FitchRatings

State of Washington

The State of Washington's 'AA+' Long-Term IDR and GO bond ratings reflect its broad and growing economy, with solid long-term revenue growth prospects, and demonstrated commitment to fiscal balance and long-term liabilities that place a low burden on resources. The ratings also incorporate the state's very strong financial resilience, which is supported by a statutory requirement for a balanced four-year budget and formulaic funding of the budget stabilization account (BSA), which has led to the accumulation of solid reserves. Education poses continued spending pressure for the state given steady population growth and the state's role as the primary funding source for K-12 schools.

Ratings

Long-Term IDR	AA+

Outlooks

Long-Term IDR	Stable

New Issues

$829,935,000 Various Purpose General Obligation Bonds, Series 2025A	AA+
$208,390,000 Motor Vehicle Fuel Tax and Vehicle Related Fees General Obligation Bonds, Series 2025B	AA+
$45,180,000 General Obligation Bonds, Series 2025T (Taxable)	AA+
$286,580,000 Various Purpose General Obligation Refunding Bonds, Series R-2025A	AA+

Sale Date

June 25, 2024

Outstanding Debt

General Obligation Bonds	AA+
General Obligation Motor Vehicle Fuel Tax Bonds	AA+
General Obligation Motor Vehicle Fuel Tax & Vehicle Related Fees Bonds	AA+
School District Credit Enhancement Program	AA+

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria - Effective from May 4, 2021 to April 2, 2024

Related Research

Fitch Rates State of Washington's $1.4 Billion GOs 'AA+'; Outlook Stable (June 2024)

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Key Rating Drivers

Revenue Framework - 'aaa'

Revenue performance over time has exceeded U.S. GDP growth, and Fitch expects this to continue to support strong 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 possesses ample expenditure flexibility, with statutory commitments, broad responsibility for education and infrastructure spending offset by low carrying costs. Washington also benefits from the broad expense-cutting authority common to most U.S. states. Washington's spending growth, absent policy actions, will likely be marginally above its solid revenue growth, requiring regular budget management to ensure ongoing balance.

Long-Term Liability Burden - 'aaa'

The combined burden of debt and net pension liabilities is low as a percentage of personal income but above the median for U.S. states. 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 and budget flexibility with solid reserves. The state has prudently built up its fiscal reserves in times of economic recovery and expansion despite spending pressures linked to education and other pressing needs.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

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

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Ability to sustain formal reserves, other than those in ending general fund balance, to at least pre-pandemic levels;
- Long-term management of expenditure growth pressures, particularly of education costs obligated to the general fund.

Economic Resource Base

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

IDR Current Developments

Economic Recovery Outpaces National Levels

Washington's post-pandemic job rebound has exceeded national trends. Early in the pandemic, Washington's labor market suffered a less severe decline than the nation's with 11.8% of the state's jobs lost between February and April 2020, versus 15% nationally. Employment in Washington as of April 2024 was 3.9% higher than pre-pandemic levels, on par with the average national employment recovery of 3.4% and well above the median rate of 2.7%.

Washington's headline unemployment rate of 4.8% in April 2024 was slightly above the 3.9% U.S. rate for the same month, which is consistent with the differential between the two rates just prior to the pandemic. Washington's labor force growth has also slightly exceeded national trends, reflecting the state's ongoing economic expansion. The state's employment to population ratio (EPOP, a measure of labor force utilization) was 60.7% as of April 2024, nearing the February 2020 level of 62.8%. The national EPOP of 60.2% in April 2024 still lags the national February 2020 level of 61.2%.

Washington Fiscal Update

Conservative revenue forecasting and sophisticated budgeting practices enabled Washington to prudently navigate uncertain, yet ultimately favorable, economic conditions over the past four years. State reserves, particularly general fund balance, grew to unprecedented levels as state revenues were propelled through the pandemic era by, among other factors, unexpectedly high price growth. As economic growth slows to a still-strong annual pace of 3%-4%, Washington's four-year budget outlook currently brings online new broad-based programs across priority areas of health, education, transportation and the environment, initiatives partially funded through significant drawdowns of general fund balance. Fitch expects the state to maintain a solid reserve position, continuing to build its Budgetary Stabilization Account (BSA) by employing its very strong gap-closing capacity.

In addressing pandemic-era uncertainty, Washington also reshuffled its reserve position. Washington entered the pandemic with formal reserves in its BSA of $1.6 billion (7% of annual NGF revenues). By fiscal 2021, the state drew down almost all of its BSA, to just $19 million, while building up a new Washington Rescue Plan Transition Account (WRPTA) to $1 billion. Washington also grew its general fund balance to an unprecedented $6.3 billion by fiscal 2022. Total available funds grew to a new high of $8 billion (24% of NGF revenues) in fiscal 2023, with $2.7 billion (8%) of that amount formally reserved in either the BSA ($652 million) or WRPTA ($2.1 billion).

Washington is nearing the midpoint of it 2023-2025 biennium. As of its April 2024 Enacted Budget Outlook, which harmonizes the February 2024 revenue forecast with the enacted 2024 supplemental budget, the state budgeted to draw down its general fund balance to only $100 million by the end of the 2025–2027 biennium. In the same period, formal reserves are budgeted to decrease to $2.1 billion (6%) by fiscal 2027, a $600 million decrease from $2.7 billion in fiscal 2023. The WRPTA is now budgeted to be fully drawn down by the end of fiscal 2025, two years earlier than previously budgeted. Notably, the 2024 supplemental budget maintains progress on rebuilding the BSA, adding $1.4 billion to $2.1 billion. The state's latest revenue report, in June 2024, is essentially unchanged from April, with tracked revenues coming in only 0.1% above the February 2024 forecast.

Credit Profile

Revenue Framework

Fitch expects strong revenue growth that outpaces national GDP, reflecting favorable cyclical trends that are buttressed by the state's ongoing population growth and economic expansion. Recent implementation of capital gains taxes and a cap and trade regime appear to improve the state's growth prospects for revenues.

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

Washington lawmakers have recently created two crucial new revenue streams outside the general fund. The 2021 passage of ESSB 5096, along with subsequent court victories, helped the state effectuate a new 7% tax on certain capital gains over $250,000, beginning in fiscal 2023. Capital gains receipts are not general fund revenues, and are only available for state education needs. This new revenue source is projected to generate over $200 million annually to the Education Legacy Trust Account (ELTA).

In CY 2023, the state began implementation of its Climate Commitment Act (CCA), including a carbon emissions cap and trade (or cap and invest) system with some emissions allowances auctioned quarterly by the state to generate revenues. CCA proceeds are to be used for clean energy transition and assistance, clean transportation and climate resiliency projects. The state generated $1.8 billion over four auctions in CY 2023, far surpassing original estimates of $360 million annually.

Both of these new revenue sources face repeal via November 2024 ballot measures. Initiative 2109 would repeal the capital gains tax, and Initiative 2117 would repeal the state's cap and trade regime. Successful passage of either measure could impair the state's medium-term ability to raise revenues, though Fitch notes that as discussed below, Washington's legislature has the ability to amend or repeal initiatives approved by voters.

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. Washington provides essentially full basic operational funding for K–12 school districts. Since the 2011–2013 biennium, K–12 state funding has more than doubled. Local districts can also levy their own taxes to supplement state aid. The maintenance of the capital gains tax for education may improve the prospects for education-related revenue growth relative to education spending.

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 ample expenditure flexibility. While Medicaid costs are beyond the state's ability to materially change given federal requirements for the program, the state's carrying costs for long-term liabilities have decreased relative to expenditures, and the state retains the broad expense-cutting ability common to most U.S. states. Like most states, Washington's operating budget (outside of Medicaid) goes largely toward funding of services rather than direct service delivery, allowing it to shift costs to lower levels of government in times of fiscal stress. This is true even for education spending, as the state transfers 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 4.0% of personal income in fiscal 2022, was in line with the 4.0% median for U.S. states (see Fitch's "2023 State Liability Report [Post-Pandemic Asset Surge Lowers Pension Burdens]," dated Nov. 15 2023) and still low overall. This ratio increased to 4.5% for Washington in fiscal 2023.

Debt levels are twice the state median, reflecting the demands of strong population growth. However, pension liabilities are well below the median. Fitch expects the combined burden to remain at similar levels, despite large capital needs, given rapid 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 vehicle titling and registration fees. Tolls are also utilized as part of the funding solution.

In its 2022 session, the legislature adopted the Move Ahead Washington revenue package that allocated $16.9 billion over 16 years toward 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 taxes, 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 its long-term liability calculation, as it considers the recent advance to be a short-term issue affecting only a minimal portion of the contingent liability and does not believe it is 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. Washington has significantly improved its resilience since the Great Recession and the recent pandemic-driven downturn, demonstrating its willingness and ability to utilize its broad gap-closing capacity in response to revenue volatility.

During the Great Recession, the state implemented a combination of ongoing and one-time actions that fully depleted reserves. Washington then took almost a decade to rebuild its reserves, reaching then-record levels by fiscal 2019. While the state implemented spending cuts and reserve draws at the outset of the pandemic, Washington ended fiscal 2020 with reserves much less diminished than anticipated. Reserves then increased further in fiscal 2021 and 2022 to reach double pre-pandemic levels.

Washington's April 2024 Enacted Budget Outlook projects the fiscal 2023-2025 biennium to see continued increases in recurring revenues outstripped by growing appropriations to fund mostly one-time expenditures in education and social services. Fitch anticipates that, absent unknown revenue or expense shocks, the state will be able to significantly mitigate projected out-year funding gaps while modestly drawing on available general fund balances, and building formally designated reserves.

Budgeting can be pressured in part due to ongoing education and growth needs, as well as a statutory mandate that the budget show projected balance over the four-year budget outlook period, rather than just the current biennium. While the state began taking advantage of the end of the pandemic to rebuild formal fiscal reserves after a drop in fiscal 2021, the governor's proposed 2024 supplemental budget empties the WRPTA while continuing to build the BSA, somewhat setting back the maintenance of formal reserves at pre-pandemic levels by a couple years.

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 above-mentioned 1%. This measure serves to limit the effect of revenue volatility on the operating budget. The WRPTA provides an additional source of fiscal reserves, with less restrictions on accessing it than the BSA. Given its flexibility, Fitch considers the WRPTA to be a component of the state's budgetary reserves, while recognizing that the fund was constructed to be rapidly drawn down.

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.

Peer Analysis

Washington’s economic peers, or states within similar GDP decile, are Georgia ('AAA'/Stable), Ohio ('AAA'/Stable), Pennsylvania ('AA'/Stable), and New Jersey ('A+'/Stable). The state's growth prospects are favorable to most of its peers, which are generally slower-growth economies. The liability burden and carrying costs for Washington are roughly middle-of-the-pack for its peer group, reflecting the offsetting dynamics of strong resource base gains and sizable infrastructure demands from that growth. The state's operating performance is not assessed as strong as Georgia and Ohio, but materially better than Pennsylvania and New Jersey.

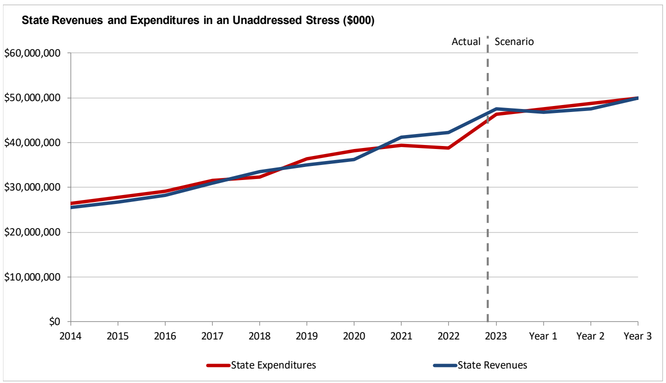
ESG Considerations

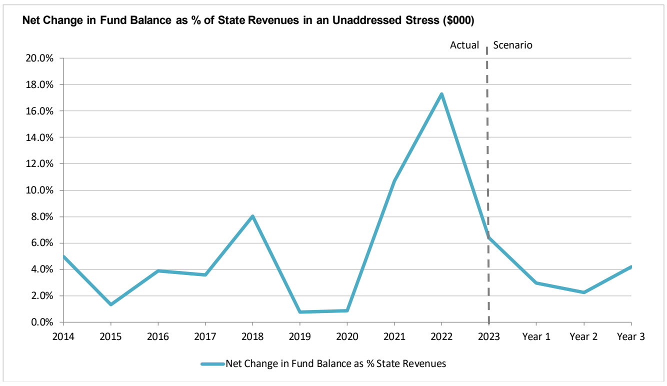
The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, due to either their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

Washington, State of (WA)

Scenario Analysis

Ver 42





Analyst Interpretation of Scenario Results

The Fitch Analytical Stress Test (FAST) model indicates that Washington's main revenue sources exhibit relatively low volatility and would decline by an estimated 1.5% in the event of a 1% decline in U.S. GDP, as modeled by FAST under the standard recession scenario. As per FAST output, Washington's state-source revenues would fully recover by year 2 of the scenario. Washington's 1.5% decline scenario is low compared to the U.S. states' median decline of -2.9%, calculated by Fitch. FAST is not a forecast, but represents Fitch's estimate of possible revenue behavior in a downturn based on historical revenue performance. Actual revenue declines will vary from FAST results, which provide a relative sense of the risk exposure of a particular state compared to other states

Scenario Parameters:			Year 1	Year 2	Year 3
GDP Assumption (% Change)			(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)			2.5%	2.5%	2.5%
Revenue Output (% Change)	*Minimum Y1 Stress:* -1%	*Case Used:* **Moderate**	(1.5%)	1.7%	4.8%

Revenues, Expenditures, and Net Change in Fund Balance	Actuals										Scenario Output		
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Year 1	Year 2	Year 3
Expenditures													
Total Expenditures	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	73,596,985	75,436,910	77,322,832	79,255,903
% Change in Total Expenditures	6.6%	7.6%	3.7%	6.2%	2.4%	9.1%	6.3%	13.4%	5.4%	10.6%	2.5%	2.5%	2.5%
State Expenditures	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	46,340,388	47,498,898	48,686,370	49,903,529
% Change in State Expenditures	4.6%	5.6%	4.5%	8.2%	2.7%	12.5%	5.1%	3.1%	(1.5%)	19.4%	2.5%	2.5%	2.5%
Revenues													
Total Revenues	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	74,819,273	74,779,219	76,250,990	79,261,333
% Change in Total Revenues	6.6%	7.1%	4.6%	6.9%	6.2%	3.8%	5.3%	21.0%	7.8%	6.8%	(0.1%)	2.0%	3.9%
Federal Revenues	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	27,256,597	27,938,012	28,636,462	29,352,374
% Change in Federal Revenues	10.8%	11.7%	2.2%	2.2%	1.8%	2.0%	9.2%	36.1%	16.8%	(1.7%)	2.5%	2.5%	2.5%
State Revenues	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	47,562,676	46,841,207	47,614,528	49,908,959
% Change in State Revenues	4.6%	4.7%	5.9%	9.3%	8.3%	4.7%	3.5%	13.8%	2.6%	12.4%	(1.5%)	1.7%	4.8%
Excess of Revenues Over Expenditures	(904,000)	(1,172,000)	(852,263)	(607,107)	1,124,982	(1,344,622)	(1,978,307)	1,844,239	3,502,170	1,222,288	(657,691)	(1,071,842)	5,430
Total Other Financing Sources	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	1,812,053	2,041,562	2,128,146	2,094,994
Net Change in Fund Balance	1,261,000	352,000	1,096,117	1,100,545	2,692,686	264,021	315,595	4,416,825	7,318,369	3,034,341	1,383,871	1,056,303	2,100,424
% Total Expenditures	3.2%	0.8%	2.5%	2.3%	5.6%	0.5%	0.6%	7.0%	11.0%	4.1%	1.8%	1.4%	2.7%
% State Expenditures	4.8%	1.3%	3.8%	3.5%	8.3%	0.7%	0.8%	11.2%	18.9%	6.5%	2.9%	2.2%	4.2%
% Total Revenues	3.3%	0.9%	2.5%	2.4%	5.5%	0.5%	0.6%	6.8%	10.4%	4.1%	1.9%	1.4%	2.6%
% State Revenues	4.9%	1.3%	3.9%	3.6%	8.0%	0.8%	0.9%	10.7%	17.3%	6.4%	3.0%	2.2%	4.2%

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.

SOLICITATION & PARTICIPATION STATUS

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.

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