FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	STBTC	**ORIGINAL DATE**	3/8/23
SHORT TITLE	Future Oil & Gas Royalty rates	**BILL NUMBER**	CS/Senate Bill 164/STBTCS
		ANALYST	Gaussoin

REVENUE*
(dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY23-FY25	FY26	FY27		
	$50,000.0	$50,000.0	Recurring	Land Grant Permanent Fund
	Indeterminate but minimally negative	Indeterminate but minimally negative	Recurring	Land Maintenance Fund

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

Relates to House Bill 95.

Sources of Information

LFC Files

Responses Received From
State Land Office (SLO)
New Mexico Attorney General (NMAG)

No Response Received
Energy, Minerals and Natural Resources Department (EMNRD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of STBTC Substitute for Senate Bill 164

The Senate Tax, Business and Transportation Committee substitute for Senate Bill 164 (SB164/STBTCS) 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 effective date of this bill is July 1, 2023.

FISCAL IMPLICATIONS

SLO projected the original SB164, identical to the substitute in its provisions on the lease rate, would not have any impact on lease[1] revenue until FY26 because only new leases would be affected, and production typically begins two or three years after a lease is signed. In addition, because of the impact of oil and gas prices and other market factors on lease demand and production levels, the office notes it is difficult to predict how many leases will go to auction or when they will begin production. Based on the number of evaluating wells completed in the past 10 years, the average annual price of oil and gas, and predictions of production growth, the office places the average annual increase in revenue at $50 million to $84 million, money that would go into the land grant permanent fund. That fund, in turn, is invested on behalf of the specific beneficiaries of the trust land—the public school system is, by far, the largest beneficiary—and the resulting income offsets general fund revenue otherwise needed to support those entities. Given that SLO's estimate relies on a period when oil production grew dramatically and that the office reports most state trust land tracts in the high-demand Permian Basin are already leased, this analysis uses the low end of the parameter for its estimated growth in revenue.

SLO notes bonus payments on oil and gas leases, onetime 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 third 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.

SIGNIFICANT ISSUES

Royalty Rates

New Mexico's 20 percent royalty rate was last updated in the 1970s, according to SLO. While the New Mexico trust land rate is lower than Texas, which sets the rate at 25 percent, it is generally in line with other western states, the location of 85 percent of all state trust land in the nation. Rates seem to be increasing, however. Pheasant Energy, a Fort Worth-based oil exploration and production company, said royalty rates charged by states and private landowners have been rising in recent years, with royalties for private lands influenced by those being charged by the states.

SLO reports neighboring states with high production volumes already collect 25 percent royalties, as well as collecting royalties on wasted oil and gas and oil and gas used in production. SLO seems to be referring to Texas, the only neighboring state with the 25 percent rate;

[1] SLO uses three lease forms based on whether the tract is restricted (so-called because a competitive bid process is required) and whether it is classified as "regular" or "premium," based on a formula that looks at oil and gas reservoir volume and value. The proposed new form is for a development lease, only used for leases for restricted, premium tracts, what SLO calls the "most productive state trust land oil and gas leasing tracts."

however, SLO points out North Dakota, among the top three oil producers with Texas and New Mexico, only has a statutory minimum rate; the North Dakota trust land manager sets the maximum.

While the president of the New Mexico Oil and Gas Association is quoted in an April 2022 article in the environment-focused *E&E News* that higher federal royalty rates would stifle production, SLO contends New Mexico will remain competitive even with a higher rate:

> New Mexico's competitor in the Permian Basin is Texas. Texas already has a 25 percent royalty rate that it charges, so companies will also bid on 25 percent royalty rate tracts in New Mexico. It is also widely believed that private landowners may receive royalty rates greater than 25 percent. Note also that if a lease did not attract bidders at 25 percent the State Land Office could resell it at 20 percent at a future month's sale.

Notably, the federal government has been criticized for rates that many consider too low, with the budget watchdog group Taxpayers for Common Sense, among numerous organizations raising the issue in the past few years, reporting the federal government lost $12.4 billion in revenue between 2010 and 2019 because of a "grossly outdated" rate set in the 1920s.

Royalty on Lost Oil and Gas

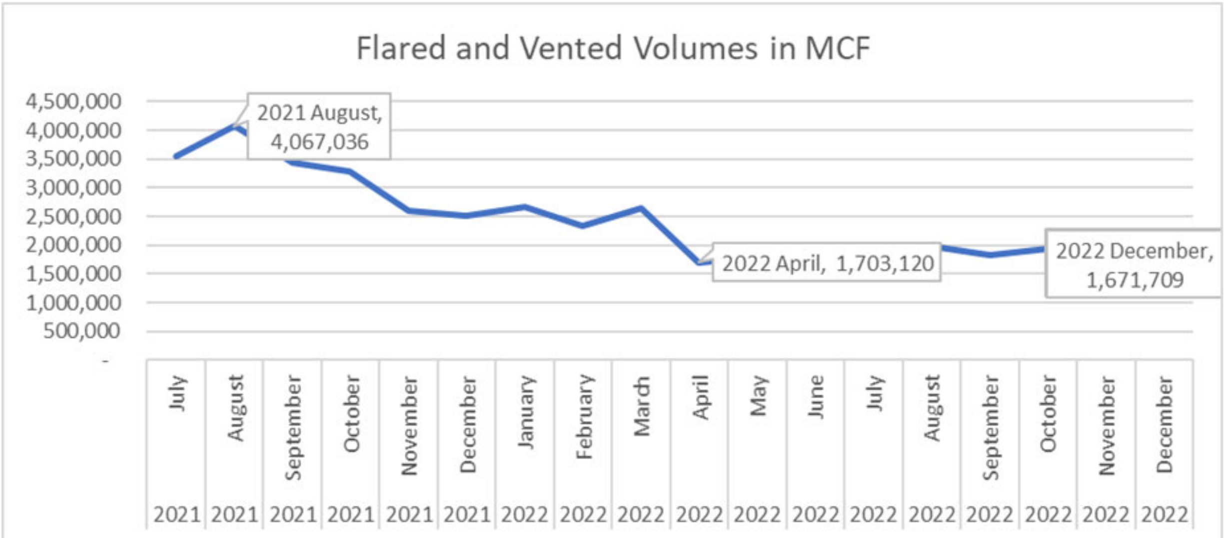
The original version of SB164 included new language in the lease agreement requiring producers to pay the rate on wasted oil and gas. That provision is not part of the substitute bill. Texas includes non-sales disposition volumes in its lease agreements, and the federal Bureau of Land Management has proposed a new rule for oil and gas production on federal and tribal lands that would impose royalties on vented or flared natural gas.[2] That rule would impose monthly limits on royalty-free flaring as part of an effort to curb methane emissions.

Supporters of charging royalties on gas lost through venting, spills, and other practices argue producers should have to pay for the resources they extract whether the oil or gas makes it to market or not and point out that producers are wasting a resource that could be serving consumers.

The Earth Observation Group at the Colorado School of Mines reports New Mexico was third in the country, behind Texas and North Dakota, for flaring volumes captured by satellites between 2014 and 2020.

SLO says venting, flaring, and other waste of natural gas has fallen significantly since 2021, when the Oil Conservation Division of the Energy, Minerals and Natural Resources Department implemented methane waste rules in concert with the implementation of new oil-field emissions rules promulgated by the Environment Department. SLO supported including the venting language in the lease.

[2] https://www.blm.gov/sites/default/files/docs/2022-11/Proposed%20Waste%20Prevention%20Rule%20RIN%201004-AE79.pdf



Graphic: Reported flared and vented volumes from July 2021 to December 2022, a period covering the new OCD methane waste rule going into effect.

Source: SLO

PERFORMANCE IMPLICATIONS

From SLO's analysis of the original SB164:

> 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

SLO reported the original Senate Bill 164 would require the agency to revise form templates and IT systems, posting a minor administrative burden.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB164 relates to House Bill 95, which would codify a renewable energy office at SLO.

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