LFC Requester:	Klundt

AGENCY BILL ANALYSIS - 2025 REGULAR SESSION

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SECTION I: GENERAL INFORMATION

{Indicate if analysis is on an original bill, amendment, substitute or a correction of a previous bill}

Date Prepared: *Feb 12, 2025*
Bill Number: *HB7*

Check all that apply:
Original x_ Correction __
Amendment __ Substitute __

Sponsor: Rep. Serrato, Speaker Martinez

Agency Name and Code Number: 337-State Investment Council

Person Writing Iglesias/Wollmann

Short Title: Children's Future Act & Fund

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SECTION II: FISCAL IMPACT

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY25	FY26		
	($5,000.0)	NR	General Fund
	$5,000.0	NR	Children's Future Fund / DFA

(Parenthesis ( ) indicate expenditure decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY25	FY26	FY27	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	This bill will likely require additional staff, particularly for non-investment policy-related functions, as well as additional time from existing staff (*see administrative implications*)				NR/R	SIC (LGPF/STPF)

<u>SECTION III: NARRATIVE</u>

BILL SUMMARY

<u>Synopsis:</u>

HB7 seeks to create a Children's Future Act ("the Act") and Children's Future Fund ("CFF") to invest in New Mexico-born children upon birth to create financial resources those beneficiaries can use later in life in pursuit of education, housing, business, retirement and investment opportunities, under rules to be developed by a Children's Future Task Force ("Task Force") and recommended to the governor and legislature by December 31, 2025.

The bill appropriates $5 million from the general fund to the CFF in FY26.

The CFF is to be managed by the State Investment Officer (SIO) pursuant to the Uniform Prudent Investor Act and in consultation with the secretary of the Department of Finance and Administration (DFA).

The bill requires 2/3 of any appropriation to the CFF to be invested by the SIO for 18 years, then that 2/3 and any associated investment earnings is to be invested by the State Treasurer. *[Note, the bill does not make a transfer of funds from the State Investment Council to the State Treasurer, requiring separate investment responsibilities within the same single fund – see Significant Issues*] The remaining 1/3 of any appropriation to the CFF is to be invested by the SIO.

The bill appropriates the entirety of the fund to DFA for the purposes of the Act, who will also administer the fund, with administrative costs limited to no more than 3% of the fund balance each year.

Anyone receiving, collecting, disbursing, expending or investing money from the CFF for a beneficiary shall be deemed a fiduciary, with all the responsibilities entailed in that designation. Beneficiaries are defined as any person born in New Mexico on or after January 1, 2025 and whose primary residence since birth is continuously in New Mexico. Additionally, the bill specifies the purpose of the CFF is to assist beneficiaries who graduate from a New Mexico high school.

Monies transferred to, or spent on behalf of, a beneficiary are to be exempt from state taxation.

The Task Force created by the bill would be in operation until December 31, 2025, for purposes of studying and creating optimal structures for the CFF. The bill requires the State Investment Council to staff and provide administrative support for the Task Force.

The Task Force is to be comprised of a representative from the state investment council to serve as chair, a representative from the state treasurer's office to serve as vice-chair, one representative from DFA, one member appointed by the governor and four public members to be appointed singularly each by the president pro tem of the senate, the senate minority leader, the speaker of the house of representatives, and the house minority floor leader. Public members of the Task Force shall include two members with a minimum of five-years professional investment or financial experience and two members who represent community-based organizations focused on family financial and economic well-being.

Task Force members shall meet at least once per month as directed by the chair or 2/5 of the Task Force's membership, and members are to receive reimbursement pursuant to the Per Diem and Mileage Act.

The Task Force is to research and produce a report including recommendations for implementing the Act, including design and administration of the program, a financial plan for financing and implementing the Act within five years, eligibility requirements for beneficiaries including a process to certify that eligibility, guidelines for application processes and time periods beneficiaries may use their CFF, as well as conditions on how the monies may transition to investment or retirement accounts.

The Task Force's report would also identify third parties with whom to contract and assist in administration of provisions of the Act, develop measures to ensure equity for beneficiaries born in different years, and other matters as determined by the Task Force.

Additionally, the Task Force's report shall include advice and recommendations regarding investment risk and asset allocation of the CFF.

The Task Force is to have members appointed by July 1, 2025, and shall function from that date for six months, through December 31, 2025.

FISCAL IMPLICATIONS

This bill appropriates $5 million from the general fund to the Children's Future Fund in FY26.

Growth of the CFF's value over first 18 years would be dependent on the performance of the investments and the returns they deliver. A $5 million investment returning 4% per year would take a full 18 years to double in size. A 7% average annual return would double the amount in just over 10 ¼ years.

The bill appropriates the entirety of the balance of the fund to DFA for the purposes of the Act, and the bill allows DFA to expend up to 3% of the fund balance for administrative costs, which would be $150 thousand in FY26. *[see Technical Issues]*

While the bill requires SIC to staff and provide administrative support for the Task Force, the bill does not make any appropriation to the State Investment Council for administrative costs. *[see Administrative Implications]*

SIGNIFICANT ISSUES

Expenditure Funds vs. Trust Funds

Unlike other trust funds under the State Investment Council's management, this bill does not create a separate program/expenditure fund to which the trust fund could make distributions. Instead, the entirety of the fund is appropriated to DFA and expenditures would be made directly from the CFF.

Distributions from the trust funds the SIC invests typically occur once per year, and no other trust fund under SIC's management is a direct expenditure fund used for operational expenses.

Infrequent and predicable distributions enables the SIC to invest in certain private asset classes (such as private equity, real estate, etc.) that can earn return premiums due in part to their illiquid nature – those dollars may be “locked up” for long periods of time, generally several years, and getting cash out of those allocations can be very expensive (e.g. forced selling at extreme discounts to market value). Expenditure funds, on the other hand, often have greater liquidity needs and irregular withdrawals, which would limit the types of assets in which SIC can invest those funds, and the similarly could lower expected rates of return or the heightening of risk to achieve target goals.

SIC staff recommend the bill be restructured to create two separate and distinct funds – one to act as a trust fund with a long-term investment horizon, and a separate expenditure fund that could be appropriated to DFA for administration of the Children’s Future Act.

Splitting Investment of a Single Fund between SIC and the State Treasurer’s Office (STO)

The bill requires 2/3 of any appropriation to the CFF to be invested by SIC for 18 years, then that 2/3 and any associated investment earnings is to be invested by the State Treasurer. However, the bill does not make a transfer of funds from the State Investment Council to the State Treasurer. Instead, it gives SIC and STO separate investment responsibilities within the same fund.

This setup may not be technically possible, given the nature of how funds are created within the treasury system and with our custodian bank.

Presumably, the purpose of this distinction between what SIC will manage versus what STO will manage is that, once the invested funds will need to be accessed after 18 years, they can be managed predominantly in more liquid, lower risk assets by the State Treasurer.

Again, SIC staff recommend the bill be restructured to create two separate and distinct funds such that distributions can be made from a trust fund invested by the SIC to an expenditure fund invested by STO and administered by DFA.

Splitting Investment of Individual Appropriations/Transfers

Because the bill splits the investment responsibility of individual appropriations or transfers into the CFF, the initial $5 million appropriation contemplated in this bill would have to be tracked and managed differently than any future appropriations to the fund, which would create significant administrative complexity.

Asset Allocation Decisions Driven by the Task Force

SIC invests a dozen different funds for the state of New Mexico, many with different purposes, liquidity needs, investment horizons, and risk/return profiles. The majority of those funds are invested prudently, in a manner strategically determined by the Council, or in some cases in collaboration or with additional guidance from the primary beneficiary of the fund. In the end, however, those funds and how they achieve their returns to meet long-term goals are determined by the State Investment Officer and SIC’s investment professionals, as guided by the Council’s fiduciary board.

Other third-party funds that are invested by the SIC – more than $2B in governmental client funds – are self-directed by the clients themselves (ideally in tandem with fiduciary advisors) and then invested across a menu of investment pool options.

As proposed by this bill, the structure of the CFF would seem to be most similar to the SIC client funds, as the Council would not be responsible for determining the investment allocation for the CFF. Instead, the Task Force would potentially dictate risk levels, asset allocation and even investment strategies. Given the utmost importance of asset allocation in determining both short and long-term investment outcomes, this is potentially problematic for the SIC.

If the desire is for the Task Force to determine the CFF's long-term strategic asset allocation, and not the SIC, it is recommended the fund be invested with SIC as a client fund through a joint powers agreement, rather than placing the fund directly under SIC's investment management.

Six Month Project Period

The bill requires the Task Force to produce a full report complete with policy and procedural recommendations for the Children's Future Act during the six-month period from July 2025 to December 31, 2025, which may not be enough time for the Task Force to develop all facets of the program envisioned by the Act.

ADMINISTRATIVE IMPLICATIONS

SIC Providing Staff and Administrative Support to the Task Force

While the bill provides DFA with funding for administrative costs, the bill places the responsibility of staffing and providing administrative support for the Task Force on the SIC.

The Task Force consists of 8 appointed, uncompensated members required to meet at least once per month between July and December 2025.

During this 6 month period, the Task Force is responsible for researching and producing a full report with policy recommendations on the design of the Children's Future Act programs, a financial plan for implementing the Act and gathering data on the efficacy of baby bonds, eligibility requirements and application processes, conditions and limitations on use of the funds, measures of fairness and equity for beneficiaries, and other policy matters.

Requiring SIC to staff the Task Force would likely create significant administrative burdens related to creating the required report – including conducting policy research, gathering data, writing policy documents and administrative rules, drafting financial plans, and designing application processes.

SIC is currently staffed with investment professionals, investment accountants, legal staff, and administrative staff. However, SIC does not currently have staff that are well-versed in this type of policy and procedural design. Therefore, SIC would need likely to hire additional qualified people to staff the Task Force during the 6 month project period.

Notably, the SIC's budget is funded by the Land Grant Permanent Fund and Severance Tax Permanent Fund, and it is unclear whether SIC can use the permanent funds to hire staff to support the Children's Future Task Force.

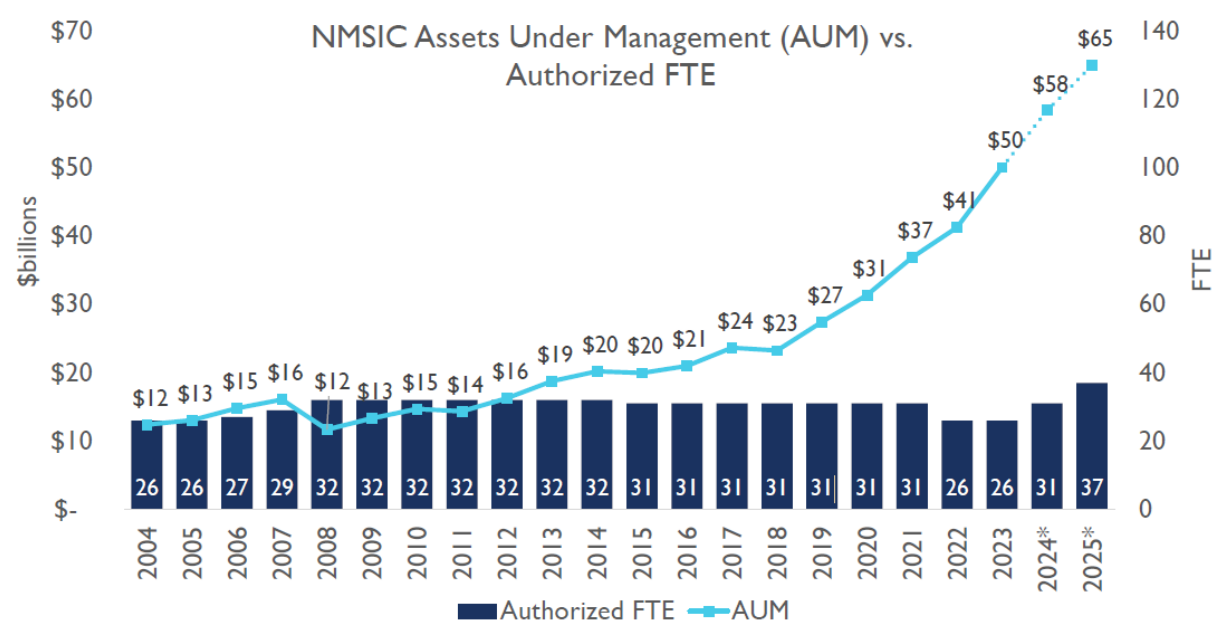
Investment Management of New Funds

The creation of a new fund for SIC management will require additional time from investment, accounting, and administrative staff at the SIC. The SIC's budget is funded out of the land grant and severance tax permanent funds and does not receive general fund support.

Historically, the SIC managed 4 permanent funds (the land grant permanent fund, severance tax permanent fund, water trust fund, and tobacco settlement permanent fund). Since 2019, the Legislature placed 8 additional funds under SIC management, bringing total funds under SIC management to 12 and growing total assets under management (AUM) to over $58 billion as of December 2024 (more than double the $27.4 billion total AUM at the end of December 2019).

Growth in AUM requires increasing staff time to implement the funds' asset allocation strategies, which rely heavily on private market investments (e.g. private equity, private credit, real estate, etc.) in addition to traditional stock and bond exposures. About 30 percent of total AUM is invested in private market strategies, which seek to enhance returns and diversify exposures, and the Council's strategic asset allocations target over 50 percent private assets. Having more assets allocated to these strategies requires staff to source and diligence a growing number of new private fund commitments each year, which is a time-intensive and rigorous process.

Despite rapid growth in AUM, authorized FTE for the State Investment Office has not kept pace, as shown in the chart below. The SIC's budget request for FY26 included full funding for all 37 authorized FTE, and expert, external opinions discussed at the SIC's strategic retreat in December 2024 suggested a need to double the number of investment staff and increase the number of legal and accounting staff to facilitate increased workloads, mitigate risk and maintain proper ongoing due diligence of investments.



*Estimated AUM
Note: AUM reflects total assets under management, including all permanent endowment trust funds, reserve funds, and third party client assets. AUM reported as of calendar year end, except 2004-2007 which reflect fiscal year end balances for TSPF, WTF, and third party clients. FTE reported as of fiscal year end.
Source: NMSIC files, RVK, LFC Volume II reports

This bill is one of several bills introduced so far this session that seek to create new funds to be placed under SIC management:

- House Bill 11 seeks to create a new Paid Family Medical Leave Fund to be managed by the SIC (however, SIC noted in its fiscal impact report that this is an expenditure fund that would be best managed by the State Treasurer's Office).
- House Bill 25 creates a new Land Grant-Merced Infrastructure Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $20 million general fund appropriation.
- House Bill 113 creates a new Animal Welfare Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $10 million general fund appropriation.
- Senate Bill 1 creates a new Behavioral Health Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $1 billion general fund appropriation.
- Senate Bill 88 creates a new Medicaid Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $300 million general fund appropriation.
- Senate Bill 234 creates a new Tribal Education Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $100 million general fund appropriation.
- Senate Bill 358 creates a new Equine Welfare Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $20 million general fund appropriation.

TECHNICAL ISSUES

The bill allows DFA to expend up to 3% of the "balance of the children's future fund at the end of a fiscal year" for administrative costs. The bill appropriates $5 million to the CFF in FY26, which would be deposited on or after July 1, 2025. Therefore, the fund balance at the end of FY25 (June 30, 2025) would be $0, which would presumably mean no administrative funding would be available for FY26.

If administrative funding from the CFF is not available until FY27, the fund would be unable to support per diem and mileage for the Task Force (which is only in effect July to December 2025) or any other administrative costs incurred during the 2026 fiscal year.

OTHER SUBSTANTIVE ISSUES

The Children's Future Act and the trust fund it seeks to create for the benefit of current and future generations of New Mexicans, offers potential solutions or at least mitigating factors to help address New Mexico's long-standing challenges around poverty, access to higher education, a lack of widespread investment & business opportunities as well as options for retirement funding for many of our citizens. The broad solutions the Act contemplates in these targeted areas could be core to creating lasting opportunities for New Mexico families that can help them escape the cycle of poverty by developing generational wealth that can drastically improve many lives.

There are, however, potential structural, legal and logistical challenges around the proposal, including a permanent funding source, potential conflict with the state's anti-donation clause, and uncertain costs around the long-term administration of such a program.

ALTERNATIVES

SIC staff recommend the bill be restructured to create two separate and distinct funds – one to act as a trust fund with a long-term investment horizon, and a separate expenditure fund that could be appropriated to DFA for administration of the Children's Future Act. *[see discussion in the Significant Issues section]*