Public Finance Predictions for 2015.

Tight budgets, declining oil prices and pension scares are some key finance topics that state and local governments will face in 2015.

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More belt tightening

The general consensus on 2015's economy is that state and local revenues will continue to inch along, basically growing a little more than the cost of inflation. That leaves little room for increased spending in areas that saw funding drops during the recession. This is particularly true for cities, which have the least taxing power yet fund a lot of essential daily services. Throw in the fact that most citizens aren't keen on higher taxes, and Jeff Winter, partner-in-charge of RubinBrown's Public Sector Services Group, said that means governments will need to keep a tight lid on their expenses. "We're seeing steady growth but at a slower rate than we were in 2012," he said. "And cities that are sales-tax-dependent are not going to have huge increases in revenue sources in the future. There still needs to be attention paid to personnel costs and capital projects may have to be put on hold or financed in another way."

However, economies will vary widely. Standard & Poor's Gabriel Petek predicted that economic growth in the West and Southwest will likely outpace the other regions in 2015, particularly in new housing growth. Income and wealth, however, will remain starkly higher on the coasts than in the South and Midwest.

Muni market activity will pick up (slightly)

Many analysts are predicting an uptick in municipal market activity for the first time in three years. The general consensus is that total offerings by governments, which include new bond sales and refinances, will increase in volume to about $335 billion, compared to an estimated $328 billion this year. Wells Fargo Senior Analyst Natalie Cohen predicts a slightly higher total ($340 billion) with a little more than half of that due to new bond issuance. "The higher new money issuance reflects economic improvement and a desire in many communities to 'get on with it' despite the chronic lack of action in Washington," Cohen wrote in her analysis this month. "Voters gave this positive signal at the ballot box, by approving significantly more bond issues than last year ($13 billion compared with $7 billion)."

Tom Kozlik, municipal credit analyst for Janney Montgomery Scott, offers up a dissenting view. He predicts that volume will decrease for a fourth straight year to no more than $275 billion total (and in fact, it won't pick up again until 2018). He attributes the dip to an expected increase in interest rates in 2015.

Here comes Kroll

As credit ratings agencies have increasingly disagreed with each other about the health of state and local governments, Loop Capital Markets' Chief Strategist Chris Mier pointed out in a year-end analysis that agitation has caused "a number of high-profile issuers to change their line-up, tossing out one firm and substituting another." (More specifically, Kozlik in a report this summer noted that has commonly meant that municipalities have favored using their ratings from S&P.) Mier also said in his assessment that "the increasing presence of Kroll Ratings" was contributing to that trend. Started in 2009, the agency named for its founder is small but growing fast, with revenue doubling every year, notes Forbes. Its biggest gains have come in the U.S. commercial and residential mortgage backed securities markets. This year it also expanded its public finance team and became a listed rating agency in EMMA, the online database where governments file municipal market disclosures. Look for Kroll to continue to elbow its way into rating the municipal market in 2015.

GASB stirring the pot

The Government Accounting Standards Board's (GASB) new rules on pension accounting will become visible for the first time on government balance sheets. Analysts have said the stricter view of unfunded liabilities are likely to encourage talks of reform in states– Namely, New Jersey, Illinois, Pennsylvania, Kentucky, Connecticut and Rhode Island–that are struggling to fund their pensions. New Jersey recently disclosed in its official statement that as a result of the more conservative GASB approach to calculating pension funding, its funded level decreased to 30 percent from 50 percent and its liabilities to $50 billion from $37 billion. "Stronger reporting standards alone won't solve or even address the challenge of pension funding," wrote Janney Montgomery Scott's Alan Schankel in a December analysis. "But they may draw closer attention to the most underfunded systems, pressuring political leadership to consider often needed reforms."

GASB is also likely to create some budgeting angst if it succeeds in its quest to require governments to report as lost income the tax incentives they award to companies. The new disclosures could shed light on a previously murky area of government finance and provide hard data on information that has often been assembled piecemeal, if at all. Some government finance organizations will likely push back on the proposal and argue that reporting tax abatements isn't an accounting issue – that policymakers think of these decisions as investments, rather than a drain on finances. Stakeholders have until Jan. 30 to comment but the debate will likely play out through the year.

Oil prices will impact state budgets

The recent decline in oil prices will give way to some mid-year budget scrambling as oil-dependent states revise their revenue expectations for fiscal 2015. But not all energy-based economies are equal. Alaska has been repeatedly cited by observers as particularly vulnerable. However, notes S&P's Petek, its extraordinarily high budget reserve levels buy the state time to develop a response. Alaska's fiscal 2015 budget originally assumed oil prices would average $105.06 per barrel, which would mean about 495,900 barrels per day of production on Alaska's North Slope, according to S&P. Based on more recent price and production information, the state has revised its estimates to $76 per barrel and 509,500 barrels per day for fiscal 2015.

Alaska is hugely dependent on oil – those revenues made up 88 percent of its estimated revenue for the 2014 fiscal year. With the updated figures, the state's budget gap has widened to $3.5 billion – equal to 57 percent of general fund expenditures. But Alaska's extraordinarily large budget reserves (which total more than three times its general fund expenses) are saving the state from a budgeting crisis at the moment. However if lower oil prices persist through 2015, the economies and finances of other energy producing states — Texas, Louisiana, Alaska, Wyoming, New Mexico, Oklahoma, and North Dakota – will also be put to the test.

For non oil-producing states and cities, look for some easing in costs (particularly in transportation) and a potential bump up in sales tax revenues as consumers saving money on gas are likely to spend that elsewhere.

An answer in Illinois

After a circuit court struck down Illinois' pension reform legislation, the state's Supreme Court is now weighing the constitutionality of provisions that reduce cost of living raises for retirees, cap eligible earnings and delay the retirement age for certain employees. An unfavorable ruling for the state could have "financial and societal consequences," predicted Municipal Market Advisors' Matt Fabian in his 2015 outlook, "including lower government employment, higher taxes, reduced social services, lower education spending, constrained investment in infrastructure, etc." However a ruling that the state was justified in its legislation, "would likely lead to healthier negotiations centered on obtaining the best sustainable compromise," Fabian said.

More clarity on the SEC's definition of a no-no.

In 2014, the SEC ran its Municipalities Continuing Disclosure Cooperation Initiative. The program allowed municipalities to look for and submit any additional information (like a credit rating change) they should have filed as a financial update to any bond sales completed in the last five years. Governments must continue to update investors with relevant information for as long as the bonds are outstanding. The Securities and Exchange Commission indicated it would offer "favorable" settlement agreements with those who fessed up but has been pretty mum on what kinds of omissions it would levy a more severe sentence.

The coming year should help clear that up as the SEC begins announcing its so-called enforcement actions against governments that have been lax with their disclosures. LeeAnn Gaunt, chief of the SEC enforcement division's municipal securities and public pensions unit, recently told a group of government finance officers the initiative showed that "many" official statements released in the past five years have incorrectly stated that issuers were in full disclosure. She declined to reveal just how many or what the worst cases were, reported the Bond Buyer. But thankfully, that wait should soon be over.

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