

## CREDIT OPINION

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### New Issue

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## State of Washington

New Issue - Moody's assigns Aa1 to \$522M Washington State GO bonds, Series 2016C&D; outlook stable

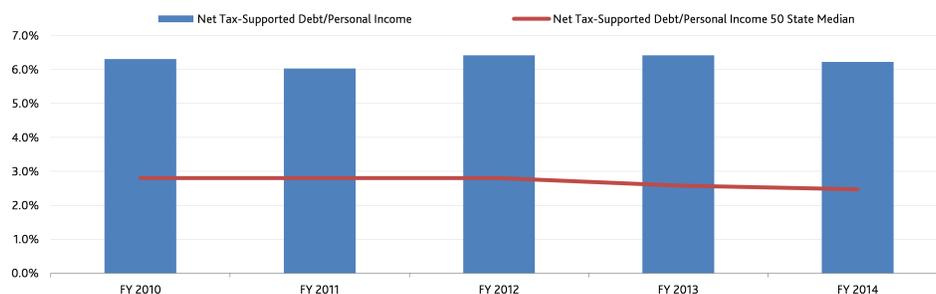
### Summary Rating Rationale

Moody's Investors Service has assigned Aa1 ratings to the State of Washington's Various Purpose General Obligation Bonds, Series 2016C, and Motor Vehicle Fuel Tax General Obligation Bonds, Series 2016D. The Series 2016C and 2016D bonds are expected to be issued in the amounts of \$321.6 million and \$200.5 million, respectively. Following the issuance of these bonds, the state will have approximately \$19.1 billion of general obligation bonds outstanding, including bonds additionally secured by fuel taxes and tolls, all rated Aa1.

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 education spending mandates, exposure to the cyclical aerospace industry and other export markets, 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.

Exhibit 1

### Washington's Debt Level Exceed 50-State Medians



Source: Moody's Investors Service US State Debt Medians Reports.

## Credit 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

## Credit Challenges

- » Significant future increases required in K-12 education funding
- » Exposure to cyclical commercial aerospace industry and export market
- » Above-average debt ratios
- » Voter initiative activity adding element of fiscal uncertainty

## Rating Outlook

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

## Factors that Could Lead to an Upgrade

- » 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

## Factors that Could Lead to a Downgrade

- » Employment erosion
- » Protracted structural budget imbalance
- » Increased reliance on one-time budget solutions
- » Deterioration of the state's cash position

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Key Indicators

Exhibit 2

### Washington Has Rebuilt Reserves Since the Recession

| Washington  | FY 2010    | FY 2011    | FY 2012    | FY 2013    | FY 2014    |
|---|------------|------------|------------|------------|------------|
| Operating Fund Revenues (000s)  | 14,645,913 | 16,252,763 | 16,099,012 | 17,067,211 | 17,765,292 |
| Balances as % of Operating Fund Revenues                              | -3.8%      | -0.7%      | 0.8%       | 2.4%       | 4.2%       |
| Net Tax-Supported Debt (000s)   | 17,712,354 | 17,677,697 | 19,425,533 | 20,386,128 | 20,422,165 |
| Net Tax-Supported Debt/Personal Income                                | 6.3%       | 6.0%       | 6.4%       | 6.4%       | 6.2%       |
| Net Tax-Supported Debt/Personal Income 50 State Median                | 2.8%       | 2.8%       | 2.8%       | 2.6%       | 2.5%       |
| Debt/All Governmental Funds Revenue                                   | 53.1%      | 50.6%      | 56.4%      | 56.2%      | 52.7%      |
| Debt/All Governmental Funds Revenue 50 State Median                   | 23.4%      | 22.7%      | 24.3%      | 23.8%      | 23.0%      |
| Adjusted Net Pension Liability/All Govt Funds Revenue                 | 27.8%      | 32.7%      | 25.2%      | 43.5%      | 56.7%      |
| Adjusted Net Pension Liability/All Govt Funds Revenue 50 State Median | 57.1%      | 48.7%      | 63.9%      | 60.3%      | 59.2%      |
| Total Non-Farm Employment Change (CY)                                 | -1.3%      | 1.3%       | 1.6%       | 4.3%       | 2.8%       |
| Per Capita Income as a % of US (CY)                                   | 106.0%     | 105.3%     | 106.5%     | 106.6%     | 107.5%     |

Sources: State Audited Financial Statements with Moody's Investors Service Adjustments; Moody's Investors Service State Debt and Pension Medians Reports; US Bureau of Labor Statistics; US Bureau of Economic Analysis.

## Recent Developments

Recent developments are incorporated in the Detailed Rating Considerations.

## Detailed Rating Consideration

### Economy and Tax Base

Washington State benefits from a high-value-added, but often cyclical, commercial aircraft industry; a fast growing information technology industry; and above average per capita income and household wealth. Large agriculture and timber sectors are vulnerable to volatile commodity prices and export demand. Officials indicate that a significant and growing share of the state's exports go to China, with China accounting for 22.8% of total exports in 2014.

The state's unemployment rate declined to 5.3% in November, compared to 6.3% one year earlier. The unemployment rate in the Seattle area fell to 4.2%. Personal income in the state grew by 5.8% in 2014, compared to 4.4% for the US, but growth slowed in the first three quarters of 2015. Housing construction, driven by the Seattle area, was particularly strong in the first quarter of 2015. Transportation exports (primarily Boeing aircraft) increased by 7.7% in the first 11 months of 2015, compared to the same period in 2014. But exports other than transportation equipment dropped by 16.3%, largely due to the stronger dollar and economic weakness overseas. The state's economic forecasts expect continued steady economic growth, with increasing employment in most sectors.

### Financial Operations and Reserves

Driven by economic growth, state revenues have grown steadily since the recession. On a GAAP basis, the state's non-federal operating fund revenues grew at a compound annual rate of 5.1% from fiscal 2010 through 2015. In its November 2015 forecast, the state projected that General Fund revenues will increase by 5.8% and 3.5% in fiscal 2016 and 2017, respectively. The projections are slightly higher than those of earlier forecasts.

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 \$1,477 million (7.9% of revenues) at the end of fiscal 2015. In the November forecast, the state projected that total budget-basis reserves will increase from \$1,524 million at the end of fiscal 2015 to \$1,618 million at the end of the 2015-2017 biennium, including \$891 million in the Budget Stabilization Account. This increase would bring reserves back to pre-recession levels.

The governor's supplemental (mid-biennium) budget includes moderate expenditure increases for Medicaid caseload growth, mental health needs, and wildfire response. These changes could reduce ending balances slightly from the November forecast.

The enacted budget for the 2015-17 biennium included a significant increase in K-12 education funding in response to the State Supreme Court's ruling in the "McCleary" case. The budget also includes additional funding for higher education. In conjunction with the approval of the budget, the legislature suspended for three years Initiative 1351 which would have required additional increases in K-12 funding.

Subsequent to the adoption of the 2015-17 budget, the Supreme Court ruled that the state had still not complied fully with its ruling in the McCleary case and imposed a fine on the state of \$100,000 per day. The legislature has not yet responded to the court's latest ruling.

#### 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 the 12 months from January through December 2015. The state does not issue cash flow notes.

### Debt and Pension

#### DEBT STRUCTURE

Washington's debt ratios are more than twice Moody's 2015 50-state median level; net tax-supported debt as a percentage of personal income is 6.2%, compared with Moody's 50-state median of 2.5%. 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 (\$2,892) is more than twice the national median of \$1,012. Annual debt service costs relative to revenue available for debt service (Moody's calculation) was also relatively high at 9.8% in fiscal 2014 versus a median of 5.3%.

#### DEBT-RELATED DERIVATIVES

The state has no variable rate debt and 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 calculated that the overall retirement systems' adjusted net pension liability (ANPL) was 43.5% of governmental revenues, well below the 50-state median of 60.3%. Other pension ratios such as ANPL to personal income, GDP, and population are similarly below the medians.

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, 2015, the most recent date for which a full valuation was prepared, the actuarial accrued liability attributable to the state (after retiree contributions) was \$5.274 billion. 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.

### Management and 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.

### Legal Security

The 2016C bonds are general obligations of the state, to which the state has pledged its full faith, credit and taxing power. The 2016D bonds are also general obligations, but are additionally secured by and expected to be paid from motor vehicle fuel taxes.

### Use of Proceeds

Proceeds of the 2016C bonds will be used to fund various state capital projects and programs, including K-12 school renewal and replacement projects, facilities for universities and colleges, state facility projects, outdoor recreation facilities, water supply development, flood mitigation and prevention, habitat conservation, and farmland and riparian protection. Proceeds of the 2016D bonds will be used to fund transportation projects, including high occupancy vehicle projects, widening of I-405, and other highway improvements.

## Obligor Profile

Washington is the thirteenth largest state by population, at 6.9 million. Its state gross domestic product is fourteenth largest. The population is wealthy, with per capita personal income equal to 107.5% of the US level and a poverty rate in the bottom third among states.

## 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.moody.com](http://www.moody.com) for a copy of this methodology.

## Ratings

Exhibit 3

### WASHINGTON (STATE OF)

| Issue   | Rating             |
|---|--------------------|
| Motor Vehicle Fuel Tax General Obligation Bonds, Series 2016D | Aa1                |
| Rating Type   | Underlying LT      |
| Sale Amount   | \$200,525,000      |
| Expected Sale Date  | 02/09/2016         |
| Rating Description  | General Obligation |
| Various Purpose General Obligation Bonds, Series 2016C        | Aa1                |
| Rating Type   | Underlying LT      |
| Sale Amount   | \$321,580,000      |
| Expected Sale Date  | 02/09/2016         |
| Rating Description  | General Obligation |

Source: Moody's Investors Service

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