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

		ORIGINAL DATE	2/8/18		
SPONSOR	Cervantes	**LAST UPDATED**		**HB**	
SHORT TITLE	Permanent Funds for Longer School Year			**SJR**	11
				ANALYST	Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
--	--	**($159,232.0)**	**($167,704.0)**	**($176,365.0)**	Recurring	LGPF
--	--	$135,347.0	$142,548.0	$149,910.0	Recurring	General Fund
--	--	$23,885.0	$25,156.0	$26,455.0	Recurring	Other LGPF Beneficiaries

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$50.0		$50.0	Nonrecurring	Election Fund

Parenthesis ( ) indicate expenditure decreases

Companion to SB171; Conflicts with HJR1, HJR2, SJR2; Relates to SJR7, HJR3, HJR10, SJR15

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)
State Land Office (SLO)
Public Education Department (PED)

SUMMARY

Senate Joint Resolution 11 seeks to amend Article 12, Section 7 of the state constitution, to provide additional yearly distributions of 1 percent from the Land Grant Permanent Fund (LGPF) to the funds beneficiaries. This brings the total distribution to 6 percent from the current level of 5 percent.

Additionally, the proposed amendment stipulates the amount of the additional distribution coming from the permanent school fund (which is the largest component of the land grant permanent fund allocated to support "common schools"), is to be earmarked for use to increase the minimum instructional hours and days in a school year as provided by law.

The additional 1 percent distributions will not be made if the five-year average value of the LGPF falls below $10 billion. Similarly, legislators can vote to suspend the additional 1 percent distribution by a three-fifths majority of both House and Senate.

The constitutional amendment requires approval by voters in a statewide election, either in the 2018 general election or at a special statewide election held for this purpose. Subsequent approval by US Congress is also required before the amendment can be enacted.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

Assuming adoption by the voters, the proposed amendment would deliver a significant infusion of capital to the state. The portion of this additional distribution coming from the permanent school fund (a component of the LGPF representing about 85 percent) is to be applied by legislators for purposes of extending the school day and school year. However, there is a trade-off. The additional distribution will lessen future earnings and reduce the greater benefits that a larger fund would produce long-term at the lower distribution rate.

The long-term effect of foregoing investment earnings by increasing the distribution can be mitigated by higher inflows in the LGPF from investment returns and oil and gas royalty contributions. However, the opposite holds true as well, where depressed oil/gas prices, coupled with lower investment returns (which are predicted over the next decade) and a higher spending rate, have potential to negatively impact the health of the endowment long-term.

Over the next 7-10 years, SIC expects lower-than-historical investment returns, with a return target of about 7 percent. Though oil and natural gas prices are currently on an upswing, volatility remains a serious concern and prices remain far below their 2014 highs. While the Permian basin has seen resurgence in production and sizable capital expenditures from producers over the previous year, potentially signaling a new resource extraction 'boom' for the region, other factors related to global competition and long-term environmental concerns make the future less certain for the decades ahead.

The following table provided by SIC shows the impact of distributing an additional 1 percent from the LGPF over time. SIC's projections are based on the value of the LGPF as of December 31, 2017, an assumed investment return of 6.8 percent, and an assumed inflow from the State Land Office (SLO) of $500 million starting in CY18 and increasing by 1.5 percent annually. Portions of the chart are highlighted for comparison purposes.

Calendar Year	Corresponding Fiscal Year	($B) LGPF Value Current (5%)	LGPF Distribution @5%	($B) LGPF Value w/SJR11 (6.0%)	LGPF Distribution @6.0%	Compounded Difference in 5% & 6% LGPF Distribution	Difference in LGPF Value ($B)
2017	2019	17.28827	$747,542,992	17.28827	$747,542,992		
2018	**2020**	18.246	$796,161,175	18.246	$955,393,410	$159,232,235	$0
2019	**2021**	19.222	$843,297,102	19.142	$1,011,001,128	$326,936,261	**($0.08)**
2020	**2022**	20.224	$901,514,007	19.976	$1,077,879,438	$503,301,692	**($0.25)**
2021	**2023**	21.250	$962,299,366	20.813	$1,145,572,699	$686,575,025	**($0.44)**
2022	**2024**	22.294	$1,012,354,454	21.647	$1,197,874,860	$872,095,431	**($0.65)**
2023	**2025**	23.361	$1,063,510,108	22.486	$1,248,756,989	$1,057,342,312	**($0.88)**
2024	**2026**	24.458	$1,115,875,760	23.338	$1,299,107,589	$1,240,574,141	**($1.12)**
2025	**2027**	25.587	$1,169,500,739	24.206	$1,349,870,930	$1,420,944,332	**($1.38)**
2026	**2028**	26.747	$1,224,473,460	25.091	$1,401,210,475	$1,597,681,347	**($1.66)**
2027	**2029**	27.941	$1,280,943,655	25.993	$1,453,367,492	$1,770,105,184	**($1.95)**
2028	**2030**	29.168	$1,339,016,290	26.914	$1,506,503,945	$1,937,592,839	**($2.25)**
2029	**2031**	30.431	$1,398,739,915	27.853	$1,560,681,273	$2,099,534,197	**($2.58)**
2030	**2032**	31.729	$1,460,161,762	28.811	$1,615,941,376	$2,255,313,811	**($2.92)**
2031	**2033**	33.064	$1,523,327,968	29.789	$1,672,315,659	$2,404,301,502	**($3.28)**
2032	**2034**	34.436	$1,588,283,727	30.786	$1,729,830,535	$2,545,848,310	**($3.65)**
2033	**2035**	35.847	$1,655,073,961	31.804	$1,788,509,160	$2,679,283,509	**($4.04)**
2034	**2036**	37.298	$1,723,744,125	32.842	$1,848,373,342	$2,803,912,726	**($4.46)**
2035	**2037**	38.789	$1,794,340,562	33.900	$1,909,444,518	$2,919,016,682	**($4.89)**
2036	**2038**	40.321	$1,866,910,582	34.980	$1,971,744,091	$3,023,850,191	**($5.34)**
2037	**2039**	41.896	$1,941,502,532	36.082	$2,035,293,616	$3,117,641,275	**($5.81)**
2038	**2040**	43.514	$2,018,165,842	37.205	$2,100,114,897	$3,199,590,330	**($6.31)**
2039	**2041**	45.176	$2,096,951,065	38.351	$2,166,230,046	$3,268,869,311	**($6.83)**
2040	**2042**	46.885	$2,177,909,906	39.520	$2,233,661,511	$3,324,620,916	**($7.36)**
2041	**2043**	48.639	$2,261,095,249	40.711	$2,302,432,093	$3,365,957,760	**($7.93)**
2042	**2044**	50.442	$2,346,561,186	41.926	$2,372,564,956	$3,391,961,530	**($8.52)**
2043	**2045**	52.294	$2,434,363,042	43.165	$2,444,083,640	$3,401,682,128	**($9.13)**
2044	**2046**	54.196	$2,524,557,403	44.429	$2,517,012,065	$3,394,136,790	**($9.77)**
2045	**2047**	56.149	$2,617,202,145	45.717	$2,591,374,536	$3,368,309,181	**($10.43)**
2046	**2048**	58.155	$2,712,356,462	47.030	$2,667,195,756	$3,323,148,475	**($11.13)**
2047	**2049**	60.215	$2,810,080,894	48.368	$2,744,500,824	$3,257,568,405	**($11.85)**
2048	**2050**	62.330	$2,910,437,357	49.733	$2,823,315,249	$3,170,446,297	**($12.60)**

The following points of comparison are provided by SIC:

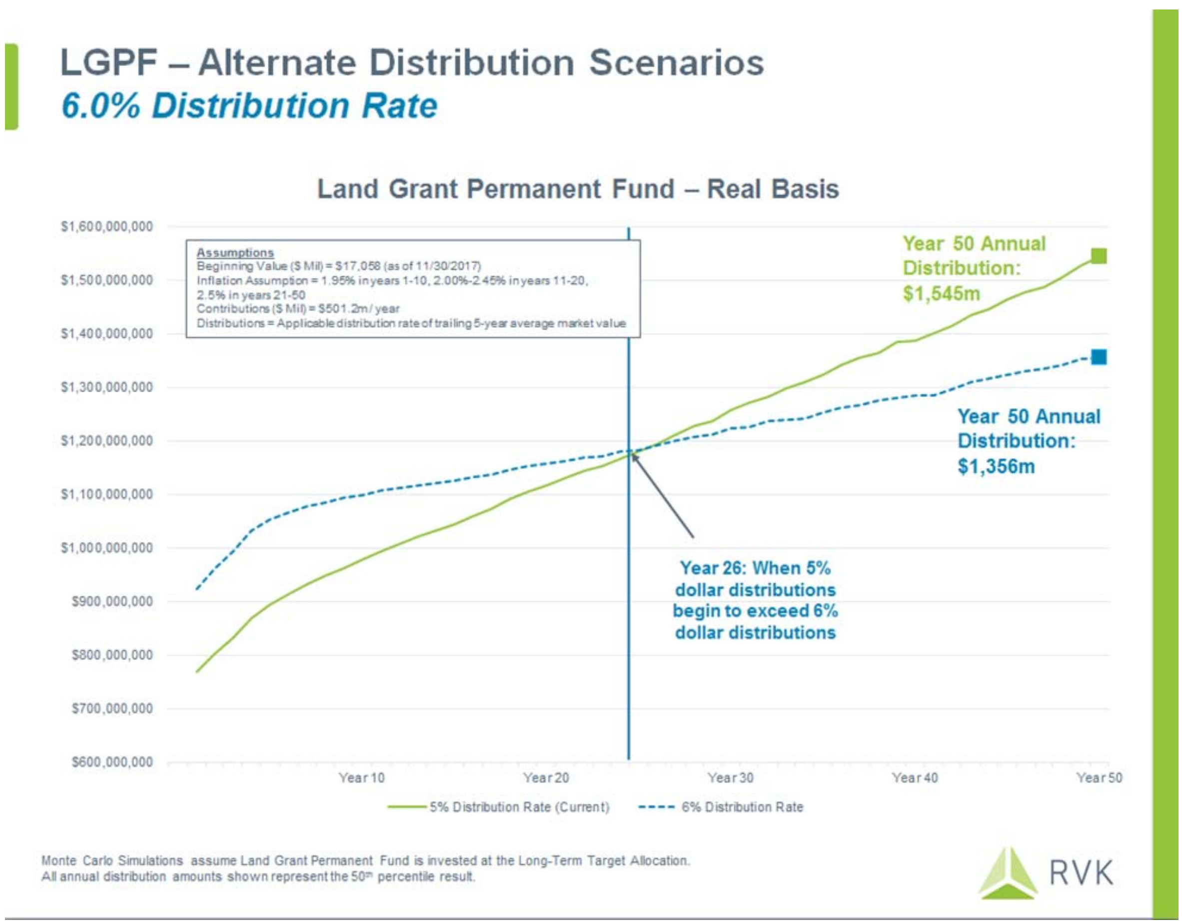
- In the first year of enactment, the proposed amendment would take an additional $160 million out of the LGPF over and above the 5 percent distribution rate.
- Year over year, that increase is more than $200 million ($747 million in FY19 to $955 million in FY2020)
- 12-years into the spending policy prescribed by the proposed amendment, the LGPF would have delivered an additional $2.1 billion to beneficiaries.
- Due to lost earnings on the $2.1 billion, the LGPF corpus would be $2.92 billion less after the first dozen years of distributions at the 6 percent rate, an estimated $800 million in potential lost earnings.

- Looking forward, those estimated revenue losses grow and accelerate, with the smaller fund earning at least $198 million less for the state each year after 2030.
- That $198 million – a nine-figure annual opportunity cost in lost earnings – would continue to grow annually, and at an accelerating rate as investment earnings are compounded.

SIC notes that this projection does not take into account less-certain variables including potential growth of the state population, or potential impact high inflation would have on the real dollar value of the LGPF benefits. Neither does it consider the possibility of calamitous investment market events as witnessed in 2008/2009, as well as compromised inflows from the Land Office, as these potential factors are extremely difficult to quantify.

The "Tipping Point". If the LGPF annual distribution increased by 1 percent indefinitely, as proposed under this legislation, within 26 years the distribution amount generated under 6 percent of a smaller fund would be less than the distribution amount generated from 5 percent of a larger fund. The trade-off is apparent in the bottom line. In those 26 years, the LGPF would have provided an additional $3.4 billion in funding to beneficiaries, but at a cost of more than $10 billion in lost earnings. The difference – an estimated $7 billion in opportunity cost – compounds and grows every year thereafter, and comes at the expense of every subsequent generation. An average year's earnings on $7 billion would produce about $476 million.

SIC's fiduciary consultant RVK illustrates it graphically below, on an inflation-adjusted basis using 'today dollar' values.



Similar to SIC's analysis, the State Land Office (SLO) states increased distributions from the LGPF increase the risk that the corpus of the LGPF will be diminished and that less money will be available in future years. In the long run, the increased distribution will have a negative impact on the LGPF and distributions to the beneficiaries. SLO's internal financial analysis indicates that if all analytical variables other than the distribution rate were held constant, comparing a 5 percent distribution (current law) to a 6 percent distribution in FY2020 and thereafter (as proposed), the beneficiaries would receive approximately $1.6 billion more in total distributions during the next 10 years and would receive approximately $4.7 billion less in total distributions over the next 50 years. The analysis indicates that the beneficiaries will start to see a reduction in funds distributed within 26 years if this legislation is enacted and approved. The internal analysis also indicates that the value of the fund will be approximately $27.1 billion dollars higher in 50 years if current distribution rates remain in place as compared to those proposed in this legislation.

Analysis of Prior LGPF Distribution Increases. In 2003, voters passed a constitutional amendment to raise the annual distribution to 5 percent (up from 4.7 percent) and provide additional distributions (0.8 percent and then 0.5 percent) from FY06-FY16 to implement educational reforms. Analysis from the SIC's external fiduciary consultant RVK determined that had New Mexico not enacted its constitutional amendment in 2003, the LGPF would be approximately $1.5 billion larger today. For CY17 an additional $1.5 billion would have generated another $223 million in net earnings for the fund, while also producing an additional $25 million in distributions (at the 5 percent rate) to LGPF beneficiaries for FY19. This information helps to inform the fiscal estimates and expected implication of the distribution changes proposed in this legislation.

Analysis of Impacts on Public Education. In response to the proposed amendment's companion bill, SB171, the Public Education Department (PED) estimates a cost of $229.3 million annually for increasing the minimum instructional hours and school days. However, this proposed amendment would only cover about 65 percent of that annual cost. PED states the gap between the funding needed and the funding provided by this amendment leaves "a significant unfunded mandate on school districts and charter schools to make up. The state would have to find a way to make up this amount or allow the unit value to drop in future years as a result of the additional units generated."

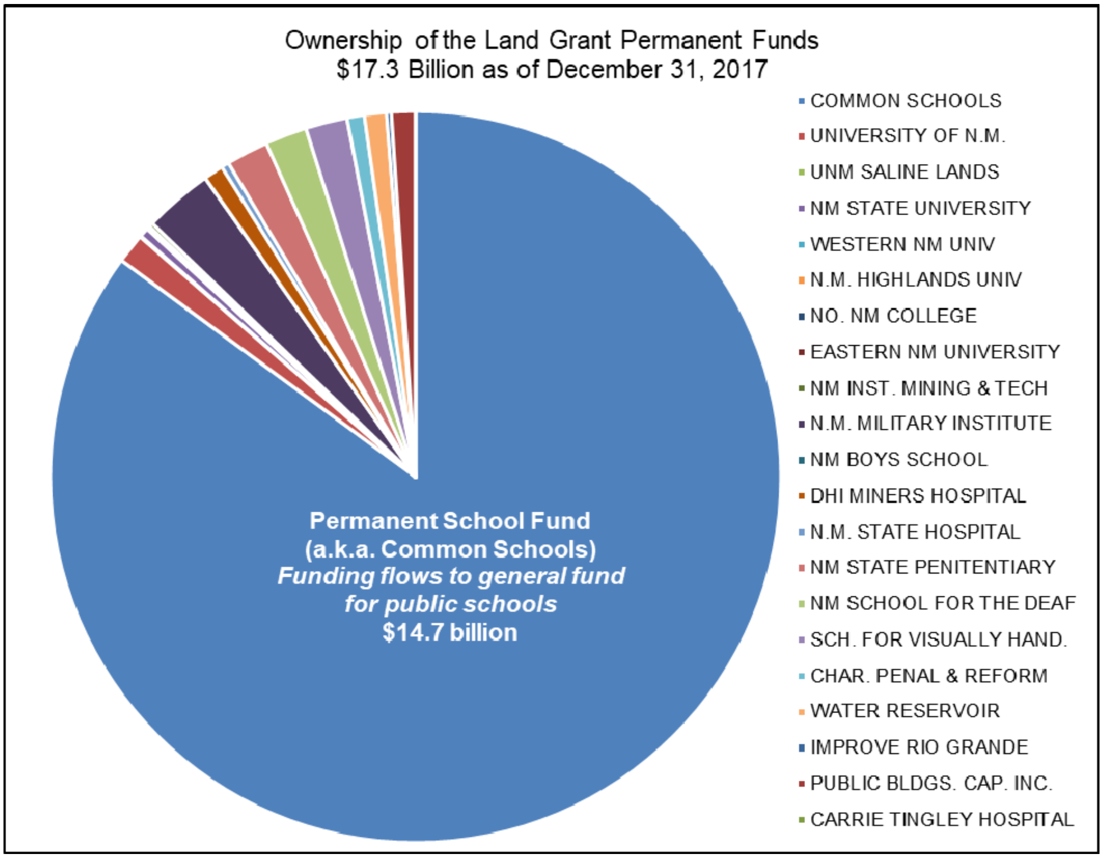
PED states increases to the length of school day will have associated increases to costs to public education entities. Examples of increased costs include those for fixed costs with rising expenses for utilities and operations; transportation, when the ability to tier routes is diminished and more buses are required to run, and additional labor costs, among others. PED states these costs would be partially offset by the increased dollars generated per the provisions of the proposed amendment.

According to PED, the companion bill (SB171) would require 205 school days in all schools for grades K-5, which effectively makes the K-3 Plus program universal, eliminating the need for the current special appropriation.

Election Costs. Section 1-16-13 NMSA 1978 requires the Secretary of State (SOS) to print the full text of each proposed constitutional amendment, in both Spanish and English, in an amount equal to 10 percent of the registered voters in the state. The SOS is also constitutionally required to publish the full text of each proposed constitutional amendment once a week for four weeks preceding the election in newspapers in every county in the state. According to Secretary of State, the most recent cost to print a constitutional amendment is $47.60 per word.

SIGNIFICANT ISSUES

Distribution Issues. It is important to note the "permanent school fund" and the "land grant permanent fund" are not the same. The permanent school fund is but a component (the largest portion) of the land grant permanent fund, accounting for about 85 percent of the LGPF. The proposed amendment increases the distribution to all beneficiaries, and requires only that the additional distributions from the permanent school fund be used for increasing instructional hours and school days. The additional distribution, which flows to the other 20 beneficiaries of the LGPF, does not appear to be earmarked for education.



Public Education. PED states the proposed amendment's companion bill (SB171) makes numerous changes to the length of school day and the minimum instructional hours section of the Public School code as outlined in the chart below. Entities must meet either the hours per day or the hours per year requirement. PED indicates the state's half-day Kindergarten program would be removed under these proposed changes, leaving in place only full-day Kindergarten.

According to PED, the passage of the companion bill (SB171) "would move the state further away from a base cost differential weighting of 1.0 for basic program units. The reallocation of cost differentials appears to be based upon projected revenues that may be generated from the Land Grant Permanent Fund under [this proposed amendment] instead of based upon the expenditure data and a cost study methodology that informed cost differential changes in the past

(see "Other Substantive Issues"). The provisions of SB 171 therefore may provide more money statewide for some grades than is necessary and underfund others."
PED notes that the companion bill (SB171) would be implemented whenever the Secretary of State certifies that the New Mexico constitution has been amended, but that a mid-year implementation would likely create large issues for teacher contracts negotiated in the prior year as these are often drafted and finalized prior to the summer break.

Some studies show that decreased classroom time can be a cause of poor student performance. The National Conference of State Legislature indicates the majority of states currently require 180 instructional days, though some states require more or fewer and others, like New Mexico, measure instructional time by hours rather than days. Education Commission of the States' data shows that New Mexico is one of nine states that currently do not require a number of minimum school days. Two states, Kansas and North Carolina, require more than the average 180 instructional days – 186 and 185 respectively.

The 2016 Legislative Finance Committee program evaluation, *Assessing "Time-on-Task" and Efforts to Extend Learning Time*, found students in New Mexico's public schools lose over a third of available instructional time per year on non-instructional activities and that lost instructional time directly impacts student achievement. The evaluation found that public schools have used flexibility in state statute to implement a wide variety of school calendars and school days and almost all schools have implemented extended school days resulting in shorter school years of about 167 days while still exceeding yearly requirements for instructional hours. At least 26 school districts already exceed 1,127.5 total elementary hours per school year, the number of hours that would be required by the companion bill (SB171).

LFC's evaluation recommends increasing minimum instructional time by equalizing elementary and secondary school hourly requirements and ensuring school districts use best practices and effective strategies to maximize time-on-task. Additionally, the LFC evaluation recommends repealing parent-teacher conferences and home visits from counting towards instructional hours to increase the time students are engaged in learning, which PED points out is not addressed by the companion bill (SB171).

PERFORMANCE IMPLICATIONS

Below are LGPF investment returns, net of fees as of 11/30/17:

	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
LGPF Investment Returns	15.45	6.71	8.88	5.28	7.41	6.38

A higher distribution rate could pressure the State Investment Council to achieve higher rates of return on investment in order to maintain the value of the fund. This is a potentially challenging goal during periods of national or economic decline, and could lead SIC to take on greater investment risk in hopes of achieving higher returns in order to protect the earning power of the fund. The past few years the SIC has taken the opposite approach, however, by diversifying investments, and lessening its annual return target to a more realistic 7.0 percent return, from the previous 8.5 percent.

Over the next decade, SIC expects it will likely be one of both volatility and depressed investment returns, given high, or in some cases record valuations, currently seen among publicly-traded companies. Depending on LGPF inflows from the State Land Office, the rate of inflation (which we anticipate will rise in the years ahead), and uncertain investment returns, SIC claims it is a reasonable assumption that a 6.5 percent distribution rate would have a greater impact on the LGPF corpus more frequently than distributions have in the past.

ADMINISTRATIVE IMPLICATIONS

According to PED, increasing the distributions to the current school fund alone is unlikely to disrupt or impact PED operations. However, extending the minimum hours in a school day or year in state law will cause PED to revisit and revise most of its internal processes as well as administrative rule frameworks. PED states the school calendar review processes would need to be changed, all guidance on the funding formula would need to be altered, and many steps regarding program approval would be impacted among many other considerations.

CONFLICT, COMPANIONSHIP, RELATIONSHIP

The proposed amendment is a companion to SB171, which seeks to changes the minimum instructional hours and days in the school year, lengthening the school hours and days for some grades.

Other related legislation:
- Conflicts with HJR1, which seeks increase LGPF distributions by 1 percent, of which the amount from the permanent school fund is earmarked for educational programs and early childhood education.
- Relates to HJR2, which seeks additional annual LGPF distributions by 0.5 percent for public safety.
- Relates to HJR3, which seeks additional annual STPF distributions by 0.5 percent for public safety.
- Relates to HJR10, which transfers 0.25 percent of the permanent school fund to create a new permanent education emergency reserve fund
- Conflicts with SJR2, which seeks to increase LGPF distributions by 1.5 percent, of which the amount from the permanent school fund is earmarked for early childhood education.
- Relates to SJR3, which seeks to create the Early Childhood Education Department.
- Relates to SJR7, which seeks to increase distributions by 0.8 percent from the STPF for early childhood education.
- Relates to SJR15, which transfers an amount from the LGPF to create a new state trust beneficiary reserve fund.

TECHNICAL ISSUES

SIC indicates the proposed amendment includes an asset value “safety valve” intended to protect the fund from the burden of additional distributions during times of financial stress. The valve is designed to stop the additional 1 percent distribution should the 5-year average of the fund drop below $10 billion at calendar end of any given year. The construction of the LGPF constitutional distribution policy by using a 5-year fund average is intended to result in smooth, steady pay-outs that take year-over-year volatility largely out of the mix. This allows for greater legislative budgetary planning. SIC states that, unfortunately, the intentional “smoothing effect” of this process also renders the “safety valve” concept unintentionally ineffective. Using an extreme example, the LGPF could currently lose a quarter of its value every year for the next four years and still not trip the $10 billion average to automatically suspend the additional distributions. In this scenario, that would only occur when the LGPF value hit the $4.1 billion mark in year five of 25 percent reductions.

SIC indicates the provision could prove to be more effective as a safety net, if set at levels closer to the LGPF's current value of over $17 billion. As of December 31, 2017, the five-year average of the LGPF was $14.9 billion.

Although the companion bill (SB171) is contingent upon passage of this proposed constitutional amendment; the enactment of this proposed amendment is not contingent upon passage of SB171. Therefore, if this proposed amendment were to pass, but SB171 did not, subsequent legislation would need to be passed to carry out the mandate of this proposed amendment.

OTHER SUBSTANTIVE ISSUES

Other State Permanent Funds. The State Investment Council notes the vast majority of other states with permanent funds, as well as similar university endowments take a more conservative approach to endowment fund spending policies than New Mexico.

- Annual distributions by domestic sovereign wealth & educational endowment funds:
- Alabama: 5 percent of rolling 3-year average
- Alaska: income earned only;
- Idaho: 5 percent of previous 3-year average value
- North Dakota Legacy Fund: 25 percent of annual earnings, through 2039
- Wyoming: 5 percent of the 5-year average value
- Texas Permanent School Fund: 3.3 percent;
- Utah: may not exceed 4 percent
- Arizona: 2.5 percent of previous 5 year average value

DI/sb

APPENDIX

Quick Facts on the Land Grant Permanent Fund

What is the Land Grant Permanent Fund?

- Established in 1912 through New Mexico's entry into statehood.
- Tied to the federal Enabling Act of 1910, which stipulated that such land grants were to be held in trust for the benefit of the public schools, universities, and other specific beneficiary institutions.
- The "land grant permanent fund" is really a collection of permanent funds.
    - The largest fund – representing about 85 percent of the total LGPF – is the Permanent School Fund, which is allocated for common schools and ultimately flows through the general fund for public school funding.
    - The other permanent funds belong to 20 different beneficiaries, including universities, hospitals, and other public institutions.
- Oil and gas revenues (rents, royalties, and bonuses) make up over 90 percent of contributions to the fund – 2016 contributions totaled about $371 million.
- One of the largest sovereign wealth funds in the country – about $17 billion as November 30, 2017.

Current Distributions from LGPF

Currently, 5 percent of the LGPF five-year average is distributed to 21 beneficiaries of the fund based on land-ownership. In FY18, total LGPF distributions to the beneficiaries will be about $689 million. About 85 percent of this amount (~$585 million) will go to the general fund for public schools.

Distribution History

- Originally, only interest earnings were distributed to beneficiaries.
- 1996, voters passed a constitutional amendment to raise the distribution amount to 4.7 percent of the five-year average value of the fund.
- 2003, by a slim margin (92.2 thousand for, 92.0 thousand against), voters passed a constitutional amendment to:
    - Raise the annual distribution to 5 percent,
    - Provide an additional distribution of 0.8 percent from FY06 – FY12 (totaling 5.8 percent),
    - Reduce the additional distribution to 0.5 percent from FY13 – FY16 (totaling 5.5 percent),
    - Earmark the general fund portion of the additional distributions to implement educational reforms.
- FY17, the distribution reverted back to 5 percent.

Important Considerations

LGPF was established and is required by law to benefit public schools and other beneficiaries indefinitely. It is funded by income from non-renewable resources and is designed to provide for future generations of New Mexicans even when those resources are exhausted.

Land Grand Permanent Fund (LGPF) Beneficiaries Percent distribution as of December 1, 2017	
COMMON SCHOOLS	85.095328%
UNIVERSITY OF N.M	1.311620%
UNM SALINE LANDS	0.045397%
N.M. STATE UNIVERSITY	0.414673%
WESTERN N.M. UNIVERSITY	0.024367%
N.M. HIGHLANDS UNIVERSITY	0.024243%
NO. N.M. COLLEGE	0.019696%
EASTERN N.M. UNIVERSITY	0.076008%
N.M INST. MINING & TECH	0.186236%
N.M. MILITARY INSTITUTE	3.029412%
N.M. BOYS SCHOOL	0.005324%
DHI MINERS HOSPITAL	0.867286%
N.M. STATE HOSPITAL	0.333710%
N.M. STATE PENITENTIARY	1.866190%
N.M. SCHOOL FOR THE DEAF	1.844919%
SCH. FOR VISUALLY HAND.	1.841087%
CHAR. PENAL & REFORM	0.769716%
WATER RESERVOIR	0.968725%
IMPROVE RIO GRANDE	0.216647%
PUBLIC BLDGS. CAP. INC.	1.058073%
CARRIE TINGLEY HOSPITAL	0.001342%
Total	100%