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INVESTORS SERVICE

Rating Action: MOODY'S ASSIGNS Aa1 RATING TO STATE OF WASHINGTON'S $500M MOTOR VEHICLE FUEL TAX GENERAL OBLIGATION BONDS (SR 520 CORRIDOR PROGRAM-TOLL REVENUE), SERIES 2012C

Global Credit Research - 03 Oct 2011

OUTLOOK IS STABLE; APPROXIMATELY $17.2 BILLION OUTSTANDING G.O. DEBT

New York, October 03, 2011 -- Moody's Rating

Issue: Motor Vehicle Fuel Tax General Obligation Bonds (SR 520 Corridor Program-Toll Revenue), Series 2012C; Rating: Aa1; Sale Amount: $500,000,000; Expected Sale Date: 10/13/2011; Rating Description: General Obligation

Opinion

Moody's Investors Service has assigned a Aa1 rating with a stable outlook to the State of Washington's $500 million Motor Vehicle Fuel Tax General Obligation (SR 520 Corridor Program-Toll Revenue), Series 2012C. The bonds are general obligations of the state, secured also by state's excise taxes on motor vehicles and special fuels as well as by toll revenues from the state's SR 520 Corridor toll facilities, which encompass the State Route (SR) 520 bridge replacement and high occupancy vehicle (HOV) program. The state expects to issue revenue bonds that will have first and second lien claims on the toll revenues. The Series 2012C bonds will be third tier with respect to the toll revenues. The bonds are expected to price on October 13. Proceeds will be used to fund a portion of the Washington State Department of Transportation's (WSDOT) SR 520 floating bridge and eastside project. Interest is capitalized for seven months.

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, 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 going into the 2009-2011 biennium, and a subsequent shortfall of $1.2 billion. 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. The enacted budget for the 2011-2013 biennium relies primarily on program cuts to close a projected $4.9 billion gap. The latest revenue forecast (September 2011) revealed a $1.4 billion shortfall for the current biennium. The governor has called a special legislative session for the end of November to address the latest gap, and state agencies have been asked to identify additional cuts of 5% to 10%. 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.

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

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.

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, continuing revenue underperformance, 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. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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