Cross-sector – Seattle, Washington region

Rapid spread of coronavirus highlights risks facing municipalities

The State of Washington’s (Aaa stable) greater Seattle region, the first area with a reported coronavirus death in the US and experiencing a rapid spread of the illness, offers an example of how many types of issuers face risks from the virus and the potential credit effects. The region is an early indicator of a pattern swiftly emerging in other metro areas with a heavy concentration of coronavirus cases. Containment and mitigation efforts will likely decrease revenue and increase short-term costs for a range of local governments, infrastructure issuers, higher education institutions and healthcare entities (see sector-by-sector commentary below). The coronavirus also serves as a major social issue with its widespread health and safety implications.

Strong governance actions stand to blunt the effects of the virus, though the potential credit effects will ultimately depend on the severity and duration of the virus, the resources of the issuers, federal and state support and the broader US economy. We recently lowered our estimate for US GDP growth in 2020 to 1.5% from 1.7%. Public finance entities in the Seattle area (often referred to as the Puget Sound) with strong reserves and liquidity, as well as significant debt service coverage and proactive management, will remain better positioned to endure near-term revenue declines or cost overruns. However, there is considerable uncertainty around the length and severity of the outbreak and the negative effects on the US economy could be larger.

Multiple municipalities, including the City of Seattle (Aaa stable), have issued emergency declarations to allow for swifter responses to the coronavirus, and on March 12, Governor Jay Inslee announced the closure of all schools in King (Aaa stable), Snohomish (Aa1 stable) and Pierce (Aa1 stable) counties through April 24.
Many public finance entities will face both revenue declines and near-term cost increases as containment and migration efforts ramp up

Cities and counties: Costs to rise and drop in visitors poses a challenge; state and federal support likely to reduce the burden

The coronavirus stands to materially increase costs for local governments, though state and federal support will offset some of the burden, reducing the likelihood of a widespread reduction in credit quality. On March 13, President Trump declared a state of emergency in the US that allows the federal government to take steps toward providing states and local governments with financial relief in the face of the pandemic. Many local governments also benefit from property taxes as a relatively stable source of revenue, because the property value declines that would negatively affect the tax rolls occur on a lag. Yet issuers heavily reliant on economically sensitive sales and hotel taxes related to tourism and business travel will take a revenue hit from the virus. Sales taxes will, as with hurricanes, spike over a relatively brief period as people stock up on basic necessities.

King County’s per-day expenditure estimates tied to the virus have risen to $100,000 as of March 6 from approximately $30,000 two weeks prior and County Executive Dow Constantine estimates that the county will ultimately spend around $50 million in the short term dealing with the public health crisis. A greater need for testing and identification will likely increase costs, including capital expenses. Early in March, King County announced that it would purchase a motel to house coronavirus patients, and that housing originally bought for homeless people will instead be used to isolate recovering coronavirus patients.

Issuers heavily reliant on sales and hotel taxes related to tourism and business travel will face substantial challenges

A lengthy reduction in tourism and continued cancellations of conferences and other business-related gatherings will hurt issuers heavily dependent on sales and/or hotel tax revenue. On March 11, Governor Inslee announced a ban on gatherings of more than 250 people in the three most heavily affected counties, King, Snohomish and Pierce. Conference attendance and tourism have become an increasingly important part of the Seattle-area economy; according to Visit Seattle, the area had 41.9 million visitors in 2019 (up 2.3% from the prior year) and $8.1 billion in visitor spending, supporting 80,317 jobs. Lodging taxes generated $109.6 million in revenue for the Washington State Convention Center Public Facilities District (Aa3 stable) in 2018 covering debt service on more than $1.0 billion in bonds.

The short-term spike in sales taxes from purchasing supplies and nonperishable goods as the crisis worsens will wane. Activity at restaurants, shopping centers and theaters and public transit ridership was already declining prior to the governor’s ban as people began to avoid areas with larger numbers of people, and news outlets have reported layoffs and business closures as a result. For the City of Seattle, business, sales and excise taxes contributed $953 million of the city’s $1.6 billion of governmental revenues in 2018, with most of the remaining from property taxes.

Healthcare: Surge in patient volumes will increase costs and reduce elective and nonessential services

The coronavirus will increase patient volumes and expenses at the Seattle region’s hospitals, including King County P.H.D. 2 (EvergreenHealth) (Aa2 stable), hospitals owned by Providence St. Joseph Health (Aa3 stable), the University of Washington Medical Center (owned by the University of Washington, Aaa negative), Virginia Mason Medical Center (Baa2 negative), Overlake Hospital Medical Center, WA (A2 stable) and others.

For hospitals, flu and virus outbreaks increase patient volumes but can curb margins. As the coronavirus spreads, the impact on hospitals will largely depend on how quickly volumes surge, the use of resources, and the length of stay of infected patients. Hospitals incur higher costs when patient volumes surge, including overtime and other unbudgeted staffing costs; the financial impact will partly depend on the level of additional funding provided by the federal government. Hospitals in Seattle and other major metropolitan areas are canceling elective surgeries in order to preserve capacity and resources for a possible surge in patients. Elective surgeries are among the most profitable services a hospital provides; cancellations or postponements over a protracted period would likely lead to a material downturn in hospital margins.
K-12 school districts: Negative effects from closures mitigated by state funding
On March 13, Governor Inslee ordered that all K-12 public and private schools in the state close through April 24. The state has indicated that it intends to maintain school funding despite any closures, as long as districts extend the school year to June 19, which is already near the last day of the normal school year in Washington. Districts report they may experience modest additional unplanned expenditures related to providing service remotely, either through online curriculum enhancements or providing supportive services to students while at home.

Airport and ports: Travel and trade disruptions are credit negative
As a growing international gateway for Asia-Pacific travel and shipping, the Port of Seattle (A1 stable intermediate lien revenue bond rating) — operator of the Seattle-Tacoma International Airport (SEA) and a marine cargo joint venture, the Northwest Seaport Alliance (NWSA), with the Port of Tacoma (A1 stable subordinate lien bond rating) — has exposure to effects from the coronavirus domestically and in Asia. A decline in air travel, cruise and marine cargo activity pose credit risks for the Port, though mitigants such as cost-recovery mechanisms at the airport and guaranteed payments at the ports will help offset financial hurdles, as will the Port’s good debt service coverage and liquidity.

For the March-June period, we expect a severe decline in airline passengers at SEA as the Airports Council International expects a drop near 30% for all airports nationwide and the potential for wider bans on air travel remains. This dovetails with our recent change in the outlook for the US airport sector to stable from positive. While a reduction in air travel demand is a negative for SEA, structural protections, contractual arrangements, and strong liquidity will ensure that the credit effects are ultimately manageable.

A reduction in passenger traffic will impact non-airline revenue from concessions, parking and rental car activity, reducing cash flow for the Port and revenue-sharing for airlines. However, the Port’s airline agreement provides for a strong and comprehensive cost recovery; substantially all revenues used to pay airport-related debt service come from airline cost centers. The Port also benefits from an “extraordinary coverage” option, in which it can raise airline fees to recover lost revenues from non-airline sources. Lower passenger volumes would normally alleviate throughput constraints and reduce operating expenses, but additional costs related to increased cleaning and other safety measures will limit the degree of savings.

Seaport-related revenue stands to decline because of a slowdown in cruise travel and drop in cargo throughput, and we estimate container cargo will drop by 15% in the first quarter because of supply-chain issues in China. However, cargo will likely strengthen in Q2 as a result of recovering production levels in China beginning in March; this is our baseline assumption, but there is considerable uncertainty around the length and severity of the disruption. Importantly the NWSA’s high level of minimum annual guarantees (MAGs), which comprise nearly 70% of operating revenue, will also minimize revenue declines.

Higher education: Credit quality likely to remain stable in short run, though risks loom into the fall
Several universities and colleges in the Seattle area have halted in-person classes and moved their programs fully online. Across the university sector nationally, for fiscal 2020 (end date June 30 for most issuers), costs associated with the coronavirus will suppress operating margins, and potentially require a use of reserves. Depending on the severity and duration of the epidemic, the credit effects for fiscal 2021 stand to be more material, with the coronavirus potentially curbing summer revenue and fall 2020 enrollment, resulting in a decrease in net tuition revenue and cash flow. If current financial market volatility continues, a number of other revenue streams, including endowment income and gifts, stand to decline.

The University of Washington (UW, Aaa negative), the largest university in the state, announced on March 9 that classes will be fully online for the last two weeks of its winter quarter through March 20, although students remain on campus in residences and other facilities remain open. Governor Inslee’s orders on March 13 will require the university to continue to refrain from holding in-person classes through at least April 24, meaning the start of the spring quarter will also be online.

At around 31%, UW has a large percentage of students from outside the state and country, with international students accounting for about half that figure. International students tend to pay full tuition, so a substantial reduction in attendance would significantly curb revenue. Still, the university’s diverse revenue streams (23% from net tuition revenue, 23% from government appropriations and 35% from patient revenue with its hospital operations) will serve as a substantial buffer against any decline in tuition revenue. The coronavirus’ effect on UW’s academic medical center and hospital revenue will suppress university margins if expenses to treat the virus soar.
Mass transit: Slowing economy and lower riderships will suppress revenue
The Central Puget Sound Regional Transit Authority (Sound Transit, prior bonds Aaa stable, parity bonds Aa1 stable) will likely experience a shortfall in the sales, motor vehicle and car rental taxes pledged to its debt as well as in farebox revenue as economic activity and ridership slow. Debt service coverage will, however, remain very strong. Coverage of maximum annual debt service on the prior and parity bonds by 2019 pledged tax revenues exceeded 25x and 10x, respectively, and Sound Transit has limited future borrowing plans. A protracted regional economic slowdown and shortfall in tax revenue could force the authority to scale back or delay elements of its large capital plan. The decline in farebox revenue stands to present some operating budget challenges, but the source represent less than 5% of Sound Transit’s revenue.

Strong governance will help mitigate negative credit effects
Governmental response at the state and local level has been strong. The state and King County issued emergency declarations relatively early, though the absence of widespread coronavirus testing poses a significant health and safety risk. Accurate, timely dissemination of information to the public will remain crucial.

The state implemented mandatory sick leave beginning January 1, 2018 for all employers in the state under Initiative 1433, making it more likely that individuals with coronavirus symptoms will self-isolate, and government leaders have encouraged people with illnesses to stay home. The state is just one of 11 in the country (plus Washington, DC) with mandatory sick leave laws (30 localities have them). Additionally, the uninsured rate in the State of Washington (6.4% in 2018) is below the US uninsured rate (8.9%), suggesting the state may be better positioned to respond to health-related crises than the country as a whole, potentially limiting negative fiscal effects.

Coronavirus is a major health and safety risk that complicates other social issues
The virus is in itself a major social risk, affecting the health and safety and education of many in the region. It also presents complications for the large and growing homeless population in the Seattle area. Like indigent populations elsewhere in the country, the homeless are less likely to receive treatment and more likely to have existing health problems than the general population. The high cost of living in the Seattle area also increases the likelihood that individuals who work hourly-wage jobs will ignore safety precautions (such as self-isolation when sick) in order to continue to earn income, potentially further spreading the virus. The cost of healthcare also has the potential to discourage individuals from seeking a diagnosis and treatment, even for those with health insurance if their plan has high deductible levels. Rapid governmental response will be crucial in increasing public confidence and mitigating the human and economic costs of a public health crisis.
Moody’s related publications

» Global: Coronavirus and oil price shocks: managing ratings in turbulent times, March 17, 2020

» Global Macro Outlook 2020-21 (March 2020 Update) – Coronavirus will hurt economic growth in many countries through first half of 2020, March 6, 2020
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