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

SPONSOR Sanchez, M.
ORIGINAL DATE 01/21/11
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HB

SHORT TITLE Recovery Investment Bonding Act
SB 1

ANALYST Burrows/Daly

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY11	**FY12**		
	$68,400.0	Recurring (five years)	Recovery Investment Bonding Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	**FY12**	**FY13**		
	$68,400.0	$68,400.0	Recurring (five years)	Recovery Investment Bonding Fund
	($68,400.0)	($68,400.0)	Recurring (five years)	General Fund
	$300,000.0	$0.0	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to HJR 1

SOURCES OF INFORMATION
LFC Files

Responses Received From
Department of Finance and Administration (DFA)
State Investment Office (SIC)
State Land Office (SLO)
Attorney General's Office (AGO)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 1 creates the Recovery Investment Bonding Act, which authorizes the Board of Finance to issue up to $300 million in revenue bonds, known as "recovery investment notes," the proceeds of which would supplement the general fund in order to meet general fund appropriations. The recovery investment notes would be sold to the State Investment Council, and are essentially a loan from the Land Grant Permanent Fund and/or Severance Tax Permanent Fund to be repaid with interest over a maximum of five years.

The bill stipulates the rate of interest payable on the recovery investment notes shall not exceed the equivalent treasury yield plus 200 basis points (or 2 percentage points). The bill creates a recovery investment bonding fund, which is pledged for the payment of principal and interest. Beginning in the month in which the state board of finance certifies the issuance of recovery investment notes, up to $5.7 million per month (or $68.4 million annually) would be distributed from net gross receipts tax collections to the recovery investment bonding fund. At the end of the 5-year repayment period, any funds remaining in the recovery investment bonding fund will revert to the general fund.

Recovery investment notes must be issued on or before June 30, 2012. This bill contains an emergency clause.

FISCAL IMPLICATIONS

Assuming an issuance of $300 million in fiscal year 2012, the bill would have a positive fiscal impact to the general fund of $231.6 million in fiscal year 2012 ($300 million bond proceeds to the general fund less the $68.4 million gross receipts tax distribution to the recovery investment bonding fund for debt service). In fiscal years 2013 through 2016, the bill will result in a negative impact to the general fund of $68.4 million per fiscal year as a result of the gross receipts tax distribution to the recovery investment bonding fund. Netting these amounts, there will be a total negative impact to the general fund of $42 million over 5 years. However, the $42 million ***should not*** be considered a positive fiscal impact to the Land Grant and Severance Tax Permanent Funds because the $300 million would have otherwise been invested. In other words, the return on investment should not be considered as additional revenue.

At a maximum annual debt service of $68.4 million on a $300 million issuance, the bill allows for an interest rate as high as 4.9 percent to be negotiated on the recovery investment notes. Since the bill limits interest to 2 percent above current treasury rates, five-year treasury rates could be as high as 2.9 percent at the time of bond issuance, and the maximum interest rate could still be enjoyed by the State Investment Council.

This bill creates a new fund and provides for continuing appropriations. The LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities.

SIGNIFICANT ISSUES

Future gross receipts tax revenue has been pledged to pay debt service on the bonds at a five-year maximum of $42 million. These earmarked revenues will lead to decreased funding available for other programs. The loss of revenue to debt service has the potential to create even greater budget deficits beginning in FY2013.

To illustrate the additional stress the bill will impose on the General Fund in future years, the table below presents the December 2010 consensus revenue estimates and year-over-year revenue growth percentages under the status quo as well as under the fiscal impact of Senate Bill 1. Though revenue growth is expected to be strongest in FY12 under the status quo at 4.4 percent, the bill would boost FY12 growth to 8.8 percent. In FY13, the General Fund would be expected to experience ***negative*** revenue growth of 1.3 percent.

December 2010 Consensus General Fund Revenue Estimate ($ in millions)

	FY11	FY12	FY13	FY14	FY15
Est. Recurring w/o SB1	$5,164.3	$5,389.8	$5,615.3	$5,827.3	$6,056.6
Est. % Growth Y-O-Y		4.4%	4.2%	3.8%	3.9%
Est. Recurring with SB1	$5,164.3	$5,621.4	$5,546.9	$5,758.9	$5,988.2
Est. % Growth Y-O-Y		8.8%	(1.3%)	3.8%	4.0%

Source: Board of Finance

The precedent set by such a proposal, however, has a much greater impact on the state than the one-time issuance. The stock of funds held by the New Mexico government bolsters the credit rating of the state, which reduces the cost of borrowing money by lowering the interest rate on state-issued bonds. Habitual use of permanent funds to offset budget shortfalls could elicit a negative reaction from ratings agencies, because such proposals limit the state's future financial flexibility by committing future tax revenues for current operations. The use of medium- to long-term debt financing in order to address a state's budget deficit is traditionally frowned upon.

ADMINISTRATIVE IMPLICATIONS

The bill would create an additional bonding program for the Board of Finance to administer. It is anticipated that staff and the Board's advisors would need to do a significant amount of analysis upfront to implement the brand new program.

RELATIONSHIP

House Joint Resolution 1 proposes to permanently increase the distribution rate of the LGPF to the general fund and other beneficiaries. If this resolution is approved by the Legislator and New Mexico voters it will impact the corpus of the fund. Issuance of bonds under Senate Bill 1 might then have a greater impact on the permanent fund.

TECHNICAL ISSUES

Senate Bill 1 carries emergency language, and since there are no restrictions in the bill regarding the date of sale, the bonds could be issued as early as FY11. Language may need to be added specifying the issuance period and/or the appropriation period. This analysis assumes the bonds will be issued and appropriated to the general fund in FY12.

The State Investment Office has suggested replacing on page 7, lines 21-22 “State Investment Officer” with “State Investment Council.” The State Investment Office points to 2010 Legislative Session changes to Section 6-8-7, NMSA 1978, that “allow the State Investment Council to delegate day to day investment duties, but it is clear that such a large investment cannot be approved by one individual, and its terms would have to be approved by the full Council.”

The Department of Finance and Administration has suggested clarifying “required reserve” language on page 4, line 13 and page 9, line 5. The bill does not provide for the Board of Finance to set aside a specific amount in reserves. It is unclear whether required/necessary reserves would be $0, or whether the Board of Finance is meant to have discretion in the setting of required/necessary reserves.

OTHER SUBSTANTIVE ISSUES

The permanent funds were established so that the extraction of non-renewable resources would create continuous income to the state, and allow future generations to derive equal financial benefits from these resources. The permanent funds are similar to endowment funds held by institutions of higher education, designed to maintain their real value over time, while also providing continuing benefits to the population through investment returns. This purpose is at odds with proposals to use the permanent funds as a source of additional funding during difficult economic times.

As of 11/30/10, a $300 million investment would amount to approximately 8.2% of the STPF, and 3.1% of the LGPF. According to the AGO, the State Constitution requires a three-fourths legislative majority to change investment criteria of the land grant permanent fund (Article XII, Section 7), although one could argue in response that the bill is simply authorizing this form of investment. Given this potential conflict the entire issue might most likely be purchased through the STPF.

The level of distribution from the STPF is already too high to maintain the value of the fund. After controlling for inflation, the fund decreased in value by $1.9 billion – or almost 30 percent – between fiscal year 2000 and fiscal year 2010. Since there are few contributions made to the STPF, the market value of the STPF is largely dependent on the size of investment returns relative to the size of distributions and inflation. If investment returns are less than the sum of distributions and inflation, then the fund loses value. Four and seven-tenths percent of the five-year average market value is distributed to the state’s general fund each fiscal year. Inflation averaged 3 percent over the last 10 years. If inflation continues at this rate, the annual rate of return must be greater than 7.7 percent to maintain the real value of the fund. A purchase under the proposed bill could crowd out other potentially more attractive investment opportunities.

As recently as December 2010, five-year treasury rates were about 2 percent, which would result in an interest rate of 4 percent on the notes. Even at the maximum rate of 4.9 percent outlined above, the return on investment will be less than the 7.7 percent required to maintain the value of the fund at current rates of inflation. As the value of the STPF shrinks, investment returns decrease, as do future distributions to the state's general fund. Thus if the fund's performance were negatively affected, Senate Bill 1 would cause an indirect negative impact on general fund revenue for an extended period.

The LGPF distributes 5.8 percent of the average 5-year market value of the fund to 19 beneficiaries, including the general fund. If the bonds are purchased through the LGPF, distributions to these beneficiaries could be affected. This impact could be positive or negative, depending on other investment opportunities that are available.

Given the mandates of the Uniform Prudent Investment Act, which governs the Council's investment decisions, the SIC questions the appropriateness of the 2 percent risk premium, noting that "investment vehicles of this nature do not offer an attractive risk/reward profile under current market conditions." According to the State Investment Office, investments of this size always carry a degree of risk.

Department of Finance and Administration:

> "…the State of New Mexico would be borrowing long-term to fund state operations, which is contrary to basic prudent public finance principles. The Board of Finance's Financial Advisor notes that by borrowing future General Fund receipts for use in the current fiscal year, this year's deficit is pushed into the next five years, based on the presumption that the next five years will be a better time to absorb the pain of cuts. This type of fix may be increasingly common in today's challenging economic environment, but it will be viewed as a negative credit factor both because of borrowing for operating costs, and doing so in a manner that creates additional strain on the General Fund in future years…

And,

> "[Senate Bill 1] permits the state to defer action on structural budgetary issues of exponential cost growth for medical assistance and education…The state has reserves for the purported purpose."

Although there are constitutional limitations on state indebtedness, according to the Attorney General's Office the use of a "special fund" (or non-general revenues, such as certain gross receipts tax receipts, which are expressly appropriated in Section 10) for repayment of the bond circumvents the requirement for voter approval.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The fiscal year 2012 general fund budget will need to be balanced using other tools available, such as expenditure reductions, tax increases, and/or reserves. The amount of general fund revenue available for fiscal years 2013 through 2016 will not be reduced to bolster fiscal Year 2012.

LKB:MD/mew/bym