Moody's Investors Service

New Issue: MOODY'S ASSIGNS Aa1 RATING AND STABLE OUTLOOK TO STATE OF WASHINGTON'S $730M G.O. BONDS AND $646M G.O. REFUNDING BONDS

Global Credit Research - 09 Oct 2009

MOODY'S AFFIRMS Aa1 RATING ON TOTAL OF APPROXIMATELY $15 B OF DEBT; OUTLOOK IS STABLE

State
WA

Moody's Rating

ISSUE		RATING
Various Purpose General Obligation Bonds, Series 2010C		Aa1
Sale Amount	$229,970,000	
Expected Sale Date	10/14/09	
Rating Description	General Obligation	
Various Purpose General Obligation Refunding Bonds, Series R-2010B		Aa1
Sale Amount	$417,925,000	
Expected Sale Date	10/14/09	
Rating Description	General Obligation	
Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2010C		Aa1
Sale Amount	$227,760,000	
Expected Sale Date	10/14/09	
Rating Description	General Obligation	
Motor Vehicle Fuel Tax General Obligation Bonds, Series 2010D (Taxable Build America Bonds - Direct Payment)		Aa1
Sale Amount	$500,000,000	
Expected Sale Date	10/15/09	
Rating Description	General Obligation	

Opinion

NEW YORK, Oct 9, 2009 -- Moody's Investors Service has assigned a rating of Aa1 with a stable outlook to the State of Washington's $229.97 million Various Purpose General Obligation Bonds, Series 2010C, $417.925 million Various Purpose General Obligation Refunding Bonds, Series R-2010B; $227.76 million Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2010C, and $504.2 million Motor Vehicle Fuel Tax General Obligation Bonds, Series 2010D (Taxable Build America Bonds - Direct Payment). Concurrently, Moody's affirmed the outstanding Aa1 rating on approximately $14.1 billion outstanding general obligation bonds and the Aa2 rating on approximately $799 million in outstanding certificates of participation. The outlook is stable.

Proceeds of the bonds will be used as follows: various purpose bonds for statewide projects; refunding outstanding bonds for net present value savings, and motor fuel tax general obligation bonds for transportation projects. The Series 2010D motor vehicle fuel tax general obligation bonds will be issued as taxable direct payment Build America Bonds (BABs).. The bond resolution provides for the BAB subsidy payment to be deposited into the bond fund. All series of bonds are scheduled to be sold the week of October 12.

State credit strengths are:

*Institutionalized conservative budgetary controls.

*Improved financial flexibility with increased rainy day fund (RDF) levels going into recession

*Strong demographic trends

*Maintenance of sound liquidity levels despite recessionary stresses

State credit challenges are:

*Economic weakness and steeper-than-forecast housing downturn drive large downward revenue revisions.

*Significant use of one-time actions to balance current biennial budget reduces flexibility to address unexpected revenue shortfalls

*Exposure to cyclical commercial aerospace industry.

*Debt ratios above average and likely to increase.

*Voter initiative activity adds element of fiscal uncertainty.

REVENUE DECLINE CONTINUES BUT PACE SLOWS

Washington's regularly scheduled quarterly revenue forecast in September revealed a revenue shortfall of $231 million for the 2009-2011 biennium, or about 0.7% of biennial appropriations. Weaker economic factors accounted for $100 million of the revised forecast while $75 million was due to weaker than forecast revenue collections relative to the June 2009 forecast. A change in business and occupation taxes resulted in a non-economic decline of $46 million. While revenues continue to be revised downward, the latest forecast represents the smallest downward revision thus far for the current biennium. Since June 2008, the revenue forecast for the 2009-2011 biennium has now been lowered by a cumulative $4.7 billion. The state has not yet formulated a plan to close the gap that has emerged, however the governor's supplemental budget is expected to address the shortfall when it is presented in December, by which time the next quarterly forecast will be available. Washington drew on its RDF to address a budget shortfall that emerged at the end of the 2007-2009 biennium. As a result, the state currently projects negative available reserves for the end of the 2010-2011 biennium absent gap-closing measures that the state expects to adopt when the legislature begins its session in January.

Despite the weak revenue performance, Washington's liquidity position remains sound with no need to issue short term notes for cash flow purposes. As in many states, Washington has not yet articulated a plan to cover expenditures once the one-time federal stimulus funds have been exhausted at the end of fiscal 2011.

ADOPTED 2009-2011 BIENNIAL BUDGET AND FISCAL YEAR 2009 SUPPLEMENTAL BUDGET CLOSED SUBTANTIAL $9 BILLION COMBINED GAP

Last spring, Washington faced a large shortfall of $1.3 billion for the 2007-2009 biennium and an even more substantial gap of $7.7 billion in the now current 2009-2011 biennium, a gap that amounted to about one-fourth of the budget. As one of nine states without an income tax, Washington was spared the recent precipitous decline in capital gains-related revenue that many states experienced this past spring. However, sales taxes account for approximately 54% of Washington's general fund collections, and much of the revised forecasts reflect historically low levels of consumer confidence. The weak economy is also hurting business and occupation taxes, which represent almost one-fifth of the state's general fund revenues. In addition, projections for real estate excise taxes have also been sharply reduced due to the severity of the housing market downturn in the state.

To close the combined $9 billion budget shortfall, the adopted supplemental fiscal 2009 and 2009-2011 biennial budgets relied on a combination of $3.2 billion in spending cuts, $3 billion in federal stimulus funds, $445 million from the rainy day fund (RDF), and $400 million in fund transfers and new resources. The state expects the following expenditure savings: 1) $600 million from reduced Initiative 728 allocations to school districts for class size reduction; 2) $557 million in cuts to higher education; 3) $449 million from a change in pension actuarial assumptions and calculation methods; 4) $338 million due to the suspension of

Initiative 732 salary increases for K-12 teachers and staff; 5) $255 million in administrative reductions across agencies; and 6) $255 million in health care spending cuts, including reduced enrollment in the basic health plan. One-time resources such as the federal stimulus money and RDF draws represent nearly half of the Washington's budget solution. Forecast risk includes an extended recession that puts further downward pressure on the state's primary revenue source, sales taxes, which are vulnerable to the consumer confidence factors that are resulting in the current revenue underperformance. As in other states that have incorporated the receipt of federal stimulus money in their budget plans, Washington will need to formulate plans to achieve budget balance once these resources are exhausted.

REDUCED RESERVES PROJECTED FOLLOW DOWNWARD REVENUE REVISIONS

Washington's combined available reserves as of the end of the 2007-2009 biennium are now estimated at $211 million on a GAAP basis, with $21 million in the RDF and the remainder in unreserved, undesignated General Fund balance. The 2009 legislature's supplemental budget for the 2007-09 biennium used most of the balance in the RDF to help fill gaps created as revenue forecasts were repeatedly revised downward as the recession took hold. The 2009 legislature also provided an unreserved, undesignated balance that was available to cover the revenue reductions made in the June 2009 and September 2009 quarterly forecast updates. Given what are now smaller beginning reserves and lower revenue forecast for the 2009-2011 biennium, the enacted budget now has a significantly lower combined reserve of negative $185 million projected for the end of fiscal year 2011. The state expects to adopted gap-closing measures that will address the budget shortfall and result in positive reserve balances by the end of the biennium.

In November 2007, Washington voters approved a constitutional amendment that permanently established a rainy day fund and provided for annual automatic deposits to the fund amounting to 1% of General Fund revenues, up to a maximum of 10% of General Fund revenues. Washington's emergency reserve (a precursor to the newly created RDF that was not constitutionally protected) peaked at $754 million at the end of fiscal 2000, just before the 2001 recession, and was rapidly depleted by fiscal 2004 as the state addressed previous revenue shortfalls. Going into the current recession, Washington had approximately $980 million in combined available reserves, including $303 million in the emergency reserve and $677 million in unreserved, undesignated general fund balance.

JOBS DECLINE AS ECONOMY WEAKENS

Washington's recent downward revenue revisions correspond to continuing weakness in the economy. However, there are signs that the state's underlying economy is beginning to stabilize as job losses moderate. Moody's expects Washington's economic recovery to parallel that of the nation in the near term, although there are risks centering on the state's major employers, including Boeing and Microsoft. Over the long term, the state should benefit from its educated work force and industry concentration is well-paying high technology and aerospace jobs.

Washington's unemployment rate in August was 9.2%, below the national level of 9.7% the same month. While there have been large scale layoffs at both Boeing and for the first time at Microsoft, the job cuts have been somewhat lower that expected. Exports from the state's important aerospace and software publishing industries are expected to contribute to the state's economic recovery although slower national and international economic improvements would affect Washington's economic outlook.

ABOVE-AVERAGE DEBT LEVELS REFLECT GROWTH-RELATED FINANCINGS

Washington's debt ratios are about twice Moody's 50-state median level; net tax-supported debt as a percentage of personal income is 5.1%, compared with Moody's 50-state median of 2.5% in 2009. 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 $2,087, Washington's net-tax supported debt per capita is more than twice the national median of $865. The state's debt ratios will likely remain high given continued sizeable borrowing plans, especially for transportation purposes.

Washington has managed its debt levels through a combination of statutory and constitutional debt limits, measured by debt service as a percentage of average general state revenues for the preceding three fiscal years. This ratio is limited to 7% by statute and 9% by constitution. The state legislature recently adopted a bill to align the statutory debt limit with the constitutional limit. This creates a single transparent constraint and also provides some flexibility to support debt issuance at a time of weak revenue performance.

In recent years, Washington substantially increased its transportation infrastructure funding program, which is largely financed through the issuance of motor vehicle fuel tax general obligation bonds. As of the end of June 2009, approximately $6.9 billion in motor vehicle general obligation bonds will be authorized but unissued. Effective July 1, 2005, the state gas tax increased by 9.5 cents (phased-in over a four-year period) in order to support the planned issuance of motor vehicle fuel tax bonds. Washington's motor vehicle fuel tax bonds are not subject to the state's debt limitation. The bonds are payable first from the state's excise taxes on motor vehicles and special fuels. The state legislature has agreed to continue to impose those excise taxes in amounts sufficient to pay debt service on the motor vehicle fuel tax general obligation bonds. On or before June 30 of each year, the Senate Finance Committee certifies to the state treasurer the amount required to pay principal of and interest on the bonds in the next fiscal year. The state treasurer shall withdraw revenues from any general state revenues received in the state treasury and from the motor vehicle fund, as applicable, and deposit in the bond fund on or before each debt service payment date amounts required to pay debt service on the bonds. While the state's gas tax receipts have been negatively affected by the recession, fiscal 2009 coverage of annual debt service on outstanding motor vehicle fuel tax general obligation bonds is expected to remain satisfactory at about 3.3 times. Almost one-third of the state's total general obligation debt is payable from motor fuel excise taxes. The state's full faith credit and taxing power are also irrevocably pledged to the payment of the bonds.

Based on an August 2008 valuation released by the State Actuary, Washington's other post-employment benefits (OPEB) liability for state employees is $4 billion, and the annual required contribution (ARC) for fiscal year 2009 is $331.7 million. Of that, actual contributions for fiscal year 2009 are estimated at $86.7 million, approximately 26% of the ARC. Now that states are required to disclose actuarially compliant figures, the size of the liabilities relative to one another and their impact on states' financial statements are becoming clearer. As a result, OPEB funding status will become more visible among the many attributes Moody's assesses in the municipal credit rating process.

Washington has about $140 million in general obligation variable rate demand bonds outstanding, representing about 1% of the state's total outstanding. The bonds are remarketed weekly and are supported by a standby bond purchase agreement with Helaba. The state has no interest rate swaps.

LAST RATING ACTION AND METHODOLOGY

The last rating action was on September 14, 2009, when Moody's assigned a Aa2 rating and stable outlook to the State of Washington's Certificates of Participation, Refunding Series 2009G (State Agency Real Property). The principal methodology used in rating the State of Washington's Various Purpose General Obligation Bonds, Series 2010C, Various Purpose General Obligation Refunding Bonds, Series R-2010B, Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2010C, and Motor Vehicle Fuel Tax General Obligation Bonds, Series 2010D (Taxable Build America Bonds - Direct Payment) was Moody's State Rating Methodology, published in October 2004 and available on www.moodys.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

Outlook

Washington's rating outlook is stable, reflecting our expectation that the state's finances will remain well-managed despite the recent sizeable budget shortfalls that emerged as the economy weakened. Economic concentration in some industries that are historically volatile poses longer-term credit risk. However, the state demonstrated impressive financial flexibility through the last 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 that restrains consumer confidence, leading to prolonged revenue weakness and employment erosion.

*Protracted structural budget imbalance.

*Increased reliance on one-time budget solutions.

*Cash flow narrowing, leading to strained liquidity.

*Failure to adopt plan to cover expenditures once federal fiscal stimulus monies are no longer available

Analysts

Nicole Johnson
Analyst
Public Finance Group
Moody's Investors Service

Nicholas Samuels
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

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

Moody's Investors Service