

MEMORANDUM

TO: Joint Budget Committee

FROM: Carly Jacobs, Joint Budget Committee Staff

SUBJECT: OSPB Request for Bill to Transfer Severance Tax Revenue to the General Fund

DATE: January 15, 2015

The Governor's FY 2014-15 supplemental package includes a request for the Joint Budget Committee to sponsor legislation transferring \$47.0 million of FY 2014-15 severance tax revenue to the General Fund for FY 2015-16. This memo provides a brief summary of the proposed legislation and potential impacts, as well as background information on severance tax revenue projections and distributions. The requested bill has three main components:

1) Establishing a \$278.0 million cap on the distribution of FY 2014-15 severance tax revenues.

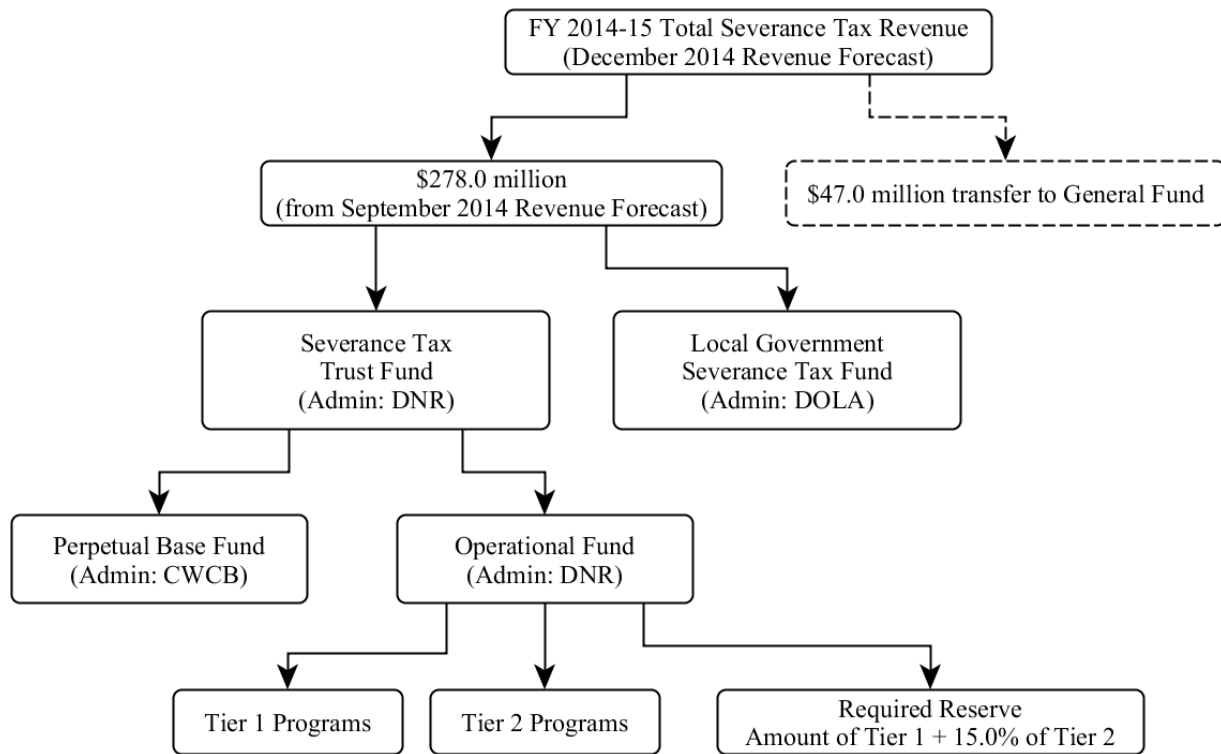
As shown in the table below, the December 2014 revenue forecasts from the Office of State Planning and Budget (OSPB) and Legislative Council Staff (LCS) projected higher severance tax revenues in FY 2014-15 than the September 2014 forecasts.

FY 2014-15 Severance Tax Revenue Forecasts		
	OSPB	LCS
September 2014	\$278.2 million	\$269.2 million
December 2014	\$349.7 million	\$301.7 million
Total Increase	\$71.5 million	\$32.5 million
<i>Percent Change</i>	<i>25.7%</i>	<i>12.1%</i>

The requested legislation would make the transfer from severance tax revenue *above* a cap of \$278.0 million, which is the amount of projected severance tax revenue from the September 2014 OSPB forecast. Revenue above the proposed cap has not been programed or awarded in FY 2014-15 so programs that receive or distribute severance tax revenues would continue to operate as they would under the September 2014 forecast. The transfer would not impact the budget in the current fiscal year because available revenue would remain constant from an agency perspective.

2) Exempting \$47.0 million in severance tax revenues from the statutory distribution formula.

The distribution of severance tax revenues is defined by statute (Section 39-29-108 to 39-29-109.3, C.R.S.). As illustrated in the following figure, the requested bill would change statute to exempt \$47.0 million in severance tax revenue *above the cap* from being distributed to the Department of Natural Resources and the Department of Local Affairs in FY 2014-15 (dashed lines). All revenue under the \$278.0 million cap would be distributed according to the existing formula (solid lines).



Please note that the December 2014 forecast from OSPB projects an increase of \$71.5 million in severance tax revenue over the September 2014 forecast. This is \$24.5 million *more* than the transfer amount requested by the Governor. At the time of the request, \$47.0 million is the amount needed to balance the General Fund in FY 2015-16 according to the December 2014 forecast. However, OSPB indicated that the actual transfer could be any amount up to the projected \$71.5 million depending on future revenue projections.

Impact to the Severance Tax Perpetual Base Fund

The Colorado Water Conservation Board (CWCB) administers the Severance Tax Perpetual Base Fund, which receives 25.0 percent of total severance tax revenues for water projects loans. The amount available for loans in FY 2014-15 would not change because the requested legislation exempts revenue *above* the cap. For FY 2015-16, the CWCB anticipates that reductions in severance tax revenue due to low oil prices will decrease available funding for water projects by an estimated \$18.6 million. Diverting \$47.0 million of the additional revenue projected in FY 2014-15 would prevent that revenue from acting as a cushion and reduce the amount that would have been available for loans in FY 2015-16 had the transfer not occurred.

Impact to the Severance Tax Operational Fund

The Department of Natural Resources administers the Severance Tax Operational Fund, which receives 25.0 percent of total severance tax revenues to support ongoing programs and personnel in the Department. Under the December 2014 revenue forecast, the requested legislation does not appear to have a negative impact on the Operational Fund. There will still be sufficient revenue to fully fund all Tier I and Tier II programs and maintain the required reserves in both

FY 2014-15 and FY 2015-16, even after accounting for the projected decrease in severance tax revenue in FY 2015-16.

This assumes, however, that future revenue forecasts will not differ significantly from the December 2014 forecast. Severance tax revenues are challenging to predict and projections tend to be somewhat unstable across forecasts. There is no guarantee actual revenues at year end will be consistent with the current forecast, and the impact of the legislation on the Operational Fund may depend on future forecasts.

Impact to the Local Government Severance Tax Fund

The Department of Local Affairs (DOLA) administers 50.0 percent of total severance tax revenues, which are disbursed to counties and municipalities impacted by mineral production in the form of direct distributions and grants. DOLA indicated that amounts made available for FY 2014-15 are within the \$278.0 million cap specified in the request and does not anticipate a negative impact on grants or distributions during the current fiscal year.

DOLA is considering program changes to the 2016 grants and distributions cycle in preparation for the projected reduction in severance tax revenues in FY 2015-16 due to low oil prices. Like the Perpetual Base Fund, the diversion of additional revenue projected in FY 2014-15 would reduce the amount in the Local Government Severance Tax Fund available for distribution in FY 2015-16.

3) Transferring \$47.0 million in severance tax revenues to the General Fund for FY 2015-16.

Severance tax revenues are cash funds subject to TABOR and the increase in projected revenue is disproportionately contributing to an expected refund in FY 2015-16. To account for the impact of increased severance tax revenues, the requested bill would transfer \$47.0 million in severance tax revenue to the General Fund on June 30, 2015 to be available at the start of FY 2015-16. The request specifies that the dollar amount of the required transfer will likely change based on the actual revenue collected, the final budget approved for FY 2015-16, and the size of the reduction in federal Medicaid funds. OSPB indicated that it would be reasonable to wait for the March 2015 forecast and the completion of figure setting to determine the exact amount needed for balancing purposes.

Staff Recommendation

Staff recommends the Committee postpone a decision on whether to sponsor the requested legislation until updated information on severance tax revenue is available from the March 2015 revenue forecasts and figure setting is complete. However, since the statutory change required for the transfer is largely a technical adjustment, the Committee could review the mechanism for the transfer with numbers omitted until a later date. If the Committee would like to request a draft of the bill at this time, staff requests permission to allow OSPB to work directly with Legal Services to develop the necessary language.