MOODY'S INVESTORS SERVICE

New Issue: Moody's assigns Aa2 rating and negative outlook to state of Washington Certificates of Participation, Series 2012B (State and Local Agency Real and Personal Property)

Global Credit Research - 26 Jul 2012

Approximately $568 million in similarly secured obligations outstanding

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

Moody's Rating

ISSUE	RATING
Certificates of Participation, Series 2012B	Aa2

Sale Amount	$85,390,000
Expected Sale Date	08/07/12
Rating Description	Lease Rental: Appropriation

Moody's Outlook

Opinion

NEW YORK, July 26, 2012 --Moody's Investors Service has assigned a rating of Aa2 with a negative outlook to the State of Washington's Certificates of Participation, in conjunction with the upcoming $85.39 million Series 2012B (State and Local Agency Real and Personal Property) issuance. 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 August 7. Proceeds will finance the acquisition and construction of real and personal property projects, the largest of which are the construction of buildings on the main campuses of Lower Columbia College ($36.6 million) and Skagit Valley College ($29 million), both of which are overseen by the State Board for Community and Technical Colleges, a state agency.

SUMMARY RATINGS RATIONALE

The Aa2 rating reflects the credit standing of the State of Washington (general obligation bonds rated Aa1 with a negative 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 sound management tools such as its quarterly consensus revenue forecasting process and demonstrated willingness to address budget shortfalls, along with 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 an economy that proved more vulnerable to the housing downturn than expected. 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. Many states reported little or no budget gaps for fiscal 2012 as revenues improved and even over performed in some cases. Washington, however, announced a revenue shortfall of $1.4 billion last fall amounting to about 5% of the biennial budget. This was after the state closed a $4.9 billion budget gap going into the current 2011-2013 biennium that began on July 2, 2011. Forward-looking economic indicators are positive and high paying aerospace and technology jobs will eventually help Washington outperform the nation. While there are signs of stabilization, the state's construction industry continues to have a drag on the state's recovery reflecting a housing downturn that hit Washington later than most states and was worse than the state expected. In addition, public sector employment is declining as the state and local governments downsize in response to budget challenges.

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 despite recessionary stresses

-- Healthy pension funding levels and modest retiree health insurance liability

CHALLENGES:

-- Economic weakness and steeper-than-forecast housing downturn that have driven sizeable consecutive downward revenue revisions.

-- Diminished financial flexibility given depletion of financial reserves, significant use of one-time actions to balance budgets, and implementation of large budget reductions over the past several 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

The local agencies participating 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 a local agency 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 July 5, 2012.

Outlook

Washington's rating outlook is negative reflecting the magnitude of the revenue falloff that has challenged the state as it struggles to recover from the recession; depleted reserves and GAAP-based balances that will remain negative at least through fiscal 2012; and high fixed costs for the state's above-average debt position. Moody's expects that the state will continue to address any budget gaps that emerge, as it has in the past, although financial flexibility will remain strained over the near term and out year structural gaps will likely be challenging to resolve. 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

-- Delayed or muted recovery that continues to restrain consumer confidence, leading to further revenue weakness and 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 The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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