FitchRatings

09 FEB 2024

Fitch Affirms Oklahoma's Long-Term IDR at 'AA'; Outlook to Positive

Fitch Ratings - New York - 09 Feb 2024: Fitch Ratings has affirmed the state of Oklahoma's Long-Term Issuer Default Rating (IDR) at 'AA'. Fitch has also affirmed the following related ratings of the state:

--$1.4 billion of lease revenue bonds issued by the Oklahoma Capitol Improvements Authority at 'AA-';

--$86.6 million of Transportation Infrastructure Finance and Innovation Act (TIFIA) loan obligations issued by the Oklahoma Capital Improvement Authority at 'AA-';

--$400 million of lease revenue bonds issued by the Oklahoma Development Finance Authority at 'AA-'.

The Rating Outlook has been revised to Positive from Stable.

Fitch's revision of the Outlook on Oklahoma's 'AA' long-term IDR to Positive from Stable reflects the state's sustained improvements in expenditure flexibility and overall fiscal management, particularly its adherence to conservative budgeting practices through economic cycles including the recent period of revenue volatility caused by the coronavirus pandemic. The state has consistently taken timely action to address revenue shortfalls and budgets only 95% of projected operating revenues. A long pattern of supplemental pension contributions and restoration of service levels enhances the state's ability to adjust spending when necessary.

The 'AA' rating also reflects a low long-term liability burden and Oklahoma's still-sizable concentration in natural resource development industries, which has somewhat limited its long-term revenue growth prospects while increasing tax revenue volatility. The state's reserves have been strongly affected by economic cycles in the past. Fitch expects this will continue to be the case for the medium term, although Oklahoma's sizable reserve cushion is now at the highest-ever levels.

Oklahoma's annual appropriation-backed debt consists primarily of lease revenue bonds and loans issued by the state's two primary conduit issuers - the Oklahoma Development Finance Authority (ODFA) and the Oklahoma Capitol Improvement Authority (OCIA). The 'AA-' ratings on the debt are directly linked to the state's IDR. The one-notch rating differential with the IDR reflects a slightly elevated risk of non-appropriation of moneys sufficient to pay debt service on the bonds. All annual appropriation bonds carry ratings one notch below that of the state's IDR.

SECURITY

Oklahoma's lease revenue bonds are limited special obligations of the OCIA and the ODFA backed by annual state budgetary appropriations to the respective state agencies overseeing the projects so financed. The lease revenue bonds are issued pursuant to lease purchase agreements entered into between the respective state agency or other obligor (e.g. the Oklahoma State Board of Regents for Higher Education for higher education-related projects) and the OCIA or ODFA. For larger projects such as those undertaken by the regents, the regents will act on behalf of the state colleges and universities for whose benefit the projects are being undertaken pursuant to the terms of a master lease purchase agreement entered into between the regents and either ODFA or OCIA. For other state agencies and entities issuing debt through the conduits, the financing structure is nearly identical.

TIFIA loan repayments rely on annual legislative appropriations from the state's general and road funds. The timing and legal terms of the loan are designed so that loan repayments commence on July 1, 2024, by which time the related projects are estimated to be complete. The risk of non-appropriation is mitigated by the state's reliance on similarly-structured annual appropriation debt issued to fund its capital program and by the requirement for legislative approval for both projects and financings.

KEY RATING DRIVERS

Fitch expects Oklahoma's revenues, which are supported by broad-based taxes and fees, will continue to reflect above-average economic volatility tied to the natural resource sector over the medium term. The state legislature has unlimited independent legal ability to raise operating revenues, but tax rate increases require either a legislative supermajority or direct voter approval, somewhat limiting the state's practical revenue-raising flexibility.

Revenue Framework - 'aa'

The state maintains ample expenditure flexibility with a low burden of carrying costs for liabilities and the broad expense-cutting ability common to most U.S. states. As with most states, Medicaid remains a key expense driver but one that Fitch expects the state will continue to actively manage to prevent impairment of other functions.

Expenditure Framework - 'aaa'

On a combined basis, the state's debt and net pension liabilities are well below the median for U.S. states as a percentage of personal income, and are a low burden on the resource base. Net pension liabilities have shrunk as a proportion of statewide personal income over the past decade as a result of the state's decision to fund annual pension contributions above their actuarially-determined amounts since the early 2010s. Oklahoma's other post-employment benefit (OPEB) obligations are minimal compared to debt and net pension liabilities.

Long-Term Liability Burden - 'aaa'

A constitutional provision limiting appropriations to 95% of expected General Revenue Fund revenues provides a cushion for revenue variability, while the state's proactive management of financial operations has, to some extent, offset underlying revenue volatility. The state rapidly rebuilds reserves during periods of economic growth, but regular drawdowns during periods of low crude oil and natural gas prices have tended to limit the state's prospects for sustained financial resilience. Consistently strong budget and revenue forecasting have provided the state with ample gap-closing capacity, while its adroit management of long-term liabilities has kept carrying costs low. Reserve levels are currently above historical norms.

Operating Performance - 'aa'

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

--An inability to maintain dedicated fiscal reserves at or near the pre-pandemic peak of 12% of revenues through economic cycles;

--State revenue growth that falls below the level of Fitch's expectations for long-term U.S. inflation for an extended period of time;

--Evidence of weaker budget management practices that lead to recurring budgetary structural imbalances.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Maintenance of fiscal reserves at or near current levels as a percentage of revenues and sustained prudent budgeting practices including management of recurring expenditure growth to maintain structural balance;

--Revenues demonstrate less volatility and/or grow at a faster pace, ahead of Fitch's long-term expectations for national inflation;

--Material diversification of the state's economy such that natural resource market volatility is less consequential for operating performance.

PROFILE

Oklahoma's economy is broad but with high concentration in natural resources given the state's role as a major producer of crude oil and natural gas. Nearly one-fifth of state GDP is directly tied to natural resource development and multiplier effects boost this concentration still further. Excluding federal offshore areas, Oklahoma was the sixth-largest crude oil producing state in 2022 and fifth-largest natural gas producer. The economic base also includes notable health care, higher education, trade and federal government components.

Sources of Information

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

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Oklahoma, State of (OK) [General Government] has an ESG Relevance Score of '4' for Biodiversity and Natural Resource Management due to the impact of natural resources management on its economy and governmental operations, which has a negative impact on the credit profile, and is relevant to the rating in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Oklahoma, State of (OK) [General Government]	LT IDR	AA	Affirmed		AA
• Oklahoma, State of (OK) /Issuer Default Rating - General Government/ 1 LT	LT	AA	Affirmed		AA
• Oklahoma, State of (OK) /State Appropriation/ 1 LT	LT	AA-	Affirmed		AA-

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

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

Applicable Models

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

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

Additional Disclosures

Solicitation Status

Endorsement Status

Oklahoma, State of (OK)	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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