New Issue: Moody's assigns Aa1 to $484M Washington State GO Bonds

Global Credit Research - 03 Feb 2015

Approximately $19B GO bonds outstanding; outlook stable

WASHINGTON (STATE OF)
State Governments (including Puerto Rico and US Territories)
WA

Moody's Rating

ISSUE		RATING
Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2015F		Aa1
Sale Amount	$177,865,000	
Expected Sale Date	02/10/15	
Rating Description	General Obligation	
Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2015H		Aa1
Sale Amount	$133,480,000	
Expected Sale Date	02/10/15	
Rating Description	General Obligation	
Various Purpose General Obligation Refunding Bonds, Series R-2015G		Aa1
Sale Amount	$172,270,000	
Expected Sale Date	02/10/15	
Rating Description	General Obligation	

Moody's Outlook STA

NEW YORK, February 03, 2015 --Moody's Investors Service has assigned Aa1 ratings to the State of Washington's Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2015F, Various Purpose General Obligation Refunding Bonds, Series R-2015G, and Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2015H, to be issued in a combined amount estimated at $484 million. Following the issuance of these bonds, the state will have approximately $18.9 billion general obligations bonds outstanding, including bonds additionally secured by fuel taxes and tolls, all rated Aa1. The outlook on all of these ratings is stable.

SUMMARY RATINGS RATIONALE

Washington's Aa1 general obligation rating incorporates the state's sound management tools such as its quarterly consensus revenue forecasting process and demonstrated willingness to address budget shortfalls, along with an economy that is improving and expected to out-perform the nation over the long term. Revenue trends are positive, supported by employment gains and improvement in the state's housing market, and available reserves are increasing. These strengths are tempered by a sizable budget gap for the 2015-17 biennium driven largely by education spending mandates, exposure to the cyclical aerospace industry, and above average debt ratios. Frequent voter initiative activity adds budget challenges although the state legislature has a history of responding effectively to maintain budget balance.

OUTLOOK

Washington's rating outlook is stable reflecting economic gains that are boosting revenues, improving reserve position, and budget balancing solutions that are largely recurring. Moody's expects that the state will continue to address any budget gaps that emerge, as it has in the past, and absorb the substantial increase in mandated basic education funding. Economic concentration in some industries that are historically volatile poses longer-term credit risk.

WHAT COULD MAKE THE RATING GO UP

- Sustained trend of structural budget balance, plus maintenance of strong reserve levels

- Economic expansion and improved industry diversification

- Reduction of debt ratios to levels closer to Moody's 50-state medians

WHAT COULD MAKE THE RATING GO DOWN

- Slower recovery that restrains consumer confidence, leading to renewed revenue weakness and large budget shortfalls

- Employment erosion

- Protracted structural budget imbalance

- Increased reliance on one-time budget solutions

- Deterioration of the state's cash position

STRENGTHS

- Institutionalized governance practices such as consensus revenue forecasting, multi-year revenue and expenditure projections, and timely budget adoption

- Strong demographic trends

- Satisfactory overall liquidity levels maintained in pooled resources

- Healthy pension funding levels and modest retiree health insurance liability

- Increasing available reserves

CHALLENGES

- Significant future increases required in K-12 education funding

- Exposure to cyclical commercial aerospace industry

- Above-average debt ratios

- Voter initiative activity adding element of fiscal uncertainty

RECENT DEVELOPMENTS

There have been no significant new developments since our last report on the state, dated January 12, 2015.

DETAILED RATING RATIONALE

ECONOMY

The state's November 2014 economic forecast expects continued steady economic growth, with increasing employment in most sectors. Government sector jobs are maintaining modest upward momentum as state and local government employment offsets declining federal employment. Washington's government employment sector accounted for 18.2% of statewide employment in 2013, greater than the 16% nationwide share, due in part to the significant military presence in the state.

Aerospace jobs increased over the summer, but are still expected to decline over the next several years, largely due to productivity improvements rather than reductions in productions since backlog orders continue to increase. Housing permits continue to increase, driven by multi-family construction, particularly in Seattle, which is offsetting some continued weakness in single-family housing construction. Washington's unemployment rate rose modestly to 6.2% in October, slightly above the national rate.

FINANCES AND LIQUIDITY

Driven by economic growth, state revenues have grown steadily since the recession, albeit at a relatively moderate rate. On a GAAP basis, the state's non-federal operating fund revenues grew at a compound annual rate of 4.9% from fiscal 2010 through 2014. In its November 2014 forecast, the state forecasts that General Fund revenues for the fiscal 2015 will be 4.1% higher than 2014, and will increase by 4.0% and 4.8% in fiscal 2016 and 2017, respectively.

Due to rising revenues and expenditure controls, reserves, which fell to negative levels during the recession, have been gradually rebuilt. On a GAAP basis, available reserves, which consist of Unassigned General Fund Balance plus the state's Budget Stabilization Account increased from a negative $107 million (0.7% of revenues) at the end of fiscal 2011 to a positive $751 million (4.2% of revenues) at the end of fiscal 2014. In the November forecast, the state projects that total budget-basis reserves will increase to $1,297 million at the end of fiscal 2015, including $712 million in General Fund unrestricted ending balance and $585 million in the Budget Stabilization Account. This increase would bring reserves close to pre-recession levels.

The governor's proposed budget for the 2015-17 biennium projected a shortfall of $4.45 billion. The shortfall is primarily attributable to education spending mandates including the cost of complying with the state Supreme Court's "McCleary" decision ($1.2 billion) and the cost of funding Initiative 1351 ($2.0 billion). Initiative 1351 was approved by voters in the November 2014 election and mandates reduced class sizes and other school staffing increases. Other factors include salary increases and increased pension costs.

The governor's budget addresses the shortfall with a combination expenditure cuts and new revenues. New revenues would total $1.4 billion for the biennium and include a new capital gains tax ($798 million) and a new carbon pollution charge ($379 million). The governor also proposes that the legislature amend Initiative 1351 to reduce its spending impact. In Washington, the legislature has broad authority to amend voter-approved initiatives, a governance strength. The budget as proposed is projected to result in a drawdown in total reserves of approximately $210 million. It is unclear how the legislature will respond to the governor's proposals.

Liquidity

The state's overall liquidity is sound and has improved notably over the last four years with the improvement in GAAP-basis financial position. Average daily balances in the Treasury and Treasurer's Trust Fund were $4.4 billion for calendar year 2014. The state does not issue cash flow notes.

DEBT AND PENSIONS

Debt Structure

Washington's debt ratios are more than twice Moody's 2014 50-state median level; net tax-supported debt as a percentage of personal income is 6.4%, compared with Moody's 50-state median of 2.6%. Despite the significant increase in total debt outstanding during the previous decade, the debt-to-personal income ratio has remained fairly stable due to Washington's strong personal income growth. Washington's net-tax supported debt per capita ($2,924) is more than twice the national median of $1,054. Annual debt service costs relative to revenue available for debt service (Moody's calculation) was also relatively high at 9.1% in fiscal 2013 versus a median of 5.2%. Washington has no variable rate debt or interest rate swaps.

Debt-Related Derivatives

The state has no debt-related derivatives.

Pensions and OPEB

While debt ratios are above average, the state's aggregate pension funding is relatively strong. Based on the Washington's fiscal 2013 pension data, Moody's has have calculated that the overall retirement systems' adjusted net pension liability (ANPL) was 43.5% of governmental revenues, well below the 50-state median of 60.33.9%. Other pension ratios such as ANPL to personal income, GDP, and population are similarly below the medians. In August, the state Supreme Court upheld pension reforms adopted by the legislature in 2007 and 2011, avoiding an increase in the state's pension liabilities.

In Washington, retiree benefits are set as part of the biennial budget process and funded on a pay-as-you-go-basis. As of January 1, 2013, the most recent date for which a full valuation was prepared, Washington's other post-employment benefits (OPEB) liability for state employees was relatively modest at $3.7 billion (present value of future benefits), largely due to implicit rate subsidies. The annual required contribution (ARC) for fiscal year 2014 was $354 million, about 1.4% of the state's total governmental revenues, excluding federal aid.

GOVERNANCE

The state has strong governance practices including a quarterly consensus revenue forecasting process, multi-year revenue and expenditure projections, timely budget adoption, and a demonstrated willingness to address budget shortfalls. Although frequent voter initiative activity can create budget challenges, the state legislature has broad powers to amend or suspend voter-approved initiatives.

KEY SCORECARD STATISTICS

Per capita income relative to U.S. average: (105.6%)

Industrial diversity (1=most diverse): (0.66)

Employment volatility (U.S.=100):

Available balances as % of operating revenue (5-yr. avg.): (0%)

NTSD/total governmental revenue: (56.2%)

3-year avg. adjusted net pension liability/total governmental revenue: (33%)

OBLIGOR PROFILE

Washington is the thirteenth largest state by population, at 6.9 million. Its state gross domestic product is fourteenth largest. The state is wealthy, with per capita personal income equal to 107% of the US level and a poverty rate in the bottom third among states.

LEGAL SECURITY

The Series R-2015G bonds are general obligations of the state, to which the state has pledged its full faith, credit and taxing power. The Series R-2015F and R-2015H bonds are also general obligations, but additionally secured by and expected to be paid from motor vehicle fuel taxes.

USE OF PROCEEDS

Proceeds of the Series R-2015F, R-2015G and R-2015H bonds will be used to refund outstanding bonds for debt service savings.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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Analysts

Kenneth Kurtz
Lead Analyst
Public Finance Group
Moody's Investors Service

Nicholas Samuels
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA