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

SPONSOR: Thompson DATE TYPED: 3/19/03 HJM 124

SHORT TITLE: Study Amendments Affecting Land Grant Fund SB

ANALYST: Neel

REVENUE

Estimated Revenue		**Subsequent Years Impact**	**Recurring or Non-Rec**	**Fund Affected**
FY03	**FY04**			
		(Significant) See Fiscal Implications	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC files

Responses Received From

SUMMARY

Synopsis of Bill

House Joint Memorial 124 requests Secretary of State and Legislative Council Service to Consult with the State Land Office regarding proposed Constitutional Amendments affecting the Land Grant Permanent Fund.

Significant Issues

Senate Floor Substitute for Senate Joint Resolution 6 proposes to amend the New Mexico Constitution to increase the annual distribution from the Land Grant Permanent Fund (LGPF) from 4.7% to:

- 5 percent of the five-year ending average market values,
- 5.8 percent for FY2005 to FY 2012 (.8 is designated to implement education reforms contingent on market values of the LGPF being in excess $5.8 billion); and
- 5.5 percent for FY 2013 to FY2016 (.5 is designated to implement education reforms contingent on market values of the LGPF being in excess $5.8 billion)

The land grant permanent fund (LGPF) was established by the Ferguson Act of 1898 and confirmed by the Enabling Act for New Mexico of 1910. Together, these acts transferred approximately 9.2 million surface acres of federal lands and 13.1 million acres of federal mineral interests to the territory of New Mexico. These lands were to be held in trust for the benefit of public schools and 19 other state institutions.

The LGPF consists of proceeds from the sale of state lands, royalties from natural resource production, and five percent of the proceeds from the sales of federal public lands in the state. Rental, bonus, and other public land income are also distributed to trust beneficiaries. The common school fund (a subset of the general fund) is the beneficiary of around 83 percent of trust income. The market value of the fund as of June 30, 2002 was $6.7 billion.

Under CS/SJR 6 the value of the LGPF would be approximately $30 billion in FY 2040 or about $5 billion less than under current law (see figure 1). As expected, General Fund distributions, which include earmarked public school reform funds are higher under SJR 6 through FY 2017, but thereafter are less than under current statute (see figure 2).

FISCAL IMPLICATIONS

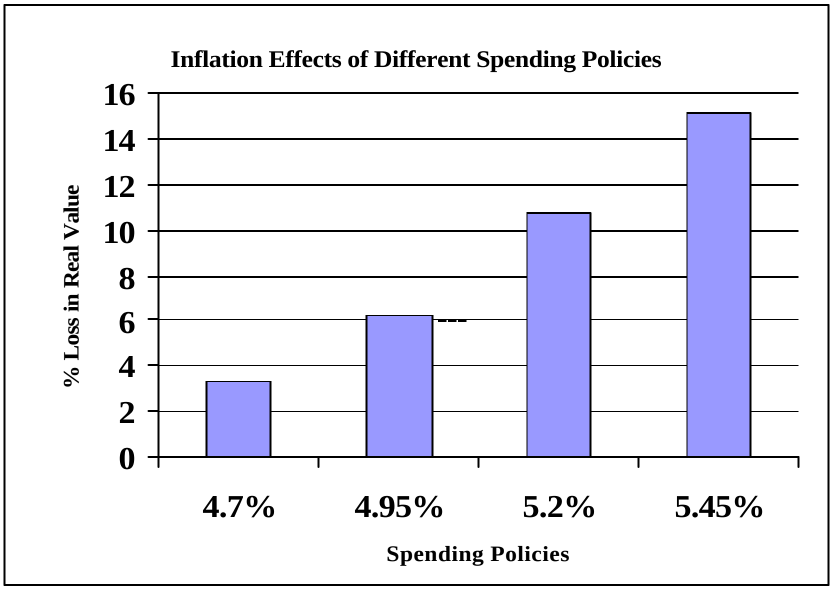
The notation in the revenue table reflects the uncertainty about the date of the election. The $77.2 million is the full year general fund impact for FY04.

A 1994 constitutional amendment mandates that 4.7 percent plus administrative expenses of a 5-year average of the fund's year-end market valuations shall be distributed to the beneficiaries. Absent a spectacular rebound, recent market performance virtually guarantees lower distributions in the future to LGPF beneficiaries. The forecasts in the table below are consistent with NEPC's 8.5 percent return assumption and a 6 percent distribution policy.

Fiscal Year	General Fund Distribution (millions)	% Increase
2004	356	n.a.
2005	352	-1.1%
2006	342	-3.1%
2007	335	-1.9%

Investment consultants look at permanent funds as an endowment, not a "rainy day fund". This is an important distinction because it implies the current generation is obligated to pass the fund on to future generations intact. This notion is often referred to as "inter-generational equity". Specifically, it means the inflation adjusted purchasing power of the distributions should not be diminished. Alternately, it means the present value (a way of adjusting for the time value of money) of the funds' corpus and distributions should not be impaired. Implicit in this standard is the assumed trade-off between the value of a dollar today and in the future (known as the discount rate). A lower rate makes future dollars more attractive; conversely, a higher rate implies that today's distributions have a higher value than tomorrow's increased fund balances. Experts note that the discount rate in these studies has typically ranged from a high of 15 percent to a low of 5 percent.

In 2002, the State Investment Council contracted with New England Pension Consultants (NEPC) to review the appropriateness of the permanent funds' distribution policy. The following graph illustrates the tradeoff between spending and inflation. The values on the x-axis are spending policies. The values on the y-axis are the total loss in real value from increasing spending. For example the loss from moving from a 4.7 percent to a 4.95 percent distribution is a cumulative 6.2 percent of the funds' real value. Please note that NEPC analyzed different proposals; the results for a 6.0 percent distribution policy would of course be larger.



TECHNICAL ISSUES

- The Legislative Council Service has noted that an election could be scheduled so that the distribution would be effective in FY04.

- The Council Service believes that the state would not have to seek congressional approval for a distribution rate change. *An Attorney General opinion issued March 6th , recommends that "any Joint Resolution altering the current distribution rate be made expressly contingent on the approval of the United State Congress." The opinion goes on to state "Without Congressional consent, the federal Enabling Act may conflict with the proposed elevated distribution levels on several grounds."*

OTHER SUBSTANTIVE ISSUES

By far the most important value judgment underlying the spending policy analysis is the supposition that the maintenance of the endowment is of greater good to society than any alternative investment. As a recent Wall Street Journal article shows, many trustees have and do question this principle. The article's most poignant argument for the spend-it-all approach comes from 1913; Julius Rosenwald, chairman of Sears, Roebuck and Co., declared, "Permanent endowment tends to lessen the amount available for immediate needs, and our immediate needs are too plain and too urgent to allow us to do the work of future generations. "The article goes on to note that "In the first half of the century, Mr. Rosenwald's fund gave away the equivalent of more than $700 million in today's dollars. Among many other projects, Mr. Rosenwald contributed to the construction of nearly 5,400 schools for black children in the South. In the years following World

War I, an estimated 60% of American blacks who had completed primary school had been educated in Rosenwald schools".

The point here is that the quantitative measures presented in these studies are still governed by subjective influences; they are not "scientific" nor are they sufficient information on which to make an informed judgment. The investments that depleted the Rosenwald endowments had dramatic returns to society but would probably fare quite poorly by the present value and inflation statistics presented in the NEPC study. In the end, policy makers must make their own judgments as to what expenditures have the highest return for society.

SN/njw