NATIONAL ASSOCIATION OF STATE BUDGET OFFICERS

Impact of Falling Oil Prices on States

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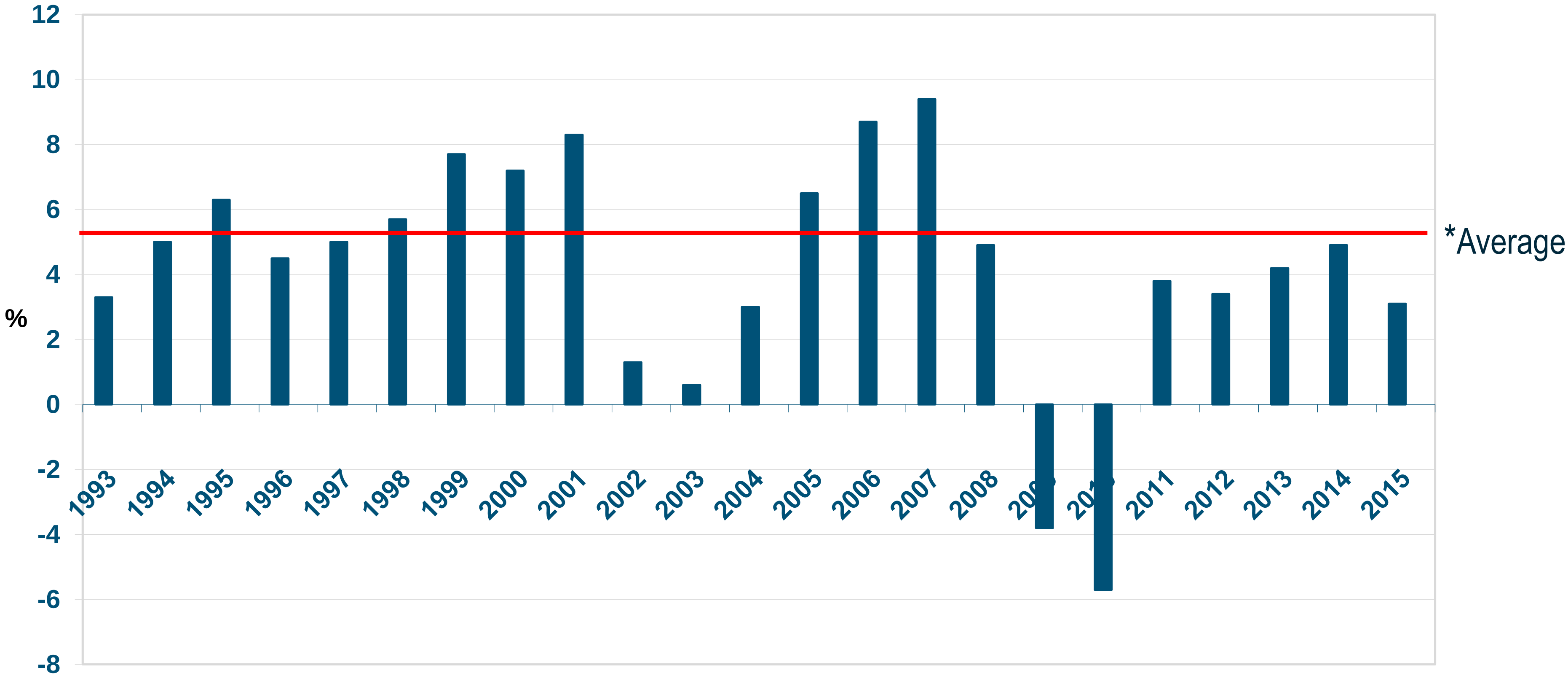
State Fiscal Overview

- Fiscal 2015 marks the 5th consecutive annual increase in general fund spending and revenues
- Signs of fiscal distress have subsided and the fiscal environment for most states indicates continued stability and slow growth
- Some states are facing difficult budget environments due to various issues including federal cuts, tax related issues, long-term liabilities, decline in oil prices, etc.
- Fiscal improvements over the last several years have not returned states to normal patterns of growth

Slow Budget Growth Continues

General Fund Expenditure Growth (%)

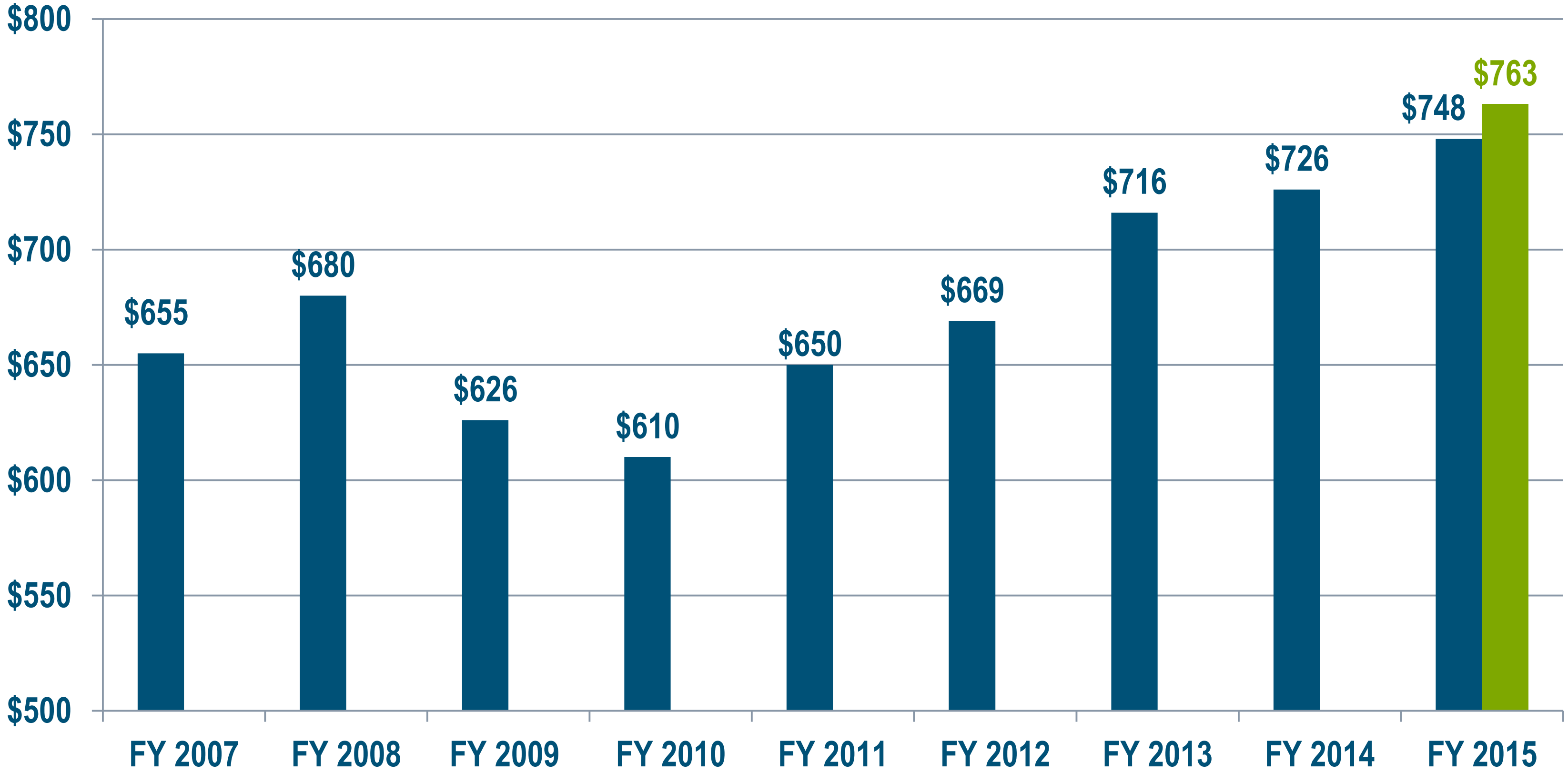


*37-year historical average annual rate of growth is 5.5 percent
Source: NASBO Fall 2014 Fiscal Survey of States

*Fiscal 2015 numbers are enacted

GF Revenue Below Pre-Recession Peak Adjusted for Inflation

General Fund Revenue: FY 2007-FY 2015



Source: NASBO Fall 2014 Fiscal Survey of States; Fiscal 2015 numbers are enacted
**Aggregate revenue levels would need to be $763 billon to remain equivalent with real 2008 revenue levels.*

Governors' Proposed Budgets for Fiscal 2016

- Many governors noted economic improvements in their state since end of the recession
- Majority of budget recommendations include projections of modest revenue growth, moderate state spending increases, and stable reserves
- However, budget proposals remain cautious with emphasis on ensuring budgets are structurally balanced and sustainable

Current Revenue Outlook

- Through March, most states fiscal 2015 revenues were on target or at least slightly above projections
- Early indications are that most states are seeing a positive April surprise with income taxes
- However, some states were seeing significant declines in certain revenue sources including severance taxes

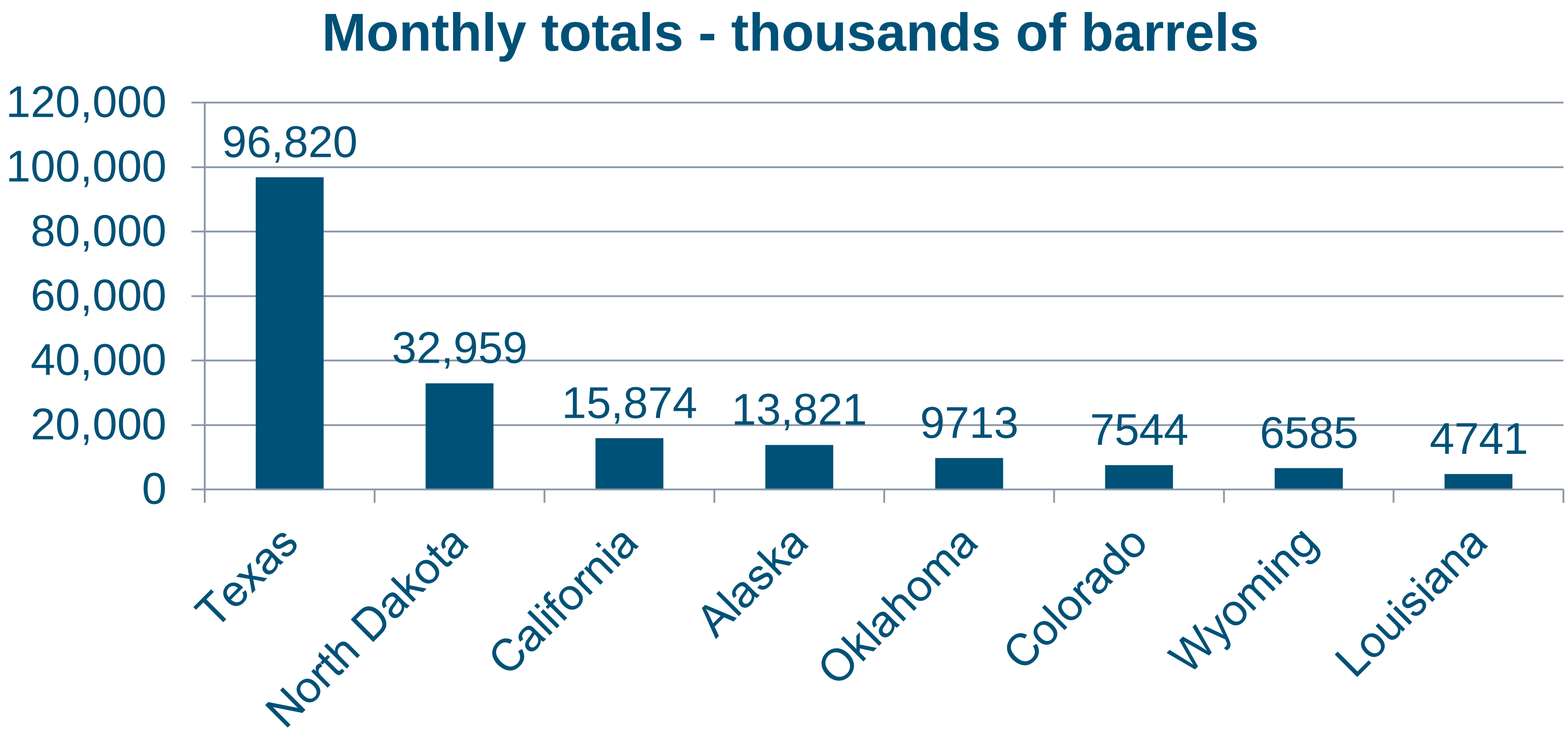
Reasons for oil price declines

- Demand remains low in many areas because of weak economic activity, while supply is high because of increase in U.S. and other countries
- OPEC failing to reach agreement on production curbs in November
- Saudi Arabia and some other countries having enough reserves to tolerate lower prices; hope that some high cost drilling will be eliminated
- Oil speculators also played a role

Economic impact

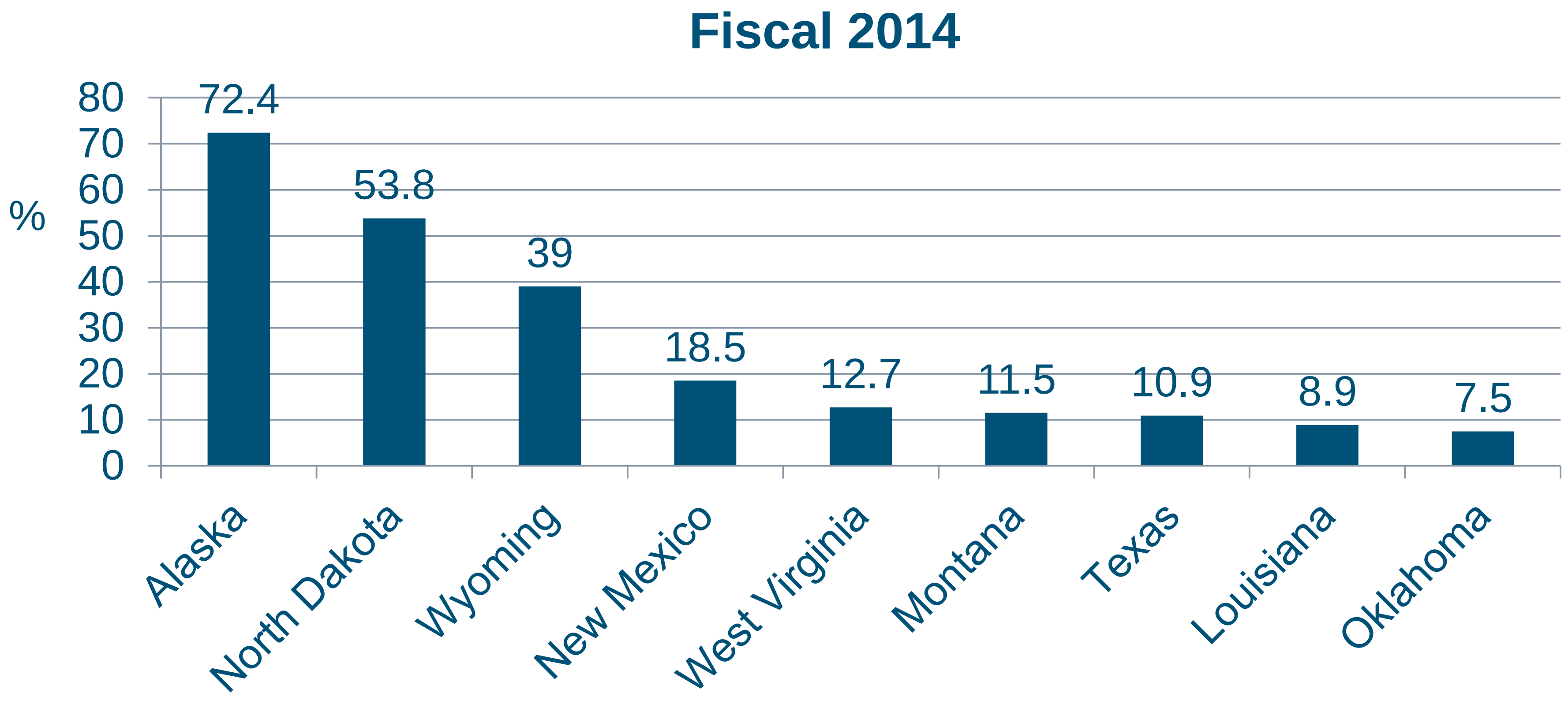
- For many states, decline in gas prices could be positive
- Consumers typically spend savings at the pump leading to greater economic growth
  - However, most states are reporting sluggish sales tax growth
- People could drive more with prices lower, leading to greater gas tax collections
  - However, gasoline consumption is typically relatively stable despite fluctuations in price
- Overall impact on oil producing states partly dependent on diversification of economy and revenue sources
  - In states that are more heavily reliant on severance taxes, any economic benefits are unlikely to be sufficient to offset revenue declines due to the falling price of oil

Crude oil production – February 2015



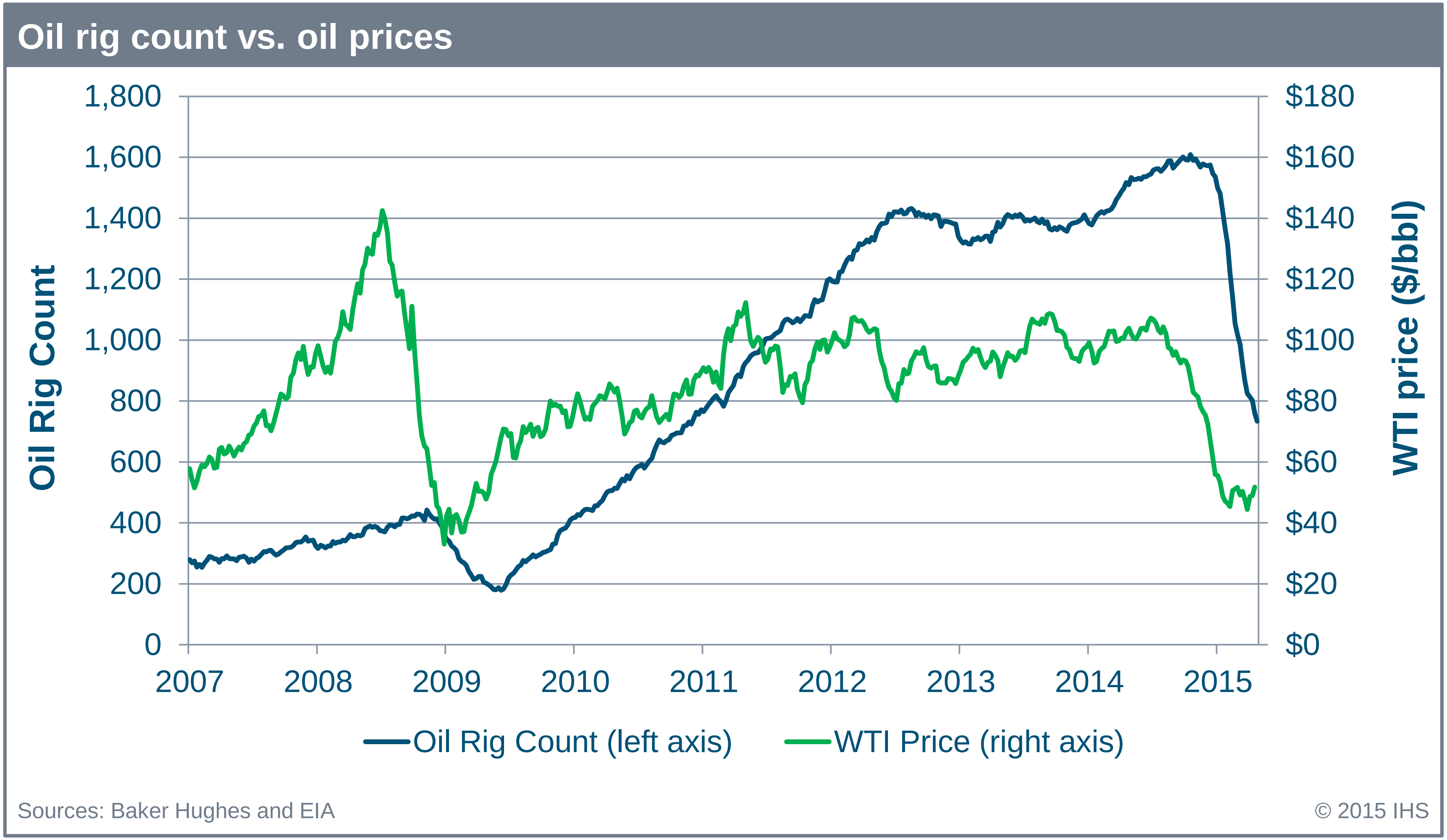
Source: U.S. Energy Information Administration

State Severance Tax Revenue as a Percentage of Total State Tax Collections

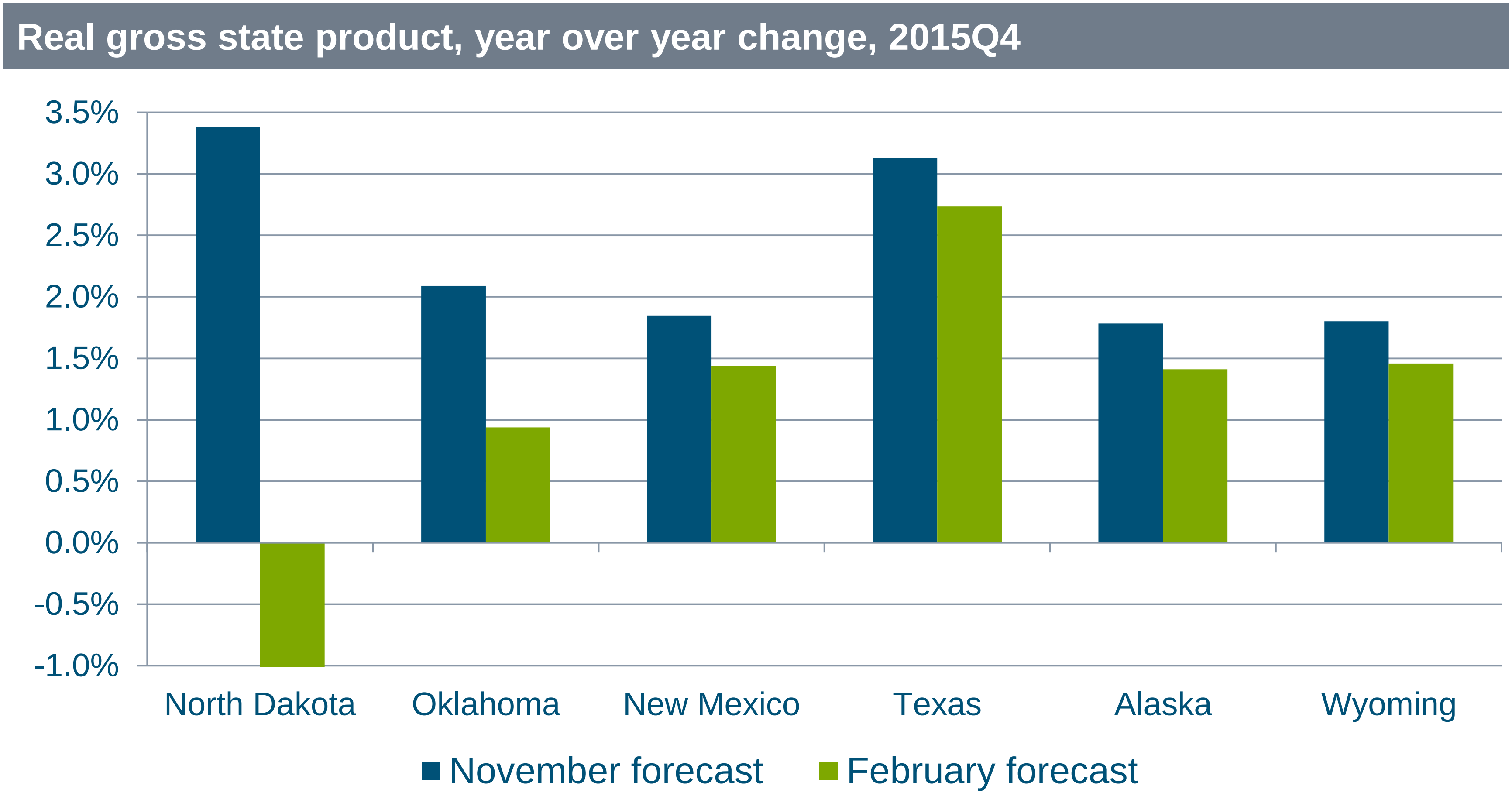


Source: U.S. Census Bureau

Sharp Decline in Oil Rigs in 1st Quarter of 2015 (IHS Economic)



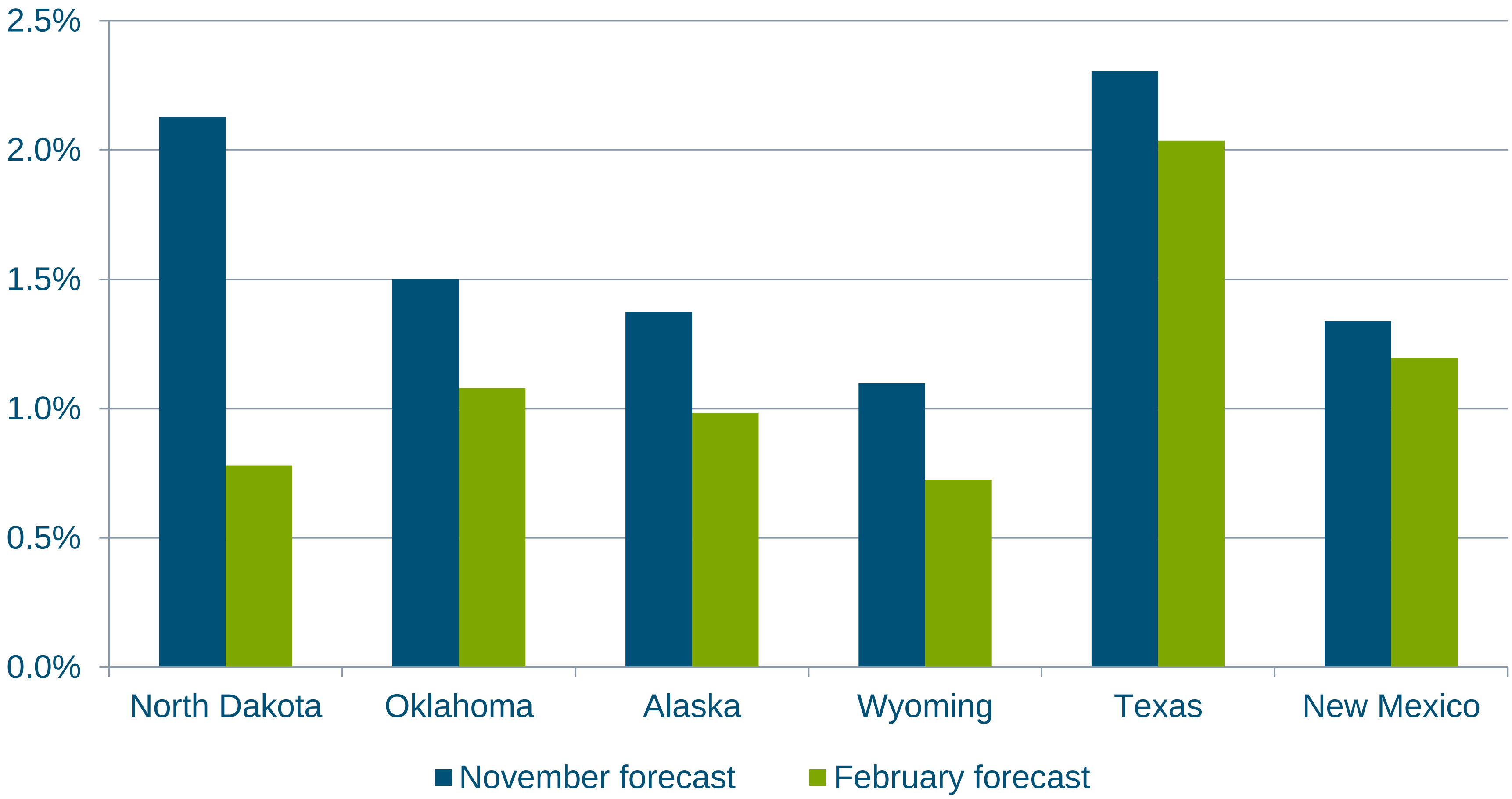
Decline in economic growth in energy states (IHS Economics)



Source: IHS

Job Growth Also Slows in Energy States (IHS Economics)

Total employment, year over year change, 2015Q4



Impact on Severance Tax States

- North Dakota
  - March forecast reduced projected oil tax revenues for new biennium by $870M
  - Approved a new oil extraction tax bill in April
  - Governor said bill should lead to greater revenue predictability and expects a rebound in oil prices by end of the year
- Wyoming
  - Supplemental budget bill in March intercepted $200 million that was intended for reserves due to lower energy prices
  - Legislature created Task Force on Mineral Taxes in April to examine how state values and collects taxes on natural resources
- New Mexico
  - Governor signed a fiscal 2016 budget in April increasing state spending 1.3%
  - Drop in oil prices caused projections for new revenue to be decreased from $285 million last summer to $83 million now
- West Virginia
  - State expects a $60 million deficit in fiscal 2015
  - Biggest contributor to shortfall is decline in severance taxes

Impact on Severance Tax States (continued)

- Montana
  - House increased revenue projection for next two-year budget in April
  - Forecasted declines in oil and gas production taxes were outweighed by projected increases in other revenue sources
- Texas
  - Comptroller projects the state will have a 9.5% increase in revenue over the course of the next biennium
  - He did note that there will likely be a marked slowdown in oil exploration and production which will dampen overall economic growth in the state
- Louisiana
  - State is facing a projected $1.6 billion shortfall in fiscal 2016 and announced plans to address a midyear gap in fiscal 2015
  - Oil price declines part of the reason for shortfall although state is collecting less revenue overall
- Oklahoma
  - March revenue collections were $28 million less than the prior year partly due to a 48% drop in oil and natural gas gross production receipts
  - State is facing a $611 million deficit in fiscal 2016

Outlook for Severance Tax States

- Oil prices expected to rebound rest of 2015 and into 2016
  - U.S. Energy Information Administration expects Brent Crude to average $59 a barrel in 2015 and $75 in 2016 (April 7 forecast)
- Severance tax states will continue to have some of the most volatile revenue sources
  - Most have done a good job building up reserves
- States will likely continue to examine tax structures
- Similar to non-severance tax states, future spending growth is likely to be constrained and states will continue to make some painful choices
  - Slow economic growth, uncertainty regarding future federal funds, tough competition for general funds, infrastructure demands, face long-term liabilities

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