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

SPONSOR Stapleton
ORIGINAL DATE 01/28/11
LAST UPDATED
HB 44

SHORT TITLE Severance Tax Investment in Energy
SB

ANALYST Golebiewski

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	**FY12**	**FY13**		
	Minimal	Minimal	Recurring	Severance Tax Permanent Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicates, Relates to, Conflicts with, Companion to

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Office (SIO)
Attorney General's Office

SUMMARY

Synopsis of Bill

House Bill 44 allows for up to 10 percent of the market value of the Severance Tax Permanent Fund (STPF) to be invested in New Mexico renewable energy investments, pursuant to the Uniform Prudent Investor Act. All investments pursuant to this section are subject to the approval of the State Investment Council. If the investment is made by a private equity fund, it must also be reviewed by the Private Equity Investment Advisory Committee.

"New Mexico Renewable Energy" is defined as

- A business with principal office and majority of full time employees in state, which primarily deals in equipment used to generate storage or transmission of renewable energy or improve energy efficiency, or a manufacturing business, employing more than 50 employees, which produces such equipment.
- A renewable energy project located in NM.
- Bonds issued under the Renewable Energy Financing District Act; energy efficiency bonds issued under the Energy Efficiency and Renewable Energy Bonding Act;

utility revenue bonds issued by a local government to maintain or improve facilities required to produce, store or transmit renewable energy; renewable energy transmission bonds issued under the NM Renewable Energy Transmission Authority Act; NM renewable energy private equity fund which make equity investments in renewable energy projects located in NM alongside institutional investors.

"Renewable Energy" is defined as energy derived from solar heat, solar light, wind, geothermal energy, landfill gas or biomass or a combination thereof, which produces low or zero emissions and has substantial long term production potential.

"Renewable Energy Project" is a facility located in NM, with the primary purpose of generation, transmission or storage of renewable energy.

"Storage" means an energy storage technology that converts stores and subsequently uses energy to alleviate disparities between energy supply and demand, driven by market conditions.

FISCAL IMPLICATIONS

According to the SIO, "[t]here is a potential for additional fiscal impact to the SIC as investments of this nature – as with any alternative investments – require an additional level of expertise to assess in comparison to public equity and fixed income investments. The level of impact would be dependent on the number of potential investments and the sophistication of the projects that would have to be assessed for qualification under the Uniform Prudent Investment Act (UPIA).

From a practical standpoint, HB 44 does not require SIC to make investments in renewable energy, renewable energy projects, funds or storage facilities. Because of this, the real world impact may be muted, as the SIC can currently make investments as outlined in the bill. There is no mandate as written in HB 44, other than such investments must be prudent, must have qualified co-investors, and cannot exceed 10% of the STPF (whether to do so would be prudent or not)."

SIGNIFICANT ISSUES

HB 44 suggests legislative intent to invest 10% of the severance tax permanent fund (STPF) in New Mexico renewable energy, which currently translates to approximately $380 million. Investing 10% of the STPF in New Mexico renewable energy investments may itself be inconsistent with the Uniform Prudent Investor Act, as it shrinks the potential to provide adequate diversification of assets.

Current statute authorizes 69% of the STPF to be used in economically-targeted investments (ETIs). These investments include:

- Up to 9% of the STPF for the New Mexico Private Equity Investment Program
- Up to 6% of the STPF for the New Mexico Film Investment Program
- One-percent of the STPF for the New Mexico Small Business Investment Corporation

The ETIs currently in statute have been the main driver in the underperformance of the STPF investments, relative to the land grant permanent fund (LGPF). In FY10, for example, the STPF underperformed the LGPF by approximately 220 basis points.

PERFORMANCE IMPLICATIONS

It is unclear whether New Mexico renewable energy investments will produce comparable investment returns to other assets in the STPF portfolio.

The economic downturn and related depressed levels of investment returns, in combination with the 4.8% rate of distribution has resulted in substantial losses in the value of the STPF over the past 10 years. Between FY00 and FY10, the STPF has lost approximately $1.7 billion in real value, that is, after controlling for inflation. The STPF was designed to maintain its real value over time and to provide continuous income to the general fund. Contributions to the STPF are close to zero, which leaves investment returns as the only income to the fund. Further legislative mandates regarding investments in ETIs are likely to contribute to the declining value of the fund.

ADMINISTRATIVE IMPLICATIONS

The SIO may need to hire personnel with expertise in this area to properly assess renewable energy investments, as this is a relatively new asset class.

RELATIONSHIP

SB 1 is related to this bill – SB 1 would require the SIC to invest the STPF in revenue anticipation bonds from the state of New Mexico.

TECHNICAL ISSUES

Section 1(C) is confusing. The Attorney General's Office notes "…is the State Investment Office mandated to invest in several of the alternatives to establish diversification?"

Also, Section 1(B) is inconsistent with legislation passed in 2010. According to current statute, all investments must be approved by the State Investment Council, and the State Investment Officer has no authority to make investments without their approval. The SIO suggests that the language of HB 44 be revised to put the decision making powers with the Council.

The Attorney General's Office also notes that Section 1(D)(1)(c), defining New Mexico Renewable Energy as "a renewable energy project in New Mexico," may not be sufficiently specific and may have ambiguous interpretation.

OTHER SUBSTANTIVE ISSUES

According to the SIO, "[a]t this time the SIC has approximately $85 million spread across more than a dozen investments in renewable energy companies or private equity funds with a clean or green strategy. That would be approximately 2.2% of the STPF. Additional investments in renewable energy funds are made outside of the STPF, through the Land Grant Permanent Fund, but those may not have the New Mexico focus required by HB 44.

HB 44 does not take into account, and for that matter it may be impossible to calculate the portion of SIC investments made in non-New Mexico renewable energy vehicles through investment via hedge funds or publicly traded equities, i.e. Exxon or other energy companies expanding their strategies in this area."

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Not passing HB 44 will simply not cap the amount of the STPF that can be invested in New Mexico renewable energy investments, under the Uniform Prudent Investor Rule.

JAG/bym