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

SPONSOR Cisneros **ORIGINAL DATE** 01/31/13 **LAST UPDATED** ______ **HB** ______

SHORT TITLE Supplemental Severance Tax Bonds **SB** 98

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	FY14	FY15	FY16	FY17		
		($38,400.0)	($39,800.0)	($40,200.0)	Recurring	Public School Capital Outlay
		$19,200.0	$19,900.0	$20,100.0	Recurring	Road Fund
		$19,200.0	$19,900.0	$20,100.0	Recurring	Higher Education Capital Outlay

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
Public Education Department (PED)
Higher Education Department (HED)
Public School Facilities Authority (PSFA)

SUMMARY

Synopsis of Bill

Senate Bill 98, endorsed by the Legislative Finance Committee, amends the Severance Tax Bonding Act to temporarily create additional types of supplemental severance tax bonds (SSTBs). Currently, there is one kind of SSTB, the proceeds of which are dedicated for public school facility capital projects awarded by the Public School Capital Outlay Council (PSCOC).

The bill would create two additional categories: supplemental road STBs to be used for maintenance, construction, and improvements of state transportation projects; and supplemental higher education STBs, to be used for construction, maintenance, and improvements of state higher education infrastructure projects.

Supplemental road STBs would be issued only upon resolution by the State Transportation Commission, and supplemental higher education STBs would be issued only upon resolution by the Higher Education Department (HED). Supplemental public school STBs would continue to be issued only upon certification of need by the PSCOC.

Any supplemental bonds would be limited to statutory capacity. Up to 50 percent of prior fiscal year revenue into the severance tax bonding fund may be used for senior STB debt service, which would remain unchanged.

Under current law, up to 95 percent of prior fiscal year revenue may be used for SSTBs, which all benefit public schools. Assuming senior capacity is all utilized, that means 45 percent (95 percent less 50 percent) is available for public school facilities. This bill would split the 45 percent that benefits supplemental bonds into four parts:

- 12.5 percent (from 50 to 62.5 percent of prior year revenue) would still benefit public school facilities through service of long-term SSTBs ;
- 4.5 percent (from 62.5 to 67 percent) would now benefit maintenance, construction and improvements of state transportation projects through service of short-term SSTBs. The bill provides that debt service on supplemental transportation STBs may not exceed 4.5 percent of prior year revenue to the severance tax bonding fund;
- 4.5 percent (from 67 to 71.5 percent) would now benefit maintenance, construction and improvements of higher education infrastructure through service of short-term SSTBs. The bill provides that debt service on supplemental higher education STBs may not exceed 4.5 percent of prior year revenue to the severance tax bonding fund; and
- 23.5 percent (from 71.5 to 95 percent) would still benefit public school facilities through service of short-term supplemental STBs.

The bill provides that the Board of Finance (BoF) may only issue the newly created types of bonds for “eligible projects,” defined as projects that are ready to begin expending funds within twelve months of issuance of the bonds, and specifically authorized by law. This provision would make projects funded with proceeds of supplemental road and supplemental higher education severance tax bonds subject to legislative appropriation.

If the Legislature fails to appropriate the supplemental road and supplemental higher education severance tax bond proceeds in a given year, that capacity would remain available for public school capital outlay projects.

The bill contains two effective dates. The provisions creating road and higher education SSTBs take effect July 1, 2014, and the provisions ending the three-year program take effect July 1, 2017. These effective dates create an effective sunset of the road and higher education SSTBs on July 1, 2017.

FISCAL IMPLICATIONS

Current law reserves proceeds from SSTBs for public school capital outlay projects. The bill would reduce the amount of SSTB capacity available for public school capital projects and would increase the amount available for transportation and higher education projects. The amounts available for senior STBs for legislative projects and funds earmarked for the water project fund, colonias infrastructure, and tribal infrastructure would remain unchanged.

Currently, SSTB capacity available for public schools is estimated as follows for FY14 through FY17: $180.7 million, $191.9 million; $198.9 million; and $200.7 million. The revenue table on page 1 of this analysis shows the estimated funding available to road and higher education infrastructure projects pursuant to this bill, as well as the subsequent reduction to available public school capital outlay funding.

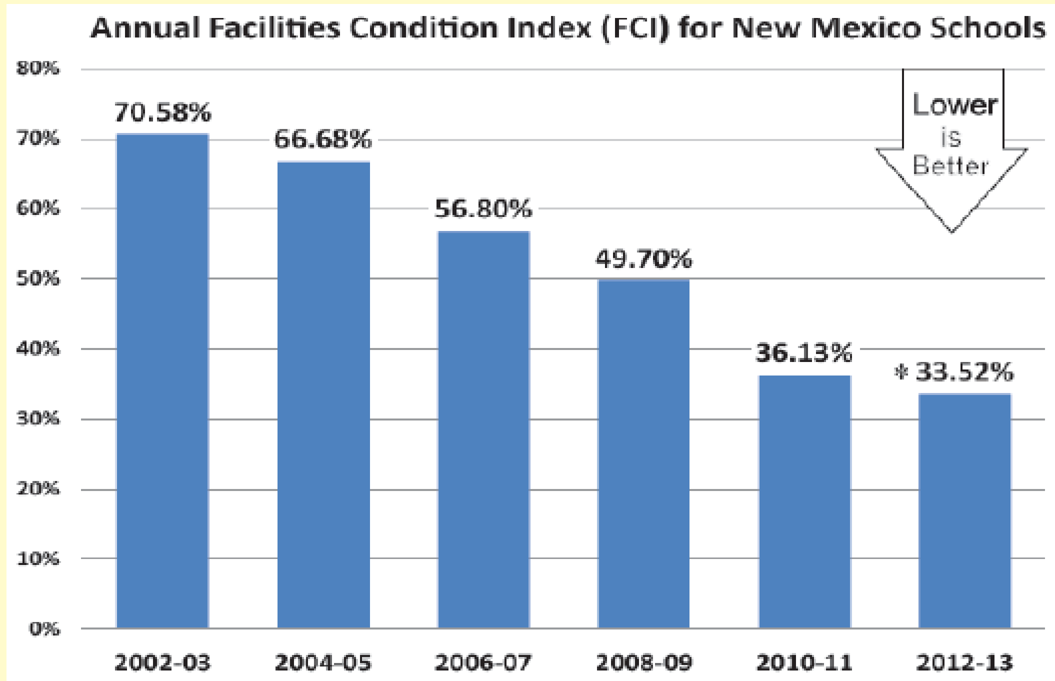
SIGNIFICANT ISSUES

In 1999-2000, as a result of the "Zuni" lawsuit, which successfully challenged the constitutionality of New Mexico's educational financing and required the State to establish and implement a uniform system of funding future public school capital improvements, the supplemental STB program was created to provide a dedicated funding stream for public school capital improvements. In 1999, capacity for all STBs was increased from the long-standing rate of 50 percent of prior fiscal year revenue to 62.5 percent. In 2000 it was increased to 87.5 percent. In 2004, the percentage of prior fiscal year revenue that can be used for debt service was again increased, to 95 percent.

It is unclear whether reduction of the amount of SSTB capacity available for public school facilities as proposed in this bill would put the State out of compliance with its obligations under the Zuni lawsuit. Careful consideration must be given to the cost of maintaining the public school facilities at current levels and the legal implications of decreasing funding for public school capital outlay. A final judgment has never been issued in the Zuni lawsuit. Reallocating a portion of SSTB capacity for projects other than public school capital outlay needs that jeopardizes adequate standards-based funding may risk a status hearing and judicial intervention or directives.

Some policymakers have begun to raise questions about whether too much of the State's scarce capital outlay funding is currently being directed towards public school facilities. Over a decade has passed since the SSTB program began to direct large amounts of funding annually to public school facilities. Since the supplemental STB program originated in FY00, the State has issued $2.2 billion of supplemental STBs for public schools, which is an average of $170.4 million per year.

The average Facility Condition Index (FCI) for all educational school facilities in New Mexico is 33.5 percent. A translation of this is if a building costs $100,000 and has an FCI of 34 percent, that building needs $34 thousand in repairs—lower FCI's are better. The statewide average FCI is sharply improved from ten years ago. A rule of thumb in determining whether to replace or repair a school building has been subject to a rule of thumb stating that if the FCI of a facility is greater than 60 percent, the building should be replaced. A building with an FCI less than 60 percent would be a candidate for repair, rather than replacement. With this in mind, the average FCI of 33.5 percent indicates reasonably good school facility conditions.



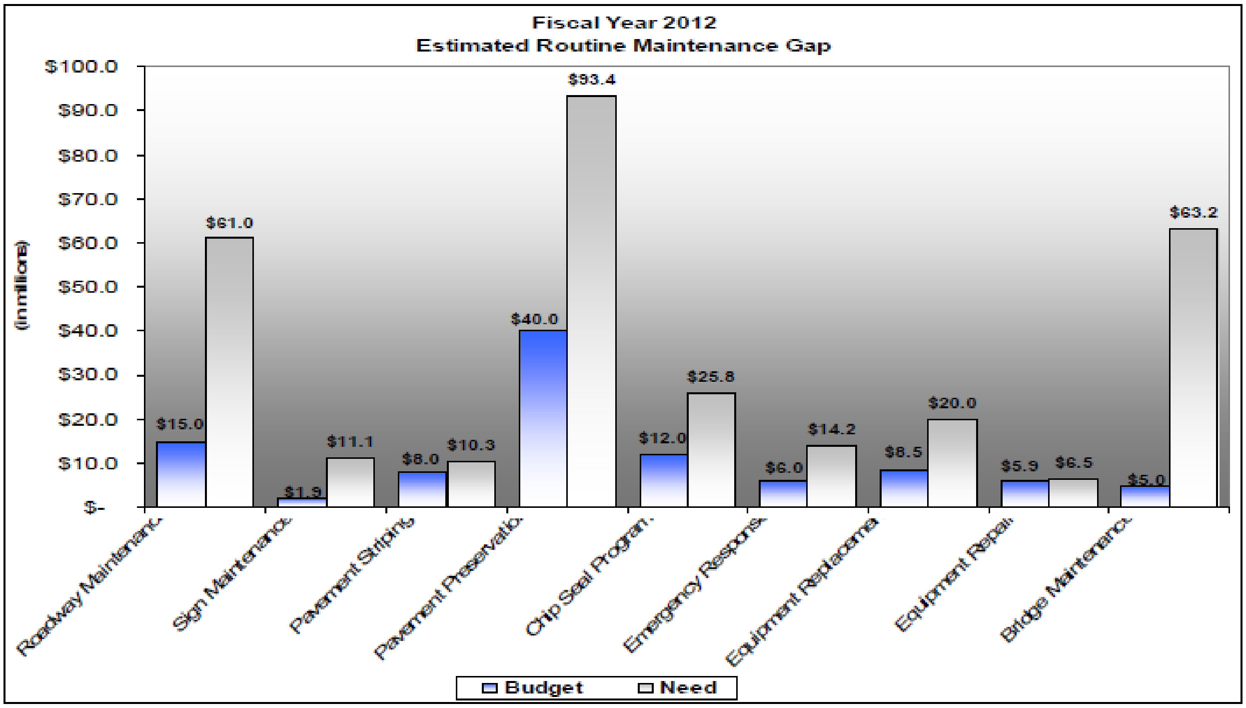
** There is a direct relationship between the average statewide FCI and the level of annual funding. The average condition of school facilities statewide has improved 53 percent since 2002—from 70.6 to 33.5 percent.*

Graph 2

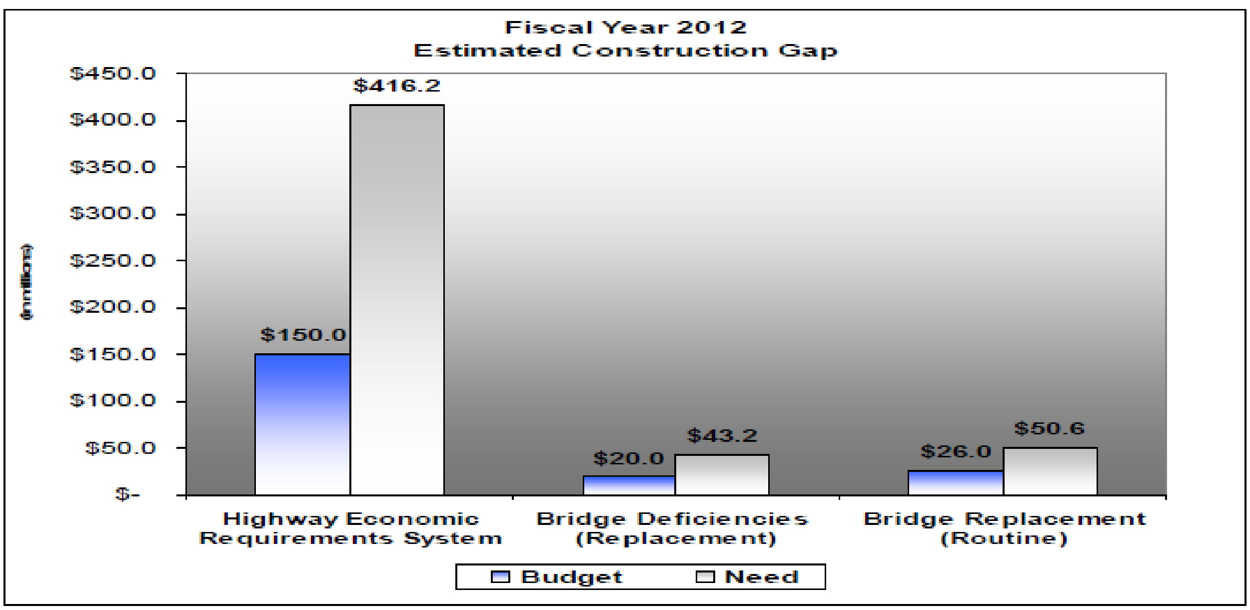
The Public School Facilities Authority (PSFA) notes that its Facility Assessment Database (FAD) estimates that an average of $367 million (from all sources) per year in capital expenditures is required over the next six fiscal years to maintain the calculated statewide average FCI. The state share of this funding is approximately $143 million per year. According to the PSFA, funding public school capital outlay at a lower level as proposed in this bill will place the state's investment and gains in school facilities condition at risk.

Capital improvements to roads have traditionally been funded through the state road fund, most notably through the massive Governor Richardson's Investment Partnership (GRIP) bond program. The state road fund experiences a high degree of pressure due to the large geographical size of New Mexico and because growth in state and federal transportation-related revenues to the fund have not kept pace with inflation.

The New Mexico Department of Transportation (NMDOT) has identified a backlog of transportation projects across the state that would benefit from the additional severance tax dollars. Currently, NMDOT estimates the need to be performing approximately $203 million of pavement preservation activities annually, including: patching, pothole, ditch, drainage and guardrail repair, liter and graffiti removal, and snow plowing. NMDOT reports that an additional $390 million in GRIP projects are unfunded and deferred due to funding availability. A graphical representation is as follows:



In addition, the estimated construction gap reflects a number of a number of "total reconstruction" projects that need to be implemented in order to maintain the economic activities of the state. A graphical representation is as follows:



Capital improvements at higher education institutions have traditionally been funded with general obligation bonds. The failure of the higher education ballot in the 2010 general election reduced the available funding for capital improvements; however, the bonds were approved in the 2012 general election. Senate Bill 98 would supplement these funds.

ADMINISTRATIVE IMPLICATIONS

The BoF reports its staff would review four additional project certifications/resolutions per year pursuant to the two new types of supplemental STBs. The modeling of STB capacity will become more complex and tracking the distribution of supplemental capacity between three rather than one purposes will be somewhat difficult.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 211 and Senate Bill 60 include the following appropriations from the Public School Capital Outlay Fund: $8 million to the New Mexico School for the Deaf; $9.2 million to the New Mexico School for the Blind and Visually Impaired; $2.5 million to PED for prekindergarten classrooms; $3 million to PED for school busses.

HB 264 establishes a new $15 million grant program using Public School Capital Outlay Fund proceeds for building systems.

House Bill 291 appropriates $10 million from the Public School Capital Outlay Fund to address deferred maintenance.

Senate Bill 98 decreases supplemental severance tax bonds available for public school capital outlay projects by $38.4 million.

Enactment of any or all of these bills will decrease funds available for the core mission of the Public School Capital Outlay Act of ensuring students are in adequate facilities, and may result in reopening of the Zuni lawsuit. The Legislature should consider these bills simultaneously and analyze the merits of each appropriation to ensure the state will continue to meet its constitutional obligations under the Zuni court decree.

TECHNICAL ISSUES

The sponsor may want to consider an amendment to make Senate Bill 98 effective July 1, 2013, rather than July 1, 2014. The 2013 LFC budget recommendation includes a nonrecurring transfer of $25 million from the general fund to the state road fund in FY14 to support road maintenance and construction projects. However, downside risks to the general fund revenue estimates indicate this revenue transfer may not be viable. The state road fund remains in need of additional funding and it may be advisable to accelerate the effective date of the SSTB transfers proposed in this bill.

In its analysis of Senate Bill 98, DFA suggests the following technical amendments:

- Page 2, Lines 12 through 21: DFA recommends amending the bill to change the three similar sentences each to read, "supplemental ________ severance tax bonds, the proceeds of which will be used for _____________…"

- Page 2, Line 23, change the word "used" to "issued" to clarify that proceeds from supplemental road and higher education bonds issued during FY15-FY17 may still be expended for roads and higher education in FY18 and beyond.

- Page 5, Lines 3-4 and Page 7, Lines 16-17: DFA recommends amending the bill to require a certification of the Secretary of the Higher Education Department rather than a resolution of the Higher Education Department. Resolutions are typically adopted by governing bodies such as boards and commissions, while certifications are adopted by individuals. The Higher Education Department is not a governing body, although alternatively HED does have a capital outlay committee that could approve a resolution.

- Page 5, Lines 9-10, see paragraph below on the possibility of deleting references to Laws 1999, Chapter 6, Section 19, Paragraph A(2) in their entirety. If the language is not deleted, recommend reversing the bill's change of the Commission on Higher Education to the Higher Education Department. The 1999 appropriation did require a resolution from the Commission on Higher Education, and if the language merely stays in statute for the sake of history, then the history should be accurately reflected.

- Page 8, Lines 9-12: The definition of "eligible project" may be problematic. Generally, individual severance tax bond bills authorizing projects specify that project recipients must certify that they expect to encumber 5 percent of project funds within 6 months of bond issuance and expend 85 percent of project funds within 3 years. The introduction of a new 12-month readiness timeline is expected to cause administrative confusion and add complexity to DFA's project tracking. DFA recommends that an eligible project simply be defined as one that has been specifically authorized by law.

- Page 16: The DFA believes Section 8 of the bill, which repeals Laws 2001, Chapter 37, Section 1, is unnecessary because the bill already amends the language contained in that existing law. Consider amending the bill to delete Section 8.

- It may be necessary to amend descriptions in the bill of the allowable uses of supplemental road STBs to ensure that they cannot be used to pay debt service on existing bonds, such as the GRIP bonds.

- DFA would defer to the Legislative Council Service's bill drafting practices, but there are several paragraphs in the Severance Tax Bonding Act referencing to an appropriation from Laws 1999 (1st S.S), Chapter 6, Section 19, Paragraph A(2) that potentially could be deleted in their entirety to simplify the Severance Tax Bonding Act. DFA has confirmed that the entire $25 million that was appropriated in that 1999 law has been expended and all bond series that were issued to fund the $25 million are extinguished.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

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