

RatingsDirect®

Summary:

Selah, Washington; General Obligation

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| <i>Long Term Rating</i> | AA-/Stable | Affirmed | |
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Rationale

S&P Global Ratings affirmed its 'AA-' long-term rating on Selah, Wash.'s previously issued series 2014 general obligation (GO) bonds. The outlook is stable.

Selah will have about \$1.7 million in governmental debt at the end of 2019.

Security and use of proceeds

The city's full faith and credit, subject to statutory limitations, secure the city's limited-tax GO bonds. These include what is typically a 1% limit on annual property tax revenue growth without a voter override and a limit on the city's levy rate of \$3.60 per \$1,000 of assessed value (AV) under current conditions. The city's 2019 general levy rate is \$2.27.

Because the tax base supporting the city's limited-tax debt is the same that would secure unlimited-tax GO bonds and because we view the city's property tax revenue as lacking limitations on fungibility, our rating is on parity with our view of the city's general creditworthiness.

Proceeds funded previously issued GO debt to achieve interest expense savings.

Credit overview

Selah has recently experienced a jump in AV, which suggests that its tax revenue performance is likely to improve in the medium term and help it maintain or increase its reserves from an already very strong level before an adjustment for cash-basis reporting. We view the city's credit profile as primarily constrained by the quality of its financial reporting, with biennial audits and a lack of accrual-based accounting, as well as a minimum reserve policy that allows for the general fund to fall to close to our threshold for low nominal reserves. However, we also think the city's strong debt and contingent liability profile, including low pension carrying charges, provides it flexibility to finance future capital needs.

The rating reflects our assessment of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area;
- Adequate management, with standard financial policies and practices under our financial management assessment methodology;

- Strong budgetary performance, with an operating surplus in the general fund and break-even operating results at the total governmental fund level in fiscal 2017;
- Strong budgetary flexibility, with an available cash reserve in fiscal 2017 of 18% of operating expenditures;
- Very strong liquidity, with total government available cash at 98% of total governmental fund expenditures and 17x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 5.8% of expenditures and net direct debt that is 19.5% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization of direct debt; and
- Adequate institutional framework score.

Strong economy

We consider Selah's economy strong. The city, with an estimated population of 7,820, is located in Yakima County in the Yakima metropolitan statistical area, which we consider broad and diverse. The city has a projected per capita effective buying income of 88% of the national level and per capita market value of \$93,600. Preliminary data show county unemployment rate was 6.4% in 2018, down from 6.8% in the prior year.

The city is undergoing a surge in AV, which is equal to market value in the state, with a 7% increase in 2018 and a 14% increase in 2019 to \$731.6 million after a 2% annual average in the prior five years. Management attributes this largely to rising residential property values. We have seen home prices rise in pockets of Eastern Washington as a consequence of unaffordability in the Portland and Seattle regions, and this could be part of that trend, as Yakima County is well connected to both of those areas and is one of the most affordable parts of the state. We think this could eventually spur housing development, but we understand that fruit packers still dominate among taxpayers, with the latest data from 2014 showing four alone making up 16% of total AV.

Adequate management

We view the city's management as adequate, with standard financial policies and practices under our financial management assessment methodology, indicating our view that the finance department maintains adequate policies in some but not all key areas.

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

- The close tracking of tax revenue line items and cost components, as well as guidance from the county assessor to build budgetary assumptions;
- Monthly budget-to-actual reports to council;
- Lack of formalized annually updated long-term financial planning;
- Capital plan that is updated every other year covering a six-year horizon and including projects' timing and funding sources;
- Internal investment policy prioritizing preservation of principal and mandating compliance with state and federal rules but without specific numerical constraints, and reporting that occurs every other year in audited financial statements;
- Internal debt management policy that includes basic principles but lacks ratio constraints; and

- Formal reserve policy to maintain the general fund balance at 10% of annual operating expenditures for emergencies, with a two-year replenishment requirement.

Strong budgetary performance

Selah's budgetary performance is strong, in our opinion. The city had surplus operating results in the general fund of 2.0% of expenditures and balanced results across all governmental funds of 0.3% in fiscal 2017. With a small budget relative to that of its state and national peers, we note that small changes in dollar terms can result in large changes in percentage terms. The best available information we have points to a 7% general fund net result in 2018 and a 4% negative result for 2019.

Broadly speaking, we view Selah's financial performance as likely to come in stronger in 2019 than the budget suggests. This is because we find that even if statutory limits tend to make AV changes a poor indicator of property tax revenue, we find strong AV growth can be an indicator of tax-generating activity in other areas, such as fruit packers' use of water, which generates utility user taxes. Management reports that the city is considering leveraging its now much larger tax base by putting a request to voters as early as August 2019 to request an increase in property tax revenue to fund fire protection service improvements. The city's revenue structure suggests exposure to economic cycles with gross receipts tax revenue (known as business and occupation tax in the state) the leading tax revenue source at 34% of the general fund, followed by sales taxes (26% of total general fund revenues) and property taxes (20%).

Strong budgetary flexibility

Selah's budgetary flexibility is strong, in our view, with an available cash reserve in fiscal 2017 of 18% of operating expenditures, or \$1.1 million. This was up slightly from 2016, and we anticipate that strong budgetary performance will lead to growth in some form in 2018 and 2019.

Negatively affecting our view of budgetary flexibility, in our view, is Selah's use of cash accounting, which reduces clarity about the amount of funds that are truly available. Similarly, we see the city's audited financial reporting on an every-other-year basis as a credit weakness because it provides external stakeholders with less transparency than is typical nationwide, particularly because reports tend to be released about 13 months after the end of the reporting period. Partly mitigating this concern is the state auditor's office's requirement that all local governments provide financial data within five months of the end of a fiscal year for posting on its website.

Very strong liquidity

In our opinion, Selah's liquidity is very strong, with total government available cash at 98.2% of total governmental fund expenditures and 17x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary, with a record of tapping the public markets for GO debt and state loans for utility debt during the past 20 years. The city's investments as of the end of 2017 consisted primarily of agencies (56% of total holdings), followed by a money market account (25%) and the state investment pool (19%). Management has confirmed that the city has no alternative financing, such as direct purchase debt, which we find can represent a source of contingent liquidity risk, outstanding.

Very strong debt and contingent liability profile

In our view, Selah's debt and contingent liability profile is very strong. Total governmental fund debt service is 5.8% of total governmental fund expenditures, and net direct debt is 19.5% of total governmental fund revenue. Overall net debt is low at 2.1% of market value, which is, in our view, a positive credit factor and amortization is rapid, with 84% of direct debt scheduled to be repaid during the next 10 years. Management reports that the city is considering moving its police department to permanent from rented space, which could lead to a debt issuance, but any proposals are in the early development stage.

The city participates in cost-sharing, multiple-employer public employee defined benefit and defined contribution retirement plans managed by the Public Employees' Retirement System (PERS) and does not provide other postemployment benefits. The city's pension contribution, which was equal to its required contribution, was 4.6% of total governmental fund expenditures in 2017.

Using Governmental Accounting Standard Board Statement Nos. 67 and 68 reporting guidelines, the city's proportionate shares of the net pension liability managed by PERS were \$845,100 for PERS 1 and \$796,000 for PERS 2/3 as of June 30, 2017. The city also participates in PERS-managed law enforcement officers and firefighters system plans 1 and 2, which were more than 100% funded. PERS 1, the largest plan by liability, maintained a funded level of 61.2% as of June 30, 2017, using its fiduciary net position as a percentage of the total pension liability, followed by PERS 2/3, at 91.0%. These ratios point to the likelihood of proportionally higher contribution requirements in the coming years, but from a base that we don't consider large.

Adequate institutional framework

The institutional framework score for Washington municipalities is adequate, partly as a result of statutory discretion regarding financial disclosure practices.

Outlook

The stable outlook reflects our view that Selah's surge in property values is likely to correlate with stronger tax revenue overall, which, we think, will lead to an easier budgetary environment, particularly if it leads to voters being willing to approve a property tax override. Although we don't expect the city to issue additional GO debt in the medium term, we wouldn't expect an issuance to harm the city's credit quality given the impending maturity of its existing obligations in 2022 and its very strong debt and contingent liability profile overall. At the same time, we anticipate that the city's financial reporting practices will continue to represent a weakness insofar as the city could take longer to identify and respond to operating imbalance or other financial challenge, but we think that the city council's monthly review of financial performance will help mitigate this risk. We do not expect to change our rating during the next two years.

Upside scenario

We could raise the rating if multiple factors we view as important to credit quality strengthened concurrently, such as if the city made multiple enhancements to its financial policies and practices as inventoried in our financial management assessment, if its general fund cash position significantly strengthened, and if its economic profile continued to strengthen.

Downside scenario

We could lower the rating if the city's general fund position fell to a level below its 10%-of-expenditures minimum cash threshold, which is slightly above our \$500,000 threshold for low nominal balances, particularly if we thought the city were entering a period of structural operating challenges.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 24, 2018
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2018 Update Of Institutional Framework For U.S. Local Governments

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