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State of Oklahoma Credit Update

State of Oklahoma	Ratings	Outlooks
General Obligation bonds	Aa1/AA+/AA+	stable/stable/stable
Appropriation bonds*	Aa2/AA/AA	stable/stable/stable

Sources: FitchRatings; Moody's; S&P

*Includes bonds secured by State appropriations and issued through the Oklahoma Capitol Improvement Authority and the Oklahoma Development Finance Authority.

Fundamental Rating Factors:

- Relatively stable, commodity-based economy with a focus in oil and gas production and various agricultural products. The economy has diversified somewhat, with military and manufacturing sectors providing some economic balance.
- Constitutional provision that requires State budget surpluses (up to a total of 15% of revenues) be deposited in a reserve fund, which has allowed Oklahoma to build substantial rainy day reserves during positive economic environments.
- A strong liquidity position (as a result of the reserve fund deposits) has kept the state from relying on external borrowing for cash flow needs.
- A low debt burden.
- A high level of unfunded pension liabilities, though the state passed several pension reforms in fiscal 2011 that are expected to have a significant positive influence on pension funding levels over time.

Oklahoma has benefited in recent years from relatively high oil and gas prices that have driven strong growth in energy production and related businesses in the state. The energy sector and linked businesses represent an estimated one in seven jobs in Oklahoma and account for roughly one-third of Oklahoma's gross state product. The State has also benefited from an expansion of manufacturing employment over the past decade. As a result, Oklahoma's unemployment rate (4.9% in July 2012) is more than three full points below the national average, driving better than average growth in personal incomes and taxable sales in the state.

In its fiscal year 2013 budget (FY ending June 30, 2013), the state projected average oil prices above \$96 per barrel and natural gas averaging \$3.64 per 1,000 cubic feet. So far in 2012, energy prices have been tracking below those levels, which has driven a slow-down in oil and gas production in the state and a resulting decline in energy-related revenues. Strong growth in personal income tax, corporate income tax and sales tax revenues has largely offset the revenue declines from energy and related businesses, keeping year-to-date budget performance relatively in line with projections.

Oklahoma depleted its rainy day funds in FY2009 and FY2010, using reserves to close substantial budget shortfalls in those years. Oklahoma ended FY 2011 with revenues exceeding projections by \$249 million (5.1%) due to revenue growth and tight expenditure controls. The \$249 million was deposited into the Constitutional Reserve Fund (CRF), raising the balance from \$0. The State ended FY2012 with another surplus, triggering another deposit into the CRF, which now posts a balance of \$577.5 million, or slightly more than 10% of Oklahoma's FY2012 general fund revenues.

Oklahoma has ranked near the bottom of all states in its level of pension funding in recent years. During FY 2011, the State's Legislature enacted pension reform measures including: eliminating unfunded cost of living adjustments, raising the minimum retirement age for new employees and requiring higher state and employee contribution rates. The changes are expected to improve the state's long-term pension funding position, though Oklahoma will likely remain at a funding level below the national median.

A recent analysis by Loop Capital Markets shows Oklahoma's aggregate pension funding level did improve substantially from the end of FY2010 to the end of FY2011, due in large part to the plan changes. The study shows Oklahoma jumping from a 58% funded level (ranked 46th out of 50 states) in FY2010 to a 63% funded level (ranked 30th) in FY2011. Though the State remains well below the national average of 73%, it is showing positive progress at a time when most states' pension funding is worsening.



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