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

ORIGINAL DATE 1/26/18
SPONSOR Padilla **LAST UPDATED** 2/08/18 **HB**

SHORT TITLE Land Grant Funds For Education, Ca **SJR** 2

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
$0.0	$0.0	**($238,848.0)**	**($251,414).0**	**($263,965.0)**	Recurring	LGPF
$0.0	$0.0	$203,021.0	$213,702.0	$224,370.0	Recurring	General Fund
$0.0	$0.0	$35,827.0	$37,712.0	$39,595.0	Recurring	Other LGPF beneficiaries

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$50.0			Nonrecurring	Election Fund

Parenthesis ( ) indicate expenditure decreases

Related to HJR1, HJR2, HJR3, SJR3, SJR7, SJR11

SOURCES OF INFORMATION
LFC Files

<u>Responses Received From</u>
State Investment Council (SIC)
State Land Office (SLO)
Attorney General's Office (NMAG)
Children, Youth and Families Department (CYFD)

<u>Responses Not Received From</u>
Public Education Department (PED)

SUMMARY

Synopsis of Bill

Senate Joint Resolution 2 seeks to amend Article 12, Section 7 of the state constitution, to provide additional yearly distributions of 1.5 percent of the five-year average ending balance from the Land Grant Permanent Fund (LGPF). This would raise the overall LGPF distribution to 6.5 percent per year.

The portion of the additional distribution from the permanent school fund (which currently flows into the general fund, earmarked for public schools) is to be used for early childhood educational (ECE) services, be defined as "nonsectarian services provided by the state, provided to children not yet eligible for kindergarten and provided by: (1) a state agency; (2) an Indian nation, tribe or pueblo; (3) the New Mexico school for the blind and visually impaired; or (4) the New Mexico school for the deaf."

The additional 1.5 percent distributions will not be made if the five-year average value of the LGPF falls below $10 billion. Similarly, legislators can vote to suspend the additional 1 percent distribution by a three-fifths majority of both House and Senate.

The constitutional amendment requires approval by voters in a statewide election, either in the 2018 general election or at a special statewide election held for this purpose. Subsequent approval by US Congress is also required before the amendment can be enacted.

FISCAL IMPLICATIONS

Analysis of Prior Distribution Increases

In 2003, voters passed a constitutional amendment to raise the annual distribution to 5 percent (up from 4.7 percent) and provide additional distributions (0.8 percent and then 0.5 percent) from FY06-FY16 to implement educational reforms. Analysis from the SIC's external fiduciary consultant RVK determined that had New Mexico not enacted its constitutional amendment in 2003, the LGPF would be approximately $1.5 billion larger today. For CY17 an additional $1.5 billion would have generated another $223 million in net earnings for the fund, while also producing an additional $25 million in distributions (at the 5 percent rate) to LGPF beneficiaries for FY19. This information helps to inform the fiscal estimates and expected implication of the distribution changes proposed in this legislation.

Analysis of Distribution Changes Proposed in this Joint Resolution

The State Investment Council (SIC) indicates, in the short term, additional distributions from the LGPF will produce significantly more revenue to the general fund for early childhood education and to the other LGPF beneficiaries. However, there is a trade-off. The additional distribution will lessen future earnings and reduce the significantly greater benefits that a larger fund would produce long-term at the lower distribution rate.

The long-term effect of foregoing investment earnings by increasing the distribution can be mitigated by higher inflows in the LGPF from investment returns and oil and gas royalty contributions. However, the opposite holds true as well, where depressed oil/gas prices, coupled with lower investment returns (which are predicted over the next decade) and a higher spending rate, have potential to negatively impact the health of the endowment long-term.

Opportunity Cost. In taking an additional 1.5 percent from the LGPF every year, this proposal would deliver an additional $3.1 billion in revenue over the first dozen years, or an average of an additional $256 million annually. After the first dozen years, the additional draw-down would cut estimated value of the LGPF by $4.3 billion, or an average of $358 million per year over the first 12 years. The difference in the fund values - is the "opportunity cost" in deploying the additional capital, and the trade-off of $1.2 billion is the price of taking additional distributions early rather than investing the capital.

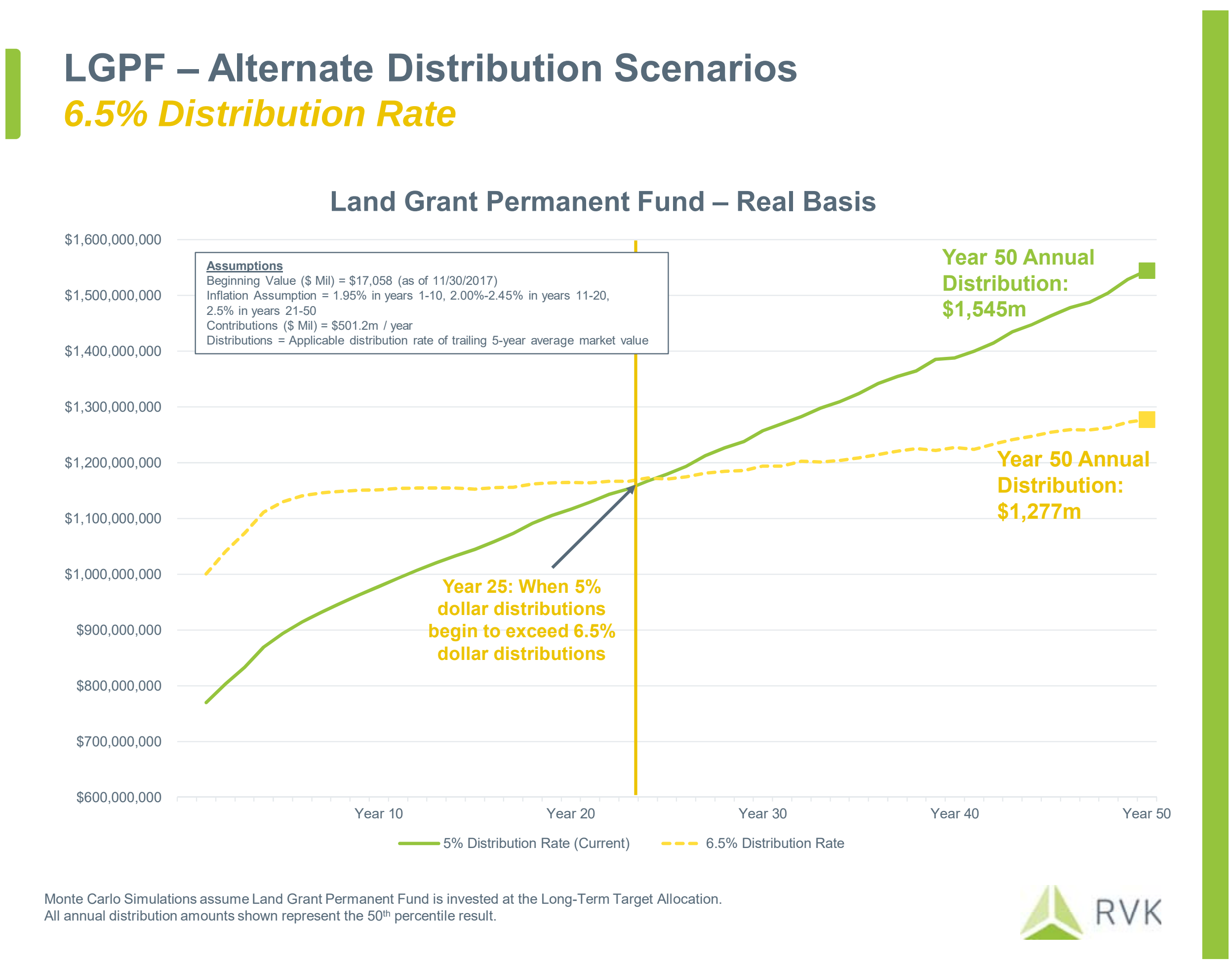
SIC provided the chart below, which tracks the first 30 years of projected distributions at both the 5 percent and 6.5 percent rates, assuming the following: investment returns of 6.8 percent net, and inflows of $500 million from the Land Office annually for the first 10 years, increasing by 2 percent annually thereafter, both projections which are in-line with long-term expectations.

Calendar Year	Corresponding Fiscal Year	($B) LGPF Value Current (5.0%)	LGPF Distribution @5.0%	($B) LGPF Value w/SJR7 (6.5%)	LGPF Distribution @6.5%	Compounded Difference in 5.0% & 6.5% LGPF Distribution	Difference in LGPF Value ($B)
2017	2019	17.28826869	$747,542,992	17.28826869	$747,542,992		
2018	2020	18.246	$796,161,175	18.246	$1,035,009,527	$238,848,352	$0
2019	2021	19.214	$843,222,102	19.095	$1,094,636,218	$490,262,468	($0.12)
2020	2022	20.201	$901,208,157	19.829	$1,165,173,299	$754,227,610	($0.37)
2021	2023	21.203	$961,520,480	20.547	$1,235,055,117	$1,027,762,247	($0.66)
2022	2024	22.213	$1,010,768,973	21.244	$1,286,480,560	$1,303,473,834	($0.97)
2023	2025	23.237	$1,060,688,584	21.928	$1,334,351,721	$1,577,136,971	($1.31)
2024	2026	24.282	$1,111,363,962	22.609	$1,380,029,302	$1,845,802,311	($1.67)
2025	2027	25.347	$1,162,821,919	23.289	$1,425,012,180	$2,107,992,572	($2.06)
2026	2028	26.434	$1,215,130,239	23.970	$1,469,509,886	$2,362,372,219	($2.46)
2027	2029	27.542	$1,268,419,407	24.653	$1,513,820,526	$2,607,773,338	($2.89)
2028	2030	28.683	$1,322,875,938	25.347	$1,558,272,625	$2,843,170,025	($3.34)
2029	2031	29.858	$1,378,638,324	26.055	$1,603,076,870	$3,067,608,571	($3.80)
2030	2032	31.068	$1,435,851,283	26.777	$1,648,420,362	$3,280,177,650	($4.29)
2031	2033	32.315	$1,494,665,366	27.513	$1,694,481,057	$3,479,993,341	($4.80)
2032	2034	33.599	$1,555,236,389	28.264	$1,741,435,939	$3,666,192,891	($5.33)
2033	2035	34.922	$1,617,625,292	29.032	$1,789,331,996	$3,837,899,595	($5.89)
2034	2036	36.285	$1,681,890,237	29.815	$1,838,207,456	$3,994,216,814	($6.47)
2035	2037	37.688	$1,748,087,449	30.614	$1,888,094,146	$4,134,223,511	($7.07)
2036	2038	39.133	$1,816,271,934	31.430	$1,939,019,195	$4,256,970,772	($7.70)
2037	2039	40.622	$1,886,498,317	32.264	$1,991,006,708	$4,361,479,163	($8.36)
2038	2040	42.154	$1,958,821,812	33.114	$2,044,079,542	$4,446,736,893	($9.04)
2039	2041	43.732	$2,033,298,793	33.982	$2,098,260,375	$4,511,698,475	($9.75)
2040	2042	45.357	$2,109,986,919	34.869	$2,153,571,958	$4,555,283,514	($10.49)
2041	2043	47.029	$2,188,945,228	35.774	$2,210,037,289	$4,576,375,575	($11.26)
2042	2044	48.751	$2,270,234,209	36.698	$2,267,679,720	$4,573,821,086	($12.05)
2043	2045	50.523	$2,353,915,851	37.641	$2,326,523,018	$4,546,428,253	($12.88)
2044	2046	52.346	$2,440,053,694	38.603	$2,386,591,401	$4,492,965,960	($13.74)
2045	2047	54.223	$2,528,712,863	39.586	$2,447,909,557	$4,412,162,654	($14.64)
2046	2048	56.154	$2,619,960,113	40.589	$2,510,502,662	$4,302,705,203	($15.57)
2047	2049	58.141	$2,713,863,867	41.612	$2,574,396,393	$4,163,237,729	($16.53)
2048	2050	60.186	$2,810,494,258	42.658	$2,639,616,938	$3,992,360,409	($17.53)

The following points of comparison are provided by SIC:

- The 2003 amendment took $747 million above the current base distribution rate of 5 percent. This resolution would draw down more than $3 billion, or four times as much on a nominal basis.
- Looking forward, those estimated revenue losses grow and accelerate, and by fiscal year 2044 (24 years into this increased distribution formula) it is projected that the state will start receiving less from the LGPF than it would have if the fund had been kept at the 5 percent rate.
- At that time, the LGPF would have more than $12 billion less than had this resolution never been passed. An average one-year's earnings on $12 billion would be about $820 million.
- From year 25 and every year thereafter, the base-rate 5 percent LGPF and its slower, lower distribution rate would outpace the higher 6.5 percent distribution, and deliver significantly more money to benefit New Mexico's public schools.

This "tipping point" – where the larger fund with the lower distribution rate catches up and surpasses the fund that has grown at a slower rate due to higher distributions – was also identified by RVK, which is SIC's fiduciary consultant. The following inflation-adjusted "real dollar" value analysis from RVK illustrates this graphically, specific to this proposed joint resolution.



Similar to SIC's analysis, the State Land Office (SLO) states increased distributions from the LGPF increase the risk that the corpus of the LGPF will be diminished and that less money will be available in future years. In the long run, the increased distribution will have a negative impact on the LGPF and distributions to the beneficiaries.

The rate at which the fund is affected will depend on new money contributed by the State Land Office from state trust land royalties and fluctuations in investment returns. SLO's internal financial analysis indicates that if all analytical variables other than the distribution rate were held constant, comparing a 5 percent distribution (current law) to a 6.5 percent distribution (proposed), the beneficiaries would receive approximately $2.3 billion more in total distributions during the next ten years and would receive approximately $7.6 billion less in total distributions over the next fifty years. The analysis indicates that the beneficiaries will start to see a reduction in funds distributed within 25 years if this resolution is enacted and approved. The internal analysis also indicates that the value of the fund will be approximately $36.8 billion dollars higher in fifty years if current distribution rates remain in place as compared to those proposed in this legislation.

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

SIGNIFICANT ISSUES

Distribution 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 proposed amendment increases the distribution to all beneficiaries, and requires only that the additional distributions from the permanent school fund be used for early childhood educational services. The additional distribution, which flows to the other 20 beneficiaries of the LGPF, does not appear to be earmarked for early childhood education. [See Appendix A on pages 9 and 10 for more information on the makeup of the LGPF.]

The proposed amendment does not address who or what would be charged with determining whether the additional disbursements should be regulated and measured for effectiveness, or from a practical standpoint, what agency would help ensure that the deployment of these extra dollars meet the qualifications and full intent of the legislation.

Early Childhood Issues. New Mexico's early childhood care and education system begins prenatally and extends through age 8. Services for improving the health, safety, stability, and education of New Mexico's children span several state agencies, including the Children, Youth and Families Department (CYFD), the Department of Health (DOH), the Human Services Department (HSD), and the Public Education Department (PED).

Benefits of early childhood education include increased reading and math competency for low-income children, reduced special education designations, and more consistent utilization of early well-child visits, which should improve long-term outcomes for children. LFC's *2017 Early Childhood Accountability Report* found students who participated in New Mexico's prekindergarten program improved attendance and performance through the 5th grade. LFC has also found prekindergarten programs deliver a positive return on investment for New Mexico taxpayers based on improvement in test scores. Low-income students who participated in both prekindergarten and K-3 Plus closed the achievement gap by kindergarten entry.

In the last decade, appropriations for the Public Education Department's (PED) early childhood education programs have increased over tenfold, from about $5 million in FY07 for prekindergarten and K-3 Plus to $58.7 million for these two programs and an early reading initiative. For FY17, PED and the Children, Youth and Families Department (CYFD) were budgeted to serve 8,496 four-year-olds in state-funded prekindergarten. PED serves 5,273 children and CYFD serves 3,248. This does not include 997 three-year-olds served by CYFD in early prekindergarten.

K-3 Plus has been scientifically shown to improve student performance relative to peers when programs are executed correctly. However, there is concern the K-3 Plus program may not be implemented effectively at all schools. For increased gains, students should stay with the same teacher they had during the K-3 Plus program; however, this is not often the case. Further, more programs are now only making available 20 days of instruction rather than 25. LFC's *2017 Early Childhood Accountability Report* notes the intent of the program is not being followed and should raise concerns for policymakers that K-3 Plus is turning into summer school rather than a scientifically proven program to extend the school year for students from low-income families that need additional time-on-task to catch up to more affluent peers academically.

Additionally, the LFC report notes that currently, 3-year-old prekindergarten is only implemented by CYFD-funded private child care programs, and PED has raised concerns regarding the infrastructure and capacity of schools to expand prekindergarten to earlier ages and instead chose to focus on expansion of extended-day prekindergarten for 4-year-olds.

LFC estimates remaining statewide funding needs for all early childhood services is close to $190 million. To close service gaps and continue improving early childhood outcomes, targeted interventions are needed, such as focusing state-funded home-visiting services to at-risk, low-income families in high-need communities. Additional funding is needed to grow at a rate to both serve more clients and improve quality.

Despite a clear funding need, there is currently no master plan or specific details as to how the additional hundreds of millions of dollars made available through this legislation will be expended, or how the related benefits of those dollars will be measured and evaluated for effectiveness, in either the short- or long-term. Accountability, program effectiveness and a standard evaluation process should be important considerations when establishing long-term public policy related to such a sizeable investment of public dollars.

PERFORMANCE IMPLICATIONS

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**

A higher distribution rate could pressure the State Investment Council to achieve higher rates of return on investment in order to maintain the value of the fund. This is a potentially challenging goal during periods of national or economic decline, and could lead SIC to take on greater investment risk in hopes of achieving higher returns in order to protect the earning power of the fund. The past few years the SIC has taken the opposite approach, however, by diversifying investments, and lessening its annual return target to a more realistic 7.0 percent return, from the previous 8.5 percent.

Over the next decade, SIC expects it will likely be one of both volatility and depressed investment returns, given high, or in some cases record valuations, currently seen among publicly-traded companies. Depending on LGPF inflows from the State Land Office, the rate of inflation (which we anticipate will rise in the years ahead), and uncertain investment returns, SIC claims it is a reasonable assumption that a 6.5 percent distribution rate would have a greater impact on the LGPF corpus more frequently than distributions have in the past.

ADMINISTRATIVE IMPLICATIONS

Early Childhood Programs & Potential Conflict with Current Statute. As clarified in the Attorney General's opinion (No. 12 - 03, dated February 1, 2012), the funds from the Land Grant Permanent Fund cannot be used to support private schools (including private early childhood programs) but can be used for early childhood learning programs provided by the public schools. CYFD interprets that any distribution made pursuant to this joint resolution could only be used by the Public Education Department (PED) for early childhood programs exclusively under the control of the State. The majority of the PED's early childhood education services is provided through pre-kindergarten programs. Therefore, CYFD states the majority of the appropriations made through the distributions provided by this legislation would fund pre-kindergarten programs run by PED. CYFD indicates this is in direct contradiction to the statutory provision at NMSA 1978, § 32A-23-9 requiring that any money appropriated for pre-kindergarten programs be divided equally between PED and CYFD.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

- 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 STPF for education.
- Similar to SJR11, which seeks to increase distributions by 1 percent to lengthen the school say 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.

TECHNICAL ISSUES

Potential Conflict with Current Statute. In response to similar legislation (2018 HJR 1), the Children, Youth and Families Department (CYFD) states the provisions of this legislation may conflict with NMSA 1978, § 32A-23-9 requiring that "any money appropriated for pre-kindergarten programs shall be divided equally between the Public Education Department and the Children Youth and Families Department." CYFD administers a significant portion of the

State's early childhood services and those services are delivered through private contractors. It is unclear how this joint resolution would impact CYFD's and New Mexico's current structure for delivery of early childhood services. (See *Administrative Implications* section above).

OTHER SUBSTANTIVE ISSUES

Other State Permanent Funds. The State Investment Council notes the vast majority of other states with permanent funds, as well as similar university endowments take a more conservative approach to endowment fund spending policies than New Mexico.

- Annual distributions by domestic sovereign wealth & educational endowment funds:
- Alabama: 5 percent of rolling 3-year average
- Alaska: income earned only;
- Idaho: 5 percent of previous 3-year average value
- North Dakota Legacy Fund: 25 percent of annual earnings, through 2039
- Wyoming: 5 percent of the 5-year average value
- Texas Permanent School Fund: 3.3 percent;
- Utah: may not exceed 4 percent
- Arizona: 2.5 percent of previous 5 year average value

ALTERNATIVES

The State Land Office (SLO) indicates an alternative way to fund early childhood education without increasing LGPF distributions would be to add additional land to the trust (i.e., increase the corpus of the trust). SLO states, "this is precisely the concept driving the proposal to transfer unleased federal mineral estate to the state land office for the purpose of funding early childhood education."

DI/al/jle

APPENDIX A

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

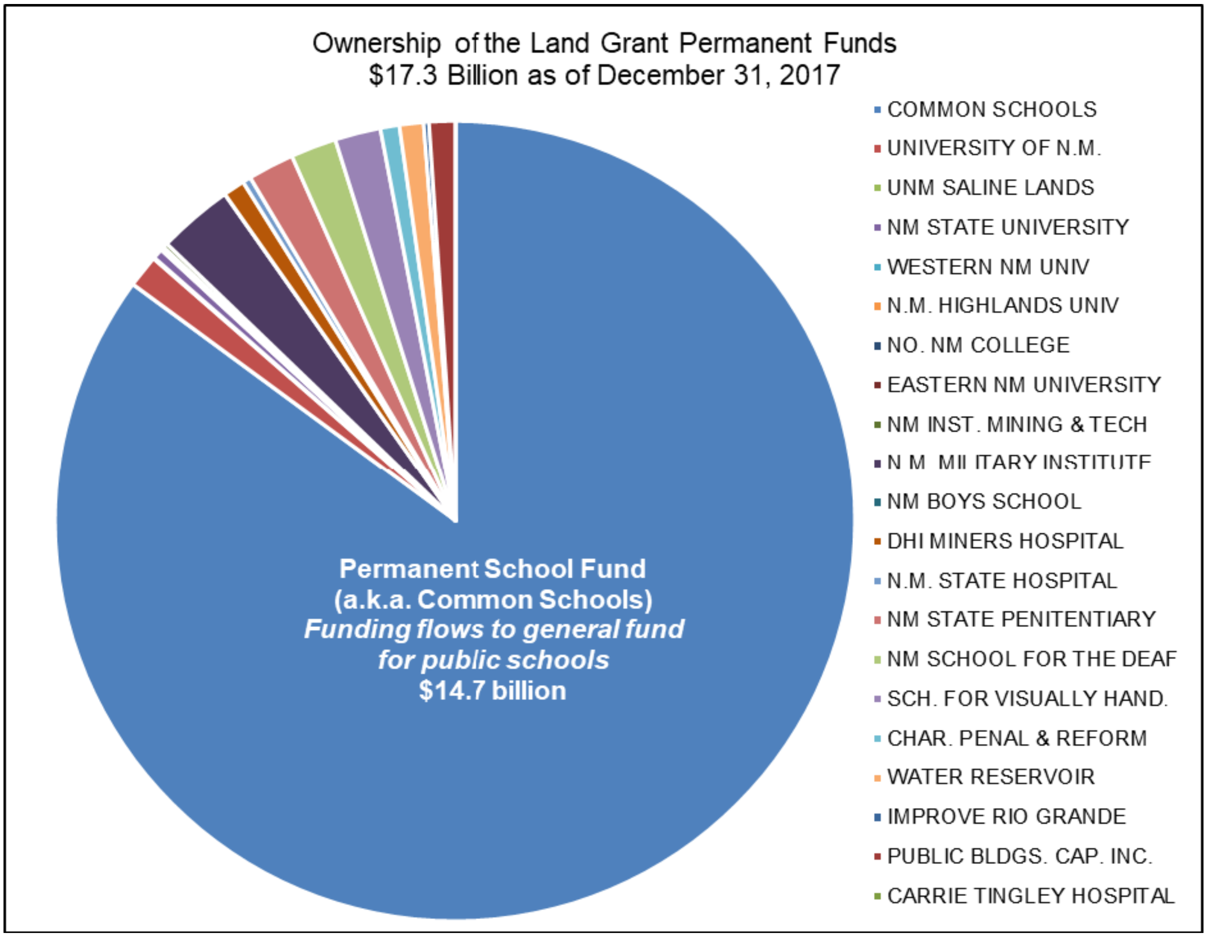
Currently, 5 percent of the LGPF five-year average is distributed to 21 beneficiaries of the fund based on land-ownership. In FY18, total LGPF distributions to the beneficiaries will be about $689 million. About 85 percent of this amount (~$585 million) will go to the general fund for public schools.

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 vote of 92.2 thousand for and 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.

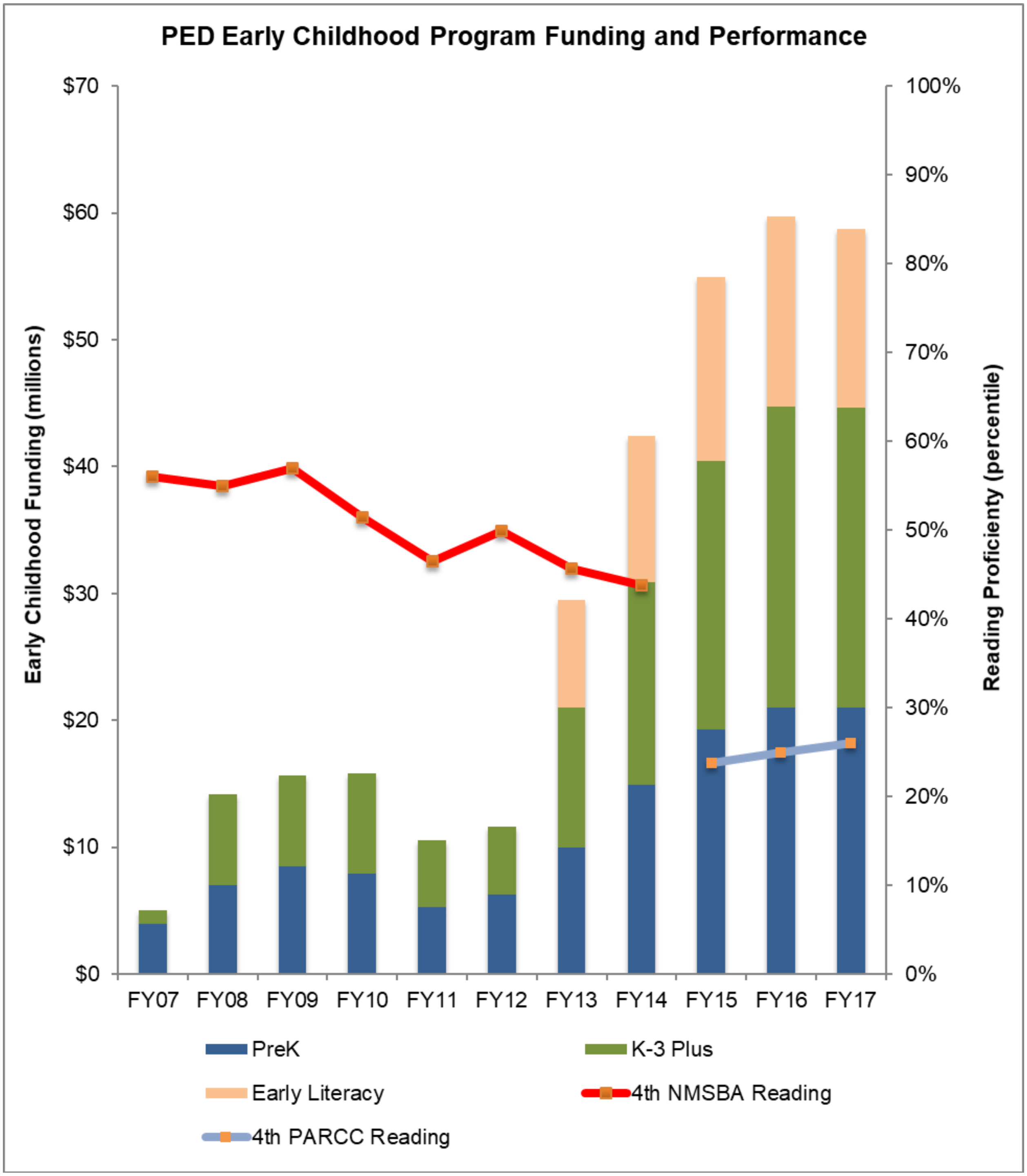
Important Considerations

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

APPENDIX B


PED Early Childhood Program Funding and Performance
Early Childhood Funding (millions)
$70
$60
$50
$40
$30
$20
$10
$0
Reading Proficienty (percentile)
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
FY07 FY08 FY09 FY10 FY11 FY12 FY13 FY14 FY15 FY16 FY17
PreK
K-3 Plus
Early Literacy
4th NMSBA Reading
4th PARCC Reading