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Research:

King County, Washington
Goat Hill Properties; Appropriation, Appropriations

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Credit Profile

US$100.045 mil lse rev bnds (King Cnty) ser 2005 due 12/01/2037	AA+pr
Sale date: 11-JAN-2005	
OUTLOOK:	STABLE

Rationale

The 'AA+pr' rating on King County, Wash.'s lease revenue bonds reflects:

- The county's limited tax general obligation pledge, which is not subject to annual appropriation risk; and
- The commencement of the county's obligation to make rental payments on the date of substantial completion of the project.

The rating also reflects the county's very strong general creditworthiness, which includes:

- A broad and deep economic base that is showing indications of recovery after a protracted period of flat performance;
- A very large and growing tax base with strong income measures;
- Very strong financial management despite a limited capacity to raise revenues; and
- Moderate, but affordable, debt levels.

An offsetting credit concern is the pressure that Initiative 747 (I-747) continues to place on county finances. In 2001, Washington voters approved I-747, which limits the growth of tax revenues to 101% of revenues from the previous year, plus new construction. In response to the loss of tax revenues, the county budgets conservatively by assuming low growth in sales tax revenues and by reducing expenditures. In addition, management and staff have been creative in developing ways to make operations self-supporting and by contributing to projects that will provide increases in revenues other than property taxes.

The bonds are being issued by Goat Hill Properties (GHP), a Washington nonprofit corporation. Project construction will occur pursuant to a developer agreement between GHP and the developer. GHP is a single purpose entity issuing the bonds and acting on behalf of the county in the developer agreement.

The bonds are limited-tax general obligations of the county. The full faith, credit, and resources of the county are irrevocably pledged for the annual levy and collection of taxes and the prompt payment of rent--which constitutes debt service on the bonds. In addition, the county has pledged, for as long as any of the bonds are outstanding and unpaid, to include in its budget each year and to levy ad valorem taxes within the constitutional and statutory limitations necessary for repayment. The bonds are not subject to appropriation risk.

Bond proceeds will finance the construction of a new governmental office building and parking garage. The building will be a 295,000-square-foot office building intended to house the county's Department of Community and Human Services. The county estimates that approximately 1,400 employees will work in the building, most of which currently work in office space leased by the county. In addition, the proceeds will finance the construction of an eight-story garage with 817 parking spaces. Both structures will be located centrally in downtown Seattle as a part of the county's urban campus.

According to the lease agreement, the county's obligation to make rental payments, which will constitute debt service, commences upon substantial completion of the project, which is scheduled to occur in February of 2007. During the construction period, debt service on the bonds will be paid from capitalized interest, which is funded from bond proceeds through Dec. 1, 2007, or about 10 months beyond the estimated construction period.

Outlook

The stable outlook reflects the expectation that management will continue to make budgetary adjustments as necessary to achieve budget balance while maintaining adequate financial reserves pursuant to its policies.

Economy

King County, with a population of 1.78 million, is Washington's most populous county. One-third of county residents live in Seattle, the Pacific Northwest's economic center. The county's economy is currently recovering from a protracted economic slowdown, which it entered in 2001. Job losses overall--as well as losses in manufacturing and high technology sectors that were particularly impacted by the slowdown--tapered off from spring 2004 through summer 2004. Leading employers continue to include Boeing (52,806 employees), Microsoft (27,657), University of Washington (23,500), King County (14,700), and Seattle (10,600).

Fueled by a continued low interest rate environment, the county's assessed value (AV) for the 2004 tax year totaled $236 billion, a 4.6% increase from the previous year. Reflecting steady increases in new construction, annual increases in AV have averaged 9.36% over the past five years--although the growth trend has begun to moderate over the past two years. The value of new building permits increased 11% between 1998 and 2002. Property wealth has risen to a high $132,566 per capita, and tax base concentration remains low--the 10 leading taxpayers account for just 3.76% of total AV, led by Boeing (1.2%).

The commercial real estate sector remains very soft, with office vacancy rates in downtown Seattle at a very high 14.9% at the fourth quarter of 2003, although this was down somewhat from 17.5% at the beginning of 2002.

Finances

County finances are under considerable pressure due to a structural misalignment between revenues and expenditures. Total general government expenditures are projected to grow at approximately 6.0% per year while revenue growth is expected to grow at 2.0% or less per year. While the county is constrained in its ability to raise new revenues, largely due to the effects of I-747, it has been responsive on the expenditure side of the budget, cutting more than $90 million of projected spending in both fiscals 2002 and 2003 and an additional $24 million in fiscal 2004. In addition, in May 2003, the county received voter approval for a property tax parks levy in the amount of $0.049 per $1,000 of AV, which generated an estimated $11.5 million in fiscal 2004. This additional revenue flowed to the parks fund and resulted in approximately $7 million of offsetting support for the current expense fund. As a result, the county has maintained its financial reserves at strong levels. However, structural realignment between revenues and expenditures will be necessary as the county approaches exhausting its ability to limit expenditure growth.

Financial History

For the fiscal year ended Dec. 31, 2003, King County reported a net general fund surplus of $5.1 million and an unreserved fund balance of $87.7 million, or 17.6% of expenditures. Total general fund revenues increased 2.6% in 2003, the largest growth rate since 2000, when the economy was at its peak and general fund revenues grew 6.6%. Offsetting the slight decline in sales tax revenues, however, was a modest uptick in property tax revenues--the county's largest revenue category. Due to the continued strength of the real estate market and robust construction trends, property tax revenues grew 1.17% after a sharp 7.9% increase in fiscal 2002. The county's fiscal policies provide that the unreserved and undesignated general fund balance should be between 6% and 8% of estimated annual revenues.

The fiscal 2004 current expense fund, or general fund, adopted budget totals $512.9.4 million, and is currently forecast for expenditures totaling $489.4 million. Revenue projections for the year anticipate a total of $511 million with expenditures projections at $492.2 million, which will leave the county with an ending fund balance of $90.2 million, $26.3 million of which will be undesignated, still exceeding the county's policy of a 6.0% undesignated reserve. At the outset of fiscal (and calendar) 2004, the county faced a budget shortfall of $24 million. Due to the county's ongoing structural deficit, it previously cut $52 million from its 2003 budget, including parks ($10.2 million), criminal justice ($12.6 million), and human services ($10.8 million). The county's budget conservatively projected zero growth in sales tax revenues, which constitute 6.8% of current expense fund revenues. In fiscal 2005, the county will also likely face a budgetary shortfall due to the current recession, growing demands on the criminal justice system, and constraints placed on property tax growth by I-747. The county has identified expenditure reductions across numerous departments and programs to close this gap. As a part of the county's budget building process, it is implementing certain recommendations from the budget advisory task force, which was convened by the county executive in November 2002. Among the findings of the task force were service prioritization, technology improvements, and an improved alignment between service deliveries and revenues.

An important component to resolving the county's structural budget gap is eliminating the county's subsidization of urban unincorporated areas--which cost the county's current expense fund an estimated $37 million annually . While these areas are slated for annexation by existing cities, there is limited incentive on the part of the cities to incur these additional costs. To facilitate the process, the county established a $10 million annexation incentive reserve to help transition these cities into providing services to the areas they annex. Currently, unincorporated portions of the county are populated by 218,000 residents.

Debt

Overall debt remains moderate at $2,548 per capita and 1.9% of property value.

The county's property tax rates are comfortably below statutory limits, with the county currently levying 60.1% of its limit for general municipal purposes and 77.5% of its limit for road district purposes.

In the period covering fiscals 2005-2008 the county will likely issue an additional $200 million of new limited-tax GO bonds. The county is also expected to issue $250 million annually in new debt to support the wastewater division's capital plan. While this debt will carry the limited tax GO pledge of the county, it will be additionally secured by net revenues of the wastewater system.