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FISCAL IMPACT REPORT

ORIGINAL DATE 2/1/2020

SPONSOR Campos LAST UPDATED _____ HB _____

SHORT TITLE Investment in NM Funds and Businesses SB 136

ANALYST Torres

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22		
NFI	Indeterminate	Indeterminate	Recurring	Severance Tax Permanent Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

State Investment Council (SIC)

State Land Office (SLO)

SUMMARY

Synopsis of Bill

Senate Bill 136 amends section 7-27-5.15 NMSA 1978, increasing the percentage cap on New Mexico private equity and business investments, from the existing 9 percent of the Severance Tax Permanent Fund (STPF) to a new 11 percent statutory limitation on this investment program. The bill also makes clear the existing statute in subsection F of the law, which authorizes the 2 percent small business investment corporation (SBIC) allocation, is wholly separate from the existing authorization for NM private equity funds. Viewing these two separate strategies as exclusive of one another is in line with existing and historical practices by the State Investment Council.

The effective date of this bill is July 1, 2020.

FISCAL IMPLICATIONS

The value of the STPF as of December 31, 2019 was \$5.63 billion. A 2 percent increase in the cap on NM private equity would translate to approximately \$113 million in additional capacity for this investment strategy, at current market valuations.

If passed and signed into law, Senate Bill 136 would allow – but not require – the 11-person State Investment Council to increase its maximum allocation to New Mexico-centric investments in venture capital funds investing in our state, which would increase the SIC’s indirect investment exposure into top New Mexico start-up companies.

Increasing this cap would authorize additional investment into New Mexico companies, but still leave it to the discretion of the fiduciaries on the Council whether additional expansion of the strategy is prudent under the Uniform Prudent Investor Act, and in line with the long-term investment goals of the STPF. The STPF’s long-term investment target is 6.75 percent per year.

Fiscal implications are dependent on the amount of additional private equity approved by the State Investment Council and the market conditions that affect those equity investments. Even assuming the entirety of 2 percent additional capacity is invested in private equity, LFC cannot determine the outcomes of those investments.

SIGNIFICANT ISSUES

In its November action, SIC voted to expand the allocation to NM investments to 9 percent of the STPF from the previous target of 5 percent. This created additional capacity of more than \$200M over and above its previous level for this strategy.

Historically, this program – the NM Private Equity Investment Program (NMPEIP) – has seen very mixed results since it was first created in statute in 1993. The first ten years of the program had a different strategy, with a focus on job-creation and “catalyzing” New Mexico’s venture capital ecosystem, ideally through technology transfer from our national laboratories.

Results from the first decade of the program produced financial returns in the mid negative teens, and were largely seen as unsuccessful on both fronts. Despite this, the NMPEIP was expanded legislatively from a 3 percent statutory limit to 6 percent of the STPF in 2003, and then again to 9 percent of the STPF in 2006. Governance of the program continued to evolve during this time, as staff-directed investments were shelved in favor of those to be initiated and externally managed by venture capital professions chosen by SIC. That change not only largely removed the potential for political-influence in the investment process, but also gradually improved financial returns, which after many years, has pulled the NMPEIP’s since-inception returns into positive territory overall.

The following analysis were offered by SIC and SLO.

SIC: “The Council is requesting the legislature approve this change following approval of a new asset allocation study in November 2019, which increased the Council’s long-term policy target from 5 percent of the STPF to 9 percent, or the statutory cap that currently governs the strategy. The Council in its decision to increase the investment target, noted a growing opportunity set for quality investments, an expansion in recent years of entrepreneurial-support systems and incubators in our state, and the long-term trend of improved investment outcomes for these types of investments, relative to the strategy’s history.”

SLO: “The Commissioner of Public Lands, as a member of the State Investment Council,

strongly supports SB 136. By increasing the investment cap on the percentage of STFP funds that may be invested in New Mexico businesses, the SIC will be better positioned to make sound investments that generate income while also supporting emerging industries and job creation.”

PERFORMANCE IMPLICATIONS

Historically, Economically Targeted Investments (ETIs) like the NMPEIP have underperformed the broader markets, which is to be expected any time you limit an investment strategy by specific terms (i.e. early stage/seed venture capital) or geography (NM companies). This fact is recognized in statute itself (7-27-5.15 NMSA 1978), which specifically authorizes “below market” rates of return for investments that create or support New Mexico jobs.

These investments still meet the threshold for prudence as outlined in the Uniform Prudent Investment Act, given that the goal of the fund, as stated in statutory findings and purpose (7-27-5.14) for the NMPEIP, which state:

“The legislature finds that the health of the New Mexico economy is heavily dependent on the establishment and expansion of small businesses and that the lack of available private equity is an impediment to the start-up and growth of businesses in the state. The legislature further finds that the commercialization of technology conceived in the universities and the federal scientific and engineering laboratories and test facilities in the state is likely to occur elsewhere unless sources of local private equity are developed. The purpose of Section [7-27-5.15](#) NMSA 1978 is to provide a mechanism whereby the establishment of private equity funds, whose investment policies are supportive of the economic welfare of New Mexico, will be stimulated.”

Overall, different parts of the NMPEIP strategy have achieved varying degrees of success. The following are returns net of fees, as of the last available quarter (returns are lagged by one quarter, as are most private market investments):

NM SIC Regional Private Equity Performance (by Portfolio)												
As of June 30, 2019 (\$ in millions)												
Portfolio	# of Funds	Commit.	Net Contributed	Net Distributed	NAV	Total Value	Net Multiple ¹		Net IRR ¹			
							6/30/2019	6/30/2018	6/30/2019	6/30/2018		
Active Commitments												
Catalyst Fund	1	\$ 10.0	\$ 2.4	\$ -	\$ 2.5	\$ 2.5	1.02x	1.01x	1.2%	1.2%		
Co-Investment Funds	5	192.6	184.8	1.2	321.5	322.7	1.75x	1.86x	9.1%	10.8%		
Fund Investments	22	224.5	200.7	127.3	85.0	212.3	1.06x	1.08x	0.8%	1.0%		
Sub-total	28	\$ 427.0	\$ 387.9	\$ 128.5	\$ 408.9	\$ 537.5	1.39x	1.44x	4.6%	5.3%		
Liquidated Funds	10	107.0	106.9	46.6	-	46.6	0.44x	0.44x	(14.3%)	(14.3%)		
Grand Total	38	\$ 534.1	\$ 494.7	\$ 175.1	\$ 408.9	\$ 584.0	1.18x	1.21x	2.2%	2.5%		

Source: Invient
¹ Performance since inception

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Though not a certainty, there will be a heightened potential that the SIC may be statutorily restricted from making new investments into NM private equity funds and businesses during the next recession due to a decline in the value of the fund which will cause NM private equity investments to grow above the allowable percentage.

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