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

SPONSOR Maes **DATE TYPED** 2/5/04 **HB**

SHORT TITLE Create NM Centers of Excellence Fund **SB** 33/aSCORC

ANALYST Garcia

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY04	FY05	FY04	FY05		
	$18,000.0			Recurring	NM Technology Cluster Creation Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY04	FY05			
	($18,000.0)		Recurring	Severance Tax Permanent Fund
		($200.0 estimated)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

<u>Responses Received From</u>
Commission on Higher Education
State Investment Council
Economic Development Department

SUMMARY

Synopsis of SCORC Amendment

The following are the Senate Corporations and Transportation Committee amendments to SB 33: (1) changes the name of the fund to the "New Mexico Technology Cluster Creation Fund," (2) increases the pay-out from the severance tax permanent fund to the NM Technology Cluster Creation Fund from ¼ of 1 percent to ½ of 1 percent (3) adds the following language: "the manager of the technology cluster creation fund shall deliver an annual report to the governor and legislative finance committee and within thirty days of its report, the manager shall return to the severance tax permanent fund an amount equal to the net excess of the funds held by the fund…less amounts reasonably reserved for losses," (4) allows the Secretary of Economic Development to appoint a manager of the fund who will make up to 2 percent of the allocation or $380 thousand, and (5) includes "seed" equity investments.

Fiscal Implications of Amendment

The general fund receives a 4.7 percent distribution from the severance tax permanent fund (STPF) per statute. As the original bill is proposed, around $9 million would be removed from the STPF and would result in a negative impact to the general fund. An estimate is around $100 thousand negative impact to the general fund, after taking into account the five-year market value calculation of the STPF. With the amendments, the payout will double, so around $18 million annually would be removed from the STPF. In turn, this would then reduce the market value of the fund and translate into a negative impact to the general fund roughly estimated at $200 thousand. The proposed amendments will revert the investment gain to the STPF and not the corpus of the new fund "NM Technology Cluster Creation Fund." Despite this reversion, the impact to the general fund will still be negative.

Moving dollars from the STPF for investment into a new fund may pose an opportunity cost where the SIC may be able to garner a higher rate of return on similar investments. The Economic Development Department expects a target return of the new fund at 20 percent. The SIC already has the capacity to invest the money and expects a high return on its private equity investments (roughly 4 to 6 percent above the S&P 500 index). Moreover, private equity type investments in "seed" and early stage businesses are highly volatile. Positive returns are not expected, if at all, until 4 to 5 years after initial investment in these types of ventures.

Significant Issues of Amendment

1) Investments in private equity have a high risk profile. The SIC is able to mitigate some of the risk because private equity is only 6 percent of the full portfolio. Consequently, as portfolio theory suggests, private equity, although being risky investments, add positive portfolio diversification effects for the entire portfolio.

2) The manager appointed by the Secretary will in effect serve as the general partner of the fund. As a consequence, the general partner will likely serve as the fiduciary, which relieves the SIC of its fiduciary duty of the money.

3) The provision that sets aside "amounts reasonably reserved for losses" is different from any other market rate investment in the STPF. According to the SIC, no other market rate investment in the STPF is allowed to keep a "reserve" against losses.

Synopsis of Original Bill

The bill is introduced for the Senate's Economic and Rural Development and Telecommunications Committee and amends the Severance Tax Bonding Act [Section 7-27-5.15 NMSA 1978] and the Economic Development Department Act [Chapter 9, Article 15 NMSA 1978] to create the New Mexico Centers of Excellence Fund and provide for the appointment of a private equity fund manager.

The proposed legislation requires that one-fourth of one percent of the market value of the Severance Tax Permanent be invested in a limited partnership interest in the fund along with earnings from limited partnership investments from business, financial institutions, foundations or money appropriated. Money in the fund is appropriated to and administered by the Economic Development Department for the purpose of collaborating with the state's universities to make and manage early stage equity investments in "new or expanding businesses in New Mexico that possess technologies with promising prospects for commercialization to stimulate job growth."

Significant Issues

1) The state investment office already has 6 percent of the market value of the SPTF available for private equity investments. This just removes a portion and gives it to Economic Development Department for investment with university collaborations.

2) The state investment office has made numerous investments in technology based companies with the expectation that the state will receive a good rate of return on its investment as well as provide quality job growth. In addition, some of the companies have affiliations with state institutions of higher learning and the state's research laboratories.

FISCAL IMPLICATIONS

The market value of the Severance Tax Permanent Fund equaled $3.6 billion as of December 30, 2003. Consequently, the allocation of the new fund would roughly amount to $9 million. The bill does not change the basic investment policy for the Severance Tax Permanent Fund since the restriction that no more than 6 percent of the fund may be invested in state private equity funds or businesses would remain.

The state General Fund is a beneficiary of the Severance Tax Permanent Fund. The General Fund receives 4.7 percent of the five year average market value of the fund. Removing approximately $9 million in FY05 and roughly similar amounts in the future will reduce the market value of the STPF. Consequently, there will be a minimal negative impact to the General Fund.

Continuing Appropriations

This bill creates a new fund and provides for continuing appropriations. The LFC objects to including continuing appropriation language in the statutory provisions for newly created funds. Earmarking reduces the ability of the legislature to establish spending priorities.

ADMINISTRATIVE IMPLICATIONS

One quarter of one percent of the Severance Tax Permanent Fund (STPF) or roughly $9 million is appropriated to the Economic Development Department (EDD) for investment. The state investment officer, under this bill is committed to this investment, and therefore cannot be held responsible as the fiduciary of these funds. The fiduciary should be the administrator of the fund, which is EDD. However, it is unclear whether EDD has the proper administrative capacity to serve as the fiduciary of the fund.

POSSIBLE QUESTIONS

Does the proposed investment from the Economic Development Department (EDD) exceed the expected return of private equity investments from the State Investment Office?

If EDD does not expect a return above what the State Investment Office expects or receives from similar investments, is moving funds from the severance tax permanent fund to a new fund efficient or effective?

Does EDD have the capacity to adequately invest these funds and monitor its investment?

DG/lg:yr