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

		ORIGINAL DATE	02/13/13		
SPONSOR	SFC	**LAST UPDATED**	03/15/13	**HB**	
SHORT TITLE	Tobacco Fund for CYFD Programs			**SB**	113 & CS/392/SFCS/aSJC
				ANALYST	van Moorsel/Geisler/EWM

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**		
	($9,875.0)	0.0	Nonrecurring	Tobacco Settlement Permanent Fund
	$9,875.0	0.0	Nonrecurring	Lottery Tuition Fund
	($40,000.0)	0.0	Nonrecurring	General Fund Operating Reserve
	$40,000.0	0.0	Nonrecurring	Tobacco Settlement Permanent Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to:

- HB 2 - General Appropriation Act of 2013
- HB 27 - Expanding Lottery Scholarship Eligibility
- HB 28 - Lottery Scholarships at Tribal Colleges
- HB 309 - Lottery Scholarship Program Solvency
- HB 341 - No Tobacco Settlement Fund as Reserve Fund.
- HB 412 - General Fund Dollars to Tobacco Fund
- SM 22, SB 392

SOURCES OF INFORMATION

LFC Files

Responses Received From
State Investment Council (SIC)
New Mexico Lottery Authority (NMLA)
Children, Youth and Families Department (CYFD)

SUMMARY

Synopsis of HJC Amendment

The House Judiciary Committee Amendment to Substitute Senate Bill 113 and SB 392 removes the 25 percent distribution and the $9,750,000 appropriation to early childhood education.

The bill also adds a section to transfer $40 million from the general fund operating reserve to the tobacco settlement permanent fund (TSPF). This transfer represents a restoration of funds diverted from the tobacco settlement permanent fund to meet state fiscal solvency requirements.

Synopsis of Substitute Bill

The Senate Finance Committee substitute for Senate Bill 113 and the Senate Education Committee substitute for Senate Bill 392 transfers revenue intended for investment in the Tobacco Settlement Permanent fund to support the lottery scholarship program and early childhood education. The bill amends current law and provides for a distribution to increase the distributions to the lottery tuition fund. The bill provides that, beginning in FY14, 25 percent of the distribution to the tobacco settlement permanent fund be distributed from that fund to the lottery tuition fund. In addition, the bill provides for a 25 percent distribution from the Tobacco Settlement Permanent fund to the Tobacco Settlement Program fund for direct services provided by early childhood care and education programs administered by the Children, Youth and Families Department (CYFD).

The effective date of this legislation is July 1, 2013.

FISCAL IMPLICATIONS

HJC amended bill: The bill removes the appropriation for early childhood programs at the CYFD.

This amendment also transfers $40 million from the general fund operating reserve to the tobacco settlement permanent fund. Given current spending level in HB2 balances of operating reserve estimated around $200 million. Balance of TSPF is estimated at about $180 million.

According to the State Investment Council (SIC), the $40 million would be managed as the Tobacco Fund is currently, in highly liquid, primarily public investments. The TSPF is managed this way because as a reserve fund, it could still be accessed legislatively to address annual state budgetary shortfalls, and requires liquidity for potential disbursement. The TSPF's valuation has no fiscal impact to other funds, as it does not make annual distributions from the corpus.

Original substitute bill: This bill will continue the legislative practice of diverting tobacco settlement funds from long-term investment in the Tobacco Settlement Permanent Fund in order to spend it on current program needs. Absent this legislation, fifty percent of the $39.5 million projected settlement from the tobacco manufacturers for FY 14 would remain in the permanent fund for investment.

Historically the annual tobacco settlement payment has averaged $40 million, and is estimated to be $39.5 million in FY14. Thus, the transfer to the lottery tuition fund of 25 percent of the distribution to the tobacco settlement permanent fund would generate approximately $10 million per year. Similarly, the transfer to the tobacco settlement program fund would generate roughly the same amount.

The bill would create three additional revenue sources for the lottery tuition fund, which currently receives revenue generated by the New Mexico Lottery Authority. The bill transfers funds from the Tobacco Settlement Permanent Fund, transfers withholding tax on lottery winnings, and establishes criteria for the transfer of funds from the general fund operating reserve.

Current law provides that, beginning in FY07, 50 percent of the annual transfer to tobacco settlement permanent fund be transferred to the tobacco settlement program fund. In FY09-FY13, the remaining 50 percent is also transferred to the tobacco settlement program fund. The transfer provided for in the bill would take effect in the fiscal year after the expiration of the additional 50 percent transfer to the program fund.

For FY15 (academic year 2014-15) and without any action by the executive or legislative branches, either fall and spring awards would be capped at lottery revenues or an estimated $40 million annually (compared with approximately $60 million in scholarship need projected for FY13).

The bill would increase revenue to the lottery tuition fund by approximately $10 million per year. Although the additional revenue would decrease the current revenue shortfall, it would not be sufficient to keep pace with increasing expenditures. Barring program changes that would reduce expenditures, the HED would be required to reduce award amounts beginning in FY15.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity because it would reduce revenue to the general fund. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

The bill contains an appropriation for early childhood programs at the CYFD. In Fiscal Year 2014, the appropriation contained in SB 113 is $9.75 million allocated as follows:

(1) Two million dollars ($2,000,000) for reimbursement of licensed child care providers that the department has determined meet one of the top three levels of a tiered quality rating and improvement system (TQRIS) that includes educational components;
(2) Five million seven hundred fifty thousand dollars ($5,750,000) for pre-kindergarten; and
(3) Two million dollars ($2,000,000) for home visiting programs

Any unexpended or unencumbered balance remaining at the end of fiscal year 2014 shall revert to the tobacco settlement program fund. The CYFD notes that the distribution proposed by SB 113 is not part of the CYFD's request and is not part of the executive recommendation and that following FY18, the CYFD would have to seek alternative revenue to continue supporting the expansions supported by the distributions.

SIGNIFICANT ISSES

TSPF: 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 SIC 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.

<u>Impact on Lottery Scholarship program</u>

The legislative lottery scholarship program is the state's largest aid program, rewarding high school academic performance and sustained progress in college. Program costs have increased due to slightly rising student eligibility and demand and steadily increasing tuition levels. Passed during the 2012 legislative session, HJM 14 called for a legislative and executive task force to address the projected loss of lottery fund balance and relatively flat lottery revenues. The task force did not meet, though the department and legislative staff have examined possible solutions to address solvency and align the scholarship program with other state college completion goals. NMAC 5.7.20.10 states that "the amount of the award may vary dependent upon the amount of funds received from the lottery tuition fund and the number of eligible recipients. Scholarships shall only apply to tuition costs." The rule requires that HED, in May of each year, notify eligible postsecondary institutions of the percentage of tuition each scholarship will provide.

For FY14 (academic year 2013-14), the LFC projects fall 2013 semester awards can be met fully with incoming lottery revenues and remaining fund balance, but it is unlikely spring 2014 awards can be met fully. The projected annual shortfall is an estimated $5 million. By law, the department will announce the award amount for FY14 by May 2013, and the announcement might address the shortfall. For FY14, the Legislature could condition a supplemental appropriation of nonrecurring funding for this amount on a program review and the development of a solvency plan by the start of the 2014 legislative session.

During the last two legislative sessions, the Legislative Education Study Committee (LESC) and the LFC have held many hearings on the legislative lottery scholarship program, options for improving program solvency, and the impacts of possible options on the recipient pool. The scholarship program is merit-based and does not consider an eligible student's financial need, though some scholarship recipients receive additional federal, state, institutional, or other merit-based and need-based aid to meet college costs. The Legislature, the HED, institutions, and others have considered program changes such as raising eligibility requirements, including higher grade point averages, heavier semester courseloads, and means-testing; reducing the maximum number of scholarship semesters; and reducing the scholarship amount. Most of these options reduce the pool of eligible students, particularly disadvantaged students.

<u>Early Childhood Services has been removed from the amended bill:</u>

<u>Impact of Bill on Tobacco Settlement Permanent Fund</u>

The State Investment Council (SIC) has the statutory responsibility to invest the corpus of the permanent fund. The Tobacco Settlement Permanent Fund, even with no new contributions over the past five years, has experienced slow growth over that time and today stands at $158.1 million.

The SIC notes that the 50/50 split has not occurred for the past several years and that due to legislative action the Tobacco Settlement Permanent in effect has received no in-flows since 2008. The result of previous legislative action led to 100 percent of settlement revenue, or $167.8 million, going to health/anti-tobacco programs in fiscal years 2009, 2010, 2011, 2012.

Assuming the 6.28 percent long-term return for the TSPF for fiscal years FY14-FY18, and a combined average of $20M less per year flowing into the TSPF (50 percent of the $40M historic average Tobacco Settlement contribution) during those five years, the SIC projects an overall cumulative impact of $120.15 million dollars on the TSPF over the 5-year compounding life of the appropriation directed by SB 392/113.

SIC Estimate of Loss of Potential Earnings to Permanent Fund Due to SB 113		
FY	$M	Cumulative impact ($M)
2014	$19.75	$20.99
2015	$20.00	$43.56
2016	$20.00	$67.56
2017	$20.00	$93.05
2018	$20.00	$120.15
Return assumption 6.28%		

To establish itself as a self-sustaining permanent fund that could operate and distribute funds based on the size of its corpus and investment returns (e.g. with a 4.7 percent distribution like the STPF), the Tobacco Settlement Permanent Fund would need to grow to approximately $850 million dollars.

Enabling this type of growth, while not impossible, is challenging when new contributions to the fund are limited as they have been. Since inception (FY00-FY12), $532.7 million has been contributed to NM through the Tobacco Settlement Master Agreement, but the vast majority, $427.6 million of that has been diverted for general fund use.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The General Appropriation Act appropriates revenues and fund balance from the lottery tuition fund for lottery scholarships. For FY14, the LFC recommendation included $60.2 million for lottery scholarships; this amount is based on FY12 actual scholarship expenses and an average 2012-13 tuition increase of 4 percent.

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 FY 2008 the TSPF will receive “new” money.

PvM/svb:blm