



To: All interested municipal officials  
From: Kevin Bommer, Legislative & Policy Advocate  
Date: October 11, 2009  
Subject: State budget crisis and impacts on energy-related local government funds

---

Many municipal officials from energy-impacted communities around the state have communicated various forms of concern about and confusion over the impacts of the recession on the state budget as it relates to money coming back to impacted communities in the form of direct distribution and DOLA Energy Impact Assistance grants. The purpose of this memo is to:

- Provide background on the state budget and its impact on the energy-related local government funds
- Summarize the total amount of local government money that has been or is expected to be transferred to the state general fund
- Provide information on future revenue forecasts and the prognosis for the energy-related local government funds

#### **ABBREVIATED BACKGROUND OF STATE BUDGET CRISIS AND ENERGY-RELATED FUNDS**

The recession that began in December of 2007 began to hit home in the Colorado General Assembly's budget process in the fall of 2008. As the recession deepened, the state's revenue forecasts used by the legislature's Joint Budget Committee (JBC) to set the spending levels of the budget showed that expected revenues were far short of what had previously been expected. The JBC began the legislative session by making cuts to the then-current FY 08-09 budget, and then turned their attention to the more daunting task of even more cuts to the FY 09-10 budget.

The last time the legislature faced significant cuts was in 2002 and 2003 sessions. At that time, many cash funds held by the state for a multitude of programs were drained in order to prevent programmatic cuts by the state government. The cash transfers to the general fund, combined with the revenue retention allowed by Referendum C, allowed the state to essentially operate as usual and ride out the storm. As the current recession began to deepen, the cash funds that were once available to backfill the general fund were still depleted from 2003 and no longer available to provide a cushion to the state general fund. By the end of the 2009 session the legislature was beginning to cut into cash funds for local governments, including the local government severance tax fund, local government mineral impact fund, and the local government permanent fund.

In 2008, the manner in which severance tax and federal mineral lease (FML) monies are distributed was changed by two important pieces of legislation. HB 08-1083 dealt with severance tax and distributed money using new metrics that included employee residence reports (ERR) along with actual permits and production by county. (Previously, only ERR's had been used, which disadvantaged some counties with production but with few employees residing within them) Once the metric determined the county-by-county allocation, a second metric combining lane miles, population, and employees was used to determine the amounts due each municipality and the county. 50% of the severance taxes remitted by oil, gas, and mining operations in Colorado go to the Department of Local Affairs – 30% of which is returned to local governments in the form of direct distribution and the remaining 70% is deposited into the local government severance tax fund. (*See Figure 1 below*)

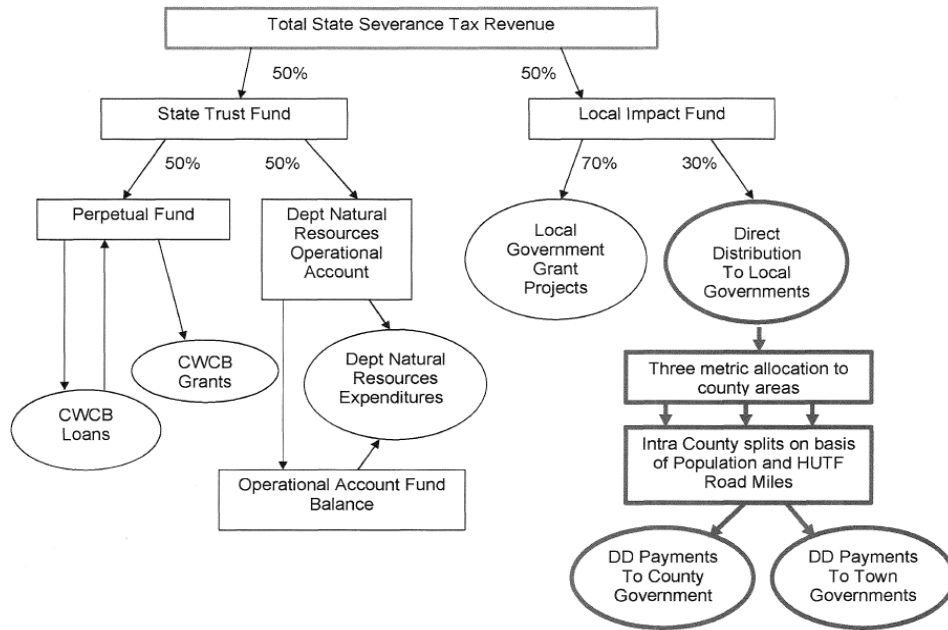


Figure 1: Severance Tax Distribution

SB 08-218 dealt with FML and ultimately preserved the traditional 40% of rents, royalties, and earnings allocated to municipalities and counties – 50% in the form of direct distributions to FML-impacted local governments and 50% into the local government mineral impact fund. Sub-county direct distributions follow the same metric as HB 08-1083. (Figure 2 below) Finally, a second source of FML revenue in the form of “bonus payments” for new leases is divided between two “permanent funds” – one for higher education and one for FML-impacted local governments. (Figure 3 next page)

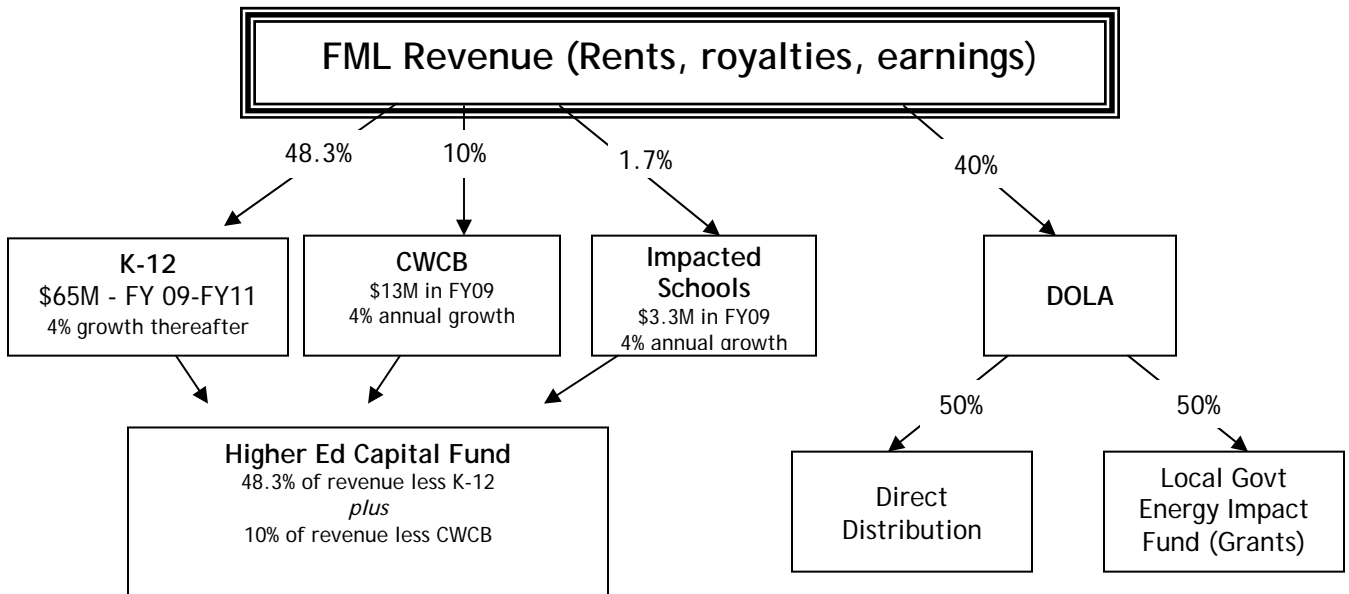


Figure 2: Federal Mineral Lease Rents, Royalties & Earnings Distribution

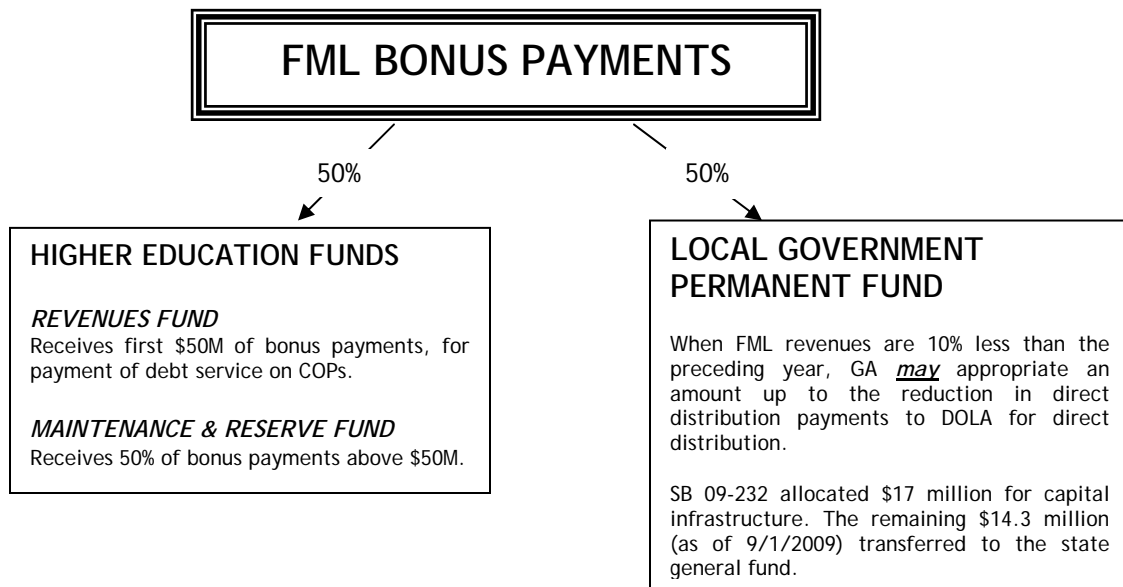


Figure 3: Federal Mineral Lease Bonus Payments Distribution

### LOCAL GOVERNMENT ENERGY FUNDS: CURRENT STATUS

As the state’s budget crisis began to deepen early in the 2009 legislative session, it became very clear that the funds that energy-impacted communities rely on to deal with the ongoing and historical effects of resource extraction were going to be targeted by the General Assembly to backfill the state’s general fund. All actual and proposed transfers of local government severance tax and FML revenue mean total state general fund backfill by local government severance tax and FML cash funds will total \$78 million. (Table 1)

Source Fund	State fiscal year effective	Amount
Local Government Severance Tax Fund	FY 08-09	\$7,500,000
Local Government Mineral Impact Fund (FML)	FY 08-09	\$1,000,000
Local Government Mineral Impact Fund (FML)	FY 09-10	\$22,600,000
Local Government Severance Tax Fund	FY 09-10*	\$7,600,000
Local Government “Permanent” Fund (FML)	FY 09-10*	\$14,300,000
Local Government Severance Tax Fund	FY 09-10* (frozen by Gov. through 1/31/10, if needed)	\$25,000,000
<b>TOTAL</b>		<b>\$78,000,000</b>

Table 1: Local government energy money transferred to state general fund

\* indicates transfers proposed by Governor’s Office of State Planning & Budgeting as of 8/25/09

The key piece of legislation driving transfers was SB 09-279. The bill contained several cash-transfer provisions affecting both the previous and the current fiscal year, including the following:

1. Transferred \$7.5 million from the local government severance tax fund for FY 08-09
2. Transferred \$1 million from the local government mineral impact fund for FY 08-09.

3. Transfers 50% of the local governments' non-bonus FML revenue in FY 09-10 up to \$22.6 million

In August, Governor Ritter proposed additional cash transfers that will require a statutory change by the legislature:

1. Transfer an additional \$7.6 million from the local government severance tax fund for FY 09-10.
2. Transfer the remaining \$14.3 million from the local government permanent fund (FML bonus revenue)
3. Freeze an additional \$25 million in the local government severance tax fund through January 21, 2010. (CML believes this money will be transferred to the general fund, as well)

CML is extremely disappointed to see cash funds specifically designated for local governments continually being absorbed into the state general fund, even if the intent to prevent programmatic cuts is honorable. In essence, the transfers would give the General Assembly an additional \$78 million cushion against reductions in the state budget. CML is grateful that Governor Ritter resisted pressure to reduce or eliminate the August 2009 direct distributions that would have occurred had any additional revenue been proposed for transfer as part of the proposals mentioned above.

#### **WHAT'S NEXT?: THE 2010 SESSION AND FUTURE REVENUE FORECASTS**

While Governor Ritter exercised significant restraint by not recommending the transfer or actually transferring more of local governments' money to the state general fund, CML holds out little faith that the same restraint will be exercised by the legislature. The state's dire budget circumstances make the prospect of additional local government revenue lost to the state general fund very likely. Certainly, municipalities and our friends in the counties empathize with the hard budget realities that exist at the state level and the very difficult decisions that the members of the JBC, the legislature, and Governor Ritter will face. However, CML is very concerned about the loss of local government energy-related funds to backfill the state budget. Budget conditions in many local governments are as bad as or worse than the state. Past history shows a tendency to look to any available cash funds to prevent programmatic cuts in the state budget, and there are few cash funds left other than severance tax and FML revenue.

Tables 2 and 3 on the last page show the forecasts through FY 11-12 for FML and severance tax. Table 4 uses those forecasts to show – barring any additional transfers to the state general fund – how much money will be available to DOLA for the Energy Assistance Grant program and direct distributions. All figures are derived from the September 21 “*Economic and Revenue Forecast, 2009-2012*” published by the General Assembly's legislative council.

Based on the forecast, CML is able to estimate what will potentially be available to DOLA for direct distribution as well as the Energy Impact Assistance grant program. As seen in Tables 2 and 3 below, the total combined FML and severance tax revenue for the entire state in FY 09-10 is forecast to be around \$131 million, of which \$54.9 million would normally be distributed to local governments via the Department of Local Affairs. However, previous legislation has already diverted \$22.6 million of FML revenue for FY 09-10, leaving only \$11.8 million in local FML revenue. Severance tax revenue directed to DOLA is expected to be \$20.5 million. Even if the state was to divert every dollar of FML and severance tax revenue into the budget shortfall, estimated to be \$560 million for the current state fiscal year, it would cover less than 25% of the amount needed to balance the state budget.

A specific concern of CML in 2010 is a result of the action taken by the legislature (mentioned above) to divert 50% of local government (non-bonus) FML revenue from rents, royalties, and earnings, up to \$22.6 million, into the state's general fund. Because the non-bonus revenue is only projected to be

\$17.2 million in the current fiscal year, the net effect of the negative number is to actually reduce the FML direct distribution to impacted communities \$5.4 million. The result is to exacerbate already deflated projections for direct distribution amount due to expected low severance tax collections. This should be a clear lesson to the General Assembly on fixing amounts in statute in connection with revenue streams that experience volatile fluctuations. Finally, the low numbers could be affected even more if the JBC and legislature move to divert any additional local government severance tax and FML revenue.

Beyond FY 10-11, the forecast predicts a modest recovery in both severance tax and FML revenues. Should the efforts to prevent the state from targeting additional local dollars to backfill the state general fund be successful, it is conceivable that normalized direct distributions and funding for Energy Impact Assistance grants may resume in 2011.

CML will continue to update these estimates as new economic forecasts are released by the General Assembly's legislative council so that municipalities may use it to help gauge any direct distribution that might be available, as well as the potential for available grant money. The next forecast is due on December 21, 2009.

CML Staff Contact:

Kevin Bommer, Legislative and Policy Advocate  
(303) 831-6411 or (866) 578-0936  
[kbommer@cml.org](mailto:kbommer@cml.org)

	<b>Federal Mineral Lease Forecast - Sept 2009</b>			
	FY 08-09 (actual)	FY 09-10	FY 10-11	FY 11-12
<b>Total FML Revenue</b>	<b>\$227.3</b>	<b>\$90.6</b>	<b>\$111.7</b>	<b>\$129.5</b>
<b>Rents, Royalties and Earnings</b>	<b>\$165.4</b>	<b>\$86.0</b>	<b>\$106.1</b>	<b>\$116.5</b>
State Public School Fund	\$65.0	\$41.6	\$51.3	\$56.3
Colorado Water Conservation Board	\$14.0	\$8.6	\$10.6	\$11.7
DOLA Energy Impact Assistance <sup>1</sup>	\$33.1	(\$5.4)	\$21.2	\$23.3
DOLA Direct Distribution	\$33.1	\$17.2	\$21.2	\$23.3
School Districts Direct Distribution	\$2.8	\$1.5	\$1.8	\$2.0
Spillover to HiEd FML Rev Fund	\$17.4	\$0.0	\$0.0	\$0.0
Spillover to HE Maint&Reserve Fund	\$0.0	\$0.0	\$0.0	\$0.0
<b>Bonus Payments (portion of total FML revenue)</b>	<b>\$61.9</b>	<b>\$4.5</b>	<b>\$5.6</b>	<b>\$12.9</b>
Local Government Perm Fund	\$30.9	\$2.3	\$2.8	\$6.5
Higher Ed Maintenance Reserve Fund	\$30.9	\$2.3	\$2.8	\$6.5

Table 2: Federal Mineral Lease revenue forecast (in millions)

	<b>Severance Tax Forecast - Sept 2009</b>			
	FY 08-09 (actual)	FY 09-10	FY 10-11	FY 11-12
<b>Total Severance Tax Revenue</b>	<b>\$319.1</b>	<b>\$41.0</b>	<b>\$134.0</b>	<b>\$165.1</b>
<b>DOLA</b>	<b>\$159.6</b>	<b>\$20.5</b>	<b>\$67.0</b>	<b>\$82.6</b>
Direct Distribution	\$47.9	\$6.2	\$20.1	\$24.8
Energy Impact Assistance	\$111.7	\$14.4	\$46.9	\$57.8
<b>DNR</b>	<b>\$159.6</b>	<b>\$20.5</b>	<b>\$67.0</b>	<b>\$82.6</b>
Perpetual Base Account	\$79.8	\$10.3	\$33.5	\$41.3
Operational Account	\$79.8	\$10.3	\$33.5	\$41.3

Table 3: Severance tax revenue forecast (in millions)

	<b>Combined FML/Sev. Tax Totals for DOLA</b>			
	FY 08-09 (actual)	FY 09-10	FY 10-11	FY 11-12
<b>Total DOLA Direct Distribution<sup>2</sup></b>	<b>\$80.9</b>	<b>\$18.0</b>	<b>\$41.3</b>	<b>\$48.1</b>
<b>Total DOLA Energy Impact Assistance<sup>3</sup></b>	<b>\$144.8</b>	<b>\$14.4</b>	<b>\$68.1</b>	<b>\$81.1</b>

Table 4: Total severance tax and FML available to DOLA for direct distribution and grants (in millions)

<sup>1</sup> SB 09-279 diverts \$22.6M to state general fund in FY 09-10. Effectively reduces FML direct distribution to \$11.8M

<sup>2</sup> Assumes no additional diversions of funds by the general assembly

<sup>3</sup> Assumes no additional diversions of funds by the general assembly