April 14th Market Demand Hearing by the Texas Railroad Commission

April 7, 2020

To the Honorable Wayne Christian – Chairman
To the Honorable Christi Craddick
To the Honorable Ryan Sitton

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Representing – University Lands and the University of Texas System

University Lands (UL) manages the surface and mineral interests of 2.1 million acres of land across nineteen counties in West Texas for the benefit of the Permanent University Fund (PUF). The PUF is the largest public university endowment in the U.S. and benefits more than 20 educational and health institutions across both The University of Texas System and Texas A&M University System. Activity on these lands dates back into the 1800s and today includes grazing and ranching, pipelines, a winery, surface leases for public schools and churches, renewable energy development, groundwater sales, and, of course, oil and gas activity.

The primary source of revenue at University Lands is royalty income from oil and gas development. Approximately 1.4 million of the 2.1 million total acres are leased for oil and gas, spanning 4,000 individual oil and gas leases. This royalty income has yielded $8.2 billion for the PUF over the past 10 years, with an additional $460 million of surface income over that same period. In 2019, gross production averaged 180,000 BOPD and 620 MMCFD from approximately 9,000 producing wells, including approximately 4,000 horizontal that have been drilled over roughly the last decade. Over 250 different oil and gas companies operate and own wells on the lands. An economic study by the Perryman Group estimated there are the equivalent of 7,500 full time personnel working on the lands every day, with another 33,000 indirect jobs created as a result of the commercial activity on the lands. Annual gross product is estimated at $3.5 billion, and there are approximately $200 million of annual state and local tax revenues generated from activity on the lands

University Lands works proactively with oil and gas operators to maximize long-term value. There are estimated to be ~20,000 potential additional drilling locations within the resource base of the lands. Like with any other business, the development of these prospective locations is subject to both the availability of capital and generation of economic returns sufficient enough to attract further capital and investment. Similar to the resource quality across the entire Permian Basin, University Lands' technical assessments indicate that the resource quality across our lands requires "break-even" oil prices that range from as low as $30/barrel in some areas to as high as $60/barrel in others, based on today's development practices and current technology. At recent drilling rates, we have more than 100 years of prospective future well inventory.

University Lands' strategy is to ensure steady and consistent development of the oil and gas resource through price cycles. Consistent development ensures that efficiencies in operations and capital spending are captured, and it enables more predictable and increased resource recovery.

To accomplish this objective, we work with some operators to provide attractive incentives to ensure they capture the economic returns required for continued success, while simultaneously maximizing the royalty income for University Lands. Examples of these incentives include creating multi-lease development agreements, which allow for more systematic drilling of longer lateral wells; sliding-scale royalty rates tied to oil price; and reduced royalty rates in areas that are more economically challenged, in exchange for increased capital commitments. These initiatives have served both operators and University Lands well; in 2019, we realized record production rates and $1B of royalty revenue.

Unfortunately, the shocking combination of demand shrink due to the COVID-19 pandemic and the simultaneous disagreement between Russia and Saudi Arabia on supply quotas has created what is not our standard oil and gas market "downcycle" but instead is more of a "chasm."

In response to this "chasm," University Lands is working with operators to significantly reduce activity. Examples include:

- Proactively promoting and accepting deferments of existing drilling requirements
- Proactively promoting and accepting well shut-ins, while ensuring leases remains in good standing
- Promoting and accepting deferments in completions and delays in bringing production online

These efforts will result in an intentional, significant slowdown in activity and a subsequent decline in production and revenue. Putting it in perspective, we expect the rig count on the lands to decline from an average of 15-20 rigs in 2019 to ~5-7 rigs by late 2020, and we are projecting that mineral revenue will decline from ~$1 billion in 2019 to ~$500 million in 2021.

The majority of this revenue flows to the PUF endowment. Therefore, University Lands is somewhat uniquely focused more on the long-term compared to most operators and other mineral owners, who often focus on short-term returns. With that long-term perspective in mind, I believe it is imperative that every effort be made to ensure the viability of oil and gas operators and oilfield service companies, as as their existence is imperative to sustained oil and gas development.

According to a new survey by the Federal Reserve Bank of Kansas City, almost 40% of oil and natural gas producers face insolvency within the year if crude prices remain ~$30/barrel. This implies that ~100 companies operating on University Lands could become insolvent if there aren't significant and quick improvements in commodity prices. This would create a significant disruption both on the lands and across the market, putting the availability of capital and manpower at further risk. Major market disruptions make consistent, steady development of state resources very difficult, and consistent, steady development is the best way to maximize value from these lands. Our latest revenue projections for the next decade indicate that revenue could range anywhere from $5-6 billion assuming $35-45/barrel oil to $8 -10 billion in a $50-$60/barrel price environment. This demonstrates the need for stability and consistent development.

Considerations for Prorationing

Among companies on University Lands, there are many operators that would support the concept of prorationing, many that would oppose, and likely many that are undecided. While all companies are hurting presently, there are many operators that are somewhat well positioned for this "chasm" and many that are in significant financial peril. There are always winners and losers in markets, and not all companies can or should be protected.   That being the case, this unparalleled challenge to our industry requires the consideration of all options and opportunities.

Over the next few weeks, the United States' position as the leading oil producer in the world could require that our federal leaders reduce the staggering oil inventories building by making a commitment to reduce oil and gas production country-wide. While market forces are already driving reductions to some extent, the volumes needed to effect real change at the global level may ultimately require some level of sacrifice by all.

Considering Texas' position as the leading producer in the United States, the Texas Railroad Commission's authority to prorate oil production is one potential "tool in the toolbox" for a U.S. solution. The proration could also provide a more orderly and organized adjustment across the state than is currently occurring, as many shut-ins are being driven by pipeline companies that are refusing to move product for smaller companies with unsecured takeaway. As part of a US wide plan, I believe UL could potentially support such an initiative.

From a more tactical perspective, the RRC should consider utilizing its prorationing authority to help promote reducing the amount of associated gas unnecessarily being flared in the Permian Basin. This could help in reducing oil supply, reducing the waste of natural gas, and demonstrating to an observing public the industry's commitment to continued environmental stewardship.

I appreciate your willingness to consider my thoughts on such an important, complex and dynamic issue. I know from my conversations with each of you that you realize the incredible positive impact that the development of our state's oil and gas resources have on Texans and all Americans as we work to provide low cost energy for the world!

Very truly yours,

Mark A. Houser
CEO
University Lands