September 2, 2011

ISSUES FOR HEARING
Severance Tax Bond Capacity
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SUMMARY:

The State Board of Finance (BOF) and LFC staffs have updated FY12 Severance Tax Bond (STB) capacity estimates to reflect July 2011 consensus revenue estimates.

- Senate Bill 218, which would have approved $237.8 million in capital projects, failed to pass the 2011 legislative session. As a result, $57.7 million that was set aside for senior sponge was made available for supplemental sponge, bringing the total issuance for public school capital outlay in FY11 to $206.1 million.
- BOF and LFC estimate Senior Long-Term capacity of $192.3 million in FY12. As in previous years, this amount was calculated to ensure that – given current revenue assumptions – the same amount can be issued in each of the next 10 fiscal years.
- Given this amount of long-term capacity, the Senior Sponge capacity would be $73.7 million and the Supplemental Sponge capacity will be $147.7 million for FY12.
- After subtracting capacity earmarked for the water project fund, the tribal infrastructure fund, and the colonias infrastructure project fund, estimated net senior bond capacity is $212.7 million, and supplemental bond capacity is $147.7 million, for a total of $360.4 million.

FY12 Severance Tax Bond Capacity

Consensus Estimate	**FY11**	**FY12**	**FY13**
Senior Long-Term Issuance	$0.0	$192.3	$192.3
Senior Sponge Issuance	$27.3	$73.7	$91.7
Senior STB Capacity	**$27.3**	**$265.9**	**$284.0**
Authorized Unissued	($0.8)	$0.0	$0.0
Water Project Fund	($26.5)	($26.6)	($28.4)
Tribal Infrastructure Fund		($13.3)	($14.2)
Colonias Infrastructure Project Fund		($13.3)	($14.2)
Net Senior STB Capacity	**$0.0**	**$212.7**	**$227.2**
Supplemental Long-Term Issuance	$0.0	$0.0	$0.0
Supplemental Sponge Issuance	$206.1	$147.7	$173.7
Supplemental STB Capacity	**$206.1**	**$147.7**	**$173.7**
Total STB Capacity	**$206.1**	**$360.4**	**$400.8**

Senior Capacity

- Senior long-term capacity is determined as the amount that can be issued each year for 10 years, assuming the total debt service in each year does not exceed 50% of severance tax revenue. The typical maturity is 10 years to correspond to the expected life of the capital project. Senior severance tax bonds are tax-exempt, which means the cost of borrowing is lower than that of taxable bonds.
- Short-term senior capacity for sponge notes is calculated as 50% of deposits to the severance tax bonding fund (or previous year's severance tax revenue) less senior debt service due in that fiscal year. The bonds are sold to the state treasurer, and repaid within a short period, usually one to two days. Sponge notes are essentially a means to access earmarked revenues. They are taxable, but because they are short-term, the interest costs are immaterial.

Supplemental Capacity

- Supplemental bonds are earmarked for public school capital outlay, which is administered by the Public School Facilities Authority.
- Long-term supplemental capacity is calculated as 62.5% of deposits to the severance tax bonding fund less senior and supplemental debt service due in that fiscal year. After 50% set aside for senior sponge notes, the amount remaining for supplemental long-term bonds is 12.5%. These are not usually issued, unless sponge capacity falls below a certain level.
- Short-term supplemental capacity is calculated as 95% of deposits to the severance tax bonding fund less senior and supplemental debt service due in that fiscal year. After 50% set aside for senior sponge notes, the amount remaining for supplemental sponge is 45%. Supplemental sponge notes typically have a maturity of one to two days, are taxable, and are sold to the state treasuer.

FY11 Capital Outlay

Senate Bill 218, which would have approved $237.8 million in capital projects, failed to pass the 2011 legislative session. As a result, $57.7 million that was set aside for senior sponge was made available for supplemental sponge, bringing the total issuance for public school capital outlay to $206.1 million. Sponge notes are short-term bonds, the proceeds of which provide additional revenues for capital projects.

The dedicated bond capacity for the NMFA water project fund, which is calculated as 10 percent of senior STB capacity as of January 15 of each year, does not require legislative approval of capital outlay. The amount issued to the water project fund in FY11 was $26.5 million in senior sponge notes. An additional $800 thousand in senior sponge issuance went towards completion of a game and fish department project authorized during the 2009 legislative session.

Approximately $7.6 million of unreserved fund balance was distributed to the Severance Tax Permanent Fund at the end of FY11.

The BOF and LFC used the following assumptions to calculate the FY12 STB capacity estimates.

- Severance tax revenue calculated using July 2011 Consensus Revenue estimates.
- Severance tax revenue estimates have increased in the short-term due to higher price and volume estimates for oil. Although, natural gas prices were decreased from the December 2010 estimate, the decline in revenue is more than offset by the strong oil forecast.
- Severance tax revenue is projected to decline in the out years.
- Senior long-term capacity has decreased from the December 2010 estimate due to the estimated decline in severance tax revenue in the out years. The failure to pass capital outlay legislation in the 2011 session has resulted in lower debt service, which minimizes the impact of decreased long-term revenue.
- The interest rate was lowered to 2.75% to suit current market conditions and future expectations.
- Level debt issuance.

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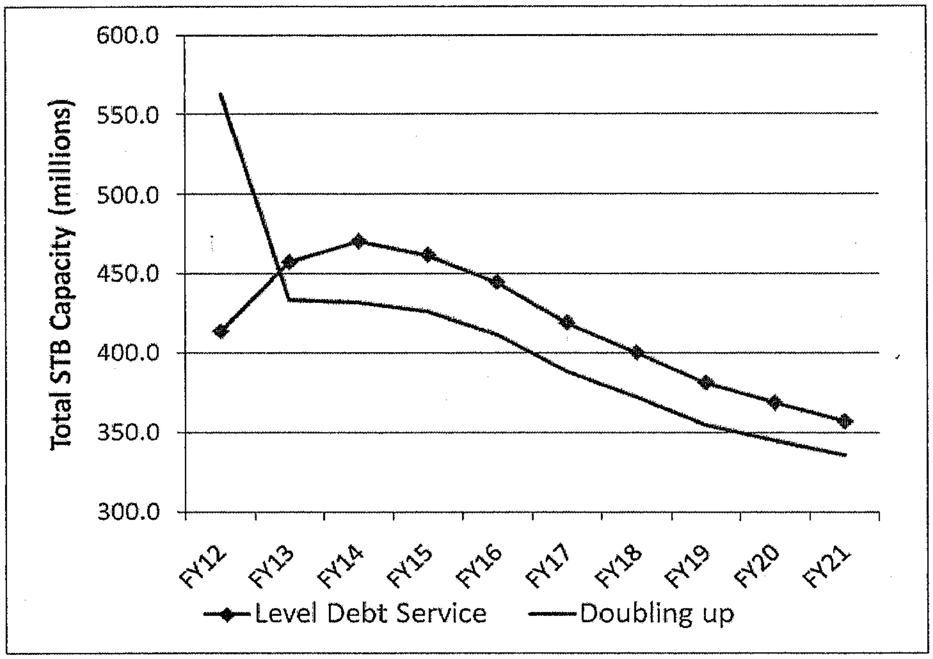
Alternative Capacity Scenario

An alternative to level debt service would be to double up the issuance in FY12, and to level debt service in FY13 and thereafter. "Doubling up" would decrease bond capacity in later years. The figure below provides a comparison of the available capacity under each scenario.



General Obligation Bond Capacity

The BOF and LFC staff have estimated general obligation (GO) bond capacity to be $303 million in FY12. A higher education official expressed interest in setting a lower capacity to avoid a potential increase from the current mill levy that might jeopardize voter approval.

The BOF has set a mill levy of 1.36 for property tax year 2011 (beginning September 1), down from 1.53 last year. The mill levy is set at a rate to generate sufficient revenue to cover debt service on outstanding general obligation bonds. An increase in net taxable property values of 2.1 percent has offset the need to increase the mill levy. Although, residential values rose by a modest 0.7 percent and nonresidential values fell by 2.7 percent, oil and gas values increased by 28.8 percent, reflecting higher prices for those commodities in recent months.