

**Legislative Finance Committee**  
**State Capitol - Room 322 - Santa Fe, New Mexico**  
**June 15-17, 2011**

**Wednesday, June 15**

The following members were present on Wednesday, June 15: 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 Carroll Leavell, John M. Sapien, Mary Kay Papen, Pete Campos, Carlos Cisneros, and Stuart Ingle. Representative Rhonda S. King and Speaker Ben Lujan attended as guests.

New committee members and staff began by providing a brief introduction.

**Joint Program Evaluation: Cost-Effective Use of the 12<sup>th</sup> Grade at New Mexico High Schools.**

Charles Sallee, deputy director, Legislative Finance Committee (LFC), said New Mexico’s public school funding formula in FY11 allocated \$457 million for more than 96 thousand high school students statewide. Funding generated by high schools students amounted to 20 percent of the overall funding distributing through the formula. Approximately 67 percent of the class of 2010 graduated in four years. Of the students who graduate, almost 70 percent went on to higher education. Unfortunately, half of those students who attended in-state institutions required remedial education. In response, the Legislature passed a number of measures to redesign high schools and improve accountability and academic rigor to better prepare students for college and the workplace. In FY11, the funding formula allocated \$96.6 million for approximately 20 thousand 12th graders.

Mr. Sallee noted enrollment in the 12th grade is the lowest of all grades but has increased approximately 9 percent over the last couple of years. The evaluators picked a representative sample of 10 high schools accounting for more than 15 percent of all 12th graders statewide in FY10. Overall, the variability of graduation requirements, high school class configurations, enrollment, costs, and data quality is remarkable for the sampled schools. Unfortunately, a significant number of minority students did not meet the state graduation requirements and were still awarded a high school diploma. Many schools require students to earn more credits to graduate than the state minimum requirement of 23. On average, students earned in excess of the state and local school district requirements. A significant disconnect still exists between high school and college curriculum despite efforts to improve articulation between the two systems. The cost of educating a 12th grade student generally cost less than the amount of revenue generated under the funding formula. Between 7 percent and 58 percent of the 12th grade students in the sample were taking less than a full-time course load. Delivering fewer credits to 12th graders decreases costs to high schools. High school spending per student and per credit varied widely due to school and class size differences, course schedules, and labor costs. The state lacks a uniform standard for classifying 12th grade enrollment for the funding formula and for determining funding levels for part-time seniors..

Peter Winograd, director, Center for Education Policy and Research, University of New Mexico (UNM), reported the evaluation included eight school districts and 10 high schools and more than 4 thousand students. Studying the 12th grade is a challenge, particularly in getting high school transcript data. Completeness, quality, and format of transcript data received from the districts varied. Transcript evaluations are often completed by noninstructional staff and are very time consuming and complex. The district with the most accurate graduate transcripts met individually with all junior and senior students and their families once or twice a year.

National trends show high school curriculum has increased in rigor. In 2009, graduates earned over three credits more than their 1990 counterparts and completed a more challenging curriculum than 1990 or 2005 graduates. The boundary between high school and higher education, nationally and in New Mexico, has become “blurry” as more high schools students take college-level courses through dual credit and advanced placement, and more college students take high-school-level courses through remediation. Mr. Winograd noted that the Legislature in 2010 passed House Bill 70 to provide the governor, the Legislature, and the citizens of New Mexico with accurate and timely information on the status of students from prekindergarten through post-graduate education.

High schools schedule courses in three different ways – block schedules, traditional “bell” schedule, and the “hybrid” schedule. The state will require the class of 2013-2014 to have 24 units to graduate. Mr. Winograd noted that because of the financial crisis, the Legislature in 2011 suspended the requirement for students to pass a high school exit exam for graduation in 2012.

The Ready for College studies indicate that 47 percent of high school graduates needed remediation in college. A 2010 study indicated that 23 percent of high school graduates from across the country could not pass the U.S. Army’s Armed Services Vocational Aptitude Battery (ASVAB). In New Mexico 28 percent of high school graduates do not pass the ASVAB. Staff is working with the Higher Education Department (HED) to gather the data to examine, in detail, how the students in this study did during their first year in college. There are a number of students in the community colleges and universities who take remediation; more than half of them are non-high school graduates.

Educators unanimously agree dual credit is good and report the expansion of advanced placement courses is helping increase academic rigor. Internships, work experience, and service learning opportunities help connect required core content with the “real” world. Principals, counselors, and superintendents strongly recommend expanding dual credit. Educators strongly recommend that remediation in college be better defined, practice tests made available, and communication between high schools and higher education strengthened. The lack of alignment in curriculum and assessments between high school and higher education is a problem.

Mr. Sallee said the funding formula allocates a 1.25 weight for students in grades 7 through 12, which is consistent with other states. However, the state also provides full funding for students who do not attend full-time. The state lacks a clear and uniform definition of a maximum age limitation, which could result in duplication between high school and adult basic education. Mr. Sallee noted the per-student and per-credit hour costs are inconsistent across schools and spending on instruction varied across schools. The funding formula generates more estimated revenue for the 12th grade than schools spend to deliver services. The sample high schools reported spending almost \$17 million on delivering services while generated an estimated \$18.6 million in formula funding.

Mr. Winograd said principals and superintendents reported they have cut counseling staff, core teachers, advanced placement, dual credit course offerings, and remediation support and are concerned about increasing class size.

Mr. Sallee concluded with the following recommendations:

- The PED should make sure districts have the capacity to gather accurate data on high school students and district personnel learn to use the data to improve the education of students and ensure more accountability for the state.
- The PED should monitor the number of state-required units students complete to graduate to ensure state standards are met.

- The PED and HED should ensure development of the Education Data System progresses to enable the state to make better decisions on public policy in the future.
- The PED and HED should ensure that the freshman-year outcome reports from higher education to high schools are developed and implemented.
- The Legislature should amend state law to define student membership and qualify students attending full time.

In addition, state law should be clarified to establish a maximum age for students qualifying for the formula funding. Mr. Sallee noted program evaluation staff will conduct a comprehensive review of dual credit, including assessing whether dual credit reduces the time for students to earn a college degree. Mr. Winograd added that one of the clearest trends nationally and in New Mexico is the “blurring” of the line between high school and higher education.

Hanna Skandera, secretary designate, Public Education Department (PED), said the department has begun an effort to focus on data to work with districts on effective reporting. Secretary-Designate Skandera noted virtual courses are offered through IDEA New Mexico. Virtual schooling is a great opportunity to provide options, access, and high quality through consistency. Graduation rates and improvement on graduation rates are part of the school grading bill passed during the 2011 legislative session, as well as rates of advanced placement courses, dual credit, and career readiness. In addition, the PED has an interest in dual credit. The state has made a commitment to transition to “common core” funding over the next three years to facilitate a more consistent expectation across the board. The PED recently received a \$350 thousand grant from the Kellogg Foundation to create a plan to transition to the common core. Secretary-Designate Skandera said while there are many opportunities to do better in the 12th grade, they need to begin much sooner. In a recent published report, third grade reading ability was the leading indicator of whether or not a student is inclined to drop out. The second highest indicator is success in ninth grade.

In response to Vice Chairman Varela, Mr. Sallee said in reviewing weights for all grades it is not out of line. In reviewing the formula in total, a lot of the potential issues are in additional units. More funding is spent subsidizing inefficiently sized schools and districts than allocating money for at-risk students in the funding formula.

In response to Representative Tripp, Secretary-Designate Skandera said the school data system called STARS contains a lot of data; however, the quality of the data is questionable. The PED is working on a plan to improve the quality of data to be more usable in a meaningful way. Secretary-Designate Skandera noted that during the 2011 legislative session, the PED made data available to representatives and senators to use in their districts.

Representative King said it is important to take the limited funding available and look at how to reallocate it within the system to get the biggest return. Mr. Sallee said categorical appropriations for early intervention programs such as home visiting, prekindergarten, Kindergarten-Three-Plus and extended learning time are ways to target money and services to students who need it the most. Secretary-Designate Skandera agreed with the need to be more efficient and effective with funding. The PED has reviewed 115 charter and district budgets and is working with four on preserving dollars to the classroom. Secretary-Designate Skandera noted the difference between the impact of a great teacher and an average teacher is an unbelievable driver for change.

Chairman Smith asked for data reflecting the overcrowding situation attributed to growth by school district. Mr. Sallee said information is available statewide and by school district. The PED collects data showing teaching loads in classrooms.

Joe Sheppard, president, Western New Mexico University, was introduced to the committee.

Public comment:

Moises Venegas, director, Quinto Sol, testified the report does not recognize charter schools and asked if the intent of the Legislature is choice or school performance improvement. Based on research, there is no significant improvement for any student moving from public school to charter school.

Tom Sullivan, executive director, New Mexico Coalition of School Administrators, testified that legislation passed in 2007 was intentionally phased in and did not impact students currently in high school. For a variety of reasons, it added requirements for students entering ninth grade in 2009.

Shirley Crawford, superintendent, Capitan, testified that funding is provided for programs to make certain students are successful as seniors. Ms. Crawford noted dual credit courses count as elective classes.

Brandon Trujillo, HED, testified that it is a priority for the department to work with the PED on STARS.

Marc Saavedra, UNM, testified there is not a statewide tuition policy. Twenty percent of UNM's students receive lottery scholarships.

Carrie Robin Menapace, policy analyst, Albuquerque Public Schools (APS), testified that APS continues to look at 12th grade funding and would like to require seniors to take six out of seven classes. APS is a strong promoter of dual credit.

Theresa Saiz, Rio Rancho Public Schools, testified that Rio Rancho Public Schools implemented additional credits before the mandate. The rigor, relevance, and the investment have assisted the state in achieving outcomes for students.

Mr. Winograd agreed with the rollout of high school redesign.

Representative Saavedra expressed concern with the state not teaching New Mexico history. Mr. Winograd said New Mexico history is required in the new redesign.

**Program Evaluation - Children, Youth and Families Child Protective Services.** Michael Weinberg, program evaluation manager, Legislative Finance Committee (LFC), said three strategies were identified for improving safety, permanency, and well-being for children in New Mexico – reallocating existing resources to increase the number of caseworkers with manageable caseloads serving families and children, investing in family preservation, and using data to continuously improve operations. The Child Protective Services Division (PSD) plays a critical role in the safety, permanency, and well-being of New Mexico's children. The PSD performs similarly to other states; however, it must improve to meet national standards. Recognizing the importance of child welfare, the Legislature minimized funding reductions and maintained its general appropriation of approximately \$58 million.

Improving child safety hinges on making sure caseworkers are prepared, supported, and given the time necessary to make sound decisions. An executive hiring freeze created an acute increase in

workloads. In addition, worker turnover, inefficient management structures, duplication of efforts, and other systemic issues have contributed to chronic case overloads that compromise child safety. LFC staff findings identify specific opportunities to reallocate fiscal and human resources to maximize the number of frontline caseworkers and improve effectiveness.

Research shows that investing in families before it is necessary to remove children is a safer, more cost-effective approach. While federal funds are geared toward back-end services, LFC staff suggests several ways PSD can shift a greater percentage of general fund dollars to preserve families and protect children.

Significant efforts in response to the Joseph A. consent decree, as well as several rounds of federal child and family services reviews (CFSRs) have helped PSD identify strengths and opportunities for growth. Important indicators are the timeliness of initiating investigations, recurrence of maltreatment, stability of placements for children in care, maltreatment of children in foster care, and number of children aging out of foster care. In addition to showing trends within New Mexico over time, staff compared New Mexico with national standards and states in federally designated regions. The third finding includes strategies for revisiting aspects of the data the PSD collects and the way it learns as an organization.

The combination of turnover, management inefficiencies, and duplicative systems has contributed to dangerously high caseloads. Based on standards of best practice, New Mexico's caseloads are high, degrading the quality of services children receive. The PSD's turnover rate for caseworkers in 2010 was 18 percent and cost between \$1 million and \$2 million, contributing to the growth in the backlog of pending investigations from 38 in July 2010 to 108 in January 2011. Foster care caseload averages have increased to 18 in 2011; higher than the Child Welfare League of America's recommendation of 12 to 15 cases per worker. In 2005, 33 of the 40 victims of maltreatment while in foster care did not have a documented home visit by the agency in the three months prior to the report.

Based on LFC survey data, caseworkers spend an average of 22 percent of their time entering data. Opportunities exist to streamline data entry, such as replicating the same information for multiple children in the same family. Reorganizing the management structure could reduce duplication of efforts by allowing PSD to reallocate up to 43 additional FTE to casework positions. The PSD currently has one supervisor for every 3.65 caseworkers, while a reasonable level is 1-to-5. Eliminating outdated and duplicative programs will also allow the PSD to shift fiscal and human resources. In 2010, the PSD spent \$335 thousand on personnel for the Adolescent and Adoption Resource Team (AART) and more on caseworker and supervisor staff time. Streamlining and modifying certain human resource functions could create a more prepared and stable workforce. Similarly, targeted case management (TCM) is no longer needed to qualify for federal funds. Caseworkers spend 14 percent of their time on case management activities such as TCM; eliminating this will increase direct services for families and children.

Providing realistic job previews to potential employees, developing standardized, research-based hiring practices, collaborating with universities to ensure federal stipend students are adequately prepared, and using existing survey data to identify retention issues help the PSD streamline and modify human resource functions to create a more prepared and stable workforce. Differentiating core training offered to new workers will reduce costs and decrease caseloads.

Matt Pahl, program evaluator, LFC, said family preservation efforts, such as in-home services, are safer and less expensive than removing children. Rates of substantiated abuse in foster care are up to

four times higher than for the general population. Mr. Pahl noted a Utah study found each foster care placement costs \$46 thousand a year, compared with \$1.7 thousand per in-home services case, and the average duration of foster care cases is nearly four times longer than in-home cases. New Mexico's percentage of victims who receive in-home services is less than the national average. The PSD's spending on these services increased from \$14 million in FY07 to \$20 million in FY11. Overall, roughly half of New Mexico's child welfare funds are federal Title IV-E dollars and use is limited to certain foster care and adoption expenses. Reallocating general fund dollars from these back-end services to family preservation efforts can save the state money in the long run while improving safety for children.

Coordinating in-home services with the CYFD's Early Childhood Division's home-visiting services could leverage federal resources to increase the effectiveness of family preservation efforts. In FY10, New Mexico received \$950 thousand from the federal home-visiting initiative and will likely receive additional appropriations through FY14. This new money will allow the state to reduce the number of referrals, investigations, and placements for the PSD. The alignment in the federal home-visiting initiative and in-home services represents an opportunity to leverage resources, potentially serving as a pilot collaboration across the state. Implementing a differential response system provides better outcomes for children, more positive experiences for families, and long-term cost savings. The PSD's modified version of a differential response pilot from 2005 to 2007 showed families who accepted assessment services had a lower rate of repeat maltreatment reports, as well as fewer children removed to foster care. Legislative changes to New Mexico's Children's Code are necessary to expand the impact of differential response. Maximizing access to federal funds will allow the PSD to reallocate a greater percentage of general fund dollars to family preservation efforts. In 2006, New Mexico received Title IV-E reimbursements for foster care maintenance payments for 73 percent of children in out-of-home placements. Recently introduced federal legislation might provide an opportunity for New Mexico to apply for Title IV-E waiver to reallocate funds toward family preservation.

Quality assurance reviews modeled on the federal CFSR process, critical incident reviews, and reports generated from the PSD's data system, FACTS, are vital process improvement tools. Potential changes in each area will more efficiently allocate resources and create a safer child welfare system. The quality assurance process is well-aligned to the CFSR standards but the division could provide more technical assistance to field offices. Expanding the scope of these reviews to include intake and investigations cases would provide performance data in crucial areas not included in CFSR measurements. Additionally, the process could include increased technical assistance and action plans. It is unclear how the PSD uses its critical incident reviews to reduce the likelihood of child maltreatment resulting in death. Though the PSD indicates it conducts approximately 10 to 12 reviews annually following serious child injuries or fatalities, the CYFD cited attorney-client privilege and denied the LFC access to the reports.

The PSD could also improve oversight of contract services by following up on corrective action plans sooner and providing technical assistance when the service array is limited. The PSD annually spends \$10 million for contracted services, such as family support, adoption assistance, training for children and families, family mental health services, and coordination of care for children of incarcerated or absent parents. Many of these contractors are under-performing, but given the limited service array, particularly in rural areas of the state, the PSD lacks alternatives. LFC staff suggests providing more technical assistance to these vendors.

Data is regularly distributed, but reports are cumbersome with limited expectations surrounding their use. The PSD's central office produces 35 reports for county office managers each month and is

overwhelmed with excessive data. Providing key data in an executive dashboard report will improve supervisory support, an issue noted frequently by caseworkers who have left or are likely to leave the PSD.

Mr. Weinberg concluded with recommendations for how CYFD can better use existing resources to improve its safety, permanency, and well-being outcomes for New Mexico families including

- Revising the New Mexico Children’s Code;
- Analyzing current organizational structure, vacancies, and strategic needs;
- Implementing research-based hiring practices;
- Differentiating training for new workers;
- Eliminating the AART and TCM programs;
- Implementing a differential response program;
- Collecting data related to the effectiveness of family preservation services;
- Expanding quality assurance reviews, providing technical feedback, and collaborating with counties;
- Publicly releasing critical incident reviews with confidential client or personnel information redacted;
- Coordinating in-home services and home-visiting services; and
- Simplifying data entry.

Yolanda Berumen-Deines, secretary, Children, Youth and Families Department (CYFD), reported the department agrees with most of the findings with several areas of concern. The department has a large vacancy rate, as well as multiple staff taking on multiple tasks, resulting in minimal quality level. The CYFD is in the process of restructuring to streamline and ensure quality is being delivered. Regional administrators, county office managers, and supervisors play an important part in developing quality services. The department is working within budget limitations to provide effective services. Supervisors provide supervision for case managers and work directly with families, children, and foster and adopted families and carry caseloads due to vacancies or absent workers. Supervisors have a critical duty to oversee decisions to protect and serve clients and coach and mentor staff. They also monitor cases and required to have frequent one-on-one supervision with staff to guide them in the decision-making process. County office managers (COMs) provide line supervision for supervisors, as well as backup due to vacancies, absences, or vacation and sick leave. County office managers provide leadership and collaboration with district court judges, training, mentoring, and coaching for supervisors. They are responsible for children, youth, and families served in their office and personally oversee complicated, complex, and high-risk cases and coordinate resources to ensure clients received needed services. County office managers also deal with recruitment, interviewing, and hiring of new staff. They seek and develop partnerships in communities to ensure a united response to ensuring child welfare. They also participate in multidisciplinary committees, groups, and partnerships to address human service needs. In addition, county office managers form part of the emergency management response team for communities they serve. Secretary Berumen-Deines noted New Mexico has failed both (CFSRs) in relation to the service array. For this reason, PSD does not see differential response as a viable option at this time.

Secretary Berumen-Deines explained that critical incident reviews (CIRs) are used in a different manner than they are used in other states. CIRs are used to determine the liability of the agency. Quality assurance reviews are used to determine quality improvement issues. Streamlining of management and utilization of program deputies will provide an opportunity to continue to assess and evaluate problems. Secretary Berumen-Deines said she does not totally disagree with differentiating staff training. More intensive training is needed based on the position that each

employee is hired to fill. However, education differentiation needs to be considered. In addition, more educated staff participating in core training brings learning to new staff that does not have the same level of education. Core training is essential for all new staff.

Vice Chairman Varela asked how critical CIRs are for providing general high-level information to the policymakers. Mr. Weinberg said it is an important piece of an overall strategy. In any given year, there are 10 to 12 incidents that are serious enough to warrant a CIR. The LFC was not able to provide information on systemic issues that get identified over time. Secretary Berumen-Deines added the CYFD counsel advised that, if CIRs are shared with LFC, the department is risking attorney/client privilege, creating additional liability for the department. Mr. Weinberg noted other states redact confidential information and release high-level findings. Mr. Sallee added legislation allowing confidential information to be shared across both branches of government has twice passed but has been vetoed. The reports requested from the CYFD are part of its quality assurance system and are intended to assist the department in identifying problems and improve. There is no indication in any of the department's rules, regulations, or internal procedures that the reports were subject to attorney/client privilege. In February 2011, CYFD changed internal procedures to claim attorney/client privilege for these reports. Secretary Berumen-Deines noted the policy was changed because of internal procedures and internal findings but recognizes the need for oversight. Vice Chairman Varela requested information on neglect and abuse between biological, foster, and adoptive parents. Secretary Berumen-Deines said the preponderance of cases is of children in biological families. Foster and adoptive neglect and abuse have been reduced to a minimal level. In response to Representative Sandoval, Secretary Berumen-Deines said the department has updated its safety risk tool to assess the safety of the environment for children; however, decisions to return children to biological families are not made solely by the CYFD. The final decision is made by the court. Best practice recommends reunification whenever possible. Representative Larranaga questioned the recommended caseworker to supervisor ratio of five-to-one. Mr. Weinberg indicated that at the current vacancy rate, New Mexico has 3.65 caseworkers per supervisor, and fully staffed, the state's ratio will be 4-to-1. Secretary Berumen-Deines indicated these staffing levels were necessary given the rural nature of the state, where some counties have only one caseworker.

## **Miscellaneous Business**

### **Action Items**

*Approval of LFC Minutes -- May 2011.* **Senator Cisneros moved to approve the May 2011 LFC meeting minutes, seconded by Senator Leavell. Motion carried.**

*Contract Approval.* Director Abbey recommended four contracts for FY12 for specialized services. Contracts are the same for the current year. Director Abbey noted that contracts over \$10 thousand require committee approval. **Senator Cisneros moved to approve the recommended contracts for FY12, seconded by Representative Larrañaga. Motion carried.**

### **Information Items**

#### ***Review of Monthly Financial Reports***

*June 2011 ARRA Government Services Status Report.* Director Abbey reported the governor still has \$2 million available for allocation. The governor is allocating funding for two months for the Supplemental Nutrition Assistance Program with the expectation that it will be covered in special session. All funding has to be expended by September 30, 2011.

Director Abbey referred members to the May 2011 Cash Balance Report, May 2011 BAR Report, the FY11 and FY12 LFC Budget Status, and the June 2011 Full-Time Employees by Agency for information.

*LFC Program Evaluation Status Report.* Mr. Sallee said program evaluation staff is working on a report on state efforts to combat healthcare fraud and abuse that includes the Medicaid program administered by Human Services Department (HSD), as well as the Medicaid Fraud Control Unit to present in July. Staff will present a report on the University of New Mexico (UNM), Health Science Center financing and state public financing in August. Staff will also begin work on a joint project with the Legislative Education Study Committee (LESC) to present to both committees in November. Staff is currently working on review of community colleges with a major emphasis on dual credit. Another project for consideration is the health care tax policy. Program evaluation staff will also provide a progress report on the state fair review and will begin taking a sample of capital outlay projects.

Rick May, secretary, Department of Finance and Administration (DFA), clarified that the executive administration did not use the word “hypocritical” in any statements made to the media regarding line-item vetoes in the General Appropriation Act (GAA) of 2012.

**Overview of Capital Outlay Process.** Linda Kehoe, principal analyst, Legislative Finance Committee (LFC), updated the committee on the 2011 post-session information regarding capacity and issues impacting certain projects. Following the failure of Senate Bill 218 and action by the State Board of Finance (BOF), the senior severance tax bond issuance for FY11 decreased from \$237.8 million to \$27.3 million. The issuance included \$26.5 million for water projects and \$800 thousand to the Department of Game and Fish. No policy or statute directs how unauthorized capacity should be addressed in the event a capital bill is not passed.

For FY12 bond capacity, two scenarios are possible: the first spreads the additional capacity evenly across 10 years, providing \$206 million in each year; the second doubles the issuance in FY12 to \$360 million and returns to the level of the December 2010 estimate in fiscal years thereafter. The unused sponge capacity at the end of FY11 will revert to the severance tax permanent fund. The failure of SB218 allowed an additional \$57 million in sponge capacity for public school construction, bringing total capacity for allocation by the Public School Capital Outlay Council to \$206.1 million.

Ms. Kehoe provided an overview of the significant difference between House and Senate versions of SB218. Significant differences were in LFC staff recommendations to fund road repairs and how the funds were reallocated by the executive and the Senate. In collaboration with the executive representative, the major Senate changes reduced and reallocated funds to complete critical projects statewide. The House Taxation and Revenue Committee (HTRC) made minor changes, but the House Appropriations and Finance Committee (HAFC) struck most Senate and House amendments, bringing the bill to nearly the introduced version. Ms. Kehoe expressed concern with delaying shovel-ready projects. Current market conditions and competition for work have driven down labor costs and profit margins, but it is difficult to predict how long it will last. While funding for a majority of projects recommended in SB218 may have to wait until 2012, LFC staff is concerned about projects near completion and waiting for final funds. Delaying projects could also have an impact on federal funds. Ms. Kehoe noted there is no funding left over to address any type of emergencies that may occur.

Rick May, secretary, Department of Finance and Administration (DFA), said the executive administration is very committed to improving and implementing changes to use tax payers money

more wisely. Secretary May said capital outlay is an ongoing process and is not prepared to give a specific set of recommendations at this time. The DFA recently participated in an internal reorganization in which the Capital Outlay Bureau was moved away from the Local Government Division and into the State Budget Division. After the various reductions of capital outlay, the Legislature appropriated \$2.6 billion in capital outlay funds for 1,525 projects. There is currently \$1.1 billion outstanding. The DFA and the previous administration undertook major improvements within the grant contract process of how local governments and nonprofit entities receive funding. Secretary May noted New Mexico's capital outlay process is reviewed by outside groups and is usually at the bottom of the list. Too many projects throughout the state stand idle or are incomplete.

The executive identified 14 basic principles for the capital outlay process, including developing a system for prioritizing projects, identifying criteria for selecting high priority projects, and ensuring funded projects go through a prioritization process. The DFA's goal is to provide policymakers with a grand list of high-priority statewide projects and high priority local government projects that have gone through a review process.

In response to Senator Cisneros, Secretary May said the loss of potential federal funds is a systemic problem throughout state government and local government. Edwynn L. Burckle, secretary, General Services Department (GSD), said the department is working with the Property Control Division to compile a list of capital projects using two principles of criteria: health and safety and matching federal funds. Senator Cisneros also expressed concern with unexpended balances. Secretary May said capital outlay expenditures are required to be expended within three years. Ms. Kehoe clarified that major projects to plan, design, and construction are given four years for completion. The purchase of furniture, equipment, vehicles, etc., have a reversion period of two years. LFC staff will provide an update of all outstanding capital projects, including those for \$1 million or greater, at the LFC hearing in August. It is expected that a significant amount of money will revert on June 30. Secretary May said of the 1,525 projects in the system, it is projected that 386 projects will revert.

Representative King expressed concern with the tracking system for capital outlay and its inefficiencies. Secretary May said that the record keeping has been greatly improved over the last few years. Speaker Lujan added that major strides have been made in addressing capital outlay.

### **Thursday, June 16**

The following members were present on Thursday, June 16: 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, Carroll Leavell, Linda M. Lopez (for John M. Sapien), Mary Kay Papen, Pete Campos, Carlos Cisneros, and Sander Rue (for Stuart Ingle). Representative Rhonda S. King attended as a guest.

### **Various Lower Rio Grande Issues and Water Trust Board Update**

Agreement between Elephant Butte Irrigation District and El Paso Water Improvement District #1. Estevan Lopez, director, Interstate Stream Commission, reported the project comprises dams, the diversion structures along the river, canals distributing water to farmers, and drains that return water back into the river. The project was built in 1906 by the federal agency that later became the U.S. Bureau of Reclamation (bureau). The project stores water in Elephant Butte Reservoir and delivers surface water to parties in the United States and Mexico. Mr. Lopez noted Mexico receives up to 60 thousand acre-feet a year under the 1907 treaty between the United States and Mexico. Up until the

early 1980s, the bureau ran the entire project as a single system. In the early 1980s, title to the canals and drains was transferred to the districts. In the early 1990s, the bureau handed over responsibilities for measuring and metering water diversions to the districts. Disagreements developed between the districts and the bureau over project operations. To resolve arguments, several operating agreements were proposed. There were also several lawsuits filed between the districts and the bureau, as well as threats of litigation over the quality and quantity of water from Texas against New Mexico. The state of New Mexico, through the Attorney General's Office, State Engineer, Interstate Stream Commission, and the Environment Department, aggressively addressed the water quality allegation and indicated a willingness to discuss the water quality issue. New Mexico was able to demonstrate that any deteriorating water quality was not a result of irrigation practices but rather natural upflows of salt water at various points.

In 2007, as a result of ongoing disputes, the bureau unilaterally implemented new operating procedures for the project. In February 2008, the two districts and the bureau announced an operating agreement and began work on an operating manual that would implement the agreement. Mr. Lopez noted that negotiations were confidential and New Mexico was not involved.

The operating agreement changed the allocation method. The El Paso (EP1) district's allocation increased and the Elephant Butte Irrigation District (EBID) allocation was reduced. Districts also received a carryover diversion account. From 2008 to 2010, the reduction to EBID's allocation has decreased from 150 thousand acre-feet a year to 190 thousand acre-feet a year. Over the same period, EP1's (Texas district) allocations increased by 140 thousand acre-feet a year to almost 180 thousand acre-feet a year. As of the end of May 2011, EBID's allocation was 56 acre-feet and EP1's allocation was over 250 thousand acre-feet. The reallocation from EBID to EP1 is significantly more than any impacts due to New Mexico groundwater pumping. Further impact of the reduction in surface water allocation is causing farmers to pump large amounts of groundwater. The EBID is paying for all groundwater pumping including any groundwater pumping in Texas. EP1 needs to pay for all Texas pumping effects to the Rio Grande Project. At the end of the water year, Texas had a carryover amount of 220 thousand acre-feet and New Mexico had a carryover of 24 thousand acre-feet. In addition, documentation does not reflect agreements. A number of parties are recording data, and it is often not reproducible. The bureau was obligated to conduct a technical analysis of the potential impacts of the operating agreement.

At the beginning of the year, New Mexico had a credit of 165 thousand acre-feet. Given that the water levels in Elephant Butte and other reservoirs were low, a restriction was placed on storage of post-compact reservoirs upstream. The EBID requested through the Texas Rio Grande Compact Commissioner relinquishment of 180 thousand acre-feet from accrued New Mexico credit water. The State Engineer offered an alternative and it was refused by the EBID and Texas. Mr. Lopez noted it is very important that continued relinquishments are not used to prop up the unsustainable and inequitable operating agreement.

Representative Larrañaga asked why New Mexico did not get involved in the operating agreement in 2008. Mr. Lopez clarified that the bureau remained involved because they controlled storage water of the dams and the releases of the dams, as well as the diversion structures along the river. New Mexico has been meeting with the Bureau of Reclamation and has reached agreement with Texas to have a third-party conduct a sensitivity analysis for pumping water on both sides of the state line. The Legislature appropriated \$1.5 million for litigation for interstate issues. Without the appropriation, New Mexico was unsuccessful in getting the bureau to respond. Vice Chairman Varela asked if there were any issues relating to delivery of water from Colorado. Mr. Lopez said the impact on Colorado are far less than to New Mexico; however, Colorado officials have concerns

with evaporation issues. Senator Leavell expressed concern with Texas not having regulations on groundwater and asked if there was any consideration for negotiations on groundwater issues. John D'Antonio, state engineer, Office of the State Engineer, responded that there are no groundwater compacts between Texas and New Mexico.

Status of Lower Rio Grande Adjudication Process. John D'Antonio, state engineer, Office of the State Engineer (OSE), reported adjudication statutes within New Mexico consider the State Engineer a technical expert and a neutral part of the courts. Mr. D'Antonio said the purpose of litigation and adjudication for the program is to obtain judicial determination on the definition of water rights within each stream system and underground basin to technically perform water rights administration and meet interstate stream obligations. Currently there are 12 active adjudications throughout the state. The agency currently is experiencing a shortfall of over \$700 thousand in the litigation adjudication program and anticipates a \$560 thousand shortfall next fiscal year. OSE was informed that the amount received from the water trust fund after FY12 will be less than \$320 thousand as investment balances have declined below the statutory threshold. Mr. D'Antonio noted there is currently a 27 percent vacancy factor within the Litigation and Adjudication Program.

Proceedings in the Lower Rio Grande Stream adjudication are currently focused on five separate stream system issues:

- Irrigation water requirements;
- The EBID's claim to a groundwater right from five deep wells on 90,640 acres of member lands;
- Priority, transferability, and beneficial use of water from domestic wells;
- Interests of the United States deriving from the establishment of the Rio Grande project; and
- Expedited *inter se* on the claims of the estate of Nathan Boyd.

Update on Status of Water Trust Board Allocations. Rick Martinez, chief of Client Services, New Mexico Finance Authority (NMFA), reported the Water Trust Board receives \$80 million to \$100 million of requests on an annual basis. The Water Trust Board is charged with prioritizing projects for recommendation to the Legislature for financing from the Water Project Fund. In addition, the board is charged with adopting rules and regulations governing the terms and conditions of grants or loans made from the Water Project Fund. Mr. Martinez noted that there is a loan component, as well as a hardship waiver through the project fund to ensure solvency of the fund.

The Water Trust Board receives an annual distribution from the Water Project Fund; 10 percent of funds are used for water rights adjudication. The board works with the acequia project fund created in 2004 to provide grant funding to legislatively authorized acequia projects. The acequia fund projects are prioritized by the Water Trust Board for recommendation to the Legislature and funding by NMFA. By statute, the Water Trust Board 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.

Priority projects are those that are shovel-ready; have water rights, funding and design requirements in place at the time of award; serve a region and share services to achieve operating efficiencies, projects that leverage state funding with local and federal funds, and urgent projects. Policies require minimum contributions from all applicants in the form of matching funds and a mandatory loan

component of between 10 percent and 20 percent for all entities supported by a rate-paying constituency. The water project fund currently has \$225,978,887. Of that, \$164,011,095 is under contract. Mr. Martinez noted the Water Trust Board currently has two vacancies.

The committee recognized Mark Weber, principal analyst, LFC, for his dedication to the LFC and to state government.

**Educational Retirement Board Refund Status Report.** Jan Goodwin, executive director, Educational Retirement Board (ERB), reported the ERB changed its interest calculation software for July 1, 2010. ERB staff noticed in July and August that interest calculations were higher than before. At the end of August 2010, the extent of the problem was realized and the interest processing for refunds was shut down. During the intervening months, several high-level staff agreed to recalculate all refunds for July and August and issue people additional monies or work to get overpayments back. In mid-September, the ERB had a retreat to discuss overpayments, as well as the halting of refunds plus interest. The ERB began issued contribution refunds in September and proceeded through early December. Beginning in early December, all interest calculation refunds, as well as regular refunds, were reprocessed. Vice Chairman asked if there was follow-up when the problem was discovered in September. Ms. Goodwin said there was no follow up at that time.

Ms. Goodwin explained that regular retirees do not receive interest. The people who do receive interest fall into three groups: members who terminate ERB employment, beneficiaries of active members, and some beneficiaries of retirees. Chairman Smith asked if there was a reason why information was kept from the Legislature. Ms. Goodwin explained that it was not a deliberate action. Chairman Smith expressed a high degree of frustration with the way the situation was handled and said active management and board members need to accept responsibility. Ms. Goodwin said she contacted Mr. Abbey in late April to meet with him regarding the situation.

Mr. Goodwin said even though there are refunds of employee contributions, employer contributions made on behalf of those members always stayed with the fund, regardless of whether or not the member was vested. Prior to July 1, 2010, the interest rate in effect was declared by the board and applied to all contributions. After July 1, 2010, the interest rate for that fiscal year was applied for each period funds were deposited. The interest rate for the period of deposit was applied to the entire time on deposit; contributions made in the early 1980s were double digit. Recalculation of all July and August interest payments were not done on a timely basis.

The ERB sent out preliminary letters to all recipients affected and is recalculating all July and August checks. Calculations have been reviewed by Moss Adams, independent auditor, who agreed with the new calculations. The total amount of overpayments is \$1,690,139.85. the ERB's executive director and deputy director personally called all recipients who received an overpayment of greater than \$1 thousand. In addition, packets were sent out to recipients describing the original calculation of error, details of the corrected calculation, the balance of interest owed to The ERB, and tax information. The ERB is asking those who received an underpayment if they want to roll payment over to another retirement account or consider it an alternative distribution. A large proportion of the amounts were for less than \$1 thousand; 188 were more than \$1 thousand. Approximately 80 percent of the total overpayments were rollover by another retirement account.

Since the end of April, the ERB has discovered additional issues with the interest calculation software. Compounding was not done correctly and should be done on a quarterly basis. The interest paid-through date was not being entered correctly and there were issues with contributions eligible for interest. The ERB has recalculated 1,300 checks processed since December; 1,053 were

underpayment, 244 were overpayments, and three had no change. Ms. Goodwin noted the largest overpayment was for \$59.62.

The interest calculation software has been completely fixed and was up and running on May 20, 2011. Both actuaries and auditors agree with the calculations. Since May 20, the ERB issued a total of 360 refunds. The ERB's goal is to issue all refunds within four weeks of application. Every software change in the future will have a senior sponsor in the department sign off. The software will have to be documented and have a plain English translation. As backup, the relevant statute or rule driving the software change will be updated. Software implementation and testing will be also be improved to become more rigorous. In addition, staff concerns will be addressed.

In response to Chairman Smith, Ms. Goodwin said the new governor was informed about the situation in April 2011. The prior governor was not aware of the situation. Senator Cisneros asked why the outgoing and incoming governors were not notified of the situation if the board was aware in September. Ms. Goodwin said she was under the impression that the problem was being taken care of by staff. In response to Senator Cisneros, Ms. Goodwin said the contractor that developed the pension software was selected through a contract. Senator Cisneros asked if the contractor was liable for discrepancies or inaccuracies of their software. Ms. Goodwin said she did not know. The general counsel for the ERB added that the information technology staff and the manager overseeing the project signed off on specifications.

Vice Chairman Varela asked what the basis is for recovering funds. The ERB general counsel responded that the ERB is subject to Internal Revenue Code provisions. The Internal Revenue Code requires recovery of overpayment plus interest on the overpayment.

**3<sup>rd</sup> Quarter Performance and Accountability Reports from Key Agencies.** David Lucero, principal analyst, Legislative Finance Committee (LFC), reported FY11 marks the 12th year of Accountability in Government Act (AGA). Performance-based budgeting played an important role in making government more accountable and effective. Over the last three years, as economic conditions deteriorated, performance data in quarterly and annual performance helped analysts prepare budget recommendations. Prior to the AGA, agencies and the Legislature were saddled with 10 or sometimes 11 budget categories or line items and multiple divisions within agency. After enactment of the AGA, performance shifted to focus on agency achievement. Relying on accurate and timely information is required to achieve the focus from line-item budgeting to performance-based budgeting. Mr. Lucero noted that prior to performance-based budgeting, duplicate and parallel performances contributed to a lack of focus on the AGA for some agencies. The result as seen in some agencies is a lack of coherent strategic plan, outdated organizational structures, and weak performance measures, especially cost-effective outcome measures.

Beginning this year, LFC staff made recommendations on report cards to include suggested areas of improvement, as well as a checklist for good performance measures. LFC staff would like to see more widespread use of performance outcomes benchmarked to national data, development of corrective action plans, and a strong link between the strategic plan, management processes, and the budget.

Charles Sallee, deputy director, LFC, said LFC staff evaluated agency quarterly reports and worked with agency staff to prepare report cards. Overall, quarterly reports provided a thoughtful opportunity for strategic planning discussions with agency staff.

*Education* - Over the last decade, ensuring every classroom has a highly qualified teacher combined

with a three-tier evaluation. High school graduation rates increased from 60 percent to 67 percent. The number of schools failing to make adequate yearly progress (AYP) is increasing, informing policy choices to develop a new grading system.

*Health and Human Services* – The Children, Youth and Families Department (CYFD), had a specific focus in collaboration with policymakers to improve the quality of child care in the state and has made tremendous progress to ensure children are in higher quality daycare centers. Despite the hiring freeze and three years of budget reductions, many of the most critical social services experienced surging enrollments without a substantial increase in the number of backlogged cases. Non-critical health functions experienced longer turnaround times.

*Natural Resources* – A high level snapshot indicates New Mexico’s natural resource agencies have been able to meet federal mandates for water delivery requirements on the Pecos and Rio Grande rivers. Water well and new septic tank inspections met or exceeded targeted levels. The percent of retail electricity from renewable energy sources is increasing. State park attendance is expected to achieve targeted levels. However, information provided by agencies is insufficient to determine whether environment resources within the state are improving.

*Public Safety* – The Corrections Department experienced a slight uptick in the number of inmate-on-inmate and inmate-on-staff assaults in the third quarter compared with previous quarters. Over the last decade, there has been a significant effort on the part of the Corrections Department to ensure facilities are safe. However, re-incarceration and recidivism rates increased compared with the previous year. The turnover rate of correction officers is down from a year ago. The Department of Public Safety reports a decrease in the number of fatal crashes. Increased enforcement resulted in more administrative citations for selling or giving alcohol to a minor.

*Oversight and Other Agencies* – Analysts continue to work with agency staff to identify meaningful measures for many of the oversight agencies. There is opportunity to re-assess the quality of agency strategic plans, the process of identifying agency mission, goals and measures, and the veracity of the data that has been collected entering into the second decade of the AGA. Given that the executive and state agencies have had a number of years to acquaint themselves with the performance-based budgeting approach, incremental improvements should no longer be considered acceptable. Measures and outcomes contained in quarterly reports should reflect that the executive and state agencies fully accept the critical importance of this activity to their mission.

Mr. Sallee and Mr. Lucero provided specific examples of agency report cards.

Rick May, secretary, Department of Finance and Administration (DFA), expressed concern with the current way performance and measures are used and said cabinet secretaries do not feel invested with current measures. The concept for performance-based budgeting is good; however, performance measures were not used in developing the executive budget. Secretary May also expressed concern with whether or not the current system provides appropriate data. Cabinet secretaries also expressed that there are too many performance measures. Duffy Rodriguez, deputy director, Budget and Policy Division, DFA, added that there is a lack of a relationship between managers and funding due to reductions.

Lupe Martinez, secretary, Corrections Department, said the definition of what is reported is not necessarily consistent with information.

Gordon Eden, Jr., secretary, Department of Public Safety (DPS), expressed concern with current

performance measures for the department. The DPS is in the process of developing better and more accurate performance measures.

Gene Moser, director, State Personnel Office (SPO), expressed concern with current standards that do not necessarily apply. Measures are needed to report success of the agency. Current measurements are not meaningful and do not reflect problematic areas.

Renada Perry-Galon, director, Administrative Services Division, Children, Youth and Families Department (CYFD), said there is always an issue with the availability of data. In addition, there is confusion with the alignment of measures with the GAA.

Danny Earp, New Mexico Independent Community Colleges, said higher education has struggled with the process because the cycle of work does not fit into quarterly and annual reporting. Mr. Earp expressed concern with the grading of the quarterly reporting process and causing an unattended effect on an agency or institution. Secretary May added that the proposed funding formula for higher education is based more on a performance-based process.

Daniel Lopez, president, New Mexico Institute of Mining and Technology, said efforts are abandoned when the focus is on technique and the culture does not change. Without the process of engaging students, no amount of measurement will make a difference.

Sidonie Squier, secretary, Human Services Department (HSD), said the department is looking for better outcome measures. Brent Earnest, deputy director, HSD, provided information related directly to programs at the HSD.

### **Spotlight on Select 3<sup>rd</sup> Quarter Agency Performance Reports.**

Sidonie Squier, secretary, Human Services Department (HSD), said that more than one in three people in the state are touched by programs in the HSD. The Supplemental Nutrition Assistance Program (SNAP) caseloads are up 36 percent since 2008 and Medicaid is up 20 percent. Clients are being enrolled in Medicaid in record numbers. Secretary Squier noted the HSD is expected to meet the target for children receiving annual checkups.

The HSD is not meeting Temporary Assistance for Needy Families (TANF) federal work participation rates. The main goal of the TANF program is and should be getting people ready to move back into the workforce. The HSD also is challenged with meeting federal rates for the number of clients exempted from work participation in state statute.

In the behavioral health program, clients in substance abuse treatment are showing improvement. The department is working with the behavioral collaborative to incorporate measures.

Child support enforcement is on track to set a record for collections. The department has more cases with support orders, which will lead to higher collections.

Edwynn L. Burckle, secretary, General Services Department (GSD), said the department consolidated three divisions: Transportation, Property Control, and Building Services. In early 2011, the Risk Management Division (RMD) had approximately \$5 million in property claims. The RMD is currently paying approximately \$4 million per quarter in unemployment compensation claims.

Secretary Burckle provided information regarding FY13 strategic initiatives. The GSD is committed

to working with clients through the Property Control Division to develop a master plan for capital planning. The state is responsible for 750 state-owned facilities; 50 percent of facilities are greater than 40 years old. Facility management is closely tied to capital planning and is referred to repairing and maintaining state-owned facilities in the Santa Fe area. The GSD is responsible for 323 property leases totaling \$42.5 million per year. The department is committed to identifying a solution to better use state-owned and leased office space. In addition, the GSD will develop guidelines for all new leases. The GSD will lead a statewide taskforce to develop procurement reform. Currently, there is a lack of statewide consistency in professional services contracts, as well as an unknown number of emergency and sole-source procurements. In addition, the state lacks an electronic procurement management system and consistent "best value" evaluation factors for awarding construction contracts. Finally, unemployment compensation is problematic. The state lacks an automated system for sharing information among departments. The RMD will work with the Workforce Solutions Department (WSD) on an integrated system. The RMD is also working to improve the delivery of employee health benefits and is working with the Interagency Benefits Advisory Committee (IBAC).

In response to Representative White, Secretary May said many current performance measures need to be improved through a collaborative effort. Representative King said in terms of the procurement code, it is important to have oversight of the audit process as part of the taskforce.

**Quarterly Investment Performance Report.** Leila Burrows, economist, LFC, reported on the third quarter investment performance report. Including investment returns, contributions and distributions, the state's aggregate fund value gained \$1.2 billion for the quarter and over \$3.6 billion for the 12 months ending March 31. As of March 31, total fund value stands at \$36.3 billion.

All funds achieved quarterly and one-year results above the 60/40 equity index. All asset classes for all funds were positive except for a slight negative return for economically targeted investments (ETIs) in the severance tax permanent fund. The State Investment Council (SIC) included private equity and credit strategies as they recover value. The PERA's managers had success with the small and mid-cap domestic equity, fixed income and hedge funds. For the first time in several quarters, the ERB's managers did not add value net of fees. However, the ERB remains the only fund to beat both the 60/40 index and internal benchmarks for the quarter, one-year and five-year periods.

Peer rankings were mixed, with the ERB slipping in its longer standings due to its lower allocation to equities than peers during the bull market. ERB and PERA funds fell in the bottom half of their respective peer groups for the one-year period. The PERA moved from the 95th percentile to the 99th for the five-year period over the last quarter.

Both permanent funds ranked in the top decile for the second consecutive quarter and in the top half of their respective peer group for the one-year period. Their five-year standings have improved since the second quarter.

Third-quarter gains continued to help restore fund balances devastated by the 2008-2009 market collapse. Aggregate fund value increased 11 percent since last year. The ERB saw an increase of \$263 million for the first quarter of FY11 and is closing with a high of \$9.6 billion. PERA increased its total assets by over \$400 million bringing its high of \$13.5 billion. Permanent funds added \$1.3 billion in the 12-month period, which included a distribution of \$763 million.

Quarter returns for all funds ranges from 3.8 percent for the ERB to the high of 5.5 percent for the severance tax permanent fund. All funds except for the ERB beat the 60/40 index for the five-year

period, which included the 2008-2009 market collapse. The land grant permanent fund and the severance tax permanent fund continue to lag behind their benchmarks for the one-year period by 170 basis points (bps) and 270 bps, respectively. However, this underperformance might be understated as their internal benchmark requests a higher allocation to domestic equities. The SIC intends to reduce exposure to domestic equities in response to the volatility experienced during the market collapse. The ERB continues to be the only fund to demonstrate consistent outperformance over all three time periods. The PERA outperformed its benchmark for the quarter and the year but fell short in the long-term.

PERA funds fell into the bottom half of peer groups for the one-year period. The permanent funds maintained their high quarterly ranking with the severance tax permanent fund improving from the 10th to the 6th percentile. The land grant permanent fund remained at the 10th percentile for the second consecutive quarter. The PERA remains stuck in the bottom 10 percent for the five-year period comparison and is unable to overcome impacts from poor past manager underperformance that contributed to the fund's decline of \$4.2 billion during FY08-FY09.

The ERB's and PERA's overweight to domestic equities helped to explain the over-performance of the pension funds for the quarter and one-year periods. In contrast, the permanent funds underweighed equity targets.

The ERB's lower allocation to equities continues to detract from performance, resulting in a negative policy impact of 120 bps for the quarter and 240 bps for the year ending March 31. The permanent funds higher allocation to domestic equities added 220 bps of performance to the land grant permanent fund for the quarter and 360 bps for the year. Active management plagued the SIC funds, although the agency notes it has been firing underperforming managers since April 2010.

Allocation impacts reflect any deviation from the target asset allocations and how it affects performance. Much of the allocation impact for the quarter is explained by over-weighting and under-weighting domestic equities. The SIC performance is slightly offset by the fixed income allocation impact of 20 bps for the year. The PERA's over-performance for the quarter of domestic equities was undercut by a reduced allocation. The ERB's allocation impact is particularly robust for the quarter and the five-year periods.

Longer-term returns remain below the targets of 8 percent for pension plans and 8.5 percent for permanent funds. The SIC plans to review its target returns to determine if a lower target is more appropriate.

Representative White requested information regarding a state-by-state comparison for pension funds. Senator Leavell requested information on international equity.

### **Friday, June 17**

The following members were present on Friday, June 17: Chairman John Arthur Smith, Vice Chairman Luciano "Lucky" Varela, Representatives Don Tripp, William "Bill" J. Gray, James P. White, Edward C. Sandoval, Rhonda S. King, Larry A. Larrañaga, and Henry "Kiki" Saavedra; and Senators Sue Wilson Beffort, Carroll Leavell, John M. Sapien, Mary Kay Papan, Pete Campos, Carlos Cisneros, and Sander Rue (for Stuart Ingle). Representatives Nick Salazar and Rick Miera attended as guests.

Chairman Smith provided opening remarks and expressed concern with the funding formula being

too complex and not sustaining excellence in the higher education system.

### **Higher Education Funding: State Lessons on Funding to Outcomes**

Chairman Smith started the hearing noting that the current higher education funding formula is complicated and should be simplified. He also recognized that, during these budget times, the higher education community should evaluate potential savings, including reducing facilities and facilities' costs.

*New Mexico Higher Education Funding Task Force.* José Z. Garcia, secretary for the Higher Education Department (HED), stated that the department's efforts on the funding formula reflect prior LFC analysis and recommendations, particularly a move towards incentivizing improved institutional performance. The secretary summarized an HED-sponsored meeting hosted by the Western Interstate Commission for Higher Education (WICHE) on the state funding formula and how the funding formula could be changed to fund outcomes and address the state's workforce needs. The HED is engaged in a dialogue with the Workforce Solutions Department (WSD), Economic Development Department (EDD), Public Education Department (PED), and private employers and others in the private sector to develop a consensus workforce projection. The department is developing recommendations for particular measures that will address the student achievement gap in higher education. The secretary anticipates these efforts will result in incentives to be included in a new formula.

In response to the chairman's comments, the secretary reported on the agreement reached between the governor and college and university presidents that establishes a moratorium on new campus construction. Exceptions to the moratorium include projects already approved by the HED, construction that is renovating or replacing existing facilities (not increasing formula-funded square feet), and facilities built with funding other than state general funds. The department is working on other important policy issues, including reviewing the dual credit program.

Curtis Porter, chairman, Higher Education Funding Task Force (task force) and associate vice president of budget, planning and analysis at the University of New Mexico (UNM), updated the LFC on the task force's process for developing a new funding formula by the legislated October 15, 2011, deadline. The task force includes representatives from several institutions and groups and meets monthly, with topic-specific committees meeting more regularly. To date, the task force has agreed on a conceptual framework for the new funding formula, which includes two important changes: changing from an enrollment-based formula to an outputs-based one and including a funding component connected to outcome measures. Due to limited staffing resources, the HED will not run the current formula (with updated data) for FY2013, but elements of the current formula are present in the conceptual formula being considered.

The conceptual formula will continue to be run as a "base-plus" formula, meaning the last appropriation year (FY2012) will be the "base" and additional funding or adjustments within the base year funding will be the "plus." The new formula will be simplified by making the following changes: modifying the current workload grid by reducing the emphasis on enrollment of student credit hours and recognizing course completion; incorporating an amount for student services into the workload grid and eliminating a separate student services line item; and incorporating the base amount for equipment renewal and replacement (ER&R), building renovation and replacement (BR&R), and 3 percent scholarships into the base and eliminating this separate formula calculation. The task force recommends a "marginal student cost" percentage be applied to the workload grid or components with the grid, but this cost or percentage needs to be determined. The formula will likely

include a line for plant and facility operation and maintenance and utilities, instead of having multiple calculations and formula line items. A technical adjustment to the base (FY12) amount is being considered and may be proposed in October.

There is universal agreement that outcomes-based funding should reflect the different institutional missions (research, comprehensive, and community colleges); whether this is recognized in one formula or three formulas will be determined. The institutional sectors are developing outcome measures for the task force's consideration, and the HED is developing measures related to workforce needs and closing the achievement gap.

There is no agreement at this time on how to consider non-general fund revenues or revenue credits. The task force is considering a recommendation eliminate the complex revenue credit calculations and instead determine a state-level of support (percentage) for each sector based on percentages of total institutional instruction and general expenditures, and have the institutions support the remaining percentage of expenditures with institution-generated revenues. This recommendation means that tuition, mill levy, and permanent fund amounts would not be calculated separately under the new formula.

*State Funding Formulas that Incorporate Outcome Measures.* David Longanecker, president of WICHE, shared information from the HED-sponsored meeting that focused on New Mexico's current state of higher education attainment, workforce needs, and funding levels. Importantly, New Mexico is third from the bottom in its share of young adult population with a college education. Relatedly, New Mexico is relatively low in personal income and educational levels; only seven counties in New Mexico have personal income above \$30 thousand. Without addressing the education-attainment gap between younger and older workers, the state will not sustain its current per capita income levels and will continue to fall behind other states' levels.

Mr. Longanecker provided information on the percent of adults with an associate degree or higher by age group. New Mexico's best education population ranges from age 55 to 64, largely resulting from significant migration to the state during the 1950s and 1960s. When compared to national averages and highest-achieving states, New Mexico fails its students at every transition point along the educational pipeline. Only Colorado has a larger equity gap than New Mexico in educational attainment of white, non-Hispanic and minority (largely Hispanic) students. The state's lower educational levels suggest that, in 2018, 58 percent of potential jobs in New Mexico will require a college degree, meaning that approximately 58 thousand more individuals will require some post-secondary education.

Comparing state support for universities and colleges across the nation, Mr. Longanecker reported that New Mexico's research universities receive average-levels of funding, comprehensive universities receive above-average in funding, and community colleges receive slightly above-average funding. High state-support reflects lower institutional reliance on tuition revenue. And, while tuition revenues could increase, the state is limited in other ways to raise support for higher education. Mr. Longanecker recommended that (1) the state seek increased institutional performance given the average and above-average levels of state appropriations and (2) integrating state policies on state appropriations, tuition, and financial aid to target limited state resources towards educational attainment. He supported the task force's approach towards performance-base funding.

*Institutional Perspectives on Connecting Funding and Outcomes.* Daniel Lopez, president, New Mexico Institute of Mining and Technology (NMIMT), said the current formula is good; however, it was designed for another environment and another financial condition of the state. A base cost-study

was never done and so there is little information to determine the cost to put a student through the system. Higher education institutions have had six budget reductions over the last four years, averaging \$41 million a year and totaling \$164 million; more than 90 percent of reductions were from four-year institutions. In the context of budget reductions, Mr. Lopez reported it is difficult to retain faculty, and that, at NMIMT alone, 36 percent of the faculty are actively seeking other employment outside the state.

Mr. Lopez noted his reservations about performance-based funding, stating there is a mixed record of success where states have attempted it. While performance-base budgeting can improve the delineation of state and institutional priorities, enhance transparency and accountability, and increase productivity, performance-base budgeting only shows a small picture of institutions' contributions. Where the formula changes would include performance outcomes, Mr. Lopez recommends different outcomes for different types of institutions. He requested that the state consider a transition period if performance-base funding is included in formula revisions.

Steve McCleery, president, New Mexico Junior College, noted that two-year schools agree with considering student success in the formula, where success includes recognizing student progress particularly with at-risk students. Community colleges could support the concept of including a marginal cost of education, though more details are needed. The state public policy for higher education is very gray. Like the four-year institutions, two-year colleges would like to see the formula changes phased in over time to avoid unintended swings in funding and to gather data to measure outcomes. Community college leaders are concerned with using FY12 as a base, without a technical adjustment. In FY12, many policy decisions were made with respect to funding remedial education, certain tuition waivers, and dual credits – and memorializing these changes in a base for FY13 is troublesome. The community colleges generally would prefer one funding formula with sector variations for the outcome-funding component of the formula. Mr. McCleery noted at some point, dialogue has to start focusing on a statewide plan and policy for higher education and institutional and student success stories.

Tracy Hartzler-Toon, fiscal analyst, LFC, echoed the chairman's comments that the current formula is complex and the task force is working to simplify it and incorporate the LFC's recommendations to incentivize outcomes measures. While institutions have different missions, revenue sources, and student populations, there is a commitment by task force participants and apparently by institutions to have outcome measures that reflect distinct institutional missions and student populations and simplify how the formula recognizes institutional revenues.

Representative Larrañaga asked panelists about how or whether the formula changes could address student performance. Mr. Lopez stated that, because many students enroll in colleges and universities with insufficient preparation to perform at the college level, it would be appropriate to focus on improving student preparation in high schools. Noting other states' policies and funding incentives, Mr. Longanecker recommended changing the formula to pay institutions more for demonstrating success with students who come from at-risk backgrounds and including rewards in performance funding. Ms. Julia Fulghum, vice president for research and product development at the UNM, said students who are involved in research are more likely to graduate. This is a way that research universities can help student performance and expand New Mexico's economic base. She reported a number of ways UNM, and institution-based start-up companies, are benefitting students, faculty, the institution, and the local and state economy.

Senator Papen asked panelists what priorities should be funded under the new formula. Barbara Couture, president, New Mexico State University (NMSU), said restoring priority for investment in

the state's research universities would help the economy and improving faculty and staff compensation would help the research universities retain top talent. Ms. Fulghum commented further about research universities' benefits for attracting private and public funds. Senator Beffort asked whether the formula can improve pathways from high school to college. Mr. Longanecker noted the HED's efforts to address workforce issues and suggested that sector-outcome measures could include institutional incentives to improve teacher education while allowing the institutions to develop the best processes to achieve the outcomes.

Senator Papen requested that the LFC be provided with a monthly report on task force's progress. Chairman Smith supported this request.

With no further business, the committee adjourned at approximately 12:14 p.m.

  
Chairman

  
Date