
S&P: Louisiana's Resilience To Be Tested As Economic Pressures Weigh On Budget Outlook

FARMERS BRANCH (S&P Global Ratings) May 4, 2020–As Louisiana (AA-/Stable) state lawmakers return to Baton Rouge, the task of balancing the state's next budget will be met against a growing cloud of uncertainty with the U.S. economy in recession and the state addressing a COVID-19 hot spot. In S&P Global Ratings' view, Louisiana's liquidity and reserve position will adequately support it through heightened economic headwinds caused by the pandemic and ongoing energy sector volatility in the near term.

Louisiana began the current fiscal year on a positive trajectory for both its revenues and economy, with forecasts for continued modest growth. For the first eight months of fiscal year 2020, the state's principal general fund revenues–sales and individual income tax revenues–were collectively up approximately 5%, compared to the year prior. However, with the onset of the COVID-19 pandemic, S&P Global Economics now forecasts a 5.3% contraction in the U.S. output this year (see "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020, on RatingsDirect). The forecasted economic contraction will, in our view, result in a significant decline in state revenue and economic output. Additionally, given Louisiana's limited industrial diversity, which still leans on chemical manufacturing and petroleum-refining industries, the state faces added pressure as the volatility in the energy sectors intensifies. As noted by S&P Global Ratings researchers, in the first quarter of 2020, the U.S. oil and gas sector experienced the largest quarterly increase in negative bias, up by 32 percentage points as companies coped with volatile energy prices, liquidity issues, high leverage, and limited demand growth expectations in the second quarter of the year due to the pandemic. (For additional, please see "U.S. Corporate Credit Stress Surges To Recession Levels On COVID-19 And Oil Shocks," published on April 14, 2020, on RatingsDirect.) While the state has worked to support additional economic diversity, roughly 25% of its total gross state product (GSP) comes from merchandise exports, including energy products, manufacturing goods, and agricultural products linked to the prominence of shipping along the Mississippi River and Gulf of Mexico.

Favorably, Louisiana entered the recession on a relatively stable footing. As required by its constitution, when a general fund operating surplus occurs in a fiscal year, a deposit equal to 25% of the surplus is deposited into the budget stabilization fund (BSF) the subsequent fiscal year. This has resulted in the state increasing its reserve profile in fiscal 2019 following strong revenue collections in fiscal 2018. The resulting operating surplus in fiscal year 2019–totaling $535 million–required a $133 million deposit into the BSF in fiscal 2020, which, coupled with $24 million in one-time settlement funds, is estimated to bring up the balance to $565.8 million or nearly 5.8% of general fund expenditures, which we consider good. Absent the required transfers, reserve balances would cover just over 4% of expenditures. Appropriations from the BSF are limited in any fiscal year to one-third of the balance and require a two-thirds supermajority in both houses of the legislature. We anticipate the state will use a portion of its reserves, as it has in challenging economic periods, to help bridge a balance for its 2021 budget.

In addition to the positive budgetary performance coming into the recession, Louisiana's general fund liquidity position remained strong through the first half of the fiscal year, averaging slightly over $2 billion, or roughly 1.7x greater than the monthly average in fiscal 2017. This should provide flexibility as it manages its cash-flow difficult revenue periods, especially if the shift in the filing deadline for income taxes to July 15 from May 15 causes temporary disruptions. Federal relief from the Coronavirus Aid Relief and Economic Security Act and increases in the federal medical assistance percentage of Medicaid, will help alleviate some of the fiscal strain. Disbursements from Coronavirus Relief Fund to the state total $1.8 billion, although limited to direct costs associated with the pandemic. While Louisiana's revenue collections, like those across states, will meaningfully decline given the current economic environment, due to its comparatively stronger budget reserves and liquidity position, we believe it can manage these increased pressures within the short term.

Louisiana's legislative session began on March 9, 2020, but due to safety concerns stemming from the COVID-19 outbreak, legislators have been largely unable to work through the budget development process. Notably, the state's Revenue Estimating Conference (REC)–had been delayed indefinitely. We understand the REC will meet the week of May 11. The constitution requires the state's official revenue forecast to be based on existing, recurring revenues. If the state projects a shortfall, the governor and the Division of Administration can make budget amendments to improve structural budget gaps and officials are required to respond quickly and empowered to cut expenditures directly. The constitution requires the state to pass a balanced budget.

Given that the governor's stay-at-home order is currently in place until May 15, we do not expect the legislature will be able to resume budget talks for fiscal 2021 until at least early-to-mid-May. If legislators are unable to complete their work by the end of current regular sessions, which end June 1, then the governor would have to call a special session to adopt a budget. While we do not anticipate it, in the absence of a budget adoption by the beginning of the fiscal year, resources collected and held in the Bond Security and Redemption Fund would still be available to support debt service on the state's general obligation (GO) bonds. There are no debt service payments that would require a fiscal 2021 appropriation until Aug. 15, 2020.

The governor's initial 2021 budget proposal, released prior to the acceleration of the COVID-19 pandemic, reflected a modest increase in general fund outlays, which we anticipated would have to be revised downward. As the lawmakers work through the next budget, a standing challenge is the relatively limited room they have to cut, given that roughly 70% of the general fund is non-discretionary. Of the state's $9.72 billion general fund budget in fiscal 2020, the discretionary portion–totaling $2.78 billion–mostly supports higher education and health care initiatives which may be difficult to cut. In previous periods of budgetary stress, the state resorted to one-time budget measures (including using reserves) to balance its budget, although since fiscal year 2017, it has worked on structural measures to achieve balance.

However, the state's major revenue mix is far removed from what is was decades ago, when mineral-derived revenue accounted for a substantial share; it now relies on sales and personal income taxes, which together account for three-fourths of general fund revenues (net of dedications). While mineral revenues (severance and royalty) account for around 7% of general fund collections, we anticipate the hit to the current and next fiscal year budget will be the ancillary services and payrolls that support the state's energy sector. The state doesn't tax groceries intended to be prepared and consumed at home, so the temporary bump in grocery purchases will not have a meaningful effect on collections, in our view.

Ultimately, the magnitude of the effects of an energy shock and pandemic will depend on their depth and duration, but at present, Louisiana's good financial position, combined with its strong oversight, will, in our view, provide a fair degree of flexibility to manage challenges as they arise.

This report does not constitute a rating action.