



Economic Effects of the Oil Spill on the State of Alabama (Aa1/AA/AA+; Aa3 MTAM)

The Gulf Coast states may be hurt more than officials first projected as government estimates of how much oil is flowing from the BP deepwater well have risen. The increased magnitude of the spill indicates the environmental, economic, and financial effects will be far worse than initially feared.

The State of Louisiana is the most at risk since it is closer to the well, and because the State relies on off-shore oil production for a large percentage of tax revenue (17,000 workers in the State are employed in oil and gas production). However, Gulf Coast municipalities in Louisiana, Mississippi, Alabama, and Florida are all expected to see their credit ratings pressured because of the spill as tourism falls and property values drop.

Falling real estate values are one consequence of the worst environmental disaster in U.S. history as oil keeps gushing from the BP well once pumped by the Deepwater Horizon rig. Studies show that BP's oil spill may drive down the Gulf Coast's shore-area property values by 10% for at least three years. Losses may total \$4.3 billion along the 600-mile stretch from the Louisiana bayous to Clearwater (FL). Oil washing ashore will further harm property values in an area where prices fell as much as 34% from the peak of the U.S. residential real estate market in 2006.

Currently, *fear* that oil from the oil spill will damage Alabama's coast is hurting the State's economy more than oil damage itself. Tourists are staying away from restaurants and hotels, and the sport fishing industry has reported bookings down significantly. Alabama beach resorts generate 75% of their annual revenue in June, July and August, so this entire season appears to be lost. One of the first real estate casualties is anticipated to be mortgage payments by hotels and restaurants if tourists avoid the area during the peak summer season. The defaults could start happening in early fall.

The fishing and oil drilling industries are also being negatively impacted by the oil spill. The disaster has led to the closing of 78,300 square miles, or almost a third, of federal waters in the Gulf of Mexico to fishing. In addition, a six-month moratorium on offshore drilling will shut 33 deepwater rigs in the Gulf, costing as many as 20,000 jobs by the end of next year.

As the oil spill shuts down much of southwest Alabama's economy, another victim will be the State's schoolchildren. Alabama's Education Trust Fund accounts for 60% of education spending in the State. The Fund gains most of its revenue from two earmarked sources: the State sales and income taxes. Every penny collected by these taxes goes directly into the Fund, and it is used to support all education efforts from kindergarten to medical schools. The Fund's rainy day fund balance of \$437 million was already depleted during fiscal 2009.



On a positive note, the Alabama State Port Authority declared that the Port of Mobile will remain open to commercial traffic despite the Deepwater Horizon oil spill. The Authority anticipates no closures or delays associated with the oil spill. Plans are in place to handle ships in the event heavy oil hits the channel, as the Authority sees no reason to put additional burdens on the region's economy by disrupting important manufacturing supply chains.

Some of the effects of the spill may be offset temporarily by the cleanup effort. Financial support from BP, as well as job gains from the cleanup, may temper some of the damages in the near term. To assist in cleanup and help promote tourism, BP has allocated \$65 million each for Mississippi and Alabama, \$75 million for Florida, and \$360 million for Louisiana.

President Obama received a \$20 billion compensation guarantee from BP and announced that the Company would set up a major claims fund for shrimpers, restaurateurs and others whose lives and livelihoods are being wrecked by the oil flooding into the Gulf of Mexico. Mr. Obama also said the Company had agreed to set up a separate \$100 million fund to compensate oil-rig workers laid off as a result of his six-month moratorium on deep-water drilling.

The State of Alabama's overall credit quality reflects the State's longer term trend toward a more diversified economy despite the recent severe downturn in manufacturing, strong spending controls which contribute to balanced operations, and manageable debt burden. Alabama's economy has been historically dominated by agriculture, natural resource extraction, and manufacturing, including textiles and iron and steel production. Today, the State still depends more heavily on manufacturing relative to the national average, but manufacturing has shifted away from textiles and apparel, particularly to the automotive sector. This sector was hard hit in the recent recession, but the foreign-owned automakers in the State, including Honda, Hyundai, and Daimler AG, continue to invest and produce in Alabama. Further, auto supplier activity is projected to grow as assembly plants open near the Georgia border. Following several years of job growth leading into the recent recession, job losses over the past year have been significant with weakness evident across all areas of the State and all employment sectors. Year-over-year employment declined 5.3% during 2009, higher than the national level of 4.3%. Unemployment was also higher than the national average in 2009 at 10.1% versus the U.S. rate of 9.3%. The labor market is not anticipated to recover until late 2010 as trade and manufacturing are likely to lag in the national recovery. Unemployment remains higher than the U.S. average at 10.8% versus 9.7% (May 2010). Wealth indicators have typically been well below national averages, but have shown improvement in recent years. Personal income per capita is just 85% of the U.S. average, but has increased from 80% ten years ago. Quarterly personal income returned to growth in the fourth quarter of 2009, unlike the rest of the U.S. which showed a modest decline. The poverty level is still among the highest of the states.

While it is too early to estimate the direct financial impact of the oil spill, it is now certain that Alabama's economy will be harmed through property value declines, and decreases in the tourism, fishing, and oil drilling industries. MTAM will continue to monitor the situation closely, as it is expected to negatively affect the State's property, sales, and income tax revenues. We will also track the status of BP's important compensation guarantee.