GUIDELINES FOR FY14
LFC APPROPRIATION RECOMMENDATION

I. PURPOSE

The LFC budget guidelines provide analysts with direction on performance-based budgeting, the preparation of the budget narrative, and the development of FY14 recommendations on recurring appropriations, priority capital spending, and other one-time investments. The guidelines also serve to inform state agencies and the general public about LFC priorities and the committee's approach to budget recommendations for FY14.

II. REVENUE OUTLOOK

The August forecast adjusted FY12 estimated revenues upward $218 million and projected reserves at 13 percent.

At the close of the 2012 legislative session, FY13 recurring revenue was forecast to grow by 2.8 percent, to a total of $5.7 billion; however, the August forecast added $18 million to the estimate.

The August forecast increased the estimate for FY14 revenues to $5.9 billion. "New money" in FY14 – defined as FY14 projected revenue less FY13 recurring appropriations – is $273 million, an increase of 4.8 percent over FY13 appropriations.

III. FY14 PRIORITY AND APPROACH

The goal of the committee is to propose a balanced budget for the operations of government that preserves the state's most critical services and ensures at least a 10 percent general fund reserve. The committee will recommend a balanced budget focused on education, early childhood investment, public health, public safety, and protecting vulnerable citizens.

Overall, the committee will emphasize maintaining flat general fund appropriation levels in most state agency budgets. However, growth in general fund appropriations will be considered on a case-by-case basis to replace nonrecurring revenue and address changes in caseload or workload, address program waiting lists, medical and per diem inflationary costs, and implement funding formula changes.

Given the improved fiscal outlook, the committee will recommend funds to replace short-term solvency measures that expire by statute at the end of FY13: the 1.5 percent swap of retirement contributions that shifted from the state to public employees and the use of tobacco revenue to help pay for Medicaid.

Further, LFC analysts shall:

- Carefully consider committee direction when evaluating agency base budgets and requests for additional funding or staff;

- Identify opportunities for consolidating or streamlining duplicate programs and activities, eliminating earmarks, and enhancing efficiency;
- Identify successful programs that provide the best return to taxpayers and identify programs that are not producing positive results and are of lower priority to the state; and
- Continue to search for cost-saving opportunities in all areas of the budget.

IV. PERFORMANCE AND ACCOUNTABILITY

The Accountability in Government Act (AGA) remains a top priority. Analysts should 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 results, effective design, and strong planning and management. Analysts should follow these guidelines in reviewing agency performance:

- 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, and (3) programs are consistent with current resources and conditions. Agency resources should be 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. Analysts should recommend new or alternative performance measures that better gauge program outcomes as necessary.
- Performance data and results from recent LFC program evaluations should be used to identify programs that are ineffective or producing marginal results or are achieving desired outcomes.

Analysts' FY14 budget recommendation will ensure that all programs, sub-programs, and initiatives are reviewed to determine those that:

- Are no longer needed because goals or other conditions have been met or changed;
- Exhibit mission drift or have demonstrated minimal success in fulfilling their missions;
- Are restricted in scope, thus limiting impact or efficiency;
- Are unfocused, cannot demonstrate effectiveness, or cannot be evaluated;
- Are not effective according to external evaluations;
- Cannot clearly exhibit benefits;
- Are high cost; or
- Could be funded by user fees or other alternative sources.

V. BUDGET GUIDELINES

The following budget guidelines apply to all agencies.

Full-Time Equivalents (FTE) and Vacancy Rates. Analysts shall reconcile FTE by classification (permanent, term, temp), with the FTE authorized in Laws 2012, Chapter 19. A new personal services and employee benefits vacancy analysis worksheet is being implemented in the FY14 budget process. This worksheet will streamline analysis of vacant positions as well as the financial impact of these vacancies. In light of the statewide high vacancy rate, using the worksheet analysts shall consider:

- Eliminating nonessential vacant positions;
- Revenue sources that support vacant FTE;
- Prior-year budget adjustments moving funds from the personal services and employee benefits category;
- Agency-applied vacancy rate versus the cost of fully funded authorized FTE, historical vacancy rates, current operating budget funded and unfunded vacancy rate, and actual vacancy rate at the time of budget submission;
- Consideration will be given to employment levels that ensure agencies can meet AGA performance measures;
- Vacant positions not eliminated should be budgeted at a salary level that ensures effective recruitment and retention of qualified candidates; and
- Analysts should discuss funding sources being used by agencies to pursue "shared services" MOUs and mechanisms by which funding is transferred to the State Personnel Office.

Expenditures and Contractual Services. Analysts should understand the rationale behind increases or decreases in agency expenditures in the budget request compared to prior years. Where an agency made significant non-recurring expenditures, analysts shall consider adjusting expenditure levels downward for FY14 as necessary. Staff is directed to careful analyze requested expenditures for professional services contracts. This analysis should address (1) whether the proposed contracts address agency priorities, (2) include performance criteria, and (3) agency monitoring activities. Analysts shall use the monthly *Contracts Repor*t provided by DFA and information in the New Mexico Sunshine Portal 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. For agencies with significant general fund lease costs, alternatives to leasing should be evaluated, such as relocation to existing vacant state buildings or use of capital funds for new facilities. Analysts shall consider reduced staffing levels, consolidations, new market factors affecting commercial property such as commercial property vacancy rates and the continued need for space in leased and state-owned buildings.

Revenues and Cash Balances. Analysts should determine if estimates of non-state revenue sources in the agency requests (other revenues and other transfers) are reasonable based on grants awards, agreements, and program history. To reduce the need for revenue from the general fund, staff shall analyze cash balances and, where possible, recommend the use of cash balance in the FY14 budget recommendation. It is preferable that cash balances be recommended for nonrecurring purposes. Governing statutes shall be reviewed to determine if funds are budgeted appropriately and if they can be used for other purposes. Analysts should scrutinize expenditures where an earmarked revenue is in decline or unavailable.

Federal Funds. Federal funds should be leveraged to the maximum extent possible in keeping with the committee's policy priorities. Staff is directed to compare the information on the R-forms provided in the budget requests with historical budget adjustment activity, deviations from the General Appropriation Act in the operating budget, the LFC federal funds schedule for key agencies, the database provided by the Federal Funds Information for States (FFIS) service, and other sources of information on federal funds to ensure federal funds are accurately reflected in the budget recommendation. Staff shall also use historical budget adjustment request (BAR) information to determine if the level of federal funds is accurately reflected in the agency request.

Base Expansion. Staff shall critically review the merits of any expansions of existing base programs. (Workload growth is not considered a program change.) Analysts must avoid financing expansions with nonrecurring revenue. Generally, expansions, other than those identified as a committee priority, must be financed through reprioritization of current appropriation levels. All expansions must be tied to enhanced performance and explained in the budget document accordingly. Expansion positions should be budgeted for a partial year if it is unlikely they will be filled by July 1, 2013.

Capital Outlay. Staff shall consider operating budget implications when reviewing requests for facility construction, renovation, expansion, or demolition. Staff shall review agency Infrastructure Capital Improvement Plans (ICIP), agency compliance with Executive Order 2012-023 (Facility master planning guidelines), LFC quarterly reports, and monitor the progress and project outcome of significant capital appropriations made in previous years. Recommendations shall consider funding in operating budgets for maintaining infrastructure in future years.

Information Technology Request. Staff shall consider operating budget implications, such as ongoing maintenance, training, and impacts on operations, when reviewing requests for new or extended information technology (IT) projects. Staff shall review IT appropriations from previous years and monitor the progress and outcome of ongoing IT projects. Recommendations for new IT projects shall be based on conformance with stated agency priorities, agency and statewide IT plans, quality of business case, and available funding.

Agency Audit Reports. Staff shall use the agency's financial audit reports in preparing the FY14 budget recommendation. Pay close attention to reversions and unreserved/undesignated fund balances. It is important to have timely completion of the audit. Significant audit findings shall be reported to the LFC.

Budget Adjustment Requests. Budget adjustment data provides historical information regarding an agency's real budget needs. Analysts shall incorporate historical BAR information to identify opportunities to evaluate the adequacy of program funding and the potential to shift funding to other areas. Staff is directed to review BAR language in the General Appropriation Act and to propose modified language that shall clarify any ambiguities or close loopholes.

VI. TAX EXPENDITURES

The committee shall review tax expenditures to identify uses of state funds that do not meet the intended purpose or are not cost-effective and can be re-directed to higher priority uses.

VII. OTHER FINANCIAL ISSUES

In addition to agency operating budgets and revenues, committee staff should review the impact other financial issues may have on state finances and make appropriate considerations and recommendations to the committee including:

Federal Funding/Sequestration. With passage of the Federal Budget Control Act of 2011, states are facing possible declines of up to eight or nine percent for federal fiscal years 13 and 14, although there are exemptions primarily for low-income and transportation programs. The education, energy, environment, justice, community development, housing, labor, and low-income home energy assistance programs and the social services block grant will likely see these more substantial reductions in FFY13. Additionally, defense spending could see a 10 percent reduction for FFY13. New Mexico could experience impacts due to federal and military employment reductions as well as procurement and defense contracting decreases. However, Congress could act to undo all or some of the defense and other reductions.

Pension Fund Solvency. The state continues to face significant growth in funding requirements to address the unfunded liabilities for its pension benefit plans. The unfunded actuarial accrued liability (UAAL) now stands at $10.4 billion (67 percent funded), up from $8.3 billion (72 percent funded) in FY10, coupled with a $3.3 billion UAAL for retiree health benefits. The main causes of the deterioration of funded status include lackluster investment returns, relatively generous plan benefits and contributions in statute that are inadequate to cover future benefits. In addition, in this low-interest environment, pressure is mounting for the funds to lower projected investment return assumptions. Lowering investment assumptions, even slightly, shortens the time period before insolvency and may require decreasing benefits or turning for more cash from taxpayers in the form of increases to contribution rates in statute. Consideration of any employer contribution increases, including the remaining two years of .75 percent increases to the ERB fund, will be evaluated in light of comprehensive pension reform including consideration of benefit changes.

Medicaid Expansion Due to the Affordable Care Act. Pursuant to the federal Affordable Care Act, New Mexico can expand Medicaid eligibility for adults with incomes of up to 138 percent of the federal poverty level starting on January 1, 2014. The federal government will cover 100 percent of the cost of these new enrollees for the first three years but the federal match declines to 90 percent in 2020. Careful analysis of the costs and benefits of the Affordable Care Act will be necessary to determine the general fund cost to the state due to increased Medicaid enrollment as well as the impact of increased Medicaid spending (in particular federal funds) on state revenues, employment, and health care access. It may be desirable to consider a trigger for deauthorization of the Medicaid expansion if long-term federal funding commitments are not maintained.

Public School Funding Formula. Recent LFC performance evaluations indicated a need to close legal loopholes, minimize administrative costs, ensure funding equity, and align better with modern education policy. For example, the training and experience index generates $196 million, but does not directly compensate for staff salary jumps associated with teachers transitioning license levels. More than $91 million in size funding is not adequately targeted to rural, isolated schools or districts with scale inefficiencies, and charter schools disproportionately benefit from size adjustments. Additionally, the at-risk index is complex and does not fully cover the additional costs of educating at-risk students. Comprehensive changes to the funding formula will likely result in redistribution of state equalization funding. The state reserve position in FY14 may allow the use of non-recurring funding to implement changes to the funding formula with a hold harmless provision for districts and charter schools losing SEG revenue.

Road Fund Adequacy. Projections for the state road fund indicate revenues will be relatively flat and may not return to previous levels as quickly as expected. Chronic and extensive funding gaps related to the maintenance and preservation of highways, roads, and bridges across the state are expected to continue into the foreseeable future. Staff shall consider funding options to address concerns related to the sustainability of the state transportation infrastructure, including major investment projects.

Unemployment Fund Solvency. Once considered one of the most solvent, the New Mexico unemployment insurance (UI) trust fund is dangerously low with a balance below $100 million and quarterly benefit payouts still relatively high at $64 million. Employer contributions are currently set relatively low at Schedule 1 rates, will increase to Schedule 2 rates in 2013, but could increase to Schedule 6 in 2014. The Unemployment Insurance Advisory Council may recommend changes to the UI system including higher contribution rates for high risk employers, addition of a floor/ceiling mechanism for the trust fund, recalculation of the tax brackets within each contribution schedule, and criteria for suitable work.

Lottery Fund Solvency. After years of increasing student demand and rising tuition costs, the state's largest student aid program – the legislative lottery scholarship fund -- will be unable to provide full scholarships to eligible students starting in FY14. In recent years revenue from sales lottery sales dipped requiring the use of fund balances to support scholarships; however, there will be insufficient balances available to meet projected student demand for FY14. Alternatives to existing funding and program structure should be considered in light of the state's student completion goals.