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

SPONSOR Lundstrom/Sanchez/Sweetser **ORIGINAL DATE** 2/09/2020 **LAST UPDATED** 2/15/2020 **HB** 341/aHTRC

SHORT TITLE Transfer of Reserve Funds **SB**

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	**FY21**	**FY22**	**FY23**	**FY24**		
	See Fiscal Implications				Recurring	General Fund Reserves

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of HTRC Amendment

The House Taxation and Revenue Committee amendment addresses the issues identified in the *Technical Issues* section of this FIR. The amendment eliminates a potential ambiguity in interpreting the fiscal years to which the provision applies and makes clear the provision applies to the balance of the operating reserve *as of* the end of the fiscal year, which would be calculated pursuant to the audit after the fiscal year has ended.

Synopsis of Original Bill

Because the New Mexico Constitution requires a balanced budget, state government maintains general fund reserves to cover any shortfalls if revenues are unexpectedly low or expenses are unexpectedly high. They are made up of several distinct accounts: the operating reserve, tax stabilization reserve (TSR), appropriation contingency fund, state support reserve fund, and tobacco settlement permanent fund. House Bill 341 provides for a transfer at the end of the fiscal year from the TSR to the operating reserve to assure that the operating reserve has funds of at least 1 percent of the aggregate general fund appropriations for the current fiscal year.

Specifically, if at the end of the fiscal year the operating reserve is less than 1 percent of the aggregate general fund appropriations, then this bill would transfer from the TSR the lesser of 1 percent of appropriations or the amount necessary to get the operating reserve to that level. 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 general fund operating reserve provides an important buffer for the general fund in the event of a revenue shortfall. Each year, the Legislature provides transfer authority in the General Appropriation Act (GAA) that prevents the need for a special session in the event revenues fall short of the estimate by a modest amount. In FY19, the transfer authority permitted in the GAA was $85 million – meaning if revenues fell short of appropriations by $85 million or less, the governor, with Board of Finance approval, could have authorized a transfer from the operating reserve to cover the shortfall without having to call a special session. However, if there were insufficient funding in the operating reserve, it could force a special session to identify other sources of funding from which to cover appropriations or require budget cuts.

Additionally, the governor is able to draw on unappropriated general fund monies for disaster allotments – effectively, funds are drawn from the appropriation contingency fund and, if that fund is insufficient, from the operating reserve. Low balances in the operating reserve run the risk of insufficient funding to cover emergencies and disaster allotments, in which case a special session may be necessary to appropriate such funding from other sources.

The transfer of reserve funds provided in this bill would allow the state to maintain a minimum balance in the operating reserve to protect the state from unexpected revenue shortfalls and to ensure ability to address disasters. The maximum amount that could be transferred in any year would be 1 percent of that year's general fund appropriations. In years where the ending operating reserve balance were greater than 1 percent of general fund appropriations, no transfer would be made.

For example, if total recurring and nonrecurring appropriations are $8 billion, 1 percent would be $80 million. If the balance in the operating reserve at the end of the year were $75 million, this bill would transfer $5 million from the TSR to the operating reserve, to bring the operating reserve balance to $80 million. In this example, any transfer from the TSR could not exceed $80 million (or 1 percent).

SIGNIFICANT ISSUES

This bill creates a "floor" in the operating reserve to ensure the operating reserve always begins a new fiscal year with at least an amount equal to one percent of aggregate general fund appropriations for the prior fiscal year. The Department of Finance and Administration (DFA) states this minimum balance safeguards the State of New Mexico if it were to experience a modest revenue shortfall and assists the state in ensuring the ac-count has a balance in order to meet emergency appropriations and disaster allotments.

DFA also points out the operating reserve account cannot access the other state reserves without specific legislative authority. Each of those reserve funds are statutorily created and have their own requirements to be accessed. This bill would allow for an automatic transfer from the Tax

Stabilization Reserve to the Operating Reserve without the need for a two-thirds vote or a governor's emergency declaration, and only up to an amount equal to one percent of aggregate general fund appropriations. This transfer would not decrease overall general fund reserves, as the operating reserve and the tax stabilization reserve accounts are both included in the calculation of overall reserves. However, use of those funds would require Legislative appropriation.

PERFORMANCE IMPLICATIONS

Under current law, the SIC is likely to get several months notice before funds are withdrawn from the TSR. By creating an annual expectation that funds may be transferred from the TSR to the operating reserve, this bill may require that the SIC maintain a portion of the TSR in slightly more liquid investments, earning slightly less, than the slightly less liquid investments in which the TSR would otherwise be invested. According to SIC, given current funding levels of the TSR (currently more than $1 billion), the extra liquidity required by this bill is unlikely to have any significant impact on returns.

Aside from the impact of helping to maintain a balanced budget, the fiscal impact would be limited to the relatively small difference in expected earnings from the transferred funds held in the operating reserve compared to what those funds would have been expected to earn in the TSR. Although the exact lost earnings cannot be known in advance because the number will depend upon three variables (i.e., the amount transferred and the rates of return actually earned by the operating reserve and the TSR), SIC estimates the maximum potential lost earnings of a transfer of the full 1 percent of appropriations in a given fiscal year would be about $1.4 million.

ADMINISTRATIVE IMPLICATIONS

SIC staff noted the agency sees no significant issues implementing this bill.

TECHNICAL ISSUES

Striking the word "current" on page 4, lines 6, 8, 11, and 13, would eliminate a potential ambiguity in interpreting the fiscal years to which the provision applies. Additionally, changing the word "at" on page 4, line 6, to "as of" would make clear the provision applies to the balance of the operating reserve as of the end of the fiscal year, which would be calculated pursuant to the audit after the fiscal year has ended. *The HTRC amendment addresses both of these issues.*

OTHER SUBSTANTIVE ISSUES

Revenues that exceed total expenditures at the end of a fiscal year are transferred from the appropriation account to the operating reserve, pursuant to Section 6-4-2.1 NMSA 1978. If revenues come up short, the governor may transfer money from the operating reserve to cover authorized expenses, up to an amount approved in the GAA. For this reason, it is important to maintain adequate operating reserves to ensure quick access to funds in the event of a modest revenue shortfall. Once the operating reserve fund hits 8 percent of the prior budget year's recurring appropriations, the excess must be transferred to the tax stabilization reserve.

The tax stabilization reserve (TSR), also referred to as the "rainy day fund," is the most restrictive general fund reserve account. Under current law, funds can be appropriated from the

TSR only if: 1) the governor declares it "necessary for the public peace, health and safety" and only with the vote of two-thirds of both the House and Senate; or 2) revenues are determined by the governor to be insufficient to meet authorized appropriations for the current and next fiscal year and the House and Senate approve a transfer to the general fund with a majority vote to cover the projected insufficiency for either or both fiscal years.

Funds are deposited into the TSR by two mechanisms: 1) any excess of oil and gas emergency school tax revenue above the five year average, and/or 2) any funds in the operating reserve that are in excess of 8 percent of the prior budget year's recurring appropriations. The TSR also earns interests on its balances.

Under current statute, distributions to the TSR continue regardless of the size of the fund or the state's total reserves. To the extent the legislature has a target level for reserves (e.g. 25 percent of appropriations), there is a risk of growing the TSR (a more restrictive account) at the expense of the operating reserve (a less restrictive account). This is due to the statutory distributions to the fund that continue regardless of the amount of funds in the reserves.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The state could run the risk of needing to call a special session to cover modest revenue shortfalls or disaster allotments.

DI/sb