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FISCAL IMPACT REPORT

SPONSOR Gallegos, DY/Garcia ORIGINAL DATE 2/3/18
Richard LAST UPDATED 2/8/18 HJR 10

SHORT TITLE Permanent Education Emergency Fund, CA SB _____

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
--	(\$36,737.6)	*	*	*	Nonrecurring	LGPF
--	\$36,737.6	*	*	*	Nonrecurring	NEW Permanent Education Emergency Reserve Fund (PEERF)
--	--	--	(\$331.8)	(\$758.6)	Recurring	General Fund

Parenthesis () indicate revenue decreases

*Although this is a one-time transfer from the LGPF to the new PEERF, there will be a recurring impact of lost interest earnings on the LGPF and a recurring impact of interest accumulations to the new PEERF. For example, a 7 percent return (the return target for the LGPF) on \$36.7 million is about \$2.6 million.

Duplicates, Relates to, Conflicts with: HJR1, HJR2, HJR3, SJR 2, SJR3, SJR7, SJR11

SOURCES OF INFORMATION

LFC Files

Responses Received From

State Investment Council (SIC)

State Land Office (SLO)

New Mexico Attorney General's Office (NMAG)

Public Education Department (PED)

SUMMARY

Synopsis of Bill

House Joint Resolution 10 seeks to amend Article 12 of the State Constitution to create a permanent education emergency reserve fund (PEERF) by reallocating 0.25 percent of the 2017 year-end market value of the permanent school fund, a component of the Land Grant Permanent Fund. This distribution to the fund would be made on January 1, 2019. Money in the new PEERF would be managed and invested by the State Investment Council. All additions to this fund and

all earnings, including interest, dividends and capital gains, from investment of the PEERF would be credited to the PEERF. During years of where general fund revenue is forecast to decline 5 percent or more, any amount over the PEERF corpus of \$36 million could be appropriated to the permanent school fund beneficiaries.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends. The proposed constitutional amendment would not become effective without approval by the voters at the next general election or at any special election prior to that date that may be called for that purpose.

FISCAL IMPLICATIONS

The proposed amendment would distribute 0.25 percent of the “permanent school fund” value as of December 31, 2017 and place it in an annex fund, the newly created PEERF, which could be appropriated by the Legislature if two conditions are met: 1) the value of the PEERF is more than \$36 million, and 2) the general fund revenue forecast for the current or following fiscal year is down 5 percent or more from its prior fiscal year level.

The permanent school fund is a component of the Land Grant Permanent Fund (LGPF), to which public schools are the beneficiary. The value of the LGPF as of December 31, 2017 was \$17.29 billion. The State Investment Council (SIC) states the permanent school fund portion of that amount is approximately 85 percent, or about \$14.7 billion. One quarter of one percent of this value is \$36.7 million – this is the amount that would be reallocated from the permanent school fund to the PEERF on January 1, 2019. SIC states, given that the proposed amendment stipulates the fund would be invested as the LGPF is invested, the fund would continue to grow at a rate in-line with the bigger fund, until it qualified for appropriation due to an actual or estimated general fund revenue decline of 5 percent or greater.

Due to the amendment’s requirements, if a revenue shortfall occurred in FY20 or FY21, SIC states the Legislature would have about \$737.6 thousand in callable funding from the PEERF that could be appropriated to public schools. Though initially the amount available during a budgetary downturn would be small, there is potential that the fund would grow over time. Assuming average returns of 7 percent, and no drawdowns from the PEERF over the first ten years, SIC indicates the fund value would likely double over that time. Accepting those assumptions, after a decade the PEERF would offer approximately \$37 million of reserve capital (not including the \$36 million corpus) for the Legislature to access to fill budget shortfalls for state public schools.

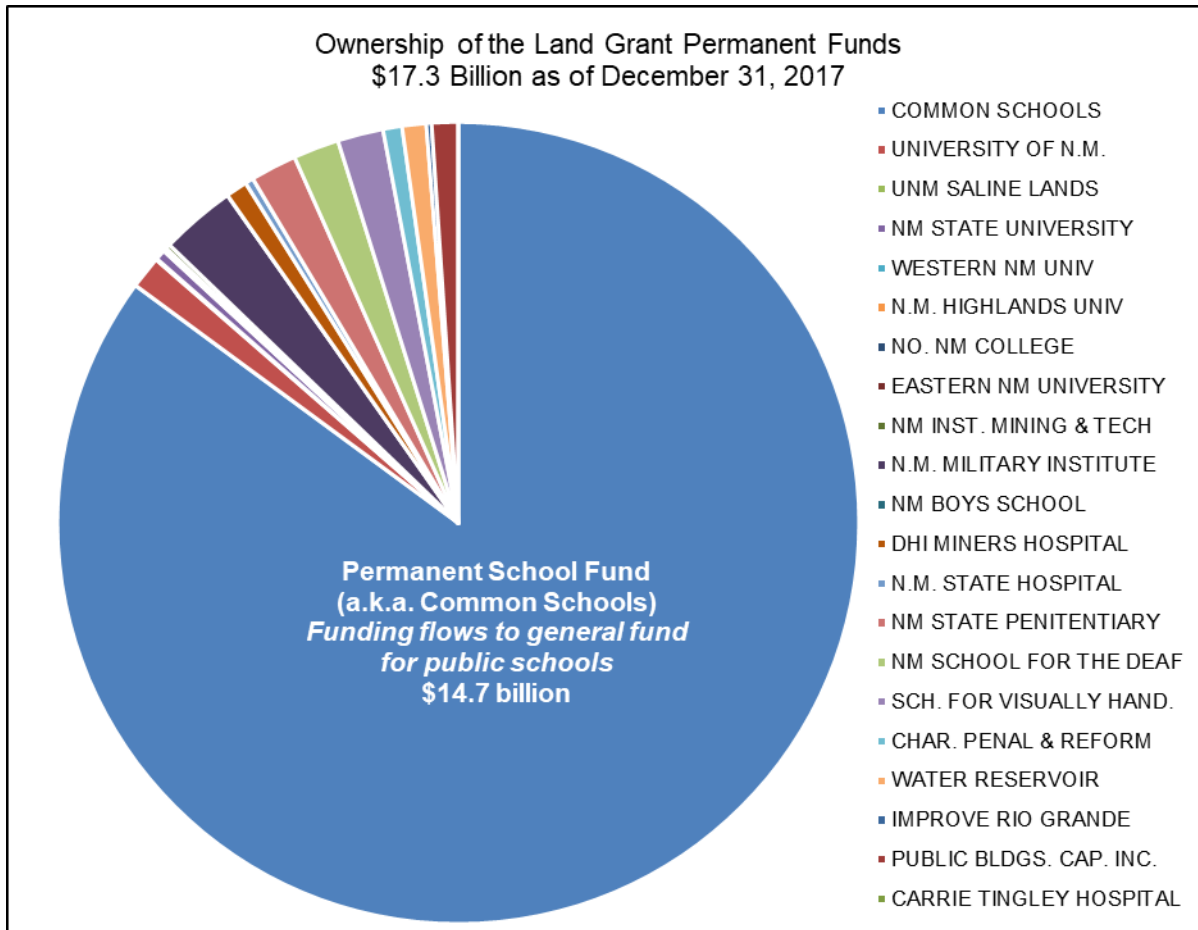
When compared to the consensus revenue forecast, there is a small negative impact to the general fund. Annual distributions from the LGPF to the beneficiaries are set at 5 percent of the five-year average of the fund. Since the bill would reduce the 2019 year-end balance of the permanent school fund by \$36.7 million, the five-year average will be somewhat smaller, resulting in an estimated loss of \$331.8 thousand in FY21 and \$758.6 thousand in FY22. The loss, which is essentially an opportunity cost, will grow over time due to compounded loss of interest earnings.

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. According to Secretary of State, the most recent cost to print a constitutional amendment is \$47.60 per word.

SIGNIFICANT ISSUES

It is important to note the “permanent school fund” and the “land grant permanent fund” are not the same. The permanent school fund is but a component (the largest portion) of the land grant permanent fund, accounting for about 85 percent of the LGPF. The other 15 percent of the LGPF belongs to 20 other permanent fund beneficiaries.



The Public Education Department (PED) points out the proposed amendment does not tie the General Fund revenue forecast to a calendar date to determine if a five percent decline occurred. Similarly, PED states it is unclear when the timing of appropriation occurs; whether this is when budget proposals are submitted, the beginning of session, House Appropriations and Finance Committee action or concurrence, or signature by the Governor. For these reasons, PED indicates it is unclear if the timeliest revenue forecast would be available at time of appropriation.

On the above point, PED offers the following additional analysis:

“It is unclear, in a year like 2017 where a deficit turned into a surplus rather quickly, whether appropriators would be able to access the Permanent Education Emergency Reserve Fund

prior to the start of session when it may not have been necessary. Without better clarification of either the timing of the General Fund consensus revenue forecast being used or what defines the time of appropriation, it is unclear what triggers the five percent decline and allows for appropriations from the proposed fund. [The proposed amendment] also does not clarify who would make a determination that the declined; whether it is the Executive or Legislative branches or the Consensus Revenue Forecasting group.”

The State Land Office (SLO) points out that, unlike other proposed constitutional amendments increasing annual distributions from the Land Grant Permanent Fund, the proposed amendment does not state that consent of the U.S. Congress is required. Under the Enabling Act, New Mexico was required to incorporate the Enabling Act’s state trust land provisions into its Constitution and was prohibited from changing those provisions without the consent of Congress. When proposed changes in the LGPF provisions in the New Mexico Constitution were made in 1996, it was stipulated that those changes would not become effective until the U.S. Congress consented to those changes, which was done through an amendment to the Enabling Act. See SJR 1 (1996) § 6; Pub. L. No. 105-37, 111 Stat. 1113.

However, it could be argued that since the transfer is only from only the permanent school fund and intended to only benefit the permanent school fund beneficiaries, congressional approval may not be necessary. While the response from the New Mexico Attorney General’s (NMAG) office did not address this issue, it may be helpful to seek further guidance from NMAG on this issue.

PERFORMANCE IMPLICATIONS

The State Investment Council indicates this proposal has the benefit of continuing to grow its fund through investment until the time it is actually called down. This offers the benefits of considerable growth over time due to investment gains of an institutional quality portfolio, rather than limited benefits offered had the money been put into short-term investments. However, SIC provides caution, stated the fund could be impacted by negative market environments, which have the potential to result in short-term losses, which could drive the \$36 million corpus below its minimum value for appropriation, especially during early years of the PEERF. Along those lines, the SIC does forecast returns below their historic averages over the next 7-10 years, due to above-average returns over the past several years, combined with the market’s tendency to revert to historic averages.

Below are LGPF investment returns, net of fees as of 11/30/17:

	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
LGPF Investment Returns	15.45	6.71	8.88	5.28	7.41	6.38

ADMINISTRATIVE IMPLICATIONS

It is a fair assumption that the SIC would continue to manage the new PEERF fund, given the language that it is to be invested as the LGPF is. SIC states an additional fund/account would add minimal complexity or administrative burden to the SIC.

TECHNICAL ISSUES

The New Mexico Attorney General’s (NMAG) office notes a punctuation error needs correction in Section 1 where there is a comma outside of the quotation marks: “permanent education emergency reserve fund”,

It should be corrected to read: “permanent education emergency fund,”

RELATIONSHIP

- Relates to SJR2, which seeks to increase distributions by 1.5 percent from the LGPF for early childhood education.
- Relates to SJR3, which seeks to create the Early Childhood Education Department.
- Similar to SJR7, which seeks to increase distributions by 0.8 percent from the severance tax permanent fund (STPF) for education.
- Similar to SJR11, which seeks to increase distributions by 1 percent to lengthen the school year and school year.
- Similar to HJR1, which seeks to increase LGPF distributions by 1 percent for education.
- Similar to HJR2, which seeks additional annual LGPF distributions by 0.5 percent for public safety.
- Similar to HJR3, which seeks additional annual STPF distributions by 0.5 percent for public safety.

ALTERNATIVES

PED offers the following for consideration:

“The sponsors may wish to consider whether or not the creation of a new fund to smooth the availability of education revenues requires a constitutional amendment or whether this could be accomplished via a new non-reverting fund in state statute.”

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APPENDIX

Quick Facts on the Land Grant Permanent Fund

What is the Land Grant Permanent Fund?

- The “land grant permanent fund” is really a collection of permanent funds.
 - The largest fund – representing about 85 percent of the total LGPF – is the Permanent School Fund, which is allocated for common schools and ultimately flows through the general fund for public school funding.
 - The other permanent funds belong to 20 different beneficiaries, including universities, hospitals, and other public institutions.
- Established in 1912 through New Mexico’s entry into statehood.
- Tied to the federal Enabling Act of 1910, which stipulated that such land grants were to be held in trust for the benefit of the public schools, universities, and other specific beneficiary institutions.
- Oil and gas revenues (rents, royalties, and bonuses) make up over 90 percent of contributions to the fund – 2016 contributions totaled about \$371 million.
- One of the largest sovereign wealth funds in the country – about \$17 billion as November 30, 2017.

Current Distributions from LGPF

Currently, 5 percent of the LGPF five-year average is distributed to 21 beneficiaries of the fund based on land-ownership. In FY18, total LGPF distributions to the beneficiaries will be about \$689 million. About 85 percent of this amount (~\$585 million) will go to the general fund for public schools.

Distribution History

- Originally, only interest earnings were distributed to beneficiaries.
- 1996, voters passed a constitutional amendment to raise the distribution amount to 4.7 percent of the five-year average value of the fund.
- 2003, by a slim margin (92.2 thousand for, 92.0 thousand against), voters passed a constitutional amendment to:
 - Raise the annual distribution to 5 percent,
 - Provide an additional distribution of 0.8 percent from FY06 – FY12 (totaling 5.8 percent),
 - Reduce the additional distribution to 0.5 percent from FY13 – FY16 (totaling 5.5 percent),
 - Earmark the general fund portion of the additional distributions to implement educational reforms.
- FY17, the distribution reverted back to 5 percent.

Important Considerations

LGPF was established and is required by law to benefit public schools and other beneficiaries indefinitely. It is funded by income from non-renewable resources and is designed to provide for future generations of New Mexicans even when those resources are exhausted.

Land Grand Permanent Fund (LGPF) Beneficiaries	
Percent distribution as of <u>December 1, 2017</u>	
COMMON SCHOOLS	<u>85.095328%</u>
UNIVERSITY OF N.M	<u>1.311620%</u>
UNM SALINE LANDS	<u>0.045397%</u>
<u>N.M.</u> STATE UNIVERSITY	<u>0.414673%</u>
WESTERN <u>N.M.</u> UNIVERSITY	<u>0.024367%</u>
<u>N.M.</u> HIGHLANDS UNIVERSITY	<u>0.024243%</u>
NO. <u>N.M.</u> COLLEGE	<u>0.019696%</u>
EASTERN <u>N.M.</u> UNIVERSITY	<u>0.076008%</u>
N.M INST. MINING & TECH	<u>0.186236%</u>
<u>N.M.</u> MILITARY INSTITUTE	<u>3.029412%</u>
<u>N.M.</u> BOYS SCHOOL	<u>0.005324%</u>
DHI MINERS HOSPITAL	<u>0.867286%</u>
<u>N.M.</u> STATE HOSPITAL	<u>0.333710%</u>
<u>N.M.</u> STATE PENITENTIARY	<u>1.866190%</u>
<u>N.M.</u> SCHOOL FOR THE DEAF	<u>1.844919%</u>
SCH. FOR VISUALLY HAND.	<u>1.841087%</u>
CHAR. PENAL & REFORM	<u>0.769716%</u>
WATER RESERVOIR	<u>0.968725%</u>
IMPROVE RIO GRANDE	<u>0.216647%</u>
PUBLIC BLDGS. CAP. INC.	<u>1.058073%</u>
CARRIE TINGLEY HOSPITAL	<u>0.001342%</u>
Total	<u>100%</u>