FitchRatings

21 APR 2023

# Fitch Rates Oregon's $157 Million GOs 'AA+'; Outlook Stable

Fitch Ratings - San Francisco - 21 Apr 2023: Fitch Ratings has assigned 'AA+' ratings to the following state of Oregon general obligation (GO) bonds:

--$30.340 million GO bonds (Higher Education), 2023 Series F Article XI-F(1) (New Money) (Tax-Exempt);

--$66.805 million GO bonds (Higher Education), 2023 Series G Article XI-G (New Money) (Tax-Exempt);

--$40.225 million GO bonds (Higher Education), 2023 Series H Article XI-F(1) (New Money) (Federally Taxable);

--$19.775 million GO bonds (Higher Education), 2023 Series I Article XI-G (Refunding) (Tax-Exempt).

The bonds are expected to sell via negotiated sale May 2, 2023.

Proceeds from the 2023 series F, G & H bonds will finance various university and community college projects. Proceeds from the 2023 series I bonds will refund for savings certain maturities of GO bonds, series 2013 series C & I, subject to market conditions.

The Rating Outlook is Stable.

## SECURITY

The GO bonds are direct general obligations of the state of Oregon, with the full faith and credit of the state pledged to bond repayment.

## ANALYTICAL CONCLUSION

Oregon's 'AA+' Issuer Default Rating (IDR) and GO bond rating reflect the state's strong control over revenues and spending, low liabilities, and record of prompt actions to maintain financial flexibility during challenging revenue periods. The state's operating performance is sustained by a diverse economy with strong long-term growth prospects. Strong financial management is critical to the rating given a revenue structure largely dependent on the personal income tax (increasingly skewed toward middle- and upper-income earners), exposure to voter initiatives that can have negative fiscal impacts, and constitutional 'kicker' provisions that limit revenue growth captured by the state.

### Economic Resource Base

The state has made steady economic gains in recent years due to its more diversified economy and growing population, with technology and manufacturing sectors showing particular strength. However, it remains vulnerable to economic volatility and disruptions to international trade during recessionary periods.

## KEY RATING DRIVERS

### Revenue Framework: 'aaa'

Fitch expects Oregon's revenues, which are heavily dependent on personal income tax revenues given the lack of a sales tax, to continue to reflect the strength of its economy and exhibit growth consistent with long-term expectations for national GDP growth. The state has an unlimited legal ability to raise operating revenues as needed.

### Expenditure Framework: 'aaa'

The state maintains ample expenditure flexibility with a low burden of carrying costs for long-term liabilities and the broad expense-cutting ability common to most U.S. states. As with most states, Medicaid remains a key expense driver, but one that Fitch expects to remain manageable.

### Long-Term Liability Burden: 'aaa'

Combined debt and pension liabilities represent a low burden on resources, even when taking planned future debt issuances into account. Other post-employment benefit obligations are modest.

### Operating Performance: 'aa'

The state's strong management of its financial operations leaves it well-positioned to deal with economic downturns, but resilience remains constrained by voter-approved fiscal restraints and revenue volatility. The state has very strong gap-closing capacity in the form of its control over revenues and spending. State balancing measures in downturns include reserve draws and there is a consistent history of rebuilding reserves as the economy strengthens. An active voter initiative environment periodically affects state finances.

## RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--Increased gap-closing capacity, including maintenance of reserves at levels in line with recent years that are in excess of a fully-funded Rainy Day fund, Education Stabilization Fund and kicker liability;

--Structural changes to the state's voter initiative process that reduce constraints on the state's operating flexibility.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--Failure to implement available policy measures that offset risks associated with future economic contractions, resulting in erosion of the state's gap-closing capacity.

## Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

## CURRENT DEVELOPMENTS

In the third quarter of 2022, Oregon achieved full employment recovery from a sharp pandemic drop-off. Nonfarm payrolls declined by about 14% at the pandemic's start (from February to April 2020), matching the states' median rate. Job recovery had slightly lagged the median state rate, but at 109% of jobs recovered through December 2022, now exceeds the 100% median.

State unemployment has decreased from higher levels, with Oregon's official monthly unemployment rate at 4.5% in December 2022, above the states' median rate of 3.5%. Fitch also considers the employment to population ratio (EPOP) when evaluating the health of labor markets. Oregon's EPOP of 60.1% in December is higher than its pre-pandemic rate of 58.9% and in line with the states median of 60.1%, indicating a potentially faster economic growth trajectory than other states given its higher labor force utilization.

Oregon Budget Update

As with many states, Oregon's revenue emerged from the downturn stronger than forecast. The impact of the downturn on Oregon's revenues was mitigated in part by the state's progressive personal income tax (PIT) structure that generated solid revenue gains as job losses were skewed toward low wage earners relative to higher wage earners and higher taxpayers.

Since tax revenues in the fiscal 2019-2021 biennium exceeded the 2019 close of session forecast, they triggered both the personal income and corporate income tax kickers. A record-breaking estimated $1.9 billion personal income tax kicker was paid out as a refundable credit on April 2022 tax returns, the fourth successive kicker rebate since 2016. The $847 million corporate income tax kicker was allocated to K-12 public education spending, as required under the state constitution. It will not affect general fund revenues in the fiscal 2021-2023 biennium.

Strong performance in both the personal and corporate income taxes is continuing in the current fiscal 2021-2023 biennium with revenue projections revised upward in every quarterly forecast from December 2021 to March 2023. The March 2023 forecast for the fiscal 2021-2023 biennium of $28.8 billion is 23% higher than the 2021 close of session forecast for the same period. The state now anticipates generating personal income tax and corporate income tax kickers, potentially totaling close to $5.5 billion. The $4 billion PIT kicker would be returned to tax payers on their April 2024 tax returns and the $1.5 billion CIT kicker would be allocated to K-12 public education.

The current legislatively authorized expenditure budget for the 2021-2023 biennium includes expenditures of $29.3 billion for the combined general and lottery funds, a 22.6% increase over the previous biennium. The main drivers for increased spending are human services (wildfire response, caseload and rate adjustments, and service enhancements), the Oregon Health Authority (health care system changes and service investments) and housing agencies (wildfire recovery efforts and affordable housing support).

The governor's proposed 2023-2025 biennium budget raises general fund spending 24.9% to $30.3 billion, primarily due to increased Human Services spending to simultaneously backfill reduced enhanced public health emergency FMAP subsidies and fund ambitious new services aimed at reducing homelessness statewide. The governor's budget assumes a 10.3% drop in general fund revenue versus the March 2023 estimate, to $25.7 billion.

This decline is largely from decreased personal income tax revenue necessary to accommodate the prior fiscal year's kicker. The budget bridges the anticipated revenue gap using over $4 billion in general fund balance, including over $1 billion in carry-over reversions from the 2021-2023 biennium. $303 million would remain in the general fund balance, for a total of $3.1 billion in reserves including the Rainy Day Fund and Education Stabilization Fund (12.3% of revenues).

The state allocated its $2.8 billion American Rescue Plan Act (ARPA) direct allocation (including capital project funding) to a variety of largely one-time/non-recurring state priorities, including for affordable housing, wildfire recovery and prevention, water quality and sewer system improvements, broadband expansion, as well as for permitted revenue replacement.

## CREDIT PROFILE

For additional information on the state of Oregon's IDR, see "Fitch Rates Oregon's $986.1 MM GOs 'AA+'; Outlook Stable," published on Feb. 28, 2023 and available at www.fitchratings.com.

## Date of Relevant Committee

27 February 2023

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria listed below. In addition, the following sources of information which are not discussed in the criteria were used:

## ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

## Fitch Ratings Analysts

**Bryan Quevedo**
Director
Primary Rating Analyst
+1 415 732 7576
Fitch Ratings, Inc. One Post Street Suite 900 San Francisco, CA 94104

**Karen Krop**
Senior Director
Secondary Rating Analyst
+1 212 908 0661

**Karen Ribble**
Senior Director
Committee Chairperson
+1 415 732 5611

## Media Contacts

**Sandro Scenga**
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

## Rating Actions

| ENTITY/DEBT | RATING | | | RECOVERY | PRIOR |
|---|---|---|---|---|---|
| Oregon, State of (OR) [General Government] | | | | | |
| • Oregon, State of | LT | AA+ | Affirmed | | AA+ |

| ENTITY/DEBT | RATING | | RECOVERY | PRIOR |
|---|---|---|---|---|
| (OR) /General Obligation - Unlimited Tax/ 1 LT | | | | |

| RATINGS KEY | OUTLOOK | WATCH |
|---|---|---|
| POSITIVE | ⊕ | ⬘ |
| NEGATIVE | ⊖ | ⬙ |
| EVOLVING | ⊙ | ◆ |
| STABLE | ◘ | |

## Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub.04 May 2021) (including rating assumption sensitivity)

## Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

## Additional Disclosures

Solicitation Status

## Endorsement Status

| | |
|---|---|
| Oregon, State of (OR) | EU Endorsed, UK Endorsed |

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