LFC Requester:	Austin Davidson

AGENCY BILL ANALYSIS - 2025 REGULAR SESSION

WITHIN 24 HOURS OF BILL POSTING, UPLOAD ANALYSIS TO
AgencyAnalysis.nmlegis.gov and email to **billanalysis@dfa.nm.gov**
(Analysis must be uploaded as a PDF)

SECTION I: GENERAL INFORMATION

{Indicate if analysis is on an original bill, amendment, substitute or a correction of a previous bill}

Date Prepared: 1/22/25 *Check all that apply:*
Bill Number: *SB 23* Original *X* Correction __
Amendment __ Substitute __

Sponsor: Sen. Munoz

Short Title: Oil& Gas Rate Changes

Agency Name and Code Number: State Land Office - 539

Person Writing Sunalei Stewart

Phone: 505-827-5755 **Email** sstewart@nmslo.gov

SECTION II: FISCAL IMPACT

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY25	FY26		
None	None	N/A	N/A

(Parenthesis ( ) indicate expenditure decreases)

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY26-28	FY29	FY29		
None, minimal	$50,000,000	$50,000,000	Recurring	Land Grant Permanent Fund
Indeterminate but minimally negative	Indeterminate but minimally negative	Indeterminate but minimally negative	Recurring	Land Maintenance Fund

(Parenthesis ( ) indicate revenue decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY25	FY26	FY27	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	0	0	0	$0	N/A	N/A

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates/Conflicts with/Companion to/Relates to:
Duplicates/Relates to Appropriation in the General Appropriation Act

SECTION III: NARRATIVE

BILL SUMMARY

The bill sets a new royalty rate range for "premium" parcels of state trust land leased in the most productive oil and gas area in southeastern New Mexico. For this geological area, the State Land Office would be authorized to set the royalty rate between 20 – 25%. The specific royalty rate (e.g., 20% or 25%) for each new lease would be set in accordance with the process laid out in existing state law for evaluating the production value of parcels prior to auction.

When issuing oil and gas leases for state trust lands, existing law requires the Commissioner of Public Lands to use one of three statutory lease forms. NMSA 1978 § 19-10-4 (1985). The particular form of lease depends on whether the lands are within a restricted district (area of historical oil and gas production) established by the Legislature or the Commissioner (see NMSA 1978, § 19-10-16 (1931)) and whether the tract within a restricted district is categorized as "premium" or "regular." Categorizing a tract as "regular" or "premium" involves an assessment of the following statutorily prescribed factors relating to the tract: (1) oil and gas trends; (2) oil and gas traps; (3) reservoir volume and recovery rating; (4) lease bonus rating; and (5) exploration and activity. See NMSA 1978, § 19-10-3 (1985); 19.2.100.11 NMAC. The statutory factors are more specifically defined in the State Land Office's oil and gas leasing rule.

The royalty rates under the existing statutory oil and gas lease forms are as follows:

Exploratory Form	1/8 (12.5%)
Discovery Form	1/6 (16.66%)
Development Form	**3/16 (18.75%) – 1/5 (20%)**

See NMSA 1978, §§ 19-10-4.1 to 19-10-4.3; 19.2.100.13 NMAC.

The bill would revise the statutory form that is used for oil and gas "development" leases issued by the State Land Office for lands classified as restricted lands and categorized as "premium" (see Section 19-10-3 NMSA 1978). The changes would only apply to new leases issued on or after July 1, 2025 and to certain leasing areas of demonstrated production that include the most productive oil and gas tracts.

The legal land description (Public Land Survey System) in the bill that sets the area of applicability for the increased royalty rate range includes state trust lands within Eddy and Lea counties, as well as a sliver of southeastern Chaves County and the most southeastern part of Roosevelt County. The definition of the area of applicability was tailored to reflect the location of oil and gas resources (geological formations/basins), consolidated state trust lands and the corresponding high-production value of the lands within the area. Maps showing the geographic boundary in reference to historical oil and gas production, geological formations and state trust lands are attached.

Under current law, the royalty rate for a development lease ranges from three-sixteenths

(18.75%) to a maximum of one-fifth (20%). This range would continue to apply to all other areas in the state where development leases are utilized. The new 20 - 25% range, which would be limited to certain area within southeastern New Mexico, would be reflective of the market rate (private lands in New Mexico and Texas, and state leasing rates in Texas) for the most productive and highly sought-after parcels.

The bill makes other non-substantive Legislative Counsel Service technical changes to the lease form.

FISCAL IMPLICATIONS

Royalty payments, which are what a company pays for oil and gas resources extracted from public lands, are received by the State Land Office and transferred to the Land Grant Permanent Fund (LGPF) for investment by the State Investment Council (SIC). After investment and growth, the SIC distributes earnings to 21 state land trust beneficiaries – primarily public schools, universities and hospitals. Money earned by the State Land Office and invested by the SIC ultimately reduces the tax burden on New Mexicans by providing financial support for public services that would otherwise fall on taxpayers. Since 2019, the State Land Office has contributed over $10 billion to the LGPF.

While the current version of the bill takes a slightly different approach than the version introduced in the 56th Legislative Session (HB 48/SB 24), the fiscal impact of the bill is expected to remain the same. While under the previous bill the increased 25% rate would technically be applicable to development leases statewide, because the “best of the best” oil and gas development areas are located in the Permian Basin, where the current bill restricts the higher rate to, the impact would remain the same – the increased rate would apply to the most productive new leases in southeastern New Mexico.

According to the Legislative Finance Committee’s previous fiscal estimate, charging the market rate of 25% for premium oil and gas leases is estimated to result in additional annual contributions of between $50 - $75 million to the LGPF. The SIC estimated that the additional inflow of royalties from the State Land Office that would occur under the proposal would result in between $1.5 - $2 billion in increased value of the LGPF by 2050, and between $750 million and $1.3 billion more in cumulative distributions from the LGPF by 2050.

The bill is expected to significantly increase State Land Office revenue from royalties in the coming years. However, because the bill only applies to leases issued after July 1, 2025, it is difficult to calculate with precision how many leases will go to auction, when they will begin production, market factors such as price that may impact development timelines, how new technologies may affect production levels, and other related variables.

Since the bill only applies to new leases, and most leases do not begin production for two to three years, revenue increases would likely begin to be realized in FY 2028. The State Land Office estimates that the bill would eventually result in an average annual increase in revenue of $50 - $84 million from the bill’s royalty rate increase. This range reflects the amount of additional money that would be transferred to the LGPF. The revenue estimate does not include the much more significant value of the LGPF distributions to beneficiary institutions that would occur over the decades the leases would be in effect (state oil and gas leases are “held by production,” meaning they do not expire as long as they continue producing in paying quantities). This estimate is derived by evaluating wells completed within the past ten years and considering a royalty rate at 25% rather than 20% or 18.75%. Prices used for the estimate were based on the annual price averages for oil and gas. The estimate takes into account annual production growth.

Bonus payments, which are onetime payments at the State Land Office's monthly oil and gas auction for the right to obtain a lease, may be a little lower for leases with higher royalty rates. The higher royalty rate could result in a very small decrease in bonus payments on leases, which are distributed through the Land Maintenance Fund. However, even assuming that these payments are reduced in out years for the most productive tracts, the royalty payments received that go to the Land Grant Permanent Fund for investment over the next decades would vastly outweigh any reduction in bonuses received by the State Land Office through the Land Maintenance Fund.

SIGNIFICANT ISSUES

The Commissioner of Public Lands has a fiduciary responsibility to ensure that the state land trust receives appropriate value for the state-owned resources being leased to oil and gas producers. Under the Constitution and by statute, the Commissioner has jurisdiction over and is entrusted with the management, care, custody, control and disposition of state trust lands in accordance with the Enabling Act. N.M. Const. art. XII, § 2; NMSA 1978 § 19-1-1 (1912). The Commissioner's responsibility is as a fiduciary serving the long-term interests of the Enabling Act trust and the supported institutions to ensure that the land is managed solely for the long-term support of those institutions. Furthermore, the State as a whole has a trust responsibility to ensure that state trust lands serve their intended purposes; i.e., providing the maximum support to the trust land beneficiaries while stewarding the land for future generations. *See State ex rel. State Highway Commission v. Walker*, 1956-NMSC-080, ¶ 5, 61 N.M. 374 (noting that the Enabling Act requires management of state trust lands "for the purpose of the trust imposed – that is, for the benefit of the various state institutions to which the lands were granted").

The last time New Mexico's royalty rate was updated was in the 1970s. Neighboring states with significant volumes of oil and gas production, such as Texas, already collect one-fourth royalty on all oil and gas production. Texas has had the higher 25% royalty rate since the 1990s. North Dakota sets a statutory minimum but not a maximum royalty rate, which instead is determined by that state's equivalent of the State Land Office. This bill would bring the State Land Office closer to parity with those states as well as the many private landowners in New Mexico and Texas who charge 25%.

The new royalty rate will not impact New Mexico's competitiveness. New Mexico's competitor in the Permian Basin is Texas, which already has a 25% royalty rate. Oil and gas companies themselves charge 25% on private lands in New Mexico. The Permian Basin is one of the world's best oil and gas plays and operators will drill where the resource exists. Mike Sommers, CEO of the American Petroleum Institute, recently noted: "We expect that the Permian Basin is going to continue to be the most prolific basin in the United States for years and even decades to come." (*Santa Fe New Mexican*, National Fossil Fuel Group Touts Permian Basin's Importance to Future of Oil and Gas, January 10, 2024). There is no reason to prevent the State Land Office from seeking the market rate for premium oil and gas tracts. This is especially true considering the fact that if a lease did not attract bidders at 25%, the State Land Office could simply place the lease on a future month's auction at the 20% rate. The agency should, however, have the ability to seek the appropriate market rate in meeting its trust obligation to generate revenue for public schools, universities and hospitals across the state.

PERFORMANCE IMPLICATIONS

The bill would advance the State Land Office's core mission of generating revenue for trust beneficiaries as well as 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

The bill would require the agency to revise its oil and gas development form templates in IT systems and processes. This would be a very minor administrative burden.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

TECHNICAL ISSUES

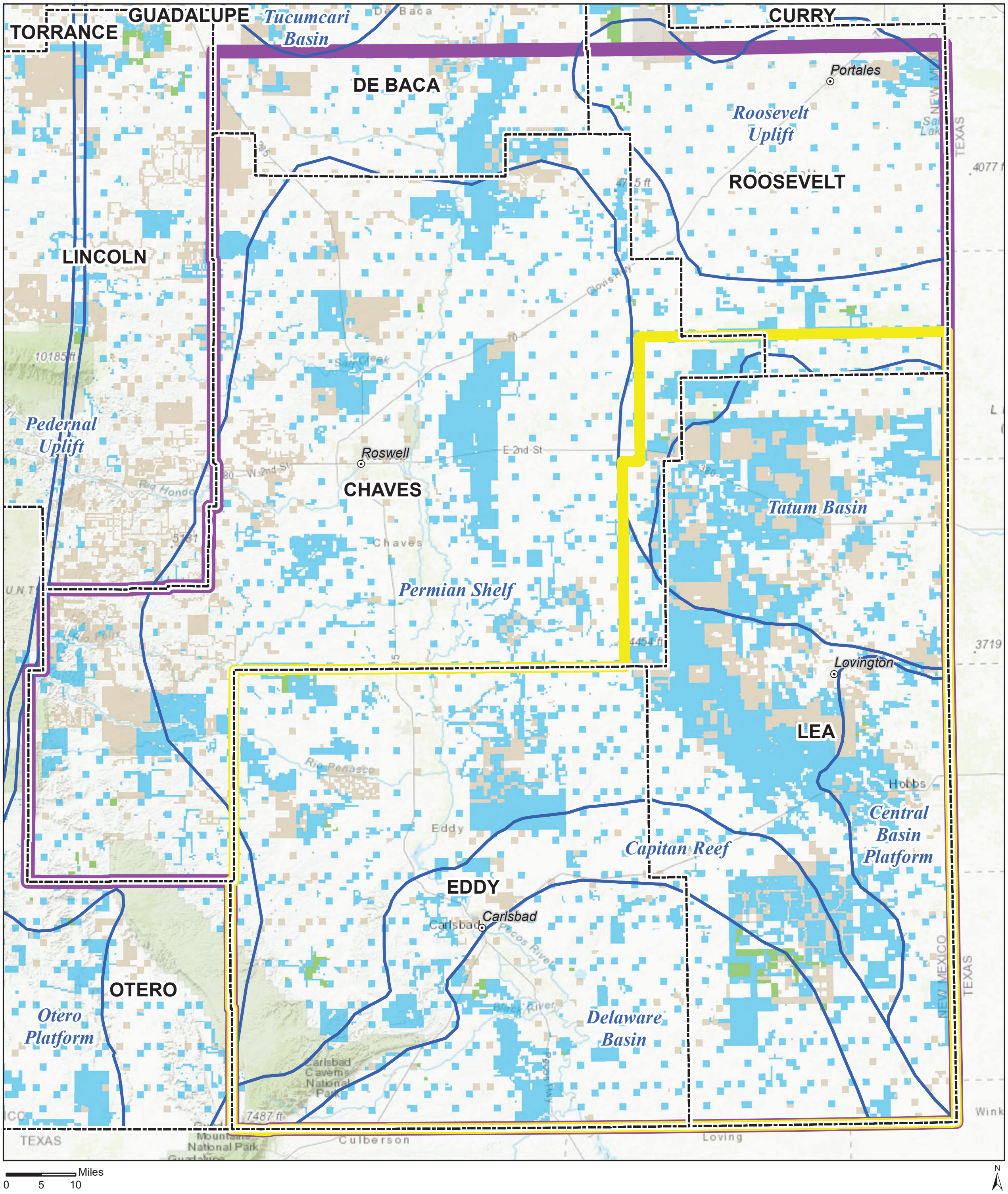
OTHER SUBSTANTIVE ISSUES

ALTERNATIVES

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

In March 2024, Commissioner Garcia Richard placed a pause on leasing new oil and gas leases for the best tracts in the Permian Basin until the State Land Office was authorized to receive appropriate market value for the parcels. Without passage of this bill, this pause will remain in effect. Because the royalty rate is set when the lease is issued, and that rate stays in effect as long as the lease is producing, which could be many decades, the State Land Office only has one opportunity to get the market value from the lease. The pause may defer inflows, but the long-term fiscal impact of leasing at a below-market rate is much more significant.

AMENDMENTS

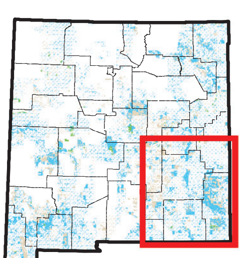


Proposed Royalty Rate Increase Area

- Proposed Rate Increase Area
- Oil and Gas Restricted District
- Oil and Gas Geologic Regions

State Trust Lands Ownership

- Mineral Estate
- Surface Estate
- Both Estates
- County Boundaries



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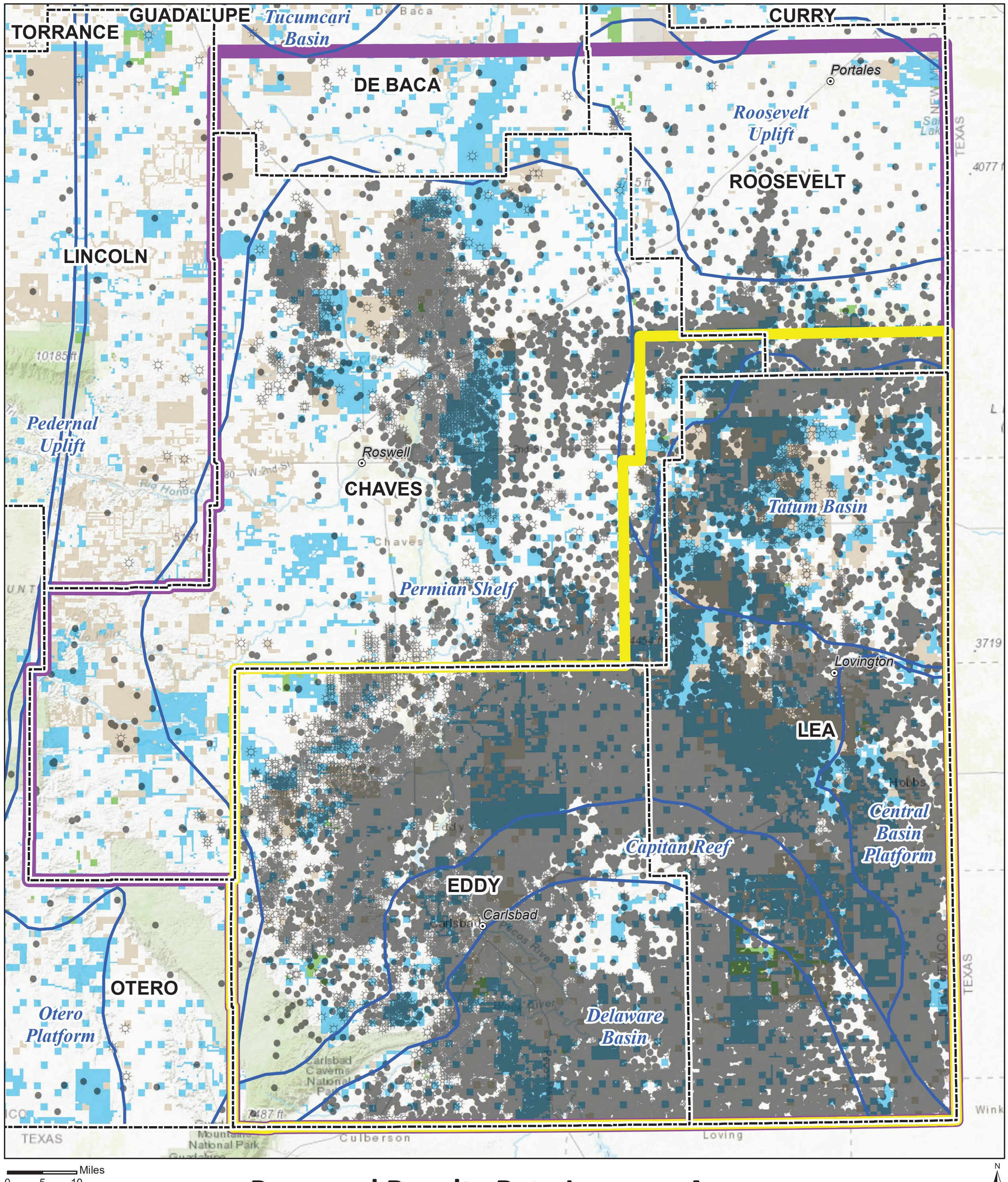


Proposed Royalty Rate Increase Area with Oil and Gas Wells

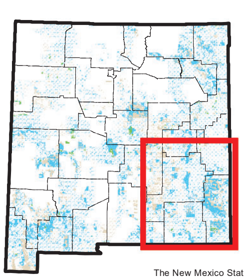
Proposed Rate Increase Area
Oil and Gas Restricted District
Oil and Gas Geologic Regions

Wells

Oil
Gas

State Trust Lands Ownership

Mineral Estate
Surface Estate
Both Estates
County Boundaries



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