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## FISCAL IMPACT REPORT

ORIGINAL DATE 3/06/15

SPONSOR Cervantes LAST UPDATED \_\_\_\_\_ HJR \_\_\_\_\_

SHORT TITLE Land Grant Fund for Longer School Time, CA SJR 12

ANALYST van Moorsel

### REVENUE (dollars in thousands)

Estimated Revenue (by Beneficiary)					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
\$0.0	\$0.0	\$109,456.3	\$119,738.3	\$128,209.6	Recurring	General Fund
\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	Recurring	Other Beneficiaries

(Parenthesis ( ) indicate revenue decreases

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
<b>Total</b>	\$0.0	\$0.0	\$15.2	\$15.2	Nonrecurring	General Fund

(Parenthesis ( ) indicate expenditure decreases

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

State Investment Council (SIC)

State Land Office (SLO)

Children, Youth, and Families Department (CYFD)

Public Education Department (PED)

### SUMMARY

#### Synopsis of Bill

Senate Joint Resolution 12 proposes an amendment to Article XII, Section 7 of the Constitution of New Mexico, which governs the distributions from the land grant permanent fund (LGPF). If approved by voters, the amendments to the constitution would create an additional distribution from the permanent school fund (to the general fund) in the amount of 1 percent of the five-year average of the year-end market value of the fund, beginning in FY17, to “provided that any additional distribution from the permanent school fund pursuant to this subsection shall be used to implement and maintain a school year for public school students in kindergarten through fifth

## Senate Joint Resolution 12 – Page 2

grade that is longer than the school year provided by law as of the effective date of this amendment.” The additional distribution would result in a 6 percent annual distribution from the permanent school fund and a 5 percent distribution from the remainder of the LGPF.

The table below compares current and proposed LGPF distribution rates, showing the 1.0 percent increase in distributions from the permanent school fund beginning in FY17:

Fiscal Year	Other LGPF Component Funds			Permanent School Fund		
	Current	Proposed	Difference	Current	Proposed	Difference
2015	5.5%	5.5%	0.0%	5.5%	5.5%	0.0%
2016	5.5%	5.5%	0.0%	5.5%	5.5%	0.0%
2017	5.0%	5.0%	0.0%	5.0%	6.0%	1.0%
2018	5.0%	5.0%	0.0%	5.0%	6.0%	1.0%
2019	5.0%	5.0%	0.0%	5.0%	6.0%	1.0%
Beyond 2019	5.0%	5.0%	0.0%	5.0%	6.0%	1.0%

The joint resolution would amend the constitution to suspend any additional distribution from the LGPF above 5 percent if the five-year average of the year-end market value of the fund is less than \$10 billion.

The Legislature, by a three-fifths' vote of the members of each house, may suspend any additional distributions from the LGPF above 5 percent.

The amendment proposed by this resolution shall be submitted to the people for their approval or rejection at the next general election or at any special election prior to that date that may be called for that purpose.

### FISCAL IMPLICATIONS

The impact of SJR 12 was estimated by assuming annual contributions into the fund are a function of historical contributions. Investment returns are assumed to be the State Investment Council's (SIC) long-term target of 7.5 percent, less 50 basis points for management fees. Holding these inputs constant, the effect of the increased distribution can be estimated, as shown in the revenue table above, compared with the consensus estimate for LGPF distributions. Because only the permanent school fund's distribution is increased, the estimate splits the LGPF into the permanent school fund and the other component funds based on the calendar year 2014-ending share of ownership. Based on this data, it is assumed that as of calendar year 2014, the permanent school fund comprises 84.4 percent of the LGPF.

In the short term, additional contributions from the permanent school fund will produce more revenue to the general fund.

However, in the long term, and taking into consideration fund contributions from the oil and gas revenues, as well as expectations for general inflation and fluctuations in investment income, this proposal increases the risk that the permanent school fund will not be able to continue to deliver the same benefits to the general fund as the fund does today.

**Compared with current distribution rates, this increased distribution will result in a lower permanent school fund balance fund over time.** The lower fund balance will decrease the purchasing power of distributions from the fund. The additional distributions (estimated to total \$357 million for FY17-FY19) would reduce the balance in the fund available for investment, and (assuming positive returns on investment) reduce further growth in the fund. By 2020, the corpus of the fund is diminished by \$629 million, and ten years after that, the negative impact has grown to nearly \$3.2 billion. Further, beginning in FY25, the size of the excess distribution proposed in SJR 12 over the current distribution begins to diminish. Beginning in FY44 the distribution from the permanent school fund under the higher proposed distribution rate would be lower than the 5 percent distribution currently provided for in the constitution.

Through 2055, the five-year average of the year-end market value of the balance in the fund is not estimated to fall below \$10 billion.

The SIC cites recent LGPF distributions in illustrating the argument that the bigger the fund, the bigger the benefits, as seen in the \$60 million growth in the distribution from the fund year over year. Distributions have grown \$120 million since FY14. Of the \$655.8 distribution, more than \$551.6 million goes directly to general fund/public schools in FY16.

	FY14 Distribution (\$1000s)	FY15 Dist. (\$1000s)	FY16 Dist. (\$1000s)
Land Grant Permanent Fund	535,157	595,994	655,785
Severance Tax Permanent Fund	170,473	182,723	193,510
<b>Total</b>	<b>705,629</b>	<b>778,717</b>	<b>849,295</b>

## SIGNIFICANT ISSUES

***Distribution Issues.*** A 2003 constitutional amendment provided for 0.8 percent additional distribution of the LGPF from FY06 through FY12, and a 0.5 percent additional distribution from FY13 through FY16. The 2003 constitutional amendment required that the additional distribution from the permanent school fund be used to implement educational reforms. The proposed amendment would make the additional 0.5 percent distribution permanent.

The decision to deplete an endowment is a policy decision rather than a financial dictum or “best practice.” The question is whether the benefits of the expenditures will outweigh the benefits of greater income tomorrow. Below is a preliminary investment performance summary for the LGPF as of November, 2013. The financial market volatility during the 2008-09 crisis continues to impact return averages, with the LGPF not achieving its 7.5 percent annualized return target for any long-term time period.

***Investment Issues.*** While FY14 performance was more than double its annual investment target, such performance is not something the SIC anticipates with consistency moving forward. Even with the bounce back from the 2008 financial meltdown, the LGPF’s annualized returns for longer time periods of 10 and 15 years show investment returns far below the annual target of 7.5 percent. Depending on LGPF inflows from the State Land Office, the rate of inflation (anticipated to grow), and investment returns, it is a reasonable assumption that under the distribution rate contemplated by SJR12, the LGPF would have suffered damage to its corpus over many of the previous 10 or 15 years.

**Public School Funding.** Senate Education Committee Substitute for Senate Bill 563 amends Public School Code provisions related to the length of a school year. The bill establishes a 205-day school year for kindergarten through fifth grade and requires each instructional day to consist of 5.5 hours per day. The bill also requires the 205 days to be as evenly spaced in a balanced calendar as practicable and increases the funding formula basic program unit cost differentials for kindergarten through 12<sup>th</sup> grade students by 15 percent to accommodate the increase in instructional days. Provisions of the bill will become effective during the 2017-2018 school year (FY18) if Senate Joint Resolution 12 is approved by the people of New Mexico.

Provisions of SB 563 are intended to close the widening achievement gap and ensure young students are on grade level and able to read. Nationally, the majority of states require a minimum of 180 instructional days, though some states require more or fewer and others, like New Mexico, measure instructional time by hours rather than days. Education Commission of the States' (ECS) data shows that New Mexico is one of nine states that currently do not require a minimum number of instructional days, but rather measure instructional time based on hours. Because of this, there is great variance among New Mexico school districts in the number of instructional days.

Some studies show that decreased classroom time can be a cause of poor student performance. Paul Vallas, a superintendent with a long history of leading school reform efforts nationally, refers to the need to “shake the trees” in education. Educators should adopt those practices that have the greatest impact on student learning. Time on task is a critical component of improved student achievement. Time on task refers to the time a student spends in the class room actively engaged in learning. Simply increasing the amount of time available for instruction is not enough to achieve learning gains. Time allocated for instruction must be appropriate, effective and meaningful, and teacher understanding of time on task must be enhanced. Instructional time must be reexamined to ensure that it is being used as effective learning time by addressing students' needs and interests.

## **ADMINISTRATIVE IMPLICATIONS**

Under Section 1-16-13 NMSA 1978 and the NM constitution, the Secretary of State is required to print samples of the text of each constitutional amendment, in both Spanish and English, in an amount equal to ten percent of the registered voters in the state. The SOS is also required to publish them once a week for four weeks preceding the election in newspapers in every county in the state. In 2014, the SOS estimated the cost per constitutional amendment to be \$15,217. However, if the ballot size is greater than one page, front and back, it would increase the cost of conducting the general election. In addition to the cost of the ballot, there will be added time for processing voters to vote and would mean additional ballot printing systems would be required to avoid having lines at voting convenience centers.

## **OTHER SUBSTANTIVE ISSUES**

SIC points out that the 2003 constitutional amendment requiring additional distributions to be put toward education reforms was never approved by the US Congress, despite an opinion from the NM Attorney General at the time, indicating such changes would require Congressional approval.

## ALTERNATIVES

SIC reports the vast majority of other states with permanent funds, as well as similar university endowments are taking a more conservative approach to fund spending policies:

Annual distributions by domestic sovereign wealth funds:

- Alaska: seeking 5% cap
- Wyoming: 5%
- Texas Permanent School Fund: 3.3%
- North Dakota Legacy Fund: distributions may begin in 2017 with legislative approval

Alaska is the largest of the Permanent Funds at \$51 billion – they write checks to their citizens based on earnings, but are seeking to cap annual distributions at 5 percent or less. Wyoming, which has more than \$18 billion in various permanent endowment funds, has a current distribution policy of 5 percent. The Texas Permanent School Fund with more than \$35 billion will only expend 3.3 percent in FY15. Arizona voters in 2012 by a narrow 51-to-49 percent margin, increased their distributions to 2.5 percent for their relatively young \$4 billion endowment. And the North Dakota Legacy Fund – created with oil and gas windfall, won't distribute any dollars until 2017 at the earliest. North Dakota currently deposits in that fund 30 percent of severance taxes.

University endowments:

- University of Texas: 3.5%-5.5%
- Yale: 5% of market value average
- Stanford: 5.25% with a previous year adjustment
- University Pennsylvania: 4.7% of 3-yr average
- Columbia: 4.5% of market value average
- Texas A&M: capped at 5% of rolling average
- Washington: 3%-5.5% based on 5-year average

University endowments are also similar to the LGPF, as they raise money, are bequeathed gifts, and see significant inflows every year, combining to strike a balance with their distributions. Typically, most endowments average distributions of 4-4.5 percent. These are prudent spending rates which the SIC supports.

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