



Oklahoma Economic Report™

News and analysis of Oklahoma's economy



A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

March 1 action by S&P is first Oklahoma ratings downgrade since 1987

After 30 years, state credit rating downgraded

In light of weak revenue collections, missed estimates, and suboptimal budget practices, Oklahoma's credit ratings have been downgraded by Standard & Poor's Global Ratings (S&P).

It is the first downgrade of Oklahoma's bond ratings in 30 years by one of the three major rating agencies, according to State Bond Advisor Jim Joseph.

Records show the last time the state's bond ratings were downgraded was by Moody's in 1987, as Oklahoma was continuing to recover from the oil bust.

The new S&P rating for Oklahoma General Obligation (GO) bonds was notched down one position from AA+ to AA. For appropriation-dependent debt, the rating was reduced to AA- from AA.

S&P said, "the downgrade reflects our view that persistently weak revenue collections – leading to a declared

revenue failure for the remainder of the fiscal year – have further compounded the state's challenge to achieve structural balance in fiscal 2018."

The state's ongoing use of one-time funding sources to fill budget holes, during good times and bad, exacerbated the

“The state's ongoing use of one-time funding sources to fill budget holes, in good times and bad, exacerbated the problem.”

problem.

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Editor

Tim Allen, Deputy Treasurer for Communications and Program Administration

State pensions funded status down slightly

Thanks to legislatively-enacted reforms and record high investment returns, Oklahoma's seven public pension systems have seen tremendous improvement in funded status during the past several years.

However, the numbers slipped a little during the last fiscal year as investment performance took a strong hit, a report recently presented to the Oklahoma State Pension Commission shows.

The report prepared by New England Pension Consultants (NEPC) shows the state's systems range in funding from 110.8 percent for the Judges and Justices system to 65.7 percent for the

Teachers Retirement System (TRS). The average funding for the seven systems is 75.4 percent at the end of FY-16. That compares to a funded percentage of 76 percent at the end of the previous fiscal year.

Poor investment returns account for the slight decrease in funded percentages, according to NEPC. Of note is that Oklahoma's systems are not unique in experiencing suboptimal investment returns.

The average return on investments during FY-16 on a Market Value basis was -1.12 percent. However, investment

SEE PENSIONS PAGE 4



Guest Commentary By Governor Mary Fallin

Oklahoma's fiscal ailments will continue until budget structural deficits are corrected

Oklahoma is a resilient state, made of strong people with a long, proud history of facing our challenges head-on and coming out in a better place. But Oklahoma will continue to struggle if we don't fix the structural deficits of our budget.

There is no question the dramatic downturn in our energy sector and an increased loss of sales tax revenue from online shopping the last couple of years have affected our state, both in our private and public sectors.

At the start of this year's session, I told the Legislature we needed to have a reality check on our budget deficit. For decades we have attempted to balance our budget with the use of one-time resources. We cannot afford to pass another budget using a large amount of non-recurring revenue.

For the last three years, I have called upon our Legislature to work with me to fix the structural problems in our budget. We can't keep moving money from one place to the other in what I call 'a smoke and mirrors game' acting like we had revenue when we

didn't, by using one-time funds or taking money from revolving funds.

Fixing the structural issues in our budget includes looking at off-the-top money, economic incentives and our sales tax code, which has been in place since the 1930s. We're in a modern-day economy that has changed tremendously with the use of technology.

“We need sufficient revenues to meet the basic responsibilities that our government owes to its citizens.”

My proposed budget is just a starting point of ideas on how to close the state's large budget hole. The energy sector slump and migration to online shopping have created a situation where 85 percent of state agencies have received an average of 20 percent budget cuts. Some agencies in the past several years have had cuts up to 50 percent (See Chart 1, page 9).



We need sufficient revenues to meet the basic responsibilities that our government owes to its citizens. Some claim we should just make deeper cuts to state agencies.

But consider this: If we keep funding flat to just the top seven agencies in terms of state appropriations, we would have no money to fund the 60 other state agencies.

And we still would end up with a budget hole of nearly \$20 million. (See Chart 2, page 10)

Obviously, no money would be available for teacher pay raises or to prevent trooper furloughs.

Since 2011, my administration has submitted 76 cost-saving proposals. Of those, 42 have been adopted, saving well over a half-billion dollars. I am always looking for opportunities to save taxpayers money.

SEE GOVERNOR PAGE 3



Governor

FROM PAGE 2

It's important to note my tax reform package has meaningful tax relief components that will help many Oklahoma citizens and position our state to prosper in the future. To help our families, I proposed eliminating the state sales tax on groceries, which is expected to result in annual savings of \$350 to \$676 for a family of four.

Cities and counties, though, will still have the option to keep the sales tax on groceries, thus not hurting city and county revenue.

I've also called for eliminating the corporate income tax, which would reduce the paperwork and red tape burden of many small businesses and boost economic development. It also would provide more transparency as

it would eliminate the need for the Legislature to pick winners and losers with specific tax credits.

We must find a workable solution with the Legislature to address these difficult challenges. By investing in our state, we are creating a stronger business climate and a place where people want to live, work and raise a family.

Downgrade

FROM PAGE 1

"In the absence of meaningful structural reforms that align revenues and expenditures and that do not materially depend on one-time budget solutions or measures that carry significant implementation risk, we could lower the ratings," the S&P announcement reads.

Leaders react

State Treasurer Ken Miller said the warning statement from S&P of possible future downgrades "should serve as a call to action" during this legislative session.

"Perhaps the critique of Oklahoma's revenue problem coming from an independent, nonpartisan and credible third party will finally spur action to correct the revenue imbalance," Miller said.

"This downgrade of Oklahoma's credit rating should come as no surprise to anyone who follows state finance," he said.

"During my time as treasurer, other state leaders and I have worked to draw attention and action to solve the state's structural budget problems cited in the downgrade statement."

Miller continued, "Years of suboptimal budgeting that has relied heavily on the use of nonrecurring revenue is now impossible for the rating agencies to ignore.

"This downgrade, and others likely to come, will lead to higher debt costs for future infrastructure projects unless sustainable corrective action is taken.

"These problems are well understood by most officers in the executive branch who stand ready, willing and able to work on solutions with our partners in the legislative branch."

Secretary of Finance, Administration and Information Technology Preston Doerflinger also reacted to the S&P downgrade.

"This report highlights several things that we've been saying for some time now," Doerflinger said. "We need to fix the structural budget deficit and our revenue problem."

Gauging the impact

The downgrade, announced March 1, comes as the Oklahoma Capitol Improvement Authority (OCIA) prepares to issue \$70 million in bonds for renovation of the State Capitol Building.

The OCIA is scheduled to get pricing on those bonds on March 7 and 8.

The bond issuance will use the new, lower AA- rating from S&P along with a one-notch higher AA rating from Fitch Ratings.

Bond ratings are akin to credit scores for consumers. The lower a bond rating, the higher the interest rate that is assessed

SEE DOWNGRADE PAGE 4

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Downgrade

FROM PAGE 3

on debt. However, Joseph said it is not possible to immediately determine the amount of increased cost the S&P downgrade will mean to the state.

One thing is certain, however, borrowing costs for the Capitol renovation project will be higher than if the downgrade had not occurred.

In context

Fiscal challenges caused by the Oklahoma economy's strong dependence on the oil and gas industry are at the heart of the state's ongoing problems. But the way in which state policymakers choose to respond to the problem will be key in determining whether Oklahoma's credit ratings improve or are further weakened.

Ignoring the problem by resorting to the

practice of artificially propping up the budget with nonrecurring revenue will likely result in further negative ratings action.

Learn more

Read the complete bond rating report on Oklahoma's downgrade from Standard & Poor's Global Ratings: <http://go.usa.gov/xXazC>

Pensions

FROM PAGE 1

returns on an Actuarial Value basis was 7.45 percent due to what NEPC terms as "delayed recognition of prior years' gains and recent years' losses.

Last year, total plan liabilities increased by 6 percent.

For comparison purposes, the average

U.S. public pension plan was 73.7 percent funded – slightly behind Oklahoma's systems average.

NEPC reported that even though the funded status of the plans decreased slightly in the past fiscal year, they have made great improvement in the last seven years.

Legislative changes in 2011 regarding funding of cost of living adjustments (COLAs) and strong investment performance from 2010 to 2014 have resulted in funded status improvement.

Individual systems funding

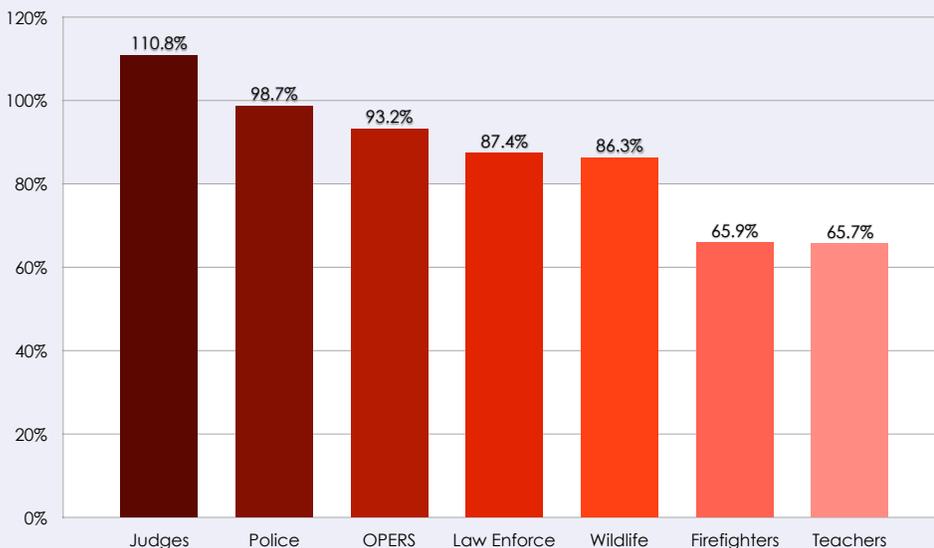
TRS remains Oklahoma's largest and least funded public pension plan. With \$22.2 billion in liabilities and \$14.6 billion in assets, TRS is 65.7 percent funded.

However, if current funding and benefit levels continue, the plan's Unfunded Accrued Liability would be funded after 23 years. Of note is that prior to 2011, actuaries projected the time required to fully fund TRS as "infinite," meaning if the same contributions and assumptions continued as existed in 2011, the plan would never reach fully funded status.

The Oklahoma Public Employees Retirement System (OPERS) is funded at 93.2 percent with \$9.4 billion liabilities and \$8.8 billion in assets. Pensions funded at or above 80 percent are generally considered to be in healthy condition.

SEE PENSIONS PAGE 5

Oklahoma Public Pensions Funded Status FY-16



Sources: NEPC



Pensions

FROM PAGE 4

The Police Retirement System was funded at 98.2 percent at the end of FY-16. It had \$2.4 billion in liabilities and \$2.3 billion in assets.

The Firefighters system finished FY-16 at 65 percent funded with \$3.5 billion in liabilities and \$2.3 billion in assets.

Law Enforcement was 87.8 percent funded with \$1 billion in liabilities and \$911 million in assets.

Wildlife booked an 96.5 percent funded level with \$119 million in liabilities and \$102 million in assets.

The Judges system was 110.9 percent funded with \$276 million in liabilities

and \$306 million in assets.

Learn more

The complete Summary of Actuarial Reports can be found here: <https://go.usa.gov/xXqeU>

FY-17 revenue failure projected as FY-18 estimated hole grows

For a second consecutive year, projections show appropriations from the General Revenue Fund (GRF) will

fall short of collections and will require across-the-board cuts to appropriated agencies in the final months of the fiscal

year. Projections presented to the State Board of Equalization on February 21 show allocations to the GRF are expected to fall 5.7 percent below the final estimate adopted in June 2016.

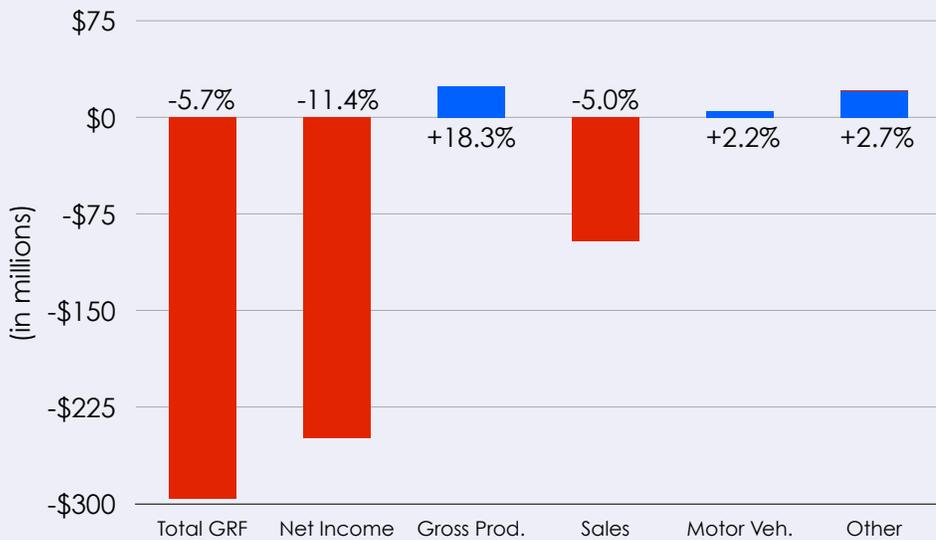
The Oklahoma Constitution limits appropriations to 95 percent of estimated revenue, allowing for a 5 percent variance in collections. However, projections anticipate collections will fall about \$37 million, 0.7 percent, below the cushion.

At the February 21 meeting, the board also adopted a final estimate of revenue for FY-18 for the Legislature to use in writing a budget. The final FY-18 estimate is \$878.2 million, or 12.7 percent, less than the estimate for FY-17.

Commonly referred to as a “budget hole,” the almost \$900 million reduction in anticipated revenue will have to be addressed by the Legislature through spending cuts and/or revenue enhancements.

Governor Fallin has started the discussion by proposing eliminating the state sales tax on groceries while lifting tax exemptions on services and raising fuel and cigarette taxes.

FY-17 Final Estimate (6/16) vs. Final Projection (2/17)



FY-17	June 2016 Est.	Feb. 2017 Proj.	\$ Diff.	% Change
TOTAL GEN REVENUE	\$5,220.3	\$4,924.0	-\$296.4	-5.7%
Net Income Tax	\$2,183.2	\$1,934.5	-\$248.7	-11.4%
Gross Production	\$128.2	\$151.7	\$23.5	18.3%
Sales Tax	\$1,935.9	\$1,839.5	-\$96.4	-5.0%
Motor Vehicle	\$214.0	\$218.7	\$4.8	2.2%
Other Sources	\$759.1	\$779.6	\$20.5	2.7%

Source: Office of Management and Enterprise Services



January Gross Receipts & General Revenue compared

January Gross Receipts to the Treasury totalled \$990.5 million, while the General Revenue Fund (GRF), as reported by the Office of Management and Enterprise Services, received \$505.1 million, or 51%, of the total.

The GRF received between 29.7% and 52.8% of monthly gross receipts during the past 12 months.

From January gross receipts, the GRF received:

- Individual income tax: 67%
- Corporate income tax: None
- Sales tax: 44.1%
- Gross production-Gas: 57.6%
- Gross production-Oil: 11.4%
- Motor vehicle tax: 27.1%
- Other sources: 54.4%

January GRF allocations are below the estimate by \$17.9 million, or 3.4%. Year-to-date GRF revenue trails the estimate by \$83.9 million, or 2.8%.

January insurance premium taxes totaled \$139,894, an increase of \$35,982 million, or 34.6%, from the prior year.

Tribal gaming fees generated \$11 million during the month, down by \$534,022, or 4.6%, from last January.

January brings end to 20-month slide in Gross Receipts to the Treasury

(Original release date: February 7, 2017.)

Gross Receipts to the Treasury grew in January, spelling an end to a 20-month string of shrinking collections, State Treasurer Ken Miller announced.

At \$990.5 million, January Gross Receipts to the Treasury expanded by \$5.1 million, or 0.5 percent, compared to January of 2016, driven primarily by increasing oil and gas gross production collections.

“Several data points – rising GDP, rig counts, business conditions, and employment – give reason for cautious optimism.”

“Low prices and curtailed production in the oil field led us into the latest downturn, and it appears rising prices

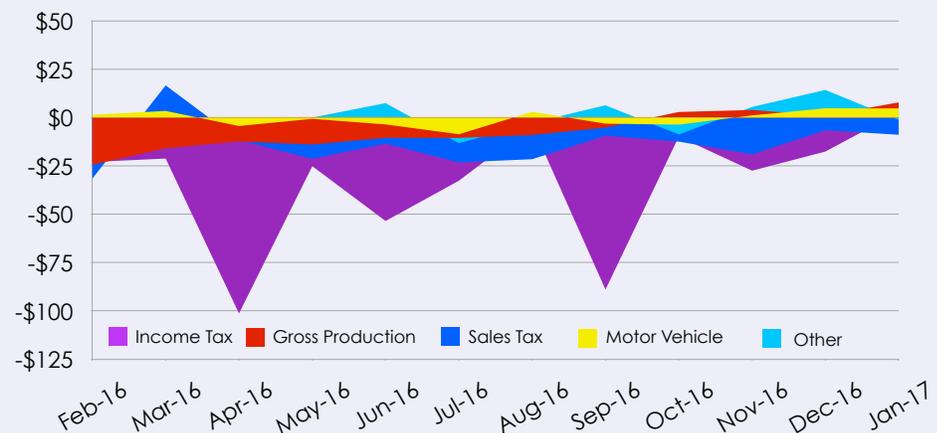
and production are leading us out,” Miller said. “Several data points – rising state GDP, rig counts, business conditions, and employment – give reason for cautious optimism.”

January gross production collections of \$33.1 million

were more than the same month of the prior year for a fourth consecutive month, rising by \$7.8 million, or 31

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Monthly Gross Receipts vs. Prior Year



PRELIMINARY	Jan-17	Jan-17	Variance From Prior Year	
Income Tax	\$377.07	\$379.77	\$2.70	0.7%
Gross Production	\$25.24	\$33.05	\$7.82	31.0%
Sales Tax (1)	\$374.62	\$365.71	-\$8.91	-2.4%
Motor Vehicle	\$67.24	\$71.97	\$4.73	7.0%
Other Sources (2)	\$141.22	\$139.96	-\$1.27	-0.9%
TOTAL REVENUE	\$985.40	\$990.46	\$5.07	0.5%

Dollar change (in millions) from prior year

Source: Office of the State Treasurer



Revenue

FROM PAGE 6

percent. January collections come from November oil field activity when the average price of benchmark West Texas Intermediate crude oil was \$45.66 per barrel.

Individual income tax receipts and motor vehicle collections also were more than amounts received in January 2016.

Individual income tax rose by 3.4 percent and motor vehicle climbed by 7 percent.

Gross sales tax collections continue to push the numbers lower. At \$365.7 million, January sales tax receipts are \$8.9 million, or 2.4 percent, less than the same month of last year.

Gross receipts for the past 12 months total \$10.8 billion and are \$711.8 million, or 6.2 percent, less than collections from the previous 12 month period.

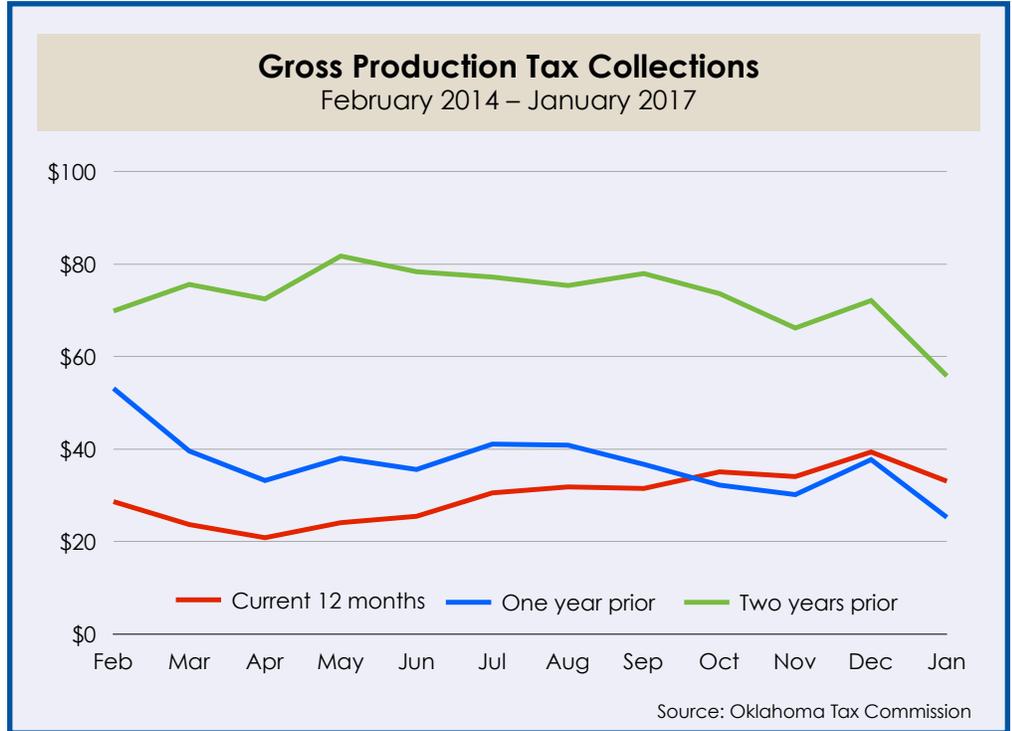
Each of the state’s major revenue sources – income, gross production, sales and motor vehicle taxes – are less than collections from the prior 12 months.

Other indicators

For a sixth consecutive month, Oklahoma’s unemployment rate in December was higher than the national jobless number.

However, at 5.0 percent, the state jobless rate has decreased by one-tenth of one percentage point each month since October. The U.S. unemployment rate was set at 4.7 percent in December.

The Oklahoma Business Conditions



Index, predicting economic activity for the next three to six months, was set at 52.3 in January. The monthly number ends seven months of negative ratings. Numbers above 50 indicate anticipated economic expansion.

About Gross Receipts to the Treasury

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

It is provided in conjunction with the General Revenue Fund allocation report from the Office of Management and Enterprise Services, which provides important information to state agencies for budgetary planning purposes.

The General Revenue Fund receives

slightly less than half of the state’s gross receipts with the remainder paid in rebates and refunds, remitted to cities and counties, and placed into off-the-top earmarks to other state funds.

Annual state jobless rate set at 4.9 percent

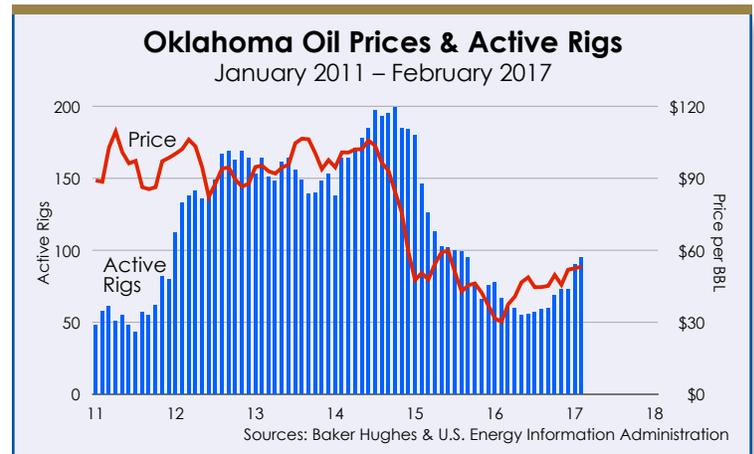
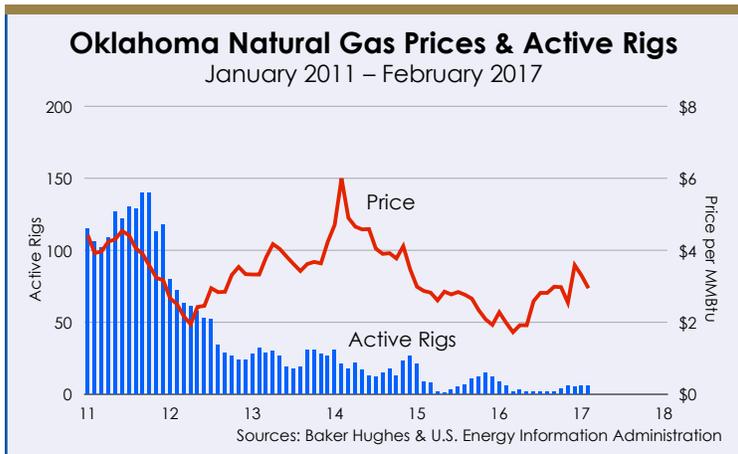
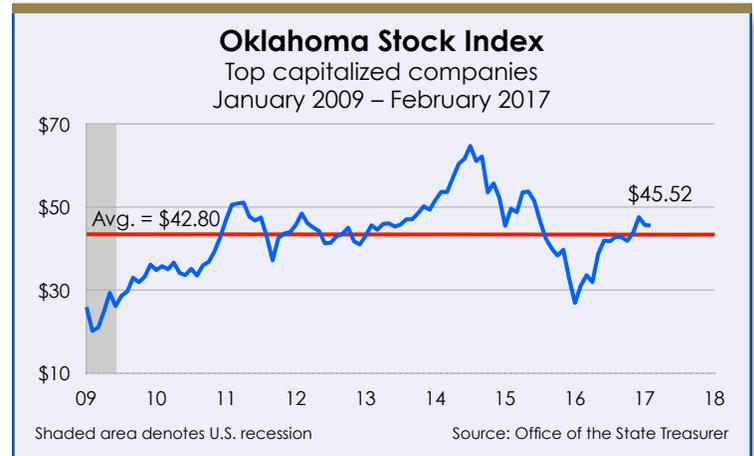
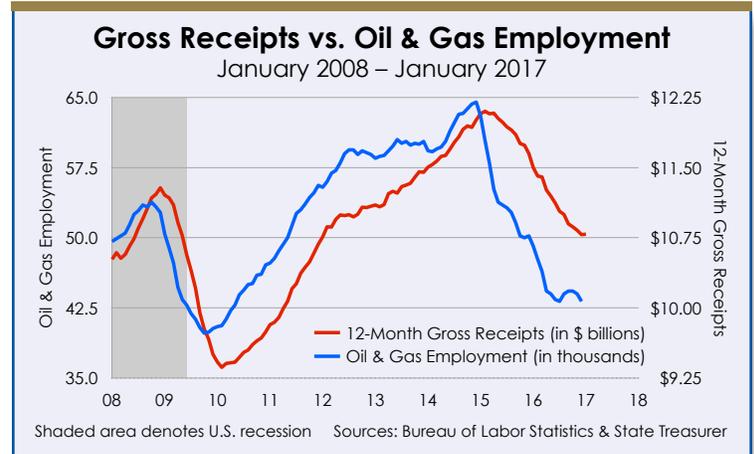
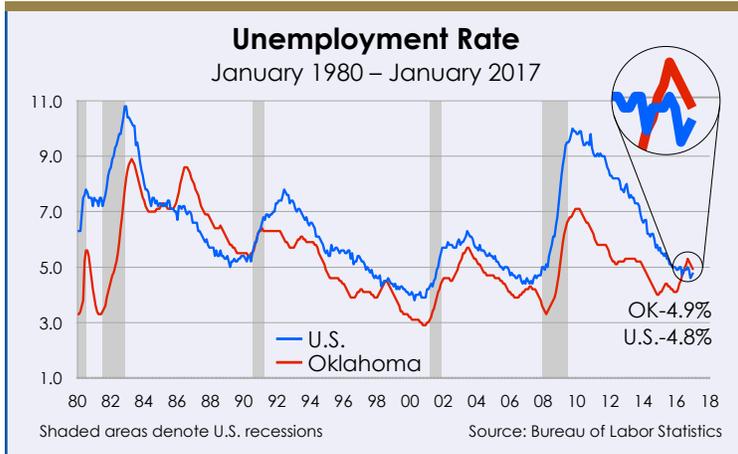
Oklahoma’s unemployment rate for calendar year 2016 was set at 4.9 percent by the federal Bureau of Labor Statistics.

The Oklahoma rate is equal to the average unemployment rate for the United States.

Compared to 2015, the state’s jobless rate rose by one half of one percentage point.



Economic Indicators





Governor's Chart 1

Appropriated Amount Change Between FY 2009 and FY 2017

-40% or more

Educational TV Authority
 Attorney General
 Emergency Management
 Narc. & Dang. Drugs Control
 Arts Council
 Space Industry Development
 Auditor & Inspector
 Bond Advisor, State
 Lieutenant Governor
 Disability Concerns

-30% to -39%

Treasurer
 Environmental Quality, Dept. of
 Tourism & Recreation
 Merit Protection Commission
 REAP
 Center for Adv. /Sc. & Tech.
 J. M. Davis Memorial Commission
 Fire Marshal
 Phys. Manpower Trng. Comm.
 Law Enf. Educ. & Training
 Department of Libraries
 Senate
 A.B.L.E. Commission
 Agriculture, Food & Forestry
 Governor
 House of Representatives
 Horse Racing Commission
 Children & Youth Commission
 Commerce, Dept. of

-20% to -29%

Investigation, Bureau of
 Health Department
 Historical Society
 Transportation Department
 Career. & Techn Education
 Management & Enterprise Services,
 Office of
 Military Department
 Mines, Department of
 Veterans Affairs Department
 Higher Educ., Regents for
 Supreme Court

-10% to -19%

School of Science & Math
 District Attorneys Council
 University Hospitals Authority
 Water Resources Board
 Educational Quality & Accountability
 Corporation Commission
 Office of Juvenile Affairs
 J.D. McCarty Center
 Conservation Commission
 Tax Commission
 Pardon & Parole Board
 Indigent Defense System

0% to -9%

Rehabilitation Svcs., Dept. of
 Public Safety Department
 District Courts
 Education, Dept. of
 Corrections Department
 Labor Department

0% and up

Court of Criminal Appeals
 Ethics Commission
 Election Board
 Human Services Dept.
 Health Care Authority
 Mental Health Department
 Land Office, Commissioners of the
 Medicolegal Investigatons Board
 Legislative Service Bureau



**Governor's
Chart 2**

Funding Only the Top Seven Agencies

1. Education, Dept. of	\$2,426,721,434
2. Health Care Authority	\$991,050,514
3. Higher Educ., Regents for	\$810,022,109
4. Human Services Dept. (g)	\$651,500,262
5. Corrections Department	\$484,900,943
6. Mental Health Department (h)	\$324,823,085
7. Transportation Department	\$154,958,361

-\$19 MILLION

Agencies Receiving no Appropriation

\$0

Career. & Techn Education	\$0	School of Science & Math	\$0
Office of Juvenile Affairs	\$0	Attorney General (a)	\$0
Public Safety Department	\$0	Environmental Quality, Dept. of (d)	\$0
District Courts	\$0	Water Resources Board	\$0
Health Department	\$0	Department of Libraries	\$0
Tax Commission	\$0	J.D. McCarty Center	\$0
Management & Enterprise Services, Office of (e)	\$0	Labor Department	\$0
University Hospitals Authority	\$0	Auditor & Inspector	\$0
District Attorneys Council	\$0	Court of Criminal Appeals	\$0
Veterans Affairs Department	\$0	Phys. Manpower Trng. Comm.	\$0
Rehabilitation Svcs., Dept.of	\$0	Narc. & Dang. Drugs Control (b)	\$0
Agriculture, Food & Forestry	\$0	Arts Council	\$0
Commerce, Dept. of	\$0	Law Enf. Educ. & Training	\$0
Tourism & Recreation	\$0	Educational TV Authority	\$0
Supreme Court	\$0	Treasurer (c)	\$0
Indigent Defense System	\$0	A.B.L.E. Commission	\$0
Center for Adv. /Sc. & Tech.	\$0	Pardon & Parole Board	\$0
Legislative Service Bureau	\$0	Horse Racing Commission	\$0
House of Representatives	\$0	Children & Youth Commission	\$0
Investigation, Bureau of	\$0	Governor	\$0
Historical Society	\$0	Educational Quality & Accountability (f)	\$0
Corporation Commission	\$0	Fire Marshal	\$0
OSU Medical Authority	\$0	Mines, Department of	\$0
Military Department	\$0	Ethics Commission, Okla.	\$0
REAP - local gov'ts thru commerce/formerly through auditor	\$0	Emergency Management	\$0
Senate	\$0	Lieutenant Governor	\$0
Conservation Commission	\$0	Merit Protection Commission	\$0
Medicolegal Investigatons Board (i)	\$0	Space Industry Development	\$0
Land Office, Commissioners of the	\$0	Disability Concerns	\$0
Election Board	\$0	J. M. Davis Memorial Commission	\$0