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

ORIGINAL DATE 02/20/14
SPONSOR Maestas & Keller **LAST UPDATED** **HJR** 16

SHORT TITLE Land Grant Fund Care & Investments, CA **SJR**

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
See "Fiscal Implications," below						

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY14	FY15	FY16	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$46.0		$46.0	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Similar to SJR 4 – Land Grant Fund Care & Investments, CA

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)

SUMMARY

Synopsis of Bill

House Joint Resolution 16 proposes an amendment to Article, XII, Section 7 of the Constitution of New Mexico, to require the State Investment Council invest and manage the land grant permanent fund (LGPF) in accordance with the Uniform Prudent Investor Act. The proposed amendment would also strike the provision that no more than 15 percent of the book value of the fund may be invested in international securities at any one time.

The amendment proposed in the joint resolution provides that the additional 0.5 percent distributions from the LGPF for educational reforms would not be made from the LGPF if the five-year average of the year-end market value of the fund is less than $10 billion.

The amendment proposed by this resolution shall be submitted to the people for their approval or rejection at the next general election or at any special election prior to that date that may be called for that purpose.

FISCAL IMPLICATIONS

The approximate cost per constitutional amendment is $46 thousand. The costs include publishing the amendments in newspapers statewide, publishing the voter guide, and recording and broadcasting the constitutional amendments in Native American languages on radio.

The fiscal impact of HJR 16 is indeterminate, as it would depend on any change in portfolio allocation and the investment performance in those asset classes whose allocation would be changed pursuant to removal of the international cap. The SIC notes not amending the constitution would impact the prudent investment of the funds, citing as an example the fact that a one percent outperformance on a billion dollars equals $10,000,000 in annual value. In the last ten years (as of 11/30/13) the Russell 3000 Index has produced annualized returns of 8.09 percent; the international MSCI Emerging Market Index produced annualized returns of 12.11 percent. The SIC had US equity exposure of more than $6.7 billion, compared with the capped international allocation of $2.6 billion. Had this restriction not been in place, even a slight shift in allocation, which would put SIC closer to its institutional peers, would potentially have significantly to the returns on investment of the LGPF over that period.

Increases in investment returns would help to support high LGPF market values, and would subsequently contribute to higher distributions from that fund to its beneficiaries, including the general fund. The LGPF distribution is a significant general fund revenue source, estimated to be nearly $490 million in FY15.

SIGNIFICANT ISSUES

A similar Senate Joint Resolution was endorsed by the Investments and Pensions Oversight Committee.

The SIC notes current statute places a higher standard of care (Uniform Prudent Investment Act) on fund management than does the constitution (businessmen of ordinary prudence). This joint resolution seeks to address this conflict, and to allow the State Investment Officer and the SIC, as fiduciaries to the LGPF, to carry out their required duties.

The primary investment change being sought in this amendment allows the SIC, as fiduciaries and investment experts, to invest the LGPF in international investments at an appropriate level of risk and reward to meet the long term return goals of the fund. The SIC is currently restricted by the current 15 percent cap on international equities, and SIC notes it has had to structure the portfolio accordingly, sometimes in a non-optimal manner.

The SIC provides the following points for consideration:

- Since restructuring by the Legislature in 2010 to remove undue political influence from the SIC, the council and its 11 members have been a balanced, thoughtful and engaged organization, comprised of three elected officials, four Governor's appointees and four legislative appointees. These members are charged with guiding and protecting the second largest sovereign wealth fund in the country, and all take their fiduciary duty seriously.
- From a macro-economic point of view, since the international cap was previously put in place the investment markets have changed, and a "global economy" has emerged.
- More than half of investment opportunity is now found in global equity overseas.
- Most of the world's Gross Domestic Product is generated internationally.
- The best economic growth rates are available outside the US, in rapidly growing and emerging economies. That economic growth is the "raw material" of investment returns.
- Foreign market investment opportunities exist in fixed income, real estate and private equity (each of these an asset class the SIC currently invests in) in increasing amounts with competitive, and often better, expected returns than in the US.
- By prudency as well as statute, the SIC is required to diversify its investments, and since the Council has reached its 15 percent international cap, the constitution restricts the SIC's fulfillment of prudent investment standards. Diversification of assets is a critical component of risk control in portfolio construction and the LGPF portfolio could be better diversified with increased access to the international investment markets.
- SIC lags most peer funds in this regard, with the majority of institutional investors allocating more than 15 percent of their portfolios internationally. As of the third quarter 2013, PERA had structured its portfolio with more than 24 percent, while ERB's exposure was 16 percent. Both also have significant exposure to global fixed income securities and other global investment strategies. Neither fund has a constitutional or statutory cap like the SIC.

PERFORMANCE IMPLICATIONS

The SIC adds that, although direct impact of removing the international investment cap from the LGPF is indeterminate, failure to remove the cap could result in limited or depressed investment returns for the LGPF over time, especially during times of economic growth and market expansion. Today and during the recent decade, many institutional investors have targeted international allocations upward of 20 percent, and for the most part they have been rewarded for this strategy. The following annualized return numbers are based on 11/30/13 reporting, and compare benchmark indexes for the Russell 3000, MSCI International Developed and MSCI International Emerging stock indexes.

While international markets are more volatile in the short term, over the last decade, they may have provided greater returns to investors.

	1-Year	3-Year	5-Year	10-Year
Russell 3000 Index	31.71	17.79	18.54	8.09
MSCI EAFE Index (Intl Dev)	24.84	10.46	13.42	7.56
MSCI Emg Mkts Index (Intl)	3.66	.70	16.87	12.11

ADMINISTRATIVE IMPLICATIONS

SIC reports, pending approval by voters in the next general election that it would explore whether additional international investments were appropriate at that time, to meet the long-term investment goals of the LGPF. The Council would not be bound by any mandate to invest additional capital overseas, but would act solely on the prudence of the market opportunity at the time.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

PvM/jl