Severance Tax Distribution Changes - Effects on Public School Capital Outlay Programs and the Statewide Facilities Condition Index

Presented to:

Public School Capital Outlay Oversight Task Force

October 27, 2014

By:

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School facilities are important and school construction creates thousands of jobs. Over the next 18 months, the PSCOC is projected to award $404 million in State matching funds for school construction. These projects, already in motion, will create approximately 3,900 on-site construction jobs, 1,850 indirect jobs from supplying construction materials and services and 5,775 induced jobs in the New Mexico economy (See Appendix B).

The Public School Capital Outlay Oversight Task Force at their meeting on September 3, 2014 requested the staff of the Public School Facilities Authority (PSFA) present fiscal impact analysis of scenarios that gradually restore severance tax distributions to the Severance Tax Permanent Fund (STPF). The STPF, managed by the State Investment Council (SIC) invests the state permanent funds and annually distributes funds to the state general fund for the benefit of the state. [1] Four scenarios presented in this analysis gradually reduce funding for Public School Capital Outlay (PSCO) and increase distributions to the Severance Tax Permanent Fund (STPF).

[1] SIC Report 09/03/14 to the PSCOOTF. Severance Tax Permanent Fund, Assets under management at FY09: Approximately $3.1 billion. At FY14: Approximately 4.6 billion - a 48% increase. The STPF fund "high water mark" in FY07 prior to the "great recession" was $4.7 billion.

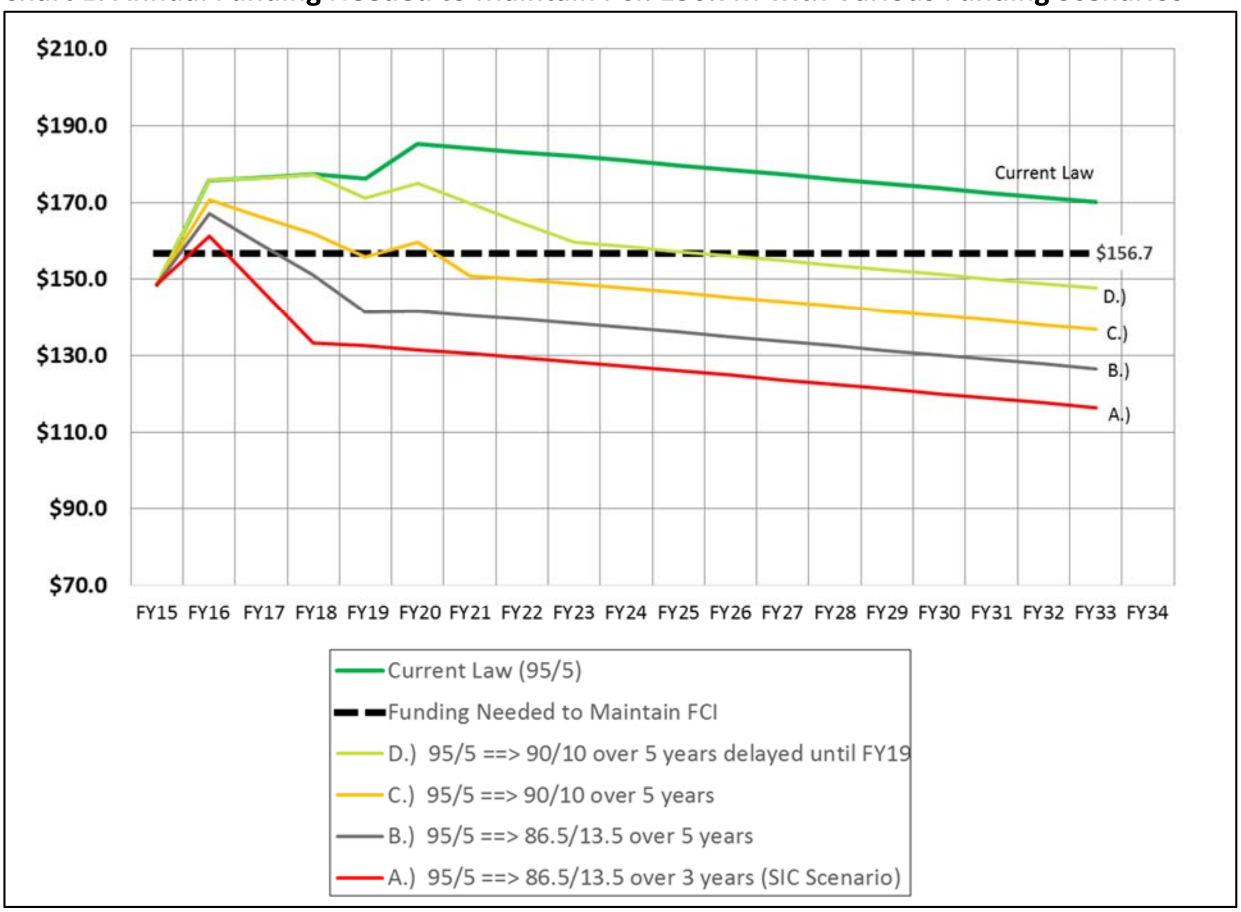
SCENARIOS:

A. 95/5 ==> 86.5/13.5 over 3 years FY16-FY18 (hereinafter referred to as the "SIC Scenario")
B. 95/5 ==> 86.5/13.5 over 5 years beginning in FY16
C. 95/5 ==> 90/10 over 5 years beginning in FY16
D. 95/5 ==> 90/10 over 5 years beginning in FY19

Scenarios (A-D) gradually increase revenue distributions to the severance tax permanent fund. This impacts funds available for school improvements and changes to the trajectory of improvement of school facilities statewide, measured by the statewide Facility Condition Index, (FCI).

A statewide school FCI target (and funding level to maintain it is a strategic question just as is the level of allocations to the Severance Tax Permanent Fund or for other uses. This analysis presents projected fiscal impacts as well as the impact the revenue shift has on the school Facility Conditions Index (FCI) statewide.

Chart 1. Annual Funding Needed to Maintain FCI: 156.7M with Various Funding Scenarios



FISCAL IMPACTS

Table 1A: Scenario A.) The "SIC Scenario" 95/5 ==> 86.5/13.5 over 3 years FY16-FY18

Estimated Revenue (dollars in thousands)					Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18	FY19	FY20 & out years		
14,368.0	28,973.0	43,784.0	43,784.0	43,784.0	Recurring	Severance Tax Permanent Fund
(14,368.0)	(28,973.0)	(43,784.0)	(43,784.0)	(43,784.0)	Recurring	Public School Capital Outlay Fund

Table 1B: Scenario B.) 95/5 ==> 86.5/13.5 over 5 years beginning in FY16

Estimated Revenue (dollars in thousands)					Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18	FY19	FY20		
8,621.0	17,385.0	26,271.0	35,028.0	43,784.0	Recurring	Severance Tax Permanent Fund
(8,621.0)	(17,385.0)	(26,271.0)	(35,028.0)	(43,784.0)	Recurring	Public School Capital Outlay Fund

Table 1C: Scenario C.) 95/5 ==> 90/10 over 5 years beginning in FY16

Estimated Revenue (dollars in thousands)					Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18	FY19	FY20		
5,071.0	10,227.0	15,453.0	20,604.0	25,756.0	Recurring	Severance Tax Permanent Fund
(5,071.0)	(10,227.0)	(15,453.0)	(20,604.0)	(25,756.0)	Recurring	Public School Capital Outlay Fund

Table 1D: Scenario D.) 95/5 ==> 90/10 over 5 years beginning in FY19 (11.1% decrease in PSCO revenue over 5 years – delayed until FY19)

Estimated Revenue (dollars in thousands)					Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18	FY19	FY20		
0.0	0.0	0.0	5,151.0	10,302.0	Recurring	Severance Tax Permanent Fund
0.0	0.0	0.0	(5,151.0)	(10,302.0)	Recurring	Public School Capital Outlay Fund

Chart 2. Impacts on the School Facility Conditions Index (FCI) Statewide.

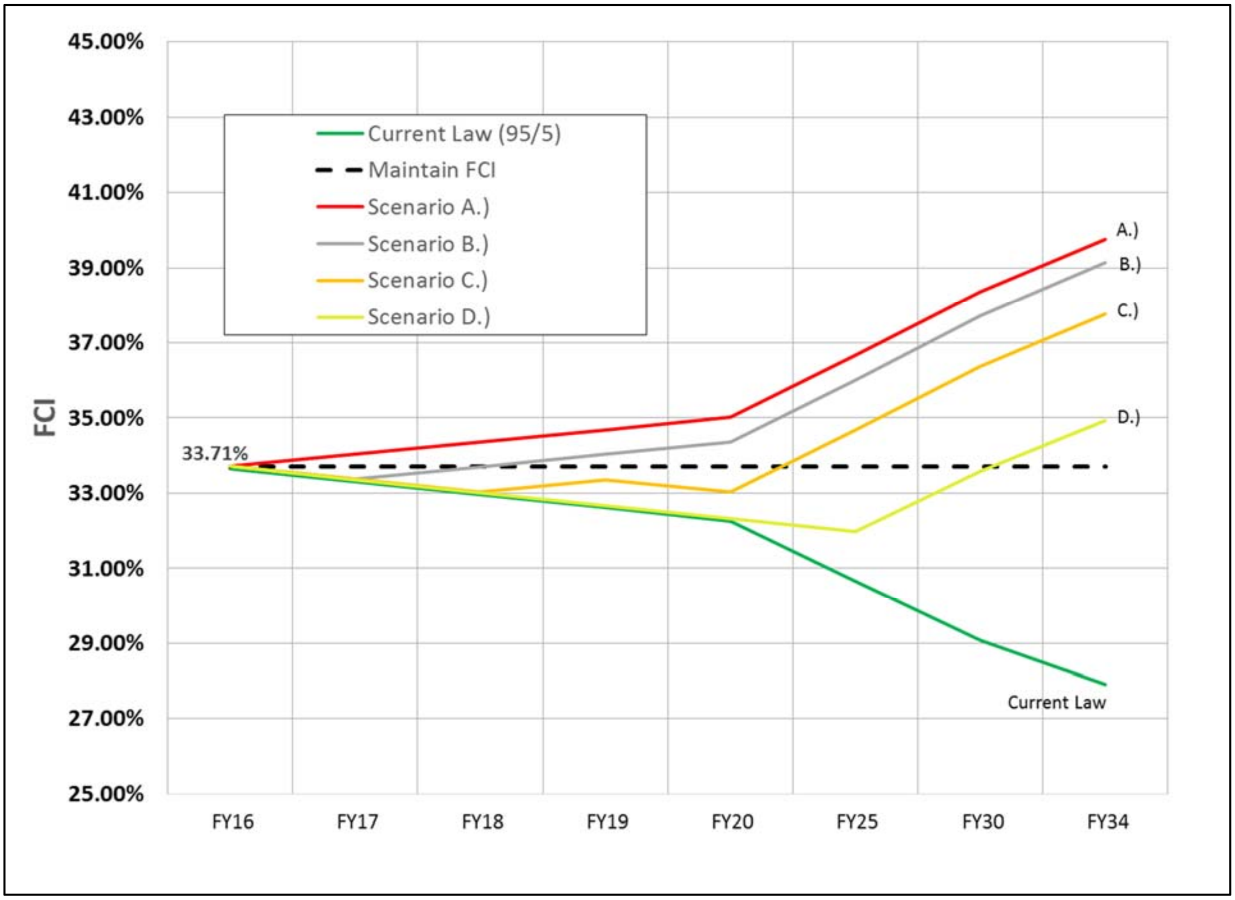


Table 2A: FCI Impacts of Scenario A.) The "SIC Scenario" 95/5 ==> 86.5/13.5 over 3 years FY16-FY18

	FY16	FY17	FY18	FY19	FY20	FY25	FY30	FY34
FCI Current Funding	*33.71%*	*33.36%*	*33.01%*	*32.66%*	*32.32%*	*30.64%*	*29.08%*	*27.90%*
FCI Scenario A.	*33.72%*	*34.05%*	*34.37%*	*34.69%*	*35.01%*	*36.66%*	*38.36%*	*39.75%*
Change	*-0.01%*	*-0.69%*	*-1.36%*	*-2.02%*	*-2.70%*	*-6.02%*	*-9.28%*	*-11.85%*

Table 2B: FCI Impacts of Scenario B.) 95/5 ==> 86.5/13.5 over 5 years beginning in FY16

	FY16	FY17	FY18	FY19	FY20	FY25	FY30	FY34
FCI Current Funding	*33.71%*	*33.36%*	*33.01%*	*32.66%*	*32.32%*	*30.64%*	*29.08%*	*27.90%*
FCI Scenario B.	*33.72%*	*33.38%*	*33.71%*	*34.03%*	*34.35%*	*36.02%*	*37.73%*	*39.14%*
Change	*-0.01%*	*-0.02%*	*-0.70%*	*-1.36%*	*-2.04%*	*-5.37%*	*-8.65%*	*-11.24%*

Table 2C: FCI Impacts of Scenario C.) 95/5 ==> 90/10 over 5 years beginning in FY16

	FY16	FY17	FY18	FY19	FY20	FY25	FY30	FY34
FCI Current Funding	*33.71%*	*33.36%*	*33.01%*	*32.66%*	*32.32%*	*30.64%*	*29.08%*	*27.90%*
FCI Scenario C.	*33.71%*	*33.37%*	*33.03%*	*33.36%*	*33.03%*	*34.67%*	*36.37%*	*37.76%*
Change	*0.00%*	*-0.01%*	*-0.03%*	*-0.70%*	*-0.71%*	*-4.02%*	*-7.29%*	*-9.86%*

Table 2D: FCI Impacts of Scenario D.) 95/5 ==> 90/10 over 5 years beginning in FY19 (11.1% decrease in PSCO revenue over 5 years – delayed until FY19)

	FY16	FY17	FY18	FY19	FY20	FY25	FY30	FY34
FCI Current Funding	*33.71%*	*33.36%*	*33.01%*	*32.66%*	*32.32%*	*30.64%*	*29.08%*	*27.90%*
FCI Scenario D.	*33.71%*	*33.36%*	*33.01%*	*32.67%*	*32.33%*	*31.98%*	*33.59%*	*34.92%*
Change	*0.00%*	*0.00%*	*0.00%*	*0.00%*	*-0.01%*	*-1.34%*	*-4.51%*	*-7.02%*

SIGNIFICANT ISSUES

The priority uses of SSTB proceeds in the PSCOC Financial Plan are:

1. Capital Improvements Act Distributions (SB-9);
2. Lease Assistance Awards;
3. School District Master Plan Assistance Awards;
4. Transfers to Construction Industries Division for priority school inspections
5. The PSFA Operating Budget;
6. Standards-based Project Awards and
7. "Other" [2]

Due to the prioritization of uses, all impacts on changes in funding affect the school construction program while the funding levels of the other programs are not affected.

[2] Other uses include appropriations in Capital Outlay Bills SB60 & HB 55 for NMSD, NMSBVI, Pre-kindergarten classroom construction & school bus replacement.

Table 3: School Capital Outlay Impacts of the "SIC Scenario" (millions)

SOURCES:	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
SSTB Capacity Estimate	$228.2	$230.1	$231.8	$231.8	$231.8

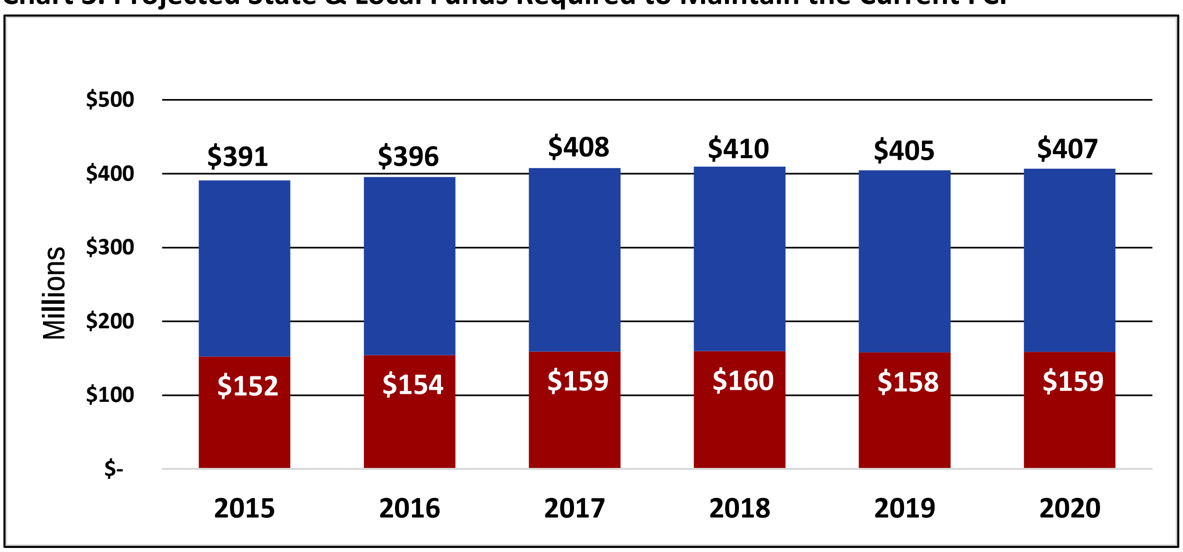
USES:	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
Capital Improvements Act (SB-9)	20.2	20.4	20.4	20.4	20.4
Lease Assistance	15.3	16.1	16.9	17.7	18.6
Master Plan Assistance	0.4	0.4	0.4	0.4	0.4
PSFA Operating Budget	6.5	6.8	6.8	6.8	6.8
Transfers to CID	0.25	0.25	0.25	0.25	0.25
Broadband Deficiencies Correction	10.00	10.00	10.00	10.00	0.00
PSCOC Projects	161.2	147.2	133.3	132.4	141.5
STPF Transfers	14.4	29.0	43.8	43.8	43.8
TOTAL:	**$228.2**	**$230.1**	**$231.8**	**$231.8**	**$231.8**

School Capital Outlay Impacts	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
School Construction Projects (current level)	175.5	176.2	177.1	176.2	185.3
School Construction Projects (SIC Scenario)	161.2	147.2	133.3	132.4	141.5
Increase/(Decrease):	($14.4)	($29.0)	($43.8)	($43.8)	($43.8)
Percent change:	*-8.2%*	*-16.4%*	*-24.7%*	*-24.8%*	*-23.6%*

Projected State & Local Funds Required to Maintain the Current FCI

PSFA's estimates that to maintain the current FCI statewide, an average of $404 million annually would need to be invested in school facilities. State funding currently represents approximately 39% of statewide school construction funding (See Appendix A). Based upon this metric, funds from state sources (PSCOC standards-based projects) require an average of $156.7 million per annum.

Chart 3. Projected State & Local Funds Required to Maintain the Current FCI



(Assumes State (PSCOC) Funds 39%; School District Funds 61%)[2]

At lower funding levels, degradation exceeds renovation/repair and facilities start to decline.

The Investment in Schools FY04 – FY14

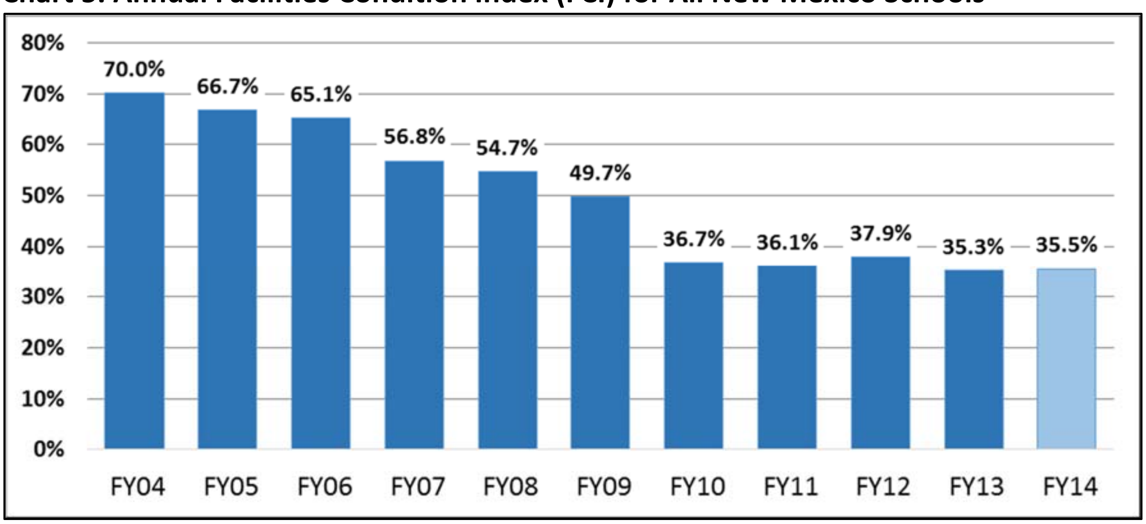
Between 1982 and 1999, the state bonding program operated so that 50% of the severance taxes were used for statewide capital projects and the other 50% deposited into the Severance Tax Permanent Fund (STPF).

In 1998, the Zuni school district brought a capital funding/facilities suit against the state, Zuni School District v. State, CV-98-14-II (Dist. Ct., McKinley County Oct. 14, 1999), claiming that the funding system for capital items was unconstitutional. The trial court granted partial summary judgment in favor of the plaintiffs and ordered the state to "establish and implement a uniform funding system for capital improvements". In response, the Legislature amended the Severance Tax Bonding Act to create a new category of bonds to be funded by severance taxes termed "Supplemental Severance Tax Bonds (SSTB's).

Since 2004, all but 5% of the balance of the deposits in the Bonding Fund is used for issuing supplemental severance tax bonds for public school capital outlay and senior bonds for statewide projects.[3]

As a result of this significant investment, the New Mexico Average Facilities Condition Index (FCI) for school buildings has fallen from 70.0% to 35.5% from FY03 to FY14. But as Chart 4. Shows, progress in lowering the FCI further has "leveled out" since 2010.

Chart 5. Annual Facilities Condition Index (FCI) for All New Mexico Schools



School facilities are important and school construction creates thousands of jobs. Over the next 18 months the PSCOC is projected to award $404 million in State matching funds for school construction. These

[3] The legislature has increased the limit to issue supplemental sponge notes several times: 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).

projects, already in motion, will create approximately 3,900 on-site construction jobs, 1,850 indirect jobs from supplying construction materials and services and 5,775 induced jobs in the New Mexico economy.

APPENDIX A.

State of New Mexico
Public School Facilities Authority

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Tim Berry, Deputy Director

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MEMORANDUM

January 18, 2013

To: Robert Gorrell, Director
Tim Berry, Deputy Director

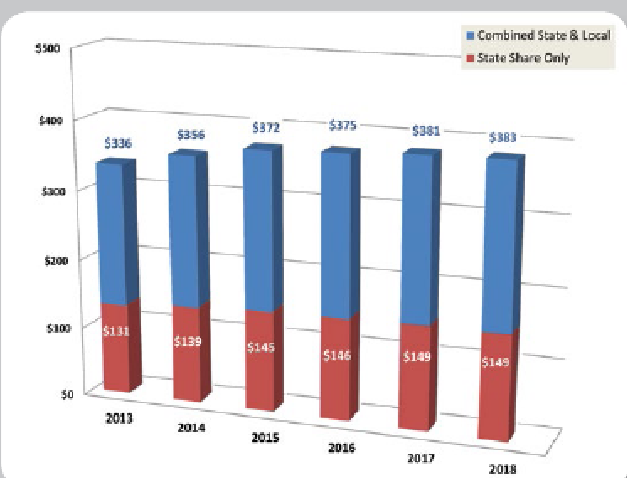
From: Jeffrey Eaton, Chief Financial Officer

Subject: Differences in PSFA and PED School Capital Outlay Reporting

The following is a summary review made at your request to outline the differences in reporting between the PSFA and the PED as it concerns public school capital outlay expenditures. The differences were identified and further explanation was raised by PSCOC member and DFA Cabinet Secretary, Tom Clifford.

In the draft 2012 PSCOC Annual Report, it is reported that over the next five years, an average of $367 million annually would need to be invested in school facilities (all funding sources, state & local):

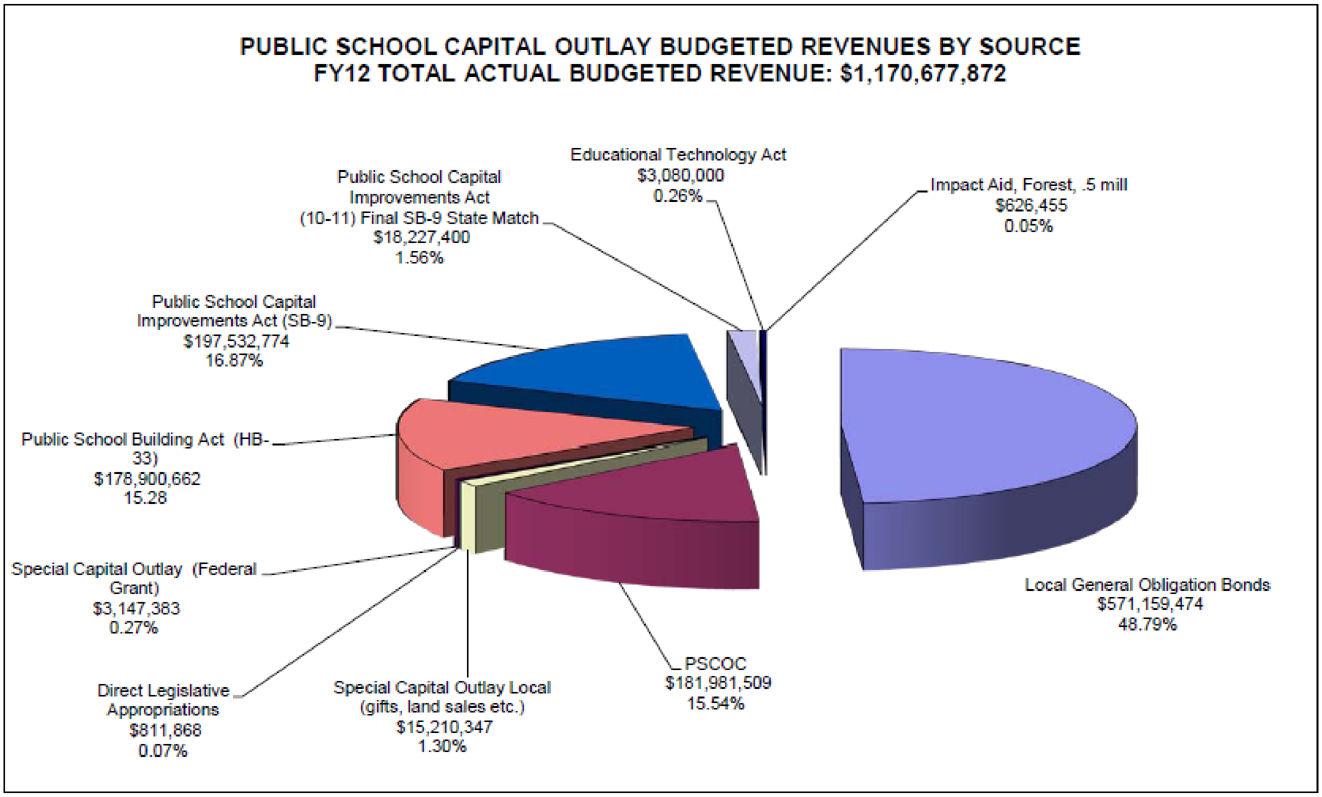
Funds Required to Maintain the Current FCI



To maintain the current FCI over the next six years, an average of $367 million annually would need to be invested in school facilities—state funding currently represents 39% of school construction, so funds from the state share needs require an average of $143 million per annum over the next six years. At lower funding levels, degradation exceeds renovation/repair and facilities start to decline. District share depending mainly on bonding capacity, among other factors.

Partnering with New Mexico's communities to provide quality, sustainable school facilities for our students and educators

By contrast, in the PED Capital Outlay Bureau 2012 Reference Data Report, it is reported that FY12 Total Actual Budgeted Revenue is $1.17 billion dollars:



The differences between the two reported figures are:

The PSFAs figure is an average of estimated annual expenditures
The PEDs figure is an actual budget figure.

Capital budgets typically are multi-year budgets that extend across fiscal years. Antonio Ortiz of PED confirmed that their budget figure is an aggregate of school districts budgeted amounts of which annually only a portion is expended. School districts budget proceeds from the sale of bonds approved by a bond election. School districts generally budget all of the proceeds in a fiscal year (as reported in the fiscal year report graph above). But, the proceeds are expended over the course of many months - crossing fiscal years. Unexpended balances from the original sale are “re-budgeted” in subsequent fiscal years until fully expended.

To test to see if a comparison can be made, we have to estimate annual expenditures from the reported “budget” figure as data from PED is not available at the time of this analysis.

The upper limit on the imposition of a 10 mill levy is six years (22-26-3 NMSA). The midpoint of three (3) years is estimated to be the average maturity of all outstanding and budgeted bonds in FY12. Assuming that all budgeted proceeds are expended on public school capital outlay, and assuming that all expenditures are made during the estimated period of taxation (3 years), we can calculate the estimated annual expenditure as: $1,170,677,872/3 years = $390 million.

By way of comparison, PSFA’s estimate to maintain the FCI is $367 million. Because the PED report above includes sources like Public Improvements Act and Educational Technology that can be expended on non-capital related expenditures, it appears that PSFAs expenditure figure is comparable to estimated expenditures derived from PED’s budgeted revenues figure.

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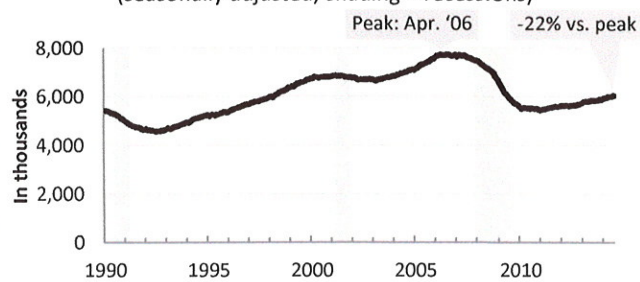
The Economic Impact of Construction in the United States and New Mexico

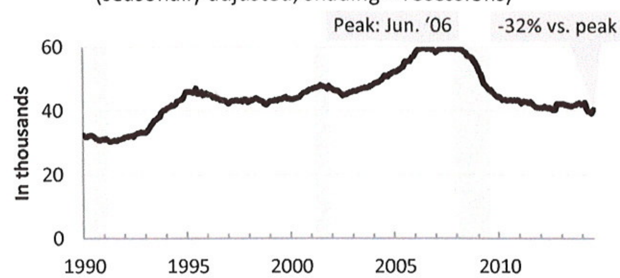
Economic Impact of Investment in Nonresidential Construction:

- An additional $1 billion invested in nonresidential construction would add $3.4 billion to Gross Domestic Product (GDP), $1.1 billion to personal earnings and create or sustain 28,500 jobs.
  - About one-third (9,700) of these jobs would be on-site construction jobs.
  - About one-sixth (4,600) of the jobs would be indirect jobs from supplying construction materials and services. Most jobs would be in-state, depending on the project and the mix of in-state suppliers.
  - About half (14,300) of the jobs would be induced jobs created when the construction and supplier workers and owners spend their additional incomes. These jobs would be a mix of in-state and out-of-state jobs. Conversely, investments elsewhere would support some indirect and induced jobs in the state.

U.S Construction Employment, 1/90-7/14
(seasonally adjusted; shading = recessions)



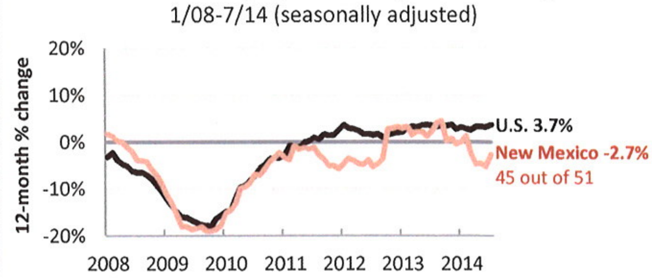
New Mexico Construction Employment, 1/90-7/14
(seasonally adjusted; shading = recessions)



Nonresidential Construction Spending:

- Nonresidential spending in the U.S. in 2013 totaled $569 billion ($305 billion private, $264 billion public).
- Private nonresidential spending in New Mexico totaled $2.5 billion in 2012 and $2.2 billion in 2013. (Public spending is not available by state.)
- Nonresidential starts in New Mexico totaled $1.3 billion in 2013, according to Reed Construction Data.

Construction Employment Change from Year Ago
1/08-7/14 (seasonally adjusted)



Construction Employment (Seasonally Adjusted):

- Construction (residential + nonresidential) employed 6.0 million workers in July 2014, an increase of 218,000 (3.7%) from July 2013 and a decrease of 1.7 million (22%) from April 2006, when U.S. construction employment peaked.
- Construction employment in New Mexico in July totaled 40,400, a decrease of 2.7% from July 2013 and a decrease of 32% from the state's peak in June 2006.

Empl. Change by Metro (not seasonally adjusted)		Rank
Metro area or division	7/13-7/14	(out of 339)
Statewide* (Const/mining/logging)	2%	
Albuquerque*	-1%	269
Las Cruces*	0%	224
Santa Fe*	11%	32

*The Bureau of Labor Statistics reports employment for construction, mining and logging combined for most metro areas and some states in which mining and logging have few employers. To allow comparisons between states and their metros, the table shows combined employment change.

Construction Industry Pay:

- In 2013, annual pay of all construction workers in the United States averaged $53,200, 7% more than the average for all private sector employees.
- Construction workers' pay in New Mexico averaged $41,500, 5% more than all private sector employees in the state.

Small Business:

- The United States had 652,900 construction firms in 2012, of which 92% employed fewer than 20 workers.
- New Mexico had 4,400 construction firms in 2012, of which 90% were small (<20 employees).

Source: Ken Simonson, Chief Economist, AGC of America, simonsonk@agc.org, from Prof. Stephen Fuller, George Mason University (investment); Census Bureau (spending); Reed Construction Data (starts); Bureau of Labor Statistics (jobs, pay); Small Business Administration (small business)

September 18, 2014