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

SPONSOR Herrera **ORIGINAL DATE** 2/15/07 **LAST UPDATED** **HB** 1190

SHORT TITLE Economic Development and Loan Guarantees **SB**

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	(0.1)		Recurring	General Fund
	(0.1)		Recurring	Severance Tax Permanent Fund
	* See Narrative for possible fiscal impacts			

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicates SB1130.

SOURCES OF INFORMATION
LFC Files

Responses Received From
NM Finance Authority
State Investment Council (SIC)
Economic Development Department (EDD)

SUMMARY

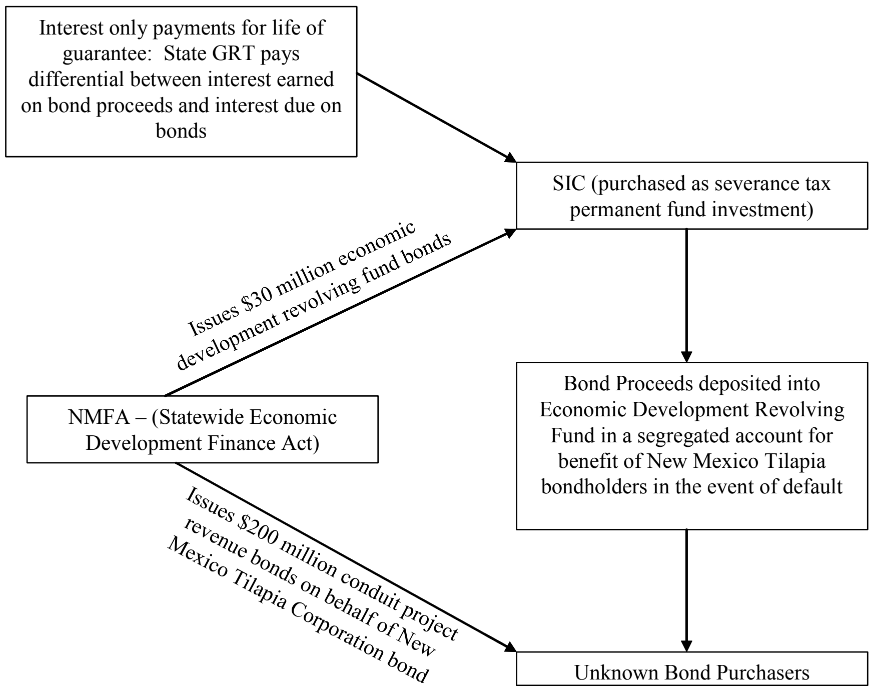
Synopsis of Bill

House Bill 1190 amends the Statewide Economic Development Finance Act (SWEDFA) to allow the New Mexico Finance Administration (NMFA) to issue bonds to guarantee project revenue bonds issued for economic development. These loan guarantee bonds can only be sold to the State Investment Council (SIC), which will purchase them as part of their severance tax permanent fund investments. The maximum amount of outstanding bonds is capped at $100 million.

The economic development revolving fund bonds ("EDRF bonds") would need to be authorized by law and approved by the state Board of Finance (BOF) as well as reviewed by the Legislative Finance Committee and the NMFA Oversight Committee. The duration of the bonds will be the same as the project revenue bond they are guaranteeing.

The EDRF bonds will be paid off from an account within the Economic Development Revolving Fund (EDRF) that consists of payments on the underlying project revenue bonds that come from the project or other sources and a distribution from net gross receipt tax collections. If the project payments are insufficient to cover the EDRF bond payments owed to EDRF bond holders (i.e. SIC) than a distribution from net gross receipts taxes (GRT) will be made to the EDRF. The GRT distributions will be made along with any other distributions required for debt service payments and prior to any other distributions.

NMFA has provided a flow chart of how the EDRF bonds would work:



Source: NMFA

A temporary provision of HB 1190 allows NMFA to immediately guarantee a loan for tilapia aquaculture and hydroponic vegetable production project developed by the NM Tilapia Corporation. The bond for this project cannot exceed $30 million.

EDD:

> This project is an expansion of a New Mexico based company that will be a full scale tilapia food processing facility. The proceeds would be used for buildings, land and infrastructure for the tilapia processing facility. The project would still have to approved by the NMFA board under the SWEDFA act. NMFA would provide the due diligence to the NMFA board and the economic development department would provide the cost-benefit analysis and determine the economic development benefits as required under SWEDFA.

There is an emergency clause so this legislation will take effect upon signing by the Governor.

FISCAL IMPLICATIONS

The fiscal impact on the general fund, where gross receipts tax revenue flows, cannot be determined as the calculation relies on (1) the interest rate of project loans guaranteed, (2) the duration of the project loans and (3) the level of defaults. If, for example, all of the bonds were 10 year maturity issued at 5 percent and they all defaulted, the fiscal impact would be approximately $12 million.

There are also implications for SIC's investment return. These investments are likely to be at rates at or below fair market rates and so the impact will be the differential between the average rate of return earned on SIC investments and this lower rate. If the economic development revolving loan bonds paid 4.5 percent that would be 400 basis points below the long term average for SIC. The investment of $100 million would cost SIC $4 million per annum by not being able to invest that amount in other asset classes.

SIC:

> The bill caps the amount allowable to be invested under this amendment at $100 million dollars out of the STPF, which as of 12/31/06 was $4,383,867,930. $100MM is approximately 2.3% of that STPF balance. As a "differential rate" investment, though not specified by the legislation, it is assumed that the interest rate earned on such bonds would be far below a "market rate" investment. Current rates on US Treasury notes are about 5%. For the calendar year ending 12/31/06 the STPF earned 13.3% overall, 40 basis points (or 0.4%) above its benchmark. It is assumed these investments would return less than T-bills, and considerably less than the STPF historical investment-return average of 8.5%.

SIC reports that this would be considered a "differential rate" investment or an "economically targeted investment" which means that the primary goal of these investments is not necessarily highest return. These investments have an economic development component. Currently, they have allocation targets of 5 percent for film, 6 percent for NM private equity and 0.75 percent for the Small Business Investment Corporation (there is legislation pending to increase all of these targets). Adding $100 million to this allocation will increase the overall target allocation to almost 15 percent. Any changes in allocation will come from other asset classes that may yield higher returns.

SIGNIFICANT ISSUES

The mechanism proposed here is highly irregular. The distribution of GRT would be unknown each month. There is no indication as to whether these distributions would be monthly, semiannually or annually which makes a difference in the processing of tax revenues. Presumably the use of GRT is because it is a revenue stream of sufficient size and regularity that it can be and has been successfully used for bonding purposes. The state, through the building revolving loan fund, and local government are able to issue high quality bonds by dedicating gross receipts tax revenues.

SIC:

> On page 4, Section 2A, item (7) reads: *"the principal paid to the holders of the economic development revolving fund bonds and the corresponding interest shall be reduced by any unrecouped amounts paid to the holders of the project revenue bonds;"* Assuming

the holders are the SIC, the SIC is unclear on what this is trying to say. Does that somehow allow the issuer to lower the amount of repayment, thereby reducing the amount of principal due to the bond holders (SIC)?

On page 8, Section 6B, indicates authorization for the SIC invoking the guarantee on a defaulted bond, "*...shall be released only upon the order of a court or upon certification of the New Mexico finance authority that revenue from the project is insufficient to make the bond payments and that, without the bond payments, the project would be in default on the project revenue bonds.*" The SIC interprets this as saying its only form of recourse should the bond issuer default, and the NMFA for whatever reason not acknowledge that default, would be a legal action in the civil courts. Such action is costly in time, resources and investment. Furthermore, the legislation is unclear on who would be held accountable – the project that defaulted on the bonds, or the state itself through NMFA, or a combination of the two; potentially creating a situation where one state agency sues another to recoup monies. If NMFA agrees that a project has defaulted, the related costs and financial losses would still fall upon the state, and not whatever company or project received the funding from the original bond issuance & investment.

SIC is concerned about default and how they would exercise their fiduciary responsibility to recover the assets when the issuing agency is NMFA. While the language refers to the GRT paying the debt service if there is not enough in the special account, there is a lack of clarity regarding what specifically happens in case of default.

NMFA:

The state investment council is able to receive a "market rate" or "differential rate" on its investments. The distribution of gross receipt tax used to pay of debt service is pledged to pay the differential interest only. This could be a 2 to 3 point spread because of the discrepancy between the interest earnings of the special account and the interest rate that would be required by the prudent investor act governing the Severance Tax Permanent Fund. If there is a call on the guarantee, the money held in the segregated account of the Economic Development Revolving Fund would be used to pay bondholders. In that instance, the State GRT will be required to make the entire interest payment due on the bonds during the life of the bonds. At bond maturity, the fund held in the segregated account will be used to pay principal on the bonds. It is unclear how bonds will be paid if there is a call on the guarantee and which fund bears the burden of the default in that instance.

PERFORMANCE IMPLICATIONS

NMFA:

The finance authority is supportive of the implementation of loan and bond guarantee mechanisms described in this bill. Several of New Mexico's neighboring states offer multiple finance incentives to promote economic development and New Mexico will continue to be at a disadvantage in the economic development arena without tools such as guarantees. Amendments made to the Statewide Economic Development Finance Act in 2005 expressly authorized the implementation of bond and loan guarantees.

ADMINISTRATIVE IMPLICATIONS

NMFA:

The Statewide Economic Development Finance Act (the "Act") partners NMFA and NMEDD and empowers the partnership to implement four "programs:" loan participations, direct loans, guarantees and conduit bonding. Through amendments made the Act in 2005, the NMFA and NMEDD have the statutory power to support the proposed bond issuance and corresponding guarantee, but neither has yet developed the policies nor adopted the rules necessary to adequately safeguard the public's interest.

In order to issue bonds, the NMFA and NMEDD would each have to promulgate rules to implement the authority to issue conduit bonds. For NMEDD this involves the public rulemaking process and for NMFA, this requires both NMFA Board and NMFA Legislative Oversight Committee approval of the rules. Additionally, the NMFA would have to develop policies to ensure proper monitoring and due diligence are in place prior to the rule adoption. Similarly, the NMFA and NMEDD would have to adopt policies and rules through the respective processes to implement a guarantee program. Lastly, since this is the first of the projects to receive such a guarantee, it is likely that the Attorney General's Office and Legislative Finance Committee will want to review the proposed terms of the guarantee to ensure adequate safeguards are in place to protect the State's interest.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB1130 is a duplicate.

TECHNICAL ISSUES

SIC:

On page 5, Section 2A, item (9) states: *"the economic development revolving fund bonds shall be issued under terms that provide that no principal shall be payable to the bond holders until the term of the loan guarantee has expired.*" As written, that would make the payment due to the SIC only *after* the loan guarantee has already expired. The point of having a guarantee is to ensure that it remains in effect fully until *after* payment of principal is finalized. There are mechanics involved in this kind of transaction that would make any kind of simultaneous expiration of the guarantee and transfer of repayment difficult, as well as unnecessary. Bottom line, the guarantee should be good until the bond holder (SIC) is repaid in full.

ALTERNATIVES

To address concerns about default, specific language regarding the default of the EDRF bonds and how SIC is protected would be an appropriate amendment.

SIC has a valid concern about its fiduciary responsibility protecting their investment (i.e. the EDRF bonds) and the NMFA ability to select and approve projects. Additional clarification about the roles may be prudent.

NF/mt