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## FISCAL IMPACT REPORT

<b>SPONSOR</b> <u>Romero, A</u>	<b>LAST UPDATED</b> _____
	<b>ORIGINAL DATE</b> <u>2/2/23</u>
<b>SHORT TITLE</b> <u>Transfer Excess Oil &amp; Gas Fund To Arts School</u>	<b>BILL NUMBER</b> <u>House Bill 99</u>
	<b>ANALYST</b> <u>Torres, I</u>

### REVENUE\* (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25		
(\$2,000.0)	(\$2,081.0)	(\$2,212.0)	Recurring	Early Childhood Trust Fund
-	-	(\$33.3)	Recurring	Early Childhood Education and Care Program Fund
-	\$2,000.0	\$2,000.0	Recurring	NM School for the Arts Dormitory Fund

Parenthesis ( ) indicate revenue decreases  
 \*Amounts reflect most recent version of this legislation.

Conflicts/Relates to HB89, HB191, SB26

### Sources of Information

LFC Files

Responses Received From  
 State Investment Council (SIC)  
 Early Childhood Education and Care Department (ECECD)

## SUMMARY

### Synopsis of House Bill 99

House Bill 99 creates the New Mexico School for the Arts (NMSFA) dormitory fund and could distribute \$2 million each fiscal year from the excess extraction taxes suspense fund to the newly created dormitory fund.

Section 1 provides for a \$2 million distribution to the new dormitory fund from the excess extraction taxes suspense fund. It would do so when oil and gas emergency school taxes exceed a five-year average and would receive the \$2 million before/in place of the early childhood trust fund.

Section 2 creates the new NMSFA dormitory fund as a nonreverting fund in the state treasury that will receive the distribution from the excess extraction taxes suspense fund as well as any income from investment of the fund (managed by the State Treasurer). The bill directs the new dormitory fund to be administered by the School for the Arts to pay the expenses of providing room and board to residential students that are over and above dormitory fees charged pursuant to Section 22-15F-7 NMSA 1978 and for operating costs of the dormitory.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed.

## **FISCAL IMPLICATIONS**

Under current law, the excess extraction taxes suspense fund receives Oil and Gas Emergency School Tax revenue in excess of the five-year average, then distributes the money in the fund to the Tax Stabilization Reserve (TSR) until total general fund reserve balances are at least 25 percent of recurring appropriations. Once the TSR reaches 25 percent, the remainder of the excess extraction taxes suspense fund then distributes to the Early Childhood Education and Care Fund (i.e., “Early Childhood Trust Fund” or ECTF).

House Bill 99 would not affect the Tax Stabilization Reserve (TSR) but would intercept \$2 million otherwise headed to the early childhood trust fund and send the money to the new NMSFA dormitory fund. Any remaining amounts in the suspense fund would then continue to the ECTF.

If total general fund reserve balances are at least 25 percent of recurring appropriations, HB99 would distribute \$2 million from the excess extraction taxes suspense fund to the new NMSFA dormitory fund, reducing the amount that would be distributed to the Early Childhood Trust Fund (ECTF). This reduced distribution to the ECTF would have a compounding effect on the balance of the trust fund through lost interest earnings on the estimated inflows to the fund and subsequently result in reduced distributions to the early childhood program fund managed by Early Childhood Education and Care Department (ECECD).

The fiscal impact to both funds is estimated by the State Investment Council as shown below:

The tables below show the estimated impact to the ECTF and the early childhood program fund, assuming annual investment earnings of 5.7 percent, which is consistent with our April 2022 asset allocation study that considers our general consultant RVK’s capital market assumptions and return expectations for the various asset classes in which the ECTF is invested.

Calendar Year	ECE Trust Fund Balance (\$MM)		
	Current Law	HB 99	Difference (\$millions)
2023	\$ 6,788.9	\$ 6,786.9	\$ (2.0)
2024	\$ 8,876.1	\$ 8,872.0	\$ (4.1)
2025	\$ 10,158.8	\$ 10,152.6	\$ (6.2)
2026	\$ 10,762.5	\$ 10,754.1	\$ (8.4)
2027	\$ 10,896.6	\$ 10,886.1	\$ (10.5)
2028	\$ 10,987.4	\$ 10,976.7	\$ (10.7)
2029	\$ 11,069.6	\$ 11,058.8	\$ (10.8)
2030	\$ 11,151.3	\$ 11,140.4	\$ (10.9)

Fiscal Year	Distribution to ECE Program Fund (\$thousands)		
	Current Law	HB 99	Difference (\$thousands)
FY23	\$ 30,000.0	\$ 30,000.0	\$ -
FY24	\$ 68,036.6	\$ 68,036.6	\$ -
FY25	\$176,083.1	\$176,049.7	\$ (33.3)
FY26	\$318,783.4	\$318,682.1	\$ (101.3)
FY27	\$430,396.0	\$430,191.1	\$ (204.9)
FY28	\$496,621.7	\$496,310.8	\$ (310.9)
FY29	\$530,297.1	\$529,878.8	\$ (418.3)
FY30	\$544,108.0	\$543,614.7	\$ (493.3)

NEW Distribution of Excess School Tax to NM School for the Arts	
Fiscal Year	HB 99 (\$thousands)
FY23	**
FY24	\$ 2,000.0
FY25	\$ 2,000.0
FY26	\$ 2,000.0
FY27	\$ 2,000.0
FY28	\$ 2,000.0
FY29	\$ -
FY30	\$ -

Due to reduced inflows into the ECTF and compounded lost earnings on those inflows, the estimate above shows distributions to the early childhood program fund could be reduced by \$33 thousand in FY25 and by \$493 thousand by FY30....

Notably, the estimates above assume no above-average revenue from the oil and gas school tax would be collected in the suspense fund after FY27. The consensus revenue estimate expects the five-year average of school tax revenue to progressively increase each year through FY27, meaning amounts above the five-year average would fall and transfers to the suspense fund could reach \$0 after FY27 if the total school tax collections no longer exceed the five-year average. The implication of this for HB99 would be that the new NMSFA dormitory fund may experience years in which it receives no distributions to the fund.

Although the first \$2 million distribution from the suspense fund is expected to come from FY23 school tax revenue (since the bill has no stated effective date and would therefore become effective in FY23 if signed), the actual transfer of monies into the new NMSFA dormitory fund is not expected to occur until after completion of the fiscal year audit, in which DFA confirms the transfer amounts from the suspense fund. Therefore, the actual transfer to the NMSA dormitory fund would likely occur around December 2023 (FY24).

## SIGNIFICANT ISSUES

The excess extraction taxes suspense fund captures windfall (above-average) revenues from the oil and gas school tax. As such, the \$2 million distribution to the new NMSFA dormitory fund would only receive revenues in years in which the state receives above-average oil and gas school tax revenue. Oil and gas revenues can be extremely volatile, and while the current consensus revenue estimate expects the suspense fund to continue capturing above-trend revenues for the next five years, an unexpected shock to oil and/or natural gas prices/production could change this outlook – potentially resulting in no distribution to the suspense fund (and therefore no distribution to the new NMSFA dormitory fund). Thus, the volatile nature of oil and gas revenues could negatively affect the consistency of funding for the new dormitory fund.

The following was noted by the Early Childhood Education and Care Department:

HB99 would reduce the amount transferred to the early childhood and care fund as originally established by law, by prioritizing the new School for the arts dormitory fund as a recipient, and at a fixed rate every year (\$2 million). This change would alter the law as originally intended to transfer the funds from the excess extraction taxes suspense fund in support of the Early Childhood Education and Care Department’s mission to provide

services to children and families of New Mexico.

By opening up this distribution to other entities, such as the New Mexico School for the Arts dormitory fund, this bill (HB99) will set an unintended precedent for other funds to be added as further recipients in the future, thereby reducing the distribution to the early childhood education and care fund in future years and reducing services for statewide Early Childhood education and care.

## PERFORMANCE IMPLICATIONS

Below is the most recent investment performance data for the early childhood trust fund:

<b>As of 9/30/22</b>	<b>QTD</b>	<b>1 year</b>	<b>3 years</b>	<b>2021</b>
Early Childhood Trust Fund – Net Returns	-0.75	-0.85	n/a	9.57

Returns are reported net of fees. The ECTF was created in 2020; therefore, longer-term performance data for the fund is unavailable. Strong performance in CY21 was followed by a challenging year for markets in 2022, reflected in the performance data above. However, very large inflows of excess oil and gas revenues to the fund at the end of CY22 resulted in the fund ending the year with a market value of \$3.462 billion, significantly above the \$314.1 million value of the fund at the beginning of the year. Because of the now higher valuation of the ECTF, the reduced \$2 million inflow into the fund appears unlikely to have a significant impact on the fund’s overall growth and performance.

As noted by the ECECD:

HB99 would reduce the amount distributed to the early childhood education and care fund and reduce the amount of funding available to the Early Childhood Education and Care Department to carry out its mission to: “Optimize the health, development, education, and well-being of babies, toddlers and preschoolers through a family driven, equitable, community-based system of high quality prenatal and early childhood programs and services.”

## TECHNICAL ISSUES

The bill could create administrative impossibilities for DFA by requiring a \$2 million distribution when there is no money in the excess extraction taxes suspense fund. Recommend amending page 2 line 14 after “(\$2,000,000)” to include the words “provided that, if the balance in the excess extraction taxes suspense fund is not sufficient to meet that level, the entire balance shall be transferred to the New Mexico school for the arts dormitory fund”

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