Moody's
INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS Aa2 RATING AND STABLE OUTLOOK TO STATE OF WASHINGTON $14 MILLION CERTIFICATES OF PARTICIPATION, SERIES 2011A (STATE AND LOCAL AGENCY REAL PROPERTY)

Global Credit Research - 13 Jan 2011

APPROXIMATELY $615 MILLION IN SIMILARLY SECURED OBLIGATIONS OUTSTANDING

Washington (State of)
State
WA

Moody's Rating

ISSUE	RATING
Certificates of Participation, Series 2011A (State and Local Real Property)	Aa2

Sale Amount	$14,000,000
Expected Sale Date	01/25/11
Rating Description	Certificates of Participation

Opinion

NEW YORK, Jan 13, 2011 -- Moody's Investors Service has assigned a rating of Aa2 with a stable outlook to the State of Washington's Certificates of Participation, in conjunction with the upcoming Series 2011A (State and Local Agency Real Property) issuance.

SUMMARY RATINGS RATIONALE

The certificates are payable from anticipated state base rent payments, under a master financing lease, which are in turn derived from underlying agency rental payments by the state and local agencies.

The certificates will be sold on January 25. Proceeds will finance relocation of a furniture factory operated by the correctional industries division of the state Department of Corrections; construction of a building to accommodate business and culinary education programs, a bookstore and a library at Bellingham Technical College; and refinancing of outstanding certificates of participation issued to construct an administration building for Woodinville Fire District.

The Aa2 rating reflects the credit standing of the State of Washington (general obligation bonds rated Aa1 with a stable outlook), the limited subject-to-appropriation nature of the state's master financing contract payment obligations, active administration of the financing program by the state treasurer's office, and the state's established track record of making appropriation-backed debt payments under a variety of financing programs. Moody's anticipates that the state will continue to avail itself of appropriation-backed financings for various purposes in the future.

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, 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. The state closed a sizeable $7.7 billion budget gap coming into the 2009-2011 biennium. Since then, revenues have continued to underperform and spending pressures have risen, largely due to increased demand for social services. As a result, the state has faced large budget shortfalls totaling approximately $3.8 billion 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 proposed budget for the 2011-2013 biennium relies primarily on program cuts to close a projected $4.6 billion gap, including funding of the General Fund deficit from 2010.

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 drive 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

CERTIFICATES ISSUED IN CONNECTION WITH MASTER FINANCING CONTRACT; STATE BASE RENT PAYMENTS SUBJECT TO APPROPRIATION

The certificates are issued in connection with a Master Financing Lease between the State of Washington, acting through the state treasurer, and the Washington Finance Officers Association (WFOA), a Washington nonprofit corporation. Under the terms of the master contract, the state treasurer will enter into agency financing leases with each participating state and local agency for various projects. State base rent payments pursuant to the master financing contract are subject to appropriation and emergency order reduction. The state has never failed to appropriate funds for any outstanding lease obligation. Permitted termination events include non-appropriation or executive order emergency reduction in state funding, although these are not events of default. The obligation of the state to make base rent payments, and of the respective agencies to make agency rent payments, is not subject to abatement or set-off. As with other state certificate financings, there is no debt service reserve fund.

Pursuant to a Master Indenture the state treasurer has covenanted to include in the biennial budget all scheduled agency rent payments due during that biennium. In addition, the state treasurer is obligated to make payments on behalf of any agency, subject to the availability of appropriated funds and also subject to any executive order reduction. The legislature is not legally bound to make appropriations, and any appropriations made are subject to executive order reduction by the governor during the biennium. Should one or more agencies default on payment obligations to the state, it is possible that this could affect the legislature's willingness to make future biennial appropriations. Mitigating this risk, however, is the active involvement of the state treasurer and the statewide benefit of the certificate issuance program, especially to small local agencies. Agency payments are due one month prior to certificate payment dates of July and January, thereby reducing the risk of non-payment in the event of a late budget. Washington has a history of adopting its budgets on time, if not early.

FULL FAITH AND CREDIT PLEDGE SECURES LOCAL AGENCY RENT PAYMENTS; STATE AGENCY PAYMENTS SUBJECT TO APPROPRIATION

Woodinville Fire District's participation in this issue has been approved by the state treasurer's office based on the project to be funded as well as ability to service the payments. Local agency debt service is secured by a full faith and credit pledge of the agency. In the event the district fails to make any scheduled payment when due, the treasurer is obligated to withhold distributions of tax or other revenues held by the treasurer on behalf of such agency, if any, and to the extent statutorily permissible (e.g. basic school aid may not be withheld). In addition, the treasurer is further obligated to make scheduled debt service payments on behalf of the local agency, subject to the availability of legally appropriated funds.

For state agency projects, debt service is secured by rent payments by state agencies subject to biennial appropriation by the legislature and mid-year executive order reduction by the governor. The risk of non-appropriation is mitigated by the lump-sum nature of appropriations to each state agency. Non-appropriation would require specific statutory language by the legislature.

For additional credit information on the state of Washington please see Moody's report published January 13, 2011.

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.

- Deterioration of the state's cash position.

The principal methodology used in this rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in October, 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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