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**AGENCY BILL ANALYSIS**
**2024 REGULAR SESSION**

**WITHIN 24 HOURS OF BILL POSTING, UPLOAD ANALYSIS TO:**

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## SECTION I: GENERAL INFORMATION

***{Indicate if analysis is on an original bill, amendment, substitute or a correction of a previous bill}***

*Check all that apply:*

**Original** ___ **Amendment** ____
**Correction** ___ **Substitute** ____

**Date** 1/26/2024
**Bill No**: HB 253

**Sponsor:** Derrick Lente & Nathan Small
**Short Title:** Capital Outlay Changes

**Agency Name and Code Number**: SBOF/DFA-341
**Person Writing** Ashley Leach
**Phone:** 505-629-9745 **Email** Ashley.leach@dfa.nm.gov

## SECTION II: FISCAL IMPACT

**APPROPRIATION (dollars in thousands)**

| Appropriation | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|
| FY24 | FY25 | | |
| | ($31,000) | Recurring for 10 years | Senior Severance Tax Bond Proceeds |
| | | | |

(Parenthesis ( ) Indicate Expenditure Decreases)

**REVENUE (dollars in thousands)**

| Estimated Revenue | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|
| FY24 | FY25 | FY26 | | |
| | $31,000 | $62,000 | Recurring Compounding | Capital Development & Reserve Fund |
| | | $1,630 | Recurring | Capital Development Program Fund |

| | | | | |
|---|---|---|---|---|
| | ($257,000) | ($257,000) | Nonrecurring | Senior Severance Tax Bonding Capacity Available for Appropriation |

(Parenthesis ( ) Indicate Expenditure Decreases)

**ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)**

| | FY24 | FY25 | FY26 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **Total** | | | | | | |

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates/Conflicts with/Companion to/Relates to:
Duplicates/Relates to Appropriation in the General Appropriation Act

**SECTION III: NARRATIVE**

**BILL SUMMARY**

House Appropriations and Finance Committee Amendment to HB 253
House Appropriations and Finance Committee amendment to HB 253 amends the bill to allow for the State Board of Finance (SBOF) to issue up to $500 million in severance tax bonds or notes in Fiscal Year 2024 for depositing into the Capital Development and Reserve Fund.

The amendment strikes language that restricts the SBOF from issuing only $682.2 million in supplemental severance tax bonds.

The amendment changes the date on which the State Investment Committee (SIC) will make transfers from the Capital Development and Reserve Fund to the Capital Development Program Fund from July 1 to January 1.

The amendment stipulates that money in the Capital Development and Reserve Fund is subject to appropriation by the legislature or for transfer to the Severance Tax Permanent Fund.

The amendment clarifies that the Capital Development Program Fund should be housed as a subaccount of the Severance Tax Bonding Fund and stipulates that any unexpended or unencumbered balance of an appropriation from that fund would revert to the Severance Tax Permanent Fund two years after the appropriation.

HB 253 as Introduced

HB 253 amends the Severance Tax Bonding Act to require the State Board of Finance (SBOF) to distribute any cash savings resulting from reduced long-term bond issuance (also known as debt service savings) annually to a newly established reserve fund called the Capital Development and Reserve Fund. The bill further amends the Act to require the SBOF to estimate debt service savings by calculating the difference between (1) severance tax bonding capacity for appropriation pursuant to existing statutory debt limitations and SBOF policy on issuing level debt over 10 years and (2) a lower capacity available for appropriation that would result in stable levels of state tax-supported debt relative to the median state debt ratios published by the national municipal bond rating agencies.

Estimated debt service savings, if realized, would be estimated by the SBOF by January 15th of each year. The SBOF would be authorized to issue taxable short-term severance tax notes (also known as sponge bonds) over the period in which the SBOF issues long-term debt (historically 10 years) in order to transfer the estimated debt service savings to the Capital Development and Reserve Fund. Transfers of debt service savings, if realized, would begin with the anticipated taxable severance tax note issuance in June 2025.

The bill requires the State Investment Council (SIC) to hold and invest the Capital Development and Reserve Fund. On July 1 of each year, the SIC would distribute 5 percent of the average of the year-end market values of the Capital Development and Reserve Fund for the previous three calendar years to a newly established Capital Development Program Fund. In years 1 through 3, the SIC would distribute 5 percent of the average of the year-end market values of the fund for however many years the fund has been in existence.

The Capital Development Program Fund would be administered by the Department of Finance and Administration (DFA). The bill allows for appropriations from the Capital Development Program Fund for two purposes: (1) the funding of capital projects that total less than $5,000,000 and (2) planning and design only of capital projects that total more than $5,000,000.

**FISCAL IMPLICATIONS**

House Appropriations and Finance Committee Amendment to HB 253

The amendment contemplates the SBOF issuing up to $500 million in severance tax notes in Fiscal Year 2024 for transfer to the Capital Development and Reserve Fund. This would mean that the SBOF would utilize any remaining FY24 capacity that is not otherwise appropriated for other purposes. FY24 severance tax note capacity is currently estimated at $718.2 million. There is $9.4 million in previous capital project appropriations that will be considered for funding in FY24, and the SBOF is anticipating appropriation of $283.9 million in FY24 to earmark programs, including Water Trust, Colonias Infrastructure, Tribal Infrastructure, and the New Mexico Housing Trust Fund. This would leave an estimated $425 million in unappropriated capacity. Should other initiatives be funded in the 2024 legislative session, this number could be less and as low as $0.

Per the amendment, distributions by the SIC from the Capital Development and Reserve Fund to the Capital Development Program Fund from July 1 to January 1, and the housing of the fund in the Severance Tax Bonding Fund, would allow for the balance in the Capital Development Program Fund to be appropriated during the legislative session each year, prior to the required transfer of the balance of the Severance Tax Bonding to the Severance Tax Permanent Fund. This would ensure that the Capital Development Program Fund would be utilized immediately for capital projects, and any unutilized balance in the fund would flow to the Severance Tax Permanent Fund by June 30 of each year, as contemplated by the New Mexico Constitution.

HB 253 as Introduced

The fiscal impacts to the bill relate to (1) severance tax bonding capacity available for appropriation, (2) funding of a newly established Capital Development and Reserve Fund, and

(3) funding of a newly established Capital Development Program Fund.

The bill constrains the capacity available for appropriation in years in which capacity for appropriation, established using statutory debt limitations and SBOF policy, exceeds the capacity for appropriation that also maintains stable debt ratios over time. Given current revenue estimates and US median debt ratios for all states as published by Moody's (debt per capita, $1,179, and debt as a percentage of personal income, 2.1 percent), capacity available for appropriation, while maintaining stable debt ratios over time, would be approximately $846 million in FY25, including a reduced long-term severance tax bonding capacity of $400 million from $657 million. (This assumes an issuance of $350 million in long-term senior severance tax bonds in FY24.) This reflects a reduced capacity available for appropriation of approximately $257 million in FY25. It's important to note that the reduced capacity available for appropriation of $846 million is still significantly higher than historic levels, which were nearly always below $300 million annually. The reduction in capacity for appropriation would fluctuate beyond FY25 based on numerous factors, including oil and gas severance tax revenues, growth in outstanding debt across the state's bonding programs (severance tax, general obligation, and transportation), population growth, and income growth.

Given the above estimates and an issuance maturity term of 10 years, the Board would issue approximately $31 million in taxable short-term senior severance tax notes at the end of FY25 and transfer that amount to the newly established Capital Development and Reserve Fund, beginning July 1, 2025 (FY26). The transfer would occur annually for a total of 10 years (FY26 through FY35) as long as revenues remain sufficiently high to include such an amount in taxable short-term senior severance tax note issuances. This amount reflects the estimated debt service savings between issuing $657 million in long-term severance tax bonds (the amount based on statutory debt limitations and SBOF policy) and issuing $400 million (also accounting for stable tax-supported debt ratios over time), spread across a 10-year period. Should revenues remain sufficiently high to make this transfer for the entire 10-year period, the transfer of debt service savings related to FY25 alone would total approximately $310 million.

The amount of transfer would compound for each year that debt service savings would be realized by issuing lower long-term severance tax bonds. Should revenues remain high, the annual compounding transfers could be substantial. If revenues fall, the transfer to the Capital Development and Reserve Fund could drop to zero in any given year. Projecting severance tax revenues is inherently challenging given the volatility of the source of revenues. That said, given the most recent oil and gas volumes and prices projections from the Consensus Revenue Estimating Group (CREG), the SBOF is projecting annual level long-term severance tax bond capacity of $657 million for FY25 through FY34. If issuance of long-term severance tax bonds is constrained to $400 million annually for that period to ensure stabilized debt ratios, the compounded revenues to be transferred to the Capital Development and Reserve Fund would total close to $1.7 billion for the FY26 to FY35 period. That will inevitably be less or more given changes to various factors, primarily actual and projected severance tax revenues and estimated debt ratios. Assuming a conservative 5 percent return on these invested funds, the future value of those deposits over ten years could reach close to $2.0 billion. With this assumption, the Capital Development Program Fund would be estimated to receive $1.63 million in FY26, growing to $63 million in FY35, should debt service savings be realized and transferred to the Capital Development and Reserve Fund and investment of that fund realize a conservative 5 percent return.

**SIGNIFICANT ISSUES**

House Appropriations and Finance Committee Amendment to HB 253

The amendment stipulating that money in the Capital Development and Reserve Fund is subject to appropriation by the legislature or for transfer to the Severance Tax Permanent Fund seeks to address concerns around the Article VIII, Section 2 of the New Mexico Constitution that requires that severance tax revenues exceeding the amount reserved by statute for payment of debt service payments on severance tax bonds be transferred to the severance tax permanent fund. The amendment to house the Capital Development Program Fund in the Severance Tax Bonding Fund seeks to ensure that any unappropriated funds are quickly transferred to the Severance Tax Permanent Fund if not appropriated by the legislature and included in a severance tax note sale that fiscal year in which the funds are transferred. These amendments provide for a mechanism in which the Capital Development and Reserve Fund and the Capital Development Program Fund are utilized for debt service and Severance Tax Permanent Fund transfers.

HB 253 as Introduced

The bill addresses two issues: (1) projected growth in traditional debt ratios used by ratings agencies in evaluating the state's debt burden and financial strength and (2) using long-term debt service savings from issuing lower amounts of long-term severance tax bonds than current policy would support to build a reserve fund for capital use and a program fund that will support the funding of smaller capital projects and design and engineering costs of larger capital projects.

In its 2023 Debt Affordability Study, the SBOF recommended debt levels that would stabilize debt ratios over time, including debt per capita and debt as a percentage of personal income. Stabilizing ratios would result in state debt ratios, estimated in that study at $1,299 per capita and 2.4 percent as a percentage of personal income, being generally in line with median ratios for all states, estimated at $1,179 per capita and 2.1 percent of median personal income in 2023, across a 10-year period, which is the standard maturity term for each severance tax long-term bond issuance. The SBOF has recommended debt levels that stabilize these ratios because these ratios, along with the level of financial reserves and trends in state revenues and other financial resources, directly impact the state bond ratings, and the state bond ratings, in turn, directly impact the state's cost of capital. Understanding the position of the state relative to its peers allows stakeholders across the state to monitor its financial and debt positions and provides a framework for benchmarking with respect to debt issuance levels, debt capacity, and levels of new investment. Due in large measure to the conservative debt management practices of the state, the key debt ratios have historically allowed for regular issuances of new bonds without any adverse impact on debt metrics. Increases in new debt indicated by the State's long-standing debt capacity policies and the state's historic revenue levels could change that. Restraining long-term severance tax debt to levels to keep state debt ratios in line with median levels across the county would ensure the state is not over-burdening its population with outstanding debt relative to the practices among peer states. It would also reduce the risk to the state of availability of funds for capital purposes in the future, should severance tax revenues decline, by reducing the long-term debt service costs related to current issuance. Finally, it would signal to the bond ratings agencies that the state remains committed to prudent fiscal management of the state's debt programs and financial resources.

The development of the Capital Development and Reserve Fund, with balances growing as the state continues to see high revenues, could address concerns with funding capital projects in the event severance tax revenues decline significantly in the future. Severance tax revenues have historically been the main source of funding capital in the state. A major decline in revenues has in the past and could in the future jeopardize the state's ability to fund capital. The bill ensures that the Capital Development and Reserve fund could be tapped in future years when severance tax revenues do not support capital investments.

The development of the Capital Development Program Fund creates a recurring revenue source that supports not just the funding of smaller capital projects but also the funding of planning efforts related to larger capital projects. A critical factor for the state's capital outlay process is to ensure that capital appropriations are expended timely and for the purpose originally envisioned. This requires sufficient and thoughtful planning of projects prior to receipt of appropriations. Recurring revenues that support better planning prior to appropriations for construction can strengthen the pipeline of capital appropriations, ensure more timely expenditures, and ensure development of capital projects that are priorities identified by local public entities throughout the state. Additionally, it is best practice to prioritize the use of long-term tax-exempt municipal debt for large capital projects. New Mexico is the only state that funds small dollar amount capital with tax-exempt municipal debt. The establishment of the Capital Development Program Fund, in combination with the Capital Development and Reserve Fund, could move the state towards the best practice of reserving long-term debt for major capital initiatives.

The bill does not specify how the annual distributions to the Capital Development Program Fund will be programmed and expended by the DFA. Details on how those funds will be appropriated and expended should be clarified or established through statute.

Article VIII, Section 2 of the New Mexico Constitution requires that severance tax revenues exceeding the amount reserved by statute for payment of debt service payments on severance tax bonds be transferred to the severance tax permanent fund and provides for the method of distributions from such fund. The provisions of HB 253 could be subject to challenge by creating, in essence, a parallel severance tax permanent fund which permits distributions differing from what the constitution allows for the severance tax permanent fund. Although the amounts held in the capital development program fund are subject to appropriation by the legislature, as written, the legislation appears to allow for at least some portion of severance tax bond proceeds to never be used for projects and instead be placed into the capital development reserve fund and never reach the severance tax permanent fund. This may seem to be contrary to the intent of Article VIII, Section 2, that all bond proceeds be used for projects, and that all proceeds not needed for severance tax bond debt service be transferred to the severance tax permanent fund.

An option for addressing this concern would be providing a mechanism by which amounts in the capital development reserve fund are periodically transferred to the severance tax permanent fund to ensure that the intent of Article VIII, Section 2 is fulfilled.

**PERFORMANCE IMPLICATIONS**

**ADMINISTRATIVE IMPLICATIONS**

House Appropriations and Finance Committee Amendment to HB 253
No additional or revised input from the introduced draft.

HB 253 as Introduced

Oversight and management of the estimation of capacity, the funding of any estimated debt service savings amount via senior short-term taxable severance tax notes, and the transfer of funds to the Capital Reserve and Planning Fund held at the SIC will not require additional resources or budget for the SBOF.

The administrative implications to the DFA of administering the Capital Development and Program Fund are unknown, as the bill does not address how the fund will be administered, except by appropriation. Should the DFA be required to establish rules and undertake additional oversight of funds, it could have a measurable impact on the agency and require additional personnel and information technology resources.

## CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

<u>House Appropriations and Finance Committee Amendment to HB 253</u>
SB 300, Public Peace, Health, Safety & Welfare, authorizes the SBOF to fund up to $205.8 million in five transportation projects utilizing Severance Tax Notes. If enacted, the appropriations within SB 300 would utilize severance tax note capacity in FY24 for these projects and would leave less for transfer to the Capital Development and Reserve Fund that is contemplated in the HAFC amendment to HB 253.

Should an enacted SB 275, Capital Outlay Projects, authorize the SBOF to fund any capital initiatives with severance tax bonds or notes, there may be less to nothing available for transfer to the Capital Development and Reserve Fund in FY24.

<u>HB 253 as Introduced</u>
SB 217, Severance Tax Bond Fund Distributions, which requires the SBOF to transfer $82.53 million to the Severance Tax Permanent Fund (STPF) by December 1 of each year from 2024 through 2034 would impact the estimated debt service savings and capacity available for appropriation, because such required transfers to the STPF would reduce the revenues used to estimate capacity for appropriation each year.

## TECHNICAL ISSUES

## OTHER SUBSTANTIVE ISSUES

## ALTERNATIVES

## WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

## AMENDMENTS