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CREDIT OPINION
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Washington (State of)

Update to credit analysis

Summary

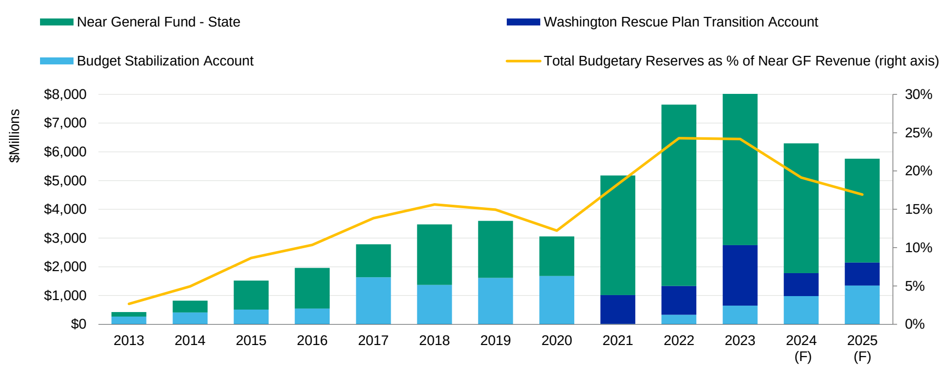
The State of Washington's (Aaa stable) credit profile is supported by its strong economic fundamentals, above-average demographic profile, sound financial position and prudent fiscal governance practices. Better than expected revenue performance and the availability of significant federal pandemic aid in recent years have strengthened the state's reserve position (see Exhibit 1), which will help the state weather rising costs amid slower economic and revenue growth. While the state's total leverage (debt, pension, OPEB, other long-term liabilities) is moderately higher than the 50-state median, it has declined in recent years and the state's fixed costs are in-line with the sector median. Frequent voter initiative activity can add budget challenges, but the legislature has broad authority to suspend voter-enacted statutes and a history of responding effectively to maintain budget balance.

The State of Washington's low economic reliance on federal spending, sound finances, manageable leverage and fiscal autonomy support its ability to surpass the United State's rating (Aaa negative) in the event of a one-notch US downgrade.

Exhibit 1

Washington's strengthened reserves will help it weather rising costs amid slowing economic and revenue growth

Cash basis; fiscal year



The Washington Rescue Plan Transition Account was established during the pandemic for related expenditures and serves as a secondary rainy day fund, but with less restrictions.
(F) reflects the state's November 2023 quarterly revenue forecast and incorporates the enacted 2023-2025 biennium budget.
Near General Fund – State includes General Fund - State and certain funds that are statutorily designated as "related funds": the Opportunity Pathways Account ("OPA"), the Education Legacy Trust Account ("ELTA"), and the Workforce Education Investment Account ("WEIA")
Source: State of Washington; Moody's calculations

Credit strengths

» Strong economic and demographic fundamentals

» Sound financial reserves and liquidity

» Pension funding levels are positive and retiree health insurance liability is manageable

» Institutionalized governance practices are strong

Credit challenges

» Steep surge in costs of living could slow down population growth and drive continued spending pressure for social related services

» Exposure to cyclical commercial aerospace industry and commodity export markets, although reduced in recent years

» Debt burden is above average, but has been declining

Rating outlook

Washington's outlook is stable, reflecting the positive underlying fundamentals of its economy and the state's strong governance practices which will continue to support sound reserves. Long-term liabilities are expected to remain manageable.

Factors that could lead to an upgrade

» Not applicable

Factors that could lead to a downgrade

» A significant deterioration of the state's reserve and liquidity position, including a weakening of budgetary reserves

» Protracted structural budget imbalance and/or a shift to reliance on one-time budget solutions

» A sustained or structural weakening of the state's economy and demographic trends

» A material increase in leverage and fixed costs to levels well above sector medians

Key indicators

Exhibit 2

	2021	2022	2023	State Medians (2022)
Economy				
Nominal GDP ($billions)	688.6	738.1	NA	294.6
Real GDP, annual growth	6.8%	1.6%	NA	1.7%
RPP-adjusted per capita income as % of US	105.7%	104.7%	NA	97.8%
Nonfarm employment, annual growth	2.7%	4.8%	NA	3.6%
Financial performance				
Available balance as % of own-source revenue	22.8%	40.5%	42.1%	38.2%
Net unrestricted cash as % of own-source revenue	35.4%	48.2%	46.1%	72.5%
Leverage				
Total long-term liabilities as % of own-source revenue	188.3%	150.7%	115.4%	131.0%
Adjusted fixed costs as % of own-source revenue	6.6%	4.9%	5.9%	4.8%

Source: State of Washington ACFRs with Moody's adjustments; US Bureau of Economic Analysis; US Bureau of Labor Statistics.

Profile

Washington is the thirteenth largest state by population, at 7.9 million. Its nominal gross domestic product (GDP) is the tenth largest, at $738 billion as of 2022. Resident income measures are above average, although Washington's cost of living has surged in recent years. Washington's per capita personal income is equal to 104.7% of the US after adjusting for high regional cost of living.

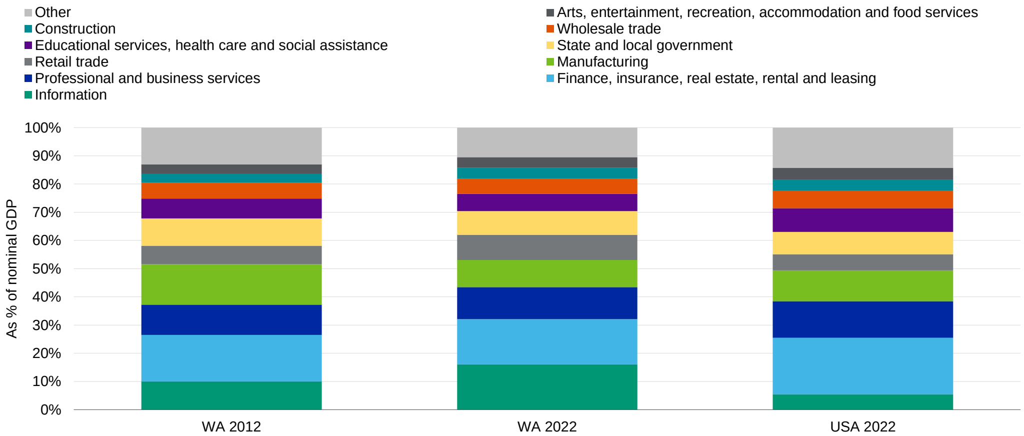
Detailed credit considerations

Economy

Washington's economic growth will advance slowly in coming quarters as the state's key technology and manufacturing sectors adjust to higher interest rates. Over the longer-term, we expect Washington's economic performance will continue to outperform the nation's, given its dynamic and diverse industrial base; however, the state's economic growth could slip closer to the national average as population growth decelerates given the state's weakened affordability (see ESG section).

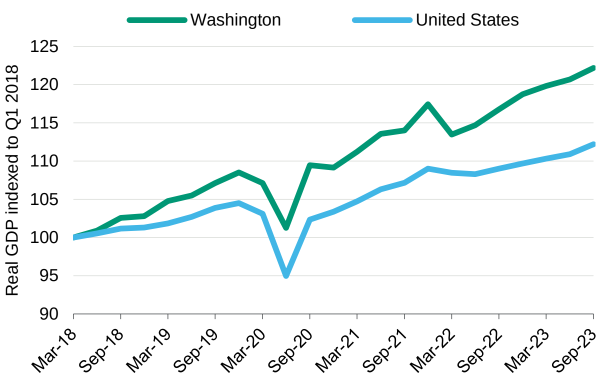
Washington's economic performance is heavily supported by the technology sector centered in and around City of Seattle (Aaa stable). The Puget Sound region hosts the headquarters or major centers of operations for a dozen Fortune 500 companies, including Amazon.com (A1 stable), Microsoft (Aaa stable), Costco Wholesale Corporation (Aa3 stable), The Boeing Company (Baa2 stable) and Starbucks (Baa1 stable), among others. Overall, Washington has a much greater reliance on the information industry than the nation overall (Exhibit 3). The state's tech sector also has lessened its traditional dependence on aircraft manufacturing in recent years.

Exhibit 3
Washington's growing information technology industry has lessened the state's traditional dependence on aircraft manufacturing



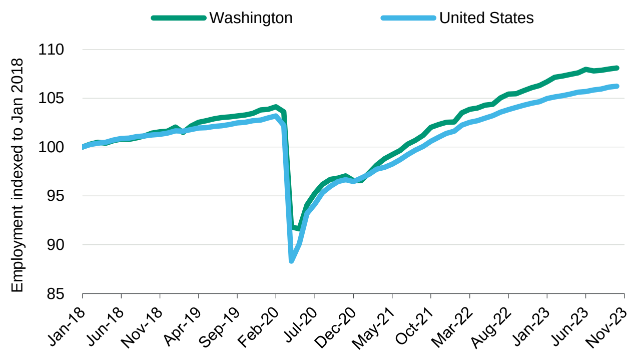
Source: US Bureau of Economic Analysis; Moody's Analytics

Exhibit 4
Washington's real GDP growth outpaces the US



Source: U.S. Bureau of Economic Analysis; Moody's Investors Service

Exhibit 5
...and job growth also outperforms the nation

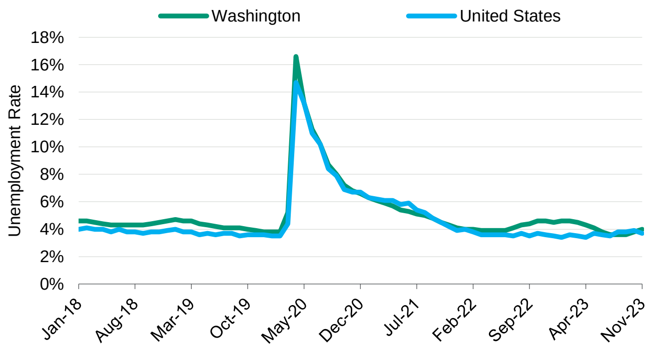


Source: U.S. Bureau of Economic Analysis; Moody's Investors Service

The state's real GDP growth in the first three quarters of 2023 outpaced that of the nation's (Exhibit 4). Similar to many peers, Washington's employment growth is slowing as the post-covid recovery nears the finish line. Notably, employment in Washington's information industry has contracted on a year-over-year basis, the first time since the Great Financial Crisis. But, Washington's economy is still expanding despite turbulence from the tech sector, given continued recovery in other industries, including education and health services, leisure and hospitality. Washington's unemployment rate remains low and generally tracks that of the US (Exhibit 6), and the state benefits from a higher labor force participation rate (Exhibit 7).

Exhibit 6

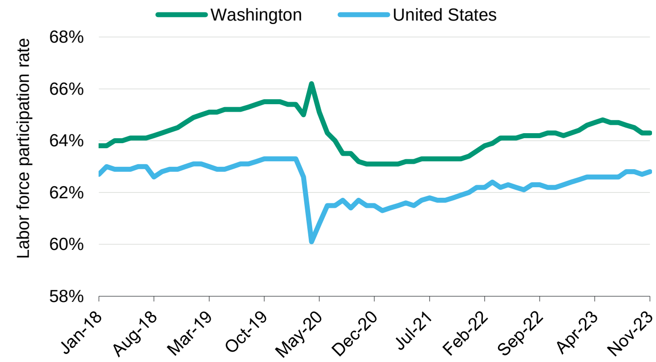
Washington's unemployment rate tracks closely to the US rate...



Source: US Bureau of Labor Statistics; Moody's Analytics.

Exhibit 7

...but Washington benefits from a higher labor force participation rate

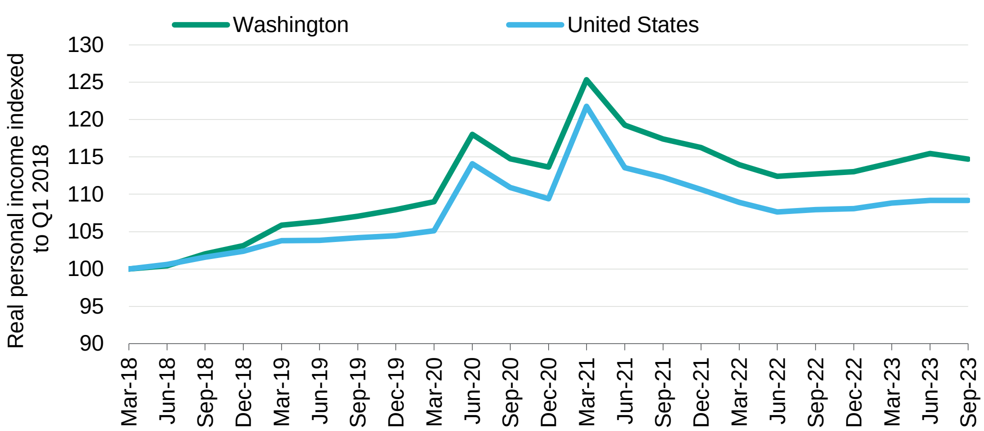


Source: US Bureau of Labor Statistics; Moody's Analytics.

Washington's per capita personal income is above average and personal income growth has exceeded that of the nation over the last few years (exhibit below); however, similar to the nation, Washington's real personal income growth has been hampered by high inflation in recent quarters.

Exhibit 8

Washington's personal income growth is above average, but also hampered by high inflation in recent quarters



Note: real personal income is adjusted by quarter average consumer price index.
Source: US Bureau of Labor Statistics; Moody's Analytics.

Finances and Liquidity

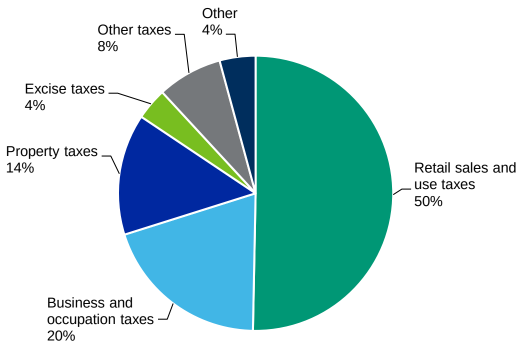
Washington has a sound financial position that will remain a key credit strength.

Similar to many of its peers, Washington's revenue growth is moderating after experiencing strong increases in fiscal 2022 and 2021 that benefited from taxpayers' income boost from federal stimulus aid, capital gains, and rising inflation rate. Washington's cash basis Near General Fund – State [1] revenues increased by 5.6% nominally in fiscal 2023, outperforming the state's forecast and benefitted from the addition of a capital gains tax. Volatility in this tax is somewhat insulated by the fact that only the first $500 million (indexed annually by inflation) becomes Near General Fund – State operating revenue; collections beyond $500 million (indexed annually) are deposited into the Common Schools Construction Fund for capital needs.

Sales tax and gross receipts tax (business and occupation tax) represent the largest sources of the state's general fund own source revenue. We expect these taxes will moderate in coming quarters as higher interest rates and softening economic conditions weigh on consumer sentiments and businesses. Positively, Washington's property taxes, the third largest revenue source, are relatively stable.

Exhibit 9

Sales and business tax represents the largest source of the state's general fund own source revenue
Fiscal 2023 GAAP basis



Source: State of Washington audited financial statement; Moody's Investors Service

The state's latest November 2023 economic and revenue forecast projects Near General Fund – State revenue to decline by 1.2% nominally in fiscal 2024 and then grow by 3.6% in fiscal 2025. Fiscal year 2024 year-to-date collections through November 2023 have outperformed this forecast and were up 0.2% compared to the same period in fiscal 2023. The state's budgetary reserves are at record levels after two years of strong revenue growth and will remain sound even with planned draw down. As of fiscal year end 2023, the state's budget basis available reserves (Near General Fund – State, Budget Stabilization Account and a newly established Washington Rescue Plan Transition Account) [2]) totaled a robust $8.0 billion on a cash basis, representing 24.2% of Near General Fund – State revenue.

Washington's enacted Near General Fund operating budget for the 2023-2025 biennium entails policy changes totaling $4.7 billion (7.3% increase from maintenance level). Major spending increases will tackle the state's most pressing needs, including K-12 education (salary increases, special education enhancements etc.), housing affordability and homelessness, behavioral health services, increased reimbursement rates for home care providers, and climate-related investments. The budget also provides employee wage increases to address retention challenges. Nearly $1 billion in Near General Fund spending is one-time, including operating support for University of Washington (Aaa stable)'s Medical Centers, grants to local governments and nonprofits for housing, and electronic health record projects.

The Governor released his proposed 2024 supplemental budget in December 2023 that further increases expenditures for social needs (behavior health, homelessness, substance overuse) and additional K-12 salary increase, with operating policy changes totaling $1 billion. Based on the Governor's proposed budget amendment, Washington would draw down its budgetary reserves to roughly 12.1% of Near General Fund - State revenue by fiscal end 2025. The state targets to maintain overall budget basis reserves at no less than 10% of Near General Fund - State revenue. Washington has traditionally taken a conservative approach to financial planning and has a strong record of outperforming budgets.

Liquidity

The state's liquidity position will remain sound with conservative fiscal management. Available operating reserves, which for the purpose of our analysis includes unassigned, committed and assigned general fund and non-major governmental fund balances and internal services fund balance, totaled $16.9 billion as of fiscal end 2023, representing a robust 42.1% of own-source revenue. Unrestricted operating cash totaled $18.5 billion or 46.1% of revenue as of fiscal end 2023. The state does not issue cash flow notes.

Leverage and fixed costs

The state's overall leverage (total debt, pension, OPEB and other long-term liabilities) is moderately higher than the sector median, but has declined. Consistent with sector-wide trends, Washington's ability to service long-term liabilities improved in recent years as it saw strong revenue growth; also, its pension burden declined in part because of higher interest rates we use to discount these liabilities.

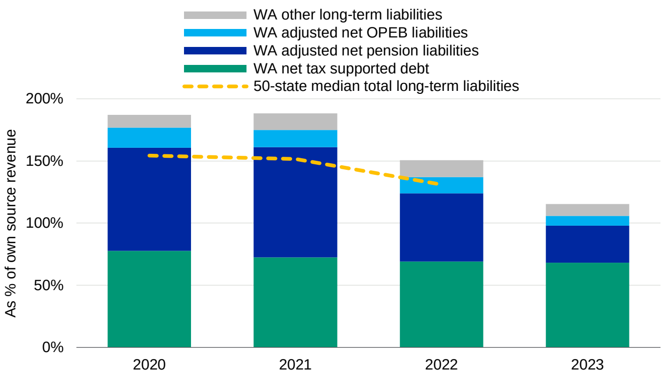
As of fiscal year end 2022, the state's total leverage represented 150.7% of own source revenue, above the 50-state median (131.0% of own source revenue). As of fiscal year end 2023, the state's total leverage represented 115.4% of own source revenue (sector median is not yet available but expected to decline from fiscal 2022 level).

Washington's fixed costs, based on Moody's pension tread water metric, are moderate and represented 5.9% of own-source revenue in fiscal 2023. Washington's fixed costs generally tracks closely with the sector median (see below exhibit).

Exhibit 10

Washington's leverage is moderately above median, but declined in recent years

Fiscal year

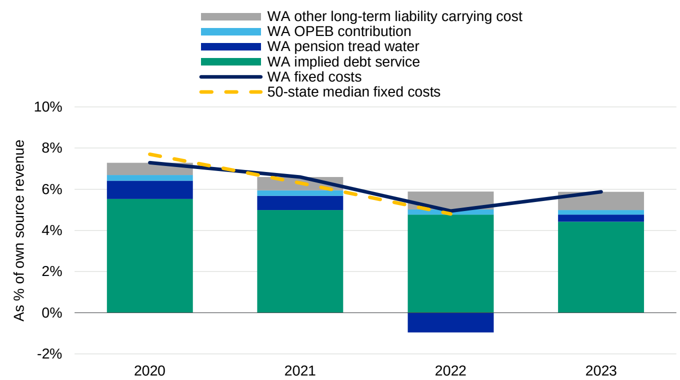


Source: State of Washington; Moody's Investors Service

Exhibit 11

...and Washington's total fixed costs has also moderated, tracking closely with the sector median

Fiscal year



Note: many states saw sizable pension tread water indicator declines in fiscal 2022 reporting mainly as a result of strong investment returns in 2021.
Source: State of Washington; Moody's Investors Service

Debt and debt structure

Debt currently represents the largest component of Washington's long-term liabilities, and Washington's debt burden is higher than the sector median.

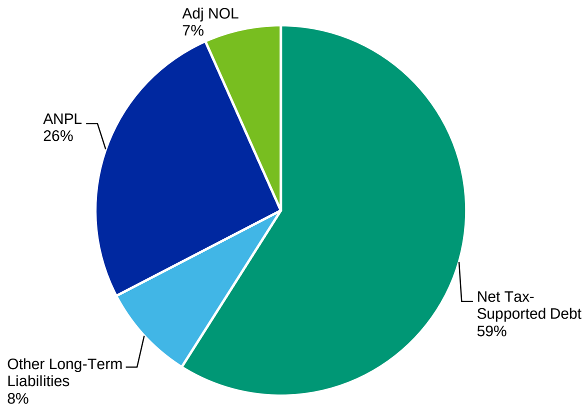
Washington's net tax-supported debt (NTSD) consists primarily of general obligation bonds, including those secured by and expected to be paid from transportation revenue. The state's bonds are long-term fixed rate bonds, mainly issued with a 25-year maturity and level debt service structure; on an aggregate basis, the state's debt has a declining debt service structure.

Currently, the MVFT GO bonds constitute the largest share of the state's transportation-related debt. However, pursuant to Senate Bill 5898 (effective June 9, 2022), future GO backed transportation-related bonds that remain unissued under previous authorizations are expected to be issued as MVFT/VRF GO Bonds, including any bonds issued to refund outstanding MVFT GO Bonds. As such, the MVFT/VRF GO Bonds will constitute an increasing share of the state's debt mix as the MVFT GO bonds mature and are refunded.

Exhibit 12

Debt represents the largest component of Washington's long-term liabilities

Fiscal 2023 long term liability breakdown



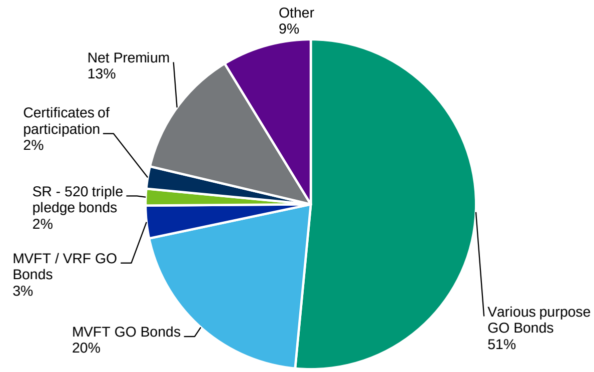
ANPL stands for adjusted net pension liability; Adj NOL stands for adjusted net OPEB liability

Source: State of Washington; Moody's Investors Service

Exhibit 13

Washington's net tax supported debt consists primarily of general obligation bonds

Fiscal 2023



Source: State of Washington; Moody's Investors Service

Debt legal security

The state has four classes of general obligation bonds: General Obligation Bonds or Various Purpose General Obligation Bonds, Motor Vehicle Fuel Tax ("MVFT") General Obligation Bonds, Motor Vehicle Fuel Tax and Vehicle Related Fees ("MVFT/VRF") General Obligation Bonds and Triple Pledge Bonds – all of which are general obligations of the state, to which the state has pledged its full faith, credit and taxing power. The MVFT bonds are additionally secured by and expected to be paid from motor vehicle fuel taxes. The MVFT/VRF bonds are additionally secured by and expected to be paid from motor vehicle fuel taxes and other vehicle-related fees. The Triple Pledge Bonds are additionally secured by motor vehicle fuel taxes and toll revenues and expected to be paid from toll revenues.

The state also issues certificates of participation, rated Aa1, to finance capital projects and equipment on behalf of state and local agencies. The COPs are secured by and expected to be paid from payments made by participating state and local agencies including: (1) lease payments for real property projects, and (2) installment purchase payments for personal property. Payments made by the state agencies are subject to appropriation by the legislature and executive order reduction by the governor. The state has never failed to make needed appropriations to meet the payment obligations for state agencies related to its COPs. Payments made by the local agencies are secured by the full faith and credit of the local agencies, effectively general obligation, limited tax obligations. In the event any local agency fails to make its scheduled payment, the state treasurer is obligated to make the payment on behalf of the local agency using state funds; such state payments, if necessary, are subject to appropriation by the legislature and executive order reduction by the governor. The treasurer is further obligated to withhold an amount equal to the payment advance from the local agency's share of state aid, to the extent legally permissible. No local agency has ever failed to make a payment obligation related to state-issued COPs.

Debt-related derivatives

The state has no variable rate debt and no debt-related derivatives.

Pensions and OPEB

Washington's pension liability will continue to remain moderate, supported by proactive management. Based on the state's fiscal 2022 reporting, Moody's has calculated that the state's adjusted net pension liability (ANPL) to be $20.2 billion or 54.8% of own-source governmental revenues, well below the latest 50-state median (79.8% of own source revenue). The state's fiscal 2023 ANPL was $12.0 billion or 29.9% of governmental revenue. Moody's adjustments are not intended to replace the state's reported liability information, but to improve comparability with other rated entities.

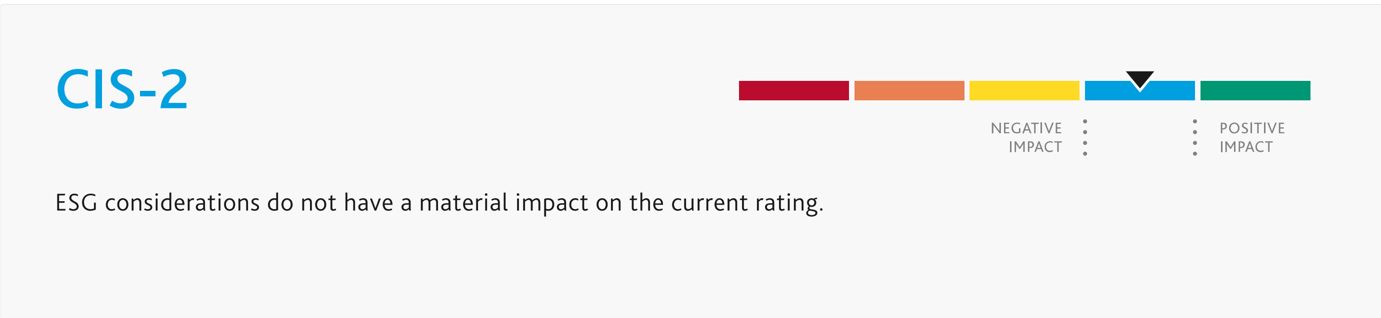
The state is committed to fully funding actuarially determined pension contributions. Notably, the state's pension contributions have consistently exceeded Moody's calculated tread water level, or the level of contribution that would prevent reported unfunded liabilities from growing under reported assumptions. Contributing at above the treadwater level signals that the state's reported pension burden will continue to decline if investment targets are achieved.

The state's other post-employment benefit (OPEB) liability is moderate. As of fiscal 2022 reporting, Moody's has calculated the state's adjusted net OPEB liability (ANOL) to be $4.8 billion, representing 13.1% of own source revenue, slightly above the 50-state median (8.8% of own source revenue). The state’s fiscal 2023 adjusted net OPEB liability was $3.1 billion or 7.7% of own source revenue.

ESG considerations

Washington (State of)'s ESG credit impact score is CIS-2

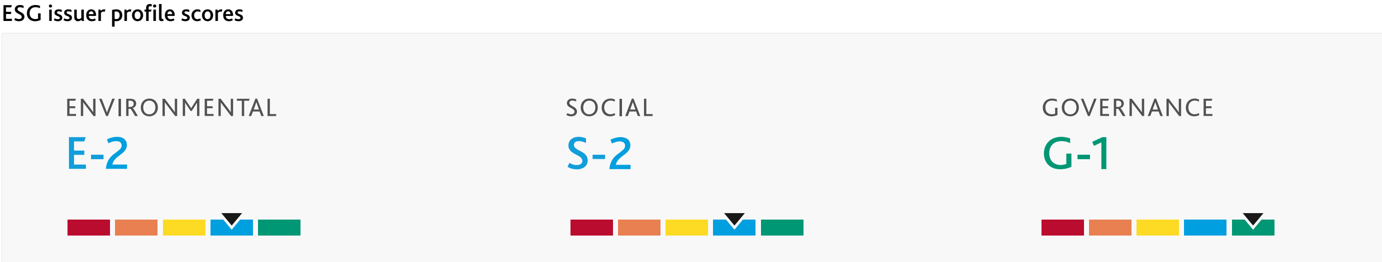
Exhibit 14
ESG credit impact score



Source: Moody's Investors Service

Washington's ESG Credit Impact Score is neutral-to-low (**CIS-2**) reflecting its neutral-to-low exposure to environmental risks and social risks and positive governance profile.

Exhibit 15
ESG issuer profile scores



Source: Moody's Investors Service

Environmental

Washington's E issuer profile score is **E-2**. According to data from Moody's ESG Solutions, Washington counties average projected rate of change in five climate risk factors, when weighted by county GDP, is below average in the nation. King County, which accounts for nearly 50% of the state's GDP, is not projected to have high risk in any of the five climate factors according to ESG solution's assessment scale. The most significant impact of climate change for Washington may be an increase in the frequency and severity of wildfires. The state budgets a contingent amount for fires each year, but it will continue to depend upon the availability of federal aid through FEMA to mitigate the cost of the largest fires.

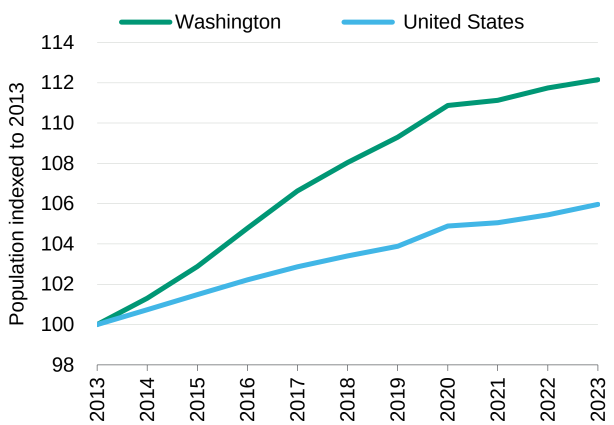
Social

Washington's S issuer profile is **S-2**. Demographic trends and income levels are generally positive and have contributed to its strong economic growth, particularly in the Seattle area, where there has been growth in the working-age population supporting growth in high-wage industries. Residents have above average educational attainment and the state's labor force participation rate is above average. All of these factors contribute to the state's strong economic fundamentals.

However, Washington's housing affordability has eroded and it is now one of the least affordable among 50 states. Weakened affordability will likely slow down migration, a main driver of the state's population growth. Washington also has one of the highest per capita homeless rates. The state has prioritized historic new investments in housing and homelessness in recent years.

Exhibit 16

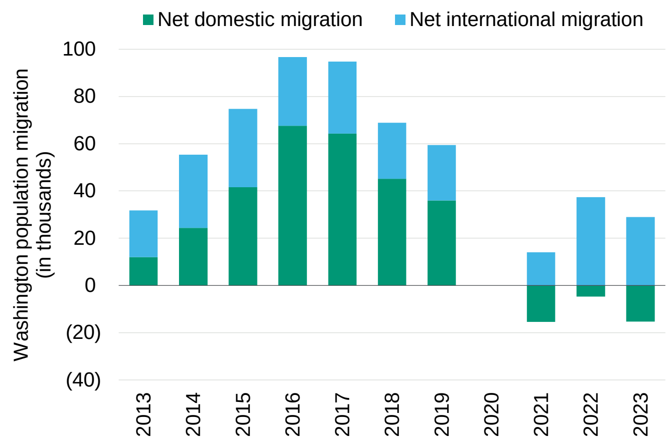
Washington's population growth has favorably outpaced the nation's over the last decade, although growth has decelerated....



Source: U.S. Census Bureau; Moody's Investors Service

Exhibit 17

...as population in-migration into Washington has softened given weakening affordability



Migration data is not available during census year (2020)

Source: U.S. Census Bureau; Moody's Investors Service

Governance

Washington's G issuer profile score is **G-1**. Washington has strong governance practices including a quarterly consensus revenue forecasting process, multi-year revenue and expenditure projections, timely budget adoption and a demonstrated willingness to address budget shortfalls.

Since 2007, the State Constitution has required maintenance of a mandatory rainy day fund (Budget Stabilization Account), which requires the transfer, by the June 30 close of each fiscal year, of at least 1% of General State Revenues for that fiscal year. In addition, by June 30 of the second year of each Biennium, three-quarters of any “extraordinary revenue growth” must be transferred to the Budget Stabilization Account, unless the average state employment growth for the preceding biennium averaged less than 1% per fiscal year. “Extraordinary revenue growth” is defined as the amount by which the growth in General State Revenues exceeds the average biennial percentage growth in General State Revenues over the prior five biennia by more than one third. The state's constitutionally restricted Budget Stabilization Account may be spent only after appropriation and under specific circumstances: by legislation approved by a simple majority if the governor declares a state of emergency, or if employment growth is forecasted to be less than 1% for that fiscal year; or by legislation approved by at least 3/5 of the members of each house.

Although frequent voter initiative activity can create budget challenges, the state legislature has broad powers to amend or suspend voter-approved initiatives and a track record of doing so as needed to maintain budgetary balance.

Rating methodology and scorecard factors

The US States and Territories Rating Methodology includes a scorecard, which summarizes the rating factors generally most important to state and territory credit profiles. Because the scorecard is a summary, and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not map closely to the actual rating assigned.

Exhibit 18

US states and territories rating methodology scorecard

Washington (State of)

	Measure	Weight	Score
Economy			
Resident Income (PCI Adjusted for RPP / US PCI)	104.7%	15%	Aaa
Economic Growth (5-year CAGR real GDP - 5-year CAGR US real GDP)	1.8%	15%	Aaa
Financial performance			
Financial performance	Aaa	20%	Aaa
Governance/Institutional Framework			
Governance/Institutional Framework	Aaa	20%	Aaa
Leverage			
Long-term liabilities ratio (adjusted long-term liabilities / own-source revenue)	115.4%	20%	Aa
Fixed-costs ratio (adjusted fixed costs / own-source revenue)	5.9%	10%	Aaa
Notching factors			
Very limited and concentrated economy	NA		
Scorecard-Indicated Outcome			Aaa
Assigned rating			Aaa

Source: US Bureau of Economic Analysis, State of Washington, Moody's Investors Service

Endnotes

1 Near General Fund is the designation for the state's primary operating fund, which including General Fund and related funds (Education Legacy Trust Fund, Washington Opportunity Pathways Account and Workforce Education Investment Account)

2 The Washington Rescue Plan Transition Account was established under the pandemic for related expenditures and serves as a secondary rainy day fund, but with less restrictions. Monies in this account are balanced directed by the legislature from unassigned general fund balances and may only be spent after appropriation.

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