Oil and Gas Revenue to the State of New Mexico

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Legislative Finance Committee
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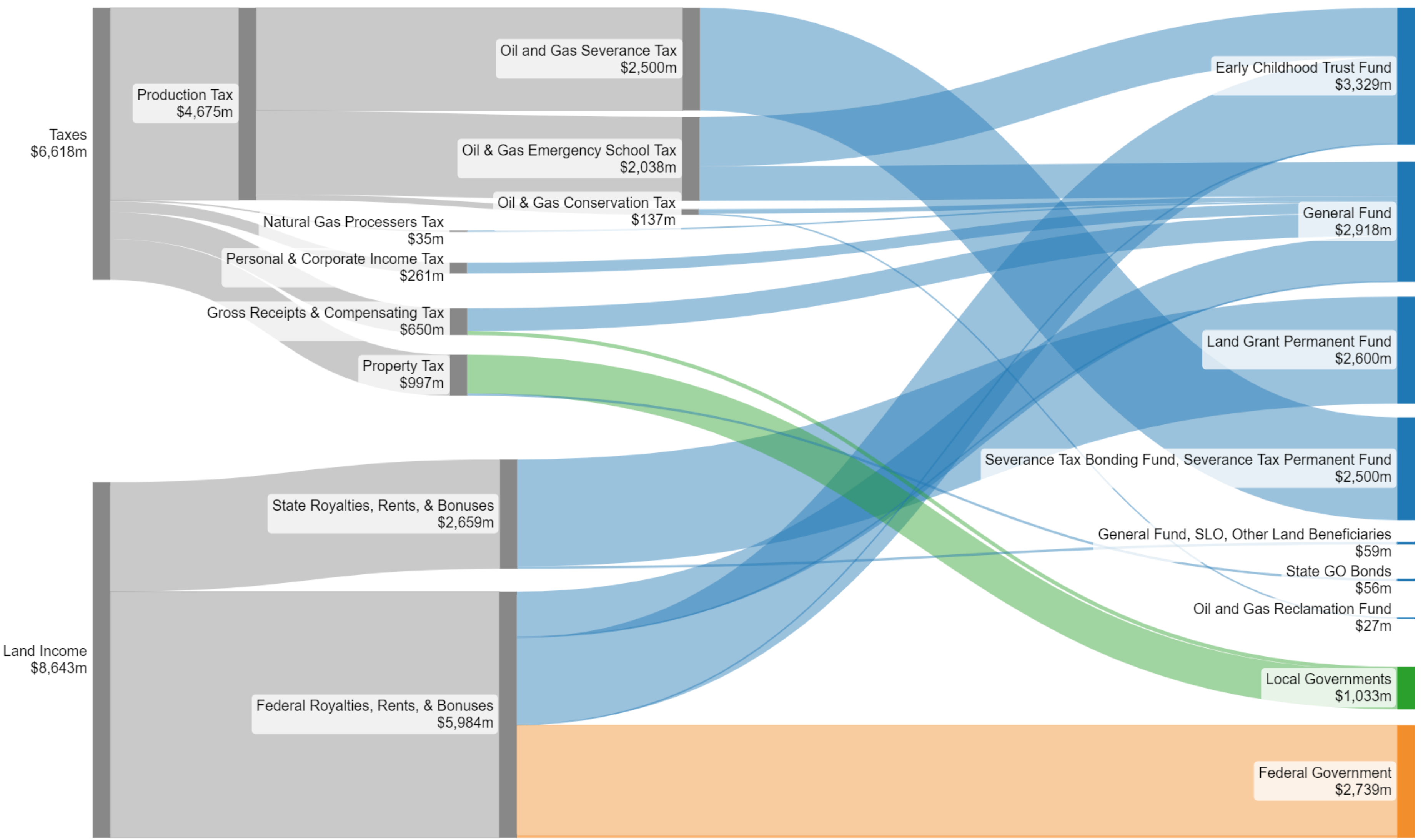
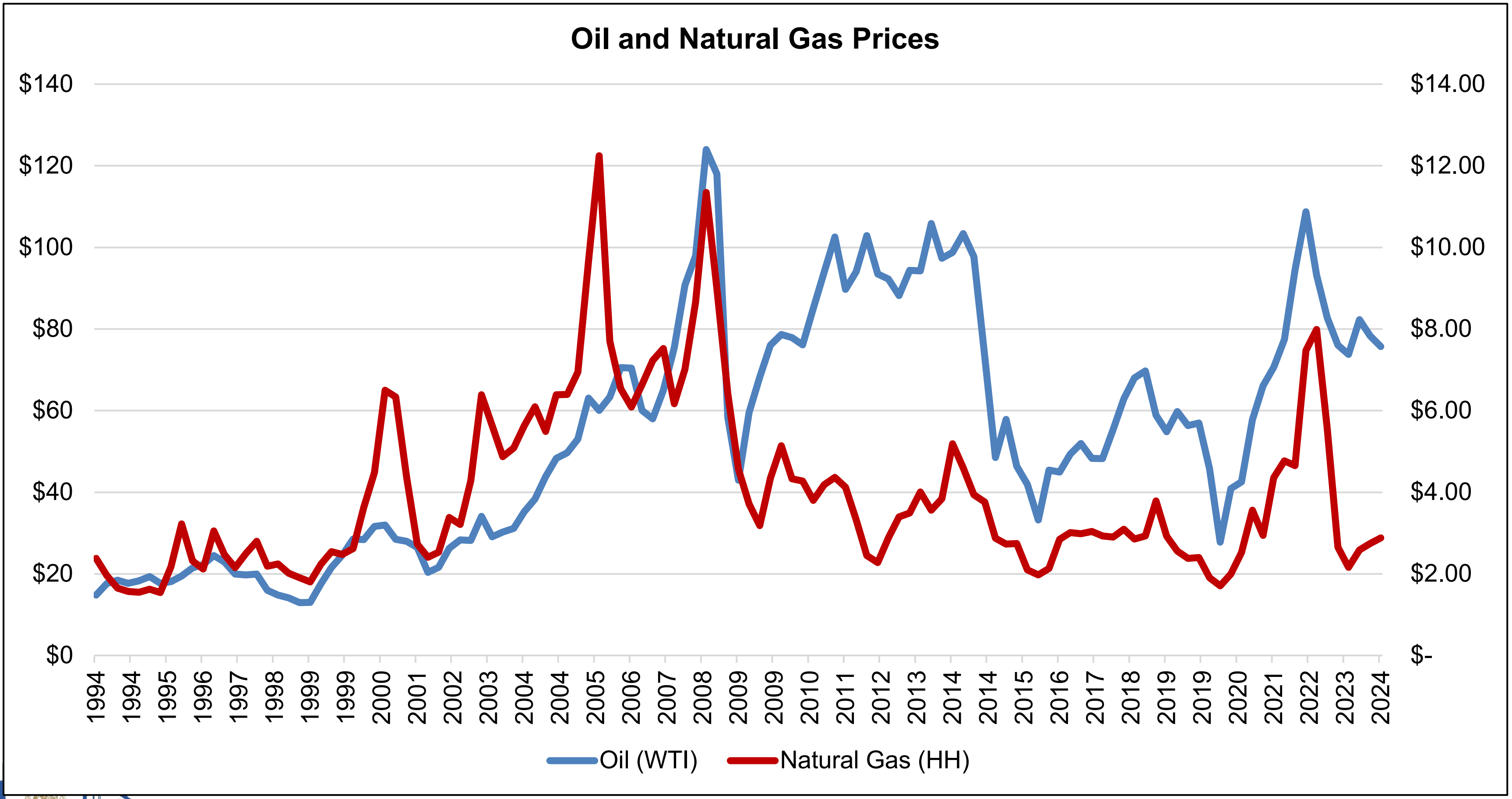
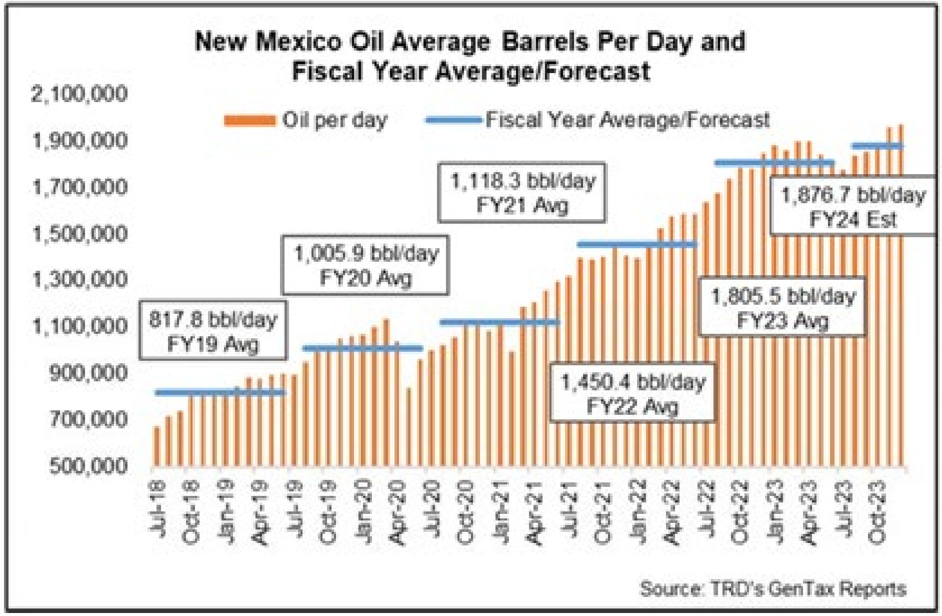
FY2023 Oil and Gas Revenue Flow

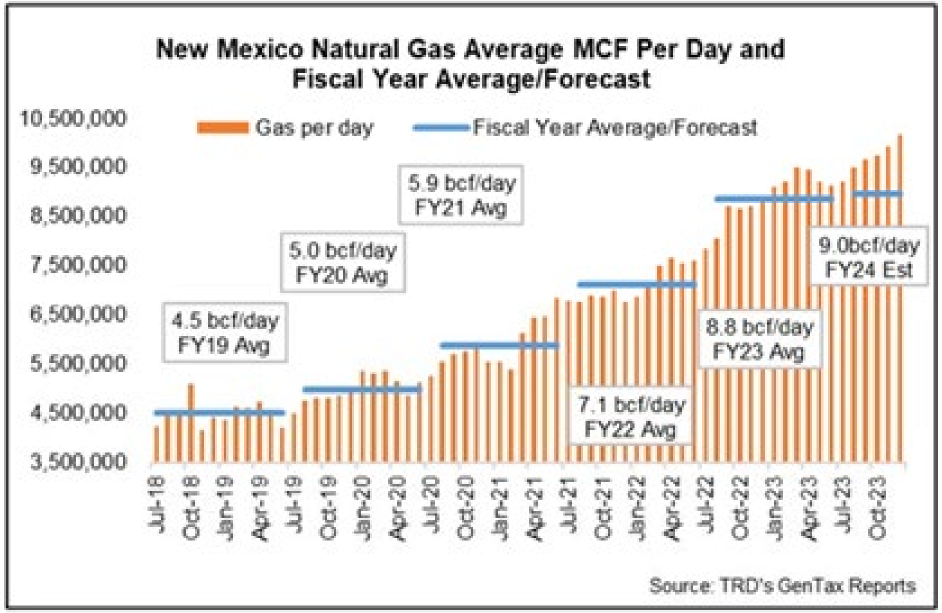


Oil prices are tracking at near-record levels due to national and global market conditions…



…leading to an acceleration in New Mexico’s oil and natural gas production.





What do changes in production and prices mean for New Mexico revenues?

- Based on December 2023 estimate for direct oil and gas revenues (production taxes and federal royalties),
  - A $1 change in the annual average NM price of oil has about a $59.8 million impact on revenues.
  - A 10-cent change in the annual average NM price of natural gas has about a $45.7 million impact.
  - Each additional million barrels of oil generates about $6.9 million in severance taxes and federal royalties.
  - Each additional 10 billion cubic feet of natural gas generates about $4.8 million in severance taxes and federal royalties.

Note: general fund impacts include effects on the tax stabilization reserve

Total oil and gas revenues to the state have more than quadrupled in five years.

State OGAS Revenues (in millions)			
	FY18	**FY23**	***Growth***
General Fund	$1,355	$2,918	*115%*
Early Childhood Trust Fund	$0	$3,329	
Oil and Gas Reclamation Fund	$3	$27	*800%*
Severance Tax Bonding/Permanent Fund	$496	$2,500	*404%*
State GO Bonds	$9	$56	*522%*
Land Grant Permanent Fund	$679	$2,600	*283%*
General Fund, SLO, Other Land Beneficiaries	$112	$59	*-47%*
Total	**$2,654**	**$11,489**	***333%***

Taxes on oil stack to equal roughly 8.27 percent of the value of oil severed in New Mexico.

Taxes on Oil	Net Price of Oil ($/bbl)		
	Under $15	**$15 to $18**	**Over $18**
Oil and Gas Emergency School Tax	1.58%	2.36%	3.15%
Oil and Gas Severance Tax	1.88%	2.81%	3.75%
Subtotal	**3.46%**	**5.17%**	**6.90%**
Oil and Gas Conservation Tax	0.19% - 0.24%	0.19% - 0.24%	0.19% - 0.24%
Production Ad Valorem Tax	1.04%	1.04%	1.04%
Production Equipment Ad Valorem Tax	0.14%	0.14%	0.14%
Total	**4.83%**	**6.54%**	**8.27%**

Taxes on natural gas are slightly higher, totaling 8.97 percent of the value.

Taxes on Natural Gas	Net Price of Natural Gas ($/mcf)		
	Under $1.15	**$1.15 to $1.35**	**Over $1.35**
Oil and Gas Emergency School Tax	2.00%	3.00%	4.00%
Oil and Gas Severance Tax	1.88%	2.81%	3.75%
Subtotal	**3.88%**	**5.81%**	**7.75%**
Oil and Gas Conservation Tax	0.19%	0.19%	0.19%
Production Ad Valorem Tax	0.88%	0.88%	0.88%
Production Equipment Ad Valorem Tax	0.15%	0.15%	0.15%
Total	**5.10%**	**7.03%**	**8.97%**
Natural Gas Processor's Tax			*depends*

When comparing effective tax rates across states, New Mexico lies in the middle, roughly the same as Texas.

Based on an LFC Study in 2016 of severance, production and property taxes paid

in ratio to taxable valuation of production

State	Property Tax (Y/N)	Taxable Value (in billions)	Tax Collected (in millions)	Effective Tax Rate
Oklahoma	NO	$11.236	$364.9	3.2%
Idaho	YES	$0.003	$0.1	4.0%
Utah (1)	YES	$1.625	$99.0	6.1%
Texas (1)	YES	$53.491	$4,458.1	8.3%
New Mexico (2)	YES	$6.841	$584.4	8.5%
North Dakota	NO	$14.958	$1,404.8	9.4%
Montana	YES	$0.919	$91.1	9.9%
Alaska	YES	$5.456	$653.8	12.0%
Louisiana	YES	$5.062	$671.2	13.3%
Wyoming	YES	$6.173	$827.6	13.4%
Unweighted average rate				8.8%

(1) Utah and Texas assess an ad valorem property tax on the market value of mineral reserves, and this tax is assessed every year on the remaining value of the reserves.

(2) New Mexico was NOT included in this study; however, LFC staff used similar methodology to calculate the effective tax rate and included NM for reference only. New Mexico assesses an ad valorem tax on production and equipment in lieu of property tax.

Source: Covenant Consulting Group, January 2017

However, state royalty rates are lower than Texas for prime Permian tracts.

- Royalty rates on state trust lands range from 12.5 percent to 20 percent. The royalty rate for the most productive tracts can be no lower than 18.75 percent and no higher than 20 percent.
- State trust revenue flows to the land grant permanent fund.
- FY23 state royalties, rents, and bonuses = $2.7 billion

Oil and Gas Lease Rates for Trust Land in Select States
(in percent)

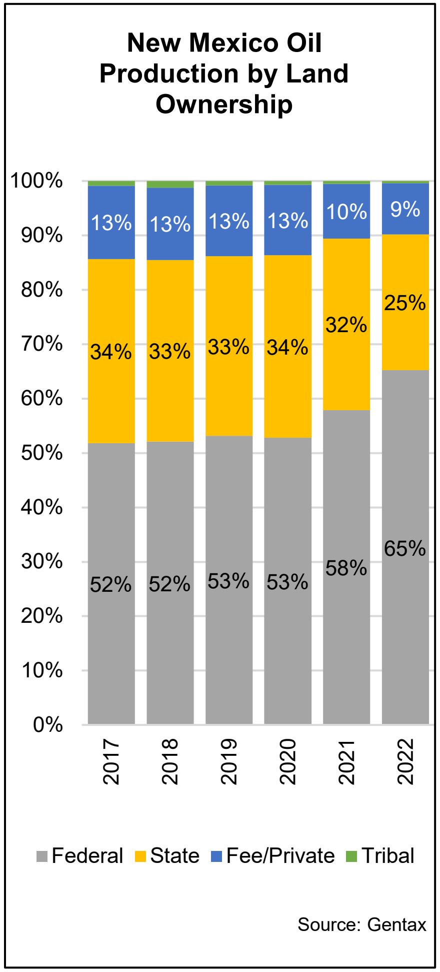
Jurisdiction	Max Rate
Arizona	12.5
South Dakota	12.5
California[1]	16.67
Montana	16.67
Wyoming	16.67
North Dakota[2]	18.75
Oklahoma	18.75
Colorado	20
New Mexico	20
Utah[3]	20
Texas	25

[1]Negotiated lease-to-lease, generally no higher than 16.67 percent
[2]ND sets a minimum of 12.5 percent in statute. Rates range from 16.67 to 18.75 percent.
[3]Utah's standard rate is 16.67 percent but the rate is 20 percent in better-producing areas.

Source: LFC and U.S. Department of the Interior

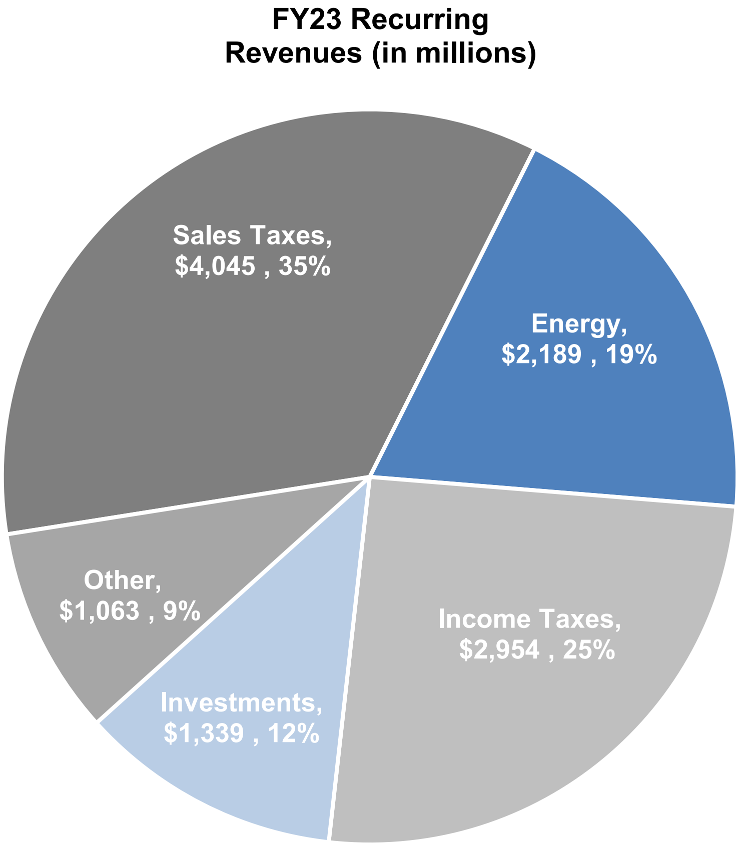
A large share of New Mexico's oil and gas revenue is from federal royalties as the share of production on federal land grows.

- The Mineral Leasing Act was passed in 1920 and set royalties at a minimum of 12.5 percent for oil and gas produced from federal lands. The federal royalty rates are set to increase to 16.67 percent with a cap of 18.75 percent.
- Half of royalties paid on production from federal land are distributed to the state.
- Federal royalty revenue up to the 5-year average is distributed to the general fund. Everything else is sent to the Early Childhood Trust Fund.
    - Beginning next year, revenues to the general fund will be capped at FY24 levels and the excess revenue after distributions to ECTF will flow to the severance tax permanent fund.
- FY23 Federal Royalties = $5.98 billion
    - $2.7 billion to the federal government
    - $2.1 billion to the Early Childhood Trust Fund
    - $1.1 billion to the general fund



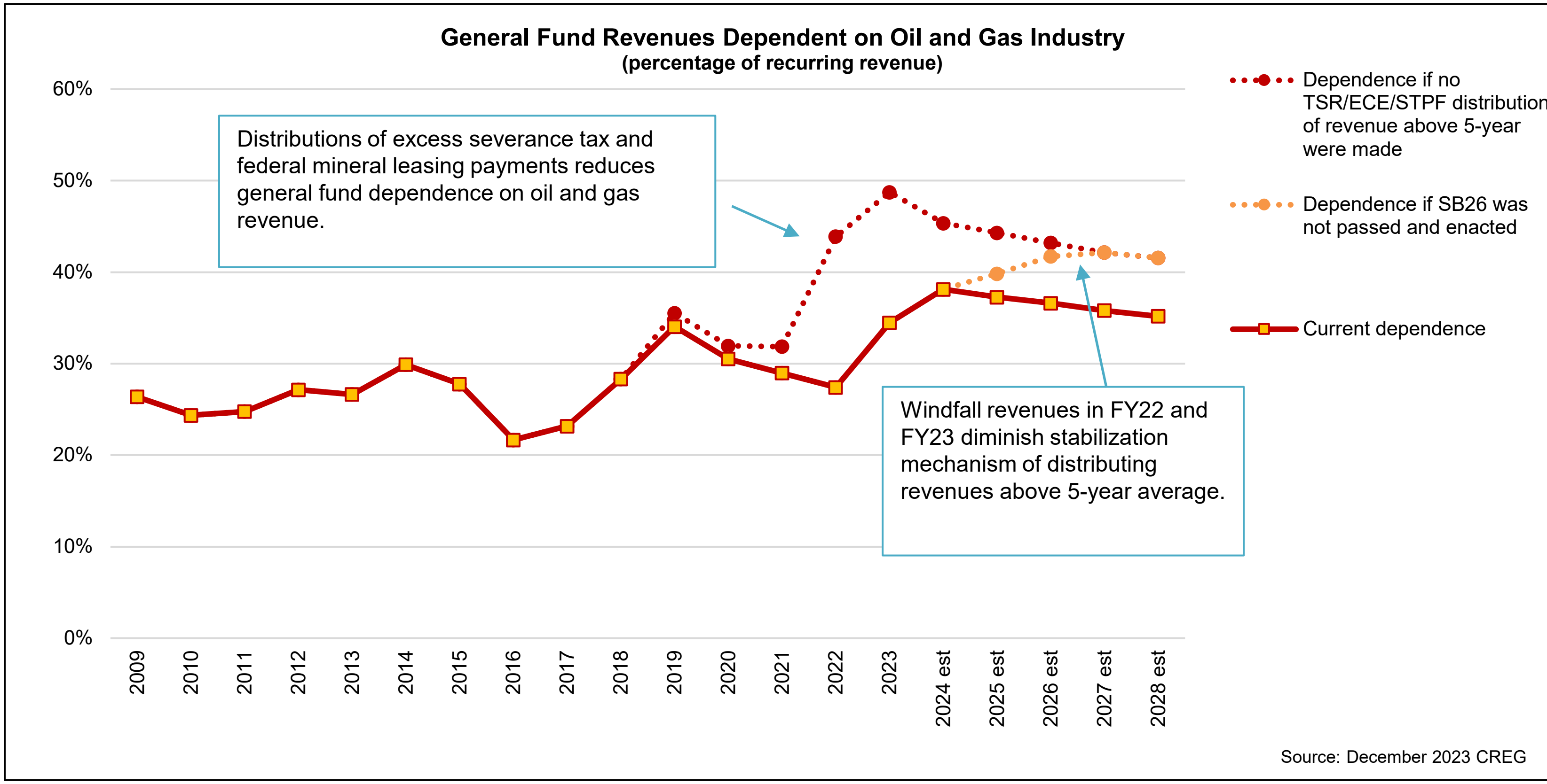
Direct oil and gas revenue makes up 19 percent of recurring general fund revenue. Including indirect revenue from GRT, PIT, and CIT bumps the share to close to 35 percent.

- Direct taxes on oil and gas total $2.19 billion.
- An estimated 35 percent of GRT and 20 percent of PIT is attributed to the oil and gas industry.
- The state's investment accounts contribute another $1.4 billion, or 14 percent, to the general fund. While this stable spin-off investment revenue is independent, the permanent funds themselves are largely funded through oil and gas revenue.

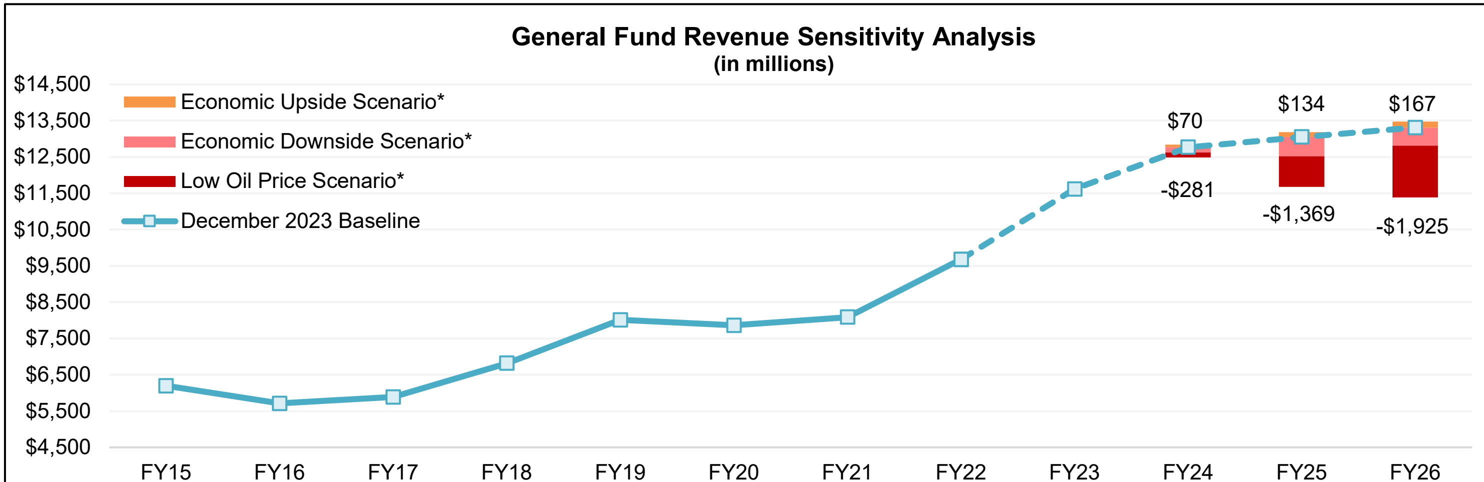


Source: December 2023 CREG Estimate, post-legis, post-veto

The revenue growth is driving the state into further dependence on oil and gas, although expectations for reliance are falling.



General fund reserves have enough money to cover "worst-case" stress test scenario.

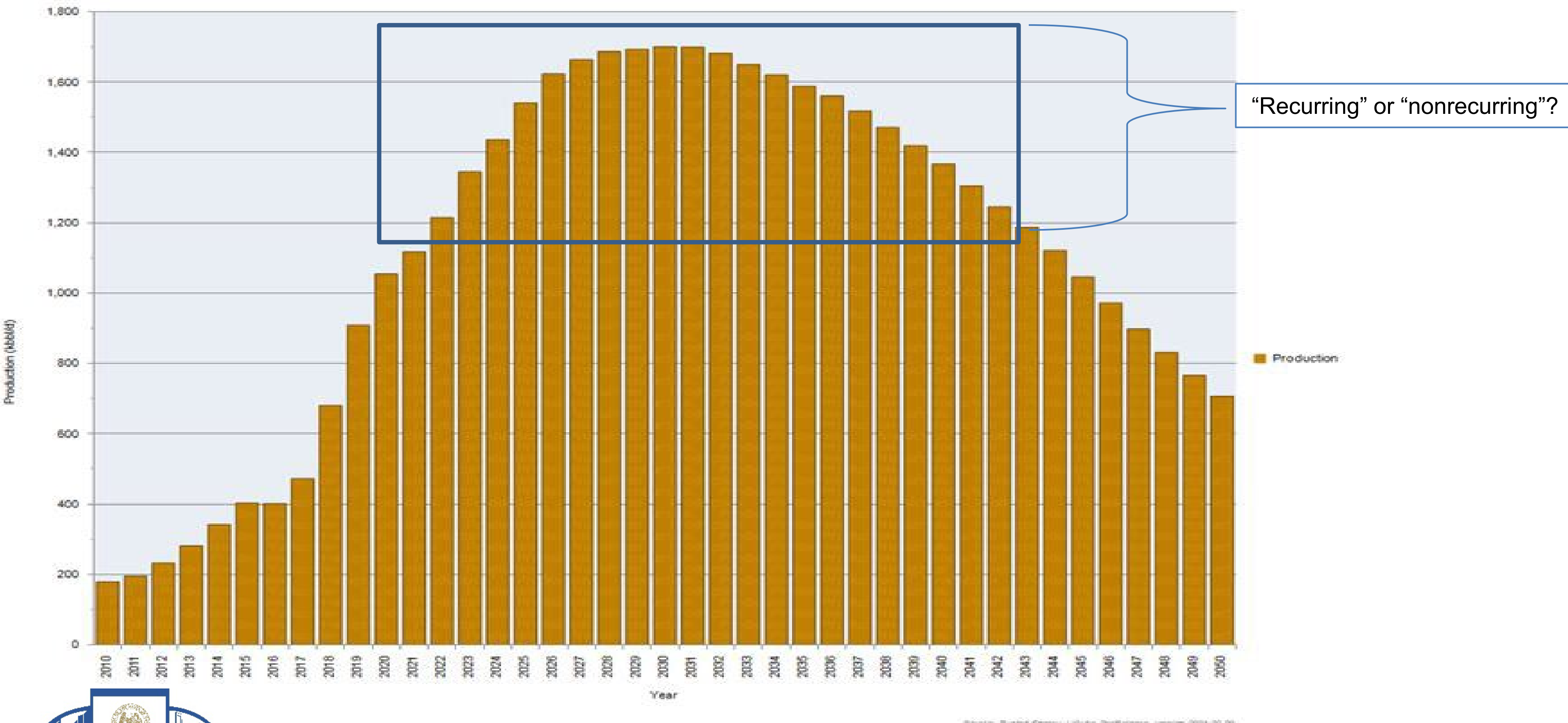


	S8: Low Oil Price			S3: Economic Downside			S1: Economic Upside		
Scenario	**FY24**	**FY25**	**FY26**	**FY24**	**FY25**	**FY26**	**FY24**	**FY25**	**FY26**
Severance Taxes to GF	-$36	-$437	-$480	-$8	-$42	-$25	$2	$4	$5
Federal Mineral Leasing to GF	$0	-$217	-$545	$0	$0	$0	$0	$0	$0
Gross Receipts Taxes	-$182	-$555	-$712	-$97	-$322	-$319	$60	$98	$116
Personal Income Taxes	-$62	-$160	-$188	-$34	-$158	-$151	$8	$32	$46
General Fund Difference from Baseline	-$281	-$1,369	-$1,925	-$140	-$522	-$496	$70	$134	$167
General Fund Percent of Total Impact	*25%*	*45%*	*55%*	*45%*	*31%*	*30%*	*35%*	*40%*	*38%*
Severance Taxes to TSR or ECE	-$499	-$428	-$130	-$131	-$428	-$130	$34	$76	$82
Severance Taxes to STPF	0	-$252	-$507	0	-$116	-$257	0	$7	$23
Federal Mineral Leasing to ECE	-$345	-$708	-$284	-$37	-$636	-$284	$94	$100	$124
Federal Mineral Leasing to STPF	$0	-$293	-$659	$0	-$7	-$459	$0	$19	$42
TSR/ECE Transfers Diff. from Baseline	-$844	-$1,681	-$1,580	-$168	-$1,187	-$1,130	$128	$201	$272
TSR/ECE/STPF Transfers Percent of Total Impact	*75%*	*55%*	*45%*	*55%*	*69%*	*70%*	*65%*	*60%*	*62%*
Total Difference from Baseline	-$1,125	-$3,050	-$3,505	-$308	-$1,709	-$1,626	$198	$336	$439

Note: in millions

While energy analytics firms expect NM oil production to continue growing for the next few years, production is currently expected to peak in the 2030s.

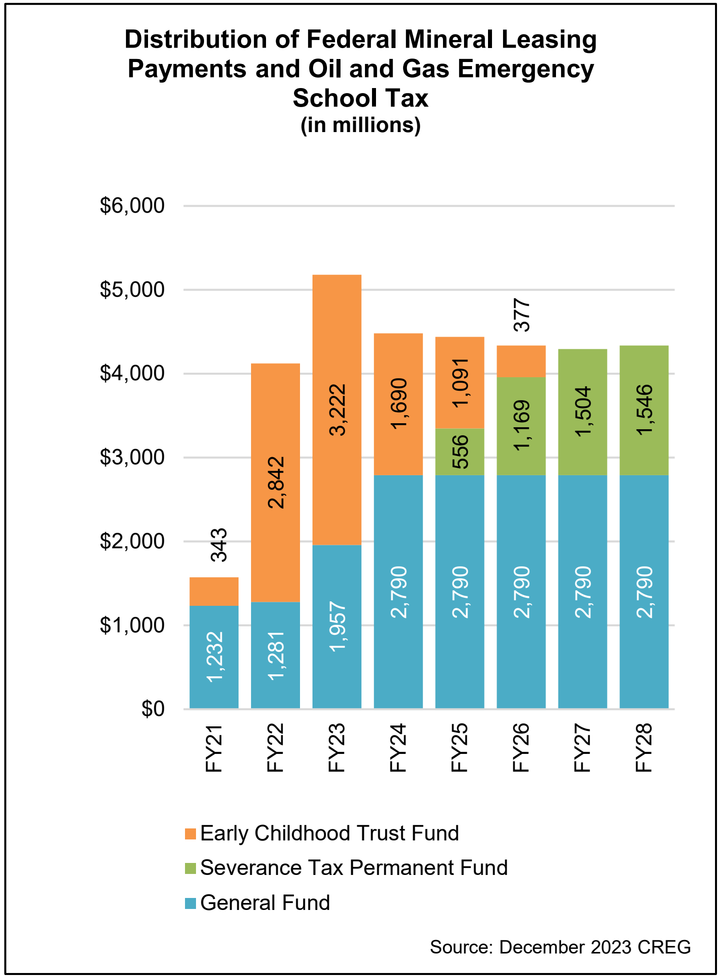
Rystad Energy – New Mexico Long-Term Oil Production Outlook



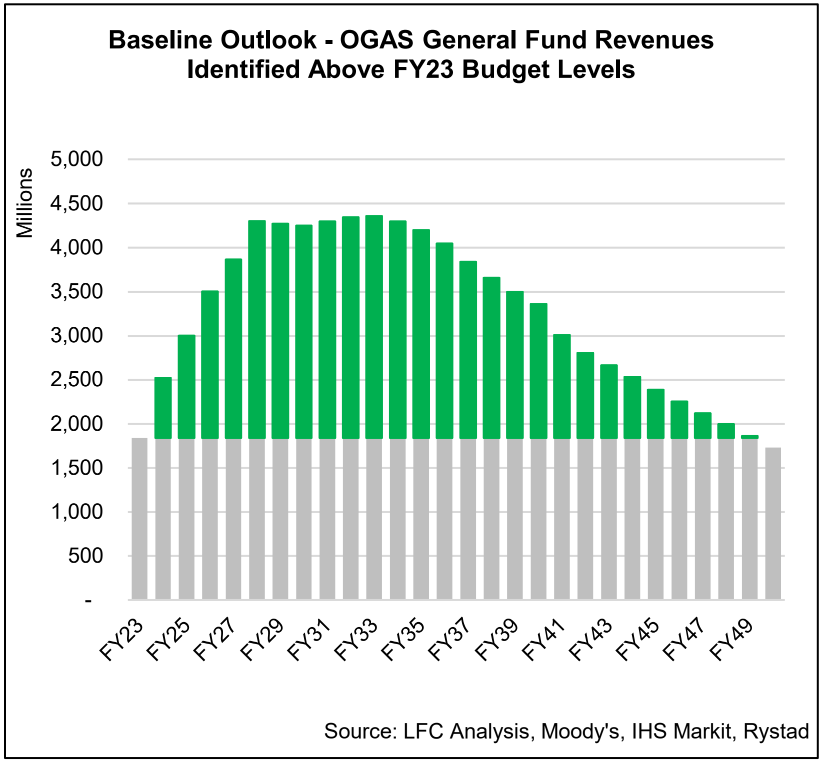
In addition to the general fund, oil and gas revenues benefit the early childhood trust fund and, beginning in FY25, the severance tax permanent fund.

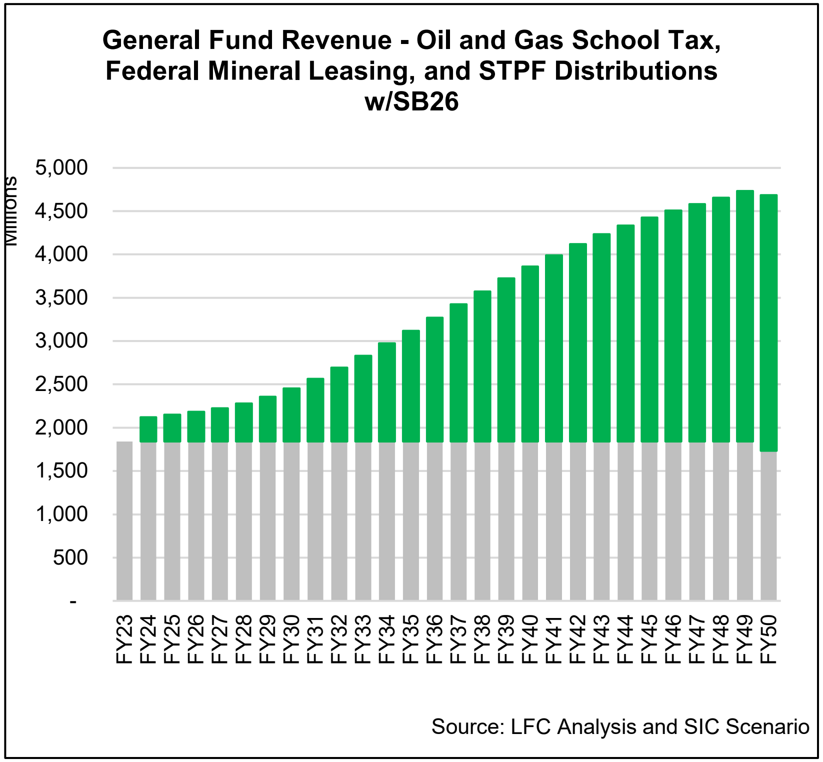
- Oil and gas revenues increased 162% y-o-y in FY22 and grew to over $5b in FY23
  - $1.95b to general fund
  - $3.2b to early childhood trust fund or tax stabilization reserve

- Oil and gas revenue from federal mineral leasing and the emergency school tax that flows to the general fund is capped at $2.79 billion.



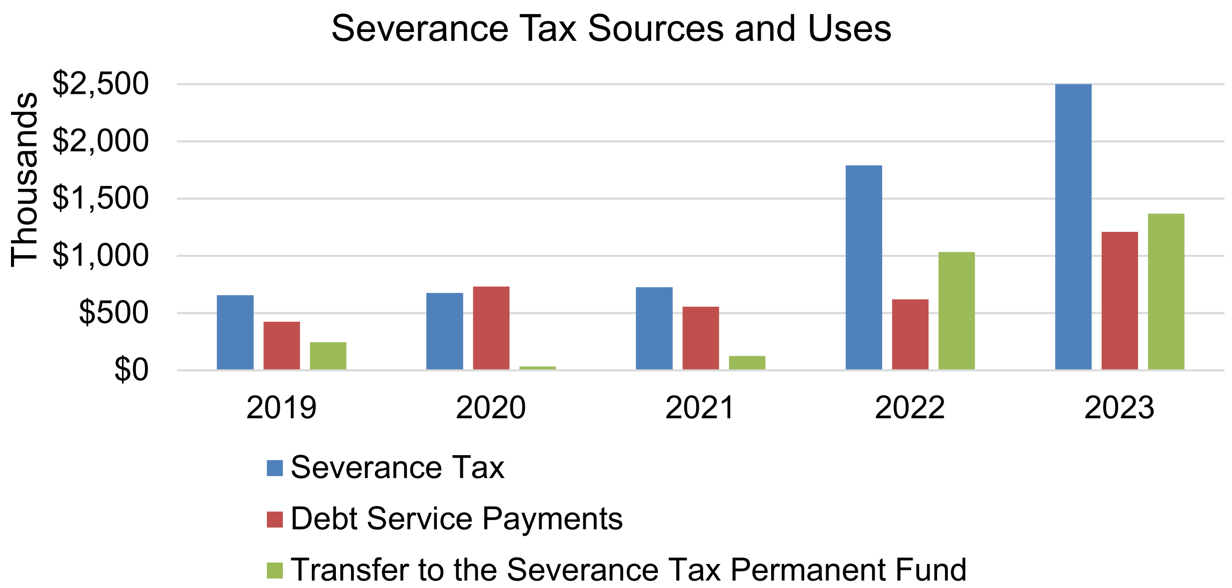
Distributions to the severance tax permanent fund are intended to reverse the impact of declining oil and gas revenues in the general fund.





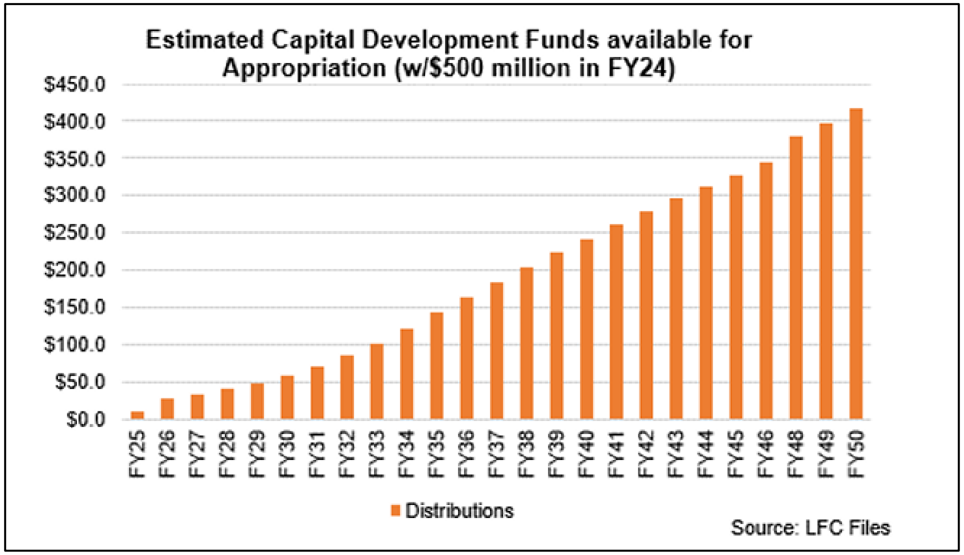
While general fund volatility and reliance on OGAS has been largely addressed, many other state fiscal programs are over-exposed.

- Prior to legislative action in 2024, the state capital program was heavily reliant on oil and gas revenue.
- Booming OGAS revenues caused rapid growth in the capital program, contributing to large project backlogs, increased project costs, and billions of unused (and uninvested) funds.



The new capital development and reserve fund will help stabilize and grow capital funding over time.

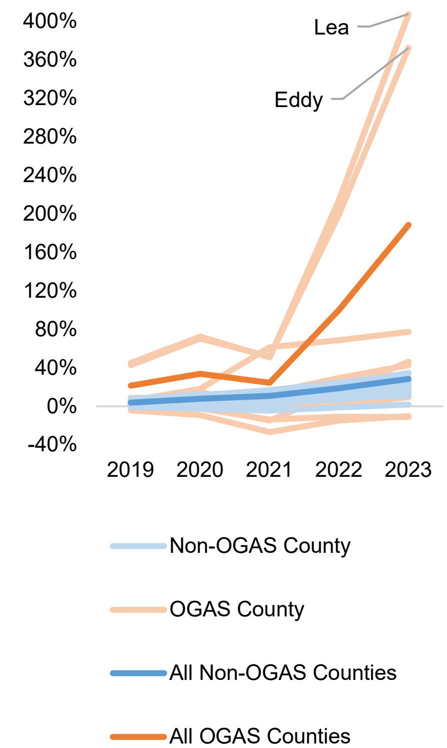
- House Bill 253 authorizes the Board of Finance to convert any excess cash available in the severance tax bonding fund at the end of FY24, up to $500 million, into a one-time distribution to the capital development and reserve fund. It also constrains future long-term debt and sends savings to the fund.
- Similarly to how the permanent funds help stabilize the general fund, this development and reserve fund will leverage investment earnings to “spin-off” reliable revenue and replace some severance tax revenue for capital projects.



Property taxes, which fund the state general obligation bond program, are becoming more dependent on oil and gas revenue.

- Oil and gas properties comprised 37 percent of taxable property values in 2023, up from an average share of 8 to 14 percent prior to 2021.
- Property taxes primarily benefit local governments. About 5 percent of property taxes fund the state general obligation bond program.
- FY23 Ad Valorem Taxes (est.) = $997 million
    - $941 to local governments
    - $56 million to statewide GO bonds

Net Taxable Value Growth over 2018 Levels



Source: LFC analysis of DFA data

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QUESTIONS?

The Oil and Gas Severance Tax

- The severance tax rate is 3.75 percent of taxable value (price x production) of all oil and natural gas severed and sold, excluding royalties paid to federal, state, or tribal governments and some transportation costs.
- The severance tax is distributed to the severance tax bonding fund, with any excess being distributed to the severance tax permanent fund.
- FY23 Severance Tax = $2.5 billion
  - $1.2 billion for capital
  - $1.3 billion to the permanent fund

The Oil and Gas Emergency School Tax

- The oil and gas emergency school tax rate is 4 percent of the value of natural gas and 3.25 percent of the value of oil, excluding royalties and transportation costs.
- School tax revenue up to the 5-year average is distributed to the general fund. Everything else is sent to the early childhood trust fund.
  - Beginning next year, revenues to the general fund will be capped at FY24 levels and the excess revenue after distributions to ECTF will flow to the severance tax permanent fund.
- FY23 Emergency School Tax = $2.04 billion
  - $838 million to the general fund
  - $1.2 billion to the early childhood trust fund

The Oil and Gas Conservation Tax

- The oil and gas conservation tax 0.19 percent unless the average price of oil exceeds $70 per barrel, in which case the rate increases to 0.24 percent.
- When the tax is 0.19 percent, approximately 10 percent of the revenue from the conservation tax is distributed to the oil and gas reclamation fund, used to reclaim and plug abandoned wells. This distribution increases to roughly 20 percent when the tax is 0.24 percent. The rest goes to the general fund.
- FY23 Conservation Tax = $137 million
  - $110 million to the general fund
  - $27 million to the oil and gas reclamation fund

Natural Gas Processors Tax

- The natural gas processors tax is a tax on the privilege of operating a natural gas processing plant in New Mexico (in lieu of GRT).
- The rate is set initially at $.0065 per mmbtu and is adjusted every year by a factor equal to the average value of natural gas produced in New Mexico the preceding calendar year divided by $1.33 ($.0282/mmbtu in FY24).
- FY23 Natural Gas Processors Tax= $35 million

Oil and Gas Revenue Distribution Decision Tree

Does federal royalty revenue exceed the 5-year average and FY24 levels?

- No: Transfer all revenue to the general fund
- Yes:
  1. Transfer revenue equal to FY24 levels to the general fund
  2. Transfer excess of 5-year average to the early childhood trust fund
  3. Transfer any leftover revenue to the severance tax permanent fund

Does emergency school tax revenue exceed the 5-year average and FY24 levels?

- No: Transfer all revenue to the general fund
- Yes:
  1. Transfer revenue equal to FY24 levels to the general fund
  2. Transfer excess of 5-year average to the tax stabilization reserve until 25% reserve target
  3. Transfer remaining excess of 5-year average to the early childhood trust fund
  4. Transfer any leftover revenue to the severance tax permanent fund