S&P Global Ratings

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Oklahoma Capitol Improvement Authority
Oklahoma; Appropriations; General Obligation; General Obligation Equivalent Security

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Credit Profile		
US$70.0 mil state facs rev bnds (Oklahoma) (Capitol Repair Proj) ser 2017B due 01/01/2026		
Long Term Rating	AA-/Stable	New
Oklahoma GO		
Long Term Rating	AA/Stable	Downgraded
Oklahoma		
Oklahoma Dev Fin Auth, Oklahoma		
Oklahoma St Brd of Regents, Oklahoma		
Oklahoma		
Oklahoma Envir Fin Auth, Oklahoma		
Oklahoma Dev Fin Auth (Oklahoma) (St Sys of Hgr Ed) (Master Equip)		
Long Term Rating	AA-/Stable	Downgraded

Rationale

S&P Global Ratings lowered its rating on the state of Oklahoma's general obligation (GO) bonds and appropriation debt backed by the state's credit enhancement reserve fund one notch to 'AA' from 'AA+'. At the same time, we lowered our rating on the state's appropriation debt to 'AA-' from 'AA'. The outlook is stable.

S&P Global Ratings also assigned its 'AA-' rating, with a stable outlook, to the Oklahoma Capitol Improvement Authority (OCIA)'s series 2017B (Capitol Repair Project) state facilities revenue bonds, issued for Oklahoma.

The downgrade reflects our view that persistently weak revenue collections--leading to a declared revenues failure for the remainder of the fiscal year (2017)--have further compounded the state's challenge to achieve structural balance in fiscal 2018. While the revenue failure alone, in our view, is nominal relative to previous revenue failures, collectively the state's financial position has deteriorated to a point that further precludes the state from building up reserves in subsequent fiscal years. As such, we believe that, relative to a year ago, the state is more vulnerable to broad regional or national economic weakness. With the revenue failure declared on Feb. 21, revenues are estimated to be $701.5 million, or nearly 10.5%, less than appropriated for fiscal 2017 exclusive of additional budgetary authorizations. General revenue fund revisions for the remainder of fiscal 2017 reflect revenues declining below the 5.0% threshold, at 5.7%, or $296.4 million, requiring a budget reductions equivalent of 0.7% to restore balance. Since the December revenue estimate, personal income tax and corporate income taxes were revised downward by $72.3 million (3.8%) and $16.6 million (15.4%), respectively. While other revenue sources were revised upward, including sales taxes ($3.98 million), gross production-gas ($10.5 million), and motor vehicle taxes ($10.75 million), collectively general revenue funds were projected to be down $64.9 million more than December's estimate. Governor Fallin's fiscal 2018 budget proposes no one-time revenues to achieve structural balance but hinges on broadening the sales tax base by applying the levy to services and increasing motor fuel taxes and cigarette taxes, among other revenue enhancers. The budget also eliminates corporate income taxes and sales tax on groceries.

The 'AA' GO debt rating reflects our view of Oklahoma's:

- Constitutional amendment that requires deposits to a reserve fund when available, which has allowed the state to build substantial reserves in positive economic times to mitigate the funding effects, although reserves have declined significantly since their peak in 2009;
- Low debt burden, coupled with rapid amortization of tax-supported debt; and
- Historically strong liquidity position that kept the state from relying on external borrowing for cash flow purposes, although this trend is tested in light of weaker budgetary performance.

Offsetting factors include Oklahoma's:

- Economy that is anchored by the government and trade, transportation, and utility sectors and that has struggled to overcome weaknesses in the energy sector and global markets;
- Pension funded levels, which have historically constrained the rating, but are showing some improvement due to Oklahoma's improved funding of its actuarially determined contribution (ADC), although the state's funding policy and prior track record bring into question the sustainability of this improved trend; and
- Exposure to fluctuations in oil and gas prices and their potential effects on the economy.

The 'AA-' ratings reflect our view of Oklahoma's strong general creditworthiness and the annual appropriation risks.

The 'AA' ratings on the Oklahoma Development Finance Authority (ODFA) backed by the Oklahoma's CERF reflects our view the state's guarantee per its respectively policies which in our view are equivalent to the state's GO rating. The ODFA serves as administrator of the state's CERF, and will deliver a CERF financial guarantee policy in an amount equal to the par amount of the issuer or the debt service reserve requirement to the trustee as additional security for payment of the bonds. If loan repayments are insufficient to make debt service payments, the trustee can draw funds from the CERF. The fund's claim reserve was $1.192 million as of Jan. 31, 2017, and was invested in U.S. Treasuries. The ODFA, as administrator of the CERF, agrees that if there is not sufficient money available in the fund's claims reserve to meet debt service requirements, it will issue general obligation (GO) bonds secured by Oklahoma's full faith and credit pledge and transfer net proceeds into the trust to ensure prompt payment.

In our view, the CERF provides sufficient liquidity to allow sufficient time for the state to enter the market and issue bonds. In our view, the state could access the market in less than 180 days, as it is highly rated, a frequent issuer, and has established a plan on how to address the issuance of debt if required to do so; this contributes to a low market risk profile. There has never been a draw on the CERF since the program's inception.

Series 2017B (OCIA)

Bond proceeds will used to finance the acquisition of real property and improvements to the State Capitol Building.

State agency payments to the OCIA under lease agreements secure the bonds. Payments under these agreements are payable from funds budgeted and appropriated by the state legislature for the Office of Management and Enterprise Services (OMES). Pursuant to Title 73, Oklahoma Statutes 2001, Section 151 (the act), the OCIA can require state department or agencies to enter into use occupancy agreements and to pay rent for such agreements. Under the act, the state regents are directed to allocate to participating campus lessees amounts sufficient to pay the rental payments on the bonds. The OCIA is authorized to fix and revise rental payments and is required to notify the OMES Jan. 1, the rent amounts required for the upcoming fiscal year so that these can be incorporated into the budget request. The obligation to pay rent, once the funds have been appropriated, is unconditional.

Lease payments are due monthly by the 15th, and debt service payments are due on Jan. 1 for principal and interest and July 1 for interest only. Oklahoma's fiscal year-end is June 30. The lessee agrees to pay rent monthly in amounts sufficient to pay principal and interest on the bonds. The lessee agrees to pay for the maintenance, insurance, and operation of the facilities. Self-insurance is allowed and Oklahoma's Risk Management Program, which administers a self-insurance pool for all state entities, manages liability insurance centrally. Although insurance coverage does not have to be sufficient to cover replacement value, the lessees have an affirmative obligation to and are required by law to make their lease payments under the leases. The lessees have no right to counterclaim or setoff and no provision for the abatement of lease payments exists.

Pursuant to Title 73, Oklahoma Statutes 2011, Section 151, the OCIA is authorized to issue the bonds. The OCIA consists of eight members, including the governor, the lieutenant governor, the director of the Office of Management and Enterprise Services, the director of the Dept. of Human Services, the secretary of the Oklahoma Tax Commission, the state treasurer, the director of the Dept. of Tourism and Recreation, and the director of the Dept. of Transportation.

We have assigned a total score of '1.7' to Oklahoma under our State Ratings Methodology, on a scale where '1.0' is the strongest score and '4.0' is the weakest.

Outlook

The stable outlook reflects our view that, within our one-year outlook horizon, despite continued budgetary pressures anticipated through the remainder of fiscal 2017 and fiscal 2018, the state's budgetary framework and debt and liability profile will continue to provide strong credit quality. It also reflects our expectation that meaningful measures to align revenue expectations with recurring expenditures will support future budgetary performance. Given the state's reliance on nonrecurring measures to balance the fiscal 2016 and 2017 budgets, coupled with shrinking reserve balances, we nevertheless believe the state is vulnerable to further revenue declines to levels well below current estimates. In the event budgetary performance were to weaken beyond current estimates, we could lower our ratings with the outlook horizon. In the absence of meaningful structural reforms that align revenues and expenditures and that do not materially depend on one-time budget solutions or measures that carry significant implementation risk, we could lower the ratings. A recovery in economic indicators, improvements in state revenue performance that we view as sustainable, and growth in reserves could lead us to raise the ratings.

Government Framework

Article X, Section 23 of Oklahoma's constitution mandates that the state adopt a balanced budget annually, with expenditures limited to 95% of certified revenues plus all appropriated federal funds, available funds, and excess general revenue fund collections from the prior year. State law requires the state's budget to remain in balance every fiscal year. In the event of a revenue shortfall, the director of the Office of Management and Enterprise Services (OMES) is required to proportionately adjust each agency's allocation of general revenue money so that expenditures do not exceed revenue collections.

The state constitution precludes the levy of an ad valorem property tax for state purposes. In addition, Article V, Section 33 of the constitution requires that all bills for raising revenue must be approved by a three-quarter supermajority of both the state House of Representatives and Senate or by voters. Oklahoma has historically exhibited a high degree of flexibility in adjusting disbursements, including recent reductions in state funding for public schools and state agencies during the fiscal year. State assistance to local governments is highly flexible, in our view, as evidenced by recent reductions in state funding for public schools during the fiscal year.

Oklahoma can issue a wide variety of appropriation debt. Except for specific circumstances, the issuance of GO debt requires voter approval, and its legal authorization must specify its purpose and provide for a direct annual tax to pay debt service. The state issues most of its debt through the OCIA and the Oklahoma Development Finance Authority (ODFA). In the past, there have been several legal challenges to these programs, mostly tied to specific bond issuances.

Oklahoma has some voter initiative activity, including requirements for voter approval of revenue increases and GO debt; however, this has not historically weakened operations or limited flexibility. State Question No. 708, passed by the electorate on Nov. 2, 2004, reduced "rainy day" fund spending. Before the constitutional amendment, up to half of the rainy day fund balance was available for emergency purposes. Now, officials can only expend one-quarter of fund balance for emergencies. The maximum size of the constitutional reserve fund (CRF) was increased to 15% of general revenue certified from the preceding fiscal year from 10% through the passage of State Question No. 757 in November 2010. Voters also approved State Question No. 764 (2015), a constitutional amendment that authorizes the Oklahoma Water Resources Board to issue up to $300 million in GO bonds to serve as a credit enhancement for certain water and sewer programs. The board would only use this borrowing authority for the bonds' repayment after using other money and sources. Oklahoma's debt levels are low, in our view, and we do not expect any potential issuance under this authorization to significantly change the state's debt and liability profile.

On Nov. 8, 2016, Oklahoma voters rejected State Question 779, which considered a 1% sales tax increase to fund teacher pay increases and higher education. This measure would have required Oklahoma not to reduce existing educational spending. While overall state revenues would have increased, the dedicated funding would not have freed up revenues for other expenditures. In our view, the failure of this measure preserves state flexibility to cut expenditures, which has helped the state balance the budget in the recent biennium. However, the state may face increased pressure to fund teacher pay increases in future budgets.

We have assigned a score of '1.3' to Oklahoma's government framework, on a scale where '1.0' is the strongest score and '4.0' is the weakest.

Financial Management Assessment: Good

S&P Global Ratings views its Financial Management Assessment (FMA) of Oklahoma as good. An FMA of good indicates financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Financial policy highlights include annual revenue forecasts, developed by state economists and supported by econometric modeling performed by the University of Oklahoma, Oklahoma State University, and Region Track, a private company providing regional economic forecasting and analysis. The State Board of Equalization (SBE) formally updates revenue assumptions--which have been, in general, conservative--three times annually. The OMES reviews revenue forecasts for the upcoming fiscal year and prepares annual expenditure requirements. The Oklahoma Constitution limits general fund appropriations to 95% of estimated revenues plus any cash funds on hand and available for appropriation. The OMES monitors revenue collections and reports on them monthly. When the legislature is not in session, if revenue collections decline below revenue forecasts for the current fiscal year, the director of the OMES can proportionately reduce state agencies' appropriations or borrow from available funds to prevent deficit spending. We understand that currently, the state does not perform formal multiyear financial projections for operating funds. The Long Range Capital Planning Commission (LRCPC) oversees an eight-year capital improvement plan that identifies funding sources for all projects. State agency officials must include how proposed capital projects will affect the operating budget in all state agency capital project requests. The LRCPC annually adopts the capital plan and submits it to the governor and legislative leadership for consideration.

The state constitution imposes a ceiling on reserves, or the rainy day fund, equal to 15% of the previous fiscal year's certified general fund collections. At the beginning of each fiscal year, officials automatically deposit collections that exceed the previous fiscal year's estimate into the rainy day fund until the total balance equals the constitutional limit. State management, however, has not adopted a minimum reserve policy. State Question No. 708 placed tighter controls on rainy day fund spending. If the SBE determines state revenues to be collected during the fiscal year are less than projected, officials can expend up to three-eighths of the rainy day fund. The total amount the state can expend due to revenue failure, however, cannot exceed the shortfall amount. Before the constitutional amendment, up to half of the rainy day fund balance was available for emergency purposes. Now, officials can only expend one-quarter of fund balance for emergencies. Since the recession, Oklahoma has drawn on reserves twice, and it recently approved additional draws for fiscal 2016. Historically, Oklahoma had funded the CRF at its maximum level in positive economic environments, but balances have been well below CRF maximum levels in recent years. While fiscal 2012 reserves were $577.5 million, or 8.9% of expenditures, they have subsequently declined to roughly 3.5% of total authorized fiscal 2016 budget.

As part of the fiscal 2017 budget, Oklahoma passed legislation creating the revenue stabilization fund (RSF) to address funding needs when a revenue failure has been declared and provide stabilization to the general revenue fund in times of revenue volatility. The RSF will receive deposits from oil and gas production taxes when receipts from those sources exceed 100% of average collections for the past five fiscal years. It will also receive 75% of any amounts above the five-year average from corporate tax collections, with the additional 25% being deposited into the CRF. Given that revenues peaked in the past five years and have significantly declined over the past year, it is likely that deposits into the RSF will not occur for multiple years.

The state treasurer has a formal investment policy, and it provides monthly investment reports to the governor and Oklahoma Legislature. In October 2007, the Oklahoma Council of Bond Oversight adopted formal debt policies. These policies discuss credit considerations, disclosure issues, security pledges available, the adequacy of funding sources, structural considerations, and the use of derivatives. The council reviews and approves the issuance of all debt issued by the state and its agencies. During the 2013 legislative session, House Bill 2195 (effective Nov. 1, 2013) prohibited debt issuance that causes annual debt service payments from the general fund to exceed 5% of the five-year average of certified revenues. The 5% debt limit excludes master-lease debt, but includes debt issued through the OCIA, which is one of the state's largest bonding programs. If a decline in revenues causes the state to exceed the limit, no additional debt may be issued until debt service falls below 5%. The limit could be exceeded if an emergency is declared and a vote to exceed the limit passes with two-thirds of the members of both houses. No payments on debt issued under this emergency provision would count toward the debt service limit.

Budget Management Framework

The SBE provides revenue estimates twice each year, between 35 and 45 days before the start of the legislative session (typically in late December or early January) and after the February revenue apportionment. In addition, the SBE meets in June to incorporate any legislative changes enacted during the legislative session into its estimate. The OMES monitors revenue collections and reports on them monthly. When the legislature is not in session, if revenue collections decline below revenue forecasts for the current fiscal year, the director of the OMES must proportionately reduce state agencies' appropriations or borrow from available revenues to prevent deficit spending, and Oklahoma has a well-established track record of making difficult decisions, including recent reductions in state funding for public schools and state agencies to restore balance during the fiscal year. Gap-closing solutions generally are a mix of structural and nonstructural fixes, although they have tended to focus on structural budget balance. Deficits are not carried forward between fiscal years.

We have assigned a score of '1.5' to the state's financial management framework, on a scale where '1.0' is the strongest score and '4.0' is the weakest.

Economy

Oklahoma's economy recovered quickly from the Great Recession and outpaced the national recovery. However, this recovery was fueled partly by growth in the oil industry, which subsequently weakened as the oil and gas sector sharply declined. Although Oklahoma's economy is gradually becoming less dependent on oil and gas production, the petroleum sector remains an important economic engine. Growth in Oklahoma GDP had been above the U.S. growth rate over 10- and five-year averages, supported partly by high oil prices, though it has lagged in the last two years. Real gross state product (GSP) contracted 2.9% in 2016, whereas the national economy expanded by 1.6%. Collapsing oil prices, lower agricultural commodity prices, and weaker global growth will likely continue to dampen growth over

2017. IHS projects that Oklahoma's GSP and employment growth over 2017 will be an anemic 1.2% and 0.4%, respectively, compared with the U.S. averages of 2.3% and 1.5%. Despite these challenges, we believe the state's resources, employment opportunities, cost of living, cost of doing business, and tax structure will continue to make it an attractive place for business over the long term.

State population growth has exceeded that of the nation in the past 10 years. Oklahoma's population grew 0.98% annually from 2005 to 2015, to 3.9 million, well above the nation's annual growth rate of 0.85%. At 64.7%, Oklahoma's age dependency ratio in 2015, as defined by the U.S. Census Bureau, is slightly higher than nation's 60.7% average.

The state's average annual unemployment rate was 4.2% in 2015 (lower than the national rate of 5.3%), down from 4.5% in 2014, and down considerably from 6.8% in 2010. The national unemployment rate had peaked at 9.6% in 2010. As of November 2016, mining and logging employment fell 5.8% year over year, while manufacturing employment fell 3.8%. Machinery accounts for 23% of the state's manufacturing employment, followed by fabricated metal products, at 18%. These sectors are particularly tied to oil prices and global economic trends.

At $45,042, state per capita income was 85% of the nation's in 2015, down from 95% in 2014. Nominal state GDP per capita was also below average, at 83% of the nation in 2015. Oklahoma's employment focuses mainly on government, trade, transportation, and utilities, as well as education and health services and professional and business services. Manufacturing accounts for 8.2% of employment, which is below the U.S. average of 8.7%, although recent declines in global demand for Oklahoma's exports have contributed to job losses in this sector. While mining and logging accounts for just 3.3% of employment, down from 3.7% in 2014, this is above the U.S. average of 0.6%. Oklahoma's export merchandise value plunged 17% in 2015, with nine of the state's top 10 export product categories declining. Machinery, the state's largest export category, fell 24.3%, although the second-largest category--transportation equipment--increased 14.1%. Agricultural commodity prices have also fallen, contributing to lower farm income and lower related farm capital spending.

We have assigned a score of '2.5' to the state's economy, on a scale where '1.0' is the strongest score and '4.0' is the weakest.

Budget Performance

Certified revenues are budgeted annually at 95% of projections, providing a de facto 5% cushion relative to estimates. In addition, the state has a rainy day fund: the CRF that is funded at a level up to 15% of certified revenues by any revenues in excess of certified levels. The maximum size of the CRF was increased to 15% of certified revenues from 10% through the passage of State Question No. 757 in November 2010. The state can access the CRF if the independent SBE determines that a revenue failure has occurred, among other reasons. Although Oklahoma drew down the CRF to mitigate the funding effects of revenue declines during the Great Recession, revenues in excess of certified levels are constitutionally dedicated to rebuilding the fund and had resulted in a return to prerecession funding levels. Oklahoma has drawn down on its reserves since 2013 and authorized the use of reserves in 2017, although it is undetermined if they will be utilized by fiscal year-end.

To provide for its cash flow needs at the beginning of each fiscal year, Oklahoma deposits 10% of the general revenue fund's certified appropriations into the cash flow reserve fund at the end of each fiscal year. The OMES monitors cash balances daily and monthly, and has broad authority to adjust disbursements through across-the-board reductions, if necessary. The state has not historically relied on external borrowing for cash flow purposes.

We consider the state's tax revenue structure diverse. In fiscal 2016, individual income tax accounted for 44% of total general revenues used to establish certified amounts available for appropriation, while sales tax represented 36%. Because all bills raising taxes must receive approval from a three-quarter supermajority of both the state House of Representatives and Senate or from voters, revenue adjustments are not typically a key part of short-term solutions to structural imbalance. However, we believe Oklahoma has a demonstrated track record of implementing revenue adjustments as part of longer-term solutions to structural imbalance when necessary. For example, in the 1980s, the state raised the sales tax rate incrementally to 4% from 2% as it weathered the effects of a downturn in the oil and gas industry. The SBE, which consists of the governor, lieutenant governor, treasurer, auditor and inspector, attorney general, superintendent of public instruction, and secretary of agriculture, develops a formal revenue forecast that guides budget development and reviews it several times during the fiscal year. Expenditures are generally predictable, and Oklahoma has a high degree of flexibility to reduce services and expenditures that it has historically exercised when revenues have declined.

Because of the constitutional mandate that any revenues in excess of certified levels be used to build the CRF up to its maximum size (currently 15%), surpluses are regularly recorded in periods of positive economic growth and used to fund reserves. In our view, during periods of economic decline, Oklahoma generally focuses on structural solutions, especially spending cuts, to address budget imbalances. The state's rainy day fund, the CRF, is funded at a level up to 15% of certified revenues by any revenues in excess of certified levels. Historically, Oklahoma had funded the CRF at its maximum level in positive economic environments. During the Great Recession, the state drew and depleted the CRF to mitigate the funding effects of revenue. In the past two years, however, Oklahoma replenished the CRF, and in fiscal 2016 had $240.74 million in reserves, significantly less than the $596.6 million balance held in both fiscal years 2008 and 2009. Revenues in excess of certified levels are constitutionally dedicated to rebuilding the fund.

The enacted fiscal 2017 budget totaled $6.78 billion, down 1% from fiscal 2016 projected appropriations. Most agency spending was reduced about 12% compared to the original fiscal 2016 budget. Additionally, $200 million in bonding for transportation projects that typically would be funded with cash was included, freeing additional resources.

The legislature adopted several ongoing revenue adjustments expected to generate additional revenue in fiscal 2017. These include:

- Reduction of the at-risk well rebate ($111 million);
- Elimination of the double deduction on state income tax returns ($87.3 million);
- Revision to make the earned income tax credit non-deductible ($25.9 million);
- Modification of the cash flow reserve process to allow balances unlikely to be needed in the current fiscal year to be appropriated by the Oklahoma legislature ($132 million); and
- Enforcement of existing laws to enhance revenue collection through a tax auditing initiative ($49 million).

We understand that modification to the cash flow reserve process pertains to the difference in timing of when the revenues identified as available for appropriation rather than a change from the total amount used historically. In the past, Oklahoma has used about $120 million of these reserves annually, but these revenues were not previously subject to formal analysis and review by the SBE as this change requires. This change is intended to stabilize and maintain the integrity of the fund and quantify a specific amount available for appropriations in each upcoming fiscal year.

Oklahoma also passed legislation creating the RSF, which we view as a strength over the long term, but we do not expect that the state will build significant RSF reserves for several years. The purpose of the RSF is to address funding needs when a revenue failure has been declared. The RSF will receive deposits from oil and gas production taxes when receipts from those sources exceed 100% of average collections for the past five fiscal years. It will also receive deposits from corporate tax receipts when those exceed 75% of the five-year average. While the state is also statutorily required to deposit surplus funds in the CRF fund, it has not increased reserves since fiscal 2012 despite periods of economic growth. Despite diversification of its economy since the 1980s oil sector downturn, ties to the oil industry remain strong, as evidenced by the state's substantial revenue shortfalls. For states such as Oklahoma that have concentrations in cyclical industries, such as the oil industry, we consider reserves of particular importance to the state's credit quality.

A recent cut to the state's personal income tax rate and tax breaks for the oil industry during periods of price declines have compounded the state's revenue shortfall. In January 2016, a 0.25% personal income tax cut for the state's highest tax bracket took effect, which partly contributes to year-over-year income tax revenue declines. The state estimated that the 0.25% cut to the personal income tax will result in a loss of $57 million in revenues for fiscal 2016 and $147 million in fiscal 2017. Oklahoma's top personal income tax was as high as 6.65% in 2003, was cut to 5.5% in 2009, and is 5% currently. An additional 0.15% income tax cut (lowering the rate to 4.85%) will not take effect as a result of the final finding of the SBE on Feb. 21, 2017, that total general revenue fund estimates for fiscal 2018 are less than the estimated effect of a 0.15% decrease in the top marginal income tax rate. Lawmakers could modify the trigger for future years during this legislative session. The state also previously provided generous tax breaks for certain gross production well operators during periods of low prices, which has contributed to lower receipts over fiscal 2016. Statutory changes were made during the 2016 legislative session to mitigate costs of the rebates for fiscal year 2017, resulting in an expected increase in gross production oil and gas collections of more than $120 million with a budgetary impact of approximately $111 million. Additionally, a temporary reduction in that tax to 1% for horizontal wells was set to expire next year, which would have returned the tax rate to 7%. Changes enacted prior to the expiration date now assess the same a 2% tax on all new wells for 36 months--both horizontal and vertical. After 36 months, all production is taxed at 7%.

Fiscal 2016

As a result of the declared revenue failure in December 2015, Oklahoma made 3% general revenue fund budget cuts across state agencies, including public education, and an additional 4% in March, which in total amount to 7%, or $412.8 million. The state has also authorized $78.6 million of appropriations from the CRF for the Departments of Education and Corrections. Before taking into account recent revenue shortfalls, Oklahoma's fiscal 2016 budget at adoption was not, in our view, structurally balanced. To address a projected $600 million revenue shortfall compared with fiscal 2015, its enacted fiscal 2016 budget relied on a $150 million use of the CRF, $121 million in cash flow reserve funds, $125 million in agency revolving account reconciliations, and several sources of nonrecurring revenues and account sweeps to close the gap. On Jan. 1, 2016, a 0.25% income tax reduction went into effect, exacerbating the revenue shortfall. Actual revenues exceeded most recent SBE estimates, and additional funds were appropriated on a pro rata basis.

Oklahoma finished fiscal 2016 with revenue collections reflecting the economic challenges facing the state as revenues fell below estimates and prior-year collections. Total general revenue fund collections for fiscal 2016 were $5.2 billion, which was $541.3 million, or 9.4%, below the official estimate and $521.9 million, or 9.1%, below prior-year collections. However, Oklahoma ended fiscal 2016 with a $140.8 million surplus because midyear cuts were deeper than necessary given final revenue collections. The greater-than-anticipated revenue could not be allocated into the CRF given it was not in excess of the authorized revenue estimate, and consequently the difference was reallocated to the affected agencies on a pro rata basis.

Audited fiscal 2016 (GAAP-basis)

The state's fiscal 2016 comprehensive annual financial report (CAFR) reflects negative operating results of $1.03 billion for total governmental funds on a generally accepted accounting principles (GAAP) basis after other financing sources inclusive of other financing sources and uses. Excluding other sources and uses, the negative operating result totaled $1.16 billion. The general fund posted a $1.13 billion operating deficit before other financing sources and uses, and a $991.9 million deficit after other financing sources and uses. The total fund balance for the general fund was $2.95 billion, down from fiscal 2015's $3.9 billion. The balance reflects $896 million in nonspendable and restricted funds, $2 billion in committed funds, and $26.5 million in unassigned and assigned funds. The state had $3.1 billion in cash and cash equivalents in its total governmental funds, $2.9 billion of which was in the general fund. Liquidity for the state is good, in our opinion, and Oklahoma does not rely on short-term borrowing for liquidity. As noted in the state's CAFR, Oklahoma budgets are developed using unencumbered cash plus 95% of the itemized revenue estimate approved by the state's Board of Equalization. The statutorily defined general revenue fund represents approximately 75% of the state's total tax revenue of its governmental funds as defined by GAAP. At the beginning of the current fiscal year, the CRF was $240.8 million, or approximately 4.5% of the fiscal year's general revenue fund collections.

Fiscal 2017

With the revenue failure declared on Feb. 21, revenues are estimated to be $701.5 million, or nearly 10.5%, less that appropriated for fiscal 2017 exclusive of additional budgetary authorizations. General revenue fund revisions for the remainder of fiscal 2017 reflect revenues declining below the 5% threshold at 5.7%, or $296.4 million, requiring budget reductions equivalent of 0.7% in order restore balance. Since the December revenue estimate, personal income tax and corporate income taxes were revised downward by $72.3 million (3.8%) and $16.6 million (15.4%), respectively. While other revenue sources were revised upward, including sales taxes ($3.98 million), gross production-gas ($10.5 million), and motor vehicle taxes ($10.75 million), collectively general revenue funds were projected to be down $64.9 million more than December's estimate. Governor Fallin's fiscal 2018 budget proposes no one-time revenues to achieve structural balance, but it hinges on broadening the sales tax base by applying the level to services, and increasing motor fuel taxes and cigarette taxes, among other revenue enhancers. The budget also eliminates corporate income taxes and the state sales tax on groceries. While the legislative session is ongoing, we view the likelihood and willingness to add sufficient revenue enhancer to achieve structural balance to be low.

In the absence of significant revenue boosts within the remaining fiscal year, it is likely that the failure to address structural balance in preceding years will lead to a ballooning budget gap for fiscal 2018, as demonstrated by the recent revenue failure. Weighing favorably for fiscal 2018's budget development is that the anticipated income tax reduction to 4.85% from 5.00% will not be authorized, given total general revenue fund estimates for fiscal 2018 are less than the estimated effect of a 0.15% decrease in the top marginal income tax rate. While the U.S. has exhibited positive growth in the past year, the state's overall economy has waned and is consequently vulnerable to a downturn in the national economy. This could have negative repercussions for Oklahoma's primary revenue streams. During the 2008 U.S. recession, Oklahoma had stronger reserves than it currently has, and the large magnitude of budget cuts enacted to address fiscal 2016-2017 shortfalls somewhat limits the state's flexibility to cut expenditures further, in our view. In the years following the recession, Oklahoma's revenues benefited from high oil and commodity prices, but those levels are not anticipated to increase significantly in the near term. Given our overall assessment that Oklahoma is markedly vulnerable in the event of a U.S. downturn, and that management has yet to demonstrate a sustainable path toward improving its financial position, even modest economic softness could have prolonged negative effects.

We have assigned a score of '1.3' to the state's budgetary performance on a scale where '1.0' is the strongest score and '4.0' is the weakest.

Debt And Liability Profile

Oklahoma's debt levels remain low, in our opinion. As of Dec. 31, 2015, the state had just $122.1 million of GO bonds outstanding, including $40 million remaining from GO bonds issued by the Industrial Finance Authority. Lease revenue bonds issued by the OCIA totaling $1 billion and $636 million in ODFA master-lease program obligations, along with other state obligations totaling $342 million, bring Oklahoma's total tax-supported debt to $2.1 billion. Combined, tax-supported debt is moderate, in our view, at about $532 per capita, and is low, in our opinion, at an estimated 1.2% of state personal income and 1.1% of GSP. Oklahoma's debt service burden as a percentage of expenditures is low, in our view, with fiscal 2015 tax-supported debt service accounting for 1.9% of appropriations on an audited basis. Debt amortization is average, in our opinion, with 47% of tax-supported debt principal repaid in 10 years.

Pensions

Oklahoma's unfunded pension liability represents its proportionate share of seven public employee defined-benefit retirement plans: the Oklahoma Public Employees Retirement System (OPERS), the Teachers Retirement System (TRS), the Uniform Retirement System for Justices and Judges (URSJJ), the Firefighters Pension and Retirement System, the Police Pension and Retirement System, the Law Enforcement Retirement System (LERS), and the Wildlife Conservation Retirement Plan (WCRP).

Given the most recent data available, which include market values as of June 30, 2016, of TRS, OPERS, and URSJJ, we consider the state's three-year average pension funded ratio relatively low, at 79% on a GASB 67/68 basis. TRS, which represents the largest share of the state's liability, was 62.24% funded as of June 30, 2016, down from 70.31% the prior year. The lower funded ratio largely reflects a decrease in its assumed rate of return to 7.5% from 8.0%, as well as changes to other assumptions. TRS reported a negative 2.2% return on investment to end June 2016. OPERS, the state's second-largest plan, had a decrease in funded ratio as well, to 89.48% from 96.00%. The plan reduced its assumed rate of return to 7.25% from 7.50% and reported a 0.18% return on investments to end fiscal 2016.

For TRS, the state's largest pension plan, the state has funded its annual required contribution (ARC) since 2012. All employers participating in TRS are responsible for paying a fixed employer contribution rate set forth in state law, which is not actuarially determined, and the state also contributes 5% of revenues from its individual income tax, corporate income tax, sales tax, use tax, and lottery proceeds. Given fluctuations in state revenues, it is possible that contributions in the future could fall below ADCs. Additionally, we calculate that total annual plan contributions for TRS in fiscal 2016 did not cover levels equal to service cost and an interest cost component plus some amortization of the unfunded liability. While contributions in fiscals 2014 and 2015 exceeded service cost and interest cost, given that contributions are subject to economic fluctuations, we could see contributions fall short again in fiscal 2017.

We acknowledge that Oklahoma plans have shown strong progress in funding certain annual costs, as of the most recent plan reports, even though Oklahoma's pension funding is based on the dedication of certain revenues to fund pensions and does not directly correlate to an ADC. We note that, prior to fiscal 2012, Oklahoma had funded its pensions at levels that were less than 70% of the ARC. However, pension reform efforts eliminated the cost-of-living adjustment and reduced the state's liability, bringing the ARC closer in line with the revenue stream dedicated to fund it. Over the past four years, Oklahoma's contributions exceeded the ARC on an aggregate basis with overfunding of some plans and underfunding of others. This, however, could turn out to be temporary as the funding formula is driven by economically sensitive revenues, does not have an actuarial basis, and does not adjust to increases in estimated liability.

We believe, on the whole, management factors and actuarial inputs for TRS do not significantly encumber or improve our view of the state's overall pension funding discipline. TRS assumes an open, 20-year amortization period and a "level percentage of pay" method, which assumes rising future payroll and results in escalating pension contributions over time. The plan reported an actual 7.8% five-year average rate of return as of June 30, 2016, in line with its actuarial assumed rate of return. Its one-year return for 2016 was negative 2.2%. Its actuarial study states that the plan does not have a crossover date, which, based on recent contributions relative to ADC, is reasonable, in our view. However, it is possible that lower contributions or below-forecast investment returns could lead us to question this assumption. The plan's ratio of active members to beneficiaries equals 1.49, which is in line with the median national ratio of 1.50. However, we consider the plan's funded ratio relatively low. It is TRS' practice to produce an experience study every five years.

Oklahoma's proportionate share of net pension liability translates to what we view as a relatively low $762 per capita and 1.7% of personal income.

In November 2011, the Oklahoma Legislature adopted two pension reform measures that resulted in a $5.5 billion reduction in the liability and an improved overall funded level of 66.7% compared with 57.5% the previous year. The first measure (House Bill, or HB, 2132) requires identification of funding sources for any proposed cost-of-living adjustment. The second measure (Senate Bill 794) changes the normal and early retirement age for employees hired on or after Nov. 1, 2011, to 65 years and 60, respectively, from 62 and 55 previously. In June 2014, Governor Fallin signed a bill that moves future employees of the state's nonhazardous plans to a 401(k) defined-contribution plan; teachers and state workers designated as "hazardous duty," including firefighters and law enforcement officers, are exempt.

On May 30, 2014, HB 2630 became effective, which created a defined-contribution plan for OPERS participants effective Nov. 1, 2015, for employees hired on or after that date. This legislation has been challenged by certain taxpayers and participants, and a judgment was filed in favor of the defendants in January 2016. The matter was under appeal with the Oklahoma Supreme Court, and we understand that the court upheld the state's pension reforms in October 2016. However, the court did not address a question regarding the initial funding of the defined contribution plan and sent it back to the lower courts. We understand that employers pay 16.5% of payroll to OPERS regardless of the employee's plan. Any surplus made for each defined-contribution employee is used to pay down the unfunded liability in the defined-benefit plan.

Other postemployment benefits (OPEBs)

Oklahoma provides OPEBs, including disability and death benefits, as part of its OPERS, TRS, URSJJ, LERS, and WCRP plans. Benefits are provided through the State and Education Employee Group Insurance Board (SEEGIB) and are statutorily capped at $105 per employee per month. The Department of Wildlife Conservation is the only department that makes a contribution on behalf of its retirees and had an OPEB liability of $4.8 million with an ARC of $346,000 in fiscal 2015, $213,000 of which the department contributed on a pay-as-you-go basis. This small OPEB liability (combined contributions totaled $50 million for fiscal 2015) is included in the state's pension liabilities. Oklahoma has determined that SEEGIB does not constitute an OPEB plan, according to the provisions of GASB Statement 43.

On a scale where '1.0' is the strongest score and '4.0' is the weakest, we have assigned a score of '2.0' to the state's debt and liability profile.

Ratings Detail (As Of March 1, 2017)		
Oklahoma GO		
Unenhanced Rating	AA(SPUR)/Stable	Downgraded
Oklahoma		
Oklahoma Dev Fin Auth, Oklahoma		
Oklahoma (Oklahoma Dev Fin Auth) GOEQUIV		
Long Term Rating	AA/Stable	Downgraded
Oklahoma Building Bonds Commission, Oklahoma		
Oklahoma		
Oklahoma Bldg Bnds Comm (Oklahoma) GO		
Long Term Rating	AA/Stable	Downgraded
Oklahoma Cap Imp Auth, Oklahoma		
Oklahoma		
Oklahoma Cap Imp Auth (Oklahoma) ser 2015B		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) state agy facs rfdg rev bnds (Oklahoma) ser 2016 due 07/01/2029		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) state facs rev bnds (Oklahoma) (Oklahoma Tourism And Recreation Dept Proj) ser 2017A due 07/01/2047		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) state hwy cap imp rev bnds (Oklahoma) ser 2016 due 07/01/2034		

Ratings Detail (As Of March 1, 2017) (cont.)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) 2014A		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) (Cap Dome Proj)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) (Conserv Comm Projs)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) (Hgr Ed Projs)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) (Native Ameican Cultl & Educl Auth Proj)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Cap Imp Auth (Oklahoma) (Supreme Court Proj)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth, Oklahoma		
Oklahoma		
Oklahoma Dev Fin Auth (Oklahoma) fed taxable master real prop lse rev bnds		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) master eqip lse rev rfdg bnds (Oklahoma) ser 2016B due 06/01/2026		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) master equip lse rev bnds (Oklahoma) ser 2015C due 06/01/2025		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) master equip lse rev rfdg bnds (Oklahoma) ser 2016A due 06/01/2026		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) master equip ser 2017A		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) master equip ser 2017B		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) master real property lse rev bnds (Oklahoma) (Oklahoma State System Of Higher Ed)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) master real prop lse rev bnds		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) master real prop lse rev bnds (Oklahoma) ser 2016E due 06/01/2046		

Ratings Detail (As Of March 1, 2017) (cont.)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) master real prop lse rev rfdg bnds (Oklahoma) ser 2016B due 06/01/2036		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) master real prop lse rev rfdg bnds (Oklahoma) ser 2016C due 06/01/2034		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) ok state sys of hgr ed Master Real Prop lse rev bnds (Oklahoma) ser 2016F		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) state sys of hgr ed master real prop lse rev bnds		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) Master Real Property Lease Rev Bnd Anticpation Notes (Oklahoma) ser 2014 dtd		

Ratings Detail (As Of March 1, 2017) (cont.)		
02/19/2015 due 12/01/2018		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (Master Real)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (St Sys of Hgr Ed) (Master Real)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (St Sys of Hgr Ed) (Master Real) ser 2015B		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (St Sys of Hgr Ed) (Master Real) ser 2015C		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (St Sys Of Hgr Ed) (Master Real) ser 2015D		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Dept of Human Svcs Projs)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Oklahoma Dev Fin Auth (Northern Oklahoma Coll Proj)		
Long Term Rating	AA/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma Office of State Fin Proj)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (Cleet Proj)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (Dept of Corrections Proj)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (Dept of Human Svcs Projs)		
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (Langston Univ-Stadium Proj)		
Long Term Rating	AA/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (Leflore Cnty Hlth Dept Proj)		
Long Term Rating	AA/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (Rogers State Univ Proj CERF)		
Long Term Rating	AA/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (Seminole St Coll - Cap Imp Proj		
Long Term Rating	AA/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (St Sys of Hgr Ed) (Master Equip)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (St Sys of Hgr Ed) (Master Lease)		

Ratings Detail (As Of March 1, 2017) (cont.)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Oklahoma) (St Sys of Hgr Ed) (Master Real)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Long Term Rating	AA-/Stable	Downgraded
Oklahoma Dev Fin Auth (Pittsburg Cnty Hlth Dept Proj)		
Long Term Rating	AA/Stable	Downgraded
Oklahoma Dev Fin Auth (Pontotoc Cnty Hlth Dept Proj)		
Long Term Rating	AA/Stable	Downgraded
Oklahoma Dev Fin Auth (Univ of Central Oklahoma Proj)		
Long Term Rating	AA/Stable	Downgraded
Oklahoma Dev Fin Auth (Washington Cnty Hlth Dept Proj)		
Long Term Rating	AA/Stable	Downgraded

Many issues are enhanced by bond insurance.