Severance Tax and General Obligation Bonding Programs

Department of Finance and Administration

NMHED 2021 Capital Outlay Training Series
Administration of Capital Outlay

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What is a Municipal Bond?

A municipal bond is a <u>debt instrument</u> issued by a governmental entity.

New Mexico wants to fund capital projects. To do so, they usually "borrow" the money by selling bonds.

A municipal bond is a <u>security</u>.

New Mexico pledges/guarantees to pay back the money borrowed.

A municipal bond is an <u>obligation</u>.

New Mexico is obligated to repay the debt

Why borrow?

Allows the state to fund capital projects regardless of the money available from the General Fund (note that General Fund dollars are not pledged to paying the debt)

Often advantageous if the interest rate on the debt is very low.

How do Bonds Work?

An investor buys the bonds, thus loaning money to the governmental entity (issuer).

- The governmental entity gets the money for capital projects
- The investor gets interest income on loaning that money

Debt instruments typically specify:

- **An obligation to pay**
- **A stated amount |** the principal
- **At a given time |** Known as the “term of the bond” or “maturity” and represents the borrowing period (i.e., how long does the state have to pay off the debt)
- **With interest |** Can be fixed or variable

Bonds can be taxable or tax-exempt

- Relates to whether the investor must pay taxes on income earned.

Tax-Exempt & Taxable Bonds

Tax-Exempt Bonds

- Governmental entities may issue tax-exempt bonds.
- In essence, a subsidy of the federal government because it allows interest earned on the bonds to be exempt from the bondholder's taxable income.
- Generally limited to projects that are capital assets (i.e., brick and mortar), not used by a private entity (i.e., not leased to a non-profit), and benefit the public at large.

  NOTE There is a 10 percent "bad money" allowance in an issuance. This means 10 percent of the total issuance can be used for taxable and or non-capital projects.

Why would an issuer sell a tax-exempt bond? Because it results in a lower cost of capital/borrowing because less is paid in interest.

Why would an investor buy a tax-exempt bond? The income they receive is not taxable, the bonds serve a public purpose, and municipal bonds typically have a very low rate of default.

Taxable Bonds

- Includes all corporate bonds and some governmental bonds (issued when there's private use)

Overview of Bonding Programs

The State Board of Finance (SBOF) manages the General Obligation Bond and Severance Tax Bond programs.

General Obligation Bonds:

- Issued as tax-exempt bonds every two years (usually in the spring)
- Issued with a 10-year maturity
- Secured by the full faith and credit of the State
- Paid by property tax revenues generated from the mill levy and ad valorem tax revenues on oil, gas, and minerals production and equipment
- Funds higher education, aging & long-term (senior), and library capital projects (and occasionally public education and public safety projects)
- Subject to voter approval

Overview of Bonding Programs

Severance Tax Bonds & Notes:

- Long-term Senior and Supplemental Severance Tax Bonds and short-term Senior and Supplemental Severance Tax Notes are issued by the BOF.
- **Senior** Severance Tax Bonds and Notes fund capital projects appropriated by the legislature, including earmarks for tribal, colonias, and water projects.
- **Supplemental** STBs (bonds and notes) are issued to fund public school capital projects, as certified and managed by PSCOC.
- **All STBs** are secured and paid by severance tax revenues.

	SENIOR	SUPPLEMENTAL
Long-Term Bonds	Funds capital projects as authorized by the Legislature Tax-Exempt Sold 1x/year, competitively 10-year maturity	Funds public school capital projects as certified by PSCOC Tax-exempt Sold infrequently, competitively 10-year maturity
Short-Term "Sponge" Notes	Funds capital projects as authorized by the Legislature Taxable 1-2-day maturity ("pay as you go") Sold 1-2x/year (Dec/June)	Funds public school capital projects as certified by PSCOC Taxable 1-2-day maturity ("pay as you go") Sold 1-2x/year (Dec/June)

Bonding Capacity Estimates: Key Factors

Bonding capacity is an estimate of the amount of debt the State can incur, taking into account several key factors, including:

- Statutory Limits on Debt
  - GOB: 1 percent of the total assessed value of property in the State
  - STB: *Senior* annual debt service cannot exceed 47.6 percent of the lesser of the prior year's actual severance tax revenues and the current year's estimated revenues.
  - *Senior and Supplemental* annual debt service cannot exceed 87.8 percent of the lesser of the prior year's actual revenues and current year's estimated revenues.
- Projected Future Severance Tax Revenues (primarily oil and gas)
  - The BOF uses 10-year severance and property tax revenue projections produced by the DFA Chief Economist and the Consensus Revenue Estimating Group (CREG).
- Outstanding and future projected long-term debt service
  - Long-term debt service (both STBs and GOBs) is spread across a 10-year period, because the State issues its long-term bonds with a maturity of 10 years.
  - Short-term debt service (notes) hits within one fiscal year, as notes are sold to the State Treasurer overnight to "sponge" up cash in the severance tax bonding fund.

Bonding Capacity Estimates: Timing

Bonding capacity estimates are used to guide the legislature when it makes capital project appropriations during the Legislative session.

- SBOF staff, with the State's financial adviser, prepare preliminary capacity estimates each August, upon release of new tax revenue projections from the Consensus Revenue Estimating Group (CREG) and the DFA chief economist.
- The SBOF updates capacity estimates in December for release to the legislature prior to session start in January.
- If major changes occur that will impact revenue projections during the year, SBOF staff will update the capacity estimates to reflect the most recent revenue outlook.

Bonding Capacity Estimates: Use

The Legislature:

- Uses capacity estimates to appropriate funding to capital outlay projects that will be funded with bond proceeds.
- Makes GOB appropriations in *even* years for sale in the following odd-year spring.
- Makes STB appropriations every year (typically).
- The Senior Severance Tax bonding capacity available for new appropriations equals the total capacity net:
  - Any past capital project appropriations not yet funded (known as "Authorized but Unissued" projects)
  - Earmark projects, including water, colonias, and tribal set asides.
  - Water project funding is managed by the Water Trust Board, which receives 9 percent of annual senior severance tax bonding capacity.
  - Tribal project funding is managed by the Tribal Infrastructure Board, and Colonias project funding is managed by the Colonias Infrastructure Board. Each receive 4.5 percent of annual senior severance tax bonding capacity.

Current Capacity Estimates

Senior STB

$477.1 million for new senior statewide capital projects
(to be funded with a combination of long-term STBs and short-term ST notes… $471.4 million in HB 285 sans vetoes)

Supplemental ST Notes

$232.9 million for public school capital projects, based on the certified need of the PSCOC

GOB

Currently $218.0 million, although projects will not be appropriated until the 2022 session (selling $198 million in May)

Sources and Uses of Bonding Capacity Available for Authorization and Severance Tax Permanent Fund Transfer (in millions)
FEBRUARY 2021 Estimate

Sources of Funds	FY21	FY22	FY23	FY24	FY25	5-Year
General Obligation Bonds		**$218.0**		**$218.0**		**$436.0**
Senior STBs	**$591.8**	**$589.0**	**$575.9**	**$548.2**	**$522.6**	**$2,827.4**
Severance Tax Bonds	$428.5	$428.5	$428.5	$428.5	$428.5	$2,142.5
Severance Tax Notes	$163.3	$160.5	$147.4	$119.7	$94.1	$684.9
Supplemental STBs	**$232.9**	**$234.3**	**$256.0**	**$265.9**	**$269.2**	**$1,258.3**
Supplemental Severance Tax Bonds	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Supplemental Severance Tax Notes	$232.9	$234.3	$256.0	$265.9	$269.2	$1,258.3
TOTAL Sources of Funds	**$824.7**	**$1,041.3**	**$831.9**	**$1,032.0**	**$791.7**	**$4,521.7**

Uses of Funds	FY21	FY22	FY23	FY24	FY25	5-Year
GOB Projects Approved by Referendum		**$218.0**		**$218.0**		**$436.0**
Authorized but Unissued STB Projects (1)	$7.9	$0.0	$0.0	$0.0	$0.0	$7.9
Reassigned STB Projects (2)	$0.2	$0.0	$0.0	$0.0	$0.0	$0.2
9% of Senior STB for Water Projects	$53.3	$53.0	$51.8	$49.3	$47.0	$254.5
4.5% of Senior STB for Colonias Projects	$26.6	$26.5	$25.9	$24.7	$23.5	$127.2
4.5% of Senior STB for Tribal Projects	$26.6	$26.5	$25.9	$24.7	$23.5	$127.2
New Senior STB Statewide Capital Projects	**$477.1**	**$483.0**	**$472.2**	**$449.5**	**$428.5**	**$2,310.3**
PSCOC Public School Capital	$207.9	$209.3	$256.0	$265.9	$269.2	$1,208.33
PED Instructional Materials/Transportation	$25.0	$25.0	$0.0	$0.0	$0.0	$50.00
TOTAL Uses of Funds	**$824.7**	**$1,041.3**	**$831.9**	**$1,032.0**	**$791.7**	**$4,521.7**

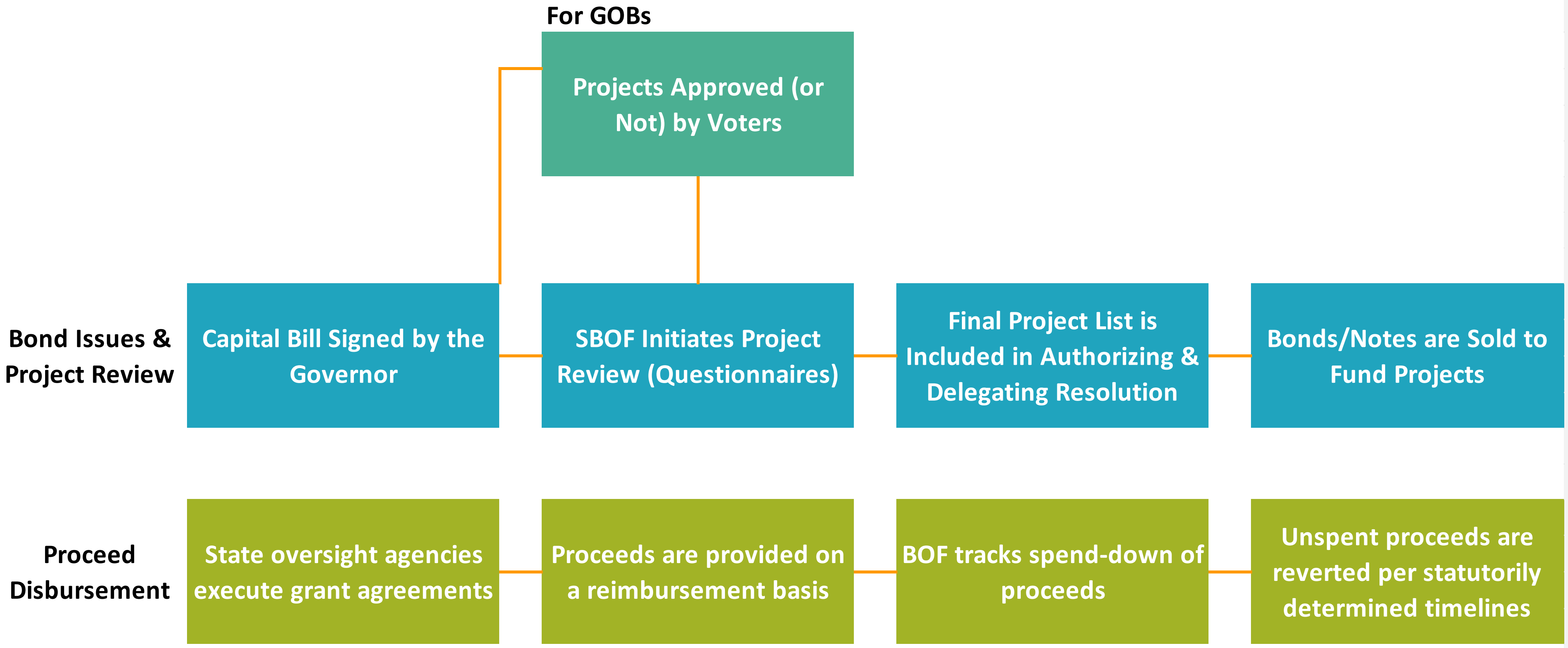
(1) Includes projects authorized that have either not yet met requirements for funding or were not able to be funded with annual senior capacity.

(2) Includes projects that have remained inactive for a period of at least 18 months following bond issuance for which the proceeds have been reassigned to ready projects.

Estimated Transfer to Severance Tax Permanent Fund

	FY21	FY22	FY23	FY24	FY25	5-Year
Severance Tax Permanent Fund Transfer	**$87.4**	**$83.7**	**$100.2**	**$94.0**	**$105.1**	**$470.4**

Bond Proceeds for Capital Projects



Questionnaires are used to evaluate projects for: Tax Law & State Law

Examples:

Is the project going to begin before the next set of funding is available?

Are the intended uses of the project allowable under the appropriation language?

Can the entity fund the entire project or a well-defined phase of the project?

Does the project service a public benefit?