NEW MEXICO LEGISLATIVE FINANCE COMMITTEE

Infrastructure Funding: Severance Tax Bonds

Land Grant Committee
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Roadmap

Extraction

Oil & gas extracted from state lands

Tax

Severance tax levied on production

Fund

Revenue flows to the bonding fund

Bonds

Fund backs bond issuance

Projects

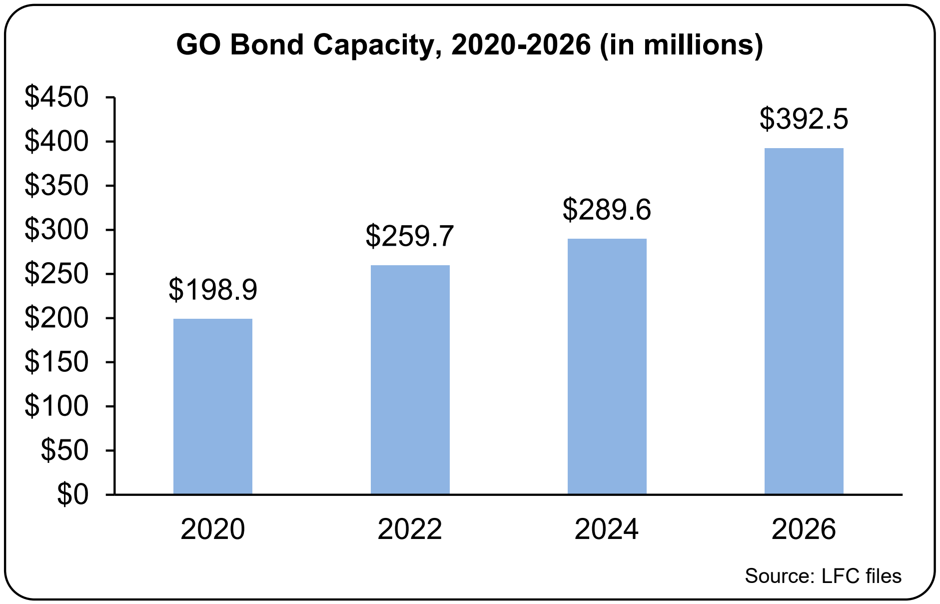
Proceeds finance capital projects

Not today's focus, but there are two main sources of infrastructure funding – severance tax bonds and general obligation bonds. **General obligation bonds** are issued against property taxes and approved by voters.

- The Legislature authorizes the issuance of general obligation bonds during even-numbered years, when the state holds a statewide election.

- In practice, GO bond capacity is determined by mill rates and tax revenue, frequently held flat.

- GO bonds typically fund higher education, senior center and library projects.



Severance taxes are based on natural resources severed and sold from New Mexico. Price and production combine to create the value of a product. If either price or production move, revenues follow. In NM, taxes are primarily driven by oil and gas.

PRICE

$ per barrel & per MCF

×

VOLUME

Barrels & MCF

=

MARKET VALUE

The revenue base

Price

swings with global markets

Production

wells decline; new wells added

Volatile State Revenue

Small moves in either compound into large swings in the state budget

What is the severance tax?

- A tax on extracting a nonrenewable resource — oil, natural gas, coal, potash, other minerals, timber
- Different from GRT or income tax: this taxes the depletion of an asset, not a transaction or earnings
- One of several severance style taxes the state imposes is named the "severance tax" which is used for the severance tax bonding program.

Taxes on Oil	Net Price of Oil ($/bbl)		
	Under $15	$15 to $18	Over $18
Oil and Gas Emergency School Tax	1.58%	2.36%	3.15%
Oil and Gas Severance Tax	1.88%	2.81%	3.75%
Subtotal	**3.46%**	**5.17%**	**6.90%**
Oil and Gas Conservation Tax	0.19% - 0.24%	0.19% - 0.24%	0.19% - 0.24%
Production Ad Valorem Tax	1.04%	1.04%	1.04%
Production Equipment Ad Valorem Tax	0.14%	0.14%	0.14%
Total	**4.83%**	**6.54%**	**8.27%**

Where does the money go?

- Severance tax collections flow into the Severance Tax Bonding Fund
- The Bonding Fund's first job: pay debt service on outstanding severance tax bonds
- Whatever is not needed for debt service spills over to the Severance Tax Permanent Fund

Borrowing against the bonding fund looks different depending on the project and length of pay-off.

Long-Term Bonds

- For projects or assets with lifespans at least as long as the bond term
- Spend within 3 years — or risk tax penalties
- Stricter legal & federal tax rules

Short-Term Notes

the "sponge" bonds

- Use only cash not pledged to long-term bonds
- Must hold enough cash to repay them quickly
- Soak up leftover bonding-fund capacity

The Board of Finance manages these rules alongside many other calculations and appropriations.

The decision tree of senior, supplemental, long-term, and short-term instruments can create serious constraints if not properly coordinated.

- Capacity is derived from a formula, recalculated every session — not a fixed pot of money. Combined senior + supplemental capacity is capped at 86.2% of the same lesser-of-two-years revenue base.
- Supplemental capacity carries a second constraint: a market test limiting issuance to the lesser of statutory capacity or actual cash availability after senior debt service
- Two independent limits, both tied to the same underlying, forecast-based revenue number

	SENIOR (first 47.6%)	**SUPPLEMENTAL (second 38.6%)**
Long-Term Bonds	Funds capital projects as authorized by the Legislature Sold 1x/year, competitively 10-year maturity	Funds public school capital projects as certified by PSCOC Sold infrequently, competitively 10-year maturity
Short-Term "Sponge" Notes	Funds capital projects and earmarks as authorized by the Legislature 1-3-day maturity ("pay as you go") Sold 1-2x/year (Dec/June)	Funds public school capital projects as certified by PSCOC 1-3-day maturity ("pay as you go") Sold 1-2x/year (Dec/June)

Competing claims on capacity often have waterfall effects and are further complicated by the differentiated pots (long-, short-term, and seniority).

Capital Outlay Bill — total capacity

1 · Statutory set-asides — taken off the top

- Tribal (4.5%)
- Colonias (4.5%)
- Water (9%)
- Housing (2.5%)

2 · Statewide + member-share projects

What remains

So less remains for:

Public Schools

K-12 education funding

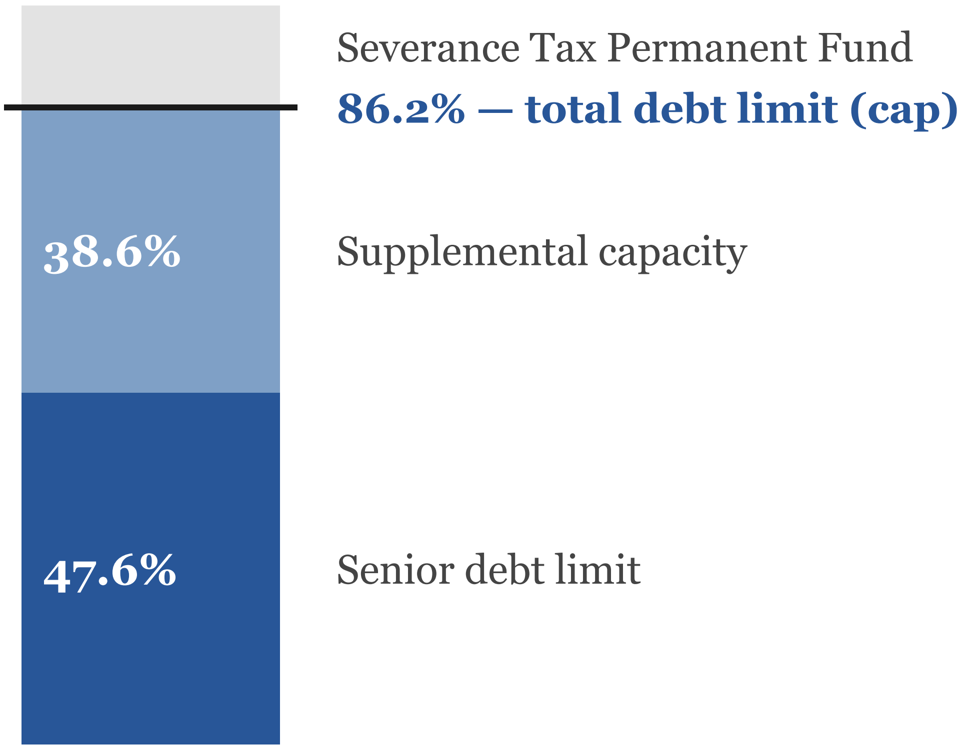
Future Savings

a buffer for a lower energy-revenue future

Until recently the capital program was almost entirely reliant on oil and gas revenues.

Borrowing capacity

share of bonding-fund revenue



Saving unused capacity

the CDRF — new in 2024

Unused debt service capacity → debt-service savings

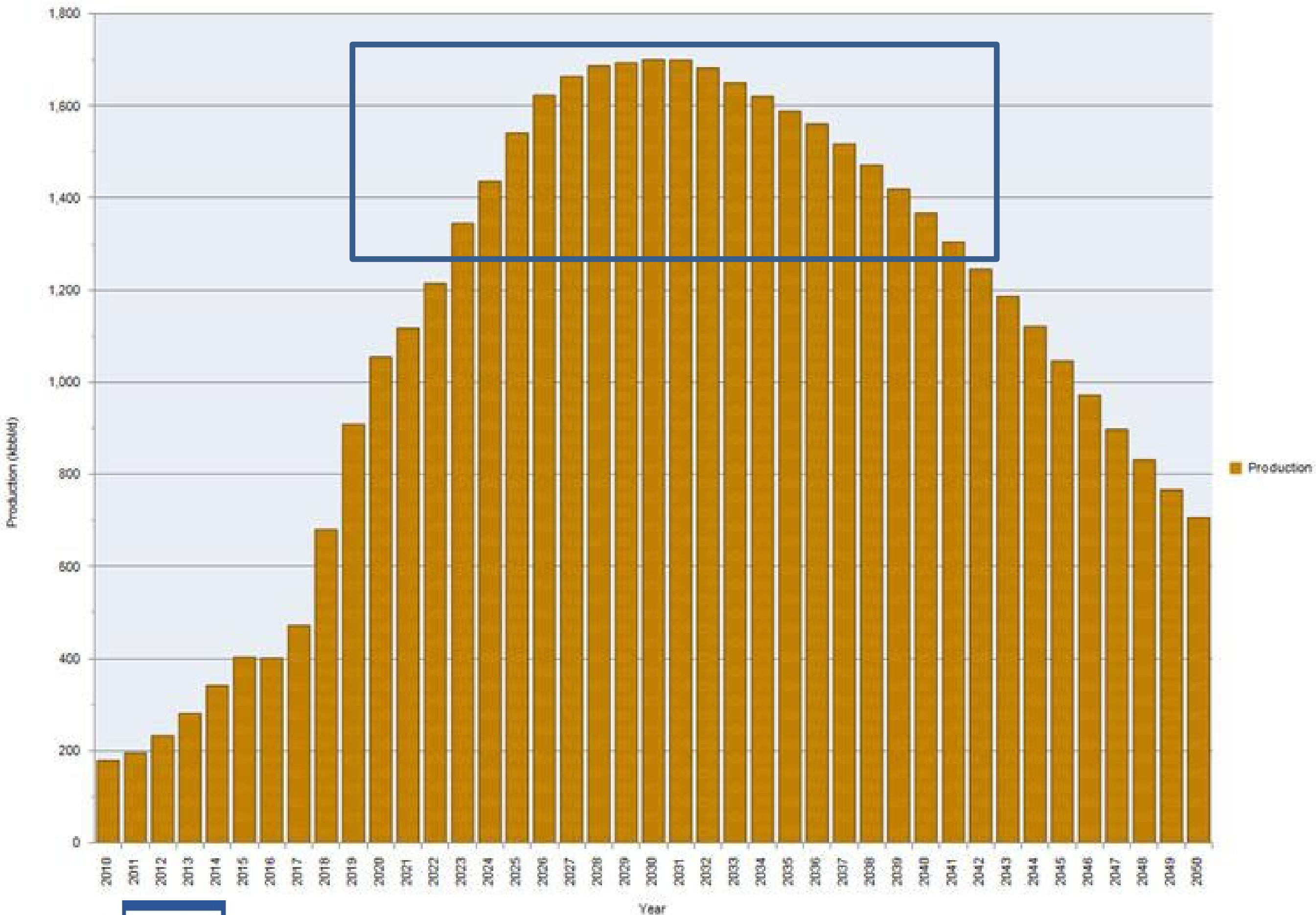
Capital Development Reserve Fund

Est. 2024

A save-now buffer as severance revenue declines — the capital-outlay counterpart to the Early Childhood Trust Fund.

While energy analytics firms expect NM oil production to continue growing for the next few years, production is currently expected to peak in the 2030s.

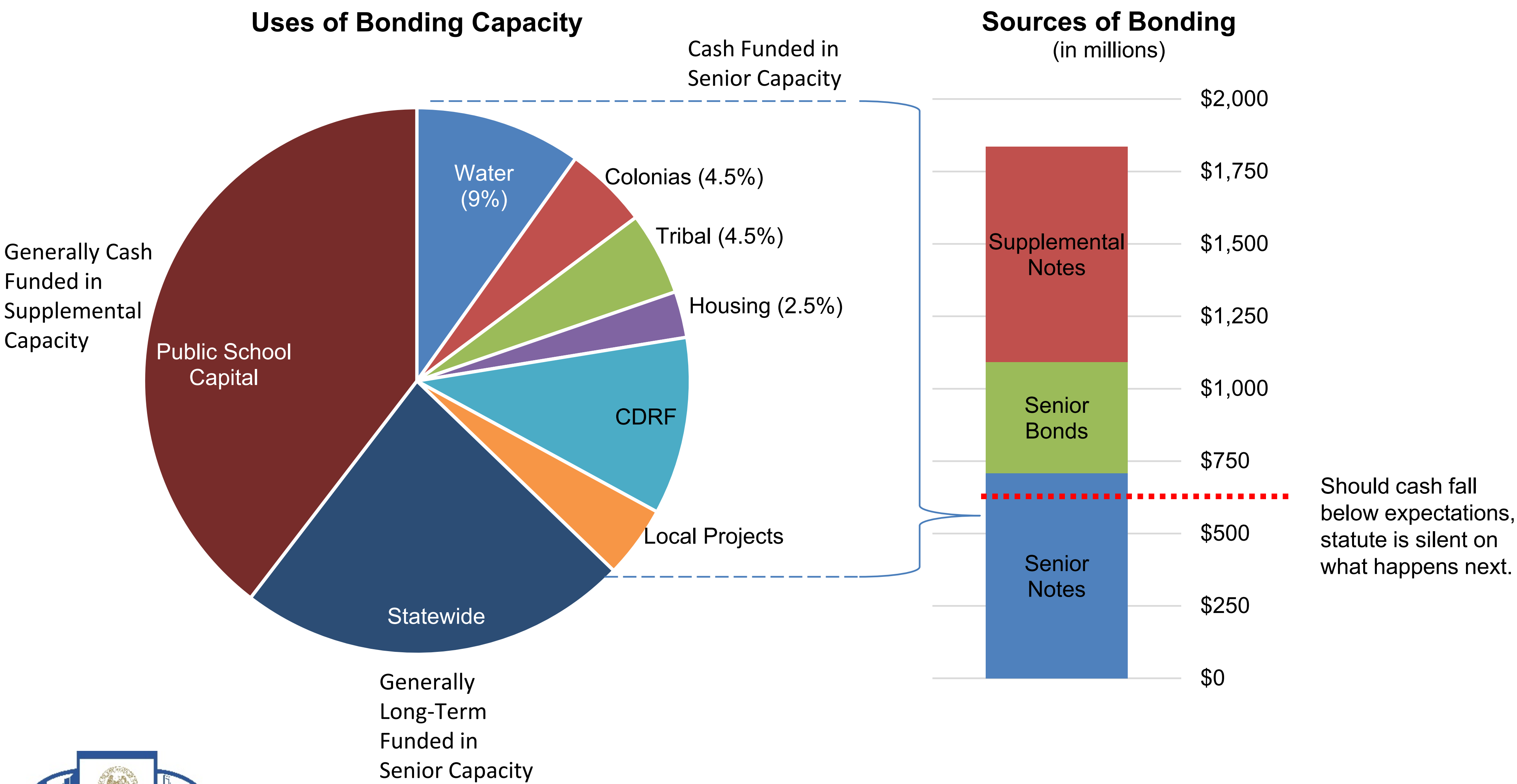
Rystad Energy – New Mexico Long-Term Oil Production Outlook



Estimated Capital Development Funds available for Appropriation

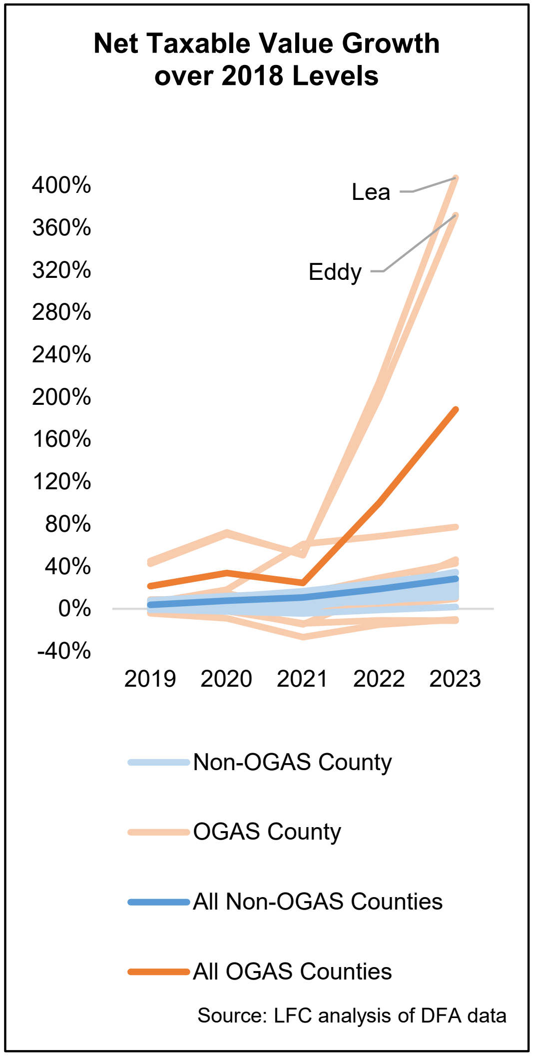
Source: LFC Files

Despite being set as a share of total capacity, most of the spending occurs in notes, only. What happens when there is insufficient cash to cover those commitments?



Property taxes, which fund the state general obligation bond program, are becoming more dependent on oil and gas revenue.

- Oil and gas properties comprised 37 percent of taxable property values in 2023, up from an average share of 8 to 14 percent prior to 2021.
- Property taxes primarily benefit local governments. About 5 percent of property taxes fund the state general obligation bond program.
- FY23 Ad Valorem Taxes (est.) = $997 million
  - $941 to local governments
  - $56 million to statewide GO bonds



QUESTIONS?

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Overview of STB Program: Key Differences Between Notes and Bonds

- Notes are sold to the State Treasurer's Office to "sponge" up extra cash in the Severance Tax Bonding Fund before balances are transferred to the Severance Tax Permanent Fund.
- Taxable projects, as determined through the review process, are typically included in the Notes, allowing for projects that may conflict with IRS requirements for tax-exempt issuances.
- Earmark Projects (Water Trust Board, Colonias Infrastructure Board, and Tribal Infrastructure Board) are typically included in the June Senior Severance Tax Note.
  - Receive a statutorily mandated percentage of the Senior Severance Tax Bonding Capacity (9.0% for WTB and 4.5% for each of CIB and TIB).
- Bond ratings are received for any long-term debt issued. Ratings are received from Moody's and Standard & Poors.
  - Senior STBs have a senior or first priority lien in the event of default. As a result, Supplemental STBs are rated one notch lower than Senior STBs.

Sources and Uses of Bonding Capacity Available for Authorization and Severance Tax Permanent Fund Transfer (in millions) December 2025

Sources of Funds	FY26	FY27	FY28	FY29	FY30	5-Year
General Obligation Bonds	**$380.3**		**$380.3**		**$380.3**	**$1,140.9**
Senior STBs	**$1,116.9**	**$1,115.6**	**$1,157.3**	**$1,203.2**	**$1,191.4**	**$5,784.4**
Severance Tax Bonds Issued[1]	$385.0	$385.0	$385.0	$385.0	$385.0	$1,925.0
Severance Tax Notes	$731.9	$730.6	$772.3	$818.2	$806.4	$3,859.4
Supplemental STBs	**$742.6**	**$760.8**	**$819.8**	**$882.7**	**$898.3**	**$4,104.2**
Supplemental Severance Tax Bonds	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Supplemental Severance Tax Notes	$742.6	$760.8	$819.8	$882.7	$898.3	$4,104.2
TOTAL Sources of STB Funds	**$1,859.5**	**$1,876.5**	**$1,977.0**	**$2,085.9**	**$2,089.7**	**$9,888.6**

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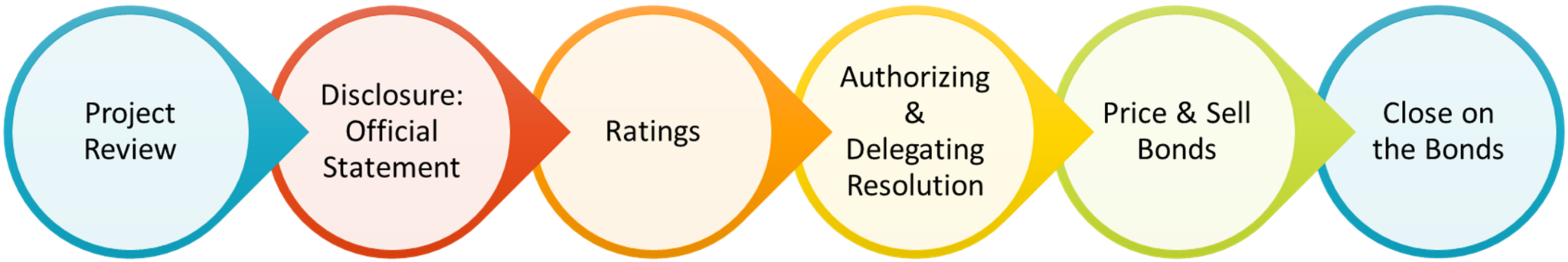
Senior Severance Tax Bonds	**$1,116.9**	**$1,876.5**	**$1,977.0**	**$2,085.9**	**$2,089.7**	**$9,146.0**
Authorized but Unissued STB Projects	$63.5	$0.0	$0.0	$0.0	$0.0	$63.5
Earmark Programs						
9.0% of Senior STB for Water Projects	$184.8	$184.7	$188.5	$192.6	$191.6	$942.2
4.5% of Senior STB for Colonias Projects	$92.4	$92.4	$94.2	$96.3	$95.8	$471.1
4.5% of Senior STB for Tribal Projects	$92.4	$92.4	$94.2	$96.3	$95.8	$471.1
2.5% Housing Trust Fund Projects	$51.3	$51.3	$52.4	$53.5	$53.2	$261.7
Capital Development Reserve & Program Funds[2]						
Capital Dev. & Reserve Fund Contribution	$197.1	$312.6	$428.2	$543.7	$659.2	$2,140.9
New Senior STB Statewide Capital Projects	$435.2	$382.2	$299.8	$220.7	$95.9	$1,433.8
PSCOC Public School Capital	**$742.6**	**$760.8**	**$819.8**	**$882.7**	**$898.3**	**$4,104.2**
TOTAL STB Uses of Funds	**$1,859.5**	**$1,876.5**	**$1,977.0**	**$2,085.9**	**$2,089.7**	**$9,888.6**

Estimated Transfer to Severance Tax Permanent Fund & Capital Development Program Fund Disbursement

	FY26	FY27	FY28	FY29	FY30	5-Year
Severance Tax Permanent Fund Transfer	**$681.9**	**$643.2**	**$787.9**	**$755.0**	**$874.4**	**$3,742.4**
Capital Dev. Program Fund Disbursement	**$26.5**	**$30.9**	**$41.8**	**$58.4**	**$81.4**	**$239.1**

STB Sources and Uses

The STB Sale Process: Timeline



- The bond sale process is very involved and typically takes around 3 months in total.
- Participants in the process are broad and include several departments, bond counsel, tax counsel, disclosure counsel, Board of Finance counsel, and the State's financial adviser.
- Bond recipients have to certify "readiness" to proceed including compliance with anti-donation, a proper fiscal agent, and ability to spend within 3-years.
    - Board of Finance's ability for due diligence is limited, especially in "readiness" for projects beyond this limited scope.

The Bond Sale Process

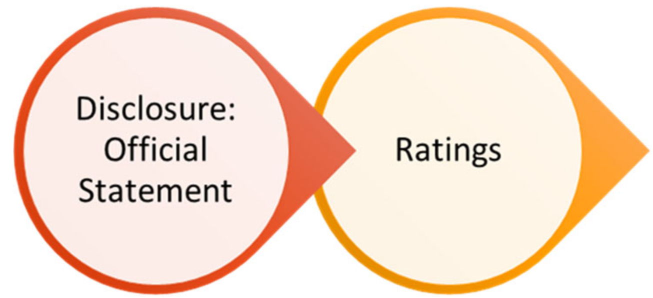
Project Review

Project Review: The Questionnaire Process

- BOF staff and legal counsel send project questionnaires to the local entities that will be receiving proceeds.
- BOF staff and legal counsel review all projects to identify if any do not meet requirements of state and federal law (tax issues, anti-donation issues, project readiness).
- Projects that are determined to comply with state and federal law and are "ready" to be included in the issuance will be included in the sale.

- What typically causes a delay in disbursing project funds?
  - Recipient will not be able to encumber 5 percent of the funds within 6 months of bond issuance or expend 85 percent of the funds within 3 years of bond issuance (tax-exempt requirement).
  - Funding is not sufficient to complete the project or a well-defined phase of the project.
  - The project has Constitutional anti-donation issues.
  - Project will be operated by a private or non-profit entity but fair market rent or services in lieu of cash rent has not been established through a lease.
  - The public body receiving the appropriation does not own the site.

The Bond Sale Process



- Drafting of Preliminary & Official Statement
  - Requirements for disclosure are outlined by the Federal Securities and Exchange Commission
  - Extremely important document used to “disclose” any “material” matter related to the state that a reasonable bondholder might consider to impact his/her/its purchase of the bonds.
  - The general financial well-being of the state: financial problems, lawsuits, unfunded liabilities, statutory changes (i.e., is there anything that could negatively impact the state’s ability to meet its debt obligation?)
  - Gets published prior to the sales as an informational document to potential bond buyers.

- Ratings
  - Several DFA divisions participate in presenting to the ratings agencies on the state’s economy, budget, fiscal health, and new initiatives.
  - Ratings will impact the interest rate at which the bonds are sold.

The Bond Sale Process

- Board of Finance adopts an authorizing and delegating resolution approving the sale of the bonds.
- The final project list is produced, following completion of the questionnaire process.
- Bonds are priced and sold in a competitive bid process
  - The offeror providing the lowest interest rate will be awarded the sale.
  - Typically anywhere from five to seven offerors

- Agencies provide certifications for proceeds
  - Agencies must certify that at least 5 percent of proceeds will be expended or encumbered within 6 months and 85 percent will be expended within 3 years.
  - Agencies request and instruct the Board to issue and sell the bonds.
  - Agencies certify all conditions, contingencies, and limitations imposed by the act have been satisfied.

Bond Ratings

Higher bond ratings result in a lower cost of issuance to the state as interest rates offered by competitive bidders is lower.

- "Positives" for the ratings agencies:
  - Declining debt service and rapid debt amortization (10-year maturity)
  - Strong existing and statutory debt service coverage and continued conservative debt practices for leveraging volatile revenues (conservative issuance of debt)
  - 25%+ reserves
  - Strong economic fundamentals (strong budgeting practices and debt management, even in economic hardship or challenges)
- Focus areas for potential future upgrades:
  - Economic diversity for less concentration in energy and government employment.
  - Reductions in direct and indirect pension liabilities (although recent legislative action related to PERA and ERB has been viewed as positive steps by ratings agencies)
  - Better vetting of bonded projects and consistent bond program size.