FISCAL IMPACT REPORT

		LAST UPDATED	2/20/2025
SPONSOR	Campos	**ORIGINAL DATE**	2/17/2025
SHORT TITLE	Severance Tax Permanent Fund Investments	**BILL NUMBER**	Senate Bill 162/aSTBTC
		ANALYST	Gray/Torres

REVENUE*
(dollars in thousands)

Type	FY25	FY26	FY27	FY28	FY29	Recurring or Nonrecurring	Fund Affected
STPF Interest Earnings	No fiscal impact until FY2032					Recurring	General Fund

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

Sources of Information
LFC Files

Agency Analysis Received From
State Investment Council (SIC)
Economic Development Department (EDD)
New Mexico Attorney General (NMAG)

Agency Analysis Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of STBTC Amendment to Senate Bill 162

The Senate Tax, Business and Transportation Committee amendment to Senate Bill 162 (SB162) increases the amount the State Investment Council may allocate from the severance tax permanent fund to the New Mexico Private Equity Investment Program (NMPEIP) from $700 million to $1 billion.

Synopsis of Senate Bill 162

Senate Bill 162 (SB162) changes the allocation of the severance tax permanent fund for certain investments that do not maximize investment return from the current percentage allocation to a dollar allocation. Specifically, the bill changes the amount the State Investment Council (SIC) may allocate from the severance tax permanent fund to the New Mexico Private Equity Investment Program (NMPEIP) from the current allowable allocation of 11 percent to $700 million.

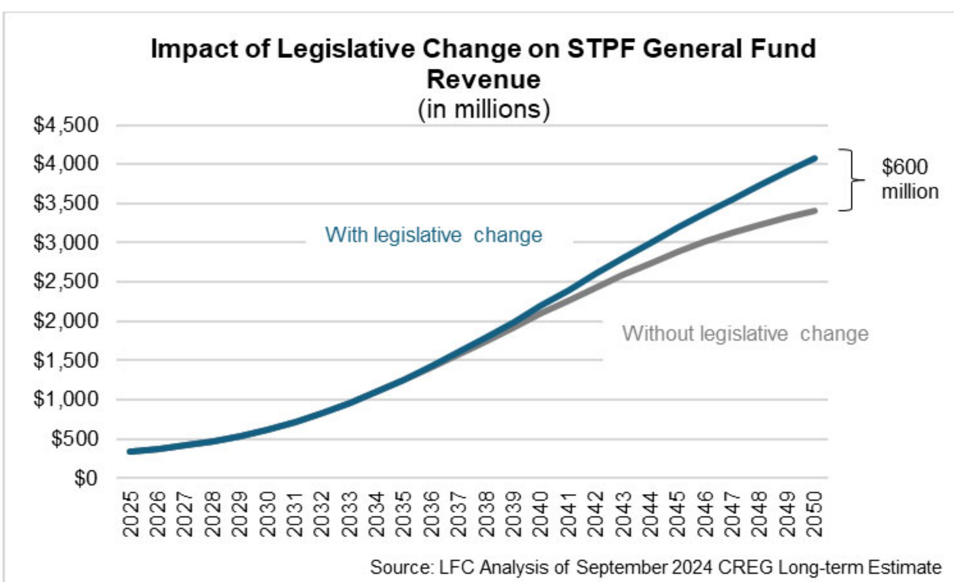
The effective date of this bill is July 1, 2025

FISCAL IMPLICATIONS

The revenue impact considers the current size of the NMPEIP, the size of the severance tax permanent fund, and the magnitude of commitments the SIC has made to date. Where applicable, this analysis uses estimates from the December 2024 consensus revenue estimating group forecast.

To estimate the revenue impact, this analysis first calculates the investment impact of NMPEIP. This estimate assumes two-thirds of the difference between severance tax permanent fund investment performance and land grant permanent fund investment performance are attributable to NMPEIP. Under the bill, the magnitude of this impact decreases over time as NMPEIP receives a fixed share ($1 billion) of severance tax permanent fund assets. Because NMPEIP investments have lower returns than other severance tax permanent fund investments, growth in the size of the severance tax permanent fund will dilute the influence of lower-performing NMPEIP investments on the overall return rate of severance tax permanent fund investments. As a result, overall severance tax permanent fund investment performance is assumed to improve and gradually approach that of the land grant permanent fund, increasing distributions from the severance tax permanent fund to the general fund. General fund distributions under this scenario are compared to current estimates for the annual general fund impact.

This analysis assumes SIC would have otherwise kept the NMPEIP allocation at its current level, about 4.7 percent of the severance tax permanent fund. Under this assumption, the bill would increase general fund revenue beginning in FY35 by about $5 million before growing to above $100 million in FY41 and as high as $600 million in FY50. The estimated general fund revenue impact compounds because SIC can invest severance tax receipts into higher performing investments, which compound over time.

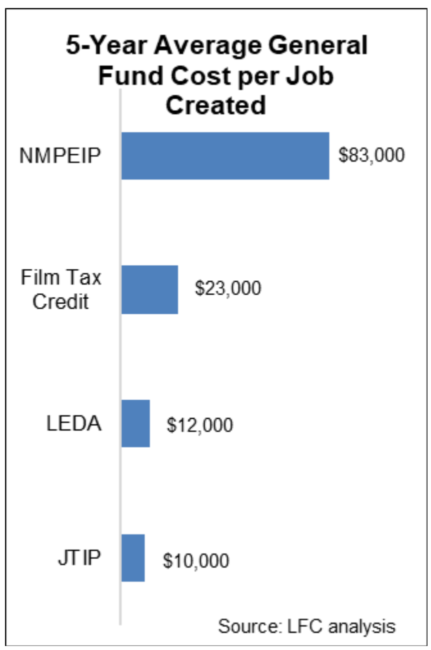


SIGNIFICANT ISSUES

NMPEIP supports private equity funds that make investments into New Mexico companies. The program's objective is to promote economic development. In August 2024, the value of the severance tax permanent fund was $9.93 billion, and NMPEIP was valued at $467 million, or approximately 4.7 percent of the overall fund. Over the last 10 years, the return of NMPEIP investments has been negative, with the fund's internal rate of return (IRR) at negative 1.2 percent. Actual returns were negative 0.4 percent over that period, according to agency analysis.

The NMPEIP carries a dual mandate of producing general fund investment returns and stimulating economic development. The program has not met the first prong of this mandate.

NMPEIP likely meets the second prong of its mandate to stimulate economic development, but the program accomplishes this mandate at a high cost. SIC measures the economic impact of NMPEIP with estimates of job growth, total payroll, and various other performance measures. Between the first quarter of 2019 and the first quarter of 2024, the program is estimated to have created 1,781 jobs for an average general fund cost per job of about $83 thousand, significantly more expensive than other state economic development programs. Limiting the size of the NMPEIP will ensure that state dollars are better allocated towards programs and investments with higher returns.



Regarding its lagging performance, SIC notes the agency has restructured its investment program, shifting away from a dedicated co-investment strategy to diversify its portfolio and increase the number of managers and total companies. The agency notes it has hired a new consultant and made a series of major investment "commitments" to fund managers, who will make investments in New Mexico start-ups. These commitments will be drawn down over a period of five years. The agency writes, "These are long-term commitments that, while promising and well-considered at this time, will take several years to prove successful or not."

The agency asserts that capping commitments would have negative impacts on future and existing commitments the NMPEIP has made in support of New Mexico businesses and fund managers. The agency writes: "From SIC's perspective, this bill is seeking to solve a problem that the council has already been actively working to address for the past several years, and which could take additional years to firmly evaluate for success or failure."

Constitutional Concerns. In its analysis of the introduced version of the bill, SIC noted potential constitutional limitations on the Legislature's ability to interfere with existing contractual obligations. Specifically, the agency cited Article II, Section 19, of the New Mexico Constitution, which provides "no ex post law, bill of attainder nor law impairing the obligation of contracts shall be enacted by the Legislature." The agency asserted the bill impairs its existing contractual obligations and financial commitments over the last several years, which, according to the agency, total $774 million.

Article II, Section 19, of the New Mexico Constitution has been subject to extensive review by the courts specifying the extent of its provisions. The state Supreme Court in *Temple Baptist Church, Inc. v. City of Albuquerque* (1982-NMSC-055, ¶ 44, 98 N.M. 138, 147, 646 P.2d 565, 574) citing *Green v. Town of Gallup*, (46 N.M. 71, 120 P.2d 619 (1941)), stated, "Existing contracts are subject to the legitimate exercise of police power." *Temple Baptist Church* and *Green* suggest that if legislative action is reasonably related to the benefit of public health, convenience, safety, or general welfare, the action passes constitutional muster.

The amended version of SB162 increases the allowable allocation from $700 million to $1 billion, providing a potential remedy to the constitutional concerns raised by the agency. This analysis will be updated upon receipt of additional agency analysis on the amended version of the bill.

Attachment:

1. October 2024 LFC Report *SIC Investments Performance Spotlight*

BG/IT/SL2/sgs/SL2

SIC Investments Performance Spotlight

THIS REPORT details investment performance of the State Investment Council (SIC).

Prepared By: Brendon Gray

The three large long-term investment funds managed by the State Investment Council (SIC) grew by $24.2 billion, or 101.6 percent, over the last five years ending in the fourth quarter of FY24. This period of rapid growth for the state's three largest long-term investment funds—the land grant permanent fund (LGPF), the severance tax permanent fund (STPF), and the early childhood education and care fund (ECTF)—has been propelled by excess oil and gas revenues, accounting for 53.8 percent of the funds' five-year growth. Total assets managed by SIC were $57.8 billion in August, more than double what they were five years ago. The number of funds managed by the agency increased from five in 2019 to 12 in August 2024. Over that period, the agency's total budget has grown by 18.9 percent.

A persistent performance challenge is low returns of the STPF. Performance of the STPF is important because it is the primary fund the state relies on to overcome future declining oil and gas revenues. In the most recent quarter, STPF recorded a one-year return of 6.87 percent while LGPF's return was 8.47 percent over that period. This continues a yearslong trend, where STPF returns have been below the LGPF for the last five fiscal years. This performance gap is estimated to cost the general fund $160 million over the next 10 years and grow in the future, with billions in lost balances.

These low returns are the result of differential rate investments into the New Mexico Private Equity Investment Program (NMPEIP)–a legislatively created program that directs a portion of the STPF to New Mexico companies–the Small Business Investment Corporation (SBIC)–which offers loans and makes investments into small businesses in the state–and the small business recovery loan program, designed to offer low-interest loans to businesses that experienced financial hardship early in the pandemic. The in-state private equity program is the largest of these differential rate investments.

Key Points

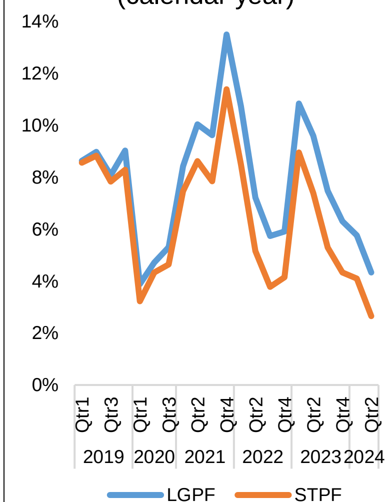
- The market value of the NMPEIP was $454.3 million in July, making it the largest state program designed to create jobs and support businesses.
- The in-state private equity program's internal rate of return (IRR)—a measure of an investment's profitability—was negative 5.5 percent in the five-year period ending 2023. In contrast, private equity investments in national businesses (excluding New Mexico) had an IRR of 15.7 percent over that period.
- The unfavorable returns of the New Mexico private equity program drag overall STPF performance. Among large national public funds over the three-year period, the LGPF was among the best performing, coming in the top 20th percentile in FY24. In contrast, the STPF was in the bottom 70th percentile.
- By FY50, the performance gap—if it persists–will cost the STPF $11 billion compared to what the fund value would be if it returns matched the LGPF's performance.

Returns of SIC-managed Funds
(1-year returns as of 7/31/24)

Fund	Returns
Conservation Legacy	10.35
Early Childhood	9.16
Land Grant	8.30
Rural Libraries	7.40
Tobacco Settlement	6.96
Severance Tax	6.85
Tax Stabilization	4.05

Source: SIC

Historical Three-Year Annualized Returns
(calendar year)



Source: SIC

Performance Gap Between STPF and LGPF

One-year STPF returns have lagged the LGPF by an average of 3.2 percentage points over the last five fiscal years. The gap was similar over returns with a longer time horizon. STPF's five-year average returns were the worst among New Mexico's large investment funds in each quarter since FY22 and have averaged 1.1 percentage points below the LGPF five-year average returns.

LGPF and STPF Asset Allocation and 1-Year Returns
(as of 6/30/2024)

	LGPF Allocation (returns)	STPF Allocation (returns)
US Equity	19% (24%)	18% (23%)
International Equity	16% (11%)	19% (11%)
Fixed Income	32% (6%)	28% (6%)
Alternatives		
Private Equity	10% (5%)	4% (5%)
*★NM Private Equity**	0% (NA)	4% (-7%)
Real Estate	7% (-9%)	8% (-9%)
Real Assets	7% (10%)	8% (10%)
★ETI	0% (NA)	3% (-5%)
Cash	8% (5%)	8% (5%)

*Returns for the NM Private Equity Program are 5-year annualized returns. Shorter periods can be highly volatile.

Source: SIC RVK Performance Review

Asset Allocation

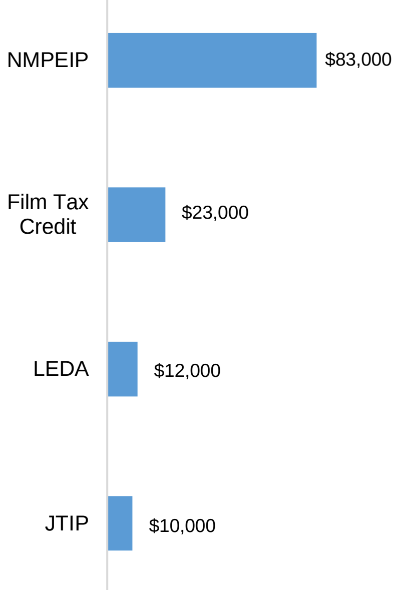
Performance differences between LGPF and STPF result from their asset allocation. Both funds share a similar asset allocation, with about 30 percent each allocated to three investment classes—public equity, fixed income, and alternative investments—and the rest held as cash. However, the major difference between the STPF and the LGPF is the differential rate investment to the in-state private equity program. The council currently allocates about 4 percent of the STPF to the program, but it has set an interim target allocation of 6 percent. The Legislature has authorized the council to invest up to 11 percent of the STPF. In addition to the in-state private equity program, SIC is required to allocate 2 percent of the STPF to the New Mexico Small Business Investment Corporation (NMSBIC), which also acts as a drag on STPF performance.

Impacts of Performance Gap

The cumulative impact of the STPF-LGPF performance gap is large. By FY50, the balance of the STPF is expected to be $11 billion lower than it would have been had it matched LGPF performance. By FY50, this will translate to about $370 million a year in foregone general fund revenue because STPF distributes 4.7 percent of its five-year average fund value to the general fund.

The opportunity costs of the in-state private equity program are large because the STPF is expected to grow rapidly. Historically, the fund grew around 5 percent annually; in the next 10 years, it's expected to grow at three times that rate due to new distributions to the fund. Because the in-state private equity program is authorized to make up a share of the STPF, the program could grow at that same rate and losses could proliferate without legislative changes.

5-Year Average General Fund Cost per Job Created



Source: LFC analysis

Benefits

SIC measures the economic impact of the in-state private equity program with estimates of job growth, total payroll, and various other performance measures. Between the first quarter of 2019 and the first quarter of 2024, the program is estimated to have created 1,781 jobs for an average general fund cost per job of about $83 thousand. This general fund cost per job is nearly seven times higher than the average cost per job of LEDA and eight times higher than the average cost per job of JTIP, some of the state's largest direct job creation programs.[1]

[1] This analysis estimates the cost per job by dividing the estimated general fund cost by the total number of jobs created. General fund cost was estimated by projecting general fund revenue foregone because money was allocated to the NMPEIP instead of the STPF, which makes general fund distributions.