STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Washington; Appropriations; General Obligation

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Credit Profile		
US$526.060 mil various purp GO rfdg bnds ser R-2015C due 07/01/2031		
Long Term Rating	AA+/Stable	New
US$238.6 mil motor veh fuel tax GO rfdg bnds ser R-2015D due 07/01/2030		
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 to the state of Washington's:

- $526.1 million various purpose general obligation (GO) refunding bonds, series R-2015C; and
- $238.6 million motor vehicle fuel tax (MVFT) GO refunding bonds, series R-2015D.

At the same time, we affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the state's existing GO and MVFT GO debt. We also affirmed our 'AA' rating on the state's appropriation-backed debt. The outlook on all long-term ratings is stable.

The ratings reflect our view of the state's:

- Relatively well-educated workforce and good income indicators;
- Sales tax-based revenue structure that exhibits sensitivity to economic cycles but to a lesser degree than those of states that rely primarily on personal and corporate income taxes;
- Good internal access to sources of liquidity;
- 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; and
- Moderately high per capita debt burden but well-funded pension plans.

The state's full faith, credit, and taxing powers secure the state's GO bonds. The state's MVFT GO bonds are first payable from state excise taxes on motor vehicle and special fuels. The refunding GO and refunding MVFT GO bonds are being issued to refinance some of the state's existing debt.

The state will have a total of $18.96 billion of GO bonds outstanding after the current offering. Of this, $7.45 billion of the state's GO debt is payable first from excise taxes on motor vehicle and special fuels or toll revenue. The state also has $1.03 billion of certificates of participation and other appropriation-backed debt outstanding. Of this, $84.5 million is GO debt of various local agencies within the state and is a contingent obligation of the state government in the event of nonpayment by a local government agency.

Washington's economy has outpaced the rate of expansion anticipated by the state's Economic and Revenue Forecast

Council (ERFC) in its mid-June outlook publication. During the two months of jobs data available since the prior forecast, the state has added 17,900 jobs, or over 35% above what had been projected. Job growth momentum has benefitted the state's budget performance, with revenues topping the ERFC's forecast by $115 million, or 3.1%, through Sept. 10. Despite an expansion that has remained gradual when compared with prior expansions, the state's economy has outperformed the nation. In both 2012 and 2013, the state's GDP grew at a faster clip than the nation.

The updated projected ending balance of $606 million is 11 times the $53 million expected at the time the 2013-2015 budget was enacted. In addition, the state now forecasts a $578 million balance in its budget stabilization reserve. Together, according to the current forecast, the state would have $1.19 billion in ending balance and budget reserves at the end of fiscal 2015, equal to 7.2% of general fund expenditures. The state estimates that it ended fiscal 2014 with a $367 million ending balance and $414 million in its budget stabilization reserve for a total of $781 million or 4.9% of expenditures. At these levels, we would view the state's reserves in both years, if they materialize, as good. They would also be one indicator suggesting that the state's fiscal position is stronger than at any point since at least 2009.

There is potential for the state to face fiscal pressure even if the economy continues to perform well. In 2012, the State Supreme Court ruled, in McCleary vs. State of Washington, that state funding for education falls short of what the state constitution calls for. The court did not specify how much additional funding was necessary, but there was broad consensus on the need for about $1 billion in additional education spending in the 2013-2015 biennium, which the budget included. On a supplemental basis, the legislature added $58 million in funding to the education budget for fiscal 2015. But according to a report from the legislature's joint select committee, by fiscal 2019, the state would need to spend another $1.9 billion annually on education to bring the state into compliance with the court's ruling. As it stands, approximately 46% of the state-funded portion of general fund expenditures goes toward public education.

The Supreme Court has ratcheted up the pressure on the state and in September 2014, found the state in contempt for failing to have a more fully developed plan for remedying the underfunding situation. Prior to the start of the current biennium, the state confronted a $2.5 billion projected budget gap. The legislature found itself in a standoff that wasn't resolved during its regularly scheduled session.

In our view, depending on the state's updated caseload and other expenditure forecast, the legislature may face difficult tradeoffs as it turns to deliberating the 2015-2017 budget. According to the ERFC's September forecast, revenues are projected to increase $2.75 billion through the 2015-2017 biennium. But even assuming the forecast—and the underlying economic performance on which it's based—holds, the state could confront a large shortfall heading into the next biennium. Apart from non-education caseload and other normal spending increases, the level of new McClearly-mandated education-related expenditures could more than absorb the new revenues.

To the benefit of the state's credit quality, the legislature has taken a more structural approach to crafting fiscal policy in recent years, in our view. One reason is a 2012 statute requiring the state to enact a budget that it projects will remain balanced through four fiscal years. For technical reasons, additional education-related expenses resulting from the McCleary decision were excluded from general fund expenditure estimates for the current biennium. Projected expenses related to the McCleary ruling will, however, be part of the forecast as part of the 2015-2017 budget, adding to the legislature's challenge. Nevertheless—or perhaps because of it—we believe the statute has favorable implications for the state's credit quality by encouraging a greater use of ongoing solutions to projected budget shortfalls, when they arise.

In general, Washington's approach to financial management is strong, in our view, 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.

In 2013, real state GDP expanded at an estimated 2.7% rate, well ahead of the national growth rate of 2.2%. However, the differential relative to the nation has subsided and we now anticipate that at 2.1% national GDP growth in 2014 could be faster than Washington's (2.0%, per IHS Global Insight). State GDP growth could hover around 2.8% through 2017, whereas we now forecast national output to grow by approximately 3.1%. Among the factors contributing to the leveling off of the state's economic growth is its exposure to Boeing, which downsized its workforce by 2,300 in 2013 and recently announced plans to move 4,300 jobs out of the state. As the largest employer in the state (81,939 employees), Boeing's activities have an outsized effect due in part to its numerous suppliers. There are approximately 1,350 aerospace-related firms with more than 132,000 employees in the state. Boeing's workforce reductions have contributed to soft employment trends in the manufacturing sector, which has increased just 0.4% (year-over-year as of August). Overall employment gains have been considerably stronger, up 2.1%. Sectors leading the job growth have been construction, natural resources, and mining (3.8%), trade, transportation, and utilizes (3.2%), and leisure and hospitality (3.9%).

At this point, the state has recovered all of the jobs it lost during the Great Recession. From March 2008 through February 2010, the state lost 184,200 payroll jobs (6.1% of the total) but since then has added back 240,100 jobs, an 8.5% increase. At the end of August, Washington's unemployment rate was 5.6%, lower than the nation's, which was 6.1% at that time.

Through the second quarter of 2014, housing starts came in slightly below the state's forecast with multifamily starts making up for the modest underperformance relative to the forecast in single family starts. With a seasonally adjusted annual rate of 37,200 new housing permits issued during the second quarter, the state is slightly behind the 37,400 that had been forecast for the period. Starts fell slightly short of forecast during the first quarter as well, which the ERFC attributed at the time to a weaker-than-expected January. The bounce-back, which the ERFC suggested was possible, didn't materialize, at least within the second quarter. In 2013, housing permits increased 8.8% over the number issued in 2012. In addition, according to the S&P/Case-Shiller Home Price Index, home prices in the Seattle metro area increased 7.2% in the 12 months through July 2014, which was slightly higher than the 6.8% increase for the 20-city composite index. Prices are also 32.5% above the trough they reached in February 2012.

For September 2014, the state treasury and treasurer's trust fund's month-end cash balance was $4.3 billion, similar to the $4.45 billion at the same point in 2013. As with fiscal 2014, cash balances in fiscal 2015 are well above where they stood in the fiscal 2010-through-2012 timeframe. Investments are conservative, in our view, with an average of 73.9% of funds invested in U.S. Treasurys and agencies in August 2014. Repurchase agreements, which are subject to a maximum term of 180 days, represented just 1.1% of investments. In addition to the state's investment guidelines, state policies require that collateral in repurchase agreements 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 the end of fiscal 2013, the state's direct tax-supported debt burden ($19.2 billion in GO and appropriation-backed bonds outstanding) was moderately high, in our opinion, at $2,784 per capita (based on the U.S. Census 2013 state population of 6.9 million), 5.9% of total personal income (2013), and 4.7% of state gross domestic product (2013).

Gross GO and lease appropriation-backed debt service is moderate, at 5.56% of general government-wide (all funds) spending in fiscal year 2013 (audited). Portions of the state's debt are funded from self-supporting or reimbursable sources, however. Considering just the general fund, adjusted for these offsetting revenues, we estimate that debt service was 6.0%, moderate in our view. We anticipate that continuing transportation needs, including two major urban highway projects, will likely translate into continuing GO issuance in the next two to three years. The state currently projects that it may issue approximately $861 million in new GO and MVFT GO bonds in January 2015. The state also estimates that it may issue around $85 million in certificates of participation in 2014.

Long-term state liabilities include those related to the state's pension system and retiree health care. As of June 30, 2013, the actuarial accrued liability (AAL) of the defined-benefit portion of the state's 12 pension plans totaled $69.8 billion. Actuarial assets of $65.5 billion in aggregate accounted for 94% of the AAL. The plan 1 unfunded actuarial accrued liabilities (UAAL) are $7.6 billion (estimated as of June 30, 2013) whereas the other plans have actuarial assets in-excess of their actuarial liabilities.

Based on the most recent comprehensive annual financial report, in 2013 (reflecting actuarial data through fiscal 2012), the state's aggregated total UAAL on a combined basis for its pension plans was $4.4 billion, equal to $626 per capita (using 2013 U.S. Census population figures), which we view as lower than average. Relative to total personal income, it is 1.3%, which is low in our view (which we score as "strong"). The state's contributions to the pension funds totaled $398 million in fiscal 2013, equal to a low 1.67% of general fund expenditures. Although the state makes its required contributions to each plan as set forth in the plans' respective funding policies, contributions tend not to equal the annual required contributions (ARC). For fiscal year 2013, the total contributions from the state and other plan participants equaled 75% of the ARC.

Other postemployment benefits (OPEB) are funded on a pay-as-you-go basis. The state's OPEBs produce 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 portion of the AAL made up $3.71 billion of the total, and the annual OPEB cost was $347 million in fiscal year 2013, according to the state's fiscal 2013 audited financial statements. The state contributed $69.1 million for current pay-as-you-go expenses for retiree benefits, equal to less than 1% of annual general fund expenditures that same year. We understand that the state does not plan to fully fund the ARC for the foreseeable future.

Based on the analytic factors we evaluate for states, on a scale of 1 (strongest) to 4, we have assigned Washington a composite score of '1.8'.

Outlook

The stable outlook reflects our view that the state's liquidity, financial trends, and strengthening economy point to an improving financial position. Coupled with the state's strong financial management policies and institutions, we see the credit rating as stable through the outlook period. Although we see potential for the state's pace of economic expansion to level off a bit through 2014 and into 2015, we see the gains to date as having helped bolster the state's fiscal position. This offers some cushion heading into the latter part of the current biennium which will encompass the budget development process for the 2015-2017 biennium.

While the legislature and governor have a good track record of resolving fiscal challenges, the upcoming budget cycle stands out, in our view, as particularly challenging. As they are now, the facts point to the need for the governor and legislature to reconcile baseline expenditures that—once the new education funding is included—are growing more quickly than revenues. And this assumes the economy continues to grow. An unanticipated softening of economic performance would likely result in more acute fiscal pressure.

In our view, the state approaches what could be a difficult stretch on solid fiscal footing. Despite a contentious 2013-2015 budget development process, the state adhered to its automatic budget-stabilization fund deposits which are likely to serve its credit quality well. The state could end the current biennium with an ending balance and budgetary reserve equal to more than 7% of expenditures. Having remained committed to its reserve rebuilding efforts will offer some fiscal cushion as it transitions to a higher funding base for its K-12 education system.

Related Criteria And Research

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 8, 2014

Ratings Detail (As Of October 6, 2014)		
Washington certs of part (Washington St Dept of Gen Admin Tacoma Co-Location Proj) dtd 12/01/1996		
Long Term Rating	AA/Stable	Affirmed
Washington motor veh fuel tax GO rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed
Washington motor veh fuel tax GO rfdg bnds ser R-2013B		
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 ser 2013B-1&2 due 08/01/2042		
Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of October 6, 2014) (cont.)		
Washington mtr veh fuel tax GO bnds ser 2014E due 02/01/2039		
Long Term Rating	AA+/Stable	Affirmed
Washington mtr veh fuel tax GO rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed
Washington various purp gen oblig bnds		
Long Term Rating	AA+/Stable	Affirmed
Washington various purp GO rfdg bnds ser R-2014A due 07/01/2020		
Long Term Rating	AA+/Stable	Affirmed
Washington var purp GO bnds ser 2014D due 02/01/2039		
Long Term Rating	AA+/Stable	Affirmed
Washington var purp GO bnds ser 2015A-1 due 08/01/2039		
Long Term Rating	AA+/Stable	Affirmed
Washington var purp GO bnds ser 2015A-2 due 08/01/2039		
Long Term Rating	AA+/Stable	Affirmed
Washington var purp GO rfdg bnds ser R-2013C		
Long Term Rating	AA+/Stable	Affirmed
Washington var purp GO rfdg bnds ser R-2015A due 07/01/2026		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO bnds		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO bnds ser 2013T due 08/01/2018		
Long Term Rating	AA+/Stable	Affirmed
Washington GO Mtr Veh Fuel Tx		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO & mtr veh fuel tax (MBIA/National)		
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 (Motor Vehicle Fuel Tax)		
Long Term Rating	AA+/Stable	Affirmed
Washington certs of part rfdg (Dept of Ecology St Office Bldg Proj) ser RE-2003-B		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Ratings Detail (As Of October 6, 2014) (cont.)		
Aberdeen, Washington		
Washington		
Aberdeen (Washington) spl rfdg rev bnds (Stafford Creek Corrections Ctr) ser 2009		
Long Term Rating	AA/Stable	Affirmed
FYI Properties, Washington		
Washington		
FYI Properties (Washington) Lease rev bnds (State Of Washington Dis Proj) ser 2009		
Long Term Rating	AA/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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