



CREDIT OPINION

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 Rate this Research

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Broken Arrow (City of) OK

Update to credit analysis

Summary

The [City of Broken Arrow \(Aa3\)](#), Oklahoma's credit profile will benefit from improved cash levels in fiscal 2018 following a reclassification of cash that had been incorrectly marked as restricted in fiscal 2017. The city's profile is anchored by a tax base that is large and continues to grow. Resident wealth and incomes are favorable and the city's debt profile is manageable. The city's unfunded pension liabilities are rising due to inadequate funding of cost sharing state plans and could be a source of credit pressure in the future.

Credit strengths

- » Large tax base benefiting from proximity to Tulsa
- » Favorable resident wealth and incomes

Credit challenges

- » Low liquidity
- » Reliance on economically sensitive revenues
- » Slightly elevated but manageable debt profile with exposure to variable rate debt
- » Rising unfunded pension liability due to inadequate funding of state plans

Rating outlook

Moody's does not usually assign outlooks to local government credits with this amount of debt outstanding.

Factors that could lead to an upgrade

- » Significant improvement in general fund cash balance
- » Reduction or elimination of general fund subsidy for the utility system
- » Material tax base expansion

Factors that could lead to a downgrade

- » Further reduction in liquidity
- » Increased subsidies to utility system or other city funds that pressure fund balance or cash position

» Tax base contraction

Key indicators

Exhibit 1

Broken Arrow (City of) OK	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value (\$000)	\$6,656,029	\$6,875,106	\$7,061,421	\$7,329,988	\$7,663,014
Population					
Full Value Per Capita	100,464	101,917	103,437	104,869	108,303
Median Family Income (% of US Median)	\$66,253	\$67,458	\$68,268	\$69,897	\$70,755
Finances					
Operating Revenue (\$000)	\$58,687	\$62,481	\$69,320	\$73,709	\$70,726
Fund Balance (\$000)	\$16,168	\$16,609	\$18,115	\$15,206	\$19,467
Cash Balance (\$000)	\$10,307	\$10,768	\$12,848	\$7,490	\$9,066
Fund Balance as a % of Revenues	27.5%	26.6%	26.1%	20.6%	27.5%
Cash Balance as a % of Revenues	17.6%	17.2%	18.5%	10.2%	12.8%
Debt/Pensions					
Net Direct Debt (\$000)	\$108,558	\$108,788	\$113,668	\$117,198	\$125,228
3-Year Average of Moody's ANPL (\$000)	\$66,649	\$71,443	\$78,815	\$90,892	\$118,396
Net Direct Debt / Full Value (%)	1.6%	1.6%	1.6%	1.6%	1.6%
Net Direct Debt / Operating Revenues (x)	1.8x	1.7x	1.6x	1.6x	1.8x
Moody's- adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.0%	1.0%	1.1%	1.2%	1.5%
Moody's- adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.1x	1.1x	1.1x	1.2x	1.7x

Finances reflect general and debt service funds

Source: City of Broken Arrow, OK Annual Financial Statements (2013 - 2017), Moody's Investors Service

Profile

The City of Broken Arrow is a bedroom community of the [City of Tulsa, OK](#) (Aa1 stable), located 14 miles southeast of downtown. As of 2016 the city's population totaled approximately 104,869.

Detailed credit considerations

Economy and tax base: growing tax base with favorable resident incomes

The city's tax base will likely continue to grow at a moderate rate over the medium term given ongoing development and proximity to City of Tulsa. Located in southeastern Tulsa County, with a portion in Wagoner County, the City of Broken Arrow is a bedroom community to Tulsa. Fueled by strong population growth and housing demand, taxable values within the city continue to grow. In fiscal 2019, assessed values grew by 6.2% to reach \$929.4 million based on full value of \$8.6 billion. On average, net assessed values (AV) grew 4.5% annually over the five year period through fiscal 2019. The city's tax base is diverse, with the top 10 taxpayers accounting for only 6.8% of fiscal 2018 AV. City officials report sustained residential development with several active subdivisions. Additionally, commercial development is strong with two manufacturers expressing interest in the city's industrial plant located on the east side. A medical office complex continues to grow while several retail offerings are under construction within the city. As a direct result, city officials are projecting AVs will grow 3.9% annually for the next three years and 3.5% thereafter.

The city's stable tax base is further supported by favorable resident incomes with a median family income equal to 114.4% of the national median, per the 2016 American Community Survey. Due to access to employment opportunities in nearby Tulsa, the city's August 2018 unemployment rate of 3% was lower than both the state's and the nation's. The 2016 estimated population was 104,869.

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Financial operations and reserves: weak liquidity levels will improve in fiscal 2018

The city's steady financial performance will likely continue over the next two to three years supported by increasing revenues, and limited general fund needs. The city's finances will also benefit from improved cash following a reclassification of funds that had previously been marked as restricted. However, the general fund is somewhat strained by annual subsidies to Broken Arrow Municipal Authority (BAMA), the city's utility service provider. Recent rate increases in October 2017 and October 2018 will alleviate some of the pressure from BAMA but future rate increases will be needed for the fund to be completely self supporting.

The general fund itself has demonstrated steady operating performance with surpluses in the last three fiscal years. In fiscal 2017, which ended on June 30, 2017, the general fund reported a \$2.6 million surplus improving the total fund balance to \$12.6 million (a satisfactory 17.7% of general fund revenues); \$10.9 million (15.3%) was available. Including the debt service fund, the available operating fund balance was \$19.5 million (27.5% of operating revenues).

Unaudited results for fiscal 2018 reflect another solid year with city officials expecting to report a surplus of \$2.1 million in the general fund supported by favorable sales taxes compared to budget. Sales taxes are important for the city because they account for almost 50% of general fund revenues. In fiscal 2018, city officials report sales taxes were about 3% higher than the prior year, when adjusting for collections from the recent sales tax increase that has been allocated for public safety.

The fiscal 2019 budget is underway and through the first quarter, city officials report sales taxes are up 7.1% compared to the prior year, while expenditures are in line with the adopted budget, which reflected balanced operations.

LIQUIDITY

The city's cash position is expected to increase materially in fiscal 2018. Historically, the city's finances have been challenged by extremely low levels of liquidity in the general fund. Within the past five years, the general fund cash position has remained below 5% of revenues, which is well below similarly rated peers. The city's liquidity challenges are a result of multiple years of subsidies provided to BAMA to fund capital needs which are ultimately reimbursed by the state (Oklahoma Water Resource Board, OWRB).

In fiscal 2017, general fund cash improved to \$610 thousand or a thin 0.9% of revenues but the general fund reported a receivable of \$7.5 million from BAMA; BAMA did not have any unrestricted cash and reported \$41.3 million in restricted cash. Following the audit release, city officials reported that the cash levels had been inaccurately classified. During the year, the general fund had paid out several invoices on behalf of BAMA but had not been repaid with bond proceeds, which were marked as restricted cash. As such, city officials indicate that the correct BAMA unrestricted cash should be \$307 thousand with \$35.9 million marked as restricted. Within the general fund, the cash position should have been \$5.7 million (an adequate 8% of general fund revenues).

Unaudited results for fiscal 2018 reflect a \$1.7 million cash improvement in the general fund, which will improve the cash position to \$7.4 million (10.4% of fiscal 2017 general fund revenues). BAMA is also expected to see an increase in cash of \$4.2 million. However, the general fund will still report a receivable from BAMA.

Although operating performance within BAMA has improved, the fund is still scheduled to receive some subsidies from the general within the next two to three years. However, BAMA has reported two years of rate increases in fiscal 2018 and 2019. While this has improved the revenue performance, the fund still relies on subsidies from the general fund and subsidies will likely continue until the next two to three years until utility operations stabilize. City officials report that the last rate study conducted for the utility system projects rate increases (5.5% for water, 7% for sewer and 9% for stormwater) annually through fiscal 2021. However, future rate increases and amounts are subject to council approval.

Debt and pensions: slightly elevated debt, exposure to state's cost sharing plan

The city's debt burden will remain slightly elevated but manageable over the next three to five years due to planned debt issuances and principal amortization that is slower than that of similarly rated peers. At 1.8% of fiscal 2019 full value, the city's direct debt burden is slightly higher than the national median for the rating category. Approximately \$198 million from the August 2018 election and \$525 thousand from the 2014 election will remain authorized but unissued following this sale. City officials anticipate annual debt issuance until final maturity in 2027.

DEBT STRUCTURE

Including the November 2018 sale, the city's debt consists of \$143.5 million fixed-rate general obligation bonds, maturing over the long term (final maturity fiscal 2038). The current debt service schedule calls for 62.1% of principal retired within 10 years.

DEBT-RELATED DERIVATIVES

The city has a total of \$18.4 million in variable rate debt outstanding (not rated by Moody's), accounting for approximately 14% of the total debt profile. The city issued variable rate notes in May 2004 for a Bass Pro facility. This note is secured by lease payments to the city and a maximum amount of \$2.8 million in annual sales tax revenue (subject to annual appropriation). The obligation has annually been fulfilled with a combination of lease payments and sales tax revenues. As of October 2018, \$10.7 million remains outstanding. The note is also hedged with a swap with [Bank of America N.A.](#) (Aa3 stable) as the counterparty. The swap agreement requires the city to pay a fixed rate of 7.3% to the bank in exchange for 6-month LIBOR plus 1%. There is no remarketing risk associated with the note, as Bank of America, must hold the note until final maturity in November 2025. The November 6, 2018 mark to market value of the swap was negative \$1.2 million.

In November 2010, the city issued a variable rate note with the Bank of Oklahoma for inducements for Flight Safety International. The agreement requires the city to pay the bank 6-month LIBOR plus 2%. The 2010 note is secured by a 1/8th of 1% sales tax and is subject to annual appropriation by city council. As of October 2018, \$7.7 million remains outstanding on the note.

PENSIONS AND OPEB

City employees participate in one of three retirement plans: Oklahoma Municipal Retirement Fund (OkMRF), Oklahoma Firefighters' Pension and Retirement Fund (OkFPRF) and the Oklahoma Police Pension and Retirement Fund (OkPPRF). OkMRF is a multiple employer, defined contribution public employee retirement system managed by a nine-member board of trustees on behalf of the city.

The Firefighters and Police pension plans are cost-sharing, multiple-employer defined benefit retirement plans sponsored by the state. The city makes annual contributions to the system at a rate established by state law. In 2016, the legally required contribution represented only 46.3% of the "tread water" level, the contribution amount at which Moody's has determined that there would be no increase in unfunded liability based on reported assumptions. This funding gap has increased very slowly over the past three years, and could negatively pressure the credit profile as underfunding continues. In fiscal 2017, the city's total contribution was \$3.1 million (4.4% of operating revenues), compared to the \$6.7 million (9.5% of operating revenues) tread water contribution.

Moody's adjusted net pension liability (ANPL) for the city was \$145.4 million, or a moderately high 2.06 times operating revenues for fiscal 2017. The three year average ANPL to operating revenues and full value were 1.67 times and 1.6%, respectively.

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 of the statewide cost sharing plans, but to improve comparability with other rated entities.

Management and governance: moderate institutional framework

The city operates under a Council-Manager form of government. The legislative and policy-making body consists of a five-member City Council, elected by wards with staggered terms for a period of four years. The Mayor is elected within the Council membership. The City Manager is responsible for the day-to-day operations of City government.

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.

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