A RENTER’S MARKET:
OUTDATED OIL & GAS RENTAL RATES FAIL TAXPayers

AUGUST 2014

Center for Western Priorities
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The federal government’s failure to charge a rational rental rate for oil and gas companies holding undeveloped leases on public lands is costing taxpayers tens of millions in annual revenue. Small increases to federal rental rates for the first time in decades could generate over $50 million annually.

Rentals are the fees companies pay to the federal government for the right to hold public lands without producing oil and gas. Rental rate reform could help pay down the national debt, provide funding assistance to communities responding to the effects of oil and gas drilling on local infrastructure, and incentivize the timely production of already leased lands.

Every year the federal government leases millions of public acres to oil and gas companies. Since 2010, the Bureau of Land Management (BLM) has leased over 6 million acres of public lands—an area nearly the size of Massachusetts—for oil and gas drilling. A majority of these lands sit idle for years under the control of private companies, but are not being explored or developed for oil and gas. Unreasonably low rental rates incentivize land speculation, as it costs companies next to nothing to rent public lands and stockpile leases.

### Federal Acres Leased to Oil and Gas Companies Each Year Since 2010

- **FY2013**: 1.2 Million Acres
- **FY2012**: 1.8 Million Acres
- **FY2011**: 2.0 Million Acres
- **FY2010**: 1.4 Million Acres
By the end of fiscal year 2013, oil and gas companies were sitting on nearly 7,000 unused, but approved drilling permits and over 23 million acres of leased public lands that were not producing oil or gas. Companies holding nonproducing federal oil and gas leases pay a minimal rental fee to maintain the lease—$1.50 per acre per year for the first five years and $2.00 per acre per year thereafter.

A market-based approach to rental rates could generate significant new revenues for the U.S. Treasury and energy producing states. This is particularly true in the American West where most federal lands are located.

A calculation by the Center for Western Priorities finds that adjusting rental rates to $3.00 for the first five years of a lease and $5.00 thereafter would have generated an additional $56 million during FY 2013. Since oil and gas revenues are split roughly 50:50 between the federal government and states, a rational rental rate policy would have generated roughly $28 million in new revenue for the U.S. Treasury in FY 2013 and $28 million for energy producing states.

As a point of comparison, some states charge companies an even higher rental rate on state lands. In Texas, companies have to pay an annual rental rate of $5 per acre during the first three years of a lease on state lands. If a lease is not developed by the end of the third year, the rental rate goes up to $25 per acre. The higher rental rates in the state have not dissuaded companies, which continue leasing and developing oil and gas in Texas.

Making it more expensive to sit on federal leases would also deter companies from stockpiling leases, and encourage companies to either relinquish nonproducing leases or more quickly produce oil and gas and begin paying royalties. Royalty payments from federal oil and gas production are how taxpayers receive the largest financial benefit from federal leasing, making up nearly 90 percent of all federal onshore oil and natural gas revenues.

The federal government could do much more to promote diligent oil and gas development on federal lands. The Obama administration has called for oil and gas reforms and has the authority to increase rental rates without Congressional approval, but no action has been taken. While the Department of the Interior has recently stated that it will “move forward with a rulemaking process to revise its existing regulations to allow the secretary broad flexibility in setting onshore royalty rates,” it has made no such commitments for updating outdated rental rates.

The federal government has a responsibility to the American taxpayers to maximize the benefits of the domestic oil and gas boom; it could begin by creating a rational rental rate for companies holding public oil and gas leases.
The BLM is the nation’s largest landlord, overseeing 245 million acres of land and 700 million acres of sub-surface mineral resources for the long-term benefit of the American people. The BLM’s outdoor spaces are open for all to enjoy a hike into the mountains, a hunting trip with friends, or a night under the stars. The lands provide fresh drinking water for cities, habitat for big game and other species, and natural resources like timber, minerals, wind, solar, oil and gas to power the country.

One of the BLM’s many responsibilities is to administer oil and gas leases on federal lands. When the BLM leases public lands to a private company, the company is obligated to compensate American taxpayers for the use of the land and for the oil and gas extracted. Revenues are collected through three primary streams: royalties, bonus bids, and rental payments.

**Onshore Federal Oil and Gas Revenue Streams, Percent of Revenues Generated in FY2013**

- **6.3% Rental Payments**
- **1.4% Bonus Bids**
- **92.3% Royalties**

**Bonus Bids:** Federal oil and gas leases are offered through a competitive bidding process. A company must bid at least $2 per acre to lease federal public lands, but bids often range much higher.

**Royalties:** Once a lease begins producing, energy companies pay a 12.5 percent royalty to the federal government for the right to extract oil and natural gas from public lands. Royalties are assessed as a percentage on the value of the oil or natural gas extracted. After a lease begins producing oil or gas, royalties are paid in place of rent. Royalty payments make up the great majority of federal oil and gas revenues, contributing over 90 percent of all federal onshore oil- and natural gas-related revenues in 2013.

**Rental Payments:** Rentals are paid on oil and gas leases that are not in production. A company holding a lease on public lands, but not currently producing oil or gas, must pay the federal government an annual rental fee of $1.50 per acre in the first five years and $2.00 per acre each year thereafter. This rate was set in 1987, more than twenty five years ago.
Revenue from oil and gas development on federal lands directly benefits the states where extraction takes place. Mineral revenues are distributed to the states through a formula that returns about half of the revenues to the state where drilling occurs, with the remainder being deposited into the U.S. Treasury.\textsuperscript{xx}

States use federal mineral revenues to fund road construction, schools, universities, communities affected by energy development, and general funds. In Wyoming, federal mineral receipts fund schools and colleges, highway and road construction, city and town budgets and the state’s budget reserve. In Montana, counties impacted by mineral development receive 25 percent of state’s federal mineral distributions; the remaining 75 percent is deposited into the general fund.\textsuperscript{xxi} Federal mineral revenues in Colorado are deposited in the Colorado Mineral Leasing Fund, which distributes money to local communities affected by energy development, schools, and the state water board.\textsuperscript{xxi}
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Low rental rates provide little incentive for companies to diligently develop federal oil and gas leases. As of 2012, there were nearly 21 million acres of unexplored and undeveloped public lands under control by private oil and gas companies.\textsuperscript{xxiii} Nonproducing leases currently account for about 70 percent of all onshore federal leases.\textsuperscript{xxiv} Companies are sitting on nearly 7,000 approved federal permits, ready for drilling and energy extraction, but sitting idle.\textsuperscript{xxv}

After the release of a 2011 government report highlighting the problem of unused federal oil and gas leases, Secretary of the Interior Ken Salazar made it clear that the BLM was committed to encouraging more diligent oil and gas development:

“There are resources that belong to the American people, and they expect those supplies to be developed in a timely and responsible manner and with a fair return to taxpayers. As we continue to offer new areas onshore and offshore for leasing... we will also be exploring ways to provide incentives to companies to bring production online quickly and safely.”\textsuperscript{xxvi}

—Former Secretary of the Interior Ken Salazar

In 1979, the General Accounting Office issued a report to Congress asserting that existing BLM policies made it possible for companies to hold onto oil and gas leases for years without exploration. The report pointed, specifically, to the low cost of holding nonproducing federal leases. At the time, annual rental rates were set at $1.00 per acre, or $3.25 per acre in 2014 accounting for inflation.\textsuperscript{xxvii}

Keeping pace with the 1979 rental rates, which the General Accounting Office declared far too low to encourage diligent development, requires BLM to more than double the base rate.
According to the Center for Western Priorities’ analysis, rational rental rate reform could create an additional $56 million, raising the total government revenue from rentals to more than $100 million for municipalities, states, and the Treasury.

CWP's analysis finds that in fiscal year 2013, rental payments on nonproducing leases generated about $43 million. Raising rental rates from $1.50 per acre in the first five years of a lease, and $2.00 per acre for each year thereafter, to $3.00 per acre and $5.00 per acre respectively, would have generated nearly $101 million—or $56 million above current levels in FY2013. Approximately $28 million would have been deposited into the U.S. Treasury, with the remaining $28 million distributed to the states where rentals were generated.
Study Caveats and Assumptions

- The analysis estimates changes in gross revenue to the government and does not consider changes in net revenue from increasing rental rates.
- The analysis does not consider the effect of higher rental rates to bonus bids or royalty payments.
- The study assumes that any rental rate increase would be applied to all nonproducing onshore federal oil and gas leases.
- The analysis does not consider changes in bidding on federal leases or oil and gas production levels.
- The analysis assumes the data from the Bureau of Land Management and Office of Natural Resources Revenue is accurate.

There is a precedent for higher rental rates. Texas, for example, requires companies to pay an annual rental rate of $5 per acre during the first three years of a lease on state lands. If a lease is not developed by the end of the third year, the rental rate is increased by 500 percent, to $25 per acre per year.\textsuperscript{209}

Increasing the cost to hold onto nonproducing federal leases will encourage companies to begin producing oil and gas on federal lands or relinquish leases, and ultimately bring in more revenue through royalty payments.

Rental rates are only a small percentage of all oil and gas revenues. Moving leases from rent-paying to royalty-paying will generate even more revenues for the federal government and states, while helping assure taxpayers receive a fair share from federal oil and gas leasing. This may negate some revenue gains from higher rental rates—there may be fewer nonproducing federal leases—but any decrease would be more than made up for through increased royalty revenues.
Royalties are by far the largest contributor to federal oil and gas revenues and represent one of the federal government’s largest nontax revenue sources. But taxpayers are missing out on a significant opportunity because the federal onshore royalty rate has remained stagnant since the 1920s at 12.5 percent.

In 2012 alone, between $400 and $600 million in additional revenue would have been generated and distributed to states in the Rocky Mountain West, if royalty rates were increased to 16.67 percent or 18.75 percent.

Modernizing federal oil and gas royalties would generate significant new revenues for federal and state governments. According to President Obama’s FY15 budget, reforming the federal oil and gas leasing system, including modernizing royalty rates, would generate $2.5 billion in net revenue to the U.S. Treasury over the decade. In 2012 alone, between $400 and $600 million in additional revenue would have been generated and distributed to states in the Rocky Mountain West, if royalty rates were increased to 16.67 percent or 18.75 percent.

### Federal Oil and Gas Royalty Distributions to Western States (FY 2012)

<table>
<thead>
<tr>
<th>State</th>
<th>Royalty Rate: 16.67%</th>
<th>Royalty Rate: 18.75%</th>
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<tr>
<td>Colorado</td>
<td>$37 million</td>
<td>$55 million</td>
</tr>
<tr>
<td>Montana</td>
<td>$6 million</td>
<td>$9 million</td>
</tr>
<tr>
<td>New Mexico</td>
<td>$156 million</td>
<td>$233 million</td>
</tr>
<tr>
<td>Utah</td>
<td>$44 million</td>
<td>$66 million</td>
</tr>
<tr>
<td>Wyoming</td>
<td>$161 million</td>
<td>$242 million</td>
</tr>
<tr>
<td>Five State Total</td>
<td>$403 million</td>
<td>$604 million</td>
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At a time when the federal government faces continued budget challenges, and struggles to balance oil and gas drilling with other important uses on public lands, common ground solutions remain elusive. Reforming how the federal government assesses rentals and royalties for oil and gas development on public lands represents a significant potential source of new nontax revenues.

In a 2008 report to Congress, the U.S. Government Accountability Office (GAO) concluded as much: “…The country could benefit from increased oil and gas production sooner, and the federal government could realize higher revenues through royalties and rent.” Each of President Barack Obama’s budgets since 2010 has heeded the GAO’s advice. The President’s FY2011 budget, for example, called to “[Establish] fees for new nonproducing oil and gas leases… to encourage more timely production” and to “[Make] administrative changes to Federal oil and gas royalties, such as adjusting royalty rates…”

The Obama administration has yet to act. But given the ongoing intransigence in Congress, it is time for President Obama and Interior Secretary Sally Jewell to use their administrative authority and implement needed oil and gas revenue reforms, including establishing a rational rental rate and a fair royalty rate.
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[xv] Ibid.


[xxii] Ibid.


[xxviii] Rental rate projections are based on publicly-available date from the Bureau of Land Management’s Oil and Gas Statistics, available at http://www.blm.gov/wo/st/eng prog/energy/oil_and_gas/statistics.html. For “Total Number of Acres Under Lease as of the Last Day of the Fiscal Year” and “Number of Producing Acres on Federal Lands” see Table 3 and Table 7. Total nonproducing acres—i.e. rent-paying acres—is the difference between the datasets. The percentage of leases paying $1.50 per acre and the percentage paying $2.00 per acre was provided in a personal communication with Stacey Kaiser at the Office of Natural Resources Revenue. Some lease pay at a rate of other than $1.50 or $2.00 per acre. For the purpose of this analysis, those leases were split evenly between the two standard rates. In FY12, 36 percent of leases paid $1.50 per acre, while 64 percent of leases paid $2.00 per acre.
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