

# MEMORANDUM

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**TO:** Joint Budget Committee Members

**FROM:** Carly Jacobs, Joint Budget Committee Staff

**SUBJECT:** Governor's Request to Transfer \$3.8 million in Severance Tax Revenue to the General Fund in FY 2015-16

**DATE:** December 3, 2015

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The Governor's FY 2016-17 budget submission includes a request for legislation to transfer \$3.8 million in severance tax revenue to the General Fund in FY 2015-16. This memo provides background information on the Governor's request to divert severance tax revenues in FY 2014-15 and the resulting bill (S.B. 15-255), as well a brief summary of the requested legislation and a discussion of potential impacts.

## ***Background***

The December 2014 Legislative Council Staff revenue forecast projected record-high severance tax revenues of \$301.7 million in FY 2014-15, a 20.1 percent increase over the previous year and more than double total revenue in FY 2012-13. As cash funds subject to TABOR, large increases in severance tax revenue were disproportionately contributing to expected refunds from the General Fund. In January 2015, the Governor requested legislation to divert \$47.0 million in severance tax revenue to the General Fund in the last several months of FY 2014-15 to help offset the impact of the increase in projected cash funds revenue from severance tax.

### *Senate Bill 15-255*

The General Assembly ultimately passed S.B. 15-255, which credited the first \$20.0 million of gross severance tax revenues received between the effective date of the bill and the end of FY 2014-15 to the General Fund. Initial estimates of gross severance tax revenue collections from the Department of Revenue indicated there would be sufficient revenue to accommodate the full diversion. However, three technical factors contributed to a reduction in the pool of severance tax revenue available to divert to the General Fund:

1. *"Gross Receipts" in Practice*

Language in S.B. 15-255 specifies that the first \$20.0 million of "gross receipts" from severance taxes be credited to the General Fund. Remaining gross receipts are then divided according to the statutory distribution formula (Sections 39-29-108 to 39-29-109.3, C.R.S.). In practice, however, the Department of Revenue interprets "gross receipts" as revenue left over after refunds and other adjustments. This means that diversion was essentially made from net revenue. Just over \$9.0 million in refunds were deducted from gross severance tax revenues in May and June of 2015.

2. *High Initial Estimates*

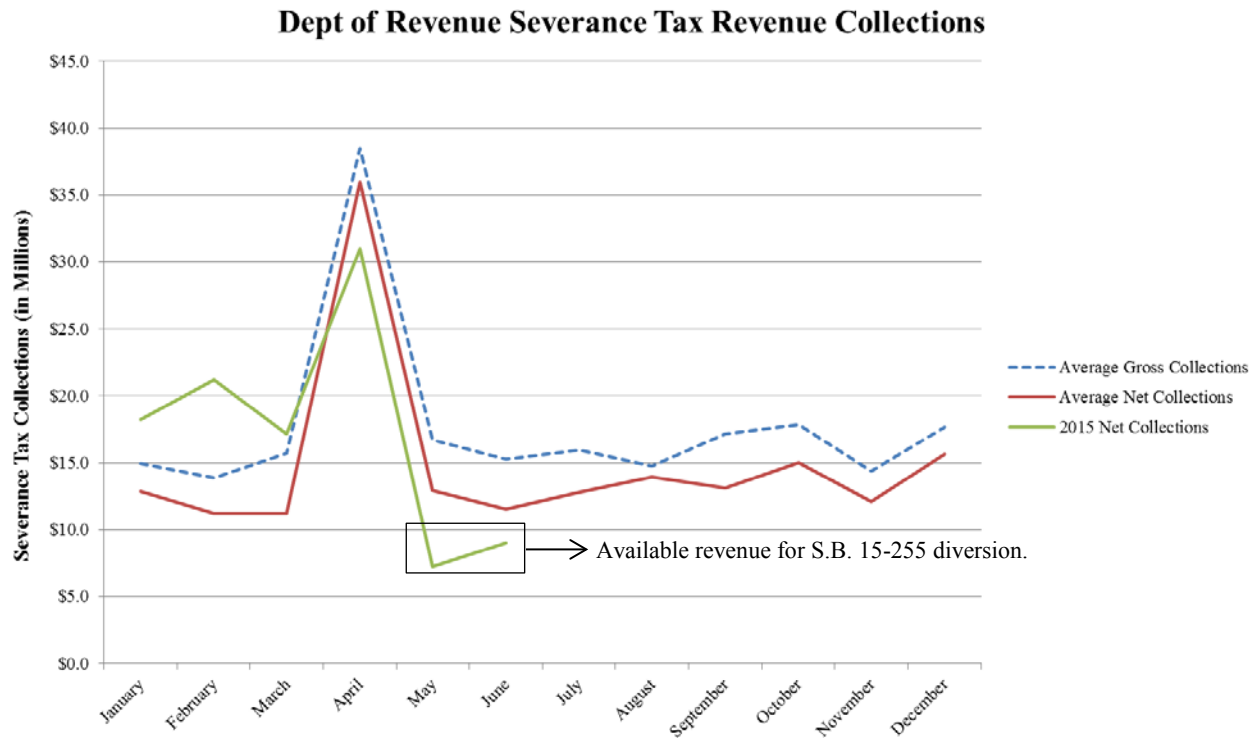
The initial estimates provided by the Department of Revenue ended up exceeding actual severance tax collections in the last two months of FY 2014-15. Net collections in May 2015

were almost \$5.7 million below the six-year average for collections in that month while net collections in June 2015 were \$2.6 million lower than average.

3. *Timing*

Senate Bill 15-255 was introduced after the March 2015 LCS revenue forecast, made its way through the legislative process during the month of April, and was signed into law on May 1, 2015. This limited the effective time period of the bill to two months, May and June, and eliminated the possibility of any diversions from April revenue. April collections are far and away the highest of any month, while May and June taper off as the end of the fiscal year approaches. Just under \$31.0 million in net severance tax revenue was collected in April 2015. Had the bill taken effect even a week earlier, there would have been enough revenue for the full \$20.0 million diversion.

To illustrate these issues, the following figure shows 6-year averages of gross (as in total revenue) and net (as in total revenue less refunds) severance tax collections by month, as well as net severance tax collections for the last half of FY 2014-15. Data was provided by the Department of Revenue.



In sum, the amount of severance tax revenue collections from which diversions could be made under S.B. 15-255 was smaller than anticipated for a variety of reasons and a total of \$16.2 million was diverted to the General Fund by the end of FY 2014-15, \$3.8 million less than the intended \$20.0 million diversion.

***Governor's Request for FY 2015-16 Transfer***

The Governor is requesting legislation to secure the remaining balance of severance tax revenue (\$3.8 million in FY 2015-16) that was not credited to the General Fund under S.B. 15-255. Unlike S.B. 15-255, however, revenue would be transferred out of each of the funds that receive severance tax rather than diverted directly to the General Fund. The impact of the bill as requested would be proportionally distributed across funds according to the statutory distribution formula. This includes the Severance Tax Operational Fund and the Severance Tax Perpetual Base Fund, administered by the Department of Natural Resources, and the Local Government Severance Tax Fund administered by the Department of Local Affairs.

***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 bill would reduce revenue available for loans by \$950,000 in FY 2015-16.

***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. The bill would reduce available revenue by \$950,000 in FY 2015-16.

Based on the September 2015 LCS revenue forecast, there would still be enough revenue in the Operational Fund to avoid cuts to Tier II programs in FY 2015-16 after accounting for the impact of the proposed legislation. However, by reducing revenue in the current year, the requested bill would intensify cuts that were already anticipated in FY 2016-17 from 16.3 percent to 18.9 percent. The table below compares authorized expenditures and estimated distributions to Tier II programs with and without the requested bill:

<b>Estimated Distributions to Tier II Programs in FY 2016-17</b>				
	<b>Authorized Expenditures</b>	<b>Without Proposed Bill</b>	<b>With Proposed Bill</b>	<b>Impact of Bill by Program</b>
Water Infrastructure Development	\$10,000,000	\$8,366,200	\$8,108,594	(\$257,606 )
Soil Conservation Districts Matching Grants	450,000	376,479	364,887	(11,592 )
Water Efficiency Grants	550,000	460,141	445,973	(14,168 )
Species Conservation Trust Fund	5,000,000	4,183,100	4,054,297	(128,803)
Low Income Energy Assistance	13,000,000	10,876,060	10,541,173	(334,887)
Renewable Energy - Agriculture	500,000	418,310	405,430	(12,880 )
Interbasin Water Compacts	745,067	623,338	604,145	(19,193 )
Forest Restoration/Bark Beetle Grants	2,500,000	2,091,550	2,027,149	(64,401 )
Aquatic Nuisance Species Fund	4,006,005	3,351,504	3,248,307	(103,197 )
Forfeited Mine Site Reclamation	127,000	106,251	102,979	(3,272 )
Phreatophyte/Tamarisk Control Grants*	0	0	0	0
<b>Total</b>	<b>\$36,878,072</b>	<b>\$30,852,933</b>	<b>\$29,902,933</b>	<b>(\$950,000)</b>

\*H.B. 15-1006 included a provision to eliminate this transfer in FY 2016-17 if proportional reductions are required to other Tier II programs. As such the authorized amount is reduced to \$0 in this table.

*Impact to the Local Government Severance Tax Fund*

The Department of Local Affairs (DOLA) administers the Local Government Severance Tax Fund, which receives 50.0 percent of total severance tax revenues. Moneys are disbursed to counties and municipalities impacted by mineral production in the form of direct distributions and grants. The requested legislation would reduce available revenue to DOLA by \$1.9 million in FY 2015-16. DOLA will have the opportunity to discuss the impact of the requested legislation in detail during the department's hearing with the JBC this afternoon (December 3, 2015).

***Conclusions and Recommendation***

Staff believes the operating assumption for budgeting purposes was that S.B. 15-255 would yield the full \$20.0 million in revenue to the General Fund, though the actual language in the bill did not guarantee that result. It is also staff's position that the shortfall in revenue collected under S.B. 15-255 is a product of technical issues that affected the implementation of the bill.

*Options for Action*

1. Decline to carry the as bill as a committee and allow other members of the General Assembly to sponsor legislation if desired.
2. Transfer the \$3.8 million to the General Fund in FY 2015-16, splitting the revenue reduction proportionally between DOLA and DNR funds.
3. Transfer the \$3.8 million to the General Fund in FY 2015-16, but rebalance the transfers to pull more revenue from some funds over others.
4. Transfer a smaller amount severance tax revenue to the General Fund in FY 2015-16 (with proportionally-distributed reductions or not), and use other sources of funding to make up the difference.
5. Do not transfer any severance tax revenue to the General Fund in FY 2015-16 and use other sources of funding to balance.

*Recommendation*

Unless the Committee wishes to decline to carry the bill, staff recommends revisiting the requested transfer when the Committee considers potential legislation in January 2016. Importantly, this will allow staff to revise estimates of proportional reductions to Tier II programs in FY 2016-17 based on the December 2016 Legislative Council Staff revenue forecast and more accurately reflect the impact of the requested bill. Also, the JBC will have the opportunity to speak with the impacted departments—DOLA and DNR—during hearings between now and then which may yield additional helpful information.

**Severance Tax Operational Fund**  
**(Includes Legislation Impacting FY 2015-16 as Requested by the Governor)**

	Statutory Cite	Actual FY 13-14	Estimated FY 14-15	Appropriated FY 15-16	Projected FY 16-17	Projected FY 17-18
Beginning balance		\$18,981,011	\$34,935,927	\$52,247,465	\$17,726,371	\$14,792,916
Revenue		65,222,486	68,307,732 est.	24,427,545 est.	42,137,394 est.	53,156,398 est.
Transfers to General Fund	39-29-109.3 (6)	0	0	(950,000) req.		
<b>TOTAL Available for Expenditure</b>		<b>\$84,203,497</b> 100.0%	<b>\$103,243,659</b> 100.0%	<b>\$75,725,010</b> 100.0%	<b>\$59,863,765</b> 100.0%	<b>\$67,949,314</b> 100.0%
<b>Roll-forwards (TOTAL)</b>				<b>\$828,217</b>		
<b>Off-the-Top Expenditures</b>						
Colorado Energy Office (H.B. 12-1315)		\$0	\$0	\$375,000	\$375,000	\$375,000
Public School Energy Fund	39-29-109.5	53,638	64,305	TBD	TBD	TBD
<b>SUBTOTAL OTT</b>		<b>\$53,638</b>	<b>\$64,305</b>	<b>\$375,000</b>	<b>\$375,000</b>	<b>\$375,000</b>
<b>Tier 1</b>	39-29-109.3 (1)					
Oil and Gas Conservation Commission	(a)	\$3,212,032 3.8%	\$2,863,742 2.8%	\$4,398,129 5.8%	\$4,398,067 7.3%	\$4,398,067 6.5%
Colorado Geological Survey	(b)	1,257,148 1.5%	1,342,243 1.3%	1,408,265 1.9%	1,408,265 2.4%	1,408,265 2.1%
Avalanche Information Center	(b.5)	494,961 0.6%	397,481 0.4%	495,790 0.7%	545,415 0.9%	556,323 0.8%
Div of Reclamation, Mining, and Safety	(c)	4,495,666 5.3%	4,344,195 4.2%	4,517,990 6.0%	4,559,701 7.6%	4,650,895 6.8%
Colorado Water Conservation Board	(d)	1,305,010 1.5%	1,310,800 1.3%	1,319,250 1.7%	1,319,250 2.2%	1,319,250 1.9%
Division of Parks and Wildlife	(f)	2,370,397 2.8%	2,422,356 2.3%	2,577,926 3.4%	2,562,218 4.3%	2,562,218 3.8%
<b>SUBTOTAL Tier 1</b>		<b>\$13,135,214</b> 15.6%	<b>\$12,680,817</b> 12.3%	<b>\$14,717,350</b> 19.4%	<b>\$14,792,916</b> 24.7%	<b>\$14,895,018</b> 21.9%
<b>Tier 2</b>	39-29-109.3 (2)					
Water Infrastructure Development	(a)	\$10,091,639	\$10,000,000	\$10,000,000	\$8,108,594	\$10,000,000
Soil Conservation Districts Matching Grants	(b)	454,124	450,000	450,000	364,887	450,000
Water Efficiency Grants	(c)	555,040	550,000	550,000	445,973	550,000
Species Conservation Trust Fund	(d) & (e)	4,036,656	6,500,000	5,000,000	4,054,297	5,000,000
Low Income Energy Assistance	(f)	13,119,131	13,000,000	13,000,000	10,541,173	13,000,000
Renewable energy - Agriculture	(h)	504,582	500,000	500,000	405,430	0
Interbasin Water Compacts	(i)	751,895	745,067	745,067	604,145	745,067
Forest restoration grants/ bark beetle	(k) & (n)	2,522,910	2,500,000	2,500,000	2,027,149	0
Aquatic Nuisance Species Fund	(m)	4,042,714	4,006,005	4,006,005	3,248,307	4,006,005
Forfeited Mine Site Reclamation (H.B. 15-1150)	(o)		127,000	127,000	102,979	127,000
Wildfire Risk Reduction Grants (S.B. 15-022)	(p)		1,000,000	1,000,000	0	0
Watershed Restoration (S.B. 15-253)	(q)		1,000,000	1,000,000	0	0
Dam Spillway Analysis (S.B. 15-253)	(r)		1,200,000	1,200,000	0	0
Phreatophyte Control Program (H.B. 15-1006)	(s)		2,000,000	2,000,000	0	0
<b>SUBTOTAL Tier 2</b>		<b>\$36,078,691</b> 42.8%	<b>\$38,251,072</b> 37.0%	<b>\$42,078,072</b> 55.6%	<b>\$29,902,933</b> 50.0%	<b>\$33,878,072</b> 49.9%
<b>TOTAL Expenditures</b>		<b>\$49,267,570</b>	<b>\$50,996,194</b>	<b>\$57,998,639</b>	<b>\$45,070,849</b>	<b>\$49,148,090</b>
<b>Ending Balance</b>		<b>\$34,935,927</b>	<b>\$52,247,465</b>	<b>\$17,726,371</b>	<b>\$14,792,916</b>	<b>\$18,801,223</b>
Tier 1 Reserve	39-29-109.3 (3)	\$13,135,214	\$12,680,817	\$14,717,350	\$14,792,916	\$14,895,018
Tier 2/LEAP Reserve	39-29-109.3 (3)	5,362,661	5,737,661	6,311,711	5,531,711	5,081,711
<b>TOTAL Reserve Requirement</b>		<b>\$18,497,875</b> 22.0%	<b>\$18,418,478</b> 17.8%	<b>\$21,029,061</b> 27.8%	<b>\$20,324,627</b> 34.0%	<b>\$19,976,729</b> 29.4%
<b>UNOBLIGATED BALANCE</b>		<b>\$16,438,052</b> 19.5%	<b>\$33,828,987</b> 32.8%	<b>(\$3,302,690)</b> -4.4%	<b>(\$5,531,711)</b> -9.2%	<b>(\$1,175,506)</b> -1.7%

est. = estimate. Revenue estimates are based on the Legislative Council Staff's September 2015 Revenue Forecast and include interest income of \$396,350 in FY 2015-16 and \$172,335 in FY 2016-17. Current projections indicate that Tier 2 distributions will be made in full in FY 2015-16, but proportional reductions of 19.0 percent are anticipated in FY 2016-17.

req. = legislation requested by the Governor in the FY 2016-17 budget submission.

TBD = to be determined.