F I S C A L I M P A C T R E P O R T

		ORIGINAL DATE	02/05/14		
SPONSOR	HAFC	**LAST UPDATED**	02/18/14	**HB**	146/HAFCS

SHORT TITLE Severance Tax Fund Bonding and Project Limits **SB**

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	**FY15**	**FY16**	**FY17**	**FY18**		
$0.0	$53,000.0	$57,100.0	$56,400.0	$51,300.0	Recurring	Severance Tax Permanent Fund
$0.0	$0.0	$0.0	$500.0	$1,500.0	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	($66,700.0)	($69,300.0)	($67,000.0)	($203,000.0)	Recurring	Severance Tax Bonding Capacity
See attached table for detail of effects on STB capacity.						

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
Administrative Office of the Courts (AOC)
Department of Finance and Administration (DFA)
State Investment Council (SIC)
Office of the State Engineer (OSE)
Indian Affairs Department (IAD)
Public School Facilities Authority (PSFA)

SUMMARY

Synopsis of Bill

House Appropriations and Finance Committee Substitute for House Bill 146 makes several changes to the Severance Tax Bonding Act that would reduce capacity for severance tax bonds and notes while increasing the amount of severance tax revenue that flows to the Severance Tax Permanent Fund (STPF).

Bonding Capacity. HB 146/HAFCs would reduce the amount of severance tax bonding capacity for projects appropriated by the legislature; water infrastructure, tribal infrastructure, colonias infrastructure, and public school capital projects:

The overall size of the senior severance tax bond program, which funds legislative projects, water, tribal, and colonias infrastructure, is reduced from 50 percent of previous fiscal year bonding fund receipts to 48 percent of previous or current fiscal year bonding fund receipts.

The senior severance tax bond capacity is subject to several statutory earmarks, some of which are changed in the legislation:

- The does not change the 10 percent earmark for water projects.
- The earmark for tribal infrastructure projects is increased from five percent to 5.5 percent; and
- The earmark for colonias infrastructure projects is increased from five percent to 5.5 percent.
- Under current law, ten percent of water project funds are dedicated to the Office of the State Engineer for water rights adjudication, and twenty percent of the adjudication funds are dedicated to the Administrative Office of the Courts. The bill reduces the State Engineer earmark to 7.5 percent.

The overall size of both the senior and supplemental severance tax bonding programs is reduced from 95 to 85.5 percent of severance tax revenue, resulting in an effective reduction of the supplemental program, used to fund public school capital outlay projects, from 45 to 37.5 percent of severance tax revenue.

STPF Inflows. Current law limits bonding capacity by previous fiscal year revenues. The HAFC substitute would limit capacity to issue bonds to the lesser of previous fiscal year revenues or current fiscal year revenues, as estimated by the Board of Finance. This has would ensure a transfer to the STPF in years when revenues decline compared with the prior fiscal year. Paired with the reduction of revenues that may be used to service the debt on bonds from 95 percent to 85.5 percent, this provision would increase inflows to the severance tax permanent fund.

The bill also contains a provision requiring revenues received in excess of 15 percent of the past five years' average to be transferred to the STPF.

The effective date of the provisions of this act is July 1, 2014.

FISCAL IMPLICATIONS

State Board of Finance staff estimated the net effects of the changes made in HB 146/HAFCS by specific bonding program or earmark. The ten-year estimated effects are detailed on the attached table, and summarized below:

- Senior capacity is reduced from 50 percent of previous fiscal year bonding fund receipts to 48 percent of previous or current fiscal year bonding fund receipts. Over 10 years, senior capacity is reduced by $195.3 million. Within senior capacity, existing earmarks are reduced as follows:
  - Water trust fund capacity is reduced by $19.5 million over 10 years. Even though the earmark is not reduced, the reduction in overall senior capacity translates to a negative effect on the water trust fund allocation.

   - o Within the amount appropriated for water, the amount earmarked for the State Engineer for water rights adjudications is reduced from 10 to 7.5 percent ($5.6 million over 10 years), and the amount appropriated to the Administrative Office of the Courts is reduced $1.4 million over 10 years. The net dollar impact on non-earmarked portion of funds available for general water projects is lowered to $12.6 million over 10 years.

- Tribal infrastructure capacity is increased from 5 to 5.5 percent of senior capacity (increase of approximately $0.2 million over 10 years).

- Colonias infrastructure capacity is reduced from 5 to 5.5 percent of senior capacity (increase of approximately $0.2 million over 10 years).

- The amount available for legislative appropriation is reduced $176.2 million over 10 years.

- While under current law about 45 percent of capacity (95 less 50 percent) is reserved for the supplemental program benefitting public school capital projects, the bill would reduce the amount for public schools to 37.5 percent (85.5 less 48 percent). Capacity for public school capital projects is reduced by $332.0 million over 10 years.

The Board of Finance estimated the bill will increase inflows of severance taxes into the STPF by $460.2 million over 10 years. In addition, assuming 7.5 percent compound interest, these increased distributions to the STPF will result in an additional $173 million in STPF interest earnings over 10 years.

By increasing the corpus of the STPF, the bill will also result in an increase in STPF distributions to the General Fund. General Fund revenues are estimated to increase by $41.3 million over 10 years.

The December 2013 consensus revenue estimate for oil and natural gas prices and volumes is relatively flat over the 10-year forecast period. Given the relatively flat estimate, the Board of Finance notes the bill's provision requiring revenues received in excess of 15 percent of the past five years' average to be transferred to the STPF has no fiscal impact. However, if in the future oil and gas revenues are more volatile than forecast (a distinct possibility), the BOF adds the bill may result in additional revenue being transferred to the STPF instead of being used to pay debt service on severance tax bonds and notes.

SIGNIFICANT ISSUES

In its analysis of the bill, the Department of Finance and Administration summarizes the history of the severance tax bonding program: When the severance tax bonding program and STPF were created, roughly half of severance tax revenues were used for capital projects (bonds), and roughly half were transferred to the STPF. Over time, and notably as a result of the Zuni lawsuit (which successfully challenged the constitutionality of New Mexico’s educational financing and required the State to establish and implement a uniform system of funding future public school capital improvements), the amount of severance tax revenues that may be used for capital projects has increased and the amount transferred to the STPF has conversely decreased. The statutory capacity to issue bonds was increased from 50 percent to 62.5 percent in 1999, then to 75 percent and further to 87.5 percent in 2000, and finally to 95 percent in 2004.

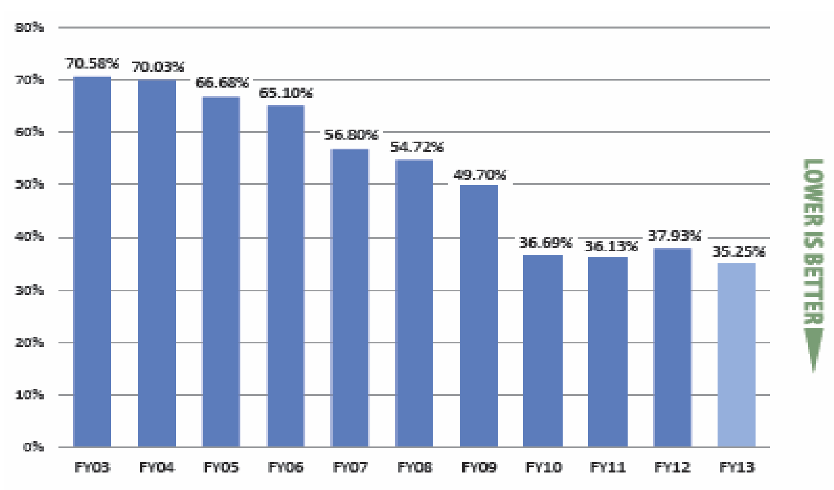
This bill proposes to partially reverse this trend by reducing the amount of severance tax revenue that can be used for bond debt service from 95 percent of previous fiscal year revenue to 85.5 percent of the lesser of previous or current fiscal year revenue. The 48 percent limit on the senior bonding program leaves 37.5 percent of revenues for the supplemental severance tax bonding program used to finance public school capital outlay.

These changes would reduce dollars available to fund state and local infrastructure, public schools, and water projects. However, the changes increase the ability of the STPF balance to grow, increasing the likelihood that distributions from the STPF to the General Fund keep pace with inflation over the long-term.

It is unclear whether reduction of the amount of SSTB capacity available for public school facilities as proposed in this bill would put the State out of compliance with its obligations under the Zuni lawsuit. Careful consideration must be given to the cost of maintaining the public school facilities at current levels and the legal implications of decreasing funding for public school capital outlay. A final judgment has never been issued in the Zuni lawsuit. Reallocating a portion of SSTB capacity for projects other than public school capital outlay needs that jeopardizes adequate standards-based funding may risk a status hearing and judicial intervention or directives.

Some policymakers have begun to raise questions about whether too much of the State's scarce capital outlay funding is currently being directed towards public school facilities. Over a decade has passed since the SSTB program began to direct large amounts of funding annually to public school facilities. Since the supplemental STB program originated in FY00, the State has issued $2.2 billion of supplemental STBs for public schools, which is an average of $170.4 million per year.

A key performance measure for public school building condition is the average Facilities Condition Index (FCI). The current FCI stands at 35.25 percent, improving by 50 percent since FY03. A translation of this is if a building costs $100,000 and has an FCI of 35 percent, that building needs $35 thousand in repairs—lower FCI’s are better. The statewide average FCI is sharply improved from ten years ago. A rule of thumb in determining whether to replace or repair a school building has been if the FCI of a facility is greater than 60 percent, the building should be replaced. A building with an FCI less than 60 percent would be a candidate for repair, rather than replacement. With this in mind, the average FCI of 35.25 percent indicates reasonably good school facility conditions.



SOURCE: PSFA

However, the PSFA notes its Facility Assessment Database (FAD) estimates that an average of $360 million (from all sources) per year in capital expenditures is required over the next 6 fiscal years to maintain the calculated statewide average Facility Condition Index. The annual funding from the Public School Capital Outlay Council (PSCOC) estimated to be required to maintain the FCI at its current level is $140-150 million. Funding at lower levels as proposed in this bill will place the state's investment and gains in school facilities condition at risk.

PSFA has also expressed concern that the reduced supplemental severance tax bonding capacity would potentially harm its ability to finance future phases of already-approved public school capital outlay projects. PSFA staff report a high balance of certified but unissued bonds presents an issue for the PSCOC because it risks delaying projects. PSFA notes a high balance of certified but unissued projects peaks in FY16, caused primarily by awards with high phase 2 construction cost estimates, exacerbated by recently projected construction cost inflation.

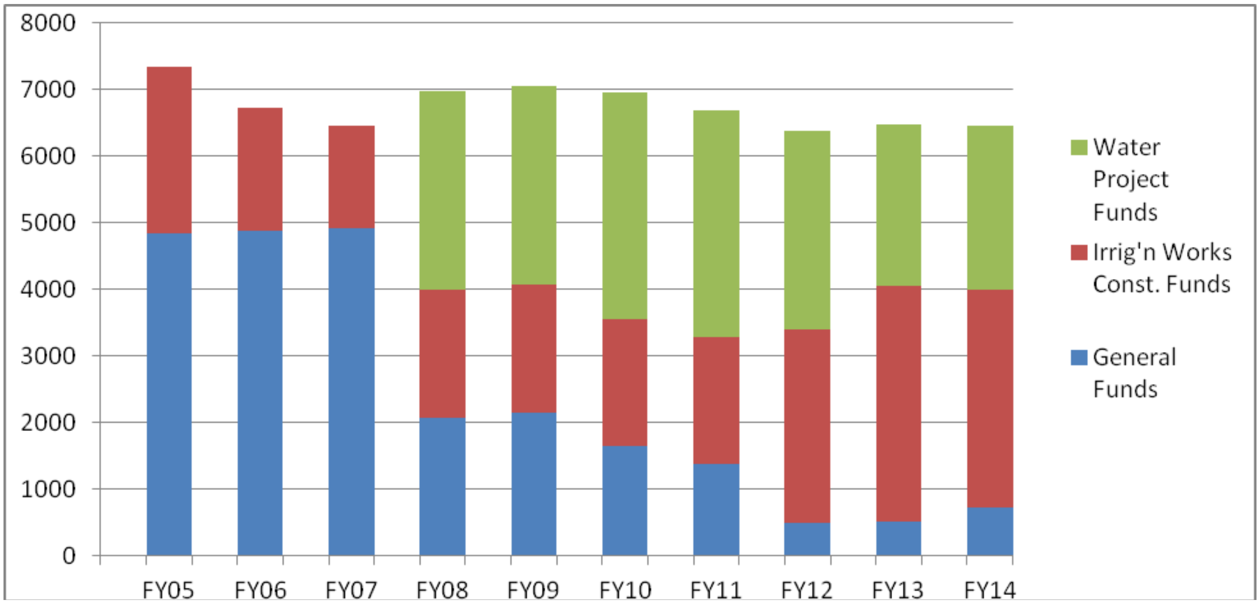
The authority therefore cautions that reductions in SSTB capacity available for PSCOC uses also increase the risk of project delays. There is no immediate risk to projects ready to proceed in the near term (12 months or less) because of the budgeted funds currently available. However, some projects ready to proceed in the FY16-17 time period may be at risk of delay.

The authority suggests delaying the implementation of the bill so that future awards may be structured with consideration of the reduced SSTB capacity, and that the authority may further change adequacy standards to move toward reduced the per-pupil square footage and cost-per-square-foot for new school construction. PSFA stated these changes could better enable the Public School Capital Outlay Council and the PSFA to maximize the use of the reduced funding source.

The Office of the State Engineer (OSE) currently receives 10 percent of the Water Project fund for water rights adjudications and the Administrative Office of the Courts currently receives 20 percent of the OSE allocation. The OSE provided the chart below, which illustrates the reduction in general fund support to the OSE Litigation and Adjudication Program (LAP) since the amendment of the Water Project Finance Act in 2005 that started the dedication water project funds to the state engineer. The OSE notes LAP has become nearly totally dependent on the WPF distribution and the Irrigation Works Construction Fund to operate.

The Administrative Office of the Courts notes water project funding is the sole source of funding for the AOC water rights adjudication program. Under this proposal, DFA estimates the net decrease to the AOC is approximately 28 percent.

LAP Operating Budget Funding Sources – FY05–FY14



Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

PvM/ds:jl

Fiscal Impact Estimate of HAFC Substitute for HB 146 versus Current Law

Sources of Funds (millions)	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**10-Year**
Severance Tax Bonds	-	(13.7)	(13.7)	(13.7)	(13.7)	(13.7)	(13.7)	(13.7)	(13.7)	(13.7)	(123.3)
Severance Tax Notes	-	(13.5)	(15.2)	(13.6)	(9.6)	(9.5)	(5.3)	(3.5)	(1.8)	(0.0)	(72.0)
Subtotal Senior STBs	-	***(27.2)***	***(28.9)***	***(27.3)***	***(23.3)***	***(23.2)***	***(19.0)***	***(17.2)***	***(15.5)***	***(13.7)***	***(195.3)***
Supplemental Severance Tax Bonds	-	-	-	-	-	-	-	-	-	-	-
Supplemental Severance Tax Notes	-	(39.5)	(40.4)	(39.7)	(37.1)	(37.8)	(35.1)	(34.6)	(34.1)	(33.7)	(332.0)
Subtotal Supplemental STBs	-	***(39.5)***	***(40.4)***	***(39.7)***	***(37.1)***	***(37.8)***	***(35.1)***	***(34.6)***	***(34.1)***	***(33.7)***	***(332.0)***
Total Sources of Funds	**$0.0**	**($66.7)**	**($69.3)**	**($67.0)**	**($60.4)**	**($61.0)**	**($54.1)**	**($51.8)**	**($49.6)**	**($47.4)**	**($527.3)**

Uses of Funds (millions)	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**10-Year**
10% Water Projects	-	(2.7)	(2.9)	(2.7)	(2.3)	(2.3)	(1.9)	(1.7)	(1.5)	(1.4)	(19.5)
Water Projects	-	(1.8)	(2.0)	(1.9)	(1.5)	(1.5)	(1.2)	(1.0)	(0.9)	(0.8)	(12.6)
State Engineer - Water Rights Adjudications	-	(0.8)	(0.7)	(0.7)	(0.6)	(0.6)	(0.6)	(0.5)	(0.5)	(0.5)	(5.6)
Admin Office of Courts - Water Rights Adjudications	-	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)	(1.4)
Colonias Projects - 5.5%	-	0.0	(0.2)	(0.2)	(0.0)	(0.1)	0.1	0.2	0.2	0.2	0.2
Tribal Projects - 5.5%	-	0.0	(0.2)	(0.2)	(0.0)	(0.1)	0.1	0.2	0.2	0.2	0.2
New Senior STB Statewide Capital Projects	-	(24.5)	(25.6)	(24.2)	(20.9)	(20.7)	(17.3)	(15.8)	(14.4)	(12.8)	(176.2)
Education Capital	-	(39.5)	(40.4)	(39.7)	(37.1)	(37.8)	(35.1)	(34.6)	(34.1)	(33.7)	(332.0)
Total Uses of Funds	**$0.0**	**($66.7)**	**($69.3)**	**($67.0)**	**($60.4)**	**($61.0)**	**($54.1)**	**($51.8)**	**($49.6)**	**($47.4)**	**($527.3)**

Estimated STPF Transfer	(0.0)	53.0	57.1	56.4	51.3	53.6	48.2	47.5	46.9	46.2	460.2
STPF Earnings on Contributions - 7.5% Compounding	-	(0.0)	4.0	8.6	13.4	18.3	23.7	29.1	34.8	40.9	172.7
General Fund Distributions from STPF	-	-	-	0.5	1.5	3.1	5.2	7.7	10.4	12.9	41.3

Source: Department of Finance and Administration