LEGISLATIVE EDUCATION STUDY COMMITTEE
BILL ANALYSIS

Bill Number: **HJR 10a** **51st Legislature, 1st Session, 2013**

Tracking Number: **.191920.3**

Short Title: **Land Grant Fund Distribution, CA**

Sponsor(s): **Representative Jim R. Trujillo and Others**

Analyst: **Kevin Force** **Date:** **March 6, 2013**

AS AMENDED

The House Voters and Elections Committee amendments:

- **reduce the additional distribution to 0.5 percent from 0.8 percent;**
- **change instances of "maintain educational reforms" to "increase educational performance";**
- **change the minimum balance that must be maintained in the Land Grant Permanent Fund before any additional distributions from the fund will be permitted to $10.0 billion from $8.0 billion.**

Original Bill Summary:

HJR 10 proposes to amend Article 12, Section 7 of the Constitution of New Mexico, to change the annual distribution from the Land Grant Permanent Fund (LGPF). Specifically, HJR 10 would:

- *permanently* add an additional distribution of 0.8 percent of the five-year average of the year-end market value of the fund, to implement and maintain educational reforms;
- increase the LGPF "failsafe" value, which would suspend increased distributions, from $5.8 billion to $8.0 billion; and
- permit the Legislature to suspend the additional 0.8 percent distribution upon a three-fifths vote of both chambers.

Original Fiscal Impact:

HJR 10 does not contain an appropriation.

According to the Fiscal Impact Report (FIR) from the Legislative Finance Committee (LFC), recurring impacts to revenue would be as follows:

- To the General Fund, for:
    - FY 15, an additional $27.27 million;
    - FY 16, an additional $28.75 million;
    - FY 17, an additional $80.94 million;

- FY 18, an additional $85.0 million; and
- FY 19, an additional $88.13 million.

- To the LGPF, for:

  - FY 15, a decrease of $32.74 million;
  - FY 16, a decrease of $34.52 million;
  - FY 17, a decrease of $97.17 million;
  - FY 18, a decrease of $102.05 million; and
  - FY 19, a decrease of $105.80 million.

- To other LGPF beneficiaries, for:

  - FY 15, an additional $5.47 million;
  - FY 16, an additional $5.75 million;
  - FY 17, an additional $16.27 million;
  - FY 18, an additional $17.04 million; and
  - FY 19, an additional $18.11 million.

- Joint resolutions require that proposed constitutional amendments be submitted to the people at the next general election or at any special election prior to that date that may be called for that purpose.
- If approved at the next general election in November 2014, the additional distribution could be implemented during FY 15.
- Assuming the additional distribution was so implemented during FY 15, the difference in the distribution from that in current law would be as illustrated in the following table:

Land Grant Permanent Fund Distribution Rate			
Fiscal Year	Current Rate	HJR 10	Difference
2013	5.5 percent	5.5 percent	0.0 percent
2014	5.5 percent	5.5 percent	0.0 percent
2015	5.5 percent	5.8 percent	0.3 percent
2016	5.5 percent	5.8 percent	0.3 percent
2017	5.0 percent	5.8 percent	0.8 percent
2018	5.0 percent	5.8 percent	0.8 percent
2019	5.0 percent	5.8 percent	0.8 percent
2020	5.0 percent	5.8 percent	0.8 percent
2021	5.0 percent	5.8 percent	0.8 percent
2022	5.0 percent	5.8 percent	0.8 percent

Original Fiscal Issues:

According to the FIR:

- The impact of HJR 10 assumes annual contributions into the fund of $438 million, the four-year average for calendar years 2008-2011.
- Investment returns are assumed to be the State Investment Council's (SIC) long-term target of 7.5 percent.
- Holding these inputs constant, the effect of the increased distribution can be estimated, as shown in "Fiscal Impact," above.

- In the short term, additional contributions from the LGPF will produce more revenue to the General Fund and other LGPF constitutional beneficiaries, primarily public education, the largest of the beneficiaries, which accounts for approximately 83.3 percent of the distribution from the fund.
- In the long term, taking into consideration fund contributions from the oil and gas revenues, as well as expectations for general inflation and fluctuations in investment income, this proposal greatly increases the risk that the LGPF will not be able to deliver the same benefits to the General Fund, and other beneficiaries, as it does today.
- **This increased distribution will undoubtedly deplete the fund over time.** (Emphasis in original.) The additional distributions, estimated to total $372.3 million for FY 15 to FY 19, would reduce both the corpus of the fund and, even assuming positive returns on investment, would reduce further growth in the fund.
- By 2020, the corpus of the fund will be diminished by $570 million.
- By 2030, the negative impact will have grown to almost $2.6 billion.
- Beginning in FY 20, the size of the excess distribution proposed in HJR 10 will begin to diminish, as well.

According to the State Land Office (SLO):

- In addition to ratification by the voters at the next general election, or special election held for this purpose, the constitutional amendment might not take effect until there is a corresponding Congressional amendment of the *Enabling Act* (see "Background," below).
- Increasing the failsafe for fund distribution, from $5.0 billion to $8.0 billion, partially addresses issues about protecting the corpus of the fund, but does not address the effect of inflation.
- Sustaining distribution at 5.8 percent prevents currently scheduled decreases in distribution, in FY 13 (0.3 percent) and FY 16 (0.5 percent).
- The extent that the 0.8 percent distribution causes the value of the LGPF to decrease, stay the same or increase depends on new funds contributed by the SLO from state trust land royalties and from the SIC from net investment earnings.
- Based on SIC audits of the LGPF, during the last five years:
  - total contributions over the last five years were $2.230 billion;
  - average contributions were $445.30 million per year;
  - total distributions during the last five years were $2.61billion;
  - average distributions were $521.30 million;
  - total net income earnings were $467.70 million;
  - average net income earnings were $93.50 million; and
  - the fund grew by 6.0 percent from $10.154 billion at the end of 2008, to $10.80 billion at the end of FY 12.
- Total distributions outpaced earnings by $2.1 billion over the five-year period when distributions were made at 5.80 percent.
- Assuming:
  - continued contributions at $483 million to $515 million through 2017;
  - 5.0 percent to 7.5 percent returns on investments; and
  - distributions at 5.8 percent, beginning in FY 15; then

- the impact of the proposed change in distributions would *not* result in a negative impact on the fund; and
- the corpus would not fall below the $8.0 billion floor set by HJR 10.

Original Substantive Issues:

According to the FIR:

- A 2003 constitutional amendment:

  - provided for 0.8 percent additional distribution of the LGPF from FY 06 through FY 12, and a 0.5 percent additional distribution from FY 13 through FY 16; and
  - required that the additional distribution from the Permanent School Fund be used to implement educational reforms.

- The proposed amendment would make that additional 0.8 percent distribution permanent.
- The decision to deplete an endowment is a policy decision rather than a financial dictum or a "best practice." The real question is whether the benefits of the expenditures will outweigh the benefits of greater income tomorrow.
- The drastic effects of financial market volatility during the 2008-2009 crisis continue to impact return averages, with the LGPF not achieving its 7.5 percent annualized return target for any long-term time period.
- Below, from the SIC, is a preliminary investment performance summary for the LGPF for the calendar year ending December 31, 2012:

LGPF	1-year	3-year	5-year	7-year	10-year	15-year	20-year
Returns %	14.49	9.11	2.35	4.85	7.3	5.78	7.39

- The SIC undertook an extensive asset allocation study in 2011, and concluded that, without taking excessive risk, it could not achieve its previous annual target of 8.5 percent, and lowered the return target to a more modest 7.5 percent.
- Other institutional investors, including ERB and PERA, have taken similar steps in recent years, with some peer funds around the country reducing long-term expectations to 7.0 percent, 6.0 percent, or even lower.
- When determining an appropriate asset allocation mix, in 2011, the SIC built a portfolio and investment strategy seeking to return 7.5 percent to the corpus of the fund, which on a conservative basis should be sufficient to cover 5.0 percent to 5.5 percent annual distributions, protect against inflation, and provide a small measure of real fund growth.
- The growth is to be both a cushion for when inflation exceeds expected rates, and for years when investment returns or contributions from the Land Office fall short of expectations, and must also serve to increase the fund's long-term purchasing power in preparation for the eventual day when natural resource contributions plateau, and inevitably decline.

According to the SLO, the proposed amendment may require corresponding amendment of the *Enabling Act* in three different respects:

- The proposed amendment appears to contemplate 0.8 percent distributions from the entire LGPF to fund educational reforms. Because distributions from the entire LGPF would include funds held in trust for other purposes dictated by the *Enabling Act*, money that is supposed to be used for those other purposes would be diverted to education. As drafted, the proposed amendment appears to violate the *Enabling Act*, and would require a corresponding amendment.

- If "educational reforms as provided by law" is construed as common school reforms, the use of 0.8 percent of the common school fund for that purpose would be consistent with the *Enabling Act*. If, however, "educational reforms" includes programs not historically understood as being part of "common schools," distribution from the LGPF for such purposes could violate the *Enabling Act*, thus requiring an amendment.
- The proposed amendment might require Congressional amendment of the *Enabling Act* because the distributions may go beyond what the 1997 *Enabling Act* amendments authorized[1]. In 1997, the *Enabling Act* was amended to say that LGPF distributions "shall be made as provided in Article 12, Section 7 of the Constitution of the State of New Mexico." At that time, as a result of the 1996 amendment to the Constitution of New Mexico, Article 12, Section 7 required that 5.0 percent of the LGPF be distributed annually. Thus, the *Enabling Act* could be construed as allowing only the 5.0 percent distribution that the Constitution of New Mexico provided for at that time.

According to Attorney General Opinion No. 12-03, dated February 1, 2012:

- The land grant permanent funds are derived from the lands granted to the state by Congress in the *Enabling Act* and are therefore subject to the terms of the act:

  - The *Enabling Act* set the terms by which New Mexico would be admitted to the union as a state.
  - In Article 12, Section 10 of the state constitution, New Mexico consented to all terms of the act stating, "[t]his ordinance is irrevocable without the consent of the United States and the people of this state, and no change or abrogation of this ordinance, in whole or in part, shall be made by any constitutional amendment without the consent of congress."
  - The lands granted to New Mexico and any proceeds from them are to be held in trust. If those lands or the money derived from them are used for something other than the expressed purposes, it is a breach of trust.
  - The New Mexico Supreme Court has stated that "[s]ection 10 of the *Enabling Act* became a part of our fundamental law to the same extent as if it had been directly incorporated into the Constitution when thus expressly consented to by the state and its people in Article 21, Section 9 of the Constitution."[2] The trust is binding and the Legislature is without power to divert the fund for another purpose than that expressed[3].

- In 1996, New Mexico voters adopted amendments to Article 12, Section 7 of the constitution, which were approved by Congress with amendments to the act, stating, "distributions from the trust fund shall be made according to Article 12, Section 7."[4]
- Thus, it appears that changes to how the funds are distributed may be made as long as it is accomplished by amendments to Section 7, and the funds are used for purposes permitted by the *Enabling Act*.

[1] This issue was never dealt with in connection with the 2003 amendment of the New Mexico Constitution.
[2] See: *State ex rel. Interstate Stream Commission v. Reynolds,* 71 N.M. 389, 396, 378 P.2d 622, 627 (1963).
[3] Id.
[4] See Public Law 105-37, 105th Congress, August 7, 1997.

The Attorney General (AG) has addressed issues similar to those raised by HJR 10 previously. In an advisory letter dated March 6, 2003, the AG expressed serious reservations about any proposed amendment to the Constitution of New Mexico that seeks to increase the distribution rate of the LGPF without Congressional approval:

- The Supremacy Clause in Article 6 of the US Constitution provides that federal law prevails over conflicting state law.
- Any federal law that appears to conflict with New Mexico law may give rise to expensive, lengthy litigation, with no guarantee of a favorable outcome.
- Without Congressional consent, the *Enabling Act* may conflict with proposed elevated distribution levels on several grounds:

  - Congress approved the 1996 amendments to the Constitution of New Mexico, which did not appear to endanger the Permanent School Fund.
  - Congress may withhold its approval of higher distribution rates, however, because the rates may conflict with existing safeguards for trust funds in the act.
  - The Congressional law enacted to approve the 1996 amendments was explicitly intended to "protect the permanent trust funds of the State of New Mexico from erosion."
  - This express purpose weighs against any theory that New Mexico now has plenary power to expend trust money without seeking Congressional approval.

- The most prudent course is to seek Congressional approval, by requiring that any joint resolution proposing to alter current distribution rates be made contingent upon approval of the US Congress.

<u>Technical Issues</u>:

According to the FIR:

- HJR 10 calls for the additional distributions to "implement and maintain educational reforms as provided by law." While the LGPF is often referred as the "Permanent School Fund," it is not entirely composed of educational interests.
- More than 16 percent of the LGPF annual distributions go to beneficiaries outside the scope of "common schools," including:

  - 5.9 percent to state universities[5];
  - 3.8 percent to specialty schools[6];
  - 1.3 percent for hospitals; and
  - 5.4 percent for other LGPF beneficiaries[7].

- It is unclear how these beneficiaries would use the additional distributions to "implement and maintain educational reforms as provided by law."

[5] University of New Mexico, New Mexico State University, Eastern New Mexico University, Western New Mexico University, New Mexico Tech, Northern New Mexico School, and New Mexico Highlands University.

[6] New Mexico Military Institute, New Mexico School for the Visually Handicapped, and New Mexico School for the Deaf.

[7] Includes public buildings, the state penitentiary, and water needs.

SLO raises similar concerns, noting that, assuming that the intent of HJR 10 is to fund educational reforms from the Permanent School Fund only, and not the parts of the LGPF held in trust to support other purposes such as universities and state prisons, the proposed resolution should be amended to state either that the 0.8 percent distribution is limited to the Permanent School Fund, or that the part of the 0.8 percent distribution used to fund educations reforms is limited to the Permanent School Fund.

Background:

According to the SIC:

- In 2003, the permanent funds were treated as "rainy day funds" to accommodate a political push to increase distributions from the LGPF.
- The SIC, under guidance of the previous investment officer, pushed the LGPF return target from 8.0 percent to 8.5 percent, and put strong emphasis on a greater percentage of stock market bets and other highly volatile investments. The results, combined with the fiscal crisis in 2008 and 2009, were not beneficial to the funds. FY 09 third quarter LGPF returns were among the worst in the country, bottom quartile against our peers for one-, three-, and five-year time periods, and 10-year returns ranked New Mexico last among public funds over $1.0 billion.
- The current SIC, after restructuring by the Legislature in 2010, has taken a risk-adverse investment approach, resulting in top third performance against our peers for nine of the last 11 quarters. The LGPF returns are likely to place us in the top 25 percent for both one- and three-year periods.
- Despite strong recent returns, the permanent funds remain hundreds of millions below the high water mark for assets set in 2007.
- An examination of top endowment funds at universities across the country indicated that few have annual disbursements of more than 6.0 percent of, usually based on some rolling average of previous years' values.

During the 2011 interim LESC hearing on the LGPF, New Mexico Voices for Children (Voices) and St. Joseph Community Health (SJCH) presented the results of a study conducted by Research and Polling, Inc. to measure public opinion regarding early childhood development programs in New Mexico[8]. The results of the poll indicated both widespread concern for the state of early childhood education in New Mexico, and support for increasing state funding to support early childhood education programs, including a constitutional amendment to increase distribution from the LGPF:

- 80 percent of survey respondents indicated they wanted investment for these programs to be placed on an election ballot;
- 58 percent of the respondents felt that the state is doing too little to support early childhood education;
- 54 percent of respondents indicated "strong support" for greater funding of these programs;
- 76 percent indicated that they were not aware of the fund prior to the survey;

[8] *St. Joseph Community Health Early Childhood Survey, October 2011*. The survey included a random telephone interview of 603 adult New Mexico residents, with a ± 4.0 percent margin of error.

- 71 percent indicated that they were not aware that the fund balance was greater than $10.0 billion; and
- 57 percent strongly supported a proposal to distribute an additional 1.5 percent of the fund to early childhood education, while 14 percent opposed it.

During the hearing, a committee member stated that, while the survey respondents indicate support for early childhood education, the survey questions did not address the effect on the fund, primarily the impact to the beneficiaries of the fund. In response, SJCH indicated that they were only presenting the summary of the survey results, and that the full survey report addressed the fund's growth and investments. However, upon review of the full survey, LESC staff did not find any reference to potential effects upon either the corpus of the fund, or the fund's designated beneficiaries.

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 State Land Office 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; and
- 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.

As noted above, 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.

At that time, the increased distribution was considered conservative, and was not expected to erode the corpus of the fund[9].

This table 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

[9] *CONSTITUTIONAL AMENDMENTS PROPOSED BY THE LEGISLATURE IN 2003, 0.03 APPEARING ON THE SEPTEMBER 23, 2003 SPECIAL ELECTION BALLOT, Brief Analysis and Arguments For And Against*, New Mexico Legislative Council Service, June 2003.

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

Institutions	**Percentage LGPF ownership**
Common Schools	83.20
NMMI	3.38
NM School for the Deaf	2.07
School for the 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 and Reform	0.91
NMSU	0.50
Improve Rio Grande	0.27
NM State Hospital	0.24
NM Inst. Mining and Technology	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
Total	**100.00**

Committee Referrals:

HVEC/HAFC/SFC

Related Bills:

HB 35 *Use of Funds by Land Grant Council*
SJR 1 *Land Grant Permanent Fund Changes, CA*
SJR 3aa *Land Grant Fund Balance & Distribution, CA*