WYOMING LEGISLATIVE SERVICE OFFICE

Memorandum

DATE April 25, 2014

TO Members, 62nd Legislature

FROM Don Richards, Budget/Fiscal Manager

SUBJECT April 2014 Revenue Update

The information presented in this report constitutes the April 2014 revenue update. The LSO Budget Fiscal section prepares state revenue updates in April and July of each year which, together with the October and January Consensus Revenue Estimating Group (CREG) reports, provide revenue information to state policymakers on a quarterly basis. Please note this report does not change the January 2014 CREG projections or the LSO profile (goldenrod) dated March 18, 2014. The January CREG report remains the official fiscal forecast and the March profile remains LSO's estimate of projected account balances on June 30, 2014 and June 30, 2016, after taking into account forecasted revenues, transfers and appropriations. This update serves as a comparison of actual state revenues as of March 31, 2014 to the projections made in January for FY 2014. The report also offers additional insights on recent developments that may impact state revenues.

The executive branch regularly prepares its own April and July revenue updates, which tend to be similar, though not identical to LSO's. The differences can generally be explained by report timing and differences in methodology used to estimate the expected pace of revenue collections. While the different approaches serve as a check of one group's methods against the other, we are currently exploring the consolidation of these quarterly updates to further reduce differences and opportunities for confusion.

General Fund

At the end of this update, a summary of revenues deposited into the General Fund (GF) and Budget Reserve Account (BRA) is presented in Tables 1 and 2, respectively. The three largest sources of revenue for the GF (severance taxes, sales and use taxes, and investment income) are shown separately. All other revenue sources (franchise taxes, cigarette taxes, charges from sales and service, fees, penalties and interest, etc.) are grouped together.

Column 1 reflects the total FY 2014 CREG projections of GF revenue by major source. Column 2 contains the actual year-to-date (YTD) revenue received. Column 3 is the percentage of the projection that has been received (column 2 divided by column 1). Column 4 illustrates the percentage of the projection, as calculated by LSO, expected at this point in the fiscal year. Column 5 shows the difference of the actual revenue to date as a percentage of the total amount forecast for FY 2014 versus the expected pace of the FY 2014 forecast (column 3 minus column 4). Occasionally, percentages may not add due to rounding.

As you can see from column 5 in Table 1, actual total revenues received are currently 1.6 percent ahead of forecast levels. All major categories of GF revenues except for Permanent Wyoming Mineral Trust Fund (PWMTF) and Pooled Interest, which include dividends and interest, are exceeding the forecasted levels as of the end of March 2014. Interest and dividends directed to the GF are 3.7 percent behind forecast levels, largely due to a lower than anticipated interest rate environment and some divergence from investment manager expectations. On the other end of the spectrum, the "all other sources" of state revenue are exceeding the forecast level by 8.1 percent. Of the major revenue components in this category, franchise taxes are exceeding the projection by the greatest amount. Recall that several revenue sources, including such items as penalties and interest, are included in the "all other sources" category, and many of them do not flow to the state with predictable timing over the course of a fiscal year.

As illustrated in Table 1, the GF share of severance taxes is exceeding the forecast by 2.1 percent or $4.7 million. A more detailed discussion of this revenue category is included in the next section of this report.

In FY 2013, sales and use taxes were lagging expectations at this point in the fiscal year. In contrast with last year, state sales and use tax receipts are exceeding the January 2014 CREG estimate by 1.8 percent, or $9.1 million. This is, at least in part, due to a one-time vendor payment. A vendor in the mining industry, after discovering and reporting a several million dollar underpayment, remitted the underpayment of use taxes in February 2014. The underpayments spanned a five year period. As a result, a portion of the revenue in this category is due to a one-time, unusual circumstance. Nonetheless, Wyoming sales and use tax collections are exhibiting signs of strength through the first three quarters of the fiscal year. While four counties (Fremont, Goshen, Sweetwater, and Uinta) show year-over-year declines in sales and use tax collections, these declines are slight – decreases of one to four percent. The remaining counties show year-over-year increased collections, with seven counties (Big Horn, Hot Springs, Johnson, Laramie, Park, Platte, and Sheridan) showing more than ten percent.

Investment income in the form of interest and dividends from the Permanent Wyoming Mineral Trust Fund (PWMTF) is 6.6 percent, or $8.9 million behind the projection through March 31, 2014 while interest and dividend income from the State Agency Pool directed to the GF is 1.9 percent, or $1.3 million ahead the projected levels at this time. Since investment income from the PWMTF is a larger share of GF revenue than investment income from the State Agency Pool, overall the interest and dividends received are 3.7 percent, or $7.6 million, behind the January 2014 CREG forecast.

Realized Capital Gains

Importantly, recall that CREG does not project realized capital gains or losses for any of the state's profiled accounts. To date, deferred realized capital gains from the PWMTF exceed $200 million. In contrast, the GF share of deferred realized capital losses from investments in the State Agency Pool amount to approximately $20 million as of this writing. To add further context, the deferred realized capital gains from the PWMTF as of March 2014 are roughly the same as realized capital gains experienced through March 2013. A significant difference between FY 2013 and FY 2014 is the deferred realized capital gains directed to the General Fund from investments in the State Agency Pool were in the neighborhood of $100 million as of March 2013, whereas in FY 2014, there are $22 million in realized losses. According to the State Treasurer's Office, the policy formally implemented by former State Treasurer Joe Meyer that defers net capital losses until such time as they can be offset by capital gains will continue to be practiced. As a result, the approximately $20 million in realized capital losses attributable to the GF and invested within the State Agency Pool will be carried forward to the next and possibly subsequent fiscal years, if not offset by capital gains in the last four months of FY 2014.

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Budget Reserve Account

Table 2 illustrates the two primary revenue streams for the BRA – severance taxes and federal mineral royalties (FMRs). Consistent with the GF, severance tax receipts are ahead of the January 2014 CREG forecast, exceeding the estimate by 3.8 percent through March 2014. FMRs, without adjusting for the federal fiscal year (FFY) 2014 budget sequester, are 4 percent behind the January CREG forecast. However, recall that the January 2014 CREG report included a statement of support for LSO to incorporate the best available information regarding the level of federal sequester in its 2014 Budget Session profiles (goldenrods). LSO Budget/Fiscal section made such an adjustment. Therefore, the adjusted (Adj) FMR totals and BRA amounts are also listed in Table 3. After taking into account the impacts of the FFY 2014 sequester, FMRs are actually running 0.6 percent ahead of the adjusted forecast figure, as used in the March 18, 2014 profile. Finally, it is important to recall that if the federal administration adheres to past practice and current law, the sequestration of federal mineral revenue is treated as a "withholding", not a sequester, and will be paid to states with federal mineral revenue production at the beginning of the 2015 FFY, sometime after October 1, 2014.

Bottom-line - General Fund/Budget Reserve Account

In total and by major category, the actual GF and BRA revenues are slightly ahead (1.6 percent and 1.9 percent, respectively) of the overall January 2014 CREG estimates through March 2014. Interest and dividends are the sole outlier to the downside, though it appears that any miss to the downside will more than be offset with other revenue sources, presuming current trends hold. Anticipated, but not forecasted, capital gains generated from the PWMTF are on pace to be sufficient to deposit $45 million (the maximum transfer pursuant to the 2014 Budget Bill) in the Strategic Investments and Projects Account (SIPA), transfer at least $70 million to the Legislative Stabilization Reserve Account (LSRA), fill the PWMTF Spending Policy Reserve Account to $190 million (an increase of $15 million) and, barring a change in the financial markets and actions by the state's investment managers, deposit tens of millions into the PWMTF corpus, as directed by statute and Session Law. Any revenues above the current CREG forecast from other revenue categories, offset by areas that fall short of the forecast, will be also swept to the LSRA at the conclusion of FY 2014.

Mineral Severance Taxes

Following the same format as Tables 1 and 2, Table 3 shows that total severance tax revenues are 2.5 percent ahead of expectations for FY 2014 through March 31, 2014. The price of oil for FY 2014, to date, is slightly ahead of projection at just over $87/bbl compared to the forecast of $85/bbl. Production of oil, after repeated increases in the forecast levels by CREG, is consistent to slightly ahead of the current projection. Furthermore, since fall 2013 oil rig counts are exceeding prior year levels by six to ten rigs, depending upon the month. Natural gas prices are also slightly exceeding the forecasted level, though tax receipts from February through April, 2014 have not yet been incorporated. Given this circumstance and in combination with current spot markets and near-term future markets, indications suggest that natural gas prices for FY 2014 will likely exceed the forecasted levels that make up the January 2014 CREG report. Natural gas production volumes have been declining and are forecast by CREG to continue to do so throughout the forecast period. Currently natural gas production volumes are roughly consistent with anticipated production decline, as estimated by CREG. However, the impacts of the fire at the Opal natural gas processing facility on Wyoming natural gas production cannot be assessed at this time. Surface coal pricing is averaging about $0.15/ton less than the CREG

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estimate of $13.50/ton, though there are some early indications that the month-over-month price declines have leveled off. Further, the spot market price for Powder River Basin coal has been increasing. Production of coal for FY 2014 is generally in-line with levels estimated by CREG. Actual prices and production levels for trona are somewhat under the levels forecast by CREG in January 2014 but not to the level that would materially impact the overall severance tax collection forecast.

Bottom-line - Severance Taxes

In total, severance tax collections are somewhat ahead of the January 2014 CREG estimates. The favorable natural gas pricing (due to a colder than normal winter) in many geographic areas of the United States serves as a key positive highlight to the state's severance tax outlook. Strong growth in oil production is also a positive for the state's revenue, though this growth, to date, has largely been built into the CREG forecast and is consistently tracking. Coal prices appear to have stabilized and may be on the upswing in the near-term. The near-term opportunities for coal production may also be buoyed by the higher than anticipated price of natural gas (substitution effect) and the comparatively low levels of coal reserves at some electric utilities. At least four issues for continued monitoring and potential concern include evidence of an increasing price differential in oil for Wyoming producers, continued slide in natural gas production despite a near-term environment of higher prices, impact of the fire at the Opal natural gas processing facility, and the federal regulatory environment facing the consumption of coal.

Federal Mineral Royalties

Included in Table 3 of this report is an analysis of federal mineral royalties (FMRs). The columns in this table are identical to those in Table 1 with column 5 indicating that FMRs, excluding coal lease bonus revenue, are currently 4 percent behind expectations for the year. This difference can almost entirely be explained by the reduction of the monthly payments due to federal sequestration, or withholding, as previously discussed. Aside from the impact of the federal sequestration, total receipts from FMRs are in-line with January 2014 CREG projections, roughly mirroring severance tax collections. Another item worth noting is evidence that the increase in oil production included in the severance tax collections is largely occurring on private lands, not federal lands. As a result, the impact from the state revenue perspective will be realized in ad valorem taxes and severance taxes but not to the same degree in federal mineral revenue receipts.

Coal lease bonuses are also shown in Table 3. Actual receipts of coal lease bonus payments occur on a payment schedule determined at the time the federal government finalizes the lease agreement; therefore amounts reflected here are not indicative of revenue trends. Coal lease bonus payments are proceeding as expected, as adjusted by the federal sequester.

Other Revenue Issues of Note

Investment income in the form of interest and dividends derived from the Common School Permanent Land Fund (CSPLF) are lagging the estimate by 8.1 percent, or $4.9 million through March 2014. On the other hand, roughly $100 million in capital gains from the CSPLF have been realized but have not yet been distributed to the Common School Permanent Land Income Fund and School Foundation Program. Recall that any gains will first be used to offset any capital losses before distribution at the end of the fiscal year. Then, an amount equal to investment earnings in excess of the spending policy for CSPLF will be deposited into the CSPLF Spending Policy Reserve Account until it reaches its cap. (This account

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is currently $6.5 million shy of the cap.) Finally, an amount equal to any excess beyond the amount necessary to fill the Reserve Account would be deposited into the CSPLF corpus.

Recall that any revenues in excess of the forecasted levels for the education accounts (School Foundation Program and School Capital Construction Account) roll over to the Permanent Land Fund (PLF) Holding Account. Any amount in excess of $475 million at the end of the biennium in the PLF Holding Account will also be transferred to the CSPLF corpus.

Conclusions

At the current pace of collections the GF, BRA and SFP are slightly ahead of January 2014 CREG projections. Interest and dividends are the single, major category lagging the projection. The Wyoming State Treasurer is generating sizeable unforecasted, but anticipated, realized capital gains in both the PWMTF and the CSPLF. Revenues from the more prominent mineral commodities (oil, gas, and coal) are generally on pace to meet or exceed FY 2014 expectations, though the price and production trends within each of the three commodities offers different short, intermediate, and long-term challenges and opportunities. Although the federal sequester is impacting Wyoming's share of federal mineral revenue receipts, if legal precedent holds those withheld payments will be made up in the subsequent fiscal period and are already accounted for in the Legislature's March 18, 2014 profile (goldenrod). Finally, impacts on Wyoming natural gas production and delivery resulting from the fire at the Opal natural gas processing facility are not incorporated into this analysis.

As always, we will continue to monitor the revenue situation and keep you informed. Let me know if you have any questions.

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Table 1. FY 2014 General Fund (GF) Revenue Update
(Revenues received from July 1, 2013 through March 31, 2014)

Source	1 Projected FY 2014 Total	2 Actual Revenue Received YTD	3 Actual as % of Proj.	4 LSO % of Proj. Expected	5 Actual % vs. Proj. %
Severance Tax	$219,300,000	$149,526,326	68.2%	66.1%	2.1%
Sales & Use Tax	$504,800,000	$337,150,969	66.8%	65.0%	1.8%
PWMTF & Pooled Interest	$204,600,000	$145,832,650	71.3%	75.0%	-3.7%
All Other Sources	$128,500,000	$106,843,059	83.1%	75.0%	8.1%
Totals	**$1,057,200,000**	**$739,353,004**	**69.9%**	**68.4%**	**1.6%**

Table 2. FY 2014 Budget Reserve Account (BRA) Revenue Update
(Revenues received from July 1, 2013 through March 31, 2014)

Source	1 Projected FY 2014 Total	2 Actual Revenue Received YTD	3 Actual as % of Proj.	4 LSO % of Proj. Expected	5 Actual % vs. Proj. %
Severance Tax	$245,600,000	$106,046,667	43.2%	39.4%	3.8%
FMRs	$400,800,000	$169,283,053	42.2%	46.2%	-4.0%
Adj FMRs	*$367,200,000*	*$169,283,053*	*46.1%*	*45.5%*	*0.6%*
Totals	$646,400,000	$275,329,720	42.6%	43.6%	-1.0%
Adj Totals	***$612,800,000***	***$275,329,720***	***44.9%***	***43.1%***	***1.9%***

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Table 3. FY 2014 Mineral Severance Tax & Federal Mineral Royalty Revenue Update
(Revenues received from July 1, 2013 through March 31, 2014)

Source	1 Projected FY 2014 Total	2 Actual Revenue Received YTD	3 Actual as % of Proj.	4 LSO % of Proj. Expected	5 Actual % vs. Proj. %
Total Severance Tax	$888,500,000	$532,095,237	59.9%	57.4%	2.5%
FMRs wo/coal bonus	$801,200,000	$453,949,975	56.7%	59.7%	-3.0%
Adj FMRs wo/coal	*$750,800,000*	*$453,949,975*	*60.5%*	*60.0%*	*0.4%*
Coal lease bonus	$227,000,000	$185,619,579	81.8%	NA	NA
Adj Coal lease bonus	*$211,600,000*	*$185,619,579*	*87.7%*	*NA*	*NA*
Total FMRs	$1,028,200,000	$639,569,554	62.2%	NA	NA
Adj Total FMRs	*$962,400,000*	*$639,569,554*	*66.5%*	*NA*	*NA*

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