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FISCAL IMPACT REPORT

ORIGINAL DATE 2/4/18
 SPONSOR Munoz LAST UPDATED 2/9/18 HB _____
 SHORT TITLE State Trust Beneficiary Reserve Fund, CA SJR 15
 ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
--	(\$3,594,783.3)	(\$714,869.6)	(\$350,761.4)	*	Nonrecurring	LGPF
--	\$3,594,783.3	\$768,791.4	\$416,215.0	\$71,696.8	Recurring	NEW State Trust Beneficiary Reserve Fund
--	--	--	(\$35,519.7)	(\$79,302.2)	Recurring	General Fund
--	--	--	(\$6,376.9)	(\$14,237.1)	Recurring	Other LGPF Beneficiaries

Parenthesis () indicate revenue decreases

*Although transfers from the LGPF to the new State Trust Beneficiary Reserve Fund (STBRF) only occur from January 1, 2019 through December 31, 2020, there will be a recurring impact to the LGPF of lost interest earnings on the transferred amount.

SOURCES OF INFORMATION

LFC Files

Responses Received From
 State Land Office (SLO)

Responses Not Received From
 State Investment Council (SIC)

SUMMARY

Senate Joint Resolution 15 seeks to amend Article 12, Section 7 of the State Constitution to create a state trust beneficiary reserve fund (STBRF) by reallocating all amounts in excess of \$15 billion of the land grant permanent fund (LGPF) from January 1, 2019 through December 31, 2020 to the STBRF. All additions to the STBRF and all earnings, including interest, dividends, and capital gains, from investment of the STBRF would be credited to the STBRF. The Legislature could appropriate money from the STBRF to the beneficiaries of the LGPF for fiscal

years 2020 through 2029, and any unspent balance in the STBRF by the end of FY29 will revert back to the LGPF.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends. The proposed constitutional amendment would not become effective without approval by the voters at the next general election or at any special election prior to that date that may be called for that purpose.

FISCAL IMPLICATIONS

The proposed amendment would transfer from the land grant permanent fund (LGPF) all amounts in excess of \$15 billion to an annex fund, the newly created state trust beneficiary reserve fund (STBRF), for calendar years 2019 and 2020. The Legislature would then be able to appropriate from the STBRF to the beneficiaries of the LGPF between FY20 and FY29. There are 21 beneficiaries of the LGPF. The largest is the public schools (general fund), which owns 85 percent. The remaining 15 percent is owned by the 20 other beneficiaries at varying percentages.

In effect, the proposed amendment caps the LGPF at \$15 billion for calendar years 2019 and 2020. The value of the LGPF as of December 31, 2017 was \$17.29 billion. Based on expected interest earnings at the LGPF target rate of 7 percent and expected contributions from the State Land Office (SLO) for royalties on non-renewable resources, the expected value of the fund as of January 1, 2019 is \$18.23 billion. Since the proposed amendment would transfer the excess of \$15 billion to the new STBRF, the initial transfer on January 1, 2019 is estimated at \$3.23 billion.

Additionally, in FY19 the new reserve fund will receive the SLO contributions and interest earnings that would ordinarily go to the LGPF, bringing the estimated FY19 amount of the new STBRF to about \$3.59 billion. In FY20 and for half of FY21, the SLO contributions and interest earnings ordinarily credited to the LGPF would instead go to the new STBRF. In addition, the STBRF would generate its own interest earnings, which would grow as the fund grows. If the funds are not appropriated and allowed to grow, the interest earnings and combined transfers from LGPF would bring the new fund to over \$4.5 billion by the end of FY22. These estimates are based on an assumed annual contribution by SLO of \$450 million for CY19 and CY20, plus STBRF interest earnings at a 1.5 percent return, which is typical for core investments by the State Treasurer's Office.

Notably, the proposed amendment does not indicate how the new beneficiary reserve fund is to be managed or invested. Presumably, the STBRF would be managed by the State Treasurer's Office. If this is the case, the fund would be expected to grow at a rate that is typical for STO investments.

The proposed amendment would also have a general fund impact. Currently, there is an annual distribution from the LGPF in an amount equal to 5 percent of the five-year average of the fund. For example, the 2019 year-end balance will affect FY21 distributions. Because the LGPF will be over \$3 billion smaller than it would have otherwise been, the annual distributions will be smaller. When compared to the consensus revenue forecast, general fund revenue is estimated to be about \$35.5 million lower in FY21 than it would have otherwise been, and about \$79 million lower in FY22 (due to the compounded loss of interest earnings). The effect on other LGPF beneficiaries is an estimated combined loss of \$6.4 million in FY21 and loss of \$14.2 million in

FY22. However, since the proposed amendment allows the Legislature to appropriate from the new STBRF, the lost revenues in LGPF distributions could be appropriated to the beneficiaries from the new reserve fund, offsetting the impact. But, such action would mitigate the estimated growth of the new fund.

It is also noted that there will be a recurring impact to the LGPF of lost interest earnings on the transferred amounts. According to an internal analysis by the State Land Office, at the end of 50 years, the LGPF balance would be approximately \$8.8 billion low under this proposed amendment that it would be compared to current law.

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

It is unclear exactly how the transfers from the LGPF to the new STBRF will be made (e.g. will the transfers be monthly or occur at the end of the calendar year?). Additionally, as noted above, the proposed amendment does not indicate how the new beneficiary reserve fund is to be managed or invested. Presumably, the fund would be managed by the State Treasurer's Office and invested in a manner similar to treasury balances.

By making the funds in the new STBRF appropriable by the Legislature, the funds could presumably be spent by a simple majority vote. While the proposed amendment does not specify beneficiary ownership of the new reserve fund, it is assumed the new fund will have a similar ownership structure as the LGPF (i.e. 85 percent will be allocated to public schools and the remaining 15 percent will be allocated to the other 20 beneficiaries). The percentage ownership would then, in turn, need to be considered when appropriating funds from the STBRF. This could add complexity to managing the fund, particularly if the legislature chooses to appropriate funds to some beneficiaries but not others, which would require SIC (or whoever manages the funds) to track exactly how much of the remaining fund is allocated to each beneficiary.

This proposal has the benefit of continuing to grow the new reserve fund through investment until the time it is actually called down for appropriation by the Legislature. This offers the benefits of considerable growth over time due to investment gains of an institutional quality portfolio, rather than limited benefits offered had the money been put into short-term investments. However, the fund could be impacted by negative market environments, which have the potential to result in short-term losses, which could drive down the corpus of the fund. Along those lines, SIC forecasts investment returns below their historic averages over the next 7-10 years, due to above-average returns over the past several years, combined with the market's tendency to revert to historic averages.

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

ADMINISTRATIVE IMPACT

According to the State Land Office, the need to change SLO books, records and processes to distribute trust land proceeds to a new fund (essentially one new fund for each beneficiary) would impose a significant additional administrative burden on the state land office.

RELATIONSHIP

- Similar to HJR 10, which seeks to create a new permanent education emergency reserve fund from a one-time transfer from the LGPF.
- Relates to SJR2, which seeks to increase distributions by 1.5 percent from the LGPF 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 severance tax permanent fund (STPF) for education.
- Relates to SJR11, which seeks to increase distributions by 1 percent to lengthen the school year and school year.
- Relates to HJR1, which seeks to increase LGPF distributions by 1 percent for 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.

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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.
- 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.
- General fund distributions are earmarked for public schools.

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. The general fund (earmarked for common schools) is the largest fund beneficiary, receiving approximately 85 percent of the distribution. Other beneficiaries include universities, hospitals, and other public institutions. In FY18, LGPF distributions to the general fund will be about \$585 million.

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 vote of 92.2 thousand for, and 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 to FY12 (totaling 5.8 percent),
 - Reduce the additional distribution to 0.5 percent from FY13 to 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 was 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 <u>December 1, 2017</u>	
COMMON SCHOOLS	<u>85.095328%</u>
UNIVERSITY OF N.M	<u>1.311620%</u>
UNM SALINE LANDS	<u>0.045397%</u>
N.M. STATE UNIVERSITY	<u>0.414673%</u>
WESTERN N.M. UNIVERSITY	<u>0.024367%</u>
N.M. HIGHLANDS UNIVERSITY	<u>0.024243%</u>
NO. N.M. COLLEGE	<u>0.019696%</u>
EASTERN N.M. UNIVERSITY	<u>0.076008%</u>
N.M INST. MINING & TECH	<u>0.186236%</u>
N.M. MILITARY INSTITUTE	<u>3.029412%</u>
N.M. BOYS SCHOOL	<u>0.005324%</u>
DHI MINERS HOSPITAL	<u>0.867286%</u>
N.M. STATE HOSPITAL	<u>0.333710%</u>
N.M. STATE PENITENTIARY	<u>1.866190%</u>
N.M. SCHOOL FOR THE DEAF	<u>1.844919%</u>
SCH. FOR VISUALLY HAND.	<u>1.841087%</u>
CHAR. PENAL & REFORM	<u>0.769716%</u>
WATER RESERVOIR	<u>0.968725%</u>
IMPROVE RIO GRANDE	<u>0.216647%</u>
PUBLIC BLDGS. CAP. INC.	<u>1.058073%</u>
CARRIE TINGLEY HOSPITAL	<u>0.001342%</u>
Total	<u>100%</u>