MOODY'S
INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS Aa1 RATING TO STATE OF WASHINGTON'S $434 MILLION GENERAL OBLIGATION BONDS; OUTLOOK IS STABLE

Global Credit Research - 13 Jan 2011

AFFIRMS Aa1 RATING ON APPROXIMATELY $16.4 BILLION OF OUTSTANDING G.O. DEBT AND $8.3 BILLION OF DEBT GUARANTEED UNDER WASHINGTON SCHOOL BOND GUARANTY PROGRAM; AND Aa2 RATING ON $615 MILLION CERTIFICATES OF PARTICIPATION

Washington (State of)
State
WA

Moody's Rating

ISSUE		RATING
Various Purpose General Obligation Bonds, Series 2011B		Aa1
Sale Amount	$343,500,000	
Expected Sale Date	01/19/11	
Rating Description	General Obligation	
General Obligation Bonds, Series 2011T-2 (Taxable)		Aa1
Sale Amount	$90,400,000	
Expected Sale Date	01/19/11	
Rating Description	General Obligation	

Opinion

NEW YORK, Jan 13, 2011 -- Moody's Investors Service has assigned Aa1 ratings with a stable outlook to the State of Washington's $343.5 million Various Purpose General Obligation Bonds, Series 2011B and $90.4 million General Obligation Bonds, Series 2011T-2 (Taxable). The bonds are general obligations of the state and are expected to price on January 19, 2011. Proceeds will finance various capital projects. At this time, Moody's has also affirmed the Aa1 ratings affecting $16.4 billion of outstanding general obligation debt and $8.3 billion of debt enhanced by the state's general obligation guaranty through the Washington School Bond Guaranty Program. Concurrently, Moody's has affirmed the Aa2 rating affecting $615 million of outstanding Certificates of Participation. The rating outlook is stable.

SUMMARY RATINGS RATIONALE

The Aa1 general obligation rating incorporates Washington's strong management tools such as its quarterly consensus revenue forecasting process and conservative budgetary controls, absence of liquidity strain, and strong demographic trends that will help propel the economic recovery once it takes hold. These strengths are tempered by exposure to the cyclical aerospace industry, above average debt ratios, and frequent voter initiative activity that introduces budget challenges. As a state with heavy dependence on sales tax receipts and no personal income tax, Washington's revenues have been hit hard by the negative impact of the recession on consumer confidence. The state closed a sizeable $7.7 billion budget gap coming into the 2009-2011 biennium. Since then, revenues have continued to underperform and spending pressures have risen, largely due to increased demand for social services. As a result, the state has faced large budget shortfalls totaling approximately $3.8 billion for the 2009-2011 biennium. Gaps were closed through a combination of new recurring revenues, ongoing expenditure savings, and significant one-time resources, including depletion of General Fund reserves as of fiscal 2010. Given continued revenue weakness and failure to obtain voter approval for new revenue sources or extension of previously enacted temporary revenues in the November 2010 election, the proposed budget for the 2011-2013 biennium relies primarily on program cuts to close a projected $4.6 billion gap, including funding of the General Fund deficit from 2010.

State credit strengths are:

- Institutionalized conservative budgetary controls.

- Strong demographic trends

- Satisfactory overall liquidity levels despite recessionary stresses

- Relatively healthy pension funding levels and modest retiree health insurance liability

State credit challenges are:

- Economic weakness and steeper-than-forecast housing downturn drive large consecutive downward revenue revisions.

- Diminished financial flexibility given depletion of financial reserves, significant use of one-time actions to balance current biennial budget, and implementation of sizeable budget reductions over the past two years

- Exposure to cyclical commercial aerospace industry.

- Debt ratios above average and likely to increase.

- Voter initiative activity adds element of fiscal uncertainty.

DETAILED CREDIT DISCUSSION

CONSECUTIVE DOWNWARD REVENUE REVISIONS CHALLENGE 2009-2011 BUDGET

The state's adopted budget for the 2009-2011 biennium closed a sizeable $7.7 billion gap. Nevertheless, last spring, Washington faced a cumulative revenue shortfall (since June 2009) totaling a sizeable $1.8 billion while expenditures had increased by about $1 billion, largely driven by increased social services caseloads, particularly for Medicaid, opening up an additional $2.8 billion gap for the current biennium. To address the shortfall, the legislature adopted and the governor signed a supplemental budget in April 2010. The supplemental budget included program cuts totaling $755 million, and new permanent as well as temporary revenue enhancements totaling $757 million. The remaining budget solutions provided substantial one-time resources from the depletion of the rainy day fund and use other fund transfers, together totaling $690 million, as well as $618 million in approved or anticipated additional federal stimulus funds, including receipt of $480 million from the extension of enhanced FMAP funding through the remainder of fiscal 2011.

Continued revenue weakness and increased expenditure demands opened up an additional $1 billion budget gap as of November 2010. In response, the Governor implemented a 6.3% across-the-board budget cut effective October 1, 2010. Further, cuts totaling $488 million (includes some overlap with 6.3% reduction) were approved during a one-day special legislative session, along with the identification of $100 million of additional resources, primarily fund transfers. A supplemental budget was subsequently released on December 17, 2010 including $244 million of expenditure cuts, the deferral of a $253 million aid payment to school districts from June 30, 2010 to July 1, 2011, and $165 million of fund transfers to close the projected gap, leaving a projected ending budgetary basis fund balance of $99 million projected for fiscal 2011.

To date, the state has faced gaps totaling nearly $12 billion since the outset of the fiscal 2009-2011 budget process, equivalent to a significant approximately 25% of biennial expenditures, underscoring the severe fiscal distress the state has experienced during this economic downturn. Moody's believes that given the one-time actions already incorporated in the enacted budget, including use of rainy day funds, fund balance transfers, and federal stimulus money ($2.1 million in the General Fund), and the extent of expenditure cuts adopted to date, the state has reduced flexibility to address continued budget challenges. Favorably, despite the weak revenue performance, Washington's liquidity position remains satisfactory with no need to issue short-term notes for cash flow purposes.

PROPOSED BUDGET FOR 2011-2013 BIENNIUM INCLUDES FURTHER PROGRAM REDUCTIONS

The most recent downward revisions to the revenue forecast for the 2011-2013 biennium, reflecting deceleration of the economic recovery since the summer of 2010 and the failure of voters to enact or extend revenue enhancements, compounded by increasing expenditure demands, resulted in a $4.6 billion projected gap coming into the fiscal 2011-2013 biennial budget, including the cost of fully funding initiatives approved by voters in 2000 which increased state support for K-12 Education ($1.6 billion). The Governor's proposed budget addresses this gap by continuing the suspension of these initiatives and implementing further education program cuts (total K-12 program reductions equal $2.25 billion), and imposing further reductions to Higher Education ($570 million), Corrections ($114 million) and Parks ($60 million). These reductions include the impact of a temporary 3% reduction to employee compensation and increased employee health insurance contributions. The budget proposal also eliminates cost of living increases (COLAs) for the state's closed pension plans ($268 million). The proposal assumes 7.3% year-over-year revenue growth in fiscal 2011, reflecting the projected modest economic recovery from the low 2010 baseline, followed by 8.6% growth in 2012 reflecting projected economic strengthening next year. A return to the state's historic revenue growth rate of 6.2% is projected as of 2013. Given the state's commitment to addressing revenue shortfalls through budget reductions, Moody's expects expenditures would be adjusted as needed to maintain budget balance in the event the economic recovery lags current projections. Favorably, the proposal projects an $881 million ending fund balance providing potential budgetary flexibility, although this balance may ultimately be appropriated by the legislature prior to budget adoption.

REDUCED RESERVES PROJECTED FOLLOWING DOWNWARD REVENUE REVISIONS; CONSTITUTIONAL AMENDMENT PROVIDES FOR AUTOMATIC RAINY DAY FUND DEPOSITS

On a GAAP basis, Washington reported a available reserve position at the end of fiscal year 2010, the midpoint of the 2009-2011 biennium, with the RDF depleted and a deficit unreserved, undesignated General Fund balance (-$561 million), equivalent to -4.1% of General Fund revenues, net of federal aid.

In November 2007, Washington voters approved a constitutional amendment that permanently established a rainy day fund and provided for annual automatic deposits to the fund amounting to 1% of General Fund revenues, up to a maximum of 10% of General Fund revenues. Washington's emergency reserve (a precursor to the new RDF that was not constitutionally protected) peaked at $754 million at the end of fiscal 2000, just before the 2001 recession, and was rapidly depleted by fiscal 2004 as the state addressed previous revenue shortfalls. Going into the current recession, Washington had approximately $980 million in combined available reserves, including $303 million in the emergency reserve and $677 million in unreserved, undesignated general fund balance.

SOME SIGNS OF ECONOMIC STABILIZATION AND IMPROVEMENT

Washington's downward revenue revisions over the past year corresponded to continued weakness in the economy. However, there are signs that the state's underlying economy is beginning to stabilize. There have been modest private sector job gains in recent months, and although the construction sector continues to decline, the rate of job loss has slowed. In addition, export growth is strong and is expected to support the state's economic recovery. Moody's expects Washington's economic recovery to parallel that of the nation in the near term, although the non-residential construction sector will remain weak. Over the long term, the state should benefit from its educated work force and industry concentration in well-paying high technology and aerospace jobs.

Washington's unemployment rate in November 2010 was 9.2%, slightly below the national level of 9.8% for the same month. During the recession there were large scale layoffs at both Boeing (rated A2/negative outlook) and for the first time at Microsoft (rated Aaa/stable outlook). Of Boeing's nationwide 10,000 expected total layoffs, Washington's total job cuts are estimated at almost 5,000. Boeing's employment reductions in this recession are relatively modest compared with approximately 52,000 layoffs in 2001. For Microsoft, Washington job losses are approximately 2,400 out of a total of 5,000 company-wide. Exports from the state's important aerospace and software publishing industries are expected to contribute to the state's economic recovery although slower national and international economic improvements would affect Washington's economic outlook.

While Washington's near-term prospects for economic recovery appear to be favorable, we note a number of economic risks over the intermediate term. Boeing, the state's largest employer with more than 76,000 employees, recently chose to locate its second B787 production line in South Carolina and away from its traditional airplane assembly in Washington. Additionally, Washington's government employment sector accounted for 19.4% of statewide employment, greater than the 17.2% nationwide share, due in part to several military bases. These bases could be impacted by ongoing pressure on the federal budget. Moody's will monitor Boeing's decisions regarding future plant locations and the impact of potential military downsizing on Washington's economy over the intermediate term.

ABOVE-AVERAGE DEBT LEVELS REFLECT GROWTH-RELATED FINANCINGS

Washington's debt ratios are about twice Moody's 50-state median level; net tax-supported debt as a percentage of personal income is 5.3%, compared with Moody's 50-state median of 2.5% in 2010. 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. Even so, at $2,226, Washington's net-tax supported debt per capita is more than twice the national median of $936. The state's debt ratios will likely remain high given continued sizeable borrowing plans, especially for transportation purposes.

Washington has managed its debt levels through a combination of statutory and constitutional debt limits, measured by debt service as a percentage of average general state revenues for the preceding three fiscal years. This ratio is limited to 9% by constitution. Last year, the state legislature adopted a bill to align the statutory debt limit with the constitutional limit. This creates a single transparent constraint.

In recent years, Washington substantially increased its transportation infrastructure funding program, which is largely financed through the issuance of motor vehicle fuel tax general obligation bonds. Effective July 1, 2005, the state gas tax increased by 9.5 cents (phased-in over a four-year period) in order to support the planned issuance of motor vehicle fuel tax bonds. Washington's motor vehicle fuel tax bonds are not subject to the state's debt limitation. The bonds are payable first from the state's excise taxes on motor vehicles and special fuels. The state legislature has agreed to continue to impose those excise taxes in amounts sufficient to pay debt service on the motor vehicle fuel tax general obligation bonds. On or before June 30 of each year, the Senate Finance Committee certifies to the state treasurer the amount required to pay principal of and interest on the bonds in the next fiscal year. The state treasurer is required to withdraw revenues from any general state revenues received in the state treasury and from the motor vehicle fund, as applicable, and deposit in the bond fund on or before each debt service payment date amounts required to pay debt service on the bonds. While the state's gas tax receipts have been negatively affected by the recession, fiscal 2010 coverage of annual debt service on outstanding motor vehicle fuel tax general obligation bonds was satisfactory at about 1.6 times. About one-third of the state's total general obligation debt is payable from motor fuel excise taxes. The state's full faith credit and taxing power are also irrevocably pledged to the payment of the bonds.

Washington has $131.4 million in general obligation variable rate demand bonds outstanding, representing 1% of the state's total debt outstanding. The bonds are remarketed weekly and are supported by a standby bond purchase agreement with Helaba which expires in 2015. The state has no interest rate swaps.

While debt ratios are above average, the state's aggregate pension funding ratio is strong at 99% as of 2009. This represents over-funding of the state's open pension plans which masks underfunding of closed plans for state employees and teachers (funded ratios of 75% and 70%, respectively), despite statutory requirements for funding the closed plans' unfunded liabilities. A constitutional amendment to require funding of this liability (state is responsible for $3.8 billion) based on actuarial inputs is currently under discussion.

In Washington, retiree benefits are set as part of the biennial budget process and funded on a pay-as-you-go-basis. Based on a preliminary valuation as of June 30, 2010 by the State Actuary, Washington's other post-employment benefits (OPEB) liability for state employees is relatively modest at $7.2 billion, largely due to implicit rate subsidies. The annual required contribution (ARC) for fiscal year 2010 was $665 million (2.8% of General Fund expenditures).

Outlook

Washington's rating outlook is stable reflecting Moody's expectation that the state's finances will remain well-managed despite its recent sizeable budget shortfalls although uncertainty surrounding the timing and strength of the economic recovery could pose additional budget challenges. Given the substantial use of one-time actions to balance budget gaps thus far, Washington's reserve levels will likely remain slim over the near term. In addition, considerable out year structural gaps will likely be challenging to resolve. Economic concentration in some industries that are historically volatile poses longer-term credit risk. However, the state demonstrated impressive financial flexibility through the 2001 recession as it accommodated resulting economic and revenue swings and has shown a willingness to curtail spending during this economic cycle.

What Could Make The Rating Go Up

*Sustained trend of structural budget balance, plus restoration and 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

*Deeper and longer recession or muted recovery that restrains consumer confidence, leading to prolonged revenue weakness and employment erosion.

*Protracted structural budget imbalance.

*Increased reliance on one-time budget solutions.

*Deterioration of the state's cash position.

The principal methodology used in this rating was Moody's State Rating Methodology published in November, 2004.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings, public information, and confidential and proprietary Moody's Analytics information.

Moody's Investors Service considers the quality of information available on the credit satisfactory for the purposes of assigning a credit rating.

Moody's adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable including, when appropriate, independent third-party sources. However, Moody's is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

Please see ratings tab on the issuer/entity page on Moodys.com for the last rating action and the rating history.

The date on which some Credit Ratings were first released goes back to a time before Moody's Investors Service's Credit Ratings were fully digitized and accurate data may not be available. Consequently, Moody's Investors Service provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website www.moodys.com for further information.

Please see the Credit Policy page on Moodys.com for the methodologies used in determining ratings, further information on the meaning of each rating category and the definition of default and recovery.

Analysts

Lisa Cole
Analyst
Public Finance Group
Moody's Investors Service

Nicole Johnson
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

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

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