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

SPONSOR Maestas **ORIGINAL DATE** 2/14/17 **LAST UPDATED** 3/09/17 **HB** 405/aHLEDC/aHTRC

SHORT TITLE Financing In-State Infrastructure Projects **SB**

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue	R or NR **	Fund Affected
FY17 – FY21		
Indeterminate	Recurring	Land Grant Permanent Fund (LGPF)
Indeterminate	Recurring	Severance Tax Permanent Fund (STPF)
Indeterminate	Recurring	General Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

Relates to HB128, HJR1, HJR2, SJR3, SJR14, SJR18

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of HTRC Amendment

The House Taxation and Revenue Committee (HTRC) amendment to House Bill 405 clears up the short title to reflect the changes made by the HLEDC amendment, and more clearly states that the intent of the bill is to recommend the Council make “at least one-half of the investments in publicly financed infrastructure projects it makes from the permanent funds in projects in New Mexico.” Previously the language was potentially ambiguous, as to whether the “half” referred to infrastructure investments, or half of the permanent fund.

Synopsis of HLEDC Amendment

The House Labor and Economic Development Committee (HLEDC) amend this bill to strike “shall” from page 7, line 22, and insert in lieu thereof “may”. Thus, the bill allows, instead of requires, the State Investment Council (SIC) to “make at least one-half of the permanent funds investments in publicly financed infrastructure projects it makes in projects in New Mexico.”

Synopsis of Original Bill

This bill amends NMSA § 6-8-7 to require SIC to invest at least one-half of the land grant permanent fund (LGPF) and severance tax permanent fund (STPF) investments in publicly financed infrastructure projects in publicly financed infrastructure projects in New Mexico.
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

This bill as amended seeks to change the State Investment Council's (SIC) enabling statute, suggesting SIC "may make at least one-half of investments in publicly financed infrastructure projects it makes from permanent funds in projects in New Mexico." This change provides for the State Investment Council to use its discretion as to whether or not it will choose to engage in these, now permissible, investment activities. However, it still seems to indicate that if the SIC chooses this path it needs to be "at least" half or none at all.

It should be noted, there is nothing currently inhibiting SIC from making investments in publicly financed projects in New Mexico.

Based on the amendments to the bill, SIC perceives the potential costs associated with the bill to be largely mitigated, given the bill would no longer require SIC to place half of its infrastructure investments in New Mexico-based publicly-funded infrastructure projects.

SIC expects some indeterminate costs associated with trying to source and perform diligence on equity or debt investments in this strategy – primarily due to the need for a specialized manager focusing on New Mexico, or additional SIC investment staff to execute such investments. While there are some potential examples of such deals being available in New Mexico – primarily in the energy infrastructure space – broader infrastructure investments in airports, toll roads, ports and other revenue-generating infrastructure projects are not common here, and may not achieve financial attractiveness compared to similar opportunities available on a global menu.

Given that SIC is required to invest to standards under the Uniform Prudent Investor Act, and that this bill as amended does not statutorily allow for a differential (below-market) rate of return – as do many investment strategies available from the Severance Tax Permanent Fund – this would add another layer of complexity, and potentially cost, to this process.

Currently SIC invests more than $21 billion in a highly diversified portfolio of investments. As of 12/31/16, these investments are allocated in the following ways:

- Fixed Income: 23 percent
- Private Market Investments: 32 percent
- Public Equity: 45 percent

Private Market Investments, also known as "alternatives", cover a broad range of investment strategies, including private equity, real estate, hedge funds, and "real return", which includes infrastructure as a subset of its holdings.

As of its most recent report, SIC has $356 million invested with six infrastructure-related funds, comprising about one-fourth of SIC's allocation to "real assets"/real return strategies. Additional commitments not yet drawn down raise the total SIC exposure to infrastructure to $515 million. These commitments are long-term, typically lasting at least 10-15 years and can only be liquidated earlier than that, if done so through sale on the secondary market, usually at a steep discount.

SIGNIFICANT ISSUES

In considering the amended bill, SIC notes a potentially serious issue that it failed to note the agency's original analysis, which could put this bill at odds with the state constitution. Article XII, Section 7(D) of the state constitution, which governs the land grant permanent fund, reads as follows:

> "D. The legislature may establish criteria for investing the fund if the criteria are enacted by a three-fourths' vote of the members elected to each house…"

SIC states that, arguably, this bill seeks to establish criteria for investing the LGPF without the requisite supermajority.

PERFORMANCE IMPLICATIONS

Assuming passage as written, this bill as amended would suggest SIC to consider restructuring its infrastructure investment portfolio, either through expansion of existing commitments, or through liquidation of the current portfolio, or a combination thereof. SIC indicates none of the steps involved would be profitable or cheap to accomplish. Selling fund shares on the secondary sales market would potentially result in losses approaching 20 percent to 40 percent, especially given the specialized nature of infrastructure funds and the long-term commitment they require.

Additional in-house specialists would be a prudent requirement in trying to manage such a program, though SIC notes potential difficulties and additional costs in attracting such expertise to New Mexico. SIC has a long history of trying to attract top financial talent to New Mexico, but typically cannot compete with larger peer funds, pensions, endowments or private investment firms based on salary alone, given the inflexibility of the state's compensation restrictions.

ADMINISTRATIVE IMPLICATIONS

SIC points out, even if opportunities for a quality investment were presented to SIC, it is questionable whether current in-house SIC personnel are qualified to create and maintain such a specialized and geographically-restricted portfolio of such investments. There are only a handful of managers who deal with this type of investment, and given the relative immaturity of infrastructure strategies in the broader investment spectrum, many of those have limited track-records from which to compare.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 128 seeks to require SIC to invest 0.25 percent of the market value of the severance tax permanent fund (STPF) in New Mexico businesses approved by the Technology Research Collaborative. HJR1, SJR3, SJR14, and SJR18 attempt to change the permanent funds' percent distribution to beneficiaries. HJR2 seeks to require $7 billion of the land grant permanent fund to be withdrawn and invested in economic stimulus programs.

TECHNICAL ISSUES

The language in this bill as amended could be interpreted as suggesting SIC invest half of its total assets ($10.5 billion) in publicly financed infrastructure projects in New Mexico.

Additionally, infrastructure is not defined in the bill, other than stipulating it involves "publicly financed" projects.

OTHER SUBSTANTIVE ISSUES

Today, without exception, the SIC invests in private market assets only via investment managers. These professional managers, who are vetted and hired based on their expertise, track record, and perceived ability to deliver optimal risk-adjusted returns, raise investment funds from multiple investors or limited partners, including SIC. In turn, SIC, as a minority shareholder, is a passive investor in this regard, protecting its interests via contractual agreement, but also having very limited abilities (if any) in controlling how the general partner pursues their strategy. The fund manager/general partner is incentivized to make the best possible return for his investors/limited partners in two ways: profit sharing, and reputation. Reputation is obviously critical in lining up future investors and funds. Profit sharing terms can vary, depending on the strategy and negotiation of the commitment, but serve to align the manager's interests with that of his investors.

Most of SIC's infrastructure investments are not "publicly financed", but rather are privately-held infrastructure (bridges, roads, airports, pipelines, etc.) investments, for which SIC achieves a rate of return in-line with the risks taken as investors. As mentioned above, SIC invests in this strategy via fund institutional managers, who are relied on to act as fiduciaries in shepherding-through successful investments. Currently there are no investment managers of which SIC is aware – quality or otherwise – who are investing in infrastructure with a New Mexico focus. SIC states, if there were a manager focusing at least 50 percent of their investments in a state New Mexico's size, it would be a red flag, given concentration risk and its associated geographic risks. The risks associated with a concentrated portfolio of infrastructure assets – even if diversified across infrastructure subsectors - would severely increase the geographic, regulatory, counterparty and economic risk involved. The expected returns required to take the additional risk may not be achievable without significant leverage, which in itself amplifies overall investment risk.

The Economic Development Department (EDD) also notes it may be difficult to find funds or instruments that specifically invest in public infrastructure and then isolate the ones that will be investing in New Mexico projects. EDD points out funds that generally invest in publicly financed infrastructure projects look for projects that generate a revenue stream of cash flows to support the investment or government guarantees to make the projects profitable. Projects would still have to follow standard financial due diligence and expected internal rate of returns. According to EDD, this bill would not seem to change that dynamic and one would not expect it to increase the number of publicly financed infrastructure projects, per se.

New Mexico, while having many needs potentially viewed as relating to infrastructure, actually has few legitimate investment opportunities in this space. The following is a summary of the kinds of assets currently in the SIC's infrastructure portfolio:

- Container terminals
- Airports
- Telecom Infrastructure (from local cell towers to massive telecom hubs)
- District heating and cooling (think a group of downtown buildings sharing a steam or cooling plant)
- Integrated logistics (rail systems and supporting infrastructure)
- Toll roads
- Hydro electric dams
- Desalination plants
- Water systems

New Mexico is geographically and population challenged, having no ports, desalinization plants and hydroelectric facilities, and a small population that does not lend itself to a need for toll roads. SIC is unaware of existing infrastructure investments which might be open to acquisition, such as the Albuquerque Sunport.

DI/al/jle/sb/jle