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## FISCAL IMPACT REPORT

ORIGINAL DATE 2/7/18

SPONSOR Munoz LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Treasurer Use of Certain Revenue SB 262

ANALYST Clark

### APPROPRIATION (dollars in thousands)

Appropriation					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
\$0.0	\$228.0	\$228.0	\$228.0	\$228.0	Recurring	State Treasurer's Office

Parenthesis ( ) indicate expenditure decreases

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
\$0.0	(\$228.0)	(\$228.0)	(\$228.0)	(\$228.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

Relates to Appropriation in the General Appropriation Act

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

State Treasurer's Office (STO)

### SUMMARY

#### Synopsis of Bill

Senate Bill 262 expands the authorized expenditure by the State Treasurer's Office (STO) of management fees that it collects from the local government investment pool (LGIP) to include operations of STO, effectively expanding the annual other state funds appropriation that is part of the agency's budget in the General Appropriation Act. It provides for this to be a continuing appropriation. Any remaining balance at year end would revert.

The effective date of this bill is July 1, 2019.

### **FISCAL IMPLICATIONS**

Approximately \$350 thousand in management fees for administration of the LGIP are received by STO annually. The Legislature appropriates \$122.3 thousand of these funds to STO for the prescribed uses, and the remainder reverts to the general fund. This bill does not prevent the reversion, but the assumption is the agency would use these additional funds, substantially reducing or eliminating the annual reversion and creating a negative general fund impact.

This bill provides for continuing appropriations. LFC has concerns with including continuing appropriation language in new or amended statutory provisions for funds, as earmarking reduces the ability of the Legislature to establish spending priorities.

### **SIGNIFICANT ISSUES**

This bill is a duplicate of Senate Bill 382 of the 2017 regular legislative session. That bill passed the Legislature but was vetoed.

STO reported to the House Appropriations and Finance Committee a need to fill additional positions, in particular a chief risk officer and a portfolio manager. The General Appropriation Act includes an increase of \$119.6 thousand in the personal services and employee benefits category compared with the FY18 category level to help fill vacant positions.

STO agency staff are very responsive to LFC information requests and provide prompt monthly reporting on fund balances. STO was also very helpful to LFC staff during the recent fiscal crisis, providing daily general fund balance information during the worst of the revenue downturn, which enabled good analysis and productive discussions about the state's fiscal needs.

STO provided the following analysis.

STO manages approximately \$706 million in LGIP funds. STO charges a 0.05 percent management fee to help cover the costs that the agency incurs in managing the LGIP. These fees fluctuate depending on how much is in the LGIP, but on average total \$350 thousand annually. Currently, the Legislature allows STO to retain a portion of the fees (\$122.3 thousand), and the balance is credited to the general fund.

This bill, as proposed, would enable STO to hire critical positions pertaining to the investment and security of funds and would allow STO to respond to market changes more effectively.

The amount appropriated to STO to cover administration of the LGIP has not been increased in a number of years, yet STO has managed this portfolio without incident. The risks that must be managed, however, are ever-increasing and include, but are not limited to, interest rate risk, cyber security risk, credit risk, operation risk, fraud risk and liquidity risk, as well as the ability to hire competent, experienced portfolio managers who oversee the funds.

The costs to oversee the fund have also risen. These additional costs or expenses include, but are not limited to the following:

- portfolio management, transaction settlement and administrative staffing
- rating agency fees
- Bloomberg trading platform costs
- annual audit and investment accounting costs

The funds are vulnerable when STO is operating without a portfolio manager and financial chief risk officer. This proposal would provide the much needed funding to help cover the costs of these positions and other critical investment related costs as mentioned above.

## RELATIONSHIP

This bill relates to the appropriation to STO in the General Appropriation Act.

## OTHER SUBSTANTIVE ISSUES

The priorities for STO's investment strategies are (1) safety of the principal, (2) maintenance of liquidity, and (3) maximum return on investments. During FY17, general fund balances gradually fell until revenues stabilized and legislative solvency action began to take effect late in the fiscal year. To ensure the ability to pay the state's bills, STO transferred funds from its core investment portfolio to its liquidity portfolio over the course of FY17 but began shifting funds back to the core portfolio in FY18. At the end of FY17, the core portfolio was 51 percent of the total general fund pool compared with 75 percent at the end of FY16. The core portfolio is primarily intended to maximize return with minimal risk to principal, and the liquidity portfolio is intended to provide day-to-day liquid assets for the operations of state government.

The agency generated an apparently unprecedented loss of \$3.2 million in general fund earnings for FY17 due to market losses as interest rates rose. This was due to \$12.8 million of unrealized losses from required adjustments to account for market valuation changes, and the agency's positive, realized earnings were not substantial enough to offset these losses. Interest rate risk and the average maturity of STO's investment funds are highly correlated, and the agency is maintaining an average general fund portfolio maturity of about one year to minimize this risk, significantly below the standard benchmark of two years. As general fund balances increase and interest rates stabilize, losses should return to gains and then begin to increase sharply before plateauing.

### **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