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

		ORIGINAL DATE	02/24/11		
SPONSOR	HBIC	**LAST UPDATED**	03/08/11	**HB**	CS/415/aHTRC
SHORT TITLE	STPF Investment in Small-Budget New Mexico Films			**SB**	
				ANALYST	Golebiewski

REVENUE (dollars in thousands)

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

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)
Economic Development Department (EDD)

SUMMARY

Synopsis of HTRC Amendment

The HTRC amendment provides a sunset date of June 30, 2016 for the policy proposed by HB 415. It also limits the size of the loans to $3 million and imposes an aggregate amount of small-budget film loans in a fiscal year of $17 million, with $2 million earmarked for Native American filmmakers. The amendment requires the small-budget film loans to be no longer than 4 years to maturity and states that the loans should carry a rate of interest of the prime rate plus 3 percent. It also increases the size of the incentives for certain film production characteristics from ½ percent to 1 percent.

Synopsis of Original Bill

House Business and Industry Committee substitute for House Bill 415 would provide for New Mexico small-budget film loans, as part of the approved amount of the STPF to be used for film loans. The loans would be in amounts between $150 thousand and $5 million.

The SIO shall make investments only upon approval of the council after a review by the private equity investment advisory committee and after a review and recommendation by the New Mexico Film Commission.

The SIO may make debt or equity investments in small-budget New Mexico film projects that:

- are filmed wholly or substantially in New Mexico;
- have a distribution contract in place with a reputable distribution company;
- have New Mexico residents as the majority of the production crew;
- have posted a completion bond (the completion bond requirement would be waived should the film project obtain a guarantor);
- have obtained a guarantor from a entity or a substantial subsidiary of an entity that has a credit rating of not less than BAA or BBB by a national rating agency; or a letter of credit from a United States incorporated bank with a credit rating of not less than A by a national rating agency; or a letter of credit from a substantial and solvent entity as determined by the council in accordance with its standards and practices.

House Bill 415 also requires the film company to pay a processing fee of one and a half percent and a market rate of interest on the loan – with deductions for certain production characteristics.

FISCAL IMPLICATIONS

SIC:

The State Investment Office perceives a potential for an indeterminate fiscal impact, depending on the number of loans approved by the Council. Additional administrative burden could also add costs above and beyond the layer of opportunity costs lost to deployment of dollars which would otherwise be invested in potentially more profitable assets.

The SIC has only made one film loan of this size – less than $2MM - out of 24 granted since program inception in 2002. That film, *Cruel World*, did not result in profit and the SIC had to call the project's letter of credit to collect its loan. Subsequent loans to film and television projects were not under $3 million and in more recent years the Council has been averse to smaller, low-budget projects entirely, due to their lower probability to produce significant earnings.

It should be noted that the film loan program, while not losing any principal, in general has not produced net revenue for the Severance Tax Permanent Fund. Since inception, the SIC has shared in $500k in profit, and collected an additional $398k in interest paid on film loans. This compares to nearly $29MM in opportunity cost, had the loans been invested in US Treasuries instead.

On the other side of the equation however, it is also notable that the 24 productions which received loans from the SIC also paid nearly $65MM in payroll to New Mexico crew, and spent more than $245MM in New Mexico, as reported by the New Mexico Film Office and the Taxation and Revenue Department. The SIC only reports actual dollars spent, and does not apply economic development multipliers to those figures.

This, and the statutory authority granted to the SIC to make these differential (non-market) rate investments, account for the program's activity since 2002.

SIGNIFICANT ISSUES

House Bill 415, as substituted, provides for small-budget film loans. There are a number of additional risks associated with this particular subsection of the industry, which may be inconsistent with the requirements of the Uniform Prudent Investor Act. Additionally, although the language of the bill provides for some investment return, a market rate of interest on the loans, it also has an opportunity cost: film loan dollars cannot be invested in more profitable investment instruments. The economically targeted investments of the STPF have caused the fund to underperform in past years: in FY10, the STPF performed 220 basis points lower than the LGPF. FY11 returns have been on the order of 12 percent so far, whereas market rate on these loans would be closer to 5 percent.

SIC:

> The State Investment Council is closely monitoring possible legislative actions this session regarding the state's film incentive programs, but the matter of the program's direction has been debated at length by both the Private Equity Investment Advisory Committee and the members of the Council in recent months.
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> The SIC has not executed a film loan since November of 2008, when it loaned $15MM to *Book of Eli*. Two subsequent loans were approved, but not finalized when the projects lost and failed to replace domestic distributors for their films in a manner the SIC found acceptable. The films were both shot in NM and later released nationwide, without SIC participation.
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> The *Book of Eli* grossed $150MM on an $80MM budget worldwide, and may yet result in profit sharing of 7.5% post break even revenues with the SIC in the future. Revenue waterfalls in film and television projects have a multi-year horizon due to additional distribution formats, including DVD sales & rentals, premium and cable and network television, in addition to alternative delivery systems such as internet streaming, i.e. Netflix. The SIC has secured an audit firm to assess potential profits and anticipates deploying this firm relative to *Book of Eli* in the next 12-18 months.
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> Historically, with several thousand film projects being produced annually, and less than 100 seeing wide release in theatres, the Council has looked to maximize potential for profit by avoiding smaller, independent productions.
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> In addition to concerns about a lack of profitable productions in which the SIC might participate, the Council has questioned whether film loans should play a role in the long-term investment strategies of the Permanent Funds, whose main goals are growth and annual distributions to the general fund and beneficiaries.
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> In recent weeks the Council has contemplated capping the amount allowed to be invested under the film loan program to $100MM (Currently there is $75MM outstanding) and whether an interest-free/percentage profit participation is still a viable model, considering the history of the program. The Council has requested staff to produce an assessment and recommendation for the PEIAC and SIC at their March meetings.

The Economic Development Department's (EDD) Film Office suggests the following issues:

Allowing a film project to forego the requirement of a completion bond is a huge liability for the state's investment since the guarantor is guaranteeing a completed product.

It is very difficult for films of this size to find upfront distribution deals with reputable film distribution companies.

ADMINISTRATIVE IMPLICATIONS

SIC:

Should the PEIAC and SIC embrace small loans to New Mexico film projects, there is potential for significant administrative burden. This burden will be heavily dependent on several factors however:

- Number of applicants
- Number of qualified applicants
- Type of guarantor & loan securitization sought
- Structure of program moving forward (interest free vs. market rate)
- Definition of acceptable distribution contract with 'reputable' distribution company

The main stumbling blocks which have always been a challenge to NM filmmakers seeking to participate in the current NM film loan program have been the 1. Acceptable guarantor/letter of credit, and 2. Requirement of distribution agreement prior to production. It is not clear that this legislation will help small filmmakers overcome either of those current challenges.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Related to HB 19 and HB 627.

TECHNICAL ISSUES

The EDD Film Office reports the bill should define more clearly:

- "…wholly or substantially in New Mexico."
- "…a majority of the production crew will be New Mexico residents."
- "(4) have posted a completion bond that has been approved by the Commission; provided that a completion bond shall not be required if the fund or project is guaranteed…" A completion bond is a written contract that guarantees that the film project will be finished and delivered on schedule and within budget. Allowing a film project to forego the requirement of a completion bond is a huge liability for the state's investment since the guarantor is guaranteeing a completed and finished product.

JAG/svb