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## FISCAL IMPACT REPORT

ORIGINAL DATE 2/19/07

SPONSOR Robinson LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Severance Tax Fund Investments In Art SB 1142

ANALYST Francis

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	(\$0.1)		Recurring	Severance Tax Permanent Fund
	(\$0.1) *See narrative for more detail		Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Public Education Department (PED)

State Investment Council (SIC)

Cultural Affairs Department (CAD)

### SUMMARY

#### Synopsis of Bill

Senate Bill 1142 allows the State Investment Council to invest up to 3 percent of the Severance Tax Permanent Fund (STPF) in New Mexico fine art and fine musical instrument private equity funds. No more than \$60 million could be invested in fine art private equity funds and no more than \$40 million could be invested in fine musical instrument private equity funds. These investments are to be included under “differential rate” investments that are intended to stimulate the economy of New Mexico as well as provide income to the STPF.

The State Investment Officer shall make investments upon approval of the Private Equity Investment Advisory Committee in funds that are managed by reputable companies with sufficient expertise in these assets, and

- whose representations and warranties have been approved by the SIC;

- who have provided audited quarterly statements to SIC;
- whose bank accounts are in NM banking institutions;
- who will place the art in the Museum of New Mexico or a traveling in-state exhibit;
- who will place the musical instruments at University of NM, NM State University, the NM Symphony or the Santa Fe Opera; and
- whose fund managers fully insure all acquisitions for use, show or loan against theft and damage.

NM fine art private equity fund is defined as any limited partnership, limited liability company or corporation organized and operating in NM whose primary business is acquiring fine art for sale opportunistically. An eligible fund also only accepts investments from accredited investors as defined by the Securities and Exchange Commission (SEC).

NM fine musical instrument private equity fund is defined similarly but the allowed investments are restricted to stringed, unfretted musical instruments from Italy, France, Germany or England made from 1600 to 1800 and have a value between \$100,000 to \$8,000,000.

## **FISCAL IMPLICATIONS**

The STPF had a balance of \$4.196 billion as of 9/30/06. Three percent of that would be \$125 million that would be available to invest in these assets. The fiscal impact on the fund would be the difference between investing \$125 million in other SIC investments and investing in these assets. An assumption of 4 percent interest for fine art and fine musical instrument return compared to 8.5 percent SIC historic return means the STPF would forego \$5.6 million in investment return to invest in these assets. Since a portion of the STPF is distributed to the general fund (as well as numerous other beneficiaries), the general fund impact would be \$263 thousand (5 percent of \$5.6 million).

## **SIGNIFICANT ISSUES**

SIC makes the point that under the Prudent Investor Act, these asset classes are already available to them.

SIC:

Niche private equity investments in art and musical instruments have seen notable popularity in recent years among private individuals as well as some university endowments, and some institutional investors consider this asset class to be a prudent investment with an expectation of reasonable returns and risk characteristics when used in conjunction with other asset classes for portfolio optimization. However, the fine art and musical instrument markets also lack a significant base of historical performance data. In 2002, the National Bureau of Economic Research compiled multiple studies on the art investment field and summarized the following findings:

*“Because estimated returns on investment in art depend heavily on the time frame studied, the method used and the data available, the authors conclude that it is difficult to come to any broad conclusions about art investment returns. They calculate that estimates of real returns from investing in art range from 1 to 4.9 percent in the 15 studies reviewed, but they caution that auction prices may reflect an unrepresentative*

*slice of the art market, that transactions costs of up to 25 percent are not included in the estimates and that investing in art involves significant theft and fire risks.”*

While several changes have taken place in the five years since this study, there is little evidence that would show a sea change regarding the overall volatility of fine art investments or their vulnerability to the shifting whims, tastes and trends of the marketplace.

Cultural Affairs:

The Museum of New Mexico would not participate in exhibiting or storing the works or traveling them around the state. Museum policy prohibits this activity. Museums are established as public trusts and cannot engage in profit making endeavors that involve the objects in their trust. This would be a violation of the American Association of Museums “best practices” and could result in the loss of the state museum’s accredited status, and would be viewed by the profession as an ethical violation.

Additionally, as the Museum of New Mexico is a state owned museum, it is unethical for the governing body of the museums (State of New Mexico) to be involved in activities that are in direct conflict with the museums’ stated mission. In essence, the state would be in competition with its museums.

Furthermore, the high valued works that are proposed for these investments would require a level of care (conservation), storage, and handling that the State of New Mexico is not equipped to provide outside of the state museum system as administered by the Department of Cultural Affairs.

PED:

This legislation will provide future opportunities for applied learning, apprenticeships and work training for those students to carry forward in arts education fields.

Visual and Performing Arts investments across the state can help promote student interest in learning. The arts can enhance communication in many ways including the following: verbal and nonverbal; literal or symbolic; invoke response; create dialogue; inform; evolve; persuade; require interaction; and be formal or informal.

Reading, writing, invention, computation, valuing one’s own and other’s cultures and problem solving can be enhanced through major fine arts and fine musical instruments investments. In addition, the housing of these fine arts and fine musical instruments will promote community, museum and public school learning through field trips, workshops, traveling exhibits and other such displays. These methods will enhance student learning tied to New Mexico Standards and Benchmarks and selected measurable Performance Standards and can capture students’ beliefs and imaginations and greatly enhance their learning.

Student learning through a program with curriculum based upon learning through community, arts and culture via museum and other cultural institutions builds life-long learning.

The New Mexico Content Standards for the Arts makes a foundation for this learning and the world of work along with other Content Standards through:

- Demonstration of an understanding of the dynamics of the creative process.
- Observation, discussion, analysis and making critical judgments about artistic works.
- Increased awareness of diverse peoples through film, visual and performing arts.
- Knowledge about how invention and technology have historically influenced artists and offered them new possibilities for expression.
- Connections and parallels among the arts disciplines as well as all other content areas, Science, Math, Language Arts, Social Studies, Modern, Classical and Native Languages, Physical Education and Health and Career Technology.
- Contributions to local and international communities by sharing learning experiences in dance, music, theater/drama and visual arts and by participating in cultural activities in their community and cultural stories developed and recorded through their films.

As the world moves from a logical, linear Information Age into an economy and society built on the inventive, big picture capabilities of a Conceptual Age, creative design, story, symphony, empathy, play and meaning\* will emerge to be as valued as logical thinking and linear skills are now.

\*concepts from Daniel Pink's A WHOLE NEW MIND. Riverhead Books, NY. March, 2005.

## ADMINISTRATIVE IMPLICATIONS

SIC:

Enacting this legislation would most likely require the SIC to hire an additional advisor to choose and perform due diligence on any prospective funds in these categories, which could increase administrative costs and may require additional personnel to run the program.

Cultural Affairs:

Museum registrars, collections managers and conservators would need to be involved in the care, storage and handling of the proposed artworks. The state museums could not ethically provide any staff toward this effort.

## TECHNICAL ISSUES

As other legislation affecting SIC investments in private equity has demonstrated, tribal entities are excluded from the allowed investors in these types of funds.

SIC:

SB 1142 defines in Section 7-27-5 that it is intended to be a differential rate investment. As a differential rate investment, it is assumed that in addition to returns the investment will produce undefined and underlying benefits to the state's economy. While differential investments can achieve market rate returns, and are still governed under the Uniform Prudent Investment Act, there is typically a higher rate of risk involved.

As the funds must be located and managed within New Mexico, this would provide employment opportunities in art appraisal while also showcasing the rich art heritage of the state. However, this particular restriction may also lead to sub-optimal investment returns if, in the opinion of the SIC and its advisor, better funds with higher expected returns exist outside New Mexico. As specialized a field as this is, that is a definite possibility.

## **ALTERNATIVES**

It is unclear why instruments of this particular provenance are the only ones allowed. There is a large secondary market in instruments owned by all rock and roll stars and several of those investments have paid off well. According to Juliens Auctions, one of Beatle George Harrison's guitar is being auctioned for \$200,000.

[http://www.juliensauctions.com/auctions/entertainment\\_legends/george-harrison-guitar.html](http://www.juliensauctions.com/auctions/entertainment_legends/george-harrison-guitar.html)

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