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## FISCAL IMPACT REPORT

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| <b>SPONSOR</b> <u>Senate Finance Committee</u>               | <b>LAST UPDATED</b> _____                        |
|  | <b>ORIGINAL DATE</b> <u>2/19/2025</u>            |
| <b>SHORT TITLE</b> <u>Oil &amp; Gas Royalty Rate Changes</u> | <b>BILL NUMBER</b> <u>CS/Senate Bill 23/SFCS</u> |
|  | <b>ANALYST</b> <u>Gaussoin/Torres</u>            |

### REVENUE\* (dollars in thousands)

| Type    | FY25 | FY26 | FY27 | FY28                           | FY29                           | Recurring or Nonrecurring | Fund Affected             |
|---------|------|------|------|--------------------------------|--------------------------------|---------------------------|---------------------------|
| Royalty |      |      |      | Up to 50,000.0                 | Up to \$75,000.0               | Recurring                 | Land Grant Permanent Fund |
|         |      |      |      | Indeterminate but minimal loss | Indeterminate but minimal loss | Recurring                 | Land Maintenance Fund     |

Parentheses ( ) indicate revenue decreases.

\*Amounts reflect most recent analysis of this legislation.

### Sources of Information

LFC Files

#### Agency Analysis Received From

State Land Office (SLO)

Energy, Minerals and Natural Resources (EMNRD)

State Investment Council (SIC)

## SUMMARY

### Synopsis of SFC Substitute for Senate Bill 23

The Senate Finance Committee substitute for Senate Bill 23 (SB23) sets a new maximum royalty rate—the amount oil producers pay on the value of oil or gas removed—on oil and gas leases on “premium” state trust land in the Permian Basin. The rate would increase from one-fifth of the value of the oil or natural gas produced to one-fourth of the value of the oil or gas removed. A new lease form with the higher maximum rate would be used for leases issued on or after July 1, 2025.

The bill provides for greater emphasis on two provisions already contained within the statutorily mandated lease form by requiring the State Land Office to post with each lease notice its calculation of the classification of the lease tract and adding language to statute that limits the office to canceling a lease only on the failure or default of the lessee to comply with the lease.

The effective date of the bill is July 1, 2025.

## FISCAL IMPLICATIONS

**Land Grant Permanent Fund.** The change in the royalty rate is expected to generate from \$50 million to \$75 million of additional revenue for the land grant permanent fund, the depository for royalties paid on mineral production on state trust land. The estimate is based on the Consensus Revenue Estimating Group’s projection of oil and gas prices and Rystad Energy estimates of future New Mexico oil and gas production from wells that have not yet been permitted, drilled, or completed. The estimate was then narrowed to reflect a State Land Office estimate that just 1 percent of the prime leasing land that would be affected by the new lease rates is available (see attachment). In addition, because the new royalty rate would only affect new leases and production typically starts two or three years after a lease is signed, the fiscal impact to the land grant permanent fund is expected to be delayed until FY28.

The State Land Office (SLO) estimates the change in royalty rate would result in an additional \$50 million to \$84 million in revenue to the land grant permanent fund. SLO says it based its estimate on an evaluation of production, and production growth, from wells on state trust land completed within the last 10 years and the average annual prices for oil and gas.

The State Investment Council (SIC) reports it cannot independently estimate the potential annual increase in revenue to the land grant permanent fund without data on the availability of new leases or the production potential on newly leased lands, but—using SLO’s revenue estimate—the market value of the permanent fund could grow by \$1.5 billion to \$2.5 billion by 2050. In turn, because public schools (primarily) and other state agencies receive distributions from the permanent fund, the additional revenue in the fund would increase the amounts in those distributions, offsetting the need for general fund revenues to support those agencies. From SIC:

Using the previous SLO estimates for additional annual revenue to the land grant permanent fund, SIC staff estimate land grant permanent fund beneficiaries could receive an additional \$750 million to \$1.3 billion in cumulative distributions through 2050, approximately 87 percent of which would benefit the general fund through distributions to common schools. This estimate assumes the land grant permanent fund target annual average return of 7 percent.

**Land Maintenance Fund.** SLO notes bonus payments on oil and gas leases, one-time payments for the right to obtain a lease that are deposited in the land maintenance fund, are generally lower for leases with higher royalty rates. About 20 percent of the revenue in the maintenance fund pays for the operations of the land office. Money left in that fund after SLO expenses are, along with much larger distributions from the land grant permanent fund, distributed to the beneficiaries. Although the impact is much smaller, reductions in the maintenance fund reduce the amount distributed to beneficiaries, increasing their reliance on general fund revenue in some cases. Nevertheless, the impact on the land maintenance fund is likely to be small.

**Risk to Estimate.** In addition to the risks to any revenue estimate involving oil and gas production from the volatility in prices, the estimate of the fiscal impact of a royalty rate increase is challenged by the lack of leases available in the state’s high-production areas. Less than 1 percent of tracts in the high-production zone of the State Land Office’s Southeast District remain available for new lease rates. Leases have an initial term of five years but can be held by the lessee for as long as they are productive, meaning new royalty rates might not have significant impacts on production or revenues because nearly all productive lands are already leased at the

lower levels.

## SIGNIFICANT ISSUES

Royalty rates on state trust lands range from 12.5 percent to 20 percent. The State Land Office, which manages 12.7 million subsurface acres and 9 million surface acres on behalf of 21 beneficiaries, uses three lease forms, set in statute, based on whether the tract is in a restricted area (where oil and gas production normally occurs) and whether it is classified as “regular” or “premium,” based on a formula that looks at oil and gas reservoir volume and value. The royalty rate for restricted, premium tracts, what the office calls the “most productive state trust land oil and gas leasing tracts,” can be no lower than 18.75 percent and no higher than 20 percent. The bill would set the range at 20 percent to 25 percent for specific premium tracts in the Permian Basin identified by township. From the State Land Office:

The legal land description ... includes state trust lands within Eddy and Lea counties, as well as a sliver of southeastern Chaves County and the most southeastern part of Roosevelt County. The definition of the area of applicability was tailored to reflect the location of oil and gas resources (geological formations/basins), consolidated state trust lands, and the corresponding high-production value of the lands within the area.

***New Mexico Compared with Other States.*** New Mexico’s 20 percent maximum royalty rate for oil and gas leases on trust land, last updated in the 1970s, is higher than those in most other states with trust land but less than that charged by Texas, New Mexico’s competitor in the high-production Permian Basin. Information from a 2021 federal Department of Interior report and a 2024 informal survey of states with trust lands by LFC staff shows oil and gas royalty rates in trust land states ranging between 12.5 percent and 25 percent, with most charging 16.67 or 18.75 percent.

Texas charges as little as 20 percent on some leases but charges 25 percent on leases for tracts in the Delaware Basin, part of the Permian Basin, and those tracts in direct competition with New Mexico’s highest value tracts. SLO argues New Mexico leases would be “more industry friendly” than those on trust land in Texas, even if the royalty rate were raised to 25 percent, because New Mexico, among other conditions, offers longer lease terms and charges the royalty on a calculation of proceeds that allows for some deductions, rather than gross proceeds. The office, in addition, contends the bill would bring trust land rates closer to parity with “the many private landowners in New Mexico and Texas who charge 25 percent.”

North Dakota, the third largest oil producer behind Texas and New Mexico, sets a minimum in statute of 12.5 percent but charges between 16.67 percent and 18.75 percent. The North Dakota counties at the higher rate are all within the high-producing Bakken Formation, although some counties within the formation are at the lower rate.

While New Mexico rates are generally higher than those charged for trust land in other states, rates seem to be increasing. Pheasant Energy, a Fort Worth-based oil exploration and production company, reported in late 2022 royalty rates charged by states and private landowners are on upward trend, with royalties for private lands influenced by those being charged by states.

**Oil and Gas Lease Rates on Trust Lands in Select States  
2024**

| Jurisdiction              | Max Rate |
|---------------------------|----------|
| Arizona                   | 12.5%    |
| South Dakota              | 12.5%    |
| California <sup>1</sup>   | 16.67%   |
| Montana                   | 16.67%   |
| Wyoming                   | 16.67%   |
| North Dakota <sup>2</sup> | 18.75%   |
| Oklahoma                  | 18.75%   |
| Colorado                  | 20%      |
| New Mexico                | 20%      |
| Utah <sup>3</sup>         | 20%      |
| Texas                     | 25       |

<sup>1</sup>Negotiated lease-to-lease, generally no higher than 16.67 percent.

<sup>2</sup>ND sets a minimum of 12.5 percent in statute. Rates range from 16.67 to 18.75 percent.

<sup>3</sup>Utah's standard rate is 16.67 percent but the rate is 20 percent in better areas.

Source: LFC and U.S. Department of the Interior

**Current Permian Basin Lease Activity.** In March 2024, the State Land Office “paused” oil and gas leasing of certain tracts in the Permian Basin pending legislative approval to raise the maximum royalty rate. The office argued that, because the rate in the lease remains in effect as long as the lease is productive, lower-than-market lease rates would lock the state into earning less in the long term.

## PERFORMANCE IMPLICATIONS

From the State Land Office:

The bill would advance the State Land Office’s core mission of generating revenue for trust beneficiaries as well as the agency’s legislative performance measures. While the immediate and short-term impact is difficult to determine, particularly given the uncertainty about how many new leases would be issued each month, the time it takes for a newly issued lease to go into production, future oil and gas price and production levels, etc., it is clear that the legislation would result in significant increases in State Land Office annual royalty transfers to the (land grant permanent fund), which in turn would result in substantial increases in distributions from the LGPF to beneficiaries as these contributions are invested and gain additional value over the long term.

## ADMINISTRATIVE IMPLICATIONS

While SLO would need to update its lease forms, this represents a minor administrative burden.

## CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB23 is similar to bills from 2019 (SB500), 2023 (SB164), and 2024 (HB48), which passed in the House but died in the Senate. Significantly, those bills increased the maximum rate for all premium tracts. SB23 only raises the rate for premium tracts in the Permian Basin, although the restriction does not change what parcels would be affected.

## OTHER SUBSTANTIVE ISSUES

SLO suggests the restating of existing law restricting lease cancellations that is included in the

committee substitute for SB23 was added to the original bill because of concerns the State Land Commissioner could cancel a lease arbitrarily in order to trigger a new lease at the higher rate for the same parcel. Lease rates stay in place as long as the lease is in place, generally until the well stops producing. State law already prevents arbitrary cancellations.

Similarly, the provision requiring the public posting of certain lease information merely reinforces existing law:

Under the current State Land Office practices, tracts may be put out for auction either on the agency's own initiative or at the request of an outside party who nominates a specific tract for consideration. While the State Land Office has a process for receiving and considering nominations of lease tracts to be offered for lease through a lease auction, the State Land Office is not required to act on nominations and retains discretion whether to offer any particular tract for lease. The existence of a nomination and the name of the party making the nomination is not disclosed until after that month's lease sale is completed. The SFC substitute would require the State Land Office to maintain confidentiality with regard to the name of the nominating company until after that month's lease sale is completed. However, as it is under current practices, once an auction is complete the information would be subject to public disclosure.

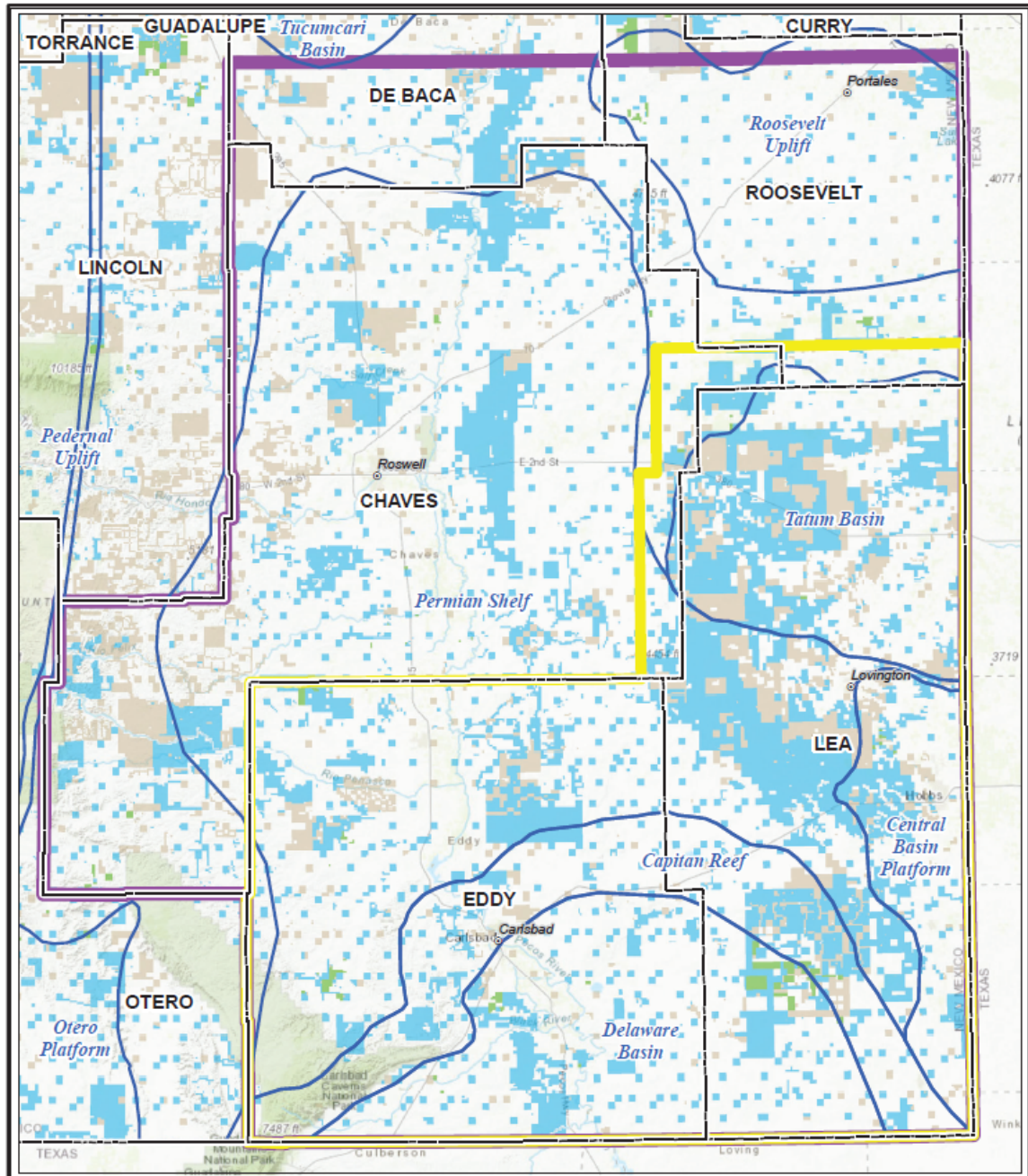
## **WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

The State Land Office reports the pause in leases will remain in place.








Attachments: Royalty Rate Increase Area  
Royalty Rate Increase Area with Wells

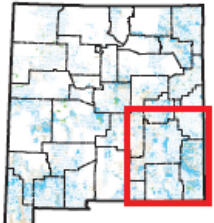
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**Proposed Royalty Rate Increase Area**

- |   |   |
|---|---|
|  Proposed Rate Increase Area     |  Mineral Estate    |
|  Oil and Gas Restricted District |  Surface Estate    |
|  Oil and Gas Geologic Regions    |  Both Estates      |
|   |  County Boundaries |



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