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

SPONSOR Robinson **DATE TYPED** 1/22/04 **HB**

SHORT TITLE Investment of Severance Tax Permanent Fund **SB** 18

ANALYST Garcia

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY04	FY05			
		See Narrative		

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

SUMMARY

Synopsis of Bill

SB 18 adds a new statutory section on available investment instruments for the Severance Tax Permanent Fund to allow direct investment in New Mexico owned and operated fine art and fine music private equity funds. SB 18 places a three percent ceiling on the proposed fine arts and music investments with no single investment exceeding $50 million in a single private equity fund. The bill provides criteria the SIC must follow in determining funding selections and reporting requirements. Such criteria includes: a review by the private equity investment committee and the state investment council, as well as financial reporting requirements that ensure the investment fund is a reputable firm with proper expertise.

SB 18 defines the “New Mexico Fine Art Private Equity Fund” and the “New Mexico Fine Musical Instrument Fund” as a limited liability company, limited partnership or corporation that acquire fine art or musical instruments that have a value of between $250,000 and $6.5 million for fine art and $150,000 and $8 million for fine musical instruments. Further requirements are made limiting the types of musical instruments in which SIC can invest. The requirements refer to the musical instruments’ origin and resale value.

The bill contains an emergency clause.

Significant Issues

The FY03 returns of the severance tax permanent fund (STPF) were 3.0 percent. The STPF outpaced its policy target return by 30 basis points. The U.S. equity portfolio missed the S&P 500 index by 60 basis points, due in large part by under-performance from the internally managed U.S. large capitalization portfolio. The private equity portfolio had a -23.7 percent return for FY03, which outpaced the key benchmark, Cambridge VC index, by 5.7 percent.

Private equity investments are difficult to assess given the lag in investment returns. In the initial years of private equity investments, returns are typically negative due to management fees and debt, which are drawn from committee capital. After several years (typically 4 to 5 years) when the company matures, investment returns begin to turn positive.

Following the award of $34 million for several projects in September of 2003, SIC learned of flaws in its due diligence efforts from an approved investment partner that had some past problems undiscovered by SIC. As a result, SIC withdrew the $34 million worth of awards, terminated its consultant, and recently hired another consultant.

OTHER SUBSTANTIVE ISSUES

A portion of STPF is allocated to economically targeted investments. For example, STPF may purchase certificates of deposit in New Mexico financial institutions and may purchase participations of up to 80 percent of real-estate-related bank loans. As of June 2003, STPF held roughly $43.2 million, or 1.3 percent of the fund, in these non-market rate investments. Legislation enacted in 2000 authorized SIC to invest in film ventures; currently, the state has invested in three films totaling $22 million in loans.

Pursuant to the statutes creating the New Mexico venture capital program, the state investment officer and the council are required to give consideration to investments in venture capital funds where the investments enhance the economic development objectives of the state. However, such investments must offer a rate of return comparable to other venture capital investments currently available.

Implicit in these statutes is the notion of some sort of subsidy. Without legislative imperatives, investments would be made in some other (presumably more profitable) asset class. At this point, the opportunity cost of these investments is unknown. In addition, the benefits these subsidies generate from increased economic activity are also unmeasured.

D**G/yr**