

# FY23 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 FY23 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 FY23.

## **II. REVENUE OUTLOOK**

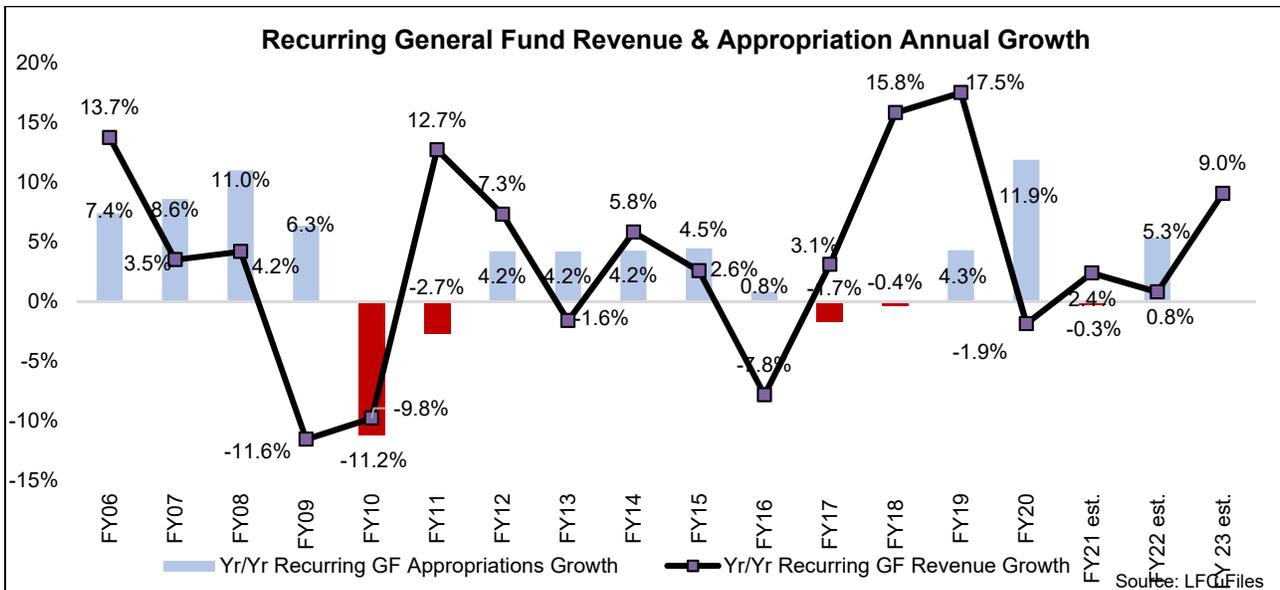
Federal stimulus and the reopening of the global economy kept New Mexico's revenues afloat despite significant peril from the coronavirus pandemic. Recurring revenues for FY21 are estimated at \$8 billion, up \$185 million, or 2.4 percent, from FY20 as stimulus-fueled consumer spending and high- and mid-wage employment grew in the first half of 2021. Additionally, strong recovery in the oil and gas markets are pushing severance tax and federal royalty collections well above their five-year averages, resulting in large transfers to the newly created early childhood trust fund. Recurring revenues for FY22 are estimated at \$8.1 billion, up \$632.8 million from the February 2021 estimate, and FY23 recurring revenues are estimated at \$8.842 billion. "New money," defined as projected recurring revenues for the following fiscal year less current year recurring appropriations, is estimated at \$1.392 billion for FY23, or 18.7 percent growth from the FY22 recurring budget.

Due to the higher than anticipated revenues, reserves remain strong. FY22 ending reserve balances are estimated at \$3.1 billion, or 42 percent, prior to any legislative action in the 2022 session and before accounting for \$1.1 billion in unappropriated and unexpended federal American Rescue Plan Act (ARPA) funds.

Revenues remain at risk to fluctuations in global energy markets, broader economic cycles, and uncertainty in legislative changes to recreational cannabis and other tax programs. For example, should oil prices crash again in the forecast horizon, total general fund, severance tax, and federal mineral leasing revenue could fall short of the baseline expectations by \$1.4 and \$1.5 billion in FY23 and FY24. However, implementation of revenue stabilizing distributions of above average severance taxes and federal royalty payments helps insulate the general fund from some revenue volatility.

## **III. FY23 PRIORITY AND APPROACH**

General fund revenue growth has again plummeted and then significantly increased since the financial crisis of the Great Recession and oil price collapse. The committee's goal is to propose a balanced budget that supports essential growth in programs and services that result in better outcomes for New Mexicans.



Education continues to be the state and Legislature’s highest priority and biggest fiscal and policy challenge. Other committee priorities include early childhood investments, 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 appropriations adjustment in most state agency budgets. Priority larger increases 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, Martinez-Yazzie responses, 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 offsetting general fund revenue with other state and federal funds for multi-year investments, and targeted cost savings where appropriate, 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. In other cases, consideration will be given to backfill depleted non-recurring funding in agency operating budgets, including federal stimulus funding for Medicaid.

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 the Medicaid waiver for people with developmental disabilities. The committee will seek to maintain General Fund reserve levels of 30 percent because of continued dependence on energy revenues.

**IV. PERFORMANCE AND ACCOUNTABILITY**

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 FY23 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.**

As the labor market heals from the effects of the Covid-19 lockdowns, competition for qualified workers will increase as higher-than-normal inflation pushes wages up nationwide. Employee-paid pension contributions for educational and state employees are scheduled to increase as will health insurance rates. To stay competitive, the State of New Mexico should examine providing across-the-board salary increases sufficient to pay for increased benefit costs as well as to replace all or a portion of increases rescinded in the first special session of 2020 and reflect the increasing cost of living. Targeted compensation increases should also be examined for hard to fill positions and included in agency base budget recommendations. Also, elevated vacancy rates have resulted in large amounts of PS&EB funding transferred to other areas of the budget.

**Benefits.** Public employees receive insurance through three separate entities: The General Services Department; the New Mexico Public Schools Insurance Authority; and Albuquerque Public Schools. Dividing public employees into three separate pools may drive costs up as purchasing power of the pools is diminished because of their small size. Additionally, the trifurcation of insurance purchasing has created disparities in coverage cost based on employers. Analysts will examine options of reducing health insurance coverage costs by increasing insurance pool size.

***Authorized FTE.*** Analysts shall review historic staffing levels and determine an appropriate vacancy rate to be applied to agency budgets. Recommendations for FY23 will consider elimination of authorized, but vacant, positions to reflect historic staffing levels. Recommendations to reduce funded vacancy rates should reflect analysis of workload and any waiting lists for services.

**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.

**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 FY23 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.

**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 federal stimulus Acts in 2020 and 2021 and determine availability of all stimulus funds for FY23. Additionally, analysts will use historical budget adjustment information to determine if the level of federal funds is accurately reflected in the agency request.

The Committee will make recommendations to authorize the use of American Rescue Plan Act state fiscal recovery fund revenue at the 2021 special session on apportionment or the 2022 regular session.

**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 or that lack a long-term financial plan. 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, 2023.

**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.*** The Committee intends to have a Capital Outlay subcommittee review staff recommendations for a capital outlay framework. 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 agency use of state- owned and leased space, based on space utilization standards adopted by the Capitol Buildings Planning Commission, lease costs, and square feet per employee. Further, required telecommuting in response to the public health emergency and enhanced online services provide opportunities to reexamine space needs. For agencies with significant general fund lease costs, alternatives to leasing should be evaluated, such as relocation to existing vacant state buildings or a proposed executive office building. Analyst should consider opportunities for providing recurring maintenance revenue through a building-use fee to maintain state-owned facilities. Funding maintenance costs through annual fees will increase severance tax bond proceed availability for larger impact projects.

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 significant number of outstanding IT projects and delayed projects, 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 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 FY23 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 RATES**

Tax reform discussions over the years have often considered base-broadening efforts that reduce or eliminate tax expenditures to pay for lowering the GRT rate or expanding anti-pyramiding provisions in the tax code. Such actions would reduce the burden of doing business in New Mexico with the goal of improving the state's economic conditions. Tax pyramiding occurs when the GRT is applied to business-to-business purchases of goods and services, creating an extra layer of taxation at each stage of production. New Mexico currently has anti-pyramiding provisions for many goods-based inputs, but service-based inputs are still largely taxed, which can be particularly difficult for smaller businesses unable to bring those services in-house and instead contract for services like accountants, attorneys, and human resource functions. The burden of pyramiding is then exacerbated by rising GRT rates. A tax reform package that broadens the GRT base and lowers rates would help mitigate the impact of pyramiding and alleviate the taxpayer burden created by high rates. Tax changes passed in the 2019 legislative session contained several base-broadening efforts, including the addition of internet sales and nonprofit and government hospital receipts to the GRT base; however, the revenue generated from the 2019 tax changes effectively paid for additional film tax credits rather than lowering GRT rates.

Consideration will be given to lowering GRT rates and anti-pyramiding mechanisms. Unfortunately, rate reduction is expensive. A one percent decrease in the state GRT rate (currently 5.125 percent) would cost about \$615 million as of the last consensus revenue estimate, with the cost increasing as estimated GRT collections increase. Some recent proposals have considered more manageable rate reductions, such as one-quarter or one-eighth percent, which would cost the state roughly \$75 million to \$155 million. However, small reductions in the state GRT rate may fail to address the issue of New Mexico's high combined state and local GRT rates, which exceeds 9 percent in some areas. While New Mexico's state GRT rate is relatively low compared with other states, ranking 32nd as of January 2021, the combined state and local average rate is the 15th highest in the nation. The most effective tax reform proposals would incorporate reasonable limits to local rate increases and include base-broadening measures that enhance and stabilize local government revenues.

Addressing the kinds of pyramiding that remain in our tax system (e.g. sale of services to businesses) could make New Mexico more competitive for service-based businesses – an important consideration as the services proportion of the economy grows and the state faces national and international competition from locations that often do not have transaction taxes that create pyramiding problems. Because pyramiding is rate-sensitive, lowering the rate inherently helps address the problem, as would incorporating specific anti-pyramiding measures for transactions of business-to-business services. In a 2016 memo, LFC economists estimated the costs of eliminating all pyramiding of business-to-business services could cost the state up to \$490 million, and the exact cost is unclear due to lack of sufficient data. However, more targeted anti-pyramiding measures could limit the expected costs and provide relief for industries most affected by GRT rate pyramiding.

## **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 or other federal funding for services that improve 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 FY22, the Legislature appropriated \$3.4 billion to public schools, an increase of \$233 million, or 7 percent, over the prior year. Federal aid will also contribute \$1.5 billion to New Mexico schools in response to the Covid-19 pandemic until FY24.

Lost learning time from Covid-19 school closures will exacerbate existing student achievement gaps, a key deficiency highlighted in the Martinez-Yazzie education sufficiency lawsuit. To help students recover from the Covid-19 slide and build a world-class education system in New Mexico, the committee will again prioritize evidence-based programs and initiatives that enhance school leadership and teacher quality, provide extended learning opportunities, ensure college and career readiness, improve accountability, and address at-risk student needs.

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 increased over the previous decade, 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 FY23 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 capacity for providers to implement services, including PreK for 3 year olds, high quality infant care, and Medicaid financed 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 high 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. Findings from a recent LFC evaluation determined the state sometimes intervenes with foster placements when less traumatic and costly alternatives are available. Short-term placements sometimes unnecessarily traumatize children and are costly to the state. Analysts should prioritize funding for evidence based child welfare prevention and early intervention services, including

differential response, and identify savings in other areas including short-term foster care placements and programs that can leverage more federal revenue. Analysts should examine cost savings opportunities from decreased need for out of home placements and reinvestment options.

**Behavioral Health.** The state has not recovered from the pandemic's 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 FY22 and the Human Services Department (HSD) and Children, Youth and Families Department (CYFD) 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 and take into consideration increased federal funding available for services. 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 FY22, an estimated 899,277 New Mexicans will be enrolled in Medicaid, according to current program projections, down from a high of 953,114 in December 2020. Enrollment in the program increased due to the COVID-19 public health emergency, and federal requirements prevent disenrollment of individuals no longer eligible for Medicaid during the public health emergency. . An enhanced federal FMAP through the emergency extended through at least half of FY22 helped stabilize funding, but whether the federal government continues enhanced federal aid into the latter half of FY22 into FY23 remains unknown. The federal funds swaps in the summer of 2020 were not fully restored in the 2021 legislative session and significant backfilling of general fund revenue should be examined by analysts for the FY23 budget. 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. Analysts should ensure Medicaid funding is appropriately leveraged across multiple departments and examine options for other state funds to replace or augment general fund revenues, such as intergovernmental transfers, and pharmacy rebates. Analysts should monitor Medicaid spending and identify opportunities for enhancing healthcare workforce and quality, 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 among the lowest in the nation and is insufficient to meet the maintenance needs of the transportation network. To bridge the funding gap, the Legislature allocated significant non-recurring appropriations for major state road projects and increased revenue from the Motor Vehicle excise tax for recurring transfer to the road fund and authorized the sale of road project bonds in 2021. While the appropriation increases have helped improve the system, additional revenue will be needed to prevent further deterioration and address major investment projects beyond simple heavy maintenance. Currently, New Mexico receives no road maintenance revenue from the operators of electric vehicles (EVs). Twenty-eight states have approved additional registration fees on EVs to offset loss of fuel tax revenue. Analysts will consider how fees could be assessed on EVs to ensure all users of New Mexico roads pay their fair share.

**Higher Education.** The Committee intends to have a Higher Education Subcommittee review financing and other relevant policy and performance topics for higher education during the 2021 interim. More than eight years ago, the Legislature transitioned from an input-based funding formula to one based on student performance from which to base funding recommendations. Now, recommendations allocating state funding to 24 institutions are managed using an outcomes-based funding formula. A competitive pool of funding -- from a percentage of existing budgets and new money for instruction – is used to reward institutions. Staff should examine opportunities to streamline the formula, ensure incentives are strong enough to encourage performance and fair enough for the wide spectrum of missions and size of higher education institutions, and avoid redistribution mechanisms so institutions can focus on improved outcomes. Further, funding for categorical and research and public service projects has outpaced increases for Instruction and General. LFC staff should analyze need for non-instructional funding that focuses on supporting student success and improved institutional efficiency, such as wraparound student support services; transfer and articulation agreements, including role of dual credit; and student financial aid.