MOODY'S INVESTORS SERVICE

New Issue: Moody's assigns Aa1 to Washington State GO Series R-2015C&D

Global Credit Research - 03 Oct 2014

Approximately $18.7B GO bonds outstanding; outlook stable

WASHINGTON (STATE OF)
State Governments (including Puerto Rico and US Territories)
WA

Moody's Rating

ISSUE		RATING
Various Purpose General Obligation Refunding Bonds, Series R-2015C		Aa1
Sale Amount	$526,000,000	
Expected Sale Date	10/15/14	
Rating Description	General Obligation	
Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2015D		Aa1
Sale Amount	$239,000,000	
Expected Sale Date	10/15/14	
Rating Description	General Obligation	

Moody's Outlook STA

Opinion

NEW YORK, October 03, 2014 --Moody's Investors Service has assigned Aa1 ratings to the State of Washington's Various Purpose General Obligation Refunding Bonds, Series R-2015C and Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2015D, expected to be issued in the approximate amounts of $526 million and $239 million, respectively. Proceeds of bonds will be used to refund outstanding bonds for debt service savings. The state has approximately $18.7 general obligations bonds outstanding, including bonds additionally secured by fuel taxes and tolls, all rated Aa1. The outlook on all of these ratings is stable.

SUMMARY RATINGS RATIONALE

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, despite a slow recovery. Revenue trends are positive, supported by employment gains and improvement in the state's housing market, and available reserves are increasing, though they remain modest relative to historical levels. 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. Early this year, Boeing Company (A2 stable) machinists approved a new contract, following which the company confirmed plans to assemble its next airplane, the 777X, and build its new wing in Washington, where it has been for nearly 100 years. As a result, thousands of high-paying, highly skilled aerospace manufacturing jobs should remain in the Puget Sound region, at least over the medium-term. Boeing is the state's largest private employer with approximately 86,000 workers statewide, representing about 3% of the state's labor force.

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

- Available reserve are increasing

CHALLENGES:

- Significant future increases required in K-12 education funding will pose out year budget challenges

- Diminished financial flexibility given financial reserves that are modest relative to historical levels

- Exposure to cyclical commercial aerospace industry

- Debt ratios above average

- Voter initiative activity adds element of fiscal uncertainty

DETAILED CREDIT DISCUSSION

ECONOMIC FORECAST ON TRACK

The state's September 2014 economic forecast expects continued steady economic growth, with increasing employment in most sectors. Government sector jobs are maintaining modest upward momentum as state and local government employment offsets declining federal employment. Washington's government employment sector accounted for 18.2% of statewide employment in 2013, greater than the 16% nationwide share, due in part to the significant military presence in the state. Aerospace jobs increased over the summer, but are still expected to decline over the next several years, largely due to productivity improvements rather than reductions in productions since backlog orders continue to increase.

Housing permits continue to increase, driven by multi-family construction, particularly in Seattle, which is offsetting some continued weakness in single-family housing construction. Washington's unemployment rate declined to 5.6% in August 2014, down over a percentage point from 7.0% in August 2013 and notably below the national rate of 6.1%. Washington's unemployment rate has now been below the national rate for 23 consecutive months.

REVENUE COLLECTIONS ESSENTIALLY PERFORMING IN LINE WITH PRIOR FORECASTS

The September forecast shows that revenue collections for the 2013-15 biennium are essentially on track at about $168.5 million or 0.4% above the June forecast. The state reports that sales tax collections, adjusted for large payments and refunds as well as amnesty payments and a change in taxpayer reporting frequency, were up 4.6% year-over-year in the first quarter and 7.9% in the second quarter of 2014. This positive performance offsets a decline in B&O tax receipts due to the July 2013 removal of the surcharge on service businesses. With no personal income tax, sales taxes represent Washington's largest resource at 48% of the state's fiscal 2013 general fund revenues, excluding federal aid. Real estate excise tax (REET) collections are above forecast, in part reflecting strong commercial activity in the Seattle office market. However, REET activity remains below the pre-recession peak.

Projected available reserves at the end of fiscal year 2015 now total $1,167.5 million, including $583.5 million in General Fund unrestricted ending balance and $584.0 million in the budget stabilization account (BSA). The expected ending balance is slightly higher than projected in November 2013 ($960 million) and well above the enacted budget for 2013-15 which showed expected combined available reserves totaling $630 million at the end of the biennium.

GAAP-basis results at fiscal year-end 2013 continued a trend of improving balances that had turned negative on a GAAP basis during the recession. Even so, the balance at the end of the fiscal 2013 was 2.8% of annual revenues, well below the state's 7% peak prior to the recession. Reserve levels are important given Washington's heavy reliance on sales taxes.

School funding costs will likely pose a significant budget challenge for the next biennium, 2015-17. The state Supreme Court recently issued an order finding the state in contempt for failing to submit a plan to increase K-12 education funding pursuant to the court's McCleary decision. The legislature will respond to the court's ruling during the 2015 legislative session.

ABOVE-AVERAGE DEBT LEVELS REFLECT GROWTH-RELATED FINANCINGS; STRONG OVERALL PENSION FUNDED RATIOS

Washington's debt ratios are more than twice Moody's 2014 50-state median level; net tax-supported debt as a percentage of personal income is 6.4%, compared with Moody's 50-state median of 2.6%. 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 ($2,924) is more than twice the national median of $1,054. Annual debt service costs relative to revenue available for debt service (Moody's calculation) was also relatively high at 9.1% in fiscal 2013 versus a median of 5.2%. Washington has no variable rate debt or interest rate swaps.

While debt ratios are above average, the state's aggregate pension funding ratio was strong at 101% as of June 2012. 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 69% and 79%, respectively), despite statutory requirements for funding the closed plans' unfunded liabilities. In August, the state Supreme Court upheld pension reforms adopted by the legislature in 2007 and 2011, avoiding an increase in the state's pension liabilities.

Based on the Washington's fiscal 2012 pension data, we have calculated that the overall retirement systems' adjusted net pension liability (ANPL) was 25.2% of revenues, below the 50-state median of 63.9%. 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, 2013, Washington's other post-employment benefits (OPEB) liability for state employees was relatively modest at $3.7 billion (present value of future benefits), largely due to implicit rate subsidies. The annual required contribution (ARC) for fiscal year 2013 was $342 million, about 1.4% of the state's total governmental revenues, excluding federal aid.

Outlook

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

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

- Slower recovery that restrains consumer confidence, leading to renewed revenue weakness and large budget shortfalls

- 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 US States Rating Methodology published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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