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

ORIGINAL DATE 1/16/15
SPONSOR Padilla **LAST UPDATED** 3/7/15 **HB**

SHORT TITLE School Fund for Early Childhood, CA **SJR** 5/aSRC

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue (by Beneficiary)					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
$0.0	$0.0	$54,728.2	$180,236.9	$194,152.7	Recurring	General Fund
$0.0	$0.0	$10,146.4	$33,415.3	$35,995.3	Recurring	Other LGPF Beneficiaries

(Parenthesis ( ) indicate revenue decreases

Estimated Revenue (by Purpose)					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
$0.0	$0.0	$16,218.6	$53,413.0	$57,537.0	Recurring	Educational Programs
$0.0	$0.0	$48,655.9	$160,239.1	$172,611.0	Recurring	Early Childhood

(Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total			$15.2	$15.2	NR	General Fund

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

<u>Responses Received From</u>
State Investment Council (SIC)
State Land Office (SLO)
Children, Youth, and Families Department (CYFD)
Public Education Department (PED)

SUMMARY

Synopsis of SRC Amendment

The Senate Rules Committee Amendments limit the increased distribution to 1.0 percent and limit the term of the additional distribution to ten years, beginning in the first fiscal year following the effective date of the amendment. Assuming the amendment is enacted in the 2016 general election, which takes place in FY17, the amendment would increase the distribution from the LGPF by 1 percent in FY18-FY27. (**See “Amended Fiscal Implications”**)

The amendment also includes charter schools among institutions that may provide early childhood education nonsectarian services.

Synopsis of Original Bill

Senate Joint Resolution proposes an amendment to Article, XII, Section 7 of the Constitution of New Mexico, which governs the distributions from the land grant permanent fund (LGPF). If approved by voters, the amendments to the constitution would make permanent the additional distribution of 0.5 percent of the five-year average of the year-end market value of the fund to “implement and maintain educational programs as provided by law.” The additional distribution would result in a permanent 5.5 percent annual distribution from the LGPF.

Beginning in FY17, the amendment would create an additional distribution from the LGPF of 1.5 percent of the five-year average of the year-end market value of the fund and require this additional distribution to be used for early childhood education nonsectarian services administered by the state for the benefit of children before they are eligible to attend kindergarten, as provided by law.

The table below compares current and proposed LGPF distribution rates, showing the 2 percent increase in distributions beginning in FY17:

Fiscal Year	Current	Proposed	Difference
2015	5.5%	5.5%	0.0%
2016	5.5%	5.5%	0.0%
2017	5.0%	7.0%	2.0%
2018	5.0%	7.0%	2.0%
2019	5.0%	7.0%	2.0%
Beyond 2019	5.0%	7.0%	2.0%

The amendment would provide that the early childhood services may be provided by a school district, a state contractor, an entity of an Indian nation, tribe or pueblo, the New Mexico School for the Blind and Visually Impaired (NMSBVI), or the New Mexico School for the Deaf (NMSD). Early childhood services provided by NMSBVI and NMSD may not be provided by a contractor.

SJR 5 would amend the constitution to suspend any additional distribution from the LGPF above 5 percent if the five-year average of the year-end market value of the fund is less than $10 billion, adjusted for inflation, adjusted each year beginning July 1, 2016.

The Legislature, by a three-fifths' vote of the members of each house, may suspend any additional distributions from the LGPF above 5 percent.

The amendment proposed by this resolution shall be submitted to the people for their approval or rejection at the next general election or at any special election prior to that date that may be called for that purpose.

The bill contains a contingent effective date providing that the amendment proposed shall not become effective without the consent of the U.S. Congress.

AMENDED FISCAL IMPLICATIONS

The impact of SJR 5 as amended by SRC was estimated by assuming annual contributions into the fund are a function of historical contributions. Investment returns are assumed to be the State Investment Council's (SIC) long-term target of 7.5 percent, less 50 basis points for management fees. Holding these inputs constant, the effect of the increased distribution can be estimated, as shown in the revenue table above, compared with the consensus estimate for LGPF distributions.

To inflation-adjust the $10 billion market value floor for additional distributions this analysis uses the estimate for inflation provided by the forecasting service to which LFC subscribes.

In the short term, additional contributions from the LGPF will produce more revenue to the general fund and other LGPF constitutional beneficiaries, primarily public education, the largest of the beneficiaries accounting for approximately 84 percent of the distribution from the fund.

However, in the long term, and taking into consideration fund contributions from the oil and gas revenues, as well as expectations for general inflation and fluctuations in investment income, this proposal increases the risk that the LGPF will not be able to continue to deliver the same benefits to the general fund and other beneficiaries as the fund does today.

Compared with current distribution rates, this increased distribution will result in a lower fund balance fund over time. The lower fund balance will decrease the purchasing power of distributions from the fund. The additional distributions (estimated to total $508 million for FY17-FY19) would reduce the balance in the fund available for investment, and (assuming positive returns on investment) reduce further growth in the fund. By 2020, the corpus of the fund is diminished by $965 million, and ten years after that, the negative impact has grown to nearly $4.36 billion. Further, beginning in FY24, the size of the excess distribution proposed in SJR5 over the current distribution begins to diminish. Because the additional 1% distribution expires after FY27, in FY28 the 5.5% distribution is less than the 5.0 percent distribution would be under current constitutional provisions. By 2050, the 505% distribution is projected to be nearly $240 million less than the 5.0 percent distribution would be under current provisions.

Through 2055, the five-year average of the year-end market value of the balance in the fund is not estimated to fall below the inflation-adjusted minimum level, thus suspending the additional distribution.

The SIC cites recent LGPF distributions in illustrating the argument that the bigger the fund, the bigger the benefits, as seen in the $60 million growth in the distribution from the fund year over year. Distributions have grown $120 million since FY14. Of the $655.8 distribution, more than

$551.6 million goes directly to general fund/public schools in FY16.

	FY14 Distribution ($1000s)	FY15 Dist. ($1000s)	FY16 Dist. ($1000s)
Land Grant Permanent Fund	535,157	595,994	655,785
Severance Tax Permanent Fund	170,473	182,723	193,510
Total	**705,629**	**778,717**	**849,295**

SIGNIFICANT ISSUES

Distribution Issues. A 2003 constitutional amendment provided for 0.8 percent additional distribution of the LGPF from FY06 through FY12, and a 0.5 percent additional distribution from FY13 through FY16. The 2003 constitutional amendment required that the additional distribution from the permanent school fund be used to implement educational reforms. The proposed amendment would make the additional 0.5 percent distribution permanent.

The decision to deplete an endowment is a policy decision rather than a financial dictum or "best practice." The question is whether the benefits of the expenditures will outweigh the benefits of greater income tomorrow. Below is a preliminary investment performance summary for the LGPF as of November, 2013. The financial market volatility during the 2008-09 crisis continues to impact return averages, with the LGPF not achieving its 7.5 percent annualized return target for any long-term time period.

Investment Issues. While FY14 performance was more than double its annual investment target, such performance is not something the SIC anticipates with consistency moving forward. Even with the bounce back from the 2008 financial meltdown, the LGPF's annualized returns for longer time periods of 10 and 15 years show investment returns far below the annual target of 7.5 percent. Depending on LGPF inflows from the State Land Office, the rate of inflation (anticipated to grow), and investment returns, it is a reasonable assumption that under the 7 percent distribution rate contemplated by SJR5, the LGPF would have suffered damage to its corpus over many of the previous 10 or 15 years.

Early Childhood Issues. Volume I of the LFC Report for Fiscal Year 2016 discusses in detail the increased funding commitment to early childhood education. New Mexico continues to show leadership in increased investment in early care and education. Despite significant focus on early childhood programs, New Mexico continues to rank low in the Annie E. Casey Foundation's annual *Kids Count Data Book*, which ranks states according to 16 child well-being measures, primarily because of the large number of children in need of services.

In FY15, the Legislature increased funding for early childhood well-being programs by 13 percent. Early childhood funding has grown nearly 70 percent since FY12. However, improved leadership, coordination, and oversight are needed. By investing in early childhood programs, taxpayers may save more over time through decreased juvenile delinquency, criminal activity and educational remediation. Strategic investments, along with careful attention to implementation and monitoring performance, could improve the social and cognitive skills of children, with benefits extending throughout a child's life.

It is unclear whether the increased funding resulting from the provisions in SJR 5 could be spent with the oversight and accountability necessary to ensure the dollars are spent in the most effective way possible. Nor is it clear that the capacity exists for an expansion in early childhood services in the magnitude suggested by the large funding increase associated with a 1.5 percent LGPF distribution.

PED's analysis notes Executive does not support "raiding" the permanent fund to expand government. Early childhood spending on targeted programs has proven to be effective and the executive recommendation includes funding for many of these programs.

ADMINISTRATIVE IMPLICATIONS

Under Section 1-16-13 NMSA 1978 and the NM constitution, the Secretary of State is required to print samples of the text of each constitutional amendment, in both Spanish and English, in an amount equal to ten percent of the registered voters in the state. The SOS is also required to publish them once a week for four weeks preceding the election in newspapers in every county in the state. In 2014, the SOS estimated the cost per constitutional amendment to be $15,217. However, if the ballot size is greater than one page, front and back, it would increase the cost of conducting the general election. In addition to the cost of the ballot, there will be added time for processing voters to vote and would mean additional ballot printing systems would be required to avoid having lines at voting convenience centers.

TECHNICAL ISSUES

SIC identifies an issue with SJR5's requirement that 1.5 percent of the additional annual LGPF distributions be used for early childhood education programs. While one can make the assumption that the largest LGPF beneficiary, public education, would be able to make strong efforts to deploy the additional several hundred million dollars in windfall as intended for statewide early learning programs, SIC states more than half of the LGPF beneficiaries listed below are either not educational facilities or have a mission completely unrelated to ECE.

Institutions	**LGPF Ownership**	**ECE Focus**
Public schools	84.18%	**Y**
NM Military Institute	3.23%	**N**
NM School for the Deaf	1.96%	**?**
School for Blind & Visually Impaired	1.96%	**?**
NM State Penitentiary	1.96%	**N**
University of New Mexico	1.41%	**?**
Public buildings	1.10%	**N**
Water reservoir	1.05%	**N**
DHI Miners Hospital	0.93%	**N**
Penal reform	0.84%	**N**
NM State University	0.45%	**?**
NM State Hospital	0.29%	**N**
Improvement of the Rio Grande	0.24%	**N**
NM Institute of Mining & Technology	0.20%	**N**
Eastern NM University	0.08%	**?**
UNM Saline Lands	0.04%	**N**
Western NM University	0.03%	**?**
NM Highlands University	0.03%	**?**

Northern NM Community College	0.02%	**?**
NM Boys School	0.01%	**?**
Carrie Tingley Hospital	0.00%	**N**

SIC adds that, given the wording of SJR5, there is a possibility these beneficiaries would not be able to legally access the additional distribution amount, and the mandate might also present significant challenges for all beneficiaries outside the core "common schools" scope, which today "own" 16 percent of the LGPF. Should that be the case, these beneficiaries would have to essentially waive a portion of their rightful share of the Land Grant Permanent Fund, as established upon granting of statehood by the United States.

OTHER SUBSTANTIVE ISSUES

SIC points out that the 2003 constitutional amendment requiring additional distributions to be put toward education reforms, was never approved by the US Congress, despite an opinion from the NM Attorney General at the time, indicating such changes would require Congressional approval.

ALTERNATIVES

SIC reports the vast majority of other states with permanent funds, as well as similar university endowments are taking a more conservative approach to fund spending policies:

Annual distributions by domestic sovereign wealth funds:
- Alaska: seeking 5% cap
- Wyoming: 5%
- Texas Permanent School Fund: 3.3%
- North Dakota Legacy Fund: distributions may begin in 2017 with legislative approval

Alaska is the largest of the Permanent Funds at $51 billion – they write checks to their citizens based on earnings, but are seeking to cap annual distributions at 5 percent or less. Wyoming, which has more than $18 billion in various permanent endowment funds, has a current distribution policy of 5 percent. The Texas Permanent School Fund with more than $35 billion will only expend 3.3 percent in FY15. Arizona voters in 2012 by a narrow 51-to-49 percent margin, increased their distributions to 2.5 percent for their relatively young $4 billion endowment. And the North Dakota Legacy Fund – created with oil and gas windfall, won't distribute any dollars until 2017 at the earliest. North Dakota currently deposits in that fund 30 percent of severance taxes.

University endowments:
- University of Texas: 3.5%-5.5%
- Yale: 5% of market value average
- Stanford: 5.25% with a previous year adjustment
- University Pennsylvania: 4.7% of 3-yr average
- Columbia: 4.5% of market value average
- Texas A&M: capped at 5% of rolling average
- Washington: 3%-5.5% based on 5-year average

University endowments are also similar to the LGPF, as they raise money, are bequeathed gifts, and see significant inflows every year, combining to strike a balance with their distributions. Typically, most endowments average distributions of 4-4.5 percent. These are prudent spending rates which the SIC supports.

PvM/aml/je/aml