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## FISCAL IMPACT REPORT

ORIGINAL DATE 02/1/10

SPONSOR Stewart LAST UPDATED \_\_\_\_\_ HJR 2

SHORT TITLE Increase Land Grant Fund Distribution, CA SB \_\_\_\_\_

ANALYST White

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	FY11	FY12		
\$0.0	\$0.0	\$30,900.0	Recurring	General Fund
\$0.0	\$0.0	\$6,300.0	Recurring	Other LGPF Beneficiaries

(Parenthesis ( ) Indicate Revenue Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Attorney General's Office (AGO)  
 State Investment Council (SIC)  
 State Land Office (SLO)  
 Public Education Department (PED)  
 Higher Education Department (HED)

#### Responses Not Received From

New Mexico Corrections Department (NMCD)

### SUMMARY

#### Synopsis of Bill

House Joint Resolution 2 proposes to amend Article XII, Section 7 of the New Mexico constitution in order to increase annual distributions from the Land Grant Permanent Fund (LGPF) to 6.2 percent from 5 percent. The proposed constitutional amendment would also eliminate additional distributions from the fund "used to implement and maintain educational reforms as provided by law." Such additional distributions are constitutionally set currently at 0.8 percent until FY12 and are subsequently scheduled to decrease to 0.5 percent in FY13 and are eliminated entirely in FY17.

## House Joint Resolution 2 – Page 2

The proposed constitutional amendment would also suspend distributions from the fund if the five-year average market value of the fund falls below \$5.8 billion. Currently, only additional distributions are suspended if the fund's average value falls below \$5.8 billion. In the event that House Joint Resolution 2 is approved by both houses of the legislature, the proposed constitutional amendments will require approval by the people of New Mexico during the next statewide general election.

### FISCAL IMPLICATIONS

The proposed amendment would have a significant fiscal impact on the LGPF and its beneficiaries. In FY09 the LGPF made \$521.5 million in distributions to a variety of beneficiaries.

#### **FY09 LGPF Distributions by Beneficiary**

COMMON SCHOOLS (GF)	\$	433,497,273.84
UNIVERSITY OF N.M.	\$	8,463,533.78
UNM SALINE LANDS	\$	32,362.17
N.M. STATE UNIVERSITY	\$	2,577,671.73
WESTERN NM UNIV	\$	154,014.40
N.M. HIGHLANDS UNIV	\$	153,074.24
NO. N.M. COMM. COLLEGE	\$	118,660.50
EASTERN N.M. UNIVERSITY	\$	452,160.93
N.M. INST. MINING & TECH	\$	1,054,872.78
N.M. MILITARY INSTITUTE	\$	17,789,808.13
N.M. BOYS SCHOOL	\$	35,547.28
DHI MINERS HOSPITAL	\$	5,537,318.46
N.M. STATE HOSPITAL	\$	1,267,130.18
N.M. STATE PENITENTIARY	\$	10,438,512.77
N.M. SCHOOL FOR THE DEAF	\$	10,791,848.93
SCH. FOR VISUALLY HAND.	\$	10,762,881.16
CHAR. PENAL & REFORM	\$	4,783,309.92
WATER RESERVOIR	\$	6,015,400.79
IMPROVE RIO GRANDE	\$	1,478,953.05
PUBLIC BLDGS. CAP. INC.	\$	6,116,660.90
	\$	<u>521,520,995.94</u>

These distributions play an important part in the operating budgets of each beneficiary. The distributions to the general fund in particular typically represent approximately 10 percent of total recurring general fund revenue. If the proposed amendment is adopted by both the legislature and people of New Mexico, the State Investment Council (SIC) estimates that overall distributions made from the LGPF will be approximately \$892.4 million greater over the next ten fiscal years. These calculations are approximations based upon an average annual fund return of 8.5 percent. The chart below shows the increases broken out by fiscal year, however it is important to note that the distribution increase proposed in House Joint Resolution would most likely not occur until FY12 due to the fact that voter approval probably cannot be obtained until mid FY11.

<u>Fiscal Year</u>	<u>Current LGPF Distributions \$MM</u>	<u>Proposed LGPF Distributions @ 6.2%</u>	<u>Increase Dist. \$MM HJR2</u>
2011	\$535.90	\$572.90	\$37.00
2012	\$544.50	\$582.10	\$37.60
2013	\$515.80	\$581.50	\$65.70
2014	\$510.70	\$575.70	\$65.00
2015	\$541.70	\$610.60	\$68.90
2016	\$564.30	\$636.10	\$71.80
2017	\$534.50	\$662.80	\$128.30
2018	\$557.10	\$690.80	\$133.70
2019	\$580.50	\$719.80	\$139.30
2020	\$604.70	\$749.80	\$145.10
			<b>\$892.4MM</b>

Source: State Investment Council (SIC)

### SIGNIFICANT ISSUES

Article XII, Section 7 of the New Mexico constitution describes the investment and distribution of the LGPF consisting of revenues collected by the State Land Office (SLO) from the sale or lease of lands and mineral rights granted to the state by the federal government. As of December 31, 2009 the market value of the fund stood at approximately \$9.2 billion.

The proposed legislation would have a significant effect upon educational funding in New Mexico. The majority of LGPF distributions are made to New Mexico higher education institutions and the general fund for common school funding. However, because the current HED funding formula takes credit for LGPF distributions, public postsecondary institutions would only benefit from the increase for two years due to a two year lag. The 3 New Mexico special school beneficiaries would continue to benefit for the life of the increase as they are not subject to the funding formula.

SLO expresses significant concerns in its analysis that an increase in the distribution rate of the LGPF could have lasting detrimental effects on the corpus of the fund. The agency’s analysis claims that even under current distribution rates “(t)he permanent fund is already at risk of gradual decline, and as such is not permanent...” due to a variety of factors most notably inflationary concerns.

State Land Office (SLO):

“The proposed amendment is unlawful; our Supreme Court has determined that the terms of the Enabling Act trust apply to all three branches of state government. *Asplund v. Hannett*, 31 N.M. 641, 666, 249 P. 1074, 1083 (1926) (“When a trust is committed to a state, it must be in view of the fact that the trustee is constituted with three co-ordinate governmental branches. The execution of the trust is committed to all three within their respective spheres.”) Thus, any statute seeking to make distributions from the Land Grant Permanent Fund (LGPF) in contravention of the fund’s stated purpose would be unlawful...

The fact that the legislatively sanctioned current formulaic distributions have avoided censure as unlawful is no reason to continue this trend. In fact, it is clear that Congress still retains a concern that the Enabling Act trust and LGPF remain a permanent and viable resource for New Mexico. The 1997 amendment was accomplished by the “New Mexico Statehood and Enabling Act Amendments of 1997” which was prefaced by the explanatory title: “An Act to amend the Act of June 20, 1910, to protect the permanent trust funds of the State of New Mexico from erosion due to inflation and modify the basis on which distributions are made from those funds.” At the end of PL-105-37 Congress repeats this evident concern by stating that :

Congress consents to the amendments to the Constitution of the State of New Mexico proposed by Senate Joint Resolution 2 of the 42nd Legislature of the State of New Mexico, Second Session, 1996, entitled "A Joint Resolution proposing amendments to Article 8, Section 10 and Article 12, Sections 2, 4 and 7 of the Constitution of New Mexico to protect the State's permanent funds against inflation by limiting distributions to a percentage of each fund's market value and by modifying certain investment restrictions to allow optimal diversification of investments.

Given the current economic climate, it is highly unlikely that the proposed amendment will protect the LGPF as Congress has mandated, and would, in fact, be fiscally imprudent.”

The chart below shows calendar year end market values for the LGPF since 2000 and thus includes the effects of investment activity and net inflows and outflows from the fund. The fund has seen annual declines 3 of the eight years presented, the largest of which was experienced in 2008 and eliminated more than 5 years of growth. The majority of the 2008 decline came as the result of one of the most challenging investment environments seen in decades brought on by the nation’s current financial crisis.

<b>LGPF Calendar Year End Market Values</b>		
<b>Year</b>	<b>Market Value</b>	<b>YOY Change</b>
2000	\$ 7,624,358,974.00	N/A
2001	\$ 7,196,181,501.00	\$ (428,177,473.00)
2002	\$ 6,255,967,057.00	\$ (940,214,444.00)
2003	\$ 7,508,917,699.00	\$ 1,252,950,642.00
2004	\$ 8,176,959,919.05	\$ 668,042,220.05
2005	\$ 8,702,071,367.00	\$ 525,111,447.95
2006	\$ 9,870,353,747.00	\$ 1,168,282,380.00
2007	\$ 10,697,580,800.00	\$ 827,227,053.00
2008	\$ 7,853,022,663.00	\$ (2,844,558,137.00)

Source: LFC Files

## TECHNICAL ISSUES

The Attorney General’s Office expresses concern in its analysis with the potential suspension of all LGPF distributions if the average balance falls below \$5.8 billion.

Attorney General’s Office (AGO):

Currently the State Legislature is granted authority to suspend *additional* distributions. There is no language providing for the suspension of the entire annual distribution to all of the beneficiaries provided in the Constitution. However, if enacted as written, the

amendments to that section would provide in part: “A *distribution shall not be made pursuant to the provisions of this section in any fiscal year if the average of the year-end market values of the fund for the immediately preceding five calendar years is less than five billion eight hundred million dollars (\$5,800,000,000).*” This could have the effect of eliminating funding for all of the named beneficiaries of the Permanent School Fund and Land Grant Permanent Funds if that average does not equal or exceed that amount.

Aside from having the effect of reducing or eliminating funding for many state institutions, such language could conflict with the Enabling Act for New Mexico which granted public lands upon statehood and which established those funds and provided for their expenditure. See Section 10 of the Act of June 20, 1910, 36 Statutes at Large 557, Chapter 10 (the “Enabling Act”) which declares those funds to be trust funds and provides in part “Distributions from the trust funds shall be made as provided in Article 12, Section 7 of the Constitution of the State of New Mexico.” It does not appear that the United States Congress contemplated a complete suspension of all distributions, as would be provided by this Joint Resolution.

**OTHER SUBSTANTIVE ISSUES**

Recently an independent operating and fiduciary review (IOFR) of state investment practices was performed for the Legislative Council and State Board of Finance by Ennis Knupp and Associates. One of the recommendations of the IOFR was to amend the New Mexico constitution to bring the State Investment Officer’s (SIO’s) level of fiduciary responsibility in line with statute. Currently the SIO is statutorily required to invest the state’s funds under the “prudent investor” standard. Under the constitution however, the SIO is only required to operate under the “prudent man” standard which is a lower level of fiduciary responsibility. House Joint Resolution 2 already proposes changes to the relevant article, and therefore it may be prudent to include this recommended fiduciary change in the proposed legislation.

**WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

If the proposed legislation is not enacted by the legislature or approved by New Mexico voters, the current LGPF distribution schedule will remain as follows:

<b><u>Current LGPF Distribution Schedule</u></b>	
<b><u>Fiscal Year</u></b>	<b><u>Distribution Rate</u></b>
2011	5.80%
2012	5.80%
2013	5.50%
2014	5.50%
2015	5.50%
2016	5.50%
2017	5.00%