STANDARD & POOR'S
RATINGS SERVICES

RatingsDirect®

Washington; Appropriations; General Obligation

Primary Credit Analyst:
Gabriel J Petek, CFA, San Francisco (1) 415-371-5042; gabriel.petek@standardandpoors.com

Secondary Contact:
David G Hitchcock, New York (1) 212-438-2022; david.hitchcock@standardandpoors.com

Table Of Contents

Washington; Appropriations; General Obligation

Credit Profile		
US$120.665 mil various purp GO rfdg bnds ser R-2014A due 07/01/2020		
Long Term Rating	AA+/Stable	New
US$108.28 mil mtr veh fuel tax GO rfdg bnds ser R-2014B due 07/01/2021		
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:

- $120.15 million various purpose general obligation (GO) refunding bonds, series R-2014A and
- $107.94 million motor vehicle fuel tax (MVFT) GO refunding bonds, series R-2014B;

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. The outlook on all long-term ratings and SPURs is stable. Finally, we also affirmed our 'AA' rating on the state's appropriation-backed debt.

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 new 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 new GO bonds. The state's MVFT GO bonds are first payable from state excise taxes on motor vehicle and special fuels. According to the state Treasurer's office, proceeds from the bonds will be used to refinance some of the state's existing debt. The proposed refinancing does not involve a new maturity schedule, nor do they have a final maturity later than that of the existing bonds.

The state will have a total of $18.7 billion of GO bonds outstanding after the current offering. Of this, $7.38 billion of the state's GO debt is payable first from state excise taxes on motor vehicle and special fuels or toll revenue. The state also has $1.02 billion of certificates of participation, and other appropriation-backed debt outstanding. Of this, $89.5 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.

In its recently released September revenue report and updated forecast, the state's Economic and Revenue Forecast Council (ERFC) delivered favorable news. For the current 2013-2015 biennium, the ERFC raised its revenue forecast by $345 million, bringing total expected general fund revenues to $33.01 billion for the period. Considering that the prior forecast, in June, was only about three months ago, the 1.1% upward revision reflects a notable improvement. However, we note that most of the favorable variance from the prior forecast occurred in September and one month is insufficient to determine whether it reflects a developing trend.

What was initially a $900 million projected 2013-2015 budget shortfall grew to approximately $2.5 billion during Washington's legislative session. The original projected deficit resulted from growth in underlying program costs and some upward estimates to student enrollment and other caseloads. Another $1.6 billion of the projected deficit stemmed from some early education, and health and human services program expansions, and -- most significantly -- higher funding for the state's public education system. The latter is due to a 2012 State Supreme Court ruling (McCleary vs. State of Washington), which found that the state is not funding its kindergarten through grade 12 education system at its constitutionally required level. Disagreement emerged in the legislature over how to allocate approximately $1 billion in additional spending in the education budget and whether it should be supported with revenue increases or budget cuts elsewhere.

A standoff between the state house of representatives and senate emerged, and the budget went unresolved through both the regular legislative session and a subsequent special session. In a second special session, the legislature came to terms just prior to the start of the new fiscal year. Despite a contentious process, the final package included elements preferred by each side of the legislature that had become politically divided on how to close the projected fiscal gap. Total deficit solutions of almost $2.5 billion include spending cuts ($1.55 billion), new revenue from reforms to the estate tax and telecommunications taxes ($259 million), fund transfers and revenue redirection ($519 million), and deployment of $140 million of projected underspending.

Even though lawmakers grappled with closing a projected deficit, the new budget nevertheless includes a $308.5 million appropriation to the state's budget stabilization fund, bringing the total balance to $577.2 million. In addition, the state estimates an ending general fund balance of $53.2 million by fiscal 2015. In total, the state's reserves would equal $630.3 million at the end of the biennium, equal to roughly 3.8% of fiscal 2015 expenditures. The state began the new budget biennium with total general fund reserves (on a budgetary basis) of $363.4 million, equal to 2.3% of fiscal 2013 spending.

Because of a 2012 statute, the legislature was required to enact a budget that the state projects will remained balanced through four fiscal years. We believe the provision encourages greater use of ongoing solutions to budget shortfalls. We only consider about 11% ($277 million) of the recently enacted deficit solutions to be nonrecurring.

In general, Washington's approach to financial management is strong, in our view, as reflected in our financial management assessment (FMA) 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.

As it has since 2000, Washington's economy is expanding at a faster clip than the nation. Since 2000, the state's real GDP compound annual growth rate has been 1.91% compared with the U.S., which grew at 1.51%. More recently, the state's relative performance has been even better, with real GDP growth of 3.63% in 2012 versus the nation, which expanded at 2.8%. Looking ahead, according to the IHS Global Insight model, we project growth will accelerate from 1.9% in 2013, to 2.4% in 2014, and 3.3% in 2015. The ERFC similarly anticipates 2.1% real personal income growth in 2013 before picking up to 3.8% in 2014 before subsiding a bit to 3.6% in 2015. Personal income is getting a boost from strong employment trends in the high-wage software industry.

Overall, employment trends in the state have outpaced the nation. During the 12 months ending in August 2013, the state added 64,300 nonfarm jobs, representing a 2.23% increase. Nationally, nonfarm payrolls increased 1.64% during the same period. At this point, the state has recovered 165,400, or 83% of the total jobs lost, from the peak of March 2008 to the trough of February 2010 during the Great Recession. At the end of August, Washington's unemployment rate was 7.0%, lower than the nation's 7.3%.

Construction and real estate have helped support the state's recovery in recent months. New housing permits issued during the first quarter increased at an annualized rate of 83% compared with the fourth quarter of 2012. Stronger trends in housing have lifted construction sector employment, which was up 4.9% year-over-year as of August. Total construction employment peaked at 211,600 in June 2007 before falling 36% to 135,400 as of October 2011. However, both housing permits and construction employment remain well below pre-recession highs. Even after increasing 34%, the new housing permits issued in 2012 equal just 53% of the peak number issued in 2005. Now forecast by the ERFC at 33,014 in 2013, the state would reach 62% of peak permits. Similarly, since reaching bottom, construction employment has increased by 9,300 jobs, restoring just 12.2% of the total 76,200 jobs lost during the downturn. Nevertheless, we view the stabilization and improvement as favorable since housing has been weighing on Washington's economic recovery as it has in other states.

For September 2013, the state treasury and treasurer's trust fund's month-end cash balance was $4.36 billion, well above the $3.68 billion balance at the same time in 2012. Average daily balances have also increased, at $3.96 billion in August 2013 versus $3.9 billion for the 12-months ending in August 2013. Investments are conservative in our view, with an average for the month of August of 57% of funds invested in U.S. Treasurys and agencies. Repurchase agreements, which are subject to a maximum term of 180 days, represent 7.6% 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 2012, the state's direct tax-supported debt burden ($18.74 billion in GO and appropriation-backed bonds outstanding) was moderately high, in our opinion, at $2,743 per capita (based on U.S. Census 2011 state population of 6.83 million), 5.98% of total personal income (2012), and 4.99% of state gross domestic product (2012).

Unlike 18 other states in the U.S., Washington maintains a positive balance in its unemployment insurance fund -- $3 billion as of Aug. 31, 2013 -- sufficient to fund benefits for an estimated 15.1 months.

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 state's credit rating as stable through the outlook period. Moreover, we believe the favorable trajectory of these factors helps offset risks from the state's acrimonious budget development process for the 2013-2015 biennium. By failing to reach a budget accord until the final days of the previous biennium, state officials were forced to draw up contingency plans for a potential state government shutdown. Although we understand state debt service would have continued to be paid in a shutdown scenario, the legislature's difficulty resolving its differences on fiscal matters presents some medium-term risk. In our view, the state's credit rating could come under negative pressure if -- in a more negatively trending economy -- the state faced a larger projected deficit and similar recalcitrance by opposing legislative caucuses.

The state's automatic budget-stabilization fund deposits, which it continued to make even despite the difficult budget process, are likely to serve its credit well when the economy -- and revenues -- take a negative turn. At present, the state is in a reserve rebuilding phase, which we view as important to the state's credit quality going forward. The state's tendency to deplete reserves during economic downturns limits the state's rating from moving upward.

At this stage, with a budget now in place, downside credit risk would likely have economic origins. If a downturn were sudden enough to create a mid-biennium budget gap, we believe there is some risk for downward pressure on the rating to intensify should the legislature experience significant difficulty resolving its differences in the supplemental budget. The current federal continuing resolution and debt limit deliberations create significant uncertainty to the state and national economic forecast, in our view, and could create weak credit conditions for the sector if there is a protracted breakdown in negotiations among federal policymakers. We will continue to monitor developments in this area as it relates to state revenues and overall budget balance.

Washington State And Health Care Reform

Washington is implementing Medicaid expansion as envisioned under the federal Affordable Care Act (ACA) and is opening a state-run health insurance exchange. The state Medicaid program presently covers approximately 1.2 million people. Beginning in January, the state's Medicaid program will offer coverage to about 250,000 newly eligible people, under ACA, including childless adults with modified adjusted gross incomes of up to 138% of the federal poverty level. In addition, the state estimates there are 87,000 people that are currently eligible, but not enrolled in Medicaid. Under the ACA, the federal government will cover 100% of the cost of the newly eligible beneficiaries. However, for the currently eligible population, Washington will continue to receive federal matching funds at a rate of 50%. In light of the ACA's requirement that most individuals obtain health insurance coverage, the state has reported a total increase in Medicaid outlays of $2.1 billion through 2019. Nevertheless, the state anticipates realizing net savings of $351 million in the 2013-2015 biennium as a result of opting into Medicaid expansion. The state anticipates that the initial 100% federal subsidy will more than offset the cost of providing coverage to the currently eligible but unenrolled population.

Post-Employment Benefit Liabilities

Pension plans are well funded

Long-term state liabilities include those related to the state's pension system and retiree health care. As of June 30, 2012, the actuarial accrued liability (AAL) of the defined-benefit portion of the state's 12 pension plans totaled $62.6 billion, the actuarial assets of which ($63.1 billion) in aggregate accounted for 101%. The funded ratio improved after recent changes to the plan 1 (Public Employee Retirement System (PERS) and Teacher Retirement System--TRS). During its 2011 session, the legislature rescinded automatic cost of living adjustments (COLAs) to the PERS plan 1 and the TRS plan 1. Elimination of the UCOLA reduces the plan 1 unfunded actuarial accrued liabilities (UAAL) to $5.76 billion (as of June 30, 2012) from $6.86 billion (as of June 30, 2009).

Based on the most recent comprehensive annual financial report, in 2012 (reflecting actuarial data through fiscal 2011), the state's total UAAL for its pension plans was $4.1 billion, equal to $601 per capita (using 2011 U.S. Census population figures), which we view as lower than average. Relative to total personal income, it is just 1.4%, which is low in our view (which we score as "strong"). Contributions to pension funding equaled $392.6 million in fiscal 2012, equal to a low 1.65% 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 2012, the total contributions from the state and other plan participants equaled 74% of the ARC.

OPEB is funded on a pay-as-you-go basis

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 $3.49 billion of the total, and the annual OPEB cost was $330 million in fiscal year 2012, according to the state's fiscal 2012 audited financial statements. The state contributed $78.7 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.

Related Criteria And Research

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Ratings Detail (As Of October 2, 2013)		
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

Ratings Detail (As Of October 2, 2013) (cont.)		
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
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 var purp GO rfdg bnds ser R-2013C		
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
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.