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Rating Action: Moody's upgrades Washington State GOs to Aaa from Aa1; outlook stable

23 Aug 2019

New York, August 23, 2019 -- Moody's Investors Service has upgraded the ratings on the State of Washington's approximately \$19.4 billion outstanding general obligation bonds, including bonds additionally secured by motor vehicle fuel taxes and toll revenues, to Aaa from Aa1.

In conjunction with the upgrade of the general obligation ratings, we have upgraded the following related ratings:

- The Washington State School Bond Guarantee Program (approximately \$13.5 billion bonds guaranteed) to Aaa from Aa1;
- The state's certificates of participation (approximately \$870 million outstanding) to Aa1 from Aa2;
- The TOP Lease Revenue Refunding Bonds, 2014 (Washington State Office Building) (\$35.8 million outstanding) to Aa1 from Aa2; and
- The City of Aberdeen, Special Revenue Bonds, Series 2002 (Stafford Creek Corrections Center Project) (\$670,000 outstanding) to Aa2 from Aa3.

We have affirmed the A2 rating on the state's \$517 million outstanding Federal Highway Grant Anticipation Revenue Bonds, Series 2012F & 2014C (GARVEE) (SR 520 Corridor Program).

At this time, we have assigned Aaa ratings to the state's planned general obligation bond issues:

- \$457.9 million Various Purpose General Obligation Bonds, Series 2020A;
- \$222.5 million Motor Vehicle Fuel Tax & Vehicle Related Fees General Obligation Bonds, Series 2020B;
- \$38.4 million General Obligation Bonds, Series 2020T;
- \$91.8 million Various Purpose General Obligation Refunding Bonds, Series R-2020A; and
- \$53.1 million Motor Vehicle Fuel Tax General Obligation Refunding Bonds, Series R-2020B.

We have also assigned a Aa1 rating to the state's planned issue of \$87.7 million Certificates of Participation, Series 2019D (State and Local Agency Real and Personal Property).

The outlook on the state's debt and the school bond guarantee program is stable.

RATINGS RATIONALE

The upgrade of the general obligation bonds and school bond guarantee program to Aaa reflects a significant increase in financial reserves even as the state increased funding for K-12 education in response to a state supreme court mandate, the exceptional growth of the state's economy driven largely by the technology sector in the Seattle metro area, and the consequent diversification of the state's economy lessening dependence on aircraft manufacturing by The Boeing Company (A2 negative). Additional strengths include above-average wealth and income levels, and the state's strong fiscal governance practices. While the state's debt levels are above average, they have been declining relative to the 50-state medians and the state's debt and pension liabilities combined and fixed costs are comparable to medians. The grounding of Boeing's 737 MAX aircraft, while a credit negative for the company, has not impacted employment or state tax revenues to date; a prolonged reduction 737 MAX production, not currently foreseen, should not have a significant negative impact on the state. Frequent voter initiative activity adds budget challenges, but the legislature has broad authority to suspend voter-enacted statutes and a history of responding effectively to maintain budget balance.

The upgrade of the state's certificates of participation, its 2014 TOP lease revenue bonds, and the City of

Aberdeen 2002 special revenue bonds reflects the improvement in the state's general credit quality represented by the upgrade of the general obligation rating. The Aa1 ratings on the certificates of participation, one notch below the general obligation rating, incorporates the essential nature of the property being financed, the moderate legal structure and subject-to-appropriation nature of the state's payment obligations, and the active administration of the financing program by the state treasurer's office. The Aa1 rating on the 2014 TOP lease revenue bonds incorporates the essential nature of the leased asset, a state office building in Tumwater, and the moderate legal structure and subject-to-appropriation nature of the state's obligation to make lease payments. The Aa2 rating on the City of Aberdeen 2002 special revenue bonds, two notches below the general obligation rating, incorporates the subject-to-appropriation nature of the Washington State Department of Corrections' obligation to make system development fee payments pursuant to an agreement between the department and the city, and the absence of a leased asset associated with the payments. The rating on all the lease/appropriation-backed debt reflects the state's established track record of making appropriation-backed payments under a variety of financing programs.

The A2 rating on the grant anticipation revenue bonds reflects the limited nature of the state's obligation to make payments, ample coverage of debt service by pledged federal highway aid, and a strong additional bonds test. Pledged federal aid is subject to periodic federal reauthorization risk and vulnerable to a large structural imbalance in the federal Highway Trust Fund (HTF).

RATING OUTLOOK

Washington's rating outlook is stable, reflecting the strength of its economy, sizable reserves, and manageable long-term liabilities. We expect that the state will continue to address any budget gaps that emerge, as it has in the past.

FACTORS THAT COULD LEAD TO AN UPGRADE

For the general obligation bonds, the school bond guarantee program, the certificates of participation, 2014 TOP lease revenue bonds, and the City of Aberdeen 2002 special revenue bonds:

- Not applicable

For the grant anticipation revenue bonds:

- A return to multi-year reauthorizations of the federal highway aid program or the addition of a sustainable dedicated revenue source for the federal HTF.

FACTORS THAT COULD LEAD TO A DOWNGRADE

For the general obligation bonds, the school bond guarantee program, the certificates of participation, 2014 TOP lease revenue bonds, and the City of Aberdeen 2002 special revenue bonds:

- An unexpected weakening of the state's economy
- Protracted structural budget imbalance and/or a shift to reliance on one-time budget solutions
- Deterioration of the state's cash position

For the grant anticipation revenue bonds:

- A significant reduction in or disruption of pledged federal transportation funds.

LEGAL SECURITY

The state issues four classes of the general obligation bonds - general obligation bonds or various purpose general obligation bonds, motor vehicle fuel tax general obligation bonds, motor vehicle fuel tax & vehicle related fees 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 motor vehicle fuel tax general obligation bonds are additionally secured by and expected to be paid from motor vehicle fuel taxes. The motor vehicle fuel tax & vehicle related fees general obligation 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 Washington State School Bond Guarantee Program is backed by the state's full faith and credit, and

taxing power, on parity with the state's general obligation bonds.

The state's certificates of participation are secured by and expected to be paid from payments made by participating agencies including: (1) lease payments made by participating state and local agencies for real property projects, and (2) installment purchase payments made by participating state and local agencies 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.

The 2014 TOP lease revenue bonds are secured by lease payments made by the state for use of Edna Lucille Goodrich State Office Building in Tumwater. The state's obligation to make the lease payments is subject to appropriation.

The City of Aberdeen 2002 special revenue bonds, are secured by System Development Fee Payments made by the Washington State Department of Corrections to the city pursuant to an Agreement for Extension of Utilities for the Stafford Creek Corrections Center between the department and the city. The department's obligation to make payments is subject to appropriation.

The grant anticipation revenue bonds are secured by a pledge of federal highway aid received by the state.

USE OF PROCEEDS

Proceeds of the Series 2020A and 2020T general obligation bonds will be used to fund various non-transportation state capital projects. Proceeds of the Series 2020B bonds will be used to fund various state highway projects. Proceeds of the Series 2019D COPs will be used to finance and/or refinance the cost of acquisition and construction of real and personal property for various state and local agencies. Proceeds of the Series R-2020A and R-2020B bonds will be used to refund outstanding general obligation bonds for debt service savings.

PROFILE

Washington is the thirteenth largest state by population, at 7.5 million. Its state gross domestic product is twelfth largest, at \$563.2 billion. The population is relatively wealthy, with per capita personal income equal to 113.2% of the US level and a poverty rate in the bottom third among states.

METHODOLOGY

The principal methodology used in general obligation and programmatic ratings was US States and Territories published in April 2018. The principal methodology used in the lease/appropriation ratings, including the certificates of participation, the 2014 TOP lease revenue bonds, and the City of Aberdeen 2002 special revenue bonds ratings was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2018. The principal methodology used in the grant anticipation revenue bonds ratings was US Public Finance Special Tax Methodology published in July 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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