FISCAL IMPACT REPORT

		LAST UPDATED	1/21/24
SPONSOR	Reps. McQueen and Lujan/Sen. Tallman	**ORIGINAL DATE**	1/19/24
SHORT TITLE	Oil and Gas Future Royalty Rate	**BILL NUMBER**	House Bill 48
		ANALYST	Gaussoin

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
				Up to $50,000.0	Up to $75,000.0	Recurring	Land Grant Permanent Funds
				Indeterminate but minimal loss	Indeterminate but minimal loss	Recurring	Land Maintenance Fund

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

Duplicates Senate Bill 24

Sources of Information

LFC Files

Agency Analysis Received From
State Land Office (SLO)
State Investment Council (SIC)

SUMMARY

Synopsis of House Bill 48

House Bill 48 (HB48) amends the State Land Office lease form for certain oil and gas tracts of state trust land to increase the maximum royalty rate—the amount oil producers pay on the value of oil or gas removed. The rate would increase from one-fifth of the value of the oil or natural gas produced to one-fourth of the value of the oil or gas. The new form would be used for leases issued on or after July 1, 2024, also the effective date of the bill.

FISCAL IMPLICATIONS

Land Grant Permanent Fund. The change in the royalty rate is expected to generate from $50 million to $75 million of additional revenue for the land grant permanent fund, the depository for royalties paid on mineral production on state trust land. The estimate is based on the Consensus Revenue Estimating Group's projection of oil and gas prices and Rystad Energy estimates of future New Mexico oil and gas production from wells that have not yet been permitted, drilled, or completed. The estimate was then narrowed to reflect a State Land Office (SLO) estimate that just 1 percent of the prime leasing land that would be affected by the new lease rates is available (see attachment). In addition, because the new royalty rate would only affect new leases and production typically starts two or three years after a lease is signed, the fiscal impact to the land grant permanent fund is expected to be delayed until FY27.

SLO estimates the change in royalty rate would result in an additional \$50 million to \$84 million in revenue to the land grant permanent fund. SLO says it based its estimate on an evaluation of production, and production growth, from wells on state trust land completed within the last 10 years and the average annual prices for oil and gas.

The State Investment Council (SIC) reports it cannot independently estimate the potential annual increase in revenue to the land grant permanent fund without data on the availability of new leases or the production potential on newly leased lands, but—using SLO's revenue estimate—the market value of the permanent fund could grow by \$1.5 billion to \$2.5 billion by 2050. In turn, because public schools (primarily) and other state agencies receive distributions from the permanent fund, the additional revenue in the fund would increase the amounts in those distributions, offsetting the need for general fund revenues to support those agencies.

From SIC:

> Using the previous SLO estimates for additional annual revenue to the LGPF, SIC staff estimate LGPF beneficiaries could receive an additional \$750 million to \$1.3 billion in cumulative distributions through 2050, approximately 87 percent of which would benefit the general fund through distributions to common schools. This estimate assumes the LGPF target annual average return of 7 percent.

Land Maintenance Fund. SLO notes bonus payments on oil and gas leases, one time payments at the monthly oil and gas auction for the right to obtain a lease that are deposited in the land maintenance fund, are generally lower for leases with higher royalty rates. About a quarter of the revenue in the maintenance fund pays for the operations of the land office. Money left in that fund after SLO expenses are, along with much larger distributions from the land grant permanent fund, distributed to the beneficiaries. Although the impact is much smaller, reductions in the maintenance fund reduce the amount distributed to beneficiaries, increasing their reliance on general fund revenue in some cases. Nevertheless, the impact on the land maintenance fund is likely to be small.

Risk to Estimate. In addition to the risks to any revenue estimate involving oil and gas production from the volatility in prices, the estimate of the fiscal impact of a royalty rate increase is challenged by the lack of leases available in the state's high-production areas. Less than 1 percent of tracts in the high-production zone of the State Land Office's Southeast District remain available for new lease rates. Leases have an initial term of five years but can be held by the lessee for as long as they are productive, meaning new royalty rates might not have significant impacts on production or revenues because nearly all productive lands are already leased at the lower levels.

SIGNIFICANT ISSUES

Royalty rates on state trust lands range from 12.5 percent to 20 percent. The State Land Office, which manages 12.7 million subsurface acres and 9 million surface acres on behalf of 21 beneficiaries, uses three lease forms, set in statute, based on whether the tract is in a restricted area (where oil and gas production normally occurs) and whether it is classified as "regular" or "premium," based on a formula that looks at oil and gas reservoir volume and value. The royalty rate for restricted, premium tracts, what the office calls the "most productive state trust land oil and gas leasing tracts," can be no lower than 18.75 percent and no higher than 20 percent. The bill would raise the maximum rate to 25 percent.

New Mexico Compared With Other States. New Mexico's 20 percent maximum royalty rate for oil and gas leases on trust land, last updated in the 1970s, is higher than those in most other states with trust land but less than that charged by Texas, New Mexico's competitor in the high-production Permian Basin. Information from a 2021 federal Department of Interior report and an informal survey of states with trust lands by LFC staff shows oil and gas royalty rates in trust land states between 12.5 percent 25 percent, with most charging 16.67 or 18.75 percent.

Texas charges as little as 20 percent on some leases but charges 25 percent on leases for tracts in the Delaware Basin, part of the Permian Basin and those tracts in direct competition with New Mexico's highest value tracts. The State Land Office argues New Mexico leases would be "more industry friendly" than those on trust land in Texas, even if the royalty rate were raised to 25 percent, because New Mexico, among other conditions, offers longer lease terms and charges the royalty on a calculation of proceeds that allows for some deductions, rather than gross proceeds.

North Dakota, the third largest oil producer behind Texas and New Mexico, sets a minimum in statute of 12.5 percent but charges between 16.67 percent and 18.75 percent. The North Dakota counties at the higher rate are all within the high-producing Bakken Formation, although some counties within the formation are at the lower rate.

While New Mexico rates are generally higher than those charged for trust land in other states, rates seem to be increasing. Pheasant Energy, a Fort Worth- based oil exploration and production company, reported in late 2022 royalty rates charged by states and private landowners are on upward trend, with royalties for private lands influenced by those being charged by states.

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

Royalties on Wasted Oil and Gas. Although several states require producers to pay royalties on oil and gas lost through venting, spills, and other practices, New Mexico does not. Texas includes "non-sales disposition" volumes in its lease agreements, and the federal Bureau of Land Management has proposed a new rule for oil and gas production on federal and tribal lands that would impose royalties on vented or flared natural gas.[1] That rule would impose monthly limits on royalty-free flaring as part of an effort to curb methane emissions.

PERFORMANCE IMPLICATIONS

From SLO:

> The bill would advance the State Land Office's core mission of generating revenue for trust beneficiaries as well as adherence to the agency's legislative performance measures. While the immediate and short-term impact is difficult to determine, particularly given the uncertainty about how many new leases would be issued each month, the time it takes for a newly issued lease to go into production, future oil and gas price and production levels, etc., it is clear that the legislation would result in significant increases in State Land Office annual royalty transfers to the LGPF, which in turn would result in substantial increases in distributions from the LGPF to beneficiaries as these contributions are invested and gain additional value over the long-term.

ADMINISTRATIVE IMPLICATIONS

While SLO would need to update its lease forms, this represents a minor administrative burden.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 48 is identical to Senate Bill 24 and nearly identical to the final version of Senate Bill 164 from the 2023 legislative session. That bill was approved by two Senate committees before it died through lack of action.

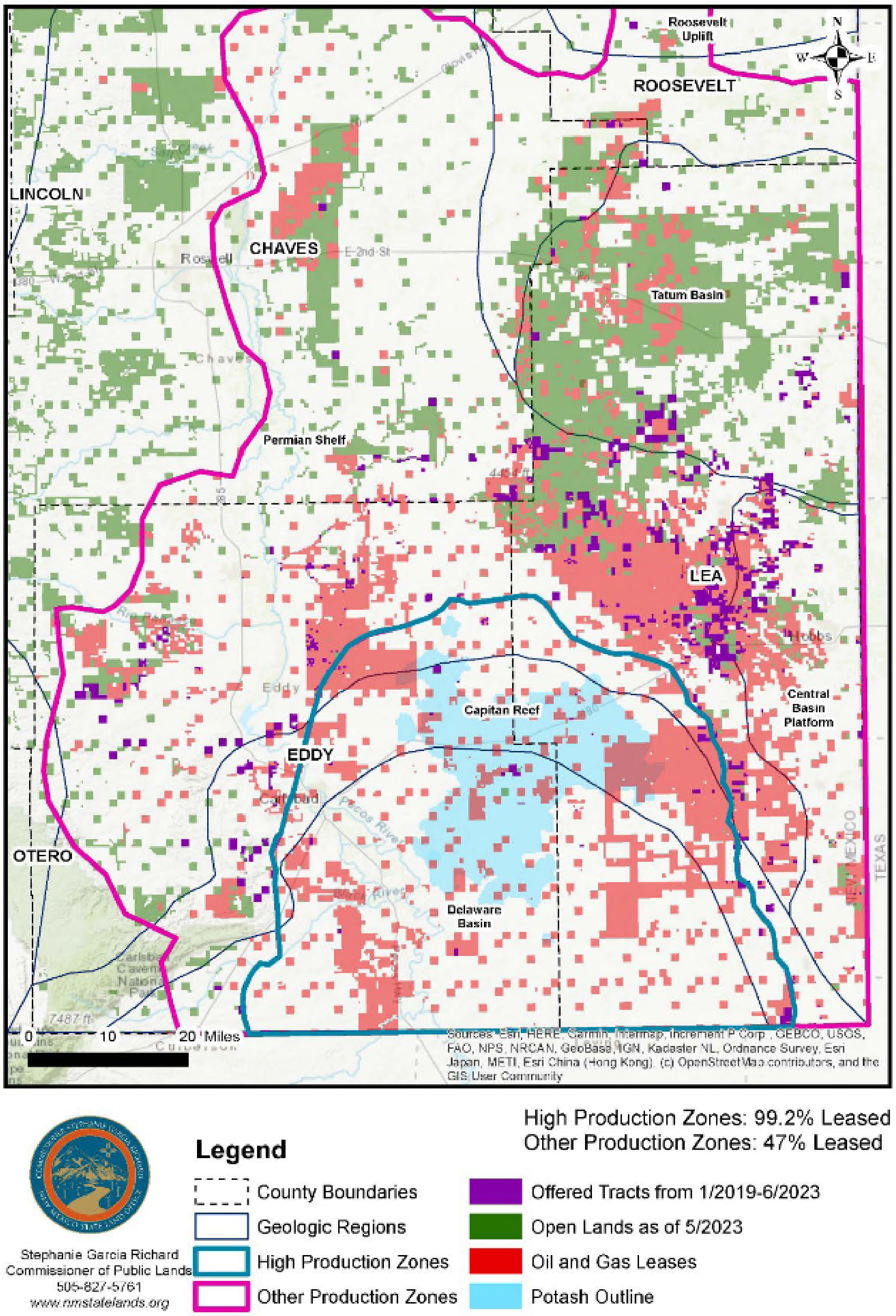
HG/ss/ne/ss/rl

---

[1] https://www.federalregister.gov/documents/2022/11/30/2022-25345/waste-prevention-production-subject-to-royalties-and-resource-conservation

Attachment

Southeast Restricted District Production Zones, Offered Tracts from 1/2019-6/2023, and Open vs. Leased Lands



The New Mexico State Land Office assumes no responsibility or liability for, or in connection with, the accuracy, reliability or use of the information provided here, in State Land Office data layers or any other data layer.