DRAFT GUIDELINES

These guidelines are for discussion purposes only and subject to change upon adoption by LFC.

FY22 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 FY22 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 FY22.

II. REVENUE OUTLOOK

Following the outbreak of the novel coronavirus pandemic and subsequent crash in the oil market, New Mexico's revenue sources faced significant strain in the last half of FY20 that is expected to persist in the years to come. On the heels of two consecutive years of double-digit growth, recurring revenue in FY20 is estimated at $7.3 billion, a drop of 8.4 percent from the prior year, and FY21 revenues are projected to fall another 20 percent to $5.9 billion. Although the June 2020 consensus revenue estimate projects growth in FY22, recurring revenue is projected to be $991 million below FY21 recurring appropriations of $7.2 billion. About $146 million of the $991 million was a federal fund swap in FY21 that would need to be backfilled to maintain spending levels, or not.

The 2020 special session ended with a plan to spend about $1 billion of general fund reserves in FY20 and FY21, leaving a projected ending reserve balance of $818 million, or 11.4 percent, heading into FY22. This projection depends on whether federal CARES Act state relief funds are fully expended on eligible costs in FY21 with no reversions to the federal government, which would require the further use of state reserves.

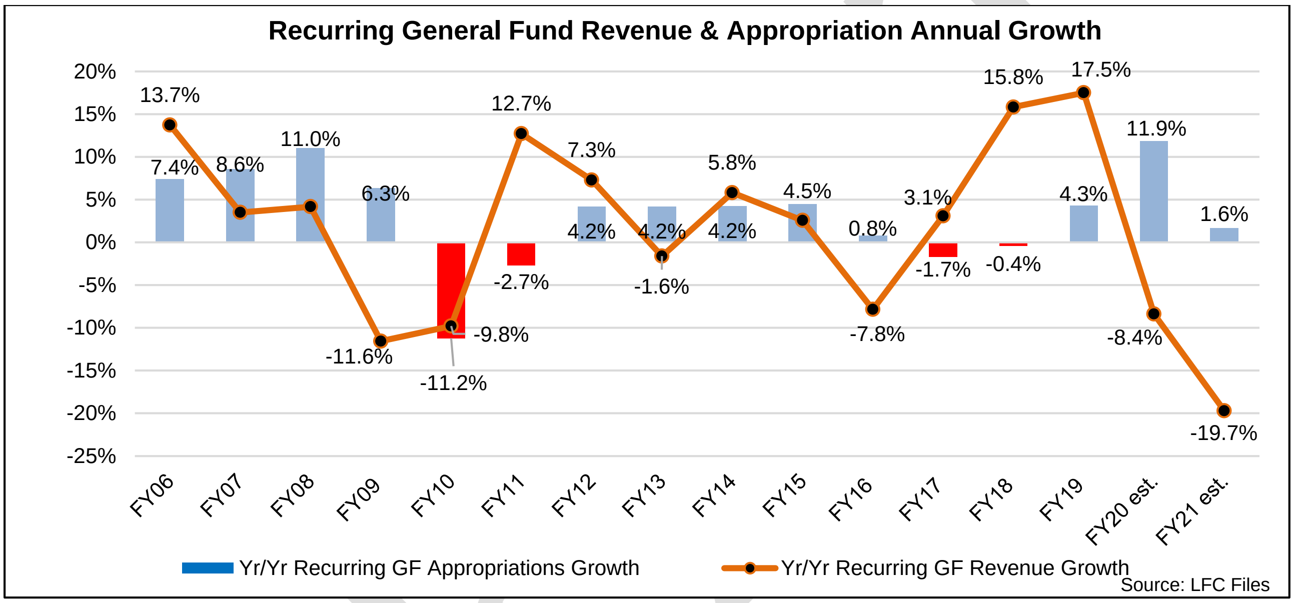
Recent data shows early signs of potential upside to the consensus forecast. Gross receipts tax revenue in April fell less than expected, unemployment levels dropped in May and June, drilling rig count declines have slowed significantly, and New Mexico's oil prices are currently tracking about $4 per barrel ahead of the forecasted FY21 average price of $31. If that strength holds, revenues may decline less than originally projected, which would reduce the gap between recurring revenues and recurring appropriations in FY22.

Notably, however, even under the consensus estimate's optimistic scenario that assumed higher energy prices, stronger production, and a faster economic recovery than the baseline forecast, FY22 recurring revenues were still projected to fall short of current budget levels. Additionally, the current economic recovery depends on the ability to keep the virus under control. Infection rates are growing in some states as their economies reopen, which threatens the recent job recovery, particularly in the leisure and hospitality sectors. Updated revenue estimates will be released in the fall, but in any case, New Mexico is not out-of-the-woods of having to make difficult decisions for the budget year to come.

III. FY22 PRIORITY AND APPROACH

General fund revenue growth has again plummeted significantly since the financial crisis of the Great Recession and oil price collapse. The committee's goal is to propose a balanced budget with an average general fund reduction of $350 million, or five percent.

Instead of balancing the budget with appropriation reductions alone, the committee will approach closing the $991 million gap use a mix of appropriation reductions, other non-recurring revenue, and recurring revenue increases, such as reducing tax expenditures, with each strategy contributing about a third of the cost to close the budget gap.



Education continues to be the state and Legislature's highest priority and 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 consider general fund appropriation reductions in most state agency budgets. Priority for smaller reductions will be considered to improve outcomes for New Mexicans, including evidence-based programs, and demonstrated cost-effectiveness. Adjustments will recognize changes in public and higher education enrollment, program caseload, workload, waiting lists, and medical and per diem inflationary costs.

In order to maintain as much funding as possible for prioritized programs, the committee will consider replacing general fund revenue with other state funds, such as the Public Education Reform fund and federal funds; and 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.

Given continued reliance on volatile revenue sources, the committee will also focus on fiscal stability measures, such as stabilization funds that could provide a source of future revenue to priority areas, including public schools, higher education and early childhood services. The committee will seek to maintain General Fund reserve levels of 10 percent to 15 percent because of continued 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 FY22 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 boosted spending on personal services and employee benefits (PS&EB). Also, elevated vacancy rates have resulted in large amounts of PS&EB funding transferred to other areas of the budget.

A hiring freeze, combined with historically high vacancy rates, have created savings in agency budgets. Analysts shall review historic staffing levels and determine an appropriate vacancy rate to be applied to agency budgets. Recommendations for FY22 will consider elimination of authorized, but vacant, positions to reflect historic staffing levels.

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 SHARE, the state's accounting system, 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.

Building Lease Costs. State employment remains well below peak levels while leased and owned square footage has not changed. Further, required telecommuting in response to the public health emergency and enhanced online services provide opportunities to reexamine the need for as much space. For agencies with significant general fund lease costs, alternatives to leasing should be evaluated, such as relocation to existing vacant state buildings.

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 FY22 budget recommendation. Governing statutes shall be reviewed to ensure that funds are budgeted appropriately and whether they may be used for other purposes. Analysts shall determine where opportunities exist to raise fee and other revenues for agency operations. See Section VI.

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. Analysts should ensure state funding is not duplicating what could be used with federal funds, and to account for federal funds carrying over from year to year. 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, and other sources of information on federal funds. Analysts shall track all federal funds received under the CARES and related federal act and determine availability of all stimulus funds for FY22. Additional, analysts will 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 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, 2022.

Maintaining Investments in Technology and Facilities. Recurring annual investments in agency based operating budgets for information technology upgrades and replacement of equipment, and for basic maintenance of state facilities has lagged due to multiple rounds of solvency actions over the past decade. However, agencies made significant investments into refreshing technology in FY19 and FY20. The committee will consider appropriations for recurring information technology and facility maintenance funding for agencies with critical needs, which leverage other funds, and have multi-year plans to address enhanced services and efficiencies.

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. Given the revenue decline, only the state's most critical 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 shall not consider IT funding requests are not 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).

Agency Audit Reports. Analysts shall use the agency's financial audit reports in preparing the FY21 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 REVENUE RAISING OPTIONS

As states face sharp revenue declines following the pandemic, many are exploring options for revenue enhancement. The National Association of State Budget Officers found that tax collections from cigarettes, alcohol, and marijuana across states have grown somewhat during the pandemic despite declines in other types of tax collections. Some states are considering tax increases on these items to help with budget shortfalls. Maryland approved a tobacco tax increase in March and other states including New Jersey, Georgia, Colorado, and Michigan are considering similar measures. Budget concerns may also prompt more states to pursue alcohol tax increases and marijuana legalization efforts. Although estimates vary, analysis from the Taxation and Revenue Department in 2019 suggests the state could expect $30-$40 million a year in additional revenue from marijuana legalization, once the industry has scaled to capacity. Additionally, in 2018, legislation permanently increasing the distributions of the liquor excise tax cost the general fund nearly $4 million a year, and a temporary adjustment in these distributions could help shore up the general fund.

Other opportunities to raise revenues exist where taxes can be exported outside of the state or in ways that limit negative impacts on consumers. For example, HB 278 of the 2020 session proposed increasing the health insurance premium surtax, which state economists estimated would result in about $125 million of additional revenue, the majority of which would be borne by the federal government in Medicaid funds. Additionally, with the repeal of the federal health care provider fee in December 2019, this tax could replace the federal revenue collection without affecting short-term premium rates. Separately, with wind now comprising about a quarter of the state's power generation, and since power generated from wind is often exported to other states, New Mexico could consider forms of additional revenue generation from wind development. This could include a production tax similar to Wyoming's or an alternate form of taxation on wind generation that balances potential tradeoffs between revenue raising and economic development.

Tax expenditure reforms are another option for preserving and stabilizing state revenues. Various tax credits, deductions, and exemptions – tax expenditures – have narrowed the state's taxable base, leading to the need for higher rates to maintain equivalent revenue levels. The state spends over $1 billion annually on various tax expenditures, the largest of which are GRT deductions for food and medical spending (including hold harmless payments to local governments), prescription drug GRT deductions, the exemption of nonprofit organizations from GRT, and film production tax credits against income taxes. Unlike other forms of spending, tax expenditures are often not reduced in lean times similar to other budgets. For example, current statute allows for unlimited expansion of film credits through uncapped, film-partner tax credits, and credits must continue to be paid regardless of the state's fiscal circumstances.

Nonrecurring revenues can also help shore up budgets during downturns. Such options include sweeps of funds with large cash balances, swapping general fund dollars with other sources like federal funds or agency-specific revenues. These so called 'swap' and 'sweep' strategies yield varying amounts of general fund savings depending on individual agency needs. For example, estimates from the Board of Finance show the state will have about $145 million of available severance tax bonding capacity in FY21 after accounting for the projects that were authorized in the 2020 session, and some the capacity could be used to replace general fund financing of capital projects.

Reassessing user fees for government services to reflect a true-cost is also a viable option for supporting state government functions and revenues. Such fees and charges that result from voluntary choices, such as entering a park, connect the burden of financing activities to those who directly benefit from them and can help reduce the allocation of other state revenues to those direct beneficiaries. Notably, however, fees can be volatile revenue sources since collections are sensitive to economic fluctuations, which complicates financing of programs dependent on those revenue streams.

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 46 percent of total general fund appropriations – the largest category of state spending in New Mexico. In FY20, the Legislature appropriated $3.25 billion, an increase of $448.2 million, or 16 percent, over the prior year for public education. Despite a 25 percent drop in projected revenue, the Legislature grew funding in FY21 by almost 1.4 percent, and over 4 percent with the addition of federal stimulus funds. Legislative and executive education reforms have focused on: 1) supporting high quality teaching and effective school leadership; 2) expanded learning opportunities, particularly for at-risk students; 3) implementation of high quality, cultural and linguistically relevant curriculum; and 4) ensuring effective accountability systems for better student outcomes. Significant learning losses due to the COVID-19 public health emergency which required closure of schools and only a partial reopening the next school year, put recent gains in districts' student achievement at risk. Resolution for the education sufficiency lawsuits and local schools ability to effectively use the new resources to support improved student achievement remain an ongoing concern. In addition, the Legislature should continue to monitor implementation of educational reforms in response to the Yazzie-Martinez lawsuit requiring practice or administrative changes by local schools, PED and education preparation programs, including ensuring compliance with state and federal law for the Indian Education Act, Bilingual Multicultural Act and use of at-risk student funding.

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 FY22 include ensuring effective and efficient implementation of funding to equitably close the achievement gap, enhancing instructional time, maintaining public education accountability systems, and coordinating access to early childhood programs with significant evidence of improving student outcomes. Aside from using the Public Education Reform fund to implement evidence-based educational interventions and backfill general fund revenue, analysts should identify opportunities to maintain and build on the education reform efforts by recognizing workload adjustments, administrative efficiencies, reducing or eliminating ineffective interventions and reallocating resources accordingly.

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, and coordinate expansion to avoid duplication of services. Priorities for FY22 include targeting existing services to children birth to age 4, enhanced accountability for all the programs transferred to the Early Childhood Care and Education Department, and building in new revenue streams to support services, including from the Early Childhood Education and Care Fund and federal funding, particularly for Medicaid home visiting. Analysts should examine agency coordination and planning to avoid duplication of service funding for 3 & 4 year olds in preschool settings; and infants and toddlers in home visiting programs. New Mexico continues to struggle in some areas to meet quality early childhood program standards, such as the providers' level of technical skills, education, and stability among caregivers. Investment in workforce development will be necessary to meet continued growth of early childhood services. Priority for funding will be given to early childhood programs that have a demonstrated impact on education, health and child well-being, including through performance reporting and rigorous research of program models.

New Mexico continues to face increased rates of child abuse and neglect, in large part driven by parental substance use disorders, and out-of-home placement of children in foster care and other settings. Analysts should prioritize options for evidence-based child welfare prevention and early intervention services, including those that leverage federal funding such as Medicaid financed home visiting, in addition to workload changes in child protective services.

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. Funding increases to improve the network of behavioral health was largely left intact for FY21 and the Human Services Department (HSD) and Children, Youth and Families Department (CYFD) efforts should continue to ensure the behavioral health network is sufficient and effective to meet the needs of the state's most vulnerable populations. Working together with HSD and CYFD, analysts will analyze access, costs and expenditures, outcomes, and services available to best address gaps and improve outcomes with limited resources, including reallocating resources and maximizing federal revenue.

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 need for recurring funding to support services that cross systems for individuals with mental health and substance use disorders that also are involved in the criminal justice system or that need housing to alleviate homelessness.

Public Safety. Improved performance management and coordination among the various state and local criminal justice agencies (courts, district attorneys, law enforcement, public defender, counties), combined with effective implementation of evidence-based criminal justice reforms offers New Mexico a path towards improved overall public safety. Effective reforms, including technical parole violation revocation practices, offer potential for taxpayer savings from reduced costs associated with incarceration and repeated incarceration. Analysts should examine opportunities for investments in proven public safety programs and potential savings that can be reinvested further in public safety, including ensuring appropriate prison space is available, and behavioral health efforts.

Medicaid. By the end of FY21, an estimated 883,543 New Mexicans will be enrolled in Medicaid, according to current program projections. Enrollment in the program is increasing due to the COVID-19 public health emergency, which causes enormous economic changes and unemployment, at a time state revenues are plummeting. An enhanced federal FMAP for FY21 will help stabilize funding, but whether the federal government continues enhanced federal aid into FY22 remains unknown. Medicaid service providers received multiple rate increases from FY19 through FY21, but performance outcomes remain sluggish, particularly for children's prenatal and preventive care, and in multiple areas of behavioral health. States also have a set of options to increase revenue from various sources, including the federal government. This includes maximizing federal matching funds, in general, and particularly for Native Americans. States can also enhance provider taxes, intergovernmental transfers, recoveries, and other revenues such as supplemental pharmacy rebates. Analysts should monitor Medicaid spending and identify opportunities for savings that priorities access to effective services and examine savings opportunities in overhead costs, ineffective programs, and higher than needed payment rates.

Transportation. Transportation infrastructure, including state and local roads, bridges, airports and distribution hubs, require significant recurring and non-recurring funding increases to meet regular maintenance and improve the system overall. New Mexico's gas tax of 17 cents per gallon was last increased in 1993 and is among the lowest in the region. The Legislature allocated significant non-recurring appropriations for major state road projects, non-recurring increases to the Road Fund for heavy maintenance projects, and increased revenue from the Motor Vehicle excise tax for recurring transfer to the Road fund. In the 2020 special session the Legislature authorized swaps of some of these general fund appropriations with road debt. Analysts should monitor implementation of these projects, impact of the economic and health crisis on recurring road revenues, retirement of existing debt and opportunities for additional general fund swaps.