STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

Research

Washington; Federal or State Grant Programs

Primary Credit Analyst:
Mary Ellen E Wriedt, San Francisco (1) 415-371-5027; maryellen.wriedt@standardandpoors.com

Secondary Contact:
Anita Pancholy, Dallas (1) 214-871-1402; anita.pancholy@standardandpoors.com

Table Of Contents

1565870 | 300642892

Washington; Federal or State Grant Programs

Credit Profile		
Washington State of Washington GARVEE prog		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA' long-term rating on Washington's $724 million series federal highway grant anticipation revenue (GARVEE) bonds outstanding. The outlook is stable.

The rating reflects our view of good future debt service coverage (DSC) based on historical federal grant receipts, and a sound bond structure. All federal highway revenues that the state receives under the Federal-Aid Highway Program (FAHP) administered by the Federal Highway Administration (FHWA) are pledged to the payment of the bonds.

The rating also reflects our opinion of the following credit strengths:

- Strong maximum annual debt service (MADS) coverage of the bonds at 6x based on the federal fiscal 2015 obligation authority (OA), along with essentially level annual debt service requirements;
- A memorandum of understanding (MOU) between the state and FHWA that approves the use of federal aid for debt service;
- Good bond provisions, including a sound additional bonds test requiring the eligible OA the state received in one of the two most recent federal fiscal years to be 3.50x MADS on outstanding and proposed bonds, as well as a more restrictive state policy that includes a 3.75x multiple for additional debt; and
- Generally positive trends in OA and receipts of Title 23 federal aid money, as well as the state's track record of maximizing federal grants and effectively managing the grant reimbursement process.

In our view, partially offsetting the preceding credit strengths is the narrow pledge of federal transportation funds to the state, combined with a possible drop in revenues resulting from a decline in funds from the Highway Trust Fund (HTF) or in Congress-appropriated amounts, changes to the FAHP, or delays to congressional reauthorization.

A direct pledge of all FAHP funds paid to the state secures the GARVEEs. The bonds were issued to finance a portion of the costs of the state's state route (SR) 520 project. The state's GARVEE bonds have to have a final maturity of Sept. 1, 2024.

OA (including redistributions) grew to $671 million in federal fiscal 2010, before decreasing slightly to $649 million in federal fiscal 2011, then declining further to $619.3 million in fiscal 2012. OA was essentially flat in federal fiscal 2013 at $620 million, and increased in federal fiscal 2014 to $631 million and in federal fiscal 2015 to $638 million. Actual reimbursements were $813 million in fiscal 2012, $845 million in federal fiscal 2013, $904 million in federal fiscal 2014, and $753 million in fiscal 2015.

Coverage of the state's GARVEE bonds MADS is strong, in our view, at 6x based on federal fiscal 2015 OA of $638 million. MADS is approximately $100 million; debt service is basically level. No additional debt is planned. DSC will likely remain strong, in our opinion, even with reductions in federal receipts. We view the bond provisions as good for a stand-alone GARVEE structure; these include a supportive legal framework provided by the enabling legislation, the MOU, and a master bond resolution.

The rating on these GARVEE bonds, like all other GARVEE ratings we maintain, assumes that the supportive legislative framework and Congressional appropriations funding transportation grant programs will continue into the future through the enactment of multiyear authorizations or continuing temporary extensions. This assumption is based on historical precedent, our view of the political and economic importance of national highway and mass transit systems, the broad historical bipartisan political support for transportation spending programs at all levels of government, and Congress' track record of continuing appropriations and extensions to budget authorizations when they expire.

The most recent highway transportation legislation, Fixing America's Surface Transportation (FAST) Act, took effect Dec. 4, 2015, and authorizes federal funding through federal fiscal 2020. We believe the FAST Act generally supports the sector's credit quality due to a longer period of funding certainty and increased funding levels. The multiyear legislation will provide approximately $230 billion for highways, $60 billion for public transportation, $10 billion for passenger rail, and $5 billion for highway safety programs. This is an approximately 11% increase from current funding levels over five years. Furthermore, FAST provides a 5.1% increase in highway fund distributions to states for fiscal 2016, and growth rates of 2.1% to 2.4% thereafter. Previous funding growth rates were lower, and until the FAST Act, Standard & Poor's had cited federal budget deficits as a concern affecting highway funding levels.

Standard & Poor's ratings in this sector range from 'A-' to 'AA' where only federal funding is pledged, and as high as 'AAA' where state agencies blend the federal funding with an additional pledge of state funding. We base the relatively strong ratings in this sector on the issuer's pledge of the HTF grants from the federal government. Overall, we believe, the FAST Act's signing confirms Standard & Poor's views of ongoing and widespread Congressional support for preserving and expanding the national highway system. States and local transportation agencies that receive distributions from the HTF can confidently move forward with complex multiyear transportation projects because the questions surrounding federal funding no longer loom. Nevertheless, we carefully evaluate the risks to state programs that leverage these funds, including the timing of receipts, level of funding, and erosion in dollars either due to lower authorized or appropriated levels or programmatic changes that negatively affect recipients. We will continue to monitor the sector to evaluate how each individual state issuer might adjust its debt or capital spending plans, given the new law.

Although reauthorization risk cannot be completely eliminated, it has been minimized through conservative financial structures inherent in all rated GARVEE transactions, which have resulted in the relatively high ratings on these transactions. This includes the use of back-up credit support, debt service reserves, robust DSC levels, shorter final maturities, and restrictive additional debt provisions. In addition, many nonquantitative credit factors influence the rating, such as funding mechanics and timing; evaluation of state processes for managing and administering the program; history of federal receipts and volatility; each state's donor status, underlying economy, and transportation needs; and each state's respective political representation and congressional influence.

In addition to applying our "Methodology And Assumptions: Rating U.S. Federal Transportation Grant-Secured

Obligations" criteria, we also are applying our "USPF Criteria: Federal Future Flow Securitization, March 12, 2012" criteria to determine the maximum possible rating level relative to the U.S. debt rating because Washington's GARVEE bonds are solely secured by federal aid cash flows. Our application of such criteria on Washington's GARVEE program resulted in an overall score of '1.2.', indicating that the maximum possible rating level is 'AA', one notch below the U.S. debt rating.

Outlook

The stable outlook reflects our expectation that we will not raise or lower the rating over our two-year horizon. Specifically, we expect that the long-standing FAHP will continue to receive significant funding and that Washington will receive its historical share of annual Title 23 distributions. The outlook also reflects our expectation that federal reimbursement revenue will continue to provide strong DSC on the state's GARVEE debt.

Upside scenario

While unlikely, we could raise the Washington GARVEE rating if the U.S. debt rating is raised and we expect Washington's coverage based on pro forma MADS will remain strong.

Downside scenario

If the U.S. debt rating is lowered or the outlook revised to negative, we would lower the rating or revise the outlook on the Washington GARVEE rating accordingly. In addition, a significant decline in coverage based on pro forma MADS could also lead to a negative rating action.

Bond Terms

The security for the bonds is a pledge of all funds received by the state pursuant to its OA under the FAHP, including direct GARVEE reimbursements pursuant to the MOU with the FHWA, and reimbursements of all FAHP funds on deposit in the state's Motor Vehicle Fund (MVF), which are reimbursements for projects or portions of projects not financed with GARVEE bond proceeds. Funds for the GARVEE debt service are obligated first in each federal fiscal year, and the Washington State Department of Transportation (WSDOT) will de-obligate funds on existing programmed projects and re-obligate those for the GARVEE debt service if necessary. If direct GARVEE reimbursements are not received by the payment date, reimbursements on deposit in the MVF will be used.

The resolution includes an additional bonds test that requires that OA during one of the two prior federal fiscal years be at least 3.5x MADS, which Standard & Poor's considers to be stronger than the more standard 3.0x multiple. The state finance committee has also implemented a more restrictive policy increasing that multiple to 3.75x, which Standard & Poor's views favorably.

Under the terms of the MOU with the FHWA, the elements of the SR 520 project are authorized and approved as advance construction projects under Title 23, Section 115 of the U.S. Code. The conversion of advance construction to OA will be the first obligation in the federal fiscal year of pledged federal aid legally available funds. WSDOT will not obligate pledged federal aid for any other federal aid projects until advance construction is obligated. Under the MOU, WSDOT may bill the FHWA at least seven days prior to the scheduled debt service payment date. Additional GARVEE bonds are not currently authorized for any projects other than the SR 520 project.

Related Criteria And Research

Related Criteria

- USPF Criteria: Methodology And Assumptions: Rating U.S. Federal Transportation Grant-Secured Obligations, May 29, 2009
- USPF Criteria: Federal Future Flow Securitization, March 12, 2012
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009