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

		ORIGINAL DATE	03/04/09		
SPONSOR	SCONC	**LAST UPDATED**	03/09/09	**HB**	
SHORT TITLE	Severance Tax Investment in Green Industries			**SB**	420/SCONCS/aSFC
				ANALYST	White

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	Indeterminate	Indeterminate	Nonrecurring	Severance Tax Permanent Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY09	FY10	FY11	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		$ 0.0 - $ 631.4	$ 0.0 - $ 631.4	$ 0.0 - $ 631.4	Recurring	Severance Tax Permanent Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files
State Investment Council

Responses Received From
State Investment Council (SIC)
Environment Department (NMED)
Economic Development Department (EDD)

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee amendment to the SCORC substitute for Senate Bill 420 strikes language requiring the State Investment Council (SIC) to invest three-quarters of one percent of the Severance Tax Permanent Fund (STPF) in New Mexico “green industries.” The amendment then inserts language stating that SIC “may invest” in New Mexico green industries provided that the total amount of investment does not exceed two percent of the total fund. Two new paragraphs are also inserted requiring the total investments pursuant to this section in combination with investments in "New Mexico private equity funds and New Mexico businesses" to not exceed nine percent of the STPF. SIC may also "by rule, set a minimum amount for each investment" made pursuant to the proposed legislation.

Synopsis of SCONC Substitute

Senate Conservation Committee Substitute for Senate Bill 420 differs from the original bill by changing the percentage amount the State Investment Council (SIC) may invest in New Mexico green industries from six percent of the market value of the severance tax permanent fund (STPF) to two percent of the market value of the STPF. The substitute also requires SIC to invest "no less than three-fourths of the market value" of the STPF if "in accordance with the Uniform Prudent Investor Act and if otherwise feasible." The substitute also addresses issues in the original legislation by requiring that all investments made pursuant to this legislation must now be certified by a task force convened by the Governor as opposed to the "Green Jobs Cabinet" created recently by executive order. The substitute would also make the investments made pursuant to this legislation "differential rate investments" meaning that they are intended to stimulate the economy of New Mexico and to provide income to the severance tax permanent fund. Additionally the substitute eliminates the ability of the SIC to make tax rebate anticipation loans for up to 80 percent of a company's estimated tax credit rebate as provided in the original bill.

FISCAL IMPLICATIONS

This bill carries possible additional operating budget impacts to SIC. This legislation mandates the creation of a task force of "state and private officials with expertise in investments, alternative energy or the environment to investigate all applications for investments." The legislation does not specify where the funding will come from to finance the operation of this task force convened by the Governor; however one can reasonably assume it will be included in the SIC budget. SIC notes that this legislation if enacted "would likely require additional staff or expertise from outside consultants…existing consultants and SIC staff would not be able to handle any significant number of assessments on companies seeking investment." These costs would be in addition to the costs of due diligence also required under the Uniform Prudent Investor Act. SIC and its advisors believe a conservative estimate for these costs would be approximately $20,000 for an average sized investment, and that the average investment size under this program will be approximately $2 million. Based on the amount of money the SIC would be required to invest as per this legislation to meet its "three-fourths percent" mandate, additional due diligence costs would then be approximately $236,761 dollars. If the SIC were to invest in projects up to the statutory maximum of two percent of STPF market value than due diligence costs could be as high as $631,362.

Figure 1:

3/4 of 1% of STPF Market Value	$	23,676,103.08
Number of Projects at $2 Million/Project		11.84
Cost of Due Diligence ($20k/Project)	$	236,761.03

Although SIC has already made various investments which would theoretically be applicable under this legislation, SIC is not currently statutorily mandated to make these investments as "differential rate investments." Differential rate investments historically have produced very little if any significant investment returns due to the fact that they are intended more as an economic stimulant than as a viable investment.

State Investment Council (SIC):

> Currently, the STPF has approximately 37% of its assets in alternative investments, including private equity, real estate, absolute return strategies (hedge funds), and economically targeted investments (ETI). Six percent are in fixed income strategies (bonds), while 56% are in public equities (stocks). In comparison, the Land Grant Permanent Fund (LGPF) had approximately 25% of its investments in the alternative assets space, and none in ETIs, as they are not allowed in the LGPF. For the year ending 12/31/08, the LGPF outperformed the STPF by approximately 190 basis points, or 1.9%.
> A contributing factor to the LGPF's 12-month out-performance of the STPF was the fact that the LGPF portfolio did not include any "differential rate" ETI investments. LFC staff estimated the effect these investments would have on the STPF's returns by taking two percent of the fund's total asset value as of December 31, 2008 and multiplying it by the fund's target return for each fiscal year.

Figure 2:

STPF Market Value (12/31/08)	$	3,156,813,744
2% of STPF Market Value	$	63,136,275
Lost Return (8.5% Target)	$	5,050,902

The calculation in Figure 2 shows the potential annual lost return to the STPF if the investments made pursuant to this legislation were to break even. The SIC notes that due to the fact that these investments would most likely be private equity investments, the investment horizons involved would be long-term (7-12 years). Most private equity investments do not reach a break even point until their sixth or seventh year if they break even at all and therefore the lost return shown in Figure 1 could be a best case scenario for the first few years of the program. Although this will result in a loss of annual investment revenue, the loss is expected to be too small to materially effect annual STPF distributions to the general fund.

The SFC amendment strikes language requiring SIC make investments pursuant to the proposed legislation and instead states that SIC "may" make investments in New Mexico green industries as "differential rate" investments. Therefore the revenue impact of this legislation is indeterminate as the exact amount to be invested will depend upon future investment opportunities in conjunction with decisions to be made by SIC. The additional operating impact may be as high as $631,362 if SIC were to invest the full two percent permitted under the proposed legislation however this impact is contingent on SIC actually making these investments which they are no longer required to do. The costs of creating and maintaining the "task force" required by the proposed legislation would also have to be incurred if SIC were to make any investments pursuant to the proposed legislation. The exact amounts of these costs are currently unknown as the makeup of the task force will not be known until members are appointed by the Governor.

SIGNIFICANT ISSUES

Several mandates for "economically targeted investments" (ETI) are already in statute in reference to the STPF. According to SIC the STPF may already invest up to 9 percent of the STPF in the New Mexico Private Equity Investment Program (NMPEIP), up to 6 percent of the STPF in the New Mexico Film Investment Program, and must allocate one percent of the STPF for the New Mexico Small Business Investment Corporation (SBIC).

SIC also has a variety of other mandated programs which provide loans for the New Mexico Farmer's Home Administration, allow the SIC to purchase Educational Institution Revenue Bonds, and allow investments to be made with New Mexico Financial Institutions. All of these programs are administered through the STPF meaning that approximately 66 percent of the STPF has already been mandated for targeted investment programs.
State Investment Council (SIC):

> In addition to the 66% of existing STPF carve-outs *capacity* in current New Mexico statute, there is additional statutory authority under various sections of NMSA 1978, 7-27-5 regarding the STPF, allowing specific dollar-capped investments totaling up to an additional $133MM (about 4%) for several differential rate investments, including mortgage participations and capital renovation bonds.
>
> Overall, with the passage of SB 420[SCONC Substitute], more than 70% of the STPF would potentially be spoken for by legislative mandate for non-traditional, NM-centric investments.

The NMPEIP has already invested in 54 New Mexico companies since 1994 and at least 10 of those companies, representing approximately 20 percent of the portfolio, would be classified as green industries under the proposed legislation. Additionally the SIC managed "New Mexico Venture" fund, formerly known as the "direct co-investment program, consists of approximately 45% of "clean-tech" New Mexico companies. This means that there could be some significant duplication of investments in certain sectors which would substantially decrease the amount of diversification in the fund's alternative investment portfolio.

TECHNICAL ISSUES

This legislation does not specify whether or not "green" investments which have already been entered into by SIC qualify as meeting the "three-fourths percent" mandate in this legislation. As currently drafted LFC staff believes these investments would not qualify as they have not been "certified" by the task force created through the legislation.

The SCONC substitute states that the "state investment officer <u>shall</u> commit to investing no less than three-fourths percent" of the market value of the STPF in New Mexico green industries. This requirement must be met if found to be in "accordance with the Uniform Prudent Investor Act and…otherwise feasible." This language could possibly be amended to include the word may instead of shall in order to bring the bill more in line with past pieces of legislation related to differential rate investments.

The SFC amendment addresses these technical issues by inserting the word "may" in place of "shall" as stated in the SCONC substitute. SIC would no longer be required to maintain a certain level of investment pursuant to the proposed legislation but instead could invest up to two percent of the STPF in differential rate New Mexico "green industry" investments if it so chooses.

OTHER SUBSTANTIVE ISSUES

Economic Development Department (EDD):

Upon review and comparison, this substitute bill seems to have addressed many of the most serious concerns EDD had with the original bill. A few potential issues remain:

- Would the development and manufacture of "green grid" technologies qualify? The Governor is proposing to be a leader in "green grid" technologies, so these should not be excluded.
- Solar technologies are called out specifically for installation and maintenance, but it seems like the bill should apply to all renewable energy technologies generally. There can be inadvertent negative consequences when one renewable energy technology is privileged over others.
- Under the manufacture of sustainable technologies section, it is not clear whether suppliers of components for sustainable technologies would also qualify. For example, would a glass manufacturer who provided glass for solar panels qualify? Attracting these suppliers to New Mexico will help to strengthen this sector as well.
- Would generators of renewable energy qualify in the provided definition of green industries? How about providers of transmission for renewable energy? Renewable energy generation is another important industry for New Mexico's economic development and seems to fit the intended spirit of the bill.
- Will bio-gas production qualify? It is not clear whether this is considered a "bio-fuels" or not. NM dairy farmers have the potential to turn manure into valuable bio-gas and this should also be included in the definition of green industries.
- Will the specified ceiling of 2% invested through this program possibly prevent some worthy companies from receiving funding?

Environment Department (NMED):

The state's coal-fired power plants emit contaminants into the air including oxides of nitrogen, sulfur dioxide, particulates, mercury and carbon dioxide. Those pollutants adversely impact public health, visibility and the global climate. CS SB 420 would fund the development of green technologies that could help to obviate the need to construct new conventional coal-fired power plants that emit more air pollution, and could bring economic development to New Mexico.

The Environment Department's Air Quality Bureau has a legislative performance measure to reduce annual statewide greenhouse gas emissions to a target level. Similarly, the Governor's Accountability and Performance Contract contains goals for reduction of greenhouse gas emissions. Finally, the Governor's Executive Order on Climate change also contains goals for the reduction of greenhouse gas emissions to 2000 levels by 2012, 10 percent below that by 2020 and 5 percent below 2000 levels by 2050. That Executive Order also requires the Energy Minerals and Natural Resources Department (EMNRD) to establish financial incentives for distributed and centralized renewable energy.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

If this legislation is not enacted, the types of investments identified in this bill may not receive as much funding. However, SIC is already investing in the types of investments outlined in this legislation and will most likely continue to increase its allocation to these types of investments whether this legislation is enacted or not.

DMW/svb:mc