

PRELIMINARY OFFICIAL STATEMENT DATED OCTOBER 25, 2012

This Official Statement has been prepared on behalf of the State of Oregon, acting by and through the Office of the Oregon State Treasurer, to provide information on the 2012 Bonds. Selected information presented on this cover page is for the convenience of the users. To make an informed decision regarding the 2012 Bonds, a prospective investor should read this Official Statement in its entirety. Unless otherwise indicated, capitalized terms used on the cover page have the meanings given in this Official Statement.

**NEW ISSUES
BOOK-ENTRY ONLY**

RATINGS: See "Ratings"

\$11,445,000*
STATE OF OREGON
GENERAL OBLIGATION BONDS
2012 SERIES P
(POLLUTION CONTROL PROJECTS)

| | |
|--------------------------------|---|
| DATED: Date of Delivery | DUE: As shown on the inside cover pages |
| Tax Status | In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel ("Bond Counsel") to the State of Oregon (the "State"), under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the State of Oregon General Obligation Bonds, 2012 Series P (Pollution Control Projects) (the "2012 Bonds") is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) interest on the 2012 Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In the opinion of Bond Counsel, interest on the 2012 Bonds is exempt from Oregon personal income tax under existing law. See "TAX MATTERS" herein for a discussion of the opinion of Bond Counsel. |
| Purpose and Authority | The 2012 Bonds are being issued to pay all or a portion of the costs of various State projects and to pay costs of issuing the 2012 Bonds, as described herein. The 2012 Bonds are being issued under authority granted by Article XI-H of the Oregon Constitution, as applicable; and applicable provisions of Oregon Revised Statutes, chapters 286A and 470, as amended. The 2012 Bonds are being issued pursuant to an Issuance Certificate of the State Treasurer to be dated as of the date of delivery of the 2012 Bonds. |
| Security | The 2012 Bonds are direct general obligations of the State, and the full faith and credit and taxing power of the State are irrevocably pledged to pay the 2012 Bonds when due. |
| Interest Payment Dates | Interest on the 2012 Bonds is payable semiannually on each May 1 and November 1, commencing November 1, 2013. |
| Denominations | The 2012 Bonds will be available in denominations of \$5,000 and integral multiples thereof. |
| Redemption | The 2012 Bonds are subject to redemption prior to maturity at the times, under the conditions and at the prices described herein. |
| Closing/Settlement | The 2012 Bonds are expected to be available for delivery through the facilities of DTC in New York, New York on or about November __, 2012. |
| Legal Counsel | Hawkins Delafield & Wood LLP, Portland, Oregon, Bond Counsel; the Oregon Department of Justice, Salem, Oregon, Counsel to the State; Orrick, Herrington & Sutcliffe LLP, Portland, Oregon, Disclosure Counsel to the State. |
| Paying Agent | The Bank of New York Mellon, as the State of Oregon's Fiscal Agent. |

* Preliminary, subject to change.

MATURITY SCHEDULES

\$11,445,000*

STATE OF OREGON

GENERAL OBLIGATION BONDS

2012 SERIES P

(POLLUTION CONTROL PROJECTS)

| <u>Maturity Date</u> <u>(November 1)</u> | <u>Principal</u> <u>Amount</u> | <u>Interest</u> <u>Rate</u> | <u>Yield</u> | <u>CUSIP**</u> <u>(68608U)</u> |
|---|-----------------------------------|--------------------------------|--------------|-----------------------------------|
| 2013 | \$ 95,000 | | | |
| 2014 | 420,000 | | | |
| 2015 | 440,000 | | | |
| 2016 | 455,000 | | | |
| 2017 | 470,000 | | | |
| 2018 | 495,000 | | | |
| 2019 | 515,000 | | | |
| 2020 | 530,000 | | | |
| 2021 | 555,000 | | | |
| 2022 | 580,000 | | | |
| 2023 | 600,000 | | | |
| 2024 | 615,000 | | | |
| 2025 | 635,000 | | | |
| 2026 | 655,000 | | | |
| 2027 | 675,000 | | | |
| 2028 | 700,000 | | | |
| 2029 | 715,000 | | | |
| 2030 | 740,000 | | | |
| 2031 | 765,000 | | | |
| 2032 | 790,000 | | | |

* Preliminary, subject to change.

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No dealer, broker, salesperson or other person is authorized by the State or the Underwriters to give any information or to make any representation other than those contained in this Official Statement and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing.

No website mentioned in this Official Statement is part of this Official Statement, and readers should not rely upon any information presented on any such website in determining whether to purchase the 2012 Bonds. Any references to any website mentioned in this Official Statement are not hyperlinks and do not incorporate such websites by reference.

In connection with this offering, the Underwriters may over allot or effect transactions that stabilize or maintain the market price of the 2012 Bonds at a level above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time. The public offering prices or yields set forth on the inside cover pages hereof may be changed from time to time by the Underwriters. The Underwriters may offer and sell the 2012 Bonds to certain dealers, unit investment trusts or money market funds at prices lower than the public offering prices stated on the inside cover pages hereof.

This Preliminary Official Statement has been "deemed final" as of its date by the State, except for the omission of offering prices, interest rates, selling commissions, aggregate principal amount, principal amount per maturity, delivery dates and other terms of the 2012 Bonds depending on such matters, in accordance with Rule 15c2-12(b)(i) under the Securities Exchange Act of 1934, as amended.

Certain statements contained in this Official Statement do not reflect historical facts but are forecasts and "forward-looking statements." No assurance is given that any future results discussed herein will be achieved, and actual results may differ materially from any forecasts described herein. In this respect, the words such as "estimate," "project," "forecast," "anticipate," "expect," "intend," "plan," "believe" and similar expressions identify forward-looking statements. All projections, forecasts, assumptions, expressions of opinion and other forward-looking statements are expressly qualified in their entirety by the cautionary statements set forth in this Official Statement.

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OREGON STATE GOVERNOR

John Kitzhaber

OREGON STATE TREASURER

Ted Wheeler

OREGON DEPARTMENT OF ENVIRONMENTAL QUALITY

Dick Pedersen
Oregon Department of Environmental Quality Director

SPECIAL SERVICES

BOND COUNSEL

Hawkins Delafield & Wood LLP
200 SW Market Street, Suite 350
Portland, OR 97201

FINANCIAL ADVISOR

Western Financial Group
3300 NW 185th Ave., #270
Portland, OR 97229

FISCAL AGENT

The Bank of New York Mellon
Corporate Trust Administration
101 Barclay Street, 7 West
New York, NY 10286

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\$11,445,000*
STATE OF OREGON
GENERAL OBLIGATION BONDS
2012 SERIES P
(POLLUTION CONTROL PROJECTS)

INTRODUCTION

This Official Statement, including the cover page, inside cover pages and appendices, provides information in connection with the issuance of the State of Oregon General Obligation Bonds, 2012 Series P (Pollution Control Projects) (the “2012 Bonds”).

The 2012 Bonds are direct, general obligations of the State of Oregon (the “State”), and the full faith and credit and taxing power of the State are irrevocably pledged to pay the 2012 Bonds when due, including the power to levy an ad valorem property tax for the 2012 Bonds. See “SECURITY AND SOURCES OF PAYMENT,” “STATE FINANCIAL INFORMATION” and APPENDIX A—“REVENUES.”

The 2012 Bonds will be issued by the State, acting by and through the State Treasurer, at the request of the Oregon Department of Environmental Quality (“DEQ”) pursuant to constitutional and statutory authority described herein.

The 2012 Bonds are being issued under the pollution control financing authority under Article XI-H (“Article XI-H”) of the Oregon Constitution to (i) fund the State matching component for federal grants to the Clean Water State Revolving Fund (“CWSRF”) loan program, (ii) fund current “orphan site” environmental clean-up projects, and (iii) pay costs of issuing the 2012 Bonds. Other authorized projects may be substituted for any of these projects. See “THE DEPARTMENT OF ENVIRONMENTAL QUALITY—The 2012 Pollution Control Projects.”

The 2012 Bonds will bear interest that is excludable from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, interest on the 2012 Bonds will be included in adjusted current earnings for the purpose of computing the federal alternative minimum tax imposed on certain corporations. The 2012 Bonds will bear interest that is exempt from Oregon personal income taxation. See “TAX MATTERS.”

AUTHORITY FOR ISSUANCE

Constitutional Authority and Limits

The Oregon Constitution authorizes the issuance of general obligation bonds for a variety of purposes under Articles XI-A through XI-Q. Approximately \$5.079 billion of State general obligation bonds were outstanding as of October 1, 2012, including outstanding Article XI-H Bonds, as described below. See “SECURITY AND SOURCES OF PAYMENT—BOND DEBT SERVICE” and see APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—DEBT

* Preliminary, subject to change.

AUTHORITY AND BOND ISSUANCE” and Tables 28 through 30 therein for a summary of the State’s outstanding debt obligations, including outstanding general obligation bonds.

Article XI-H. The 2012 Bonds are being issued under authority granted by Article XI-H of the Oregon Constitution. Article XI-H authorizes the issuance of general obligation bonds to provide funds (i) to be advanced, by contract, grant, loan or otherwise, to any municipal corporation, city, county or agency of the State, or combinations thereof, for the purpose of planning, acquisition, construction, alteration or improvement of facilities for or activities related to, the collection, treatment, dilution and disposal of all forms of waste in or upon the air, water and land of the State, (ii) for the acquisition, by purchase, loan or otherwise, of bonds, notes or other obligations of any municipal corporation, city, county or agency of the State, or combinations thereof, issued or made for the purposes of subsection (i) above and (iii) to refund general obligation indebtedness incurred under Article XI-H. The State voters adopted Article XI-H in May 1970, as amended by the voters in May 1990.

The Oregon Constitution limits State general obligation bonds issued under Article XI-H (collectively, the “Article XI-H Bonds”) outstanding at any one time to one percent of the “true cash value” of all taxable property in the State. The amount of true cash value, as determined by the State Department of Revenue, is the market value of all nonexempt real and personal property in the State as of the valuation date (January 1) for the tax and fiscal year beginning the following July 1. As of January 1, 2011, the real market value of nonexempt real and personal property in the State was approximately \$434 billion. The table below shows the total approximate amount of outstanding Article XI-H Bonds and the approximate percentage of remaining bonding authority under Article XI-H. The amount of outstanding Article XI-H Bonds shown in the following table excludes the 2012 Bonds. See APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—DEBT AUTHORITY AND BOND ISSUANCE” and Table 28 therein.

**TABLE 1
ARTICLE XI-H BOND DEBT OUTSTANDING AND
REMAINING AUTHORITY UNDER CONSTITUTIONAL LIMIT⁽¹⁾**

| | <u>October 1, 2012⁽²⁾</u> |
|---|--------------------------------------|
| Article XI-H Bonded Debt Constitutional Limit | \$2.17 billion |
| Article XI-H Bonds Outstanding ⁽³⁾ | \$37.76 million |
| Percent of Remaining Authority Under Constitutional Limit, XI-H Bonds | 98.3% |

⁽¹⁾ Amounts shown are approximate; totals may not add due to rounding.

⁽²⁾ The limit on Article XI-H Bonds, excluding the 2012 Bonds, is based on the true cash value of statewide property as of January 1, 2011.

⁽³⁾ Excludes the 2012 Bonds.

Source: Debt Management Division, Office of the State Treasurer.

Legislative Authority

2011-2013 Biennium Authority. State law requires the Legislative Assembly to establish the amount of bonds that may be issued during each two-year budget period (a “biennium”) for purposes other than refunding. The table below shows the total amount of general obligation bonds authorized for the 2011-2013 biennium by the Legislative Assembly, and the total amount issued prior to the issuance of the 2012 Bonds, not including any refunding bonds that may be issued during the 2011-2013 biennium. See “—Constitutional Authority and Limits” and APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—DEBT AUTHORITY AND BOND ISSUANCE” for a summary of the State’s outstanding debt obligations.

TABLE 2
GENERAL OBLIGATION BOND 2011-2013 ISSUANCE AUTHORITY⁽¹⁾

| | <u>Authorized</u> | <u>Issued⁽²⁾</u> |
|--|-------------------|-----------------------------|
| Total General Obligation Bond Issuance Authority | \$ 749,000,000 | \$ 215,000,000 |
| Article XI-H (DEQ) Issuance Authority | 16,740,000 | -0- |

⁽¹⁾ Amounts shown are approximate; totals may not add due to rounding.

⁽²⁾ Excludes the 2012 Bonds.

Source: Debt Management Division, Office of the State Treasurer; data as of October 1, 2012.

Other Authority

The 2012 Bonds are issued pursuant to Oregon Revised Statutes (“ORS”) chapters 286A and 468. Additionally, the 2012 Bonds are issued in accordance with resolutions of the Environmental Quality Commission (the “Commission”) adopted on December 16, 2011 and August 24, 2012 (collectively, the “DEQ Resolution”). The State Treasurer will execute and deliver an issuance certificate to be dated the date of delivery of the 2012 Bonds (the “Issuance Certificate”).

SECURITY AND SOURCES OF PAYMENT

Pledge of Full Faith and Credit

The 2012 Bonds are direct general obligations of the State, and the full faith and credit and taxing power of the State are irrevocably pledged to pay the 2012 Bonds when due, including the power to levy an ad valorem property tax in connection with the 2012 Bonds.

Sources of Payment for 2012 Bonds

Pollution Control Fund

To the extent that moneys held in the Pollution Control Sinking Fund, the Clean Water State Revolving Fund (CWSRF), the Orphan Site Account of the Hazardous Substance Remedial Action Fund and any unrestricted State funds (collectively, “Revenues”) are sufficient, the State intends to pay debt service on the 2012 Bonds and all other outstanding Article XI-H Bonds from those Revenues. Additionally, the Legislative Assembly appropriates general funds to service a portion of the debt on Article XI-H Bonds (the “XI-H General Fund Appropriation”) issued to fund cleanup of industrial orphan sites. The State expects the Revenues and XI-H General Fund Appropriations (together, “Program Revenues”) to be sufficient to pay the debt service requirements of the 2012 Bonds. See APPENDIX C—“INFORMATION RELATING TO THE OREGON DEPARTMENT OF ENVIRONMENTAL QUALITY.”

Payment from Other Sources

In the event Program Revenues are insufficient to pay the Article XI-H Bonds and the Legislative Assembly is in session, the Legislative Assembly may appropriate additional moneys from the General Fund or from other unrestricted sources to pay the debt service on Article XI-H Bonds, including the 2012 Bonds. If the Legislative Assembly is not in session, the Emergency Board, established under Article III, Section 3 of the Oregon Constitution may allocate moneys to pay debt service out of the emergency fund that is appropriated to it by the full Legislative Assembly. In addition, if Program Revenues or other amounts expected to pay the Article XI-H Bonds are not available for any reason, the Treasurer may

make an interfund loan from funds held in the Oregon State Treasury to pay debt service on those bonds. See “STATE FINANCIAL INFORMATION—General Fund Revenues” and APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—THE STATE OF OREGON GOVERNMENTAL ORGANIZATION—The Legislative Branch” and “—STATE FINANCIAL OPERATIONS—Budgetary Process” and “—DEBT AUTHORITY AND BOND ISSUANCE.”

Property Taxes

The State has not imposed property taxes for many years and does not expect that property taxes would be levied to pay the 2012 Bonds. Instead, the State expects that the Legislative Assembly or the Emergency Board would find replacement revenues to pay the 2012 Bonds as described in the preceding paragraph. However, the State is authorized to impose an annual property tax to pay the 2012 Bonds.

If DAS determines that amounts available during a fiscal year from Program Revenues and the other sources described above will not be sufficient to pay the 2012 Bonds, current Oregon law requires the State to impose an *ad valorem* property tax levy on all taxable property within the State in an amount equal to the deficit.

Bond Debt Service

The table below shows annual fiscal year debt service on all outstanding general obligation bonds of the State as of October 1, 2012 and the 2012 Bonds to be outstanding as of November __, 2012, the date the State expects to issue the 2012 Bonds.

TABLE 3*
STATE OF OREGON
GENERAL OBLIGATION BOND DEBT SERVICE

| Fiscal Year Ending June 30 | Outstanding General Obligation Bonds ⁽¹⁾ | | | 2012 Bonds | | | Combined Total General Obligation Bond Debt Service ⁽²⁾ |
|-------------------------------|---|-------------------------|------------------------|------------|----------|-------------------|--|
| | Principal | Interest ⁽³⁾ | Bond Debt Service | Principal | Interest | Bond Debt Service | |
| 2013 | \$ 103,065,000 | \$ 203,186,803 | \$ 306,251,803 | | | | |
| 2014 | 183,974,060 | 253,377,045 | 437,351,105 | | | | |
| 2015 | 200,071,440 | 243,306,213 | 443,377,653 | | | | |
| 2016 | 212,691,434 | 235,451,662 | 448,143,096 | | | | |
| 2017 | 222,055,162 | 227,241,288 | 449,296,450 | | | | |
| 2018 | 233,137,240 | 214,302,141 | 447,439,381 | | | | |
| 2019 | 253,668,074 | 199,643,778 | 453,311,853 | | | | |
| 2020 | 293,124,966 | 186,949,125 | 480,074,091 | | | | |
| 2021 | 288,673,352 | 169,760,003 | 458,433,355 | | | | |
| 2022 | 288,015,187 | 154,417,950 | 442,433,136 | | | | |
| 2023 | 306,615,000 | 138,050,930 | 444,665,930 | | | | |
| 2024 | 314,910,000 | 122,030,526 | 436,940,526 | | | | |
| 2025 | 331,190,000 | 105,094,436 | 436,284,436 | | | | |
| 2026 | 358,165,000 | 86,967,088 | 445,132,088 | | | | |
| 2027 | 374,960,000 | 67,310,092 | 442,270,092 | | | | |
| 2028 | 109,860,000 | 46,804,768 | 156,664,768 | | | | |
| 2029 | 103,185,000 | 41,953,258 | 145,138,258 | | | | |
| 2030 | 100,690,000 | 37,347,086 | 138,037,086 | | | | |
| 2031 | 96,585,000 | 32,905,846 | 129,490,846 | | | | |
| 2032 | 96,705,000 | 28,564,900 | 125,269,900 | | | | |
| 2033 | 86,165,000 | 24,482,928 | 110,647,928 | | | | |
| 2034 | 89,660,000 | 20,603,529 | 110,263,529 | | | | |
| 2035 | 83,110,000 | 16,774,232 | 99,884,232 | | | | |
| 2036 | 83,550,000 | 13,010,344 | 96,560,344 | | | | |
| 2037 | 62,965,000 | 9,384,552 | 72,349,552 | | | | |
| 2038 | 59,780,000 | 6,579,991 | 66,359,991 | | | | |
| 2039 | 57,730,000 | 3,936,518 | 61,666,518 | | | | |
| 2040 | 37,140,000 | 1,982,367 | 39,122,367 | | | | |
| 2041 | 20,120,000 | 999,180 | 21,119,180 | | | | |
| 2042 | 16,875,000 | 357,079 | 17,232,079 | | | | |
| 2043 | 2,875,000 | 76,644 | 2,951,644 | | | | |
| 2044 | 2,910,000 | 55,636 | 2,965,636 | | | | |
| 2045 | 2,975,000 | 40,846 | 3,015,846 | | | | |
| 2046 | 1,640,000 | 27,476 | 1,667,476 | | | | |
| 2047 | 200,000 | 17,100 | 217,100 | | | | |
| 2048 | 210,000 | 7,481 | 217,481 | | | | |
| TOTAL | \$5,079,245,915 | \$2,893,000,840 | \$7,972,246,755 | | | | |

* Preliminary, subject to change.

⁽¹⁾ Includes all outstanding general obligation bonds of the State as of October 1, 2012.

⁽²⁾ Includes all outstanding general obligation bonds of the State as of October 1, 2012, and the 2012 Bonds as of November __, 2012 the date the 2012 Bonds are expected to be delivered.

⁽³⁾ The interest calculation on variable rate obligations is determined by multiplying the most recent interest rate reset for each obligation times its outstanding principal over the life of the bonds.

Source: Debt Management Division, Office of the State Treasurer.

STATE FINANCIAL INFORMATION

Budgeting

The Oregon Constitution requires the Legislative Assembly to balance the State's General Fund budget. The Legislative Assembly adopts individual budgets for all State agencies or programs. Each budget includes appropriations of General Fund moneys or program revenues for the payment of debt service to those State agencies for which general obligation bonds have been issued by the State Treasurer. Historically, the Legislative Assembly met in regular session once every two years and budgeted for the two-year period (a "biennium") that follows the regular session. In 2010, however, the Oregon Constitution was amended to provide for annual legislative sessions. As a consequence, the Legislative Assembly may now make some budgetary determinations for a single fiscal year. Once the Legislative Assembly has appropriated moneys for debt service, Oregon law does not permit the amount allocated to debt service to be subsequently reduced administratively in order to balance the General Fund budget; budget reductions must be made in other program areas. See APPENDIX A—"GENERAL INFORMATION RELATING TO THE STATE OF OREGON—STATE FINANCIAL OPERATIONS—Budgetary Process" for more information about the State budget and payment of State general obligation bonds.

General Fund Revenues

The State General Fund is comprised of various revenue sources including, among other things, taxes, fines and fees, liquor sales apportionment, charges for services, interest earnings and miscellaneous revenues. Additionally, revenues from the operation of the Oregon State Lottery comprise a significant source of money in the State's budget. The State also receives moneys from the federal government. The Legislative Assembly may authorize receipt of federal funds for specific purposes. The Legislative Assembly must appropriate and use any federal funds in accordance with any restrictions placed on such funds by the federal government. See APPENDIX A—"GENERAL INFORMATION RELATING TO THE STATE OF OREGON—REVENUES" for a detailed description of sources of General Fund revenues and other sources of revenues available to the State.

Oregon law requires DAS, with the assistance of the Department of Revenue, to prepare an estimate for each calendar quarter of the revenue available for State purposes for the current fiscal year, as well as the amount of revenue received quarterly, through the biennium (the "State Economic and Revenue Forecast"). The DAS Office of Economic Analysis (the "OEA") produces the State Economic and Revenue Forecast based upon information available at the time of preparation and upon a wide variety of assumptions. The State's actual results will be affected by subsequent national and state economic activity and other events, including events that are not within the State's control. See "RECENT DEVELOPMENTS."

If amounts budgeted or expected to pay any general obligation bonds of the State, including the 2012 Bonds, are not available for any reason, the Treasurer may make an intrafund or interfund loan from funds held in the Oregon State Treasury to pay debt service on those bonds. Any intrafund loan is repaid without interest. Any interfund loan is repaid with interest and may only be made if the borrowing fund is expected to be able to repay the borrowed funds, with interest, before the borrowed funds are needed by the lending fund, and if the interfund loan meets certain other conditions. The State is not obligated to obtain loans from these funds and may decide to seek other sources of funds to pay its legal obligations.

The table below presents historical State General Fund Revenues for the 2005-2007, 2007-2009 and 2009-2011 biennia, and forecast State General Fund Revenues for the 2011-2013 biennia as presented in the State Economic and Revenue Forecast, released on August 29, 2012 (the “September 2012 Forecast”). See “RECENT DEVELOPMENTS—Economic and Revenue Forecast” and APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—REVENUES.”

TABLE 4
STATE OF OREGON
GENERAL FUND REVENUE STATEMENT
(\$ In Thousands)⁽¹⁾

| | 2005-2007 | 2007-2009 | 2009-2011 | 2011-13 |
|--------------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|------------------------------------|
| Taxes | Actuals⁽²⁾ (\$) | Actuals⁽³⁾ (\$) | Actuals⁽⁴⁾ (\$) | Forecast⁽⁵⁾ (\$) |
| Personal | 11,040,347 | 11,174,799 ⁽⁶⁾ | 10,467,225 | 11,956,608 |
| Corporate Excise and Income | 844,082 | 684,485 | 827,614 | 842,577 |
| Insurance | 114,718 | 93,328 | 90,496 | 96,381 |
| Estate | 168,933 | 196,820 | 168,864 | 195,638 |
| Cigarette | 88,789 | 81,649 | 76,837 | 74,434 |
| Other Tobacco Products | 32,553 | 34,518 | 47,328 | 57,016 |
| Other | 2,504 | 1,477 | 2,496 | 1,550 |
| Fines and Fees | | | | |
| State Court Fees | 48,036 | 55,625 | 50,464 | 133,196 |
| Secretary of State Corp. Fees | 20,402 | 22,496 | 41,950 | 50,800 |
| Criminal Fines and Assessments | 88,741 | 72,855 | 59,460 | 68,692 |
| Securities Fees | 18,226 | 19,576 | 19,263 | 19,545 |
| Central Service Charge | 6,687 | 8,713 | 8,174 | 11,152 |
| Liquor Apportionment | 146,110 | 184,326 | 196,283 | 230,471 |
| Interest Earnings | 101,356 | 84,344 | 4,927 | 10,913 |
| Miscellaneous Revenues | 15,698 | 11,976 | 10,932 | 9,897 |
| One-time Transfers | 4,824 | 86,104 | 447,383 | 162,086 |
| Gross General Fund Revenues | 12,742,006 | 12,813,091 | 12,521,696 | 13,920,956 |
| <i>Total Kicker Refunds /Credits</i> | 0 | (1,084,201) | 0 | 0 |
| Net General Fund Revenues | 12,742,006 | 11,728,890 | 12,521,696 | 13,920,956 |
| Beginning Balance | 308,523 | 1,436,710 | 0 | 0 |
| Anticipated Administrative Actions | 4,937 | (42,140) ⁽⁷⁾ | (8,200) ⁽⁷⁾ | (4,395) ⁽⁷⁾ |
| Legislative Adopted Actions | 0 | (319,288) ⁽⁸⁾ | 0 | 0 |
| Available Resources | 13,050,529 | 12,804,172 | 12,513,496 | 13,916,561 |
| Appropriations | 11,641,200 | 12,793,534 | 13,432,875 | 13,723,770 |
| Adjusted Appropriations | 11,646,137 | 12,793,534 | 13,432,875 | 13,723,770 |
| Reversion | (32,319) | (762) | 0 | 0 |
| Administrative Actions | 0 | 0 | (954,613) ⁽⁹⁾ | 0 |
| Projected Expenditures | 11,613,818 | 12,792,772 | 12,478,261 | 13,723,770 |
| Ending Balance | 1,436,710 | 11,400 ⁽¹⁰⁾ | 35,235 ⁽¹⁰⁾ | 192,791 |

Note: One-time action and expenditure changes from SB 5562, HB 5015 and SB 581 are included for FY 2009.

(1) Totals may not agree with sum of components due to rounding.

(2) September 2007 Economic and Revenue Forecast, adjusted for reversions.

(3) December 2009 Economic and Revenue Forecast, subject to adjustments through June 2010.

(4) September 2011 Economic and Revenue Forecast.

(5) September 2012 Economic and Revenue Forecast.

(6) Not reduced by \$1,084,201 Kicker.

(7) Interest expense associated with the Tax Anticipation Notes program, and is exclusive of any internal borrowing.

(8) Equals 2005-2007 portion of corporate surplus designated for the Rainy Day Fund.

(9) Allotment reductions to agencies.

(10) The ending balances for 2007-2009 and 2009-2011 were transferred to the Rainy Day Fund so the beginning balances for 2009-2011 and 2011-2013, respectively, were assumed to be -0-.

Source: State of Oregon, Budget and Management, and Oregon Office of Economic Analysis Revenue Forecasts.

Reserve Funds

The State has two budgetary reserve funds, the Education Stability Fund (the “ESF”) and the Oregon Rainy Day Fund (the “Rainy Day Fund”), that may be drawn on in the event of General Fund revenue shortfalls or economic downturns within a biennium subject to certain restrictions that are described in APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—REVENUES—Reserve Funds.”

As presented in the September 2012 Forecast, as of the end of the 2011-2013 biennium, the projected ending balance of the Rainy Day Fund is \$61.8 million and the projected ending balance of the ESF is \$6.9 million. The projected ending balance of the ESF reflects the net available amount in the ESF, exclusive of funds held in the Oregon Growth Account that may be illiquid. The projected ESF ending balance also reflects the staged transfers from the ESF totaling approximately \$182.2 million, as approved by the Legislative Assembly in the 2011-2013 biennium budget. These projected ending balances are based upon information available at the time of preparation of the September 2012 Forecast and upon certain assumptions set out in the forecast. The actual amount of reserves will be affected by national and State economic activity and other events, including events that are not within the State’s control. See “RECENT DEVELOPMENTS.”

Pension Benefit Programs

The State is one of many participants in the statewide Oregon Public Employees’ Retirement System (“PERS”). The State participates in three retirement pension benefit programs provided through PERS that are commonly referred to as Tier 1, Tier 2, and the Oregon Public Service Retirement Plan (“OPSRP”). A majority of local governments in Oregon and the State participate in PERS. For a description of these retirement benefit programs, see APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—PENSION AND POST EMPLOYMENT BENEFITS.” Oregon statutes require an actuarial valuation of PERS by an actuary, at least every two years. Under current practice, actuarial valuations are performed annually, but only valuations as of the end of each odd-numbered year are used to determine annual required employer contribution rates. The actuarial valuations use the Projected Unit Credit actuarial cost method, as adopted by the PERS Board, and the market value method to determine asset valuation, without smoothing. Valuations are released approximately one year after the valuation date. The current PERS actuary is Milliman, Inc. See APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—PENSION AND POST EMPLOYMENT BENEFITS—System Pension Programs—*System Pension Plan Asset and Liabilities Valuations.*”

Funding Levels and State Contributions. At the August 28, 2012 PERS Board meeting, Milliman presented the actuarial valuation of assets and liabilities for the System as of December 31, 2011 (the “2011 Milliman Presentation”). The official actuarial valuation report for the System as of December 31, 2011 (the “2011 System Valuation”) is expected to be released prior to the end of calendar year 2012. The State does not expect to update this Official Statement with information from the 2011 System Valuation unless it determines that the 2011 System Valuation materially differs from the 2011 Milliman Presentation. In October 2012, the State’s individual 2011 actuarial valuation report (the “2011 State Report”) was released which includes information regarding the State’s share of the PERS unfunded actuarial accrued liability as of December 31, 2011. The table below provides summary information and a comparison of the statewide PERS (as reported in the 2011 Milliman Presentation for the System as of December 31, 2011) and State valuations. See APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—PENSION AND POST EMPLOYMENT BENEFITS—System Pension Programs—*System Pension Plan Asset and Liabilities Valuations.*”

The State’s actuarial valuation report as of December 31, 2009 (the “2009 State Report”) includes combined employer contribution rates for the current 2011-2013 biennium for the State. The 2011 State Report includes combined employer contribution rates for the 2013-2015 biennium for the State. See APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—PENSION AND POST EMPLOYMENT BENEFITS—State Employer Contribution Rates” and “—State Contributions.” The 2011-2013 employer contribution rates were derived using a rate stabilization methodology designed to cap rate increases and reduce large fluctuations in employer contribution rates; such rate increases are shifted to future biennia, including the 2013-2015 biennium. In the 2011 Milliman Presentation, Milliman stated that barring future investment performance above assumption, employer contribution rates are more likely than not to be at 2013-2015 levels (or higher) for the foreseeable future. For information regarding the contribution rate stabilization method and the State’s employer contribution rates, see APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—PENSION AND POST EMPLOYMENT BENEFITS—System Pension Programs—*System Pension Plan Asset and Liabilities Valuations* and —*State Employer Contribution Rates*.”

TABLE 5
SUMMARY OF SYSTEM AND STATE FUNDING LEVELS
(\$ In Millions)

| Calendar Year | SYSTEM ⁽¹⁾ | | | | STATE | | | |
|---------------|--|--------------------------------|--------------------|-----------------------------|--|--------------------------------|--------------------|-----------------------------|
| | Actuarial Value of Assets ⁽²⁾ | Actuarial Value of Liabilities | Unfunded Liability | Funded Ratio ⁽³⁾ | Actuarial Value of Assets ⁽⁴⁾ | Actuarial Value of Liabilities | Unfunded Liability | Funded Ratio ⁽³⁾ |
| 2007 | 59,327.8 | 52,871.2 | (6,456.6) | 112.2 | 15,769.3 | 13,611.1 | (2,158.2) | 115.9 |
| 2008 | 43,520.6 | 54,259.5 | 10,738.9 | 80.2 | 11,600.1 | 14,036.0 | 2,435.9 | 82.6 |
| 2009 | 48,729.2 | 56,810.6 | 8,081.4 | 85.8 | 13,014.7 | 14,771.7 | 1,757.0 | 88.1 |
| 2010 | 51,583.6 | 59,329.5 | 7,745.9 | 86.9 | 13,529.8 | 15,116.4 | 1,586.5 | 89.5 |
| 2011 | 50,168.0 | 61,198.0 | 11,030.0 | 82.0 | 13,208.2 | 15,660.0 | 2,451.8 | 84.3 |

⁽¹⁾ System funding levels composed of Tier 1 and Tier 2 and Oregon Public Service Retirement Plan (“OPSRP”) pensions but excluding retiree healthcare subsidies of RHIA and RHIPA.

⁽²⁾ Includes proceeds of pension bonds issued by Oregon local governments and the State.

⁽³⁾ Funded ratios are based on “mark to market” accounting procedures.

⁽⁴⁾ Includes State Pension Bonds proceeds.

Source: PERS.

Other Post-Employment Benefits

In addition to the pension benefits provided through PERS, the State provides healthcare benefits (medical, vision and dental) through two PERS health insurance programs and through the Oregon Public Employees’ Benefit Board (“PEBB”). At the time of retirement, State employees can choose whether to obtain post-employment benefits through PERS or through PEBB. Approximately 52,944 retirees received healthcare benefits through PERS health insurance programs and approximately 2,500 retirees receive healthcare benefits through PEBB. See APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—PENSION AND POST EMPLOYMENT BENEFITS” for information regarding the State’s obligations to provide benefits through PEBB.

THE 2012 BONDS

When issued the 2012 Bonds will be dated their date of delivery and will bear interest at the rates per annum and will mature, subject to redemption prior to maturity, on the dates and in the principal amounts, set forth on the inside cover pages of this Official Statement. Interest on the 2012 Bonds, will be calculated on the basis of a 360-day year comprising twelve 30-day months. Interest on the 2012 Bonds will be payable on May 1 and November 1 of each year, commencing November 1, 2013. The 2012 Bonds are issuable in fully registered form, in denominations of \$5,000 and integral multiples

thereof, without coupons. The State's fiscal agent, currently The Bank of New York Mellon (the "Fiscal Agent"), is to serve as paying agent and registrar for the 2012 Bonds.

When issued, the 2012 Bonds will be registered in the name of Cede & Co., as registered owner and nominee of The Depository Trust Company ("DTC"). DTC is to act as securities depository for the 2012 Bonds. Individual purchases may be made only in book-entry form. Purchasers will not receive certificates representing their interests in the 2012 Bonds purchased. So long as Cede & Co. (or such other name as may be requested by an authorized representative of DTC) is the registered owner of the 2012 Bonds as nominee of DTC, all payments and notices, including redemption notices, are to be made to DTC or to its nominee and not to the Beneficial Owners of the 2012 Bonds. References in this Official Statement to "Owners," "Bondholders" or "Registered Owners" mean Cede & Co. or DTC and not the Beneficial Owners of the 2012 Bonds. In this Official Statement, the term "Beneficial Owner" means the person for whom its DTC participant acquires an interest in the 2012 Bonds. See "DESCRIPTION OF DTC AND ITS BOOK-ENTRY SYSTEM" in Appendix F.

The information in "DESCRIPTION OF DTC AND ITS BOOK-ENTRY SYSTEM" in Appendix F regarding DTC and its book-entry system has been furnished by DTC and no representation is made by the State or the Financial Advisor as to the accuracy or completeness of such information.

If the 2012 Bonds are no longer issued in book-entry form, the Fiscal Agent will be required to mail each 2012 Bond interest payment when due to the registered owner at the address appearing on the 2012 Bond Register as of the fifteenth day of the month preceding a 2012 Bond payment date. If payment is so mailed, neither the State nor the Fiscal Agent will have any further liability to any party for such payment.

REDEMPTION OF THE 2012 BONDS

Optional Redemption of 2012 Bonds*

The 2012 Bonds maturing on or after November 1, 2023 are subject to redemption prior to maturity at the option of the State, in whole or in part at any time on or after November 1, 2022 (with the maturities to be selected by the State and by lot within a maturity) at a redemption price equal to 100 percent of the principal amount thereof, plus accrued but unpaid interest to the date fixed for redemption.

Selection for Redemption; Notice and Effect of Redemption

Selection for Redemption of 2012 Bonds. If fewer than all of the 2012 Bonds of a series and maturity are to be redeemed prior to maturity, then (i) if the 2012 Bonds of such series and maturity are in book-entry form at the time of such redemption, the Fiscal Agent is required to instruct DTC to instruct the DTC Participants to select the specific 2012 Bonds of such series and maturity for redemption by lot, and neither the State nor the Fiscal Agent will have any responsibility to ensure that DTC or the DTC Participants properly select such 2012 Bonds of a series and maturity for redemption; and (ii) if the 2012 Bonds of such series and maturity are not then in book-entry form at the time of such redemption, the 2012 Bonds of such series and maturity will be assigned certificate numbers and on each redemption date, the Fiscal Agent is required to select the specific maturities of such series of 2012 Bonds for redemption within a maturity in the order of the assigned certificate numbers.

* Preliminary, subject to change.

Notice and Effect of Redemption; Conditional Notice of Optional Redemption. Unless the book-entry only system with DTC is discontinued, notice of redemption of any Series of 2012 Bonds is to be given to DTC not less than 20 days prior to the date fixed for redemption. DTC is responsible for notifying the DTC Participants of such redemption.

The Issuance Certificate for the 2012 Bonds provides that except as described in the next sentence in the case of an optional redemption, interest on any 2012 Bond so called for redemption shall cease to accrue on the redemption date designated in the notice. The Issuance Certificate permits any optional redemption to be conditioned upon the receipt by the Fiscal Agent of moneys sufficient to pay the redemption price of such 2012 Bonds or upon the satisfaction of any other condition and permits the State to rescind its notice of optional redemption if such condition is not satisfied or upon the occurrence of any other event. Notice of such rescission or of the failure of any such condition is to be given by the Fiscal Agent to the affected Bondowners of any 2012 Bond as promptly as practicable upon the failure of such condition or the occurrence of such other event.

THE OREGON DEPARTMENT OF ENVIRONMENTAL QUALITY

DEQ is responsible for programs pertaining to water quality, air quality, hazardous and solid waste, and environmental cleanups. DEQ also has the authority to provide technical consultation and advisory services to local and state governmental bodies, to cooperate in demonstration programs with local governments and to encourage agencies or industries voluntarily to execute plans for prevention and abatement of pollution. DEQ serves as the State agency responsible for receipt of money from the federal government or other public or private agencies for the purposes of air and water pollution control, hazardous and solid waste, recycling and environmental cleanup. See APPENDIX C—“INFORMATION RELATING TO THE OREGON DEPARTMENT OF ENVIRONMENTAL QUALITY.”

The 2012 Pollution Control Projects

DEQ expects to use a portion of the proceeds received from the sale of the 2012 Bonds to pay costs of issuing the 2012 Bonds and to pay a portion of the costs of the projects listed in the following table. Other authorized projects may be substituted for any of these projects.

**TABLE 6
EXPECTED PROJECTS – 2012 BONDS***

| Amount | Project Description |
|---------------|--|
| \$4,900,000 | State matching component for federal grants to the CWSRF |
| 7,029,000 | “Orphan site” Environmental Clean-up |

Source: Oregon Department of Environmental Quality.

* Preliminary, subject to change.

Estimated Sources and Uses of Funds for 2012 Bonds

The estimated sources and uses of funds for the 2012 Bonds are shown below.

Sources of Funds:

Principal Amount of 2012 Bonds

Net Original Issue Premium/(Discount) _____

Total Sources

Uses of Funds:

Deposit to Pollution Control Fund

Underwriter's Discount

Costs of Issuance⁽¹⁾ _____

Total Uses

⁽¹⁾ Includes legal fees, printing costs, fees and expenses of financial advisor and rating agencies and other miscellaneous expenses.

RECENT DEVELOPMENTS

Actions of the Legislative Assembly

The Legislative Assembly completed its 2012 Legislative Session on March 5, 2012 (the "2012 Legislative Session"). Actions taken during the 2012 Legislative Session included revising the balanced budget to reflect a decline in projected General Fund Revenues of approximately \$305 million between the State Economic and Revenue Forecast that was released on May 12, 2011 (the "2011 Close of Session Forecast"), and the State Economic and Revenue Forecast released on February 8, 2012 (the "March 2012 Forecast"). The Legislative Assembly also restored certain program reductions included in the initial Legislatively Adopted Budget for the 2011-2013 biennium (the "LAB") adopted during the 2011 session of the Legislative Assembly that adjourned on June 30, 2011. After the 2012 Legislative Session, the combined General Fund and Lottery Revenues budget totaled \$14.786 billion. Other legislation was enacted during the 2012 Legislative Session, including House Bill 4164 to create a health insurance exchange. Through the actions taken in the 2012 Legislative Session, the combined General Fund and Lottery Fund ending balance was projected to be approximately \$115 million. Based on the September 2012 Forecast, the General Fund ending balance is projected to be \$95.1 million prior to any future action taken by the Emergency Board or Legislative Assembly. Based on the September 2012 Forecast, the projected ending balances in the Rainy Day Fund and the ESF are \$61.7 million and \$10.5 million, respectively.

Combined General Fund and Lottery Fund expenditures in the LAB for the 2011-2013 biennium are primarily divided among the agencies and program areas described in the table below.

TABLE 7
2011-2013 BIENNIUM LEGISLATIVE APPROVED BUDGET

| Amount | Agency/Program Area |
|-----------------|--|
| \$7.395 billion | Education, including: \$5.714 billion for the K-12 State School Fund \$861 million for the public universities \$425 million for community colleges and workforce programs \$395 million for other education programs (including early learning) |
| \$3.874 billion | Human Services |
| \$2.549 billion | Public Safety/Judicial |
| \$300 million | Natural Resources |
| \$174 million | Economic and Community Development |
| \$494 million | All Other Program Areas |

Source: 2011-2013 LAB.

Economic Information

According to the September 2012 Forecast, the OEA projects General Fund revenues to be \$13.921 billion for the 2011-13 biennium. This represents an increase of \$88 million from the March 2012 Forecast and is \$111 million below the 2011 Close of Session Forecast. According to the September 2012 Forecast, collections of most major revenue types came in stronger than expected over the summer.

In its September 2012 Forecast, OEA notes that employment growth in Oregon continues to increase at a slow, subdued pace through early 2012, approximately in line with the gains seen at the U.S. level. The employment data discussed in the September 2012 Forecast is adjusted for two important technical purposes: seasonality and certain upcoming benchmark revisions discussed in detail in the forecast. After adjustments, the data reveals that Oregon's economy continues to expand slowly, adding nearly 19,000 jobs in the past year (through the second quarter of 2012) for a growth rate of 1.2 percent during that 12-month period.

According to the September 2012 Forecast, similar to the overall economy, the two leading indicator series for Oregon both have moved in fits and starts in recent years. Following growth in late 2011 through early 2012, both indices declined sharply in June. However, both remain positive on a six-month growth basis, which is consistent with an expanding economy in the near future. OEA's Oregon Index of Leading Indicators, which are described in detail in the forecast (the "OEA OILI"), was led downward by large movements in a few indicators, while most indicators point to continued growth. Overall, weakness in the OEA OILI is being led by the indicators most affected by the global economic weakness, particularly in the manufacturing sector. OEA forecasts an employment outlook that is essentially unchanged for 2012. The rate of growth is projected to pick up in 2013 to 1.8 percent and further in 2014 to 1.9 percent.

Lottery revenue forecasts for the 2011-2013 biennium are expected to total \$1.075 billion, a decrease of \$17.0 million compared to the June 2012 Forecast. The decline in projections is attributed to slower than expected video lottery sales, which dominate overall lottery earnings. Although growth has been relatively slow, the September 2012 Forecast notes that Lottery revenues have stabilized the gains continued in the fiscal year ended June 30, 2012.

The next State Economic and Revenue Forecast is expected to be released on or about November 20, 2012.

Initiatives, Referendum and Referrals

The Oregon Constitution, Article IV, Section 1, reserves to the people of the State (1) the initiative power to amend the Oregon Constitution or to enact State legislation by placing measures on the statewide general election ballot for consideration by the voters and (2) the referendum power to approve or reject at an election any act passed by the Legislative Assembly that does not become effective earlier than 90 days after the end of the legislative session. The Legislative Assembly may also refer an act to the voters for approval or rejection. See APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—INITIATIVE PETITIONS, LEGISLATIVE REFERRALS AND REFERENDUM PETITIONS” for additional information on the election requirements for these actions.

Nine referred or initiated measures will appear on November 2012 general election ballot. Measure 84, if approved by voters, would create statutory provisions that phase out the State’s current inheritance tax statutes. The financial impact statement appearing in the official voters’ guide estimates that, if approved by voters, the measure would reduce State revenue by approximately \$17 million in fiscal year 2013-2014, \$43 million in 2014-2015, \$72 million in 2015-2016 and by approximately \$100 million per year thereafter.

Measure 85, if approved, would amend the Oregon Constitution to direct the corporate income and excise tax refund (“Corporate Kicker”) to the General Fund to be expended on kindergarten through grade 12 public education. See APPENDIX A—“GENERAL INFORMATION RELATING TO THE STATE OF OREGON—REVENUES for an explanation of the Corporate Kicker. The financial impact statement for the measure indicates that if it had been in place over the past ten budget periods approximately \$101 million to \$203 million would have been available in those periods for public education.

Several other measures may have an immaterial impact the State’s General Fund, or an impact that is too uncertain to predict. For instance Measures 82 and 83 would permit the development of a private casino that may compete with State lottery revenues, but the casino would also transfer a portion of its revenues to the State’s general fund. Measure 79 would prohibit the imposition of a real estate transfer tax; a tax that is currently not imposed by State law. Measure 80, if approved would legalize and regulate marijuana in the State, involving administrative costs to the State as well as licensing fee revenues.

LITIGATION

Members of the public and advocacy groups from time to time assert that they intend to file a legal action against the State challenging certain programs, laws or actions that the State or its officers or agencies have taken. Because the State cannot be certain as to whether such actions will actually be filed, the legal assertions that may be made in a potential action or the remedy sought in terms of the amount of damages or performance requested of the State, the State includes as threatened litigation only situations in which the State is engaged in active settlement negotiations with a person or advocacy group in order to pre-empt filing of a lawsuit.

The State discloses only pending or threatened litigation which the State has determined may have a materially adverse impact on the State’s financial position in relation to the bonds offered for sale; for the 2012 Bonds, the current level of materiality involves litigation where the damages or performance

sought has a reasonable probability of imposing liability of \$50 million or more against the State's General Fund.

Community Mental Health Investigation.

The State is engaged in discussions with the United States Department of Justice ("USDOJ") concerning the State's community mental health programs. The USDOJ is investigating whether the State's programs comply with the federal Americans with Disabilities Act. The investigation is ongoing, and the State has no specific information on the cost of implementing any changes that may result from the investigation. The State expects that if the USDOJ determines there are violations of federal law, the USDOJ will issue written findings that specify the nature of any violations, and the State will then be in a better position to estimate the costs to remedy any asserted violations. It is possible that the costs of changes to the State's community mental health programs could reach or exceed \$50 million.

No Litigation Challenging the 2012 Bonds

No litigation is pending against the State or, to the knowledge of the officers of the State charged with issuing the 2012 Bonds, threatened in any court or other tribunal of competent jurisdiction, state or federal, that has a reasonable probability of success in any way (1) restraining or enjoining the issuance, sale or delivery of the 2012 Bonds or (2) questioning or affecting the validity of the 2012 Bonds or any of the proceedings for the authorization, sale, execution or delivery of the 2012 Bonds.

Claims Against the State of Oregon Exceeding \$50 Million

Tobacco Cases

Estate of Williams, Estate of Schwarz v. Philip Morris, Inc.

The State and Philip Morris, Inc. ("Philip Morris"), together with a number of other states and U.S. territories (the "Settling States") and tobacco manufacturers, are parties to a Master Settlement Agreement (the "MSA"). Under the terms of the MSA, the State expects to receive periodic payments from the tobacco manufacturers that will total approximately \$2 billion between the settlement date and the year 2025. Separate tort actions were filed in the State circuit court against Philip Morris on behalf of two decedents claiming their deaths from tobacco-related causes were due to the actions of Philip Morris. The plaintiffs prevailed in the trial court. The estate of Williams was awarded approximately \$80 million in punitive damages. The estate of Schwarz was awarded approximately \$100 million in punitive damages.

By statute, the State is entitled to 60 percent of all punitive damages awards. Philip Morris appealed the punitive damages awards in both cases to the Oregon appellate courts and the United States Supreme Court. The appellate courts upheld the awards through several appeals. The last decision of the Oregon Supreme Court issued in December 2011 in the Williams case also upheld the prior Williams decisions. Philip Morris sought reconsideration, which the Supreme Court denied. The amount of damages in the Schwarz case was reconsidered in the trial court and reduced to \$25 million. Philip Morris has stated that it expects to continue to appeal the Schwarz case.

Philip Morris indicated that it will pay the full amount of the judgment in the Williams case, including interest. Philip Morris has not indicated whether they will seek an offset against their upcoming MSA payment or institute any other legal action regarding this judgment.

Non-participating Manufacturer Claims

The MSA contains a number of payment adjustment mechanisms. The non-participating manufacturers' adjustment ("NPM Adjustment") reduces the annual payments required of the manufacturers participating in the MSA ("Participating Manufacturers" or "PMs") when the following three conditions are met: (1) loss of market share by the PMs, (2) a finding by economic consultants that the MSA was a significant factor in the PMs' market share loss, and (3) a finding that the Settling State in question did not enact or diligently enforce model escrow legislation required by the MSA.

To date, the first two conditions have occurred for payment years beginning in 2003. As a result, the PMs have paid part of their annual payments into a disputed payment account. Between 2006 and 2012, Oregon has received approximately 8 to 15 percent less in each year than its anticipated payment of approximately \$75 million to \$90 million. It is possible that the PMs will withhold more from the State's payments in the future.

Oregon is currently litigating with the PMs whether the State "diligently enforced" its model escrow legislation in 2003. In April 2006, the State filed suit in Oregon's Multnomah County Circuit Court seeking full payment from the PMs. The court found that the dispute is subject to nationwide arbitration in which the Settling States are on one "side" of the dispute and the PMs are on the other "side." An arbitration panel has been formed and the PMs and the Settling States are working toward arbitration of the issues in this case. If it is determined in the arbitration that the State did not diligently enforce its model escrow statutes, the full amount of the yearly payment at issue could be deducted by the PMs from the next annual payment that the State is scheduled to receive.

Potential Superfund Site Liability

Two State agencies are involved in a confidential, non-judicial mediation process that will result in an allocation of costs associated with the investigation and cleanup of sediment contamination in the Portland Harbor, a 10-mile stretch of the lower Willamette River area that the U.S. Environmental Protection Agency (the "EPA") has listed as a Superfund site under the federal Superfund law ("CERCLA"). Over 200 parties, private companies and public entities, may eventually be found liable for a share of the costs related to investigation and clean-up of the Portland Harbor Superfund Site.

The Oregon Department of Transportation ("ODOT") and the Oregon Department of State Lands ("DSL") have received General Notice Letters from the EPA informing them that the State, by and through those agencies, is a potentially responsible party ("PRP") under CERCLA for cleanup costs at the site. The EPA's letter to ODOT asserts that ODOT may incur CERCLA liability for releasing hazardous substances into the study area from a storm water system. As to DSL, the EPA letter charges that the State, through DSL and the State Land Board, is a PRP because of releases of hazardous substances on submerged and submersible leased lands at the site.

It is too early in the EPA's remedial action process to estimate the total amount of cleanup costs that will be shared by liable parties, however, the potential amount of cleanup costs is discussed in a draft Feasibility Study delivered to EPA on March 30, 2012. The draft Feasibility Study outlines eleven alternative options for cleaning up the Portland Harbor Superfund Site with a range of costs from \$269 million to \$1.8 billion depending on which alternative is adopted by EPA. In addition, it is too early to estimate the proportionate share of liability for cleanup costs, if any, that may ultimately be assessed against either of the State agencies involved in the allocation process. When the mediation will end is not known, but it may be as late as 2015.

The Portland Harbor Superfund will also involve a separate allocation of liability for injuries to natural resources caused by contamination at the site, which is an additional type of recovery under the Superfund law known as natural resource damages (“NRD”). This NRD claim is asserted against all PRPs, including ODOT and DSL, by the Portland Harbor natural resource trustees, a group composed of five tribes, two federal agencies and the State, acting through its trustee, the Oregon Department of Fish and Wildlife. The trustees have initiated a cooperative injury assessment process that provides an opportunity for early settlement of the NRD claim. The NRD process will result in an allocation of liability at the same time as the allocation of liability for remedial costs. It is too early to evaluate what, if any, share of liability either ODOT or DSL may ultimately bear for this NRD claim.

Another potential financial risk for the State involves the Superfund’s orphan share obligations. When settling its claim against PRPs, EPA may agree to pay some portion of the financial liability assigned to those parties who are insolvent or defunct, and unaffiliated with any other viable liable party (the “Orphan Share”). EPA may thereafter request, as authorized by the Superfund law, that the State pay 10 percent of any orphan share payment made by EPA, plus the costs of continuing operation and maintenance of the orphan site(s). At this time, whether the State would enter into such an agreement and the amount the State would pay are unknown, and will depend on the outcome of negotiations with the EPA.

Pro Se Cases

There are also several *pro se* cases pending against the State in which plaintiffs representing themselves are suing the State for many millions of dollars. The possibility of the State having to pay anything in any of these cases is negligible.

TAX MATTERS

Opinion of Bond Counsel

In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the State, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the 2012 Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the “Code”), and (ii) interest on the 2012 Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering its opinion, Bond Counsel has relied on certain representations, certifications of fact, and statements of reasonable expectations made by the State in connection with the 2012 Bonds, and Bond Counsel has assumed compliance by the State with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the 2012 Bonds from gross income under Section 103 of the Code.

In addition, in the opinion of Bond Counsel to the State, under existing statutes, interest on the 2012 Bonds is exempt from State of Oregon personal income tax.

Bond Counsel expresses no opinion regarding any other Federal or state tax consequences with respect to the 2012 Bonds. Bond Counsel renders its opinion under existing statutes and court decisions as of the issue date, and assumes no obligation to update, revise or supplement its opinion to reflect any action hereafter taken or not taken, or any facts or circumstances that may hereafter come to its attention, or changes in law or in interpretations thereof that may hereafter occur, or for any other reason. Bond Counsel expresses no opinion on the effect of any action hereafter taken or not taken in reliance upon an

opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the 2012 Bonds, or under state and local tax law.

Certain Ongoing Federal Tax Requirements and Covenants

The Code establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the 2012 Bonds in order that interest on the 2012 Bonds be and remain excluded from gross income under Section 103 of the Code. These requirements include, but are not limited to, requirements relating to use and expenditure of gross proceeds of the 2012 Bonds, yield and other restrictions on investments of gross proceeds, and the arbitrage rebate requirement that certain excess earnings on gross proceeds be rebated to the Federal government. Noncompliance with such requirements may cause interest on the 2012 Bonds to become included in gross income for Federal income tax purposes retroactive to their issue date, irrespective of the date on which such noncompliance occurs or is discovered. The State has covenanted to comply with certain applicable requirements of the Code to assure the exclusion of interest on the 2012 Bonds from gross income under Section 103 of the Code.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral Federal income tax matters with respect to the 2012 Bonds. It does not purport to address all aspects of Federal taxation that may be relevant to a particular owner of a 2012 Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the 2012 Bonds.

Prospective owners of the 2012 Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S corporations and foreign corporations), financial institutions, property and casualty and life insurance companies, individual recipients of Social Security and railroad retirement benefits, individuals otherwise eligible for the earned income tax credit, and taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is excluded from gross income for Federal income tax purposes. Interest on the 2012 Bonds may be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Original Issue Discount

“Original issue discount” (“OID”) is the excess of the sum of all amounts payable at the stated maturity of a 2012 Bond (excluding certain “qualified stated interest” that is unconditionally payable at least annually at prescribed rates) over the issue price of that maturity. In general, the “issue price” of a maturity means the first price at which a substantial amount of the 2012 Bonds of that maturity was sold (excluding sales to bond houses, brokers, or similar persons acting in the capacity as underwriters, placement agents, or wholesalers). In general, the issue price for each maturity of 2012 Bonds is expected to be the initial public offering price set forth on the inside cover page of the Official Statement. Bond Counsel further is of the opinion that, for any 2012 Bonds having OID (a “Discount Bond”), OID that has accrued and is properly allocable to the owners of the Discount Bonds under Section 1288 of the Code is excludable from gross income for Federal income tax purposes to the same extent as other interest on the 2012 Bonds.

In general, under Section 1288 of the Code, OID on a Discount Bond accrues under a constant yield method, based on periodic compounding of interest over prescribed accrual periods using a

compounding rate determined by reference to the yield on that Discount Bond. An owner's adjusted basis in a Discount Bond is increased by accrued OID for purposes of determining gain or loss on sale, exchange, or other disposition of such 2012 Bond. Accrued OID may be taken into account as an increase in the amount of tax-exempt income received or deemed to have been received for purposes of determining various other tax consequences of owning a Discount Bond even though there will not be a corresponding cash payment.

Owners of Discount Bonds should consult their own tax advisors with respect to the treatment of original issue discount for Federal income tax purposes, including various special rules relating thereto, and the state and local tax consequences of acquiring, holding, and disposing of Discount Bonds.

Bond Premium

In general, if an owner acquires a 2012 Bond for a purchase price (excluding accrued interest) or otherwise at a tax basis that reflects a premium over the sum of all amounts payable on the 2012 Bond after the acquisition date (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates), that premium constitutes "bond premium" on that 2012 Bond (a "Premium Bond"). In general, under Section 171 of the Code, an owner of a Premium Bond must amortize the bond premium over the remaining term of the Premium Bond, based on the owner's yield over the remaining term of the Premium Bond determined based on constant yield principles (in certain cases involving a Premium Bond callable prior to its stated maturity date, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such bond). An owner of a Premium Bond must amortize the bond premium by offsetting the qualified stated interest allocable to each interest accrual period under the owner's regular method of accounting against the bond premium allocable to that period. In the case of a tax-exempt Premium Bond, if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to that accrual period, the excess is a nondeductible loss. Under certain circumstances, the owner of a Premium Bond may realize a taxable gain upon disposition of the Premium Bond even though it is sold or redeemed for an amount less than or equal to the owner's original acquisition cost. Owners of any Premium Bonds should consult their own tax advisors regarding the treatment of bond premium for Federal income tax purposes, including various special rules relating thereto, and state and local tax consequences, in connection with the acquisition, ownership, amortization of bond premium on, sale, exchange, or other disposition of Premium Bonds.

Information Reporting and Backup Withholding

Information reporting requirements apply to interest paid on tax-exempt obligations, including the 2012 Bonds. In general, such requirements are satisfied if the interest recipient completes, and provides the payor with, a Form W-9, "Request for Taxpayer Identification Number and Certification," or if the recipient is one of a limited class of exempt recipients. A recipient not otherwise exempt from information reporting who fails to satisfy the information reporting requirements will be subject to "backup withholding," which means that the payor is required to deduct and withhold a tax from the interest payment, calculated in the manner set forth in the Code. For the foregoing purpose, a "payor" generally refers to the person or entity from whom a recipient receives its payments of interest or who collects such payments on behalf of the recipient.

If an owner purchasing a 2012 Bond through a brokerage account has executed a Form W-9 in connection with the establishment of such account, as generally can be expected, no backup withholding should occur. In any event, backup withholding does not affect the excludability of the interest on the 2012 Bonds from gross income for Federal income tax purposes. Any amounts withheld pursuant to

backup withholding would be allowed as a refund or a credit against the owner's Federal income tax once the required information is furnished to the Internal Revenue Service.

Miscellaneous

Tax legislation, administrative actions taken by tax authorities, or court decisions, whether at the Federal or state level, may adversely affect the tax-exempt status of interest on the 2012 Bonds under Federal or state law or otherwise prevent beneficial owners of the 2012 Bonds from realizing the full current benefit of the tax status of such interest. In addition, such legislation or actions (whether currently proposed, proposed in the future, or enacted) and such decisions could affect the market price or marketability of the 2012 Bonds.

Prospective purchasers of the 2012 Bonds should consult their own tax advisors regarding the foregoing matters.

RATINGS

Fitch Ratings ("Fitch"), Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Ratings Services, a division of The McGraw Hill Companies ("Standard & Poor's") have assigned their municipal bond ratings of "AA+," "Aa1" and "AA+," respectively, to the 2012 Bonds.

Any explanation of the significance of ratings should be obtained directly from the agencies. There is no assurance that any rating will not be subsequently revised or withdrawn entirely if, in the judgment of the assigning agency, circumstances so warrant. The State has undertaken to provide timely notice of any change in such ratings. See "CONTINUING DISCLOSURE" below.

FINANCIAL ADVISOR

The Department has retained Western Financial Group (the "Financial Advisor"), as financial advisor in connection with the preparation of this Official Statement and with respect to the issuance of the 2012 Bonds. The Financial Advisor is not obligated to undertake, and has not undertaken, to make an independent verification or to assume responsibility for the accuracy, completeness, or fairness of the information contained in this Official Statement.

UNDERWRITING

The 2012 Bonds are being purchased by _____ acting as Underwriter who successfully bid for the 2012 Bonds in a competitive sale on November __, 2012. The bid provides that the Underwriter will purchase all of the 2012 Bonds at a price of \$_____ (the principal amount of the 2012 Bonds (\$_____), [plus/less] a net original issue [premium/discount] of \$_____ and less an Underwriter's discount of \$_____). The 2012 Bonds will be re-offered at an average price of ____% of the par value of the 2012 Bonds. After the initial public offering, the public offering prices may vary from time to time.

CERTAIN LEGAL MATTERS

Hawkins Delafield & Wood LLP, Portland, Oregon, Bond Counsel to the State, will render its opinions with respect to the authorization, validity and enforceability of the 2012 Bonds in substantially the form set forth in Appendix D. Hawkins Delafield & Wood LLP occasionally represents underwriters in connection with certain other State bond matters. In connection with the 2012 Bonds, certain legal matters will be passed upon for the State by the Oregon Department of Justice, Salem, Oregon.

Certain legal matters in connection with the preparation of this Official Statement will be passed upon for the State by Orrick, Herrington & Sutcliffe LLP, Portland, Oregon, Disclosure Counsel to the State. Orrick, Herrington & Sutcliffe LLP represents the State in certain bond and other matters and also represents the Public Employees' Retirement Board and the State acting by and through the Oregon Investment Council on behalf of the Oregon Public Employees' Retirement Fund. Orrick, Herrington & Sutcliffe LLP occasionally represents underwriters in connection with certain other State bond matters.

CONTINUING DISCLOSURE

The State, acting by and through the State Treasurer and the Department, with respect to the 2012 Bonds will undertake in Continuing Disclosure Certificates for the benefit of registered and beneficial Owners of the 2012 Bonds to provide to the Municipal Securities Rulemaking Board (the "MSRB"), on an annual basis on or before nine months after the end of each fiscal year, commencing with the fiscal year ending June 30, 2012, certain specified financial information and operating data. In addition, the State and the Department will undertake for the benefit of registered and beneficial Owners of the 2012 Bonds, to provide to the MSRB in a timely manner notices of certain material events. This undertaking is to assist the Underwriter in complying with Rule 15c2-12 of the Securities and Exchange Commission. The State has complied in all material respects with its previous continuing disclosure undertakings under Rule 15c2-12. The proposed form of Continuing Disclosure Certificate are contained in Appendix E.

MISCELLANEOUS

References are made herein to certain documents and reports of which brief summaries are contained herein, which do not purport to be complete or definitive, and reference is made to such documents and reports for full and complete statements of the contents thereof.

Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not to be construed as a contract or agreement between the State and the purchasers or holders of any of the 2012 Bonds.

This Official Statement is submitted in connection with the sale of the securities referred to herein and may not be reproduced or used in whole or in part, for any other purpose.

By Order of
Ted Wheeler
Oregon State Treasurer

By: _____
Director, Debt Management Division

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APPENDIX A
GENERAL INFORMATION RELATING TO
THE STATE OF OREGON

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THE STATE OF OREGON GOVERNMENTAL ORGANIZATION

The Oregon Constitution divides the powers of State government among the Legislative, Executive and Judicial branches.

The Legislative Branch

Oregon has a bicameral Legislative Assembly consisting of the Senate with thirty members elected to serve four-year terms and the House of Representatives with sixty members elected to two-year terms.

The Legislative Assembly convenes its regular session in January of each year, with normal sessions in odd-numbered years (“regular sessions”) and abbreviated sessions in even-numbered years. Legislative sessions are limited to 160 days in odd numbered years, and 35 days in even numbered years. Sessions may be extended for five days at a time, by a two-thirds majority vote of both chambers of the legislature. During a typical regular legislative session, approximately one-third of the estimated 3,000 bills introduced become law. The Governor or a majority of each house may call special sessions of the Legislative Assembly to deal with emergencies.

The primary functions of the Legislative Assembly are to adopt a balanced budget for all State funds, as required by the Oregon Constitution and to enact general laws. Historically, the Legislative Assembly budgeted on a biennial basis because it convened biennially. However, the Oregon Constitution was amended in 2010 to provide for annual sessions. Therefore, the Legislative Assembly may adopt annual budgets for State agencies, rather than for the entire biennium, or may adopt biennial agency budgets that are adjusted in an interim legislative session. State law requires a financial report of State operations to be prepared at the end of each fiscal year. The State’s fiscal year ends June 30.

The Oregon Constitution authorizes the Emergency Board (“E-Board”), a joint legislative committee, to meet between legislative sessions to address financial matters of the State arising in the interim period. The seventeen-member E-Board consists of the President of the Senate, Speaker of the House of Representatives, Co-Chairpersons of the Joint Ways and Means Committee, six other Senate members and seven other House members. The E-Board, which may schedule its own meetings, usually meets once every other month during the interim between regular sessions. If an emergency exists, the E-Board may allocate additional moneys to any State agency out of funds appropriated to the E-Board by the Legislative Assembly during its regular session. The Board may also provide moneys for an activity required by law for which the Legislative Assembly did not appropriate moneys to increase expenditure authority from dedicated or continuously appropriated funds, and approve funding for a new activity coming into existence at a time that would preclude submission of a budget to the Legislative Assembly.

The Executive Branch

The chief executive power of the State is vested in the Governor. The Governor is elected to a four-year term and is limited to serving two terms in any twelve-year period. John Kitzhaber was recently elected to his third term as Governor after an eight year absence and is scheduled to serve until January 2015. The Governor proposes, plans, and recommends a budget for almost all of State government to the Legislative Assembly. The Governor also may call special sessions of the Legislative Assembly and appoint judges to vacant judicial positions. The Governor directly appoints the directors of most State agencies and many other State officials.

The Secretary of State is a statewide constitutionally elected officer designated as the auditor of

public accounts in the State and as the State's chief elections officer. As auditor, the Secretary of State audits or reviews the accounts and financial affairs of State boards, commissions, departments and institutions. The Secretary of State also edits, codifies and publishes administrative rules, which supplement laws passed by the Legislative Assembly and prescribe the manner in which State agencies conduct business.

The State Treasurer is also a statewide constitutionally elected officer. The Treasurer is responsible for all moneys paid into the State Treasury and administers the State's banking, cash flow, borrowing and investment operations. The State Treasurer also chairs or serves on numerous State boards and commissions responsible for investing several State funds and for setting borrowing policies for the State.

The Governor, the Secretary of State and the State Treasurer comprise the State Land Board, established by the Oregon Constitution to manage the Common School Fund and certain lands dedicated at statehood for educational purposes. The Common School Fund's most recent valuation was approximately \$1.07 billion as of December 31, 2011. Its value fluctuates based on market conditions and the amount of withdrawals. The fund is managed as a perpetual trust fund with approximately two to five percent of its value distributed annually to the State Superintendent of Public Schools for distribution to the State's K-12 public school districts.

In addition to the Offices of the Secretary of State and the State Treasurer, the Executive Branch includes other offices administered by statewide elected officials. The State Attorney General manages the Department of Justice and the State's legal affairs. The Labor Commissioner manages the Bureau of Labor and Industries that oversees and enforces the State's labor and wage laws.

The Judicial Branch

The Oregon Constitution establishes the Judicial Branch and consists of the Supreme Court, Court of Appeals, Tax Court, and 36 Circuit Courts in 27 judicial districts. The Chief Justice of the Oregon Supreme Court administers the State court system and is the head of the Oregon Judicial Department. The Court of Appeals hears most of the civil and criminal appeals from the Circuit Courts and reviews most State administrative agency actions. The Circuit Courts are Oregon's trial courts of general jurisdiction. The Tax Court is a special one-judge court that has exclusive, statewide jurisdiction to hear only cases involving Oregon's tax laws. All Oregon judges are elected by popular vote. The Governor, however, may appoint judges to fill vacancies that occur.

Services Provided by State Government

The Governor appoints the heads of and coordinates numerous State agencies that provide services through program areas that include: (1) Consumer and Business Services for protecting consumers and workers, promoting a positive business climate and regulation of various professions; (2) Economic and Community Development that aids businesses and people, including job creation, placement and retention services, business recruitment, community development and affordable housing; (3) Education from pre-kindergarten to post-secondary and life-long learning through community colleges and workforce development programs; (4) Human Services that relate to physical, mental and public health, self-sufficiency, child protective services and care for seniors and people with disabilities; (5) Natural Resources overseeing pollution control, land use, water quality and conservation, agriculture and food products, forests, watersheds and fisheries; (6) Public Safety that protects Oregon's people, property and natural resources, through trained militia, law enforcement, prosecution and incarceration of juvenile and adult offenders; (7) Transportation; and (8) Administration that manages and provides policy direction and central services to other State agencies, such as data and networking infrastructure and

procurement activities. The management of elections and tax collection activities are also under this program area.

See Table 15 for a summary of expenditures by program area.

Employee Relations

For the 2011-13 biennium, there are approximately 50,735 employees providing services through State government. Approximately 70 percent of non-management or executive service employees in State government are members of bargaining units subject to collective bargaining. Employees of the State of Oregon and of certain political subdivisions have the right to form, join, and participate in the activities of labor organizations for representation and collective bargaining on matters concerning employment relations. An officially recognized or certified labor organization is the exclusive representative of its covered employees for collective bargaining. The scope of representation may include, but is not limited to, matters concerning wages, hours, paid leave and grievance procedures. The public employer must bargain in good faith with respect to employment relations. If a contract remains unsettled after a 150-day period of good faith contract negotiations, either or both of the parties may notify the Employment Relations Board of an impasse and the need for a mediator. The parties may mutually agree to request a mediator before the end of the 150-day period by notifying the Board. If the parties do not reach settlement through mediation, then after a 30-day cooling off period for strike-permitted bargaining units the employer may unilaterally implement its last offer and/or the union may strike. For strike-prohibited bargaining units, either the employer or the exclusive representative may initiate binding arbitration to establish a successor collective bargaining agreement if mediation fails to produce a settlement. All State labor contracts expire at the end of each biennium (June 30, every two years) and are re-negotiated for the following biennium.

ECONOMIC AND DEMOGRAPHIC INFORMATION

Historical Perspective

The Oregon economy has transitioned and diversified from a predominant concentration in timber harvesting and wood products' manufacturing to high-tech manufacturing. As high-tech manufacturing grew in Oregon, the State also developed stronger ties to major export markets in the Pacific Rim. Population growth has historically exceeded the national rate, fueled by the in-migration of young professional and retiree populations attracted by the high-quality jobs, relatively low cost of living and affordable housing.

Sectors of increasing importance in the Oregon economy include construction, retail trade, health services, and leisure and hospitality services. Exports also continue to be a significant driver for the Oregon economy, nearly doubling since 2001.

Recently, the collapse of the national housing market has affected associated Oregon industries, with job losses in wood products and construction. As the financial crisis led to a deeper recession for the U.S. economy, this in turn deepened the recession for Oregon. While Oregon's housing market has been affected by the economic downturn, it is better off than several other western states including California, Nevada, and Arizona.

Employment

The following two tables compare Oregon and the United States with respect to unemployment rates and the composition of annual average employment.

TABLE 1
UNEMPLOYMENT RATES
OREGON AND UNITED STATES
(ANNUAL AVERAGES, IN THOUSANDS)

| <u>Year</u> | <u>Total Civilian Labor Force</u> | | | | <u>Unemployment Rate as %</u> | |
|-------------|-----------------------------------|---------------------------|-------------------------|---------------------------|-------------------------------|-------------|
| | <u>Oregon</u> | <u>Percent Change (%)</u> | <u>U.S.¹</u> | <u>Percent Change (%)</u> | <u>Oregon</u> | <u>U.S.</u> |
| 2001 | 1,825 | -- | 143,734 | -- | 6.4 | 4.7 |
| 2002 | 1,836 | 0.6 | 144,863 | 0.8 | 7.6 | 5.8 |
| 2003 | 1,844 | 0.4 | 146,510 | 1.1 | 8.2 | 6.0 |
| 2004 | 1,845 | 0.1 | 147,401 | 0.6 | 7.3 | 5.5 |
| 2005 | 1,856 | 0.6 | 149,320 | 1.3 | 6.2 | 5.1 |
| 2006 | 1,893 | 1.8 | 151,428 | 1.4 | 5.4 | 4.6 |
| 2007 | 1,921 | 1.4 | 153,124 | 1.1 | 5.1 | 4.6 |
| 2008 | 1,957 | 1.7 | 154,287 | 0.8 | 6.5 | 5.8 |
| 2009 | 1,979 | 0.8 | 154,142 | -0.1 | 11.0 | 9.3 |
| 2010 | 1,983 | 0.1 | 153,889 | -0.2 | 10.6 | 9.6 |
| 2011 | 1,992 | 1.5 | 153,617 | -0.2 | 9.5 | 8.9 |

Source: U.S. Bureau of Labor Statistics (Seasonally Adjusted).

(1) Reflects recent revised population controls and/or model re-estimation.

TABLE 2
COMPOSITION OF ANNUAL AVERAGE
EMPLOYMENT OREGON AND
THE UNITED STATES 2006 AND 2011

| | <u>2006</u> | | | | <u>2011</u> | | | |
|--|------------------|-------------------|----------------------|-------------------|------------------|-------------------|----------------------|-------------------|
| | <u>Oregon</u> | | <u>United States</u> | | <u>Oregon</u> | | <u>United States</u> | |
| | <u># of Jobs</u> | <u>% of Total</u> | <u># of Jobs</u> | <u>% of Total</u> | <u># of Jobs</u> | <u>% of Total</u> | <u># of Jobs</u> | <u>% of Total</u> |
| Mining and logging | 9,400 | 0.6 | 684,000 | 0.5 | 6,900 | 0.4 | 784,000 | 0.6 |
| Construction | 100,900 | 5.9 | 7,691,000 | 5.7 | 68,800 | 4.3 | 5,504,000 | 4.2 |
| Durable goods manufacturing | 154,700 | 9.1 | 8,981,000 | 6.6 | 117,900 | 7.2 | 7,274,000 | 5.5 |
| Nondurable goods manufacturing | 52,600 | 3.1 | 5,174,000 | 3.8 | 48,700 | 3.1 | 4,460,000 | 3.4 |
| Wholesale Trade | 79,900 | 4.7 | 5,904,500 | 4.3 | 74,400 | 4.9 | 5,528,800 | 4.2 |
| Retail trade | 197,300 | 11.6 | 15,353,300 | 11.4 | 184,700 | 11.5 | 14,642,900 | 11.1 |
| Transportation, warehousing, and utilities | 58,400 | 3.4 | 5,018,100 | 3.7 | 53,300 | 3.2 | 4,847,400 | 3.7 |
| Information | 34,900 | 2.0 | 3,038,000 | 2.2 | 32,300 | 2.0 | 2,659,000 | 2.0 |
| Financial activities | 106,100 | 6.2 | 8,328,000 | 6.1 | 92,000 | 5.7 | 7,681,000 | 5.8 |
| Professional and business services | 194,400 | 11.4 | 17,566,000 | 12.9 | 186,000 | 11.4 | 17,331,000 | 13.2 |
| Educational services | 28,200 | 1.7 | 2,900,900 | 2.1 | 33,600 | 2.0 | 3,240,700 | 2.5 |
| Health care and social assistance | 176,800 | 10.4 | 14,925,300 | 11.0 | 201,500 | 12.5 | 16,642,800 | 12.7 |
| Leisure and hospitality | 164,900 | 9.7 | 13,292,000 | 9.8 | 165,300 | 10.4 | 13,320,000 | 10.2 |
| Other services | 58,900 | 3.5 | 5,438,000 | 4.0 | 57,500 | 3.5 | 5,342,000 | 4.1 |
| Government | 286,100 | 16.8 | 21,974,000 | 16.1 | 295,400 | 18.1 | 22,104,000 | 16.8 |
| Total Nonfarm jobs ¹ | 1,703,500 | | 136,086,000 | | 1,618,100 | | 131,359,000 | |

Sources: Oregon Employment Department, Oregon Labor Market Information Services; U.S. Bureau of Labor Statistics (Not Seasonally Adjusted).

(1) Totals may not agree with sum of components due to categorization and rounding.

Note: US 2011 Annual data is preliminary.

Oregon Gross Domestic Product

Oregon Gross Domestic Product (GDP) represents the value of goods and services produced by the State. The following table illustrates the changes in the components of the State's GDP over the 2006 to 2011 five-year period.

TABLE 3
OREGON GROSS DOMESTIC PRODUCT
(DOLLARS IN MILLIONS)

| <u>Industry</u> | <u>2006 (\$)</u> | <u>% of Total</u> | <u>2011 (\$)</u> | <u>% of Total</u> |
|--|-------------------------|--------------------------|-------------------------|--------------------------|
| Agriculture, forestry, fishing and hunting | 3,783 | 2.4 | 3,249 | 1.7 |
| Mining | 271 | 0.2 | 230 | 0.1 |
| Utilities | 2,045 | 1.3 | 2,107 | 1.1 |
| Construction | 7,580 | 4.7 | 6,372 | 3.3 |
| Durable goods manufacturing | 30,185 | 18.9 | 50,905 | 26.1 |
| Nondurable goods manufacturing | 4,649 | 2.9 | 5,097 | 2.6 |
| Wholesale trade | 9,845 | 6.2 | 10,717 | 5.5 |
| Retail trade | 8,941 | 5.6 | 9,138 | 4.7 |
| Transportation and warehousing, excluding Postal Service | 4,603 | 2.9 | 4,436 | 2.3 |
| Information | 4,794 | 3.0 | 5,589 | 2.9 |
| Finance and insurance | 8,027 | 5.0 | 8,887 | 4.6 |
| Real estate, rental, and leasing | 20,444 | 12.8 | 22,164 | 11.4 |
| Professional and technical services | 7,507 | 4.7 | 9,934 | 4.8 |
| Management of companies and enterprises | 3,077 | 1.9 | 3,536 | 1.8 |
| Administrative and waste services | 4,083 | 2.6 | 4,378 | 2.2 |
| Educational services | 1,144 | 0.7 | 1,489 | 0.8 |
| Health care and social assistance | 11,104 | 6.9 | 14,742 | 7.6 |
| Arts, entertainment, and recreation | 948 | 0.6 | 1,062 | 0.5 |
| Accommodation and food services | 4,118 | 2.6 | 4,757 | 2.4 |
| Other Services, except government | 3,927 | 2.5 | 4,128 | 2.1 |
| Government | 18,826 | 11.8 | 22,365 | 11.5 |
| Total Oregon GDP | 159,899 | | 194,742 | |

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Residential Construction

The following table shows the number of Oregon residential building permits issued over the last ten years.

**TABLE 4
OREGON RESIDENTIAL BUILDING PERMITS**

| <u>Year</u> | <u>Single-Family Dwellings</u> | <u>Percent Change (%)</u> | <u>Multi-Family Dwellings</u> | <u>Percent Change (%)</u> |
|-------------|------------------------------------|-------------------------------|-----------------------------------|-------------------------------|
| 2002 | 17,413 | 6.7 | 4,773 | -4.5 |
| 2003 | 17,875 | 2.7 | 7,140 | 49.6 |
| 2004 | 20,728 | 16.0 | 6,581 | -7.8 |
| 2005 | 23,840 | 15.0 | 7,184 | 9.2 |
| 2006 | 19,859 | -16.7 | 6,764 | -5.8 |
| 2007 | 15,310 | -22.9 | 5,791 | -14.4 |
| 2008 | 7,466 | -51.2 | 4,210 | -27.3 |
| 2009 | 5,278 | -29.3 | 1,761 | -58.2 |
| 2010 | 5,259 | -0.4 | 1,609 | -8.6 |
| 2011 | 4,854 | -7.7 | 2,809 | 74.6 |

Source: U.S. Census Bureau, May 18, 2012.

International Trade and Exports

International trade is an increasingly important component of the State's economy. Canada was Oregon's top export market from 2002 through mid-2008; since then however, exports to Canada have fallen dramatically. China is playing an increasing role in both the international community and Oregon's local economy. Since the 3rd quarter of 2008, China has become the largest export market destination for Oregon products, accounting for nearly 23 percent of its exports.

The State's geography and natural resources have been instrumental in the development of the State's international trade activities. The State has twenty-three port districts all located on navigable waterways. The majority of the State's international trade occurs through the Port of Portland. Other important ports are located at the coastal cities of Astoria, Newport and Coos Bay. The following two tables show Oregon's top exports by industry and Oregon's major trading partners in 2006 and 2011.

TABLE 5
OREGON EXPORTS BY INDUSTRY
(DOLLARS IN MILLIONS, CALENDAR YEAR)

| | <u>2006 (\$)</u> | <u>% of Total</u> | <u>2011 (\$)</u> | <u>% of Total</u> |
|-----------------------------------|------------------|-------------------|------------------|-------------------|
| Computer and Electronics Products | 6,542 | 42.8 | 6,479 | 35.4 |
| Agricultural Products | 1,490 | 9.7 | 2,841 | 15.5 |
| Chemicals | 500 | 3.3 | 1,730 | 9.5 |
| Machinery, except Electrical | 1,579 | 10.3 | 1,555 | 8.5 |
| Transportation Equipment | 1,900 | 12.4 | 920 | 5.0 |
| Primary Metal Manufacturing | 495 | 3.2 | 654 | 3.6 |
| Waste and Scrap | 307 | 2.0 | 614 | 3.4 |
| Food and Kindred Products | 321 | 2.1 | 546 | 3.0 |
| Wood Products | 373 | 2.4 | 535 | 2.9 |
| Paper | 374 | 2.4 | 470 | 2.6 |
| Other | <u>1,422</u> | 9.3 | <u>1,948</u> | 10.6 |
| Total All Industries | 15,303 | | 18,292 | |

Source: Office of Economic Analysis

TABLE 6
OREGON EXPORTS TO MAJOR TRADING PARTNERS
(DOLLARS IN MILLIONS, CALENDAR YEAR)

| | <u>2006</u> | <u>% of Total</u> | <u>2011</u> | <u>% of Total</u> |
|----------------------------|--------------|-------------------|--------------|-------------------|
| China (Mainland) | 1,396 | 9.1 | 3,161 | 17.3 |
| Canada | 2,219 | 17.6 | 2,713 | 14.8 |
| Malaysia | 1,215 | 7.9 | 2,219 | 12.1 |
| Japan | 1,254 | 8.2 | 1,649 | 9.0 |
| Korea, Republic Of | 1,189 | 8.4 | 1,062 | 5.8 |
| China (Taiwan) | 855 | 5.6 | 721 | 3.9 |
| Germany | 386 | 2.5 | 511 | 2.8 |
| Costa Rica | 584 | 3.8 | 500 | 2.7 |
| Brazil | 63 | 0.4 | 444 | 2.4 |
| Singapore | 491 | 3.2 | 406 | 2.2 |
| Australia | 418 | 2.7 | 355 | 1.9 |
| Hong Kong | 253 | 1.7 | 297 | 1.6 |
| Mexico | 856 | 5.6 | 285 | 1.6 |
| United Kingdom | 296 | 1.9 | 277 | 1.5 |
| Other | <u>2,325</u> | 15.2 | <u>2,948</u> | 16.1 |
| Total All Countries | 15,303 | | 18,292 | |

Source: Office of Economic Analysis

Income

The following two tables compare Oregon and the United States with respect to personal income and per capita income from 2002 to 2011.

TABLE 7
PERSONAL INCOME
(DOLLARS IN MILLIONS, CALENDAR YEAR)

| <u>Year</u> | <u>Oregon (\$)</u> | <u>Percent Change (%)</u> | <u>U.S. (\$)</u> | <u>Percent Change (%)</u> | <u>Oregon as a % of U.S.</u> |
|-------------|--------------------|---------------------------|------------------|---------------------------|------------------------------|
| 2002 | 104,690 | 3.2 | 9,054,702 | 2.0 | 1.16 |
| 2003 | 108,487 | 3.6 | 9,369,072 | 3.5 | 1.16 |
| 2004 | 112,974 | 4.1 | 9,928,790 | 6.0 | 1.14 |
| 2005 | 117,634 | 4.1 | 10,476,669 | 5.5 | 1.12 |
| 2006 | 127,403 | 8.3 | 11,256,516 | 7.4 | 1.13 |
| 2007 | 133,821 | 5.0 | 11,900,562 | 5.7 | 1.12 |
| 2008 | 140,979 | 5.3 | 12,451,660 | 4.6 | 1.13 |
| 2009 | 135,079 | (4.2) | 11,916,773 | (4.3) | 1.13 |
| 2010 | 139,395 | 3.2 | 12,353,577 | 3.7 | 1.13 |
| 2011 | 145,300 | 4.2 | 12,949,905 | 4.8 | 1.12 |

Source: U.S. Bureau of Economic Analysis, October 3, 2012.

TABLE 8
PER CAPITA INCOME
(CALENDAR YEAR)

| <u>Year</u> | <u>Oregon (\$)</u> | <u>Percent Change (%)</u> | <u>U.S. (\$)</u> | <u>Percent Change (%)</u> | <u>Oregon as a % of U.S.</u> |
|-------------|--------------------|---------------------------|------------------|---------------------------|------------------------------|
| 2002 | 29,797 | 1.9 | 31,481 | 1.0 | 94.7 |
| 2003 | 30,582 | 2.6 | 32,295 | 2.6 | 94.7 |
| 2004 | 31,650 | 3.5 | 33,909 | 5.0 | 93.3 |
| 2005 | 32,557 | 2.9 | 35,452 | 4.6 | 91.8 |
| 2006 | 34,706 | 6.6 | 37,725 | 6.4 | 92.0 |
| 2007 | 35,950 | 3.6 | 39,506 | 4.7 | 91.0 |
| 2008 | 37,407 | 4.1 | 40,947 | 3.6 | 91.4 |
| 2009 | 35,467 | (5.2) | 38,846 | (5.1) | 91.3 |
| 2010 | 36,317 | 2.4 | 39,937 | 2.8 | 90.9 |
| 2011 | 37,527 | 4.5 | 41,560 | 4.5 | 90.3 |

Source: U.S. Bureau of Economic Analysis October 3, 2012

(p) Preliminary

Population

In 2010, the U.S. Census Bureau ranked Oregon as the 27th most populous state with a population of 3.87 million. Oregon's population growth rate since the 2000 census is the 14th fastest in the nation.

TABLE 9
POPULATION CHANGE
OREGON AND UNITED STATES, 1990 – 2020

| <u>Year</u> | <u>Oregon</u> | <u>Percent Change (%)</u> | <u>United States¹</u> | <u>Percent Change (%)</u> |
|------------------|---------------|-------------------------------|----------------------------------|-------------------------------|
| 1990 | 2,860,400 | -- | 248,709,873 | -- |
| 2000 | 3,431,100 | 20.0 | 281,421,906 | 13.2 |
| 2010 | 3,837,300 | 11.8 | 308,745,538 | 9.7 |
| 2020 (projected) | 4,268,600 | 11.2 | 341,387,000 | 10.6 |

Sources: Office of Economic Analysis, March 2012 Oregon Economic and Revenue Forecast; U.S. Census Bureau.

(1) As of April 1 (with corrections).

STATE FINANCIAL OPERATIONS

Budgetary Process

The Oregon constitution requires the State's budget to balance at the end of each biennium. Article IX, Section 2 of the Oregon Constitution states that the Legislative Assembly shall provide for raising revenue sufficiently to defray the expenses of the State for each fiscal year. Article IX, Section 6 of the constitution states that "whenever the expenses, of any fiscal year, shall exceed the income, the Legislative Assembly shall provide for levying a tax, for the ensuing fiscal year, sufficient, with other sources of income, to pay the deficiency, as well as the estimated expense [sic] of the ensuing fiscal year." Because of these two provisions, Oregon may not budget a deficit and is required to alleviate any revenue shortfalls within each biennium.

Historically, during the regular legislative session at the start of every biennium, the Legislative Assembly adopts a budget covering all of the State's operations for the next biennium. A biennium begins July 1 and ends June 30 of odd-numbered years. The budget is adopted through the enactment of separate budget bills for each State agency and for the Legislative and Judicial Branches (the "Budget Bills"). There are four different categories of funds included in the State's budget: (i) General Funds, (ii) Lottery Funds, (iii) Other Funds (dedicated funds), and (iv) Federal Funds.

The budgeting process begins with the Governor's submission of a recommended budget for State agencies in the December preceding the start of a new regular legislative session. Concurrently, each agency prepares and files Budget Bills during December so that when the Legislative Assembly convenes in January for its regular session, the Joint Ways and Means Committee can begin consideration of each bill. By statute, the budget may not permit certain governmental purpose expenditures to exceed eight percent of the State's personal income. This limitation may be exceeded only if the Governor declares an emergency and if three-fifths of each house of the Legislative Assembly votes to exceed the limit.

The Legislative Assembly may provide spending authority to a State agency through a continuous appropriation of a fund dedicated for a certain purpose. In that case, spending is limited only by the amount of revenues received in or held by the fund. The Legislative Assembly may also limit the amount of money spent by placing an expenditure limitation on a continuously appropriated and dedicated fund. In addition, the Legislative Assembly enacts one-time appropriations of moneys to specific agencies or programs from moneys expected to be received or held by the State's General Fund and from lottery revenues. After the Budget Bills are passed, the Governor may veto an entire bill, single items in appropriation bills or the emergency clause in a bill. A two-thirds vote of the Legislative Assembly may override the Governor's veto.

If budget adjustments are required after a legislative session has ended, the Legislative Assembly may meet again in a specially called session, or the Legislative E- Board may adjust agency budgets.

Revenue Forecasting

Oregon law requires DAS to prepare an estimate for each calendar quarter of the total amount of revenue, including General Fund and lottery revenues, available for State purposes for the current fiscal year, as well as the amount of revenue received quarterly, cumulated through the biennium. DAS must report its estimates to the Legislative Assembly, when it is in session, and to certain interim committees of the Legislative Assembly, when it is not in session. The reports are issued as of the first day of each March, June, September and December. These reports are commonly known as the quarterly "revenue forecast", and focus on the amount of expected General Fund and lottery revenues. In odd-numbered

years when the Legislative Assembly is in session, the June forecast is released approximately May 15 and is commonly referred to as the “close of session” or “COS” forecast.

Oregon law also requires DAS to set forth the methodology and assumptions used to develop each quarterly revenue forecast. Currently, the State uses an econometric model to forecast the Oregon economy and personal and corporate income taxes (over 80 percent of the State’s General Fund revenue). The system receives new data each quarter, with revisions to the model as necessary. The econometric model has two major parts: (1) a State economic model that estimates employment, wages and personal income; and (2) a revenue forecasting system based on the economic model, for use in estimating personal and corporate income taxes. The model does not include the fees and other miscellaneous revenues that comprise the balance of General Fund revenues.

The development of a revenue forecast involves three steps. First, a forecast of economic conditions in Oregon is made, then projected income and population is translated into projected tax receipts other than from corporate and excise taxes and finally corporate income and excise tax collections are projected. In developing its projections the State uses the national baseline forecasts of Global Insight, Inc.

Accounting Practices

Oregon law designates DAS as the agency responsible for the overall administration and coordination of the State’s internal accounting and other fiscal controls and procedures. DAS has developed the Oregon Accounting Manual that sets forth internal policies and uniform procedures for agencies to follow in their fiscal management, accounting and reporting.

DAS must prepare a financial report for the State of Oregon within 180 days after the close of each fiscal year. The reporting entity of the State of Oregon includes all State agencies, universities, commissions and boards for which elected State officials have oversight responsibility. Oregon’s financial statements are prepared in conformity with generally accepted accounting principles (“GAAP”) applicable to state governments.

All governmental funds use the modified accrual basis of accounting. Revenues are recognized when they become measurable and available. On the modified accrual basis of accounting, taxpayer assessed taxes are recognized when the underlying exchange has occurred and the resources are available. Expenditures are recognized under the modified accrual basis of accounting when the related liability is incurred. An exception to this general rule of expenditure recognition is that principal and interest on general long-term debt is recognized when due.

All proprietary and fiduciary funds are accounted for using the accrual basis of accounting. Revenues are recognized when they are earned, and expenses (other than debt service) are recognized when they are incurred.

Controls

Audits

The Secretary of State, as State Auditor, may audit or review the accounts and financial affairs of each State agency as deemed appropriate under ORS 297.210. An audit or review may also occur when there is a change in the executive head of an institution or department. The Governor, Legislative Fiscal Officer and DAS receive a report on each audit. The Secretary of State’s Audit Division reviews the funds of the State’s larger agencies in connection with the development of the State’s annual financial report and provides annual audits, as requested, for the State’s revenue bond funded programs.

Disbursements and Allotments

Oregon law requires that State agency spending be monitored and that moneys be disbursed throughout the biennium through an allotment process that is administered by DAS. Under this process, DAS allots to each agency the amount of appropriated moneys that may be spent during each of the eight quarters in a biennium. The amount of an allotment is based on estimates submitted by agencies of their statutory duties and projected expenditures to fulfill the purposes for which moneys were appropriated to them. DAS may amend allotments previously made by it at the request of an agency or after notice by DAS to an agency. In addition, if DAS declares at any time during the biennium that there is a projected budget deficit due to insufficient revenues, then DAS, with the Governor's approval, may reduce previously made allotments to a level necessary to prevent the deficit. Allotments made for the purpose of debt service payments, however, may not be reduced.

Fiscal Checks and Balances

Oregon law provides for a system of checks and balances with respect to the deposit, accounting and expenditure of State moneys. DAS supervises State agency accounting and prescribes rules and regulations for preparation of agency budgets. The Secretary of State, the constitutionally designated auditor of public accounts, may disapprove claims for payment from any moneys in the State Treasury. State agencies are required to turn the moneys collected by them over to the State Treasurer for deposit into various funds that comprise the State Treasury. The State Treasurer is responsible for control of State banking relationships, cash management and the investment of State funds. Some State moneys are deposited with outside trustees who administer the cash and investments.

On a day-to-day basis, DAS, along with the State Treasurer and the Secretary of State, maintains the system of checks and balances. For example, DAS reconciles its accounts monthly with the related account balances maintained by the State Treasurer, which facilitates the adjustment of any imbalances or other errors. DAS also follows up on major deficiencies listed in the audit reports prepared by the Audits Division of the Secretary of State. Agencies must respond to DAS stating in detail how they will correct the deficiencies.

Loss Management

The State Services Division of DAS is responsible for managing the State's risk of loss due to various types of loss or liability. The primary kinds of loss that the division works to prevent or pay include employee injuries; property loss; employee theft or dishonesty and tort liability claims arising from an alleged failure of state agencies or employees to perform their duties. The State Insurance Fund (the "Fund") generally pays up to a set amount for various types of losses through its self-insurance program, with excess amounts covered by purchased commercial insurance policies. The State Services Division pays for both its self-insurance losses and commercial insurance premiums from the Fund. For each separate category of potential loss, the Division determines the appropriate level of the Fund or commercial insurance. Agencies pay assessments to the Fund for each category of loss. For additional information, see note 19 of the Basic Financial Statements for the State for the fiscal year ended June 30, 2011.

REVENUES

Revenues available to the State are discussed below based on the following categories: General Funds, Lottery Funds, Reserve Funds, Other Funds and Federal Funds. Certain of these revenues are available only to finance permitted purposes as authorized by State or federal law.

General Fund Revenues

The following describes the largest sources of the State's General Fund revenues. For additional information on the General Fund revenue amounts collected each biennium see Table 11 under "Oregon Financial Information."

Taxes

Personal Income Taxes. Oregon taxes the personal income of individuals, estates, and trusts. Taxable income is calculated using the Internal Revenue Code of 1986, as amended and in effect applicable to the tax year of the taxpayer. Oregon employers withhold income tax from their employees' wages. The employees then file Oregon tax returns for refunds or pay additional tax by April 15 of each year. Self-employed persons and others not subject to withholding must pay quarterly estimated tax payments.

Oregon tax rates for single filers are graduated between 5 percent for income under \$3,050 to 11 percent for income over \$250,000 for the 2011 tax year. The amount of applicable income is doubled for joint returns. The income amount to which a certain rate applies is indexed to changes in the Consumer Price Index. Beginning with the 2012 tax year the top tax rate is reduced to 9.9 percent for single filers with income over \$125,000.

Corporate Excise and Income Taxes. Corporations are subject to either a corporate excise tax or the corporate income tax under Oregon law.

The corporate excise tax is imposed for the privilege of doing business in Oregon. A corporation is doing business in Oregon when it engages in any profit-seeking activity in Oregon. The amount of excise tax is 6.6 percent for corporate taxable income of \$250,000 and under and 7.6 percent for income over \$250,000. However, there is a minimum tax of \$150 for S corporations and Partnerships or between \$150 and \$100,000 for C Corporations, depending on Oregon sales. Beginning in 2013, the tax rate will be 6.6 percent for taxable income of \$10 million or less and 7.6 percent for taxable income greater than \$10 million.

The corporate income tax is imposed on any corporation that is not doing business in Oregon, but that has income from an Oregon source. Corporations that operate in more than one state must determine the share of their income attributable to Oregon activities using Oregon sales relative to sales in all states. The corporate income tax rate mirrors that of the excise tax rate on taxable income derived from sources within Oregon.

Insurance Taxes. All authorized insurers in Oregon are subject to the corporate excise tax; however, foreign insurers (those domiciled in other states) and alien insurers (those domiciled in other countries) are also subject to a retaliatory tax. The Oregon Department of Revenue collects the excise tax. The Insurance Division of the Department of Consumer and Business Services collects the retaliatory tax.

Estate Taxes. Oregon's estate tax is imposed as a percentage of the Oregon estate. Because Oregon calculates its tax differently than the federal estate tax, the Oregon inheritance tax amount may be different from the federal tax amount, even though the Oregon tax is tied to the Federal Internal Revenue Code.

Cigarette and Other Tobacco Taxes. The State imposes an excise tax on the distribution of all tobacco products in Oregon. The tax rate on cigarettes is \$0.059 per cigarette (\$1.18 for a pack). The tax rate on the other tobacco products is 65 percent of the wholesale price, and \$0.50 per cigar. Moist snuff is

taxed at \$1.78 per ounce with a minimum of \$2.14 per container. The cigarette and other tobacco products taxes are distributed primarily to the General Fund, with the balance distributed equally among cities, counties and the Department of Transportation.

Other Taxes. A portion of the moneys collected from the Eastern Oregon Severance Tax, Western Oregon Severance Tax and Amusement Device Tax are allocated to the General Fund.

Fines and Fees

The fines and fees section of General Fund revenues includes State Court Fees, Secretary of State Corporation Fees, Criminal Fines and Assessments, and Securities Fees. These are fees imposed by agencies or the State courts for the filing of certain court-related or corporate documents and certain fines for violations of the law.

Liquor Sales Apportionment

The State imposes taxes on beer and wine manufactured or distributed in Oregon. The current tax rates are 8.4 cents per gallon of beer (\$2.60 per 31-gallon barrel), 67 cents per gallon of wine with 14 percent or less alcohol, and 77 cents per gallon of wine with 14 percent – 21 percent alcohol. The Oregon Liquor Control Commission (OLCC) exclusively imports and distributes beverages with 21 percent or more alcohol. The OLCC sets retail prices, on average, at 101 percent above the sum of costs, shipping, and federal taxes. The net revenue from these operations goes into an OLCC account, which distributes approximately 56 percent of the revenues to the General Fund.

Other Sources

Other major sources of General Fund revenue include charges for central services performed by DAS, interest earnings, and miscellaneous revenues.

General Fund Revenue Reduction Due to Income Tax Return (2% Surplus Kicker)

Under the Oregon Constitution, if biennium revenues actually received exceed estimated amounts to be received from either of two General Fund revenue categories, personal or corporate taxes, by more than two percent, a tax credit is issued to individual taxpayers and corporate taxpayers. This credit of excess revenues is popularly known as the “kicker.” For individuals, the refundable credit is based on the previous calendar year’s tax liability (for example, 2008 liability for the 2007-09 kicker). For corporations, the credit is based on the tax liability for the calendar year containing the end of the biennium (for example, 2009 liability for the 2007-09 kicker). The State may retain the corporate or individual kicker moneys only if two-thirds of each house of the Legislative Assembly votes to keep the kicker. See “Reserve Funds – *Rainy Day Fund*” below.

Lottery Funds

Revenues from the operation of the Oregon State Lottery comprise a significant source of money in the State’s budget. After the payment of prizes and operating the State Lottery, revenues are constitutionally dedicated to education, economic development, and natural resources program areas. According to the Oregon Constitution, approximately 84 percent of the total annual revenues from the sale of lottery tickets or shares shall be returned to the public in the form of prizes and net revenues benefiting the public purpose. After paying player prizes and operating expenses, the Lottery transfers the remaining revenues to the Administrative Services Economic Development Fund. The constitution and the Legislative Assembly direct how moneys from this fund are distributed. Presently, the Education Stability Fund and the Parks and Natural Resources Fund receive about 33 percent of total transfers. Debt

service payments, State school funding, and economic development efforts are the primary uses for the remainder. For a discussion on lottery revenue bonds, see “Debt Authority and Bond Issuance - Direct Revenue Bonds, *Lottery Revenue Bonds*” below.

Reserve Funds

Reserve Funds. The State has two budgetary reserve funds, the Education Stability Fund and the Oregon Rainy Day Fund that may be drawn on in the event of General Fund revenue shortfalls or economic downturns within a biennium subject to certain restrictions described below.

Education Stability Fund (ESF). Under the Oregon Constitution, 18 percent of the net proceeds from the State Lottery must be deposited in the ESF. The ESF retains earnings or spends them on public education. The Legislative Assembly also may appropriate other moneys or revenues to the ESF. The amount in the ESF may not exceed 5 percent of the amount that was accrued as revenues in the State’s General Fund during the prior biennium. If three-fifths of the Legislative Assembly approves, the Legislative Assembly can appropriate all or a portion of the money in the ESF for public education expenditures subject to the Governor declaring an emergency or the Legislative Assembly finding that at least one of the following conditions exists: (i) General Fund moneys in the next biennium will be at least three percent below current biennium appropriations; (ii) nonfarm employment has declined for two consecutive quarters in the last twelve months or (iii) General Fund revenues have dropped at least two percent below the current close of session forecast.

Rainy Day Fund (RDF). The 2007 Legislative Assembly authorized the establishment of the Oregon Rainy Day Fund, codified in ORS 293.144 to 293.148. ORS 293.146 provides for deposits to the RDF in an amount equal to up to one percent of the State’s General Fund appropriations for a biennium. The deposit is payable from the State’s General Fund ending balance at the end of a particular biennium. The actual amount of the deposit up to the one percent requirement will depend on the size of the State’s General Fund ending balance. Additional transfers to the RDF cannot be made if the balance in the RDF exceeds 7.5 percent of the amount of General Fund revenues collected in the prior biennium. If 3/5ths of the Legislative Assembly approves, the Legislative Assembly may appropriate money from the RDF if it finds that at least one of the following conditions exists: (i) General Fund moneys in the next biennium will be at least three percent below current biennium appropriations; (ii) nonfarm employment has declined for two consecutive quarters in the last twelve months or (iii) General Fund revenues have dropped at least two percent below the current close of session forecast.

The chart below presents historic amounts in the State’s reserve funds. The Oregon Constitution requires 18 percent of net lottery revenues be deposited in the ESF each year. Under state law, the Oregon Growth Account generally receives 5 percent of that amount.

TABLE 10
HISTORIC EDUCATION STABILITY
AND RAINY DAY FUNDS
(DOLLARS IN MILLIONS)

| <u>Biennium</u> | <u>Education Stability Fund</u> ^{1,2} (\$) | <u>Rainy Day Fund</u> (\$) | <u>Total</u> (\$) |
|-----------------|---|--------------------------------|-------------------|
| 1999-01 | 171.6 | | |
| 2001-03 | 16.1 | | |
| 2003-05 | 32.6 | | |
| 2005-07 | 178.9 | | |
| 2007-09 | 0.0 | 112.5 | 112.5 |
| 2009-11 | 5.1 | 10.4 | 15.5 |
| 2011-13 | 6.9 | 61.8 | 68.7 |

Source: Office of Economic Analysis.

- (1) Effective July 1, 2003 the Oregon Constitution was amended to change the Education Endowment Fund to the Education Stability Fund and to increase the contribution from 15 percent of net proceeds to 18 percent of the net lottery proceeds.
- (2) Reflects net available amount in the ESF, exclusive of funds held in the Oregon Growth Account that may be illiquid and any subsequent transfers by the Legislative Assembly.

Other Funds Revenues

A description of the largest sources of the State’s Other Funds revenue follows below. For additional information on the Other Funds revenue amounts collected each biennium see Table 14, “Oregon Financial Information.”

Selective Sales and Use Taxes

Cigarette and Other Tobacco Taxes. As described above, a large part of the cigarette and other tobacco products taxes is distributed to the General Fund. Part of those taxes, however, is also distributed as Other Funds revenue. The Oregon Health Plan is the primary recipient of the cigarette tax distributed as Other Funds, with small amounts distributed to tobacco cessation programs and among cities, counties, and elderly and disabled transportation programs. The remaining tobacco products tax distributed as Other Funds goes primarily to the Oregon Health Plan with a small amount to tobacco cessation programs.

Motor Fuels Tax and Weight-Mile Tax. Oregon imposes a tax at the rate of 30 cents per gallon on the sale of gasoline and other fuels used to propel motor vehicles on the State’s highways. The Oregon Department of Transportation (ODOT) also assesses a weight-mile tax and road use fees on commercial vehicles that operate on public roads within Oregon. The weight-mile tax is based on the declared combination of vehicle weight and vehicle classification group. Revenues derived from the fuels tax, weight-mile tax and road use assessment fees are paid into the State Highway Fund.

Gross Receipts Business Taxes

Public Utilities. Regulated utilities operating within the State must pay in taxes up to 0.25 percent of gross operating revenues. These taxes are collected to cover the cost of utility regulation performed by the Oregon Public Utility Commission.

Employer-Employee Taxes

Employment Taxes. Employers and employees in Oregon must pay unemployment taxes. The rate of unemployment tax depends upon the balance in the Unemployment Compensation Trust Fund as of August 31 of each year, the taxable payroll, and the amount of unemployment benefits paid.

Workers' Compensation Insurance. Oregon employers and employees also pay a workers' compensation assessment. The Director of the Department of Consumer and Business Services determines the amount of workers' compensation assessments.

Severance Taxes

Portions of the Eastern Oregon, Western Oregon and Other Severance taxes are paid to funds outside of the General Fund for various forest-related and other programs.

Licenses and Fees

Owners and operators of motor vehicles pay fees to ODOT for the licensing, registration, and titling of their vehicles. These moneys are dedicated to the State Highway Fund, the Student Driver Training Fund, and the Motor Vehicle Accident Fund. Another source of revenue comes from the sale of hunting and fishing licenses and tags and occupational licenses.

Other Revenues

Charges for Services. Major portions of these Other Funds revenues are collected by the Oregon University System and consist of auxiliary enterprise and service income. Sales of State Forest Lands and Common School Lands also provide income. This category also includes revenue from veterans' home loan repayments and retirement system contributions, as well as various other smaller sources.

Fines, Rents and Royalties, Bond Sales. The State collects income from State-owned properties that are leased or rented. It also collects royalties or similar returns through the Oregon University System and some loan and grant programs. Proceeds from the sale of bonds issued by the State are deposited into various program funds and accounts for disbursement to construction projects, or loan and grant programs operated by various State agencies.

Sales, Donations and Loan Repayments. The State from time to time sells State-owned properties, receives donations from various parties and receives repayments on loans made to governmental and private entities under various programs.

Federal Funds

Federal Funds are moneys received from the federal government. The Legislative Assembly may authorize receipt of Federal Funds for specific purposes. These funds must be appropriated by the Legislative Assembly and used in accordance with any restrictions placed on the funds by the federal government.

OREGON FINANCIAL INFORMATION

Table 11 presents historical State General Fund Revenues for three biennia and the 2011-13 biennia forecast.

TABLE 11
STATE OF OREGON
GENERAL FUND REVENUE STATEMENT
(DOLLARS IN THOUSANDS) ¹

| Taxes | 2005-07 Actuals ² (\$) | 2007-09 Actuals ³ (\$) | 2009-11 Actuals ⁴ (\$) | 2011-13 Forecast ⁵ (\$) |
|-------------------------------------|--|--|--|---|
| Personal Income | 11,040,347 | 11,174,799 ⁶ | 10,467,225 | 11,956,608 |
| Corporate Excise and Income | 844,082 | 684,485 | 827,614 | 842,577 |
| Insurance | 114,718 | 93,328 | 90,496 | 96,381 |
| Estate | 168,933 | 196,820 | 168,864 | 195,638 |
| Cigarette | 88,789 | 81,649 | 76,837 | 74,434 |
| Other Tobacco Products | 32,553 | 34,518 | 47,328 | 57,016 |
| Other | 2,504 | 1,477 | 2,496 | 1,550 |
| Fines and Fees | | | | |
| State Court Fees | 48,036 | 55,625 | 50,464 | 133,196 |
| Secretary of State Corp. Fees | 20,402 | 22,496 | 41,950 | 50,800 |
| Criminal Fines and Assessments | 88,741 | 72,855 | 59,460 | 69,692 |
| Securities Fees | 18,226 | 19,576 | 19,263 | 19,545 |
| Central Service Charge | 6,687 | 8,713 | 8,174 | 11,152 |
| Liquor Apportionment | 146,110 | 184,326 | 198,283 | 230,471 |
| Interest Earnings | 101,356 | 84,344 | 4,927 | 10,913 |
| Miscellaneous Revenues | 15,698 | 11,976 | 10,932 | 9,897 |
| One-time Transfers | <u>4,824</u> | <u>86,104</u> | <u>447,383</u> | <u>162,086</u> |
| Gross General Fund Revenues | 12,742,006 | 12,813,091 | 12,521,696 | 13,920,956 |
| <i>Total Kicker Refunds/Credits</i> | 0 | (1,084,201) | 0 | 0 |
| Net General Fund Revenues | 12,742,006 | 11,728,890 | 12,521,696 | 13,920,956 |
| Beginning Balance | 308,523 | 1,436,710 | 0 | 0 |
| Anticipated Administrative Actions | 4,937 | (42,140) ⁷ | (8,200) ⁷ | (4,395) ⁷ |
| Legislative Adopted Actions | 0 | (319,288) ⁸ | 0 | 0 |
| Available Resources | <u>13,050,529</u> | <u>12,804,172</u> | <u>12,513,496</u> | <u>13,916,561</u> |
| Appropriations | 11,641,200 | 12,793,534 | 13,432,875 | 13,723,770 |
| Adjusted Appropriations | 11,646,137 | 12,793,534 | 13,432,875 | 13,723,770 |
| Reversions | (32,319) | (762) | 0 | 0 |
| Administrative Actions | 0 | 0 | (954,613) ⁹ | 0 |
| Projected Expenditures | <u>11,613,818</u> | <u>12,792,772</u> | <u>12,478,261</u> | <u>13,723,770</u> |
| Ending Balance | <u>1,436,710</u> | <u>11,400</u> ¹⁰ | <u>35,235</u> ¹⁰ | <u>192,791</u> |

Source: State of Oregon, Budget and Management, and Oregon Office of Economic Analysis Revenue Forecasts.

Note: One-time Action and expenditure changes from SB 5562, HB 5015 and SB 581 are included for FY 2009.

- (1) Totals may not agree with sum of components due to rounding.
- (2) September 2007 Oregon Economic and Revenue Forecast, adjusted for reversions.
- (3) December 2009 Oregon Economic and Revenue Forecast, subject to adjustments through June 2010.
- (4) September 2011 Oregon Economic and Revenue Forecast.
- (5) September 2012 Oregon Economic and Revenue Forecast.
- (6) Not reduced by \$1,084,201 Kicker.
- (7) Interest expense associated with the Tax Anticipation Notes program, and is exclusive of any internal borrowing.
- (8) Equals 2005-07 portion of corporate surplus designated for the Rainy Day Fund.
- (9) Allotment reductions to agencies.
- (10) The ending balances for 2007-09 and 2009-11 biennia were transferred to the Rainy Day Fund so the beginning balances for 2009-11 and 2011-13 respectively, were assumed to be -0-.

Table 12 compares budgeted and actual General Fund Revenues for the 2001-03 through the 2009-11 biennia.

TABLE 12
STATE OF OREGON
ACTUAL GENERAL FUND REVENUES COMPARED WITH
LEGISLATIVELY ADOPTED BUDGET ESTIMATES
(DOLLARS IN BILLIONS)

| <u>Biennium</u> | | <u>Budget at Close of Session (\$) ¹</u> | <u>Actual (\$) ²</u> | <u>Difference (\$)</u> | <u>Percent Difference (%)</u> |
|-----------------|-----------------------|---|---------------------------------|------------------------|-----------------------------------|
| 2001-03 | Personal Income Tax | 9.445 | 7.700 | (1.745) | (18.5) |
| | Corporate Income Tax | 0.860 | 0.420 | (0.440) | (51.2) |
| | <u>Other Revenues</u> | <u>0.750</u> | <u>1.246</u> | <u>0.496</u> | <u>66.1</u> |
| | Total | 11.055 | 9.366 | (1.689) | (15.3) |
| 2003-05 | Personal Income Tax | 9.395 | 8.992 | (0.403) | (4.3) |
| | Corporate Income Tax | 0.540 | 0.641 | 0.101 | 18.7 |
| | <u>Other Revenues</u> | <u>0.803</u> | <u>0.806</u> | <u>0.003</u> | <u>0.4</u> |
| | Total | 10.738 | 10.439 | (0.299) | (2.8) |
| 2005-07 | Personal Income Tax | 10.124 | 11.040 | 0.916 | 9.1 |
| | Corporate Income Tax | 0.500 | 0.844 | 0.344 | 68.9 |
| | <u>Other Revenues</u> | <u>0.703</u> | <u>0.858</u> | <u>0.155</u> | <u>22.1</u> |
| | Total | 11.327 | 12.742 | 1.415 | 12.5 |
| 2007-09 | Personal Income Tax | 11.332 | 10.091 | (1.241) | (11.0) |
| | Corporate Income Tax | 0.921 | 0.685 | (0.236) | (25.6) |
| | <u>Other Revenues</u> | <u>0.834</u> | <u>0.954</u> | <u>0.120</u> | <u>14.4</u> |
| | Total | 13.087 | 11.729 | (1.358) | (10.4) |
| 2009-11 | Personal Income Tax | 11.546 | 10.467 | (1.079) | (9.3) |
| | Corporate Income Tax | 0.832 | 0.828 | (0.004) | (0.5) |
| | <u>Other Revenues</u> | <u>1.198</u> | <u>1.227</u> | <u>0.029</u> | <u>2.4</u> |
| | Total | 13.576 | 12.522 | (1.054) | (7.8) |

Source: *Oregon Economic and Revenue Forecasts.*

- (1) "Budget at Close of Session" reported in the September 2001, 2003, 2005, 2007, and 2009 Oregon Economic and Revenue Forecasts, respectively.
- (2) "Actuals" are reported the following biennium in the September or December 2003, 2005, 2007, 2009 and 2011 Oregon Economic and Revenue Forecasts, respectively.

Table 13 presents historical and forecasted Lottery Revenues and Distributions for the 2003-05 through the 2011-13 biennia.

TABLE 13
LOTTERY REVENUE STATEMENT
(DOLLARS IN MILLIONS)

| | <u>2003-05</u> <u>Actual (\$)</u> | <u>2005-07</u> <u>Actual (\$)</u> | <u>2007-09</u> <u>Actual (\$)</u> ² | <u>2009-11</u> <u>Forecast</u> ³ | <u>2011-13</u> <u>Forecast</u> ⁴ |
|---|--------------------------------------|--------------------------------------|---|--|--|
| LOTTERY EARNINGS ¹ | | | | | |
| Regular Lottery | | | | | |
| Sports Action | 4.0 | 3.6 | 0.0 | 0.0 | 0.0 |
| Traditional Lottery | <u>140.1</u> | <u>143.3</u> | <u>132.2</u> | <u>134.1</u> | <u>117.2</u> |
| Total Regular Lottery | 144.1 | 146.9 | 132.2 | 134.1 | 117.2 |
| Video Lottery | 601.9 | 914.1 | 1,091.2 | 922.7 | 950.7 |
| Other Earnings / Administrative Savings | <u>34.5</u> | <u>26.7</u> | <u>103.5</u> | <u>29.3</u> | <u>8.0</u> |
| Total Available to Transfer | <u>780.6</u> | <u>1,087.7</u> | <u>1,326.9</u> | <u>1,086.1</u> | <u>1,075.9</u> |
| ECONOMIC DEVELOPMENT FUND | | | | | |
| Beginning Balance | 11.1 | 0.0 | 64.1 | 1.4 | 0.3 |
| Resources | | | | | |
| Lottery Transfers | 780.6 | 1,087.7 | 1,326.9 | 1,086.1 | 1,075.9 |
| Other Resources ⁵ | 1.8 | 8.0 | 9.3 | 1.1 | 2.3 |
| Total Available Resources | <u>793.5</u> | <u>1,095.7</u> | <u>1,400.2</u> | <u>1,088.6</u> | <u>1,078.5</u> |
| Allocation of Resources | | | | | |
| County Economic Development ⁶ | 25.4 | 37.2 | 40.0 | 30.5 | 37.1 |
| Education Stability Fund ⁷ | 140.5 | 195.8 | 238.8 | 195.5 | 193.7 |
| Parks and Natural Resources Fund ⁸ | 117.1 | 163.2 | 199.0 | 162.9 | 161.4 |
| OUS Sports Lottery Account ⁹ | 4.0 | 3.6 | 11.7 | 9.7 | 8.6 |
| Gambling Addiction ⁹ | 6.5 | 8.3 | 12.1 | 8.7 | 10.6 |
| County Fairs | 2.5 | 3.3 | 3.6 | 2.8 | 3.6 |
| Debt Service on Lottery Bonds ¹⁰ | 119.4 | 133.7 | 161.7 | 216.4 | 259.4 |
| Other Legislatively Adopted Allocations | <u>378.0</u> | <u>486.4</u> | <u>732.9</u> | <u>461.7</u> | <u>415.5</u> |
| Total Distributions | <u>793.5</u> | <u>1,031.6</u> | <u>1,399.9</u> | <u>1,088.3</u> | <u>1,089.9</u> |
| Ending Balance/Discretionary Resources | <u>0.0</u> | <u>64.1</u> | <u>0.4</u> | <u>0.2</u> | <u>(11.4)</u> |

Source: State of Oregon, Department of Administrative Services, Office of Economic Analysis.

Note: Some totals may not foot due to rounding.

- (1) Actuals are reported in the odd year September Oregon Economic and Revenue Forecast unless otherwise noted.
- (2) Reported in the May 2009 Oregon Economic and Revenue Forecast.
- (3) Reported in the May 2011 Oregon Economic and Revenue Forecast.
- (4) Reported in the September 2012 Oregon Economic and Revenue Forecast.
- (5) Includes interest earnings of Economic Development Fund and reversions.
- (6) County Economic Development includes \$1,023,139 for the Economic Revitalization Team.
- (7) Eighteen percent of proceeds accrue to the Education Stability Fund, until the balance equals 5% of general fund revenues. Thereafter, 15% of proceeds accrue to the Oregon Capital Matching Account.
- (8) The Parks and Natural Resources Fund constitutional amendment requires the transfer of 15% of net proceeds to this fund.
- (9) One percent of net lottery proceeds are dedicated to Collegiate Athletics and Gambling Addiction programs, respectively. Certain limits are imposed by HB3199 and HB 2126 for 2009-11.
- (10) Figures reflect gross debt service on lottery bonds. Figures do not include future issuance.

Table 14 summarizes Other Funds and Lottery Distributions by revenue source for the 2005-07 through the 2011-13 biennia.

TABLE 14
STATE OF OREGON
OTHER FUNDS AND LOTTERY DISTRIBUTIONS BY REVENUE SOURCE

| TAXES | 2005-07 ¹ | 2007-09 ² | 2009-11 ² | 2011-13 ² |
|--|-----------------------------|-----------------------------|---|-----------------------------------|
| | Actual (\$) | Actual (\$) | Legislatively Approved Budget (\$) | Governor's Budget (\$) |
| SELECTIVE SALES AND USE TAXES | | | | |
| Tobacco Taxes | 410,013,524 | 420,856,663 | 323,910,858 | 374,768,943 |
| Motor Fuels Taxes | 863,150,810 | 842,985,199 | 980,292,371 | 1,105,858,226 |
| Weight-Mile Taxes | 476,209,486 | 449,214,083 | 630,233,795 | 610,756,359 |
| Privilege Taxes | 30,054,781 | 25,829,423 | 25,791,600 | 27,557,520 |
| Other Selective Sales and Use Taxes | 271,075,561 | 206,357,807 | 521,025,947 | 484,553,643 |
| GROSS RECEIPTS BUSINESS TAXES | | | | |
| Other Gross Receipts Business Taxes | 2,251,027 | 3,945,380 | 4,500,000 | 3,500,000 |
| Amusement Taxes | 3,586,366 | 4,009,248 | 3,280,000 | 3,280,000 |
| Public Utilities Taxes | 162,870,230 | 177,922,724 | 173,660,379 | 145,960,666 |
| Insurance Taxes | 0 | 0 | 89,775,432 | 116,625,285 |
| EMPLOYER-EMPLOYEE TAXES | | | | |
| Employment Taxes | 1,444,814,898 | 1,501,612,279 | 1,463,541,745 | 2,020,663,852 |
| Workers' Compensation Insurance Taxes | 106,189,142 | 77,130,779 | 77,495,482 | 104,622,864 |
| Other Employer-Employee Taxes | 593,876,930 | 618,371,527 | 621,843,492 | 620,621,938 |
| SEVERANCE TAXES | | | | |
| Eastern Oregon Severance Taxes | 46,175 | 16,723 | 0 | 0 |
| Western Oregon Severance Taxes | 815,318 | 400,442 | 562,400 | 562,400 |
| Other Severance Taxes | 189,721 | 644,508 | 237,000 | 237,000 |
| OTHER TAXES | | | | |
| Forest Protection Taxes | 35,976,950 | 40,460,582 | 35,504,046 | 39,808,450 |
| Other Taxes | 177,133,073 | 155,743,036 | 156,759,514 | 151,516,116 |
| LICENSES AND FEES | | | | |
| BUSINESS LICENSES AND FEES | | | | |
| | 376,711,949 | 419,047,961 | 312,131,594 | 323,076,444 |
| NONBUSINESS LICENSES AND FEES | | | | |
| Park User Fees | 32,224,521 | 34,123,590 | 37,663,226 | 44,735,501 |
| Vehicle Licenses | 411,683,613 | 385,422,899 | 564,625,314 | 604,702,401 |
| Drivers Licenses | 78,574,016 | 68,177,426 | 72,972,973 | 71,882,076 |
| Transportation Licenses and Fees | 48,660,707 | 46,388,291 | 72,796,536 | 96,613,799 |
| Hunter and Angler Licenses | 82,815,768 | 81,929,342 | 105,992,819 | 110,237,475 |
| Other Non-business Licenses and Fees | 118,071,956 | 129,957,483 | 101,915,482 | 100,406,561 |
| State Court Fees | 7,533,684 | 6,632,031 | 71,078,563 | 71,078,563 |
| FEDERAL FUNDS AS OTHER FUNDS | | | | |
| | 1,802,139,258 | 1,830,050,839 | 2,256,934,680 | 1,851,084,679 |
| OTHER REVENUES | | | | |
| CHARGES FOR SERVICES | | | | |
| Tuition and Fees -- Higher Education | 1,114,587,427 | 1,305,881,105 | 1,580,300,544 | 1,917,950,731 |
| Fee Remissions -- Higher Education | -66,939,618 | -85,813,819 | -130,024,269 | -150,360,863 |
| Aux. Enterprise & Service Fees Higher Ed. | 383,764,158 | 435,805,302 | 432,968,915 | 547,065,787 |
| Sales and Service Fees -- Higher Education | 264,291,877 | 278,118,134 | 271,524,273 | 328,699,340 |
| Other Charges for Services | 730,200,616 | 882,935,425 | 1,678,836,926 | 2,469,843,154 |
| FINES, RENTS, AND ROYALTIES | | | | |
| Fines and Forfeitures | 163,687,145 | 172,125,662 | 209,616,511 | 199,782,503 |
| Rents and Royalties | 113,740,146 | 126,585,545 | 128,250,387 | 105,315,114 |

TABLE 14 (Continued)

| <u>OTHER REVENUES (continued)</u> | <u>2005-07¹</u> <u>Actual (\$)</u> | <u>2007-09²</u> <u>Legislatively</u> <u>Approved (\$)</u> | <u>2009-11²</u> <u>Legislatively</u> <u>Approved</u> <u>Budget (\$)</u> | <u>2011-13²</u> <u>Governor's</u> <u>Budget (\$)</u> |
|--|--|---|---|--|
| BOND SALES | | | | |
| General Fund Obligation Bonds | 91,454,190 | 216,904,596 | 159,117,000 | 16,740,000 |
| Dedicated Fund Obligation Bonds | 501,729,004 | 549,707,401 | 780,859,070 | 695,503,503 |
| Lottery Bonds | 71,595,971 | 492,062,892 | 230,235,810 | 255,557,040 |
| Certificates of Participation | 74,684,419 | 411,770,845 | 802,876,487 | 219,841,513 |
| Revenue Bonds | 1,642,471,614 | 978,159,419 | 1,367,031,774 | 853,031,774 |
| Refunding Bonds | 514,839,301 | 51,942,970 | 400,000,000 | 0 |
| INTEREST EARNINGS | | | | |
| Interest Income | 21,443,799,619 | 253,959,538 | 6,929,053,437 | 7,791,684,039 |
| SALES INCOME | | | | |
| Liquor Sales | 216,490,423 | 248,207,505 | 284,855,575 | 287,255,420 |
| Pari-mutuel Receipts | 3,568,924 | 3,207,081 | 3,960,314 | 3,009,800 |
| State Forest Lands | 183,645,529 | 141,604,849 | 104,069,774 | 121,258,234 |
| Common School Land | 21,967,084 | 23,134,842 | 24,134,139 | 33,316,000 |
| Other Sales Income | 60,778,171 | 66,738,164 | 60,670,555 | 58,063,315 |
| DONATIONS AND CONTRIBUTIONS | | | | |
| Donations and Grants (Non-Fed) | 612,899,282 | 511,538,091 | 393,195,578 | 503,897,264 |
| Retirement System Contribution | 3,082,055,144 | 2,718,796,511 | 3,389,600,000 | 3,074,179,800 |
| LOAN REPAYMENTS | | | | |
| Housing Division Loan Repayment | 262,608,754 | 201,457,724 | 225,278,721 | 213,664,618 |
| Senior Citizen Property Tax Repayments | 32,994,742 | 32,559,971 | 38,497,653 | 38,497,653 |
| Veterans' Loan Repayments | 113,923,053 | 88,706,787 | 150,000,000 | 75,000,000 |
| Other Loan Repayments | 120,251,533 | 178,522,161 | 177,021,462 | 198,194,209 |
| Loan Proceeds | 40,715,501 | 67,425,000 | 34,787,000 | 9,000,000 |
| LOTTERY DISTRIBUTIONS | 1,087,677,035 | 1,326,917,350 | 1,310,950,324 | 1,162,062,058 |
| OTHER REVENUES | <u>1,239,280,493</u> | <u>2,113,921,564</u> | <u>1,071,680,031</u> | <u>3,105,897,944</u> |
| TOTAL OTHER FUNDS & LOTTERY DISTRIBUTIONS | <u>41,665,431,001</u> | <u>21,320,116,880</u> | <u>31,998,217,722</u> | <u>33,218,660,711</u> |

Source: State of Oregon, Department of Administrative Services, Budget and Management Division.

- (1) Reported in 2009-11 Governor's Budget, Schedule II.
(2) Reported in 2011-13 Governor's Budget, Schedule II.

Table 15 summarizes expenditures by statewide program area for all fund types for the 2005-07 through the 2011-13 biennia.

TABLE 15
SUMMARY OF EXPENDITURES BY PROGRAM AREA BY FUND
(DOLLARS IN MILLIONS)

| Program Area | 2005-07 Actual Expenditures ¹ | | | | | 2007-09 Actual Expenditures ² | | | | | 2009-11 Legislatively Adopted Budget ³ | | | | | 2011-13 Legislatively Adopted Budget ³ | | | | |
|---|--|--------------|---------------|--------------|---------------|--|--------------|---------------|---------------|---------------|---|--------------|---------------|---------------|---------------|---|--------------|---------------|---------------|---------------|
| | General | Lottery | Other | Federal | Total | General | Lottery | Other | Federal | Total | General | Lottery | Other | Federal | Total | General | Lottery | Other | Federal | Total |
| | <u>Fund</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Fund</u> | <u>Funds</u> | <u>Fund</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> | <u>Funds</u> |
| Education | 6,418 | 513 | 3,969 | 1,136 | 12,036 | 6,752 | 1,145 | 4,714 | 1,342 | 13,953 | 6,985 | 590 | 4,881 | 1,761 | 14,217 | 6,752 | 642 | 4,710 | 1,319 | 13,423 |
| Human Services | 2,781 | 9 | 1,166 | 6,035 | 9,991 | 3,196 | 12 | 1,364 | 7,334 | 11,907 | 3,502 | 11 | 1,911 | 10,436 | 15,860 | 3,804 | 11 | 5,736 | 10,516 | 20,067 |
| Public Safety | 1,528 | 6 | 410 | 338 | 2,283 | 1,828 | 7 | 647 | 449 | 2,931 | 1,858 | 7 | 694 | 561 | 3,121 | 1,906 | 7 | 530 | 472 | 2,915 |
| Judicial Branch | 466 | --- | 31 | 1 | 449 | 522 | --- | 55 | 1 | 578 | 507 | --- | 94 | 1 | 602 | 582 | --- | 26 | 1 | 609 |
| Economic & Community Development | 22 | 98 | 3,477 | 485 | 4,083 | 34 | 128 | 4,355 | 679 | 5,196 | 29 | 120 | 5,706 | 2,327 | 8,182 | 24 | 147 | 3,683 | 1,634 | 5,488 |
| Natural Resources | 143 | 159 | 838 | 185 | 1,324 | 165 | 198 | 958 | 176 | 1,497 | 147 | 182 | 1,128 | 305 | 1,761 | 129 | 167 | 1,114 | 315 | 1,725 |
| Transportation | 9 | 23 | 2,806 | 54 | 2,891 | 5 | 47 | 3,009 | 72 | 3,132 | 20 | 85 | 4,089 | 92 | 4,287 | 17 | 70 | 3,576 | 142 | 3,805 |
| Consumer and Business Services | 12 | --- | 780 | 2 | 793 | 13 | --- | 908 | 2 | 922 | 13 | --- | 1,027 | 4 | 1,044 | 11 | --- | 596 | 7 | 615 |
| Administration | 169 | 7 | 6,619 | 10 | 6,805 | 188 | 7 | 8,009 | 11 | 8,215 | 194 | 12 | 10,270 | 12 | 10,488 | 184 | 14 | 8,802 | 13 | 9,013 |
| Legislative Branch | 6 | --- | 7 | --- | 70 | 78 | --- | 39 | --- | 116 | 75 | --- | 8 | --- | 83 | 80 | --- | 7 | --- | 87 |
| Miscellaneous-(Incl. E-Board) | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | 73 | --- | --- | --- | 73 | 73 | --- | --- | --- | 73 |
| Statewide Total Expenditures⁴ | 11,609 | 816 | 20,103 | 8,246 | 40,774 | 12,779 | 1,544 | 24,059 | 10,065 | 48,447 | 13,405 | 1,007 | 29,807 | 15,500 | 59,719 | 13,593 | 1,056 | 28,782 | 14,419 | 57,820 |

Source: State of Oregon, Department of Administrative Services, Budget and Management Division.

- (1) Reported in Governor's Balanced Budget, 2009-11.
- (2) Reported in Governor's Balance Budget, 2011-13.
- (3) Source: ORBITS budget system as of November 22, 2011.
- (4) Totals may not agree with sum of components due to rounding.

STATE OF OREGON INVESTMENT POLICIES

The Office of the State Treasurer (the “OST”) invests moneys held on behalf of state agencies and participating local governments through two pooled investment vehicles or through separate accounts with guidelines specific to the agency’s investment needs. Some of the agency moneys invested by the OST are bond proceeds or moneys used to pay bond debt service. The State’s investment policies are governed by Oregon Revised Statutes and the Oregon Investment Council (the “OIC”). The OIC, created by a 1965 legislative act, establishes investment policies for all State funds. The OST is responsible for implementing those policies. The Governor appoints four of the OIC’s five voting members, who are subject to confirmation by the Oregon Senate. The State Treasurer serves by statute. OST pooled investment vehicles are the statutory Oregon Short-Term Fund (the “OSTF”) and the internally established Oregon Intermediate-Term Pool (the “OITP”).

The OSTF is a short-term cash investment vehicle created by statute to invest State agency and Oregon local government moneys. The OSTF is not registered with the U.S. Securities and Exchange Commission as an investment company. The OST manages the OSTF within guidelines established by the OIC, with advice from and in consultation with, the OSTF Board. Primary investment objectives established for the fund are, in order of priority: preservation of principal, liquidity and yield. As of August 31, 2012, the OSTF totaled approximately \$10.2 billion.

The guidelines currently in place for the OSTF require at least 50 percent of the portfolio to mature or re-price within 93 days; no more than 25 percent of the portfolio may have a maturity longer than one year; and no investments may have a final maturity longer than three years as measured from the settlement date of the initial transaction. Total weighted average credit quality of the portfolio must be a minimum of AA or Aa2 by Standard & Poor’s, or Moody’s Investors Services, respectively. The guidelines currently in use for the OSTF, allow the following:

- Investments with minimum long-term ratings of AA-, Aa3, or AA-, or better, by Standard & Poor’s, Moody’s Investors Services, or Fitch Ratings, respectively, consisting of:
 - U.S. Treasury Securities
 - Senior Unsecured Debt Obligations guaranteed by the Federal Deposit Insurance Corporation (“FDIC”) under the Temporary Liquidity Guarantee Program (TLGP)
 - U.S. Government Agency Securities
 - U.S. dollar-denominated Foreign Government Securities and their Instrumentalities
- Commercial Paper with at least two minimum short-term ratings of A-1, P-1 or F1 by Standard & Poor’s, Moody’s or Fitch Ratings, respectively.
- Corporate indebtedness with minimum long-term ratings of A-, A3 or A- by Standard & Poor’s, Moody’s or Fitch Ratings, respectively, at the time of purchase.
- Certificates of deposit issued by banks in Oregon and insured by the FDIC or collateralized according to ORS Chapter 295, and negotiable certificates of deposit and banker’s acceptances from domestic commercial banks with minimum long-term ratings of AA-, Aa3 or AA- by Standard & Poor’s, Moody’s or Fitch Ratings, respectively.
- Municipal debt obligations (agencies, instrumentalities, and political subdivisions) that have long-term ratings of AA-, Aa3 or AA-, or better, or are rated in the highest category for short-term municipal debt by Standard & Poor’s, Moody’s Investors Services, or Fitch Ratings, respectively, at the time of purchase.
- Repurchase agreements and reverse repurchase agreements that mature in no more than 90 days are fully collateralized with cash, government obligations or obligations of agencies of the federal government and are entered into with primary dealers as recognized by the Federal Reserve Bank or the State’s custodial bank and certain other types of debt or similar instruments.

The OITP is an alternative to the OSTF for State agencies. The moneys in the OITP are pooled and managed by OST to invest dollars not needed to cover short-term needs and able to withstand price volatility to achieve returns often associated with longer-term investments. The OITP is a voluntary investment vehicle for State agencies with funds that are allowed to be invested.

The OITP's management objective is to maximize total return, which includes investment value and coupon income within the desired risk parameters and fixed income investments prescribed in the portfolio guidelines. The OITP's benchmark index is the BofA Merrill Lynch 1-5 Year AAA-A U.S. Corporate & Government Index. The OITP is not structured to provide 100 percent net asset value on each participant's initial investment at all times. For consistency with the portfolio's total return objective, the value of each participant's investment is determined on a proportional basis to the net market value of the entire portfolio. The OITP is not registered with the U.S. Securities and Exchange Commission as an investment company.

Eligible investments are detailed in the OITP guidelines, but in general, the OITP may invest, subject to diversification requirements, in several types of investment grade rated debt market instruments denominated in U.S. dollars. These may include:

- Obligations of U.S. and non-U.S. private issuers;
- Obligations of the U.S. government and its agencies and instrumentalities;
- Obligations issued or guaranteed by non-U.S. governments and instrumentalities;
- Taxable debt securities issued by U.S. states or local governments and their agencies, authorities and other U.S. state government-sponsored enterprises;
- Repurchase agreements and Reverse repurchase agreements.

The OITP invests in securities that, at the time of purchase, are investment grade rated by nationally recognized rating agencies, such as Moody's or Standard & Poor's. The overall portfolio must maintain an average modified duration of 3.0 years or less. Limitations on individual investment terms to maturity vary by security type, but in general, securities have a maximum term of 10.25 years.

Except for U.S. Treasury and U.S. Agency securities, no more than 5 percent of the OITP may be invested in the securities of any one issuer and a maximum of 25 percent may be invested in any one of 10 broad sectors as defined by the Bloomberg Industry Classification System (BICS).

INITIATIVE PETITIONS, LEGISLATIVE REFERRALS AND REFERENDUM PETITIONS

Initiative Petitions

General. The State Constitution, Article IV, Section 1, reserves to the people of the State (1) the initiative power to amend the State constitution or to enact State legislation by placing measures on the statewide general election ballot for consideration by the voters and (2) the referendum power to approve or reject at an election any act passed by the Legislative Assembly that does not become effective earlier than 90 days after the end of the legislative session. The Legislative Assembly may also refer an act to the voters for approval or rejection.

State law permits any person to file a proposed initiative with the Secretary of State's office without payment of fees or other burdensome requirements. Although a large number of initiative measures are submitted to the Secretary of State's office, a much smaller number of petitions contain sufficient signatures to be placed on the ballot. Because many proposed initiative measures are submitted that do not qualify for the ballot, the State does not formally or systematically monitor the impact of those

measures or estimate their financial effect prior to the time the measures qualify for the ballot. Consequently, the State does not ordinarily disclose information about proposed initiative measures that have not qualified for the ballot.

Requirements for Proposed Initiative Measures to Be Placed on the Ballot. To place a proposed initiative on a general election ballot, the proponents must submit to the Secretary of State initiative petitions signed by the number of qualified voters equal to a specified percentage of the total number of votes cast for all candidates for governor at the gubernatorial election at which a governor was elected for a term of four years next preceding the filing of the petition with the Secretary of State. Any elector may sign an initiative petition for any measure on which the elector is entitled to vote.

The initiative petition must be submitted to the Secretary of State not less than four months prior to the general election at which the proposed measure is to be voted upon. As a practical matter, proponents of an initiative have approximately two years in which to gather the necessary number of signatures. State law permits persons circulating initiative petitions to pay money to persons obtaining signatures for the petition.

Although a large number of initiative measures are submitted to the Secretary of State’s office, a much smaller number of petitions contain sufficient signatures to be placed on the ballot. Once an initiative measure has gathered a sufficient number of signatures and qualified for placement on the ballot, the State is required to prepare a formal estimate of the measure’s financial impact. Typically, this estimate is limited to an evaluation of the direct dollar impact. Historically, a larger number of initiative measures have qualified for the ballot than have been approved by the electors.

| <u>Year of General Election</u> | <u>Number of Initiatives that Qualified</u> | <u>Number of Initiatives that Passed</u> |
|---------------------------------|---|--|
| 2002 | 7 | 3 |
| 2004 | 6 | 2 |
| 2006 | 10 | 3 |
| 2008 | 8 | 0 |
| 2010 | 4 | 2 |

Source: Elections Division, Oregon Secretary of State.

Legislative Referrals and Referendum Petitions

The Legislative Assembly may refer constitutional amendments or statutory changes to the Oregon voters for their approval. In addition, within 90 days after the end of a legislative session, any person may file a petition seeking to have any act passed by the Legislative Assembly that does not become effective earlier than 90 days after the end of the legislative session referred to the voters for their approval or rejection at the next general election, or at a special election provided for by the Legislative Assembly. To place a proposed referendum on the ballot, the proponents must submit to the Secretary of State within 90 days after the end of the legislative session referendum petitions signed by the number of qualified voters equal to four percent of the total number of votes cast for all candidates for governor at the gubernatorial election at which a governor was elected for a term of four years next preceding the filing of the petition with the Secretary of State. Any elector may sign a referendum petition for any measure on which the elector is entitled to vote. An act approved by the voters through the referendum process becomes effective 30 days after the date of the election at which it was approved. A referendum on part of an act does not prevent the remainder of the act from becoming effective as provided in the act.

PENSION AND POST EMPLOYMENT BENEFITS

The State is one of many participants in the statewide Oregon Public Employees' Retirement System ("PERS" or "System"). The State participates in three retirement pension benefit programs provided through PERS and three retirement healthcare benefit programs (two provided through PERS and one provided by the State's Public Employees' Benefit Board ("PEBB")). Most public employers in Oregon, including State government employers, participate in PERS.¹ Benefits provided through PERS are paid from the Oregon Public Employees' Retirement Fund ("OPERF"). The Public Employees' Retirement Board (the "PERS Board") administers PERS and is responsible for setting policies and for providing administrative direction to PERS.

System Pension Programs

The three PERS pension programs are composed of two defined benefit programs and one program that has features similar to a defined contribution plan. In a defined benefit plan, the investment risk for the plan assets is borne by the employer. In a defined contribution plan, the investment risk for the plan assets is borne by the employee. A combination of participating employer contributions (determined by the PERS Board based upon the results of actuarial valuations), investment earnings and employee contributions (determined by statute, currently 6 percent of salaries and 7 percent for judges) fund these pension programs.

Employees hired before January 1, 1996 are known as "Tier 1" participants. The retirement benefits applicable to Tier 1 participants are based primarily on a defined benefit model. Employees hired on or after January 1, 1996 and before August 29, 2003 are known as "Tier 2" participants. The Tier 2 program also provides a defined benefit but with lower expected costs to employers than under the Tier 1 benefit. Employees hired on or after August 29, 2003 are participants in a successor retirement program to the Tier 1 and Tier 2 retirement programs (the "T1/T2 Pension Programs") known as the Oregon Public Service Retirement Plan ("OPSRP").

PERS also offers a program that has features similar to a defined contribution benefit known as the Individual Account Program ("IAP"). Effective January 1, 2004, active Tier 1, Tier 2 (T1/T2) and OPSRP employees became members of the IAP. Tier 1 and Tier 2 employees retain their existing T1/T2 Pension Program account, but the IAP account receives any future member contributions.

The current pensions programs are the result of legislation enacted in 2003 that made significant changes to PERS. Several Oregon employees filed lawsuits challenging various aspects of the 2003 legislation. All of the significant challenges to the PERS legislation and resulting actions by the PERS board have been resolved except a question involving the transfer of \$61 million to a contingency reserve account. In that case, the Oregon Supreme Court held that it did not have enough information to determine whether the transfer was reasonable and remanded that issue back to the trial court. The most recent actuarial valuations of the PERS system take into account the court decisions in existence when the valuations were completed.

¹ In addition, the Oregon Health and Science University and the Oregon University System have each established alternatives to the participation in PERS. See footnote 12 in the State's Basic Financial Statements in Appendix B.

System Pension Plan Asset and Liabilities Valuations

Oregon statutes require an actuarial valuation of the System by a competent actuary at least once every two years. Under current practice, actuarial valuations are performed annually, but only valuations as of the end of each odd-numbered year are used to determine annual required employer contribution rates. Valuations are released approximately one year after the valuation date. The PERS current actuary, Milliman, Inc. replaced the prior actuary, Mercer (US), Inc. (“Mercer”) in January 2012.

The PERS actuary released its December 31, 2009 valuation for the System (the “2009 System Valuation”) on October 27, 2010 and its December 31, 2010 valuation for the System (the “2010 System Valuation”) on November 10, 2011. The 2009 System Valuation and the 2010 System Valuation include actuarial valuations for the T1/T2 Pension Programs and OPSRP. The actuarial valuation report for the System as of December 31, 2011 is expected to be released in late October or early November 2012. In connection with the T1/T2 Pension Programs, the State is pooled with certain local governments and community college districts (the “State and Local Government Rate Pool” or “SLGRP”). Because OPSRP’s assets and liabilities are pooled on a program-wide basis, the State is pooled with all Oregon local governments in connection with OPSRP. The PERS actuary released the State’s individual 2009 valuation report as of December 31, 2009 (the “2009 State Valuation”) on September 27, 2010, the State’s individual 2010 valuation report as of December 31, 2011 (the “2011 State Valuation”) on September 28, 2012, which provides the State’s portion of the unfunded actuarial liabilities of the SLGRP and OPSRP based on the State’s proportionate share of total System covered payroll.

An employer’s unfunded actuarial liability (“UAL”) is the excess of the actuarially determined present value of the employer’s benefit obligations to employees over the existing actuarially determined assets available to pay those benefits. The following methods and assumptions adopted by the PERS Board are the basis for the actuarial valuations:

Assumption/Method

| | | |
|---|-------|--|
| Actuarial Cost Method: | | Projected Unit Credit |
| UAL Amortization Method: | | |
| T1/T2 Programs | | Level Percentage of Payroll over 20 years (fixed) |
| OPSRP | | Level Percentage of Payroll over 16 years (fixed) |
| Asset Valuation Method: | | Market Value ¹ |
| Investment Rate of Return: | | 8.00% |
| Payroll Growth Rate: | | 3.75% |
| Inflation Level: | | 2.75% |
| Contribution Rate Stabilization Method: | | Contribution rate may increase or decrease by 3% to 6% of payroll or by 20% of the previous rate; whichever is greater, when an employer’s funded status is between 80% and 120%. At a funded status of 70% or less, or 130% or more, the limitation doubles to 6% of payroll or 40% of the previous rate, whichever is greater. At a funded status between 70% and 80% or 120% and 130%, the limitation increases in increments between 3%-6% of payroll or 20%-40% of the previous rate, whichever is greater. |

(1) Market value of assets reduced by value of assets in statutory reserves (contingency, capital preservation and rate guarantee reserves).

In addition to the actuarial methods and assumptions listed above, the actuary uses other methods, procedures and economic and demographic assumptions when performing its actuarial valuations.

The table below shows the actuarial value of assets and liabilities, the UALs and surpluses and funded ratios for PERS pension plans for the past ten years. For similar information regarding the PERS-sponsored retirement healthcare benefit programs see Tables 22 and 23.

TABLE 16
PUBLIC EMPLOYEES' RETIREMENT SYSTEM – PENSION
HISTORICAL ACTUARIAL FUNDED RATIOS
(DOLLARS IN MILLIONS)¹

| Calendar Year Ending | Actuarial Value of Assets² (\$) | Actuarial Liability (\$) | Unfunded Actuarial Liability (\$) | Funded Ratio (%) |
|-------------------------------------|---|-------------------------------------|--|-----------------------------|
| 2002 | 35,446.9 | 38,947.0 | 3,500.1 | 91.0 |
| 2003 | 42,753.3 | 44,078.1 | 1,324.8 | 97.0 |
| 2004 ³ | 45,708.3 | 47,398.6 | 1,690.3 | 96.4 |
| 2005 ^{4,5} | 51,403.9 | 49,294.0 | -2,109.9 | 104.3 |
| 2006 | 56,616.5 | 51,252.9 | -5,363.6 | 110.5 |
| 2007 | 59,327.8 | 52,871.2 | -6,456.6 | 112.2 |
| 2008 | 43,520.6 | 54,259.5 | 10,738.9 | 80.2 |
| 2009 | 48,729.2 | 56,810.6 | 8,081.4 | 85.8 |
| 2010 | 51,583.6 | 59,329.5 | 7,745.9 | 86.9 |
| 2011 ⁶ | 50,168 | 61,198 | 11,030 | 82.0 |

Sources: *Actuarial valuations of System for years 2002-2010; 2011 State Valuation for year 2011.*

- (1) Composed of Tier 1/Tier 2 and OPSRP pensions but excluding retiree healthcare subsidies of RHIP and RHIPA.
- (2) Includes proceeds of pension bonds issued by Oregon local governments and the State.
- (3) In 2003, the Oregon Legislative Assembly enacted significant changes to the System and created OPSRP. The 2003 legislative reforms were enacted in response to a growing UAL of the System and to increasing charges to public employers to fund the System. Two actuarial valuations of the System were performed as of December 31, 2001, one prior to and one after the enactment of the 2003 reform legislation. The 2001 numbers reported in this table reflect the impact from the 2003 reform legislation. See "Litigation – Challenges Related to PERS" for discussion on litigation regarding the 2003 reform legislation.
- (4) Effective with the 2004 valuation, the cost method changed from Entry Age Normal to Projected Unit Credit, and the actuarial value of assets was changed from a four-year smoothed value to market value among other changes.
- (5) Assets and liabilities for OPSRP are first valued in the 2005 OPSRP Valuation.
- (6) Only rounded figures are currently available.

The following table shows the investment returns for the OPERF for the last ten calendar years.

TABLE 17
OREGON PUBLIC EMPLOYEES
RETIREMENT FUND INVESTMENT RETURNS¹

| <u>Year</u> <u>Ending</u> | <u>Net</u> <u>Returns (%)</u> |
|--|--|
| 2002 | -7.9 |
| 2003 | 22.7 |
| 2004 | 14.5 |
| 2005 | 13.5 |
| 2006 | 15.3 |
| 2007 | 9.7 |
| 2008 | -27.0 |
| 2009 | 19.4 |
| 2010 | 12.6 |
| 2011 | 2.2 |

Source: Office of the State Treasurer.

(1) Regular account, before administrative expenses.

The funded status of the pension programs may change depending on the market performance of the securities that OPERF is invested in, future changes in compensation and benefits of covered employees, demographic characteristics of members and methodologies and assumptions used by the actuary in estimating the assets and liabilities of PERS. Additionally, the market value of the investments held in OPERF is determined using various sources. For descriptions of the methodologies applied by the Office of the Oregon State Treasurer to determine the market value of OPERF investments see the *State of Oregon Comprehensive Financial Report for the Fiscal Year ended June 30, 2011* Note 1.D., captioned “Deposits and Investments” and the *Oregon Public Employees’ Retirement System Comprehensive Financial Report for the Fiscal Year Ended June 30, 2011*, Note 15.B. captioned “Summary of Significant Accounting Policies”.

State of Oregon Experience

The following table shows the number of active State members in the T1/T2 Pension Programs and OPSRP.

TABLE 18
ACTIVE STATE PERS MEMBERS

| <u>Year Ending</u> | <u>Active T1/T2 Members</u> | <u>Active OPSRP Members¹</u> | <u>Total</u> | <u>Percent Change (%)</u> |
|--------------------|---------------------------------|---|--------------|-------------------------------|
| 2002 | 41,389 | --- | 41,389 | --- |
| 2003 | 40,010 | --- | 40,010 | -3.3 |
| 2004 | 37,419 | --- | 37,419 | -6.5 ² |
| 2005 | 34,588 | 6,583 | 41,171 | 10.0 |
| 2006 | 34,151 | 8,411 | 42,562 | 3.4 |
| 2007 | 32,140 | 10,684 | 42,824 | 0.6 |
| 2008 | 30,615 | 13,643 | 44,258 | 3.3 |
| 2009 | 29,154 | 16,689 | 45,843 | 3.6 |
| 2010 | 27,569 | 20,288 | 47,857 | 4.2 |
| 2011 | 25,623 | 19,751 | 45,374 | -5.2 |

Source: *Oregon PERS.*

- (1) Information regarding OPSRP membership not available prior to 2005 because first year actuarial valuation of OPSRP is as of December 31, 2005.
- (2) Decrease in percentage of active State PERS members reflects lack of information regarding OPSRP membership prior to 2005. New employees hired after August 29, 2003 became members of OPSRP.

State Pension Plan Asset and Liabilities

The following table shows the State's portion of the actuarial value of assets and liabilities, UALs and surpluses and funded ratios for PERS pension programs for the past ten years for which actuarial valuations were performed. For the T1/T2 Pension Programs, the State's portion of PERS' assets and liabilities is based upon the State's proportionate share of SLGRP's pooled covered payroll (as of December 31, 2011, approximately 47.82 percent) and reflects proceeds from the State pension bonds issued in October 2003 in the aggregate principal amount of \$2.1 billion (the "State Pension Bonds"). For OPSRP, the State's proportionate share is based upon the State's share of total System covered payroll (as of December 31, 2011, approximately 27.60 percent). The State's proportionate liability may increase if other participants fail to pay their full employer contributions.

TABLE 19
STATE OF OREGON
HISTORICAL ACTUARIAL FUNDED RATIOS – PENSION
(DOLLARS IN MILLIONS)

| Year Ending¹ | Actuarial Value of Assets² (\$) | Actuarial Liability (\$) | Unfunded Actuarial Liability (\$) | Funded Ratio (%) |
|------------------------------------|---|-------------------------------------|--|-----------------------------|
| 2002 | 11,421.3 | 10,724.3 | (697.0) | 106.5 |
| 2003 | 12,348.7 | 12,157.5 | (191.1) | 101.6 |
| 2004 ³ | 13,084.7 | 13,217.0 | 132.3 | 99.0 |
| 2005 ⁴ | 14,155.8 | 13,339.1 | (816.7) | 106.1 |
| 2006 | 15,598.1 | 13,823.3 | (1,774.8) | 112.8 |
| 2007 | 15,769.3 | 13,611.1 | (2,158.2) | 115.9 |
| 2008 | 11,600.1 | 14,036.0 | 2,435.9 | 82.6 |
| 2009 | 13,014.7 | 14,771.7 | 1,757.0 | 88.1 |
| 2010 | 13,529.8 | 15,116.4 | 1,586.5 | 89.5 |
| 2011 | 13,208.2 | 15,660.0 | 2,451.8 | 84.3 |

Source: *State Actuarial Valuation Reports.*

- (1) Information regarding the State's actuarial funded ratios separate from SLGRP is not available prior to 2002.
- (2) Includes State Pension Bonds proceeds beginning in 2002. Although the State Pension Bonds were issued in October 2003, the State's PERS actuary included the proceeds of the State Pension Bonds in the State's 2002 valuation by discounting the proceeds on a present value basis to December 31, 2002.
- (3) Effective with the 2004 valuation, the cost method was changed from Entry Age Normal to Projected Unit Credit, and the actuarial value of assets was changed from a four-year smoothed value to market value.
- (4) Assets and liabilities for OPSRP are first valued in the 2005 OPSRP Valuation.

State Employer Contribution Rates

At the end of each odd-numbered year, actuarial valuations determine the employer contribution rates that are officially set by the PERS Board. The 2009 State Valuation contains the current employer contribution rates. These rates are effective for the 2011-13 biennium. The 2011 State Valuation contains the State's employer contribution rates for the 2013-15 biennium. All employers participating in PERS are required to make their contribution to PERS based on the employer contribution rates set by the PERS Board.

The following table shows the State's employer contribution rates expressed as percentages of the actuarially determined covered payroll for PERS pension and PERS-sponsored healthcare costs for the 2011-13 biennium based on the 2009 State Valuation and the 2013-15 biennium based on the 2011 State Valuation.

**TABLE 20
STATE CONTRIBUTION RATES**

| <u>Payrolls Paid</u> | <u>2011-13 (%)</u> | <u>2013-15 (%)</u> |
|------------------------|--------------------|--------------------|
| T1/T2 | 10.73 | 15.36 |
| OPSRP General Services | 8.05 | 12.54 |
| OPSRP Police and Fire | 10.76 | 15.27 |
| Judiciary ¹ | 18.33 | 22.31 |
| Blended Rate | 9.60 | 14.49 ² |

Sources: 2009 State Valuation, State Judiciary Valuation as of December 31, 2009, 2011 State Valuation and PERS.

- (1) Members of the Oregon state judiciary are participants of the Judge Retirement Program and the employee contribution rate for the Judge Retirement Program is calculated separately. According to the 2009 System Valuation and the State Judiciary Valuation as of December 31, 2009, the value of the covered payroll of the judiciary as of December 31, 2009 is approximately \$17.7 million, compared to the value of the covered payroll of all Pension Programs of approximately \$8,512.2 million as of December 31, 2009.
- (2) This preliminary blended rate was calculated by the PERS Actuary before completion of the 2011 State Valuation and adoption of the 2013-15 contribution rates by the PERS Board. A final blended rate is not yet available.

State Contributions

The following table shows the amount of State contributions paid to PERS for the three pension programs and the PERS-sponsored health care programs for the past ten fiscal years and the amount paid for the debt service on the State Pension Bonds.

TABLE 21
STATE CONTRIBUTIONS TO PERS AND PERS-RELATED DEBT SERVICE
(DOLLARS IN MILLIONS)
 As of June 30, 2011

| Year Ending 6/30 | State Contribution to PERS ¹ (\$) | Percent Change (%) | Employee Contribution ² (\$) | POB Debt Service ³ (\$) | Total (\$) | Percent Change (%) |
|-------------------|--|--------------------|---|------------------------------------|------------|--------------------|
| 2001 | 193.4 | 5.5 | 101.3 | --- | 294.7 | 5.4 |
| 2002 | 189.4 | -2.1 | 105.4 | --- | 294.8 | 0.0 |
| 2003 | 195.1 | 3.0 | 103.8 | --- | 298.9 | 1.4 |
| 2004 | 132.0 | -32.3 | 111.1 | --- | 243.1 | -18.7 |
| 2005 | 107.6 | -18.5 | 108.7 | 111.5 | 327.8 | 34.8 |
| 2006 | 176.2 | 63.8 | 115.9 | 118.8 | 410.9 | 25.4 |
| 2007 | 179.2 | 1.7 | 123.8 | 120.8 | 423.8 | 3.1 |
| 2008 | 160.8 | -10.3 | 131.9 | 131.3 | 424.0 | 0.0 |
| 2009 | 170.8 | 6.2 | 141.2 | 136.9 | 448.9 | 5.9 |
| 2010 ⁴ | 87.9 | -48.5 | 133.7 | 142.7 | 364.3 | -18.8 |
| 2011 ⁵ | 100.5 | 14.3 | | 148.8 | | |

Sources: Footnote 12, State of Oregon Basic Financial Statements for Fiscal Years (FYs) ended June 30, 2005 and 2004; Oregon State Controller's Division for FY ended June 30, 2006; Footnote 13, State of Oregon Basic Financial Statements for FYs ending June 30, 2007, 2008 and 2009; and Footnotes 15 and 16, State of Oregon Basic Financial Statements for FY ending June 30, 2010 and June 30, 2011; PERS and Office of the State Treasurer.

- (1) Amount does not include employer paid employee portion but does include amounts paid for RHIA and RHIPA and discretely presented component units (SAIF Corporation and Oregon Health and Science University) as well as primary government.
- (2) The State pays employee contributions. Years 2000, 2001 and 2007 through 2010 amounts are based on 6 percent contribution rate and actual annual covered payroll. Years 2003 through and including 2006 amounts based on 6 percent contribution rate and combined valuation-covered payroll from actuarial valuations of the System.
- (3) Fiscal Year State Pension Bonds debt service. Fiscal year 2004 and 2005 debt service is net of capitalized interest. The State issued Pension Bonds October 31, 2003. As of June 30, 2011, \$2.02 billion principal amount of State Pension Bonds remain outstanding.
- (4) The State's PERS contribution rate was 6.71 percent of payroll from January 1, 2009 through June 30, 2009. That rate dropped to 3.17 percent of payroll for the second half of 2009 and all of 2010, resulting in a substantial decrease in the State's contribution to PERS.
- (5) Employee Contribution for 2011 not available as of October 25, 2012.

Other Post Employment Benefits

In addition to pension benefits, the State provides healthcare benefits (medical, vision and dental) to approximately 55,922 retirees through PERS health insurance programs. At the time of retirement, State employees can choose whether to obtain post-employment benefits through PERS or through PEBB.

PERS-Sponsored Retirement Health Insurance Account Plan (RHIA)

Retirees who receive pension benefits through the T1/T2 Pension Programs and are enrolled in certain PERS-administered health insurance programs may receive a subsidy towards the payment of health insurance premiums. ORS 238.420 established the Retirement Health Insurance Account ("RHIA") program under which qualified retirees may receive a subsidy for Medicare supplemental health insurance of up to \$60 per month towards the cost of their health insurance premiums. The State's employer contribution rate for the RHIA program for the 2011-13 biennium is 0.59 percent of payroll and

is a component of the State blended employer contribution rate of 9.6 percent for the 2011-13 biennium. The State's employer contribution rate for the RHIA program for the 2013-15 biennium is 0.59 percent of payroll and is a component of the estimated State blended employer contribution rate of 14.49 percent for the 2013-15 biennium. The employer contribution rate for RHIA paid by the State is based on the annual required contribution (ARC) calculated for the biennium. As of December 31, 2011 the RHIA program has an unfunded actuarial liability of approximately \$221.5 million representing a funded ratio of approximately 52.0 percent, of which \$61.6 million is allocable to the State.

TABLE 22
RETIREMENT HEALTH INSURANCE ACCOUNT (RHIA)
HISTORICAL ACTUARIAL FUNDED RATIOS
(DOLLARS IN MILLIONS)¹

| <u>Year</u> <u>Ending</u> | <u>Program</u> <u>UAL (\$)</u> | <u>Program</u> <u>Funded Ratio (%)</u> | <u>State Share</u> <u>of UAL (\$)</u> |
|------------------------------|-----------------------------------|---|--|
| 2003 | 405.4 | 22.4 | 111.1 |
| 2004 | 408.9 | 26.6 | 111.7 |
| 2005 | 314.9 | 36.5 | 84.7 |
| 2006 | 290.3 | 43.3 | 77.1 |
| 2007 | 248.8 | 50.2 | 66.5 |
| 2008 | 310.2 | 37.2 | 83.9 |
| 2009 | 296.9 | 41.9 | 82.7 |
| 2010 | 314.8 | 42.5 | 85.6 |
| 2011 | 221.5 | 52.0 | 61.6 |

Source: Actuarial valuations of System; PERS.

PERS-Sponsored Retiree Health Insurance Premium Account Plan (RHIPA)

Another subsidy is available to pre-Medicare-age State retirees through the Retiree Health Insurance Premium Account (RHIPA) plan. On or before January 1 of each year, the PERS Board calculates the average difference between the health insurance premiums paid by retired State employees under contracts entered into by the PERS Board and health insurance premiums paid by State employees who are not retired. RHIPA authorizes payment of this average difference to qualified retired State employees. The State's employer contribution rate for the RHIPA plan for the 2011-13 biennium is 0.16 percent of payroll and is a component of the State blended employer contribution rate of 9.60 percent for the 2011-13 biennium. The State's employer contribution rate for the RHIPA program for the 2013-15 biennium is 0.27 percent of payroll and is a component of the estimated State blended employer contribution rate of 14.49 percent for the 2013-15 biennium. The employer contribution rate for RHIPA paid by the State is based on the ARC calculated for the biennium. As of December 31, 2011, the RHIPA program had an unfunded actuarial liability (the "RHIPA UAL") of approximately \$29.9 million, representing a funded ratio of approximately 13.1 percent, all of which is allocable to the State.

TABLE 23
RETIREE HEALTH INSURANCE PREMIUM ACCOUNT (RHIPA)
HISTORICAL ACTUARIAL FUNDED RATIOS
(DOLLARS IN MILLIONS) ¹

| <u>Year Ending</u> | <u>Program UAL (\$)</u> | <u>Program Funded Ratio (%)</u> |
|--------------------|-------------------------|---------------------------------|
| 2002 | 28.4 | 9.0 |
| 2003 | 21.0 | 16.0 |
| 2004 | 23.0 | 18.4 |
| 2005 | 20.9 | 22.7 |
| 2006 | 16.4 | 29.9 |
| 2007 | 15.5 | 33.6 |
| 2008 | 15.6 | 26.7 |
| 2009 | 18.1 | 26.1 |
| 2010 | 28.2 | 16.8 |
| 2011 | 29.9 | 13.1 |

Source: Actuarial valuations of System.

- (1) RHIPA benefits are only available to State employees; therefore, the RHIPA plan UAL is allocable entirely to the State.

PEBB Retiree Health Insurance Benefit Plan

In addition to the pension and healthcare benefits provided to retired State employees through PERS, the State provides healthcare benefits (medical, vision and dental) through PEBB to approximately 2,000 retirees who do not receive healthcare benefits through PERS and are not yet eligible for Medicare. PEBB's obligations to provide benefits are State obligations for accounting purposes. The PEBB OPEB obligation exists because the State is providing an implicit rate subsidy to retirees for PEBB benefits that are offered to both retirees and active employees, where the retiree pays the same premium amount as active employees.

On June 25, 2010, the State's actuary for PEBB, released an actuarial valuation as of July 1, 2009 (the "2009 PEBB Valuation") for purposes of complying with the OPEB standards (GASB 43 and GASB 45). The valuation was prepared using the Entry Age Normal actuarial cost method, an amortization period of 30 years, and an assumed discount rate of 4.0 percent. The State's unfunded actuarial accrued liability at the valuation date of July 1, 2009 for post-employment benefits provided through PEBB was estimated \$161.7 million. For fiscal year 2011, the ARC for post-employment benefits provided through PEBB, was \$17.4 million, plus interest on the net OPEB obligation of \$1.9 million, less the ARC adjustment of \$2.7 million. Because the State continues to fund the PEBB OPEB on a pay-as-you-go basis, the net OPEB obligation reported at the end of fiscal year 2011 in the State's financial statements is \$55.4 million. The \$55.4 million is the sum of the prior year's ending balance of \$47.7 million and the fiscal year 2011 annual OPEB expense of \$16.6 million, less the pay-as-you-go contribution of approximately \$8.9 million.

DEBT AUTHORITY AND BOND ISSUANCE

Administration

Oregon law authorizes the State Treasurer to coordinate the issuance of all State of Oregon bonds. The Treasurer reviews and approves the terms and conditions of bond sales and issues all bonds for State agencies. By centralizing this authority, the agencies for which bonds are issued are encouraged to plan their offerings well in advance and to work together to obtain the most favorable market reception. In

addition, the uniform approach permits greater control of the State's overall debt position, allowing the Treasurer to address the interests and concerns of the financial community and rating agencies as well as those of the State agencies.

The State Treasurer advises the Governor on the total biennial bonding level for State agency programs in the development of the Governor's recommended budget. The Legislative Assembly authorizes bonds to be issued for each agency's program in the "biennial bonding bill". The Governor's recommended budget includes requests by agencies for bonds to fund their capital project needs, as well as agencies' grant and loan programs. The Legislative Assembly reviews each program request and approves what it determines to be an appropriate level of issuance in the biennial bonding bill.

The State generally issues four types of "long-term" financing obligations: general obligation bonds, appropriation obligations, direct revenue bonds and conduit revenue bonds. The State also may issue full faith and credit short-term borrowings, known as "Tax Anticipation Notes." The Treasurer approves financing agreements, including lease purchase agreements, installment sales agreements and loan agreements to finance real or personal property and approves certificates of participation with respect to the financing agreements. The principal amount of such financing agreements is treated as bonds subject to the biennial bonding bill.

Prior to the issuance of bonds, typically agencies submit reports to the State Treasurer that project future cash flows, the agency's ability to meet future debt service, and the agency's historical performance on payments and delinquencies. Agencies must also provide cash flow projections and other requested information to the State Treasurer on a periodic basis. Agency bond programs may be audited annually with the audit results published as soon after the audit as possible.

Capital Needs and Budget Process

Oregon law requires the Governor's budget to include capital construction needs for a minimum of six years. Prior to the biennial preparation of the Governor's recommended budget, agencies submit their projected capital needs for the upcoming biennium and for the two subsequent biennia. These requests are evaluated and placed in the Governor's recommended budget under one of two categories: capital improvements (less than \$500,000) or major construction and acquisition projects (greater than \$500,000). The capital improvement projects are included in agency operating budget appropriation bills. The major construction and acquisition projects are approved by the Legislative Assembly in the biennial bonding bill.

Authorization

The Oregon Constitution generally prohibits state government from incurring any indebtedness that exceeds \$50,000. Consequently, all general obligation bonds are authorized by an amendment to the Oregon Constitution that has been approved by Oregon voters and that permits bonds to be issued as an exception to the constitutional debt limit. The State's various bond programs are summarized in the text and tables that follow. Table 24 lists the amount of debt that the Legislative Assembly has authorized for State agencies in the current biennium. Table 25 summarizes the various bond programs and provides information on constitutional and statutory debt limits and remaining authority for each active bond program.

General Obligation Bonds

The amount of general obligation bonds that may be issued is usually expressed in the Constitution as a percentage of the statewide property value. The general obligation bond programs are also subject to legislative direction. The Legislative Assembly may place limits on general obligation bond programs that are more restrictive than those approved by the voters.

The State's general obligation debt is secured by a pledge of the full faith and credit and statutory taxing power of the State of Oregon. In addition to any revenues from the program for which the bonds are issued, general obligation bonds may be paid from any undedicated and unrestricted moneys of the State. A property tax, where authorized by the Oregon Constitution, may also be levied to pay some general obligation bonds, although the State has not levied such a tax to pay any bonds in many years.

Currently, there are 17 constitutionally authorized general obligation bond programs. Although each of these programs may draw on the State's General Fund or other taxing authority, many of the programs are fully self-supporting from program or other revenue streams. See Tables 24 and 25 for more information about applicable constitutional and statutory debt limits and remaining authority for each active general obligation bond program. See Table 26 for a summary of general obligation debt outstanding for the State. See Table 27 for the State of Oregon Aggregate General Obligation Debt Service.

The following active general obligation bond programs are primarily supported by the State's General Fund: Higher Education Facilities and Community College Bonds, Pollution Control Bonds, Alternate Energy Bonds, Oregon Opportunity Bonds, Seismic Rehabilitation Bonds for Public Education and Emergency Services Buildings, and a portion of the Pension Obligation Bonds and State Property Bonds.

The following active general obligation bond programs are either partially (as identified in Table 25) or fully self-supporting: Veterans' Welfare Bonds, Higher Education Facilities Bonds, Pollution Control Bonds, Water Resources Bonds, Elderly and Disabled Housing Bonds, Alternate Energy Bonds and a portion of the Pension Obligation Bonds and State Property Bonds.

In addition to the active general obligation bond programs described above, the Oregon Constitution authorizes the State Treasurer to pledge the full faith and credit of the State to guarantee the general obligation bonds of Oregon's common or union high school districts, education service districts or community college districts. The State guarantees outstanding school district bonds of approximately \$3.2 billion under this program and has not issued any bonds under this authorization. The Oregon Constitution also authorizes the State to incur indebtedness to provide funds to school districts to finance capital costs of the district.

Tax Anticipation Notes

ORS 293.173 authorizes a short-term, full faith and credit, borrowing program for the State through the issuance of Tax Anticipation Notes (TANs). The State may borrow and issue notes in anticipation of the collection of State taxes and revenues to be received during a biennium. The notes typically mature within 13 months. They are not considered debt within the meaning of any Constitutional prohibition because they mature and are repaid within a biennium. If the State General Fund or other available revenues are insufficient to pay the TANs, the State Treasurer may use internal borrowing to make any required payment.

Appropriation Credits

The State also issues appropriation credits that are special limited obligations of the State payable solely from funds appropriated or otherwise made available by the Legislative Assembly. The obligation of the State to provide appropriated moneys and to pay those borrowings is subject to future appropriation by the Legislative Assembly for the fiscal period in which payments are due. See Tables 24 and 25 for more information on the statutory debt limits and outstanding amount of special limited obligations of the State. The following appropriation credits are authorized under Oregon Law:

Oregon Appropriation Bonds. After an approximately \$2-billion decline in revenues during the

2001-2003 biennium, the Legislative Assembly authorized the issuance of Oregon Appropriation Bonds (Oregon Laws 2003, chapter 11) to pay for education, human services and other expenditures and to provide a beginning General Fund balance for the next biennium. The obligations are appropriation credits and payment is subject to an appropriation by the Legislative Assembly in each biennium. The State does not have current authority to issue additional Oregon Appropriation Bonds.

Certificates of Participation. Under Oregon law (ORS 283.085 to 283.092), the State is authorized to enter into financing agreements to finance real and personal property projects for State agencies using certificates of participation. Each certificate represents an interest in and right to receive a portion of loan payments made by the State to a trustee for the certificate holders. The State's obligation to make the loan payments is subject to appropriation by the Legislative Assembly of the payment amounts each biennium. In some cases, the State's repayment obligation is also secured by a pledge of certain projects financed by the certificates as collateral. Following voter approval of an amendment to the Oregon Constitution in 2010 that authorizes the State to issue general obligation bonds to finance real and personal property projects under Article XI-Q of the Oregon Constitution, the State expects to use Certificate of Participation authority on a more limited basis.

Direct Revenue Bonds

State revenue bond programs operate under statutory authority from the Legislative Assembly. Each program is fully self-supporting, and has no general obligation backing from the State. The Legislative Assembly, however, could provide a funding stream if program revenues were insufficient to support debt service payments. The Legislative Assembly normally limits revenue bonds to a specific dollar amount.

The following are active revenue bond programs authorized by the Legislative Assembly: State Highway User Tax Bonds, Lottery Revenue Bonds, Oregon Bond Bank Revenue Bonds, and Single-Family and Multifamily Revenue Bonds. See Tables 24 and 25 for more information about applicable constitutional and/or statutory debt limits and remaining authority for each active State revenue bond program.

Conduit Revenue Bonds

The State has three authorized and active conduit or "pass-through" revenue bond programs consisting of the Oregon Facilities Authority, Industrial and Economic Development Revenue Bonds, and Housing Development Revenue Bonds. The Legislative Assembly has authorized these conduit revenue bond programs, and pursuant to that authority the State is the issuer of the bonds. The bonds are repaid only from revenues generated by the projects financed or from other sources available to a borrower. The State has no financial obligation for these bonds and bondholders have no recourse against the properties, funds or assets of the State. See Tables 24 and 25 for more information about applicable statutory debt limits and remaining authority for each active State conduit revenue bond program.

TABLE 24
STATE OF OREGON
GENERAL OBLIGATION AND REVENUE BOND AND
CERTIFICATES OF PARTICIPATION
2011-13 BIENNIUM ISSUANCE LIMITS
As of March 6, 2012

| State Agency or Authority | Laws | Constitutional / Statutory | Bond Limits General Obligation (\$) |
|---|-------------------|---------------------------------------|---|
| Department of Veterans' Affairs | HB 5005 | Article XI-A | 100,000,000 |
| Oregon University System | HB 5005 | Article XI-F(1) | 166,722,070 |
| Oregon University System | HB 5005 | Article XI-G | 17,608,000 |
| Department of Community Colleges & Workforce Development | HB 5005 | Article XI-G | 24,500,000 |
| Department of Environment Quality | HB 5005 | Article XI-H | 16,740,000 |
| Housing and Community Services Department | HB 5005 | Article XI-I(2) | 50,000,000 |
| Department of Energy | HB 5005 | Article XI-J | 150,000,000 |
| Water Resources Department | HB 5005 | Article XI-I(1) | 15,000,000 |
| Oregon Military Department | HB 5005 | Article XI-M | 7,614,000 |
| Department of Administrative Services | HB 5005/5201-A | Article XI-Q | <u>200,645,000</u> |
| Total General Obligation Bonds | | | 748,829,070 |
| | | | Direct Revenue Bonds |
| Housing and Community Services Department | HB 5005 | ORS 456.661 | 300,000,000 |
| Department of Transportation | | | |
| Highway User Tax | HB 5005 | ORS 367.025 | 663,000,000 |
| Transportation Infrastructure Fund | HB 5005 | ORS 367.030 | 18,360,000 |
| Oregon Business Development Department | HB 5005 | ORS 285B.473 | 100,000,000 |
| Department of Administrative Services Lottery | HB 5005/5201-A | Various | 233,330,000 |
| Department of Energy | HB 5005 | | <u>25,000,000</u> |
| Total Direct Revenue Bonds | | | 1,339,690,000 |
| | | | Pass Through Revenue Bonds |
| Economic & Community Development Department | | | |
| Industrial Development Revenue Bonds | HB 5005 | ORS 285B.344 | 125,000,000 |
| Oregon Facilities Authority | HB 5005 | ORS 289.200 | 550,000,000 |
| Housing and Community Services Department | HB 5005 | ORS 456.692 | <u>125,000,000</u> |
| Total Pass Through Revenue Bonds | | | 800,000,000 |
| | | | Certificates of Participation and Other Financing Agreements |
| Department of Administrative Services | HB 5005/5201-A | ORS 283.020-092 | 12,500,000 |
| Total Financing Agreements or Certificates of Participation (COPs) | | | 12,500,000 |

Source: HB 5005, 76th OREGON LEGISLATIVE ASSEMBLY – 2011 Regular Session, the Oregon Constitution and Oregon Revised Statutes. HB 5201-A, 2012 Annual Session.

TABLE 25
STATE OF OREGON OUTSTANDING LONG-TERM FINANCIAL OBLIGATIONS
AND CONSTITUTIONAL AND STATUTORY PROVISIONS
AS OF June 30, 2012 ¹

| | Constitutional Debt Limit (as % RMV)² | Constitutional Debt Limit(\$)³ | Statutory Debt Limit (\$) | Amount Outstanding (\$) | Constitutional Authorization Remaining (\$)⁴ |
|---|---|--|--------------------------------------|------------------------------------|--|
| General Obligation Bonds | | | | | |
| <i>General Fund Supported</i> | | | | | |
| Higher Ed. Facility (XI-G) ⁵ | 0.7500 | 3,258,219,357 | --- | 392,056,452 | |
| Community College Bonds (XI-G) | | | | 115,090,000 | 2,751,072,905 |
| Pollution Control ⁶ (42%) | 0.5000 | 2,172,146,238 | 109,200,000 | 16,107,000 | |
| Alternate Energy Projects ⁷ (18%) | 0.5000 | 2,172,146,238 | | 43,682,400 | 347,303,923 |
| Oregon Opportunity Bonds ⁸ | 0.5000 | 2,172,146,238 | 203,175,000 | 138,830,000 | |
| Seismic Rehab– Public Education Bldgs. | 0.2000 | 868,858,495 | | 10,815,000 | 858,043,495 |
| Seismic Rehab– Emergency Serv. Bldgs. | 0.2000 | 868,858,495 | | 10,645,000 | 858,043,495 |
| Pension Obligations ⁹ (32%) | 1.0000 | 4,344,292,476 | --- | 634,971,200 | |
| General Purpose General Obligation Bonds | 1.0000 | 4,344,292,476 | | <u>645,165,000</u> | 3,699,127,476 |
| Total General Fund Supported | | | | 2,007,362,052 | |
| <i>Self-Supporting</i> | | | | | |
| Veteran’s Welfare ⁵ | 8.0000 | 34,754,339,804 | --- | 348,590,000 | 34,405,749,804 |
| Higher Ed. Building (XI-F) ⁵ | 0.7500 | 3,258,219,357 | --- | 1,094,241,823 | 2,163,977,533 |
| Pollution Control ⁶ (57%) | 0.5000 | 2,172,146,238 | 260,000,000 | 22,243,000 | 2,011,346,238 |
| Water Resources | 1.5000 | 6,516,438,713 | | | 6,516,438,713 |
| Elderly & Disabled Housing | 0.5000 | 2,172,146,238 | --- | 141,830,000 | 2,030,316,238 |
| Alternate Energy Projects ⁷ (82%) | 0.5000 | 2,172,146,238 | --- | 198,997,600 | 1,582,162,315 |
| Pension Obligations ⁹ (68%) | 1.0000 | 4,344,292,476 | --- | <u>1,349,313,800</u> | |
| Total Self-Supporting | | | | 3,155,216,223 | |
| Total General Obligation Bonds | | | | <u>5,162,578,275</u> | |
| Appropriation Credits | | | | | |
| Certificates of Participation - GF ¹⁰ (85%) | --- | --- | --- | 893,039,750 | |
| Certificates of Participation – Non-GF (15%) | | | | 157,595,250 | |
| Oregon Appropriation Bonds | --- | --- | 431,560,000 | <u>98,095,000</u> | |
| Total Appropriation Credits | | | | 1,148,730,000 | |
| Direct Revenue Bonds | | | | | |
| Lottery Revenue Program(s) | --- | --- | --- | 1,129,055,000 | |
| Transportation Infrastructure Bank | --- | --- | 200,000,000 | 0 | 200,000,000 |
| Highway User Tax | --- | --- | 3,240,000,000 | 2,142,990,000 | |
| Single & Multi-Family Housing | --- | --- | 2,500,000,000 | 1,235,985,000 | 1,264,015,000 |
| Oregon Business Development Dept. | --- | --- | --- | <u>116,555,000</u> | |
| Total Direct Revenue Bonds | | | | 4,624,585,000 | |
| Conduit Revenue Bonds | | | | | |
| Industrial Development – OBDD | --- | --- | --- | 466,564,210 | |
| Oregon Facilities Authority | --- | --- | --- | 1,636,369,753 | |
| Multi-family Housing Programs | --- | --- | --- | <u>190,968,871</u> | |
| Total Conduit Revenue Bonds | | | | 2,293,902,833 | |

Source: Debt Management Division, Office of the Oregon State Treasurer.

- (1) Excludes the impact, if any, of the issuance of obligations offered by this Official Statement. Does not include: Bond or Tax Anticipation Notes issued for less than 13 months, refunded and defeased bonds.
- (2) Percentages listed are of Real Market Value (RMV) of all taxable real property in the State.
- (3) Based on the January 1, 2011 Real Market Value (RMV) of \$434,429,247,553. Authorizations may not include inactive programs.
- (4) For those active debt issuing programs whose remaining debt authorization is determined by current outstanding debt. The Constitutional authorization remaining is depicted in the Self-Supporting section for programs with General Fund (“GF”) and Self-Supporting bond portions. It is calculated by subtracting the sum of the GF and Self-Supporting bonds outstanding from the Constitutional debt limit.
- (5) Outstanding Department of Veterans’ Affairs and State Board of Higher Education general obligation debt reflect the proceeds amount of original issue discount and deferred interest bonds.
- (6) The amount of GF debt service support varies depending on a variety of factors such as which bonds are coming due. In this Table Pollution Control Debt is reported at 42% GF supported and 58% self-supporting; calculated by the ratio of remaining debt service times outstanding amount.
- (7) The amount of GF support varies depending on the amortization and budgeted allocation of each bond. Alternate Energy debt is reported at 18% GF supported and 82% self-supporting; calculated by the ratio of remaining debt service times outstanding amount.
- (8) Authorized to finance capital construction at Oregon Health and Science University in an aggregate principal amount that produces net proceeds in an amount that does not exceed \$200 million.
- (9) Approved by the voters September 16, 2003. 32% is assumed to be paid from the GF, and 68% is assumed to be paid from Non-GF sources; calculated by the ratio of remaining debt service times outstanding amount.
- (10) The amount of GF support varies depending on the amortization and budgeted allocation of each obligation. COP obligations are reported at 85% GF supported and 15% self-supporting.

TABLE 26
STATE OF OREGON
GENERAL OBLIGATION DEBT OUTSTANDING SUMMARY
(FISCAL YEAR, AS OF JUNE 30, 2012)

| | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| Gross General Obligation Debt ¹ | \$4,520,412,674 | \$4,620,536,873 | \$4,797,381,780 | \$5,020,564,093 | \$5,162,578,275 |
| Revenue Supported GO Debt | \$3,260,150,251 | \$3,229,084,387 | \$3,383,126,683 | \$3,316,344,503 | \$3,155,216,223 |
| Net GO Debt | \$1,260,262,423 | \$1,391,452,486 | \$1,414,255,097 | \$1,704,219,590 | \$2,007,362,052 |
| Population ² | 3,784,600 | 3,815,800 | 3,837,300 | 3,856,300 | 3,887,000 |
| Gross Debt per Capita | \$1,194 | \$1,211 | \$1,250 | \$1,302 | \$1,328 |
| Net Debt per Capita | \$333 | \$365 | \$369 | \$442 | \$516 |
| Real Market Value (RMV) ³ | \$501,152,650,155 | \$525,356,272,908 | \$498,657,322,131 | \$458,518,867,537 | \$434,429,247,553 |
| Gross Debt as Percent of RMV | 0.90% | 0.88% | 0.96% | 1.09% | 1.19% |
| Net Debt as Percent of RMV | 0.25% | 0.26% | 0.28% | 0.37% | 0.46% |
| Total Personal Income ⁴ | \$136,300,000,000 | \$135,100,000,000 | \$139,400,000,000 | \$146,800,000,000 | \$151,600,000,000 |
| Revenue Supported GO Debt as Percent of Total Personal Income | 2.39% | 2.39% | 2.43% | 2.26% | 2.08% |
| Net GO Debt as Percent of Total Personal Income | 0.92% | 1.03% | 1.01% | 1.16% | 1.32% |

Compiled by: Office of the Oregon State Treasurer, Debt Management Division.

Source: Oregon Department of Administrative Services, Office of Economic Analysis, June 2012 State Economic & Revenue Forecast, Tables A.1 Annual Forecast for Personal Income estimates & Table C.3 for Population estimates.

- (1) Excludes the impact of the issuance (if any) of the obligations offered by this Official Statement. Does not include notes issued for less than 13 months or refunded and defeased bonds.
- (2) Population figures are as of July 1 each year.
- (3) Based on true cash value of statewide property as of January 1, of the prior year.
- (4) Total personal income includes all classes of income.

TABLE 27
STATE OF OREGON
AGGREGATE GENERAL OBLIGATION DEBT SERVICE¹
(FISCAL YEAR, AS OF JUNE 30, 2012)

| <u>Year</u> | <u>Principal(\$)</u> | <u>Interest(\$)²</u> | <u>Total (\$)</u> |
|--------------|---------------------------|---------------------------------|---------------------------|
| 2012-2013 | \$164,492,360.25 | \$271,039,045.07 | \$435,531,405.32 |
| 2013-2014 | 184,044,060.00 | 263,921,483.43 | 447,965,543.43 |
| 2014-2015 | 200,146,440.30 | 253,714,102.04 | 453,860,542.34 |
| 2015-2016 | 212,771,434.30 | 245,512,573.05 | 458,284,007.35 |
| 2016-2017 | 222,385,162.15 | 236,798,539.16 | 459,183,701.31 |
| 2017-2018 | 233,252,239.65 | 223,316,704.56 | 456,568,944.21 |
| 2018-2019 | 252,888,074.25 | 208,059,915.31 | 460,947,989.56 |
| 2019-2020 | 314,209,965.75 | 194,726,404.20 | 508,936,369.95 |
| 2020-2021 | 288,023,352.10 | 176,851,369.36 | 464,874,721.46 |
| 2021-2022 | 288,085,186.50 | 160,792,415.35 | 448,877,601.85 |
| 2022-2023 | 306,120,000.00 | 143,672,942.15 | 449,792,942.15 |
| 2023-2024 | 314,400,000.00 | 126,885,313.99 | 441,285,313.99 |
| 2024-2025 | 330,665,000.00 | 109,344,872.47 | 440,009,872.47 |
| 2025-2026 | 357,640,000.00 | 90,764,932.17 | 448,404,932.17 |
| 2026-2027 | 374,430,000.00 | 70,666,814.72 | 445,096,814.72 |
| 2027-2028 | 109,345,000.00 | 49,713,726.80 | 159,058,726.80 |
| 2028-2029 | 102,915,000.00 | 44,469,552.80 | 147,384,552.80 |
| 2029-2030 | 100,415,000.00 | 39,614,909.62 | 140,029,909.62 |
| 2030-2031 | 96,315,000.00 | 34,986,318.63 | 131,301,318.63 |
| 2031-2032 | 96,395,000.00 | 30,484,092.98 | 126,879,092.98 |
| 2032-2033 | 85,855,000.00 | 26,269,850.01 | 112,124,850.01 |
| 2033-2034 | 89,970,000.00 | 22,240,317.38 | 112,210,317.38 |
| 2034-2035 | 83,445,000.00 | 18,243,279.43 | 101,688,279.43 |
| 2035-2036 | 83,930,000.00 | 14,320,089.56 | 98,250,089.56 |
| 2036-2037 | 63,370,000.00 | 10,543,279.28 | 73,913,279.28 |
| 2037-2038 | 60,625,000.00 | 7,595,785.90 | 68,220,785.90 |
| 2038-2039 | 58,605,000.00 | 4,782,081.75 | 63,387,081.75 |
| 2039-2040 | 38,075,000.00 | 2,627,090.65 | 40,702,090.65 |
| 2040-2041 | 21,110,000.00 | 1,440,181.75 | 22,550,181.75 |
| 2041-2042 | 17,925,000.00 | 646,216.25 | 18,571,216.25 |
| 2042-2043 | 2,795,000.00 | 243,812.50 | 3,038,812.50 |
| 2043-2044 | 2,910,000.00 | 163,717.50 | 3,073,717.50 |
| 2044-2045 | 2,975,000.00 | 102,433.75 | 3,077,433.75 |
| 2045-2046 | 1,640,000.00 | 40,018.75 | 1,680,018.75 |
| 2046-2047 | 200,000.00 | 17,100.00 | 217,100.00 |
| 2047-2048 | 210,000.00 | 7,481.25 | 217,481.25 |
| Total | \$5,162,578,275.25 | \$3,084,618,763.57 | \$8,247,197,038.82 |

Source: Office of the State Treasurer, Debt Management Division.

- (1) Does not reflect the impact, if any, of the issuance of obligations offered by this Official Statement.
- (2) The interest calculation on variable rate obligations is determined by multiplying the most recent interest rate reset for each obligation times its outstanding principle over the life of the bonds.

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APPENDIX B

**BASIC FINANCIAL STATEMENTS FOR
THE STATE OF OREGON FOR
THE YEAR ENDED JUNE 30, 2011**

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Oregon

Comprehensive Annual Financial Report

For the Fiscal Year Ended June 30, 2011



John Kitzhaber, MD
Governor

Michael Jordan
State Chief Operating Officer
Director, Department of Administrative Services

Joy Sebastian, Acting Administrator
State Controller's Division

Report Prepared by:

Statewide Accounting and Reporting Services
State Controller's Division, Department of Administrative Services

Kathryn Ross, CPA, Manager
Jeanne Bock, CPA
Kathy Dixon, CPA
Barbara Homewood
Lieb Lee
Jane Moreland
Shrikant Vajratkar
Aaron Wallace
Margaret Wert, CPA
Karen Williams

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**COMPREHENSIVE ANNUAL FINANCIAL REPORT
For The Year Ended June 30, 2011**

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Introductory Section



Oregon

Theodore R. Kulongoski, Governor

Department of Administrative Services

State Controller's Division
155 Cottage Street NE, U50
Salem, OR 97301-3969
(503) 378-3156
FAX (503) 378-3514

January 18, 2011

To the Honorable Governor John Kitzhaber, MD, and Citizens of the State of Oregon:

We are pleased to provide you with the Comprehensive Annual Financial Report of the State of Oregon for the fiscal year ended June 30, 2011. This report is published to fulfill the requirement for annual financial statements in Oregon Revised Statute 291.040.

This report consists of management's representations concerning the finances of the State of Oregon (State). Consequently, management assumes full responsibility for the completeness and reliability of all the information presented in this report. To provide a reasonable basis for making these representations, management of the State has established a comprehensive internal control framework. The framework is designed to protect the State's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the State's financial statements in conformity with generally accepted accounting principles (GAAP). Because the cost of internal controls should not outweigh their benefits, the State's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. We believe the information presented is accurate in all material respects.

The Secretary of State Audits Division, the constitutional auditor of public accounts in Oregon, audited the State's financial statements for the fiscal year ended June 30, 2011. The goal of the independent audit was to provide reasonable assurance that the financial statements are free of material misstatement. Based on the audit, the auditors concluded that there was a reasonable basis for rendering an unqualified opinion that the financial statements for fiscal year 2011 are fairly presented in accordance with GAAP. The audit report is the first component in the financial section of this report.

The audit of the financial statements was part of a broader, federally mandated "Single Audit" designed to meet the needs of federal agencies that provide aid to the State. The standards governing single audit engagements require the auditor to report on the State's internal controls and compliance with legal requirements, particularly as they relate to federal awards. This information, also prepared by the Audits Division, will be available in a separately issued report on or about March 31, 2012.

Management's Discussion and Analysis (MD&A) immediately follows the independent auditor's report and provides a narrative introduction, overview, and analysis of the basic financial statements. The MD&A complements this letter of transmittal and should be read in conjunction with it.

Profile of the Government

The State provides services to Oregon's citizens through a wide range of programs including education, human services, public safety, economic and community development, natural resources, transportation, consumer and business services, administrative support, legislative, and judicial programs. Oregon's primary government as reported in the accompanying financial statements consists of approximately 90 state agencies. In addition to the primary government, three entities are reported as discretely presented component units to emphasize that they are legally separate from the State. A more detailed discussion of the reporting entity can be found in Note 1 to the basic financial statements.

Oregon's Legislature adopts a budget on a biennial basis, where the biennium begins July 1 and ends June 30 of each odd-numbered year. This biennial budget serves as the foundation for the State's financial planning and control. Appropriation bills approved through the legislative process include one or more appropriations which may be at the agency, program, or activity level. Accordingly, the legal level of budgetary control is at one of these various levels depending on the Legislature's view of the activity. Legislative authority is required to authorize the transfer of expenditure authority between appropriations. Management can reallocate within an appropriation without legislative approval. The following budgeted appropriated fund types have been established to account for the State's budgetary activities: general funds, federal funds, lottery funds, and other funds. Additional information about the budget process and budgetary monitoring are presented in the notes to the required supplementary information.

Local Economy

Oregon is the least populous of the three west coast states that also include California and Washington. Oregon has almost 2 million of the three states' 23.7 million workers. Oregon's largest metro area is centered in Portland, stretching west to Hillsboro and north across the Columbia River to Vancouver, Washington. The Portland area has the sixth largest number of workers of all metro areas in the three states. One-half of Oregon's jobs are located within the Oregon portion of the Portland metro area.

From late 2003 to mid-2006, Oregon gained jobs at roughly 3 percent per year. Oregon's nonfarm payroll jobs peaked in February 2008, two months after the start of the current national recession, and the State lost 8.5 percent of its jobs before reaching bottom in December 2009. Since that low point, seven of Oregon's 11 major industries have added back jobs lost during the recession for a net gain of 32,300 jobs. The financial activities, transportation, warehousing, and utilities, and wholesale trade sectors are the only private industries that have not added jobs since December 2009. Government was the only major sector to show significant over-the-year job losses in November 2011.

Oregon had the nation's highest or second highest state unemployment rate for 39 of the 40 months from May 2001 to August 2004. The State's population continued to grow despite the high unemployment rate. Rapid job growth from late 2003 to mid-2006 pulled the unemployment rate down to a low of 5 percent in early 2007. In the summer of 2008, the rate began rising rapidly in response to job losses in many industries. It hit a recent peak of 11.6 percent in spring 2009, the second highest in the nation. As of November 2011, it was down to 9.1 percent.

Oregon's major foreign-export-related industries include computers and electronic products, agricultural products, machinery, chemicals, and transportation equipment. The largest foreign consumers of Oregon's products are China, Malaysia, Canada, and Japan. Oregon also ships large values of goods to domestic markets. These shipments include wood, food, nursery products, transportation equipment, machinery, instruments, and plastic and paper products. Oregon also serves both foreign and domestic tourists.

Oregon's annual nonfarm employment level in 2011 should grow about 1.5 percent over 2010's level and is expected to grow another 1.3 percent in 2012, reflecting the modest recovery in jobs following the recession. Employment growth is expected to rise to 2.5 percent in 2012 and remain above 2 percent each year through 2016. The State's job growth mirrors the national trends, although Oregon's job growth is expected to be slightly faster. Job growth over this period is expected to be fastest in construction and professional and business services, as these industries recover from some of the jobs cut during the recession. Professional and business services and health care and social assistance will likely add the most jobs between 2011 and 2016. Overall, population could grow faster than employment in Oregon between 2011 and 2016.

Spending for education reported by the State's governmental funds during fiscal year 2011 was down \$325.7 million, or 7.6 percent, compared to fiscal year 2010, but was 18.9 percent higher than the amount spent on education ten years ago. However, as a percentage of total expenditures, the amount devoted to education was 6.7 percent lower in the current fiscal year than it was in fiscal year 2002. Governmental fund expenditures for administration in fiscal year 2011 were down \$35.2 million, or 8.1 percent, compared to fiscal year 2010. However, the amount spent on administration in the current year was 21.8 percent lower than in fiscal year 2002 and, as a percentage of total expenditures, was 2.2 percent lower. The decrease in expenditures for education and administration as a percentage of total expenditures reflects a shift in the allocation of expenditures to other program areas such as human services and debt service. Governmental fund expenditures related to debt service, for example, have increased as the State expands its use of low-

cost capital financing. Debt service expenditures in fiscal year 2011 were more than four times higher than the amount spent on debt service in fiscal year 2002 and, as a percentage of total expenditures, were 2.6 percent higher than ten years ago.

During this same ten-year period, tax revenues, while increasing in amount overall, decreased 8.3 percent as a percentage of total governmental fund revenues. The reason for this decline is the relative increase in governmental fund expenditures for federally supported programs (e.g., human services) versus governmental activities funded by taxes. As a percentage of total revenues, federal revenues were 10 percent higher than they were ten years ago, evidence of the State's increased participation in federal assistance programs.

Prolonged Recession Impacts Oregon's Budget

The legislatively adopted budget for the State of Oregon for the 2011-13 biennium is \$57.8 billion total funds, a decrease of \$4.4 billion, or 7.1 percent, from the 2009-11 legislatively approved budget of \$62.2 billion. Most of the decline is the result of decreases in federal funding, which dropped by \$3.3 billion, or 18.6 percent, between the two biennia. (Due to the one-time economic stimulus provided by the U.S. Congress during the 2009-11 biennium, the State's federally funded expenditures jumped from \$10.1 billion in the 2007-09 biennium to over \$17.7 billion in 2009-11.) The decline in the 2011-13 total funds adopted budget is the first biennial decline since the 1981-83 biennium.

The Oregon Legislature dealt with declining revenues throughout the 2009-11 biennium. From the time the 2009-11 budget was passed in June 2009 until release of the March 2011 economic and revenue forecast, General Fund revenues decreased by \$1.1 billion. Most of the revenue reductions, including another decline of \$15.7 million projected by the May 2011 forecast had been managed through a mixture of budget reductions and fund shifts, transfers to the General Fund, federal stimulus dollars, and utilization of emergency fund balances.

Following the release of the May 2011 forecast, final adjustments were made to the 2011-13 biennium budget. Combined General Fund and lottery funds expenditures for 2011-13 total \$14.6 billion, up \$1 billion from the legislatively approved budget for the 2009-11 biennium, an increase of 7.5 percent. General Fund appropriations increased by \$1 billion, or 8.7 percent, over the 2009-11 approved level, while the net lottery funds expenditure limitation decreased \$66 million, or 5.9 percent. Budget assumptions included a cap on personal services growth, elimination of the standard inflation factor, continuation of the allotment reduction cuts instituted during the 2009-11 biennium, and an additional 6.5 percent reduction in expenditures for services and supplies. Nonetheless, the General Fund and lottery funds budget is \$3.2 billion, or 18.1 percent, below the calculated 2011-13 "current service level" budget – the amount needed to continue all 2009-11 existing programs, services, and revenue sources for the next two budget years.

In February 2011, the State Debt Policy Advisory Commission updated its recommended capacity limits for the General Fund and lottery funds debt based upon the updated revenue forecast. At the time, debt service requirements already exceeded the State's target of 5 percent of revenues. Therefore, the Commission recommended that the Legislature and Governor refrain from using new General Fund supported debt for the 2011-13 biennium. To provide some capacity for 2011-13, the Legislature took action early in 2011 to remove the bonding authorization for approximately \$200 million in projects that had been approved for the 2009-11 biennium. Another \$52 million of debt authorized for 2009-11 was not issued.

Long-term Financial Planning

The 2011-13 legislatively adopted budget for capital construction is \$1.3 billion. This total includes \$264.6 million of capital construction and deferred maintenance projects for the Oregon University System (OUS). The projects will be funded through a variety of sources, including various categories of bonds, gifts, grants, donations, and other cash balances. No General Fund was appropriated to support OUS capital construction or deferred maintenance expenditures; all support comes from other funds.

The largest General Fund project includes \$62.7 million to continue work on a new facility to replace the current State Hospital which was constructed in 1893. The new 620-bed Salem campus is expected to be completed during fiscal year 2012. An additional \$5 million was approved for further planning and infrastructure development of both mental health and correctional facilities at Junction City.

The 2011-13 transportation budget includes \$600 million in highway revenue bond proceeds for bridge construction authorized under the Oregon Transportation Investment Act enacted by the Legislature in 2003; \$75 million in bond proceeds for the State Radio Replacement Project (formerly known as the Oregon Wireless Interoperability Network Project); and \$478.5 million for highway projects identified in the Legislature's enactment of the Jobs and Transportation Act of 2009.

The Legislature also authorized the sale of \$40 million of lottery revenue bonds for Connect Oregon (a 60 percent reduction from the prior biennium). This sale is in addition to the \$100 million Connect Oregon bond sale authorized in the 2005-07 biennium, the \$100 million Connect Oregon II bond sale in 2007-09, and the \$100 million Connect Oregon III bond sale in 2009-11. Launched to expand the State's investment in key non-highway facilities, Connect Oregon is a multi-modal transportation initiative that includes public transit and air, rail, and marine transportation infrastructure.

The December 2011 economic and revenue forecast projects \$13.8 billion of General Fund gross revenues for the 2011-13 biennium. The projected General Fund ending balance for 2011-13 is \$169.3 million. General Fund resources are forecasted to increase by 13.9 percent in the 2013-15 biennium and 12.1 percent in the 2015-17 biennium.

Relevant Financial Policies

The State currently administers two general reserve accounts, the Oregon Rainy Day Fund and the Education Stability Fund.

Established by the 2007 Legislature, the Oregon Rainy Day Fund is funded from the General Fund's ending balance up to one percent of General Fund appropriations for the prior biennium. The Legislature may deposit additional funds as it did to create the fund, using surplus corporate income tax revenues from the 2005-07 biennium. The Rainy Day Fund also earns interest on the moneys in the fund. Fund balance is capped at 7.5 percent of General Fund revenues in the prior biennium.

Amounts in the Rainy Day Fund may be spent only if approved by three-fifths of both chambers of the Legislature and if one of three specific economic triggers occurs. Withdrawals are capped at two-thirds of the balance as of the beginning of the biennium in question. During the 2009 legislative session, two bills were passed that affected the Rainy Day Fund. The first bill transferred \$225 million to the General Fund for the 2009-11 biennium. The second bill directed revenue collected from corporate income and excise tax rates above 6.6 percent to be deposited in the Rainy Day Fund beginning with the 2013-15 biennium. During the 2010 special session, the Legislature approved an additional \$10 million transfer to the General Fund. The Rainy Day Fund ended the 2009-11 biennium with a balance of \$10.4 million.

The Education Stability Fund is the State's second general reserve fund. Its current reserve structure and mechanics are the result of a constitutional amendment in 2002. This fund receives 18 percent of lottery earnings, deposited on a quarterly basis. The fund does not retain interest earnings. The withdrawal triggers are similar to the Rainy Day Fund, except for the two-thirds cap on withdrawals. Fund balance is capped at five percent of General Fund revenues collected in the prior biennium. The Education Stability Fund can also be used if the Governor declares an emergency that is approved by three-fifths of both chambers of the Legislature.

As the result of two bills, one passed by the 2009 regular session and the other by the 2010 special session, a total of \$200 million was transferred from the two reserve funds to the State School Fund for the 2009-11 biennium; the Rainy Day Fund transferred \$115.7 million, with \$84.3 million coming from the Education Stability Fund. An additional transfer of \$96.4 million from the Education Stability Fund to the State School Fund was authorized during the 2011 legislative session in order to balance the 2009-11 budget and to address federal post-secondary education maintenance of effort requirements. The Education Stability Fund ended the 2009-11 biennium with a balance of \$5.1 million.

The 2011 Legislature approved prospective transfers from the Education Stability Fund to the State School Fund: \$100 million in June 2012 as part of the 2011-13 budget and \$82.2 million in May 2013 to be used for several education-related programs in the 2011-13 legislatively adopted budget, including an enhancement of the State School Fund's initial funding level. In addition, the General Fund ending balance for 2009-11 of \$35.2 million was deposited in the Rainy Day Fund at the beginning of the 2011-13 biennium.

After taking all of these transfers into account, the December 2011 economic and revenue forecast projects the Rainy Day Fund will end 2011-13 with a balance of \$45.9 million. The Education Stability Fund is expected to end the biennium with a balance of \$10.7 million, including deposits of \$188 million based on lottery sales and scheduled withdrawals of \$182.7 million.

Major Initiatives

Of the major projects and related efforts included in the 2011-2013 legislatively adopted budget, several are of particular interest due to their overall cost, complexity and risk, importance to public safety and health, and/or cross-biennium timeframes. These projects include:

- Oregon Judicial Department's eCourt Program
- Oregon Department of Transportation's State Radio Project (formerly known as the Oregon Wireless Interoperability Network Project)
- Oregon Health Authority's Health Insurance Exchange Project

The Judicial Department's 2011-13 budget includes \$10.5 million of other funds for development costs related to the eCourt Program that will be financed with bond proceeds and repaid with General Fund debt service, as well as \$2 million of General Fund for program operations and maintenance. The Legislature asked the Judicial Department to remediate 37 key program deficiency areas as a condition of issuance of additional bond funding in the February 2012 regular session.

The Legislature directed the leadership of the State Radio Project to scale back the project to the first goal established in the original 2005 legislation, which was to simply upgrade all existing state radios and infrastructure to assure the continued proper operation of an "integrated statewide radio network." The scaled back project is estimated to cost a total of \$209 million of which \$121.4 million will be expended in the 2011-13 biennium and \$43 million in the 2013-15 biennium.

Due to the complexity of the Health Insurance Exchange Project and the short federal timeframes for completing the work required by a \$48 million federal grant, the Legislature directed the Oregon Health Authority to develop a detailed project plan that identifies the key activities, milestones, and performance measures necessary to ensure the project proceeds according to schedule and budget. Oregon resources dedicated to the project are approximately \$55 million. (A health insurance exchange is a set of state-regulated and standardized health care plans from which individuals may purchase health insurance that is eligible for federal subsidies. All exchanges must be fully certified and operational by January 1, 2014 under federal law.)

Awards and Acknowledgements

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Oregon for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2010. This was the nineteenth consecutive year that the State has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current Comprehensive Annual Financial Report continues to meet the Certificate of Achievement program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

The State Controller's Division takes great pride in the preparation of the Oregon Comprehensive Annual Financial Report. We greatly appreciate the professionalism, commitment, and effort of Statewide Accounting and Reporting Services and the other individuals involved. We also want to thank all state agencies for their continuing support in planning and conducting the financial operations of the State in a professionally responsible manner. Without the participation and cooperation of the agencies' fiscal units, the preparation of this report would not have been possible. In addition, we appreciate the contributions of the Office of

Economic Analysis, the Budget and Management Division, the Office of the State Treasurer, and the staff of the Secretary of State Audits Division.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Joy Sebastian". The signature is enclosed in a thin yellow rectangular border.

Joy Sebastian, Acting Administrator
State Controller's Division
State of Oregon

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Oregon

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2010

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



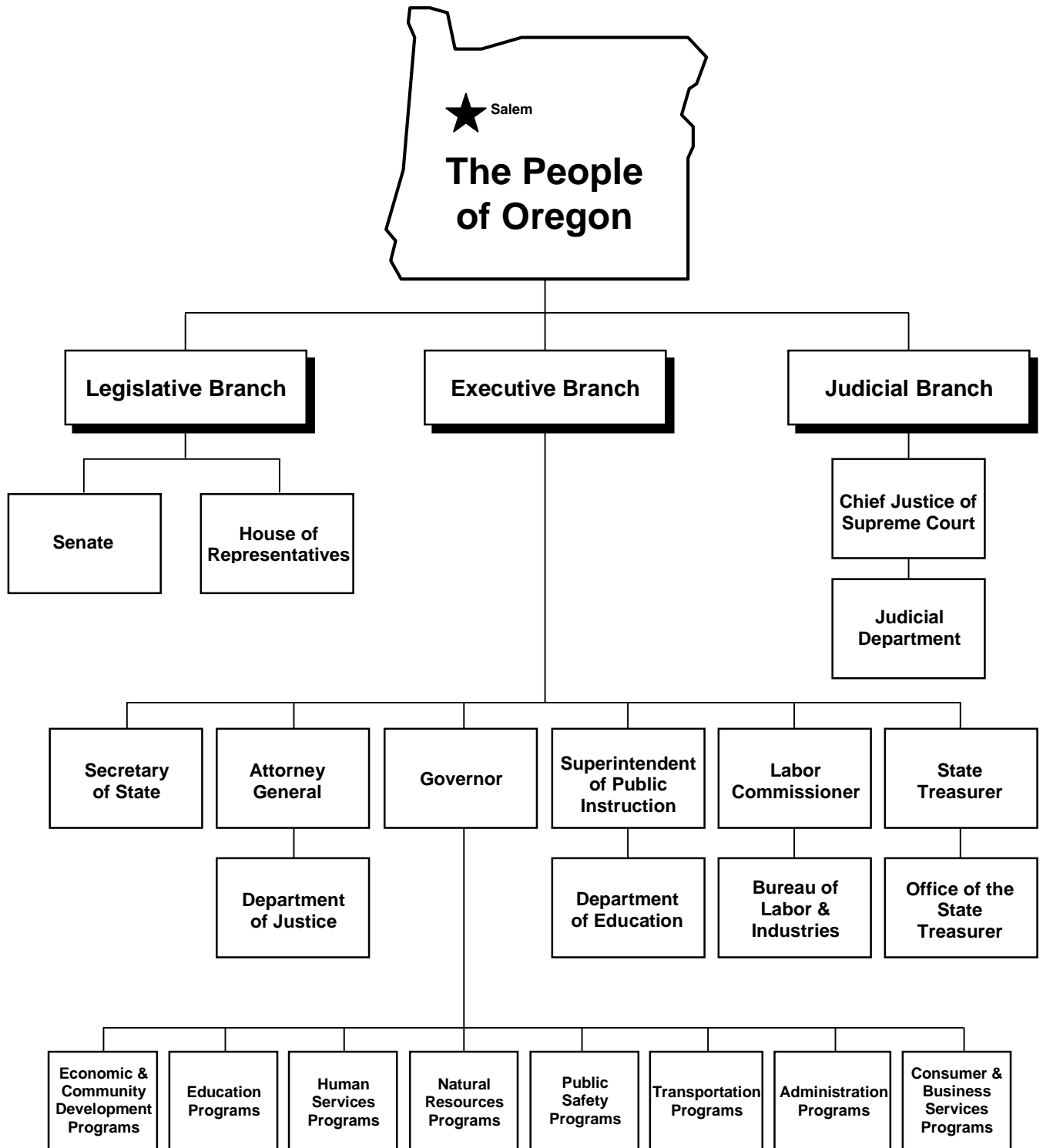
Linda C. Davison

President

Jeffrey R. Emer

Executive Director

STATE OF OREGON ORGANIZATION CHART



Principal State Officials



EXECUTIVE

John A. Kitzhaber, MD, Governor

Kate Brown, Secretary of State

Ted Wheeler, State Treasurer

John R. Kroger, Attorney General

Brad Avakian, Commissioner, Labor and Industries

Susan Castillo, Superintendent of Public Instruction

LEGISLATIVE

Peter Courtney, Senate President

Bruce Hanna, Co-speaker of the House of Representatives

Arnie Roblan, Co-speaker of the House of Representatives

JUDICIAL

Paul J. DeMuniz, Chief Justice of the Supreme Court



Financial Section

Office of the Secretary of State

Kate Brown
Secretary of State

Barry Pack
Deputy Secretary of State



Audits Division

Gary Blackmer
Director

255 Capitol St. NE, Suite 500
Salem, OR 97310

(503) 986-2255
fax (503) 378-6767

The Honorable John Kitzhaber
Governor of Oregon

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Oregon, as of and for the year ended June 30, 2011, which collectively comprise the State of Oregon's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of Oregon's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the discretely presented component units. We also did not audit the financial statements of the University System, the Veterans' Loan Fund, or the Public Employees Retirement System. The University System and Veterans' Loan Fund represent 48 percent, 40 percent, and 30 percent, of the assets, net assets, and revenues, respectively, of the business-type activities. The Public Employees Retirement System represents 85 percent, 90 percent, and 69 percent, respectively, of the assets, net assets, and additions/revenues of the aggregate remaining funds. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the discretely presented component units, the University System, the Veterans' Loan Fund, and the Public Employees Retirement System, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the Oregon University System Foundations, a discretely presented component unit, were not audited in accordance with *Government Auditing Standards*. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. As part of our audit, we performed audit procedures related to the Common School Fund, a major governmental fund. The State Land Board was created to manage lands dedicated to the Common School Fund with the objective of obtaining the greatest benefit for the people of Oregon. The Oregon Constitution designates the Secretary of State as both a member of the State Land Board and Auditor of Public Accounts. To minimize this impairment, auditors who did not have any known personal impairments in relation to the Common School Fund performed the audit. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Oregon, as of June 30, 2011, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, during the year ended June 30, 2011, the State implemented Governmental Accounting Standards Board *Statement No. 54 Fund Balance Reporting and Governmental Fund Type Definitions*.

In accordance with *Government Auditing Standards*, we also issue a separate report on our consideration of the State of Oregon's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis, budgetary comparison information, and the schedule of funding progress, as listed in table of contents, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of Oregon's basic financial statements. The introductory section, combining fund financial statements and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining fund financial statements have been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the report of other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section and statistical section have not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, accordingly, we express no opinion on them.

OREGON AUDITS DIVISION



Kate Brown
Secretary of State

January 17, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Oregon (State) Comprehensive Annual Financial Report presents a discussion and analysis of the financial performance of the State (primary government) during the fiscal year ended June 30, 2011. This discussion and analysis is intended to serve as an introduction to the State's basic financial statements. It is designed to (a) assist the reader in focusing on significant financial issues, (b) provide an overview of the State's financial activities, (c) identify any material changes from the original budget, and (d) highlight individual fund issues.

We encourage readers to consider the information presented in this analysis in conjunction with the transmittal letter beginning on page 2 of this report.

FINANCIAL HIGHLIGHTS

- On June 30, 2011, the assets of the State exceeded its liabilities by \$15.1 billion (net assets). Of this amount, \$2.5 billion were classified as unrestricted net assets, while \$3.3 billion were restricted for specific uses. The remaining \$9.3 billion were invested in capital assets, net of related debt.
- The State's total net assets increased \$1.5 billion compared to the prior year. The net assets for governmental activities increased 9.6 percent, while the net assets for business-type activities increased 13.6 percent.
- As of June 30, 2011, the State's governmental funds reported combined ending fund balances of \$4.9 billion. Of this total, approximately 5.6 percent was considered nonspendable and included amounts related to inventories, prepaid amounts, and permanent fund principal.
- Over 81.1 percent of ending fund balances was classified as restricted and included amounts that were subject to constraints imposed by external parties, such as creditors, grantors, or the laws and regulations of other governments (including the federal government), or imposed by constitutional provisions or enabling legislation. Restricted fund balances totaled \$4 billion.
- The remaining 13.3 percent of ending fund balances was classified as unrestricted and included the fund balance categories designated as committed, assigned and unassigned. Committed fund balances are available for spending only with legislative approval. Assigned and unassigned fund balance may be spent at the government's discretion. Total unrestricted fund balances equaled \$660.1 million. Additional information on the classification of governmental fund balances may be found in Notes 1 and 21 in the notes to the financial statements.
- At fiscal year end, unrestricted fund balance (committed, assigned and unassigned categories) in the General Fund was \$127.4 million.
- Outstanding debt (bonds and certificates of participation) increased by \$161.7 million during fiscal year 2011. On May 18, 2011, the State completed the inaugural sale of bonds issued under the authority of Article XI-Q of the State Constitution. Oregon voters approved a constitutional amendment in November 2010 authorizing the use of general obligation bonds to finance (or refinance) the costs of acquiring, constructing, and equipping real or personal property. Article XI-Q bonds are expected to replace the Certificate of Participation program and result in significant savings in borrowing costs.

OVERVIEW OF THE FINANCIAL STATEMENTS

In addition to this discussion and analysis, the financial section of this annual report contains the *basic financial statements*, *required supplementary information*, and the *combining financial statements* for nonmajor funds, internal service funds, and fiduciary funds. A *statistical section* follows the combining fund statements.

The basic financial statements contain three components: government-wide financial statements, fund financial statements, and notes to the financial statements.

Government-wide Financial Statements

The *government-wide financial statements* are designed to provide a broad overview of the State's finances in a manner similar to a private-sector business. All of the State's activities are reported in the government-wide statements except for activities accounted for in fiduciary funds because resources of those funds are not available to support the State's own programs.

- The *statement of net assets* presents information on all of the State's assets and liabilities, with the difference between the two reported as *net assets*.
- The *statement of activities* presents information showing how the State's net assets changed during the fiscal year. All of the changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Revenues are recognized when earned and expenses are recorded at the time liabilities are incurred. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (e.g., uncollected taxes).

Net assets are one measure of the State's financial health, or financial position. Over time, increases or decreases in the State's net assets may serve as a useful indicator of whether the State's financial position is improving or deteriorating. However, to assess the overall health of the State, the reader needs to consider additional non-financial factors such as changes in Oregon's income tax base and changes in Oregon's economy.

The activities reported in the government-wide financial statements are divided into three categories:

- *Governmental activities*. This category includes the basic services provided by the State to its citizens, such as K-12 schools and community colleges, public assistance programs, public safety, and public transportation. Income taxes and federal grants finance most of these activities. The State's internal service funds, which provide services to other state agencies, are included in governmental activities because these services predominately benefit governmental programs rather than business-type functions.
- *Business-type activities*. The State charges fees to customers to help cover the costs of certain services it provides. For example, the State administers loan programs to provide housing to citizens with low incomes and those who are elderly or disabled. The operation of the State's lottery and the Oregon University System are also reported under business-type activities.
- *Component units*. The State includes three other entities in its report: SAIF Corporation, Oregon Health and Science University, and the Oregon University System Foundations. Although legally separate, these entities are reported as component units either because the State is financially accountable for them or because of the nature and significance of their relationship to the State. Financial information for the component units is reported separately from the financial information of the primary government.

The government-wide financial statements can be found on pages 28–31 of this report.

Fund Financial Statements

The fund financial statements provide more detailed information about the State's most significant funds (not the State as a whole). Funds are accounting mechanisms the State uses to keep track of specific sources of funding and spending for particular purposes. Similar to other state and local governments, the State uses fund accounting to demonstrate and ensure compliance with finance-related legal requirements. Some funds are required by state law (such as the Lottery Operations Fund) or by bond covenants. The State establishes other funds to control and manage money for particular purposes, such as health and social services, or to show that it is properly using certain taxes and grants, such as gas taxes for transportation.

All of the State's funds can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds. Most of the State's basic services are included in governmental funds, which focus on (1) how cash and other financial resources that can be readily converted to cash flow in and out and (2) the balances remaining at year end that are available to spend. Thus, the governmental fund statements provide a detailed short-term view that helps to determine whether there are more or less financial resources that can be spent in the near future to finance the State's programs. Because this information does not encompass the long-term focus of the government-wide statements, additional information has been provided following each governmental fund statement that reconciles the government-wide focus to the governmental fund focus.

The State maintains twenty-one individual governmental funds. Information is presented separately in the governmental fund financial statements for the six major governmental funds, including the General Fund. Data from the other fifteen governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the combining statements presented later in this report. The basic governmental fund financial statements can be found on pages 32–39 of this report.

Proprietary funds. Services for which the State charges customers a fee, similar to a business operation, are generally reported in proprietary funds. Proprietary fund statements, like the government-wide statements, provide both long-term and short-term financial information. The State's enterprise funds (one type of proprietary fund) are the same as the business-type activities reported in the government-wide statements, except that the fund statements provide more detail and additional information, such as cash flows. The State also uses internal service funds (the other type of proprietary fund). The Central Services Fund, for example, is used to report activities that provide services to other agencies.

The proprietary fund financial statements provide separate information for the State's five major proprietary funds. Data from the other nine proprietary funds are combined into a single, aggregated presentation. All internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for each of the nonmajor proprietary funds and for each of the internal service funds is provided in the combining statements presented later in this report. The basic proprietary fund financial statements can be found on pages 40–49 of this report.

Fiduciary funds. Fiduciary funds account for resources held for the benefit of parties outside the government. The State is the trustee, or fiduciary, for its employees' pension plan. It is also responsible for other assets that, due to a trust arrangement, can be used only for the trust beneficiaries. Fiduciary funds are accounted for in a manner similar to proprietary funds. All of the State's fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. These activities have been excluded from the State's government-wide financial statements because the State cannot use these assets to finance its operations.

The basic fiduciary fund financial statements include the private purpose trust fund, the investment trust fund, the agency fund, and aggregated data for the State's pension and other employee benefit trust funds. Individual fund data for each of the pension and other employee benefit trust funds is provided in the combining statements presented later in this report. The basic fiduciary fund financial statements can be found on pages 50–51 of this report.

Discretely Presented Component Units

Combining statements that report the activities of the State's discretely presented component units, SAIF Corporation, Oregon Health and Science University, and the Oregon University System Foundations, can be found on pages 53–55 of this report. In the government-wide statements, the activities of the component units are aggregated into a single column; the combining statements presented later in this report provide greater detail for each component unit.

Notes to the Financial Statements

The basic financial statements also include notes that provide additional information essential to a full understanding of the data presented in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 57–153 of this report.

Other Information

In addition to the basic financial statements and accompanying notes, this report presents a section of *required supplementary information* (RSI), beginning on page 155, which contains budget-to-actual comparison schedules for all of the State’s budgeted appropriated funds as well as accompanying notes. This section also includes a Schedule of Funding Progress and accompanying notes for the Retiree Health Insurance Premium Account, a defined benefit single-employer postemployment healthcare benefit plan, and the Public Employees Benefit Board Plan, an agent multiple-employer postemployment healthcare benefit plan.

The combining financial statements referred to earlier are presented immediately following the required supplementary information beginning on page 167 of this report. These combining statements provide details about the nonmajor governmental funds, nonmajor enterprise funds, and internal service funds, each of which has been aggregated and presented in a single column in the basic financial statements. The combining financial statements also provide details about the pension and other employee benefit trust funds.

A statistical section containing information regarding financial trends, revenue capacity, and debt capacity, as well as demographic, economic, and operating information follows immediately after the combining statements.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net assets. The State’s *combined* net assets at June 30, 2011, were approximately \$15.1 billion as shown in Table 1. Most of this balance was invested in capital assets, with infrastructure being the largest component. The amount invested in capital assets, net of related debt, was \$9.3 billion. Restricted net assets represent resources that are subject to external restrictions on how they may be used. At June 30, 2011, restricted net assets totaled \$3.3 billion. The remaining balance of \$2.5 billion was classified as unrestricted net assets.

Table 1
State of Oregon’s Net Assets
(in millions)

| | Governmental Activities | | Business-type Activities | | Total | |
|--|-------------------------|-------------------|--------------------------|-------------------|--------------------|--------------------|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Current and other assets | \$ 10,180.9 | \$ 9,956.1 | \$ 6,844.1 | \$ 6,862.3 | \$ 17,025.0 | \$ 16,818.4 |
| Capital assets | 11,690.4 | 11,271.1 | 2,841.0 | 2,293.1 | 14,531.4 | 13,564.2 |
| Total assets | 21,871.3 | 21,227.2 | 9,685.1 | 9,155.4 | 31,556.4 | 30,382.6 |
| Long-term liabilities | 8,173.6 | 8,178.0 | 4,156.5 | 4,015.0 | 12,330.1 | 12,193.0 |
| Other liabilities | 2,868.9 | 3,171.7 | 1,283.8 | 1,405.1 | 4,152.7 | 4,576.8 |
| Total liabilities | 11,042.5 | 11,349.7 | 5,440.3 | 5,420.1 | 16,482.8 | 16,769.8 |
| Net assets: | | | | | | |
| Invested in capital assets, net of related debt | 8,107.7 | 8,672.4 | 1,195.6 | 977.2 | 9,303.3 | 9,649.6 |
| Restricted | 2,582.7 | 1,287.4 | 670.7 | 556.6 | 3,253.4 | 1,844.0 |
| Unrestricted | 138.4 | (82.3) | 2,378.4 | 2,201.5 | 2,516.8 | 2,119.2 |
| Total net assets | \$ 10,828.8 | \$ 9,877.5 | \$ 4,244.7 | \$ 3,735.3 | \$ 15,073.5 | \$ 13,612.8 |

Changes in net assets. The State's total net assets increased \$1.5 billion compared to the prior year. The net assets of governmental activities increased 9.6 percent, while the net assets of business-type activities increased 13.6 percent.

Total ending net assets of governmental activities for fiscal year 2011 were \$10.8 billion compared to \$9.9 billion reported in fiscal year 2010. As shown in Table 2, operating grants and contributions were up \$633.7 million, reflecting the increase in federal revenues received for health and social service programs. Both personal and corporate income tax revenues were significantly higher in fiscal year 2011 due in part to two bills voters approved in January 2010. The first bill increased the State's corporate income tax rate and established a new corporate minimum tax. The second bill increased the State's personal income tax rate on high income filers and phased out the subtraction for federal taxes. Strong growth in investment income in 2010, as well as enhanced collection efforts, also contributed to the rise in tax revenues. Finally, capital grants and contributions increased \$52.3 million, up 115.2 percent over the prior year. State matching requirements for capital construction projects and the Build America Bond interest subsidy were the two major contributing factors.

Due to recent economic conditions and state budget reductions, spending on education and administration was down in fiscal year 2011. However, the prolonged recession and the State's high unemployment rate increased the need for spending in the area of human services, up \$673.1 million, or 9.8 percent. Transportation expenses were down \$292.5 million due to the capitalization of costs associated with major highway and bridge construction and improvements. Interest expense on long-term debt related to governmental activities increased 17.4 percent, an indication of the State's reliance on low-cost capital financing.

As shown in Table 2, total ending net assets of business-type activities for fiscal year 2011 were \$4.2 billion compared to \$3.7 billion reported in fiscal year 2010. Although federal funding for unemployment benefits (which is reported under operating grants and contributions) decreased year over year, it was more than offset by a reduction in unemployment benefit payments. Together, these two changes reflect Oregon's slowly improving unemployment rate and, in some cases, the expiration of extended benefits.

During fiscal year 2011, it was determined that the Standard Retiree Health Insurance Account, which had previously been reported in a fiduciary fund, should be reported in a proprietary fund. As a consequence, both charges for services and other expenses under business-type activities saw significant, but offsetting, increases. The rise in charges for services also includes supplementary revenues collected by the Employment Department due to a temporary surcharge added to agency assessments.

Table 2
State of Oregon's Changes in Net Assets
(in millions)

| | Governmental Activities | | Business-type Activities | | Total | |
|--|----------------------------|-------------------|-----------------------------|-------------------|-------------------|-------------------|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Revenues: | | | | | | |
| Program revenues: | | | | | | |
| Charges for services | \$ 1,403.7 | \$ 1,309.4 | \$ 4,224.1 | \$ 3,737.3 | \$ 5,627.8 | \$ 5,046.7 |
| Operating grants & contributions | 8,324.8 | 7,691.1 | 1,986.4 | 2,238.2 | 10,311.2 | 9,929.3 |
| Capital grants & contributions | 97.7 | 45.4 | 60.1 | 108.3 | 157.8 | 153.7 |
| General revenues: | | | | | | |
| Personal income taxes | 5,597.8 | 4,958.6 | - | - | 5,597.8 | 4,958.6 |
| Corporate income taxes | 502.9 | 387.6 | - | - | 502.9 | 387.6 |
| Other taxes | 1,924.0 | 1,786.6 | 16.2 | 16.8 | 1,940.2 | 1,803.4 |
| Unrestricted investment earnings | 3.3 | 3.2 | - | - | 3.3 | 3.2 |
| Total revenues | 17,854.2 | 16,181.9 | 6,286.8 | 6,100.6 | 24,141.0 | 22,282.5 |
| Expenses: | | | | | | |
| Education | 3,979.5 | 4,303.1 | - | - | 3,979.5 | 4,303.1 |
| Human services | 7,535.1 | 6,862.0 | - | - | 7,535.1 | 6,862.0 |
| Public safety | 1,180.4 | 1,199.6 | - | - | 1,180.4 | 1,199.6 |
| Economic & community development | 480.2 | 455.5 | - | - | 480.2 | 455.5 |
| Natural resources | 629.2 | 593.1 | - | - | 629.2 | 593.1 |
| Transportation | 1,566.2 | 1,858.7 | - | - | 1,566.2 | 1,858.7 |
| Consumer and business services | 424.5 | 463.5 | - | - | 424.5 | 463.5 |
| Administration | 376.8 | 474.6 | - | - | 376.8 | 474.6 |
| Legislative | 37.8 | 33.0 | - | - | 37.8 | 33.0 |
| Judicial | 313.9 | 308.6 | - | - | 313.9 | 308.6 |
| Interest on long-term debt | 351.7 | 299.5 | - | - | 351.7 | 299.5 |
| Housing and community services | - | - | 78.2 | 84.3 | 78.2 | 84.3 |
| Veterans' loan | - | - | 19.4 | 19.7 | 19.4 | 19.7 |
| Lottery operations | - | - | 510.4 | 518.1 | 510.4 | 518.1 |
| Unemployment compensation | - | - | 2,306.5 | 3,020.4 | 2,306.5 | 3,020.4 |
| University system | - | - | 2,146.9 | 2,003.7 | 2,146.9 | 2,003.7 |
| State hospitals | - | - | 248.0 | 222.3 | 248.0 | 222.3 |
| Liquor control | - | - | 325.4 | 312.9 | 325.4 | 312.9 |
| Other business-type activities | - | - | 269.2 | 89.5 | 269.2 | 89.5 |
| Total expenses | 16,875.3 | 16,851.2 | 5,904.0 | 6,270.9 | 22,779.3 | 23,122.1 |
| Increase (decrease) before contributions, special and extraordinary items, and transfers | 978.9 | (669.3) | 382.8 | (170.3) | 1,361.7 | (839.6) |
| Contributions to permanent funds | - | 0.3 | - | - | - | 0.3 |
| Transfers | (62.9) | 129.0 | 62.9 | (129.0) | - | - |
| Increase (decrease) in net assets | 916.0 | (540.0) | 445.7 | (299.3) | 1,361.7 | (839.3) |
| Net assets – beginning | 9,877.5 | 10,122.0 | 3,735.3 | 3,973.3 | 13,612.8 | 14,095.3 |
| Prior period adjustments | 35.3 | 295.5 | 63.7 | 61.3 | 99.0 | 356.8 |
| Cumulative effect of accounting change | - | - | - | - | - | - |
| Net assets – beginning – as restated | 9,912.8 | 10,417.5 | 3,799.0 | 4,034.6 | 13,711.8 | 14,452.1 |
| Net assets – ending | \$10,828.8 | \$ 9,877.5 | \$ 4,244.7 | \$ 3,735.3 | \$15,073.5 | \$13,612.8 |

Figure 1 below illustrates fiscal year 2011 revenues of the State as a whole, by source. Approximately 42.7 percent of total revenue comes from other entities and governments in the form of operating grants and contributions (e.g., federal revenues). An additional 25.3 percent comes from personal and corporate income taxes and 23.3 percent comes from charges for services provided.

Figure 1
State of Oregon's Revenue by Source
For the Year Ended June 30, 2011

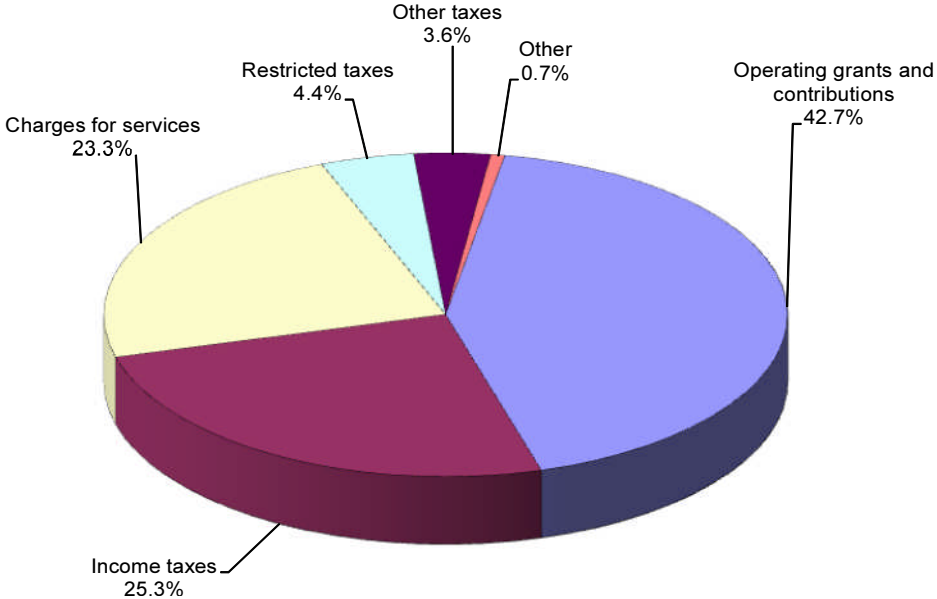
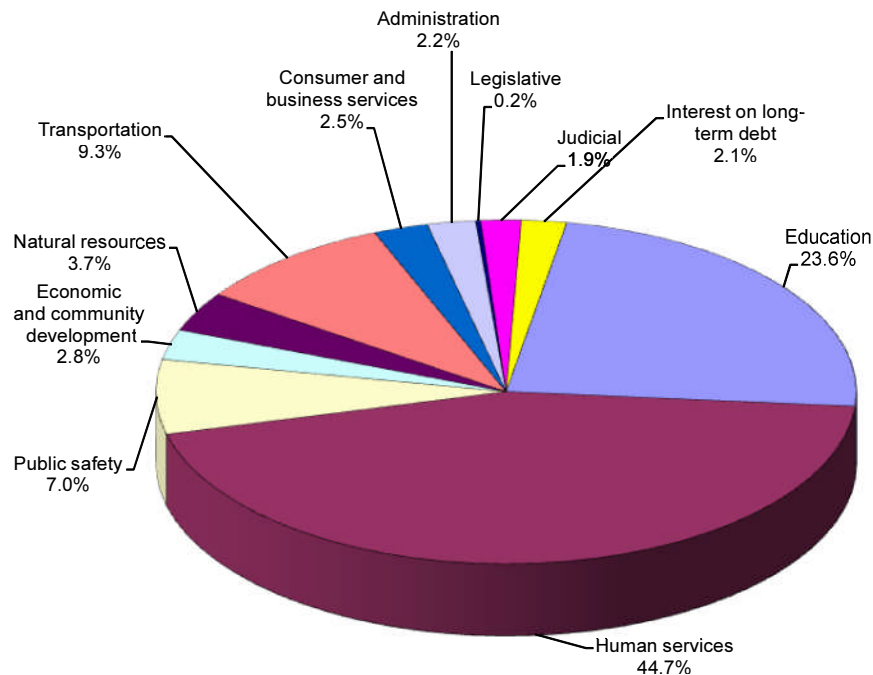


Figure 2 below shows the percentages of total governmental activity expenses for each function of the State. The largest area of expenses is human services provided for Oregon's citizens in need of assistance at 44.7 percent, with elementary and secondary education the second largest at 23.6 percent of total governmental activity expenses.

Figure 2
State of Oregon's Governmental Expenses by Function
For the Year Ended June 30, 2011



FINANCIAL ANALYSIS OF THE STATE'S FUNDS

As noted earlier, the State of Oregon uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the State's governmental funds is to provide information on near-term inflows, outflows, and balances of *spendable* financial resources. In governmental funds, such information may serve as a useful measure of a government's net resources available for spending. At the end of fiscal year 2011, the State's governmental funds reported combined ending fund balances of \$4.9 billion, up \$424.6 million over the prior year. Additional information concerning governmental funds and the effects of Governmental Accounting Standards Board Statement No. 54 may be found in Notes 1 and 21 in the notes to the financial statements.

Nonspendable balances of \$275.5 million, or 5.6 percent, included amounts that were either not in spendable form or were legally or contractually required to be maintained intact, while restricted fund balances of \$4 billion, or 81.1 percent, were restricted for specific purposes. These restrictions included, for example, vehicle-related taxes that must be used for transportation purposes; federal funding that must be spent in accordance with the underlying grants; and lottery revenues restricted by the Oregon Constitution for job

creation, economic development, financing public education, and restoring and protecting Oregon's parks and beaches.

Committed fund balances of \$514 million comprised 10.4 percent of total fund balances. This category represents amounts committed to specific purposes, such as residential assistance and community protection programs, as the result of constraints imposed by legislation. These amounts may not be used for other purposes unless the legislation is modified or rescinded by passing additional legislation. The assigned fund balance category of \$37 million represents amounts constrained by the State's intent to be used for specific purposes. Legislative authority is not required to create or modify an assignment. The remaining unassigned balance of \$109.1 million in the General Fund had not been restricted, committed, or assigned to a specific purpose.

In the General Fund, which is the operating fund of the State, total ending fund balance for fiscal year 2011 was up \$751.5 million, or 148.1 percent, from the prior year. Several factors contributed to this large increase. As explained in Note 1, due to the implementation of GASB Statement No. 54, certain activities that were previously reported in special revenue funds are now reported in the General Fund. This shift resulted in a \$264.5 million restatement of beginning fund balance. In addition, personal income tax revenues increased \$591.1 million over the prior year, or 11.9 percent, while corporate income tax revenues jumped \$101.4 million, or 26.6 percent. These gains were due to earlier legislation that raised the income tax rates on corporations and high income filers, increased collection efforts, and a healthy rise in investment income in 2010.

The Health and Social Services Fund saw a slight decrease in fund balance for fiscal year 2011. Total revenues were up \$339.8 million, or 7 percent; healthcare provider taxes rose 21.7 percent, while federal funding increased 7.3 percent. However, the demand for spending on human services programs and the shift of certain activities to the General Fund more than offset the increase in revenues.

In the Public Transportation Fund, ending fund balance decreased \$260.8 million, or 25.4 percent. Although revenues from the collection of motor fuels, weight-mile, and vehicle registration taxes grew due to increases in the underlying tax rates, expenditures in the fund exceeded revenues by \$116 million. Other factors contributing to the decline in fund balance included a 10.9 percent increase in transfers to other funds and a major decrease in long-term debt issues, which dropped \$483.9 million, or 83.4 percent, compared to the prior year.

Ending fund balance in the Common School Fund was up 28 percent for fiscal year 2011. Two factors played a major role. First, strong financial asset performance resulted in investment income of \$207.5 million, a 72.8 percent increase over the prior year. Secondly, the fund recognized revenue related to unclaimed property of \$50.8 million, which represented an increase of 270.6 percent over the \$13.7 million reported in fiscal year 2010.

Due to the implementation of GASB Statement No. 54, the Oregon Rainy Day Fund is now reported as part of the General Fund. Its beginning fund balance was \$125.6 million. However, after taking into account investment income of \$547 thousand and transfers to the State School Fund of \$115.7 million, only \$10.4 million of the General Fund's ending fund balance was attributable to the Oregon Rainy Day Fund.

Proprietary funds. The State's enterprise funds provide the same type of information presented for business-type activities in the government-wide financial statements, but in greater detail.

Housing and Community Services finances home ownership and multi-family units for elderly, disabled, and low to moderate income persons through the issuance of bonds. The Veterans' Loan Program provides home purchase and home improvement loans at favorable interest rates to eligible veterans. For fiscal year 2011, both funds saw minor changes in net assets. The Housing and Community Services Fund reported operating income of \$171 thousand, investment income of \$3.3 million, and transfers to other funds of \$174 million, resulting in an increase in net assets of \$3.2 million, or 1.6 percent. The Veterans' Loan Fund experienced an operating loss of \$4.4 million that was almost entirely offset by investment income of \$4 million. The net result was a small decrease in ending net assets of \$821 thousand.

Net assets in the Lottery Operations Fund decreased \$23.1 million for fiscal year 2011. Overall, net product sales increased \$10.3 million, or 1 percent. This increase was primarily attributable to an increase in Video

LotterySM revenue. Although the national and local economic recession continued to impact consumer spending on entertainment such as lottery games, Video LotterySM revenue increased after two consecutive years of decline. Investment income, however, decreased \$7.7 million due to the combined effects of a decrease in the market value of investments and lower interest earnings on cash balances. The Lottery also transferred \$555.2 million to other funds, an increase of \$9.4 million compared to the prior fiscal year. Of the total amount transferred to other funds, the Economic Development Fund received \$547 million.

For fiscal year 2011, the Unemployment Compensation Fund reported assessments of \$1 billion, an increase of 30 percent. This increase was the result of an administrative decision by the Employment Department to add a temporary surcharge to agency assessments. Although federal revenues declined for the first time in two years, benefit payments to unemployed Oregonians also declined. These two factors reflect Oregon's generally declining unemployment rate and, in some cases, the expiration of extended benefits. As a result of these changes, net assets in the Unemployment Compensation Fund increased \$76.7 million, or 6.5 percent.

The University System Fund saw an 11.5 percent increase in total operating revenues, while operating expenses increased only 7 percent. As a result, the fund's operating loss for fiscal year 2011 was \$364.2 million, an improvement of 10 percent over the prior year's loss. Even with the operating loss, the University System Fund saw an increase in net assets of \$140.6 million due to capital contributions of \$46.6 million and transfers from other funds, including a transfer of \$374.6 million from the General Fund.

As noted earlier, it was determined during fiscal year 2011 that the Standard Retiree Health Insurance Account, which had previously been reported in a fiduciary fund, should be reported in a proprietary fund. Consequently, both charges for services and expenses in the other (nonmajor) proprietary fund increased significantly in fiscal year 2011. The \$164.4 million increase in charges for services was primarily attributable to healthcare insurance premiums collected from retirees under this program. Operating expenses in the form of special payments experienced a similar increase due to the related cost of claims.

Capital contributions in the other (nonmajor) proprietary fund also increased in fiscal year 2011. Capital assets of \$229.5 million were transferred from governmental activities to the State Hospital Fund (a nonmajor proprietary fund reported in the combining proprietary fund statements).

At the end of fiscal year 2011, approximately 56 percent of the total net assets reported by the State's proprietary funds was classified as unrestricted and was available for spending on business-activities. However, restrictions significantly affected the availability of resources in the Housing and Community Services Fund with 95.5 percent of the fund's net assets restricted for debt service. In the University System Fund, 53.6 percent of net assets was invested in capital assets, net of related debt, while 23.9 percent was restricted for education, debt service, capital construction, and for purposes stipulated by donors.

Fiduciary funds. Fiduciary funds account for resources held for the benefit of parties outside the government. Net assets of the Pension and Other Employee Benefit Trust Fund, which accounts for resources held in trust for the payment of retirement, disability, postemployment healthcare, and death benefits to members of the Public Employees Retirement System, increased by \$9.4 billion, or 18.3 percent. The net appreciation in fair value of investments was the primary factor contributing to this increase. Net assets of all fiduciary funds are reported as held in trust for particular purposes.

GENERAL FUND BUDGETARY HIGHLIGHTS

The State budgets on a biennial basis rather than an annual basis. Budgets are prepared on the cash basis utilizing encumbrance accounting. The original budget amounts reported for revenues in the budgetary statements represent original estimates, while budgeted expenditures represent the first complete appropriated budget adopted by the Legislature. The final budget amounts reported for revenues represent revised estimates, while the final budgeted expenditures represent the original appropriated budget modified by legally authorized legislative and executive changes, as well as Emergency Board actions taken during the year. For the 2009-11 biennium, final estimated revenues for the General Fund decreased 9.7 percent compared to the original estimate. The bulk of this \$1.3 billion reduction was a \$1.2 billion decrease in estimated personal income taxes. The General Fund's final budgeted expenditures were also reduced by \$820.3 million, or 6.2 percent.

For fiscal year 2011, actual General Fund revenues and other financing sources exceeded actual expenditures and other financing uses by \$827.8 million, leaving an ending budget balance of \$522.3 million. Actual revenues for the biennium were 98.9 percent of final budgeted revenues, or \$11.7 billion, while actual cash expenditures were 98.8 percent of those budgeted, or \$12.3 billion. The remaining budget is expected to be used during the six-month lapse period from July 1 to December 31, 2011, to pay for obligations incurred prior to July 1, 2011. To manage differences in the timing of cash flows, the State issued \$788 million of tax anticipation notes in July 2011. These notes will be repaid with income tax revenue prior to the end of fiscal year 2012.

DEBT ADMINISTRATION

The State Debt Policy Advisory Commission advises the Governor and the legislative assembly regarding policies and actions that enhance and preserve the State’s credit rating and maintain the future availability of low cost capital financing. As of June 30, 2011, the State’s debt credit ratings, which are an indication of the State’s ability to repay its debt, were AA+ by Fitch, AA+ by Standard & Poor’s, and Aa1 by Moody’s. Standard & Poor’s upgraded the State’s credit rating in March 2011 from AA based on strong financial practices, the balanced budget proposed by the governor, and because of confidence in the state’s ability to cover its pension obligations.

Debt outstanding for the years ended June 30, 2011 and 2010, is summarized in Table 3. The majority of general obligation bonds issued in fiscal year 2011 were Article XI-Q bonds to be used to help finance the new state mental hospital, renovation of the Department of Transportation’s headquarters building, construction projects and improvements to various instructional buildings throughout the Oregon University System, and seismic grants for public schools and public safety buildings. Oregon voters approved a constitutional amendment in November 2010 authorizing the use of general obligation bonds to finance (or refinance) the costs of acquiring, constructing, and equipping real or personal property. The 2011 Legislative Assembly enacted a bill to provide the statutory framework for the Article XI-Q bonds, which are expected to replace Certificates of Participation and result in significant savings in borrowing costs. General obligation bonds were also issued to finance acquisition and construction of new higher education facilities.

During fiscal year 2011, revenue bonds were issued for transportation and economic development projects, residential assistance for low income families, and community college capital construction projects. The majority of new revenue bonds issued for business-type activities in fiscal year 2011 were single-family mortgage and multi-family housing revenue bonds. Additional information on the State’s long-term debt may be found in Note 9 of this report.

**Table 3
State of Oregon’s Outstanding Debt
For the Years Ended June 30, 2011 and 2010
(dollars in millions)**

| | 2011 | 2010 | 2011 Over (Under) 2010 | |
|-------------------------------|--------------------|--------------------|------------------------|-------------|
| | | | Amount | Percent |
| General Obligation Bonds | \$ 5,079.7 | \$ 4,599.3 | \$ 480.4 | 10.4% |
| Revenue Bonds | 4,929.2 | 4,972.0 | (42.8) | -0.9% |
| Certificates of Participation | 1,410.2 | 1,621.8 | (211.6) | -13.0% |
| General Appropriation Bonds | 171.6 | 235.9 | (64.3) | -27.3% |
| Total | \$ 11,590.7 | \$ 11,429.0 | \$ 161.7 | 1.4% |

CAPITAL ASSETS

The State's investment in capital assets for its governmental and business-type activities as of June 30, 2011, was \$14.5 billion (net of accumulated depreciation) as summarized in Table 4. Capital assets include land, buildings, improvements, equipment, construction in progress, highways, tunnels and bridges, and works of art and other nondepreciable assets. The State's investment in capital assets for fiscal year 2011 increased \$967.2 million, or 7.1 percent.

Table 4
State of Oregon's Capital Assets, Net of Depreciation
(in millions)

| | Governmental Activities | | Business-type Activities | | Total | |
|--|-------------------------|--------------------|--------------------------|-------------------|--------------------|--------------------|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Land | \$ 1,778.3 | \$ 1,724.4 | \$ 132.2 | \$ 121.3 | \$ 1,910.5 | \$ 1,845.7 |
| Buildings, property and equipment | 1,800.9 | 1,740.1 | 2,256.2 | 1,711.9 | 4,057.1 | 3,452.0 |
| Construction in progress | 1,469.8 | 2,071.3 | 332.7 | 354.2 | 1,802.5 | 2,425.5 |
| Infrastructure | 6,639.5 | 5,733.6 | 47.4 | 41.3 | 6,686.9 | 5,774.9 |
| Works of art and other nondepreciable assets | 1.9 | 1.7 | 72.5 | 64.4 | 74.4 | 66.1 |
| Total | \$ 11,690.4 | \$ 11,271.1 | \$ 2,841.0 | \$ 2,293.1 | \$ 14,531.4 | \$ 13,564.2 |

Major capital asset events during the fiscal year included the following:

- Commitments of \$1 billion were made for highway and bridge construction.
- The decrease in construction in progress was primarily the result of completion of projects or project phases related to State highways, tunnels, and bridges; the Oregon State Hospital replacement project; and higher education facilities.

Additional information on the State's capital assets may be found in Note 6 of this report.

ECONOMIC FACTORS AND NEXT BIENNIUM'S BUDGET

Oregon's unemployment rate for November 2011 was the lowest rate in three years, 9.1 percent compared to 10.6 percent in November 2010. The U.S. unemployment rate for November 2011 was 8.6 percent. Since reaching a high point of 11.6 percent in May and June 2009, the rate has slowly declined for the past two and a half years. At 9.1 percent in November, Oregon's unemployment rate is at its lowest point since November 2008, when the rate was 8.4 percent. Overall, job growth is up 1.5 percent on the year, which ranks Oregon thirteenth across all states.

Employment in Oregon in both the second and third quarters of calendar year 2011 was essentially flat following a very strong start to 2011. The recent weakness is largely attributable to public sector cuts as the private sector slowly continued to add jobs. Budget shortfalls have caught up with the public sector, with declines in all three government levels, notably local education.

If Europe's banking problems remain primarily a regional issue and do not short circuit the global flow of credit, Oregon's slow expansion can be expected to persist. Being home to a relatively small banking industry and having few direct trade links with Europe, Oregon's economy has relatively little exposure to Europe's troubles. Even so, given Europe's size and the depth of its financial problems, the threat of a renewed global recession is uncomfortably high.

As expected, investment and exports are leading the State's recovery. Consumer spending remains strong and the public sector drag has decreased the past two quarters. Nevertheless, overall employment growth remains slow; governments and housing-related industries are unlikely to add a significant number of workers any time soon. Employment is expected to increase by 0.6 percent in the fourth quarter of 2011 and 1.4

percent in the first quarter of 2012. Job gains will remain subdued in 2012, improving at a pace of 1.3 percent, following gains in 2011 of 1.5 percent.

The December 2011 forecast for General Fund revenues for the 2011-13 biennium is \$13.8 billion. This figure is \$277 million below the amount forecasted at the close of the 2011 legislative session. The projected General Fund ending balance for the 2011-13 biennium is \$169.3 million. The December 2011 revenue forecast also projects increases in General Fund revenues for the next two biennia, up 13.9 percent to \$15.7 billion in 2013-15 and 12.1 percent to \$17.6 billion in 2015-17.



Basic Financial Statements

State of Oregon

Statement of Net Assets
June 30, 2011
(In Thousands)

| | Primary Government | | | Component Units |
|---|------------------------------------|-------------------------------------|-------------------|----------------------------|
| | Governmental Activities | Business-type Activities | Total | |
| ASSETS AND DEFERRED OUTFLOWS | | | | |
| Current Assets: | | | | |
| Cash and Cash Equivalents | \$ 1,419,503 | \$ 2,017,546 | \$ 3,437,049 | \$ 270,140 |
| Cash and Cash Equivalents - Restricted | - | 13,804 | 13,804 | - |
| Investments | 1,170,189 | 17,585 | 1,187,774 | 4,115,525 |
| Investments - Restricted | - | 103,580 | 103,580 | - |
| Securities Lending Collateral | 870,259 | 537,661 | 1,407,920 | 228,043 |
| Accounts and Interest Receivable (net) | 780,932 | 562,404 | 1,343,336 | 608,977 |
| Taxes Receivable (net) | 443,168 | - | 443,168 | - |
| Pledges, Contributions, and Grants Receivable (net) | - | - | - | 235,492 |
| Internal Balances | 154,705 | (154,705) | - | - |
| Due from Component Units | - | 19,600 | 19,600 | - |
| Due from Other Governments | 1 | 14,928 | 14,929 | - |
| Due from Primary Government | - | - | - | 20,064 |
| Inventories | 86,178 | 37,900 | 124,078 | 15,715 |
| Prepaid Items | 163,969 | 25,838 | 189,807 | 58,679 |
| Foreclosed and Deeded Property | - | 12,354 | 12,354 | - |
| Total Current Assets | 5,088,904 | 3,208,495 | 8,297,399 | 5,552,635 |
| Noncurrent Assets: | | | | |
| Cash and Cash Equivalents - Restricted | 1,525,199 | 698,842 | 2,224,041 | - |
| Investments | 98,816 | 124,362 | 223,178 | 516,280 |
| Investments - Restricted | 278,094 | 472,961 | 751,055 | 1,738,813 |
| Custodial Assets | 34,959 | - | 34,959 | - |
| Taxes Receivable (net) | 486,109 | - | 486,109 | - |
| Deferred Charges | 36,131 | 16,516 | 52,647 | 7,508 |
| Interfund Loans | (328) | 328 | - | - |
| Advances to Component Units | - | 46,518 | 46,518 | - |
| Net Contracts, Notes, and Other Receivables | 352,445 | 95,726 | 448,171 | 4,066 |
| Loans Receivable (net) | 601,776 | 2,153,142 | 2,754,918 | - |
| Pledges, Contributions, and Grants Receivable (net) | - | - | - | 71,406 |
| Net Pension Asset | 1,678,700 | - | 1,678,700 | - |
| Capital Assets: | | | | |
| Land | 1,778,293 | 132,230 | 1,910,523 | 69,041 |
| Buildings, Property, and Equipment | 3,146,327 | 3,883,143 | 7,029,470 | 2,196,275 |
| Construction in Progress | 1,469,843 | 332,727 | 1,802,570 | 59,406 |
| Infrastructure | 16,167,440 | 96,237 | 16,263,677 | - |
| Works of Art and Other Nondepreciable Assets | 1,924 | 72,450 | 74,374 | - |
| Less Accumulated Depreciation and Amortization | (10,873,378) | (1,675,793) | (12,549,171) | (1,020,375) |
| Total Noncurrent Assets | 16,782,350 | 6,449,389 | 23,231,739 | 3,642,420 |
| Deferred Outflows | - | 27,218 | 27,218 | 7,776 |
| Total Assets and Deferred Outflows | 21,871,254 | 9,685,102 | 31,556,356 | 9,202,831 |

The notes to the financial statements are an integral part of this statement.

State of Oregon

Statement of Net Assets
June 30, 2011
(In Thousands)

| | Primary Government | | | Component Units |
|---|------------------------------------|-------------------------------------|----------------------|----------------------------|
| | Governmental Activities | Business-type Activities | Total | |
| LIABILITIES | | | | |
| Current Liabilities: | | | | |
| Accounts and Interest Payable | 846,914 | 265,386 | 1,112,300 | 249,695 |
| Obligations Under Securities Lending | 870,259 | 537,661 | 1,407,920 | 228,042 |
| Due to Component Units | 11,596 | 5,606 | 17,202 | - |
| Due to Other Governments | 147,251 | 19,617 | 166,868 | 16,077 |
| Due to Primary Government | - | - | - | 33,431 |
| Unearned Revenue | 35,571 | 126,071 | 161,642 | 207,660 |
| Matured Bonds/COPS and Coupons Payable | - | 2,890 | 2,890 | - |
| Compensated Absences Payable | 109,207 | 52,727 | 161,934 | 55,957 |
| Reserve for Loss and Loss Adjustment Expense | - | - | - | 209,117 |
| Claims and Judgments Payable | 128,543 | 23,492 | 152,035 | 20,253 |
| Lottery Prize Awards Payable | - | 38,530 | 38,530 | - |
| Arbitrage Rebate Payable | 652 | 126 | 778 | - |
| Custodial Liabilities | 269,222 | 26,810 | 296,032 | 8,667 |
| Contracts, Mortgages and Notes Payable | 100,410 | 13,389 | 113,799 | 1,690 |
| Bonds/COPS Payable | 341,910 | 171,223 | 513,133 | 11,441 |
| Obligations Under Capital Lease | 4,439 | 73 | 4,512 | 1,141 |
| Pollution Remediation Obligation | 2,942 | 147 | 3,089 | - |
| Total Current Liabilities | 2,868,916 | 1,283,748 | 4,152,664 | 1,043,171 |
| Noncurrent Liabilities: | | | | |
| Obligations Under Life Income Agreements | - | - | - | 93,698 |
| Compensated Absences Payable | 56,247 | 9,491 | 65,738 | - |
| Reserve for Loss and Loss Adjustment Expense | - | - | - | 2,795,522 |
| Claims and Judgments Payable | 933,585 | - | 933,585 | 35,838 |
| Lottery Prize Awards Payable | - | 102,579 | 102,579 | - |
| Arbitrage Rebate Payable | 850 | 13,422 | 14,272 | - |
| Custodial Liabilities | 3,825 | 11,194 | 15,019 | - |
| Contracts, Mortgages, and Notes Payable | 1,772 | 4,744 | 6,516 | 65,888 |
| Contracts Payable to Component Unit | - | 22,423 | 22,423 | - |
| Bonds/COPS Payable | 7,126,949 | 3,947,013 | 11,073,962 | 687,498 |
| Obligations Under Capital Lease | 5,199 | 542 | 5,741 | 4,664 |
| Advances from Primary Government | - | - | - | 46,518 |
| Pollution Remediation Obligation | 7,944 | - | 7,944 | - |
| Net OPEB Obligation | 37,187 | 17,828 | 55,015 | 6,331 |
| Derivative Instrument Liabilities | - | 27,218 | 27,218 | 7,776 |
| Total Noncurrent Liabilities | 8,173,558 | 4,156,454 | 12,330,012 | 3,743,733 |
| Deferred Inflows | - | 147 | 147 | - |
| Total Liabilities and Deferred Inflows | 11,042,474 | 5,440,349 | 16,482,823 | 4,786,904 |
| NET ASSETS | | | | |
| Invested in Capital Assets, Net of Related Debt | 8,107,685 | 1,195,629 | 9,303,314 | 602,783 |
| Expendable Net Assets Restricted for: | | | | |
| Health and Social Services Programs | 205,304 | - | 205,304 | - |
| Transportation Programs | 307,389 | - | 307,389 | - |
| Natural Resource Programs | 636,049 | - | 636,049 | - |
| Education | 1,044,891 | 167,602 | 1,212,493 | 1,001,662 |
| Community Protection | 101,959 | - | 101,959 | - |
| Consumer Protection | 35,993 | - | 35,993 | - |
| Employment Services | 14,005 | - | 14,005 | - |
| Workers' Compensation | - | - | - | 1,149,611 |
| Residential Assistance | 118,473 | 2,219 | 120,692 | - |
| Debt Service | 7,808 | 383,832 | 391,640 | - |
| Capital Projects | 3,726 | 100,632 | 104,358 | - |
| Other Purposes | 80,100 | - | 80,100 | - |
| Nonexpendable Net Assets Restricted for: | | | | |
| Donor Purposes | - | 16,387 | 16,387 | 706,668 |
| Education | 1,710 | - | 1,710 | 165,488 |
| Residential Assistance | 23,551 | - | 23,551 | - |
| Natural Resource Programs | 1,500 | - | 1,500 | - |
| Workers' Compensation | 250 | - | 250 | - |
| Unrestricted | 138,387 | 2,378,452 | 2,516,839 | 789,715 |
| Total Net Assets | \$ 10,828,780 | \$ 4,244,753 | \$ 15,073,533 | \$ 4,415,927 |

State of Oregon

**Statement of Activities
For the Year Ended June 30, 2011
(In Thousands)**

| | <u>Program Revenues</u> | | | | |
|--------------------------------------|-------------------------|---------------------------------|---|---|--------------------------------------|
| | <u>Expenses</u> | <u>Charges for Services</u> | <u>Operating Grants and Contributions</u> | <u>Capital Grants and Contributions</u> | <u>Net (Expense) Revenue</u> |
| Functions/Programs | | | | | |
| Primary Government: | | | | | |
| Governmental Activities: | | | | | |
| Education | \$ 3,979,440 | \$ 11,853 | \$ 735,470 | \$ 36,733 | \$ (3,195,384) |
| Human Services | 7,535,059 | 289,686 | 5,302,435 | 2,072 | (1,940,866) |
| Public Safety | 1,180,405 | 80,842 | 168,310 | 46,426 | (884,827) |
| Economic and Community Development | 480,196 | 24,574 | 447,655 | - | (7,967) |
| Natural Resources | 629,222 | 285,394 | 466,747 | 178 | 123,097 |
| Transportation | 1,566,210 | 138,383 | 726,240 | 12,273 | (689,314) |
| Consumer and Business Services | 424,534 | 270,467 | 20,521 | - | (133,546) |
| Administration | 376,821 | 115,365 | 455,680 | - | 194,224 |
| Legislative | 37,801 | 1,641 | 14 | - | (36,146) |
| Judicial | 313,886 | 185,523 | 1,769 | - | (126,594) |
| Interest on Long-term Debt | 351,713 | - | - | - | (351,713) |
| Total Governmental Activities | <u>16,875,287</u> | <u>1,403,728</u> | <u>8,324,841</u> | <u>97,682</u> | <u>(7,049,036)</u> |
| Business-type Activities: | | | | | |
| Housing and Community Services | 78,194 | 78,248 | 3,320 | - | 3,374 |
| Veterans' Loan | 19,365 | 14,732 | 4,043 | - | (590) |
| Lottery Operations | 510,401 | 1,038,805 | 3,587 | - | 531,991 |
| Unemployment Compensation | 2,306,502 | 1,022,592 | 1,393,180 | - | 109,270 |
| University System | 2,146,867 | 1,288,143 | 576,546 | 46,562 | (235,616) |
| State Hospitals | 248,072 | 83,241 | - | - | (164,831) |
| Liquor Control | 325,410 | 443,120 | - | - | 117,710 |
| Other Business-type Activities | 269,217 | 255,249 | 5,750 | 13,519 | 5,301 |
| Total Business-type Activities | <u>5,904,028</u> | <u>4,224,130</u> | <u>1,986,426</u> | <u>60,081</u> | <u>366,609</u> |
| Total Primary Government | <u>\$ 22,779,315</u> | <u>\$ 5,627,858</u> | <u>\$ 10,311,267</u> | <u>\$ 157,763</u> | <u>\$ (6,682,427)</u> |
| Component Units: | | | | | |
| SAIF Corporation | \$ 547,327 | \$ 350,183 | \$ 418,707 | \$ - | \$ 221,563 |
| Oregon Health and Science University | 1,914,817 | 1,514,434 | 570,516 | 4,281 | 174,414 |
| Oregon University System Foundations | 196,346 | 23,746 | 344,693 | - | 172,093 |
| Total Component Units | <u>\$ 2,658,490</u> | <u>\$ 1,888,363</u> | <u>\$ 1,333,916</u> | <u>\$ 4,281</u> | <u>\$ 568,070</u> |

The notes to the financial statements are an integral part of this statement.

State of Oregon

Statement of Activities
For the Year Ended June 30, 2011
(In Thousands)

| | Primary Government | | | Component Units |
|---|------------------------------------|--|-----------------------------|----------------------------|
| | Governmental Activities | Business- type Activities | Total | |
| Changes in Net Assets: | | | | |
| Net (Expense) Revenue | \$ (7,049,036) | \$ 366,609 | \$ (6,682,427) | \$ 568,070 |
| General Revenues: | | | | |
| Taxes: | | | | |
| Personal Income Taxes | 5,597,821 | - | 5,597,821 | - |
| Corporate Income Taxes | 502,862 | - | 502,862 | - |
| Tobacco Taxes | 258,453 | - | 258,453 | - |
| Healthcare Provider Taxes | 233,826 | - | 233,826 | - |
| Inheritance Taxes | 80,482 | - | 80,482 | - |
| Public Utilities Taxes | 71,939 | - | 71,939 | - |
| Insurance Premium Taxes | 90,085 | - | 90,085 | - |
| Other Taxes | 119,882 | 16,204 | 136,086 | - |
| Restricted for Transportation Purposes: | | | | |
| Motor Fuels Taxes | 449,462 | - | 449,462 | - |
| Weight Mile Taxes | 240,056 | - | 240,056 | - |
| Vehicle Registration Taxes | 275,344 | - | 275,344 | - |
| Restricted for Workers' Compensation and Workplace Safety Programs: | | | | |
| Workers' Compensation Insurance Taxes | 34,942 | - | 34,942 | - |
| Employer-Employee Taxes | 69,429 | - | 69,429 | - |
| Total Taxes | <u>8,024,583</u> | <u>16,204</u> | <u>8,040,787</u> | <u>-</u> |
| Unrestricted Investment Earnings | 3,306 | - | 3,306 | - |
| Contributions to Permanent Funds | 14 | - | 14 | - |
| Transfers - Internal Activities | (62,910) | 62,910 | - | - |
| Total General Revenues, Contributions, Special Items, Extraordinary Items, and Transfers | <u>7,964,993</u> | <u>79,114</u> | <u>8,044,107</u> | <u>-</u> |
| Change in Net Assets | <u>915,957</u> | <u>445,723</u> | <u>1,361,680</u> | <u>568,070</u> |
| Net Assets - Beginning | 9,877,473 | 3,735,264 | 13,612,737 | 3,847,857 |
| Prior Period Adjustments | 35,350 | 63,766 | 99,116 | - |
| Net Assets - Beginning - As Restated | <u>9,912,823</u> | <u>3,799,030</u> | <u>13,711,853</u> | <u>3,847,857</u> |
| Net Assets - Ending | <u><u>\$ 10,828,780</u></u> | <u><u>\$ 4,244,753</u></u> | <u><u>\$ 15,073,533</u></u> | <u><u>\$ 4,415,927</u></u> |

State of Oregon

**Balance Sheet
Governmental Funds
June 30, 2011
(In Thousands)**

| | General | Health and Social Services | Public Transportation | Environmental Management |
|---|---------------------|-------------------------------|--------------------------|-----------------------------|
| ASSETS | | | | |
| Cash and Cash Equivalents | \$ 102,861 | \$ 477,806 | \$ 636,992 | \$ 354,625 |
| Investments | 4,164 | - | 154,430 | - |
| Custodial Assets | 82 | - | 23,818 | 954 |
| Securities Lending Collateral | 33,764 | 119,346 | 226,359 | 114,191 |
| Accounts and Interest Receivable (net) | 19,056 | 233,131 | 75,450 | 40,891 |
| Taxes Receivable (net) | 841,102 | 13,208 | 73,141 | - |
| Due from Other Funds | 261,901 | 3,156 | 4,706 | 19,812 |
| Due from Other Governments | - | - | - | - |
| Inventories | 26,461 | 1,091 | 26,594 | 27,578 |
| Prepaid Items | 53,426 | 107,722 | 781 | 23 |
| Advances to Other Funds | - | - | - | - |
| Net Contracts, Notes, and Other Receivables | 27,944 | 29,909 | 3,496 | 5,645 |
| Loans Receivable (net) | - | 817 | 29,647 | 415,325 |
| Total Assets | \$ 1,370,761 | \$ 986,186 | \$ 1,255,414 | \$ 979,044 |
| LIABILITIES AND FUND BALANCES | | | | |
| Liabilities: | | | | |
| Accounts and Interest Payable | \$ 272,425 | \$ 52,779 | \$ 124,478 | \$ 24,801 |
| Obligations Under Securities Lending | 33,764 | 119,346 | 226,359 | 114,191 |
| Due to Other Funds | 145,313 | 37,905 | 19,036 | 7,070 |
| Due to Component Units | - | 11,567 | - | 29 |
| Due to Other Governments | 32,372 | - | 78,206 | 14,749 |
| Deferred Revenue | 628,209 | 35,657 | 16,459 | 23,906 |
| Claims and Judgments Payable | 5,176 | - | - | - |
| Custodial Liabilities | 8,671 | 44,140 | 23,863 | 6,398 |
| Contracts, Mortgages, and Notes Payable | - | 95,000 | - | - |
| Advances from Other Funds | 677 | - | - | 300 |
| Total Liabilities | 1,126,607 | 396,394 | 488,401 | 191,444 |
| Fund Balances: | | | | |
| Nonspendable | 79,891 | 108,865 | 27,355 | 28,027 |
| Restricted by: | | | | |
| Federal Laws and Regulations | 290 | 26,407 | 94,561 | 504,899 |
| Oregon Constitution | 10,026 | 142 | 167,640 | 68,066 |
| Enabling Legislation | 21,032 | 252,685 | 79,925 | 83,350 |
| Debt Covenants | 5,534 | 66,887 | 397,532 | 45,890 |
| Donors and Other External Parties | - | 5,044 | - | 276 |
| Committed | 10,400 | 125,722 | - | 49,550 |
| Assigned | 7,864 | 4,040 | - | 7,542 |
| Unassigned | 109,117 | - | - | - |
| Total Fund Balances | 244,154 | 589,792 | 767,013 | 787,600 |
| Total Liabilities and Fund Balances | \$ 1,370,761 | \$ 986,186 | \$ 1,255,414 | \$ 979,044 |

The notes to the financial statements are an integral part of this statement.

State of Oregon

| Common School | Oregon Rainy Day | Other | Total |
|---------------------|---------------------|---------------------|---------------------|
| \$ 79,540 | \$ - | \$ 1,059,539 | \$ 2,711,363 |
| 1,082,628 | - | 245,388 | 1,486,610 |
| 7,810 | - | 2,295 | 34,959 |
| 24,987 | - | 197,835 | 716,482 |
| 45,974 | - | 280,288 | 694,790 |
| - | - | 1,826 | 929,277 |
| 800 | - | 156,742 | 447,117 |
| - | - | 1 | 1 |
| 3 | - | 3,031 | 84,758 |
| 1 | - | 1,778 | 163,731 |
| 300 | - | - | 300 |
| - | - | 285,422 | 352,416 |
| - | - | 155,989 | 601,778 |
| \$ 1,242,043 | \$ - | \$ 2,390,134 | \$ 8,223,582 |
| | | | |
| \$ 75,011 | \$ - | \$ 217,745 | \$ 767,239 |
| 24,987 | - | 197,835 | 716,482 |
| 25,224 | - | 34,106 | 268,654 |
| - | - | - | 11,596 |
| - | - | 21,926 | 147,253 |
| - | - | 295,590 | 999,821 |
| - | - | - | 5,176 |
| 171,532 | - | 10,162 | 264,766 |
| - | - | - | 95,000 |
| - | - | 101 | 1,078 |
| 296,754 | - | 777,465 | 3,277,065 |
| | | | |
| 4 | - | 31,324 | 275,466 |
| - | - | 138,188 | 764,345 |
| 705,735 | - | 375,120 | 1,326,729 |
| 237,232 | - | 308,888 | 983,112 |
| - | - | 409,543 | 925,386 |
| 2,318 | - | 3,717 | 11,355 |
| - | - | 328,325 | 513,997 |
| - | - | 17,564 | 37,010 |
| - | - | - | 109,117 |
| 945,289 | - | 1,612,669 | 4,946,517 |
| \$ 1,242,043 | \$ - | \$ 2,390,134 | \$ 8,223,582 |

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Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets
June 30, 2011
(In Thousands)

Total fund balances of governmental funds \$ 4,946,517

Amounts reported for governmental activities in the Statement of Net Assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. These assets consist of:

| | | |
|---|---------------------|------------|
| Land | 1,768,950 | |
| Buildings, property, and equipment | 2,563,308 | |
| Construction in progress | 1,463,831 | |
| Infrastructure | 16,166,803 | |
| Works of art and historical treasures | 1,757 | |
| Accumulated depreciation and amortization | <u>(10,565,543)</u> | |
| Total capital assets | | 11,399,106 |

The net pension asset resulting from contributions in excess of the annual required contribution in 2004 is not a financial resource and, therefore, is not reported in the funds. (See Note 15) 1,678,700

Some of the State's revenues will be collected after year-end but are not available soon enough to pay the current year liabilities and, therefore, are deferred in the funds. 964,656

Internal service funds are used by management to charge the costs of certain activities to individual funds. The assets and liabilities of the internal service funds are included in the governmental activities in the Statement of Net Assets. 266,196

Unamortized debt issuance costs are reported as deferred charges for governmental activities in the Statement of Net Assets but are reported as expenditures in the funds. 35,401

Some liabilities are not due and payable in the current year and, therefore, are not reported in the funds. Those liabilities consist of:

| | | |
|---|----------------|--------------------|
| Bonds and COPS | (7,336,680) | |
| Accrued interest on bonds and COPS | (51,020) | |
| Claims and judgments | (863,372) | |
| Compensated absences | (154,943) | |
| Obligations under capital lease | (661) | |
| Net OPEB obligation | (35,571) | |
| Arbitrage rebate | (1,481) | |
| Pollution remediation obligation | (10,886) | |
| Contracts, mortgages, and notes payable | <u>(7,182)</u> | |
| Total long-term liabilities | | <u>(8,461,796)</u> |

Net assets of governmental activities **\$ 10,828,780**

State of Oregon

**Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2011
(In Thousands)**

| | General | Health and Social Services | Public Transportation | Environmental Management |
|---|-------------------|-------------------------------|--------------------------|-----------------------------|
| Revenues: | | | | |
| Personal Income Taxes | \$ 5,538,417 | \$ - | \$ - | \$ - |
| Corporate Income Taxes | 482,360 | - | - | - |
| Tobacco Taxes | 69,521 | 202,261 | - | - |
| Healthcare Provider Taxes | - | 233,826 | - | - |
| Inheritance Taxes | 76,480 | - | - | - |
| Public Utilities Taxes | - | - | - | - |
| Insurance Premium Taxes | 42,627 | 47,457 | - | - |
| Motor Fuels Taxes | - | - | 449,291 | - |
| Weight Mile Taxes | - | - | 239,967 | - |
| Vehicle Registration Taxes | - | - | 273,489 | - |
| Employer-Employee Taxes | - | - | - | - |
| Workers' Compensation Insurance Taxes | - | - | - | - |
| Other Taxes | 75,515 | - | 1,549 | 21,786 |
| Licenses and Fees | 59,812 | 84,274 | 82,742 | 121,577 |
| Federal | 194 | 4,133,997 | 787,155 | 185,182 |
| Charges for Services | 16,050 | 143,947 | 44,677 | 28,200 |
| Fines and Forfeitures | 17,251 | 165 | 3,565 | 766 |
| Rents and Royalties | 461 | 29 | 5,174 | 2,555 |
| Investment Income | 3,306 | 2,981 | 14,391 | 15,750 |
| Sales | 1,496 | 3,878 | 3,690 | 76,351 |
| Donations and Grants | 2,262 | 561 | - | 1,212 |
| Contributions to Permanent Funds | - | - | - | - |
| Tobacco Settlement Proceeds | - | 77,426 | - | - |
| Pension Bond Debt Service Assessments | - | - | - | - |
| Unclaimed Property Revenue | - | - | - | - |
| Other | 14,503 | 232,769 | 5,740 | 10,861 |
| Total Revenues | 6,400,255 | 5,163,571 | 1,911,430 | 464,240 |
| Expenditures: | | | | |
| Current: | | | | |
| Education | 2,958,976 | - | - | - |
| Human Services | 1,627,560 | 4,901,134 | - | - |
| Public Safety | 862,259 | - | - | - |
| Economic and Community Development | 20,133 | - | - | - |
| Natural Resources | 78,921 | - | - | 517,998 |
| Transportation | 11,772 | - | 1,932,886 | - |
| Consumer and Business Services | 5,963 | 176,974 | - | - |
| Administration | 203,764 | 14,110 | 92,963 | - |
| Legislative | 32,857 | - | - | - |
| Judicial | 234,585 | 1,355 | - | - |
| Capital Improvements and Capital Construction | - | - | - | - |
| Debt Service: | | | | |
| Principal | 71,915 | - | - | 8 |
| Interest | 52,558 | - | 652 | - |
| Other Debt Service | 1,090 | 492 | 961 | 114 |
| Total Expenditures | 6,162,353 | 5,094,065 | 2,027,462 | 518,120 |
| Excess (Deficiency) of Revenues Over (Under) Expenditures | 237,902 | 69,506 | (116,032) | (53,880) |
| Other Financing Sources (Uses): | | | | |
| Transfers from Other Funds | 1,470,651 | 70,313 | 7,175 | 122,033 |
| Transfers to Other Funds | (1,222,466) | (212,793) | (256,709) | (59,822) |
| Insurance Recoveries | 1,929 | - | 991 | 157 |
| Long-term Debt Issued | - | 68,167 | 96,370 | 5,790 |
| Debt Issuance Premium | - | 7,838 | 8,287 | 155 |
| Refunding Debt Issued | - | - | - | - |
| Leases Incurred | - | - | - | 18 |
| Refunded Debt Payment to Escrow Agent | - | - | - | - |
| Total Other Financing Sources (Uses) | 250,114 | (66,475) | (143,886) | 68,331 |
| Net Change in Fund Balances | 488,016 | 3,031 | (259,918) | 14,451 |
| Fund Balances - Beginning | (507,344) | 606,442 | 1,027,785 | 776,428 |
| Cumulative Effect of Change in Accounting Principle | 264,471 | (28,582) | - | (12,578) |
| Prior Period Adjustments | 2,213 | 8,617 | (1,799) | 3,876 |
| Fund Balances - Beginning - As Restated | (240,660) | 586,477 | 1,025,986 | 767,726 |
| Change in Inventories | (3,202) | 284 | 945 | 5,423 |
| Fund Balances - Ending | \$ 244,154 | \$ 589,792 | \$ 767,013 | \$ 787,600 |

The notes to the financial statements are an integral part of this statement.

State of Oregon

| Common School | Oregon Rainy Day | Other | Total |
|-------------------|---------------------|---------------------|---------------------|
| \$ - | \$ - | \$ - | \$ 5,538,417 |
| - | - | - | 482,360 |
| - | - | - | 271,782 |
| - | - | - | 233,826 |
| - | - | - | 76,480 |
| - | - | 71,939 | 71,939 |
| - | - | - | 90,084 |
| - | - | - | 449,291 |
| - | - | - | 239,967 |
| - | - | - | 273,489 |
| - | - | 69,831 | 69,831 |
| - | - | 34,942 | 34,942 |
| - | - | 21,624 | 120,474 |
| 672 | - | 166,514 | 515,591 |
| - | - | 2,865,193 | 7,971,721 |
| 179 | - | 56,509 | 289,562 |
| 71 | - | 59,231 | 81,049 |
| 3,992 | - | 2,719 | 14,930 |
| 207,543 | - | 26,294 | 270,265 |
| 7,950 | - | 3,813 | 97,178 |
| 5 | - | 53,717 | 57,757 |
| - | - | 14 | 14 |
| - | - | - | 77,426 |
| - | - | 5,608 | 5,608 |
| 50,827 | - | - | 50,827 |
| 247 | - | 78,148 | 342,268 |
| <u>271,486</u> | <u>-</u> | <u>3,516,096</u> | <u>17,727,078</u> |
| - | - | 1,019,447 | 3,978,423 |
| - | - | 1,187,929 | 7,716,623 |
| - | - | 296,342 | 1,158,601 |
| - | - | 463,159 | 483,292 |
| 16,855 | - | 42,852 | 656,626 |
| - | - | 12,064 | 1,956,722 |
| - | - | 280,962 | 463,899 |
| - | - | 89,081 | 399,918 |
| - | - | 3,201 | 36,058 |
| - | - | 81,357 | 317,297 |
| - | - | 127,409 | 127,409 |
| - | - | 228,900 | 300,823 |
| - | - | 301,508 | 354,718 |
| - | - | 2,304 | 4,961 |
| <u>16,855</u> | <u>-</u> | <u>4,136,515</u> | <u>17,955,370</u> |
| 254,631 | - | (620,419) | (228,292) |
| 8,952 | - | 1,134,112 | 2,813,236 |
| (54,562) | - | (800,684) | (2,607,036) |
| - | - | 63 | 3,140 |
| - | - | 209,042 | 379,369 |
| - | - | 30,306 | 46,586 |
| - | - | 112,876 | 112,876 |
| - | - | - | 18 |
| - | - | (129,074) | (129,074) |
| <u>(45,610)</u> | <u>-</u> | <u>556,641</u> | <u>619,115</u> |
| 209,021 | - | (63,778) | 390,823 |
| 738,760 | 125,579 | 1,754,294 | 4,521,944 |
| - | (125,579) | (102,190) | (4,458) |
| <u>(2,492)</u> | <u>-</u> | <u>24,548</u> | <u>34,963</u> |
| 736,268 | - | 1,676,652 | 4,552,449 |
| - | - | (205) | 3,245 |
| <u>\$ 945,289</u> | <u>\$ -</u> | <u>\$ 1,612,669</u> | <u>\$ 4,946,517</u> |

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**Reconciliation of the Governmental Funds Statement of Revenues, Expenditures,
and Changes in Fund Balances to the Statement of Activities
For the Year Ended June 30, 2011
(In Thousands)**

| | |
|--|--------------------------|
| Net change in fund balances of total governmental funds | \$ 390,823 |
| <p>Amounts reported for governmental activities in the Statement of Activities are different because:</p> | |
| <p>Capital outlay is reported as an expenditure in governmental funds. However, in the Statement of Activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current year, these amounts are:</p> | |
| Capital outlay | 931,996 |
| Depreciation expense | <u>(262,628)</u> |
| Excess of capital outlays over depreciation | 669,368 |
| <p>The net effect of sales, transfers, impairments, and donations of capital assets is a decrease to net assets.</p> | |
| | (233,409) |
| <p>Some capital additions were financed through capital leases. In governmental funds, a capital lease arrangement is considered a source of financing. In the Statement of Net Assets, a lease obligation is reported as a liability.</p> | |
| | (18) |
| <p>Bond proceeds provide current financial resources to governmental funds. However, issuing debt increases long-term liabilities in the Statement of Net Assets.</p> | |
| | (538,831) |
| <p>Repayment of long-term debt is reported as an expenditure in governmental funds. However, the repayment reduces long-term liabilities in the Statement of Net Assets.</p> | |
| | 429,897 |
| <p>Governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these items are deferred and amortized in the Statement of Activities.</p> | |
| | 12,650 |
| <p>Some expenses reported in the Statement of Activities do not require the use of current financial resources. Therefore, they are not reported as expenditures in governmental funds.</p> | |
| Accrued interest on long-term debt | (1,744) |
| Claims and judgments payable | 37,219 |
| Compensated absences | (776) |
| Net pension asset | (57,100) |
| Net OPEB obligation | (4,786) |
| Pollution remediation obligation | 3,553 |
| Contracts, mortgages, and notes payable | <u>2,789</u> |
| Total | (20,845) |
| <p>Investment income related to rebatable arbitrage does not provide current financial resources and is not reported as revenue in the governmental funds.</p> | |
| | (12) |
| <p>Some revenues will not be collected for several months after the State's fiscal year ends. Therefore, they are not considered "available" revenues and are deferred in the governmental funds.</p> | |
| | 144,325 |
| <p>The change in inventory is reported as a separate line after the change in fund balances in governmental funds but is included in expenses in the Statement of Activities.</p> | |
| | 3,245 |
| <p>Internal service funds are used by management to charge the costs of certain activities to individual funds. The net expense of the internal service funds is reported within governmental activities.</p> | |
| | <u>58,764</u> |
| Change in net assets of governmental activities | <u>\$ 915,957</u> |

**Balance Sheet
Proprietary Funds
June 30, 2011
(In Thousands)**

| | Business-type Activities - Enterprise Funds | | |
|--|--|---------------------------|-------------------------------|
| | Housing and Community Services | Veterans' Loan | Lottery Operations |
| ASSETS AND DEFERRED OUTFLOWS | | | |
| Current Assets: | | | |
| Cash and Cash Equivalents | \$ 5,874 | \$ 92,655 | \$ 231,543 |
| Cash and Cash Equivalents - Restricted | 8,880 | 3,107 | - |
| Investments | - | 3,541 | 14,044 |
| Investments - Restricted | 98,575 | 5,005 | - |
| Securities Lending Collateral | 18,154 | 67,609 | 121,485 |
| Accounts and Interest Receivable (net) | 9,060 | 1,738 | 15,790 |
| Due from Other Funds | 53 | 66 | - |
| Due from Component Units | - | - | - |
| Due from Other Governments | - | - | - |
| Inventories | - | - | 2,345 |
| Prepaid Items | 2 | 7 | 557 |
| Foreclosed and Deeded Property | 10,784 | 1,570 | - |
| Total Current Assets | 151,382 | 175,298 | 385,764 |
| Noncurrent Assets: | | | |
| Cash and Cash Equivalents - Restricted | 45,264 | 139,489 | - |
| Investments | - | 21,783 | 102,579 |
| Investments - Restricted | 221,595 | 3,269 | - |
| Deferred Charges | 10,526 | 1,937 | - |
| Advances to Other Funds | - | - | - |
| Advances to Component Units | - | - | - |
| Net Contracts, Notes, and Other Receivables | - | 1,961 | 2,946 |
| Loans Receivable (net) | 1,288,880 | 245,582 | - |
| Capital Assets: | | | |
| Land | - | - | - |
| Buildings, Property, and Equipment | 162 | 8,954 | 184,393 |
| Construction in Progress | - | - | - |
| Infrastructure | - | - | - |
| Works of Art and Other Nondepreciable Assets | - | 85 | - |
| Less Accumulated Depreciation and Amortization | (162) | (5,009) | (121,587) |
| Total Noncurrent Assets | 1,566,265 | 418,051 | 168,331 |
| Deferred Outflows | 25,409 | 1,809 | - |
| Total Assets and Deferred Outflows | \$ 1,743,056 | \$ 595,158 | \$ 554,095 |

The notes to the financial statements are an integral part of this statement.

State of Oregon

Business-type Activities - Enterprise Funds

| Business-type Activities - Enterprise Funds | | | | Governmental Activities Internal Service Funds |
|--|------------------------------|---------------------|---------------------|---|
| Unemployment Compensation | University System | Other | Total | |
| \$ 962,325 | \$ 395,755 | \$ 329,394 | \$ 2,017,546 | \$ 128,587 |
| - | 1,688 | 129 | 13,804 | - |
| - | - | - | 17,585 | - |
| - | - | - | 103,580 | - |
| 3,663 | 253,626 | 73,124 | 537,661 | 153,778 |
| 298,557 | 205,322 | 32,306 | 562,773 | 86,142 |
| 87 | 8,099 | 1,237 | 9,542 | 2,307 |
| - | 19,600 | - | 19,600 | - |
| 14,928 | - | - | 14,928 | - |
| - | 7,033 | 28,522 | 37,900 | 1,420 |
| - | 24,412 | 860 | 25,838 | 234 |
| - | - | - | 12,354 | - |
| 1,279,560 | 915,535 | 465,572 | 3,373,111 | 372,468 |
| - | 456,350 | 57,739 | 698,842 | 104,752 |
| - | - | - | 124,362 | - |
| - | 248,097 | - | 472,961 | 60,487 |
| - | - | 4,053 | 16,516 | 730 |
| - | - | 91,571 | 91,571 | 677 |
| - | 46,518 | - | 46,518 | - |
| 33,966 | 56,826 | 27 | 95,726 | 28 |
| - | - | 618,680 | 2,153,142 | - |
| - | 125,248 | 6,982 | 132,230 | 9,343 |
| - | 3,342,878 | 346,756 | 3,883,143 | 583,019 |
| - | 331,076 | 1,651 | 332,727 | 6,012 |
| - | 94,847 | 1,390 | 96,237 | 637 |
| - | 72,325 | 40 | 72,450 | 167 |
| - | (1,493,170) | (55,865) | (1,675,793) | (307,835) |
| 33,966 | 3,280,995 | 1,073,024 | 6,540,632 | 458,017 |
| - | - | - | 27,218 | - |
| \$ 1,313,526 | \$ 4,196,530 | \$ 1,538,596 | \$ 9,940,961 | \$ 830,485 |

(continued on next page)

State of Oregon

**Balance Sheet
Proprietary Funds
June 30, 2011
(In Thousands)**

(continued from previous page)

| | Business-type Activities - Enterprise Funds | | |
|---|--|---------------------------|-------------------------------|
| | Housing and Community Services | Veterans' Loan | Lottery Operations |
| LIABILITIES AND NET ASSETS | | | |
| Current Liabilities: | | | |
| Accounts and Interest Payable | \$ 29,686 | \$ 1,350 | \$ 5,322 |
| Obligations Under Securities Lending | 18,154 | 67,609 | 121,485 |
| Due to Other Funds | 16 | - | 145,612 |
| Due to Other Governments | - | - | - |
| Due to Component Units | - | - | - |
| Unearned Revenue | 1,045 | - | 585 |
| Matured Bonds/COPS and Coupons Payable | - | 1,073 | - |
| Compensated Absences Payable | 162 | 296 | 1,791 |
| Claims and Judgments Payable | - | - | - |
| Lottery Prize Awards Payable | - | - | 38,530 |
| Arbitrage Rebate Payable | - | - | - |
| Custodial Liabilities | - | 1,977 | 135 |
| Contracts, Mortgages, and Notes Payable | - | - | 15 |
| Bonds/COPS Payable | 78,525 | 3,302 | - |
| Obligations under Capital Lease | - | - | - |
| Pollution Remediation Obligation | - | - | - |
| Total Current Liabilities | 127,588 | 75,607 | 313,475 |
| Noncurrent Liabilities: | | | |
| Compensated Absences Payable | 84 | 152 | 923 |
| Claims and Judgments Payable | - | - | - |
| Lottery Prize Awards Payable | - | - | 102,579 |
| Arbitrage Rebate Payable | 102 | 13,171 | - |
| Custodial Liabilities | - | - | - |
| Contracts, Mortgages, and Notes Payable | 1,500 | - | - |
| Contracts Payable to Component Unit | - | - | - |
| Bonds/COPS Payable | 1,378,345 | 371,040 | - |
| Obligations Under Capital Lease | - | - | - |
| Advances from Other Funds | - | - | - |
| Net OPEB Obligation | 67 | 88 | 520 |
| Derivative Instrument Liabilities | 25,409 | 1,809 | - |
| Total Noncurrent Liabilities | 1,405,507 | 386,260 | 104,022 |
| Deferred Inflows | - | - | - |
| Total Liabilities and Deferred Inflows | 1,533,095 | 461,867 | 417,497 |
| Net Assets: | | | |
| Invested in Capital Assets, Net of Related Debt | - | 4,030 | 62,806 |
| Expendable Net Assets Restricted for: | | | |
| Residential Assistance | 2,219 | - | - |
| Education | - | - | - |
| Debt Service | 200,498 | - | - |
| Capital Projects | - | - | - |
| Nonexpendable Net Assets Restricted for: | | | |
| Donor Purposes | - | - | - |
| Unrestricted | 7,244 | 129,261 | 73,792 |
| Total Net Assets | 209,961 | 133,291 | 136,598 |
| Total Liabilities, Deferred Inflows and Net Assets | \$ 1,743,056 | \$ 595,158 | \$ 554,095 |

The notes to the financial statements are an integral part of this statement.

State of Oregon

| Business-type Activities - Enterprise Funds | | | | | Governmental Activities Internal Service Funds |
|--|------------------------------|---------------------|---------------------|-----------|---|
| Unemployment Compensation | University System | Other | Total | | |
| \$ 29,973 | \$ 164,073 | \$ 34,982 | \$ 265,386 | \$ | 28,647 |
| 3,663 | 253,626 | 73,124 | 537,661 | | 153,778 |
| 1,589 | 86 | 22,960 | 170,263 | | 20,420 |
| 19,609 | - | 8 | 19,617 | | - |
| - | 5,606 | - | 5,606 | | - |
| - | 124,148 | 293 | 126,071 | | 406 |
| - | 1,688 | 129 | 2,890 | | - |
| - | 42,895 | 7,583 | 52,727 | | 6,937 |
| - | - | 23,492 | 23,492 | | 29,305 |
| - | - | - | 38,530 | | - |
| - | 126 | - | 126 | | 21 |
| - | 19,665 | 5,033 | 26,810 | | 5,009 |
| - | 13,374 | - | 13,389 | | - |
| - | 58,376 | 31,020 | 171,223 | | 13,899 |
| - | 73 | - | 73 | | 3,782 |
| - | 147 | - | 147 | | - |
| 54,834 | 683,883 | 198,624 | 1,454,011 | | 262,204 |
| - | 4,528 | 3,804 | 9,491 | | 3,574 |
| - | - | - | - | | 164,275 |
| - | - | - | 102,579 | | - |
| - | 149 | - | 13,422 | | - |
| - | 10,830 | 364 | 11,194 | | 3,271 |
| - | 3,244 | - | 4,744 | | - |
| - | 22,423 | - | 22,423 | | - |
| - | 1,811,111 | 386,517 | 3,947,013 | | 118,280 |
| - | 542 | - | 542 | | 5,195 |
| - | 91,144 | 100 | 91,244 | | 226 |
| - | 14,116 | 3,037 | 17,828 | | 1,616 |
| - | - | - | 27,218 | | - |
| - | 1,958,087 | 393,822 | 4,247,698 | | 296,437 |
| - | 147 | - | 147 | | - |
| 54,834 | 2,642,117 | 592,446 | 5,701,856 | | 558,641 |
| - | 833,522 | 295,271 | 1,195,629 | | 150,050 |
| - | - | - | 2,219 | | - |
| - | 167,602 | - | 167,602 | | - |
| - | 87,314 | 96,020 | 383,832 | | - |
| - | 100,632 | - | 100,632 | | - |
| - | 16,387 | - | 16,387 | | - |
| 1,258,692 | 348,956 | 554,859 | 2,372,804 | | 121,794 |
| 1,258,692 | 1,554,413 | 946,150 | 4,239,105 | | 271,844 |
| \$ 1,313,526 | \$ 4,196,530 | \$ 1,538,596 | \$ 9,940,961 | \$ | 830,485 |

Some amounts reported for business-type activities in the statement of net assets are different because certain internal service funds assets and liabilities are included within the business-type activities.

| | |
|--|--------------|
| | 5,648 |
| Net assets of business-type activities | \$ 4,244,753 |

State of Oregon

Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended June 30, 2011
(In Thousands)

| | Business-type Activities - Enterprise Funds | | |
|--|--|---------------------------|-------------------------------|
| | Housing and Community Services | Veterans' Loan | Lottery Operations |
| Operating Revenues: | | | |
| Assessments | \$ - | \$ - | \$ - |
| Licenses and Fees | 4,755 | 135 | - |
| Federal | - | - | - |
| Charges for Services | 1,091 | 1,734 | - |
| Fines and Forfeitures | - | - | - |
| Rents and Royalties | - | 683 | - |
| Sales | - | - | 1,037,835 |
| Loan Interest Income | 72,358 | 11,937 | - |
| Gifts, Grants, and Contracts | - | - | - |
| Other | 382 | 180 | 1,142 |
| Gain (Loss) on Foreclosed Property | (259) | 296 | - |
| Total Operating Revenues | <u>78,327</u> | <u>14,965</u> | <u>1,038,977</u> |
| Operating Expenses: | | | |
| Salaries and Wages | 4,195 | 5,718 | 35,512 |
| Services and Supplies | 9,451 | 3,948 | 240,156 |
| Cost of Goods Sold | - | - | - |
| Distributions to Other Governments | 435 | - | - |
| Loan Interest Expense | 49 | - | - |
| Special Payments | 1,567 | 67 | 201,946 |
| Bond and COP Interest | 62,459 | 8,521 | - |
| Other Debt Service | - | 640 | - |
| Depreciation and Amortization | - | 117 | 29,773 |
| Bad Debt Expense | - | 360 | - |
| Total Operating Expenses | <u>78,156</u> | <u>19,371</u> | <u>507,387</u> |
| Operating Income (Loss) | <u>171</u> | <u>(4,406)</u> | <u>531,590</u> |
| Nonoperating Revenues (Expenses): | | | |
| Bond and COP Interest | - | - | - |
| Investment Income (Loss) | 3,320 | 4,043 | 3,587 |
| Other Taxes | - | - | - |
| Gain (Loss) on Disposition of Assets | (2) | - | (2,920) |
| Insurance Recoveries | - | - | 65 |
| Loan Interest Income | - | - | - |
| Loan Interest Expense | - | - | - |
| Other Nonoperating Items | (79) | (232) | (237) |
| Total Nonoperating Revenues (Expenses) | <u>3,239</u> | <u>3,811</u> | <u>495</u> |
| Income (Loss) Before Contributions, Special Items, Extraordinary Items, and Transfers | 3,410 | (595) | 532,085 |
| Capital Contributions | - | - | - |
| Transfers from Other Funds | - | - | - |
| Transfers to Other Funds | (174) | (226) | (555,167) |
| Change in Net Assets | <u>3,236</u> | <u>(821)</u> | <u>(23,082)</u> |
| Net Assets - Beginning | 206,725 | 134,201 | 159,680 |
| Prior Period Adjustments | - | (89) | - |
| Cumulative Effect of Change in Accounting Principles | - | - | - |
| Net Assets - Beginning - As Restated | <u>206,725</u> | <u>134,112</u> | <u>159,680</u> |
| Net Assets - Ending | <u>\$ 209,961</u> | <u>\$ 133,291</u> | <u>\$ 136,598</u> |

The notes to the financial statements are an integral part of this statement.

State of Oregon

Business-type Activities - Enterprise Funds

| Unemployment Compensation | University System | Other | Total | Governmental Activities Internal Service Funds |
|------------------------------|----------------------|-------------------|---------------------|---|
| \$ 1,005,811 | \$ - | \$ - | \$ 1,005,811 | \$ - |
| - | - | 7,759 | 12,649 | - |
| 1,351,638 | 335,573 | 5,151 | 1,692,362 | - |
| - | 719,852 | 281,319 | 1,003,996 | 953,124 |
| 1,904 | - | 518 | 2,422 | - |
| - | - | 66 | 749 | 43,993 |
| - | 410,034 | 460,286 | 1,908,155 | 8,347 |
| - | - | 27,557 | 111,852 | - |
| - | 213,795 | - | 213,795 | - |
| 14,886 | 27,406 | 4,173 | 48,169 | 3,966 |
| - | - | - | 37 | - |
| 2,374,239 | 1,706,660 | 786,829 | 5,999,997 | 1,009,430 |
| - | 1,328,156 | 226,855 | 1,600,436 | 130,897 |
| - | 498,248 | 137,734 | 889,537 | 727,165 |
| - | - | 229,694 | 229,694 | 10,364 |
| - | - | 49,334 | 49,769 | 955 |
| - | - | - | 49 | - |
| 2,291,430 | 130,715 | 170,401 | 2,796,126 | 125 |
| - | - | 17,951 | 88,931 | 6,161 |
| - | - | 147 | 787 | 260 |
| - | 113,725 | 5,823 | 149,438 | 36,657 |
| 15,179 | - | 1,325 | 16,864 | - |
| 2,306,609 | 2,070,844 | 839,264 | 5,821,631 | 912,584 |
| 67,630 | (364,184) | (52,435) | 178,366 | 96,846 |
| - | (76,765) | - | (76,765) | - |
| 41,542 | 27,178 | 1,478 | 81,148 | 3,547 |
| - | - | 16,204 | 16,204 | - |
| - | (201) | (3,435) | (6,558) | (817) |
| - | 2,539 | 12 | 2,616 | 217 |
| - | - | - | - | 41 |
| - | - | - | - | (14) |
| (9) | 128,312 | (161) | 127,594 | (1,240) |
| 41,533 | 81,063 | 14,098 | 144,239 | 1,734 |
| 109,163 | (283,121) | (38,337) | 322,605 | 98,580 |
| - | 46,562 | 242,204 | 288,766 | 1,390 |
| 1,100 | 408,604 | 201,554 | 611,258 | 3,064 |
| (35,751) | (31,426) | (155,087) | (77,831) | (43,345) |
| 74,512 | 140,619 | 250,334 | 444,798 | 59,689 |
| 1,182,018 | 1,413,794 | 634,123 | 3,730,541 | 213,808 |
| 2,162 | - | 61,693 | 63,766 | (6,111) |
| - | - | - | - | 4,458 |
| 1,184,180 | 1,413,794 | 695,816 | 3,794,307 | 212,155 |
| \$ 1,258,692 | \$ 1,554,413 | \$ 946,150 | \$ 4,239,105 | \$ 271,844 |

Some amounts reported for business-type activities in the statement of activities are different because the net revenue (expense) of certain internal service funds is reported within the business-type activities.

| | |
|--|------------|
| Change in net assets of business-type activities | 925 |
| | \$ 445,723 |

Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2011
(In Thousands)

| | Business-type Activities - Enterprise Funds | | |
|--|--|---------------------------|-------------------------------|
| | Housing and Community Services | Veterans' Loan | Lottery Operations |
| Cash Flows from Operating Activities: | | | |
| Receipts from Customers | \$ 5,951 | \$ 1,130 | \$ 1,035,014 |
| Receipts from Other Funds for Services | - | 1,542 | - |
| Loan Principal Repayments | 117,147 | 44,894 | - |
| Loan Interest Received | 72,665 | 15,190 | - |
| Taxes and Assessments Received | - | - | - |
| Payments to Employees for Services | (4,331) | (5,694) | (35,438) |
| Payments to Suppliers | (7,627) | (2,335) | (239,081) |
| Payments to Other Funds for Services | - | (903) | - |
| Payments to Prize Winners | - | - | (197,605) |
| Claims Paid | - | - | - |
| Loans Made | (90,650) | (19,312) | - |
| Distributions to Other Governments | - | - | - |
| Other Receipts (Payments) | 5,103 | 2,018 | 658 |
| Net Cash Provided (Used) in Operating Activities | <u>98,258</u> | <u>36,530</u> | <u>563,548</u> |
| Cash Flows from Noncapital Financing Activities: | | | |
| Proceeds from Bond/COP Sales | 229,410 | 82,950 | - |
| Principal Payments on Bonds/COPS | (328,800) | (151,198) | - |
| Interest Payments on Bonds/COPS | (66,123) | (8,565) | - |
| Interest Payments on Loans | (49) | - | - |
| Bond/COP Issuance Costs | (2,649) | (1,371) | - |
| Taxes and Assessments Received | - | - | - |
| Other Gifts and Private Contracts | - | - | - |
| Insurance Recoveries for Other than Capital Assets | - | - | - |
| Transfers from Other Funds | - | - | - |
| Transfers to Other Funds | (173) | (226) | (561,428) |
| Net Cash Provided (Used) in Noncapital Financing Activities | <u>(168,384)</u> | <u>(78,410)</u> | <u>(561,428)</u> |
| Cash Flows from Capital and Related Financing Activities: | | | |
| Proceeds from Bond/COP Sales | - | - | - |
| Principal Payments on Bonds/COPS | - | - | - |
| Interest Payments on Bonds/COPS | - | - | - |
| Bond/COP Issuance Costs | - | - | - |
| Repayments on Advances Received | - | - | - |
| Interest on Advances | - | - | - |
| Principal Payments on Loans | - | - | (23) |
| Interest Payments on Loans | - | - | - |
| Acquisition of Capital Assets | - | (42) | (6,296) |
| Proceeds from Disposition of Capital Assets | - | - | 50 |
| Insurance Recoveries for Capital Assets | - | - | 65 |
| Capital Contributions | - | - | - |
| Transfers from Other Funds | - | - | - |
| Net Cash Provided (Used) in Capital and Related Financing Activities | <u>-</u> | <u>(42)</u> | <u>(6,204)</u> |
| Cash Flows from Investing Activities: | | | |
| Purchases of Investments | (1,956,793) | (14,000) | (13,292) |
| Proceeds from Sales and Maturities of Investments | 1,986,224 | 28,033 | 13,188 |
| Interest on Investments and Cash Balances | 4,821 | 2,218 | 926 |
| Interest Income from Securities Lending | 110 | 324 | 383 |
| Interest Expense from Securities Lending | (79) | (232) | (237) |
| Net Cash Provided (Used) in Investing Activities | <u>34,283</u> | <u>16,343</u> | <u>968</u> |
| Net Increase (Decrease) in Cash and Cash Equivalents | <u>(35,843)</u> | <u>(25,579)</u> | <u>(3,116)</u> |
| Cash and Cash Equivalents - Beginning | 95,861 | 260,830 | 234,659 |
| Prior Period Adjustments Restating Beginning Cash Balances | - | - | - |
| Cash and Cash Equivalents - Ending | <u>\$ 60,018</u> | <u>\$ 235,251</u> | <u>\$ 231,543</u> |

The notes to the financial statements are an integral part of this statement.

State of Oregon

| Business-type Activities - Enterprise Funds | | | | Governmental Activities Internal Service Funds |
|--|------------------------------|--------------|--------------|---|
| Unemployment Compensation | University System | Other | Total | |
| \$ - | \$ 1,677,117 | \$ 755,790 | \$ 3,475,002 | \$ 710,059 |
| - | - | 6 | 1,548 | 279,252 |
| - | 13,495 | 62,004 | 237,540 | - |
| - | - | 28,290 | 116,145 | - |
| 954,663 | - | - | 954,663 | - |
| - | (1,322,302) | (226,546) | (1,594,311) | (138,442) |
| - | (475,768) | (329,058) | (1,053,869) | (737,998) |
| - | - | (7,081) | (7,984) | (32,684) |
| - | - | - | (197,605) | - |
| (2,328,644) | - | (150,423) | (2,479,067) | (12,604) |
| - | (128,006) | (133,442) | (371,410) | - |
| - | - | (53,320) | (53,320) | (896) |
| 1,547,989 | 26,098 | (12,786) | 1,569,080 | 51,982 |
| 174,008 | (209,366) | (66,566) | 596,412 | 118,669 |
| - | - | 107,013 | 419,373 | - |
| - | - | (55,070) | (535,068) | - |
| - | - | (17,967) | (92,655) | - |
| - | - | - | (49) | - |
| - | - | (585) | (4,605) | - |
| - | - | 16,231 | 16,231 | - |
| - | 106,231 | - | 106,231 | - |
| - | 2,539 | 5 | 2,544 | 38 |
| - | 392,316 | 201,261 | 593,577 | 8,583 |
| (35,317) | (33,162) | (155,511) | (785,817) | (23,642) |
| (35,317) | 467,924 | 95,377 | (280,238) | (15,021) |
| - | 249,420 | - | 249,420 | - |
| - | (42,997) | (1,195) | (44,192) | (22,968) |
| - | (75,316) | (293) | (75,609) | (6,648) |
| - | - | - | - | (62) |
| - | - | - | - | 28 |
| - | - | - | - | 41 |
| - | - | - | (23) | (34) |
| - | - | - | - | (14) |
| - | (463,077) | (4,645) | (474,060) | (17,165) |
| - | 15,353 | 3 | 15,406 | 2,853 |
| - | - | 8 | 73 | 179 |
| - | 46,853 | 11,223 | 58,076 | - |
| - | 37,745 | - | 37,745 | - |
| - | (232,019) | 5,101 | (233,164) | (43,790) |
| - | (166,140) | - | (2,150,225) | (26,546) |
| - | - | - | 2,027,445 | 21,850 |
| 49,777 | 9,459 | 1,255 | 68,456 | 3,668 |
| 12 | 1,025 | 225 | 2,079 | 307 |
| (9) | (731) | (160) | (1,448) | (220) |
| 49,780 | (156,387) | 1,320 | (53,693) | (941) |
| 188,471 | (129,848) | 35,232 | 29,317 | 58,917 |
| 773,854 | 983,641 | 268,248 | 2,617,093 | 170,531 |
| - | - | 83,782 | 83,782 | 3,891 |
| \$ 962,325 | \$ 853,793 | \$ 387,262 | \$ 2,730,192 | \$ 233,339 |

(continued on next page)

Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2011
(In Thousands)
(continued from previous page)

| | Business-type Activities - Enterprise Funds | | |
|---|--|---------------------------|-------------------------------|
| | Housing and Community Services | Veterans' Loan | Lottery Operations |
| Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities: | | | |
| Operating Income (Loss) | \$ 171 | \$ (4,406) | \$ 531,590 |
| Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities: | | | |
| Depreciation and Amortization | - | 117 | 29,773 |
| Amortization of Bond/COP Issuance Costs | 862 | - | - |
| Amortization of Bond/COP Premium and Discount | (454) | 342 | - |
| Amortization of Deferred Charges | (937) | 581 | - |
| Bad Debt Expense | - | - | - |
| Interest Payments Reported as Operating Expense | 62,724 | 8,565 | - |
| Bond/COP Issuance Costs Reported as Operating Expense | - | 1,371 | - |
| Net Changes in Assets and Liabilities: | | | |
| Accounts and Interest Receivable | 489 | 331 | (3,585) |
| Due from Other Funds | - | 1 | - |
| Due from Other Governments | - | - | - |
| Inventories | - | - | (27) |
| Prepaid Items | (2) | 1 | 166 |
| Foreclosed and Deeded Property | (2,734) | (141) | - |
| Deferred Charges | - | - | - |
| Advances to Other Funds | - | - | - |
| Loans Receivable | 38,392 | 27,858 | - |
| Net Contracts, Notes, and Other Receivables | - | - | - |
| Accounts and Interest Payable | (290) | (167) | 722 |
| Due to Other Funds | - | - | - |
| Due to Other Governments | - | - | - |
| Custodial Liabilities | - | (141) | 10 |
| Unearned Revenue | 131 | - | 280 |
| Claims and Judgments Payable | - | - | - |
| Arbitrage Payable | - | 2,197 | - |
| Contracts, Mortgages, and Notes Payable | - | - | - |
| Compensated Absences Payable | (101) | 9 | 6 |
| Lottery Prize Awards Payable | - | - | 4,545 |
| Net OPEB Obligation | 7 | 12 | 68 |
| Total Adjustments | <u>98,087</u> | <u>40,936</u> | <u>31,958</u> |
| Net Cash Provided (Used) by Operating Activities | <u>\$ 98,258</u> | <u>\$ 36,530</u> | <u>\$ 563,548</u> |
| Noncash Investing and Capital and Related Financing Activities: | | | |
| Net Change in Fair Value of Investments | \$ (2,345) | \$ 751 | \$ 2,277 |
| Capital Assets Transferred from Governmental Funds | - | - | - |
| Capital Leases Entered into During the Year | - | - | - |
| Capital Assets Contributed | - | - | - |
| Foreclosed Property | 28,880 | 1,570 | - |
| Capital Assets Transferred to Governmental Funds | - | - | - |
| Loan Modifications | 247 | - | - |
| Capital Assets Traded for Other Capital Assets | - | - | 27 |
| Advanced Debt Refunding Deposited with Escrow Agent | - | - | - |
| Total Noncash Investing and Capital and Related Financing Activities | <u>\$ 26,782</u> | <u>\$ 2,321</u> | <u>\$ 2,304</u> |

The notes to the financial statements are an integral part of this statement.

State of Oregon

| Business-type Activities - Enterprise Funds | | | | Governmental Activities Internal Service Funds |
|--|------------------------------|--------------------|-------------------|---|
| Unemployment Compensation | University System | Other | Total | |
| \$ 67,630 | \$ (364,184) | \$ (52,435) | \$ 178,366 | \$ 96,846 |
| - | 113,725 | 5,823 | 149,438 | 36,656 |
| - | - | 289 | 1,151 | 24 |
| - | - | (368) | (480) | (508) |
| - | - | 67 | (289) | 219 |
| - | - | 1,325 | 1,325 | - |
| - | - | 17,930 | 89,219 | 6,648 |
| - | - | 587 | 1,958 | 82 |
| 111,686 | 7,579 | 2,340 | 118,840 | 122,067 |
| (6) | - | (1,238) | (1,243) | (9) |
| (640) | - | - | (640) | - |
| - | (151) | (2,964) | (3,142) | 178 |
| - | (7,660) | 34 | (7,461) | 367 |
| - | - | - | (2,875) | - |
| - | - | (1,165) | (1,165) | 193 |
| - | - | (33,872) | (33,872) | - |
| - | - | (20,298) | 45,952 | - |
| (4,639) | 11,192 | (27) | 6,526 | 654 |
| (5,825) | 23,913 | (591) | 17,762 | (36,319) |
| 405 | - | 12,027 | 12,432 | (9) |
| 5,397 | - | (3) | 5,394 | - |
| - | 173 | 2,801 | 2,843 | (75,188) |
| - | (21,442) | 55 | (20,976) | (18,660) |
| - | - | 2,130 | 2,130 | (15,973) |
| - | - | - | 2,197 | - |
| - | 27,489 | - | 27,489 | - |
| - | - | 547 | 461 | 1,179 |
| - | - | - | 4,545 | - |
| - | - | 440 | 527 | 222 |
| <u>106,378</u> | <u>154,818</u> | <u>(14,131)</u> | <u>418,046</u> | <u>21,823</u> |
| <u>\$ 174,008</u> | <u>\$ (209,366)</u> | <u>\$ (66,566)</u> | <u>\$ 596,412</u> | <u>\$ 118,669</u> |
| \$ - | \$ 17,198 | \$ - | \$ 17,881 | \$ (472) |
| - | - | 229,481 | 229,481 | 1,390 |
| - | 18 | - | 18 | 1,751 |
| - | 3,079 | 1,500 | 4,579 | - |
| - | - | - | 30,450 | - |
| - | - | - | - | (1,020) |
| - | - | - | 247 | - |
| - | - | - | 27 | - |
| - | 1,481 | - | 1,481 | - |
| <u>\$ -</u> | <u>\$ 21,776</u> | <u>\$ 230,981</u> | <u>\$ 284,164</u> | <u>\$ 1,649</u> |

State of Oregon

Statement of Fiduciary Net Assets
Fiduciary Funds
June 30, 2011
(In Thousands)

| | Pension and Other Employee Benefit Trust | Private Purpose Trust | Investment Trust | Agency |
|---|--|-----------------------------|---------------------|------------------|
| ASSETS | | | | |
| Cash and Cash Equivalents | \$ 2,728,503 | \$ 27,135 | \$ 4,046,073 | \$ - |
| Investments: | | | | |
| Fixed Income | 15,032,999 | 255 | - | - |
| Public Equity | 24,143,158 | 389 | - | - |
| Real Estate | 6,135,410 | - | - | - |
| Annuity Contracts | - | 249 | - | - |
| Private Equity | 13,748,215 | - | - | - |
| Opportunity Portfolio | 1,142,876 | - | - | - |
| Total Investments | <u>60,202,658</u> | <u>893</u> | <u>-</u> | <u>-</u> |
| Custodial Assets | - | 4,723 | - | 1,602,565 |
| Securities Lending Collateral | 2,708,351 | 8,119 | 1,004,288 | - |
| Receivables: | | | | |
| Employer Contributions | 9,095 | - | - | - |
| Plan Member Contributions | 10,874 | - | - | - |
| Interest and Dividends | 343,494 | - | 12,916 | - |
| Member Loans | 8,671 | - | - | - |
| Investment Sales | 780,006 | - | 42,362 | - |
| Accounts | - | 51 | - | 11,063 |
| From Other Funds | 10,595 | 2 | - | - |
| Total Receivables | <u>1,162,735</u> | <u>53</u> | <u>55,278</u> | <u>11,063</u> |
| Prepaid Items | 9,430 | - | - | - |
| Net Contracts, Notes and Other Receivables | - | - | - | 108,661 |
| Receivership Assets | - | - | - | 64,097 |
| Loans Receivable (net) | - | - | 95,027 | - |
| Capital Assets (net of accumulated depreciation): | | | | |
| Land | 944 | 14 | - | - |
| Construction in Progress | 165 | - | - | - |
| Buildings, Property and Equipment | 38,207 | - | - | - |
| Total Assets | <u>66,850,993</u> | <u>40,937</u> | <u>5,200,666</u> | <u>1,786,386</u> |
| LIABILITIES | | | | |
| Accounts and Interest Payable | 2,855,325 | 288 | 268 | 40 |
| Obligations Under Securities Lending | 2,725,936 | 8,119 | 1,004,288 | - |
| Due to Other Funds | 10,226 | - | - | - |
| Due to Other Governments | - | 1 | - | 5,684 |
| Bonds/COPS Payable | 3,615 | - | - | - |
| Custodial Liabilities | 64,992 | 1,681 | - | 1,780,662 |
| Deferred Revenue | 760 | - | - | - |
| Contracts, Mortgages and Notes Payable | - | 2,174 | - | - |
| Net OPEB Obligation | 364 | - | - | - |
| Total Liabilities | <u>5,661,218</u> | <u>12,263</u> | <u>1,004,556</u> | <u>1,786,386</u> |
| NET ASSETS | | | | |
| Held in Trust for: | | | | |
| Pension Benefits | 59,831,686 | - | - | - |
| Other Postemployment Benefits | 253,113 | - | - | - |
| Other Employee Benefits | 1,104,976 | - | - | - |
| External Investment Pool Participants | - | - | 4,196,110 | - |
| Individuals, Organizations and Other Governments | - | 28,674 | - | - |
| Total Net Assets | <u>\$ 61,189,775</u> | <u>\$ 28,674</u> | <u>\$ 4,196,110</u> | <u>\$ -</u> |

The notes to the financial statements are an integral part of this statement.

**Statement of Changes in Fiduciary Net Assets
Fiduciary Funds
For the Year Ended June 30, 2011
(In Thousands)**

| | Pension and Other Employee Benefit Trust | Private Purpose Trust | Investment Trust |
|---|--|-----------------------------|---------------------|
| ADDITIONS | | | |
| Contributions: | | | |
| Employer | \$ 447,706 | \$ - | \$ - |
| Plan Members | 601,032 | - | - |
| Total Contributions | <u>1,048,738</u> | <u>-</u> | <u>-</u> |
| Investment Income: | | | |
| Net Appreciation (Depreciation) in Fair Value of Investments | 10,747,330 | - | - |
| Interest, Dividends and Other Investment Income | 1,517,623 | 125 | 49,423 |
| Total Investment Income | <u>12,264,953</u> | <u>125</u> | <u>49,423</u> |
| Less Investment Expense | 373,536 | 25 | 5,228 |
| Net Investment Income | <u>11,891,417</u> | <u>100</u> | <u>44,195</u> |
| Gifts, Grants and Contracts | - | 3,720 | - |
| Veterans' Income | - | 6,784 | - |
| Other Income | 1,163 | 639 | - |
| Share Transactions: | | | |
| Participant Contributions | - | - | 20,934,511 |
| Participant Withdrawals | - | - | 20,625,031 |
| Net Share Transactions | <u>-</u> | <u>-</u> | <u>309,480</u> |
| Transfers from Other Funds | <u>-</u> | <u>654</u> | <u>-</u> |
| Total Additions | <u>12,941,318</u> | <u>11,897</u> | <u>353,675</u> |
| DEDUCTIONS | | | |
| Pension Benefits | 3,330,303 | - | - |
| Death Benefits | 7,607 | - | - |
| Contributions Refunded | 26,487 | - | - |
| Healthcare Premium Subsidies | 32,276 | - | - |
| Distributions to Other Governments | - | 344 | - |
| Distributions to Participants | - | - | 24,578 |
| Deferred Compensation Benefits | 55,929 | - | - |
| Administrative Expenses | 38,595 | 9,012 | - |
| Payments in Accordance with Trust Agreements | - | 4,775 | - |
| Total Deductions | <u>3,491,197</u> | <u>14,131</u> | <u>24,578</u> |
| Change in Net Assets Held in Trust For: | | | |
| Pension Benefits | 9,218,464 | - | - |
| Other Postemployment Benefits | 38,622 | - | - |
| Other Employee Benefits | 193,035 | - | - |
| External Investment Pool Participants | - | - | 329,097 |
| Individuals, Organizations and Other Governments | - | (2,234) | - |
| Net Assets - Beginning | 51,747,945 | 30,908 | 3,867,013 |
| Prior Period Adjustments | (8,291) | - | - |
| Net Assets - Beginning - As Restated | <u>51,739,654</u> | <u>30,908</u> | <u>3,867,013</u> |
| Net Assets - Ending | <u>\$ 61,189,775</u> | <u>\$ 28,674</u> | <u>\$ 4,196,110</u> |

The notes to the financial statements are an integral part of this statement.

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State of Oregon

**Combining Balance Sheet
Discretely Presented Component Units
June 30, 2011
(In Thousands)**

| | SAIF Corporation | Oregon Health and Science University | Oregon University System Foundations | Total |
|---|---------------------|--|---|---------------------|
| ASSETS AND DEFERRED OUTFLOWS | | | | |
| Current Assets: | | | | |
| Cash and Cash Equivalents | \$ 41,742 | \$ 190,537 | \$ 37,861 | \$ 270,140 |
| Investments | 4,037,034 | 78,491 | - | 4,115,525 |
| Securities Lending Collateral | 228,043 | - | - | 228,043 |
| Accounts and Interest Receivable (net) | 334,249 | 274,728 | - | 608,977 |
| Pledges, Contributions, and Grants Receivable (net) | - | 23,175 | 212,317 | 235,492 |
| Due from Primary Government | 113 | 19,951 | - | 20,064 |
| Inventories | 80 | 15,635 | - | 15,715 |
| Prepaid Items | 6,900 | 13,515 | 38,264 | 58,679 |
| Total Current Assets | 4,648,161 | 616,032 | 288,442 | 5,552,635 |
| Noncurrent Assets: | | | | |
| Investments | - | 516,280 | - | 516,280 |
| Investments - Restricted | - | 509,545 | 1,229,268 | 1,738,813 |
| Deferred Charges | - | 7,508 | - | 7,508 |
| Net Contracts, Notes and Other Receivables | - | 4,066 | - | 4,066 |
| Pledges, Contributions, and Grants Receivable (net) | - | 71,406 | - | 71,406 |
| Capital Assets: | | | | |
| Land | 3,029 | 58,770 | 7,242 | 69,041 |
| Buildings, Property, and Equipment | 42,227 | 2,098,774 | 55,274 | 2,196,275 |
| Construction in Progress | - | 59,406 | - | 59,406 |
| Less Accumulated Depreciation and Amortization | (27,715) | (979,795) | (12,865) | (1,020,375) |
| Total Noncurrent Assets | 17,541 | 2,345,960 | 1,278,919 | 3,642,420 |
| Deferred Outflows | - | 7,776 | - | 7,776 |
| Total Assets and Deferred Outflows | \$ 4,665,702 | \$ 2,969,768 | \$ 1,567,361 | \$ 9,202,831 |
| LIABILITIES AND NET ASSETS | | | | |
| Current Liabilities: | | | | |
| Accounts and Interest Payable | \$ 65,559 | \$ 176,713 | \$ 7,423 | \$ 249,695 |
| Reserve for Loss and Loss Adjustment Expense | 209,117 | - | - | 209,117 |
| Obligations Under Securities Lending | 228,042 | - | - | 228,042 |
| Due to Other Governments | 2,546 | 13,531 | - | 16,077 |
| Due to Primary Government | 15,905 | 2,130 | 15,396 | 33,431 |
| Obligations Under Capital Lease | - | 1,141 | - | 1,141 |
| Bonds/COPS Payable | - | 11,441 | - | 11,441 |
| Claims and Judgments Payable | - | 20,253 | - | 20,253 |
| Custodial Liabilities | 8,667 | - | - | 8,667 |
| Unearned Revenue | 168,288 | 27,301 | 12,071 | 207,660 |
| Compensated Absences Payable | 3,644 | 52,313 | - | 55,957 |
| Contracts, Mortgages, and Notes Payable | - | 1,690 | - | 1,690 |
| Total Current Liabilities | 701,768 | 306,513 | 34,890 | 1,043,171 |
| Noncurrent Liabilities: | | | | |
| Bonds/COPS Payable | - | 641,207 | 46,291 | 687,498 |
| Obligations Under Capital Lease | - | 4,664 | - | 4,664 |
| Obligations Under Life Income Agreements | - | 17,134 | 76,564 | 93,698 |
| Advances from Primary Government | - | 46,518 | - | 46,518 |
| Reserve for Loss and Loss Adjustment Expense | 2,795,522 | - | - | 2,795,522 |
| Claims and Judgments Payable | - | 35,838 | - | 35,838 |
| Net OPEB Obligation | 1,260 | 5,071 | - | 6,331 |
| Contracts, Mortgages, and Notes Payable | - | 34,959 | 30,929 | 65,888 |
| Derivative Instrument Liability | - | 7,776 | - | 7,776 |
| Total Noncurrent Liabilities | 2,796,782 | 793,167 | 153,784 | 3,743,733 |
| Total Liabilities | 3,498,550 | 1,099,680 | 188,674 | 4,786,904 |
| Net Assets: | | | | |
| Invested in Capital Assets, Net of Related Debt | 17,541 | 585,242 | - | 602,783 |
| Expendable Net Assets Restricted for: | | | | |
| Workers' Compensation | 1,149,611 | - | - | 1,149,611 |
| Education | - | 346,172 | 655,490 | 1,001,662 |
| Nonexpendable Net Assets Restricted for: | | | | |
| Donor Purposes | - | - | 706,668 | 706,668 |
| Education | - | 165,488 | - | 165,488 |
| Unrestricted | - | 773,186 | 16,529 | 789,715 |
| Total Net Assets | 1,167,152 | 1,870,088 | 1,378,687 | 4,415,927 |
| Total Liabilities and Net Assets | \$ 4,665,702 | \$ 2,969,768 | \$ 1,567,361 | \$ 9,202,831 |

The notes to the financial statements are an integral part of this statement.

State of Oregon

**Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets
Discretely Presented Component Units
For the Year Ended June 30, 2011
(In Thousands)**

| | SAIF Corporation | Oregon Health and Science University | Oregon University System Foundations |
|---|---------------------|--|--|
| Operating Revenues: | | | |
| Charges for Services | \$ - | \$ 1,421,217 | \$ - |
| Sales | - | 18,584 | - |
| Premiums Earned (net) | 333,323 | - | - |
| Investment Income (net) | - | - | 149,976 |
| Gifts, Grants, and Contracts | - | 442,628 | 194,717 |
| Auxiliary Enterprises (net) | - | 17,550 | - |
| Other Revenues | 16,860 | 50,378 | 23,746 |
| Total Operating Revenues | <u>350,183</u> | <u>1,950,357</u> | <u>368,439</u> |
| Operating Expenses: | | | |
| Salaries and Wages | - | 1,117,504 | - |
| Services and Supplies | - | 609,545 | 187,902 |
| Loss and Loss Adjustment Expense | 365,021 | - | - |
| Policyholders' Dividends | 99,975 | - | - |
| Underwriting Expenses | 80,963 | - | - |
| Bond and COP Interest | - | 36,554 | - |
| Depreciation and Amortization | 1,368 | 106,647 | - |
| Bad Debt Expense | - | 44,567 | - |
| Other Expenses | - | - | 8,444 |
| Total Operating Expenses | <u>547,327</u> | <u>1,914,817</u> | <u>196,346</u> |
| Operating Income (Loss) | <u>(197,144)</u> | <u>35,540</u> | <u>172,093</u> |
| Nonoperating Revenues (Expenses): | | | |
| Investment Income | 418,707 | 88,729 | - |
| Other | - | 6,705 | - |
| State Appropriations | - | 39,159 | - |
| Total Nonoperating Revenues (Expenses) | <u>418,707</u> | <u>134,593</u> | <u>-</u> |
| Income (Loss) Before Capital Contributions and Transfers | 221,563 | 170,133 | 172,093 |
| Capital Contributions | - | 4,281 | - |
| Change in Net Assets | <u>221,563</u> | <u>174,414</u> | <u>172,093</u> |
| Net Assets - Beginning | 945,589 | 1,695,674 | 1,206,594 |
| Net Assets - Ending | <u>\$ 1,167,152</u> | <u>\$ 1,870,088</u> | <u>\$ 1,378,687</u> |

The notes to the financial statements are an integral part of this statement.

| Total | Adjustments to Recast | Statement of Activities |
|---------------------|--------------------------|----------------------------|
| \$ 1,421,217 | \$ 467,146 | \$ 1,888,363 |
| 18,584 | (18,584) | - |
| 333,323 | (333,323) | - |
| 149,976 | (149,976) | - |
| 637,345 | 696,571 | 1,333,916 |
| 17,550 | (17,550) | - |
| 90,984 | (90,984) | - |
| <u>2,668,979</u> | <u>553,300</u> | <u>3,222,279</u> |
| 1,117,504 | - | 1,117,504 |
| 797,447 | - | 797,447 |
| 365,021 | - | 365,021 |
| 99,975 | - | 99,975 |
| 80,963 | - | 80,963 |
| 36,554 | - | 36,554 |
| 108,015 | - | 108,015 |
| 44,567 | - | 44,567 |
| 8,444 | - | 8,444 |
| <u>2,658,490</u> | <u>-</u> | <u>2,658,490</u> |
| <u>10,489</u> | <u>553,300</u> | <u>563,789</u> |
| 507,436 | (507,436) | - |
| 6,705 | (6,705) | - |
| 39,159 | (39,159) | - |
| <u>553,300</u> | <u>(553,300)</u> | <u>-</u> |
| 563,789 | - | 563,789 |
| 4,281 | - | 4,281 |
| <u>568,070</u> | <u>-</u> | <u>568,070</u> |
| 3,847,857 | - | 3,847,857 |
| <u>\$ 4,415,927</u> | <u>\$ -</u> | <u>\$ 4,415,927</u> |

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The State of Oregon (State) was admitted to the Union in 1859 and is governed by an elected governor and a ninety-member elected legislative body. The accompanying financial statements present the State, which includes all agencies, boards, commissions, courts, and colleges and universities that are legally part of the State (primary government) and its component units. Component units are legally separate entities for which the primary government is financially accountable or entities that warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government.

Blended Component Unit

Although legally separate entities, component units that are in substance part of the government's operations are reported as part of the primary government through a blended presentation.

The Oregon Affordable Housing Assistance Corporation (OAHAC) is a blended component unit of the State of Oregon included within the financial activity of the Housing and Community Services Department. OAHAC is a nonprofit organization. It is responsible for administration of grants, loans, and other forms of financial resources which work to prevent or mitigate the impact of foreclosures on low and moderate income Oregonians. At this time OAHAC is administering Oregon's share of the Federal Hardest Hit Program.

Discretely Presented Component Units

The State reports its discretely presented component units in a separate column in the government-wide financial statements to emphasize that they are legally separate from the State. The component unit column in the government-wide financial statements includes the data of the State's three discretely presented component units.

SAIF Corporation (SAIF) is a public corporation created by an act of the Legislature. SAIF is authorized to write workers' compensation insurance coverage in Oregon and certain other jurisdictions as required by the Department of Consumer and Business Services and to service accounts in the assigned risk pool. SAIF is governed by a board of directors appointed by the Governor and is financed solely through policyholder premiums and investment income. The term of office for a board member is four years, but a member serves at the pleasure of the Governor. SAIF reports on a fiscal year ended December 31 and uses proprietary fund accounting principles. The December 31, 2010, financial information of SAIF is included in this report.

The Oregon Health and Science University (OHSU) is a governmental entity performing governmental functions and exercising governmental powers. OHSU is an independent public corporation governed by a board of directors appointed by the Governor and confirmed by the Senate. It is an academic health center that provides education and training to health care professionals, conducts biomedical research, and provides patient care and public service. It is financed primarily through patient service fees, government grants and contracts, tuition charges, and other incidental fees. OHSU also receives General Fund moneys from the State. The State legislature has acknowledged its intent to make funds available to pay any shortfall in general obligation bonds issued for OHSU purposes prior to July 1, 1995, when OHSU became an independent public corporation. OHSU uses proprietary fund accounting principles.

The Oregon University System (OUS) Foundations are not-for-profit corporations that provide assistance in fundraising, public outreach, and other support for the missions of Oregon's seven public universities. The OUS foundations report under Financial Accounting Standards Board (FASB) Statement No. 117, *Financial Statements of Not-for-Profit Organizations*. The OUS foundations are component units of the Oregon University System, a proprietary fund of the State, because the majority of resources that each foundation holds and invests can only be used by, or for the benefit of, the OUS universities. Combined, the foundations are discretely presented as a component unit of the State.

Readers may obtain complete financial statements for SAIF, OHSU, and OUS from their respective administrative offices or from the Oregon State Controller's Division, 155 Cottage Street NE U50, Salem, Oregon 97301-3969.

State of Oregon
Notes to the Financial Statements

Related Organizations

The following professional and occupational licensing boards are semi-independent: the Board of Architect Examiners, the Board of Examiners for Engineering and Land Surveying, the Landscape Architect Board, the Board of Geologist Examiners, the Board of Optometry, the Board of Massage Therapists, the Physical Therapists Licensing Board, the Appraiser Certification and Licensure Board, the Landscape Contractors Board, the Wine Board, and the Patient Safety Commission. Although the Governor appoints the administrators of these boards, the boards are all self-supporting and the State's accountability for these organizations does not extend beyond making the appointments. The State has no financial accountability for these related organizations.

The Oregon Utility Notification Center (OUNC) is an independent nonprofit public corporation. Although the Governor appoints members to OUNC's board of directors, OUNC is funded through fees paid by operators of underground utilities who subscribe to OUNC. The OUNC receives no general fund moneys, and the State has no financial accountability for OUNC.

B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the primary government and its component units. The effect of interfund activity has been eliminated from these statements through consolidation, except for interfund activity that represents a true exchange of goods and services between funds. *Governmental activities*, which are primarily supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support. Interfund activity within governmental and within business-type activities has been eliminated through consolidation; however, balances due and resource flows between governmental and business-type activities have not been eliminated. The *primary government* is reported separately from its *component units*.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function. Direct expenses include administrative overhead charges for centralized services charged to functions through internal service funds. *Program revenues* include (1) charges to customers who purchase, use, or directly benefit from goods, services, or privileges provided by a given function, (2) operating grants and contributions that are restricted to meeting the operational requirements of a particular function, and (3) capital grants and contributions that are restricted to meeting the capital requirements of a particular function. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though fiduciary funds are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported in separate columns in the fund financial statements.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements with the exception of agency funds, which have no measurement focus. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Income taxes are recognized as revenue, net of estimated refunds, in the year when the underlying exchange (earning of income) has occurred, to the extent such amounts are measurable. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are both measurable and available. Revenues are considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities existing at the end of the year. For this purpose, the State considers revenues to be available if they are collected within 90 days of the end of the current fiscal year. Primary revenue sources susceptible to accrual are income taxes, excise taxes, fines, forfeitures, and federal revenues. Income tax revenue, net of estimated refunds, is recognized in the fiscal year in which the

State of Oregon
Notes to the Financial Statements

underlying exchange has occurred and it becomes measurable and available. Expenditure-driven grants are recognized as revenue when the qualifying expenditures have been incurred and all other grant eligibility requirements have been met. Revenue items not susceptible to accrual, such as licenses, fees, and the cash sales of goods and services, are considered measurable and available only when cash is received.

For governmental funds, expenditures generally are recognized when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

The State reports the following major governmental funds:

The *General Fund* is the State's primary operating fund and accounts for all financial resources of the general government, except those accounted for in another fund. Beginning in fiscal year 2011, the General Fund includes some activity previously accounted for in special revenue funds. The implementation of Governmental Accounting Standards Board (GASB) Statement No. 54 required this change. Statement No. 54 clarifies that one or more specific restricted or committed revenues must comprise a substantial portion of the "inflows" reported in a special revenue fund. The State considers 30 percent as "substantial" for financial reporting purposes. In special revenue funds where a substantial portion of the inflows will not derive from specific restricted or committed revenue sources, the funds' activities are accounted for in the General Fund. The *Oregon Rainy Day Fund*, for example, was previously reported as an individual major special revenue fund but is now reported in the General Fund. The Rainy Day fund relies on resources that are "transferred" from the General Fund in accordance with state law and which, along with investment income generated, can be appropriated by the Legislature only when certain specific criteria related to economic or revenue conditions have been met. The funding source for the Rainy Day Fund is not a specific restricted or committed revenue.

The *Health and Social Services Fund* accounts for programs that provide assistance, services, training, and health care to individuals and families who do not have sufficient resources to meet their basic needs. The primary sources of funding for these programs come from federal grants, tobacco taxes, healthcare provider taxes, and charges for services.

The *Public Transportation Fund* accounts for the planning, design, construction, and maintenance of highways, roads, bridges, and public systems relating to air, water, rail, and highway transportation. Funding is provided from dedicated highway user taxes and vehicle registration taxes, in addition to various federal highway administration funds.

The *Environmental Management Fund* accounts for programs that promote, protect, and preserve the State's forests, parks, wildlife, fish, and waterways. The main funding sources for these programs are user fees, federal grants, and sales revenue.

The *Common School Fund* accounts for programs to manage state-owned land, including a leasing program that generates annual revenues, for the benefit of the public school system. Estate funds that become the property of the State, unclaimed property, and income derived from unclaimed property are also accounted for in this fund. Statutory and constitutional provisions stipulate that the assets of the fund, including investment income, must be used for common school purposes. The primary funding sources for these programs include investment income, leasing revenues, forest management, unclaimed property receipts, and transfers from other funds.

The State reports the following major proprietary (enterprise) funds:

The *Housing and Community Services Fund* accounts for activities that finance multi-family rental housing and single-family mortgages for low to moderate income families. Mortgage loans related to these activities are financed with the proceeds of bonds issued under various bond indentures of trust. Mortgage loan payments and interest earnings on invested bond proceeds are used to pay debt service on the bonds.

The *Veterans' Loan Fund* accounts for activities to finance owner-occupied, single-family residential housing for qualified eligible Oregon veterans. Funds for lending are provided through the issuance of

State of Oregon
Notes to the Financial Statements

general obligation bonds that are repaid from the interest and principal payments made on mortgages.

The *Lottery Operations Fund* accounts for the operation of the Oregon State Lottery which markets and sells lottery products to the public. The primary objective of the Oregon State Lottery is to produce the maximum amount of net revenues to be used for creating jobs, furthering economic development, financing public education, and restoring and protecting Oregon's parks, beaches, watersheds, and critical fish and wildlife habitats.

The *Unemployment Compensation Fund* accounts for federal moneys and unemployment taxes collected from employers to provide payment of benefits to the unemployed.

The *University System Fund* accounts for the operations of Oregon's seven public universities, including the Chancellor's Office. Funding is from General Fund appropriations, tuition and fees, and auxiliary enterprise revenues, in addition to funds from external donors and federal agencies.

Additionally, the State reports the following fund types:

The *Internal Service Funds* account for goods and services provided by state agencies or departments to other state agencies or departments and to other governmental units on a cost-reimbursement basis. These include central services such as accounting, budgeting, personnel, mail, printing, copy center, data center, property development, telecommunications, motor pool, and an insurance fund. Legal, banking, and audit services are also accounted for in internal service funds.

The *Pension and Other Employee Benefit Trust Funds* account for activities of the Public Employees Retirement System, which administers resources for the payment of retirement, disability, postemployment healthcare, and death benefits to members and beneficiaries of the retirement system.

The *Private Purpose Trust Funds* account for all trust arrangements, other than those properly reported in pension and other employee benefit trust funds or investment trust funds, under which principal and income benefit individuals, private organizations, or other governments.

The *Investment Trust Fund* accounts for the portion of the Oregon Short-term Fund (OSTF) belonging to local governments. The OSTF is a cash and investment pool, managed by the Office of the State Treasurer, which is available for use by all funds and local governments. Oregon reports the State's portion of the pool within the funds of the State.

The *Agency Fund* accounts for assets held by the State as an agent for other governmental units, organizations, or individuals. For example, the Department of Consumer and Business Services holds deposits and investments to secure the faithful performance by insurers of insurance company obligations, including claims due to policyholders. Agency funds are custodial in nature (i.e., assets equal liabilities) and do not measure the results of operations.

Private sector standards of accounting and financial reporting issued prior to December 1, 1989, are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with, or contradict the guidance of, the Governmental Accounting Standards Board. Governments also have the option of following subsequent private sector guidance for their business-type activities and enterprise funds. However, neither the primary government, nor its component units, currently applies private sector guidance issued after November 30, 1989, except for those standards limited to not-for-profit organizations.

Proprietary funds distinguish operating revenues and expenses from nonoperating revenues and expenses. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

D. Deposits and Investments

Deposits

Cash deposits not held in a cash management or investment pool are classified as cash and cash equivalents. Cash deposits that are held in a cash management or investment pool are classified as cash and cash equivalents when the pool has the general characteristics of a demand deposit account. Cash and cash equivalents include: cash on hand, cash and investments held by the Office of the State Treasurer in the Oregon Short-term Fund (OSTF), cash deposits held in demand deposit accounts with custodial banks, and cash deposits of debt proceeds in investment funds held by a trustee.

Investments

Investments are reported at fair value with the following exceptions, which are reported using cost-based measures:

- Nonparticipating interest-earning investment contracts and certain investments not held for investment purposes.
- Investments in the OSTF with remaining maturities of up to 90 days are carried at amortized cost, which approximates fair value. The State reports these investments as cash and cash equivalents on the balance sheet or statement of net assets, but as investments in Note 2.

Changes in the fair value of investments are recognized as investment income (loss) in the current year.

The fair value of publicly traded debt and equity securities in active markets is determined by the custodian's pricing agent using nationally recognized pricing services. The custodian's pricing agent values equity securities traded on a national or international exchange at the last reported sales price and generally values debt securities by using evaluated bid prices. The fair value of publicly traded real estate investment trust (REIT) securities is determined by the custodian's pricing agent using recognized pricing services. For securities that do not have an active market, such as private placements or commingled investment vehicles, the custodian's pricing agent or investment manager uses a similar benchmark security to estimate fair value. The benchmark used to value a debt security, for example, typically has a coupon rate and maturity date comparable to the debt security being valued, as well as similar market risk.

Investments in private equities are recorded at fair value, as of June 30, 2011, as determined by PERS management based on valuation information provided by the general partner. Investments in private equities representing publicly traded securities are stated at quoted market price. Where observable market inputs are not available, valuation models are applied. The general partner determines fair value based on the best information available and by reference to the following: projected sales, net earnings, earnings before interest, taxes, depreciation and amortization, balance sheets, public and private transactions, valuations for publicly traded comparable companies, and/or other measures, and consideration of any other pertinent information including the types of securities held and the general partner's own assumptions regarding the investment. The methods used to determine the fair value of these investments typically include (1) the market approach, whereby fair value is derived by reference to observable valuation measures for comparable companies or assets, and (2) the income approach (e.g., the discounted cash flow method).

Investments in real estate, with the exception of publicly traded REITS for which observable market prices in active markets do not exist, are reported at fair value as of June 30, 2011, as determined by PERS management based on valuation information provided in good faith by the general partner. Direct investments in real estate are appraised every two to three years and, between appraisals, investment managers adjust values to reflect current and projected operating performance and financial transactions. Valuation of investments in real estate partnerships, in the absence of observable market prices, rely on the general partners to determine fair value by using valuation methodologies considered to be most appropriate for the type of investment, giving consideration to a range of factors they believe would be considered by market participants, including the nature of the investment, local market conditions, trading values on public exchanges for comparable investments, current and projected operating performance, and financing transactions subsequent to the acquisition of the investment.

State of Oregon
Notes to the Financial Statements

Investments in the PERS Opportunity Portfolio are recorded at fair value as of June 30, 2011, as determined by the respective general partner or account manager. (The Opportunity Portfolio is an investment portfolio within the PERS Fund that utilizes innovative investment approaches across a wide range of investment opportunities.) Investments in the Opportunity Portfolio representing publicly traded securities are stated at quoted market price. Where observable market inputs are not available, valuation models are applied. The general partner determines fair value based on the best information available and by reference to the following: projected sales, net earnings, earnings before interest, taxes, depreciation and amortization, balance sheets, public and private transactions, valuations for publicly traded comparable companies, and/or other measures, and consideration of any other pertinent information including the types of securities held and the general partner's own assumptions regarding the investment. The methods used to determine the fair value of these investments typically include (1) the market approach, whereby fair value is derived by reference to observable valuation measures for comparable companies or assets, and (2) the income approach (e.g., the discounted cash flow method).

Due to the inherent uncertainty and the degree of judgment involved in determining certain private equity, Opportunity Portfolio, and real estate portfolio investment valuations, the fair values reflected in the accompanying financial statements may differ significantly from values that would have been used had a readily determinable market value for the investments existed, and the difference could be material. In addition, these investments are generally considered to be illiquid long-term investments; the recorded fair values may materially differ from the amounts eventually realized from the sale or other disposition of these investments.

Derivatives

In accordance with State investment policies, the Office of the State Treasurer participates in contracts that have derivative characteristics. Derivative instruments are used to lower the cost of borrowing, to hedge against fluctuations in foreign currency rates, and to manage the overall risk of investment portfolios. The fair value of *effective* hedging derivative instruments are reported on the balance sheet and statement of net assets as assets and liabilities as applicable, with offsetting balances reported as deferred inflows or deferred outflows. The changes in fair value of effective hedging derivative instruments are also reflected on the balance sheet and the statement of net assets; such changes are not reported on the statement of changes in fund balances and the statement of changes in fund net assets. *Ineffective* hedging derivative instruments and derivatives purchased as investments are reported at fair value on the balance sheet and the statement of net assets. The related changes in fair value are reported on the statement of changes in fund balances and the statement of changes in fund net assets.

E. Receivables and Payables

Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" or "advances to/from other funds." All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

Trade receivables consist of revenues earned or accrued in the current period and are shown net of estimated uncollectible amounts. Income tax receivables deemed reasonably estimable are reported, net of estimated uncollectible amounts, in the fiscal year when the underlying exchange has occurred. Income tax receivables that may arise in the future from audits of prior years and discovery of non-filers are not included in receivables or revenues in the financial statements because these transactions are not measurable.

F. Intrafund Transactions

Intrafund balances (due to/from other funds and advances to/from other funds) and intrafund activity (transfers to/from other funds) within each fund in the financial statements have been eliminated.

G. Inventories

Inventories, which consist primarily of operating supplies, are stated at cost utilizing the first-in, first-out cost valuation method. In governmental funds, inventories are recorded as expenditures when purchased. Reported inventories in governmental funds are offset by nonspendable fund balance since the fund balance associated with inventory is not in spendable form. However, in the case of inventory held for resale, if the

State of Oregon
Notes to the Financial Statements

proceeds from the sale of the inventory are restricted, committed, or assigned to a specific purpose, the related fund balance is classified as restricted, committed, or assigned, as appropriate, rather than as nonspendable. In proprietary funds, inventories are expended when consumed rather than when purchased.

H. Prepaid Items

Payments made to vendors for services that will benefit periods beyond June 30 are recorded as prepaid items. In governmental funds and proprietary funds, prepaid items are accounted for using the consumption method. In governmental funds, a portion of fund balance equal to the prepaid items is classified as nonspendable to indicate that it is not in spendable form.

I. Restricted Assets

Certain proceeds of the State's bond and certificate of participation (COP) issues, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet or statement of net assets because their use is limited by applicable bond covenants or COP financing agreements. Other restrictions on asset use may change the nature and availability of an asset. Various grant moneys, loan acquisition funds, customer deposits, and insurance funds, are also classified as restricted assets.

J. Foreclosed and Deeded Properties

Properties acquired through foreclosure proceedings or by acceptance of deeds in lieu of foreclosure are recorded at the lower of cost or market.

K. Receivership Assets

Net assets of insurance companies that have been placed into receivership under the control of the Department of Consumer and Business Services in accordance with Oregon Revised Statutes are recorded as receivership assets in the agency fund.

L. Capital Assets

Capital assets, which include property, equipment, and infrastructure assets (i.e., highways, tunnels, bridges, and similar items), are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the State as assets with an initial cost of \$5,000 or more and an estimated useful life of more than one year. Such assets, when purchased or constructed, are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at estimated fair market value at the date of donation. Infrastructure acquired prior to fiscal years ended after June 30, 1980, is reported. The costs of normal maintenance and repairs that do not add to the value of assets or significantly extend asset lives are expensed rather than capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Significant interest expense incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

Capital assets of the primary government, as well as its component units, are depreciated over their estimated useful lives using the straight-line method, unless they are considered inexhaustible. Useful lives for buildings and related assets range from 10 to 75 years, while useful lives of equipment and machinery range from 3 to 50 years. For infrastructure assets, useful lives range from 5 to 75 years, with docks, dikes and dams having useful lives between 30 to 50 years. Useful lives for works of art and historical treasures range from 10 to 30 years, and useful lives for motor vehicles range from 3 to 30 years. Data processing software and hardware have useful lives ranging from 3 to 10 years.

M. Compensated Absences

Employees accumulate earned but unused vacation and sick leave benefits. There is no liability for unpaid accumulated sick leave since the State does not pay any amounts when employees separate from state service. A liability for vacation leave (compensated absences) is accrued when incurred in the government-wide, proprietary fund, and fiduciary fund financial statements. A liability for compensated absences is reported in governmental funds only if the liabilities have matured, for example, as the result of employee resignations and retirements.

N. Long-term Obligations

In the government-wide statement of net assets, long-term debt and other long-term obligations are reported as liabilities for governmental activities or business-type activities, as applicable. In proprietary funds, long-term debt and other long-term obligations are reported as liabilities in the balance sheet. Bond or certificate of participation (COP) premiums and discounts, as well as issuance costs, are deferred and amortized over the term of the debt. Bonds/COP payable is reported net of the applicable bond/COP premium or discount. Bond/COP issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental funds recognize bond/COP premiums and discounts, as well as bond/COP issuance costs, in the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issues are reported as other financing sources, while discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as other debt service expenditures.

O. Fund Equity

The difference between assets and liabilities is labeled as “Net Assets” on the government-wide, proprietary fund, and fiduciary fund financial statements and as “Fund Balance” on the governmental fund financial statements.

In governmental funds, fund balance is reported in five components: (1) nonspendable, (2) restricted, (3) committed, (4) assigned, and (5) unassigned.

Nonspendable fund balances include amounts that cannot be spent because they are either not spendable form or they are legally or contractually required to be maintained intact.

Restricted fund balances result from constraints imposed on net assets by law through constitutional provisions or enabling legislation or by parties outside the State, such as creditors, grantors, contributors, or laws or regulations of other governments. Enabling legislation authorizes the State to levy, assess, charge, or otherwise mandate payment from external resource providers and includes a legally enforceable requirement that those resources be used only for specific purposes stipulated by the legislation. The restricted fund balance category has been further broken down on the face of the governmental fund financial statements to indicate the various sources of those constraints.

Committed fund balance results from constraints imposed by bills (passed by the Legislature and signed into law by the Governor) that are separate from the authorization to raise the underlying revenue.

Assigned fund balance is the residual amount in governmental funds other than the General Fund. It represents amounts that are constrained by the state’s intent to be used for a specific purpose, but which are neither restricted nor committed.

Unassigned fund balance is the residual amount in the General Fund not included in the previous four categories. Deficit fund balances in other governmental funds are reported as unassigned. See Note 21 for additional information on fund equity.

In the government-wide statement of net assets and the proprietary fund balance sheet, net assets are reported in three components: (1) invested in capital assets, net of related debt, (2) restricted, and (3) unrestricted. Restricted net assets result from restrictions imposed on a portion of net assets by law through constitutional provisions or enabling legislation or by parties outside the State, such as creditors, grantors, contributors, or laws or regulations of other governments.

The state maintains two stabilization funds: the Oregon Rainy Day Fund within the General Fund and the Education Stability Fund within the Educational Support Fund, a nonmajor special revenue fund. The resources in both funds may be expended only when specific non-routine budget shortfalls occur. See Note 21 for additional information about the stabilization funds.

For fund balance classification purposes, state agencies determined the appropriate classification of each of their detail-level funds based on the resources accounted for in those funds and the constraints on spending those resources. Agencies expend resources from the appropriate funds based on each fund’s specific

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spending constraints. Ending fund balances, therefore, are the result of that spending. In the event that an expenditure/expense is incurred for purposes for which both restricted and unrestricted resources are available for use, the individual state agencies determine the order in which those resources are spent. The same is true of an expenditure incurred for purposes for which unrestricted (committed, assigned and unassigned) resources are available.

P. Changes in Accounting Principle

For the fiscal year ended June 30, 2011, the State implemented one new accounting standard issued by the GASB.

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, establishes accounting and financial reporting standards for all governments that report governmental funds. The statement provides more clearly defined categories for classifying fund balance to make the nature and extent of the constraints placed on a government's fund balance more transparent. It also clarifies existing governmental fund type definitions to improve the comparability, usefulness, and understandability of governmental fund balance information. See Note 21 for additional information.

2. DEPOSITS AND INVESTMENTS

The State's investment policies are governed by statute and the Oregon Investment Council (Council). The State Treasurer (Treasurer) is the investment officer for the Council and is responsible for the funds on deposit with the Oregon State Treasury (Treasury). In accordance with Oregon statutes, the investment funds are invested, and the investments of those funds managed, as a prudent investor would do, exercising reasonable care, skill, and caution. The Treasurer is authorized to use demand deposit accounts, fixed income investments, and direct equity investment transactions, although the majority of equity investments are currently directed by external investment managers under contract with the Council. Furthermore, equity investments are limited to not more than 50 percent of the moneys contributed to the Oregon Public Employees Retirement Fund (OPERF) and the Industrial Accident Fund (SAIF Corporation) and not more than 65 percent of the other trust and endowment funds managed by the Council or the Treasury. The Deferred Compensation Fund, the Education Stability Fund, the State Board of Higher Education, and the Oregon Health and Science University (OHSU) may also invest in equities.

The Treasurer maintains the Oregon Short-term Fund (OSTF), a cash and investment pool that is available for use by all funds and local governments. Oregon reports the State's portion of the pool within the funds of the State. The portion of the pool belonging to local governments is reported in the investment trust fund. Because the pool operates as a demand deposit account, each fund's portion of the pool is classified on the financial statements as cash and cash equivalents. A separate financial report for the OSTF is prepared by the Treasurer. Copies of the report may be obtained from the Oregon State Treasury, Finance Division, 350 Winter Street NE, Suite 100, Salem, Oregon 97301-3896, or from the Treasury's website at: <http://www.ost.state.or.us/About/Investment/>

The Treasurer also makes short-term and long-term investments, which are held separately by several of the State's funds. The Treasury's direct investments in short-term securities are limited by portfolio rules established by the OSTF Board and the Council. Other investments are made directly by state agencies with the approval of the Treasurer.

A. Custodial Credit Risk

Custodial Credit Risk for Deposits

The custodial credit risk for deposits is the risk that, in the event of a depository financial institution failure, the State will not be able to recover deposits or collateral securities that are in the possession of an outside party. The State does not have a formal policy regarding custodial credit risk for deposits. However, banking regulations and Oregon law establish the insurance and collateral requirements for deposits in the OSTF.

Oregon Revised Statutes (ORS), Chapter 295, governs the collateralization of public funds. Bank depositories are required to pledge collateral against any public fund deposits in excess of deposit insurance amounts. This requirement provides additional protection for public funds in the event of a bank loss. ORS Chapter 295 sets the specific value of the collateral, as well as the types of collateral that are acceptable.

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ORS Chapter 295 provides the statutory authority for the Public Funds Collateralization Program (PFCP). The PFCP is an application created by the Treasury to facilitate bank depository, custodian, and public official compliance with ORS Chapter 295. Under the PFCP, banks are required to report quarterly to the Treasury, providing quarter-end public fund balances in excess of Federal Deposit Insurance Corporation (FDIC) limits. Banks are also required to report their net worth and FDIC capitalization information. The FDIC assigns each bank a capitalization category quarterly: well capitalized, adequately capitalized, or undercapitalized. Based on this information, the bank's minimum collateral required to be pledged with the custodian and the maximum liability in the pool of all banks are calculated for the next quarter. The maximum liability is reported to the bank, the Treasury, and the custodian.

Barring any exceptions, a bank depository is required to pledge collateral valued at least 10 percent of the bank's quarter-end public fund deposits if the bank is well capitalized and 110 percent if the bank is adequately capitalized, undercapitalized, or assigned to pledge 110 percent by Treasury.

There are three exceptions to this calculation, and any exceptions are required to be collateralized at 100 percent.

1. A bank may not accept public fund deposits from one depositor in excess of the bank's net worth. If the bank has a drop in net worth that takes it out of compliance, the bank is required to post 100 percent collateral on any amount the depositor has in excess of the bank's net worth while working to eliminate that excess.
2. A bank may not hold aggregate public funds in excess of a percentage of the bank's net worth based on its capitalization category (100 percent for undercapitalized, 150 percent for adequately capitalized, 200 percent for well capitalized) unless approved for a period of 90 days or less by the Treasury.
3. A bank may hold in excess of 30 percent of all aggregate public funds reported by all banks holding Oregon public funds, only if the excess is collateralized at 100 percent.

All deposits in the OSTF at June 30, 2011, were with financial institutions participating in the FDIC's Transaction Account Guarantee Program. Under that program, all non-interest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. Consequently, the entire bank balance of uninvested OSTF deposits was fully insured.

As of June 30, 2011, \$2.1 billion in other bank balances of the primary government and its discretely presented component units were exposed to custodial credit risk (in thousands):

| | Primary Government | Discretely Presented Component Units | Balance at June 30, 2011 |
|---|-----------------------|--|-----------------------------|
| Uninsured and uncollateralized | \$ 2,121,209 | \$ 23,357 | \$ 2,144,566 |
| Uninsured and collateralized by the pledging bank's trust department, but not in the State's name | 3,089 | - | 3,089 |
| Total | <u>\$ 2,124,298</u> | <u>\$ 23,357</u> | <u>\$ 2,147,655</u> |

Custodial Credit Risk for Investments

Custodial credit risk for investments of the primary government is the risk that, in the event of the failure of the counterparty to a transaction, the State will not be able to recover the value of an investment or collateral securities in the possession of an outside party. The Council has no formal policy regarding the holding of securities by a custodian or counterparty. For the year ended June 30, 2011, no investment holdings of the primary government, SAIF Corporation, or Oregon Health and Science University were exposed to custodial credit risk.

B. Investments – Primary Government (Excluding the OPERF)

Investments Held at Treasury

Investments of the primary government (excluding the OPERF) held by the Treasurer require the exercise of prudent and reasonable care in the context of a fund's investment portfolio and as part of an overall investment strategy. The Treasurer is required to diversify investments unless it is not prudent to do so. In addition, the Treasurer must exercise reasonable care to incorporate risk and return objectives suitable to the particular investment fund. Each Treasury fund has a policy and procedure that addresses objectives and strategies.

Interest Rate Risk

Investment policy for fixed income investments under the direct management of the Treasurer generally limits the time horizon of the portfolio to an average maturity of 1 to 5 years. In addition, externally managed fixed income investment funds are required by policy to maintain an average bond duration level within 20 percent of the benchmark bond index. For investments not under the management of the Treasurer, there are no formal policies on interest rate risk. Investment objectives and strategies of the primary government (excluding the OPERF) are based on credit quality, asset diversification, and staggered maturities. For variable rate securities, the next interest rate reset date is used instead of the maturity date. The average effective duration is reported in years for all applicable funds.

Credit Risk

Investment policies for fixed income investments under the management of the Treasurer require that the portfolio maintain an average Standard and Poor's (S&P) credit quality of AA or A, as determined for each investment fund. For investments not under management of the Treasurer, there are no formal policies on credit risk.

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The credit rating and average effective duration for the investments at Treasury, held within the governmental funds, excluding the Common School Fund, at June 30, 2011 (dollars in thousands):

| Reporting Fund ¹ | Investment Type | Credit Rating | Balance at June 30, 2011 | Average Effective Duration |
|-----------------------------|---------------------------------------|-----------------|-----------------------------|----------------------------------|
| General | Alternative equities | N/A | <u>\$ 4,164</u> | N/A |
| Public Transportation | U.S. Agency securities | A | 11,560 | 1.05 |
| | | Corporate bonds | 36,763 | |
| | | A | 82,655 | |
| | | BBB | <u>22,153</u> | |
| | | | 141,571 | 1.36 |
| | Lehman Brothers | N/A | <u>1,299</u> | N/A |
| | | | <u>154,430</u> | |
| Employment Services | U.S. Agency securities | AAA | 18,607 | |
| | | A | <u>11,035</u> | |
| | | | 29,642 | 1.38 |
| | Corporate bonds | AAA | 468 | |
| | | AA | 22,612 | |
| | | A | 58,261 | |
| | | BBB | <u>22,717</u> | |
| | | | 104,058 | 1.95 |
| | Municipal bonds | AA | 1,742 | 1.10 |
| | Lehman Brothers and Washington Mutual | N/A | <u>2,050</u> | N/A |
| | | <u>137,492</u> | | |
| Education Support | Alternative equities | N/A | 27,815 | N/A |
| Residential Assistance | U.S. Agency securities | AAA | <u>16,906</u> | 1.72 |
| Total | | | <u>\$ 340,807</u> | |

¹ See separate Common School Fund schedule.

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The credit rating and average effective duration for the Common School Fund's investments, held at Treasury, at June 30, 2011 (dollars in thousands):

| Investment Type | Credit Rating ¹ | Balance at June 30, 2011 | Average Effective Duration |
|---------------------------------------|----------------------------|-----------------------------|-------------------------------|
| U.S. Treasury securities | AAA | \$ 13,512 | 12.73 |
| U.S. Treasury strips | AAA | 600 | 13.33 |
| U.S. Treasury tips | AAA | 2,006 | 11.37 |
| U.S. Agency mortgages | AAA | 21,960 | 3.96 |
| U.S. Agency TBAs | AAA | 28,202 | 4.00 |
| U.S. Agency securities | AAA | 368 | |
| U.S. Agency securities | Not rated | 710 | |
| | | <u>1,078</u> | 3.23 |
| Corporate bonds | AA | 1,262 | |
| | A | 13,119 | |
| | BBB | 12,592 | |
| | BB | 3,031 | |
| | B | 42 | |
| | Not rated | 1 | |
| | | <u>30,047</u> | 6.17 |
| International debt securities | AA | 661 | |
| | A | 3,401 | |
| | BBB | 2,994 | |
| | BB | 501 | |
| | B | 66 | |
| | | <u>7,623</u> | 5.73 |
| Collateralized mortgage obligations | AAA | 2,756 | |
| | A | 575 | |
| | BBB | 494 | |
| | BB | 1,341 | |
| | B | 3,057 | |
| | CCC and Below | 6,532 | |
| | Not rated | 923 | |
| | | <u>15,678</u> | 5.62 |
| Asset-backed securities - other | AAA | 2,079 | |
| | AA | 918 | |
| | A | 598 | |
| | BBB | 118 | |
| | B | 549 | |
| | CCC and Below | 1,931 | |
| | Not rated | 279 | |
| | | <u>6,472</u> | 2.03 |
| Municipal bonds | AAA | 255 | 0.01 |
| Domestic equity securities | N/A | 166,765 | N/A |
| International equity securities | N/A | 229,737 | N/A |
| Domestic mutual funds - debt | Not rated | 166,879 | 4.97 |
| Domestic mutual funds - equity | N/A | 178,354 | N/A |
| International mutual funds - debt | Not rated | 6,199 | 4.01 |
| International mutual funds - equity | N/A | 137,593 | N/A |
| Real estate and real estate mortgages | N/A | 1,911 | N/A |
| Alternative equities | N/A | 66,656 | N/A |
| Total ² | | <u>\$ 1,081,527</u> | |

¹ Within investments rated AAA are \$13,512 in U.S. Treasury securities, \$600 in U.S. Treasury Strips, \$2,006 in U.S. Treasury Tips, and \$13,547 in U.S. Agency securities invested in the Government National Mortgage Association (GNMA). These investments are explicitly guaranteed by the U.S. government.

² \$1,101 in real estate investments are held outside Treasury. See separate schedule.

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The credit rating and average effective duration for the investments, held within the proprietary funds, at June 30, 2011 (dollars in thousands):

| Reporting Fund | Investment Type | Credit Rating ³ | Balance at June 30, 2011 | Average Effective Duration |
|---|---|----------------------------|--------------------------|----------------------------|
| Housing and Community Services ¹ | | | | |
| | U.S. Treasury securities | AAA | \$ 8,465 | 8.66 |
| | U.S. Agency securities | AAA | 11,884 | 10.26 |
| | | | <u>20,349</u> | |
| Veterans' Loan | | | | |
| | U.S. Agency securities | A | 5,255 | 1.05 |
| | Corporate bonds | AA | 9,504 | |
| | | A | 12,030 | |
| | | | <u>21,534</u> | 0.19 |
| | Guaranteed investment contracts (GICs) ² | N/A | 3,269 | N/A |
| | Lehman Brothers and Washington Mutual | N/A | 3,540 | N/A |
| | | | <u>33,598</u> | |
| Lottery Operations | | | | |
| | U.S. Treasury strips | AAA | 87,934 | 8.42 |
| | U.S. Agency strips | Not rated | 28,689 | 3.21 |
| | | | <u>116,623</u> | |
| University System | | | | |
| | U.S. Treasury securities | AAA | 5,073 | 8.36 |
| | U.S. Agency securities | AAA | 29,645 | |
| | U.S. Agency securities | A | 3,185 | |
| | | | <u>32,830</u> | 3.87 |
| | Corporate bonds | AAA | 4,203 | |
| | Corporate bonds | AA | 4,903 | |
| | Corporate bonds | A | 21,365 | |
| | Corporate bonds | BBB | 4,553 | |
| | | | <u>35,024</u> | 3.08 |
| | Municipal bonds | AA | 1,916 | 6.71 |
| | Domestic mutual funds - debt | AAA | 34,471 | |
| | Domestic mutual funds - debt | AA | 10,338 | |
| | Domestic mutual funds - debt | A | 28,580 | |
| | Domestic mutual funds - debt | BBB | 37,230 | |
| | Domestic mutual funds - debt | Below BBB | 1,518 | |
| | Domestic mutual funds - debt | Not rated | 916 | |
| | | | <u>113,053</u> | 3.87 |
| | Asset backed securities | AAA | 5,895 | 2.60 |
| | Collateralized mortgage obligations | AAA | 5,473 | 3.96 |
| | Money market fund | Not rated | 1,056 | 0.50 |
| | GICs | N/A | 2,844 | 3.00 |
| | Equity investments | N/A | 36,937 | N/A |
| | Real estate and real estate mortgages | N/A | 2,251 | N/A |
| | Alternative equities | N/A | 6,801 | N/A |
| | Less: University System amounts recorded as cash | | (1,056) | |
| | | | <u>248,097</u> | |
| Central Services | | | | |
| | U.S. Agency securities | AAA | 4,779 | |
| | | A | 1,051 | |
| | | | <u>5,830</u> | 1.48 |
| | Corporate bonds | AAA | 3,994 | |
| | | AA | 12,136 | |
| | | A | 26,472 | |
| | | BBB | 9,408 | |
| | | | <u>52,010</u> | 1.57 |
| | Municipal bonds | AA | 1,493 | 1.10 |
| | Lehman Brothers and Washington Mutual | N/A | 1,154 | N/A |
| | | | <u>60,487</u> | |
| Total | | | <u>\$ 479,154</u> | |

¹ \$299,821 in investments are held outside of Treasury. See separate schedule.

² Mature in 2029 and beyond.

³ Within investments rated AAA are \$13,538 in U.S. Treasury securities and \$87,934 in U.S. Treasury strips which are explicitly guaranteed by the U.S. government.

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Investments Held Outside of the Treasury

For investments held outside of the Treasury, statutes govern the placement of funds with outside parties as part of trust agreements or mandatory asset holdings by regulatory agencies.

The credit rating and segmented time distribution for investments held outside Treasury as of June 30, 2011 (in thousands):

| Reporting Fund | Investment Type | Credit Rating ³ | Investment Maturities (in years) | | | | Balance at June 30, 2011 |
|--------------------------------|---|----------------------------|----------------------------------|-------------------|-----------------|----------------------|--------------------------|
| | | | Less than 1 | 1 to 5 | 6 to 10 | More than 10 or none | |
| Consumer Protection | U.S. Agency securities ¹ | AAA | \$ 550 | \$ - | \$ - | \$ - | \$ 550 |
| Public Transportation | U.S. Agency securities ¹ | Not rated | - | 1,034 | - | - | 1,034 |
| | Municipal bonds ¹ | Not rated | 1,256 | - | - | - | 1,256 |
| | | | <u>1,256</u> | <u>1,034</u> | <u>-</u> | <u>-</u> | <u>2,290</u> |
| Common School | U.S. Agency strips ¹ | AAA | - | 5 | 6 | - | 11 |
| | U.S. Treasury strips ¹ | AAA | - | 2 | 2 | - | 4 |
| | Corporate bonds ¹ | AA | - | 21 | - | - | 21 |
| | Municipal bonds ¹ | AAA | 11 | 8 | - | 1 | 20 |
| | Domestic equity securities ¹ | N/A | - | - | - | 5,912 | 5,912 |
| | Real estate ¹ | N/A | - | - | - | 1,186 | 1,186 |
| | Mutual funds ¹ | N/A | 1,657 | - | - | - | 1,657 |
| | | | <u>1,668</u> | <u>36</u> | <u>8</u> | <u>7,099</u> | <u>8,811</u> |
| Revenue Bond | GICs | N/A | - | 60,652 | - | 2,523 | 63,175 |
| | | | <u>-</u> | <u>60,652</u> | <u>-</u> | <u>2,523</u> | <u>63,175</u> |
| Housing and Community Services | U.S. Treasury securities | AAA | 106,684 | - | 1,087 | 601 | 108,372 |
| | U.S. Agency securities | AAA | 17,880 | 27,603 | 5,307 | 39,806 | 90,596 |
| | | P-1 | 44,067 | - | - | - | 44,067 |
| | | Not rated | 7,306 | - | - | - | 7,306 |
| | Municipal bonds | AAA | - | - | - | 49,480 | 49,480 |
| | | | <u>175,937</u> | <u>27,603</u> | <u>6,394</u> | <u>89,887</u> | <u>299,821</u> |
| Private Purpose Trust | U.S. Treasury securities | AAA | 3 | 236 | - | 16 | 255 |
| | Domestic equity securities | N/A | - | - | - | 142 | 142 |
| | Domestic mutual funds - debt | N/A | - | - | - | 247 | 247 |
| | Annuity contracts | N/A | - | - | - | 249 | 249 |
| | | | <u>3</u> | <u>236</u> | <u>-</u> | <u>654</u> | <u>893</u> |
| Agency | U.S. Treasury securities ² | AAA | 18,002 | 44,645 | - | - | 62,647 |
| | U.S. Agency securities ² | AAA | - | 33 | - | - | 33 |
| | Municipal bonds ¹ | AAA | 100 | - | - | - | 100 |
| | | AA | - | - | 44 | 101 | 145 |
| | | A | - | 615 | - | - | 615 |
| | | Not rated | - | - | 115 | - | 115 |
| | Time certificates of deposit ² | N/A | 542 | - | - | - | 542 |
| | | | <u>18,644</u> | <u>45,293</u> | <u>159</u> | <u>101</u> | <u>64,197</u> |
| Total | | | <u>\$ 198,058</u> | <u>\$ 134,854</u> | <u>\$ 6,561</u> | <u>\$ 100,264</u> | <u>\$ 439,737</u> |

¹ Some investments are reported as part of custodial assets on the balance sheet.

² Some investments (along with certain cash deposits) are reported as receivership assets on the balance sheet.

³ Within investments rated AAA are \$171,275 in U.S. Treasury securities and \$4 in U.S. Treasury strips. These securities are explicitly guaranteed by the U.S. government.

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Investments of the Oregon Short-term Fund (OSTF)

The OSTF is an external investment pool open to state agencies and local governments. Because the OSTF acts as a demand deposit account, both the cash and investments within the OSTF are shown as cash and cash equivalents on the balance sheet and statement of net assets. The external portion of the OSTF is reported within the Investment Trust Fund. The OSTF staff manages interest rate risk by limiting the maturity of the investments. The portfolio rules require that at least 50 percent of the portfolio mature within 93 days; not more than 25 percent of the portfolio may mature in over a year; and no investments may mature over three years from settlement date. For variable rate securities, the next interest rate reset date is used instead of the maturity date. For variable rate securities in a fixed rate period that will switch to a variable rate at a later date, the maturity is based on the final maturity of the bond, not the next variable reset date.

Interest rate risk for the OSTF investments as of June 30, 2011 (in thousands):

| Investment Type | Investment Maturities (in years) | | | | Balance at June 30, 2011 ² |
|-------------------------------------|----------------------------------|------------------------|-----------------------|------------------------|--|
| | Up to 93 Days | 94 Days to One Year | One to Three Years | Defaulted ¹ | |
| U.S. Treasury and Agency securities | \$ 1,599,923 | \$ 1,665,088 | \$ 407,006 | \$ - | \$ 3,672,017 |
| Commercial paper | 255,810 | - | - | - | 255,810 |
| Time certificates of deposit | 60,200 | - | - | - | 60,200 |
| Corporate notes | 2,674,859 | 239,593 | 1,405,481 | 49,336 | 4,369,269 |
| Bank notes | 82,555 | 31,660 | - | - | 114,215 |
| Municipal bonds | 56,999 | - | - | - | 56,999 |
| Temporary liquidity guarantee | 513,308 | 221,962 | 281,558 | - | 1,016,828 |
| Total | \$ 5,243,654 | \$ 2,158,303 | \$ 2,094,045 | \$ 49,336 | \$ 9,545,338 |

¹ Lehman Brothers securities, \$191.3 million par value.

² Balance at June 30, 2011, is a combination of amortized cost and fair value.

OSTF policies provide minimum weighted average credit quality ratings for the fund's holdings: AA and Aa2 for Standard and Poor's (S&P) and Moody's, respectively. The Oregon Investment Council (Council) made changes to the allowable minimum ratings in April, 2010. The current minimums for corporate notes are an S&P rating of A-, Moody's rating of A3, and Fitch rating of A-. Commercial paper is required to have a minimum short-term credit rating at the time of purchase from two of three ratings services with current minimum ratings from S&P of A-1, Moody's of P-1, and Fitch of F-1. Foreign government securities or their instrumentalities were added by the Council as approved investments at the same time and are required to have minimum credit ratings from S&P of AA-, Moody's of Aa3, and Fitch of AA-. Occasionally, securities are downgraded, but OSTF policies allow them to be retained at the Senior Investment Officer's discretion. Ratings for holdings of Lehman Brothers securities, totaling \$191.3 million par value, were withdrawn by all three agencies due to bankruptcy. Rating groups were determined using the lowest actual rating from S&P, Moody's, or Fitch.

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Credit risk schedule for the OSTF investments as of June 30, 2011 (in thousands):

| Investment Type | AAA ¹ | AA | A | BBB ² | N/A ³ | Balance at June 30, 2011 |
|-------------------------------------|---------------------|---------------------|---------------------|------------------|-------------------|-----------------------------|
| U.S. Treasury and Agency securities | \$ 3,521,279 | \$ - | \$ 150,738 | \$ - | \$ - | \$ 3,672,017 |
| Commercial paper | - | 24,998 | 230,812 | - | - | 255,810 |
| Time certificates of deposit | - | - | - | - | 60,200 | 60,200 |
| Corporate notes | 47,366 | 1,599,983 | 2,654,719 | 17,865 | 49,336 | 4,369,269 |
| Bank notes | - | 49,891 | 64,324 | - | - | 114,215 |
| Municipal bonds | - | 56,999 | - | - | - | 56,999 |
| Temporary liquidity guarantee | 1,016,828 | - | - | - | - | 1,016,828 |
| Total | <u>\$ 4,585,473</u> | <u>\$ 1,731,871</u> | <u>\$ 3,100,593</u> | <u>\$ 17,865</u> | <u>\$ 109,536</u> | <u>\$ 9,545,338</u> |

¹ Within investments rated AAA are \$951,643 in U.S. Treasury securities and \$1,016,828 in the temporary liquidity guarantee program, which are explicitly guaranteed by the U.S. government.

² Securities rated BBB in this table continue to meet the investment quality rules of the OSTF.

³ Ratings for the Lehman Brothers corporate note were withdrawn. Time certificates of deposit are not rated.

Interest Rate Sensitive Investments

As of June 30, 2011, the primary government held \$150.2 million in step-coupon debt investments. The interest rate of these securities adjusts on a predetermined schedule at predetermined increments. Because these adjustments are not correlated with any current indices or rates, the value of the securities may change significantly in a period of interest rate volatility. The primary government also held approximately \$43.1 million in debt instruments backed by pooled mortgages, collateralized mortgage obligations, or fixed rate mortgages. These securities represent a stream of principal and interest payments from underlying mortgages. Assets with these characteristics are susceptible to prepayment by the mortgage holders which may result in a decrease in total interest realized. The value of these securities can be volatile as interest rates fluctuate. Additionally, the risk of default exists and collateral held may potentially be insufficient to cover the principal due. In addition, the primary government held \$12.4 million of debt instruments that were asset-backed securities collateralized primarily by automobile and manufactured home loans and student loan receivables as well as approximately \$28.2 million in To-Be-Announced (TBA) federal agency-issued mortgage pools.

Concentration of Credit Risk

Investment policies for fixed income investments under the management of the Treasurer generally limit investments in a single issuer to 5 percent of the portfolio, with the exception of securities of the U.S. government and U.S. agencies. For investments not under the management of the Treasurer, there are no formal policies on concentration of credit risk. At June 30, 2011, there were three issuers that exceeded 5 percent of the primary government's holdings (excluding the OPERF): \$1.2 billion (10.1 percent) in Federal Home Loan Bank (FHLB); \$909.6 million (7.5 percent) in Federal Home Loan Mortgage Corporation (FHLMC) and \$693.7 million (5.7 percent) in Federal National Mortgage Association (FNMA).

The Oregon Housing and Community Services Department also carried concentration of credit risk with 25.5 percent of the department's total investments in FHLB and 8.8 percent in FNMA.

Total investments for the Oregon Department of Veterans' Affairs included 20.9 percent in Goldman Sachs, 20.8 percent in Westpac Banking, 15.6 percent in FNMA, 14.9 percent in Bear Stearns, 10.5 percent in Lehman Brothers Holdings Inc., 7.5 percent in General Electric Capital Corporation, and 5.3 percent in HypoVereinsbank.

The Oregon State Lottery's investments included 24.6 percent in the Resolution Funding Corporation (RFC), a U.S. government agency. The U.S. government does not explicitly guarantee these investments. However, interest payments are backed by the U.S. government, and the principal is protected by the purchase of zero-coupon bonds with an equivalent face value.

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Within the major governmental funds, the Public Transportation Fund's investments included 8.3 percent in General Electric Capital Corporation, 7.5 percent in Wachovia Bank, 7.4 percent in FNMA, 7.1 percent in UBS AG Stamford, 7.1 percent in Westpac Banking Corporation, and 5 percent in Goldman Sachs. The aggregated nonmajor governmental funds' total investments included 18 percent in FNMA, and 6.9 percent in FHLMC. These funds also held nonparticipating guaranteed investment contracts with the following concentrations: 10.6 percent in the International Netherlands Group and 9.1 percent in American International Group.

The Central Services Fund held 7.9 percent of its investments in FNMA.

The investments of the Oregon University System included 8.9 percent in FHLMC, 7.6 percent in FNMA, and 5.1 percent in Agribank.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. State agencies are required to deposit moneys in state-qualified depositories under Oregon law. Exceptions due to foreign field offices and related circumstances are approved by the Treasurer. International debt securities denominated in U.S. dollars are not subject to currency risk if the investment's obligations will be paid in U.S. dollars. Investment policies for fixed income investments under the management of the Treasurer generally prohibit investments in non-dollar denominated securities. The Common School Fund and the Oregon University System Pooled Endowment Fund are allowed to invest in international equity securities within a target allocation range of 25 to 35 percent of their respective portfolios. For investments not under the management of the Treasurer, there are no formal policies on foreign currency risk.

Deposits and investments exposed to foreign currency risk for the primary government (excluding the OPERF) as of June 30, 2011 (in thousands):

| Foreign Currency Denomination | Deposits and Investments (U.S. Dollars) | | | | Total |
|----------------------------------|---|---------------------------------------|------------------------------------|-------------------|-------|
| | Deposits | International Equity Securities | Real Estate Investment Trust | | |
| Australian dollar | \$ 102 | \$ 11,261 | \$ - | \$ 11,363 | |
| British sterling pound | 72 | 45,839 | - | 45,911 | |
| Canadian dollar | 92 | 14,913 | - | 15,005 | |
| Swiss franc | 75 | 10,589 | - | 10,664 | |
| Danish krone | 41 | 5,400 | - | 5,441 | |
| Euro | 298 | 81,172 | - | 81,470 | |
| Hong Kong dollar | 95 | 4,176 | 10 | 4,281 | |
| Israel new shekel | 12 | 1,077 | - | 1,089 | |
| Japanese yen | 478 | 39,245 | - | 39,723 | |
| Norwegian krone | 153 | 4,437 | - | 4,590 | |
| New Zealand dollar | 17 | 439 | - | 456 | |
| Singapore dollar | 82 | 2,489 | - | 2,571 | |
| Swedish krona | 78 | 2,747 | - | 2,825 | |
| Total | \$ 1,595 | \$ 223,784 | \$ 10 | \$ 225,389 | |

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C. Investments – Primary Government – Oregon Public Employees Retirement Fund

The Council establishes policies for the investment of moneys in the OPERF. Policies are based on the primary investment class of each investment manager and do not reflect the classifications of individual holdings as presented in the financial statements. Contracts with individual investment managers provide additional guidelines that vary from manager to manager.

Investments in the OPERF as of June 30, 2011 (in thousands):

| Investment Type | Fair Value |
|---|-----------------------------|
| Repurchase agreements | \$ 6,002 |
| U.S. Treasury securities | 884,311 |
| U.S. Treasury strips | 49,506 |
| U.S. Treasury TIPS | 83,722 |
| U.S. Agency securities | 425,064 |
| U.S. Agency mortgages | 925,107 |
| U.S. Agency mortgage TBAs | 1,345,603 |
| U.S. Agency strips | 58,727 |
| International debt securities | 2,167,882 |
| Corporate bonds | 3,438,255 |
| Bank loans | 1,970,464 |
| Municipal bonds | 85,753 |
| Collateralized mortgage obligations | 1,173,832 |
| Asset-backed securities | 616,729 |
| Mutual funds - domestic fixed income | 1,378,146 |
| Mutual funds - international fixed income | 423,896 |
| Total debt securities | <u>15,032,999</u> |
| Derivatives | 40,162 |
| Domestic equity securities | 7,077,336 |
| International equity securities | 10,675,308 |
| Mutual funds - domestic equity | 2,390,280 |
| Mutual funds - global equity | 948,197 |
| Mutual funds - international equity | 2,741,024 |
| Mutual funds - target date | 270,851 |
| Limited partnerships and leveraged buyouts | 13,748,215 |
| Real estate and real estate investment trusts | 6,135,410 |
| Opportunity Portfolio | 1,142,876 |
| Total investments | <u><u>\$ 60,202,658</u></u> |

Interest Rate Risk

Interest rate risk is managed within the OPERF using the effective duration methodology. Investment policies require that the fixed income manager positions will maintain a weighted average effective duration within plus or minus 20 percent of the benchmark's effective duration. There is no policy restriction for non-fixed income investment managers who may hold fixed income positions. As of June 30, 2011, the weighted average duration of the fixed income portfolio was 4.37 years and there were no individual fixed income investment manager portfolios outside the policy guidelines.

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Notes to the Financial Statements

Debt investments of the OPERF as of June 30, 2011 (in thousands):

| Investment Type | Balance at June 30, 2011 | Weighted Average Duration |
|--|-----------------------------|---------------------------------|
| U.S. Treasury securities | \$ 884,311 | 9.02 |
| U.S. Treasury strips | 49,505 | 13.81 |
| U.S. Treasury TIPS | 83,722 | 6.64 |
| U.S. Agency securities | 425,064 | 4.35 |
| U.S. Agency mortgages | 845,765 | 3.88 |
| U.S. Agency mortgage TBAs | 1,345,603 | 5.44 |
| U.S. Agency strips | 58,727 | 8.67 |
| International debt securities | 2,018,832 | 4.61 |
| Corporate bonds | 3,416,869 | 4.92 |
| Bank loans | 1,895,732 | 0.54 |
| Municipal bonds | 85,753 | 6.79 |
| Collateralized mortgage obligations | 1,039,853 | 4.97 |
| Asset-backed securities | 459,302 | 2.11 |
| Mutual funds - domestic fixed income | 1,135,413 | 3.37 |
| Mutual funds - domestic fixed income (OSGP) | 80,639 | 4.69 |
| Mutual funds - international fixed income | 423,896 | 5.52 |
| Mutual funds - stable value | 162,094 | 2.51 |
| No effective duration: | | |
| U.S. Agency mortgages | 79,343 | |
| International debt securities | 149,050 | |
| Corporate bonds | 21,386 | |
| Bank loans | 74,732 | |
| Collateralized mortgage obligations | 133,978 | |
| Asset-backed securities | 157,428 | |
| Repurchase agreements | 6,002 | |
| Total debt securities | 15,032,999 | |
| Cash equivalent - U.S. government short-term funds | 52,471 | 25 days ¹ |
| Total subject to interest rate risk | \$ 15,085,470 | |

¹ Weighted average maturity

Credit Risk

Investment policy requires that no more than 35 percent of the fixed income manager positions be below investment grade. Securities with a quality rating below BBB- (S&P) are considered below investment grade. There is no policy restriction on other investment managers who may hold debt securities. As of June 30, 2011, the fair value of below grade investments, excluding unrated securities, was \$2.5 billion, or 28.1 percent, of total securities subject to credit risk, and the weighted quality rating average was A. Overall credit quality deteriorated due to downgrades in both corporate bonds and non-agency mortgages. Unrated securities included \$2 billion in bank loans, \$1.8 billion in mutual funds, and \$861.9 million in other debt securities.

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Credit ratings for debt securities within the OPERF as of June 30, 2011 (in thousands):

| Credit Rating | Balance at June 30, 2011 |
|---------------|-----------------------------|
| AAA | \$ 3,100,005 |
| AA | 269,917 |
| A | 1,122,489 |
| BBB | 1,813,626 |
| BB | 836,409 |
| B | 936,367 |
| CCC | 594,148 |
| CC | 20,710 |
| C | 40,696 |
| D | 38,567 |
| Not rated | 4,634,399 |
| Total | <u>\$ 13,407,333</u> |

Concentrations of Credit Risk

The Council's investment policy pertaining to OPERF investments requires that investment managers maintain diversified portfolios. There is no limit on single issuer investments for domestic, global, and international equity fund managers. Policy requires that the asset classes be diversified across their respective markets. Additionally, both passive and active investing strategies are employed, and several external managers engage in active management. Policy provides the following limitations for fixed income investment manager positions:

- There are no restrictions on obligations issued or guaranteed by the U.S. government, U.S. agencies, or government sponsored enterprises.
- No more than 10 percent of the debt investment portfolio per issuer may be invested in obligations of other national governments.
- No more than 10 percent of the debt investment portfolio per issuer or 25 percent in a single issuer, after meeting additional collateral requirements, can be invested in private mortgage-backed and asset-backed securities. The collateral must be credit-independent of the issuer and the security's credit enhancement generated internally.
- No more than 3 percent of the debt investment portfolio may be invested in other issuers, excluding investments in commingled investments.

At June 30, 2011, there were no single issuer debt investments that exceeded the above guidelines, nor were there investments in any one issuer that represented 5 percent or more of total investments.

Foreign Currency Risk

Foreign currency and security risk of loss arises from changes in currency exchange rates. Foreign currency risk within the OPERF is controlled via contractual agreements with the investment managers. Investment policies require that no more than 15 percent of the fixed income manager positions may be invested in non-dollar denominated securities. Policies for the non-fixed portion of the OPERF are silent regarding this risk. As of June 30, 2011, approximately 3.6 percent of the debt investment portfolio was invested in non-dollar denominated securities.

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The OPERF's exposure to foreign currency risk as of June 30, 2011 (in thousands):

| Deposits and Investments (U.S. Dollars) | | | | | | |
|---|---------------------------------|--------------------|---------------------|-------------------|-------------------|----------------------|
| Foreign Currency Denomination | Cash and Cash Equivalents | Debt Securities | Public Equity | Real Estate | Private Equity | Total |
| Argentine peso | \$ 81 | \$ - | \$ - | \$ - | \$ - | \$ 81 |
| Australian dollar | 25,440 | 115,676 | 396,930 | 77,731 | - | 615,777 |
| Brazilian real | 5,089 | 36,764 | 210,057 | 1,494 | - | 253,404 |
| British sterling pound | 14,867 | 128,315 | 1,576,800 | 57,004 | - | 1,776,986 |
| Canadian dollar | 4,930 | 56,895 | 512,097 | 17,693 | - | 591,615 |
| Chilean peso | 13 | - | 5,028 | - | - | 5,041 |
| Chinese yuan | 63 | - | - | 890 | - | 953 |
| Colombian peso | - | 885 | 4,920 | - | - | 5,805 |
| Czech koruna | 1,151 | - | 14,834 | - | - | 15,985 |
| Danish krone | 1,036 | 24 | 104,284 | - | - | 105,344 |
| Dominican Republic peso | - | 1,195 | - | - | - | 1,195 |
| Egyptian pound | 114 | - | 15,617 | - | - | 15,731 |
| Euro | 58,608 | 194,872 | 2,345,164 | 62,842 | 380,370 | 3,041,856 |
| Hong Kong dollar | 8,958 | - | 479,699 | 117,906 | - | 606,563 |
| Hungarian forint | 92 | - | 16,812 | - | - | 16,904 |
| Indian rupee | - | - | 18,622 | - | - | 18,622 |
| Indonesian rupiah | 340 | - | 91,563 | - | - | 91,903 |
| Israeli shekel | 230 | - | 25,026 | - | - | 25,256 |
| Japanese yen | 28,152 | - | 1,747,404 | 65,198 | - | 1,840,754 |
| Jordanian dinar | 1 | - | - | - | - | 1 |
| Malaysian ringgit | 651 | - | 54,180 | - | - | 54,831 |
| Mexican peso | 221 | 3,056 | 41,488 | - | - | 44,765 |
| New Zealand dollar | 264 | - | 22,138 | - | - | 22,402 |
| Nigerian naira | - | - | 626 | - | - | 626 |
| Norwegian krone | 496 | 477 | 83,426 | - | - | 84,399 |
| Pakistan rupee | 170 | - | 3,590 | - | - | 3,760 |
| Peruvian nuevo sol | - | 90 | 801 | - | - | 891 |
| Philippine peso | 159 | - | 16,999 | 1,038 | - | 18,196 |
| Polish zloty | 19 | 1,257 | 49,143 | - | - | 50,419 |
| Russian ruble | 60 | 2,853 | - | - | - | 2,913 |
| Singapore dollar | 363 | - | 119,907 | 25,179 | - | 145,449 |
| South African rand | 1,601 | 629 | 202,820 | 950 | - | 206,000 |
| South Korean won | 1,578 | - | 438,757 | - | - | 440,335 |
| Swedish krona | 216 | - | 145,034 | 5,068 | - | 150,318 |
| Swiss franc | 2,426 | - | 437,049 | 5,677 | - | 445,152 |
| Taiwanese dollar | 5,363 | - | 217,801 | - | - | 223,164 |
| Thai baht | 710 | - | 84,364 | 1,519 | - | 86,593 |
| Turkish lira | 246 | - | 83,637 | - | - | 83,883 |
| Uruguayan peso | - | 1,528 | - | - | - | 1,528 |
| Venezuelan bolivar fuerte | 6 | - | - | - | - | 6 |
| Total | \$ 163,714 | \$ 544,516 | \$ 9,566,617 | \$ 440,189 | \$ 380,370 | \$ 11,095,406 |

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D. Investments – Discretely Presented Component Units

SAIF Corporation (SAIF)

SAIF's investment policies are governed by statute and the Oregon Investment Council (Council). The State Treasurer (Treasurer) is the investment officer for the Council and is responsible for the funds on deposit in the State Treasury. In accordance with ORS 293.726, the investment funds are to be invested, and the investments of those funds managed, as a prudent investor would do, exercising reasonable care, skill, and caution. While the Treasurer is authorized to use demand deposit accounts and fixed income investments, equity investment transactions must be directed by external investment managers that are under contract with the Council. Equity investments are limited to not more than 50 percent of the moneys contributed to the Industrial Accident Fund (SAIF Corporation). However, SAIF's adopted investment policy as approved by the Council limits equity holdings to a range of 7 to 13 percent of the market value of invested assets with a target allocation of 10 percent.

Bond, mortgage-backed, asset-backed, and equity security transactions are recorded on a trade date basis, generally three business days prior to the settlement date. However, the number of days between trade and settlement dates for mortgage-backed securities can be up to 30 days or longer, depending on the security.

Interest Rate Risk

SAIF's policy for fixed income investments effective January 27, 2010, provides that a duration target be used to manage interest rate risk. The policy calls for the portfolio duration to be within 20 percent of the benchmark duration. The benchmark duration as of December 31, 2010, was 5.90 years, with an acceptable range of 4.72 to 7.08 years. As of that date, the fixed income portfolio's duration was 6.34 years.

The following 2010 maturity distribution schedule includes \$1.1 billion in interest-rate sensitive securities. As of December 31, 2010, SAIF held \$696.1 million of U.S. federal agency mortgage-backed securities and \$215.7 million of commercial mortgage obligations. These securities are based on cash flows from principal and interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. As of December 31, 2010, SAIF held \$144.8 million of asset-backed securities which consist primarily of utility, student loan, and equipment lease receivables, and pass-through certificates issued by airlines and railroads. The value of these securities can be volatile as interest rates fluctuate. Additional risk inherent with these securities is the unpredictability of default on loans that are the collateral for the debt.

The following schedule presents SAIF's investments by maturity date as of December 31, 2010, using the segmented time distribution method (in thousands):

| Investment Type | Investment Maturities (in years) | | | | Balance at December 31, 2010 |
|-------------------------------------|----------------------------------|-------------------|---------------------|----------------------------|------------------------------------|
| | Less than 1 | 1 to 5 | 6 to 10 | More than 10 or none | |
| U.S. Treasury securities | \$ 7,610 | \$ 7,657 | \$ 7,792 | \$ 29,104 | \$ 52,163 |
| U.S. Agency securities | - | 8,406 | 65,005 | 31,847 | 105,258 |
| U.S. Agency mortgages | 107,262 | 223,607 | 120,733 | 244,457 | 696,059 |
| Corporate bonds | 26,786 | 389,290 | 698,265 | 739,972 | 1,854,313 |
| Municipal bonds | - | 12,391 | 2,752 | 82,490 | 97,633 |
| Collateralized mortgage obligations | 21,566 | 97,707 | 52,885 | 43,564 | 215,722 |
| Asset-backed securities | 14,646 | 111,044 | 19,125 | - | 144,815 |
| International debt securities | 1,816 | 116,274 | 172,645 | 112,191 | 402,926 |
| BlackRock MSCI ACWI IMI index fund | - | - | - | 467,988 | 467,988 |
| Other invested assets | - | - | - | 157 | 157 |
| Total | \$ 179,686 | \$ 966,376 | \$ 1,139,202 | \$ 1,751,770 | \$ 4,037,034 |

Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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Credit Risk

SAIF's credit risk policy is to maintain a well diversified investment portfolio. Fixed income holdings shall be the largest component of the portfolio. The policy seeks to maintain an overall fixed income portfolio quality of at least A or higher. The majority of SAIF's debt securities as of December 31, 2010, were rated by Moody's and Standard & Poor's, which are nationally recognized statistical rating organizations. The following schedule represents the ratings of debt securities by investment type as of December 31, 2010, using the Standard & Poor's rating scale (in thousands):

| Investment Type | AAA ¹ | AA | A | BBB | BB | B or below | Not rated | Balance at December 31, 2010 |
|-------------------------------|------------------|------------|--------------|------------|------------|------------|------------|------------------------------|
| U.S. Treasury securities | \$ 52,163 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 52,163 |
| U.S. Agency securities | 105,258 | - | - | - | - | - | - | 105,258 |
| U.S. Agency mortgages | 696,059 | - | - | - | - | - | - | 696,059 |
| Corporate bonds | 12,766 | 216,134 | 854,340 | 557,367 | 161,278 | 39,806 | 12,622 | 1,854,313 |
| Municipal bonds | 1,813 | 57,863 | 20,646 | 7,275 | - | - | 10,036 | 97,633 |
| Collateralized mortgages | 115,543 | 7,992 | 7,798 | 2,506 | - | 14,535 | 67,348 | 215,722 |
| Asset-backed securities | 74,092 | 14,828 | 4,781 | - | - | 511 | 50,603 | 144,815 |
| International debt securities | 10,263 | 62,855 | 138,859 | 171,061 | 10,472 | 9,416 | - | 402,926 |
| Total | \$ 1,067,957 | \$ 359,672 | \$ 1,026,424 | \$ 738,209 | \$ 171,750 | \$ 64,268 | \$ 140,609 | \$ 3,568,889 |

¹ Within investments rated AAA are \$52,163 in U.S. Treasury securities and \$181,961 in U.S. Agency mortgages invested in GNMA. These securities are explicitly guaranteed by the U.S. government.

Oregon Health and Science University (OHSU)

OHSU held \$32.5 million of asset-backed securities collateralized primarily by auto loans, credit card receivables, and collateralized mortgage obligations as of June 30, 2011. These securities are valued at their estimated fair values. The valuation of these securities is sensitive to principal prepayments, which may result from a decline in interest rates, and they are sensitive to an increase in average maturity, which may result from interest rate increases that lead to decreasing prepayments. These factors may increase the interest rate volatility of this component of OHSU's investment portfolio.

At June 30, 2011, OHSU had partnerships, alternative investments, real estate investments, and other investments. These investments may contain elements of both credit and market risk. Such risks may include limited liquidity, absence of regulatory oversight, dependence upon key individuals, and nondisclosure of portfolio composition. Because these investments are not readily marketable, their estimated fair value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. Such differences could be material.

Interest Rate Risk

OHSU investment policies vary based on the investment objectives of the portfolio. The operating and trustee-held portfolios seek to preserve principal with the intent of maximizing total return within appropriate risk parameters. Maturities of securities in these portfolios are based upon returns available at the time of investing while considering cash requirements of the organization.

The endowment portfolio, which is included in long-term investments, seeks to produce a predictable and stable payout stream that increases over time, while achieving growth of corpus. Foundation investment policies are set based on the investment objectives of the portfolio. Each portfolio has its own board-authorized asset allocation guideline. The current fund seeks to preserve principal and generate an above average rate of return. The current fund may invest in cash, cash equivalents, and fixed income securities, which have a maturity or average life of five years or less and the average weighted maturity of the portfolio shall not exceed three years. The endowment fund seeks to produce a predictable and stable payout stream that increases over time, while achieving growth of corpus. The endowment fund may invest in cash and cash equivalents, fixed income securities, domestic and international equity securities, and other alternative investments. Fixed income securities held in this fund shall have a medium to long average duration (three to eight years).

The charitable gift annuity pool seeks to produce a relatively predictable and stable payout stream that will satisfy the funds distribution obligations while achieving long-term capital appreciation of the overall fund balance. The charitable gift annuity pool may invest in cash and cash equivalents, domestic and international equities, fixed income, and real estate. Charitable trusts are managed to produce a relatively predictable and

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stable payout stream that will satisfy the funds distribution obligations while achieving long-term capital appreciation of the overall fund balance. Charitable trust investment objectives and asset allocation guidelines are determined based on the individual circumstances of each trust account. Allowable investments include cash and cash equivalents, domestic and international equities, fixed income, and real estate.

As of June 30, 2011, OHSU had the following investments and maturities at fair value (in thousands):

| Investment Type | Credit Rating | Investment Maturities (in years) | | | | Balance at June 30, 2011 |
|--------------------------------------|---------------|----------------------------------|-------------------|------------------|----------------------|--------------------------|
| | | Less than 1 | 1 to 5 | 6 to 10 | More than 10 or none | |
| Cash and money market funds | N/A | \$ 121,280 | \$ - | \$ - | \$ - | \$ 121,280 |
| U.S. Treasury securities | AAA | 48,482 | 180,889 | 32,428 | 6,817 | 268,616 |
| U.S. Agency securities | AAA | 29,205 | 34,335 | - | - | 63,540 |
| Domestic equity securities | N/A | - | - | - | 65,047 | 65,047 |
| International equity securities | N/A | - | - | - | 127,148 | 127,148 |
| International debt securities | AAA | - | 2,426 | 770 | 2,353 | 5,549 |
| | AA | - | 542 | 354 | 1,914 | 2,810 |
| | A | 400 | 872 | 1,880 | 678 | 3,830 |
| | BBB | - | 373 | 780 | - | 1,153 |
| | BB | - | - | 77 | 467 | 544 |
| Commercial Paper | A | 7,496 | - | - | - | 7,496 |
| | A-1 | 3,000 | - | - | - | 3,000 |
| Corporate bonds | AAA | 9,275 | 5,369 | - | - | 14,644 |
| | AA | 6,139 | 13,210 | 1,755 | - | 21,104 |
| | A | 8,444 | 30,306 | 4,895 | - | 43,645 |
| | BBB | 2,495 | 21,726 | 7,880 | - | 32,101 |
| | B | - | 248 | - | - | 248 |
| International corporate bonds | AAA | - | 6,848 | - | - | 6,848 |
| | AA | 5,024 | 19,171 | - | - | 24,195 |
| | A | 1,907 | 3,380 | 2,723 | - | 8,010 |
| | BBB | - | 7,005 | 1,340 | - | 8,345 |
| Interest receivable | Various | 247 | - | - | - | 247 |
| Asset-backed securities ¹ | AAA | 3,949 | 24,308 | 2,790 | 516 | 31,563 |
| | BBB | - | 900 | - | - | 900 |
| Partnerships | N/A | - | - | - | 50,940 | 50,940 |
| Domestic mutual funds - debt | AAA | 70 | 1,263 | 440 | 123 | 1,896 |
| | AA | - | 2,231 | 586 | 10 | 2,827 |
| | A | 146 | 437 | 391 | 17 | 991 |
| | BBB | 8 | 547 | 271 | 13 | 839 |
| | BB | 15 | 26 | 37 | 2 | 80 |
| | B | 17 | 10 | 37 | 1 | 65 |
| | Below B | 3 | 5 | 17 | 1 | 26 |
| Not rated | 47 | 6 | 29 | 4 | 86 | |
| Municipal bonds | AAA | - | 3,270 | - | - | 3,270 |
| | AA | - | 3,978 | - | - | 3,978 |
| | A | - | 4,191 | - | - | 4,191 |
| Domestic mutual funds - equity | N/A | - | - | - | 14,438 | 14,438 |
| Alternative investments | N/A | - | - | - | 133,744 | 133,744 |
| Real estate investments and other | | - | - | - | 25,082 | 25,082 |
| Total | | \$ 247,649 | \$ 367,872 | \$ 59,480 | \$ 429,315 | \$ 1,104,316 |

¹ Includes \$1,785 which is invested in GNMA. These securities are explicitly guaranteed by the U.S. government.

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Credit Risk

The OHSU operating and trustee-held portfolios require the following minimum ratings or better from Moody's or Standard & Poor's at the date of purchase:

| | Moody's | S&P |
|--|---------|---------|
| Bankers acceptances, commercial paper | A-1 | P-1 |
| CDs, deposit notes, Eurodollar CDs or Eurodollar time deposits | A | A-1/P-1 |
| Yankee CDs | A-1 | P-1 |
| Corporate debt, foreign government, and supranational debt | Baa3 | BBB- |
| Insurance company annuity contracts, GICs, mortgage pass-through securities, structured securities including asset-backed securities | Aaa | AAA |
| Pooled investments | Aa | AA |

The endowment portfolio requires a weighted average credit rating for each fixed income portfolio (within the pool) of A or higher and an avoidance of the prospect of credit failure or risk of permanent loss. Issues of state or municipal agencies are prohibited, except under unusual circumstances. The endowment portfolio may hold up to a maximum of 10 percent of the fixed income portion of the fund in below investment grade (but rated B or higher by Moody's or Standard & Poor's) fixed income securities.

The charitable gift annuity and charitable trust investments require a minimum credit quality rating in investment grade Baa/BBB bond investments and a minimum rating of A-1/P-1 for investments in commercial paper.

Concentration of Credit Risk

OHSU's operating and trustee-held portfolios limit investments in any one issue to a maximum of 10 percent, depending upon the investment type, except for issues of the U.S. Government or agencies of the U.S. Government, which may be held without limitation. The endowment and charitable gift annuity portfolios limit investments in any one issue to a maximum of 5 percent, except for issues of the U.S. Government or agencies of the U.S. Government, which may also be held without limitation. The charitable trusts place no limit on the amount that may be invested in any one issuer. As of June 30, 2011, OHSU had no investments in excess of the thresholds discussed above.

Foreign Currency Risk

OHSU's investment policies permit investments in international equities and other asset classes, which can include foreign currency exposure. The operating and trustee-held portfolios allow investments in Eurodollar CDs. The endowment portfolio allows up to 35 percent of the portfolio to be invested in international equities and up to 25 percent of the fixed income portion of the portfolio to be invested in non-U.S. dollar denominated bonds. The investment policy for the charitable gift annuity portfolio allows for up to 10 percent of the portfolio to be invested in international equities. The charitable trust investments are permitted to include international equities and the amount of the investment is determined based on the individual circumstances of each trust account.

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The fair value of OHSU foreign-denominated securities by currency type as of June 30, 2011 (in thousands):

| <u>Foreign Currency Denomination</u> | <u>Investments (U.S. Dollars)</u> |
|--------------------------------------|---------------------------------------|
| Australian dollar | \$ 34 |
| Brazilian real | 8 |
| British sterling pound | 6,617 |
| Canadian dollar | 571 |
| Chinese renminbi | 580 |
| Euro | 4,239 |
| Hungarian forint | 373 |
| Indonesian rupiah | 544 |
| South Korean won | 670 |
| Malaysian ringgit | 702 |
| Mexican peso | 678 |
| New Zealand dollar | 32 |
| Norwegian krone | 811 |
| Polish zloty | 945 |
| South African rand | 435 |
| Singapore dollar | 293 |
| Swiss franc | 2,125 |
| Turkish lira | 589 |
| Total | <u>\$ 20,246</u> |

E. Repurchase Agreements

Investments in repurchase agreements made with cash collateral from securities lending transactions had the following fair values at June 30, 2011:

- \$801 million, or 29.2 percent, of the Oregon Short-term Investment Fund, the cash collateral pool for all agencies excluding OPERF.
- \$1 billion, or 38.8 percent, of the OPERF cash collateral pool.

F. Securities Lending

The State participates in securities lending transactions in accordance with State investment policies. The Treasury has, through a Securities Lending Agreement, authorized State Street Bank and Trust Company (State Street) to lend the State's securities to broker-dealers and banks pursuant to a form of loan agreement. There were no significant violations of the provisions of securities lending agreements as of June 30, 2011.

During the year, State Street loaned U.S. Treasury and agency securities, domestic fixed income and equity securities, and international fixed income and equity securities, and received as collateral U.S. dollar-denominated cash, U.S. Treasury and agency securities, and international debt and equity securities. Borrowers were required to deliver collateral for each loan equal to at least 102 percent of the fair value of the loaned security, or 105 percent in the case of international equity securities and Canadian fixed income securities. Loans are marked to market daily. If the market value of collateral falls below 102 percent or 105 percent of the fair value of the loaned security, the lender may demand from the borrower sufficient collateral to raise the market value to 102 percent or 105 percent. If the market value of collateral falls below 100 percent, the borrower must provide additional collateral to raise the market value to 102 percent or 105 percent. The State did not impose any restrictions during the fiscal year on the amount of the loans State Street made on its behalf. The State did not have the ability to pledge or sell collateral securities absent a borrower default, but was fully indemnified by State Street against such losses.

State Street, as lending agent, has created a fund to reinvest cash collateral received on behalf of participants in State Street's securities lending program. As permitted under the fund's Declaration of Trust (Declaration), participant purchases and redemptions are transacted at \$1 per unit ("constant value") based on the

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amortized cost of the fund's investments. Accordingly, the securities lending collateral held and the obligation to the lending agent are both stated at constant value on the balance sheet and statement of net assets. The Declaration also provides that if a significant difference exists between the constant value and the market-based net asset value of investments made with the collateral, the agent may determine that a condition exists that would create inequitable results if redemptions were made at the constant value. In that case, the agent may direct that units be redeemed at fair value, engage in in-kind redemptions, or take other actions to avoid inequitable results for the fund participants, until the difference between the constant value and the fair value is deemed immaterial.

The fair value of investments held by the fund is based upon valuations provided by a recognized pricing service. These funds are not registered with the Securities and Exchange Commission, but the custodial agent is subject to the oversight of the Federal Reserve Board and the Massachusetts Commissioner of Banks. Since the funds are accounted for at amortized cost, the fair value of the State's position in the funds is not the same as the value of the funds' shares. No income from the funds was assigned to any other funds.

During the year, the State and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral is reported on the balance sheet and statement of net assets and, since the cash collateral for all agencies is pooled, it is not exposed to custodial credit risk. Because loans were terminable at will by either party, their duration did not generally match the duration of investments made with cash collateral in either the pool or the fund. The State had no credit risk exposure to borrowers related to securities on loan.

Securities lending balances on loan, collateral received, and investments of cash collateral as of June 30, 2011, of the primary government, including the OPERF (in thousands):

| Investment Type | Cash and Securities Collateral Received | Securities on Loan at Fair Value | Investments of Cash Collateral at Fair Value |
|---------------------------------------|--|--|--|
| US Treasury and Agency securities | \$ 2,686,559 | \$ 2,631,503 | \$ 2,444,906 |
| Domestic equity securities | 1,387,281 | 1,361,612 | 1,299,781 |
| International equity securities | 1,150,730 | 1,111,815 | 686,756 |
| Domestic fixed income securities | 558,658 | 547,382 | 636,139 |
| International fixed income securities | 201,867 | 196,547 | 64,197 |
| Total | <u>\$ 5,985,095</u> | <u>\$ 5,848,859</u> | <u>\$ 5,131,779</u> |

On July 1, 2010, OPERF moved its reinvested cash collateral from the commingled pool to a pool solely owned by OPERF. Consequently, OPERF bears the entire risk of any loss and the reinvested cash collateral is stated at fair value in the Pension and Other Employee Benefit Trust Funds in the Statement of Fiduciary Net Assets.

The credit risk of OPERF securities lending invested cash collateral as of June 30, 2011 (in thousands):

| Quality Rating | Fair Value |
|---|---------------------|
| AAA | \$ 444,437 |
| AA ¹ | 1,056,459 |
| A ¹ | 733,965 |
| BBB | 175,000 |
| BB and B | 16,972 |
| Unrated | 230,508 |
| Total subject to credit risk | <u>2,657,341</u> |
| Invested cash collateral not subject to credit risk | 965 |
| Allocation from the Oregon Short-term Fund | 50,839 |
| Total securities lending invested cash collateral | <u>\$ 2,709,145</u> |

¹ Commercial paper ratings of A-1+/P-1 are categorized as AA; A-1/P-1 as A.

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Notes to the Financial Statements

The interest rate risk of OPERF securities lending invested cash collateral as of June 30, 2011 (in thousands):

| Security Type | Fair Value | Effective Weighted Duration Rate (in days) ¹ |
|--|--------------|--|
| Asset-backed securities | \$ 433,462 | 45 |
| Bank note | 396,274 | 24 |
| Commercial paper | 666,436 | 35 |
| Corporate | 62,409 | 27 |
| U.S. Agency | 67,710 | 11 |
| Repurchase agreement | 1,031,050 | 1 |
| Total subject to interest rate risk | 2,657,341 | 21 |
| Invested cash collateral not subject to interest rate risk | 965 | |
| Allocation from the Oregon Short-term Fund | 50,839 | |
| Total securities lending invested cash collateral | \$ 2,709,145 | |

¹ Weighted average days to maturity or next reset date.

As of December 31, 2010, the fair values of securities on loan and collateral held for SAIF Corporation were \$225 million and \$228 million, respectively.

G. Restricted Assets

Included in deposits and investments are amounts which are committed for specific purposes, including loan acquisitions, payment of debt service, lottery prizes, and deferred compensation. At June 30, 2011, the primary government had restricted assets of \$2.2 billion in deposits and \$854.6 million in investments. The discretely presented component units had restricted assets of \$1.7 billion in investments.

3. DERIVATIVES

Derivatives are financial instruments whose value is derived from underlying assets, reference rates, or indexes. They generally take the form of contracts in which two parties agree to make payments at a later date based on the value of the underlying assets, reference rates, or indexes. The main types of derivatives are futures, forwards, options, and swaps. The State uses derivative instruments as hedges against certain risks, for example, to counter increases in interest costs and as investments. For investment derivatives, the Office of the State Treasurer (Treasury) policy allows, with some restrictions, for the use of derivative instruments in the prudent management of the State's investments. Certain external management firms are allowed, through contract, to invest in derivative instruments in order to carry out their investment management activities.

A. Hedging Derivatives - Primary Government (Excluding the Oregon Public Employees Retirement Fund)

Housing and Community Services Department

The Oregon Housing and Community Services Department (OHCS D) has entered into fourteen separate pay-fixed, receive-variable interest rate swaps to hedge against changes in variable rate interest and to lower borrowing costs compared to fixed rate bonds. The notional amounts of the swaps match the principal amounts of the associated debt. The notional amounts totaled \$305.6 million and the fair value of the swaps totaled negative \$25.4 million as of June 30, 2011. During the fiscal year, the swap fair value declined by \$5.8 million. The fair value balance, including any change during the fiscal year, is shown on the proprietary funds balance sheet and the government-wide statement of net assets under deferred outflows and derivative instrument liabilities. The fair values were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net

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settlement on the swap. This methodology is believed to be consistent with accepted practice in the market for interest rate swaps.

The terms, fair values, counterparties, and credit ratings of OHCS D's outstanding swaps as of June 30, 2011 (dollars in thousands):

| Bond Series | Notional Amounts | Effective Date | Fixed Rate Paid | Variable Rate Received | Fair Value | Swap Term Date | Counterparty | S&P |
|-------------------------|-------------------|----------------|-----------------|---------------------------------------|--------------------|----------------|----------------------|-----|
| MF ¹ 2004 B | \$ 14,295 | 12/16/2004 | 3.89% | 64% of 1-mo LIBOR ³ + .27% | \$ (1,071) | 7/1/46 | Merrill Lynch | A |
| MRB ² 2003 L | 15,000 | 4/21/2010 | 3.64% | 64.7% of 3-mo LIBOR + .23% | (610) | 7/1/34 | Royal Bank of Canada | AA- |
| MRB 2004 C | 15,000 | 1/24/2006 | 4.03% | 64% of 1-mo LIBOR + .29% | (960) | 7/1/34 | Morgan Stanley | A |
| MRB 2004 I | 15,000 | 1/24/2006 | 4.01% | 64% of 1-mo LIBOR + .29% | (1,034) | 7/1/34 | Morgan Stanley | A |
| MRB 2004 L | 15,000 | 5/27/2010 | 3.43% | 64.8% of 3-mo LIBOR + .22% | (470) | 7/1/35 | Royal Bank of Canada | AA- |
| MRB 2005 C | 10,500 | 5/27/2010 | 3.35% | 64.8% of 3-mo LIBOR + .22% | (320) | 7/1/35 | Royal Bank of Canada | AA- |
| MRB 2006 C | 20,000 | 2/28/2006 | 4.18% | 64% of 1-mo LIBOR + .29% | (1,926) | 7/1/36 | Morgan Stanley | A |
| MRB 2006 F | 20,000 | 7/18/2006 | 4.43% | 64% of 1-mo LIBOR + .29% | (2,306) | 7/1/37 | Bank of America | A+ |
| MRB 2006 G | 16,105 | 7/18/2006 | 3.83% | 64% of 1-mo LIBOR + .19% | (2,119) | 7/1/16 | Merrill Lynch | A |
| MRB 2007 E | 30,000 | 7/31/2007 | 4.39% | 64% of 1-mo LIBOR + .29% | (3,795) | 7/1/38 | JP Morgan Chase | AA- |
| MRB 2007 H | 30,000 | 11/20/2007 | 4.06% | 64% of 1-mo LIBOR + .30% | (3,060) | 7/1/38 | Merrill Lynch | A |
| MRB 2008 C | 35,000 | 2/26/2008 | 3.75% | 64% of 1-mo LIBOR + .30% | (2,522) | 7/1/38 | Bank of America | A+ |
| MRB 2008 F | 35,000 | 5/13/2008 | 3.74% | 64% of 1-mo LIBOR + .31% | (2,231) | 7/1/39 | Bank of America | A+ |
| MRB 2008 I | 34,650 | 8/26/2008 | 3.72% | 64% of 1-mo LIBOR + .31% | (2,985) | 7/1/37 | Bank of America | A+ |
| Total | <u>\$ 305,550</u> | | | | <u>\$ (25,409)</u> | | | |

¹ Multifamily housing revenue bonds

² Mortgage revenue bonds

³ London Interbank Offered Rate (LIBOR)

The multifamily housing revenue bonds (MF) 2004 B swap has a call option where OHCS D has the right to "call" (cancel) the swap in whole or in part semiannually beginning on January 1, 2015. The mortgage revenue bonds (MRB) swaps include options giving OHCS D the right to call the swaps in whole or in part, depending on the exercise date, semiannually beginning on January 1, 2012 (2004 C), July 1, 2012 (2004 I), January 1, 2013 (2006 C), July 1, 2013 (2006 F and 2008 F), January 1, 2014 (2003 L), July 1, 2014 (2007 E), January 1, 2015 (2007 H and 2008 C), July 1, 2015 (2004 L and 2005 C), and January 1, 2016 (2008 I). These options provide flexibility to manage the prepayments of loans and the related bonds.

Basis risk is the risk that arises when variable interest rates on a derivative and the associated bond are based on different indexes. All variable interest rates on OHCS D's tax-exempt bonds are determined weekly by a remarketing agent. OHCS D is exposed to basis risk when the variable rates received, which are based on the one or three-month London Interbank Offered Rates (LIBOR), do not offset the variable rates paid on the bonds. As of June 30, 2011, the one-month LIBOR was 0.19 percent and the three-month LIBOR was 0.25 percent. OHCS D's variable rates as of June 30, 2011, can be found in Note 9.

Termination risk is the risk of an unscheduled termination of a swap prior to its planned maturity. OHCS D or the counterparty may terminate any of the swaps if the other party fails to perform under the terms of the swap agreement. If any of the swaps are terminated, the associated variable rate bonds would no longer carry synthetic fixed interest rates and OHCS D would then be exposed to interest rate risk. In addition, if any of the swaps had a negative value at termination, OHCS D would be liable to the counterparty for a payment equal to the fair value of the swap.

Rollover risk is the risk that occurs when the swap termination date does not extend to the maturity date of the associated debt. OHCS D is exposed to rollover risk for the MRB 2006 G swap, which has a swap termination date of July 1, 2016. The associated bonds do not mature until 2028.

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Notes to the Financial Statements

Debt service requirements of the variable rate debt and net swap payments of OHCS D, using interest rates as of June 30, 2011 (in thousands):

| Year Ending June 30 | Principal | Interest | Interest Rate Swaps (Net) | Total |
|------------------------|-------------------|-----------------|------------------------------|-------------------|
| 2012 | \$ 180 | \$ 533 | \$ 10,648 | \$ 11,361 |
| 2013 | 190 | 304 | 10,690 | 11,184 |
| 2014 | 200 | 304 | 10,687 | 11,191 |
| 2015 | 205 | 304 | 10,679 | 11,188 |
| 2016 | 215 | 303 | 10,673 | 11,191 |
| 2017-2021 | 1,220 | 1,513 | 50,685 | 53,418 |
| 2022-2026 | 14,920 | 1,482 | 49,293 | 65,695 |
| 2027-2031 | 93,655 | 1,278 | 43,316 | 138,249 |
| 2032-2036 | 139,295 | 670 | 23,064 | 163,029 |
| 2037-2041 | 51,705 | 116 | 3,878 | 55,699 |
| 2042-2046 | 3,385 | 11 | 403 | 3,799 |
| 2047-2051 | 380 | - | 7 | 387 |
| Total | <u>\$ 305,550</u> | <u>\$ 6,818</u> | <u>\$ 224,023</u> | <u>\$ 536,391</u> |

OHCS D's swaps, except for the MF 2004 B and the MRB 2007 E swaps, include provisions that require collateral to be posted if the rating on the senior bonds issued under the 1988 indenture (MRB) are not above either Baa1 (Moody's) or BBB+ (S&P). If the bonds are at or below these levels, collateral in the amount of the current swap fair value (rounded to the nearest \$10 thousand) is required to be posted. The minimum transfer amount is \$100 thousand or \$0 if neither rating agency rates the bonds. The total fair value on June 30, 2011, of the swaps that include these provisions is negative \$20.5 million. At June 30, 2011, the bonds subject to these provisions are rated Aa2 by Moody's and are not rated by S&P.

Department of Veterans' Affairs

The Oregon Department of Veterans' Affairs has an interest rate swap in connection with a portion of its Loan Program General Obligation Veterans' Welfare Bonds, Series 84. The swap and underlying floating rate bonds together create synthetic fixed rate debt. During fiscal year 2011, the Department of Veterans' Affairs did not enter into, terminate, or have any maturities of derivatives. The fair value balance of the interest rate swap is reported on the proprietary funds balance sheet and the government-wide statement of net assets under deferred outflows and derivative instrument liabilities.

Changes to the fair value balance during the year ending June 30, 2011 (in thousands):

| Description | Notional Amount | Fair Value June 30, 2010 | Fair Value Increase/(Decrease) | Fair Value June 30, 2011 |
|-------------|--------------------|-----------------------------|-----------------------------------|-----------------------------|
| Series 84 | \$ 25,000 | \$ (2,250) | \$ 441 | \$ (1,809) |

Because of interest rate decreases after the swap was executed, the fair value as of June 30, 2011, is negative. The fair value of the interest rate swap is estimated using the zero-coupon method. This method calculates the future payments required by the swap by assuming that the current forward rates implied by the yield curve are the market's best estimate of future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for a hypothetical zero-coupon rate bond due on the date of each future net settlement payment on the swap.

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Notes to the Financial Statements

The terms and objectives of the Department of Veterans' Affairs outstanding derivative instruments as of June 30, 2011 (dollars in thousands):

| Type | Objective | Notional Amount | Effective Date | Termination Date | Fixed Rate Paid | Variable Rate Received | Fair Value |
|------------------------------|---|-----------------|----------------|------------------|-----------------|--------------------------------|------------|
| Pay-fixed interest rate swap | Hedge of changes in cash flows on the Series 84 bonds, specifically related to changes in municipal tax-exempt interest rates | \$ 25,000 | 3/1/2008 | 6/1/2040 | 3.67% | 62.6% of 1-month LIBOR + .265% | \$ (1,809) |

The Series 84 swap was structured with an option that gives the Department of Veterans' Affairs the right to cancel or terminate the swap at par on any payment date, in whole or in part, commencing June 1, 2017. This option enhances asset/liability matching and provides flexibility to adjust the outstanding notional amount of the swap over time.

Credit risk is the risk that a counterparty will not fulfill its obligations. The Department of Veterans' Affairs interest rate swap is with Morgan Stanley Services (counterparty), which is rated A by Standard and Poor's (S&P). If the counterparty's credit rating falls below certain levels, the counterparty is required to post collateral to the lower of the following ratings (in thousands):

| S & P Rating | Moody's Rating | Threshold | Minimum Transfer Amount ¹ |
|----------------------------|----------------------------|-----------|--------------------------------------|
| AA- or higher | Aa3 or higher | Infinite | N/A |
| A+ | A1 | \$ 10,000 | \$ 1,000 |
| A | A2 | 5,000 | 1,000 |
| A- | A3 | 2,500 | 1,000 |
| BBB+ or below or not rated | Baa1 or below or not rated | - | 100 |

¹ Minimum transfer amount shall be \$0 if, and for as long as, neither Moody's nor S&P rate the long-term unsecured, unsubordinated debt securities of Morgan Stanley.

Since the fair value of the swap as of June 30, 2011, is negative, the counterparty is not required to post collateral. The State may require collateralization or other credit enhancements to secure any or all swap payment obligations where the Office of the State Treasurer determines such security is necessary to limit the credit risk or otherwise protect the interests of the State.

The Department of Veterans' Affairs is exposed to interest rate risk on its pay-fixed, receive-variable interest rate swap. As the one-month LIBOR decreases, the net payment on the swap increases.

The Department of Veterans' Affairs is exposed to basis risk because the variable rate bonds, which are hedged by the interest rate swap, are variable rate demand obligation (VRDO) bonds that are remarketed weekly. The Department of Veterans' Affairs becomes exposed to basis risk because the variable rate payments received by the Department of Veterans' Affairs are based on a rate other than the interest rate paid on the VRDO bonds. At June 30, 2011, the interest rate on the variable rate hedged debt is 2.25 percent, while the 62.6 percent of one-month LIBOR plus 0.27 percent is 0.39 percent.

The Department of Veterans' Affairs or its counterparties may terminate the interest rate swap if the other party fails to perform under the terms of the contract thereby exposing the Department of Veterans' Affairs to termination risk.

As interest rates fluctuate, variable rate bond interest payments and net swap payments will differ between the fixed payments paid to the counterparty and the variable rate paid to the Department of Veterans' Affairs.

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Notes to the Financial Statements

Using interest rates as of June 30, 2011, the following table presents the debt service requirements of the variable rate debt (on the notional amount of the swap) and net swap payments (in thousands):

| Year Ending June 30, | Principal | Interest | Interest Rate Swap (Net) | Total |
|-------------------------|------------------|------------------|-----------------------------|------------------|
| 2012 | \$ - | \$ 563 | \$ 822 | \$ 1,385 |
| 2013 | - | 562 | 822 | 1,384 |
| 2014 | - | 563 | 821 | 1,384 |
| 2015 | - | 563 | 821 | 1,384 |
| 2016 | 410 | 560 | 812 | 1,782 |
| 2017-2021 | 2,550 | 2,640 | 3,821 | 9,011 |
| 2022-2026 | 3,505 | 2,306 | 3,320 | 9,131 |
| 2027-2031 | 4,825 | 1,847 | 2,630 | 9,302 |
| 2032-2036 | 6,640 | 1,213 | 1,681 | 9,534 |
| 2037-2040 | 7,070 | 358 | 426 | 7,854 |
| Total | <u>\$ 25,000</u> | <u>\$ 11,175</u> | <u>\$ 15,976</u> | <u>\$ 52,151</u> |

If the State's unsecured, unenhanced, general obligation debt rating reaches certain levels, the Department of Veterans' Affairs is required to post collateral to the lower of the following ratings (in thousands):

| S&P Rating | Moody's Rating | Threshold | Minimum Transfer Amount ¹ |
|---------------|-------------------|-----------|--|
| A- or higher | A3 or higher | Infinite | N/A |
| BBB+ or below | Baa1 or below | \$ - | \$ 100 |

¹ Minimum transfer amount shall be \$0 if, and for as long as, neither Moody's nor S&P rate the applicable department's debt.

B. Investment Derivatives - Primary Government (Excluding the Oregon Public Employees Retirement Fund)

Oregon University System

Deposits in foreign currency run the risk of changing value due to fluctuations in foreign exchange rates. In the course of providing students and faculty opportunities for international studies and research abroad, the Oregon University System (OUS) has established foreign bank accounts in several countries. To mitigate foreign currency risk for these activities, OUS periodically enters into forward foreign currency contracts.

State of Oregon
Notes to the Financial Statements

The terms of the OUS forward contracts outstanding at June 30, 2011 (in thousands):

| Currency | Notional Amount | Principal Amount | Effective Date | Maturity Date | Contract Rate | Fair Value |
|------------------------|--------------------|---------------------|-------------------|------------------|------------------|---------------|
| Euro | \$ 341 | \$ 470 | 8/1/2010 | 9/14/2011 | 1.38 | \$ 23 |
| | 161 | 241 | 6/1/2011 | 10/31/2011 | 1.50 | (9) |
| | 500 | 678 | 12/1/2011 | 1/26/2012 | 1.36 | 45 |
| | 500 | 675 | 3/1/2012 | 4/30/2012 | 1.35 | 48 |
| British sterling pound | 200 | 312 | 6/1/2011 | 8/20/2011 | 1.56 | 8 |
| | 200 | 305 | 9/1/2011 | 9/12/2011 | 1.53 | 15 |
| | 200 | 305 | 9/1/2011 | 10/31/2011 | 1.53 | 15 |
| Australian dollar | 23 | 24 | 9/30/2011 | 9/30/2011 | 1.03 | 1 |
| Total | <u>\$ 2,125</u> | <u>\$ 3,010</u> | | | | <u>\$ 146</u> |

OUS invests part of its endowment fund in international equity securities. The investment manager of the fund routinely enters into forward foreign currency exchange agreements to hedge currency risk related to these investments. A foreign currency exchange contract is a forward contract that is a commitment to purchase or sell a foreign currency at a future date at a negotiated forward rate. Foreign currency forward contracts are privately negotiated contracts with customized terms and are transacted in over-the-counter markets. Risk associated with such contracts includes the movement in value of foreign currencies and the failure of the counterparty to perform.

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Notes to the Financial Statements

The following schedule presents the OUS foreign currency exchange contracts as of June 30, 2011 (in thousands):

| Description | Delivery Dates | Notional Value | Fair Market Value |
|--|----------------|----------------|-------------------|
| Foreign currency exchange contracts purchased: | | | |
| Australian dollar | 9/21/2011 | \$ 1,979 | \$ 2,013 |
| British pound sterling | 9/21/2011 | 1,636 | 1,618 |
| Canadian dollar | 9/21/2011 | 590 | 598 |
| Danish krone | 9/21/2011 | 81 | 82 |
| Euro | 9/21/2011 | 4,458 | 4,498 |
| Hong Kong dollar | 9/21/2011 | 447 | 447 |
| Israeli shekel | 9/21/2011 | 2 | 2 |
| Japanese yen | 9/21/2011 | 1,484 | 1,475 |
| New Zealand dollar | 9/21/2011 | 90 | 90 |
| Norwegian krone | 9/21/2011 | 317 | 320 |
| Singapore dollar | 9/21/2011 | 422 | 425 |
| Swedish krona | 9/21/2011 | 455 | 457 |
| Swiss franc | 9/21/2011 | 922 | 921 |
| Total contracts purchased | | 12,883 | 12,946 |
| Foreign currency exchange contracts sold: | | | |
| Australian dollar | 9/21/2011 | 1,981 | 2,005 |
| British pound sterling | 9/21/2011 | 2,132 | 2,111 |
| Canadian dollar | 9/21/2011 | 590 | 598 |
| Danish krone | 9/21/2011 | 243 | 245 |
| Euro | 9/21/2011 | 4,459 | 4,499 |
| Hong Kong dollar | 9/21/2011 | 447 | 447 |
| Japanese yen | 9/21/2011 | 1,336 | 1,328 |
| New Zealand dollar | 9/21/2011 | 90 | 90 |
| Norwegian krone | 9/21/2011 | 434 | 444 |
| Singapore dollar | 9/21/2011 | 423 | 425 |
| Swedish krona | 9/21/2011 | 451 | 457 |
| Swiss franc | 9/21/2011 | 298 | 298 |
| Total contracts sold | | 12,884 | 12,947 |
| Total foreign currency exchange contracts | | \$ 25,767 | \$ 25,893 |

The fair value of all derivatives held by OUS is reported as investments on the proprietary funds balance sheet. The change in fair value for all OUS derivatives is reported with investment income on the proprietary funds statement of revenues, expenses, and changes in fund net assets.

Common School Fund

In the Common School Fund (CSF) portfolio, forward currency exchange contracts may be used to gain exposure or hedge against the effects of fluctuations in foreign currency exchange rates. A foreign currency exchange contract is a forward contract that is a commitment to purchase or sell a foreign currency at a future date at a negotiated forward rate. Foreign currency forward contracts are privately negotiated contracts with customized terms and are transacted in over-the-counter markets. Risk associated with such contracts includes movement in the value of foreign currencies and the failure of the counterparty to perform. The change in fair value for all of the CSF's foreign currency exchange contracts for the year ended June 30, 2011, was negative \$221 thousand.

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The foreign currency exchange contracts within the CSF as of June 30, 2011 (in thousands):

| Description | Delivery Dates | Notional Value | Fair Market Value |
|--|----------------|-------------------|----------------------|
| Foreign currency exchange contracts purchased: | | | |
| Australian dollar | 9/21/2011 | \$ 5,760 | \$ 5,860 |
| British pound sterling | 9/21/2011 | 3,178 | 3,127 |
| Canadian dollar | 9/21/2011 | 2,316 | 2,347 |
| Danish krone | 9/21/2011 | 75 | 77 |
| Euro | 9/21/2011 | 11,308 | 11,363 |
| Hong Kong dollar | 9/21/2011 | 2,163 | 2,165 |
| Israeli shekel | 9/21/2011 | 45 | 45 |
| Japanese yen | 9/21/2011 | 7,124 | 7,087 |
| Norwegian krone | 9/21/2011 | 647 | 645 |
| Singapore dollar | 9/21/2011 | 1,850 | 1,859 |
| Swedish krona | 9/21/2011 | 2,386 | 2,396 |
| Swiss franc | 9/21/2011 | 12,487 | 12,491 |
| Total contracts purchased | | 49,339 | 49,462 |
| Foreign currency exchange contracts sold: | | | |
| Australian dollar | 9/21/2011 | 4,745 | 4,735 |
| Canadian dollar | 9/21/2011 | 2,317 | 2,286 |
| Danish krone | 9/21/2011 | 1,361 | 1,356 |
| Euro | 9/21/2011 | 11,286 | 11,210 |
| Hong Kong dollar | 9/21/2011 | 1,630 | 1,629 |
| Japanese yen | 9/21/2011 | 5,737 | 5,776 |
| Norwegian krone | 9/21/2011 | 2,037 | 1,991 |
| British pound sterling | 9/21/2011 | 8,191 | 8,266 |
| Singapore dollar | 9/21/2011 | 1,856 | 1,854 |
| Swedish krona | 9/21/2011 | 2,367 | 2,337 |
| Swiss franc | 9/21/2011 | 7,763 | 7,761 |
| Total contracts sold | | 49,290 | 49,201 |
| Total foreign currency exchange contracts | | \$ 98,629 | \$ 98,663 |

In the CSF portfolio, rights and warrants are often obtained and held due to existing investments. Rights are the right, but not the obligation, to purchase newly issued equity shares, often in proportion to the number of shares currently owned, in a specified company, at a pre-established price on or within a predetermined date. A warrant provides the holder the right, but not the obligation, to purchase securities from the issuing entity at a specific price and within a certain period. Rights and warrants are privately transacted in over-the-counter markets. Both are subject to general market risk and liquidity risk. The change in fair value for the CSF's rights and warrants for the year ended June 30, 2011, was \$191.8 thousand. The fair value of rights and warrants within the CSF portfolio as of June 30, 2011 (in thousands):

| Type | Expiration Date | Related Number of Shares | Fair Value |
|--------|-----------------|--------------------------------|------------|
| Rights | 7/18/2011 | 2159 | \$ 4.9 |

The fair value of all derivative instruments within the CSF are reported on the governmental funds balance sheet as investments, accounts and interest receivable, and accounts and interest payable. The change in fair value for all CSF derivative instruments is reported with investment income on the governmental funds statement of revenues, expenditures, and changes in fund balances.

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Notes to the Financial Statements

C. Investment Derivatives - Primary Government - Oregon Public Employees Retirement Fund (OPERF)

Oregon Investment Council policy allows, with some restrictions, for the use of derivative instruments in the prudent management of the Public Employees Retirement System (PERS) investments. Certain internally and externally managed accounts are allowed, through contract and policy, to invest in derivative instruments in order to carry out their investment management activities. Risks inherent with derivatives are managed through investment management's adherence to contractual and policy prescribed terms that are consistent with the OPERF's investing objectives. All derivatives are considered investments. The fair value of the derivative investments is reported in equity investments, investment sales receivable, and accounts and interest payable on the statement of fiduciary net assets. Changes in fair value during the fiscal year are reported in the net appreciation (depreciation) in fair value of investments line on the statement of changes in fiduciary net assets. The fair values reported in the following PERS tables are not the same as amounts reported as investments in the financial statements because derivatives with net loss positions have been reclassified as liabilities.

Currency Forwards

A foreign currency exchange contract is a forward contract that is a commitment to purchase or sell a foreign currency at a future date at a negotiated forward rate. Foreign currency forward contracts are privately negotiated contracts with customized terms and are transacted in over-the-counter markets. In the PERS portfolio, forward currency exchange contracts may be used to gain exposure to or hedge against the effects of fluctuations in foreign currency exchange rates. Risk associated with such contracts includes movement in the value of foreign currencies and the failure of the counterparty to perform. The change in fair value arising from the difference between the original contracts and the closing of such contracts is negative \$88.6 million for the fiscal year ended June 30, 2011.

Foreign currency forward contracts that represent purchase commitments within the PERS portfolio as of June 30, 2011 (in thousands):

| Description | Delivery Dates | Notional Value | Fair Value |
|--------------------|------------------------|---------------------|------------------|
| Australian dollar | 7/5/2011 - 9/21/2011 | \$ 326,107 | \$ 4,749 |
| Brazilian real | 7/5/2011 - 8/2/2011 | 12,294 | 48 |
| Canadian dollar | 7/7/2011 - 9/21/2011 | 90,278 | 737 |
| Chinese yuan | 9/27/2011 - 9/8/2015 | 13,361 | 137 |
| Danish krone | 7/8/2011 - 9/21/2011 | 18,593 | 129 |
| Euro | 7/1/2011 - 9/21/2011 | 481,513 | 5,326 |
| Hong Kong dollar | 7/8/2011 - 6/12/2012 | 51,225 | 16 |
| Indonesian rupiah | 7/20/2011 - 7/29/2011 | 1,602 | 9 |
| Israeli shekel | 7/27/2011 - 9/21/2011 | 12,044 | 117 |
| Japanese yen | 7/7/2011 - 10/7/2011 | 168,796 | (295) |
| Kazakhstan tenge | 7/7/2011 - 10/7/2011 | 1,261 | (4) |
| Malaysian ringgit | 9/21/2011 | 626 | - |
| Mexican peso | 8/18/2011 - 9/21/2011 | 742 | 7 |
| New Zealand dollar | 8/15/2011 - 9/21/2011 | 119,037 | 3,151 |
| Norwegian krone | 7/8/2011 - 9/21/2011 | 149,111 | 2,662 |
| Philippine peso | 7/29/2011 - 11/15/2011 | 2,220 | (5) |
| Polish zloty | 9/21/2011 | 327 | (6) |
| Pound sterling | 7/1/2011 - 9/24/2012 | 244,173 | (3,198) |
| Singapore dollar | 7/8/2011 - 9/21/2011 | 48,958 | 379 |
| South Korean won | 8/12/2011 - 9/21/2011 | 1,563 | 62 |
| Swedish krona | 7/8/2011 - 9/21/2011 | 273,404 | (3,231) |
| Swiss franc | 7/8/2011 - 9/21/2011 | 125,891 | 1,918 |
| Total | | <u>\$ 2,143,126</u> | <u>\$ 12,708</u> |

State of Oregon
Notes to the Financial Statements

Foreign currency forward contracts that represent sell commitments within the PERS portfolio as of June 30, 2011 (in thousands):

| Description | Delivery Dates | Notional Value | Fair Value |
|----------------------|------------------------|---------------------|--------------------|
| Australian dollar | 7/5/2011 - 10/7/2011 | \$ 316,373 | \$ (13,622) |
| Brazilian real | 7/5/2011 - 9/2/2011 | 42,838 | (1,409) |
| Canadian dollar | 7/7/2011 - 10/7/2011 | 148,917 | (1,621) |
| Chinese yuan | 7/20/2012 - 10/15/2013 | 1,362 | 10 |
| Colombian peso | 7/29/2011 | 576 | (5) |
| Danish krone | 7/1/2011 - 9/21/2011 | 21,941 | (145) |
| Euro | 7/1/2011 - 3/21/2012 | 714,220 | (12,023) |
| Hong Kong dollar | 9/21/2011 - 6/12/2012 | 51,763 | (25) |
| Israeli shekel | 9/21/2011 | 409 | 1 |
| Japanese yen | 7/1/2011 - 9/21/2011 | 376,006 | (4,365) |
| Mexican peso | 8/18/2011 | 1,125 | (19) |
| New Zealand dollar | 9/21/2011 | 84,848 | (880) |
| Norwegian krone | 9/21/2011 - 12/21/2011 | 34,954 | (551) |
| Peruvian nouveau sol | 9/21/2011 | 93 | (2) |
| Polish zloty | 7/18/2011 | 585 | (8) |
| Pound sterling | 7/4/2011 - 11/29/2013 | 479,683 | 4,415 |
| Singapore dollar | 7/5/2011 - 9/21/2011 | 33,939 | (184) |
| South African rand | 9/21/2011 | 625 | - |
| Swedish krona | 8/15/2011 - 12/21/2011 | 70,405 | (37) |
| Swiss franc | 7/6/2011 - 3/21/2012 | 100,392 | (2,384) |
| Total | | <u>\$ 2,481,054</u> | <u>\$ (32,854)</u> |

Futures and Forwards

Futures and forward contracts represent commitments to buy or sell an underlying asset at a future date and at a specified price. Futures contracts have standardized terms and are exchange-traded. Forward contracts are privately negotiated contracts with customized terms and are transacted in over-the-counter markets. The counterparty credit risk for futures is generally less than privately negotiated forward contracts, since the clearinghouse, which is the issuer of or counterparty to each exchange-traded future, daily settles the net change in the futures contract's value in cash with the broker. In the PERS portfolio, futures and forward contracts may be used to gain exposure to or hedge against the effects of fluctuations in interest rates, currency exchange rates, equity indexes, and other market conditions. The OPERF bears the market risk that arises from changes in the value of these instruments and the imperfect correlation between movements in the price of the futures and forward contracts and movements in the price of the securities hedged or used for cover. The change in fair value resulting from futures contract settlements totaled \$135.7 million for the fiscal year ended June 30, 2011. The change in fair value resulting from forward contract settlements totaled \$9.1 million for the fiscal year ended June 30, 2011. The fair value of the futures contracts reported within the PERS portfolio is \$0.

State of Oregon
Notes to the Financial Statements

The balance of the fixed income futures contracts within the PERS portfolio as of June 30, 2011 (dollars in thousands):

| Fixed Income Type | Expiration Date | Number of Contracts | Notional Value |
|-----------------------------------|------------------------|------------------------|---------------------|
| Long cash and cash equivalents: | | | |
| 90 day Euro | 12/19/2011 - 6/13/2016 | 1,396 | \$ 344,164 |
| Short cash and cash equivalents: | | | |
| 90 day Euro | 12/19/2011 - 6/17/2013 | 2,766 | (686,783) |
| Long fixed income: | | | |
| 30 year U.S. Treasury bonds | 9/21/2011 | 2,095 | 257,750 |
| 10 year U.S. Treasury notes | 9/21/2011 | 2,373 | 290,284 |
| 5 year U.S. Treasury notes | 9/30/2011 | 6,175 | 736,031 |
| 2 year U.S. Treasury notes | 9/30/2011 | 5,102 | 1,119,092 |
| Ultra long U.S. Treasury bonds | 9/21/2011 | 1,435 | 181,169 |
| German Euro-Bobl | 9/8/2011 | 670 | 113,246 |
| UK long gilt bond | 9/28/2011 | 384 | 74,072 |
| Total long fixed income | | | <u>2,771,644</u> |
| Short fixed income: | | | |
| 30 year U.S. Treasury bonds | 9/21/2011 | 1,835 | (225,762) |
| 10 year Canadian Government bonds | 9/21/2011 | 295 | (37,900) |
| 10 year Australian Treasury bonds | 9/15/2011 | 170 | (17,251) |
| 10 year U.S. Treasury notes | 9/21/2011 | 4,110 | (502,769) |
| 2 year U.S. Treasury notes | 9/30/2011 | 749 | (164,288) |
| Total short fixed income | | | <u>(947,970)</u> |
| Total | | | <u>\$ 1,481,055</u> |

State of Oregon
Notes to the Financial Statements

The balance of the index futures contracts within the PERS portfolio as of June 30, 2011 (dollars in thousands):

| Index Type | Expiration Date | Number of Contracts | Notional Value |
|-------------------------------|-----------------|---------------------|----------------|
| Long purchased indexes: | | | |
| CAC 40 | 7/15/2011 | 1,065 | \$ 61,447 |
| DAX | 9/16/2011 | 183 | 49,028 |
| FTSE 100 | 9/16/2011 | 1,136 | 107,649 |
| FTSE MIB | 9/16/2011 | 289 | 42,347 |
| Hang Seng | 7/28/2011 | 186 | 26,806 |
| IBEX 35 | 7/15/2011 | 24 | 3,575 |
| Russell 1000 mini | 9/16/2011 | 587 | 42,957 |
| Russell 2000 mini | 9/16/2011 | 1,586 | 130,908 |
| S&P 500 E mini | 9/16/2011 | 373 | 24,534 |
| S&P 500 | 9/15/2011 | 37 | 12,168 |
| S&P midcap 400 E mini | 9/16/2011 | 80 | 7,812 |
| SGX MSCI Singapore | 7/28/2011 | 35 | 2,055 |
| TOPIX | 9/9/2011 | 45 | 4,734 |
| Total long purchased indexes | | | 516,020 |
| Short purchased indexes: | | | |
| AEX | 7/15/2011 | 74 | (7,290) |
| ASX SPI 200 | 9/15/2011 | 899 | (110,708) |
| CAC 40 | 7/15/2011 | 369 | (21,290) |
| DAX | 7/15/2011 | 70 | (18,754) |
| Euro STOXX 50 | 9/16/2011 | 529 | (21,843) |
| FTSE 100 | 9/16/2011 | 434 | (41,127) |
| FTSE MIB | 9/16/2011 | 39 | (5,715) |
| Hang Seng | 7/28/2011 | 54 | (7,782) |
| IBEX 35 | 7/15/2011 | 48 | (7,149) |
| OMX 30 | 7/15/2011 | 1,817 | (32,107) |
| S&P 500 E mini | 9/16/2011 | 3,230 | (212,453) |
| S&P TSE 60 | 9/15/2011 | 190 | (30,011) |
| Swiss market | 9/16/2011 | 1,257 | (92,379) |
| TOPIX | 9/9/2011 | 443 | (46,599) |
| Total short purchased indexes | | | (655,207) |
| Total | | | \$ (139,187) |

The balance of the forward contracts within the PERS portfolio as of June 30, 2011 (in thousands):

| Type of Forward Contract | Expiration Date | Notional Value | Fair Value |
|---------------------------|-----------------|----------------|------------|
| Forward assets: | | | |
| U.S. Treasury notes | 2/15/2021 | \$ 58,266 | \$(1,376) |
| U.S. Treasury strips | 11/15/2021 | 34,357 | (902) |
| Total forward assets | | 92,623 | (2,278) |
| Forward liabilities: | | | |
| U.S. Treasury TIPS | 1/15/2021 | (54,763) | 597 |
| Total forward liabilities | | (54,763) | 597 |
| Total | | \$ 37,860 | \$(1,681) |

Swaps

A swap is an agreement that obligates two parties to exchange a series of cash flows or the net value of cash flows at specified intervals based upon or calculated by reference to changes in specified prices or rates for a specified amount of an underlying asset. The OPERF may enter into various types of swaps, including credit default, interest rate, and total return swaps. The OPERF may use swaps to obtain efficient investment exposure or to hedge exposure to interest and currency rates and to movements in the debt and equity markets. The payment flows are usually netted against each other, with the difference being paid by one party or another. In addition, collateral may be pledged or received by the OPERF to provide value and recourse to the OPERF or its counterparties in accordance with the terms of the respective swap agreements.

Credit default swaps represent agreements between parties to exchange a fixed rate premium by the buyer of protection in exchange for a contingent payment by the seller of protection equal to the loss in value of an underlying debt instrument triggered by the occurrence of a defined credit event (such as bankruptcy, restructuring, failure to make payments when due, and repudiation/moratorium for sovereign underlying instruments). Under the terms of the swap, the protection seller acts as a “guarantor” receiving a periodic payment that is equal to a fixed percentage applied to a notional principal amount. In return, the seller of protection agrees to pay the notional amount of the underlying instrument, less its distressed value, if a credit event occurs during the term of the swap. Credit default swaps are privately negotiated contracts with customized terms and are transacted in over-the-counter markets. In the PERS portfolio, credit default swap contracts may be used to gain exposure to, or hedge against the effects of, fluctuations in specific investments, bond markets, and other market conditions. Credit default swaps are subject to general market risk, liquidity risk, credit risk, and the risk that the counterparty will fail to perform.

Interest rate swaps represent agreements between two parties to exchange cash flows or the net value of cash flows based on a notional amount and an underlying interest rate. Interest rate swaps are privately negotiated contracts with customized terms and are transacted in over-the-counter markets. The OPERF may elect to pay a fixed rate and receive a floating rate or receive a fixed rate and pay a floating rate based on a notional amount and a reference rate. In the PERS portfolio, interest rate swap contracts may be used to gain exposure to or hedge against the effects of fluctuations in interest rates, bond markets and other market conditions. Risk associated with such contracts includes liquidity risk, interest rate risk, and the risk that the counterparty will fail to perform.

Total return swaps are agreements to exchange the return generated by one instrument for the return generated by another instrument. Total return swaps are privately negotiated contracts with customized terms that are transacted in over-the-counter markets. In the PERS portfolio, total return swap contracts may be used to gain exposure to or hedge against the effects of fluctuations in interest rates, bond markets, equity markets, and other market conditions. Total return swaps are subject to general market risk, liquidity risk, and the risk that the counterparty will fail to perform.

State of Oregon
Notes to the Financial Statements

The change in fair value for swaps contracts within the PERS portfolio for the year ended June 30, 2011, was \$57.7 million. The balances of the swap contracts as of June 30, 2011 (in thousands):

| Description | PERS Receives | PERS Pays | Maturity date | Notional Value | Fair Value |
|---|------------------------------|-----------------------|------------------------|---------------------|--------------------|
| Interest rate swaps - pay fixed asset | 3 month LIBOR | 2.72% - 3.69% | 9/20/2020 - 11/3/2040 | \$ 31,200 | \$ 2,148 |
| Interest rate swaps - pay fixed liability | 3 month LIBOR | 0.73% - 5% | 5/7/2012 - 5/24/2041 | 971,617 | (24,705) |
| Interest rate swaps - receive fixed asset | 2.37% - 11.57% | See note ¹ | 2/4/2014 - 12/19/2023 | 129,905 | 3,997 |
| Interest rate swaps - receive fixed liability | 11.49% | 1 day BRCDI | 1/2/2012 | 5,200 | (9) |
| Credit default swaps - pay fixed assets | CDP ² | 0.07% - 2.5% | 3/20/2012 - 2/17/2051 | 145,868 | 12,487 |
| Credit default swaps - pay fixed liabilities | CDP ² | 0.11% - 5% | 9/20/2011 - 3/20/2019 | 334,885 | (18,418) |
| Credit default swaps - receive fixed assets | 0.81% - 5% | CDP ² | 8/20/2011 - 6/25/2036 | 42,506 | 1,372 |
| Credit default swaps - receive fixed liabilities | 0.09% - 3.5% | CDP ² | 9/20/2012 - 10/12/2052 | 169,141 | (27,799) |
| Total return swaps - pay set reference asset | 1 or 12 month LIBOR | 1 or 12 month LIBOR | 1/12/2040 | 23,178 | 150 |
| Total return swaps - receive set reference liability | TRX CMBS reset index | TRX CMBS index | 10/1/2011 - 1/1/2012 | 8,225 | (34) |
| Total return swaps - pay/receive variable reference asset | Market FNMA 5% or 6% indexes | 1 month LIBOR | 1/12/2040 | 19,770 | 23 |
| Total equity return swaps | Equity position | 3 month LIBOR | 5/15/2012 | 121 | (121) |
| Total | | | | <u>\$ 1,881,616</u> | <u>\$ (50,909)</u> |

¹ PERS pays/receives counterparty based on daily CETIP, 1-month Mexican TIIE rate, 3-month CDOR, 3-month LIBOR, 6-month CDOR.

² Credit default protection.

State of Oregon
Notes to the Financial Statements

The counterparties' credit ratings for swaps contracts within the PERS portfolio as of June 30, 2011 (in thousands):

| Counterparty Information | S&P | Moody's | Credit Default Swaps | Interest Rate Swaps | Total Return Swaps | Total Return Equity Swaps | Total |
|------------------------------------|-----|---------|----------------------------|---------------------------|--------------------------|---------------------------------|-------------|
| Bank of America Merrill Lynch | A | A+ | \$ (2,005) | \$ (4,161) | \$ - | \$ - | \$ (6,166) |
| Barclay's Bank | AA- | AA- | (1,294) | (3,240) | 68 | - | (4,466) |
| BNP PARIBAS S.A. | AA | AA- | (23) | - | - | - | (23) |
| Citibank | A | A+ | (11,175) | - | - | - | (11,175) |
| Credit Suisse | A+ | AA- | 1,508 | - | 12 | - | 1,520 |
| Deutsche Bank | A+ | AA- | (3,569) | (6,712) | - | - | (10,281) |
| Goldman Sachs | A | A+ | (2,540) | (2,378) | 66 | - | (4,852) |
| HBSC Bank | N/A | N/A | (4) | - | - | - | (4) |
| JP Morgan Chase | AA- | AA- | (2,866) | (604) | (7) | - | (3,477) |
| Morgan Stanley | A | A | (9,377) | (1,209) | - | - | (10,586) |
| Royal Bank of Canada | AA- | AA | - | 261 | - | - | 261 |
| Royal Bank of Scotland | A+ | AA- | (104) | (526) | - | - | (630) |
| UBS AG Stamford | A+ | A+ | (922) | - | - | - | (922) |
| Other | N/A | N/A | 13 | - | - | (121) | (108) |
| Total swaps subject to credit risk | | | \$ (32,358) | \$ (18,569) | \$ 139 | \$ (121) | \$ (50,909) |

Options

An option is an instrument that gives one party the right, but not the obligation, to buy or sell an underlying asset from or to another party at a fixed price over a specified period of time. A European option is an option that can only be exercised on the expiration date. A call option gives the purchaser the option to buy (and the seller the obligation to sell) the underlying investment at the contracted exercise price. A put option gives the purchaser the option to sell (and the writer the obligation to buy) the underlying investment at the contracted exercise price. Options can be exchange-traded or private contracts between two or more parties. Exchange-traded options are cleared through and guaranteed by clearing houses. In the PERS portfolio, option and European option contracts may be bought or sold to gain exposure to, or hedge against, the effects of fluctuations in interest rates, currency exchange rates, bond markets, equity markets, and other market conditions.

In writing an option, the OPERF bears the market risk of an unfavorable change in the price of the underlying investment of the written option. Exercise of an option written by the OPERF could result in the OPERF selling or buying an asset at a price different from the current market value. The risk associated with purchasing an option is that the OPERF pays a premium whether or not the option is exercised. Options and European options may be subject to interest rate risk, general market risk, liquidity risk, credit risk, foreign currency risk and, for non-exchange-traded options, the risk that the counterparty will fail to perform. The change in fair value from options contracts within the PERS portfolio for the year ended June 30, 2011, was \$2.8 million.

State of Oregon
Notes to the Financial Statements

The balance of the options contracts within the PERS portfolio as of June 30, 2011 (dollars in thousands):

| Description | Expiration Date | Contracts | Units | Fair Value |
|---------------------------|-------------------------|------------|---------------------|-----------------|
| Fixed Income: | | | | |
| <i>Written calls</i> | | | | |
| INF Cap USD CPURNSA | 3/4/2015 | 1,800,000 | (1,800,000) | \$ (16) |
| FN 5.0 9 39 101 | 10/11/2011 - 11/14/2011 | 39,400,000 | (39,400,000) | (640) |
| Total written calls | | | <u>(41,200,000)</u> | <u>(656)</u> |
| <i>Written puts</i> | | | | |
| INF floor USD CPURNS | 3/4/2015 - 10/13/2020 | 2,600,000 | (2,600,000) | (12) |
| IRO USD 3Y P2.75 DUB | 6/18/2012 | 3,600,000 | (3,600,000) | (17) |
| IRO USD 3Y P2.75 RYL | 6/18/2012 | 3,000,000 | (3,000,000) | (14) |
| IRO 2Y RYL | 9/24/2012 | 11,700,000 | (11,700,000) | (60) |
| IRO USD 1Y GLM | 11/19/2012 | 4,700,000 | (4,700,000) | (27) |
| Total written puts | | | <u>(25,600,000)</u> | <u>(130)</u> |
| Total fixed income | | | <u>(66,800,000)</u> | <u>(786)</u> |
| Foreign Currency: | | | | |
| <i>Written calls</i> | | | | |
| OTC ECAL USD V KRW | 9/21/2011 | 1,700,000 | (1,700,000) | (9) |
| <i>Written puts</i> | | | | |
| OTC USD VS JPY 79 | 7/19/2011 | 1,100,000 | (1,100,000) | (2) |
| OTC EPUT AUD VS USD | 9/15/2011 | 3,300,000 | (3,300,000) | (28) |
| Total written puts | | | <u>(4,400,000)</u> | <u>(30)</u> |
| Total foreign currency | | | <u>(6,100,000)</u> | <u>(39)</u> |
| Option futures: | | | | |
| <i>Calls</i> | | | | |
| Purchased: | | | | |
| 10 year Treasury note | 7/22/2011 - 8/26/2011 | 575 | 575,000 | 284 |
| Written: | | | | |
| 10 year Treasury note | 7/22/2011 - 8/26/2011 | 256 | (256,000) | (48) |
| Euro | 3/19/2012 | 642 | (1,605,000) | (376) |
| Total calls written | | | <u>(1,861,000)</u> | <u>(424)</u> |
| Total option future calls | | | <u>(1,286,000)</u> | <u>(140)</u> |
| <i>Puts</i> | | | | |
| Purchased: | | | | |
| 10 year Treasury note | 8/26/2011 | 1,862 | 1,862,000 | 568 |
| 5 year Treasury note | 8/26/2011 | 485 | 485,000 | 138 |
| 1 year Euro midcurve | 9/16/2011 | 395 | 987,500 | 72 |
| 2 year Euro midcurve | 8/12/2011 | 141 | 352,500 | 63 |
| Total puts purchased | | | <u>3,687,000</u> | <u>841</u> |
| Written: | | | | |
| Euro | 3/19/2012 | 642 | (1,605,000) | (185) |
| 1 year Euro midcurve | 9/16/2011 | 395 | (987,500) | (7) |
| 10 year Treasury note | 8/26/2011 | 128 | (128,000) | (136) |
| Total puts written | | | <u>(2,720,500)</u> | <u>(328)</u> |
| Total option future puts | | | <u>966,500</u> | <u>513</u> |
| Total option futures | | | <u>(319,500)</u> | <u>373</u> |
| Total | | | <u>(73,219,500)</u> | <u>\$ (452)</u> |

State of Oregon
Notes to the Financial Statements

Swaptions

A swaption is an option to enter into an interest rate swap at an agreed upon fixed rate until or at some future date. Swaption contracts entered into by the OPERF typically represent an option that gives the purchaser the right, but not the obligation, to enter into a swap contract on a future date. If a call swaption is exercised, the purchaser will enter into a swap contract to receive the fixed rate and pay a floating rate in exchange. Exercising a put swaption would entitle the purchaser to pay a fixed rate and receive a floating rate. Swaptions are privately negotiated contracts with customized terms and are transacted in the over-the-counter markets. In the PERS portfolio, swaption contracts may be bought or sold to gain exposure to or hedge against the effects of fluctuations in interest rates, bond markets, and other market conditions.

In writing a swaption, the OPERF bears the market risk of an unfavorable change in the price of the underlying investment of the written swaption. Exercise of a swaption written by the OPERF could result in the OPERF selling or buying an asset at a price different from the current market value. The risk associated with purchasing a swaption is that the OPERF pays a premium, whether or not the option to enter a swap is exercised. Swaptions may be subject to interest rate risk, liquidity risk, and the risk that the counterparty will fail to perform. The change in fair value from swaptions contracts within the PERS portfolio for the year ended June 30, 2011, was \$640 thousand. The balance of the swaption contracts as of June 30, 2011 (dollars in thousands):

| Description | Expiration Date | Contracts | Units | Fair Value |
|-------------------------|-----------------|------------|--------------|------------|
| Puts | | | | |
| <i>Purchased</i> | | | | |
| Great Britain pound | 12/15/2015 | 2,800,000 | 2,800,000 | \$ 504 |
| IRO Great Britain pound | 12/15/2015 | 6,300,000 | 6,300,000 | 1,134 |
| Swaption SWP011027 | 9/21/2011 | 3,675,000 | 3,675,000 | 62 |
| Total puts purchased | | | 12,775,000 | 1,700 |
| <i>Written</i> | | | | |
| IRO Eurodollar | 7/1/2014 | 2,500,000 | (2,500,000) | (1) |
| Swaption 317U153B3 | 7/11/2011 | 3,800,000 | (3,800,000) | - |
| Swaption 27 2.25 BOA | 9/24/2012 | 10,500,000 | (10,500,000) | (53) |
| Swaption 9W9011068 | 9/21/2011 | 3,675,000 | (3,675,000) | (26) |
| Swaption 317U153B3 | 7/11/2011 | 3,675,000 | (3,675,000) | (41) |
| Total puts written | | | (24,150,000) | (121) |
| Total | | | (11,375,000) | \$ 1,579 |

Rights and Warrants

Rights are the right, but not the obligation, to purchase newly issued equity shares, often in proportion to the number of shares currently owned, in a specified company, at a pre-established price on or within a pre-determined date. Rights are privately transacted in over-the-counter markets. In the PERS portfolio, rights are often obtained and held due to existing investments. Rights are subject to general market risk and liquidity risk.

A warrant provides the holder the right, but not the obligation, to purchase securities from the issuing entity at a specific price and within a certain time period. Warrants are privately transacted in over-the-counter markets. In the PERS portfolio, warrants are often obtained and held due to existing investments. Warrants are subject to general market risk and liquidity risk. The change in fair value from rights and warrants for the year ended June 30, 2011, was \$5.1 million.

State of Oregon
Notes to the Financial Statements

The fair value of rights and warrants within the PERS portfolio as of June 30, 2011 (dollars in thousands):

| Type | Expiration Date | Related Number of Shares | Fair Value |
|----------|------------------------|-----------------------------|---------------|
| Rights | 7/12/2011 - 7/15/2011 | 468,752 | \$ 212 |
| Warrants | 10/28/2011 - 1/19/2021 | 5,260,967 | 16,936 |
| Total | | 5,729,719 | \$ 17,148 |

D. Hedging Derivatives - Discretely Presented Component Units

Oregon Health and Science University (OHSU)

OHSU interest rate swap agreements (collectively, the swaps) as of June 30, 2011:

| | Notional Amount | Fair Value |
|-----------------|--------------------|-------------|
| 2005 Swap No. 1 | \$ 44,475 | \$ (4,206) |
| 2005 Swap No. 2 | 44,450 | (4,209) |
| 2004 Swap No. 1 | 52,350 | (955) |
| 2004 Swap No. 2 | 52,350 | (955) |
| Total | \$ 193,625 | \$ (10,325) |

The notional amounts of the swaps and the principal amounts of the associated debt decline over time and terminate on January 1 and January 3, 2012, respectively for the 2004 swaps, and on July 1, 2028, for the 2005 swaps. The 2004 swaps originated on January 1, 2007, and the 2005 swaps originated on October 18, 2005. For the 2005 swaps, OHSU is currently making fixed rate interest payments of 3.36 percent to the counterparty and receives variable rate payments computed as 62.67 percent of the LIBOR plus 0.18 percent. For the 2004 swaps, OHSU pays the counterparties a fixed payment of 3.37 percent and receives a variable payment computed as 67 percent of the LIBOR. The fair value represents the estimated amount that OHSU would pay or receive if the swap agreements were terminated at year-end, taking into account current interest rates and the creditworthiness of the underlying counterparty. Total cash payments made to swap counterparties were \$6 million during the year ended June 30, 2011.

Each of the swaps was established as part of a hedging arrangement during fiscal year 2009, as a hedge of total cash flows associated with the interest payments on the Series 1998 A, Series 1998 B, Series 2002 B, and Series 2009 B bonds. Management has evaluated the effectiveness of the current hedges assuming hybrid instruments; each swap consists of a companion debt instrument, representing the value of the swap at the inception of the current hedge, and a hedging instrument, representing the hypothetical value of the swap had it held a \$0 value at the inception of the hedge.

The companion debt instrument for the 2005 swaps is reported on the combining balance sheet for discretely presented components units under deferred outflows and derivative instrument liabilities. The liability is being amortized over the remaining term of the swap agreements as an offset to interest expense. The deferred outflow is being amortized according to the same schedule as other debt issuance costs associated with the Series 2005A and Series 2005B bonds as an offset to amortization expense. The liability value is \$5.8 million as of June 30, 2011.

The companion debt instrument for the 2004 swaps is reported on the combining balance sheet for discretely presented components units under deferred outflows and derivative instrument liabilities. The liability is being amortized over the remaining term of the swap agreements as an offset to interest expense. The liability value was \$1.2 million as of June 30, 2011.

The current hedging instruments for both the 2004 swaps and the 2005 swaps are recorded on the combining balance sheet for discretely presented components units under deferred outflows and derivative instrument liabilities. Subsequent changes to the value of the hedging instruments are recorded by increasing or decreasing these balance sheet accounts. The liability value was \$815 thousand as of June 30, 2011.

OHSU is exposed to credit risk, which is the risk that the counterparty will not fulfill its obligation. As of June 30, 2011, the counterparties' credit ratings were A+ from Standard & Poor's, Aa3 from Moody's, and A+ from Fitch. Additionally, the swap exposes OHSU to basis risk, which is the risk that arises when the relationship between the rates on the variable rate bonds and the swap formulas noted above vary from historical norms.

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If this occurs, swap payments received by OHSU may not fully offset its bond interest payments. As these rates change, the effective synthetic rate on the bonds will change.

OHSU is additionally responsible for posting collateral if the total swap liability for swaps with one of the counterparties exceeds a predetermined value on the reporting date. The collateral posting limit was \$15 million compared to a total relevant swap liability value of \$9.4 million as of June 30, 2011, resulting in a requirement that OHSU post collateral totaling \$0 as of June 30, 2011.

OHSU or the counterparties may terminate the swaps if the other party fails to perform under the terms of the contracts.

4. RECEIVABLES AND PAYABLES

A. Receivables

The following tables disaggregate receivable balances reported in the fund financial statements as accounts and interest receivable (net) and net contracts, notes, and other receivables. Contracts, notes, and other receivables are not expected to be collected within one year of the date of the financial statements.

Receivables reported for governmental activities at June 30, 2011 (in thousands):

| | General | Health and Social Services | Public Transportation | Environmental Management | Common School | Other | Total | Internal Service |
|----------------------------------|-----------|----------------------------------|--------------------------|-----------------------------|------------------|------------|--------------|---------------------|
| Governmental activities: | | | | | | | | |
| General accounts | \$ 19,033 | \$ 53,482 | \$ 10,407 | \$ 2,661 | \$ 4,146 | \$ 118,019 | \$ 207,748 | \$ 85,410 |
| Due from federal government | 23 | 112,552 | 62,967 | 34,268 | - | 152,964 | 362,774 | - |
| Interest | - | - | 2,076 | 3,962 | 1,608 | 9,305 | 16,951 | 732 |
| Healthcare providers | - | 45,476 | - | - | - | - | 45,476 | - |
| Broker receivable | - | - | - | - | 40,220 | - | 40,220 | - |
| Notes | - | - | - | 100 | - | - | 100 | - |
| Contracts | - | - | 1,147 | 422 | - | - | 1,569 | - |
| Mortgages | - | 5,065 | - | 13 | - | - | 5,078 | - |
| Benefit recoveries | 25,738 | 52,342 | - | - | - | - | 78,080 | - |
| Court fines and fees | - | - | - | - | - | 436,407 | 436,407 | - |
| Collection assessments | - | - | - | - | - | 342,280 | 342,280 | - |
| Child support recoveries | - | - | - | - | - | 267,002 | 267,002 | - |
| Workers' compensation recoveries | - | - | - | - | - | 56,495 | 56,495 | - |
| Other | 18,832 | - | 3,102 | 8,873 | - | 104,993 | 135,800 | 45 |
| Gross receivables | 63,626 | 268,917 | 79,699 | 50,299 | 45,974 | 1,487,465 | 1,995,980 | 86,187 |
| Allowance for uncollectibles | (16,626) | (5,877) | (753) | (3,763) | - | (921,755) | (948,774) | (17) |
| Total receivables, net | \$ 47,000 | \$ 263,040 | \$ 78,946 | \$ 46,536 | \$ 45,974 | \$ 565,710 | \$ 1,047,206 | \$ 86,170 |

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Receivables reported for business-type activities at June 30, 2011 (in thousands):

| | Housing and Community Services | Veterans' Loan | Lottery Operations | Unemployment Compensation | University System | Other | Total |
|----------------------------------|--------------------------------------|-------------------|-----------------------|------------------------------|----------------------|----------|-----------|
| Business-type activities: | | | | | | | |
| General accounts | \$ 1,351 | \$ 96 | \$ 15,790 | \$ 283,340 | \$ 139,030 | \$17,635 | \$457,242 |
| Due from federal government | - | - | - | 14,672 | 49,356 | 831 | 64,859 |
| Interest | 7,709 | 1,642 | - | 545 | - | 13,840 | 23,736 |
| Broker receivable | - | - | - | - | 412 | - | 412 |
| Contracts | - | 1,437 | - | - | - | - | 1,437 |
| Loans | - | - | - | - | 16,524 | - | 16,524 |
| Loans - long-term | - | - | - | - | 64,150 | - | 64,150 |
| Benefit recoveries | - | - | - | 26,390 | - | - | 26,390 |
| Other | - | 524 | 2,946 | 17,016 | - | 76 | 20,562 |
| Gross receivables | 9,060 | 3,699 | 18,736 | 341,963 | 269,472 | 32,382 | 675,312 |
| Allowance for uncollectibles | - | - | - | (9,440) | (7,324) | (49) | (16,813) |
| Total receivables, net | \$ 9,060 | \$ 3,699 | \$ 18,736 | \$ 332,523 | \$ 262,148 | \$32,333 | \$658,499 |

Receivables reported for fiduciary funds at June 30, 2011 (in thousands):

| | Agency |
|-----------------------------------|------------|
| Fiduciary fund activities: | |
| General accounts | \$ 11,063 |
| Restitution | 427,766 |
| Other | 2,669 |
| Gross receivables | 441,498 |
| Allowance for uncollectibles | (321,774) |
| Total receivables, net | \$ 119,724 |

Receivables reported for the SAIF Corporation (SAIF) at December 31, 2010, and the Oregon Health and Science University (OHSU) at June 30, 2011 (in thousands):

| | SAIF | OHSU |
|--|------------|------------|
| Discretely presented component units: | | |
| Patient accounts | \$ - | \$ 213,481 |
| Premiums | 281,555 | - |
| Due from federal government | - | 32,765 |
| Interest | 40,167 | 2,509 |
| Student loans | - | 34,382 |
| Broker receivable | 162 | - |
| Other | 13,897 | 15,984 |
| Gross receivables | 335,781 | 299,121 |
| Allowance for uncollectibles | (1,532) | (20,327) |
| Total receivables, net | \$ 334,249 | \$ 278,794 |

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B. Payables

The following tables disaggregate payables reported in the fund financial statements as accounts and interest payable and contracts, mortgages, and notes payable.

Payables reported for governmental activities at June 30, 2011 (in thousands):

| | General | Health and Social Services | Public Transportation | Environmental Management | Common School | Other | Total | Internal Service |
|---------------------------------|-------------------|----------------------------------|--------------------------|-----------------------------|------------------|------------------|------------------|---------------------|
| Governmental activities: | | | | | | | | |
| General accounts | \$ 272,400 | \$ 52,709 | \$ 124,478 | \$ 24,801 | \$ 3,829 | \$217,745 | \$695,962 | \$27,641 |
| Interest | - | 70 | - | - | - | - | 70 | 1,006 |
| Broker payable | - | - | - | - | 71,182 | - | 71,182 | - |
| Taxes | 25 | - | - | - | - | - | 25 | - |
| Loans | - | 95,000 | - | - | - | - | 95,000 | - |
| Total payables | \$ 272,425 | \$147,779 | \$ 124,478 | \$ 24,801 | \$ 75,011 | \$217,745 | \$862,239 | \$28,647 |

Payables reported for business-type activities at June 30, 2011 (in thousands):

| | Housing and Community Services | Veterans' Loan | Lottery Operations | Unemployment Compensation | University System | Other | Total |
|----------------------------------|--------------------------------------|-------------------|-----------------------|------------------------------|----------------------|------------------|-------------------|
| Business-type activities: | | | | | | | |
| General accounts | \$ 742 | \$ 385 | \$ 5,322 | \$ 29,973 | \$133,842 | \$ 28,442 | \$ 198,706 |
| Interest | 28,944 | 965 | - | - | 29,543 | 6,540 | 65,992 |
| Broker payable | - | - | - | - | 688 | - | 688 |
| Loans | 1,500 | - | 15 | - | 5,235 | - | 6,750 |
| Contracts | - | - | - | - | 11,383 | - | 11,383 |
| Total payables | \$ 31,186 | \$ 1,350 | \$ 5,337 | \$ 29,973 | \$180,691 | \$ 34,982 | \$ 283,519 |

Payables reported for fiduciary funds at June 30, 2011 (in thousands):

| | Pension and Other Employee Benefit Trust | Private Purpose Trust | Investment Trust | Agency |
|-----------------------------------|---|-----------------------------|---------------------|--------------|
| Fiduciary fund activities: | | | | |
| General accounts | \$ 296,886 | \$ 288 | \$ 268 | \$ 40 |
| Compensated absences payable | 1,452 | - | - | - |
| Broker payable | 2,556,987 | - | - | - |
| Mortgages | - | 2,174 | - | - |
| Total payables | \$ 2,855,325 | \$ 2,462 | \$ 268 | \$ 40 |

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Payables reported for SAIF Corporation (SAIF) at December 31, 2010, and the Oregon Health and Science University (OHSU) at June 30, 2011 (in thousands):

| | SAIF | OHSU |
|--|------------------|-------------------|
| Discretely presented component units: | | |
| General accounts | \$ 21,124 | \$ 176,713 |
| Contracts | - | 36,649 |
| Reinsurance | 6,218 | - |
| Commission payable | 7,912 | - |
| Retrospective premiums | 30,305 | - |
| Total payables | <u>\$ 65,559</u> | <u>\$ 213,362</u> |

5. JOINT VENTURE

The Multi-State Lottery Association (MUSL) was established in 1987 to coordinate lottery games with larger prizes than the individual states could offer by themselves. The Oregon Lottery has been a participating member since the inception of MUSL. Each participating state sells its choice of MUSL products and keeps all profits earned. Participating states contribute amounts necessary to fund the estimated and actual prizes won, reserve prize pools, and the operating expenses of MUSL. For fiscal years ended June 30, 2011 and 2010, the Oregon Lottery's share of MUSL's operating expenses was \$32.5 thousand and \$31 thousand, respectively.

MUSL is governed by a board on which each member lottery is represented. Each member lottery has one vote. The board's responsibilities to administer multi-state lottery games are performed through product groups, advisory committees, or panels staffed by officers and independent contractors as appointed by the board. These officers and consultants serve at the pleasure of the board and the board prescribes their powers, duties, and qualifications. The executive committee carries out the budgeting and financing of MUSL, and the board contracts annually with an independent auditor. Upon termination of the MUSL's existence, if such termination should occur, the member lotteries would receive any proceeds determined available for distribution by the board.

The following schedule presents the summarized financial activity of MUSL as of June 30, 2011 and 2010 (in thousands).

| | 2011 | 2010 |
|-----------------------------------|-------------------|-------------------|
| Assets | <u>\$ 641,435</u> | <u>\$ 736,287</u> |
| Liabilities | \$ 641,194 | \$ 735,783 |
| Net Assets - unrestricted | 241 | 504 |
| Liabilities and net assets | <u>\$ 641,435</u> | <u>\$ 736,287</u> |
| Unrestricted revenues | \$ 4,101 | \$ 3,712 |
| Unrestricted expenses | 4,364 | 4,002 |
| Change in unrestricted net assets | <u>\$ (263)</u> | <u>\$ (290)</u> |

Long-term liabilities of MUSL are limited to prize annuities due, which are fully funded through investments in U.S. Government securities.

Separate financial statements for MUSL may be obtained from the Multi-State Lottery Association, Attention: Chuck Strutt, 4400 NW Urbandale Drive, Urbandale, Iowa, 50322.

6. CAPITAL ASSETS

A. Primary Government

Capital Asset Activity

Capital asset activity for the primary government for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Increases | Decreases | Ending Balance |
|--|----------------------|---------------------|---------------------|----------------------|
| Governmental activities: | | | | |
| <i>Capital assets not being depreciated:</i> | | | | |
| Land | \$ 1,724,396 | \$ 56,320 | \$ 2,423 | \$ 1,778,293 |
| Construction in progress | 2,071,340 | 1,541,779 | 2,143,276 | 1,469,843 |
| Works of art and other nondepreciable assets | 1,746 | 178 | - | 1,924 |
| Total capital assets not being depreciated | <u>3,797,482</u> | <u>1,598,277</u> | <u>2,145,699</u> | <u>3,250,060</u> |
| <i>Capital assets being depreciated:</i> | | | | |
| Buildings, property, and equipment | 2,977,163 | 431,189 | 262,025 | 3,146,327 |
| Infrastructure | 15,216,359 | 3,168,826 | 2,217,745 | 16,167,440 |
| Total capital assets being depreciated | <u>18,193,522</u> | <u>3,600,015</u> | <u>2,479,770</u> | <u>19,313,767</u> |
| Less accumulated depreciation for: | | | | |
| Buildings, property, and equipment | 1,246,352 | 126,445 | 27,374 | 1,345,423 |
| Infrastructure | 9,414,749 | 527,418 | 414,212 | 9,527,955 |
| Total accumulated depreciation | <u>10,661,101</u> | <u>653,863</u> | <u>441,586</u> | <u>10,873,378</u> |
| Total capital assets being depreciated, net | <u>7,532,421</u> | <u>2,946,152</u> | <u>2,038,184</u> | <u>8,440,389</u> |
| Governmental activities capital assets, net | <u>\$ 11,329,903</u> | <u>\$ 4,544,429</u> | <u>\$ 4,183,883</u> | <u>\$ 11,690,449</u> |

The beginning balance has been restated from \$11,271,055 to \$11,329,903 to reflect prior period adjustments totaling \$58,848. Increases in accumulated depreciation include current year depreciation expense of \$299,285 and a prior period adjustment of \$354,578.

| | Beginning Balance | Increases | Decreases | Ending Balance |
|--|----------------------|-------------------|------------------|---------------------|
| Business-type activities: | | | | |
| <i>Capital assets not being depreciated:</i> | | | | |
| Land | \$ 121,340 | \$ 10,890 | \$ - | \$ 132,230 |
| Construction in progress | 354,174 | 1,613 | 23,060 | 332,727 |
| Works of art and other nondepreciable assets | 64,429 | 8,021 | - | 72,450 |
| Total capital assets not being depreciated | <u>539,943</u> | <u>20,524</u> | <u>23,060</u> | <u>537,407</u> |
| <i>Capital assets being depreciated:</i> | | | | |
| Buildings, property, and equipment | 3,207,747 | 682,435 | 7,039 | 3,883,143 |
| Infrastructure | 86,058 | 10,179 | - | 96,237 |
| Total capital assets being depreciated | <u>3,293,805</u> | <u>692,614</u> | <u>7,039</u> | <u>3,979,380</u> |
| Less accumulated depreciation for: | | | | |
| Buildings, property, and equipment | 1,495,877 | 145,366 | 14,286 | 1,626,957 |
| Infrastructure | 44,764 | 4,072 | - | 48,836 |
| Total accumulated depreciation | <u>1,540,641</u> | <u>149,438</u> | <u>14,286</u> | <u>1,675,793</u> |
| Total capital assets being depreciated, net | <u>1,753,164</u> | <u>543,176</u> | <u>(7,247)</u> | <u>2,303,587</u> |
| Business-type activities capital assets, net | <u>\$ 2,293,107</u> | <u>\$ 563,700</u> | <u>\$ 15,813</u> | <u>\$ 2,840,994</u> |

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| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|----------------------|-----------|-----------|-------------------|
| Fiduciary fund activities: | | | | |
| <i>Capital assets not being depreciated:</i> | | | | |
| Land | \$ 958 | \$ - | \$ - | \$ 958 |
| Construction in progress | - | 165 | - | 165 |
| Total capital assets not being depreciated | 958 | 165 | - | 1,123 |
| <i>Capital assets being depreciated:</i> | | | | |
| Buildings, property, and equipment | 43,223 | 5,912 | 65 | 49,070 |
| Total capital assets being depreciated | 43,223 | 5,912 | 65 | 49,070 |
| Less accumulated depreciation for: | | | | |
| Buildings, property, and equipment | 9,161 | 1,767 | 65 | 10,863 |
| Total accumulated depreciation | 9,161 | 1,767 | 65 | 10,863 |
| Total capital assets being depreciated, net | 34,062 | 4,145 | - | 38,207 |
| Fiduciary fund activities capital assets, net | \$ 35,020 | \$ 4,310 | \$ - | \$ 39,330 |

Depreciation Expense

Depreciation expense charged to functions of the primary government (in thousands):

Governmental activities:

| | |
|--|-------------------|
| Education | \$ 593 |
| Human services | 4,486 |
| Public safety | 36,509 |
| Economic and community development | 1,238 |
| Natural resources | 17,233 |
| Transportation | 193,073 |
| Consumer and business services | 754 |
| Administration | 5,585 |
| Legislative | 1,667 |
| Judicial | 1,490 |
| Subtotal | 262,628 |
| Internal service funds | 36,657 |
| Total depreciation expense - governmental activities | <u>\$ 299,285</u> |

Business-type activities:

| | |
|---|-------------------|
| Veterans' Loan | \$ 117 |
| Lottery Operations | 29,773 |
| University System | 113,725 |
| Other business-type activities | 5,823 |
| Total depreciation expense - business-type activities | <u>\$ 149,438</u> |

Fiduciary fund activities:

| | |
|---|-----------------|
| Pension and Other Employee Benefit Trust | \$ 1,767 |
| Total depreciation expense - fiduciary activities | <u>\$ 1,767</u> |

In fiscal year 2011, the Department of Transportation extended the service life of over \$12 billion in state highway infrastructure assets and also recognized a residual value related to these assets. As a result, depreciation expense for fiscal year 2011 decreased approximately \$495 million compared to the prior year.

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Construction Commitments

The State has active construction projects which will be funded either through General Fund appropriations, federal grants, lottery resources, or other funding sources as noted in the schedule below. The State's construction commitments with contractors as of June 30, 2011 (in thousands):

| Project | Spent-to-Date | Remaining Commitment | Remaining Commitment Source of Funds | | | |
|---|---------------------|-------------------------|--------------------------------------|-------------------|------------------|---------------------|
| | | | General | Federal | Lottery | Other |
| Military facilities | \$ 89,533 | \$ 21,368 | \$ - | \$ 18,504 | \$ - | \$ 2,864 |
| Oregon State Hospital facility | 295,852 | 80,523 | - | - | - | 80,523 |
| Prison construction and upgrades | 40,715 | 5,654 | 390 | - | - | 5,264 |
| University buildings and upgrades | 930,935 | 394,867 | 6,342 | - | 23,747 | 364,778 |
| Road and bridge construction | 1,001,440 | 766,500 | - | 421,700 | - | 344,800 |
| State parks facilities | 3,404 | 1,698 | - | 1,273 | 330 | 95 |
| Upgrade/maintenance of various facilities | 56,580 | 267,293 | 252 | 1,442 | - | 265,599 |
| Total | \$ 2,418,459 | \$ 1,537,903 | \$ 6,984 | \$ 442,919 | \$ 24,077 | \$ 1,063,923 |

Collections Not Capitalized

Certain collections of historic artifacts and works of art are not reported in the accompanying financial statements. These assets include highway maintenance equipment displayed at various district and regional offices; printing equipment displayed at the Salem print plant; historic documents displayed at the Oregon State Archives; a museum of military artifacts at Camp Withycombe in Clackamas, Oregon; a collection of historic buildings, furniture, paintings, and ancestral artifacts displayed at various state parks; a collection of wildlife mounts displayed at various Department of Fish and Wildlife locations; and a collection of photographs portraying various Oregon locales displayed at the Oregon Liquor Control Commission headquarters. They have not been capitalized because they meet all of the conditions that qualify them as collections that are not required to be capitalized. These conditions are:

- The collections are held for public exhibition or education in the furtherance of public service, not held for financial gain;
- The collections are protected, kept unencumbered, cared for, and preserved; and
- The collections are subject to policies that require the proceeds from sales of collection items to be used to acquire other items for the collections.

Insurance Recoveries

In the government-wide statement of activities, program revenues include insurance recoveries of the applicable functions (in thousands):

Governmental activities:

| | |
|--|-----------------|
| Public safety | \$ 1,886 |
| Natural resources | 26 |
| Transportation | 991 |
| Administration | 454 |
| Total insurance recoveries - governmental activities | <u>\$ 3,357</u> |

Business-type activities:

| | |
|---|-----------------|
| University System | \$ 2,539 |
| Lottery Operations | 65 |
| Other business-type activities | 12 |
| Total insurance recoveries - business-type activities | <u>\$ 2,616</u> |

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Idle Impaired Capital Assets

At fiscal year end, the Department of Corrections' Deer Ridge Correctional Institution, a medium security facility with a carrying value of \$108.4 million, and the Oregon State Penitentiary Minimum facility with a carrying value of \$1.9 million were temporarily idle due to budget constraints and a delay in the implementation of Ballot Measure 57, the Mandatory Prison Sentences for Three or More Felonies Act.

B. Discretely Presented Component Units

Activity for SAIF Corporation for the year ended December 31, 2010 (in thousands):

| | Beginning Balance | Increases | Decreases | Ending Balance |
|--|----------------------|-----------|-----------|-------------------|
| <i>Capital assets not being depreciated:</i> | | | | |
| Land | \$ 3,029 | \$ - | \$ - | \$ 3,029 |
| Total capital assets not being depreciated | 3,029 | - | - | 3,029 |
| <i>Capital assets being depreciated:</i> | | | | |
| Buildings, property, and equipment | 43,274 | 712 | 1,759 | 42,227 |
| Total capital assets being depreciated | 43,274 | 712 | 1,759 | 42,227 |
| Less accumulated depreciation for: | | | | |
| Buildings, property, and equipment | 28,056 | 1,399 | 1,740 | 27,715 |
| Total accumulated depreciation | 28,056 | 1,399 | 1,740 | 27,715 |
| Total capital assets being depreciated, net | 15,218 | (687) | 19 | 14,512 |
| SAIF Corporation capital assets, net | \$ 18,247 | \$ (687) | \$ 19 | \$ 17,541 |

Activity for the Oregon Health and Science University (OHSU) for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Increases | Decreases | Ending Balance |
|--|----------------------|-----------|-----------|-------------------|
| <i>Capital assets not being depreciated:</i> | | | | |
| Land | \$ 57,470 | \$ 1,300 | \$ - | \$ 58,770 |
| Construction in progress | 29,021 | 79,805 | 49,420 | 59,406 |
| Total capital assets not being depreciated | 86,491 | 81,105 | 49,420 | 118,176 |
| <i>Capital assets being depreciated:</i> | | | | |
| Buildings, property, and equipment | 2,013,686 | 97,393 | 12,305 | 2,098,774 |
| Total capital assets being depreciated | 2,013,686 | 97,393 | 12,305 | 2,098,774 |
| Less accumulated depreciation for: | | | | |
| Buildings, property, and equipment | 885,156 | 106,647 | 12,008 | 979,795 |
| Total accumulated depreciation | 885,156 | 106,647 | 12,008 | 979,795 |
| Total capital assets being depreciated, net | 1,128,530 | (9,254) | 297 | 1,118,979 |
| OHSU capital assets, net | \$ 1,215,021 | \$ 71,851 | \$ 49,717 | \$ 1,237,155 |

7. LEASES

A. Operating Leases

The State and its discretely presented component units have entered into various non-cancelable rental agreements that are accounted for as operating leases because the agreements do not meet the criteria to be classified as capital leases. Operating lease payments are chargeable as rent and reported in services and supplies. Rental costs for operating leases for the year ended June 30, 2011, were \$108.7 million for the primary government and \$24 million for component units.

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Future minimum rental payments for operating leases in effect as of June 30, 2011 (in thousands):

| Year Ending June 30, | Primary Government | Component Units |
|--------------------------------------|-----------------------|--------------------|
| 2012 | \$ 91,952 | \$ 17,648 |
| 2013 | 73,188 | 17,057 |
| 2014 | 60,049 | 13,765 |
| 2015 | 49,481 | 11,235 |
| 2016 | 42,097 | 11,047 |
| 2017-2021 | 125,626 | 40,565 |
| 2022-2026 | 25,309 | 7,678 |
| 2027-2031 | 5,374 | - |
| 2032-2036 | 927 | - |
| 2037-2041 | 170 | - |
| 2042-2046 | 1 | - |
| 2047-2051 | 1 | - |
| 2052-2056 | 1 | - |
| Total future minimum rental payments | <u>\$ 474,176</u> | <u>\$ 118,995</u> |

B. Capital Leases

A capital lease is accounted for similar to a purchase on a long-term contract. The underlying property is capitalized at an amount equal to the present value of the minimum lease payments and a corresponding liability is recorded. The liability for capital leases is reported as obligations under capital lease in the accompanying financial statements.

Carrying value of assets acquired through capital leases as of June 30, 2011 (in thousands):

| Asset Class | Governmental Activities | Business-type Activities | Component Units |
|------------------------------------|----------------------------|-----------------------------|--------------------|
| Buildings, property, and equipment | \$ 17,953 | \$ 797 | \$ 17,002 |
| Less accumulated depreciation | (4,489) | (158) | (9,895) |
| Total | <u>\$ 13,464</u> | <u>\$ 639</u> | <u>\$ 7,107</u> |

Future minimum lease payments for capital leases and the related net present value as of June 30, 2011 (in thousands):

| Year Ending June 30, | Governmental Activities | Business-type Activities | Component Units |
|---|----------------------------|-----------------------------|--------------------|
| 2012 | \$ 5,038 | \$ 119 | \$ 1,460 |
| 2013 | 4,205 | 103 | 4,182 |
| 2014 | 1,021 | 98 | 419 |
| 2015 | 663 | 96 | 148 |
| 2016 | - | 93 | 124 |
| 2017-2021 | - | 326 | - |
| Total future minimum lease payments | <u>10,927</u> | <u>835</u> | <u>6,333</u> |
| Less amounts representing interest | <u>(1,289)</u> | <u>(220)</u> | <u>(528)</u> |
| Present value of minimum lease payments | <u>\$ 9,638</u> | <u>\$ 615</u> | <u>\$ 5,805</u> |

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C. Lease Receivables

The State receives income from operating leases on land, property, and equipment leased to non-state entities. The State received rental income of \$11.3 million for the year ended June 30, 2011, on leased assets with a carrying value of \$49.9 million, net of \$17 million in accumulated depreciation.

Future minimum lease revenues for non-cancelable operating leases as of June 30, 2011 (in thousands):

| <u>Year Ending June 30,</u> | <u>Primary Government</u> |
|-------------------------------------|-------------------------------|
| 2012 | \$ 8,972 |
| 2013 | 7,138 |
| 2014 | 5,623 |
| 2015 | 3,744 |
| 2016 | 3,355 |
| 2017-2021 | 13,157 |
| 2022-2026 | 10,537 |
| 2027-2031 | 10,969 |
| 2032-2036 | 10,895 |
| 2037-2041 | 8,016 |
| 2042-2046 | 3,283 |
| 2047-2051 | 532 |
| 2052-2056 | 246 |
| Total future minimum lease revenues | <u>\$ 86,467</u> |

8. DONOR-RESTRICTED ENDOWMENTS

Oregon University System

Oregon Revised Statute 351.130 gives the Oregon University System (OUS) authority to use the interest, income, dividends, or profits from donor-restricted endowments for the benefit of the designated institution. The OUS board's current spending policy calls for the annual distribution of 4 percent of the preceding 20-quarter moving average of the market value of the endowment funds. For the year ended June 30, 2011, the net amount of appreciation available for authorization for expenditure was \$17.3 million. The amount available for distribution during fiscal year 2012 is estimated to be \$2.6 million. The corpus of the endowment funds is reported as nonexpendable net assets, restricted for donor purposes, on the proprietary funds balance sheet and the government-wide statement of net assets. The amount of net appreciation is reported as part of expendable net assets, restricted for education.

Oregon Health and Science University

Oregon Revised Statutes 128.318, 128.322, 128.326, and 128.328 give the Oregon Health and Science University (OHSU) authority to use the net appreciation of restricted endowments subject to the terms established by the donors. The OHSU board's current spending policy calls for the annual distribution of 4.5 percent of the preceding three-year moving average of the market value of the endowment pool. The net amount of appreciation available for authorization for expenditure at June 30, 2011, was \$61.4 million. The corpus of the endowment funds is reported as nonexpendable net assets, restricted for education, on the combining balance sheet of the discretely presented component units. The amount of net appreciation is reported as part of expendable net assets, restricted for education.

9. SHORT AND LONG-TERM DEBT

A. Short-term Debt

During the year, the State repaid the tax anticipation notes that were issued in July 2010, to meet seasonal cash management needs within fiscal year 2011. In addition, the Oregon Department of Human Services (DHS) borrowed from the Oregon Short-term Fund to cover end of biennium cash flow needs.

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Short-term debt activity for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Additions | Deductions | Ending Balance |
|---------------------------------|----------------------|-------------------|-------------------|------------------|
| Governmental activities: | | | | |
| Tax anticipation notes | \$ - | \$ 850,815 | \$ 850,815 | \$ - |
| DHS line of credit | - | 95,000 | - | 95,000 |
| Total short-term debt activity | <u>\$ -</u> | <u>\$ 945,815</u> | <u>\$ 850,815</u> | <u>\$ 95,000</u> |

B. General Obligation Bonds

The State issues general obligation bonds to provide funds for a variety of projects as authorized by the Oregon Constitution. General obligation bonds are secured by a pledge of the full faith, credit, and taxing power of the State.

Specific provisions of the Oregon Constitution authorize general obligation debt to be issued for governmental activities. Article XI-G provides authorization to finance buildings and projects for community colleges. Debt service requirements for community colleges are financed through an appropriation from the General Fund. Obligations issued for highway construction pursuant to Article XI, Section 7, are fully self-supporting. Article XI-H authorizes the financing of pollution abatement and control facilities as well as pollution control and disposal activities. Facilities acquired under the pollution control program are required to conservatively appear to be at least 70 percent self-supporting and self-liquidating from revenues, gifts, federal grants, assessments, user charges, and other fees. Article XI-L provides authorization to finance capital costs of the Oregon Health and Science University. Article XI-O provides authorization to finance pension liabilities through the issuance of general obligation bonds. Article XI-M provides authorization to finance Seismic Rehabilitation projects for public education buildings and XI-N for Emergency Services Buildings. The newly enacted Article XI-Q provides authorization to finance real or personal property projects that will be owned or operated by the State.

The Oregon Constitution also authorizes general obligation debt to be used for business-type activities. Article XI-A authorizes the creation of the Oregon War Veterans' Fund to finance farm and home loans for eligible veterans. Financing of multi-family housing for elderly and disabled persons is authorized in Article XI-I (2). Article XI-J provides authorization to finance loans for the development of small-scale local energy projects. Issuance of general obligation bonds to finance higher education building projects is authorized in Article XI-F (1). The preceding bonds of business-type activities are fully self-supporting. Article XI-G authorizes financing of higher education facilities and institution activities. Debt service requirements for these higher education obligations are financed through an appropriation from the General Fund.

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Notes to the Financial Statements

Debt service requirements for general obligation bonds as of June 30, 2011 (in thousands):

| Year ending June 30, | Governmental Activities | | Business-type Activities | |
|----------------------|----------------------------|--------------|-----------------------------|--------------|
| | Principal | Interest | Principal ¹ | Interest |
| 2012 | \$ 55,425 | \$ 141,526 | \$ 76,888 | \$ 108,718 |
| 2013 | 66,240 | 140,440 | 71,210 | 109,715 |
| 2014 | 83,040 | 137,413 | 72,844 | 106,051 |
| 2015 | 93,685 | 133,315 | 76,097 | 100,890 |
| 2016 | 104,815 | 128,634 | 79,826 | 98,846 |
| 2017-2021 | 685,045 | 549,904 | 467,014 | 429,149 |
| 2022-2026 | 1,114,995 | 313,500 | 437,925 | 299,253 |
| 2027-2031 | 333,995 | 44,043 | 431,110 | 191,727 |
| 2032-2036 | 76,600 | 11,064 | 347,215 | 101,085 |
| 2037-2041 | 2,960 | 150 | 242,405 | 28,644 |
| 2042-2046 | - | - | 31,345 | 1,332 |
| 2047-2051 | - | - | 410 | 25 |
| Total | \$ 2,616,800 | \$ 1,599,989 | \$ 2,334,289 | \$ 1,575,435 |

¹ Includes a total of \$209.4 million of bonds with variable interest rates adjusted daily or weekly based on the rates determined by the remarketing agent. The interest rates at the end of the fiscal year were 0.08 percent for \$44 million of these bonds, 1.5 percent for \$85.5 million, 1.9 percent for \$38.9 million, and 2.25 percent for \$41 million.

C. Revenue Bonds

Oregon Revised Statutes (ORS) authorize the State to issue revenue bonds. Revenue bonds are secured by a pledge of revenues derived from the operation of the programs funded by the issuance of these obligations. The resulting bond obligations are not general obligations of the State.

ORS 286A.560 through 286A.585, 327.700 through 327.711, and 348.716 authorize the State to issue revenue bonds that are supported by unobligated net lottery proceeds. To date, lottery revenue bonds have been issued for infrastructure improvements, state parks, expansion and refurbishment of school facilities, light rail transportation, improvements to state fair facilities, acquisition of state forestland, watershed project grants, and economic development in rural and distressed communities. Lottery revenue bonds have been issued for both governmental and business-type activities.

ORS 367.605 through 367.665 authorize the Oregon Department of Transportation to issue highway user tax bonds for governmental activities to build and maintain public roads. Debt service payments for these bonds are funded by highway user taxes and vehicle registration fees.

ORS 456.645 authorizes the Oregon Housing and Community Services Department to issue revenue bonds for financing single-family mortgage loans and multi-family housing projects. Mortgage payments and fees and rental revenues support these bonds. ORS 285B.467 through 285B.482 authorize the Oregon Business Development Department to issue revenue bonds for financing infrastructure improvement projects through the Special Public Works Fund, while ORS 285B.572 through 285B.599 authorize the issuance of revenue bonds for financing water projects through the Water Fund. Loan repayments support the bonds associated with these business-type activities.

ORS 353.340 authorizes the Oregon Health and Science University (OHSU), a discretely presented component unit of the State, to issue revenue bonds for the construction and refurbishment of facilities and the acquisition of equipment in accordance with ORS Chapter 287A. The revenue bonds are payable from the revenues of OHSU.

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Debt service requirements for revenue bonds as of June 30, 2011 (in thousands):

| Year ending June 30, | Governmental Activities | | Business-type Activities | | Discretely Presented Component Units | |
|----------------------|----------------------------|---------------------|-----------------------------|-------------------|---|-------------------|
| | Principal ¹ | Interest | Principal ^{2,3} | Interest | Principal ^{4,5} | Interest |
| 2012 | \$ 126,054 | \$ 154,396 | \$ 85,181 | \$ 53,593 | \$ 11,441 | \$ 30,652 |
| 2013 | 125,038 | 148,745 | 48,026 | 53,099 | 11,785 | 30,365 |
| 2014 | 123,348 | 143,044 | 43,977 | 51,582 | 13,391 | 29,944 |
| 2015 | 126,624 | 137,151 | 47,941 | 49,975 | 15,446 | 30,155 |
| 2016 | 114,674 | 131,744 | 47,731 | 48,134 | 16,185 | 30,513 |
| 2017-2021 | 621,763 | 572,563 | 256,783 | 210,102 | 62,346 | 167,459 |
| 2022-2026 | 750,692 | 423,603 | 311,993 | 148,652 | 118,663 | 121,389 |
| 2027-2031 | 748,499 | 243,060 | 314,786 | 81,769 | 145,625 | 82,285 |
| 2032-2036 | 544,805 | 62,918 | 274,870 | 37,113 | 135,550 | 45,930 |
| 2037-2041 | - | - | 118,685 | 11,846 | 98,090 | 14,494 |
| 2042-2046 | - | - | 19,250 | 2,216 | - | - |
| 2047-2051 | - | - | 3,000 | 514 | - | - |
| 2052-2056 | - | - | 775 | 38 | - | - |
| Total | \$ 3,281,497 | \$ 2,017,224 | \$ 1,572,998 | \$ 748,633 | \$ 628,522 | \$ 583,186 |

¹ Includes a total of \$265.2 million of bonds with variable interest rates adjusted weekly based on the rates determined by the remarketing agent. The interest rates at the end of the fiscal year were 2.25 percent for \$160.1 million of these bonds and 3 percent for \$105.1 million.

² Includes bonds with variable interest rates adjusted monthly based on the London Interbank Offered Rate (LIBOR) plus 0.4 percent not to exceed 11 percent for \$1.4 million of the bonds and 11.5 percent for \$1.9 million. The interest rate at the end of the fiscal year for these bonds was 0.6 percent.

³ Includes bonds with variable interest rates adjusted weekly based on the rates determined by the remarketing agent, not to exceed 12 percent. The interest rates at the end of the fiscal year were 0.06 percent for \$16.1 million of these bonds, 0.07 percent for \$20 million, 0.08 percent for \$44.9 million, 0.09 percent for \$34.7 million, 0.1 percent for \$119.8 million, 0.12 percent for \$50 million, and 0.13 percent for \$35 million.

⁴ Includes bonds with variable rates of interest adjusted every 35 days based on the auction rate. The rate as of fiscal year-end was 0.25 percent for \$86.8 million of these bonds and 0.35 percent for \$46.9 million.

⁵ Includes \$79.5 million of bonds with a variable rate of interest that is adjusted weekly. The rate as of fiscal year-end was 0.53 percent.

D. Certificates of Participation

ORS 283.085 through 283.092 authorize the State to enter into financing agreements through the issuance of certificates of participation. The State has issued certificates of participation to provide funds for the acquisition of computer and telecommunication systems and the acquisition, construction, or remodeling of State facilities. Certificates of participation have been issued for governmental, business-type, and fiduciary activities.

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Debt service requirements for certificates of participation as of June 30, 2011 (in thousands):

| Year ending June 30, | Governmental Activities | | Business-type Activities | | Fiduciary Fund | Activities |
|----------------------|----------------------------|------------|-----------------------------|-----------|----------------|------------|
| | Principal | Interest | Principal | Interest | Principal | Interest |
| 2012 | \$ 95,331 | \$ 59,454 | \$ 9,154 | \$ 5,083 | \$ 520 | \$ 188 |
| 2013 | 98,099 | 55,045 | 8,921 | 4,709 | 550 | 161 |
| 2014 | 83,462 | 50,769 | 7,938 | 4,341 | 580 | 132 |
| 2015 | 81,463 | 46,834 | 6,783 | 3,971 | 615 | 101 |
| 2016 | 68,762 | 43,252 | 4,938 | 3,694 | 640 | 69 |
| 2017-2021 | 320,571 | 170,512 | 22,363 | 15,412 | 675 | 35 |
| 2022-2026 | 217,880 | 104,268 | 23,675 | 10,263 | - | - |
| 2027-2031 | 186,425 | 54,951 | 17,980 | 4,083 | - | - |
| 2032-2036 | 93,345 | 14,166 | 5,705 | 899 | - | - |
| 2037-2041 | 10,180 | 1,087 | - | - | - | - |
| Total | \$ 1,255,518 | \$ 600,338 | \$ 107,457 | \$ 52,455 | \$ 3,580 | \$ 686 |

E. General Appropriation Bonds

During the 2003 legislative session, Senate Bill 856 authorized the State to issue general appropriation bonds. The State has issued general appropriation bonds for general government activities.

Debt service requirements for general appropriation bonds as of June 30, 2011 (in thousands):

| Year ending June 30, | Governmental Activities | |
|----------------------|----------------------------|-----------|
| | Principal | Interest |
| 2012 | \$ 65,100 | \$ 6,502 |
| 2013 | 69,900 | 3,136 |
| 2014 | 28,195 | 696 |
| Total | \$ 163,195 | \$ 10,334 |

F. Changes in Long-Term Debt

Changes in long-term debt for governmental activities for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|---|----------------------|------------|------------|-------------------|------------------------|
| Governmental activities: | | | | | |
| Bonds/certificates payable: | | | | | |
| General obligation bonds | \$ 2,326,280 | \$ 331,035 | \$ 40,515 | \$ 2,616,800 | \$ 55,425 |
| Revenue bonds | 3,270,139 | 155,799 | 144,441 | 3,281,497 | 126,054 |
| Certificates of participation | 1,452,354 | 744 | 197,580 | 1,255,518 | 95,331 |
| General appropriation bonds | 223,740 | - | 60,545 | 163,195 | 65,100 |
| Less deferred amounts: | | | | | |
| For issuance discounts | (3,241) | - | (154) | (3,087) | - |
| For issuance premiums | 149,102 | 46,603 | 16,151 | 179,554 | - |
| On refunding | (25,852) | (3,298) | (4,532) | (24,618) | - |
| Total governmental bonds/certificates payable | \$ 7,392,522 | \$ 530,883 | \$ 454,546 | \$ 7,468,859 | \$ 341,910 |

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Changes in long-term debt for business-type activities for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|---|----------------------|-------------------|-------------------|---------------------|------------------------|
| Business-type activities: | | | | | |
| Bonds/certificates payable: | | | | | |
| General obligation bonds | \$ 2,189,767 | \$ 380,110 | \$ 235,588 | \$ 2,334,289 | \$ 76,888 |
| Revenue bonds | 1,634,977 | 325,201 | 387,180 | 1,572,998 | 85,181 |
| Certificates of participation | 116,675 | - | 9,218 | 107,457 | 9,154 |
| Less deferred amounts: | | | | | |
| For issuance discounts | (1,837) | (222) | (577) | (1,482) | - |
| For issuance premiums | 48,926 | 22,092 | 5,604 | 65,414 | - |
| On refunding | (18,861) | (1,455) | (1,472) | (18,844) | - |
| Accreted interest | 62,677 | 5,860 | 10,133 | 58,404 | - |
| Total business bonds/certificates payable | <u>\$ 4,032,324</u> | <u>\$ 731,586</u> | <u>\$ 645,674</u> | <u>\$ 4,118,236</u> | <u>\$ 171,223</u> |

Changes in long-term debt for fiduciary fund activities for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|--|----------------------|-------------|---------------|-------------------|------------------------|
| Fiduciary fund activities: | | | | | |
| Bonds/certificates payable: | | | | | |
| Certificates of participation | \$ 4,080 | \$ - | \$ 500 | \$ 3,580 | \$ 520 |
| Less deferred amounts: | | | | | |
| For issuance premiums | 174 | - | 26 | 148 | - |
| On refunding | (142) | - | (29) | (113) | - |
| Total fiduciary bonds/certificates payable | <u>\$ 4,112</u> | <u>\$ -</u> | <u>\$ 497</u> | <u>\$ 3,615</u> | <u>\$ 520</u> |

Changes in long-term debt for the Oregon Health and Science University (OHSU) for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|--|----------------------|-----------------|------------------|-------------------|------------------------|
| Discretely presented component units: | | | | | |
| Bonds/certificates payable: | | | | | |
| Revenue bonds | \$ 639,507 | \$ - | \$ 10,985 | \$ 628,522 | \$ 11,441 |
| Less deferred amounts: | | | | | |
| For issuance discounts | (5,925) | - | (336) | (5,589) | - |
| For issuance premiums | 829 | - | 49 | 780 | - |
| On refunding | (4,352) | - | (347) | (4,005) | - |
| Accreted interest | 30,963 | 3,097 | 1,120 | 32,940 | - |
| Total OHSU bonds/certificates payable | <u>\$ 661,022</u> | <u>\$ 3,097</u> | <u>\$ 11,471</u> | <u>\$ 652,648</u> | <u>\$ 11,441</u> |

G. Demand Bonds

Department of Transportation

Included in revenue bonds payable are \$265.3 million in State of Oregon, Department of Transportation Highway User Tax Revenue Subordinate Lien Variable Rate Bonds. These bonds are special revenue obligations of the Oregon Department of Transportation (ODOT) and do not constitute a debt or general obligation of the State or any subdivision of the State. The variable rate bonds are secured by and payable solely from pledged State Highway Fund revenues on a subordinate, junior, and inferior basis to ODOT's Senior Lien Bonds as described in the official statement for the respective bond series.

ODOT's variable rate bonds are remarketed weekly by a remarketing agent. Bondholders may elect to tender these bonds by providing written notice to the remarketing agent as specified in the official statement for the series. On the date that bonds are tendered, the remarketing agent will use its best effort to sell the bonds or

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may purchase the bonds for its own account. ODOT pays the designated remarketing agent a fee for this service.

ODOT has entered into standby purchase agreements (SBPA) with Dexia Credit Local to provide liquidity in the event that the remarketing agents are unable to sell the tendered bonds and do not choose to buy the bonds for their own account. The SBPA requires Dexia Credit Local to provide funds for the purchase of any un-remarketed bonds, subject to certain conditions set forth in the respective SBPAs.

If a liquidity advance does occur for either the Series 2006B bonds or Series 2007B bonds, the bonds become bank bonds and will begin to accrue interest at the bank's base rate (federal funds rate plus 0.5 percent for the first ninety days; for days 91-180 the rate would be 1 percent plus the higher of (a) the prime rate as listed in the Wall Street Journal or (b) 0.5 percent plus the federal funds rate; thereafter the rate would be 2 percent plus the higher of (a) the prime rate as listed in the Wall Street Journal or (b) 0.5 percent plus the federal funds rate). The bonds remain bank bonds until they are sold by the remarketing agent or the remarketing agent purchases them for its own account. If the bank bonds are not remarketed or purchased by the remarketing agent, principal due in connection with each bank bond will be payable in equal, semi-annual installments commencing on the first business day of the sixth month immediately succeeding the date of the liquidity advance and continuing on the first business day of each sixth month thereafter; provided, that all principal due in connection with the liquidity advance will be due and payable in full no later than the term out end date as specified in the respective SBPA. The maximum bank bond interest rate is the lesser of 12 percent per annum or the maximum rate of interest as permitted by the laws of the State of Oregon.

No tender advances or draws were necessary to purchase any un-remarketed bonds under either Series 2006B bonds or Series 2007B bonds during fiscal year 2011. Therefore, no tender advances or draws were outstanding at June 30, 2011.

Certain terms of the standby bond purchase agreements at June 30, 2011, are listed below (dollars in thousands):

| Series | Outstanding Amount | Liquidity Provider | Expiration Date | Commitment Fee | Remarketing Agent | Remarketing Fee |
|---------|--------------------|--------------------|-----------------|----------------|-------------------------------|-----------------|
| 2006-B1 | \$ 50,135 | Dexia Credit Local | 6/14/2016 | 0.0950% | JP Morgan Securities | 0.05% |
| 2006-B2 | 50,135 | Dexia Credit Local | 6/14/2016 | 0.0950% | Morgan Stanley | 0.05% |
| 2007-B1 | 55,000 | Dexia Credit Local | 6/17/2017 | 0.0950% | Morgan Stanley | 0.05% |
| 2007-B2 | 55,000 | Dexia Credit Local | 6/17/2017 | 0.0950% | Bank of America Merrill Lynch | 0.05% |
| 2007-B3 | 55,000 | Dexia Credit Local | 6/17/2017 | 0.0950% | JP Morgan Securities | 0.05% |

Department of Veterans' Affairs

Included in long-term debt are the following State of Oregon, General Obligation, Veterans' Welfare Variable Rate Demand Bonds, along with selected terms of their standby bond purchase agreements (SBPAs) at June 30, 2011 (dollars in thousands):

| Series | Outstanding Amount | Liquidity Provider | Expiration Date | Commitment Fee | Remarketing Agent | Remarketing Fee |
|--------|--------------------|-----------------------|-------------------------|----------------|---------------------------|-----------------|
| 73H | \$ 44,000 | Bayerische Landesbank | 11/30/2015 ¹ | 0.0850% | JP Morgan Securities Inc. | 0.05% |
| 83 | 10,965 | Dexia Credit Local | 12/31/2014 | 0.0925% | JP Morgan Securities Inc. | 0.05% |
| 84 | 30,000 | Dexia Credit Local | 12/31/2014 | 0.0925% | JP Morgan Securities Inc. | 0.05% |
| 85 | 15,140 | Dexia Credit Local | 12/31/2014 | 0.0925% | JP Morgan Securities Inc. | 0.07% |
| 86 | 31,320 | Dexia Credit Local | 12/31/2014 | 0.0925% | JP Morgan Securities Inc. | 0.07% |
| 87C | 9,045 | Dexia Credit Local | 12/31/2014 | 0.0925% | JP Morgan Securities Inc. | 0.07% |
| 88B | 30,000 | Dexia Credit Local | 12/31/2014 | 0.0925% | JP Morgan Securities Inc. | 0.07% |
| 90B | 38,885 | Dexia Credit Local | 12/31/2013 | 0.2500% | JP Morgan Securities Inc. | 0.07% |

¹ Bayerische Landesbank has the option to terminate its purchase commitment obligations, at its sole discretion, as of June 27, 2012.

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These bonds are general obligations of the State and are payable from revenues and reserves of the Veterans' Loan program. The bondholders may tender these bonds on specified dates at a price equal to principal plus accrued interest.

The Department of Veterans' Affairs (DVA) remarketing agent is authorized to use its best efforts to sell the repurchased bonds at face value by adjusting the interest rate on a daily or weekly basis based on the applicable mode. The designated remarketing agent for such bonds will determine the interest rate borne by each series of bonds. DVA pays its designated remarketing agent a fee for this service.

In the event the bonds cannot be remarketed, they will be purchased as specified by the respective SBPA. Under the SBPA for Series 73H, Bayerische Landesbank Girozentrale will commit to purchase any Series 73H unremarketed bonds, in each case subject to certain conditions set forth in the SBPAs. Under the SBPAs for Series 83, 84, 85, 86, 87C, 88B, 89B, and 90B ("Series 83-90B"), Dexia Credit Local will commit to purchase any unremarketed bonds, subject to certain conditions set forth in the SBPAs.

If a tender advance does occur under the Series 73H SBPAs, it will accrue interest at the bank's base rate (either a prime lending rate or the federal funds rate plus one half of 1 percent, whichever is higher). If the tender advance is in default, interest will accrue at the bank's base rate plus 1 percent. Interest on a tender advance must generally be repaid before the principal portion of a tender advance is repaid. In most cases, tender advances are required to be repaid in approximately two years. Tender advances can be repaid earlier than two years, if DVA elects to do so. If repayment of any tender advance does not occur within the specified time frame contained in Series 73H SBPAs, a default will have occurred.

During fiscal year 2011, no tender advances or draws were necessary to purchase any unremarketed bonds under the Series 73H SBPAs. Therefore, no tender advances or draws were outstanding at June 30, 2011.

If a tender advance does occur under the Series 83-90B SBPAs, it will accrue interest at the bank's base rate (either a prime lending rate or the federal funds rate plus one half of 1 percent, whichever is higher) for the time period up to 91 days; at the bank's base rate plus 1 percent for the time period covering 92 days up to the day before the end of the purchase commitment period; at the bank's base rate plus 2 percent for the time period thereafter. If the tender advance is in default, interest will accrue at the bank's base rate plus 2.5 percent. Interest on a tender advance must generally be repaid before the principal portion of a tender advance is repaid. In most cases, tender advances are required to be repaid on the earliest of (a) the date the applicable bonds are paid in full; (b) the conversion date of all or a portion of the applicable bonds to a fixed rate or indexed rate; or (c) the effective date of delivery of a substitute alternative liquidity facility. If repayment of any tender advance does not occur within the specified timeframe contained in the Series 83-90B SBPAs, a default has occurred.

During fiscal year 2011, no tender advances or draws were necessary to purchase unremarketed bonds under the Series 83-90B SBPAs. Therefore, no tender advances or draws were outstanding as of June 30, 2011.

Housing and Community Services Department

Included in Oregon Housing and Community Services Department's (OHCS) long-term debt is \$320.4 million in variable rate demand bonds. OHCS's variable rate demand bonds are remarketed weekly by a remarketing agent. Bondholders may elect to tender their bonds by providing written notice to the remarketing agent as specified in the official statement for the series. On the date that bonds are tendered, the remarketing agent will use its best effort to sell the bonds or may purchase the bonds for its own account.

OHCS has entered into standby bond purchase agreements to provide liquidity in the event that the remarketing agent is unable to sell the tendered bonds and does not choose to buy the bonds for its own account. The standby bond purchase agreement requires the liquidity provider to provide funds for the purchase of the tendered bonds. On the purchase date the bonds become known as liquidity provider bonds or bank bonds and bear interest at the bank rate in accordance with the standby bond purchase agreement. The maximum rate is 12 percent (Bank of America, N. A. and State Street Bank and Trust Company) or 13 percent (KBC Bank N.V.). The bonds remain bank bonds until they are sold by the remarketing agent or the remarketing agent purchases them for its own account. If the bonds are not remarketed or purchased by the remarketing agent for its own account, mandatory redemption in ten equal installments will be paid on the first

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business day of January and July, commencing on the first such date to occur after the bonds become liquidity provider bonds (State Street Bank and Trust Company) or at least ninety days after the related purchase date (Bank of America, N.A. and KBC Bank N.V.). There were no bank bonds on June 30, 2011.

Certain terms of the standby purchase agreements and remarketing agreements are listed below (dollars in thousands):

| Series | Outstanding Amount | Liquidity Provider | Expiration Date | Commitment Fee | Remarketing Agent | Remarketing Fee |
|-------------------------|--------------------|-------------------------------------|-----------------|----------------|--|-----------------|
| MF 2004 B ¹ | \$ 14,295 | Bank of America, N.A. | 8/27/2011 | 0.4750% | Merrill Lynch, Pierce, Fenner & Smith Inc. | 0.08% |
| MRB 2003 L ³ | 15,000 | State Street Bank and Trust Company | 12/16/2011 | 0.1300% | J.P. Morgan Securities, Inc. | 0.07% |
| MRB 2004 C ³ | 15,000 | State Street Bank and Trust Company | 12/16/2011 | 0.1300% | CitiGroup Global Markets, Inc. | 0.07% |
| MRB 2004 I ³ | 15,000 | State Street Bank and Trust Company | 12/16/2011 | 0.1300% | J.P. Morgan Securities, Inc. | 0.07% |
| MRB 2004 L ³ | 15,000 | State Street Bank and Trust Company | 12/16/2011 | 0.1300% | CitiGroup Global Markets, Inc. | 0.07% |
| MRB 2005 C ³ | 10,500 | State Street Bank and Trust Company | 12/16/2011 | 0.1300% | J.P. Morgan Securities, Inc. | 0.07% |
| MRB 2005 F ³ | 14,885 | State Street Bank and Trust Company | 12/16/2011 | 0.1300% | CitiGroup Global Markets, Inc. | 0.07% |
| MRB 2006 C ³ | 20,000 | State Street Bank and Trust Company | 12/16/2011 | 0.1300% | J.P. Morgan Securities, Inc. | 0.07% |
| MRB 2006 F ³ | 20,000 | State Street Bank and Trust Company | 12/16/2011 | 0.1300% | CitiGroup Global Markets, Inc. | 0.07% |
| MRB 2006 G ³ | 16,105 | State Street Bank and Trust Company | 12/16/2011 | 0.1300% | CitiGroup Global Markets, Inc. | 0.07% |
| MRB 2007 E | 30,000 | KBC Bank N.V., New York Branch | 7/30/2012 | 0.0775% | CitiGroup Global Markets, Inc. | 0.07% |
| MRB 2007 H | 30,000 | KBC Bank N.V., New York Branch | 7/30/2012 | 0.0775% | J.P. Morgan Securities, Inc. | 0.07% |
| MRB 2008 C | 35,000 | KBC Bank N.V., New York Branch | 7/30/2012 | 0.2300% | Merrill Lynch, Pierce, Fenner & Smith Inc. | 0.07% |
| MRB 2008 F | 35,000 | Bank of America, N.A. | 5/12/2014 | 0.8000% | Merrill Lynch, Pierce, Fenner & Smith Inc. | 0.07% |
| MRB 2008 I ² | 34,650 | Bank of America, N.A. | 8/25/2011 | 0.4750% | Merrill Lynch, Pierce, Fenner & Smith Inc. | 0.07% |

¹ After June 30, 2011, the expiration date was extended to August 27, 2014. The commitment fee increased to 0.8 percent in August 2011.

² After June 30, 2011, the expiration date was extended to August 25, 2014. The commitment fee increased to 0.8 percent in August 2011.

³ After June 30, 2011, the expiration date was extended to November 1, 2014. The commitment fee increased to 0.8 percent in December 2011.

Discretely Presented Component Unit

Included in the long-term debt of the discretely presented component unit, Oregon Health Sciences University (OHSU), are demand bonds which are subject to a long-term amortization period but may be put to OHSU at the option of the bondholders in connection with certain remarketing dates. OHSU entered into a three-year irrevocable standby letter of credit with US Bank, NA effective July 17, 2009. The letter of credit will fund any put made by bondholders that is not successfully remarketed. In the event the letter of credit funds a put by bondholders, no principal payments are due for 367 days. If at that time the bonds have not been remarketed or redeemed, the principal is due over a 30-month period. As a result, the bonds are classified as long-term except for the portion that matures within 12 months after June 30, 2011.

H. No-Commitment Debt

No-commitment debt refers to debt issued to finance public purpose expenditures intended for beneficial ownership by private entities. Such debt bears the name of the State but is secured solely by the credit of the private entity and usually is serviced and administered by a trustee independent of the State. The State has no obligation for payment of this debt. Accordingly, this debt is not reported in the accompanying financial statements.

State of Oregon
Notes to the Financial Statements

No-commitment debt as of June 30, 2011 (in thousands):

Primary Government

| | | |
|---|-----------|------------------|
| Oregon Business Development Department | \$ | 489,700 |
| Oregon Facilities Authority | | 1,565,187 |
| Housing and Community Services Department | | 194,862 |
| Total no-commitment debt | <u>\$</u> | <u>2,249,749</u> |

I. Debt Refundings

Occasionally, the State issues new long-term debt to extinguish the obligation of previously issued bonds or certificates of participation in order to take advantage of lower interest rates. In instances of advanced refunding, the money from the sale of new debt is placed in an irrevocable trust to provide for all future debt service payments on the old debt. The amount of these issuances has provided funds to pay the interest and principal when due on the refunded debt to and including the dates irrevocably fixed for redemption. The trust account assets and liabilities for the defeased debt are not included in the accompanying financial statements.

The following provides a brief description of the current and advance refunding issues that occurred between July 1, 2010 and June 30, 2011:

On August 24, 2010, the Department of Housing and Community Services issued \$88.4 million in 2010 Series A and B Mortgage Revenue Bonds with an average interest rate of 3.8 percent. These certificates refunded \$88.4 million of various series outstanding revenue bonds with an average interest rate of 5.7 percent. The current refunding was undertaken to reduce the total debt service payments over the next 20 years by \$20.7 million and resulted in an economic gain of \$13.6 million.

On August 25, 2010, the Department of Housing and Community Services issued \$77.7 million in 2010 Series A Multifamily Housing Revenue Bonds with an average interest rate of 4.1 percent. These bonds refunded \$77.7 million of various series outstanding revenue bonds with an average interest rate of 5.5 percent. The current refunding was undertaken to reduce the total debt service payments over the next 32 years by \$15.4 million and resulted in an economic gain of \$9 million.

On March 29, 2011, the Oregon Department of Energy issued \$13.2 million in 2011 Series A and B General Obligation Bonds with an average interest rate of 4.7 percent. These bonds refunded \$14.1 million of outstanding 1998 Series C, 1998 Series E, and 1999 Series A General Obligation Bonds with an average interest rate of 4.9 percent. The current refunding was undertaken to reduce the total debt service payments over the next 7 years by \$1.4 million and resulted in an economic loss of \$70 thousand.

On March 31, 2011, the Department of Administrative Services issued \$23.8 million in 2011 Series B Lottery Revenue Bonds with an average interest rate of 4.7 percent. The bonds were issued to refund \$25.4 million of various series of outstanding lottery revenue bonds with an average interest rate of 4.0 percent. The current refunding of \$4.5 million and the advanced refunding of \$20.9 million were undertaken to reduce the total debt service payments over the next 10 years by \$3.9 million and resulted in an economic loss of \$717.7 thousand.

On May 18, 2011, the Department of Administrative Services, on behalf of the Department of Corrections, issued \$90.6 million in 2011 Series L (XI-Q) General Obligation Bonds with an average interest rate of 5.1 percent. The bonds were issued to refund \$102.2 million of outstanding 2001 Series B Certificates of Participation with an average interest rate of 3.2 percent. The current refunding was undertaken to reduce the total debt service payments over the next 15 years by \$17.7 million and resulted in an economic loss of \$1.8 million.

State of Oregon
Notes to the Financial Statements

J. Defeased Debt

Bonds and certificates of participation outstanding that are considered defeased as of June 30, 2011 (in thousands):

Primary Government

| | |
|--|-------------------|
| Department of Administrative Services | \$ 62,944 |
| Business Oregon | 19,845 |
| Oregon University System | 185,772 |
| Department of Parks and Recreation | 882 |
| Department of Transportation | 277,154 |
| Department of Housing and Community Services | 398 |
| Total defeased bonds and certificates of participation | <u>\$ 546,995</u> |

10. OTHER LONG-TERM LIABILITIES

A. Changes in Other Long-Term Liabilities

Changes in other long-term liabilities for governmental activities for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|--|----------------------|---------------------|---------------------|---------------------|------------------------|
| Governmental activities: | | | | | |
| Compensated absences payable | \$ 163,501 | \$ 3,991 | \$ 2,038 | \$ 165,454 | \$ 109,207 |
| Claims and judgments payable | 1,110,143 | 627,897 | 675,912 | 1,062,128 | 128,543 |
| Arbitrage rebate payable | 1,615 | 462 | 575 | 1,502 | 652 |
| Custodial liabilities | 280,962 | 351,571 | 359,486 | 273,047 | 269,222 |
| Contracts, mortgages, and notes payable | 11,081 | 96,422 | 5,321 | 102,182 | 100,410 |
| Obligations under capital lease | 13,250 | 1,773 | 5,385 | 9,638 | 4,439 |
| Pollution remediation obligation | 14,439 | 363 | 3,916 | 10,886 | 2,942 |
| Net OPEB obligation | 32,179 | 5,008 | - | 37,187 | - |
| Total governmental other long-term liabilities | <u>\$ 1,627,170</u> | <u>\$ 1,087,487</u> | <u>\$ 1,052,633</u> | <u>\$ 1,662,024</u> | <u>\$ 615,415</u> |

Internal service funds predominantly serve the governmental funds. Therefore, long-term liabilities for internal service funds are included as part of the totals for governmental activities. The compensated absences liability is generally liquidated through the General Fund, the Public Transportation Fund, the Health and Social Services Fund, the Environmental Management Fund, the Employment Services Fund, and the Community Protection Fund. The claims and judgments liability is generally liquidated through the Employment Services Fund and the Central Services Fund, an internal service fund. The arbitrage rebate liability is generally liquidated through the Revenue Bond Fund. The custodial liabilities are expected to be liquidated by the Common School Fund and the Health and Social Services Fund. The liability for contracts, mortgages, and notes is generally liquidated through the Employment Services Fund and the General Fund. The capital lease obligations are generally liquidated through the Central Services Fund. The pollution remediation obligation will be mainly liquidated through the Environmental Management Fund and the Public Transportation Fund.

State of Oregon
Notes to the Financial Statements

Changes in other long-term liabilities for business-type activities for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|--|----------------------|-------------------|-------------------|-------------------|------------------------|
| Business-type activities: | | | | | |
| Compensated absences payable | \$ 59,374 | \$ 2,992 | \$ 148 | \$ 62,218 | \$ 52,727 |
| Lottery prize awards payable | 136,566 | 221,638 | 217,095 | 141,109 | 38,530 |
| Arbitrage rebate payable | 11,635 | 2,872 | 959 | 13,548 | 126 |
| Custodial liabilities | 39,262 | 13,505 | 14,763 | 38,004 | 26,810 |
| Contracts, mortgages, and notes payable | 14,413 | 5,352 | 1,632 | 18,133 | 13,389 |
| Contracts payable to component unit | - | 28,634 | 605 | 28,029 | 5,606 |
| Obligations under capital lease | 697 | 18 | 100 | 615 | 73 |
| Net OPEB obligation | 15,220 | 2,608 | - | 17,828 | - |
| Derivative instruments liability | 33,458 | - | 6,240 | 27,218 | - |
| Total business other long-term liabilities | <u>\$ 310,625</u> | <u>\$ 277,619</u> | <u>\$ 241,542</u> | <u>\$ 346,702</u> | <u>\$ 137,261</u> |

Changes in other long-term liabilities for fiduciary fund activities for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|---|----------------------|---------------------|---------------------|---------------------|------------------------|
| Fiduciary fund activities: | | | | | |
| Custodial liabilities | \$ 2,084,387 | \$ 3,716,743 | \$ 3,953,795 | \$ 1,847,335 | \$ 1,736,956 |
| Contracts, mortgages, and notes payable | 2,207 | 232 | 265 | 2,174 | 69 |
| Net OPEB obligation | 333 | 50 | 19 | 364 | - |
| Total fiduciary other long-term liabilities | <u>\$ 2,086,927</u> | <u>\$ 3,717,025</u> | <u>\$ 3,954,079</u> | <u>\$ 1,849,873</u> | <u>\$ 1,737,025</u> |

Changes in other long-term liabilities for SAIF Corporation (SAIF) for the year ended December 31, 2010, and for the Oregon Health and Science University (OHSU) for the year ended June 30, 2011 (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|--|----------------------|-------------------|-------------------|---------------------|------------------------|
| Discretely presented component units: | | | | | |
| Obligations under life income agreements | \$ 16,906 | \$ 228 | \$ - | \$ 17,134 | \$ - |
| Reserve for loss and loss adjustment expense | 2,958,911 | 365,150 | 319,422 | 3,004,639 | 209,117 |
| Claims and judgments payable | 70,743 | - | 14,652 | 56,091 | 20,253 |
| Contracts, mortgages, and notes payable | 37,413 | 3,246 | 4,010 | 36,649 | 1,690 |
| Obligations under capital lease | 7,063 | - | 1,258 | 5,805 | 1,141 |
| Advances from primary government | 22,100 | 30,924 | 4,376 | 48,648 | 2,130 |
| Net OPEB obligation | 5,108 | 1,223 | - | 6,331 | - |
| Derivative instruments liability | 12,750 | - | 4,974 | 7,776 | - |
| Total comp unit other long-term liabilities | <u>\$ 3,130,994</u> | <u>\$ 400,771</u> | <u>\$ 348,692</u> | <u>\$ 3,183,073</u> | <u>\$ 234,331</u> |

State of Oregon
Notes to the Financial Statements

B. Arbitrage Rebate Liability

The Tax Reform Act of 1986 placed restrictions on the non-purpose investment earnings from the proceeds of qualified tax-exempt bonds issued after August 15, 1986. Specifically, the non-purpose investment earnings on these bonds are limited to the yield on each individual bond issue (based on the initial offering price to the public). Non-purpose investment earnings in excess of the bond yield limitations are subject to rebate to the federal government. Outstanding arbitrage rebate liabilities as of June 30, 2011 (in thousands):

| <u>Primary Government</u> | |
|---|------------------|
| Department of Human Services | \$ 53 |
| Department of Administrative Services | 31 |
| Oregon Business Development Department | 279 |
| Legislative Administration Committee | 24 |
| Military Department | 10 |
| Department of Veterans' Affairs | 13,171 |
| Department of Corrections | 324 |
| Department of Environmental Quality | 2 |
| Oregon Youth Authority | 2 |
| Oregon University System | 275 |
| Department of Education | 708 |
| Department of Forestry | 2 |
| Parks and Recreation Department | 42 |
| Department of Fish and Wildlife | 1 |
| Department of Transportation | 13 |
| Housing and Community Services Department | 113 |
| Total arbitrage rebate liability | <u>\$ 15,050</u> |

11. POLLUTION REMEDIATION OBLIGATION

Pollution remediation obligations address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities, including pre-cleanup activities, cleanup activities, government oversight and enforcement-related activities, and postremediation monitoring. Excluded from pollution remediation obligations are obligations for pollution prevention and control activities, fines and penalties, landfill closure and postclosure care, and other future remediation activities required upon retirement of an asset.

The State recognizes a pollution remediation obligation when it can reasonably estimate the range of expected cash outlays. At June 30, 2011, the State recognized an estimated liability of \$11 million for pollution remediation activities. The liability, which is reported in the government-wide statement of net assets, was recorded at the current value of the costs the State expects to incur to perform the work.

For many projects, the State can reasonably estimate the range of expected outlays early in the process, using the State's remediation history for similar sites as the basis for the calculations. In other cases, the estimated liability is based on the amount specified in a contract for remediation services or the estimate of the cleanup costs provided by an environmental consulting firm. Expected recoveries from responsible parties or potentially responsible parties and insurance recoveries are included in the estimates and reduce the State's expense. No material expected recoveries were included in the measurement of the State's pollution remediation obligation at June 30, 2011.

When new information indicates changes in expected outlays, the liability for pollution remediation is adjusted. Adjustments may occur due to price fluctuations resulting from delays in contracting specific remediation jobs, changes in technology, changes in legal or regulatory requirements, and changes in the remediation plan or operating conditions.

Currently, the Oregon Department of Environmental Quality (DEQ), as a government responsible for sharing costs under federal law, is obligated to clean up two Superfund sites. Both sites are contaminated with chemicals used in the wood-treatment industry. Contamination was found in the soil, groundwater, and

sediments of adjacent rivers. The Oregon Department of Transportation (ODOT) also performs ongoing pollution remediation. For example, to facilitate the agency's transportation goals, ODOT voluntarily conducts the cleanup of contaminated soil and ground water found within the footprint of a construction project and also removes lead-based paint when performing bridge repairs. In other cases, DEQ has named ODOT as a responsible party or potentially responsible party, or ODOT has entered the contaminated site into the DEQ's Voluntary Cleanup program as the responsible party.

As of June 30, 2011, the State is involved in negotiations related to a confidential, non-judicial mediation process that will result in an allocation of costs associated with the investigation and cleanup of contamination in the Portland Harbor Superfund site. There are over 200 parties, private and public, that may eventually bear a share of the costs. It is too early in the Environmental Protection Agency's remedial action process to estimate the total cleanup costs that may be shared by the liable parties and what portion of that, if any, will be assessed against the State. The Portland Harbor Superfund site is discussed in greater detail in Note 23.

12. PLEDGED REVENUES

A. Unobligated Net Lottery Proceeds

The State has pledged future unobligated net lottery proceeds to repay \$1.2 billion of lottery revenue bonds. Unobligated net lottery proceeds consist of all revenues derived from the operation of the Oregon State Lottery except for revenues used for payment of prizes and expenses of the Lottery. Proceeds from lottery revenue bonds provide financing for economic development within the state, as well as for the improvement and expansion of state parks and school facilities. The bonds are payable solely from the pledged revenues and are payable through 2031. In fiscal year 2012, principal and interest payments on the bonds are expected to require approximately 24.2 percent of unobligated net lottery proceeds. The total principal and interest remaining to be paid on the bonds is \$1.8 billion. Principal and interest paid for the current year and total unobligated net lottery proceeds were \$127.5 million and \$553.7 million, respectively.

B. Highway User Taxes and Vehicle Registration Fees

The State has pledged future highway user taxes and vehicle registration fees, net of administrative expenses, operating transfers, and statutory transfers to counties, to repay \$2.2 billion of highway user tax revenue bonds. Proceeds from the bonds provide financing for the construction, reconstruction, improvement, repair, maintenance and operation, and use of public highways, roads, streets, and roadside rest areas for the State. The bonds are payable solely from the pledged revenues and are payable through November 2034. Fiscal year 2012 principal and interest payments on the bonds are expected to require approximately 25.1 percent of pledged revenues. The total principal and interest remaining to be paid on the bonds is \$3.7 billion. Principal and interest paid for the current year and total pledged revenues were \$151.6 million and \$594 million, respectively.

13. INTERFUND TRANSACTIONS

Interfund balances reported in the fund financial statements as of June 30, 2011 (in thousands):

Due from Other Funds

| Due to Other Funds | General | Health and Social Services | Public Transportation | Environmental Management | Common School |
|--------------------------------|-------------------|----------------------------------|--------------------------|-----------------------------|------------------|
| General | \$ - | \$ 1,684 | \$ 75 | \$ 4,520 | \$ 563 |
| Health and Social Services | 37,178 | - | - | 142 | - |
| Public Transportation | 165 | - | - | 12,522 | - |
| Environmental Management | 2,161 | 33 | 4,155 | - | 237 |
| Common School | 24,373 | - | - | 829 | - |
| Nonmajor Governmental Funds | 11,996 | 687 | 476 | 224 | - |
| Housing and Community Services | - | - | - | - | - |
| Lottery Operations | 145,612 | - | - | - | - |
| Unemployment Compensation | - | - | - | - | - |
| University System | - | - | - | - | - |
| Nonmajor Enterprise Funds | 20,190 | 752 | - | 1,575 | - |
| Internal Service Funds | 20,226 | - | - | - | - |
| Fiduciary Funds | - | - | - | - | - |
| Total | <u>\$ 261,901</u> | <u>\$ 3,156</u> | <u>\$ 4,706</u> | <u>\$ 19,812</u> | <u>\$ 800</u> |

Advances to Other Funds

| Advances from Other Funds | Common School | Nonmajor Enterprise Funds | Internal Service Funds | Total |
|----------------------------------|------------------|------------------------------|---------------------------|------------------|
| General | \$ - | \$ - | \$ 677 | \$ 677 |
| Environmental Management | 300 | - | - | 300 |
| Nonmajor Governmental Funds | - | 101 | - | 101 |
| University System | - | 91,144 | - | 91,144 |
| Nonmajor Enterprise Funds | - | 100 | - | 100 |
| Internal Service Funds | - | 226 | - | 226 |
| Total | <u>\$ 300</u> | <u>\$ 91,571</u> | <u>\$ 677</u> | <u>\$ 92,548</u> |

Interfund balances result from the time lag between dates that (1) interfund goods and services are provided or reimbursable expenditures/expenses occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made. Advances to and from other funds are not expected to be repaid within one year.

State of Oregon
Notes to the Financial Statements

| Nonmajor Governmental Funds | Housing and Community Services | Veterans' Loan | Unemployment Compensation | University System | Nonmajor Enterprise Funds | Internal Service Funds | Fiduciary Funds | Total |
|-----------------------------------|--------------------------------------|-------------------|------------------------------|----------------------|---------------------------------|------------------------------|--------------------|-------------------|
| \$ 129,752 | \$ - | \$ - | \$ 4 | \$ 7,550 | \$ 1,078 | \$ 87 | \$ - | \$ 145,313 |
| 441 | - | - | - | - | 144 | - | - | 37,905 |
| 6,349 | - | - | - | - | - | - | - | 19,036 |
| 374 | - | - | - | 110 | - | - | - | 7,070 |
| 20 | - | - | - | - | - | - | 2 | 25,224 |
| 17,931 | 53 | - | 83 | 439 | - | 2,217 | - | 34,106 |
| 16 | - | - | - | - | - | - | - | 16 |
| - | - | - | - | - | - | - | - | 145,612 |
| 1,589 | - | - | - | - | - | - | - | 1,589 |
| 86 | - | - | - | - | - | - | - | 86 |
| 1 | - | 66 | - | - | 7 | - | 369 | 22,960 |
| 183 | - | - | - | - | 8 | 3 | - | 20,420 |
| - | - | - | - | - | - | - | 10,226 | 10,226 |
| \$ 156,742 | \$ 53 | \$ 66 | \$ 87 | \$ 8,099 | \$ 1,237 | \$ 2,307 | \$ 10,597 | \$ 469,563 |

State of Oregon
Notes to the Financial Statements

Interfund transfers reported in the fund financial statements as of June 30, 2011 (in thousands):

| Transfers to Other Funds | Transfers from Other Funds | | | | |
|---------------------------------|-----------------------------------|----------------------------------|--------------------------|-----------------------------|------------------|
| | General | Health and Social Services | Public Transportation | Environmental Management | Common School |
| General | \$ - | \$ 14,611 | \$ 788 | \$ 84,630 | \$ 243 |
| Health and Social Services | 69,443 | - | - | 675 | - |
| Public Transportation | 4,999 | - | - | 30,120 | - |
| Environmental Management | 21,625 | 84 | 352 | - | 8,709 |
| Common School | 48,745 | - | - | 5,530 | - |
| Nonmajor Governmental Funds | 623,055 | 39,969 | 954 | 616 | - |
| Housing and Community Services | - | - | - | - | - |
| Veterans' Loan | - | - | - | - | - |
| Lottery Operations | 553,723 | - | - | - | - |
| Unemployment Compensation | - | - | - | - | - |
| University System | 2,562 | - | - | - | - |
| Nonmajor Enterprise Funds | 123,141 | 7,980 | 5,081 | 87 | - |
| Internal Service Funds | 23,358 | 7,669 | - | 375 | - |
| Total | <u>\$ 1,470,651</u> | <u>\$ 70,313</u> | <u>\$ 7,175</u> | <u>\$ 122,033</u> | <u>\$ 8,952</u> |

Transfers are used to (1) move revenues from the fund required by statute or the State's budget to collect them to the fund authorized by statute or the State's budget to expend them; (2) move receipts restricted to debt service or capital construction to the appropriate funds; and (3) move unrestricted revenues collected by the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorization.

State of Oregon
Notes to the Financial Statements

| Nonmajor Governmental Funds | Unemployment Compensation | University System | Nonmajor Enterprise Funds | Internal Service Funds | Fiduciary Funds | Total |
|-----------------------------------|------------------------------|----------------------|---------------------------------|------------------------------|--------------------|---------------------|
| \$ 605,703 | \$ - | \$ 374,616 | \$ 141,875 | \$ - | \$ - | \$ 1,222,466 |
| 103,189 | - | - | 37,395 | 2,091 | - | 212,793 |
| 221,590 | - | - | - | - | - | 256,709 |
| 26,826 | - | 2,021 | - | 205 | - | 59,822 |
| 287 | - | - | - | - | - | 54,562 |
| 83,982 | 1,100 | 31,967 | 18,473 | - | 568 | 800,684 |
| 174 | - | - | - | - | - | 174 |
| 226 | - | - | - | - | - | 226 |
| 1,444 | - | - | - | - | - | 555,167 |
| 35,751 | - | - | - | - | - | 35,751 |
| 28,778 | - | - | - | - | 86 | 31,426 |
| 14,270 | - | - | 3,760 | 768 | - | 155,087 |
| 11,892 | - | - | 51 | - | - | 43,345 |
| \$ 1,134,112 | \$ 1,100 | \$ 408,604 | \$ 201,554 | \$ 3,064 | \$ 654 | \$ 3,428,212 |

14. SEGMENT INFORMATION

Oregon Revised Statutes (ORS) 285B.410 through 285B.482 create the Special Public Works Fund and authorize the Oregon Business Development Department (OBDD) to issue revenue bonds to finance loans to municipalities for infrastructure projects. ORS 285B.560 through 285B.599 establish the Water Fund and authorize OBDD to issue revenue bonds to finance loans to municipalities for safe drinking water projects and waste water system improvement projects. Loan repayments are pledged to repay the outstanding bonds.

ORS 456.645 authorizes the Oregon Housing and Community Services Department (OHCS) to issue revenue bonds to finance single-family mortgage loans and multi-family housing projects. Article XI-I (2) of the Oregon Constitution authorizes OHCS to finance multi-family housing for elderly and disabled persons. Mortgage payments and fees and rental revenues support these bonds.

Summary financial information for the Special Public Works Fund, the Water Fund, and OHCS's various bond funds for the year ended June 30, 2011 (in thousands):

| Condensed balance sheet | Special Public Works Fund | Water Fund | Mortgage Revenue Bonds | Homeowner Revenue Bonds |
|---|---------------------------------|-------------------|------------------------------|-------------------------------|
| Assets: | | | | |
| Interfund receivables | \$ 7 | \$ 100 | \$ 5 | \$ 8 |
| Other current assets | 146,697 | 20,045 | 44,124 | 68,020 |
| Other noncurrent assets | 223,617 | 104,408 | 1,050,697 | 92,232 |
| Deferred outflows | - | - | 24,338 | - |
| Total assets | \$ 370,321 | \$ 124,553 | \$ 1,119,164 | \$ 160,260 |
| Liabilities: | | | | |
| Due to other funds | \$ 1 | \$ 5 | \$ 8 | \$ 37 |
| Current liabilities | 41,733 | 8,356 | 27,415 | 67,813 |
| Noncurrent liabilities | 98,157 | 53,079 | 1,003,388 | 90,221 |
| Total liabilities | 139,891 | 61,440 | 1,030,811 | 158,071 |
| Net assets: | | | | |
| Restricted | 76,008 | 15,085 | 88,353 | 2,189 |
| Unrestricted | 154,422 | 48,028 | - | - |
| Total net assets | 230,430 | 63,113 | 88,353 | 2,189 |
| Total liabilities and net assets | \$ 370,321 | \$ 124,553 | \$ 1,119,164 | \$ 160,260 |

| Condensed statement of revenues, expenses, and changes in fund net assets | Special Public Works Fund | Water Fund | Mortgage Revenue Bonds | Homeowner Revenue Bonds |
|--|---------------------------------|------------------|------------------------------|-------------------------------|
| Operating activities: | | | | |
| Loan interest income | \$ 7,729 | \$ 4,347 | \$ 50,636 | \$ 433 |
| Other operating revenue | 134 | - | 1 | - |
| Amortization | - | - | (506) | (118) |
| Other operating expenses | (9,066) | (3,829) | (49,787) | (1,970) |
| Operating income (loss) | (1,203) | 518 | 344 | (1,655) |
| Total nonoperating revenues (expenses) | 491 | 77 | 2,657 | 136 |
| Transfers from other funds | 18,049 | 523 | 1,955 | 3,563 |
| Transfers to other funds | (11,683) | (3,434) | (4,300) | - |
| Change in net assets | 5,654 | (2,316) | 656 | 2,044 |
| Beginning net assets (as restated) | 224,776 | 65,429 | 87,697 | 145 |
| Ending net assets | \$ 230,430 | \$ 63,113 | \$ 88,353 | \$ 2,189 |

State of Oregon
Notes to the Financial Statements

| Condensed statement of cash flows | Special Public Works Fund | Water Fund | Mortgage Revenue Bonds | Homeowner Revenue Bonds |
|---|---------------------------------|------------------|------------------------------|-------------------------------|
| Net cash provided (used) by: | | | | |
| Operating activities | \$ 32,197 | \$ (1,514) | \$ 149,738 | \$ (52,587) |
| Noncapital financing activities | (10,495) | 1,506 | (164,823) | 39,993 |
| Investing activities | 491 | 77 | 11,587 | 13,085 |
| Net increase (decrease) | 22,193 | 69 | (3,498) | 491 |
| Beginning cash and cash equivalents (as restated) | 90,759 | 15,516 | 19,504 | - |
| Ending cash and cash equivalents | <u>\$ 112,952</u> | <u>\$ 15,585</u> | <u>\$ 16,006</u> | <u>\$ 491</u> |

| Condensed balance sheet | Multifamily Housing Revenue Bonds | Multiple Purpose Bonds | Elderly and Disabled Housing Fund |
|----------------------------------|--|------------------------------|--|
| Assets: | | | |
| Current assets | \$ 8,587 | \$ 1,323 | \$ 20,704 |
| Noncurrent assets | 184,990 | 13,093 | 204,386 |
| Deferred outflows | 1,071 | - | - |
| Total assets | <u>\$ 194,648</u> | <u>\$ 14,416</u> | <u>\$ 225,090</u> |
| Liabilities: | | | |
| Interfund payables | \$ - | \$ - | \$ 1 |
| Other current liabilities | 7,713 | 1,218 | 19,777 |
| Noncurrent liabilities | 166,046 | 3,731 | 140,508 |
| Total liabilities | <u>173,759</u> | <u>4,949</u> | <u>160,286</u> |
| Net assets: | | | |
| Restricted | 20,889 | 9,467 | 64,804 |
| Total net assets | <u>20,889</u> | <u>9,467</u> | <u>64,804</u> |
| Total liabilities and net assets | <u>\$ 194,648</u> | <u>\$ 14,416</u> | <u>\$ 225,090</u> |

| Condensed statement of revenues, expenses, and changes in fund net assets | Multifamily Housing Revenue Bonds | Multiple Purpose Bonds | Elderly and Disabled Housing Fund |
|--|--|------------------------------|--|
| Operating activities: | | | |
| Loan interest income | \$ 9,811 | \$ 770 | \$ 10,486 |
| Other operating revenue | - | - | 74 |
| Depreciation and amortization | (123) | (21) | (117) |
| Other operating expenses | (8,223) | (640) | (10,151) |
| Operating income (loss) | <u>1,465</u> | <u>109</u> | <u>292</u> |
| Total nonoperating revenues (expenses) | (515) | 48 | 687 |
| Transfers from other funds | 1,425 | - | - |
| Transfers to other funds | (2,000) | (2,925) | (159) |
| Change in net assets | <u>375</u> | <u>(2,768)</u> | <u>820</u> |
| Beginning net assets (as restated) | 20,514 | 12,235 | 63,984 |
| Ending net assets | <u>\$ 20,889</u> | <u>\$ 9,467</u> | <u>\$ 64,804</u> |

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| Condensed statement of cash flows | Multifamily Housing Revenue Bonds | Multiple Purpose Bonds | Elderly and Disabled Housing Fund |
|---|--|------------------------------|--|
| Net cash provided (used) by: | | | |
| Operating activities | \$ (613) | \$ 6,639 | \$ (4,593) |
| Noncapital financing activities | 2,464 | (13,201) | (35,036) |
| Investing activities | (2,129) | 6,123 | 5,912 |
| Net increase (decrease) | (278) | (439) | (33,717) |
| Beginning cash and cash equivalents (as restated) | 1,611 | 716 | 68,899 |
| Ending cash and cash equivalents | <u>\$ 1,333</u> | <u>\$ 277</u> | <u>\$ 35,182</u> |

15. EMPLOYEE RETIREMENT PLANS

A. Plan Descriptions

Public Employees Retirement System

The Public Employees Retirement System (PERS) provides defined benefit and defined contribution retirement plans for units of State government, school districts, community colleges, and political subdivisions. PERS is administered under the Oregon Revised Statutes (ORS), Chapters 238 and 238A, and Internal Revenue Code Section 401(a) by the Public Employees Retirement Board. Plan assets of the defined benefit, defined contribution, postemployment healthcare, and deferred compensation plans may legally be used to pay benefits only to the plan members or plan beneficiaries for whom the assets were accumulated. The PERS defined benefit plans provide pension benefits, death benefits, disability benefits, and postemployment healthcare benefits.

PERS features both a cost-sharing multiple-employer pension plan and an agent multiple-employer pension plan. Participation in the PERS cost-sharing multiple-employer plan is mandatory for state agencies that comprise the primary government, as well as community colleges and school districts. PERS is an agent multiple-employer plan for political subdivisions that have not elected to join the State and Local Government Rate Pool. Participation by most political subdivisions is optional, but irrevocable if elected. The State has no obligation to contribute, and it does not contribute, to the agent multiple-employer pension plan. At June 30, 2011, PERS had 906 employer members consisting of:

| | |
|------------------------|-----|
| State agencies | 115 |
| Community colleges | 17 |
| School districts | 289 |
| Political subdivisions | 485 |

In 1995, the Oregon Legislature passed a bill that created a second tier of benefits for those employees who established membership on or after January 1, 1996. The second tier does not enjoy the Tier One assumed earnings rate guarantee and sets the normal retirement age at 60, compared to 58 for Tier One. As of June 30, 2011, there were 51,503 active and 21,119 inactive members for a total of 72,622 PERS Tier One plan members and 51,093 active and 17,115 inactive members for a total of 68,208 PERS Tier Two plan members.

In 2003, the Oregon Legislature enacted a bill that created the Oregon Public Service Retirement Plan (OPSRP). OPSRP consists of the defined benefit Pension Program and the defined contribution Individual Account Program (IAP). OPSRP is part of PERS and is administered by the PERS Board. Membership includes public employees hired on or after August 29, 2003. As of June 30, 2011, there were 80,753 active and 3,598 inactive members for a total of 84,351 OPSRP members.

Beginning January 1, 2004, active PERS Tier One and Tier Two plan members became members of the IAP. The Tier One and Tier Two plan members retain their existing PERS accounts; however, member contributions are now deposited into the members' IAP accounts.

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The PERS defined benefit and defined contribution retirement plans are reported as pension trust funds in the fiduciary funds combining statements and as part of the Pension and Other Employee Benefit Trust in the fiduciary funds basic financial statements. PERS issues a separate, publicly available financial report that includes audited financial statements and required supplementary information. That report may be obtained by writing to the Public Employees Retirement System, Fiscal Services Division, PO Box 23700, Tigard, OR 97281-3700. The report may also be accessed online at:

http://oregon.gov/PERS/section/financial_reports/financials.shtml

Optional Plans

The 1995 Oregon Legislature enacted legislation that authorized the Oregon University System (OUS) to offer a defined contribution retirement plan as an alternative to PERS. Effective April 1, 1996, OUS established the Optional Retirement Plan (ORP), which was made available to OUS unclassified faculty and staff who are eligible for PERS membership. The ORP consists of three tiers. Membership in ORP Tier One and Tier Two is determined using the same criteria as PERS. The third tier is determined by membership in OPSRP.

In addition to PERS and ORP, eligible unclassified employees hired on or before September 9, 1995, may participate in the Teacher's Insurance and Annuity Association and College Retirement Equities Fund retirement program. This defined contribution plan was closed to new enrollment at the time the ORP became effective in 1996.

Effective July 1, 1996, the Oregon Health and Science University (OHSU), which is a discretely presented component unit, established the University Pension Plan (UPP). The UPP is a defined contribution plan that is available to employees as an alternative to PERS. Employees become fully vested in employer contributions over a three to four-year period.

B. Summary of Significant Accounting Policies

The financial statements for the PERS retirement plans are prepared using the accrual basis of accounting. Contributions are recognized in the period in which the contributions are due. Expenses are recognized when incurred. Benefits and refunds are recognized when due and payable.

Plan investments are reported at fair value. The fair value of publicly traded debt and equity securities in active markets is determined by the custodian's pricing agent using nationally recognized pricing services. The custodian's pricing agent values equity securities traded on a national or international exchange at the last reported sales price and, generally, values debt securities by using evaluated bid prices. The fair value of publicly traded real estate investment trust (REIT) securities is determined by the custodian's pricing agent using recognized pricing services. For securities that do not have an active market, such as private placements or commingled investment vehicles, the custodian's pricing agent or investment manager uses a similar benchmark security to estimate fair value. The benchmark used to value a debt security, for example, typically has a coupon rate and maturity date comparable to the debt security being valued, as well as similar market risk.

Investments in private equities are recorded at fair value, as of June 30, 2011, as determined by PERS management based on valuation information provided by the general partner. Investments in private equities representing publicly traded securities are stated at quoted market price. Where observable market inputs are not available, valuation models are applied. The general partner determines fair value based on the best information available and by reference to the following: projected sales, net earnings, earnings before interest, taxes, depreciation and amortization, balance sheets, public and private transactions, valuations for publicly traded comparable companies, and/or other measures, and consideration of any other pertinent information including the types of securities held and the general partner's own assumptions regarding the investment. The methods used to determine the fair value of these investments typically include (1) the market approach, whereby fair value is derived by reference to observable valuation measures for comparable companies or assets, and (2) the income approach (e.g., the discounted cash flow method).

Investments in real estate, with the exception of publicly traded REITS for which observable market prices in active markets do not exist, are reported at fair value as of June 30, 2011, as determined by PERS management based on valuation information provided in good faith by the general partner. Direct investments in real estate are appraised every two to three years and, between appraisals, investment managers adjust values to reflect current and projected operating performance and financial transactions. Valuation of

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investments in real estate partnerships, in the absence of observable market prices, rely on the general partners to determine fair value by using valuation methodologies considered to be most appropriate for the type of investment, giving consideration to a range of factors they believe would be considered by market participants, including the nature of the investment, local market conditions, trading values on public exchanges for comparable investments, current and projected operating performance, and financing transactions subsequent to the acquisition of the investment.

Investments in the PERS Opportunity Portfolio are recorded at fair values as of June 30, 2011, as determined by the respective general partner or account manager. (The Opportunity Portfolio is an investment portfolio within the PERS Fund that utilizes innovative investment approaches across a wide range of investment opportunities.) Investments in the Opportunity Portfolio representing publicly traded securities are stated at quoted market price. Where observable market inputs are not available, valuation models are applied. The general partner determines fair value based on the best information available and by reference to the following: projected sales, net earnings, earnings before interest, taxes, depreciation and amortization, balance sheets, public and private transactions, valuations for publicly traded comparable companies, and/or other measures, and consideration of any other pertinent information including the types of securities held and the general partner's own assumptions regarding the investment. The methods used to determine the fair value of these investments typically include (1) the market approach, whereby fair value is derived by reference to observable valuation measures for comparable companies or assets, and (2) the income approach (e.g., the discounted cash flow method).

Due to the inherent uncertainty and the degree of judgment involved in determining certain private equity, real estate portfolio, and Opportunity Portfolio investment valuations, the fair values reflected in the accompanying financial statements may differ significantly from values that would have been used had a readily determinable market value for the investments existed, and the difference could be material. In addition, these investments are generally considered to be illiquid long-term investments; the recorded fair values may materially differ from the amounts eventually realized from the sale or other disposition of these investments.

C. Funding

Primary Government

To pay for PERS pension benefits, state agencies make required contributions based on a percentage of employee payrolls. The retirement contribution rates include an actuarially determined employer rate and a member contribution rate. The PERS Board updates the employer rates every two years, effective July 1 of each odd-numbered year. Currently, the member contribution, known as the 6% pick-up, is set by statute and is paid by state agencies. These two contributions are paid to the State's pension system and are invested at an acceptable level of investment risk as determined by the Oregon Investment Council.

The PERS employer contribution rates for state agencies for the biennium beginning July 1, 2009, and ending June 30, 2011, expressed as a percentage of covered payroll:

| <u>Tier One and Tier Two Employer Rates</u> | | <u>OPSRP Employer Rates</u> | |
|---|-----------------|-----------------------------|-----------------|
| General Service | Police and Fire | General Service | Police and Fire |
| 1.69% | 9.87% | 2.63% | 5.34% |

State agencies' employer contributions to PERS for fiscal years ended June 30, 2011, 2010, and 2009, totaled approximately \$79.5 million, \$66.4 million, and \$145.8 million, respectively. The actual contribution equaled the annual required contribution in each fiscal year. The required contribution rates for the biennium ending June 30, 2011, were significantly lower than the required contribution rates for the prior biennium.

In fiscal year 2004, the State issued \$2 billion in pension obligation bonds to reduce the PERS pension liability. As a result, the actual contribution exceeded the annual required contribution in that fiscal year, creating a net pension asset that is being amortized using the level dollar closed method over 22 years and an assumed interest rate of 8 percent. The primary government's employer cost for the PERS pension plan for fiscal year 2011 was \$136.6 million and included \$57.1 million of amortization. State agencies pay an additional assessment to cover the annual debt service requirements attributable to the pension bonds.

Oregon University System's Optional Retirement Plan (ORP)

Under the ORP, the employee contribution rate is 6 percent and is paid by OUS. The employer contribution rates for fiscal year 2011 were 11.9 percent for ORP Tier One and ORP Tier Two and 5.9 percent for the OPSRP equivalent. Total OUS employer contributions to the ORP for the years ended June 30, 2011, 2010, and 2009, were approximately \$21.6 million, \$21 million, and \$25.8 million, respectively. The OUS employee contributions to the ORP for the years ended June 30, 2011, 2010, and 2009, were approximately \$14.2 million, \$13.6 million, and \$13 million.

Discretely Presented Component Units

The SAIF Corporation's employer contributions to PERS for years ended December 31, 2010, 2009, and 2008, were approximately \$1.3 million, \$2.6 million, and \$3.7 million, respectively. Employer contributions to PERS for the Oregon Health and Science University (OHSU) for fiscal years ended June 30, 2011, 2010, and 2009, were approximately \$12.5 million, \$11.7 million, and \$11.8 million, respectively. For both component units, the actual contribution equaled the annual required contribution in each year.

The OHSU Board of Directors determines the contribution rate for OHSU's University Pension Plan (UPP). Employer contributions to the plan are 6 percent of salary and employee contributions are an additional 6 percent. Currently, OHSU is funding employee contributions. OHSU's employer contributions to the UPP for the years ended June 30, 2011, 2010, and 2009, were approximately \$21.6 million, \$18.4 million, and \$16.2 million, respectively, and were equal to the employee contributions for each year.

16. OTHER POSTEMPLOYMENT BENEFIT PLANS

A. Public Employees Retirement System

Plan Descriptions

The Public Employees Retirement System (PERS) board contracts for health insurance coverage on behalf of the members of PERS. Eligible retirees pay their own age-adjusted premiums. To help retirees defray the cost of these premiums, PERS also administers two separate defined benefit other postemployment benefit (OPEB) plans: the Retirement Health Insurance Account (RHIA) and the Retiree Health Insurance Premium Account (RHIPA).

The RHIA is a cost-sharing, multiple-employer OPEB plan in which 906 employers participate. Established under Oregon Revised Statute (ORS) 238.420, the plan provides a payment of up to \$60 toward the monthly cost of health insurance for eligible PERS members. To be eligible to receive the RHIA subsidy, the member must (1) have eight years or more of qualifying service in PERS at the time of retirement or receive a disability allowance as if the member had eight years or more of creditable service in PERS, (2) receive both Medicare parts A and B coverage, and (3) enroll in a PERS-sponsored health plan. A surviving spouse or dependent of a deceased PERS retiree who was eligible to receive the subsidy is eligible to receive the subsidy if he or she (1) is receiving a retirement benefit or allowance from PERS or (2) was insured at the time the member died and the member retired before May 1, 1991. The Legislature has sole authority to amend the benefit provisions and employer obligations for the RHIA plan. The number of RHIA plan members receiving benefits was 40,292 as of June 30, 2011.

The RHIPA is a single-employer OPEB plan established under ORS 238.415. The plan provides payment of the average difference between the health insurance premiums paid by retired state employees under contracts entered into by the PERS board and health insurance premiums paid by state employees who are not retired. PERS members are qualified to receive the RHIPA subsidy if they have eight or more years of qualifying service in PERS at the time of retirement or receive a disability pension calculated as if they had eight or more years of qualifying service, but are not eligible for federal Medicare coverage. A surviving spouse or dependent of a deceased retired state employee is eligible to receive the subsidy if he or she (1) is receiving a retirement benefit or allowance from PERS or (2) was insured at the time the member died and the member retired on or after September 29, 1991. The Legislature has sole authority to amend the benefit provisions and employer obligations of the RHIPA plan. The number of RHIPA plan members receiving benefits was 1,004 as of June 30, 2011.

Both RHIA and RHIPA are closed to employees hired on or after August 29, 2003, who had not established membership prior to that date.

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The RHIA and RHIPA defined benefit OPEB plans are reported separately under Other Employee Benefit Trust Funds in the fiduciary funds combining statements and as part of the Pension and Other Employee Benefit Trust in the fiduciary funds basic financial statements. PERS issues a separate, publicly available financial report that includes audited financial statements and required supplementary information. That report may be obtained by writing to the Public Employees Retirement System, Fiscal Services Division, PO Box 23700, Tigard, OR 97281-3700. The report may also be accessed online at: http://oregon.gov/PERS/section/financial_reports/financials.shtml

Summary of Significant Accounting Policies

The financial statements for the PERS OPEB plans are prepared using the accrual basis of accounting. Contributions are recognized in the period in which the contributions are due. Expenses are recognized when incurred. Benefits and refunds are recognized when due and payable. Plan investments are reported at fair value. The fair value of publicly traded debt and equity securities in active markets is determined by the custodian's pricing agent using nationally recognized pricing services. The custodian's pricing agent values equity securities traded on a national or international exchange at the last reported sales price and, generally, values debt securities by using evaluated bid prices. The fair value of publicly traded real estate investment trust (REIT) securities is determined by the custodian's pricing agent using recognized pricing services. For securities that do not have an active market, such as private placements or commingled investment vehicles, the custodian's pricing agent or investment manager uses a similar benchmark security to estimate fair value. The benchmark used to value a debt security, for example, typically has a coupon rate and maturity date comparable to the debt security being valued, as well as similar market risk.

Investments in private equities are recorded at fair value, as of June 30, 2011, as determined by PERS management based on valuation information provided by the general partner. Investments in private equities representing publicly traded securities are stated at quoted market price. Where observable market inputs are not available, valuation models are applied. The general partner determines fair value based on the best information available and by reference to the following: projected sales, net earnings, earnings before interest, taxes, depreciation and amortization, balance sheets, public and private transactions, valuations for publicly traded comparable companies, and/or other measures, and consideration of any other pertinent information including the types of securities held and the general partner's own assumptions regarding the investment. The methods used to determine the fair value of these investments typically include (1) the market approach, whereby fair value is derived by reference to observable valuation measures for comparable companies or assets, and (2) the income approach (e.g., the discounted cash flow method).

Investments in real estate, with the exception of publicly traded REITS for which observable market prices in active markets do not exist, are reported at fair value as of June 30, 2011, as determined by PERS management based on valuation information provided in good faith by the general partner. Direct investments in real estate are appraised every two to three years and, between appraisals, investment managers adjust values to reflect current and projected operating performance and financial transactions. Valuation of investments in real estate partnerships, in the absence of observable market prices, rely on the general partners to determine fair value by using valuation methodologies considered to be most appropriate for the type of investment, giving consideration to a range of factors they believe would be considered by market participants, including the nature of the investment, local market conditions, trading values on public exchanges for comparable investments, current and projected operating performance, and financing transactions subsequent to the acquisition of the investment.

Investments in the PERS Opportunity Portfolio are recorded at fair values as of June 30, 2011, as determined by the respective general partner or account manager. (The Opportunity Portfolio is an investment portfolio within the PERS Fund that utilizes innovative investment approaches across a wide range of investment opportunities.) Investments in the Opportunity Portfolio representing publicly traded securities are stated at quoted market price. Where observable market inputs are not available, valuation models are applied. The general partner determines fair value based on the best information available and by reference to the following: projected sales, net earnings, earnings before interest, taxes, depreciation and amortization, balance sheets, public and private transactions, valuations for publicly traded comparable companies, and/or other measures, and consideration of any other pertinent information including the types of securities held and the general partner's own assumptions regarding the investment. The methods used to determine the fair value of these investments typically include (1) the market approach, whereby fair value is derived by

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reference to observable valuation measures for comparable companies or assets, and (2) the income approach (e.g., the discounted cash flow method).

Due to the inherent uncertainty and the degree of judgment involved in determining certain private equity, Opportunity Portfolio, and real estate portfolio investment valuations, the fair values reflected in the accompanying financial statements may differ significantly from values that would have been used had a readily determinable market value for the investments existed, and the difference could be material. In addition, these investments are generally considered to be illiquid long-term investments; the recorded fair values may materially differ from the amounts eventually realized from the sale or other disposition of these investments.

Funding

Both of the OPEB plans administered by PERS are funded through actuarially determined employer contributions. For the biennium ended June 30, 2011, state agencies contributed 0.1 percent of PERS-covered payroll for Tier One and Tier Two plan members to fund the normal cost portion of RHIA benefits. In addition, state agencies contributed 0.19 percent of all PERS-covered payroll to amortize the unfunded actuarial accrued liability over a fixed period with new unfunded actuarial accrued liabilities amortized over 20 years. The required employer contributions were approximately \$5.8 million, \$5.8 million, and \$7.5 million for years ended June 30, 2011, 2010, and 2009, respectively. The actual contribution equaled the annual required contribution in each fiscal year. (See Note 15 for details concerning Tier One, Tier Two, and OPSRP membership in PERS.)

The funded status of the RHIA postemployment healthcare plan as of the most recent actuarial valuation date (dollars in millions):

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll ((b-a)/c) |
|--------------------------|-------------------------------|---------------------------------------|---------------------------|--------------------|---------------------|--|
| 12/31/2010 | \$232.3 | \$547.1 | \$314.8 | 42.5% | \$8,750.1 | 3.6% |

For the biennium ended June 30, 2011, state agencies contributed 0.06 percent of PERS-covered payroll for Tier One and Tier Two plan members to fund the normal cost portion of RHIPA benefits. In addition, state agencies contributed 0.02 percent of all PERS-covered payroll to amortize the unfunded actuarial accrued liability over a fixed period with new unfunded actuarial accrued liabilities amortized over 20 years. The required employer contributions were approximately \$1.4 million, \$1.5 million, and \$2 million for the years ended June 30, 2011, 2010, and 2009, respectively. The actual contribution equaled the annual required contribution in each fiscal year.

The funded status of the RHIPA postemployment healthcare plan as of the most recent actuarial valuation date (dollars in millions):

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll ((b-a)/c) |
|--------------------------|-------------------------------|---------------------------------------|---------------------------|--------------------|---------------------|--|
| 12/31/2010 | \$5.7 | \$33.9 | \$28.2 | 16.8% | \$2,379.7 | 1.2% |

Actuarial Methods and Assumptions

The PERS postemployment healthcare benefit obligation, including both RHIA and RHIPA, was determined as part of the actuarial valuation prepared by the PERS consulting actuary at December 31, 2010, using the projected unit credit cost method. Significant assumptions used in the actuarial valuation include an 8 percent per annum rate of return on the investment of present and future assets and projected payroll growth of 3.75 percent for both the RHIA and RHIPA plans. The RHIPA plan uses a healthcare cost inflation adjustment

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graded from 7 percent in 2011 to 4.5 percent in 2029. The RHIPA plan's inflation assumption is 2.75 percent, which is a subcomponent of the payroll growth rate. There is no inflation assumption for RHIA postemployment benefits because the payment amount is set by statute and is not adjusted for increases in healthcare costs. The actuarial value of plan assets for both the RHIA and the RHIPA is equal to the asset's fair market value on the valuation date. The amount of net assets available for other postemployment benefits for RHIA and RHIPA at June 30, 2011, was \$248 million and \$5.1 million, respectively.

B. Public Employees Benefit Board

Plan Description

The State participates in a defined benefit postemployment healthcare plan administered by the Public Employees Benefit Board (PEBB). This plan offers healthcare assistance to eligible retired employees and their beneficiaries. Chapter 243 of the Oregon Revised Statutes gives the board the authority to establish and amend the benefit provisions of the PEBB Plan. Eleven employers participate in the PEBB Plan, which is considered an agent multiple-employer plan for financial reporting purposes. As of June 30, 2011, PEBB Plan members consisted of 50,450 active employees and 1,963 retired employees and beneficiaries receiving benefits. PEBB does not issue a separate, publicly available financial report.

The PEBB Plan allows qualifying retired employees to continue their "active" health insurance coverage on a self-pay basis until they are eligible for Medicare. Participating retirees pay their own monthly premiums. However, the premium amount is based on a blended rate that is determined by pooling the qualifying retirees with active employees, thus, creating an "implicit rate subsidy."

Summary of Significant Accounting Policies

The PEBB plan's implicit rate subsidy, if not fully funded, represents an obligation of the State, the net OPEB obligation. The net OPEB obligation for the year ended June 30, 2011, is \$55.4 million and is allocated to the participating funds based on each fund's proportionate share of annual health insurance premium costs. The portion of the net OPEB obligation related to governmental activities is reported in the internal service funds balance sheet and the government-wide statement of net assets; the portion related to business-type activities is reported in the proprietary funds balance sheet and the government-wide statement of net assets. The portion related to fiduciary activities is reported in the statement of fiduciary net assets.

Funding

The PEBB's funding policy provides for employer contributions in amounts sufficient to fund the cost of active employee health benefits, including the retiree rate subsidy, on a pay-as-you-go basis. Administrative costs of the PEBB Plan are financed by up to 2 percent of employer and plan member contributions. For the year ended June 30, 2011, retired plan members contributed \$25.8 million through their required contributions. The average monthly contribution was \$1,097. Active employees do not make contributions.

The funded status of the PEBB postemployment healthcare plan as of the most recent actuarial valuation date (dollars in millions):

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll ((b-a)/c) |
|--------------------------|-------------------------------|---------------------------------------|---------------------------|--------------------|---------------------|--|
| 7/1/2009 | - | \$161.7 | \$161.7 | - | \$2,562.5 | 6.3% |

The schedule of funding progress, which is included in the required supplementary information that immediately follows the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions

The PEBB postemployment healthcare benefit obligation was determined as part of the actuarial valuation prepared by the PEBB consulting actuary at July 1, 2009, using the entry age normal cost method. The

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State's annual OPEB expense is based on the annual required contribution (ARC), an amount actuarially determined in accordance with GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities over thirty years. Significant assumptions used in the actuarial valuation include a 4 percent per annum rate of return on the investment of present and future assets, and a medical healthcare cost inflation adjustment graded from an average of 8.35 percent in 2010 to an average of 4.5 percent in 2026 and beyond. The dental healthcare cost inflation adjustment was graded from an average of 5.75 percent in 2010 to an average of 4.5 percent for 2026 and beyond. The vision healthcare cost inflation adjustment was graded at 3 percent for all years. The unfunded actuarial accrued liability is being amortized as a level dollar amount using an open 30-year period.

For fiscal years ended June 30, 2011, 2010, and 2009, the components of the PEBB Plan's annual OPEB cost, the amounts actually contributed, and changes to the net OPEB obligation (in millions):

| | June 30, 2011 | June 30, 2010 | June 30, 2009 |
|---|------------------|------------------|------------------|
| Annual required contribution | \$ 17.4 | \$ 16.7 | \$ 36.2 |
| Interest on net OPEB obligation | 1.9 | 1.6 | 0.9 |
| ARC adjustment | <u>(2.7)</u> | <u>(2.3)</u> | <u>(1.3)</u> |
| Annual OPEB cost (expense) | 16.6 | 16.0 | 35.8 |
| Contributions made | <u>(8.9)</u> | <u>(8.4)</u> | <u>(16.0)</u> |
| Increase in net OPEB obligation | 7.7 | 7.6 | 19.8 |
| Net OPEB obligation - beginning of year | <u>47.7</u> | <u>40.1</u> | <u>20.3</u> |
| Net OPEB obligation - end of year | <u>\$ 55.4</u> | <u>\$ 47.7</u> | <u>\$ 40.1</u> |
| Percent of annual OPEB cost contributed | 53.6% | 52.5% | 44.7% |

C. Discretely Presented Component Units

SAIF Corporation

SAIF Corporation (SAIF) administers a single-employer defined benefit postemployment healthcare plan. SAIF employees retiring under Oregon PERS are eligible to receive medical coverage for the employee and eligible dependents until age 65. Retirees must pay the premium for the coverage elected. Premiums for coverage are identical for active and retired employees, except to the extent that SAIF pays all or a portion of its active employees' premiums. Participating retirees pay their own monthly premiums based on a blended premium rate since retirees are pooled together with active employees for insurance rating purposes. Benefit provisions are established by SAIF Corporation. The plan does not issue a separate, publicly available financial report.

SAIF's funding policy provides for contributions at amounts sufficient to fund benefits on a pay-as-you-go basis. For the year ended December 31, 2010, retired plan members contributed \$645 thousand through their required contributions. The required contribution rate per member was an average of \$572 per month.

The funded status of the SAIF plan as of the most recent actuarial valuation date (dollars in thousands):

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll ((b-a)/c) |
|--------------------------------|--|---|------------------------------------|--------------------------|---------------------------|--|
| 1/1/2009 | - | \$5,701 | \$5,701 | - | \$57,228 | 10% |

The postemployment healthcare benefit obligation was determined as part of the actuarial valuation prepared by a consulting actuary as of January 1, 2009, using the projected unit credit cost method. Significant assumptions used in the actuarial valuation include a 5.5 percent investment rate of return. The annual medical healthcare cost trend rate is expected to increase 7.5 percent in the first year, 6.5 percent in the second year, 6 percent in the third through seventh year, 5.5 percent for the eighth through twenty-seventh

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year, and 5 percent thereafter. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis for 15 years.

For the years ended December 31, 2010, 2009, and 2008, the components of SAIF's annual OPEB cost, the amounts actually contributed to the plan, and changes in SAIF's net OPEB obligation (in thousands):

| | December 31, 2010 | December 31, 2009 | December 31, 2008 |
|---|----------------------|----------------------|----------------------|
| Annual required contribution | \$ 762 | \$ 730 | \$ 408 |
| Interest on net OPEB obligation | 49 | 26 | 13 |
| ARC adjustment | (68) | (36) | (19) |
| Annual OPEB cost (expense) | 743 | 720 | 402 |
| Contributions made | (376) | (299) | (174) |
| Increase in net OPEB obligation | 367 | 421 | 228 |
| Net OPEB obligation - beginning of year | 893 | 472 | 244 |
| Net OPEB obligation - end of year | <u>\$ 1,260</u> | <u>\$ 893</u> | <u>\$ 472</u> |
| Percent of annual OPEB cost contributed | 50.6% | 41.5% | 43.3% |

Oregon Health and Science University

The Oregon Health and Science University (OHSU) administers a single-employer defined benefit postemployment healthcare plan. OHSU retiring employees are eligible to receive medical coverage for themselves and spouses until age 65. Retirees must pay the full premium for the coverage elected. The plan funding policy provides for contributions at amounts sufficient to fund benefits on a pay-as-you-go basis. Full-time active employees also make contributions. Participating retirees pay their own monthly premiums based on a blended premium rate since retirees are pooled together with active employees for insurance rating purposes. The plan does not issue a separate, publicly available financial report.

The funded status of the OHSU plan as of the most recent actuarial valuation date (dollars in thousands):

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll ((b-a)/c) |
|--------------------------------|--|---|------------------------------------|--------------------------|---------------------------|--|
| 1/1/2010 | - | \$19,185 | \$19,185 | - | \$669,000 | 2.9% |

The actuarial valuation as of January 1, 2010, used an assumed discount rate of 3.5 percent. The assumed healthcare cost trend rate is 8.7 percent in 2011, declining gradually to 4.5 percent in 2027, and remaining at 4.5 percent thereafter. The actuarial cost method used is the projected unit credit method.

For fiscal years ended June 30, 2011, 2010, and 2009, the components of OHSU's annual OPEB cost, the amounts actually contributed to the plan, and changes in OHSU's net OPEB obligation (in thousands):

| | June 30, 2011 | June 30, 2010 | June 30, 2009 |
|---|------------------|------------------|------------------|
| Annual required contribution | \$ 1,719 | \$ 2,262 | \$ 2,355 |
| Interest on net OPEB obligation | 145 | 102 | 185 |
| Annual OPEB cost (expense) | 1,864 | 2,364 | 2,540 |
| Contributions made | (1,008) | (1,064) | (960) |
| Increase in net OPEB obligation | 856 | 1,300 | 1,580 |
| Net OPEB obligation - beginning of year | 4,215 | 2,915 | 1,335 |
| Net OPEB obligation - end of year | <u>\$ 5,071</u> | <u>\$ 4,215</u> | <u>\$ 2,915</u> |
| Percent of annual OPEB cost contributed | 54% | 45% | 38% |

D. Using Actuarial Valuations

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. Actuarial calculations reflect a long-term perspective and include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

17. DEFERRED COMPENSATION PLANS

A. Primary Government

The Oregon Savings Growth Plan (OSGP) is a deferred compensation plan available to eligible state employees. Employee contributions are deposited into the Deferred Compensation Fund established by Oregon Revised Statute 243.411. To participate, an employee enters into an individual agreement with the State to defer current earnings to be paid at a future date. The Public Employees Retirement System (PERS) administers the plan. As trustee of the assets, PERS contracts with ING to maintain OSGP participant records. The Office of the State Treasurer, as custodian of the assets, contracts with State Street Bank and Trust Company to provide financial services. PERS may assess a charge to participants not to exceed 2 percent on amounts deferred, both contributions and investment earnings, to cover costs incurred for administering the program. Actual charges to participants, including investment charges, for the year ended June 30, 2011, averaged 0.25 percent of amounts deferred.

Participants direct the selection of investment options and also bear any market risk. Although the State has no liability for losses under the OSGP, the State does have the prudent investor responsibility of due care. Activity of the OSGP is reported under the Deferred Compensation Plan in the fiduciary funds combining financial statements. As of June 30, 2011, the fair value of the investments was \$1 billion.

B. Discretely Presented Component Units

SAIF Corporation

SAIF Corporation (SAIF), a discretely presented component unit, administers a deferred compensation plan (SAIF Plan) that is available to eligible SAIF employees. Employees may enter into an individual agreement with SAIF to defer current earnings to be paid at a future date. The SAIF Plan assets are held in a custodial account or an annuity contract by the plan provider for the exclusive benefit of the participants or their beneficiaries. SAIF does not perform the investing function and has no fiduciary accountability for the plan. Therefore, plan assets and any related liability to plan participants are not reported in the SAIF financial statements as of December 31, 2010.

The OSGP and the SAIF Plan are administered in compliance with Internal Revenue Code Section 457. Participants are not required to pay federal or state income taxes on the deferred earnings until those earnings are received. Participants or their beneficiaries cannot receive the funds until at least one of the following circumstances occurs: termination due to death, disability, resignation, or retirement; unforeseeable emergency; or by requesting a *de minimus* distribution from inactive accounts valued at less than \$5,000.

Oregon Health and Science University

The Oregon Health and Science University, a discretely presented component unit, offers all eligible employees the option to participate in one of two tax deferred savings plans through the University Voluntary Savings Program. One plan is administered under Internal Revenue Code Section 403 and the other under Section 457. The contribution and investment earnings under these plans are tax deferred and accumulated for distribution at a future date.

18. TERMINATION BENEFITS

Oregon State University (OSU) offered a voluntary tenure relinquishment plan from May 1 to December 1, 2010. Tenured faculty had to meet specific length of service and retirement eligibility criteria to qualify. In exchange for relinquishing tenure, faculty members will receive subsidy payments for health benefits for a

term not to exceed 36 months following retirement. The subsidy payment will be adjusted annually based on specified premium rates. Thirty-four faculty members entered into a contractual agreement with OSU to participate in this plan.

Eastern Oregon University (EOU) is offering a tenure relinquishment plan that closes November 30, 2011. Faculty members who accept the plan will retire December 31, 2011, and will receive a fixed subsidy amount for health benefits covering the term until the faculty member turns 65. As of June 30, 2011, three faculty members had selected retirement under this plan with terms ranging from 11 to 42 months.

Since 1998, Southern Oregon University (SOU) has offered a voluntary tenure relinquishment and early retirement program to tenured faculty at least 55 years of age. Faculty members who elect this plan relinquish all claims to tenure and receive an annual full-time fixed term contract for up to three years. An option within the plan provides that SOU will subsidize health and dental benefits up to a specified dollar amount for up to seven years after the employee's retirement date. As of June 30, 2011, ten retirees were participating in the health and benefits option of this plan.

The liability for early retirement benefits is reported in contracts, mortgages, and notes payable on the proprietary funds balance sheet under the University System Fund. The current and noncurrent portions of the liability are \$695 thousand and \$1.2 million, respectively. The amount of the liability was determined by calculating the discounted present value of expected future benefit payments using discount rates ranging from 0.65 to 6 percent.

19. RISK FINANCING

A. Property, Liability, and Workers' Compensation Coverage for State Government

The Department of Administrative Services, State Services Division, administers the State's property, liability, and workers' compensation insurance program. State Services Division has found it is more economical to manage the risk of loss internally and, therefore, minimize the purchase of commercial insurance policies to the extent possible. The moneys set aside by State Services Division under Chapter 278 of the Oregon Revised Statutes are used to service the following risks:

- Direct physical loss or damage to State property
- Tort liability claims brought against the State, its officers, employees, or agents
- Inmate injury
- Workers' compensation
- Employee dishonesty
- Faithful performance bonds for key positions as required by law and additional positions as determined by agency policy

State Services Division purchases commercial insurance for specific insurance needs not covered by self-funding. For example, the self-insured property and liability program is backed by an excess property policy with a limit of \$400 million and a blanket commercial crime policy with a limit of \$20 million. The amount of claim settlements did not exceed commercial insurance coverage for each of the past three fiscal years.

All State agencies, commissions, and boards participate in the self-insured property and liability program. State Services Division allocates the cost of claims and claims administration by charging an assessment to each State entity, based on its share of losses. Statewide risk charges are based on independent biennial actuarial forecasts and division expenses, less any available fund balance from the prior biennium.

State Services Division purchases workers' compensation insurance for the State from SAIF Corporation, a discretely presented component unit, utilizing retrospective paid loss plans. These plans are ten years in length and have cash flow and investment earnings advantages. The accumulated claim loss liability for the plans was approximately \$60 million as of June 30, 2011. Independent actuaries determine biennial loss forecasts.

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Periodically, State Services Division reevaluates claims liabilities taking into consideration recently settled claims, the frequency of claims, and other economic and social factors. Contracted actuaries estimate claims and allocated and unallocated expenses using the last 20 to 25 years of State claims experience and the projected numbers of employees, payroll, vehicles, and other property. Liabilities include an amount for claims and legal expenses that have been incurred but not reported and are discounted at an annual rate of two percent. The actuaries forecast ultimate losses by line of coverage.

Changes in the balance of aggregate claims liabilities for the property, liability, and workers' compensation insurance program for the years ended June 30, 2011 and 2010 (in thousands):

| Fiscal Year | Beginning Balance | Increase in Claims or Estimate | Claims Payments | Ending Balance |
|-------------|----------------------|--------------------------------------|--------------------|-------------------|
| 2011 | \$ 126,051 | \$ 43,840 | \$ (33,723) | \$ 136,168 |
| 2010 | 119,260 | 41,629 | (34,838) | 126,051 |

The June 30, 2011, balance of claims liabilities is included in claims and judgments payable on the combining balance sheet of the internal service funds under Central Services.

B. State Self-insured Healthcare Plans

Chapter 243 of the Oregon Revised Statutes authorizes the Public Employees' Benefit Board (PEBB) to establish and maintain medical, dental, and vision insurance plans for the benefit of PEBB members. Currently, the State provides these benefits through four self-insured plans.

PEBB is responsible for controlling expenditures, stabilizing benefit premium rates, and minimizing the risk of loss. Funds set aside in a stabilization fund may be used to offset any actual premium deficiencies in the self-funded plans. PEBB has not purchased stop-loss coverage on any of the plans. With the launch of a new statewide self-insured medical plan and a new self-insured vision plan beginning January 1, 2010, the liability reported for fiscal year ending June 30, 2010, increased significantly over the prior year but has stabilized in FY 2011.

Contracted actuaries and consultants estimate the claims liability. Incurred but not reported expenses are estimated by using claims lag triangles from the plans to develop completion factors. For the most recent months, incurred claims are estimated based upon reviewing the most recent claims experience per employee and adjusting for trend and seasonality to the projection month. Since most of the claims will be paid out within the year, the estimated amounts are not discounted. Specific adjustments for subrogation or other anticipated recoveries are not included. Overall, these adjustments are not expected to be significant.

For calendar year 2008, settlements exceeded coverage for the Samaritan Health Select medical plan. This regional self-insured plan was terminated December 31, 2008. In addition, vision claims exceeded self-insurance coverage during the first half of calendar year 2011.

Changes in the balance of aggregate claims liabilities for the self-insured healthcare plans for the years ended June 30, 2011 and 2010 (in thousands):

| Fiscal Year | Beginning Balance | Increase in Claims or Estimate | Claims Payments | Ending Balance |
|-------------|----------------------|--------------------------------------|--------------------|-------------------|
| 2011 | \$ 83,502 | \$ 573,549 | \$ (599,639) | \$ 57,412 |
| 2010 | 2,906 | 320,311 | (239,715) | 83,502 |

The June 30, 2011, balance of claims liabilities is included in claims and judgments payable on the combining balance sheet of the internal service funds under Central Services.

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C. Supplemental Workers' Compensation Insurance

The Department of Consumer and Business Services operates several supplemental workers' compensation benefit programs. These programs are accounted for in special revenue funds. The primary program is the Retroactive Program, established by Oregon Revised Statute 656.506. It provides increased insurance benefits to claimants or their beneficiaries when current payment requirements exceed benefits in effect at the time of injury.

The Department of Consumer and Business Services determines the funding of supplemental workers' compensation insurance programs through cash flow projections based on historical data and economic forecasts. Employer work hour assessments, contributions by employees, workers' compensation insurance premium assessments, and investment and interest earnings pay for the programs. Long-term liabilities were actuarially computed as of June 30, 2011, using a 6 percent discount rate.

Changes in the balance of aggregate claims liabilities for supplemental workers' compensation insurance for the years ended June 30, 2011 and 2010 (in thousands):

| Fiscal Year | Beginning Balance | Increase in Claims or Estimate | Claims Payments | Ending Balance |
|-------------|----------------------|--------------------------------------|--------------------|-------------------|
| 2011 | \$ 900,553 | \$ - | \$ (37,219) | \$ 863,334 |
| 2010 | 887,411 | 13,142 | - | 900,553 |

The June 30, 2011, balance of claims liabilities is included in claims and judgments payable on the government-wide statement of net assets under governmental activities.

D. SAIF Corporation Workers' Compensation Insurance

The Legislature created SAIF Corporation (SAIF) to transact workers' compensation insurance and reinsurance business. SAIF is an independent public corporation, a discretely presented component unit of the State, and the largest workers' compensation insurer in Oregon.

SAIF has established a reserve for both reported and unreported insured events, which includes estimates of future payments of losses and related loss adjustment expenses. In estimating the liability for loss and loss adjustment expense, SAIF considers prior experience, industry information, currently recognized trends affecting data specific to SAIF, and other factors relating to workers' compensation insurance underwritten by SAIF.

The liability for loss and loss adjustment expense increased \$45.7 million in calendar year 2010, which was net of favorable development of \$45 million. The favorable development is attributed to the more recent accident years, as permanent total disability and permanent partial disability medical reserves had lower loss development than was expected. The favorable development was offset somewhat by unfavorable development for indemnity loss reserves, which may be due to fewer return-to-work opportunities. Loss adjustment expense reserves decreased \$11.8 million. The favorable loss adjustment expense development was largely attributed to a reduction in the long-term loss adjustment expense escalation rate due to the average increase in salary and benefits trending downward.

SAIF discounts the indemnity reserve for known unpaid fatal and permanent total disability losses on a tabular basis, using a discount rate of 3.5 percent. SAIF does not discount any incurred but not reported reserves, medical unpaid losses, or unpaid loss adjustment expense. The gross reserve subject to tabular discounting for calendar year 2010 was \$269.3 million. The related discount was \$93.8 million as of December 31, 2010.

Anticipated salvage and subrogation of \$25.7 million was included as a reduction of the reserve for loss and loss adjustment expense at December 31, 2010.

As of December 31, 2010, SAIF had provided reserves of \$29 million for loss and loss adjustment expense related to asbestos claims. SAIF's exposure to asbestos claims arose from the sale of workers' compensation policies.

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Changes in the balance of the liability for loss and loss adjustment expense related to workers' compensation insurance underwritten by SAIF for 2010 and 2009 (in thousands):

| Calendar Year | Beginning Balance | Incurred Losses and Loss Adjustment Expenses | Loss and Loss Adjustment Expense Payments | Ending Balance |
|---------------|-------------------|--|---|----------------|
| 2010 | \$ 2,958,911 | \$ 365,150 | \$ (319,422) | \$ 3,004,639 |
| 2009 | 2,911,309 | 377,118 | (329,516) | 2,958,911 |

This liability is reported as the reserve for loss and loss adjustment expense on the combining balance sheet of the discretely presented component units under SAIF Corporation.

E. Oregon Health and Science University Self-funded Insurance Programs

The Oregon Health and Science University (OHSU), which is also a discretely presented component unit of the State, maintains several self-funded insurance programs. Coverage for professional, general, automobile, directors and officers, and employment practices liabilities is provided through OHSU's solely-owned captive insurance company, OHSU Insurance Company.

OHSU has contracted with independent actuaries to estimate the ultimate cost of settlements related to the coverage provided by OHSU Insurance Company. The liability reported for fiscal year 2011 was calculated using a 5 percent discount rate. OHSU Insurance Company has also entered into reinsurance agreements with various insurers to fully reinsure claims that may exceed coverage limits for claims made prior to July 1, 2002, and claims made on or after July 1, 2009. Coverage is written on a claims made basis.

In addition, OHSU is self-insured for its risk of loss related to costs to insure its employees for medical, dental, and vision coverage. OHSU utilized a third-party actuary to assist in the estimation of OHSU's liability for the employee health programs related to claims payable and those claims incurred but not yet paid or reported of approximately \$12.7 million as of June 30, 2011.

OHSU also purchases workers' compensation coverage from SAIF. The SAIF policy is written as a paid loss retrospective plan. OHSU's liability includes an estimate of claims incurred but not yet reported based on annual actuarial projections.

In December 2007, the Oregon Supreme Court found unconstitutional certain provisions of the Oregon Tort Claims Act that limited OHSU's liability for the acts of its employees and agents in large damages cases. The impact of this decision has been included in the liability for self-funded insurance programs in the accompanying financial statements.

Settlement of six malpractice claims exceeded OHSU's professional liability insurance coverage during fiscal year 2009. The amount of claims settlements did not exceed OHSU's self-insurance and commercial insurance coverage for fiscal years 2010 and 2011.

The total liability reported for OHSU's self-funded insurance programs was \$56.1 million and \$70.7 million for fiscal years ended June 30, 2011 and 2010, respectively. This liability is reported as claims and judgments payable on the combining balance sheet of the discretely presented component units under Oregon Health and Science University.

20. DISCOUNTS AND ALLOWANCES IN PROPRIETARY FUNDS

Proprietary fund revenues, including discretely presented component units, are reported net of discounts and allowances in the accompanying financial statements.

Discounts and allowances in proprietary funds for the year ended June 30, 2011 (in thousands):

Primary Government

| Proprietary Funds | Type of Revenue | Amount |
|---------------------------|-----------------------|-------------------|
| Lottery Operations | Sales | \$ 1,270 |
| Unemployment Compensation | Assessments | 552 |
| Unemployment Compensation | Fines and forfeitures | (81) |
| University System | Charges for services | 160,691 |
| Nonmajor Enterprise Funds | Charges for services | 788 |
| Nonmajor Enterprise Funds | Sales | 5,515 |
| Internal Service Funds | Other | 169 |
| Total primary government | | <u>\$ 168,904</u> |

Discretely Presented Component Units

| Component Units | Type of Revenue | Amount |
|--|-----------------------------|---------------------|
| SAIF Corporation | Charges for services | \$ (79) |
| Oregon Health and Science University | Charges for services | 1,125,757 |
| Oregon Health and Science University | Gifts, grants and contracts | 729 |
| Total discretely presented component units | | <u>\$ 1,126,407</u> |

21. FUND EQUITY

A. Net Assets Restricted by Enabling Legislation

The following schedule summarizes the State's net assets at June 30, 2011, that are restricted by enabling legislation (in thousands). All of the legislative restrictions are in governmental activities.

| | Restricted Net Assets |
|---|--------------------------|
| Expendable net assets restricted for: | |
| Health and social service programs | \$ 252,685 |
| Public transportation programs | 79,925 |
| Natural resource programs | 83,350 |
| Education | 237,232 |
| Employment services | 138,200 |
| Consumer protection | 70,767 |
| Other programs | 120,953 |
| Nonexpendable net assets restricted for: | |
| Education | 1,710 |
| Residential assistance | 23,551 |
| Natural resource programs | 1,500 |
| Workers' compensation | 250 |
| Total net assets restricted by enabling legislation | <u>\$ 1,010,123</u> |

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B. Changes to Beginning Fund Balance

As of June 30, 2011, the beginning fund balances were restated as follows (in thousands):

| | Beginning Balance | Prior Period Adjustments | Accounting Changes | Beginning Balance-Restated |
|--|----------------------|-----------------------------|-----------------------|-------------------------------|
| Governmental funds and activities: | | | | |
| General | \$ (507,344) | \$ 2,213 | \$ 264,471 | \$ (240,660) |
| Health and Social Services | 606,442 | 8,617 | (28,582) | 586,477 |
| Public Transportation | 1,027,785 | (1,799) | - | 1,025,986 |
| Environmental Management | 776,428 | 3,876 | (12,578) | 767,726 |
| Common School | 738,760 | (2,492) | - | 736,268 |
| Oregon Rainy Day | 125,579 | - | (125,579) | - |
| Other (nonmajor) | 1,754,294 | 24,548 | (102,190) | 1,676,652 |
| Capital assets, net of depreciation | 10,952,084 | 11,142 | - | 10,963,226 |
| Other noncurrent assets | 1,769,431 | (6,096) | - | 1,763,335 |
| Long-term liabilities | (7,579,794) | 1,452 | - | (7,578,342) |
| Internal service funds | 213,808 | (6,111) | 4,458 | 212,155 |
| Total governmental funds and activities | <u>\$ 9,877,473</u> | <u>\$ 35,350</u> | <u>\$ -</u> | <u>\$ 9,912,823</u> |
| Proprietary funds and business-type activities: | | | | |
| Housing and Community Services | \$ 206,725 | \$ - | \$ - | \$ 206,725 |
| Veterans' Loan | 134,201 | (89) | - | 134,112 |
| Lottery Operations | 159,680 | - | - | 159,680 |
| Unemployment Compensation | 1,182,018 | 2,162 | - | 1,184,180 |
| University System | 1,413,794 | - | - | 1,413,794 |
| Other (nonmajor) | 634,123 | 61,693 | - | 695,816 |
| Internal service funds adjustment | 4,723 | - | - | 4,723 |
| Total proprietary funds and business-type activities | <u>\$ 3,735,264</u> | <u>\$ 63,766</u> | <u>\$ -</u> | <u>\$ 3,799,030</u> |
| Fiduciary funds: | | | | |
| Pension and Other Employee Benefit Trust | \$ 51,747,945 | \$ (8,291) | \$ - | \$ 51,739,654 |
| Private Purpose Trust | 30,908 | - | - | 30,908 |
| Investment Trust | 3,867,013 | - | - | 3,867,013 |
| Total fiduciary funds | <u>\$ 55,645,866</u> | <u>\$ (8,291)</u> | <u>\$ -</u> | <u>\$ 55,637,575</u> |
| Discretely presented component units: | | | | |
| SAIF Corporation | \$ 945,589 | \$ - | \$ - | \$ 945,589 |
| Oregon Health and Science University | 1,695,674 | - | - | 1,695,674 |
| Oregon University System Foundations | 1,206,594 | - | - | 1,206,594 |
| Total discretely presented component units | <u>\$ 3,847,857</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 3,847,857</u> |

Significant prior period adjustments were made in three governmental funds or activities. An \$8.7 million adjustment was made to correct expenditures that had been overstated in prior fiscal years in the Health and Social Services Fund. In the Other (nonmajor) Fund, an adjustment of \$11.3 million was made to recognize pension bond assessments that should have been accrued in the prior year. In addition, several agencies made corrections to their capital asset accounts, including a \$16.9 million adjustment to infrastructure capitalization and depreciation.

In the Unemployment Compensation Fund, adjustments of \$8.3 million to record interest income that should have been recognized in prior fiscal years and \$6 million to recognize federal revenue that should have been accrued in the prior fiscal year were offset by an \$11.9 million adjustment to recognize distributions to individuals that should have been accrued in the prior fiscal year.

Prior to fiscal year 2011, the activity of the Standard Retiree Health Insurance Account (SRHIA) was reported in a fiduciary fund. It has since been determined that the activity should be reported in a proprietary fund. To make this correction, a prior period adjustment of \$8.3 million was recorded in the Pension and Other

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Employee Benefit Trust Fund, with an offsetting entry in the Other (nonmajor) Proprietary Fund. In addition, a \$54.2 million prior period adjustment was recorded in the Other (nonmajor) Proprietary Fund to reflect certain deposits and estimated claims expenses of the SRHIA not reported in prior fiscal years.

All accounting changes reported in the governmental funds and activities are the result of implementing GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This statement clarified that the foundation of a special revenue fund must be a specific revenue source which is restricted or committed to expenditure for a specific purpose other than debt service or capital projects. Activities previously accounted for in special revenue funds that do not meet this new definition are now reported in the General Fund.

C. Fund Balances – Governmental Funds

The following table displays in detail the June 30, 2011, fund balances that are reported in the aggregate on the governmental funds balance sheet (in thousands).

| Fund balances: | General | Health and Social Services | Public Transportation | Environmental Management | Common School | Other | Total |
|------------------------------------|-------------------|----------------------------------|--------------------------|-----------------------------|-------------------|---------------------|---------------------|
| Nonspendable: | | | | | | | |
| Not in spendable form | \$ 79,887 | \$ 108,813 | \$ 27,315 | \$ 27,675 | \$ 4 | \$ 4,097 | \$ 247,791 |
| Required to be maintained intact | 4 | 52 | 40 | 352 | - | 27,227 | 27,675 |
| Restricted for: | | | | | | | |
| Health and social service programs | 16,854 | 351,165 | - | - | - | - | 368,019 |
| Transportation programs | - | - | 739,658 | - | - | - | 739,658 |
| Natural resource programs | 1,091 | - | - | 702,481 | - | - | 703,572 |
| Education | - | - | - | - | 945,285 | 150,775 | 1,096,060 |
| Education stabilization | - | - | - | - | - | 13,759 | 13,759 |
| Community protection | - | - | - | - | - | 140,461 | 140,461 |
| Consumer protection | - | - | - | - | - | 70,767 | 70,767 |
| Employment services | - | - | - | - | - | 138,200 | 138,200 |
| Residential assistance | - | - | - | - | - | 141,540 | 141,540 |
| Debt service | - | - | - | - | - | 404,767 | 404,767 |
| Capital projects | - | - | - | - | - | 109,613 | 109,613 |
| Other purposes | 18,937 | - | - | - | - | 65,574 | 84,511 |
| Committed to: | | | | | | | |
| Health and social service programs | - | 125,722 | - | - | - | - | 125,722 |
| Natural resource programs | - | - | - | 49,550 | - | - | 49,550 |
| Education | - | - | - | - | - | 12,886 | 12,886 |
| Business development | - | - | - | - | - | 23,421 | 23,421 |
| Community protection | - | - | - | - | - | 68,210 | 68,210 |
| Consumer protection | - | - | - | - | - | 27,990 | 27,990 |
| Employment services | - | - | - | - | - | 60,280 | 60,280 |
| Residential assistance | - | - | - | - | - | 134,531 | 134,531 |
| Stabilization | 10,400 | - | - | - | - | - | 10,400 |
| Other purposes | - | - | - | - | - | 1,007 | 1,007 |
| Assigned to: | | | | | | | |
| Health and social service programs | - | 4,040 | - | - | - | - | 4,040 |
| Natural resource programs | - | - | - | 7,542 | - | - | 7,542 |
| Education | - | - | - | - | - | 3,228 | 3,228 |
| Community protection | - | - | - | - | - | 8,275 | 8,275 |
| Other purposes | 7,864 | - | - | - | - | 6,061 | 13,925 |
| Unassigned: | 109,117 | - | - | - | - | - | 109,117 |
| Total fund balances | \$ 244,154 | \$ 589,792 | \$ 767,013 | \$ 787,600 | \$ 945,289 | \$ 1,612,669 | \$ 4,946,517 |

Nonspendable fund balances include inventories and prepaid items, which are not in spendable form, and fund balances associated with the corpus of revolving funds and permanent fund principal, which are legally or contractually required to be maintained intact.

Restricted fund balances result from constraints imposed on net assets by law through constitutional provisions or enabling legislation or by parties outside the State, such as creditors, grantors, contributors, or laws or regulations of other governments. Enabling legislation authorizes the State to levy, assess, charge, or otherwise mandate payment from external resource providers and includes a legally enforceable requirement that those resources be used only for specific purposes stipulated by the legislation.

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Committed fund balance results from constraints imposed by bills passed by the Legislature and signed into law by the Governor. The constraints on the use of resources are separate from the authorization to raise the underlying revenue and may be modified or rescinded only by passing additional legislation.

Assigned fund balance represents amounts that are constrained by the state's intent to use them for specific purposes, which are neither restricted nor committed. Assignments of fund balance may be made by the legislature, a budget committee, an agency head or other official who has been delegated the authority to assign amounts to specific purposes. Assigned fund balance is also the residual amount in governmental funds other than the General Fund.

D. Stabilization Arrangements

Oregon maintains two stabilization funds – the Oregon Rainy Day Fund and the Education Stability Fund.

Established by the 2007 Legislature, the Oregon Rainy Day Fund is funded from the General Fund's ending balance up to 1 percent of General Fund appropriations for the prior biennium. The Legislature may deposit additional funds as it did to create the fund, using surplus corporate income tax revenues from the 2005-07 biennium. The Rainy Day Fund also earns interest on the moneys in the fund. Fund balance is capped at 7.5 percent of General Fund revenues in the prior biennium.

Stabilization amounts in the Oregon Rainy Day Fund may be spent only if approved by three-fifths of the members of the Legislative Assembly and if one of the following conditions exists:

- The last quarterly economic and revenue forecast for a biennium indicates that moneys available to the General Fund for the next biennium will be at least 3 percent less than appropriations from the General Fund for the current biennium;
- There has been a decline for two or more consecutive quarters in the last 12 months in seasonally adjusted nonfarm payroll employment; or
- A quarterly economic and revenue forecast projects that revenues in the General Fund in the current biennium will be at least 2 percent below what the revenues were projected to be in the revenue forecast on which the legislatively adopted budget for the current biennium was based.

For any one biennium, the Legislative Assembly may not appropriate more than two-thirds of the amount that is in the Oregon Rainy Day Fund at the beginning of that biennium. If the appropriation is for a biennium that has not yet begun, the Legislative Assembly may use as the base the most recent estimate of the amount that will be in the Oregon Rainy Day Fund at the beginning of the biennium for which the appropriation is made. The fund balance of the Oregon Rainy Day Fund as of June 30, 2011, was \$10.4 million.

The Education Stability Fund is authorized in the Oregon Constitution, Article XV. Section 4, part (4)(d), requires that 18 percent of net Lottery proceeds be deposited in the fund. Earnings on moneys in the fund are continuously appropriated to finance public education under Oregon Revised Statute 348.696. The balance in the fund may not exceed 5 percent of General Fund revenues of the prior biennium.

Amounts in the Education Stability Fund may be spent under the same conditions as those required for spending moneys in the Oregon Rainy Day Fund. However, if none of the conditions are met, the Education Stability Fund can also be used by the Legislature for public education in Oregon if the Governor declares an emergency and the expenditure is approved by a three-fifths majority in each chamber of the Legislature. The fund balance of the Education Stability Fund as of June 30, 2011, was \$13.8 million.

22. COMMITMENTS

The State has significant commitments as of June 30, 2011, in addition to the construction contract commitments disclosed in Note 6. Commitments are defined as existing arrangements to enter into future transactions or events, such as contractual obligations with vendors for future purchases or services at specified prices and sometimes at specified quantities. Commitments may also include agreements to make grants and loans.

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Commitments in effect as of June 30, 2011, and the anticipated sources of funding (in thousands):

| Purpose | General Funds | Federal Funds | Lottery Funds | Other Funds | Total |
|------------------------------|--------------------------|--------------------------|--------------------------|------------------------|---------------------|
| Community services contracts | \$ 417,019 | \$ 558,461 | \$ 4,748 | \$ 42,823 | \$ 1,023,051 |
| Grant & loan commitments | 30,239 | 175,515 | 52,143 | 287,439 | 545,336 |
| Personal services contracts | 84,539 | 64,936 | 270 | 22,125 | 171,870 |
| Equipment purchases | 142 | 414 | 7,343 | 1 | 7,900 |
| Public defense contracts | 42,673 | - | - | - | 42,673 |
| Systems development | 497 | 3,425 | - | 4,955 | 8,877 |
| Total | \$ 575,109 | \$ 802,751 | \$ 64,504 | \$ 357,343 | \$ 1,799,707 |

The Oregon Investment Council has entered into agreements that commit the investment managers for the Public Employees Retirement Fund (PERF), the Common School Fund (CSF), and the Oregon University System (OUS) Endowment Fund, upon request, to make additional investment purchases up to a predetermined amount. The Oregon Growth Account (OGA) Board makes similar commitments for investment purchases. As of June 30, 2011, the PERF had \$7.8 billion in commitments to purchase private equity investments, \$1.8 billion to purchase real estate investments, and \$489.9 million to purchase Opportunity Fund investments. As of June 30, 2011, the CSF, OUS Endowment Fund, and the OGA had \$73.3 million, \$4.6 million, and \$35.9 million, respectively, in commitments to purchase private equity investments. These amounts are unfunded and are not recorded in the financial statements.

23. CONTINGENCIES

A. Litigation

Several Oregon employees filed lawsuits challenging various aspects of the 2003 legislation that enacted significant changes to the Public Employees Retirement System (PERS). The PERS legislation, among other things, reduces the earnings credited to certain members' accounts. The initial challenges to the PERS legislation were consolidated and decided by the Oregon Supreme Court in 2005 and the federal courts in 2008.

The PERS legislation, however, also provided a statutory remedy to a prior case filed by the City of Eugene and other public employers. Several cases were filed challenging, among other things, the settlement, the adjustment of crediting to member accounts, and the recovery of over-credited amounts from retirees. The Oregon Supreme Court recently issued opinions in those cases that upheld all but one of the Board's actions. The Court held that it did not have enough information to determine whether transferring \$61 million from a contingency reserve to employer accounts was reasonable and remanded that issue back to the trial court to decide whether the amount of the transfer was consistent with the Board's fiduciary duty.

The most recent actuarial valuations of the PERS system take into account the court decisions in existence when the valuations were completed.

Two state agencies are involved in negotiations related to a confidential, non-judicial mediation process that will result in an allocation of costs associated with the investigation and cleanup of sediment contamination in the Portland Harbor, a ten-mile stretch of the lower Willamette River area that the U.S. Environmental Protection Agency (EPA) has listed as a Superfund site under the federal Superfund law (CERCLA). There are over 200 parties, private companies, and public entities that may eventually be found liable for a share of the costs related to investigation and cleanup of the site.

The Oregon Department of Transportation (ODOT) and the Oregon Department of State Lands (DSL) have received General Notice Letters from the EPA informing them that the State, by and through those agencies, is a potentially responsible party (PRP) under CERCLA for cleanup costs at the site. It is too early in the process to estimate the total amount of the cleanup costs although some parties predict that cleanup costs could be in the \$1 billion range. Also, it is too early to estimate the proportionate share of liability for cleanup costs, if any, that may ultimately be assessed against either of the State agencies. When the mediation will end is not known but it could be as late as 2015.

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The Portland Harbor Superfund will also involve a separate allocation of liability for injuries to natural resources, known as natural resource damages (NRD), caused by contamination at the site. The NRD claim is asserted against all PRPs, including ODOT and DSL, by the Portland Harbor natural resource trustees, a group composed of tribal, federal, and state trustees. The trustees have initiated a cooperative injury assessment process that provides an opportunity for early settlement of the NRD claim. The allocation of liability for this NRD claim is taking place at the same time as the allocation of liability for remedial costs. It is too early to estimate what, if any, share of the liability the State may ultimately bear for natural resource damages.

Another potential risk for the state involves the Superfund law's orphan share obligations. When the EPA negotiates a settlement with the liable parties for the Portland Harbor Superfund, it may agree to pay some portion of the financial responsibility assigned to potentially responsible parties who are insolvent or defunct, and unaffiliated with any other viable liable party (the orphan share). As authorized by the Superfund law, the State may be asked to pay 10 percent of any orphan share payment made by the EPA, plus the costs of continuing operation and maintenance of the orphan site. At this time, whether the State would enter into such an agreement and the amount the State would pay are unknown and will depend on the outcome of negotiations with the EPA.

B. Debt Guarantees

Article XI-K of the Oregon Constitution authorizes the State to guarantee the general obligation bonded debt issued by Oregon school districts, community colleges, and education service districts. The Article authorizes the issuance of state general obligation bonds to satisfy the guarantee. The State has not issued, nor does it expect to issue, any bonds under this authorization. Several other sources of State funds are expected to be used to pay debt service on any defaulting bonds prior to issuing State general obligation bonds for this purpose. As of June 30, 2011, Oregon school districts, community colleges, and education service districts had issued a total of \$3.1 billion of bonds that are guaranteed under these provisions.

C. Unemployment Benefits

State employees who qualify are entitled to benefit payments during periods of unemployment. Each state agency is required to reimburse the Employment Department for benefit payments made to former employees. The amount of future benefit payments to claimants and the resulting liability to the State cannot be reasonably estimated. Consequently, this potential obligation is not reported in the accompanying financial statements. Expenditures relating to these benefits for the year ended June 30, 2011, totaled approximately \$20.4 million.

D. Federal Issues

The State has received federal grants for specific purposes that are subject to review and audit by the grantor agencies. Entitlement to these resources is generally conditional upon compliance with the terms and conditions of grant agreements and applicable federal regulations, including the expenditure of resources for allowable purposes. Any disallowance resulting from a federal audit may become a liability of the State. Institutions of higher education and other state agencies are required to comply with various federal regulations issued by the Office of Management and Budget, if such agencies are recipients of federal grants, contracts, or other sponsored agreements. Certain state agencies may not be in total compliance with these regulations. Failure to comply with these regulations may result in the disallowance of related direct and indirect charges claimed under the grant agreements.

24. SUBSEQUENT EVENTS

A. Long-term Debt Issues

Long-term debt issued, including refundings, since July 1, 2011 (in thousands):

General Obligation Bonds

| | |
|---------------------------------------|------------|
| Department of Administrative Services | \$ 141,635 |
|---------------------------------------|------------|

Revenue Bonds

| | |
|---|-----------|
| Housing and Community Services Department | \$ 18,000 |
|---|-----------|

Loans

| | |
|------------------------------|------------|
| Department of Transportation | \$ 265,270 |
|------------------------------|------------|

B. Bond Calls

Bond calls that have occurred since July 1, 2011 (in thousands):

General Obligation Bonds

| | |
|---|-----------|
| Housing and Community Services Department | \$ 16,290 |
| Department of Veterans' Affairs | 1,025 |

Revenue Bonds

| | |
|---|-----------|
| Housing and Community Services Department | \$ 22,195 |
|---|-----------|

C. Conversions

The Housing and Community Services Department converted \$27 million of New Issue Bond Program escrow bonds from short-term debt to long-term debt.

D. Tax Anticipation Notes Issuance

On July 28, 2011, the State issued \$788 million of full faith and credit Tax Anticipation Notes, 2011 Series A. The proceeds of these notes will be used to meet seasonal cash needs of the State and for cash management purposes within the 2011-2013 biennium.

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E. Debt Guarantees

Under Article XI-K of the Oregon Constitution, \$257.5 million in bonds for school districts were issued and guaranteed following the fiscal year ended June 30, 2011, as noted below (in thousands). Debt service payments remain the ultimate responsibility of the respective district.

| <u>School District</u> | <u>Series</u> | <u>Amount</u> |
|---|---------------|------------------|
| Central Curry County School District | 2011 | \$ 3,150 |
| Crook County School District | 2011 | 1,510 |
| Jackson County School District 4 (Phoenix-Talent) | 2011 | 2,490 |
| Lane County School District 4J (Eugene) | 2011A | 15,870 |
| Lane County School District 4J (Eugene) | 2011B | 15,000 |
| Lane County School District 4J (Eugene) | 2011C | 4,127 |
| Lincoln County Unified School District | 2011A | 48,000 |
| Lincoln County Unified School District | 2011B | 15,000 |
| Multnomah County School District 3 (Parkrose) | 2011A | 48,000 |
| Multnomah County School District 3 (Parkrose) | 2011B | 15,000 |
| Washington County School District 23J (Tigard-Tualatin) | 2011A | 10,004 |
| Washington County School District 23J (Tigard-Tualatin) | 2011B | 10,000 |
| Washington County School District 48J (Beaverton) | 2011 | 42,175 |
| Yamhill County School District 29J (Newberg) | 2011A | 12,140 |
| Yamhill County School District 29J (Newberg) | 2011B | 15,000 |
| Total Debt Guarantees | | <u>\$257,466</u> |

F. Liquidity – Dexia Credit Local

Department of Veterans' Affairs

Effective October 12, 2011, the Department of Veterans' Affairs (ODVA) terminated its Standby Bond Purchase Agreements (SBPAs) with Dexia Credit Local (Dexia). These SBPAs, which in the aggregate totaled \$165.4 million, had provided liquidity support for the Series 83, 84, 85, 86, 87C, 88B, and 90B bonds and were outstanding as of June 30, 2011. Effective October 7, 2011, ODVA, working with the Oregon State Treasury, entered into new SBPAs with U.S. Bank and the Bank of Tokyo-Mitsubishi to provide liquidity support for the affected bonds. The Bank of Tokyo-Mitsubishi SBPA, in the amount of \$79.9 million, provides liquidity support on the Series 83, 84, and 90B bonds and the U.S. Bank SBPA, in the amount of \$85.5 million, provides liquidity support for the Series 85, 86, 87C, and 88B bonds.

In conjunction with the change in liquidity providers, ODVA remarketed the affected bonds described above, which had a total par value outstanding of \$165.4 million. The remarketing occurred on October 7, 2011.

Department of Transportation

Effective November 16, 2011, the Department of Transportation (ODOT) terminated its SBPAs with Dexia. These SBPAs, which in the aggregate totaled \$265.3 million, had provided liquidity support for the Series 2006B and 2007B bonds and were outstanding as of June 30, 2011. Effective November 9, 2011, ODOT, working with the Oregon State Treasury, entered into a new Direct Placement Floating Rate Note with Citigroup Global Markets Inc. to refund the affected bonds.

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APPENDIX C

**INFORMATION RELATING TO THE OREGON
DEPARTMENT OF ENVIRONMENTAL QUALITY**

General

Oregon's history of environmental regulation dates back to 1938 when the Oregon State Sanitary Authority was formed. As a division within the State Board of Health, the Authority was created in response to passage of an initiative petition known as the "Water Purification and Prevention of Pollution Bill." Overwhelmingly approved by Oregon voters in November, 1938, the bill declared a state policy to preserve Oregon waters from pollution. The Sanitary Authority was statutorily replaced in 1969 with the Environmental Quality Commission ("EQC") and the Department of Environmental Quality ("DEQ"). In addition to water quality programs, DEQ was given responsibility for programs pertaining to air quality, hazardous and solid waste, and environmental cleanups. Pursuant to ORS 468.035, DEQ, subject to policy direction of the EQC, is directed, among other things, to encourage voluntary cooperation by the people, municipalities, counties, industries, agriculture, and other pursuits, in restoring and preserving the quality and purity of the air and waters of the State in accordance with the rules and standards established by the EQC and to seek enforcement of the air and water pollution laws of the State.

DEQ also has the authority to provide technical consultation and advisory services to local and state governmental bodies, to cooperate in demonstration programs with local governments and to encourage agencies or industries voluntarily to execute plans for prevention and abatement of pollution. DEQ serves as the State agency responsible for receipt of money from the federal government or other public or private agencies for the purposes of air and water pollution control, hazardous and solid waste, recycling and environmental cleanup.

The EQC is the governing board of DEQ. Five state citizens, appointed by the Governor and confirmed by the Oregon Senate, establish DEQ policy and regulations. Commissioners are appointed for terms of four years.

DEQ administers the Clean Water State Revolving Fund and Orphan-Site Environmental Cleanup programs described below. These programs operate pursuant to policies, guidelines and rules set by the Environmental Quality Commission and the Director of the Department. The following descriptions of these programs reflect the current policies, guidelines and rules of the Department, which are subject to change, including in connection with the issuance of the 2012 Series P Bonds.

Capitalized terms used but not defined in this Appendix C have the meanings given to such terms in the forepart of this Official Statement.

Pollution Control Fund

The Pollution Control Fund was established in 1969 as a fund separate and distinct from the State's general fund.

The proceeds of Article XI-H Pollution Control Bonds are required to be credited to the Pollution Control Fund to be used for certain purposes established by statute, including the following: (a) to grant funds not to exceed 30 percent of total project costs for eligible projects or sewage systems; (b) to acquire certain bonds of any municipal corporation, city, county, or agency of the State; (c) to grant funds (not to exceed 30 percent of the total project costs) for facilities for the disposal of solid waste; (d) to make loans or grants to any municipal corporation, city, county, or agency of the State for sewerage systems or facilities for the disposal of solid waste or for planning of certain eligible projects; (e) to acquire for the

State real property and facilities for the disposal by landfill, storage, incineration or otherwise of solid waste, hazardous waste, or PCB; (f) to dispose of environmentally hazardous wastes whenever DEQ finds that an emergency exists requiring such disposal; (g) to provide funding for the Assessment Deferral Loan Program Revolving Fund; (h) to provide funding for the Orphan Site Account; (i) to advance funds to any municipal corporation or city for facilities or activities related to removal or remedial action of hazardous substances; (j) to provide funding for the Clean Water State Revolving Fund (CWSRF) (statutorily designated as the Water Pollution Control Revolving Fund) either as a grant or an advance; and (k) to fund loans to or buy debt obligations of a public agency that finance the costs of treatment works which are funded in part through the Clean Water State Revolving Fund.

Orphan Site Environmental Cleanup Program

Historically, hazardous substances were often disposed of in ways that are now known to endanger public health and the environment. In order to address the problem of hazardous substances that have been improperly disposed of in the State, the 1987 Legislative Assembly passed the Environmental Cleanup Law. This law established a comprehensive framework for DEQ to identify, investigate and clean up contamination from releases of hazardous substances throughout the State. These wastes can pollute surface and ground water and present serious health threats.

The Oregon Environmental Cleanup Law, along with the federal superfund statute, provides a comprehensive set of laws delineating liability for the costs to clean up contaminated sites. DEQ makes every effort to ensure that the party legally responsible for the contamination pays for cleanup, including reimbursing DEQ's cleanup oversight costs.

The Environmental Cleanup Law authorizes DEQ to oversee investigation and cleanup of contaminated sites by responsible parties. In addition, DEQ itself may conduct environmental investigation and cleanup work. With the exception of the Orphan Site Account discussed below, revenue for environmental cleanup activities has been provided by the following sources: federal grants, a fee on disposal of hazardous waste, recovery of State expenditures from responsible parties and, to a limited extent, the State's general fund.

The program's cleanup task is to find and investigate contaminated sites and ensure their cleanup. The program has identified nearly 5,000 sites where contamination from hazardous releases is suspected or confirmed. (This figure excludes releases from underground storage tanks where petroleum is the sole contaminant). DEQ has determined that approximately 1,600 – or about 1/3 – of these sites require no further investigation or cleanup.

The Environmental Cleanup Law provides a reliable means of financing the investigation and cleanup of "Orphan" sites, i.e., sites that require environmental cleanup where parties causing the contamination are unknown, unwilling, or unable to complete needed cleanup. DEQ has declared 98 sites as orphans since beginning the program in 1989. These include sites that have been cleaned up, those still being cleaned up, and inactive sites that have undergone a partial cleanup.

The Environmental Cleanup Law established three fees (petroleum load, hazardous substance possession and solid waste disposal) for supporting orphan site activities and a process for authorizing the issuance of Article XI-H Pollution Control Bonds for financing orphan site environmental cleanup work. Two of these fees (petroleum loan and hazardous substance possession) were authorized to finance industrial orphan sites and the third fee (solid waste disposal) was established to finance cleanups of solid waste disposal sites.

In 1991, DEQ requested and received approval to activate the Orphan Site Account and collect the associated fees. All of the orphan site Article XI-H Pollution Control Bonds issued to date have been

for cleanup of industrial orphan sites. The petroleum load fee has not been used to fund orphan site cleanups since 1993, when an Oregon Supreme Court ruling cast doubt on the constitutionality of using the fee for other than highway purposes. As a result, the Legislative Assembly has authorized the continued use of the hazardous substance possession fee to service a portion of the debt and has also appropriated general funds to service a portion of the debt on orphan site Pollution Control Bonds.

The hazardous substance possession fee is an annual fee imposed on any person possessing a hazardous substance at facilities in the state in aggregate amounts at or above threshold quantities designated by rule by the State Fire Marshal. Fee schedules are established by the State Fire Marshal. Pursuant to ORS 465.381, deposits to the Orphan Site Account from collected fees cannot exceed \$1 million annually.

Clean Water State Revolving Fund Loan Program

The federal Water Quality Act amendments of 1987 created the state wastewater treatment revolving loan fund program. The primary source of funds for this program is federal capitalization grants and repayments of principal and interest on existing loans. The federal act requires states to match federal dollars with state funds in an amount at least equal to twenty percent of the federal capital grant. DEQ issues General Obligation Pollution Control Bonds for the purpose of the match, which is authorized by the statewide Bond Bill each biennium.

The CWSRF provides below market interest rate loans to public agencies, including counties and municipalities, for three kinds of water pollution abatement projects: wastewater collection, treatment, and disposal systems; nonpoint source water pollution control measures; and implementation of management plans for federally designated estuaries (Tillamook and Lower Columbia River). DEQ issued its first CWSRF loan in 1991, and as of June 30, 2012, has written loans amounting to over \$985 million to 147 Oregon communities.

The proceeds of the Pollution Control Bonds designated for the CWSRF Program will be used to provide a match to approximately \$25 million of federal capitalization grants received by the program in the current 2011-2013 biennium.

Because the capital for the CWSRF Loan Program has been provided primarily by federal Capitalization Grants (80%), most of the current CWSRF loans were, in effect, funded by the federal grants. However, the accumulated interest paid on all of the loans is available for paying the CWSRF portion of the debt service on the CWSRF-related Pollution Control Bonds, including the CWSRF portion of the 2012 Series P Pollution Control bonds.

The CWSRF Program is subject to annual audits by the Oregon Secretary of State and by the U.S. Environmental Protection Agency.

Financial Statements

The financial statements of the Department are currently audited by the Oregon Secretary of State. The most recent audited financial statements for the Department are for the fiscal year ending June 30, 2011. Table 1 provides the assets and liabilities as of that date.

TABLE 1
OREGON DEPARTMENT OF ENVIRONMENTAL QUALITY
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2011
(In Dollars)

| | General | Environmental Management | General Obligation Bond | Total Governmental Funds |
|--|---------------------|-----------------------------|-------------------------------|--------------------------------|
| Assets | | | | |
| Cash and Cash Equivalents | \$ - | \$ 175,111,170 | \$ 1,798,847 | \$ 176,910,017 |
| Cash and Cash Equivalents - Restricted | - | - | - | - |
| Investments | - | - | - | - |
| Investments - Restricted | - | - | - | - |
| Accounts and Interest Receivable (net) | 10,976 | 7,722,579 | - | 7,733,555 |
| Due from State General Fund | 784,572 | - | - | 784,572 |
| Due from Other Funds | 165,347 | 2,275,056 | - | 2,440,403 |
| Due from Other Agencies | - | 274,233 | - | 274,233 |
| Inventories | 459,842 | 1,205,790 | - | 1,665,632 |
| Prepaid Items | 26,225 | 13,389 | - | 39,614 |
| Notes and Other Receivables, net | - | - | - | - |
| Civil Penalties (net) | 283,052 | 856,476 | - | 1,139,528 |
| Loans Receivable (net) | - | 414,269,777 | - | 414,269,777 |
| Total Assets | \$ 1,730,014 | \$ 601,728,470 | \$ 1,798,847 | \$ 605,257,331 |
| Liabilities and Fund Balances | | | | |
| Liabilities: | | | | |
| Accounts Payable | \$ 811,717 | \$ 1,820,501 | \$ - | \$ 2,632,218 |
| Due to Other Funds | 149,178 | 2,291,223 | - | 2,440,401 |
| Due to Other Agencies | - | 3,939,937 | - | 3,939,937 |
| Due to State General Fund | 283,052 | - | - | 283,052 |
| Trust Funds Payable | - | 4,495,236 | - | 4,495,236 |
| Deferred Revenue | - | 7,274,952 | - | 7,274,952 |
| Arbitrage Rebate Payable | - | - | - | - |
| Total Liabilities | 1,243,947 | 19,821,849 | - | 21,065,796 |
| Fund Balances: | | | | |
| Nonspendable | 486,067 | 1,229,179 | - | 1,715,246 |
| Restricted by: | | | | |
| Federal Laws and Regulations | - | 489,614,683 | - | 489,614,683 |
| Oregon Constitution | - | 10,505 | - | 10,505 |
| Enabling Legislation | - | 32,154,011 | - | 32,154,011 |
| Debt Covenants | - | 42,891,121 | 1,798,755 | 44,689,876 |
| Donors and Other External Parties | - | 40,370 | - | 40,370 |
| Committed | - | 15,966,752 | 92 | 15,966,844 |
| Assigned | - | - | - | - |
| Unassigned | - | - | - | - |
| Total Fund Balances | 486,067 | 581,906,621 | 1,798,847 | 584,191,535 |
| Total Liabilities and Fund Balances | \$ 1,730,014 | \$ 601,728,470 | \$ 1,798,847 | \$ 605,257,331 |

SOURCE: Oregon Department of Environmental Quality

Table 2 below is a summary of revenues and expenses of the Department for the most recently completed fiscal year for which audited financial statements are available.

TABLE 2
OREGON DEPARTMENT OF ENVIRONMENTAL QUALITY
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
GOVERNMENTAL FUNDS
For the Year Ended June 30, 2011
(In Dollars)

| | General | Environmental Management | General Obligation Bond | Total Governmental Funds |
|--|---------------------|-----------------------------|-------------------------------|--------------------------------|
| Revenues: | | | | |
| Licenses and Fees | \$ - | \$ 39,192,204 | \$ - | \$ 39,192,204 |
| Federal Grants | - | 57,751,196 | - | 57,751,196 |
| Interest on Investments | - | 14,491,550 | 9,285 | 14,500,835 |
| Charges for Services | - | 8,840,399 | - | 8,840,399 |
| Other Revenue | 165 | 718,706 | - | 718,871 |
| Civil Penalties | 567,754 | 141,459 | - | 709,213 |
| Total Revenues | 567,919 | 121,135,514 | 9,285 | 121,712,718 |
| Expenditures: | | | | |
| Personal Services | 8,197,642 | 50,163,883 | - | 58,361,525 |
| Services and Supplies | 3,627,210 | 19,753,706 | - | 23,380,916 |
| Special Payments | 93,182 | 14,090,174 | - | 14,183,356 |
| Capital Outlay | 59,368 | 401,793 | - | 461,161 |
| Debt Service: | | | | |
| Principal - Bonds | 1,820,000 | - | 2,365,000 | 4,185,000 |
| Interest - Bonds | 626,590 | - | 1,157,378 | 1,783,968 |
| Total Expenditures | 14,423,992 | 84,409,556 | 3,522,378 | 102,355,926 |
| Excess (Deficiency) of Revenues Over Expenditures | (13,856,073) | 36,725,958 | (3,513,093) | 19,356,792 |
| Other Financing Sources (Uses): | | | | |
| Transfers In (Operating) | - | 16,857,995 | 3,522,286 | 20,380,281 |
| Transfers Out (Operating) | (1,593,896) | (18,699,444) | - | (20,293,340) |
| Transfers In (Other Agencies) | - | 6,315,128 | - | 6,315,128 |
| Transfers Out (Other Agencies) | - | (404,246) | - | (404,246) |
| Transfers Out (State General Fund) | (567,919) | - | - | (567,919) |
| Long-Term Debt Issued | - | 4,945,000 | - | 4,945,000 |
| Debt Issuance Premium | - | 54,874 | - | 54,874 |
| Debt Issuance Cost | - | (101,038) | - | (101,038) |
| State Appropriations | 15,935,719 | - | - | 15,935,719 |
| Total Other Financing Sources (Uses) | 13,773,904 | 8,968,269 | 3,522,286 | 26,264,459 |
| Net Change in Fund Balances | (82,169) | 45,694,227 | 9,193 | 45,621,251 |
| Fund Balances - Beginning | 385,621 | 536,005,485 | 1,789,654 | 538,180,760 |
| Change in Reserve for Inventories | 182,615 | 206,909 | - | 389,524 |
| Fund Balances - Ending | \$ 486,067 | \$ 581,906,621 | \$ 1,798,847 | \$ 584,191,535 |

SOURCE: Oregon Department of Environmental Quality

Investment of DEQ Funds

The State Treasurer is responsible for investing all moneys of the Department, which as of June 30, 2012, totaled approximately \$208 million. Department moneys are invested in the Oregon Short Term Fund. The investment policy of the State Treasurer for the Oregon Short Term Fund is described under APPENDIX A—"GENERAL INFORMATION RELATING TO THE STATE OF OREGON—STATE OF OREGON INVESTMENT POLICIES."

APPENDIX D

FORM OF BOND COUNSEL OPINION

On the date of issuance of the Bonds, Hawkins Delafield & Wood LLP, Bond Counsel, proposes to issue its approving opinions in substantially the following form:

_____, 2012

Oregon State Treasury
350 Winter Street N.E., Suite 100
Salem, Oregon 97301

Oregon Department of Environmental Quality
811 S.W. Sixth Avenue
Portland, Oregon 97204

Subject: \$_____ State of Oregon General Obligation Bonds, 2012 Series P (Pollution Control Projects)

We have acted as bond counsel in connection with the issuance by the State of Oregon (the "State") of its General Obligation Bonds, 2012 Series P (Pollution Control Projects) (the "2012 Series P Bonds") that are dated _____, 2012 and are in the aggregate principal amount of \$_____. The 2012 Series P Bonds are issued pursuant to Article XI-H of the Oregon Constitution, Oregon Revised Statutes Chapters 286A and 470, as amended, resolutions of the Environmental Quality Commission of the State adopted on December 16, 2011 and August 24, 2012 (collectively, the "Resolutions"), and an Issuance Certificate of the State Treasurer dated the date of issuance of the 2012 Series P Bonds (the "Issuance Certificate").

We have examined the law and such certified proceedings and other documents as we deem necessary to render this opinion.

We have not been engaged or undertaken to review the accuracy, completeness or sufficiency of the official statement or other offering material relating to the 2012 Series P Bonds, and we express no opinion relating thereto, excepting only the matters set forth as our opinion in the official statement.

Regarding questions of fact material to our opinion, we have relied on representations of the State in the Issuance Certificate and in the certified proceedings and on other certifications of public officials and others furnished to us without undertaking to verify the same by independent investigation.

Based on the foregoing, we are of the opinion that, under existing law:

1. The 2012 Series P Bonds are legally authorized, sold and issued under and pursuant to the Constitution and Statutes of the State of Oregon, the Resolutions and the Issuance Certificate, and constitute valid and legally binding obligations of the State.

2. The 2012 Series P Bonds are general obligations of the State, and the full faith and credit and taxing power of the State are pledged for the payment of principal and interest on the 2012 Series P Bonds when due. The ad valorem taxing power of the State is pledged to pay the 2012 Series P Bonds.

3. Under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described below, (i) interest on the 2012 Series P Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) interest on the 2012 Series P Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. [Bond counsel further is of the opinion that, for any 2012 Series P Bonds having original issue discount (a "Discount Bond"), original issue discount that has accrued and is properly allocable to the owners of the Discount Bonds under Section 1288 of the Code is excludable from gross income for Federal income tax purposes to the same extent as other interest on the 2012 Series P Bonds.] In rendering our opinion, we have relied on certain representations, certifications of fact, and statements of reasonable expectations made by the State, and others in

connection with the 2012 Series P Bonds, and we have assumed compliance by the State and others with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the 2012 Series P Bonds from gross income under Section 103 of the Code.

The Code establishes certain requirements that must be met subsequent to the issuance and delivery of the 2012 Series P Bonds in order that, for Federal income tax purposes, interest on the 2012 Series P Bonds not be included in gross income pursuant to Section 103 of the Code. These requirements include, but are not limited to, requirements relating to the use and expenditure of 2012 Series P Bond proceeds, restrictions on the investment of 2012 Series P Bond proceeds prior to expenditure and the requirement that certain earnings be rebated to the Federal government. Noncompliance with such requirements may cause interest on the 2012 Series P Bonds to become subject to Federal income taxation retroactive to their date of issue, irrespective of the date on which such noncompliance occurs or is ascertained.

On the date of delivery of the 2012 Series P Bonds, the State will execute a Tax Certificate (the "Tax Certificate") containing provisions and procedures pursuant to which such requirements can be satisfied. In executing the Tax Certificate, the State covenants that it will comply with the provisions and procedures set forth therein and comply with any other requirements of the Code necessary to assure that interest paid on the 2012 Series P Bonds will, for Federal income tax purposes, be excluded from gross income.

In rendering the opinion in paragraph 3 hereof, we have relied upon and assumed (i) the material accuracy of the representations, statements of intention and reasonable expectation, and certifications of fact contained in the Tax Certificate with respect to matters affecting the status of interest paid on the 2012 Series P Bonds, and (ii) compliance by the State with the procedures and covenants set forth in the Tax Certificate as to such tax matters.

4. Interest on the 2012 Series P Bonds is exempt from Oregon personal income tax.

Except as stated in paragraphs 3 and 4 above, we express no opinion as to any other Federal, state or local tax consequences arising with respect to the 2012 Series P Bonds or the ownership or disposition thereof. We render our opinion under existing statutes and court decisions as of the issue date, and we assume no obligation to update, revise or supplement this opinion after the issue date to reflect any action hereafter taken or not taken, or any facts or circumstances, or any change in law or in interpretations thereof, or otherwise, that may hereafter arise or occur, or for any other reason. Furthermore, we express no opinion herein as to the effect of any action hereafter taken or not taken in reliance upon an opinion of counsel other than ourselves on the exclusion from gross income for Federal income tax purposes of interest on the 2012 Series P Bonds.

The portion of this opinion that is set forth in paragraph 1, above, is qualified only to the extent that enforceability of the 2012 Series P Bonds may be limited by or rendered ineffective by (i) bankruptcy, insolvency, fraudulent conveyance, reorganization, moratorium and other similar laws affecting creditors' rights generally; (ii) the application of equitable principles and the exercise of judicial discretion in appropriate cases; (iii) common law and statutes affecting the enforceability of contractual obligations generally; (iv) principles of public policy concerning, affecting or limiting the enforcement of rights or remedies against governmental entities such as the State.

This opinion is given as of the date hereof and is based on existing law, and we assume no obligation to update, revise, or supplement this opinion to reflect any action hereafter taken or not taken, or any facts or circumstances that may hereafter come to our attention or any changes in law or interpretations thereof that may hereafter arise or occur, or for any other reason.

This opinion is limited to matters of Oregon law and applicable Federal law, and we assume no responsibility as to the applicability of laws of other jurisdictions.

This opinion is provided to you as a legal opinion only, and not as a guaranty or warranty of the matters discussed herein. No opinions may be inferred or implied beyond the matters expressly stated herein. No

qualification, limitation or exception contained herein shall be construed in any way to limit the scope of the other qualifications, limitations and exceptions. For purposes of this opinion, the terms “law” and “laws” do not include unpublished judicial decisions, and we disclaim the effect of any such decision on this opinion.

We have served as bond counsel only to the State in connection with the 2012 Series P Bonds and have not represented and are not representing any other party in connection with the 2012 Series P Bonds. This opinion is given solely for the benefit of the State in connection with the 2012 Series P Bonds and may not be relied on in any manner or for any purpose by any person or entity other than the State, the owners of the 2012 Series P Bonds, and any person to whom we may send a formal reliance letter indicating that the recipient is entitled to rely on this opinion.

Very truly yours,

APPENDIX E

FORM OF CONTINUING DISCLOSURE CERTIFICATE

CONTINUING DISCLOSURE CERTIFICATE

§ _____
STATE OF OREGON
GENERAL OBLIGATION BONDS, 2012 SERIES P
(POLLUTION CONTROL PROJECTS)

This Continuing Disclosure Certificate (the “Certificate”) is executed and delivered by the State of Oregon, acting by and through the State Treasurer (the “State”) at the request of the State Department of Environmental Quality (collectively, the “Issuer”) in connection with the issuance of its General Obligation Bonds, 2012 Series P (Pollution Control Projects) (the “Securities”), which are in the aggregate principal amount of \$ _____. The Securities are being issued pursuant to an Issuance Certificate of the State Treasurer dated the date of delivery of the Securities (the “Issuance Certificate”). The Issuer covenants as follows:

Section 1. Purpose of Certificate. This Certificate is being executed and delivered by the Issuer for the benefit of registered and beneficial holders of the Securities and to assist the underwriters of the Securities in complying with paragraph (b)(5) of Securities and Exchange Commission Rule 15c2-12 (17 C.F.R. § 240.15c2-12) (the “Rule”).

Section 2. Annual Financial Information. The State, as the “obligated person” for purposes of the Rule, hereby agrees to provide or cause to be provided at least annually to the Municipal Securities Rulemaking Board (the “MSRB”), the financial information regarding the State of the type set forth (i) in Tables 11, 12, 13, 14, 15, 16, 18, 19, 20, 21, 24, 25, 26, and 27 of Appendix A “General Information Relating to the State of Oregon” of the official statement dated _____, 2012 (the “Official Statement”), and (ii) in the Basic Financial Statements for the State for the Year Ended June 30, 2011 (which are presented in Appendix B of the Official Statement in audited form).

The annual financial information described above will be available no later than nine months after the end of the preceding fiscal year, beginning with the State’s fiscal year ending June 30, 2012. Such information will include audited financial statements prepared in accordance with generally accepted accounting principles as established by the Government Accounting Standards Board as in effect from time to time; provided, however, that if audited financial statements are not available within nine months after the end of the preceding fiscal year, unaudited financial statements will be provided with audited financial statements to follow when available.

Certain items of annual financial information may be provided by way of cross-reference to other documents previously provided to the MSRB.

Section 3. Material Events. The State agrees to provide or cause to be provided to the MSRB in a timely manner not in excess of ten business days after the occurrence of the event, notice of any of the following events with respect to the Securities:

- (a) Principal and interest payment delinquencies;
- (b) Non-payment related defaults, if material;
- (c) Unscheduled draws on debt service reserves reflecting financial difficulties;

- (d) Unscheduled draws on credit enhancements reflecting financial difficulties;
- (e) Substitution of credit or liquidity providers or their failure to perform;
- (f) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the Security;
- (g) Modifications to the rights of Security holders, if material;
- (h) Bond calls, if material, and tender offers;
- (i) Defeasances;
- (j) Release, substitution or sale of property securing repayment of the Securities, if material;
- (k) Rating changes;
- (l) Bankruptcy, insolvency, receivership or similar event of the obligated person; (Note: For the purposes of the event identified in this paragraph (l), the event is considered to occur when any of the following occur: The appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the United States Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.);
- (m) The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material;
- (n) Appointment of a successor or additional trustee or the change of name of a trustee, if material.

The State may from time to time choose to provide notice of the occurrence of certain other events, in addition to those listed above, if, in the judgment of the State, such other event is material with respect to the Securities, but the State does not undertake any commitment to provide such notice of any event except those events listed above.

Section 4. Failure to File Annual Financial Information. The State agrees to provide or cause to be provided, in a timely manner, to the MSRB, notice of a failure by the State to provide the annual financial information described in Section 2 above on or prior to the time set forth in Section 2.

Section 5. Dissemination Agent. The State may, from time to time, engage or appoint an agent to assist the State in disseminating information hereunder (the “Dissemination Agent”). The State may discharge any Dissemination Agent with or without appointing a successor Dissemination Agent.

Section 6. Termination of Obligations. Pursuant to paragraph (b)(5)(iii) of the Rule, the State’s obligation to provide annual financial information and notice of material events, as set forth above, shall terminate if and when the State no longer remains an obligated person with respect to the Securities or upon either the prepayment in full of the Securities or the legal defeasance of the Securities. In addition, and notwithstanding the provisions of Section 8 below, the State may rescind its obligations under this Certificate, in whole or in part, if (i) the State obtains an opinion of nationally recognized bond counsel that those portions of the Rule that required the execution and delivery of this Certificate are invalid, have been repealed, or otherwise do not apply to the Securities, and (ii) the State notifies and provides the MSRB a copy of such legal opinion.

Section 7. Enforceability and Remedies. The State agrees that this Certificate is intended to be for the benefit of registered and beneficial holders of the Securities and shall be enforceable by or on behalf of any such holder; provided that, the right of any certificate holder to challenge the adequacy of the information furnished hereunder shall be limited to an action by or on behalf of holders representing at least twenty-five percent (25%) of the aggregate outstanding principal amount represented by the Securities. Any failure by the State to comply with the provisions of this undertaking shall not be an event of default under the Issuance Certificate, any other documents executed in relation to the Securities or the Securities. This Certificate confers no right, on any person or entity other than the State, holders of the Securities, and any Dissemination Agent.

Section 8. Amendment. The State may amend this Certificate without the consent of holders of the Securities under the following conditions:

- (a) The amendment may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the obligated person or type of business conducted;
- (b) This Certificate, as amended, would have complied with the requirements of the Rule at the time of the original issuance of the Securities, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and
- (c) The amendment does not materially impair the interest of holders of the Securities, as determined either by parties unaffiliated with the State (such as nationally recognized bond counsel), or by approving vote of holders representing at least sixty percent (60%) of the aggregate outstanding principal amount represented by the Securities, as applicable.

The State shall provide to the MSRB notice of any amendment that changes the accounting principles followed by the State in preparation of its annual financial information. The initial annual financial information after the amendment shall explain, in narrative form, the reasons for the amendment and the effect of the change in the type of operating data or financial information being provided.

Section 9. Form of Information. All information required to be provided under this certificate will be provided in an electronic format as prescribed by the MSRB and with the identifying information prescribed by the MSRB.

Section 10. Submitting Information Through EMMA. So long as the MSRB continues to approve the use of the Electronic Municipal Market Access (“EMMA”) continuing disclosure service, any information required to be provided to the MSRB under this Certificate may be provided through EMMA. As of the date of this Certificate, the web portal for EMMA is emma.msrb.org.

Section 11. Choice of Law. This Certificate shall be governed by and construed in accordance with the laws of the State of Oregon without regard to principles of conflicts of laws, provided that to the extent this Certificate addresses matters of federal securities laws, including the Rule, this Certificate shall be construed in accordance with such federal securities laws and official interpretations thereof.

Section 12. Counterparts. This Certificate may be executed in several counterparts, each of which shall be an original and all of which shall constitute one instrument.

Dated as of the _____ day of _____ 2012.

**Office of the State Treasurer,
State of Oregon**

Authorized Officer

Oregon Department of Environmental Quality

Authorized Officer

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APPENDIX F

DESCRIPTION OF DTC AND ITS BOOK-ENTRY SYSTEM

The Depository Trust Company (“DTC”), New York, NY, will act as securities depository for the 2012 Bonds. The 2012 Bonds will be issued as fully registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered certificate will be issued for each series of the 2012 Bonds, each in the aggregate principal amount of such series, and will be deposited with DTC.

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has a Standard & Poor’s rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of 2012 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2012 Bonds on DTC’s records. The ownership interest of each actual purchaser of each 2012 Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the 2012 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the 2012 Bonds, except in the event that use of the book-entry system for the 2012 Bonds is discontinued.

To facilitate subsequent transfers, all 2012 Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of 2012 Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 2012 Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such 2012 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of 2012 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the 2012 Bonds, such as prepayments, tenders, defaults, and proposed amendments to the security documents relating to the 2012 Bonds. For example, Beneficial Owners of 2012 Bonds may wish to ascertain that the nominee holding the 2012 Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Certificate Registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the 2012 Bonds within a series are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to 2012 Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the State as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts 2012 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments represented by the 2012 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State or the Fiscal Agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Fiscal Agent, or the State, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State or the Fiscal Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the 2012 Bonds at any time by giving reasonable notice to the State or the Fiscal Agent. Under such circumstances, in the event that a successor depository is not obtained, certificates are required to be printed and delivered.

To the extent permitted by law, the State may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, certificates will be printed and delivered to DTC.

THE ABOVE INFORMATION CONCERNING DTC AND DTC'S BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE STATE BELIEVES TO BE RELIABLE, BUT THE STATE TAKES NO RESPONSIBILITY FOR THE ACCURACY THEREOF. NEITHER THE STATE NOR THE FISCAL AGENT WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO PARTICIPANTS OR THE PERSONS FOR WHOM THEY ACT AS NOMINEES OR BENEFICIAL OWNERS WITH RESPECT TO DTC'S RECORD KEEPING, PAYMENTS BY DTC OR PARTICIPANTS, NOTICES TO BE DELIVERED BY DTC, OR ANY OTHER ACTION TAKEN BY DTC AS REGISTERED OWNER OF THE 2012 BONDS.

So long as Cede & Co. is the registered owner of the 2012 Bonds, as nominee for DTC, references herein to the holders or registered owners of the 2012 Bonds (other than under the caption "TAX MATTERS") shall mean Cede & Co., as aforesaid, and shall not mean the Beneficial Owners of the 2012 Bonds. When reference is made to any action, which is required or permitted to be taken by the Beneficial Owners, such reference shall only relate to those permitted to act (by statute, regulation or otherwise) on behalf of such Beneficial Owners for such purposes. When notices are given the State or the Fiscal Agent shall send them to DTC only.

For every transfer and exchange of the 2012 Bonds, the Beneficial Owner may be charged a sum sufficient to cover any tax, fee or other governmental charge that may be imposed in relation thereto.

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