
OVERVIEW OF THE SEVERANCE TAX PERMANENT FUND

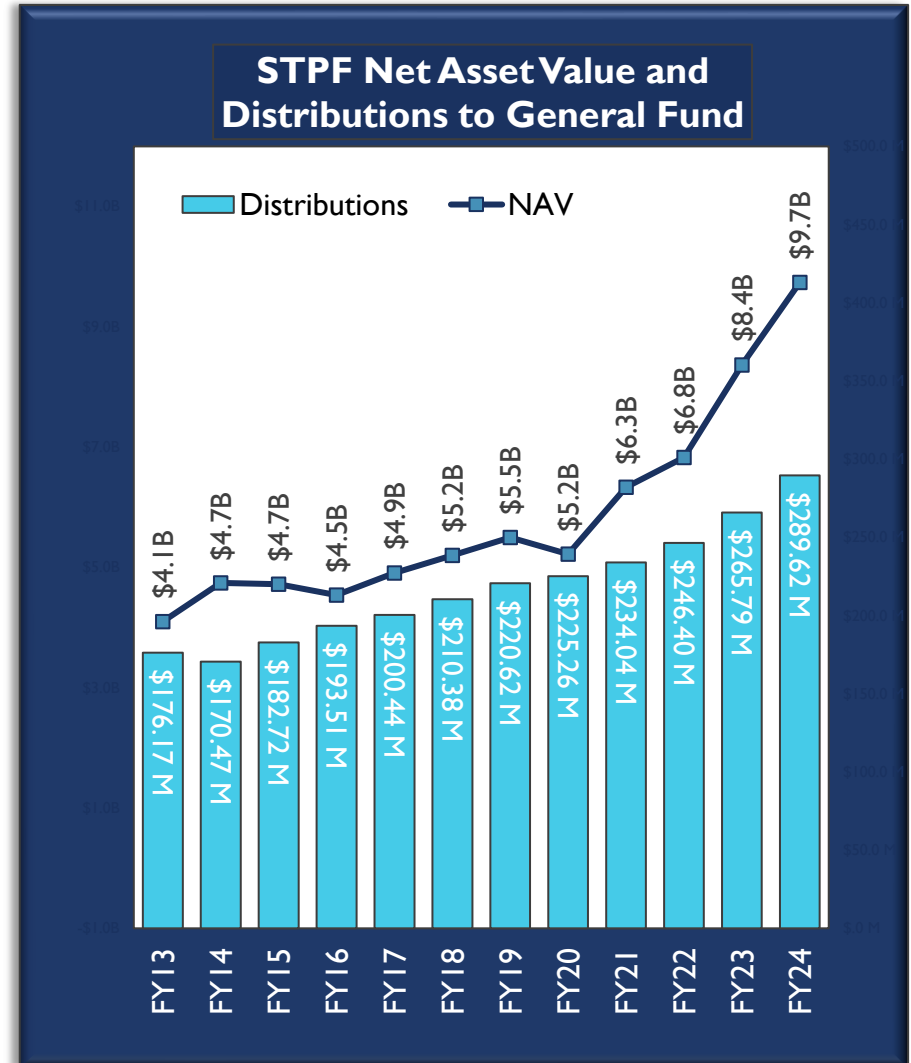
Presentation to the Investments & Pensions Oversight Committee (IPOC)

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October 1, 2024



PRESENTATION OVERVIEW

- History and background of the Severance Tax Permanent Fund (STPF)
- STPF distributions to the general fund
- STPF investment performance
- Economically targeted investments from the STPF
- Importance of permanent funds in securing NM's future



STPF HISTORY AND BACKGROUND

SEVERANCE TAXES & RELATIONSHIP TO THE SEVERANCE TAX BONDING FUND

- The Severance Tax Permanent Fund (STPF) was created by the New Mexico Legislature in 1973 to save and invest the severance taxes not being used to bond capital projects.
- The **severance tax** is one of three production taxes the state levies on oil, natural gas, and other natural resources as they are “severed” from lands in New Mexico.
- Severance tax revenue is deposited into the Severance Tax Bonding Fund and is used to issue and service debt for severance tax bonds each year.
 - By law, total debt is limited to set percentages of the lesser of current-year or prior-year bonding fund revenue (*Section 7-27-17 NMSA 1978*).
 - For decades, the amount of total debt was limited to 50 percent of prior-year revenue.
 - Beginning in 1999, the state began issuing short-term “supplemental severance tax bonds” and increased the limits on the amount of bonding fund revenue that could be used for debt. By 2004, the limit had grown to 95 percent.
 - In 2015, the Legislature adopted a plan to phase-in lower limits and stabilize contributions to the permanent fund.
 - Under the plan, total debt was limited to 92.8 percent in FY16 and was phased down to 86.2 percent in FY22. The remaining 13.8 percent of severance tax revenue is to be invested in the STPF.
 - **Uncommitted money in the bonding fund is transferred twice a year to the Severance Tax Permanent Fund, which is invested by the State Investment Council.**
 - In recent years, when capital outlay projects were cash-funded from the general fund, the Legislature passed minimum required distributions from the bonding fund to the STPF, which represented the amount of debt service the state would have paid if STBs were issued for capital outlay.
 - \$23.69M per year from 2019-2028, plus \$92M per year from 2023-2033**

* Note, the statute allows for lower severance tax rates on oil and natural gas if prices fall below certain levels.

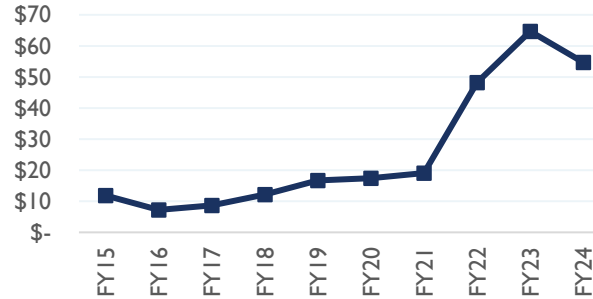
** See SB535 (2019) and SB 378 (2023) – these distributions codify the investment of those debt service savings in the STPF

STPF HISTORY AND BACKGROUND

FUND INFLOWS FROM THE SEVERANCE TAX BONDING FUND

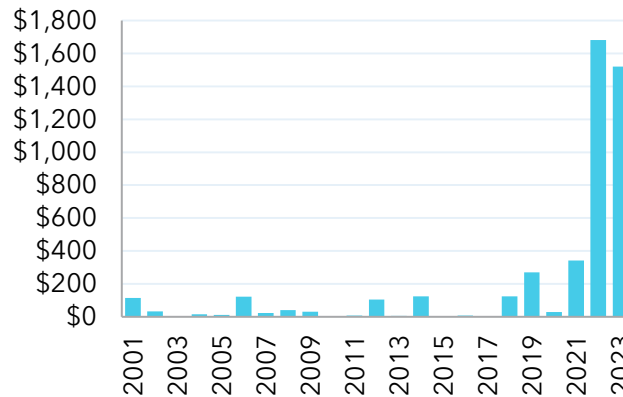
- In the 20 years between 2002-2021, the STPF received a total of \$1.082 billion of inflows into the fund.
- In 2022 & 2023, the STPF received abnormally large contributions due to the statutory limitation of bonding against the **lesser** of current or prior-year severance tax revenues.
 - Oil and gas taxable values more than doubled from FY21 to FY22, limiting bonding capacity to FY21 revenues.
 - Oil and gas taxable values increased again in FY23, limiting bonding capacity to FY22 revenues resulted in another large contribution to the STPF in 2023.

Oil & Natural Gas Taxable Values by Fiscal Year* (\$billions)



Source: GenTax; *FY reflects timing of deposits into bonding fund (May to April production months)

Severance Tax Permanent Fund Inflow History (\$MM)



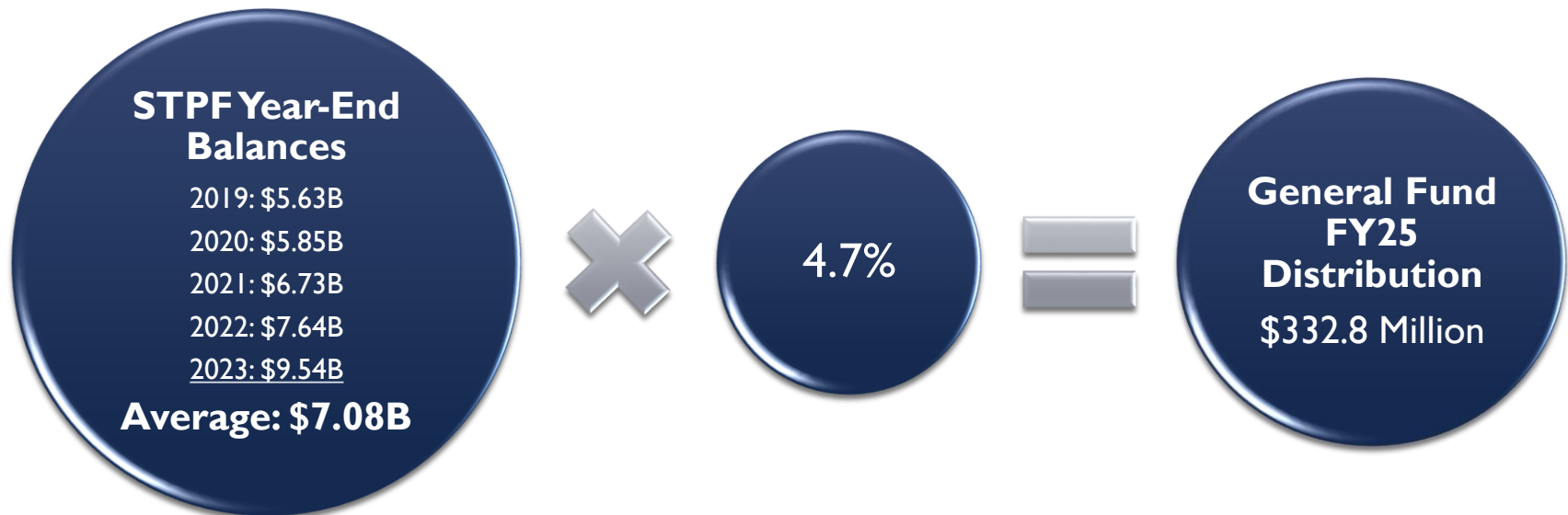
Source: NM State Investment Office
 Note: 2023 also includes a \$475M legislative approp. to the STPF

Calendar Year	Contribution to STPF (\$mm)
2001	\$ 114.3
2002	\$ 32.0
2003	\$ 1.0
2004	\$ 16.3
2005	\$ 12.4
2006	\$ 123.2
2007	\$ 24.1
2008	\$ 41.4
2009	\$ 30.2
2010	\$ 3.5
2011	\$ 7.6
2012	\$ 103.9
2013	\$ 5.3
2014	\$ 124.7
2015	\$ 0.8
2016	\$ 7.7
2017	\$ 0.0
2018	\$ 123.4
2019	\$ 270.9
2020	\$ 29.3
2021	\$ 342.2
2022	\$ 1,682.3
2023	\$ 1,519.4

STPF HISTORY AND BACKGROUND

DISTRIBUTIONS TO THE GENERAL FUND

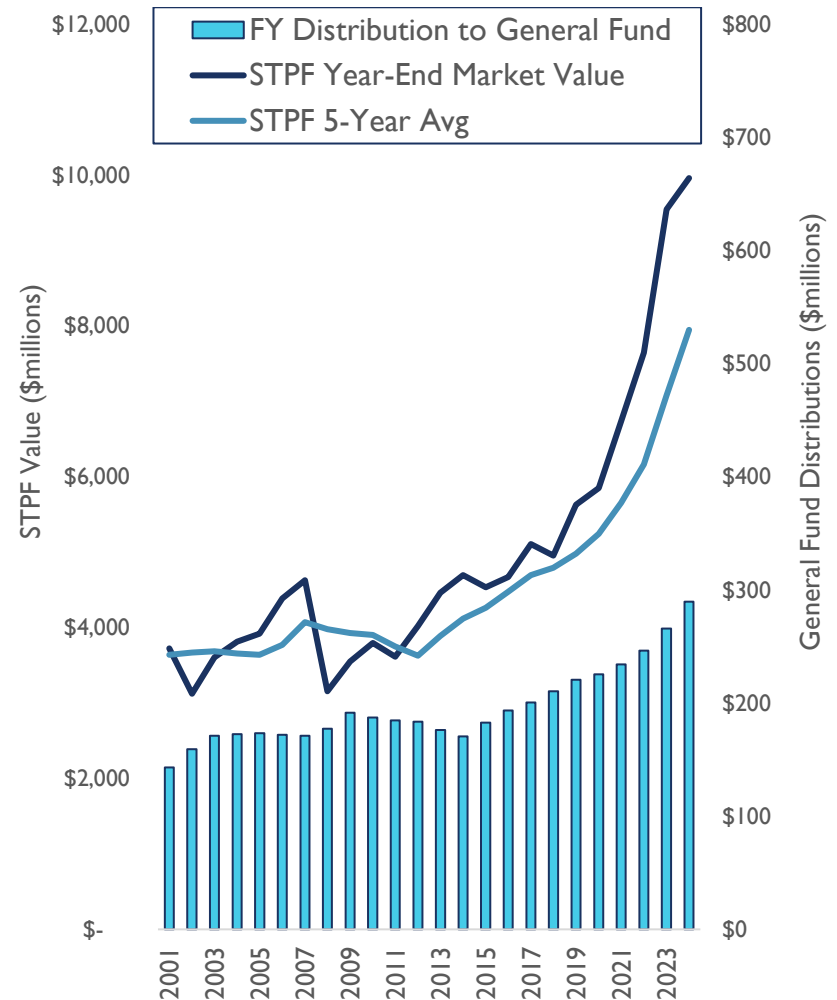
- In 1976, voters approved constitutional protections for the STPF that restrict the ability to appropriate from the corpus of the fund.
 - Under these original provisions, distributions from the STPF to the general fund were limited to the income generated from investments (i.e. investment earnings only).
- In 1996, voters passed a constitutional amendment to allow for a general fund distribution of 4.7 percent of the five-year average value of the STPF.
 - Annual distributions from the STPF flow to the general fund in equal monthly installments and are not earmarked for any specific purpose, allowing STPF revenues to broadly support general fund budgets.



STPF DISTRIBUTIONS TO THE GENERAL FUND

DISTRIBUTION FORMULA REDUCES GENERAL FUND REVENUE VOLATILITY

- Basing distributions on the 5-year average reduces annual volatility in the STPF caused by market swings.
 - For example, in 2008 the value of the STPF fell nearly 32% during the Global Financial Crisis
 - However, general fund distributions from the STPF **grew** by 3.6% in FY08 and by 8% in FY09.
- Distributions from the permanent funds are among the state's most stable (i.e. least volatile) source of general fund revenue.*

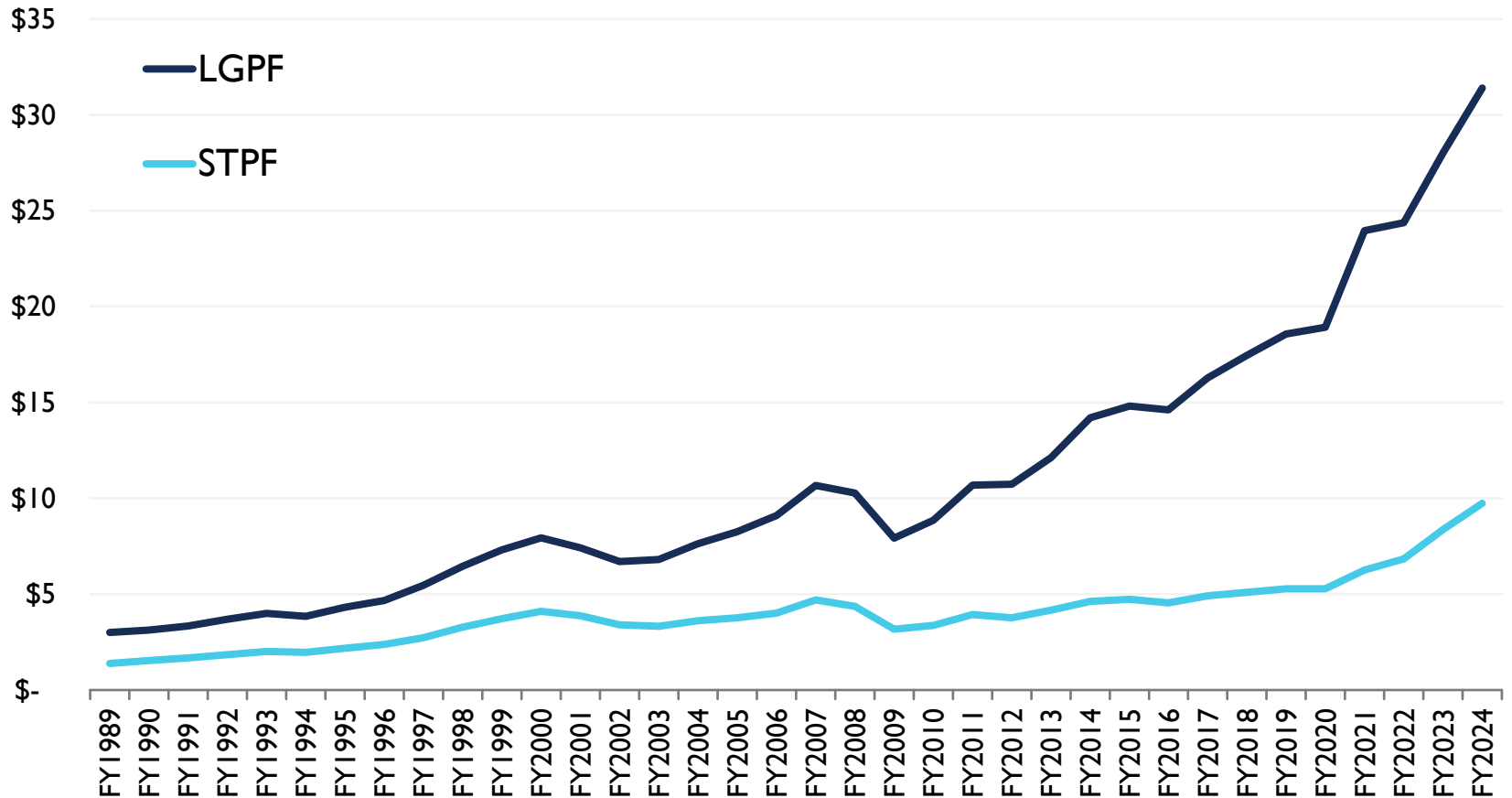


* LFC Hearing Brief, "State Revenue Volatility and Enhancing Fiscal Stability", July 2024

STPF PERFORMANCE

GROWTH RELATIVE TO THE LAND GRANT PERMANENT FUND (LGPF)

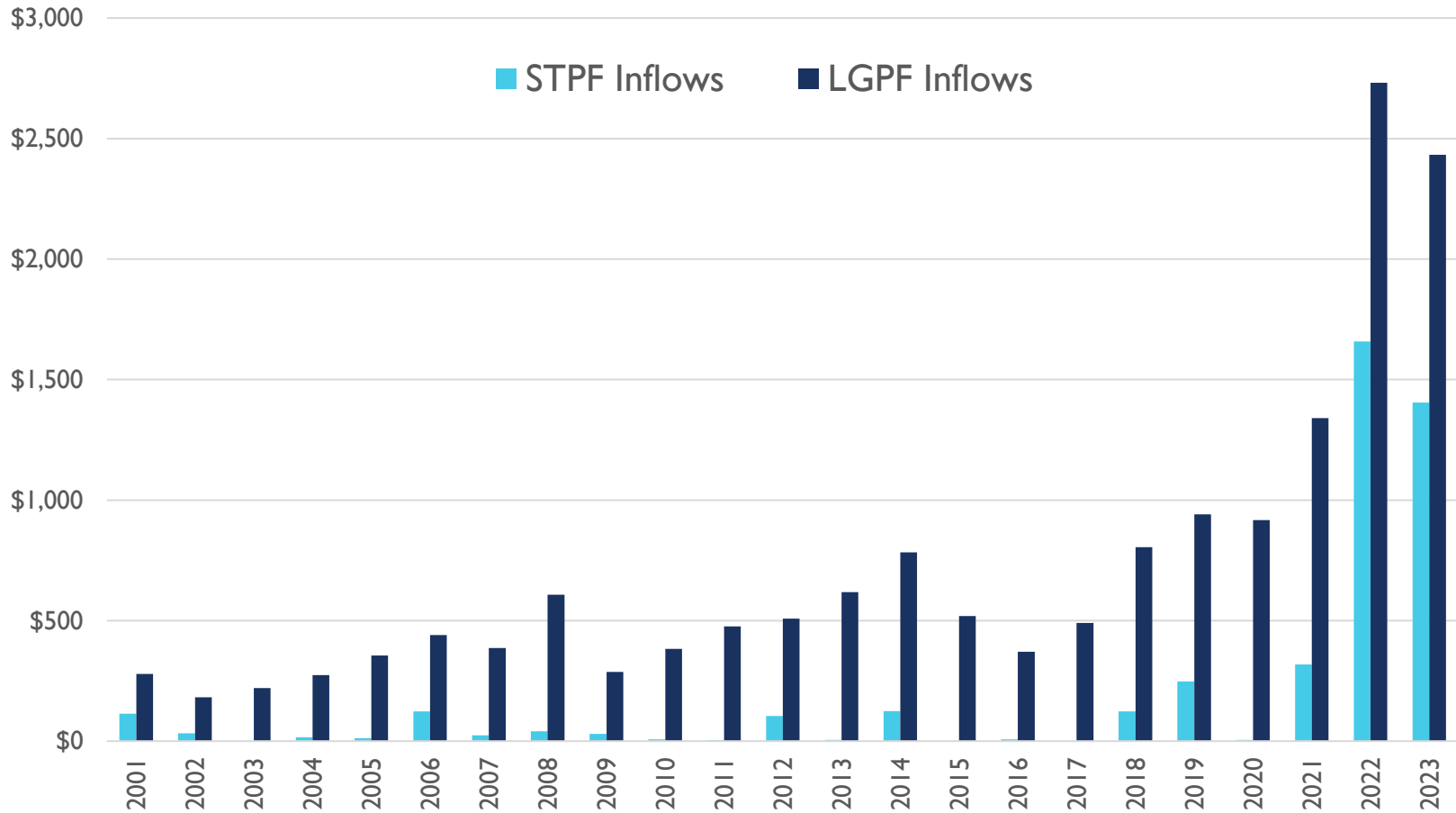
Permanent Fund Growth, FY1989-FY2024
(dollars in billions)



STPF PERFORMANCE

GROWTH RELATIVE TO THE LAND GRANT PERMANENT FUND (LGPF)

Permanent Fund Contributions
(dollars in millions)



STPF PERFORMANCE

ECONOMICALLY TARGETED INVESTMENTS (ETIs)

Various statutes authorize below market rates of return for STPF investments intended to stimulate the economy of New Mexico - these are known as economically targeted or "differential rate" investments.

NM Small Business Investment Corporation (SBIC)

- Statute requires 2% of the STPF to be committed to the SBIC for the purpose of creating new job opportunities in the state.
- Made venture capital equity investments in the past, but now focuses on small business lending.

Small Business Recovery and Stimulus Act (2021)

- Statute provides for up to \$500 million for small business loans at a very low interest rate.

STPF PERFORMANCE

ECONOMICALLY TARGETED INVESTMENTS (ETIs)

New Mexico Private Equity Investment Program (NMPEIP)

- Statute allows up to 11% of the STPF to be allocated toward NM private equity and business investments.
 - Created in 1993, the statutory limits began at 3% and were later increased to 6% in 2003, to 9% in 2006, and to 11% in 2021.
- The SIC's Private Equity Investment Program (NMPEIP) is one of several programs currently assisting with the launch of NM start-up companies
 - NM Finance Authority Venture Program (\$50 million)
 - Impact investments, emerging managers
 - NM Economic Development Department & the State Small Business Credit Initiative (Up to \$74 million)
 - Three-tranches of federal funding, combination of equity and debt funding, with focus on economic development over return on capital

STPF PERFORMANCE

INVESTMENT RETURNS

Returns, net of fees, annualized, as of 6/30/24

	1-year	3-year	5-year	7-year	10-year
Land Grant Permanent Fund	8.58	4.44	7.56	7.46	6.88
<i>Benchmark</i>	8.28	4.29	7.51	7.4	6.81
Severance Tax Permanent Fund	6.87	2.65	5.64	6.00	5.78
<i>Benchmark</i>	5.56	2.41	6.12	6.44	6.16
Peer Median, public funds > \$1B*	9.57	3.03	7.16	6.29	7.62
LGPF Total Fund Rank*	78	18	37	36	33
STPF Total Fund Rank*	93	71	96	92	80

* RVK Executive Summary Performance Review, June 30 2024

** LFC Investment Performance Quarterly Report, 4Q FY24

Long-term investment return targets: LGPF (7.0%), STPF (6.75%)

STPF: INVESTMENTS TO DIVERSIFY THE NEW MEXICO ECONOMY

The law's focus is on tech transfer & commercialization, which lends itself to New Mexico's strengths & existing resources - national labs & research universities

The Council has focused on emerging "Frontier Technologies":

- Quantum Sciences
- Next Generation Computing
- Artificial Intelligence
- Aerospace
- Advanced Manufacturing
- Synthetic Biology
- Advanced Energy
- 6G/Communications
- Climate Technologies

Section 7-27-5.14. Findings and purpose.

The legislature finds that the health of the New Mexico economy is heavily dependent on the establishment and expansion of small businesses and that the lack of available private equity is an impediment to the start-up and growth of businesses in the state. The legislature further finds that the commercialization of technology conceived in the universities and the federal scientific and engineering laboratories and test facilities in the state is likely to occur elsewhere unless sources of local private equity are developed. The purpose of Section 7-27-5.15 NMSA 1978 is to provide a mechanism whereby the establishment of private equity funds, whose investment policies are supportive of the economic welfare of New Mexico, will be stimulated.

CAPITALIZING ON NM'S HARD SCIENCE RESOURCES

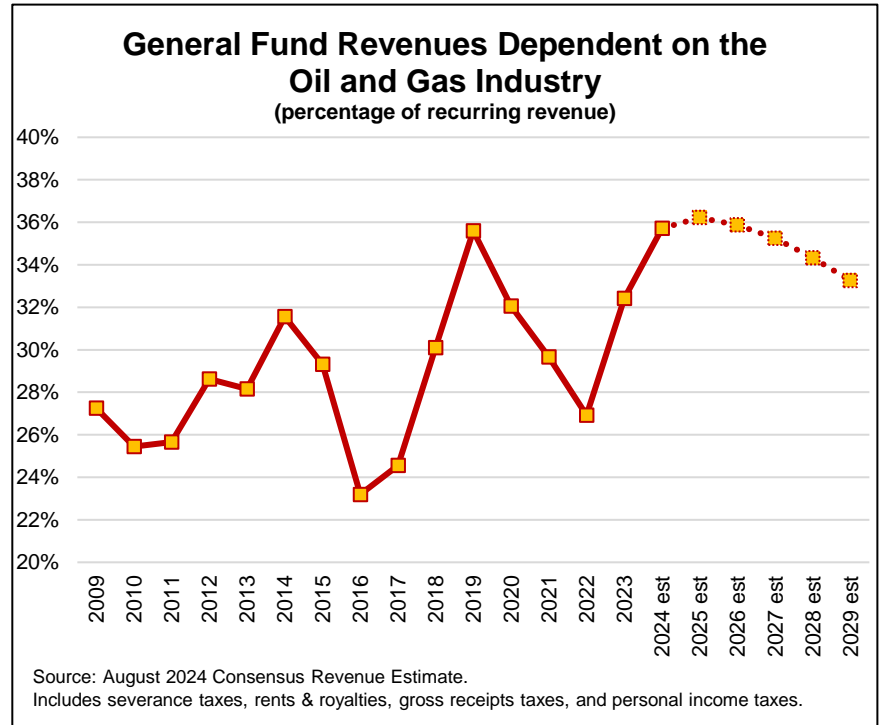
Recent/Pending SIC Commitments to NM-focused Venture Funds

<u>Date</u>	<u>Fund Selected</u>	<u>SIC Commitment of up to (\$) millions</u>
November 2022 / Aug. 2024	America's Frontier Fund / Roadrunner Fund	\$100
November 2022	Crosslink Ventures X/Endeavor	\$35
March 2023	Lux Ventures VIII	\$62.5
March 2023	Playground Ventures II	\$35
August 2023	Antler US II	\$40
August 2023	Thayer Ventures IV	\$10
August 2023	Tramway Ventures III	\$20
September 2023	At One Ventures	\$20
November 2023	Khosla Ventures VIII	\$75
November 2023	Dangerous Ventures I	\$10
January 2024	Next Frontier Ventures IV	\$10
February 2024	Airbus Ventures IV	\$20
February 2024	Upfront Ventures VIII	\$50
March 2024	DCVC Climate	\$50
May 2024	J2 Ventures Argonne Fund	\$15
August 2024	Outlander 3 Magellan	\$30
September 2024	Builders VC Fund III	\$65
September 2024	TK MediaTech Ventures	\$15
October 2024	Pending	TBA
Total Commitment		>\$662.5 million

ECONOMIC DIVERSIFICATION vs. REVENUE REPLACEMENT

- The mining industry represents less than 3% of total employment in the state and about 10% of New Mexico’s GDP
- However, the oil & gas industry directly accounts for about 24% of general fund revenue (through severance taxes, rents and royalties) and more than 30% of the general fund when including sales taxes and other revenues

New Mexico GDP by Industry (2023)	
Government	23%
Finance, insurance, real estate, rental, and leasing	15%
Professional & business services	12%
Mining, quarrying, oil & gas extraction	10%
Educational services, healthcare, social assistance	8%
Retail trade	6%
Leisure & hospitality	5%
Construction	4%
Manufacturing	3%
Wholesale trade	3%
All other industries	10%



Source: Bureau of Economic Analysis

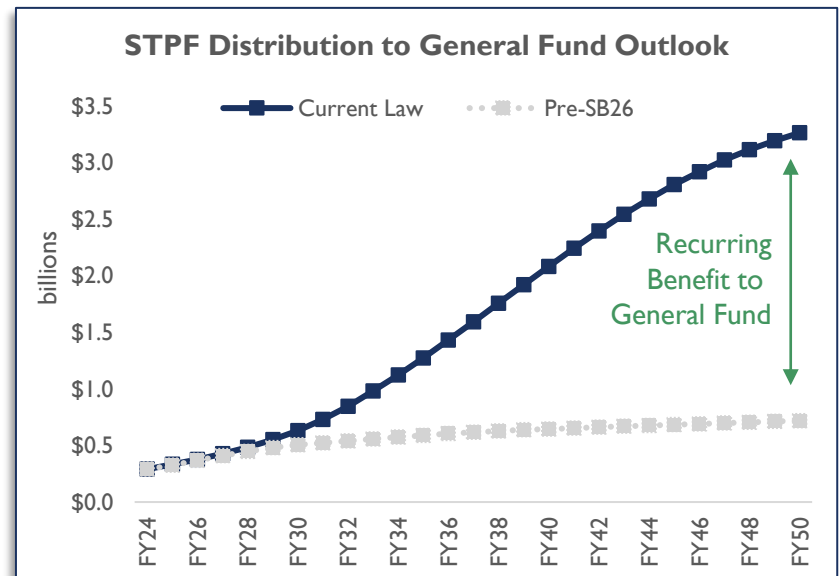
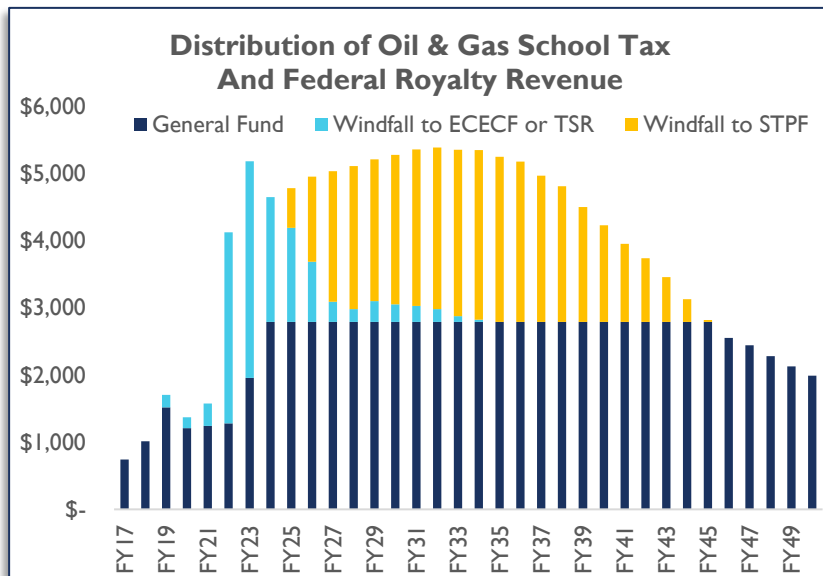
A REVENUE SOLUTION TO A REVENUE PROBLEM

Senate Bill 26 (2023) capped the amount of oil- and gas-related revenues reaching the general fund from the oil and gas emergency school tax and federal mineral leasing payments, the two largest sources of general fund oil and gas revenues.

- Does not affect the five-year average calculation that determines the amount of revenue the ECECF/TSR receives - only the revenues above the cap, but below the moving average, will be distributed to the STPF beginning in FY25

Key Benefits:

- Significantly reduces oil- and gas-related revenue volatility for the general fund
- Simplifies general fund revenue estimating for sources that are historically very difficult to predict
- Reduces general fund dependence on oil and gas revenues
- Improves general fund stability by replacing volatile energy revenue with more stable investment distributions



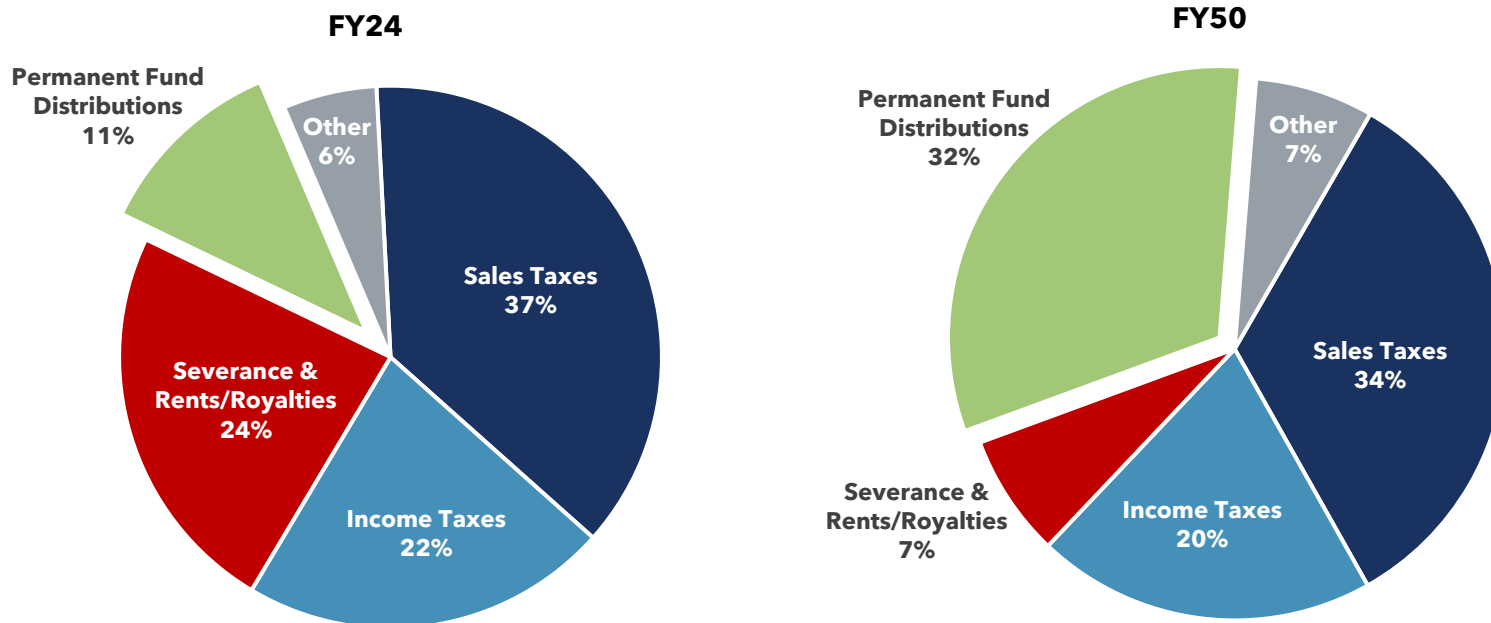
Source: Estimates from the NM Consensus Revenue Estimating Group September 2024 Long-Term Revenue Outlook. Actual future oil and gas revenues and STPF distributions will depend on market performance and fund contributions.

TRANSITIONING FROM VOLATILE OIL & GAS RELIANCE TO MORE STABLE PERMANENT FUND DISTRIBUTIONS

In its September 2024 Long-Term Revenue Outlook, NM's Consensus Revenue Estimating Group projects general fund revenues from the oil and gas industry will decline over time as the world transitions beyond traditional energy sources.

As energy-related revenues decline, permanent fund distributions will grow significantly as a share of general fund revenue, helping to displace estimated future declines in oil and gas revenues.

Estimated Sources of General Fund Revenue



PERMANENT FUNDS HELP SECURE NM'S FUTURE



FOR IMMEDIATE RELEASE

September 17, 2024

Permanent fund investments to surpass oil and gas revenue, securing New Mexico's future by 2039

Albuquerque, NM — The state's Consensus Revenue Estimating Group (CREG) is projecting that permanent fund investments in New Mexico will surpass oil and gas as the state's leading source of revenue by 2039.

CREG's economic experts unveiled the long-term revenue outlook during a meeting of the Legislative Finance Committee on Tuesday.

"Thanks to our strategic investments in the state's permanent funds and endowments, New Mexicans will continue to benefit from strong public programs such as early childhood education and the Opportunity Scholarship," said **Gov. Michelle Lujan Grisham**. "We're securing long-term prosperity and moving toward a more resilient and diversified revenue base that will pay dividends for generations to come."

Record year-over-year revenue growth has enabled historic investments in New Mexico's permanent funds, as well as education, health care, economic development, public safety and the environment, while also reducing taxes for New Mexicans.

"For years, we've talked about the need to diversify the state's revenue stream to ensure that we can continue to deliver the level of services New Mexicans deserve. We've made incredible progress," said Taxation and Revenue **Sec. Stephanie Schardin Clarke**

In 2023, the Legislature allocated \$475 million to the Severance Tax Permanent Fund, with plans to reach \$1 billion by 2033, contributing \$92 million annually. In FY25, the permanent funds will distribute more than \$2 billion to the general fund and other public entities and programs. By the decade's end, the state will deposit an estimated \$4.7 billion into this fund.

"...permanent fund investments in New Mexico will surpass oil and gas as the state's leading source of revenue by 2039."