Revenue and Supplemental Severance Tax Bonding Capacity Projections

Department of Finance and Administration

Public School Capital Outlay Oversight Task Force

November 23, 2020

Agenda

Overview of the Severance Tax Bonding Program

Producing Severance Tax Bonding Capacity Estimates
Revenues & Debt Service
Statutory Limits
Capacity versus Note "Sizing"
Timeline

Historical Supplemental Note Issues & Expenditures

Current Preliminary Bonding Capacity for Supplemental Severance Tax Notes

Oil & Gas Revenue Estimates: The Process

Recent Trends in the Oil & Gas Industry

Overview of Severance Tax Bonding Program

Severance Tax Bonding Program

General Information

The modern Severance Tax Bonding Program dates to 1973, when the Severance Tax Permanent Fund (STPF) was created.

Paid by mineral extraction industries on the value of resources severed from the ground (Severance Tax)

Tax revenues are held within the Severance Tax Bonding Fund (STBF) and are only available to pay debt service, limited costs of administering the STB program, or for transfers to the STPF.

- The remaining balance in the STBF, minus the next two debt service payments, is statutorily mandated to be transferred to the STPF 2x/year (December and June).

Debt service payments (on long-term bonds) are paid in January (interest only) and July (principal & interest)

The State issues both Senior and Supplemental Bonds and Notes.

Severance Tax Bonding Program

	Senior	Supplemental
Long-Term Bonds	**Funds:** Various Capital Projects as authorized by Legislature **Tax-Exempt** **Sold 1x/year, competively** **10-Year Maturity**	**Funds:** Public School Capital Projects as certified by PSCOC **Tax-Exempt** **Sold Infrequently, competively** **10-Year Maturity**
Short-Term "Sponge" Notes	**Funds:** Various Capital Projects (Legislative, Tribal, Colonias, Water) as authorized by Legislature **Taxable** **1-2 Day Notes ("Pay As You Go")** **Sold 2x/year (Jun/Dec)**	**Funds:** Public School Capital Projects as certified by PSCOC **Taxable** **1-2 Day Notes ("Pay As You Go")** **Sold 2x/year (June/Dec)**

Producing Severance Tax Bonding Capacity Estimates

Capacity Estimates: Key Factors

Statutory Limits on Debt

Projected Future Severance Tax Revenues (primarily oil and gas)

Outstanding and future projected long-term debt service

Issuing long-term Senior Severance Tax debt so that debt service for long-term bonds matches revenues in year 10.

Capacity Estimates: Revenue Inputs & Debt Service

Revenues

FY20 Actual Revenues

96% Oil and Gas Severance Tax Revenues

2.6% Investment Income **0.8%** Coal and Other Mineral Revenues

**based on FY20 revenues*

Estimated Revenues

CREG 5-year estimates (oil and gas prices and volumes) and DFA out-year estimates (years 6–10)

DFA 10-year estimates for all other revenues

Debt Service

FY20 Actual Annual Debt Service

$168.4 million

Projected Annual Debt Service Payments

Based on projected Senior long-term debt

Capacity Estimates: Statutory Limits

Senior Severance Tax Bonds and Notes are issued to the point where debt service does not exceed 47.6% of lesser of prior year actual revenues or current year estimated revenues.

Senior AND Supplemental Severance Tax Bonds and Notes are issued to the point where debt service does not exceed 87.8% (dropping to 86.2%) of the lesser of prior year actual revenues or current year estimated revenues.

This limits issuance both by percentage of revenues and by using the lesser of the two years of revenues (actual prior and current estimated).

Capacity Estimates: An Annual Snapshot

Total STB Capacity FY 2021

$361.95

Senior Long-Term Bond Capacity

Represents the maximum amount of bonds that can be authorized (i.e., the cash available the last year the long-term issuance is outstanding would equal zero, meaning we issued to the maximum amount)

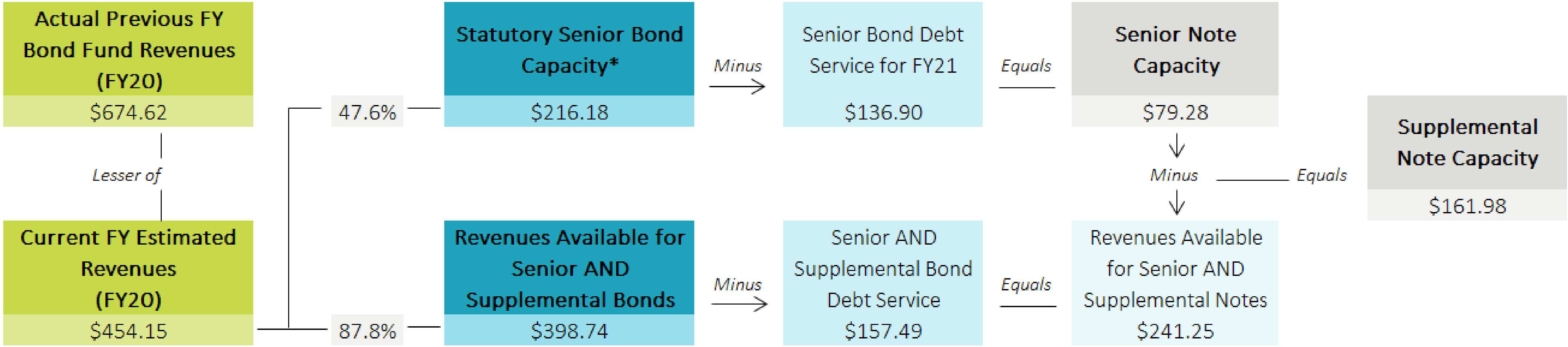
Note Capacity

This is based on statutory limitations equal to 47.6% for Senior Note and 87.8% for Senior and Supplemental Note (in FY 20, dropping to an ultimate 86.2% in FY22)

Equals

Total Note Capacity

$241.25



Capacity Estimates: Capacity versus Note "Sizing"

"Sizing" means determining how much we will issue in a senior and/or supplemental Severance Tax Note in December/June.

Why do we size? Just because we estimated a certain amount of capacity doesn't mean we will end up with the amount of cash on hand in the STBF.

- If revenues are lower, we won't issue more than we have in cash on hand, minus the next two debt service payments.
- If revenues are higher, we may be able to issue more, and more may be transferred to the Severance Tax Permanent Fund, per statutory requirement.

This means that for Severance Tax Notes, capacity is *always* an estimate, subject to change based on the actual revenues received into the STBF.

Capacity Estimates: Timeline

August

Capacity estimates are updated based on released oil and gas prices and volumes from the CREG.

- This is a preliminary estimate for planning purposes.

December

August capacity estimates are updated based on *updated* oil and gas prices and volumes from the CREG.

- CREG estimates incorporate additional data available.
- Capacity estimated at this time is almost always the final estimate that's provided to the legislature.

This represents a typical year. But, as we have learned with 2020, not all years are typical. CREG estimates and capacity estimates can and do get updated mid-year when significant changes occur in the oil and gas market.

Capacity & Severance Tax Bond and Note Issues

December

Capacity estimates are updated based on *updated* oil and gas prices and volumes from the CREG.

Board of Finance determines whether a Senior and/or Supplemental Note will be issued

- Based on cash in the bonding fund
- Based on the updated capacity estimates
- Based on the status of "Authorized but Unissued" (ABUs) capital projects.

January

Capacity estimates are provided to the legislature for capital project appropriations.

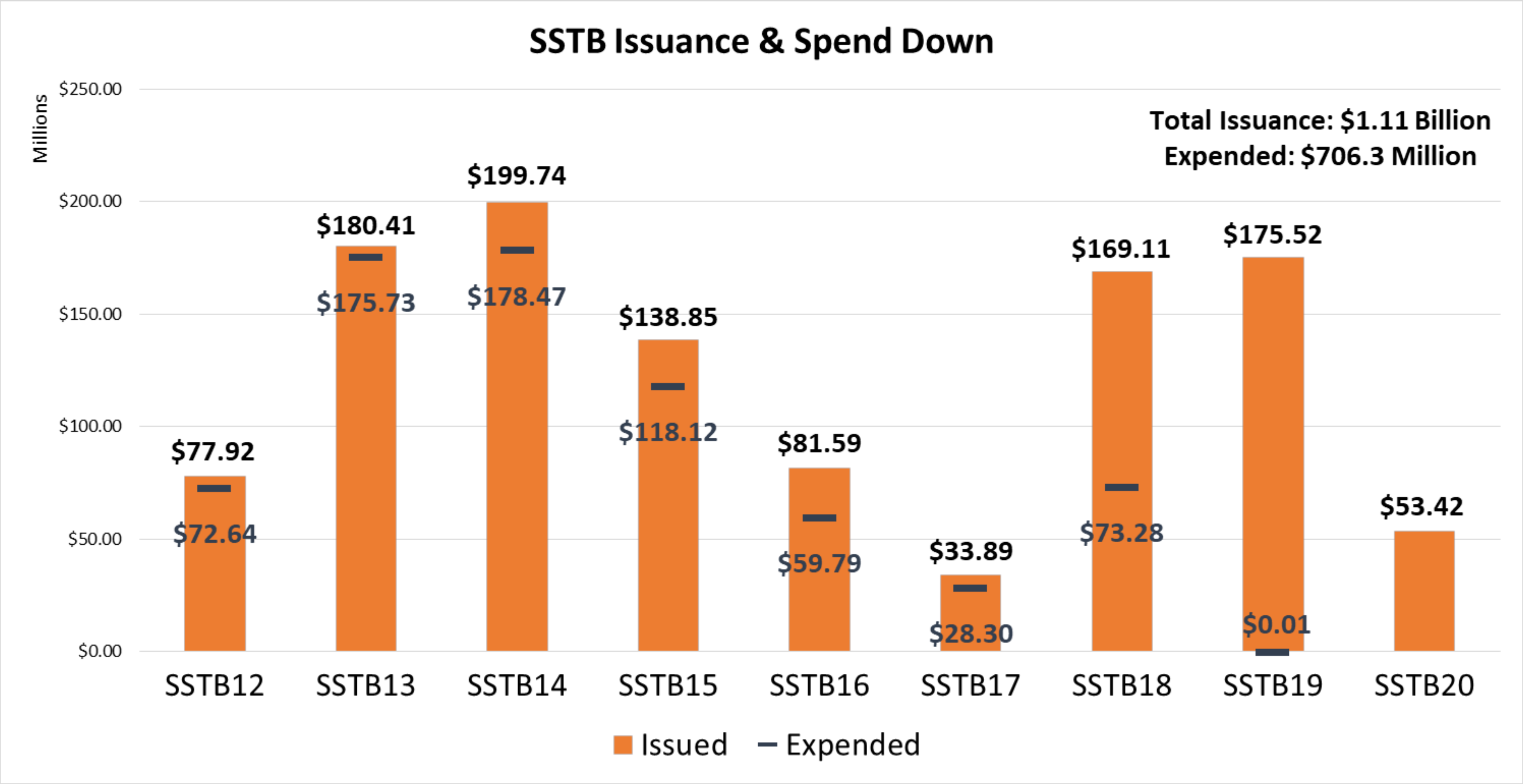
June

A long-term Senior Severance Tax Bond and Senior Severance Tax Note are typically issued to fund capital projects appropriated during that year's legislative session (and any remaining ABUs that are ready to be funded).

A Supplemental Severance Tax Note may be issued if there's available cash and the maximum amount (per the statutory capacity) has not already been issued.

Historical Supplemental Note Issues & Expenditures

Historical Supplemental Note Issues & Expenditures



$25 million annually goes to PED for instructional materials and transportation projects
$5 million annually goes to PSCOC for pre-kindergarten classrooms statewide (since FY18)

Current Preliminary Bonding Capacity for Supplemental Severance Tax Notes

Current Preliminary Bonding Capacity for Supplemental Severance Tax Notes

NOVEMBER 2020 Estimate

Sources of Funds	FY21	FY22	FY23	FY24	FY25	5-Year
General Obligation Bonds		**$203.7**		**$203.7**		**$407.4**
Senior STBs (1)	**$441.2**	**$439.4**	**$438.8**	**$427.6**	**$422.4**	**$2,169.5**
Severance Tax Bonds	$362.0	$362.0	$362.0	$362.0	$362.0	$1,809.8
Severance Tax Notes	$79.3	$77.4	$76.9	$65.6	$60.5	$359.7
Supplemental STBs	**$162.0**	**$166.2**	**$191.9**	**$209.0**	**$222.7**	**$951.8**
Supplemental Severance Tax Bonds	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Supplemental Severance Tax Notes	$162.0	$166.2	$191.9	$209.0	$222.7	$951.8
TOTAL Sources of Funds	**$603.2**	**$809.3**	**$630.8**	**$840.3**	**$645.2**	**$3,528.7**

Uses of Funds	FY21	FY22	FY23	FY24	FY25	5-Year
GOB Projects Approved by Referendum		**$203.7**		**$203.7**		**$407.4**
Authorized but Unissued STB Projects (1)	$7.9	$0.0	$0.0	$0.0	$0.0	$7.9
Reassigned STB Projects (2)	$0.2	$0.0	$0.0	$0.0	$0.0	$0.2
9% of Senior STB for Water Projects	$39.7	$39.5	$39.5	$38.5	$38.0	$195.3
4.5% of Senior STB for Colonias Projects	$19.9	$19.8	$19.7	$19.2	$19.0	$97.6
4.5% of Senior STB for Tribal Projects	$19.9	$19.8	$19.7	$19.2	$19.0	$97.6
New Senior STB Statewide Capital Projects	**$353.7**	**$360.3**	**$359.9**	**$350.6**	**$346.4**	**$1,770.8**
PSCOC Public School Capital	$137.0	$141.2	$191.9	$209.0	$222.7	$901.84
PED Instructional Materials/Transportation	$25.0	$25.0	$0.0	$0.0	$0.0	$50.00
TOTAL Uses of Funds	**$603.2**	**$809.3**	**$630.8**	**$840.3**	**$645.2**	**$3,528.7**

Estimated Transfer to Severance Tax Permanent Fund

	FY21	FY22	FY23	FY24	FY25	5-Year
Severance Tax Permanent Fund Transfer	**$79.6**	**$96.5**	**$83.2**	**$90.9**	**$96.6**	**$446.7**

Oil & Gas Revenue Estimates: The Process

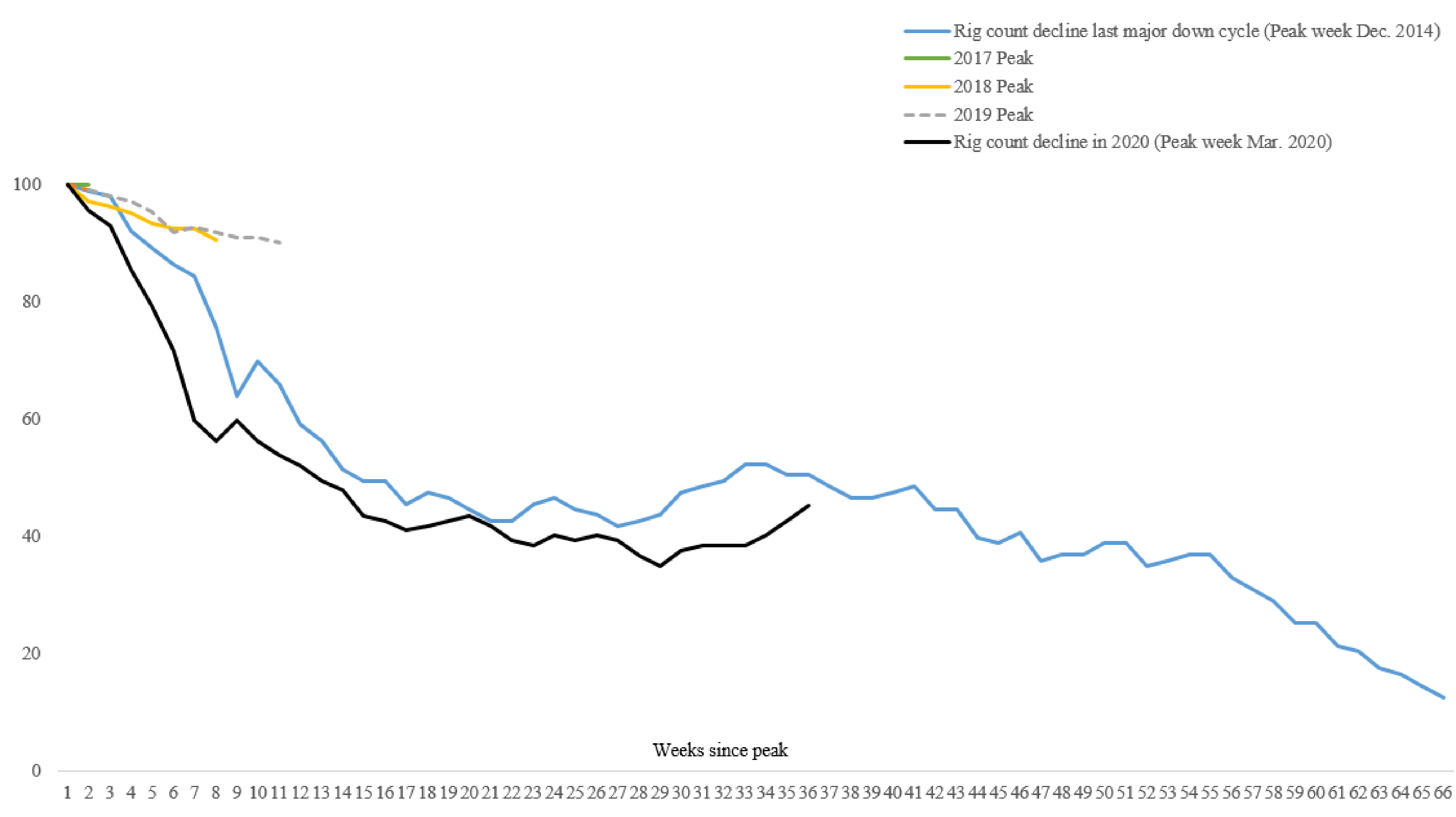
Consensus Revenue Estimating Group Participating Agencies

New Mexico Department of Finance and Administration Leonardo Delgado, Chief Economist Noel Martinez, Senior Economist	**New Mexico Taxation and Revenue Department** Lucinda Sydow, Chief Economist Robert McGrail, Senior Economist
New Mexico Department of Transportation Laura Bianchini, Chief Economist Mallika Pung, Senior Economist	**Legislative Finance Committee** Dawn Iglesias, Chief Economist Ismael Torres, Economist

Recent Trends in the Oil & Gas Industry

New Mexico Rig Count

New Mexico Oil Drilling Rig Count, speed of decline in 2020 vs. previous down cycles



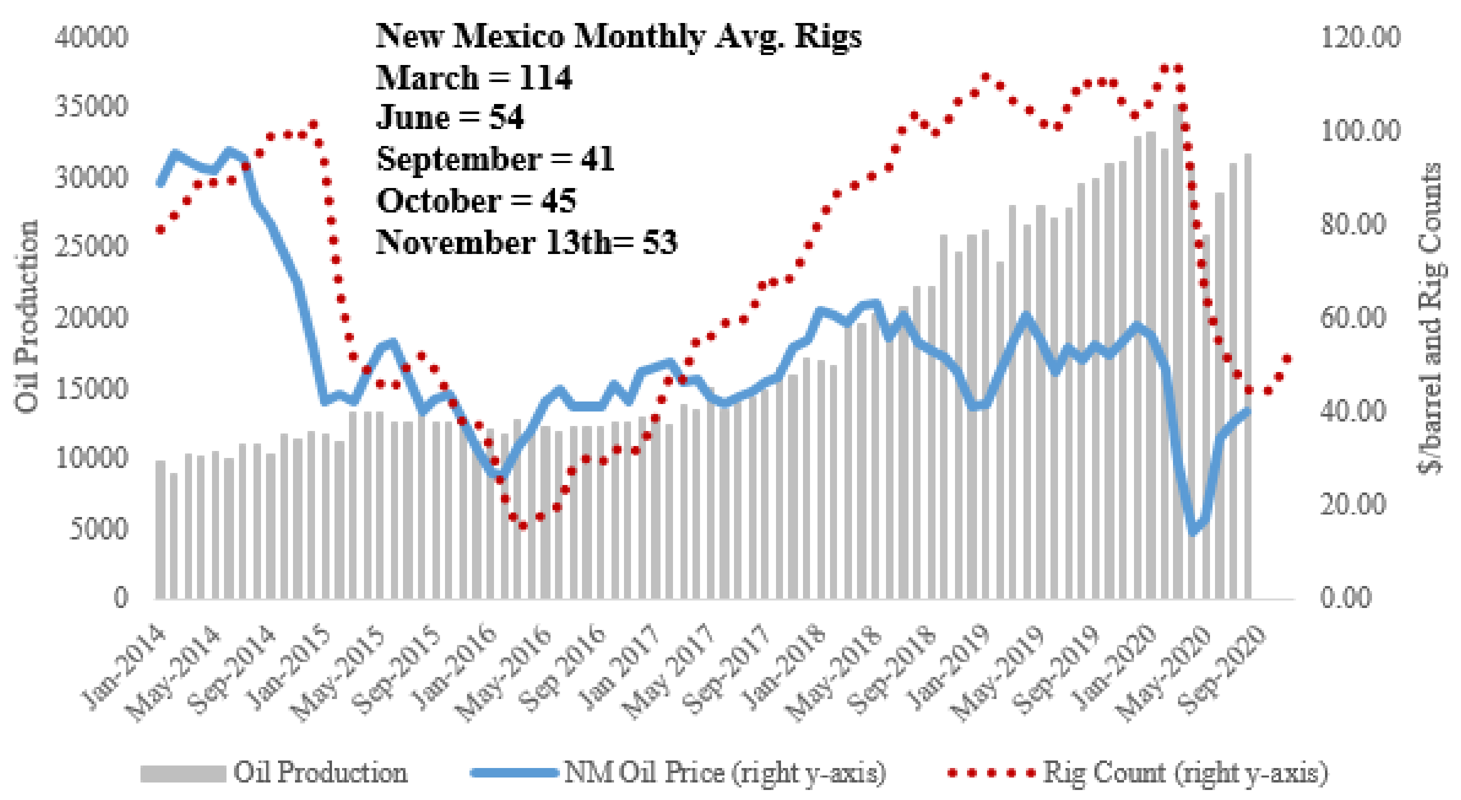
Source: Baker Hughes Rig Count Summary

Note: Peak week is week 1, All peak weeks indexed to 100

- Previous major down cycle began on December 19th, 2014 and ended on March 18th , 2016.
  - From a peak to before bottoming out the rig count decline lasted 65 weeks.
  - NM rigs declined from 103 to 13 rigs.
- In 2020, NM rig counts peaked at 117 in March and declined to 41 rigs in September.
  - The NM rig count declined for 31 weeks in 2020.
  - When compared to the previous major rig count decline, the 2020 rig count has declined faster.
  - Through October and November rigs counts leveled off and are currently at 53 rigs.
- It is unlikely we will see substantial increases in rig counts while oil is in the low $40s/barrel.

New Mexico Oil Production

NM Oil Production (1000 barrels), NM Oil Price ($ per barrel), & NM Rig Count (number)
January 2014 to November 2020

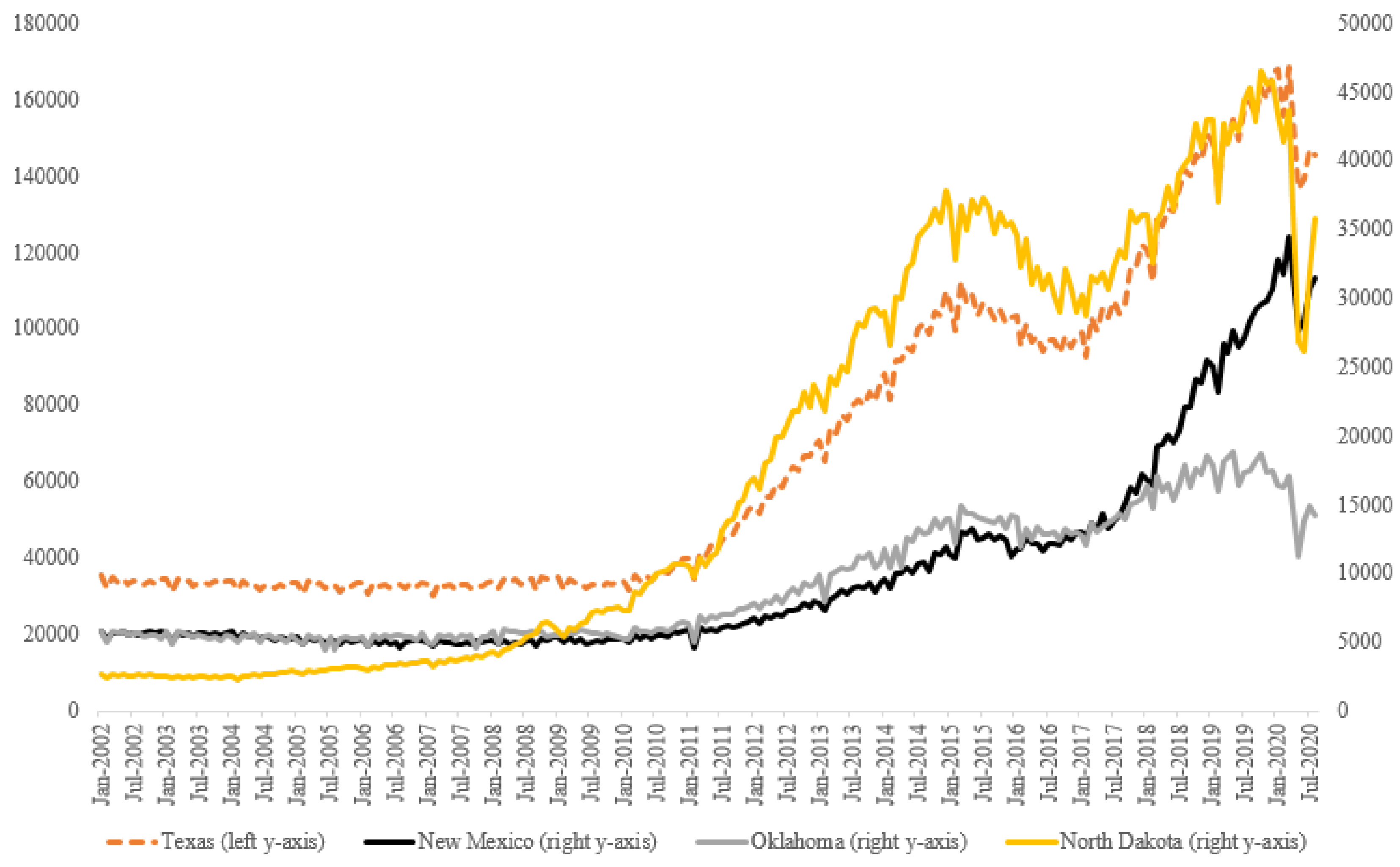


Source: Baker Hughes, TRD (Production and price through August 2020, Rigs through November 2020)

- In 2020 oil prices have been impacted by both supply and demand side shocks due to the oil price war early in the year and the COVID-19 pandemic.
- Oil prices are inherently volatile. Oil prices are dependent on demand recovery, OPEC+ decisions, inventory builds/drawdowns, and other factors.
- Oil production in the Permian has become a greater contributor to national oil production. This trend is expected to continue as the technology, geology, and the economics make the Permian attractive for producers.

New Mexico vs. Other States

Top 4 Oil Producing States in US (thousand barrels)
Jan 2002 to Aug 2020



Sources: eia.gov

- National oil production is expected to decline through 2021 (EIA).
- However, the Permian basin is expected to recover to pre-COVID-19 levels by the mid-2020s (Rystad Energy).
  - Lowers costs for E&Ps.
- Other trends
  - Consolidation in industry.
  - Focus on reduction in costs versus aggressive growth.

PSCOC Financial Plan Summary

- The PSCOF has a dedicated funding stream from Supplemental Severance Tax Bonds (SSTBs).
- SSTBs are issued by New Mexico Board of Finance, paid for by revenue derived from taxes levied on "natural resource products severed and saved from the soil."
- Annual uses of funds include: PSCOC funding programs, state match of SB-9, legislative appropriations, and PSFA operating budget.
  - Saved and unexpended funds from any of these uses remain in the PSCOF for future use on capital projects.

Sources	**FY21 est.**	**FY22 est.**	**FY23 est.**	**FY24 est.**	**FY25 est.**
Cash Balance from Prior Year	225.7	215.9	106.9	23.3	(39.7)
Totals (millions of dollars)	137.8	121.2	134.7	150.9	163.3
Uses					
Totals (millions of dollars)	147.6	230.2	218.3	213.9	201.2
Estimated Uncommitted Balance	**215.9**	**106.9**	**23.3**	**(39.7)**	**(77.6)**

PSCOC and PSFA Funding Process

- PSFA works with districts to plan for upcoming applicants, 1-2 years in advance.
- PSFA plans for actual/projected project needs, from project development - construction phases.
- PSCOC plans for other non-project funding needs. (SB9, school bus replacements, transportation and instructional materials, lease assistance, etc.)
- Certify to Board of Finance the SSTB need from December and June sales.
- PSCOC plans for existing and future awards for standards, systems, other projects.
  - Last 6 years of awards were irregular – 3 years of low awards, then 3 years of high awards.
- PSCOC may certify for total estimated project cost at time of award, or incrementally.
- Fund balance grows until projects moves into construction phase.
  - Typical project time for planning, design, construction is 3 - 5 years.
  - Large projects expend very little funding during planning and design, with most of the funding needed at the beginning of the construction phase (10% design, 90% construction).