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

SPONSOR Munoz **ORIGINAL DATE** 2/25/15 **LAST UPDATED** **HB**

SHORT TITLE Investment in Local Economic Development **SB** 618

ANALYST van Moorsel

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18**	**FY19**		
$0.0	Negative – see "Fiscal Implications."				Recurring	STPF Earnings
$0.0	$0.0	Negative – see "Fiscal Implications"			Recurring	General Fund (STPF Distribution)

Parenthesis ( ) indicate revenue decreases

Conflicts with SB 533 – Severance Tax Fund in NM Credit Union; SB544 – Permanent Fund to Ec. Development Department; HB 66 – Investment in NM Tech Collaborative Companies; HB 179 - Severance Fund Investment in Renewable Energy.

SOURCES OF INFORMATION

LFC Files

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

SUMMARY

Synopsis of Bill

Senate Bill 618 amends the Severance Tax Bonding Act to create a minimum of 6 percent of the market value of the severance tax permanent fund (STPF) that must be invested in local economic development and infrastructure projects. Authorized investments include investments in land, buildings, roads and other fixed assets of municipalities and counties as necessary to attract and maintain business development.

The bill also would seek to revoke the current statutory authorization for the New Mexico Small Business Investment Corporation, and the State Investment Council's investment of the Severance Tax Permanent Fund (STPF) in New Mexico private equity & business investments.

The bill includes a reporting requirement – investments must be reported by the Investment Officer to the Legislative Finance Committee and the Revenue Stabilization and Tax Policy

Committee and must include amount invested in each fixed asset, as well as information about the objectives of the investments and how each investment enhances local economic development objectives.

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

Although indeterminate, this bill will likely result in lower net returns for the investment of the STPF. Lower investment returns place additional downward pressure on the corpus of the STPF, which has not seen the growth of the larger Land Grant Permanent Fund because it does not enjoy consistently large contributions. Finally, a lower STPF corpus would result in reduced general fund revenues, as 4.7 percent of the five-year average of the year-ending STPF market values is distributed to the general fund each year. Although there is no effective date, if the SIC begins to make these investments in FY16, it could see reduced investment returns beginning that fiscal year.

As with other differential-rate investments, the investments required in this bill are not targeted solely at delivering returns. The reduced levels of expected financial return from slouch investments are typically justified by the expected economic development benefits that the investment is expected to deliver.

SIC echoes this interpretation in its analysis of the bill, reporting a negative yet indeterminate fiscal impact. Further, in order to maintain its 7.5 percent long-term return target, the council may need to consider more risky investments with a higher expected return to offset the lower returns of investments proposed in this bill.

SIC also notes the bill does not mandate a timeline for executing its requirements, which would appear to cause the SIC to shift its focus from investments in NM companies (and the SBIC's focus on loans to small business) to purchase of land, buildings or roads. SIC states the scope of the 6-10 percent allocation of the STPF is substantial, reporting the fund is valued at $4.65 billion. This would mean the legislative mandate would demand deployment of between $279 million and $465 million into New Mexico local infrastructure purchases.

The bill would also revoke authorization on approximately 6 percent of pre-existing STPF investments, including its current 5 percent target for New Mexico private equity investments, and the 1 percent allocated to and managed by the SBIC. SIC notes it would face a fiduciary challenge, in having to either liquidate these assets on the secondary markets – likely at a discount, or reallocate them to another portion of the portfolio, and in doing so, forsaking more attractive and better returning investments.

The economic impact of the legislation is difficult to determine. However, SIC provides anecdotes of previous "direct investments" made by SIC in three New Mexico companies in 2003-2004 that were sourced and completed in part through "Invest New Mexico," an economically-focused investment partnership between SIC and EDD. According to SIC, these investments in Eclipse Aviation, Earthstone International, and TCI Medical, resulted in STPF equity losses of more than $36 million, while only Eclipse created a significant number of jobs and economic development benefits to the state.

SIGNIFICANT ISSUES

SIC adds the following concerning the investments required in the bill:

> Despite having legislative authorization to operate a large portion of the STPF to seek a ‘differential rate’ of return in exchange for economic development benefits, statute also requires that the STPF comply with the Uniform Prudent Investor Act, which requires a balanced and prudent approach in investing the fund with utmost loyalty to the fund’s beneficiaries – in this case, the state general fund and NM taxpayer. Arguably, given the rigid requirements outlined in SB 618, accomplishing this goal of prudency through either “fire sale” or portfolio rebalancing may not be feasible.

The SIC comments on the bill’s provision requiring a certain type of public investment:

> STPF, as a constitutionally protected fund, cannot be appropriated from directly by the legislature. An argument could be made that by forcing the SIC, an investment agency, to dedicate hundreds of millions of dollars in what has the potential to be economic development grants, the Legislature may be in violation of Article 8 Section 10 of the Constitution.

The SIC analysis of the bill does point out the Legislature has previously mandated or allowed more than 70 percent of the STPF to be used in various differential rate. However, the SIC analysis contends that these investments had potential for financial return on investment. SIC goes on to state that the investments required in SB 618 do not appear to be aimed investment returns.

The SIC also raises the issue of liabilities associated with investing in local infrastructure, questioning whether the SIC would have the capacity to take on potential liabilities associated with property management and maintenance.

OTHER SUBSTANTIVE ISSUES

The SIC analysis of this bill raises several issues and concerns with the bill:

- There is no indication how the required investments could be monetized. For example, if the Council “invested” in a road, would the Council be allowed to set up a toll to get a return on the investment?
- The bill terminates SIC authority to invest in New Mexico private equity and the SBIC. If the SIC were forced to liquidate its positions, there would be a significant costs because: i) private equity is largely illiquid, meaning there is no ready market for it, sales price would be substantially below a reasonable value; ii) the SBIC has made loans and simply does not have the money or the ability to get those loans back except under the terms of the loan—if we wanted to liquidate the SBIC we would have to sell those loans, and again, there is no ready market for these loans and we would likely lose a substantial amount of value.
- The SIC would be put into the position of making investments that “enhance local economic development objectives” something about which the SIC has no expertise, or basis for deciding.
- There is a question whether such investments or grants will be effective in attracting new companies to New Mexico.

- The statute suggests no details on policies, procedures, or governance other than the SIC shall approve and fund such projects. Methodology behind selecting, ranking, and tracking such projects is not contemplated. SIC would need to expend significant resources in developing appropriate governance and operational structure for such a program to avoid potential misuse or undue political influence in awarding such funds to only the best and most appropriate projects around the state.

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

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