FISCAL IMPACT REPORT

ORIGINAL DATE 01/28/16
SPONSOR Maestas/Martinez, J. **LAST UPDATED** ______ **HJR** 10

SHORT TITLE Permanent Funds For Early Childhood, CA **SB** ______

ANALYST Alejandro

REVENUE (dollars in thousands)

Estimated Revenue				Recurring or Nonrecurring	Fund Affected
FY16	**FY17**	**FY18**	**FY19**		
0.0	$29,479.0	$31,620.0	$33,032.0	Recurring	General Fund (Ed. Reforms)
0.0	$9,826.3	$10,540.0	$11,010.7	Recurring	Other LGPF beneficiaries (Ed Reforms)
0.0	$161,943.3	$173,704.9	$181,461.6	Recurring	General Fund (Early Childhood)
0.0	$53,981.1	$57,901.6	$60,487.2	Recurring	Other beneficiaries (Early Childhood)
0.0	**$215,924.4**	**$231,606.5**	**$241,948.8**	**Recurring**	**Total General Fund**
0.0	**$39,305.3**	**$42,160.0**	**$44,042.7**	**Recurring**	**Total Other Beneficiaries**

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	**FY17**	**FY18**	**3 Year Total Cost**	**Recurring or Nonrecurring**	**Fund Affected**
Total		$104.0		$104.0	Nonrecurring	Election Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Public Education Department (PED)
State Investment Council (SIC)
Secretary of State (SOS)

SUMMARY

House Joint Resolution 10 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 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.

HJR 10 would also require an additional 1.5 percent of the LGPF's 5-year rolling average to be spent for early childhood education services administered by the state, as provided by law. Early childhood education services are defined as "nonsectarian services for children until eligible for kindergarten… 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 or the New Mexico school for the deaf; provided that early childhood education services available from the New Mexico school for the blind and visually impaired or the New Mexico school for the deaf shall not be delivered by a state contractor."

The Legislature, by a three-fifths' vote of the members of each house, may suspend any additional distributions from the LGPF above 5 percent. Further, the additional distribution would be suspended should the 5-year LGPF average drop below $10 billion.

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.

FISCAL IMPLICATIONS

SIC indicates that in the short term under HJR 10, additional distributions from the LGPF will produce significantly more revenue to the general fund and other LGPF constitutional beneficiaries, primarily public education (84.6 percent LGPF share as of 11/30/15).

In the long term however, and taking into consideration the potential for diminished in-flows to the fund due to reduced oil and gas revenue (today's in-flows are approximately half of 2014 levels), and uncertainty related to long-term investment return expectations (the Council in 2015 lowered its long-term investment target from 7.5 percent to 7.0 percent), this proposal greatly increases the risk that the LGPF will be unable to deliver equal or greater benefits to LGPF beneficiaries in the future.

The following chart shows the end-year values of the LGPF, as well as projections for LGPF values and distributions for the next 12 years, at both the 5.0 percent rate and 7.0 percent rate proposed under HJR 10.

Cal.Year	LGPF Value ($M) (5.0% rate)	LGPF Distribution ($M) (5.0% rate)	LGPF Value ($M) (7.0% rate)	LGPF Distribution ($M) (7.0%)	Distr Difference ($M)	Fiscal Year
2014	$ 14,508.3	$ 655.8	$ 14,508.3	$ 655.8	$ -	2016
2015	$ 14,402.6	$ 638.1	$ 14,402.6	$ 893.3	$ 255.2	2017
2016	$ 15,140.7	$ 688.9	$ 15,013.1	$ 962.6	$ 273.8	2018
2017	$ 15,911.6	$ 733.5	$ 15,511.0	$ 1,019.5	$ 286.0	2019
2018	$ 16,686.5	$ 766.5	$ 15,979.1	$ 1,055.8	$ 289.3	2020
2019	$ 17,474.5	$ 796.2	$ 16,432.1	$ 1,082.7	$ 286.6	2021
2020	$ 18,284.0	$ 835.0	$ 16,883.8	$ 1,117.5	$ 282.5	2022
2021	$ 19,113.5	$ 874.7	$ 17,334.9	$ 1,150.0	$ 275.3	2023
2022	$ 19,959.2	$ 915.2	$ 17,782.6	$ 1,181.8	$ 266.6	2024
2023	$ 20,821.6	$ 956.5	$ 18,228.2	$ 1,213.3	$ 256.7	2025
2024	$ 21,700.7	$ 998.8	$ 18,672.0	$ 1,244.6	$ 245.8	2026
2025	$ 22,597.0	$ 1,041.9	$ 19,114.0	$ 1,275.8	$ 233.9	2027
2026	$ 23,510.7	$ 1,085.9	$ 19,554.4	$ 1,306.9	$ 221.0	2028

The 12-year time frame was chosen for a comparison basis, as the most recent constitutional amendment requiring additional distributions from the LGPF was also 12 years, from FY2005-2016, and resulted in $747 million of additional pay-outs over and above the base 5 percent, to LGPF beneficiaries during that time.

The SIC provides the following observations regarding the impact of HJR 10, compared to the current 5 percent base rate:

- Barring market corrections, negative return years (like calendar year 2015) or sharp drops in oil/gas revenue like we are seeing today, the LGPF will continue to grow on a nominal basis, though real dollar value would not keep up in a high or above-average inflation environment.
- At the 7.0 percent rate, the LGPF would deliver an additional $3.2 billion to beneficiaries over the next dozen years, on average $264 million annually.
- That projected $3.2 billion is more than four times (4.25x) the excess amount drawn down from the permanent fund by the previous constitutional amendment of 2003 ($747 million) over the same time period.
- At the 7.0 percent rate, at the end of a dozen years, the LGPF value will be diminished by a projected $3.96 billion, compared to the 5 percent current base rate.
- Other variables, including higher than average oil/gas in-flows, or higher than average investment returns – neither of which appear abundantly likely in the coming decade - could mitigate the impact to a degree. However, in the case of lower than expected variables, the impact to the corpus would potentially be amplified.

Reduced value of the corpus results in diminished capacity to participate in positive investment return environments, increasing volatility overall to the LGPF's yearly benefits. The smaller the fund, the smaller the benefits, and the lesser its ability to recover from negative returns through subsequent positive investment performance.

SOS estimates the cost of placing a constitutional amendment on the ballot to be $104 thousand based on 2010 actual expenditures. This includes all necessary printing and publications.

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.

Investment Issues. The SIC provides, below, preliminary investment performance data for the LGPF, as of 12/31/15:

Investment Returns 12/31/15	1 year	3-year	5-year	10-year
Composite - gross of fees	0.37%	7.63%	7.12%	5.57%

While the three-year and five-year annualized investment returns slightly exceed the SIC's annual return target of 7.0 percent, such performance is not something the Council anticipates with consistency moving forward over the next decade. It is also noteworthy that even with the near historic bounce back from the 2008 financial meltdown, the LGPF's annualized returns for the last decade remain below 6 percent.

Depending on LGPF inflows from the State Land Office, the rate of inflation (which we anticipate will grow), and investment returns, it is a reasonable assumption that under the 7.0 percent distribution rate prescribed by HJR 10, the LGPF would have suffered damage to its corpus over many of the previous 10 years.

Early Childhood Issues. Volume I of the LFC Report for Fiscal Year 2017 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.

Early childhood funding has grown by more than 80 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 HJR 10 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 the 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.

PERFORMANCE IMPLICATIONS

According to PED, if HJR 10 is enacted, it will impact the New Mexico PreK Program (Children's Code, 32A-23-1-8). The program provides voluntary pre-kindergarten services to four-year-old children in the state. The program shall address the total developmental needs of preschool children including physical, cognitive, social and emotional needs and, also, health care, nutrition, safety and multicultural sensitivity.

In FY2016, $22.9 million was allocated to 55 school districts, 14 of which are served through two regional education cooperatives, and six state charter schools to serve 5,428 four-year olds in 220 classrooms at 140 school sites. Every district that submitted a complete and timely application for PreK in FY16 was funded, however not all were funded at the level requested. One district submitted an incomplete application after the deadline, so was not funded.

ADMINISTRATIVE IMPLICATIONS

The PED would require additional personnel in the Literacy and Early Childhood, Procurement, and Fiscal Grants Management bureaus to support, monitor and fund additional early childhood programs

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HJR 10 conflicts with the general appropriation act where funds for early childhood programs are included in both the executive and LFC recommendation.

Relates to SJR2, which seeks to provide a 1.5 percent additional annual distribution of the LGPF to fund non-sectarian early childhood education programs administered by the state.

Relates to SJR3, which seeks to increase the base distribution rate of the LGPF to 5.8 percent.

TECHNICAL ISSUES

According to the SIC, HJR 10 includes an asset value "safety valve" intended to protect the fund from additional distributions during times of financial duress should the 5-year average of the fund drop below $10 billion at calendar end of any given year.

The construction of the LGPF distributions are based on a 5-year fund average with the goal of steadying pay-outs in a smooth, consistent manner, to better accommodate legislative advance planning. However, the safety valve sought to protect the fund in HJR 10 does not account for that, as the LGPF could technically go to $0 in 2016, and the 5-year average would still be $10.7 billion. An alternate technical safety-valve might better be tripped when the current LGPF corpus value itself drops below $10 billion, or some similar appropriate value.

Further, SIC identifies an issue with HJR 10'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 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 early childhood education.

Institutions	**LGPF Ownership**	**Early Childhood Education Focus**
Public schools	84.18 percent	**Y**
NM Military Institute	3.23 percent	**N**
NM School for the Deaf	1.96 percent	**?**
School for Blind & Visually Impaired	1.96 percent	**?**
NM State Penitentiary	1.96 percent	**N**
University of New Mexico	1.41 percent	**?**
Public buildings	1.10 percent	**N**
Water reservoir	1.05 percent	**N**
DHI Miners Hospital	0.93 percent	**N**
Penal reform	0.84 percent	**N**
NM State University	0.45 percent	**?**
NM State Hospital	0.29 percent	**N**
Improvement of the Rio Grande	0.24 percent	**N**
NM Institute of Mining & Technology	0.20 percent	**N**
Eastern NM University	0.08 percent	**?**
UNM Saline Lands	0.04 percent	**N**
Western NM University	0.03 percent	**?**
NM Highlands University	0.03 percent	**?**
Northern NM Community College	0.02 percent	**?**
NM Boys School	0.01 percent	**?**
Carrie Tingley Hospital	0.00 percent	**N**

SIC adds that, given the wording of HJR 10, 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” 15 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 New Mexico Attorney General at the time, indicating such changes would require Congressional approval.

ALTERNATIVES

SIC indicates that 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:
    - Alabama: 5 percent of rolling 3-year average;
    - Alaska: seeking 5 percent cap; principal may not be spent;
    - Idaho: 5 percent of 3-year average with adjustments; current rate below 4 percent
    - Wyoming: 5 percent;
    - Texas Perm School Fund: 3.3 percent; returns must exceed distributions over 10 years; and
    - North Dakota Legacy Fund: distributions may begin in June 2017.

Alaska is the largest of the Permanent Funds at $51 billion – the state writes 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 its relatively young $4 billion endowment. And the North Dakota Legacy Fund – created a few years ago with its significant oil/gas windfall, will not distribute any dollars until 2017 at the earliest, following exhaustive study and planning by lawmakers.

International sovereign wealth funds also have varying rates of spending, often predicated on the size of the fund, the amount of natural resources available in their countries, and the long-term goals of their governments. The largest fund in the world belongs to Norway, which has a 4 percent spending rule. Norway announced in January 2016 that it would not be dipping into its fund or increasing distributions in reaction to plummeting global oil/gas prices, but would instead rely on free cash-flow produced by its massive $780 billion fund to prop up budgetary needs. Norway has grown its permanent fund to such a degree that it effectively stabilizes the country's economy and its budgeting process, even during times of fiscal crisis.

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 below 5 percent. Below are a handful of such endowments with recent spending rates:

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

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Per the PED, if HJR 10 is not enacted, early childhood programs will continue to receive funding from the GAA. Certain educational programs will not be implemented or maintained.

LA/al/jle/jo