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INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS Aa1 RATING AND STABLE OUTLOOK TO STATE OF WASHINGTON MOTOR VEHICLE FUEL TAX GENERAL OBLIGATION BONDS, SERIES 2010F (TAXABLE BUILD AMERICA BONDS - DIRECT PAY)

Global Credit Research - 13 May 2010

MOODY'S AFFIRMS Aa1 RATING ON APPROXIMATELY $15 BILLION OUTSTANDING G.O. BONDS AND Aa2 RATING ON APPROXIMATELY $806 MILLION OUTSTANDING CERTIFICATES OF PARTICIPATION

State
WA

Moody's Rating

ISSUE		RATING
Motor Vehicle Fuel Tax General Obligation Bonds, Series 2010F (Taxable Build America Bonds - Direct Payment)		Aa1
Sale Amount	$1,130,000,000	
Expected Sale Date	05/25/10	
Rating Description	General Obligation	

Opinion

NEW YORK, May 13, 2010 -- Moody's Investors Service has assigned a rating of Aa1 to the State of Washington's $1.13 billion Motor Vehicle Fuel Tax General Obligation Bonds, Series 2010F (Taxable Build America Bonds - Direct Pay). Concurrently, Moody's has affirmed the Aa1 rating on the state's outstanding general obligation bonds (approximately $15 billion) and the Aa2 rating on approximately $806 million in outstanding certificates of participation. The Aa1 rating incorporates Washington's strong management tools such as its quarterly consensus revenue forecasting process and conservative budgetary controls; lack of liquidity strain; strong demographic trends that will help propel the economic recovery once it takes hold; 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. Last year, the state closed a sizeable combined budget gap of $9 billion as it ended fiscal year 2009 and enacted its 2009-2011 biennial budget. Over the past year, revenues continued to underperform and spending pressures rose, largely due to increased demand for social services. As a result, the state faced another large budget shortfall of approximately $2.8 billion for the 2009-2011 biennium, representing nearly 10% of projected general fund expenditures. Last month, a supplemental budget was adopted to close the gap with a combination of new recurring, ongoing expenditure savings, and significant one-time resources.

The state expects to sell the Series 2010F general obligation bonds on May 25. Proceeds will be used for statewide transportation projects.

State credit strengths are:

*Institutionalized conservative budgetary controls.

*Improved financial flexibility with increased rainy day fund (RDF) levels going into the 2007-2009 recession

*Strong demographic trends

*Maintenance of sound liquidity levels despite recessionary stresses

State credit challenges are:

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

*Significant use of one-time actions to balance current biennial budget reduces flexibility to address unexpected revenue shortfalls

*Exposure to cyclical commercial aerospace industry.

*Debt ratios above average and likely to increase.

*Voter initiative activity adds element of fiscal uncertainty.

CONSECUTIVE DOWNWARD REVENUE REVISIONS ADD BUDGET CHALLENGES

Washington's cumulative revenue under performance since June 2009 totals a sizeable $1.8 billion while expenditures have increased by about $1 billion, largely by increased social services as caseloads grew, particularly for Medicaid. This resulted in a new budget shortfall of approximately $2.8 billion for the 2009-2011 biennium. The amount is sizeable at almost 10% of projected expenditures for the biennium, based on the adopted supplemental budget. In addition, the gap arose after the state adopted a biennial budget that closed a $7.7 billion projected imbalance. Altogether, the budget shortfalls for the 2009-2011 biennium total a staggering amount that is roughly one-third of Washington's general fund biennial budget.

Last month, the legislature adopted and the governor signed a supplemental budget to address the latest shortfall. Program cuts total $447 million, including substantial reductions to K-12 ($125 million), health and human services ($108 million), and higher education ($73 million). New permanent as well as temporary revenue enhancements total $757 million. By narrowing tax preferences and establishing economic nexus standards, the state projects additional ongoing revenues totaling approximately $300 million. An increase in cigarette and tobacco taxes is expected to bring in $101 million, also permanent. Approximately $125 million is estimated from taxes were raised temporarily on beer, soda, candy, and bottled water. In addition, the state's business and occupation tax rate on services was temporarily raised from 1.5% to 1.8%, expected to bring in about $242 million. The temporary taxes are scheduled to expire on June 20, 2013 although they could be extended by the legislature.

The remaining budget solutions provide 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. Washington currently projects that it will end the biennium with a modest General Fund balance of $453 million, about 1.6% of projected expenditures. Given the one-time actions already incorporated in the enacted budget, including rainy day funds, fund balance transfers, and federal stimulus money, the state has reduced flexibility to address continued budget challenges.

Washington still faces forecast risks that include an extended recession that puts further downward pressure on the state's primary revenue source, sales taxes, which are vulnerable to the consumer confidence factors that have hurt the state's revenue underperformance. As in other states that have incorporated the receipt of federal stimulus money in their budgets, Washington will need to formulate plans to achieve budget balance once these resources are exhausted.

Despite the weak revenue performance, Washington's liquidity position remains sound with no need to issue short-term notes for cash flow purposes.

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

Washington's combined available reserves at the end of fiscal year 2009, the end of the 2007-2009 biennium, totaled approximately $210 million on a GAAP basis, with $21 million in the RDF and the remainder in unreserved, undesignated General Fund balance. The total amount was relatively modest at about 1.4% of annual general fund revenues, net of federal aid. The 2009-2011 biennial budget includes the required transfer of funds to the RDF but also the depletion of the fund by the end of the biennium to balance the budget.

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 job gains so far this year, although the construction sector continues to decline. In addition, the state's housing market is improving and exports are growing. 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 March 2010 was 9.5%, slightly below the national level of 9.7% the same month. During the recession there were large scale layoffs at both Boeing and for the first time at Microsoft. Of Boeing's nationwide 10,000 expected total layoffs, Washington's total job cuts are estimated at almost 6,000. Boeing's employment reductions in this recession are relatively modest compared with approximately 52,000 layoffs in 2001. For Microsoft, 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.

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 5.1%, compared with Moody's 50-state median of 2.5% in 2009. 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 $2,087, Washington's net-tax supported debt per capita is more than twice the national median of $865. 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 2009 coverage of annual debt service on outstanding motor vehicle fuel tax general obligation bonds was satisfactory at about 2.9 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.

While debt ratios are above average, the state's pension funding ratio was 100% funded on a combined basis as of 2008. However, the state budgeted approximately $449 million in savings in the current biennium from a change in pension actuarial assumptions and calculation methods. Based on an August 2008 valuation released by the State Actuary, Washington's other post-employment benefits (OPEB) liability for state employees is $4 billion and $3.5 billion for K-12 employees. Both amounts are largely due to implicit rate subsidies. The annual required contribution (ARC) for fiscal year 2009 was $331.7 million and $314.5 million for K-12 employees. In Washington, retiree benefits are set as part of the biennial budget process and funded on a pay-as-you-go-basis. In 2009, the explicit subsidy cost was $107 million and the implicit cost was $50.7 million. Now that states are required to disclose actuarially compliant figures, the size of the liabilities relative to one another and their impact on states' financial statements are becoming clearer. As a result, OPEB funding status will become more visible among the many attributes Moody's assesses in the municipal credit rating process.

Washington has about $140 million in general obligation variable rate demand bonds outstanding, representing about 1% of the state's total debt outstanding. The bonds are remarketed weekly and are supported by a standby bond purchase agreement with Helaba. The state has no interest rate swaps.

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 would change the rating - 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 change the rating - 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.

*Cash flow narrowing, leading to strained liquidity.

*Failure to adopt plan to cover expenditures once federal fiscal stimulus monies are no longer available

LAST RATING ACTION AND METHODOLOGY

The last rating action was on December 31, 2009, when Moody's assigned a Aa1 rating to the State of Washington's Various Purpose General Obligation Bonds, Series 2010E, and revised the outlook on the state's rating to negative from stable.

The principal methodology used in rating the State of Washington's Motor Vehicle Fuel Tax General Obligation Bonds, Series 2010F (Taxable Build America Bonds - Direct Pay) was Moody's State Rating Methodology, published in October 2004 and available on www.moodys.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

RECALIBRATION OF RATING TO THE GLOBAL RATING SCALE

The rating assigned to the State of Washington's Motor Vehicle Fuel Tax General Obligation Bonds, Series 2010F (Taxable Build America Bonds - Direct Pay) was issued on Moody's global rating scale. Market participants should not view the recalibration of municipal ratings as rating upgrades, but rather as a recalibration of the ratings to a different rating scale. This recalibration does not reflect an improvement in credit quality or a change in our credit opinion for rated municipal debt issuers. For further details regarding the recalibration of Moody's U.S. municipal ratings to its global scale please visit www.moodys.com/gsr.

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