

## State of Washington; Appropriations; General Obligation

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# State of Washington; Appropriations; General Obligation

## Credit Profile

US\$506.4 mil var purp GO rfdg bnds ser R-2018C due 08/01/2034

*Long Term Rating*

AA+/Stable

New

Washington GO

*Long Term Rating*

AA+/Stable

Affirmed

## Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to the State of Washington's series R-2018C various purpose general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term and underlying ratings on the state's GO and motor vehicle fuel tax GO debt outstanding, and its 'AA' rating on the state's appropriation-backed debt outstanding. The outlook on all ratings is stable.

The ratings reflect our view of Washington's:

- Relatively well-educated workforce and good income indicators;
- Good recent economic growth relative to that of the nation and sales tax-based revenue structure, which has demonstrated less sensitivity to economic cycles than income tax-reliant states;
- High cost of housing, especially in key economic centers that could impede long-term growth prospects;
- Good internal access to sources of liquidity in the treasury and treasurer trust funds;
- Strong financial policies and practices, including statutory provisions requiring that the state's biennial budget and projected subsequent two fiscal years' spending plans be balanced, which is key given increasing expenditure pressures; and
- Moderately high per capita debt burden, but relatively low unfunded pension and other postemployment benefit (OPEB) liability.

The state's full faith, credit, and taxing powers secure the GO bonds. We understand that the proceeds from the series R-2018C bonds will be used to refund certain debt outstanding for debt service savings.

As of Oct. 1, 2017, Washington has about \$17.6 billion in GO bonds outstanding, net of reimbursements. Of this, about \$6.3 billion of the state's net GO debt is payable first from excise taxes on motor vehicles and special fuels. Currently, the state also has about \$810 million of certificates of participation (COPs) outstanding including COPs for state and local agencies. Appropriation-backed debt outstanding includes the city of Aberdeen's revenue refunding bonds for a Stafford Creek Corrections Center project and FYI Properties' lease revenue bonds for the Department of Information Services.

Washington's September 2017 Economic and Revenue Forecast Council (ERFC) forecast revised general revenue upward by \$2.4 billion for the 2017-2019 biennium to \$43.3 billion. Changes reflect \$2.1 billion of non-economic legislative changes and \$279 million of upward revenue revisions that stem from higher-than-expected collections in

the current fiscal year (\$87 million) and changes to forecast (\$192 million). Total forecast 2017-2019 general fund revenue is 12.9% higher than that of the previous biennium, while the 2019-2021 biennium revenue forecast of \$47.4 billion is \$4.1 billion, or 9.6%, higher than the 2017-2019 biennium estimate. The ERFC's baseline scenario for the 2017-2019 biennium incorporates continued projected economic growth, including 1.2% nonfarm payroll employment growth in 2018, 1.0% growth in 2019, and 0.8% growth in 2020, which reflects assumed gradual deceleration in the state economy as economic recovery matures. The September 2017 ERFC also incorporated modest growth in housing starts of 0.8% in 2018 and a slight 0.6% decrease in nominal annual personal income growth for fiscal 2018 to 4.5% from 5.1% in the June forecast. The ERFC's forecast 2018 and 2019 nominal annual personal income growth is particularly strong at 4.5% and 5.5%, respectively; it differs slightly from IHS Markit's projections of 4.2% in 2018 and 4.9% in 2019.

On June 30, 2017, Washington enacted its \$43.7 billion 2017-2019 biennium operating budget for the state general fund, education legacy trust account, and opportunity pathways account. The enacted budget is \$5.2 billion, or 13.5%, higher than the supplemental budget for the 2015-2017 biennium, due primarily to recommended increases to education spending in response to the Washington State Supreme Court's 2012 decision (the "McCleary" ruling), which opined that the state has systematically underfunded its public education system. The enacted budget allots a total of \$22 billion of biennial spending on kindergarten to grade 12 (K-12) education, which represents approximately 50% of the total budget. The 2015-2017 biennium budget made some progress in raising education spending to address a portion of Washington's obligations under the McCleary ruling. The state's 2017-2019 enacted budget includes education funding initiatives that management believes address the remaining requirements outlined in the ruling. Any action concerning the court's termination or maintenance of jurisdiction over the case is expected in the fall of 2017. Growth in spending also reflects funding for class size reduction, recommended employee salary increases, overhaul of the mental health system, various higher education costs, and collective bargaining and related compensation costs.

The 2017-2019 enacted biennium operating budget also includes revenue additions expected to bring in an additional \$2.07 billion over the biennium. Additions include increasing the state property tax rate to \$2.70 per \$1,000 of assessed value (\$1.614 billion) and certain changes to the state's sales tax collections (\$456 million). Washington now projects a combined budget stabilization fund and unrestricted general fund balance of \$2 billion at the close of the current biennium, or about 4.8% of biennial general fund expenditures (excluding federal expenditures), which we view as adequate. On an annualized basis, which is more comparable to other states, the ending biennium balance, as enacted, would equate to a strong 10% of general fund expenditures budgeted for fiscal 2018. We note that the enacted budget reduces reserves in the state's budget stabilization account by \$480 million (29.3%) to \$1.16 billion, from \$1.64 billion in the previous biennium, largely due to payments made into a pension fund to reduce liabilities. However, we believe Washington's current reserves position the state well for future cyclicity or an unexpected downturn.

The state legislature enacted a capital budget to refund existing appropriations, but has not yet passed a capital budget for new projects due to negotiations about rural water rights. The timeline for passage is uncertain and new capital projects will not begin until a full capital budget is in place. The state's \$5.7 billion transportation budget was passed in April 2017.

Washington's reliance on retail sales and business and occupation (gross receipts taxes) for a combined 69% of general

fund revenues (on a budgetary basis) typically affords the state more revenue stability than other states that rely on personal income tax revenues. However, cyclicalities in the economy could pressure revenue, as reflected in the ERFC's pessimistic economic scenario that reflects 5% lower revenue than currently estimated for the next biennium due to downside risks from a potential national recession, national and global political uncertainty, or a stock market crash.

Although state employment, personal income, and GDP trends remain positive, exposure to weakness in the global economy and effects on exports, as well as weaker manufacturing activity and volatile stock markets, remain mitigating risks to Washington's revenue forecast. The strong dollar and weak global economic growth contributed to declines in state exports in 2016. According to IHS Markit, state exports in 2016 were down 7.8% compared with 2015, including a 11.6% decline in transportation equipment exports, which was somewhat offset by improvement in agriculture exports. Washington is the third-largest exporter in the country, and the state's exports as a percent of gross state product (GSP) is the second-highest proportion in the country at 16.8%.

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 gaps.

For September 2017, the state treasury and treasurer's trust fund's month-end cash balance was \$5.2 billion, compared to the average annual \$5.9 billion balance through September 2017. Investments are conservative, in our view, with an average of 58.8% of funds invested in U.S. treasuries and agencies as of September 2017. In addition to Washington's investment guidelines, state policies require that collateral in repurchase agreements (of which the state currently has none) for U.S. Treasury, agency, and money market instruments be priced at 102% of market value. Mortgage-backed repurchase agreements of more than seven days are subject to a higher, 105% requirement.

According to unaudited results for fiscal year-end 2017, Washington's gross direct tax-supported debt burden was \$20.3 billion in GO and appropriation-backed bonds outstanding, but a somewhat lower \$18.8 billion when accounting for self-supported debt. Tax-supported debt was moderately high, in our opinion, at about \$2,542 per capita and 4.8% of total personal income. Debt paydown remained average, in our view, with about 53% of principal outstanding amortized over 10 years. Gross GO and lease appropriation-backed debt service is moderate, in our opinion, at 4.7% of the funds' expenditures from which the state pays debt service. However, portions of Washington's debt are funded from self-supporting or reimbursable sources. Considering just the general fund, adjusted for these offsetting revenues, we estimate that debt service was a still-moderate, in our view, 5.4%. Even after recent issuance of about \$1.5 billion of additional debt since the end of fiscal 2016, we estimate the state's debt burden remains moderately high.

Long-term liabilities include those related to the state's pension system and retiree health care. Based on June 30, 2017, comprehensive annual financial reports for the cost-sharing plans, we calculate Washington's share of the net pension liability across 12 pension plans (not including a share of the school employees retirement system liability) totaled about \$2.5 billion as of June 30, 2017, or \$353 per capita, which is very low, in our view. This is reduced from approximately \$4 billion or \$553 per capita in fiscal 2016 after strong investment returns were reported for the 2017 fiscal year. Relative to total personal income, the state's share of the net pension liability was 0.7%, which is also what

we consider very low. The aggregate funded ratio across plans, including cost-sharing plans in which the state participates as of June 30, 2017, is what we consider good at almost 87%, although this represents a slight decline from a funded level close to 91% as of June 30, 2014, and Washington's pension contributions have fallen short of actuarially determined contribution levels.

OPEBs are funded on a pay-as-you-go basis. The state's OPEBs produce an implicit liability by allowing retired employees to purchase health, life, and vision insurance in the same pool as current employees, at a subsidized rate.

Based on the analytic factors we evaluate for states, we have assigned Washington a composite '1.7' on a four-point scale whereby '1.0' is the strongest and '4.0' is the weakest.

## Outlook

The stable outlook reflects our view of Washington continuing to benefit from above-forecast end-of-biennium revenue trends. Nevertheless, we expect that significant upward pressure on spending originating in legal- and voter-approved mandates will remain a soft point in the state's credit profile. However, legal requirements that Washington enact budgets that not only balance for the current biennium but also project balance through the following biennium help facilitate a structural approach. That, coupled with Washington's ongoing discipline vis-a-vis funding the state's budget reserves, should help insulate the state rating from unexpected economic or revenue weakening. Potential for upward movement would likely entail a permanent fix to Washington's education funding challenges, moderation of growth in debt levels, and sustainable growth in revenue that keeps pace with the state's underlying economic growth rates.

Downside pressure on the state rating would likely have economic origins. A sharp falloff in the housing market or sustained weak demand for key state exports, fueled in part by a strong U.S. dollar, changes in trade policy, or slower-than-expected growth from China, could all contribute to such a scenario. State policymakers' response to a downside economic scenario--whether it's timely and structurally oriented--would likely dictate any effect on our rating on Washington. If lawmakers delayed taking corrective action or relied extensively on one-time solutions to budget gaps, allowing the state's reserve balances to decline precipitously, this could result in downward pressure on the rating.

## Governmental Framework

Washington's statutory requirement to adopt a balanced budget, when coupled with the state's financial management policies, encourages the state to ensure ongoing fiscal solvency. 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 the state's various payment obligations.

The governor has 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.

An active voter-initiative environment complicates Washington's governmental framework. We view the initiative as limiting the state's fiscal flexibility somewhat. However, the legislature's willingness and ability to set aside provisions of voter-approved initiatives when fiscal conditions warrant has proven beneficial to credit quality, in our view. (Initiatives may be amended with a two-thirds vote of the legislature within two years of passage and a simple majority of the legislature thereafter.) We noted, for instance, that during the 2011-2013 biennium and eight of the 14 preceding years to that biennium, the legislature temporarily suspended Initiatives 732 and 728 (for teacher cost-of-living salary increases and smaller class sizes, respectively). During the 2012 legislative session, the legislature repealed I-728 altogether. The legislature also suspended I-732 again for the 2013-2015 biennium and suspended features of I-1351 (class size reduction) for the current biennium. The state constitution allows the state to raise taxes with a majority vote of the legislature.

During the 2011 legislative session, the legislature added a debt commission to the state's process of developing its debt affordability study. The debt commission evaluated Washington's use of debt and made policy or constitutional change recommendations, including creation of a new constitutional debt limit. Given that Washington's debt levels are already moderately high on most measures, we believe steps to contain the growth of its debt burden are favorable for the state's credit quality.

In 2012, the legislature put on the ballot, and the voters subsequently approved, a constitutional amendment related to the previous state debt limit. The amendment lowers the limit on Washington's annual debt service to 8.25% of a six-year moving average of general fund revenue by 2016 and to 8% by 2034, from the previous limit equal to 9% of a three-year moving average. Finally, in 2012, the legislature approved reducing early retirement benefits for newly hired employees in three state pension plans and phased in reduction of the assumed rate of return for its pensions to 7.7% for the 2017-2019 biennium from 7.9% in the 2013-2015 biennium.

On a scale ranging from '1.0' (strongest) to '4.0', we have assigned a score of '1.7' to Washington's governmental framework.

## **Financial Management**

### **Financial management assessment: Strong**

We consider Washington's financial management practices strong under our FMA methodology. An FMA of strong indicates our view that practices are strong, well embedded, and likely sustainable. The state ERFC, which is made up of representatives appointed by the governor's office, both houses 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, which are based on a modified IHS Connect model of the U.S. economy, 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 2013-2015 biennium, state law required

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 per year, the state convenes a Caseload Forecast Council, which forecasts service requirements in such areas as public assistance, state corrections, medical assistance, and K-12 education. The executive branch uses these forecasts, along with historical expenditures, to formulate budget proposals and midbiennium revisions.

Further guiding budgeting 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 structural imbalances before the next budget cycle begins. Although the state does not have a minimum reserve policy, Washington Constitution requires the state to set aside 1% of most unrestricted state revenues in each fiscal year into a budget stabilization fund, a form of 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 addition, in November 2011, voters approved a measure requiring that any revenue growth that exceeds one-third of the average biennial growth in state revenues during the previous five biennia be transferred to the budget stabilization account.

Other policies and practices include:

- Capital spending that the state budgets for on a biennial schedule but plans on a rolling, 10-year basis and includes funding sources;
- A formal investment management policy that covers eligible investments, maximum maturities (10 years), allocations of nongovernment securities, and internal and external controls; and
- Debt management under an issuance policy that, among other elements, addresses refunding savings thresholds.

## **Budget Management Framework**

Washington adheres to budget management practices we consider generally strong. 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. In addition, when deficits emerge midcycle, the state has generally responded with timely corrective actions. Revenue projections are apolitical and are developed according to the state's independent revenue forecasts. When deficits do emerge, however, the state tends to include nonrecurring measures among its solutions, and its updates-to-actual fiscal performance that includes both revenue and spending trends is not regularly available at intrayear intervals.

On a scale ranging from '1.0' (strongest) to '4.0', we have assigned a score of '1.5' to Washington's financial management.

## **Economy**

The state continues to experience consistently strong economic growth trends relative to national levels, with year-over-year population growth in 2016 of 1.78%, compared to the national 0.70% growth, and Washington's population is forecast to continue to increase more than 1% annually for the next few years. Furthermore, its relatively low age-dependency ratio (59.1), good per capita GSP (113% of the national average as of 2016), and good per capita incomes (111% of the U.S. average for 2016) are characteristic of the state's relatively strong economic profile. Washington has continued to see strong job growth across most sectors and particularly in trade, transportation, and utilities, as well as in construction and education and health. The state unemployment rate has also improved gradually, recorded at 4.6, in September 2017, and continued good labor force and workforce participation in the state has kept the rate at about 0.5% above that of the U.S in 2016. Economic development prospects remain relatively good, in our view, with the state's above-average education level among residents, access to ports, and below-average energy costs.

Washington is an important gateway for trade with Asia and Canada, and ranks third in the nation in annual export value and first in export value per capita. Trade helps to diversify the state's prospects for growth while somewhat insulating it from U.S. economic cycles. Being a heavy exporter-state also has a downside, however, by exposing Washington's economy to a strong dollar, adverse changes in trade policy, and fluctuations in economic performance from around the globe. Boeing Co., the state's largest employer with nearly 80,000 full-time employees, also accounts for most of the state's transportation exports; civilian aircraft, engines, and parts account for a large 60.2% of total state exports valued at \$47.9 billion in 2016. Boeing is ramping up production at its Renton plant to address a more than 4,300-aircraft backlog, although several airlines have recently deferred orders of the aircraft to later dates. At the same time, the firm has been reducing its workforce due to increased operational efficiencies, cutting more than 3,000 jobs in the state in the previous two years, and announced a reduction of 4,000 more in its commercial airplane division in 2016. In May 2016, although Boeing opened its new \$1 billion wing plant for its new largest passenger aircraft, the 777x, it announced reducing production of the aircraft by about half due to slower-than-expected orders. This has led to cuts in positions at the Everett plant, which is expected to reduce its workforce by an additional 2,000 positions by the end of 2017.

On a scale ranging from '1.0' (strongest) to '4.0', we assigned a score of '1.3' to Washington's economy.

## **Budgetary Performance**

The state's lack of a formal policy for its budget reserve level allows for low balances to persist through protracted periods of economic and revenue softness. However, during expansionary phases of the economic cycle, Washington consistently returns operating surpluses and good budgetary reserve positions. The state projects that the combined general fund and budget stabilization account reserves as of fiscal 2017 to be \$2.4 billion, or 6.2% of the 2015-2017 biennium budget (excluding federal expenditures). The fiscal 2017-2019 enacted biennium budget also includes a combined ending balance of \$2.4 billion.



Retail sales and business and occupation (gross receipts) taxes together account for a combined 69% of general fund tax revenues and typically afford 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 and formal revenue and caseload forecasts inform budget decisions, and political leaders have demonstrated a willingness to make difficult adjustments when necessary to target structural budget balance.

Similar to many other states, significant spending areas in Washington's budget are largely nondiscretionary. The state estimates that as much as two-thirds of spending--primarily for K-12 education, Medicaid, foster care, debt service, and pensions--is effectively legally required by some combination of the state constitution, statute, court decision, or federal mandate. In addition, Washington voters have, over the years, approved initiatives that have reduced the revenue and spending autonomy of the state. The McCleary decision further pressures state spending by requiring higher state funding for K-12 school districts.

Washington's liquidity has strengthened markedly since the aftermath of the Great Recession when monthly general fund cash deficits had grown to more than \$1 billion. As of the end of September 2017, general fund cash totaled negative \$284 million compared with \$329 million in September 2016. Although it is common in some months for the state's general fund cash balances to fall into negative territory, this has occurred less often in the previous two years. Based on treasury cash reports, the general fund cash month-end position never fell below zero in 2017, and only did so twice in fiscal 2016 compared to eight out of 12 months in fiscal 2015 and 11 out of 12 in fiscal 2014. 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 comingled basis. As a result of its good access to internal liquidity, Washington does not rely on external borrowing for cash flow management. As such, we continue to view the state's internal liquidity sources as sufficient to support its general fund budget operations--which we expect will remain on track, along with state revenues and the economy more broadly. State authority to defer payments and issue cash flow notes, if needed, also serve as contingency liquidity measures, but Washington managed through the Great Recession without taking these steps.

### **Fiscal 2017 unaudited results**

According to unaudited financial statements for fiscal 2017, the state's general fund assigned and unassigned fund balance, on a generally accepted accounting principles (GAAP) basis, was \$2.4 billion, or a good 7.4% of expenditures, which is down slightly from audited fiscal 2016 results. However, the general fund posted a \$971 million operating surplus net of transfers which is higher than the \$564 million surplus reported in fiscal 2016 audited statements. In addition, the unaudited fund balance improved to \$4.2 billion (a strong 13.2% of expenditures) in fiscal 2017 compared with \$3.2 billion (a strong 10.7% of expenditures) in fiscal 2016 audited results.

### **Fiscal 2016 audited results**

As of the end of fiscal 2016, the state's general fund assigned and unassigned fund balance, on a GAAP basis, was \$2.5 billion, or a good 8.3% of expenditures. The general fund posted a \$565 million operating surplus net of transfers, and the audited fund balance improved compared with fiscal 2015 when it was almost \$2 billion, or a good 7% of expenditures. During expansionary phases of the economic cycle, the state consistently returns operating surpluses and good reserve positions. However, Washington had much lower audited reserves in fiscal 2010 due to draws during

the recession to just \$302 million, or 1.2% of expenditures.

On a scale ranging from '1.0' (strongest) to '4.0', we have assigned a score of '1.8' to Washington's budget performance.

## **Debt And Liability Profile**

As noted, Washington's debt is moderately high by several measures, in our opinion, including debt per capita and debt as percent of personal income. We expect debt levels to remain moderately high given anticipated future issuance, particularly for the state's transportation capital program. In 2015, the legislature passed fuel taxes and certain license fees as part of a transportation revenue package to help fund significant transportation investment in the state over the next 16 years. The state's transportation revenue forecast council forecasts total transportation revenues of \$6.3 billion for current biennium, including new revenue from the 2015 transportation package, which will help support \$5.3 billion authorized in future GO bonds for the total program.

### **State pension liability**

Washington's unfunded pension liability represents its proportionate share of several pension plans and consists primarily of its share of the unfunded liability for Washington Public Employees Retirement System 2 and 3 (PERS 2/3) and Washington Public Employees Retirement System 1 (PERS 1). We consider the state's three-year average pension-funded ratio good at 87%. The state's pension-funded ratio as of June 30, 2017, was still good at 89.5%, albeit slightly below the 90.6% reported in fiscal 2014.

While statutes require the Office of the State Actuary (OSA) to calculate an actuarially determined contribution (ADC), actual contribution levels across plans do not always meet the ADC. 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 frequently fall short of the ADC because they are not adjusted after the budget is adopted. In addition, adopted contribution levels for most plans have been different than 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 as of the most recent experience study. Furthermore, we calculate that average total annual plan contributions in the previous three years did not cover a level equal to service cost and an interest cost component plus some amortization of the unfunded liability across plans; however, trends have been improving in recent years and contributions were approximately 97% of costs in fiscal 2017.

We believe, on the whole, management factors and actuarial inputs do not significantly worsen or improve our view of the state's overall pension funding discipline. PERS 1 assumes a rolling 10-year amortization period and uses a "level percentage of pay" method, which assumes rising future payroll and results in escalating pension contributions over time. The actual average net investment return over the previous five years for both PERS 1 and PERS 2/3 exceeds the actuarial assumed 7.7% rate of return. In fiscal 2017, both plans reported increased investment returns, at 13.84% for PERS1 and 14.10% for PERS 2/3. As of fiscal 2015, all of the plans--except for the smaller veterans and volunteer firefighters retirement plans--use an assumed 7.7% actuarial rate of return, and no plans have projected an asset depletion date under Governmental Accounting Standards Board 67, which we believe is reasonable. Since PERS 1 is closed to new members and projected benefit payments are declining, the ratio of active members to beneficiaries of

0.05 is well below the median national ratio of 1.5. The PERS 1 plan funded ratio of 61.24% in fiscal 2017 is relatively low, in our opinion, although cash flow projections reflect a fairly short horizon of future plan contributions through 2031, assuming plan assets will generate the assumed 7.7% annual rate of return to pay remaining member benefits as the plan winds down. On the other hand, PERS 2/3 has a strong 3.3 active-to-beneficiary ratio relative to the national median, and what we consider a strong 91% plan-funded ratio. We believe the system generally incorporates experience trends and industry standards in its experience studies and updates its economic experience studies every two years, although updates to the demographic experience studies occur every six years, which we believe are relatively infrequent. An updated economic experience study was issued in August 2017.

Washington's proportionate share of all plans' net pension liability translates to what we view as a relatively small \$353 per capita and 0.7% of personal income.

### **OPEBs are funded on a pay-as-you-go basis**

The state provides both an explicit and implicit subsidy for retiree health benefits. Washington's OPEBs produce an implicit liability by allowing retired employees to purchase health, life, dental, and disability insurance in the same pool as current employees at a subsidized rate. The explicit benefit subsidizes retired members' monthly premiums up to \$150 per member per month for enrollment in Medicare Parts A and B.

On an actuarial basis, Washington's portion of the actuarial accrued liability was \$5.5 billion, or about half of the total plan liability, as of Jan. 1, 2017. The state's annual OPEB cost was \$5.0 million (1.7% of general fund expenditures), according to Washington's fiscal 2017 unaudited financial statements.

According to unaudited results for fiscal 2017, the state contributed \$95 million for pay-as-you-go expenses for retiree benefits, equal to less than 1% of annual general fund expenditures that same year.

We understand that Washington does not plan to fully fund the actuarially required contribution for the foreseeable future.

On a scale ranging from '1.0' (strongest) to '4.0', we have assigned a score of '2.3' to Washington's debt and liability profile.

### **Ratings Detail (As Of November 1, 2017)**

Washington motor vehicle fuel tax GO bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor vehicle fuel tax GO bnds ser 2015C due 02/01/2040		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor veh fuel tax GO bnds ser 2008D dtd 01/22/2008 due 01/01/2009-2033		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor veh fuel tax GO bnds ser 2010B dtd 07/28/2009 due 08/01/2010-2032 2034		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor veh fuel tax GO rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington motor veh fuel tax GO rfdg bnds ser R-2015D due 07/01/2030		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

## Ratings Detail (As Of November 1, 2017) (cont.)

Washington mtr veh fuel tax GO bnds (Build America Bnds) taxable ser 2010D dtd 10/22/2009 due 08/01/2020-2024 2029 2039

*Long Term Rating* AA+/Stable Affirmed

Washington mtr veh fuel tax GO bnds (SR-520 Corridor Program -Toll Rev) ser 2012C dtd 10/31/2011 due 06/01/2017-2033 2041

*Long Term Rating* AA+/Stable Affirmed

Washington mtr veh fuel tax GO rfdg bnds

*Long Term Rating* AA+/Stable Affirmed

Washington mtr veh fuel tax GO rfdg bnds ser R-2010C dtd 10/28/2009 due 01/01/2012-2026

*Long Term Rating* AA+/Stable Affirmed

Washington mtr veh fuel tax GO rfdg bnds ser R-2014B dtd 10/24/2013 due 07/01/2014-2021

*Long Term Rating* AA+/Stable Affirmed

Washington various purp gen oblig bnds

*Long Term Rating* AA+/Stable Affirmed

Washington var purpose GO bnds

*Long Term Rating* AA+/Stable Affirmed

Washington var purp GO rfdg bnds ser R-2015G due 07/01/2032

*Long Term Rating* AA+/Stable Affirmed

Washington GO

*Long Term Rating* AA+/Stable Affirmed

Washington GO bnds

*Unenhanced Rating* AA+(SPUR)/Stable Affirmed

Washington GO bnds (Motor Vehicle Fuel Tax) ser 2004B dtd 08/06/2003 due 07/01/2004-2028

*Unenhanced Rating* AA+(SPUR)/Stable Affirmed

Washington GO comp int bnds ser 1999S-2 dtd 05/20/1999 due 01/01/2017-2019

*Unenhanced Rating* AA+(SPUR)/Stable Affirmed

Washington GO Mtr Veh Fuel Tx

*Unenhanced Rating* AA+(SPUR)/Stable Affirmed

Washington GO & mtr veh fuel tax rev bnds ser 1993B DD-12 CC-9 dtd 05/01/1993 due 03/01/1994-2010 2018 & 05/01/2005-2010 2018

*Long Term Rating* AA+/Stable Affirmed

Washington GO & mtr veh fuel tax (MBIA/National)

*Unenhanced Rating* AA+(SPUR)/Stable Affirmed

Washington GO (Motor Vehicle Fuel Tax)

*Long Term Rating* AA+/Stable Affirmed

Washington Washington St Var Purp #2 dtd 2-1-83

*Unenhanced Rating* AA+(SPUR)/Stable Affirmed

Washington GO

*Unenhanced Rating* AA+(SPUR)/Stable Affirmed

Washington GO

*Long Term Rating* AA+/Stable Affirmed

## Ratings Detail (As Of November 1, 2017) (cont.)

[illegible]

Many issues are enhanced by bond insurance.

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