LEGISLATIVE EDUCATION STUDY COMMITTEE
BILL ANALYSIS

Bill Number: SJR 10a **50th Legislature, 1st Session, 2011**

Tracking Number: .183487.6

Short Title: Land Grant Permanent Fund Distribution, CA

Sponsor(s): Senators Cynthia Nava and Michael S. Sanchez and Others

Analyst: Craig J. Johnson **Date: March 15, 2011**

AS AMENDED

The Senate Rules Committee amendments:

- **add language in the title and in the body of the bill clarifying that the additional distributions are "for the benefit of non-school-age children";**
- **specify in the title of the bill that additional distributions are for the sole benefit of public schools; and**
- **provide for an additional distribution of three-tenths (0.3) percent in fiscal year 2024 and beyond.**

Original Bill Summary:

SJR 10 would amend the New Mexico constitution[1] to:

- increase the distribution[2] from the Land Grant Permanent Fund (LGPF);
- increase the LGPF value that would suspend increased distributions from $5.8 billion to $8.0 billion; and
- require a portion of the increased distribution to be used for early childhood education programs.

SJR 10 requires passage by the Legislature and voter approval to amend the constitution.

SJR 10 calls for additional 1.5 percent distributions to be made to the beneficiaries of the LGPF (see "Background," below) for FY 14 through FY 23, with specific earmarks that the additional 1.5 percent "…be used for early childhood education programs operated by public schools or pursuant to contracts between the state and private entities, as provided by law." The additional distributions would be as follows:

- FY 14: 1/3 of additional distributions for early childhood education;
- FY 15: 2/3 of additional distributions for early childhood education; and
- FY 16-FY 23: all additional distributions for early childhood education

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[1] Article XII, Section 7
[2] Distributions are a set percentage of the average of the year-end market values of the fund for the immediately preceding five calendar years.

Fiscal Impact:

SJR 10 does not contain an appropriation.

SJR 10 would have an impact beginning in FY 14 when the annual distribution is increased by 1.5 percent. The table below shows how SJR 10, if approved, would change the LGPF distributions.

Land Grant Permanent Fund Distribution Rate		
Fiscal Year	**Current Law**	**SJR 10**
2012	5.8%	5.8%
2013	5.5%	5.5%
2014	5.5%	7.0%
2015	5.5%	7.0%
2016	5.5%	7.0%
2017-2023	5.0%	7.0%

Fiscal Issues:

The additional distributions from the LGPF mandated by the passage of Amendment 2 in 2003 called for additional distributions above the 5.0 percent base distribution of:

- 0.8 percent (FY 05-FY 12); and
- 0.5 percent (FY 13-FY16).

The State Investment Council (SIC) analysis indicates that the increased distributions established in 2003 have resulted in approximately $537 million in additional funds for LGPF beneficiaries as shown below.

FY	$>5.0%
2005:	$58.2MM
2006:	$58.8MM
2007:	$60.5MM
2008:	$64.8MM
2009:	$71.9MM
2010:	$72.5MM
2011:	$73.9MM
2012:	$76.3MM
TOT:	$537.1MM

The SIC analysis estimates that SJR 10 would result in:

- additional distributions that average approximately $193 million per year or nearly $1.93 billion greater over the 10-year period; and
- the corpus of the fund being an estimated $214 billion less when the additional distributions sunset.

The methods and assumptions used by the SIC to estimate the impact of SJR 10 are described below:

"While it is an imprecise exercise to predict investment returns and fund value through FY 2023, the SIC will offer the following estimates from now through FY2023, based on these criteria: annualized 6.9 percent investment returns, average oil & gas contributions of $280 million/year, both of which are based on 15-year averages for the LGPF as of 12/31/10. Both of these numbers have fluctuated to a very significant degree from year to year, but based on 15-year historic data, SIC staff believes this is a fair, if not particularly conservative assumption.

Under current statutorily mandated distributions and historic return assumptions as stated above, the LGPF could grow from $10.2 billion today (12/31/10) to approximately $15.8 billion by end of calendar year (CY) 2021 (12/31/21), which would result in FY 2023 distributions of $733 million (at 5 percent of the LGPF 5-year average). This estimate does not take into account the true value of the Fund relative to inflation.

LGPF total distributions from FY 2014 to FY 2023 would be approximately $6.288 billion.

However, should SJR 10 be passed and approved by the electorate, and under the same contribution and return assumptions as above, the LGPF value would grow from $10.2 billion to be approximately $13.7 billion by the end of CY 2021 (12/31/21), resulting in FY 2023 distributions of $923.9 million (@7.0 percent of the 5-year average of the LGPF). FY 2024 distributions at 5.5 percent would drop to $742.5 million.

During the FY 2014-2023 time period, an estimated $8.225 billion would have been distributed to beneficiaries from the LGPF."

FY2014-2023	Est LGPF Value ($B)		Total Est Dist ($B)		Ave Dist ($B)
Current Dist Rate	$	15.8	$	6.29	.629
SJR 10	$	13.7	$	8.22	.822

<u>Technical Issues</u>:

Analysis from the SIC notes the following, "A potential conflict arises when applying language in SJR10 that specifically allocates additional distributions specifically to early childhood education. Namely, not all of the beneficiaries would be able to apply these distributions in such a manner, nor should they. While the LGPF is often considered to be the Permanent School Fund, its beneficiaries also include state universities, specialized schools, prisons, miner's hospital, public buildings and other entities which do not have primary education as their sole focus. It is unclear how these entities would be tasked to use their fair share of the additional distributions under the mandate for which SJR10 calls."

Analysis from the Higher Education Department noted that, “This bill would allow a direct allocation of the state’s land grant permanent fund to both public and private providers of early childhood education. Adding private providers to the beneficiaries of the LGPF is a major policy shift.”
The following analysis from the State Land Office (SLO) highlights a concern about inflation and offers an amendment. “Keeping pace with inflation is an unaddressed flaw in the bill. Although the bill increases the failsafe, above the level set, there is no escalation factor to assure that the fund will retain the full value of its corpus. Change the “failsafe” to be equal to the corpus of the LGPF at the time of implementation of the amendment and add an inflation factor set to the appropriate segment of the Consumer Price Index.

On page 4 line 6, add: adjusted annually by the percentage equal to the change in the special aggregate index for energy (alternatively the “all items less medical care”).”

Substantive Issues:

The SIC notes the following:

- “It should be emphasized that the ability of the LGPF to grow is driven **greatly** by the total contributions to the fund by oil/gas revenues. While the past decade these have been at all-time highs ($480MM in FY 2009), during the 90’s, contributions were much more modest - typically averaging $125MM.

- When making assumptions about rate of return, one should be extremely cautious. For example, while the LGPF’s 15-year average return has improved to 6.9 percent, the LGPF 10-year remains at only 4.3 percent per annum, considerably below the historical assumed average of 8 percent annual returns. Following the market collapses of the past decade, many institutional investors now believe that the 8% model may not be attainable.

- Assuming 6.9 percent returns, and taking into account a rising level of inflation, and potential for diminished contributions from the oil and gas sector, an aggressive distribution level of 7.0 percent for a 10-year period poses a high potential for decreasing the overall value to the Permanent Fund. Even modest drops in value have significant impact when applied over future decades.

- Several members of the Council have voiced concerns previously about increased distributions from the LGPF and the potential they have to erode the corpus of the Fund in both the short term and over time. Some have generally stated that such declines in value run contrary to the concept of “intergenerational equity”, creating which was the intent behind the genesis of the Permanent Fund.”

Background:

During the 2009 interim LESC hearing on the LGPF, the SIC provided the following history: The United States transferred 13.4 million acres of federal land to the Territory of New Mexico in anticipation of a grant of statehood. The *Fergusson Act of 1898* and the *Enabling Act of 1910* were the primary federal legislative vehicles for the public land transfers. The acts stipulate that such lands are to be held in trust for the benefit of the public schools and 19 other specifically identified state institutions. The Commissioner of Public Lands and SLO are the trustees for the original 13.4 million acres of mineral resources and the remaining 8.75 million acres of surface land. The Commissioner of Public Lands leases the trust lands for mineral exploration and grazing rights and, under certain conditions, may also sell or exchange trust properties. A substantial portion of royalties and income from the sales of land are transferred to the LGPF and are then invested by the State Investment Office.

Prior to 1997, US congressional approval was required for any change to the way in which distributions were made from the LGPF. However, in 1997, Congress approved amendments to the federal *Enabling Act of 1910*, one of which specified that future distributions "shall be made as provided in Article 12, Section 7 of the Constitution of the State of New Mexico. The last changes to Article 12, Section 7 occurred in 2003, when voters approved a constitutional amendment to:

- increase the annual distribution from the LGPF to the fund's beneficiaries (including public schools) from 4.7 percent to 5.0 percent of the average of the year-end market values of the fund for the immediately preceding five years;
- provide an additional 0.8 percent annual distribution from FY 05 to FY 12 (for a total distribution of 5.8 percent) and an additional 0.5 percent annual distribution from FY 13 to FY 16 (for a total distribution of 5.5 percent) to be used for education reform as provided by law;
- provide that the above additional distributions shall not be made in any fiscal year if the average of the year-end market values of the fund for the immediately preceding five calendar years is less than $5.8 billion;
- authorize the Legislature, by a three-fifths' vote of the members of each house, to suspend any of the above additional distributions; and
- revert the distribution to 5.0 percent in FY 17.

The table below shows LGPF contributions, disbursements, market values, and returns for FY 89 through FY 10.

Date	Beginning Market Value	Contrib	Disburs	$ Investment Return	Ending Market Value	% Investment Return
Fiscal Year 1989	2,786,201	95,909	252,270	372,361	3,002,201	14.2%
Fiscal Year 1990	3,002,201	104,922	258,961	278,496	3,126,658	9.7%
Fiscal Year 1991	3,126,658	121,159	259,366	354,364	3,342,815	11.3%
Fiscal Year 1992	3,342,815	104,381	261,965	498,843	3,684,074	15.1%
Fiscal Year 1993	3,684,074	122,950	261,546	455,701	4,001,179	12.6%
Fiscal Year 1994	4,001,179	115,598	257,924	-9,996	3,848,857	-0.5%
Fiscal Year 1995	3,848,857	97,299	248,102	625,176	4,323,230	16.0%
Fiscal Year 1996	4,323,230	100,171	246,027	495,049	4,672,423	12.1%
Fiscal Year 1997	4,672,423	147,767	251,228	895,751	5,464,713	18.5%
Fiscal Year 1998	5,464,713	129,981	255,415	1,115,799	6,455,078	21.5%
Fiscal Year 1999	6,455,078	104,747	262,420	1,014,822	7,312,227	15.8%
Fiscal Year 2000	7,312,227	217,905	344,316	745,209	7,931,025	10.2%
Fiscal Year 2001	7,931,025	325,947	322,153	-516,236	7,418,583	-6.6%
Fiscal Year 2002	7,418,583	213,348	283,142	-652,613	6,696,176	-7.9%
Fiscal Year 2003	6,696,176	222,985	332,784	221,267	6,807,644	3.6%
Fiscal Year 2004	6,807,644	269,743	400,746	959,800	7,636,441	14.2%
Fiscal Year 2005	7,636,441	324,689	432,499	722,473	8,251,104	9.7%
Fiscal Year 2006	8,251,104	465,306	477,675	860,293	9,099,028	10.6%
Fiscal Year 2007	9,099,028	449,303	499,512	1,624,378	10,673,196	17.9%
Fiscal Year 2008	10,673,196	460,648	462,235	-401,154	10,270,455	-3.8%
Fiscal Year 2009	10,270,455	480,526	521,521	-2,300,960	7,928,500	-22.4%
Fiscal Year 2010	7,928,500	330,275	525,513	1,113,148	8,846,410	14.0%
Cumulative *	7,928,500	330,275	525,513	1,113,148	8,846,410	14.0%

* Average Annual Return

The LGPF beneficiaries and their respective percent ownership are shown below:

Institutions	% of LGPF ownership
Common Schools	83.20%
NMMI	3.38%
NM School for the Deaf	2.07%
School for Visually Handicapped	2.06%
NM State Penitentiary	2.02%
UNM	1.60%
Public Bldgs. Cap Inc.	1.17%
Water Reservoir	1.15%
DHI Miners Hospital	1.04%
Char. Penal & Reform	0.91%
NMSU	0.50%
Improve Rio Grande	0.27%
NM State Hospital	0.24%
NM Inst. Mining & Tech	0.21%
ENMU	0.08%
WNMU	0.03%
NM Highlands	0.03%
Northern NM College	0.02%
NM Boys School	0.01%
UNM Saline Lands	0.01%
Carrie Tingley Hospital	0.00%
	100.00%

<u>Related Bills</u>:

HFS/HJR 1 *Land Grant Fund Annual Distributions, CA*