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FISCAL IMPACT REPORT

ORIGINAL DATE 1/22/16
LAST UPDATED 2/4/16 **HB** 31/aHWMC

SPONSOR Trujillo, CA

SHORT TITLE New Mexico Private Equity Fund Definition **SB** _____

ANALYST Malone

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17		
		Indeterminate Positive	Recurring	Severance Tax Permanent Fund

(Parenthesis () Indicate Revenue Decreases)

Duplicates SB 15

SOURCES OF INFORMATION

LFC Files

Responses Received From

State Investment Council (SIC)
 State Treasurer’s Office (STO)
 New Mexico Finance Authority (NMFA)

SUMMARY

Synopsis of HWMC Amendment

The House Ways and Means Committee amendment to House Bill 31 amends Section 7-27-5.14 NMSA 1978 to eliminate in the purpose statement the reference to “locally managed” private equity funds to make the language consistent with the changes in the original bill.

Synopsis of Original Bill

House Bill 31 amends Section 7-27-5.15—which dictates how the State Investment Council (SIC) may invest some of the severance tax permanent fund—to broaden the definition of “New Mexico Private equity fund.” The bill removes language limiting the definition to entities maintaining an office staffed by a full-time investment officer in NM. It replaces the removed language with a definition that includes entities that make, manage, or source potential investments in New Mexico businesses.

FISCAL IMPLICATIONS

SIC notes that HB 31 causes no direct fiscal impact, either positive or negative to the general or permanent funds. Conceptually, what it seeks to accomplish is an improvement of NM private equity investments by attracting more and better quality managers to look at venture capital deals in New Mexico. Assuming positive outcomes in the future, such improvement will positively impact the Severance Tax Permanent Fund.

SIGNIFICANT ISSUES

STO notes that investing NM Severance Tax Permanent Fund cash in NM private equity funds and businesses has the possibility of enhancing economic growth and development within in NM, thereby increasing the potential for tax revenues. The definition change should increase the availability of qualifying NM funds and businesses.

SIC offered the following comments regarding the legislation: The Council, through extensive study during the past year regarding these types of investments, determined that the primary roadblock to having best-in-class managers participate in the New Mexico Private Equity Investment Program (NMPEIP) is the requirement that they open an office here and staff it full time. There are two primary reasons for this: limited resources that venture capital funds have built into their management, and so called “most-favored nation” clauses demanded by other co-investors outside New Mexico.

As an example from our experience, Fund XYZ is based in Denver, and is raising a \$100M fund. They have very specific industry expertise and contacts around the country, and they are interested in various technologies being commercialized in NM. They would like a \$10 million commitment from the NMPEIP, but with only 6 investors on their team, the cost in manpower and financial impact of establishing an office here makes this a challenge. Other co-investors, based in Utah, may also press them for equal rights for their commitment, meaning fund XYZ would also have to open an office in Salt Lake City. The result, fund XYZ decides to pass on NM’s commitment.

The key to positive outcomes in this very specialized investment strategy is not where you live, but your level of experience, expertise and network. The Council concluded it is more beneficial to have a top-flight investor here looking at deals once a quarter, than a third-tier manager who is here every day.

The key requirement will remain in statute and is unaffected by HB 31: If New Mexico commits \$10 million to your fund, your fund must invest at least that much back into New Mexico companies.

PERFORMANCE IMPLICATIONS

SIC explains that the NM Private Equity Program has been focused primarily on investment returns the past decade, versus the economic development aspects of these investments, which were initially the priority at the program’s inception in 1993. The results of this shift, and a more professional approach overall, have helped improve the program’s returns, and turn them positive in recent years. The following chart summarizes this progress over time.

**NMPEIP Financial Performance Improvement
1993-2003 vs. 2004-Present**

Metric	1993-2003	2004-Present	Difference
Internal Rate of Return	-18.2%	4.8%	+23.0%
Since Inception Returns	\$-56.5M	\$74.4M	\$130.9M
Distributions to the SIC	\$5.0M	\$139.6M	\$134.6M
Non-Program Investment Into NM-based Companies	\$0.5B	\$1.4B	+180%

Source: Inviert

Program focused on economic development

Program focused on financial returns
Advisor - Sun Mountain Capital

SIC believes that continued evolution of the NMPEIP will help improve investment returns, and by identifying and fixing things that are not optimal – like the residency requirement – will improve the state’s ability to attract top performers.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill is a companion bill to SB 15.

TECHNICAL ISSUES

SIC reports that the Investment Pensions Oversight Committee raised concerns about lost tax revenue, and agrees that having a full-time person establish a household here and pay taxes on their salary is certainly preferable, but that the impact that one person’s taxable salary offers is minimal when weighed against the potential improvement of investment results involving millions of dollars.

OTHER SUBSTANTIVE ISSUES

SIC is amenable to establishing a requirement that a fund manager spend a specific amount of time in New Mexico per quarter or year, can be built into SIC investment policy, or in our investment contract with the manager. The Council has indicated it will address these issues should this measure pass, and determine an appropriate time period for fund managers.

CM/jle