

**THE STATE OF NEW MEXICO**

**CONTINUING DISCLOSURE**  
**ANNUAL FINANCIAL INFORMATION FILING**

**FISCAL YEAR 2001**

**NEW MEXICO**  
**STATE BOARD OF FINANCE**

**January 2002**

**STATE OF NEW MEXICO  
OUTSTANDING AND ADDITIONAL BONDS**

**CAPITAL PROGRAM**

The principal sources of funding for capital projects by the State of New Mexico (the "State") are surplus general fund balances, General Obligation Bonds, Severance Tax Bonds (including Supplemental Severance Tax Bonds), Highway Bonds and the New Mexico Finance Authority. The following details capital funding, by source, for fiscal years 1998 through 2001 and for the first six months of fiscal year 2002.

**Principal Sources of Capital Project Funding  
Fiscal Year Ending June 30  
(In millions)**

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u> <u>YTD</u>
<b>Proceeds from General Obligation Bonding Program</b>					
General Obligation Bonds	-	80.9	-	62.6	-
General Obligation Funding Notes	-	1.6	-	-	-
<b>Subtotal</b>	-	\$ 82.5	-	\$ 62.6	-
<b>Proceeds from Severance Tax Bonding Program</b>					
Severance Tax Bonds	136.1	50.7	59.7	-	-
Severance Tax Funding Notes*	4.4	26.7	3.4	5.7	23.0
Supplemental Severance Tax Bonds	-	-	12.0	12.0	65.0
Supplemental Severance Tax Funding Notes*	-	-	55.0	74.5	35.1
<b>Subtotal</b>	\$ 140.5	\$ 77.4	\$ 130.1	\$ 92.2	\$ 123.1
<b>Proceeds From Other Sources</b>					
General Fund	18.6	-	23.4	-	-
E-911 Revenue Bonds	-	-	-	4.5	-
Special Funds	28.5	3.4	-	-	-
Highway Bonds	127.3	412.2	690.6	198.8	95.0
New Mexico Finance Authority	26.3	23.3	52.3	18.5	88.1
<b>Subtotal</b>	\$ 200.7	\$ 438.9	\$ 766.3	\$ 221.8	\$ 183.1
<b>Total</b>	<b>\$ 341.2</b>	<b>\$ 598.8</b>	<b>\$ 896.4</b>	<b>\$ 376.6</b>	<b>\$ 306.2</b>

\*In order to take advantage of Bonding Fund revenue that would otherwise be transferred to the Severance Tax Permanent Fund, the Board issues Severance Tax Funding Notes to the State Treasurer with such revenue, to fund authorized projects (which are retired within the same fiscal year).

**GENERAL OBLIGATION BONDS**

Sections 7 and 8 of Article IX of the Constitution of the State limits the power of State officials to incur general obligation indebtedness extending beyond the fiscal year in three ways:

- (a) The state may borrow money not exceeding the sum of two hundred thousand dollars (\$200,000) in the aggregate to meet casual deficits or failure in revenue, or for necessary expenses.
- (b) Other debt may be contracted by or on behalf of the State only when authorized by law for some specified work or object. Such a law takes effect only after being submitted to the qualified electors of the State and having received a majority of all votes cast thereon at a general election. No debt may be created if the total indebtedness of the State, exclusive of the debts of the territory and several counties thereof assumed by the State, would thereby be made to exceed one percent (1%) of the assessed valuation of all property subject to taxation in the State, as shown by the last preceding general assessment.
- (c) The State may also contract debts to suppress insurrection and to provide for the public defense.

## Outstanding and Additional Parity General Obligation Bonds

The principal amounts of outstanding General Obligation Bonds as of December 31, 2001 are as follows:

General Obligation Bonds	Series	1993	\$12,687,000
General Obligation Bonds	Series	1997	14,675,000
General Obligation Bonds	Series	1999	65,455,000
General Obligation Bonds	Series	2001	62,550,000
General Obligation Bonds	Series	2001 A	25,860,000
General Obligation Bonds	Series	2001 B	<u>23,830,000</u>
	<b>Total:</b>		\$205,057,000

Future debt payments, by fiscal year, on outstanding General Obligation Bonds as of December 31, 2001 are as follows:

Fiscal Year	Principal	Interest	Total
2002	\$ 4,770,000	\$4,355,652	\$ 9,125,652
2003	41,532,000	8,068,879	49,600,879
2004	30,200,000	6,444,838	36,644,838
2005	31,225,000	4,970,563	36,195,563
2006	23,360,000	3,717,738	27,077,738
2007	24,520,000	2,684,313	27,204,313
2008	16,820,000	1,821,738	18,641,738
2009	17,560,000	1,140,638	18,700,638
2010	7,355,000	640,476	7,995,476
2011	7,715,000	327,888	8,042,888
<b>Total</b>	<b>\$205,057,000</b>	<b>\$34,172,723</b>	<b>\$239,229,723</b>

Additional general obligation bonds, other than for refunding purposes, and the levy of additional *ad valorem taxes* are subject to approval of the voters.

## SEVERANCE TAX BONDS

Pursuant to amendments to the Severance Tax Bonding Act enacted in 1999 and 2000, there are two categories of bonds issued by the State Board of Finance wherein the money in the Severance Tax Bonding Fund is pledged for retirement. These bonds are legally known as “New Mexico Severance Tax Bonds” and as “New Mexico Supplemental Severance Tax Bonds” but are referred to herein as “Senior Severance Tax Bonds” and “Supplemental Severance Tax Bonds”, respectively. The Board is prohibited by statute from issuing Senior Severance Tax Bonds and short term Senior Severance Tax Funding Notes unless the aggregate amount of total Senior Severance Tax Bonds and Funding Notes outstanding can be serviced with not more than 50% of the annual deposits into the Bonding Fund, as determined by the deposits during the State’s preceding fiscal year. Pursuant to the 1999 and 2000 amendments to the Severance Tax Bonding Act, the Board is prohibited by statute from issuing Supplemental Severance Tax Bonds unless the aggregate amount of total Senior Severance Tax Bonds and Supplemental Severance Tax Bonds outstanding can be serviced with not more than 62.5% of the annual deposits into the Bonding Fund, as determined by the deposits during the State’s preceding fiscal year. In addition, short-term Supplemental Severance Tax Funding Notes may be issued in a fiscal year if the debt service on such Supplemental Severance Tax Funding Notes, when added to the debt service previously paid or scheduled to be paid during that fiscal year on Senior and Supplemental Severance Tax Bonds and Funding Notes does not exceed 87.5% of the deposits into the Bonding Fund. The total aggregate principal amount of outstanding Severance Tax Bonds and Supplemental Severance Tax Bonds issued by the State does not exceed any applicable limit prescribed by the Constitution or laws of the State. The Senior Severance Tax Bonds and Funding Notes fund all types of capital projects while Supplemental Severance Tax Bonds and Funding Notes fund public educational facility projects.

**Outstanding and Additional Parity Senior Severance Tax Bonds**

The principal amounts of outstanding Senior Severance Tax Bonds as of December 31, 2001 are as follows:

Severance Tax Bonds	Series	1993	B	\$ 8,180,000
Severance Tax Bonds	Series	1995	A	1,066,000
Severance Tax Bonds	Series	1995	B	6,215,000
Severance Tax Bond Refunding	Series	1998	A	22,655,000
Severance Tax Bonds	Series	1998	B	39,500,000
Severance Tax Bonds	Series	1999	B	19,920,000
Severance Tax Bonds	Series	2000		51,725,000
Severance Tax Bonds	Series	2001	A	<u>115,380,000</u>
				\$264,641,000

Future payments, by fiscal year, on outstanding Senior Severance Tax Bonds as of December 31, 2001 are as follows:

Fiscal Year	Principal	Interest	Total*
2002		\$6,526,321	\$6,526,321
2003	53,161,000	12,712,867	65,873,867
2004	49,540,000	9,297,363	58,837,363
2005	42,500,000	7,036,288	49,536,288
2006	37,035,000	5,046,125	42,081,125
2007	29,920,000	3,372,250	33,292,250
2008	23,555,000	2,035,375	25,590,375
2009	22,645,000	880,375	23,525,375
2010	6,285,000	157,125	6,442,125
<b>Total</b>	<b>\$264,641,000</b>	<b>\$47,064,089</b>	<b>\$311,705,089</b>

\*excludes senior bond debt service payable from escrowed portfolio of securities.

Additional parity bonds and short term funding notes may be issued in the future if all fiscal year debt service on outstanding Senior Severance Tax Bonds and Funding Notes can be serviced with not more than fifty percent (50%) of the annual fiscal year deposits into the state Bonding Fund. The size of new issues is determined by the deposits during the fiscal year proceeding the date of issuance of such parity bonds. As of December 31, 2001, \$1.1 million of parity bonds have been authorized for capital projects but have not been issued. In addition, \$77 million of parity bonds have been authorized for public school deficiency capital projects but have not been issued, and \$20 million of parity bonds have been authorized for sewer projects in the North and South Valley between FY 2001 through FY 2010; however of which, no more than \$2 million can be sold per fiscal year except for FY 2001, in which \$4 million were sold.

**Outstanding and Additional Parity Supplemental Severance Tax Bonds**

The principal amounts of Supplemental Severance Tax Bonds that are outstanding, as of January 25, 2002 are as follows:

Supplemental Severance Tax Bonds	Series	1999	A	\$ 9,000,000
Supplemental Severance Tax Bonds	Series	2000	C	\$10,670,000
Supplemental Severance Tax Bonds	Series	2002	A	<u>\$65,000,000</u>
Total				\$84,670,000

The future fiscal year debt payments on outstanding Supplemental Severance Tax Bonds, as of January 25, 2002, are as follows:

Fiscal Year	Principal	Interest	Total
2003	\$8,645,000.00	\$4,111,892.92	\$12,756,892.92
2004	9,125,000.00	3,481,975.00	12,606,975.00
2005	9,460,000.00	3,077,128.13	12,537,128.13
2006	9,820,000.00	2,623,425.01	12,443,425.01
2007	10,210,000.00	2,127,096.88	12,337,096.88
2008	8,560,000.00	1,656,500.00	10,216,500.00
2009	6,790,000.00	1,272,750.00	8,062,750.00
2010	7,060,000.00	926,500.00	7,986,500.00
2011	7,345,000.00	566,375.00	7,911,375.00
2012	7,655,000.00	191,375.00	7,846,375.00
<b>Total</b>	<b>\$84,670,000.00</b>	<b>\$20,035,017.94</b>	<b>\$104,705,017.94</b>

Supplemental Severance Tax Bonds may be issued in the future if all outstanding Severance Tax Bonds, including the proposed bonds, can be serviced with not more than 62.5% of the annual deposits into the Bonding Fund as determined by the deposits during the fiscal year preceding the date of issuance of such Supplemental Severance Tax Bonds. In addition, short-term Supplemental Severance Tax Funding Notes may be issued in a fiscal year if the debt service on such Supplemental Severance Tax Funding Notes, when added to the debt service previously paid or scheduled to be paid during that fiscal year on Severance Tax Bonds and Severance Tax Funding Notes does not exceed 87.5% of the deposits into the Bonding Fund. The lien of the pledge of such Supplemental Severance Tax Bonds is subordinate to any outstanding Senior Severance Tax Bonds.

**TAX AND REVENUE ANTICIPATION NOTES**

The State has issued, and expects to issue from time to time, Tax and Revenue Anticipation Notes. The Notes are not general obligations of the State. The purpose of the Notes is to fund a portion of the State’s cash flow needs during the fiscal year in which the Notes are sold. As of December 31, 2001, \$350,000,000 Tax and Revenue Anticipation Notes, Series 2001 and \$240,000,000 Tax and Revenue Anticipation Notes, Series 2001A were outstanding and are due to mature on June 28, 2002.

**ENHANCED 911 REVENUE BONDS**

The E-911 Act was adopted as an emergency measure by the State legislature in the 1989 legislative session and became effective on March 10, 1989. The E-911 Act was adopted in response to a perceived need to upgrade basic 911 service throughout most areas of the state. The primary objectives of the E-911 Program are to provide state-wide funding, administrative and technical services leading to the installation of better telecommunications and computer equipment for faster location of and response to emergency calls. The Act authorizes the Board of Finance to issue and sell Enhanced 911 bonds to provide grant funds to local governments to acquire, extend, enlarge, better, repair, improve, construct, purchase, furnish, equip or rehabilitate E-911 systems.

**Outstanding Enhanced Revenue 911 Bonds**

The principal amounts of Enhanced 911 Revenue Bonds that are outstanding, as of December 31, 2001 are as follows:

Enhanced 911 Revenue Bonds Series 2000 \$3,980,000

The future fiscal year debt payments on outstanding Enhanced 911 Revenue Bonds, as of December 31, 2001, are as follows:

Fiscal Year	Principal	Interest	Total
2002	-0-	\$92,896	\$92,896
2003	590,000	168,388	758,388
2004	615,000	137,606	752,606
2005	645,000	110,040	755,040
2006	675,000	80,663	755,663
2007	710,000	49,500	759,500
2008	745,000	16,763	761,763
<b>Total</b>	<b>\$3,980,000</b>	<b>\$655,855</b>	<b>\$4,635,855</b>

**SEVERANCE TAX BONDING FUND AND DEBT SERVICE REQUIREMENTS**

Severance tax receipts contribute over 90 percent of total revenue to the Severance Tax Bonding Fund, with the remainder attributable to interest and other investment income. Severance taxes are almost entirely attributable to natural gas, crude oil and coal sales. Natural gas and crude oil together accounted for approximately 86.7 percent of total FY 2001 severance tax receipts.

**Severance Tax Bonding Fund  
Receipts, Disbursements and Transfers  
Fiscal Year Ending June 30 (1)(2)(3)  
(Dollars in thousands)**

	<u>1999</u>	<u>2000</u>	<u>2001 (6)</u>
<b>Beginning Balance</b>	\$68,983	\$69,934	\$70,521
<b>Receipts:</b>			
Oil & Gas Severance Tax	110,427	156,146	309,365
Other Minerals Severance Taxes	28,753	28,161	28,255
<b>Total Severance Tax Receipts</b>	<b>\$139,180</b>	<b>\$184,307</b>	<b>\$337,620</b>
Interest on Investments	7,783	10,515	13,875
Bond Proceeds	427	827	100
Other financing sources	451	1,114	5,262
Subtotal	<b>\$8,661</b>	<b>\$12,456</b>	<b>\$19,237</b>
<b>Total Bonding Fund Receipts</b>	<b>\$147,841</b>	<b>\$196,763</b>	<b>\$356,857</b>
<b>Disbursements:</b>			
Senior Bond Debt Service	66,842	69,924	68,475
Senior Short-term Obligations (4)	26,737	3,400	5,685
Supplemental Bond Debt Service			
Supplemental Short-term Obligations (4)		54,954	74,500
Fiscal Charges	70	421	367
<b>Total Disbursements</b>	<b>\$93,649</b>	<b>\$128,699</b>	<b>\$149,027</b>
<b>Transfers:</b>			
To Severance Tax Permanent Fund	\$53,241	\$67,475	\$195,753
Other (5)		1	1,848
<b>Total transfers</b>	<b>\$53,241</b>	<b>\$67,476</b>	<b>\$197,601</b>
<b>Ending Balance</b>	<b>\$69,934</b>	<b>\$70,521</b>	<b>\$80,750</b>

*Note:* The breakout of Severance Tax collections by mineral is calculated by the Department of Finance and Administration based upon information from the Taxation and Revenue Department. This breakout is not separately reported in the audited financial statements.

*Source:* New Mexico State Board of Finance based on Defined Entity audits of the Office of the State Treasurer.

All receipts, expenditures and balances are for debt service accounts only and exclude amounts in rebate accounts reserved for potential arbitrage rebates.

(1) All receipts, expenditures and balances exclude amounts in rebate accounts received for potential arbitrage rebates.

(2) Balances exclude loan receivable from Department of Labor. Loan repayments amounts are included as other income received. FY 2000-01 loan repayments were \$192,918.

(3) Proceeds and expenditures attributable to refunding bonds are excluded from this table since these amounts are reserved for payment to the escrow agent and are not available for debt service payments.

(4) The Board, in order to take advantage of Bonding Fund revenues that would otherwise be transferred to the Severance Tax Permanent Fund, issues short-term Severance Tax funding notes and Supplemental Severance Tax Funding notes to the State Treasurer which is retired within the same fiscal year with such revenue to fund authorized projects.

(5) Includes Receipts, Project reversions and other miscellaneous revenue.

(6) Unaudited preliminary FY 2000-2001 results.

## **Investments**

Funds on deposit in the Severance Tax Bonding Fund, including the Debt Service Account and Project Fund, established in accordance with the Bond Resolution, are invested by the State Treasurer at the direction of the Board, pursuant to the Investment Policy, which is approved by the Board. Investments must be in securities, which are at the time legal investments of the State, and no such investment or deposit shall violate any applicable restrictions imposed by the Code (defined below) and applicable Treasury Regulations relating to the market price and the existence of an established market. Furthermore, investments must be consistent with the State Treasurer's Investment Policy.

Except for funds deposited into the Rebate Fund (defined in the Bond Resolution), interest earned on the amounts on deposit in the Debt Service Account shall be retained therein, and interest earned on the amounts on deposit in the Project Fund shall be credited to the Debt Service Account and applied to the payment of principal and interest on the Bonds next becoming due. Any loss resulting from any such investment shall be charged to the applicable account from which such investment was made.

## **Severance Tax Collections and Reporting**

Operators, purchasers or working interest owners are required to submit monthly reports to the Tax Department showing the total value, volume and kind of products sold from each production unit during the month. Taxes must be paid at the same time. Each production report must be accompanied by a company identification number, which facilitates automated processing of return information. Production and associated tax liability is reported by "production unit" a designation for a well or group of wells that is assigned by the Tax Department based on the master operation, property name identification and pool. A suffix is added to the production unit number to designate the specific land type and taxing authority—including school districts.

The Tax Department receives approximately 750 oil and gas returns per month. These returns contain an average of about 75,000 lines of detailed information about production from different production units. Complete reporting forms must be mailed or delivered, or their information electronically transmitted, on or before the twenty-fifth day of the second month after the calendar month for which the report is required. Taxpayers whose total tax liability for the month – including the oil and gas emergency school tax, the oil and gas conservation tax and the oil and gas ad valorem tax, as well as the oil and gas severance tax – exceeds \$25,000 must provide payment by automated clearinghouse or by wire transfer on or before the due date. Taxpayers who fail to report or pay in a timely fashion are assessed interest at a rate of 1.25 percent per month beginning the day after the due date and continuing until the date the tax is reported or paid. A penalty is assessed when a taxpayer fails to pay any tax or file any report by the due date because of negligence or disregard of rules and regulations. A penalty is charged at a rate of 2 percent a month, up to a maximum of 10 percent of the tax due.

The State maintains an automated database system to monitor transactions with oil and natural gas producers. The system, called "ONGARD" for Oil and Natural Gas Administration and Revenue Database, is jointly developed and maintained by the Oil Conservation Division of the Energy, Minerals and Natural Resources Department, the State Land Office and the Tax Department. ONGARD functions include: managing the inventory of lands within the State and tracking all leases to determine whether royalty payments are owed to the State; monitoring all oil and gas wells for compliance with unitization agreements and other production-related information; and processing tax and royalty payments due to the State. The integrated database gives the State enhanced capabilities to compare and evaluate production, tax and royalty reports and to issue automated exception reports.

Severance tax amounts received by the Tax Department are deposited into the Oil and Gas Suspense Fund. Using the ONGARD system, the Tax Department reconciles monthly information reports with the payments received to identify the appropriate amounts to distribute to each tax beneficiary. Oil and gas severance tax amounts that have been reconciled are then transferred, once a month, to the Bonding Fund.

## **Severance Tax on Indian Land**

The United States Supreme Court has ruled that the State can tax non-Indian oil and gas production on tribal land (Cotton Petroleum Co. v. State of New Mexico, 490 US 163, 104 L. Ed. 2d 209, 109 S. Ct. 1968 [1989]). The authority of the State to impose severance taxes on Indian oil and gas production on tribal land was upheld by the United States District Court in New Mexico (Jicarilla Apache Tribe v. New Mexico Taxation and Revenue Department, No. USDC 87-922).

The Tax Department reports that natural gas production and crude oil production on Indian land was approximately 4.7% and 1.1%, respectively, of total taxable statewide production in 2000. In 1998, 43% of the severance tax collections on coal production, or about \$12.3 million, is estimated to be derived from Indian lands. DFA estimates that oil and gas production on Indian lands generated \$4.3 million in severance tax revenues to the State in the production months corresponding to FY 1998. No potash or copper is produced on Indian land.

Laws 1995, Chapter 171 authorizes a credit against State production and property taxes for similar taxes imposed by tribal governments. The credit applies to crude oil and natural gas from new wells drilled on or after July 1, 1995, on land within Indian reservation boundaries on March 1, 1995. The amount of the credit is 75% of the lesser of State taxes or tribal taxes imposed. If the applicable tribal taxes are raised after March 1, 1995, then the amount of the State's credit would be lowered. The Tax Department reports that total credits claimed under this provision were about \$500,000 in 1999. The Bonding Fund revenue projection assumes that this amount will grow slowly in the future.

### Severance Taxes on Natural Gas

Severance taxes are owed on the severance and sale of natural gas in the State. Tax rates are set by statute and are levied on the volume of natural gas sold or transported. With the exceptions noted below, tax rates have been imposed on an ad valorem basis, with deductions allowed for royalties paid to governments and also for certain expenses of transporting and processing products. Taxes are due 55 days following the end of each calendar month in which products are sold. The following table presents sales volume and total sales revenue for natural gas subject to severance tax.

#### New Mexico Natural Gas Subject to Taxation Fiscal Years Ending June 30

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Sales Volume (bcf)	1,554	1,616	1,607	1,620	1,628
Value (\$ millions)	\$3,290	\$3,343	\$2,700	\$3,985	\$8,107
Average Price (\$/mcf)	\$2.13	\$2.08	\$1.68	\$2.46	\$4.98

Source: NM Department of Finance and Administration.

Severance tax was initially imposed on natural gas and oil in 1959 at a rate of 2.5 percent of sales value. Rates were increased to 3.75 percent in 1974. Beginning July 1, 1977, the severance tax rate on natural gas was converted to a per unit rate of \$0.05/mcf.

On July 1, 1978, and on July 1 of each succeeding year, Severance Taxes on natural gas were increased by surtax. The surtax rate was indexed to the Consumer Price Index. The 1980 Legislature raised the base tax on each mcf of natural gas to \$0.087. The surtax remained applicable. By July 1, 1986 the surtax had reached \$0.076 and the total of surtax and base tax was \$0.163/mcf. With the sharp decline in average wellhead natural gas prices in 1986, the effective severance tax on natural gas came to represent over 8 percent of average wellhead prices. The total effective tax rate on gas production—including General Fund taxes—was over 11 percent, significantly greater than the tax burden in Oklahoma and Texas.

The following table summarizes the history of statutory tax rates imposed on both natural gas and oil.

#### History of Severance Tax Rates on Oil and Natural Gas

<u>Year of Statutory Change</u>	<u>Natural Gas</u>	<u>Oil</u>
1959	2.5%	2.5%
1974	3.75%	3.75%
1977	\$0.05/mcf + surtax	\$0.45/bbl + surtax
1980	\$0.087/mcf + surtax	3.75%
1987	3.75%	3.75%

Source: NM Department of Finance and Administration.

In 1995 the Legislature authorized tax incentives for crude oil and natural gas, including a 10-year exemption from severance taxes for previously non-producing wells ("restoration") and a 50 percent reduction in severance tax for incremental production from a qualifying work over ("recompletion") project. During FY 2000, 4.0 percent of natural gas sales and 1.7 percent of crude oil sales qualified for one or the other of these incentives. Total qualified volumes are expected to grow slowly over time, but the impacts on average effective tax rates are expected to be small.

In response to sharply lower oil prices and declining production of oil and associated natural gas, the 1999 Legislature adopted new severance tax incentives for production from recompletion wells and stripper wells. Instead of a 50% rate reduction (from 3.75% to 1.875%) for only the *incremental* production from re-completion wells, a tax rate of 2.45% will apply to all production from qualified wells.



This proposal is expected to have a minimal effect on severance tax collections, as the higher incentive tax rate will offset the increase in eligible volumes.

For stripper well production, the new legislation introduced a sliding scale of applicable tax rates, depending on the prevailing taxable value of products. For natural gas, a stripper well is defined as one having average daily production of less than 60,000 cubic feet per day. For oil wells, the threshold is 10 barrels per day.

The following table summarizes incentive tax rates applying to various categories of production as of FY 2000.

**Oil and Gas Tax Incentive Programs**

<u>Incentive Category:</u>	<u>Incentive Tax Rate:</u>	<u>Threshold price below which incentive rate applies:</u>	<u>Qualified production as a percent of FY 2000 total:</u>
Restoration wells	0.0%	\$24.00 per barrel <sup>1</sup>	0.2% Oil 0.5% Natural Gas
Recompletion wells	2.45%	\$24.00 per barrel <sup>1</sup>	1.7% Oil 3.8% Natural Gas
Stripper wells	1.875%	\$1.15 per mcf-Gas <sup>2</sup> \$15.00 per barrel-Oil <sup>2</sup>	0.0% Natural Gas <sup>3</sup> 8.9% Oil
	2.8125%	\$1.35 per mcf-Gas <sup>2</sup> \$18.00 per barrel-Oil <sup>2</sup>	0% Natural Gas <sup>3</sup> 0.0% Oil
Enhanced oil recovery	1.875%	\$28.00 per barrel <sup>1</sup>	5.0% Oil

Notes:

1. Average price for West Texas Intermediate crude oil.
2. Average annual taxable value of natural gas or oil sold in New Mexico during the preceding calendar year.
3. No natural gas volumes are expected to qualify for these incentives during the period because average taxable value exceeds the threshold levels.

Although the State now offers reduced severance tax rates for several categories of production, the cumulative effect of these programs on severance tax receipts is expected to be small. Based on projections of qualified volumes for FY 2000, the total reduction of revenues from oil and gas due to all incentive programs would be approximately \$5.8 million, or about 2.8% of total severance tax bonding fund revenue. This estimate may overstate projected revenue generation because it neglects any increase in production volumes that is stimulated by the incentive programs. Conditioning the incentives on prevailing product prices ensures that they will help to offset the negative impacts of low prices on industry, but they will not reduce tax collections during the periods when prices are high.

**Severance Taxes on Oil**

Since March 1, 1980, the severance tax rate on oil has been levied at 3.75 percent of value, as defined by statute. Chapter 38, Laws 1992 provides for a 50 percent reduction in the oil and gas severance tax rate for oil produced through enhanced recovery methods. The legislation reduces the statutory rate for qualifying oil production from 3.75 percent to 1.875 percent. Enhanced methods include carbon dioxide miscible fluid displacement, water flood, pressure maintenance, and thermal methods. The reduced rate is applicable to all production from an enhanced recovery project following certification of a positive production response by the EMNRD’s Oil Conservation Division. During FY 2000, approximately 2.0 million barrels of production qualified for the reduced tax rate. This represents about 3 percent of total sales. Qualified volumes are expected to increase gradually over time.

The 1995 Legislature authorized reduced severance tax rates for certain categories of production. A 10-year exemption from severance taxes was provided for production from previously non-producing wells (“restoration”). A 50% rate reduction was provided from incremental production from a qualifying work over project (“recompletion”). Qualified volumes are expected to grow slowly over time. The 1999 Legislature expanded the incentive program for recompletion wells and created a new incentive for stripper wells. Altogether, these incentives are estimated to have reduced Bonding Fund revenue from oil production by \$3.5 million in FY 2000.

**New Mexico Oil Subject to Taxation:**

### Fiscal Years Ending June 30

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Sales volume (million barrels)	75.4	73.5	66.0	67.3	70.1
Value (million dollars)	\$1,590	\$1,238	\$740	\$1,485	\$2,012
Average price (\$ per barrel)	\$21.37	\$16.84	\$11.75	\$22.07	28.7

#### Severance Taxes on Coal

Excise taxes have been imposed on coal sales in New Mexico since 1933. Revenues were initially earmarked to the Severance Tax Bonding Fund in 1961. At that time the tax rate on coal was 0.125 percent. The rate was increased by statute to 0.5 percent in 1974, and then converted to a per unit tax of \$0.38 per ton in 1977. A surtax was added in 1977 that was indexed to the Consumer Price Index. The per unit rate was increased to \$0.57 per ton in 1980. Effective July 1, 1989, the severance surtax was frozen for a period of four years at \$0.60 per ton for surface coal and \$0.58 per ton for underground coal. When added to the base tax rate, this action had the effect of freezing the total rate at \$1.17 per ton for surface coal and \$1.13 per ton for underground coal (no underground mines are currently in operation in the state). The Legislature extended the freeze on the surtax, after which time the surtax is adjusted in accordance with the increase in the Producer Price Index (PPI), for coal. In no case will the surtax be decreased, so a fall in the PPI for coal will not trigger a drop in the surtax rate. The surtax rate for fiscal year 1994-95 increased \$0.01 to \$0.61/per ton for surface coal and \$0.59/per ton for underground coal. Tax rates have not increased since then because coal prices have been flat or declining.

The 1990 Legislature enacted temporary suspension of the severance surtax for coal sold under new contracts entered into on or after July 1, 1990 and before July 1, 1994. The provision also extends to incremental sales under existing contracts measured by the increase in sales over the annual average established in the years 1987-1989. The 1992 Legislature extended the surtax exemption to incremental sales under renegotiated contracts. Subsequent Legislatures have extended the period for new contracts qualifying for the surtax exemption to new sales occurring before June 30, 1999.

The 1999 Legislature undertook a reexamination of coal severance taxes in the light of deregulation of the electric power market. Increased competition in power markets will make it harder for utilities to pass on the cost of high production taxes. A recent study of coal taxes in western states found New Mexico's taxes to be among the highest in the region. In view of these issues, the 1999 Legislature acted to repeal the sunset of the severance surtax exemption. Thus, as existing contracts that are currently subject to the surtax expire, any subsequent contracts to sell coal from the same mine will not be subject to the surtax. Although a total of \$11.7 million in severance surtax was collected in FY 1998, the impacts of the new statute are expected to be small, as most contracts subject to the surtax do not expire for a number of years. The change reduced FY 2000 revenues by less than \$1 million. The full impact of the provision will not be felt until all existing contracts expire, in about 15 years.

### Taxable Coal Sales and Average Price Fiscal Years Ended June 30

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
Sales Volume (million tons)	24.9	25.5	26.9	27.0	25.0
Sales Value (million dollars)	\$601	\$580	\$540	\$552	\$506
Average Price (\$ per ton)	\$24.34	\$22.75	\$20.00	\$20.48	\$20.20

Source: N.M. Department of Finance and Administration.

#### Carbon Dioxide

The Bravo Dome carbon dioxide field, encompassing 1.2 million acres in Harding, Union and Quay Counties in the northeastern area of the State, contains estimated resources of 16.3 trillion cubic feet, of which 7.0 to 10.6 trillion cubic feet are considered recoverable. Although the State has long produced limited quantities of liquid and solid carbon dioxide (CO<sub>2</sub>) for use in the food and the engineering industries, the main commercial value of carbon dioxide deposits is derived from the use of the product in its gaseous form in enhanced oil recovery projects in the Permian Basin of Texas and New Mexico. Sales ultimately will depend on the CO<sub>2</sub> requirements of such projects and on the State's proportion of the market, which is shared with Colorado's Sheep Mountain and Little Sheep Mountain, McElmo Dome and Doe Creek Fields.

In 1993, a large number of new wells were drilled. Total CO<sub>2</sub> wells increased from 265 in May of 1993 to 346 wells in December of 1993. The December data consisted of 333 producing well and 13 non-producing wells. (In recent years, there was a stable number of about 190 producing wells.) This activity is consistent with Amoco's (operator of the major Bravo Dome development) previously announced plans to increase capacity by 25 percent, and the forecast assumes a sales level of around 125 bcf per year.

The wellhead value of CO<sub>2</sub> sales currently is approximately \$0.36 per mcf, and is expected to remain stable over the forecast period. Severance taxes on CO<sub>2</sub> are levied at the rate of 3.75 percent of sales value.

**Other Minerals**

Many other minerals and natural resources are taxed in the State upon their severance from the earth or, in some cases, their sale or shipment. Existing tax rates are listed below. In many cases, flat percentage deductions are allowed to account for certain production costs, with the result that the taxable value is a percentage of the "full" value. The "full value", in turn, is sometimes based upon published prices rather than actual revenues, as noted in the following table:

<u>Mineral Resources</u>	<u>Tax Rate</u>	<u>Taxable Value as Percent of Full Value</u>
Potash	2.500%	16.67%
Copper	0.500%	16.67%*
Timber, Pumice, Gypsum, Sand, Gravel, Clay, Fluorspar, Other	0.125%	100.00%**
Molybdenum	0.125%	50.00%
Lead, Zinc	0.125%	16.67%*
Gold	0.200%	50.00%*
Silver	0.200%	30.00%*
Uranium	3.500%	50.00%

\* Value based upon the indicated percentage of specified Comex, LME or London spot prices published in Metals Week.

\*\* For products with a price at the point of production, value is that price less deductions allowed for actual costs for hoisting, loading, and crushing of up to 50 percent of price. For products, which must be processed before sale, deductions are allowed for cost of processing and freight charges to the point of sale.

Tax revenue from potash was \$784,102 in FY 2000. Severance tax revenue from copper is limited because of the statutorily defined narrow tax base. Revenue from copper peaked at \$593,000 in FY 1996, a result of the combination of high prices and strong production, but most recent revenues were \$273,190 in FY 2000. Copper prices have been depressed for the last several years by weakness in world copper prices.

**GENERAL INFORMATION CONCERNING THE STATE OF NEW MEXICO**

The State of New Mexico admitted as the forty-seventh state on January 6, 1912, is the fifth largest state, containing approximately 121,593 square miles. Sunshine and warm bright skies characterize the State's climate in both winter and summer. The State has a semiarid climate with light precipitation. Thunderstorms in July and August bring most of the moisture. December to March snowfalls vary from 2 inches (lower Rio Grande Valley) to 300 inches (north central mountains).

Major industries in the State are energy resources, manufacturing, services, tourism, arts and crafts, agribusiness, government, and mining. Major federally funded scientific research facilities at Los Alamos, Albuquerque and White Sands are also a notable part of the State's economy. Agriculture plays a major role in the State's economy with irrigation and a variety of climatic conditions, a diverse assortment of quality agriculture products are produced.

**GOVERNMENTAL ORGANIZATION**

The State's government consists of the three branches characteristic of the American political system: executive, legislative and judicial. The head of the executive branch is the Governor who is elected for a four-year term. A governor may succeed himself in office once. Following a reorganization plan implemented in 1978 to reduce and consolidate some 390 agencies, boards and commissions, the primary functions of the executive branch are now carried out by sixteen cabinet departments, each headed by a cabinet secretary appointed by the Governor.

The Board of Finance has seven members consisting of the Governor, the Lieutenant Governor, the Treasurer and four members appointed by the Governor with the advice and consent of the Senate; no more than two such appointed members may be from the same political party. The Board, in addition to other powers and duties provided by law, has general supervisory authority over the fiscal affairs of the State and over the safekeeping and depositing of all money and securities belonging to, or in the custody of, the State.

The Department of Finance and Administration, created in 1957 as a part of governmental reorganization measures of that year, is the principal financial organization of State government and performs through its divisions the duties and functions relating to

State and local government financing and general administration. On July 1, 1983, the Department of Finance and Administration was re-organized into the DFA, which retained the prior name and handles the State's financial functions and the General Services Department, which now handles the administrative functions. The executive and administrative head of the DFA is the Secretary, who is appointed by the Governor with the advice and consent of the Senate, and who also serves as Executive Officer of the Board. In 1983, a Board of Finance Division was created in the DFA, to staff and coordinate the functions of the Board.

The Legislature consists of 112 members and is divided into a Senate and a House of Representatives. Senators are elected for four-year terms, members of the House for two-year terms. The Legislature convenes in regular session annually on the third Tuesday in January. Regular sessions are constitutionally limited in length to sixty calendar days in odd-numbered years and thirty calendar days in even-numbered years. In addition, special sessions of the Legislature may be convened by the Governor, and under certain limited circumstances, extraordinary sessions may be convened by the Legislature. Legislators receive no salary, but do receive per diem and mileage allowances while in session or on official State business.

The judicial branch is composed of a statewide system including Magistrate and District Courts, the Court of Appeals and the Supreme Court. The district court is the trial court of record with general jurisdiction.

**PENSION FUNDS**

Two retirement plans, covering most of the employees of the State and its political subdivisions, have been established by statute. These retirement plans are described below. All financing of the plans, including employer and employee contributions and fund investment provisions, as well as all benefit provisions, are established by the Legislature and are not subject to negotiation.

**Educational Retirement Association**

Total membership as of June 30, 2001 was officially reported as 100,547. The annual actuarial valuation of the Educational Retirement Act of the State was conducted and reported as of June 30, 2001 by Gabriel, Roeder, Smith & Co. The Educational Retirement Board accepted the actuary's conclusion that the existing statutory contributions equal to 7.6 percent by members and 8.65 percent by employers were adequate to provide for the benefits payable under the system. Accrued assets at fair value on June 30, 2001 were \$6.6 billion and the unfunded liability was \$665.3 million.

**The Public Employees Retirement Association**

Gabriel, Roeder, Smith & Co completed an actuarial valuation of the Public Employees Retirement Fund (PERA), Judicial Retirement Fund, Magistrate Fund, Legislative Division and Volunteer Firefighter Fund (VFF) as of June 30, 2001. The Public Employees Retirement Board accepted the actuary's conclusions that the assets, benefit values, reserves and computed contribution rates reflect utilization of an inflation rate of 5% per annum, compounded annually, and other risk assumption changes including salary increases for longevity and merit, the real rate of return on investments, mortality, active member withdrawals, disability and retirement rates to allow for expected future experience. Actuarial information, for each fund, as of June 30, 2001 is as follows (dollars in thousands):

	<u>PERA</u>	<u>Judicial</u>	<u>Legislative</u>	<u>Magistrate</u>	<u>VFF</u>
Membership	63,748	175	255	105	5,370*
<u>Actuarial Information</u>					
Accrued Liability	\$7,876,574.9	\$70,604.1	\$6,872.0	\$26,685.3	\$15,806.8
Value of Assets	<u>\$8,302,819.8</u>	<u>\$59,522.6</u>	<u>\$5,390.2</u>	<u>\$30,258.1</u>	<u>\$27,991.6</u>
Unfunded (Overfunded) Accrued Liability	(\$426,244.9)	\$11,081.5	\$1,481.8	(\$3,572.8)	(\$12,184.8)
Present Value of Statutory Obligations	\$10,738,377.9	\$89,451.6	\$7,710.0	\$36,616.9	\$30,837.0

\*Number of active volunteer firefighters was significantly reduced due to new criteria used by the actuary. Only firefighters with service credit earned in the last ten years are considered active members of the plan.

**FINANCIAL OVERVIEW**

**State Auditing and Accounting Systems**

By statute, the financial affairs of every agency in the State are thoroughly examined and audited each year by the State Auditor, personnel of his office designated by him, or by the independent auditors approved by him. The audits are conducted in accordance with generally accepted auditing standards. The audit reports include financial statements that are presented in accordance with generally accepted accounting principles.

**State Budgetary and Appropriation Process**

All State agencies are required to submit their budget requests to the Budget Division of the DFA by September 1 of each year

following guidelines and forms provided in advance for this purpose. Budget hearings are scheduled for the purpose of examining the merits of budget requests through the fall and are usually completed by the middle of December. Statutes require the Budget Division to present comprehensive budget recommendations to the Governor annually by January 2.

By statute, the Governor is required to submit a budget for the upcoming fiscal year to the Legislature by the twenty-fifth legislative day. The Governor's budget includes the executive recommendations for higher education, public education and State agencies as well as historical information on prior expenditures and revenues and revenue projections, among other information. The State budget is contained in a General Appropriation Bill, which is first referred to the House Appropriations and Finance Committee for consideration. The General Appropriation Act may also contain proposals for supplemental and deficiency appropriations for the then current fiscal year.

The Senate and the Senate Finance Committee consider the General Appropriation Act after its approval by the House of Representatives. Upon Senate passage the Governor may sign the General Appropriation Act, veto it, veto line items or veto parts of it. After the Governor has signed the General Appropriation Act, the Budget Division of the DFA approves the agency budgets and monitors the expenditure of the funds beginning on July 1, the first day of the fiscal year.

### **State Treasurer's Investment Responsibilities**

A major responsibility of the State Treasurer is to invest money in his custody not immediately needed for the operations of State government in order to enhance state revenues. The State Treasurer's Investment Policy states that in keeping with the office's fiduciary responsibility, all investment decisions made by the State Treasurer will adhere to the following three fundamental principles: safety, liquidity and return.

This investment policy is a comprehensive one that governs the investment activities of the State Treasurer. This policy applies to all financial assets of the State invested by the Treasurer in the exercise of his statutory authority or invested as directed by other agencies which have specific investment authority and for which the Treasurer acts as agent. These funds include, but are not limited to the State's General Fund, and agency funds such as the Local Government Investment Pool, bond funds, debt service reserve funds, those pension and permanent fund monies not yet allocated to money managers and all float.

According to the investment policies, an Investment Committee must be appointed by the State Treasurer with the specific purpose and responsibility of establishing, maintaining and administering the investment policy. The Investment Committee consists of four (4) voting members: the Treasurer, who will be the Chairman, Deputy Treasurer who will be the Vice Chairman, Chief Investment Officer and the Director of the State Board of Finance. As of October 1, 2000, the Investment Committee was expanded to include a fifth member, from the private sector.

The Investment Committee is charged with the following responsibilities:

- Reviewing and recommending changes to the investment policy at least annually.
- Monitoring the investment transactions to ensure that proper controls are in place to guarantee the integrity and security of the Treasurer's investment portfolio.
- Ensuring that current state laws and policies of the State Board of Finance and the State Treasurer's Investment Policy are being adhered to by the office of the State Treasurer.
- Approving written investment procedures.
- Meeting monthly to deliberate such topics as: economic outlook, portfolio diversification and maturity structure, potential risks and the target rate of return on the investment portfolio.
- Authorizing and recommending depositories, custodians and broker/dealers. By statute the ultimate responsibility for conducting the investment program resides with the State Treasurer consistent with the State Treasurer's Investment Policy.

### **General Fund**

The State derives the majority of its recurring General Fund revenues from four major sources: general and selective sales taxes, income taxes, taxes and royalties on natural resource production, and investment earnings from its two permanent funds and the State Treasurer's Office. Effective July 1, 1981, the Legislature suspended all property taxes for State operating purposes.

Weakness in crude oil and natural gas markets in the 1980's contributed to a major restructuring of the State's tax base by the 1986, 1987, 1988, 1990, 1993 and 1994 Legislatures. Reliance on sales and income taxes were increased to offset declines in severance tax and royalty revenues. The following summary details revenues, expenditures and ending fund balances over the last four fiscal years and estimated amounts for the current fiscal year.

**GENERAL FUND FINANCIAL SUMMARY:  
FISCAL YEAR 1998 – 2002 ACTUAL AND ESTIMATES  
(dollars in thousands)**

	Actual 1998	Actual 1999	Actual 2000	Pre-Audit 2001	Estimated 2002
<b>A. APPROPRIATION ACCOUNT</b>					
<b>Receipts:</b>					
General & Selective Sales Taxes	\$1,339,876	\$1,368,059	\$1,415,090	1,535,925	1,585,400
Income Taxes	989,299	985,925	1,047,417	1,150,109	1,244,000
Severance Taxes	183,941	132,847	194,517	363,521	222,700
License Fees	29,970	29,678	32,414	34,408	35,800
Investment Income	387,697	417,014	410,629	453,439	470,200
Rents & Royalties	185,684	147,628	221,107	401,703	218,300
Miscellaneous Receipts	25,705	24,629	29,924	26,886	24,000
Reversions/adjustments	15,822	17,216	22,290	24,553	24,000
Tribal Revenue Sharing					8,000
Total Recurring Receipts	\$3,157,995	\$3,122,997	\$3,373,388	\$3,990,543	3,832,400
Nonrecurring & Adjustments	29,672	18,558	30,042	4,000	90,000
Tribal Revenue Sharing	<u>18,721</u>	<u>30,180</u>	<u>17,917</u>		
Nonrecurring & Adjustments	48,393	48,739	47,959	4,000	90,000
<b>Total Receipts</b>	<b>\$3,206,388</b>	<b>\$3,171,735</b>	<b>\$3,421,346</b>	<b>\$3,994,543</b>	<b>3,922,400</b>
<b>Appropriations:</b>					
Recurring					
Legislative	10,903	17,809	15,531	19,781	13,747
Judicial	91,849	101,658	107,628	115,120	125,866
General Control	123,730	123,330	149,266	199,405	188,184
Commerce & Industry/Examination & Licensing	42,895	35,419	40,214	44,814	44,829
Agriculture, Energy & Natural Resources	53,137	52,409	50,981	54,841	58,361
Health & Human Services	646,766	615,451	641,661	681,416	781,700
Public Safety	182,943	201,174	215,606	236,311	256,280
Other Education	16,709	16,545	19,872	25,039	23,328
Higher Education	482,867	515,075	520,628	565,129	569,403
Public School Support	1,357,576	1,470,716	1,543,036	1,632,305	1,782,210
Total Recurring Appropriations	\$3,009,374	\$3,149,585	3,304,421	3,574,160	3,843,909
Other Recurring Appropriations	-	3,095	24,068	-	
Total Recurring Appropriations	\$3,009,374	\$3,152,680	\$3,328,490	3,574,160	3,843,909
Nonrecurring					
Capital Outlay/Supplemental/Contingency	4,435	11,389	28,356	252,336	52,300
Other Nonrecurring adjustments for legislation	47,336	35,109	33,171	1,152	2,075
Total Nonrecurring	51,771	46,498	61,527	253,489	54,375
<b>Total Expenditures</b>	<b>\$3,061,145</b>	<b>\$3,199,179</b>	<b>\$3,390,016</b>	<b>\$3,827,649</b>	<b>3,898,284</b>
<b>TRANSFER TO RESERVES</b>	<b>\$145,244</b>	<b>(\$27,443)</b>	<b>31,330</b>	<b>166,894</b>	<b>24,116</b>
<b>B. OPERATING RESERVE</b>					
<b>Beginning Balance</b>	<b>80,781</b>	<b>225,323</b>	<b>185,425</b>	<b>191,600</b>	<b>267,187</b>
Revenues/Loan Repayments	0	0	0	0	0
Appropriations:					
Contingencies					
Other Appropriations & Adjustments	(702)	(17,700)	(15,323)	(3,744)	(2,300)
Total Appropriations	(702)	(17,700)	(15,323)	(3,744)	(2,300)
Transfers:					
To General Fund/SSR	0	5,246	0	0	0
From General Fund (Appropriation Account)	145,244	(27,443)	31,330	79,179	24,116
Special Session/Appropriation Contingency Fund	0	0	(10,000)	0	0
Total Transfers	145,244	(22,198)	21,330	79,179	24,116
Other Adjustments	0	0	168	152	0
Change in Loan Repay Balances	0	0	0	0	0
<b>Ending Balance</b>	<b>\$225,323</b>	<b>\$185,425</b>	<b>\$191,600</b>	<b>\$267,187</b>	<b>289,003</b>

**GENERAL FUND FINANCIAL SUMMARY (CONTINUED)**

	Actual 1998	Actual 1999	Actual 2000	Pre-Audit 2001	Estimate 2002
<b>C. STATE SUPPORT RESERVE</b>					
<b>Beginning Balance</b>	<b>5,246</b>	<b>5,246</b>	<b>0</b>	<b>0</b>	<b>0</b>
Revenues					
Appropriations:					
For Equalization Guarantee	-	-	-	-	
Transfers:					
From Public School Support/ACF	0	0	0	0	0
From Operating Reserve/Appropriation Account	0	(5,246)	0	0	0
<b>Ending Balance</b>	<b>\$5,246</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b>D. APPROPRIATION CONTINGENCY FUND</b>					
<b>Beginning Balance</b>	9,425	6,875	3,617	958	93,987
Appropriations:					
Disaster Allotments	(3,858)	(3,258)	(16,666)	(6,150)	(3,200)
Medicaid Allotments				(68,000)	
Allotment Reversions	1,308		4,007	2,779	(5,000)
Transfers:					
From General Fund	0	0	10,000	164,400	0
To Surplus/State Support Reserve					
<b>Ending Balance</b>	<b>\$6,875</b>	<b>\$3,617</b>	<b>\$958</b>	<b>\$93,987</b>	<b>\$85,787</b>
<b>E. TASK STABILIZATION RESERVE</b>					
<b>Beginning Balance</b>					\$87,715
Transfers In				87,715	0
Transfers Out				0	0
<b>Ending Balance</b>			<b>\$0</b>	<b>\$87,715</b>	<b>\$87,715</b>
<b>F. TOTAL BALANCES</b>					
<b>Beginning of Period</b>	<b>231,655</b>	<b>377,936</b>	<b>321,812</b>	<b>192,558</b>	<b>448,889</b>
<b>End of Period</b>	<b>377,936</b>	<b>321,812</b>	<b>192,558</b>	<b>448,889</b>	<b>550,220</b>

Note: Detail may not add to column total due to independent rounding.

**Fiscal Year 1998**

FY 1998 total revenue was \$3.21 billion, 5.7 percent higher than for FY 1997. Continued growth in gross receipts tax collections and unexpectedly strong growth in personal income taxes accounted for much of total revenue growth. Receipts from personal income taxes grew 18 percent over the previous year due to a combination of a strong stock market and increases in capital gains realizations resulting from a change in federal law that reduced the top tax rate on capital gain income. Growth in personal income taxes is not expected to continue at the same rate in subsequent years. Legislative changes enacted in the 1998 Legislative Session reduced personal income taxes by \$15.8 million on a recurring basis. Capital gains realizations will likely slow in future fiscal years. Total non-recurring revenue was \$48.4 million with revenue sharing from Indian gaming operations accounting for \$18.7 million and reversions accounting for \$26.5 million. \$16.1 million of the non-recurring reversions are attributable to savings in the Medicaid program. Total revenue exceeded appropriations by \$145.2 million. The operating reserve balance rose to \$225.3 million or 7.5 percent of recurring appropriations.

**Fiscal Year 1999**

FY 1999 total revenue was \$3.17 billion. Oil and natural gas related revenue fell by \$90 million as prices fell sharply. Corporate income tax collections fell as the international economic slowdown reduced earnings for the State's mining and manufacturing companies within the state. Personal income tax collections were only slightly above the level of FY 1998 as a new computer system was fully implemented, and a large backlog of refunds attributable to the previous fiscal year was processed. Total appropriations exceeded total revenue by \$27.4 million. Ending balance in the Operating Reserve declined to \$185.4 million, 5.9% of recurring appropriations.

**Fiscal Year 2000**

FY 2000 total General Fund revenue reached \$3.42 billion, with recurring revenue growth of 8.0 percent above the previous fiscal year. The General Fund saw strong growth in revenues related to mineral production in the State as energy prices recovered from low levels in the prior year. Total expenditures for FY2000 were approximately \$3.39 billion, an increase of 7.5 percent over FY1999. \$31.5 million was transferred to the Operating Reserve, resulting in an ending balance of \$191.6 million. Year-end total General Fund balances were approximately \$192.6 million as the Risk Reserve was transferred out of the General Fund.

**Fiscal Year 2001**

Recurring (unaudited) General Fund revenue in FY 2001 was \$3.99 billion, representing growth of 17.7 percent over the previous fiscal year. Robust revenue growth continued during FY 2001 bolstered by strong energy prices. Revenues relating to mineral production and rents and royalties increased 84.1 percent over the previous year. General sales revenue grew by 9.9 percent, the corporate income tax revenue grew 36.4 percent, and investment income grew 10.4 percent. Revenues from the personal income tax increased 9.8 percent before adjusting for legislative changes.

Total appropriations for FY 2001 were \$3.8 billion. However, this amount includes an appropriation of \$163 million to the Appropriation Contingency Fund (\$68 million specifically for the Medicaid Program – of this amount \$53 million has been deemed as recurring expenditure).

In FY 2001, there is an anticipated transfer of \$167 million to the operating reserve less an approximate transfer of \$88 million to the Tax Stabilization Reserve. The operating reserve is expected to finish the fiscal year with an ending balance of \$268 million or 7.5 percent of recurring appropriations. Total reserves exceed 12 percent of recurring appropriations.

**Fiscal Year 2002**

Total recurring revenue is projected to be \$145 million lower than FY 2001 or \$3.83 billion. Estimated revenue declined considerably following the September 11, 2001 terrorist attacks and an already weakening economy. A significant downward revision in the price of natural gas also contributed to the decline. \$3.84 billion of recurring appropriations were signed into law, an increase of 7.6 percent over the previous fiscal year. Total General Fund reserve balances are projected at \$550 million or 14.3 percent of recurring appropriations.

**STATE TAXES AND REVENUE**

Programs and operations of the State are predominantly funded through a system of 29 major taxes administered by the Taxation and Revenue Department. The State Corporation Commission (whose duties were assumed in 1999 by the Public Regulation Commission) collects taxes on insurance premiums. In addition, distributions from the Land Grant Permanent Fund and the Severance Tax Permanent Fund provide important sources of revenue for State purposes. The most important tax and revenue sources, as measured by magnitude of revenue generation and the application of the monies to certain funds and purposes, are described below.

**Gross Receipts and Compensating Taxes**

The gross receipts tax is levied on the total amount of money or the value of other consideration received from selling property (including tangible personal property) in the State, from leasing property employed in the State, from performing services in the state and from research and development services performed outside the State on a product which is initially used in the State. The tax is paid by the seller but generally passed on to the purchaser. The compensating tax is imposed generally on property used in the state but purchased elsewhere. Gross receipts and compensating taxes are due on the 25th day of the month following the month in which the transaction occurs.

Exemptions from gross receipts tax include, but are not limited to, certain receipts of governmental agencies and certain non-profit organizations and receipts from the sale of certain vehicles, occasional sales of property or services, wages, certain agricultural products, dividends and interest and receipts from the sale of or lease of natural gas, oil or mineral interests. Deductions from the gross receipts tax include, but are not limited to, receipts from various types of sales or leases of tangible personal property or service, receipts from certain sales of property to governmental agencies or to certain non-profit organizations, receipts from



certain processing of some agricultural products, receipts from certain publication sales, and certain receipts from interstate commerce transactions. There are over 50 specified exemptions and deductions from gross receipts taxation; nevertheless, the general presumption is that all receipts of an entity engaging in business are subject to gross receipts tax.

The gross receipts and compensating taxes are the largest single source of State General Fund revenue. The gross receipts tax is a primary source of revenue for cities and counties. The gross receipts tax includes the statewide gross receipts tax levy of 5 percent plus several local option city and county levies. A credit of 0.5 percent against the statewide rate of 5 percent is allowed for municipal local option taxes. Receipts from the statewide gross receipts tax levy, less disbursement to each incorporated municipality of 1.225 percent of the taxable gross receipts reported in that municipality and less disbursement to the State Aviation Fund of 3.59 percent of the value of jet fuel sales, are deposited in the State General Fund. After all other distributions, the General Fund share of gross receipts tax collections is about 63 percent. In terms of the compensating tax, after distributions of 10 percent to the small cities assistance fund and 10 percent to the small counties assistance fund, the remaining receipts from the 5 percent compensating tax are deposited in the State General Fund.

In FY 2001, total distributions to the General Fund from gross receipts and compensating taxes grew a preliminary 9.9 percent over the previous fiscal year to \$1.29 billion. These combined revenues represented 32.3 percent of total General Fund revenue.

### Personal Income Tax

The personal income tax is imposed on the net income of every resident individual and upon the net income from business, property, or employment of non-resident individuals. State taxable income is generally equal to federal adjusted gross income less standard deductions or itemized deductions and amounts not taxable by the laws or Constitution of the State or the United States. The State also allows deductions for income earned by Indians on reservations and graduated deductions for income earned by taxpayers 65 years or older. Collections, net of refunds, are placed in the General Fund.

State statutes provide for a number of tax rebates and tax credits which are paid from or credited against the personal income tax and which have the effect of reducing available personal income tax collections. Rebate programs target those with very low incomes and include a general low-income rebate and a rebate for property taxes paid by the elderly. Credits are available for day care costs.

In FY 2001, the General Fund received \$906.1 million of recurring revenue from net personal income tax. This represents 22.7 percent of total General Fund receipts. Personal income tax collections grew by 4.1 percent for the full fiscal year after adjusting for federal and state filing extensions provided to the victims of the Cerro Grande fire. Estimated collections would have been \$50 million higher, resulting in growth of 9.8 percent had the extensions not been provided. Below are State tax rates by filing status.

<b>If Taxable Income is:</b>	<b>Married filing Separate</b>	<b>If Taxable Income is:</b>	<b>Surviving Spouses and Married filing Joint</b>
Not over \$4,000	1.7% of taxable income	Not over \$8,000	1.7% of taxable income
\$4,000 to \$8,000	\$68 plus 3.2% of excess over \$4,000	\$8,000 to \$16,000	\$136 plus 3.2% of excess over \$8,000
\$8,000 to \$12,000	\$196 plus 4.7% of excess over \$8,000	\$16,000 to \$24,000	\$392 plus 4.7% of excess over \$16,000
\$12,000 to \$20,000	\$384 plus 6.0% of excess over \$12,000	\$24,000 to \$40,000	\$768 plus 6.0% of excess over \$24,000
\$20,000 to \$32,000	\$864 plus 7.1% of excess over \$20,000	\$40,000 to \$64,000	\$1,728 plus 7.1% of excess over \$40,000
\$32,000 to \$50,000	\$1,716 plus 7.9% of excess over \$32,000	\$64,000 to \$100,000	\$3,432 plus 7.9% of excess over \$64,000
Over \$50,000	\$3,138 plus 8.2% of excess over \$50,000	Over \$100,000	\$6,276 plus 8.2% of excess over \$100,000
<b>If Taxable Income is:</b>	<b>Single including Estates &amp; Trusts</b>	<b>If Taxable Income is:</b>	<b>Head of Household</b>
Not over \$5,500	1.7% of taxable income	Not over \$7,000	1.7% of taxable income
\$5,500 to \$11,000	\$93.50 plus 3.2% of excess over \$5,500	\$7,000-\$14,000	\$119 plus 3.2% of excess over \$7,000
\$11,000 to \$16,000	\$269.50 plus 4.7% of excess over \$11,000	\$14,000 to \$20,000	\$343 plus 4.7% of excess over \$14,000
\$16,000 to \$26,000	\$504.50 plus 6.0% of excess over \$16,000	\$20,000 to \$33,000	\$625 plus 6.0% of excess over \$20,000
\$26,000 to \$42,000	\$1,104.50 plus 7.1% of excess over \$26,000	\$33,000 to \$53,000	\$1,405 plus 7.1% of excess over \$33,000
\$42,000 to \$65,000	\$2,240.50 plus 7.9% of excess over \$42,000	\$53,000 to \$83,000	\$2,825 plus 7.9% of excess over \$53,000
Over \$65,000	\$4,057.50 plus 8.2% of excess over \$65,000	Over \$83,000	\$5,195 plus 8.2% of excess over \$83,000

### Corporate Income Tax

The corporate income tax is imposed on the net income of a corporation doing business in the State or deriving any income from property and employment in the State. No corporate income tax is imposed upon insurance companies, which pay a premium tax to the State, or on nonprofit organizations or retirement trust funds. Collections, net of refunds, are placed in the General Fund. Corporations are required to file a return on or before the fifteenth day of the third month following the end of each taxable year at which time corporate income taxes are also due. A corporation is required to file estimated tax payments if the tax, net of credits, is \$5,000 or more.

Tax rates are established under a graduated table and range from 4.8% on the first \$500,000 or less of taxable income to 7.6% on income in excess of \$1,000,000. In FY 2001, net receipts received by the General Fund from corporate income tax were \$219.8

million, representing growth of 36.4 percent over FY 2000. The corporate income tax represents 5.5 percent of total General Fund revenues.

### **Oil and Gas Emergency School Tax**

The oil and gas emergency school tax is imposed for the privilege of engaging in the business of severing oil, natural gas, liquid hydrocarbons and carbon dioxide from the soil of the State. Tax is imposed at a rate of 3.15 percent of taxable value of oil and 4.0 percent of taxable value for natural gas. Taxable value reflects gross sales value less deductions for royalties paid to government entities and for certain processing and transportation expenses. This is the same definition of taxable value that is used for calculation of oil and gas severance tax liability.

Oil and gas emergency school tax receipts are disbursed to the General Fund. Oil and gas emergency school tax receipts were \$329.0 million in FY 2001. Other General Fund taxes on natural resources production amounted to \$34.5 million. Together, severance-related taxes contributed approximately 9.1 percent of total General Fund revenue in FY 2001.

### **Royalties, Rents and Bonuses**

**Federal Lands.** Under terms of the 1920 federal Mineral Leasing Act the State receives a 50 percent share of all income generated from the leasing of federally held lands located in the State for mineral production. Principal sources of income on federal lands are royalty payments on oil and gas production. Additional income is derived from bonus payments for oil and gas leases and royalty payments on production of coal, potash and other minerals. The U.S. Minerals Management Service collects federal mineral lease income where the State's share of administrative costs is deducted. The State receives payments on a monthly basis and makes the deposits to the General Fund, almost exclusively for funding public schools. In FY 2001, an estimated \$374.5 million, or represents 9.4 percent of total receipts, was deposited in the General Fund from this source.

**State Lands.** The State Land Office manages lands acquired by the State under the federal Fergusson Act enacted prior to statehood, as well as under the State Constitution. All income from such lands is dedicated to specific educational purposes and institutions. As with federal lands, the oil and gas industry is the principal source of revenue from State lands. Bonus income is also collected in the form of cash payments as a result of competitive bidding for State leases. Rentals and bonus income are distributed to the respective beneficiary institutions, with the single largest beneficiary being the State's public schools. FY 2001 receipts were \$27.2 million.

Minerals production from State trust lands also generates royalty income, which is deposited in the State Land Grant Permanent Fund. Royalties are imposed on most minerals production values at the rate of 12.5 percent, although there is a provision for rates of up to 20 percent for new leases on developed acreage. Beneficiaries of the State Land Grant Permanent Fund are the same as those educational and public institutions benefiting from "State lands."

### **State Land Grant Permanent Fund and Severance Tax Permanent Fund**

The New Mexico State Land Grant Permanent Fund is designed solely to benefit the educational system of the State and other specified institutions. The seeds of the Fund are found in the Fergusson Act of 1898, which granted two sections of land in every township for the benefit of the public schools in the territories of New Mexico. Also under this Act, specific acreage was granted to individual education, medical and penal institutions in the territory. The initial grant totaled in excess of 5.5 million acres. In 1910, the Enabling Act granted additional lands to various beneficiaries in New Mexico, including the public schools, with the latter receiving the largest share. This brought the total lands placed in trust for the common school system and other beneficiaries to over 13 million acres. Over the years, some land has been sold (and the proceeds used to increase the corpus of the Fund), bringing the current total to 8.9 million surface acres and 12.7 million subsurface acres.

The State Land Office is charged with the custody and disposition of the land granted to the State. Through the Commissioner of Public Lands these properties granted to the State are sold and/or leased in accordance with the provisions of the appropriate statutes. The State Investment Officer under the direction of the State Investment Council invests the corpus of the Land Grant Permanent Fund. As of June 30, 2001, the market value of the Permanent Fund was \$7.395 billion, a decrease of approximately 6.7% over the prior year.

The Severance Tax Permanent Fund was established in the State Treasury in 1973 to receive the residual revenues from the Severance Tax Bonding Fund and serve as an endowment for future capital projects. In the General Election of 1976, the electorate approved a constitutional amendment giving the Severance Tax Permanent Fund constitutional status. In the General Election of 1982, the electorate approved a second constitutional amendment, which removed the discretionary power of the Legislature to appropriate funds from the corpus of the Severance Tax Permanent Fund. Distributions from investments of the Fund, however, may be appropriated by the Legislature in the same manner as other general revenues are appropriated. Severance tax receipts are the primary source of funding for the Severance Tax Permanent Fund. The market value of the Severance Tax Permanent Fund as of June 30, 2001 was \$3.862 billion, an approximate decrease of 7.5 percent over the prior year.

In November 1996, the electorate of New Mexico approved a constitutional amendment regarding distributions from the State's permanent funds. Distributions will be based on a total return basis rather than an income distribution method. Distributions to beneficiaries will be based on a formula under which 4.7 percent of the previous average five-year market value of the fund would be distributed. The objective of the new formula is to protect the funds against inflation by distributing long term expected "real" return (total return minus inflation), thus allowing the funds to grow at a rate equal to inflation. The formula was derived based on 50-year historic trends. The new distribution formula was implemented in FY 2001 for the Land Grant Permanent Fund and in FY 2002 for the Severance Tax Permanent Fund.

**Investment Income**

Investment earnings are generated from three primary sources: the State Land Grant Permanent Fund, the Severance Tax Permanent Fund, and cash balances held by the State Treasurer. Income from the State Land Grant Permanent Fund is distributed among the beneficiary educational institutions and public schools. The 82.3% share dedicated to public schools is deposited in the General Fund. In FY 2000, \$234.3 million of Land Grant Permanent Fund earnings were transferred to the General Fund for public school purposes. \$144.7 million of income was generated from the Severance Tax Permanent Fund, all of which was deposited in the General Fund. In FY 2001, Treasurer's cash balances produced \$74.5 million of investment income, which was credited to the General Fund. Total FY 2001 interest and investment income credited to the General Fund was \$453.4 million, representing 11.4 percent of total General Fund receipts.

**PROPERTY VALUATION AND TAXATION**

Property Tax Year ("PTY") is September 1 to August 31. A re-valuation assessment started in property tax year 1986, as mandated by statute, and was completed within a 10-year period. In PTY 1995, strong growth in residential valuations occurred as a result of timely re-valuation assessment to comply with the statute. The valuation of oil and gas production and the assessment of the ad valorem production tax are based on the actual value of production on a monthly basis from September 1 to August 31 of each year. Pursuant to Section 7-32-15 NMSA 1978 as amended, oil and gas valuation is from the calendar year preceding the property tax year. For rate setting, Local Government Division ("LGD") may adjust levy for changes in oil and gas values.

On November 3, 1998, as a result of approval by the New Mexico electorate, Article 8, Section 1 of the New Mexico Constitution was amended to authorize the Legislature to limit increases in valuation of residential property for property taxes. The limitation may be applied to classes of residential property taxpayers based on owner-occupancy, age or income. The limitations may be authorized statewide or at the option of a local jurisdiction and may include conditions under which the limitation is applied. Any valuation limitations authorized, as a local jurisdiction option, shall provide for applying statewide or multi-jurisdictional property tax rates to the value of the property as if the valuations increase limitation did not apply. This amendment may have an impact on future property taxation increases.

The 2000 Legislature passed and the Governor signed legislation limiting the increase in the value of residential property for property valuation purposes. Laws of 2000, Chapter 10 provides that the value of a property in any tax year, starting in 2001 and subsequent tax years, shall not exceed the higher of 103 percent of the value in the tax year prior to the tax year in which the property is being valued or 106.1 percent of the value in the tax year two years prior to the tax year in which the property is being valued. The following table shows net taxable valuations for the last ten years.

<b>Final Net Taxable Valuations (in thousands)</b>					
<u>PTY</u>	<u>Residential</u>	<u>Non-residential</u>	<u>Oil &amp; Gas</u>	<u>Copper</u>	<u>Net Taxable Value</u>
1992	8,236,961	7,059,737	1,452,517	210,417	\$16,959,632
1993	8,419,063	7,286,479	1,721,983	177,834	\$17,605,359
1994	8,723,123	7,342,186	1,893,527	173,007	\$18,131,843
1995	10,729,781	7,867,383	1,694,195	184,300	\$20,475,659
1996	11,150,455	8,120,033	1,562,623	214,300	\$21,047,411
1997	12,228,583	8,563,893	2,371,034	235,557	\$23,399,067
1998	12,678,034	8,750,029	2,520,530	236,629	\$24,185,223
1999	14,660,993	9,311,907	1,852,447	192,897	\$26,018,245
2000	15,311,042	9,946,121	2,166,427	160,906	\$27,584,497
2001*	16,288,212	10,132,672	4,152,677	117,376	\$30,690,938

\* Estimate

Source: Department of Finance and Administration, Local Government Division.

**Production and Property Taxes on Oil and Gas**

The School Tax rate imposed on natural gas was raised from 3.15 percent to 4.00 percent effective July 1, 1993, pursuant to Laws 1993, Chapter 360. This action was taken partially to compensate for the large decreases in revenues due to the 1987 tax changes for natural gas. Further, it was believed that the tax increase was tolerable to the industry because of relatively higher prices. The

School Tax rate imposed on crude oil continues to be 3.15 percent.

Statutory tax rates on oil and gas for the School Tax (3.15%), the Oil and Gas Severance Tax (3.75%) and the Conservation Tax (0.19%) are effectively reduced by deductions for royalties paid to governments and for certain transportation expenses. The ad valorem taxes are imposed in lieu of property taxes on reserves and lease equipment, and local rates vary in accordance with jurisdiction.

Current effective production and property tax rates expressed on ad valorem and unit bases are shown below. The rates were based on data from FY 2000 and reflect an average sales price of \$22.07 per barrel for oil and \$2.46 per thousand cubic feet (mcf) for natural gas. The effective rates presented in the table show taxes paid as a percentage of gross sales value before subtracting allowable deductions.

<u>Type of Tax</u>	<b>Effective Tax Rates</b>			
	<u>Crude Oil</u>		<u>Natural Gas</u>	
	<u>Ad Valorem</u>	<u>Per Barrel</u>	<u>Ad Valorem</u>	<u>Per mcf</u>
School Tax	2.79%	\$0.62	3.15%	\$0.078
Oil and Gas Severance Tax	3.23	0.72	2.89	0.071
Conservation Tax	0.17	0.04	0.24	0.006
Ad Valorem Production	0.99	0.22	0.85	0.021
<u>Ad Valorem Production Equipment</u>	<u>0.30</u>	<u>0.03</u>	<u>0.25</u>	<u>0.030</u>
Total	<u>7.48%</u>	<u>\$1.63</u>	<u>7.38%</u>	<u>\$0.206</u>

**Production, Sales and Property Taxes on Coal**

The average burden of production and property taxes on a ton of coal produced and sold during fiscal year 1998-1999 were as follows:

<u>Type of Tax</u>	<u>Effective Rate</u>	<u>Amount</u>
Severance Tax & Surtax	\$1.063 per ton	\$26,570,656
Resources Excise Tax	0.152 per ton	3,799,163
Gross Receipts Tax	0.969 per ton	24,219,661
Property Tax	0.278 per ton	6,939,804
Conservation Tax	<u>0.038 per ton</u>	<u>961,050</u>
Total	<u>\$2.500 per ton</u>	<u>\$62,490,334</u>

Statutory rates for the Resources Excise and the Conservation Tax are effectively reduced by a deduction for Federal, State and Indian royalties. The effective severance tax rate on coal reflects the mix of old and new contract sales and of underground and surface mines. Property tax pertained to both equipment and production values. Fundamental differences in tax bases preclude a true comparison between property taxes and other taxes shown above. However, property taxes are included in this analysis to prevent understating the tax burden.

In addition to production taxes, gross receipts tax is imposed on coal produced and sold within the State. Currently, about 85 percent of all coal produced in the State is subject to gross receipts tax, even though a substantial portion is shipped out of the State for ultimate consumption. The combined state and local tax rate is 5.625 percent of value.

To convert taxes per unit of output to tax rates per dollar of sales, the taxes shown above may be divided by the average price per ton of coal in FY 2000, which was approximately \$20.20.

Excluding Gross Receipts Tax	$\$1.53/\$20.20 = 7.6\%$
Including Gross Receipts Tax	$\$2.50/\$20.20 = 12.4\%$