MINUTES
LEGISLATIVE FINANCE COMMITTEE
August 1-4, 2006

The following LFC members were present on August 1st:

Representative Henry "Kiki" Saavedra, chairman, called the Audit, Computers and Capital Subcommittee meeting to order on Tuesday, August 1, 2006, at 8:11 am.

Senator Phil Griego, vice chairman, Representatives Luciano "Lucky" Varela, Edward Sandoval for Donald Whitaker, Jeannette Wallace, Edward Sandoval for Donald Whitaker, and Senators Shannon Robinson for Joseph Fidel, Joseph Carraro, and Leonard Lee Rawson.

Representative Nick Salazar, chairman, called the Strategic Planning Subcommittee meeting to order on Tuesday, August 1, 2006, at 8:15 am.

Representatives Luciano "Lucky" Varela, Jeannette Wallace, Larry Larranaga for Sandra Townsend, Brian Moore, and Rhonda King, and Senators Shannon Robinson for Joseph Fidel, Joseph Carraro, Sue Wilson Beffort, and Timothy Jennings.

Representative Luciano "Lucky" Varela, chairman, called the Legislative Finance Committee meeting to order on Tuesday, August 1, 2006, at 1:10 pm., at Highlands University, Las Vegas.

The following LFC members were present on August 2nd:

Representative Luciano "Lucky" Varela, chairman, Senator Shannon Robinson for Joseph Fidel, vice chairman, Representatives Nick Salazar, Rhonda King, Jeannette Wallace, Larry Larranaga for Sandra Townsend, Brian Moore, Edward Sandoval for Donald Whitaker, and Henry "Kiki" Saavedra, and Senators Timothy Jennings, Phil Griego, Joseph Carraro, and Sue Wilson Beffort. Senators Cisco McSorley and Clinton Harden joined the committee as guests.

The following LFC members were present on August 3rd:

Representative Luciano "Lucky" Varela, chairman, Senator Shannon Robinson for Joseph Fidel, vice chairman, Representatives Nick Salazar, Rhonda King, Jeannette Wallace, Larry Larranaga for Sandra Townsend, Brian Moore, Edward Sandoval for Donald Whitaker, and Henry "Kiki" Saavedra, and Senators Timothy Jennings, Phil Griego, Pete Campos, Joseph Carraro, Sue Wilson Beffort, and John Smith. Senators Cisco McSorley and Clinton Harden joined the committee as guests.

The following LFC members were present on August 4th:

Representative Luciano "Lucky" Varela, chairman, Senator Shannon Robinson for Joseph Fidel, vice chairman, Representatives Nick Salazar, Rhonda King, Jeannette Wallace, Larry Larranaga for Sandra Townsend, Brian Moore, Edward Sandoval for Donald Whitaker, and Henry "Kiki" Saavedra, and Senators Timothy Jennings, Phil Griego, Pete Campos, Joseph Carraro, Sue Wilson Beffort, and John Smith. Senators Cisco McSorley and Clinton Harden joined the committee as guests.

REGIONAL HOUSING AUTHORITY PERFORMANCE REVIEW AND AUDIT

Olivia Padilla Jackson of the Board of Finance told the committee the governor ordered the Board of Finance to contract to investigate regional housing authorities. The board used Community Strategies Institute (CSI), a Colorado-based housing policy consulting group, after soliciting recommendations from housing authorities and experts.

CSI reported regional housing authorities aren't really meeting their mission of providing low income housing. They also lack oversight. Accounting systems are inadequate. Regional housing authorities should have strategic plans and operating plans. They should be made to comply with the statutory definition of low-income targeted population. CSI recommends that the state consider consolidating number of regional housing authorities and that the members of the boards should have qualifications pertinent to housing.

Gary Bland, state investment officer, reported the State Investment Council (SIC) acquired the two regional housing authority bonds ($2.5 million each) as a way to get involved in affordable housing and because the bonds were attractive market rate investments. Bonds were placed with a trustee to be drawn down by R3, consisting of Housing Enterprises Inc. and Region III Housing Authority Inc. Bland believes that rather than selling all refurbished homes to low income persons, R3 was selling, or leasing, homes to anyone, regardless of income. R3 pulled about $3.4 million into its operating and the quarterly reports were extremely inaccurate.

Bland indicated SIC has learned some lessons. An internal general counsel at SIC could have caught the lack of reporting. They now have general counsel.

Morrow Hall, former commissioner of R3, current executive director of R4, and chairman of Housing Enterprises Inc. (HEI), said HEI is a nonprofit created to assist regional housing authorities (RHAs) provide affordable housing in New Mexico. They provided a detailed response to the CSI report, and they want it included in the record on this hearing. Now, programs are in danger because of bad publicity, not poor management. New Mexico housing needs are great, and RHAs are in a unique position to help. RHAs were created by statute decades ago, and for years were dormant. Richardson appointed new people to revitalize boards. R3 has the primary role: Richardson charged Smiley Gallegos to get R3 on its feet and to assist other regions in 2001. Mr. Hall said Mr. Gallegos established strict accounting procedures for his region and hired Dennis Kennedy, a certified public accountant, to oversee financial management. He has worked with other regions to adopt the same procedures. R3 has been investigated by several agencies in last few months, but no accusations have come of the investigations. R3 has better bond ratings and has received unqualified audits. There is an immediate economic impact of $250 million because of the housing activities. Mr. Hall said this bad publicity has brought all that progress to a standstill. R3 borrowed $5 million from SIC and has paid over $700 thousand interest. In August, R3 was denied extension of bonds. He said R3 made some honest mistakes involving tax-exempt status and has since stopped the practices. He said they believe they can help families earning up to 140 percent of the media income and stand by their interpretation of statute. Investigations did not show financial misconduct and nobody has been indicted.

The chairman noted that LFC is not here to validate or question RHA activities. It is SIC's responsibility to recover their investment. But the Attorney General is responsible for determining if violations have occurred. LFC will turn over any information to appropriate agencies.

Gary Bland indicated that the increased credit rating was for R3 bonds backed by banks not the RHA itself. SIC is not prepared to respond to everything yet and doesn't want to compromise any ongoing investigations.

House Speaker Ben Lujan asked for details about the BOF and SIC contracts. Padilla-Jackson reiterated that the governor asked BOF to contract with a consultant and an RFP was unnecessary because the contract was under $30 thousand. BOF sought recommendations from the Mortgage Finance Authority and nonprofit housing organizations and they wanted someone out of state, independent, no ties to the governor, the RHAs or the legislature.

SIC hired an outside audit firm as well. They didn't request proposals even though the contract was for $50 thousand because it was considered an emergency. Speaker Lujan expressed concern because state agencies are required to seek proposals for contracts over $30 thousand. Mr. Bland said a request for proposals was not necessary because it was an emergency procurement.

Speaker Lujan requested LFC be given a copy of the audit contract as well as the investigative attorney's contract. [LFC has received both of these contracts from SIC].

Responding to Speaker Lujan, Mr. Bland reported that R3 had made all of the interest payments and that other bonds had defaulted in the past. Enron and Worldcom bonds were larger totaling $11 million; $5.5 million has been recovered from Worldcom. Mr. Bland was not sure yet how much of the Enron bond they will recover. Over the years, SIC has dealt with many defaults.

Speaker Lujan urged the LFC audit subcommittee to audit R3 and find out if Morrow Hall's presentation was correct. Mr. Bland reported that the contract attorney working on the R3 issue represents the Mortgage Finance Authority. Senator Robinson objected to an attorney for the Mortgage Finance Authority receiving the no-bid contract from SIC.

Bob Jacksha, deputy investment officer for SIC, reported that R3 came to SIC with the proposal for the bonds. In statutes, the Legislature authorized the purchase of R3 bonds by state entities. SIC wanted to help provide lowincome housing in New Mexico. The bonds were structured so that they were a reasonable investment at the level of interest charged. The bond covenant was not followed in terms of cash flows. Upon sale of a house, the proceeds were supposed to flow back to trustee, where R3 could draw them again. R3 retained proceeds instead of giving them to trustee. That's why they are in default.

The purpose of the bonds was specifically to finance acquisition and rehabilitation of low income housing, not geographically limited to R3. But the covenant disallowed use of proceeds for operations or to make loans to other regions. It appears the proceeds were used to pay operating expenses of RHAs and not for housing projects.

Senator Carraro asked if bond ratings reflected incompetence. Mr. Jacksha replied that the bond-rating company cited by Mr. Hall, Standard and Poors, probably did not review the R3 bonds. Senator Carraro pointed to Exhibit 2 in the [Region III] binder that talks about the S&P report and suggested Standard and Poors (S&P) would be looking at something like this. Mr. Jacksha responded that S&P looks at an individual bond that has credit enhancement. Repayment comes from individual projects, and there is a bank as a backup source of repayment. Upgrade of credit of the trustee bank has nothing to do with R3's rating.

Senator Carraro refer to Las Cruces projects detailed in the LFC brief, pertaining to how much funding goes to low income versus non-low-income housing. Senator Carraro said he has heard rumors that some of the houses built are as much as $200 thousand. Mr. Hall said the RHA reading of statute allows them to loan to people up to 140 percent of median income. Median income varies by county.

Mr. Bland, responding to Senator Griego, said that it was unclear who owned some of the properties in R3s inventory. The records and reports indicate discrepancies but they have not seen the actual deeds. Senator Griego asked where the money will come from to pay back the loans. Mr. Bland reported that there should have been money but the money went into the operating account and then it was used for various purposes. Salaries were paid; cars were bought. SIC is open to a payment plan or extending the maturity.

Mr. Bland responded to Representative Larranaga that the performance review should be done in September. Senator Robinson asked Mr. Bland if they have any evidence of fraud. Mr. Bland said the SIC is not an investigative agency, so can't make those types of judgments.

Chairman Varela asked Katherine Miller, Department of Finance and Administration secretary, about oversight authority of RHAs. Ms. Miller responded that some oversight of RHAs was lost when the Legislature moved those programs under the Mortgage Finance Auhority. The RHA act creates seven regional authorities and authorizes the creation of nonprofit organizations under them. She said the statutes are unclear beyond that. She said the review under way will look at how statutes should be amended to provide for greater oversight. Chairman Varela suggests starting this legislation be presented committees early in the legislative session. Ms. Miller said legislation is being drafted.

Senator Jennings said he would like SIC to ensure regional housing authority funds are used for real property and not operating expenses. Mr. Mr. Bland said that the use of proceeds for operations was specifically prohibited in these R3 bonds.

FY06 GENERAL FUND REVENUE REPORT AND OUTLOOK

Norton Francis, LFC economist, presented the revenue outlook. Secretaries Miller and Jan Goodwin of the Taxation and Revenue Department were also available for questions.

Recurring revenue is expected to reach $5.5 billion in FY06, $151.1 million above the January 2006 estimate. Recurring revenue is expected to grow 1.2 percent in FY07 to $5.58 billion. This represents an increase of $345.4 million over the January 2006 estimate. Growth in FY07 is driven by gross receipts and income taxes, while energy revenues are expected to fall

In FY08, recurring revenue is estimated to grow by 2.6 percent to $5.73 billion as energy prices continue to decline and as the State Treasurer's portfolio balance falls. The August 2006 estimate for FY08 is $443.7 million higher than the January 2006 estimate. In FY09-FY11, revenues will grow by an average of 3.4 percent as energy prices continue to decline.

FY06 was a period of economic shocks and volatility. In January 2006, Global Insight forecast FY06 inflation to be 3 percent, but that forecast rose a full percentage point to 4 percent since then. Inflation may be responsible for part of the unexpectedly strong growth in gross receipts tax in the last half of FY06. Inflation is expected to fall to below 2 percent in FY07 and beyond.

Global Insight expects the Federal Reserve to increase the federal funds rate from an average of 4.2 percent in FY06 to 5.4 percent in FY07. The Federal Reserve's actions will depend on how inflation impacts the economy. Employment grew 2.7 percent in New Mexico in FY06, faster than the national average. Employment growth is expected to fall gradually throughout the forecast period.

The August 2006 natural gas price forecast of $7.50/mcf in FY06 and $6.10/mcf in FY07 is unchanged from the January 2006 estimate. The natural gas price forecast increased by 30 cents to $6.10 in FY08 and by 25 cents to $5.75 in FY09. The spread between Henry Hub prices and the prices New Mexico receives in the San Juan and Permian basins increased dramatically in the fall but has since fallen back to normal levels.

Oil price increases in past years were driven by extraordinary economic growth worldwide, concerns about oil supply in light of political unrest in many of the world's oil-producing areas, and hurricanes. Ongoing uncertainty in the Middle East, Venezuela, and Nigeria, coupled with strong world economic growth, continue to drive the forecast higher. The gap between New Mexico oil prices and the NYMEX West Texas Intermediate future prices has increased and stays relatively high in the out years. Much of this spread is now driven by speculation rather than factors influencing supply and demand.

In addition to severance, rental, and royalty revenue, other taxes are impacted by the oil and gas industry. According to the Taxation and Revenue Department, in FY06, $311 million of gross receipts and income taxes can be attributed to the oil and gas industry (excluding indirect impacts of the industry). For the gross receipts and compensating taxes, oil and gas receipts generate 3.2 percent of the total revenues. For personal income tax, oil and gas receipts, including oil and gas withholding, comprise 6.7 percent of net receipts. For corporate income tax, the share is almost 50 percent.

Personal income taxes have shown unexpected strength, even with recent rate reductions. The estimate was revised upward to account for this growth. The tax rate reductions enacted in 2003 and 2005 are still being phased in and will continue until 2008. In tax year 2008, the rate on the highest earning taxpayers will be 4.9 percent, down from 8.2 percent in 2002. In tax year 2006, the rate is 5.3 percent. In FY06 corporate income taxes are expected to have grown about 60 percent over FY05. About half of this growth is attributable to energy profits, but the other half reflects large manufacturers and broad-based economic growth. The gross receipts tax (GRT) forecast has been revised upward significantly. While much of the emerging strength is attributable to growth in construction and mining receipts, the state's entire economy is expanding at a healthy pace. It is probable that some of the growth in the construction base is due to construction cost increases rather than increased construction activity.

Beginning in FY07, the GRT forecast includes an additional $25 million per year due to Los Alamos National Laboratory's new contract arrangement. This $25 million was included in the January 2006 estimate as well. The anticipated revenue impact from the KMart Supreme Court case was amended in the August 2006 forecast. Nonrecurring revenue that will be lost due to refunds was reduced from -$40 million to -$25 million, and the timing of the refunds was delayed from FY06 to FY07.

There are both upside and downside risks to the forecast due to economic volatility. As natural resource revenues constitute a greater share of recurring general fund revenues, general fund revenues should be expected to be more volatile. Energy revenues comprised about 18.4 percent of recurring general fund revenues in FY05 and are expected to increase to a modern record of 20.8 percent in FY06. After FY06, the share will decline as energy prices ease and other revenues, such as GRT and personal income tax

(PIT), exhibit stronger growth. Increased growth in GRT and PIT included in the August 2006 forecast moderate this risk somewhat.

The August 2006 forecast is based on Global Insight's expectation that inflation will peak at 4 percent in FY06 before falling to 1.5 percent in FY07. The consensus group believes this FY07 reduction in inflation may be overly optimistic. If inflation is higher than expected, it is likely interest rates will be higher as well. The last several months have indicated that the housing market nationwide has slowed down. So far, the New Mexico market has remained robust. Tremendous growth in the world economy (notably China and India), coupled with oil supply concerns, has led to high construction cost inflation. Cement shortages are of particular concern because in addition to increasing construction costs, shortages delay projects. If interest rates rise more than forecast, residential construction may decelerate more quickly than expected.

Corporate income tax (CIT) rose as a share of recurring revenue from 3 percent in FY04 to 5 percent in FY05. CIT is expected to rise further to 7.1 percent of recurring revenue in FY06 and 7.7 percent in FY07. CIT is volatile because it is heavily tied to energy profits, which are difficult to forecast. In FY05, mineral extraction (oil and gas primarily) represented 50 percent of CIT collections, up from 36 percent in FY04. Significant cost pressures pose a threat to profits. Energy costs this year should show up in next year's profits. Of particular concern are the rising costs of healthcare benefits.

The General Fund Financial Summary updated for the August 2006 estimate suggests that total general fund reserves were 14.3 percent of recurring appropriations in FY06 and are expected to be 20.7 percent in FY07. High reserves will trigger a transfer of $374.1 million from the operating reserve to the tax stabilization reserve in FY07. Statute requires a transfer if operating reserve balances exceed 8 percent of the previous year's recurring appropriations. High reserves will also trigger a transfer of $191.7 million from the tax stabilization reserve to the taxpayers' dividend fund in FY07. Statute requires a transfer if tax stabilization reserve balances exceed 6 percent of the previous year's recurring appropriations.

Beginning in FY07, tobacco settlement payments will not accrue to the general fund. Instead, half the payments will remain in the tobacco permanent fund and half will go to the tobacco program fund.

New money for the FY08 budget is expected to be $612 million, a modern record. About $44 million of this new money will be needed for prior year commitments to ERB, corrections, and three-tier teacher licensure. Total general fund reserve in excess of 10 percent of recurring appropriations is $547.6 million in FY07. However, this includes $191.7 million scheduled to transfer to the taxpayers dividend fund at the end of FY07.

The consensus group has a history of underestimating the forecast, both 6 and 18 months out. The primary reason for underestimating revenue is the volatility in oil and natural gas prices.

ALTERNATIVE INVESTMENTS

Allen Martin from New England Pension Consultants, advisor to both SIC and the Educational Retirement Board (ERB), presented information on diversification of investment funds. Due to the needs of the pension funds, they need an investment return of 8 percent to meet obligation. If they don't, taxpayers will end up shoring up the account to maintain benefits for retirees. Investing in only fixed income and equities exposes the investments to increased volatility. Investing in alternatives such as private equity and hedge funds is a way to minimize the volatility and maintain high returns.

The risk/return calculation is made in the context of portfolio and not by individual asset class. Alternative investments, even if riskier than traditional asset classes, do not move in the same way and so dampen overall risk and improve return of portfolio. In other words, they have low or negative correlation with traditional asset classes which narrows the range of volatility on the whole portfolio.

Most investment managers, to attain a high return, think beyond equities and bonds. They are seeking alpha which is a measure of management performance—where a manager beats an index. Adding alternatives broaden asset classes to reduce volatility. When markets are more bearish, hedge funds, in particular, tend to have higher returns since they are insurance policies against a bear market. The presentation shows a correlation matrix of how asset classes interact and which classes work in opposite directions, lowering overall volatility.

In today's world, investing is more risky without alternatives. Hedge funds are a technique for managing money, not a strict asset class. They usually have a benchmark of the rate of return on US Treasury bills plus 300 basis points. So if a T-bill returned 3 percent, the benchmark would be 6 percent. With interest rates increasing, the bond portfolio (fixed income) underperformed and so there was a need for new market-neutral assets.

TRACKING ALTERNATIVE INVESTMENT PERFORMANCE

David Abbey introduced John Spagnola, of PFM, noting that PFM provided consulting services to the Legislative Council Service during the State Treasurer's Office investigation last fall. Their advice resulted in legislation strengthening rules at STO.

John Spagnola presented a chart that showed the risk and return of various asset classes, noting that there is a trade-off with some of the alternative asset classes but overall they help to lower the volatility of the portfolio. The main issue with many of the alternatives is that the value is not known until the asset is sold or publicly traded so the uncertainty is huge.

Endowments have led the way in investing in alternatives because they don't have the same liabilities as a pension fund. They are able to weather down-years a lot better. Now that a lot of funds are moving into alternatives, policymakers need to consider whether capacity constraints where the volume is high enough that the return declines.

In hedge funds, transparency is the key. Hedge funds command half of the value of a given trading days volume. They depend on an edge in price mismatching but with this volume the edge is diminished. Thorough reporting requirements are the key to monitoring hedge fund investments and the directors need to require this reporting as part of their contract language.

The Securities and Exchange Commission is moving toward more regulation but very little exists now over hedge funds. The nature of hedge funds requires some level of secrecy to protect their trading advantages.

Real estate investing is not new and has been around since people owned land and property. These investments have two components: yield in terms of rents and appreciation. But the value is not known until an asset is sold, lending a degree of risk.

Senator Carraro noted that the state is making investments for all of the residents and it should be more conservative than an individual's portfolio. Risky investments have to be carefully considered. Mr. Martin responded that the single most important things are having policies and procedures, good advisors, and oversight. Even when staff leaves, the policies and procedures stay on and continue to provide safeguards.

In response to a query from Senator Beffort, Mr. Martin acknowledged the lack of a model contract but that the SIC and ERB had model features that they require in each contract such as clawbacks of performance fees.

Senator Harden was concerned about the investment agencies not being subject to the procurement code for procuring investment services. Martin indicated that all of the agencies had board-approved procurement policies that follow the same general rules as the state procurement code but allow the funds to move more quickly in procuring services.

ALTERNATIVE INVESTMENT UPDATE FOR STATE FUNDS

Frank Foy, investment officer for ERB, was asked to clarify his position with ERB by the chairman. Mr. Foy indicated that he was moving to a classified senior investment analyst position and that the investment officer position is still open. Evalynn Mueller reported that the job had been posted and advertised and that the board wanted someone more familiar with alternative investments to take Mr. Foy's place. Mr. Foy reported that they would be looking for more FTE to oversee some of the investments ERB is moving into.

Chairman Varela asked about the structure of the board and whether the Legislature should consider legislation to change the structure. He noted that the state investment officer was also on the ERB board. Mr. Foy indicated that there were seven board members: three elected by the membership, two appointed by the governor, and two ex officio members (the state treasurer and the secretary of the Public Education Department). Chairman Varela directed the question to Bob Gish of the Public Employee Retirement Association (PERA), who indicated that all of their board is elected and not appointed.

Mr. Gish reported that PERA had hired a new consultant, RJ Kuhns, who they hope will respond better to alternative investments. They also hired an alternative investment advisor, Cliffwater. They have not adopted the appropriate policies so they have not made any investments but they hope to do so soon. The policy should be set in the next 90 days but they don't expect to meet their target allocation for five years. The target is 15 percent, split evenly among private equity, hedge funds, and real estate.

As to the procurement process, Mr. Gish stated that the primary issues addressed with a request for proposals are addressed by the transparency and diligence of the policies and the board approval of any contract. Responding to a question about commodity investing, Mr. Gish reported that they would likely choose a manager who specializes in commodities and the benchmark would be the Goldman Sachs Commodity Index. Real assets as an asset class, per the PERA definition, include timber, real estate, but also Treasury Inflation-Protected Securities.

Jeff Varela, a PERA board member in the audience, reported that the motor transport officers of the Department of Public Safety had been working on an actuarial study of a 20-year retirement program and that he'd heard rumors of groups of educators thinking about switching to PERA but there were no requests so far for inclusion. That study should be out soon.

Mr. Foy updated the committee on the ERB's entry into the alternative investment space. ERB did an asset liability study, conducted by the New England Pension Consultant (also an advisor to SIC). ERB hired NEPC, following a request for proposals, as general advisor and started exploring hedge funds. They committed $20 million to a second market private equity fund as a way to make an investment and to avoid the negative portion of the j-curve. By investing in a secondary fund, the private equity investments of the fund, theoretically, should be closer to viability. In March, ERB issued a request for proposals for a private equity consultant and the board approved Aldus Equity in May. The contract with Aldus is still being drafted.

ERB has decided to invest 15 percent in alternative investments split among hedge funds, real estate, and private equity. They will move their current allocation in REITs (Real Estate Investment Trusts) to fund the real estate portion. Like PERA, it will take a long time to fully re-allocate. ERB estimates four years to fully fund private equity but the hedge funds investment will take place much earlier. They have the policies and procedures in place for the private equity and hedge fund investments and the real estate policies should be completed soon.

Adam Levine of SIC updated the committee on the SIC's activity in alternative investments. SIC divides their investments into two categories: differential or economically targeted, such as New Mexico private equity and film, and market rate. They have committed $237 million in New Mexico private equity, $107 million of which has been drawn down to make investments. That $107 million has attracted over $600 million in outside private investment. Thirty-five companies have been funded accounting for 938 jobs, $28.4 million in local purchases and $68 million in payroll. The average salary of these companies is $72.8 thousand, far above the average New Mexico salary of $29,570. The multiplier of attracted investment for each dollar of SIC investment is 5.5.

The film program has 14 outstanding investments that are guaranteed loans. The only money at risk is the foregone interest. SIC has loaned $128 million and they are currently closing on two more deals. Two loans came due and were paid off. There are currently no defaults. Of the $150 million loaned out, the total amount spent in New Mexico was $94 million, $34 million of which was below-the-line payroll for 2,127 jobs.

On the market side, SIC has money in private equity, real estate, and hedge funds. There are over 130 private equity investments totaling $1.7 billion committed and $600 million funded. As of March 31, 2006, the internal rate of return (IRR) is 15 percent for the total class. The IRR for the severance tax permanent fund is 30 percent while the younger land grant permanent fund has an IRR of 5.83 percent. The real estate program is young and SIC has over $200 million invested in four pooled funds and five joint ventures. Pooled fund is like a private equity fund while joint ventures are direct investments. So far a lot of the returns have been eaten up by fees. Total quarter to date income return is 1.1 percent and one year return is 6.2 percent.

Senator Carraro asked how many years SIC had been investing in films and what those investments have earned. Mr. Levine responded that SIC does not receive interest on the loans but a participation percentage and that none of the films have made a profit and so SIC has received no income from these investments. Due to the program's success, though, they are attracting higher quality films than at the beginning.

Responding to Senator Carraro's question on the return of socially oriented investments, both ERB and PERA indicated that they do not make non-market investments as part of their fiduciary duties. SIC makes economically targeted investments and there is a return in terms of jobs and local spending.

QUARTERLY INVESTMENT PERFORMANCE REPORT

Chairman Varela indicated that the report had been received and distributed and that a presentation was not necessary.

REVIEW OF BAR # 061434, $6.4 MILLION BUDGET INCREASE FOR MEDICAL ASSISTANCE DIVISION SUBMITTED JUNE 30, 2006

Secretary Miller stated the Human Services Department submits budget adjustment requests (BARs) at the end of each fiscal year to make final adjustments and close out the year. DFA feels it is best practice to recognize revenue in the year earned and expenditures in the year they occur. Approving this BAR minimizes the amount of expenditures carried over to the subsequent fiscal year. Secretary Miller indicated the BAR was reviewed, adjusted to align with available revenue from the Department of Health (DOH) and approved on June 30.

Secretary Miller noted the Legislature specifically granted agencies the ability to request a budget increase from internal service funds/interagency transfers as long as the amount does not exceed 5 percent of such transfers. Secretary Miller rebutted the LFC contention that statute requires a "companion BAR" to increase DOH funds when funds are transferred to the Human Services Department (HSD) from the county-supported Medicaid fund. Secretary Miller noted DFA distributes the funds from the county-supported Medicaid fund, not the State Treasurer, and adequate funds are available for this BAR. DFA treats the county-supported Medicaid fund as an agency fund and holds the funds until requested by the appropriate agency. Secretary Miller stated DFA has the flexibility to adjust these appropriations when excess funds are available.

Mark Weber, LFC analyst, said BAR 061434 was submitted by HSD to DFA on June 27 with the corresponding pink LFC copy received on June 29. The original BAR as prepared by HSD was for $9.7 million. Of this total, $8.469 million was to be transferred from DOH for the developmental disabilities program ($7.55 million), early intervention ($771 thousand), and public nursing facilities rate increase ($148 thousand) as state match for DOH Medicaid spending. The balance of the budget increase, $1.321 million, was to come from the county-supported Medicaid fund to support the general Medicaid program.

Mr. Weber continued the BAR was approved by DFA on June 30 and submitted to LFC on the same day, the last day of FY06. The BAR sent to LFC contained factual errors and that would have led to an objection if presented on any day other than the last day of the fiscal year.

At DFA the revenue was reduced to $6.404.1 million in a hand-written initialed correction but without comment or justification. Mr. Weber noted that as written and presented to LFC the legal authority was incorrect.

Mr. Weber indicated DFA used the "5 percent rule" (Laws 2005 Chapter 33 Section 10 (D)) as the legal authority. Based on the other state funds/interagency transfer authority for the Medical Assistance

Division (MAD) in the General Appropriation Act (GAA) the total of $6.4 million falls within the increase allowed by the "5 percent rule."

Mr. Weber stated that LFC staff questioned the legal authority for each revenue source based on the following:

The amount of DOH funds available for transfer remains unknown and will probably require a general fund supplemental appropriation. Without the certainty of a revenue source, a budget increase should not take place. DOH Deputy Secretary Duffy Rodriguez was called upon and testified it was currently unclear if funds were available or not. She indicated bills were still being processed and the final expenditure level for the developmentally disabled program had not been determined.

County-supported Medicaid funds are available only through legislation. The statute clearly states the funds are "subject to appropriation by the legislature." This situation is analogous to using a BAR to increase funds from the Tobacco Settlement Program Fund if an agency had an appropriation from this fund and wanted more. In addition, the statue requires a corresponding appropriation to DOH for primary healthcare services. While this issue would need to be addressed by a companion BAR, it appears an HSD increase cannot take place in the absence of the DOH increase. Furthermore, there is not a statement from the Treasurer indicating the funds are currently available. Laws 2005 Chapter 33 Section 10 (D) applies only to funds collected inside the agency, not funds such as the count-supported Medicaid monies earned by a county sales tax and deposited in a State Treasurer's account. The program did not collect any money as required by Laws 2005 Chapter 33 Section 10 (D).

Mr. Weber concluded that since the BAR was sent to LFC on June 30, the last day of FY06, there could be no objection by statute and it becomes effective immediately by default. BARs with any question of legal authority should not be processed this late in the fiscal year.

General discussion ensued regarding the appropriateness of this BAR particularly because it was processed at such a late date. The committee expressed interest in thought being given to tightening the BAR increase language in the GAA.

MISCELLANEOUS BUSINESS

Approval of LFC Minutes - July 2006

Representative Saavedra moved to approve the minutes from the July 2006 LFC meeting, Representative Salazar seconded the motion, and it passed with no objection.

David Abbey, LFC director, discussed the following information items: LFC budget status, status of the audit work plan and Cash Balance Report for July 2006

UPDATE ON HIGHER EDUCATION FACILITY CONDITION INDEX

Beverley McClure, secretary, Higher Education Department, and Miguel Hidalgo, deputy secretary, Higher Education Department, briefed the committee on the process and structure of 3DI's update of the facility assessment for higher education facilities. Mr. Hidalgo indicated the reason for partnering with 3DI for the assessment was due to the direction HED was given more than six years ago by the Legislature to get an independent assessment and costs for improving infrastructure for higher education facilities statewide. Mr. Hidalgo indicated the assessment of the 27 institutions will address 100 percent of general academic space. The comprehensive assessment will report on approximately 1,000 buildings totaling 17,000,000 square feet. The results of the findings will highlight the most significant projects and costs that need to be addressed. Not only will the assessment be helpful to address infrastructure needs; it will also provide accountability for funds provided to institutions for maintenance. Building renewal and replacement (BR&R) funds are not nearly enough to maintain the facilities at its funded level of 40 percent. Due to under-funding of BR&R, a backlog of maintenance for statewide facilities has been created. The average age of higher education buildings is increasing. Many four-year school facilities are over 50 years old. New Mexico Highlands University is a prime example. The 3DI assessment will benefit both large and small schools.

Mr. Hidalgo introduced John Oualline, project manager for the updated facility audit. Mr. Qualline has been involved with the assessments for kindergarten through 12th grade (K-12). Mr. Qualline explained the assessment will provide system-level deficiencies based on life-cycle models for each building and infrastructure component. Life-cycle system-based cost models will be created from existing records and interviews, and the cost-model assumptions will be confirmed through an on-site assessment of actual conditions on a building-by-building basis. Data and information will then be analyzed to develop a budget for deferred maintenance and capital renewal with projected costs for renewal of system upon expiration.

Mr. Qualline indicated deliverables will include the study as well as software that will inventory the system and the status of each facility. Mr. Hidalgo indicated it will be important that the system be updated to reflect investment and maintenance efforts for each facility in the future. Mr. Qualline indicated training will be provided to institutions throughout the state. A complete inventory will be provided of all ING space and will be broken up into a life cycle system, i.e., roof, HVAC, etc. Every year structures will be ranked and scored so that the worst structure is at top. Mr. Qualline explained the facility condition index (FCI). FCI is determined by the condition, suitability, and sufficiency of a facility divided by the replacement value. By November 1 the first report will be delivered and by November 17 there will be a final report.

Senator Jennings indicated the report sounds good, but questioned where funds will come from and who will set aside money to support these facility needs. Mr. Hidalgo indicated that part of the report will red-flag projects in advance so that institutions will be given appropriate time to plan and provide funds, whether it be combining funds or requesting funds to properly address the needs of the facility. Senator Smith commented that the assessment and FCI will create efficiency; in the past some projects may have been thrown over the ship.

Dan Lopez, New Mexico Tech president, spoke on behalf of Eastern New Mexico University (ENMU) and Western New Mexico University (WNMU), as well as the Council of University Presidents. He stated that many campuses look nice on the outside but behind the walls facilities are in sad shape. He pointed out that public schools are addressing needs by asking taxpayers to pass a $350 million bond, but he has concerns that bonds of this amount may hurt the chances of a similar bond for higher education. By working with 3DI on this process, there is hope of defining a system to address infrastructure needs for structure in New Mexico. NM Tech is no exception to the critical needs for maintaining infrastructure. There is a need to replace utility structure including an electrical system that had 25 breaks in one year, and three breaks in one week that left parts of the campus with no heating for at least 24 hours. This is crucial not only to NM Tech but other universities and colleges that use laboratories for long-term experiments if there is one major failure it can be detrimental to studies.

Ben Woods, vice president of planning at New Mexico State University, stated the investing money in buildings is not about the buildings but about the people in the buildings.. David Harris, interim president of the University of New Mexico (UNM), indicated there are 8.4 million square feet to maintain at UNM. It is not possible for the Legislature to fund all the needs of UNM. Danny Earp of Independent Community Colleges supports the effort taken on by HED to document the facilities index. He stated the examples given by NMSU and UNM are typical examples shared with other universities and small schools. He indicated he has always appreciated the long-term funding and nonrecurring funding given by the Legislature.

Manuel Pacheco, interim president of Highlands University, introduced Manu Patel, vicepresident of finance and administrative services. Mr. Patel indicated Highlands has spent $750 thousand over the last two years to repair steam leaks. In November 2005 the school had to relocate students to a nearby hotel because of a busted pipe. Over $350 thousand is needed to fix the electrical system; to date it has not been fixed. Highlands will address infrastructure problems using a phased approach, i.e., the request for $25.5 million will be broken down as phase 1 for heating systems in seven buildings, underground utility and steam line repair. Requests for phases 2, 3, and 4 will be requested for other infrastructure needs in later years.

Responding to Senator Griego, Ms. McClure responded that this is not the first time this study has been conducted. The last time it was done it was not done to full extent, but this time around all aspects will be addressed. K-12 used this system and had issues addressed and now its time for the Legislature to give HED a chance.

Senator Griego commented that the information received today is no different from information received over the last 12 years. What difference is this study going to make when legislation doesn't get approved. Money doesn't guarantee the members of the Legislature that the governor will not veto money. Ms. McClure responded there is no guarantee that the money will not be vetoed. The capital assessment simply addresses all needs of HED and ensures accountability on projects.

Senator Griego questioned the directive to agencies by DFA of submitting flat budgets. It didn't make sense that a flat budget is presented to the committee yet legislators are expected to fund the infrastructure of HED and inflation costs. So it is not a true picture of a flat budget. Ms. McClure indicated she has no explanation for a flat budget because she had not received the letter from DFA instructing agencies to submit a flat budget.

Senator Jennings questioned if criteria would be set up to ensure funding goes to maintenance of existing buildings. At least 99 percent of funding capacity should fix buildings although the schools first problem to address is planning and maintenance. There is a significant lack of maintenance to the buildings. HED needs to build credibility with this system. Senator Jennings was curious if all presidents would support a no-new-building plan, until existing needs are fixed. Mr. Harris indicated he is trying to eliminate buildings that need replacement, for example, three buildings could be demolished and replaced by one new facility. Mr. Lopez said there is no either/or approach to that question. For example, computer science people need the most updated facilities and those must be built from the ground up. Mr. Woods stated that Dona Ana Community College had 10 percent growth and must add new space to address the students. NMSU has received money from three previous bonds for renovations to existing buildings only. All bonds are consistent with the idea Senator Jennings presents about no new buildings.

Senator Carraro indicated higher education has had problems with its buildings for at least 20 years. He asked if the governor had explained his veto of $60 million for higher education construction. Ms.

McClure responded by stating the money would be vetoed by governor if there was no consensus from universities to utilize the money. The department is working on getting a consensus from the universities for the next legislative session.

It was questioned if there could be an override at the beginning of the upcoming session to ask for the vetoed money to be given to HED. Representative Saavedra answered there cannot be an override at the beginning of session.

Representative Larranaga stated the problem is funds are sometimes spread out too thin, something 3DI is not looking at. He said he doesn't believe this study has a real assessment of utilization.

Representative Sandoval said the problem is that the capital outlay pot is limited. Representative Sandoval indicated he has in the past mentioned to Mr. Hidalgo and other college presidents that they must address needs and stop working on projects piece-meal. He suggested the solution might be to address the needs of one or two universities a year instead of each legislator working on the needs of the schools in the legislator's district. He asked if the universities are ready if money becomes available. Mr. Lopez of New Mexico Tech, said the universities are ready. Ms. McClure stated she needs universities to come to a consensus; with a consensus there would not be risk of vetoed capital outlay funds because money can be obtained through a severance bond package.

Representative Saavedra commented that New Mexico Tech is an example of how schools should start buildings. He also questioned the reasoning for the Board of Finance (BOF) to reject the legislative funds for the UNM golf course. He further questioned if consideration will be made to take the request back to BOF and wanted to know if the HED secretary would be present at the next BOF meeting. Ms. McClure stated there are some exceptions when new buildings are needed; 60 percent of the proceeds from the general obligation bond was to be used for new buildings. There is a perception new buildings are being built while existing buildings are not being taken care of. She stated she will meet individually with members of BOF. Mr. Hidalgo indicated he made the presentation for BOF approval, but BOF would only support projects that pertained to academics. Mr. Hidalgo indicated BOF felt the funds were for an auxillary project. Mr. Hidalgo indicated the vote was deferred and will be bringing the project back to BOF.

Senator McSorely commented that in 2006 it was relayed to legislators that the governor's position was there was a lack of evidence needed for postsecondary education yet there was a clear indication that the Legislature was going to pass the $60 million. Ms. McClure responded that some institutions were not included in the $60 million and they felt they had safety issues as well. Ms. McClure indicated she supports the governor's position and reports to the governor.

Senator Smith questioned the need for additional buildings, but not necessarily new ones. His concern is there is nothing in place to ensure this will not be a problem 10 years down the road. Senator Smith indicated he would like cooperation with the executive branch. He indicated the Senate Finance Committee used HED's initial recommendations for what was needed from general obligation bond funding. However, what was originally recommended by HED did not come out the same way by the executive branch. Senator Smith invited the executive branch to step up to the plate and the Senate Finance Committee was told they would be there, but they never showed up. Senator Smith suggested to

Ms. McClure that when working with governor she should encourage funding to maintain existing buildings.

When questioned about how the assessment was funded, Ms. McClure responded that institutions have agreed to shave some funds off their share of the $20 million appropriated for BR&R to fund the 3DI project.

<u>CORRECTIONS DEPARTMENT POPULATION AND FACILITY GROWTH PLANNING</u>

Joe Williams, Secretary; Erma Sedillo, Deputy secretary for operations; Jolene Gonzales, Deputy Secretary for administration

Mr. Joe Williams, Secretary for Corrections Department, reported male population hit a high of 6,131 on June 30, 2006. The male population on July 27, 2006, was 6,105 with 42 general population beds available. By the end of FY07, the male population has been projected to increase by 401.

Mr. Williams reported the department is handling increases by negotiations with Cornell's Regional Correctional Center for 192 beds for pending transfers into the private or public facilities. Springer will take care of growth through FY07 and Clayton will take care of growth through FY08. The New Mexico Corrections Department (NMCD) has asked Clayton to look at the possibility to expand from 600 to 900 beds for the facility. With this increase the male population would be covered through FY10.

The female population as of June 30, 2006, was 692. The female population as of July 27, 2006, was 702 with 130 general population beds available. By the end of FY07, the female population has been projected to increase by 47. By the end of FY08, the female population is projected to increase by another 36. By the end of FY09, the female population is projected to increase by 35.

Chairman Varela asked how female inmates are selected to come from the New Mexico Women's Correctional Facility in Grants to the Camino Nuevo Correctional Center in Albuquerque. Mr. Williams stated that it is done by security level, with level 1 and 2 females going to the Camino Nuevo Correctional Center. Chairman Varela asked what the options were for the growing female population beyond FY09. Mr. Williams stated they have not looked beyond FY09; however, more than likely the department would look to expand the facility in Grants. Chairman Varela asked if the American Civil Liberties Union lawsuit has been resolved. Mr. Williams stated the Population Control Committee will convene on August 8. Mr. Williams stated the Population Control Commission statute will sunset at the end of FY07. Chairman Varela asked if the rates had been established for the Clayton Correctional Facility. Mr. Williams stated the construction costs are rising. Mr. Williams stated the department is waiting to review the possibility of 900 beds at Clayton, which could decrease per diem costs. Mr. Williams stated that the department plans to open the Clayton facility early in calendar year 2008.

Representative Sandoval asked if the department was looking at the former Bernalillo County jail for state inmates. Mr. Williams stated that is indeed the facility and renovations have taken place. Representative Sandoval asked how that works with costs regarding beds that are not needed immediately. Mr. Williams reported that the male projections shows need within the next year. The price will be based on a per diem rate. Representative Sandoval asked how the mental health inmates will be dealt with. Mr. Williams reported that inmates will go to the appropriate facility if deemed to have mental health needs. Mr. Williams stated it is in the department's capital outlay request for the expansion of the Mental Health Treatment Center in the Los Lunas facility.

Representative Larranaga asked for specifics pertaining to the ACLU lawsuit. Nick DeAngelo, chief counsel, stated per the agreement a monthly report of the female facilities will be given, the commission will be called three times, and the statute sunsets on June 30, 2007. Representative. Larranaga asked about the Springer facility and whether it has a DWI program. Mr. Williams stated that the Springer Facility will be for level 1 and 2 male inmates; however, the majority will be DWI offenders and that will involved programming. Representative Larranaga asked if the governor's crime package is factored into the inmate growth projections. Representative Larranaga asked that projections include the effect of the crime package.

Senator McSorley asked if current numbers are available with the end of FY06. Ms. Gonzales stated the department is still verifying the most recent projection numbers. Ms. Gonzales stated that the department is working quickly and will release them once verified. Senator McSorley asked when the Springer facility will open. Mr. Williams stated that it is set to open in January 2006. Senator McSorley asked if mental health staff will be available at the Regional Correctional Center. Mr. Williams stated the mental health staff would be supplied by the department's medical contractor. Senator McSorley asked if the department is looking to contract with the Regional Correctional Center for the next two years. Mr. Williams stated the department will need to contract with the Regional Correctional Center for the next two years until the Clayton facility opens. Mr. Williams stated the department is using $60 as the rate for the Regional Correctional Center but that does not include programming. Senator McSorley asked if there were plans to move the Monte Vista Region II office. Mr. Williams stated there are problems with the Monte Vista building but there are no plans to move. Senator McSorley asked what the construction cost are from Bradbury-Stamm, the contractor. Mike Running, Clayton Town manager, testified the original bid was $68.5 million, but the costs have been negotiated down. Mr. Running stated the construction numbers should be finalized by mid-August.

Chairman Varela asked for help for the committee and the Courts, Corrections and Justice Subcommittee on the costs of the Clayton facility. Chairman Varela stated with the capital outlay available consideration should be given to the state building the Clayton facility.

Representative Moore stated Clayton is the first private facility to split operational and facility costs in the per diem. Representative Moore stated Clayton has done an exceptional job in working with the Corrections Department and addressing issues.

Chairman Varela asked about the high probation and parole caseloads. Mr. Williams stated there are recruitment and retention issues due to low pay. Chairman Varela asked if the secretary was aware of the line-item veto of raises for probation and parole officers. Mr. Williams stated that was due to the collective bargaining agreement. Representative Varela stated that the Legislature was trying to address this issue and it was line-itemed vetoed. Sandy Perez, state personnel director, said the probation and parole officers are under the collective bargaining agreement. She stated that studies are being conducted to generate a thoughtful request for pay raises. Chairman Varela asked Carter Bundy of the American Federation of State, County and Municipal Employees if the language was in violation of the collective bargaining agreement. Mr. Bundy stated the language was not in violation of the bargaining agreement.

IMPLEMENTATION OF PERSONNEL TRANSITIONS AT SPRINGER FACILITY

Mr. Williams stated the Corrections Department jumped on the opportunity to add additional beds by taking over the Springer facility. The name will be changed to the Springer Correctional Center. The department has received $5 million for operations and $4 million for capital outlay to take over the Springer facility.

Ms. Perez, State Personnel Diredtor, said the State Personnel Office (SPO), New Mexico Corrections Department (NMCD) and Children, Youth and Families Department (CYFD) have all worked closely together in dealing with the transition of Springer. Perez reported that information was gathered from each employee to ensure their skills and abilities are considered in identifying appropriate placement. Perez stated there were communication efforts consisting of agency meetings, Springer local community forums, New Mexico Boys' School meetings, American Federation of State, County and Municipal Employees meetings and legislative hearings. Ms. Perez reported in January 2006 there were 168 employees at the Boys' School and 87 of those have accepted positions with NMCD, and 27 accepted positions with CYFD's Area I; 34 additional placements and 23 employees are without an identified placement. Ms. Perez stated 19 of the 23 employees without identified placement are juvenile correctional officers.

Ms. Dodson, Secretary, Children, Youth and Families Department, stated the department is committed to finding job placements for all 23 employees without identified placement. Ms. Dodson reports they are very mindful of the sensitivity and how ingrained the Boys' School is in the Springer community. Ms. Dodson states many employees have stated they are excited about the changes.

Mayor Danny Sanchez of Springer stated the community has issues with economic development. Mr. Sanchez stated he looks for any opportunity to bring jobs to the area. Mr. Sanchez stated that he attended meetings where people are afraid to speak out. Mr. Sanchez said his numbers show 10 teachers who have no job placement past the contract with CYFD ending June 30, 2007. Mr. Sanchez stated that the transition did not have to happen. He said the state mental health hospital could have absorbed the Springer facility.

Chairman Varela asked who the workers are afraid of. Mr. Sanchez stated they are afraid because they are afraid to lose there jobs.

Representative Saavedra stated the smaller the community the more afraid people are to speak due to lack of jobs.

Chairman Varela stated that he attended a town hall meeting with Senator Griego where it appeared the town had buy-in on the transition and felt it had been adequately explained to the community.

Senator Griego said the state hospital should have vacancy savings, and he asked for an audit of the state mental health hospital.

Ms. Dodson said she disagreed with Mr. Sanchez's numbers and she would work with the mayor to deal one-on-one with anyone who is afraid. Mr. Dodson said no one has been left out in the cold or not considered.

Senator Griego asked why a lack of beds at the Youth Diagnostic Development Center (YDDC) was causing 18 juveniles to sleep in the gymnasium. Ms. Dodson said plumbing problems in one cottage had forced the 18 juveniles into the gym. She said this is a temporary placement and is not due to a shortage of beds. Senator Griego requested CYFD provide an analysis of their facilities.

Senator Harden asked if the ACLU lawsuit had been settled. Ms. Dodson stated that there was no lawsuit and that CYFD entered into a four-year contract with the ACLU in February 2006. Senator Harden stated that a meeting in fall of 2005 brought forth a possible ACLU lawsuit and at that time it was stated there would be no loss of jobs.

Senator McSorley asked if there was a way to hire an independent company to conduct a confidential survey of the employees. David Abbey, LFC director, asked if SPO could provide a report of current and new positions. Senator McSorley stated the issue is people reporting they were not treated with respect. Senator McSorley would like to hear the attitude of the employees and whether they were treated with respect in the transition process.

Chairman Varela asked why some of the juvenile correctional officers did not meet NMCD's criteria for the academy. Mr. Gallegos, director of the NMCD academy, testified that the criteria is a polygraph test, psychological test, drug test, criminal background check, and physical agility test. Mr. Gallegos stated none of the juvenile correctional officers did not pass the physical agility test.

Representative Balderas was critical of the transition. One year ago the New Mexico Boys' School clients were not a part of the discussion. The discussions didn't continue with the LFC members. The decision was made without public input. He said legislators promised to make other options part of the discussion but those options did not become part of the discussion. Representative Balderas said employees were treated as if they were no longer needed when the message could have been that their juvenile-corrections expertise made them valuable adult-corrections employees. The community was forced to defend itself in the media and it is still unclear how many employees are involved and when the transition will take place. The communication has not been good. Representative Balderas said he hopes Area 1 is developed quickly. He asked how many youthful offenders are in the system. Ms. Dodson said she did not have that information.

Senator Robinson stated he believes the J. Paul Taylor facility is not an acceptable placement for youth. Senator Robinson stated there are no common rooms, programming, or other services. Senator Robinson stated putting more kids at the J. Paul Taylor facility is not or should not be legal. Responding to Senator Robinson, Ms. Dodson responded that YDDC is not over capacity. Senator Robinson asked if Santa Fe County is increasing its capacity and if it can they take higher-risk kids. Ms. Dodson stated Santa Fe County already takes high-risk/high-need kids. Senator Robinson said New Mexico has not done a good job of housing juveniles and it is difficult to operate under a consent decree. Senator Robinson asked about whether early release is a possibility. Ms. Dodson responded that CYFD has been working hard with the Juvenile Parole Board.

Fred Perea, an employee union representative, said employees were never asked if they wanted to go to NMCD. Perea stated 17 teachers have lost their contracts.

UNCOMPENSATED CARE AND TRAUMA

Mark Weber, LFC principal analyst, provided an overview on trauma care issues.

Representative Varela asked about the impacts of the line-item vetoes on trauma.

Representative Saavedra noted that he had met with Bernalillo County officials on the gross receipts tax issue for indigent care but that the *Albuquerque Journal* had negative editorials criticizing UNM hospital financial management.

Senator Wilson Beffort suggested that there needed to be better accountability on spending of indigent care funds.

Secretary Pam Hyde of the Human Services Department briefed the committee on the governor's five-point plan to insure New Mexicans. The five elements are 1) require vendors doing business with the state to offer health insurance to employees; 2) assure state employees are insured; 3) maximize Medicaid for low-income adults; 4) expand the state coverage initiative program; 5) analyze health coverage models for New Mexico.

Ms. Hyde then compared other state models for providing insurance coverage for the poor with what is currently done in New Mexico.

First, Dr. Paul Roth of the UNM Health Sciences Center identified two groups who tend to receive uncompensated care: 1) those who qualify for charity care and 2) the working poor. Working poor numbers are extremely large in New Mexico. These are employees who work in jobs that do not include health insurance. Dr. Roth identified three variables creating the crisis: Healthcare costs have continued to rise, reimbursement from third-party payers have been reduced over time, and the numbers of persons working without insurance has escalated because of the increasing cost of the benefit.

Every hospital is facing a nursing shortage as well. For example, UNMH has 30 beds in the hospital not staffed in spite of aggressive recruiting of nursing. Instead of investing in salaries and recruitment, UNMH has had to subsidize cost of unsubsidized care.

A key measure is the number of times the emergency department is understaffed or over-whelmed, and patients are diverted to alternate facilities. This situation is characterized as more patients than capacity. The ER is on "divert status" an average of 20 hours per month. Some people have waited in the emergency room as long as a day before a bed opened up. This is a problem at other hospitals as well.

He noted the cost/revenue gap for UNM Hospital is $45 million.

He noted the increase in funding provided by the Legislature 2006 with details provided and discussed for recurring and nonrecurring appropriations. He said it was an incredible support from the New Mexico Legislature when he compares notes with his counterparts in other states, even though it did not fully satisfy the UNM need.

Back in early 1990s, there was an additional gross receipts tax to send to Santa Fe to match with Medicaid; 32 counties imposed that 1/16 percent permissible addition to the tax for support of the Medicaid program. Bernalillo County did not. An arrangement between the Bernalillo County commission and UNMH allowed for an intergovernmental transfer between the hospital and the state to send an equivalent amount, $1.5 million to $2 million, for reimbursement. UNM Hospital cannot absorb this anymore, and over the years the requirement has grown to about $10 million.

Roth noted that Bernalillo County recently approved a GRT increment that will pay the portion currently funded by the UNMH inter-governmental transfer. This would free up UNM hospital from making the inter-government transfer. To benefit from a full-year impact, the county commission would have had to approve it in April or May. They have yet to pass it. It is on the agenda for August 9, 2006, meeting. If approved, it will not go into effect until January and cash won't flow until March. The failure of the commission to act until late in the year may potentially require the funds to come from UNMH until the county has generated enough cash to begin payments.

In response to Representative Varela, Dr. Roth said current mill levy funds flow to the county, then are transferred to UNM. It is about $64 million per year, based on the value of the property, but does not grow as quickly as gross receipts or as quickly as medical inflation costs.

In response to Representative Varela's question about $31 million of costs from residents of other counties, Dr. Roth noted the majority are from immediately surrounding counties. Representative Moore asked for a further breakdown for indigent care versus working poor; officials from UNM hospital indicated they would provide the information.

Dr. Roth discussed work with the Robert Wood Johnson Foundation to consider establishing a healthcare policy center focusing on disparities of care for Hispanos and Native Americans. He noted $20 million might be available from Robert Wood Johnson. In response to Representative Varela, he noted the grant would be for five years for about $18.5 million. He said the intent would not be to come to the Legislature to continue the funding if this funding source dried up.

Alex Valdez, president and chief executive officer of St. Vincent Regional Medical Center in Santa Fe, discussed how uncompensated care impacts the facility.

There are 22 beds in the St. Vincent ER and it is not uncommon to be backed up with four to six patients waiting for beds. Currently there are 50 nursing vacancies and about 20 beds that are empty due to staff shortage. Contract nurses often fill the gaps but it is quite expensive. As the sole area hospital St. Vincent does not go on divert. However the physicians are questioning why the hospital is a trauma center since it puts so much pressure on the staff to work extra.

In terms of uncompensated care, there are no incentives for physicians in private practice to come in and provide services at the ER. St. Vincent has the same issue as UNM on providing care for non-county residents. Total direct and indirect uncompensated care provided is $26 million. Sole community provider funding of $21 million is essential, reducing the loss to $5.2 million. Uncompensated care for out of county residents is $2.4 million. Santa Fe County will not be able to put up the match needed to maximize the supplemental sole community provider funding. HSD has helped but the hospital may need legislative help. Indigent primary care of $1.9 million is provided by the county to support medical services. Sole community provider funding is 12 percent of the total budget. Mr. Valdez thanked the Legislature for their support of the expansion of the emergency room at St. Vincent.

David Roddy, executive director of the New Mexico Primary Care Association, provided an overview of the primary care safety net. There are 14 federally and state-funded health organizations in New Mexico: 13 community health centers, one center for the homeless, and two migrant health centers. There are 135 delivery sites serving about 290,000 patients annually. Approximately 46 percent of these patients are uninsured and 84 percent earn less than 200 percent of the federal poverty level. Funding provided to the Rural Primary Health Care Act supports our facilities. Recurring general funding is approximately $9.4 million. There is an additional county-supported primary care funding of $1.9 million.

Comprehensive primary care is provided with referrals to specialists, discounted pharmaceuticals, and limited dental care and mental health. New Mexico ranks 11th nationally in service penetration for the underserved. Clinics invest in outreach, education, case management and disease prevention, so costs are higher than private primary care practices. Federal support for disease management in areas such as asthma, diabetes, cardiovascular disease, and cancer is utilized. Demographics indicate clients are 46 percent are uninsured, 36 percent Medicare/Medicaid and 17 percent private pay. The majority of uninsured are between 19 and 64 and often characterized as the working poor. Staffing at federal/state-funded clinics is 1,649. The net loss on $125.5 million in expenditures was $2.7 million.

Dr. Roth provided a general overview of the various levels of trauma classification for hospitals. Currently UNM is the only level one facility in the state. San Juan Medical Center in Farmington and St. Vincent Hospital in Santa Fe are level III trauma centers. New Mexico faces unique challenges in providing emergency medical care because of its large geographical area and because it has a higher rate of death by accidents.

Tress Snell of DOH provided an update on the $4.7 million appropriated by the state for trauma. Of the funding, $1.3 million will be sent to UNM and $3.4 million will be allocated to support the development of additional trauma centers and upgrading of lower level trauma centers.

MASSACHUSETTS HEALTH INSURANCE INITIATIVE

Mike Batte of the Public Regulation Commission Insurance Division provided an update on the Massachusetts Health Insurance Initiative. A major feature of the “Mass” plan is that all residents must obtain health insurance effective July 1, 2007. It restores, preserves, and expands Medicaid coverage. Eligibility for children is increased up to 300 percent of the federal poverty level (FPL) and Medicaid like coverage is extended to all adults below 100 percent FPL. However, in response to questions from members, Mr. Batte noted there are many differences in demographics, state income levels, and medical financing systems between the two states.

STATE AGENCY EFFORTS TO ADDRESS METHAMPHETAMINE USE

Matthew Chandler, 9th judicial district attorney; Herman Silva, drug czar, Department of Public Safety; Danny Sandoval, deputy secretary, Children, Youth and Family; Peter Brochert, statewide drug court coordinator, Administrative Office of the Courts; Jack Pischner, deputy director, Behavioral Health Division, Department of Health.

Matthew Chandler presented slides of pictures of methamphetamine laboratories. Mr. Chandler presented slides of where methamphetamine labs are being found in New Mexico. The labs are being found in hotel rooms, trunk of cars, homes, under patios, garages, trailers, and other places. Mr. Chandler states methamphetamine must be cleaned up due to high cost to clean up labs and to free up law enforcement officers. Methamphetamine users are very dangerous to law enforcement officers. The labs are unsafe environments for children. Children in a lab will test positive for methamphetamine. Average county jail population is half full with methamphetamine users, 27 percent increase in identity theft and 70 percent increase in robberies/burglaries. Methamphetamine injuries from iodine explosions, overdoses, crank bites, dental problems, etc. Mr. Chandler presented progression photos of methamphetamine users. Eddy County reports methamphetamine accounts for 70 percent of all drugs sold and consumed. NM Office of Medical Investigators reports 36 deaths directly attributed to methamphetamine use. San Juan County estimates it has20,000 users of methamphetamine out of a population of 140,000. Mr. Chandler reports they have started a Meth Watch Program with stickers in high traffic areas with products used to produce methamphetamine. Program started in Curry and Roosevelt County and is now in all 33 counties. Mr. Chandler reviewed the new statute locking up pseudoephedrine.

Representative Saavedra asked if the school could show the progression pictures of the effects of methamphetamine. Terry Haake, 5th Judicial District Attorney, reported they are taking information to

New Mexico schools. Representative Saavedra stated he would like to work with the district attorneys in developing statute to bring information to the schools.

Herman Silva, drug czar, Department of Public Safety, reported it is not completely statewide in every county. Mr. Silva reported New Mexico has a Meth Working Group of 12 federal and state agencies that made recommendations passed into statute in the last legislative session. Mr. Silva reported the behavior health collaborative is involved in addressing methamphetamine use. Mr. Silva reported the number of methamphetamine lab clean is down. Lab clean ups are down 62 percent. Mr. Silva reported the majority of methamphetamine lab clean ups are in Bernalillo County. From 2004 to April 13, 2006, 694 children were placed in protective custody due to methamphetamine labs. State Police conducted 21 training session with 972 participants in 22 counties. Most of the training was initially for first responders. The State Police launched an awareness campaign regarding methamphetamine. The state has numerous prevention programs planned.

Danny Sandoval, deputy secretary, CYFD, said 694 children since 2004 have entered state custody due to methamphetamine. National research shows more and more children are using methamphetamine. Mr. Sandoval reported they are trying to deal with staff exposure to methamphetamine laboratories. In 2005, a first responder protocol was established in dealing with methamphetamine labs. Mr. Sandoval stated they have developed methamphetamine kits for CYFD employees. CYFD is trying to understand the health outcomes to foster children exposed to methamphetamine. Mr. Sandoval reports CYFD is very active in Farmington in getting information to the children.

Jack Pishner, deputy direction of Behavioral Health Division, Department of Health, reported on the "Meth and More" presentation. Mr. Pishner stated alcohol, tobacco and heroin are killing and adversely affecting more people than methamphetamine. Heroin is still a bigger problem in Rio Arriba and Santa Fe. Mr. Pishner stated adequate resources are needed in the communities. He stated treatment is needed statewide. Mr. Pishner stated the behavioral health collaborative has formed a methamphetamine team. The guiding principle is that methamphetamine is a problem in an array of substance abuse issues. Prevention, interdiction, treatment and recovery support are all equally important. Capital expenditures include $2 million to San Juan County for treatment and services; $840 thousand to Bernalillo County for a treatment center; $240 thousand to Eddy County for campus facility to treat methamphetamine users; and $45 thousand to Grant County for a substance abuse treatment facility. Operational expenditures include $800 thousand for a mobile crisis teams in Dona Ana and Bernalillo counties; $100 thousand for intensive outpatient treatment; $350 thousand for combined methamphetamine, DWI and other substance abuse treatment; and statewide $1.1 million for intensive outpatient programs, $284 thousand for care program, and $559 thousand for San Juan Regional Partnership. Mr. Pishner reported there is discretionary funding of $850,250 to purchase services throughout the state.

Peter Brochert, statewide drug court coordinator, Administrative Office of the Courts, reported drug court programs are 12 to 14 months in length. Of graduates only 13.5 percent re-offend. Mr. Brochert stated methamphetamine is a highly localized problem, and most drug court programs state they noticed the problem with methamphetamine starting in 2005. Mr. Brochert stated the drug court methamphetamine data is very preliminary. Mr. Brochert stated methamphetamine addicts can be treated successfully. The matrix model is used for methamphetamine treatment. The matrix model closely resembles the drug court model.

Chairman Varela requested a letter be drafted to the courts to submit with their budget recommendations their involvement with drug courts. Chairman Varela asked the drug czar to provide information pertaining to the courts involvement in the methamphetamine work group. Peter Brochert stated the courts are participating with the behavioral health collaborative on the methamphetamine funding.

Senator Carraro stated he passed a bill in the 2006 legislative session for education to children on the methamphetamine issue. Senator Carraro stated the legislation was vetoed by the governor. Senator Carraro encouraged pictures to reach out to adults and children regarding methamphetamine education. Senator Carraro asked why the Montana model was not being followed. Herman Silva stated that New Mexico is basically following that model. Mr. Pishner stated it is not as physically addictive. After a while addicts will continue taking the drug to avoid the crash. Mr. Pishner stated is a conditioning addiction in which over time more is needed to sustain a high. Lieutenant Harvill, State Police, reported it was $500 to $800 an ounce to purchase methamphetamine on the streets.

Senator Jennings stated the problem is the drug-addicted mother continually having babies. Matthew Chandler reported the district attorneys cannot prosecute an addict mother who has given birth.

Senator Smith stated methamphetamine labs are down but usage is on the increase. Matthew Chandler reports that 80 percent is coming from outside the state. Lieutenant Harvill stated that majority of methamphetamine coming into New Mexico is from Phoenix and Los Angeles. Senator Smith stated that the methamphetamine issue has been entrenched on the border for years. Herman Silva stated that the methamphetamine issue has been dominant on the border. Senator Smith asked why the school systems are sitting on information regarding methamphetamine. Chris Mier with the Public Education Department stated the schools do keep data on drug use by students. Responding to Senator Smith, Mr. Pishner stated it is difficult to come up with an exact cost for treating a meth addict, and one size does not fit all with treatment. Senator Smith requested a statewide plan of the cost to address the methamphetamine issue.

Senator Harden asked how far this should be taken for mandatory sentencing. Matthew Chandler stated that the methamphetamine users are bonding out and re-offending. Mr. Chandler stated mandatory sentencing would get them off the street; however, mandatory treatment may be more beneficial.

Senator McSorley asked how many slots are available for the public to "self refer" for mental health/substance abuse treatment. Mr. Pishner did not know a specific number and referred the question to the Value Options representatives who had left the hearing. McSorley asserted the only way to get treatment was to commit a crime in a judicial district with a drug court.

Representative Saveedra asked for the cost of a drug court in every county in the state. Mr. Brochert answered that is would cost approximately $8 million to fund all the courts included in the Drug Court Advisory Committee's five-year plan.

Chairman Varela adjourned the meeting at 11:58 AM

Chairman Date