

CREDIT OPINION

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Broken Arrow (City of) OK

Update to credit analysis

Summary

The [City of Broken Arrow's](#), OK (Aa3) credit profile benefits from its large and growing tax base, favorable wealth indices and manageable debt profile. Recent operating performance has strengthened the fund balance. However, the city's financial position is weakened by low cash levels which are not expected to improve until the end of fiscal 2018. The credit profile is further challenged by high dependence on economically sensitive sales tax revenues.

Credit strengths

- » Large tax base benefiting from proximity to Tulsa
- » Favorable wealth indices

Credit challenges

- » Below average reserves and liquidity
- » Reliance on economically sensitive revenues
- » Slightly elevated, though manageable, debt profile with exposure to variable rate debt
- » Rising 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 tax base expansion
- » Trend of surplus operations leading to improved reserves and liquidity

Factors that could lead to a downgrade

- » Tax base contraction
- » Decline in sales tax collections
- » Further reduction in liquidity

Key indicators

Exhibit 1

Broken Arrow (City of) OK	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value (\$000)	\$6,549,778	\$6,656,029	\$6,875,106	\$7,061,421	\$7,329,988
Population	98,648	100,464	101,917	103,437	104,869
Full Value Per Capita	\$66,395	\$66,253	\$67,458	\$68,268	\$69,897
Median Family Income (% of US Median)	116.3%	115.5%	116.5%	115.0%	114.4%
Finances					
Operating Revenue (\$000)	\$58,227	\$58,687	\$62,481	\$69,320	\$73,709
Fund Balance (\$000)	\$16,714	\$16,168	\$16,609	\$18,115	\$15,206
Cash Balance (\$000)	\$11,715	\$10,307	\$10,768	\$12,848	\$7,490
Fund Balance as a % of Revenues	28.7%	27.5%	26.6%	26.1%	20.6%
Cash Balance as a % of Revenues	20.1%	17.6%	17.2%	18.5%	10.2%
Debt/Pensions					
Net Direct Debt (\$000)	\$106,768	\$108,558	\$108,788	\$113,668	\$117,198
3-Year Average of Moody's ANPL (\$000)	\$60,853	\$66,649	\$71,443	\$78,815	\$90,892
Net Direct Debt / Operating Revenues (x)	1.8x	1.8x	1.7x	1.6x	1.6x
Net Direct Debt / Full Value (%)	1.6%	1.6%	1.6%	1.6%	1.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.0x	1.1x	1.1x	1.1x	1.2x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.9%	1.0%	1.0%	1.1%	1.2%

Finances reflect general and debt service funds

Source: City of Broken Arrow, OK Annual Financial Statements (2012 - 2016), Moody's Investors Service

Profile

The city is a bedroom community of [Tulsa](#) (Aa1 stable), located 14 miles southeast of downtown, with an estimated 2016 population of 104,869.

Detailed credit considerations

Economy and tax base: growing tax base with favorable income indices

The city's tax base is expected to remain stable 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 serves as a bedroom community to Tulsa. Fueled by strong population growth and housing demand, taxable values within the city continue to demonstrate growth, albeit at a somewhat slower pace than the robust economic expansion in the early 2000s. In fiscal 2018, assessed values grew by 5.5% to reach \$874.7 million, equivalent to \$8.1 billion in full valuation. On average, net assessed values (AV) grew 3.9% annually over the five-year period through fiscal 2018. 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 and commercial development with nine active subdivisions and six more anticipated within the near term. Additionally, two local companies in the manufacturing and industrial sectors are undergoing expansions that should yield approximately 600 new jobs in the area. As a direct result, city officials are projecting AVs will grow between 3.5% and 4% within the next four years.

The city's stable tax base is further supported by favorable income levels with a median family income equal to 114.4% of national levels, per the 2016 American Community Survey. Due to access to employment opportunities in nearby Tulsa, the city's December 2017 unemployment rate of 3.4% 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: improving financial position but cash remains low

The city's financial position should continue to steadily improve over the near-term supported by increasing revenues. The improvement should boost current limited cash reserves and a general fund balance that is below the median for similarly rated credits. However, the city's financial position continues to be challenged by a high reliance on economically sensitive sales tax revenues.

Fiscal 2016 concluded with a general fund surplus of \$1.6 million, improving the fund balance to \$10 million, or 13.5% of revenues. When including the debt service fund, total operating balance equaled \$17.4 million, or a healthier 23.7% of total revenues.

Like other Oklahoma cities, Broken Arrow is largely dependent on economically sensitive sales taxes as its main revenue stream. The city levies a 3.55% sales and use tax and designates 1.5% of the receipts to general purposes, 1.0% pledged to the municipal utility authority (BAMA), 0.5% for capital improvements, 0.3% for public safety, and 0.25% for streets. General fund sales tax revenues of \$35.7 million in fiscal 2016 represented 48.1% of total general fund revenues. Over the past five years, general fund sales tax collections have increased annually by 4.8%, on average. Unaudited 2017 sales tax collections reflect a 7% increase over the prior year. The city's second largest revenue stream (19.2% in fiscal 2016) is transfers in from BAMA, which reflect payment in lieu of taxes (PILOT) payments and overhead and the unused portion of the utility's 1% sales tax.

Unaudited results for fiscal 2017 reflect a \$3.6 million surplus with city officials projecting an ending general fund balance of \$12.7 million, due to higher than anticipated sales tax collections. The fiscal 2018 budget was balanced. Year to date, city officials report strong sales tax collections with revenues 2.4% higher than the prior year and use tax collections 43% higher than the total in the prior year due to the expansion of the tax base to include a major online retailer. Current projections reflect a \$3.3 million increase in the general fund by fiscal year end.

LIQUIDITY

Despite an improving fund balance position, the city's liquidity remains significantly weaker than peers, which are driven by sizeable receivables from BAMA. However, the receivables are expected to be collected in fiscal 2018, significantly boosting the cash position.

In fiscal 2016, the city's general fund cash position remained a limited \$126 thousand, 0.2% of general fund revenues, falling from its high of 2% of revenues in fiscal 2012 within the past five years. The cash position has narrowed significantly in the recent past due to inter-fund loans between the general fund and BAMA. The general fund has loaned monies to BAMA for capital needs that will be reimbursed by the state once requests are filed, typically after fiscal year end. Unaudited fiscal 2017 results reflect a \$300 thousand cash position with a \$7.5 million receivable from BAMA at fiscal year end. City officials report that as of March 2018, the city had submitted requests totaling \$11.7 million to the state. Thus far, \$2 million has been received and the city anticipates \$9.7 million within the next 60 days, which will be sufficient to satisfy the receivable in the general fund and significantly improve the cash position at fiscal year end. Additionally, city officials anticipate that the surplus projected for fiscal 2018 will also improve the cash position, resulting in a cash position that is compared to the fund balance.

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

The city's debt burden will remain slightly elevated over the medium term due to planned debt issuances and principal amortization that is below similarly rated peers. At 1.7% of fiscal 2018 full value, the city's direct debt burden is slightly higher than the national median for the rating category. Approximately \$11.3 million in unissued debt authorization remains from the 2014 election, and the city plans to sell the bonds in December 2018. City officials anticipate calling a bond election for \$210 million for August. If approved, the authorization will be issued annually until exhaustion.

DEBT STRUCTURE

The city's debt consists of \$124.9 million fixed-rate general obligation bonds, maturing over the long term (final maturity fiscal 2038). The current debt service schedule calls for 66.3% of principal retired within 10 years.

DEBT-RELATED DERIVATIVES

The city has a total of \$19.1 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 March 2018, \$11.8 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 and the city will receive 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 June 30, 2017 mark to market value of the swap was negative \$1.8 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 March 2018, \$8 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 49.8% 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.

Moody's adjusted net pension liability (ANPL) for the city was \$107 million, or a manageable 1.45 times operating revenues for fiscal 2016. The three year average ANPL to operating revenues and full value were 1.23 times and 1.24%, 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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