2nd Draft

Initiative #121
Distribution of Oil and Gas Revenue

Proposition ? proposes amending the <u>Colorado statutes</u> to:

- prohibit the distribution of state revenue related to the development of minerals to any city, town, or county that limits oil and gas activities within its boundaries; and

- reduce state revenue distributed to any special district that overlaps a portion of a city or county in which oil and gas activities are limited, and clarify that a new special district may not be created in order to avoid such a reduction.

Summary and Analysis

The state collects revenue from the exploration, development, production, and sale of certain minerals, including oil, natural gas, oil shale, coal, and various metallic minerals, such as molybdenum and gold. This revenue is collected in the form of taxes, payments from the federal government, and land leases. The majority of this money comes from oil and gas activities in the state. A portion of this money pays for state oversight of mineral development (including energy development) and natural resources. Most remaining money is distributed to cities, counties, and school districts as formula-based payments, grants, and loans. Special districts and private entities are also eligible to apply for grants and loans.

Sources of oil and gas revenue. The measure identifies three primary sources of affected revenue: state severance taxes, revenue from federal mineral leasing (FML) activities, and State Land Board revenue from energy development. However, the measure will mainly affect just the first two revenue sources since State Land Board revenue primarily goes to local school districts, which do not have the authority to limit oil and gas activities.

- *Severance taxes* are collected on minerals removed from the land. In budget year 2012-13, the state collected $147.7 million in severance taxes.

- *FML revenue* is received as a result of energy development activities on federal land in Colorado. In budget year 2012-13, the state collected $120.8 million in FML revenue.

The amount of revenue from these sources varies widely from year to year.

Distribution of oil and gas revenue. A portion of state oil and gas revenue is distributed to cities, counties, and school districts according to factors set in state law, while additional moneys are distributed as grants and loans after review by state officials. Typically, the more oil and gas activity in a region, the greater its share of state revenue. A city or county with little or no oil and gas activity may see little revenue from the state. What revenue it does receive may come in the form of grants and loans to address the impact of oil and gas activities in neighboring cities or counties.

Role of local governments. Colorado currently has 3,480 active local governments, including cities, towns, counties, special districts, and other political subdivisions of the state. State law generally prohibits a local government from regulating oil and gas activities within its boundaries. However, Colorado cities, towns, and counties have the authority to make decisions on how land within their boundaries is used, including regulating zoning, noise, access, and visual impact. Recently, several local communities have enacted restrictions on oil and gas activities, such as hydraulic fracturing (commonly known as fracking), within their boundaries. A ban on fracking effectively limits all new oil and gas activity in a region because this technique is used to increase production from most wells in Colorado. Pending lawsuits have challenged the legality and effect of these recent bans on oil and gas activities.

The city of Lafayette permanently bans all forms of drilling, and the cities of Boulder, Fort Collins, and Longmont, and the city and county of Broomfield have each enacted a five-year ban on fracking. In budget year 2012-13, about $600,000 in total was distributed to these five local governments according to the state severance tax formula and from FML revenue. This figure does not account for any money distributed to these local governments in the form of grants or loans.

Changes under Proposition ?. This measure makes any city, town, or county in which any oil and gas activities have been limited ineligible to receive any state revenue from mineral development. This includes revenue distributions in the form of regular payments, grants, or loans. Limiting activities may include a temporary or permanent ban on a particular technique used to access oil or natural gas such as fracking, a limit on new drilling, or a permanent ban on all drilling activities within the boundaries of a particular local government.

The measure redistributes money that would have otherwise been distributed to a city, town, or county that imposes limits on oil and gas activities to other eligible local governments. It also prevents a limiting city or county from receiving offsetting revenue from the state, or from creating a special district, in order to recover revenue forfeited as a result of a limit or ban on oil and gas activities. Finally, it reduces the share of revenue distributed to a special district located, in whole or part, within or across the boundaries of a city or county that limits oil and gas activities. A special district is a type of local government without land use authority that is set up to provide certain services, such as water or fire protection. If the ban on oil and gas activities is lifted, a local government is again eligible to receive its share of state revenue from mineral development.

For information on those issue committees that support or oppose the measures on the ballot at the November 4, 2014, election, go to the Colorado Secretary of State's elections center web site hyperlink for ballot and initiative information:

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> http://www.sos.state.co.us/pubs/elections/Initiatives/InitiativesHome.html

Arguments For

1) The measure improves the system for distributing the state's share of revenue from oil and gas activities to local communities. It also creates a financial consequence for communities that ban such activities. A local community that does not support an industry that is crucial to Colorado's economy should not benefit financially, especially when its actions could result in the loss of jobs and state revenue.

2) When a community bans oil and gas activities, it creates a confusing patchwork of regulations that conflict with state policies, and it takes away the rights of individual citizens to develop minerals on their property. The state has a nationally recognized framework for regulating oil and gas activities that balances economic interests, the protection of natural resources, and local participation in policy making. Sharing state revenue only with those communities that allow oil and gas activities creates an incentive for local communities to preserve this framework.

Arguments Against

1) The measure establishes an overreaching, all-or-nothing policy where state funds can be withheld from a community that limits any amount or type of oil and gas activity, even if other activities that contribute to state revenue are still allowed. A policy that withholds money fails to recognize that communities are impacted by mineral development that has already occurred or by activities that occur outside of their boundaries. For example, under this measure a limiting county will not receive funds that could be used to mitigate road impacts or negative air quality, though the county may continue to handle traffic or air pollution associated with oil and gas activity in a neighboring county. The measure also penalizes special districts, such as water districts, which have no control over land use decisions made by cities and counties with overlapping boundaries, but might otherwise apply for grant funds to mitigate oil and gas impacts.

2) A local community may have legitimate reasons to ban one or more types of oil and gas activities and should be free to make decisions about land use within its boundaries without risking the loss of an important source of revenue. For example, a community may decide to limit drilling activity to alleviate noise, odor, or other effects that could be harmful to residents and businesses. Colorado law has a long tradition of valuing decisions made at the local level, which this measure jeopardizes.

Estimate of Fiscal Impact

The measure will increase state costs by about $50,000 in the first year and $10,000 in subsequent years to verify eligibility for and adjust the distribution of severance tax and FML money. Based on current limitations and revenue collections, this analysis assumes that the cities of Boulder, Fort Collins, Lafayette, and Longmont, and the city and county of Broomfield will experience a reduction in funding totaling at least $600,000 per year. This money will be redistributed to other local governments. Finally, to the extent that this measure encourages cities, towns, and counties to lift limitations on oil and gas activities, the amount of severance tax paid to the state may increase.