Capital Outlay

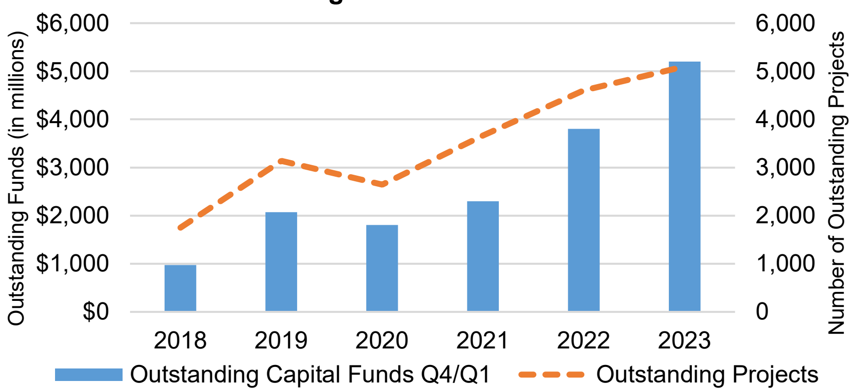
Quarterly Report, November 2023

NEW MEXICO LEGISLATIVE FINANCE COMMITTEE

Unspent Capital Funds Continue to Hover Around $5 Billion

At the end of the first quarter of FY24, outstanding capital outlay balances totaled an estimated $5 billion across roughly 4,900 projects. The unspent funds include projects authorized by the Legislature ($2.8 billion), projects funded through severance tax bond earmark programs ($472.7 million), supplemental severance tax bonds for public school construction ($1.2 billion), and special appropriations to capital projects ($514.2 million). The last figure represents uncommitted and unspent funds from $977.4 million in special appropriations from 2021 and 2022. **Attachment A**

Chart 1. Increased Capital Appropriations are Contributing to Construction Demand



Source: LFC files

Key Points

- Estimated outstanding balances and active project counts for the first quarter of FY24 include projects with reversion dates of June 2023 that had not yet been closed in the state's reporting and financial system. LFC staff will report on reversions from these appropriations next quarter.
- Additionally, some data transfer issues occurred during the transition to a new capital reporting system. While most data on expenditures transferred correctly from the state's financial system, in some cases, staff had to rely on FY23 fourth quarter data for projects where issues could not be resolved. LFC staff is working with DFA to resolve the remaining data issues before the next quarterly data pull.
- Construction costs remain extraordinarily high and contractors continue to report difficulty in attracting and retaining qualified tradespeople to meet demand.
- The Legislature is likely to receive several billions in new capital outlay requests for 2024 in a construction market that is already oversaturated.

LFC QUARTERLY REPORTS provide analysis on the progress of capital appropriations.

Data is derived from the Department of Finance and Administration, state and local entities, and the Budget Formulation and Management System. Outstanding balances reported in this memo reflect reported expenditures as of September 2023 and do not include encumbered but unspent funds, with the exception of balances reported for special appropriations. Due to data transfer issues with the transition to a new reporting system, reported balances for the first quarter of FY24 are estimates and include funds with 2023 reversion dates that had not yet been reverted when data was pulled.

General Fund Reversions

For several years, the capital outlay bill has included a requirement that general fund projects encumber at least 5 percent of their respective appropriations within the first fiscal year or funds revert. Because the 2023 capital bill was funded almost entirely with general fund, most projects will be subject to the 5 percent encumbrance requirement by June 30, 2024.

Agencies that administer most local capital outlay appropriations have issued grant agreements to projects that were eligible to move forward, or those not on the authorized but unissued list. Local communities should prioritize executing those grant agreements so they can move forward with encumbering funds and starting projects. LFC staff will continue to monitor progress toward the encumbrance threshold as the year progresses and alert legislators to funds at risk of reversion. Attachment A shows the status of grant agreement issuance and execution for local 2023 appropriations administered by the Department of Finance and Administration, Indian Affairs Department, and Environment Department.

Construction Costs and Cost Overruns

- Construction costs remain high and are making it difficult to complete projects that even recently were believed to be fully funded. LFC has received several additional requests from both state agencies and higher education institutions for 2024 to cover anticipated or known cost increases.

- LFC staff worked with DFA to develop a survey that was sent out last week asking local communities to report existing capital outlay projects that are delayed or stalled due to cost overruns. The survey was sent out by state agencies to all capital outlay grantees and circulated to New Mexico Counties, the New Mexico Municipal League and councils of governments. **The deadline for completing the survey is noon on November 22.** LFC staff will have results available when the committee convenes in December.

- The goal of the survey is to gather information that could allow the Legislature to prioritize completing existing projects in 2024 before funding new projects. Such an approach could help reduce the backlog of unspent funds and complete projects the Legislature has already deemed a priority. LFC staff are using a similar approach in drafting recommendations for statewide projects for 2024.

Project Development, Vetting, and Funding

- LFC staff are available to provide training to caucuses, chambers, or other groups of Legislators on using the vetting checklist included on the new project request sheet and on alternative funding sources for local projects. We are also available to review the results of the local cost overrun survey with Legislators and discuss options for prioritizing 2024 appropriations.

- The number of reauthorized projects in 2023 doubled over the previous year and a similar pattern may occur this year due to the challenges of the construction market. However, given the growing backlog, the Legislature may want to consider putting boundaries around new reauthorizations – for instance, not reauthorizing small amounts for purposes beyond the original appropriation.

- LFC staff are working with DFA to refine a proposal for a centralized infrastructure division within DFA. The goal is to improve support for project development for local communities, improve coordination of funding sources and assist communities in identifying and securing funding to complement capital outlay, to improve statewide tracking of capital projects regardless of funding sources, and to build capacity for grant and project management to support project completion.

- For 2025 and beyond, LFC staff recommends the Legislature consider setting an earlier deadline for local capital outlay requests and using any increased legislative staffing to implement a basic vetting process for legislative appropriations to local entities.

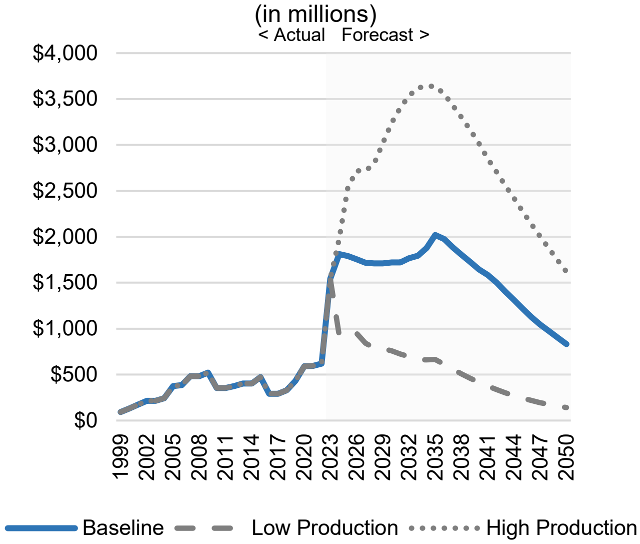
- Such a process change could allow the Legislature to separate appropriations for planning and design from funding for construction and support any number of targeted future initiatives the body as a whole or individual chambers might want to pursue.

Debt Capacity and Long-Term Revenue Issues

Problem Statements

- Dramatic increases in bonding capacity, if fully utilized, could jeopardize the state's bond ratings.
- The state has no long-term back-up plan for funding capital projects as severance tax revenues decline.
- Declining severance tax revenues are likely to make it difficult for the state to both finance new capital projects and to maintain the investments it is making today. This challenge will weigh on the general fund as it becomes a replacement source for capital at a time when general fund revenues will already face headwinds from declining oil and gas production.
- New Mexico is an outlier in using long-term debt to finance small as well as large capital projects.

Chart 2. Debt Service Capacity with Projected Severance Tax Revenue
(in millions)



Note: Low and high production estimates are based on CREG oil and gas scenarios.

Source: LFC

Potential Solution: Cap Debt Capacity and Redirect Savings

The state could cap annual bonding capacity at a lower level than currently allowed in statute with several goals:

- To extend the overall life of the bonding program with projected severance tax revenues.
- To protect the state's bond ratings.
- To generate savings that could be directed to either a new capital reserve or the severance tax permanent fund.

$1 Million and Greater Report – Attachment A

LFC's $1 million and greater report for the first quarter of FY24 is the first produced with data from the state's new capital outlay reporting system. For the quarter, LFC reported on 766 active projects with appropriations totaling $3.6 billion.

During the system transition, several data transfer errors occurred that DFA is working with the vendor and IT support to resolve. Reversions for projects with 2023 reversions data had not all been recorded when the data was pulled and many reverting projects were not yet closed.

Blue-rated appropriations reported as complete or fully expended this quarter include:

- Vladem Contemporary Museum of Art in Santa Fe;
- Upgrades to the Albuquerque Police Department evidence lab;
- Albuquerque fire vehicle purchase; and
- Eastern New Mexico University Roosevelt Science Hall Phase 1.

Red-rated appropriations, indicating no activity, no reporting, recent reauthorization, significant challenges or delays, or significant unspent funds, include:

- Guadalupe County magistrate court relocation;
- $2.8 million in balances on a few senior center projects funded with 2018 general obligation bonds;
- Numerous appropriations to the City of Santa Fe that are stalled due to audit non-compliance;
- Numerous local appropriations for road projects that required reauthorization in 2023; and
- Three 2022 appropriations to CYFD that were reauthorized into a single appropriation for a therapeutic group home in 2023, for which plans still have yet to develop.

Earmark Funds

The status of projects funded through the Water Trust Board (**Attachment B**), the Colonias Infrastructure Board (**Attachment C**), and the Tribal Infrastructure Fund (**Attachment D**) are summarized in the respective attachments.

Authorized But Unissued Projects (Attachment E)

Attachment E provides a list of projects authorized by the Legislature for which bonds have not yet been sold. Projects may be stalled due to lack of audit compliance or readiness to proceed. As of July 2023, a total of $15.7 million for 71 projects was authorized but unissued.