F I S C A L   I M P A C T   R E P O R T

SPONSOR HTRC **ORIGINAL DATE** 02/17/10 **LAST UPDATED** **HB** 268/HTRCS

SHORT TITLE Severance & Supplemental Tax Bonds **SB**

ANALYST White/Earnest

APPROPRIATION (dollars in thousands)

Appropriation			Recurring or Non-Rec	Fund Affected
FY10	**FY11**	FY12		
$0.0	$100,000.0	$0.0	Nonrecurring	Senior/Supplemental STB Capacity
$0.0	$76,200.0	$0.0	Nonrecurring	General Fund
$0.0	$9,100.0	$0.0	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	**FY11**	**FY12**		
$0.0	$100,000.0	$0.0	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Conflicts with, SB 185, SB 192, SB 208, and SB 255
Relates to SB 184

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of House Taxation and Revenue Committee Substitute

The House Taxation and Revenue Committee Substitute for House Bill 268 authorizes the State Board of Finance (BOF) to issue up to $100 million in short-term, or sponge, severance tax (STB) and supplemental severance tax (SSTB) bonds during FY11 "when the secretary of finance and administration certifies that such bonds are needed because:"

- an FY11 general fund consensus revenue forecast projects general fund reserves of less than five percent; and or
- federal legislation has not been enacted prior to January 1, 2011 extending an

increase in the federal medical assistance percentage (FMAP) provided in the American Reinvestment or Recovery Act (ARRA) of 2009.

Proceeds from the sale of the bonds would be appropriated to the general fund "to restore the allotments made from the general fund for capital project general fund appropriations enacted in prior" legislative sessions which had an expenditure period ending on or after June 30, 2010.

After the certification of these bonds from the Secretary of the Department of Finance and Administration (DFA), up to $76.2 million will be appropriated to the medical assistance program of the Human Services Department (HSD) and up to $9.1 million will be appropriated to the developmental disabilities support program of the Department of Health for Medicaid waiver programs.

The actual amounts of these appropriations will be determined by the difference, as calculated by the Secretary of DFA in consultation with the Director of the LFC, between the amount of federal funds estimated to have been received in FY11 had the increases been extended through the end of the fiscal year and the amount of federal funds estimated to actually be received by each program.

The proposed legislation carries an emergency clause.

FISCAL IMPLICATIONS

Based upon the January STB capacity estimate, insufficient FY11 STB senior sponge capacity exists to facilitate the entire $100 million appropriation authorized in the substitute. Therefore, in order to meet the maximum amount of appropriations to the general fund allowed, the use of SSTB capacity would be necessary.

Table 1: Impacts on FY11 Capital Outlay

LFC FORECAST OF CAPITAL OUTLAY AVAILABLE		
	FY11	
	Current	**HB268**
Senior Long-Term Issuance	149.5	149.5
Senior Sponge Issuance	70.4	70.4
Senior STB Capacity - January 2010	**219.9**	**219.9**
Water Project Fund (Statutory 10% of STB)	*(22.0)*	*(22.0)*
HB 268 Proposed Sponge for GF	**-**	***(70.4)***
Net Senior STB CAPACITY	**197.9**	**127.5**
Supplemental Long-Term Issuance	-	-
Supplemental Sponge Issuance	140.5	140.5
Supplemental STB CAPACITY	**140.5**	**140.5**
HB 268 Proposed Sponge for GF	**-**	***(29.6)***
Net Supplemental STB Capacity	**140.5**	**110.9**

Table 1 shows the impacts of using both senior and supplemental STB proceeds to meet the maximum appropriation of $100 million proposed in the substitute. As only $70.4 million of senior sponge capacity is projected to be available, approximately $29.6 million of SSTB capacity would need to be used as well. This scenario would lower net senior STB capacity, or capital outlay available for appropriation by the legislature during the FY11 regular session, from $197.9 million to $127.5 million, representing a decrease of nearly 36 percent. The scenario would also lower net supplemental STB capacity, or public school capital outlay to be awarded by the Public School Capital Outlay Council (PSCOC), from $140.5 million to $110.9 million representing a decrease of more than 21 percent.

Although insufficient senior STB sponge capacity exists for the appropriations laid out in the substitute, the January capacity estimate did forecast that approximately $32.6 million in excess revenues would be available at the end of FY11. These revenues would normally flow into the severance tax permanent fund (STPF), however precedent does exist which would allow the legislature to use notwithstanding language to appropriate these monies in what is known as a "sweep" or "super-sponge." The precedent for using these funds is however, limited to appropriation for capital expenditures. The use of a sweep could mitigate the overall impacts on FY11 capital outlay levels, and potentially eliminate the need to use SSTB capacity to reach the $100 million appropriation set out in the proposed legislation. However, it should be noted that these moneys eligible to be swept would otherwise be deposited in the STPF where they would earn interest and make future distributions to the general fund. Therefore an STB sweep is essentially a forfeiture of future general fund revenues for immediate purposes. Usually these immediate purposes represent funding for long-term infrastructure projects. In the instance of the proposed legislation however, these purposes would represent short-term operating expenditures. This raises a concern that such a use of an STB sweep could artificially support what are potentially unsustainable long-term expenditure levels. The mechanics of STB sweeps are discussed in more detail in the significant issues section below.

Table 2: Impacts on FY11 Capital Outlay with an STB Sweep

LFC FORECAST OF CAPITAL OUTLAY AVAILABLE		
	FY11	
	Current	**HB268**
Senior Long-Term Issuance	149.5	149.5
Senior Sponge Issuance	70.4	70.4
Senior STB Capacity - January 2010	**219.9**	**219.9**
Potential Sweep	**32.6**	**32.6**
Water Project Fund (Statutory 10% of STB)	*(22.0)*	*(22.0)*
HB 268 Proposed Sponge for GF	**-**	***(100.0)***
Net Senior STB CAPACITY	**230.5**	**130.5**
Supplemental Long-Term Issuance	-	-
Supplemental Sponge Issuance	140.5	140.5
Supplemental STB CAPACITY	**140.5**	**140.5**
HB 268 Proposed Sponge for GF	**-**	-
Net Supplemental STB Capacity	**140.5**	**140.5**

The table above shows that the proposed legislation, through the use of a potential sweep, would decrease FY11 net senior STB capacity by up to $100 million. This would leave the legislature approximately $130.5 million to appropriate for capital outlay projects during the 2011 regular session and have the potential to hold public school capital outlay net harmless.

SIGNIFICANT ISSUES

An STB sweep can occur when STB revenues increase year over year. Because statutory STB capacity is determined as a percentage of the prior year's revenues, an increasing revenue environment will typically result in a large amount of STB revenue left over to revert to the STPF. These extra funds normally flow into the STPF unless they are "swept" by the legislature for use in capital projects. This type of transaction has occurred multiple times over the past 10 years due to record oil and gas revenues. In Accordance with Senate Bill 268, instead of sweeping the money for capital projects, the legislature would choose to sweep the money into the general fund. Sweeps are typically accomplished through the use of not withstanding language in the severance tax bonding act. The notwithstanding language needed for sweeps is usually inserted by the legislature during the regular session in which year the appropriation actually occurs. As House Bill 268 does not currently contain such language, the use of SSTB capacity would be necessary to make the proposed $100 million maximum appropriation. However those SSTB proceeds could be replaced with the aforementioned sponge proceeds in an attempt to hold public school capital outlay net harmless.

The issuances included in the proposed legislation are typically referred to as deficit financing bonds. The use of deficit financing bonds, even overnight sponge deficit financing bonds, are often viewed as exposing a structural problem within a state or municipality's operating budget associated with declining revenues and an unsustainable recurring expenditure level. The bond proposal included in House Bill 268 is not likely to elicit such a reaction when looked at individually, as it includes short-term notes issued and paid off in the same fiscal year in which the proceeds will be used. The precedent set by such a proposal however, has a much greater impact on the state than the one-time issuance. Many investors could interpret such a precedent as a fundamental change to the severance tax bonding program as a whole, in which capital projects are no longer its main focus. Additionally, ratings agencies could look upon the precedent as a continuing facet of the state's budget practices, through which revenues are routinely taken from long-term infrastructure projects to fund expenditure levels above and beyond those supported by organic recurring general fund revenue sources.

Over the past few years the state enjoyed record amounts of funding for long-term infrastructure projects due to record oil and gas revenues. Based on projections from the consensus revenue group however, severance tax revenues are not expected to reach those record levels again for an extended period of time. Last year, in a letter to Legislative leadership, the BOF cited various downfalls to the State's current capital outlay program and its effects on state bond ratings. The letter also stated that capital resources to the state "are inherently scarce, and are likely to be more scarce over the next several years."

OTHER SUBSTANTIVE ISSUES

The American Recovery and Reinvestment Act (ARRA) increased the federal matching rate for state Medicaid programs – known as the federal medical assistance percentage (FMAP). Under current law, this enhanced FMAP rate, found in Section 5001 of the bill, expires on December 31, 2010. Federal legislation has been introduced to extend this enhanced FMAP rates for two more quarters, through June 30, 2011.

House Bill 2, as passed by the House and as amended by the Senate, assumes that Congress will enact this extension. Due to this assumption, the general fund appropriation for Medicaid remains relatively flat over the FY10 budget. This bill provides a contingency appropriation to address a potential budget shortfall in Medicaid programs if Congress fails to enact an extension of the enhanced FMAP.

The appropriations provided may not fully replace the difference between the amount received without an extension and the amount that would have been received with an extension. However, the $76.2 million and the $9.1 million appropriations are based on appropriations included in the LFC recommendations to replace supplanted general fund appropriations in FY10.

TECHNICAL ISSUES

The difference between the amount of federal Medicaid funds the state is estimated to have received in FY11 and the amount estimated to actually be received could be as large as $160 million to $170 million. Therefore the appropriations included in the substitute may not be large enough to cover the entire difference. In order to address this issue on page 6, line 13 and page 7, line 7 the passages “shall equal the difference,” may need to be changed to “shall be no more than the difference.”

Furthermore, when calculating the difference in determining the appropriation to be made to Medicaid, the Medical Assistance Program and the Medicaid Behavioral Health Program should be explicitly listed. In order to address this issue on page 6, line 19 and page 7, line 1 after the word program, “and Medicaid Behavioral Health Program” should be inserted.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 268 both conflicts and at times duplicates Senate Bill 192 which would appropriate the proceeds of $100 million in FY11 senior sponge bonds to fund a newly created fund known as the “stimulus lock box” (SLB). The SLB would be used to replace federal funding that may roll off after FY11.

House Bill 268 conflicts with Senate Bill 185 which proposes to use approximately $76.3 million in FY11 senior STB sponge capacity to avoid public employee salary decreases.

House Bill 268 also relates to and possibly conflicts with Senate Bill 208 and Senate Bill 255, which temporarily alter the severance tax rate. If either of these bills and House Bill 268 were to be enacted, sufficient short-term STB capacity may not exist to cover the entire appropriation made in House Bill 268.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

If the substitute is not enacted, the legislature will have up to $100 million more in combined STB and SSTB capacity to appropriate to long-term statewide and public school infrastructure projects in the FY11 regular session. However, $100 million in bond proceeds will not be deposited into the state general fund for the purpose of increasing reserves or replacing certain federal funds.

DMW/mew