Global Credit Portal
RatingsDirect®

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Washington; General Obligation

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Credit Profile		
US$350.88 mil Various purp GO bnds ser 2011A due 08/01/2035		
Long Term Rating	AA+/Stable	New
US$251.17 mil Various purp GO rfdg bnds ser R-2011A due 01/01/2022		
Long Term Rating	AA+/Stable	New
US$118.29 mil (Taxable) GO bnds ser 2011T due 08/01/2020		
Long Term Rating	AA+/Stable	New
Washington GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating, with a stable outlook, to the State of Washington's series 2011A various-purpose general obligation (GO) bonds, 2011T taxable GO bonds, and R-2011A various-purpose GO refunding bonds. In addition, we affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the state's outstanding GO debt.

The ratings reflect our view of the state's:

- Relatively well-educated workforce and good income indicators;
- Sales-tax-focused revenue structure that exhibits sensitivity to economic cycles but to a lesser degree than states relying primarily on personal and corporate income taxes;
- Historically good year-end reserve balances, including a constitutional budget stabilization account, that have helped moderate the scale of corrective actions needed to balance the state's operations;
- Strong financial policies and practices; and
- Moderate per capita debt burden and well-funded pension plans in aggregate, although challenges remain in two underfunded plans.

The state's full faith, credit, and taxing powers secure the bonds.

We understand that proceeds of the series 2011A will fund and reimburse the state for a variety of capital projects, including state buildings, public school skill centers, water supply, open space, and agriculture. We understand that proceeds of the series 2011T will fund taxable projects within the state and that proceeds of the series R-2011A will refund certain existing GO bonds, including all or portions of series 2002A, 2002B, and R-2003A.

We believe that Washington is experiencing a tepid economic recovery that is slightly outpacing that of the nation as a whole. We also believe that the state has benefited from its export orientation relative to most of the rest of the U.S. and strong recent sales among its two most prominent employers, Boeing and Microsoft. We consider the state's median household effective buying income to be good at 109% of the U.S. level and believe that, in the long term, an above-average proportion of residents with a bachelor's degree positions the state well to generate continuing personal income growth. Employment growth during the 12 months through May 2010 was modest in our view, at 0.1%, but the state's Economic and Revenue Forecast Council projects an acceleration to what we consider to be a moderate 1.5% in the 12 months through June 2011.

The state's budgets have come under continuing pressure during the current economic trough, reflecting what we understand has been largely economy-driven weakness in the state's two largest general fund revenue streams: retail sales taxes (about 47% of general fund revenues) and business gross receipts taxes (19%). Despite the moderating effects of grants under the America Recovery and Reinvestment Act and the ability to use a budget stabilization account, the state needed to tackle a forecast 21%-of-biennial-expenditures budgetary gap at the outset of the biennium that runs through fiscal 2011 and another 9% gap as part of the spring 2010 legislative session. Budget actions in the current biennium have focused on expenditure reductions but also on tax increases and other revenue changes.

Based on discussions with management and media reports, we believe that the governor is likely to implement further across-the-board additional reductions or possibly convene a special session of the legislature to maintain a positive general fund balance if budgetary pressure reemerges. The state's most recent quarterly revenue forecast, released in June, showed lower projected revenues before the recent tax law changes and, similar to many other states we have reviewed, the most recent amended budget assumes that the state will receive about $480 million in federal Medicaid assistance funds, or about 3% of annual expenditures, that have not yet been passed by Congress. Other potential influences on financial performance in fiscal 2011 and the next biennium include proposed citizen initiatives for the November 2010 ballot that we understand would rescind a portion of the tax changes adopted in 2010, impose a two-thirds majority threshold for the legislature to raise taxes and fees, and create a net increase in tax revenues that would be designated for education and health care spending. The state economist also believes that the pace of personal income growth relative to a slower increase in sales tax revenues suggests that state revenues could grow faster than forecast to the degree that households become more optimistic about economic conditions.

We consider the state's management practices "strong" under our Financial Management Assessment (FMA) methodology. An FMA of "strong" indicates our view that practices are strong, well embedded, and likely sustainable. These include, among other elements, quarterly revenue forecast updates and monthly economic and revenue performance monitoring.

The state's direct tax-supported debt burden (GO and appropriation-backed) is moderate, in our opinion, at $2,694 per capita. However, as a percentage of personal income it is above average relative to other states, at 6%. Pro forma 2012 carrying charges translate into what we view as a low 4.8% of fiscal 2009 governmentwide, non-capital expenditures. We expect that continuing transportation needs, including two major urban highway projects, will likely translate into continuing GO issuance in the medium term. As of June 30, 2008, the actuarial accrued liability (AAL) of the defined-benefit portion of the state's 13 pension plans totaled $57.9 billion and actuarial assets in aggregate totaled 94% of this liability. However, we note that funds from one plan cannot make up for shortfalls in another and that the state's Public Employees Retirement System (PERS) Plan 1 and Teachers Retirement System (TRS) Plan 1 together represented 43% of the state's AAL and were funded at what we consider to be low 71% and 77% ratios, respectively. The state's other postretirement employee benefit (OPEB) liability consists primarily of an explicit subsidy of Medicare Parts A and B payments and totaled $4 billion as of the latest valuation, on Jan. 1, 2008. The non-actuarial cost for retiree benefits was $86 million in fiscal 2009, as compared with the $332 million actuarially required payment (about 2% of expenditures) needed to amortize the liability as of the latest valuation.

Table 1

Washington Economic Data

	2012(p)	2011(p)	2010(p)	2009	2008	2007	2006	2005
Employment (NAICS), Total Nonfarm (thousand)	2,962.30	2,882.01	2,815.86	2,825.77	2,959.08	2,933.63	2,859.09	2,777.08
Housing Starts, Private Multi-Family (thousand, SAAR)	8.17	6.25	2.67	3.31	9.26	11.37	10.36	8.97
Housing Starts, Private Single-Family (thousand, SAAR)	32.12	26.41	18.52	12.58	18.89	30.13	36.99	39.96
Net Migration (thousand)	52.8	54.75	56.69	58.43	59.69	56.51	61.32	55.8
New Passenger Car & Light Truck Registrations (thousand)	256.21	230.16	199.8	170.49	223.93	285.48	290.99	286.77
Personal Income (mil. $)	322,073.76	305,522.26	289,599.53	278,236.50	280,677.50	271,008.00	252,023.25	230,001.75
Population (thousand)	6,959.19	6,867.28	6,773.02	6,676.35	6,578.04	6,478.02	6,382.58	6,277.15
Real Gross State Product (mil. 2000$)	287,172.01	277,831.74	269,356.90	259,872.76	264,635.54	259,387.00	248,490.00	241,807.00
Retail Sales, Total (mil. $ SAAR)	104,192.96	98,463.27	92,739.47	87,518.81	92,947.41	92,971.59	87,758.46	81,137.76
Unemployment Rate (%)	7.44	8.07	9.26	8.88	5.39	4.55	4.93	5.51

NAICS--North American Industry Classification System. p--Projected. SAAR--Seasonally adjusted annual rate. Source: IHS Global Insight Inc. as of July 12, 2010.

Outlook

The stable outlook reflects what we view as strong financial management and continuing evidence that the state is willing to make timely and proactive budget amendments as it deems necessary to maintain budgetary balance. We believe that automatic budget stabilization fund deposits and federal grants have absorbed much of the revenue effects of the recession and that recent budget actions will likely allow the state to maintain what we consider to be an adequate budgetary balance and liquidity position through the end of the biennium. An improved credit profile could result if, over the next two years, we believe that the state has substantially and sustainably improved its financial position. But we also believe that successive rounds of expenditure reductions and the current economic climate make further spending cuts or tax increases more difficult, and that credit quality could come under pressure over the upcoming two-year period if the state is unable to adjust its budget in response to the absence of Medicaid assistance extension or a revenue recovery that is weaker than forecast.

Economy: Employment Starting to Grow Again

We believe that Washington, a state with above-average exposure to export markets, is experiencing a weak economic recovery, with employment performance slightly stronger than that of the U.S. as a whole. During the 12 months through May 2010, the state's seasonally adjusted employment increased by what we consider to be a tepid less than 0.1% but better than the 0.7% decline nationwide. Likewise, the state's seasonally adjusted unemployment rate has remained below 10% during the current economic trough, and most recently stood at 9.2% in May 2010, as compared with 9.7% nationwide. The state's Economic and Revenue Forecast Council, noting a May 2010 fall in private sector employment that was masked by hiring for the decennial Census, expects employment growth to be uneven in the coming months, in line with its expectations for the pattern nationwide. We understand that the state's most prominent employers, Boeing and Microsoft, which are located in the Seattle area, are experiencing strong demand for their products and that agricultural exports, which are a strong driver of economic performance in the eastern portion of the state, remain competitive despite the fall in the value of the euro due to their orientation toward East Asian markets. In the short run, the forecast council expects statewide employment growth to accelerate to 1.5% for the 12 months through June 2011, which corresponds to the state's fiscal year, and 3.3% in fiscal 2012. We also note that the state's independent chief economist, Arun Raha, believes that consumer spending decisions will be a key influence on the speed of economic recovery, citing statewide personal income growth that has started to pull ahead of state revenue collections, which primarily consist of sales taxes and gross receipt taxes on businesses.

Supporting long-term economic performance, in our view, is the state's relatively highly educated population, with 30.7% of residents aged 25 and above holding a bachelor's or more advanced degree, as compared with 27.7% nationwide. The state's largest urban center, Seattle, attracts college graduates from outside the state and is home to the state's flagship research university. We believe that this is related to the prominence of the information industry (7.2% of personal earnings, as compared with 3.3% for the U.S. as a whole) and contributes to what we consider good median household effective buying income at 109% of the U.S. level. Durable-goods manufacturing also makes up an above-average share of personal earnings in the state (8.3%, as compared with 6.3%), which we believe reflects the long-term role of aerospace as an economic anchor and the availability of low-cost hydroelectric power. However, we also believe that the Seattle region's increasing traffic congestion likely represents a constraint on long-term economic growth.

Finances: Rainy-Day Set-Asides Moderate Continuing Revenue Pressure

Recent economic trends have created budgeting challenges in our view because of the size of the associated revenue effects and because of the need to respond to progressive downward revisions to forecast revenues, but the state has shown a willingness to adjust its budgets in response. At the outset of the biennial budget cycle in spring 2009, the state tackled a forecast budget gap of $7.7 billion, or about 21% of expenditures, for the biennium ending June 30, 2011, with a combination of budget cuts and tax increases. Subsequent revisions to economic assumptions reopened the forecast gap to $2.8 billion on a budgetary basis of accounting, or what we consider to be a still-significant approximately 9% of biennial expenditures, and on May 4, 2010, Governor Chris Gregoire signed a supplemental budget with some modifications through a line-item veto. Components of the changes included $757 million in additional revenues due to tax changes; $747 million in cuts, primarily in education and human services; $618 million in federal funding assumptions (most of which consists of a proposed, but not passed, federal extension of special Medicaid assistance to states); and the balance in transfers from other funds. Inclusive of these budget revisions and the latest (downwardly revised) revenue forecast in June, the state forecasts a fiscal 2011 ending general fund balance of $253.6 million, which translates into what we consider to be an adequate 1.7% of annual expenditures. Should the Medicaid extension, which management estimates would represent about $480 million, not pass, we believe that the governor is likely to impose across-the-board spending reductions to maintain a positive general fund balance, albeit one of nominal size, at the end of fiscal 2011.

We understand that at the end of fiscal 2011, the state will have fully used two budgetary cushions in the current cycle: federal grants under the ARRA and its constitutionally restricted budget stabilization fund, which the state forecasts will hold $5.8 million (included within the general fund total above). We note that the February 2010 biennial revenue forecast revision was the first that was favorable relative to its quarterly predecessor, and that, notwithstanding the downward revision for the current biennium through fiscal 2011, the state's June 2010 forecast for the biennium covering fiscals 2012 and 2013 increased slightly from the prior forecast. At $34.1 billion, revenues in the biennium ending fiscal 2013 are forecast to increase by 16% from the current biennium as the state benefits from a national economic recovery and exposure to international trade.

In contrast with states that depend on income tax revenues for operations, the state has not needed to borrow for cash flow needs since 1983, and at the end of June 2010 held about $4 billion, or roughly 29% of annual general fund expenditures, in cash available for temporary use by the general fund. The lowest monthly point in the state's liquidity during the past two years was $1.8 billion.

November 2010 Ballot Could Bring Changes to State Revenues

Also potentially affecting state revenues in the second half of fiscal 2011 and beyond are what we understand are six citizen initiatives that could qualify for the November 2010 ballot. The most significant of these in the short term, in our view, is Initiative 1107, which we understand would rescind temporary taxes on beer, soda, candy, and bottled water. The state forecasts that these revenues will total $121.1 million through fiscal 2011; we understand that a portion of this total would not materialize if the initiative qualifies for the ballot and is approved. Potentially affecting the upcoming biennium is Initiative 1053, which would echo prior successful initiatives that imposed two-thirds majority thresholds for the legislature to increase taxes or fees. Under the state constitution, the legislature can modify statutes laws passed by initiative after two years with a majority vote, and exercised this ability as part of the spring 2010 budget revisions. Based on media reports and discussions with management, we expect that the state will focus on spending reductions rather than further tax increases to balance its operations should its budget come under further pressure regardless of whether the initiative becomes law, but we also believe that it will reduce revenue flexibility. Finally, Initiative 1098 would institute an income tax on high-income earners in one of a small number of states that does not have an income tax and concurrently exempt the state's gross receipts tax on what proponents say is about 80% of businesses and lower the state's property tax levy by 20%. We understand that Initiative 1098 would direct 70% of what its proponents say would be about $1.1 billion in net new annual revenues for education spending and 30% for health care spending, although we note that, as with other initiatives, the legislature could modify such restrictions after two years.

Financial Management Assessment: 'Strong'

We consider the state's management practices "strong" under our Financial Management Assessment (FMA) methodology. An FMA of "strong" indicates our view that practices are strong, well embedded, and likely sustainable. The state Economic and Revenue Forecast Council, which is made up of representatives appointed by the governor's office, both houses of the legislature, and both political parties, produces an analytical report on economic and revenue performance each month and by statute presents quarterly revenue forecasts covering the current and upcoming biennium. The state uses the council's forecasts, which are based on a modified IHI Global Insight model of the U.S. economy, to set revenue parameters at biennial budget adoption and has a record of making budget adjustments within the biennium when the forecast council materially changes its forecasts. In addition, the state convenes a Caseload Forecast Council three times per year that forecasts service requirements in such areas as public assistance, state corrections, medical assistance, and K-12 education. The executive branch uses these forecasts, along with historical expenditures, to formulate budget proposals and mid-biennium revisions. Further guiding budgeting decisions is a rolling four-year general fund outlook maintained by the governor's Office of Financial Management. The state uses these forecasts to quantify the timing and scope of potential deficits in the subsequent biennium and in some cases to begin to address structural imbalances before the next budget cycle begins. Although the state does not have a minimum reserve policy, the state constitution requires the state to set aside 1% of most unrestricted state revenues in each fiscal year into a budget stabilization fund, a form of rainy-day fund. That fund can and is being tapped in the current biennium under a provision that the state can draw on the fund when employment growth falls below 1% and is also available in the event of a catastrophic emergency, or by 60% supermajority vote of the legislature. When it reaches 10% of estimated general state revenues in that fiscal year the state can also draw excess funds for education capital projects.

Other policies and practices include:

- Capital spending that the state budgets for on a biennial schedule but plans on a rolling 10-year basis, including funding sources;
- A formal investment management policy that covers eligible investments, maximum maturities (10 years), allocations of non-government securities, and internal and external controls; and
- Debt management under an issuance policy that, among other elements, addresses refunding savings thresholds.

Moderate Debt Burden with Ongoing Transportation Capital Needs

The state's direct tax-supported debt burden (GO and appropriation-backed) is moderate, in our opinion, at $2,694 per capita. However, as a percentage of personal income, it is above average relative to that of other states, at 6%. Pro forma 2012 carrying charges translate into what we view as a low 4.8% of fiscal 2009 governmentwide, non-capital expenditures. Although federal grants have historically supported a portion of transportation projects, we believe that transportation capital needs will likely lead to significant additional GO debt over time. Of particular focus for the state in the coming decade are the replacements of State Route 520 bridge (estimated at $2.6 billion) and Alaskan Way Viaduct (estimated at $3.1 billion), two Seattle-area highway segments that are vulnerable to seismic damage.

Pension and Other Postretirement Employee Benefits

The state manages eight retirement systems and 13 plans on behalf of the state and local governments. Combined, these plans have what we consider to be a good 94% funding ratio as of June 30, 2008, based on the entry age normal method approach, although we note that each plan is managed separately and that the state cannot commingle assets among plans. The four most significant are two defined-benefit plans for public employees and two plans for teachers. Public Employees Retirement System (PERS) Plan 1 and Teachers Retirement System (TRS) Plan 1, are closed to employees hired on or after Oct. 1, 1977, and were funded at what we consider to be relatively low funded ratios of 71% and 77%, respectively, at the end of fiscal 2008. The PERS Plan 2/3 and TRS Plan 2/3 include the defined-benefit Plan 2 and the defined-benefit portion of Plan 3, and both are open to new members. These are funded at what we consider to be well-above-average ratios of 101% and 108%. (For more information on U.S. state pensions, please see our report "Pension Funding And Policy Challenges Loom For U.S. States," published July 8, 2010, on RatingsDirect on the Global Credit Portal.) Other plans administered by the state include the School Employees Retirement system Plan 2/3 and Law Enforcement Officers' and Fire Fighters' (LEOFF) Plans 1 and 2, which primarily cover full-time, fully compensated, local law enforcement commissioned officers, firefighters, and emergency medical technicians, with 80% of contributions coming from employees and employers and what we consider to be a modest 20% from the state.

The state legislature updates annual required contribution rates for each plan at least as often as each biennial budget adoption based on the conclusion of the pension funding council, a joint executive and legislative group that we understand primarily relies on recommendations of the state actuary for its assumptions. We understand that the biennial budget covering fiscals 2010 and 2011 incorporated some but not all of the state actuary's long-term assumptions. Relative to the state actuary's calculations in 2009, this had the effect of reducing the state's biennial general fund contributions by $429 million (about 1% of expenditures) and would increase the size of contributions by $132 million in the biennium ending in fiscal 2013.

Table 2

Washington State Pension Plans

Plan	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio 2008 (%)	Funded Ratio 2007 (%)
(Mil. $)					
PERS Plan 1*	9,852.90	13,901.00	4,048.10	71	71
PERS Plan 2/3¶§	16,692.70	16,508.00	(184.7)	101	102
School Employees' Retirement System Plan 2/3¶§	2,302.60	2,207.30	(95.3)	104	107
PSERS Plan 2§	38.7	32.9	(5.7)	117	115
TRS Plan 1*	8,262.30	10,753.90	2,491.60	77	77
TRS Plan 2/3¶§	5,681.00	5,263.80	(417.2)	108	113
LEOFF Plan 1*	5,592.50	4,367.70	(1,224.70)	128	122
LEOFF Plan 2§	5,052.70	3,998.20	(1,054.50)	126	120
WSPRS 1/2§	869.7	745.3	(124.4)	117	114
Judicial Retirement System*	1	91.5	90.6	1	1
Judges Retirement Fund*	3.6	3.5	(0.1)	104	103

PERS--Public Employee Retirement System. *--Closed to new members. ¶--Defined-benefit portion. §--Although these plans use the aggregate actuarial cost method, which does not separately amortize unfunded actuarial liabilities, the state has reported these liabilities under the entry age normal method under Government Accounting Standards Board Statement 50 guidelines. PSERS--Public Safety Employees Retirement System. TERS--Teachers' Retirement System. LEOFF--Law Enforcement Officers' and Fire Fighters' Retirement System. WSPRS--Washington State Patrol Retirement System. Source--Wash. State Department of Retirement Systems 2009 Comprehensive Annual Financial Report.

In addition, the state offers OPEBs. According to the state's latest valuation, issued in August 2008, the statewide total unfunded postemployment benefit liability was $7.9 billion as of Jan. 1, 2008, assuming a 4.5% discount rate. The state's OPEB includes an implicit liability from allowing retired employees to purchase health, life, and vision insurance in the same pool as current employees at a subsidized rate. The explicit benefit subsidizes retired members' monthly premiums for enrollment in Medicare parts A and B. On an actuarial basis, the state's accrued liability made up $4 billion of the total, and the annual required contribution was $312 million of the statewide $683 million for inactive and active members. Of the $332 million (about 2% of annual expenditures), $256 million represents the state's explicit subsidy, $73 million is in the form of an implicit rate study, and $3 million is attributable to life insurance. In fiscal 2009, the state contributed $86 million for current pay-as-you-go expenses of the retiree benefits. We understand that the state does not plan to fully fund the annual required contribution for the foreseeable future.

Related Criteria And Research

USPF Criteria: GO Debt, Oct. 12, 2006

Ratings Detail (As Of July 22, 2010)

Ratings Detail (As Of July 22, 2010) **(cont.)**		
Washington motor veh fuel tax GO bnds ser 2008D		
Long Term Rating	AA+/Stable	Affirmed
Washington mtr veh fuel tax go bnds ser 2004C dtd 08/06/2003 due 06/01/2009-2030		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington mtr veh fuel tax GO bnds (Build America Bnds) ser 2010D		
Long Term Rating	AA+/Stable	Affirmed
Washington various purp GO bnds ser 2008C		
Long Term Rating	AA+/Stable	Affirmed
Washington various purp GO bnds ser 2009A		
Long Term Rating	AA+/Stable	Affirmed
Washington var purp GO bnds		
Long Term Rating	AA+/Stable	Affirmed
Washington GO bnds		
Long Term Rating	AA+/Stable	Affirmed
Washington GO bnds		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO bnds (Motor Vehicle Fuel Tax) ser 2009B		
Long Term Rating	AA+/Stable	Affirmed
Washington GO bnds (Taxable) ser 2009T		
Long Term Rating	AA+/Stable	Affirmed
Washington GO Mtr Veh Fuel Tx		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO (wrap of insured) (AMBAC) (ASSURED GTY - SEC MKT)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO (wrap of insured) (FGIC & AGM) (SEC MKT)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.