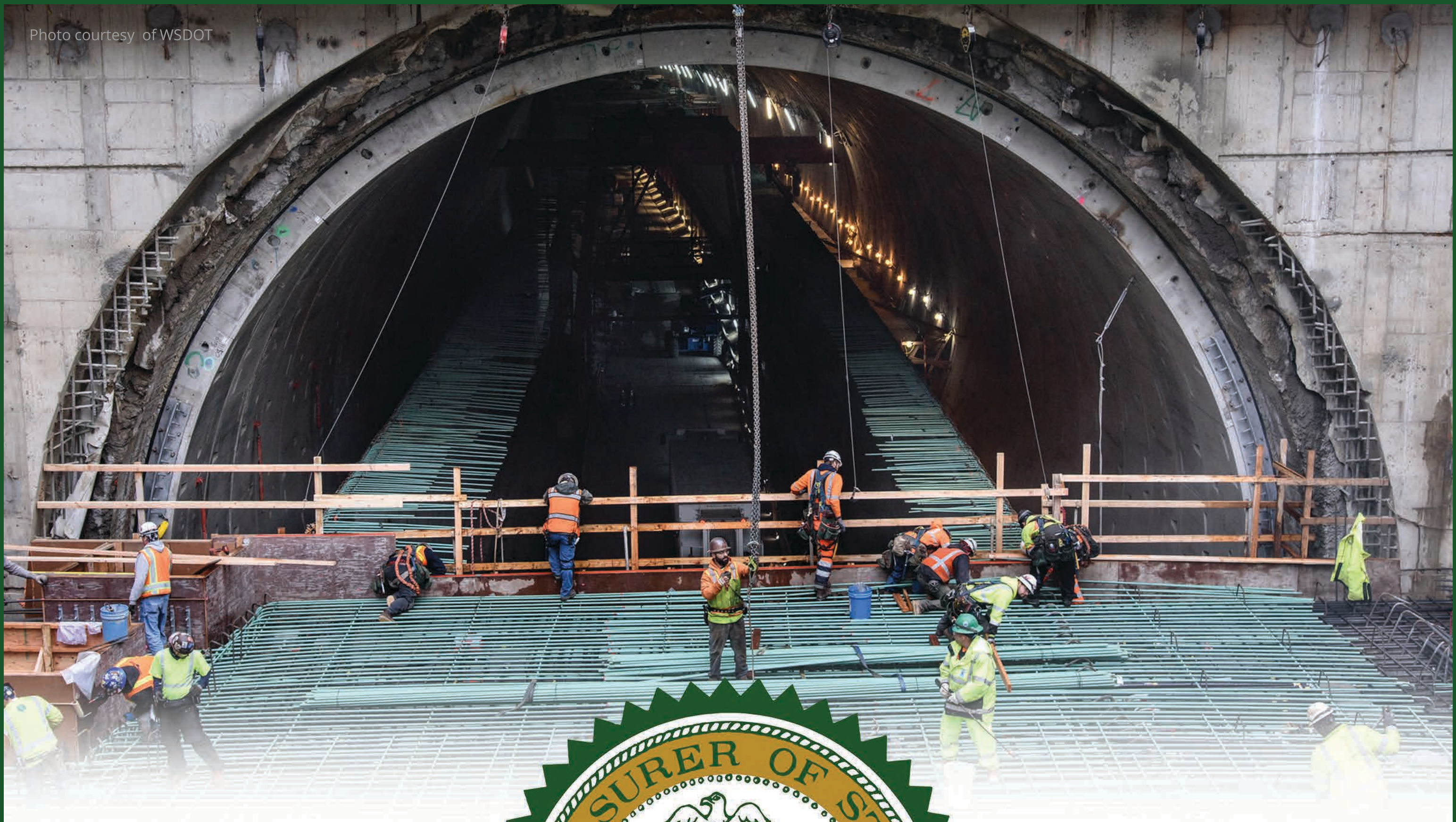

Photo courtesy of WSDOT

Debt Affordability Study 2019

Duane A. Davidson, CPA
Washington State Treasurer

DUANE A. DAVIDSON
State Treasurer

State of Washington
Office of the State Treasurer

Dear Washingtonians,

It is with great pleasure that I present you with the State's 2019 Debt Affordability Study. This annual report provides a comprehensive review of the State's outstanding debt and other financial obligations, credit ratings, and financing practices. My goal with this report is to expand the transparency of the Office of the State Treasurer, educate residents on Washington's financial condition, and inform policymakers as they make budgetary and capital spending decisions.

Over the past twenty years, Washington's outstanding general obligation debt portfolio has increased from $6.9 billion to $19.2 billion. Proceeds of these bonds go towards a variety of projects, such as building schools and hospitals, managing floodplains, preserving state parks, and constructing bridges, tunnels, and other improvements. Along with transportation-related debt and financing contracts, the State's total outstanding obligations at the close of FY 2018 equaled $21.2 billion.

Washington is one of the most highly leveraged states in the country. According to Moody's and Standard and Poor's (S&P), the State ranks in the top ten nationally for "debt per capita" (7th highest by Moody's, 6th by S&P). Every Washingtonian would have to pay approximately $2,662 in order to repay the State's outstanding debt, well over the national median of $987. Washington rates poorly in other metrics as well, such as "debt burden as a % of revenue" (7th highest by Moody's and S&P), and "net tax-supported debt as a % of personal income" (10th highest by Moody's, 9th by S&P).

There are, of course, a number of other factors that support Washington's strong credit ratings (AA+ by S&P, Aa1 by Moody's, and AA+ by Fitch). The State's high personal income levels, growing population, income growth, and diverse economy are cited as credit positives. The State's ratings are also based on the rating agencies' determination that Washington has sound financial management practices and access to significant reserves and liquidity.

Preserving the State's strong credit ratings and future borrowing capacity is essential for continued economic growth and capital investment. A significant economic downturn could inhibit the State's use of debt financing at a time when it may be most needed, which is why I strongly urge lawmakers to increase the use of pay-go project financing, reduce debt service as a percent of State revenues, protect our general fund and rainy day fund balances, and improve the funding status of the State's pension plans in order to prepare the State to ride out the next economic storm.

Sincerely,

Duane A. Davidson,
State Treasurer and Chair, State Finance Committee

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This study has not been prepared with a view to, nor is it suitable for, any investment decision in the bonds or financial obligations of the State or any of its agencies. Any investor in the bonds or financial obligations of the State or any of its agencies should obtain the filings of the State at EMMA.msrb.org related to those bonds before making any investment decision.

The Office of the State Treasurer issues debt and financing contracts on behalf of the State of Washington ("the State" or "Washington") to fund capital projects such as real estate acquisition, building construction, transportation infrastructure, and equipment purchases. In fact, debt financed approximately 67.9% of the State's 2017-19 capital budget.

Washington's general obligation pledge, which is the State's highest rated credit, has been assigned ratings of AA+/Aa1/AA+ (S&P/Moody's/Fitch). These very strong ratings reflect the State's prudent financial management and conservative debt portfolio, which includes no variable rate debt, derivatives, or other complex financial instruments. More importantly, these strong ratings allow the State, Washington school districts (through the school bond guarantee program), and participants in the State's LOCAL program to borrow at very low interest rates. Given the important role that financings play in Washington's budget, the State's financial strength and its strong ratings should be protected at all cost.

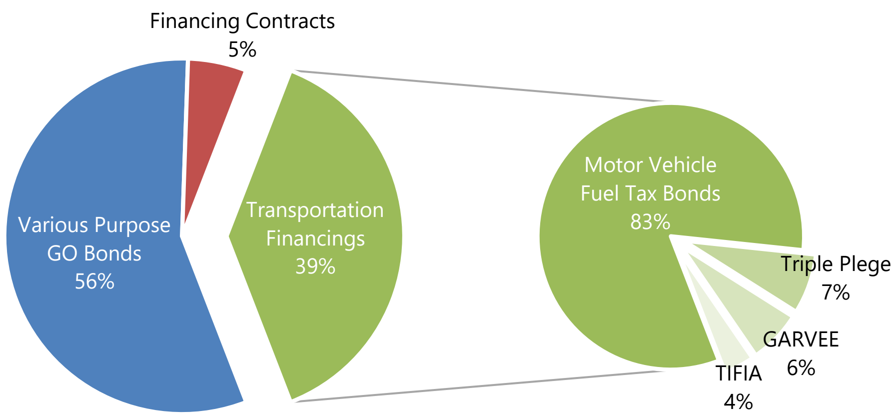
In the upcoming year, the Office of the State Treasurer looks forward to continuing in its role as steward of the State's portfolio of debt and other financial obligations. As always, this office remains committed to serving as a resource for our State and local government partners and to ensuring the efficient, effective, and prudent management of the State's financial obligations.

1. Overview of State Debt and Other Financial Obligations

The bulk of Washington's portfolio of debt and other financial obligations (about 56%) consists of Various Purpose General Obligation (VP GO) bonds issued to finance general capital projects. VP GO bonds are backed by the full faith and credit of the State (GO pledge) and are repaid primarily from General Fund-State revenues (e.g. sales tax, property tax, etc.).

Approximately 39% of the State's portfolio of debt and other financial obligations consists of transportation-related financings for projects such as highways, roads, bridges, and the State ferry system. Of Washington's transportation financings, 83% are supported by Motor Vehicle Fuel Tax (MVFT) revenues, backed up by the guarantee of the State's GO pledge. The remaining transportation financings (Triple Pledge, TIFIA, and GARVEE)* are project-specific and are backed by toll revenues or federal aid, and in the case of Triple Pledge Bonds, also by MVFT revenues and the State's GO pledge.

Figure 1. State Debt and Other Financial Obligations (as of 12/31/18)



Source: Office of the State Treasurer

TIFIA and GARVEE are acronyms for federally-sponsored programs. The full names are Transportation Infrastructure Finance and Innovation Act (TIFIA) and Grant Anticipation Revenue Vehicle (GARVEE).

Financing contracts account for approximately 5% of the State's portfolio of debt and other financial obligations and are primarily issued in the form of financing contracts known as Certificates of Participation (COPs). COPs consolidate various financing contracts with State agencies, which enter into lease agreements for property or equipment to be purchased. These leases are structured to expire on or before the end of the property's useful life, while ownership is retained by the agency.

Another form of financing contracts are 63-20 lease revenue bonds. 63-20 bonds are a special type of financing authorized by IRS Revenue Ruling 63-20, that are issued by a non-profit corporation on behalf of the State. In this arrangement, the non-profit constructs a facility and the State agrees to lease the property once completed. Ownership is transferred to the State upon maturity of the bonds.

Figure 2. Debt and Other Financial Obligations ($ in millions)

	6/30/2014	6/30/2015	6/30/2016	6/30/2017	6/30/2018	12/31/2018
Various Purpose GO Bonds	$11,433	$11,358	$11,523	$11,759	$11,845	$11,792
Transportation-Related Bonds						
GO-Backed Bonds:						
MVFT GO Bonds	$7,010	$6,890	$6,996	$6,837	$6,753	$6,599
Triple Pledge Bonds	519	519	519	596	583	583
Non-GO Backed Bonds:						
GARVEE Bonds	786	786	724	658	589	517
TIFIA Bond	0	195	300	300	297	295
Total Bonds Outstanding	$19,749	$19,748	$20,062	$20,150	$20,067	$19,787
Financing Contracts						
COPs	$605	$615	$748	$814	$843	$814
"63-20" Bonds	337	331	323	314	305	303
Total Financing Contracts	$942	$946	$1,071	$1,128	$1,149	$1,117
Total Outstanding	$20,690	$20,694	$21,133	$21,278	$21,216	$20,904

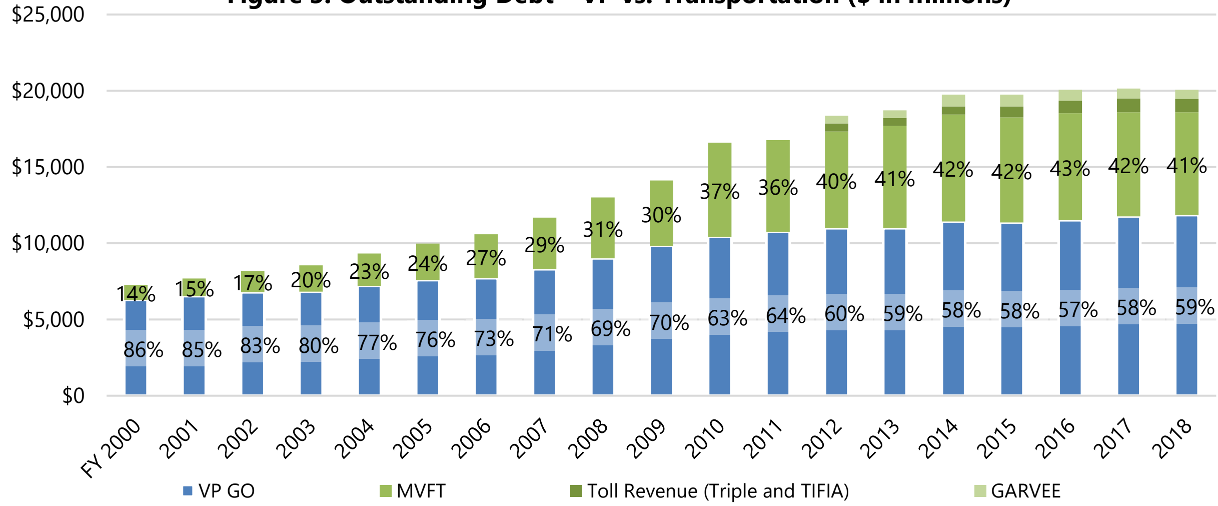
Source: Office of the State Treasurer

Figure 2 shows the State's total portfolio of debt and other financial obligations by type of obligation. The amount of outstanding State debt has been stable in recent years, with less than a 1% increase since 2014. Most notably, debt financing for major transportation projects has slowed, while bond and COP issuance to fund infrastructure investments in education, the environment, and general government have increased at a modest pace.

At the end of FY 2018, Washington's portfolio of debt and other financial obligations stood at $21.216 billion. Total annual payments of principal and interest continue to rise, surpassing $2.0 billion in FY 2018. In FY 2019, debt payments are expected to account for 5.3% of General Fund-State revenues and 40.5% of MVFT revenues.

Over the last two decades transporation-related obligations have increased as a share of the State's overall portfolio of debt and other financial obligations. Of the State's total bonds outstanding, transportation-related debt has increased from 14% to 41% since 2000, as shown in Figure 3.

Figure 3. Outstanding Debt – VP vs. Transportation ($ in millions)



Source: Office of the State Treasurer

Reimbursable General Obligation Debt

Approximately $1.4 billion of the State's GO backed debt is reimbursable, meaning that the General Fund-State or MVFT revenue sources are reimbursed or repaid from sources outside of General Fund-State and MVFT revenues. Reimbursable VP GO debt includes bonds for technical education facilities that are repaid from interest on the Permanent Common School Fund, certain bonds for higher education facilities that are repaid from parking or student fees, bonds for a stadium and exhibition center repaid from admission, parking and certain sales taxes, and financings for "multimodal" facilities that are repaid from licenses and fees. In addition, $346 million of outstanding MVFT GO Bonds are to be repaid from toll revenues from the Tacoma Narrows Bridge (TNB) while all of the State's outstanding Triple Pledge Bonds are to be repaid from tolls collected on the SR 520 Corridor. For the TNB and SR 520 financings, State statute and/or bond covenants require tolls to be set to generate sufficient revenues to repay the debt. Figure 4 shows the outstanding principal of the State's GO-backed debt, net of the principal portion of the reimbursable obligations.

Figure 4. General Obligation Debt Outstanding Net of Reimbursable Debt ($ in millions)

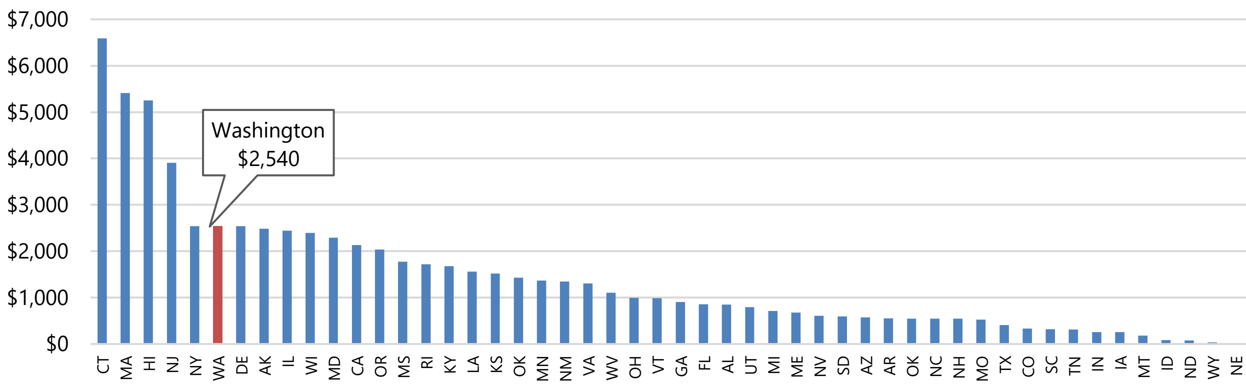
	6/30/2014	6/30/2015	6/30/2016	6/30/2017	6/30/2018	12/31/2018
Various Purpose	$11,433	$11,358	$11,523	$11,759	$11,845	$11,792
Reimbursed from various sources	(747)	(671)	(588)	(520)	(455)	(437)
	$10,686	$10,687	$10,935	$11,239	$11,390	$11,356
Motor Vehicle Fuel Tax	$7,010	$6,890	$6,996	$6,837	$6,753	$6,599
Reimbursed from tolls on TNB	(502)	(471)	(437)	(399)	(364)	(346)
	$6,508	$6,418	$6,560	$6,438	$6,389	$6,253
Triple Pledge	$519	$519	$519	$596	$583	$583
Payable from SR 520 tolls	(519)	(519)	(519)	(596)	(583)	(583)
	$0	$0	$0	$0	$0	$0
Total GO Debt	$18,962	$18,766	$19,038	$19,192	$19,181	$18,975
Total Reimbursables	(1,769)	(1,661)	(1,544)	(1,515)	(1,402)	(1,366)
GO Debt Net of Reimbursables	$17,194	$17,105	$17,495	$17,677	$17,779	$17,609

Source: Office of the State Treasurer

Peer Comparison

According to research conducted by Standard and Poor's (S&P), Washington is one of the most highly-leveraged states in the nation. For example, Figure 5 shows net tax supported debt per capita for all 50 states. S&P calculated Washington's debt per capita to be $2,540, the 6th highest in the country, and over 2.5 times the $945 national median in FY 2017. Debt per capita is one of the common metrics used by rating agencies to assess how leveraged a state is (along with debt as a percentage of personal income and debt as a percentage of gross state product). A comparison of the State's performance across a number of different metrics can be found in Figure 7 in the following section.

Figure 5. Net Tax Supported Debt Per Capita



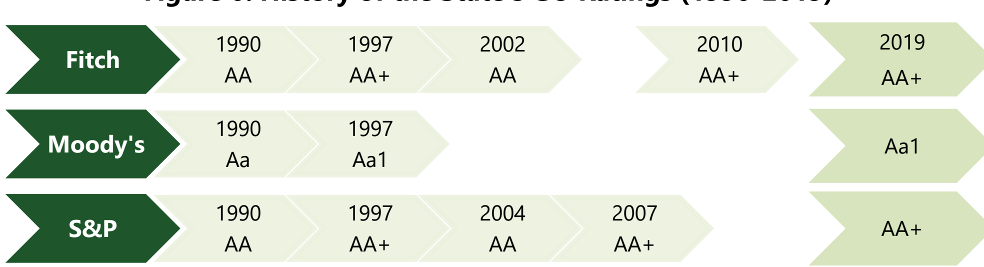
Source: U.S. State Debt Reflects Long-Term Management Strategies and Affordabilities Concerns. S&P. May 14, 2018

2. Credit Ratings and Debt Metrics

Washington is fortunate to be home to a strong and diverse economy, with a growing population, high personal income levels, and solid job growth. The State operates with sound financial management practices and has access to significant liquidity and reserves. For these reasons, the State has received high marks from credit rating agencies. Fitch, Moody's, and S&P each rate the State's credit in their second highest category, AA+/Aa1/AA+.

Figure 6 shows a history of changes to Washington's GO rating by the three major rating agencies since 1990. Maintaining these strong and stable ratings is critical to ensuring that the State continues to have access to low interest rates on its future borrowings.

Figure 6. History of the State's GO Ratings (1990-2019)



Although highly-rated, it is important to note that Washington's high debt burden places it among the top ten states in the nation as measured by debt per capita, debt as a percentage of personal income, debt service as a percentage of governmental expenditures, and debt as a percentage of gross state product. While citing debt levels as a potential risk, each rating agency has recognized that fundamental credit strengths of the State help to mitigate the State's above-average debt burden.*

Fitch (August 16, 2018)

> *On a combined basis, Washington's burden of direct debt and adjusted net pension liabilities, at 7.8%, is above the 6% median for U.S. states (both figures per Fitch's special report "Pensions Driving State Liability Burdens (2017 State Pension Update)," dated Dec. 12, 2017). Debt levels are more than twice the U.S. state median while pension liabilities are below average. The combined liabilities place a low burden on the state's resource base, and Fitch expects this to remain so even given the state's large capital projects.*

Moody's (August 15, 2018)

> *Washington's Aa1 general obligation rating incorporates the state's sound management practices such as its quarterly consensus revenue forecasting process, multi-year revenue and expenditure projections, timely budget adoption, and demonstrated willingness to address budget shortfalls. The rating also reflects an economy that is growing and has out-performed the nation. Revenue trends are positive, supported by employment gains and improvement in the state's housing market, and available reserves have increased. These strengths are tempered by economic exposure to the cyclical aerospace industry and commodity export markets, and above-average debt ratios. Frequent voter initiative activity adds budget challenges although the state legislature has a history of responding effectively to maintain budget balance.*

Standard and Poor's (August 16, 2018)

> *In general, we consider Washington's approach to financial management strong, as reflected in our Financial Management Assessment (FMA) and budget management scores. Well-established economic and revenue forecasting, and increasingly refined debt management practices and oversight, served the state's credit quality well during the recession and its aftermath. Forward-looking state policies facilitate budget practices we view as prudent, including minimal reliance on payment deferrals or other one-time responses to anticipated budget gap.... Tax-supported debt was moderately high, in our opinion, at about $2,500 per capita and 4.5% of total personal income at the end of fiscal 2017. Debt paydown remained average, in our view, with about 55% of principal outstanding amortized over 10 years. We expect debt levels to remain moderately high given anticipated future issuance, particularly for the state's transportation capital program.*

In recent years, credit analysts have focused attention on the overall liability profile of each state when reviewing debt affordability. As shown in Figure 7, Washington's debt burden is at least twice that of the national median. However, when the broader liability profile including pension and OPEB liabilities is taken into account, Washington's liability metrics are near the national median measures and the State's relative ranking improves significantly.

*Rating agency reports on the State can be found on Washington State Treasurer's website: https://tre.wa.gov/home/debt-management/debt-information/

Figure 7. Debt Metrics: A Comparison to National Medians

	Moody's	S&P
Net Tax-Supported Debt ($ millions)[1,2]		
Washington	**$19,711**	**$18,809**
Median of States	$4,451	$4,076
WA Rank Compared to Other States	7th	7th
Net Tax-Supported Debt Per Capita[1,2]		
Washington	**$2,662**	**$2,540**
Median of States	$987	$945
WA Rank Compared to Other States	7th	6th
Net Tax-Supported Debt as % of Personal Income[1,2]		
Washington	**5.0%**	**4.5%**
Median of States	2.3%	2.1%
WA Rank Compared to Other States	10th	9th
Net Tax-Supported Debt as % of Gross State Product[1,2]		
Washington	**4.1%**	**3.7%**
Median of States	2.1%	1.9%
WA Rank Compared to Other States	8th	8th
Debt Burden as % of State Revenue/Spending[1,4]		
Washington	**7.7%**	**7.1%**
Median of States	4.0%	3.8%
WA Rank Compared to Other States	7th	7th
Debt + Pension + OPEB as % of State Revenue/Spending[3,4]		
Washington	**10.6%**	**12.9%**
Median of States	8.5%	10.6%
WA Rank Compared to Other States	20th	16th
Debt + Net Pension Liability + OPEB Per Capita[5]		
Washington		**$3,628**
Median of States		$3,630
WA Rank Compared to Other States		26th

1. Medians - State debt continues slow growth trend. Moody's. April 24, 2018
2. Level U.S. State Debt Reflects Long-Term Management Strategies And Affordability Concerns. S&P. May 14, 2018
3. Medians - Adjusted net pension liabilities spike in advance of moderate declines. Moody's. August 27, 2018
4. Between a Budget and a Hard Place: The Risks of Deferring Maintenance For U.S. Infrastructure. S&P. May 15, 2018
5. U.S. State Pensions Struggle For Gains Amid Market Shifts And Demographic Headwinds. S&P. October 30, 2018.

Comparing Washington's debt metrics with those of other states with comparable or higher credit ratings provides insight as to areas of financial strengths and weaknesses, shows how the State compares to its peers financially, and indicates opportunities for improving the State's credit ratings. Figure 8 shows a comparison of Washington to states with similar or better credit ratings, as well as the primary metrics used by rating agencies to calculate a state's debt burden.

While many of these states have fundamentally different economic, revenue, debt, and income characteristics, only Massachusetts exceeds Washington in debt per capita, debt service as a percentage of general spending, and debt as a percentage of gross state product. Washington ranks third in debt as a percentage of personal income, with Delaware joining Massachusetts at the top of the list.

Figure 8. Comparing the State of Washington to Peer States[1]

	Ratings (S&P/ Moody's/ Fitch)	Debt Per Capita[2]	Debt as % of Personal Income[2]	Debt Service as % of General Spending[2]	Debt as % Gross State Product[2]	Total Net Tax-Supported Debt[2] ($ millions)
Colorado	AA / Aa1 / NR	$332	0.6%	2.6%	0.5%	$1,862
Delaware	AAA / Aaa / AAA	$2,538	5.2%	5.1%	3.3%	$2,441
Florida	AAA / Aaa / AAA	$856	1.8%	5.9%	1.9%	$17,958
Georgia	AAA / Aaa / AAA	$904	2.1%	6.1%	1.7%	$9,424
Maryland	AAA / Aaa / AAA	$2,295	3.9%	5.9%	3.5%	$13,891
Massachusetts	AA+ / Aa1 / AA+	$5,411	8.2%	7.2%	7.0%	$37,119
Minnesota	AA+ / Aa1 / AAA	$1,367	2.6%	3.9%	2.2%	$7,621
Missouri	AAA / Aaa / AAA	$523	1.2%	3.3%	1.1%	$3,198
Nevada	AA / Aa2 / AA+	$608	1.4%	2.1%	1.2%	$1,823
North Carolina	AAA / Aaa / AAA	$546	1.3%	2.8%	1.0%	$5,608
Ohio	AA+ / Aa1 / AA+	$993	2.2%	4.5%	1.8%	$11,581
Oregon	AA+ / Aa1 / AA+	$2,036	4.4%	5.4%	3.6%	$8,435
Texas	AAA / Aaa / AAA	$410	0.9%	2.4%	0.7%	$11,600
Utah	AAA / Aaa / AAA	$795	1.9%	5.4%	1.5%	$2,467
Virginia	AAA / Aaa / AAA	$1,308	2.4%	4.6%	2.2%	$11,075
Washington	**AA+ / Aa1/ AA+**	**$2,540**	**4.5%**	**7.1%**	**3.7%**	**$18,809**
National Median		$945	2.1%	3.8%	1.9%	$4,076

1. Cells colored yellow are the highest value for the column; cells colored blue are the second highest.
2. Level U.S. State Debt Reflects Long-Term Management Strategies and Affordability Concerns. S&P. May 14, 2018.

3. Constraints on Debt Issuance

Constitutional Debt Limit

Since ratification in 1889, the Washington Constitution has limited the amount of certain types of State debt that can be issued. Originally, the State had a fixed debt limit of $400,000. In 1972, this was replaced with a limit on the State's maximum annual debt service (MADS) relative to a historical average of general state revenues. Today, the Constitution prohibits the MADS subject to this limit from exceeding a constitutionally-specified percentage (currently 8.25%) of the average general state revenues for the six preceding fiscal years. Debt service on nearly all VP GO debt is subject to the constitutional debt limit.

Under the Constitution, general state revenues include all State money received in the State treasury from each and every source, including monies received from ad valorem taxes levied by the State and deposited in the general fund, but not including: (1) fees and other revenues derived from the ownership or operation of any undertaking, facility, or project; (2) monies received as gifts, grants, donations, aid, or assistance when the terms and conditions require the application of such moneys otherwise than for general purposes of the State; (3) retirement system monies and performance bonds and deposits; (4) trust fund monies; (5) monies received from taxes levied for specific purposes and required to be deposited into specified funds or accounts other than the general fund; and (6) proceeds from the sale of bonds or other indebtedness.

The Office of the State Treasurer certifies the debt limit when general state revenues are published, typically in December. The most recent Debt Limit report, published on December 21, 2018, certified that the MADS for debt subject to the constitutional limit was $316.2 million less than the constitutional debt service limitation.[*] This number represents the difference between 8.25% of the 6-year average of general state revenues ($1.511 billion) and the MADS as of November 13, 2018 ($1.194 billion).

Modeling Future Debt Capacity

The Legislature, the Office of Financial Management, and the Office of the State Treasurer developed a model to estimate debt capacity and to assess the affordability of bonds subject to the constitutional debt limit. The debt model is used for long-term debt planning and as an "early warning" mechanism during times of decreasing revenues. The model estimates debt service and debt capacity over a 30-year period as a function of the constitutional debt limit, projected general state revenues, and future interest rates. The model also assumes a fixed growth rate for biennial bond authorizations and that bonds authorized for each biennium are issued over a four-year period and amortized over 25-years with level annual debt service payments. Projections are reviewed at least quarterly. Both revenue and interest rate assumptions are aligned with projections from the Washington State Economic and Revenue Forecast Council and IHS Markit over the forecast horizon.

The debt model determines the maximum bond authorization for each biennium as the dollar amount that causes projected MADS to equal the specified percentage of general state revenues, which is based on the State's constitutional debt limit, given the assumed growth in general state revenues, future biennial bond authorizations, and the resultant future bond issuance. To the extent that the maximum bond authorization for the current biennium is increased, future projected maximum bond authorizations must be decreased to keep MADS below the limits and vice versa. Thus, the model provides regularly updated measures of current and projected future debt capacity governed primarily by projected growth in general state revenues.

Exemptions from the Constitutional Debt Limit

Article VIII of the Constitution excludes certain types of debt from the debt limit, most notably debt payable from motor vehicle fuel taxes, license fees on motor vehicles, and interest on the permanent common school fund (provided that there are sufficient revenues to repay the debt service from the specific revenue source). All forms of non-recourse revenue debt, as well as debt approved by both the Legislature and the voters are also excluded from the limit.

MVFT GO Bonds are exempt from the constitutional debt limit provided there are sufficient motor vehicle fuel tax revenues to pay the debt service on such bonds. Mindful of the constitutional provision, legislative bond authorizations for MVFT GO bonds include a statutory commitment to continue to impose excise taxes on motor vehicle fuels in amounts sufficient to pay principal and interest. The State Finance Committee's MVFT GO authorizing resolutions include this pledge and it is incorporated into the contractual obligation made by the State to investors.

[*] The 2019 Report on the State of Washington's Debt Limitation can be found on the Washington State Treasurer's website: https://tre.wa.gov/home/debt-management/debt-information/#toggle-id-2

Triple Pledge Bonds are exempt from the debt limit provided there are sufficient SR 520 toll revenues or MVFT revenues to pay the debt service on such bonds. The Triple Pledge Bond indenture provides specific toll rate covenants and additional bonds tests which set minimum debt service coverage levels. While backed by both MVFT revenues and the State's GO pledge, to date, toll revenues have been, and the State expects that they will continue to be sufficient to fully fund debt service payments for the Triple Pledge Bonds, as well as all requirements identified in the indenture.

GARVEE Bonds (Grant Anticipation Revenue Vehicle) are exempt from the debt limit as they are payable solely from Federal Aid-Highway Program funds, including federal reimbursements of debt service on the bonds and federal reimbursements to the State for projects or portions of projects not financed with bond proceeds. These bonds do not constitute either a legal or moral obligation of the State, nor does the State pledge its full faith, credit, or taxing power. The State's capacity for GARVEEs is estimated to be approximately $345 million; however, no additional GARVEE issuance has been authorized since 2014.

TIFIA Bond (Transportation Infrastructure Finance and Innovation Act) is exempt from the debt limit as it is held by the United States Department of Transportation and is payable solely from net SR 520 toll revenues. The pledge of net SR 520 toll revenues for the TIFIA Bond is junior to the pledge of such revenues to the outstanding Triple Pledge Bonds.

Financing Contracts such as COPs and 63-20s are not subject to the debt limit as these obligations do not constitute debt as defined by the State's Constitution. Budgetary consideration is given to future annual appropriations necessary for each financing. The State Finance Committee is responsible for establishing the maximum aggregate principal amount of financing contracts that may be issued.

4. Various Purpose General Obligation Bonds

Various Purpose General Obligation Bonds (VP GO)

VP GO bonds are issued to pay for a wide variety of projects including K-12 public school construction, higher education facilities, correctional facilities, environmental preservation, State office buildings, and public works infrastructure. The term of each financing is generally 25 years or less, but always within the expected weighted average useful life of the asset(s) being financed. In recent years, VP GO bonds have been used to fund approximately 60% of capital appropriations. In the 2017-19 biennium, bonds funded 67.9% of the appropriations, with the remainder funded primarily from dedicated State revenues and federal funding. Figure 9 shows historical capital budget appropriations for projects funded by bonds and the percentage of total appropriations funded by bonds.

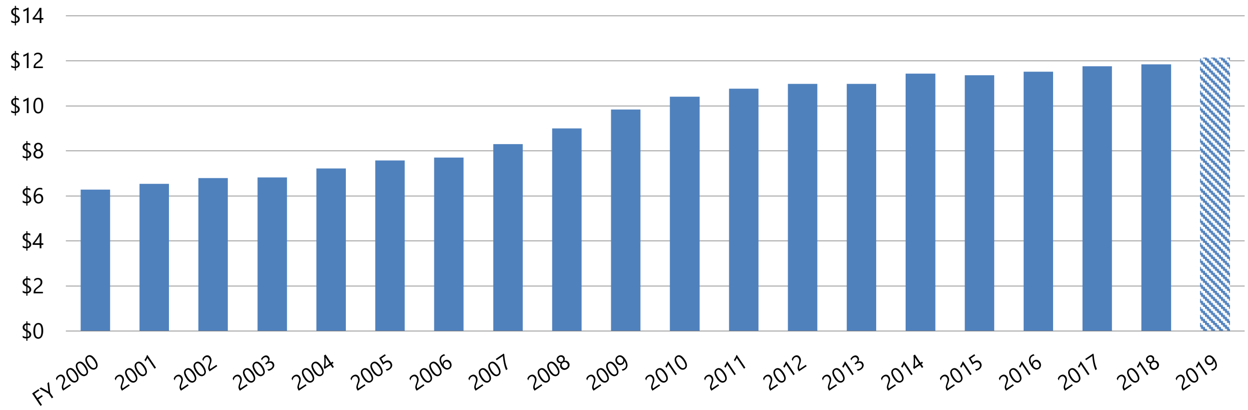
Figure 9. New Capital Appropriations ($ in millions)

	2009-11	2011-13	2013-15	2015-17	2017-19
Bond Appropriations					
Governmental Operations	$466	$346	$536	$509	$721
Human Services	64	104	70	134	159
Natural Resources	343	313	547	522	766
Higher Education	504	404	425	541	497
K-12 Education	655	497	463	627	827
Total Bond Appropriations	$2,032	$1,663	$2,040	$2,333	$2,971
Other Funds Appropriated	$1,166	$1,694	$1,369	$1,421	$1,403
Total Appropriations	$3,198	$3,357	$3,409	$3,754	$4,374
Percent Funded by Bonds	64%	50%	60%	62%	68%

Source: Legislative Evaluation & Accountability Program (LEAP) Committee

The State irrevocably pledges its full faith, credit, and taxing power to the payment of its VP GO bonds. The ability of the State to make this pledge is provided in the State Constitution. The constitutional mandate regarding payment of State debt requires that the Legislature appropriate sufficient funds to pay State debt when due and provides expressly for judicial enforcement of the State's payment obligation on that debt. No other provision of the Constitution contains comparable language providing courts with authority to compel payment of other State obligations. As Figure 10 shows, the State's total outstanding VP GO debt totaled $11.8 billion in FY 2018; an 89.6% increase since FY 2000 and a 13.8% increase since 2010.

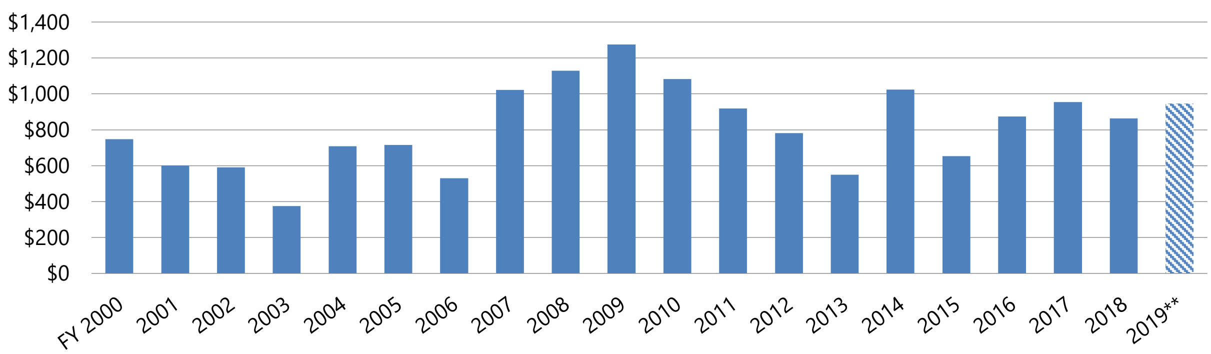
Figure 10. Outstanding VP GO Bonds ($ in billions)



Source: Office of the State Treasurer

The annual issuance of VP GO bonds increased from FY 2015 through FY 2017. As shown in Figure 11, new money issuance in FY 2019 is expected to exceed the prior year issuance by $81.6 million, or 9.5%.

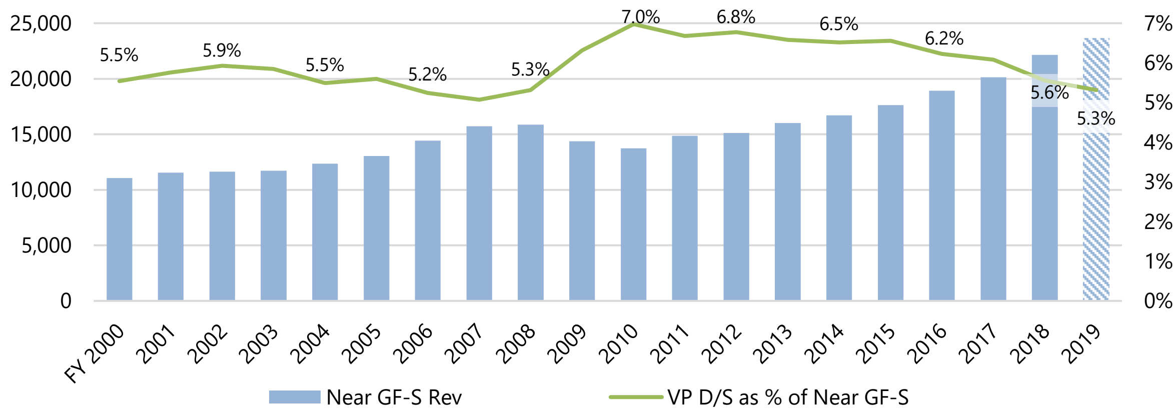
Figure 11. Annual Issuance of VP GO Bonds* ($ in millions)



**Excludes refundings.*
***FY 2019 issuance estimated as of Dec. 4, 2018.*
Source: Office of the State Treasurer

Figure 12 shows the State's annual VP GO debt service since 2000 and the portion of General Fund-State (GF-S) revenue dedicated to repay annual debt service. Prior to the Great Recession, the portion of GF-S revenues used to pay debt service ranged from 5.07% to 5.93%, but climbed to nearly 7.0% in 2010 as revenues declined. In FY 2019, debt service on VP GO bonds is projected to total $1.3 billion or 5.3% of GF-S revenues.

Figure 12. Various Purpose GO Debt Service as a Percent of Near General Fund-State Revenues* ($ in millions)



**Near General Fund-State revenues include General Fund-State, the Education Legacy Trust Account (ELTA), and the Opportunity Pathways Account (OPA).*
Source: Economic & Revenue Forecast Council, Office of the State Treasurer

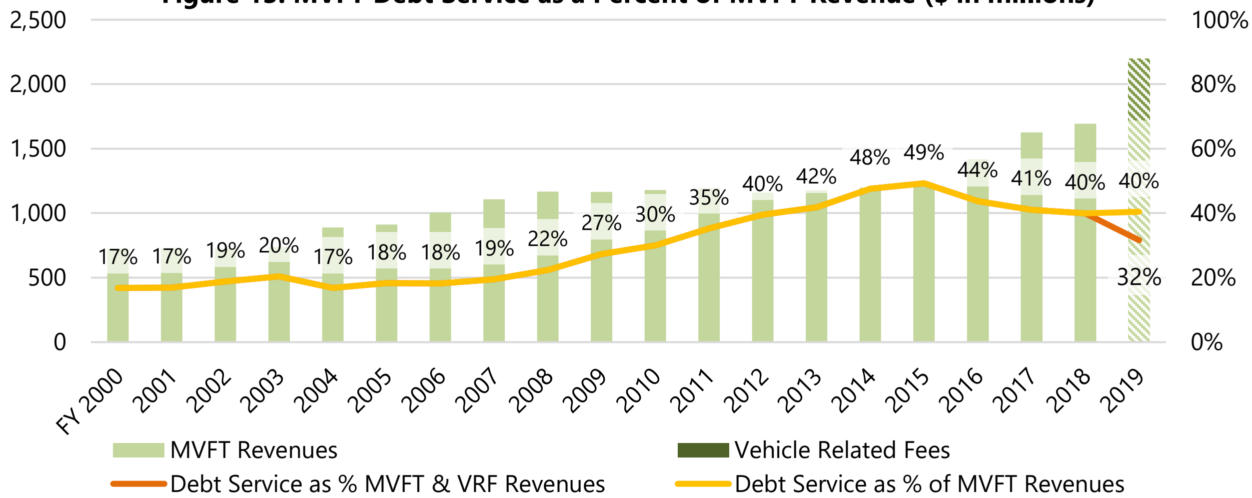
5. Transportation Debt

MVFT GO, Triple Pledge, TIFIA, and GARVEE Bonds

MVFT GO bonds are paid from State excise taxes on motor vehicle fuels and are backed by the full faith, credit, and taxing power of the State. Proceeds of MVFT GO bonds are constitutionally restricted to highway capital projects, which include public highways, county roads, bridges, city streets, and the ferry system. MVFT GO bonds carry the same ratings as VP GO bonds and borrowing rates are essentially the same. The term of each financing is generally 25 years or less, but always within the expected weighted average useful life of the asset(s) being financed.

Over the past decade, Washington has significantly increased its reliance on MVFT GO bonds to implement legislative spending plans associated with gas tax increases. Leveraging revenues from the 2003 Nickel Act and the 2005 Transportation Partnership Act, which collectively raised the gas tax 14.5¢, increased the State's annual MVFT GO issuance from $65 million in the 1990s, to over $2 billion with the issuance of Build America Bonds in FY 2010. In 2015, the Legislature approved an additional 11.9¢ gas tax increase and allowed for leveraging certain vehicle-related fees (VRFs) in the Connecting Washington transportation package, as shown in Figure 13. To date, no bonds have been issued under the Connecting Washington authorization.

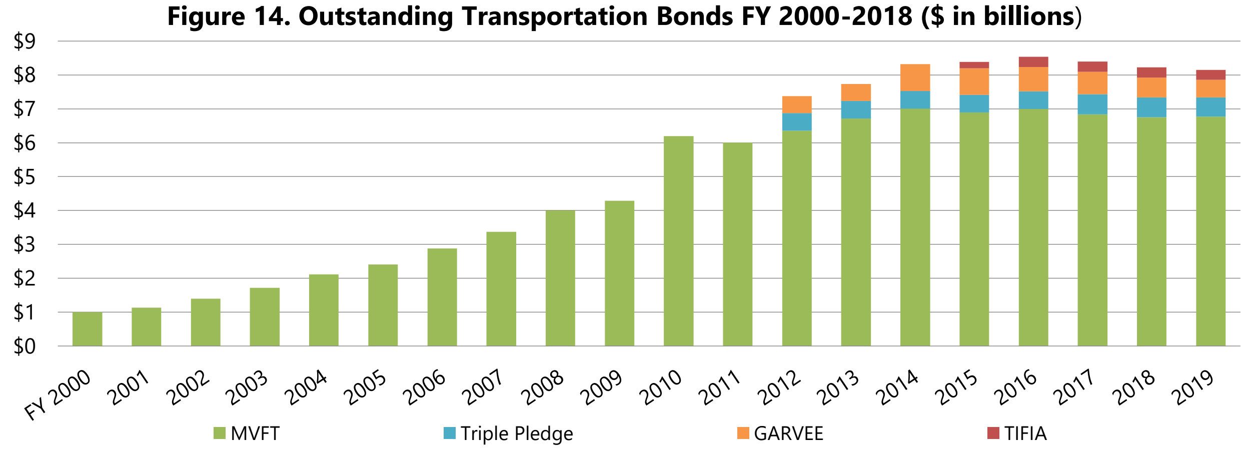
Figure 13. MVFT Debt Service as a Percent of MVFT Revenue ($ in millions)



Source: Office of the State Treasurer

As seen in Figure 14, at the end of FY 2018 the State had $6.8 billion of outstanding MVFT GO debt. Of this amount, $1.57 billion was issued as Build America Bonds (BABs) in FY 2010. BABs were created through the American Recovery and Reinvestment Act of 2009. This program offered states and local governments federal subsidies on taxable municipal bonds.

Figure 14. Outstanding Transportation Bonds FY 2000-2018 ($ in billions)

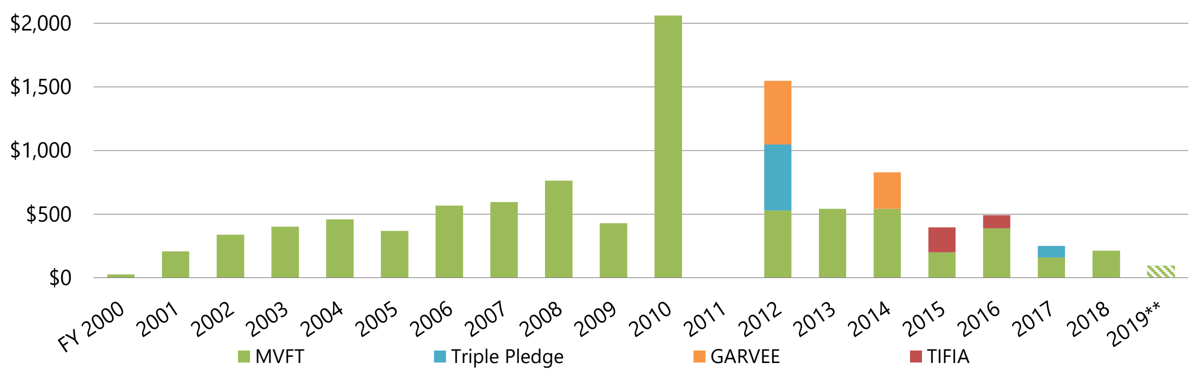


Source: Office of the State Treasurer

In addition to MVFT GO financings, the State has issued three additional types of transportation bonds to finance the SR 520 Bridge Replacement and HOV Program: Triple Pledge, GARVEE, and TIFIA. Between FY 2012 and FY 2017, the State issued a total of $609 million in Triple Pledge Bonds, which are bonds first paid from SR 520 toll revenue, further backed by MVFT revenues, as well as the State's GO pledge. Triple Pledge Bonds carry the same ratings as other GO bonds and borrowing rates are essentially the same.

The State has also issued two forms of transportation bonds which are not backed by the State's GO pledge: (1) Grant Anticipation Revenue Bonds, or GARVEE bonds, secured solely by funds received from the Federal Highway Administration (FHWA), and (2) a Transportation Infrastructure Finance and Innovation Act (TIFIA) bond which is a draw-down loan from the FHWA, paid solely from SR 520 toll revenues. The State issued $786.3 million in GARVEE bonds in 2012 and 2013, and a $300 million TIFIA Bond in 2012. The State has not issued new Triple Pledge, GARVEE or TIFIA loans since 2017. By the end of FY 2018, the combined outstanding amount of these bonds was approximately $1.5 billion. Figure 15 below shows the amount of the State's annual transportation debt issuances, excluding refundings, by fiscal year.

Figure 15. Issuance of Transportation Bonds ($ in millions)



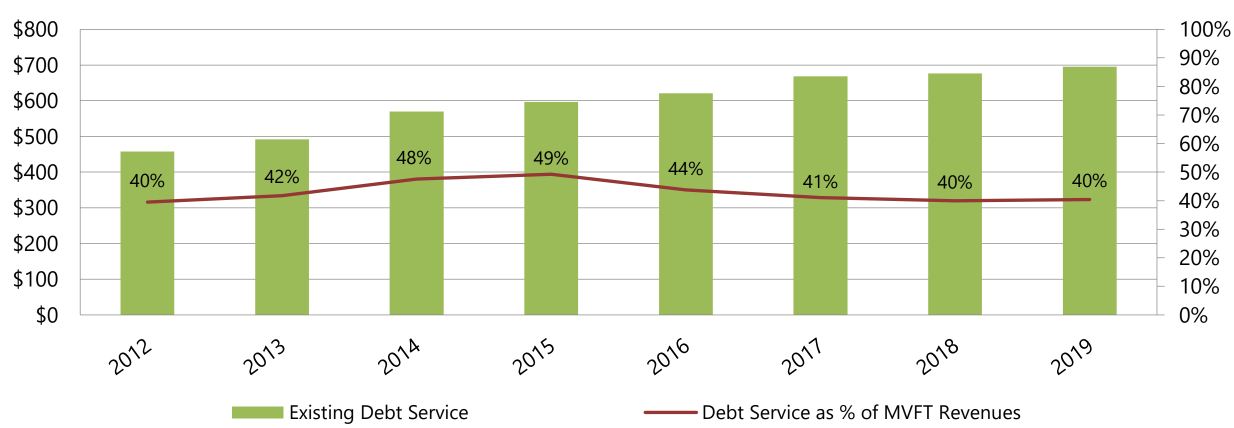
***FY 2019 issuance estimated as of Dec. 4, 2018.*
Source: Office of the State Treasurer

Estimating Transportation Debt Capacity

In collaboration with the Washington State Department of Transportation (WSDOT), the Office of the State Treasurer is in the process of developing a technical model to estimate transportation debt capacity, similar to that used for capital projects. The model estimates debt service and debt capacity over a 30-year period as a function of projected transportation revenues, future interest rates, and the expected phasing of major construction projects.

In the near term, the ratio of debt service to revenues for the State's MVFT GO bonds is decreasing. This is a result of growth in MVFT and VRF revenues outpacing additional debt service. In future biennia, debt service is expected to increase as a percentage of MVFT revenues due to increased construction, the pace of bond funding, and the cost of financing. In FY 2018, debt service on MVFT GO bonds accounted for approximately 40% of MVFT revenues, down from 50% in FY 2015 (Figure 16).

Figure 16. MVFT GO Debt Service Totals ($ in millions)



Source: Transportation Revenue Forecast Council, WSDOT, and Office of the State Treasurer.

6. Other State Obligations

State Financing Contracts

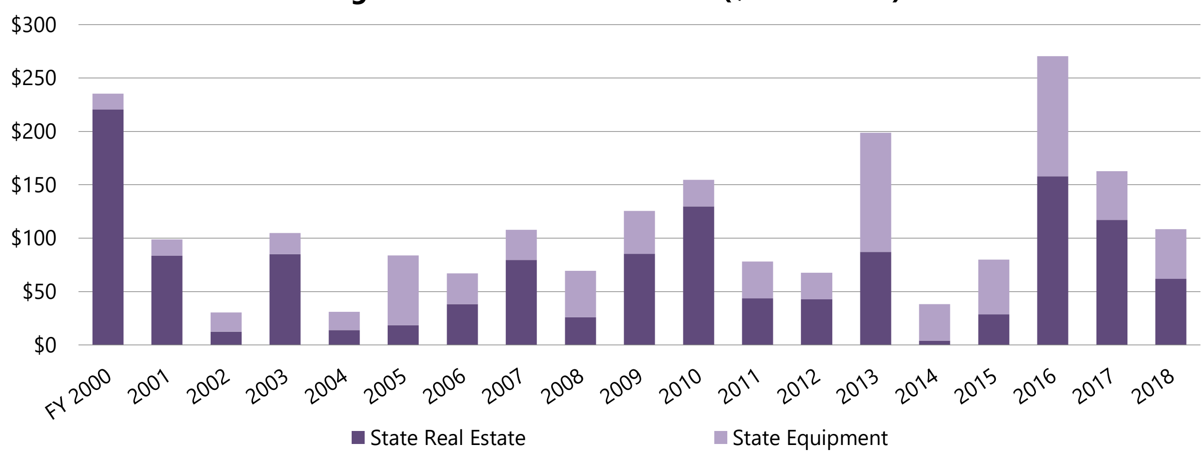
Certificates of Participation - State

The State often finances real estate projects and equipment purchases by issuing certificates of participation (COPs). COPs consolidate multiple financing contracts used to finance real property, such as land and building acquisition, new construction, facility improvements, or personal property, such as vehicles, computer hardware, and office equipment. The maximum term of each lease is determined by the useful life of the asset(s) being financed. Real estate financings have a maximum term of 25 years, while equipment is typically financed for a period of three to ten years. Consolidating multiple financings in each COP issuance achieves economies of scale and minimizes issuance costs for participating agencies. Approximately half of the State's outstanding COPs will be paid off within five years.

COPs are not backed by the full faith and credit of the State. COPs are payable only from current appropriations and/or from funds that do not constitute general state revenues. COPs typically are rated one notch below GO debt, and borrowing rates are somewhat higher as a result. State real estate acquisition and construction projects financed with COPs must be authorized by the Legislature. The Office of the State Treasurer may require prior legislative approval for major equipment acquisitions.

As seen in Figure 17, COP issuance peaked at $270 million in FY 2016. In FY 2018 the State issued $108.5 million worth of COP financings ($62 million for real estate and $46.5 million for equipment). At the end of FY 2018, the State had $813.9 million in outstanding COPs (Figure 18, below).

Figure 17. State COP Issuance ($ in millions)



Source: Office of the State Treasurer

Figure 18. State COP Outstanding ($ in millions)

	6/30/2014	6/30/2015	6/30/2016	6/30/2017	6/30/2018	12/31/2018
State COP Outstanding	$605.2	$615.5	$748.0	$813.6	$843.2	$813.9

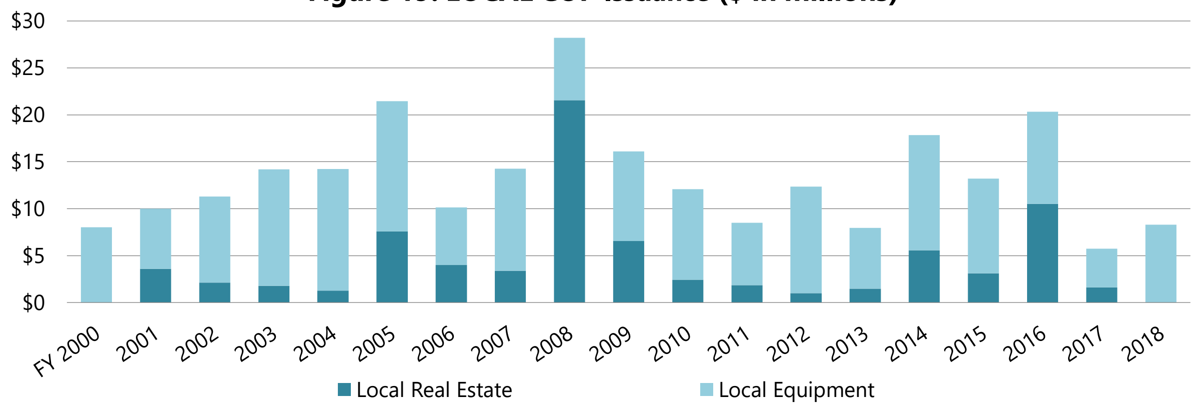
Source: Office of the State Treasurer

Certificates of Participation - Local

In partnership with the COP program, the Office of the State Treasurer operates the Local Option Capital Assets Lending (LOCAL) Program. The LOCAL program is a special financing program available to local governments that are able to provide a general obligation pledge and meet the State's established credit criteria. The LOCAL program offers local agencies a way to finance essential real estate and equipment over a multi-year period. The program provides the same economies of scale and low interest rates available through the State COP program by efficiently pooling local government financing contracts with the State's larger financing contracts. Figure 19 shows LOCAL COP issuance from FY 2000 through FY 2018, and Figure 20 (below) shows the total outstanding obligations of the program. LOCAL COP issuance peaked in FY 2008 with $28.2 million in new financing contracts issued.

In FY 2018, new issues totaled $8.3 million. Total outstanding for LOCAL COPs at the end of 2018 was $62.1 million. Debt service for the LOCAL Program is paid by the contracted entity.

Figure 19. LOCAL COP Issuance ($ in millions)



Source: Office of the State Treasurer

Figure 20. LOCAL COP Outstanding ($ in millions)

	6/30/2014	6/30/2015	6/30/2016	6/30/2017	6/30/2018	12/31/18
LOCAL COPs Outstanding	$84.4	$81.2	$77.5	$70.6	$67.6	$62.1

Source: Office of the State Treasurer

63-20 Lease Revenue Bonds

The State has entered into two long-term leases known as "63-20" lease revenue bond financings. With this type of financing, a non-profit corporation issues bonds on behalf of the State and uses the proceeds for the design and construction of a facility. Once the project has been completed, the State leases the facility from the non-profit and the lease payments are pledged to the repayment of the bonds. Upon repayment of the bonds, the State takes title to the property. Similar to the COPs, the State's lease payments are subject to appropriation risk and across-the-board cuts by the Governor.

The State's two 63-20 projects are highlighted below in Figure 21. Final maturity for the Edna Lucille Goodrich Building and the 1500 Jefferson Building are July 1, 2028 and June 1, 2039, respectively.

Figure 21. 63-20 Lease Revenue Bonds Outstanding ($ in thousands)

	6/30/2014	6/30/2015	6/30/2016	6/30/2017	6/30/2018	12/31/2018
Edna Lucille Goodrich Building	$43,435	$43,435	$41,870	$40,075	$38,065	$35,830
1500 Jefferson Building	299,330	287,315	281,005	274,375	267,410	267,410
Total	$336,765	$330,750	$322,875	$314,450	$305,475	$303,240

Source: Office of the State Treasurer

PENSIONS

Washington's pension plans are consistently recognized as some of the better funded plans in the nation. The State administers 13 defined benefit retirement plans, three of which contain hybrid defined benefit/defined contribution options. The most recent actuarial report was released in August 2018 for the year ended June 30, 2017. According to the report, the plans covered 177,685 retirees and beneficiaries with 317,677 active members contributing to plans. The combined funded status for all the State-administered retirement plans was 86%—up from 84% for the fiscal year ending June 30, 2016—with $92.8 billion of liabilities and $80.2 billion as the accrual value of assets, leaving a total of $12.6 billion in unfunded liabilities.

Another measure, Net Pension Liabilities, represents unfunded actuarial accrued liability, and equals the total pension liability (a measure of the total cost of future pension benefit payments already earned, stated in current dollars) minus the value of the assets in the pension trust that can be used to make benefit payments. Under the Governmental Accounting Standards Board (GASB) reporting standards, the State's share of Net Pension Liabilities as of June 30, 2017 is a collective $1.960 billion—a decrease of $1.8 billion from the prior year.

Figure 22. Comparing Washington to Other State Pension Systems

	Ratings (S&P/ Moody's/ Fitch)	**Funded Ratio**[1]	**Net Pension Liability per Capita**[1]	**Debt, Pension and OPEB per Capita**[1]
Colorado	AA / Aa1 / NR	42.8%	$3,171	$3,735
Delaware	AAA / Aaa / AAA	82.8%	$1,858	$12,978
Florida	AAA / Aaa / AAA	83.9%	$256	$2,017
Georgia	AAA / Aaa / AAA	79.0%	$706	$3,311
Maryland	AAA / Aaa / AAA	69.4%	$3,348	$7,475
Massachusetts	AA / Aa1 / AA+	59.5%	$5,438	$13,732
Minnesota	AAA / Aa1 / AAA	61.0%	$1,780	$3,257
Missouri	AAA / Aaa / AAA	58.5%	$1,037	$2,009
Nevada	AA / Aa2 / AA+	74.5%	$731	$1,842
North Carolina	AAA / Aaa / AAA	90.7%	$188	$3,919
Ohio	AA+ / Aa1 / AA+	76.3%	$450	$2,979
Oregon	AA+ / Aa1 / AA+	83.1%	$673	$2,728
Texas	AAA / Aaa / AAA	76.1%	$1,582	$5,125
Utah	AAA / Aaa / AAA	86.0%	$523	$1,354
Virginia	AAA / Aaa / AAA	74.9%	$811	$2,734
Washington	**AA+ / Aa1 / AA+**	**89.5%**	**$348**	**$3,628**
National Median		69.5%	$1,111	$3,630

1. *U.S. State Pensions Struggle For Gains Amid Market Shifts And Demographic Headwinds. S&P. October 30, 2018.*

OPEB (Other Post-Employment Benefits)

The State provides health care benefits to its retirees through implicit and explicit subsidies. Unlike the State's pensions, both the implicit and explicit subsidies are not contractual obligations to retirees. The State allows retirees not yet eligible for Medicare to use their own money to pay for health insurance at group rates negotiated for public employees (an implicit subsidy). While there is no contractual liability for the State, including retirees in this purchasing pool marginally increases overall insurance rates. The State provides an explicit subsidy to reduce Medicare-eligible retiree Part A and B premiums by an amount determined each year by the Public Employee Benefits Board (PEBB). Like the implicit subsidy, this is also not a contractual obligation because each year the Legislature determines whether or not to include it in the State's budget. The State funds the implicit and explicit subsidies on a pay-as-you-go basis. That is, the State pays the costs as they occur. The State's annual OPEB cost for FYs 2016 and 2017 was $520.7 million and $530.3 million, respectively.

GASB Statement No. 75 requires that the total OPEB liability to be determined through an actuarial evaluation of the future costs of the implicit and explicit subsidies. Under GASB 75, the State's total OPEB liability was reported as $5.83 billion as of June 30, 2018, a decrease of $416.8 million from the prior year.

School Bond Guarantee Program

The School Bond Guarantee Program is a direct credit enhancement program that provides savings to State taxpayers by pledging the full faith, credit, and taxing power of the State to the payment of voter-approved school district GO bonds. The State's obligation is a contingent obligation and is excluded from the Constitutional Debt Limitation. The State has never been called upon to pay debt service on any bonds guaranteed by the Program. Since its inception in 2000, the School Bond Guarantee Program has saved taxpayers approximately $21 million annually, with total savings of approximately $350 million.

As of December 31, 2018, the average par amount of each issue guaranteed was $34 million, with a total of 469 bond issues guaranteed, and total principal outstanding as of December 31, 2018 of $13.487 billion (Figure 23).

Figure 23. Outstanding Guaranteed School District Bonds

	6/30/2014	6/30/2015	6/30/2016	6/30/2017	6/30/2018	12/31/2018
Guaranteed Principal Amount Outstanding[1]	$8,977	$9,480	$10,339	$11,712	$12,979	$13,487
Number of participating school districts	176	179	182	185	181	177

1. In millions
Source: Office of the State Treasurer

Guaranteed Education Tuition Program

The Washington Guaranteed Education Tuition Program ("GET program") is a 529 savings plan that allows Washington residents to prepay college tuition. Individual accounts are guaranteed by the State to keep pace with rising college tuition, based on the highest tuition at Washington's public universities. The after-tax contributions to a GET account grow tax-free and can be withdrawn tax-free when used for eligible higher education expenses. In 2018, the State also began offering the DreamAhead College Investment Plan, a tuition savings plan that is managed and invested separately from assets in the GET program.

The budget enacted during the 2015 legislative session reduced tuition for State colleges and universities for two years and limits tuition growth in subsequent years. For the upcoming academic years thereafter, the Committee on Advanced Tuition Payment and College Savings is authorized to make program adjustments necessary to ensure that the total payout value of each account is not decreased or diluted as a result of the tuition changes. On July 1, 2015, the Committee suspended new program enrollments and most purchases of new units. The GET Committee reopened the program on November 1, 2017 to new enrollments and unit purchases.

As of June 30, 2018, GET program assets totaled $2.2 billion, or 130.2% of estimated program obligations. When the DreamAhead Plan opened, eligible customers in the GET Program were provided a 90-day period during which they could roll their accounts over to the DreamAhead Plan at a special "unit cash value price." By the end of that 90-day rollover period, September 12, 2018, GET program customers had rolled $875 million in assets over to the DreamAhead Plan. The market value of remaining GET program assets as of September 30, 2018, as measured by the Washington State Investment Board (WSIB), was $1.2 billion.

7. Refinancings

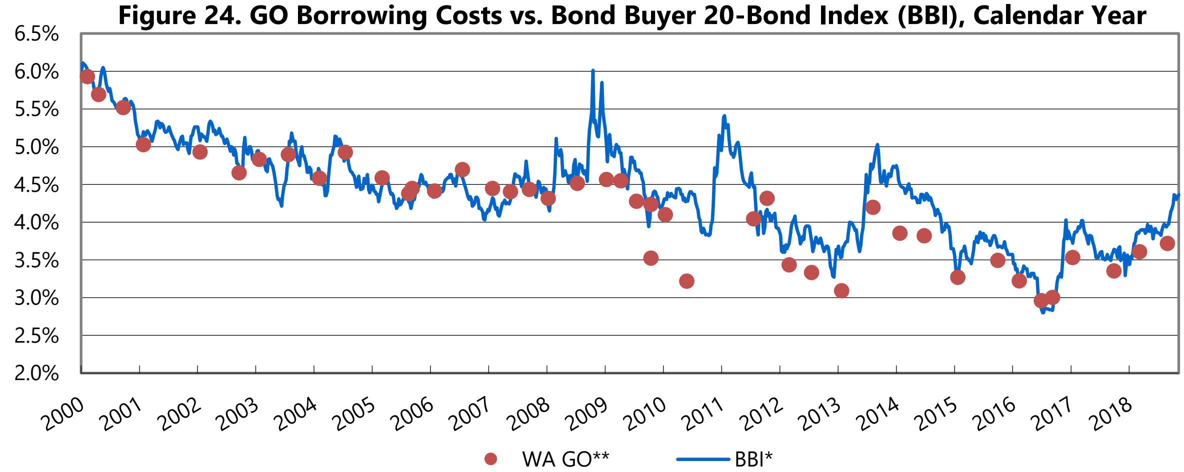
The Office of the State Treasurer regularly monitors the State's portfolio of debt and other financial obligations for opportunities to lower its borrowing costs through refinancings. All refinancings are executed in accordance with the debt policies of the State Finance Committee, which specify minimum savings thresholds.

Unfortunately, the Federal Tax Cuts and Jobs Act of 2017 resulted in the loss of the State's ability to issue tax-exempt advance refunding bonds (refunding bonds issued more than 90 days in advance of the call date of the bonds to be refunded). The loss of advance refundings reduces the State's financial flexibility and severely limits its ability to lock in debt service savings during periods of low interest rates. While flexibility is now limited, the State will continue to monitor its outstanding obligations for opportunities to reduce debt service costs through current refundings (refunding bonds issued within 90 days of the call date of the bonds to be refunded).

Borrowing Costs

The State executes most bond sales through a competitive electronic auction process. Borrowing costs in FY 2018 continued to rise from the historically low rates observed following the Great Recession. The August 2018 sale of Various Purpose, MVFT, and taxable GO bonds (series 2019A, 2019B and 2019T, respectively) with a 25-year final maturity and level debt service achieved a True Interest Cost (TIC) of 3.71%. The weighted average cost of funds for the entire VP GO bond portfolio is currently 3.33%. Figure 24 compares the State's borrowing costs to the 20-Year Bond Buyer Index (BBI). BBI averages the yield of 20 different bonds that have an Aa2 (Moody's) or AA (S&P) average rating.

Figure 24. GO Borrowing Costs vs. Bond Buyer 20-Bond Index (BBI), Calendar Year



** WA GO - Borrowing Costs of 25-year general obligation bonds*
*** BBI - Bond Buyer 20-Bond Index of Municipal Yields (20 years)*
Source: Office of the State Treasurer

8. Obligations of Other State Entities

Revenue bonds and COPs issued by the State's colleges and universities, conduit issuers and financing authorities, and Tobacco Settlement Authorization are not legal or moral obligations of the State and the debt service on those revenue bonds and obligations is payable solely from the revenues pledged to the repayment of the obligations.

College and University Revenue Bonds

Revenue bonds and COPs can be issued by the State's colleges and universities to finance major campus construction projects for the State's universities and colleges. In addition, certain State colleges and universities are authorized to independently issue revenue bonds for the construction of certain types of revenue-generating facilities for student housing, dining, and parking. These revenue bonds are payable solely from revenues derived from the operation of the constructed facilities. Figure 25 lists the total revenue bonds outstanding for each university over the past five years.

Figure 25. Higher Education Revenue Bonds Outstanding ($ in thousands)

	6/30/2014	6/30/2015	6/30/2016	6/30/2017	6/30/2018
University of Washington	$1,764,855	$1,709,066	$1,992,944	$2,112,330	$2,168,866
Washington State University	530,840	596,825	609,625	585,750	566,345
Central Washington University	126,339	122,781	119,265	115,386	156,966
Western Washington University	72,443	68,638	64,515	60,236	90,972
Eastern Washington University	52,435	50,810	49,125	82,865	80,520
The Evergreen State College	4,525	4,080	3,665	3,340	3,000
Total	$2,551,437	$2,552,200	$2,839,139	$2,959,907	$3,066,669

Source: Office of Financial Management

CONDUIT ISSUERS/FINANCING AUTHORITIES

Washington has created four financing authorities that can issue non-recourse revenue bonds to make loans to qualified borrowers for capital projects: the Washington Health Care Facilities Authority (WHCFA), the Washington State Housing Finance Commission (WSHFC), the Washington Economic Development Finance Authority (WEDFA), and the Washington Higher Education Facilities Authority (WHEFA). All four financing authorities are financially self-supported and do not receive funding from the State.

Figure 26. Conduit Issuer Debt Outstanding ($ in thousands)

	6/30/2014	6/30/2015	6/30/2016	6/30/2017	6/30/2018
WHCFA	$5,452,000	$5,609,000	$5,682,000	$5,662,000	$5,832,545
WSHFC	3,411,461	3,419,567	3,727,679	4,271,164	4,800,559
WEDFA	702,442	682,472	678,160	688,432	841,794
WHEFA	766,485	759,833	742,667	630,233	624,856
Total	$10,332,388	$10,470,872	$10,830,506	$11,251,829	$12,099,754

Source: Office of Financial Management

TOBACCO SETTLEMENT SECURITIZATION

The Tobacco Settlement Authority (TSA) was created to securitize a portion of the State's revenue from the 1998 Tobacco Master Settlement Agreement. In 2002, the TSA issued $517.9 million in bonds and transferred $450 million to the State to be used for increased health care, long-term care, and other programs. The TSA bonds are not obligations of the State. As of June 30, 2018, TSA had approximately $178.5 million of outstanding bonds.

9. RECOMMENDATIONS

This section is intended to provide a set of recommended policy considerations that are based on best practices and peer comparisons, with a goal of protecting the State's strong credit ratings, putting Washington in the best possible position for the next economic downturn, and moving the State closer to a rating upgrade.

The recommendations focus on three metrics: 1) debt service as percentage of revenues, 2) general fund and rainy day fund balance, and 3) the funding status of the State's pension plans. "AAA rated" states are used as a benchmark for comparison. Striving for the "AAA rated" state metrics provides meaningful goals, and moving towards these goals could help reduce borrowing costs for the State and local governments, and also better prepare the State for weathering an economic downturn.

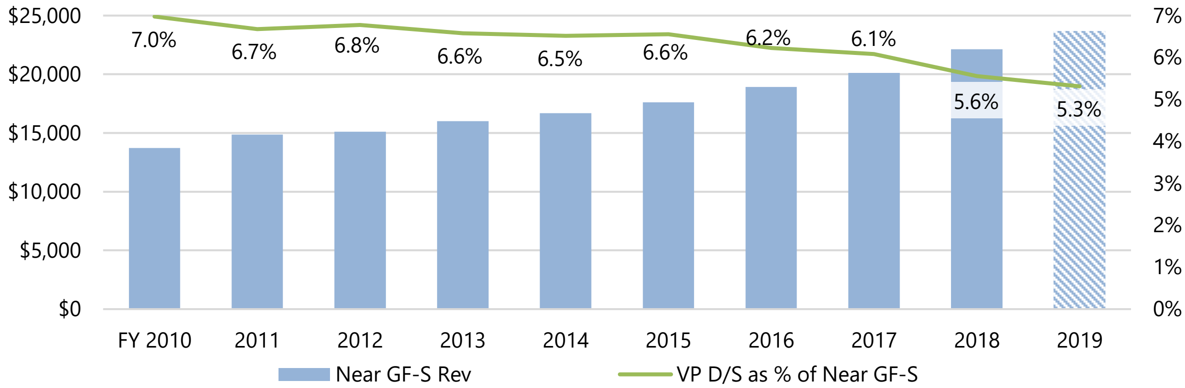
DEBT SERVICE AS A PERCENT OF REVENUES

Recommendation 1: Reduce the ratio of VP GO debt service to Near General Fund-State revenues to 5% or less.

The first metric of comparison is debt service as a percent of revenues. As more money is dedicated to principal and interest, fewer resources are available to provide State services. Economic downturns can exacerbate this problem as revenues decrease.

The State's VP GO debt service as a percent of Near General Fund-State revenues is projected to be 5.3% in FY 2019, down from a high of nearly 7.0% following the Great Recession. Reducing this amount below 5% helps ensure that resources are available for state services in the event of decreased revenues.

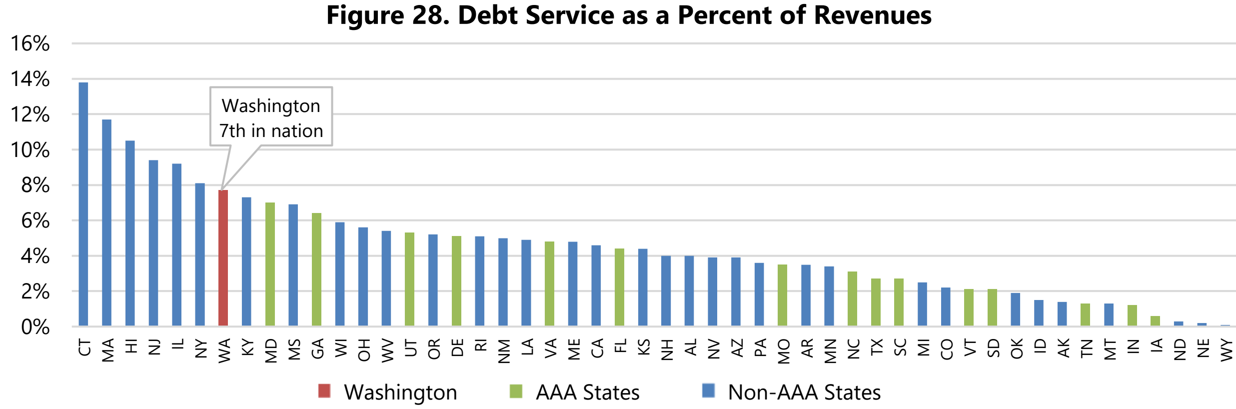
Figure 27. Various Purpose GO Debt Service as a Percent of Near General Fund-State Revenues* ($ in millions)



**Near General Fund-State revenues include General Fund-State as well as the Education Legacy Trust Account (ELTA) and Opportunity Pathways Account (OPA) which are used for K-12 and higher education.*
Source: Economic & Revenue Forecast Council, Office of the State Treasurer

In comparison to its peers, Washington has a high debt load. Based on a 2018 Moody's report, Washington has the 7th highest level of debt service as a percent of revenues. In this metric, Washington exceeded all Moody's "AAA-rated" states, which averaged 3.49%. The national median was 4.2%.

Figure 28. Debt Service as a Percent of Revenues



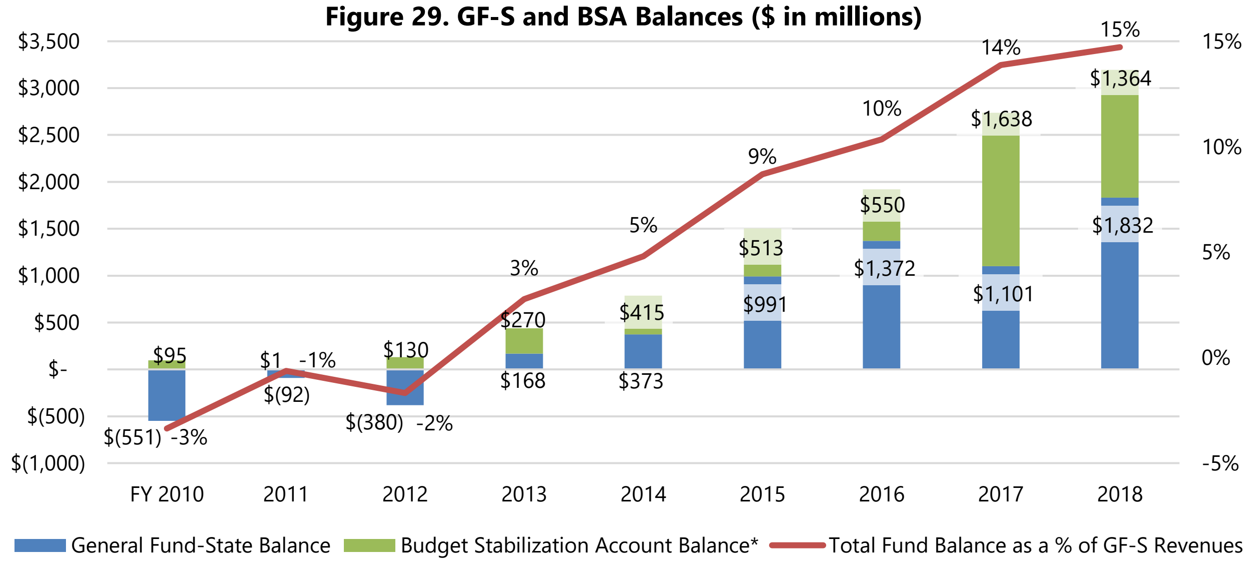
Source: Medians - State debt continues slow growth trend. Moody's. April 24, 2018.

Fund Balance

Recommendation 2: Establish a formal policy on targeted amounts for the State's unrestricted fund balances, maintain the State's current strong General Fund/Budget Stabilization Account (BSA or Rainy Day Fund) balances, and set a target amount for the BSA of 10% of revenues.

Like many states, Washington maintains a BSA to mitigate declining revenues during an economic downturn. At the end of FY 2018, the State's BSA as a percent of revenues reached 6.3%, just above the national median of 5.8%. On a combined basis, the State's General Fund-State and BSA balances have increased significantly since 2010, reaching approximately 15% of revenues by the end of FY 2018 (Figure 29).

Figure 29. GF-S and BSA Balances ($ in millions)

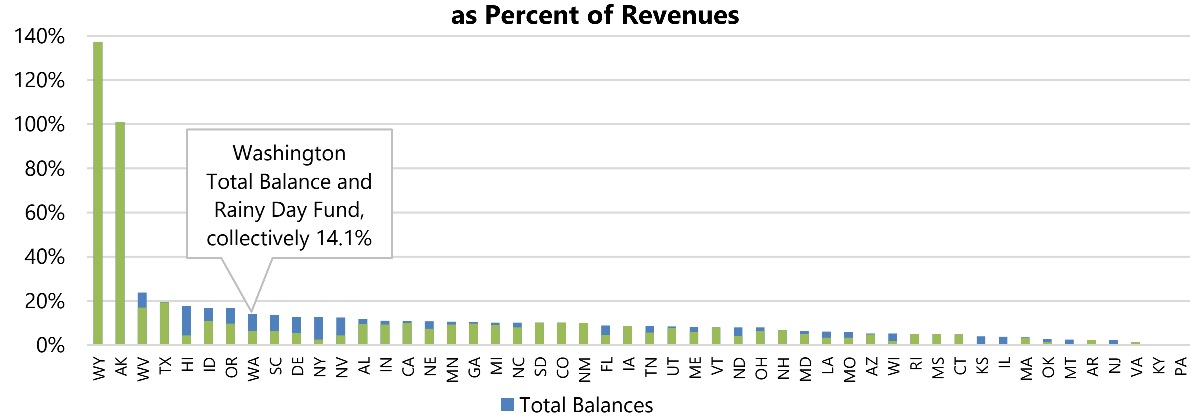


Note: Fund balances at close of fiscal year. Provided revenue data is displayed on a cash basis.
Source: Office of Financial Management, Economic & Revenume Forecast Council

The Government Finance Officers Association (GFOA) also recommends maintaining adequate fund balance levels to prepare for financial fluctuations and to stabilize tax rates. At a minimum, GFOA recommends maintaining two months' worth of operating revenues (or expenditures) in the unrestricted fund balance. Factors to consider in maintaining a minimum balance are: the predictability of revenues and expenditures, the likelihood of significant one-time outlays, the availability of other funds that draw from the general fund, the impact of the fund balance on credit ratings and future borrowing, and funds restricted to certain expenditures.

According to a report from Moody's, Washington's "total fund balance" as a percentage of revenues, as shown in Figure 30, is above average. At 14.1%, Washington has the 8th highest combined general fund and rainy day fund balance as a percent of revenues, and compares favorably to the median of 8.7%. The distribution of Moody's "AAA-rated" states is more varied—ranging from 19.4% and 1.4%—with Washington falling in the top one-third of this group.

Figure 30. Total Fund Balance and Rainy Day Balance as Percent of Revenues



Source: Stress-Testing States 2018. Moody's. Sept. 15, 2018.

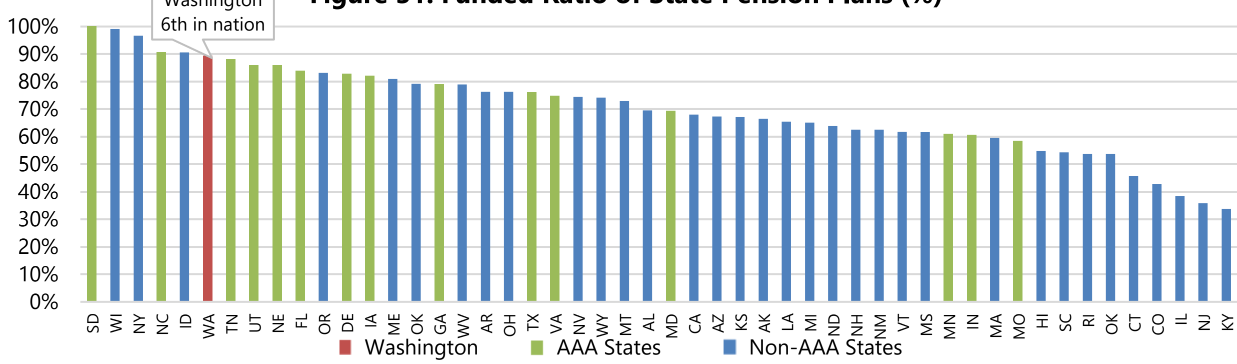
As a reference, in 2018, Moody's performed financial stress tests on all 50 states' fund balances. This study indicated that a moderate fiscal shock would reduce Washington's combined fund balance by an amount equal to 9% of revenues. Consequently, in order to weather such a shock without raising taxes or cutting spending, Washington would need at least 9% of revenues reserved in the BSA. As such, increasing the BSA to 10% of expenditures would better prepare the State for a moderate recession, providing a greater defense for the State's programs and more flexibility in weathering the storm.

State Pension Funding

Recommendation 3: Fully fund the State's annual actuarially determined contributions and use one-time (extraordinary) revenues to improve pension funding.

Relative to other states, Washington enjoys relatively well funded pension plans. According to the most recent actuarial report for the year ended June 30, 2017, the total funded status across all plans measured at 86% (up from 84% as of June 30, 2016). S&P published a report in October 2018 for comparing all states in pension performance. In this report, Washington ranked 6th for its funded ratio (Figure 31). In this regard, the State outperforms many AAA-rated states, which have an average funded ratio of 78.6%.

Figure 31. Funded Ratio of State Pension Plans (%)



Source: U.S. State Pensions Struggle For Gains Amid Market Shifts And Demographic Headwinds. S&P. Oct. 30, 2018.

Though its pension funding status is relatively higher than many peers, the State's unfunded liability amounts to $12.624 billion dollars. With an assumed annual rate of return of 7.50% (and an actual return over the past 20 years of approximately 7.67%), the State's unfunded pension liability is its most expensive obligation. Accordingly, the Office of the State Treasurer recommends that the State fully fund its annual actuarially determined pension contributions and apply one time (extraordinary) revenues to improving the pension system's funding status.

"Over the past twenty years, Washington's outstanding general obligation debt has increased from $6.9 billion to $19.2 billion. While these financings have funded a variety of important projects, our heavy reliance on bonds has left the State with a high debt burden.

Washington has the 6th highest debt per capita in the country. Every Washingtonian would have to contribute $2,662 to fully repay the State's debt, well over the national average of $987. In FY 2019, the State will pay more than $1.3 billion in debt service payments for its various purpose general obligation bonds, or 5.3% of total revenues.

Washington enjoys a robust economy and strong revenue collections. This presents an opportunity to strengthen the State's credit by emphasizing pay-go project financing, protecting our general fund and rainy day fund balances, and improving the funding status of our pension system. Now that the economy is strong, I urge the Legislature to ensure that the 2019-21 budget prepares the State to ride out the next economic downturn."

– Duane A. Davidson, Washington State Treasurer

The following quotes provide an example of how the State's credit is viewed and analyzed by the rating agencies:

> "Washington's AA+ GP rating and Issuer Default Rating (IDR) reflect the state's solid economy with strong growth prospects, a demonstrated commitment to fiscal balance, and combined long-term liabilities that place a low burden on resources despite an above-average debt load."
>
> *– Fitch Ratings*

> "The state's debt ratios are more than twice Moody's 2018 50-State medians; net tax-supported debt as a percentage of personal income is 5.4%, compared with Moody's median of 2.5%, and net tax-supported debt per capita is $2,662, compared to a median of $987."
>
> *– Moody's Investor Services*

> "In general, we consider Washington's approach to financial management strong, as reflected in our Financial Management Assessment (FMA) and budget management scores. Well-established economic and revenue forecasting, and increasingly refined debt management practices and oversight, served the state's credit quality well during the recession and its aftermath."
>
> *– S&P Global Ratings*

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