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FISCAL IMPACT REPORT

ORIGINAL DATE 02/26/13

SPONSOR Moores LAST UPDATED 02/28/13 HB _____

SHORT TITLE Control Over NMFA Operations SB 531

ANALYST Daly

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY13	FY14	FY15	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	\$8,700.0*	\$65.0*	\$65.0*	\$8,830.0*	\$8,700.0 Nonrecurring; \$65.0 Recurring	NMFA Operating Funds

(Parenthesis () Indicate Expenditure Decreases)

*See Fiscal Implications

Relates to SB 12

SOURCES OF INFORMATION

LFC Files

Responses Received From

Attorney General's Office (AGO)

Department of Finance and Administration (DFA)

New Mexico Finance Authority (NMFA)

SUMMARY

Synopsis of Bill

Senate Bill 531 shifts budgetary and financial control for the operations of the New Mexico Finance Authority (NMFA or Finance Authority) from the NMFA to the Department of Finance and Administration (DFA). The NMFA budget process is placed under the supervision and control of the state budget division of the DFA, which requires the NMFA, like all executive agencies, to annually submit its proposed budget to the DFA for approval. The NMFA is made subject to the provisions of the Accountability in Government Act, including developing and reporting on performance measures and participating in performance-based budgeting. It is also added to the list of state agencies or other state entities for which the financial control division of the DFA formulates, approves, controls and sets standards for accounting methods and procedures. SB 531 mandates that the financial systems of the NMFA be integrated into the statewide accounting system network (SHARE) administered by the DFA by July 1, 2013. It

also requires warrants drawing monies from rural county cancer treatment fund and the metropolitan court bond guarantee fund be signed by the secretary of the DFA pursuant to vouchers signed by the NMFA's chief executive officer or that officer's designee.

The NMFA is made subject to the provisions of the Procurement Code, although it is excluded from procuring through the state purchasing agent.

In light of these changes, the New Mexico Finance Authority Act (the Act) is amended to provide that other laws (such as those being amended in this bill to bring the NMFA within their scope) may limit its powers and subject the NMFA to the supervision and control of other agencies of the state.

The bill contains a temporary provision allowing the secretary of the DFA to delay implementation of any provision of SB 531 if the secretary determines, in consultation with the NMFA, that such implementation would unconstitutionally impair the NMFA's existing agreements with bondholders. The secretary shall report any delay to the New Mexico Finance Authority Oversight Committee.

FISCAL IMPLICATIONS

The NMFA reports it would likely be faced with significant additional costs in order to transition to SHARE, the central accounting system of the state. The Oracle-based SHARE system does not include a module for loan servicing or accounts receivable. The 'treasury' module is available in SHARE; however the configuration does not provide the compliance and cash management functionality that is required for the trustee and cash investment activity of the Finance Authority. Daily reconciliation is currently performed for this activity. Configuration of the grants module, also existing in SHARE, would be necessary for the maintenance of the grantee accounts and federal activity of the NMFA. Such configuration of the grants module for other agencies has cost in excess of \$1.3 million. The NMFA reports it is difficult to determine a cost for the purchase and configuration of the other modules (treasury, accounts receivable, loan servicing), but it would likely exceed \$7.4 million, the cost of the entire annual operating budget for the Finance Authority. All of these costs total \$8.7 million, which is the number reflected in the Estimated Additional Operating Budget Impact table above for FY 13. The NMFA anticipates that after that transition, it will have continuing costs due to the need for 2 additional FTEs, costing approximately \$65.0 thousand per year, which cost is also reflected in that table for FY 14 and FY 15.

The DFA reports no budgetary impact.

SIGNIFICANT ISSUES

The DFA explains that the current administrative structure of the NMFA does not provide sufficient accountability:

Symptoms of the lack of adequate financial controls include: the preparation and dissemination of a fraudulent audit with the resulting expense of \$1.3 million for a special audit; alleged abuse of expense accounts and car allowances; a general lack of controls including the fact the Act does not require the budget to be approved or adopted by the NMFA governing board. The DFA believes increased

oversight will improve responsibility as well as taxpayers' confidence in the agency.

The DFA believes SB 531 should not impair the NMFA's ability to conduct its operations, as all local government lending and bond issuance activities would proceed as under current law. The proposed changes are administrative in nature and would merely require changes in internal processes at the NMFA. Requiring the NMFA to use the State's central accounting system, SHARE, will improve transparency and accountability.

The DFA notes that under this bill, the NMFA would not be treated as a state agency for the purpose of other laws such as the State Personnel Act, Mileage and Per Diem Act, Public Employees Retirement Act, Retiree Health Care Act, and other laws relating to group benefits of state employees. The State Investment Council and the Public School Facilities Authority are two examples of entities treated as state agencies under some statutes but not others.

The Attorney General's Office (AGO) surmises that the bill is intended to provide oversight of the NMFA's operational budget and accounting, but not infringe on the NMFA's primary function of coordinating, planning and financing state and local capital improvement projects through the issuance of bonds and other funding mechanisms.

The NMFA, on the other hand, raises a number of concerns relating to the changes made in SB 531, as it summarizes as follows:

First it would expose the State to potential liability for payment of Finance Authority bonds, thereby subjecting the State to financial risk and possibly threatening the State's credit rating as a whole. Second, it may undermine rating agency and investor confidence in the Finance Authority's continued ability to pay debt service on its bonds, and to do so timely. Third, certain of the Finance Authority's bond programs which finance State facilities could be jeopardized under New Mexico case law.

1. Potential State Liability for the NMFA Bonds and Impacts on State Credit Rating

As to the NMFA's first concern, the potential State liability for outstanding NMFA bonds, the Finance Authority explains:

The State is currently shielded from liability relating to Finance Authority bonds because of statutory language creating the Finance Authority as a governmental instrumentality separate and apart from the State. Section 6-21-11(B) of the Act provides that all bonds or other obligations issued by the Finance Authority are obligations of the Finance Authority and "shall not create an obligation, debt or liability of the state." That section further provides that the Finance Authority may not "impose a pecuniary liability or a charge upon the general credit or taxing power of the state..." In fact, shielding the State from such liability is the primary purpose of this language. However, the language would not be sufficient to shield the State from liability if in fact the State exercised substantial control over the Finance Authority's operations.

Under current law, the executive department of the State has the power to make appointments to the Finance Authority's Board. The legislative department has the power to modify or repeal statutes under which the Finance Authority operates, and to authorize projects for Finance Authority financing. Neither of these levels of control involves the State in the day-to-day operations of the Finance Authority.

By subjecting the Finance Authority to the State Budget Act and other typical "state agency" laws, both the executive and the legislative branches of the State gain power over the routine operations of the Finance Authority, including power over the portion of the Finance Authority's budget relating to the payment of debt service on Finance Authority bonds. This level of control may breach the legal separation between the State and the Finance Authority required to shield the State itself from liability for the Finance Authority's debt. *See State Office Building Commission v. Trujillo*, 46 N.M. 29 (1941). The Supreme Court held, in that case, that while the legislation creating the State Office Building Commission had stated that the Commission was separate and apart from the State, numerous characteristics of the Commission indicated that it was in fact an agency of the State and that there was no meaningful way to characterize the Commission's debt to finance a State facility as other than an obligation of the State itself. Likewise, the Supreme Court, in a more recent case, stated that where an entity, even a private entity, has so many public attributes, is so controlled and conducted by, or otherwise is so affiliated with the public entity, that, as a matter of fairness, it must be considered the same entity. *See Memorial Medical Center, Inc. v. Tatsch Construction*, 129 N.M. 677, 686-687 (2000). Blurring the distinction between the State and the Finance Authority will result in potential liability to the State.

The NMFA also expresses concern over an unintended consequence of SB 531 on the State's credit rating, because it believes the State would likely be deemed responsible for satisfying the Finance Authority's debt service:

By subjecting the Finance Authority to the State Budget Act, the ability of the Finance Authority to pay debt service on its bonds may be deemed to be subject to the budgeting process, requiring prior approval of both the Executive and Legislative branches for the Finance Authority's budget, and therefore payment of debt service on its bonds. The Finance Authority has achieved its AAA rating and the confidence of investors by adopting a prudent conservative bond financing strategy. Rating agencies and investors have relied on the track record of the Finance Authority and its management and Board to maintain these controls and strategies. Putting the Finance Authority's budget under control of the Executive and Legislative branches could create uncertainty over the ability of the Finance Authority to manage its own finances, and therefore bond payments. The mere power of, and potential for, the two branches to appropriate debt service and Finance Authority assets through the State Budget Act could undermine investor confidence in the Finance Authority's bonds.

2. Rating Agency and Investor Confidence in NMFA Bonds

In addition, the NMFA points to the non-impairment provision of the Act and the impact of SB 531 on activities of the NMFA related to it:

Section 6-21-11(B) provides that all bonds or other obligations issued by the Finance Authority are obligations of the Finance Authority and “shall not create an obligation, debt or liability of the state.” That section further provides that the Finance Authority may not “impose a pecuniary liability or a charge upon the general credit or taxing power of the state...” The Finance Authority has included the provisions of Section 6-21-11(B) in its Master Indenture of Trust applicable to all of its Public Projects Revolving Fund (PPRF) Bonds, and in each of the PPRF Bonds that it issues expressly incorporates the non-impairment agreement.

The passage of legislation that categorizes the Finance Authority as a “state agency” raises substantial issues related to whether the legislation would be held by a court to be a violation of the non-impairment statutory provisions in the New Mexico Finance Authority Act (the “Act”), the Tax Administration Act or the prohibition in the United States and State Constitution of the impairment of obligations under existing contracts, or each of them.

Article I, Section 10 of the United States Constitution and Article II, Section 19 of the State Constitution prohibit passage of laws by the State that impair obligations of a party to an existing contract. The existence of those legal issues regarding the constitutionality of the proposed legislation would have a substantial impact on the issuance of the Finance Authority’s PPRF Bonds in the form of higher interest rates due to a market perception that the New Mexico Legislature has impaired Finance Authority’s obligations to its bond holders. Thus, this bill would run counter to the Legislature’s stated purpose in passing the Act, “to provide financing for public projects in a manner that will not impair the capacity of the public project revolving fund.” *See*, § 6-21-2(C), NMSA 1978.

The NMFA also calls attention to Section 6-21-18 of the Act, which contains a pledge made by the legislature on behalf of the State to holders of PPRF bonds issued by the Finance Authority. The NMFA cites that language and explains its significance:

“that the state will not limit or alter the rights hereby vested in the authority to fulfill the terms of any agreements made with the holders thereof. The authority is authorized to include this pledge and agreement of the state in any agreement with the holders of the bonds or notes.” (Emphasis added).

Pursuant to the provision cited above, the Finance Authority has included the authorized non-impairment agreement in its Master Indenture of Trust and Pledge (“Master Indenture”) applicable to all of its PPRF Bonds. Section 6-21-6(A) also provides that the PPRF “shall be administered by the authority as a separate account.” The Master Indenture further creates a trust with respect to all the funds pledged to pay Public Project Revolving Fund bonds (“PPRF Bonds”), which includes the PPRF itself (the “Trust Estate”). The Master

Indenture by its terms forms a contract between the Finance Authority and the holders of PPRF Bonds, and in that document not just the Finance Authority, but the State itself, covenants that it will not do anything to impair the Trust Estate in any way.

Thus, the statutory non-impairment provision has become a contract between the Finance Authority and its bondholders. Article I, Section 10 of the United States Constitution and Article II, Section 19 of the State Constitution prohibit the passage of laws by the State that impair obligations of a party to an existing contract, and the State has made an explicit covenant to that effect in the contract that is the Master Indenture.

In addition to the non-impairment provision in the Act, the NMFA points to a similar non-impairment provision in Section 7-1-6.38 of the Tax Administration Act, which provides for distribution of seventy-five percent (75%) of the governmental gross receipts tax to the PPRF. The NMFA emphasizes certain language in Subsection D of that section and explains its significance:

“The state pledges to and agrees with the holders of any bonds or notes issued by the NMFA... and payable from the net receipts attributable to the governmental gross receipts tax distributed to the NMFA... that the state will not limit, reduce or alter the rate of imposition of the governmental gross receipts tax until the bonds or notes together with the interest thereon are fully met and discharged...” (Emphasis added).

The Finance Authority is authorized to include this pledge and agreements of the State in any agreement with the holders of the bonds or notes.

In response to this particular concern, the DFA calls attention to the specific transition language in Section 12 of the bill to protect all outstanding obligations from impairment due to the proposed changes, which can be delayed if necessary under the process set out in that section. It should be noted, however, that since this language applies only to outstanding obligations, it appears that any bond issues following the effective date of SB 531 would have to be structured in a manner consistent with its provisions.

3. Impact on the NMFA Bonds for State Facilities

The NMFA’s final concern relates to certain NMFA bonds backed by state gross receipts taxes:

Certain Finance Authority bonding authority is for the purpose of financing State facilities through the issuance of bonds backed by various State gross receipts taxes. Under the reasoning of the Trujillo case, above, if the Finance Authority were to be deemed to be nothing more than an agency of the state as a result of being subjected to the State Budget Act, the issuance of bonds for, say, state office buildings backed by the State gross receipts taxes, could run afoul of the constitutional prohibitions relating to the creation of debts of the State. *See, e.g., Montano v. Gabaldon*, 108 N.M. 940 (1989) and McKinley v. Alamogordo Municipal School District Authority, 81 N.M. 196(1969).

PERFORMANCE IMPLICATIONS

The NMFA advises that SHARE does not provide for loan servicing or accounts receivable activity. Until SHARE becomes functional in this area, performance of the main activity of the Finance Authority, servicing loans, cannot be performed through SHARE. Additionally, cash reconciliation activity will be impacted.

Further, the NMFA points out that the SHARE platform conforms to governmental accounting. The Finance Authority utilizes enterprise accounting and, in connection with serving as majority owner and LLC manager of Finance New Mexico, LLC, follows Financial Accounting Standards Board standards. This inconsistency makes reporting activity extremely difficult.

RELATIONSHIP

SB 531 is related to SB 12, which changes the composition and imposes restrictions on members of the NMFA's governing body. It also makes other changes to the internal operations of and methods by which the NMFA conducts its fiduciary and management responsibilities.

OTHER SUBSTANTIVE ISSUES

The NMFA calls attention to one particular example where, if the NMFA ends up being categorized as a "state agency" because of the provisions of SB 531 and is deemed an alter ego of the State, it believes the potential exists for the State to be held liable for the NMFA's obligations. That example arises from the NMFA's ownership of Finance New Mexico LLC, a for-profit limited liability company established pursuant to express authority in the Statewide Economic Development Finance Act for the sole purpose of operating the New Markets Tax Credit program. The NMFA reports:

Finance New Mexico, LLC was created in 2006 and is owned 99 percent by the Finance Authority and 1 percent by New Mexico Community Capital; the Finance Authority acts as the Member Manager. Participation of Finance New Mexico, LLC in the New Markets Tax Credit program is governed by contracts referred to as "allocation agreements" between Finance New Mexico, LLC and its various subsidiaries and the Community Development Financial Institutions Fund, a division of the U.S. Department of Treasury.

In 2006, Finance New Mexico, LLC received its certification as a Community Development Entity from the Community Development Financial Institutions Fund, and subsequently applied for and was awarded a total of \$156 million in New Markets Tax Credits allocations. To date, Finance New Mexico has deployed more than \$132 million of the awarded credit with three institutional investors for 10 transactions.

As part of each New Markets Tax Credit transaction, subsidiaries of Finance New Mexico, LLC must provide a limited indemnification to the investor/tax credit purchaser, and Finance New Mexico, LLC, as Member Manager in each transaction, owes duties arising from that role to the investor/tax credit purchasers and, further, provides limited indemnification related to some of those duties to the investor/tax credit purchasers. While the Finance Authority has shielded itself to the greatest extent possible from potential claims, the fund pledged to make

investors whole would be subject to the indirect ownership and control of the State under SB 531. Further, the State's ownership of a for-profit company (which itself has, at this point, thirteen active for-profit subsidiaries) resulting from SB 531 may trigger legal issues that could substantially increase Finance New Mexico, LLC's liability to its investors. Also, if an investor/tax credit purchaser, a business receiving financial assistance in a New Markets Tax Credit transaction or some other third party with a claim related to that program prevailed in court with a valid claim and then somehow successfully pierced the statutory and contractual defenses which the Finance Authority has utilized to avoid exposure of the Finance Authority or its assets to liability from the program, the bill would expose the State and its assets (instead of just the Finance Authority and its assets) to payment of those claims if the effect of the bill is to cause the Finance Authority to be an alter ego of the State.

Finally, as mentioned above, participation of Finance New Mexico, LLC in the New Markets Tax Credit program is governed contractually by allocation agreements with the federal government. Finance New Mexico, LLC is a "government controlled entity" under the terms of the allocation agreements and the Finance Authority, *in its current non-state agency structure*, is described in extensive detail as the governmental entity controlling Finance New Mexico, LLC. Finance New Mexico, LLC's success in being awarded \$156,000,000 in New Markets Tax Credits allocation likely turned in significant part on the Community Development Financial Institution Fund's positive view of the Finance Authority since Finance New Mexico, LLC applied for allocation as a start-up entity with no track record of its own. The designation of the Finance Authority as a state agency under the bill (with the attendant consequences of much more direct control of the day to day matters of the Finance Authority by the Executive and Legislative branches as described above) could arguably cause a material adverse effect on the ability of Finance New Mexico, LLC and its subsidiaries to meet their obligations under the allocation agreements since the Community Development Financial Institutions Fund could determine that the Finance Authority structured as a state agency is a markedly different controlling entity for purposes of Finance New Mexico, LLC's New Markets Tax Credit program than the Finance Authority in its existing structure as a body politic and corporate, separate and distinct from the State. If this is the case, then the bill will either unconstitutionally impair the contracts between Finance New Mexico, LLC and the federal government or, if the bill is found to be constitutional with respect to that issue, will still have the effect of causing negative ramifications under the allocation agreements which could then have negative impacts on each of the existing New Markets Tax Credit transactions.

While SHARE can accommodate transfer of day to day financial transactions, customizing the system to produce unique reports relative to an agency's operations is time consuming and expensive. The transition for the Department of Transportation took approximately four years to comply with reporting requirement of the federal government. Similar time periods may be required for the NMFA financial operations.