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

ORIGINAL DATE 1/23/2020
SPONSOR Maestas/Martinez, J. **LAST UPDATED** 2/19/2020 **HJR** 1/aSRC

SHORT TITLE Permanent Funds For Early Childhood, CA **SB**

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	**FY21**	**FY22**	**FY23**	**FY24**		
		($90,199.0)	($96,730.6)	($101,301.1)	Recurring	Land Grant Permanent Fund
		$76,767.1	$82,326.0	$86,215.9	Recurring	General Fund (public schools for early childhood education)
		$13,431.9	$14,404.5	$15,085.1	Recurring	Other Land Grant Permanent Fund beneficiaries

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY20	FY21	FY22	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$150.0		$150.0	Nonrecurring	General Fund

Parenthesis ( ) indicate expenditure decreases

Related to Senate Bill 3 and House Bill 83

SOURCES OF INFORMATION

LFC Files

Responses Received From
State Investment Council (SIC)
State Land Office (SLO)
Children, Youth and Families Department (CYFD)
New Mexico Attorney General (NMAG)
Public Education Department (PED)

SUMMARY

Synopsis of SRC Amendment

The Senate Rules Committee amendment reduces the additional distribution from the permanent fund to 0.5 percent. The amendment also changes the automatic asset value "safety valve" from $10 billion to $17 billion, which is intended to protect the corpus should its 5-year average value fall below a certain level at calendar-end of any given year. See *Technical Issues*.

Synopsis of Original Bill

House Joint Resolution 1 seeks to amend Article XII, Section 7 of the New Mexico Constitution to provide an additional 1 percent annual distribution from the Land Grant Permanent Fund (LGPF). The proposed amendment stipulates the amount of the additional distribution coming from the permanent school fund (which is the largest component of the land grant permanent fund allocated to support "common schools"), is to be earmarked for early childhood educational (ECE) services. The amendment defines "early childhood educational services" as nonsectarian and nondenominational services for children until they are eligible for kindergarten.

The Constitutional Amendment would only be effective if passed by voters in the next general election (2020) or via a statewide special election held for this purpose. Subsequent to approval by the voters, the amendment would require the consent of the U.S. Congress before becoming effective.

FISCAL IMPLICATIONS

The fiscal impact table reflects the SRC amendment and assumes voters approve the amendment in the next general election (November 2020) and that Congressional approval is granted by July 1, 2021. Therefore, assuming the 5.5 percent distribution would begin in FY22, LFC staff analysis shows the proposed amendment would deliver about $90 million in additional distributions that year, of which about $77 million would go the general fund for early childhood educational services. The remaining $13 million would go to the other 20 beneficiaries of the LGPF. Depending on the timing of potential voter and Congressional approval of the amendment, it is possible for additional distributions to begin sooner.

The proposal does not contain a delayed repeal date; therefore, the additional 0.5 percent distribution would continue into perpetuity.

Increasing the distribution rate results in more general fund revenue in the short term, but reduces the total value of the fund. Doing so, limits the fund's ability to grow over time and reduces the general fund distributions in the long term. The following table shows LFC staff's analysis of the differences in the 5 percent distribution rate versus a 5.5 percent distribution. The analysis assumes (1) inflows from oil and gas royalties consistent with the consensus revenue forecast's expected growth in oil and gas value over the next five years and static inflows for the years after that, and (2) a 5.5 percent investment return over the next 10 years then a 7 percent return afterwards consistent with the SIC's target, on average.

The additional benefits of the 5.5 percent distribution rate would continue to outpace benefits of a 5 percent distribution rate fund until about 2050, at which point, 28-years into the new distributions, the larger 5 percent fund would produce more dollars in annual distributions than the 5.5 percent fund, due to its smaller fund value. The LFC staff analysis below shows the market value of the fund is expected to increase on an annual basis despite additional distributions; however, the expected ending value of the fund is over $1.5 billion less within 10 years under the 5.5 percent distribution scenario and nearly $8 billion less within 30 years.

Calendar Year	Corresponding Fiscal year	LGPF Value ($B) at CY-end at current 5%	LGPF Distribution at 5% of 5-year average		LGPF Value ($B) at CY-End w/ HJR1 5.5%	LGPF Distribution at 5.5% of 5-year average	Difference in LGPF Value ($B)	Difference in LGPF Distribution
2019	2021	$19.720	$836,367,381		$19.720	$836,367,381	$-	$-
2020	2022	$23.496	$901,990,379		$23.347	$992,189,417	$(0.149)	$90,199,038
2021	2023	$24.775	$972,539,349		$24.514	$1,069,269,904	$(0.261)	$96,730,555
2022	2024	$26.062	$1,034,612,708		$25.677	$1,135,913,774	$(0.385)	$101,301,066
2023	2025	$27.345	$1,111,819,441		$26.826	$1,217,965,252	$(0.520)	$106,145,811
2024	2026	$28.632	$1,175,238,019		$27.969	$1,283,487,873	$(0.663)	$108,249,853
2025	2027	$29.922	$1,239,041,359		$29.109	$1,347,956,620	$(0.814)	$108,915,261
2026	2028	$31.216	$1,303,099,087		$30.243	$1,411,654,154	$(0.973)	$108,555,067
2027	2029	$32.513	$1,367,366,501		$31.374	$1,475,033,001	$(1.139)	$107,666,500
2028	2030	$34.278	$1,431,774,240		$32.947	$1,538,058,316	$(1.331)	$106,284,076
2029	2031	$36.096	$1,496,281,367		$34.561	$1,600,724,945	$(1.535)	$104,443,578
2030	2032	$37.964	$1,565,612,401		$36.213	$1,668,057,819	$(1.751)	$102,445,417
2031	2033	$39.880	$1,640,252,590		$37.900	$1,740,562,408	$(1.980)	$100,309,818
2032	2034	$41.841	$1,720,670,824		$39.618	$1,818,710,192	$(2.222)	$98,039,367
2033	2035	$43.842	$1,807,312,453		$41.363	$1,902,934,908	$(2.479)	$95,622,455
2034	2036	$45.883	$1,900,592,127		$43.132	$1,993,627,061	$(2.750)	$93,034,934
2035	2037	$47.963	$1,996,229,186		$44.926	$2,086,208,136	$(3.037)	$89,978,951
2036	2038	$50.082	$2,094,093,976		$46.742	$2,180,496,843	$(3.340)	$86,402,867
2037	2039	$52.242	$2,194,077,451		$48.583	$2,276,335,931	$(3.659)	$82,258,480
2038	2040	$54.443	$2,296,098,992		$50.448	$2,373,601,613	$(3.995)	$77,502,621
2039	2041	$56.686	$2,400,114,307		$52.337	$2,472,212,892	$(4.349)	$72,098,585
2040	2042	$58.971	$2,506,123,243		$54.250	$2,572,140,609	$(4.720)	$66,017,366
2041	2043	$61.299	$2,614,152,428		$56.189	$2,673,387,077	$(5.110)	$59,234,649
2042	2044	$63.671	$2,724,233,409		$58.153	$2,775,960,425	$(5.519)	$51,727,016
2043	2045	$66.089	$2,836,401,412		$60.142	$2,879,872,959	$(5.947)	$43,471,547
2044	2046	$68.552	$2,950,694,223		$62.157	$2,985,139,673	$(6.395)	$34,445,450
2045	2047	$71.061	$3,067,151,310		$64.199	$3,091,777,076	$(6.863)	$24,625,765
2046	2048	$73.619	$3,185,813,291		$66.267	$3,199,802,462	$(7.352)	$13,989,171
2047	2049	$76.224	$3,306,721,725		$68.362	$3,309,233,610	$(7.863)	$2,511,886
2048	2050	$78.879	$3,429,919,050		$70.484	$3,420,088,672	$(8.396)	$(9,830,378)
2049	2051	$81.584	$3,555,448,557		$72.633	$3,532,386,106	$(8.951)	$(23,062,452)
2050	2052	$84.341	$3,683,354,374		$74.811	$3,646,144,645	$(9.530)	$(37,209,729)
2051	2053	$87.149	$3,813,681,477		$77.017	$3,761,383,284	$(10.132)	$(52,298,193)
2052	2054	$90.011	$3,946,475,695		$79.252	$3,878,121,271	$(10.759)	$(68,354,424)
2053	2055	$92.927	$4,081,783,730		$81.516	$3,996,378,110	$(11.411)	$(85,405,620)
2054	2056	$95.898	$4,219,653,167		$83.809	$4,116,173,560	$(12.089)	$(103,479,607)
2055	2057	$98.926	$4,360,132,495		$86.132	$4,237,527,640	$(12.793)	$(122,604,855)
2056	2058	$102.010	$4,503,271,118		$88.486	$4,360,460,627	$(13.525)	$(142,810,491)
2057	2059	$105.153	$4,649,119,377		$90.870	$4,484,993,064	$(14.284)	$(164,126,313)
2058	2060	$108.356	$4,797,728,566		$93.285	$4,611,145,761	$(15.071)	$(186,582,804)

The impact of an additional 0.5 percent distribution of the permanent fund can also be swayed substantially by investment returns and annual revenue inflows to the permanent fund, which are driven primarily by oil and gas royalties. Put simply, higher oil and gas inflows to the LGPF and higher than expected investment returns significantly help mitigate the long-term effects of spending additional investment earnings through an increased drawdown. However, the opposite holds true as well, where depressed oil and gas prices, coupled with lower investment returns (which many predict over the next decade), and a higher spending rate have a much greater potential to negatively impact the health and growth of the endowment long-term.

SIC points out that while investment markets are expected to see increased volatility, the outlook regarding inflows to the LGPF has taken a much improved turn since 2016 and especially over the past three years. In 2019, the LGPF received a record $940 million in contributions from the State Land Office. This $940 million inflow – $135 million more than any prior year – compares to the $371 million contributed to the LGPF just a few years ago in 2016. During the 2019 calendar year, the LGPF distributed $811 million or $129 million less than the total contributed to the LGPF.

According to analysis by the State Land Office (SLO), the corpus of the LGPF would be preserved with an additional 1 percent distribution from the fund, with SLO defining "corpus" as the sum of all the inflation-adjusted royalty contributions to the LGPF from SLO since inception of the fund.

Notably, the additional 0.5 percent distribution from the LGPF via the permanent school fund would go to the common school fund prior to being distributed to public schools. The common school fund is not an investment fund; it is a fund within the state treasury. Funds in the common school fund would have much lower interest earnings than if that same amount remained in the permanent school fund. Additionally, similar to other treasury funds, all earned interest would be distributed as unearmarked revenue to the general fund; interest would not accrue to the common school fund. Therefore, any earnings gained while in the common school fund would not necessarily accrue to the benefit of early childhood education. In other words, not increasing the LGPF distribution will have better long-term financial benefits than an increased distribution that sits in the common school fund until the state has the capacity to absorb the additional distribution.

Tradeoffs and the "Tipping Point". Within 29 years of the amendment's approval, the distribution amount generated from a 5.5 percent distribution from a smaller fund will be less than the distribution amount generated from 5 percent of a larger fund.

The 2003 amendment to the LGPF permanently increased the LGPF distribution from 4.7 percent to 5 percent, and temporarily increased it to 5.8 percent from FY06-FY12 and 5.5 percent from FY13-FY16. If the 2003 amendment to LGPF were never passed, the fund would have been $1.5 billion greater in FY18. For CY17 an additional $1.5 billion would have generated another $223 million in net earnings for the fund.

By 2017, distributions to the general fund were smaller than they would have been if the 2003 amendment had never occurred. If the distribution had never increased from 4.7 percent, the annual general fund distribution would have been about $20 million higher in FY17 and $25 million higher in FY18. The original FIR for this legislation (SJR6, 2013) accurately projected the timeframe of this tipping point.

Impact to State Agencies. New Mexico's early childhood education and care system spans 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). The table below shows the early childhood educational services provided by each agency and the age range of children served.

Early Childhood Education and Care System

State Agency	Program	Age Range
CYFD	Head Start and Early Head Start	prenatal-4
CYFD	Childcare Assistance	3 weeks-13
CYFD	Home Visiting	prenatal-4
CYFD	Prekindergarten	3-4
DOH	Family, Infants, and Toddlers	birth-3
DOH	Women, Infants, and Children	birth-5
HSD	Home Visiting	prenatal-4
PED	Prekindergarten	4
PED	K-3 Plus	5-8
PED	Services for Developmentally Delayed Students	3-4

Source: LFC and LESC Analysis

In response to prior versions of this joint resolution, PED stated this bill will deliver significant revenue to the state to be applied to the state's ongoing efforts to expand state pre-K and other ECE programs. This bill would establish a recurring revenue stream for early childhood initiatives in perpetuity, given the amendment does not have a sunset clause.

However, it is important to note that 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 *Technical Issues* section).

Election Costs. Under Section 1-16-13 NMSA 1978 and the New Mexico constitution, the Secretary of State (SoS) is required to print samples of the text of each constitutional amendment, in both Spanish and English, in an amount equal to ten percent of the registered voters in the state. The SoS is also required to publish them once a week for four weeks preceding the election in newspapers in every county in the state. The estimated cost per constitutional amendment is $125 thousand to $150 thousand depending upon the size and number of ballots and if additional ballot stations are needed.

SIGNIFICANT ISSUES

Distributions. Notably, the "permanent school fund" and the "land grant permanent fund" are not the same. The permanent school fund is one 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 that flows to the other 20 beneficiaries of the LGPF is not earmarked for early childhood education.

Early Childhood Education. New Mexico's early childhood care and education system begins prenatally and extends through age 8. Benefits of prekindergarten include improved math and reading proficiencies for low-income 4-year-olds, lower special education and retention rates, and lessened negative effects of mobility.

According to the LFC *2019 Early Childhood Accountability report*, the state has increased its funding to various ECE programs in recent years, spending more than $500 million in FY20 across childcare assistance, home visiting, pre-K, K-5 Plus, early literacy and head-start programs. This was an increase of more than $100 million, year over year. Despite significant barriers to expansion, New Mexico is close to providing sufficient funding to ensure all low-income 4-year-olds receive at least some type of early education through childcare assistance, prekindergarten, or Head Start.

In the last decade, appropriations for the PED early childhood education programs have increased over tenfold, from about $5 million in FY07 for prekindergarten and K-3 Plus to $68 million for these two programs and an early reading initiative. In FY19, over 11 thousand children received prekindergarten services, including extended day services. Prior to FY16, prekindergarten was only available to 4-year-olds but policymakers expanded services for 3-year-olds to support continued gains in student achievement outcomes, and authorized extended day services. The state has also increased its funding to various early childhood education programs in recent years, most recently allocating $300 million across childcare assistance, home visiting, pre-K, K-3 Plus, and early literacy programs in FY19.

While this amendment focuses on early childhood education funding, it could also help address current shortfalls in the state's educational challenges. These issues have been notably identified in the *Yazzie/Martinez v. State of New Mexico* lawsuit, in which the state District Court ruled that state government has failed to live up to its constitutional duty in educating its children. This 2018 ruling does not attach a specific monetary amount that might bring the state into compliance, but it does define several avenues in which the state can address the deficiency. These include implementing statewide Pre-K programs for all children, with an emphasis on at-risk students. The state will require additional capacity building in infrastructure and professional development of teachers as it expands its early childhood education efforts.

PERFORMANCE IMPLICATIONS

According to PED, a large increase in NM Pre-K programs will require additional training, coaching, and technical assistance to ensure quality, as well as scholarships to increase the number of highly qualified teachers and educational assistants. The PED would need to work with colleges and universities to ensure that degree programs are expanded to serve sufficient numbers of teachers and educational assistants.

CYFD provided the following statement regarding the early childhood workforce:

> "New Mexico has a limited workforce qualified in early childhood education. Early childhood educational services encompass a range of programs with differing degree and licensure requirements for providers. Disparities in workforce qualifications, licensure requirements, and compensation can create an environment in which programs compete for highly-qualified early childhood educational service providers. Expansion of early childhood

> educational services cannot outpace the development of a highly qualified early childhood workforce."

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.

ADMINISTRATIVE IMPLICATIONS

CYFD noted the following:

> "This joint resolution defines 'early childhood educational services' as nonsectarian and nondenominational services for children until they are eligible for kindergarten that are administered by the state. The primary agency which would primarily receive funding under this joint resolution is presumptively the Early Childhood Education and Care Department (ECECD). Currently, New Mexico's Early Learning System spans from prenatal to age five. With the exception of Early Childhood Special Education (PED) and Head Start (Funded directly by the federal Government through Health and Human Services Agency), all programs are transitioning from their originating Agency (Department of Health, Public Education Department and CYFD) to the ECECD."

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 3 and House Bill 83 would establish the early childhood education and care fund and the early childhood education and care program fund, dedicated to supporting early childhood education and care programs. SB3 and HB83 would fund early childhood initiatives while maintaining the corpus of the land grant permanent fund.

TECHNICAL ISSUES

Administration of Early Childhood Educational Services. The proposal appears to be in conflict with Section 32A-23-9 NMSA 1978, which requires any money appropriated for pre-kindergarten programs be divided equally between PED and CYFD. Attorney General Opinion No. 12 - 03, dated February 1, 2012, clarifies that any proposed constitutional amendment to increase distributions from the LGPF for early childhood learning programs would only be permissible if the increased distributions were limited to those programs provided by the public schools. However, CYFD administers a significant portion of the State's early childhood services and those services are delivered through private contractors.

CYFD provided the following statement on the bill's impact on the department and its early childhood programs:

> "According to the Attorney General's opinion, 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. Any distribution made pursuant to this joint resolution could only be used by the Public Education Department for early childhood programs exclusively under the control of the State. The

> majority of the Public Education Department's early childhood education services is provided through PreKindergarten programs. Therefore, the majority of the appropriations made through the distributions provided by the joint resolution would fund Pre-Kindergarten programs run by the Public Education Department.
>
> It is unclear as to whether these funds could legally be awarded to private providers who are now funded for [prekindergarten] and other early childhood services through CYFD (currently) or ECECD (starting FY2021). It is also unclear as to whether these funds could flow to ECECD rather than the PED. Additionally, the 2019 Legislative Education Study Committee staff analysis of this proposal states the amendment's definition of early childhood educational services as nonsectarian and nondenominational, make it appear the intent is to appropriate the additional 1 percent permanent school fund distribution to entities other than public schools for early childhood educational services."

PED reiterated these concerns, stating, "It is unclear as to whether these funds could legally be awarded to private providers who will be funded for NM PreK and other early childhood services through ECECD. It is also unclear as to whether these funds could flow to the proposed Early Education and Care Department rather than the PED."

Additionally, the Legislative Education Study Committee (LESC) staff analysis of this proposal states, "Of note is that public schools are the primary beneficiaries of the [permanent school fund] – but not the specific recipients indicated in HJR1. The Legislature may want to consider the legal and fiscal impact of increasing distributions from the [permanent school fund] for services other than public school services.

Safety Mechanism. The amendment retains an automatic asset value "safety valve" intended to protect the corpus should its 5-year average value fall below $10 billion at calendar-end of any given year. This is currently in the Constitution and is not changed by the original bill. *The SRC amendment changes the "safety valve" asset value from $10 billion to $17 billion.*

The structure of the LGPF constitutional distribution formula uses a 5-year fund average with the intention of steadying the revenue stream for legislators to plan around, and to minimize the year-over-year volatility investment markets often bring. Unfortunately, a side effect of this "smoothing effect" also largely renders the "safety valve" concept ineffective. For example, the value of the LGPF actually went down in CY2018, but due to growth in the previous 4-years, the LGPF will deliver an additional $41 million to its beneficiaries in FY2020.

Similarly, the fund could sustain a loss of 50 percent the next two years in a row, and still not cross the $10 billion fund average threshold, though the fund corpus itself would only be $4.2 billion at that point. It is for this reason that this element, already in the Constitution, should not be viewed as effective at current valuations, and why it is critical to retain the ability of three-fifths of the legislature to vote a temporary stoppage of additional distributions should the fund be endangered.

OTHER SUBSTANTIVE ISSUES

The chart below lists the 21 existing beneficiaries of the LGPF, and the percentage and dollars of the distributions they receive on a monthly basis.

Land Grand Permanent Fund (LGPF) Beneficiaries Percent distribution as of November 1, 2019	
COMMON SCHOOLS	85.807%
UNIVERSITY OF N.M	1.234%
UNM SALINE LANDS	0.043%
N.M. STATE UNIVERSITY	0.383%
WESTERN N.M. UNIVERSITY	0.023%
N.M. HIGHLANDS UNIVERSITY	0.023%
NO. N.M. COLLEGE	0.018%
EASTERN N.M. UNIVERSITY	0.070%
N.M INST. MINING & TECH	0.180%
N.M. MILITARY INSTITUTE	2.929%
N.M. BOYS SCHOOL	0.005%
DHI MINERS HOSPITAL	0.805%
N.M. STATE HOSPITAL	0.336%
N.M. STATE PENITENTIARY	1.764%
N.M. SCHOOL FOR THE DEAF	1.749%
SCH. FOR VISUALLY HAND.	1.745%
CHARITABLE PENAL & REFORM	0.714%
WATER RESERVOIR	0.895%
IMPROVE RIO GRANDE	0.200%
PUBLIC BUILDINGS	1.080%
CARRIE TINGLEY HOSPITAL	0.001%
Total	100%

DI/rl/al/sb/al