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

SPONSOR Sanchez, M.
ORIGINAL DATE 01/29/10
LAST UPDATED
HB

SHORT TITLE Sell Bonds to Avoid Salary Reductions
SB 185

ANALYST White

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY10	FY11		
$0.0	($76,300.0)	Nonrecurring	Senior Severance Tax Bonding Capacity
$0.0	$16,800.0	Nonrecurring	DFA
$0.0	$40,500.0	Nonrecurring	PED
$0.0	$900.0	Nonrecurring	NMDOT
$0.0	$18,100.0	Nonrecurring	HED

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to the General Appropriation Act

SOURCES OF INFORMATION
LFC Files

Responses Received From
New Mexico Attorney General's Office (AGO)
Public Education Department (PED)

SUMMARY

Synopsis of Bill

Senate Bill 185 authorizes the state Board of Finance (BOF) to issue up to $76.3 million worth of short-term, or sponge, severance tax notes in FY11. The notes can only be issued for the purpose of avoiding potential public employee salary reductions as part of the 2010 General Appropriation Act (GAA). The proposed legislation appropriates the bond proceeds as follows:

- $16.8 million to the Department of Finance and Administration (DFA) for expenditure in FY11 to avoid salary reductions for executive, legislative, and judicial employees,

- $40.5 million to the state equalization guarantee distribution in order to avoid potential salary reductions for public school employees,
- $900,000 to the transportation distribution to avoid salary reductions for transportation employees,
- $18.1 million to the Higher Education Department (HED) to avoid salary reductions at each higher education institution.

In the event that these appropriations are insufficient to fully avoid salary reductions, the appropriations "shall be distributed proportionately so that each employee's salary will be reduced by the same percentage." All unexpended or unencumbered bond proceeds remaining at the end of FY11 are required to revert to the severance tax bonding fund (STBF).

Additionally, Senate Bill 185 requires DFA to transfer appropriate amounts to non-general fund agencies to avoid salary reductions of up to 2 percent for non-general fund employees.

FISCAL IMPLICATIONS

Senate Bill 185 makes a non-recurring appropriation of severance tax bond (STB) proceeds in FY11, thus decreasing the amount of net senior STB capacity available for appropriation by the legislature for capital outlay projects. If $76.3 million were to be appropriated for the uses outlined in the proposed legislation, net senior STB capacity, based on December 2009 estimates, would be approximately $109.2 million.

LFC FORECAST OF CAPITAL OUTLAY AVAILABLE		
Severance Tax Bonding		
	Current FY11	**SB 185 FY11**
Senior Long-Term Issuance	149.5	149.5
Senior Sponge Issuance	56.7	56.7
Senior STB Capacity - December 2009	**206.2**	**206.2**
Water Project Fund (Statutory 10% of STB)	*(20.6)*	*(20.6)*
Proposed Sponge for Salary Reductions	-	*(76.3)*
Net Senior STB CAPACITY	**185.5**	**109.2**
Supplemental Long-Term Issuance	-	-
Supplemental Sponge Issuance	126.7	126.7
Supplemental STB CAPACITY	**126.7**	**126.7**

It is extremely important to note that based on the December 2009 capacity estimate, senior sponge capacity is only forecast to be approximately $56.7 million. Thus sufficient senior sponge capacity does not exist to meet the appropriations contained in Senate Bill 185.

SIGNIFICANT ISSUES

The proposed legislation amounts to the issuance of what are essentially known as deficit financing bonds. Legislative bodies in certain other states have recently approved such measures, after a determination that the current economic downturn has hit so hard so quickly that severe budget crises were unavoidable. These approvals were also made on the assumption that the economic turmoil currently experienced by states is a temporary cyclical event, which will soon be replaced by rapid growth and economic expansion. While these types of financings may result in a short-term budget fix, potentially eliminating the possibility of public employee salary reductions, there are potential disadvantages that accompany them as well.

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 increased expenditures. The bond proposals included in Senate Bill 185 are likely not to elicit this type of reaction on their own, as they are short-term notes designed to pay off current year obligations with revenues from the same year. 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 statutory 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 oil and gas revenue 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 states 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."

The use of STB proceeds to finance operational expenditures would be in conflict with federal tax guidelines for tax-exempt bonds. The federal guidelines require bond proceeds to be used solely for capital expenditures and working capital expenditures related to "depreciable assets" in order to qualify for a federal tax-exemption. Therefore these issues would have to be sold as taxable bonds which generally carry a higher interest rate than typical tax-exempt STB's. If these short-term bonds are issued on an overnight sponge basis, the effect of these higher rates will most likely prove negligible.

TECHNICAL ISSUES

Although insufficient capacity exists for the appropriations laid out in Senate Bill 185 the capacity forecast however, did estimate that approximately $58.2 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 notwithstanding language typically needed for this type of appropriation must be explicitly inserted by the legislature. Therefore the proposed legislation as currently drafted would not be able to technically appropriate any funds above and beyond what is determined to be senior severance tax sponge capacity in FY11.

Senate Bill 185 has the potential to conflict with existing state statute by using bond proceeds to fund operational expenditures. The current severance tax bonding act, Section 7-27-27 NMSA 1978, states that severance tax bonds may only be issued to "finance specific projects authorized by the legislature." Although allocation and appropriation language is included in the proposed legislation, the prevention of salary reductions are not explicitly defined as an eligible "project" under the act. It is unclear whether or not the authorizations provided for in the proposed legislation are senior to or not withstanding the current statutory requirements.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 185 relates to both the General Appropriation Act (House Bill 2) as it attempts to minimize the effects of possible public employee salary reductions which could be made in order to maintain a reasonable level of FY11 general fund reserves.

Senate Bill 185 conflicts with Senate Bill 192, which uses up to $100 million senior short-term STB capacity in FY11 for the purpose of funding a "stimulus lock box." The new fund would be used to compensate the general fund for the loss of federal revenues in future fiscal years.

Senate Bill also relates and possibly conflicts with Senate Bill 208, which temporarily alters severance tax rate. If both Senate Bill 208 and Senate Bill 185 were to be enacted, sufficient short-term STB capacity may not exist to cover the entire appropriation made in Senate Bill 185.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

If Senate Bill 185 is not enacted, the legislature is estimated to have approximately $185.5 million in net senior STB capacity to appropriate to long-term infrastructure projects in the FY11 regular session. Additionally without passage of the proposed legislation the possibility does exist, depending on decisions made by the legislature with regard to the 2010 General Appropriation Act, for public employee salary reductions to occur.

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