MINUTES
of the
THIRD MEETING
of the
STATE PERMANENT FUND TASK FORCE

September 9-10, 2004
Santa Fe

The third meeting of the State Permanent Fund Task Force (SPFTF) was called to order by Senator Joseph J. Carraro, chair, at 10:20 a.m. on September 9, 2004 in Room 322 of the State Capitol in Santa Fe.

PRESENT	**ABSENT**
Sen. Joseph J. Carraro, Chair	Sen. Joseph A. Fidel
Rep. Luciano "Lucky" Varela, Vice Chair	Deborah Gallegos
Gary Bland	
Frank Foy	
Bob Gish	
Sen. John Grubesic	
Bob Jacksha	
Rep. Larry A. Larrañaga	
Rep. Henry Kiki Saavedra	
Scott Stovall (in lieu of Secretary James Jimenez)	

Staff
Douglas Williams
Larry Matlock

Guests
The guest list is in the meeting file.

<u>Thursday, September 9</u>

Paula Tackett provided a background on the history of the Public School Capital Outlay Council (PSCOC). The PSCOC:

- is responding to statutory deficiencies;
- created a standards-based system;
- monitors maintenance;
- created the Public School Facilities Authority (PSFA), the successor to the Deficiencies Correction Unit (DCU); and
- has a standing authorization to use supplemental severance tax bonds (SSTB) to finance capital outlay.

Representative Varela requested an organization chart describing the relationship among the PSCOC, PSFA and Public School Capital Outlay Task Force.

Bob Gorrell provided an overview of the organization and function of the PSFA and the interaction with local schools (see handout), summarized as follows:

- standards were adopted in August 2002;
- projects are ranked according to the New Mexico Condition Index (NMCI); and
- deficiency projects must be identified (and funded) by June 2005 and completed by June 2007.

Janet Peacock described the equity component of the capital outlay process as defined by the state-share formula.

Dave Tentinger, Michael Vardas and Michael Pettit of Northern Trust Global Investments made a presentation concerning securities lending (see handout), summarized as follows:

- Northern Trust is the custodial bank for the state treasurer, Public Employees Retirement Association (PERA), Educational Retirement Board (ERB) and State Investment Council (SIC);
- in practice, Wells Fargo acts as fiscal agent between the State of New Mexico and Northern Trust because of a prohibition in current law concerning dealing with out-of-state banks as a custodial;
- no in-state New Mexico bank has the capacity to act as custodial agent;
- current law prevents the custodial bank from acting as the securities lending agent because of a principle known as "duty of loyalty";
- both PERA and ERB earn approximately $1.5 million per year through lending of securities; and
- earnings are actually the result of investing cash collateral in a short-term money fund.

Representative Saavedra suggested a two-day workshop in January to brief the members on the work of the SPFTF and proposed legislation.

Scott Stovall and David Paul gave a presentation concerning bond capacity and alternative methods of financing capital projects (see handout), summarized as follows:

- severance tax bonds (STB) are classified as revenue bonds and are not backed by the full faith of the state; unlike general obligation bonds, there is no promise to raise taxes to pay the debt service on STBs; instead, STBs are backed by a dedicated revenue stream;
- projected total bonding capacity for FY 2005 is $305.435 million with $172.261 million available for legislative appropriations and $133.175 million available for use by the PSCOC;
- if no new senior STBs or long-term supplemental STBs are issued commencing in FY 2005, then in 10 years, bonding capacity would exceed the capacity that is forecast pursuant to the current practice;
- there are substantial benefits to using the issuance of commercial paper to finance capital

projects when a project is ready in all respects to commence; the interest rate on commercial paper is very low (0.8 percent - 1.2 percent) compared to 10-year bonds (~4.0 percent); also, no debt is issued if the money is not going to be used (currently 30 percent of bonded debt issued goes unspent); and
- technically, the commercial paper would be a "bond anticipation note" and would require a legislative debt/bond authorization; commercial paper would be issued incrementally to finance projects and, once a year, the commercial paper would be redeemed through the issuance of 10-year STBs.

The meeting recessed at 4:30 p.m.

Friday, September 10

The meeting reconvened at 9:40 a.m. on Friday, September 10, 2004.

Evalynne Hunnemuller made a presentation concerning the status of the Educational Retirement Fund (see handout), summarized as follows:

- until 1955, retirement contributions were 100 percent employer paid;
- there are significant disparities between ERB and PERA employer contributions and COLA benefits;
- the number of retirees receiving benefits is growing faster than the number of active employees contributing to the fund;
- fund investments are recovering but the fund is paying out more in pensions because retirees are living longer and active employees are retiring with higher average salaries;
- the current unfunded liability is $2.3 billion;
- the period for paying off the unfunded liability has increased from 78 years to infinity, i.e., given current contributions, investment performance and benefit payments, the unfunded liability will never be paid; and
- solutions include increased contributions from employees, increased contributions from the legislature, mandatory 30-year retirement and issuance of pension obligation bonds.

Representative Varela indicated that he would like to take additional testimony on methods to reduce the unfunded liability; the LESC or LFC may take the lead on this issue.

Terry Slattery made a presentation concerning the status of PERA (see handout), summarized as follows:

- 73 percent of the funding for retirement benefits comes from investments; and
- the current period for paying off the unfunded liability is 17 years.

Domingo Martinez, state auditor, made a presentation concerning audits of the trust funds, summarized as follows:

- the state auditor is responsible for approving the audits prepared by outside CPA firms contracted by the investment agencies;
- contract CPA auditors must be changed every six years;
- the state auditor primarily reviews outside audits for GASB compliance; and
- the state auditor establishes guidelines for selection of contract CPAs but does not have the expertise (or staff) to conduct audits of the trust funds.

The meeting adjourned at 1:00 p.m.