Legislative Finance Committee
Meeting Minutes
Angel Fire, New Mexico
August 22-24, 2012

Wednesday, August 22

The following members and designees were present on Wednesday, August 22, 2012: Chairman John Arthur Smith, Vice Chairman Luciano "Lucky" Varela, Representatives Henry "Kiki" Saavedra, Larry A. Larrañaga, Edward C. Sandoval, William "Bill" J. Gray, Nick L. Salazar, James P. White, and Donald Bratton; Senators Carlos R. Cisneros, Sue Wilson Beffort, Mary Kay Papen, John M. Sapien, Carroll Leavell, Steven P. Neville, and Pete Campos.

Welcoming Remarks and Community Input. Village of Angel Fire Mayor Barbara Cottam and Eagle Nest Mayor Richard Cordova welcomed the committee. Mayor Cottam urged members to try the only zipline in the state of New Mexico and said Colfax County depends heavily on tourism.

Rebecca Latham, chair, Enchanted Circle Marketing Co-op, told the committee six municipalities make up the Enchanted Circle – Taos, Questa, Red River, Eagle Nest, Angel Fire, and Taos Ski Valley, as well as the chambers of commerce and the Vietnam Memorial in Angel Fire. The co-op is funded in part by the Tourism Department, which will receive matching funds this year. Many communities in the Enchanted Circle are enjoying a banner year for tourism.

James Gallegos, superintendent, Cimarron Municipal Schools, said the district serves approximately 320 students and covers 1,400 square miles, with some students riding the bus up to 80 miles one way to get to school. The district has been on a four-day week since 1973. Mr. Gallegos said Cimarron Middle School's new principal analyzed the schedule and found 48 more instructional hours to improve their current rating, and the high school is partnering with Luna Community College for dual credit. Mr. Gallegos said the district has the best facilities for instruction because of capital outlay and thanked the communities.

Mayor Cottam said gross receipts tax revenue (GRT) has declined 15 percent from last year but are increasing. Mayor Cordova said Eagle Nest has not been as fortunate as Angel Fire, and GRT was down 10 percent from last year. GRT is estimated to be between $150 thousand to $155 thousand. Both mayors stated budgets are cut thin.

In response to Senator Sapien and Chairman Smith, Mr. Gallegos said he has many questions for the PED and likened the new public school grading system to being a parent and having your child's teacher tell you what grade your child received but not explaining how grades were calculated. Mr. Gallegos also questioned why a school in his district was "school improvement 2" last year, but under the new system received an "A" this year. Districts do not have adequate information from the PED.

General Fund Consensus Revenue Estimates. Demesia Padilla, secretary, Taxation and Revenue Department (TRD), stated the new forecast generally reflects the widespread weakness and uncertainty in today's economy. Recent national forecasts reflect lowered expectations for the balance of FY13 and predicted only limited rebound thereafter. New Mexico's forecast is similar—with a "bright spot" relating to the strength of the oil production sector.

Strong GRT revenues in early FY12 drive the revision in the state's tax receipts, 35 percent of New Mexico's general fund forecasted revenue. In FY12, taxable gross receipts increased by approximately $2.5 billion with $900 million of that increase directly tied to the oil and gas industry. Ms. Padilla said it must also be acknowledged that impacts of the high-wage jobs tax credits significantly weaken the GRT forecast. The phased implementation of the anti-pyramiding manufacturing deductions has increasing impacts in the forecasts beginning in 2013. In contrast, the large retail trade component, which constitutes 25 percent of taxable gross receipts, is experiencing anemic growth of only slightly greater than 1 percent in FY12. Weakness in construction reflects a continuing decline in FY12 with a nearly 2 percent loss reported in taxable gross receipts.

Ms. Padilla said compensating tax is one of the most difficult of the tax revenue streams to forecast and track because it is dependent on out-of-state sales. Insurance tax premiums are impacted to a limited extent by the implementation of the Affordable Care Act patient protection provisions now included in New Mexico law. Additional significant changes may be anticipated to these revenue streams if the state chooses to adopt the Medicaid eligibility expansion.

Personal income tax revenues are forecasted slightly stronger, but corporate profits are weaker than previously anticipated, driving a significant decline in the corporate income tax (CIT) revenue collections into FY13 and FY14. CIT revenues are received primarily from large corporations doing business in New Mexico with greater than $1 million in taxable income. Ms. Padilla noted New Mexico film credits were less than $10 million in FY12. More than 90 percent of those credits decrease CIT liabilities. There is a backlog of applications for credits, which will be reflected in FY13.

The stronger severance tax forecast largely relates to much higher oil production volumes. Oil prices and natural gas production revenues are generally lower than previously expected. The real strength of the oil and gas sector is demonstrated in bonuses paid for leases and mineral revenues from federal lands.

Projects that will help further stabilize market opportunities for New Mexico oil production and may help moderate domestic price volatility by greater insulation from world markets are the completion of the Gulf Coast Project oil pipeline, along with the potential development of the Keystone XL pipeline In contrast, the domestic natural gas industry is suffering. Excess supplies have driven "real" natural gas prices – after adjusting for inflation - to their lowest levels since implementation of price deregulation under the Natural Gas Policy Act of 1978.

Department of Finance and Administration Secretary Tom Clifford said FY12 total recurring revenue has been revised up by $218 million due to stronger than expected oil and gas revenue. FY13 total recurring revenue has been revised up by $18 million because oil and gas prices have been revised down from the prior forecast. Corporate income taxes are also down significantly. Total recurring revenue for FY14 has been revised up by $120 million.

Reserves are at 13 percent of recurring appropriations. Mr. Clifford stated the new money, or FY14 recurring revenue less FY13 appropriations, is $272 million, about 5 percent of the appropriation base. Senior severance bond capacity will be $224 million after allowing $44 million for authorized but unissued bonds.

Employment is a fundamental factor economists look at for New Mexico's economy. In FY12, the state's total payroll employment grew by only 0.2 percent, below the 0.7 percent forecast from December. New Mexico's unemployment rate is lower than the national rate, but Mr. Clifford said it is not a positive indicator because people are discouraged.

In FY12, economists have oil prices dropping from about $90 a barrel to $85. Global demand growth has slowed, and New Mexico has kept pace with drilling activity. Natural gas decreased only 1 percent in FY12, and economists are projecting a 4 percent decline in FY13 and a 3 percent decline in FY14. The decrease in gas-directed drilling at the national level should eventually help to provide some support to natural gas prices.

Mr. Clifford told the committee economists assume the claims against the high-wage jobs tax credit should go up from $26 million in FY12 to $50 million in FY13 and remain at the level.

Elisa Walker-Moran, chief economist, LFC, told the committee the new money of $272 million includes a $44 million transfer to the tax stabilization reserve. Also impacting the new money is approximately $74 million in appropriations -- the state employees 1.5 percent retirement contribution expiring in 2014, the Education Retirement Board's 0.75 percent employer contribution, and 50 percent of the state's tobacco settlement, which drops the total of new money to $198 million.

Ms. Walker-Moran reiterated risks to the forecast and said that tax credits are a large risk Ms. Walker-Moran said economists are still reviewing the full impact of the manufacturing job credit, as well as carry-forwards from the renewable energy production tax credit, which could potentially be up to $70 million. Economists are also working on what the changes in the death tax means to New Mexico. Other side risks to the forecast are the Digital Goods and Services Tax Fairness Act and the continuing risk of losing money from the tobacco master settlement agreement because of ongoing litigation.

John Tysseling, chief economist with the TRD, told Senator Beffort the tax provisions provided by the Affordable Care Act would flow to the federal government. Premium tax benefits are anticipated if the Medicaid eligibility is expanded.

Regarding film tax credits, Mr. Clifford stated August 31, 2012, will close the accrual period for the payment back to FY12, but $10 million is what the economists are estimating for FY13. Mr. Clifford attributes the decrease to the rush to get credits processed at the end FY11 to qualify under the old law. Responding to Senator Beffort, Mr. Clifford said at a high point the state allocated $75 million for film credits, and the film office indicated to him the $50 million cap would be reached this year. Ms. Padilla added that under the new law, credits are tied to when corporate tax returns are filed and many big companies file extensions, so the credit is pushed back. Senator Sapien said he recognizes the administrative rush to get tax credits in, but economic life in New Mexico is on a continuum, so in reality if New Mexico only sees $10 million this year, films did not come and the state lost business.

The committee and panel also discussed the Medicaid expansion. One of the fees associated with the new program is an insurer excise fee, which will be paid by New Mexico's managed care providers under Medicaid, and the state will have to compensate for that. Mr. Clifford estimated a $5 million impact over several years. Chairman Smith indicated a hearing on Medicaid is scheduled for September.

Ms. Padilla told the committee that GRT removal will enable small businesses to expand and compete, using a cheese factory in southern New Mexico as an example. The law goes into effect January 1, 2013. Mr. Clifford told Senator Sapien the forecast incorporates the higher figures.

Representative Larrañaga asked where the Department of Transportation (NMDOT) stands in their revenue forecast. Clinton Turner, chief economist with the New Mexico Transportation Department said its forecast is flat with very small growth. The department's per-unit taxes are constrained compared with the general fund growth, he said. Mr. Clifford stated the Transportation Commission has very creative options on the table to address his concerns.

Chairman Smith said hopefully the administration can work with the Legislature collectively to come up with greater stability in revenue streams and have better analysis of long-term debt obligations.

Review of Earmarked Severance Tax Bonds. *Public Schools.* Mr. Robert Gorrell, director, Public School Facilities Authority, said a key performance measure for public school building conditions is the average facility condition index (FCI), which has improved 37 percent since 2003, but the rate of improvement has slowed. Mr. Gorrell pointed out there is currently a $354 million backlog that would fund these facilities, and the council assumes the work will be done. Some current projects in the backlog where bonds have not been sold are Deming, Mayfield, and Gadsden High School.

A more important measure the council uses to look at a school's functionality is the weighted New Mexico conditions index, with the average of top 30 schools not improving over the past four years. Seven schools have been in the top 30 without applying for assistance for more than four years. Mr. Gorrell stated schools are going to get worse unless funding is put into them. The strategy of taking the worst schools in the state and improving them has begun to falter.

Mr. Gorrell told the committee an average of $343 million ($134 million state, $210 million district) needs to be invested annually in school facilities for the FCI to be maintained at the required 34 percent. At lower levels, degradation exceeds renovation and facilities decline.

Water Projects and Colonias. Matthew Jaramillo, New Mexico Finance Authority (NMFA), said funding from the Water Trust Board (WTB) is supported through the financial framework of three funds for statewide water projects: the acequia project fund, the water trust fund, and the water project fund (WPF).

Mr. Jaramillo told the committee funding for the WPF is derived from10 percent of senior severance tax capacity annually. Of the WPF funding, 10 percent is transferred to the Office of the State Engineer (OSE) for water rights adjudication, and 20 percent of the OSE funds are allocated to the Administrative Office of the Courts for eligible costs associated with those adjudications.

A water project management team makes recommendations to the WTB Project Review Committee and applications are ranked. The WTB determines funding, and the NMFA then makes loans and grants to qualified entities for projects prioritized by the board and for projects previously authorized by the Legislature. By statute, the WTB may fund five types of projects: storage, conveyance and delivery of water; implementation of the Endangered Species Act collaborative programs; restoration and management of watersheds; flood prevention; and conservation, recycling, treatment or reuse.

All water rights, funding, and design requirements must be in place at the time of the award. Approved policies require minimum contributions from all applicants in the form of matching funds, ensuring buy-in. There is a mandatory loan component of between 10 percent and 40 percent of the allocation for all entities supported by a rate-paying constituency. Mr. Jaramillo briefly went over eligibility and minimum criteria for evaluating water project proposals.

Mr. Jaramillo reported that since 2002, 116 entities have received approval for 247 funding awards totaling $255,170,154.

Tribal Infrastructure. Secretary Arthur Allison, Indian Affairs Department (IAD), told the committee the department was very appreciative of the tribal infrastructure fund (TIF) authorized by the Legislature. Graham Knowles said the program received 86 applications for projects, ultimately selecting 28 projects in this cycle – 14 for planning projects and 14 for design/construction projects. These projects, Mr. Knowles said, add to the 80 projects funded out of the $25 million since 2005. In this particular cycle, funding is derived from 5 percent of severance tax bond capacity. The allocations resulted from a series of workshops around the state. Mr. Knowles mentioned two critical highlights: the federal match for the state's $13.2 million investment is $18 million, with further anticipation that the grantee communities will be able to secure leverage funding for the projects of another $18 million. Secondly, 520 short-term project-specific jobs will be created as a result of these projects; additionally, 310 long-term jobs will be created when projects are complete.

Local Projects. Secretary Tom Clifford, Department of Finance and Administration, told the committee the state over the next five years will have over $3 billion in funding for capital outlay projects, including NMFA funds that can generate another $1 billion, which is enough if the funds are spent wisely. He said many good projects were only partially funded, leading to inflation, cost escalation, and waste.

When it comes to local projects, a lack of coordination between local governments and the state is an important issue. Secretary Clifford said the current process lacks planning, prioritization of projects, and clear direction in the appropriation language. Finally, oversight and accountability in project management is important.

Requiring the Infrastructure Capital Improvement Plan (ICIP) for local projects to move forward is necessary to collect more complete information. Currently, the governor and Legislature lack adequate information with which to evaluate projects. For local capital outlay, the DFA is implementing improvements to the ICIP to get more budget detail and a better sense of the local priorities. The goal is to try to get to full funding. A current initiative for statewide projects is an executive order mandating state agencies prepare a five-year facilities master plan as directed by the Property Control Division.

Secretary Clifford discussed a few more reform options and said best practices could include an infrastructure development council to oversee all state-funded projects. He concluded by saying that although statutory changes are not needed to implement all the recommended changes, statutory guidance could be helpful.

Colonias. Rick Martinez, NMFA, told the committee the colonias infrastructure fund provided funding for 47 projects in 10 different counties, totaling more than $18 million and including the $13.2 million derived from 5 percent of senior severance tax bond capacity. Within the revolving loan program, some communities get a hardship waiver. Mr. Martinez stated the board is pleased with the outcome of the projects that were funded.

Linda Kehoe, principal analyst, LFC, thanked Mr. Knowles for his help to the Indian Affairs Department for administration of the tribal infrastructure fund. She stated one of her biggest concerns is lack of project management at the local level for both the TIF and the water project fund projects. Ms. Kehoe emphasized it is allowable to pay fiscal agents out of these funds, so there is no excuse for not having project oversight at the field level.

Senator Cisneros asked about the charge of the task force and Secretary Clifford said he hopes the task force will develop ways of comparing priorities across agencies and communities, and then find ways to apply it to local projects to ensure they are fully funded.

In response to Representative Sandoval, Mr. Knowles said the uniform funding application has evolved over the last three years into a suite of services provided to communities that have needs for water and wastewater infrastructure. The portal is on the department's website, and once the application is filled out, a community services coordinator visits the community and clarifies needs and other funding streams for that community. In the majority of cases, local officials have limited or no knowledge of all of the different funding streams available.

In response to Senator Beffort, Mr. Gorrell said adequacy is still an issue. Adequacy standards were developed from the status quo of the country, which are too generous. Senator Beffort said the issue should be on the table for future planning.

Chairman Smith introduced Mayor Pro-Tem Chuck Howe, president, David Westphall Veterans Foundation and Vietnam Veterans' National Memorial. Mr. Howe told the committee on September 1, 2012, an annual brick-laying for veterans will be held.

Sustainable Financial Proposals for State Pension Benefits *New Mexico Public Employees Retirement Association (PERA).* Wayne Propst, executive director, PERA, introduced board members and said assets and fund balances declined by $6 billion during the financial market meltdown a few years ago. The current funded level is 70.5 percent. This level will decline without action. Although PERA's assets have increased since the downturn, PERA still has an unfunded liability of $4.9 billion, which cannot be made up by investment returns or by increasing employee/employer contributions alone. Mr. Propst added the issue cannot be addressed by placing the burden on future hires. Changes to the benefit structure across all membership groups are required to pay off the unfunded liability and return the PERA to financial solvency.

Mr. Propst said House Joint Memorial 19 required the PERA propose changes to bring its funding status to 100 percent by 2041 and present benefit-structure changes affecting future and active members and retirees to the Investments and Pensions Oversight Committee (IPOC) by October 1, 2012. This requirement has been fulfilled. The benefit reform proposal was voted on by the board of trustees in June and approved.

For future hires, including employees hired after June 30, 2010, the board proposes establishing a new benefit structure from what is currently offered to include lowering the annual pension factor from 3 percent to 2.5 percent; establishing an age and service rule of 85, or age 65 with 10 years of service; a final average salary base on five instead of three years; increasing the vesting period from five to eight years; establishing a 90 percent pension maximum, and a 2 percent compounded cost-of-living allowance (COLA).

For current retirees, the board is proposing reducing the annual COLA rate from 3 percent to 2 percent. This will result in an immediate $1.5 billion, or approximately 30 percent, reduction in the unfunded liability. The board also recommends changing COLA eligibility to seven calendar years after retirement, or at age 65, as opposed to the current two years. There would be no change for employees who retire age 65 or older or due to disability. Finally, the board is recommending increasing the pension benefit maximum to 90 percent.

Relating to employer/employee contributions, the board requests the Legislature consider increasing the employee contribution rate by 1.5 percent. For state employees covered by the remaining pension swap, this would be accomplished by removing the sunset of that 1.5 percent contribution shift. Statutory employer contribution rates would increase by a half percent over two fiscal years beginning July 1, 2014, which would be the first increase since 1997. If all components are approved by the Legislature, the PERA funded level would reach 100 percent by 2031 and 127 percent by 2041.

The PERA changed a few rules beginning with using the final average salary to purchase service credit and setting the rate of interest paid to an employee who refunds PERA contributions to 2 percent from 5.25 percent.

New Mexico Educational Retirement Board (ERB). Jan Goodwin, executive director, ERB, said the same is true with the ERB; in the good times benefits were added that are not as easily sustainable today. Last year, ERB's unfunded liability was 5.7 billion, and as of June, 2012, it is expected to reach $6 billion. Assuming a 13.9 percent employer contribution rate in FY15, and an employee contribution rate returning to 7.9 percent in FY14, the funded status will continue to decline.

Ms. Goodwin said stakeholders reached unanimous consent on a proposal in July 2012. The proposal contains three elements, including an increase in the contribution rate for all current employees to 10.7 percent beginning in FY15. Employees are willing to make this significant contribution. The second element, affecting new employees only, is to raise the minimum retirement age to 55. The third and final element is the COLA. The ERB COLA, on average and over time is 2 percent when the retiree reaches age 65. Under the proposal, COLA would be delayed until age 67 for new members.

This proposal allows the ERB to pay off its unfunded liability in 30 year; currently, the ERB will never to be able to pay off their unfunded liability. This proposal will meet the ERB's funding goals. The ERB board recently tabled this proposal so that there will be time for other proposals to be considered, and a meeting to select a recommendation is scheduled September 19, 2012.

New Mexico Retiree Health Care Authority (RHCA). Mark Tyndall, interim executive director, RHCA, gave a brief history of the authority and stated benefits are not a contractual right, so benefits can be modified and are under the control of the board of directors, who have broad statutory authority. The only requirement with regard to Legislative approval is the contribution rates that come from active employees and employers.

The RHCA FY13 budget is $240 million, and the plan covers 50 thousand members -- 40 percent are under age 65. Mr. Tyndall explained what is offered, and said that even though subsidized at about 50 percent, this is not a free benefit and the retiree pays premiums and incurs out-of-pocket expenses when they access care.

Because of an unfunded liability that had reached $4.1 billion and the benefits fund set to reach "0" within seven years, the board reduced subsidies for most pre-Medicare members and premiums were increased to match costs. Today, the benefit fund reports a $3.3 billion unfunded liability and the benefits fund is set to reach "0" within 15 years, as opposed to seven years.

Mr. Tyndall said the fund will continue to deteriorate unless further action is taken because health care costs are increasing at a rate higher than revenue sources. Secondly, what an average active employee will pay during the course of his career is substantially lower than what the average retiree will receive in benefits during the course of an average retirement.

The board of directors is currently working on a five-year plan to prevent the fund from reaching "0" within a projected 15 year period. The RHCA is phasing out family coverage subsidies for retirees with multiple dependent children. Beginning in 2013 there will be no such thing as a "zero pay" child. Effective January 1, 2013, the RHCA is introducing co-insurance to mail order prescriptions, which is currently a flat co-pay rate. The RHCA is also increasing the specialist copayments on pre-Medicare plans.

The RCHA is looking into how to manage a minimum retirement age in order to receive a subsidy, increasing years of service required to receive the maximum subsidy, reducing pre-Medicare retiree and spousal subsidies, implementing enhanced wellness programs, and increasing employee/employer contribution levels.

All presenters said statewide outreach meetings were conducted.

Representative Larrañaga asked if there was any resistance to raising the retirement age to 60 for hazardous duty tier employees. Mr. Propst said he expects a lot of opposition to what the board has proposed, adding he would defer to representatives of hazardous duty employees. The hazardous duty tier is in recognition of the unique nature of working conditions, and the plan is to put all employees in the peace officer/public safety plan, including motor transportation, under the hazardous duty tier.

Ms. Goodwin told Senator Sapien it would cost approximately $7 million per year to keep the "under $20 thousand a year" employees at 7.9 percent. The ERB has not run a separate actuarial calculation. Senator Sapien requested the ERB run this actuarial.

In response to Vice Chairman Varela, Mr. Propst said the average reduction to a current retiree's benefit would be approximately 8 percent to 10 percent; the average reduction to the expected benefit of a current employee is in the range of 18 percent to 20 percent, and for new hires, the impact would be nearly 30 percent.

Ms. Goodwin told Representative White the ERB proposal isn't as aggressive as PERA's because ERB benefits are lower and members pay a larger portion of the benefit than PERA members. For instance, the PERA multiplier is higher at 3 percent compared with 2.35 percent for ERB members, the PERA COLA is 3 percent compounded beginning year three of retirement, contrasted with the ERB COLA tied to the consumer price index beginning at age 65. The ERB COLA have averaged 2 percent over time.

Representative Bratton stated it would be beneficial to know the percentage of hazardous duty employees who would receive social security benefits on top of the proposed 90 percent pension benefit. Representative Bratton said one of the biggest complaints he gets is how the public safety sector of state government receives 80 percent retirement and can retire at age 45.

Ms. Goodwin told Chairman Smith the board is looking at ways to solve the full-time benefit for part-time worked dilemma and will have recommendations in October. Although the board could accomplish this through rulemaking, legislative action is more sustainable. Chairman Smith said his concern over actuarial soundness of retirement plans dates back 10 years, very little has been done, and he does not think people realize the severity of the problem.

Quarterly Capital Outlay Report. Linda Kehoe and Sonya Snyder, LFC capital outlay analysts, briefed the committee. Ms. Snyder reported that for this quarter approximately $378.8 million for 1,057 projects remains unexpended, including $114.4 million for 287 projects authorized in the 2012 session. Since March 2012, approximately $64.8 million was expended or reverted and 109 projects were closed. An additional $5.4 million for 139 projects is expected to be expended or reverted by September 2012—27 percent from the general fund (GF), 64 percent from severance tax bonds (STB), and 9 percent from other state funds (OSF). Ms. Snyder reported that of the $223.4 million authorized from general obligation bonds (GOB) in 2008 approximately $19.2 million for 87 projects remains unexpended; 28 projects were completed since last quarter totaling $64.7 million. Of the $378.8 million outstanding balance, $6.8 million is GF, $321.2 million is STB, $35.7 million in GOB, and 15.1 million is from OSF. The Board of Finance (BOF) reports that 12 projects totaling $43.8 million are not ready. Projects reauthorized in 2012 projects total $57.8 million—27 for statewide projects and 70 for local projects by the House and Senate. The governor reauthorized eight local projects for an all-inclusive regional park facility in Rio Rancho. Ms. Snyder said the BOF has not approved the change of purpose due to an anti-donation issue because the proposed site for the park is owned by Presbyterian Hospital.

Ms. Kehoe reported that of the $378.8 million outstanding for $1 million or greater projects, the LFC staff tracks $297.2 million for 162 projects, nearly 78 percent of all outstanding projects. Since March, $49.4 million was expended or reverted and 35 projects closed.

Nine projects were completed for higher education for a total of $48.9 million from the 2008 GOB, five projects totaling $14.3 million for Department of Health facilities, and $1.5 million for senior citizen projects. Other completed projects include $13.5 million for Las Cruces

Regional Recreation and Aquatic Center, $7.5 million for GRIP I, and $6.3 million for the New Mexico Archaeology Center.

Ms. Kehoe said she recommends changing language allowing for construction with library money in future GOB bills. The Legislature may also want to consider including reversion dates in the bill.

Senator Cisneros asked Ms. Kehoe if she knew what projects and what amount of funds may be needed for capital outlay in 2013. In response, Ms. Kehoe stated that three legislative sessions have passed without a capital outlay recommendation from the executive; however, the deputy secretary for the Department of Finance and Administration has confirmed the executive will recommend capital expenditures in 2013. Ms. Kehoe also stated the staff will provide a "capital outlay preview" to the LFC at its September hearings of the most critical needs.

Thursday, August 23

The following members and designees were present on Thursday, August 23, 2012: Chairman John Arthur Smith, Vice Chairman Luciano "Lucky" Varela, Representatives Henry "Kiki" Saavedra, Larry A. Larrañaga, Edward C. Sandoval, William "Bill" J. Gray, Nick L. Salazar, James P. White, and Donald Bratton; Senators Carlos R. Cisneros, Sue Wilson Beffort, Mary Kay Papen, John M. Sapien, Carroll Leavell, Steven P. Neville, and Pete Campos. Senator Cisco McSorley and Representative Rick Miera attended as guests.

Program Evaluation: Job Creation Instruments: The Job Training Incentive Program, Local Economic Development Act Grants and Select Economic Development Tax Expenditures. Maria Griego and Brenda Fresquez, LFC evaluators, told the committee the evaluation focuses on three programs designed to spur economic development in New Mexico: the Job Training Incentive Program (JTIP), the Local Economic Development Ace (LEDA), which are both administered by the Economic Development Department (EDD), and a selection of tax credits administered by the TRD. (The complete evaluation and agency response is on the LFC website: http://www.nmlegis.gov/lcs/lfc/lfcdefault.aspx)

KEY FINDINGS. New Mexico lacks a comprehensive approach for financing and monitoring performance of job creation incentives. The state uses a mix of incentives for job creation that cost an estimated $467.5 million between FY07 and FY11, including tax expenditures, direct incentives such as the JTIP, and capital infrastructure investment though LEDA. The vast majority of the state's investment in economic development occurs within the tax code through various tax credits, totaling foregone revenue of $374.5 million, followed by grants through LEDA totaling $63 million. The state spends the least on direct incentives under the JTIP, with a total of $30 million expended between FY07 and FY11.

Previous LFC analyses highlighted a fragmented and uncoordinated approach to job creation, which continues to this day. In a 2009 LFC brief, staff identified various areas of concern in the execution and monitoring of economic development incentive programs and offered the following recommendations:

1. Prepare a statewide economic development plan that includes a variety of high-performance measures;
2. Require incentive agreements;

3. Link incentives to performance;
4. Establish minimum wage standards for job creation and retention requirements; and
5. Require incentive recapture (clawbacks) for non-performance.

Lack of a comprehensive and regularly produced tax expenditure budget hampers decision-making and monitoring foregone revenue costs to the state. The Taxation and Revenue Department (TRD) was due to release a tax expenditure report in summer 2012 per executive order, but as of the publishing of this evaluation, the report has not been released publicly. The tax expenditure report is a first step in reviewing the effectiveness of tax credits for achieving policy goals. The TRD's testimony at the LFC July 2012 hearings indicates it is a tool for identifying and referencing the large amount of tax expenditures in statute. Further steps are needed to bring New Mexico in line with best practices of in-depth analysis.
The Pew Center for the States released a report in 2012 describing various methods for measuring tax incentive effectiveness:

1. *Build evaluation of incentives into policy and budget deliberations;*
2. *Establish a strategic and ongoing schedule to review tax expenditures;*
3. *Ask and answer the right questions using good data and analysis;*
4. *Determine whether tax incentives are achieving the state's goals.*

The report rated New Mexico as having mixed results in its ability to effectively review its tax credits, exemptions and deductions.

Without across-the-board strategic planning and accountability, the state is not well-positioned to invest in incentives that create jobs at a reasonable cost to taxpayers. Total incentives given to a particular company, including tax credits, are valuable information for the Legislature and taxpayers. In the case of Schott Solar, for example, the company received state and city LEDA grants, JTIP reimbursements, loans facilitated through the New Mexico Finance Authority, and likely also received high-wage job tax credits. Due to lack of communication and coordination between the various entities supporting Schott Solar, it is difficult to accurately value the costs and benefits of these incentives and losses from the plant's closure.

Information sensitivity and issues of confidentiality have proven a significant barrier in performing a thorough assessment of economic development programs. State law requires the TRD to maintain taxpayer confidentiality. This has presented a problem in performing a thorough assessment of tax incentives, even leading to data being omitted by the department in their reporting to omit identifying information. LFC staff does not have access to confidential data, and therefore cannot perform an in-depth study of the effectiveness of tax credits. The JTIP would be able to more effectively measure success of the program if it could monitor a trainee's progress through unemployment insurance filings housed at the Workforce Solutions Department (WSD).

Combined incentives cost an estimated $31 thousand for each job subsidized by the state, but the EDD and the TRD do not analyze or report this total cost per job created. Based on cost-per-job analysis on a sample of companies receiving incentives, it costs the state of New Mexico on average an estimated $31 thousand to attract a job, with an average salary of $43 thousand. The LFC performed this analysis based on JTIP and LEDA funding data and independently estimated sample companies' eligibility for the high-wage jobs tax credit and rural job tax credit for companies awarded JTIP funds between FY07 and FY11. The TRD and the EDD do not currently analyze costs to the state of all job creation incentives per job they create.

Furthermore, the TRD does not report a number for jobs created from a particular tax credit, making an actual versus estimated total cost per job with tax incentives for all jobs created difficult to assess.

Since 2007, the state has issued $64 million in Local Economic Development Act grants without safeguards to ensure jobs are created. From 2007 to 2011, the EDD has received $64 million in capital outlay appropriations to provide LEDA grants statewide. The grants were distributed to various political subdivisions and for specific economic development projects, such as Schott Solar and Fidelity Investments in Bernalillo County. As of June 2012, 29 LEDA projects total $56 million, of which 19 are complete.

LEDA agreements do not include clawback provisions, keeping the state from recouping any funds if a company closes or reduces its workforce. Clawbacks are limited to the local entity's contributions and not state funds, even when the state has contributed a larger portion of the funding. In 2009, the LFC reported that state incentive agreements need to link incentives to performance and recommended the state require incentive clawbacks for non-performance.

Job creation requirements vary and there are no requirements in place for job retention. The 2009 LFC brief on the *Survey of Economic Development Initiatives* recommended that minimum standards for both job creation and retention be established. Hewlett Packard's project participation agreement (PPA) with the city of Rio Rancho clearly defines the number of jobs with a full-time-equivalent as 2,080 hours per year. Examples of the various job creation requirements in other project participation agreements:

- Job creation defined in job years and it is not always clear how many jobs are to be created;
- Target number of jobs created on an annual basis with and without a cumulative total; and
- Direct or indirect number of hours within a stipulated time period or over a period of time, not specific as to number of jobs to be created.

Having different job creation requirements makes it difficult to capture benchmark data. In some instances, there are targets in the PPAs for maintaining a certain number of jobs over time, but none of the nine PPAs the LFC reviewed include specific requirements for job retention.

Better accountability measures are needed to ensure the Job Training Incentive Program produces sustainable long-term results. In FY11, the program paid out $1.2 million to support the creation of 613 jobs, 43 of which were in rural areas. Average trainee salary for FY11 totaled $58 thousand per year.

JTIP funds small and large projects alike without a prioritization that aligns with an overall state economic development strategy. Funds are currently made available on a first-come-first-served basis instead of being budgeted strategically to achieve specific goals. In the EDD FY13 strategic plan, the JTIP's objectives include increasing company participation in the program, increasing the number of jobs funded, and sustaining the quality of jobs funded. The plan reflects the focus on total jobs trained as opposed to having a strategic focus for different industries in different areas of the state based on region-specific strengths.

The JTIP paid $25 million in reimbursements of a total $50.2 million, or 50 percent encumbered between FY07 and FY11. Job and wage data provided in the JTIP application have been amended during the contract period. These amendments account for actual reimbursement payments being less than originally budgeted. While unexpended funds are eventually unencumbered and returned to the overall JTIP budget, this 50 percent differential in budgeting may prevent other applicants from being able to access funds.

JTIP performance measures do not meaningfully assess the effectiveness of the program. If JTIP is a job-creation incentive, performance measures currently in place do not measure effectiveness through job retention or changes in employee wages at the recipient company. However, if JTIP is intended as a workforce training program, then performance measures should be tied to the trainee over the long-term.

<u>The Taxation and Revenue Department cannot accurately measure foregone revenue or impact from tax expenditures designed to spur economic growth.</u> The TRD does not routinely review and report effectiveness of economic development tax credits to the Legislature, which is inconsistent with best practices, and in some cases, does not comply with statute. For example, for the rural jobs tax credit, the WSD and the EDD are required to evaluate and report on the credit in conjunction with the TRD, but none of the three agencies could produce a report for this credit that had been presented to the Legislature.

The state does not have an established regular timeline for evaluating tax expenditures. While some credits do have requirements for review within statute, this does not span all credits. Similarly, while some credits such as the high-wage jobs tax credit have sunsets, New Mexico does not have universal sunset provisions for tax expenditures. Evaluation timelines and sunset provisions both create a timely process for reviewing tax expenditures.

The TRD does not have a system for collection and analysis of tax expenditure data, limiting its ability to measure effectiveness and inform the Legislature. In the case of the economic development tax expenditures reviewed for this evaluation, the TRD does not have a method for cataloguing data and performing analysis electronically. Tax forms provide a great deal of data that could be used to measure how the tax credits perform. However, LFC staff does not have statutory authority to access the data needed to assess the effectiveness of these expenditures.

The high-wage jobs credit's recent increase makes it comparable in size to the film production credit, raising similar concerns over future unchecked growth. Constituents have voiced their concerns in other interim committees over potential loopholes in the language of the high-wage job credit statute, creating potential gray areas in claiming and administering the credit. In testimony before the Revenue Stabilization and Tax Policy Committee, Albuquerque Economic Development (AED) identified areas to be addressed:

- Definition of Wages to Determine Size of Credit
- Wage Rates
- Lack of Time Limits to Claim Credit
- Sunset Provision

The AED also testified that during this interim, representatives from the EDD, the TRD, the Department of Finance and Administration, and the economic development community are convening to draft legislation to address some statutory issues surrounding the High Wage Jobs Tax Credit.

KEY RECOMMENDATIONS

The Legislature should formalize within statute

- Public disclosure requirements for businesses receiving economic development tax credits;
- Clawback provisions for all economic development direct expenditures to ensure clawback requirements are consistently applied.
- Cost-effective evidence-based economic development incentives;
- Sunset provisions for economic development tax incentives, including regular review of fixed wage and population definitions for credit eligibility; and
- Guidelines for reporting on all tax credits to the Legislature to create uniformity in information being reported and frequency of reporting.

The Economic Development Department should

- Include clawback provisions for state funds in its intergovernmental agreements, and require local entities to include clawback provisions for state funds in its project participation agreements;
- Establish a standard requirement for defining the number of jobs created;
- Include job reporting requirements in the intergovernmental agreements for the LEDA that include actual jobs created and retained, holding the local entity responsible for obtaining the information and providing the quarterly wage and contribution reports to the state to ensure accountability through the duration of the company's project participation agreement;
- Institute state-specific minimum wage and job count requirements to fully access JTIP reimbursement to drive economic development goals for the state; and
- Require JTIP recipient companies to report on job retention and wages for a period of time after final reimbursement for longitudinal analysis, such as three to five years.

The Taxation and Revenue Department should

- Research and formalize a measure of economic return to the state from job growth in conjunction with economic research resources such as the Bureau for Business and Economic Research at the University of New Mexico (BBER) or the Arrowhead Center at New Mexico State University;
- Follow current statutory requirements on the reporting of economic development tax expenditures; and
- Establish criteria for tax expenditure analysis using recommendations from the Pew Center for the States as a guide.

Agency Response. Wade Jackson, general counsel, Economic Development Department (EDD), said the economic development incentives that the report examined are necessary in New Mexico because the state's tax climate is very poor. Numerous incentives are only necessary, he said, because New Mexico taxes goods and services that surrounding states do not. The EDD uses tax incentives as a substitute for tax reform and while there are benefits, a revised tax code rather than the incentives would send a clear message and avoid the costs of assessing them annually and continuing debate.

JTIP's mission is to establish classroom, on-the-job, and skill training to enhance the workforce. The JTIP board establishes policies with a primary focus to match program with business needs in the community. In recent years, the board has adapted its policies to encourage participation by industries to pay higher wages and decrease participation by those who pay lower wages, such as the call centers in the evaluation. Existing policy also rewards businesses in rural and economically distressed areas. Mr. Jackson stated the LFC evaluation focuses on the costs of the program, but not the benefits. The JTIP has funded more than 1,000 projects, creating more than 40 thousand jobs, and is considered the state's most successful incentive.

The JTIP performance standards analyzed in the report use a double layer of compliance and audit reviews through reviews during and after the contract period. Mr. Jackson stated clawback language has existed in JTIP contracts since 2007, but the EDD has not had to use those clawback measures due to performance measures. There are recapture provisions for non-compliance—between 2007 and 2011, $235 thousand was recovered through the compliance process.

The evaluation also looked at capital outlay for LEDA grants, and EDD's failure to prioritize projects. Mr. Jackson said there is no mention in LEDA of state funds or state involvement; rather the local government is to prioritize projects and negotiate terms.

Mr. Jackson said between 2007 and 2011, the EDD received $63.6 million in capital outlay appropriations for LEDA projects and 59.6 percent went to four specific projects. The LFC report made recommendations on policies and procedures the EDD should adopt when selecting projects, yet 60 percent of direct appropriations from the Legislature for the projects evaluated (Schott Solar, Hewlett Packard, Fidelity Investments, and Santa Fe Studios) circumvented the policies and procedures the EDD had in place. Of the remaining $25.7 million appropriated for LEDA projects, all but $2.55 million went to projects outside Albuquerque, Rio Rancho, Las Cruces, and Santa Fe. Mr. Jackson broke down the two types of projects —infrastructure and economic development and said neither allow for clawbacks as the LFC report envisions them because the EDD has contractual relationships, grants funds and reimburses to local governments rather than companies.

Mr. Jackson said the EDD does not want to be seen as an obstacle to the assessment of incentives, yet the 2012 LFC report includes factual errors. Mr. Jackson said the EDD response to the evaluation is on Page 36 of the bound report. The real issue, he said, is continuing the piece-meal approach to understanding incentives or having a real discussion on how to implement a repeal the corporate income tax to benefit business and create jobs.

Secretary Demesia Padilla said the TRD is not able to share a lot of tax information. In terms of tax credits, all information is received through a manual process. The TRD is trying to get information from companies electronically, but without any teeth in statute, tax consultants do not comply. The TRD has difficulty deciphering specific data on deductions, exemptions and credit, there is no penalty for misreporting information. Ms. Padilla said she makes no apologies for protecting taxpayer information in many circumstances, although some information can be shared.

The high-wage job credit has too many leaks and deficiencies, Ms. Padilla said. There is no statute of limitation to apply for the credit. Regarding the definition of benefits, the statute makes reference to the internal revenue code, which changes frequently.

Chairman Smith stated the evaluation and the EDD's response reflects the fact New Mexico needs legitimate tax reform. Chairman Smith said that the bottom line for New Mexico is the Legislature, executive and education system need to work together in the spirit of compromise and asked for the support of the executive branch to move the state forward. Chairman Smith said he isn't sure the EDD is working under the correct model because in rural New Mexico, universities are depended on much more than the EDD.

Representative Larrañaga asked why JTIP only spent half of the funds encumbered to reimburse companies between FY07 and FY11. Ms. Griego said left over funds are put back into the budget and are recycled for future use. Companies obtain JTIP funding, contracts are amended for various reasons, and because JTIP is a post-performance initiative, funds have not been allocated. Ms. Griego said the LFC recommendation is to look at ways to tighten up that system because when the program is based on a first-come, first-served basis and funds are encumbered, some potential applicants who may not think JTIP funds are available, which hinders economic development.

The discussion turned to a ready workforce. Ms. Griego said there is an opportunity within JTIP to address why, as industries mature, New Mexico continues to pay full training reimbursement on a person who may already have certain skills.

Senator Leavell and Representative Bratton stated it is important to look at regulatory costs in New Mexico with regard to economic development. Representative Bratton said New Mexico must have a significant clawback.

Public School Funding Formula Updates. Charles Sallee, deputy director, LFC, gave the committee background information on the funding formula. For FY13, New Mexico will allocate about $2.3 billion through its public school funding formula to 183 school districts and charter schools to serve 322 thousand students. Mr. Sallee stated the current formula has served the state well, however, recent budget challenges and analysis has highlighted acute formula issues such as the ineffective allocation of resources to high need areas, administrative complexity, and weakened oversight.

Increasing formula funding for at-risk students, moving to a census-based special education funding, reforming size adjustments, and either eliminating or aligning an adjustment to the three-tiered licensure system are all common themes in recommendations for changes and adjustments to the funding formula among studies by the American Institutes of Research (AIR) the LFC/LESC staff report from 2011, a new study by a school of finance expert from Syracuse University commissioned by the Maddox Foundation, and the Superintendents' Association in New Mexico.

Mr. Sallee stated charter schools are also a funding formula concern. Some charter school funding, due to the size-adjustment factor, rivals that of rural isolated school districts. The state and districts are taking on liability from a facilities standpoint to meet requirements to have charters in public buildings and up to common standard.

Gloria Rendón, executive director, New Mexico School Administrators Association, stated the K-12 Funding Formula Workgroup met six times this year, focusing on methods to improve the distribution model of the current funding formula. The group looked effect of the three-tier system and the fact that the migration of teachers from one tier to another effects budgets on an annual basis.

Ms. Rendón stated charter school data was studied in great detail and clarified no one in the group is arguing for the elimination of charter schools. Charter schools play an important role in the education system, however, the proliferation of charter schools affects the funding formula immensely. Public school funding was distributed to 89 districts and is currently distributed to 89 districts and 91 charter schools. The workgroup discovered a significant amount of State Equalization Guarantee (SEG) funds are used for facilities at charter schools, whereas at districts funds for capital outlay generally do not come out of SEG.

Although the workgroup realizes there are many disparities among districts, it was decided to leave the training and education part of the formula alone because there may be changes to the both the teacher and principal evaluations.

Another area needing attention is district- and school size-adjustments. The number of districts requesting emergency supplemental funding has increased threefold in the last decade. Ms. Rendón stated it obvious when the same small school districts request funding every year to provide the basic program, it is no longer an emergency. There is a problem with the manner in which the funds are distributed.

The impact of poverty and English-language learners on student achievement is not new information, however, now there is clear and compelling data that early and intensive intervention will have the greatest impact on student achievements. The workgroup examined data from the three aforementioned reports which had similar findings: use a census-based approach for special education, incorporate fine arts and physical education funding into the regular SEG, replace the current training and experience index, revise the size adjustment factors, increase the at-risk factors, and adjust the charter school units.

Ms. Rendón stated the workgroup welcomes accountability in performance-based budgeting that serves the purpose of helping teachers improve and will continue further discussions. Appropriate funding and the authority to use those funds to serve individual districts is important, she said.

The workgroup has made suggestions to the LFC for a sample run of the funding formula incorporating some of the recommendations and at the next meeting the workgroups will make adjustments.

Paul Aguilar, deputy secretary, Public Education Department, began by saying sufficiency is not a function of money, it is a function of the ability to best serve children. The PED suggests taking the dollar sign out of sufficiency and urged the committee to consider categorical funding to fund above the line what is needed to get schools running properly, retirement – all the things needed to be covered as a baseline while holding schools accountable. The PED is supportive of getting rid of categories within the funding formula that do not make sense and distributing money where it is needed.

Mr. Aguilar stated the PED is supportive of working with the task force to address the problem with micro-districts with regards to emergency supplemental funding to figure out how these districts can get proper funding for operations and pay raises.

The PED has implemented a new audit unit to account for one third of schools every year. Mr. Aguilar noted the number of units claimed for special education is down to $7 million as a result of the new unit.

The administration is proposing aligning the three-tier licensure within training and education with new teacher effectiveness rules. Also, the PED is addressing the migration of teachers between tiers.

Addressing charter schools, Mr. Aguilar submitted that statute is causing double-funding issues the first year the school is open and after that the appropriation is above the line—the PED would like to fix that component. Economies of scale needs to be considered for charter schools to have sufficient money to operate. The facilities issue regarding charter schools is also an issue to alleviate operational concerns.

A 1.5 unit multiplier for nationally board certified teachers is currently in place, and the administration proposes that once the teacher effectiveness model is in place, that a similar multiplier be included in the funding formula that would reward exemplary teachers yearly.

Senator Beffort said early childhood education, as a specialty, would be the best reform for not paying the three-tier licensure that then usurps money for other things, and said it should be on the table. Representative Larrañaga added that intervention in early childhood education could help special education. Ms. Rendón stated as a teacher, principal, and superintendent, she knows first-hand what a long, difficult process it is to qualify a child for special education.

Mr. Sallee told Senator McSorley non-categorical money for programs such as fine arts is still available in the formula for districts to apply for and to make decisions about implementation. Ms. Sallee said it is not certain whether the $30 million allocated now is actually being spent on those particular programs. Senator McSorley stated taking fine arts is important and if it is eviscerated once more, New Mexico is shooting themselves in the foot.

Enhancing Childcare Quality and Access for New Mexico's Most At-Risk Children. Yolanda Berumen-Deines, secretary, Children, Youth, and Families Department (CYFD), spoke briefly about childcare licensing regulation. Ms. Beruman-Deines said the need for business-friendly licensing requirements must be balanced with the need to protect the health and safety of the children in childcare facilities. Current regulations support and promote children's well-being. The CYFD staff is directed to taking a general commonsense approach and to work collaboratively with childcare providers. Any efforts at accommodation or acquiescence cannot come at the expense of the best interests for children.

Ms. Deines cited a 2012 study by Child Care Aware of America ranking New Mexico 30th among all states for standards and oversights of childcare centers, an improvement from 43rd in 2010. The study also ranked New Mexico 24th in standards and oversight in homes providing childcare. New Mexico has made significant improvements, but still has much to do. A short video by the Office of Child Care was shown detailing their efforts through the child care development fund.

Dan Haggard, deputy director of Early Childhood Services at the CYFD, presented to the committee on upcoming quality rating system improvements. Mr. Haggard informed the committee on the current tiered childcare quality rating system called Aim High, which was initiated in 1999. The system has five rating levels, with higher rated programs getting bigger subsidies for taking lower-income children. Aim High has two primary goals: (1) increase the number of high-quality childcare programs in the state, and (2) increase the amount of low-income children in such high-quality programs. The program was successful with both goals and increased the amount of low-income children in high-quality programs from 14 percent in FY05 to 76 percent in FY12.

Mr. Haggard also informed the committee on the upcoming third generation quality rating system called Focus. Focus system will be geared more towards children's learning and measuring learning outcomes than the Aim High system. About 75 percent of children entering kindergarten in New Mexico were not adequately prepared. The system is voluntary, like Aim High, and will be piloted in January. Aim High system will gradually transition or phase out to adhere to the Focus system.

Mr. Haggard stated the TEACH scholarship program is effective. Teachers' knowledge of early childhood is one of the most important quality indicators. The heart of the Focus system will be the use of the Authentic Child Assessment and Curriculum Planning Process of the New Mexico early learning guidelines. The bottom line is to have happy, healthy, successful children in childcare programs.

Diana Gonzalez, director of early childhood services at the CYFD, presented to the committee on the status of childcare and the waiting list. Ms. Gonzalez said 21,756 children were served in the last year , and the waiting list is 3,114 children, down from almost 7,000 in March. The majority of children served are infants and toddlers. Childcare is helping families continue to work and hopefully achieve self-sufficiency. The CYFD currently cannot measure children's learning outcomes, but will be able to with the new Focus program. The CYFD is funded to serve approximately 22 thousand children per month in FY13 and will continue to remove children off the waiting list as attrition allows. The CYFD is in the middle of proposed regulation changes, including some cost containment measures.

Lillian Montoya-Rael, member of the Early Learning Advisory Council, presented to the committee on the council's current efforts. The advisory council of 15 members had its first meeting in April. The council is focused on quality, access, and investment in training and development.

Mr. Aguilar presented to the committee on the Race to the Top Early Learning Challenge and said final requirements should be in by the upcoming week, with funding awards coming in December. New Mexico stands to receive about $25 million. A significant requirement is for the state to have a successful organizational structure for grant management. Another requirement is for the state to have high-quality programs in place adopting statewide early learning development standards. New Mexico has such requirements in place, among others.

Mimi Aledo-Sandoval, senior fiscal analyst, LFC, said the state's commitment to early childhood endeavors is very strong. The general fund appropriations for childcare assistance have increased by 325 percent over the past 10 years. The demand for childcare assistance is still great and current funding levels are inadequate to meet the demand. Ms. Aledo-Sandoval clarified that the CYFD's waiting list can only serve as a proxy for the true demand throughout the state. High-quality childcare, four-star and five-star ratings, is limited throughout the state, especially in rural areas. Only 26 percent of children on childcare assistance are served in four-star or five-star facilities. About 80 percent of providers in New Mexico are unlicensed registered homes.

Ms. Aledo-Sandoval said the integrity of five-star facilities is being challenged because many facilities that are rated at five-stars are not meeting highest standards, and some barely meet the basic requirements for licensure.

Addressing the CYFD waiting lists, Ms. Aledo-Sandoval said the current cutoff for receiving childcare subsidies is 100 percent of the federal poverty line. To change the cutoff to 125 percent of the poverty line would cost $9.9 million., and to change the cutoff to 150 percent would cost $19.9 million. The state could lose $1.6 million of federal funds if sequestration moves forward. Also, the replacement of federal funding for oversight of registered homes will cost about $800 thousand.

Senator Papen asked about the accreditation process for home licensing. Secretary Beruman-Deines acknowledged that the process is complicated, and Mr. Haggard clarified numerous national accreditation entities provide documentation meeting National Association for the Education of Young Children standards. Five have met the standards and at least as many have not in the last 13 years. Current state standards require a level five-star rating if it meets the national accreditation standards. The CYFD does not have the authority to assess or adjust national accreditation standards.

Representative White asked whether all children in early childcare programs receive both the childcare and early childhood education components of the programs. Aguilar clarified that some children do only take advantage of only one component.

Representative White asked about the effectiveness of early childhood programs on third-grade reading levels. Mr. Aguilar said data is not sufficient to judge the effectiveness. Ms. Beruman-Deines added that it may be hard to judge because small proportions of children are participating in the programs each year making it difficult to ascertain widespread impact. She added that a challenge remains in helping children who already are starting behind in kindergarten.

Vice Chairman Varela asked about the difference between a registered home and a family home. Gonzalez said licensed family homes are allowed family homes that are allowed to care for six children with a maximum of two infants. Licensed group homes can provide for 12 children with two providers. Registered family homes, which are not licensed, are allowed to care for four non-resident children. Ms. Beruman-Deines that 80 percent of CYFD childcare is being done in registered homes.

Vice Chairman Varela asked how much it would cost to cover the children on the waiting list up to 125 percent of the federal poverty line. Ms. Beruman-Deines said about $10 million.

Vice Chairman Varela asked about 5-star-rated facilities. Ms. Beruman-Deines said about 17 percent of children in the CYFD childcare programs are in five-star facilities. Children can enter programs as early as six weeks old, and approximately 42 percent of children are in two-star rated facilities.

Senator Wilson-Beffort commented on the disconnect between national accreditation standards and the CYFD standards and asked about the CYFD's authority with standards at registered homes. Ms. Beruman-Deines said that ideally registered homes would be phased out as licensed homes provide better oversight. Senator Wilson-Beffort added that Pennsylvania has set laws requiring licensure.

<u>General Services Department Risk Pool and Vehicle Leasing Rates for FY14.</u> Ed Burckle, secretary of the General Services Department (GSD), presented to the committee on the GSD's recommended transportation and risk rates, saying the good news is the administration is holding most rates and risk steady. There is no growth for FY14 with notable exception of the health fund, where they are requesting a 15 percent premium increase for both the employer and the employee. There will be a serious shortfall without the increase. This predicament is occurring because the health rate has been held steady for the past five fiscal years.

In the last six months the Risk Management Division (RMD) has rebid the third-party contracts with Lovelace, Blue Cross Blue Shield, and Presbyterian. The new contracts are now in place through 2016 and the RMD negotiated a reduction in administrative expenses the state pays for all three plans.

The administration is recommending the total revenue be held constant in FY14 from FY13 for the following risk funds: public property, public liability, and worker's compensation.

Mr. Burckle commented on transportation rates, saying they will request a slight rate increase going from $133 per month per vehicle to $174. This would allow the department to replenish the fleet. In the last two years the administration has reduced the vehicle fleet from 2,146 vehicles to 1,985 vehicles. The department will request that the aviation bureau changes to a general fund mechanism rather than an enterprise fund. The annual budget has decreased from $1.6 million to less than $1 million due to the sale of aircraft down to one airplane. A general fund mechanism would allow for better economies of scale and effectiveness, and it would allow the department to charge less to use the airplane.

Mike Unthank, deputy director of operations at the GSD, presented to the committee. The department has made significant progress in reducing the number of vehicles, especially those that are underutilized. If a vehicle is used at a rate less than 11 thousand miles per year, then the department using that vehicle needs to justify what the vehicle is used for. Such vehicles should be turned in to the general motor pool. The department is increasing the amount of defensive driving courses and scrutinizing individual drivers to ensure they are fully qualified to drive state vehicles. Mr. Unthank stated consolidation of vehicles should be considered.

The current fleet is 1,985 vehicles, a reduction of 171 vehicles since 2010. The department wants to expand the Quick Ride program. In addition, the department wants to have a vehicle replacement component so money is not wasted on ineffective maintenance work. Many vehicles from 2009 and earlier need to be replaced. The current fund balance is $6.7 million with a projected fund balance at the end of FY13 of $2.9 million. Mr. Unthank would like the Legislature's permission to purchase 100 vehicles to revamp the fleet. The department wants an increase for vehicles the state leases out with third parties. The department is going to implement an online program to enhance the defensive driving certification, and Mr. Unthank stated the GSD's vehicle program is one of the best in country.

Representative Bratton asked about the current air fleet. Mr. Unthank said there is one aircraft, with two pilots and a mechanic. Representative Bratton asked if it would be better economically to drop the aircraft and lease aircraft when needed. Secretary Burckle said it may be uneconomical sometimes, but the governor wants an aircraft for emergency situations such as for fires. He also reiterated his desire for a generally funded mechanism rather than an enterprise fund as it would allow for more regular usage and economic efficiency. Representative Bratton suggested the possibility of contracting with a company like Net Jet, and suggested looking at increasing the size or dropping the current craft in favor of leasing.

Jay Hone, director, Risk Management Division (RMD), gave a detailed explanation of the department's requested rates for FY14. Mr. Hone first talked about the public property fund, saying that all but $1 million will be recovered from freeze claims earlier in the year. They are about back to where they would like to be, which is at a $4 million balance. The workers' compensation fund is on track. An issue for the fund is the need to look ahead to future liabilities for the fund. Senator Leavell suggested looking ahead to ensure the workers' compensation fund is not overwhelmed in the future.

Mr. Hone said the department's public liability fund is looking at a $26 million budget adjustment request. Director Abbey expressed concern over the public liability fund's projections, and said it is critical for the numbers to be accurate, especially because the unemployment insurance fund's shortfalls are reliant on the public liability fund. Director Abbey said it is critical to reconcile data with departments and stressed this fund has been severely under-budgeted.

Vice Chairman Varela asked about the 19 vacancies in the RMD. Mr. Hone explained there are rigorous hiring processes for some positions such as bureau chiefs. The RMD is currently missing three bureau chiefs.

Director Abbey said it is desirable have accurate budgeting information, adequate balances, and to achieve an actuarial goal of 50 percent. The current percentages, he stated, such as public liability at 196 percent, may be inaccurate.

Mr. Hone stated he thinks the worst has passed regarding the unemployment fund. Costs were up as much $5 million to $6 million per quarter a year and a half ago, and the costs for this year were $2.3 million in the first quarter and $1.7 million in the second quarter. Because premiums have been going up and costs have been going down, Mr. Hone said he anticipates loans to be paid off within two years. The department borrowed $5 million in loans and have authorization to borrow another $10 million.

Friday, August 24

The following members and designees were present on Friday, August 24, 2012: Chairman John Arthur Smith, Vice Chairman Luciano "Lucky" Varela, Representatives Henry "Kiki" Saavedra, Larry Larrañaga, Edward C. Sandoval, William "Bill" J. Gray, Nick L. Salazar, James P. White, and Donald Bratton; Senators Carlos R. Cisneros, Sue Wilson Beffort, Mary Kay Papen, John M. Sapien, Carroll Leavell, and Steven P. Neville.

Unemployment Insurance Trust Fund: Projected Financial Conditions and Tax Rates; Options for Controlling Expenditures, Adjusting Experience Ratings and Tax Rate

Schedules. Celina Bussey, secretary, New Mexico Workforce Solutions Department (WSD) told the committee trust fund issues are critical to New Mexico's economy because they directly impact the business community and the unemployed. Unemployment initiatives include policy issues and the operational perspective.

New Mexico's Unemployment Compensation Advisory Council (UCAC) was activated in November 2011 and charged with a number of things including: examining the tax structure; targeting a examining certain reforms such as overhauling the contribution rate structure and potentially adding schedules and experience rating bands to ensure more gradual, equitable and predictable rate changes, and enacting measures to prevent fraudulent claims and overpayments.

Ms. Bussey stated the meetings have proved to be productive, and the council has discussed and considered reform in the following unemployment insurance topic areas: communication and outreach material improvements; work search requirements, suitable work requirements, partial benefits, double affirmation, Unemployment Insurance (UI) trust fund reserve ration and floor/ceiling mechanism, overhaul of the current contribution schedule, and negative account balances.

The biggest issue effecting the trust fund has resulted from ineffective charges – those benefits that are paid that far exceed the revenues employers have paid into the system. In 2008, ineffective charges represented about $15 million dollars in benefits above what contributions were received and by 2011, New Mexico was at $90 million.

On the operational side, New Mexico will be the first state in the country to implement a single, complete system that integrates both UI tax and claims called uFACTS. This system will better reduce incidents of fraud and overpayments that directly impact the trust fund. Ms. Bussey stated employers are underserved with the current system, and uFACTS will allow them to submit wage reporting online, pay quarterly contributions electronically, and perform many other functions electronically in real time. Claimants will also be able to view correspondence online, receive answers faster, access the jobs system directly, all seamlessly.

Ms. Bussey reported the trust fund balance as of August 23, 2012, was $83 million, and will continue to decrease for the remainder of 2012 and through March 2013. The WSD has received the majority of contributions for 2012, with revenue declining in the fund in the third and fourth quarters. Benefit payout, quarterly employer contributions, and overall unemployment and the labor force are major factors impacting the UI trust fund balance.

Approximately 31 thousand people are certifying for UI benefits every week, down from about 45 thousand weekly certifications in 2011. In New Mexico, claimants are eligible for a maximum of 60 weeks, going down to 54 weeks in September 2012. Ms. Bussey explained everything beyond week 26 is currently federally funded.

The statewide unemployment rate in July, 2012, was 6.6 percent, averaging 6.9 percent so far in 2012. Out of a total labor force of 924 thousand people, approximately 61 thousand are unemployed. Ms. Bussey stated the NMWSD is very mindful of unemployment rates because it effects the overall solvency of the UI fund.

Mr. Abbey stated there is a big jump from schedule two to schedule three, and it is concerning to face tax increases when the state goes to schedule six. Regardless of the schedule, the top rate is 5.4 percent, and Mr. Abbey suggests the option of raising the top rate as well as the schedule. Mr. Abbey went on to explain the experience schedule, saying that the further down the schedule, the more that is payed out in benefits relative to the tax revenues payed in to those employees. Any changes to the tax system is built into statute.

Ms. Bussey explained the process employers go through when a former employee applies for benefits and said employers do have the right to protest their portion of liability for benefit charges.

The committee also briefly discussed drug testing and the implementation of uFACTs.

<u>Miscellaneous Business</u>

Action Items

Approval of July 2012 Minutes - **Senator Cisneros moved to approve the July 2012 meeting minutes, seconded by Representative Sandoval. The motion carried.**

Approval of Updated LFC Policies and Procedures – **Senator Cisneros moved to approve the updated LFC Policies and Procedures, seconded by Representative Sandoval. The motion carried.**

Approval of FY14 Budget Guidelines – **Senator Cisneros moved to approve the FY14 Budget Guidelines, seconded by Representative White. The motion carried.**

Approval of FY14 LFC Budget Request – **Senator Cisneros moved to approve the FY14 LFC budget request, seconded by Senator Leavell. The motion carried.**

Approval of Contracts – Director Abbey recommended continuation of a contract with the Bureau of Business and Economic Research. **Senator Cisneros moved to approve the contract, seconded by Senator Papen. The motion carried.**

<u>Information Items</u>

Director Abbey briefed the committee on FTE and Budget Adjustment Requests. Chairman Smith said it takes a long time to fill vacancies.

With no further business, the meeting adjourned at 9:27 a.m.

John Arthur Smith, Chairman

Luciano "Lucky" Varela, Vice Chairman