



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

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

Many unhappy returns

The investment markets were not kind to Oklahoma's seven public pensions during Fiscal Year 2016. Only three of the systems made positive returns, while four found their portfolios had lost ground as of June 30, 2016.

The Oklahoma Public Employees Retirement System (OPERS), Firefighters, Judges, and Wildlife made modest gains, ranging from 1.1 percent to 0.3 percent.

The Oklahoma Teachers Retirement System (OTRS), Police, and Law Enforcement all went below zero with returns ranging from -2.2 percent to -0.2

percent. On average, the state's public pensions finished FY-16 in negative territory with -1 percent in investment earnings.

Compared to their peers, Oklahoma's pensions generally underperformed with five of the seven systems reporting investment performance in the bottom half of all systems. On average, the state's pensions ranked in the 81st percentile, with returns weaker than all but 19 percent of all public pensions.

Peer rankings notwithstanding, Oklahoma's public pensions aren't the only ones experiencing lower returns,

and projections point to suppressed investment earnings for the next 10 to 20 years. The Wilshire Trust Universe Comparison Service reports U.S. public pension plans generated a median return of 1.1 percent during FY-16, down from a median of 3.4 percent during FY-15.

This year's returns stand in stark contrast to earnings of just a few years ago. In FY-14, the average Oklahoma pension return was 19.9 percent, and during FY-11, the average was 21.2 percent with OTRS leading the nation with 23.5 percent in investment gains.

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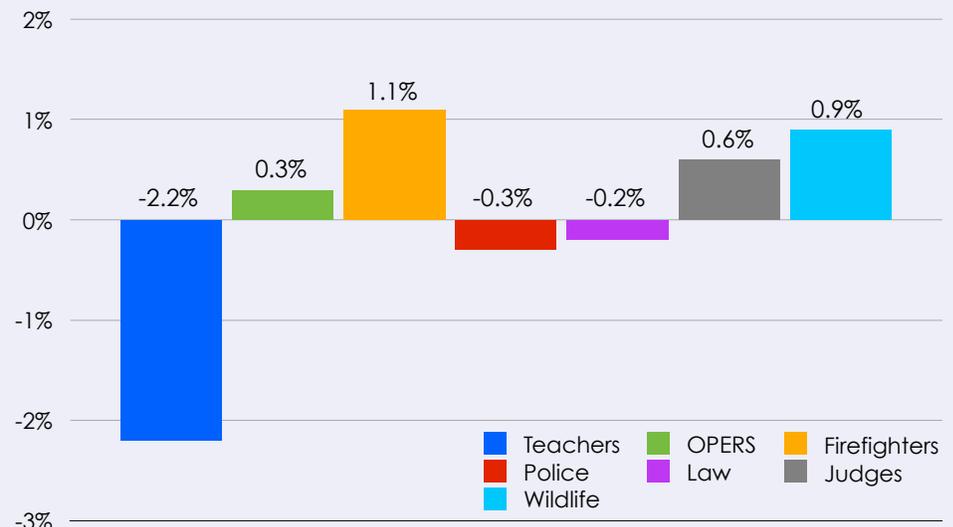
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Editor

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Public Pensions Investment Performance

FY-16



Source: NEPC



Treasurer's Commentary

By Ken Miller, Ph.D.



Pensions: still wanting more

Investment earnings from the state's public pensions have fallen in the past few years. After shrinking considerably during the Great Recession, investment returns grew at double-digit rates during the recovery. But the gains were unsustainable and lean times have returned.

The long-term outlook for returns is expected to be below the actuarial assumed rate of return for the foreseeable future, and some Oklahoma plans are beginning to adjust to the changing landscape.

We've made great improvements to our pension systems, but that doesn't mean we're finished. With current returns reminding that more can be done to strengthen our pensions, there is an opportunity not present during better times to make long-term changes in the governance and plan design of the systems.

With two key improvements still looking for a reform-minded legislator to take up the cause, here, again, are my thoughts:

Governance

I continue to believe that Oklahoma's current pension governance with its seven independent boards and administrations is inefficient, costly and unnecessary. Our pensioners

have to foot the bill for \$100 million in administrative bureaucracy before one dollar is spent on actual benefits.

Ideal reform: Reduce the number of pension systems from seven to two by establishing one for public safety employees and one for non-public safety employees, and add the treasurer to the boards.

“It makes zero sense for the treasurer to be excluded from the state's largest investments.”

Combining the state's non-public safety plans would cut administrative costs, but more importantly would offer large investment economies of scale. Millions would be saved each year by packaging them together for investment, while keeping the funds separate for legal and accounting purposes.

I'm sure that for every million dollars in potential savings there will be a million excuses from defenders of the status quo for why it can't work. Well, it can and it does.

For just one example of a well-executed pension system, check out the Tennessee Consolidated Pension System. For economies of scale deniers, check out the fees of OPERS and OTRS relative to our smaller plans. And for those who wish to “caution” of potential reductions in investment earnings due to converging strategies, compare the historical returns of our seven plans.

Whether the boards are consolidated or not, the state treasurer should serve on them. The treasurer is directly accountable to the people and constitutionally assigned to manage state investments. It makes zero sense for the treasurer to be excluded from the state's largest investments.

Since this logic is impossible to dispute, opponents will surely label it a “power grab.” To ensure this reform stays focused on sound financial practices rather than politics and

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Commentary

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personalities, I propose adding the treasurer to the pension boards be made effective after my term.

Plan design

Support is growing for increasing teacher salaries and it appears likely that changes are coming, but current proposals address only the near term. What is also needed are solutions to address teacher compensation for the long term.

Since last November, all new state employees under OPERS are participating in a defined contribution pension plan, due to legislative changes passed in 2014. Left unchanged was the plan design for teachers. But it remains my belief that a defined contribution option makes sense for teachers that want it.

Ideal reform: Give teachers a choice – receive a higher salary up front with a defined contribution plan, or defer some compensation until retirement

with the traditional defined benefit plan.

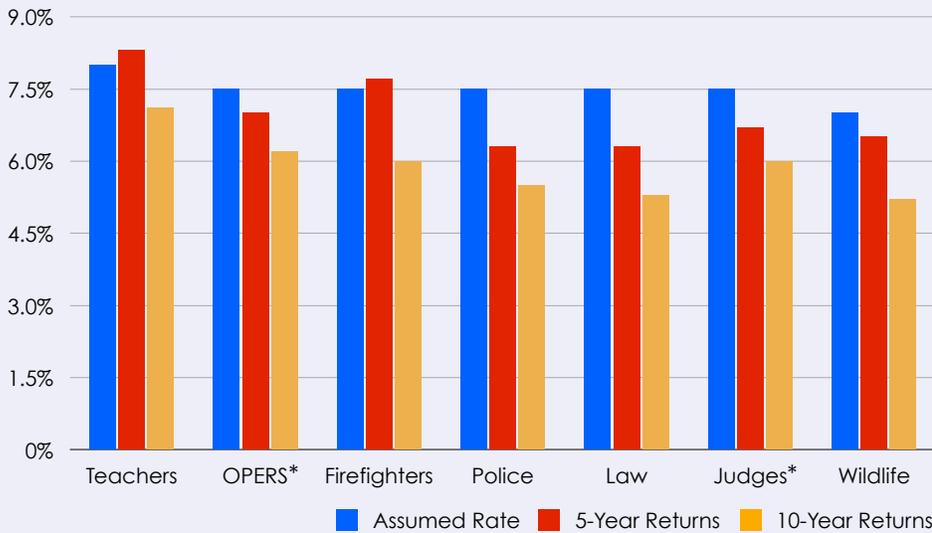
Let us not forget that many of those who have left the teaching profession have moved into higher-paying private sector jobs that offer 401(k), defined contribution pensions.

It is likely state revenues will continue to be strained and lower investment returns a new normal. Regardless, these governance and plan design improvements will benefit both the state and retirees.

Pensions

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Assumed Rates of Return vs. Performance



*Assumed rates of return lowered to 7.25% effective for the actuarial valuation for June 30, 2016.

Source: NEPC

Riding the ups and downs

When world financial markets tumbled during the Great Recession in 2008 and 2009, state pension investment performance followed suit with returns falling a collective -4.4 percent in FY-08 and -16.6 percent in FY-09.

But the economic recovery made the portfolios of each state system healthy again with strong investment performance, including double-digit returns in four of the following six years.

During FY-15, the tide began to turn with returns falling into the low single digits. Investment experts point to falling returns in fixed-income investments and a less bearish stock market.

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Pensions

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Making assumptions

With returns in the bond market at historic lows, little room for growth seen in the equity markets, and a pessimistic outlook for the next decade, public pensions across the nation are adjusting their investment strategies and lowering their expectations.

A number of public pensions have moved to lower their actuarial assumed

rates of return, the average long-term rate of earnings expected on current and future investments to pay benefits.

Among those lowering their expectations is the California Public Employees' Retirement System, or CALPERS, the nation's largest public pension system with more than \$300 billion. In November, CALPERS approved a policy which could eventually lower its assumed rate of return from the current 7.5% to 6.5%.

Other systems ratcheting down their assumed rates include New York State Common Retirement Fund, New Hampshire Retirement System, Pennsylvania Public School Employees' Retirement System, and Missouri State Employees' Retirement System.

Oklahoma joins in

OPERS has joined the recent trend by lowering its actuarial assumed rate of return on investments. In August, the OPERS board voted to reduce the rate to 7.25 percent from the 7.5 percent it had used for more than 30 years. The board's action could be the first of multiple steps to ratchet down its assumed rate of return due to lower expected investment returns, especially in fixed-income investments. The reduction in assumed rate also applies to the Judges and Justices Retirement System for the state's judiciary.

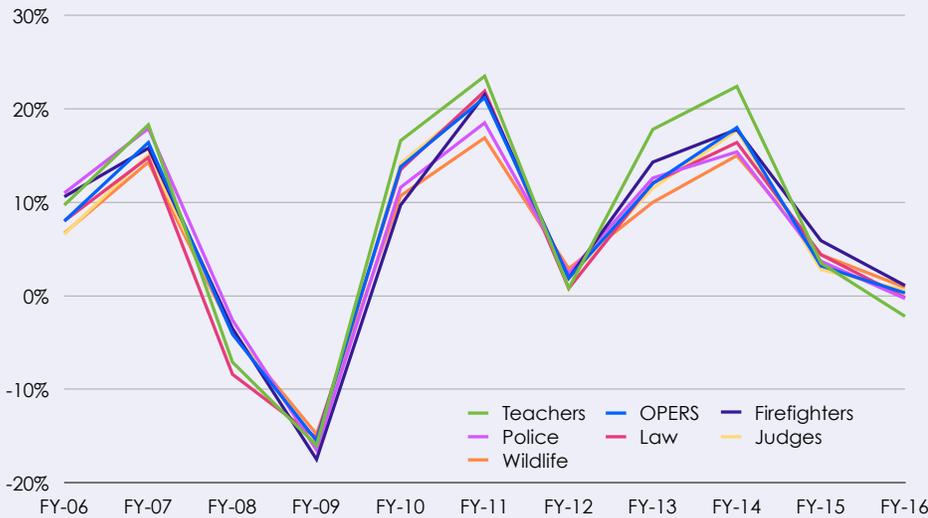
While no action has yet been proposed, Oklahoma Teachers is also looking into changing its assumed rate, which at 8 percent is the highest among the state's seven systems.

In addition to OPERS and Judges,

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Oklahoma Public Pensions Investment Returns

FY-06 – FY-16



	FY-06	FY-07	FY-08	FY-09	FY-10	FY-11	FY-12	FY-13	FY-14	FY-15	FY-16
All OK Pensions	9.3%	16.8%	-4.4%	-16.6%	12.7%	21.2%	1.9%	14.9%	19.9%	3.6%	-1.0%
Teachers	9.7%	18.3%	-7.1%	-16.0%	16.6%	23.5%	0.8%	17.8%	22.4%	3.5%	-2.2%
OPERS	8.0%	16.4%	-4.1%	-15.5%	13.8%	21.2%	1.9%	12.0%	18.0%	3.2%	0.3%
Firefighters	10.6%	15.8%	-3.5%	-17.5%	9.7%	21.5%	1.9%	14.3%	17.8%	5.9%	1.1%
Police	11.0%	17.9%	-2.6%	-16.5%	11.6%	18.5%	2.4%	12.6%	15.4%	3.7%	-0.3%
Law	8.0%	14.8%	-8.4%	-15.2%	13.5%	21.9%	0.8%	12.1%	16.4%	4.4%	-0.2%
Judges	6.6%	15.1%	-3.7%	-15.7%	14.2%	21.4%	1.8%	11.5%	17.7%	2.8%	0.6%
Wildlife	6.7%	14.3%	-3.9%	-14.8%	10.7%	16.9%	2.9%	10.0%	15.0%	4.4%	0.9%

Source: NEPC



Pensions

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Firefighters, Police and Law Enforcement have historically used 7.5 percent as their assumed rates. Wildlife has used 7 percent.

Expected impact

Using a lower assumed rate of return on investments will result in lower funded

status for the systems. In other words, the lower the assumed rate of return, the higher the unfunded liability of a pension system.

The OPERS actuary reported that had the new 7.25 percent assumed rate of return been in effect at the end of FY-15, the funded status would have been about two percent points lower.

At the end of FY-15, OPERS was 93.6 percent funded. The Judges' system was 110.9 percent funded.

Learn more:

Read the complete Oklahoma State Pension Commission Investment Summary at go.usa.gov/xWy2A

General Revenue collections miss estimate in July

After finishing FY-16 below the estimate by 9.4 percent, the General Revenue Fund (GRF) started FY-17 in the same vein, missing the estimate by 4.4 percent.

Ironically, in the midst of a state economic recession driven by low oil and gas prices, the only major revenue source above the estimate in July was gross production tax collections, exceeding expected receipts by 7.9 percent, or some \$600,000.

Officials at the Office of Management and Enterprise Services pointed to sales tax collections as the biggest concern, as receipts from this consumption tax have been below the estimate for 17 of the past 18 months.

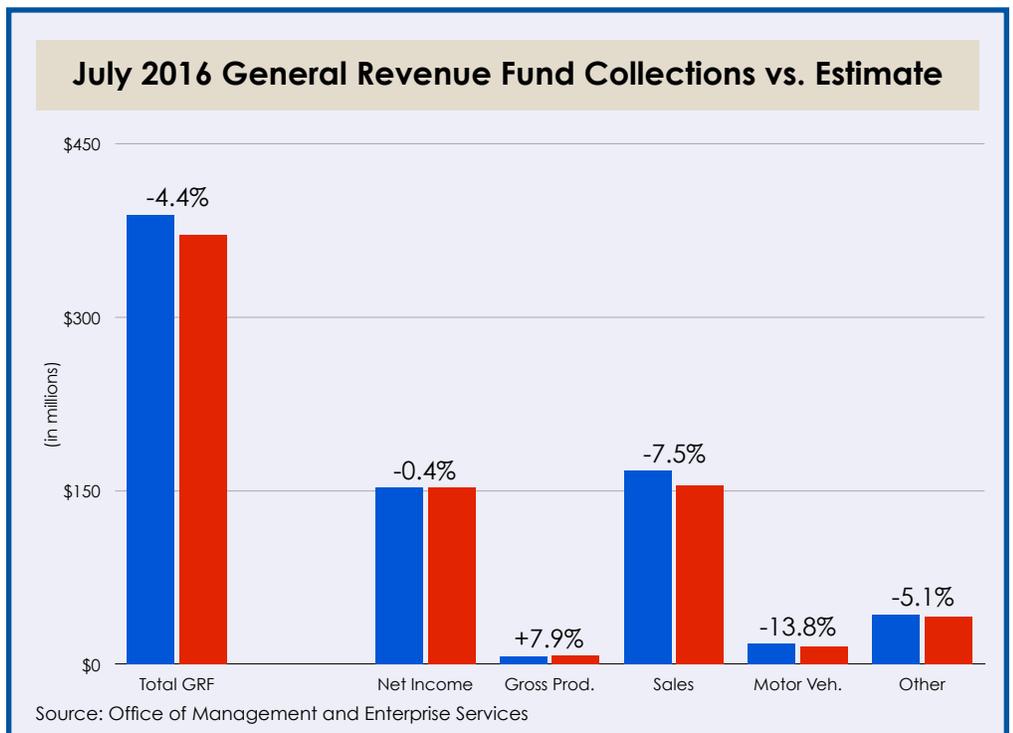
In an August 10 news release, Finance Secretary Preston Doerflinger said the prolonged downturn in sales tax collections are reflective of the energy price downturn, but he also assigned blame to the state's "outdated sales tax code" that ignores all services and most online sales. July sales tax allocations missed the estimate by 7.5 percent, or \$12.5 million.

Net income tax collections, a combination of individual and corporate receipts, were marginally off the estimate by 0.4 percent, or about \$600,000.

Motor vehicle allocations were below the monthly estimate by 13.8 percent, or \$2.5 million.

Other revenue sources were below the monthly estimate by 5.1 percent, or \$2.2 million.

The GRF is state government's main operating fund and the primary funding source for annual state budget appropriations. GRF allocations are remaining revenues after rebates, refunds and earmarks.





July Gross Receipts & General Revenue compared

July Gross Receipts to the Treasury totalled \$853.9 million, while the General Revenue Fund (GRF), as reported by the Office of Management and Enterprise Services, received \$371.8 million, or 43.5%, of the total.

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

From July gross receipts, the GRF received:

- Personal income tax: 59.9%
- Corporate income tax: 45.4%
- Sales tax: 43.6%
- Gross production-Gas: 55.1%
- Gross production-Oil: 7.2%
- Motor vehicle tax: 25.8%
- Other sources: 27.4%

July GRF allocations are below the estimate by \$17.2 million, or 4.4%. In the first month of the fiscal year, year-to-date collections are identical to July figures.

July insurance premium taxes totaled \$399,548, an increase of \$318,502, or 393%, from the prior year.

Tribal gaming fees generated \$10.49 million during the month, up by \$10,618, or 0.1%, from last July.

Current downturn in Gross Receipts lasting longer than during Great Recession

(Original release date: August 5, 2016. A subsequent gross receipts release is available [here](#).) The ongoing contraction in state Gross Receipts to the Treasury has now lasted longer than the downturn experienced from the Great Recession, State Treasurer Ken Miller announced as he released the July revenue report.

The current decline has thus far lasted 17 months, while the previous contraction ended after 14 months. From the last peak, in February 2015, 12-month collections have fallen by \$1.1 billion, or 8.8 percent. During the Great Recession, 12-month gross receipts

shrank by \$1.9 billion, or 17 percent, between December 2008 and February 2010.

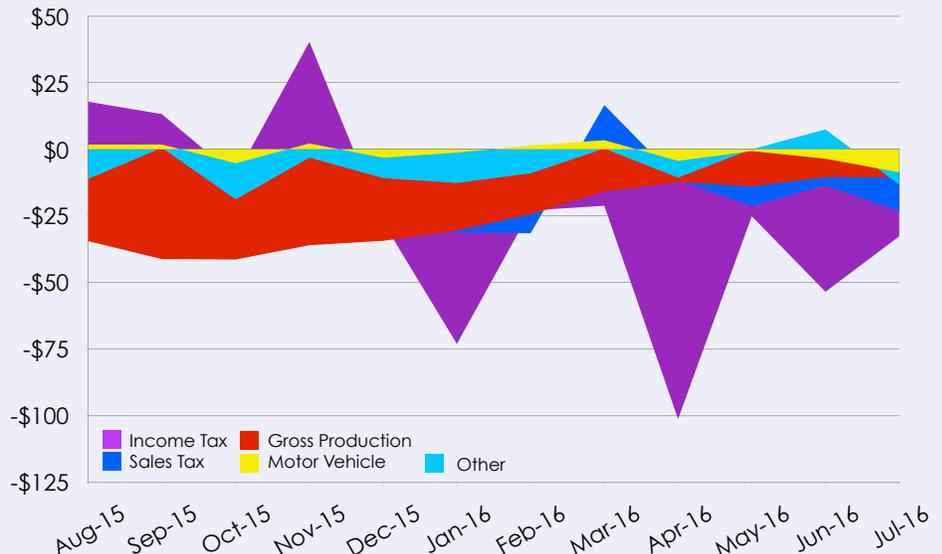
“Though we are still looking for the bottom of the current economic contraction, the news is not all dire,” Miller said. “To date, this downturn has not been as steep as before and unemployment rates have not risen as high.”

At the recession’s peak, in 2010, Oklahoma unemployment reached 7.1 percent. Jobless figures from July showed state unemployment at 5.0 percent.

“To date, this downturn has not been as steep as before and unemployment rates have not risen as high.”

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Monthly Gross Receipts vs. Prior Year



Dollar change (in millions) from prior year

Source: Office of the State Treasurer



Revenue

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The July Gross Receipts to the Treasury report shows monthly collections are 9.4 percent below collections of the same month of the prior year and are down in each major source of revenue – individual income, corporate income, sales, gross production, and motor vehicle taxes. During the past 12

months, total collections are down by 7.6 percent compared to the prior period and also show contraction in all major revenue streams.

State recession

The Bureau of Economic Analysis issued state gross domestic product

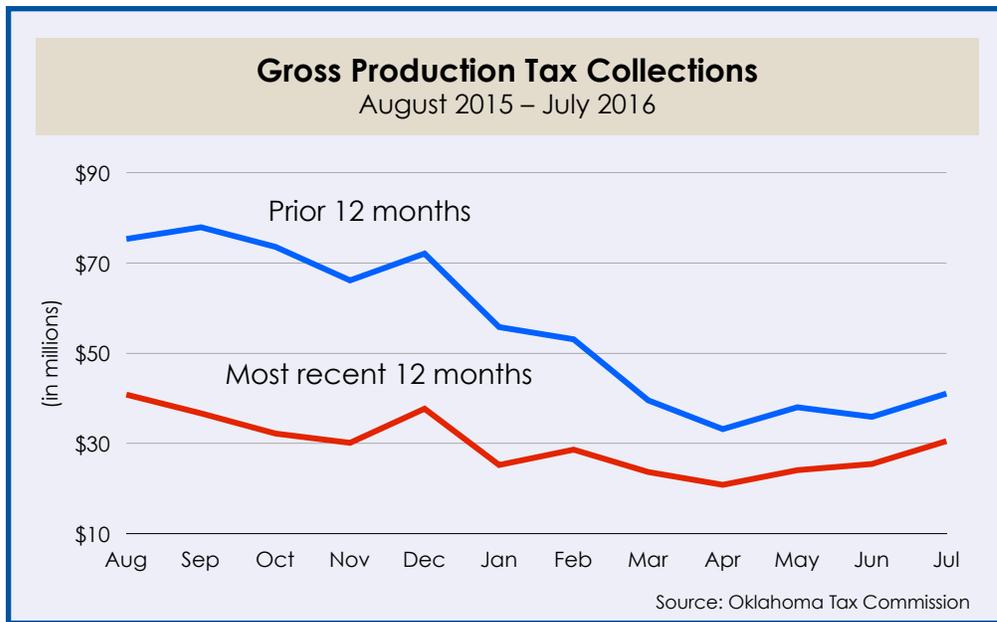
(GDP) figures in late July showing the downturn in the Oklahoma economy, which began in the second quarter of 2015, continued through the first quarter of 2016. Oklahoma’s first quarter GDP was listed as having shrunk by 0.5 percent.

The data would appear to indicate Oklahoma has been in a recession for at least a full year. Recessions are traditionally defined as at least two consecutive quarters of GDP reduction.

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 budgetary information to state agencies.



State unemployment exceeds U.S. rate for first time since 1990

Oklahoma’s seasonally-adjusted unemployment rate was set at 5.0 percent in July, up by two-tenths of a percentage point from June, according to the Oklahoma Employment Security Commission (OESC).

It marks the first time since October 1990 the Oklahoma jobless rate has been higher than the U.S. rate, which was set at 4.9 percent in July.

The number of jobless Oklahomans increased by 1,727 during the month and 11,476 over the year.

OKLAHOMA	Unemp. rate*	Labor force*	Employment*	Unemployment*
July '16	5.0%	1,834,347	1,742,896	91,451
June '16	4.8%	1,850,770	1,761,046	89,724
May '16	4.7%	1,864,194	1,776,399	87,795
April '16	4.5%	1,871,604	1,786,474	85,130
Mar '16	4.4%	1,870,152	1,788,383	81,769
Feb '16	4.2%	1,862,135	1,784,329	77,806
July '15	4.3%	1,843,616	1,763,641	79,975

* Data adjusted for seasonal factors

Source: OESC



Economic Indicators

