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New Issue

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Oregon (State of)

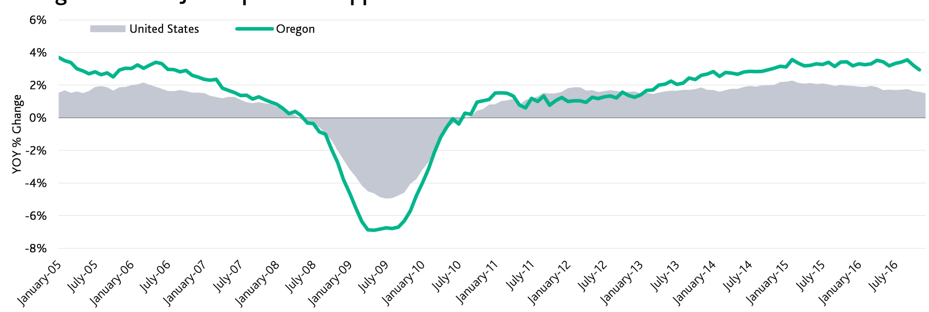
New Issue - Moody's assigns Aa1 to Oregon's $473M GO bonds, 2017 Series A-G; outlook is stable

Summary Rating Rationale

Moody's Investors Service has assigned a Aa1 to Oregon's $473 million General Obligation Bonds, 2017 Series A through G. The outlook is stable.

The Aa1 general obligation underlying rating reflects the state's maintenance of moderate reserve levels during the recession; recent growth in these reserves; strong governance factors that include effective management of voter initiatives in the context of maintaining budget balance; and strong job growth trends that will support continued economic expansion. The rating also incorporates Oregon's high exposure to personal income tax volatility, and the constitutional 2% kicker on personal income taxes that prevents the state from fully capturing the revenue boost during periods of economic strength. Building up Oregon's Rainy Day Fund (RDF) will help balance the state's revenue volatility and kicker limitations, and have a positive effect on the state's long-term fiscal health.

Exhibit 1
Strong Non-Farm Job Expansion Supports Continued Revenue Growth



Source: Bureau of Labor Statistics; Moody's Investors Service

Credit Strengths

- Above average economic growth that is supporting steady revenue growth
- Sound financial controls underscored by executive authority to reduce spending
- Maintenance of a moderate Rainy Day Fund balance
- Relatively well funded retirement system following pension obligation bond issuance and reforms, although recent reforms have been diluted by an April 2015 court decision

Credit Challenges

- Unusually high reliance on economically sensitive personal income taxes can create budgetary strain in times of economic downturn
- Constitutional 2% “kicker” that requires refunds of personal income taxes if collections are 2% or more than the budgeted amount, which could add budgetary and cash flow pressures
- Above-average debt ratios as per Moody's 50-state debt medians, partially offset by low OPEB liabilities and below-average fixed costs

Rating Outlook

Oregon's stable outlook reflects the sound governance that improves fiscal stability, and strong economic growth that will support planned increases in reserves. Oregon's unusually high dependence on personal income taxes poses downside forecast risk, particularly in light of recent stock market volatility, however maintenance of reserves and sustained revenue growth will mitigate that risk.

Factors that Could Lead to an Upgrade

- Continued maintenance of structural budget balance
- Maintenance of strong General Fund reserve levels sufficient to offset revenue volatility during economic downturns
- Sustained healthy job growth

Factors that Could Lead to a Downgrade

- Deterioration in the state's financial performance and reductions in reserve levels
- A return to using non-recurring solutions to balance budget
- Slowing of economic recovery leading to employment erosion and revenue weakness

Key Indicators

Exhibit 2

Oregon	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Operating Fund Revenues (000s)	7,196,040	7,162,624	7,684,761	7,959,721	9,037,956
Balances as % of Operating Fund Revenues	1.9%	0.3%	7.5%	7.2%	11.9%
Net Tax-Supported Debt (000s)	7,801,979	7,585,606	7,544,999	7,598,819	7,683,117
Net Tax-Supported Debt/Personal Income	5.5%	5.2%	4.9%	4.1%	4.6%
Net Tax-Supported Debt/Personal Income 50 State Median	2.8%	2.8%	2.6%	2.5%	2.5%
Debt/All Governmental Funds Revenue	43.5%	42.9%	41.0%	37.4%	33.6%
Debt/All Governmental Funds Revenue 50 State Median*	22.5%	23.8%	23.5%	23.0%	20.4%
Adjusted Net Pension Liability/All Govt Funds Revenue	24.7%	66.1%	54.4%	32.7%	20.9%
Adjusted Net Pension Liability/All Govt Funds Revenue 50 State Median	48.7%	63.9%	60.3%	59.2%	50.4%
Total Non-Farm Employment Change (CY)	1.1%	1.1%	2.2%	2.8%	3.3%
Per Capita Income as a % of US (CY)	88.1%	88.3%	88.8%	89.8%	91.0%

Source: OR Comprehensive Annual Financial Reports; Moody's Investors Service

Recent Developments

The December 2016 forecast for 2015-17 General Fund revenues (net of offsets and transfers) declined slightly from the September forecast, but remained $8.2 million above the close of session estimate (COS) set in June 2015. This is primarily related to personal income taxes, which the state estimates will be $35 million below the COS estimate. The forecast for the General Fund ending balance declined to $245 million (1.4% of estimated fiscal 2017 revenues) from the COS estimate of $324 million (1.8% of revenues). The decline is due to supplemental appropriations for human services for seniors and developmentally disabled, additional spending in early childhood education, and recovery costs for the 2015 forest fires. The state still expects to transfer $180.7 million to its Rainy Day Fund at the end of fiscal 2017.

Detailed Rating Consideration

Economy and Tax Base

Oregon's job market has been performing well and expanding faster than the US. Total non-farm job growth has been above the US rate since early 2013, and YOY growth was 2.9% through November, compared to 1.6% for the US. Job growth has been particularly strong in professional and business services, leisure and hospitality, health services, and construction. Oregon's unemployment rate remains above the US average at 5.0% in November, compared to 4.6% for the nation. This laregly reflects the rapid labor force growth, which was 4.4% YOY in November, compared to 1.3% YOY for the US.

Oregon's economic growth has been bolstered by strong in-migration contributing to accelerating population growth. Population growth increased to 1.45% in 2015 from 0.8% in 2013, compared to 0.8% for the US. In addition, personal income growth has been well-above the US rate since mid-2013, reflecting the strong job growth in high wage industries. Year-over-year personal income growth reached a peak of 6.5% in fourth quarter 2014 (compared to 5.2% for the US), and was 4.6% in third quarter 2016 (compared to 3.5% for the US).

The state's economic expansion has been geographically uneven, and counties outside the larger metropolitan areas have not fully recovered jobs lost during the recession. The state has targeted economic development initiatives in these areas, to reinforce the timber industry, rural infrastructure, and public higher education.

According to Moody's Analytics, Oregon's economic growth will continue to outpace the nation, benefitting from the high-wage technology sector expansion and related housing and construction surge. The state also benefits from export trades, driven by its high concentration of semiconductor manufacturing and logging industry. Exports may introduce some uncertainty in the near term, given potential shifts in federal trade policy, but support growth in the medium-term.

Financial Operations and Reserves

The Governor's proposed 2017-2019 biennial General Fund budget increases 8.6% ($1.5 billion) over the prior budget to $19.6 billion. Budget growth is primarily driven by Medicaid costs and other human services, pension contributions and commitments related to new ballot measures passed in November 2016. The budget growth will be balanced by projected 8.3% base revenue growth plus proposed revenue increases that will raise total biennial revenue growth to 9.7%. Base revenue growth assumptions of 5.5% and 2.2% in fiscal 2018 and 2019, respectively, are reasonable compared to 5 year average annual growth of 5.5%. However, fiscal 2017 revenue growth is currently projected to be 2.2%, the slowest year-over-year growth since the recession.

In the 2017-19 biennium, Medicaid cost growth is exacerbated by the loss of one-time revenue that supported the prior budget, the phased reduction in the Federal match for ACA-related coverage, as well as a reduced FMAP for pre-ACA Medicaid costs. As a result, the Governor has proposed various revenue increases to hospital and insurer assessments, and cigarette, tobacco and liquor taxes. These revenue enhancements require legislative approval, and the final amount and composition will likely change during the budget process.

The proposed budget continues to increase rainy day funds, which is especially important given Oregon's exposure to volatility in its personal income tax collections. Personal income taxes are the state's primary revenue source, and comprise 84% of the state's 2017-2019 General Fund and Lottery Fund revenues. The budget includes deposits to the RDF and the education stability fund (ESF), which are projected to increase to $1.2 billion by the end of fiscal 2019 (12% of revenues) from $778 million (8.8% of revenues) at the end of fiscal 2019. This is a significant improvement over the recent fiscal 2011 low of 0.8% of revenues, and is nearing the fiscal 2007 high of 12.7%.

The state projects that it will add to reserves through the 2023-25 biennium, at which point the RDF and ESF could reach 20% of projected fiscal 2025 revenues. The RDF receives biennial deposits from the General Fund ending balance, with amounts limited to the lesser of the actual General Fund ending balance for the preceding biennium or 1% of General Fund appropriations for the preceding biennium, incremental growth in corporate taxes, and interest earnings of the fund. The ESF is also supported by 18% of net lottery revenues.

LIQUIDITY

On a GAAP basis, the state's fiscal 2016 available reserves (unassigned fund balance plus Rainy Day Fund and Education Stability Fund) increased to $1.3 billion (13.9% of operating revenues) from $1.08 billion (11.9% of operating revenues) in fiscal 2015.

Since the 2001-03 biennium, Oregon has regularly issued tax anticipation notes to manage cash flow needs. The state's $600 million 2016 Series A TAN represents approximately 6.5% of projected fiscal 2017 general fund receipts (excluding the note proceeds and federal aid).

In the event of a cash shortfall in the general fund, two sources may be used for internal borrowings: restricted accounts within the general fund (intra-fund sources); and available balances in other funds of the state treasury (inter-fund sources). Available intra-fund resources, primarily comprised of the state's rainy day fund, were projected to be $346 million at the end of fiscal 2016. The state is not required to pay interest on intra-fund borrowings, nor must it repay such loans by the end of the biennium in which the loan was made. The fiscal 2016 ending balance of inter-fund borrowable funds was projected to be $13.8 billion. These alternative liquidity resources are expected to remain substantial through the biennium.

Debt and Pensions

DEBT STRUCTURE

Oregon's 2015 net tax-supported debt as a percentage of personal income was 4.6%, and debt per capita was $1,907, above Moody's 50-state medians of 2.5% and $1,025, respectively. A $2 billion pension bond issuance in fiscal year 2004 significantly improved Oregon's pension funding levels, which increased to over 100% funding in 2007 but also substantially increased its debt burden. The pension bonds are backed by the full faith and credit of the state; they are not secured by any assets of the pension system.

Despite above-average debt ratios, the state's combined fixed costs are below the median, largely due to the relatively low OPEB liabilities (more below). Oregon's combined debt service, pension, and OPEB contributions in fiscal 2015 were 7.1% of own-source governmental revenues, below the median of 8.5%.

DEBT-RELATED DERIVATIVES

The state has approximately $138.9 million of variable rate general obligation bonds outstanding. The variable rate bonds are uninsured and there are currently no bank bonds. The variable rate bonds have liquidity enhancements provided by standby bond purchase agreements, with Bank of Tokyo-Mitsubishi UFJ, Ltd (A1(cr)/P-1(cr)) and U.S. Bank National Association (Aa2(cr)/P-1(cr)). Of the approximately $138.9 million, $50 million is swapped synthetically to fixed rate debt.

The state also has approximately $2.3 billion in highway user tax revenue bonds issued through the Oregon State Department of Transportation (rated Aa1, senior lien and Aa2, subordinate lien). This includes $265 million of privately placed SIFMA Index rate notes. There are no swaps on the highway revenue bonds.

PENSIONS AND OPEB

Based on Oregon's fiscal 2014 pension data, our measure of the Oregon Public Employees' Retirement System (PERS) pension burden was $4.8 billion, 38% of state-source governmental revenues and lower than the 50-state median of 85%. Moody's ANPL reflects certain adjustments made to improve comparability of reported pension liabilities.

The state's 2014 reported total pension liability increased 20% to $20 billion due to a court decision, revised actuarial assumptions, and lower-than-assumed interest earnings. Net of assets (excluding $2 billion of additional assets in side accounts), the state's unfunded liability increased to $3.1 billion from $488 million, and the funded ratio declined to 84.5%. The increase was primarily due to an April 2015 decision by the Oregon state supreme court that struck down most of the reductions to pension cost-of-living-adjustments (COLAs) passed by the state legislature in 2013. In addition, the OPERS board revised various actuarial assumptions and lowered the interest earning assumptions to 7.5% from 7.75%.

Due to the liability increase, the state's actuary projects that the state's share of pension contributions should increase by $234.5 million (8.7% of the 2014 payroll). The General Fund would be responsible for approximately one-third of this, or $78 million. However, the state's actual contribution will be less than this, as pension contribution increases are collared by state statute to 3% to 6% of payroll. These contribution collars smooth the budget impact of asset and liability changes, similar to other states' use of a smoothed actuarial valuation of assets. In contrast, Oregon PERS measures pension assets by market value.

In terms of other post-employment benefits (OPEB), Oregon's obligations are low. As of December 31, 2015, the state's share of unfunded OPEB liabilities were $13.6 million for the plan that offers retirees a subsidy for Medicare supplemental health insurance (RHIA), and $56.6 million for a smaller subsidy for pre-Medicare age retirees (RHIPA).

The state’s combined debt service, pension, and OPEB contributions in fiscal 2015 were 7.1% of own-source governmental revenues, below the median of 8.5%.

For more information on Moody's insights on employee pensions and the related credit impact on companies, governments and other entities across the globe, please visit Moody's on Pensions at www.moodys.com/pensions.

Management and Governance

Oregon has sound financial best practices, evidenced by a binding consensus revenue forecasting, timely budgets and timely audited financial reporting. Although the state does not publish financial forecasts that include both revenue and expenditure projections, the state has sophisticated quarterly economic and revenue forecasts and a quarterly allotment process for spending that provide sound financial controls. However the state is subject to a voter initiative process that in the past placed constraints on financial operations. In particular, the “2% kicker” (now embedded in the State Constitution) requiring tax credits to individual income taxpayer's whenever revenue growth is more than 2% above budget levels, makes it difficult for the state to apply any of the dividend from economic growth towards building budgetary cushions.

The state has taken action to mitigate the effects of the kicker. During the 2007 legislative session, Oregon established a rainy day fund (RDF) that was initially funded at $319 million from a one-time suspension of the corporate kicker law which is similar to the personal income tax kicker. The RDF is capped at 7.5% of General Fund revenues for a biennium and a three-fifths vote of each house of the Legislative Assembly is required to appropriate RDF moneys in the event of certain triggers. In November 2012 voters approved Measure 85, which permanently allocates the 2% corporate kicker to education funding, providing for additional operating support.

Legal Security

The bonds are general obligations of the state of Oregon, backed by the full faith and credit and taxing power of the state. The Alternate Energy Project bonds are also secured by the state's power to levy an unlimited ad valorem property tax. The Oregon constitution authorizes the issuance of general obligation bonds for a variety of purposes under articles XI-A through XI-Q.

Use of Proceeds

Proceeds of the Series A, B, C & D bonds will finance various capital improvements and seismic retrofits in the state. Proceeds of Series E, F, & G will refund outstanding bonds for estimated net present value savings.

Obligor Profile

Oregon is the 27th largest state, with a population of 3.9 million. It's GDP of $219.6 billion ranks 25th among states.

Methodology

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 3

Oregon (State of)

Issue	Rating
General Obligation Bonds, 2017 Series A (Article XI-Q State Projects) (Tax-Exempt)	Aa1
Rating Type	Underlying LT
Sale Amount	$242,505,000
Expected Sale Date	02/08/2017
Rating Description	General Obligation
General Obligation Bonds, 2017 Series B (Article XI-Q State Projects) (Federally Taxable)	Aa1
Rating Type	Underlying LT
Sale Amount	$40,285,000
Expected Sale Date	02/08/2017
Rating Description	General Obligation
General Obligation Bonds, 2017 Series C (Article XI-M Seismic Projects) (Tax-Exempt)	Aa1
Rating Type	Underlying LT
Sale Amount	$107,755,000
Expected Sale Date	02/08/2017
Rating Description	General Obligation
General Obligation Bonds, 2017 Series D (Article XI-N Seismic Projects) (Tax-Exempt)	Aa1
Rating Type	Underlying LT
Sale Amount	$25,865,000
Expected Sale Date	02/08/2017
Rating Description	General Obligation
General Obligation Bonds, 2017 Series E (Article XI-J Alternate Energy Projects) (Tax-Exempt)	Aa1
Rating Type	Underlying LT
Sale Amount	$41,260,000
Expected Sale Date	02/08/2017
Rating Description	General Obligation
General Obligation Bonds, 2017 Series F (Article XI-J Alternate Energy Projects) (Federally Taxable)	Aa1
Rating Type	Underlying LT
Sale Amount	$3,990,000
Expected Sale Date	02/08/2017
Rating Description	General Obligation
General Obligation Bonds, 2017 Series G (Article XI-J Alternate Energy Projects) (AMT)	Aa1
Rating Type	Underlying LT
Sale Amount	$11,445,000
Expected Sale Date	02/08/2017
Rating Description	General Obligation

Source: Moody's Investors Service

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