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Bond Market Rescue for Oklahoma's Budget Woes Entices Governor.

Oklahoma, grappling with the fallout from the collapse in oil prices, may turn to the municipal-bond market to provide relief from a $1.3 billion budget deficit rather than cutting spending or raising taxes.

Borrowing would free money for other priorities, such as pension costs and education, that would ease the way of balancing the budget as options proposed by Governor Mary Fallin aren't palatable to some lawmakers.

It would also fall just short of a maneuver known as "scoop-and-toss" that involves selling debt to pay off maturing securities, a practice employed by issuers ranging from Puerto Rico to Chicago that has led to disastrous results.

"The budget situation is very serious, it's a matter of deciding priorities with limited resources," said Tim Allen, deputy to Oklahoma Treasurer Ken Miller. "Borrowing is something the treasurer supports looking at."

Oil-patch states around the U.S. are grappling with lower revenue since the price of oil has crashed to as low as $27 a barrel this year after peaking in mid-2014 at over $100 a barrel. Besides Oklahoma, states hardest hit are Alaska, Louisiana and North Dakota.

By borrowing for $100 million or so for road projects now funded on a pay-as-you-go basis, the state could apply most of that money to other priorities while only using about $7 million for debt service, said Jim Joseph, the state's bond adviser, who has discussed the idea with lawmakers. No decisions have been made about what alternatives to pursue, said Oklahoma state Representative Earl Sears, the Republican chairman of the House appropriations committee.

"We have been looking at hundreds of proposals, but we don't have a clue which ones we will use," Sears said, in an interview. "We may have a better answer in a month."

After oil prices fell 21 percent between Dec. 21 and mid February, Oklahoma's projected deficit widened by 19 percent to $1.3 billion. Governor Fallin's budget proposed last month included $910 million of new revenue from removing sales tax exemptions and raising cigarette taxes while cutting spending by $167 million.

How the state balances its budget will be watched closely by companies that rate the state's municipal debt. Failing to balance its budget and under-funding state pensions could lead to rating cuts, Standard & Poor's said in a Feb. 4 report.

Considering Options

"The governor's budget addresses to a large extent the large deficit," said Carol Spain, an S&P analyst who covers the AA+ rated state. "Whatever they do to address the budget gap will be critical for the state's credit quality."

Oklahoma officials said they aren't opposed to the possibility of bonding combined with other changes to state finances.

"We might consider a bond if a larger reform package of recurring revenues was also enacted," said Preston Doerflinger, the state's finance secretary, in an e-mail. "This budget challenge is a multi-year challenge while a bond is a one-time, one-year option."

Borrowing to weather tough economic times isn't new to the municipal-bond market, though Chicago this year backed away from using so-called "scoop-and-toss" to extend debt payments for budget relief. Louisiana lawmakers last week asked for any refinancing of state debt to put the savings in the current and next fiscal year for relief from nearly $3 billion of deficits. Alaska, on the other hand, which faces a $3.6 billion spending gap, will rely on reserves to cover shortfalls, said Devin Mitchell, debt manager, in an e-mail.

Prior Recession

Oklahoma borrowed to manage itself through the last recession, using scoop-and-toss to extend debt payments for budget relief, said Joseph, the bond adviser. The state sold $132 million of bonds through the Oklahoma Capital Improvement Authority in 2010 "to provide budgetary relief by extending and restructuring debt service," rather than provide savings, according to bond documents.

Now, because the state has used pay-as-you-go financing for so many of its previous projects, it has capacity to borrow for capital projects, he said. It wouldn't be scoop-and-toss if the state did it because the state would be bonding for capital projects rather than pushing out payments. The state typically pays back 40 percent of new borrowings within five years, and some debt will be coming off the books soon, said Joseph.

"The idea is to take money that is going to projects and bond it," Joseph said. "It's perfectly appropriate to borrow for capital projects to free up cash."

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