

Consensus General Fund Revenue Outlook

New Mexico Department of Finance and Administration

Presented to the Legislative Finance Committee

December 4, 2017



Overview

- Preliminary FY17 revenue exceeded August expectation by \$145 million largely due to higher reversions and income tax revenue.
- In FY18 and FY19 total recurring General Fund revenues are expected to grow by 3.5 percent and 3.1 percent, respectively, resulting in total FY19 revenue of \$6.3 billion and “new money” of \$199 million.
- Moderate macroeconomic growth is expected to continue nationally and in New Mexico.
 - A near term US recession is not forecast in the baseline scenario, but remains around a 20% probability.
- Moody’s Analytics and UNM BBER expectations for future New Mexico growth have remained near one another and are not significantly changed from August.
 - New Mexico employment is expected to grow around one percent in both of the next two years, but at around a half percent higher level compared to August.
 - Details provided in attached Appendix 2.
- Due to the volatility of revenues and range of risks New Mexico should target at least 10% reserves.

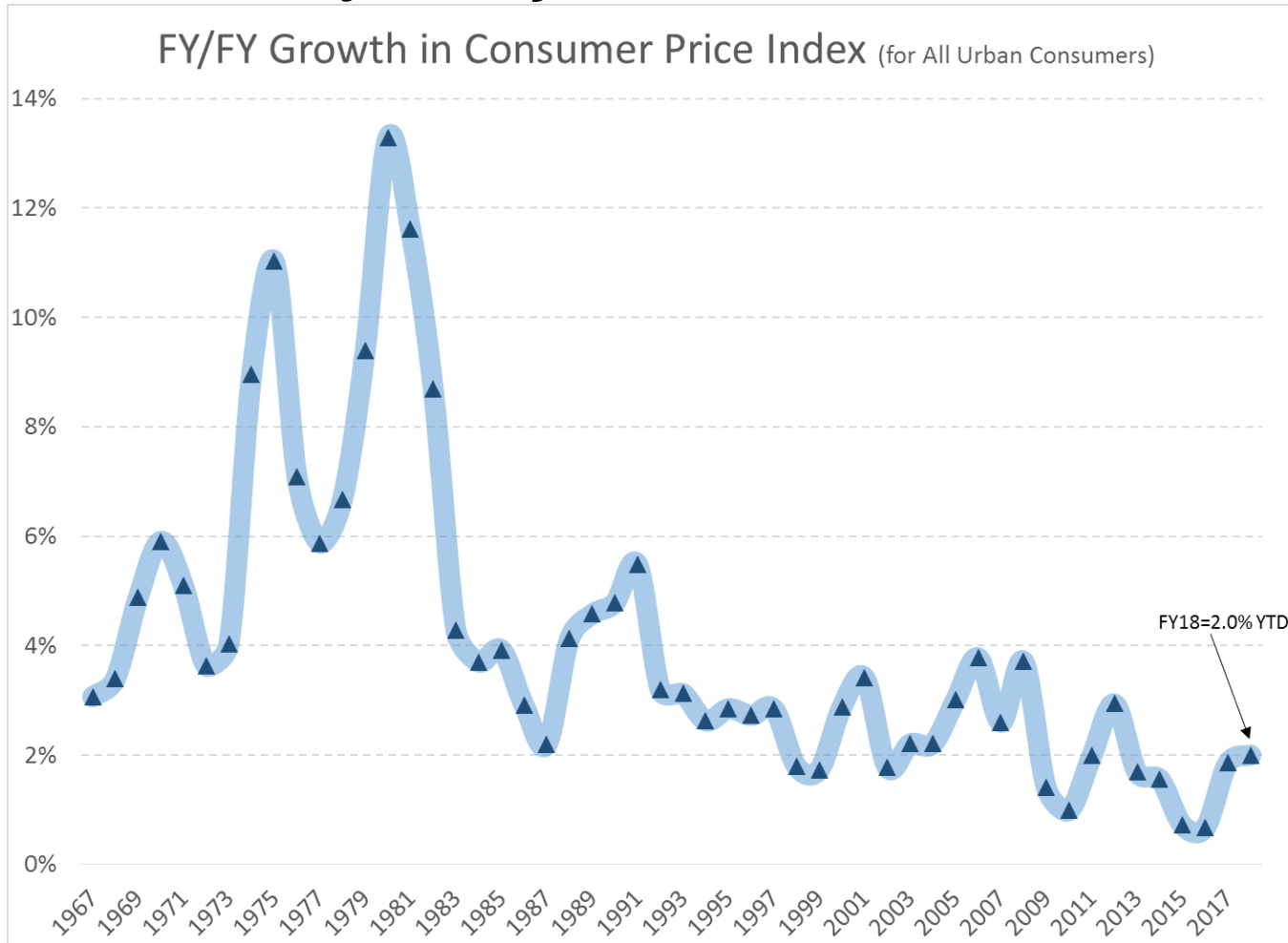
Major Forecast Revisions vs. August

- Personal Income Tax (PIT) – at the very end of FY17 \$69 million of previously unmatched CRS payments were identified as withholding (PIT). Along with other strength at the end of FY17, PIT exceeded August expectations for FY17 by \$96 million. This strength is expected to continue into FY18 and FY19 with forecasts for those two years being increased by \$71 million and \$83 million.
- Corporate Income Tax (CIT) – Preliminary FY17 net CIT exceeded August expectations by \$20 million, this strength along with a strong initial estimated quarterly payment in FY18 and slightly higher national expectations, has also increased the estimated CIT in FY18 and FY19 by \$35 million and \$36 million.
- Oil and Gas: due to increased price and volume expectations along with higher recent State Land Office and Federal Mineral Leasing payments, forecast oil and gas revenues from severance taxes and rents and royalties have been increased by approximately \$70 million in both FY18 and FY19.

US/Global Outlook

- Overall US Real GDP is expected to continue growing between two and three percent for the next couple years.
- Inflation is expected to return to longer term averages climbing above two percent in FY19 and FY20 (now both Moody's and Global Insight share this expectation).
- After appreciating by one-third between mid 2011 and Jan. 2016, the value of the US dollar has leveled off and declined by over six percent since January.
- The proposed federal tax reform offers the largest changes in decades and would have major positive and negative impacts on NM revenue; however, its final passage and form are highly uncertain at this time.
- Federal Funds rate hikes are expected to continue in 2018 at a measured pace.

Historically low Inflation = lower nominal revenue growth



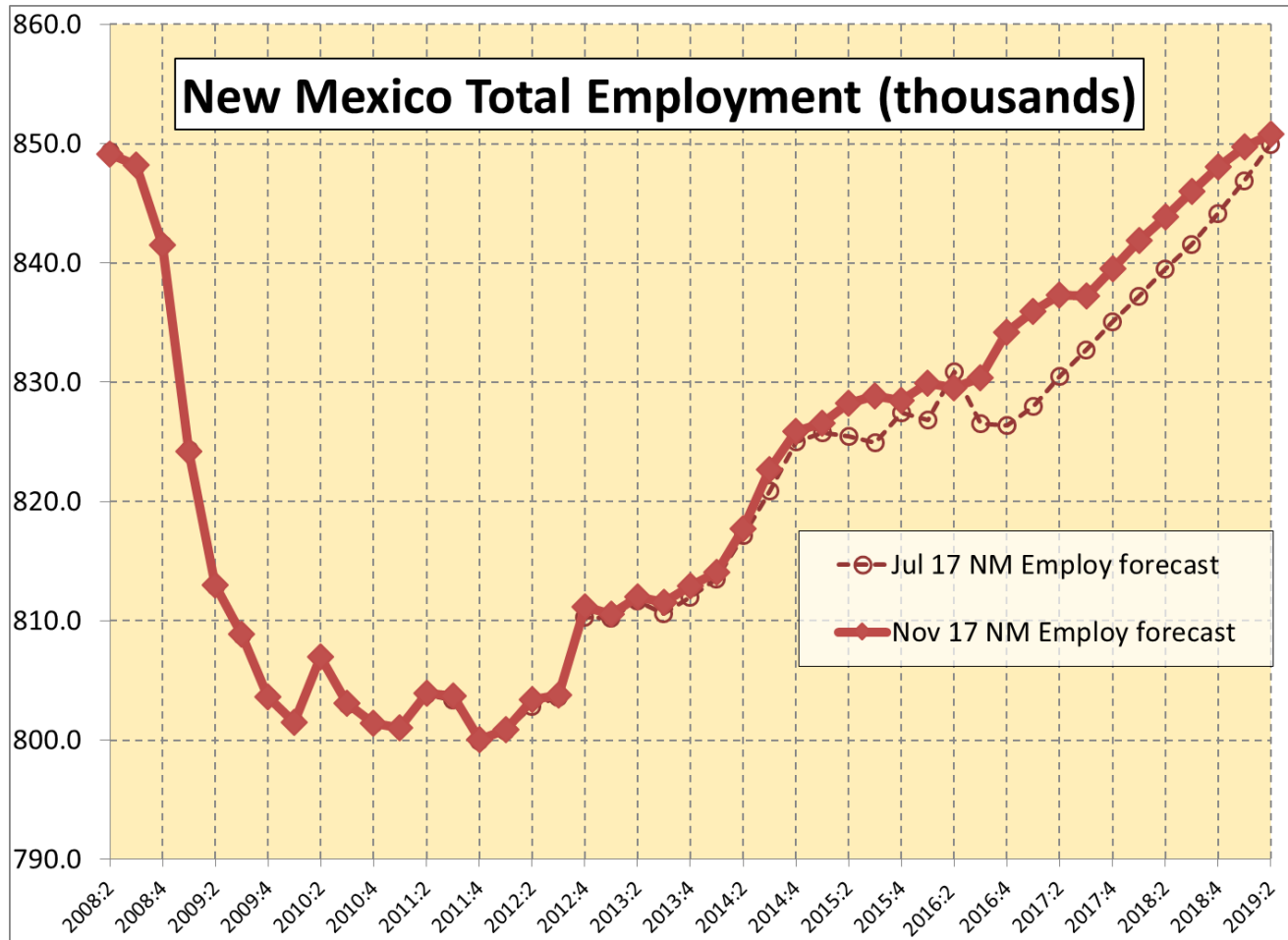
- *Inflation had been relatively stable for decades:*
 - 10 year average 1995-2004 = 2.4%
 - 10 year average 2005-2014 = 2.4%
- *FY15 and FY16 lowest inflation in 60 years, only 0.7%*
- *FY17 began to normalize at 1.9%*
- *FY18 on track for 2.0% YTD*

New Mexico Outlook

- Recent employment growth was revised upward; future growth forecasts remain around one percent but at a higher level.
- The Rio Grande Corridor grew moderately in FY17, and is on pace to grow slightly faster in FY18.
- Southeast New Mexico has rebounded sharply and is on pace to exceed August expectations.
- A dashboard of current economic indicators for New Mexico can be found at: <https://research.stlouisfed.org/dashboard/9235>



Moody's Analytics Forecast Changes



- Employment recently revised upwards and higher than forecast.
- Total employment expected to reach 2008 levels in 2019.



Gross Receipts- *substantial oil patch rebound & core growth*

FY 17 Y/Y General Fund GRT \$millions

| | | | | | |
|-------------------|----------------------------|-------------------|-------------------|-----------------|-------------------|
| San Juan -15.7 | Rio Arriba -1.9 | Taos -2.1 | Colfax 1.0 | Union 0.2 | |
| McKinley -2.9 | Sandoval -0.7 | Los Alamos 5.6 | Mora 0.3 | Harding 0.1 | Quay 0.5 |
| Cibola -1.8 | Bernalillo 12.9 | Santa Fe 2.4 | San Miguel 0.3 | Curry 3.2 | |
| Catron -0.4 | Valencia 4.7 | Torrance 3.5 | Guadalupe 0.7 | De Baca -0.3 | Roosevelt -1.8 |
| Grant -0.5 | Sierra 0.0 | Socorro 0.6 | Lincoln -0.9 | Lea -4.3 | |
| Luna 2.7 | Doña Ana 7.4 | Otero -2.4 | Chaves 4.1 | Eddy 2.4 | |
| Hidalgo 0.3 | Out-of-State: 2.3 | | | | |

FY 18 Q1 Y/Y General Fund GRT

| | | | | | |
|------------------|---------------------------|-------------------|-------------------|-----------------|------------------|
| San Juan 3.3 | Rio Arriba 0.5 | Taos -0.3 | Colfax 0.3 | Union 0.0 | |
| McKinley -0.5 | Sandoval -0.4 | Los Alamos 0.5 | Mora 0.2 | Harding 0.0 | Quay -0.2 |
| Cibola -0.1 | Bernalillo 6.1 | Santa Fe 1.7 | San Miguel 0.4 | Curry -1.8 | |
| Catron 0.0 | Valencia 3.5 | Torrance 1.0 | Guadalupe -0.1 | De Baca -0.3 | Roosevelt 0.3 |
| Grant 0.4 | Sierra -0.9 | Socorro -0.2 | Lincoln 0.4 | Lea 13.5 | |
| Luna 0.8 | Doña Ana 0.4 | Otero -0.2 | Chaves 1.5 | Eddy 15.0 | |
| Hidalgo 1.7 | Out-of-State: 16.7 | | | | |

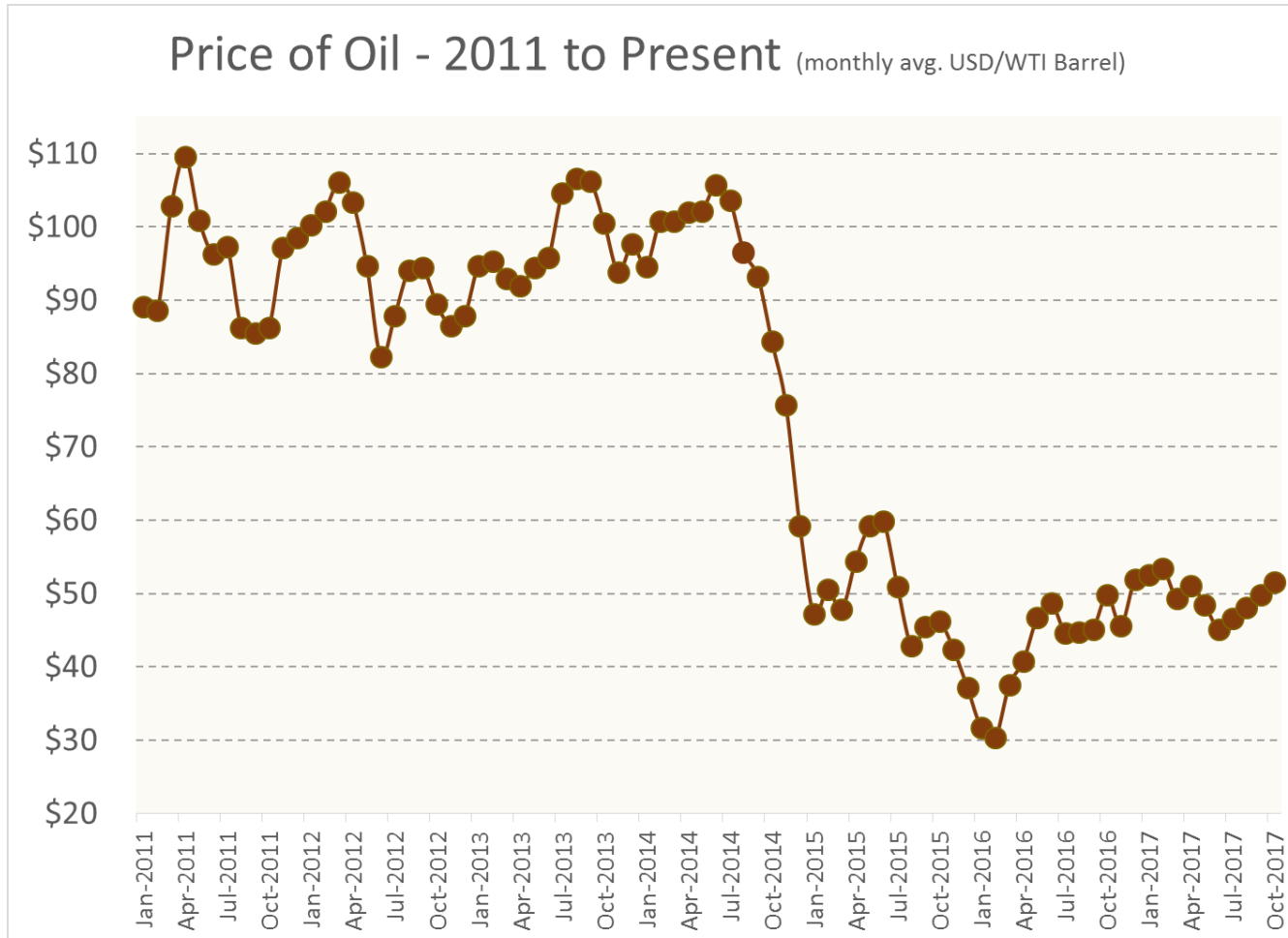
FY17: Further declines in the Northwest; Southwest & Out-of-State were near level FY-over-FY; continued moderate growth in Santa Fe-ABQ-Las Cruces corridor.

First Quarter of FY18: The decline has reversed (at least temporarily) in San Juan, growth is accelerating in Santa Fe, and the ABQ metro (Bernalillo, Valencia, & Torrance are all tracking in excess of last year's growth).

Note: See Appendix 4 for calculation and additional detail



Oil Price Volatility



- *After years of relative stability, oil prices plummeted.*
- *Prices dipped into the mid-\$20 in February 2016 before clawing back to around \$50.*
- *Prices recently hit two year highs, briefly exceeding \$58.*

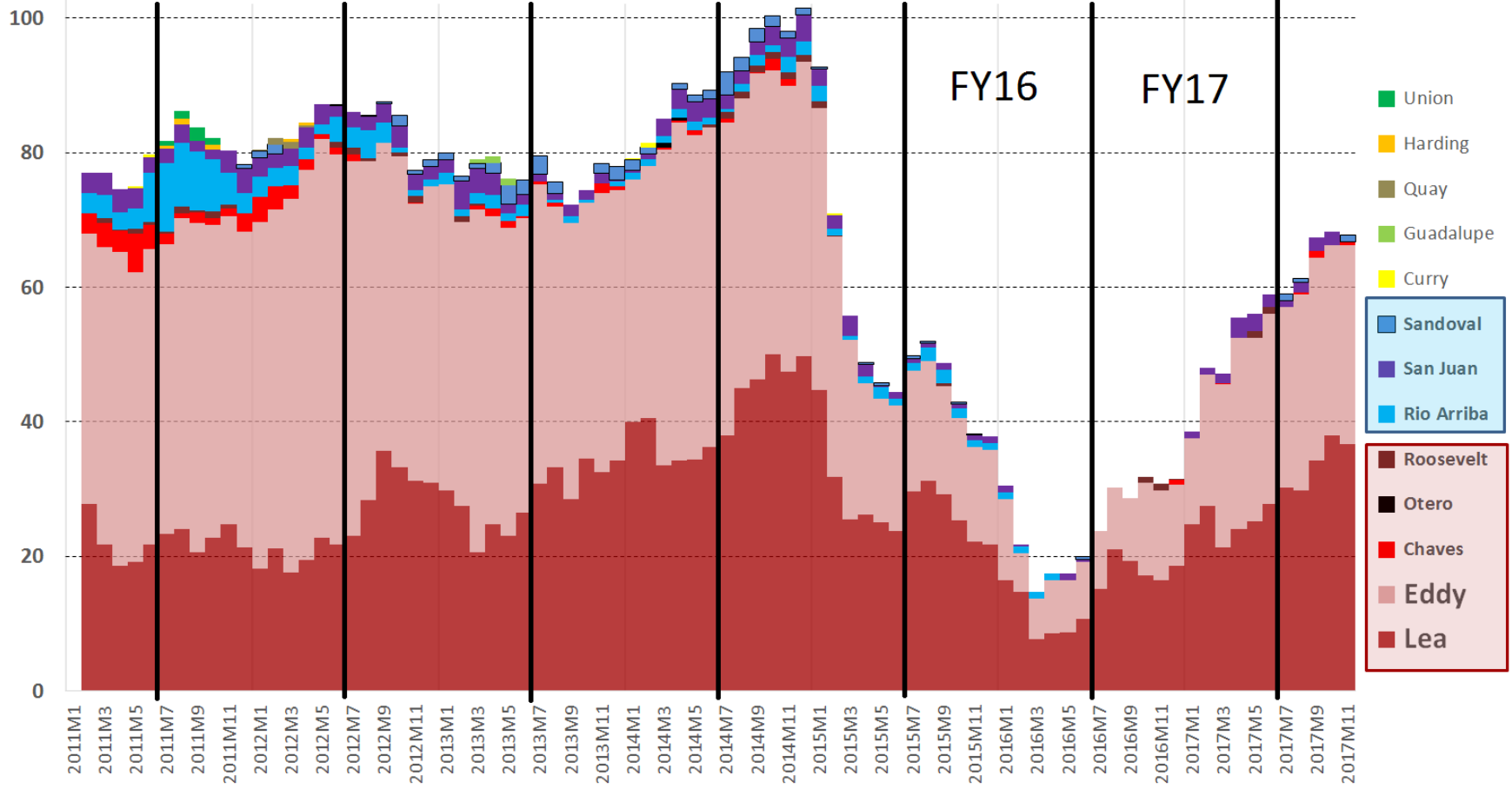
Rebounding Exploration:

FY16: averaged 33 rigs

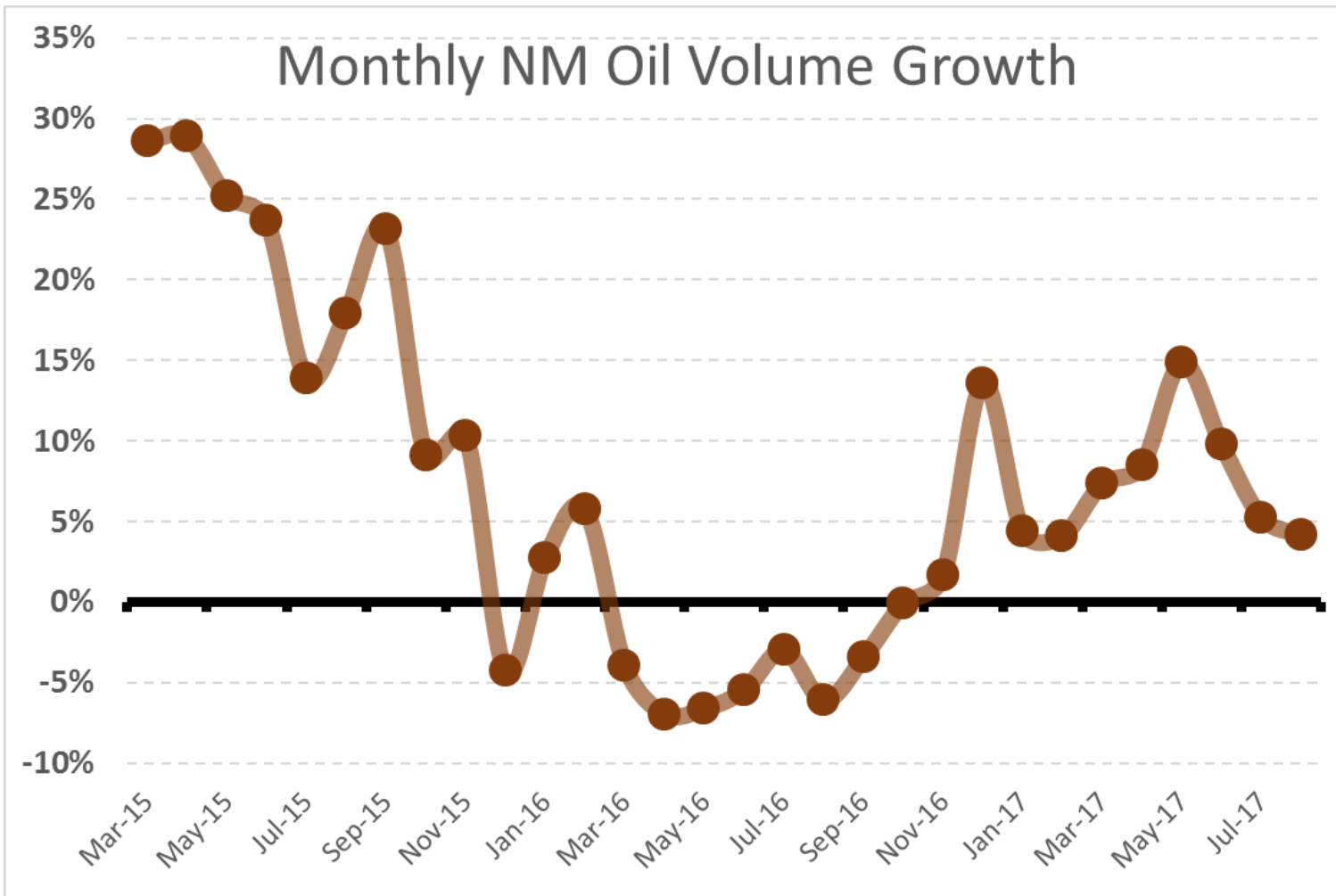
FY17: averaged 40 rigs (over 20% growth, compared to roughly flat expectations)

FY18: expected to average around 70 rigs (of higher productivity)

New Mexico Rig Count by County (monthly avg.)



Rebound in Oil Production



New Mexico Oil & Gas Outlook

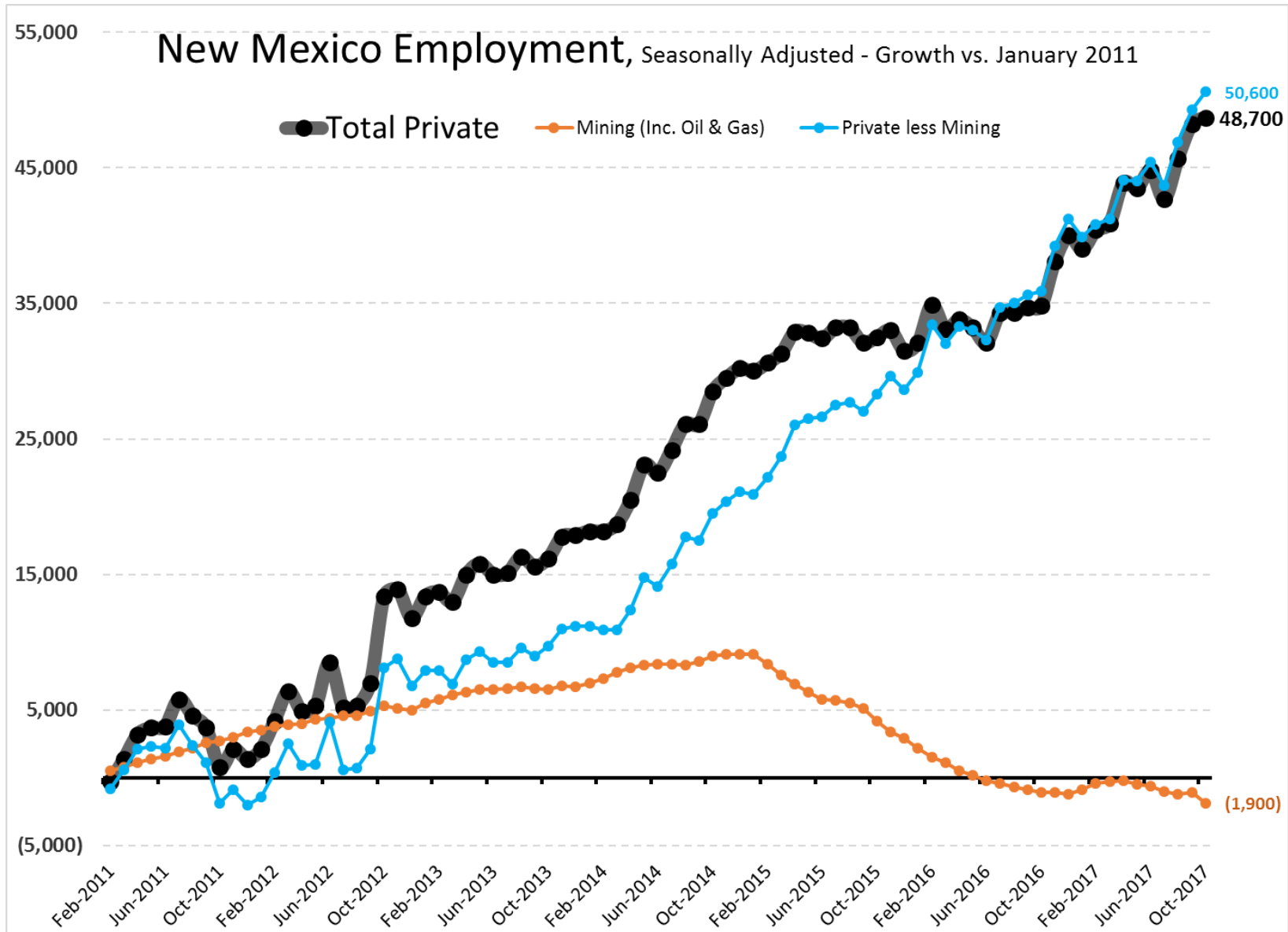
| | FY16 | FY17 | FY18 | FY19 |
|----------------------------|---------|---------|---------|---------|
| Crude Oil: | | | | |
| Price (\$/barrel) | \$37.85 | \$45.00 | \$47.50 | \$49.50 |
| Production (mill. barrels) | 147 | 153 | 158 | 162 |

| | | | | |
|----------------------------|--------|--------|--------|--------|
| Natural Gas: | | | | |
| Price (\$/1,000 cu. ft.) | \$2.42 | \$3.26 | \$3.25 | \$3.25 |
| Production (Bill. cu. ft.) | 1,175 | 1,220 | 1,230 | 1,220 |

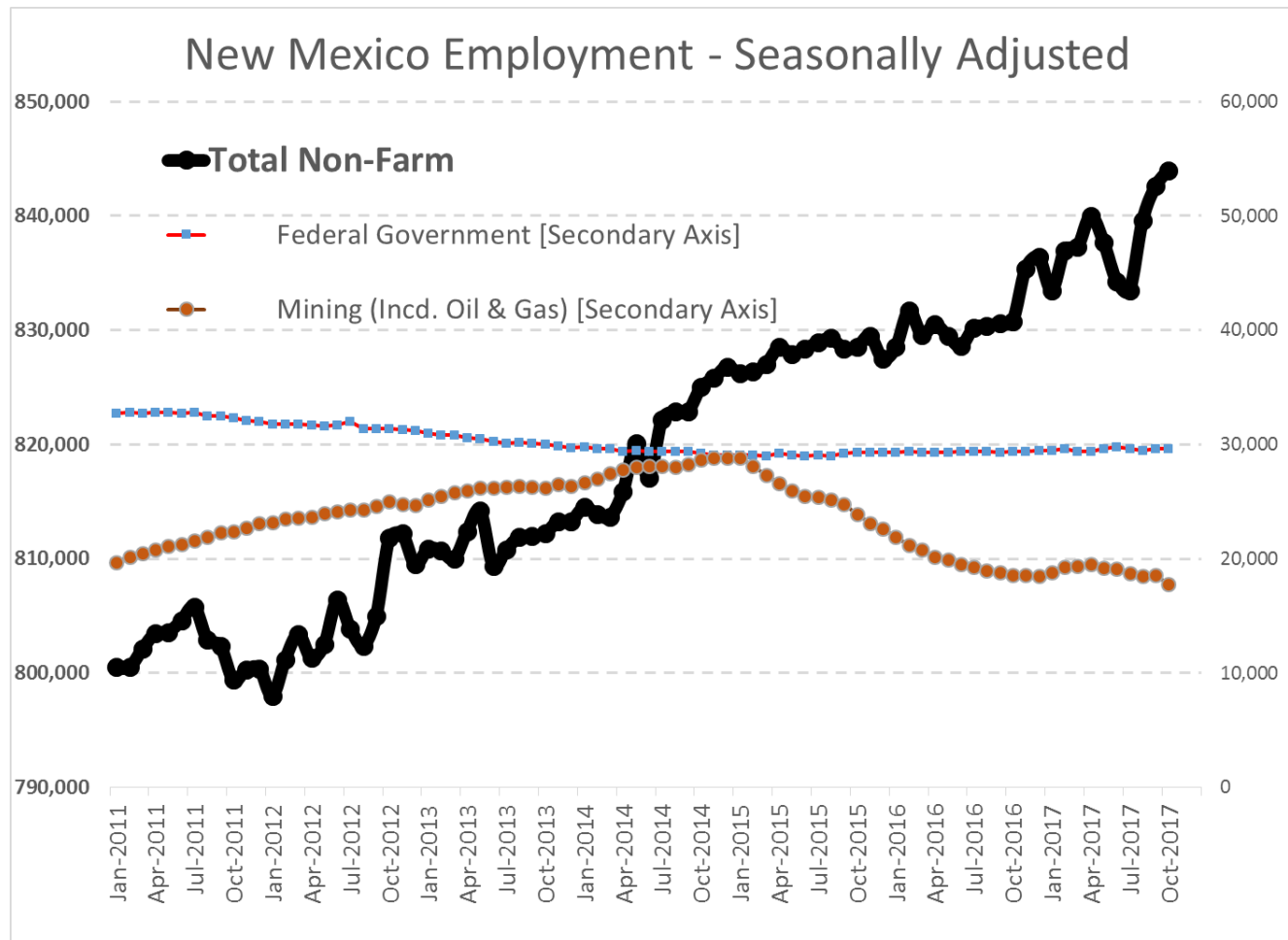
Source: ONGARD; Consensus Revenue Estimating Group

- *Oil prices revised up \$3.00 and \$4.00 (from \$44.50 in FY18 and \$45.50 in FY19), while volume is expected to grow 3.3 percent in FY18 and 2.5 percent in FY19.*
- *Natural gas volume now forecast to increase slightly and then revert to long term trend of gradual decline.*

Private Employment Growth



Increased Diversification



- Historically highly-reliant on federal government and energy sector.
- Greater proportion of employment base in other industries.

A Sampling of New NM Companies

| Company | County | Industry | Jobs |
|---------------------|------------|-------------------------|-------|
| Solaro | Socorro | Green Energy | 25 |
| Rural Sourcing, Inc | Bernalillo | Tech | 125 |
| Ready Roast, Inc. | Roosevelt | Manufacturing (Food) | 200 |
| Facebook | Valencia | Tech | 100 |
| Southwest Cheese | Curry | Value Added Agriculture | 400 |
| Safelite AutoGlass | Sandoval | Insurance | 900 |
| FedEx | Dona Ana | Shipping/Transportation | 200 |
| Fidelity | Bernalillo | Financial | 1,250 |
| Unity PBO | Bernalillo | Tech/Healthcare | 300 |
| Keter Plastics | Valencia | Manufacturing | 175 |

Examples of Business Retention & Expansion

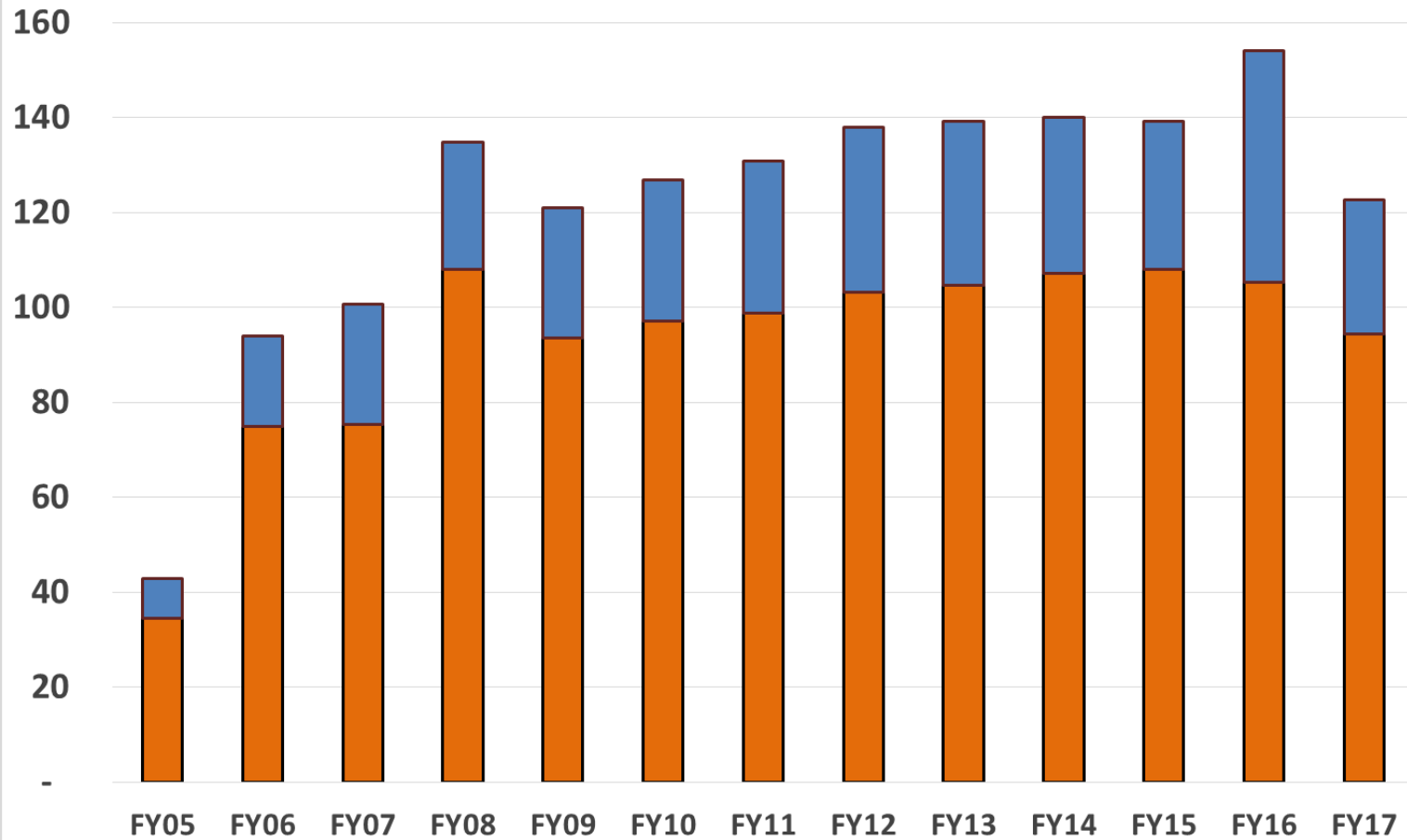
| <u>Company</u> | <u>County</u> | <u>Jobs</u> |
|----------------------------|-------------------|-------------|
| Amfab/Phat Steel | Sandoval | 86 |
| Descartes Labs | Santa Fe | 50 |
| Pesco | San Juan | 170 |
| Ideum | Sandoval | 67 |
| Compass | Luna | 142 |
| Mount Taylor Manufacturing | Bernalillo/Cibola | 5 |
| RiskSense | Bernalillo | 60 |
| Sundance Pools | Otero | 3 |
| Wholesome Valley Farms | Dona Ana | 90 |
| UbiQD | Los Alamos | 20 |
| X2nSAT | Dona Ana | 45 |
| Wildflower International | Santa Fe | 81 |
| Skorpios | Bernalillo | 300 |
| Sol Aero | Bernalillo | 100 |

- Positive impact of JTIP, LEDA, etc.



Cost to General Fund of Hold Harmless Distributions (\$millions)

Food Hold Harmless Distribution Medical Hold Harmless Distribution



- FY16 cost reached almost \$154 million.
- Total cost since 2005 = \$1.6 billion.

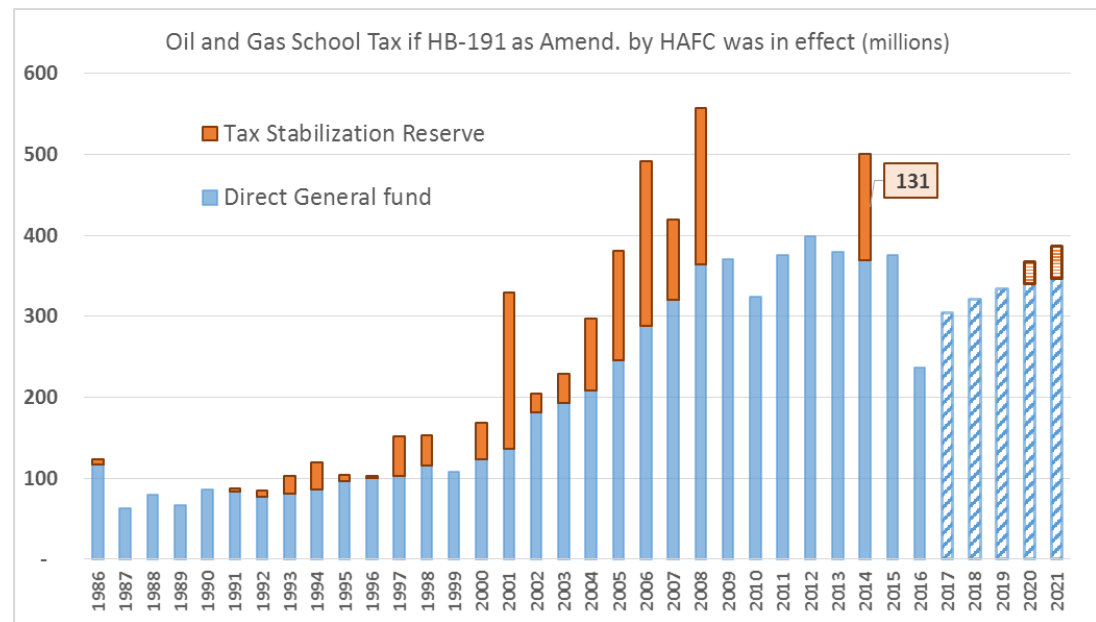
| Counties | <u>FY15</u> | <u>FY16</u> | <u>FY17</u> | FY17 Estimated Revenue (\$ millions) |
|-----------------------|--------------------|--------------------|--------------------|---------------------------------------------|
| Bernalillo | | 0.250% | 0.250% | 42.6 |
| Chaves | | 0.375% | 0.375% | 4.3 |
| Cibola | 0.375% | 0.375% | 0.375% | 1.2 |
| Colfax | 0.250% | 0.250% | 0.250% | 0.7 |
| Curry | 0.250% | 0.250% | 0.250% | 2.7 |
| De Baca | | 0.375% | 0.375% | 0.1 |
| Dona Ana | | 0.375% | 0.375% | 13.2 |
| Eddy | | 0.125% | 0.125% | 4.0 |
| Grant | 0.375% | 0.375% | 0.375% | 1.6 |
| Harding | 0.375% | 0.375% | 0.375% | 0.1 |
| Luna | | 0.375% | 0.375% | 1.4 |
| Mora | | 0.375% | 0.375% | 0.1 |
| Otero | 0.250% | 0.375% | 0.375% | 3.4 |
| Roosevelt | | 0.375% | 0.375% | 1.0 |
| San Juan | 0.250% | 0.250% | 0.250% | 7.4 |
| San Miguel | | 0.250% | 0.250% | 0.8 |
| Santa Fe | | 0.125% | 0.125% | 4.7 |
| Sierra | 0.375% | 0.375% | 0.375% | 0.7 |
| Valencia | 0.375% | 0.375% | 0.375% | 3.2 |
| Municipalities | <u>FY15</u> | <u>FY16</u> | <u>FY17</u> | |
| Artesia | | 0.250% | 0.250% | 1.4 |
| Corrales | 0.375% | 0.375% | 0.375% | 0.3 |
| Cuba | | | 0.375% | 0.1 |
| Espanola | 0.375% | 0.375% | 0.375% | 0.9 |
| Farmington | | 0.250% | 0.250% | 4.1 |
| Jemez Springs | | 0.375% | 0.375% | 0.0 |
| Las Cruces | 0.375% | 0.375% | 0.375% | 9.4 |
| Lovington | 0.375% | 0.375% | 0.375% | 0.8 |
| Reserve | | 0.375% | 0.375% | 0.0 |
| Springer | | 0.375% | 0.375% | 0.0 |
| Sunland Park | | 0.375% | 0.375% | 0.4 |
| Total | | | | 110.7 |

Imposition of new local option hold harmless GRT increments

- Increased local taxes by \$110 million

Oil & Gas School Tax to Stabilization Reserve: *Passed in 2017 Special Session HB-2*

- This legislation removed a portion of the volatility in the oil and natural gas revenues into New Mexico's General Fund.
- Beginning in FY19, oil and gas emergency school tax revenue in excess of its prior five fiscal year annual average will be directed to the tax stabilization reserve fund.
- The graph below shows the past 30 year history of oil and gas school tax revenues and how much would have been diverted to the Tax Stabilization Reserve Fund if this legislation had been in place during these periods.
- If this legislation had been in place, \$131 million of the above average revenue in FY14 would have been set aside from the General Fund and been available to address a portion of the FY16 or FY17 shortfalls.
- This mechanism is expected to set aside \$28 million in FY20 and \$39 million in FY21.



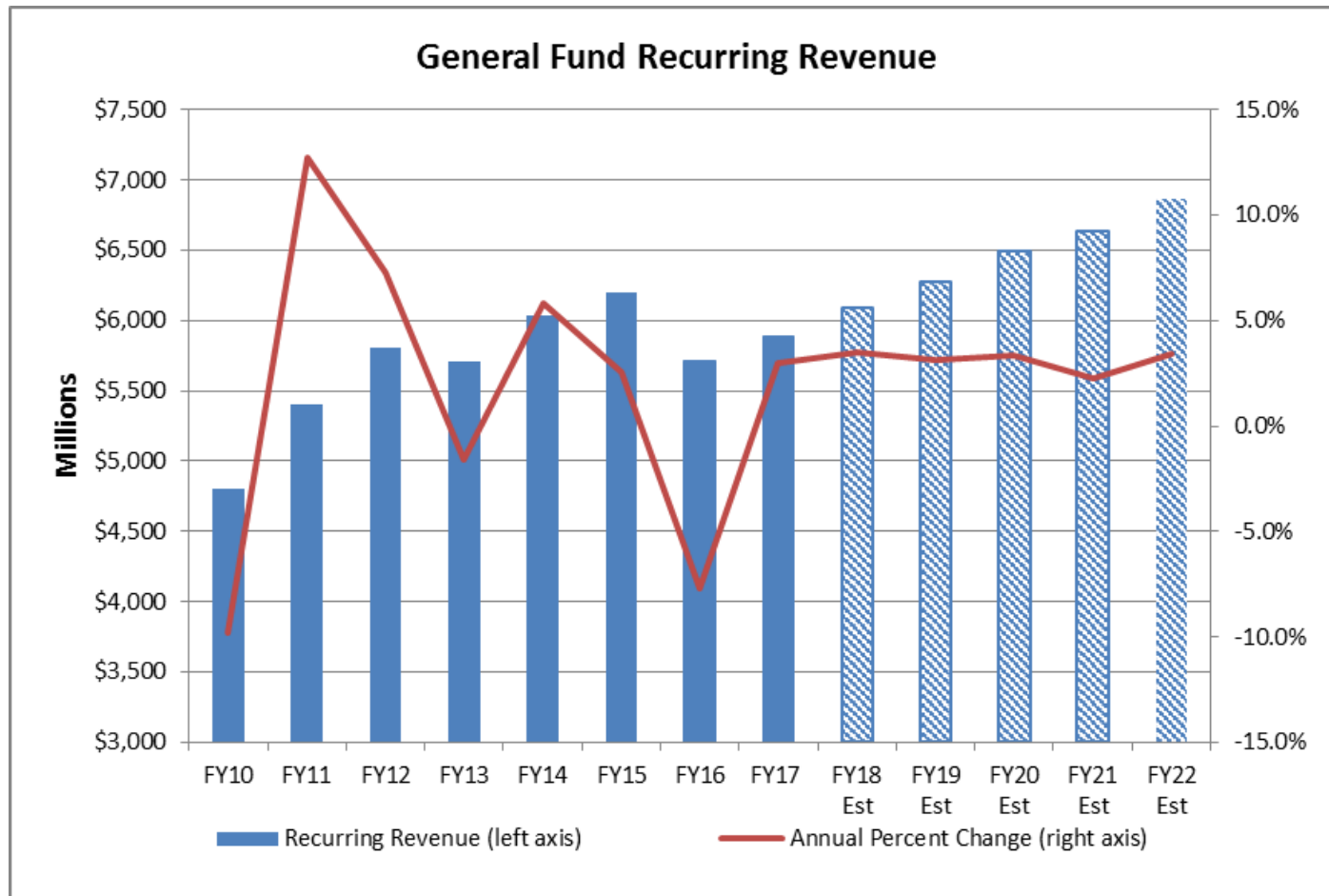
General Fund Forecast Summary

| December 2017 Consensus General Fund Forecast | | | | | | |
|-----------------------------------------------|----------------|-------------|----------------|-------------|----------------|-------------|
| | FY17 | | FY18 | | FY19 | |
| | \$ Millions | % Change | \$ Millions | % Change | \$ Millions | % Change |
| General Sales | \$2,062 | 2.0% | \$2,118 | 2.7% | \$2,185 | 3.2% |
| Selective Sales | \$543 | 1.2% | \$574 | 5.5% | \$590 | 2.8% |
| Income Taxes | \$1,451 | 0.4% | \$1,486 | 2.4% | \$1,519 | 2.2% |
| O&G Revenue | \$849 | 18.3% | \$908 | 7.0% | \$909 | 0.0% |
| Investment Income | \$738 | -4.1% | \$795 | 7.7% | \$859 | 8.0% |
| Other | \$242 | 8.2% | \$210 | -13.3% | \$221 | 5.2% |
| <u>Total Recurring Revenue</u> | <u>\$5,886</u> | <u>3.0%</u> | <u>\$6,091</u> | <u>3.5%</u> | <u>\$6,281</u> | <u>3.1%</u> |

- General Sales and Income Taxes moving closer to long run average growth rates.
- Oil and gas related revenue growth.
- Selective Sales growth rates inflated by Liquor Excise Tax revenue diversion to lottery scholarship fund reverting to normal General Fund distribution in FY18.
- Details in Appendix 1 and Appendix 3.

General Fund Revenue Outlook

- Recurring revenue reached record high in FY15, now estimated to be exceeded in FY19
- FY18 total growth estimated at 3.5%.
- FY19 total growth estimated to be 3.1%.



General Fund Financial Summary

(\$ in millions)

| | FY17 | FY18 | FY19 |
|---------------------------|-------------|-------------|----------------------------------|
| Beginning Balance | \$148 | \$505 | \$611 |
| Total Revenue | \$6,461 | \$6,128 | \$6,281 |
| Spending | (\$6,130) | (\$6,082) | “New Money” \$199 |
| Reserve Transfers, etc. | \$26 | \$0 | |
| Ending Balance | \$505 | \$550 | |
| Percent of Appropriations | 8.3% | 9.0% | |

Risks to the Forecast

- Direct sensitivity to oil and gas price: severance, GRT, and income taxes.
 - New Mexico severance revenues are increasingly driven by the global oil price instead of a mix previously dominated by regional natural gas price.
 - Sensitivity/risk levels will be higher in FY18 than last year (severance more focused on Permian oil and gas production and GRT related to Permian oil exploration significantly higher).
- Natural gas supply glut and price drop possible if oil production surges resulting in a spike of associated natural gas production without natural gas infrastructure and demand growth.
- Major investment choices in healthcare and international trade sectors delayed and will hinge on uncertain outcomes at the federal level may have significant impacts on New Mexico.
- Increased complexity of and spending through the tax code (e.g. food & medical deductions/exemptions and hold harmless distributions) expose the General Fund revenues to higher volatility and uncertainty.
- The proposed federal tax reform offers the largest changes in decades and would have major positive and negative impacts on NM revenue; however, its final passage and form are highly uncertain at this time.
- Risks indicate a minimum of 10% reserves should be targeted.