Severance Tax Bonding Program and Severance Tax Permanent Fund

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Topics Covered

- History of Severance Taxes
- History of Severance Tax Bonding (STB) Program and Severance Tax Permanent Fund (Permanent Fund)
- Why are Permanent Fund Contributions so Volatile? Three Scenarios
- Contributions to the Permanent Fund
- Policy Considerations

History & Collections of Severance Taxes

- Severance taxes have been collected by New Mexico since 1937.
- NM imposes several different taxes on natural resource production:
  - School Tax: General Fund
  - Severance Tax: Severance Tax Bonding Fund
  - Ad Valorem Taxes: Local Governments
  - Conservation Tax: General Fund & Reclamation Fund
- In addition, the State receives royalty payments from production on State and federal lands.
  - The Land Grant Permanent Fund contributes about $450 million per year to the State general fund
  - Federal Mineral Leasing contributes about $500 million per year to the State general fund
  - The State makes diversified use of over $2 billion per year in revenues from oil and gas production. Roughly half of the revenue is used for operations, one quarter for capital projects, and one quarter for Permanent Funds.

History of Severance Tax Bonding Program

- Since 1959, certain severance tax receipts have been deposited into the Bonding Fund and used to service Severance Tax Bonds (STBs) to fund capital improvements.
- The modern STB program dates to 1973 along with the creation of the Permanent Fund, and the diversion of severance taxes into that fund. At that time, statute restricted capacity to issue new STBs such that debt service could be paid with 50% of prior fiscal year Bonding Fund revenue.
- In 1976 the Permanent Fund reached constitutional status.
- In 1982 a constitutional amendment removed the option to appropriate from the corpus of the Permanent Fund.

Supplemental Severance Tax Bonds

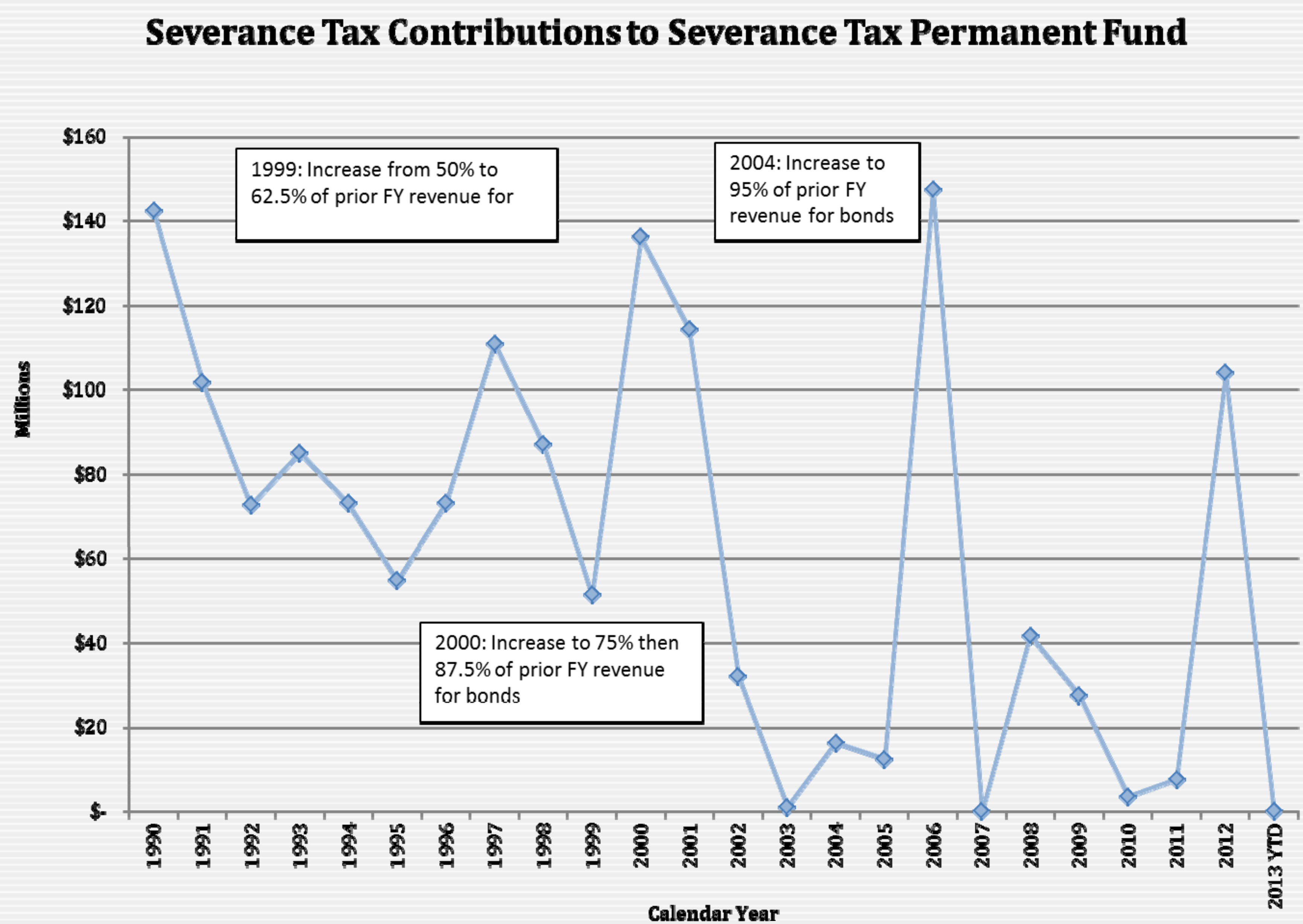
- Beginning in 1999, as a result of the Zuni lawsuit, a judge's order required the State to establish and implement a uniform system of funding future public school capital improvements, the STB program was expanded so that additional revenue could be used to pay debt service on Supplemental Severance Tax Bonds (SSTBs).

- SSTBs finance public school capital improvements. Currently 45% of prior fiscal year Bonding Fund revenue can be used for SSTBs (or potentially more if senior capacity were not fully utilized).

- Since 1999, SSTBs have provided $2.4 billion for public school construction statewide. These are funds that would have otherwise gone to the Permanent Fund.

Types of Severance Tax Bonds Issued

	Senior	Supplemental
Short Term "Sponge" Notes	Various Capital Projects (Legislative, Tribal, Colonias, Water) Taxable (Allows projects with Private Use and Non-Capital Purposes) Sold to State Treasurer each June and December 1-2 Day Notes ("Pay As You Go") Projects Authorized by Legislature	Public School Capital Projects Taxable Sold to State Treasurer each June and December 1-2 Day Notes ("Pay As You Go") Projects Certified by Public School Capital Outlay Council
Long Term Bonds	Various Capital Projects (Legislative) Tax-Exempt (Must exclude projects with Private Use and be for Capital Purposes) Sold Competitively (Typically each Spring) 10-Year Bonds Projects Authorized by Legislature	Public School Capital Projects Tax-Exempt Sold Competitively (Have Not Been Issued Since 2010) 10-Year Bonds Projects Certified by Public School Capital Outlay Council


Severance Tax Contributions to Severance Tax Permanent Fund
1999: Increase from 50% to 62.5% of prior FY revenue for
2004: Increase to 95% of prior FY revenue for bonds
2000: Increase to 75% then 87.5% of prior FY revenue for bonds
$160
$140
$120
$100
$80
$60
$40
$20
$-
Millions
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013 YTD
Calendar Year

Why are Contributions to the STPF So Volatile?

- STBF revenues are derived from the production of oil, natural gas, and other minerals. The value of these products is naturally volatile
- Hurricanes, pipeline constraints, geopolitical events, and supply and demand all contribute to revenue volatility
- *Statutory capacity*: Statute allows for bonds to be issued up to the point where debt service is 95 percent of the previous fiscal year's STBF revenue
- *Cash available*: The current fiscal year's revenue is the amount of cash available for debt service
- The amount of bonds issued is the *lesser* of *statutory capacity* or *cash available*
- The following pages illustrate three examples to make clear why Permanent Fund distributions are so volatile.

Scenario 1: Revenues Remain Stable

- STBF revenues total $200 Million in FY2000
- STBF revenues total $200 Million in FY2001
- *Statute* allows 95 percent of FY2000 revenue, or *$190 million* to be used for bond debt service in FY2001
- *Cash available* in FY2001 is *$200 million*
- *Statutory capacity* of $190 million < $200 million *cash available*
- $190 million is used for bond debt service in FY2001
- The remaining $10 million cash available transfers to the Permanent Fund

Scenario 2: Revenue Increase Results in Larger Permanent Fund Contributions

- STBF revenues total $200 Million in FY2000
- STBF revenues total $400 Million in FY2001
- *Statute* allows 95 percent of FY2000 revenue, or *$190 million* to be used for bond debt service in FY2001
- *Cash available* in FY2001 is *$400 million*
- *Statutory capacity* of $190 million < $400 million *cash available*
- $190 million is used for bond debt service in FY2001
- The remaining $210 million cash available transfers to the Permanent Fund
- This scenario explains large distributions to the Permanent Fund in FY06 following Hurricanes Katrina and Rita

Scenario 3: Revenues Decrease Results in Smaller Permanent Fund Contributions

- STBF revenues total $200 Million in FY2000
- STBF revenues total $100 Million in FY2001
- *Statute* allows 95 percent of FY2000 revenue, or *$190 million* to be used for bond debt service in FY2001
- *Cash available* in FY2001 is *$100 million*
- *Statutory capacity* of $190 million > $100 million *cash available*
- The entire $100 million cash available is used for bond debt service in FY2001
- Nothing transfers to the Permanent Fund
- This scenario explains why almost nothing was distributed to the Permanent Fund in FY13. FY12 STBF revenues were $480 million but FY13 revenues fell to $421 million as a result of lower oil and natural gas prices.

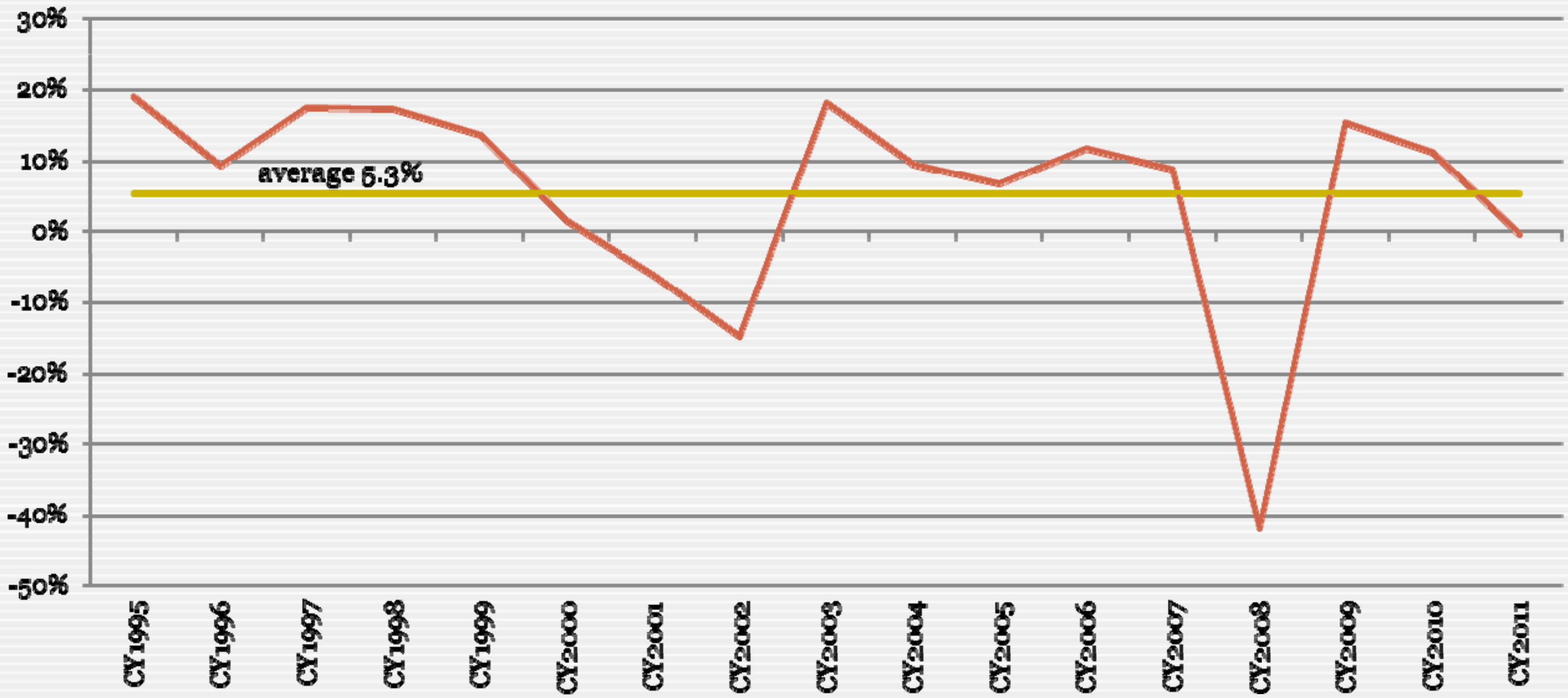
Policy Considerations

- The bonding programs and Permanent Fund contributions are both worthwhile competing uses for severance tax revenue. Both uses stimulate the New Mexico economy in their own way.
- STBs and SSTBs finance capital assets which will last for many years. In this sense, capital projects financed with STBs – like Permanent Fund contributions – are also an investment in the future of New Mexico.
- But the State must choose projects strategically to ensure the State's investment in capital assets yields lasting benefits.
- Capital projects stimulate the economy in the near term through construction activity and generation of gross receipts.
- The availability of productive capital assets increases the productivity of the state's economy.

Policy Considerations (continued)

- The Permanent Fund contributes to General Fund revenue, stimulating the economy through government spending over the long term. For every dollar the State wants to spend, Permanent Fund distributions to the general fund reduce the amount of taxes that must be collected.
- Permanent Fund contributions increase future General Fund revenue, approximately 45 percent of which goes to public education.
- Permanent funds generate distributions that currently finance 10.8% of General Fund recurring revenue. This is a large “down payment” on State government operations.
- Investing severance tax revenues in the Permanent Fund is not without risk (see chart on following page).
- From 1994 to present, after roughly adjusting for contributions and distributions, estimated annual return on the Permanent Fund has fluctuated from -29% to 22% with an average return over the period of 5.3%.

Permanent Fund Returns Adjusted for Contributions and Distributions



Policy Considerations (cont.)

- Other possible uses of severance tax revenues include:
  - lowering tax burdens on oil and gas producers;
  - lowering taxes on other businesses and NM households;
  - spending the funds in some other way.

- Some states with oil and gas revenue make a direct distribution to households from the proceeds.

- Each of these uses could also have positive effects on the New Mexico economy.

Questions?

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