STANDARD & POOR'S

Global Credit Portal®
RatingsDirect®

September 29, 2011

Washington; Appropriations; General Obligation; Liquidity Facility

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

Secondary Credit Analyst:
David Hitchcock G, New York (1) 212-438-2022; david_hitchcock@standardandpoors.com

Table Of Contents

Washington; Appropriations; General Obligation; Liquidity Facility

Credit Profile		
US$656.14 mil various puprose gen oblig bnds ser R-2012-A due 07/01/2028		
Long Term Rating	AA+/Stable	New
US$516.77 mil motor veh fuel tax GO bnds (Sr-520 Corridor Program-toll Rev) ser 2012C due 06/01/2041		
Long Term Rating	AA+/Stable	New
US$116.1 mil motor veh fuel tax GO rfdg bnds ser R-2012-B due 07/01/2028		
Long Term Rating	AA+/Stable	New
Washington GO		
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

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating to the state of Washington's $516.8 million motor vehicle fuel tax (MVFT) SR 520 corridor program toll revenue general obligation (GO) bonds series 2012C. At the same time, we assigned our 'AA+' rating to the state's $656 million various purpose GO refunding bonds series R-2012A and $116.1 million motor vehicle (MVFT) GO refunding bonds, series R-2012B. In addition, we affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the state's existing GO debt. We also affirmed our 'AA' rating on the state's appropriation-backed debt. The outlook on all 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 liquidity;
- Strong financial policies and practices, including consistently good responsiveness to recurring downward revisions to state revenue forecasts; and
- Moderately high per capita debt burden but well-funded pension plans.

The state's full faith, credit, and taxing powers secure the new and refunding series of bonds. The series 2012C bonds are first payable from a third-tier lien on toll revenue from the operation of the state's SR 520 corridor. The series 2012C bonds and the series R-2012B bonds are also payable from the state's MVFT revenues. We understand that proceeds of the series R-2012A and R-2012B bonds will be used to refund certain existing general purpose GO and MVFT-GO bonds, respectively, of the state. The state will have a total of $17.7 billion GO bonds outstanding after the current offering. Of this, $6.8 billion of the state's GO debt is payable first from state excise taxes on motor vehicle and special fuels.

The state's independent economic and revenue forecast council revised down in September the state's revenue projections by $1.4 billion through fiscal 2013. If actual revenues materialize consistent with the forecast and no corrective measures were taken, the new lowered revenues stream would erase the enacted budget's ending reserve of $723 million and result in a negative $1.27 billion ending position in the general fund at the end of the biennium. Despite the negative revenue revision (equal to 4.7% of biennial revenue), we are maintaining the 'AA+' rating and stable outlook on the state's GO debt. Foremost, we continue to believe the state's economy will recover at a slightly faster pace than the nation. In addition, the state continues to exhibit responsiveness to recurring fiscal setbacks. Finally, the state's internal liquidity remains strong (despite negative cash in the general fund), and the projected revenue downturn is backloaded in the biennium, allowing time for budget adjustments to take effect.

After closing what had been a projected $4.9 billion budget deficit with $4.5 billion in program reductions for the fiscal 2011-2013 biennium, early in fiscal 2012 Governor Chris Gregoire began calling for state agencies to identify additional ways to reduce spending. In August, the governor requested state agencies to prepare proposals for how to accommodate funding reductions of up to 10% for the biennium. Upon release of the September revenue forecast, the governor called for a special session of the legislature, to convene on Nov. 28, 2011, to solve the projected shortfall in a more strategic way than through across-the-board allotment reductions, which she has the authority to impose (except for education, debt service, and pension-related costs). Targeted reductions are necessary in our view since more than 60% of expenditures in the state budget are legally required for education, pensions, debt service, or are mandated by federal requirements in order to receive federal matching or reimbursement funding. The governor is seeking $2 billion in budget fixes to allow for some fiscal cushion in the event revenues deteriorate further.

The September revenue forecast, while down from the June forecast, still calls for 7.5% general fund revenue growth during the 2011-2013 biennium versus the prior biennium. Most negative influences on the state's forecast relate to macroeconomic risk, such as the European sovereign debt crisis, eroding consumer confidence, and uncertainty stemming from the effects of the federal deficit reduction efforts currently underway. Washington's economy nonetheless remains well-poised for recovery, albeit at a slower pace than from previous recessions. Whereas we forecast that the U.S. real GDP will increase 1.9% during 2012, IHS Global Insight expects Washington's economy to expand by 2.0%. Total employment in Washington is also expected to grow faster than the nation, at 1.2% compared with 1.0%. This would be consistent with its track record. Washington's real state GDP has increased at an average (geometric mean) annual rate of 2.46% versus the nation's 2.22% average annual rate since 1997. Strong performance in the high wage industries of aerospace and high technology suggest continued increases in total state personal income, which are forecast to grow by 1.6% in 2012.

As in other states, the housing sector has been a source of negative drag on the state's economy. Home construction troughed in 2009 and, according to the state's economist, is unlikely to rebound until home prices recover. Although home prices in the Seattle metropolitan area increased 0.1% in July according to the S&P/Case-Shiller home price index; on a year-over-year basis, prices were down 6.4%, which was worse than the 10- and 20-city national indices, which were down 3.7% and 4.1%, respectively. There is reason to believe the housing market may be reaching an inflection point, however. Whereas the state ranks 23 in the nation in seriously delinquent mortgages (slightly more than 6%) it ranks much more favorably, at 47, when considering mortgages that are 30-days delinquent. The state economist interprets this as a precursor to stabilization in the real estate market.

Washington's financial liquidity remains adequate and shows improvement despite its negative $1.05 billion general fund cash balance at the end of August 2011. At the same point in 2010, general fund cash was negative by $1.6 billion. The state has access to cash for liquidity in its treasury and treasury trust funds, the former of which is subject to legislative appropriation. This cash is held in the custody of and invested on a comingled basis by the state treasurer. As a result of its good access to internal liquidity, the state does not rely on external borrowing for cash flow management. Of the $1.4 billion in downward revenue revision, $500 million is expected in fiscal 2012 with $900 million of the weaker revenue attributable to fiscal 2013. If the timing of the weaker revenue performance follows the forecast's expectation, the state's budget adjustments should have time to take effect. As such, we continue to view the state's internal liquidity sources as sufficient to support its general fund budget operations.

For August 2011, the treasury and treasurer's trust fund's average cash balance was $3.22 billion. Its month-end cash balance was $3.01 billion, which is below the $3.20 billion balance at the same time in 2010. Investments are conservative in our view, with 43% of funds invested with U.S. Treasury and agencies. Repurchase agreements, which are subject to a maximum term of 180 days, represent 39% 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.

Washington's $31.7 billion, two-year budget was signed by the governor on June 15, 2011. It addressed what at the time had been a projected $4.9 billion deficit by making $4.5 billion in program reductions. The balance of budget solutions comes from fund transfers and from using the state's beginning balance left from the prior biennium. By agreeing to a budget package that resolves the state's anticipated deficit largely with recurring measures, the state has helped preserve its credit strength in our view.

Among the largest budget expenses of the state is the Medicaid program, which is funded jointly by the federal and state governments and operates under Washington's Health Care Authority (HCA) and its Department of Social and Health Services (DSHS). For fiscal 2012, the budgets for the state's HCA and DSHS total approximately $8.8 billion, of which the state funds approximately $4.4 billion. The state receives approximately $500 million per month in federal inflows, with the largest share going to the Medicaid program. The state is reimbursed for prior state disbursement of funds that paid for service delivery. Net of federal inflows, state cash outflows approximate $500 million per month. The fiscal 2011-2013 budget included no tax increases but made significant cuts. Among the largest spending reductions were the suspension of two education initiatives for class-size reduction and teacher pay increases ($1.2 billion of budgetary savings), higher education ($535 million), pension benefit ($344 million), kindergarten through -grade 4 class size enhancement ($215 million), K-12 employee salaries ($179 million), and state employee pay ($177 million).

In November 2010, the Washington electorate rejected a state income tax on high-income earners, repealed a previously enacted tax on snack foods, and raised the threshold to two-thirds from a simple majority of the legislature to increase future taxes.

The state's direct tax-supported debt burden (GO and appropriation-backed) is moderately high, in our opinion, at $2,707 per capita, 6.2% of general fund expenditures, 6.2% of total personal income, and 5.3% of gross state product. Gross GO and lease appropriation-backed debt service is also moderately high, at 5.27% of general government-wide (all funds) spending in fiscal 2010. Portions of the state's debt are funded from self-supporting or reimbursable sources. When adjusting for these offsetting revenues, debt service is moderate in our view, at 5.3% of general fund expenditures. We expect 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 up to approximately $2.1 billion in new transportation-related and various purpose GO bonds between now and the spring of 2012.

Unlike a majority of states (approximately 30) in the U.S., Washington maintains a positive balance in its unemployment insurance fund of $2.7 billion, sufficient to fund benefits for an estimated 15 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 financial management is strong, as demonstrated by its continued willingness to make timely and proactive budget amendments as it deems necessary to maintain budgetary balance. The state's automatic budget stabilization fund deposits serve its credit well when the economy -- and revenues -- take a negative turn. Pending voter approval, the budget stabilization funding mechanism could become stronger, which would likely benefit the state's credit quality. At present, the state's reserves are low and, absent additional budget corrections, could deteriorate further despite its practice of making regular reserve contributions -- a reflection of the halting economic recovery. The low reserves limit the state's rating from moving upward and, in fact, render its rating vulnerable to downward movement if revenues deteriorate further without very timely corrective budget action.

Debt And Liability Profile

As noted, Washington's debt is moderately high by several of our measures. Debt paydown is average, in our view, with 44% of outstanding principal amortized over 10 years.

Pension reform will likely reduce unfunded actuarial liabilities. Other long-term state liabilities include pension and retiree health care. As of June 30, 2009, the actuarial accrued liability (AAL) of the defined-benefit portion of the state's eight pension plans (not including the judges' retirement system and judges' retirement funds) totaled $57.2 billion, of which actuarial assets ($58.4 billion) in aggregate accounted for 102%. 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 (COLA) to the PERS plan 1 and the TRS plan 1. Elimination of the uniform cola (UCOLA) generates $344 million in general fund savings for the fiscal 2012 and 2013 biennium. More importantly, in our view, over the longer run, elimination of the UCOLA reduces the plan 1 unfunded actuarial accrued liabilities (UAAL) to $4.4 billion from $6.88 billion, or 36% of the prior plan 1 UAAL, according to estimates from the state actuary. This represents a significant improvement in the state's overall pension funded status in our view.

Based on the most recent comprehensive annual financial report of 2010, the state's total UAAL for its pension plans is $4.94 billion, equal to $719 per capita, which we view as moderate. However, relative to total personal income, it is just 1.6%, which is low in our view. Contributions to pension funding are generally less than the actuarial required contribution (ARC), and for fiscal 2010, total actual contributions were 52.5% of the ARC.

Other post-employment benefits (OPEB) are funded on a pay-as-you-go basis. 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 portion of the AAL made up $3.8 billion of the total, and the annual OPEB cost was $354 million according to the most recent actuarial valuation report from January 2009.

In fiscal 2010, the state contributed $70.1 million for current pay-as-you-go expenses of the retiree benefits, equal to less than 1% of annual general fund expenditures. 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: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Ratings Detail (As Of September 29, 2011)		
Washington adj rate GO bnds ser VR-96A&B due 06/01/2020		
Long Term Rating	AA+/A-1+/Stable	Affirmed
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 GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO bnds		
Unenhanced Rating	AA+(SPUR)/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 (Motor Vehicle Fuel Tax)		
Long Term Rating	AA+/Stable	Affirmed
Washington (St Office Bldg Proj - Dept of Ecology) ser 91 A 99		
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.