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

August 8-9, 2018
Angel Fire Community Center
Angel Fire

The third meeting of the New Mexico Finance Authority (NMFA) Oversight Committee was called to order by Senator Jacob R. Candelaria, chair, on August 8, 2018 at 9:23 a.m. at the Angel Fire Community Center in Angel Fire.

Present
Sen. Jacob R. Candelaria, Chair
Rep. Bill McCamley, Vice Chair
Rep. Alonzo Baldonado (8/9)
Sen. Craig W. Brandt
Rep. Kelly K. Fajardo (8/9)
Rep. Harry Garcia
Sen. Ron Griggs
Sen. Richard C. Martinez
Rep. Jane E. Powdrell-Culbert (8/9)
Rep. Debbie A. Rodella
Rep. Patricia Roybal Caballero
Rep. Linda M. Trujillo (8/9)

Absent
Sen. Joseph Cervantes
Rep. Sharon Clahchischilliage
Rep. George Dodge, Jr.
Rep. Jimmie C. Hall
Sen. Michael Padilla
Sen. Nancy Rodriguez
Rep. Patricio Ruiloba
Sen. William E. Sharer

Advisory Members
Rep. Bealquin Bill Gomez
Sen. John Pinto
Rep. Tomás E. Salazar
Rep. Monica Youngblood (8/8)

Rep. Rebecca Dow
Rep. Brian Egolf
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. Clemente Sanchez
Rep. Sheryl Williams Stapleton
Sen. Jeff Steinborn
Sen. Bill Tallman
Sen. Pat Woods

(Attendance dates are noted for members not present for the entire meeting.)

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

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file and posted on the legislature's website.

<u>Wednesday, August 8</u>

Committee Updates

Revisiting a topic discussed at the previous meeting, Senator Candelaria announced that any member wishing to see one or more unsuccessful applications for Tribal Infrastructure Project Fund program funding could do so by contacting Mr. Eaton. He noted that the Indian Affairs Department did not provide staff with individual scoring sheets for those applications. Senator Candelaria also expressed misgivings about the Navajo Nation's, the Jicarilla Apache Nation's and the Mescalero Apache Tribe's nonperformance in naming representatives to serve on the Tribal Infrastructure Board.

NMFA Staff Transition

Kathy Ulibarri, NMFA board member and chair of the board's Strategic Planning Task Force, announced that Robert P. Coalter, chief executive officer (CEO), NMFA, who was in the audience, resigned from his position, effective in early September, to take a job with the City of Dallas. Ms. Ulibarri and several committee members praised Mr. Coalter for his work for the NMFA.

NMFA Strategic Plan Update

Ms. Ulibarri; Heather Boone, chief regulatory compliance officer, NMFA; and Linh Nguyen, LEH Consulting Group, introduced themselves and presented on the development of a new NMFA strategic plan as follows.

The NMFA board undertook the strategic planning initiative, having recognized the relationship between infrastructure and long-term economic development in the state. The NMFA is about halfway through, or in the second phase of, the plan development process. The process began with staff and board members defining the NMFA's purpose, function and potential. The current phase primarily involves gathering information from focus groups consisting of representatives of entities that the NMFA serves, as well as examining the NMFA's purpose, mission, values, core competencies, value-added competencies and vision. Many of these components — both as-identified and as-envisioned — are detailed in the presentation handout. The last component of the plan, the strategic framework, involves identifying the NMFA's direction and ways it can execute the vision defined through the planning process. Specifically, the plan will outline ways to increase the NMFA's impact through: 1) capacity building; 2) integrated project planning; 3) collaborative program financing; and 4) operational excellence. Ideally, these measures will help the NMFA facilitate large and small projects to help the state reach its potential.

Questions and Discussion

Strategic plan development. A member questioned the meaning of some of the proposed phrasing of statements integral to the strategic plan, insofar as the phrasing seemed similar to the existing mission and duties of the NMFA.

Follow-up on strategic plan; requests for information. A member requested that the NMFA follow up on the presentation at a future meeting, including by elaborating on the strategic plan results and on the specific steps the NMFA plans to take to concretely improve its performance. Mr. Coalter agreed to the request. He said that the strategic planning process is a methodology to help the NMFA better fulfill its mission, not to expand itself beyond that mission. Another member requested that the NMFA bring before the committee proposals for statutory change, if any, necessary for the NMFA to fully implement its strategic plan.

Mr. Coalter further elaborated on the strategic planning process, saying that it is intended in part to stimulate dialogue with representatives of small-scale and large-scale clients and partners and to learn their estimation of the NMFA's performance.

Recommendations for the NMFA. Members recommended that the NMFA: 1) in anticipation of a new administration, prepare to articulate its goals to the new administration; 2) make its application processes clearer and easier and offer training to those completing applications; 3) help applicants better understand whether programs are loan-based, grant-based or both; 4) through its strategic planning information gathering, gather feedback from all of its constituency types; 5) collaborate with other state agencies and private lending institutions; and 6) present to the committee.

NMFA board. Ms. Ulibarri noted that several members of the board will remain on the board throughout and after the period of transition to a new executive branch administration.

NMFA's role in the state's financing landscape. Mr. Coalter noted that the NMFA seeks not to compete with other financing service providers in the state but, rather, to provide a service otherwise unavailable to its clients. By virtue of their particular characteristics and needs, certain local governments such as the City of Albuquerque, he said, are better suited to access financial markets on their own.

Overview of Drinking Water State Revolving Loan Fund

Marquita D. Russel, chief of programs, NMFA, delivered a presentation on the Drinking Water State Revolving Loan Fund program administered by the NMFA as follows.

Program overview. The Drinking Water State Revolving Loan Fund program, in which the NMFA partners with the Department of Environment's Drinking Water Bureau, has been in place since 1997. Since then, a significant number of loans, made possible through United States Environmental Protection Agency (EPA) grants and state matches, have been repaid. The bureau handles the technical aspects of the program's administration, and the NMFA handles the program's financial aspects and reporting.

Loans and loan terms. Program loan interest amounts vary but are at or below market rates. A portion of all loans made are to small systems. Borrowers classified as severely disadvantaged communities enjoy 0% rates on amounts up to $600,000 and terms up to 30 years. Somewhat less advantageous loan terms apply to borrowers classified as disadvantaged communities, non-disadvantaged communities and private nonprofit water systems. Meanwhile, an additional subsidy, in the form of partial principal forgiveness, is available to borrowers. It brings a grant-like element to the program.

Considerations related to federal funding. Given the program's federal element, certain restrictions, termed "cross cutters", apply to project spending. The restrictions generally increase project costs and time for project completion.

Fiscal year (FY) 2018 program highlights. New Mexico has managed to substantially improve its rate of program spending. Whereas 12 years ago it had 48% of its program funds unspent, at the end of FY 2018, that figure was at less than 4%. The EPA has recognized New Mexico for this achievement. Furthermore, the state is making progress toward meeting, or has met, other federal targets, such as having all "legacy" grants expended. At present, there are 29 projects, with an aggregate construction budget of about $24.5 million, under construction.

<u>Questions and Discussion</u>

Proposed program changes; request for information. Ms. Russel noted that the NMFA is considering changes to its program policies to make the program more attractive to borrowers and is working with the federal government to attempt to mitigate the effects of the cross cutters.

Senator Candelaria instructed committee staff to draft a letter from the committee to the EPA requesting that it consider relaxing some of the federal requirements limiting the program's potential. He also requested that NMFA staff provide committee staff with lists of: 1) the 29 projects under construction; 2) program loans closed; and 3) program projects completed.

Report on NMFA Low-Activity Funds

As follows, Ms. Russel reported on the NMFA funds labeled in a report by the Office of the State Auditor as "stagnant", or marked by low activity. Of those funds, only one, the Primary Care Capital Fund, is active. The General Appropriation Act of 2018 swept money from the remaining dormant funds, whose combined balances before the sweep totaled about $1.5 million. The Primary Care Capital Fund's low activity is due in part to recent changes at the federal level diminishing borrowers' ability to carry debt. In response, the NMFA is exploring the possibility of broadening the eligibility associated with that fund's program to increase use of the fund.

Questions and Discussion

Clarification on programs associated with funds. In response to members' questions, Ms. Russel clarified aspects of the programs discussed.

Reversion of money in bond funds. Mr. Coalter noted that, in contrast to general funds and state funds, many of the NMFA's funds hold deposits of money from bond sales and are not revertible. Following a review of its funds, the NMFA determined that the most that could be reverted from those funds was the approximately $1.5 million transferred to the General Fund.

Proposed program changes; request for follow-up. Senator Candelaria instructed committee staff to work with NMFA staff on drafting a bill, for presentation at the December meeting and to the Legislative Health and Human Services Committee, reflecting the changes contemplated by the NMFA.

Overview of the New Mexico Municipal League (NMML) and New Mexico Counties (NMC) — Suggested Changes to the NMFA Act

Santiago Chavez, finance and administration director, NMC, and Regina Romero, intergovernmental relations director, NMML, outlined as follows some of the NMFA-related statutory changes that the NMML and NMC have considered. Mr. Chavez noted that NMC has not formally endorsed any of the measures. Zach Dillenback, chief lending officer, NMFA, joined the presenters.

County correctional facility gross receipts tax. A bill introduced in the last session would ease requirements for local governments in their use of excess revenue from the county correctional facility gross receipts tax. Currently, counties that have pledged such revenue to the repayment of bonds or other indebtedness must deposit excess revenue in a mandatory redemption fund. This requirement strains those counties' finances and complicates accounting for associated lenders.

Mr. Dillenback commented that the current law embodies a deviation from standard business practice. He added that it has interfered with the NMFA's ability to serve, and in some cases has driven up costs for, local governments.

County emergency communications tax. Another such bill would have expanded the permissible uses of revenue from the county emergency communications and emergency medical and behavioral health services tax to include building-related needs.

Mr. Dillenback noted that the NMFA has observed the need of some counties for the construction or improvement of buildings housing emergency communications equipment.

Fire Protection Fund. A third proposed change in law involves loans from the Fire Protection Fund. Were the change enacted, a borrower could have more than one (the current limit) outstanding loan at a time and would be able to use loan money to purchase land for fire stations and fire substations.

Municipal revenue and refunding bonds. Lastly, a previously introduced bill would amend the statute authorizing municipalities to issue refunding bonds. The amendment would allow for changes to the pledge of revenue when issuing refunding bonds. Currently, the law allows counties, but not municipalities, to make such changes.

Mr. Chavez noted the possibility that the disparity in law is attributable to the fact that municipalities generally engage in more enterprises than counties.

Mr. Dillenback commented that the current law impedes both the financial markets and local governments.

<u>Questions and Discussion</u>

County emergency communications tax. Mr. Dillenback clarified that some counties do, and others do not, have the bonding capacity to pursue the construction or improvement of buildings housing emergency communications equipment through their imposition of the county emergency communications tax. He agreed to follow up with the committee on permissible uses of the county emergency communications and emergency medical and behavioral health services tax.

In response to a member's request, Mr. Chavez agreed to provide to committee staff an updated table of county gross receipts taxes for distribution to the committee.

Fire Protection Fund. Some members expressed agreement with the idea of allowing for multiple outstanding loans from the Fire Protection Fund; others questioned the need for the provision. Ms. Romero noted that it would give local governments greater flexibility. Meanwhile, a member expressed uncertainty toward the idea of expanding the allowable uses of money from those loans, and another member remarked that local governments should be given greater freedom, generally, in their uses of tax revenue.

Mr. Dillenback clarified that the state fire marshal controls the formula determining the amounts of money distributed to local governments from the Fire Protection Fund. He said, too, that money from the fund cannot be used without the state fire marshal's approval; that provision prevents a local government from assuming too much related debt. He also noted that the NMFA carefully analyzes its borrowers' capacity to repay loans and makes conservative loan decisions.

Municipal revenue and refunding bonds. Ms. Romero stated that the measure changing the law on municipal revenue and refunding bonds would help some municipalities with declining populations. Mr. Dillenback clarified that the matter pertains to refunding existing debt obligations.

NMC and NMML endorsement. Ms. Romero said that the NMML will identify its policy priorities at a future NMML meeting. Senator Candelaria asked that, concerning the legislative proposals presented, the NMML, NMC and the NMFA inform the committee of their respective organizations' priorities and bring to a future committee meeting those among them that they would like considered for endorsement.

NMFA's Use of Delegation Authority for Public Securities Sales; Highlights of the Department of Transportation (DOT) and Public Project Revolving Fund (PPRF) Bond Programs

Michael Zavelle, chief financial strategist, NMFA, and Mr. Dillenback reported as follows on the use by public bodies of delegation authority for finalizing final terms of bond sales, which use is authorized under a law that took effect on July 1, 2017. A provision of the new law requires the reporting.

NMFA's use of delegation authority for public securities sales. Use of the delegation authority has benefited the NMFA. It has increased the flexibility around bond sale timing and, thus, the NMFA's efficiency. It has encouraged NMFA board members to engage more in the bond sale process. It has also allowed for the elimination of approval risk premiums.

The NMFA plans to put forth a proposal to make analogous changes to the PPRF program — specifically, changes that would replace the legislative project authorization requirement with a reporting requirement or that would increase the threshold for project cost that triggers the requirement for authorization. Such a change would give entities that did not anticipate the need for borrowing from the PPRF access to PPRF financing.

DOT bond sale. The recent refinance of DOT debt, which eliminated the cliff payments the state would have had to make in 2025 and 2026, is an example of how money can be saved through use of the delegation authority provision.

PPRF program. The PPRF program, NMFA's flagship program, features senior and subordinate lien components. The senior lien is rated AAA by Standard & Poor's (S&P), and Aa1 by Moody's. The subordinate lien is rated AAA by S&P and Aa2 by Moody's. Graphs in the presentation handout show the proportions of PPRF revenue in future years, one with and one without governmental gross receipts tax (GGRT) revenue, to debt service over time. Other graphs and tables show, for that period, the proportions of revenue to debt service for each of the PPRF's liens.

The GGRT component of the PPRF program markedly strengthens the program. That strength was compromised following the diversion away from the PPRF of about $65 million in GGRT revenue over the past four years. Because of that diversion, the NMFA had to use its line of credit and impose a moratorium on disadvantaged funding for the program.

High loan credit standards, too, make the PPRF program strong. That strength is evinced by the program's absence of loan defaults.

Tables and charts in the presentation handout show various PPRF program interest rates, the concentration of loan revenues by borrower and pledge for the largest 20 borrowers and the concentration of loan revenues for the smallest 20 borrowers.

<u>Questions and Discussion</u>

GGRT diversions. Mr. Coalter characterized the GGRT diversions discussed in the presentation as damaging to the PPRF program. He added that lowering the percentage allocation of GGRT revenue to the PPRF would have grave consequences, including the loss of faith by investors. Mr. Zavelle added that the NMFA would not be requesting a replenishment of the diverted money and that, if the program continues without detriment to it, the disadvantaged funding component will be reinstated.

Agriculture finance program proposal. A member spoke in favor of the idea of diversifying the state's economy by establishing a low-interest agricultural loan program. Mr. Coalter recommended involving experts in agriculture in the discussions around establishing such a program and then turning to the NMFA for help in establishing the program's financing component.

DOT bond refinance. Mr. Zavelle clarified that the most important outcome of the recent DOT bond refinance was the elimination of risk. Several changes in circumstance made it advantageous to engage in the transaction at the time the state did, he said.

Recess

The committee recessed at 2:35 p.m.

<u>Thursday, August 9</u>

The committee reconvened at 9:17 a.m. on Thursday, August 9, with Senator Candelaria chairing the meeting.

NMFA staff transition. Mr. Coalter announced that the NMFA had selected John Gasparich to serve as its interim CEO.

Charter School Facility Financing

Matt Pahl, executive director, New Mexico Coalition for Charter Schools; Marit Rogne, fiscal analyst, Legislative Education Study Committee (LESC); and Mr. Dillenback presented on charter school facility financing.

New Mexico Coalition for Charter Schools perspective. As follows, Mr. Pahl gave an overview of charter schools in New Mexico, the history of charter school facilities, the current sources of funding for charter school facilities and issues with that funding.

Charter schools, which have been in the state since 2002 and which employ innovation in their educational methods, are free and open to all students. They are governed independently but held accountable to their authorizing bodies. Generally, they are funded as school districts are funded. At present, there are 96 charter schools with 25,000 students in the state.

Having originally not been provided for, state-based assistance for charter school facility funding began in 2005 through the Public School Capital Outlay Council (PSCOC) lease assistance program. In the absence of that assistance, charter schools generally use portions of their state equalization guarantee distributions, which are ordinarily intended to pay for operations, to pay for their facilities. The PSCOC has announced a plan to reduce its lease assistance program funding by 20%.

Meanwhile, charter schools are struggling to secure adequate facilities, and their growth is stymied by the facilities-related issues they face. The law requires charter schools, in time, to occupy public buildings, but there are no available public buildings in many places. The law also requires that school districts make their unused facilities available to charter schools, but that law is not complied with faithfully. Furthermore, charter schools, unlike school districts, are not entitled to property tax revenue for facilities, and the PSCOC capital awards made to charter schools are difficult for the schools to access. Graphs in the presentation handout show the disparities in operational and facilities funding for school districts and charter schools.

To finance their facilities, charter schools can turn to lease assistance and, for district-authorized charter schools, capital assistance from those districts. Neither is a reliable, adequate source of funding. In the case of lease assistance, the amounts of funding fall short of true costs, and many leases' terms leave charter schools at a disadvantage.

Mr. Pahl proposed the following potential remedies for the issues he raised: 1) encourage the co-location of charter schools and district schools; 2) clarify the law to improve charter schools' access to funding from local mill levy bonds; 3) allocate portable classrooms to charter schools; 4) establish a revolving loan fund for charter school financing; 5) improve the ease with which charter schools can finance their facilities through NMFA-administered programs; and 6) encourage the construction of campuses customized to meet charter schools' needs.

LESC perspective. Ms. Rogne responded as follows. The lease assistance program was never intended to cover all, but rather only about one-half, of charter schools' lease costs. Furthermore, it was designed not as an entitlement program but, rather, as a benefit program. Amid the decline of other programs, the lease assistance program has grown. The PSCOC recently found that some charter schools were reporting more square footage than they actually occupy in their applications for lease assistance.

NMFA perspective. Mr. Dillenback introduced his presentation by noting that the NMFA has involved itself in charter school facility financing through its Smart Money Loan Participation, New Markets Tax Credit and PPRF programs. He continued as follows. Many charter schools have requested PPRF funding and, consequently, PPRF authorization bills include many charter school projects; however, that inclusion does not necessarily signal creditworthiness or loan readiness, and often the risk associated with charter schools makes them ineligible for PPRF loans.

When the NMFA reviews a charter school's application for PPRF funding, it looks at the length of the school's existence; its administrative and financial capacity; its loan-to-value collateral ratio or, in the case of a school district acting on behalf of the charter school, that of the school district; and coverage as a proportion of total revenue.

The NMFA has engaged in two charter school-related PPRF transactions. One was a loan made in August 2013 to the Albuquerque Public School District (APS) for the Digital Arts and Technology Academy. The transaction consisted of an arrangement in which the NMFA owned the facility and leased it to the APS, which in turn leased it to the charter school. Payments on that loan were made on time and as agreed, and the loan has been repaid in full following the APS's exercise of its purchase option. The other was a loan to Socorro County for the Cottonwood Valley Charter School. The loan was made in November 2013 and is scheduled to mature in May 2023. Underlying that loan are a lease by the county to the charter school and a pledge of the county's gross receipts tax revenue.

In general, the NMFA faces limitations in its PPRF financing of charter school facilities. First, the PPRF program was not designed for that purpose. Second, the terms of most PPRF loans exceed charter schools' charter renewal cycles; that imbalance increases the risk of loan default. Relatedly, when the NMFA engages in these types of transactions, it runs the risk of acquiring a charter school facility, which it is not in a position to easily dispose of or manage.

Questions and Discussion

Lease assistance program. On the subject of the Public School Facilities Authority's (PSFA's) administration of the lease assistance program and issues surrounding the recent audits of charter schools participating in the program, Mr. Pahl expressed the view that part of the problem stemmed from charter schools' misunderstanding of the criteria for reimbursement of lease costs. He said that the PSFA recently changed the criteria amid charter schools' continuation of their program reporting practices. Ms. Rogne asserted that the criteria have not changed. A member expressed the view that, in the context of this issue, there is too little transparency and communication to the legislature by the PSCOC.

Charter school facilities; PPRF financing. Members cited specific examples of problems charter schools have faced in securing permanent, long-term facilities, saying that the situation hampers charter schools' abilities to fulfill their educational missions. Other members remarked that the PPRF program is an ill fit for charter school facility financing, in that it introduces too much risk to the program. A member suggested the possibility of financing such facilities through the establishment of a separate fund with different requirements and higher risk tolerance.

Regarding charter school facilities, Mr. Pahl said that: 1) the Construction Industries Division of the Regulation and Licensing Department has developed standards for educational occupancy, which influence the design of charter school facilities; 2) groupings of portable classrooms on publicly owned land satisfy the legal requirement for occupancy in a public building; and 3) if a charter school failed to pay on an underlying lease, the entity underwriting a PPRF loan could lease the property to another charter school.

New Mexico Coalition for Charter Schools — information presented and recommendation. A member remarked that some of the information in the graphs of the New Mexico Coalition for Charter Schools handout seemed deceiving and characterized some of the comparisons as unfair. Another member recommended that the coalition develop a comprehensive model for charter schools to reference when securing and financing their facilities, one that includes a list of ways to partner with local governments and surrounding communities. Mr. Pahl noted that the coalition sometimes offers its services to non-coalition-member charter schools.

Other charter school issues. Mr. Pahl clarified that: 1) the decrease in the number of charter schools since 2015 is partly due to some charter schools' failure to meet the performance measures outlined in their contracts; and 2) the solvency measure that swept schools' cash balances applied to charter schools and, in some cases, dispensed with money that the schools had been saving to purchase facilities.

Adjournment

There being no further business before the committee, the third meeting of the NMFA Oversight Committee of the 2018 interim adjourned at 11:33 a.m.