

## Research

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### Summary:

# Washington State; Appropriations; General Obligation

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### Credit Profile

US\$134.715 mil motor veh fuel tax go bnds ser 2016B due 08/01/2041		
<i>Long Term Rating</i>	AA+/Stable	New
US\$90.325 mil motor veh fuel tax go bnds (SR 520 Corridor Prog-toll Rev) ser 2016C due 06/01/2041		
<i>Long Term Rating</i>	AA+/Stable	New
Washington GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

## Rationale

S&P Global Ratings assigned its 'AA+' long-term rating and stable outlook to the State of Washington's series 2017B motor vehicle fuel tax general obligation (GO) bonds and series 2017C motor vehicle fuel tax GO bonds (SR 520 Corridor Program – Toll Revenue).

At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating and underlying rating on the state's GO and motor vehicle fuel tax (MVFT) GO debt outstanding, and its 'AA' rating on the state's appropriation-backed debt outstanding. The outlook on all ratings is stable.

The ratings reflect our view of Washington's:

- Relatively well-educated workforce and good income indicators;
- Sales tax-based revenue structure that, although somewhat less sensitive to economic cycles than income tax-reliant states, is following a decades-long stagnating trajectory as a share of total revenue;
- High cost of housing, especially in key economic centers that could impede long-term growth prospects;
- Good internal access to sources of liquidity in the treasury and treasurer trust funds;
- Strong financial policies and practices, including statutory provisions requiring that the state's biennial budget and projected subsequent two fiscal years' spending plans be balanced, which is key given growing expenditure pressures; and
- Moderately high per capita debt burden but well-funded pension plans.

The state's full faith, credit, and taxing powers secure the GO bonds. Washington's MVFT GO bonds are first payable from state excise taxes on motor vehicle and special fuels, but ultimately also backed by the state's full faith, credit, and taxing powers. The series 2017C motor vehicle fuel tax GO bonds (SR 520 Corridor Program – Toll Revenue) bonds are first payable from a third lien on toll revenue from the SR 520 corridor, second from state excise taxes on motor vehicle and special fuels, but also ultimately backed by the state's full faith, credit, and taxing powers. We understand that the series 2017B bonds are being issued to fund various state capital projects and programs. Series 2017C bond proceeds will be used toward continued construction of the SR 520 corridor, a major east-west link across

Lake Washington. The state expects additional bonds, federal funds, toll revenue, and excise taxes on motor vehicle and special fuels will cover the remaining cost of the total estimated \$4.56 billion project.

Washington will have about \$17.5 billion of GO bonds outstanding, net of reimbursements, after the current offering. Of this, about \$6.5 billion of the state's net GO debt is payable first from excise taxes on motor vehicles and special fuels. The state will also have about \$890 million of certificates of participation outstanding, including certificates of participation for state and local agencies, and other appropriation-backed debt outstanding as of Aug. 30, 2016.

The state's economy has sustained above-average rates of growth with real GDP and employment expanding at a strong 2.9%, respectively, in 2015, outpacing the nation's 2.4% and 2.0%, respectively. Housing starts have grown steadily along with home prices contributing to strong growth in construction employment, along with large public works projects. Washington's June 2016 Economic and Revenue Forecast Council (ERFC) forecasts baseline 2.4% nonfarm payroll employment growth in 2016 and 1.6% growth in 2017, with a 1.2% average growth through 2021, which reflects projected gradual deceleration in the economy. The ERFC's forecasted 2016 nominal personal income growth is particularly strong at 4.1%, which is below our estimated 4.9% (based on IHS Connect's modeling), and averages 4.8% annual growth over the ERFC forecast period through 2021.

Although employment, personal income, housing, and GDP trends remain positive, exposure to weakness in the global economy and effects on exports, as well as weaker manufacturing activity and volatile stock markets, remain mitigating risks to Washington's revenue forecast. The state's job growth has been healthy across most sectors, including robust growth in construction employment as well as expansion in the trade, transportation, and utilities sector. Amazon.com Inc., the sixth-largest employer in the state, added 3,500 jobs in the first quarter of 2016, mainly in the cities of Seattle and Kent. Furthermore, Washington's export value ranks third among all states and exports have represented a large and growing 21% of gross state product. The state's primary export trading partners include Canada, China, and Japan. However, exports were down 15.6% in the first quarter of 2016 compared with the same period in 2015 due in part to weakness in trading partner economies and a strong dollar. Export declines included a 17.4% year-over-year decline in transportation equipment exports, which represent 59% of total state exports and are concentrated in Boeing planes. Despite some expected layoffs at Boeing Co., the state's largest private sector employer, the company still has a seven-year backlog on orders for planes due to still-strong global demand for 737s aircraft. In May 2016, Boeing Co. opened its new \$1 billion wing plant for its new largest passenger aircraft, the 777x, which it expects to assemble in the Seattle area, although orders are slow after the model was launched in 2013.

In June 2016, the state's ERFC revised its general revenue forecast for the 2015-2017 biennium upward by \$294 million, or 0.8%, due to increases in retail sales and real estate excise taxes, following a \$67 million downward revision in February 2016. Actual general fund revenue collections for fiscal 2017 are 4.4% above the June forecast, reflecting, in part, one-time audit payments and refunds received in July 2016; excluding the one-time payments, cumulative collections are still 3.5% above forecast. Total forecasted 2015-2017 general fund revenue is 11.2% higher than that of the previous biennium and the 2015-2019 biennium revenue forecast of \$40.3 billion is 7.5% higher than the current biennium. Commercial property sales, higher inflation, and forecasted housing permit growth have contributed to higher forecasted retail sales and real estate excise tax revenue growth, although downside risk remains. Washington's reliance on retail sales and business and occupation (gross receipts) taxes for a combined 68% of general fund

revenues (on a budgetary basis) typically affords the state more revenue stability than other states that rely on personal income tax revenues. Although voters passed an initiative to reduce the local retail sales tax rate to 5.5% from 6.5%, the Washington State Supreme Court upheld the superior court decision declaring the initiative unconstitutional on May 26, 2016.

Incorporating the June 2016 revenue forecast, the state projects a combined budget stabilization fund and unrestricted general fund balance of nearly \$1.5 billion at the close of the biennium, or about 2% of biennium expenditures, which we view as adequate. On an annualized basis, which is more comparable to other states, the ending biennium balance, as proposed, would equate to a good 4% of expenditures budgeted for fiscal 2017. We believe currently strong reserves position Washington well for future cyclical or an unexpected downturn. (See our commentary, "Fiscal Resilience Among U.S. States Varies As Economic Expansion Surpasses Seven-Year Mark," published Aug. 9, 2016, on RatingsDirect.)

Education funding continues to pose fiscal pressures for the state. The Washington State Supreme Court's 2012 decision (the McCleary ruling) deemed that the state has systematically underfunded its public education system. The 2015-2017 biennium budget made some progress in raising education spending to address a portion of Washington's obligations under the McCleary ruling; however, there remains pressure for education reform to address education inequality. In May 2016, the state's ERFC released two versions of the outlook for the enacted 2016 supplemental budget. While the initial outlook projects a small budgetary gap of almost \$350 million, or 0.8% of projected \$41.5 billion in appropriations, the alternative version of the outlook reflects \$3.5 billion of projected additional kindergarten to grade 12 spending related to the McCleary decision.

The state supreme court issued an order in August 2015 to fine the state \$100,000 per day, paid into a segregated account for basic education until Washington adopts a complete compliance plan to fully fund all elements of basic education by 2018. In response, the 2016 legislature enacted a bill that establishes an education funding task force to analyze data and a plan to take action by the end of 2017 to change education program funding to eliminate dependence on local school district levies. Washington's joint select committee issued a report to the state supreme court to argue that the recent legislative plan is sufficient to dissolve the court's order of contempt and eliminate the fine. The parties expect to appear before the Washington State Supreme Court in September 2016 to address whether the state is in compliance with the court's order.

In general, we consider Washington's approach to financial management strong, as reflected in our financial management assessment and budget management scores. Well-established economic and revenue forecasting and increasingly refined debt management practices and oversight served the state's credit quality well during the recession and its aftermath. Forward-looking state policies facilitate budget practices we view as prudent, including minimal reliance on payment deferrals or other one-time responses to anticipated budget gaps.

For July 2016, the state treasury and treasurer's trust fund's month-end cash balance was \$5.9 billion, up somewhat from the \$4.3 billion at the same point in July 2015. Investments are conservative, in our view, with an average of 58% of funds invested in U.S. treasuries and agencies in July 2016. In addition to Washington's investment guidelines, state policies require that collateral in repurchase agreements (of which the state currently has none) for U.S. treasury, agency, and money market instruments be priced at 102% of market value. Mortgage-backed repurchase agreements

of more than seven days are subject to a higher, 105% requirement.

As of fiscal year-end 2015, Washington's gross direct tax-supported debt burden was \$19.7 billion in GO and appropriation-backed bonds outstanding but a somewhat lower \$18 billion when accounting for self-supported debt. Tax-supported debt was moderately high, in our opinion, at about \$2500 per capita, 4.9% of total personal income, and 4.3% of state GDP. Debt paydown remained average, in our view, with about 50% of principal outstanding amortized over 10 years. Gross GO and lease appropriation-backed debt service is moderate, in our opinion, at 5.0% of the funds' expenditures from which the state pays debt service. However, portions of Washington's debt are funded from self-supporting or reimbursable sources. Considering just the general fund, adjusted for these offsetting revenues, we estimate that debt service was 5.7%, moderate our view. After this issuance, the state expects to issue an additional \$400 million in various purpose GO bonds and another \$35 million of motor vehicle fuel tax GO bonds in the first quarter of 2017. Even with the expected issuance, we estimate the state's debt burden will remain moderately high.

Long-term liabilities include those related to the state's pension system and retiree health care. Washington's pension liability profile has improved somewhat as of the state's fiscal 2015 audited financial statements because of the lower reported net pension liability based on the state's allocation across 12 pension systems. The state adjusted the discount rate applied to its liabilities to 7.8% from 7.9% in the current biennium, and the rate is scheduled to decline further to 7.7% in the 2017-2019 biennium. Based on June 30, 2015, comprehensive annual financial reports for the cost-sharing plans, we calculate Washington's share of the net pension liability across 12 pension plans (not including a share of the school employees retirement system liability) totaled almost \$2.7 billion, or \$372 per capita, which is low in our view. Relative to total personal income, the state's share of the net pension liability was 0.7%, which is also what we consider very low. The aggregate funded ratio across plans, including cost-sharing plans in which the state participates as of June 30, 2015, is above average, in our view, at almost 87%, although this represents a slight decline from 90% funded levels as of June 30, 2014, and funding has historically fallen short of actuarially determined contribution levels. With its biennial budget process, the state legislature appropriates pension contributions every two years. Although contributions have historically been set to equal the required contribution, they frequently fall short of the actuarially determined contribution because they are not adjusted after the budget is adopted.

Other postemployment benefits (OPEB) are funded on a pay-as-you-go basis. The state's OPEBs produce an implicit liability by allowing retired employees to purchase health, life, and vision insurance in the same pool as current employees, at a subsidized rate.

Based on the analytic factors we evaluate for states, we have assigned Washington a composite '1.7' on a four-point scale whereby '1.0' is the strongest and '4.0' is the weakest.

## Outlook

The stable outlook reflects our view of Washington continuing to benefit from above-forecast end-of-biennium revenue trends. Nevertheless, we expect that significant upward pressure on spending originating in legal- and voter-approved mandates will remain a soft point in the state's credit profile. However, legal requirements that Washington enact budgets that not only balance for the current biennium but also project balance through the following biennium help

facilitate a structural approach. That, coupled with the state's ongoing discipline vis-a-vis funding its budget reserves, should help insulate the state rating from unexpected economic or revenue weakening. Potential for upward movement would likely entail a more permanent fix to Washington's education funding challenges and, potentially, revenue trends that better keep pace with the state's underlying economic growth rates.

Given that Washington's previous projected budget gap was solved with stronger-than-expected revenues, downside pressure on the state rating would likely have economic origins. Sustained weak demand for key state exports, fueled in part by a strong U.S. dollar, slower-than-expected growth from China, and a sharp falloff in the housing market could all contribute to such a scenario. State policymakers' response to a downside economic scenario--whether it's timely and structurally oriented--would likely dictate any impact on our rating on Washington. If lawmakers delayed taking corrective action or relied extensively on one-time solutions to budget gaps, allowing the state's reserve balances to decline precipitously, this could result in downward pressure on the rating.

## Related Research

U.S. State And Local Government Credit Conditions Forecast, July 27, 2016

Ratings Detail (As Of August 26, 2016)		
Washington certs of part (Washington St Dept of Gen Admin Tacoma Co-Location Proj) dtd 12/01/1996		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Washington go & motor veh fuel tax ser 1992B AT-7 III-g EE-1 dtd 06/01/92 due 03/01 & 06/01/1993-2012 2017 03/01/2013		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor vehicle fuel tax GO bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor vehicle fuel tax GO bnds ser 2015C due 02/01/2040		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor veh fuel tax GO bnds ser 2008D dtd 01/22/2008 due 01/01/2009-2033		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor veh fuel tax GO bnds ser 2010B dtd 07/28/2009 due 08/01/2010-2032 2034		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor veh fuel tax GO rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor veh fuel tax GO rfdg bnds ser R-2015D due 07/01/2030		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington mtr veh fuel tax GO bnds ser 2008B dtd 09/26/2007 due 07/01/2008-2030 2032		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington mtr veh fuel tax GO bnds (Build America Bnds) taxable ser 2010D dtd 10/22/2009 due 08/01/2020-2024 2029 2039		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington mtr veh fuel tax GO bnds (SR-520 Corridor Program -Toll Rev) ser 2012C dtd 10/31/2011 due 06/01/2017-2033 2041		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

## Ratings Detail (As Of August 26, 2016) (cont.)

Washington mtr veh fuel tax GO rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington mtr veh fuel tax GO rfdg bnds ser R-2010C dtd 10/28/2009 due 01/01/2012-2026		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington mtr veh fuel tax GO rfdg bnds ser R-2014B dtd 10/24/2013 due 07/01/2014-2021		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington mtr veh Fuel Tax GO bnds ser 2007D dtd 02/06/2007 due 01/01/2008-2030 2032		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington various purp gen oblig bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington var purpose GO bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington var purp GO bnds ser 2007A dtd 08/01/2006 due 07/01/2014-2031		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington var purp GO bnds ser 2007F dtd 05/30/2007 due 07/01/2008-2029 2032		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington var purp GO rfdg bnds ser R-2007A dtd 11/14/06 due 01/01/2007-2026		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington var purp GO rfdg bnds ser R-2015G due 07/01/2032		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington GO bnds		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington GO bnds (Motor Vehicle Fuel Tax) ser 2004B dtd 08/06/2003 due 07/01/2004-2028		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington GO comp int bnds ser 1999S-2 dtd 05/20/1999 due 01/01/2017-2019		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington GO Mtr Veh Fuel Tx		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington GO & mtr veh fuel tax rev bnds ser 1993B DD-12 CC-9 dtd 05/01/1993 due 03/01/1994-2010 2018 & 05/01/2005-2010 2018		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington GO & mtr veh fuel tax (MBIA/National)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington GO (wrap of insured) (AMBAC) (ASSURED GTY - SEC MKT)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington GO (wrap of insured) (FGIC & AGM) (SEC MKT)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed

## Ratings Detail (As Of August 26, 2016) (cont.)

Washington GO (Motor Vehicle Fuel Tax)		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington Various purp GO bnds ser 2007C dtd 02/06/2007 due 01/01/2008-2032		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington Washington St Var Purp #2 dtd 2-1-83		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington GO		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
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<i>Long Term Rating</i>	AA+/Stable	Affirmed
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<i>Long Term Rating</i>	AA+/Stable	Affirmed
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<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

**Washington GO**

Ratings Detail (As Of August 26, 2016) (cont.)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
<b>Aberdeen, Washington</b>		
State of Washington, Washington		
Aberdeen (Washington) APPROP		
<i>Long Term Rating</i>	AA/Stable	Affirmed
<b>FYI Properties, Washington</b>		
State of Washington, Washington		
FYI Properties (Washington) APPROP		
<i>Long Term Rating</i>	AA/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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