F I S C A L I M P A C T R E P O R T

		ORIGINAL DATE	03/02/10
SPONSOR	HTRC	**LAST UPDATED**	
HB	6/HTRCS		
SHORT TITLE	Severance & Supplemental Tax Bonds	**SB**	
		ANALYST	White/Earnest

APPROPRIATION (dollars in thousands)

Appropriation			**Recurring or Non-Rec**	**Fund Affected**
FY10	**FY11**	FY12		
$0.0	$110,300.0	$0.0	Nonrecurring	Senior/Supplemental STB Capacity
$0.0	$76,200.0	$0.0	Nonrecurring	General Fund
$0.0	$9,100.0	$0.0	Nonrecurring	General Fund
$0.0	$25,000.0	$0.0	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

Estimated Revenue			**Recurring or Non-Rec**	**Fund Affected**
FY10	**FY11**	**FY12**		
$0.0	$110,300.0	$0.0	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Bill

The House Taxation and Revenue Committee substitute for House Bill 6 authorizes the State Board of Finance (BOF) to issue up to $110.3 million in short-term, or sponge, severance tax (STB) and supplemental severance tax (SSTB) bonds during FY11 when the secretary of education certifies that such bonds are needed because:

- the general fund portion of the FY11 state equalization guarantee (SEG) distribution will be lower than in FY09.

Or if the secretary of finance and administration certifies that such bonds are needed because:

- an FY11 general fund consensus revenue forecast projects general fund reserves of less than five percent; and or
- federal legislation has not been enacted prior to January 1, 2011, extending an increase in the federal medical assistance percentage (FMAP) provided in the American Reinvestment or Recovery Act (ARRA) of 2009.

Proceeds from the sale of the bonds would be appropriated to the general fund "to restore the allotments made from the general fund for capital project general fund appropriations enacted in prior" legislative sessions which had an expenditure period ending on or after June 30, 2010.

After the certification of such bonds from the Secretary of Education, up to $25 million will be appropriated to the SEG distribution for public school funding. After the certification of these bonds from the Secretary of the Department of Finance and Administration (DFA), up to $76.2 million will be appropriated to the medical assistance program of the Human Services Department (HSD) and up to $9.1 million will be appropriated to the developmental disabilities support program of the Department of Health for Medicaid waiver programs.

The actual amounts of these appropriations will be determined by the difference, as calculated by the Secretary of DFA in consultation with the Director of the LFC, between the amount of federal funds estimated to have been received in FY11 had the increases been extended through the end of the fiscal year and the amount of federal funds estimated to actually be received by each program.

The proposed legislation also includes language for BOF to issue "sweep" or "super-sponge" severance tax bonds above and beyond those issued under current law. The mechanics of such an issuance are discussed in more detail below.

The proposed legislation carries an emergency clause.

FISCAL IMPLICATIONS

Even with the inclusion of a proposed sweep, insufficient FY11 STB senior sponge capacity exists to facilitate the entire $110.3 million appropriation authorized in the proposed legislation. Therefore, in order to meet the maximum amount of appropriations to the general fund allowed, the use of SSTB capacity would be necessary. The January capacity estimate did forecast that approximately $32.6 million in excess revenues would be available at the end of FY11. These revenues would normally flow into the severance tax permanent fund (STPF), however precedent does exist which would allow the legislature to use notwithstanding language to appropriate these monies in what is known as a "sweep" or "super-sponge."

The precedent for using these funds is, however, limited to appropriation for capital expenditures. The use of a sweep could mitigate the overall impacts on FY11 capital outlay levels, and partially mitigate the need to use SSTB capacity to reach the $110.3 million appropriation set out in the proposed legislation. However, it should be noted that these moneys eligible to be swept would otherwise be deposited in the STPF where they would earn interest and make future distributions to the general fund. Therefore an STB sweep is essentially a forfeiture of future general fund revenues for immediate purposes. Usually these immediate purposes represent funding for long-term infrastructure projects. In the instance of the proposed legislation, however, these purposes would represent short-term operating expenditures. This raises a concern that such a use of an STB sweep could artificially support what are potentially unsustainable long-term expenditure levels. The mechanics of STB sweeps are discussed in more detail in the significant issues section below.

Table 1: Impacts on FY11 Capital Outlay

LFC FORECAST OF CAPITAL OUTLAY AVAILABLE		
	FY11	
	Current	**HB 6**
Senior Long-Term Issuance	149.5	149.5
Senior Sponge Issuance	70.4	70.4
Senior STB Capacity - January 2010	**219.9**	**219.9**
Water Project Fund (Statutory 10% of STB)	*(22.0)*	*(22.0)*
HB 6 Proposed Sponge for GF	**-**	***(70.4)***
Net Senior STB CAPACITY	**197.9**	**127.5**
Supplemental Long-Term Issuance	-	-
Supplemental Sponge Issuance	140.5	140.5
HB 6 Proposed Sweep	-	32.6
Supplemental STB CAPACITY	**140.5**	**173.1**
HB 6 Proposed Sponge for GF	**-**	***(39.9)***
Net Supplemental STB Capacity	**140.5**	**133.2**

The table above shows that the proposed legislation, through the use of a potential sweep, would decrease FY11 net senior STB capacity by up to $70.4 million. This would leave the legislature approximately $127.5 million to appropriate for capital outlay projects during the 2011 regular session. The proposed legislation would also result in a net decrease to FY11 public school capital outlay of approximately $7.3 million.

The proposed legislation would also potentially increase appropriations to the medical assistance program ($76.2 million), the developmental disabilities support program ($9.1 million), and the state equalization guarantee for public schools ($25 million).

SIGNIFICANT ISSUES

An STB sweep can occur when STB revenues increase year over year. Because statutory STB capacity is determined as a percentage of the prior year's revenues, an increasing revenue environment will typically result in a large amount of STB revenue left over to revert to the STPF. These extra funds normally flow into the STPF unless they are "swept" by the legislature for use in capital projects. This type of transaction has occurred multiple times over the past 10 years due to record oil and gas revenues. The proposed legislation would allow the legislature, instead of sweeping the money for capital projects, to choose to sweep the money into the general fund. Sweeps are typically accomplished through the use of not withstanding language in the severance tax bonding act. The notwithstanding language needed for sweeps is usually inserted by the legislature during the regular session in the year the appropriation actually occurs. As the proposed legislation does not currently contain such language, the use of SSTB capacity would be necessary to make the proposed $100 million maximum appropriation. However those SSTB proceeds could be replaced with the aforementioned sponge proceeds in an attempt to hold public school capital outlay net harmless.

The issuances included in the proposed legislation are typically referred to as deficit financing bonds. The use of deficit financing bonds, even overnight sponge deficit financing bonds, are often viewed as exposing a structural problem within a state or municipality's operating budget associated with declining revenues and an unsustainable recurring expenditure level. The bond proposal included in the proposed legislation is not likely to elicit such a reaction when looked at individually, as it includes short-term notes issued and paid off in the same fiscal year in which the proceeds will be used. The precedent set by such a proposal, however, has a much greater impact on the state than the one-time issuance. Many investors could interpret such a precedent as a fundamental change to the severance tax bonding program as a whole, in which capital projects are no longer its main focus. Additionally, ratings agencies could look upon the precedent as a continuing facet of the state's budget practices, through which revenues are routinely taken from long-term infrastructure projects to fund expenditure levels above and beyond those supported by organic recurring general fund revenue sources.

Over the past few years the state enjoyed record funding for long-term infrastructure projects due to record oil and gas revenues. Based on projections from the consensus revenue group, however, severance tax revenues are not expected to reach those record levels again for an extended period of time. Last year, in a letter to legislative leadership, the BOF cited various downfalls to the state's current capital outlay program and its effects on state bond ratings. The letter also stated that capital resources to the state "are inherently scarce, and are likely to be more scarce over the next several years."

OTHER SUBSTANTIVE ISSUES

Based on current revenue and budget projections, FY11 general fund SEG appropriations are likely going to be lower than FY09 levels therefore the $25 million contingency appropriation included in the proposed legislation would be virtually guaranteed upon enactment. The two other contingent appropriations included in the bill are decidedly more uncertain.

The American Recovery and Reinvestment Act (ARRA) increased the federal matching rate for state Medicaid programs – known as the federal medical assistance percentage (FMAP). Under current law, this enhanced FMAP rate, found in Section 5001 of the bill, expires on December 31, 2010. Federal legislation has been introduced to extend this enhanced FMAP rate for two more quarters, through June 30, 2011.

House Bill 2 from the 2010 regular session, as passed by the House and as amended by the Senate, assumes that Congress will enact this extension. Due to this assumption, the general fund appropriation for Medicaid programs remains relatively flat over the FY10 budget. This bill provides a contingency appropriation to address a potential budget shortfall in Medicaid programs if Congress fails to enact an extension of the enhanced FMAP.

The appropriations provided would not fully replace the difference between the amount received without an extension and the amount that would have been received with an extension. However, the $76.2 million and the $9.1 million appropriations are based on appropriations included in the LFC recommendations to replace supplanted general fund appropriations in FY10.

TECHNICAL ISSUES

The difference between the amount of federal Medicaid funds the state is estimated to have received in FY11 and the amount estimated to actually be received could be as large as $160 million to $170 million. Therefore the appropriations included in the proposed legislation may not be large enough to cover the entire difference. In order to address this issue on page 7, line 7 and page 7, line 24 the passages "shall equal the difference," may need to be changed to "shall be no more than the difference."

Furthermore, when calculating the difference in determining the appropriation to be made to Medicaid, the Medical Assistance Program and the Medicaid Behavioral Health Program should be explicitly listed. In order to address this issue on page 7, line 11 and page 7, line 18 after the word program, "and Medicaid Behavioral Health Program" should be inserted.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

If the proposed legislation is not enacted, the legislature will have up to $110.3 million more in combined STB and SSTB capacity to appropriate to long-term statewide and public school infrastructure projects in the FY11 regular session. However, $110.3 million in bond proceeds will not be deposited into the state general fund for the purpose of increasing public education funding or replacing certain federal funds.

DMW/mt:svb