

Washington; Federal or state grant programs

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Credit Profile

US\$432 mil state of washington GARVEE prog ser 2012F due 09/01/2024

Long Term Rating

AA/Stable

New

Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating to Washington's \$432 million series 2012F federal highway grant anticipation revenue (GARVEE) bonds. This is the state's first issuance of GARVEE bonds. The outlook is stable.

The rating reflects our view of good future debt service coverage (DSC) based on historical federal grant receipts, and a sound bond structure. All federal highway revenues that the state receives under the Federal-Aid Highway Program (FAHP) administered by the Federal Highway Administration (FHWA) are pledged to the payment of the bonds.

The rating also reflects our opinion of the following credit strengths:

- Strong maximum annual debt service (MADS) coverage of the 2012F bonds at 11x based on the federal fiscal 2012 obligation authority (OA), along with essentially level annual debt service requirements, and 6x coverage of future MADS following the issuance of additional planned debt;
- A memorandum of understanding (MOU) between the state and FHWA that approves the use of federal aid for debt service;
- Good bond provisions, including a sound additional bonds test requiring the eligible OA the state received in one of the two most recent federal fiscal years to be 3.5x MADS on outstanding and proposed bonds as well as a more restrictive state policy that includes a 3.75x multiple for additional debt; and
- Generally positive trends in OA and receipts of Title 23 federal aid money, as well as the state's track record of maximizing federal grants and effectively managing the grant reimbursement process.

In our view, partially offsetting the preceding credit strengths is the narrow pledge of federal transportation funds to the state, possibly lower pledged revenues resulting from a decline in funds from the Highway Trust Fund (HTF) or in Congress-appropriated amounts, changes to the FAHP, delays to congressional reauthorization, or the state's failure to prudently manage the reimbursement process.

A direct pledge of all FAHP funds paid to the state secures the GARVEEs. The bonds are being used to finance a portion of the costs of the state's State Route (SR) 520 Project. The state's GARVEE bonds are expected to have a final maturity of Sept. 1, 2024.

OA has generally increased. OA (including redistributions) grew to \$671 million in federal fiscal 2010, before declining slightly to \$649 million in federal fiscal 2011. Given constrained federal resources, we anticipate funding levels to be lower in the future, but we do not expect the lower funding levels to affect the credit quality of these bonds.

Coverage of the state's series 2012F MADS is strong, in our view, at 11x based on federal fiscal 2012 OA. With a

planned issuance of approximately \$412 million in 2013, MADS coverage based on 2012 OA is expected to be approximately 6x. DSC will likely remain strong, in our opinion, even with reductions in federal receipts. We view the bond provisions as good for a stand-alone GARVEE structure; these include a supportive legal framework provided by the enabling legislation, the MOU, and a master bond resolution.

In our view, potential delays in authorizations, changes in law, declining HTF balances, or Congressional or administrative modifications to grant programs will not end the long-standing practice of federal aid for transportation on which we base our grant anticipation ratings. However, program rule changes, constrained funding sources, and federal budget pressures could lead to lower authorization and appropriation levels and diminish coverage, which we currently view as very strong for most GARVEE issues we rate. Weaker or varying levels of appropriations could reduce the overall level of support and predictability associated with the grant programs, which, in turn, could affect our ratings. Finally, until it passes a new reauthorization program (the most recent multiyear authorizing statute, the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, or SAFETEA-LU, was enacted for the six-year federal fiscal year period 2004 through 2009), we expect that Congress will continue to provide extensions as needed to allow uninterrupted construction programs and debt service payments; the current FAHP expired Sept. 30, 2009 and has been extended several times to June 30, 2012.

Outlook

The stable outlook reflects our anticipation that the longstanding FAHP will continue to receive significant funding and that the state will continue to receive its historical share of annual Title 23 distributions. The outlook also reflects our assumption of continued strong coverage levels despite potentially lower federal reimbursement levels, as well as the timely receipt of pledged revenues and the state's ability to prudently manage the reimbursement process. We do not expect to change the rating during the two-year outlook period.

The Project

The SR 520 corridor is 12.8 miles, connecting I-5 in Seattle on the west side of Lake Washington (downtown Seattle and University of Washington) to the east side of Lake Washington (Bellevue, Kirkland, and Redmond). The main SR 520 bridge (the bridge) span is 1.4 miles -- the longest floating bridge span in the world. The SR 520 project includes a replacement for the existing floating bridge and associated corridor improvements.

SR 520 is the northern of two east-west routes across Lake Washington. Average daily traffic (ADT) on the bridge prior to tolling was 100,000 (originally designed to carry only 65,000 vehicles per day) and is a major commuter route in both directions. Parallel is the I-90 bridge approximately four miles to the south; it has an ADT of 126,000. Truck traffic primarily uses I-90. Traffic volumes are relatively stable throughout the year.

The total project cost is \$2.4 billion through 2019. The state legislature has authorized the State Finance Committee to determine the appropriate mix of bonds, including GARVEE bonds, toll bonds, and triple pledge bonds. The current plan of finance for the project includes approximately \$800 million to 900 million in GARVEE bonds, \$112 million in toll revenue bonds, and \$550 million in triple pledge bonds, with the remainder of funds coming from federal, state, local, and toll revenues. We understand that in addition to the current issuance of GARVEE bonds, the state plans to issue \$412 million in GARVEE bonds in 2013.

In our opinion, construction risk for the project has been somewhat mitigated by several factors. The Washington

State Department of Transportation (WSDOT) has a strong history of successfully delivering very large projects (e.g., the \$735 million Tacoma Narrows Bridge and the \$500 million Hood Canal Floating Bridge), as well as daily operations maintaining more than 18,500 highway lane miles and 3,600 bridge structures (including the four longest floating bridges in the U.S.) throughout the state. Furthermore, a significant portion (more than 96%) of the floating bridge and eastside project is already under contract. In addition, WSDOT has built into the project significant liquidated damages for each day of delay, a one-year general warranty, and adequate contingency funding.

Bond Terms

The security for the bonds is a pledge of all funds received by the state pursuant to its OA under the FAHP, including direct GARVEE reimbursements pursuant to the MOU with the FHWA, and reimbursements of all FAHP funds on deposit in the state's Motor Vehicle Fund (MVF) which are reimbursements for projects or portions of projects not financed with GARVEE bond proceeds. Funds for the GARVEE debt service are obligated first in each federal fiscal year, and WSDOT will de-obligate funds on existing programmed projects and re-obligate those for the GARVEE debt service if necessary. If direct GARVEE reimbursements are not received by the payment date, reimbursements on deposit in the MVF will be used. In fiscal 2011 the average monthly FAHP reimbursements was \$46 million. MADS for the series 2012F bonds is expected to be \$56 million, and MADS for the entire GARVEE program including future issuance is expected to be \$109 million, according to management. MADS coverage based on fiscal 2012 OA is estimated at 6x for the entire program or 11x only on the series 2012F bonds.

The resolution includes an additional bonds test that requires that OA during one of the two prior federal fiscal years was at least 3.5x MADS, which Standard & Poor's considers to be stronger than the more standard 3.0x multiple. The state is planning to implement a more restrictive policy increasing that multiple to 3.75x, which Standard & Poor's views favorably.

Under the terms of the MOU with the FHWA, the elements of the SR 520 project are authorized and approved as advance construction projects under Title 23, Section 115 of the U.S. Code. The conversion of advance construction to OA will be the first obligation in the federal fiscal year of pledged federal aid legally available funds. WSDOT will not obligate pledged federal aid for any other federal aid projects until advance construction is obligated. Under the MOU, WSDOT may bill the FHWA at least seven days prior to the scheduled debt service payment date. The MOU contemplates issuing \$800 million to \$900 million in GARVEE bonds, and additional GARVEE bonds are not currently authorized for any other projects.

Related Criteria And Research

USPF Criteria: Methodology And Assumptions: Rating U.S. Federal Transportation Grant-Secured Obligations, May 29, 2009

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