Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current FIRs (in HTML & Adobe PDF formats) are available on the NM Legislative Website (www.nmlegis.gov). Adobe PDF versions include all attachments, whereas HTML versions may not. Previously issued FIRs and attachments may be obtained from the LFC in Suite 101 of the State Capitol Building North.

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

		ORIGINAL DATE	1/30/19		
SPONSOR	Stapleton	**LAST UPDATED**	2/05/19	**HB**	289/aHENRC
SHORT TITLE	Fund Investment In Renewable Energy			**SB**	
				ANALYST	Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
Indeterminate (see fiscal implications)					Recurring	Severance Tax Permanent Fund (STPF)

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	Indeterminate (see administrative implications)				Recurring	STPF

Parenthesis ( ) indicate expenditure decreases

Relates to SB30

SOURCES OF INFORMATION

Responses Received From
State Investment Council (SIC)
Economic Development Department (EDD)
Energy, Minerals and Natural Resource Department (EMNRD)

SUMMARY

Synopsis of HENRC Amendment

House Energy, Environment and Natural Resources Committee (HENRC) amendment for House Bill 289 clarifies the timing and methodology in which the State Investment Council (SIC) would annually assess its progress towards fulfilling the mandate to invest no less than 1 percent of the Severance Tax Permanent Fund (STPF) in renewable energy, as defined in the bill. The state investment officer would be required to annually advice the council on the ratio of the market value of investments in New Mexico renewable energy to the market value of the STPF, and the council would be required to use that ratio in determining any necessary investment changes.

The amendment appears to address a technical issue raised by SIC staff in their analysis of this bill. According to SIC staff, the amendment provides a way to periodically reinforce the legislative intent behind this bill, while not enforcing a specific deadline on the Council to reach the 1 percent target. A specific timeline or related penalties for non-compliance could be viewed as a statutory directive that would potentially compete with the overriding requirement (and the Council's fiduciary duty) that all such investments be qualified under the Uniform Prudent Investor Act.

Synopsis of Bill

House Bill 289 requires no less than 1 percent of the market value of the STPF be invested across a diverse portfolio of New Mexico renewable energy business entities, pursuant to the Uniform Prudent Investor Act. Any investment in a renewable energy project may not exceed 50 percent of the estimated cost of the project. The bill also specifies the investments made by the state investment officer must be approved by the SIC.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

The market value of the STPF as of Dec. 31, 2018 was $4.953 billion. Assuming passage of this bill, SIC would be required to invest approximately $49.5 million in various renewable energy businesses as defined in the bill. The bill does not specify any required timing of such investments.

According to SIC staff, the fiscal impact of this bill on the STPF is indeterminate. The agency analysis states the following:

> "While history has illustrated the risky nature of early-stage venture investments, there are also high rewards that can be achieved through these types of investments when they succeed. HB289 does not specify that its investments be in start-ups, though in New Mexico those early-stage opportunities far outweigh those of mature, revenue-positive businesses that are looking to expand. The specific investment opportunity-set that exists in New Mexico, even with the many types of investments authorized by the bill, has not been vetted fully and will need to be identified, assuming passage."

This bill requires SIC investments be made pursuant to the Uniform Prudent Investor Act (UPIA), and as the investments are restricted to the STPF, where they may either be made at a market or differential (below-market) rate of expected financial return. Below market rate investments are made from the STPF with the intent of stimulating the New Mexico economy through job or industry creation, which helps offset the expectation that the financial returns of such investments may be diminished for various reasons.

SIGNIFICANT ISSUES

Currently the SIC has several legislatively-mandated STPF "carve outs" for New Mexico focused economically-targeted investments (ETIs), including:

- Up to 9 percent of the STPF for the New Mexico Private Equity Investment Program (currently at ~6 percent)
- Up to 6 percent of the STPF for the New Mexico Film Investment Program (inactive)
- One-percent of the STPF for the New Mexico Small Business Investment Corporation (mandatory)

In addition, the following programs have been earmarked by the legislature for investment from the STPF, but are currently not in use:

- Up to 20 percent of the STPF for NM Farmers' Home Administration Loans (Section 7-27-5.4 NMSA 1978)
- Up to 10 percent of the STPF for Educational Institution Revenue Bonds (Section 7-27-5.13 NMSA 1978)
- Up to 20 percent of the STPF for investments with NM Financial Institutions (Section 7-27-5.19 NMSA 1978)
- $130 million (about 2.6 percent) of dollar specific STPF-authorized investments

SIC staff provide the following analysis:

> "Best intentions regarding job-creation aside, limiting investments by geography or strategy - such as renewable energy based in New Mexico - is likely to increase risk and reduce long-term financial returns. This is evidenced by negative investment returns in New Mexico-centric venture capital during the first decade of the program, as well as venture investments made from the STPF via the Small Business Investment Corporation. While financial returns of both these initiatives have improved over time, those initial losses amounted to tens of millions of dollars and continue to drag on the overall returns to the fund.
>
> The impact of lessened investment returns does result in lowered valuation of the STPF, which will ultimately reduce the annual benefits the fund creates for the state's general fund (the general fund will receive $225 million in FY20). It is certainly possible that successful investments of this nature could result in added financial returns, in addition to positive impacts on businesses and jobs in the state.
>
> Currently, other than general fiduciary expertise, the SIC only has limited expertise internally and through our external advisors that is specific to renewable energy. A mandate requiring additional millions to be invested in this area will result in additional costs to locate and oversee investments of this nature, though those costs are difficult to quantify."

PERFORMANCE IMPLICATIONS

SIC staff analysis point to an LFC assessment in 2010 that found diminished returns related to the New Mexico Private Equity Program and Film Loan Program cost the STPF approximately 1 percent per year, or about $40 million. SIC staff note this observation has been fairly accurate over time, though not always. Improvements in the program have resulted in a more selective process of New Mexico-focused investments that has resulted in improved returns in recent years. SIC staff note that valuation write-ups during 2018 in New Mexico private equity investments today have the STPF outperforming the Land Grant Permanent Fund, though this is on a short-term basis, and the investments have not yet been realized by successful exits.

ADMINISTRATIVE IMPLICATIONS

The SIC may need additional resources and expertise to assess renewable energy investments in New Mexico for viability/prudence in this emerging asset class. If this bill is enacted, the SIC will need to assess what additional fiduciary tools will be necessary to implement the new strategy, be it internal or external advisors and experts in the field who can locate, research and vet the best renewable energy projects and investment opportunities in New Mexico.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill relates to SB30 investments in New Mexico technology research collaborative.

TECHNICAL ISSUES

SIC staff note the following technical issues:

> This bill requires that the investments shall be diversified among the bills five broad definitions for: New Mexico renewable energy, New Mexico renewable energy private equity fund, renewable energy, renewable energy project, and storage. However, it does not offer guidance on potential allocation structure, or consider potential negatives associated with fast-changing technology, potential infrastructure needs that could limit opportunities, or other external factors.
>
> This bill requires that the SIC must invest 1 percent of the market value of STPF but, does not provide direction or a date to determine market value of STPF. The STPF market value fluctuates and it is an important factor on determining the 1 percent investment target.
>
> This bill does not indicate a timeline for requiring the SIC to invest 1 percent in renewable energy, or the result should the Council fail to find renewable energy opportunities that qualify under the Uniform Prudent Investor Act.
>
> This bill does not specify a sunset clause or provide guidance or flexibility on in the event of a market downturn in renewable energy in New Mexico. This is noteworthy since manufacturing may be less expensive in China, as new efficiencies are found, as was the case in factors that contributed greatly in the demise of Advent Solar.
>
> This bill does not specify if the 1 percent investment is a one-time investment or if it is a rolling 1 percent allocation in renewable energy in New Mexico.

Additionally, SIC staff point out the bill does not appear to consider that it may be impossible to calculate the portion of SIC investments made in non-New Mexico renewable energy vehicles through existing investments via publicly traded equities, i.e. Exxon or other energy companies expanding their strategies in this area.

OTHER SUBSTANTIVE ISSUES

The scope of this bill is broad in the potential menu of investments, including:

- A business that manufacturers, distributes, sells, installs renewable energy storage, generation or transmission equipment and has its principal office & majority of employees in NM;
- A renewable energy-related product manufacturer with more than 50 employees in NM;
- A NM-based renewable energy project;
- Bonds issued under the Renewable Energy Financing District Act;
- Energy efficiency bonds issued under the Energy Efficiency and Renewable Energy Bonding Act;
- Utility revenue bonds issued by a city or county to acquire or improve a facility with the primary purpose of renewable energy generation, storage or transmission;
- Renewable energy transmission bonds issued by the New Mexico Renewable Energy Transmission Authority (RETA) Act;
- A "New Mexico renewable energy private equity fund" with the primary business of investing in renewable energy projects located in New Mexico; and
- Renewable energy projects tied to facilities located in the state with the purpose of generation, transmission or storage.

SIC currently makes some of these types of investments in renewable energy businesses via its New Mexico private equity investment program (NMPEIP), not because they involve renewable energy, but because they are attractive from a risk/return and diversification profile. The NMPEIP is statutorily authorized to invest up to 9 percent of the STPF, with a current long-term policy target of 5 percent and carrying value closer to 6 percent of the STPF's value at last report. The primary focus of NMPEIP investments is on early-stage companies, often startups using new technologies originating from the state's research universities or national laboratories. According to SIC staff analysis, this bill's scope would include those investments, as well as several other potential investment strategies, including renewable energy manufacturing, transmission, storage and sales to name a few.

SIC staff state there have been seven NMPEIP investments in recent years which would qualify under the investment guidelines prescribed by this bill, in which the SIC has invested about $30 million dollars under the guidance of NM venture funds in the NMPEIP structure. Of those seven companies:

- Four renewable energy investments are still active in NMPEIP, with a collective valuation around $13 million.
- One renewable energy investment exited NMPEIP at a 123 percent realized gain of $208,692.
- The other two renewable energy companies exited NMPEIP at a realized loss of $19,449,961, the bulk of that coming with the closure and sale of Advent Solar in 2009.

According to SIC staff, it would appear that at least the current investments would qualify under the guidelines proposed by this bill, and as such, would require that the STPF invest millions more in these types of companies, though not the full 1 percent or about $49.5 million. Likewise, growth of or declining value of the STPF would impact that expected amount needed to be invested to satisfy the guidelines of this bill, though there is no timeline in the bill to indicate when such adjustments based on the 1 percent metric should be calibrated. Existing law related to a similar allocation from the STPF (1-percent dedicated to the Small Business Investment Corporation – SBIC) is adjusted on a fiscal year basis every time the value of the STPF rises, fiscal year over fiscal year.

DI/sb/gb