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

SPONSOR Williams-Stapleton **ORIGINAL DATE** 01/29/10 **LAST UPDATED** 02/10/10 **HB** 197/aHTRC

SHORT TITLE Severance Fund Investment in Renewable Energy **SB**

ANALYST White

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	**FY11**	**FY12**		
	Indeterminate	Indeterminate	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY10	FY11	FY12	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total	$0.1	$0.1	$0.1	$0.1	Recurring	SIC Operating Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)
NM Renewable Energy Transmission Authority (RETA)

Responses Not Received From
Energy, Minerals, and Natural Resources, Department (EMNRD)

SUMMARY

Synopsis of HTRC Amendment

The House Taxation and Revenue Committee amendment to House Bill 197 eliminates language requiring “no less than three percent of the market value” of the severance tax permanent fund (STPF) be invested in New Mexico renewable energy. The proposed legislation would still however cap all STPF investment in New Mexico renewable energy at 10 percent.

<u>Synopsis of Original Bill</u>

House Bill 197 requires – "if investments in accordance with the Uniform Prudent Investor Act are available" – no less than 3 percent and no more than 10 percent of the market value of the severance tax permanent fund (STPF) be invested in New Mexico renewable energy. Beginning on July 1, 2012 and reoccurring every July thereafter, the state investment officer (SIO) shall be required to ensure that at least 3 percent of the market value of the STPF is invested in qualified renewable energy investments. If insufficient investments exist as part of the portfolio then the SIO is required to make additional investments until the 3 percent requirement is met or certify to the Governor, Legislature, and Energy, Minerals, and Natural Resources Department (EMNRD) that no additional investments in New Mexico renewable energy exist which would comply with the Uniform Prudent Investor Act. All investments made to the proposed legislation must also be certified by EMNRD and the Economic Development Department (EDD).

FISCAL IMPLICATIONS

This bill carries possible additional operating budget impacts to SIC as the proposed legislation requires these investments to receive approval from outside agencies, and existing statute requires the majority of these investments to be formally approved by both the Private Equity Investment Advisory Committee (PEIAC) and the full SIC.

As of December 31, 2009 the market value of the STPF was approximately $3.6 billion. Therefore, if the amended legislation were in effect today, the SIO would be permitted to invest "no more than" $360 million in New Mexico renewable energy. Therefore if the SIO wished to invest more than 10 percent of the fund in New Mexico renewable energy, as defined in the proposed legislation, because such investments were perceived attractive pursuant to the Uniform Prudent Investor Act, he may not be able to do so. As noted by the SIC in its analysis, and by various respected investment experts, statutory mandates with respect to investment decisions often result in negative investment performance. Evidence of such phenomena is presented below:

LGPF Performance vs. Policy Benchmarks (9/30/09)

Quarter			1 Year			5 Year		
Fund	Benchmark	Ranking	Fund	Benchmark	Ranking	Fund	Benchmark	Ranking
10.30%	12.00%	56	-7.10%	-3.40%	99	3.40%	3.30%	86

STPF Performance vs. Policy Benchmarks (9/30/09)

Quarter			1 Year			5 Year		
Fund	Benchmark	Ranking	Fund	Benchmark	Ranking	Fund	Benchmark	Ranking
9.50%	11.30%	65	-9.20%	-4.60%	99	2.70%	3.40%	91

When comparing the latest audited performance data from both the STPF and the land grant permanent fund (LGPF), it becomes evident that the STPF underperforms on a consistent basis. These numbers show that, for all three time periods presented, the LGPF has actually outperformed the STPF by an average of 1.2 percent. The primary difference between the investment strategies of the funds' are their portfolio allocations driven by the statutory mandates currently in place on the STPF. This is evident in comparing the funds' policy benchmarks, which represent a fund's market performance based upon its asset allocation policy. Using these metrics for comparison which eliminate all other major variables except for portfolio allocation policies, the STPF still underperformed for all three time periods by an average of 0.6 percent.

Both the STPF and LGPF make annual appropriations of 4.7 and 5.8 percent respectively to the general fund based upon their average market value for the preceding five calendar years. In FY10 the funds will distribute approximately $624 million to the general fund combined, representing more than 10 percent of all recurring general fund revenue.

Historical GF Distributions

	LGPF	STPF
FY09	$433.2	$191.3
FY08	$390.5	$177.2
FY07	$364.7	$171.0
FY06	$354.2	$171.8
FY05	$350.3	$173.2
FY04	$292.2	$172.4

Any piece of legislation which potentially decreases STPF performance therefore has an indirect negative impact on the general fund. Based upon the evidence above and the myriad of potential unknown variable at play, it can be inferred that House Bill 197 could have an indeterminable but significant impact on general fund revenue.

SIGNIFICANT ISSUES

Several investment mandates are already in statute in reference to the STPF. The SIO may already invest up to 9 percent of the STPF in the New Mexico Private Equity Investment Program (NMPEIP), up to 6 percent of the STPF in the New Mexico Film Investment Program, and must allocate one percent of the STPF for the New Mexico Small Business Investment Corporation (SBIC).

The STPF also has a variety of other mandated programs which provide loans for the New Mexico Farmer’s Home Administration, allow the SIC to purchase Educational Institution Revenue Bonds, allow investments to be made with New Mexico Financial Institutions, and other investments including mortgage participations, capital renovation bonds, etc. All of these programs are administered through the STPF meaning that approximately 70 percent of the STPF has already been mandated for targeted investment programs. With the passage of HB 197 that amount could increase to potentially as high as 80 percent of the overall fund. The SIC notes that these investments have generally underperformed broader markets, and have contributed to the underperformance of the STPF relative to the LGPF.

State Investment Council (SIC):

> “The amendment, in removing a floor or required base investment minimum of 3% has taken away a potential conflict with the Uniform Prudent Investment Act…
>
> The amendment also fails to address a concern noted in previous analysis, which requires all renewable energy investments made from the STPF to receive prior approval from EMNRD and EDD. This requirement giving investment approval or denial powers to non-investment professionals would seem to be in conflict with the Uniform Prudent Investment Act…

While the bill seems to encourage prudent investment in renewable energy in New Mexico, it does not require the Investment Council to make such investments. It appears that the bill as amended will mandate…

- A statutory cap of 10% of the STPF on such investments
- The granting of investment influence and investment denial powers to the Economic Development and Energy Minerals and Natural Resources Departments…"

OTHER SUBSTANTIVE ISSUES

NM Renewable Energy Transmission Authority (RETA):

"HB 197 would greatly assist with the financing of large scale renewable energy projects and would support the New Mexico Renewable Energy Transmission Authority's charge to promote and utilize New Mexico's renewable energy resources."

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

If this legislation is not enacted, statutory language would not exist explicitly stating that the SIO may invest "no more than" 10 percent of the STPF in New Mexico renewable energy.

DMW/mt