Legislative Finance Committee
Meeting Minutes
Red River, New Mexico
August 17 – 19, 2011

Wednesday, August 17

Conference Center

The following members were present on Wednesday, August 17: Chairman John Arthur Smith, Vice Chairman Luciano "Lucky" Varela, Representatives Don Tripp, William "Bill" J. Gray, James P. White, Edward C. Sandoval, Nick L. Salazar, Larry A. Larrañaga and Henry "Kiki" Saavedra; and Senators Sue Wilson Beffort, Steven Neville (for Stuart Ingle), Carlos R. Cisneros, Carroll H. Leavell, and John M. Sapien.

Red River Mayor Linda Calhoun welcomed the committee and gave an overview. Red River has a population of 450 and swells for holidays and special events. A $1.1 million fire station and prekindergarten building were recently completed, and their charter school has made adequate yearly progress for the last nine years. Mayor Calhoun introduced Russell Church, town administrator, and Rebecca Latham, director of economic development.

Kate O'Neill from the University of New Mexico-Taos welcomed the committee, thanked the members for their support and stated UNM-Taos had the largest group of new students this fall. UNM-Taos has a successful nursing program, and all 14 nursing candidates graduated. Eleven nursing graduates work locally, significant because six out of 10 jobs in Taos are in health care.

James Gallegos, superintendent of schools in Cimarron, stated schools in his district still offer band and art because it is a priority in their budget. Children are bused as far as 80 miles one direction to get to school and the district covers 1,400 square miles. Mr. Gallegos stated his district has a balanced budget without staff cuts.

Senator Cisneros, the committee's host, thanked the mayor and community for their hard work.

Developing a Strategic Plan to Implement the Early Childhood Care and Education Act. Yolanda Berumen-Deines, secretary, Children, Youth and Families Department (CYFD), presented information on the Early Learning Advisory Council (ELAC), established in 2011. The ELAC's goal is for all of New Mexico's children to have equal opportunity for success in school based on equitable access to an aligned and high-quality early learning system. Approximately $987 thousand in federal funding is available to support the council over three years. The council's five identified objectives are the following: establishing an aligned early learning system with programs that are more efficiently and intentionally funded so that all families have consistent access to a seamless continuum of appropriate services, with assurance that children who are most at-risk for school failure have equitable access to the highest quality programs; increase the participation of children (especially those who are at-risk for school failure) in the highest quality programs; ensure a continuum of family support services are equitably available to all families in New Mexico; and aligning the early learning system with the public education (kindergarten to third grade) system as the foundation for New Mexico's preschool through college (P-20) education system through the promotion of ready schools.

Secretary Berumen-Deines thanked Representative Rhonda King and Senator Sapien for helping pass Senate Bill 120, the Early Childhood Care and Education Act. SB120 established the membership and responsibilities of the Early Learning Advisory Council, defined the components of a high-quality early childhood care and education system, and established a fund, or a holding place, for future money to support implementation of a high-quality early childhood care and education system. A successful, high-quality early learning system is data-driven, accessible, family-centered and accountable. Nongovernmental partners in implementing SB120 are New Mexico Early Childhood Development Partnership, New Mexico First, New Mexico Business Roundtable, and many early childhood practitioners, stakeholders and advocates. The four working groups New Mexico has facilitated in conjunction with SB120 are groups dealing with funding strategies, quality strategies, school readiness, and data systems. Secretary Berumen-Deines stressed early learning begins before birth and the programs that the CYFD is funding, promoting, implementing, and sustaining are all programs geared toward recognizing this fact.

AnnaLisa Banegas-Peña, director of Student Success, Public Education Department (PED), provided an overview of the department's prekindergarten program. Ms. Banegas-Peña stressed the importance of an "early foundation start" for children in rural and low-income families. The PED has 91 prekindergarten classrooms in 51 school sites, and enrollment has increased with higher incidences of rural participation. The PED distributes funds according to projected enrollment, decreases funding because of empty child slots, and redistributes slots and funding to those programs with long waiting lists.

The PED prekindergarten programs accept all students. All prekindergarten teachers are certified in early childhood, elementary education, or special education, with 48 percent of teachers licensed in birth to third-grade education. The last National Institute of Early Education Research prekindergarten program evaluation revealed students who participated in prekindergarten performed better in vocabulary, early math skills, and early literacy print awareness. Prekindergarten students are assessed as follows: physical development; literacy; numeracy; scientific conceptual understandings; self, family and community; approaches to learning; and the overall percentage of student proficiency levels.

In collaboration with the CYFD, the PED will apply for the Race to the Top Early Learning Challenge Grant. The PED is mapping alignment of the early-learning guidelines with the New Mexico English Language Development Standards and the common core standards. The PED is also working on vertically aligning prekindergarten programs with kindergarten programs.

Dr. Catherine Torres, secretary, Department of Health, stated the goal of the Family, Infant, Toddler Program (FIT) is to promote healthy development of infants and toddlers by helping parents and other caregivers support children's learning. The FIT serves about 13,707 children from birth to age three and their families, and as a result of cost-containment measures, the annual growth increase in FY11 was just 0.6 percent. Entitlement is based on eligibility under the federal Individuals with Disabilities Education Act, Part C, and children must have or be at risk for developmental delays and disability. The FIT's intervention services include assistive technology, developmental instruction, family therapy, nutrition, nursing, occupational therapy, and speech therapy. Services are provided through 36 provider agencies statewide, including the School for the Deaf and the School for the Blind and Visually Impaired.

In January 2008, the FIT established a process of centralized billing through FIT-KIDS, which stands for Key Information Data System, maximizes federal Medicaid funding, enables third-party claims to be sent to health plans, and prevents billing errors. The FIT received $9 million in American Recovery and Reinvestment Act (ARRA) funds for direct services and system enhancement projects. Under the ARRA, the federal medical assistance percentage (FMAP) was increased, which decreases the match the FIT pays. ARRA funds became available in July 2009 and will be fully expended by September 2011.

The FIT instituted a number of cost-saving measures by changing eligibility, changing services delivery models, and lowering the prior authorization level. Senate Bill 330 ended services to children over the age of three, effective July 1, 2012. The FIT Program budget for FY12 is $39 million.

In hospitals and specialty clinics statewide, Children's Medical Services provides medical services and care coordination for medically fragile children and children with high-cost illnesses like cancer and heart disease. In addition, they provide newborn genetic and hearing screening. Dr. Torres noted early hearing screenings make a big difference in a deaf child's life.

Another program Dr. Torres spoke about was immunizations, with the goal to immunize age-appropriately 90 percent of all children and at-risk adults. The immunization program serves over 500 thousand New Mexico children birth though age 18, and 70 thousand high risk adults at public health offices statewide.

The Office of Oral Health promotes oral health as an integral part to general health and to prevent and reduce the incidence of early childhood caries. Statewide, 625 children are served with the Fluoride Varnish Program and 650 children participate in the Santa Fe/Rio Arriba project. The Santa Fe/Rio Arriba project provides fluoride varnish and dental case management, conducts oral health education for children and parents, applies varnish for three applications, and notifies parents about child's oral health status. Dr. Torres stressed the importance of having good teeth to reduce other chronic illnesses associated with poor oral hygiene.

Dr. Torres talked about the Supplemental Nutrition Program for Women, Infants, and Children (WIC), saying the program promotes better birth outcomes, and healthier mothers. WIC serves 62,000 pregnant, postpartum and breastfeeding women, infants and children under the age of five with supplemental nutritious food and nutrition education. WIC gives referrals for other health and social services. There are 89 WIC clinics and three mobile units statewide.

Families First is a prenatal case management program with goals to increase levels of prenatal care, decrease high-risk pregnancies, improve pregnancy outcomes, increase immunization rates, increase early identification of developmental delays and special healthcare needs, and decrease neonatal intensive care cost. Families First served 3.2 thousand pregnant women and children birth to age three on Medicaid in FY11. Representative Saavedra asked for the definition of "pregnancy outcome" and Dr. Torres said that outcomes could be stillbirths, premature births, and defects.

WIC has a Commodity Supplemental Food Program with the goal of promoting better birth outcomes and healthier mothers and children from birth to age six and seniors. The program serves about 17 thousand seniors and 5 thousand women, infants and children under 6 years old and is open to people with incomes at or below 130 percent of the poverty level. Commodity foods include dried eggs, dried milk, fruits and vegetables. There are four warehouses and 52 tailgating sites statewide.

The goal for the Farmers' Market Nutrition Program is to keep New Mexico lands arable and promote consumption of fruits and vegetables by pregnant, breastfeeding, and postpartum women, and infants and children under five years old. This program serves over 22 thousand people with a $28 coupon book per season for approved farmers' markets.

Maternal and child health epidemiology provides data for policy, resource decisions, and action by programs to improve child health indicators and serves all ages, including child health indicators linked to parents' health. The data allows the department to research interventions and used research-based approaches.

Project LAUNCH (Linking Actions for Unmet Needs in Children's Health) is part of DOH's Maternal and Child Health Bureau and is funded by a federal grant. The five-year project is in Santa Fe. LAUNCH's goals include increasing access to developmental assessments, screenings, and services for young children and their families; having a workforce that understands children's healthy development; and having more children entering school ready to learn. LAUNCH serves children birth through age eight and their families.

Also under maternal and child health is Early Childhood Comprehensive Systems, which brings together public and private early childhood leaders from all sectors; encourages collaboration, support, and alignment of early childhood programs and systems; and serves children birth through age eight and their families.

Dr. Maggie Gallaher, with the Public Health Division in DOH, explained the Firstborn Program is home visiting that supports new families in delivering services to a new child. The FIT program is specifically designed to address children's needs around developmental concerns. The Firstborn Program is not statewide. Dr. Torres added the Firstborn Program is being looked at as a program for home nursing statewide.

Andy Gomm, FIT Program manager for the Department of Health, spoke to Representative Larrañaga's concerns about annual growth of the FIT and heading in the right direction. Mr. Gomm stated that, in conjunction with the PED, they are measuring where the child is when they start in the program compared with typical development and where they are when they leave the program three years later. When a child transitions into preschool settings at age three, the PED continues the same measurement. In kindergarten, a child's readiness to learn is measured in terms of typical development. Mr. Gomm stated he would provide the committee with statistics.

Representative Larrañaga asked if there is a real program that works on parents responsible for the child's development. Secretary Berumen-Deines stated several home-visiting programs statewide teach parents about prenatal care and proper nutrition. Ms. Banegas-Peña agreed with Representative Larrañaga that meaningful engagement from parents, while considering working low-income families, is the key to a child's success. The PED has analyzed all requirements for parent engagement and parent/family involvement across different programs and is coordinating efforts to join resources. Ms. Banegas-Peña said because prekindergarten programs aren't universal, the PED uses available prekindergarten data to assess kindergarteners and accelerate instruction. If children are behind in kindergarten, it's not a matter of remediating; it's about accelerating to go to first grade reading. Representative Larrañaga disagreed and stated that there is a universal prekindergarten program and it is called, "the parent."

Ms. Banegas-Peña told Vice Chairman Varela that Kindergarten-Three Plus began in 2006, in terms of measuring early childhood programs and whether or not they make a difference, she stated the PED has data on prekindergarten programs that shows the program is absolutely working. Ms. Banegas-Peña also said they are working on refining the vertical articulation coming from prekindergarten into kindergarten and how outcomes from kindergarten are best measured. What the PED has learned from the field is children coming from prekindergarten are well-prepared for kindergarten but aren't necessarily making and continuing those gains in kindergarten. Vice Chairman Varela asked where the data is, and Director Abbey said to some extent data can be found on home-visiting from the Rand Corporation and prekindergarten with the National Institute for Early Education Research (NIEER). Director Abbey said he would have his staff prepare a memo for the committee for the next meeting summarizing the status of effectiveness evaluations being conducted.

Senator Beffort asked where the Early Learning Advisory Council obtains funding and if all prekindergarten programs are being tested to weigh private outcomes with public outcomes. Secretary Berumen-Deines said the funding is being addressed through the funding strategies working group that was established through New Mexico First. This group will look at what the funding sources are and how it is going to be implemented.

Senator Neville asked if the federal No Child Left Behind Act had any effect on prekindergarten and how many schools across the state are making AYP. Ms. Banegas-Peña stated accountability for early grades are measured at third grade. Out of approximately 1 thousand schools, about 823 schools did not make adequate yearly progress, a figure Ms. Banegas-Peña said is up significantly from five years ago. She said the new school grading system will capture the growth of students from year to year and will give schools credit for bringing students from point "a" to point "b."

Secretary Berumen-Deines stated that currently approximately 1800 children are in foster care. The CYFD stresses the importance of permanency and safety for children through its program.

Parent involvement dialogue continued and Secretary Berumen-Deines stated many parents who want to be good parents seek out opportunities but many parents model behavior they grew up with. There is a difference between discipline and punishment and many young parents lack empathy and have a sense of entitlement. The CYFD is tasked with helping create the awareness of what good parenting looks like and how to provide that for children. Ms. Banegas-Peña stated the PED will have family and parent training modules online in English and Spanish.

In response to Senator Sapien's question about Race to the Top, Ms. Banegas-Peña said the PED is extremely enthusiastic to collaborate with other agencies with expertise to win a Race to the Top grant. Senator Sapien urged the committee to allow this council to form, allow alignment within the agencies to take place, and allow the successes to be achieved.

Early Childhood Programs: Return on Investments: Mimi Aledo-Sandoval, senior fiscal analyst, LFC, said the Early Child Care and Education Act establishes the Early Learning Advisory Council; however, appointments to that council haven't been made. Ms. Aledo-Sandoval noted LFC data does not indicate return on investments on these programs or alignment of services. Services and programs for early childhood are spread over three departments without meaningful alignment. All children must receive all targeted services across the spectrum for optimum return on investment. Policymakers have two tools available -- the geographic information systems (GIS) epidemiology mapping, and return-on-investment ratios. Ms. Aledo-Sandoval's report describes the following seven childhood programs and highlights issues and concerns of each program: home visiting, FIT, childcare assistance, early childhood special education, prekindergarten, early Head Start and Head Start, and kindergarten-three-plus. Federal funding opportunities and community highlights are also included in her report.

Survey of Early Childhood Services and Identifying Gaps and Needs Statewide by County: Peter Winograd, director, University of New Mexico Center for Education Policy Research, spoke on the importance of a collective effort and a common agenda. Early childhood is the first step that pays dividends into adulthood and the time for effective data systems is now, he said. An effective data system will answer these three key questions: where are children most at risk in New Mexico; which children do and do not have access to high-quality early childhood health, development, care and education programs; and how does the state use its early childhood education resources most efficiently and effectively. Mr. Winograd suggests using the epidemiological approach the CYFD and the DOH have been using because it prioritizes limited resources successfully.

Mr. Winograd used color maps of New Mexico by county to show where at-risk children are located based on teen births, late prenatal care, low birth rates, and families in poverty. Mr. Winograd said this data tool has the ability to build indices where families are most at risk based on combined risk factors.

The slides showed all counties in terms of rank, where the programs are, and where the gaps in the programs are throughout the state. As an example, based on data from 2007, one map demonstrated 16.7 percent of women giving birth in Quay County wait until the third trimester to receive prenatal care.

One of the important issues of GIS mapping is the level of data available; more data is available when also using census tracts. Mr. Winograd explained all of this information is available on the computer, making it easy for legislators to view their areas.

Other example slides showed the number of high quality childcare programs in areas most at risk. Mr. Winograd said by mapping risk indicators with program information, the powerful data allows legislators to ask policy questions and make decisions about children and families most at risk.

According to the data presented, 59.5 percent of children are not reading proficiently in third grade in McKinley County. Statewide, 42.5 percent of 25,674 third graders scored below proficiency on New Mexico's standards-based assessments in 2009-2010.

More slides presented data on Head Start, prekindergarten and childcare sites and correlated them with combined risk factors, the number of children under five, and number of four- and five-star licensed childcare facilities.

Mr. Winograd stated the state faces challenges and needs support in developing an early childhood data system, including a unique identifier for children that links to the P-20 data system. Doing so would enable tracking children from early childhood through high school and higher education to understand the impact of New Mexico's education programs, avoid unnecessary duplication of services, and target interventions in a more effective and efficient manner. The data will allow New Mexicans to make the best choices possible.

<u>Children, Youth and Families Department Childcare Assistance Plan to Address Waitlist.</u> Diana Martinez-Gonzales, director, Early Childhood Services Division, Children, Youth and Families Department, explained the Child Care Assistance program subsidizes the cost of child care for families with incomes at or below 200 percent of the federal poverty level that are working or in school. Seventy percent of funding comes from federal dollars, with the requirement that CYFD serves eligible children up to age 13. Approximately 73 percent of funding serves children birth to age five, and the remaining 27 percent serves children from six to 13. Since January of 2010, the CYFD has had a waiting list of 5,876 families with incomes between 100 percent and 200 percent of the poverty level. The program currently serves 22,028 children. Ms. Martinez-Gonzales researched other states and discovered half of the states do not have waiting lists.

Ms. Martinez-Gonzales stated within the next couple of months the division will have a formal plan, clearly identified cost-saving measures, projected savings, and a clear picture of how many children they can take off the waiting list. Children who leave the program may not necessarily be replaced one-for-one because of the different payment rates for type of care, age of children, and family co-payments. Ms. Martinez-Gonzales noted with current funding in FY12, the CYFD is able to serve an average 21.4 thousand children.

The CYFD has the constant dilemma of quality versus quantity. As providers increase quality and move up through the Star quality rating system, the cost per child increases. Fewer children will be served if funding remains the same. Providing quality child care is necessary to achieve school readiness for our children. In FY05, 13.88 percent of subsidized children received high quality child care. Today, almost 70 percent are receiving the benefit of a quality early learning opportunity.

The federal government recommends the state pays at the 75th percentile of the market rate for child care to assure equal access, or the same opportunities private-paid children have. New Mexico is paying 34 percent less than the 75th percentile for the care of subsidized children. Many centers are setting fewer subsidy slots aside or not at all because they cannot to provide care at the subsidy rate. Santa Fe, Rio Arriba, and Taos counties are at a crisis point because subsidy families are being told to find care elsewhere. Ms. Martinez-Gonzales closed by stating having a quality childcare system is an important part of the whole picture.

<u>Community Perspectives and Next Steps.</u> Larry Langley, chief executive officer, New Mexico Business Roundtable. The Business Roundtable's membership represents about 300 thousand employees in the state, with the exclusive focus on public education. In the last 12 years, technology, the economy, and workforce needs have changed drastically. The business community is having a tough time getting graduates with developed skills, which can be attributed to lack of quality high schools and middle schools. Ultimately, developing a quality workforce for the 21st century begins in early childhood.

Lillian Montoya-Rael, program manager for the New Mexico Early Childhood Development Partnership, stated the two-year-old partnership is a Kellogg-funded initiative focused on getting the business community to the table to help advocate for effective public policy in early childhood and prioritize investment in early childhood. Now that SB120 is law, the partnership works with communities around the state to implement provisions of the law. Implementation teams are working on data systems and school readiness. The partnership is collaborating with the CYFD and the PED, talking specifically about their roles in embedding criteria within the working groups to put a competitive proposal together for the Race to the Top Early Learning Challenge grant. Ms. Montoya-Rael said the state needs the Race to the Top funding and it will help generate momentum for investment in early childhood.

Rebecca Dow, director, Appletree Education Center in Truth or Consequences, tearfully testified she was struck by the needs of Sierra County when she came back as an adult in 1997. A lady she went to church with in her youth had shot and killed her husband who was on meth, and in the park she met a woman whose child drank nothing but coffee. Ms. Dow stated she learned only 40 children under the age of five out of 650 had child care and the community had limited access to pediatricians, prenatal care, and immunizations. Back then, the state's reimbursement rate was so low dog kennels were reimbursed more for keeping a stray pet than she was for providing care for a child on assistance. Today, Ms. Dow has a five-star program, an educated staff and with county collaboration, created an Early Childhood Council as well as a Health Council. Immunization rates have more than doubled, more children eligible for Medicaid are on Medicaid and FIT serves three times the number of children than it did 10 years ago. Head Start has more than doubled in capacity, parent education is now available, and programs now have home visiting. Through community effort, high-quality early childhood education became part of Sierra County's definition of health and wellness. Ms. Dow stressed the importance of the Child Care Assistance program because the program supports the working poor and is the only program that supports the whole family. Child care is economic development, she stated, with 850 licensed centers and homes in the state.

Rosa Barraza, president, New Mexico Early Care and Learning Association, said its mission is to provide high-quality programs for children in New Mexico. Important services the association uses: FIT, Nutrition Program, Home Visiting Program, medical services, prekindergarten, Teach Program, and the Child Care Program. High-quality early education helps prepare young children to become better citizens by earning more, paying taxes, and committing fewer crimes.

Allen Sanchez, president and chief executive officer, St. Joseph Community Health spoke about the shifts St. Joseph's made in their First Born Model. Three years ago the board asked the question, "Where will our dollar give the greatest return?" The answer was early child development, with the goal that children reach kindergarten with the health and family support necessary to support learning. The first phase is Home Based Education, a curriculum in First Born, with home visits beginning prenatally once a week until age three. Mr. Sanchez anticipates reaching 600 home visits a week in Sandoval, Valencia and Bernalillo counties. The second phase will go to 1,200 home visits per week in 2013, representing 1,500 children. The goal is to get to $60 a home visit, $3 thousand a year per child in the investment.

Senator Beffort stated New Mexico needs to look at educating, paying and retaining childcare providers so they don't go to the private sector. Senator Beffort also said unless there is a merit component put into the Race to the Top proposal this year, the state will not win.

Senator Tripp stated last year the Legislature had a bill that proposed to hold students back at the third-grade level and asked Mr. Winograd for his opinion. Mr. Winograd said he was very supportive of the governor's effort to hold students back in third grade if there is a system with programs in place to help children from birth through second grade. Mr. Winograd added he believed the bill include exceptions for special education and non-English-speaking students.

Senator Smith said although the frustration level is high, the state must find greater efficiencies in the delivery system.

General Services Department and Information Technology Rates. Jay Hone, director for Risk Management Division (RMD), General Services Department (GSD), stated no premium increases are planned for group health benefits for FY13. The fund balance for FY11 was $65.6 million, higher than recommended reserves. The projected ending fund balance for FY13 is $22.5 million. To meet the suggested actuarial reserves for FY13, an additional $20.4 million will be required in the absence of plan design changes. The GSD plans on contracting a four-year actuarial service to advise on plan design changes that spread risk in different ways, reducing cost to state and employees.

As a reimbursable employer, the RMD compensates the Department of Workforce Solutions (DWS) dollar-for-dollar for unemployment compensation claims expenses paid to former employees. In FY12, the department projects $13.7 million in revenues and $13.7 in expenses. Mr. Hone stated actual claims expenses are still unknown for the last two quarters of FY11 due to challenges with bills received from the DWS. The unpaid FY11 balance is expected to be close to $8 million.

At the end of FY11, the public liability fund balance at the RMD was $47.9 million. The projected revenues for FY13 are $33.8 million, with expenses at $34.6 million. The negative $800 thousand would bring reserves down to $51.8 million, still 53.6 percent, slightly above the recommended reserves.

The public property fund took a large hit due to northern New Mexico freezes and a helicopter crash; end of year reserves are $500 thousand. Mr. Hone stated the excess insurer recognized multiple freezes as only two freeze incidents, hitting the retention of $500 thousand. In FY12 and FY13, the projected fund balance is $3.5 million, which is good, he said.

The workers' compensation fund had $14.7 million in reserves at the end of FY11 and projected $19.4 million at the end of FY12. Projected revenues for FY13 are $18.5 million, with expenses at $15 million, bringing the projected balance up to $22.9 million.

James Chaves, deputy director of the Transportation Services Division, stated the rates for FY13 will remain flat. Long-term leased vehicles decreased by 78 vehicles from January to August 2011. Mr. Chaves stated the fleet was used to travel about 1.5 million miles less than last fiscal year and maintenance costs went down $200 thousand. All vehicles must meet or exceed federal standards. Mr. Chaves also said gas cards are assigned to vehicles and the division will offer another training class on proper use of card.

In response to Vice Chairman Varela, deputy secretary Mike Unthank of the GSD said the state contracted a broker, Wetzel Aviation, to list the Department of Public Safety's (DPS) aircraft for sale and there have been a number of inquiries.

Mr. Hone stated he has an inquiry through a nationwide group asking how other states are determining reserve soundness, and he will also ask how states are budgeting through their departments for the purpose of accessing federal funding. Mr. Hone added the RMD will back up a quarter to April 1 every year to compute rates.

Department of Information Technology Secretary Darryl Ackley stated FY13 rates were assessed by the rate committee as per the Department of Information Technology (DoIT) Act.

Vice Chairman Varela asked about consolidation and Mr. Ackley stated he didn't want to guess a number, but in terms of a true consolidation, the DoIT is in the middle of the road. With investments already made in the state data center, it makes sense to continue with the consolidation.

As of FY11, there hasn't been an appropriation for the state's super computer. Mr. Ackley stated operational expenses have exceeded revenues generated, adding the governor's intention is for the DoIT to evaluate clauses, terms, and conditions, with the possibility of selling it whole, or in multiple components. Currently, the New Mexico Center for Advanced Computing (NMCAC) operates the computer. Vice Chairman Varela asked for a report on how the computer is being used, to include who is responsible for it, what type of services it provides, and a summary of costs and revenues. Secretary Ackley stated he is in a precarious position because he is both the DoIT secretary and a board member and chief executive officer for the nonprofit NMCAC.

Senator Sapien asked how the state benefits from the computer and Secretary Ackley replied that the benefit to the state is indirect, although there is a lack of measurable impact. Senator Sapien stated we should sell the computer. Secretary Ackley stated he would prepare a report documenting memorandums of understanding regarding the super computer.

Capital Outlay Report. Linda Kehoe, principal analyst, LFC, began with the quarterly report. Ms. Kehoe explained for new members that the appropriations, expenditures, and balances from outstanding capital bills are derived from three systems: the capital project monitoring system, SHARE, and data from the Board of Finance.

Current outstanding balances total approximately $436.5 million for 1,414 projects, compared with $766 million for 1,684 projects in December 2010. Of the outstanding $436.5 million, approximately $36.9 million for 419 projects will revert in September. Overall $329.5 million for 270 projects was expended or reverted since December 2010. In addition, 123 projects were reauthorized in the 2011 session, with 13 projects having zero balances. The three general obligation bond (GOB) issues passed in November 2010 totaling $19.7 million were incorporated into the report; projects were certified and bonds sold April 19, 2011. The unexpended balances by fund are $29.8 million in the general fund, $284.3 million in severance tax bonds (STB), $112 million in GOB, and $10.3 million in other state funds. Differences between balances and expenditures reported by the state versus activity at the local level may occur if local entities and schools have not requested reimbursement. LFC staff exceeded the FY11 performance measure of 62 percent for tracking and keeping major projects on schedule -- projects kept on schedule reached 75 percent.

State agencies provide information on expenditures and quarterly milestones for $1 million or greater capital funds; LFC staff tracks about 80 percent of all unexpended funds -- approximately $347.1 million for 190 projects. Yellow- and red-flagged projects are monitored closely to resolve bottleneck issues or to recommend potential reversion or reauthorization in 2012. Updates for projects costing $1 million or greater report were problematic this reporting period because of staff turnover at the executive level, thus LFC staff will offer training to agencies.

Completed projects or projects with significant activity since the last report are as follows: the Albuquerque senior center central kitchen, which will be completed by end of August; domestic violence shelters statewide projects, now on schedule; 13 grant agreements executed to higher education institutions for film and media production, education, training, and other initiatives statewide; public health facilities in Sunland Park, Alamogordo, and Portales, near completion; and $51.3 million of the Spaceport Authority's unexpended funds, scheduled for reversion in June 2012, unless reauthorized.

Appropriations unexpended for the tribal infrastructure project fund are awaiting invoices from various tribal entities, the Health and Human Services Complex land purchase is awaiting governor's approval, and the Indian Water Rights Settlement is awaiting additional state match funds.

Three projects have been inactive since last quarter: Educational Retirement Board headquarters phase one, in process of evaluating trade or renovation of existing building versus construction of a new building; Lake Roberts dam and spillway renovation phase three, pending additional data to complete alternative study; and the colonies infrastructure fund, delayed due to staff turnover and reorganization.

Regarding 2011 capital funding status, Ms. Kehoe stated at the direction of the chair, staff collaborated with state and federal agencies to determine the potential loss of federal dollars if state match dollars weren't authorized by September 30, 2011. Staff concluded only the Farmington Readiness Center for military police battalion training would lose $8.5 million.

Ms. Kehoe expressed concern regarding the Human Services Department's integrated service delivery eligibility system (ISD2R). She stated although the department will not lose federal money, it is at high risk for a catastrophic situation because the antiquated system, which delivers benefits totaling $3.8 billion in 40 various categories, could fail at any time. This time-sensitive project requires a $13.6 million state match. Overall, the $70 million project needs a state match of $39 million over a three-year-period.

Severance tax bond capacity in FY12 is $212.7 million. Using criteria approved by LFC, staff identified 20 of 55 time-sensitive projects originally in Senate Bill 218 totaling $70 million, less than 30 percent of the money lost in the last session.

On behalf of the New Mexico Library Association representing public schools, public libraries, academic libraries and tribal libraries, Ms. Cynthia Shatter presented a request totaling $29.6 million from GOB to help libraries and communities across the state.

Chairman Smith asked what the severance tax bond capacity would be in January 2012, if only an abbreviated capital bill passed in the special session. Ms. Kehoe responded approximately $151 million would remain for January 2012. Chairman Smith asked Ms. Kehoe to speak on special schools and Ms. Kehoe stated Public Facilities Schools Authority staff has a December timeline to assess, prioritize deficiencies, and meet with architects. Approximately $8 million has been set aside by the Public School Capital Outlay Council to address special school deficiencies.

Chairman Smith reminded the committee the abbreviated capital issues list discussed in the staff brief was only a preliminary review. The final recommendation is up to the Legislature and members needed to ensure both parties were brought into the discussions at their respective caucuses to determine the schools' needs and overall capital outlay concerns.

Thursday, August 18

The following members were present on Thursday, August 18, 2011: Chairman John Arthur Smith, Vice Chairman Luciano "Lucky" Varela, Representatives Don Tripp, William "Bill" J. Gray, James P. White, Edward C. Sandoval, Nick L. Salazar, Larry A. Larrañaga, and Henry "Kiki" Saavedra; and Senators Sue Wilson Beffort, Steven Neville (for Stuart Ingle), Carlos R. Cisneros, Carroll H. Leavell, and John M. Sapien. Representative Roberto "Bobby" J. Gonzales attended as a guest.

Improving Solvency of Pension Funds and Retiree Health Care. Tom Pollard, legislative fiscal analyst, Investment Oversight Committee, stated the Government Accounting Standards Board (GASB) has proposed changes in accounting standards on pension reporting. Pension liabilities will be in the front of accounting statements as of July 2012. Secondly, there will be shorter amortization for unfunded liabilities to make them inter-generationally equitable. The GASB also proposes to lower the investment assumption rate to 5 percent or 6 percent, which means the current value of liabilities will be higher.

In response to Vice Chairman Varela, Richard May, Department of Finance and Administration secretary, cautioned against abandoning the GASB standard because it could raise a red flag to the community as to what our long-term solution is when the state has worked hard to meet its GASB standards.

Mr. Pollard continued with a briefing on what other states are doing to deal with pension plans. In 2010 and 2011, 25 states increased their employee and employer contributions and 23 states raised retirement ages and service requirements for new members. Mr. Pollard stated the only change so far is the change in requirement for COLAs (cost of living allowances) for existing employees.

Board and Directors Perspective. Jan Goodwin, executive director, Educational Retirement Board (ERB), stated there has not been a huge increase in the average New Mexico pension. As of 2010, the average New Mexico pension was $20,320 annually. At the ERB, employee contributions have equaled employer contributions for a long time. Effective FY12, ERB members will pay a higher rate of contribution with the 3.25 percent swap than the employers are paying.

ERB's actuaries recommended lowering the investment return to 7.75 percent for pension solvency projections, raising the unfunded liability. The June 30, 2011, actuarial projections for unfunded liabilities are $5.9 billion. Ms. Goodwin stated the GASB wants the funded ratio at 80 percent amortized over a 30-year period.

Investment return was 19.9 percent for FY11, and total investment gains were $1.6 billion, putting New Mexico in the 81st percentile for large pension funds in the U.S.

The ERB is currently working with actuaries to construct a solvency matrix that looks at time and funded ratios in order to compare many studies at one time.

Terry L. Slattery, executive director, Public Employees Retirement Association, explained the PERA has adopted new economic assumptions, specifically dropping the rate of expected long-term inflation to 3.5 percent. Investment rate of return went from 8 percent to 7.75 percent, with the rate of wage inflation down to 4 percent. The rate of payroll growth is 4 percent. The overall PERA funded ratio dropped from 78.5 percent down to 76.6 percent and Mr. Slattery said he expects it to drop to 70 percent in 2011. The performance return for FY11 was 22.5 percent.

The proposed "Ideal Plan" which would replace HB573, is a full retirement plan for general members hired after June 30, 2010, and includes some peace officers. The PERA is having a meeting August 25, 2011, to have an idea-sharing meeting. The board believes five-year vesting is appropriate and lowered the pension factor to 2.5 percent from 3 percent. Employee contribution rates of 10.67 percent would stay the same under the proposed plan.

The proposed Ideal Plan raises the retirement age to 55, with the sum of age and service equal to 85. The final average salary (FAS) would be the average of the highest 60 consecutive months, instead of the average of the highest 36 consecutive months of salary.

The PERA board wants to increase the pension calculation maximum to 90 percent of the FAS after 36 years of service credit. Mr. Slattery explained someone working for 36 years is likely to receive that benefit for a shorter period of time so less money goes out of the system.

Currently members work under multiple plans of the PERA. Statute allows for the member who has 30 or more years to earn the highest pension coverage. The board proposes to prorate the earned service credit in two or more plans.

Mr. Slattery stated the COLA is costly, and the board is proposing only 75 percent of the change in CPI (consumer price index) with a 0 percent floor and a 3 percent maximum increase.

Wayne Propst, executive director, Retiree Health Care Authority, stated retiree health care was in critical condition in 2007. In 2009, retirees paid higher out-of-pocket costs with significant changes to plan designs. Today, the plan is solvent into 2027 and there is a $213 million fund balance and a $3.3 billion unfunded liability. Currently, the board is developing a five-year sustainability funding plan to be voted on in 2012. Adoption of the plan would extend solvency into 2032.

To ensure this benefit for current and future retirees, subsidy levels and other plan designs need to change. Some options the board is evaluating are adjusting pre-Medicare plan deductibles and combining plans, adjusting prescription copayments, and establishing a minimum age requirement or years of service requirements. Mr. Propst said realistically total contributions should be 6 percent if solvency is extended to 2032 and a possible option is to increase active employer and employee contributions by 1 percent over three years, beginning in FY16.

Mr. Propst stated Mark Tyndall is spearheading the joint "big bid" procurement process with the Albuquerque Public Schools, General Services Department, and Public School Insurance Authority for all medical, dental, and vision plans in FY13. The authority has also begun a refocused implementation on wellness and chronic disease management control programs with specific clinical measures. Mr. Propst said the board at a July meeting voted to increase premiums for pre-Medicare retirees beginning January 1, 2012, by 8 percent and 6 percent for Medicare retirees on the Blue Cross Blue Shield Medicare supplement plan. The board also voted to eliminate basic life insurance coverage paid at 100 percent effective January 1, 2012, for new retirees.

Representative White asked Ms. Goodwin about the status of recovering money from retirees who were overpaid earlier this year and Ms. Goodwin stated the money did not go to retirees. The overpayments were made to people who refunded all of their contributions and severed their ties to the fund. The first round of letters went out in mid-June, and the second round is slated to go out next week. A number of complete payments are in, and ERB has finalized terms of payment plans for repayment. Ms. Goodwin said ERB is making good progress and will continue to work on the situation and does not anticipate a legal challenge.

Regarding PERA's Ideal Plan, Representative White asked if the intent is to maintain purchasing power, why not adjust the CPI. Mr. Slattery said costs of providing COLA and maintaining a reasonable purchasing power was most beneficial to affordability and keeping within 75 percent of CPI was reasonable. Mr. Slattery said only members hired after June 30, 2010, would be affected by the proposed Ideal Plan.

Mr. Propst, in response to Senator Leavell, said the basic cost per individual for life insurance is $6 a month per member. In response to Vice Chairman Varela, Mr. Propst stated approximately 18 thousand pre-Medicare retirees and 27 thousand retirees are on the Medicare plan.

Representative Larrañaga asked if PERA has a plan in place for municipal safety workers and Mr. Slattery stated PERA is looking at a 25-year plan for safety members, as well as a minimum retirement age of 50, but there is a lot of opposition. Mr. Slattery clarified that special investigators, motor transportation officers, and juvenile corrections officers would still be in the general plan.

Representative Larrañaga asked Ms. Goodwin if the committee was going to get a proposed plan for the ERB before the legislative session. Ms. Goodwin stated the board has reviewed one set of a solvency matrix and is developing changes to its plan that will improve their funding status. The goal is to get 80 percent funding, amortize the unfunded liability over a 30-year period, and keep the current multiplier at 2.35 percent for all current and future ERB members. Ms. Goodwin also stated the ERB is looking at the minimum retirement age and changing the FAS period.

In response to Representative Gray, Mr. Propst said Medicare becomes the primary payer and NMRHCA becomes the secondary payer when a retiree reaches the age of 65. NMRHCA provides a subsidy for Medicare and pre-Medicare eligible members.

Chairman Smith asked Ms. Goodwin to check on school bus operators paying into the ERB who find loopholes if they have more than one fleet. Chairman Smith also asked Ms. Goodwin about additional defendants. Ms. Goodwin stated the ERB filed an amended complaint that did list additional defendants and names have been released.

Chairman Smith asked the PERA, ERB and RHCA to keep in mind taxpayers are footing the bill and there is a big difference between being fair and being responsible.

Balancing Post-Employment Benefits and Direct Compensation. Gene Moser, director, State Personnel Office, compared the State of New Mexico employer costs for employee compensation with those in other states around the country. Mr. Moser said although New Mexico's state employees are paid lower wages than other states, the benefits are substantially higher. Mr. Moser explained for every dollar of pay, 40 cents goes directly to pay off the benefit, and 59 cents goes to wages and salaries. New Mexico's leave rates are higher, at 8.9 percent compared with 7.5 percent, and insurances are 5.9 percent higher than insurances provided by other states. Most of that is in health insurance. The state picks up 80 percent of the benefit costs for employees earning $50 thousand or less.

There has been no structured adjustment to pay plans since 2005. Director Moser stated salaries for new hires are closer to the mid-point of salary ranges rather than entry levels because that is where the market is. Moving salaries and adjusting the pay structure will result in a 15 percent to 18 percent increase in compensation schedules. Mr. Moser said the amount the state pays for benefits needs to be lowered to offset salary increases. The state's 40.5 percent benefit rate makes it difficult to raise the compensation rate.

Richard E. May, secretary, Department of Finance and Administration, said DFA is looking at the various proposals and the administration is not ready to endorse any particular pension plan. This is not the only crisis within the state's budget. There are issues with school funding, road funds, and the state's Medicaid cash flow problem of up to $100 million. Secretary May stressed the importance of working together and looking at these problems in a comprehensive way.

Carter Bundy, political action representative, American Federation of State, County and Municipal Employees (AFSCME), briefed the committee on pension reform, and stated it is possible for all employees to be on one plan, with enhancements for public safety. Mr. Bundy presented eligibility comparison charts with the current Rule of 80, Rule of 85, and Rule of 85 with a 25-year minimum. AFSCME endorses the Rule of 85 with 25 service years and enhancements only for the years worked in public safety.

Addressing public safety employees under AFSCME's proposed system, a 22-year-old starting in public safety and staying there is eligible for retirement at 45 years old after working 23 years. AFSCME drafted numbers and went with 35 percent for enhancements because there is resistance from fire and police employees proposing anything above 20 years. Mr. Bundy indicated it was important to streamline what is considered public safety and what is not.

AFSCME proposes going to a straight CPI regarding COLA and waiting four years to get it. If the retiree is over 60 years old, the 2-year wait for COLA would remain the same. Mr. Bundy said another way to reform funds is for the state to go from a three-year final average salary (FAS) to an eight-year FAS, so liabilities for that pension would be reduced 5.8 percent.

Representative Larrañaga asked what would happen if parties didn't reach an agreement and Director Moser stated the current contract would go forward; however, by October 1, 2011, parties would come to an agreement with a 30-day window to move it forward. In November, impasse procedures kick in. Ultimately, contracts are valid until December 31, 2011. Then, it's the "last/best" offer arbitration. Mr. Bundy added the Legislature and executive have final say over all budgetary issues.

Senator Neville indicated the state needs a good, valid, life expectancy number for public safety employees to make informed decisions. Mr. Bundy clarified life expectancy for corrections officers is 59. Mr. Slattery stated mortality rates between public safety and non-public safety employees are similar to other states, generally almost 15 years higher than age 59.

In response to Representative Tripp, Director Moser stated health insurance is set by statute but life insurance is not. The amount the state pays for health insurance is driven by employee income level. Health insurance premiums are not under the state's control. Secretary May added DFA is in constant communication with GSD regarding risk rates with health insurance.

Public Safety Initiatives. Aurora Sánchez, principal analyst, LFC, directed the committee to the LFC brief and introduced Gregg Marcantel, deputy secretary, Department of Public Safety, and Robert Shilling, State Police chief and deputy secretary of Operations.

Deputy Secretary Marcantel said DPS has four major programs: Law Enforcement, Motor Transportation, Statewide Law Enforcement Support, and Program Support.

The Statewide Law Enforcement Support Program is composed of technical support and professional services. This program promotes higher levels of communication, coordination across normal boundaries and includes Technical Support, the Forensic Laboratory Bureau, Information Technology Bureau and Training and Recruiting. Deputy Secretary Marcantel said DPS has a critically aging capital infrastructure and the training center is insufficiently staffed, carrying a 20 percent vacancy.

The policing function has two programs; Law Enforcement and Motor Transportation. Within the Law Enforcement Program are the State Police and the Special Investigations Divisions. The State Police have kept pace with crime and continue to provide quality policing services to rural New Mexico. Chief Shilling indicated Special Investigations Division (SID) is primarily responsible for licensed liquor establishment compliance and administration of the New Mexico Concealed Handgun Carry Act. Motor Transportation Division regulates the trucking industry and has enforcement authority over noncommercial vehicles.

Chief Shilling stated the department is implementing initiatives to promote efficiency and effectiveness. Those include collaboration among policing units and on enforcement strategies, sharing overtime funds, reducing the motor pool fleet, combining K-9 units, consolidating fleet management and implementing a new officer electronic daily activity reporting system. The DPS is also looking into expanding video testimony to reduce travel budgets and increase the use of Livescan submissions to reduce manual fingerprint record keeping.

Deputy Secretary Marcantel said DPS is working with the Veterans Services Department and military organizations to design the "transition with honor" program that will identify returning veterans with law enforcement training, including case analysis and dispatching that meet the peace officer certification. The department is also looking at internship programs for returning injured veterans. Chief Shilling stated that State Police manpower is hovering around 400, and it will be necessary to run two recruit schools every year instead of one beginning in FY13 to keep up with the attrition rates and bring up the number of officers. The Special Investigations Division (SID) and Motor Transportation Division (MTD) have difficulty in retention so vacancies tend to be high.

A significant fuel deficit has been identified due to current gas pump prices. Strict consumption monitoring based on patrol plans is in place and some districts are on modified shifts. Regarding fleet, the DPS is keeping cars longer, resulting in higher maintenance costs. Chief Shilling stated to replace the entire fleet and get the DPS "up to snuff" would cost more than $7 million.

Based on current and FY12 projections, Deputy Secretary Marcantel stated the DPS is considering closing the lab in Hobbs in January 2012. Although accessibility of a lab is an issue, the department does not have the more than $100 thousand needed to keep it open. Senator Leavell stated he was very disappointed to hear about the closure of the lab in Hobbs. Representative Saavedra indicated the DPS should go back and look at its budgets to help Hobbs keep the lab open.

Representative Gray asked what the DPS has done with federal stimulus money the Governor has given them three times. Chief Shilling stated for FY12, the DPS received $750 thousand in ARRA funds, which were applied to its fuel deficit. Although the stimulus helped, State Police has a $750 thousand deficit, the MTD has a $150 thousand deficit, and the SID has about $50 thousand in deficits.

Representative Sandoval inquired about the additional mental health training funds and if training has been implemented. Deputy Secretary Marcantel stated implementation was close, with a new post-traumatic stress disorder curriculum, but gave no date.

Chairman Smith said the DPS needed to get a handle on its budget and streamlining is the name of the game. Deputy Secretary Marcantel indicated he looked forward to improving the committee's opinion of the DPS.

Program Evaluation – University of New Mexico: Health Sciences Center Finances and Outcomes. Pamela Galbraith, program evaluator, LFC, stated in FY11 the Health Sciences Center (HSC) employed 8.6 thousand FTE, including 930 faculty, educated over 1600 students, conducted leading research, and provided clinical care in seven hospitals and 80 clinics. The HSC administers the Poison Information Control Center, Office of the Medical Investigator, TeleMedicine Program, and the Emergency Medical Service Training Program. In FY10, the HSC generated over $1.1 billion in revenues.

In November 2010, the HSC began a reorganization to establish vertical integration of operations, create links for efficiencies, and promote benefits from economies of scale. The reorganization established a new Board of Directors appointed by UNM's Board of Regents but also maintained the UNM Hospital Board of Trustees.

A key finding in LFC's evaluation was better accountability is necessary to ensure investments in educating health professionals help meet state needs. In FY10, the Legislature appropriated $97.8 million in instruction and general (I&G) funding to the HSC, which, in turn, spent $94 million to educate 1,636 health professional students.

I&G funding for the HSC is appropriated in two ways: directly to the HSC for medical student education not driven by the funding formula and to UNM Main Campus for other health profession training programs, funded through the formula. UNM Main Campus then transfers I&G to the HSC. UNM does not have a policy in place directing the transfer of formula-funded I&G, tuition and fees from main campus to the HSC, so the process could not be evaluated. The UNM Internal Audit Department was to perform an audit to determine appropriate transfer fund process and policies prior to completion of the evaluation, but the information was not yet available.

Although from FY08 to FY10 increases occurred in I&G support for all UNM HSC students, changes in workload as measured by student enrollment or credit hours have been minimal. To contrast the HSC I&G in relationship to their workload, enrollment and student credit hours, LFC compared it with UNM Main Campus. From FY08 to FY10, main campus enrollment increased 12 percent, and I&G funding increased by 5 percent. The HSC enrollment growth during the same period was 2 percent, with I&G funding increasing by 11 percent. From 2003 to 2012 HSC funding has increased by 35 percent.

LFC evaluators relied on a report of actuals to review I&G funding. This report is required by the Higher Education Department (HED) from each higher education institution annually. The HED uses this report for funding appropriations to the DFA and Legislature. The HED format does not require or direct agencies to declare all financial information, which might impact funding decisions and allows revenues like sales and services to be rolled into a miscellaneous account, obscuring individual programs. Although UNM submits quarterly financial reports to the HED, they are not HSC-specific.

<u>School of Medicine.</u> Similar to other schools in the country, funding for UNM's School of Medicine (SOM) is not formula-driven, which limits legislative ability to recommend changes based on workload and cost. An in-depth analysis by the HSC has not been done to ensure spending is in line with goals and to ascertain state funding needs of the SOM educational component. Multiple funding sources and lack of objectivity in identifying faculty effort in education make developing a methodology difficult. The HSC does not have a methodology for determining the cost to educate a SOM student. LFC estimated the cost for SOM I&G funding of $127 thousand a year per medical student.

<u>Combined BA/MD Degree Program.</u> Brenda Fresquez, program evaluator, LFC, briefed the committee on the Combined BA/MD Degree Program, saying the return on investments is long-term and will not be fully realized for at least a decade. The eight-year program, started in 2006, is designed to help address the physician shortage in underserved New Mexico communities.

Each year, 28 students from New Mexico are accepted into the program. Currently, 142 students are in the program with an overall retention rate of 84 percent. Most students from the first cohort will finish medical school in 2014. Student credit hours for the undergraduate portion of the program do not generate I&G formula dollars; the HSC designates student credit hours as restricted to protect the state from double funding the program. The state has provided $15.7 million in funding for the BA/MD program from FY06 through FY11. The HSC reported I&G costs of $2.4 million in FY10; in the same year, there were 15 medical departments in the SOM with instruction spending less than that of the BA/MD program. Scholarships are just over 30 percent of the cost of the program and to date the program has awarded $3.3 million.

The BA/MD program is not unique to UNM SOM. More than 30 schools offer combined medical degree programs that range from six to eight years. At least a couple of other schools have similar goals as UNM's BA/MD program to address rural health needs; University of Indiana and Sophie Davis School of Biomedical Education.

College of Nursing. The College of Nursing's (CON) enrollment and degree production has decreased even though investments in nurse education have increased since FY08. Resources allocated toward direct instruction have increased 35 percent from $2.9 million in FY08 to $4 million in FY11. During the past four years, CON received $8.2 million in additional funding through the nurse expansion program, program development enhancement fund, and supplemental nursing compensation. The primary purpose of the additional funding is to increase the number of bachelor-degree nurses and increase the number of faculty to teach. Although enrollment has decreased, the HSC reported graduation rates increased 75 percent in FY09 and 80 percent in FY10.

Research and Public Service Projects (RPSP). Comprehensive reporting and the HED oversight of RPSP would help improved funding decisions and accountability for results at UNM HSC. Ms. Fresquez indicated the HED continues to struggle to perform adequate oversight of RPSPs since the LFC program evaluation. The HSC obtains RPSP performance reports but has not performed or reported on RPSP since then. Administrative rule requires periodic review of RPSPs to determine ongoing need and effectiveness of projects. Projects are supposed to be reviewed at least once every four years. The Legislature appropriated funding for this oversight function, but the HED did not deploy the positions for intended purpose. In some instances, lack of oversight has allowed stale data to be reported, hindering effective performance based budgeting. The HED's RPSP performance reporting instructions lack clarity, resulting in submission of old data. For example, FY07 performance information was provided in the FY09 performance reports.

RPSP reporting does not provide comprehensive financial information, which makes determining the state's role in financing key HSC functions more difficult. As examples, the Cancer Center and the New Born ICU have other revenue sources and costs that are not evident in the RPSP performance reports and report of actuals. Ms. Fresquez said the Legislature granted the HSC flexibility in managing RPSPs by allowing line-item RPSP funding to be moved to the base I&G appropriation, resulting in RPSPs decreasing from 40 in FY08 to 17 in FY12. Alternative accountability measure will be necessary for the programs that have moved into I&G. Performance reporting required by the Accountability in Government Act could be used.

Ms. Fresquez stated some HSC projects clearly serve a statewide purpose and require a different level of oversight than RPSPs intended to be temporary. For example, the Office of the Medical Investigator (OMI) and the New Mexico Poison and Drug Information Center both perform public service functions required by statute or that meet a statewide need.

During the evaluation, the LFC identified concerns with funding in these two programs. Continued attention towards financing OMI workload is needed to ensure it can carry out timely investigation and autopsies at a reasonable cost. The Poison and Drug Information Center has experienced a 13 percent decrease in general fund appropriations from $1.48 million in FY09 to $1.29 million in FY12. Given benefits from avoided inpatient hospital costs due to poisonings, alternative financing models should be explored. For example, West Virginia hospitals voluntarily help finance their poison control center in a similar way that the nurse advice lines do here in New Mexico.

<u>University of New Mexico Hospital (UNMH) and Sandoval Regional Medical Center.</u> Ms. Galbraith told the committee UNMH is a major safety net hospital in the state and a teaching facility for the UNM Health Science Center. The FY10 UNMH workload was 77,567 emergency room visits, 416,317 outpatient visits, 177,094 routine inpatient days, 80,074 intensive care days, and more than 3.5 million ancillary services.

UNMH is highly reliant on state and federal funds. From FY08 and FY10, the New Mexico Medicaid program reimbursed UNMH $646 million, including $107 million from the UNMH-specific State Coverage Insurance Program. Ms. Galbraith explained Molina Healthcare contracts with the New Mexico Human Services Department and UNMH to provide the administrative services associated with the State Coverage Insurance Program. Molina receives a capitation payment for each enrollee, which was 11.78 percent in FY11, down from 13.5 percent in FY10.

UNMH received another $161 million in supplemental payments from the disproportionate share hospital funding, given to hospitals that have a disproportionate share of Medicaid or low-income clients; and upper payment limit for hospitals with public expenditures less than the Medicare rate, with the federal and state government paying the difference.

Medical residents receive two types of funding: graduate medical education funding and indirect medical education. UNMH graduate education costs are subsidized with $37 million by this funding.

More than $135 million in other state and local funds bolster UNMH revenues for operations and patient care, including contracts with state agencies that reimbursed UNMH over $19.2 million in FY10. The hospital also received $12.8 million from general fund appropriations for the operations of Carrie Tingley Hospital, Children's Psychiatric Center and the Young Children's Health Center, and $1.16 million from the out-of-county indigent fund. However, UNMH $1.16

million provided $21 million in uncompensated care. UNMH also received $90.6 million from a Bernalillo County mill levy in FY10 for operations and maintenance.

Ms. Galbraith stated UNMH has fared well financially; however, reimbursement and structural changes in the healthcare arena will create financial challenges that require close monitoring. If the federal reform plan to slowly decrease disproportionate share funds to zero in some states occurs before the federal insurance mandate, there will be a gap in revenues. Also, the change in Medicaid outpatient care reimbursement will cost UNMH $20 million this year.

Construction of the Sandoval Regional Medical Center requires close monitoring to ensure it does not threaten finances of the UNM Health System. Although Moody's Investor Services ranks UNM favorably, the group stated the presence of two new facilities in Sandoval County makes it difficult for either of them to be profitable in the short term. UNM expects to be in the red the first two years.

Now that Sandoval County will have two hospitals the impact of the increase in capacity on healthcare costs and quality is unknown. Studies show more beds equal higher healthcare costs, although New Mexico historically has not produced higher than average per capita spending compared to other regions.

Key Recommendations: The Legislature should routinely receive reports to monitor the progress of costly programs to ensure value to the state. UNM should develop and implement policies governing the transfer of the instruction and general funds between the HSC and main campus and share audit results on transfer funding with LFC.

UNM HSC should work with the HED and the LFC to develop metrics to inform and justify budget changes; ensure RPSP performance reports include most current data; develop an integrated financial reporting format to inform the HED and the Legislature of all revenues and expenses including adjunct services; the HSC, Poison and Drug Information Center and OMI should work towards a recommended plan with their LFC analyst to deal with funding issues and concerns, including OMI's negative fund balance; develop methodologies for calculating educational cost per medical student and report in the General Appropriation Ace (GAA) performance measures; develop CON GAA performance measures specifying annual bachelor degree enrollment and degrees awarded and the number of graduates practicing in New Mexico, bi-annually.

Ms. Galbraith stated the HED was actively involved in the process but could not be present.

The HED should develop a method for reporting, specific to the UNM Health Sciences Center, to capture detail revenues by source, delineate expenditures, and identify state resource expenditures for each medical education student; implement audits of RPSP, report results to the LFC and implement an analysis process to ensure statutory mandates are satisfied.

The HSC governing boards should continue close monitoring of the UNM Health System financial status to ensure changes in operations are true to the institutional mission and will foster positive growth and are in sync with other successful medical centers.

UNM Health System should share strategic plans for mitigation of the impact of changes in health care financing with LFC; improve public accessibility of UNMH financial and quality data, currently buried in its website.

The HSC Response. HSC's senior finance official Ava Lovell presented the agency's response, with an in-depth response forthcoming. Ms. Lovell stated the HSC agrees with all recommendations for UNM and HSC, yet there are places the HSC diverges on analysis and conclusions. Referring the committee to the written response in the back of the brief, Ms. Lovell stated reserves are necessary to continue working while waiting for reimbursements. There is one bank account for the entire university, and Ms. Lovell stated the $622 million worth of bonds on the university's balance sheet is backed up by the reserves.

Although HSC recognizes accountability for investments in the education of healthcare professionals is important, it diverges from the notion that determining the cost of teaching future doctors can easily be achieved. The HSC is working toward this goal.

The evaluation pointed out that the results of investments in the BA/MD Degree Program are not known. Ms. Lovell stated what is known is two-thirds of the students are under-represented minorities and two-thirds are from rural areas, the retention rate is 84 percent, and it is UNM's number one funding request.

The review of the College of Nursing confirmed the need for stabilized funding to achieve long-term increases in the number of nursing graduates. Dr. Nancy Ridenour helped stabilize funding and programs and although there have been spikes in one-time funding, the CON has doubled the number of first-time licensee graduates, which shows a significant, positive trend.

Ms. Lovell briefly explained funding for many RPSPs are rolled into I&G and will be clarified in the HSC's detailed response. She also said the UNM Health Sciences Center Board of Directors will work on streamlining billing systems, scheduling systems and patient care among hospitals, including the new Sandoval Regional Medical Center.

Ms. Lovell, in response to Representative Larrañaga, indicated the last funding request of $1.63 million for the BA/MD Program will be in January. Twenty-eight students a year are admitted into the program, and 118 students are in their first, second, or third year of medical school or are undergraduates. The HSC has future plans for a BA/DD program as well. Representative Larrañaga asked Ms. Lovell if the HSC was requesting a follow-up on its in-depth forthcoming response and Ms. Lovell indicated yes, the HSC appreciated any time the committee has to address the report in detail. Chairman Smith stated he didn't find anything extremely alarming on the evaluation to merit more time until the session.

Ms. Lovell told Representative Sandoval the total cost of uncompensated care in Bernalillo County was $140 million in FY10.

In response to Vice Chairman Varela, Ms. Lovell stated the new Sandoval Regional Medical Center is a community hospital with operating rooms, behavioral health beds, pediatrics, general care, and an emergency room. It will not be a level 1 trauma center.

Update on Questa Mine Operations and Status of Legacy Environment Issues. David Partridge, vice president of operational excellence and technical services for Chevron Mining, briefed the committee. CMI Questa Mine began mining and milling molybdenum on approximately six square miles east of Questa, New Mexico, in 1918. Molybdenum is primarily used to reinforce stainless and alloy steels, and the Questa mine has one of the highest quality molybdenum deposits in the world, with several decades of proven reserves. In 2009, after a steep drop in molybdenum prices, the mine reduced the number of shifts, went through a reduction in workforce, and currently employs 200 people.

Chevron Mining and Chevron Technology Ventures collaborated to build a solar energy test facility using concentrating photovoltaic power (CPV) in 2010 to gain understanding of CPV technology and potential benefits. The facility was built on 20 acres of the Questa Mine tailing site and gained attention and approval of the Wilderness Society. The CPV technology works by focusing direct sunlight through layered Fresnel lenses onto a solar cell, which then coverts sunlight into energy. In addition, CMI is working with the U.S. Environmental Protection Agency, N.M. Environment Department, and Mining and Minerals Division on a test to determine the appropriate depth of cover soil for remediation of the tailing impoundments.

In 2001, the mine agreed to go into an administrative order of consent and work through the comprehensive Environmental Response Liability and Reliability Act to look at what environmental damages might have been done because of the legacy mining operations in the area. During the past 10 years, CMI funded and conducted the requisite Remedial Investigation and Feasibility Study to determine an appropriate cleanup strategy for the characteristics of the site and evaluate alternative approaches to cleanup on the basis of effectiveness, safety and cost. Last year, the EPA released the record of decision, and CMI will work on producing a statement of work, which will detail how the mine will meet overall cleanup objectives.

Approximately 80 percent of molybdenum comes as a byproduct of copper mines. Senator Leavell asked where the final market for molybdenum is, and Mr. Partridge stated the moly disulphide is roasted in Arizona or Pennsylvania and then sold worldwide. Molybdenum, as an oxide, is around $15 a pound.

Senator Tripp asked about water quality where there are rock piles, and Mr. Partridge indicated water quality and long-term stability is a concern. Aluminum, manganese, and iron are some of the contaminants to be concerned about. Wells and trenches intercept water coming out of the rock piles, and the water is pumped, neutralized and run through the milling and tailing process.

Senator Cisneros thanked Mr. Partridge for presenting and affirmed the good work the mine does in the community.

Miscellaneous Business

Action Items
Approval of LFC Minutes. **Senator Cisneros moved to approve the July 2011 meeting minutes, seconded by Representative Saavedra, Motion carried.**

FY13 Budget Guidelines. There is $367 million in FY13 projected revenues over this year's spending and the plan is to review estimates in October. Director Abbey said guidelines are standard to what the LFC has dealt with in the past. **Vice Chairman Varela moved to approve FY13 Budget Guidelines, seconded by Senator Cisneros, Motion carried.**

LFC FY13 Budget Request. Director Abbey is asking approval subject adjustments approved by the chair and vice chair. The request is for an increase of 0.8 percent and provides for an increase in contracts. **Representative Saavedra moved to approve the LFC FY13 Budget Request, seconded by Senator Cisneros, Motion carried.**

Information Items

Overview of FY10 CAFR. The CAFR has been prepared using SHARE at a significant cost to the state for years and Director Abbey will bring the CAFR to the committee's attention more than he has in the past.

Status Report on Agency Program and Performance Measure Changes Pursuant to Accountability in Government Act. Director Abbey said status reports and action plans are important but there isn't a high level of interest from the executive branch.

Vice Chairman Varela said the committee would benefit from possibly redefining the measures and targets as well as getting consensus. As an example, Director Abbey said he's concerned the DOH substantially reduced the number of measures for Public Health, a $100 million program. It is hard to advocate maintaining a high level of funding without accountability measures.

Review of Monthly Financial Reports

July 2011 ARRA Status Report. In August, the executive made three ARRA allocations: $120 thousand to the district attorneys; $250 thousand for Expo New Mexico; and $130 to the Department of Public Safety for hardware that provides connectivity and access to criminal justice data. Director Abbey stated there is still $100 thousand left and it has to be spent at the end of the month.

In response to Representative Saavedra, Director Abbey stated there will be a performance review of the State Fair in October.

Director Abbey referred committee members to the July 2011 Cash Balance Report, the July 2011 BAR Report, and the FY12 LFC Budget Status.

Friday, August 19, 2011

The following members were present on Friday, August 19, 2011: Chairman John Arthur Smith, Vice Chairman Luciano "Lucky" Varela, Representatives Don Tripp, William "Bill" J. Gray, James P. White, Edward C. Sandoval, Nick L. Salazar, Larry A. Larrañaga and Henry "Kiki" Saavedra; and Senators Clinton D. Harden (for Sue Wilson Beffort), Steven Neville (for Stuart Ingle), Carlos R. Cisneros, Carroll H. Leavell, John M. Sapien, and Cisco McSorley (for Mary Kay Papen). Representative Roberto "Bobby" J. Gonzales attended as a guest.

Review of New Mexico's Tax Expenditures.

Definitions, Evaluation Methods and Policy Considerations. Demesia Padilla, secretary, Taxation and Revenue Department, stated tax reporting has to strike a balance between businesses and policymakers to come up with a win/win situation.

Tom Clifford briefed the committee on the TRD's preliminary ideas regarding Executive Order 2011-071, with a goal of having a full report before the executive session. Input from many agencies is necessary, and the report will distinguish tax expenditures from other provisions, identify fiscal impacts, evaluate whether or not purposes of provisions is being achieved, estimate cost-effectiveness, consider alternatives, and recommend improvements.

Mr. Clifford said certain tax benefits are a substitute for state spending. The governor is concerned New Mexico needs a more systematic way of evaluating tax expenditures. A number of exemptions and deductions in the tax code are designed to prevent double taxation and are not tax expenditures.

Defining tax expenditures is usually done by comparing a provision with a "normal" or "benchmark" tax base. Mr. Clifford stated the gross receipts tax is the "main game." Many tax expenditures are built into the federal income tax and the state income tax piggybacks on those provisions. Thinking about exemptions and deductions in the federal income tax code and decoupling is a major set of issues in itself, he said.

Defining the benchmark base sometimes involves many decisions and judgments about what should and should not be considered tax expenditure. In the context of income tax, policymakers should ask the following: Should the tax base be income or consumption? How progressive should the tax rate structure be? Should corporations be taxed as well as individuals? What's the appropriate tax base for sales tax? Should the base be retail sales, all consumption, or value added, and should business purchases be included in the base tax?

Some of the challenges in measuring tax expenditures are tax return data are unavailable for many tax provisions; most GRT deductions and exemptions are not separately stated on the return; and data are available only for credit affecting small numbers of taxpayers. Requiring detailed reporting would significantly increase administrative and compliance costs.

Challenges in evaluating tax expenditures are having a clear purpose of the tax expenditure being evaluated, tax policy criteria may not be relevant if a provision is really a substitute for expenditure policy, information is lacking to evaluate positive or negative effects of behavior on others, or "externalities."

Mr. Clifford stated in an ideal world taxpayers benefitting from tax incentives should be able and willing to report them each year. In reality, it is burdensome, so balance is needed. Demands on information might impair the effectiveness of the program. When small businesses, for example, go through red tape to get the tax credit, it might not be worth their while.

One alternative the state should be prepared to consider with tax expenditures versus direct spending is why the tax code would be used rather than direct spending if it's a matter of spending public money to achieve a public purpose. Tax expenditures enable targeting and allow taxpayers to make independent decisions when responding to incentives. Another argument often made is it enables decentralized decision-making. General guidelines allow flexibility in programs, so value of tax benefits may not be known until long after a taxpayer spends/invests, making them hard to predict. Mr. Clifford stated using the tax code is more complicated.

The Tax Expenditure Report should include the purpose of the program; clarified eligibility and certification requirements, quantifiable program evaluation criteria, balanced information on the reporting burden, shortcomings, and alternative policies. Criteria to evaluate tax expenditures should include efficiency, economic impact, equity, benefits, fairness, and cost.

Richard Anklam with the New Mexico Tax Research Institute told the committee tax expenditures are deviations from a normal base and evaluation is subjective. Exemptions, deductions and credits can and are used to define the tax base and noted not all tax exemptions, deductions and credits are tax expenditures. Tax expenditures generally occur when transactions are excluded from the baseline tax structure and are generally positive and can be negative when transactions not in the baseline tax structure are taxed or taxed more heavily than those in the baseline. In practice, tax expenditures are exact or estimated depending on available data. Mr. Anklam noted the upside to coupling and following federal rules is everything is simplified for everyone. The downside is the state is at the "whim" of the federal government.

Referring to a table scoring New Mexico's tax expenditures by the LFC and TRD, Mr. Anklam noted 96 provisions for a total of $941.1 million in FY12 general fund impact, illustrating tax expenditures take many forms and serve different purposes. Rate differentials in oil and gas taxation were also used as an example.

Tax expenditures should be the most effective way of accomplishing the policy objective and periodically evaluated to ensure the needs still exist and the approach is still effective. Tax expenditures cannot all be evaluated the same way. Mr. Anklam used the film credit tax incentives as an example, stating most people ask what the return on investment is when it cannot be measured by static cost alone, and real analysis is costly and subjective.

In summary, Mr. Anklam stated tax expenditure documents could be a useful tool to the Legislature in determining the long-term impact of existing and proposed laws, and it is important to know what tax expenditure is and how to evaluate it.

Marcus Mimms, chair of the taxation committee, New Mexico Association of Commerce and Industry, stated a process to quantify the benefits of tax expenditures is a worthwhile endeavor. There are good policy decisions behind some tax expenditures currently in place. The process to evaluate tax expenditures should strike a balance between accountability and efficiency. Mr. Mimms stated that in order to quantify deductions under the gross receipts tax, the necessary form taxpayers fill out would be fairly long, complex and costly to prepare. While an examination of the tax expenditure benefits and objectives are worthwhile, it is necessary to identify what tax expenditures are and how to go forward.

Jon Barela, secretary designate, Economic Development Department, stated New Mexico ranked 51st in a 2009 Earnst & Young report on states with the highest effective tax rate and 45th in GRT/sales tax and has the nation's highest effective tax rate on new investment at 16.6 percent. New Mexico also ranked 35th in regulatory environment in Forbes—the Best States for Business 2010.

Mr. Barela indicated manufacturing needs to be more robust in New Mexico, including the array of energy that would create jobs in rural New Mexico. The GRT can be punitive on manufacturers with GRT on utilities, services and consumables.

Traveling throughout the state, Mr. Barela said he always hears that New Mexico needs to be more business-friendly, with a less burdensome regulatory environment. Business people stressed the need for tax reform to become more competitive with other states in business retention and recruitment. On the positive side, the Job Training Incentive Program is a great success, as well as the MainStreet Program.

Mr. Barela gave examples of projects New Mexico lost in the last two years: First Solar, an "Intel-sized business" that did not believe the state had competitive tax incentives; Project Selection, not the real name for disclosure reasons, a 350-person customer service and sales operation that went to Utah because of a $548.5 thousand tax credit; Project Sapphire, a 300-person shared services operation that went to Texas after receiving $3.1 million from Texas Enterprise Fund; and Project Compute, leasing a building in El Paso due to New Mexico's personal income tax.

A snapshot of EDD's incentive success includes citing a four-firm, four-year example, the value of incentives was $69.1 million. When including these incentives and the agency's budget, the total cost to the state was $105.2 million, with $335 million in revenues generated over 20 years.

The EDD created the Office of Business Advocacy (OBA), which helps businesses with state regulatory issues. Since opening in January, the OBA has successfully helped 61 businesses, saving 101 jobs and helping to create 420 jobs.

In response to Representative White, Mr. Clifford stated Executive Order 2011-071 calls for a detailed tax expenditure budget identifying all tax expenditures in the budget. One approach to building the executive order would be to distinguish those tax provisions that are not expenditures. Mr. Turner will present ideas the TRD has about gross receipts tax and how we would evaluate various provisions relative to an appropriate benchmark.
Representative White asked if the film credit was a tax incentive or expenditure. Mr. Clifford said because it is in the tax code, it would be a tax incentive. Being a refundable tax credit, it goes beyond any tax liability the company might have. When talking about the tax code versus just using a direct spending program, there is an issue about the anti-donation clause. The state is essentially providing funds to a private entity. Given the anti-donation clause, what is the constitutional status? The state's lawyers say some tax incentives are in a gray area because they

appear to violate the anti-donation clause. It is worthwhile for the state to consider a grant program with a constitutional amendment, so money is budgeted for a certain purpose with program criteria and an explicit process.

In response to Senator Sapien, Mr. Anklam stated a tax expenditure report is looking back as opposed to a budgetary forward-looking tool to manage tax expenditures and the intent of the executive order is a rearward-looking analysis trying to determine the effectiveness of tax expenditures within the state's policies.

Mr. Jon Barela, in response to Senator Sapien, said the New Mexico Partnership's budget was down from $1.2 million to $600 thousand. The Partnership is responsible for two things: market and recruit New Mexico and showcase New Mexico for visitors. The EDD enacted sound, prudent decisions to reduce expenditures and increase effectiveness.

Senator Leavell stated economic development and regulation are in the same conversation. Mr. Barela responded by saying a good environment across the board is needed and he is happy to visit communities and work with legislators to solve this program.

Representative Larrañaga asked whether tax change or review is more important to the business community. Mr. Mimms stated the focus should be on reducing the cost of compliance and regulatory burdens.

Representative Tripp asked about the "single sales" factor. Mr. Barela said manufacturers get taxed on sales, property and payroll. Under a "single sales" factor, the manufacturer could opt to be taxed on all "widgets" produced to sell within the state. Whatever is exported wouldn't be subject to state income tax.

In response to Representative Gonzales, Mr. Clifford said he sees difficulty taxpayers face trying to get tax credits, and federal law must be followed. Difficulty reduces predictability for taxpayers. Mr. Clifford stated it would be worthwhile to consider a grant program where taxpayers could get assurance up front. Representative Gonzales stated he is concerned about anti-donation clause "gray area." Mr. Clifford stated it would be difficult to challenge the constitutionality of some programs. Mr. Barela added it is incumbent on the EDD to present to businesses what they can expect, agreeing predictability is important.

Chairman Smith thanked everyone for a fascinating conversation and summarized by saying a better job needs to be done for a greater return to taxpayers in the state of New Mexico. He reminded legislators to read their FIRs.

<u>Inventory of New Mexico Tax Expenditures.</u> Elisa Walker-Moran, chief economist, LFC, outlined the LFC hearing brief, saying tax expenditures are government spending programs authorized through the tax code, and although they are an important component of the state's annual budget, the state does not have a systematic means of reporting and analyzing their effect. Per Executive Order 2011-071, the TRD will be the lead agency in preparing an annual tax expenditure budget. Tax expenditures can be an efficient means of targeting selected populations for benefits and influencing the decisions of private individuals to further the goals of public policy. New Mexico's tax code has hundreds of tax expenditures, affecting all New

Mexico taxpayers. These programs give people, groups and businesses special tax credits, deductions, exclusions, exemptions, deferrals, and preferential rates in support of various government policies. Tax expenditures are not limited to economic development incentives. It can be easier for larger businesses to claim these credits.

Total general fund revenue foregone in FY13 is estimated at $922 million. Tax expenditures are identified under four categories: economic development, $84 million; poverty, health, and education, $367 million; renewable energy, $24 million; and all other, $445 million.

Tax expenditures can be difficult to define and identify. Tax expenditures do not include provisions that define the proper scope of the tax base, prevent double taxation or avoid interference in interstate commerce. A good tax expenditure report is easily accessible by being published annually and on the Web, broad in scope and has all tax expenditures listed and detailed to include current and future cost, description of, and who benefits from each tax expenditure. Also, it includes an analysis of intended purpose and successes in accomplishing that purpose.

Best Practices in Other States. Leila Burrows, economist, LFC, stated of the 50 states and Washington, D.C., 44 states regularly publish some sort of tax expenditure report, and 35 states have statutory requirements that a tax expenditure budget be prepared on a regular basis. Four other states, including New Mexico, have published a one-time or irregularly released report. Minnesota is required by statute to report the cost of producing their tax expenditure report, most recently costing $130 thousand. Most states included analysis of tax expenditures affecting personal income taxes, corporate income taxes, and sales/use taxes. Excise taxes were also commonly reported. Other types of taxes included less frequently were property tax, severance tax, estate tax, and other taxes.

Tax Expenditure Concept as it Relates to New Mexico's Gross Receipts Tax. Clinton Turner, chief economist, Taxation and Revenue Department, began his presentation by saying gross receipts tax (GRT) is New Mexico's biggest revenue source, making New Mexico different from most states. GRT is legally structured as a tax on the privilege of engaging in business in New Mexico and is imposed on sellers, not buyers. Gross receipts include revenue from selling property, leasing or licensing property, granting franchise rights, or performing services. To get to the hybrid, Mr. Turner stated some major exemptions are wages and salaries, transactions taxed under other taxes, sales to and by governments and nonprofits, and certain financial institutions receipts. New Mexico also deducts sales for re-sale, property sold to the government, manufacturers' ingredients, food for home consumption, medical services.

Some implications of having a broad GRT base is many business-to-business services are taxable. The GRT on property has narrow deductions, and most business purchases are taxable. The GRT on intangibles, such as trademarks and copyrights, causes pyramiding that compounds the tax burden through the supply chain. Retail trade is only 25 percent of the GRT tax base. Many states are moving in the direction of taxing other services, but not as many as New Mexico.

Attempting to define the benchmark tax to evaluate GRT tax expenditures involves many decisions and judgments about what should and should not be considered tax expenditure.

Should the base be retail sales, all consumption or value-added tax? Should business purchases be included in the tax base?

Economists agree that taxing consumption and exempting savings and investment would increase economic growth. A recent study of Canadian provinces found that reducing tax on business inputs, by switching to a value-added tax, increased the level of investment by about 12 percent. A consumption tax base would exclude sales of goods and services to businesses, with the value of these sales taxed when the businesses' outputs are sold. The consumption tax would also exclude financial assets, real assets and natural resources, stocks, bonds, land and existing buildings. Another adjustment to make on tax of all consumption is adjusting the bare minimum level of consumption, and doing that is complicated. Mr. Clinton used excluding commodities like food, medical services and prescription drugs, clothing as an example, but said it is very costly. An alternative is to tax these commodities but provide relief through the income tax code.

Mr. Clinton stated when the benchmark tax base compared with the tax policy principals is good. Shifting toward the aforementioned tax base would encourage economic growth and is neutral. The consumption tax would be fair and transparent. The current GRT effectively hides the ultimate rate of taxation on a product.

The GRT base is so comprehensive that it would impose tax on many transactions that are subject to other taxes if they were not explicitly exempt: wages, oil and gas sales at the point of severance, motor vehicles, insurance premiums and gasoline or diesel. What the benchmark base doesn't tell is what the rate of taxation should be.

Mr. Clinton stated some exemptions such as sales by Indians on Indian land and sales to foreign diplomats exist to comply with laws that supersede New Mexico statutes. If New Mexico didn't have these exemptions, no additional revenue could be collected.

Taxing 100 percent of consumption is inappropriate because the cost of compliance and administration is too large for the amount of revenue collected. There is always a gray area: What is the level of compliance costs the state is willing to impose and what level of administrative costs is the state willing to pay for.

In conclusion, a benchmark base is required to identify and measure tax expenditures. The TRD found that a benchmark taxing all final consumption with some adjustments is appropriate.

<u>Royalty Deduction for Oil and Gas.</u> Ms. Burrows told the committee royalties are paid to oil and natural gas owners by producers for the right to extract resources. Revenues and risks are shared and royalties are typically paid as a percentage of total production value. In New Mexico, the royalty deduction is calculated by taking off the taxable value of production and only applied to federal, state and tribal royalties. The federal rate is 12.5 percent, and state is between 12.5 and 20 percent. Approximately 80 percent of production in New Mexico is on public land.

The LFC has adopted the following tax principles to guide responsible and effective tax policy decisions: adequacy, efficiency, equity, simplicity and accountability/transparency. Ms. Burrows noted while it can be argued royalties are a type of revenue-sharing arrangement some, claim they are a form of taxation. From this perspective, removing the deduction would result in multiple levies on the same dollar of income. However, this type of tax expenditure may encourage growth in the oil and gas industry.

Approximately 29 percent of general fund revenue is generated directly or indirectly from oil and gas production, not including corporate tax. Ms. Burrows noted approximately $900 million in oil and gas revenue is dedicated to public schools.

Ms. Burrows said, although New Mexico has a higher combined rate of severance taxes, New Mexico has more public land so when the deduction is applied, oil and gas could pay less.

Potential legislative changes are a statutory requirement to produce an annual report on total royalty deduction claimed and a higher royalty rate on state land if federal government raises onshore royalty rates to match offshore rate.

Food Deduction. Economist Charles Kassacieh with the LFC stated food deductions reduce the GRT that would otherwise be due on sales of food for home consumption. In 2004 HB625 removed the GRT on food for home consumption, effective in 2005.

In May 2011, 417 thousand people used food stamps, up 15 percent from May 2010. Total benefits paid out totaled nearly $542 million in FY10. In New Mexico the average participant received $126.54 monthly, while the national average is $133.79. As of FY11, the reduction in GRT was $3.1 billion. New Mexico paid nearly $99 million in payments to local governments.

Alternatives for SNAP are food pantries, community feeding centers, or offering an income tax credit to offset the tax on food paid by low-income households.

LFC Program Evaluation. Charles Sallee, deputy director, LFC, told the committee a program evaluation on healthcare tax policy will be presented in October.

With no further business, the committee adjourned at approximately 11:17 a.m.

Chairman

10-20-11
Date