

# State of Washington



## Ratings

Long Term Issuer Default Rating AA+

## New Issues

\$715,060,000 Various Purpose General Obligation Refunding Bonds, Series R-2023A AA+  
\$310,510,000 Motor Vehicle Fuel Tax and Vehicle Related Fees General Obligation Refunding Bonds, Series R-2023 AA+

## Outstanding Debt

School Bond Guarantee Program AA+  
General Obligation Bonds AA+  
General Obligation Motor Vehicle Fuel Tax Bonds AA+  
General Obligation Motor Vehicle Fuel Tax and Vehicle-Related Fees Bonds AA+

## Rating Outlook

Stable

## Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (May 2021)

## Related Research

Fitch Rates State of Washington's \$1.026B Refunding GOs 'AA+'; Outlook Stable (April 2023)

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## New Issue Summary

**Sale Date:** The bonds are expected to sell competitively on or about April 26, 2023

**Series:** \$715,060,000 Various Purpose GO Refunding Bonds, Series R-2023A; and \$310,510,000 Motor Vehicle Fuel Tax and Vehicle Related Fees GO Refunding Bonds, Series R-2023

**Purpose:** Proceeds of the bonds will be used to refund outstanding GO debt incurred on various capital and transportation projects.

**Security:** All GO bonds are general obligations of the state to which the state has irrevocably pledged its full faith, credit and taxing power. The series R-2023B bonds are further secured by motor vehicle fuel tax and vehicle related fees.

Washington's 'AA+' Issuer Default Rating (IDR) and GO bond rating reflect the state's broad and steadily growing economy, with solid long-term revenue growth prospects, a demonstrated commitment to fiscal balance and combined long-term liabilities that place a low burden on resources. The ratings also reflect the state's very strong financial resilience supported by a statutory requirement for a balanced multiyear budget and formulaic funding of the budget stabilization account (BSA) leading to solid reserves. Education poses a unique spending pressure for the state given both steady population growth and the state's role as the primary funder for K-12 schools across the state.

**Economic Resource Base:** Washington's fundamental economic profile remains strong, with long-term steady growth prospects, particularly in information technology, and a diverse employment base. Continued economic gains will be supported by high educational attainment and income levels above the national average.

## Key Rating Drivers

**Revenue Framework: 'aaa':** Revenue performance over time has generally been above long-term inflation, and Fitch expects this to continue to support solid growth prospects. The state has complete independent control over taxation, with an unlimited legal ability to raise operating revenues as needed.

**Expenditure Framework: 'aa':** Washington benefits from solid expenditure flexibility, although its flexibility is somewhat more restricted than most states due to court mandates, statutory commitments and broad responsibility for education funding. Rapid demographic growth also exerts pressure on infrastructure spending. The state has a low burden of carrying costs, and benefits from broad expense-cutting authority common to most U.S. states.

**Long-Term Liability Burden: 'aaa':** The combined burden of debt plus net pension liabilities is low as a percentage of personal income but above the median for U.S. states. Elevated debt ratios incorporate the funding of substantial capital needs, particularly for transportation, but are offset by a moderate net pension liability and an expanding economic resource base.

**Operating Performance: 'aa':** Washington maintains very strong gap-closing capacity in the form of its superior budget flexibility and solid reserves. The state has prudently built up reserves in times of economic recovery and expansion, despite spending pressure for education and other pressing needs.

## Rating Sensitivities

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Strong economic and revenue growth that outpaces national GDP over time.

- Long-term management of higher spending for education and other overall growth pressures, while establishing superior gap-closing capacity, such as through maintaining reserves above the recent peak of 20% of spending.

**Factors that could, individually or collectively, lead to negative rating action/downgrade:**

- A sustained increase in the long-term liability burden to 10% or more of personal income.
- Unanticipated shift in fiscal management that materially weakens fiscal resilience, such as sizable and continuing draws on reserves to support operations, particularly during times of economic expansion.

**Rating History (IDR)**

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	1/10/23
AA+	Affirmed	Stable	7/19/13
AA+	Affirmed	Negative	1/27/12
AA+	Revised	Stable	4/05/10
AA	Affirmed	Stable	12/31/08
AA	Affirmed	Positive	9/04/07
AA	Affirmed	Stable	4/13/06
AA	Downgraded	—	1/11/02
AA+	Upgraded	—	11/25/97
AA	Assigned	—	8/18/92

**Current Developments**

**Economic Recovery Picks Up Pace**

Washington's recovery from the pandemic has been in line with national trends. As of February 2023, the state housed more jobs than before the pandemic (125% of pre-pandemic jobs), ahead of the 114% national recovery through that same month. February 2023 headline unemployment of 4.6% was somewhat above the national 3.6% rate that month, mostly consistent with the pattern heading into the pandemic.

Washington's labor force growth has been ahead of national trends, reflecting the state's ongoing economic expansion. The state's employment to population ratio (EPOP, a measure of labor force utilization) as of February 2023 was 61.5%, near full recovery to the February 2020 level of 62.8%. Nationally, EPOP of 60.2% lags the February 2020 level of 61.2%.

**Washington Fiscal Update**

Conservative revenue forecasting practices have allowed the state to prudently navigate challenging yet ultimately favorable economic conditions over the past years. The most recent update from the state's Economic and Revenue Forecast Council (ERFC) in March 2023 projected fiscal 2023-2025 biennium revenues at levels 42% higher than 2017-2019 biennium revenues.

Upward revisions to the revenue forecast come despite mixed projections for key economic indicators such as personal income, state GDP and employment. Importantly, the state's economist notes that unexpectedly and persistently high inflation drives state sales tax growth, which is not inflation-adjusted. As prices rise, so have collections.

Following the February 2022 upwards forecast revision, the state enacted a supplemental 2022 budget bill in March that added approximately \$5 billion in near general fund (NGF) appropriations for the current biennium. NGF is the designation for the state's primary operating funds. The additional appropriations were a mix of one-time allocations such as a \$2 billion transfer to the state's transportation fund and most of the \$1.1 billion of allocated ARPA aid and recurring spending including \$232 million for wage and compensation increases for state employees. Any additional revenues forecast in subsequent 2022 revisions and ERFC forecast adjustments are being incorporated into the legislature's 2023 session.

The state's budgetary reserves have shifted considerably through the pandemic and are now on a path towards exceeding pre-pandemic levels. Reduced balances in the constitutional BSA were followed by a sharp increase in ending balance in fiscal 2020, a steep decline in fiscal 2021, and moderate growth in fiscal 2022 and 2023. The legislature also established a new reserve fund, the Washington Rescue Plan Transition Account (WRPTA) and allocated \$1 billion towards it in fiscal 2022 in the enacted biennial budget.

The supplemental 2022 budget bill brings the fiscal 2023 allocation to \$2.1 billion. The WRPTA has statutory restrictions, but they are relatively broad and the fund provides an important source of future fiscal flexibility for Washington. Fitch anticipates future legislative sessions could provide further clarity on policymakers' long-term intentions regarding the WRPTA and its viability as a source of sustained fiscal resilience for the state.

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The state has added over \$2 billion in reserves compared to pre-pandemic levels. The March 2023 revenue forecast predicts fiscal 2023 ending combined reserves (ending balance plus BSA plus WRPTA) of \$6.0 billion (19% of projected general fund revenues). This is a more than a 60% increase from \$3.6 billion in reserves at the end of fiscal 2019. In the current Four-Year Budget Outlook (a statutorily-required budget forecast that reflects the supplemental 2022 budget bill, but not the March 2023 revenue forecast update), the state anticipates another \$500 million WRPTA deposit by the end of the 2023-2025 biennium.

## Credit Profile

Boeing remains a large employer in Washington and an important contributor to its economy; however, the state's overall manufacturing sector is about the same proportion of GDP as the nation's manufacturing sector, while Washington's information technology sector generates triple the proportion of GDP as the nation. Microsoft and Amazon combined employ almost two times more individuals than Boeing, and several software and information companies continue to expand in the state. The workforce is highly educated, income levels are comparatively high and the state poverty rate is below the national average.

## Revenue Framework

Washington relies on broad consumption-based revenues to fund operations and does not levy an income tax. This revenue mix results in collections that quickly reflect consumer spending and construction trends as construction (labor and materials) is assessed under the broad sales tax and as these receipts are significant to sales tax revenue performance, the revenue stream is exposed to housing market volatility. Overall, general fund revenues exhibit a moderate level of volatility.

The retail sales and use tax generates about half of total general fund state revenues with the Business and Occupations tax (just under 20% of revenues) and state property tax (approximately 15%) lesser but important components. The property tax, unusual for a state, is statutorily dedicated to meeting the state's K-12 funding obligations. The importance of the real estate excise tax (6% of tax revenues in fiscal 2022) varies considerably depending on the point in the economic cycle. The state enacted a capital gains tax in 2021 that is forecast to generate about \$500 million annually, primarily for education, by fiscal 2025, equal to less than 2% of general fund-state revenues that year. The tax is currently being challenged in court, but is nonetheless included in state revenue projections.

Fitch expects revenues to continue to reflect cyclical trends offset somewhat by the state's ongoing population growth and economic expansion.

Washington has complete independent legal ability to control taxes, a significant credit strength.

In 2023, the state begins implementation of its Climate Commitment Act, including a carbon emissions cap and trade (or cap and invest) system with some emissions allowances auctioned by the state to generate revenues. The state anticipates the program will generate \$360 million annually, to be used for clean energy transition and assistance, clean transportation and climate resiliency projects.

## Expenditure Framework

As in most states, education and health and human services are Washington's largest operating expenses. Education is the larger line item, with state funding for local school districts and the public university and college system accounting for more than half of state general fund expenditures. Human services programs represent another third.

Washington's spending growth, absent policy actions, will likely be marginally above its solid revenue growth, requiring regular budget management to ensure ongoing balance. Education, specifically K-12, poses a particular pressure point. Several courts have interpreted the constitutional obligation to require significant investment by the state. Washington provides essentially full basic operational funding for K-12 school operations. Since the 2011-2013 biennium, K-12 state funding has more than doubled. Local districts can levy their own taxes to supplement state aid.

The fiscal challenge of Medicaid is common to all U.S. states and the nature of the program as well as federal government rules limit the states' options in managing the pace of spending growth. As with all federal initiatives, Medicaid remains subject to regulatory changes that could affect various aspects. However, federal action to revise Medicaid's fundamental programmatic and financial structure does not appear to be a near-term priority of the current federal administration or congressional leadership.

Washington retains solid expenditure flexibility. While Medicaid costs are somewhat beyond the state's ability to materially change given federal requirements for the program, the state's carrying costs for long-term liabilities are low. Like most states, Washington's operating budget (outside of Medicaid) goes largely toward funding of services rather than direct service delivery, allowing the state to shift costs to lower levels of government in times of fiscal stress. This is true even for education spending, as the state appropriates money to local school districts rather than operating any schools itself.

### Long-Term Liability Burden

On a combined basis, Washington's burden of direct debt and adjusted net pension liabilities, at 5.3% of personal income, is above the 4.6% median for U.S. states (see Fitch's "2022 State Liability Update (Personal Income Surge Offsets Liability Increase)", dated Nov. 15 2022) but still low overall. Debt levels are twice the U.S. state median, reflecting in part the demands of many years of strong population growth. However, pension liabilities are below the median. Fitch expects the combined burden to remain at similar levels going forward, despite large capital needs, given strong population and personal income growth.

Capital needs are substantial, particularly for transportation, and future borrowing is anticipated. The state has repeatedly demonstrated its ability and willingness to raise revenues in support of transportation capital investment, most recently through an electrification fee for electric vehicles and an increase to the service fee for vehicle title transaction and registration. Tolling is also utilized as part of the funding solution. In its 2022 session, the legislature also adopted the Move Ahead Washington revenue package that allocated \$16.9 billion over 16 years towards various transportation needs. The largest revenue sources are \$5.4 billion from Climate Commitment Act revenues noted earlier and \$3.7 billion allocated to the state via the November 2021 federal Infrastructure Investment and Jobs Act. Approximately one-third of the state's outstanding GO debt is supported by motor-vehicle related fees and tolls.

In fiscal 2022, Washington's aggregate fiduciary pension assets more than covered total pension liabilities on a reported basis at 124%, assuming a 7.5% investment return for most of the plans. This ratio falls to an estimated 104% using Fitch's standard 6% investment return assumption. The state has made changes to manage pension costs, including elimination of cost of living adjustments. Washington has deferred full contributions to the closed pension systems in times of economic strain. Other post-employment benefits (OPEB) are limited and funded on a pay-as-you-go basis.

Contingent liabilities include the School Bond Guarantee Program, which provides a GO guarantee to outstanding school district debt. The state utilized the enhancement for the first time ever on June 1, 2021 to advance approximately \$3.2 million for Mason County when an internet connectivity issue with the county's bank delayed debt service transfers for school districts in the county. The county made the transfer within the same day, fully covering the state's advance.

Fitch continues to exclude the covered school district debt from our long-term liability calculation as we consider the recent advance a very short-term issue affecting only a minimal portion of the contingent liability and not indicative of any ongoing need for state advances.

### Operating Performance

Frequent reviews of economic and financial forecasts allow the state to respond effectively to changing conditions. During the Great Recession and the recent pandemic-driven downturn, the state demonstrated its willingness and ability to utilize broad budget flexibility in response to revenue volatility. In fiscal 2009 through fiscal 2011, the state implemented a combination of ongoing and one-time actions, and fully depleted accumulated reserves that took almost a decade to rebuild. In 2020, the state implemented spending cuts and planned reserve draws, though the ultimate draws on reserves were much less than planned at the outset of the

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pandemic. Fitch expects the state to similarly make use of its very strong gap-closing capacity, supported by its solid, reinstated reserve position, during future cyclical downturns.

Budgeting can be challenging, in part due to the spending pressures noted earlier for education and growth needs, and a statutory mandate that the budget show projected balance over the four-year Budget Outlook period rather than just the current biennium. Positively, the state took advantage of growth leading into the pandemic to rebuild financial flexibility, primarily by adding steadily to reserves.

The state has solid funding provisions for its BSA, which supports financial flexibility. This constitutional account receives the first 1% of revenues collected every year, until it reaches its cap of 10% of annual general revenues. Furthermore, 75% of extraordinary growth in state revenue (defined as growth in general state revenues that exceed by one-third the average biennial growth rate of the prior five biennia) must be transferred to the BSA on top of the 1%. This measure also serves to limit the effect of revenue volatility on the operating budget. The new WRPTA provides an additional source of fiscal reserves, with less restrictions on accessing it than the BSA. Given its flexibility, Fitch currently considers WRPTA a component of the state's budgetary reserves.

Washington's initiative and referendum environment creates a level of operating and financial uncertainty. However, it is significant that any law approved by voters in this manner can be amended or repealed by the legislature by a two-thirds vote in the first two years after approval and by a simple majority thereafter. The legislature repeatedly has shown the ability and willingness to suspend initiatives. The state constitution may not be amended by initiative or referendum.

## ESG Considerations

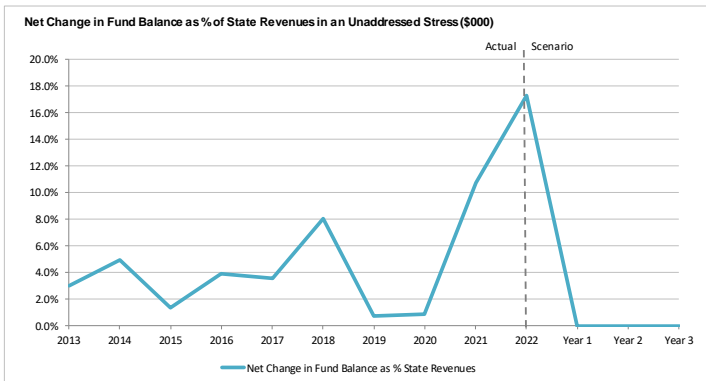
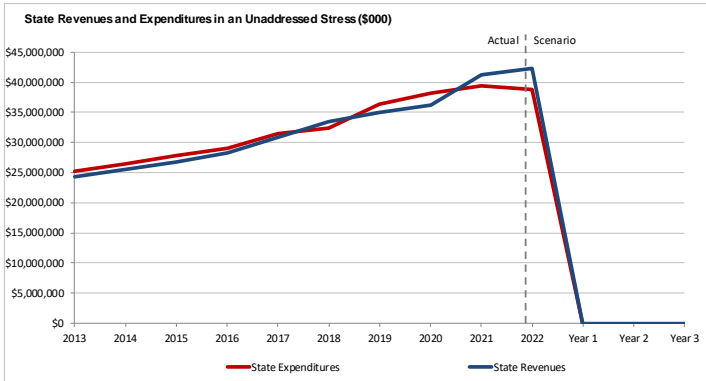
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Washington, State of (WA)

Scenario Analysis

Ver 38

Run FAST Modell



Analyst Interpretation of Scenario Results

Frequent reviews of economic and financial forecasts allow the state to respond effectively to changing conditions. During the Great Recession and the recent pandemic-driven downturn, the state demonstrated its willingness and ability to utilize broad budget flexibility in response to revenue volatility. In fiscal 2009 through fiscal 2011, the state implemented a combination of ongoing and one-time actions, and fully depleted accumulated reserves that took almost a decade to rebuild. In 2020, the state implemented spending cuts and planned reserve draws, though the ultimate draws on reserves were much less than planned at the outset of the pandemic. Fitch expects the state to similarly make use of its very strong gap-closing capacity, supported by its solid, reinstated reserve position, during future cyclical downturns.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)			
Expenditure Assumption (% Change)			
Revenue Output (% Change)	Minimum Y1 Stress: -1% Case Used: Moderate		

Revenues, Expenditures, and Net Change in Fund Balance	Actuals										Scenario Output		
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Year 1	Year 2	Year 3
<b>Expenditures</b>													
Total Expenditures	37,111,000	39,553,000	42,571,000	44,146,954	46,876,157	47,989,794	52,338,056	55,661,482	63,132,310	66,536,632			
% Change in Total Expenditures	2.3%	6.6%	7.6%	3.7%	6.2%	2.4%	9.1%	6.3%	13.4%	5.4%			
State Expenditures	25,222,000	26,385,000	27,859,000	29,113,421	31,506,179	32,343,483	36,374,765	38,221,995	39,392,543	38,812,757			
% Change in State Expenditures	3.4%	4.6%	5.6%	4.5%	8.2%	2.7%	12.5%	5.1%	3.1%	(1.5%)			
<b>Revenues</b>													
Total Revenues	36,250,000	38,649,000	41,399,000	43,294,691	46,269,050	49,114,776	50,993,434	53,683,175	64,976,549	70,038,802			
% Change in Total Revenues	5.3%	6.6%	7.1%	4.6%	6.9%	6.2%	3.8%	5.3%	21.0%	7.8%			
Federal Revenues	11,889,000	13,168,000	14,712,000	15,033,533	15,369,978	15,646,311	15,963,291	17,439,487	23,739,767	27,723,875			
% Change in Federal Revenues	(0.1%)	10.8%	11.7%	2.2%	2.2%	1.8%	2.0%	9.2%	36.1%	16.8%			
State Revenues	24,361,000	25,481,000	26,687,000	28,261,158	30,899,072	33,468,465	35,030,143	36,243,688	41,236,782	42,314,927			
% Change in State Revenues	8.2%	4.6%	4.7%	5.9%	9.3%	8.3%	4.7%	3.5%	13.8%	2.6%			
<b>Excess of Revenues Over Expenditures</b>	(861,000)	(904,000)	(1,172,000)	(852,263)	(607,107)	1,124,982	(1,344,622)	(1,978,307)	1,844,239	3,502,170			
<b>Total Other Financing Sources</b>	1,601,000	2,165,000	1,524,000	1,948,380	1,707,652	1,567,704	1,608,643	2,293,902	2,572,586	1,920,625	1,992,692	2,077,690	2,171,499
<b>Net Change in Fund Balance</b>	740,000	1,261,000	352,000	1,096,117	1,100,545	2,692,686	264,021	315,595	4,416,825	7,318,369			
% Total Expenditures	2.0%	3.2%	0.8%	2.5%	2.3%	5.6%	0.5%	0.6%	7.0%	11.0%			
% State Expenditures	2.9%	4.8%	1.3%	3.8%	3.5%	8.3%	0.7%	0.8%	11.2%	18.9%			
% Total Revenues	2.0%	3.3%	0.9%	2.5%	2.4%	5.5%	0.6%	0.6%	6.8%	10.4%			
% State Revenues	3.0%	4.9%	1.3%	3.9%	3.6%	8.0%	0.8%	0.9%	10.7%	17.3%			

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. For further details, please see Fitch's US Tax-Supported Rating Criteria.

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