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

ORIGINAL DATE 3/7/19

SPONSOR Cervantes **LAST UPDATED** **HB**

SHORT TITLE School Fund Distribution for More Hours, CA **SJR** 18

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
$0.0	$0.0	$0.0	($147,837.3)	($156,049.2)	Recurring	Permanent School Fund (portion of LGPF)
$0.0	$0.0	$0.0	$147,837.3	$156,049.2	Recurring	General Fund (public schools)

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total			$50.0	$50.0	Nonrecurring	Election Fund

Parenthesis ( ) indicate expenditure decreases

Companion to SB 554. Conflicts with HJR 1.

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)
New Mexico Attorney General (NMAG)
State Land Office (SLO)

Responses Not Received From
Public Education Department (PED)

SUMMARY

Senate Joint Resolution 18 seeks to amend Article XII, Section 7 of the State Constitution to provide an additional 1 percent annual distribution from the Permanent School Fund – the largest component of the Land Grant Permanent Fund (LGPF) – for the purposes of increasing the instructional hours and days the state provides to its public school students as provided by law.

This would bring the total distribution from the permanent school fund to 6 percent (up from 5 percent), while the distribution from the other LGPF beneficiaries will continue to be 5 percent. The additional distribution would be automatically suspended should the 5-year-average value of the LGPF fall below $10 billion, or by a three-fifths vote of the state House and Senate.

There is no effective date of this joint resolution. It is assumed the bill would become effective upon approval by voters of the proposed constitutional amendment.

FISCAL IMPLICATIONS

State Investment Council (SIC) staff estimate this bill would in an additional distribution of about $147 million from the permanent school from to the General Fund in the first year. This additional revenue would continue into perpetuity, as the joint resolution does not contain a sunset provision.

Due to the expectation of significant inflows into the permanent fund from oil and natural gas royalties, SIC staff expect the permanent fund to grow on a real dollar basis despite the additional 1 percent distribution. Similarly, analysis by the State Land Office (SLO) indicates the additional distribution would not diminish the corpus of the fund, which SLO defines as the sum of all the inflation-adjusted royalty contributions from state trust lands since the inception of the fund. However, there are opportunity costs that result from lost investment dividends and the impact diminished compounding interest. Increasing the distribution rate results in more general fund revenue in the short term, but reduces the total value of the fund. Doing so, limits the fund's ability to grow over time and reduces the general fund distributions in the long term.

According to SIC staff analysis of this proposal, the additional benefits of the 6 percent distribution rate would continue to outpace benefits of a 5 percent distribution rate fund until about 2051, at which point, 30-years into the new distributions, the larger 5 percent fund would produce more dollars in annual distributions than the 6 percent fund, due to its smaller fund value. This analysis assumes passage of the constitutional amendment by voters in the next general election with new distributions beginning in FY22, a net investment return of 6.8 percent, annual inflows from oil and gas royalties starting at $700 million and growing moderately over time.

SIC notes this proposal is difficult to model, as it only distributes an additional 1 percent from a portion of the LGPF (the permanent school fund) rather than from the entire LGPF. Currently, the permanent school fund represents about 85 percent of the LGPF. However, as additional dollars are removed from the LGPF a greater rate for the permanent school fund portion of the fund, the public school's ownership of the LGPF will shrink accordingly. SIC staff estimate that after the first dozen years of implementation, the public school's share of the LGPF will shrink to about 79 percent.

The impact of an additional 1 percent distribution of the permanent fund can also be swayed substantially by investment returns and annual revenue inflows to the permanent fund, which are driven primarily by oil and gas royalties. Put simply, higher oil and gas inflows to the LGPF and higher than expected investment returns significantly help mitigate the long-term effects of spending additional investment earnings through an increased drawdown. However, the opposite holds true as well, where depressed oil and gas prices, coupled with lower investment returns (which many predict over the next decade), and a higher spending rate have a much greater potential to negatively impact the health and growth of the endowment long-term.

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

Tradeoffs and the "Tipping Point". Within 30 years of the amendment's approval, the distribution amount generated from a 6 percent distribution from a smaller fund will be less than the distribution amount generated from 5 percent of a larger fund.

The 2003 amendment to the LGPF permanently increased the LGPF distribution from 4.7 percent to 5 percent, and temporarily increased it to 5.8 percent from FY06-FY12 and 5.5 percent from FY13-FY16. If the 2003 amendment to LGPF were never passed, the fund would have been $1.5 billion greater in FY18. For CY17 an additional $1.5 billion would have generated another $223 million in net earnings for the fund. By 2017, distributions to the general fund were smaller than they would have been if the 2003 amendment had never occurred. If the distribution had never increased from 4.7 percent, the annual general fund distribution would have been about $20 million higher in FY17 and $25 million higher in FY18. The timeframe of this tipping point was accurately predicted in the original FIR for this legislation (SJR6, 2013).

SIC staff note the key question for policymakers comes down to whether the added cost over the long-run is an appropriate and attractive trade-off for the added benefits of this amendment is expected deliver to New Mexico's education system over the next 30 years. A secondary, but also important question is whether there are other existing avenues to fund these education initiatives, while also protecting and growing the existing hundreds of millions of dollars in benefits the LGPF already delivers annually to New Mexico schools.

Increasing Instructional Time. The 2018 LFC program evaluation, *Instructional Time and Extended Learning Opportunities*, found extending the school year can be an effective strategy in closing learning achievement gaps. Many New Mexico students enter kindergarten behind grade level and lose ground in learning over summer breaks. By third grade, low-income students, on average, perform below grade level. National research has found that low income students face a 6,000-hour learning gap by the sixth grade, compared to their middle- and high-income peers, who are more likely to have access to high-quality learning opportunities outside of school. This learning gap especially impacts students who are considered at-risk, which includes 70 percent of New Mexico public school students. At the same time, students in the state now have fewer instructional days than they had a decade ago.

Additionally, the report found additional instructional time will not necessarily improve outcomes without high-quality instruction, delivered by effective teachers who engage in professional development, collaboration, and planning. The amount, content, and strategies for professional development vary significantly across LEAs. Overall, school districts have an average of seven non-instructional days for teachers, as well as time built into the school day, and many supplement this time with early release days for professional development.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This proposal is a companion to SB 554, which extends the school year as follows:

- Kindergarten: for half day programs from two and one-half hours per day or 450 hours per year to at least 500 hours in 200 instructional days. For full-day programs, from five and one-half hours per day and 990 hours per year to at least 1,100 hours in 200 instructional days.
- Grades 1 through 6: from five and one-half hours per day or 990 hours per year to 1,100 hours in 200 instructional days.
- Grades 7 through 12: from six hours per day or 1,080 hours per year to 1,200 hours in 200 instructional days.

Conflicts with House Joint Resolution 1, which increased the distribution of the entire LGPF to 6 percent.

TECHNICAL ISSUES

The amendment retains an automatic asset value "safety valve" intended to protect the corpus should its 5-year average value fall below $10 billion at calendar-end of any given year. This is currently in the Constitution and is not changed by this proposal.

The structure of the LGPF constitutional distribution formula uses a 5-year fund average with the intention of steadying the revenue stream for legislators to plan around, and to minimize the year-over-year volatility investment markets often bring. Unfortunately, a side effect of this "smoothing effect" also largely renders the "safety valve" concept ineffective. For example, the value of the LGPF actually went down in CY2018, but due to growth in the previous 4-years, the LGPF will deliver an additional $41 million to its beneficiaries in FY2020.

Similarly, the fund could sustain a loss of 50 percent the next two years in a row, and still not cross the $10 billion fund average threshold, though the fund corpus itself would only be $4.2 billion at that point. It is for this reason that this element, already in the Constitution, should not be viewed as effective at current valuations, and why it is critical to retain the ability of three-fifths of the legislature to vote a temporary stoppage of additional distributions should the fund be endangered.

OTHER SUBSTANTIVE ISSUES

New Mexico is one of a handful of states with a sovereign wealth fund or permanent endowment like the LGPF. Speaking generally, these funds have a wide variety of spending policies, which can sometimes vary due to fund inflows, investment returns or direction of a governing body. For example, Alaska's sovereign wealth fund has distributions near 5 percent, but can be impacted by annual fund cash flows. Wyoming also has a distribution around 5 percent, but the rate can vary, depending on its individual funds and each fund's long-term purpose (much like the 5 percent LGPF varies from the 4.7 percent STPF). Texas recently increased its fund distribution rate from 3.3 percent to 3.7 percent, while also creating new "rainy day" and "closing" funds for attracting business to their state. North Dakota, which only recently established its new Legacy Fund through an oil and gas boom, is basing distributions on fund earnings equivalent to 5.3 percent of the fund this year. Montana on the other hand, which invests very conservatively and receives most of its sovereign wealth inflows from natural resource revenues other than lucrative oil & gas, only distributes 2.2 percent of its fund.

University endowments, which like the LGPF employ the same strategy of using time and compounding effects to grow wealth, have generally seen increases in their spending policies recently in the wake of the multi-year equities bull-market and valuation growth. According to the National Association of College and University Business Officers (NACUBO) and its poll of more than 700 college endowments, the average distribution rate is 4.4 percent. However, university endowments of $1B or more have an average spending policy of 4.8 percent in the most recent data.

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