S&P Global Ratings

RatingsDirect®

Summary:

State of Washington; Appropriations; General Obligation

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Credit Profile		
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
State of Washington var purp GO rfdg bnds ser R-2021C due 08/01/2036		
Long Term Rating	AA+/Stable	Rating Assigned
State of Washington MVFT/VRF GO bnds ser 2021F due 06/01/2046		
Long Term Rating	AA+/Stable	Affirmed
FYI Properties, Washington		
State of Washington, Washington		
FYI Properties (Washington) APPROP		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to the State of Washington's:

- $608.5 million series 2022A various-purpose general obligation (GO) bonds;
- $42.9 million series 2022B motor vehicle fuel tax GO bonds; and
- $93.4 million series 2022T (taxable) GO bonds.

At the same time, S&P Global Ratings affirmed its 'AA+' long-term and underlying ratings on Washington's GO and motor vehicle fuel tax debt outstanding, and its 'AA' rating on the state's appropriation-backed debt outstanding. We rate these appropriation-backed debt obligations one notch lower than our rating on the state to reflect the service contract and lease payments appropriated by the state legislature for the bonds. The outlook on all ratings is stable.

Our rating on the state's GO bonds reflects Washington's full faith, credit, and taxing powers. The motor vehicle fuel tax GO bonds are also secured and expected to be paid by motor vehicle fuel taxes. The motor vehicle fuel tax and vehicle-related fees GO bonds are also secured by, and expected to be paid from, motor vehicle fuel taxes and vehicle-related fees. The triple-pledge motor vehicle fuel tax GO bonds outstanding are additionally secured by, and expected to be paid from, certain toll revenues.

Credit overview

We believe Washington's credit profile is stabilized by strong fiscal management practices and projections for strong economic growth relative to the nation. Specifically, the state's revenue forecasting practices are strong, in our view, and Washington has a history of making budget adjustments based on material changes to its forecasts. While we expect that the importance of exports to the state's economy and challenges plaguing the state's aerospace industry could weigh on a meaningful recovery, we believe Washington will benefit from forecast stronger-than-average population and gross state product (GSP) growth in the medium term. Additionally, we anticipate the debt profile will remain relatively high but manageable, given the state's comparatively low pension and other postemployment benefit (OPEB) liabilities.

Washington closed a sizeable revenue shortfall of $4.7 billion (8.9%) from its June 2020 near general fund revenue forecast--brought on by the COVID-19 pandemic--through a combination of higher-than-expected taxable economic activity, expenditure reductions, and reserve use. Notably, the state withdrew $1.82 billion from its budget stabilization account during fiscal 2021 to support its budget, essentially depleting the account. While we believe the state's lack of a formal policy for its budget reserve level allows low balances to persist through protracted periods of economic and revenue softness, Washington has historically returned to operating surpluses and good budgetary reserve positions during expansionary phases of the economic cycle.

Washington's enacted budget for the fiscal 2021-2023 biennium totals $58.8 billion for the state general fund and near general fund accounts (education legacy trust account, opportunity pathways account, and workforce education investment account). This represents $6.9 billion, or 13.2% growth from the fiscal 2019-2021 biennium, which outpaces projected revenue growth of $4.8 billion, or 9.1%, over the same period. Notable new revenue legislation supporting revenue growth includes a capital gains tax ($415 million) and captive insurer tax ($34 million). The state's budget stabilization account, which begins the year essentially empty, is expected to receive a $543 million deposit to bring its balance to 1.8% of near general fund biennial expenditures in fiscal 2023, which we consider low. However, we consider the state's commitment to rebuilding the reserve account to be a positive credit factor.

Management reports that the average daily balance of the state treasury and treasurer's trust funds was $11.2 billion in May 2021, which we consider a very strong 21.6% of budgeted fiscal 2019-2021 biennial general fund and near general fund expenditures. The funds' average daily balance has significantly increased in recent years, but management reports that balances have varied widely, generally ranging from $3 billion to $11 billion from 2006 to 2021.

The ratings reflect our view of Washington's:

- Sales tax-based revenue structure, which has demonstrated less sensitivity to economic cycles than income tax-reliant states;
- Strong financial policies and practices, including statutory provisions requiring that the state's biennial budget and projected subsequent two fiscal years' spending plans be balanced, which is key, given increasing expenditure pressures;
- High cost of housing, especially in key economic centers that could impede long-term growth prospects; and
- Moderately high debt burden across several measures, but relatively low unfunded pension and OPEB liability.

The stable outlook reflects our view of Washington's ability to maintain a strong financial position throughout changes in the business cycle. We believe the state's strong budgetary management and forecasting practices help insulate the Washington rating from its budgetary pressures. The state's legal requirements to enact budgets that are balanced--not only for the current biennium, but subsequent biennia--help provide a sustainable framework to facilitate structural balance throughout economic cycles. While we expect that significant upward pressure on spending originating in legal- and voter-approved mandates over time will remain a soft point in the state's credit profile, we believe Washington's ability to enact budgets that are balanced--not only for the current biennium, but also project balance through the following biennium--helps facilitate a structural approach.

Based on the analytic factors we evaluate for states, we have revised our composite score for Washington to '1.7' from '1.6' on a four-point scale, whereby '1.0' is the strongest and '4.0' is the weakest.

For more information on our GO rating on the state, see our full analysis on the State of Washington, published Jan. 28, 2021, on RatingsDirect.

Environmental, social, and governance (ESG) factors

In our opinion, Washington's environmental risks are elevated, given a combination of exposure to rising sea levels along the state's vast coastline and risk of wildfires in its expansive forests. Washington, which has more than 3,000 miles of coastline, derives much of its economic activity from the Puget Sound region, which includes Seattle, Olympia, Tacoma, and Bremerton. Specifically, IHS Markit estimates half of the state's population and jobs are based in the area. Other areas of the state have experienced drought conditions for at least part of the year over the past decade, and officials expect dry conditions in summer months will likely persist in the decades ahead. Washington reports it has begun preparing for a changing climate by integrating consideration of such changes into decision-making; multiple state agencies have been tasked with studying the impacts of climate change on their areas of focus and the Economic and Revenue Forecast Council prepares a climate study on an annual basis.

We view Washington's social and governance risks as in line with our view of the sector as a whole.

Stable Outlook

Downside scenario

We could lower our rating on Washington if, in the face of budgetary pressure, lawmakers delay taking corrective action in addressing revenue shortfalls or rely extensively on one-time solutions to remediate budget gaps. In our view, budgetary pressure could arise from the newly enacted capital gains tax's legal challenges or inherent cyclicality, job losses in the state's aviation industry, or diminished flexibility stemming from maintenance of various voter-approved spending initiatives or court actions (such as increases to education funding following the resolution of the McCleary decision), among others. State policymakers' response--whether timely or structurally oriented--will likely dictate any effect on our rating on Washington. We could also lower the rating if Washington fails to replenish its budget stabilization account in a timely manner, or we feel the state lacks a realistic plan to rebuild its reserve profile.

Upside scenario

Although unexpected during our outlook horizon, we could raise the rating if growth in Washington's debt levels were to moderate, alongside sustainable growth in revenue that keeps pace with both the state's underlying economic growth rates and mandated costs originating from voter-approved initiatives that, to a degree, limit the state's budgetary flexibility.

Credit Opinion

Washington revenues running ahead of estimates following an uptick in economic activity

Washington's general fund revenue collections are running ahead of previous forecasts by $1.239 billion (2.3%) through June 10, 2021. Officials note revenue collections have exceed prior expectations, due in part to a better-than-anticipated increase in taxable economic activity, especially in terms of retail sales.

The council's baseline forecast incorporates legislative changes reducing forecast general fund revenues by $101 million in the fiscal 2021-2023 biennium and $218 million in the fiscal 2023-2025 biennium. Officials disclose the largest change was a business and occupation tax credit, designed to partially offset the newly passed tax on capital gains.

The baseline projections also reflect The Boeing Co.'s announcement of significant reduction to employment across the company as well as the movement of some aircraft production from Washington to South Carolina. The forecast assumes Boeing is about two-thirds of the way through this process, and that most employment cuts going forward will be made in Washington. Specifically, Washington assumes aerospace employment will be 29,200 lower in December 2021 than in January 2020, a slight 2% decrease from the council's March 2021 forecast. Although we view Washington's economy as sensitive to swings in the state's aerospace industry, we believe the state's economy is well-diversified.

Upside risk to the forecast includes a faster-than-anticipated decline in COVID-19 cases, stronger-than-forecast consumer response to fiscal stimulus, and passage of additional infrastructure of stimulus legislation by congress. Downside risk could include more infectious COVID-19 variants leading to increased cases, thereby slowing the pace of recovery and higher-than-expected inflation stemming from slower supply chain recovery and growth in labor supply.

New tax on capital gains projected to boost state revenues, but facing legal challenges

Washington's governor recently enacted legislation that imposes an excise tax on the sale or exchange of long-term capital assets. The capital gains tax, which is effective Jan. 1, 2022, is only subject to individuals with capital gains of more than $250,000 annually and is calculated as 7.0% multiplied by the state's calculation of adjusted capital gains. In our opinion, the tax introduces some additional cyclicality to Washington's revenue mix, given the state's dependence on its top taxpayers, as well as investment performance.

The enacted legislation directs revenues for children's education purposes to the education legacy trust account; the state considers the account to be near general fund, although it is separate from the general fund itself. The first payments are due to the state in April 2023 within the final quarter of the state's current biennium. Forecasters anticipate the tax will have a positive net revenue impact of $415 million in the fiscal 2021-2023 biennium, which we consider to be relatively minor at 0.7% of projected near general fund revenues. In the following fiscal 2023-2025 biennium, the net revenue impact more than doubles to $840 million, or 1.4% of projected near general fund revenues, since the tax is presumed to be effective for the entirety of the biennium. We note that in recent years, the state has dealt with education funding challenges while at the same time pursuing efforts to diversify its tax base.

The state is currently party to a lawsuit seeking to void the capital gains tax, based on claims it is an unconstitutional income tax. We understand the litigation could potentially halt collection of the tax at some point in the future. If this scenario were to occur, we believe it could challenge both the state's structural balance, given the inclusion of capital gains revenue in current forecasting, and the plan to rebuild its budget stabilization account. However, we believe the state's history of strong fiscal management will likely insulate the state's credit profile from this budgetary pressure, based on current forecasting, should it arise.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of July 14, 2021)		
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
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Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of July 14, 2021) (cont.)		
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
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Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of July 14, 2021) (cont.)		
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
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Long Term Rating	AA+/Stable	Affirmed
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Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO (AMBAC)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO (MBIA)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Ratings Detail (As Of July 14, 2021) (cont.)		
Washington GO (MBIA) (National)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO (SYNCORA GTY)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
State of Washington, Washington		
State of Washington, Washington		
Washington St Toll Facilities, Washington		
Washington GO		
Long Term Rating	AA+/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.