LEGISLATIVE EDUCATION STUDY COMMITTEE
BILL ANALYSIS

Bill Number: HJR 21 **50th Legislature, 2nd Session, 2012**

Tracking Number: .188240.3

Short Title: Public School Support Enhancement Fund, CA

Sponsor(s): Representative Rick Miera

Analyst: Kevin Force **Date: January 31, 2012**

Bill Summary:

HJR 21 proposes to amend Article 12, 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%	5.8%
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%

Additionally, HJR 21 amends Article 12, Section 7 of the constitution to:

- create the "public school support enhancement fund" (PSSEF) in the state treasury to supplement, but not supplant, public school funding;
- appropriate money in the PSSEF to the state equalization guarantee (SEG) to supplement the annual General Fund appropriation, contingent on the current fiscal year's General Fund appropriation being at least 95 percent of the previous fiscal year's appropriation;
- stipulate that any unencumbered balance remaining in the PSSEF, and any accrued interest, shall not revert to the General Fund, but shall remain in the public school support enhancement fund; and
- prohibit any distribution to implement and maintain early childhood educational programs for children from birth to five years old in any fiscal year in which the five-year average of the year-end market value is less than $5.8 billion.

Deposits to the PSSEF (for distribution according to law) shall be made as follows:

- in FY 13, 5.8 percent of the five-year average of the year-end market value;
- in FY 14:
    - 6.5 percent to the PSSEF; and
    - 0.5 percent to be used to implement and maintain early childhood education programs for children from birth to five years;
- In FY 15:
    - 6.0 percent to the PSSEF; and
    - 1 .0 percent to be used to implement and maintain early childhood education programs for children from birth to five years;
- In FY 16 through FY 23:
    - 5.5 percent to the PSSEF; and
    - 1.5 percent to be used to implement and maintain early childhood education programs for children from birth to five years; and
- In FY 24, and each subsequent year, 5.8 percent.

<u>Fiscal Impact</u>:

HJR 21 does not contain an appropriation.

<u>Fiscal Issues</u>:

HJR 21 proposes to amend the Constitution of New Mexico to increase the distribution from the LGPF to 7.0 percent. In this regard, HJR 21 is similar to HJR 15, *Permanent Funds for Education, CA*, and implicates many of the same issues.

According to the analysis by the Public Education Department (PED):

- The LGPF is generally referred to as a "rainy day" fund and looked upon as a safety valve for the state, while in actuality, the fund is operated as an endowment fund with distributions used annually to support a number of programs funded from the General Fund.
- HJR 21 would increase the distribution from the LGPF to 7.0 percent, which is higher than the expected rate of return from investments and will result in reductions of the corpus of the LGPF.
- HJR 21 has dangerous potential to drastically reduce the value of the LGPF as the distribution levels in the joint resolution remain unsustainable.

According to the State Investment Council's (SIC) analysis of HJR 15, which has similar financial implications to HJR 21:

- 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, there would be increased risk that the LGPF may fail to deliver the same benefits to the General Fund and other beneficiaries as it does today;
- the inclusion of 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 a certain amount (in this case $5.8 billion) may not actually have the desired effect:

  - 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 Department of Finance and Administration’s (DFA) analysis of HJR 15, while 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 at least 15 years.

<u>Technical Issues</u>:

According to the SIC analysis of HJR 15:

- 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; and
- 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.

<u>Substantive Issues</u>:

According to the PED analysis:

- The amendment contained in this resolution is subject to approval or rejection by voters at the next general election.
- HJR 21 would impact the New Mexico PreK Program. In FY 11, approximately $6.4 million was allocated to 26 districts and contractors to provide public school pre-kindergarten services to 2,121 four-year-olds in 50 school sites, in a total of 86 pre-K classrooms.

According to Legislative Council Service:

- 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."[1]
- Prior to 1997, this was indeed the case; however, Congress approved amendments to several sections[2] of the *Enabling Act* in 1997, one of which specified that future *distributions* "shall be made as provided in Article 12, Section 7 of the Constitution of the State of New Mexico" (emphasis added).

While these amendments to the *Enabling Act* appear to permit changes to the distributions of the LGPF, it is unclear whether adding an additional *beneficiary* to the list of those permitted by the *Enabling Act* would be permissible absent the consent of Congress. Of particular concern is the fact that, in New Mexico, many providers of early childhood education are private or sectarian concerns, and thus may directly or indirectly benefit from distributions of the PSSEF. Congress has not amended 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 12, 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."

Further, in an advisory letter dated March 6, 2003, the Attorney General expressed serious reservations about any proposed amendment to the Constitution of New Mexico that seeks to increase the distribution rate of the LGPF without Congressional approval:

- 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:

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

[2] 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.

- 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." [3]
- 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.

As HJR 21 proposes to amend the constitution to both add a new beneficiary of the LGPF, *and* increase the distribution of the fund to levels that might "erode" the corpus of the trust, particular caution may be necessary in proceeding without any contingency requiring Congressional approval.

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.[4] 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 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

[3] See Public Law 105-37, 105th Congress, August 7, 1997.
[4] *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 % margin of error.

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, prior to 1997, US Congressional approval was required for any change to the way in which distributions were made from the LGPF. However, in 1997, Congress approved amendments to the federal *Enabling Act of 1910*, one of which specified that future distributions "shall be made as provided in Article 12, Section 7 of the Constitution of the State of New Mexico. The last changes to Article 12, 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.[5]

[5] *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

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

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*
HJR 15 *Permanent Funds for Education, CA* (Identical to SJR 9)
HJR 20 *51 Percent of Appropriations for Schools, CA* (Identical to SJR 12)
SJR 4a *Land Grant Permanent Fund Changes, CA*
SJR 12 *51 Percent of Appropriations for Schools, CA* (Identical to HJR 20)