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TO: Senator John Arthur Smith, Chairman,
Senate Finance Committee
Representative Larry A. Larrañaga, Chairman,
House Appropriations & Finance Committee
FROM: Thomas E. Clifford, PhD, Cabinet Secretary
CC: Keith Gardner, Chief of Staff, Governor Susana Martinez
SUBJECT: Updated Consensus General Fund Revenue Forecast
DATE: January 27, 2016

Summary:

Since the December consensus revenue estimate was prepared, crude oil and natural gas prices have fallen dramatically, with serious implications for General Fund revenues. In addition to direct revenues like taxes and royalties on production, oil and gas drilling is a significant source of Gross Receipts Tax (GRT) revenue to the General Fund. After a careful review of energy market developments, and a more detailed analysis of the dependence of GRT revenue on oil and gas drilling, the consensus group revised the revenue outlook for FY16 down by \$144.8 million. The forecast for FY17 was reduced by \$201.7 million. Following these revisions, General Fund balances are estimated at \$477 million or 7.7 percent of recurring appropriations at the end of FY16. Estimated new money, expected FY17 revenue less FY16 appropriations, is \$30 million.

While a 7.7 percent reserve is adequate under the current circumstances, it is still below the 10 percent reserve target. Thanks to prudent budget management over the past several years, including restrained government growth and increased reserves, the state is well positioned to weather this revenue volatility. In fact, the scenario we currently face illustrates the importance of maintaining a strong reserve, whereby state government is able to overcome periods of lower revenue without significantly cutting services or impacting its bond rating.

In the coming months, state agencies will prioritize essential spending to conserve General Fund reserves. And, with respect to the budget we will be crafting during this legislative session, it is more important than ever that the state prioritize its investments – particularly in the areas of public safety, job creation, and education reform. Indeed, exposure to the volatility in oil and gas prices should remind us of our need to diversify the State's economy and the private sector as a whole. Over the past several years, this has been, and should continue to be, the focus of our policies.

Together, we have overcome the largest structural budget deficit in state history, federal budget cuts and sequestration, a federal government shutdown, and the largest oil and gas price crash in decades. The persistently low oil and gas prices we see today simply pose the latest challenge to our budget future. However, by continuing the cooperative and constructive approach we have practiced for the past five years – restraining government growth and prioritizing new spending – we can weather these difficult financial times and continue to provide the services expected of state government.

Oil and Gas:

A perfect storm has impacted crude oil and natural gas markets since the December revenue estimate. Iran will be increasing exports of oil under the nuclear agreement reached last year. This adds to a glut created by (1) A war over market share being waged by Saudi Arabia and Russia; (2) Rapidly increasing production from Iraq; (3) Continued strong production from the US; and (4) Lower demand growth due to a slowing Chinese economy.

Almost all professional forecasts prepared by financial advisory companies expect prices to rise in the coming year, but the pace is uncertain. US production is decreasing – drilling is off by two-thirds – while global demand continues to grow, so the market will eventually balance and prices will rise. The consensus group forecast reflects this broad consensus, but takes a cautious approach with respect to how quickly prices will rebound.

Table 1

	FY15	FY16		FY17	
	Actual	Dec. Estimate	Jan. Estimate	Dec. Estimate	Jan. Estimate
Oil Price	\$ 60.67	\$ 44.00	\$ 37.00	\$ 49.00	\$ 38.00
Gas Price	\$ 3.78	\$ 2.90	\$ 2.55	\$ 3.20	\$ 2.90

Economic indicators:

Forecast levels for both US Gross Domestic Product and New Mexico Gross State Product were revised downward, in large part due to the slowdown of oil and gas drilling. New Mexico job growth has slowed its pace, again in large part due to the slowdown of oil and gas drilling. Stock markets around the world have fallen sharply since the beginning of the year. This does not necessarily imply the real economy will follow suit. Economic fundamentals for the U.S. economy remain strong, including job growth, lower household and business debt levels, and rising home prices. Low inflation and falling gasoline prices continue to boost household purchasing power.

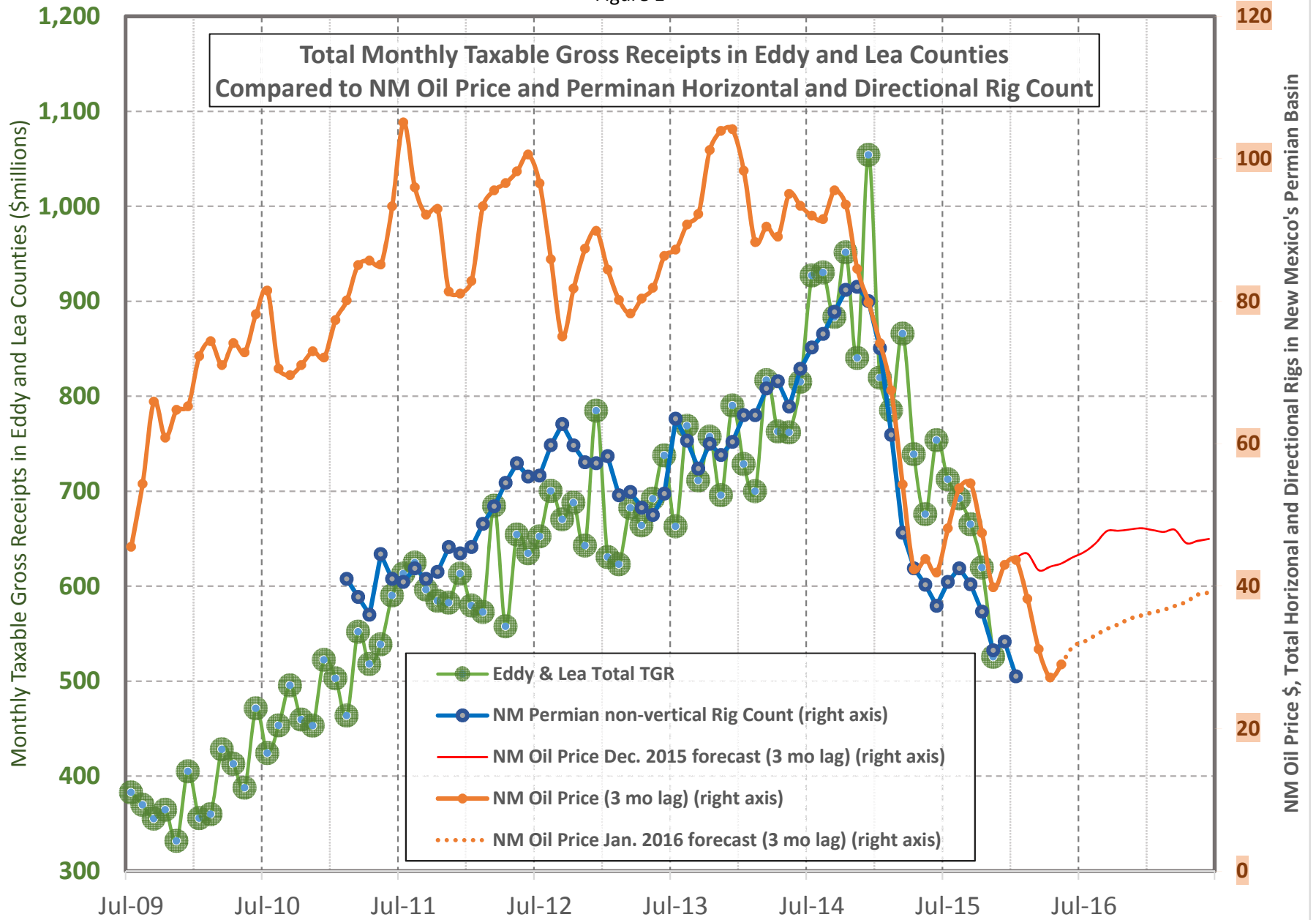
GRT revenue trends have deteriorated significantly:

Two more months of GRT collections since the December forecast were well below expectations, falling by 11 percent in the first five months of the fiscal year. Some of the decline appears to be due to one-time factors, suggesting that growth should improve as the year progresses. However, Taxable Gross Receipts (TGR) in oil and gas producing counties like Eddy and Lea are down sharply. As illustrated in Figure 1, TGR in these counties is highly dependent on drilling activity, which is itself highly dependent on the level of prices. The recent drop of prices therefore signals that drilling and TGR will fall below the levels expected in the December forecast.

Other taxes:

The compensating tax has also underperformed the forecast in recent months, and was revised downward by the consensus group. Personal and corporate income taxes are generally consistent with the December forecast.

Figure 1



General Fund Revenue Estimate
January 2016

§Millions	FY15		FY16				FY17			
	A	B	C	D	E	F	G	H	I	J
	Actual	% Change from FY14	Dec. 2015	Jan. 2016	Change from Prior	% Change from FY15	Dec. 2015	Jan. 2016	Change from Prior	% Change from FY16
1 Gross Receipts Tax	2,095.2	5.2%	2,178.0	2,090.0	(88.0)	-0.2%	2,336.7	2,216.0	(120.7)	6.0%
2 Compensating Tax	71.8	-8.4%	65.5	54.4	(11.1)	-24.3%	65.4	64.1	(1.3)	17.8%
3 TOTAL GENERAL SALES	2,167.0	4.7%	2,243.5	2,144.4	(99.1)	-1.0%	2,402.1	2,280.1	(122.0)	6.3%
4 Tobacco Taxes	82.3	5.0%	82.4	82.4	-	0.1%	81.4	81.4	-	-1.2%
5 Liquor Excise	26.3	-0.5%	6.7	6.7	-	-74.5%	6.9	6.9	-	3.0%
6 Insurance Taxes	149.9	30.2%	188.0	188.0	-	25.5%	219.1	219.1	-	16.5%
7 Fire Protection Fund Reversion	15.2	-5.9%	13.7	13.7	-	-9.6%	12.4	12.4	-	-9.5%
8 Motor Vehicle Excise	138.7	4.1%	147.0	151.0	4.0	8.9%	152.0	152.0	-	0.7%
9 Gaming Excise	70.4	5.9%	70.1	70.1	-	-0.4%	70.1	70.1	-	0.0%
10 Leased Vehicle Surcharge	5.2	0.7%	5.2	5.2	-	-0.7%	5.2	5.2	-	0.0%
11 Other	0.5	-83.0%	3.2	3.2	-	540.0%	2.1	2.1	-	-34.4%
12 TOTAL SELECTIVE SALES	488.5	10.0%	516.3	520.3	4.0	6.5%	549.2	549.2	-	5.6%
13 Personal Income Tax	1,339.7	6.8%	1,401.0	1,401.0	-	4.6%	1,455.0	1,455.0	-	3.9%
14 Corporate Income Tax	254.5	29.3%	218.0	223.0	5.0	-12.4%	217.0	220.0	3.0	-1.3%
15 TOTAL INCOME TAXES	1,594.2	9.8%	1,619.0	1,624.0	5.0	1.9%	1,672.0	1,675.0	3.0	3.1%
16 Oil and Gas School Tax	375.4	-25.0%	283.7	248.5	(35.2)	-33.8%	315.3	268.0	(47.3)	7.8%
17 Oil Conservation Tax	20.1	-26.1%	15.1	13.3	(1.8)	-33.8%	16.7	14.2	(2.5)	6.8%
18 Resources Excise Tax	13.3	2.7%	13.0	13.0	-	-2.6%	13.0	13.0	-	0.0%
19 Natural Gas Processors Tax	18.6	14.8%	19.7	19.7	-	5.9%	15.0	12.8	(2.2)	-35.0%
20 TOTAL SEVERANCE TAXES	427.5	-23.3%	331.5	294.5	(37.0)	-31.1%	360.0	308.0	(52.0)	4.6%
21 LICENSE FEES	55.9	8.1%	54.5	54.5	-	-2.5%	55.5	55.5	-	1.8%
22 LGPF Interest	502.8	11.9%	553.2	553.2	-	10.0%	548.1	538.3	(9.8)	-2.7%
23 STO Interest	17.0	-10.5%	23.4	15.0	(8.4)	-11.8%	52.6	46.8	(5.8)	212.0%
24 STPF Interest	182.7	7.2%	193.5	193.5	-	5.9%	203.4	200.4	(3.0)	3.6%
25 TOTAL INTEREST	702.5	10.0%	770.1	761.7	(8.4)	8.4%	804.1	785.5	(18.6)	3.1%
26 Federal Mineral Leasing	542.2	-4.9%	421.7	400.0	(21.7)	-26.2%	407.1	385.0	(22.1)	-3.8%
27 State Land Office	42.2	-11.0%	37.6	50.0	12.4	18.4%	41.2	51.2	10.0	2.4%
28 TOTAL RENTS & ROYALTIES	584.4	-5.3%	459.3	450.0	(9.3)	-23.0%	448.3	436.2	(12.1)	-3.1%
29 TRIBAL REVENUE SHARING	67.2	-0.6%	64.3	64.3	-	-4.3%	65.8	65.8	-	2.3%
30 MISCELLANEOUS RECEIPTS	56.2	24.9%	56.5	56.5	0.0	0.5%	59.4	59.4	0.0	5.1%
31 REVERSIONS	51.5	-46.6%	50.0	50.0	-	-2.9%	50.0	50.0	-	0.0%
32 TOTAL RECURRING	6,194.7	2.6%	6,165.0	6,020.2	(144.8)	-2.8%	6,466.3	6,264.6	(201.7)	4.1%
33 TOTAL NON-RECURRING*	41.2		5.5	5.5	-	-86.7%	-	-	-	
34 GRAND TOTAL	6,235.9	3.2%	6,170.5	6,025.7	(144.8)	-3.4%	6,466.3	6,264.6	(201.7)	4.0%

General Fund Revenue Estimate
January 2016

§Millions	FY18				FY19				FY20			
	K	L	M	N	O	P	Q	R	S	T	U	V
	Dec. 2015	Jan. 2016	Change from Prior	% Change from FY17	Dec. 2015	Jan. 2016	Change from Prior	% Change from FY18	Dec. 2015	Jan. 2016	Change from Prior	% Change from FY19
1 Gross Receipts Tax	2,421.3	2,345.0	(76.3)	5.8%	2,550.0	2,460.0	(90.0)	4.9%	2,673.0	2,593.0	(80.0)	5.4%
2 Compensating Tax	66.4	65.1	(1.3)	1.6%	67.9	66.6	(1.3)	2.3%	67.5	66.2	(1.3)	-0.6%
3 TOTAL GENERAL SALES	2,487.7	2,410.1	(77.6)	5.7%	2,617.9	2,526.6	(91.3)	4.8%	2,740.5	2,659.2	(81.3)	5.2%
4 Tobacco Taxes	80.4	80.4	-	-1.2%	79.4	79.4	-	-1.2%	78.4	78.4	-	-1.3%
5 Liquor Excise	26.1	26.1	-	278.3%	28.9	28.9	-	10.7%	27.7	27.7	-	-4.2%
6 Insurance Taxes	231.8	231.8	-	5.8%	243.3	243.3	-	5.0%	255.6	255.6	-	5.1%
7 Fire Protection Fund Reversion	11.2	11.2	-	-9.7%	10.0	10.0	-	-10.7%	8.5	8.5	-	-15.0%
8 Motor Vehicle Excise	157.0	157.0	-	3.3%	161.0	161.0	-	2.5%	164.0	164.0	-	1.9%
9 Gaming Excise	70.3	70.3	-	0.3%	69.1	69.1	-	-1.7%	68.0	68.0	-	-1.6%
10 Leased Vehicle Surcharge	5.2	5.2	-	0.0%	5.2	5.2	-	0.0%	5.2	5.2	-	0.0%
11 Other	2.1	2.1	-	0.0%	2.1	2.1	-	0.0%	2.1	2.1	-	0.0%
12 TOTAL SELECTIVE SALES	584.1	584.1	-	6.4%	599.0	599.0	-	2.6%	609.5	609.5	-	1.8%
13 Personal Income Tax	1,522.0	1,522.0	-	4.6%	1,606.0	1,606.0	-	5.5%	1,683.0	1,683.0	-	4.8%
14 Corporate Income Tax	205.0	205.0	-	-6.8%	163.0	163.0	-	-20.5%	168.0	168.0	-	3.1%
15 TOTAL INCOME TAXES	1,727.0	1,727.0	-	3.1%	1,769.0	1,769.0	-	2.4%	1,851.0	1,851.0	-	4.6%
16 Oil and Gas School Tax	362.2	309.6	(52.6)	15.5%	378.1	335.9	(42.2)	8.5%	383.8	355.4	(28.4)	5.8%
17 Oil Conservation Tax	19.2	16.4	(2.8)	15.5%	20.1	17.8	(2.3)	8.5%	20.4	18.8	(1.6)	5.6%
18 Resources Excise Tax	13.0	13.0	-	0.0%	13.0	13.0	-	0.0%	13.0	13.0	-	0.0%
19 Natural Gas Processors Tax	14.8	10.7	(4.1)	-16.4%	14.5	10.5	(4.0)	-1.9%	14.3	10.3	(4.0)	-1.9%
20 TOTAL SEVERANCE TAXES	409.2	349.7	(59.5)	13.5%	425.7	377.2	(48.5)	7.9%	431.5	397.5	(34.0)	5.4%
21 LICENSE FEES	56.6	56.6	-	2.0%	57.9	57.9	-	2.3%	59.3	59.3	-	2.4%
22 LGPF Interest	601.9	581.3	(20.6)	8.0%	651.9	619.0	(32.9)	6.5%	693.9	646.9	(47.0)	4.5%
23 STO Interest	60.3	54.3	(6.0)	16.0%	67.7	60.9	(6.8)	12.2%	82.6	74.3	(8.3)	22.0%
24 STPF Interest	216.5	207.6	(8.9)	3.6%	227.5	209.5	(18.0)	0.9%	235.9	206.0	(29.9)	-1.7%
25 TOTAL INTEREST	878.7	843.1	(35.6)	7.3%	947.1	889.4	(57.7)	5.5%	1,012.4	927.2	(85.2)	4.3%
26 Federal Mineral Leasing	430.0	410.0	(20.0)	6.5%	453.0	445.0	(8.0)	8.5%	460.0	470.0	10.0	5.6%
27 State Land Office	43.7	53.7	10.0	4.9%	45.2	55.2	10.0	2.8%	45.7	55.7	10.0	0.9%
28 TOTAL RENTS & ROYALTIES	473.7	463.7	(10.0)	6.3%	498.2	500.2	2.0	7.9%	505.7	525.7	20.0	5.1%
29 TRIBAL REVENUE SHARING	67.8	67.8	-	3.0%	71.0	71.0	-	4.7%	73.1	73.1	-	3.0%
30 MISCELLANEOUS RECEIPTS	60.3	60.3	(0.0)	1.5%	61.3	61.3	0.0	1.7%	62.3	62.3	(0.0)	1.6%
31 REVERSIONS	50.0	50.0	-	0.0%	50.0	50.0	-	0.0%	50.0	50.0	-	0.0%
32 TOTAL RECURRING	6,795.1	6,612.4	(182.7)	5.6%	7,097.0	6,901.5	(195.5)	4.4%	7,395.3	7,214.8	(180.5)	4.5%
33 TOTAL NON-RECURRING*												
34 GRAND TOTAL	6,795.1	6,612.4	(182.7)	5.6%	7,097.0	6,901.5	(195.5)	4.4%	7,395.3	7,214.8	(180.5)	4.5%

Department of Finance and Administration
GENERAL FUND FINANCIAL SUMMARY
January 2016 Consensus Revenue Review
(Dollars in Millions)

	<u>Actual FY2015</u>	<u>Estimated FY2016</u>	<u>Estimated FY2017</u>
APPROPRIATION ACCOUNT			
REVENUE			
Recurring Revenue			
1	December 2015 Forecast	\$ 6,194.7	\$ 6,165.0
2	<i>January 2016 Forecast Revisions</i>	\$ -	\$ (144.8)
3	<u>Total Recurring Revenue</u>	<u>\$ 6,194.7</u>	<u>\$ 6,020.2</u>
Nonrecurring Revenue			
4	December 2015 Forecast	\$ 41.2	\$ 5.5
5	<i>January 2016 Forecast Revisions</i>	\$ -	\$ -
6	<u>Total Non-Recurring Revenue</u>	<u>\$ 41.2</u>	<u>\$ 5.5</u>
TOTAL REVENUE		<u>\$ 6,235.9</u>	<u>\$ 6,025.7</u>
APPROPRIATIONS			
Recurring Appropriations			
7	2013 & 2014 General Appropriation	\$ 6,150.6	\$ 6,219.1
8	<i>Feedbill - 2015 Regular Session*</i>	\$ 10.1	\$ 15.5
9	<i>FY15 Audit</i>	\$ 0.4	
10	<u>Total Recurring Appropriations</u>	<u>\$ 6,161.1</u>	<u>\$ 6,234.6</u>
Nonrecurring Appropriations			
11	2013-2015 Regular Sessions	\$ 110.7	\$ 1.0
12	<i>2015 Special Session</i>	\$ 4.3	\$ 30.0
13	<i>FY15 Audit</i>	\$ (0.8)	
14	<u>Total Nonrecurring Appropriations</u>	<u>\$ 114.2</u>	<u>\$ 31.0</u>
TOTAL APPROPRIATIONS		<u>\$ 6,275.3</u>	<u>\$ 6,265.6</u>
15	Transfer to (from) Reserves	\$ (39.4)	\$ (239.9)
GENERAL FUND RESERVES			
16	Beginning Balances**	\$ 637.9	\$ 613.1
17	Transfers from (to) Appropriations Account	(39.4)	(239.9)
18	Revenue and Reversions	64.9	182.2
19	Appropriations, expenditures and transfers out	(50.3)	(78.1)
20	Ending Balances	\$ 613.1	\$ 477.3
21	<i>Reserves as a Percent of Recurring Appropriations</i>	10.0%	7.7%

"New Money" \$30MM

*Legislative session expenses treated as recurring appropriation.

**Beginning balances are reduced by \$36 million in restricted fund balances for Special Education Maintenance of Effort noted in the FY14 audit

Department of Finance and Administration
GENERAL FUND FINANCIAL SUMMARY (Continued)
RESERVE DETAIL
(Dollars in Millions)

	Actual FY2015	Estimated FY2016	Estimated FY2017	
OPERATING RESERVE				
22	Beginning balance	\$ 274.5	\$ 219.6	\$ 57.7
23	BOF Emergency Fund and reversions	(0.5)	(2.0)	
24	Contingent Liability for Cash Reconciliation, FY15 Audit*		100.0	
25	Transfer to ACF	(15.0)	(20.0)	
26	Transfers from (to) appropriation account	(39.4)	(239.9)	-
27	Ending balance	\$ 219.6	\$ 57.7	\$ 57.7
APPROPRIATION CONTINGENCY FUND				
28	Beginning balance	\$ 18.4	\$ 28.5	\$ 41.5
29	Disaster allotments	(12.5)	(16.0)	(16.0)
30	Transfer from Oper Reserve to ACF (2013 & 2014 GAA)	15.0	20.0	
31	Revenue and reversions	7.7	9.0	9.0
32	Ending Balance	\$ 28.5	\$ 41.5	\$ 34.5
Education Lock Box				
33	Beginning balance	\$ 3.0	\$ 0.0	\$ -
34	Appropriations (2012, 2013 & 2014 GAA, Section 5)	(3.0)	-	-
35	Transfers in (out)	-	-	-
36	Ending balance	\$ 0.0	\$ 0.0	\$ -
STATE SUPPORT FUND				
37	Beginning balance	\$ 1.0	\$ 1.0	\$ 1.0
38	Revenues	\$ -	\$ -	\$ -
39	Appropriations	\$ -	\$ -	\$ -
40	Ending balance	\$ 1.0	\$ 1.0	\$ 1.0
TOBACCO PERMANENT FUND				
41	Beginning balance	\$ 193.5	\$ 216.4	\$ 229.6
42	Transfers in	35.0	37.0	37.0
43	Appropriation to tobacco settlement program fund	(19.3)	(18.5)	(18.5)
44	Gains/Losses	7.1	16.2	17.2
45	Additional transfers to Program Fund	-	(21.6)	
46	Ending balance	\$ 216.4	\$ 229.6	\$ 265.3
TAX STABILIZATION RESERVE				
47	Beginning balance	\$ 147.5	\$ 147.5	\$ 147.5
48	Transfers in	-	-	-
49	Transfers out	-	-	-
50	Ending balance	\$ 147.5	\$ 147.5	\$ 147.5
51	GENERAL FUND ENDING BALANCES	\$ 613.1	\$ 477.3	
52	Percent of Recurring Appropriations	10.0%	7.7%	

*Reversed loss contingency of \$100 million related to historical lack of book-to-bank reconciliation.