MOODY'S INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to $67.4M State of Washington COPs, Series 2014B

Global Credit Research - 31 Jul 2014

Outlook is stable

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

Moody's Rating

ISSUE		RATING
Certificates of Participation, Series 2014B (State and Local Agency Real and Personal Property)		Aa2
Sale Amount	$67,465,000	
Expected Sale Date	08/12/14	
Rating Description	Lease Rental: Appropriation	

Moody's Outlook STA

Opinion

NEW YORK, July 31, 2014 --Moody's Investors Service has assigned a rating of Aa2 to the State of Washington's $67.4 million Certificates of Participation, Series 2014B (State and Local Agency Real and Personal Property). The certificates are payable from anticipated state installment payments, under a master financing lease, which are in turn derived from underlying installment payments by the participating state and local agencies. Proceeds will finance and/or refinance the costs of acquiring real and personal property for the benefit of certain state and local agencies. The outlook on the rating is stable.

SUMMARY RATINGS RATIONALE

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.

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 reserves fund balances are increasing

CHALLENGES

- Significant future increases required in K-12 education funding that 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 adding element of fiscal uncertainty

DETAILED CREDIT DISCUSSION

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

The certificates are issued in connection with a master financing contract 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 contracts with each participating state and local agency for various projects. State payments pursuant to the master financing contract are subject to appropriation and executive 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 installment payments, and of the respective agencies to make agency installment 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 financing contract the state treasurer has covenanted to include in the biennial budget all scheduled agency installment payments due during that biennium. Additionally, 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 INSTALLMENT PAYMENTS; STATE AGENCY PAYMENTS SUBJECT TO APPROPRIATION

The local agencies participating in this issue have 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 payments are secured by a full faith and credit pledge of each 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). Additionally, 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 installment 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 June 11, 2014.

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

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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