MINUTES
LEGISLATIVE FINANCE COMMITTEE
August 12-13-14, 2008

Senator John Arthur Smith, Chairman, called the Legislative Finance Committee (LFC) to order on Tuesday, August 12, 2008, at 8:30 a.m.

<u>The following LFC members were present on August 12:</u>

Senator John Arthur Smith, Chair; Representative Luciano "Lucky" Varela, Vice Chair; Representatives Don E. Bratton, Don Tripp (for Brian K. Moore), Rhonda S. King, Edward C. Sandoval, Jeannette O. Wallace, Nick L. Salazar, and Henry "Kiki" Saavedra; and Senators Sue Wilson Beffort, Mary Kay Papen, Cisco McSorley (for Phil A. Griego), Leonard Lee Rawson, Carroll Leavell (for Stuart Ingle) and Carlos Cisneros.

Welcoming Remarks and Community Input. Senator John Arthur Smith, Chairman, LFC, introduced Dr. Bradley Rasch, designated mayor pro-tempore, Cloudcroft, New Mexico. Dr. Rasch welcomed the Committee and spoke about the community of Cloudcroft. Tommy Hancock, Cloudcroft public school district superintendent, made a welcoming speech and responded to a recent letter from the LFC addressed to school districts statewide regarding the Office of Education Accountability's recent report on the number of public high school students in need of remediation. Mr. Hancock expressed concern that 37.5 percent of Cloudcroft public high school students need remediation.

All three Cloudcroft campuses did meet annual yearly progress (AYP) this past year. Mr. Hancock stated that the letter implies school districts need to address student remediation and college readiness and the Cloudcroft school district does not have sufficient funding to meet this goal. College may not be appropriate for some students. Chairman Smith stated that the LFC is charged with making budgetary recommendations to the State Legislature and will continue to look at accountability with 60 percent of the State's budget directed toward public education. Committee members discussed the need for remedial education to be addressed by school districts, faculty and parents from the elementary school level. The Committee asked for more detail on state and federal mandated programs that create a negative fiscal impact on public elementary, middle and high schools.

Update of Department of Health Facilities. *New Mexico Department of Health (DOH).* Dr. Alfredo Vigil, DOH secretary, introduced Katrina Hotrum, DOH deputy secretary, who responded to concerns raised by the Committee last year regarding the Office of Facilities Management (OFM). Ms. Hotrum began with a brief overview on the State's seven facilities, including challenges faced and gave a further update on Fort Bayard Medical Center. OFM's key objectives include improving resident and patient care and services, eliminating abuse, neglect and exploitation of vulnerable populations, ensuring facilities meet standards and healthcare best practices, and creating environments that promote recovery, community inclusion, and reintegration.

The seven facilities providing statewide services include Turquoise Lodge and Sequoyah Adolescent Treatment Center in Albuquerque, New Mexico Rehab Center in Roswell, Fort Bayard Medical Center in Silver City, New Mexico Behavioral Health Institute in Las Vegas, New Mexico State Veteran's Home in Truth or Consequences, and Los Lunas Community programs. The medical and behavioral health services provided include acute and outpatient psychiatric treatment, drug detoxification and chemical dependency, sex offender treatment, counseling and crisis intervention, long term nursing care, rehabilitative therapies, and residential day programs.

Facility challenges include the recruitment and retention of qualified health professionals, increasing costs for fuel, utilities and food; rising costs of maintaining aging buildings; and the lack of a long term care psychiatric treatment center in the State that would be governed by regulations not in long term care. The OFM operating budget for FY09 is $156 million. Revenue sources for all facilities include 28 percent from 3rd party payers, Medicare and Value-Options, 34 percent from the State's general fund, 36 percent from Medicaid, and 2 percent from the Veteran's Administration. Representative Varela asked for additional information on how much of a supplemental will be requested from the legislature for FY09.

Ms. Hotrum provided an overview of each facility. There are 2000 active clients in community based services at the New Mexico Behavioral Health Institute. The New Mexico Rehab Center has 370 on the chemical dependency wait list and is working to refer where possible. Turquoise Lodge accepts patients needing medical management due to co-occurring disorders. The New Mexico State Veterans Home received two deficiency-free health surveys in 2007 and 2008. The Sequoyah Adolescent Treatment Center provides services for boys 13 to 17 who are violent or mentally ill, and amenable to treatment. Los Lunas Community Programs is expanding services for under-served medically fragile and behaviorally challenged individuals.

Fort Bayard Medical Center (FBMC) has a 200 bed nursing home and a 28 bed substance abuse unit. The Committee heard discussion on the medical and behavioral complexity of the residents served by FBMC. The United States Department of Justice (DOJ) report, dated May 1, 2006, cited numerous patient rights violations including mistreatment of residents, early release of residents into the community, and psychotropic drug therapy misuse. DOH is working collaboratively with DOJ on corrective actions. The Center for Medicare and Medicaid Services (CMS) requested that DOH voluntarily relinquish Medicaid and Medicare certification effective March 1, 2008. DOH passed a second revisit survey August 8, 2008, and is waiting a certification letter. Pinon Management, Incorporated began providing management and consulting services July 1, 2008, at $3.6 million for the first year.

Grant County. John Saari, county manager, provided an update on plans to build a new medical center on 90 acres of land purchased from the federal government for $400 thousand with county funds. The county adopted a $60 million bond issuance in 2007. The State Board of Finance has approved a 25 year lease-purchase agreement with DOH. The county will not receive any compensation for the lease unless the land is sold and purchased by the State. The State can purchase the facility at any time at fair market value by paying off the bonds. DOH has been involved in the design to ensure the new facility meets the State's needs long-term. A $49.3 million two-year contract to construct the new facility has been enacted with Jaynes Corporation. The Committee expressed concern with the additional cost of $2.5 million to guarantee a "lead silver" (green) designation, when the new facility is designed to achieve environmental efficiencies even without purchasing that designation.

Bill Taylor, GSD property control division director, emphasized that during the two-year completion phase for the new facility, the old building will still need to be maintained and life-safety codes addressed until vacated. There will also be costs incurred to decommission the old building. The Committee heard discussion on community efforts to preserve and use the historical site once vacated.

A LFC staff brief reported that the reason for privatization of FBMC management was that it would speed the construction of a new facility if done by a private entity. This has not been the case and costs due to the delay have increased from $22.3 million in 2005 to $48.5 million if completed by 2010; in addition, there will be approximately $11.7 million in other costs (capitalized interest fund, debt service reserve fund, cost of bond issuance, underwriters discount and additional proceeds) bringing the total to more than $60.2 million. Mr. Taylor stated that costs to meet standards of care, in addition to construction costs, have driven up costs for capital outlay health care projects.

Representative Bratton expressed concern when the State uses third party financing for a state-owned facility, and when cost estimates for state projects are so far off that they triple over a three year period. Senator Rawson concurred and gave examples of misleading initial cost estimates and overruns for the Rail Runner and Albuquerque municipal court building projects. Several Committee members voiced concerns with going outside the State's procurement process and awarding a sole source contract at $300 dollars per square foot for the site and new facility. Sen. Rawson also asked Dr. Vigil for a breakdown on what the cost per bed per facility per day, and the resident vacancy and employee turnover rates per facility. Dr. Vigil also agreed to provide information on the number of DOH employees not covered by health insurance.

Representative King thought the State should reconsider purchasing the land at fair market value now as opposed to in the future. Mr. Saari stated the county will discuss that option during lease negotiations with DOH. The bonds state that Grant County is responsible for operation and maintenance of the facility, but the county will pass that responsibility on to DOH in the lease as the lessee. Maintenance for the new facility will be a lot less than it has been for the current facility. Representative King asked for more information on how the $300 per square foot project cost was calculated as fair since the project was exempted from the procurement process. Mr. Taylor stated that GSD looked at the project's cost and believed it to be fair in today's market but did not elaborate.

Representative Bratton encouraged counties, municipalities and the State to pursue land swaps through the State Land Office as opposed to buying land. Chairman Smith reminded the Committee to consider statewide priorities when considering capital outlay requests for individual district needs for the future. Chairman Smith stated that neither the executive branch nor the legislative branch have done the best job possible in providing oversight to protect the State's interests.

Long Term Care Update. *Aging and Long-Term Services Department (ALTSD).* Cindy Padilla, ALTSD secretary, provided an overview of the State's coordination of long-term services (CoLTS) to the Committee. CoLTS is a coordinated effort between the Human Services Department (HSD) and ALTSD to serve certain Medicaid participants by providing medical and long-term services in one seamless, coordinated, integrated program. After a managed care RFP process, stakeholder meetings, public input, and tribal consultation, waivers were approved by CMS in July 2008.

Ms. Padilla believes that managed care organizations can help the State better manage existing resources, identify needs earlier, increase early intervention and prevention, increase access to healthcare services in rural areas, and increase participant involvement in long-term planning. New Mexico is being nationally recognized nationally for its move toward home and community-based services.

The estimated number of individuals served is expected to be 38,000. Those eligible include individuals with both Medicare and Medicaid coverage who are not receiving long-term services, persons who meet nursing home level of care, and persons with brain injuries who meet medical and financial eligibility. Services covered include all Medicaid state plan services and home and community-based services. Participants will obtain services through service coordinators who will provide a continuous assessment of participants needs.

The Committee heard discussion on the phase-in plan by county. Initial outreach activities will be provided in locations such as senior centers, independent living centers, and nursing facilities. Provider mailings, meetings, trainings and conference presentations were conducted statewide. As community capacity develops, there will be an increase in access to home and community-based services. Nursing homes will be encouraged to reinvent themselves as community centers.

A CoLTS subcommittee to the Medicaid Advisory Committee consisting of providers, consumers, advocates, and managed care organizations (MCOs), was formed to communicate on key issues important to individuals being served. The Subcommittee is charged with developing a protocol to provide advice in the area of client access, improved quality and accountability.

Human Services Department/Medical Assistance Division (HSD/MAD). Carolyn Ingram, HSD/MAD director, continued with a presentation on oversight issues. Each of the two MCOs providing care completed an intensive readiness review. The review included an assessment of network capacity, access to care, service coordination, cultural competency, and the grievance and appeals process. Financial oversight for MCOs will include monitoring plan solvency, ensuring timely financial reporting, and obtaining yearly financial audits to validate data.

Program safeguards in place include ensuring billing and provider payment timeliness. New performance measures will include vaccines for older adults, reducing emergency care visits, reducing nursing home admissions and length of stays, reducing falls, and increasing mobility.

Reimbursement is designed to help coordinate services and bring flexibility to the program. MCOs are paid a per member per month (pmpm) amount to manage an individual's entire risk. Statewide provider networks are capable of providing all covered services under the flexibility of the plan. MCOs will be required to offer Medicare products or "special needs plans" (SNPs) and coordinate the care for an individual that is dually eligible and has severe or chronic conditions. The amount of the contracts for the first phase-in year is $390 million. The annual amount is approximately $675 million. Each MCO is limited to an administration fee between 5 and 7 percent depending on the rate cohort that the individual falls within.

The average pmpm capitation payment for the CoLTS program is $1,500, which provides services for individuals to be in the community, or high-need services for individuals requiring nursing home care. Ms. Ingram provided information on how much the CoLTS program costs compared with other Medicaid programs. The average capitation payment for the Personal Care Option (PCP) is $2,600 pmpm; PACE is $2,442 pmpm; and the disability and elderly waiver (D&E) is $2,500 pmpm. Ms. Ingram brought it to the committee's attention that the capitation payment estimates included all Medicaid services, not just services received through each program.

Jim Jackson, advocate and disability coalition steering committee chair, presented a concerned consumer perspective on CoLTS. When fully phased in, CoLTS will account for over $600 million of Medicaid spending annually. Consumers support the goals of greater flexibility in providing services, better coordination of care, and promoting community services over institutional care.

The Committee heard discussion about how CoLTS is a move to capitated managed care in a for-profit environment. When services are provided through for-profit companies that are paid capitated fees, there's an inherent incentive to limit services. CoLTS is only a change in organizational structure and leaves existing eligibility requirements in place that do not expand eligibility. In 2008, the legislature passed memorials directing state agencies to consult with advocates and to address questions before implementing CoLTS. This has not happened enough in Mr. Jackson's opinion.

Mr. Jackson stated that consumer advocates are pleased that the state has raised the number of waiver slots. However, the small increase still leaves an insufficient number of slots which will hamper the MCOs in efforts to service more people in the community instead of in institutional care. The only way to get the full range of services needed by a person who needs a nursing home level of care is through the D&E waiver. Having an inadequate number of waiver slots hampers the ability to return to the community from a nursing facility. If there is no waiver slot to move into, leaving a nursing home could mean losing Medicaid eligibility. New Mexico has 10,000 to 12,000 people on the D&E waiver wait list. Consumer advocates further encourage the legislature to monitor CoLTS closely to ensure success.

Comments on Funding Adult Behavioral Health Care. Dr. Margaret McCowen, Mesilla Valley Hospital CEO, presented a brief history of the hospital. Mesilla Valley Hospital was created to provide community access to in-patient psychiatric care. Mesilla Valley Hospital is a private hospital and a major part of the behavioral health delivery system for the State. Over 50 percent of all referrals come from hospital emergency rooms statewide without psychiatric facilities caring for patients in the midst of a psychiatric crisis. Most of the referrals for residential treatment programs come through the Children, Youth and Families Department with a large number coming directly from the juvenile justice system. Referrals also come from community counselors.

Most patient reimbursement is distributed through Value Options. Each year an annual appropriation of $311 thousand provides care for adult patients in need of psychiatric hospitalization who are not covered by other insurance. The funding is distributed by Value Options to hospitals on a first-come first-served basis. There are four hospitals in southern New Mexico set up to receive this funding. The $311 thousand is insufficient for the level of need and runs out each year by mid-fiscal year. The hospital had over 1,200 unfunded patient days over an 18 month period. Mesilla Valley Hospital is not eligible to receive state indigent funding or fee-for-service Medicaid due to a federal mental disease exclusion for certain hospitals that do not provide medical surgical care. The hospital recently received a notice from Value Options about an overpayment in 2005 for services not deemed eligible.

Senator Wilson-Beffort expressed concern about similar notices being sent to providers by Value Options. Eddie Broadway, Value Options CEO, responded in general terms. Value Options is under obligation with CMS and the State to authorize behavioral health services according to recommendations made telephonically by the facility. This is done in a timely manner to make sure treatment is provided promptly and the facility gets paid. Value Options is then obligated to go back and do a retrospective review of the medical record to ensure the patient has met the criteria for the stay. Sometimes there is a discrepancy between approval of the services and what is in the medical record. Dollars recouped from providers either go back into direct services, or to the State. Mr. Broadway restated that a retrospective review is a normal process in managed care for participation in Medicaid.

Senator Papen asked Value Options to provide more detail on retrospective provider review findings statewide and notices sent regarding overpayments. Vice Chairman Varela reminded the Committee that future RFP proposals need to be well defined to avoid misunderstandings with service providers and ensure access to data necessary for policy decisions regarding funding.

Chairman Smith adjourned the Committee into two subcommittees at 1:30 p.m.

Senator John Arthur Smith, Chairman, called the Legislative Finance Committee (LFC) to order on Wednesday, August 13, 2008, at 8:45 a.m.

The following LFC members were present on August 13:

Senator John Arthur Smith, Chair; Representative Luciano "Lucky" Varela, Vice Chair; Representatives Don E. Bratton, Don Tripp (for Brian K. Moore), Rhonda S. King, Henry "Kiki" Saavedra, Edward C. Sandoval, Jeannette O. Wallace, Nick L. Salazar, and; Senators Sue Wilson Beffort, Mary Kay Papen, Cisco McSorley (for Phil A. Griego), Carroll H. Leavell (for Stuart Ingle), Leonard Lee Rawson and Carlos R. Cisneros.

Tax Incentives: How they Work Together Across Industries and Regions. Assessment of Incentives for Manufacturing, Film and Renewable Energy. *New Mexico Taxation and Revenue Department (TRD).* Rick Homans, TRD secretary, presented a personal perspective on tax incentives. Mr. Homans believes tax incentives work and gave examples of economic development successes in the State. Tax disincentives such as pyramiding in the gross receipts tax can discourage investment. The level and quality of public services that attract employees affect business costs directly. The general cost structure for labor, materials, transportation, and other items also drives investment decisions. "Quality of life" factors such as public education are becoming increasingly more important to businesses and their employees.

Good tax incentive design and follow-up analysis is essential to making sure each incentive works well. Mr. Homans talked about various studies and surveys that provided foundation research in the area of economic development tax incentives and tax reforms. The *New Mexico Economic Development Tax Incentive and Accountability Task Force Report* released in April of 2006 made recommendations concerning the data collection and analysis, methodology for analysis of economic impacts, and state agency responsibilities. The primary responsibility for data collection and analysis was given to TRD. Based on studying best practices in other states, TRD estimates that start-up costs would be about $400 thousand recurring. TRD has taken steps to develop the infrastructure required but does have the budgetary resources to support an ongoing analysis of tax incentives.

Thomas Clifford, New Mexico Tax Research Institute research director, presented a report on the role of tax incentives in a well designed state and local tax system. Dr. Clifford defined tax incentives as a "special preference to favor a particular industry, activity or class of persons." Tax incentives in current New Mexico statutes provide for the following:

(1) Relief from poverty, sickness or other disadvantages;
(2) Encourage activities that generate benefits to the general public; and
(3) Encourage the growth of a particular industry within the state or local jurisdiction.

Arguments in favor of tax incentives as economic development policy include:

- Using the tax code to attract capital investment.

- Reduce tax burdens on firms most likely to respond to a reduction in tax.
- Industrial Revenue Bond (IRB) financing to reduce New Mexico's business tax burden, particularly for property taxes and gross receipt taxes (GRT) on businesses purchases.
- Taxes play a larger role in plant locations for small and medium firms as opposed to larger businesses.

Arguments against tax incentives:

- Tax incentives create inequity in the tax system within the business community.
- Differences in tax burdens may be offset by differences in the quality of public services.
- Current economic models are not able to predict the ultimate beneficiaries of tax incentives.
- Existing firms committed to New Mexico may be more important to growth. Most of the State's current incentives are targeted to newly-relocating firms.
- Transferable tax incentives are poorly targeted because the taxpayer receiving the tax benefit pays less than the taxpayer engaged in the qualified activity.
- Poorly crafted tax incentives increase complexity for taxpayers and for TRD.

New Mexico's single biggest tax policy problem is the GRT imposed on business purchases. Incentives like IRBs, investment credits, and targeted exemptions and deductions within the GRT are in response to this problem. These incentives may make the pyramiding problem worse because they reduce the tax base and put pressure on increasing tax rates.

TRD has limited resources for enforcing accountability. Reporting requirements should balance the State's need for information with the taxpayer's need for privacy. Tax laws should be clear about the criteria by which a business earns an incentive and how that reported information may be used.

Dr. Clifford provided a list of general principles to keep in mind when evaluating proposed and existing tax incentives:

- Incentives should be narrow exceptions to the tax system.
- Is the request for an incentive suggesting the need for reform?
- Allowing a credit against withholding liability, and making a credit refundable or transferable, may indicate that the tax system is being used to provide a cash subsidy outside the budget appropriation process.
- Use of caps and sunsets may limit potential erosion of the tax base.
- Geographic targeting creates inequities.
- Is the incentive so complicated or so limited that it benefits only a few and /or provide very limited benefits to each taxpayer?
- Consolidate various incentives within each tax program. The unified credit act could contain a standardized set of definitions to reduce confusion.

Dr. Clifford gave a list of possible policy questions for proposed non-economic and economic development tax incentives and drafting questions that the legislative council service might use for a new initiative. Current statutes vary widely in their treatment of some important policy issues. The result is confusion and incentives that cannot be used by targeted populations. Dr. Clifford provided suggestions for more consistent statutory language to make statutes more clear.

Norton Francis, LFC chief economist, provided an analysis on the layering of tax and other incentives, how incentives work in different geographical areas and tax districts, and the difficulties with accountability requirements. When money is directly appropriated to benefit a certain company it is often part of a package that includes other incentives put together to make New Mexico more attractive. Many businesses receive more than one credit or incentive. Incentives against different types of tax liabilities make it difficult to get comprehensive information. Several agencies may be involved in an overall incentive package making comprehensive reporting difficult. There are also indirect incentives for other businesses or investors that benefit from policies aimed at a particular company or industry.

Mr. Francis detailed geographic issues for rural, tax increment development districts (TIDDs), and border areas. Businesses on the fringe of urban areas benefit from tax incentives designed for urban areas because of inconsistent "rural" definitions. The state receives only a fraction of the GRT that it would normally receive for capital outlay infrastructure projects within TIDDs. The state also only receives a fraction of the GRT for companies that locate within TIDDs because of tax incentives. Additional incentives for border areas create complexity in the program and may be seen as creating economic development inequities for the region.

Mr. Francis provided examples of layering tax and other incentives and results achieved using a case study approach for manufacturing, renewable energy, and film industries. Highlights included Eclipse Aviation which generated 1,386 jobs, $82.9 million in local spending, and provided a significant return on investment for the State Investment Council. There are several solar projects planned in renewable energy technologies. In 2007, wind energy made up 3.9 percent of electricity generation in New Mexico, the 3rd highest share in the country. Within the film industry, over 120 films were produced in the last five years in New Mexico. The economic impact is positive with thousands of film jobs created and hundreds of millions spent in New Mexico, but the fiscal impact to the State probably negative due to tax credits.

In closing, Mr. Francis emphasized that accountability and reporting of incentives is critical. LFC sponsored legislation in 2007 that would have had TRD and the Department of Workforce Solutions work together on a report using confidential data. Adopting "LFC recognized principals" of tax policy that become a standard part of fiscal impact reports and budget guidelines would be helpful going forward into the 2009 Legislative Session. Questions to ask when considering new incentives should include: What is the target? Is this the best way to achieve success? How will success be measured?

Taxation and Revenue Department (TRD). Jim Nunns, TRD tax policy director, presented a perspective on the differences between tax principles and tax incentives. The tax system has a set of principals designed to raise money in the most efficient and fair way. Tax incentives are designed to achieve other objectives not directly related to taxes, such as encouraging jobs and investment activity.

Taxes distort economic decisions by discouraging some form of economic activity. Only in very specific circumstances are taxes intended to discourage economic activity. One example is the tax on cigarettes, which was intended to discourage smoking. Taxes always take more resources out of the economy than just the amount of revenue. Collecting taxes imposes compliance costs for taxpayers and government agencies over and above the revenue collected from the tax.

Mr. Nunns stated that the state tax system is believed to be the most cost-effective method of administering the incentive. However, the principles of taxation are not properly applied to tax incentives. The principals for evaluating tax incentives are not as well developed, as are basic tax principles. Some set of principles other than tax principles must be used to evaluate tax incentives. These principles must look to the intended purpose of the incentive and provide clear guidance on how the effects of an incentive can be measured against its purpose.

Representative Sandoval commented that the State needs to be prudent when creating tax incentives that may erode the tax base. We need to evaluate the impact of incentives in a timely manner. Mr. Homans responded that economic development incentives are targeting businesses exporting a product or a service out of the State, and importing new dollars into the State. These dollars have a multiplier effect when spent in the local community.

Representative Varela reminded the members of the need to protect the tax policies of New Mexico. Dr. Clifford responded that a policy decision was made to use a portion of the State's GRT revenue for local infrastructure development. Mr. Francis further detailed the three TIDDs; Mesa del Sol, downtown Las Cruces, and SunCal. TIDDs can receive the incremental GRT distribution once economic activity starts and the TRD is notified. The role of the legislature is limited to authorizing the issuance of bonds in a TIDD. Mr. Francis reported on plans to use dynamic scoring for future fiscal impact reporting.

Representative Savaadra stated that there are strong arguments for tax incentives, but we need to be careful of the inequities it may create. Representative Bratton stated caution for policies that earmark tax dollars meant for the State but to be directed elsewhere. The bigger problem may be undeveloped land attracting new businesses that may erode or undermine older businesses in adjoining communities. Existing businesses need to be assured that they will be treated fairly.

Senator Rawson encouraged the use of tax incentives to attract and retain health care providers particularly for border communities. Chairman Smith stated that our tax policy does not always treat existing businesses fairly. The challenge is how to encourage new businesses to move into the state, but be fair to existing businesses. Legislators need to pay more attention to LFC fiscal impact reports for proposed legislation. Chairman Smith emphasized that it is imperative TRD respond consistently and expeditiously to businesses.

Tax Expenditure Budgeting: Update on TRD Progress Towards Developing a Tax Expenditure Budget. *Department of Taxation and Revenue (TRD).* Jim Nunns, TRD Tax Policy director, presented an overview of TRD's tax expenditure work plan, outlined a tax expenditure analysis report and provided information on a study on the GRT base. TRD's work plan is a multi-year, comprehensive review and analysis of tax expenditures. This year TRD plans to complete a report that describes the conceptual framework of tax expenditures. A second series of studies will define and measure tax expenditures for a number of specific taxes. One of the reports defining tax expenditures in the GRT is already completed. The final series of reports will provide an in-depth analysis of the effectiveness of specific tax expenditures that Mr. Nunns believes will help policymakers with decision-making.

Mr. Nunns provided an outline of a report that will provide a conceptual framework for defining, measuring, and evaluating tax expenditures and include definitions of tax expenditure for the normal or "ideal" tax base, and deviations from "ideal" tax law. The outline included:

- Uses of tax expenditures to evaluate government programs administered through taxes, and tax reform initiatives, and tax expenditures;
- Tax expenditure analysis in the federal and state governments;
- Measurement conventions used in tax expenditures and differences between that measurement and revenue estimates in fiscal impact reports;
- Description of analysis of tax expenditures including criteria for measuring the effectiveness of tax expenditures in non-tax ways; and
- Provide a history and forecast of tax incentive credits.

A TRD conceptual study, *Tax Expenditure Budget: Defining the Benchmark GRT Base,* is the first in a series to define and measure tax expenditures for a number of taxes. There are two different tax bases one might think GRT is designed to reach. One is to tax on consumption and not business-to-business sales. The objective of a consumption tax is to impose a single tax at the final point of consumption. An alternative is to tax production. A production tax means irrespective of where something is sold in New Mexico, you would tax it. There is also no tax on business-to-business sales. There would be no "pyramiding" with consumption or production taxes. State and local governments would also be taxed under this base.

A mixed consumption/production base taxes all consumption in the State, and production for export. The State is trying to capture through a "benefits tax", certain government benefits such as highways, justice system, workforce training, etc, that also benefit businesses. The report identifies tax disincentives in the current GRT which arise primarily from tax business-to-business sales or "pyramiding". There are also taxes that are substituted for the GRT in New Mexico's tax system, such as the automobile excise tax and health premiums tax, which need to be looked at comprehensively. The committee heard discussion on TRD's need for additional resources to continue to study tax policy.

New Mexico Film Initiatives. *New Mexico State University (NMSU).* Tony Popp and James Peach, NMSU Office of Policy Analysis, presented a report on the film industry and the provision of incentives. The report outlined the incentives being offered to the industry, estimated the amount and economic impact of the subsidies, and estimated the return in tax revenues to the State from the increase in economic activity.

Tax incentives for film production in New Mexico include a 25 percent film production tax rebate on production expenditures in New Mexico; a 50 percent reimbursement of wages for New Mexico labor and for pre-employment workforce training; and, a zero percent loan program up to $15 million per project. In FY03 two projects claimed tax rebates for a total of $1.1 million. In FY08 31 projects claimed tax rebates for a total of $38 million. Other film related expenditures that take place include capital expenditures on film projects and educational programs.

Job training expenditures in FY08 for The Film Credit Advancement Program (FCAP) were $850 thousand for 16 projects with 177 participants. In FY08 expenditures for the Pre-Employment Training Program (PETP) were $30 thousand for 9 classes with 270 attendees. It is expected that educational expenditures generate returns to those participating in the film education curriculum.

The State Investment Council (SIC) makes zero percent loans to the film industry. There are outstanding loans for 14 projects for a total of $161 million. Three projects for $5.5 million have been partially paid off, and 9 projects for $52.5 million have been fully paid off. The outstanding balance is $155.7 million. The State's highly anticipated percentage in terms of profits for successful projects is 8.5 to 20 percent for 14 projects; 2.5 to 6 percent for 9 projects; and, 17 percent for 3 projects. The State has received to date only $500 thousand in participation profits.

In FY04 $10 million was allocated and in FY08 $3 million was allocated for capital expenditures from the Governor's Office. Most of these capital expenditures are for educational programs. The overall cost to the State of the various film and digital media interdisciplinary educational programs in higher education is unknown.

The rebate rate was 15 percent until January of 2007. After January the rebate became 25 percent. Dr. Popp stated that the impact for FY08 includes three assumptions: all qualifying projects would not have occurred without the rebates; the total of new expenditures is four times the rebate; and, all projects occur in an area that will generate tax payments to the state. In FY08, 31 projects claimed $38.2 million in tax incentives for a presumed total of $152.8 in new spending. Total impact of FY08 expenditures in terms of output is estimated at $344 million. Income to the State is estimated at $8.2 million with total employment being 2,434 as a result of the increased economic activity.

In conclusion, Dr. Popp expects that the film industry economic activity in New Mexico will generate $1.6 in personal income tax (PIT); $556 thousand in corporate income tax (CIT), and $3.36 million in GRT. Total revenue generated is estimated at $5.52 million and rebates granted $38.2 million, for a 14.44 cents return on the dollar. Foregone interest on zero percent loans is estimated at $12.46 million. All loans are guaranteed loan programs and default measures are in place.

Eric Witt, Media Arts and Entertainment Development director, discussed the assumptions and limitations of the NMSU economic study model. Social benefits such as education and healthcare should also be evaluated on an expenditure basis. The film industry union reports that the average weekly wage is higher than those in the study. Benefits received by film industry employees do not qualify for rebates.

Once the GRT of 6 percent is paid the effective rebate rate is 19 percent. Not all projects can take full advantage of the rebate. There is great debate between the film office, the governor's office and the NMSU study as to what is the appropriate multiplier. Dr. Popp responded that the multipliers used for the model were provided based on the interactions of the industries within the economy.

Mr. Witt provided a production map which showed the disbursement of productions around the state. Studies show that the film industry can have a material impact on tourism. A comprehensive study also needs to capture the benefits to secondary businesses that do not qualify for rebates. In closing, Mr. Witt stated that because the film industry employs many skills, products and services, it can cushion against negative pressure in other areas of the economy.

A LFC staff brief reported that the legislature reauthorized capital outlay funds for film production, education and training, and other state initiatives. Film and media appropriations total $26.7 million of which $10.4 million expended leaving $16.3 million available. Of the available balance, the Film Office as approved projects totaling $9.9 million. Pending requests outstrip the uncommitted balance of $6.3 million 2 to 1 with requests totaling $12.1 million.

Senator McSorley commented that Hollywood accounting principles may be beyond the State's ability to create a way to generate participation profits on the $150 million loaned for projects. Mr. Witt responded that all film loan productions must spend 85 percent of the money in New Mexico. The accounting principles now in Hollywood must show accountability to shareholders, and a number of oversight agencies. Mr. Francis stated that loans for films can be thought of similarly as equity positions. Participation returns could be years in coming.

New Mexico and Louisiana are the top two states for film production. In FY08, New Mexico has spent $44 million in film credit taxes to capture 20 percent of the production outside of Hollywood and New York. Louisiana has spent $145 million in film credit taxes to capture that same percentage during that same time period. New Mexico has been more efficient in giving incentives due to the limitation that the money must be spent in New Mexico, and wage reimbursement limited to residents. New Mexico is also attractive to the industry because it has the largest state-based crew outside of California, good weather, and infrastructure such as sound stage facilities in place.

Chairman Smith reminds the Committee of the need to quantify what the State's tax policy does. It is critical to be able to measure that as precisely as possible because the State needs a balanced budget. Gas and oil production is on the decline historically in New Mexico. The film industry is another way to broaden the tax base. The question is whether the State can do that with fewer dollars. Dr. Peach responded that it is almost impossible to determine whether the State could have built the industry with cheaper incentives given the increased competition, the weakening economy, etc. Economic development always involves some level of risk and is difficult to model in advance.

The New Mexico Film Office is contracting with Ernst and Young to study film initiatives further that should be completed by the end of the year.

Adoption of FY10 Budget Guidelines. David Abbey, LFC director, presented to the Committee LFC guidelines for appropriation recommendations for FY10. A motion carried to update guidelines based on new revenue projections.

Action Items

Senator Cisneros moved to adopt the July 2008 minutes, Representative Salazar seconded the motion, and it passed with no objection.

Director Abbey presented the FY10 LFC budget request reflecting a one percent increase in personal services and benefits, and the draft strategic plan through FY10. The Committee requested one additional FTE to support the staff's capital outlay effort which would add an additional $70 thousand in salary and benefits to the budget request. Representative Sandoval moved to adopt the motion as amended, Senator Cisneros seconded the motion, and it passed with no objection.

Information Items

Director Abbey presented the July 2008 Cash Balance Report and July 2008 Budget Adjustment Report (BAR) to the Committee. After an LFC staff objection, DFA withdrew a BAR for federal funds from the Jobs and Growth Tax Relief Reconciliation Act of 2003. The 2003 Federal fiscal relief aid could only be used for Federal mandates or programs funded in the FY03 state budget.

The LFC is in urgent need of three additional offices for existing staff. Temporary space being used will revert back to the House for bill analysis during the 2009 Legislative Session. Committee members agreed to submit a letter to the Legislative Council Service in support of LFC staff needing more space. Director Abbey suggested obtaining two now-vacant offices from the Administrative Office of the Courts in the same building if permitted.

Other items presented for the Committees' consideration included the Status of Program Evaluation Work Plans as of July 31, 2008, Performance Accountability Evaluation Guidelines, the PFM report on Public Finance, LFC staff comments on Program and Measure Changes Pursuant to Accountability on Government Act, and the LFC Budget Status Report.

The Committee heard that the Human Services Department (HSD) refused to release certain actuarial information LFC staff requested to evaluate the physical health portion of Medicaid managed care. HSD denied the request stating that the information is made confidential by law. Director Abbey said that until this issue is resolved, reference to the denial will be included in all fiscal impact reports addressing increases for the Medicaid program. The Committee agreed to submit a letter to the Attorney General's Office asking for further direction.

Chairman Smith announced that the Committee's trip to Mexico has been postponed due to the Special Session and rescheduled tentatively for April 2009.

Chairman Smith adjourned the Committee at 3:00 p.m.

Senator John Arthur Smith, Chairman, called the Legislative Finance Committee (LFC) to order on Thursday, August 14, 2008, at 8:30 a.m.

<u>The following LFC members were present on August 14:</u>

Senator John Arthur Smith, Chair; Representative Luciano "Lucky" Varela, Vice Chair; Representatives Don E. Bratton, Don Tripp (for Brian Moore), Rhonda S. King, Henry "Kiki" Saavedra, Edward C. Sandoval, Jeannette O. Wallace, Nick L. Salazar; and Senators Mary Kay Papen, Cisco McSorley (for Phil A. Griego), Leonard Lee Rawson, Carroll H. Leavell (for Stuart Ingle) and Carlos Cisneros.

Spaceport Update. *New Mexico Spaceport Authority (NMSA).* Steve Landeene, executive director, provided a briefing on the vision, project status, and budget for *Spaceport America*. Guiding principles behind the spaceport include developing an atmosphere for economic development, creating a global tourist destination, and offering New Mexico students a range of innovative STEM education programs that enable students the opportunity to experience and solve real-world science problems. White Sands and Holloman are interested in supporting educational launches using Super Loki rockets which are capable of climbing six miles high.

Mr. Landeene stated that New Mexico needs a qualified workforce to attract space industry companies to New Mexico. NMSU has a new aerospace engineering program and expects to attract students locally and world-wide. The spaceport is not just about the commercial space industry. Recently there was a second Lockheed Martin launch performing research and development.

2008 *Spaceport America* strategic imperatives include:

- Creation of a spaceport district. Dona Ana and Sierra have both approved their spaceport district agreements.
- Successful completion of the environmental impact study (EIS) and ROD and FAA site license. The draft EIS was released for public comment along with the site application.
- A signed lease agreement with Virgin Galactic is expected mid-October.
- A construction cost maximum of $225 million.
- Finalize designs, prepare bid packages, and initiate contractor selections.
- *Spaceport America* ground-breaking to be aligned with EIS/ROS and Virgin Galactic schedule.
- *Spaceport America* to move from a planning phase into an operational phase.

2008 accomplishments include:

- Virgin Galactic White Knight II is 65 percent complete.
- Terminal and hangar design to be completed by year-end. RFPs need to be in process to move quickly after the EIS record of decision is approved.
- Sierra County GRT vote passage had a greater than 40 percent turnout.
- Northern road design complete and bid let. A temporary road to the spaceport should start construction in September.
- Sierra Electric Coop contract to bring power to the site nearly ready for signing.
- Licensed vertical operations to begin early 2009. Horizontal operations to begin late 2010.

Voters approved a space district GRT for Dona Ana County in April of 2007, and Sierra County in April 22, 2008. It is hopeful that a GRT initiative is put on the ballot for Otero County on November 4. Otero is important because they have the historical perspective for space activities in the region.

Mr. Landeene further stated that Virgin Galactic's investment in suborbital flight technology is expected to be $250 million for development of the aircraft White Knight II and Space Ship II. VG is bringing new technology to New Mexico that will attract other companies. More traditional space partners are already talking about using the new technology to take satellites into space.

A summary of RFPs was provided to the Committee. Bid packages have been broken down into smaller increments to try to afford New Mexican contractors the most opportunity to bid on construction projects. New Mexico Department of Transportation (DOT) awarded a $6.8 million contract to put in the temporary road to prepare for construction traffic by December 2008. There is a fund gap for road construction. Private and public partnerships and federal funds are being sought to help bridge the gap. NMSA is working to develop a strategy for a welcome and visitors centers.

An RFP to be issued in September 2008 will ask for construction and project management services for all onsite RFP construction of the horizontal launch area. DoIT plans to put in fiber optic infrastructure to site to be charged back through use fees. Sierra

Electric Cooperative plans to put in transmission line infrastructure with six miles aerial.

The Committee heard discussion about customer milestones for Lockheed Martin, UP Aerospace, and Virgin Galactic. The spaceport is expected to not only meet the needs for commercial space, but for governmental activity that may outpace commercial activity. Several signed memorandums of understanding are in place for Lockheed Martin, UP Aerospace, Microgravity, and Payload Specialties. UP Aerospace is launching test vehicles for Lockheed and intends to relocate to Truth or Consequences from Colorado. Microgravity makes an anti-matter energy drink and plans to expand business development in Sierra County. Lockheed Martin will house the company's research and development arm at *Spaceport America*. Payload Specialties manufactures rockets and offers launch services and plans to relocate from Missouri.

The Committee also heard discussion about activities under development for New Mexico Space Week. The legislature appropriated $750 thousand for the X Prize. A Lunar Lander challenge is scheduled for October 24 and 25 at Holloman Air Force Base. An education day is scheduled October 24 at the Space Museum offering a video feed of the Lunar Lander challenges in the IMAX theater. An Otero County public event day is scheduled for October 25 at the Space Museum. An educational launch of successful student experiments is tentatively scheduled for late April of 2009.

The *Spaceport America* educational launch initiative will begin with high school, community college, and university competitions. Students will design, build and launch payloads on annual launches beginning April 2009. There will be a teacher development program. The initiative will start with Dona Ana, Sierra, and Otero Counties and expand to all 89 school districts within 5 years. Partnerships are being developed with NMSU, UP Aerospace, Kirtland, White Sands, Holloman, and Micro Gravity among others. White Sands Missile Range has offered to donate over 200 Super Loki rockets to the spaceport.

The Committee heard about plans to augment state and federal funding with public and private partnerships, earned income strategies, grant writing activities, capital campaign concepts and volunteer programs. The $198 million project funding summary included $140 million from state appropriations, and $58 million from potential GRT sources. Of the $140 million, $7.5 million remains to be appropriated and may be requested in the FY10 legislative session. Of the GRT sources, $6.6 million is still dependent upon Otero County being put on the ballot for November 2008. To date the spaceport project has encumbered $31 million and expended $21 million for planning, design, and the EIS. The airfield runway is the largest single item accounting for $43 million of construction costs. Facilities are being designed for sustainability, but a LEED or "green" building certification will not be pursued due to cost.

Tetra Tech was given the EIS contract due to conflict of interest concerns with using NMSU to perform the EIS. The scope of the EIS expanded through the years from 400 acres to 2,700 acres of survey work. Mitigation costs are not yet fully known for cultural resources and wildlife. Representative Salazar expressed concern over rising construction contracts costs due to delays in completing the EIS. Senator Rawson stated that the location of the visitor center is very important and offered to meet privately with Mr. Landeene to discuss location alternatives at a later date.

Representative Tripp asked for more information on launch fees. Mr. Landeene replied that the issue is being studied and compared with other spaceports. The expectation is that operating fees would be covered by user fees. Gross receipts will be spent on capital improvements for the runway and other infrastructure which will augment the State appropriated funds to bring the spaceport into reality.

Virgin Galactic has received $35 million in deposits to hold seats on future flights.
Representative Bratton asked about risk and liability issues for the State. Mr. Landeene stated that the leases will contain indemnification clauses. Other states limit liability and riders sign an informed consent agreement recognizing the inherent risks.

Chairman Smith recognized chief executives from the past thirty years for their contributions to visions for both a spaceport launch concept and commuter train. Chairman Smith also recognized Jimmy Bason who had the idea behind a spaceport authority from the beginning. Mr. Bason also worked hard to protect the rights of displaced ranchers who lost ranchland.

Chairman Smith adjourned the Committee at 10:00 a.m.

Chairman 9/26/08
Date