LFC Hearing Brief

NEW MEXICO LEGISLATIVE FINANCE COMMITTEE

AGENCY: LFC Staff

DATE: December 12, 2018

PURPOSE OF HEARING: 2019 Capacity and Capital Requests

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EXPECTED OUTCOME: Informational

New Mexico is seeing unprecedented general fund revenues from oil and gas activity, but policymakers are familiar with this industry's volatility and the risk that poses to recurring revenues. Focused, one-time investments are a highly beneficial use of this funding that can encourage long-term economic development, improve New Mexicans' quality of life, and maintain existing state assets that continue to deteriorate due to limited capital project funding in recent years. New Mexicans continue to prioritize infrastructure, with all 2018 general obligation issues passing with significant support and a recent poll showing residents rank investing in roads and other infrastructure below only education and criminal justice.

While infrastructure spending is vital, New Mexico's capital outlay process is inefficient and unique among the states in earmarking funding for individual lawmakers to allocate. Efforts to improve the process for selecting and funding local capital outlay projects have been largely unsuccessful. Without legislative changes, the process continues to divert funding away from critical needs at state-owned facilities. The lack of procedures to ensure projects are adequately planned and funded means communities' deficient roads and water systems linger and conditions at state facilities continue to pose risk to clients, creating a liability for the state.

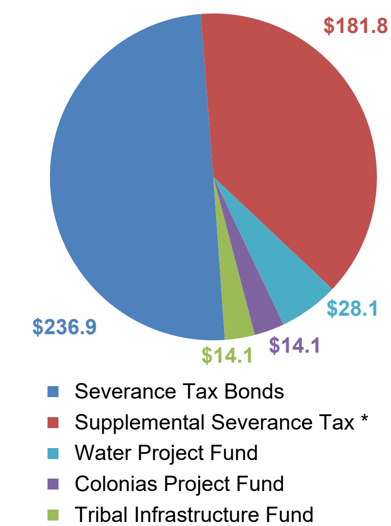
Capital Outlay

2019 Capital Funding Outlook

As detailed in *Volume III*, early revenue projections indicate net senior severance tax bonding (STB) capacity, debt repaid with taxes on oil, gas, and mineral production, is approximately $236.9 million. Earmarked funds for water infrastructure, colonias, and tribal infrastructure total $56.2 million, 18 percent of senior STB capacity, with $28.1 million for the water project fund and $14.1 million each for the colonias and tribal infrastructure funds. The supplemental STB, or "sponge bond," issuance dedicated for public school construction is expected to be about $181.8 million in 2019. Pursuant to legislation passed during the October 2016 special session, the Legislature may appropriate up to $25 million of this capacity for transportation or instructional materials. The final capacity estimates will be released by the State Board of Finance (BOF) on January 15, 2019.

The significant surge in revenues creates the financial opportunity to directly pay for capital outlay projects with general fund appropriations rather than to borrow through bonding. At a time when the state is flush with money, the ability to pay for these projects in cash generates long-term savings for the state by eliminating the cost of interest, the rates of which continue to increase. Rather than being used for debt service, the severance tax revenue could be transferred into the severance tax permanent fund over a 10-year period, increasing the size of the fund and thereby increasing earnings and transfers to the general fund in future years. To allow these savings to flow into the severance tax permanent fund, BOF and

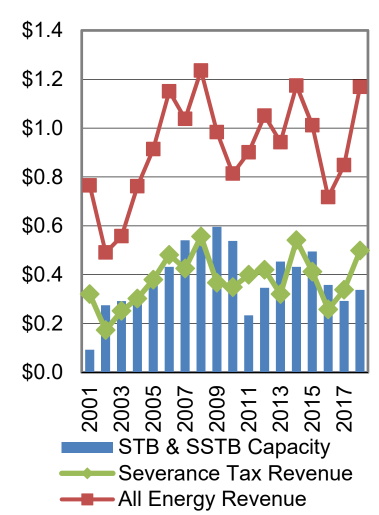
Capital Outlay Bonding Capacity for 2019
(in millions)



* For public school construction

Based on December 2018 Revenue Estimates
Source: LFC

STB Capacity and Energy Revenues
(in billions)



Source: LFC, TRD, BOF

LFC Staff Site Visits 2018

- Child Wellness Center (in construction) (Albuquerque)
- CYFD San Mateo and Lamberton facilities (Albuquerque)
- New Mexico Behavioral Health Institute (Las Vegas)
- Fort Bayard Medical Center (Santa Clara)
- New Mexico State University—main campus (Las Cruces), Grants branch, and Carlsbad branch
- UNM Los Alamos (Los Alamos)
- Western New Mexico University (Silver City)
- Western New Mexico Correctional Facility (Grants)
- Springer Correctional Center (Springer)
- Central New Mexico Correctional Facility (Los Lunas)
- New Mexico State Veterans' Home (Truth or Consequences)
- Sierra Vista Hospital (Truth or Consequences)
- Zuni Middle School and teacherages (Zuni)
- DCA Bookmobile (Rociada, Guadalupita, and Mora)

Water Infrastructure Oversight 2014 to 2017

In 2014, the Environment Department (NMED) formed a Water Infrastructure Team, with participation from state, federal, and local entities. The team developed a unified asset management plan and a checklist for technical assistance for local governments. NMED offered services to small water systems and disbursed a compiled list of contacts and sources of available funds to leverage for water projects. While NMED developed a survey of unmet needs, it has not been updated since 2017 and the Water Infrastructure Team did not meet in 2018.

Status of 2014 "Year of Water" Projects

Of $83.5 million appropriated for 191 projects, 16 projects remain active in 2018 with balances totaling $6.5 million. The Legislature appropriated $10 million to improve and expand Bradner Dam; the project has a balance of $2.2 million and is set to complete in 2019.

legislative staff will need to work together to adjust statutory language regarding the calculations for the transfers and for future bonding capacity.

Summary - No Senior STB Capacity Issued in 2019 ($millions)

Senior STB Capacity: $312.2 STPF Annual Impact: $23.0

FY	STPF - Fund Size			Distribution to General Fund		
	With STB	Without STB	Difference	With STB	Without STB	Difference
FY19	$5,691.2	$5,691.2	$0.0	$220.6	$220.6	$0.0
FY20	$5,827.1	$5,850.1	$23.0	$229.8	$229.8	$0.0
FY21	$6,001.8	$6,049.0	$47.2	$239.2	$239.2	$0.0
FY22	$6,159.6	$6,231.9	$72.3	$251.3	$251.6	$0.2
FY23	$6,314.0	$6,412.3	$98.3	$263.9	$264.5	$0.7
FY24	$6,395.4	$6,520.3	$124.9	$273.7	$275.1	$1.3
FY25	$6,473.9	$6,625.8	$151.9	$281.9	$284.2	$2.3
FY26	$6,550.4	$6,729.6	$179.2	$288.6	$292.0	$3.4
FY27	$6,625.4	$6,832.3	$206.8	$294.6	$299.3	$4.6
FY28	$6,699.9	$6,934.5	$234.7	$299.8	$305.7	$5.9
FY29	$6,774.4	$7,037.1	$262.8	$304.2	$311.3	$7.2
FY30	$7,005.0	$7,278.1	$273.0	$307.8	$316.2	$8.4

Cumulative Difference

By FY	General Fund	STPF
FY24	$2.2	$98.3
FY30	$34.0	$273.0

Source: LFC

Capital Outlay Reform

Given the volatility of severance tax revenue and the inability of available capital outlay funding to meet all of the state's infrastructure needs, legislators and the executive branch continue to scrutinize the vast amounts of unexpended appropriations and large number of projects that remain inactive. Poor project selection (including insufficient planning, a piecemeal approach to funding, and unknown construction costs) continues to delay project completion. These problems should compel policymakers to carefully distinguish future project funding by priority, readiness to proceed, need, public purpose, and merit.

Over the years, proposals have taken aim at developing an efficient process for planning, prioritizing, and funding capital outlay projects. Proposed reforms include defining the process of selecting and funding projects, clarifying the definitions and limitations on what projects are eligible for capital outlay appropriations, improving how the state monitors projects and ensures they are successfully completed, and increasing transparency by identifying which legislators fund each project included in capital outlay legislation.

Prioritization. To assess proposed capital projects, the federal Government Accountability Office recommends quantitatively assessing needs and evaluating alternatives. While some of New Mexico's local governments, state agencies, and higher education institutions have implemented scoring systems, there is no requirement to do so and project priorities and requests often change from year to year.

The Department of Finance and Administration (DFA), Aging and Long-Term Services Department, and Public School Capital Outlay Council use scoring systems based on consistent criteria. Examples of the factors used in project scoring include criticality of need, benefits to public health and safety, readiness to proceed, feasibility, cost-benefit, potential to leverage other funding sources, and opportunity for operational cost-savings. Agencies and local governments should adopt similar scoring practices to improve their infrastructure capital improvement plans (ICIP) — documents submitted annually that outline a five-year capital plan.

Although agencies and local governments submit ICIPs, funding is not always awarded in accordance with these priorities, and in some cases projects not included on ICIPs are funded while higher priority projects are neglected. The Indian Affairs Department requires projects receiving tribal infrastructure fund awards appear on the applying entity's ICIP. A similar requirement for projects funded by the Legislature would ensure funding corresponds with agency and local government priorities; alternatively, inclusion on an ICIP could be considered as a component of a project's overall score without automatic disqualification.

Minimum Funding Amount. Projects receiving less than $10 thousand are slower to spend state funds. The Legislature should consider a $50 thousand minimum level for projects funded from capital outlay, unless a lesser amount is needed to complete a project. Larger projects are more likely to realize savings to state and local governments, provide for completion of projects in a timely manner, streamline state and local administrative efforts, and ensure projects fulfill a need in the community.

Grantee Accountability. To ensure state capital outlay funds are awarded to entities that will be good stewards of taxpayer money, the request evaluation process should consider entities' history with prior awards. Federal law and state capital outlay legislation require 5 percent of funds to be encumbered within six months of the bond sale and 85 percent to be expended within three years, but many grantees fail to meet these requirements. Entities that consistently fail to meet legislative requirements and do not demonstrate they have taken steps to ensure future compliance should not receive new awards.

Boilerplate Language. In 2016, recognizing the inadequacies of the capital outlay process, representatives of the New Mexico Association of Counties and the New Mexico Municipal League and staff of the executive and legislative branches reviewed and developed administrative improvements. The group proposed changes to the "boilerplate" introductory language of the capital outlay bill to improve the timeliness of bond proceed expenditure, encourage compliance with the State Audit Act, and reduce the number of capital assets that sit unfinished as a result of insufficient funding.

Funding Requests and Considerations

State agency priority capital requests total nearly $641 million, including $103 million from higher education institutions. Critical projects impacting public health and safety continue to be a priority, but other patterns have emerged in the FY20 requests that should be considered.

In the past year, planned and ongoing projects have been affected by rising construction costs and must reduce scope or obtain additional funds to complete. More institutions and agencies have explored public-private partnerships, such as energy service performance contracting, to help finance their facilities. Issues at existing facilities have led to a renewed focus on careful planning and feasibility studies, while concerns over efficient space utilization and the cost of maintaining underutilized facilities has led more agencies and institutions to consider demolition. Finally, concerns over student security at both public schools and higher education institutions have prompted both to focus on physical access control, but in very different ways.

Capitol Buildings Planning Commission

The Capitol Buildings Planning Commission (CBPC) convened for three meetings in 2018. The committee heard testimony from the General Services Department (GSD) on the proposed acquisition of a facility for the Children, Youth and Families Department for a child wellness center in Bernalillo County. Laws 2018, Chapter 66, (Senate Bill 193) authorized the New Mexico Finance Authority to issue $20 million of state office building revenue bonds to plan, design, acquire, construct, renovate, equip, and furnish a building in Bernalillo County. The purchase aligned with the strategic plan developed in the Albuquerque master plan commissioned by the CBPC with Architectural Research Consultants, Inc. (ARC) in 2017.

The commission further discussed a memorandum of understanding among the Department of Health, GSD, and the Legislative Council Service (LCS) to facilitate master planning services. The funding was vetoed in FY18 and FY19, but with LCS funding ARC continued to perform minimal services, including master planning and maintenance of the statewide inventory database.

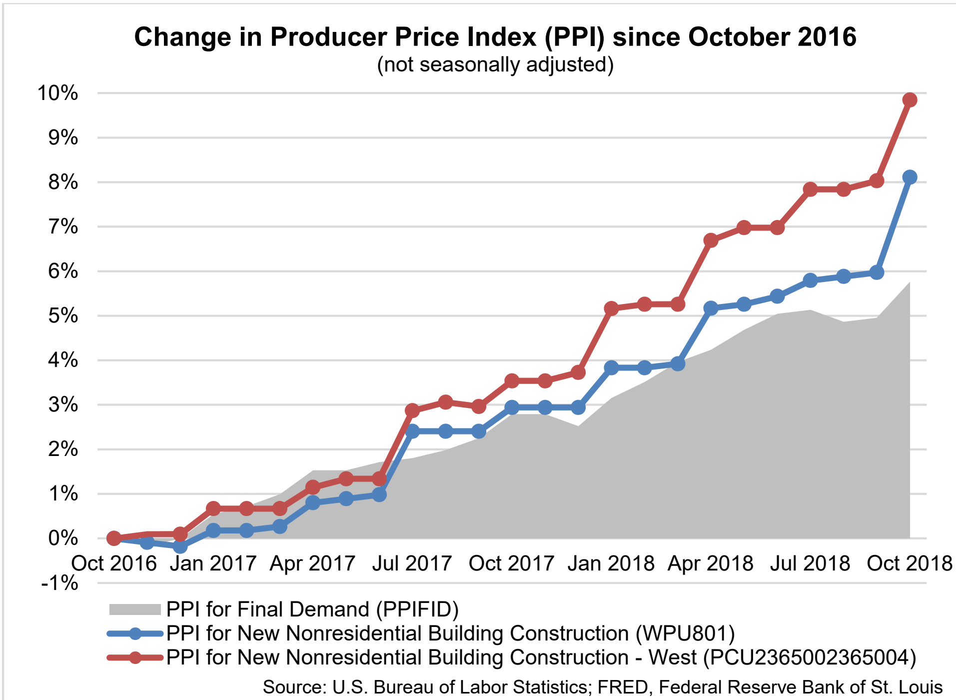
CBPC members were updated on the proposed legislation regarding a comprehensive approach for the disposition of property. However, no conclusion was reached, and the commission will discuss the legislation at their January 2019 meeting.

Department of Public Safety Evidence & Crime Lab

DPS requested $27 million to complete design and construction of its renovated and expanded evidence records storage facility and crime lab. The current evidence vaults and record storage are at capacity and the current crime lab is insufficient to support increased caseloads.

The following section outlines how these factors impact agency FY20 requests. Other significant capital outlay requests are highlighted in the sidebars.

Rising Construction Costs. Increasing materials and labor costs have significantly impacted state agency and local capital improvement projects. The U.S. Bureau of Labor Statistics' producer price index (PPI) measures the average change over time in selling prices received by domestic producers of goods and services. Since October 2016, PPI for final demand, not seasonally adjusted, has increased 5.8 percent, but construction costs have significantly outpaced this growth. Over the same period, the PPI for new nonresidential building construction, which measures the price contractors say they would charge to build a fixed set of buildings, increased by 8 percent, and the PPI for new nonresidential construction in the West increased even more, by 9.8 percent.



A significant portion of the growth in construction costs has occurred in FY18 and FY19, with the PPIs for new nonresidential construction nationally and in the West rising 5.5 percent and 6.8 percent, respectively, since July 2017.

The Department of Health (DOH) requested $1.9 million to address rising construction costs: $1.5 million for construction of the third phase of the Meadows building at the Behavioral Health Institute and $400 thousand to build the new Vital Records and Health Statistics Bureau facility. Similarly, bids for New Mexico Highlands University's (NMHU) Rodgers' Hall Administration Building renovation exceeded the project's budget by $1 million; NMHU requested this amount to complete the project.

Public-Private Partnerships. During the 2018 interim, LFC worked to develop policy on the use of public-private partnerships (P3) in state capital projects. P3 infrastructure projects require a transfer of risk and assets between partners. These agreements can be complex, outlining capital commitments and ongoing financing, operations, and maintenance obligations. While P3s may be helpful to New Mexico in addressing our infrastructure deficit, the policy surrounding them must be thoroughly vetted.

Child Wellness Center

The Children, Youth and Families Department (CYFD) requested $29.4 million to complete the new child wellness center in Albuquerque. Prior to selecting a facility, initial analysis reported to the Capital Buildings Planning Commission showed a total project cost of $29 million. This request brings the total cost for the wellness center to almost $50 million.

Completion of the project will provide office space for all CYFD's Albuquerque staff and will result in $3 million in annual lease savings as well as providing an additional 28,000 square feet of renovated space that could be utilized by another state agency. request.

Child Wellness Center Lease Savings

Facility	Square Feet	Lease Cost
San Mateo	78,216	$1,892,653
Lamberton	40,498	$1,080,883
Total	**118,714**	**$2,973,536**

Source: Capital Buildings Planning Commission

Senior Center Requests

In 2018, the Aging and Long-Term Services Department (ALTSD) received capital outlay requests totaling $28.6 million from senior center programs in 25 counties statewide. Based on a formal application process, review of the applications, site visits, and input from the area agencies on aging, ALTSD and DFA recommended $3.9 million, including $2.3 million for construction and renovation projects and $1 million for vehicles.

Criteria and Assigned Points for Prioritizing Senior Citizen Projects (120 Points Possible)

- Narrative summary and background (10 points)
- Critical need (40 points)
- Matching funds (20 points)
- Readiness to proceed (20 points)
- Project oversight (10 points)
- Project management (20 points)

One type of P3 agreement commonly used by state agencies and higher education institutions is energy service performance contracts (ESPC). ESPCs allow public entities to pledge guaranteed future utility savings to cover the cost of a capital improvement project. Energy services companies (ESCO), which are qualified by the Energy, Minerals and Natural Resources Department (EMNRD), provide upfront capital costs in return for these savings. Lighting and HVAC are some of the most efficient uses of ESPCs and can be bundled with other projects that alone would have lower savings and a longer payback period.

Higher education institutions and state agencies have engaged in investment grade audits (IGA), during which ESCOs conduct assessments of existing infrastructure to identify capital investments that could result in utility savings. In November 2018, the General Services Department's Facilities Maintenance Division (FMD) completed an IGA of all the buildings it maintains in Santa Fe, which identified about $20 million in capital projects that could be funded in this manner. Eastern New Mexico University completed an IGA for its main campus in August 2016, which identified approximately $4.5 million of capital projects that could be funded through an ESPC, and is in the process of conducting an IGA at its Roswell campus, which it expects to complete by the end of 2019. The state veterans' home in Truth or Consequences is also working with an ESCO to conduct an IGA, which it expects to complete in February 2019.

ESPCs can also be used to partially fund larger projects, like the Department of Workforce Solutions' Tiwa administration building rehabilitation and remodel. The department anticipates funding about $4.5 million of the estimated $19.8 million renovation through an ESPC, lowering the department's FY20 capital request to $12 million.

More broadly, P3 agreements have been used throughout the country with mixed results. While ESPCs are governed by statute and overseen by either EMNRD or the New Mexico Finance Authority, New Mexico has also used various other forms of P3 agreements for public facilities and infrastructure but lacks a strong statutory framework to guide these complex arrangements. A reasonable legal structure would benefit the entire state, including local governments and state agencies.

Planning and Feasibility. Careful planning is essential to ensure successful projects, especially in light of rising costs and more complex financing arrangements (such as P3s) that can be employed to support state facilities. The General Services Department (GSD) requested $500 thousand in FY20 for statewide master planning, which includes consideration of how ESPCs can best be used to support state facilities and capital projects. GSD's ongoing facility condition assessments (included in *Volume III*) provide a good basis for such analysis.

DOH recently began a master planning process that will cover its Los Lunas campus, Fort Bayard, and the Behavioral Health Institute. DOH expects to complete the master plans by the end of FY19.

In 2018, the Legislature appropriated $200 thousand to the Corrections Department (NMCD) to develop a statewide correctional facility master plan. While there is some interest in using these funds to plan a new correctional facility, according to the agency this would require $500 thousand. For FY20, NMCD requested $52 million for capital outlay projects statewide, including fire alarm and suppression systems, security upgrades, electrical upgrades, HVAC, and roofing; overall, the department estimates it has $262 million in deferred maintenance.

New Mexico Department of Agriculture

Drain Rot and Settlement at NMDA

NMDA requested $14 million to repair, replace, construct, and renovate its facility on the New Mexico State University campus. The facility is in urgent need of remediation to address life and safety risks, which include major roof leaks and cracks in load-bearing walls caused by foundation settlement. In addition to addressing these concerns, the project will separate the petroleum and chemistry labs (the proximity of which poses a serious safety risk), update the HVAC system to meet current usage, code compliance, and accreditation requirements, and install fire separation walls and a fire sprinkler system.

General Services Department Statewide Repairs

NMBHI La Planta Building

GSD requested $10.6 million for statewide deficiency, preventative, and emergency repairs, including $4.7 million for fire protection, $3.3 million for building shells and roofs, and $1 million for other emergencies.

Los Lunas Campus Cottage Bathroom

Department of Cultural Affairs

Corroded and Leaking Chiller at National Hispanic Cultural Center

DCA requested almost $18.3 million for critical repairs, structural stabilization, preservation, lifecycle repairs, and revenue generation projects statewide. The request included $2.5 million for the interior renovations to the New Mexico Museum of Art Vladem Contemporary in Santa Fe. DCA also submitted a $3.5 million special appropriation request for this project. Overall, DCA estimates the project will cost $16.3 million.

Corrections Department Facilities

Local FY20 Requests
Top 5 Priorities by Category
(estimated project costs)

Category	Requested Amount
Water	$426,217,584
Transportation	$367,330,426
Quality of Life	$196,091,421
Public Safety	$32,921,953
Environment	$29,940,477
Housing	$25,306,795
Health	$24,675,948
Econ. Development	$895,000
Facilities - Other	$99,737,145
Equipment - Other	$13,427,138
Other	$22,030,256
Total	**$1,238,574,143**

Source: DFA-Local Government Division

Staffing difficulties and facility age pose persistent difficulties for the State Veterans' Home in Truth or Consequences, and some concerns exist about whether the home's location is best suited to serve the state's veteran population. The LFC recommendation for special appropriations, also included in *Volume III*, includes $300 thousand to complete a feasibility study for a new veterans' home.

The need for careful facility planning is also reflected in public schools. In the most recent awards cycle, the Public School Capital Outlay Council provided funding for nine feasibility and utilization studies and postponed decisions on ten construction awards pending completion of these studies.

Space Utilization and Demolition. Efficient utilization of space in state-owned buildings continues to be a priority. Un- and under-utilized facilities continue to generate maintenance and utility costs while providing little value to the state. Unutilized facilities that are in poor condition and cannot be repurposed should be demolished to avoid these costs.

New Mexico State University requested $1.6 million in FY20 to fund demolition of buildings on its main campus. The institution's top priority for demolition is its Regents Row building, which was built in 1962 and costs the university $675 thousand annually to maintain. GSD requested $4.4 million for decommissioning and demolition statewide, including $1.2 million for cottages at the Behavioral Health Institute and $1.7 million for facilities at DOH's Los Lunas campus.

Student Safety and Security. New Mexico Institute of Mining and Technology (NMIMT), New Mexico State University – Doña Ana Community College (NMSU-DACC), and Western New Mexico University (WNMU) each requested funds for electronic key systems totaling almost $4.2 million. Central New Mexico Community College (CNM) is currently implementing a campuswide access control project focusing on electronic key locks, which it expects to complete in June 2019. The total cost of the project is anticipated to be $7.5 million, which CNM is funding through local general obligation bonds.

The institutions requesting funding all cited student security as a primary purpose of the project. Public schools also focused on student security and access control this year; however, those projects generally involved more significant facility changes, such as adding fencing, security vestibules, and stronger windows.

Local Government and Tribal Entities. According to ICIP compiled by DFA's Local Government Division, the five highest priorities for local and tribal governments and other political subdivisions total $1.2 billion. The most funding was requested for water projects, transportation projects, and quality of life projects (including projects at libraries, museums, and senior centers). A listing of the top five priorities for all governmental entities participating in ICIP is available through LFC or LGD.

In an effort to streamline the reimbursement process and improve project reporting, LGD revised its intergovernmental grant agreement (IGA) and payment request forms for local capital outlay projects in 2018, eliminating paper reporting and notary requirements.

Unexpended Funds

As of September 2018, approximately $712.7 million from all funding sources for 1,750 projects remains outstanding, including $83.1 million of earmarked fund balances for water ($34.6 million), colonias ($23.7 million), and tribal ($24.8 million) infrastructure projects. Balances for projects funded for $1 million or more were $603.4 million for 156 projects, or 84.7 percent of all unexpended balances.

Local projects make up $127.5 million, or 17.9 percent, of outstanding balances, with 1,189 projects active as of September 2018. Balances for local projects funded between $300 thousand and $1 million were $27.4 million for 92 projects, or 3.8 percent of all unexpended balances.

2009-2018 Capital Outlay All Fund Sources "Outstanding" Projects Only
(in millions)

Year	Number of Projects	Amount Appropriated	Amount Expended	Amount Unexpended	Percent Expended for Year
2009	1	$10.0	$9.5	$0.5	94.5%
2014	6	$7.2	$2.4	$4.7	34.0%
2015	354	$190.0	$105.2	$84.9	55.3%
2016	472	$356.6	$117.2	$239.4	32.9%
2017	109	$29.6	$4.8	$24.8	16.3%
2018	808	$374.6	$16.2	$358.4	4.3%
Total	**1750**	**$967.9**	**$255.3**	**$712.7**	**26.4%**

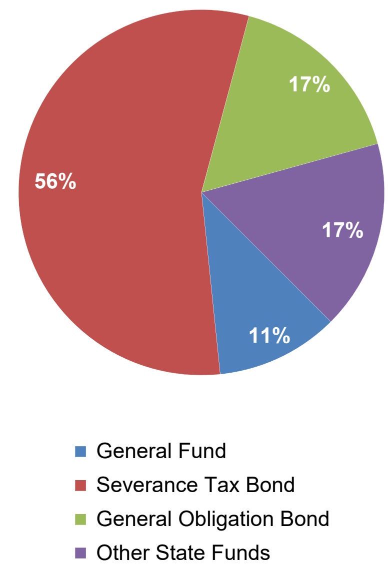
Note: Data includes projects for water, colonias, and tribal earmarked funds; 2009 balances are for Indian water rights matching funds.

Source: Capital Projects Monitoring System

Authorized but Unissued Bonds

Following the June 2018 bond sale, 60 projects authorized for $18.3 million remain unissued, including $11.5 million from a 2016 appropriation to the local economic development fund and 59 projects authorized in 2018. The June sale included five projects totaling $319.8 thousand that were removed from the March 2018 authorized but unissued list; bonds were sold for two of these projects but three others are now expired after the certification deadline passed at the end of FY18.

Percent of Unexpended Capital Balances by Fund 2009-2018



Data as of September 2018
Source: LFC

Senior Severance Tax Bonds Earmarked Funds 2013-2018
(in millions)

Fund	Projects Awarded	Amount	Balance
Water	123	$133.1	$34.6
Colonias	151	$71.0	$23.7
Tribal	118	$71.3	$24.8
Total	**392**	**$275.4**	**$83.1**

Data as of September 2018
Source: Capital Projects Monitoring System

Status of Projects Greater than $1 Million

G	Project on schedule	98
Y	Behind schedule or little activity	32
R	No activity or bonds not sold	20
Total Active Projects		**150**
Other report information:		
B	Appropriation expended or project complete	6

Data as of September 2018
Source: LFC