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CREDIT OPINION
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Oklahoma City (City of) OK

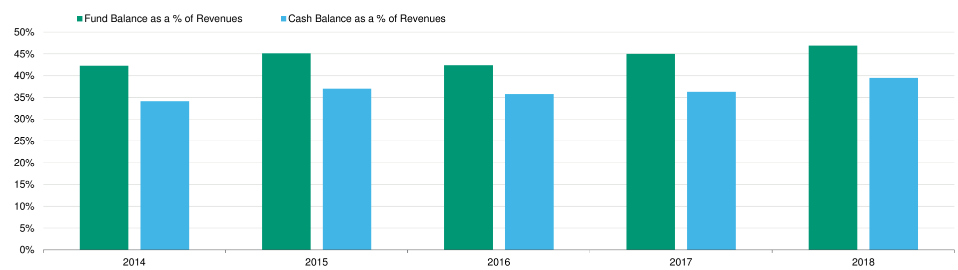
Update following Aaa affirmation of GOULT/GOLT; outlook revised to stable

Summary

The City of Oklahoma City, OK's (Aaa stable) credit profile is anchored by a large and stable regional economy and tax base that is heavily influenced by government agencies and several corporations in the energy sector. The city's economy has remained relatively unharmed by low oil prices that have become the norm in the energy sector. Importantly, the city's financial profile has remained favorable despite some draws within the past four years, and recent audited financial results reflect strong operating performance, a testament to sustained improvement in key financial and economic indicators. These indicators have resulted in significant revenue growth, although the city's financial profile remains vulnerable to economic cycles because of a high reliance on sales taxes. Debt levels are moderate and should remain affordable. The city's pension profile is manageable with a history of strong contributions to single employer plans.

On January 30, we affirmed the city's Aaa general obligation unlimited tax (GOULT) and limited tax (GOLT) ratings, and the Aa2 rating in related annual appropriation ratings. We also revised the outlook to stable from negative.

Exhibit 1
High level of liquid operating reserves maintained



Source: City of Oklahoma City, OK Comprehensive Annual Financial Reports FY 2014 - 2018

Credit strengths

» Large and regional economy anchored by government employment; sizeable tax base

» Improved sales tax collections contributing to strong operating performance; high level of reserves

» Steady economic performance; year-over-year change in employment remains positive

- History of voter support for key initiatives; voters approved an almost $1 billion bond package and a sales tax rate increases
- Healthy funding ratios for pension plans inclusive of state support; city's charter mandates city contribution at 100% of actuarial requirements

Credit challenges

- High dependence on sales taxes which are the largest source of revenues at over 50%
- Revenue raising flexibility is restricted by requirement of voter approval
- Moderately high fixed costs can constrain expenditure reduction

Rating outlook

The revision to stable outlook reflects management's ability to navigate challenging financial times evident by the maintenance of a high level of reserves. It also reflects marked operating improvement in fiscal 2018 allowing the city to achieve a sizeable surplus within its main operating fund, in spite of a budget that reflected a draw. This achievement reflects, in part, the broader improved economic and financial climate as well as an increase in the sales tax rate. Management's continued ability to navigate weak economic or financial cycles while maintaining strong credit fundamentals will be key to maintaining the rating and outlook.

Factors that could lead to an upgrade

- Not applicable

Factors that could lead to a downgrade

- Inability to manage through periods of economic or financial stress that results in weakened credit fundamentals
- Economic contraction
- Decreased revenues resulting in decreased in reserves
- Substantial increases in debt levels absent corresponding tax base growth

Key indicators

Exhibit 2

Oklahoma City (City of) OK	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value ($000)	$41,963,614	$43,956,071	$46,336,461	$48,800,765	$50,815,189
Population	600,729	610,672	620,015	653,000	661,000
Full Value Per Capita	$69,854	$71,980	$74,734	$74,733	$76,876
Median Family Income (% of US Median)	89.4%	90.9%	91.1%	91.1%	91.1%
Finances					
Operating Revenue ($000)	$486,503	$494,607	$490,855	$476,808	$527,078
Fund Balance ($000)	$205,745	$223,002	$207,882	$214,326	$247,238
Cash Balance ($000)	$165,892	$182,805	$175,897	$173,032	$208,224
Fund Balance as a % of Revenues	42.3%	45.1%	42.4%	45.0%	46.9%
Cash Balance as a % of Revenues	34.1%	37.0%	35.8%	36.3%	39.5%
Debt/Pensions					
Net Direct Debt ($000)	$704,846	$776,871	$815,566	$853,051	$886,568
3-Year Average of Moody's ANPL ($000)	N/A	$652,355	$791,412	$1,074,357	$1,166,183
Net Direct Debt / Full Value (%)	1.7%	1.8%	1.8%	1.7%	1.7%
Net Direct Debt / Operating Revenues (x)	1.4x	1.6x	1.7x	1.8x	1.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	1.5%	1.7%	2.2%	2.3%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	1.3x	1.6x	2.3x	2.2x

Financial information reflects the general and debt service funds
Source: City of Oklahoma City, OK Comprehensive Annual Financial Reports FY 2014 - 2018, Moody's Investors Service

Profile

The City of Oklahoma City is the state's capital and largest city within the state. The city serves as a regional center for the area, with energy/resources, and defense being the main economic indicators. The current estimated population is 620,015.

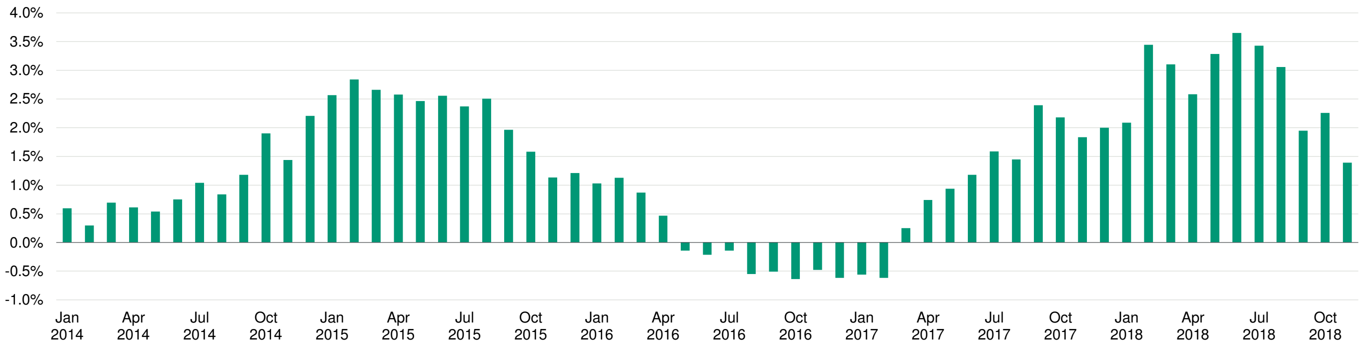
Detailed credit considerations

Economy and tax base: steady local economy, assessed valuation growth remains solid

Oklahoma City's steady economic performance will continue over the next two to three years, supported by persistent employment growth and residential and commercial demand. Oklahoma City is the largest metropolitan area in the state with a population of over 600,000 residents. The local economy is a regional powerhouse anchored largely by defense and energy employers, although education and health care are also key contributions. In spite of energy sector related challenges that stymied growth a few years ago, the city's economy has returned to persistent growth in employment (see Exhibit 3). A resurgency in energy related activities as well as continued growth in other sectors drove increases in labor force participation with the labor force reaching a high of 320,867 in September 2018. Also in September 2018, the total number employed in the city peaked at 311,703 allowing the unemployment rate to fall to a low 2.9%. Within the forseeable future, the city will remain vulnerable to the energy sector. However, the ability of energy companies to adapt to external factors, as proven with adjustments despite low oil prices, as well stabilizing forces from nonenergy sectors, should contribute to stable performance over the next three to five years.

Exhibit 3

Year over year change in Oklahoma City's employment has remained positive since March 2017



Source: US Bureau of Labor Statistics

The city's exposure to the recently ended federal shutdown was minor and not expected to hinder longer term prospects. Within Oklahoma County[1], federal workers (civilian and military) account for a modest 5.8% of total employment in 2016 per the Bereau of Economic Analysis. The largest employer in the metropolitan area is Tinker Air Force Base with over 24,000 employees, and serves a critical role in military aviation and logistics.

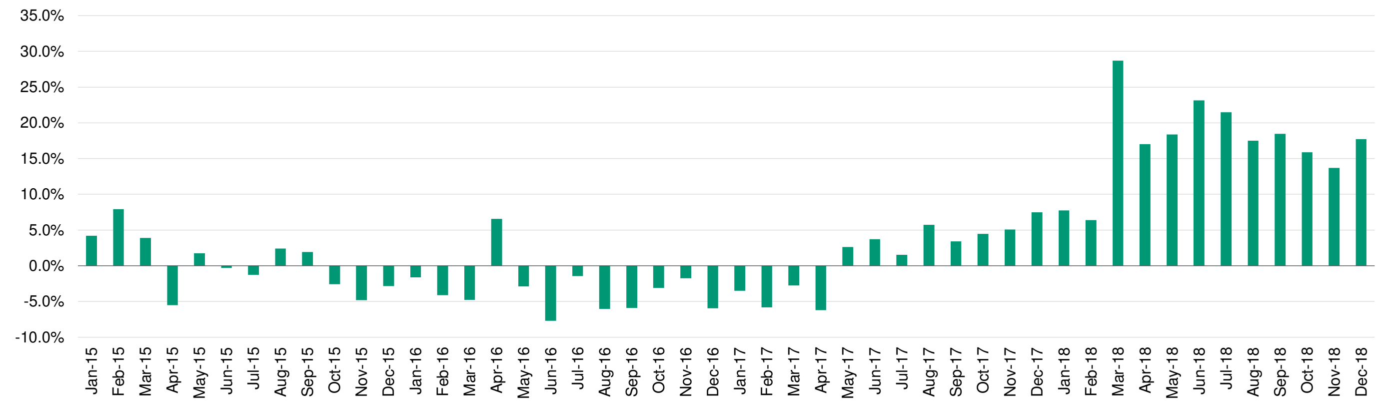
In tandem with stable economic performance, assessed valuation growth is steady with an annual average increase of 4.7% over the past five years. In fiscal 2018, values increased 3.8% to $5.9 billion, or a corresponding $50.8 billion. City officials report that fiscal 2019 recorded a 3.8% increase. Ongoing construction as well as sustained demand for residential and commercial projects should continue to drive tax base growth. Due to sizeable institutional presence, income indicators within the city are low compared to peers but have increased modestly and steadily since the 2010 census. In 2016 the median family income was equal to 91.1% of the nation.

Financial operations and reserves: fiscal 2018 reflects a return to surplus operations

The city's financial position should remain stable over the next two to three years supported by continued improvement in sales tax growth, relatively new revenue enhancements and stable economic factors. Fiscal 2018, which ended on June 30, 2018, marked a return to surplus operations, following a two year period of draws. In fiscal 2016 and 2017, the city utilized draws ($25.4 million total within the general fund) to make up for revenue shortfalls, a direct result of lackluster sales tax performance because of falling economic indicators related to an underperforming energy sector. During that period, sales taxes had consistently declined between October 2015 through April 2017, with the one exception in April 2016. Although the city made several budget cuts, implemented expenditure controls and pulled back on other cost initiatives, the combined effort was not able to offset the falling tax receipts because the city also pursued some capital initiatives during the period.

Audited results for fiscal 2018 reflected a $27.1 million surplus in the general fund, allowing the total general fund to reach $142 million (32.4% of general fund revenues), with $134.5 million (30% of general fund revenues) available. The increase was due in part to a sales tax rate increase which city officials estimate accounted for 52.7% of the surplus.[2]The results are more favorable than the $2 million general fund draw that was adopted at the start of the year benefiting from strong revenue performance. Sales taxes, the city's largest revenue source at over 50% of general fund revenues, recorded a staggering 17.7% increase over the prior year (see Exhibit 4). At the end of the year, the city's total operating fund balance (general and debt service fund) was $254.8 million (48.3% of operating revenues) with $247.2 million (46.9%) available.

Exhibit 4
Oklahoma City sales tax collections have recorded double digit growth for 10 straight months



Source: City of Oklahoma City, OK

In fiscal 2019, the city adopted a balanced budget for the general fund. Sales tax revenues were projected to grow by a total of 11% reflecting a 3% increase on the base, and the remaining increase from the new 0.25% sales tax rate. Including all other revenues, the city is projecting an 11% increase in revenues. General fund expenditures are also projected to increase by 9.8% over the prior year, as the city looks to restore some costs that were eliminated or reduced within the prior years. Since the start of the fiscal year and through November 2018, city officials report that the budget is performing better than anticipated. Total revenues surpassed expenditures by $6 million and this figure will likely grow by fiscal year end. Specifically for sales taxes and through January, city officials report that sales taxes are up 4.5% on the base, and 17.5% overall when considering the new taxes. By fiscal year end, city officials expect strong operating performance allowing the city's financial position to remain favorable.

LIQUIDITY

In tandem with the operating performance, the general fund net cash improved to $96.9 million (22.1% of general fund revenues) at fiscal year end 2018. Including the debt service fund, total operating cash was $208.2 million (39.5% of operating revenues).

Debt and pensions: affordable debt and pensions; moderate fixed cost pressure

The city's debt profile will likely increase modestly in the next three to five years based on projections of planned debt issuance. However, the debt profile is expected to remain affordable because of a growing tax base and the city's ability to access additional property tax receipts to service bond holders. As of fiscal year end 2018, the city's direct debt burden was 2.1% (2.6% overall) on a fiscal 2018 assessed valuation. The city has $44.4 million in authorized unissued debt from the 2007 election, and $893.4 million authorized but unissued from the November 2017 election. City officials anticipate issuing debt annually (between $90 and $150 million) until the authorization is exhausted. Principal payment is moderate with 72.3% repaid in 10 years; all debt retired in 20 years.

The city's total debt service levy in fiscal 2018 was $14.24 per $1,000 of assessed values. Of the total, approximately $1 was levied for the limited tax debt, well below the $5 maximum. The remaining tax rate is not subject to any limitation.

DEBT STRUCTURE

Included in the debt profile is $779.3 million in GOULT debt, $56.7 million in GOLT debt, annual appropriation debt of about $298 million, as well as notes payable and capital leases.

The lack of distinction between the city's GOULT and GOLT ratings reflect sizeable headroom under the limitation allowing sufficient capacity to service bond holders. The GOLT debt is subject to a $5 per $1,000 of assessed value maximum tax rate. In fiscal 2018, the city levied a total property tax rate of $14.24, with about $1 for the GOLT bonds. Comparing the maximum annual debt service (MADS) to the allowable maximum levy, the city maintains headroom of 373%.

The city intends that the annual appropriation debt will be self supporting from other revenue sources. Annual appropriation debt includes about $252.9 million for economic development projects, $20 million in parking bonds and $12 million in golf bonds. The two notch distinction from the city's Aaa GOULT rating and the Aa2 appropriation ratings reflects the city's commitment which is subject to annual appropriation, and the lack of essentiality of the related projects (economic development). There are four Aa2 ratings on the

Devon Tax Increment Financing #8, parking bonds, TIF #2, and convention center projects. The city's commitment is to make debt service payments from legally available revenues if allocated revenues are unavailable or insufficient. The city also commits to replenish the debt service reserve in the event it is tapped in all instances except for the convention center debt. The ratings also considers the city's plan to repay the debt from other non-general fund sources, and the availability of a debt service reserve equal to the lesser of the standard three prong test in all debt instances except for the convention center debt. There is no debt service reserve on the convention center debt. Combining all appropriation debt issues, the MADS of $26.3 million is slated for fiscal 2025, which is about 6% of fiscal 2018 general fund revenues, or 18.5% of the fiscal 2018 general fund balance.

DEBT-RELATED DERIVATIVES

The city's general government doe not have any privately placed debt issues and is not party to any derivative agreements.

PENSIONS AND OPEB

The city participates in four retirement systems. There are two single employee plans including The Central Oklahoma Transportation and Parking System (COTPA) Employee Retirement Trust, and Oklahoma City Employee Retirement System. There are also two multi-employer cost sharing plans including the Oklahoma Firefighters Pension and Retirement System, and Oklahoma Police Pension and Retirement System. The city has a strong history of meeting its annually required contribution in both the municipal and parking employee plans. Contributions in the public safety plan are based on statutory requirements.

In fiscal 2018, the city's reported unfunded liabilities for all four plans was approximately $324.7 million. Moody's adjusted net pension liability (ANPL) for the city, under our methodology for reporting pension data, was $1.2 billion (2.4 times operating revenues), net of self-supporting contributions from various city funds. The three year average ANPL to operating revenues was moderate at 2.2 times or 2.3% of full values. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported contribution information, or the reported liability Information for the statewide cost sharing plans, but to improve comparability with other credit entities.

For fiscal 2018, the city recognized total pension contributions of approximately $60.5 million. These include payments from the state which totaled $33.3 million for the public safety plans. The contributions are also net of self-supporting contributions from various city funds.

The city's fiscal 2018 contribution rate was more than the Moody's calculated “tread water” level of approximately $50.1 million. The tread water indicator is the level at which Moody's has determined the funding must be maintained to prevent unfunded liabilities from growing, under reported assumptions.

The city provides other post employment benefits (OPEB) in the form of medical benefits to employees. The city has made some changes to the benefit including increasing the eligibility age, and or service retirement. Additionally, all employees hired on or after January 1, 2017 are not eligible for subsidies from the city for retiree health care coverage. Contributions into the plan are currently made on a pay as you go basis. In fiscal 2018, the city contributed $14.6 million (57.9% of the annual OPEB required contribution).

Fixed costs including pensions, debt service (net of support from the utility fund) and other post employment benefits (OPEB) totaled $161.1 million, a high 30.6% of operating revenues in fiscal year 2018. However, 20.7% of the costs are supported by the state. Considering the state contributions, costs are 24.5% of operating revenues.

Management and governance: stable management team demonstrates prudent financial practices

Oklahoma Cities have an Institutional Framework score of A, which is moderate. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. Sales taxes, the sector's major revenue source are subject to a cap which can be overridden with voter approval only. The cap, which varies by city, limits revenue-raising ability. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Oklahoma is a Right to Work state, providing significant expenditure-cutting ability. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

The management team has exhibited an ability to manage through weak economic and financial cycles, a key considerating in the credit profile. Some of the strategies employed include a willingness to adjust budgets and more recently approach voters for an increase in the sales tax rate which was approved. A combination of these strategies were on display during the most recent period of economic stress and allowed the city's financial profile to remain stable in spite of revenue loss. Management's ability to continue to preserve strong credit fundamentals in challenging times will be key in maintaining the credit profile in the future.

In addition, the city demonstrates good governance by active management of sales tax trends including weekly budget monitoring, and internal reporting with monthly updates to City Council for sales tax collection. The city utilizes a five year forecasting model for economic and financial planning and also consults with an outside economist for state and global indicators that will impact their local economic region. Each city reserve fund is expected to maintain a 2% contingency in its budget. In fiscal 2018, the general fund balance policy was updated to a minimum of between 14% - 20% on a budgetary basis, up from between 8% - 15% on a budgetary basis.

Endnotes

1 By population, Oklahoma City accounts for 81% of the county according the 2016 American Community Survey

2 On September 12, 2017, voters approved a total sales tax rate increase of one and one-fourth cent (1.25%). The one cent (1%) sales tax is an extension of the Metropolitan Area Projects 3 sales tax which is scheduled to expire on December 31, 2017. The tax which began on January 1, 2018, is allocated for the city's capital initiatives and will sunset after 27 months on March 31, 2020. City officials estimate the 1% will generate $240 million during its authorized period. The one-fourth (0.25%) sales tax rate is permanent and will be used for public safety and general city operations. City officials estimate the 0.25% will generate an additional $26 million in revenues annually.

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