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## FISCAL IMPACT REPORT

**ORIGINAL DATE** 02/21/11  
**LAST UPDATED** 03/04/11     **HB** \_\_\_\_\_

**SPONSOR**    Burt

**SHORT TITLE**    Preserve Land Grant & Water Trust Funds, CA     **SJR** 17

**ANALYST**    Graeser

### APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY11	FY12		
	NFI	Recurring	Land Grant Permanent Fund; Water Trust Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
		\$0.0	\$0.0	\$0.0	Recurring	LGPF; WTF
		\$104.0		\$104.0	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

### SOURCES OF INFORMATION

LFC Files

### SUMMARY

#### Synopsis of Bill

Senate Joint Resolution 17 proposes a constitutional amendment to resolve a conflict between the state constitution and statute – in particular, with the duties of the State Investment Officer and the State Investment Council. The proposed constitutional investment standard for the Land Grant Permanent Fund and Water Trust Fund would become the statutory standard known as “The Uniform Prudent Investor Act.” This resolution has been endorsed by the Investments Oversight Committee.

The resolution would also propose an increase from 15% to 25% in the maximum percentage of the Land Grant Permanent Fund (LGPF) that could be invested internationally.

## **Senate Joint Resolution 17 – Page 2**

The amendment would be presented to the voters for their approval or rejection at the next general election or a special election called for the purpose.

### **FISCAL IMPLICATIONS**

The increase in limit for international investments may again be important if the US and the world experience another recession comparable to the “Great Recession” which began in December 2007 and ended in June 2009 – 18 months from peak to trough. (Note: the trough in employment was December 2009.) Because the recession began in the USA, it may well have been that the international recession was less severe than the domestic one and there might have been international investments whose performance exceeded the performance of domestic investments. However, this change in investment strategy is permissive, not mandatory. See “Other Significant Issues” below for more discussion.

The SOS notes that, “...in accordance with Section 1-16-4 NMSA 1978, upon receipt of the certified proposed constitutional amendment or other question from the Secretary of State, the county clerk shall include it in the proclamation to be issued and shall publish the full text of each proposed Constitutional amendment or other question in accordance with the constitution of New Mexico.”

“Although the county clerk includes the proposed amendments in his/her proclamation, it is the responsibility of the State to pay for the costs associated with the publication per Section 1-16-11 NMSA 1978. The approximate cost per constitutional amendment is \$104,000.”

“If the requisite number of registered qualified electors is confirmed, the question of recall of the official shall be placed for a special election to be called within ninety days of completion or the next occurring general election. The approximate cost for a statewide special election will be \$1,675,541.55; the approximate cost for an all mail-in ballot election will be \$1,968,179.31.”

Only the specific additional cost for advertising the constitutional amendment is included in the operating budget table above, assuming that the question is presented to the voters at the next general election, not at a special election called for the specific issue.

### **SIGNIFICANT ISSUES**

Although it is unusual to include a statutory standard in the constitution, the Uniform Prudent Investor Act is more complete and comprehensive than the current constitutional standard. The constitutional prudence standard reads:

Article XII, Sec. 7. [Investment of permanent school fund.] (2004 AARS)

C. In making investments, the state investment officer, under the supervision of the state investment council, shall exercise the judgment and care under the circumstances then prevailing that businessmen of ordinary prudence, discretion and intelligence exercise in the management of their own affairs not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.

The Uniform Prudent Investor Act provides a standard as follows:

“45-7-603. Standard of care; portfolio strategy; risk and return objectives. (1995)

- A. A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.
- B. A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.
- C. Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:
  - (1) general economic conditions;
  - (2) the possible effect of inflation or deflation;
  - (3) the expected tax consequences of investment decisions or strategies;
  - (4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interest in closely held enterprises, tangible and intangible personal property and real property;
  - (5) the expected total return from income and the appreciation of capital;
  - (6) other resources of the beneficiaries;
  - (7) needs for liquidity, regularity of income and preservation or appreciation of capital; and
  - (8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.
- D. A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.
- E. A trustee may invest in any kind of property or type of investment consistent with the standards of the Uniform Prudent Investor Act [45-7-601 NMSA 1978].
- F. A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.”

Pursuant to 6-8-7 NMSA 1978, the State Investment Officer and the State Investment Council are held to the investment standards imposed by the Uniform Prudent Investor Act. Thus this constitutional amendment can be viewed as providing a somewhat higher investment standard in the State Constitution than at present.

The SIC has proposed the increase in allowed international investments. The reasons offered by the SIC follow:

- About 55% of the global publicly traded equities market capitalization (global stock market value, in more layman’s terms) is represented by shares of companies domiciled outside of the US. The Land Grant Permanent Fund (LGPF) has a 55% allocation to publicly traded equity, which means to hold a market-capitalization weighted portfolio would imply (roughly) a 30% allocation to foreign equity. There is no near-term expectation of moving to a full global market-cap weight in the equities allocation, but that’s the math.
- Foreign market investment opportunities exist in fixed income, real estate and private equity (each of these an asset class the SIC currently invests in) in increasing amounts with competitive, and often better, expected returns than in the US. The domestic/international split of investable assets in these assets classes is not the same as

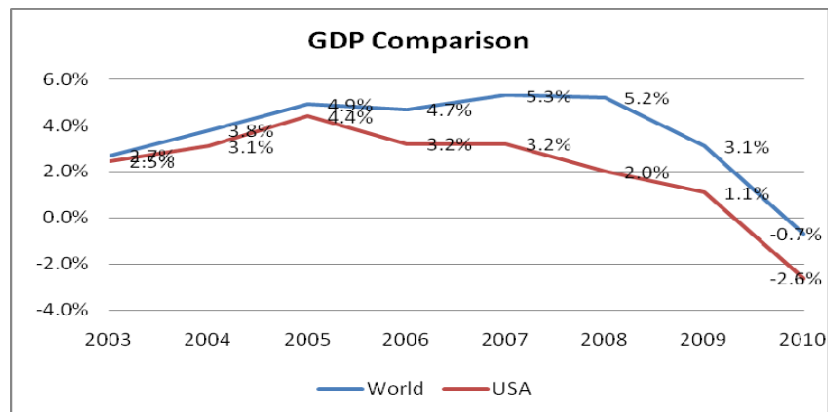
in the global publicly traded equity markets (it's lower), but their percentage of the total global opportunity set within these asset classes is growing and expected to continue to grow as a percentage in the future.

- Contribution to global GDP growth is increasingly shifting to the emerging markets. GDP growth drives investment opportunity and return.
- Diversification of assets is a critical component of risk control in portfolio construction (“investment management” in more layman terms) and the portfolio could be better diversified with increased access to the international investment markets.
- SIC portfolios are routinely compared in terms of performance and professional management to portfolios of peers, who, on the whole have greater access to the increased return and risk-reducing benefits of investing internationally. It should be noted that ERB and PERA do not have this particular restraint in statute or Constitution.
- These constitutional and statutory limitations on the investment decisions and opportunities of large, public investment pools managed by sophisticated investment offices, staff and external managers are in the minority and are increasingly rare.

## PERFORMANCE IMPLICATIONS

SIC notes that over the last 20 years, domestic equities have significantly underperformed international, European, Asian and emerging markets. In a global historical comparison, the S&P 500 has delivered top returns six times in that 20-year period. Emerging markets have delivered top returns 11 times. Conversely, the S&P 500 has delivered the worst returns 10 and emerging markets only twice.

## OTHER SUBSTANTIVE ISSUES



Assuming that investment opportunities roughly follow GDP growth, US investment opportunities have lagged international opportunities every year for the last eight years. Investments in East, South and Southeast Asia, South Africa and some of the countries of South America could possibly have moderated the extreme loss of value in the corpus of the land grant permanent fund over the last three years.

SIC notes that the current constitutional standard of prudence is far below a currently acceptable standard.

**ALTERNATIVES**

SIC points out that a better alternative to increasing from 15% to 25% international investment would be to delete the restriction altogether in the Constitution and place this or some other limit in statute. SIC requests more flexibility in managing investments – such flexibility will probably lead to greater investment performance.

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

Probably no practical consequences. The SIO and SIC are bound to the investment standard of the Uniform Prudent Investor Act. Allowing a greater exposure of investment funds to international opportunities may have been useful during the Great Recession, but the SIC and SIO should be able to find attractive domestic investments and not require the higher limit for international investments. On the other hand, the less restrictive the constitutional standard, the more opportunity for better investment returns.

The SIC expresses the consequence in the negative: “The SIC will continue to be hindered by an artificially imposed constitutional restriction against proper and prudent investment allocation when managing the second largest sovereign wealth fund in the United States.”

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