MEMORANDUM

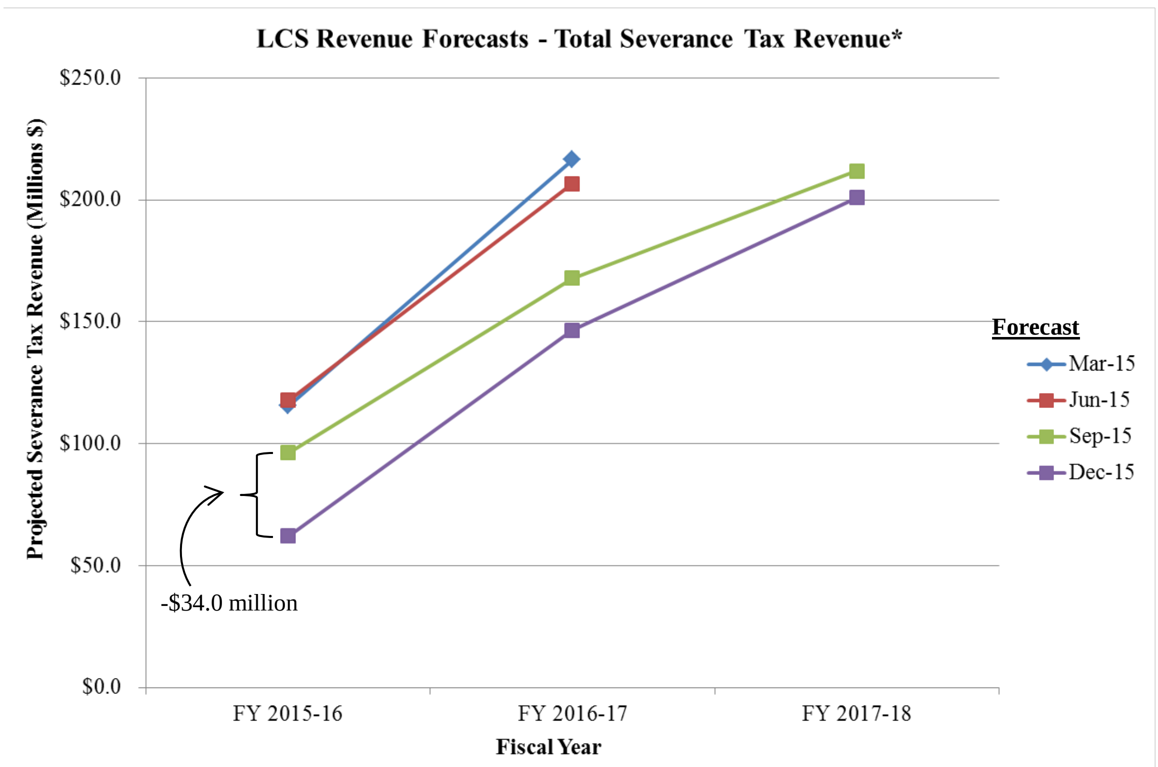
TO: Joint Budget Committee Members

FROM: Carly Jacobs, Joint Budget Committee Staff (303-866-3147)

SUBJECT: Severance Tax Update and Potential Legislation (Bills #27 and #28)

DATE: January 13, 2016

The December 2015 Legislative Council Staff (LCS) forecast for total severance tax revenue was less than the September 2015 LCS revenue forecast for FY 2015-16 through FY 2017-18. The figure below shows each of the 2015 LCS forecasts for total severance tax revenue, less interest. Projected revenue for FY 2015-16 is now $66.2 million, which is $34.0 million or 35.3 percent less than the September 2015 LCS forecast. Projected revenue for FY 2016-17 decreased by 12.6 percent to $146.6 million and FY 2017-18 projections decreased by 5.2 percent to $200.9 million.



*Does not include interest, which is kept by each individual fund rather than being disbursed through the statutory distribution formula.

Update on the Status of the Severance Tax Operational Fund

The Severance Tax Operational Fund receives 25.0 percent of total severance tax revenue, which is used to fund two tiers of agencies and programs:

1. Tier I agencies use severance tax revenue to support salaries and ongoing program costs in the Department of Natural Resources and are authorized to receive up to 100.0 percent of available moneys in the Severance Tax Operational Fund.

2. Tier II programs primarily provide grants and loans to support research and construction (Section 39-29-109.3 (2), C.R.S.) and are funded with revenue left over after Tier I appropriations are fulfilled. If mid-year projections indicate there will be insufficient Operational Fund revenue to support authorized expenditures for Tier II programs, they are all subject to proportional reductions unless the General Assembly acts to prioritize cuts via legislation.

Based on the December 2015 LCS revenue forecast, proportional reductions of 10.8 percent will now be required for Tier II programs in the current year (FY 2015-16). In FY 2016-17, Tier II programs will be subject to proportional reductions of 41.5 percent. The following table breaks down the anticipated proportional reductions for FY 2015-16 and FY 2016-17 by program:

Estimated Distributions to Tier II Programs in FY 2015-16 and FY 2016-17[/a]

	FY 2015-16			FY 2016-17		
	Authorized Expenditures	**Estimated Distributions**	**Reduction (Est-Auth)**	**Authorized Expenditures**	**Estimated Distributions**	**Reduction (Est-Auth)**
Water Infrastructure Development	$10,000,000	$8,915,120	($1,084,880)	$10,000,000	$5,847,831	($4,152,169)
Soil Conservation Districts Matching Grants	450,000	401,180	(48,820)	450,000	263,152	(186,848)
Water Efficiency Grants	550,000	490,332	(59,668)	550,000	321,631	(228,369)
Species Conserv Trust Fund	5,000,000	4,457,560	(542,440)	5,000,000	2,923,916	(2,076,084)
Low Income Energy Assistance	13,000,000	11,589,656	(1,410,344)	13,000,000	7,602,181	(5,397,819)
Renewable Energy - Ag	500,000	445,756	(54,244)	500,000	292,392	(207,608)
Interbasin Water Compacts	745,067	664,236	(80,831)	745,067	435,703	(309,364)
Forest Restoration Grants	2,500,000	2,228,780	(271,220)	2,500,000	1,461,958	(1,038,042)
Aquatic Nuisance Species	4,006,005	3,571,402	(434,603)	4,006,005	2,342,644	(1,663,361)
Forfeited Mine Site Rec.	127,000	113,222	(13,778)	127,000	74,267	(52,733)
Wildfire Risk Reduction Grants	1,000,000	891,512	(108,488)	0	0	0
Watershed Restoration	1,000,000	891,512	(108,488)	0	0	0
Dam Spillway Analysis	1,200,000	1,069,814	(130,186)	0	0	0
Phreatophyte Control Grants[/b]	2,000,000	1,783,024	(216,976)	0	0	0
Total	**$42,078,072**	**$37,513,106**	**($4,564,966)**	**$36,878,072**	**$21,565,675**	**($15,312,397)**

[/a] Does <u>not</u> include the Governor's request for legislation to transfer $3.8 million in severance tax revenue to the General Fund in FY 2015-16.
[/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.

Potential Legislation: Mitigating Severance Tax Volatility (#27)

The Committee indicated it wanted to consider possible legislation to reduce the volatility in the severance tax revenue stream and/or mitigate the impact of revenue fluctuations on the TABOR limit. The Committee also wanted to consider legislation specific to the impact of severance tax revenue volatility on the Operational Fund, including the three-part plan submitted by Department of Natural Resources during the hearing on December 10, 2015, as follows:

1. Reduce the Tier I reserve to 50.0 percent of Tier I appropriations (a savings of roughly $7.4 million in FY 2016-17);
2. Either double or triple the Tier II reserve to 30.0 percent or 45.0 percent of Tier II appropriations (a “cost” of $5.5 million to double or $11.0 million to triple the reserve, based on FY 2016-17 authorizations); and
3. Include provisions to condition Tier II reserve spending on the most recent Legislative Council Staff revenue forecast showing there is sufficient revenue to fund Tier I programs in both current and upcoming years.

Each piece of the proposal is interrelated and may be less successful in achieving the objective of reducing the impact of revenue volatility if implemented individually. Reducing the Tier I reserve by 50.0 percent in FY 2016-17 (Part I) frees up approximately $7.4 million which will help offset cuts to Tier II programs, but does not necessarily provide long-term protection against revenue volatility because it is not specifically designated to those programs. Increasing the Tier II reserve by some percentage (Part II) in tandem with the decrease in the Tier I reserve reallocates the newly-available revenue to the buffer against proportional reductions to Tier II programs. However, if severance tax revenue were to decrease enough to jeopardize Tier I funding, a provision to make the use of the Tier II reserve contingent on full funding for Tier I (Part III) would ensure Tier I programs remain protected under the new reserve requirements. In other words, the Tier II reserve could not be used at the expense of Tier I programs during a severe downturn.

Impact to Severance Tax Operational Fund Programs
JBC staff used the December 2015 LCS revenue forecast and the following assumptions to evaluate the impact of the above proposal on Operational Fund programs:

- reduces the Tier I reserve by 50.0 percent (-$7.4 million in FY 2016-17); and
- increases the Tier II reserve to 45.0 percent of authorized expenditures (+$11.0 million in FY 2016-17);
- does not include the transfer requested by the Governor; and
- includes supplementals and budget amendments as requested in Tier I.

Given these parameters, proportional reductions to Tier II in FY 2016-17 would be 21.5 percent ($7.9 million) with the changes to the reserve requirement instead of 41.5 percent ($15.3 million) without them. Proportional reductions are not called for in FY 2017-18 under any scenario but this is, as always, dependent on future revenue forecasts.

Potential Legislation: Governor's Request for $3.8 Million Transfer in FY 2015-16 (#28)

Senate Bill 15-255 credited the first $20.0 million of gross severance tax receipts between the effective date of the bill and the end of FY 2014-15 to the General Fund. Due to technical issues with the bill, 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. The Governor has requested legislation to transfer the remaining balance from S.B. 15-255 to the General Fund in FY 2015-16. The revenue would be transferred out of each of the funds that receive severance tax and the impact would be distributed across funds according to the statutory distribution formula unless otherwise specified in the bill. 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 Severance Tax Operational Fund Programs

If the transfers were made according statutory distribution formula, this bill would increase proportional reductions to Tier II programs to 13.0 percent in FY 2015-16 as shown in the table below. Please note that anticipated proportional reductions in FY 2016-17 would remain the same (41.5 percent) because Tier II programs would absorb the cut in the current year instead of passing the revenue reduction on to the following year as they would have under the September 2015 LCS revenue forecast.

Comparison of Estimated Distributions to Tier II Programs in FY 2015-16

	Authorized Expenditures	***Without* Proposed Bill**	***With* Proposed Bill**	**Impact of Bill by Program**
Water Infrastructure Development	$10,000,000	$8,915,120	$8,689,349	($225,771)
Soil Conservation Districts Matching Grants	450,000	401,180	391,021	(10,160)
Water Efficiency Grants	550,000	490,332	477,914	(12,418)
Species Conservation Trust Fund	5,000,000	4,457,560	4,344,675	(112,885)
Low Income Energy Assistance	13,000,000	11,589,656	11,296,154	(293,502)
Renewable Energy - Agriculture	500,000	445,756	434,467	(11,289)
Interbasin Water Compacts	745,067	664,236	647,415	(16,821)
Forest Restoration/Bark Beetle Grants	2,500,000	2,228,780	2,172,337	(56,443)
Aquatic Nuisance Species Fund	4,006,005	3,571,402	3,480,958	(90,444)
Forfeited Mine Site Reclamation	127,000	113,222	110,355	(2,867)
Wildfire Risk Reduction Grants	1,000,000	891,512	868,935	(22,577)
Watershed Restoration	1,000,000	891,512	868,935	(22,577)
Dam Spillway Analysis	1,200,000	1,069,814	1,042,722	(27,092)
Phreatophyte/Tamarisk Control Grants	2,000,000	1,783,024	1,737,870	(45,154)
Total	**$42,078,072**	**$37,513,106**	**$36,563,107**	**($950,000)**

Impact to Other Funds Receiving Severance Tax Revenue

Two other funds would be impacted by the requested legislation. The *Severance Tax Perpetual Base Fund* 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. 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.

Options for Committee Action

There are a number of different options the Committee could choose from regarding the proposed legislation:

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 as requested, 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.

If the Committee opts to sponsor legislation to transfer the remaining balance from S.B. 15-255 to the General Fund, staff recommends Option 3 above. *Specifically, $1.9 million should be transferred from both the Perpetual Base Fund and the Local Government Severance Tax (LGST) Fund. No transfers should be made from the Operational Fund.* The Perpetual Base Fund and the LGST Fund are very large cash funds used for loans and grants, and both have sizeable fund balances compared to the Operational Fund. These funds have enough revenue available to absorb the comparatively-small transfer with little to no impact on existing programs. In contrast, the Operational Fund is more directly tied to program operations and outcomes, and transferring revenue out of the fund would result in an immediate increase in proportional reductions to Tier II programs in FY 2015-16.