MINUTES
of the
SIXTH MEETING
of the
NEW MEXICO FINANCE AUTHORITY OVERSIGHT COMMITTEE

December 1, 2017
State Capitol, Room 322
Santa Fe

The sixth meeting of the New Mexico Finance Authority (NMFA) Oversight Committee for the 2017 interim was called to order by Representative Bill McCamley, chair, on Friday, December 1, 2017, at 8:32 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Rep. Bill McCamley, Chair
Sen. Jacob R. Candelaria, Vice Chair
Rep. Alonzo Baldonado
Sen. Craig W. Brandt
Sen. Joseph Cervantes
Rep. Sharon Clahchischilliage
Rep. Kelly K. Fajardo
Rep. Harry Garcia
Sen. Ron Griggs
Rep. Jimmie C. Hall
Sen. Richard C. Martinez
Sen. Michael Padilla
Rep. Jane E. Powdrell-Culbert
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Rep. Patricia Roybal Caballero
Rep. Patricio Ruiloba
Sen. William E. Sharer

Absent
Rep. George Dodge, Jr.
Rep. Linda M. Trujillo

Advisory Members
Rep. Bealquin Bill Gomez
Rep. Patricia A. Lundstrom
Rep. Tomás E. Salazar

Rep. Brian Egolf
Sen. Mary Kay Papen
Sen. John Pinto
Sen. Clemente Sanchez
Rep. Sheryl Williams Stapleton
Sen. Jeff Steinborn
Sen. Bill Tallman
Sen. Pat Woods
Rep. Monica Youngblood

Guest Legislator
Sen. Cisco McSorley

Staff
Jeff Eaton, Research and Fiscal Policy Analyst, Legislative Council Service (LCS)
Ric Gaudet, Researcher, LCS
Rebecca Griego, Records Officer, LCS
Tessa Ryan, Staff Attorney, LCS

Minutes Approval

Because the committee will not meet again this year, the minutes for this meeting have not been officially approved by the committee.

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

<u>Friday, December 1</u>

NMFA Board Update

Robert P. Coalter, chief executive officer, NMFA, reported to the committee on recent activities of the NMFA. The NMFA issued $267 million in bonds backed by the Public Project Revolving Fund (PPRF) in fiscal year 2017. This is a drop from the amount issued in fiscal year 2016, in which $324 million in bonds was issued. However, the amount of bonds issued has generally been steadily increasing since 2012, when only $24 million in bonds was issued. Of the six bond issuances made in fiscal year 2017, three were senior bonds and three were subordinate. All of the issuances except one were tax exempt. Most of the bonds were new issuances, backed by a variety of revenue sources, including Fire Protection Fund distributions, local and state gross receipts tax (GRT) revenue and general obligation property tax revenue. The NMFA also issued refunding bonds to refinance some 2006 and 2007 bonds.

The NMFA closed 95 PPRF loans in fiscal year 2017 totaling $380 million. This amount represents a 42 percent increase since fiscal year 2016 in the number of PPRF loans made and a nearly 30 percent increase in the total amount loaned. The rating agency Standard & Poor's increased the subordinate bond rating of the NMFA to AAA, which now matches the senior bond rating. This allows for lower financing costs for local governments.

The NMFA closed on 13 loans from the Drinking Water State Revolving Loan Fund (SRLF) totaling $11.8 million. This successful program was recently recognized by the federal Environmental Protection Agency for having the second-highest program fund spend-down rate in the nation. The NMFA made 14 loans from the Colonias Infrastructure Project Fund for a total of $12.3 million to finance infrastructure projects in many of the state's colonias areas. The NMFA also closed on three new markets tax credit transactions totaling $19.4 million. Finally, 40 grant agreements totaling $1.7 million were finalized to fund local government planning activities.

Approval of Minutes

The minutes from the November 1-2 meeting of the committee were approved without changes.

Project Infrastructure Financing

A panel of industry experts and union representatives made a presentation to the committee about the use of public-private partnerships (PPP) for the design, construction and operation of certain public infrastructure. Panelists included Marv Hounjet, senior advisor, Performance Based Building Coalition; Mike Puelle, chief executive officer, Associated General Contractors of New Mexico; Claudio Andreetta, director, business development, PPP Building Technologies, Johnson Controls; Barney Allison, partner, Nossaman, LLP; and Carter Bundy, political action representative, American Federation of State, County and Municipal Employees (AFSCME).

The traditional model for building infrastructure has used a design-bid-build pattern, in which there is normally no connection between the designer of a building and the builder and in which lowest cost is generally the primary factor in awarding a contract. Builders are often only focused on finishing a building and have little incentive to invest in components and building styles that take into account the entire life of the building. The PPP model provides much more accountability for the contractor because payment is conditioned on performance over the entire term of the design, construction and operation of the facility. In this kind of arrangement, the goals of the government client and the private partner are much more aligned than in the traditional model. A modern PPP has several benefits, including holding the developer accountable for performance over the life of the asset, creating competition on the basis of fiscal and facility performance, better management of risk related to implementation and management of the project, addressing future obligations for asset maintenance, incorporating a cost-of-ownership financial plan by taking a life cycle approach, incentivizing innovation and transferring responsibility of cost overruns and schedule delays to the developer.

A PPP project should only be chosen if it yields greater benefits to the governmental entity than using traditional procurement mechanisms. There are many kinds of public-sector projects that could be suitable for a PPP, including schools, prisons, transit facilities, railroads, water and wastewater facilities, highways, university facilities and student housing, public housing, health care facilities and sports facilities. Under a PPP contract, the lenders and equity holders do not get paid unless the project is successful. This provides an incentive for the private partner to build and maintain the asset for the entire term of the contract. In addition, many PPP contracts require the private partner to deliver the asset at the end of the contract to the public partner with a set Facility Condition Index (FCI), essentially providing the asset with a 20- to 40-

year guarantee. Since the asset is financed privately, many projects that the public entity could not otherwise finance immediately can be built.

Other countries have been using the PPP model for decades, but in the United States, tax-exempt bond financing has been seen as a disincentive to using that model. However, financing costs are just one factor in the entire life cycle costs of an asset. More than one-half of the total cost of a building during its life is incurred after construction of the building is complete. Studies have demonstrated that a PPP project can cost between 15 percent to 25 percent less than traditionally procured and maintained buildings. Many kinds of PPP projects can already be built under current New Mexico statutes, but there is no overarching framework regulating the practice. Legislation to set up such a framework is needed to encourage this kind of approach.

Mr. Bundy said that the AFSCME is not necessarily opposed to PPP projects, but the projects should not be used at the expense of public-sector workers. A private partner should not be allowed to take over a public asset and earn a profit by paying its workers less than public employees doing the same work. Many governments around the country have been burned by poorly conceived PPP projects. The privatization of state prisons is just one example for which New Mexico is still paying. Private companies built shoddy prison facilities and hired low-paid correctional officers and are still profiting handsomely. State Highway 550, which was another PPP project, worked fairly well for the state until it attempted to have the contractor perform warranty work on the highway to fix some issues. However, a legal loophole that had been drafted into the contract documents allowed the contractor to avoid fixing the problems on the highway.

Mr. Bundy said that there are some infrastructure needs that suit themselves well to the PPP model, including toll roads. For example, New Mexico needs a new highway from Santa Teresa to Interstate 10 to accommodate the huge increase in trucking in the area. A PPP project could work very well for that infrastructure need, which will otherwise not happen for decades using traditional gasoline tax revenue bonds. Any PPP project needs to include worker, consumer and environmental protections. Finally, Mr. Bundy said that the claim that the private sector can better maintain assets over the life cycle of a building is only true because governments tend not to fund maintenance costs for infrastructure.

Questions and comments from committee members included the following.

- Critics of the PPP model say that private companies are using public money to make a profit. Mr. Allison said that PPP projects can impose requirements on the developer, such as providing construction training in the community so that local people can work on a project. He said that private partners want to earn a profit, but there can also be many social benefits to a partnership. He suggested that a public entity develop contract requirements that all bidders will agree to complete before a request for proposals is issued. Mr. Hounjet said that a governmental entity needs to have very good advisors to ensure that the entity does not get burned. Mr. Bundy said that PPP legislation should include provisions that any project pay prevailing wages.

- What are some examples of PPP projects that were successful? Mr. Andreetta said that the Long Beach, California, courthouse, completed in 2013, was a successful project for all parties involved. Other projects that are ongoing include the Long Beach Civic Center and the University of California-Merced campus expansion. These projects have 30- to 40-year maintenance agreements, with reversion to the local government at an FCI rating of 85 percent. Mr. Allison said that payments do not begin until the construction is complete, and annual payments are contingent on the private partner completing performance measures. Mr. Bundy said that clawback provisions could be useful in ensuring that a project perform according to the original project specifications. Mr. Puelle said that the Town of Silver City recently signed a power purchase agreement to finance a renewable energy facility, which would otherwise not have happened using traditional financing mechanisms. The General Services Department (GSD) has a long and successful history in entering into PPP agreements to install energy-saving components in state buildings. Secretary of General Services Edwynn L. Burckle said that the GSD and the Energy, Minerals and Natural Resources Department together created a model contract for local governments to use in creating energy-saving agreements.

- Many local governments in New Mexico will not have the expertise to ensure that a PPP project is correctly designed to be beneficial to the public.

- All interested parties should have a say in any future PPP legislation.

- What has been the experience in other states that have PPP authority? Mr. Bundy said that 38 states have some kind of PPP legislation. PPP projects in California have been successful, but many PPP projects around the nation have privatized public-sector workers at a lower rate of pay.

- Some New Mexico contractors are worried that PPP projects will be constructed by large out-of-state companies without any chance for local contractors to participate. Mr. Hounjet said that it is very important for local contractors to be involved in PPP projects. Mr. Allison said that PPP legislation can require that a percentage of work be performed by local contractors, if desired.

- Could the NMFA or the GSD be able to provide the expertise necessary to ensure that PPP projects are beneficial to the public? Mr. Coalter said that the NMFA could only provide assistance with the financial aspects of a PPP project. Secretary Burckle said that proper checks are essential to a good PPP project. He said that the Capitol Buildings Planning Commission could potentially provide oversight of projects.

Authorization of Projects for Funding from the PPRF

Mr. Coalter and Zach Dillenback, chief lending officer, NMFA, presented proposed legislation for the committee's consideration that would grant the NMFA the authority to make more than 100 loans to local governmental entities for needed infrastructure projects. The annual loan authorization legislation is required for projects that cost over $1 million, and the authorizations last for three years. Mr. Dillenback said that over $380 million was loaned in fiscal year 2017, and that level may be surpassed in fiscal year 2018. The bond ratings for many government entities have been downgraded recently, which makes financing with the NMFA more attractive.

Questions and comments from committee members included the following.

- Providing funding for charter school facilities has been somewhat controversial. There are 14 charter school authorizations in the legislation. Can these authorizations be used to provide lease payments? Mr. Dillenback said that the charter schools in the legislation are trying to address the challenge of how to acquire their own facilities. The NMFA can only assist charter schools that have a lease-purchase agreement, and regular lease payments are ineligible for financing. In a lease-purchase agreement, the NMFA becomes the lessor of the building while the lease payments are being made. However, the NMFA assumes much more risk under that scenario because there is no guarantee that the school will exist at the end of the contract. Most NMFA projects have a dedicated revenue stream to pledge to the repayment of the loan. Despite the 14 loan authorizations for charter schools in the legislation this year, the NMFA has only provided one loan to a charter school. That loan was completed because the Albuquerque Public School District pledged that it would repay the loan in case the charter school was unable to pay it. Charter schools continue to request loan authorizations in the hope that they will qualify for a loan one day. Many charter schools have nonprofit foundations to support the school, but those entities are not eligible to enter into a lease-purchase agreement with the NMFA. State-chartered charter schools have the additional risk of not being backed by a school district. Thus far, no state-chartered charter school has qualified for a loan from the NMFA.

- Are the cash balances of the PPRF adequate to meet all of its responsibilities? Mr. Coalter said that the recent sweeps of money from the fund created liquidity problems for the fund. However, as long as no more money is removed from the fund, there should be sufficient liquidity in the future. The NMFA has a $100 million line of credit it can use, but that means borrowing money, which will increase financing costs to governmental entities.

- How does a governmental entity get put on the list of authorized projects? Mr. Dillenback said that the NMFA periodically contacts entities about the funding cycle. Entities can provide the NMFA with a long list of potential projects without being required to know exactly which one will be the top priority. The legislation merely authorizes the NMFA to make loans when a project is ready. He said that refunding of bonds also requires legislative authorization. Mr. Coalter said that listing specific projects in the legislation would cripple the current process. Entity priorities change from year to year, and the general language in the legislation provides for flexibility.

- The legislature should consider raising the baseline cost for projects requiring legislative approval from $1 million to $2 million.

- The congressional tax reform legislation being proposed will make it more expensive to refund bonds. The legislation would eliminate the tax-exempt status of public refunding bonds before the original bonds are defeased.

The committee unanimously endorsed the proposed legislation.

Update on the Economic Development Revolving Fund (EDRF), Drinking Water SRLF and Local Government Planning Fund (LGPF)

EDRF

Marquita Russel, chief of programs, NMFA, and John Brooks, director of commercial lending, NMFA, reported to the committee about activities of the NMFA related to economic development programs. The EDRF was created to carry out the purposes of the Statewide Economic Development Finance Act, which was enacted in 2003 to stimulate economic development in the state by providing financing options for qualifying private businesses. The EDRF contains state and federal money and provides funding for two programs. The Smart Money Program is a state-funded program that provides long-term financing to businesses. Under this program, the NMFA shares equally in the collateral available to a bank. The NMFA has participated in five loans for projects under the Smart Money Program. Banks have expressed limited support for this program because the NMFA's required collateral position does not allow any additional coverage or for additional funds to be extended to a business. Of the five projects funded, one has gone bankrupt and one is in liquidation. There is currently $1.2 million available in the fund for projects.

The Collateral Support Program is a federally funded loan participation program that provides short-term financing for construction or lines of credit. The Collateral Support Program, which has provided collateralized loans since 2012, is currently being phased out. The money for the program is being transferred to other economic development programs as loan payments are received. So far, the NMFA has transferred more than $22 million to the Economic Development Department. This program has funded many more businesses and is more flexible than the Smart Money Program. Seven loans have been paid in full, and the rest of the loans are current.

Drinking Water SRLF

Ms. Russel presented proposed legislation for the committee's consideration that would appropriate $1.8 million from the PPRF to the Drinking Water SRLF. The appropriation would leverage $8 million in federal funding and allow the NMFA to provide loans to governmental entities for drinking water systems. This is an annual appropriation bill that the NMFA requests.

The committee unanimously endorsed the proposed legislation.

LGPF

Ms. Russel presented proposed legislation for the committee's consideration that would appropriate $1.5 million from the PPRF to the LGPF. The NMFA did not request funding for the LGPF for fiscal year 2018 due to the state government fiscal crisis. The fund can be used for planning by governmental entities for infrastructure planning, water conservation planning, long-term master plans, economic development plans and energy audits. The NMFA will prioritize emergency projects as money is received, and later, it will fund other projects.

Questions and comments from committee members included the following.

- Will asset management plans be funded by the LGPF? Ms. Russel said that the Water Trust Board (WTB) requires entities to complete asset management plans in order to qualify for funding from the Water Project Fund (WPF). She said that asset management plans are eligible for funding, but emergency planning projects will be funded first in fiscal year 2019.

- Is the LGPF primarily intended for small communities? Ms. Russel said that the fund is intended to provide assistance to smaller governmental entities. Projects are eligible to receive up to $50,000. Smaller entities can receive full funding, and entities located in regions with low median-household income can also. She said that the NMFA typically funds 30 to 40 projects annually.

The committee unanimously endorsed the proposed legislation.

NMFA 2017 Interim Summary Recap

Mr. Eaton presented to the committee a summary of the committee's activities during the 2017 interim. The committee met six times during the interim throughout the state, including in Santa Fe, Gallup, Santa Teresa, Las Cruces, Portales and Clovis. The committee reviewed the activities and programs of the NMFA, Border Authority and Spaceport Authority and the programs of the WPF, Tribal Infrastructure Project Fund and Colonias Infrastructure Project Fund. The committee received presentations and reports on many issues, including the state bond rating, community banking partnerships, small business issues, programs associated with the EDRF, tribal infrastructure projects, PPRF liquidity, border development initiatives, the

Catalyst Fund, venture capital developments, renewable energy transmission projects, water projects, Water Trust Fund solvency, Spaceport America and the development of broadband in the state.

WTB Presentation of Water Projects for Legislative Approval

Tom Blaine, state engineer, and chair, WTB; William Fulginiti, executive director, New Mexico Municipal League, and vice chair, WTB; Joy Esparsen, government affairs director, New Mexico Association of Counties; and Ms. Russel presented proposed legislation for the committee's consideration that would authorize the NMFA to make loans or grants from the WPF for public water projects. Projects are recommended for funding each year by the WTB based on a set of criteria established by the board. For the 2018 funding cycle, 73 applications were submitted for over $72 million in funding. Several projects were deemed ineligible for funding, and five projects were rejected by the WTB because the projects did not meet policy requirements for expenditures. Two of those rejected projects requested reconsideration by the board and were subsequently granted. The WPF is expected to receive $20 million in 2018 for projects. The WTB typically recommends 130 percent of the amount available because some projects run into delays and are not funded. For 2018, 22 projects were recommended for flood prevention, water conservation, water storage and watersheds.

Questions and comments from committee members included the following.

- How did the action taken by the WTB to reconsider two rejected projects affect other water projects? Mr. Blaine said that the City of Gallup and the Eastern New Mexico Water Utility Authority requested that the WTB reconsider the rejection of a waiver of policy requirements that money be spent within a certain time frame. The spend-down policy was created by the WTB to ensure that money loaned or granted be spent within a reasonable amount of time. Ms. Russel said that those two projects were ranked high, and once the board granted the waiver, they were recommended for funding, which meant that nine other projects that did not rank as high were not recommended for funding.

- What happens if a governmental entity is not able to repay a loan from the WPF? Ms. Russel said that the WTB prefers that water projects have a loan component as part of their financing. However, those entities that do not have a dedicated revenue stream, such as flood control districts, can instead provide other matching money in lieu of a revenue stream as dedication. Entities that are unable to pay an existing loan can apply for a hardship waiver to defer payment for a period of time.

- The WTB changed its project evaluation process a few years ago because it used to only fund large projects. The new criteria allow for smaller projects to receive funding.

- What is the status of the Navajo-Gallup water supply project? Ms. Russel said that the WTB has provided $30 million in funding for that project from nine separate awards. Funding from the WPF has a 40 percent loan component. Mr. Blaine said that the money for that project for 2018 will be allocated for infrastructure improvements in Gallup. As part of the Navajo Water Rights Settlement Agreement, the state agreed to contribute $50 million toward completion of the project, which will deliver water in a pipeline to the eastern portion of the Navajo Nation and to Gallup. The state has already contributed its full commitment to the project.

- Most of the people living in the area between U.S. Highway 491 and State Highway 371 have not benefited from the Navajo-Gallup water supply project. Mr. Blaine said that the WTB is also providing funding for projects ancillary to the main pipeline project, including providing clean water stations to areas that do not have running water into households.

The committee unanimously endorsed the proposed legislation.

Sponsorship of Endorsed Legislation

The committee selected the following legislators to sponsor legislation endorsed by the committee.

- PPRF Loan Authorizations — .209087.3SA: Representative Lundstrom, to be carried by Senator Candelaria in the senate.
- Drinking Water SRLF Appropriation — .209103.1SA: Representative McCamley, to be carried by Senator Candelaria in the senate.
- LGPF Appropriation — .209112.1SA: Senator Candelaria, to be carried by Representative McCamley in the house of representatives.
- WPF Loan and Grant Authorizations — .209083.1SA: Senator Cervantes, to be carried by Representative McCamley in the house of representatives.

Adjournment

There being no further business, the committee adjourned at 2:40 p.m.