

RatingsDirect®

Summary:

State of Washington; General Obligation

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Credit Profile

US\$831.24 mil various purp GO bnds ser R-2022C due 07/01/2037		
<i>Long Term Rating</i>	AA+/Stable	New
US\$497.825 mil MVFT GO rfdg bnds ser R-2022D due 07/01/2042		
<i>Long Term Rating</i>	AA+/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to the State of Washington's \$831.2 million series R-2022C various purpose general obligation (GO) refunding bonds and \$497.8 million series R-2022D motor vehicle fuel tax GO refunding bonds. The outlook is stable.

Our rating on the state's series R-2022C and series R-2022D 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.

Credit overview

Washington's credit profile is characterized by strong fiscal management practices, including strong forecasting, a history of making budget adjustments based on material changes to forecasts, and demonstrated commitment to rebuilding reserves following withdrawals in economic downturns. While we anticipate Washington's debt profile will remain relatively high, we believe it is manageable, given the state's comparatively low pension and other postemployment benefit liabilities.

Washington's enacted supplemental budget for the fiscal 2021-2023 biennium totals \$64.1 billion for the state's near general fund accounts (general fund, education legacy trust account, opportunity pathways account, and workforce education investment account). This represents an increase of \$5.1 billion (8.7%) over the initial budget for the ongoing biennium and \$11.6 billion (19.7%) over the budget for the fiscal 2019-2021 biennium. Key spending priorities include initiatives related to homelessness, poverty, and environmental issues in addition to further education spending related to the COVID-19 pandemic. The supplemental budget is supported by Washington's February 2022 revenue forecast, which totals \$60.2 billion and incorporates significant, in our view, revenue growth of 10.7% over the March 2021 forecast used for the initial biennium budget. The supplemental budget makes up for \$3.4 billion revenue gap by using beginning fund balance. In our view, we believe the \$222 million forecast biennial ending balance, alongside projections for \$609 million in rainy-day funds and \$2.1 billion in a newly created reserve account called the Washington Rescue Plan Transition Account (WRPTA), provides budgetary cushion at a combined 8.5% of annual near general fund expenditures for fiscal 2023.

The state's budget stabilization account (BSA) began the fiscal year essentially empty following a withdrawal in fiscal

2021 made to help manage Washington's budget. However, the state maintained a strong ending near general fund (general fund, education legacy trust account, opportunity pathways account, and workforce education investment account) balance of \$4.2 billion, which we view as a strong 14.3% of annual near general fund expenditures that offsets the lowered BSA balance. The enacted supplemental budget for the 2021-2023 biennium anticipates \$587 million in deposits to the BSA by the end of the biennium. We consider the projected \$609 million balance to be low at 1.8% of annual near general fund expenditures for fiscal 2023. We note, however, that the state created a new reserve account, the WRPTA, which is projected to have a balance of \$2.1 billion at the end of the fiscal 2021-2023 biennium. On a combined basis, these BSA and the WRPTA reserve accounts total \$2.7 billion or a good 7.9% of annual near general fund expenditures for fiscal 2023.

Historically, the state's lack of a formal policy for its budget reserve level has allowed low balances to persist through protracted periods of economic and revenue softness. During expansionary phases of the economic cycle, however, Washington consistently returns operating surpluses and good budgetary reserve positions. We view the state's commitment to rebuilding the reserve account as a positive credit factor.

The state's most recent revenue forecast, conducted by the Economic and Revenue Forecast Council (ERFC) in February 2022, raised general fund revenue projections by 2.4% for the current fiscal 2021-2023 biennium and 2.2% for the upcoming fiscal 2023-2025 biennium. Officials note that elevated revenues are due in part to stronger-than-expected state taxable activity including retail sales and use taxes and business and occupation taxes. The forecast includes newly imposed capital gains taxes in the education legacy trust account, which the state considers to be a near general fund. We understand the ongoing litigation regarding this new tax could potentially halt collections at some point in the future. If this scenario were to occur, we believe it could somewhat affect Washington's structural balance, given the inclusion of capital gains revenue in current forecasting. However, we believe the impact of a repeal of the capital gains tax is minimal, at 0.8% of projected near general fund revenues in each of fiscal 2023, fiscal 2024, and fiscal 2025. In addition, we expect the state's history of strong fiscal management will likely insulate Washington's credit profile from this budgetary pressure, based on current forecasting, should it arise.

Washington's general fund revenue collections are running ahead of the council's February 2022 forecast, through March 14, 2022. General fund revenue collections are running ahead of forecast by \$72.3 million, or 4.2%.

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 low unfunded retirement liabilities.

The stable outlook reflects our view that 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 assigned a composite score for Washington of '1.7' on a four-point scale, whereby '1.0' is the strongest and '4.0' is the weakest.

Environmental, social, and governance

In our opinion, Washington's environmental risks are neutral to our overall credit analysis. Although the state faces a combination of exposures from rising sea levels along its vast coastline and risk of wildfires in the state's expansive forests, we believe these risks are mitigated by Washington's planning and practices. The state, 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, contributing to wildfire risk. 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. The state's legislature has passed several bills in recent years addressing climate change, including approving programs to reduce energy emissions.

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 cyclicity, 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 the state fails to replenish its BSA in a timely manner, or if we believe 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

For more information on Washington, see our analysis published Jan. 25, 2022, on RatingsDirect.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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