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FISCAL IMPACT REPORT

		LAST UPDATED	2/26/23
SPONSOR	Rodriguez	**ORIGINAL DATE**	2/22/23
SHORT TITLE	Severance Tax Fund Minimum Distribution	**BILL NUMBER**	Senate Bill 378/aSTBTC
		ANALYST	Torres, I.

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
	$92,000.0	$92,000.0	$92,000.0	$92,000.0	Recurring	Severance Tax Permanent Fund
	Positive, see fiscal implications				Recurring	General Fund

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

Sources of Information

LFC Files

Responses Received From
State Investment Council (SIC)
Board of Finance (BOF)

SUMMARY

Synopsis of STBTC Amendment

The Senate Tax, Business and Transportation Committee (STBTC) amendment to Senate Bill 378 adds a section equivalent to the previous general fund capital outlay companion bill in (SB535) the 2019 regular session with updated dates and figures to ensure bonding capacity for public schools is held harmless and remains at a level consistent with projections in the most recent Board of Finance estimates of severance tax bonding capacity.

Synopsis of Original Senate Bill 378

Senate Bill 378 (SB378) provides for $92 million to be distributed annually from the severance tax bonding fund to the severance tax permanent fund unless a lesser transfer amount is needed for Board of Finance to protect current bond holders. The transfer reflects and captures the savings from the avoided debt issuance generated from using general fund for capital outlay instead of severance tax bonds. The distribution would occur on December 31 of each year from 2023 to 2033.

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

SB378 directs $92 million to the severance tax permanent fund (STPF) annually from FY24 through FY34. This amount is an estimate of the debt service that would be needed if the Legislature authorized, and BOF issued, the full FY23 severance tax bond (STB) capacity. Because the introduced capital outlay bill does not include STB authorizations, SB378 would direct the estimated debt service amount to the STPF instead.

If the Legislature does not authorize STBs for FY23, SB378 ensures the funds would be deposited in the STPF rather than increasing supplemental severance tax bonding capacity or future capacity. The bill will not impact the distributions to the earmark funds projected in the Board of Finance's most recent estimates (Water Trust Board, colonias infrastructure fund, tribal infrastructure fund, housing trust fund), or the bonding capacity for public schools capital outlay, or future severance tax bonding capacity for new capital outlay projected.

SB378 directs the severance tax revenue to the STPF over a 10-year period, increasing the size of the fund and thereby increasing earnings and transfers to the general fund in the long-term. The State Investment Council estimates the bill would increase general fund distributions according to the timeline below:

Fiscal Year	Current Estimated STPF Distribution	**New STPF Distribution under SB378**	**Additional General Fund from STPF under SB378**
FY23	$265.8	**$265.8**	**-**
FY24	$289.6	**$289.6**	**-**
FY25	$316.5	**$317.4**	**$0.9**
FY26	$340.3	**$343.1**	**$2.8**
FY27	$365.4	**$371.0**	**$5.7**
FY28	$385.7	**$395.3**	**$9.6**
FY29	$401.0	**$415.6**	**$14.6**
FY30	$418.0	**$437.7**	**$19.7**
FY31	$435.2	**$460.1**	**$25.0**
FY32	$452.1	**$482.4**	**$30.3**
FY33	$468.4	**$504.2**	**$35.8**
FY34	$484.3	**$525.5**	**$41.3**
FY35	$499.9	**$546.7**	**$46.8**
FY36	$514.9	**$566.3**	**$51.5**
FY37	$529.7	**$584.9**	**$55.2**
FY38	$544.3	**$602.4**	**$58.1**
FY39	$558.6	**$618.5**	**$59.9**
FY40	$572.6	**$633.3**	**$60.7**
FY41	$586.3	**$647.7**	**$61.4**
FY42	$599.6	**$661.6**	**$62.0**
FY43	$612.5	**$675.0**	**$62.6**
FY44	$625.1	**$688.2**	**$63.1**
FY45	$637.3	**$700.9**	**$63.6**
FY46	$649.2	**$713.4**	**$64.2**
FY47	$660.9	**$725.6**	**$64.7**
FY48	$672.2	**$737.5**	**$65.3**
FY49	$683.3	**$749.1**	**$65.8**
FY50	$694.1	**$760.5**	**$66.3**
Cumulative Additional General Fund under SB378			**$1,156.7**

While not immediate, the additional inflows into the severance tax permanent fund under SB378 would increase the distributions from the STPF to the general fund. Through 2050, the estimates above show the cumulative additional distributions to the general fund could exceed $1 billion.

SIC staff used the following assumptions to perform this analysis:

- For calendar years 2023-2032, assume an expected annual compound return on STPF investments of 5.7 percent, consistent with the April 2022 asset allocation study that considers general consultant RVK's capital market assumptions and return expectations for the various asset classes in which the STPF is invested. Notably, this return assumption is below the SIC's long-term target return of 6.75 percent, reflecting the Council's expectation that the next decade may be one of both volatility and depressed investment returns. However, for calendar years 2033 and beyond, the analysis assumes the targeted rate of return of 6.75 percent.
- Contributions of severance tax revenue to the STPF under current law are assumed to be equal to the Board of Finance's estimates from December 2022, which provide inflow projections through 2032. Longer-term inflows into the fund are estimated using internal oil and gas price and production projections and applying the statutory limits for use of those revenues for bonding capacity.
- Distributions from the STPF to the general fund of 4.7 percent of the five-year average market value of the STPF, consistent with current law.

SIGNIFICANT ISSUES

Historically, severance tax revenues have been extremely volatile with payments to the permanent fund as low as $38 (2017) in recent memory. Before the 1990s, the STPF was able to grow, due to both strong investment returns and significant inflows delivered annually from the severance tax bonding fund, with approximately 50 percent of the state's severance taxes being used for bonding, and the other half being saved for the STPF.

Starting in the late 1990s, however, the Legislature voted to reduce the distributions to the STPF in favor of more spending from the severance tax bonding fund. Ultimately, the original 50 percent of severance tax revenue distribution to the STPF was reduced to only 5 percent of the state's severance taxes being saved to the STPF, with 95 percent being spent on bonding for capital projects.

Concerns over the restructuring of these funding streams and the associated impact on the long-term viability of the STPF led lawmakers to take action in 2015, passing HB236, which adjusted the spend/save percentage of severance tax revenues from the 95/5 ratio, to a gradual implementation of a new formula that targets saving almost 14 percent (86.2 percent/13.8 percent) of the state's severance tax collections to the STPF by fiscal year 2022. The current statute allows for this percentage to continue in perpetuity, with only 13.8 percent of revenues reaching the STPF.

The following are issues noted by the State Investment Council:

> While there is an expectation that this change will eventually help put the STPF on stronger footing long-term, the council's fiduciary consultant RVK has noted ongoing concerns about the long-term viability of the STPF, given its historically volatile funding stream. In the 20 years from 2002-2021, the STPF received an average annual inflow

from the severance tax bonding fund of less than $55 million, with contributions in some of those years totaling less than $1 million. Although the STPF received two very large contributions totaling over $1.6 billion in CY22 due to a significant rise in oil and gas prices during the year, it is likely an anomaly. The additional contributions to the STPF from Senate Bill 378 would better enable the STPF to help meet the ever-growing demands on our general fund.

A 2019 LFC volatility analysis found that distributions from the permanent funds are the state's most stable (i.e., least volatile) source of general fund revenue. This is because the distributions from the permanent fund are based on five-year averages of the fund's ending balance, which reduces annual volatility in the STPF caused by market swings and variance in oil and gas inflows. For example, in 2008 the value of the STPF fell nearly 32 percent during the Global Financial Crisis; however, general fund distributions from the STPF *grew* by 3.6 percent in FY08 and by 8 percent in FY09. By investing additional funds into the STPF, SB378 would further allow the permanent fund to ultimately deliver a stable and growing source of general fund revenue

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

A similar mechanism was established in 2019 (SB535) to set a base recurring distribution of $23.69 million from the severance tax bonding fund to the STPF from 2019 to 2028. That year, the distribution was put in place because the annual capital outlay bill did not include senior STB authorizations and the legislature instead directed the estimated debt service amount to the STPF. Similarly, if no senior STBs are authorized for the 2023 legislative session, then it is presumed that the distribution to the STPF in SB378 is the estimated about of debt service that would instead be directed to the permanent fund.

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