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

SPONSOR Nava **ORIGINAL DATE** 02/16/11 **LAST UPDATED** 03/03/11 **HB**

SHORT TITLE Land Grant Permanent Fund Distribution, CA **SJR** 10/aSRC

ANALYST Burrows

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY13	**FY14**	**FY15**		
	$41,309.0	$89,984.0	Recurring	Early Childhood Education Programs
	$82,618.6	$44,310.5	Recurring	General Fund
	$22,253.0	$27,366.0	Recurring	Other LGPF Beneficiaries

(Parenthesis ( ) Indicate Revenue Decreases)

Conflicts with HJR1, SB1

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Land Office (SLO)
New Mexico Corrections Dept (NMCD)
New Mexico Higher Education Dept (NMHED)
Attorney General's Office (AGO)
State Investment Office (SIC)
Public Education Department (PED)

Other Response Received
New Mexico Voices for Children

SUMMARY

Synopsis of SJC Amendment

Senate Joint Resolution 10 was amended by the Senate Rules Committee to include language specifying that the additional distributions in FY14 through FY23 would be for the benefit of "non-school-age children." The amendment also includes an additional distribution beginning in FY24 of 0.3 percent of the market value of the Land Grant Permanent Fund (LGPF) for the "permanent school fund" (also known as the common schools), which is part of the general fund.

FISCAL IMPLICATIONS

The age specification is a clarifying amendment that limits spending on early childhood education to children of pre-school age or younger.

The additional distribution beginning in FY24 will increase distributions to the general fund by $34.9 million in FY24 relative to current law, and will decrease distributions to other LGPF beneficiaries by $3 million relative to current law due to a greater depletion of the fund corpus in FY14 through FY23. The additional distribution will result in a $4.8 billion decrease in the fund value within 20 years. If the LGPF experiences a more modest 6.5 percent growth rate, the increase in distributions to the general fund in FY24 relative to current law would be $24.8 million.

SIGNIFICANT ISSUES

The Public Education Department (PED) reports that $6,416,374 in funding was allocated in FY11 for the New Mexico PreK Program, which provides voluntary pre-kindergarten services to four-year-old children in the state. These funds were used by 26 districts/contractors to provide public school pre-kindergarten services to 2,121 children. This year, 323 fewer children are being served as a result of budget reductions.

According to PED, children who participate in high-quality early childhood programs are:

- More likely to graduate from high school, go to college and be employed
- 40% less likely to need special education or be held back a grade
- Enter school better prepared to succeed.

ADMINISTRATIVE IMPLICATIONS

PED notes the increase in funding to early childhood programs will increase the workload of the Early Childhood Bureau staff. The staff currently has oversight of the following programs: PreK, K-3 Plus, Striving Readers (which receives federal funding), and Full-Day Kindergarten. Current staff includes: two Education Administrator A's and one support staff person. The Bureau has two vacant positions for Education Administrator that cannot be filled because of the hiring freeze.

TECHNICAL ISSUES

PED notes it is not clear to which agency the funds will be distributed, or if the funds will be distributed to schools through PED.

Synopsis of Original Bill

Senate Joint Resolution 10 raises the annual base distribution of the Land Grant Permanent Fund (LGPF) from 5.0 percent to 5.5 percent of the five-year average market value of the LGPF beginning in FY13. The resolution also requires an additional 1.5 percent increase in distributions to LGPF beneficiaries from FY14 through FY23. The additional 1.5 percent is earmarked for "early childhood education programs operated by public schools or pursuant to contracts between the state and private entities, as provided by law." With these amendments, the distributions in FY14 through FY23 would increase from 5.0 percent to 7.0 percent.

The additional distributions under Senate Joint Resolution 10 would be as follows:

- In FY14, 1/3 of the 1.5 percent additional distribution to the permanent school fund (which is part of the general fund) for early childhood education;
- In FY15, 2/3 of the 1.5 percent additional distribution to the permanent school fund for early childhood education; and
- In FY16 through FY23, total the 1.5 percent additional distribution to the permanent school fund for early childhood education.

The resolution also amends the current failsafe mechanism on additional distributions, which requires a suspension of the additional distribution should the five-year average market value of the LGPF fall below $8 billion. Under current law, suspension of the additional distribution is triggered at $5.8 billion.

If House Joint Resolution 1 passes both houses of the legislature, the proposed constitutional amendments will require approval by New Mexico voters during the next statewide general election or at any special election prior to that date that is called for this purpose.

FISCAL IMPLICATIONS

The proposed amendment would have a significant fiscal impact on the LGPF and its beneficiaries. In FY10 the LGPF made $525.5 million in distributions to a variety of beneficiaries.

FY10 LGPF Distributions by Beneficiary	
Common Schools (GF)	$437,127,589
University of NM	$8,447,972
NM State University	$2,626,981
Western NM Univ	$154,598
Eastern NM Univ	$445,886
NM Highlands Univ	$153,689
Northern NM College	$120,434
NM Inst Mining & Tech	$1,085,531
NM Military Inst	$17,789,968
NM School for the Deaf	$10,853,958
NM Sch for Visually Imp	$10,825,778
Miners Medical Ctr	$5,491,589
NM State Hospital	$1,262,780
NM State Penitentiary	$10,600,005
NM Boys School	$35,788
Char Penal & Reform	$4,781,321
Public Buildings	$6,161,957
Water Reservoirs	$6,061,534
Rio Grande Improvmt	$1,453,879
UNM Saline Lands	$31,289
	$525,512,526

Source: State Land Office
Note: "Common schools" is the same as the permanent school fund.

These distributions play an important part in the operating budgets of each beneficiary. For instance, the distributions to the general fund typically represent approximately 10 percent of total recurring general fund revenue. If the proposed legislation is adopted by the Legislature and New Mexico voters, the overall distributions from the LGPF to beneficiaries will be approximately $1.9 billion greater than current law over the ten fiscal years from FY13 to FY22. These calculations are approximations based upon an average annual fund return of 8.5 percent less transaction costs of 0.3 percent. Estimated contributions to the LGPF are consistent with consensus revenue oil and gas price and volume forecasts through calendar year 2014 and set equal to $350 million thereafter (the approximate 10-year contribution average). The chart below shows the increase by fiscal year.

	Current LGPF Distribution $MM	**HJR1 LGPF Distribution $MM**	**Change $MM**
FY2013	$536.8	$536.8	$0.0
FY2014	$547.0	$696.2	$149.2
FY2015	$596.6	$758.2	$161.7
FY2016	$641.4	$812.0	$170.6
FY2017	$620.5	$858.5	$238.0
FY2018	$659.1	$903.2	$244.1
FY2019	$700.3	$947.5	$247.2
FY2020	$743.7	$991.5	$247.8
FY2021	$789.3	$1,035.8	$246.4
FY2022	$837.2	$1,080.4	$243.3
			$1,948.2

Source: LFC Files

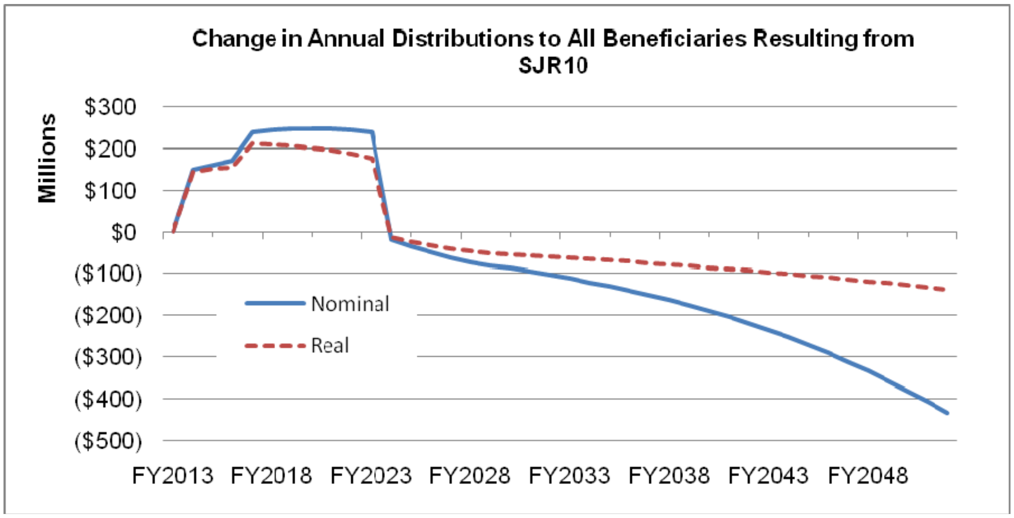
The increase in distribution to the early childhood education programs from FY14 to FY16 would result in a distribution of $41.3 million in FY14 increasing to $200.4 million in FY23.

This bill 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

In current law, distributions to beneficiaries will decrease by approximately 0.3 percent in FY13 and 0.5 percent in FY17. If Senate Joint Resolution 10 is not approved, those beneficiaries who currently rely on LGPF distributions to supplement operating budgets could experience a decrease in revenue during FY13 and FY17 that may have to be offset through general fund appropriations. This offset, coupled with the decrease in distributions to the general fund in those fiscal years, could create future budgetary challenges. However, the true impact to beneficiaries will depend on oil and gas royalty contributions, market performance, investment return and any other legislation that might affect the balance of the fund.

Although the general fund and other LGPF beneficiaries will experience an initial increase in distributions with approval of Senate Joint Resolution 10, at the higher rate of 7.0 percent beneficiaries will begin to receive less revenue than they would under current law within 12 years. The following graph illustrates the change in total distributions with approval of the resolution.



Source: LFC Files

Under Senate Joint Resolution 10, by the end of calendar year 2021 (12/31/21), the corpus of the fund would be $1.6 billion less than under current law, resulting in FY23 distributions of $1.1 billion. FY24 distributions at 5.5 percent of the five-year average market value would drop to $970 million.

The SIC provides a separate estimate of the impact of Senate Joint Resolution 10 using an assumption of 6.9 percent rate of return and $280 million annual contribution to the LGPF, both of which are based on 15-year averages. According to the SIC analysis, the corpus of the fund would be $2.1 billion less than under current law at the end of calendar year 2021, resulting in FY23 distributions of $923 million, and FY24 distributions of $742 million.

The SLO provided a third analysis of the revenue impact using the 5-year average contribution and 6.5 percent rate of return with very similar results. The office emphasizes the importance of setting the minimum balance requirements to continue the additional distribution equal to the current value of the LGPF, and increase the failsafe provision annually to adjust for inflation (see Amendment).

CONFLICT

House Joint Resolution 1 proposes to amend Article X11, Section 7 of the constitution to permanently increase the distribution from the LGPF to 5.8 percent.

Senate Bill 1 proposes to issue bonds of up to $300 million from the Severance Tax Permanent Fund (STPF) and/or the Land Grant Permanent Fund with a maximum investment return of 4.9 percent.

TECHNICAL ISSUES

SLO suggests that additional clarifying legislation will be required to formalize the distribution procedure to the early childhood education programs. The office questions whether the Public Education Department would be responsible for hiring staff and contracting private entities.

OTHER SUBSTANTIVE ISSUES

Economic studies have shown that investment in early childhood education can lead to a greater payoff in terms of educational attainment than investment at later stages of development.

The State Investment Office emphasizes the ability of the LGPF to grow is driven greatly by the total contributions to the fund of oil and gas revenues. While in the past decade these have been at all-time highs, during the 1990s contributions were much more modest.

Moreover, the SIC notes that when making assumptions about rate of return, one should be extremely cautious. For example, while the LGPF's 15-year average return has improved to 6.9 percent, the LGPF 10-year return remains at only 4.3 percent annually, considerably below the historical assumed average of 8 percent annual returns. Following the market collapses of the past decade, many institutional investors now believe that the 8 percent model may be unattainable.

At a more conservative 6.5 percent rate of return, general fund and other LGPF beneficiaries will experience a total increase in distributions from FY13 to FY22 of $1.8 billion.

The SIC also reports that at a 6.9 percent rate of return, coupled with rising inflation and potential for diminished contributions from oil and gas revenue, an aggressive distribution of 7 percent for a 10-year period poses a potential for decreasing the overall value of the LGPF. Even modest drops in value have significant impact when applied over future decades.

Several members of the State Investment Council have voiced concerns about increased distributions from the LGPF and the potential to erode the corpus of the LGPF in both the short term and over time. Some have generally stated that such declines in value run contrary to the concept of "intergenerational equity," which was the intent behind the creation of the LGPF.

HED reports the higher education institutions and special schools that have benefited from the increased distribution from the LGPF during the past seven years would benefit from an extension of that distribution, especially since their general fund appropriations will be reduced further in FY12, according to the budget recommendations of the Executive and LFC.

The New Mexico Corrections Department (NMCD) notes that the proposed distribution schedule would result in a decrease in distributions to the LGPF beneficiaries (excluding the early childhood education programs) first in FY13 when the distribution would decrease from 5.8 percent to 5.5 percent, and again in FY15 and FY16 when a greater portion of the 1.5 percent additional distribution is diverted to early childhood programs. Additional revenues and/or spending cuts would be needed to offset these reductions.

AMENDMENT

SLO recommends changing the failsafe provision to equal the corpus of the LGPF at the time of implementation of the amendment and add an inflation index to ensure the value of the corpus of the fund.

SLO also recommends on page 4, line 6, to add a provision requiring an annual adjustment by the percentage equal to the change in the special aggregate index for energy.

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:

Current LGPF Distribution Schedule

Fiscal Year	Distribution Rate
2012	5.80%
2013	5.50%
2014	5.50%
2015	5.50%
2016	5.50%
2017	5.00%

LKB/mew:svb