

**New Issue: Moody's assigns Aa1 to \$378.9M ODOT'S Series 2015A Revenue Refunding Bonds**

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Global Credit Research - 09 Jan 2015

**Approximately \$1.6B in similarly rated debt**

OREGON STATE DEPARTMENT OF TRANSPORTATION, OR  
State Governments (including Puerto Rico and US Territories)  
OR

**Moody's Rating**

<b>ISSUE</b>	<b>RATING</b>
Highway User Tax Revenue Bonds Senior Lien Refunding Bonds Series 2015A (Tax-Exempt)	Aa1
<b>Sale Amount</b>	\$378,960,000
<b>Expected Sale Date</b>	01/13/15
<b>Rating Description</b>	Special Tax: Transportation-Related

**Moody's Outlook** STA

NEW YORK, January 09, 2015 --Moody's Investors Service has assigned a Aa1 rating to the State of Oregon's Department of Transportation (ODOT) \$378.9 million Highway User Tax Revenue Refunding Senior Lien Bonds Series 2015A (Tax-Exempt). The bonds will be used to fund state highway projects. The bonds are expected to sell the week of January 12th.

**SUMMARY RATINGS RATIONALE**

The senior lien long-term ratings incorporate ODOT's diverse and stable pledged revenue stream, which is constitutionally allocated to the State Highway Fund and may only be used for highway purposes; historically strong debt service coverage levels provided by such pledged revenues; and strong legal provisions such as a three times senior lien additional bonds test. The outlook is stable.

**STRENGTHS**

- Diverse and relatively stable revenue stream provides strong coverage of debt service requirements
- Constitutional allocation of pledged revenues to State Highway Fund
- Strong additional bonds test of three times debt service on historical or projected basis

**CHALLENGES**

- Ability to leverage pledged revenue resulting in likely reduction of debt service coverage
- Legislative authority to change the allocation of pledged revenue components

**DETAILED CREDIT DISCUSSION**

**PLEDGED REVENUES FROM TAXES AND FEES CONSTITUTIONALLY DEDICATED TO HIGHWAY FUND**

Pursuant to the state constitution, taxes on highway users and motor fuels, as well as other motor vehicle licenses and fees must be dedicated to the state's Highway Fund, a trust fund separate and distinct from the General Fund. As specifically stated in the constitution, all funds deposited into the Highway Fund may only be used for the construction, reconstruction, improvement, repair, maintenance, operation and use of public highways, roads, streets and roadside rest areas. As a result, the state is prohibited from using these funds for budgetary relief.

However, the state can pledge these revenues, after administrative expenses, operating transfers, and statutory transfers to counties and cities, to the repayment of bonds issued for highway-related purposes. The legislature can make, and has made, changes in both the composition and distribution of gross revenues through rate adjustments and allocation provisions, within the constraint of the additional bonds test and sum-sufficient debt service coverage. Thus far, such changes have served to increase pledged revenues that cover debt service requirements.

#### DIVERSE REVENUE STREAM SUPPORTS DEBT SERVICE

The state's combined motor fuel and use taxes, weight-mile taxes, and vehicle registration and driver's license fees generated approximately \$1.13 billion in gross revenues in fiscal year 2014, with pledged revenues accounting for \$579 million. The state is expecting gross revenues of approximately \$1.15 billion in fiscal year 2015 based on the prior June 2014 forecast, with pledged revenues of \$589 million. These amounts will be updated with the release of the February 2015 revenue forecast.

Motor fuels and use taxes accounting for just under half (45%) of the total revenues. Between fiscal years 2009 and 2014, gross revenues grew at an average annual rate of 4.1%, although this pace includes various tax and fee increases implemented to accommodate the phased in implementation of the Jobs and Transportation Act (JTA), a new transportation program that is authorized to fund up to \$840 million in net proceeds of transportation debt and created additional revenue to support the new debt. The JTA revenue increases helped offset the slowing effect of the most recent recession on highway user taxes, particularly the weight-mile tax levied on trucks and fuel tax. Oregon's gas tax rate increased steadily in the 1980s into the early 1990s but remained the same level of \$0.24 per gallon since 1993 until January 2011, when the gas tax increased by \$.06. The current budget projects gross revenue growth of approximately 2.8% in fiscal 2014 and pledged revenue growth of 2.1%, reflecting full implementation of tax and fee increases which were approved in the 2009 legislative session.

Based on the latest figures, it is estimated that pledged revenues will provide 4.3 times coverage of senior lien debt and 3.4 times coverage of aggregate debt service, including both senior and subordinate lien debt in fiscal 2015. Over the forecast horizon through fiscal 2017, coverage will decline slightly, to about 4.2 times on the senior lien debt service and 3.1 times for aggregate debt service. However, this decline incorporates the remainder of bonds authorized under the JTA program expected to be issued by fiscal year 2016.

#### STRONG DEBT SERVICE COVERAGE BOLSTERED BY AN INCREASE IN TAXES AND FEES PLEDGED TO THE BONDS

Combined pledged revenues, net of certain expense deductions and statutory transfers, provide security for the bonds. Deductions include various administrative expenses and costs of collection. In addition, the state is statutorily required to make certain apportionments to cities and counties to fund highway improvements.

The legislature has the authority to change the amount of revenues that become pledged revenues by altering the rates of the different highway user taxes that comprise gross revenues and also by changing the set-aside and city/county allocation formulas. During the 2009 legislative session, the state approved the Jobs and Transportation Act (JTA), a new comprehensive transportation capital investment program. Under JTA, ODOT is authorized to fund up to \$840 million from net proceeds of Highway User Tax Revenue Bonds to finance a specific transportation projects. The state has issued \$430 million of JTA bonds to date yielding \$450 million of net proceeds, with the remainder of authorized bonds expected to be issued by fiscal year 2016. As mentioned earlier, In conjunction with the approval of the new program the state increased certain taxes and fees that will count as pledged revenues for the newly authorized bonds under JTA as well as the previously issued bonds under OTIA (Phases I-III). JTA increased the weight-mile flat fee and tax rates, license plate manufacturing fee, and vehicle registration and title fees. Debt service coverage projections assume maintenance of the higher level of pledged revenues, relative to the statutory allocations.

#### ADDITIONAL BONDS TEST AND OTHER BOND COVENANTS PROTECT BONDHOLDER PAYMENTS

The state has covenanted that it will not issue any additional bonds secured by the pledged revenues unless: a) revenue collections for 12 consecutive months within the prior 18 months provide at least three times maximum annual debt service (MADS) on the senior bonds and two times MADS on the aggregate of senior and subordinate bonds; or b) pledged revenues for the first full year immediately following the issuance of any additional bonds are projected to provide at least three times MADS on the senior bonds and two times MADS on the aggregate of senior and subordinate bonds. Additionally there is a monthly set aside of principal and interest on the bonds.

Since 1993, the state motor fuels tax rate had been \$0.24, a rate that was considerably lower than the neighboring

states Washington (37.5 cents) and California (36 cents). The JTA authorization increased the motor fuels tax by \$0.06 effective January 1, 2011. While Oregon is not required to maintain the motor fuels tax rate at its existing level, the state has covenanted with bondholders to assess and collect pledged revenues in amounts sufficient to meet debt service requirements on these bonds. Despite the fact that numerous tax initiatives have been considered by Oregon voters over the last decade, none of these initiatives have sought to lower the state's motor fuels tax rate.

#### OREGON IS FIRST IN THE NATION TO IMPLEMENT A STATEWIDE ROAD USAGE CHARGE SYSTEM

In 2013, Oregon Legislature passed Senate Bill 810 after successful completion of two pilot programs and authorized an initial, limited phase of implementation to evaluate the use of a "road usage charge" system (commonly referred to as VMT - Vehicle Miles Traveled) as an alternative to the state motor fuels tax. This "opt-in" program will be the nation's first and is expected to begin in fiscal year 2015 with the number of participants capped at 5,000 vehicles, or less than one percent of total passenger vehicles in the state. The creation of this program is in response to the rise in crude oil and gasoline prices, as well as an increase in the number of alternative fuel vehicles. While the first phase of this new program includes a very small number of passenger vehicles, the long term goal of moving to a road usage charge from motor fuels tax poses some risk. As noted before, motor fuels tax accounts for 45% of pledged revenues and substituting a stable long term revenue source with a new untested revenue source will introduce uncertainty to gross revenues. Moody's expects ODOT and the state will proceed with caution as we note the long history of conservative and active management. The state has proven its ability to adjust rates to ensure an adequate level of debt service coverage for the bonds. The slow phase-in of the system gives ODOT and the state time to adjust the program, if necessary. Expected revenue generated from this program is reflected in the revenue projections through fiscal 2018. Revenues collected from the system are not pledged to the bonds, however the state can amend the governing resolution to allow for it.

#### MANAGEABLE LEVELS OF VARIABLE RATE SUBORDINATE LIEN BONDS

The department has approximately \$265 million in an outstanding highway user tax subordinate SIFMA Index Rate bonds purchased by Bank of America N.A. pursuant to a continuing covenant agreement. The mandatory tender date is November 5, 2016. If the agreement is not renewed or replaced, the term-out would begin 180 days after the loan maturity, and the state would then have three years to make semi-annual payments to pay off the loan. The department has a conservative policy to maintain an average annual cash balance of \$100 million, although actual cash balances are usually higher and could also access funds in the state treasury in the event that additional liquidity is need. The department has no interest rate derivatives

#### Outlook

The outlook on Oregon's highway user tax revenue bond ratings is stable. The outlook incorporates the remainder debt issuance authorized under the JTA program expected by fiscal year 2016, and the implementation of the new road usage charge system with the expectation that the state will actively monitor the new system and address any challenges that may arise.

#### WHAT COULD MAKE THE RATING GO UP

-- Legal provisions consistent with higher rating levels on highway revenue bonds, such as a higher additional bonds test

#### WHAT COULD MAKE THE RATING GO DOWN

-- Weakened legal covenants

-- Decline in pledged revenues as a result of legislative changes that cause a major reduction in coverage levels

-- Increased leveraging to fund capital commitments without commensurate revenue growth or new revenue source

#### RATING METHODOLOGY

The principal methodology used in this rating was US Public Finance Special Tax Methodology published in January 2014. Please see the Credit Policy page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

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