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

	ORIGINAL DATE 2/22/19		
SPONSOR Gallegos	**LAST UPDATED**	**HB**	621
SHORT TITLE Permanent Education Reserve Fund		**SB**	
		ANALYST	Iglesias

APPROPRIATION (dollars in thousands)

Appropriation					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
$0.0	$60,000.0	$0.0	$0.0	$0.0	Nonrecurring	General Fund

Parenthesis ( ) indicate expenditure decreases

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
$0.0	$60,000.0	Possible Interest Earnings			Nonrecurring	NEW Permanent Education Emergency Reserve Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION

LFC Files

Responses Received From
State Investment Council (SIC)

SUMMARY

Synopsis of Bill

House Bill 621 creates a permanent education emergency reserve fund and appropriates $60 million to this fund from the general fund in FY20. The state investment officer will manage the new fund and interest earnings of the fund will be credited to the fund. The bill allows for distributions from this new fund to the state equalization guarantee (SEG) if (1) the value of the fund is at least $60 million and (2) the legislative-executive consensus forecast shows a revenue decline of five percent or more from the forecast for the preceding fiscal year. The effective date of this bill is July 1, 2019.

FISCAL IMPLICATIONS

The appropriation of $60 million to the new permanent education emergency reserve fund contained in this bill is a nonrecurring expense to the general fund.

It is unclear whether the permanent education emergency reserve fund would count toward general fund reserve balances. The bill does not specifically designate this fund as a reserve fund of the state. For example, the tobacco settlement permanent fund (TSPF) is specifically designated in statute as "a reserve fund of the state" and provides for transfers from this fund to the general fund if revenues and other reserves are insufficient to cover appropriations (Section 6-4-9.F NMSA 1978). However, the state-support reserve fund is also included in the LFC and Department of Finance and Administration's general fund financial summary as part of general fund reserves, even though statute does not specifically designate the fund as a reserve fund of the state (Section 22-8-31 NMSA 1978). This is because money in the state-support reserve fund may only be used to augment general fund appropriations for the SEG, and distributions from this fund must be used in the same manner as the SEG distributions.

To the extent the new permanent education emergency reserve fund may be considered a reserve of the general fund, the appropriation from general fund operating account to the new education reserve would not impact total general fund reserve balances for FY20. However, if this fund is not considered a general fund reserve, then ending reserve balances for FY20 would be reduced by $60 million.

SIGNIFICANT ISSUES

Considering the significant budget cuts that occurred in the recent downturns in FY16 and FY17, this new fund would provide a tool to policy makers in addressing the next budgetary crisis.

The existing state-support reserve fund can be also be used to augment SEG distributions. Section 22-8-31 NMSA 1978 includes the following provisions:

> (B) The state-support reserve fund shall be used only to augment the appropriations for the state equalization guarantee distribution in order to insure [ensure], to the extent of the amount undistributed in the fund, that the maximum figures for such distribution established by law shall not be reduced.
> (G) Distribution from this fund shall be made in the same manner and on the same basis as the state equalization guarantee distribution.

The primary difference between the new education reserve created by this bill and the existing state-support reserve fund appears to be this bill's condition that funds in the education reserve can only be accessed if there is a decline in forecasted revenues.

PERFORMANCE IMPLICATIONS

The State Investment Council (SIC) would have to determine, in consultation with stakeholders, what an appropriate level of risk/return should be for the education reserve fund, if managed similarly to the land grant permanent fund (LGPF), there would be a long-term expectation the new fund could see average returns of 7 percent.

According to SIC staff, assuming an average return of 7 percent and no drawdowns from or contributions to the education reserve over the first 10 years, the fund would likely double in value due to income generated by investments.

Below are LGPF net annualized investment returns as of December 31, 2018:

	1yr	3yrs	5yrs	7yrs	10yrs
LGPF net of fees returns	(-1.78)	6.67	5.30	8.04	8.73

While SIC still believes it can achieve a 7 percent return for the LGPF over the next 7-10 years, the strong indications that the US is in the late stages of its economic expansion cycle increase the odds against significant investment outperformance over the coming decade.

An asset allocation for the education reserve is likely to require more liquidity, as well as a conservative bias toward capital preservation rather than growth. These factors would reduce expected rates of return for the new fund.

ADMINISTRATIVE IMPLICATIONS

SIC staff indicate some additional administrative burden in managing this new fund, but after establishing an investment allocation, staff note the management of the fund would require minimal agency resources.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The House Appropriations and Finance Committee (HAFC) substitute for House Bill 2 & 3 appropriates $25 million to the state-support reserve fund, the purpose of which is to augment SEG distributions. Additionally, the HAFC substitute for HB2 & 3 includes contingent appropriations of about $182 million for extended learning time and K-5 Plus programs, of which any unexpended funds would revert to the state-support reserve fund.

TECHNICAL ISSUES

The bill states the legislature may make an appropriation from the reserve fund to the SEG if "a legislative-executive consensus forecast for general fund revenue for the current or following fiscal year shows a decline of five percent or more from the forecast for the preceding fiscal year." Consensus forecasts are commonly issued in August and December, with a mid-session update in January or February. The forecasts may cover the prior fiscal year, the current fiscal year, and the following four fiscal years. Because consensus forecasts are regularly updated, the bill should be conditional upon "<u>the most recent</u> legislative-executive consensus forecast" rather than "<u>a</u> legislative-executive consensus forecast".

Additionally, there may be circumstances in which general fund revenue forecasts could significantly decline, but the language would not allow access for the new reserve fund. For example, if the December 2019 consensus forecast for FY21 were to be down 5 percent from the December 2019 consensus forecast for FY20, then the legislature would be able to appropriate funds from the new education reserve to the SEG. However, if the 2020 mid-session update revised both the FY20 and FY21 forecast down proportionally by 10 percent, but the difference between FY20 and FY21 is still 5 percent, then the legislature could not access the reserve fund to shore up the SEG.

The bill also states, "the legislature may appropriate money from the permanent education emergency reserve fund to the state equalization guarantee distribution in a necessary amount that is in excess of fund's sixty million dollar ($60,000,000) corpus." It is unclear what constitutes a "necessary amount". It appears possible that the legislature could appropriate up to the entire amount above the fund's $60 million corpus to the SEG as long as the bill's 5 percent condition is met. If that is not the intent, then the clarification on what constitutes a necessary amount may be warranted.

Lastly, further language clarification may be needed to clarify whether or not the new education reserve should be considered part of general fund reserve balances.

DI/sb