Supplemental Severance Tax Bonding Capacity

Department of Finance and Administration

Board of Finance

Public School Capital Outlay Oversight Task Force

October 25, 2021

Overview of Severance Tax Bonding Program

Overview of Severance Tax Bond Funding of Public School Capital

Public School capital projects are funded with proceeds from Supplemental Severance Tax Bonds and Notes.

- Primary source is short-term, taxable Severance Tax Notes ("Sponge Bonds")
- Long-term, tax-exempt Supplemental STBs have been used when available cash is low and will not meet capital need, as certified by the PSCOC

The Board of Finance typically estimates bonding capacity annually

- Preliminary estimates are produced in August and updated in December
- Dependent on statutory limits and 10-year revenue projections
  - Statutory limits are conservative and limit debt service to the lesser of the previous year's revenues and the current year's revenue estimate, as well as limiting to only a certain percentage of revenues.
  - Revenue estimates are from the Consensus Revenue Estimating Group and the DFA Chief Economist.

Overview of Severance Tax Bond Funding of Public School Capital

Continued

The amount of bonds/notes issued is based on the lesser of statutory capacity <u>or</u> cash available.

The final amount of Supplemental Severance Tax Notes issued is determined at the time of issuance.

- BOF determines the amount of cash available for issuance and compares that to bonding capacity established using statutory limits.

Supplemental Severance Tax Notes are typically issued twice a year—in June and December.

Balances in the Severance Tax Bonding Fund, after notes are issued, is statutorily required to be transferred to the Severance Tax Permanent Fund.

Historical Supplemental Note Issues & Expenditures

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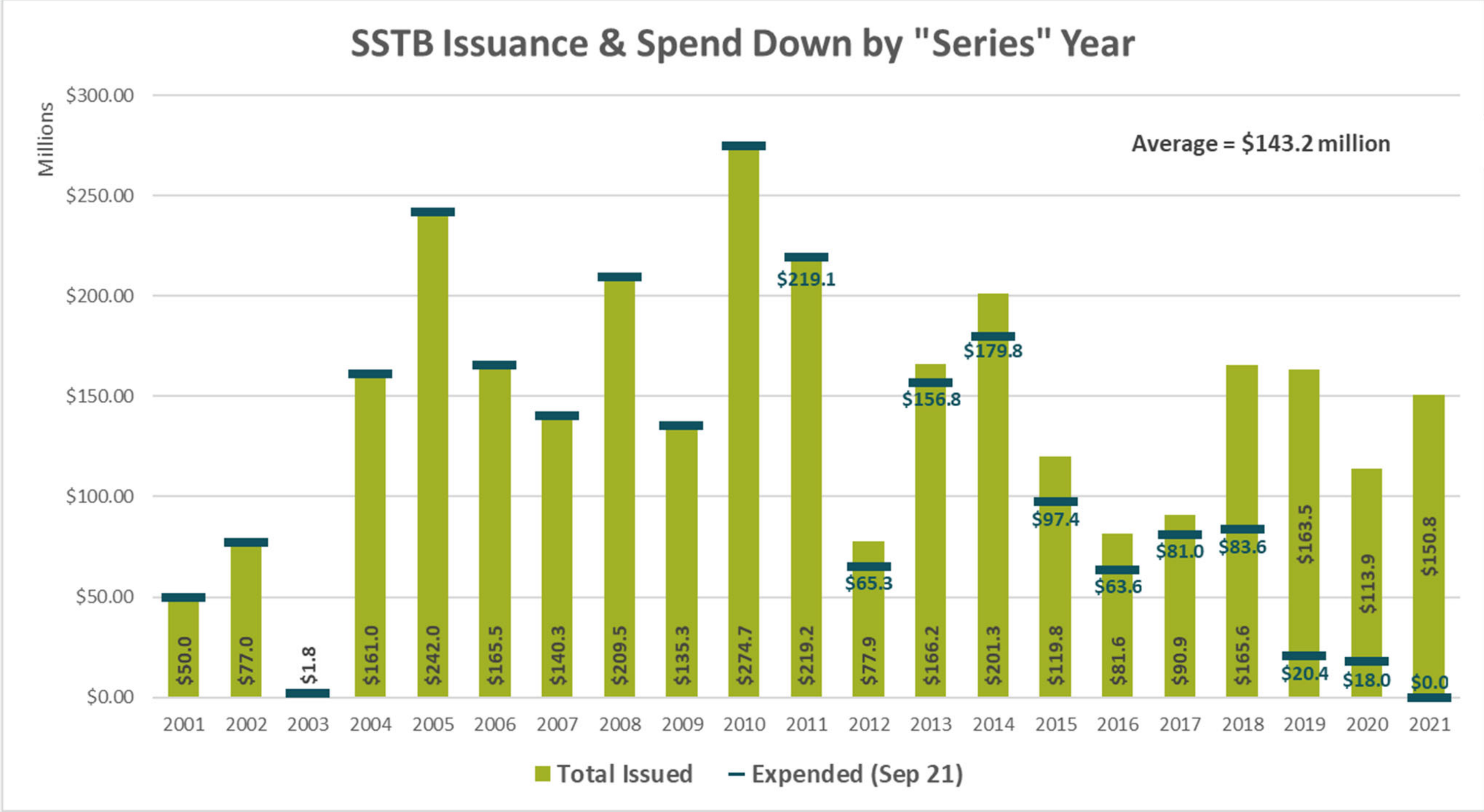
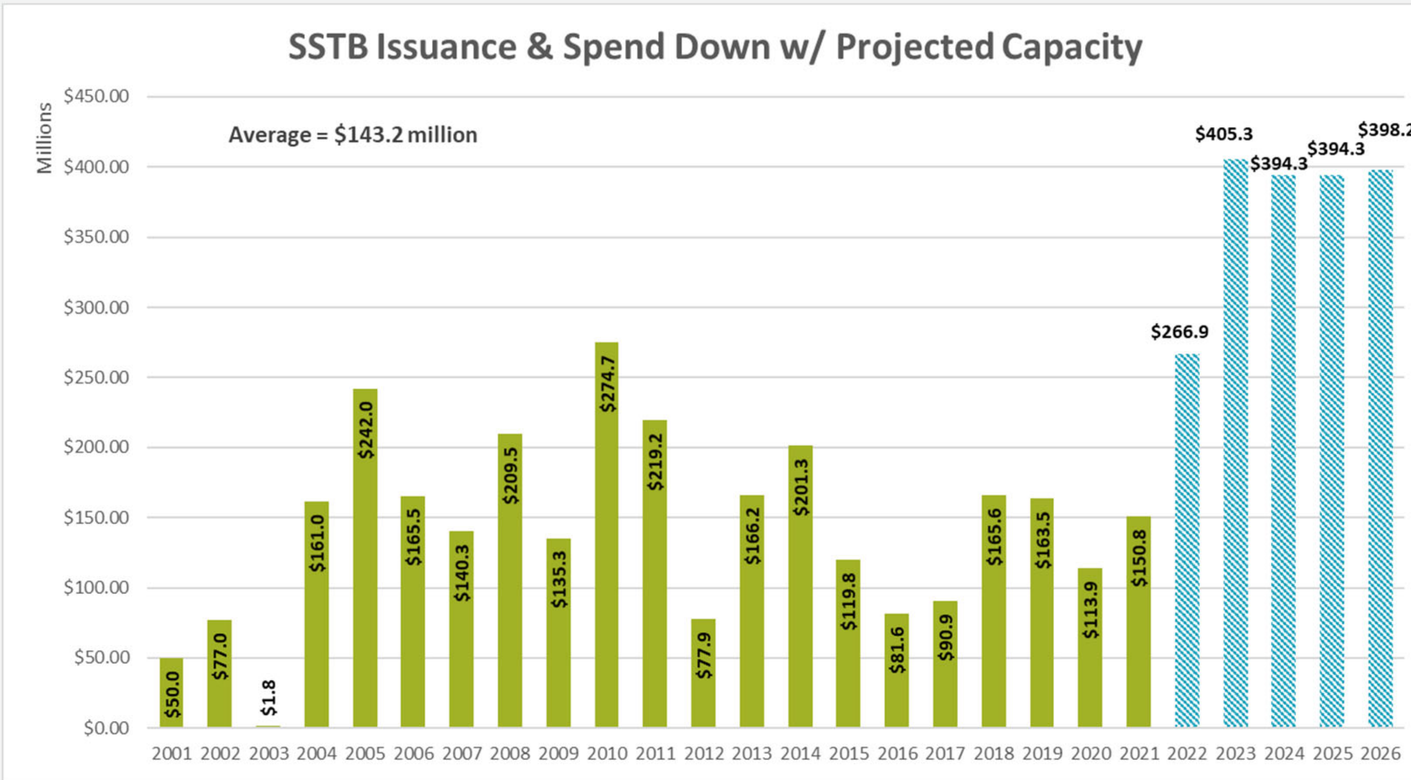


Projected Supplemental Capacity & Economic Drivers

Projected Capacity of Supplemental Severance Tax Notes

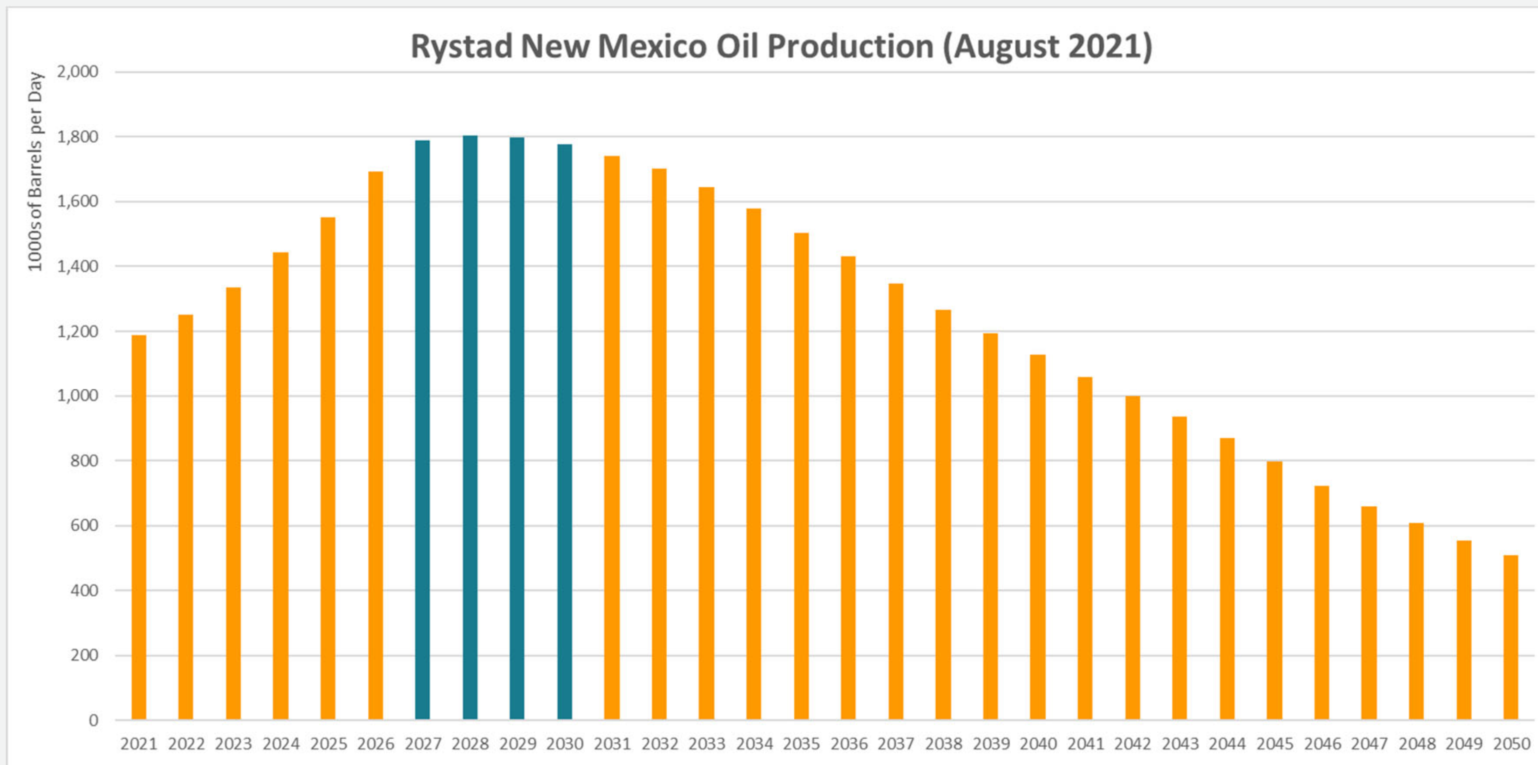
	FY22	FY23	FY24	FY25	FY26	5-Year
Supplemental Severance Tax Notes	$266.9	$405.3	$394.3	$394.3	$398.2	$1,858.8



What's Driving the Increase in Bonding Capacity?

The quick answer… increased severance tax revenues from oil production.

- Rystad Energy projecting peak oil production in New Mexico around 2028/2029.
- This was adjusted recently from a peak of around 2030/2031.



What's Driving the Increase in Bonding Capacity?

Remember that capacity is based on…

- Statutory limits and 10-year revenue projections (tied to maturity of long-term debt)
- Requires the use of the CREG estimates as well as DFA economists' out-year revenue projections.

Based on CREG revenues estimates from August 2021…

- Natural gas revenues to increase by 15.5% between 2022 and 2026 and then remain flat, at $140.3 million per year from FY27 through FY31
- Oil revenues to increase by 14.1% between 2022 and 2026 and then remain flat at $699.0 million per year from FY27 through FY31

Flat out-year revenues are a conservative approach. Per Rystad Energy projected production levels, production is expected to peak around 2028\2029. Revenues are currently being held flat from 2026 onward.

In Summary…

Increasing oil production is driving large increases in estimated capacity.

Should the level of estimated capacity be realized, significantly more funding could be available to the PSCOC for public school capital projects.

Current statute requires severance tax revenue balances to be transferred to the permanent fund twice a year. If balances are not “sponged” up for capital, those balances would be lost.

A question without an answer (yet)… How might larger revenues, and resulting note proceeds, be utilized for public schools?