New Issue: Moody's assigns Aa1 ratings to State of Washington G.O. Refunding Bonds, Various Purpose Series R-2014A and Motor Vehicle Fuel Tax R-2014B; outlook stable

Global Credit Research - 02 Oct 2013

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-2014A		Aa1
Sale Amount	$120,150,000	
Expected Sale Date	10/10/13	
Rating Description	General Obligation	
Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2014B		Aa1
Sale Amount	$107,940,000	
Expected Sale Date	10/10/13	
Rating Description	General Obligation	

Moody's Outlook

Opinion

NEW YORK, October 02, 2013 --Moody's Investors Service has assigned Aa1 ratings to the State of Washington's $120.15 million Various Purpose G.O. Refunding Bonds, Series R-2014A and $107.94 million Motor Vehicle Fuel Tax G.O. Refunding Bonds, Series R-2014B. Proceeds of bonds will be used to refund outstanding bonds for debt service savings. The bonds are scheduled to be sold on October 10.

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.

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 reserves fund balances 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 and likely to increase.

Voter initiative activity adds element of fiscal uncertainty

DETAILED CREDIT DISCUSSION

2013-15 BIENNIAL BUDGET ADDRESSES $2.5 BILLION GAP

Washington faced a $2.5 billion gap going into the 2013-15 biennium reflecting $800 million in projected expenses for existing programs and $1.7 billion in enhancements for K-12 education, health and human services programs, higher education, and early learning opportunities. The projected gap represented about 8% of the revenue forecast for the next biennium but was significantly lower than the $4.9 billion shortfall that Washington faced going into the 2011-13 biennium.

Spending cuts totaling $1.55 billion represent the largest portion of the solution to resolve the budget gap. These include: $320 million from the re-suspension of teacher cost-of-living adjustments pursuant to voter initiative I-732; $272 million from the extension of hospital safety net assessments; and $351 million in savings from Medicaid expansion offered through the Affordable Care Act. The adopted budget also relies on $259 million in new revenue, mostly through reforming the estate tax and reforms in the telecommunications tax; $519 million in fund transfers; and $140 million in assumed reversions. One-time actions from the fund transfers represent less than 2% of the total budget and some of the revenue transfers can be considered ongoing since they are budgeted to continue over the next six years.

The budget plan also incorporates $1 billion in increased spending for basic education to begin addressing the state supreme court's McCleary decision last year. The ruling concluded that the state was not meeting its constitutional mandate to fully fund K-12 education. Continuing commitments are sizeable and will pose budget challenges over the near term. The governor has proposed increasing K-12 education funding by $3.0 to $3.8 billion over the following two budget cycles.

Budget deliberations were eased after the state's supreme court of the State of Washington struck down a new law requiring a two-thirds legislative majority to make tax changes as unconstitutional. The law, approved by voter initiative in November 2012, reduced the state's flexibility to raise revenues. It would have required either a two-thirds legislative approval or a vote by the people in order to raise taxes or repeal existing tax exemptions.

REVENUE FORECAST REVISED UPWARD IN SEPTEMBER 2013 FORECAST

The September 2013 revenue forecast for the 2013-15 biennium was $345 million higher than in June, reflecting continued economic improvement as well as legislation passed in June 2013. Projected available reserves at the end of fiscal year 2015 now total $863 million, including $284 million in General Fund balance and $579 million in the budget stabilization account (BSA). The previous forecast showed a total of $630 million in combined available reserves at the end of fiscal 2015. Preliminary results for the 2011-13 biennium that just ended show $382 million in available reserves, up from the prior forecast of $363 million, continuing a trend of improving balances that had turned negative on a GAAP basis during the recession. Even so, the balance budgeted for the end of the 2013-15 biennium is less than 3% 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, which have still not fully recovered.

SIGNS OF ECONOMIC STABILIZATION AND JOB GROWTH

Washington's economy continues to show signs of stabilization with all major employment sectors experiencing growth. Government sector jobs are growing slowly due to gains in state and local government employment which is offsetting declining federal employment. Washington's government employment sector accounted for 18.8% of statewide employment in 2012, greater than the 16.4% nationwide share, due in part to several military bases. Washington's construction sector is also improving although total employment in the sector in 2012 was about one-third below the pre-recession peak. The multi-family segment has largely recovered and single family construction is improving.

The impact of federal sequestration may be greater in Washington which has a higher civilian share of employment than in many other states. The state's forecast council estimates that sequestration will reduce state revenues by approximately $6 million each month it continues.

While the state's unemployment rate was above the national average during the recession, the level has steadily dropped and reached 6.8% in May 2013, comfortably below the national rate of 7.6% the same month. Since then, unemployment has risen slightly to 7.0% in August 2013 while the national rate continued to decline to 7.3% the same month.

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

Washington's debt ratios are more than twice Moody's 2013 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 2.8%. 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 $2,817 Washington's net-tax supported debt per capita is more than twice the national median of $1,074. The state's debt ratios will likely remain high given continued sizeable borrowing plans, especially for transportation purposes. Annual debt service costs relative to revenue available for debt service (Moody's calculation) was also relatively high at 9% in fiscal 2012 versus a median of 4.9%. 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.

Based on the Washington's fiscal 2011 pension data, we have calculated that the overall retirement systems' adjusted net pension liability (ANPL) was 32.7% of revenues, below the 50-state median of 45.1%. Other pension ratios such as ANPL to personal income, GDP, and population are similarly below the median. However, the combined liability for debt and pensions is slightly above the median (8.2% versus 7.6%) due to the state's high debt levels.

In Washington, retiree benefits are set as part of the biennial budget process and funded on a pay-as-you-go-basis. As of June 30, 2011, Washington's other post-employment benefits (OPEB) liability for state employees was relatively modest at $3.49 billion (present value of future benefits), largely due to implicit rate subsidies. The annual required contribution (ARC) for fiscal year 2012 was $320 million,1.4% of the state's total governmental revenues, excluding federal aid.

Outlook

Washington's rating outlook is stable reflecting the 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

RATING METHODOLOGY

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.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Analysts

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

Kenneth Kurtz
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

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

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

MOODY'S INVESTORS SERVICE