Updated 8/28/2018

FY20 Appropriation Request Budget Guidelines

NEW MEXICO LEGISLATIVE FINANCE COMMITTEE

I. PURPOSE

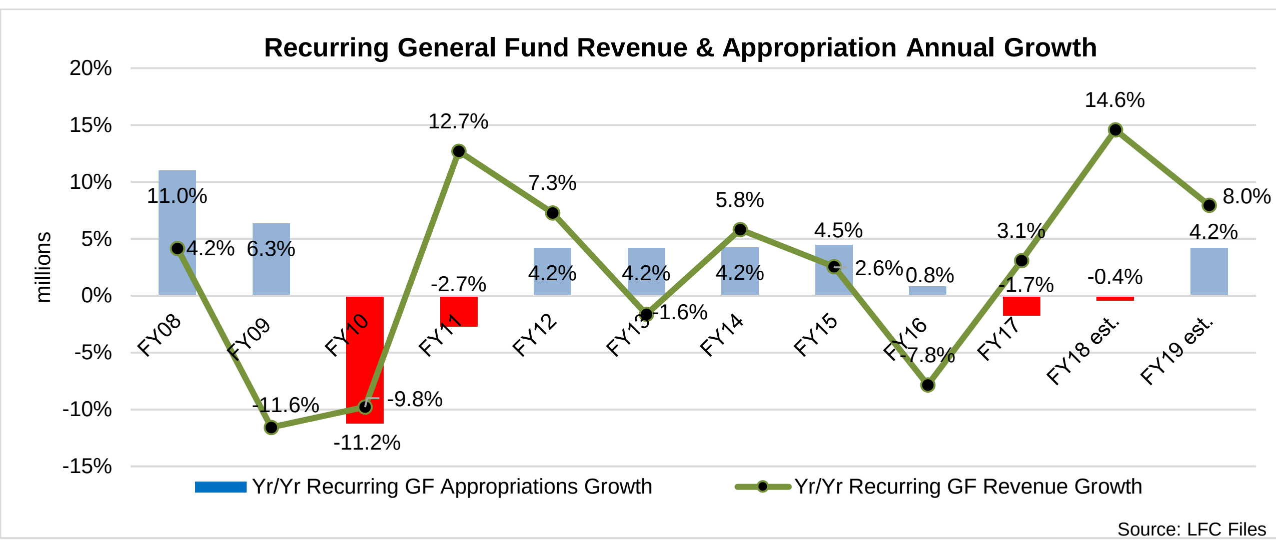
The Legislative Finance Committee (LFC) budget guidelines provide analysts with committee directions on performance-based budgeting, the preparation of the budget narrative, the development of FY20 recommendations on recurring appropriations, and priority capital spending and other one-time investments. The guidelines also serve to inform state agencies and the general public about new LFC priorities and approach to budget recommendations for FY20.

II. REVENUE OUTLOOK

Recurring general fund revenues surged in FY18, growing by an estimated 14.6 percent, a growth rate unseen in more than a decade. Recurring revenues for FY19 are estimated at $7.3 billion, an increase of $536 million, or 8 percent, from FY18. Recurring revenues for FY20 are estimated at $7.5 billion, an increase of $221.9 million, or 3 percent, from FY19. “New money,” defined as projected recurring revenues for the following fiscal year less current year recurring appropriations, is estimated at $1.2 billion for FY20, or 18 percent growth from the FY19 recurring budget level. However, New Mexico has entered a period of revenues far above the 10-year trend, and the revenues are highly volatile due to a strong and growing dependence on the energy industry. Energy-related revenues could soar or plummet if price and production levels rise or fall.

III. FY20 PRIORITY AND APPROACH

General fund revenue growth has strengthened significantly since the financial crisis of the Great Recession and oil price collapse. The committee’s goal is to propose a balanced budget that avoids unsustainable high expenditure growth rates, such as the 11 percent recurring general fund budget growth rate in FY08 and 6.3 percent in FY09 while recurring revenues fell by 11.6 percent in FY09 and by another 9.8 percent in FY10.



Instead, the goal is to use a more modest growth rate that improves service levels, increases accountability, and ensures an adequate general fund reserve. In light of the recent bond rating downgrade by Moody's, the Legislature will need to consider issues impacting the state's bond rating, including the large Medicaid caseload, large pension liabilities, a narrower and volatile revenue structure than other states with similar bond ratings, an economy lagging the rest of the country, below-average wealth levels, and weak financial reporting practices.

Education continues to be the state's and Legislature's biggest fiscal and policy challenge, other committee priorities include early childhood investment, public health, workforce development, public safety, protection of vulnerable citizens, and increased economic growth, and improving transportation infrastructure.

Overall, the committee will emphasize flat general fund appropriation levels in most state agency budgets. Growth in base general fund appropriations will be considered to address changes in program caseload, workload, waiting lists, and medical and per diem inflationary costs.

In order to fund prioritized programs, the committee will consider targeted cost savings, focusing on duplicated services, non-critical or ineffective initiatives, areas where efficiencies have been created, or where there is no evidence a program is working.

To balance the budget during the economic downturn, nonrecurring revenue was used to support ongoing operations which created a structural deficit. The committee will consider backfilling nonrecurring revenue with general fund revenue in the agency's operating budgets. The committee will seek to maintain a General Fund reserve level of at least 20 percent because of increased dependence on energy revenues.

IV. PERFORMANCE AND ACOUNTABILITY

Analysts shall integrate agency performance results into their budget analysis and, whenever possible, align budget recommendations with program achievement. Consideration for continued base funding should be given to those programs that demonstrate positive results, effective design, and strong planning and management. Analysts should follow these guidelines in reviewing agency performance:

- Analysts should recommend new or alternative performance measures, as necessary, to enable policy makers and the public to better gauge program outcomes, conversion of "explanatory" measures to outcome measures, and report results quarterly.
- Agency strategic plans should ensure: 1) the stated mission, goals, and objectives are consistent with statute and state policies; 2) overarching programs are coordinated among divisions and, where applicable, across agencies; 3) programs are consistent with current resources and conditions; and 4) resources are aligned with the agency's strategic direction and performance results.
- Performance targets should be benchmarked for priority programs whenever possible. Suggested resources for benchmarking include federal standards, best-practice standards set by other agencies and states, historical data, and desired results.
- Performance data and results from recent LFC program evaluations should be used to identify ineffective programs or producing marginal results or, conversely, are achieving desired outcomes.

Analysts shall use Results First cost-benefit analysis where available, notably in the areas of public safety, early childhood, child welfare, and behavioral health programs. In select cases, analysts may recommend new performance measures from what DFA approved during the interim for agencies to include in their FY20 budget request.

The committee will also focus on Managing for Results. Performance accountability has matured and agencies need to effectively use performance indicators and tools, such as cost-benefit analysis, to ensure limited resources are used to cut ineffective programs and bolster effective ones.

V. BUDGET GUIDELINES

The following budget guidelines apply to all agencies.

Compensation, FTE, and Vacancy Rates. Even though state employment in New Mexico remains significantly below peak employment levels seen prior to the Great Recession of 2008, out-of-cycle salary increases, targeted salary adjustments, and higher benefit costs have personal services and employee benefits (PS&EB) spending have increased. Also, elevated vacancy rates have resulted in large amounts of PS&EB funding transferred to other areas of the budget.

According to the State Personnel Office (SPO), the state's salary structure is 9.1 percent below the regional public sector comparison market. The committee will consider targeted compensation increases to address poor recruitment and retention issues impacting health care, social services, and other positions that serve vulnerable citizens and general salary increases for all public state employees to offset inflation and increases for benefits.

SPO is currently engaged in a consolidation of human resources (HR) positions statewide. The state Board of Finance authorized 67 FTE positions from 16 agencies to be reorganized under SPO. During the 2018 legislative session, legislation which would have provided specific authorization for SPO to assume all HR functions statewide failed to pass. The committee may consider whether to transfer these positions and funding from the original agencies to SPO.

Expenditures and Contractual Services. Analysts shall analyze requested expenditures for professional services and other contracts to ensure contracts address legislative priorities, and adhere to performance criteria. Analysts shall use the monthly Contracts Report provided by DFA information in the New Mexico Sunshine Portal and postings on the USD website to analyze an agency's historical use of contractual services. Analysts should note shifts of workload from FTE to contractors and ensure the cost of performing the work is not double funded.

Revenues and Cash Balances. Use of other state funds and federal funds shall be maximized based on grants, awards, agreements, budget adjustment request (BAR) activity, and program history. To reduce the need for revenue from the general fund, cash balances shall be used in the FY20 budget recommendation. Governing statutes shall be reviewed to ensure that if funds are budgeted appropriately and if they can be used for other purposes. Analysts shall scrutinize expenditures where earmarked revenue or federal funds are in decline or potentially unavailable. Analysts shall also examine funds that were swept during recent solvency efforts and the need for replacement of those funds to ensure ongoing effective operations of agencies and programs.

Federal Funds. Federal funds should be leveraged to the extent possible in keeping with the committee's policy priorities to ensure these funds are accurately reflected in the budget recommendation. The FFY19 federal omnibus budget bill included additional revenues for New Mexico. Analysts are directed to compare information on revenue forms provided in the budget requests with deviations from appropriations, the database provided by the Federal Funds Information for States (FFIS) service, the LFC June 4, 2018, federal funds guidance memo presented to the committee in Carlsbad, and other sources of information on federal funds. Analysts shall also use historical budget adjustment information to determine if the level of federal funds is accurately reflected in the agency request.

Expansion. Expansions will be limited to committee priorities that are evidence-based, tied to enhanced service delivery, and are appropriate functions of state government. Workload growth is not considered an expansion. Analysts shall avoid financing expansions with nonrecurring revenue. Generally, expansions not identified as a committee priority must be financed within current appropriation levels through reprioritization. All expansions must be tied to enhanced performance and explained in the budget document accordingly. Expansion FTE should be budgeted for a partial year if it is unlikely they will be filled by July 1, 2018.

Capital Outlay, Building Use Costs, and Space Allocation. Analysts should evaluate capital projects based on whether they will address a risk or hazard to public health and/or safety, support a core government function, and promote operating savings or efficiencies. Other factors to consider include compliance with federal codes and accreditation standards, potential to leverage other funding or resources, and whether the requested funding would complete a fully functional phase of a project and advance long-term economic development. Analysts shall evaluate the effectiveness of agency owned and leased space, including maintenance and renewal costs in future years, space utilization standards adopted by the Capitol Buildings Planning Commission, lease costs, and square feet per employee. Agency infrastructure capital improvement plans must comply with Executive Order 2012-023 (Facility Master Planning Guidelines) and 2013-006 (Uniform Funding Criteria, Grant Management, and Oversight), and analysts should consider progress and outcomes on previous capital outlay appropriations.

Analysts should evaluate if the agency has long-term debt outstanding and if so, the sufficiency of dedicated revenue to make annual debt payments.

Information Technology Requests. With the potential for additional revenues, the state's most critical and other high-priority information technology (IT) projects will be considered for funding. Funding recommendations will be based on conformance with agency priorities, agency and statewide IT plans, the quality of the specific business case, including cost-benefit analysis, and available funding. Agencies must demonstrate potential cost savings and/or efficiencies gained in impacted business processes. Analysts shall consider operating budget implications, such as ongoing maintenance, training, and impacts on operations, when reviewing requests for new or extended IT projects. Staff shall review IT appropriations from previous years and monitor the progress and outcome of ongoing IT projects. Analysts must ensure all IT funding requests are submitted through established protocol (i.e., requests are submitted directly to DFA, LFC, and DoIT using the "C2" budget request form separate from the agency's annual budget request) to ensure these requests receive the appropriate level of analysis prior to approval.

Agency Audit Reports. Analysts shall use the agency's financial audit reports in preparing the FY20 budget recommendation paying close attention to general fund reversions, unreserved/undesignated fund balances, and any long-term outstanding debt. Significant deficiencies and material weaknesses identified in the audit shall be reported to the LFC. Additionally, analysts shall identify significant, long-existing fund balances, barriers to expenditure, and potential reprioritization of accumulated balances.

VI. TAX EXPENDITURES AND TAX REFORM

As noted by Moody's in the bond rating downgrade, New Mexico faces a significant issue with narrow and volatile tax revenues. With a large projected reserve level, the state now has a cushion to protect against tax reform impact estimating errors, creating a great opportunity to address this issue. In particular, rising gross receipts tax rates and a base that is narrowing substantially over time, combined with the state's strong reliance on the oil and gas industry, creates a highly volatile tax structure that provides a third of the state's general fund revenues and much of local government revenues. A tax reform package that broadens the base and lowers rates would create a more stable revenue source and alleviate burdens on taxpayers created by these high rates. Some recurring general fund revenue could be used to help lower the rate as well. In addition, this would provide the opportunity to mitigate the negative personal income tax impacts on New Mexico's low-income families created by federal tax reform. Other key tax issues could also be addressed through this tax reform package, including eliminating certain tax expenditures to help pay for lower rates. LFC staff will use the 2018 Ernst & Young tax study to help identify and estimate the cost of possible tax expenditures for repeal.

In recent years, the number and magnitude of the state's tax expenditures contributed to revenue estimating error and significant revenue losses, and the state still faces the risk of losing hundreds of millions of dollars if taxpayers succeed with tax refund protest claims. Additionally, many tax expenditures have not been reviewed for efficacy or efficiency, and some no longer appear necessary. Revisiting some of the more costly tax expenditures and reducing or eliminating ones that do not offer significant benefits could free up funds to pay for rate reduction and also reduce possible future revenue losses through attempts to exploit the tax code.

VII. OTHER FINANCIAL ISSUES

In addition to agency operating budgets and revenues, analysts should consider other financial issues.

Analysts should evaluate cost-saving initiatives such as administrative cost ratios, payment and delivery system improvement initiatives, appropriateness of various rate structures, changes in federal requirements, client-generated revenue, and consider ways the state can leverage Medicaid dollars for services that improve outcomes, such as Medicaid financed home visiting. Additionally, analysts should evaluate programs initiated or expanded with ACA such as care coordination, pay-for-performance, and Centennial Rewards to ensure cost effectiveness and expected performance outcomes.

Public School Funding Issues. Funding for public schools represents approximately 44 percent of total general fund appropriations – the largest category of state spending in New Mexico. In FY19, the Legislature appropriated $2.8 billion, a 4 percent increase from FY18, for public education and allocated the new funding to increase teacher compensation, boost funding for at-risk students, and expand early childhood programs like prekindergarten and K-3 Plus. Recent data show schools making modest improvements in student achievement. However, resolutions for the education sufficiency lawsuits and shortfall in the federal special education maintenance of effort requirement remain an ongoing concern.

To build a world-class education system in New Mexico, the committee will again prioritize programs and initiatives that improve school leadership, teacher quality, extended learning opportunities, and accountability. Priorities of the committee for FY20 include adjusting the funding formula to equitably close the achievement gap, enhancing instructional time, maintaining public education accountability systems, increasing school employee compensation to recruit and retain the highest quality employees, and expanding access to early childhood programs with significant evidence of improving student outcomes.

Child Welfare and Early Childhood Care and Education. Although funding for early childhood initiatives have continued to increase over the previous few years, early childhood programs are under increasing pressure to improve statewide quality standards which typically increase costs. Priorities for FY20 include targeting existing services to children birth to age 4. Additionally, funding must be invested in a deliberate manner so that communities can grow local capacity and infrastructure responsibly. Enrollment in childcare assistance increased significantly in FY18, over 10 percent, and is projected to continue growing in FY19, FY20, and FY21. This coupled with increasing provider rates to fund the highest levels of quality considerably raised the need for additional childcare assistance funding in FY19 and resulting in increased funding needs in FY20 and FY21. New Mexico continues to struggle to meet quality childhood program standards, such as the providers' level of technical skills, education, and stability among caregivers; workforce development for providers will be crucial to improving child welfare. Investment in workforce development will be necessary to meet continued growth of early childhood services. Continued growth of early childhood programs demonstrating developmental and educational long-term gains like prekindergarten implemented by the Children, Youth and Families Department and Public Education Department will be prioritized.

Behavioral Health. Concerns remain that the state has not fully recovered from disruptions to the behavioral health system which exacerbated existing challenges to access and quality care. Over the interim, the LFC and the Legislative Health and Human Services Interim Committee (LHHS) jointly requested additional information about the Human Services Department's (HSD) efforts to ensure the behavioral health network is sufficient to meet the needs of the state's most vulnerable populations. Working together with HSD, analysts will analyze access, costs and expenditures, outcomes, and services available to best address gaps and improve outcomes with limited resources.

For non-Medicaid behavioral health administered by HSD’s Behavioral Health Services Division, analysts will assess changes as clients move from state-funded services to Medicaid-funded services and determine the best use for any additional savings realized. Additionally, analysts should assess the department’s plan for and anticipated costs and savings from the department’s migration to Falling Colors Inc. serving as the administrate services organization.

Pensions. New Mexico has two pension plans, one for public employees and another for educational employees. Although the Legislature moved to reduce the unfunded liability in both plans recently, more needs to be done. Without pension reform, unfunded pension obligations will continue to grow and affect the state’s bond rating, further imperiling the state’s ability to borrow money as well as potentially diverting funds from much-needed public policy initiatives.

Medicaid. By the end of FY19, an estimated 886,405 New Mexicans will be enrolled in Medicaid, 265,186 of whom became eligible pursuant to the federal Patient Protection and Affordable Care Act (ACA), which expanded Medicaid eligibility for adults with incomes up to 138 percent of the federal poverty level beginning January 1, 2014. While early projected shortfalls for FY18 were largely avoided due to declining enrollment, availability of federal funds for the Children’s Health Insurance Program, and a moratorium on a federal insurers’ tax. In April, the Human Services Department estimated a FY19 projected shortfall of approximately $7 million from the general fund. The outlook for FY20 may include funding requests for rate increases, rate adjustments based on more client acuity in certain cohorts, reduced federal support from 93 percent to 90 percent is estimated to cost

$36 million for the expansion population, and expansion of physical and behavioral health services included in Centennial Care 2.0.

Transportation. Transportation infrastructure including state and local roads, bridges, airports and distribution hubs require significant recurring and non-recurring increases. New Mexico's gas tax of 17 cents per gallon was last increased in 1993 and is among the lowest in the region. Over one third of the 30,000 state lane miles are rated in poor condition; rehabilitation costs average $180,000 per lane per mile. An additional $30 million annually is needed for bridge capacity and geometric upgrades on major interchanges.