State of New Mexico

STATE INVESTMENT COUNCIL

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GOVERNOR

STEVEN K. MOISE
STATE INVESTMENT OFFICER

STATE INVESTMENT COUNCIL MEETING
**********STATE CAPITOL, Room 309************
SANTA FE, NEW MEXICO
TUESDAY, OCTOBER 25, 2011
9:00 a.m.

1. **Opening Matters** (Doug Brown, Vice-Chair) (5 min)
   a. Introduction of guests & roll call
   b. Approval of agenda
   c. Approval of minutes: September 27th, 2011

2. **State Investment Officer's Report** (Steve Moise) (15 min)

3. **Investment Matters: Discussion or Vote** (75 min)
   a. Investment performance report & activity summary (Vince Smith)
   b. Mid/SMID/Small Cap manager recommendations (Smith & RV Kuhns)
   c. Asset allocation implementation (Smith)
   d. Requests for proposals status update (Smith)
   e. Real estate Q2 performance report (Smith & Townsend)
   f. Real estate policy review & vote (Smith & Townsend)

4. **Investment Matters: PEIAC Report; Discussion or Vote** (60 min)
   a. PEIAC committee report (Mike Martin/Moise)
   b. Platinum Equity Capital Partners III, L.P. (LP Capital & Greg Kulka)
   c. National private equity secondary sales program (LP & Kulka)
   d. NM private equity program consultant (Kulka)

5. **Governance Matters & Informational Reports: Discussion or Vote** (90 min)
   a. Severance Tax Permanent Fund discussion (Bob Grant & John Bigbee)
   b. Audit Committee report (Jim Goodwin)
   c. Budget and accounting matters (Cynthia Marietta)
   d. SIC Code of Conduct (Evan Land)

6. **Closing Matters** (5 min)
   a. Old or new business (Brown)
   b. Next SIC meeting date: Tuesday, November 22nd, 9:00am, Santa Fe, NM (Brown)

7. **Public Comment Period** (Brown) (15 min)

8. **Vote to Enter Executive Session Pursuant to NMSA, 1978**: (Brown) (45 min)
   a. 10-15-1(H)(7) Ongoing or pending litigation & investigations: placement fees; CBA
   b. 10-15-1(H)(2) Limited personnel matters: CFO;

9. **Adjournment**

5.A.1

SEVERANCE TAX PERMANENT FUND

Bob Grant and John Bigbee
October 2011

The New Mexico Severance Tax Permanent Fund (STPF): Facts, figures, questions, answers and implications.

- Severance taxes are one of many imposed by the state on entities extracting our oil and gas, minerals and natural resources.
- Oil and gas generate as much as 95 percent of the state's severance taxes. However, unlike enterprises that renew annually, they are finite resources. Once severed, these resources cannot be recovered or replaced.
- Established by law in 1973, the Severance Tax Permanent Fund (STPF) became part of New Mexico's Constitution in 1976.
- The fund was made a part of our Constitution to protect it from legislative appropriations and to guarantee its permanence and preservation.
- As an endowment, it was never intended as a "rainy day fund."
- The Constitution requires a vote of 100 percent of the members of the Legislature to remove funds from the STPF.
- Creating a permanent endowment using severance tax receipts had a dual purpose:
  1. It would create and sustain a substantial, perpetual source of wealth and income for future generations of New Mexicans to replace oil and gas revenues when wells run dry.
  2. It would serve the current population through disbursements of a portion of the fund's annual investment income to the state's general fund.
- Severance taxes deposited in the STPF are described in our Constitution as those "...in excess of that amount that has been or shall be reserved by statute for the payment of principal and interest on outstanding (severance tax) bonds..."
- All severance tax revenues are first deposited in the Severance Tax Bonding Fund (STBF) and initially used to satisfy the constitutional requirement to

pay principal and interest on all severance tax bonds issued. Money not used for bonds is transferred semiannually to the STPF.

1. For 24 years, from 1976 to July 1, 1999, the "split" between bond payments and deposits in the STPF was 50/50.
2. Beginning July 1, 1999 the legislature reduced the revenues for the STPF to 37.5 percent of severance tax receipts and increased bonding capacity to 62.5 percent.
3. At the end of fy 2000, the STPF was worth $4.1 billion.
4. On April 12, 2000, 87.5 percent of our severance taxes were made available for servicing bonds and only 12.5 percent made it to the STPF.
5. Effective July 1, 2004 the state's bonding capacity was raised to 95 percent.
6. Provisions in capital outlay bills currently provide for the bonding of any remaining amounts of severance tax proceeds, effectively reducing deposits to the STPF to almost zero.
7. As a result, just $391.9 million of $3.6 billion collected from 2002 through 2011 has found its way into the fund.
8. In 2010 only $3.4 million, about one percent of the $327.6 million collected that year, made it to the fund.
9. In fiscal year 2011 that ended June 30, only $6.5 million of $299.5 million received was deposited.

- The difference between the amounts reaching the STPF and what would have been deposited under the 50 percent rule is more than $1.33 billion. With those monies the Severance Tax Permanent Fund, now about $4.0 billion, would now be worth more than $5 billion, not counting market activity.
- Precluded by our Constitution from taking money directly from the permanent fund, in the past ten years the legislature has skirted that prohibition by simply not putting money in it.
- Even more financially devastating is what is happening to the constitutionally protected corpus of the severance tax endowment.
- Annual distributions of 4.7 percent of the fund's five-year average value are constitutionally mandated.

1. Over the six fiscal years from 2006 through 2011, $1.2 billion was distributed to the state's general fund from the Severance Tax Permanent Fund.

2. During that time, of $2.0 billion in severance taxes collected, just $312 million or 15.6 percent made its way to the STPF.
3. It gets worse: In the most recent two years less than $10 million ($3.4 million in fy 2010 and $6.5 million in fy 2011) of severance tax receipts totaling $627.1 million (1.6 percent) were added to the endowment.
4. In the last six years, distributions from the fund exceeded the money deposited by about $888 million, or an average of $148 million annually.

Continuing the practice of withholding severance taxes from the Severance Tax Permanent Fund and distributing more from it than is placed in it means an eventual perpetual decline in its value and inevitable dissolution of a unique, well conceived and, until recently, successful procedure to fund the future.

SEVERANCE TAX PERMANENT FUND

(Figures in millions of dollars)

Fiscal Year Ending June 30	Severance Taxes Collected/Deposited in ST Bonding Fund	$ Transferred from ST Bonding Fund to STPF	ST Collected Two Years Earlier	If Normal 50%	Difference
2002	$ 200.7	$ 32.4	$ 165.0 (2000)	$ 82.5	-$ 50.
2003	221.4	2.3	315.6 (2001)	157.8	- 155.5
2004	293.1	35.9	200.7 (2002)	100.4	- 64.5
2005	384.6	19.0	221.4 (2003)	110.7	- 91.7
2006	489.0	57.8	293.1 (2004)	146.6	- 88.8
2007	425.4	163.0	384.6 (2005)	192.8	- 29.8
2008	567.4	41.4	489.0 (2006)	245.0	- 203.1
2009	378.1	30.1	425.4 (2007)	212.7	- 182.6
2010	327.6	3.5	567.4 (2008)	283.7	- 284.2
2011	299.5	6.5	378.1 (2009)	189.4	- 182.6
	$3,586.3	$391.9	$3,440.1	$1,721.6	$1,332.9

Legislature and executive have "Short stopped" and spent $1.33 billion dollars that could have been deposited in the Severance Tax Permanent Fund. Future generations will suffer a significant loss of interest income and any capital appreciation that this amount would have provided when our oil and gas resources are depleted.

Dipping into New Mexico's Savings Account Compromises Future

By Bob Grant and John Bigbee

August 8, 2011

The lock on our permanent fund's bank vault has been broken and over one billion dollars are missing. And those who did it are still running the bank.

From 2002 through 2011, more than $1.33 billion that should have been deposited in the state's Severance Tax Permanent Fund was diverted for other purposes. Extraordinary actions by the legislature and executive have depleted and compromised the fund. And worse, they appear to have set an expensive and harmful precedent that could prove difficult to change.

Severance taxes are one of many imposed by the state on entities extracting our mineral resources. Taxes derived from oil and gas are New Mexico's legacy. Every barrel of oil and cubic foot of gas harvested from lands in our state are, through taxes and investments, among the largest contributors to our financial well-being. But unlike enterprises that renew annually, they are finite resources. Once severed, those revenue sources cannot be recovered or replaced.

The Severance Tax Permanent Fund was established by law in 1973 and, by passage of an amendment, became part of New Mexico's Constitution in 1976. Citizens and lawmakers recognized that the generous revenues resulting from the production of hydrocarbons would eventually cease as resources were depleted. Creating a permanent endowment using severance tax receipts had a dual purpose. First, it would create and sustain a substantial, perpetual source of wealth and income for future generations of New Mexicans to replace oil and gas revenues when wells run dry. Second, it would serve the current population through disbursements of a portion of the fund's annual investment income to the state's general fund. Money that otherwise would be furnished by taxes. As an enduring and recurring financial asset derived from what is a transient resource, the Severance Tax Permanent Fund, currently valued at about $4.0 billion, is a significant factor in New Mexico's economic future.

The fund was made a part of our Constitution to protect it from legislative appropriations and to guarantee its permanence and preservation. As an endowment it was never intended as a "rainy day fund." But its impressive balance attracted the attention of those who believe the money could be better spent on current projects and programs than on future ones, and were determined to find a way to dip into it.

Precluded by our Constitution from taking money directly from the permanent fund, in the past ten years the legislature has skirted that prohibition by simply not putting money in it - about $1.33 billion - and it's perfectly legal.

The legislature can build, maintain and improve things in our state and pay for these capital improvements by borrowing against severance tax receipts. Until 2002, no more than 50 percent of annual severance tax receipts were used to repay capital improvement bonds. Since then, the "split," which is set by law, has declined to a legal 5/95 percent with the lesser amount deposited in the permanent fund. As a result, just $391.9 million of $3.6 billion collected from 2002 through 2011 has found its way into the fund. Accounting for time lags and transfers, the difference between the amount deposited and what would have been deposited under the 50 percent rule is more than $1.33 billion. With those monies the Severance Tax Permanent Fund would now be worth more than $5 billion, not counting market activity. In 2010 only $3.4 million, about one percent of the $327.6 million collected that year, made it to the fund. In fiscal year 2011 that ended June 30, only $6.5 million of $299.5 million received was deposited.

New Mexico has been on an unparalleled spending spree using the savings and inheritance of future generations. Many of the resulting capital improvements are impressive and useful, and some were necessary. And certainly the construction activity and jobs they generated, especially in the past three years, gave a welcome boost to our lagging economy. But it begs the question of whether it was necessary to do all of them immediately at our heir's expense. Especially since, according to the Legislative Finance Committee, there are 1,546 projects representing $688.1 million in capital outlay funds approved in past years that have yet to be spent.

Even more egregious and financially devastating to the inheritors is what is happening to the corpus of the severance tax endowment. Annual distributions of 4.7 percent of the fund's five-year average value are constitutionally mandated. Over the six fiscal years from 2006 through 2011, $1.2 billion was distributed to the state's general fund from the Severance Tax Permanent Fund. During that time, $312 million was added to the fund from severance taxes. Though welcome -- and mostly unrecognized -- relief to taxpayers who otherwise would have paid these amounts to run state government, distributions from the fund exceeded the money deposited by about $840 million, or an average of $140 million annually. Continuing the practice of distributing more from the fund than is placed in it means an eventual perpetual decline in its value.

Unfortunately, the kids, grandkids, great grand kids and the future generations of New Mexicans who are the beneficiaries of this magnificent endowment are not here to complain about what has been and may continue to be taken from them.

Will dramatic invasions of the Severance Tax Permanent Fund continue, or will financial equity return? Those responsible owe the people of New Mexico an answer. And an explanation why they devastated a unique, well conceived and, until recently, successful procedure to fund the future.

5.A.2

STATE OF NEW MEXICO
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GOVERNOR SUSANA MARTINEZ
PRESIDENT

RICHARD E. MAY
CABINET SECRETARY

STEPHANIE SCHARDIN CLARKE
INTERIM DIRECTOR

MEMORANDUM

To: Rick May, DFA Secretary

From: Stephanie Schardin Clarke, Interim Director SSC

Date: August 8, 2011

Re: Severance Tax Permanent Fund Contributions

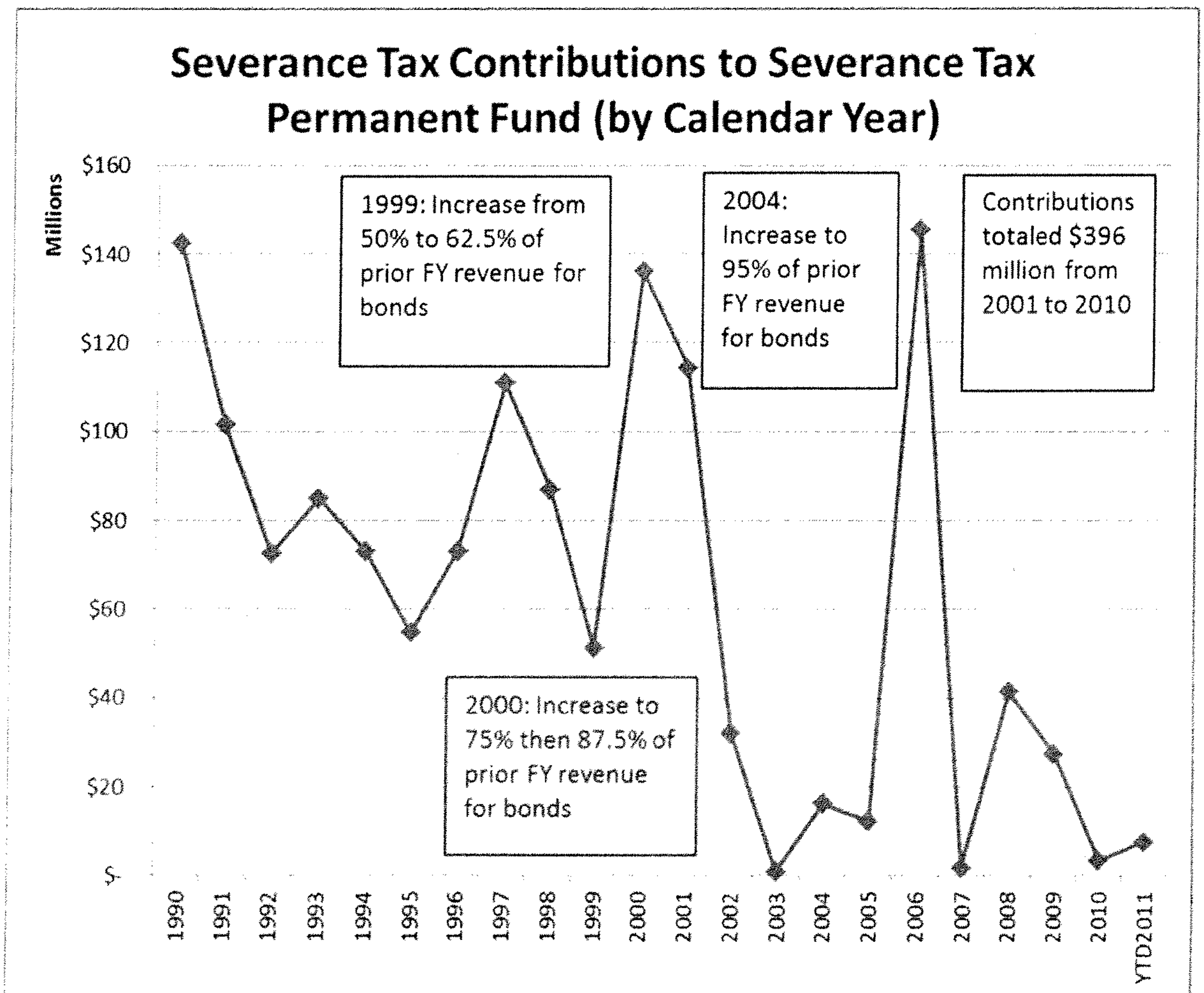
In recent months a policy question posed in various venues has been whether a greater share of severance tax revenues should be transferred to the Severance Tax Permanent Fund (the "Permanent Fund") rather than the current utilization in the Severance Tax Bond (STB) program for capital projects. Below is a brief history and additional data that I hope will be helpful in informing this dialogue.

History

Since 1937, severance taxes have been collected on the severance of natural gas, oil and a handful of other minerals from the ground in New Mexico. Since 1959, certain severance tax receipts have been deposited into the Severance Tax Bonding Fund (the "Bonding Fund") and used to service bonds issued to fund a variety of capital improvements in the State. When the severance tax bonding program was created in 1959, severance tax bonds were only issued to fund capital projects authorized by the Legislature. At that time, statute restricted capacity to issue new bonds such that debt service on outstanding bonds could be serviced with 50% of the prior fiscal year's Bonding Fund revenue. Assuming flat revenue collections from one year to the next, that meant that about half of severance taxes would be used for bonding purposes, and about half would be transferred to the Permanent Fund (however, this would vary year to year based on whether Bonding Fund revenues were rising or falling).

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, supplemental severance tax bonds were created to provide a dedicated funding stream for public school capital improvements. The statutory capacity to issue senior and supplemental severance tax bonds was increased above the long standing 50% level: capacity for bonds was increased from 50% to 62.5 percent in 1999, increased further to 75% and then 87.5 percent in 2000, and finally to the current level of 95% in 2004.

Money in the Bonding Fund has been pledged for payment of principal and interest on senior and supplemental severance tax bonds and notes. Each June 30 and December 31, excess money in the Bonding Fund over the amount necessary to meet all principal and interest payments on all outstanding STBs is transferred to the Permanent Fund, where it is invested by the State Investment Council. The chart below demonstrates that contributions to the Permanent Fund have declined since statutory capacity began to be increased in 1999. However, due to years of significant revenue growth–such as CY2006 when natural gas prices soared following hurricanes Katrina and Rita—contributions have continued to be strong with nearly $400 million transferred to the Permanent Fund from 2001 to 2010.

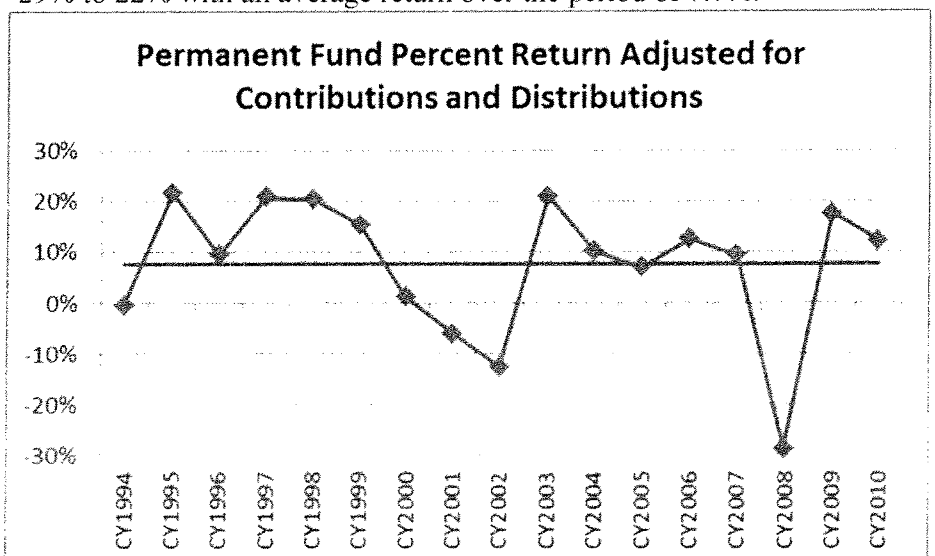


Since the supplemental STB program was initiated in FY2000, a total of $254 million in long-term bonds and $1.812 billion in short-term notes have been issued to fund public school capital improvements, an average of $172.2 million per year. In the same period, $1.1 billion of senior long-term bonds and $1.16 billion in senior short-term notes have been issued to fund statewide capital projects and water projects, an average of $184.6 million per year.

Policy Considerations

It has been suggested by some that statute setting STB capacity should be amended to reduce the capacity for STBs and allow for greater contributions to the Permanent Fund. The following policy considerations should be considered when thinking about that approach:

- If there is concern that using severance taxes for the STB program denies future generations of New Mexicans an investment in their future through the Permanent Fund, it should be considered that STBs are used to finance capital assets, not operations, and as such capital projects financed with STBs are also an investment in the future of New Mexico. This point drives home the importance of the State using STB capacity strategically to ensure the State's investment in capital assets yields a high return.
- Capital projects financed through the STB program stimulate the New Mexico economy by creating construction employment, and also reward the State through the generation of gross receipts taxes on that construction activity. Conversely, with a few exceptions, the Permanent Fund is invested out-of-state and as such does not stimulate the State economy.
- Investing severance tax revenues in the Permanent Fund is not without risk and thus does not guarantee preservation of those funds for future generations of New Mexicans. As shown in the chart below, from 1994 to present, after adjusting for contributions and distributions, annual return on the Permanent Fund has fluctuated from -29% to 22% with an average return over the period of 7.7%.



- There may be some misconception that failure to contribute to the Permanent Fund on an ongoing basis diminishes the corpus of the fund. Distributions from the Permanent Fund to the General Fund each year equal 4.7% of the five-year average market value. That means as long as return on the Permanent Fund less costs of carrying out the investments exceeds 4.7 percent, the corpus will still gain value absent any contributions.

5A3

MEMORANDUM

TO: Stephanie Schardin Clarke, Interim Director
State Board of Finance

FROM: Sutin, Thayer & Browne
By: Robbie Heyman, Rachel King, Tracy Hofmann

DATE: August 16, 2011

SUBJECT: Severance Tax Bonding Memorandum

Pursuant to your request, this memorandum describes the legislative history of the Severance Tax Bonding Act and the Severance Tax Permanent Fund for the purpose of providing this information to others.

I. Summary

As the historical description indicates, severance taxes were first used in New Mexico as a current funding source for the general fund. In 1959, the legislature authorized the use of severance taxes to back bonds issued by the State for capital projects, with any severance taxes not needed to pay interest and principal on the bonds to be deposited in the general fund. In 1973, the legislature created statutorily the Severance Tax Permanent Fund ("Permanent Fund") and directed that severance taxes not needed for debt service be deposited in the Permanent Fund rather than the general fund. The legislature created this new Permanent Fund to serve as an endowment fund for capital projects, as all income from the Permanent Fund was to be deposited into the capital program fund. In 1976, the Permanent Fund was given constitutional status by the electorate, and the electorate authorized the legislature to invade the corpus (with a $3/4^{th}$ vote in each house) of the fund for operating expenses and to use the income from the Permanent Fund for operating purposes, thus changing the Permanent Fund from an endowment for capital projects to a rainy day fund for operating purposes. In 1982, the electorate amended this constitutional provision to eliminate the possibility that the legislature would invade the corpus, thus making the Permanent Fund an endowment to produce income for operating purposes. In 1996, another constitutional amendment was adopted that forced distributions of moneys from the Permanent Fund based solely on a fixed percentage of the fund's market value, which in a declining market scenario could force distributions from the corpus even where the fund had net losses.

Until 1999, the bonding program was designed by statute to operate more or less on the assumption that half of the severance taxes were to be used to support the bonds and half to be deposited in the Permanent Fund. The mechanism to get this result is the statutory issuance test. As a result of court imposed pressure to increase dramatically state funding for public school capital outlay, the legislature began to authorize greater portions of severance tax revenues to be used for bonding rather than for deposit in the Permanent Fund with such greater portions to be exclusively used for capital projects for education. Currently, up to 95% of deposits into the

Bonding Fund, as measured by the statutory issuance test, may be used to service some type of debt for capital outlay.

II. The Severance Tax Bonding Act

A. General Purpose

New Mexico has levied taxes on the severance of various natural resources within the State since 1937, at which time all severance taxes were paid into the general fund. See Laws 1937, ch. 103, § 4. Severance taxes continued to be deposited into the State's general fund until 1959, when the legislature enacted the Severance Tax Bonding Act and created the Severance Tax Bonding Fund. Laws 1959, ch. 323, § 3. In 1961, the legislature repealed a significant portion of the 1959 law and replaced it with a substantially similar Severance Tax Bonding Act ("Act"). At that time, all severance taxes were deposited into the severance tax bonding fund to pay debt service on severance tax bonds issued to fund capital improvements authorized by the legislature, and any funds in the Bonding Fund above the amount necessary to pay debt service in the ensuing year were directed to the general fund. See Laws 1961, ch. 5, §§ 3, 4, 6. Section 27 articulated the purpose and intent of the Act:

> The purpose of the severance tax bonding act is to establish the authority who shall issue and sell all severance tax bonds for financing specific projects authorized by the legislature and to guarantee redemption of such bonds by revenue derived from the receipts from taxes levied upon natural resource products severed and saved from the soil, and such other monies as the legislature may from time to time determine. It is intended that projects to be financed from the fund shall include but not be limited to the construction of buildings for state institutions and water resource projects; and it is further intended that the income from water resource projects in excess of the amount required for operation and maintenance of the project shall be used to repay the severance tax bonding fund.

Laws 1961, ch. 5, § 27. The current version of the statute includes substantially the same provision, adding public school buildings to the list of projects to be financed and designating the use of certain bond proceeds for various specific purposes. See NMSA 1978, § 7-27-27.

B. Severance Tax Bonding Fund

To achieve its purpose, the Act created the severance tax bonding fund ("Bonding Fund") and authorized the State Board of Finance to issue and sell severance tax bonds. Laws 1961, ch. 5, §§ 3, 8.

From its inception, the statutory scheme has permitted only the pledge of severance taxes to pay debt service on the bonds. Laws 1961, ch. 5, § 4. A 1991 Attorney General opinion offered the following reason that no other tax may service the bonds: "Severance tax bonds authorized by the legislature are not the kind of debt contemplated by Article IX, sections 8 and 9 because they are not dependent on the general taxing power of the state for their retirement.

They are payable exclusively from a special fund created by the Severance Tax Bonding Act, NMSA 1978, Sections 7-27-1 through 7-27-48." 1991 Op. Att'y Gen. No. 91-01. Given that no other revenue stream may be pledged, the State's bonding capacity varies from year to year based solely on a percentage of the prior year's deposits into the Bonding Fund, as discussed more fully in Section D below. See NMSA 1978, § 7-27-14(B).

C. Severance Tax Permanent Fund

Prior to 1973, any excess funds in the Bonding Fund over the amount required to pay principal and interest on bonds were transferred to the general fund. See Laws 1961, ch. 5, § 6. In 1973, however, the legislature established the severance tax permanent fund in the state treasury to receive the residual revenues from the Bonding Fund that were not reserved for payment of severance tax bonds. Earnings from the investment of the Permanent Fund were to be appropriated to the capital program fund for capital outlay projects.[1] In this way, the Permanent Fund was originally intended to serve as an endowment for future capital projects. See Laws 1973, ch. 294, § 4.

In 1976, the electorate approved a constitutional amendment giving the Permanent Fund constitutional status. See N.M. Const. art. VIII, sec. 10. This amendment permitted the legislature in its discretion to appropriate funds from the corpus of the Permanent Fund. H.J.R. 5 (Laws 1975). The amendment also allowed the legislature to appropriate the income from investments for operating expenses. Id. In 1982, the electorate approved a second constitutional amendment that removed the legislature's discretionary power to appropriate funds from the corpus, but still authorized the legislature to appropriate the income from investments. H.J.R. 12 (Laws 1981). The 1996 constitutional amendment, which remains in effect today, provided that the legislature could appropriate limited distributions from the Permanent Fund in the same manner as other general operating revenue. S.J.R. 2 (Laws 1996); N.M. Const. art. VII, sec. 10(C). The annual distributions are calculated as 4.7% of the average of the year-end market values of the Permanent Fund for the immediately preceding five calendar years. Id. The 1996 amendment also required all earnings from investment of the Permanent Fund to be credited to the corpus of the fund. S.J.R. 2 (Laws 1996); see also, NMSA 1978, § 7-27-5 (noting that purpose of investing the Permanent Fund is to provide income to that fund).

Article VIII, section 10(A) of the New Mexico Constitution provides that that part of the severance tax revenue that is in excess of "that amount that has been or shall be reserved by statute for the payment of principal and interest on outstanding bonds to which severance tax revenue has been or shall be pledged" shall be deposited into the Permanent Fund. To this end, the state treasurer is required to transfer to the Permanent Fund on December 31 and June 30 of each year "all money in the severance tax bonding fund except the amount necessary to meet all principal and interest payments on bonds payable from the severance tax bonding fund on the next two ensuing semiannual payment dates." NMSA 1978, § 7-27-8. Given that deposits to the Bonding Fund vary each year, as do debt service payments, the amount transferred to the Permanent Fund also varies from year-to-year.

[1] Laws 1973, ch. 294, § 2 created both the severance tax permanent fund and the severance tax income fund. In 1996, the legislature abolished the severance tax income fund and transferred the proceeds in that fund to the severance tax permanent fund. Laws 1996, ch. 3, § 2.

D. Statutory Issuance Test

Severance tax bonds are issued to finance capital projects throughout the State. In 1999, following the Zuni lawsuit, the legislature created supplemental severance tax bonds to provide a dedicated funding revenue stream for public school capital improvements. NMSA 1978, § 7-27-12.2. Capacity to issue both types of bonds in a given year is determined by a statutory issuance test.

The statutory issuance test is based on the prior year's deposits into the Bonding Fund. Senior long-term severance tax bonds may be issued so long as the debt service on all outstanding and new senior bonds in any future year is 50% (or less) of the total amount deposited into the Bonding Fund in the previous year. NMSA 1978, § 7-27-14(B). Supplemental long-term severance tax bonds may be issued so long as the debt service on all outstanding bonds – senior and supplemental – is 62.5% (or less) of the total amount deposited into the Bonding Fund in the previous year. NMSA 1978, § 7-27-14(C).[2]

The Board of Finance may also issue short-term severance tax and supplemental severance tax notes (sometimes referred to as "sponge notes") to borrow against available cash in the Bonding Fund in order to fully utilize allowable capacity for capital projects. NMSA 1978, § 7-27-14(D). Senior sponge notes can be issued subject to the same statutory issuance test applicable to senior long-term bonds. Supplemental severance tax notes may be issued if total debt service for all outstanding and new severance tax bonds and notes does not exceed 95% of the total deposited in the Bonding Fund for the prior year. NMSA 1978, § 7-27-14(D).[3]

As noted above, because deposits into the Bonding Fund vary from year to year, the deposits to the Permanent Fund from the Bonding Fund necessarily change each year. In general, upward trending deposits into the Bonding Fund result in larger transfers to the Permanent Fund (because the cash in the Bonding Fund exceeds bonding capacity as measured by the statutory issuance test), while downward trending annual deposits result in less money being transferred to the Permanent Fund. We note that at least once in recent years, recognizing that a large amount of cash was available in the Bonding Fund in excess of statutory bonding capacity, the legislature authorized the Board of Finance to issue sponge notes (both senior and supplemental) in excess of the 95% statutory issuance test.

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[2] This percentage for long-term supplemental severance tax bonds represents an increase from the 50% statutory cap originally imposed on all severance tax bonds. Laws 1961, ch. 5, § 11.

[3] The legislature has increased the limit to issue supplemental sponge notes several times: the amount was originally capped at 75% of the deposits into the Bonding Fund during the preceding fiscal year (Laws 2000 (1st S.S.), ch. 6, § 7); then raised to 87.5%(Laws 2000 (2nd S.S.), ch. 11, § 2); and raised again to 95% (Laws 2004, ch. 125, § 2).