

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

---

## **Downgrade in State Oklahoma Could Impact Borrowing Costs.**

Fitch Ratings has downgraded the ratings on several Oklahoma bonds one notch — a move that could increase the state's borrowing costs on a number of projects.

The American Indian Cultural Center in Oklahoma City, the Oklahoma Museum of Popular Culture in Tulsa, some higher education construction projects and a new state Health Department lab are among upcoming bond-financed projects likely to be impacted by the downgrade.

The rating change won't impact Oklahoma Turnpike bonds, because they are backed by revenue generated by the turnpike system and are not dependent on state appropriations for the repayment of bonds.

### **Rating change**

Fitch Ratings, one of the big three municipal credit rating services, announced Tuesday that it was lowering the state of Oklahoma's issuer default rating from AA+ to AA.

Fitch also announced that it was lowering the rating on the state's general obligation bonds from AA+ to AA and reducing the ratings on the state's Oklahoma Capitol Improvement Authority and Oklahoma Development Finance Authority bonds from AA to AA-.

Following the downgrade, Fitch's Oklahoma ratings will closely align to those of Standard & Poor's credit rating service, which lowered Oklahoma's rating March 1, and Moody's rating service, which has been slightly lower than Fitch's for a number of years, said state Treasurer Ken Miller.

"This downgrade is certainly not surprising ... to anyone who has been paying attention to state finance in the last year or so," Miller said.

Miller said he and other state leaders warned before the last legislative session that a downgrade was likely if the Legislature did not take steps to address the structural imbalance that the state has in its revenue sources.

"Clearly, Fitch did not see the necessary corrective steps taken last session and this downgrade is the result," Miller said.

Oklahoma has relied on a continued drawdown of the state's Rainy Day Fund and one-time revenue sources to fill large revenue gaps over the last couple of years rather than broadening the tax base, Fitch noted in its downgrade report.

Investors rely on the credit ratings to evaluate the risk of default and generally demand a higher interest rate for bonds with a lower rating.

A drop from a rating of AA+ to AA or from AA to AA- is not a drastic change because all are

considered to be investment grade bonds of very high credit quality.

Still, the change is not insignificant.

For every \$100 million the state borrows under a 20-year repayment structure, a difference between a AA and AA- rating means the state may end up paying around \$2.4 million in additional interest over the life of the bonds, an individual knowledgeable in bond financing told *The Oklahoman*.

In 2016, the state sold \$360.2 million in tax-backed obligations, so if a similar amount were to be issued this year, the difference between a one-notch lower rating could end up costing state taxpayers an additional \$8.64 million or so over the life of the bonds.

State Bond Advisor Jim Joseph cautioned that it is impossible to predict with precision what impact a rating change will have on bond interest rates, noting that many other things factor into the decisions of investors, including the size and structure of the deal and general market conditions.

For that reason, Joseph said he has always declined to predict what interest rates might be.

Miller also pointed out that the other two rating agencies already had Oklahoma rated lower, so the lower evaluation is already likely factored into the interest rates the state has been getting.

Still, it's not going to help, Joseph said.

"Anytime you're downgraded, it's going to end up costing you more money in the long run," Joseph said. "Any investor is going to ask for more yield when they buy a lower-rated bond."

Besides making new projects more costly, higher interest rates also make it more difficult for the state's issuers to refinance outstanding bonds at a savings, he said.

The Oklahoma Museum of Popular Culture project in Tulsa will be among the first to test the impact of the credit rating downgrade. Fitch assigned the \$27.315 million deal a AA- rating. The bonds are expected to be sold through private negotiation later this month.

### **Why the downgrade?**

Fitch cited both economic factors and political factors in a five-page paper explaining the downgrade.

Oil and gas prices have been down and "about one-third of the state's gross state product is attributable to the drilling, production and economic multiplier effects of the oil and natural gas sectors," the credit agency said.

"Volatility related to the energy industry is an inherent part of the state's economy and the industry is expected to be a drag over the medium term," the report said.

"The state has been unable to address its fiscal challenges with structural and recurring measures and revenue collections continue to reflect subdued energy prices," Fitch reported.

The report noted that lawmakers are constrained, somewhat, in their ability to tap new revenue sources by a constitutional amendment that requires either a three-fourths vote of the Legislature or majority vote of the people to pass a tax increase.

Constitutional challenges have been filed to revenue-generating moves by the Legislature last session. The court will decide on the legality of new fees on cigarettes, measures involving electric

and hybrid motor vehicle registration, motor vehicle purchases and personal income tax deductions.

“The validity of the measures, which are forecast to bring in almost \$320 million in fiscal 2018, will be decided by the state’s Supreme Court in August,” the report said. “If the court rules that the measures are invalid, the state would be required to solve for any resulting budget gaps.”

### **The Oklahoman**

by Randy Ellis

Published: July 13, 2017

Copyright © 2024 Bond Case Briefs | [bondcasebriefs.com](http://bondcasebriefs.com)