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

SPONSOR Soules/Stewart **ORIGINAL DATE** 2/14/2020 **LAST UPDATED** **HB**

SHORT TITLE Fund Distribution at Certain Reserve Levels **SB** 223

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22	FY23	FY24		
-	Up to $173,200.0*	Up to $119,000.0*	Up to $91,800.0*	Up to $77,200.0*	Recurring	General Fund
-	Up to ($173,200.0)*	Up to ($119,000.0)*	Up to ($91,800.0)*	Up to ($77,200.0)*	Recurring	Tax Stabilization Reserve

(Parenthesis ( ) Indicate Revenue Decreases)

*Note: Estimated impact to general fund and tax stabilization reserve conditional on general fund reserve balances as a percent of recurring appropriations. See *Fiscal Implications*.

Conflicts with HB83 and SB3

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Bill

Senate Bill 223 amends the current distributions of the oil and gas emergency school tax to the tax stabilization reserve (TSR) to make those distributions dependent on the level of state reserves.

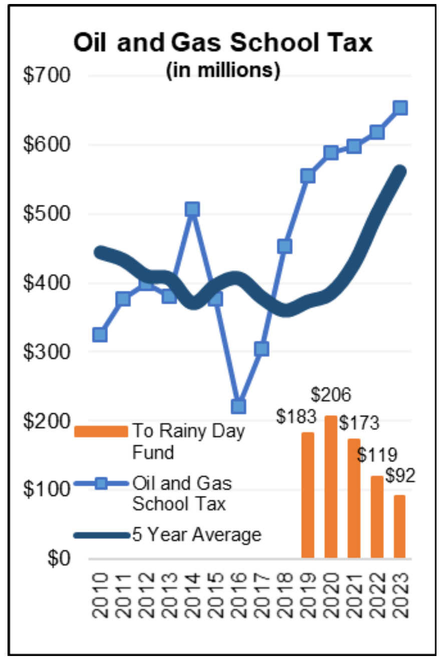
If state reserves – defined in the bill as the operating reserve, appropriation contingency fund, state-support reserve fund, tobacco settlement permanent fund, and the tax stabilization reserve – at the end of a fiscal year are below 20 percent of recurring appropriations, then the entire school tax revenue in excess of the five-year average will continue to be distributed to the tax stabilization reserve (as in current law). The bill provides that if reserves are between 20-25 percent, then half of the excess will be distributed to the TSR. If reserves are between 25-30 percent, then one-quarter of the excess will go to the TSR; and, if reserves are above 30 percent then no excess revenues will be distributed to the TSR.

The bill states the Department of Finance and Administration (DFA) will make the calculations to determine the excess to be distributed. The effective date of this bill is July 1, 2020.

FISCAL IMPLICATIONS

Under current law, if current fiscal year oil and gas emergency school tax revenue exceeds the five-year average, the excess amount is distributed to the tax stabilization reserve (TSR). Starting in FY21, this bill would make that distribution dependent on the level of state reserves prior to the distribution of excess school tax revenues. The table below illustrates the distribution percentages based on the level of state reserves as a percent of recurring appropriations.

Distribution of Excess Oil and Gas Emergency School Tax Revenues		
State Reserves	**TSR**	**General Fund**
Below 20%	100%	0%
20% to 25%	50%	50%
25% to 30%	25%	75%
Above 30%	0%	100%



In FY19, general fund reserves ended the fiscal year at 28.9 percent of recurring appropriations. Notably, since reserves are a calculated percentage, the total amount needed in reserves to meet the percentage thresholds grows as recurring appropriations grow.

The first instance of excess oil and gas emergency school tax revenues being distributed to the TSR occurred in FY19 in the amount of $183 million. The December 2019 consensus revenue estimates project this provision will distribute $206 million to the TSR in FY20 and $173 million in FY21. The chart to the right illustrates the function of this five-year average provision.

SIGNIFICANT ISSUES

The ending balance of the tax stabilization reserve at the end of FY17 was $0.0, as all of the fund balance was swept in solvency efforts for FY16 and FY17 amid an oil price downturn. Chapter 3 of the 2017 special session passed the provision to distribute oil and gas emergency school tax revenue above the five-year average to the TSR as a means to gradually restore the balance of the fund with excess revenues from the extractives industry and to reduce volatility in the general fund. The effective date of this provision was the beginning of FY19, and the only distribution to-date that has occurred pursuant to this provision was $183 million in FY19.

However, the balance of the TSR at the end of FY19 was nearly $1.1 billion. This rapid growth in the size of the fund was due to unexpected windfalls from surging oil production that resulted in significantly larger related revenues than projected in the consensus estimates – this resulted in large transfers excess revenues to the operating reserve, which receives all unappropriated revenues at the end of a fiscal year. A different statute – Section 6-4-4 NMSA 1978 – provides that at the end of a fiscal year, any balance in the operating reserve in excess of 8 percent of recurring appropriations is to be transferred to the tax stabilization reserve. At the end of FY18, $526 million was transferred from the operating reserve to the TSR as a result of this provision. Another $378 million was transferred from the operating reserve to the TSR in FY19. These two distributions generated about 83 percent of the current balance $1.1 billion balance of the TSR.

Tax Stabilization Reserve FY17-FY19 (in millions)			
Revenues/Transfers	**FY17**	**FY18**	**FY19**
Operating Reserve Transfer (excess of 8 percent of appropriations)	$0.0	$526.8	$378.3
Excess Oil and Gas Emergency School Tax Distribution	n/a	n/a	$183.2
Total Transfer to TSR	**$0.0**	**$526.8**	**$561.5**
Ending TSR Balance	**$0.0**	**$526.8**	**$1,088.3**

The TSR is the most restrictive general fund reserve account. Under current law, funds can be appropriated from this reserve account only if:

1) the governor declares it "necessary for the public peace, health and safety" and only with the vote of two-thirds of both the House and Senate; or
2) revenues are determined by the governor to be insufficient to meet authorized appropriations for the current and next fiscal year and the House and Senate approve a transfer to the general fund with a majority vote to cover the projected insufficiency for either or both fiscal years.

Under current statute, distributions to the TSR continue regardless of the size of the fund or the state's total reserves. To the extent the legislature has a target level for reserves (e.g. 25 percent of appropriations), there is a risk of growing the TSR (a more restrictive account) at the expense of the operating reserve (a less restrictive account), which impacts the ease of which the Legislature can appropriate funds for recurring or nonrecurring needs. Presumably, this bill attempts to address this issue by limiting the amount of the transfer to the TSR as the size of general fund reserves grows.

PERFORMANCE IMPLICATIONS

The current distribution of excess oil and gas emergency school tax revenues is an inherent buffer for the consensus forecast, as negative impacts of severance tax revenue volatility hits reserves first, reducing negative effects to the general fund. Additionally, this mechanism reduces uncertainty in general fund revenue forecasting, which better prepares budget-makers for the amount of revenue they can expect to appropriate in the upcoming budget year.

By requiring the transfer of excess school tax revenue to be dependent on the size of reserves, this bill increases uncertainty in revenue forecasting, as it would require revenue forecasters to attempt to determine reserve levels in the forecast. Because reserves are a percentage of appropriations, and appropriations levels are only set for current and following fiscal year, it makes this task particularly difficult for producing a five-year revenue forecast. A potential alternative would be to require that any of these excess oil and gas emergency school tax revenues not transferred to the TSR be treated as nonrecurring revenue in the general fund. This would provide guidance to revenue forecasters on how to treat these above-trend revenues and reduce uncertainty in recurring general fund revenue forecasts.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Conflicts with House Bill 83 and Senate Bill 3, which specify that oil and gas emergency school tax revenues in excess of the five-year average will flow into a new early childhood education and care fund when reserves are at least 25 percent of recurring appropriations.

ALTERNATIVES

The current mechanism for transferring oil and gas emergency school tax revenues in excess of the five-year average effectively captures and saves above-trend revenues that may not be sustainable over time. This bill proposes keeping these above-trend revenues in the general fund dependent upon the size of reserves. By doing this, these funds could be then be used to support additional recurring or nonrecurring spending. Budget makers may want to proceed with caution when allocating above-trend revenues to long-term obligations. A potential alternative would be to require that any of these excess oil and gas emergency school tax revenues not transferred to the TSR be treated as nonrecurring revenue in the general fund. This would effectively require those funds only be allocated for nonrecurring purposes.

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