

### Summary:

## Oregon; General Obligation

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Credit Profile		
US\$22.635 mil GO bnds (Alternative Energy Proj) ser 2011B due 01/01/2032		
Long Term Rating	AA+/Stable	New
US\$20.44 mil GO bnds (Alternative Energy Proj) ser 2011A due 04/01/2032		
Long Term Rating	AA+/Stable	New
Oregon GO		
Long Term Rating	AA+/Stable	Upgraded

## Rationale

Standard & Poor's Ratings Services raised its long-term rating and underlying rating (SPUR) to 'AA+' from 'AA' on Oregon's general obligation (GO) bonds. In addition, Standard & Poor's assigned its 'AA+' long-term rating and stable outlook to the state's \$20.4 million series 2011A tax-exempt alternate energy project bonds and \$23 million series 2011B alternative minimum tax alternate energy project bonds. The outlook on all ratings is stable.

The rating action reflects our view that the state has demonstrated a willingness to make revenue and expenditure adjustments to correct structural imbalances during the current low stage of the revenue cycle. Despite successive downward revenue forecasts, the state projects that mid-biennium budgetary revisions will allow it to hold combined available reserves on a budgetary basis at the end of fiscal 2011 at a level virtually equal to that at the end of fiscal 2009. We note that, absent modifications as part of the upcoming biennial budget, the state's "rainy day" fund and education stability fund would likely grow under current constitutional and statutory mechanisms.

The ratings also reflect our view of the state's:

- Strong financial policies and practices, including institutionalized quarterly reviews of financial performance and economic forecasts that guide budget assumptions; and
- Above-average pension funding ratio on a mark-to-market basis and our assessment that the state's other postemployment benefits represents a low risk.

Partially offsetting these strengths, in our view, are:

- A reliance on personal and corporate income tax revenues, which fluctuate with economic cycles; and
- Active citizen initiative process, which can restrict budgetary flexibility.

The series 2011A and 2011B bonds are secured by the full faith and credit of the state, including the state's obligation to use legally available resources and, if necessary, a tax on property within the state without limitation as to rate or amount to pay the bonds. We understand that the state will use the proceeds of each series to fund grants for various energy improvement, conservation, and renewable energy projects.

Oregon's economic recovery has proceeded slowly since summer 2009, in line with the U.S. as a whole, after its worst recession since the early 1980s. Its seasonally adjusted employment level grew by a modest aggregate 1.6% during the 12 months through December 2010 and its unemployment rate edged downward during the same period,

to 10.6% from 11%. The state economist's leading indicators index is positive among each of its major components, and we understand that exports have nearly recovered to prerecession levels. However, the state's most recent economic forecast, which serves as the basis for its revenue projections, continues to project weak employment growth, with a 1.4% increase for 2011 followed by 2% for 2012. The state economist reports that economic growth in Asia could buoy the state's high-tech manufacturing sector (we note that Intel Corp. announced in October 2010 that it would spend \$6 billion to \$8 billion to build a factory in the Portland area), but does not expect any single sector to show a commanding lead in employment growth in the coming year. We note that the historically cyclical manufacturing sector, as a share of total employment, is 16% above its proportion nationwide.

Financial performance in the second half of the biennium ending June 30, 2011, has been characterized by successive across-the-board spending reductions in response to projected revenue reductions. Since the outset of the biennium, when the state used expenditure reductions, sweeps, and tax increases (the last of which voters affirmed in January 2010) to close a \$4.2 billion gap (then about 31% of forecast revenues) on a budgetary basis of accounting, the state's biennial general fund revenue forecast has dropped by an aggregate 8.4%, or \$1.1 billion. We note that personal income taxes make up a significant 84% of forecast biennial general fund revenues, and although the state reports that personal income tax withholdings are accelerating, a drop in capital gains taxes as residents filed tax returns in spring 2010 forced a downward revision to the state's revenue forecast last year. We understand that former Gov. Ted Kulongowski exercised his "allotment" authority to reduce across-the-board expenditures by 4.6% of biennial expenditures in June 2010 in response to tax return data and by another 3% in September 2010 as the state cut its revenue forecast in response to a weaker outlook for national economic growth. Management reports that the state is on track to finish fiscal 2011 with its available reserves at what we consider to be an adequate 1.8% of annual general fund expenditures. These account for a virtually zero balance in the general fund, \$10.6 million in the rainy day fund (initially funded during the past economic expansion with \$319.3 million at in fiscal 2007), and \$100.8 million in the education stability fund (which is automatically funded by 18% of annual net lottery revenues).

For the upcoming biennium ending fiscal 2013, the state forecasts revenue growth at 10.8%, but the absence of federal grants under the America Recovery and Reinvestment Act (ARRA), coupled with baseline expenditure growth, translates into another significant budgetary gap of \$3.5 billion. We understand that the newly elected Gov. John Kitzhaber has proposed avoiding both tax increases and one-time budget actions such as furloughs to address the budgetary imbalance and to finish the biennium with a general fund increase to \$210 million (about 3% of annual revenues), some of which could be transferred to the rainy day fund under a statute that provides for the state to transfer up to 1% of general fund revenues at the end of the biennium to this fund. Management reports that the governor's proposal would also plan for a constitutionally provided transfer of 18% of net lottery revenues to the education stability fund, which would increase that fund's balance to \$292 million and bring total available reserves in the three funds to what we consider a good about 7% of annual revenues. Management reports that neither the governor's office nor the legislature is discussing deficit borrowing, debt restructuring, or reductions in pension contributions as possible sources of budget relief.

The state regularly issues tax anticipation notes to manage uneven receipts under its income-tax-weighted revenue structure, most recently \$837 million for fiscal 2011, up from \$737 million for fiscal 2010. The state's latest forecast (July 2010) reflects an expectation that year-end liquidity, most of which consists of cash in the local government investment pool that the state manages, will total \$14.5 billion, or what we consider to be strong at about 2.6x fiscal 2010 general fund expenditures on a generally accepted accounting principles basis. The state treasurer

manages short-term investments under statute and policy guidance from the Oregon Investment Council. Current guidelines require that at least 50% of holdings must mature or reprice within 93 days, and as of Feb. 28, 2011, 71% of holdings met this standard. We consider its investment guidelines to be conservative, generally restricting holdings to Treasuries, agencies, Federal Deposit Insurance Corp.-guaranteed deposits, fully collateralized repurchase agreements, and highly rated commercial paper and foreign government instruments. As of Feb. 28, corporate instruments made up 48% of the state's pooled short-term investments, followed by Treasuries at 42%.

We consider the state's management practices "strong" under our Financial Management Assessment (FMA) methodology. An FMA of "strong" indicates our view that practices are strong, well embedded, and likely sustainable.

Oregon's net tax-supported debt burden of \$7.8 billion at the end of fiscal 2010, which included a portion of its pension obligation bonds (POBs), equates to what we consider a low \$2,032 per capita, 1.6% of real market value, and 5.5% of total personal income. If POBs are excluded, the figures are \$1,502 per capita, 1.2% of real market value, and 4.1% of personal income. We note that the state's Debt Policy Advisory Commission projects that in fiscal 2012 the state will exceed a policy to limit annual general fund-supported debt service to 5% or less of annual general fund revenues, largely as a result of expenditure reductions that have reduced the denominator needed to calculate compliance with the policy. Management has stated that the state is scaling back issuance through the end of fiscal 2011 but that it will likely issue GO bonds in fiscal 2012 to continue funding the construction of a replacement for its primary mental hospital.

The state's public employees retirement system consists of three plans depending on the date of hire, with defined-benefit plans for employees hired before 1996 (known as Tier 1) and Aug. 29, 2003 (Tier 2), and a combined defined-contribution and defined-benefit plan (Oregon Public Service Retirement Plan) for later hires. The state's liability represented 26% of the systemwide \$56.8 billion liability at the end of 2009, which was funded at 85.8%, including side accounts created by the issuance of POBs. The system's reported assets are marked to market rather than smoothed, which can lead to what we consider to be significant shifts in the system's funding ratio. The ratio fell to 80.2% in 2008, from 112.2% in 2007 as the system absorbed major investment losses. We note that although this approach also can quickly shift annual required contribution (ARC) rates, the system also "collars" contribution rates to 3%-of-payroll shifts in any two-year period. Starting fiscal 2012, for example, the state's actuarial consultant calculates the average Tier 1 and Tier 2 ARCs at 19% of payroll, while the collar restricts the rate to 15.1%.

## Outlook

The stable outlook reflects our view that the state will address the forecast slow economic recovery and the absence of federal ARRA grants sufficient to balance its budget for the upcoming biennium and, potentially, add to its education stability fund and rainy day fund. We do not expect to raise the rating further during our outlook horizon, due to the potential for future citizen initiatives to reduce revenues or otherwise impair budgetary flexibility, and for the historically cyclical manufacturing sector to drive significant fluctuations in income tax receipts. We also believe that successive rounds of expenditure reductions have made further spending cuts or revenue increases more difficult, and that weaker-than-expected revenue performance or a citizen initiative that affects budgetary flexibility, absent offsetting budget revisions, could put pressure on credit quality.

## Related Criteria And Research

USPF Criteria: State Ratings Methodology, Jan. 3, 2011

Ratings Detail (As Of March 9, 2011)		
Oregon alternate energy GO bnds (Tax Exempt) ser 2008B		
Long Term Rating	AA+/Stable	Upgraded
Oregon var Rate GO bnds (Veterans Welfare) ser 87AB (MBIA)		
Long Term Rating	AA+/Stable	Upgraded
Oregon var Rate GO bnds (Veterans Welfare) 1987 (Dexia Cred Loc Liquid Prov)		
Long Term Rating	AA+/A-1	Upgraded
Oregon GO bnds (Oregon State Board of Higher Ed (tax exempt)) ser 2007C-G		
Long Term Rating	AA+/Stable	Upgraded
Oregon GO bnds (Tax Exempt) (Pollution Control) ser 2008A		
Long Term Rating	AA+/Stable	Upgraded
Oregon GO bnds (Veterans Welfare) 1986 (Dexia Cred Loc Liquid Prov)		
Long Term Rating	AA+/A-1	Upgraded
Oregon GO veterans welfare bnds ser 81 dtd 09/01/2001 due 10/01/2031 2042		
Long Term Rating	AA+/Stable	Upgraded
Oregon GO veterans welfare (var rate) 1985 (Dexia Cred Loc Liquid Prov)		
Long Term Rating	AA+/A-1/Stable	Upgraded
Oregon GO Alt Energy Proj bnds (Federally Taxable) ser 2008A		
Long Term Rating	AA+/Stable	Upgraded
Oregon GO Elderly & Disabled hsg (2007A)		
Long Term Rating	AA+/Stable	Upgraded
Oregon GO Veterans Welfare bnds (Non Amt Fixed Rate) ser 90A		
Long Term Rating	AA+/Stable	Upgraded
Oregon GO Veterans Welfare bnds (Non Amt Variable Rate) ser 90B (SBPA-Dexia Credit Local Liquid Prov)		
Long Term Rating	AA+/A-1/Stable	Upgraded
Oregon GO Veterans (2007)		
Long Term Rating	AA+/Stable	Upgraded
Oregon GO (St Brd Of Higher Ed) (AMBAC)		
Long Term Rating	AA+/Stable	Upgraded
Oregon G.O.bnds ser 73F dtd 12/19/85 (Liq Prov)		
Long Term Rating	AA+/Stable	Upgraded
Short Term Rating	NR	
Oregon G.O. bnds (Oregon Dept of Veterans Affairs) ser 73H dtd 12/19/85		
Long Term Rating	AA+/Stable	Upgraded
Short Term Rating	NR	
Oregon State of Oregon GO (Veterans Welfare) 1988B		
Long Term Rating	AA+/A-1/Stable	Upgraded

<b>Ratings Detail (As Of March 9, 2011) (cont.)</b>		
Oregon St Brd of Ed Comnty Coll & Workforce Dev (Tax Exempt) ser 2008A		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
Oregon Veterans Welfare bnds ser 84 due 12/01/2035		
<i>Long Term Rating</i>	AA+/A-1/Stable	Upgraded
Oregon (Alternate Energy Proj) Ser 94 F DTD 10-1-94 DUE 7-1-96-2015		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Upgraded
Oregon 2004 go vet welfare bnds ser 83 dtd 12/02/2004 due 12/01/2039		
<i>Long Term Rating</i>	AA+/A-1/Stable	Upgraded
<b>Oregon GO (MBIA of Illinois)</b>		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Upgraded
<b>Oregon Oregon GO (Vet Welfare)</b>		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
<b>Oregon Dept of Admin Svcs, Oregon</b>		
Oregon		
Oregon Dept of Admin Svcs (Oregon) GO bnds		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
<b>Oregon Dept of Energy, Oregon</b>		
Oregon		
Oregon Dept of Energy (Oregon) GO Alternate Energy proj bnds (Tax-Exempt) ser 2010A		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
<b>Oregon Dept of Envir Qlty, Oregon</b>		
Oregon		
Oregon Dept of Envir Qlty (Oregon) GO poll cntl bnds (Tax-Exempt) 2010 ser A		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
<b>Oregon Dept of Veterans Affairs, Oregon</b>		
Oregon		
Oregon Dept of Veterans Affairs (Oregon) GO bnds (Non-AMT)		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
Oregon Dept of Veterans Affairs (Oregon) GO Veterans Welfare bnds (Non-AMT) (Oregon) ser 91 due 06/01/2039		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
<b>Oregon St Brd of Hgr Ed, Oregon</b>		
Oregon		
Oregon St Brd of Hgr Ed (Oregon) GO bnds		
<i>Long Term Rating</i>	AA+/Stable	Upgraded

Many issues are enhanced by bond insurance.

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