MOODY'S INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS Aa1 RATING TO STATE OF WASHINGTON'S $387.86M VARIOUS PURPOSE G.O. BONDS, SERIES 2012A; $323.615M MOTOR VEHICLE FUEL TAX G.O. BONDS SEREIS 2012B-1 AND B-2; AND $27.876M G.O. BONDS SERIES 2012T

Global Credit Research - 01 Jul 2011

OUTLOOK IS STABLE; APPROXIMATELY $16.6 BILLION OUTSTANDING G.O. DEBT

State
WA

Moody's Rating

ISSUE		RATING
Various Purpose General Obligation Bonds, Series 2012A		Aa1
Sale Amount	$387,860,000	
Expected Sale Date	07/20/11	
Rating Description	General Obligation	
Motor Vehicle Fuel Tax General Obligation Bonds, Series 2012B-2		Aa1
Sale Amount	$323,615,000	
Expected Sale Date	07/20/11	
Rating Description	General Obligation	
General Obligation Bonds, Series 2012T		Aa1
Sale Amount	$27,875,000	
Expected Sale Date	07/20/11	
Rating Description	General Obligation	

Opinion

NEW YORK, Jul 1, 2011 -- Moody's Investors Service has assigned Aa1 ratings with a stable outlook to the State of Washington's $387.86 million Various Purpose General Obligation Bonds, Series 201A (Competitive Sale), $323.615 million Motor Vehicle Fuel Tax General Obligation Bonds, Series 2012B-1 (Competitive Sale) and Series 2012B-2 (Negotiated Sale), and $27.875 million General Obligation Bonds, Series 2012T (Taxable). The bonds are general obligations of the state and the are expected to price on July 20, 2011 for the competitive sales and the week of July 18 for the negotiated sale. Proceeds will finance various capital projects.

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, 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. 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. Continued revenue underperformance and spending pressures, largely due to increased demand for social services, resulted in further budget shortfalls totaling $1.2 billion since April 2010 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 enacted budget for the 2011-2013 biennium relies primarily on program cuts to close a projected $4.9 billion gap.

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 that have driven 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

ENACTED BUDGET FOR 2011-2013 BIENNIUM INCLUDES SIGNIFICANT PROGRAM REDUCTIONS

Washington faced a $4.9 billion projected gap coming into the fiscal 2011-2013 biennial budget, including the sizeable cost of fully funding initiatives approved by voters in 2000 which increased state support for K-12 Education. In addition to rising expenditure demands, the state's budget challenges was compounded by the failure of voters to enact or extend revenue enhancements. The budget addressed the gap largely by cutting expenses by $4.5 billion including: continuing the suspension of the K-12 initiatives related to class size reduction and cost of living adjustments (COLA) saving a combined total of $1.2 billion, implementing further K-12 education program cuts ($394 million), and imposing further reductions to higher education ($535 million). The reductions also include a 3% reduction to employee compensation ($177 million) as well as increased employee health insurance and pension contributions. The budget also eliminates cost of living increases (COLAs) for the state's closed pension plans ($344 million). The budget assumes 5.3% year-over-year tax revenue growth in fiscal 2012, followed by 7.3% growth in 2012 reflecting projected economic strengthening next year. Given the state's commitment to address 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. While the budget passed by the legislature included $723 million in reserve, that amount was lowered to $163 million following the downward revenue revision in the June 2011 forecast. That amount includes $281 million in the budget stabilization account (BSA) offset by a negative ending fund balance (-$118 million). If the economic recovery is slower than expected, Washington's reserve levels will likely remain slim over the near term.

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

On a GAAP basis, Washington reported a negative 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 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 improved revenue trends over the past year corresponded to signs of economic stabilization. The state's economic growth has slowed since March, in part due to the earthquake in Japan which disrupted the manufacturing supply chain. Momentum is expected to build again later in 2011 although the pace of recovery will be slower than in the past. Washington expects to return to pre-recession employment levels by December 2013, slightly faster than the nation. There have been private sector job gains in recent months, although there was no employment growth in May and the construction sector continues to decline. Residential construction appears to be stabilizing while nonresidential construction remains weak. Aerospace is expected to support the state's economic recovery. 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 May 2011 was 9.1%, the same as the national level. 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). 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 72,000 employees, faces challenges given an aging workforce and unfavorable labor contract, which expires in two years. The company 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 19.7% of statewide employment, greater than the 17.3% 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 more than twice Moody's 2011 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 2.8%. 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 $2,626, Washington's net-tax supported debt per capita is more than twice the national median of $1,066. The state's debt ratios will likely remain high given continued sizeable borrowing plans, especially for transportation purposes.

Washington published its first debt affordability study in January 2011 to provide a framework for policymakers regarding debt financings. The state 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. In 2009, 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 37% 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 as of December 2010, representing less than 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.

STRONG OVERALL PENSION FUNDED RATIOS

While debt ratios are above average, the state's aggregate pension funding ratio was strong at 99% as of June 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.

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 and uncertainty surrounding the timing and strength of the economic recovery which 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, 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 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.

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