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

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|---|---|---|---|---|---|
| | | **ORIGINAL DATE** | 3/6/19 | | |
| **SPONSOR** | Senate | **LAST UPDATED** | | **HB** | |
| **SHORT TITLE** | Rural Library Development, Program & Fund | | | **SB** | 264/SFlS |
| | | | | **ANALYST** | Martinez |

## APPROPRIATION (dollars in thousands)

| Appropriation | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|
| FY19 | FY20 | | |
| | See Fiscal Implications | | |

(Parenthesis ( ) Indicate Expenditure Decreases)

## SOURCES OF INFORMATION

LFC Files

Responses Received From
Cultural Affairs Department (DCA)
State Investment Council (SIC)

## SUMMARY

### Synopsis of Bill

SB264 creates a rural libraries endowment fund in the State Treasury to fund rural libraries (defined as any public or tribal library serving a population under 3,000 or any nonprofit library serving an unincorporated area), as well as specialized rural library services, administered by the state librarian. Starting in FY22, earnings on the fund shall be distributed based on a formula using the fund's average investment earnings, in a total amount up to 5 percent of the year-end market value of the fund for the preceding calendar year. The funds shall be distributed to the rural libraries program fund (95 percent of the distribution) and to the department of cultural affairs for the delivery of specialized services to rural libraries (5 percent of the distribution).

SB264 also creates the rural libraries program fund, administered by the State Librarian, into which disbursements from the rural libraries endowment fund are made. Funding in the rural libraries program fund shall be distributed in the forms of grants to rural libraries, including both developing and established rural libraries. Rural libraries are defined as any library located in unincorporated areas with populations less than 3,000, established by a political subdivision of the state or tribal government or established as a nonprofit corporation.

## FISCAL IMPLICATIONS

SB264 does not contain an appropriation and will not have a fiscal impact on the Department of Cultural Affairs operating budget.

It should be noted that HB2 includes a $5 million transfer of general fund revenue to the rural libraries endowment fund. SB264 states that after five years of growth in the fund, a distribution can be made of up to 5 percent of the value of the fund, approximately $240 thousand, depending on its prior years' investment earnings (see SIC chart on page 3).

SB264 seeks to create a rural libraries endowment fund and rural libraries program fund to facilitate a Rural Libraries Grant Program. The endowment would be invested "…as money in the fund described in Article 12, Section 7 of the constitution of New Mexico is invested."

Starting in FY22, and for each of the fiscal years thereafter, the endowment would distribute by formula, up to 5 percent of the endowment fund value for the preceding calendar year, or the income earned by the fund, whichever is less. Starting in FY28, the formula changes to the average fund income yielded over the preceding five years, or up to 5 percent of the fund corpus overall. This distribution would be 95 percent allocated to rural libraries program fund, with 5 percent allocated to the Cultural Affairs Department for the purpose of delivering specialized services to rural libraries. These services and programs would be under the guidance of the state librarian.

The endowment proposed under SB264 would be managed by the State Investment Council. SB264, Section 5, includes "rural libraries endowment fund," as a "permanent fund."

Continuing Appropriations Language

This bill creates a new fund and provides for continuing appropriations. LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, because earmarking reduces the ability of the Legislature to establish spending priorities.

The State Investment Council provided the following on the original version of SB264. The below still pertains to the Senate Floor Substitute for SB264:

> The State Investment Council sees limited impact in its operational and administrative agency costs should SB264 be passed. This is due to the existing structures which would allow the new endowment to be invested side-by-side with existing funds managed by the SIC.
>
> The levels of risk, liquidity needs and long-term return expectations would have to be established through an asset allocation study performed by the Council. As written, the investment guidelines in statute call for these new endowment funds to be invested "as the Land Grant Permanent Fund is invested."
>
> This language has been drafted into proposed legislation and statute in the past, but not always with successful results. This stems from the fact that about a third of the LGPF is invested in illiquid investment strategies such as private equity, real estate funds, and hard assets including energy, timber, infrastructure and agriculture funds. In exchange for

the long-term (10-15 years) commitment these investments require, the SIC expects to receive a “liquidity” premium on its investment returns. But it also restricts the SIC from exiting the investment ‘on demand’ without taking a severe loss usually associated with selling an asset prior to maturity.

For example, more than a decade ago, the SIC was charged with investing the Unemployment Trust Fund “as the LGPF is invested” in nearly identical language to SB264. However, the potential drawdown of the unemployment fund due to unpredictable fiscal needs made it impossible to invest as prescribed by statute. Given that the only prudent investments that could be made on such assets required high liquidity which typically requiring publicly-traded strategies – definitely not “as the LGPF” was invested - the Unemployment Trust Fund was never invested by the SIC, because to do so would have deviated from the law or violated fiduciary duty of the Council.

Using the SIC’s tool, the following graph shows projections assuming an annualized 7 percent rate of return (the targeted rate of return for the LGPF) on the new Rural Libraries endowment. Assumptions are that the endowment would not be drawn down until FY22.

| | | Return % | Return $ | NAV | | 5% of YE MV | Distribution (lesser of 5% of YE MV or positve return for first 6 years thereafter lesser of 5% of YE MV or average of 5 years of return or zero if average is negative) | |
|---|---|---|---|---|---|---|---|---|
| Initial contribution (say as of 7/1/19) | 5,000,000 | | | | | | | |
| CY 19 (6 months) | | 7.0% | 175,000 | 5,175,000 | | | | |
| CY 20 | | 7.0% | 362,250 | 5,537,250 | FY 22 | 276,863 | 276,863 | 1st year of distribution calculation. |
| CY 21 | | 7.0% | 239,486 | 5,776,736 | FY 23 | 288,837 | 239,486 | On NAV value, only half of prior year distribution impacts calendar year NAV. |
| CY 22 | | 7.0% | 128,125 | 5,904,861 | FY 24 | 295,243 | 128,125 | On NAV value, half of each of prior 2 years of distributions impacts calender year NAV. |
| CY 23 | | 7.0% | 216,668 | 6,121,529 | FY 25 | 306,076 | 216,668 | On NAV value, half of each of prior 2 years of distributions impacts calender year NAV. |
| CY 24 | | 7.0% | 244,043 | 6,365,572 | FY 26 | 318,279 | 244,043 | On NAV value, half of each of prior 2 years of distributions impacts calender year NAV. |
| CY 25 | | 7.0% | 199,110 | 6,564,682 | FY 27 | 328,234 | 199,110 | On NAV value, half of each of prior 2 years of distributions impacts calender year NAV. |
| CY 26 | | 7.0% | 222,441 | 6,787,123 | FY 28 | 339,356 | 202,077 | On NAV value, half of each of prior 2 years of distributions impacts calender year NAV. |
| CY 27 | | 7.0% | 260,464 | 7,047,587 | FY 29 | 352,379 | 228,545 | On NAV value, half of each of prior 2 years of distributions impacts calender year NAV. |
| CY 28 | | 7.0% | 262,948 | 7,310,535 | FY 30 | 365,527 | 237,801 | On NAV value, half of each of prior 2 years of distributions impacts calender year NAV. |
| CY 29 | | 7.0% | 262,242 | 7,572,777 | FY 31 | 378,639 | 241,441 | On NAV value, half of each of prior 2 years of distributions impacts calender year NAV. |
| CY 30 | | 7.0% | 273,700 | 7,846,477 | FY 32 | 392,324 | 256,359 | On NAV value, half of each of prior 2 years of distributions impacts calender year NAV. |
| | Average | 7.0% | 237,206 | 6,500,844 | | 331,069 | 224,593 | |

Note: Above assumes distributions are made at the beginning of a calendar year to simply return calculations.

The impact in initial years of the fund’s distribution formula would result in roughly $128 to $362 thousand per year for beneficiaries.

Volatility year-over-year may inadvertently be amplified by negative returns, money distributed in previous plus years, and a lack of offsetting inflows to the corpus. It’s those inflows that the LGPF receives annually that help greatly in minimizing the impact of negative returns or a spending policy that is out of balance in the short-term, due to poor investment returns. The proposed library endowment would not have any set inflows to offset bad years, and that may be problematic given the distribution formula and rate of 5 percent - which is on the high end of spending policy among most endowments.

> On average historically, investment markets will produce negative returns once every four or five years, but there are entire decades that have seen average negative investment returns. These are factors that should be considered, as they could result in $0 distribution years, which are not ideal for policy-makers and library administrators if they are relying on a consistent, recurring funding stream.

The Cultural Affairs Department provided the following:

> Currently, on average, the public libraries receive an annual grant averaging $7,700 through State Grants in Aid for Public Libraries. Their operating budgets range from $7,700 to $196,000. The average grant received by the non-profit libraries is $6,000; their operating budgets range from $1,150-$150,000.

**SIGNIFICANT ISSUES**

The Cultural Affairs Department provided the following:

The State Librarian and the Library Commission would establish rules governing distribution of the grants from the Rural Libraries Program Fund. Without the constitutional amendment, the nonprofit libraries receiving a disbursement will not be able to use the funds for building maintenance and repairs.

**PERFORMANCE IMPLICATIONS**

The State Investment Council provided the following:

> Investing the new endowment created under SB264 would not hinder existing operations or performance of the SIC or permanent funds.

**ADMINISTRATIVE IMPLICATIONS**

The State Investment Council provided the following:

> Similarly, administrative burdens related to research, management and monitoring of assets delivered by SB264 would be minimal.

The Cultural Affairs Department provided the following:

> The bill requires administration by the State Library, and authorizes a 5 percent distribution to DCA for delivery of specialized services to rural libraries, which includes administrative services. Expertise to administer grants exists at the State Library, which currently administers the State Grants in Aid for Public Libraries program. Passage of the bill would require minimal additional staff hours, estimated at 100 hours per year.

**OTHER SUBSTANTIVE ISSUES**

The State Investment Council provided the following:

> The SIC takes the position that endowment funds are not only a valuable resource to protect future assets and provide intergenerational equity, but also serve a key role in efficiently delivering consistent funding streams today, while also acting as a revenue generating engine to benefit current and future generations.

**ALTERNATIVES**

The State Investment Council provided the following:

> A distribution rate based on a five-year rolling average like the STPF and LGPF may provide a more stable long-term distribution, to be driven by the value of the fund, rather than one-year or multi-year market trends. Initial years leading up to a five-year average fund value could be tempered by smaller distribution rates or acceptance of $0 years to help protect and grow the corpus initially.

The Cultural Affairs Department provided the following:

> No other alternatives have been identified to address lack of sustainable funding for small rural libraries and nonprofit libraries in unincorporated areas.

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

Rural libraries in New Mexico, and all of the potential benefits they provide to the state, will continue to be challenged for a dedicated funding mechanism.

The Cultural Affairs Department provided the following:

> Libraries that have the capacity to grow and become more effective if given stronger funding will continue to maintain minimal services. Many of the libraries named in the Bill may struggle to maintain services long term and some may close.

JM/al