

# RatingsDirect®

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## Washington; Federal or state grant programs

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# Washington; Federal or state grant programs

## Credit Profile

US\$294.675 mil federal hwy grant anticipation rev bnds (GARVEE) (Senior 520 Corridor Prog) ser 2014C

*Long Term Rating* AA/Stable New

Washington State of Washington GARVEE prog

*Long Term Rating* AA/Stable Affirmed

## Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating to Washington's \$294.7 million series 2014C federal highway grant anticipation revenue (GARVEE) bonds. In addition, Standard & Poor's affirmed its 'AA' rating on outstanding parity 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 bonds at 6x based on the federal fiscal 2012 obligation authority (OA), along with essentially level annual debt service requirements;
- 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, or delays to congressional reauthorization.

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.

Historically, OA has generally increased. OA (including redistributions) grew to \$671 million in federal fiscal 2010, before decreasing slightly to \$649 million in federal fiscal 2011, then declining further to \$619.3 million in fiscal 2012. Actual reimbursements in fiscal 2012 were \$806.7 million. Given constrained federal resources, we anticipate funding levels will be lower in the future, but we do not expect the lower funding levels will affect the credit quality of these bonds.

Coverage of the state's GARVEE bonds, series 2012F and series 2014C, MADS is strong, in our view, at 6x based on federal fiscal 2012 OA of \$619.3 million. MADS is expected to be \$103.1 million, level in fiscal years 2015 through 2024. No additional debt is planned. 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. As with other transportation grant-backed bonds, we consider Congress' passage of a new reauthorization program to be a favorable development for the overall sector. However, we note that the bill ensured funding only for 27 months (to Sept. 30, 2014), while past transportation bills resulted in six-year plans.

Although we believe federal sequestration may affect transfers from the federal general fund to the HTF (which has relied on such transfers in recent years to remain solvent), we believe that any potential reductions will not impact the ratings given the high DSC.

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, thus highlighting the importance of DSC and bondholder protections that fund debt service before other permitted uses. With respect to the state's GARVEE program, we view both bond provisions and DSC as strong. Given constrained federal resources, we expect funding levels will be lower in the future, but we do not expect the lower funding levels will affect the credit quality of these bonds.

As a result of the application of the U.S. Federal Future Flow Securitization criteria the maximum indicative rating level for GARVEEs or grant anticipation notes secured solely by federal aid funds one notch below the U.S. debt rating. The rating on the U.S. is AA+/Stable.

## **Outlook**

The stable outlook reflects our anticipation that the long-standing 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. 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

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 on the bridge prior to tolling was 100,000 (the bridge was 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. Truck traffic primarily uses I-90. Based on preliminary data, SR 520 traffic performance is exceeding fiscal year 2012 projections.

According to management, the opening of the floating bridge to traffic is expected to be delayed from mid-2015 to late 2015 or early 2016 due to an error in the design of the bridge's pontoons, which has resulted in a number of change orders. The change orders have been paid from contingency funds available within the project. Standard & Poor's does not consider the issue with the pontoon design to be a credit risk. The project is being funded through multiple funding sources; additional GARVEE bonds are not expected for the SR 520 project and are not currently authorized for any other transportation project.

## **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 the Washington State Department of Transportation (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. The average monthly FAHP reimbursements was \$46 million in fiscal 2011 and increased to \$67.4 million in fiscal 2012. MADS for the GARVEE bonds is expected to be \$103.1 million, according to management. MADS coverage based on fiscal 2012 OA is estimated at 6x for the entire program.

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 finance committee has also implemented 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. Additional GARVEE bonds are not currently authorized for any projects other than the SR 520 project.

## **Related Criteria And Research**

- USPF Criteria: Federal Future Flow Securitization, March 12, 2012
- USPF Criteria: Methodology And Assumptions: Rating U.S. Federal Transportation Grant-Secured Obligations, May 29, 2009

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