Moody’s: Oklahoma outlook negative

While affirming the state’s current general obligation rating of Aa2, Moody’s Investors Service, one of three primary debt rating services, has revised Oklahoma’s outlook from stable to negative.

In a late-December credit opinion, the company said, “The negative outlook reflects the fiscal effect of an 18-month decline in the energy sector and the prospects for a prolonged, muted recovery in prices and production.”

Moody’s characterized revenue collections for the current fiscal year as having “significantly underperformed what was budgeted,” and said collections are expected to remain weak during next fiscal year.

The Moody’s opinion came shortly after declaration of a revenue failure for FY-16, triggering across-the-board funding cuts, and adoption of a preliminary revenue estimate for FY-17 that is $900.8 million less than the final estimate for the current fiscal year.

Possible improvement
Moody’s listed two factors that could lead to an upgrade – rapid recovery in the energy sector and increase in financial reserves.

However, neither would appear to be likely, at least in the short term.

Possible downgrade
The rating service’s listed factors that could lead to a downgrade, including:
• Depletion of financial reserves;
• Failure to address structural budget gap; and,
• Acceleration of energy sector downturn.

SEE OUTLOOK PAGE 3
Across the nation, energy producing states are facing challenging budget situations as oil prices collapsed and Oklahoma is no exception.

With oil prices falling to the mid-$30 per barrel range, revenue collections have fallen to the point the state does not have the revenue available to fully fund the Fiscal Year-2016 budget that went into effect July 1. Furthermore, the Board of Equalization in December projected the Legislature will have $900 million less to work with in building the next state budget when the session begins in February.

One out of every four dollars the state collects is associated with the energy industry so when oil prices plummet 70 percent and around 12,000 Oklahomans lose their jobs; the result is a reduction in every major tax collection category. The energy industry impacts every facet of economic activity in Oklahoma, so when your biggest industry goes through a bust like this, it has a ripple effect across all tax streams.

But there is more to the story of our current fiscal dilemma than just falling energy prices. Lawmakers craft roughly a $7 billion budget each year. Before we build that budget, more than $3 billion is automatically taken out of the pot of revenue due to earmarks for “off the top” funding passed by previous Legislatures.

That “off the top” amount grows annually leaving lawmakers with less money each year to appropriate – even as revenues have reached record levels in recent years.

Just eight years ago, 55 percent of revenue went to the General Revenue Fund for the Legislature to appropriate. Today, just 45 percent of state revenue makes it to the Legislature for use in the annual budget.

“Off the top” spending and the more than $1.7 billion in tax credits, incentives and exemptions given away each year will continue to be areas of focus for lawmakers in 2016 as we seek to develop a long-term approach to the broken budgeting process. That work has already begun.

Since shortly after the end of last session, House budget leaders have been meeting with counterparts in the Senate and from the Governor’s office to discuss the developing fiscal situation and begin putting together a plan for balancing the state budget in 2016, a process that doesn’t typically begin until after the legislative session convenes.

Last year, the Legislature passed a law requiring all tax credits to be reviewed every four years, starting with the costliest ones this year, to determine whether the benefit to the state is greater than the cost.

“More than $3 billion is automatically taken out of the pot of revenue due to earmarks for ‘off the top’ funding.”

Guest Commentary
By State House Speaker Jeff Hickman

Revenue shortfall presents challenges, opportunities for Oklahoma

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Oklahoma Economic Report

Hickman
FROM PAGE 2

year, lawmakers will hopefully take a close look at earmarked spending to determine whether areas that were a priority for lawmakers in the past are still needed at the same funding levels today.

Every day, Oklahoma families are required to make hard choices to live within their means. Taxpayers expect lawmakers to set priorities and reduce spending as they craft a budget that meets the core needs of the state.

There will be difficult decisions to make in 2016, but those are challenges the men and women I am honored to serve with in the House are prepared to face.

Outlook
FROM PAGE 1

Moody’s pointed to what it termed the state’s “relatively diversified economy and conservative fiscal practice including below-average debt levels and strong reserves.”

Moody’s listed as negatives energy sector volatility and the state constitution’s restriction on raising revenue.

The economy

The credit opinion points to the state’s slowing economy stemming from the energy sector slump and says the potential lifting of Iranian sanctions next year could significantly increase supply and push prices even lower than current projections.

The loss of state energy sector jobs, the opinion says, is partly due to structural changes as technological improvements in extraction technology have increased efficiency. However, Moody’s reports the large number of federal government jobs, anchored by several military facilities helps stabilize the state’s employment picture.

Finance and liquidity

In spite of “significant progress toward revenue diversification away from reliance on severance (gross production) taxes,” the opinion states the Oklahoma economy remains exposed to volatility in the energy sector.

While Moody’s characterizes the state’s reserves as sizeable, their expected use in the coming budget will cause “the state’s financial cushion to narrow.”

Debt and pensions

Moody’s lists state debt levels as low and said fiscally conservative practices are expected to continue. The state’s $1.9 billion in net tax-supported debt, at 1 percent of the economy, ranked Oklahoma 40th in 2014.

Pension liabilities for the state are above average for U.S. states, but Moody’s acknowledges Oklahoma’s “significant headway in addressing unfunded pension liabilities,” including prohibition of unfunded cost-of-living-adjustments and the November 1 switch to a defined contribution system for new employees in the Oklahoma Public Employees Retirement System.

Governance

Moody’s reiterated its concerns about the provisions of State Question 640, the constitutional amendment enacted in 1992 that prohibits revenue increases without approval of three quarters of both the House and Senate or a vote of the people.

Moody’s states, “this restriction limits the state’s ability to raise taxes and constrains financial flexibility in the context of energy sector volatility.”

Opinions and positions cited in the Oklahoma Economic Report, are not necessarily those of Oklahoma State Treasurer Ken Miller or his staff, with the exception of the Treasurer’s Commentary, which of course, is the viewpoint of the treasurer.
Revenue failure declared, across-the-board cuts ordered

Across-the-board cuts at an annualized rate of 3 percent have been ordered by Preston Doerflinger, Secretary of Finance, Administration and Information Technology.

The reductions will begin with January allocations, and with half of the fiscal year already past, the cuts will amount to 6 percent of monthly allocations for the remaining six months of the fiscal year.

Doerflinger authorized the reductions by declaring a revenue failure following the December 21 release of updated projections of collections for the remainder of FY-16, which ends on June 30, 2016.

The projections show General Revenue Fund (GRF) allocations are expected to dip below the five percent cushion that is built into appropriations language in the Oklahoma constitution.

The order means GRF allocations will be reduced by $176.9 million to cover what is expected to be a $157 million shortfall.

Agencies experiencing the biggest cuts will be the Department of Education, $46.8 million; Health Care Authority, $27.4 million; Higher Education, $24.1 million; Human Services, $18.7 million; Transportation, $13.2 million; and, Corrections, $11.8 million.

FY-17 budget hole preliminarily set at $900.8 million

The FY-17 certified preliminary estimate shows Oklahoma government with $900.8 million less than was certified for the current fiscal year.

The State Board of Equalization’s December 21 estimate will be used by Governor Fallin in proposing a state budget at the beginning of the legislative session on February 1. Later that month, the board will meet again to certify a final estimate to be used in building the FY-17 budget.

Officials have said they anticipate the hole to grow even larger.

FY-16 Final Estimate vs. FY-17 Preliminary Estimate

The preliminary estimate for the General Revenue Fund, the main funding source for state government, is down by $618.5 million, or 10.8 percent.

The reduction is blamed primarily on the impact of a prolonged downturn in the energy industry, which fuels a substantial portion of the state’s economy.

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Officials have said they anticipate the hole to grow even larger.
All I wish for session . . .

For a fourth consecutive year, the Oklahoma Economic Report presents its wish list for the upcoming legislative session, but this year is different.

The projected budget hole of more than $900 million has sucked all the air from the room, or at least the majority of it.

In years prior, we have opined on the need to modernize the tax code, focus exclusively on the budget every other year, address teacher compensation, reform pensions, and maintain state assets.

All of those items remain worthy goals, but the focus this year should be on the extreme challenge of crafting a budget that adequately funds core government services.

Even so, we must emphasize one important consumer protection program that is sure to again come under attack this session. Safeguarding the state’s unclaimed property program and the people it serves will be a top priority of the treasurer’s office.

No finger pointing

While much attention and analysis has been given to the reasons Oklahoma finds itself in this budget crisis, the purpose should not be to assess blame but to learn and make better decisions going forward.

No divisiveness

No one in the State Capitol was elected to serve a political party or individual agenda. Parties and electoral successes may be a means to an end but are not the end all. The goal is a greater and more prosperous Oklahoma. To get there, we must pull together to solve this budget crisis.

Throughout our state’s and nation’s history, statesmen have joined together to accomplish great things in times of need. The largest budget hole in state history begs for this to be one of those times.

No harm to unclaimed property

Lawmakers will face many non-budget issues, but perhaps one of the more important will be preservation of the state’s unclaimed property program.

Various elements have joined together to attempt to cripple this premier consumer protection program.

Started in 1967, Oklahoma’s program requires businesses who lose track of those to whom they owe money to remit it, along with the names and last-known addresses of its owners, to the state.

The names are published in newspapers and on the internet. Money is returned to the owners and some is used by the Legislature for public purposes.

Outside interests are attacking the program from two angles. Life insurance companies, led by Kemper Insurance, headquartered in Chicago, are seeking law to let them keep billions in unclaimed life insurance proceeds. Others are trying to dismantle the program by, in essence, stripping the state of its ability to efficiently enforce the law through contingency fee exams of businesses believed to be in violation.

Two bills were considered last year and remain available to be heard in committee. Proponents of the measures have said they will work to get them passed again this session. Dozens of lawyers and lobbyists have been hired to help.

Should the insurance-backed measure be enacted, it will keep Oklahomans from receiving millions intended for them by their loved ones. The other bill would essentially end the program for lack of enforcement ability.
Gross Receipts to the Treasury continue fall in November

Monthly Gross Receipts to the Treasury are lower than the same month of the prior year for a seventh consecutive month as low oil prices and reduced consumer spending shrank the bottom line in November, State Treasurer Ken Miller announced.

Twelve-month Gross Receipts to the Treasury also contracted, as total collections continued an eight-month downward trend and are the lowest since June 2014.

“We are seeing the ongoing impact of the slowdown in the energy industry as the effect is felt across the state’s economy,” Miller said. “The downward trajectory of revenue collections moderated slightly this month, but the overall trend continues.”

Total Gross Receipts to the Treasury for November are $830.8 million, down by more than $15 million, or almost 2 percent, from November 2014.

For an 11th consecutive month, collections from oil and natural gas production taxes are lower than the same month of the prior year. November gross production collections are more than 54 percent

SEE REVENUE PAGE 7

Gross Receipts & General Revenue compared

November Gross Receipts to the Treasury totalled $830.8 million, while the General Revenue Fund (GRF), as reported by the Office of Management and Enterprise Services, received $354.1 million, or 42.6% of the total.

The GRF received between 35.7% and 53.6% of monthly gross receipts during the past 12 months.

From November gross receipts, the GRF received:

• Personal income tax: 44.2%
• Corporate income tax: None
• Sales tax: 44.4%
• Gross production-Gas: 64.9%
• Gross production-Oil: 1.7%
• Motor vehicle tax: 27%
• Other sources: 50.8%

November GRF allocations are below the estimate by $50.1 million or 12.4%. Fiscal year-to-date collections are less than the estimate by $101.9 million or 4.6%.

November insurance premium taxes totaled $3.82 million, an increase of $155,992, or 4.3%, from the prior year.

Tribal gaming fees generated $10.49 million during the month, down by $124,305, or 1.2%, from last November.

Monthly Gross Receipts vs. Prior Year

Dollar change (in millions) from prior year

Source: Office of the State Treasurer
Oklahoma Economic Report

Revenue

FROM PAGE 6
lower than last November. Monthly receipts are based on oil field activity from September when the average price of benchmark West Texas Intermediate crude oil was $45.48 per barrel.

Sales tax collections, often viewed as an indicator of consumer confidence, have been lower than the same month of the prior year for seven of the past nine months. In November, sales tax collections fell below the prior year by almost 5 percent. The only revenue stream in positive territory for the month is gross income tax, up by more than $40 million, or almost 18 percent, due primarily to the tax commission’s PAYRight tax amnesty program.

Collections for the past 12 months total $11.74 billion, down by 192.3 million, or 1.6 percent from the trailing 12 months.

About Gross Receipts to the Treasury

Since March 2011, the Treasurer’s Office has issued the monthly Gross Receipts to the Treasury report, for a timely and broad view of the state’s macro economy.

Oklahoma jobless rate set at 4.2 percent in November

Oklahoma’s seasonally-adjusted unemployment rate was set at 4.2 percent in November, down by one-tenth of one percentage point from October, according to the Oklahoma Employment Security Commission (OESC).

Lynn Gray, OESC Director of Economic Research and Analysis, said the recent drop in the jobless rate is due to a declining number of continuing unemployment insurance claims.

He said the drop in rate and claims does not signal a strengthening economy. Instead, Gray said job seekers are beginning to exhaust their unemployment benefits.

Over the past year, Mining & Logging (including the energy sector) reported the loss of 12,900 jobs, while Manufacturing showed a reduction of 7,900 jobs. The national unemployment rate was set at 5.0 percent in November.

Oklahoma Unemployment Report

November 2015

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<th>OKLAHOMA</th>
<th>Unemp. rate*</th>
<th>Labor force*</th>
<th>Employment*</th>
<th>Unemployment*</th>
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* Data adjusted for seasonal factors

Source: OESC
Economic Indicators

Unemployment Rate
January 2001 – November 2015

Leading Economic Index
January 2001 – October 2015

Unemployment Rate
Oklahoma 12-Month Gross Receipts
January 2008 – November 2015
(in billions)

Oklahoma Stock Index
Top 23 capitalized companies
January 2009 – December 2015

Oklahoma Natural Gas Prices & Active Rigs
June 2010 – December 2015

Oklahoma Oil Prices & Active Rigs
June 2010 – December 2015