InghamEcon, LLC

Karr Ingham

P.O. Box 7531 (806) 373-4814
Amarillo, TX 79114 karr@inghamecon.com

February 3, 2015

The Midland Development Corporation
And
Security Bank
Present

The Midland-Odessa Regional Economic Index
and the
Texas Permian Basin Petroleum Index
December/4th Quarter/Annual 2015

The Midland-Odessa Regional Economic Index posted its 11th straight monthly decline in December, falling sharply to 224.5 down from 226.4 in November (revised slightly upward from the original November index of 226.3), and down 4.7% from the December 2014 MOREI of 235.5. The index peaked at 236.1 in January, and has now fallen by 4.9% compared to that peak. The contraction gained momentum in the latter part of the year, and in fact the annualized rate of decline in the fourth quarter 2015 was 10.4%.

Most components of the Midland-Odessa Regional Economic Index reached double-digit percentage rates of decline by year-end 2015, and a number of them endured that fate for the year as a whole. No component of the index escaped the contraction in 2015, including employment though the Texas Workforce Commission Current Employment Statistics monthly estimates for Midland and Odessa continue to indicate slightly higher total employment compared to year-ago levels.

Again, however, we know at this point that jobs have been lost in Midland-Odessa. The Quarterly Census of Employment and Wages suggests *the loss of over 15,550 jobs in Midland-Odessa from the employment peak established in December 2014 just through September 2015*, and employment loss almost certainly continued in the fourth quarter of the year. When the monthly data is revised to reflect the true employment situation in the combined metro area the Midland-Odessa Regional Economic Index will be revised accordingly. This means that the current results of the index are *understating* the true rate of contraction because the loss of jobs has yet to be factored in at all.

General real (inflation-adjusted) spending per sales tax receipts in 2015 was down by about 6% for the year (following a 12% increase in 2014), but by year-end was registering sharp declines. Real spending per fourth quarter sales tax receipts was down by over 19% compared to the fourth quarter of the prior year, and spending per the December sales tax total was off by 23% compared to the December 2014 total. Real auto spending was down by nearly 20% for the year as a whole, and logged a 27% year-over-year decline in the fourth quarter of the year.

Hotel/motel activity in the Petroplex reversed course in the second quarter of 2015 following five straight years of extraordinary expansion. Hotel/motel occupancy tax receipts in 2015 (which reflect lodging in the fourth quarter 2014 and the first three quarters of 2015) was down by only 3% for the year, but was down by 27% year-over-year in the most recent quarter.

Building permit activity in the two cities posted year-over-year declines in eleven of the 12 months in 2015, including double-digit percentage declines in each month May-December. For the year, building permit valuations were down by over 40% compared to the record total from 2014. The fourth quarter permit valuation total was off by about 53% year-over-year, and the December total was down by about 64% compared to December of a year ago (which in turn was up by 84% compared to December of the previous year).

Housing construction was down as well, though not dramatically, with the number of new single-family residence permits down by about 8% in 2015 compared to the 2014 annual total. That is still the third-highest total on record, behind only 2013 and 2014, though it seems logical to assume that housing construction will continue to slow in 2016.

Existing home sales were generally lagging behind 2014 all year long, and the number of closed sales in 2015 was down by over 11% compared to the 2014 annual total. In the fourth quarter, the number of homes sold was down by nearly 25%. The average price of those sales declined, but only very modestly particularly compared to the extraordinary increases in recent years, including 2014. The 2015 annual average sale price was down by only about 2.4% compared to the average in 2014, which in turn was up by over 11% compared to the prior year. The fourth quarter average was down by nearly 5% year-over-year; however, the fourth quarter 2014 average was over 14% higher compared to the previous year.

The end result is a residential real estate market that was down by about 15% in real terms last year, and down about 30% in the fourth quarter. Again, however, the decline is principally due to the decline in the number of sales, not the price of those sales.

Not surprisingly, 2015 was a year of deep contraction in the regional oil & gas economy with declines in every measure of activity other than production itself. The Texas Permian Basin Petroleum Index declined to 241.3 in December down from 253.8 in November, and down 36% from the December 2014 TPBPI. The index peaked in November 2014 and is now down by 37% compared to that pinnacle. Our projections in early 2015 with regard to the levels of activity decline have proven accurate, unfortunately, and may ultimately be worse. Our expectation was for a 40% decline in the value of the Texas Permian Basin Petroleum Index, and that is certainly going to be exceeded. We projected a decline of two-thirds in the rig count; as of last Friday, the regional rig count was down by 66% compared to its November 2014 weekly peak.

We have preliminary factored industry employment loss into the Texas Permian Basin Petroleum Index, and some extrapolations from the quarterly employment and wage data suggest the loss of nearly 9,000 oil & gas jobs in Midland-Odessa alone through December. That is a decline of close to 25% compared to December 2014 when industry employment peaked before beginning to fall.

In a year when the market is clamoring for reductions in crude oil production (and natural gas, for that matter), crude oil production in the Texas Permian Basin in 2015 exceeded the 2014 total by a whopping 16%. Production peaked earlier in the year, but continued to post year-over-year increases throughout 2015 and has come down only very slowly. Texas production has done the same, peaking in March 2015 but still out-producing 2014 by about 10%.

Market conditions have only worsened moving into 2016. Since the end of the year, crude oil prices have lost another $7-10 per barrel, with the posted price for West Texas Intermediate crude falling as low as $23.25 on January 20. The rig count has fallen yet further since year-end as well with the total for RRC districts 7C, 8, and 8A dropping to 158 last Friday. The coming few months suggest a dreary price environment for both crude oil and natural gas, driving activity levels yet further downward. And unfortunately, industry job loss in Midland-Odessa and across the region is set to continue for the foreseeable future. The regional oil and gas industry as measured by the Texas Permian Basin Petroleum

Index is very likely to continue its decline for at least the first half of the year, and perhaps most of the year depending on price movements. Global crude oil supply is likely to continue to outpace demand and the unfortunate result is generally low prices for most if not all of the year. That does not mean prices cannot be higher than they are now, however, and some measure – *any* measure – of price increase will help to stop the bleeding.