Post-Session Fiscal Review 2013

REVENUE STABILIZATION AND TAX POLICY COMMITTEE

MAY 13, 2013

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N.M. LEGISLATIVE FINANCE COMMITTEE

Overview

- Although the 2013 legislative session was a broad success, it will be remembered for the last-second passage of a major tax-reform package.

- The session ended with a balanced FY14 budget that spends $5.88 billion from the general fund, up 4.3 percent from FY13; reserves projected at over 10 percent; capital outlay appropriations of $510 million; and phased-in tax cuts, phased-out tax loopholes and clarifies two tax issues resulting in $80 million less revenue by FY17.

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Recurring revenue fell $1.2 billion or 20%, from FY08 to FY10, and slowly recovering.

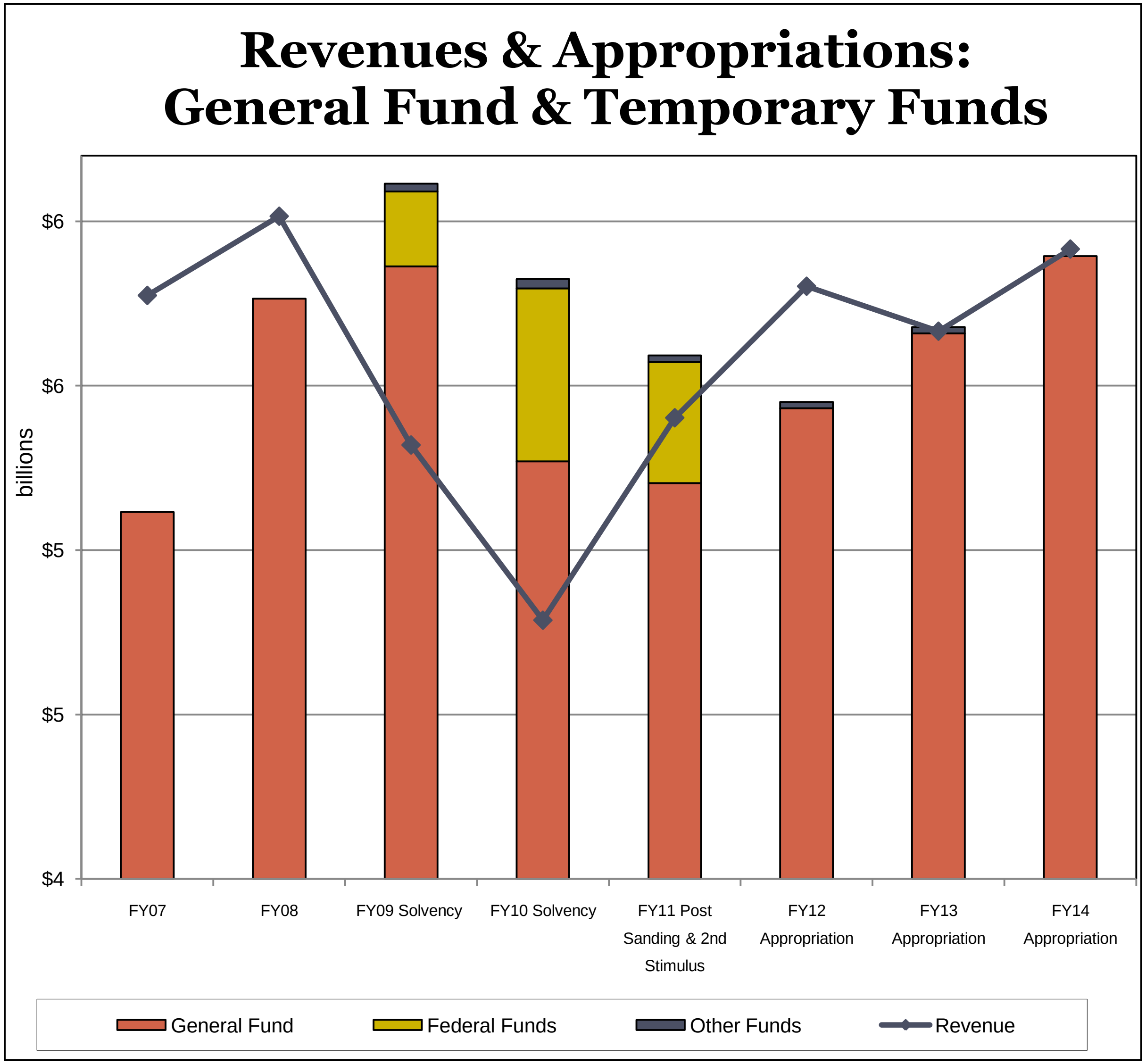
FY12 appropriations were down 10.9% from the peak in FY09.

FY14 revenue is projected to grow but remains 3% below the peak appropriation in FY09.

Pre-session forecasts reflected significant tax expenditure increases.

Mid-session revenue forecast resulted in modest adjustments adopted by the Legislature but not DFA.

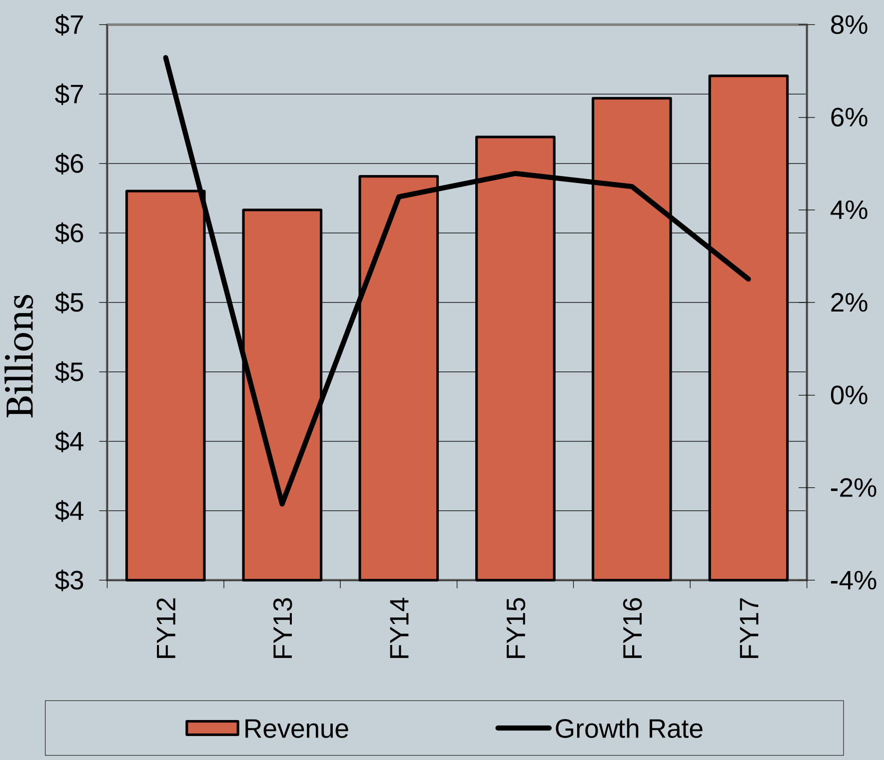
The Legislature viewed the revenue forecast more conservatively due to uncertainty in tax expenditures, job growth, and the sequester.



Source: LFC files.

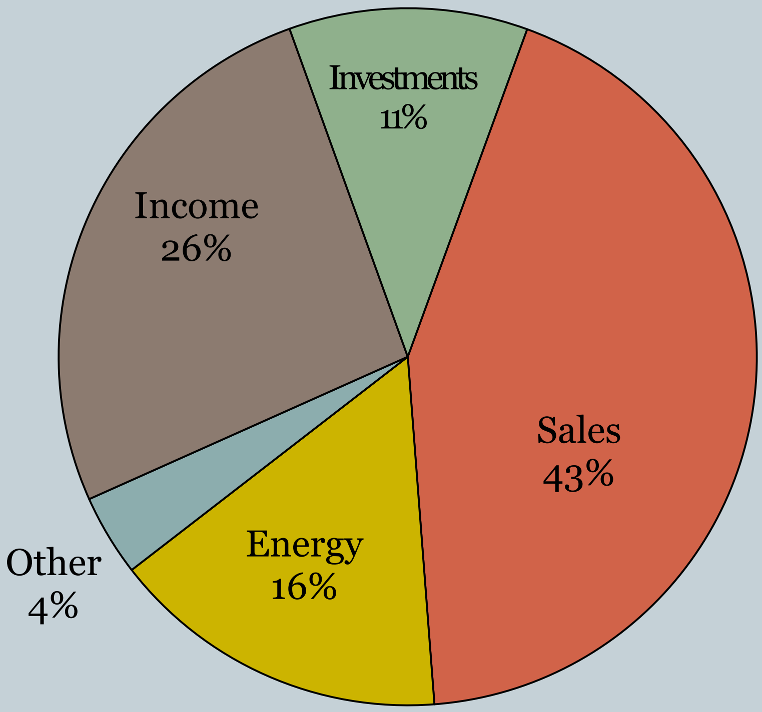
Revenue

Consensus Revenue Forecast (February 2013)



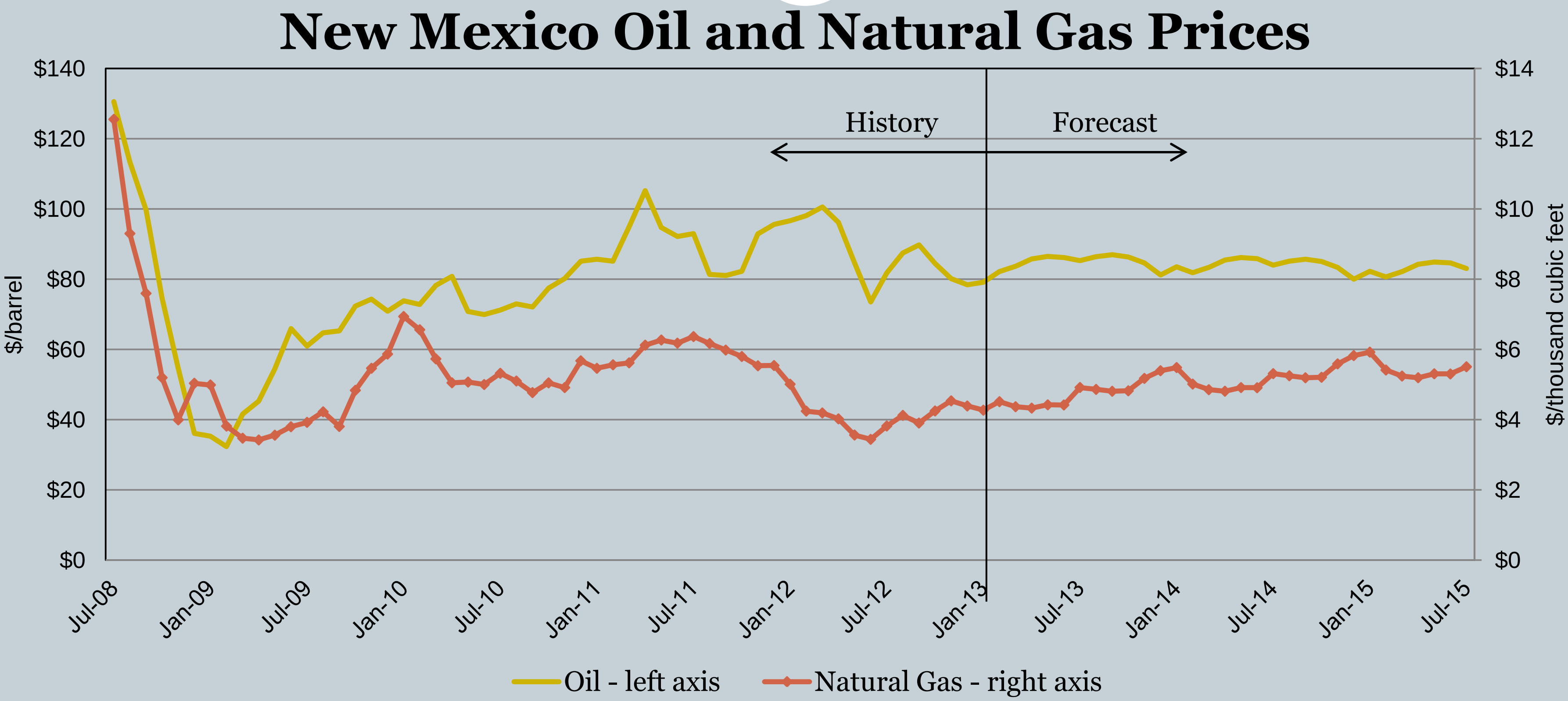
Source: LFC Files

General Fund Revenue Sources (Estimated FY14)



Source: Consensus Revenue Estimate

Energy Forecast



FY14 Consensus Revenue Forecast (February 2013)

- Oil Price (bbl): $88.00
- Natural Gas price (mcf): $5.10

Price Change Rule of Thumb Effect on General Fund

- $1/bbl: $4 million
- $1/mcf: $92 million

Budget Development

- FY14 "New Money" projected:
  - August forecast $272.4 million, or 4.8 percent, higher than FY13 appropriation levels;
  - December forecast $283 million, an increase of 5 percent over FY13 appropriations;
  - February revision $258.8 million, a decrease of $24.2 million from December, and 4.5 percent over FY13 appropriations.
- The LFC recommendation prioritized funding for Medicaid, education, and public safety and addressed general fund liabilities including reversing pension swaps and replacing tobacco settlement revenue.
- The LFC recommended a salary increase for all state and public employees.
- Executive and LFC spending recommendations differed by only $1 million.

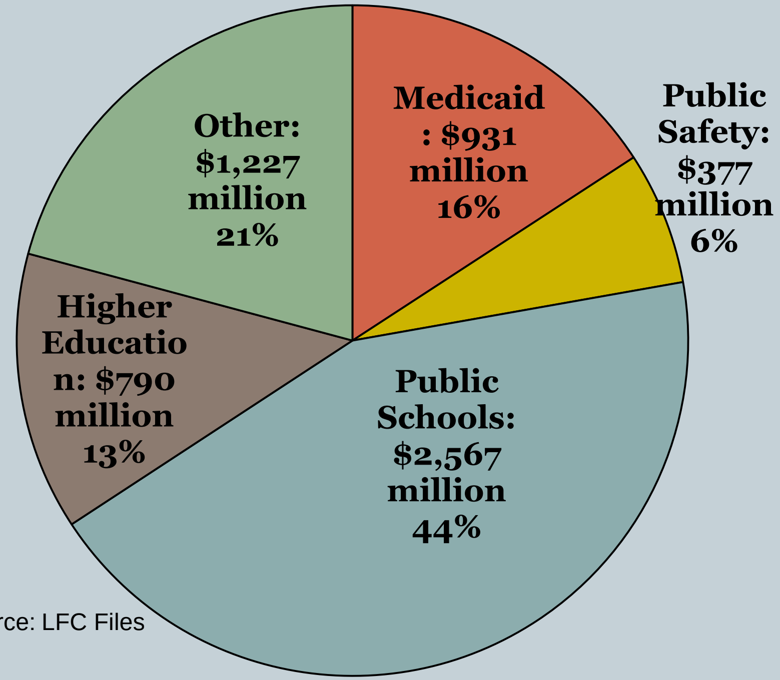
Budget Development "Curve Ball"

- Just prior to the state of the session, legislators were faced with:
  - A $70 million "Bank to Book" cash reconciliation set aside;
  - A modest decline in revenue estimates
  - A potential $100 million liability for not maintaining level spending, or maintenance of effort (MOE), for special education dating back to FY09.
  - A decision to expand Medicaid pursuant to the Affordable Care Act (ACA) that boosted revenue for the program and reduced general fund costs.
  - A concern about sequestration and approval of a federal budget.

2013 General Appropriation Act

General Fund Appropriations

$5.89 billion

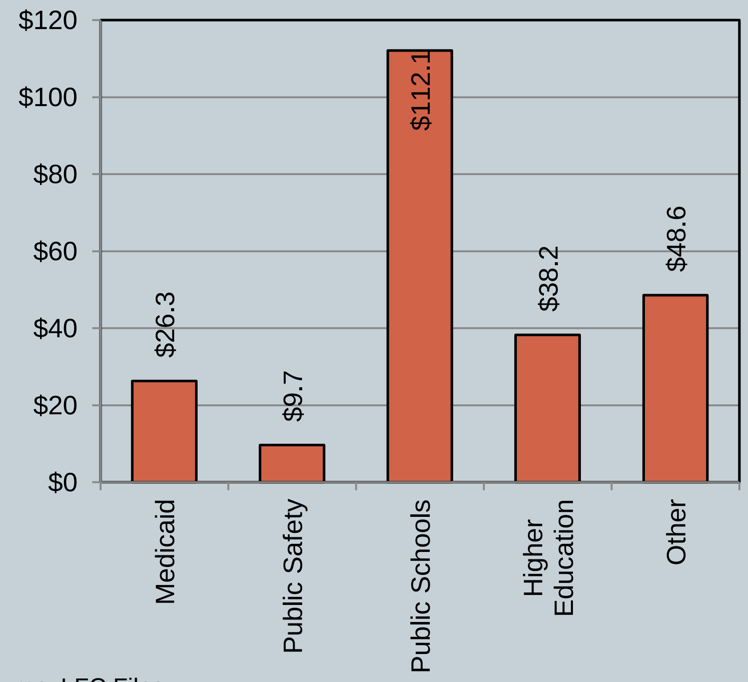


Source: LFC Files

Only $1.7 million vetoed. Continued bipartisan support, senate supported unanimously.

General Fund Appropriation Increases

$235 million (4.3%)



Source: LFC Files

Public School Issues

- General fund appropriations for public education increased 4.6 percent, or $112 million.
- Principal issues in development of public school appropriations were federal IDEA maintenance-of-effort (MOE) requirements, formula funding versus categorical and related appropriations, and increased funding for early learning and other initiatives.
- Formula funding increased $88.3 million, or 3.9 percent, and included $18.7 million for an average 1 percent salary increase for all public school employees.
- In addition to formula funding, the GAA includes a new $10 million categorical appropriation to ensure the state meets MOE in FY14. Additionally, PED is authorized to transfer of a portion of the SEG to meet MOE if the $10 million appropriation is insufficient. Both the appropriation and the transfer will be distributed through the funding formula.

Early Childhood Learning Initiatives

- The executive's focus on social promotion appropriately evolved into a focus on early childhood education and improving early reading proficiency.
- To address the persistent problems of sub-par reading and math proficiency in early grades, the Legislature increased funding for the early childhood program by $32 million or 19 percent.

Higher Education Funding Issues

- The FY14 GAA appropriates $790 million for higher education, an increase of $38.2 million, or 5 percent, above FY13 levels.
- New Mexico makes extraordinary financial commitments for higher education and has an accessible and affordable system. However, NM has very low certificate and degree completion.
- A new formula was developed 2 years ago with more emphasis on outcomes:
  - Funds statewide outcomes including increased degree completion in priority workforce areas and by financially at-risk students
  - Funds workload based on completed coursework instead of enrollment
  - Maintains budget stability near FY12 operating levels

Affordable Care Act

- The $4.3 billion Medicaid budget includes funding for the Medicaid expansion.
- Up to 170 thousands adults with incomes up to 138 percent of the federal poverty level will be eligible for Medicaid on 1/1/2014.
- The federal government will cover 100 percent of the funding for these newly eligible adults in 2014 – 2016. The federal match will gradually decrease in the out years, reaching 90 percent in FY20 and thereafter.
- In addition to improved access to primary care for adults, increased availability of behavioral health services should help with substance abuse concerns.
- Medicaid expansion is expected to produce additional tax revenue from insurance premiums and increased employment and economic activity.
- The LFC estimated a cumulative net gain to the state of about $422 million from FY14 – FY20 from the expansion.

Solvency Issue
Unemployment Insurance

New Formulas for Calculating Employer Contributions:

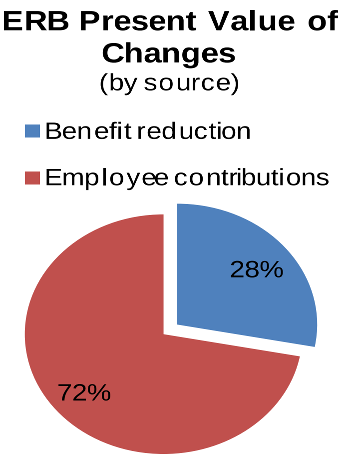
- Replaced the old reserve ratio with a new benefit ratio system – three years of benefit charges divided by three years of taxable payroll;
- New employer contribution rate set at industry average;
- Maximum contribution rate capped at 5.4 percent
- Minimum contribution rate increased from 0.03 percent to 0.33 percent;
- An excess claims premium up to 1 percent

Solvency Issue
Pension Reform

Educational Retirement

SB 115 increases employee contributions to 10.7% by FY15, reduces and ties future COLAs to the plan's funding levels, and for hires after June 30, enacts a minimum retirement age of 55, or earlier with reduced benefits, and delays COLA eligibility to 67.

SB 115 increases the plan's funded ratio from 61% to 97% in 2043 assuming assumptions for future earnings and payroll growth hold true.



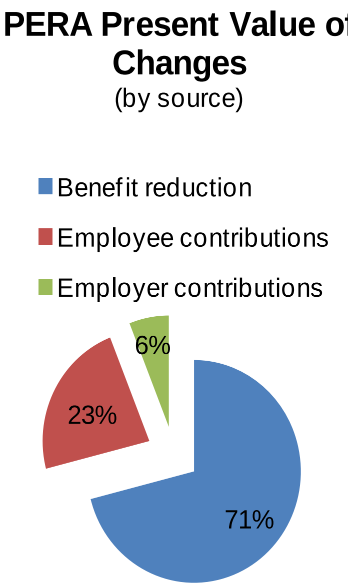
Excludes effect of employer contribution increase pursuant to Laws 2005, Chapter 273

Source: LFC

Public Employees Retirement

SB 27 increases employee contributions 1.5% and employer contributions 0.4%, reduces the COLA to 2% and delays eligibility, and for hires after June 30, enacts a new tier of benefits that includes lowering the multiplier 0.5% for most plans.

SB 27 increases the plan's funded ratio from 65% to 90% in 2043. If assumptions are not met, more benefit changes will be necessary.



Source: PERA

Tax Policy Principles

LFC Tax Policy Principles:

- Adequacy: Revenue should be adequate to fund needed government services.
- Efficiency: Tax base should be as broad as possible and avoid excess reliance on one tax.
- Equity: Different taxpayers should be treat fairly.
- Simplicity: Collection should be simple and easily understood.
- Accountability: Preferences should be easy to monitor and evaluate.

Significant tax policy issues

- Proliferation and growing cost of exemptions and credits.
- High gross tax receipts and effect on manufacturing and export sectors.

Tax Legislation

- A number of bills impact future revenues and increase general fund revenues by only $7 million in FY14 but decrease general fund revenues by $3 million in FY15, $56 million in FY16 and $80 million in FY17.

- A number of small bills passed including: a locomotive fuel gross receipts tax credit, extending the sustainable building tax credit, liquor tax deductions for small winegrowers and microbrewers.

Tax Legislation

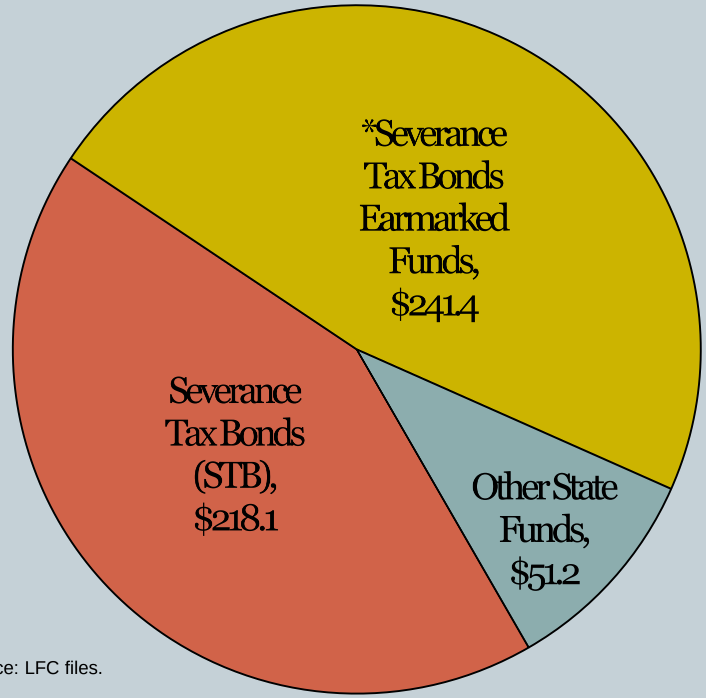
- House Bill 641, passed in the last-seconds of the session, is a major tax reform package that lowers the CIT rate over five years and authorizes local governments to increase the local-option gross receipts tax.

- The bill also clarifies two issues, one concerning the taxing of tangible goods consumed in manufacturing and one concerning a tax credit for the creation of high-wage jobs, to close loopholes costing the state significant income.

- The tax package also eliminates a hold-harmless distribution to municipalities and counties created in 2005 as compensation for the loss of gross receipts tax revenue on food and medical. A 15-year phase out will not start for 2 years.

Capital Outlay

Total capital outlay: $510.7 million



Source: LFC files.

* $174.9 is Supplemental STB for public school construction.
Other State Fund sources include Dept. of Game and Fish retirement fund, SLO maintenance fund, public school capital outlay fund, and public project revolving fund.

Capital Outlay Issues:

- No formal executive request, although required by law;
- Pre-session agreement on priorities, criteria and vetting of projects;
- Road funding is inadequate;
- Prioritization of state-owned projects focused on public health and safety issues.
- $100 million split between House and Senate for 673 local projects.
- $169 million for 119 statewide projects.