

October 13, 2008

Summary:
**King County, Washington; General
Obligation**

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Summary:

King County, Washington; General Obligation

Credit Profile		
King Cnty ltd tax go bonds (payable from swr revs) ser 2005		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
King Cnty Lmtd Tax GO bonds ser 2007E		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
King Cnty lse (Broadway Office Prop) GO		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
King Cnty GO		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AAA' rating and underlying rating (SPUR) on King County, Wash.'s outstanding \$2.0 billion in general obligation and limited tax general obligation (LTGO) bonds. The 'AAA' rating reflects the county's exceptional financial management through a spectrum of economic climates.

Confronted with slumping revenue trends and revenue-raising constraints among its relatively narrow array of tax revenue sources, county management engages in conservative and active revenue forecasting that results in generally accurate actual-to-budgeted performance. On the expense side, management has worked to control and reduce cost growth rates in stubborn areas, such as employee health care and service provision to urban unincorporated areas. A balanced budget was adopted for fiscal 2008 without needing to implement target level (across-the-board) budget reductions, although as in 2007, some reserves were deployed to achieve balance. For fiscal 2009, reaching a balanced proposed budget has been more challenging and entailed service and pay-increase reductions.

The rating additionally reflects:

- An exceptionally broad and deep economic base that is presently in a period of slower growth, although in our view one that has enough diversity to withstand both an industry or sector-specific flattening as well as broader episode of attenuated economic activity;
- A very large and growing tax base with strong income measures;
- Very strong financial management, despite a limited capacity to raise revenues on a relatively narrow revenue base; and
- Moderate debt levels that are considered affordable given county incomes.

The county's GO bonds are secured by either limited-tax or unlimited tax pledges. Approximately \$437 million of the county's total outstanding GO bonds are also secured by net sewer system revenues. Through 2009, the county anticipates issuing \$150 million in limited-tax GO bonds. A combination of additional parity sewer bonds (secured solely by net sewer revenues, rated 'AA') and sewer revenue bonds (secured by the county's LTGO and totaling \$1.0 billion) may be issued through 2010.

Budget development for fiscal 2008 was conducted with an eye toward the looming and somewhat larger budget gap anticipated in 2009 due to softening revenue trends. Absent revenue or expense adjustments, fiscal 2009 projections indicate a \$93.4 million shortfall, equivalent to approximately 7% of the 2009 budget, and include depleting the county's \$24.7 million out-year deficit reduction reserve. Recognizing the need for financial cushion due to its limited revenue flexibility and as economic growth attenuates, management has in recent years presciently made incremental increases to reserve levels a priority.

This strategy began paying dividends in fiscal 2007, when county expenses exceeded revenues (audited) thereby slightly reducing the fund balance reserve. Even with this use of reserves, on a budgetary basis, the county ended fiscal 2007 with an unreserved fund balance of \$113.0 million, or more than 19.9% of expenditures. Increased reserve balances from 2003 to 2005 are proving integral to the county's financial position in fiscals 2007-2009. Current estimates for fiscal 2008 include the expectation of a \$30 million reduction to the undesignated general fund balance compared to audited 2007 results. If these trends hold, the county will end 2008 with an undesignated reserve balance (general fund) of about \$60 million, or a still strong 9.2% of expenditures. During 2008, the county will deploy \$6.4 million of the aforementioned out-year deficit reserve, leaving \$18.3 million for fiscal 2009. In addition, as part of the 2008 budget adoption process, the council adopted and funded a new rainy day reserve, which is being capitalized with \$15 million in funds that have heretofore been held in the county's sales tax reserve fund. Like the sales tax reserve, this fund is can be accessed under a narrow set of circumstances, including council-declared emergency situations; although unlike the sales tax reserve, the rainy day reserve is not subject to a funding cap of \$15 million. While the rainy day reserve does not have a formal minimum funding level, the \$15 million balance appears to be an operating target for management and council.

Several years of strong economic and revenue growth have masked a potential underlying structural or long-term misalignment between recurring revenues, which grow at 2%-3%, and expenditures, which grow 4%-5%. A culmination of accelerating economic growth in 2005 and 2006 actually began tepidly in 2002, following the acute recession of 2001. Growth trends gained momentum after a gradual but sustained economic expansion through 2004. However, recent economic data and what it portends for revenues on a pro forma basis present a picture that is more mixed and threatens to strain the county budget. Economic trends in 2008 turned negative, after remaining in positive territory longer than much of the nation. According to Global Insight, total employment growth turned negative by 0.1% (year over year, as of Sept. 12, 2008) and has decelerated from 2007, when job growth was 1.1% above that in September 2006. Employment growth is expected to slow further with another -0.1% in 2008.

Total assessed value (AV) trends reflect the torrid pace of price appreciation and construction activity in the residential real estate market in recent years. In 2008, AV totaled almost \$341 billion and a high \$183,202 per capita, averaging 8.6% growth per year during the past five years. However, compared to AV, which lags current market conditions, are more contemporary measures of the real estate market that show signs of softening: Through July 2008, home prices in the Seattle area market were down 8.2% compared to July 2007, while for the 20-city composite, the price decline was 16.3%.

County finances continue to face the challenge of providing local municipality-like services to 370,000 residents living in unincorporated King County. The cost of providing these services (\$46.7 million in 2008) exceeds the revenues generated in the unincorporated areas (\$25.1 million), producing a so-called "urban subsidy" to unincorporated areas of \$21.1 million per year.

Throughout 2008, the projected budget shortfall for 2009 grew from \$20 million to a recent estimate of \$93.4

million. Budget pressure is derived mainly from declining sales taxes, interest earnings, and fee revenues and is exacerbated by expenditure pressure stemming from labor contracts that link cost-of-living-adjustment (COLA) salary increases to the Consumer Price Index for Urban Wage Earners (CPI-W) with a floor of 2% and a ceiling of 6%. Absent a negotiated adjustment to this increase, inflationary trends are pushing formula-based COLA closer to the 6% ceiling. However, the county executive's proposed 2009 budget assumes labor union consent on the lower COLA. Overall, the budget is balanced by: reducing the COLAs down to 3% (saving \$13 million), making permanent recurring administrative changes and service reductions of \$38 million, and seeking state-legislative authority to realign certain programs and funding sources (representing a potential \$22 million in annual recurring expenditure savings). Lastly, balancing the fiscal 2009 budget entails exhausting the remaining \$18 million out-year-budget reserve. County budget assumptions are conservative in our view and assume, for example, a 4.5% outright decline in sales tax revenues. Realistic revenue projections, a willingness to make politically difficult service reductions, and creative efforts to realign programmatic responsibilities with funding sources all contribute to the county's capacity to meet its reserve targets. These efforts generally maintain the county's credit quality and will likely enhance its market access and/or ability to successfully negotiate third-party liquidity, if necessary.

King County's management practices are considered 'strong' under Standard & Poor's financial management assessment (FMA). An FMA of 'strong' indicates that we believe its practices are strong, well embedded, and likely sustainable.

On a per capita basis, total overlapping debt is moderate at \$3,289 and is low 1.8% of total market value. Annual debt service carrying charge as a percentage of total government-wide expenses is moderate at 9.5%. In addition, the county has liabilities associated with pensions and other post-employee benefits (OPEB). County pensions are managed by the state, which does not disclose funding ratios for participating agencies, although the county has a strong record of making its full annual required contribution. Statewide, the Public Employees Retirement System (PERS) is only adequately funded (plan assets-to-actuarial accrued liability) as of the most recent actuarial report from October 2007, which reflects data through 2006, at 74%. The county is also exposed to liabilities associated with retirement health care benefits, although the plan that provides lifetime benefits to employees is now closed. Additional liability is associated with county retirees having the option to purchase insurance at the county rate (an implicit rate subsidy). A recently completed actuarial study shows a relatively limited total unfunded actuarial accrued liability of \$142 million.

Outlook

The stable outlook reflects the county's demonstrated capacity for excellent financial management through a spectrum of economic cycles. The outlook also reflects that the county, as a matter of practice, performs thorough multiyear financial forecasting and has shown the willingness and ability to make substantive spending reductions when necessary to maintain budget balance and adhere to its own reserve policies. At the current rating level, the county's responsiveness and ability to enact expenditure reductions is critical, given our view that the current regional economic expansionary cycle has fully matured and thus positions the county for reduced revenue growth for the next one to two years.

Ratings Detail (As Of October 13, 2008)

King Cnty GO RFD

Unenhanced Rating

AAA(SPUR)/Stable

Affirmed

Ratings Detail (As Of October 13, 2008) (cont.)		
King Cnty Lmtd Tax GO rfdg bnds ser 2008		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
King Cnty GO		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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