FISCAL IMPACT REPORT

ORIGINAL DATE 2/2/15
SPONSOR Williams Stapleton **LAST UPDATED** 2/3/15 **HB** 179

SHORT TITLE Severance Fund Investment in Renewable Energy **SB**

ANALYST Dorbecker

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
	($1,142)	($1,281)	($1,434)	($3,858)	Recurring	Severance Tax Perm. Fund
See "Fiscal Implications" below						

Parenthesis ( ) indicate revenue decreases)

Relates to HB 66, SB 26, and SB 174

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)

SUMMARY

Synopsis of Bill

House Bill 179 creates a new section of the Severance Tax Bonding Act called "Investment in New Mexico Renewable Energy." The bill requires that at least one percent of the severance tax permanent fund (STPF) be invested in New Mexico renewable energy investments and conform to the Uniform Prudent Investor Act (UPIA) standard. The bill indicates the state investment officer (SIO) may only make investments under this section if approved by the state investment council (SIC), and, if made in a private equity fund, with the approval of the private equity investment advisory committee (PEIAC). The bill does not provide a time period by which the 1 percent quota must be met.

STPF investments pursuant to this legislation cap participation at less than 50 percent of estimated cost of any project.

The bill includes definitions for "New Mexico renewable energy", "New Mexico renewable energy private equity fund", "renewable energy", "renewable energy project", and "storage".

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

The SIC reports as of December 31, 2014, the STPF had a market value of $ 4.696 billion, meaning the bill would require the SIC to invest approximately $47 million in renewable energy businesses in the state. The SIC states the fiscal impact of the bill will be attenuated by investments that have already been made by the SIC and because the bill requires that investments be made pursuant to the Uniform Prudent Investor Act (UPIA). Nonetheless, because investments made in New Mexico companies, even under the UPIA, have underperformed relative to the STPF's investment goals, there may be a significant negative fiscal impact. Further, the bill may increase the SIC's investment costs in order to find renewable energy investments that satisfy the UPIA standard.

According to the SIC, currently the STPF has invested approximately $6.2 million in New Mexico companies that would satisfy the bill's requirements because they are either involved in the production of renewable energy or in the more efficient use of energy. This means the bill would require the SIC to invest about $41 million more of STPF dollars in these types of companies.

The SIC acknowledges the bill's requirement that any investment satisfy the UPIA standard could cause a minimal fiscal impact because no additional investments would be made based on current investment activity in the renewable energy industry. Specifically, the UPIA requires the SIC to make investments that optimize returns on a risk adjusted basis. Under this standard, the SIC would simply not make any additional investments in renewable energy if those investments would have a negative impact on the STPF's likely returns.

To provide additional insight, the SIC estimated a fiscal impact calculated using the assumption that the SIC will be able to find renewable energy investments that have similar return characteristics to the STPF's current New Mexico private equity portfolio. In this scenario, the new investments in renewable energy would have average returns of 4.7 percent, the same as STPF's ten-year annual return on New Mexico private equity investments, which is significantly below the STPF's targeted long-term return rate of 7.5 percent. Using this difference in returns, over a ten year period, the SIC estimates the investments would cause a total loss of investment income of approximately $22.8 million.

SIC notes beyond the possible negative fiscal impact on investment income, there may be additional cost associated with finding proper investments. As with any alternative investments, there is a potential for additional fiscal impact to the SIC as investments of this nature require an additional level of expertise to assess in comparison to public equity and fixed income investments. The level of impact would be dependent on the number of potential investments and the sophistication of the projects that would have to be assessed for qualification under the UPIA standard. At the very least, the SIC would need to review current STPF investments to see if they satisfied the new renewable energy investment quota.

SIGNIFICANT ISSUES

According to the SIC, the STPF has already invested approximately $47 million in "clean technology investments" in New Mexico. Accordingly, while it is unclear what portion of the $47 million currently invested in clean technology would satisfy the new statutory definition of renewable energy investments, it is possible that a substantial portion of the bill's targeted investment has already been met.

The SIC notes, even if the investment quota has not already been met, the bill's requirement that any investment satisfy the UPIA standard makes it likely that any fiscal impact will be negligible. Specifically, the UPIA requires the SIC to make investments that optimize returns on a risk-adjusted basis. Under this standard, the SIC would simply not make any investments in renewable energy if those investments would likely have a negative impact on the STPF's potential returns.

Currently the SIC has several legislatively-mandated STPF economically-targeted investments (ETIs) for New Mexico including:

- Up to 9 percent of the STPF for the New Mexico Private Equity Investment Program;
- Up to 6 percent of the STPF for the New Mexico Film Investment Program;
- One-percent of the STPF for the New Mexico Small Business Investment Corporation.

In addition, the following programs have been earmarked by the legislature for investment from the STPF, but are currently inactive:

- Up to 20 percent of the STPF for NM Farmers' Home Administration Loans (NMSA 1978, Section 7-27-5.4);
- Up to 10 percent of the STPF for Educational Institution Revenue Bonds (NMSA 1978, Section 7-27-5.13);
- Up to 20 percent of the STPF for investments with NM Financial Institutions (NMSA 1978, Section 7-27-5.19);
- $130MM (about 3 percent) of dollar specific STPF-authorized investments.

PERFORMANCE IMPLICATIONS

The SIC notes investments under the bill do not appear to be linked to a differential rate of return and would not have any impact on investment performance.

ADMINISTRATIVE IMPLICATIONS

The SIC may need additional resources and expertise to assess certain investments for viability/prudence in this emerging asset class.

RELATIONSHIP

The bill relates to: SB 26 and HB 66 (duplicates), "investment in NM tech collaborative companies", and SB 174 "state investment changes".

TECHNICAL ISSUES

The SIC states Section 1B adds nothing substantive because under current law, all investments must be approved by the SIC. Similarly, current law requires that the PEIAC review all private equity investments. However, SB 174 proposes to eliminate the PEIAC. If SB 174 is ultimately adopted, then HB 179's reference to the PEIAC would not be valid. The SIC suggests eliminating Section 1B in its entirety to avoid conflicts with other applicable laws.

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

OTHER SUBSTANTIVE ISSUES

The SIC notes the bill does not take into consideration it may be impossible to determine the portion of SIC investments made in non-New Mexico renewable energy investments through hedge funds or publicly traded equities, i.e. Exxon, BP or other energy companies expanding their strategies in this area.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

HD/bb/je