S&P Global Ratings

RatingsDirect®

Washington; Appropriations; General Obligation

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Long Term Rating	AA/Positive	Affirmed
Washington		
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Washington (Washington St Toll Facs) GO		
Long Term Rating	AA+/Positive	Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'AA+' long-term and underlying ratings on the state of Washington's general obligation (GO) bonds, motor vehicle fuel tax GO bonds, and motor vehicle fuel tax and vehicle-related fees GO bonds outstanding, based on the application of its "Methodology For Rating U.S. Governments," published Sept. 9, 2024, on RatingsDirect.
- At the same time, we affirmed our 'AA' rating on the state's appropriation-backed debt outstanding.
- The outlook on all ratings is positive.

Security

Our rating on the state's GO bonds reflects Washington's full faith, credit, and taxing powers. The motor vehicle fuel tax and vehicle-related fees GO bonds are further secured and expected to be paid by motor vehicle fuel tax and vehicle-related fees.

We rate the state's appropriation-backed debt obligations one notch lower than our rating on Washington to reflect the service contract and lease payments appropriated by the state legislature for these bonds.

Credit overview

Amidst an evolving economic landscape over the last four years, Washington's financial management has remained resilient and its combined reserves have been preserved at solid levels, which we expect to continue moving forward. The state's robust management practices and forecasting have benefited it in tracking potential budgetary pressures, and we view its statutory mechanisms to ensure budgetary balance in out-years as prudent. We expect that the state's debt burden will remain at current levels for the foreseeable future, but given its strong pension funding, its collective liabilities should remain manageable, in our view. The GO rating also reflects our view of the state's limited formal reserve levels, which sets it apart from higher-rated peers. We will continue to monitor the state's commitment to its informal reserve targets, as well as its budgetary balance, as it prepares its next biennial budget.

This spring, the state enacted its 2024 supplemental budget, which serves as a tool to make adjustments to the enacted 2023-25 biennial budget. The state's biennial budget increased by a net $2.1 billion from the originally enacted budget, and now totals about $71.5 billion. The increases were largely driven by kindergarten through 12th grade (K-12) education, behavioral health programs, and health care caseload increases. The state plans to use a portion of reserves built up since the last biennium to fund key priorities, including behavioral health, educational staffing, supplies, special education, and caseload increases. Some of the reserves being used are from the Washington Rescue Plan Transition Account (WRPTA), which is intended to help the state navigate effects from the COVID-19 pandemic and wind down activities related to it.

Based on the enacted 2024 supplemental budget, Washington is projected to have $1.3 billion in its budget stabilization account (BSA), or 3.9% of fiscal 2025 near general fund-state (NGF-S) revenue, at biennium-end. In addition, the state's near-general fund (GF) ending balance is expected to be $2.4 billion, for a combined total of 10.8% of fiscal 2025 NGF-S revenue when added to the BSA. The state has informally targeted its combined reserves at 10% of NGF-S revenues in recent years, which it has adhered to through the current biennium, including supplemental appropriations. We view the state's commitment to preserving combined reserves at healthy levels through the current biennium as a positive credit factor, and we expect the state to continue balancing its revenues with ongoing operational needs in its upcoming biennial budget, which is an imperative factor in Washington's credit profile.

The state has two ballot initiatives in November 2024 that would alter recent changes to its finances. Specifically, these are voter initiatives to repeal Washington's cap-and-trade program, authorized by its Climate Commitment Act, and another to repeal its newly instituted capital gains tax. Both have generated significant revenues in recent years and could pose budgetary pressures absent any corresponding expenditure adjustments by the state. The state's 2024 supplemental budget delayed expenditure authority in certain funds to help navigate the potential budgetary impacts if these ballot measures were to pass. Overall, we believe Washington's proactive financial management and balanced budget requirements would position it well to navigate a potential repeal of these revenue streams, but note that their effects would be felt most acutely outside of the general fund given how these revenues are currently disbursed.

S&P Global Rating's latest economic forecast includes steady U.S. real GDP growth of 2.5% in 2024, and still expects the economy to transition to below-potential growth over the next couple of years. We forecast real GDP growth to be 1.7% in 2025 and 1.8% in 2026. We also now anticipate the Federal Reserve will begin reducing rates in September. For more information, see "Economic Outlook U.S. Q3 2024: Milder Growth Ahead," published June 24, 2024, and "A Cooling U.S. Labor Market Sets Up A September Start for Rate Cuts," published Aug. 6, 2024. Looking ahead, S&P Global Market Intelligence forecasts Washington's GSP growth to be above the nation's between 2024 and 2027, consistent with its historical performance.

Based on the state's most recent monthly economic and revenue update produced by the Economic and Revenue Forecast Council (ERFC) through early August 2024, the state's cumulative total general fund-state collections through early August were 0.5% lower than forecasted. Primary drivers included the state's retail sales tax collections and business and occupation (B&O) tax collections, which decreased 2.9% and 2.8% year over year, respectively. The auto sector was a significant factor in the decreased collections, and five of the eleven retail trade sectors recognized negative year-over-year payment growth. We believe the state's experience reflects its consumption-based structure, which has been fueled by inflationary effects in recent years, and is now recognizing a normalization following significant revenue growth.

The GO rating reflects our view of Washington's:

- Resilient and diverse economic base, with comparatively strong GSP and income figures;
- Sales tax-based revenue structure, which has demonstrated less sensitivity to economic cycles than income tax-reliant states;
- Sophisticated financial policies and proactive management practices, including statutory provisions requiring that the state's biennial budget and projected subsequent two fiscal years' spending plans be balanced;
- Strong pension funding, leading to low unfunded retirement liabilities, with the expectation for this to continue moving forward;
- Somewhat higher debt profile that we consider manageable, and that we expect will remain steady over the medium term; and
- An institutional framework that supports the predictability of the state's budgeting and operations, in our view, and demonstrates fiscal transparency through regular reporting of key financial information.

Washington's GO bonds are eligible to be rated above the sovereign because we believe the state can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013), U.S. states are considered to have moderate sensitivity to country risk. The institutional framework in the U.S. is predictable, with significant state autonomy and flexibility demonstrated by serial bond amortization as well as independent treasury management.

Environmental, social, and governance

While the state is exposed both to rising sea levels along its vast coastline and to risk of wildfires in its expansive forests, we believe physical factors are credit-neutral and mitigated by Washington's long-term planning and practices. The state has integrated considerations of a changing climate into its planning and decision-making processes, including multiple state agencies studying the effects of climate change on their areas of focus, and the Washington state ERFC preparing an annual climate study. In recent years, the state has also adopted legislation addressing climate change, including programs to reduce energy emissions. Washington's social and governance factors have an overall neutral influence in our credit analysis.

Outlook

The positive outlook reflects our expectation that there is a one-in-three chance we could raise our rating over the next two years. We expect the state's strong budgetary management will continue to produce balanced operations and that the state will demonstrate its commitment to maintaining its combined reserves.

Downside scenario

We could revise our outlook to stable if, in the face of budgetary pressure, lawmakers delay taking corrective action or rely extensively on one-time solutions to remediate potential gaps. We also could lower the rating if the state opts to use available reserves, leading the state to fall below target levels.

Upside scenario

Should the state demonstrate strong budgetary performance, leading to reserves being maintained at or above current levels, we could raise the rating.

Credit Opinion

Institutional framework

Washington's statutory requirement to adopt a balanced budget and forecast balanced budgets in out-years, coupled with the state's financial management policies, encourages ongoing fiscal solvency and supports the state's predictability. Washington's voter-initiative environment complicates its predictability, as we view the voter initiatives as somewhat limiting the state's fiscal flexibility. However, the legislature's willingness and ability to set aside provisions of voter-approved initiatives when fiscal conditions warrant has proven beneficial to the state's credit quality, in our view. Initiatives may be amended with a two-thirds vote of the legislature within two years of passage and with a simple majority of the legislature thereafter. We have observed that the legislature has temporarily suspended initiatives regularly over the past decade.

The governor has the authority to make across-the-board reductions to spending allotments when a cash deficit in a particular fund is projected. However, the authority to impose disbursement reductions does not include allotments for basic education, pension benefits, or GO debt service. The state's Office of Financial Management monitors and makes recommendations about cash management activities to the governor. In addition, the state constitution allows Washington to raise taxes with a majority vote of the legislatures, but restricts it from levying an individual income tax. Finally, we believe the state's strong transparency is demonstrated through its timely annual audits, as well as its regular, comprehensive economic and revenue forecasting and monthly revenue collections tracking.

Management

We consider Washington's budget practices, long-term planning, and management policies to be comprehensive, well-defined in most areas, and institutionalized. The state's ERFC, which is made up of representatives appointed by the governor's office, both chambers of the legislature, and both major political parties, as well as the state treasurer, produces an analytical report on economic and revenue performance each month and, by statute, presents quarterly revenue forecasts covering the current and upcoming biennium. The state uses the council's forecasts to set revenue parameters at biennial budget adoption. Washington has a record of making budget adjustments within the biennium when the forecast council materially changes its projections. Beginning with the fiscal 2013-15 biennium, state law requires the legislature to balance not just the biennial budget, but also the spending and revenues anticipated for the subsequent two-year period. In addition, three times a year the state convenes a Caseload Forecast Council, which forecasts service requirements in areas such as public assistance, state corrections, medical assistance, and K-12 education. The executive and legislative branches use these forecasts, along with historical expenditures, to formulate budget proposals and mid-biennium revisions.

Further guiding budget decisions is a rolling, four-year general fund forecast maintained by the state's ERFC. Washington uses these forecasts to quantify the timing and scope of potential deficits in the subsequent biennium and, in some cases, to begin addressing imbalances before the next budget cycle begins. The state also budgets for capital spending on a biennial schedule but plans on a rolling, 10-year basis and includes funding sources.

Washington's constitution requires the state to set aside 1% of most unrestricted state revenues in each fiscal year into a BSA in the form of a rainy day fund. That fund can be tapped under a provision allowing the state to draw on the fund when employment growth falls below 1%, in the event of a catastrophic emergency, or by a 60% supermajority vote of the legislature. When the fund reaches 10% of estimated general state revenues in that fiscal year, the state can also draw excess funds for education capital projects. In November 2011, voters approved a measure requiring that three-quarters of extraordinary revenue growth (defined as the amount by which the growth in general state revenues for that fiscal biennium exceeds by one-third the average biennial percentage growth in general state revenues over the previous five biennia) be transferred to the BSA. A formal investment management policy covers eligible investments, maximum maturities (10 years), allocations of nongovernment securities, and internal and external controls. Washington's constitution currently limits maximum annual debt service (MADS) costs on various-purpose GO bonds to 8.25% of an historical average of general state revenue; this limit falls to 8% on July 1, 2034. The treasurer releases an annual debt and credit analysis that describes issuance trends and effective constraints on debt issuances, and uses demographic and financial indicators as well as peer analysis to inform the legislature on the state's debt obligations. The state uses a model to estimate debt capacity assuming 25-year amortization and level debt service.

Economy

We view Washington's economy as a notable credit strength, given its resilience and its real economic output, which often exceeds the nation's. Washington has experienced strong population growth over the last decade, contributing to its strong economic momentum and steady growth in both its incomes and GSP on a per capita basis. We believe these figures are illustrative of the state's strong economic profile, as well as its diverse employment base. The state's economic activity is largely driven by the information sector; trade, transportation, and utilities; financial activities; as well as professional and business services.

The state's quarterly June Economic and Revenue Forecast included little change compared to its February forecast. The state's economy has been affected by recent national trends, including elevated inflation, higher interest rates, and slowing employment growth. The state slightly revised its employment growth and personal income growth down for the current year and revised its expectations related to housing construction. However, employment and income figures are projected to be stronger in the out-years, beginning in 2025.

While export trade, particularly within and between Asia and North America, has been an economic strength, it can expose the state's economy to adverse effects of changes in trade policy, fluctuations in global economic performance, and demand dynamics in a strong dollar environment. Nevertheless, trade helps diversify Washington's prospects for growth through domestic economic cycles. The state has incorporated the effects of federal trade tariffs, for example, on its exports into its forecasting. Most recently, the state's exports from the second quarter 2023 to second quarter

2024 increased by 1.6%, primarily driven by petroleum and coal and agricultural product exports.

Financial performance, reserves, and liquidity

Across different gubernatorial administrations, when confronted with projected budget gaps the state's political leadership has demonstrated a willingness to consider difficult fiscal adjustments, including both expenditure and revenue measures. When deficits emerge midcycle, the state has generally responded with timely corrective actions. In addition, revenue projections are apolitical and are developed according to Washington's independent revenue forecasts.

Retail sales tax and business and occupation taxes together account for a combined 71% of general fund tax revenues and typically afford Washington with more revenue stability than other states, many of which rely on personal income tax revenues. Spending priorities are regularly evaluated through the state's "priorities of government" approach to zero-based budgeting. Independent formal revenue and caseload forecasts inform budget decisions, and political leaders have demonstrated a willingness to make difficult adjustments when necessary to target structural balance.

The state's lack of a formal minimum budget reserve policy has allowed low balances to persist through protracted periods of economic and revenue softness. However, during expansionary phases of the economic cycle, the state consistently returns operating surpluses and good budgetary reserve positions. Washington requires a three-fifths vote of the legislature to appropriate funds from its BSA, or a simple majority if the employment growth forecast for any fiscal year is estimated to be less than 1%.

Similar to many other states, significant spending areas in Washington's budget are largely nondiscretionary. We estimate that as much as two-thirds of spending is for education and health care. The 2012 McCleary decision, for example, pressured state spending by requiring higher state funding for K-12 school districts. However, in our opinion, this enhanced funding requirement has become a predictable aspect of the budgeting process after being incorporated into the state's budget over the last decade.

In our view, Washington has a very strong liquidity profile that has persisted throughout the pandemic and in the state's recovery. General fund cash flows generally fluctuate throughout the year based on timing of receipts. When general fund cash is negative, the state has access to cash for liquidity in its treasury and treasury trust funds, the former of which is subject to legislative appropriation. This cash is held in the custody of the state treasurer, who invests it on a commingled basis, and balances have grown notably, from over $6 billion in 2014 to roughly $19 billion in 2024. Overall, we view the state's internal liquidity sources as a strong additional support available for general fund budget operations, if needed. State authority to defer payments and to issue cash-flow notes, if needed, also serve as contingency liquidity measures.

Debt and liabilities

Washington has a somewhat higher debt burden than that of most state peers. However, we estimate that 32% of the state's GO-backed debt is supported first by pledged transportation revenues, including motor vehicle fuel taxes, vehicle-related fees, and tolls. Legal protections for Washington's GO debt include a specific constitutional requirement that the legislature make appropriations in the budget for the interest and principal installment payments on state debt. Although neither state statute nor the state constitution provides that debt service be a priority relative to other state payment obligations, no other payment obligation enjoys a specific requirement that an appropriation be made. In our view, this has the practical effect of providing debt service with a strong legal position among Washington's various payment obligations.

Offsetting a somewhat higher debt profile, Washington maintains well-funded pension systems, reflecting its strong funding practices. When determining the state's liabilities, we view in aggregate Washington's proportionate share of liabilities in its eight defined-benefit retirement systems administered by the Department of Retirement Systems (DRS), with five of the eight plans overfunded.

The plan representing the largest portion of the state's net pension liability (NPL) include:

- Public Employees Retirement System 1 (PERS 1): 80% funded with the state's NPL of $963 million.

While statutes require the Office of the State Actuary (OSA) to calculate an actuarially determined contribution (ADC), actual contribution levels across plans may not always meet it. With its biennial budget process, the state legislature appropriates pension contributions every two years. Although contributions have historically been set to equal the contractually required contribution, they have fallen short of the ADC because they are not adjusted after the budget is adopted. Adopted contribution levels for most plans have been different than the OSA's calculated ADC due to legislative actions, such as the 2014 legislature's adoption of contribution levels for several pension plans, which phased in increases over a relatively lengthy six-year period to incorporate certain changes to mortality assumptions.

Washington, through a state authority, administers a single-employer other postemployment benefits (OPEB) plan that is funded on a pay-as-you-go basis, with somewhat moderate liabilities, in our view. However, plan benefit limitations should help insulate the state from some volatility in health care costs. The state provides coverage through both an explicit and implicit subsidy. Retirees may purchase health insurance in the same pool as current employees at a subsidized rate. Specifically, the explicit benefit subsidizes retired members' monthly premiums up to $183 per member per month for enrollment in Medicare Parts A and B. In our view, this coverage limitation reduces Washington's exposure to rising and volatile health care costs. The plan's net OPEB liability (NOL) was $4.2 billion in fiscal 2023, or $546 per capita.

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Washington--Credit summary	
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Table 2

Washington--Key credit metrics	2024	2023	2022	2021
Economy				
State population ('000s)	--	7,818	7,788	7,747

Table 2

Washington--Key credit metrics (cont.)				
GSP per capita ($)	--	85,976	82,326	81,432
GSP per capita % of U.S.	--	130	127	127
State PCPI ($)	--	79,757	75,312	74,131
State PCPI % of U.S.	--	117	115	115
State unemployment rate (%)	--	4.1	4.1	5.2
Financial performance - S&P Global Ratings adjusted				
Operating fund revenues (mil. $)	39,254	38,066	35,378	30,265
Operating fund expenditures (mil. $)	34,386	33,563	29,374	26,429
Operating result (mil. $)	4,868	4,503	6,004	3,836
Operating result % of revenues	12.4	11.8	17.0	12.7
Reserves and liquidity - S&P Global Ratings adjusted				
Available reserves (mil. $)	6,635	7,256	7,316	3,782
Available reserves % of operating revenues	16.9	19.1	20.7	12.5
Debt and liabilities				
Net direct debt cost % of revenues	--	3.2	3.5	3.5
Pension and OPEB cost % of revenues	--	0.9	0.8	1.0
Total current cost % of total government revenues	--	4.1	4.3	4.5
Net direct debt (mil. $)	--	20,833	20,602	20,298
Net direct debt per capita ($)	--	2,665	2,645	2,620
Direct debt 10-year amortization (%)	--	58	58	55
Combined net pension liabilities (mil. $)	--	1,025	1,283	584
Net pension liabilities per capita ($)	--	131	165	75
Combined pension plan funded ratio (%)	--	104.8	104.0	119.0

GSP--Gross state product (real). PCPI--Per capita personal income. EBI--Effective buying income. OPEB--other postemployment benefits.
*Includes combined reserve balances, including $969M in BSA, $798 in WRPTA, and $4,868 in NGF-S Ending Balance for FY24.

Related Research

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

Ratings Detail (As Of September 20, 2024)		
Washington motor vehicle fuel tax and vehicle related fees GO rfdg bnds		
Long Term Rating	AA+/Positive	Affirmed
Washington var purp GO rfdg bnds		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Positive	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Positive	Affirmed

Ratings Detail (As Of September 20, 2024) (cont.)		
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
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Long Term Rating	AA+/Positive	Affirmed
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Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
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Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed

Ratings Detail (As Of September 20, 2024) (cont.)		
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
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Long Term Rating	AA+/Positive	Affirmed
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Long Term Rating	AA+/Positive	Affirmed
Washington GO		
Long Term Rating	AA+/Positive	Affirmed
Washington GO (AMBAC)		
Unenhanced Rating	AA+(SPUR)/Positive	Affirmed
Washington GO (MBIA)		
Unenhanced Rating	AA+(SPUR)/Positive	Affirmed
Washington GO (MBIA) (National)		
Unenhanced Rating	AA+(SPUR)/Positive	Affirmed

Ratings Detail (As Of September 20, 2024) (cont.)		
Washington GO (SYNCORA GTY)		
Unenhanced Rating	AA+(SPUR)/Positive	Affirmed
Many issues are enhanced by bond insurance.		