JAMES L. McINTIRE
State Treasurer

State of Washington
Office of the Treasurer

Fellow Washingtonians,

I am pleased to present the 2015 Debt Affordability Study – our annual update on the state's debt obligations, issuance trends and borrowing costs. The Debt Affordability Study provides comprehensive information and analysis to policy makers so they can be better informed as they decide how to cost-effectively finance capital investments.

Over the past several years, Washington has undertaken an intensive period of capital construction that benefited from historically low interest rates and low construction costs. Meanwhile, strong investor demand for the state's credit helped us refund existing bonds to save nearly $1 billion in debt service.

By December 31, 2014 Washington's debt portfolio had grown to $20.1 billion – a 27 percent increase over five years. Repaying the state's debt is now taking a larger share of state revenues – especially in transportation where issuance accelerated even as motor vehicle fuel tax (MVFT) revenues fell short of projections. Debt service on outstanding MVFT-General Obligation bonds now uses approximately 50 percent of motor vehicle fuel tax revenues – and is expected to increase to 60 percent within the next five years. Growth of MVFT revenues is expected to be further constrained by a reduction of fossil fuel use due to technology, incentives and changes in consumer behavior.

MVFT-GO bonds provide the state with low borrowing costs. But the continued aggressive issuance of these bonds in the face of slowing MVFT revenue growth will limit funds for maintenance and operation costs and can affect the state's ability to share MVFT revenue with local governments. Ultimately, staying on this path can stress the general fund and negatively affect Washington's strong credit rating – which could in turn significantly increase borrowing costs for the state across the board.

As an alternative to relying as much on motor vehicle fuel tax debt for project funding, we should increase the use of tolls where appropriate, and continue developing workable, cost effective, and fair alternative revenue sources that conform to the state constitution. In the meantime, **I strongly recommend that any new transportation financing packages should pledge no more than 50 percent of new MVFT revenues to bond finance**.

Please consider my office as a resource as you make your critical decisions concerning Washington's infrastructure investments. Thank you.

Sincerely,

James L. McIntire,
State Treasurer and Chair, State Finance Committee

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Debt Affordability Study

January 2015

James L. McIntire

Washington State Treasurer

1. Overview of Debt Obligations

The State borrows to undertake capital projects such as building construction, land acquisition, and transportation projects. With each borrowing, the state makes a commitment to repay the debt with regular and approximately equal payments over the term of the borrowing. These payments include the principal amount borrowed plus some amount of interest. The term of the borrowing is within the expected useful life of the asset.

The alternative to debt financing is pay-as-you-go funding, or cash funding capital expenditures with revenues received over time. With debt financing, the state pays interest but funds are available for project construction sooner. Debt-financing can promote tax equity as each asset is paid for over its useful life. However, leveraging future tax revenues with debt financing commits resources from future biennia for today's capital projects.

The majority of Washington's debt obligations are Various Purpose General Obligation bonds that pay for capital projects such as schools, higher education buildings, and correctional facilities; Motor Vehicle Fuel Tax General Obligation bonds that pay for roads, bridges and ferries; and Certificates of Participation that are used for certain real estate and equipment needs.

Funding for the SR 520 Corridor Program also includes toll-backed obligations including "triple pledge" bonds (backed by toll revenues, Motor Vehicle Fuel Taxes, and ultimately the state's general obligation pledge) and a loan from the Federal Highway Administration, as well as Federal Highway Grant Anticipation Revenue Bonds, or GARVEEs.

The debt portfolio of the State of Washington is shown in Figure 1. As of December 31, 2014, Washington's debt totaled $20.1 billion, $18.7 billion of which is general obligation bonds.

Figure 1. **Debt Outstanding ($ thousands)**

	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014
General Obligation Bonds					
Various Purpose	10,587,866	10,929,710	11,018,933	11,276,664	11,356,597
Motor Vehicle Fuel Tax	6,093,285	6,255,063	6,459,111	6,836,842	6,798,909
Triple Pledge Bonds	-	518,775	518,775	518,775	518,775
Subtotal	16,681,151	17,703,545	17,996,819	18,632,280	18,674,281
GARVEEs	-	-	500,400	786,315	786,315
TIFIA Bond	-	-	-	-	10,000
Certificates of Participation – State *	560,750	540,101	575,224	616,557	624,804
Total	17,241,901	18,243,646	19,072,463	20,035,153	20,095,400

*Includes capital leases totaling $5.9 million in FY 2011, $7.2 million in FY 2012, $10.2 million in FY 2013 and $8.5 million in FY 2014.

Source: Office of the State Treasurer, CAFR

General Obligation Bonds

The state irrevocably pledges its full faith, credit and taxing power to the payment of "general obligations of the state". The ability of the state to make this pledge is provided in the State Constitution.

There is no express provision in the Constitution or in state law on the priority of payment of debt service on state debt as compared to the payment of other state obligations. The constitutional mandate regarding payment of state debt, however, does require that the Legislature appropriate sufficient funds to pay state debt when due, and provides expressly for judicial enforcement of the state's payment obligation on that debt. No other provision of the Constitution contains comparable language providing the courts with authority to compel payment of other state obligations.

Various Purpose General Obligation bonds, Motor Vehicle Fuel Tax General Obligation bonds, and triple pledge bonds all carry the state's general obligation pledge. Bonds with a general obligation pledge have the strongest security pledge the state can make and they carry the highest credit ratings of all the state's obligations. Accordingly, borrowing costs on general obligation bonds are lower than costs for other types of state obligations.

Various Purpose General Obligation Bonds

Various Purpose General Obligation (VP GO) bonds are issued to pay for a wide variety of projects including K-12 school construction, higher education facilities, correctional facilities, environmental preservation, state office buildings, and public works infrastructure. VP GO bonds are typically issued with 25-year maturities. As of December 31, 2014, outstanding VP GO bonds totaled $11.4 billion – an amount reflecting bonds issued over the past 25 years.

Motor Vehicle Fuel Tax General Obligation Bonds

Motor Vehicle Fuel Tax (MVFT GO) bonds are also general obligations which are backed by the full faith, credit and taxing power of the state. But, in keeping with the State Constitution, debt service on these bonds is first payable from state excise taxes on motor vehicle and special fuels.

MVFT revenues are constitutionally restricted to highway capital and operating purposes including: construction, maintenance, repair and improvements of public highways, county roads, bridges, city streets; policing of state highways; operation of movable span bridges; and ferry operations.

MVFT GO bonds carry the same ratings as VP GO bonds and borrowing rates are the same. MVFT GO bonds have been issued with 25- and 30-year maturities. As of December 31, 2014, outstanding MVFT GO bonds totaled $6.8 billion – an amount reflecting bonds issued over the past 25 years.

Triple Pledge Bonds

In 2011, the state issued $518.8 million MVFT GO (SR 520 Corridor Program – Toll Revenue) Series 2012C bonds – known as triple pledge bonds – to finance improvements to the SR 520 Corridor. These bonds are first payable from toll revenue, then from state excise taxes on motor vehicle and special fuels, and lastly supported by the general obligation pledge. Triple pledge bonds carry the same ratings as other GO bonds and borrowing costs are the same.

Triple pledge bonds incorporate the discipline of a contractual rate covenant with the low cost of a general obligation bond. In this financing, the state has contractually pledged to set toll rates necessary to generate revenue to cover operations and maintenance, debt service obligations and to fund various reserves. The state also included a debt service coverage provision to ensure the system will not negatively impact other transportation projects to be funded with MVFT revenues. In contrast, the Tacoma Narrows Bridge financing has debt service first payable from motor vehicle fuel tax revenues to be reimbursed by toll receipts.

Other Bonds

Federal Highway Grant Anticipation Revenue Bonds

The state has issued $786.3 million Federal Highway Grant Anticipation Revenue Bonds, or GARVEE bonds, which are payable from and secured solely by pledged federal aid. They are not backed by the general obligation pledge of the State. These bonds are "direct" GARVEE bonds that pledge Federal-Aid Highway Program (FAHP) funds received by the state from the Federal Highway Administration that are designated for project specific debt service under Section 122 of Chapter 1 of Title 23, United States Code and a Memorandum of Understanding between the Washington State Department of Transportation and the Federal Highway Administration.

Transportation Infrastructure Finance and Innovation Act (TIFIA) Bond

The State also issued a TIFIA bond for the SR 520 Corridor Program. This bond is a draw-down loan from the Federal Highway Administration which is payable solely from SR 520 toll revenues. The state received its first disbursement from the $300 million loan in September 2014. This first draw was for $10 million.

Short Term Borrowing and Bond Anticipation Notes

The State Constitution permits the state to issue certificates of indebtedness to meet temporary deficiencies in the state treasury, but also requires that these certificates be retired within 12 months after the date of issue. The state has not issued certificates of indebtedness since 1983 and at present does not anticipate any short-term borrowing.

The state is also authorized to issue temporary notes in anticipation of the sale of bonds. The state has not issued bond anticipation notes since 1981 and does not plan to issue bond anticipation notes.

Certificates of Participation

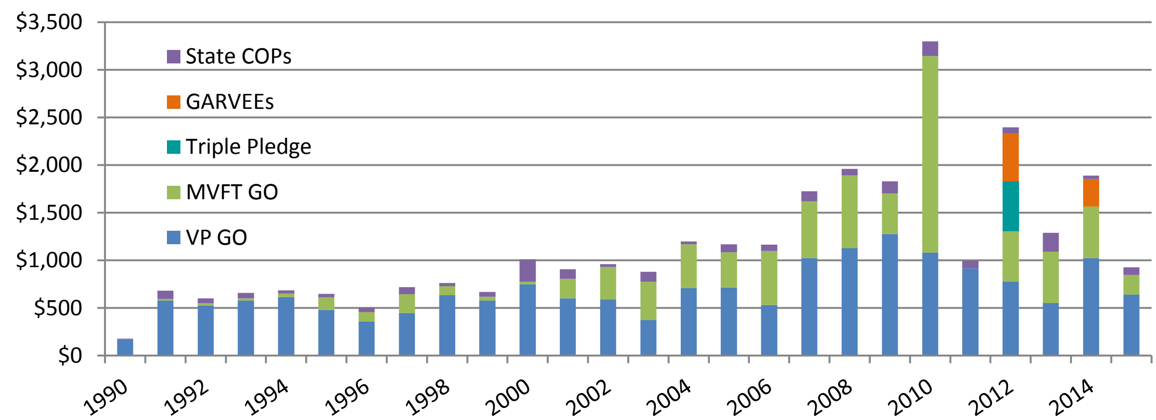
In addition to issuing bonds, the state often acquires real estate and equipment by issuing certificates of participation (COPs). Real estate COPs are used to finance new construction and facility improvements as well as the acquisition of land or buildings. Equipment COPs finance personal property such as vehicles, computer hardware and office equipment. COPs are not backed by the full faith and credit of the state and do not meet certain legal definitions of state debt.

Debt Portfolio Overview

Annual issuance of state bonds and COPs has increased significantly in the past decade (Figure 2). The growth in annual issuance has similarly increased the size of the debt portfolio over this period (Figure 3).

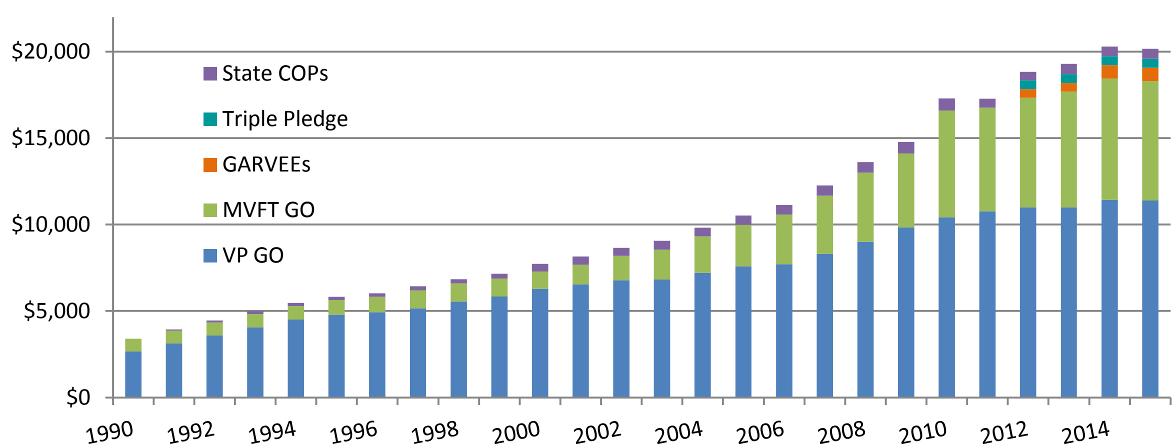
In FY 2015, annual debt service is expected to reach $1,155 million for VP GO bonds, $571 million for MVFT GO bonds, and $26 million for triple pledge bonds. An additional $39 million in GARVEE debt payments and $99 million in state lease payments are projected to be made in the same year (Figure 4).

Figure 2. **Bond and COP Issuance FY 1990-2015* ($ millions)**



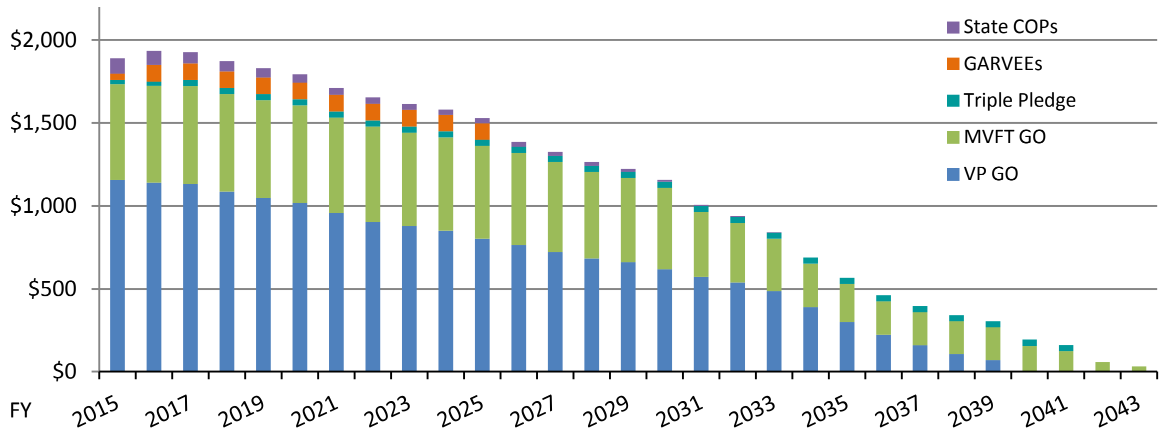
*New money only. Does not include the TIFIA bond. FY 2015 estimate. In 2010, the state accelerated FY 2011 MVFT GO sales in the Build America Bond program. Source: Office of the State Treasurer

Figure 3. **Outstanding Bonds and COPs FY 1990-2015* ($ millions)**



*FY 2015 estimate. Does not include the TIFIA bond. Source: Office of the State Treasurer

Figure 4. **Debt Service on Bonds and State COPs (on debt outstanding as of 6/30/14) ($ millions)**



Source: Office of the State Treasurer

Figure 5. **General Obligation Bond Debt Retired, Refunded, and Issued in CY 2014 ($ thousands)**

	Outstanding as of 12/31/13	Retired in CY 2014	Refunded in CY 2014	Issued in CY 2014*	Outstanding as of 12/31/2014
Various Purpose	11,276,664	(896,467)	(806,360)	1,782,760	11,356,597
MVFT	6,836,842	(581,013)	(444,930)	988,010	6,798,909
Triple Pledge	518,775	-	-	-	518,775
Total	**18,632,280**	**(1,477,480)**	**(1,251,290)**	**2,770,770**	**18,674,281**

*Includes both new money and refunding issues.

2. Credit Ratings

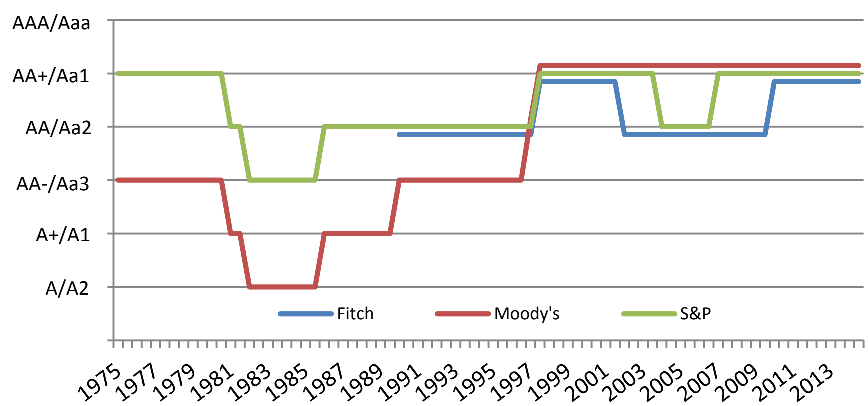
Credit ratings are relative measures of risk. They summarize a rating agency's assessment of an issuer's ability and willingness to pay its debt. A credit rating is an indication of a rating agency's opinion about an issuer's vulnerability to default – not unlike credit scores used to make similar assessments of consumers and businesses.

Ratings are one of the primary tools the investor community uses to benchmark one issuer's credit against another's. As a result, credit ratings have a significant impact on an issuer's cost of borrowing. Lower-rated borrowers pay higher interest rates and are more vulnerable to reduced market access in times of market volatility.

Figure 6 below displays the current ratings on the State's obligations and the history of Washington's general obligation ratings from each rating agency.

Figure 6. **History of Washington State GO Ratings 1975-2014**

	Rating	Outlook
GO Bonds		
Moody's	Stable	Aa1
S&P	Stable	AA+
Fitch	Stable	AA+
GARVEEs		
Moody's	Stable	A2
S&P	Stable	AA
COPs		
Moody's	Stable	Aa2
S&P	Stable	AA



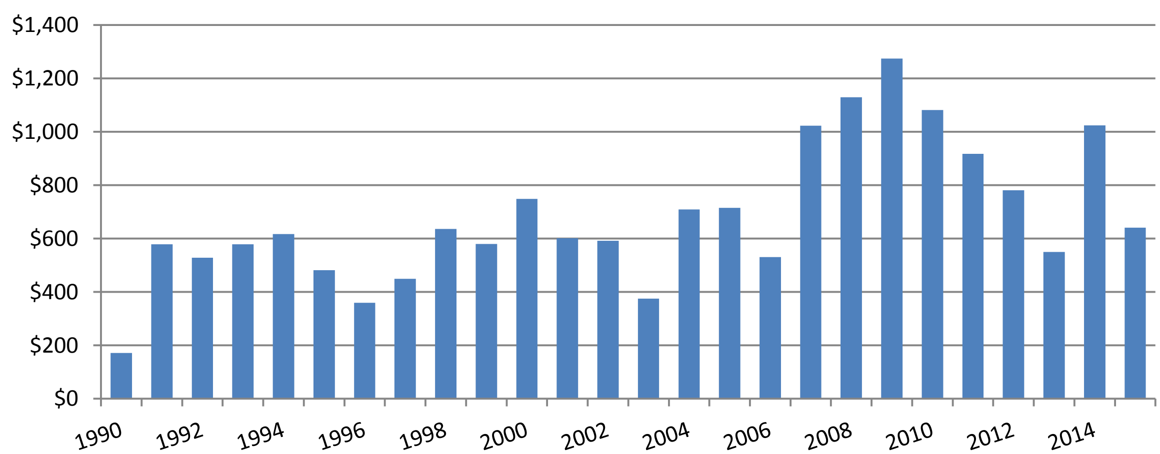
3. Bonds: Issuance, Debt Service and Amortization

Issuance Trends

Annual issuance of state bonds has increased significantly since 1990 to meet capital needs. Washington's population growth – reflecting a combination of net migration and natural increase – has driven demands for added facilities, particularly for public schools, higher education, state institutions and transportation. Issuance of VP GO bonds increased sharply in FY 2007, peaking at $1.27 billion in FY 2009 (Figure 7). In FY 2015, issuance is expected to total approximately $650 million.

Various Purpose General Obligation Bonds

Figure 7. **Issuance of Various Purpose General Obligation Bonds, FY 1990-2015 ($ millions)**



*Excludes refundings. FY 2015 estimate.

Source: Office of the State Treasurer

The Legislature and the Governor approve bond appropriations for projects and programs in biennial capital budgets. Figure 8 displays the recent history of capital budget appropriations funded by current revenues and bond proceeds. The reliance on bond financings has fluctuated with state revenues - as the size of the capital budget has varied and as state revenues have expanded or constrained debt capacity.

Figure 8. **Capital Budget Appropriations FY 1995-97 to FY 2013-15 ($ millions)**

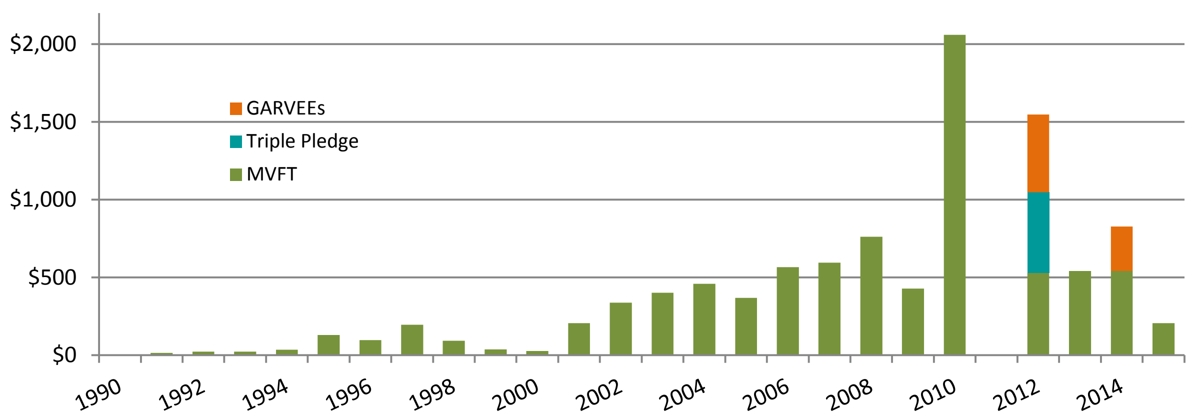
Bond Appropriations	1995-1997	1997-1999	1999-2001	2001-2003	2003-2005	2005-2007	2007-2009	2009-2011*	2011-2013	2013-2015
Governmental Operations	103	110	143	276	200	225	613	467	346	551
Human Services	191	240	175	138	252	336	224	64	104	70
Natural Resources	70	84	107	161	183	248	528	343	368	562
Higher Education	342	447	617	467	689	696	793	504	404	425
K-12 Education	104	49	101	59	167	197	361	656	443	412
Total Bond Appropriations	809	929	1,143	1,102	1,491	1,701	2,519	2,034	1,664	2,020
Other Funds Appropriated	818	1,045	1,364	1,539	1,485	1,853	1,736	1,297	2,041	1,585
Total Appropriations	1,627	1,974	2,508	2,641	2,977	3,554	4,255	3,334	3,705	3,605
% Funded by Bonds	**49.7%**	**47.1%**	**45.6%**	**41.7%**	**50.1%**	**47.9%**	**59.2%**	**61.0%**	**44.9%**	**56.0%**

Transportation Bonds: Motor Vehicle Fuel Tax General Obligation Bonds, Triple Pledge Bonds and GARVEEs

MVFT GO bonds enable the state to undertake construction and highway improvement projects sooner than would otherwise be possible by borrowing against forecasted future motor vehicle fuel tax revenues. Although MVFT revenues have risen over the past decade, recent projections show limited growth consistent with national trends.

Washington significantly increased its reliance on MVFT GO bonds to support legislative spending plans associated with gas tax hikes in 2003 and 2005 (the Nickel Act and the Transportation Partnership Act). Fully leveraging both the 2003 and 2005 gas tax increases to pay for legislatively directed projects caused the state's average annual issuance to grow from $65 million in the 1990s to over $500 million by 2013.

Figure 9. **Issuance of Transportation Bonds* FY 1990-2015 ($ millions)**



*Excludes refundings. FY 2015 estimate. In 2010, the State accelerated borrowing to access subsidized interest rates temporarily available in the federal Build America Bond program. No MVFT GO bonds were issued in 2011. Does not include the TIFIA bond.

Source: Office of the State Treasurer

REFUNDINGS

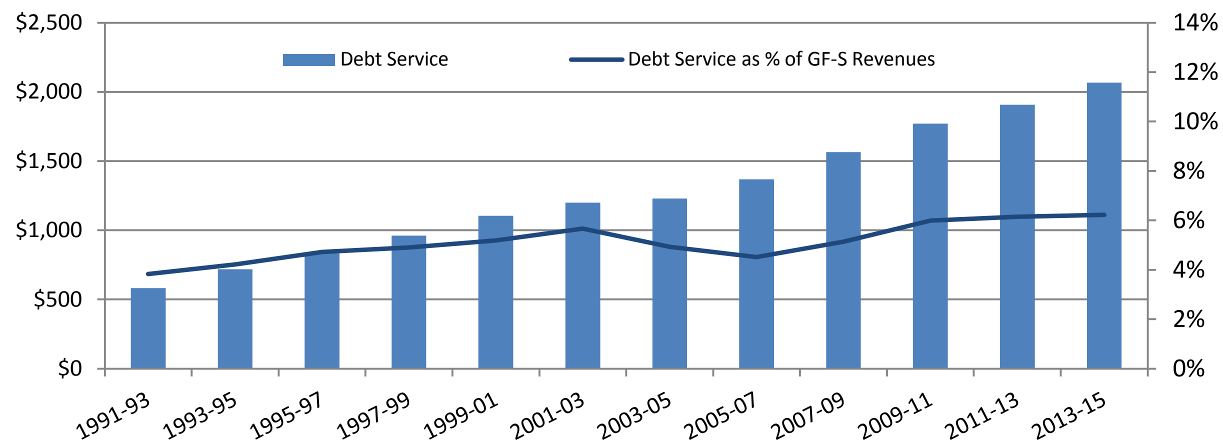
The Office of the State Treasurer regularly monitors the debt portfolio to identify opportunities to refund bonds to lower borrowing costs. All refundings are executed in accordance with savings criteria established in the State Finance Committee's Debt Issuance Policy. Since January 2009, generally declining interest rates have enabled the State to refund $7.43 billion bonds with $7.01 billion refunding bonds, saving $967.3 million in nominal terms and $778.5 million on a present value basis.

DEBT SERVICE

Prior to the recent recession, less than 5 percent of general fund-state revenue was typically spent on debt service (see Figure 10). Since then, this share has expanded. In the 2013-15 biennium, debt service on VP GO bonds is expected to total $2,080 million, or over 6.3 percent of general fund-state revenues.

While there is no express provision in the Constitution or in state law on the priority of payment of debt service on state debt as compared to the payment of other state obligations, there is a constitutional mandate that requires the Legislature to appropriate sufficient funds to pay state debt when due. No other provision of the Constitution contains comparable language providing the courts with authority to compel payment of other state obligations.

Figure 10. **VP GO Debt Service*: 1991-93 to 2013-15 ($ millions)**
Biennial Totals and as Percent of General Fund-State Revenues



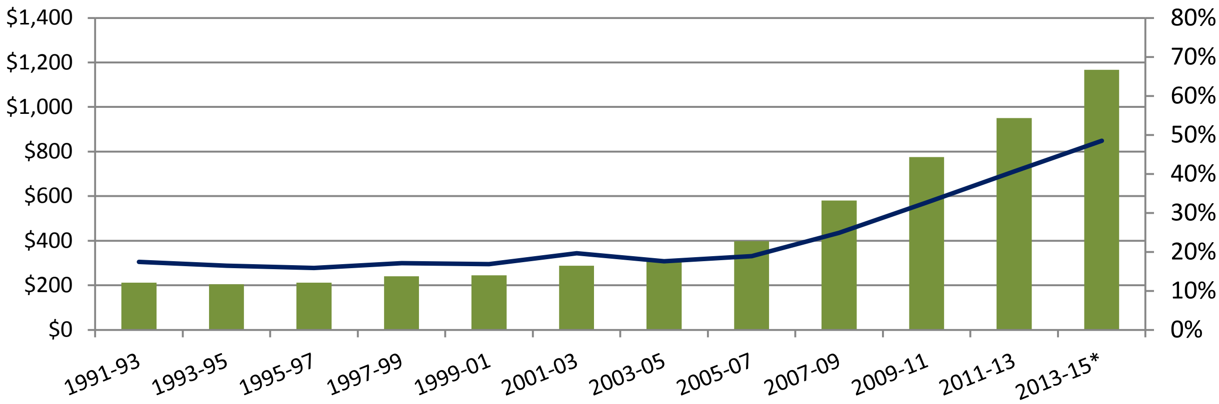
*VP GO debt service paid out of the General Fund.

Source: Office of Financial Management, Office of the State Treasurer

Debt service on MVFT GO bonds represents a significantly larger portion of state excise taxes on motor vehicle and special fuels, the source of repayment (Figure 11). Debt service on MVFT GO bonds has more than doubled from less than 20 percent of adjusted gross MVFT revenues in the 2005-07 biennium to approximately 50 percent in the current biennium. In the 2013-15 biennium, debt service on MVFT GO bonds is expected to reach $1.1 billion. Debt service is shown for all bonds pledging MVFT revenues and excludes federal subsidies related to Build America Bonds.

If the state's share of MVFT revenues were ever to prove insufficient to pay debt service on MVFT GO bonds, the payment of debt service on those bonds would take precedence over other uses of MVFT revenues, potentially interrupting distributions of MVFT revenues to counties, cities and towns or cutting spending elsewhere in the transportation budget.

Figure 11. **MVFT GO Debt Service: FY 1991-93 to 2013-15 ($ millions) Biennial Totals and as Percent of Adjusted Gross Fuel Tax Revenues**



*2013-15 adjusted gross fuel tax revenues based on the Nov. 2014 Transportation Revenue Forecast. 2013-15 debt service is projected. Debt service includes all bonds pledging MVFT revenues including triple pledge bonds. Does not include the TIFIA bond.

Source: Office of the State Treasurer, Transportation Revenue Forecast Council

Reimbursable General Obligation Debt

Debt service (principal and interest payments) on approximately $1.7 billion of the State's general obligation debt is reimbursed from funds outside of general state revenues and motor vehicle fuel tax receipts (See Figure 12). One example of reimbursable GO debt is MVFT GO bonds issued to finance the Tacoma Narrows Bridge bonds. Although these bonds are payable from motor vehicle fuel tax revenues, payments are then reimbursed by toll revenues from the facility. In fact, state statute requires that tolls be set to generate revenues sufficient to cover debt service.

Another example of reimbursable debt is the nearly $100 million of general obligation bonds authorized by the state in 2008 to finance capital expenditures on skills centers for career and technical education and school construction. Debt service on these bonds is paid from the investment income on the Permanent Common School Fund.

Figure 12. **GO Debt Outstanding Net of Reimbursables ($ thousands)**

	6/30/2011	6/30/2012	6/30/2013	6/30/2014	12/31/2014*
Various Purpose	10,763,996	10,980,895	10,980,398	11,433,124	11,356,597
Reimbursables	(928,325)	(856,447)	(822,854)	(747,385)	(722,495)
Motor Vehicle Fuel Tax	6,004,454	6,353,056	6,712,006	7,010,289	6,798,909
Reimbursed from Tolls on TNB	(596,614)	(567,176)	(536,006)	(502,479)	(488,344)
Payable from Tolls on SR 520	-	-	(518,775)	(518,775)	(518,775)
Total	15,243,511	15,910,328	15,814,769	16,674,774	16,425,892

*Estimate.

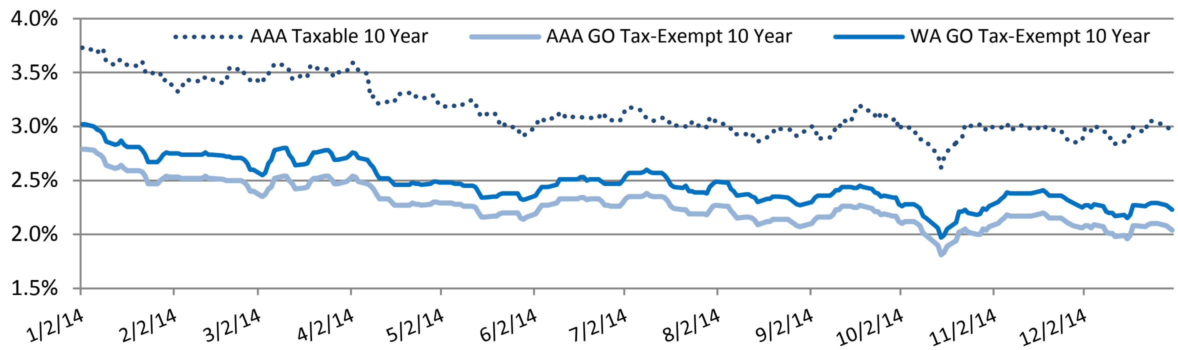
Source: Office of the State Treasurer

Borrowing Costs

Borrowing costs are influenced by a number of factors including the state's credit rating, the security pledge, supply and demand trends, the structure of the repayment schedule, and call provisions. The state's lowest cost of funds is typically achieved through tax-exempt general obligation bonds. Borrowing rates have generally declined over the past year as shown in Figure 13 which also displays the state's GO ten-year borrowing rates in relation to AAA-rated tax-exempt (MMD) and taxable benchmarks. The spread between the state's costs and the tax-exempt AAA rate averaged 20 basis points. Over the past year, taxable rates were approximately 90 basis points above tax-exempt rates. Figure 14 shows a history of the True Interest Cost (TIC) on 25-year GO issues bonds in relation to the Bond Buyer 20-Year Index.

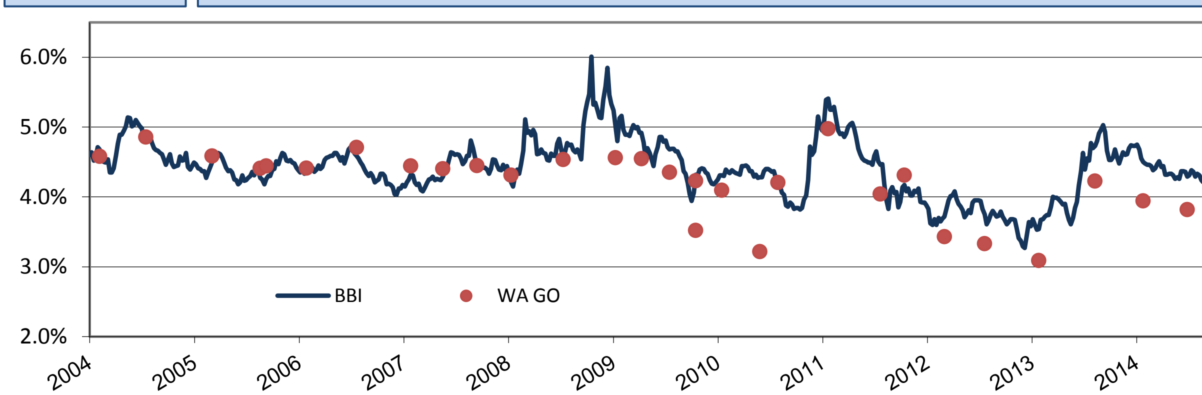
One estimate of the state's cost of funds is the weighted average of the initial TIC on all outstanding tax-exempt and taxable bonds. This calculation produces a weighted average cost of capital of 3.51% as of December 2014: 3.54% on the 97.8% portion of the portfolio that is tax-exempt and 2.19% on the taxable portion. Approximately 35% of the debt portfolio is noncallable and cannot be refunded.

Figure 13. **WA GO 10 Year Tax-Exempt Bond Yields vs. AAA Tax-Exempt and Taxable 10 Year Benchmarks (Jan-Dec 2014)**



Source: Municipal Market Data

Figure 14. **WA GO Borrowing Costs vs. 20-Year Bond Buyer Index 2004-2014**



Source: Office of the State Treasurer

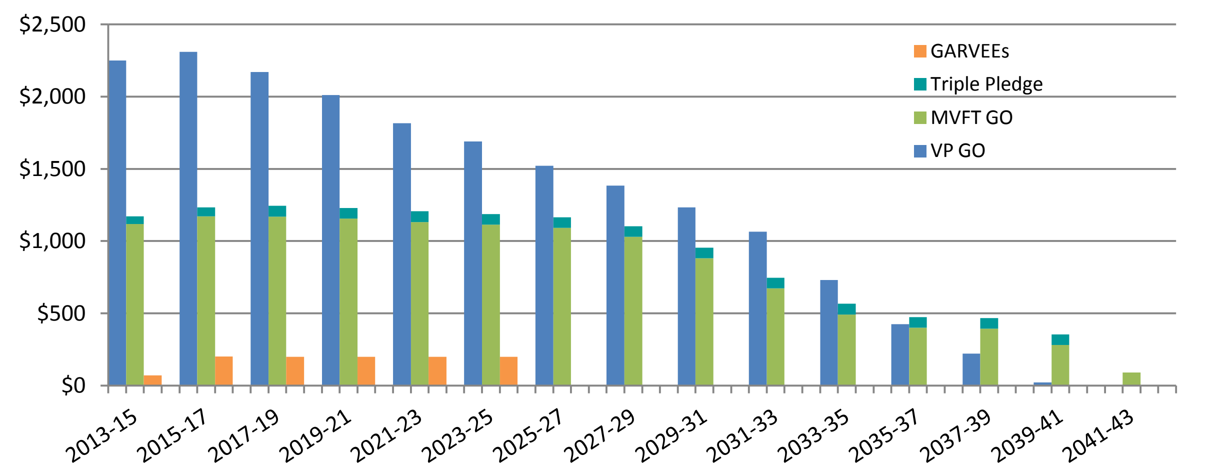
AMORTIZATION SCHEDULE

The state has typically issued GO bonds with final maturities of 25 years. The GARVEE bonds have shorter 11- and 12-year terms while the TIFIA bond has a final maturity of 40 years.

The state's borrowings have historically been structured with level debt service; much like a standard 30-year home mortgage, the annual payments of principal and interest are approximately equal over the life of the borrowing. The result is a declining overall debt service amortization structure. Each new debt issue adds incremental debt service onto each year between the sale date and the final maturity. Accordingly, the structure of the state's outstanding general obligation debt has the shape shown in Figure 15 below.

Level debt service not only shares the cost of infrastructure equally over time, it also keeps borrowing costs down. Approximately half of the state's GO debt will be repaid by 2023, or in about 10 years.

Figure 15. **Bond Debt Service: Principal and Interest Due FY 2013-15 to 2041-43 ($ millions)**



Due on debt outstanding as of 6/30/14

Source: Office of the State Treasurer

4. CERTIFICATES OF PARTICIPATION: ISSUANCE, LEASE PAYMENTS AND AMORTIZATION

The state often borrows funds to acquire real estate and equipment (real and personal property) by issuing certificates of participation (COPs). In this type of financing, the state leases property to a designated non-profit organization (without transferring ownership) and then makes periodic payments to lease the property back over the life of the financing. Multiple financings are often pooled together to achieve economies of scale in borrowing and issuance costs.

COPs are not backed by the full faith and credit of the state. Instead, each agency pledges its appropriation from the state. In practice, most state agencies, particularly community and technical colleges, rely on revenue sources such as student fees that are not considered general state revenues to make lease payments. In line with a State Finance Committee policy, COPs are to be used solely to finance property, including improvements. Moreover, the property must be of a nature that it could be relinquished if the Legislature were to choose not to appropriate funds to make the relevant lease payments. The policy further advises that care should be taken so that financing contracts are not used to avoid the constitution's debt limitation.

COPs are subject to appropriation risk and to across-the-board cuts authorized by the Governor. Accordingly, COPs typically are rated one notch below general obligation debt. The risk of non-appropriation is mitigated by the lump-sum nature of appropriations to each state agency. Non-appropriation would require specific statutory language by the Legislature.

State COP borrowings

State real estate acquisitions financed with COPs must be authorized by the Legislature, typically in the Capital Budget. Most state equipment acquisitions financed with COPs do not require legislative authorization. However, it is the policy of the Office of the State Treasurer to require prior legislative approval for state agency financing contracts used to finance major acquisitions of equipment.

Approximately $107 million state agency real estate COPs were authorized by the Legislature in the 2013-15 Capital Budget. Over a third are for the community and technical college system. In addition, an estimated $100 million in state agency equipment COPs are expected to be issued over the 2013-15 biennium.

COPs are generally issued with 20-year maturities for real estate projects and 10-year maturities for pooled equipment projects, spreading the cost over the useful life of the assets. As of December 31, 2014, outstanding state COPs totaled $616 million.

Local government participation in the state COP program

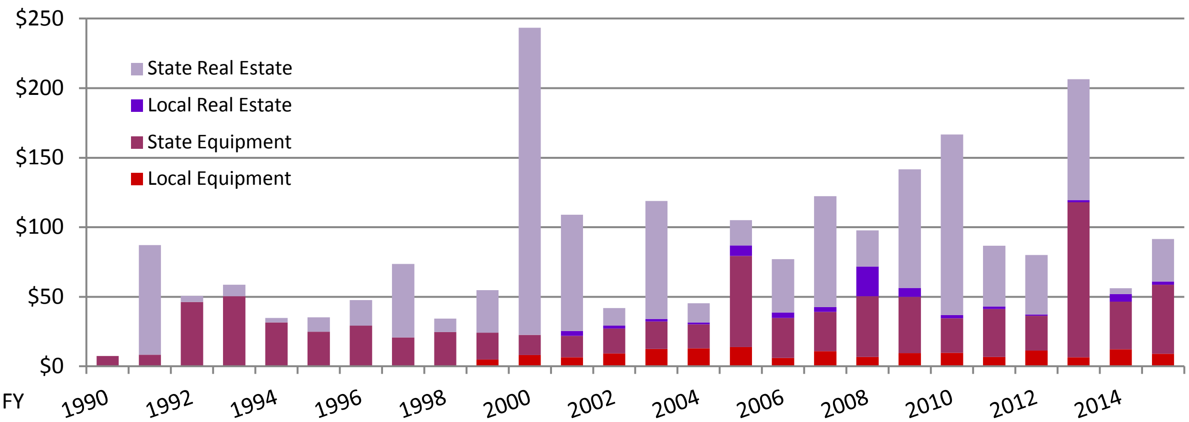
Local governments can borrow to acquire real estate or equipment through the state's COP program by using the Local Option Capital Asset Lending Program (LOCAL). In this program, local government borrowings are pooled with those of state agencies. This lets local governments borrow at the state's rates and benefit from economies of scale. LOCAL borrowing must be supported by a local government general obligation pledge and must receive credit approval from the Office of the State Treasurer.

Local government leases financed by certificates of participation through the LOCAL program are contingent obligations of the state. If a local government fails to make its lease payment, the State Treasurer must make the payment on behalf of that local government (but will then withhold that amount from that local government's state revenue sharing distribution). Local government participation in this program is estimated to total $50 million in the 2013-15 biennium.

COP Issuance

As noted above, COP issuance is much smaller than bond issuance, averaging approximately $100 million annually from 2002 to 2013. State real estate financings increased in recent years, largely to finance the expansion of community colleges, but have since declined. State equipment financings increased in FY 2014 due primarily to two technology projects for the community colleges and the Washington State Patrol.

Figure 16. COP Issuance: State and Local Real Estate and Equipment* ($ millions)

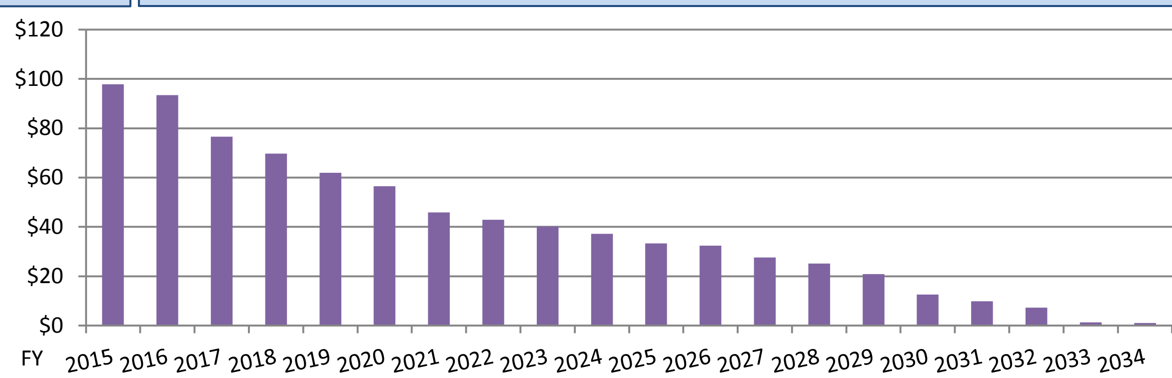


*New money only. FY 2000 includes a $185 million issue for the Washington Convention and Trade Center that has subsequently been defeased. FY 2015 estimate.
Source: Office of the State Treasurer

COP Amortization Schedule

Figure 17 shows lease payments on outstanding COPs. Like GO debt service, COP lease payments on new issues are spread evenly over the life of each financing. The final maturity of each financing is closely linked to the asset being financed. Approximately half of outstanding COPs will be paid off in about 5 years. Lease payments on outstanding state real estate and equipment COPs are expected to total $92 million in 2014, up from $86 million in 2013.

Figure 17. COP Debt Service: Principal and Interest Due on Debt Outstanding ($ millions)



Debt outstanding as of 12/31/14
Source: Office of the State Treasurer

5. Constraints on Debt Issuance

Constitutional and Statutory Debt Limits

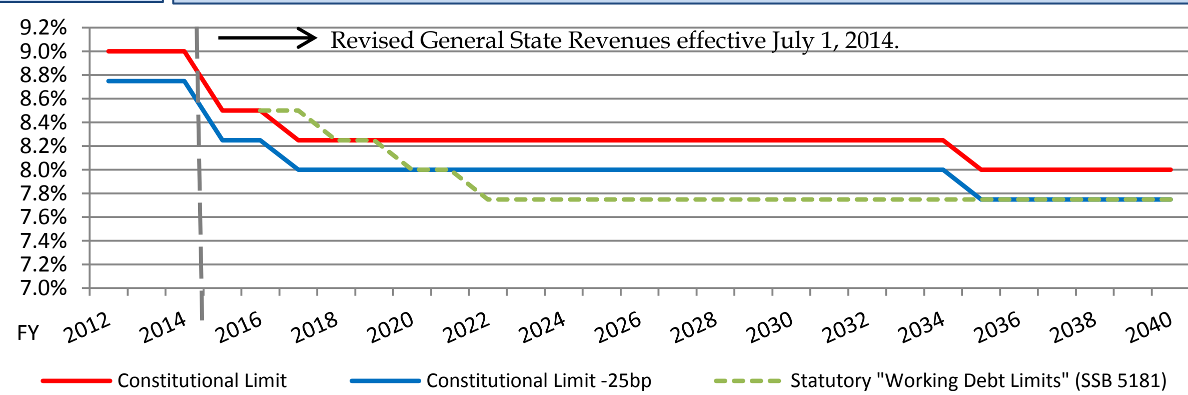
The Washington State Constitution places a firm limit on the amount of debt service the state can pay on certain forms of debt. Beginning in 1889, the state had a fixed debt limit of $400,000. In 1972, this was replaced with a limit on annual debt service (payments of principal and interest) which sets the maximum annual debt service on certain forms of debt in relation to a historical average of the state's undedicated general revenues. More specifically, the Constitution requires that maximum annual payments of principal and interest on all debt subject to this limit may not exceed a percentage of the average of the prior 6 years' general state revenues; this percentage currently stands at 8.5% and will decline to 8.0% by July 1, 2034.

Under the Constitution, "general state revenues" includes all state money received in the State treasury, with the exception of: (1) fees and revenues derived from the operation of any undertaking, facility, or project; (2) moneys received as gifts, grants, donations, aid, or assistance when the terms require the application of such moneys otherwise than for general purposes of the state; (3) retirement system moneys and performance bonds and deposits; (4) trust fund moneys, including moneys received from taxes levied for specific purposes; and (5) proceeds from sale of bonds or other indebtedness

Legislation adopted in 2011 directs the Committee to set a more restrictive working debt limit for budget development purposes. The working limit phases down to 7.75% by FY 2022, starting in FY 2016. In some years, the new constitutional limits are anticipated to be more restrictive than the previously approved statutory working debt limits.

Figure 18 displays the relationship between the constitutional debt limit, a longstanding guideline at one quarter percentage point below this limit, and the current statutory working debt limit. All are expressed in relation to general state revenues. Note that a revised definition of general state revenues became effective July 2014.

Figure 18. **Debt Limit Percentages**



Source: Office of the State Treasurer

Exemptions from Constitutional Debt Limitation

Article VIII of the Constitution excludes some types of debt from the debt limit calculations, most notably: debt payable from motor vehicle fuel taxes, debt payable from license fees on motor vehicles, debt approved by both the Legislature and a majority of the voters in a general or special election, and all forms of non-recourse revenue debt. Debt service on nearly all VP GO debt is subject to the constitutional constraint.

Constraints on Motor Vehicle Fuel Tax General Obligation Bonds

Although MVFT GO bonds are not subject to the constitutional debt limit, issuance is constrained by the amounts of current and projected tax revenues from motor vehicle and special fuels taxes (MVFT revenues) available for the payment of debt service. Under Article VIII, Section 1(g) of the state constitution, the state may "…pledge its full faith, credit, and taxing power to guarantee the payment of any obligation payable from revenues received from any of the following sources: (1) Fees collected by the state as license fees for motor vehicles; (2) Excise taxes collected by the state on the sale, distribution or use of motor vehicle fuel; and (3) Interest on the permanent common school fund: *Provided, that the legislature shall, at all times, provide sufficient revenues from such sources to pay the principal and interest due on all obligations for which said source of revenue is pledged."*

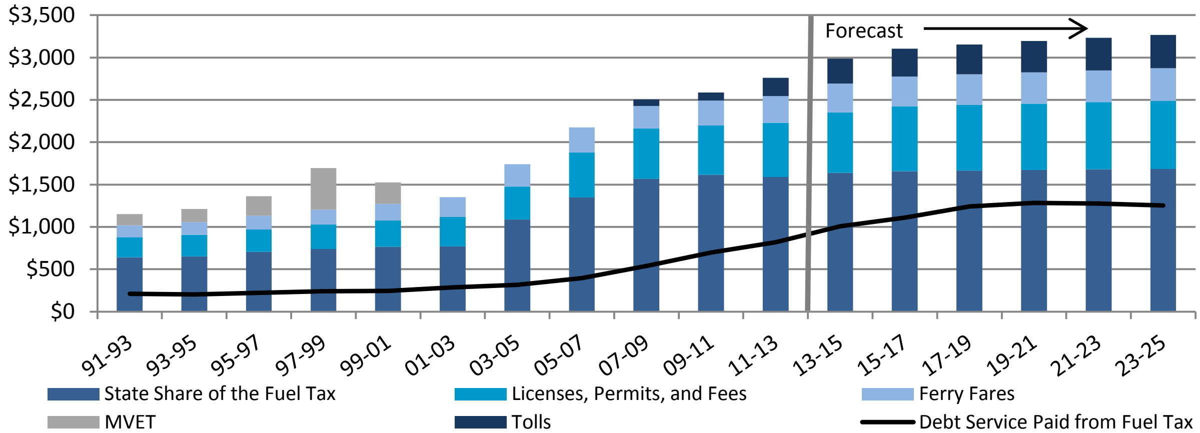
Mindful of these constitutional provisions, Legislative bond authorizations for MVFT GO bonds include a statutory commitment to continue to impose those excise taxes on motor vehicle and special fuels in amounts sufficient to pay, when due, the principal of and interest. Similarly, the State Finance Committee's MVFT GO authorizing resolutions reflect this pledge which is incorporated into the contractual obligation made by the state to investors.

Fuel tax revenues are the primary revenue for the Department of Transportation (WSDOT), providing approximately half of transportation revenues available for capital and operating expenditures (excluding bond proceeds). Other state sources such as licenses, permits, fees and tolls account for another 25 percent, with the remainder largely provided by federal funds. (See Figure 19.)

Projections of MVFT revenues – released quarterly by the Transportation Revenue Forecast Council - have been repeatedly revised downward in recent years. Improvements in fuel efficiency and the growing prevalence of alternative fuel vehicles indicate that fuel consumption and revenues are not likely to increase in the foreseeable future.

Lower than expected fuel tax revenues and downward revisions to projected revenues may constrain future capital plans for transportation. For example, transportation capital plans tied to the 14.5 cent gas tax increase in 2003 and 2005 assumed that the new tax revenues would be fully leveraged, that is, fully committed to debt service and not available for current capital or operating expenditures. To date, WSDOT has completed 361 of the 421 projects funded by these gas tax hikes. However, collected revenues have not met past projections and current projections are well below those of 2005 (see Figure 20). In FY 2014, debt service on bonds issued to finance these projects totals 104% and 72% of the state's share of the revenues from the 2003 and 2005 gas taxes. Current projections show that issuing all of the bonds for the legislatively directed list of projects means debt service would exceed fuel tax revenues generated by the 2003-2005 taxes by more than 15 percent.

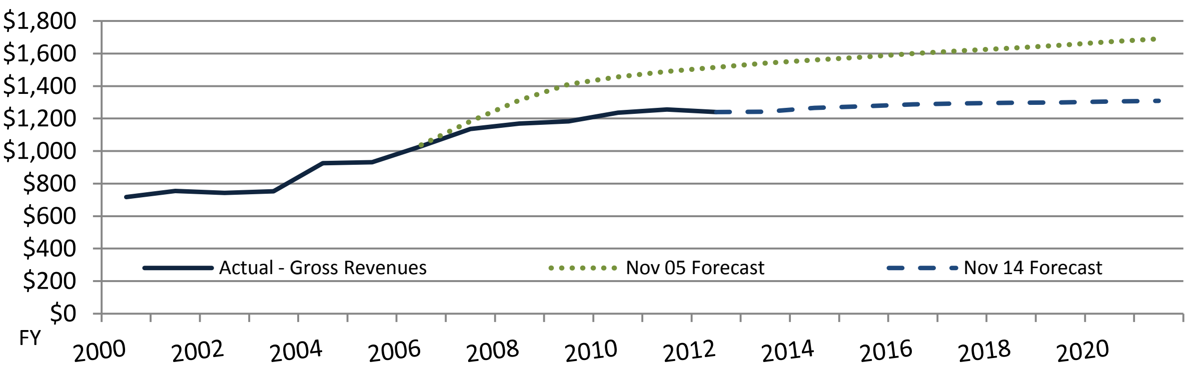
Figure 19. **WSDOT State Revenue Resources 1991-93 to 2023-25 ($ millions)**



Debt service projections are based on the 2015 transportation budget request. Does not include the TIFIA bond.

Source: Washington State Department of Transportation

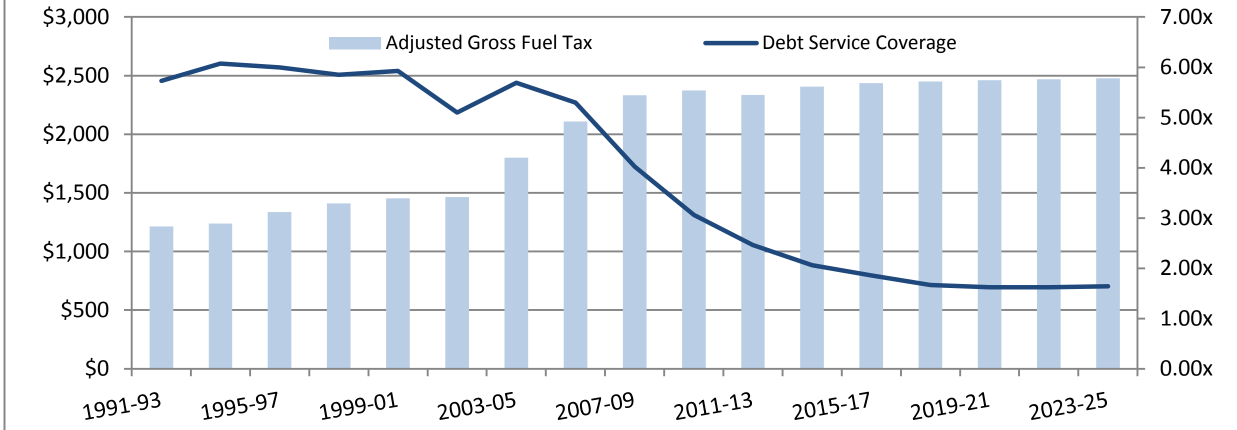
Figure 20. **Gross MVFT Revenue: Actual and Forecasted ($ millions)**



Source: CAFR, Transportation Revenue Forecast Council

The relationship between motor vehicle fuel tax revenues and debt service on MVFT GO bonds can be represented as a coverage ratio, the ratio of MVFT revenue to MVFT-backed debt service. Figure 21 shows that the coverage ratio on MVFT GO bonds has declined from over 5.0x prior to 2007 to 2.0x by the 2013-2015 Biennium. Projections indicate that the coverage ratio on the state's MVFT-backed debt could drop into the 1.6x range within five years. Figure 19 includes debt service for all bonds pledging MVFT revenues and excludes federal subsidies related to Build America Bonds.

Figure 21. **Coverage: Gross Fuel Tax Revenues* vs. MVFT GO Debt Service ($ millions)**



* Gross fuel tax revenues after non-highway and tribal refunds. Debt service projections based on the 2015 transportation budget request.
Source: Transportation Revenue Forecast Council, WSDOT

Constraints on Triple Pledge Bonds

Issuance of triple pledge bonds – payable first from toll revenues, second from MVFT revenues and third backed by the general obligation pledge of the state – is constrained in two ways. First, as these bonds pledge MVFT revenues, debt service "counts against" MVFT revenues. More importantly, issuance of triple pledge bonds is constrained by projected SR 520 net toll revenues as represented in the rate covenants and additional bonds tests contractually established in the master bond resolution. This legal framework specifies that certain financial thresholds - related to the ratio between net toll revenues on the SR 520 Corridor and maximum annual debt service - must be met before any additional bonds at one of the four specified tiers can be issued.

Constraints on GARVEE Bonds

Similarly, the issuance of GARVEE bonds is constrained by additional bonds tests governing bonds payable from pledged federal transportation funds. Pledged funds (or more specifically obligation authority) received during one of the two prior federal fiscal years must be at least 3.5 times maximum annual debt service on all GARVEE bonds. The State Finance Committee has adopted a more restrictive policy which increases this ratio to 3.75. By further limiting the percentage of federal transportation funds allocated to the payment of debt service, the state ensures that federal funds will remain available to support the state's ongoing preservation and improvement program.

The SR 520 Corridor Program is the only program of projects for which the Legislature has authorized issuance of GARVEE bonds. No additional GARVEE issuance is anticipated at this time. Technically, additional GARVEE capacity is estimated at approximately $250 million.

Constraints on Certificates of Participation

Certificates of participation are not subject to the constitutional debt limit as these obligations do not constitute debt as defined by the Constitution. Budgetary consideration is given to future annual appropriations necessary for each real estate or equipment financing. In addition, the State Finance Committee sets the maximum aggregate principal amount of outstanding financing contracts.

6. Other State Obligations

A broader characterization of the state's financial liabilities includes contingent obligations, state contractual obligations and certain revenue bonds. Contractual agreements include the state's public employee pension plans and its Guaranteed Education Tuition (GET) savings program. Other Post-Employment Benefits (OPEBs) are also discussed below, although they are not contractual obligations of the state.

Contingent Obligations

An expanded statement of the state's financial liabilities also includes contingent obligations, or obligations the state may face in the event that other governmental entities are not able to meet their financial commitments. These primarily include local government leases financed through the state's COP program and voter-approved school district bonds supported by the state School Bond Guarantee Program.

While neither of these programs involves state debt, they have provided significant value to other government entities. Since its inception in 2000, the School Bond Guarantee Program has saved school districts an estimated $11 million annually.

The statement of contingent liabilities in Figure 22 shows the full amount of debt on which the state carries a contingent obligation. It is important to note that the state has never been called upon to pay debt service on any school debt or on any local government lease financed by a COP. Even if the state does step in to make up a temporary shortfall, the debt remains the responsibility of the local government.

Figure 22. Contingent Obligations Outstanding ($ thousands)

	6/30/2011	6/30/2012	6/30/2013	6/30/2014	12/31/2014*
Certificates of Participation - LOCAL	83,901	83,167	78,093	84,445	82,995
School Bond Guarantee Program	8,350,546	8,333,934	8,547,542	8,983,648	8,558,362
Total	8,434,447	8,417,101	8,625,635	9,068,093	8,641,357

*Estimate

Source: Office of the State Treasurer

Other Financial Liabilities

63-20 Revenue Bonds

The state has entered into two long-term leases with separate nonprofit corporations that issued "63-20" lease revenue bonds on behalf of the state. With this type of financing, a non-profit corporation issues bonds on behalf of the state and uses the proceeds to manage the design and construction of a facility. Upon substantial completion of the project, the state leases the facility from the non-profit and these lease payments are pledged to the repayment of the bonds. The state takes title to the property once the bonds have been paid. The state's lease payments are subject to appropriation risk and across-the-board cuts by the Governor.

The state's 63-20 financings were issued for 20 and 30 years. Borrowing costs on both were higher than those on similarly structured COPs.

Figure 23. 63-20 Bonds Outstanding ($ thousands)

	6/30/2011	6/30/2012	6/30/2013	6/30/2014	12/31/2014*
63-20 Bonds					
Edna Lucille Goodrich Building**	53,295	52,820	51,580	43,435	43,435
1500 Jefferson Building	305,810	304,510	299,055	293,330	293,330
Total	359,735	357,330	350,635	336,765	336,765

*Estimate
**Bonds for the Edna Lucille Goodrich Building were refunded in June 2014.

Source: Office of the State Treasurer

Pensions

The state administers 13 defined benefit retirement plans, three of which contain hybrid defined benefit/defined contribution options. As of June 30, 2013, the plans covered an estimated 515,500 eligible state and local government employees. The Office of the State Actuary's (OSA) most recent actuarial valuation shows that the funded status for all the state-administered retirement plans combined as of June 30, 2013 is 94 percent. Two funds – PERS 1 and TRS 1 – are underfunded by approximately $7.6 billion as of June 30, 2013. Note that assets from one plan may not be used to fund benefits for another plan.

Guaranteed Education Tuition Program

The Washington Guaranteed Education Tuition Program ("GET program") is a 529 prepaid college tuition plan that allows Washington residents or individuals opening accounts for Washington residents to prepay for future college tuition. Individual accounts are guaranteed by the state to keep pace with rising college tuition, based on the highest tuition at Washington's public universities. The after-tax contributions to a GET account grow tax-free and can be withdrawn tax-free when used for eligible higher education expenses. GET funds are held in the state treasury and invested by the Washington State Investment Board.

According to the actuarial valuation performed by the OSA, the market value of GET program assets as of June 30, 2014, totaled $2.93 billion, or 105.8% of the "best estimate" of the actuarially determined present value of obligations for future payments of $2.77 billion.

OPEBs (Other Post Employment Benefits)

The state provides health care benefits to its retirees through implicit and explicit subsidies. But unlike the state's pensions, both the implicit and explicit subsidies are not contractual obligations to retirees. The state allows retirees not yet eligible for Medicare to use their own money to pay for health insurance at group rates negotiated for public employees (an implicit subsidy). While there is no contractual liability for the state, including retirees in this purchasing pool marginally increases overall insurance rates. The state provides an explicit subsidy to reduce Medicare-eligible retiree Part A and B premiums by an amount determined each year by the Public Employee Benefits Board (PEBB). Like the implicit subsidy, this is also not a contractual obligation because each year the Legislature determines whether or not to include it in the state budget.

OBLIGATIONS OF OTHER STATE ENTITIES

College and University Revenue Bonds

The state often issues VP GO bonds or COPs to finance major campus construction projects for five state universities, the state college and 34 community and technical colleges. In addition, certain state colleges and universities are authorized to independently issue revenue bonds for the construction of certain types of revenue-generating facilities for student housing, dining and parking. These revenue bonds are payable solely from, and are secured by, revenues derived from the operation of the constructed facilities.

Figure 24. **Higher Education Revenue Bonds Outstanding ($ thousands)**

	6/30/2010	6/30/2011	6/30/2012	6/30/2013	6/30/2014
University of Washington	773,314	1,073,369	1,447,953	1,660,115	1,764,855
Washington State University	339,400	366,130	430,995	488,620	530,840
Eastern Washington University	33,140	31,720	55,025	54,005	52,435
Central Washington University	103,171	135,430	133,269	129,658	126,339
The Evergreen State College	6,135	5,755	5,360	4,950	4,525
Western Washington University	82,150	79,043	77,423	75,483	72,443
Total	1,337,310	1,691,447	2,150,025	2,413,191	2,551,437

Source: Office of Financial Management

Conduit Issuers/Financing Authorities

Washington State has created four financing authorities that can issue private activity bonds to make loans to qualified borrowers for capital projects. These bonds are not legal or moral obligations of the state and debt service is payable from repayments of loans for which the bonds were issued. All the financing authorities are financially self-supported and do not receive funding from the state.

The Washington State Housing Finance Commission issues bonds to finance homeownership assistance, multifamily and senior affordable rental housing, nonprofit facilities, beginning farmer and rancher lands and equipment, and energy-efficiency/renewable energy projects. The Washington Higher Education Facilities Authority finances facility construction, improvements, and equipment for non-profit, independent colleges and universities. The Washington Health Care Facilities Authority finances nonprofit health care facilities and equipment. The Washington Economic Development Finance Authority finances projects primarily related to manufacturing, recycling and waste disposal facilities.

Figure 25. **Conduit Issuer Debt Outstanding ($ thousands)**

	6/30/2012	6/30/2013	6/30/2014
Washington Housing Finance Commission	3,622,082	3,490,997	3,411,461
Washington Higher Education Facilities Authority	674,828	706,243	766,485
Washington Health Care Facilities Authority	5,425,000	5,484,000	5,452,000
Washington Economic Development Finance Authority	838,121	758,663	702,442
Total	10,560,031	10,439,903	10,332,388

Source: CAFR

Tobacco Settlement Securitization

The Tobacco Settlement Authority (TSA) was created to securitize a portion of the state's revenue from the tobacco litigation settlement. In 2002, the TSA issued $517 million in bonds and transferred $450 million to the state to be used for increased health care, long-term care, and other programs. The bonds were issued with a TIC of 6.75%, approximately 1.50% above the state's cost of funds. In October 2013, the TSA refunded the outstanding $370 million in bonds for an estimated savings of approximately $90 million, or $58 million on a net present value basis. The TSA bonds are not obligations of the state.

7. Debt Metrics: Comparing Washington with National Medians

Washington is characterized by high income levels, solid population growth, a diverse state economy, and a centralized funding structure. These characteristics provide insight as to why Washington's debt ratios are higher than the national medians and higher than debt ratios in most peer states. Despite citing the state's debt levels as a potential risk, each rating agency has recognized that fundamental strengths of the state largely mitigate the above-average debt burden.

Nonetheless, Washington's debt burden places it among the top 10 states in the nation as measured by: debt per capita, debt as a percentage of personal income, debt service as a percentage of governmental expenditures, and debt as a percentage of gross state product. Further, Washington has significant infrastructure needs going forward and will therefore continue to require access to long term funding.

Fitch (October 2014)

> *Washington's debt levels are in the upper moderate range and well above average for a U.S. state, with net tax-supported debt equal to 6% of personal income. Debt is primarily GO. Capital needs are substantial, particularly for transportation, and tolling is part of the funding solution. Positively, the state has increased its focus on debt affordability. In November 2012, voters approved a constitutional amendment that tightened the constitutional debt limit.*

Moody's (October 2014)

> *Washington's debt ratios are more than twice Moody's 2014 50-state median level; net tax-supported debt as a percentage of personal income is 6.4%, compared with Moody's 50-state median of 2.6%. Despite the significant increase in total debt outstanding during the previous decade, the debt-to-personal income ratio has remained fairly stable due to Washington's strong personal income growth. Washington's net-tax supported debt per capita ($2,924) is more than twice the national median of $1,054. Annual debt service costs relative to revenue available for debt service (Moody's calculation) was also relatively high at 9.1% in fiscal 2013 versus a median of 5.2%.*

Standard and Poor's (October 2014)

> *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.*

DEBT METRICS

Two rating agencies - Moody's and S&P publish the state's debt ratios and rankings relative to national medians. The primary debt ratios are:

Debt Per Capita. Measures the debt per person, without accounting for the income of the tax base.

Debt as a Percentage of Personal Income. A large portion of the state's revenue base is generated by consumer spending, which is in turn influenced by income levels. As income increases, debt becomes more "affordable". During times of economic downturn, taxpayers' income levels may become strained.

Debt as a Percentage of Gross State Product. Low debt as a percentage of gross state product (or stable growth in the metric) suggests that the economy is generating sufficient revenues to repay debt service.

Debt Burden as a Percentage of Total General Spending. Measures the budgetary impact of issuing debt. As debt service rises as a share of expenditures, budgetary flexibility is reduced. Debt can "crowd out" the ability to fund services, infrastructure or other needs in the future.

Figure 26. Debt Metrics: A Comparison to National Medians

	Moody's[1]	S&P[2]
Net Tax-Supported Debt		
Washington	**$20,386,128,000**	**$17,283,000,000**
Median of States	$4,135,598,000	$4,103,000,000
WA Rank Compared to Other States	6th	8th
Net Tax-Supported Debt Per Capita		
Washington	**$2,924**	**$2,479**
Median of States	$1,054	$986
WA Rank Compared to Other States	6th	7th
Net Tax-Supported Debt as % of Personal Income		
Washington	**6.4%**	**5.3%**
Median of States	2.6%	2.5%
WA Rank Compared to Other States	5th	7th
Net Tax-Supported Debt as % of GSP		
Washington	**5.4%**	**4.2%**
Median of States	2.4%	2.2%
WA Rank Compared to Other States	5th	9th
Debt Burden as % of Total General Spending[3]		
Washington		**5.6%**
Median of States		4.1%

1. *2014 State Debt Medians*. Moody's U.S. Public Finance. May 22, 2014.
2. *2013 U.S. State Debt Review*. Standard & Poor's. July 10, 2013.
3. Calculated by Standard and Poor's.

It is useful to compare Washington's debt metrics with those of other highly rated states (see Figure 27). Although each state has fundamentally different economic, revenue, debt and income characteristics, the states shown below have comparable or higher credit ratings and some similar demographic characteristics. Of these peers, only Massachusetts has more debt, although Delaware, Georgia, Florida, Massachusetts, and Oregon face heavier debt burdens as a share of general spending. Within the list, only Massachusetts has higher debt per capita and debt as a percentage of personal income.

Figure 27. State of Washington Peer States

	Ratings[1] (S&P/Moody's/ Fitch)	Debt Per Capita[2]	Debt as % of Personal Income[2]	Debt Service as % of General Spending[3]	Debt as % of GSP[3,4]	Total Net Tax-Supported Debt[2,5]
Colorado	AA/Aa1/NR	$517	1.1%	2.5%	1.0%	$2,721
Delaware	AAA/Aaa/AAA	$2,485	5.7%	5.9%	3.5%	$2,300
Florida	AAA/Aa1/AAA	$1,008	2.5%	7.5%	2.9%	$19,703
Georgia	AAA/Aaa/AAA	$1,064	2.9%	7.4%	2.0%	$10,630
Maryland	AAA/Aaa/AAA	$1,791	3.4%	5.0%	3.1%	$10,618
Massachusetts	AA+/Aa1/AA+	$4,999	9.0%	8.0%	7.3%	$33,455
Minnesota	AA+/Aa1/AA+	$1,402	3.0%	3.4%	2.3%	$7,600
Missouri	AAA/Aaa/AAA	$668	1.7%	3.3%	1.5%	$4,039
Nevada	AA/Aa2/AA+	$639	1.7%	3.2%	1.4%	$1,783
North Carolina	AAA/Aaa/AAA	$806	2.1%	2.1%	1.6%	$7,936
Ohio	AA+/Aa1/AA+	$1,087	2.7%	5.4%	1.8%	$12,572
Oregon	AA+/Aa1/AA+	$1,920	4.9%	8.1%	2.8%	$7,545
Texas	AAA/Aaa/AAA	$614	1.5%	1.6%	0.6%	$16,243
Utah	AAA/Aaa/AAA	$1,187	3.4%	5.4%	2.5%	$3,442
Virginia	AAA/Aaa/AAA	$1,302	2.7%	4.4%	2.2%	$10,754
Washington	**AA+/Aa1/AA+**	**$2,924**	**6.4%**	**5.6%**	**4.2%**	**$20,386**
Median		$1,054	2.6%	4.1%	2.2%	$4,136

1. Ratings as of January 6, 2014.
2. *2014 State Debt Medians*. Moody's U.S. Public Finance. May 22, 2014.
3. *2014 U.S. State Debt Review*. Standard & Poor's. October 13, 2014.
4. GSP – Gross State Product.
5. Dollars in millions.