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

SPONSOR Brown **ORIGINAL DATE** 2/08/2020 **LAST UPDATED** 2/12/2020 **HB** 344/aHTPWC

SHORT TITLE Urgent Need Highway Project Fund **SB**

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue*					Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22	FY23	FY24		
	($25,000.0)	($25,000.0)	($25,000.0)	($7,600.0)	Recurring	General Fund
	$25,000.0	$25,000.0	$25,000.0	$7,600.0	Recurring	NEW Urgent Need High Project Fund

Parenthesis ( ) indicate revenue decreases

* Note: Estimates conditional on general fund reserves totaling 25 percent of recurring appropriations. See *Fiscal Implications* section for more details.

Conflicts with HB83 and SB3

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Treasurer's Office (STO)
State Investment Council (SIC)
Department of Transportation (DOT)

SUMMARY

Synopsis of HTPWC Amendment

The House Transportation and Public Works Committee (HTWPC) amendment addresses the technical issue in the original bill of changing management of the new urgent need highway project fund based on the size of the fund. The amendment strikes subsection C from Section 1 of the bill, removing the condition for the State Investment Council to manage the fund when the balance is below $6 million. The fund will remain in the state treasury and be managed by the State Treasurer.

Synopsis of Original Bill

House Bill 344 creates a new, nonreverting, interest-earning "urgent need highway project fund" and provides for federal mineral leasing (FML) revenue distributions to this fund. The effective date of this bill is July 1, 2020.

When FML payments to the state exceed the five-year average, up to $25 million of the excess is distributed to the new project fund, provided that state reserves are at least 25 percent of recurring appropriations. The bill appropriates the balance of the new fund to the Department of Transportation (NMDOT) to be used for projects that will improve, reconstruct, or maintain a part of the state highway system that (1) NMDOT's safety network screening process has determined is a high priority based on crash data and annual daily traffic volume (2) has fallen below a pavement condition rating of 45 or (3) has fallen below other performance criteria identified in NMDOT's asset management plan.

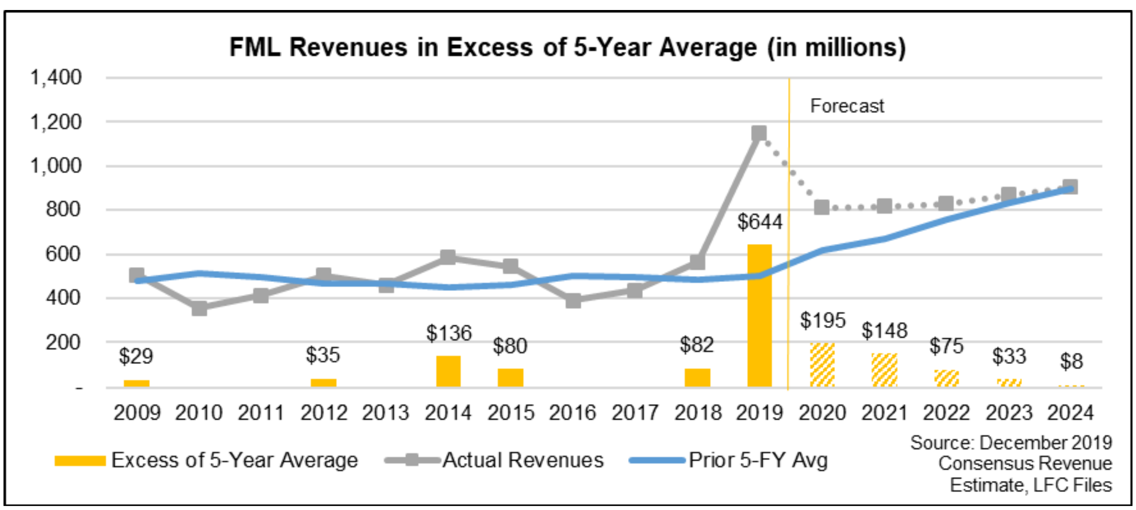
The bill provides disbursements from the fund can only occur when there is a minimum balance of $6 million at the start of the fiscal year. When there are insufficient funds for disbursement, the bill requires the money in the fund to be investment by the State Investment Officer in the same manner as the land grant permanent funds.

The bill requires NMDOT to report annually on the urgent need highway projects in each state transportation commission district, the projected cost for each project, and the status of the new project fund.

FISCAL IMPLICATIONS

This bill creates a new fund and provides for continuing appropriations. LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, because earmarking reduces the ability of the Legislature to establish spending priorities.

The fiscal impact estimates are based on the December 2019 consensus revenue forecast, which projects federal mineral leasing payments will exceed the five-year average in FY21 through FY24, as shown in the chart below. The bill provides that if FML payments exceed the five-year average by more than $25 million, then $25 million will be distributed to the new project fund. When the excess is below that threshold, then the full amount of the excess will go to the new project fund.



The excess FML revenue is estimated to exceed the bill's threshold in the first three years, allowing for a $25 million distribution to the new project fund. In FY24, the FML payments are expected to exceed the five-year average by $7.6 million, and that full amount would be distributed to the new project fund.

The fiscal impact estimates are conditional upon general fund reserves exceeding 25 percent of recurring appropriations. In FY19, general fund reserves ended the fiscal year at 28.9 percent of recurring appropriations.

The New Mexico Department of Transportation (DOT) points out that because the bill does not establish a set appropriation value, there is some uncertainty related to this revenue distribution. The amount of the distribution will not be known until the end of each fiscal year. The fund would presumably be available for projects to start in the following fiscal year.

SIGNIFICANT ISSUES

DOT provided the following discussion:

> "[This bill] limits eligibility of projects that would qualify as urgent need highway projects. NMDOT will need to conduct analyses of crash data, traffic volume data, pavement condition rating, and other performance data to determine if a particular project can be funded through the UNHPF instead of the state road fund.
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> [This bill] allows disbursement from the fund only when there is a minimum of $6 million in the fund at the start of a fiscal year. However, because the "recurring" revenues are contingency based, as described above, once the fund falls below the $6 million threshold, the money in the fund might not be available for disbursement for several years, depending on the returns from investment of the fund balance."

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Conflicts with House Bill 83, and its duplicate Senate Bill 3, which sends all federal mineral leasing revenue in excess of the five-year average to a newly created early childhood education and care fund.

PERFORMANCE IMPLICATIONS

According to DOT, this additional funding source may enable the department to increase the number of highway projects in a given fiscal year to further improve the safety and performance of the state highway system. However, DOT states that because the bill does not establish a set appropriation value for any fiscal year, project development may be limited to projects with a very short delivery timeline.

ADMINISTRATIVE IMPLICATIONS

Notably, the HTPWC amendment addresses the concerns with administration of the new fund expressed below by the State Treasurer's Office and State Investment Council staff.

The State Treasurer's Office provided the following discussion regarding the administration of the original bill:

> "This bill states that disbursements will be made by DFA when the fund's balance exceeds $6 million and that in years that there are insufficient funds to make a disbursement (balance is less than $6 million) that the state investment officer at SIC will invest the funds. Logistically, having SIC hold the funds is problematic. When DFA issues warrants to make disbursements from a fund, these warrants are drawn on the state general fund investment pool which is in STOs custody. There is no mechanism in place that would facilitate DFA funding disbursements directly from SIC. SIC would need to transfer the funds to STO so that STO could cover DFAs disbursements.
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> This structure is cumbersome especially given the relatively small size of the subject fund. The appropriate place for these funds is with STO."

The State Investment Council adds the following discussion regarding the administration of the new fund, per the original bill:

> "There is a potential concern regarding language in the bill as to how the UNHPF is to be managed. Specifically, the bill states '…In a fiscal year in which there is insufficient money for disbursement, money in the urgent need highway project fund shall be invested by the state investment officer as land grant permanent funds are invested pursuant to Chapter 6, Article 8 NMSA 1978.'
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> The bill does not explicitly say how the Investment Officer (overseen by the 11-member Council), would manage the fund at times when the UNHPF has more than its $6 million floor, or for that matter that it would be managed by the SIC at all, rather that it would be established in the Treasury. There is a natural assumption that SIC is the manager all the time, but the bill language is not explicit.
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> Further, that language, though used elsewhere in statute, has been interpreted differently at times in the past. The issue is, does investing a fund "as land grant permanent funds are invested pursuant to Ch.6 Article 8 NMSA 1978", refer to the standard of care under which the fund is to be invested, or in the precise strategies used by the LGPF? LGPF investments are a broadly diversified mix of long-term investments, the vast majority of which have an investment horizon greater than one year. Many LGPF investments seek to take advantage of their permanent status to earn an "illiquidity premium" of a long-term investment commitment – some of which can last 10 or 15 years, or even longer in some rare cases. The fund contemplated [by this bill] would not seem to be an ideal fit for such commitments, and likely would have to be invested in more liquid strategies by the SIC. The alternative would be to invest in shorter-term investment pools with the State Treasurer, who is intended to invest state and government funds with a one-year horizon or less."

TECHNICAL ISSUES

The bill provides for disbursements from the project fund only if the balance of fund at the beginning of the fiscal year is at least $6 million. However, the bill does not provide any limits on the disbursement. Therefore, if the balance at the beginning of the fiscal year is $6 million, it appears possible for the department to disburse $6 million in that fiscal year, bringing the fund balance to zero. If the purpose of the provision is to keep the fund from falling below $6 million, additional limitations on disbursements may need to be considered.

On page 2, line 6, the original bill creates the new urgent need highway project fund in the state treasury. Then, on page 2, lines 21-24, the bill states, "In a fiscal year in which there is insufficient money for disbursement, money in the urgent need highway project fund shall be invested by the state investment officer as land grant permanent funds are invested." This appears to require the State Investment Council (SIC) to assume management for investment the project fund if the balance is below $6 million but appears to leave management of the fund with the State Treasurer if the balance is above $6 million. Changing management of the fund between STO and SIC depending on the fund balance could have administrative complications for both agencies. *The HTWPC amendment addresses this issue by removing the condition for SIC to manage the fund – the fund management will remain with the state treasurer.*

On page 3, lines 13-19, the bill provides for a $25 million distribution of FML revenue to the new project fund if the amount in excess of the five-year average is at least $25 million and state reserves are at least 25 percent of recurring appropriations. On lines 19-21, the bill provides that when the excess (of the five-year average) is less than $25 million, all of the excess shall be distributed to the new project fund, but makes no requirement regarding reserve levels. It is unclear if the language as written would require state reserves to be 25 percent to distribute FML revenue to the new project fund when the excess of the five-year average is below $25 million.

On page 4, the bill defines state reserves as the general fund operating reserve, the appropriation contingency fund, the tax stabilization reserve, and the tobacco settlement permanent fund. However, it does not include the state support reserve fund in its definition, typically considered part of general fund reserves. The Legislature may want to add the state support reserve fund to the definition, otherwise, when DFA performs the calculation for potential transfer of excess emergency school tax revenue, it would need to exclude the state support reserve from this calculation.

Section 3 of HB 344 requires DFA to certify "*by June 30 of each fiscal year*" that the balance in the state reserves is greater than 25 percent of the next fiscal year recurring appropriations. However, the bill does not specify exactly when DFA would have to do that computation. It is assumed DFA would calculate reserves *as of* the end of the fiscal year, which would be finalized in the general fund audit.

OTHER SUBSTANTIVE ISSUES

SIC investments of the LGPF seek a long-term rate of return of 7 percent after fees, across a full market cycle. These strategies have a standard deviation, or risk rate of around 12 percent, meaning in "normal" markets we should see returns typically between -5 percent and +19 percent. The equivalent LGPF level of risk may in fact be too high for a relatively small fund like this new trust, which would be strongly and negatively impacted by a market correction. According to SIC staff, the result could be the new fund not being able to distribute funds for years following a significant market pull-back. *The HTWPC amendment removes the language requiring SIC to manage the fund, which makes this less of an issue.*

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