**MINUTES**
**of the**
**FOURTH MEETING**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**September 26-27, 2019**
**State Capitol, Room 322**
**Santa Fe**

The fourth meeting of the Revenue Stabilization and Tax Policy Committee for the 2019 interim was called to order by Senator Clemente "Memé" Sanchez, chair, on Thursday, September 26, 2019, at 9:01 a.m. in Room 322 of the State Capitol in Santa Fe.

| **Present** | **Absent** |
|---|---|
| Sen. Clemente "Memé" Sanchez, Chair | Sen. Mark Moores |
| Rep. Javier Martínez, Vice Chair (9/26) | |
| Sen. Pete Campos (9/27) | |
| Rep. Doreen Y. Gallegos | |
| Rep. Roberto "Bobby" J. Gonzales | |
| Rep. Jason C. Harper | |
| Rep. Susan K. Herrera | |
| Sen. Gay G. Kernan | |
| Rep. Antonio Maestas | |
| Rep. Rod Montoya | |
| Sen. George K. Munoz | |
| Sen. William E. Sharer | |
| Sen. John Arthur Smith | |
| Rep. James R.J. Strickler | |
| Rep. Jim R. Trujillo | |
| Sen. Peter Wirth | |

| **Designees** | |
|---|---|
| Rep. Christine Chandler (attending as a guest) | Rep. Abbas Akhil |
| | Rep. Eliseo Lee Alcon |
| | Rep. Cathrynn N. Brown |
| | Sen. William F. Burt |
| | Rep. Micaela Lara Cadena |
| | Sen. Jacob R. Candelaria |
| | Rep. Brian Egolf |
| | Rep. Tim D. Lewis |
| | Rep. Patricia A. Lundstrom |
| | Sen. Nancy Rodriguez |
| | Rep. Andrea Romero |
| | Rep. Angelica Rubio |

Rep. Patricio Ruiloba
Rep. Larry R. Scott
Sen. Elizabeth "Liz" Stefanics
Sen. Bill Tallman
Rep. James G. Townsend
Sen. James P. White
Sen. Pat Woods
Rep. Martin R. Zamora

(Attendance dates are noted for members who did not attend the entire meeting.)

**Staff**
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, Researcher, LCS
Rebecca Griego, Records Officer, LCS
Anthony Montoya, Staff Attorney, LCS
Sara Wiedmaier, Research Assistant, LCS

**Guests**
The guest list is in the meeting file.

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

**Thursday, September 26**

**Welcoming Remarks**
Senator Sanchez convened the meeting by commemorating the late Senator Carlos R. Cisneros, who had suddenly passed away the previous week. Committee members and staff recounted memories of him and expressed sadness over his passing. Comments about the senator included that he brought a high level of class to the Senate; that he was a great leader and never pushed his own agenda; that even when he disagreed with fellow legislators on policy, he was never disagreeable; that he provided good advice, even to members of the Republican Party; that he served in the Senate with distinction for about one-half of his life; that he represented what was best about the Senate; and that he respected and befriended Democratic and Republican colleagues and their families.

**Follow-Up Presentation on Revenue Stabilization: Enhancing Fiscal Stability and Managing Uncertainty**
Dawn Iglesias, chief economist, Legislative Finance Committee (LFC), and Ismael Torres, economist, LFC, discussed with the committee strategies that policymakers could consider to improve the state's fiscal stability over time. By identifying the causes of revenue volatility, strategies can be developed to mitigate that volatility. LFC economists measured the

state's volatility score, which is calculated based on the standard deviation of revenue streams over time, compared to other states. New Mexico has typically had an average score nationwide but has witnessed much more revenue volatility recently from the oil and gas industry. Volatility from rents and royalties has been extremely high, as has the overall volatility of revenue from Eddy and Lea counties. The legislature in 2017 enacted legislation to divert excess revenue from the oil and gas emergency school tax into the Tax Stabilization Reserve. In addition to providing a buffer to shore up state finances when revenues decline, the excess distribution also lessens the volatility of oil and gas revenues being directed to the General Fund.

Although policymakers have made some progress in managing the volatility of oil and gas tax revenue, more could be done, including:

- diverting excess revenues from federal mineral leasing payments into the Tax Stabilization Reserve;
- setting priorities on how to use one-time excess revenues;
- maintaining adequate reserve levels above national norms because of the volatile nature of much of the state's revenues; and
- using trend analysis to manage long-term revenue fluctuations and to avoid the temptation to make large long-term expenditure commitments when a revenue boom is experienced.

Questions and comments from committee members included the following.

- Why is there expected to be a large decline in bonus payments in fiscal year 2020? Ms. Iglesias said that in fiscal year 2019, the state received an unprecedented amount in bonus payments from oil and gas leases. The drop in the current fiscal year reflects that one-time spike in revenue.
- How do policymakers identify one-time revenues versus recurring revenues? Ms. Iglesias said that the Consensus Revenue Estimating Group (CREG), consisting of career economists in state agencies and the LFC, attempts to identify recurring revenues using various economic tools, but there is no formal process for making that determination. The CREG does recommend that the legislature establish a formal process for making that determination.
- What was the balance of the Tax Stabilization Reserve at the end of fiscal year 2019? Ms. Iglesias said that the audited numbers are not yet finalized, but she expected the reserve to show a year-end balance of about $900 million.
- The legislature needs to establish by law desired reserve levels and requirements for the state to "backfill" previously tapped revenue sources before spending excess revenues.

**Follow-Up Presentation on Revenue Stabilization: New Mexico's Assets and Liabilities Statement of Position**

Donna Trujillo, state controller, and director, Financial Control Division, Department of Finance and Administration (DFA), discussed with the committee the Statement of Net Position (SNP), which is published with the DFA's Comprehensive Annual Financial Report (CAFR). The SNP is the balance sheet for a government, reporting assets less liabilities for a reporting period. A government's net position is defined as liabilities plus deferred outflows subtracted from assets plus deferred inflows. Deferred outflows and inflows identify items previously classified as assets or liabilities but that have not yet been reflected as such in the current reporting period. Assets on the SNP include cash and investments of the General Fund held with the state treasurer; receivables from taxpayers, the federal government, brokers and tuition; and land, property and other capital assets held by state agencies and universities. Liabilities on the statement include accounts payable and other accrued liabilities, outstanding bonds and unfunded pension liabilities.

Ms. Trujillo said that the SNP for fiscal year 2019 is not yet completed because the CAFR still is a few months from being finalized. She presented the SNP for fiscal years 2016 through 2018, which was essentially a snapshot of the state's position as of June 30 each year. In fiscal year 2018, the state had a total of $42.3 billion in assets and $15 billion in liabilities, resulting in a total net position of $28.4 billion. This is a slight improvement from the SNP from fiscal year 2017 of $28.0 billion and a large improvement from 2016, when the state only showed a net position of $25.9 billion.

Questions and comments from committee members included the following.

- Will the CAFR for fiscal year 2019 be finished on time, in December? Ms. Trujillo said that the fiscal year 2018 CAFR was finalized in April 2019, which was five months past the statutory deadline. The fiscal year 2019 CAFR appears to be on track for completion close to the deadline.
- How is federal money shown on the SNP? Ms. Trujillo said that to track federal spending over the course of a fiscal year, one would need to consult the Statement of Activity, rather than the SNP, which is just a snapshot on one day.

**Adoption of Minutes**

The minutes from the July 25-26, 2019 meeting of the committee were adopted, without changes.

**Overview and History of the Property Tax Code**

Jim O'Neill, Esq., consultant, and Al Maury, Ph.D., economist, discussed with the committee the history of the state's Property Tax Code. Enacted in 1973, the code replaced the previous collection of tax laws under one comprehensive system of tax administration. The code established today's structure and process of rate setting, billing, collection and protest procedures. In 1974, the legislature also changed the process for handling delinquencies and for the valuation of industrial and commercial property. Since 1933, the Constitution of New Mexico has limited the total property tax levy allowed for state and local governments to $20.00 per $1,000 of value, also known commonly as "20 mills". Governments may impose additional levies only with the consent of the voters. The 20 mill limitation was parsed out in 1986 at its current levels: 11.85 mills for counties; 7.65 mills for municipalities; and .5 mills for school districts. The Public School Fund state equalization guarantee distribution currently takes credit for 75 percent of tax revenue raised by school districts resulting from their .5 mill share.

In 1981, the legislature divided property into two classifications: residential and non-residential. This subsequently led to separate protections in the constitution for residential property and for the yield control provisions of the code to work better. Various property tax exemptions have been enshrined in the constitution over the years, including $2,000 for heads of households, $4,000 for veterans and total exemptions for certain disabled veterans and for veterans' organizations. However, a much larger problem for many residential homeowners over the history of the state has been constant increases in valuation of their properties, with a subsequent increase in tax liability. The legislature has attempted several times to limit valuation increases using various strategies, none of which has worked very well. Enactment of the yield control formula in 1979 did limit somewhat the connection between increased valuations and increasing property tax levies. In general, the formula works by lowering tax rates as property valuations rise. The legislature also required county assessors to use "current and correct" values for properties. By the late 1990s, the legislature submitted to the voters a proposed constitutional amendment that would require the legislature to limit the increase in valuation for residential property based on owner-occupancy, age or income. The amendment was adopted, which subsequently resulted in yet another problem, known colloquially as "property tax lightning". This occurs because property valuations have been limited to a three percent increase each year until the property is sold, when it is required to be valued at its "current and correct" value. Many new homeowners found themselves paying much higher property taxes than their neighbors living in similar houses. Ironically, thanks to the recession and collapse in property values over the past decade, the issue of property tax lightning has diminished.

Mr. Maury discussed how tax rates are actually set, based on the requirements of the yield control formula. The Local Government Division of the DFA issues rate certificates annually for all 253 property tax rate districts in the state. Each county is divided into school districts, each of which may have a municipal rate and a county-only rate, and each of which is further separated into residential and non-residential property. Each district is subject to various property tax impositions, including the constitutional mill levies and any voter-approved mill levies. Tax rates are also set for certain ad valorem taxes on oil and gas facilities and for copper production facilities, if they exist in the county.

In some areas, residential property values have increased more than the rate of inflation or the rate of new construction growth, so the yield control formula has lowered tax rates from their statutory maximum and from their voter-approved rates. However, in that same taxing district, non-residential property has often remained at the same maximum rate for the past 35 years.

Studying these discrepancies over time allows one to better understand the economic factors at play in a taxing district.

Questions and comments from committee members included the following.

- There seems to be a conflict between the yield control formula and the three percent valuation limitation for residential property. Mr. O'Neill agreed with that assessment.
- New Mexico has the best property tax system in the nation, but probably also the worst sales tax system. Colorado residents have recently been moving to San Juan County because of low property values and also lower property tax rates.
- The Central Consolidated School District in San Juan County is about to lose its two largest property taxpayers because of the imminent closure of the San Juan Generating Station and nearby coal mine. The school district will have no property tax base to support payment of $37 million in existing bonds, nor will it probably ever be able to issue new bonds.
- The valuation limitation provisions in the constitution have resulted in the unfair situation of young homeowners paying much of the tax burden of older homeowners.

**Practical Impacts of Property Tax Provisions on Counties**

Linda Gallegos, chief deputy assessor, Colfax County, and chair, Assessors Affiliate, New Mexico Counties, and Christie Humphrey, deputy assessor, Torrance County, discussed with the committee potential effects of recent legislation related to property tax valuation. Ms. Humphrey discussed House Bill 429 of the 2019 legislative session, which was enacted as Laws 2019, Chapter 140. The legislation increased the income threshold for restricting the valuation of property for low-income senior homeowners from the original amount set out in statute in 2001 of $18,000 to $35,000. The legislation also required the Taxation and Revenue Department (TRD) to annually increase the income threshold based on inflation. As a result, each year, more homeowners will qualify for the valuation freeze, which means that property taxes for everyone else will increase in those counties that have not reached their statutory tax rate limit. This will also make it more difficult for taxing districts to meet their obligations over time as tax revenues eventually decrease. The Assessors Affiliate is recommending that the annual inflation adjustment be eliminated from statute. In addition, the affiliate pointed out a technical issue that should be fixed to disallow valuations before 2009 to be frozen at their pre-2009 levels.

Ms. Gallegos discussed House Bill 647 of the 2019 legislative session, which would have restricted the three percent valuation limitation to residential homes occupied by the owner as a primary residence and would have eliminated the valuation limitation for multifamily housing units. The Assessors Affiliate did not oppose the legislation but was concerned that some of the language regarding second homes would be impractical to administer. She also discussed House Bill 407 (Laws 2019, Chapter 212), which attempted to complete the transition to statewide local elections in odd-numbered years. Some unintended consequences of that legislation will affect county assessors and county treasurers. School bond elections will occur in November 2019, but county assessors are required to submit their valuations in October and county treasurers are required to issue tax bills in November, before the election is held.

Donna Maestas, director, Property Tax Division (PTD), TRD, said that the PTD granted extensions to 11 county treasurers to allow them to issue tax bills by December 1. However, if property owners do not pay their tax bills by December 31, they will not be allowed to deduct those tax payments from income for their 2019 federal income tax returns. The PTD has been notifying escrow companies operating in the state to ensure that property taxes are paid before the new year. Ms. Maestas also said that the Rural Heritage Task Force, created pursuant to House Memorial 81 of the 2019 legislative session, will hold its final meeting on October 22. The task force is studying potential legislation to find a method to value rural undeveloped properties, separate from the agricultural method of valuation.

Nancy Bearce, county treasurer, Bernalillo County, discussed other impacts from the passage of House Bill 407. She said that six counties use the same printing company to print tax bills, and there may not be enough time for bills to be printed, given this year's compressed schedule. Bernalillo County received an extension from the PTD to issue tax bills December 9. This will also have the effect of delaying when taxes collected by the county will be distributed to the various beneficiaries until February 2020. She also said that the same problem facing counties and school districts this year will occur again in 2021 unless the legislature modifies tax collection provisions before then.

Laura Montoya, county treasurer, Sandoval County, said that school district bond elections should be moved forward one year in order to avoid the timing problems being faced this year.

**Recess**

The committee recessed at 4:04 p.m.

**Friday, September 27**

The committee was reconvened by Senator Sanchez on Friday, September 27, 2019, at 9:03 a.m.

**Energy Outlook**

Mine Yücel, senior vice president and senior research advisor, Federal Reserve Bank of Dallas, discussed with the committee trends in the oil market. Geopolitical risks have risen considerably recently, from the attack on Saudi Arabian oil facilities, Organization of the Petroleum Exporting Countries, known as "OPEC", cuts in production and declines in oil production in Iran and Venezuela. However, the price of oil has not risen much, with West Texas Intermediate (WTI) prices hovering around $57.00 per barrel of oil. Slower global economic growth has reduced the demand for oil, which has kept prices stable. New Mexico oil production is near record highs, even though overall U.S. production is slowing and nationwide rig counts have fallen dramatically.

The recent disruption in Saudi Arabian oil production has not affected U.S. imports, mostly because that country only accounts for six percent of U.S. oil imports. Globally, the oil market has been balanced in 2019, with production decreases in some countries being offset by increases in U.S. production. However, if Saudi Arabian oil production is not restored to its pre-attack capacity by the end of the year, there will be a global undersupply of oil. Economists predict a slight oversupply of oil in 2020, which will put downward pressure on oil prices. Nationwide oil production growth has been slowing, and rig counts have fallen each month to only 719 on September 20. Shale basins are the most productive regions in the country, and the Permian Basin is the nation's most productive shale basin. Although production in the Texas portion of the Permian Basin is slowing, in New Mexico, production levels and the rig count are approaching record levels. New Mexico's economy is heavily reliant on the oil and gas sector, and state finances are also strongly tied to oil and gas revenues. However, New Mexico is not as reliant on the energy sector as other oil-producing states. Ms. Yücel cautioned that continued uncertainty and volatility in the oil market could cause problems for the state's economy.

Ms. Yücel also discussed the natural gas market and said that gas prices have remained very low for the past several years, mostly due to yearly increases in production. Much of the gas production is exported, with Mexico and Canada being the largest importers of U.S. gas. Exports are increasing, both from pipeline transport and from liquified natural gas shipments.

Questions and comments from committee members included the following.

- How is future risk in the oil market calculated? Ms. Yücel said that risk is very difficult to quantify. The market rebounded very quickly after the attack on oil facilities in Saudi Arabia, partly because that country did not immediately decrease exports and because the U.S. has large reserves to mitigate sudden disruptions in world oil supply.
- The San Juan Basin in northwest New Mexico has plenty of natural gas, but because of transportation challenges, prices are very low in that basin. How can gas from that basin be sold to Mexico? Ms. Yücel said that the U.S. sells 72 percent of gas exports to Mexico. There are three gas pipelines to Mexico that are not currently being used because of needed infrastructure improvements in Mexico. Mexico has recently recognized the need for foreign investment in its gas distribution infrastructure.
- If WTI prices drop below $45.00 per barrel, many oil companies operating in New Mexico will go bankrupt. Ms. Yücel said that in 2015, oil prices dropped significantly, and many small companies across the region were hurt; New Mexico's revenues dropped also.
- How will the increase in renewable energy production impact the oil and gas market? Ms. Yücel said that for the foreseeable future, oil and gas will still be needed for transportation and electricity production. Solar and wind energy will eventually dominate the electricity market and may someday be competitive with the oil and gas industry.

**Comparative Analysis of the Oil and Gas Industry's Fiscal Contribution to New Mexico and Other Producing States**

John Tysseling, Ph.D., consulting director, Moss Adams LLP, discussed with the committee results of a recent study comparing the oil and gas industry's fiscal contribution to various state and local governments. The study compared the fiscal impact of the industry to New Mexico, Texas, Oklahoma, Kansas, Colorado, Utah, Wyoming, Montana and North Dakota. The researchers took pains to ensure that data for each state could be compared with other states. For example, in states that have large portions of public lands, oil and gas royalty payments track differently than in those states that have very little public land. In New Mexico, most production occurs on state trust or federal land, which means that the state receives a large amount of royalty and bonus payments in addition to tax revenue. In Kansas, which has almost no production on public land, nearly all of its revenue attributable to the oil and gas industry is from tax revenue. The researchers also accounted for indirect revenues associated with oil and gas production, such as rig drilling and well-top construction activities. New Mexico has seen tremendous growth in oil and gas capital investment compared to the other states in the study.

When comparing government revenue as a percentage of total oil and gas production value, New Mexico ranks the highest. But when public land revenue is removed from the calculation, New Mexico ranks third. New Mexico far surpasses the other states when comparing just land revenue as a percentage of production value.

Questions and comments from committee members included the following.

- Are revenues from the gross receipts tax (GRT) associated with the oil and gas industry included in the calculations? Mr. Tysseling said that the researchers attempted to include GRT revenues in the study, but that data is difficult to pinpoint.
- Oil producers pay more royalties to the State Land Office for activities on state trust land than they do on federal land.

**Adjournment**

There being no further business, the committee adjourned at 11:43 a.m.