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Fitch: West Virginia Employee Wage Dispute Highlights Fiscal Pressures.

Fitch Ratings-New York-09 March 2018: Fitch Ratings believes the recent wage dispute in West Virginia, which ended with approved salary increases for the state's teachers, service personnel and state employees, is further evidence of the fiscal pressures that underpin our Negative Outlook on the state's 'AA' Issuer Default Rating (IDR).

The state's financial challenges, which have increased with the need to fund the higher salaries, are likely to continue despite recent revenue improvement. The multi-year weakness in the state's key state revenue sources has reflected its struggle with a long-term decline in coal production and related economic turmoil, despite some improvement in fiscal 2018.

The salary increases provide for a fixed-dollar-amount, average 5% raise for all employees effective July 1, 2018. The increases have a $100 million impact on the $4.8 billion (General Revenue, Lottery and Excess Lottery) executive budget for fiscal 2019; $80 million above the 1% average salary increase initially proposed by the governor. The state expects to adjust the governor's recommended budget and apply cash balances in its Medicaid program in fiscal 2019 to accommodate the increases. Fitch believes this additional cost may prove challenging to accommodate in future budgets given vacillating severance, income and sales taxes; prior use of reserves to fund operations; and the cuts the state has already made through a period of revenue weakness. As in most states, education and health and human services spending are the state's largest operating expenses, and the strong employee push for wage increases and health care plan improvement speak to the challenges of cost control efforts in these areas.

Revenues in fiscal 2018 are meeting expectations through February 2018, and the governor has identified an additional $58 million in resources to fund the fiscal 2019 budget beyond what was incorporated into his budget proposal. The legislative budget that is currently moving through both the House and the Senate does not apply the additional forecast revenue to funding the fiscal 2019 budget.

Revenue growth is forecast in personal income and sales taxes as the state anticipates economic momentum from road construction projects, increased consumer spending related to federal tax cuts and stability in the energy sector. Given fiscal performance prior to 2018, Fitch remains cautious that the state will achieve these targets. Additional resources do not include any direct windfall revenue from the federal Tax Cuts and Jobs Act as the state subsequently decoupled its personal income tax exemption policies from those of the federal government, relinquishing $140 million in estimated potential tax benefit in fiscal 2019.

The state's 'AA' IDR incorporates the state's economic concentration in natural resource development, strong ability to control revenue and spending policy, and commitment to addressing its liability profile. The rating is supported by a still sizable level of reserves at the state's disposal, and the governor's budget proposal does not appropriate from the rainy day fund for operations. The Negative Outlook reflects the risks associated with the state's cyclical natural resource markets, particularly the longer term decline in coal production, and Fitch's concern that the state will be challenged in providing a durable response to its long-term economic and financial challenges.

For more information on the state, see "Fitch Rates West Virginia's $44MM School Building Bonds 'AA-'; Outlook Remains Negative" dated Sept. 7, 2017 and available at www.fitchratings.com.

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