MINUTES
of the
SECOND MEETING IN 2011
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

July 21-22, 2011
Room 322, State Capitol
Santa Fe

The second meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2011 was called to order by Senator Tim Eichenberg, chair, on Thursday, July 21, 2011, at 9:42 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Sen. Tim Eichenberg, Chair
Rep. Edward C. Sandoval, Vice Chair
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Anna M. Crook
Sen. Clinton D. Harden, Jr.
Sen. Timothy M. Keller (7/22)
Rep. Ben Lujan, Speaker of the House
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales (7/22)
Rep. Henry Kiki Saavedra
Sen. John Arthur Smith
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo
Rep. Bob Wooley (7/21)

Absent
Sen. Mark Boitano
Sen. Timothy Z. Jennings, Senate President Pro Tempore
Sen. Gay G. Kernan

Designees
Sen. Phil A. Griego

Sen. Rod Adair
Rep. Ray Begaye
Sen. William F. Burt
Rep. Zachary J. Cook
Sen. Kent L. Cravens
Rep. Brian F. Egolf, Jr.
Rep. Miguel P. Garcia
Rep. Thomas A. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Eric G. Griego
Rep. Sandra D. Jeff
Rep. Antonio Lujan
Rep. Antonio "Moe" Maestas

Sen. George K. Munoz
Sen. Steven P. Neville
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. Bernadette M. Sanchez
Sen. John M. Sapien
Sen. William E. Sharer
Rep. James R.J. Strickler
Rep. Don L. Tripp
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth

(Attendance dates are noted for members not present for the entire meeting.)

Staff
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Pam Stokes, Staff Attorney, LCS
Andrew Pierce, LCS

Guests
The guest list is in the meeting file.

Handouts
Handouts and other written testimony are in the meeting file.

Thursday, July 21

Severance Tax Overview
Tom Clifford, policy and research director, Taxation and Revenue Department (TRD), reviewed New Mexico's taxation system on oil and gas production. Oil and gas production has four principal monthly taxes, all of which use the same tax base for calculating the tax due. The oil and gas severance tax of 3.75 percent is imposed on the taxable value of oil, gas, liquid hydrocarbons and carbon dioxide and is distributed to the Severance Tax Bonding Fund (STBF). The oil and gas emergency school tax is imposed at the rate of 3.15 percent (4 percent on natural gas), and the tax is distributed to the general fund. The oil and gas conservation tax is imposed at the rate of either .19 percent or .24 percent, depending on the average price of West Texas crude, of the taxable value of the product being severed and is distributed to the general fund and the Oil and Gas Reclamation Fund. The oil and gas ad valorem production tax is essentially a monthly property tax imposed on 50 percent of the taxable value of the product being severed. The tax is distributed to property tax beneficiaries, including counties and school districts. In addition to the monthly taxes, oil and gas equipment is assessed annually by the oil and gas production equipment ad valorem tax, which is paid on the same schedule as property taxes; and the natural gas processors tax is levied on processors based on the value of products processed.

Severance taxes on other minerals include the resources excise tax, which is actually three separate taxes collected together on timber and mineral products. The rate of the tax varies from .125 percent to .75 percent of the taxable value of the product. The major tax imposed on the severance of natural resources is the severance tax. This tax is imposed at differing rates, from .2 percent to 3.5 percent of the taxable value of the resource, except for coal, which is taxed by the ton, on the severance of potash, copper, non-metallic minerals, lead, zinc, gold, silver, timber, coal and uranium. Each natural resource has a different set of allowable deductions and method of calculating taxable value. The revenue earned from the severance tax is distributed to the STBF to pay off severance tax bonds, and remaining balances in that fund are typically transferred to the Severance Tax Permanent Fund (STPF). Finally, the copper production ad valorem tax is a property tax imposed on the taxable value of copper severed from the ground. This tax replaced the ad valorem taxation of copper formerly found in the Property Tax Code.

Oil and gas production-related tax revenues are expected to reach almost $1 billion in fiscal year 2012, which is still $400 million lower than the peak reached in fiscal year 2008. Oil and gas tax revenue accounts for 7.6 percent of general fund recurring revenue, in addition to the $400 million distributed to the STBF and $150 million distributed to local governments. If royalty payments and direct and indirect gross receipts taxation are taken into account, the industry contributes 27 percent of all general fund recurring revenue. Severance taxes on other minerals have averaged $34 million in the past few years, with about $10 million of that going to the general fund. Most of that revenue is generated from coal production, which is also taxed about $40 million annually by the gross receipts tax (GRT).

Oil and gas operations provide a substantial amount of revenue to state and local government operations and funds. The GRT is collected from the industry for direct and indirect activities associated with production, and royalties and bonuses are paid for operations on state and federal land. Annually, the oil and gas industry contributes $2.2 billion to state and local governments. Given the huge impact the industry has on government revenues, projected declines in gas production are a serious concern for the long-term revenue outlook of the state. The state needs to look at the long-term viability of the industry, including the state's tax policies. New Mexico does not control a large enough share of the national energy market to be able to export the burden of its severance taxes to out-of-state consumers, which means that the industry may go elsewhere if New Mexico's taxation level is too high.

Questions and comments from committee members included:

- How much revenue does the oil and gas industry contribute to education funding in the state? Mr. Clifford said that adding the industry's 27 percent contribution to general fund revenues and its 12 percent contribution from the land grant permanent funds (LGPFs) accounts for nearly 40 percent of education funding.

- Mr. Clifford was asked to report to the committee regarding the issue that the state may not be getting its share of tax revenue from gold extraction activities associated with copper

mining. Mr. Clifford said that the TRD is aware of the issue, and he will report on the department's progress soon.

- How many oil and gas rigs are currently in operation? Mr. Clifford said he could not remember the exact number of rigs, but the Permian Basin is very active right now and the San Juan Basin is not very active. He said that new technology has changed the gas production landscape in the country recently. Ten years ago, North Dakota was not producing any gas, but now it has surpassed New Mexico in production.

- Is the decline in natural gas production associated with less gas available, or is the decline due to state regulation and taxation levels? Mr. Clifford said that natural gas production increased significantly in New Mexico in the 1990s, mostly due to a federal tax credit. Any gas well will decrease production over time, and the only way of maintaining production levels is to drill new wells.

- Does the oil and gas industry need new incentives to encourage more development? Mr. Clifford said that oil production does not need any incentives currently, since oil prices are high enough for market forces to naturally encourage development. The natural gas sector may benefit from some targeted incentives. However, any new incentive should be targeted at encouraging new activity, rather than benefiting existing production.

- New Mexico should have lower tax rates on oil and gas production in order to get much higher production levels, and thus more tax revenue.

- The state's so-called "pit" rule has increased costs to operate wells, and that has caused some oil and gas leaseholders to leave the state. Mr. Clifford said that the state could use tax policy to offset some of the costs of environmental regulations.

Tax Expenditures in Severance Tax Acts

Richard Anklam, president, New Mexico Tax Research Institute, and Deborah Seligman, consultant for the oil and gas industry, discussed with the committee tax expenditures related to the oil and gas industry. A tax expenditure is broadly defined as a feature of the tax code that benefits a particular group or activity relative to others. Tax expenditures generally are designed to encourage or discourage particular activities, promote economic development, relieve poverty or promote certain industries. A tax expenditure can take the form of an exemption, a deduction, a credit, a rate differential, a deferral or a rebate that results in lower taxation. However, not all exemptions, deductions and credits are tax expenditures, since many are necessary to prevent duplicative taxation, pyramiding and conflicts with federal law and constitutional provisions. Tax expenditures are measured by the state revenue loss or gain that results from the differential tax treatment of the expenditure.

The oil and gas industry contributes to several tax programs, including the corporate income tax, the personal income tax, the GRT, the petroleum products loading fee, the oil and gas severance tax, the oil and gas conservation tax, the oil and gas emergency school tax, the oil

and gas ad valorem production tax, the natural gas processors tax and the oil and gas production equipment ad valorem tax. There are only two specific incentives in New Mexico's tax code to encourage oil and gas production, but those provisions are effectively sunsetted, since the incentives are triggered when the price of crude oil falls below a level that has not been seen since the early 1990s. Many other exemptions, deductions and credits found in the tax code should not be considered tax expenditures or tax incentives. Exemptions from the GRT for certain oil and gas activities are not tax expenditures because those same activities are taxed specifically through other tax programs. Severance and emergency school tax deductions for transportation and associated activities were designed not to be an incentive for the industry, but rather to establish a baseline price for the product as if it were severed and sold at the wellhead. Deductions from those taxes for royalty payments have been identified by some as tax expenditures, but they could also be seen as a base adjustment to reflect the actual revenue received by the company. The rate differential of .85 percent for oil, compared with the rate for gas, in the emergency school tax could be considered a tax expenditure, but it is difficult to determine whether it actually is. Many natural resources are taxed at different rates, and trying to determine whether one rate differential is a tax expenditure can be nearly impossible 30 years after its enactment.

Ms. Seligman noted that the distribution to the Oil and Gas Reclamation Fund from the oil and gas conservation tax may need to be modified. The distribution to the fund was increased in 2010 in order to pay for remediation of a brine well in Carlsbad. That money has not been spent, and the fund is accumulating large sums of money. Legislative Council Service staff was instructed by the committee to look into whether the distribution language needs to be amended and whether money in the fund can be used for other purposes.

Questions and comments from committee members included:

- How are mineral royalty payments calculated for production on state and federal lands? Ms. Seligman said that production companies bid on potential leases. The lease usually allows a 10-year window in which the company can begin extraction operations. Representative Bratton explained that lease bonus and royalty payments are much higher in known productive areas. He said that the federal and state governments could assume all the risk of developing a well and keep all the income, but the usual practice is to let the private sector perform that work. Once a well is productive, the lease on it runs until the well is formally abandoned.

- What is the reason for the naming of the oil and gas emergency school tax? Ms. Seligman said that has been the name of the tax since it was enacted in the 1930s. The money from that tax is distributed to the general fund, and more than one-half of that fund is used on education spending.

- The presenters were asked to explain which kinds of expenses can be deducted from oil and gas taxes. Mr. Anklam said that the severance taxes are imposed on the value of the product, and the only deductions from taxable value are expenses related to transportation and

certain royalty payments. There are deductions allowed from gross receipts for certain activities and from income taxes, but those are the normal deductions that all businesses are allowed.

- The state needs to identify incentives to encourage new oil and gas production. A bill was recently introduced in the legislature that would give a 50 percent tax credit against the cost of installing closed-loop systems instead of using the standard pit system.

- What is the average useful life of an oil well? Ms. Seligman said that some wells play out in two years, while others last more than 50 years. Representative Bratton said that producers are hesitant to permanently abandon wells because new technology may allow further extraction in the future.

State Land Office Revenue Report and Activity Update

Commissioner of Public Lands Ray Powell gave a report on the activities of the State Land Office (SLO) to the committee. Also presenting to the committee were Elaine Olah, assistant commissioner for administrative services, Bob Jenks, deputy commissioner, Harry Relkin, general counsel, and Kurt McFall, royalty management director. Commissioner Powell began the presentation by stating that all SLO transactions dealing with trust lands will be done with full public visibility and disclosure. The SLO has holdings in nearly every township in the state, which gives the agency a unique opportunity to have a positive influence in local communities on multiple levels. He mentioned two recent joint SLO economic development projects: the Mesa del Sol development and the new Sandia Tech Park, both in Albuquerque.

Ms. Olah continued the presentation and stated that the SLO is the trustee for 13 million subsurface acres and 8.9 million surface acres of land in the state, benefiting 22 governmental beneficiaries. The SLO has 151 full-time-equivalent (FTE) positions and has 12 field offices throughout the state. The SLO generates revenue for beneficiaries from three main sources. Revenue from nonrenewable resources such as mineral royalty payments and land sale proceeds is deposited into the LGPFs for investment by the State Investment Council (SIC) and distribution to the beneficiaries. Revenue generated from renewable resources, such as rents, grazing leases and rights of way, and miscellaneous revenue are deposited into the Land Maintenance Fund (LMF). The operating expenses for the SLO come from the LMF, and the remaining portion, usually about 97 percent of the fund, is distributed monthly to the trust beneficiaries.

In fiscal year 2011, the SLO deposited $87.7 million into the LMF, and $411 million into the LGPFs. The SLO performed significantly better in fiscal year 2011 than was originally budgeted. The operating expenses for the office of $13.1 million equal 2.6 percent of total revenues generated, and the SLO earned $200 million more than was anticipated at the beginning of the fiscal year. Estimates for fiscal year 2012 predict that the LMF will receive $84 million and the LGPFs will receive $502 million.

Nearly 95 percent of all revenue generated by the SLO comes from the oil and gas industry. There are 170,000 producing oil and gas wells in the state, and 44,000 of those are

located on state trust land. Two thousand oil and gas wells were drilled on trust land in fiscal year 2011. Monthly royalty income reached an all-time high of nearly $70 million in 2008, then fell to less than $20 million in 2009, but has been steadily increasing ever since. Monthly royalty payments have been between $40 million and $50 million for the past year.

Although oil and gas revenues account for the lion's share of revenue earned by the SLO, on a per-acre basis, other mineral resources are more productive. Coal generates $1,200 per acre; salt generates $600; sand and gravel generate $193; and oil and gas generate $161. However, with 2.9 million acres under lease to oil and gas interests, revenue from that sector surpasses by far the total revenue generated by all other sources combined.

Commissioner Powell said that the SLO audits many of its leases annually, which generates not only more money for the state land beneficiaries, but also more tax revenue for the state. The SLO will request authorization for additional auditors in the upcoming budget cycle, he said.

Questions and comments from committee members included:

- How does the SLO generate revenue from interest and penalties? Ms. Olah said that late royalty payments and lease renewals are charged interest, which is deposited into the LMF.

- How is the cost for grazing leases calculated? Commissioner Powell said that the price for grazing leases has declined nine percent in the past two years. New Mexico State University (NMSU) develops a formula for lease prices partially based on the cost of forage and the value of livestock. He said that the long-term drought that much of the state is experiencing is affecting the ability of leaseholders to graze animals. The SLO needs to maintain its relationship with knowledgeable leaseholder stewards. Good lessees are able to take care of the land in a sustainable manner. Mr. Jenks said that the formula for grazing leases is derived by NMSU from three U.S. Department of Agriculture indices: the forage prices index, the prices paid index and the cattle prices index. In addition, the carrying capacity of the land is a factor in the price.

- How have the recent forest fires in the Jemez Mountains affected state trust land? Commissioner Powell said that the impact from the fires could be dramatic in some areas. Some lessees may need to liquidate their herds. The area surrounding the Dixon Apple Orchard near Cochiti may experience erosion and siltation when the monsoon season brings heavy rains.

- The federal definition of commercial timber needs to be changed to allow forest-thinning projects to proceed. Commissioner Powell said that hand-thinning projects tend to be very expensive. The SLO wants to tie local economic development initiatives with any forest-thinning projects on state trust land.

- Is the SLO involved in any electric transmission line leases? Commissioner Powell said that the state could eventually earn as much money from renewable energy generation as the money earned from the oil and gas sector. However, the SLO is not interested in leasing state

land to speculators; it wants actual renewable energy activity on its lands. The renewable energy sector in New Mexico will take decades to develop, and the SLO will be an active participant in that development. The wind-power generation facility underway near Corona may involve right-of-way leases on state lands, depending on the final location of the transmission lines.

- Can the state change the list of trust land beneficiaries to add new beneficiaries? Commissioner Powell said that would require an amendment of the Enabling Act for New Mexico, which would also need approval of the people by popular vote and approval by Congress.

- Is the SLO reimbursing leaseholders who had been leasing state trust land on the location of Spaceport America? An SLO representative said that under state law, if a lease is not renewed but given to another lessee, the new lessee needs to reimburse the previous lessee for improvements made by the previous lessee.

- The LGPFs were not intended to be a savings account for state trust beneficiaries; rather, the funds were intended to benefit them. More money needs to be distributed from the funds to ensure that education is fully funded.

- How much royalty money has been underpaid by oil and gas lessees? Commissioner Powell said that figure cannot be estimated until more audits are performed.

Investment Trends of Permanent Funds

Steve Moise, state investment officer, Vince Smith, deputy state investment officer, and Charles Wollman, director of communications, SIC, gave an update on the activities of the SIC to the committee. Several reforms have been instituted at the SIC in the past year. The SIC and staff adopted fundamental investment philosophies to guide the investment of government funds. A preliminary asset allocation study was performed early in 2011, and the SIC will be implementing the new strategy in September. The investment consulting firm Ennis Knupp recommended 82 reforms in 2010, and the council has completed 28 of those, with 27 others currently being implemented. The other recommendations are still being evaluated. Several new SIC policies have been adopted, as well as a staff code of conduct. About one-third of the SIC's staff has changed in the past year, and nine external fund manager contracts have been terminated for underperformance. New external investment managers are currently being sought to replace some of the internal investing activities previously performed in-house. The SIC has several lawsuits pending to recover lost funds during the economic collapse of 2008-2009. The SIC has already recovered significant amounts, including one settlement for more than $150 million. The SIC is also fully cooperating with ongoing criminal investigations regarding past SIC dealings.

The SIC manages the state's permanent funds and manages some local government investments. The STPF and LGPFs make up most of the investment portfolio of the council. Total invested funds have grown 22 percent in fiscal year 2011, from $12.9 billion to $15.5

billion. The asset allocation of the state's primary permanent funds will change, beginning in September 2011, to align with the newly adopted investment philosophy of the council.

The legislature restructured the organization of the SIC in 2010, reducing the power of the governor to control the council. Currently, there are two positions open on the council, one appointed by the governor and one appointed by the New Mexico Legislative Council (LC). Mr. Moise asked members of the committee who serve on the LC to appoint a member with very good qualifications. The SIC earlier provided the legislature with a desired skill set for a new appointee, in addition to the stringent statutory requirements.

The SIC reduced its FTE staff from 32 to 25 in order to allow more qualified entities to manage some of the state's funds. The SIC will be able to earn more by outsourcing, said Mr. Moise. An exception is the staff that manages public equity investments, which has performed very well.

At the end of fiscal year 2011, the LGPFs had a balance of $10.8 billion. The SLO has transferred $2.3 billion to the funds in the past five years. The distribution rate from the funds to the state trust beneficiaries is currently 5.8 percent of the average balance of the funds, but that percentage will drop to 5.5 percent in fiscal year 2013 and 5.0 percent in fiscal year 2017. In the past five years, $2.6 billion has been distributed from the fund to the beneficiaries.

The STPF had a balance of $3.9 billion at the end of fiscal year 2011. After severance tax proceeds are used to pay debt service on severance tax bonds, any remaining money in the STBF is deposited into the STPF. Distributions from the fund are set at 4.7 percent of the average value of the fund and flow to the general fund. Deposits into the STPF have been minimal the past few years, because short-term supplemental severance tax bonds have been authorized to sweep any unused balance toward other purposes.

The Tobacco Settlement Permanent Fund is currently valued at $150.1 million. No new contributions to the fund have been made since fiscal year 2008, due to legislation diverting that income stream to other general appropriation uses. Money in the fund has not been distributed recently, since the amount to be distributed is tied to the amount deposited into the fund for each fiscal year.

The Water Trust Fund has a balance of $50.2 million. It was established in 2006 with an initial appropriation of $40 million, and $4 million is distributed from it annually to the Water Project Fund for water projects in the state.

Mr. Moise concluded the presentation by discussing a proposed constitutional amendment to allow up to 25 percent of the LGPFs to be invested in international equity investments, up from the current 15 percent limit. It would also change the standard of care in investing the fund to the "prudent investor" standard. This legislation passed the senate in the 2011 regular session, but time ran out before it could be addressed by the house of representatives.

Questions and comments from committee members included:

- Why is the SIC interested in investing more of its assets in U.S. equities, rather than fixed income investments? Mr. Moise said that is the current asset allocation strategy of the council, but new allocation strategies will be announced in August 2011. He said that the new allocation strategy will probably move away from relying on publicly traded equity and focus more on real-return assets such as real estate, floating-rate debt, energy, infrastructure and hedge funds.

- A legislator said that he thought the LC had recently filled a vacancy on the SIC. Speaker Lujan said that the person under consideration could not be appointed to the SIC because his political party affiliation did not match the requirement that LC appointees have a balanced party affiliation. He said that the governor's appointees are not required to have party affiliation balance, and that discrepancy may need to be addressed by the legislature.

- The 5.8 percent distribution levels from the LGPFs have not hurt the corpus of the fund. That distribution level should be made permanent.

- SIC staff was requested to report to the committee the percentage of its assets invested in fossil-fuel-based energy companies. As a rough estimate, Mr. Moise calculated that since six percent of publicly traded indices are energy companies and the SIC has 55 percent of its assets in stocks, the SIC could have approximately three percent of its assets invested in energy companies.

- Will there be more defendants in civil cases that the SIC is pursuing recovery of lost assets from recent financial scandals? Mr. Moise said that the SIC is still preparing cases against several financial management companies. He said that the SIC won a $150 million judgment against Countrywide. This case was not directly related to the "pay-to-play" cases also being pursued. The SIC is only involved in the civil aspect of the cases. The U.S. district attorney and New Mexico attorney general are still pursuing criminal cases.

- SIC staff was asked to provide to the committee specific dates for the election of the vice chair of the SIC in the past two years.

- SIC staff was asked to forward to the committee a detailed presentation given by the state's bond counsel on severance tax bonds, including supplemental severance tax bonds, commonly referred to as "sponge bonds".

- The SIC rule forbidding the use of third-party placement agents should be put into statute. Mr. Moise said that there are some legitimate uses of placement agents. Any statutory restrictions on their use should be carefully crafted.

Corn Board Manufacturing Presentation

Speaker Lujan asked that a brief presentation be made by Lane Segerstrom, chief executive officer, Corn Board Manufacturing, Inc. Mr. Segerstrom said that his company, headquartered in Texas, transforms corn stover, usually a farm waste product, into a high-quality wood replacement product. Corn board can be used in many industrial and woodworking applications. The company is interested in locating a manufacturing plant in New Mexico soon.

Speaker Lujan asked staff to schedule a full presentation from Mr. Segerstrom on the economic development potential of the new technology.

The minutes from the June 21, 2011 meeting of the committee were adopted without changes.

The committee recessed at 4:25 p.m.

Friday, July 22

The committee reconvened at 9:35 a.m.

Industrial Revenue Bonds — Purpose and Status

Deirdre Firth, manager, Economic Development Division, City of Albuquerque, and William Fulginiti, executive director, New Mexico Municipal League (NMML), made a presentation to the committee on the use of industrial revenue bonds (IRBs). An IRB is a method of financing capital assets using a governmental entity as a bond issuer. A company leases a facility from the entity, which sells bonds to a private lender. The company then uses the money to build or expand the facility. Loan repayments are made by the company through the entity back to the lender, and at the end of the term, title to the property is transferred to the company. The primary benefit of an IRB is that the governmental entity is the legal owner of the facility during the bond term, and thus the company is not assessed property taxes for the facility. A company often gets GRT and compensating tax abatement on the initial purchases of equipment with bond proceeds. IRBs are an important economic development tool for municipalities and counties to attract new businesses. The municipality or county does not use any of its own revenues to pay IRBs; the entity is merely the issuer of the bonds, which are repaid completely by the company.

Eligible IRB projects include land, buildings, furniture, fixtures and equipment; but working capital is not eligible. Suitable purposes include facilities for manufacturing, warehousing and distribution services, nonprofit entities, health care services, research facilities, industrial parks and office headquarters.

IRBs can also be issued for tax-exempt nonprofit entities to allow a municipality or county to act as a conduit issuer, as required by federal law, to help them obtain financing. These IRBs are exempt from income taxation. All other private-sector IRBs are taxable, however.

In Albuquerque, a company wishing to finance a project with an IRB issuance goes through a lengthy application and review process. After initial meetings with city staff and the identification of the bond counsel and financing source, a company will file an application with the city describing the project, the number of jobs to be created, land use and zoning considerations, financing details, economic impacts, corporate information and general community benefits of the project. City staff then evaluate the application, and the University of New Mexico Bureau of Business and Economic Research performs a fiscal impact analysis. At least three public hearings are held, and the city council makes the final decision on whether to proceed with the bonds. A project must have a positive fiscal impact for it to be recommended for approval. The company pays application and analysis fees, as well as the costs for bond counsel to prepare the documents. Total cost for an IRB issuance can be as much as $75,000, depending on the complexity of the financing. The entire process can take three to six months to complete.

Albuquerque provides for tax abatement reductions if the stated economic development goals in an application are not met, and the city provides "clawback" penalties if a facility closes prior to a specified time. The city recently reclaimed $13.1 million from Philips Semiconductors after it prematurely ended its operations. Companies can also be required to make payments in lieu of taxes (PILOTs) in order to reduce the negative property tax impact on certain entities, such as school districts. Although companies receive some tax abatements, IRBs do not affect other taxes that companies owe, including payroll, gross receipts and income taxes.

Any company can use an IRB for an eligible purpose. However, because of the financing and legal costs, IRBs are typically used for capital projects larger than $2 million. The City of Albuquerque is the largest issuer of IRBs in the state, but it typically issues only one per year. IRBs can be an effective economic development tool, but they are not used to excess, said Ms. Firth.

Questions and comments from committee members included:

- Do school districts, which are affected by IRB property tax abatements, get to vote whether to allow an IRB issuance? Mr. Fulginiti said that school districts are involved in the discussion of IRB issuance, but they do not have a vote. Ms. Firth said that a company receiving a large IRB will often make a PILOT to the school district. The legislator said that can cause problems, because property taxes cannot be used for operation expenses of a school district, but there are no restrictions on how a PILOT can be used. One school district that was using a PILOT to fund its operations suddenly lost that money when the company decided to defease its bonds. Some school districts have actually issued revenue bonds, with a PILOT backing the bonds.

- How do other states compare with New Mexico in IRB incentives? David Buchholtz, bond counsel for Albuquerque, said that given New Mexico's overly broad GRT taxation structure, IRBs make the state fairly competitive for the business sector.

- Small communities are often taken advantage of by companies wishing to get an IRB issuance. Local governments issue IRBs that do not increase the net tax revenue of the local governments in the area. Mr. Fulginiti said that the NMML provides governmental financial training seminars for municipalities, including training in IRB issues.

- Why would local governments want to give up some of their tax base to attract a company? Mr. Buchholtz said that IRBs can be issued with a requirement that a company create a certain number of permanent new jobs. Ms. Firth said that a local government can design an IRB issuance to give only a partial property tax abatement. A thorough fiscal analysis needs to be performed prior to an IRB issuance.

- How are the bonds in an IRB issuance collateralized? Mr. Buchholtz said that a private lender typically issues a mortgage or security interest in the property. The local government's credit is not at risk. The lender purchases the bonds, and the company repays the loan, using the local government as the passive trustee. There is no limit on the issuance of IRBs that a local government can issue, since an IRB is not a government debt. The amount of bonds depends on the creditworthiness of the company. The local government owns the property until the loan is paid off; then the title transfers to the company and is subject to property taxation.

- Why did Albuquerque Tortilla decide not to pursue the issuance of an IRB? Mr. Buchholtz said that the process can be expensive. In addition, IRBs require financial disclosures by the company. Some companies may decide that the additional public scrutiny and cost are not worth the effort, especially if they are able to secure other financing for the project.

- The New Mexico Renewable Energy Transmission Authority (RETA) seems to have similar functions to a county issuing IRBs. Does the RETA really serve a needed purpose not already being served? Mr. Buchholtz said that the RETA is still a new entity, and its statutory authority may eventually need some tinkering. The RETA has some tax incentive authority that is better than IRBs.

- Can an IRB be issued within a tax increment development district (TIDD)? Mr. Buchholtz said that is allowed, but the financing issues are very complicated and there are some trade-offs. A TIDD is a local government entity that receives a portion of property taxes from new companies locating in an area, but IRBs are designed to abate property taxes for companies to locate in an area.

- Allowing a municipality an unlimited ability to issue IRBs is a bad idea, since the issuance has an impact on other local governments, including the county and school districts in the area. Ms. Firth said that IRBs are not issued very often in Albuquerque and only after a thorough fiscal analysis.

- Since the local government holds title to a property during the course of an IRB, what happens during a default? Mr. Buchholtz said that technically, the local government would become a defendant, but it is not responsible to pay the default. The local government is really

acting as an independent trustee and merely needs to give up its position in order for the normal foreclosure proceedings against the company to ensue.

- Staff was instructed to acquire for the committee a list of IRBs issued by counties.

New Mexico Film Production Update

Nicolas Maniatis, director, New Mexico Film Division, Economic Development Department, updated the committee on recent changes in the film production tax credit. The legislature enacted changes to the law in 2011, setting a $50 million cap per fiscal year in the amount of tax credit allowed. Any credit not granted in a fiscal year is first in line for the credit in the next fiscal year. Film production companies must now wait until the end of their taxable year to file for the credit, and tax credits must be claimed within one year of a production's final expenditure.

Mr. Maniatis estimated that the total amount of tax credit claims for fiscal year 2012 will be $30.9 million, due to the timing structure to apply for the credit. Fiscal year 2013 should see an increase in credit claims, based on current projects in production. He expected that the $50 million cap will not cause problems for three to four years. There are currently four major productions in the principal photography phase, with four additional projects potentially coming to the state soon. Six major productions recently finished production.

Questions and comments from committee members included:

- Did changes in the film production tax credit affect the number of productions in the state? Mr. Maniatis said that during the legislative session, when the status of the tax credit was uncertain, some companies decided to produce elsewhere. However, now that the law is enacted, film production companies have a stable tax environment to plan for, and new productions have been planned.

- How can the discrepancy for fiscal year 2011 in the amount of tax credit granted be explained? Mr. Clifford said that film production companies rushed to complete their returns before the end of fiscal year 2011 and the start of the new requirements. The TRD had originally estimated the tax credit costing the state $65 million, but it actually will cost $102 million.

- Are there any local filmmakers taking advantage of the tax credit? Mr. Maniatis said that typically 60 productions file for the tax credit annually, of which 45 are small, often local, productions.

- Mr. Clifford said that the TRD is currently determining whether a tax credit can be paid to a pass-through entity that is the film production company, or whether the credit can only be paid to the owner of that company. Since the credit is only granted as part of a company's income tax return, and pass-through entities generally do not file returns, the timing provisions of when a credit gets granted may become problematic.

- Is the new legislation requiring pass-through entity withholding working as intended?

Mr. Clifford said that the new law addresses just one of many methods of payment to performing artists. The department is currently working on regulations to address all the different payment methods, but additional legislation may be needed.

There being no further business, the committee adjourned at 12:00 noon.