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

SPONSOR Cervantes

ORIGINAL DATE 2/14/17
LAST UPDATED 3/03/17

HB

SHORT TITLE Additional Permanent Fund Distribution for Longer School Day, CA

SJR 14

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue (assuming special election)*					R or NR **	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
$0.0	($124,587.5)	($129,454.1)	($132,179.3)	($134,738.7)	Recurring	LGPF
$0.0	$124,587.5	$129,454.1	$132,179.3	$134,738.7	Recurring	General Fund (Educational)
$0.0	$0.0	$0.0	$0.0	$0.0	Recurring	Other LGPF beneficiaries

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring
*Assumes a special election will be held such that the resolution could be passed prior to FY19 (see other substantive issues section).

REVENUE (dollars in thousands)

Estimated Revenue (assuming general election in Nov. 2018)*					R or NR **	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
$0.0	$0.0	($129,454.1)	($132,179.3)	($134,738.7)	Recurring	LGPF
$0.0	$0.0	$129,454.1	$132,179.3	$134,738.7	Recurring	General Fund (Educational)
$0.0	$0.0	$0.0	$0.0	$0.0	Recurring	Other LGPF beneficiaries

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring
*Assumes this resolution will be on the ballot for the general election in November 2018. Thus, additional revenues to the general fund would begin in FY20 (see other substantive issues section).

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	R or NR **	Fund Affected
Total	$0.0	$50.0 - $100.0	$0.0	$50.0 - $100.0	Nonrecurring	Election Fund

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

Companion to SB256; conflicts with SJR 3, HJR 1, and HJR2.

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)
Office of the Attorney General (OAG)
State Land Office (SLO)
Educational Retirement Board (ERB)

SUMMARY

Senate Joint Resolution 14 proposes an amendment to Article XII, Section 7 of the New Mexico Constitution, which governs the distributions from the Land Grant Permanent Fund (LGPF). The resolution would amend the state constitution to require the Land Grant Permanent Fund (LGPF) to distribute an additional 1 percent distribution from the permanent school fund within the LGPF, over and above the current 5 percent distribution. The additional 1 percent would be from the permanent school fund only, and would be used to increase the minimum instructional hours and days in a school year. The remaining LGPF beneficiaries would continue to receive a 5 percent distribution.

A three-fifths majority in both the House and Senate can vote to suspend the additional distributions, and the additional distribution would be suspended should the 5-year LGPF average drop below $10 billion. The amendment also strikes language reflecting legislative history related to the 2003 constitutional amendment which required additional distributions from FY05-FY16.

The resolution seeks approval of this constitutional amendment by the voters of New Mexico at the next general election or in a special election called for this purpose.

FISCAL IMPLICATIONS

The State Investment Council (SIC) indicates that, mathematically, the concept of allowing schools to draw down a greater percentage of their portion of the LGPF can be accomplished, although the council has yet to build specific models in this regard. SIC notes if the bill were to be fully implemented with 6 percent going to public schools and 5 percent going to the other 20 beneficiaries, the result would be a shrinking percentage of common schools ownership of the LGPF due to the higher drawdown. Accordingly, the base distribution for the other 20 beneficiaries would remain the same, though their ownership percentage would increase over time. However, in concept, the other beneficiaries could be held harmless by receiving a larger piece of an accordingly smaller pie. Activity on state trust lands does incrementally adjust on a monthly basis due to revenue-generating activity on those lands as well, further complicating this issue.

SIC indicates that in the short term under this joint resolution, additional distributions from the LGPF will produce significantly more revenue to the general fund and other LGPF constitutional beneficiaries. However, the additional distribution will lessen future earnings and reduce the benefits that a larger fund would produce in the long-term even at a lower distribution rate.

Reduced value of the corpus results in diminished capacity to participate in positive investment return environments, increasing volatility overall to the LGPF's yearly benefits. The smaller the fund, the smaller the benefits, and the lesser its ability to recover from negative returns through subsequent positive investment performance.

SIC's expectation over the next 7-10 years is for both lower-than-historical investment returns (targeting 7.0 percent), and oil/gas prices substantially below the high-water marks seen over the previous decade. Today's LGPF inflows are currently about half or less of where they were in 2014. SIC provides the following table, which shows projected year-end fund values and fund distributions for fiscal years 2019-2031, with common schools receiving an additional 1 percent. Given that the common schools ownership of the LGPF stands at 84.9 as of January 2017, this translates into a LGPF distribution rate of 5.8 percent. SIC notes it is unclear how that ownership percentage may rise or fall over time, as that is determined by revenue generation on the lands owned by each beneficiary, but typically ownership percentage changes are slow – for reference, the common schools share 20 years ago was 82.6 percent. The table also uses a side-by side comparison between increased LGPF distributions over 12 years and the corresponding, greater fall of LGPF corpus value over the same time period.

Calendar Year	Corresponding Fiscal Year	($B) LGPF Value Current (5.0%)	LGPF Distribution @5.0%	($B) LGPF Value w/SJR14 (5.8488%)	Distribution @5.8488%	Rolling Difference in LGPF Distribution	Difference in LGPF Value ($B)
2017	2019	15.92432209	$733,903,526	15.92432209	$858,490,988	$124,587,462	
2018	2020	16.67970455	$766,863,713	16.61741082	$896,317,810	$254,041,559	($0.062293731)
2019	2021	17.44686113	$796,249,788	17.25337294	$928,429,118	$386,220,889	($0.193488191)
2020	2022	18.23424408	$834,565,983	17.89697546	$969,304,636	$520,959,542	($0.337268613)
2021	2023	19.04053055	$873,256,624	18.54720594	$1,008,792,687	$656,495,605	($0.493324601)
2022	2024	19.86233479	$912,636,751	19.20082008	$1,047,119,849	$790,978,703	($0.661514708)
2023	2025	20.70016453	$952,841,351	19.85931876	$1,085,042,392	$923,179,744	($0.840845773)
2024	2026	21.5543365	$993,916,104	20.52381199	$1,123,298,680	$1,052,562,320	($1.030524510)
2025	2027	22.42509832	$1,035,824,647	21.19473686	$1,161,874,573	$1,178,612,246	($1.230361460)
2026	2028	23.31270953	$1,078,546,437	21.87219761	$1,200,768,996	$1,300,834,805	($1.440511929)
2027	2029	24.21747553	$1,122,097,844	22.55631306	$1,240,020,211	$1,418,757,172	($1.661162471)
2028	2030	25.13972425	$1,166,493,441	23.24719143	$1,279,650,190	$1,531,913,921	($1.892532819)
2029	2031	26.07979013	$1,211,747,978	23.94491806	$1,319,668,920	$1,639,834,863	($2.134872076)
2030	2032	27.03801536	$1,257,877,148	24.64956801	$1,360,082,153		($2.388447351)

The projection assumes annual inflows of $400 million and investment returns of 7 percent, with additional distributions of 1 percent beginning in FY2020. Both are consistent with SIC expectations during this time frame. The starting value of $16.68 billion is projected for the end of 2018, which determines the distribution for FY2020.

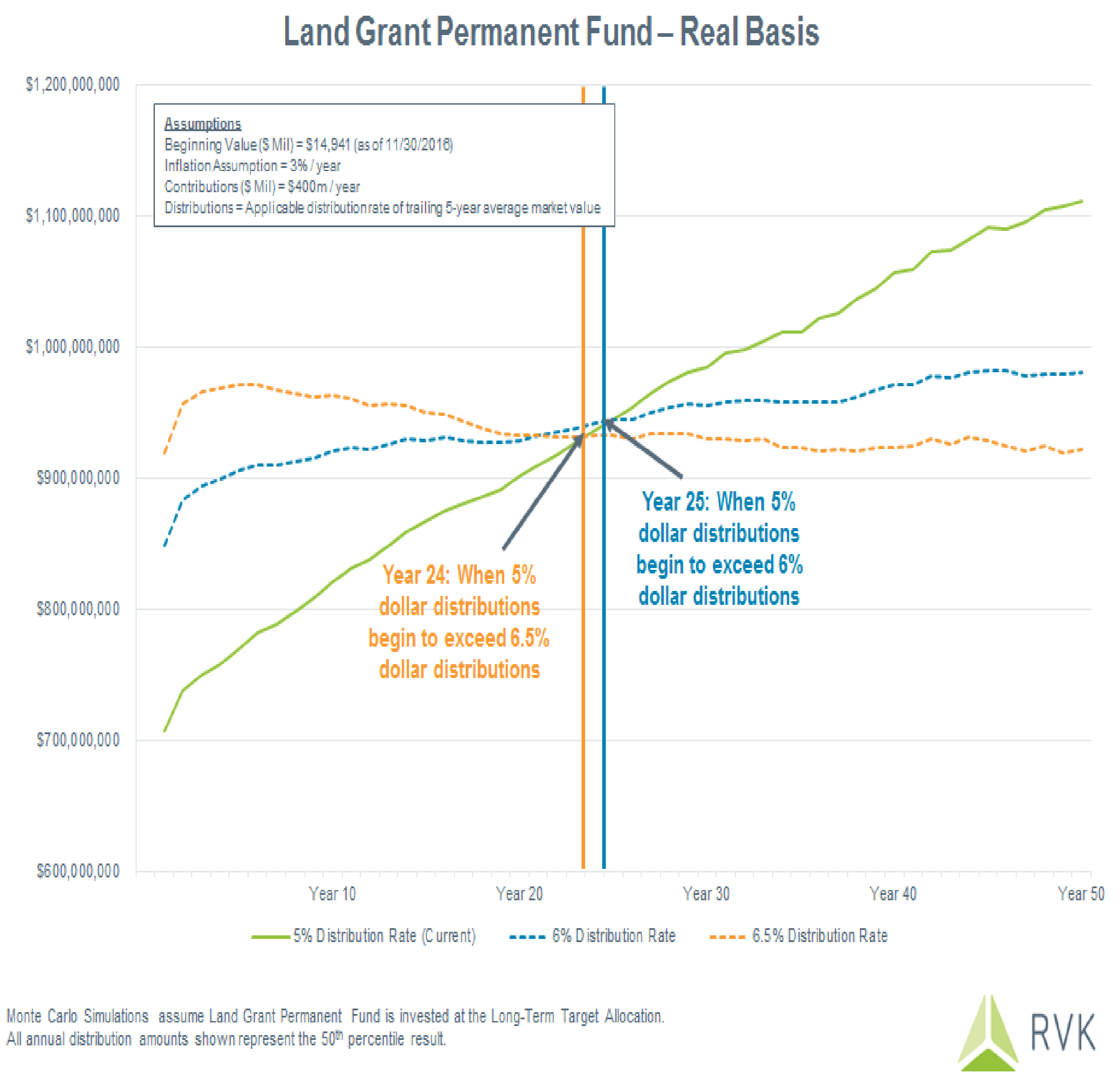
The model shows that at the higher distribution rate, after a dozen years, additional dollars will be taken from the LGPF for beneficiaries, resulting in a significantly lower fund corpus value in 2030.

While the projection provides an estimate for FY19, implementation of the additional 1 percent distribution would only be possible in FY19 if a special election is held in late 2017 or early 2018 with sufficient time to execute the new distribution by July 1, 2018. The next general election is in November 2018, which would mean the new distribution would not occur until FY20. If this is the case, there could be potential funding issues related to the companion bill SB256, which amends the Public School Code provisions to extend the school day and school year, effective during the 2018-2019 school year (FY19).

The calculation does not take into account potential future growth in state population, or the impact of inflation on the real dollar value and benefits of the LGPF. It also does not consider the impacts of possible major market events or a severely compromised inflow model to the LGPF. Such variables could greatly increase risk to the fund's long-term earning ability.

The resolution does not include any restrictions against using its additional distributions to supplant the current general fund allocations to educational programs, thereby freeing up those replaced dollars for non-educational programs.

RVK, which acts as an independent fiduciary and investment advisor to the SIC, has also projected a long-term impact on the LGPF, based on a 5 percent, 6 percent (SJR14), and 6.5 percent distribution (SJR 3). Visually, this highlights what has previously been referred to as the "tipping point", where the fund with the higher-spending policy is eventually caught and overtaken by the fund with a lower spending rate. At 6 percent, RVK predicts the short-term benefit, or tipping point, to be 25 years out.



Based on these projections, it could be argued that while increasing LGPF distributions certainly would benefit one generation, those additional dollars would be delivered at the expense of subsequent generations, who may face equal or greater challenges and uncertain needs.

Election Costs. Section 1-16-13 NMSA 1978 requires the Secretary of State (SOS) to print the full text of each proposed constitutional amendment, in both Spanish and English, in an amount equal to 10 percent of the registered voters in the state. The SOS is also constitutionally required to publish the full text of each proposed constitutional amendment once a week for four weeks preceding the election in newspapers in every county in the state. LFC staff estimate each constitutional amendment may cost up from $50 thousand to $100 thousand in printing and advertising costs based on 2016 actual expenditures.

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 1 percent distribution permanent.

Additionally, SIC states:

> *"While the common schools are the largest component of the Land Grant Permanent Fund, neither it nor the other 20 beneficiaries are allowed to self-direct how "their portion" of the permanent fund is to be directed, invested, or managed. [SIC believes] that this purview is established in New Mexico statute (NMSA 6-8-1), as well as the constitution, and to try and separate any beneficiary from the LGPF creates significant legal, logistic and practical complications, both perceived and real.*
>
> *One obvious example would be how the LGPF is managed, as the SIC takes into account the level of annual distributions from the fund, when developing its asset allocation as we strive to optimize risk-adjusted returns for the fund. Higher rates of distribution may necessitate a more aggressive (riskier) investment policy to maintain the long-term stability of the fund. Allowing one of 21 beneficiaries to direct this process potentially impacts the level of risk taken by all beneficiaries. Other legal, constitutional and logistical aspects of this concept have not yet fully been explored."*

Investment Issues. SIC provides the below investment performance data for the LGPF, as of 12/31/16:

	1 Year	3 years	5 years	10 years	15 years	20 years
Land Grant Permanent Fund Returns - % net of fees	7.37	4.63	8.73	4.90	5.87	6.70

According to SIC, while the one-year and five-year annualized investment returns slightly exceed SIC's annual return target of 7 percent, the council anticipates the next decade may be one of both volatility and depressed investment returns. Longer-term returns, which include one or both of the major global investment crises experienced this century, are still struggling to achieve SIC's long-term target of 7 percent. Like many institutional investors, SIC has reduced its return expectations in the past few years.

Educational Issues. Some studies show that decreased classroom time can be a cause of poor student performance. The National Conference of State Legislature indicates the majority of states currently require 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' data shows that New Mexico is one of nine states that currently does not require a number of minimum school days. Two states, Kansas and North Carolina, require more than the average 180 instructional days – 186 and 185 respectively.

The 2016 Legislative Finance Committee program evaluation, *Assessing "Time-on-Task" and Efforts to Extend Learning Time*, found students in New Mexico's public schools lose over a third of available instructional time per year on non-instructional activities and that lost instructional time directly impacts student achievement. The evaluation found that public schools have used flexibility in state statute to implement a wide variety of school calendars and school days and almost all schools have implemented extended school days resulting in shorter school years of about 167 days while still exceeding yearly requirements for instructional hours. At least 26 school districts already exceed 1,127.5 total elementary hours per school year, the number of hours that would be required by this bill.

Much of this instructional time made available for learning, however is lost to other noninstructional activities or impacted by absences. Elementary students, for example, lose well over a third of instructional time, even after accounting for the extra time schools have built in above state minimums. The more lost time per school corresponds directly with lower student achievement. When controlling for factors including poverty, there is a statistically significant relationship between reading standards-based assessment (SBA) scores and lost instructional time for both elementary and secondary students. As lost instructional time increases, SBA scores decrease. The evaluation concluded time for learning is important, but more time alone will not increase academic achievement. Additional time must be used efficiently and effectively. Schedules should be optimized to allow for the maximum amount of academic learning time. In schools where allocated time is not used properly, adding time to the day is ineffective, costly, and a poor use of scarce resources.

In FY09, the Legislature appropriated $14 million to the state equalization guarantee distribution (public education funding formula) to fund an additional instructional day. At the time, the Legislature enacted House Bill 691 (Chapter 276 of Laws 2009), which measured instructional time by days – establishing a 180 days of instructional time for school districts using a regular school calendar. and 150 days of instructional time for school districts using a variable calendar. However, in 2011 the Legislature returned to measuring instructional time by hours rather than instructional days, and the additional day the state paid for was never implemented.

PERFORMANCE IMPLICATIONS

SIC notes that to counter a higher spending policy, the council may have to make adjustments toward an equally aggressive investment approach to be able to protect the earning power of the fund. The past few years the council has taken the opposite approach however, diversifying investments, and lessening its annual return target to a more realistic 7 percent return, from the previous 8.5 percent. Many investment professionals are estimating average investment returns to be depressed relative to historic norms over the coming decade, with SIC expecting SIC's largest investment, global stocks, to earn 6.5 percent on an annual basis, compared to historic averages of 8 to 10 percent.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Companion to SB 256, which increases minimum instructional hours for children in grades from K through 6.

Conflicts with HJR 1 and SJR 3 (amending the same article of the constitution for educational programs, early childhood educational services) and with HJR 2 (adding distribution from Art 12, Sec. 7 for economic stimulus programs).

TECHNICAL ISSUES

Unlike the 2003 amendment that increased LGPF distributions from 5 percent to 5.5 percent, this bill does not contain a delayed repeal date.

According to the Office of the Attorney General (OAG), the amendment does not specify how, other than "as provided by law" the additional funding is to be used to fund longer school days and years. OAG presumes the funds would flow in coordination with SB 256 (increasing minimum instructional hours) for children in kindergarten and elementary schools only, not middle or high school. If the sponsor intends to fund only K-6 increases, it might be helpful to say so in the amendment.

Safety Valve. According to SIC, this resolution includes an asset value "safety valve" intended to protect the fund from the burden of additional distributions during times of financial stress. The valve is designed to stop the additional 1 percent distribution should the five-year average of the fund drop below $10 billion at calendar end of any given year.

The construction of the LGPF distributions are based on a five-year fund average with the goal of steadying pay-outs in a smooth, consistent manner, to better accommodate legislative advance planning. However, the safety valve sought to protect the fund in this joint resolution does not account for that, as the LGPF could technically go to $0 in 2017, and the five-year average would still not hit the $10 billion trigger. An alternate technical safety-valve might better be tripped when the current LGPF corpus value itself drops below $10 billion or some similar appropriate value.

Subparagraph (F) of the resolution says that the Legislature, by a 3/5 vote of each house "may suspend any additional distribution provided for in Subsection G of this section." It is unclear whether a vote to suspend the additional distribution is effective until there is a further vote to resume it, or whether the suspension is effective only for one year and those additional distributions would resume absent an additional vote to continue the suspension.

A major issue would occur if the LGPF hits the $10 billion trigger in how to replace the 1% additional distribution to education from available revenue sources.

OTHER SUBSTANTIVE ISSUES

There is a question how voters would deploy the additional capital, at least initially, given the mechanics of how the LGPF annual distributions are made, and the timing of the Constitutional Amendment's approval or rejection. Either to take effect, constitutional amendments must be approved as part of a statewide election, in a general election or a special election held specifically for the issue at hand. The next statewide general election is scheduled for November 2018, which is more than 5 months already into FY19. However, the provisions of SB256 become effective during the 2018-2019 school year (FY19). If there is no special election before November 2018, this lag may complicate how the roughly $146.8 million in additional distributions would be budgeted for, and subsequently deployed over half a fiscal year – or not at all - given the uncertainty of the final results of such an election. The 2003 amendment did pass, but only by about 200 votes in a statewide special election.

To avoid these complications and make distributions available for FY19, a special election will need to be held. It is possible that even with a special election, the budgeting process for FY19 could occur before the election, still raising the issue for whether the state should budget based on an uncertain election outcome.

On that point, the 2003 election to raise the based distribution rate from 4.7 percent to 5 percent, and to temporarily distribute an additional 0.8 percent from the LGPF resulted in a partial additional distribution during FY2004. At the 4.7 percent rate, the FY04 distribution would have been $336 million, while the at the 5.8 percent rate, the distribution would have been $415 million. The actual distribution for FY04 was $352.5 million. How that hybrid distribution number was ultimately determined in 2003/2004 is unknown to current SIC staff.

The details laid out by the resolution do not offer details as to how many additional days or hours might be gained by its enactment, nor the expectation of results to be achieved. However, there is currently a companion bill, SB256, to expand the minimum instructional hours for public schools.

The LGPF is a permanent endowment fund. SIC indicates that, nationally, peer endowments follow generally accepted distribution policies/spending policies. The most widely followed policy allows annual distributions of between 3-5 percent of the corpus/principal of the fund. As the principal of the LGPF grows, annual distributions will automatically increase – even if the percent distributed remains the same. Educational institutions & early childhood programs will benefit from those increased amounts, and share in a much greater benefit as time goes on. This is what happened between FY17 and FY18, when the LGPF distribution rose from $638 million, to $689 million, a $50+ million increase year over year, with both years at the 5 percent rate.

On this point, SLO adds:

> *"As originally conceived, the LGPF was to be invested only in interest-bearing securities, and all of the interest earned (and only the interest earned) was distributed to the beneficiaries. Thus, the LGPF was truly "permanent" because none of the corpus of the fund was distributed, except that the effect of inflation in eroding the true value of the LGPF was not taken into account. When the Enabling Act and the New Mexico Constitution were amended in the mid-1990's to allow investment of the LGPF in other kinds of securities and*

> *set the annual distribution at 4.7% of the value of the LGPF, the primary goal was to protect the corpus of the LGPF against inflation."*[1]

Thus, SLO indicates increases in the distribution percentage raise questions as to whether the LGPF is still truly a "permanent" fund where the corpus is being preserved and only income is being distributed.

OAG points out analyses of related bills continue to raise the possibility that a change to the states permanent fund distributions requires U.S. Congressional approval. This joint resolution does not include a contingency for such approval. Congressional approval was also not sought on the constitutional amendment ratified by the voters in 2015 which allowed more than 15 percent of the LGPF to be invested in international securities.

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ALTERNATIVES

SIC indicates 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:
  - Alabama: 5 percent of rolling 3-year average
  - Alaska: statutory formula, approximately 5 percent; principal may not be spent
  - Arizona: 2.5 percent
  - Idaho: 4 percent
  - Montana: 2.2 percent
  - North Dakota Legacy Fund: distributions may begin in June 2017
  - Wyoming: 5 percent
  - Texas Permanent School Fund: 3.3 percent;
  - Utah: interest & dividends only

NACUBO reported the average spending policy/distribution rate of more than 700 US universities was 4.2 percent.

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[1] See Pub. L. No. 105-37, 111 Stat. 1113 (Enabling Act amendment "to protect the permanent trust funds of the State of New Mexico from erosion due to inflation and modify the basis on which distributions are made from those funds").

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Due to a contingency clause in SB256, if SJR14 is not enacted, SB256 will not be enacted. If SJR14 passes but SB256 does not pass, the Legislature will need to pass a bill prior to the FY20 enactment of SJR14 that increases the number of instructional hours for students to comply with the intent of the constitution.

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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