



JAMES L. McINTIRE
State Treasurer

State of Washington
Office of the Treasurer

December 11, 2014

The Honorable Governor Jay Inslee
The Honorable Senator Mark Schoesler
The Honorable Senator Sharon Nelson
The Honorable Speaker Frank Chopp
The Honorable Representative Dan Kristiansen

Dear Governor Inslee, Senator Schoesler, Senator Nelson, Speaker Chopp, and Representative Kristiansen:

Washington needs to pivot toward a more sustainable transportation financing framework that systematically and deliberately moves away from our over-reliance on motor vehicle fuel tax (MVFT) financed debt as the primary source of project funding.

MVFT revenues are not increasing as had been projected due to increased fleet efficiency and reductions in miles traveled, despite our overall economic and population growth. Forecasters expect this trend to accelerate in the future as technology, incentives and consumer behavior shift away from fossil fuel consumption. Already we have had to reduce the time period for issuing MVFT bonds from 30 years to 25 years – this problem cannot wait for that future to arrive before we reach a solution.

During the 2014 Legislative Session, I shared with you my annual Debt Affordability Study, in which I demonstrated that the state is in danger of overleveraging MVFT revenues and faces a shortage of funds for critical maintenance work. Tracking the ratio of total MVFT revenue to the amount pledged to pay debt service on MVFT bonds is an important marker that credit markets use to assess the condition of our transportation finances.

As documented in the Debt Affordability Study, the coverage ratio of gross MVFT revenues to dollars pledged to MVFT bonds fell from over 5.0 to just under 2.0 between 2005 and 2014. This decline is the result of planned, increased borrowing funded by the 2003 and 2005 MVFT rate increases which pledged their entire proceeds to finance bonds for transportation projects. However, current and forecast revenues from these tax increases are falling well short of what was expected in 2005, and if all projects are financed and completed as planned, our MVFT bond coverage rate may fall to 1.5.



MVFT bonds have low borrowing costs because they are backed by the state's general obligation pledge. Continued growth in the issuance of MVFT bonds has the potential to negatively affect Washington's strong credit rating. This could significantly increase borrowing costs for the state across the board.

During the past Legislative Session, both houses proposed competing transportation financing proposals calling for significant bond financing – one proposal called for pledging 80 percent of MVFT revenues for bonds, the other 90 percent. Either of these proposals would have strained the State's ability to pay debt service out of the State's share of fuel tax revenues without seriously diminishing maintenance activities and local MVFT distributions. At that time I referred you to the Debt Affordability Study in which I recommended that any new transportation financing package pledge no more than 50 percent of new MVFT revenues to bond finance.

As we all prepare for the 2015 Legislative Session, I want to underscore this recommendation again, and offer to work with you as you develop your transportation financing strategies. To that end, following are some principals to help frame future transportation finance proposals:

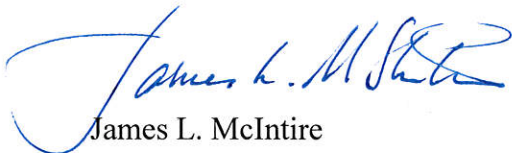
1. No more than 50 percent of MVFT revenues should be pledged to bond finance.
2. We need to recognize the political reality that limiting bond finance to 50 percent of new MVFT revenue will make passage of a transportation package more difficult because it will contain fewer projects of importance to different parts of the state. As a result, we need to limit the use of bond proceeds to the following types of projects:
 - a. projects that are too expensive to finance on a pay-go basis, and
 - b. urgent projects necessary to protect safety.
3. Manage the construction and financing schedule to keep the debt service coverage ratio for the MVFT above 1.9. The slowdown in transportation construction expenditures this year has helped with this, but more needs to be done.
4. Maintenance and preservation activities should receive first priority for new funds not obligated to bond finance projects. Credit markets do pay attention to how we maintain existing assets.
5. Address the capital and operation needs of the ferry system.
6. All remaining projects, which may or may not be identified by the legislative process, should be prioritized on a policy basis and financed on a pay-as-you-go basis. This will require the Executive and the Legislature to establish their policy priorities.

7. Maximize the use of tolls and other user fees. At a minimum, the Legislature should adopt legislation as soon as possible to toll the I-90 bridge to pay for \$1.1 billion of the \$1.4 billion cost of the west side of the 520 Corridor Project. Note that if this project is financed with MVFT revenues it would require MVFT increase of about 6 cents/gallon (if only 50 percent of MVFT revenues are pledged to bonds).
8. Address local transportation needs.
9. Any new revenue source should be 18th amendment protected so that it can backstop **new** MVFT-bonds over time and help finance new projects as MVFT revenues decline. Existing MVFT bond covenants do not allow for new substituting revenue pledges, and as a result we do not envision the replacement of the MVFT during the next 25 years as these bonds are retired.

I fully appreciate that this is an ambitious agenda, especially given the enormity of the other policy and revenue challenges of the upcoming Legislative Session. Nonetheless, taking these important steps soon in a deliberate and systematic way will not only substantially improve our state's transportation financing picture but will also establish a more robust framework for the future.

As always, my office is prepared to work with you and your excellent staff to help you craft a new transportation financing package.

Sincerely,



James L. McIntire
State Treasurer

Cc: Senator Curtis King, Senator Steve Hobbs, Representative Judy Clibborn,
Representative Ed Orcutt