CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

April 7, 2006

S. 2253
A bill to require the Secretary of the Interior to offer the 181 Area of the Gulf of Mexico for oil and gas leasing

As ordered reported by the Senate Committee on Energy and Natural Resources on March 8, 2006

SUMMARY

S. 2253 would require the Secretary of the Interior to offer a specific area in the Gulf of Mexico, known as the sale 181 area, for oil and gas leasing within a year of the bill's enactment. CBO estimates that this lease sale would increase federal receipts from oil and gas firms by $223 million in 2008 and $1.3 billion over the 2008-2016 period. The sums collected would be recorded in the budget as offsetting receipts—that is, as an offset to outlays. S. 2253 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no direct costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 2253 is shown in the following table. The costs of this legislation fall within budget function 950 (undistributed offsetting receipts).

BASIS OF THE ESTIMATE

Of the 4.4 million acres specified for leasing in the bill, 1.3 million acres of the area known as the 181 area have already been made available to oil and gas firms for leasing three times. Under current law and policy, CBO expects that an additional 2.2 million acres of the area specified by the bill will be offered for leasing in fiscal year 2008. Thus, CBO estimates that this legislation would authorize leasing of 900,000 acres that probably would not be offered for lease under current law. Although the bill would allow for the leasing of an additional 725,000 acres with the consent of the Department of Defense, CBO has no basis to assume that this acreage would be leased.

	By Fiscal Year, in Millions of Dollars									
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
DIRECT SPENDING										
OCS Receipts Under Current Law										
Estimated Budget Authority	-8,875	-10,125	-9,775	-9,975	-10,075	-9,425	-10,975	-10,825	-10,850	-11,175
Estimated Outlays	-8,875	-10,125	-9,775	-9,975	-10,075	-9,425	-10,975	-10,825	-10,850	-11,175
Changes in Receipts Under S. 2253										
Bonus Bids										
Estimated Budget Authority	0	-220	-60	-50	-50	-20	0	0	0	0
Estimated Outlays	0	-220	-60	-50	-50	-20	0	0	0	0
Rents										
Estimated Budget Authority	0	-3	-4	-4	-5-	-5	-2	-1	-1	-1
Estimated Outlays	0	-3	-4	-4	-5-	-5	-2	-1	-1	-1
Royalties										
Estimated Budget Authority	0	0	0	0	0	0	-175	-215	-255	-270
Estimated Outlays	0	0	0	0	0	0	-175	-215	-255	-270
Total Changes										
Estimated Budget Authority	0	-223	-64	-54	-55	-25	-177	-216	-256	-271
Estimated Outlays	0	-223	-64	-54	-55	-25	-177	-216	-256	-271
OCS Receipts Under S. 2253										
Estimated Budget Authority	-8,875	-10,348	-9,839	-10,029	-10,130	-9,450	-11,152	-11,041	-11,106	-11,446
Estimated Outlays	-8,875	-10,348	-9,839	-10,029	-10,130	-9,450	-11,152	-11,041	-11,106	-11,446

Under the bill, additional receipts would come from the bonus bids paid by companies over the 2008-2012 period, from rental payments on the leases while companies prepare for oil and gas production to begin, and from royalties paid on the value of any production generated from the leases. Oil and gas companies compete for leases through an auction using sealed bids. Each lease for a specific geographic tract is awarded to the bidder that offers the highest bid. The winning bid, known as a bonus bid, is paid up front for the lease at the time of sale, regardless of whether the property ever produces any oil or gas. After securing a lease, the lessee pays annual rent to the Treasury until production begins, at which time royalties are due to the federal government. Royalties are collected by the government from the lessee as a fixed percentage of the net value of oil and gas produced from the lease, often with provision for relief from paying any royalties at certain oil and gas market prices.

Bonus Bids

When deciding how much to offer as a bonus bid, oil and gas companies consider the estimated profitability of the lease as a long-term investment. Bonus bids are based on a company's expectation of long-term prices, costs to find and produce oil or gas, the amount of a resource they might produce, and expectations of future costs, including any royalty payments to the federal government. Additionally, companies must consider other financial opportunities, such as their investment alternatives and cost of capital.

The original lease sale 181 held in 2001 resulted in about 40 percent of the available acreage being leased at an average of $622 per acre. More recently, sale 198, held in March 2006, offered tracts in the Central Gulf of Mexico and resulted in high bids averaging $356 per acre for tracts in water depths similar to what would be leased under the bill. Based on information from the Department of the Interior (DOI) and industry experts, CBO has assumed that the results of the lease sale authorized by the bill would be similar to those of the 2001 sale. The high bids in 2001 reflected the significant interest in the sale 181 area. We expect that the amount of interest and the number of bidders for the first lease sale of acreage made available under the bill would be similar to those for the first lease sale 181 in 2001, again resulting in about 40 percent of available acreage being leased and high bids averaging about $600 an acre.

CBO anticipates that the legislation would cause one special sale to occur in fiscal year 2008, and that it would occur in conjunction with the special sale already expected at that time under current law. The area would then be offered annually as part of regularly scheduled sales in the Central Gulf of Mexico. Starting in 2009, we estimate that roughly 10 percent of the remaining area would receive bonus bids, but those bids will be closer to historical averages for similar tracts with less interest—about $120 per acre. We expect that all acreage of value would be leased within five years at the annual sales held by DOI. On this basis, CBO estimates that the additional area proposed for leasing under the bill would result in the collection of $220 million in bonuses in 2008 and $400 million in bonuses over the 2008-2012 period.

Rental Income

Successful bidders on OCS acreage made available by the bill would pay the government $9.25 per acre in rent until oil and gas production begins. CBO estimates that 40 percent of the additional acreage made available by S. 2253 would be leased in 2008, and that it would take firms about five years to build necessary infrastructure to commence production. We anticipate that an additional 20 percent of the acreage newly made available by the bill would be leased over the 2009-2012 period and that gas production would begin five years after

each sale. Thus, CBO estimates that rentals would total $3 million in 2008 and $25 million over the 2008-2016 period.

Royalties on Oil and Gas Production

Based on information from DOI, CBO estimates that the portion of the sale 181 area that would be made available by the bill would have a 95 percent probability of containing technically recoverable resources of 1.8 trillion cubic feet of natural gas and 250 million barrels of oil. For this estimate, we assume that natural gas will be the only resource extracted from the sale 181 area within the next 10 years. We expect that production would begin and companies would begin paying royalties starting in 2013. Production would likely continue over 25 to 35 years.

The area designated for sale by the bill is primarily in the deep waters of the OCS (waters deeper than 400 meters). The royalty rate paid by companies in such areas is 12.5 percent of the wellhead value of the production. We assume that commercial discoveries and production of gas leases would be similar to what is expected from the sale 181 area leases that have already been explored. Although relief from paying royalties could be available to companies under current law, our forecast of future gas prices over this period—between $8.80 per thousand cubic feet and $12.50 per thousand cubic feet—is above the threshold at which royalty relief would apply. (Relief from paying royalties is available to companies in certain areas of the OCS when prices are below a certain threshold.) Overall, CBO estimates that royalties from the area that would be made available by the bill would total $915 million over the 2013-2016 period, with significantly more in royalty payments accruing to the federal government for at least 20 years after 2016.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 2253 contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no direct costs on state, local, or tribal governments.

ESTIMATE PREPARED BY:

Federal Costs: Lisa Cash Driskill:
Impact on State, Local, and Tribal Governments: Marjorie Miller
Impact on the Private Sector: Tyler Kruzich

ESTIMATE APPROVED BY:

Peter H. Fontaine
Deputy Assistant Director for Budget Analysis