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FISCAL IMPACT REPORT

ORIGINAL DATE 02/08/10

SPONSOR Morales LAST UPDATED _____ HB _____

SHORT TITLE Invest in Affordable Housing SJM 44

ANALYST Escudero

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| | FY10 | FY11 | FY12 | 3 Year Total Cost | Recurring or Non-Rec | Fund Affected |
|--------------|--------|--------|--------|----------------------|-------------------------|----------------------------|
| Total | \$0.1* | \$0.1* | \$0.1* | \$0.1* | Recurring | SIC Operating Budget |

(Parenthesis () Indicate Expenditure Decreases)
 *See Fiscal Implications

Duplicates HJM 51

SOURCES OF INFORMATION

LFC Files

Responses Received From

State Investment Council (SIC)

Mortgage Finance Authority (MFA)

SUMMARY

Synopsis of Bill

Senate Joint Memorial 44 (SJM 44) requests the State Investment Council to invest at least one billion dollars through NM chartered banks and credit unions to provide funds for affordable housing.

FISCAL IMPLICATIONS

State Investment Council indicates as follows:

Risk and Assessment. Following through on implementing such a practice would have an additional, but indeterminate cost relative to the employees needed to execute such a program. A program that is currently run by the State Treasurer's office which invests in NM bank CDs takes up to 4 full time employees to properly staff.

Making an investment this large in any asset class poses significant logistical and risk assessment challenges to the SIC, to which there would undoubtedly be a cost component. As the memorial does not specifically call on the SIC to do so, quantifying such assessment costs is not feasible at this time.

Such a significant investment in any one type of alternative asset class would require no small measure of ongoing due diligence and assessment of risk. The potential detriment to investment returns for any below market rate investment allocation should be determined prior to implementation.

Mortgage Finance Authority states because a memorial does not have the force of law, this piece of legislation does not present any fiscal implications in and of itself. However, were the State Investment Council to carry out the wishes of the memorial, at least \$1 billion would be transferred from the land grant permanent fund to fund affordable housing efforts.

Both the STPF and LGPF make annual appropriations of 4.7 and 5.8 percent respectively to the general fund based upon their average market value for the preceding five calendar years. In FY10 the funds will distribute approximately \$624 million to the general fund combined, representing more than 10 percent of all recurring general fund revenue. Therefore any legislation that could possibly harm their overall performance has the potential to negatively impact general fund recurring revenue.

Historical GF Distributions

| | <u>LGPD</u> | <u>STPF</u> |
|------|-------------|-------------|
| FY09 | \$433.2 | \$191.3 |
| FY08 | \$390.5 | \$177.2 |
| FY07 | \$364.7 | \$171.0 |
| FY06 | \$354.2 | \$171.8 |
| FY05 | \$350.3 | \$173.2 |
| FY04 | \$292.2 | \$172.4 |

SIGNIFICANT ISSUES

State Investment Council indicates as follows:

Compliance and Uniform Prudent Investment Act. There is currently not a statutory allowance or imperative that would make such a large investment in New Mexico banks possible. In fact, as is suggested in the memorial, investments of this kind are currently not allowable from the Land Grant Permanent Fund (LGPF).

The \$9 billion LGPF (as of 12/31/09) has not been given legislative authority to make differential, or below market rate investments as does the Severance Tax Permanent Fund (STPF).

“There is currently a mechanism in statute that allows the SIC to invest up to 20% of the STPF in New Mexico Banks. The existing statute (NMSA 1978 Section 7-27-5.19), allows investments to be made from the STPF into Certificates of Deposit held by qualified New Mexico financial institutions. Historically, this CD investment program has seen limited use for different reasons. Under the statute, banks would only qualify for these investments if rated A by the SIC, or if providing up to 102% collateralization. This collateralization requirement has made the program unattractive to NM banks. In addition, the amount invested by the SIC in CDs with any individual bank, was limited to the amount that they were loaning to New Mexico businesses. Depending on the number and size of the bank investments, this is potentially difficult for SIC staff to monitor adequately.

It is notable that in recent months, there has been an initiative led by the State Land Commissioner to restart the CD investment program, loosen the existing policy and invest money through certificates of deposit with NM community banks. This “restart” has been hampered by two issues:

- First it was identified that the existing policy was similar, but not exactly the same as a previous Rule regarding this investment authority from 1993. This meant that to make a policy change regarding these investments (and make the program attractive to banks), was not possible as then the new policy would be in conflict with the old Rule. That Rule was repealed in late 2009 through the necessary but lengthy process. Future investments of this kind will be governed by statute and SIC policy, not Rule.
- Secondly, amid the current turmoil facing the Council relative to a federal investigation regarding outside marketer placement fees, in addition to the resignation and subsequent replacement of the state investment officer, several members of the Investment Council have voiced public concern over whether this program will be properly securitized to avoid putting permanent fund money at risk. The Council has asked that SIO Staff put together a proposed policy that would make changes sought by the bankers, while also addressing Council Members concerns over securitization and monitoring. This revamped policy is expected to be discussed once again and possibly voted on at the SIC meeting in February.”

SJM 44 does not contemplate similar stipulations on how the money must be invested.

Mortgage Finance Authority indicates as follows:

The desire to invest \$1 billion in affordable housing is laudable, and the New Mexico Mortgage Finance Authority (MFA) contends that quality, affordable housing is a very good investment for the state.

In order for the state to invest in below-market rate mortgages (*i.e.*, for the state to make a contribution equal to the differential between market rate returns and below-market rate returns on its investment), the investment program would have to be in compliance with the affordable housing exception in Article 9, Section 14 of the New Mexico Constitution.

In other words, it is questionable whether funds could be directly invested through New Mexico chartered banks and credit unions without first going through DFA and then MFA. Ultimately, MFA would be responsible for reviewing the program to ensure its compliance with the Affordable Housing Act.

PERFORMANCE IMPLICATIONS

State Investment Council indicates as follows:

Returns and Third-Party Agents. It is likely that taking \$1 Billion and placing it in a low return, potentially high risk investment program that is actually being managed and overseen by several third-party agents (the banks) would fail to produce returns necessary to maintain the corpus of the permanent fund. While the argument can be made that a

very small percentage of the fund could be made prudently into this asset category for diversification sake, other factors, including geographic and allocation concentration tends to diminish the prudence of larger commitments.

Mortgage Finance Authority indicates as follows:

In order to implement this type of investment program, the administrators of the program—as well as participating lenders—would need to have the infrastructure in place to comply with Affordable Housing Act requirements. See “Significant Issues” section above.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

As indicated by State Investment Council, HJM 51 may conflict with NMSA 1978 Section 7-27-5.19 which caps the amount available for permanent fund investments in NM banking institutions at 20% of the Severance Tax Permanent Fund, which currently stands around \$3.5 Billion. Twenty percent of the STPF would be \$700 million, much less than the \$1B proposed here.

Similar to SJM 43, SJM 44

As stated by Mortgage Finance Authority SJM44 contains provisions that are duplicative of HJM51, “Invest in Affordable Housing and Mortgages.”

OTHER SUBSTANTIVE ISSUES

State Investment Council indicates as follows:

There is a significant question whether investments of this kind could ever meet prudent investment standards, given that they would likely be:

- Below market rate
- Lacking guarantees beyond \$250k under FDIC
- Highly concentrated both in strategy and geography
- Highly illiquid on the public markets should the need arise to sell

A very significant portion of the portfolio (more than 10% of LGPF if fully deployed)

A specific statutory mandate requiring such an investment would be necessary to carry out the will of SJM 44.

There is also a question whether such a program might violate the state’s anti-donation clause, as it offers a specific subsidy for a specific group (public employees), without anything of value being returned.

Mortgage Finance Authority indicates as follows:

If the Legislature indeed wishes to direct land grant permanent fund investment in affordable housing, it already has infrastructure in place to execute such an initiative: MFA is very capable of administering this type of program on behalf of the state.

ALTERNATIVES

State Investment Council indicates as follows:

Should it be the will of the legislature to put additional emphasis on funding affordable housing, and should they decide the permanent funds are the appropriate source for that mandate, it may be more logical to make changes to the existing statute regarding bank investments through the STPF (NMSA 1978 Section 7-27-5.19).

Mortgage Finance Authority indicates as follows:

As noted in the “Other Substantive Issues” section above, if the Legislature wishes to direct land grant permanent fund investment in affordable housing in accordance with the Affordable Housing Act, MFA can accommodate this type of investment immediately. MFA works with an extensive network of lenders to deliver a wide array of affordable housing programs, so implementation of the type of program described in SJM44 would be seamless were the State Investment Council to invest permanent funds with MFA.

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