LEGISLATIVE EDUCATION STUDY COMMITTEE
BILL ANALYSIS

Bill Number: **HJR 15aa** — **50th Legislature, 2nd Session, 2012**

Tracking Number: **.188390.1**

Short Title: **Permanent Funds for Education, CA**

Sponsor(s): **Representative Rick Miera and Others**

Analyst: **Kevin Force** — **Date:** **February 13, 2012 (Revised)**

AS AMENDED

The House Judiciary Committee amendments strike all occurrences of "public schools pursuant to contracts between the state and private entities" and replace them with "state," shifting the purpose of the 1.5 percent increase in distribution, slated for disbursement in FY 14 through FY 23, from early childhood education programs that may or may not be directly operated by public schools to those that are operated by the state.

The House Education Committee amendment changes the additional 1.5 percent distribution, for FY 14 through FY 23, to 1.1 percent, as illustrated by the table, below:

Land Grant Permanent Fund Distribution Rate		
Fiscal Year	**Current Law**	**HJR 15**
2013	**5.5%**	**5.5%**
2014	**5.5%**	**6.6%**
2015	**5.5%**	**6.6%**
2016	**5.5%**	**6.6%**
2017-2023	**5.0%**	**6.6%**
2024, and after	**5.0%**	**5.8%**

Original Bill Summary:

HJR 15 proposes to amend Article XII, Section 7 of the Constitution of New Mexico to change the annual distribution from the Land Grant Permanent Fund (LGPF), based on the five-year rolling average of the fund's year end market value. The table below illustrates the changes in distribution:

Land Grant Permanent Fund Distribution Rate		
Fiscal Year	**Current Law**	**HJR 15**
2013	5.5%	5.5%
2014	5.5%	7.0%
2015	5.5%	7.0%
2016	5.5%	7.0%
2017-2023	5.0%	7.0%
2024, and after	5.0%	5.8%

For FY 14 through FY 23, HJR 15 proposes an additional 1.5 percent distribution to be made to the beneficiaries of the LGPF (see “Background,” below), with specific earmarks that the additional 1.5 percent “…be used for early childhood education programs operated by public schools or pursuant to contracts between the state and private entities for the benefit of school-age children, as provided by law.” The additional distributions would be as follows:

- FY 14: 1/3 of additional distributions for early childhood education;
- FY 15: 2/3 of additional distributions for early childhood education; and
- FY 16-FY 23: all additional distributions for early childhood education.

Among other provisions, HJR 15 proposes to:

- beginning in FY 24, and continuing in each subsequent fiscal year, add an additional 0.3 percent of the five-year rolling average of the year-end market value to the distribution from the Permanent School Fund, so that the distribution rate will become 5.8 percent; and
- increase the LGPF “failsafe” value that would suspend increased distributions from $5.8 billion to $8.0 billion.

HJR 15 requires passage by the Legislature and voter approval to amend the constitution.

Fiscal Impact:

HJR 15 does not contain an appropriation.

Fiscal Issues:

The State Investment Council (SIC) analysis of SJR 10 (2011), which was virtually identical to current HJR 15, indicates that the increased distributions established in 2003 have resulted in approximately $537 million in additional funds for LGPF beneficiaries as shown below.

FY	$>5.0%
2005:	$58.2MM
2006:	$58.8MM
2007:	$60.5MM
2008:	$64.8MM
2009:	$71.9MM
2010:	$72.5MM

2011: $73.9MM
2012: $76.3MM
TOT: $537.1MM

According to SIC's analysis of HJR 15:

- in the short term, additional contributions from the LGPF will produce significant revenue to the General Fund and other LGPF beneficiaries, primarily public education;
- in the long term, considering fund contributions from the oil and gas revenues, as well as expectations for general inflation and fluctuations in investment income, HJR 15 would increase the risk that the LGPF may fail to deliver the same benefits to the General Fund and other beneficiaries as it does today;
- HJR 15 is written to include a "safety valve," which purports to protect the fund by temporarily terminating additional distributions from the fund, should the five-year average of the fund's principal ever drop below $8.0 billion. However:

  - the LGPF five-year average has been above $8.0 billion since 2005;
  - the "safety valve may not be effective in the case of a large short term drop in the fund value, such as the one we experienced in 2011, and during the financial crisis of 2008-2009; and
  - using today's five-year LGPF rolling average of $9.57 billion, the LGPF could lose more than half of its value in 2012, dropping the value of corpus to $5.0 billion, and the safeguard would still not be triggered, because the five-year average would still be $8.4 billion on December 31, 2012; and

- the LGPF growth rate is significantly decreased, and only slightly above inflation.

According to the analysis by the Department of Finance and Administration (DFA):

- HJR 15 would have a significant fiscal impact on the LGPF and its beneficiaries.
- Distributions from the fund play an important part in the operating budgets of each beneficiary. For example:

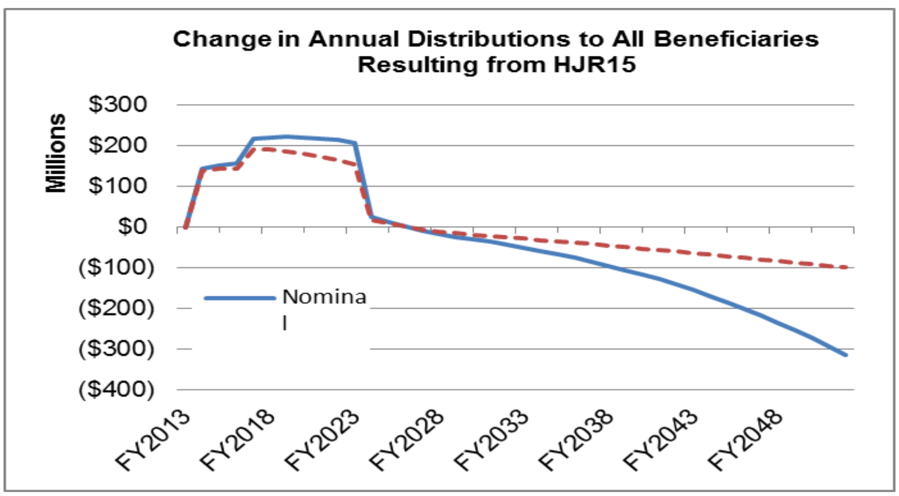
  - distributions to the General Fund typically approximate 10 percent of total recurring General Fund revenue; and
  - from FY 14 to FY 23, under HJR 15, the overall distributions from the LGPF to beneficiaries will be approximately $2.0 billion greater than they would in current law.[1]

- The chart below shows the increase by fiscal year:

[1] These calculations are approximations based upon an average annual fund return of 7.5 percent less transaction costs of 0.3 percent. Estimated contributions to the LGPF are consistent with consensus revenue oil and gas price and volume forecasts through calendar year 2015 and set equal to $350 million thereafter (the approximate 10-year contribution average).

	Childhood Programs ($MM)	General Fund ($MM)	Other Beneficiaries ($MM)	Total ($MM)
FY2013	0	$0	$0	$0
FY2014	47,797,396	$95,594,792	$0	$143,392,189
FY2015	51,153,097	$101,651,042	($133,504)	$152,670,635
FY2016	53,811,238	$104,912,301	($552,267)	$158,171,272
FY2017	55,843,417	$152,319,441	$8,279,926	$216,442,785
FY2018	58,518,583	$154,805,110	$7,696,178	$221,019,871
FY2019	61,064,581	$154,741,832	$6,645,660	$222,452,074
FY2020	63,489,854	$152,566,943	$5,214,050	$221,270,846
FY2021	65,852,792	$148,951,391	$3,514,272	$218,318,455
FY2022	68,161,715	$143,906,257	$1,545,194	$213,613,166
FY2023	70,466,361	$137,777,108	($643,036)	$207,600,433

- The increase in distribution to the early childhood education programs from FY 14 to FY 16 would result in a distribution of $47.8 million in FY 14, increasing thereafter to $70.5 million in FY 23.
- Although the General Fund and other LGPF beneficiaries would experience an initial increase in distributions under HJR 15, at the higher rate of 7.0 percent, beneficiaries will begin to receive less revenue than they would under current law within 15 years. The following graph illustrates the change in total distributions with approval of the resolution:



According to the Legislative Finance Committee's (LFC) Fiscal Impact Report (FIR) of SJR 10 (2011):

- the additional distribution beginning in FY 24 will:

  - ➢ increase distributions to the General Fund by $34.9 million in FY 24 relative to current law;
  - ➢ decrease distributions to other LGPF beneficiaries by $3.0 million relative to current law due to a greater depletion of the fund corpus in FY 14 through FY 23;
  - ➢ the additional distribution will result in a $4.8 billion decrease in the fund value within 20 years; and

- if the LGPF experiences a more modest 6.5 percent growth rate, the increase in distributions to the General Fund in FY 24 relative to current law would be $24.8 million; and

- the Public Education Department (PED) reported that:

  - $6,416,374 in funding was allocated in FY 11 for the New Mexico PreK Program, which provides voluntary pre-kindergarten services to four-year-old children in the state;
  - those funds were used by 26 districts/contractors to provide public school pre-kindergarten services to 2,121 children; and
  - in FY 12, 323 fewer children are being served as a result of budget reductions.

Original Technical Issues:

According to PED's analysis, it is unclear to which agency the funds for early childhood programs will be distributed.

According to the SIC analysis:

- HJR 15 calls for 1.5 percent of the additional distributions to "be used for early childhood education programs operated by the public schools or pursuant to contracts between the state and private entities for the benefit of non-school-age children as provided by law;"
- while the LGPF is largely accepted as the state's permanent educational endowment and has also been known as the "Permanent School Fund," it is not composed solely of educational interests;
- more than 16 percent of the LGPF annual distributions go to beneficiaries outside the scope of "common schools," including public buildings, prisons, state universities and the miner's hospital; and
- it is unclear how some of these beneficiaries would use the additional earmarked distributions for "the benefit of non-school age children."

Original Substantive Issues:

Attorney General Opinion No. 12-03, dated February 1, 2012, directly addresses many of the issues raised by HJR 15. According to the Attorney General (AG):

- An examination of the potential barrier posed by the anti-donation clause of the state constitution to direct or indirect assistance to sectarian or private schools is not required in light of HJR 15, because the *Enabling Act of 1910* and the corresponding provisions of the constitution directly prohibit the state from using money from the LGPF for private or sectarian entities.
- Unless Congress amends the *Enabling Act*, the Legislature has no authority to propose amendments to the constitution or enact laws that add a private or sectarian entity to the roster of designated land grant beneficiaries.
- Any proposed constitutional amendment to increase distributions from the Land Grant Permanent Fund for early childhood learning programs would only be permissible if the increased distributions were limited to those programs provided by the public schools.
- The land grant permanent funds are derived from the lands granted to the state by Congress in the *Enabling Act* and are therefore subject to the terms of the act:

- The *Enabling Act* set the terms by which New Mexico would be admitted to the union as a state.
- In Article XXI, Section 10 of the state constitution, New Mexico consented to all terms of the act stating, "[t]his ordinance is irrevocable without the consent of the United States and the people of this state, and no change or abrogation of this ordinance, in whole or in part, shall be made by any constitutional amendment without the consent of congress."
- The lands granted to New Mexico and any proceeds from them are to be held in trust. If those lands or the money derived from them are used for something other than the expressed purposes, it is a breach of trust.
- The New Mexico Supreme Court has stated that "[s]ection 10 of the *Enabling Act* became a part of our fundamental law to the same extent as if it had been directly incorporated into the Constitution when thus expressly consented to by the state and its people in Article XXI, Section 9 of the Constitution."[2] The trust is binding and the Legislature is without power to divert the fund for another purpose than that expressed.[3]
- Section 8 of the *Enabling Act* requires that the schools provided for in the act shall remain under the exclusive control of the state, and no part of the proceeds arising from the sale or disposal of any of those lands shall be used for the support of sectarian schools.
- The constitution contains the same limitations as the *Enabling Act*, and specifically prohibits use of the lands or money derived from the lands from being used for "the support of any sectarian, denominational *or private school* (emphasis added).

- The prohibitions of the *Enabling Act* and the constitution apply to *indirect as well as direct* land fund grant distributions:

  - These prohibitions cannot be avoided by appropriating the funds to a state agency for the purpose of disbursing funds to, or executing contracts with, sectarian or private schools not under the exclusive control of the state.
  - Such a scheme would be "an artificial attempt to circumvent the prohibitions of the act and the state constitution. Regardless of the number of intervening entities, the transaction would still amount to the use of permanent fund money or the support of private or sectarian schools contrary to the prohibitions of the *Enabling Act* and the constitution."

- The distribution of LGPF funds to a private or sectarian entity would require amendments to *both* the *Enabling Act* and the state constitution, after which both the act and the constitution would have to be amended to allow for an additional beneficiary.
- In 1996, New Mexico voters adopted amendments to Article XII, Section 7 of the constitution, which were approved by Congress with amendments to the act, stating, "distributions from the trust fund shall be made according to Article XII, Section 7."[4]
- Thus, it appears that changes to how the funds are distributed may be made as long as it is accomplished by amendments to Section 7 and the funds are used for purposes permitted by the *Enabling Act*.

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[2] See: *State ex rel. Interstate Stream Commission v. Reynolds*, 71 N.M. 389, 396, 378 P.2d 622, 627 (1963).
[3] Id.
[4] See Public Law 105-37, 105th Congress, August 7, 1997.

- The use of any increased distribution for early childhood learning programs is limited to programs *provided by the public schools*.

Additionally, Legislative Council Service appears to agree with the opinion expressed by the AG:

- Sections 6 through 9 of the federal *Enabling Act of 1910* “require that any change in the use of the trust must be consented to by Congress.”[5]
- Prior to 1997, this was indeed the case; however, as noted above, Congress approved amendments to several sections[6] of the *Enabling Act* in 1997, one of which specified that future *distributions* “shall be made as provided in Article XII, Section 7 of the Constitution of the State of New Mexico” (emphasis added).
- While these amendments to the *Enabling Act* do permit changes to the distributions of the LGPF, Congress did not amend Section 8 of the *Enabling Act*, which states that:

  > “The schools, colleges, and universities provided for in this act shall forever remain under the exclusive control of the said state, and no part of the proceeds arising from the sale or disposal of any lands granted herein for educational purposes shall be used for the support of any sectarian or denominational school, college or university.”

- This language is mirrored by the corresponding language in Article XII, Section 3 of the Constitution of New Mexico:

  “The schools, colleges, and universities provided for by this constitution shall forever remain under the exclusive control of the state, and no part of the proceeds arising from the sale or disposal of any lands granted to the state by congress, or any other funds appropriated levied or collected for educational purposes, shall be used for the support of any sectarian or denominational school, college or university.”

Given these provisions of the Constitution of New Mexico and the *Enabling Act of 1910*, it is unlikely that amendments that include changes to the beneficiaries of the LGPF, or specific allocations to those beneficiaries or to the programs within their purview, would fall within those distributions approved by Congress in the 1997 amendments to the *Enabling Act*, particularly those changes that potentially benefit private or sectarian institutions not under the exclusive control of the state.

The AG has addressed similar issues to those raised by HJR 15 previously. In an advisory letter dated March 6, 2003, the AG expressed serious reservations about any proposed amendment to the New Mexico constitution that seeks to increase the distribution rate of the LGPF without Congressional approval:

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[5] *Piecemeal Amendment of the Constitution of New Mexico, 1911-2006*, Richard H. Folmer (Seventeenth Revision (January 2007)), for the New Mexico Legislative Council Service.

[6] The sections of the *Enabling Act* amended in 1997 were:

- Sec. 7. University and internal improvement land grants; school fund;
- Sec. 9. Common school fund; and
- Sec. 10. Grants of public lands held in trust; sale or lease; price; restrictions; water power reservations; lieu sections; national forests.

- The Supremacy Clause in Article VI of the US Constitution provides that federal law prevails over conflicting state law.
- Any federal law that appears to conflict with New Mexico law may give rise to expensive, lengthy litigation, with no guarantee of a favorable outcome.
- Without Congressional consent, the *Enabling Act* may conflict with proposed elevated distribution levels on several grounds:

  - Congress approved the 1996 amendments to the Constitution of New Mexico, which did not appear to endanger the Permanent School Fund.
  - Congress may withhold its approval of higher distribution rates, however, because the rates may conflict with existing safeguards for trust funds in the act.
  - the Congressional law enacted to approve the 1996 amendments was explicitly intended to "protect the permanent trust funds of the State of New Mexico from erosion."
  - This express purpose weighs against any theory that New Mexico now has plenary power to expend trust money without seeking Congressional approval.

- The most prudent course is to seek Congressional approval, by requiring that any joint resolution proposing to alter current distribution rates be made contingent upon approval of the US Congress.

According to the PED analysis:

- The LGPF is generally referred to as a "rainy day" fund and looked upon as a safety valve for the state, while it is actually operated as an endowment fund with annual distributions to support a number of programs funded from the General Fund.
- The joint resolution provides for increasing the distribution from the Land Grant Permanent Fund to 7.0 percent, which is above the expected rate of return from investments and will result in the corpus of the fund being reduced.
- The joint resolution may "drastically reduce" the value of the fund, as the distribution levels contained in the joint resolution are unsustainable.
- The amendment contained in this resolution is subject to approval or rejection by voters at the next general election.
- The proposed amendment would impact the New Mexico PreK Program:

  - In FY 12, approximately $6.2 million was allocated to 22 districts and contractors to provide public school pre-kindergarten services to 2,380 four-year-old children in 50 school sites, in a total of 90 preK classrooms.
  - 259 more children are being served this year than last year.

Background:

During the 2011 interim LESC hearing on the LGPF, New Mexico Voices for Children (Voices) and St. Joseph Community Health (SJCH) presented the results of a study conducted by Research and Polling, Inc. to measure public opinion regarding early childhood development programs in New Mexico.[7] The results of the poll indicated both widespread concern for the state of early childhood education in New Mexico, and support for increasing state funding to

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[7] *St. Joseph Community Health Early Childhood Survey, October 2011*. The survey included a random telephone interview of 603 adult New Mexico residents, with a ± 4.0 percent margin of error.

support early childhood education programs, including a constitutional amendment to increase distribution from the LGPF:

- 80 percent of survey respondents indicated they wanted investment for these programs to be placed on an election ballot;
- 58 percent of the respondents felt that the state is doing too little to support early childhood education;
- 54 percent of respondents indicated "strong support" for greater funding of these programs;
- 76 percent indicated that they were not aware of the fund prior to the survey;
- 71 percent indicated that they were not aware that the fund balance was greater than $10.0 billion; and
- 57 percent strongly supported a proposal to distribute an additional 1.5 percent of the fund to early childhood education, while 14 percent opposed it.

During the hearing, a committee member stated that, while the survey respondents indicate support for early childhood education, the survey questions did not address the effect on the fund, primarily the impact to the beneficiaries of the fund. In response, SJCH indicated that they were only presenting the summary of the survey results, and that the full survey report addressed the fund's growth and investments. However, upon review of the full survey, LESC staff did not find any reference to potential effects upon either the corpus of the fund, or the fund's designated beneficiaries.

During the 2009 interim LESC hearing on the LGPF, the SIC provided the following history:

- The United States transferred 13.4 million acres of federal land to the Territory of New Mexico in anticipation of a grant of statehood;
- the *Fergusson Act of 1898* and the *Enabling Act of 1910* were the primary federal legislative vehicles for the public land transfers;
- the acts stipulate that such lands are to be held in trust for the benefit of the public schools and 19 other specifically identified state institutions;
- the Commissioner of Public Lands and State Land Office are the trustees for the original 13.4 million acres of mineral resources and the remaining 8.75 million acres of surface land;
- the Commissioner of Public Lands leases the trust lands for mineral exploration and grazing rights and, under certain conditions, may also sell or exchange trust properties; and
- a substantial portion of royalties and income from the sales of land are transferred to the LGPF and are then invested by the State Investment Office.

As noted above, the last changes to Article XII, Section 7 occurred in 2003, when voters approved a constitutional amendment to:

- increase the annual distribution from the LGPF to the fund's beneficiaries (including public schools) from 4.7 percent to 5.0 percent of the average of the year-end market values of the fund for the immediately preceding five years;
- provide an additional 0.8 percent annual distribution from FY 05 to FY 12 (for a total distribution of 5.8 percent) and an additional 0.5 percent annual distribution from FY 13 to FY 16 (for a total distribution of 5.5 percent) to be used for education reform as provided by law;

- provide that the above additional distributions shall not be made in any fiscal year if the average of the year-end market values of the fund for the immediately preceding five calendar years is less than $5.8 billion;
- authorize the Legislature, by a three-fifths' vote of the members of each house, to suspend any of the above additional distributions; and
- revert the distribution to 5.0 percent in FY 17.

At that time, the increased distribution was considered conservative, and was not expected to erode the corpus of the fund.[8]

This table shows LGPF contributions, disbursements, market values, and returns for FY 89 through FY 10.

Date	Beginning Market Value	Contrib	Disburs	$ Investment Return	Ending Market Value	% Investment Return
Fiscal Year 1989	2,786,201	95,909	252,270	372,361	3,002,201	14.2%
Fiscal Year 1990	3,002,201	104,922	258,961	278,496	3,126,658	9.7%
Fiscal Year 1991	3,126,658	121,159	259,366	354,364	3,342,815	11.3%
Fiscal Year 1992	3,342,815	104,381	261,965	498,843	3,684,074	15.1%
Fiscal Year 1993	3,684,074	122,950	261,546	455,701	4,001,179	12.6%
Fiscal Year 1994	4,001,179	115,598	257,924	-9,996	3,848,857	-0.5%
Fiscal Year 1995	3,848,857	97,299	248,102	625,176	4,323,230	16.0%
Fiscal Year 1996	4,323,230	100,171	246,027	495,049	4,672,423	12.1%
Fiscal Year 1997	4,672,423	147,767	251,228	895,751	5,464,713	18.5%
Fiscal Year 1998	5,464,713	129,981	255,415	1,115,799	6,455,078	21.5%
Fiscal Year 1999	6,455,078	104,747	262,420	1,014,822	7,312,227	15.8%
Fiscal Year 2000	7,312,227	217,905	344,316	745,209	7,931,025	10.2%
Fiscal Year 2001	7,931,025	325,947	322,153	-516,236	7,418,583	-6.6%
Fiscal Year 2002	7,418,583	213,348	283,142	-652,613	6,696,176	-7.9%
Fiscal Year 2003	6,696,176	222,985	332,784	221,267	6,807,644	3.6%
Fiscal Year 2004	6,807,644	269,743	400,746	959,800	7,636,441	14.2%
Fiscal Year 2005	7,636,441	324,689	432,499	722,473	8,251,104	9.7%
Fiscal Year 2006	8,251,104	465,306	477,675	860,293	9,099,028	10.6%
Fiscal Year 2007	9,099,028	449,303	499,512	1,624,378	10,673,196	17.9%
Fiscal Year 2008	10,673,196	460,648	462,235	-401,154	10,270,455	-3.8%
Fiscal Year 2009	10,270,455	480,526	521,521	-2,300,960	7,928,500	-22.4%
Fiscal Year 2010	7,928,500	330,275	525,513	1,113,148	8,846,410	14.0%
Cumulative *	7,928,500	330,275	525,513	1,113,148	8,846,410	14.0%

* Average Annual Return

[8] *CONSTITUTIONAL AMENDMENTS PROPOSED BY THE LEGISLATURE IN 2003, APPEARING ON THE SEPTEMBER 23, 2003 SPECIAL ELECTION BALLOT, Brief Analysis and Arguments For And Against*, New Mexico Legislative Council Service, June 2003

The LGPF beneficiaries and their respective percent ownership are shown below:

Institutions	% of LGPF ownership
Common Schools	83.20%
NMMI	3.38%
NM School for the Deaf	2.07%
School for Visually Handicapped	2.06%
NM State Penitentiary	2.02%
UNM	1.60%
Public Bldgs. Cap Inc.	1.17%
Water Reservoir	1.15%
DHI Miners Hospital	1.04%
Char. Penal & Reform	0.91%
NMSU	0.50%
Improve Rio Grande	0.27%
NM State Hospital	0.24%
NM Inst. Mining & Tech	0.21%
ENMU	0.08%
WNMU	0.03%
NM Highlands	0.03%
Northern NM College	0.02%
NM Boys School	0.01%
UNM Saline Lands	0.01%
Carrie Tingley Hospital	0.00%
	100.00%

<u>Related Bills</u>:

HB 21 *Limit on Land Grant Funds in Some Investments*
HJR 1 *Preserve Land Grant Permanent Fund, CA*
HJR 2 *Land Grant Fund Annual Distribution, CA*
SJR 4a *Land Grant Permanent Fund Changes, CA*
SJR 9 *Permanent Funds for Education, CA* (Identical)