



NEW MEXICO STATE INVESTMENT COUNCIL



INVESTMENTS & PENSIONS OVERSIGHT COMMITTEE

SENATOR GEORGE MUNOZ, CHAIR
REP. MONICA YOUNGBLOOD, VICE-CHAIR

IN-DEPTH: NEW MEXICO'S SEVERANCE TAX
PERMANENT FUND

JULY 21, 2015

STEVE MOISE, STATE INVESTMENT OFFICER

CHARLES WOLLMANN, DIRECTOR, COMM. & LEGIS. AFFAIRS



New Mexico State Investment Council SEVERANCE TAX PERMANENT FUND

The Severance Tax Permanent Fund (STPF) was established by the legislature as a constitutionally-protected permanent endowment in 1976, to receive and invest severance taxes collected on natural resources extracted from New Mexico lands.



INFLOWS
A severance tax is imposed on oil, natural gas, other liquid hydrocarbons, carbon dioxide and hard rock minerals severed from the land.
Collected by Tax & Revenue Department

Taxes are transferred monthly to the **Severance Tax Bonding Fund** administered by the State Treasurer's Office for **Debt Service Requirements** on Senior and Supplemental Bonds issued under the Severance Tax Bonding Act for capital projects

Amounts in the Bonding Fund in excess of the amounts necessary to service bond principal and interest payments are transferred twice a year to the

SEVERANCE TAX PERMANENT FUND

Constitutional Distribution Formula to the **State General Fund**
4.7% of 5-year average market value

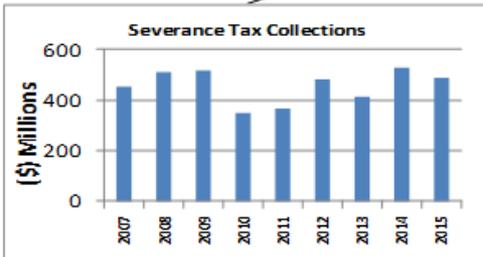
DISTRIBUTIONS TO THE GENERAL FUND

| | |
|---------|---------------|
| FY 2009 | \$191,292,480 |
| FY 2010 | \$187,488,067 |
| FY 2011 | \$184,570,728 |
| FY 2012 | \$183,423,504 |
| FY 2013 | \$176,172,684 |
| FY 2014 | \$170,472,647 |
| FY 2015 | \$182,722,980 |
| FY 2016 | \$193,509,941 |

Averages 3% of State Budget
\$1.80B over the past 10 years

Bonding Capacity Statute Changes

| Year(s) | % Split between bond payments & deposits |
|-----------|--|
| 1976-1999 | 50/50 |
| 1999 | 62.5/37.5 |
| 2000 | 87.5/12.5 |
| 2004 | 95/5 |
| 2016-2022 | 86.2/13.8 (phased in) |



Collections based on fiscal year

Most of the fluctuation in severance tax revenue is due to wide and frequent swings in the market price of oil and gas. States that rely on revenue from severance taxes face volatility in production, demand and price changes.

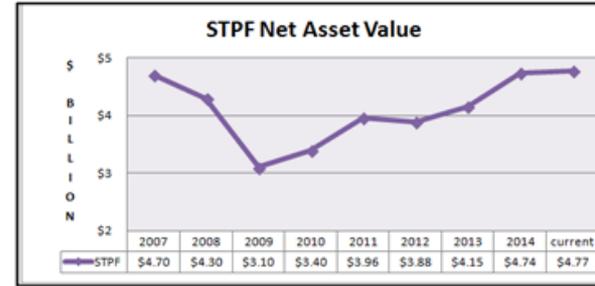
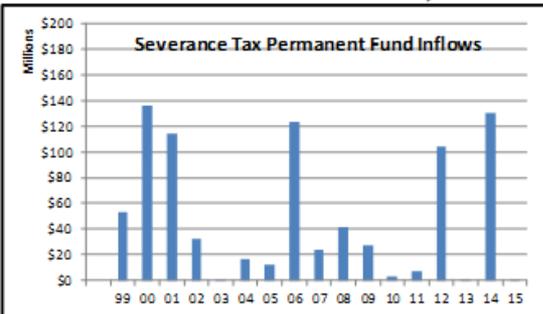
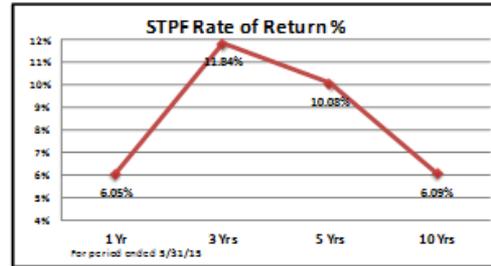


Chart based on fiscal years current = 5/31/15



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Severance Tax Permanent Fund: Overview



- STPF current value (5/31/15): \$4,776,443,244
 - Only matches previous high-water mark (October 2007)
- 2007 STPF: 85% “risk” assets
 - Core bonds only 3%
 - STPF not positioned for crisis in 2008/2009
 - Fund value dropped to \$3.1 billion (Jan 2009)

| STPF asset mix | 2007 composition | STPF asset mix | 2015 composition |
|--------------------|------------------|--------------------|------------------|
| Domestic Equity | 51.9% | Domestic Equity | 35.1% |
| Intl Equity | 13.6% | Intl Equity | 14.1% |
| Total Equity | 65.4% | Total Equity | 49.2% |
| Core Bonds | 3.1% | Core Bonds | 13.1% |
| Credit/Structured | 3.8% | Credit/Structured | 3.9% |
| High Yield | 0.2% | Unconstrained | 3.2% |
| Econ. Targeted | 5.0% | Econ. Targeted | 0.8% |
| Total Fixed Income | 12.1% | Total Fixed Income | 21.0% |
| Absolute Return | 9.1% | Absolute Return | 6.7% |
| Private Equity | 9.3% | Private Equity | 10.8% |
| Real Estate | 3.4% | Real Estate | 5.0% |
| | | Real Return | 6.0% |
| Total Alternatives | 21.8% | Total Alternatives | 28.5% |



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STPF: the road back



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- Strong investment returns vs. 7.5% target
 - As of 5/31/15:
 - 1-year: 6.1%
 - 3-year: 11.8%
 - 5-year: 10.1%
- Fund growth hampered by inconsistent in-flows
 - FY15 state severance taxes: \$486 million
 - FY15 inflows: \$88.44 in December, \$8.74 in June, for total contribution of \$97.18
- Saved to STPF: 0.00001%



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STPF: growing contributions



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- Distribution: 4.7% of 5-year fund average at 12/31
- FY 15 distributions to general fund: \$182.7 million
- FY 16 distributions to general fund: \$193.5 million
 - Record, surpassing \$191.3 million for FY 2009
- FY 17 *projected* distribution: \$202.7 million
- STPF contributions to general fund expected to grow slowly
 - STPF challenged to maintain value in low/negative investment earning years



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Severance Tax Permanent Fund: History



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- 1973: STPF established
- 1976: Given constitutional status
- 1982: Legislative discretion to appropriate from corpus removed
- Funding formula percentages over time:
 - 1976-1998: 50/50 split between bond payment & STPF
 - 1999: 62.5/37.5
 - 2000: 87.5/12.5
 - 2004-2015: 95/5
 - 2016-2022: 86.2/13.8 (phased-in)



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STPF: slow growth=shrinking share

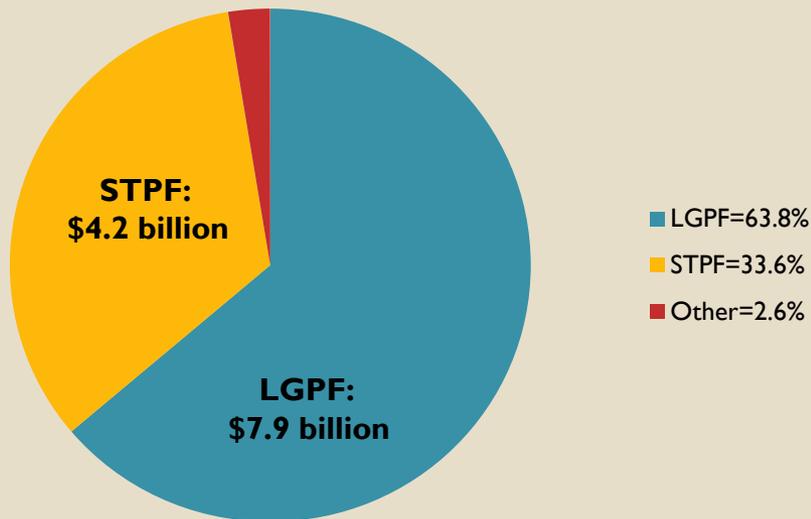


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SIC Fund Assets FY 2000

- Fund Value: \$12.4 billion

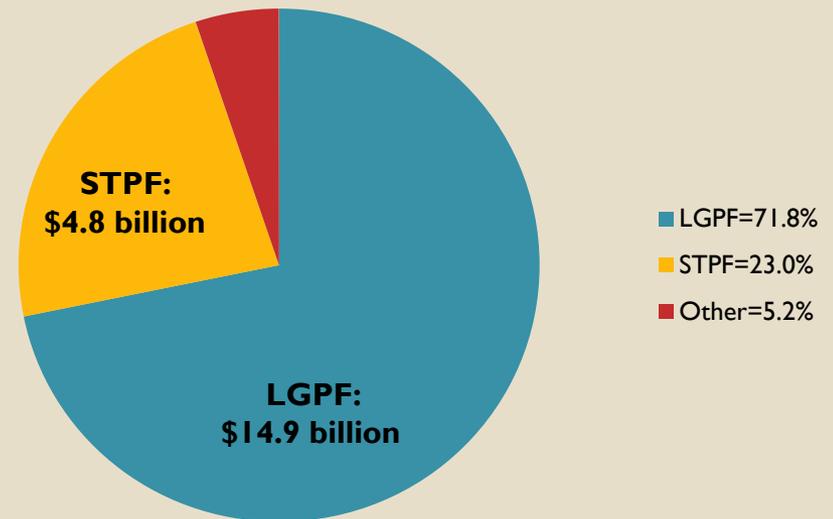
FY2000 Fund % of SIC assets



SIC Fund Assets FY 2015

- Fund value: \$20.8 billion

FY2015 Fund % of SIC assets





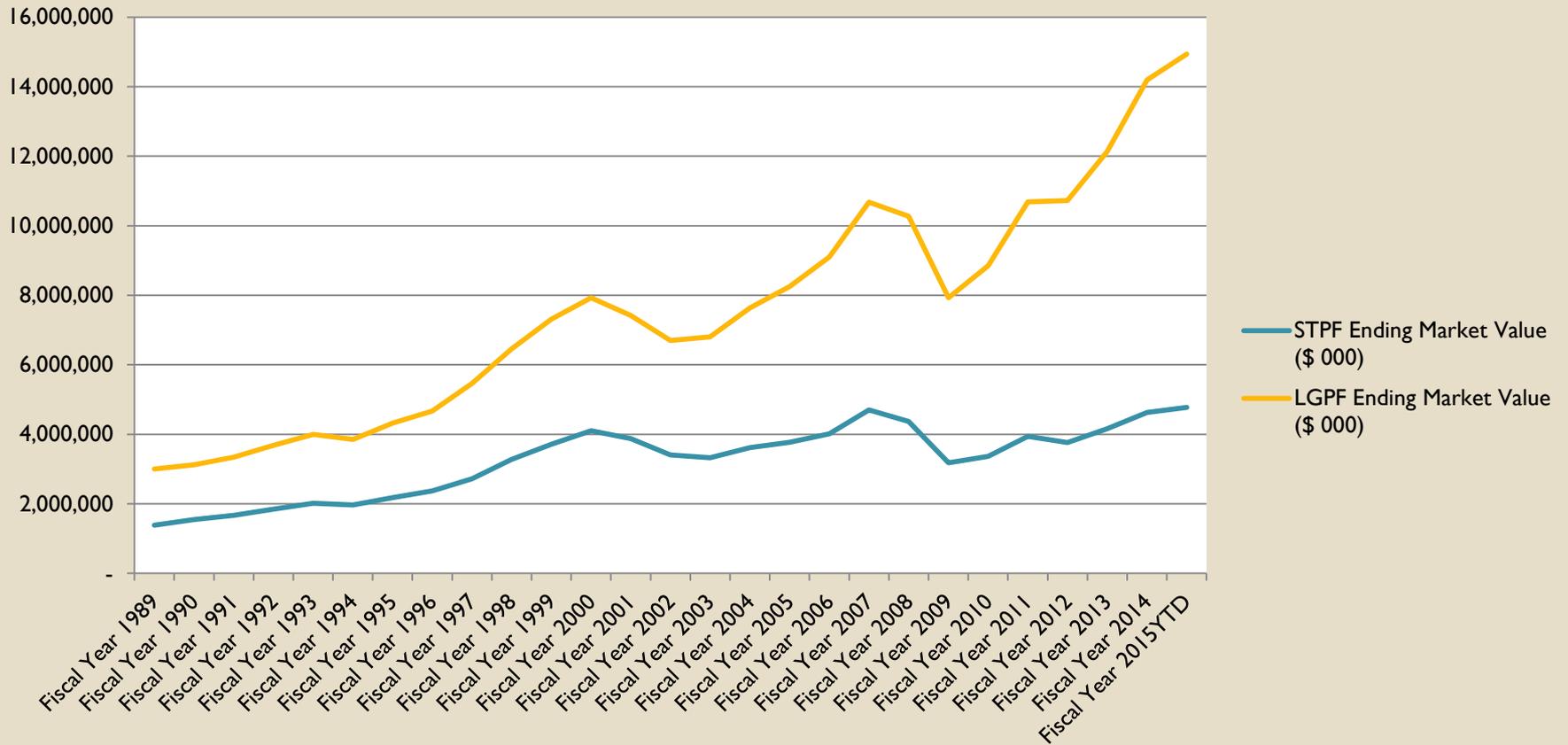
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25 years of permanent fund growth



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• STPF vs. LGPF 1989-2015





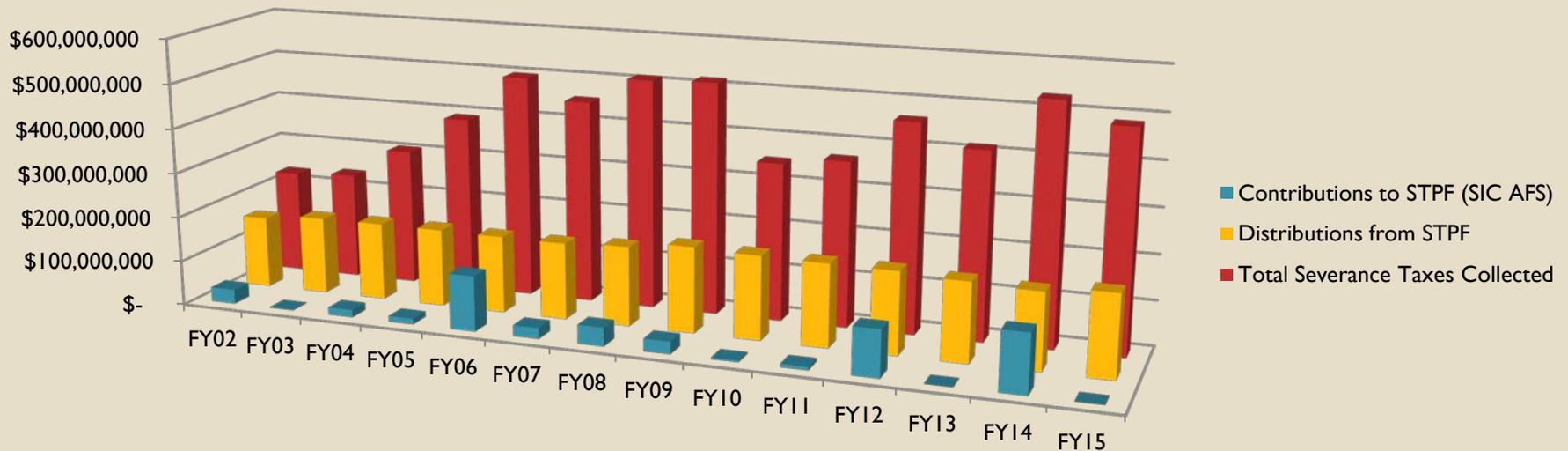
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STPF average cash-flows, 2002-present



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- Severance taxes collected: **\$411 million/year**
- STPF distributions: **\$177 million/year**
- STPF in-flows: **\$37 million/year**



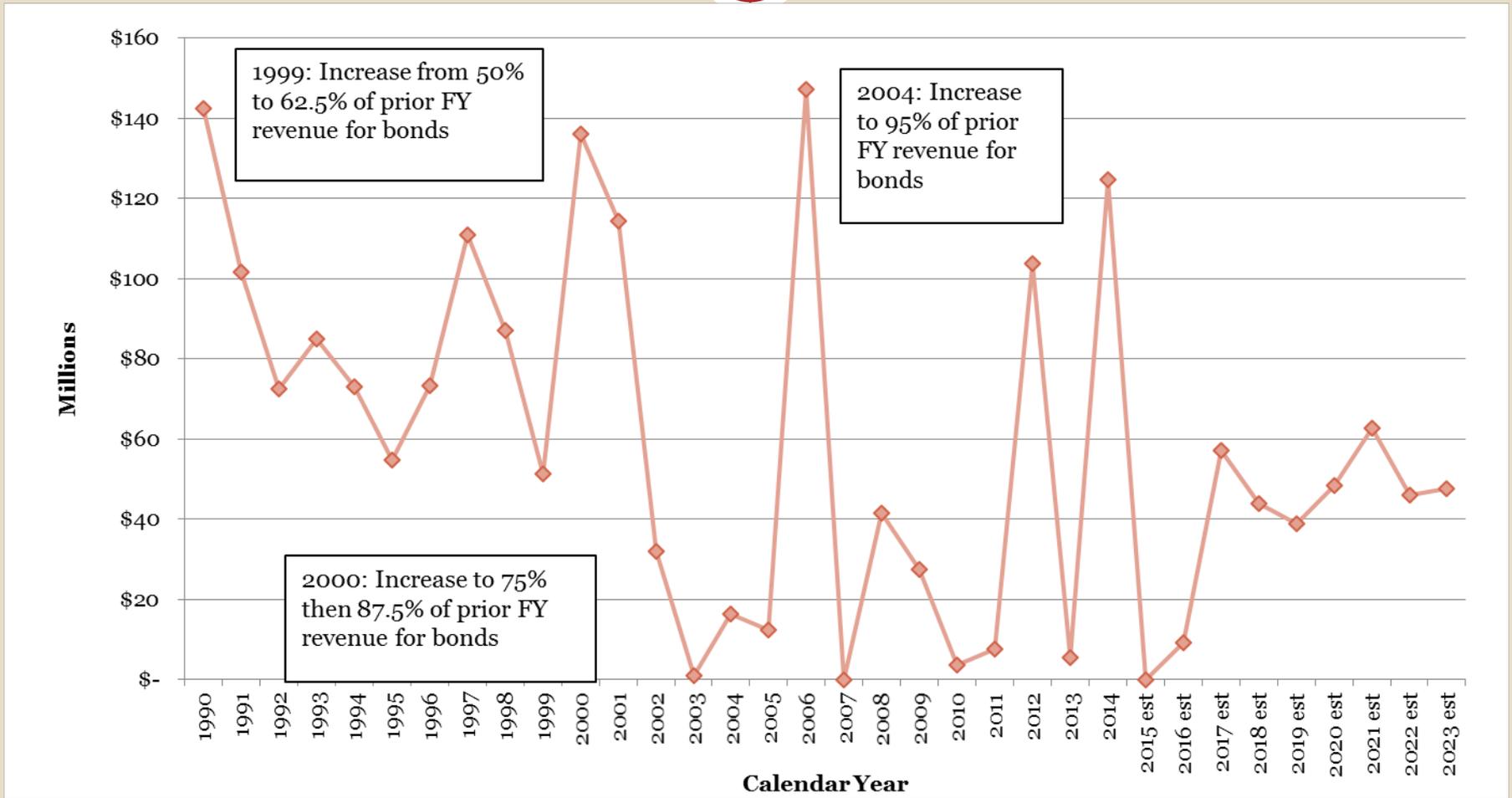


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STPF in-flows, projected

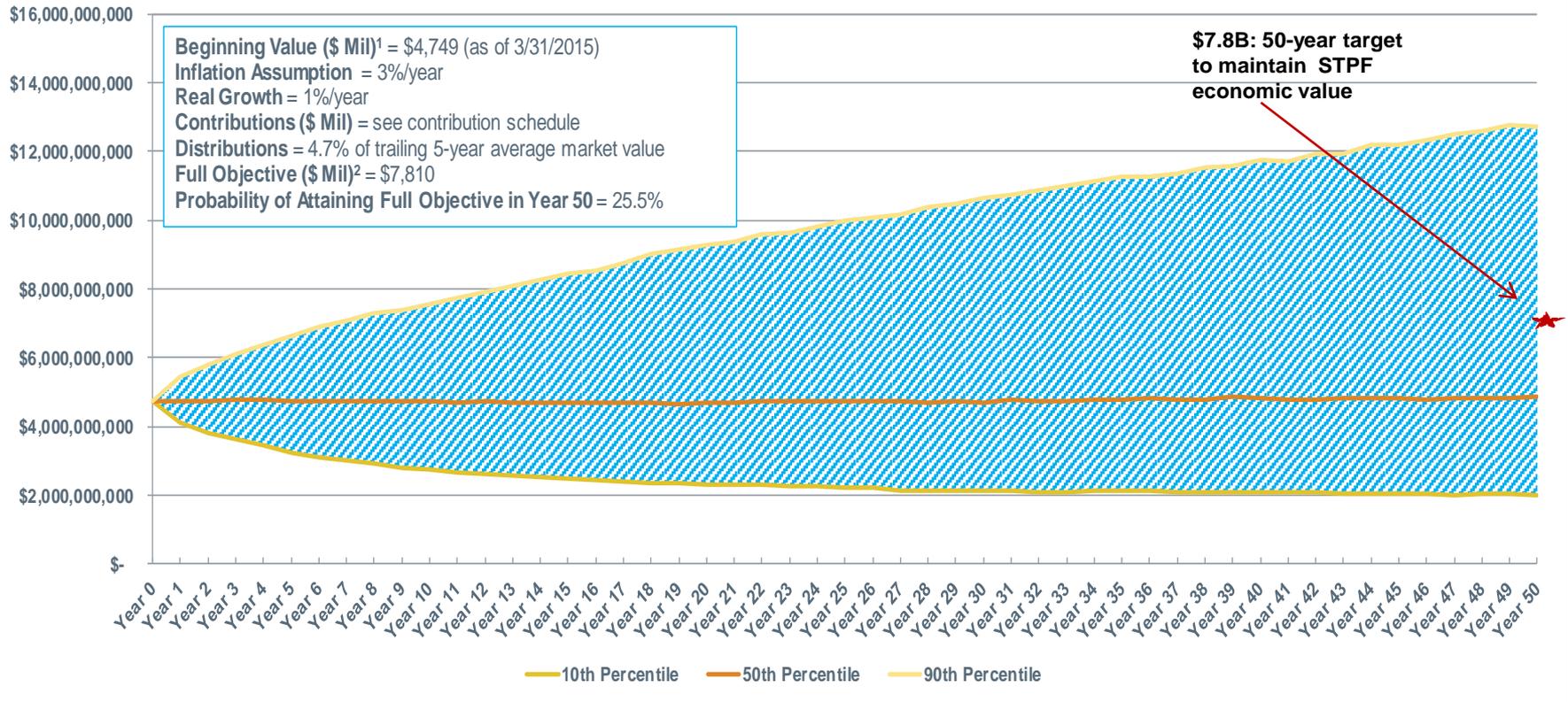


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• Source: State Board of Finance

Severance Tax Permanent Fund - Real Basis



¹Monte Carlo Simulations assume Severance Tax Permanent Fund is invested at the Long-Term Target Allocation.

²Year 50 Full Objective is estimated as the current Fund market value increased by 1% real growth each year.

Contribution schedule: Year 1, 4.8m; Year 2, 8.7m; Year 3, 52.2m; Year 4, 38.9m; Year 5, 33.5m; Year 6, 40.6m; Year 7, 51.1m; Year 8, 36.4m; Year 9, 36.5m; Years 10-50, 57.7m.

Projected Fund Market Value by Percentile for Next Fifty (50) Years

| Severance Tax Permanent Fund | Year 5 | Year 10 | Year 15 | Year 20 | Year 25 | Year 30 | Year 35 | Year 40 | Year 45 | Year 50 |
|------------------------------|------------------|------------------|------------------|------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| 10th Percentile | \$ 3,234,057,163 | \$ 2,737,742,713 | \$ 2,489,661,773 | \$ 2,322,508,444 | \$ 2,222,878,078 | \$ 2,127,319,580 | \$ 2,116,666,010 | \$ 2,084,647,611 | \$ 2,044,873,951 | \$ 2,018,792,059 |
| 25th Percentile | \$ 3,942,847,005 | \$ 3,599,456,459 | \$ 3,434,175,434 | \$ 3,336,505,530 | \$ 3,181,971,011 | \$ 3,126,227,713 | \$ 3,140,191,429 | \$ 3,088,798,409 | \$ 3,002,154,297 | \$ 2,983,640,947 |
| 50th Percentile | \$ 4,751,290,501 | \$ 4,726,732,675 | \$ 4,702,686,264 | \$ 4,693,393,725 | \$ 4,748,422,007 | \$ 4,716,479,831 | \$ 4,804,976,688 | \$ 4,819,891,982 | \$ 4,815,337,983 | \$ 4,859,123,318 |
| 75th Percentile | \$ 5,689,747,439 | \$ 6,052,089,535 | \$ 6,395,931,726 | \$ 6,682,179,942 | \$ 6,921,254,364 | \$ 7,204,430,184 | \$ 7,395,252,829 | \$ 7,627,021,292 | \$ 7,785,425,910 | \$ 7,893,140,554 |
| 90th Percentile | \$ 6,620,539,458 | \$ 7,563,241,492 | \$ 8,434,931,304 | \$ 9,285,243,579 | \$ 10,004,719,181 | \$ 10,673,659,872 | \$ 11,272,980,238 | \$ 11,749,448,572 | \$ 12,175,408,911 | \$ 12,730,798,919 |



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STPF: Critical to NM



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- **NMSA 1978, §7-27-5**
 - The severance tax permanent fund shall be invested in separate differential rate and market rate investment classes
 - Intended to stimulate the economy of NM & to provide income to the STPF (double bottom line)
 - 10 current subsets of statutorily authorized differential (below market) rate, or economically targeted investment (ETI) categories currently in statute
 - Council authorized to invest below-market rate, if other benefits are apparent
 - All market rate & differential rate investments shall be invested in accordance with the Uniform Prudent Investor Act (NMSA 1978 §45-7-601 through 612)



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ETI overview



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- **ETI summary**
 - Ten “carve outs” including SBIC
 - 56%+ STPF allowed for differential rate
 - Another 20% allowed for deposits in NM financial institutions
 - All ETIs are permissive, except SBIC

| Item No. | Statute | Description | Market Value @ 5/31/15 | Restrictions on Investment (US\$/Percent) |
|----------|-----------|--|------------------------|---|
| 1. | 7-27-5.3 | Mortgage Pass-Through Securities Secured by New Mexico Real Estate | \$0 | \$100 MM Face per Year |
| 2. | 7-27-5.4 | New Mexico Business Investments (FHA & SBA loans, rated debt) | \$21,049 | 20% of STPF |
| 3. | 7-27-5.5 | Educational Loan Notes | None | \$10 MM/Yr 10% of STPF |
| 4. | 7-27-5.13 | Educational Institution Research & Development Facilities Revenue Bonds | None | 10% of STPF |
| 5. | 7-27-5.15 | New Mexico Private Equity Funds and NM Business Investments (equity or debt) | \$244,687,372 | 9% of STPF |
| | | Small Business Investment Corporation | \$37,221,257 | 1% of STPF Required by Statute |
| 6. | 7-27-5.17 | Employers Mutual Company Revenue Bonds | None | \$10 MM |
| 7. | 7-27-5.22 | Investments in Obligations Issued under Section 33-1-19 for Corrections Facilities | None | None Stated |
| 8. | 7-27-5.24 | Investments in Obligations Issued for State Capitol Buildings and Renovations | \$0 | \$10.155 MM |
| 9. | 7-27-5.26 | Investment in Films to be Produced in New Mexico | \$0 | 6% of STPF |
| Totals | | | \$281,929,678 | |



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ETI: points of concern



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- **Basic challenges related to NM ETI programs**
 - Limited to New Mexico-centric investments
 - Fewer quality opportunities, more competition for those deals
 - Higher profile amplifies failures to public
 - Early-stage nature increases potential for losses
 - Political influence on investment process (real & imagined)
 - Difficulty in assessing firm dollar or job data benefits
 - Administrative burdens associated with programs
 - Investments? Or economic development?
- **Challenges have reduced ETI investment interest in recent years**



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Severance Tax Returns



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- Impact of Economically Targeted Investments on returns
 - LFC: up to 1% opportunity cost/year (\$40 million)
 - Today, less impact, fewer ETIs deployed, change of focus
 - ✦ No new film loans since 2008
 - ✦ SBIC: no new venture investments, no additional losses
 - ✦ NM Private Equity Program: seeking market rates of return





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Final thoughts



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- June 30, 2015 fiscal year-end preliminary data:
 - AUM: \$20.575 billion
 - One-year composite return: 3.6%
 - ✦ Above peer median
 - ✦ Below long-term target of 7.5%
 - ✦ Three & five year returns remain strong at 10.6% & 10.8%
 - ✦ Ten-year: 6.3%
- Council to review 7.5% long-term target
- FY16 distributions from STPF/LGPF: \$849 million
- Contributions on decline to LGPF
 - First 6 months of 2015: 30% drop-off year over year