F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 02/13/13
SPONSOR Taylor **LAST UPDATED** ______ **HB** 341

SHORT TITLE No Tobacco Settlement Fund As Reserve Fund **SB** ______

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**		
	NFI but impacts reserve levels			

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB113, SM22, SB 392, and SB 293. Conflicts with HB 412

SOURCES OF INFORMATION
LFC Files

Responses Received From
Department of Finance and Administration (DFA)
Attorney General's Office (AGO)
State Investment Council (SIC)
Department of Health (DOH)
State Treasurer's Office (STO)

SUMMARY

Synopsis of Bill

House bill 341 amends section 6-4-9 NMSA 1978 to provide that the tobacco settlement permanent fund shall not be considered a reserve fund of the state and therefore cannot be expended in the event that general fund balances will not meet the level of appropriations authorized from the general fund for the fiscal year. Further, the TSPF shall not be included in any estimate or document compiled by the state's professional economists that provides an estimate of state reserves available for expenditure from the general fund.

FISCAL IMPLICATIONS

If the TSPF is no longer included in the reserves, then reserves will decline by about 3 percent. Per the general fund financial summary released in Volume I of the January 2013 LFC budget documents, FY13 ending balances are projected at $653 or 11.6 percent of recurring appropriations. The TSPF ending balance will be $160 million. If the tobacco settlement permanent fund is removed from the reserve fund then reserves will be reduced to $494 or 8.7 percent or recurring appropriations.

SIGNIFICANT ISSUES

Revenues left at the end of the fiscal year are transferred to the operating reserve. If revenues come up short, the governor may transfer money from the operating reserve to cover authorized expenses. The amount the governor can transfer is capped by the Legislature each year in the General Appropriation Act. Once the operating reserve fund hits 8 percent of the prior budget year's recurring appropriations, the excess must be transferred to the tax stabilization reserve by law.

The tobacco settlement permanent fund was created to hold payments to New Mexico from cigarette companies under the master settlement agreement of 1998. Under the enabling legislation, the settlement payments are split, with half going to the permanent fund and half spent directly on health and education programs. However, during economic hard times, the Legislature has temporarily suspended deposits into the permanent fund and put the entire amount into direct spending.

Money in the tobacco settlement permanent fund is invested by the State Investment Council and interest is credited to the fund. The Legislature may authorize spending from the fund for a budget shortfall only after balances in all other reserve accounts have been exhausted.

DFA and STO have reported that, credit rating agencies Moody's and Standard & Poor's have consistently expressed concerns related to the State's general fund reserve levels. Generally, the rating agencies like to see New Mexico's reserves at or above 10 percent -- reflecting in part their concern about New Mexico's dependence on volatile oil and natural gas revenues. If reserves fall below 5 percent at any point the State will likely be reviewed for downgrade of the ratings on its General Obligation Bonds, and potentially its Severance Tax Bonds. While reserves are not projected to decline in future years, past experience is that from time to time revenues fall far short of estimates and reserves are utilized. In FY10, general fund reserves reached their lowest level in recent history at 5.2 percent, including the tobacco settlement permanent fund balance of $132 million. Without inclusion of the tobacco settlement permanent fund balance, reserves would have been 2.7 percent. At that time, policymakers would likely have needed to consider whether to further reduce State expenditures, increase taxes, or risk downgrade by credit rating agencies.

Given these concerns, it is important to note that this proposal will not have the effect of creating an additional permanent fund, similar to the Severance Tax Permanent Fund and the Land Grant Permanent Fund. Distributions from the STPF and LGPF are protected by the New Mexico Constitution, but the tobacco settlement permanent fund would not have such protections. Future legislatures could still appropriate directly from the tobacco settlement permanent fund simply by enacting new legislation.
Per SIC, since inception in 2000, the TSPF has never been deployed as a reserve fund to address appropriation shortfall, but the possibility has existed and still exists today.

From the SIC's perspective, this bill would allow additional flexibility in prudently managing the

TSPF as a true 'permanent fund', creating additional long-term investment opportunities, and improving portfolio diversification. By allowing the TSPF to invest in assets or funds requiring a longer-term commitment like private equity, real estate, real return and similar strategies, the TSPF would benefit from the illiquidity premium and potentially greater returns inherent in these private investment vehicles.

Based on current asset allocation and return projections, the SIC expects the TSPF to return about 6.25 percent annually, while the STPF and LGPF are targeting 7.5 percent annually on a long term basis. SIC reports that if invested as STPF and LGPF are the additional return to the TSPF could be as high as $2 million per year.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Relates to SB113, which would make a distribution from the Tobacco Settlement Permanent Fund to the Tobacco Settlement Program Fund in FY14 through FY18 for early childhood care and education programs administered by the Children, Youth and Families Department (CYFD).

Relates to SM22, which proposes to create a task force to study the relationship between tobacco use and employer costs, including the impacts on organizations that employ tobacco users.

Relates to SB 392 Lottery Tuition Fund distributions, provides 25 percent additional annual settlement inflows to Lottery Scholarship permanently.

Conflicts with HB412, reducing reserves by making a transfer from the general fund operating reserve to the tobacco settlement permanent fund.

SB293 provides Lottery Tuition Fund Distributions and would transfer 25 percent of the distribution to the TSPF to the lottery tuition fund (~$10 million) beginning in FY14.

TECHNICAL ISSUES

According to STO, disclosure of the impact of the proposed legislation will probably need to be included in the state's general obligation bond offering document which is in the process of being finalized at this time. Disclosure of the impact of the proposed legislation will probably need to be included in the discussion of the state's general obligation bond rating with the bond rating agencies.

If adopted, changes in the state's credit structure would need to be disclosed to the bond community through a revised filing of the state's annual information filing.

OTHER SUBSTANTIVE ISSUES

The TSPF is slated to receive 50 percent of the tobacco settlement in-flows for FY13. This would be the first time since FY08 the TSPF will receive "new" money.

As reported by DOH, the Tobacco Master Settlement Agreement (MSA) is intended to compensate states for the economic burden that tobacco use creates, and to lessen this burden by reducing tobacco use. Estimated annual smoking costs in New Mexico are $954 million ($461 million for direct medical costs and $493 million for lost productivity. Tobacco use is the single most preventable cause of death in the United States. Each year in the United States, cigarette smoking and exposure to secondhand smoke causes 443,000 (or, 1 in 5) deaths. Smoking-caused diseases result annually in $96 billion in health care costs.

Since its inception in 1998, the MSA payments from tobacco manufacturers have been allocated into the TSPF, from which 50 percent was intended to be distributed into the Tobacco Settlement Program Fund. The Tobacco Settlement Permanent Fund was established for long-term support of the Tobacco Settlement Program Fund in New Mexico, as the MSA payments from participating tobacco manufacturers decrease and eventually will end altogether. At that time, the Tobacco Settlement Permanent Fund would become the only source of perpetual MSA funding available to the programs that rely on these revenues. Allowing for additional growth of the Tobacco Settlement Permanent Fund would sustain tobacco-related and other health programs for future years.

Some states have significantly improved the health of their citizens by reducing smoking rates, thereby decreasing smoking-related diseases, deaths, and health care costs. Even in economically challenging times, states can make a significant difference in public health by employing high-impact, cost-effective tobacco control and prevention strategies.

Data from the Behavioral Risk Factor Surveillance System (BRFSS) indicates that the following groups smoke at significantly higher rates than the general population: NM adults who are lesbian, gay or bisexual; uninsured; low income (less than $20,000/year household income); unemployed; low educational attainment (no high school diploma); African American; Asian or Pacific Islander; and individuals 18 to 24 years old. (TUPAC 2013 Fact Sheet)

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The Tobacco Permanent Settlement Fund would continue to be available as a reserve fund.

EWM/blm