recovery is weaker than we expect, particularly if new public health costs materialize and the county is unable to identify and implement offsetting budget-balancing actions.

Credit Opinion

Very strong economy

King County enjoys long-term advantages in the forms of a deep reservoir of human capital, exposure to export markets, and large regional employers that are major players in their respective markets. The 2.3 million-resident county, which encompasses Seattle and most of the region's high-income cities and international airport, has a projected per capita effective buying income of 166% of the national level and per capita market value of $287,600.

Although downtown Seattle has sustained temporary and permanent economic losses associated with the pandemic, and leisure and hospitality employment countywide appears to have only recently started to recover, the information sector has not missed a beat, with online and cloud computing giant Amazon accelerating its growth. Likewise, with the pandemic and other forces increasing investor interest in and national policy supporting the life sciences industry, we anticipate that the county's biotechnology cluster will continue to add often highly paid jobs that don't lend themselves to remote work. Aircraft manufacturer Boeing, which produces its 737-Max model in the county, is reporting new orders and appears cautiously optimistic about increasing production in the coming year after receiving approval to fly in all major markets other than China following deadly crashes in 2018 and 2019.

Although we think that housing unaffordability is likely now a long-term drag on growth, an overall strengthening in the real estate market is fueling property tax base growth. The S&P CoreLogic Case-Shiller Home Price index for the region shows residential values continuing to climb into 2021, and the county's assessed value (AV) increased by 2.7% to $659.5 billion for 2021. This rate represented a clear step down from 5.9% for 2019 and 13.5% for 2020, but the county's economist anticipates similar growth through 2023. Moreover, we are increasingly optimistic about economic growth nationally, with what looks like a 6.7% real GDP increase for 2021, followed by what we anticipate will be a 3.7% increase for 2022.

Very strong management

We view the county's management as very strong, with strong financial policies and practices under our financial management assessment methodology, indicating our view that financial practices are strong, well embedded, and likely sustainable.

Highlights of the county's approach to financial management include:

- A budget formation process that incorporates internal and external analyses of historical revenue and expenditure trends, including employment of a full-time economist whose sole responsibility is to generate revenue forecasts;
- A biennial budget process with budget-to-actual reports presented to the county council quarterly and updated throughout the year if necessary;
- A formal financial forecast that covers at least five years beyond the budgeted year;
- A six-year rolling capital improvement plan, updated annually as part of the budget process, that identifies all known funding in the budgeted year;
- A formal investment policy coupled with quarterly presentation of holdings and earnings reports to the executive finance committee;

- A formal debt policy that specifies quantitative and qualitative limits as well as monitoring requirements for the county treasurer; and
- A designated general fund balance policy of 6% to 8% of expenditures, to which the county has adhered and which is based on cash flow to meet debt service obligations.

Adequate budgetary performance

The county's budgetary performance appears to be holding up in the face of the rapid onset of the recession in 2020. The county posted a positive general fund net operating result of 1.7% of expenditures in 2020 but a deficit result across all governmental funds of 3.4%, which was comparable to 2019. General fund operating results hovered within a narrow range of 2% to 3% of expenditures during the four years prior to the recession, and we think that cuts in discretionary expenditures and receipts of federal grants under the American Rescue Plan that will materialize in 2021 and 2022 at the equivalent of about 22% of expenditures in each year will likely keep performance from weakening in the intermediate term and may even temporarily strengthen it.

General fund revenue primarily consists of property taxes; fees and fines; and sales and use taxes. For the biennium covering 2021-2022 the county is budgeting for them to account for 41%, 40%, and 15% of the county's general fund revenue, respectively. We have adjusted general fund expenditures upward and the corresponding net transfers downward to reflect ongoing transfers out to various special funds to support maintenance and operations.

Management reports that the county's transit enterprise experienced a plunge in ridership and revenue in 2020 but that a multiyear buildup in reserves, a low proportion of pre-pandemic revenue that came from fares, and the ability to defer capital projects means that the enterprise is positioned well to maintain service quality without requiring additional resources such as support from the county's general fund. Likewise, federal grants have absorbed the bulk of pandemic-related costs to date and the county has been able to amend its budget as the public health environment has evolved.

Very strong budgetary flexibility

King County's budgetary flexibility is very strong, in our view, with available reserves in fiscal 2020 of 20% of adjusted operating expenditures, or $199.2 million, and inclusive of the county's "rainy day" fund, which is classified as committed in the county's audited financial statements, and excess resources in its employee benefits and risk management internal service funds. We anticipate that the negative effects of the pandemic on revenue will linger in some form and think that reserves may weaken in the intermediate term as the county's formal budget suggests, but the size of American Rescue Plan grants suggests that the risk of the county's available reserves falling to less than 15% of expenditures has receded and growth in some form is increasingly likely.

The county has a history of securing voter authorization for property tax increases for services, including approvals of levy increases in 2019 for parks and emergency medical services.

Very strong liquidity

In our opinion, King County's liquidity is very strong, with total government available cash at 126% of total governmental fund expenditures and 37x governmental debt service in 2020.

In our view, the county has exceptional access to external liquidity based on debt issuance of a variety of security types during the past 15 years. The county's investment pool is managed under a comprehensive policy and on behalf of other agencies, with 87% of holdings consisting of U.S. Treasuries, agencies, and the state-managed investment pool. We do not anticipate changing our view of the county's liquidity as very strong in the near future, based on our expectation of strong financial performance.

The county has extended its contingent loan pledge and credit enhancement agreement to about $285 million in debt, most of which has been issued by the housing authority. While acceleration of the bonds is allowed under the trust indenture, the bonds are allowed to accelerate only to the extent that money to make such payment is on hand with the trustee in the relevant bond funds. Therefore, the amount due by the county at any given time under the agreements would be only the current debt service, which we consider well within the county's ability to pay with its available liquidity. To date, the county has not had to make any payments pursuant to these agreements.

Very strong debt and contingent liability profile

Total governmental fund debt service is 3% of total governmental fund expenditures, and net direct debt is 56% of total governmental fund revenue. Overall net debt is low at 1.4% of market value, which is, in our view, a positive credit factor. These ratios could rise in the coming years as the county continues with its $1.7 billion authorization to fund the expansion and modernization of its main public hospital, but we anticipate that our view of the county's profile will remain very strong in the intermediate term, as debt issuances under the authorization would be unlikely to occur all at once. (The series 2021 represents the first $19 million.) Separately, the county is planning for about $300 million in limited-tax GO debt by end of the biennium ending 2022 for solid waste and other projects.

We consider debt outstanding backed by the county contingent loan agreement and credit enhancement agreements as direct debt. But because the county has not had to make any payments under these contingent guarantees, we view these issuances as self-supporting.

Pension and other postemployment benefit (OPEB) liabilities:

In our view, the county has no large pension or OPEB liabilities that are leading to credit pressure.

While some of the county's pension plans are poorly funded, several are overfunded, creating an overall funding situation that is not likely to lead to dramatic cost escalations. This strong funding is largely due, in our view, to the short amortization periods employed to determine funding requirements.

The county's sole OPEB plan provides benefits for police and firefighters hired in 1970 to 1977; given the limited scope of eligible beneficiaries, we don't believe this obligation will lead to credit pressure, despite the county's pay-as-you-go approach to funding.

The county participated in the following major pension plans funded as of Dec. 31, 2020:

- Public Employees Retirement System (PERS) plan 1: $312.4 million in net pension liability, and 69% funded;
- Public Employees Retirement System plan 2/3: $138.7 million in net pension liability, and 97% funded;
- Public Safety Employees' Retirement System plan 2: overfunded, at 102%;
- Law Enforcement Officers and Fire Fighters plans 1 and 2, both of which are overfunded, at 147% and 116%; and

- Seattle City Employees' Retirement System: $0.5 million in net pension liability, and 71% funded.

King County's required pension and actual OPEB contributions totaled 5.9% of total governmental fund expenditures in 2020, with 0.1% consisting of OPEB costs. The state systems' actuarially determined contributions (ADC) now match the contractually required contributions (CRCs) and exceeded both static funding and minimum funding progress, indicating our view of timely progress in reducing pension liabilities. The CRCs, which are developed using the same approach as the ADCs, are not updated following passage into law biennially and so can diverge from the annually updated ADCs. However, because CRCs determine funding requirements using an approach that approximates 10- to 15-year level percent open amortization, timely progress on reducing liabilities is still made even when ADCs exceed CRCs, and so we believe costs will likely remain stable. However, the plans' 7.4%-7.5% discount rates increase contribution volatility.

Adequate institutional framework

The institutional framework score for Washington counties is adequate, in our view, partly as a result of statutory discretion regarding the quality and timeliness of annual financial reporting.

Local ratings' relationship with U.S. sovereign

The county's GO bonds are eligible to be rated above the sovereign because we believe the county can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect, U.S. local governments are considered moderately sensitive to country risk. County-derived revenue and state grants are the primary revenue sources for the county, and the institutional framework in the U.S. is predictable, with significant local government autonomy and flexibility, as demonstrated by independent treasury management.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments