

RatingsDirect®

Summary:

Edmonds, Washington; General Obligation

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Credit Profile

US\$3.5 mil ltd tax GO bnds

Long Term Rating

AAA/Stable

New

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Edmonds, Wash.'s series 2019 limited-tax general obligation (GO) bonds. The outlook is stable.

Security and use of proceeds

The bonds are secured by the city's full faith and credit, including the obligation to levy ad valorem taxes subject to statutory limitations that include a maximum levy rate of \$3.60 per \$1,000 of assessed value under current conditions (the city's levy rate in 2019 was \$1.02) and a limitation on property tax revenue growth to 1% per year, excluding new construction. The rating is equal to our view of the city's general creditworthiness, as obligor, because the limitations do not narrow the tax base or limit the fungibility of property tax revenue for different uses.

Proceeds for the 2019 bonds are planned to be used to finance a portion of improvements to be made to its civic park project.

The 'AAA' rated bonds are eligible to be rated above the sovereign, because we believe the city 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, U.S. local governments are considered to have moderate sensitivity to country risk. The city's locally derived property taxes secure the bonds, and the institutional framework in the U.S. is predictable with significant U.S. local government autonomy. In a potential sovereign default scenario, U.S. local governments should maintain financial flexibility through the ability to continue collecting locally derived revenues and U.S. local governments have independent treasury management.

Credit Overview

Edmonds has benefitted from significant growth throughout the Seattle-Tacoma-Bellevue metropolitan statistical area (MSA) and the Puget Sound economy, bolstering income levels and property values in recent years. Given its proximity to Seattle, we expect the local economy will continue to experience economic expansion, while becoming more intertwined in the Seattle economy. The city has historically demonstrated strong financial performance, driven by conservative budgeting, revenue growth and prudent management practices and policies, which has led to the building and maintenance of its very strong reserve position. We expect the city to continue to have positive operating margins and a low debt burden, while experiencing ongoing economic growth over the medium term.

The 'AAA' rating reflects our view of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);

- Strong management, with good financial policies and practices under our Financial Management Assessment methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 45% of operating expenditures;
- Very strong liquidity, with total government available cash at 27.3% of total governmental fund expenditures and 12.9x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 2.1% of expenditures and net direct debt that is 22.8% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Adequate institutional framework score.

Very strong economy

We consider Edmonds' economy very strong. The city, with an estimated population of 42,170, is located in Snohomish County in the Seattle-Tacoma-Bellevue MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 178% of the national level and per capita market value of \$261,761. Overall, the city's market value grew by 8.0% over the past year to \$11.0 billion in 2020. The county unemployment rate was 3.8% in 2018.

Edmonds is located less than 20 miles north of downtown Seattle, and participates in the Puget Sound economy, which provides residents with ample employment opportunities throughout Snohomish and King counties, bolstering local income levels. The city is known as a daytime destination, with its economy primarily driven by retail, services, and health care. Edmonds has several car dealerships and a Swedish Hospital (217 bed capacity) off highway 99, in addition to various retail and restaurants in the city's downtown business district. Further anchoring the city's economy is its waterfront access, which provides residents access to the Washington State Ferries, a public fishing pier, and underwater park. The Port of Edmonds is located within the city, which consists of approximately 729 moorage slips and has the storage capacity for 350 dry boats. Finally, the city has a very active arts community, including several galleries in the business district and a performing arts center.

Since its low point in 2013, the city's assessed value has experienced nearly 100% growth, driven primarily by regional economic growth. The city is near full build out, but has recently experienced much redevelopment and many of its historically undeveloped properties are undergoing development. The city has various ongoing developments that are expected to continue to improve property values, including expansion to its medical campus, the addition of several apartment and assisted living complexes, and the expected addition of a light rail to the area (expected to come online in nearby Lynwood in 2024) from Seattle that will likely spur further development. Therefore, we expect the local economy will remain very strong, while continuing to benefit from the growth across Seattle-Tacoma-Bellevue MSA.

Our current projections indicate the Pacific states region will lose its real GDP growth leadership position from 2018

and fall to fourth place by 2021, getting edged out by the West South Central, Mountain, and South Atlantic regions. Its larger metropolitan areas--particularly those around Seattle and San Francisco--continue to generate jobs requiring high human capital and attract young professionals that their market-leading companies need. We anticipate that the region's median home price, which already commands a premium by national standards, will outpace regional real GDP growth. This will make it more difficult for employers outside high-skill industries, particularly in metropolitan areas, to respond to the region's business opportunities by adding staff. In the long term, lack of affordability will likely put a damper on employment and population growth in the region's highest-cost areas unless states can incentivize local governments to find and implement more innovative solutions. We continue to view the region's export orientation as a long-term strength but see risks related to sovereign-level trade disputes. California's, Oregon's, and Washington's inland agricultural areas have good access to West Coast ports but need international buyers to be able to afford their high-value crops. For more information, please see our report "U.S. State And Local Governments Will Need To Keep Their Hands On The Wheel," published July 31, 2019, on RatingsDirect.

Strong management

We view the city's management as strong, with good financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

When formulating the subsequent year's budget, management uses several years of historical trend analysis. Additionally, management works with various outside sources, including local developers and auto dealerships for revenue projections. Monthly budget-to-actual financial reporting is provided to the city council and budgetary amendments are generally made on a quarterly basis. A formalized five-year financial forecast is conducted for the general fund, inclusive of conservative projections, and is updated on an annual basis. Furthermore, the city has a formalized comprehensive five-year capital improvement plan across multiple funds, which is also updated annually.

The city has a formal investment policy in place and provides council with monthly investment holdings and performance reports. The city also has a formalized unassigned reserve fund policy to maintain a minimum of 16% of operations, in addition to a contingency reserve policy to maintain 4% of operations, in place for financial stabilization and emergencies. There is currently no debt management policy in place; however, management plans to potentially implement one next year.

Strong budgetary performance

Edmonds' budgetary performance is strong in our opinion. The city had operating surpluses of 4.5% of expenditures in the general fund and of 8.7% across all governmental funds in fiscal 2018. Driven by ongoing economic expansion and conservative budgeting practices, Edmonds has consistently produced positive operating margins, despite regularly budgeting for deficit results. Property tax revenues have remained stable with overall growth over the past decade, and the city has consistently high collection rates. Sales taxes has experienced growth on a year-to-year basis over the past decade, increasing a total of 91% since fiscal 2009. Overall, we consider the city's operating revenues as diverse, with 34% of general fund revenues derived from property tax revenues, 20% from sales taxes, and 16% from utility taxes in fiscal 2018.

The city adopted an operating deficit for fiscal 2019 and 2020, in line with historic budgeting practices. Currently,

management notes the 2019 budget is tracking well, and the city expects to realize another year of increased property and sales tax revenues. Therefore, we expect the city will continue to have strong budgetary performance over the next two fiscal years.

Very strong budgetary flexibility

Edmonds' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 45% of operating expenditures, or \$18.3 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 44% of expenditures in 2017 and 44% in 2016.

The city has historically maintained very strong reserves, consistently built by its conservative budgeting and ongoing revenue growth. In assessing the city's budgetary flexibility, we include its assigned and unassigned general fund balances. The city currently has \$2 million assigned to be used for the civic park project; however, management plans to utilize reserves from other funds to finance the project before resorting to the assigned general fund balance.

We estimate the city's operating reserve position at fiscal-year end 2018, excluding the assigned general fund balance, would be approximately 40.5% of general fund expenditures (inclusive of recurring transfers). Management notes there are no material plans to draw on unassigned operating reserves at this time. Based on operating financial forecasts, the city's general fund balance is expected to slightly decline in fiscals 2019 and 2020 (to approximately 30% of projected operations); however, we believe this is based on conservative assumptions, in line with its track record of very conservative budgeting. Therefore, we expect its budgetary flexibility will remain very strong.

We note the state's Initiative 976, which would limit car tab fees and restrict the city's authority to impose certain vehicle registration taxes and fees, would likely have negative impact for the city, leading to a potential loss of up to \$700,000 for Edmonds' street overlay budget on an annual basis. The city council recently unanimously approved a resolution opposing Initiative 976.

Very strong liquidity

In our opinion, Edmonds' liquidity is very strong, with total government available cash at 27.3% of total governmental fund expenditures and 12.9x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary. Edmonds' strong access to external liquidity is demonstrated by its issuance of GO and revenue debt over the past 15 years. We do not view the city's investments as risky, given they are held in state investment pools, certificates of deposit, and government agency securities. Therefore, we expect the city's liquidity position to remain very strong over the next two years.

The city has one bank loan with approximately \$2.6 million outstanding; however, the legal documents associated with the loan do not include any permissive events of default or acceleration provisions that would cause potential threat to the city's liquidity profile.

Very strong debt and contingent liability profile

In our view, Edmonds' debt and contingent liability profile is very strong. Total governmental fund debt service is 2.1% of total governmental fund expenditures, and net direct debt is 22.8% of total governmental fund revenue. Overall net

debt is low at 1.2% of market value, which is in our view a positive credit factor. After the issuance of the 2019 bonds, the city will have approximately \$54.8 million in total direct debt outstanding. City officials note there are no material plans to issue medium-term debt at this time. Therefore, we expect Edmonds' debt burden to remain very low.

Edmonds' combined required pension and actual other postemployment benefits (OPEB) contributions totaled 4.7% of total governmental fund expenditures in 2018. Of that amount, 3.8% represented required contributions to pension obligations, and 0.9% represented OPEB payments. The city made 100% of its annual required pension contribution in 2018.

The city participates in cost-sharing, multiple-employer, public employee, defined-benefit retirement plans managed by the Washington State Department of Retirement Systems and must make its full annual required pension contribution each year. Using reporting standards in accordance with Governmental Accounting Standards Board Statement Nos. 67 and 68, the city's proportionate share of the collective net pension liability as of June 30, 2018 was \$4.1 million for Public Employees Retirement System (PERS) 1 and \$1.9 million for PERS 2/3. As of June 30, 2018 PERS 1--its largest liability--maintained a funded level of 63.2%, using its fiduciary net position as a percentage of the total pension liability, and PERS 2/3 maintained a funded level of 95.8%.

The city participates in the Law Enforcement Officers and Fire Fighters (LEOFF) system 1 and LEOFF 2; however, the city currently has a net pension asset of \$964,613 million in LEOFF 1 and approximately \$3.7 million in LEOFF 2 since the systems are more than 100% funded.

The contribution amounts for all five of the city's DRS-administered pension plans are actuarially based. PERS 1 uses a 10-year, level-percent layered amortization approach; the city's other plans use an aggregate actuarial cost method that amortizes the unfunded actuarial accrued liabilities over the average remaining working lifetime of their employees, which effectively results in an open amortization period of approximately 15 years. We view open amortizations as more risky because they are not designed to fully pay off unfunded liability; however, with a short enough period (like 15 years), significant funding progress can still be made. Mortality rates used to determine liabilities are projected on a generational basis, which in our view reduces the risk of significant upward revisions to liabilities following experience studies--providing more consistency to contribution rates over time. The liabilities used to calculate the funded levels discussed above are discounted at 7.5% (except LEOFF 2, which assumes 7.4%), which are slightly above national averages--leading to an above-average likelihood of upward revisions to the NPL following years of poor investment performance. These actuarial methodologies and assumptions are generally comparable with those of other pension plans nationally.

Additionally, the city retained the responsibility for all benefits payable to members (or to their survivors) who retired prior to the creation of the LEOFF pension system (known as the Firemen's Pension Fund). This system is a closed, single-employer, defined-benefit pension system. During 2018 there were a total of four retirees covered under this system who are receiving pension benefits; of these four retirees, three are also receiving medical benefits from this fund. The city's net pension liability for this plan was \$504,943, with a funded ratio of 30.1%. However, carrying charges for this plan are very low, \$39,297 in fiscal 2018, and we do not consider the plan a contingent liability risk.

The city also provides limited other postemployment benefits for certain former employees, funded on a

pay-as-you-go basis.

Adequate institutional framework

The institutional framework score for Washington municipalities is adequate.

Outlook

The stable outlook reflects our view of the city's very strong local economy, characterized by its high income levels and continuously growing property values. Further supporting the outlook is the city's track record of conservative budgeting and strong budgetary performance, assisting in the maintenance of its very strong reserve position.

Therefore, we do not anticipate changing the rating over the two-year outlook horizon.

Downside scenario

We could lower the rating if the city's financial performance were to deteriorate, leading to material and sustained draws on its reserves.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 31, 2019
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- , Sept. 2, 2015

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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