

Saving Money, Supporting Schools: Job Legislation Poses Minimal Risk to Washington's Credit



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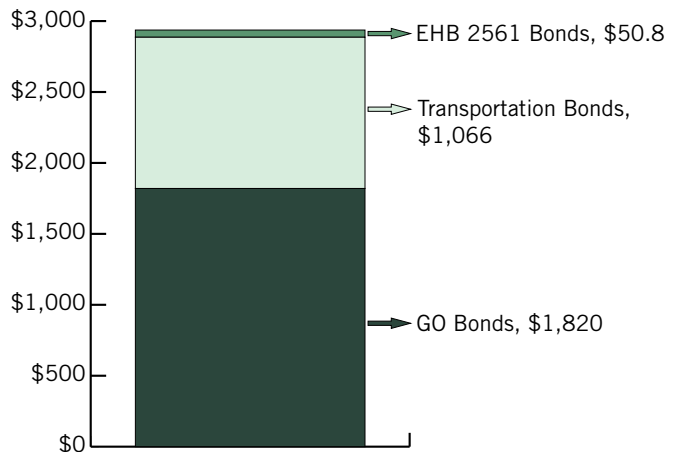
Summary

The Washington State Treasurer has expressed concern that, by increasing the amount the state can legally borrow, EHB 2561—also known as the Jobs Act—could affect Washington's credit rating.¹ *However, a review of bond rating decisions in other states suggests that the State Treasurer is being overly cautious.* The legislation will do little to put the state's credit rating at risk because it adds relatively little to Washington's debt load, a critical factor when agencies assess a state's credit worthiness.

Other factors are far more worrisome to the state's credit. The rocky economy, the state's heavy reliance on sales taxes, possible passage of voter initiatives, and proposed bonds for expensive transportation projects could all pose risks; by comparison, the effects of EHB 2561's credit provisions are minimal. And while it is true that ratings agencies have identified Washington's relatively high debt level per capita as a concern, the debt incurred by EHB 2561 is dwarfed by other new debt obligations that the legislature is proposing to undertake, particularly for large transportation projects which create an ongoing liability for the state in maintenance and operations, increase carbon emissions, and often suffer from cost overruns.^{3,4}

While energy savings created by the Jobs Act stay at the school district level and don't directly support debt service on bonds, those savings do—based on one analysis—reduce the state's long term financial obligations by extending the life of some existing school buildings by as many as 15 years.⁵ That could mean a savings of \$610 million in new school construction bonds and a potential savings of \$86.5 million in debt service over the next 8 years. The small increase to the state's debt load created by the Jobs Act, offset by the potential savings to the state's school construction budget, should provide the basis for continued solid ratings for Washington's credit in the future.

2011-13 Debt Service on GO, Transportation, and EHB 2561 Bonds (*dollars in millions*).



Source: Washington State House of Representatives.²

Analysis

The Jobs Act would allow the state to borrow up to \$860 million to finance major building upgrades and energy efficiency projects in Washington public schools.⁶ The State Treasurer's concern is that the legislation might affect the state's bond rating because it would increase debt service obligations on the general fund.⁷ A good bond rating is important, since it can help a state borrow money at a low interest rate—just the way a good credit score lets a consumer borrow money at a lower interest rate.

Is the Treasurer right to be concerned? While he's clearly doing his duty in trying to protect the state's credit rating, his position is overly cautious, and likely overstates the risk from the proposed legislation.

Typically, bond ratings are issued by a handful of ratings agencies—including Moody's, Standard & Poor's, and Fitch Ratings. A state's ratings are influenced by many factors, including a state's general fund reserve, audit findings, revenue projections, stability of local governments, past payment performance, and state and local policies.⁸

A ratings agency may downgrade a state's bond rating when the agency believes that the state will have difficulty in meeting its regular bond payments. That determination is made based largely on the state's total amount of debt compared to how much revenue the state is taking in.

Recently there has been a spate of downgrades in bond ratings for states. The major reason is the recession: states have seen revenues from sales and income taxes fall, even as demands on state budgets have risen. California is a prime example. Since last March, Moody's has downgraded California's bond rating two notches, from A1 to Baa1, citing California's "use of IOUs for non priority payments, the deadlock on the \$26 billion budget gap, and the risk to priority payments."⁹

California's downgrade came as the state's budget process reached a stalemate during one of the worst recessions in history—and California state budget rules require a two-thirds vote of each house to pass the budget. The downgrade wasn't because of any single piece of legislation but because of the economic downturn coupled with political deadlock and dwindling cash reserves. Other states, like Illinois, have faced similar downgrades in their ratings.¹⁰

However, Moody's still rates Washington State near the top of the scale in credit worthiness, affirming a rating of Aa1, just one notch below its highest rating of Aaa. Moody's "expects that the state's finances will remain well-managed despite its recent sizable budget shortfalls."¹¹ Although Moody's is concerned about ongoing economic challenges—lower sales tax revenue and waning consumer confidence—they also seem convinced Washington will be a good credit risk in the future.

An analysis by the Washington State House of Representatives shows that EHB 2561 does little, in Sightline's view, to change the picture of Washington's overall debt servicing. The state already will pay \$1.8 billion to service its general obligation, or "GO," bonds, and over \$1 billion for transportation bonds in fiscal 2011-13. Additional debt service under the Jobs Act would represent less than 2 percent of the total already expected, making it unlikely that EHB 2561 will substantially change Moody's assessment of Washington's ability to repay its obligations.

Some of the retrofits—using the well-tested principles of performance contracting—would extend the useful life of existing buildings, which are built in large part with state funds.¹² Extending the life of the buildings could therefore actually *reduce* the debt service payments for new school construction. In fact, one analysis performed by Office of the Superintendent of Public Instruction found that if

retrofits funded by the Jobs Act were completed, many schools would not have to be replaced.¹³ While the reduction in demand for school construction financing would not likely have an immediate positive effect on ratings, it could contribute to an overall strategy of *decreasing* the state's debt load, an important factor when agencies rate a state's credit risk.

Conclusion

Concerns about increasing the debt limit are legitimate since Washington carries a higher debt load than the average state, according to Moody's.¹⁴ But the amount of debt currently being carried for transportation projects and other bonds dwarfs the outlay in debt service that will be created by the Jobs Act. And EHB 2561 would only obligate the state's general fund for 10 years, a relatively short period of time, even as it provides clear economic benefits. Far from posing a potential risk to the state's credit, the Jobs Act could be part of the state's long term recovery, ensuring its credit worthiness into the future.

Sightline Institute's research on green collar job creation has pointed again and again to the importance of energy efficiency retrofits for putting people back to work, saving money for families and institutions, and reducing the state's overall demand for energy.¹⁵ By providing capital for up front costs, the Jobs Act would remove a critical barrier, enabling cash-strapped school districts to take advantage of savings that can end up back in the classroom.¹⁶

About the Author

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Sightline Institute is a non-partisan research and communication center—a think tank—based in Seattle. Founded in 1993 by Alan Durning, Sightline's mission is to bring about sustainability, a healthy, lasting prosperity grounded in place. Our focus is Cascadia, or the Pacific Northwest.

Endnotes

1. “State Treasurer James McIntire’s Statement on House Bill 2561,” Office of the Treasurer, January 20, 2010, <http://www.tre.wa.gov/news/pr100120.shtml>.
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5. “Jobs Act – School power costs and state debt service,” One Washington, February 2, 2010, <http://newsroom.housedemocrats.wa.gov/hans-dunshee/jobs-act-ndash-school-power-costs-and-state-debt-service/>.
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7. “State Treasurer James McIntire’s Statement on House Bill 2561,” Office of the Treasurer, January 20, 2010, <http://www.tre.wa.gov/news/pr100120.shtml>.
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11. Nicole Johnson, “Affirms Aa1 Rating on Approximately \$15B in Outstanding GO Debt; Outlook is Negative,” Moody’s Investors Service, December 31, 2009, http://www.tre.wa.gov/documents/MoodysBonds_Dec09.pdf. While Washington’s outlook was changed to “negative” in this assessment it is important to note that ratings agencies have changed numerous outlook assessments for state and local governments because of the economy. In April of last year Moody’s assigned a blanket outlook of “negative” to all municipalities in the United States for example.
12. “Success Stories,” General Administration, State of Washington, May 6, 2009, <http://www.ga.wa.gov/eas/epc/convinced.htm>. Performance contracting has already been used in Washington State to great effect. Loans for many projects originate from the State Treasurers Office through the Local Option Capital Asset Lending (LOCAL) program, which uses bond financing.
13. “Jobs Act – School power costs and state debt service,” One Washington, February 2, 2010, <http://newsroom.housedemocrats.wa.gov/hans-dunshee/jobs-act-ndash-school-power-costs-and-state-debt-service/>.
14. Nicole Johnson, “Affirms Aa1 Rating on Approximately \$15B in Outstanding GO Debt; Outlook is Negative,” Moody’s Investors Service, December 31, 2009, http://www.tre.wa.gov/documents/MoodysBonds_Dec09.pdf.
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