Fitch Rates Oregon's $418MM GOs 'AA+'; Outlook Stable

Fri 29 Apr, 2022 - 10:12 AM ET

Fitch Ratings - New York - 29 Apr 2022: Fitch Ratings has assigned 'AA+' ratings to the following state of Oregon general obligation (GO) bonds:

--$172.005 million GO bonds, 2022 series A;

--$175.77 million GO bonds, 2022 series B (Sustainability Bonds);

--$70.34 million GO bonds, 2022 series C.

The bonds are expected to sell via negotiation May 10, 2022.

In addition, Fitch has affirmed the state's Issuer Default Rating (IDR), $6.7 billion in outstanding GO bonds at 'AA+', the Oregon School Bond Guaranty Program at 'AA+', and $96 million in outstanding state-appropriation backed bonds at 'AA'.

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. The state guaranty under the Oregon School Bond Guaranty Program is a full faith and credit obligation of the state, on par with its GO bonds.

The outstanding state-appropriation-backed bonds are payable from moneys appropriated by the state to debt repayment. The one-notch distinction reflects greater repayment optionality.

ANALYTICAL CONCLUSION

Oregon's 'AA+' 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 towards 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 sharp declines in economic performance 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 (OPEB) obligations are modest.

Operating Performance: 'aa'

The state's strong management of its financial operations leaves it well-positioned to deal with economic downturns. 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 and significantly enhanced reserves;
--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

Oregon's experience during the economic downturn caused by the pandemic largely mirrored that of the nation, with a sharp drop-off in employment followed by a relatively rapid recovery. Nonfarm payrolls declined by about 14% at the pandemic's start (from February to April 2020), matching the states' median rate. Job recovery has slightly lagged the median rate of 89%, with Oregon recovering 87% of jobs lost through March 2022. The state anticipates full recovery by fall 2022.

State unemployment has decreased from higher levels, with Oregon's official monthly unemployment rate 3.8% in March 2022, just above the states' median rate of 3.6%. Oregon's Fitch-adjusted unemployment rate, which adds back declines in the labor force since February 2020, is 4.0%, below the states' median rate of 4%, indicative of a stronger labor market.

Oregon Budget Update

As with many states, Oregon's revenue performance emerging from the downturn has been 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 is expected to be paid out as a refundable credit on April 2022 tax returns. This will be the fourth successive kicker rebate since 2016. With a two-thirds vote, the legislature could reduce that kicker amount and its effect on the general fund in the fiscal 2021-2023 biennium. The $847 million corporate income tax kicker will be 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 is continuing in the current fiscal 2021-2023 biennium with revenue revisions in December 2021 and March 2022 raising the forecast 6.8% to $25 billion as compared to the 2021 close of session forecast of $23.4 billion. Corporate income tax collections are also performing particularly well, reportedly due to the impact of strong underlying demand and some inflationary pressure on corporate profits.

The state enacted budget for the fiscal 2021-2023 biennium included expenditures of $26.8 billion for the combined general and lottery funds, a 12% increase over the previous biennium. With the stronger than forecast revenue performance, the legislature increased spending $2.4 billion in the recently concluded short legislative session. 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 state has 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.

Revenue Framework

Oregon’s general fund relies most heavily on the personal income tax, which can demonstrate volatility, as the state does not levy a sales tax. Further, the state does not fully capture unexpected revenue growth since increases of more than 2% above the state’s close of session forecast are subject to constitutional kicker requirements.

Historical growth in the state’s revenues, after adjusting for the estimated impact of tax policy changes, has generally been above GDP, with robust growth in most years more than compensating for recessionary declines.

In recent years, the legislature has added new revenue sources that are primarily consumption based, including taxes on liquor, lodging, cannabis, vehicle privilege and use, among others. The resulting revenues, which are forecast to total $3.9 billion in the
current 2021-2023 biennium, are allocated to funds not covered by the kicker provisions.

The state has no legal limitations on its ability to raise revenues through base broadenings, rate increases, or the assessment of new taxes or fees. The state has a strong track record of adjusting revenues to accomplish programmatic goals.

**Expenditure Framework**

As in most states, education and health and human services spending are Oregon's largest operating expenses. Education is the larger line item, as the state provides significant funding for local school districts and an extensive public university and college system. Health and human services spending is the second largest area of spending, with Medicaid being the primary driver.

Consistent with most states, Oregon's spending will likely be in line with to marginally above expected revenue growth, absent offsetting policy action, driven by both education and Medicaid. The state continues to demonstrate strong support for education spending, a fundamental state responsibility. The fiscal challenge of Medicaid is common to all U.S. states and the nature of the program, as well as federal government rules, limit the states' options in managing the pace of spending growth. Federal action to revise Medicaid's fundamental programmatic and financial structure does not appear to be a near-term priority of the current federal administration or Congressional leadership. As with all federal programs, Medicaid remains subject to regulatory changes that could affect various aspects.

In other major areas of spending, Oregon can more easily adjust the trajectory of spending growth since it does not retain responsibility for direct service delivery. The state's voter initiative process remains very active and successful measures can place a financial burden on the state. The legislature retains the legal ability to modify voter-approved measures, which can provide some budgetary relief. However, the legislature must abide by voter-approved constitutional initiatives, which can only be modified by another voter-approved constitutional amendment.

Overall, Oregon retains ample ability to adjust expenditures to meet changing fiscal circumstances. Spending requirements for debt service, pension and OPEB are manageable at 4.3% of fiscal 2021 governmental funds expenditures. The state consistently funds its actuarially determined contributions for the pension system, subject to rate collars that limit and spread large contribution increases over multiple biennia. The state's funding methodology does not smooth asset performance.

The state is managing its costs associated with the 2020 and 2021 wildfire seasons through a range of available resources, including FEMA funds, state fire insurance payouts, dedicated general fund appropriations and a special purpose appropriation under the state emergency board.
Long-Term Liability Burden

Oregon's combined burden of debt and net pension liabilities, as adjusted by Fitch to a 6% return assumption, is low at 6.5% of personal income. This places Oregon's long-term liability burden slightly above the state median of 4.7% of personal income, per Fitch's 2021 report on state liabilities ("State Liability Burdens Shrink in Fiscal 2020").

Debt issuance is closely controlled by the state legislature under state constitutional guidelines. The largest portion of the state's outstanding debt is GO bonds, followed by debt issued for transportation purposes and funded by highway user and gasoline tax revenues. Fitch expects the debt burden to remain low given typically limited debt issuance plans and the State Debt Policy Advisory Commission's close monitoring of debt issuance relative to the state's debt capacity limits. The fiscal 2021-2023 budget approves up to almost $1.7 billion in GO bonds, $681 million in self-supporting GO bonds and $516 million in lottery revenue bonds.

The Oregon Public Employees Retirement System's (OPERS) funded ratio has fluctuated in recent years, reflecting pension changes, increasingly conservative actuarial assumptions, actual investment returns and increased employer contributions. On Oct. 1, 2021, the OPERS board approved a further reduction in the discount rate (to 6.9% from 7.2%) and rate collaring changes effective Jan. 1, 2022, likely increasing the actuarial liability and the employer contribution rate, depending on investment performance. Nevertheless, the state is still aiming to achieve full pension system funding by the fiscal 2041-2043 biennium.

The state is responsible for approximately 21% of the state-wide net pension liability (NPL). Using Fitch's standard 6% discount rate adjusts the state's proportionate share of the NPL to an estimated $8 billion, with a 66.3% ratio of assets to liabilities. The NPL is subject to sizable swings because asset performance is not smoothed under GASB accounting valuation rules; similarly, for its funding valuation Oregon is one of a handful of states that leaves assets unsmoothed, with contribution stability supported by its rate collar mechanism noted above.

OPEB obligations are modest, and the state funds the full actuarially required employer contributions. There are no plans to change OPEB entitlements.

Operating Performance

As demonstrated through recent downturns, including last year's pandemic-driven decline, the state retains very strong gap-closing capacity, with solid reserves. The state accumulated nearly $1.4 billion in its rainy day and education stability funds at the end of the 2019-2021 biennium, equivalent to nearly 6% of biennial general fund revenues. Deposits into the reserves continue to be made according to the legislative formula governing them. Contributions to the rainy day and education stability funds are capped at 7.5% and 5.0% of the prior biennium's general fund revenue total, respectively.
There are also legislative limits on how much can be withdrawn in any one biennium. For example, for any one biennium the legislature cannot withdraw from the rainy-day fund more than two-thirds of the amount that was in the fund at the beginning of that biennium and withdrawals from the education stability fund can only be for public education expenses.

The state expects the rainy day and education stability funds are projected to grow to over $1.9 billion, equivalent to 8% of biennial general fund revenues, by the end of the fiscal 2021-2023 biennium.

The Fitch Analytical Stress Test (FAST) scenario analysis model relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria. The FAST is not a forecast, but it provides a relative sense of the risk exposure of a particular state to economic declines compared to other states. Under a moderate revenue stress scenario, Oregon demonstrates revenue volatility that is slightly higher than the median state.

The state historically makes a robust recovery post-recession, allowing it to restore programmatic cuts, bolster aid to education, and rebuild reserves. Quarterly economic and revenue forecasts enable the state to quickly identify changes in economically sensitive personal income tax revenues. If the department of administrative services declares a projected budget deficit due to insufficient revenues, with the governor's approval the department can reduce allotments to prevent the deficit. A separate state emergency board composed of legislative leadership can reallocate appropriations when the legislature is not in session.

Accurate revenue forecasting and strong financial management are critical to the rating given a revenue structure largely dependent on the cyclical personal income tax, exposure to voter initiatives that can have negative fiscal impacts, and constitutional kicker provisions that require the return of surplus revenues to taxpayers. The state’s rigorous economic and revenue forecasting process and current reserves support its ability to withstand recessionary impacts on its revenues.

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.

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](http://www.fitchratings.com/esg)

**RATING ACTIONS**

OREGON, STATE OF (OR) [GENERAL GOVERNMENT]
LT IDR AA+ / AFFIRMED AA+

OREGON SCHOOL BOND GUARANTY PROGRAM (OR) /STATE SCHOOL BOND PROGRAM RATING/1 LT
LT AA+ / AFFIRMED AA+

OREGON, STATE OF (OR) /GENERAL OBLIGATION - UNLIMITED TAX/1 LT
LT AA+ / AFFIRMED AA+

OREGON, STATE OF (OR) /LEASE OBLIGATIONS - DEPT OF ADM SVCS/1 LT
LT AA / AFFIRMED AA

**PARTICIPATION STATUS**

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

**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**

- Dodd-Frank Rating Information Disclosure Form
- Solicitation Status
- Endorsement Policy

**ENDORSEMENT STATUS**
Oregon, State of (OR) EU Endorsed, UK Endorsed

**DISCLAIMER & DISCLOSURES**

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: [https://www.fitchratings.com/understandingcreditratings](https://www.fitchratings.com/understandingcreditratings). In addition, the following

**READ MORE**

**SOLICITATION STATUS**

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

**ENDORSEMENT POLICY**

Fitch’s international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch’s approach to endorsement in the EU and the UK can be found on Fitch’s [Regulatory Affairs](https://www.fitchratings.com/understandingcreditratings) page on Fitch’s website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.