

**Legislative Finance Committee  
Meeting Minutes  
Room 322 – State Capitol – Santa Fe, New Mexico  
November 15, 16, 17, 18, 2011**

**Tuesday, November 15**

The following members were present on Tuesday, November 15, 2011: Chairman John Arthur Smith, Vice Chairman Luciano “Lucky” Varela, Representatives Don Tripp, William “Bill” J. Gray, James P. White, Edward C. Sandoval, Rhonda King, Larry A. Larrañaga, and Henry “Kiki” Saavedra; and Senators Pete Campos, Carlos R. Cisneros, Steven Neville, Mary Kay Papen, Carroll H. Leavell, and John M. Sapien. Representative Nick L. Salazar attended as a guest.

The committee met in executive session until 9:20 a.m.

**State Engineer/Interstate Stream Commission (550)** – Scott Verhines, state engineer designee, gave background information on his career and introduced Estevan López, director, Interstate Stream Commission, who briefed the committee.

Overall, the request is \$1.2 million over the FY12 operating budget, an increase of 3.4 percent. The makeup of the budget request is \$14.6 million from the general fund, \$20.9 million in other transfers mostly from trust funds, about \$340 thousand from federal reserves, and \$681 thousand in other revenues for a total FY13 request of \$36.5 million. Expenditures under the salary and benefits category make up \$22.3 million, contractual services are \$7.8 million and \$6.4 million is spent under the “other” category. The agency has 52 vacancies.

Mr. López noted the OSE has relied more on the irrigation works construction fund as general fund appropriations have declined. Overall expenditures exceed total revenues in FY12 by approximately \$3 million and in FY13 through FY15 the number is expected to rise to \$5 million. Mr. López indicated if trends continue the fund will be depleted by FY16. The improvement to the Rio Grande income fund is healthy and increasing, however, with expenditures in FY12 around \$1.8 million.

By law, the OSE receives 10 percent of all water project funds, with 20 percent of this distribution forwarded to the Administrative Office of the Courts (AOC) for continued work on water adjudication. This year, the OSE received \$3 million and the AOC’s portion is about \$600 thousand. The Litigation Adjudication Program FY12 operating budget was almost \$3 million, leaving a revenue shortfall of about \$542,596. Mr. Lopez reported that this year, fund balance would be sufficient to cover the amount.

Annually, the OSE and the ISC are required to report the status of the Indian water rights settlement fund to the Interim Indian Affairs Committee and the LFC on three issues: The status of proposed Indian water rights settlements requiring state financing, the distribution of funds from the Indian water rights settlement fund to implement approved settlements, and

recommendations on appropriations to the fund necessary to timely implement Indian water rights settlements.

Three water rights settlements are pending. The Navajo Nation settlement, the settlement agreement with the pueblos of Nambé, Pojoaque, Tesuque, and San Ildefonso in the Aamodt adjudication, and the Taos Pueblo settlement in the Rio Pueblo de Taos/Rio Hondo adjudication. A settlement agreement was executed in 2005 or 2006 for each of these settlements, and Mr. López gave an overview of each one, noting copies of the settlement agreements can be found on the department's website.

Severance tax bonds (STB) issued in the amount of \$10 million have been allocated between the Navajo settlement and the Taos settlement. During the special session this year, the Legislature approved an additional \$15 million in STB authorization. The funding recommendation for the Indian water rights settlement fund is an additional \$15 million to fund the settlements for the next five years to complete the state's cost share.

Mr. López also briefed the committee on the status of the New Mexico unit fund, a nonreverting fund. Currently, the fund is empty. The ISC expects the first installment of \$6.6 million in January 2012.

Mr. López briefed Senator Neville on the Navajo settlement, saying there is organized opposition. D.L. Sanders, chief general counsel for the OSE, stated the agency is in the final step of finalizing the adjudication, adding that he expected a final decree by December 2013.

In response to a question from Representative Larrañaga, Mr. López stated a portion of San Juan/Chama rights is already available and water has been reallocated between the Taos and Aamodt settlements. The additional rights are from the Top of The World Farm, meaning that the reallocation is of an existing water right.

Discussion focused briefly on domestic wells with respect to the Bounds case currently in the New Mexico Appeals Court, which involves a claim against the State Engineer for allowing domestic wells without considering the possible impairment of senior water rights in a fully appropriated basin.

**Attorney General (305).** Attorney General Gary King began his presentation by highlighting agency accomplishments, referencing an article in the *Albuquerque Journal* about a successful Medicaid fraud case pursued by the Medicaid Fraud and Elder Abuse Division against a Las Cruces corporate provider and four defendants. Attorney General King said this case is significant because it is unusual for a corporation to be found guilty of a felony, and the corporation cannot provide Medicaid services again.

The Border Violence Division successfully convicted the first human trafficker under New Mexico statute. This division also works on money laundering and international extradition cases.

This last year, the Consumer Protection Division handled more than 20 thousand telephone calls, formally logged in almost 3 thousand written complaints and closed more than 3 thousand complaints, and recovered over \$3 million for consumers in FY11.

The Internet Crimes against Children subdivision has increased the number of felony ICAC prosecutions from four in 2007 to more than 22 felony prosecutions from August 2010 to 2011.

Attorney General King stated he had a written response for Chairman Smith regarding the status of criminal cases relating to the misappropriation of funds by the Region III Housing Authority, and during the discussion, gave Senator Papen a detailed timeline.

The NMAG's total budget request is \$17,648,900, a little less than a flat budget, minus a few special appropriations, Attorney General King said. The breakdown is about \$11 million from the general fund; about \$1.5 million in federal revenue; about \$5 million the Legislature directed the NMAG to spend from balances in the consumer protection fund, and \$32.4 thousand in Medicaid Fraud Program income. This is the last year the NMAG will be allowed to use that fund.

The NMAG currently has 16 vacancies, 10 in legal services. There are six vacancies in the Medicaid Fraud Unit, and the Attorney General stated they are planning to have them filled soon. There are 22 employees working under grants.

In FY12 and FY 13, the NMAG is requesting budget adjustment authority for \$500 thousand to fund a joint powers agreement with the 2nd Judicial District Attorney for prosecution of the Help America Vote Act case involving former Secretary of State Rebecca Vigil-Jiron and three other defendants. Attorney General King noted the NMAG has no authority to hire a special prosecutor and noted taking it up with the Legislature.

Attorney General King also asked for a \$1.5 million appropriation to continue supporting litigation involving interstate water conflicts.

Regarding the tobacco settlement issue, Attorney General King stated as a result of the governor's veto of legislation addressing tax exempt stamps, all participating manufacturers have brought an action claim that New Mexico's statute is out of compliance. Also, the NMAG has been fighting a general claim relating to diligent enforcement. Outside counsel has been hired. Attorney General King stated it would be inappropriate to budget money from the tobacco settlement fund in future years until results of claims are finalized, and a stronger statute is in place. If the arbitrator finds the state did not diligently enforce, it could potentially require total repayment of about \$150 million from 2003 to 2006, by reducing future money received. The loss from not having a statute that requires the non-participating manufacturers to pay into escrow is about \$8 million a year, which requires litigation to access. Attorney General King said if the participating manufacturers are successful in the current suit for not having a compliance statute, they will stop paying \$40 million into the fund.

In response to a question from Senator Papen, Attorney General King stated the Elephant Butte Irrigation District was not in agreement with the NMAG's lawsuit against the U.S. Bureau of

Reclamation regarding the operation of the Rio Grande Project (Elephant Butte Reservoir, Caballo Reservoir, EBID and El Paso #1) because the EBID asserts the operating agreement is a stop to potential future litigation by El Paso #1. Attorney General King stated that under the operating agreement El Paso #1 gets additional 100 thousand acre feet of water the irrigation district is not entitled to under the current compact. Mr. King stated that as a result of the compact, farmers in the EBID get to pump unlimited water from underground source, which will deplete the aquifer.

Vice Chairman Varela stated the NMAG should emphasize the enforcement of laws that ensure the authenticity of Native American arts and Attorney General King directed Mr. Bill Keller to follow up with the LFC.

In response to Chairman Varela, Attorney General King stated a quarter of Medicaid fraud cases go to the state, with the rest going to the federal government, and stated his Medicaid Fraud Unit is significantly more effective and efficient.

**State Auditor (308).** State Auditor Hector Balderas thanked the committee for previous recommendations and stated the OSA is requesting placing money into services, benefits and salaries, as well as costs for audit travel and expenses.

The OSA is currently down nine audit positions. Traditionally, budget comes from the general fund and a small audit fund, which is about \$200 thousand a year. This fund will be depleted after the FY13 request. The OSA has requested supplemental funding for \$58 thousand for FY12, and \$71 thousand in a special appropriation for information technology services.

Mr. Balderas stated Senator Sapien and Representative Varela sponsored initiatives in 2009 that created an OSA program identifying agencies at risk agencies for being late on financial audits or with significant findings. Initially, 91 agencies were reported late with financial audits, resulting in \$1.1 billion in unaudited funds. As of October 2011, 61 agencies were on the at-risk list. House Bill 411 was passed and requires a thorough review of why an agency is consistently late. It gives the Department of Finance and Administration authority to temporarily withhold funds for noncompliance, and becomes effective in 2012.

In 2009, Senator Sapien introduced the tiered system, the “carrot” for consistently late reporting agencies, allowing local certified public accountants to possibly conduct audits. Sixteen agencies have applied for this reduced cost audit this year. There are seven tiers of reporting that cut costs from 40 percent to 70 percent.

Mr. Balderas gave a detailed rundown of high profile OSA accomplishments: the special audit of the State Land Office in December 2010, the special audit of the Department of Corrections in June 2011, the special audit of the Santa Fe County Sheriff’s Department in July 2011, and the Public Regulation Commission risk assessment report and special audit in October 2011.

In response to Vice Chairman Varela, Mr. Balderas stated six state agencies have not submitted a financial audit for FY10, including the Higher Education Department.

Senator Sapien gave a background of Senate Bill 83, which would create a State Inspector General office, and asked Mr. Balderas how it would have impacted the OSA's budget. Mr. Balderas stated he didn't recall it being contingent on the OSA's budget. Senator Sapien stated he wanted it on the record that the intent of Senate Bill 83 was to look at the program side of audits, rather than the financial side. Mr. Balderas stated the bill called for a consolidation of certain agencies that had audit functions and he would want an impact study on independence and reporting procedures.

Chairman Smith asked how the state can best address some type of regular audits from a financial control standpoint and Mr. Balderas stated the oversight agencies could do a much better job. Mr. Balderas recommended having a report on corrective actions for repeat findings before appropriations are provided.

Oversight in vendor abuse, high-risk rural areas, employee reporting, and price fix agreements were also discussed.

**State Land Office (539).** Commissioner Ray Powell stated the State Land Office has developed a strategic plan and briefed the committee on the agency's focus in FY13 and its budget request.

Commissioner Powell stated the SLO is requesting money to focus on joint planning economic development with 104 local and incorporated communities to leverage earnings from state trust land, develop renewable energy that will provide significant revenues over time, settle lawsuits and administrative appeals, and increase onsite inspections and interaction with lessees. The SLO needs to increase its audit coverage and improve its information systems, such as the antiquated ONGARD system. The SLO is also implementing credit card payments, a costly process.

Revenue estimates for FY13 total \$513.8 million, 13.5 percent from renewable resources, with the remainder going to the permanent fund. Renewable and nonrenewable oil and gas revenue (bonus and royalty payments) make up 94 percent of the SLO's total revenue. Business and other rental income revenue is \$13.7 million, oil and gas is \$54.9 million, and miscellaneous income is about \$907 thousand. The maintenance fund is projected at \$69.6 million. The SLO's base request is \$13.3 million, a 4.4 percent increase over FY12 and a 1.2 decrease from FY11 budget. This increase is needed for salaries and benefits, contracts, increased travel costs, and training.

In addition to the base requests, the SLO is requesting three expansions totaling \$1.1 million. In the SLO's budget increase authority requests, Commissioner Powell is asking for almost \$8 million from FY12 revenue from the land maintenance fund for litigation expenses, an electrical systems upgrade, and records microfilm conversion and storage, among other needs. The total request is \$14.4 million.

In response to Vice Chairman Varela, Ms. Elaine Olah stated that given the appropriation, the SLO is planning on taking ONGARD off its mainframe.

Also discussed were the price of natural gas, and collaborating with the University of New Mexico and the LFC to develop a five-year forecast. In response to a request from a committee member, Commissioner Powell stated he would report on the prices of oil and gas.

**Secretary of State (370).** Secretary of State Diana Duran briefed the committee, beginning with the Administration and Operations Program, which provides policy and planning, information dissemination, information technology, human resources, financial services, and administration of laws like the Notary Public Act and Uniform Partnership Act. Total annual fees collected for commercial records average \$550 thousand and are deposited directly into the state general fund.

Secretary of State Duran stated the agency also administers two special programs: the confidential address program, which ensures alleged perpetrators of domestic violence or sexual assault cannot use state and local government's public records to locate their victims, and the Voter Action Act program, which oversees distribution and reporting of public election funding from the public election fund for candidates for the Public Regulation Commission and statewide judicial offices.

For the 2012 election cycle, five candidates have expressed interest in receiving public election funds. The projected balance of the public election fund at the end of FY12 is \$2.1 million. Secretary of State Duran noted the fund has also been used to fund election expenses.

Statute directs the Secretary of State to provide everything from translation of ballots into Spanish and native languages to paying mileage and per diem for the clerks to attend election training. Publishing of constitutional amendments and general obligation bonds is a huge expense, she said.

The SOS is also responsible for conducting an election canvass, auditing election returns, maintaining the voting systems used by all 33 counties providing ballots or "ballot on demand" systems, providing voter registration forms and voter information cards, paying for voting equipment and personnel for alternate early voting location on Indian land, and supplying the Election Handbook and training manuals for conducting statewide elections.

Ballots represent the single most significant election expense, and in 2007 and 2009 the agency failed to comply with the National Voter Registration Act to purge inactive voters from the voter registration list. The result: bloated voter files, erroneous numbers used to purchase election ballots, and inaccurate voter mailing lists sold to other parties. Secretary of State Duran said when projecting ballot expenses, the agency is considering the number of registered voters but analyzing voter turnout to calculate ballots needed, rather than total registered. For the 2010 general election, the agency spent \$2.1 million on ballots and is projecting ballot expenses for the 2012 general election to be \$1.4 million.

Statute also offers the option to use "ballot on demand" systems but only if the voting system certification committee determines there is cost savings. The SOS will provide the certification committee with its recommendation as well as information technology infrastructure requirements at polling locations or voter centers before such a system can be used. Vote centers

are also under review for potential cost savings. The SOS is in the process of certifying ballot on demand systems and does not yet know the cost.

In addition to election costs, the SOS administers campaign finance and reporting. The staff has been working on records management, improving the usability of the website, training users on how to use the site, and ensuring candidates are in compliance.

In FY11, which included the 2010 general election, revenue from all sources totaled \$8.2 million. This includes its \$4.5 million operating budget, a \$2.9 million special, and a \$300 thousand supplemental, as well as a \$466.1 thousand Board of Finance loan in FY11.

The FY13 request, which includes the 2012 general election, is \$6.6 million. The request reflects a transition from special and supplemental appropriations and Board of Finance loans, which has been the mechanism to make up the operating budget shortfall.

Secretary of State Duran stated, even with cuts, the agency is still projected to be \$553 thousand short. The SOS is requesting a supplemental appropriation and the expenses tie directly to statute. If the supplemental is appropriated, the agency's FY12 budget will total \$6.2 million. This is 20 percent less than was expended on the FY10 budget, the last year with primary elections.

In response to Representative Larrañaga, Secretary of State Duran stated under federal law a voter can be purged from voter rolls when the voter fails to vote in two federal elections and changes addresses. According to the Department of Justice, New Mexico cannot conduct a purge until 2015 for noncompliance.

Bobbie Shearer, Bureau of Elections director, told Representative Tripp the cost of producing ballot on demand is approximately \$8 thousand per unit, and the agency is attempting to bring that down to \$4 thousand per unit.

Senator Neville asked about the number of signatures required on nominating petitions and Ms. Shearer stated the SOS uses existing districts to calculate the numbers according to statute. Secretary of State Duran said the statute states the numbers used to determine how many signatures are needed is based on the total voter turnout in the governor's race in 2010 in 2 percent of the districts at that time.

In response to Senator Sapien, Secretary of State Duran stated the Department of Justice informed her New Mexico was the only state that failed to comply with the law in 2007 and again in 2009.

Secretary of State Duran told the committee the agency will thoroughly review the election process. Senator Sapien asked if the office has evidence of substantiated voter fraud. Ms. Shearer stated it has evidence that votes were cast where the registrations were suspicious.

**State Investment Council (337).** Steven K. Moise, state investment officer, said in the interest of time management the SIC proposes a flat budget for FY13, and stood for questions. Senator

Neville wanted clarification the SIC's budget is from earnings rather than the general fund and Mr. Moise told Senator Neville he was correct.

**Administrative Office of the Courts (218).** Artie Pepin, director, Administrative Office of the Courts, told the committee the *Judicial Compensation Commission Report* filed by Dean Washburn, dean of the University of New Mexico Law School, has been distributed. Director Pepin stated Mr. Washburn wanted to stress New Mexico judicial retirement benefits are behind most surrounding states.

Charles Daniels, chief justice, Supreme Court, thanked the committee and stated the New Mexico judiciary is only asking for what is needed.

Director Pepin stated the base budget increase requested by the courts is \$5.1 million, about a 4 percent increase. Most of this money would go to fill authorized but vacant positions. Director Pepin stated a significant amount of the request within AOC is for magistrate court, which totals \$1,284,700 for salary and facility leases. The structural gap in the budget is \$884,700. The AOC requests \$494,500 to fund the building lease for the Judicial Information Division. The odyssey case management system is slated to be complete in December 2012.

The AOC is also requesting 3.5 FTE authorizations. Only 1 would have a new general fund impact of \$33 thousand in the Court Services Division.

Director Pepin stated the other \$3 million is for filling 52 positions statewide as well as providing a modest salary increase to magistrate court employees. The vacancy rate would go from 10.54 percent to 7.24 percent and allow courts to stay open all day.

The AOC has four special appropriations requests. The first, \$500 thousand, would cover the costs associated with jurors, interpreters and witnesses. Director Pepin noted jurors in New Mexico get \$1.25 less than what is in statute. The second special appropriation request is for \$1,478,000 to repay the Board of Finance for jury and witness shortfalls. Director Pepin stated he has asked the BOF convert it from a loan to a grant, and his request is being considered. Third, \$705 thousand is needed for case management system equipment. The final request is for \$1,140,500 to fund five judgeships for half a year.

The AOC supplemental appropriations requests include \$300 thousand for the magistrate courts and \$150 thousand to pay attorneys through the court-appointed attorney fund.

Director Pepin gave an overview of the AOC legislation needing sponsors.

In response to Representative Tripp, Director Pepin said criminal case filings have leveled off, although the amount of time for certain cases has increased. Drunken driving filings have decreased, and e-filing has not affected the number of cases the court sees.

In response to Vice Chairman Varela, Director Pepin stated the governor's veto of legislation appropriating funds from a \$3 court operations fee collected from uncontested citations has

caused a significant gap in funding for the magistrate courts. In addition, the governor also vetoed an appropriation to the AOC of \$250 thousand to avoid furloughs.

Director Pepin and Chief Justice Daniels discussed reengineering specifically addressing an initiative that would streamline the appeals process for drunken driving appeals. Currently, appeals originating from limited jurisdiction (magistrate) courts are granted a de novo trial in district court. The reengineering commission recommended that the judicial branch work with the Legislature to amend the constitution to require that appeals from limited jurisdiction courts be heard by the Court of Appeals. Senator Sanchez asked for numbers dealing with de novo trials as well as appeals from the AOC.

The discussion continued with e-filing and the \$6 fee for filing. Senator Sanchez expressed disdain for e-filing. Chief Justice Daniels said the state isn't making any money in e-filing except in collateral cost savings.

In response to Representative King, Director Pepin said decriminalizing small citations is a step in the right direction and the AOC is working with the TRD.

**Administrative Office of the District Attorneys (264)** – District Attorneys' Association President Mary Lynn Newell stated district attorneys across the state worked together to come up with a budget. Ms. Newell stated the AODA is failing when it comes to attracting and retaining attorneys.

Michael Hall, interim director, Administrative Office of the District Attorneys, stated the AODA has a total 13 FTE, and 8 FTE are information technology positions connected to the central case management system serving 1.2 thousand users across the state.

### **Wednesday, November 16**

The following members were present on Wednesday, November 16, 2011: Chairman John Arthur Smith, Vice Chairman Luciano "Lucky" Varela, Representatives Don Tripp, William "Bill" J. Gray, James P. White, Edward C. Sandoval, Nick L. Salazar, Larry A. Larrañaga, and Henry "Kiki" Saavedra; and Senators Pete Campos, Sue Wilson Beffort, Carlos R. Cisneros, Steven Neville, Mary Kay Papen, Carroll H. Leavell, and John M. Sapien. Representatives Rhonda King, Patricia A. Lundstrom, and Senator Linda Lopez attended as guests.

**Program Evaluation K-12 Funding Formula: Allocation, Administration and Accountability of the Funding Formula for Public Schools.** This evaluation was presented in a joint meeting of the Legislative Finance Committee and the Legislative Education Study Committee (LESC). Charles Sallee, deputy director, LFC, said New Mexico's public schools funding formula has served the state well for over 40 years but needs to be modernized to ensure the state effectively allocates resources. He then read the executive summary in the report.

Craig Johnson, senior fiscal analyst, Legislative Education Study Committee, said the report highlights and expands on several formula concerns previously raised by the LFC and LESL.

Key Findings: *New Mexico needs to update the public school funding formula to ensure efficient allocation of resources.* The state's formula is designed to distribute funds to school districts in a noncategorical manner while providing for local school district autonomy. Formula dollars received by local districts are not earmarked for specific programs; however, districts are allocated more units through the formula to compensate for the higher costs of different student populations, activities, and programs.

*The Legislature has amended the formula more than 80 times since its inception in 1973.* For example, the formula was amended to recognize the incremental cost in educating at-risk students in 1997, and factors have been added to support new programs, such as fine arts and elementary physical education. The cost differentials for basic program, bilingual, special education, and early childhood education units have all been changed since 1990. Many of the formula components and amendments involve administrative and data requirements creating a bureaucratic ripple effect for the Public Education Department (PED) and school districts. For example, the PED identifies the data elements needed to implement the formula component and conveys this guidance to school districts and charter schools. Then at the district level, administrative policies and data gathering procedures must evolve to reflect this. Then, district staff collects and report the data to the PED, which in turn incorporates the data into its systems and spreadsheets to administer the formula.

*The American Institutes of Research or AIR, recommended changes that would simplify the distribution of the fund.* The AIR recommendation included a 14.5 percent increase in funding for additional school days and other assumed costs unrelated to the mechanics of the formula. The AIR study sought to determine both the appropriate level of education funding and a proper distribution mechanism.

Mr. Johnson stated that while the evaluation did not review funding levels, it did evaluate the formula and reached many of the same conclusions as the AIR study. The AIR study concluded that the state should consider a revised, simplified funding formula that incorporates (1) a smaller and simplified set of weighting factors, (2) a simplified set of programmatic weights, and (3) an enrollment size weighting schedule that accounts separately for the scale of district operations and charter school operations.

The formula recommendations from both the AIR review and this report would accomplish at least two goals: avoid unnecessary complexity by focusing directly on the factors associated with student needs, and make use of adjustment factors largely beyond a district's control, which minimizes the incentive to pursue funding not directly linked to student needs.

*Numerous components overly complicate the formula and increase administrative burden, yet some have limited fiscal impact on schools.* New Mexico's funding formula has 24 distinct factors. Of the 21 states that employ a base funding formula, New Mexico has the second most formula components. Each funding formula component has administrative and accountability needs that must be met to properly administer the formula. Formulas with more components present more opportunities for error or misallocation of funds and are administratively burdensome.

*Five components generate few units and have minimal to no impact on school funding.* These components create administrative burden that results in little financial impact on districts and charters. The formula components for home school student activities, rural size, and charter school activities allocated about 100 units to districts in FY11. Combined, these three factors generated only 0.02 percent of all the units allocated through the formula.

*Of the 24 formula components, 12 components generate less than 10 thousand units each. Some are for special programs that do not benefit students statewide.* The 12 components together generate 8 percent of total units, and none of the 12 components individually generate more than 1.6 percent of total units awarded. Fewer than half of the districts and charter schools benefit from two of these components, bilingual and elementary physical education. Again, a few components do not generate many units and do not benefit schools statewide.

*Some components do not effectively recognize the cost difference or fairly allocate funding for serving at-risk students.* Educating at-risk students requires additional resources. Research recognizing the additional costs necessary to serve at-risk students varies in the estimates of those costs. The LFC evaluation of southern school districts found that federal Title I funds supplement state funds aimed at at-risk students, but the combined funds might not be enough to fully cover the incremental costs to serve the state's at-risk student population.

*The at-risk index is a broken funding mechanism that is too complex and misallocates funds even when calculated accurately.* The at-risk index includes three factors: the mobility rate, English-language learning (ELL) student population, and poverty or Title I eligibility.

*Most other states allocate funds to at-risk students with more simple calculations that use federal data.* Performing similar calculations could generate a similar number of units for New Mexico's funding formula while saving administrative time. The at-risk index uses three factors. Other states that distribute at-risk funds generally use one measure for determining at-risk students, most commonly a federal measure of poverty, such as that for free and reduced lunch or food stamp eligibility.

*While there are issues with the calculation of the at-risk index, the more significant point is that New Mexico allocates a relatively small amount to its most needy students.* At-risk units generated \$71 million in 2011; on a per-student basis, this amounted to less than a 10 percent cost differential to New Mexico students that qualified for free and reduced-price lunch. States vary on the incremental dollars allocated for at-risk students, but comparatively New Mexico is low. Other states allocate per-student incremental funds ranging from 5 percent to 50 percent for students that qualify for free and reduced-price lunch.

*Fewer than half of all districts and charters currently receive state funding to support language-related services.* The majority of districts and charters receive no state funding directed to support other language and multicultural education programs. Some districts have sizable ELL populations and do not participate in bilingual programs and, therefore, do not receive bilingual units.

The AIR funding formula study and this joint evaluation both recommend providing state

funding to support language-related services by providing a cost differential for ELL students. Thirty-seven other states provide various amounts of additional funds for English-language learners as a separate category based on ELL district population. Maine funds up to an additional 60 percent for ELL students. Texas and Arizona provide an additional 10 percent and 11.5 percent, respectively.

*Formula elements incentivize school practices that run contrary to policy goals.* The AIR study and this evaluation both share the conclusion that the formula's special education funding structure encourages over-identification of special education students. A class D student generates nearly three times more funding than a class A/B program and twice as much as a class C student because of the differentials in the special education funding factors.

*Other states use census-based special education funding mechanisms that reduce the fiscal incentive to over-identify special education students and encourage early-intervention and pre-referral strategies.* Five states use a census-based special education funding structure, which provides costs based on the total number of students in the school district independent of the number of special education students. The 2008 AIR study recommended a similar system for New Mexico, stating, "Thirty-three states used special education finance systems based on actual head counts of special education students identified, all of which have exhibited increases in special education enrollment."

*Special education formula funding encourages excessive hiring of ancillary services FTE, regardless of services to children.* The funding formula incentivizes excessive hiring of ancillary staff because ancillary and related-services FTE are not controlled through a ratio with special education students and their needs. This component has been one of the most problematic in the formula. Student needs should determine the level of staffing needed to address the needs. However, because the state does not require a district to tie the number of ancillary service and diagnostic service providers claimed through the funding formula to actual student needs, the number of FTE claimed might result in over- or under-staffing of ancillary FTE.

*The training and experience (T&E) index is not aligned to the three-tiered licensure system.* The T&E index produces more units and funding for teacher salaries based on years of experience and education level. This evaluation, the New Mexico Effective Teaching Task Force final report, and the AIR funding formula study recommended better alignment of the T&E index with the three-tiered licensure system.

*The T&E index encourages higher education levels and more years of service, despite inconclusive evidence these factors increase student achievement.* No clear body of research links higher education level or more years of service with better student outcomes or achievement. Still many states, including New Mexico, continue to use education and experience as the basis for teacher compensation.

*The T&E index allows a rounding up from a half year to a full year of experience and this practice has resulted in inconsistencies across districts.* The policy is supported by statutory language allowing years of experience to follow those on district salary schedules. Districts and

charters round half years of service differently resulting in different T&E index values for teachers with similar experience.

*Size adjustments do not effectively target subsidies for scale inefficiencies and invite inappropriate formula chasing.* For example, district size units do not appropriately compensate the smallest districts to make up for their administrative inefficiencies. Very small school districts with fewer than 300 students are not given suitable funds through the formula to cover operational costs. As a result, these small districts claim the greater part of all emergency supplemental funding. From FY07-FY10, districts with fewer than 300 students accounted for more than 66 percent of emergency supplemental allocations, and some of the emergency supplemental payments were larger than the districts' initial state equalization guarantee payments.

*Size adjustment units account for a modest number of total units allocated by the formula, but generate more than a third of many district and charter school revenues.* For the past three years, size adjustment allocations, which include adjustments not just for district size but also for school size and rural isolation, totaled over \$90 million a year – roughly 4 percent of the total units. The two small-school adjustments – one for elementary and junior high schools and one for senior high schools – make up the vast majority of all the size adjustment units. Also depending on district budgetary decisions, schools that generate these funds do not necessarily receive those funds.

Small districts that receive size adjustments were dependent on them for up to 44 percent of their total generated units in FY11. In total, 27 of New Mexico's 89 school districts relied on size adjustments for more than 30 percent of the total units generated. Also, 28 of New Mexico's 84 charter schools depended on size adjustments for more than 30 percent of the units they generated.

Special provisions are necessary to fairly recognize charter schools' unique role in the education system. Charter schools can have a unique impact on the funding formula, because these generally small, local educational entities are treated as districts in the formula.

*Charter schools generally garner more units per student than their district counterparts, diluting the unit value.* A 2010 LFC evaluation found the cost per student at charter schools is 26 percent above that of traditional public schools. Since 2002, the growth in the number of charter schools has continued to have a growing impact on total state formula funding.

*Charter schools account for over half, or 32, of school districts and charter schools with per student program cost that exceeded \$10 thousand per student in FY10.* As shown in the table on page 18, Charter schools have the same high levels of program cost per student and funding formula units per student as many small rural school districts.

*In FY10, charter schools generated about \$24 million in additional funding because of their small size.* Charter schools are often designed as small sites and serve a special program. Legislative staff's interpretation of current statutes concludes that charter schools should not qualify for this additional funding. Traditional public schools generated an additional \$50

million in small-school adjustments in FY10, for a total of \$74 million between both charters and traditional public schools.

*It is easier for charters to obtain growth units due to their small size.* A 2010 LFC report found charter schools disproportionately benefit from funding for student population growth under the funding formula because of their small size. Charter schools generated \$7.5 million through growth units in FY10, more than 32 percent of growth funding in that year. School districts and charter schools do not qualify unless enrollment increases by at least 1 percent. This is easy in the average charter school, where just two students represent 1 percent of total enrollment, but more difficult in a district like Rio Rancho, where enrollment must grow by 172 students before the district qualifies. The AIR study recommends different formula adjustments for charters and traditional schools.

Like the AIR report, this report contains several recommendations to address the problems created by the complexity and incentives in the formula. The recommendations use readily available and easily verifiable data, like licensure levels. These recommendations are intended to not only improve the allocation of funds, but also to ease the administrative, implementation, and oversight burdens on PED and districts.

The evaluation recommends that funding formula be changed in the following ways:

- Eliminate components that generate few units or are not funding statewide programs;
- Adjust the at-risk index to pay a cost differential of 0.15 for the percentage of districts students identified as eligible for the free and reduced-price lunch program;
- Adjust bilingual funding to direct a cost differential of 0.15 toward ELL students statewide;
- Move to a census-based special education funding model that funds districts for serving 16 percent of districts students at a cost differential of two;
- Replace the T&E index with an “effective” teacher index that only multiplies grade-level program units with the following values corresponding to licensure: level 1 – 0.75, level 2 – 1, and level 3 – 1.25;
- Create a new district size adjustment that institutes a new size adjustment formula using the current total size unit allocation to districts and repeal all others;
- Phase out size adjustments and growth units for charter schools and create a special funding program to fund first year and growth units;
- Create a hold harmless program to allow districts to adjust to the above changes.

Overall, the funding formula recommendations would result in fewer allocated units (from 634 thousand units to 586 thousand units in FY12) and a higher formula unit value. Based on FY12 preliminary unit value, the unit value would increase from \$3,586 to \$3,887. Any savings from reduced units should be put back into the unit value.

In conclusion, these funding formula recommendations, if completely implemented, would make the formula more transparent, simpler to understand and administer, and less prone to manipulation.

Matt Pahl, program evaluator, LFC, said state funds are distributed unequally because the administration of parts of the formula is based on unclear statutes and rules. Fair and effective administration of the funding formula requires clear and reinforced ground rules for claiming funding. The team found that funding is distributed in ways inconsistent with statute and found a lack of rule and clear formula-based guidance. Local districts then make decision to capitalize on these administrative gaps and create unnecessary inequity in public school funding. Clear rules and guidance are necessary for the playing field to be level for all districts under the current formula.

*The PED distributes funding in ways inconsistent with statute.* For example, state statute specifies that instructional staff be included in the T&E index, but the PED includes other staff in the calculation, even those funded through other formula components. These positions generally increase T&E index values. An example is Lovington Municipal School's T&E index. The positions such as diagnosticians, librarians and speech therapists have relatively high T&E index values. These positions are included because of a statutory definition that is not found or used in the finance section of the public school code. Many of the additional positions included in the index are not paid out of district instructional costs. Positions not involved in direct instruction and other positions addressed elsewhere in the formula should not be included in the index.

Funding is allocated for a district's 3- and 4-year-olds with developmental delays despite no statutory language addressing 3- and 4-year-old developmentally delayed students. Prior to a change in the PED guidance, funding for 3- and 4-year-olds with developmental delays was pooled together with 3- and 4-year-olds with a developmental disability. As noted by the PED, developmentally delayed students need much fewer services than developmentally disabled students, but both are funded the same as a high needs special education student. The PED has tried to change identification of 3- and 4-year-old developmentally delayed students to fund them at a lower, more appropriate special education level, but currently there is no statutory basis for funding these children at all. The factor for 3- and 4-year-old developmentally disabled and delayed children is having an increasingly large impact on formula funding, and the Legislature should address this funding situation to better inform PED policy decisions.

Charter schools receive size adjustment units, despite statute that could make them ineligible for such units. Statute language notes that schools established to provide special programs shall not be classified as public schools for purposes of generating size adjustment program units. For example, district magnet schools and alternative high schools do not receive size adjustments. Language in the Charter School Act could interpret charter schools as a special program.

Inconsistencies in the way the PED interprets statute regarding the T&E index, 3- and 4-year-old developmentally delayed children, and size adjustments for charter schools have a significant impact on the funding formula and might not be in line with legislative intent.

*Unclear rule and guidance from the PED is also a problem in distributing public funds.* The PED's unclear guidance allows districts to claim more funds than necessary for special education services. Statute defines class A, B, C or D special education students in vague terms, but the PED does not specify these terms in rule and has taken that statute language to interpret it for districts. The guidance does not outline a threshold for a class D special education student. This

is problematic because of the financial incentive to classify students as class D and has resulted in wide variations of class D special education student populations. For some districts, nearly 30 percent of special education students are class D, while other districts have less than 10 percent. Seven districts have class D populations that make up over 18 percent of their populations and 28 districts have populations of less than 5 percent. A high percentage of class D special education students corresponds directly with higher levels of special education per-student funding. Stronger guidance in rule is needed to guide districts to appropriately classify special education students.

Mr. Pahl stated the PED's lack of rules regarding ancillary FTE allows districts to over-hire ancillary staff. Districts currently have no limit to the amount of ancillary FTE they hire because the PED does not have guidelines that regulate the ratio of ancillary FTE to special education student needs, as allowed by statute. Some districts and charters have low student to ancillary service FTE ratios. One way districts are able to claim high ancillary FTE is to claim more than 1 FTE per ancillary service provider. An ancillary FTE produces nearly \$90 thousand for districts and claiming 1.2 or 1.5 FTE in the funding formula for each ancillary service provider increases that amount by \$18 thousand to \$45 thousand. In FY11, the Cobre Consolidated School district had many of its related services staff counted as 1.2 FTE, generating thousands of dollars in revenue. In FY12 Cobre voluntarily reduced its FTE from 25.2 to 17 and in FY13, the districts plans to further reduce the FTE to 13. The initial decrease in FTE was largely achieved by reducing each ancillary services provider from 1.2 to 1 FTE in funding formula calculations. Special education is ripe for districts to take advantage of absent rules and garner additional funding. The PED could help to administer these units with more fairness to districts across the state by creating rules that address these issues.

Incomplete guidance and rules also allows districts to obtain funding for students who should be educated in a different, more appropriate education program. In FY11, approximately 627 non-special education students reached their 22 birthdays at the beginning of the school year. Most of these students are served in charter schools. For example, Gordon Bernell Charter School provides an opportunity for adults who have not been successful in traditional school environments, including inmates at the Bernalillo County Metro Detention Center, to graduate from high school. Since 2008, the school has helped more than 60 students earn high school diplomas. While the program provides a benefit to the state, the student population is one more appropriately served through adult basic education programs. The school claims funding for 145 students between the ages of 26 and 57. Adult students claimed for K-12 funding dilute funding for public schools and would be more appropriately served by adult basic education, which allows such students to earn their GED with a significantly lower cost to the state.

Proper rule and guidance are necessary to get districts on the same playing field for public school funding. The described gaps in rule and guidance for special education programs and adult students allow some districts to enhance their revenue at the expense of other districts.

*Formula incentives, along with unclear rules and guidance, allow local decisions to drive inequity in formula funding.* For example, districts make decisions that are within the rules to create or keep unnecessary small schools that result in school-size adjustment units. For example, in 2009, Lovington Municipal Schools built a new wing of their high school to become

a new freshman academy. The Lovington Freshman Academy operates on the high school campus and, for funding purposes, is considered a separate school from Lovington High School, despite sharing administration and facilities with the high school. Lovington's Freshman Academy sits adjacent to two Lovington high school buildings. Size units from the ninth grade academy garner over \$500 thousand for the district per year. It is important to note that ninth grade academies are considered a best practice; however, many districts have ninth grade academy programs that do not create separate and unnecessary schools.

The team also found Zuni Public School District (ZPSD) operates two high schools despite the capacity to serve its high school population in one building. Twin Buttes High School and Zuni High School lie three miles apart and together serve 432 students. This high school structure allows ZPSD to collect high school size adjustment units for both high schools, though Zuni High School has the capacity to serve all students. If Zuni's two high schools consolidated as one, Zuni would not generate high school size adjustment units.

The ability to garner size adjustment units through inefficient school structures has been recognized in some districts' capital plans; these districts make long-term plans to keep inefficient schools structures because of the financial incentives associated with them.

Districts also make a decision to provide a bilingual program to their students, and the formula incentivizes a longer program by directing more funds to them. These districts garner additional units for these programs but are not held accountable to spend these funds on bilingual education. While the scope of the project did not allow for a full review of bilingual programs, a broad overview of bilingual programs finds that the most expensive, or longer, bilingual programs have the lowest results on English proficiency tests and ELL students not in bilingual programs score higher on English proficiency tests than ELL students in bilingual programs.

The PED's deference to local decisions allows some districts to gain at the expense of other districts. Fair and effective administration of the funding formula requires clear and reinforced ground rules for claiming funding. The report makes several recommendations to improve statute, rule and guidance to level the funding playing field for districts, but these solutions only solve specific problems found by this group. Formulaic recommendations from chapter one of the report will address a majority of these problems by removing the incentives that cause them and ease the administrative burden on both districts and the PED. The project team also looked at the data transmission of important data used to calculate funding formula units. The team found that there were no major problems, but that the process is time and labor intensive.

*Districts are able to capitalize on funding formula and administrative deficiencies because the PED's audit function is inadequate.* The PED should be applauded for making accountability a priority. Past PED audits have made significant findings that recover public funds and maintain the integrity of public education programs. Recent PED audits, however, have not been performed in a manner consistent with commonly accepted auditing practices, and the PED does not initiate and complete enough audits to serve as an adequate accountability function. For example, bilingual audits have uncovered significant findings in the past. Most recently, the group found that Questa independent school district was claiming excessive units for both the number of students participating in the bilingual program and the type of program they offered.

These findings resulted in \$240 thousand worth of findings for FY11 alone, but bilingual audits have decreased over the past three years. In FY11, 84 districts and charters were implementing bilingual programs; if no additional bilingual programs are approved or discontinued, the PED will reach all districts and charters by 2027, allowing a student beginning kindergarten in 2001 to graduate without ever having their bilingual program audited.

T&E audits have a similar story. T&E audits conducted in FY11 found that over half of the files reviewed were incorrect. The capacity for completing audits on formula related items such as the T&E index is very low.

Again, the PED has placed district accountability low on its priority list. Recently conducted audits did not follow commonly accepted auditing practices. Audit results from last spring's district audits have yet to be released, and some districts reported not receiving entry and exit conferences. As the PED creates its new audit unit, it has an opportunity to create one with the capacity to become a productive accountability function for the department that follows auditing standards and increases transparency between the PED, the districts, and the public.

Additionally, implementing performance-based budgeting for school districts would also improve accountability. New Mexico school districts receive more than 40 percent of all state funds, but with no accountability measures in place, districts can direct funds to ineffective programs and policies. The Legislature contemplated including school districts as part of its Accountability in Government Act. Ultimately, districts were not included. Implementing a performance-based budgeting process would allow examination of student achievement along with district budgets. The use of a performance dashboard that includes much of the data districts and charters already collected would give a broad picture of whether district expenditures are working toward student achievement and would be much simpler than the current system.

Holding districts accountable for managing their programs appropriately and maintaining integrity in funding formula calculations is important. The PED is creating and should create a new audit unit with more capacity than it had in the past to ensure the responsible administration of the formula and related programs. While the PED has a great opportunity address its audit deficiencies, simplifying the formula would also decrease the need for so much audit activity.

Hanna Skandera, secretary designee, Public Education Department, stated the PED is already working on some of the findings the evaluation is an excellent opportunity for the PED accountability, and performance-based budgeting is a great next step.

Paul Aguilar, deputy secretary, Public Education Department, told the committee many of the findings in the evaluation are based on different interpretations of statute and agrees there is a need for legislative and regulatory action to tighten up the application of the funding formula; if New Mexico does not meet the disparity calculation for federal impact aid, the state could lose \$68 million from the general fund. Also, Mr. Aguilar stated he was unhappy with agency comments in the back of the report.

*The at-risk index is a broken funding mechanism that is too complex and misallocates funds when calculated accurately.* Mr. Aguilar stated there are three indicators to the at-risk calculation, yet the report only focuses on the mobility piece. The PED disagrees with this assertion. The PED staff added codes to the Student Teacher Accountability Reporting System (STARS) and is working to develop appropriate queries.

*The PED's process to approve new schools does not include a robust review of need.* The PED agrees with this finding that a more comprehensive review is necessary.

In response to the finding the state lacks a comprehensive document detailing all formula statutes, rules and reporting requirements, Mr. Aguilar stated it is absolutely true and the PED is working on a comprehensive website.

*The PED distributes funding in ways inconsistent with statute.* Mr. Aguilar said the PED disagrees with this assertion regarding the T&E calculation completely. There are statutes not in the report that define instructional providers. All three components of the statute were not accounted for.

*PED guidance for funding 3- and 4-year olds who require only speech services is not supported by current statute or administrative code.* By statute, the state is required to provide special education services to 3- and 4-year old developmentally delayed students. The state recognizes 3-year-olds who require speech-only intervention services as special education students. That 3-year-old is considered a D-level student, requiring all-day instruction, when the student only requires minor intervention, or is considered an A or B level. Because of that designation, program units should be calculated by the cost differential factor of 0.7.

*Unclear guidance allows districts to claim more funds than necessary for special education services.* Mr. Aguilar said the D-level piece is a high funding component. The rule states a D-level program approaches a full day. The PED cannot put a certain percentage on a program. There is flexibility in that program because children have different needs.

Mr. Aguilar stated one of the first priorities was restructuring, and the PED created a School Budget and Financial Analysis unit that will focus on auditing T&E, financial accounts, and the bilingual program.

The PED supports and applauds the implementation of performance-based budgeting for public schools beginning in FY14.

Mr. Sallee stated PED and LFC staff ran an estimate and it appears recommendations in issue one would improve the disparity calculation for the state. Secondly, regarding rules and guidance, the recommendations are there so as not to micromanage input for small dollar amounts, shifting focuses on better outcomes for children and well-spent taxpayer dollars.

In response to Representative Dennis Roch's question about the PED's guidance to districts being inconsistent with law, Mr. Pahl stated the rule should come from statute and the proposal

for the Legislature is to make a decision on developmentally delayed 3- and 4-year-olds so the PED can act appropriately from there.

Discussion ensued regarding charter schools, and local decisions regarding the necessity of public schools. Representative Roch said the state is trying to determine local need when it should be the locally elected school board. In response, Mr. Sallee stated that decision under the LFC's recommendations would remain local, however, the question then becomes should the state subsidize that local decision.

Senator Nava stated she was concerned about sections in the report concerning special education and bilingual education and hopes policymakers will look at the bigger issue rather than a 0.7 or a 2. Senator Nava also wanted more input before the state goes forward with a performance-based budget. Mr. Aguilar clarified there are four auditors.

In response to Representative Larrañaga, Mr. Aguilar stated the problem with many bilingual children is they aren't fluent in any language they speak, and the findings is that existing programs are not implemented effectively.

Also in response to Representative Larrañaga, Mr. Sallee stated the state would recalibrate district size adjustment to accommodate small schools. The recommendation is to heavily subsidize at district level, so the district can fund their schools.

Representative Stapleton asked for an explanation of the at-risk index, and Mr. Johnson said the report states the index is more complicated than what most states use. New Mexico uses three factors and more significantly allocates a smaller amount of money to students who need it most.

Mr. Johnson clarified size adjustment for Representative Garcia – there is a district size adjustment, a school size adjustment for elementary and junior high schools, and a rural isolation adjustment. Mr. Johnson went on to explain that the report is using the term “subsidy” to refer the funding a school district gets when it classifies a school having one administration and one building as two schools so that they can receive the small school size adjustment.

In response to Representative Garcia, Mr. Pahl stated different thresholds are locally based so there is no real continuity statewide, adding it is not a gaming issue, there are different definitions per district. Representative Garcia stated the state guidance is 51 percent, and that is continuity.

Mr. Sallee said that state statute says separate schools that provide special programs are specifically precluded from receiving small school adjustments, adding that charter schools, by their very nature, are special programs. Mr. Aguilar stated the PED disagrees with the assessment in the evaluation and charter schools are precluded but agrees special programs are included. Mr. Aguilar stated charter schools, by definition in the Charter School Act are public schools and are funded by the funding formula, where special programs are not.

In response to Senator Lopez, Mr. Pahl stated funding formula allocation given to districts is not categorical. Also discussed were ELL calculations versus bilingual calculations and the

performance-based budgeting example in the report. Mr. Sallee stated the goal is to begin implementing performance-based budgeting in FY14 to allow for training and input.

Secretary Skandera stated the Race to the Top for early childhood education application was submitted and the state should know the results in four to six weeks.

**Department of Finance and Administration (341) Special DFA Appropriations (344).** Tom Clifford, secretary designee, Department of Finance and Administration, stated the Department of Finance and Administration (DFA) is requesting a flat budget with 2 FTE positions moving to the PED. The DFA also recommends moving capital outlay to their State Budget Division. Secretary Designee Clifford stated there are seven exempt positions total and one is vacant.

Big Brothers/Big Sisters of Northern New Mexico. Chief Financial Officer Andrea Maril thanked the committee for their continuous support and introduced members of her staff. Ms. Kayla Duran and Rosa Jennings testified before the committee, saying having a relationship through BB/BS has benefitted them both.

New Mexico Land Grant Council. Mr. Juan Sanchez, chairman, said the council is administratively attached to the DFA but lost their funding in FY12. The total budget request is \$200 thousand.

Civil Legal Services. Director Abbey stated Civil Legal Services is part of the DFA request, within the Local Government Division. The CLS appropriation was \$1.6 million in FY12, and the DFA appropriation request for CLS was \$1.4 million. There was discussion as to whether the CLS can live within this budget request for FY13. Secretary Designee Clifford replied that they did believe this was one place where they could afford to reduce the budget request to try to keep the overall request flat.

Director Abbey clarified that the Courts and Criminal Justice Committee heard a bill that both the counties and the AOC are advancing that would spend money from the general fund. The AOC's proposal is to distribute part of the general fund portion of liquor excise taxes to drug courts. This would replace, at the expense of the general fund, the \$800 thousand DWI grant fund money that the Local Government Division of the DFA had previously transferred to the drug courts.

Secretary Designee Clifford stated the DFA received a \$50 thousand supplemental for the Citizen's Review Board, which is an ongoing need, and gave the status of their audits. In response to Vice Chairman Varela, Mr. Ricky Bejerano, state controller, stated 10 audits for Aging and Long-Term Services Department and Higher Education Department from FY10 will be complete by December 15, 2011.

In response to Senator Cisneros, Secretary Designee Clifford stated the governor would like a 10 percent reserve: however, there is \$200 million additional revenue over and above the forecast, bringing the reserve around 9 percent.

At the request of Senator Sapien, Mr. John Arango with Civil Legal Services testified before the committee that a decrease in funds means fewer clients they can help.

Agency overdrafts and compliance and statewide vacant positions were also discussed.

**Department of Workforce Solutions (631).** Celina Bussey, secretary, Department of Workforce Solutions (DWS), introduced Cynthia Brindley, budget director. Ms. Brindley stated the FY13 request is flat at \$50.7 million. Agency internal funds are coming in at 9 percent. Most of their budget comes from federal funds, and there is about a \$5 million decrease in federal funding levels from last year. The Workforce Transition Services Division that provides reemployment activities statewide represents more than 33 percent of the agency's overall expenditures, \$16.6 million. The Labor Relations Division and the Workforce Technology Division both use 20 percent. About 7 percent of the agency's expenses are in the Business Services Division. The remaining 40 percent is for Program Support.

Ms. Brindley stated the agency is unable to use federal funds to support state initiatives provided by the Labor Relations Division.

Ms. Brindley noted the agency requests general fund dollars in lieu of funding received from the Worker's Compensation Administration.

Henry Gonzales, chair, Human Rights Commission, thanked the committee and said the commission is supposed to be 11 members and has five members. He noted the positions are hard to fill. Secretary Bussey, in response to Vice Chairman Varela, said sitting on the commission is a huge commitment and that discourages applicants but the administration understands the urgency to fill the positions.

Alex Martinez, with SER New Mexico, testified Workforce Act funding continues to diminish, adding after 20 years, last year was the first year the organization did not receive funding. Secretary Bussey stated there is currently \$4 million in the FY12 youth allocation statewide.

Jimmy Shearer, chairman of the Eastern Workforce Development Board, stated everything was going well. In response to Senator Leavell, the southeast does have a lot of employment opportunity.

Secretary Bussey stated the unemployment insurance trust fund balance is \$109.9 million. If contributions continue at the current schedule, the WSD anticipates insolvency within the first quarter of 2013. Initial claims, with 26 weeks of benefits, continue to remain static at 1.6 thousand new claims a week. Individuals are eligible for benefits up to 86 weeks.

The department's call center has seen many customer service improvements and changes. In September 2010, the average call waiting time was 49 minutes, and in September 2011, the wait time was four minutes. In October 2010, wait time was one hr, 56 minutes; in October 2011, the average wait time was 16 minutes.

The complexity of the claims has not changed, however. Secretary Bussey stated the tier eligibility is complex, as is the appeals process. Overpayments are created when people have to wait for an appeal decision for months. The department has increased staffing levels to improve the appeal process. Within seven days of an appeal being filed, notice goes out to affected parties.

An integrated tax and claims system is slated to go online in 2012 and a 10-week integrity pilot project with 50 staff members was also discussed.

In response to Senator Sapien, Secretary Bussey verified the state has no defined contribution schedule for 2012. The vetoed language in House Bill 59 eliminated the designation of a schedule and in January 2012, the federal Unemployment Tax Act will take over. This establishes a 6 percent tax rate for businesses, and the state administers its own unemployment insurance program. Regardless of what employers pay into the state fund, they will receive two types of federal tax credits: the first is based on premiums that they have paid into the state fund; the second provides an employer with a maximum credit of 5.4 percent credit against that 6 percent FUTA rate.

Secretary Bussey continued by saying the U.S. Department of Labor has walked the DWS through procedures for 2012 and did not find New Mexico in noncompliance of federal law. What New Mexico is lacking to implement the experience-based system is a defined contribution schedule. At the end of the year, employers would not receive the additional tax credit because they did not pay premiums to the state fund, a \$400 million impact to those employers who currently benefit from the experience-based system. Lack of contributions into the state fund in 2012 would result in almost immediate insolvency and federal loan would be necessary immediately.

**Aging and Long-Term Services Department (624).** Secretary Designee Retta Ward asked the committee for its support and requested \$42.9 million from the general fund. Since FY09, the ALTSD has seen a \$5.1 million reduction in general fund revenue. The ALTSD is requesting a supplemental appropriation of \$500 thousand to maintain current levels.

Secretary Designee Ward stated the ALTSD is an essential resource for more than 200 thousand New Mexicans and by 2015, it's estimated 23.8 percent of New Mexicans will be 60 years of age or older. By 2030, New Mexico will have more citizens over the age of 60 than under the age of 18.

Secretary Designee Ward highlighted three of the department's six top strategic priorities: services in home and communities; prevention of adult abuse, neglect, and exploitation; and economic security.

The divisions in the ALTSD were mentioned, and Secretary Designee Ward stated the agency was in the final stages of completing its FY10 audit. Many factors delayed the audit, such as a dual accounting system, and a number of improvements are now in place.

The FY12 supplemental appropriation request and FY13 agency budget request will allow the Consumer and Elder Rights Division to maintain staff service levels, provide support, and maintain advocacy services. Regarding the Aging and Disability Resource Center (ADRC), funding directly impacts consumers' access to services because of staffing. Currently, the ADRC has five vacancies.

Adult Protective Services (APS) investigations stabilized slightly for FY11. Nearly 60 percent of APS victims are over age 60, and the most frequent problem is self neglect. Secretary Designate Ward also briefed the committee on the Aging Network Division, its services, and the volunteer programs within the division.

Toby Kessler and Claudio Chacon testified they supported the ALTSD FY13 budget request, but the increase request is not enough and New Mexico's senior citizens are hurting badly.

The discussion continued with Representative Salazar briefing the committee on his experience at a mock hearing and thanked the ALTSD for the good work they do around the state. Jason Sanchez told Vice Chairman Varela the FY10 audit exit conference will occur in the next few weeks, adding for FY12, the agency is completely using the SHARE accounting system.

In response to Representative Lundstrom, Ray Espinosa stated they have developed steps to improve the Manuel Vigil Senior Center.

**Department of Cultural Affairs (505).** Director Abbey read a citation of congratulations and acknowledgement from the Senate for Steven Scott Post, who was retiring after 33 dedicated years of service from the Department of Cultural Affairs as deputy director of the Office of Archaeological Studies.

Veronica Gonzales, secretary, Department of Cultural Affairs, recognized supporting members of the audience and said the department's mission is to preserve, foster, and interpret New Mexico's diverse cultural, scientific, and artistic heritage and expression for present and future generations, enhancing the quality of life and economic well-being of the state.

The department is divided into five programs, with 15 divisions. Secretary Gonzales introduced various members of museum, monument, library, and division staff. The DCA has a \$3.3 billion impact to New Mexico's economy, and supports more than 59 thousand jobs, with \$952 million in salaries.

Education is at the heart of the DCA's mission, and Secretary Gonzales stated arts and culture help children learn. The DCA has a breadth of knowledge in historians, paleontologists, librarians, archaeologists, biologists, art historians, among others, and said 72 percent of the agency's budget covers staff and personnel services. Operational costs are 18 percent of the budget, and 10 percent covers contracts and grants. Secretary Gonzales said core funding is crucial to accreditation.

The DCA's strategic plan has four major priorities: increase financial stability across the department; present a cohesive messaging and identity branding across the department;

maximize impact of programs and services through public and private partnerships, education programming and assessment; and strengthen staff to improve service delivery.

The DCA shares human resources and has created task forces to address shortfalls. The department is looking at consolidation, centralization of marketing, and sharing stock of resources statewide.

Secretary Gonzales stated the general fund budget request for FY13 is \$26.933 million. Of greatest concern is the agency's dependency on a nonrecurring cash balance to support reoccurring operating expenses. The DCA's recommendation is to stabilize core funding from the state, address fund balance, and stimulate earned revenues.

Former Mayor of Santa Fe Larry Delgado and executive director of the Lensic Theater Bob Martin thanked the DCA for its support and asked the committee to consider appropriating money for child education outreach.

Tom Rutherford with the Western States Arts Federation; Heather Heunermund, executive director for the New Mexico Coalition for Literacy; Craig Newbill, executive director for the New Mexico Humanities Council; Charlene Cerny, executive director of the Santa Fe International Folk Art Market; Bud Hamilton, board of trustee chairman of the Museum of New Mexico Foundation; Joe Sabatini with the New Mexico Library Association; testified before the committee in support of the Department of Cultural Affairs and requested additional funding in the budget.

In response to a question from Representative Sandoval concerning capital outlay, the secretary stated the DCA is requesting \$9.4 million for repairs at monuments in divisions, \$4.2 million to complete projects statewide, and \$2.5 million for equipment.

Senator Cisneros strongly encouraged the committee to restore funding to the Santa Fe International Folk Art Market, stating that the value of the activity to economic development in the region is obvious.

Representative Lundstrom stated the negative findings in the current audit reports should be a concern to the department and the committee, and the department should provide a narrative outlining the specific remedies being pursued by the department prior to budget hearings in January.

Printing promotional items in the United States and funding for county and city libraries were also discussed.

**Economic Development Department (419).** Jon Barela, secretary designee, Economic Development Department, stated the department is requesting a flat, \$6.455 million budget for FY13. Currently the EDD has 43 FTE, with four vacant positions being filled to bring them to 47.

The agency plans to reorganize in FY14 and move FTE and budgets to align with legislative language. Secretary Barela stated the EDD has been aggressive in trying to figure out ways to build department return-on-investment reporting capability and retool the New Mexico partnership and data center to support the core mission.

Secretary Barela noted since FY09 there has been a 30 percent reduction in funding. The EDD budget mainly goes to the Economic Development Division. The EDD is requesting \$1 million for MainStreet, \$1 million for arts and cultural districts, \$8 million for the Local Economic Development Act (LEDA), and \$5 million for the Job Training Incentive Program.

Representative Saavedra asked for a report of how many jobs have been created through the department.

In response to Representative Lundstrum, deputy secretary Barbara Brazil stated the EDD document detailing capital outlay projects is in the works, and the border projects needed to get off of the ground. Ms. Brazil stated other money besides LETA is going toward the projects.

Representative Tripp asked if the EDD uses a formula to determine how much money goes into a certain project and Secretary Barela stated the department is looking at a sliding matrix, or guidelines. Ms. Brazil added capital outlay money can only be used for certain projects, such as infrastructure, and stressed a local government must have a qualified project to get the money.

In response to Vice Chairman Varela, Secretary Barela stated desk audits will be instructive and most likely indicate that MainStreet needs help and having an economist in the data center is critical. An incentive compliance staff is needed as well.

#### **Thursday, November 17**

The following members were present on Thursday, November 17, 2011: Chairman John Arthur Smith, Vice Chairman Luciano “Lucky” Varela, Representatives William “Bill” J. Gray, James P. White, Edward C. Sandoval, Nick L. Salazar, Larry A. Larrañaga, and Henry “Kiki” Saavedra; and Senators Pete Campos, Sue Wilson Beffort, Carlos R. Cisneros, Steven Neville, and John M. Sapien. Representatives Donald E. Bratton, Rhonda King, Patricia A. Lundstrom; and Senators Rod Adair, Phil A. Griego, and Linda Lopez attended as guests.

The committee met in executive session until 9:50 a.m.

**Higher Education Department Update on Proposed Formula Revisions.** Secretary José Garcia acknowledged the presidents and representatives of New Mexico’s colleges and universities and the funding formula task force. The secretary told the committee the proposed formulas – one for research and comprehensive universities and one for community colleges – are simpler than the old formula, include outcome measures, and reflect different institutional missions. Secretary Garcia expressed urgency for adopting the formula to close the achievement gap while providing sufficient notice to institutions to adjust policies and practices to meet formula targets. The formula provides a good start to addressing many issues facing higher education, including remediation, dual credit, and certificate programs; closing the achievement

gap; accurately forecasting state workforce needs; proper recognition of institutions completing degrees; and transferability of credits.

Curtis Porter, associate vice president of Budget, Planning and Analysis at the University of New Mexico and chairman of the Higher Education Funding Task Force, stated the final formula addressed four objectives: It provides a transition to instruction and general (I&G) formula funding based on outputs and outcomes, recognizes enrollment growth measured by student progress and other state priorities, maintains a level of equity by sector and by institution, and simplifies the formula. The guiding principles were to maintain FY12 I&G funding levels as the base for the new formula and eliminate the tuition credit.

Mr. Porter stated the task force met most of its first-year objectives, but has more work to do on sector measures. The task force consensus recommended transitioning outcomes funding, with two-thirds based on workload course completion and one-third based on statewide outcome measures. These outcomes would be based on an awards matrix. The work of the task force was an open, inclusive process, resulting in a formula recommendation to the HED in mid-September.

David Longanecker president, Western Interstate Commission on Higher Education (WICHE), reported five common design features for effective performance funding formulas: clear goals, simple and few outcomes measures, measures that reflect different institutional missions, sufficient pay for performance toward identified goals, and integration of all financial policies in ways that maintain stable institutional funding. He supported the HED's proposed formula because it shifts funding from initial enrollment to completed enrollment and allocates funding based on institutional and student performance. Overall, the formula provides a solid foundation that lends itself well to future efforts to unify financial policies on tuition, appropriations, and financial aid.

Daniel Lopez, president of the Council of University Presidents, noted the formula process was open and fair but that total agreement on the formula should not be expected. The formula provides a foundation for moving forward, but it requires a lot of data. Changes are in production for the final product, which is positive. The biggest challenge is the formula excludes students-based outcomes, but this can be addressed in the next revision. He also reported that, after years of declining state appropriations, additional funding, above the FY12 I&G levels, should be appropriated for institutions to meet the identified outcome measures.

Felicia Casados, president of the New Mexico Association of Community Colleges, generally support the task force's recommendations but are concerned that important mission-specific measures are omitted, including transfer rates. Ms. Casados reported the secretary assured the branch colleges that student transfer data would be included in future performance measures. The association requests that the funding formula, as proposed by the HED, be postponed for one year so that the HED and LFC can include mission-specific measures and better research consequences of the proposed formula changes.

Representing New Mexico Independent Community Colleges, Steve McCleery saluted the formula development process adding that the proposal "round one" in the effort to fund

priorities. The colleges request refining both formula measures and benchmarks so institutions can develop and implement appropriate practices.

Chairman Smith said he was humbled by all of the educators representing what is right with New Mexico. Chairman Smith introduced University of New Mexico board regent and retired Lieutenant General Bradley Hosmer, who testified in support of the proposed funding formula, saying it is the single most effective tool the state to evolve New Mexico's colleges and universities into an integrated team.

Recognizing institutional competition for state funding, Representative Lundstrom asked Mr. Longenecker how the objectives he described can be achieved without integrating financial policies. Mr. Longenecker stated the goals allow for a new set of incentives and provides new ways of financing the institutions, so integrating policies can be done over time. Some members questioned how the state funding for institutions can be stable while allocating a meaningful level of funding to outcomes. If state appropriations account for less than half an institution's total budget, then a small allocation of state funding designated to outcomes might not sufficiently influence institutional efforts to increase student performance and graduation.

The discussion continued with incentivizing science, technology, engineering, mathematics, and healthcare certificates and degrees, which many committee members supported. The secretary commented that workforce awards classifications were based on national criteria and the state's workforce needs and projections. Barbara Couture, president of New Mexico State University, mentioned that nationally recognized science-based agricultural degrees are not included in the list of approved workforce programs, and she would like to see these reviewed for inclusion for next year's formula. She also requested additional funding over FY12 levels for the statewide outcomes component of the formula.

Members asked about the differences between the task force's recommendation and the HED's proposed formula, particularly the weighting of the course workload matrix and the calculation of the awards matrix. Representatives King, Sapien, and Lundstrom were concerned the HED's formula based outcomes funding on the total number of awards an institution granted and did not reward institutions for granting more awards over time or over a set benchmark; simply producing awards without demonstrating an increase over time will not help the state achieve its targets for increasing certificates and degrees. Mr. Porter responded the task force would like to see the department move toward recognizing change in awards for FY13 and requested setting a benchmark tying additional incentive to increase of degrees. There was some discussion about the accuracy of the data used for the awards matrix and whether any data will and should be corrected for the department's budget submission.

Integrating academic programs throughout the state was discussed, as well as improving articulation agreements to increase transfer rates from two- to four-year institutions. Secretary Garcia emphasized the work of the state's nursing programs to use resources efficiently, assist more students, and produce more nurses.

Senator Linda Lopez expressed concern with the formula because she has not seen numbers determining winners and losers of the formula. She is concerned the formula will be used for the

FY13 budget request, while the formula does not seem to be fully vetted and tested. Other members discussed the Legislature's role in funding higher education. Secretary Garcia replied rewriting the formula was not easy and it is imperative to implement the formula immediately to begin to change institutional funding. He also requested the Legislature respect the formula as developed and not change components or weights of formula components.

**Indian Affairs Department (609).** Arthur Allison, secretary designee, Indian Affairs Department, said the IAD has broad authority to oversee the well-being of more than 22 tribes, tribal nations and pueblos in New Mexico. The IAD is the lead coordinating agency in state government for ensuring effective interagency and state-tribal government-to-government relations. The IAD is statutorily required to consider and act on the entire subject of Indian conditions and relations.

The IAD primary activities are to assist with developing and securing legislation benefitting tribes, maintain consistent visibility, and provide capital outlay and special project funding for tribal entities.

Secretary Allison proposed three economic initiatives: marketing for Indian gaming and enterprise, expansion of capital outlay in Indian country, and investing in small businesses in Indian country. Secretary Allison stated he firmly believes the state and the IAD can come together to see these initiatives come to fruition.

The IAD's Administrative Services Director Lillian Brooks spoke of the department's flat budget request and gave a brief overview of the IAD's high vacancy rate. The IAD has 15 FTE and eight positions filled. Four positions are projected to be filled at the end of January. The total budget is \$2.6 million, with \$1.63 million dedicated to personal services and benefits, \$411 thousand for contractual services, and \$258 thousand for operations.

In response to Senator Cisneros, Rebecca Martinez stated she has overseen the tribal infrastructure fund since 2005 and in FY13 will be the first year 5 percent from the bonding capacity will come to the tribal infrastructure fund. There are unexpended balances, but projects have 18 months to be completed. Senator Cisneros asked how it is determined who receives money, and Ms. Martinez explained a release of notice of funding availability goes out in September and projects are vetted with criteria. There were 85 applications in, totaling \$60.2 million. Of the 85, 39 are for planning grants totaling \$8.2 million and 42 applications for design and construction totaling \$50.5 million. Ms. Martinez gave assurances that the day is over when funds are given before documents are in place.

Chairman Smith stated he is concerned the IAD will not get to use money earmarked, and asked if the IAD is the intermediary for the Governor's Office on a new compact with the Navajo Nation. Secretary Allison said the tribes are meeting and negotiating internally, but haven't sat down together.

**Public Regulation Commission (430).** Patrick Lyons, chairman, Public Regulation Commission, introduced commissioners, and staff, and gave an overview of the commission's accomplishments. It has launched a new website, conducting a management study with an in-

depth analysis of strengths, weaknesses, opportunities, and threats to enhance accountability, efficiency and effectiveness; and the commission has capped salaries at \$90 thousand.

The commission has been proactive in dealing with internal control weaknesses, and Commissioner Lyons stated the PRC has incorporated greater checks and balances. The PRC has focused on improving overall hiring practices, because these are technical jobs. To enhance business opportunities in the state, the PRC is also looking at eliminating some regulations.

Commissioner Lyons requested the PRC be allowed to pick the 4 FTE slated for elimination.

The PRC FY13 overall budget request is \$38.7 million, an increase of \$3.9 million. The breakdown: \$319.9 from the general fund to cover vacant position budgeted at midpoint; a \$617.2 increase from other revenue to cover position adjustments and required equipment for the State Fire Marshal's Office and Fire Fighters Training Academy, as well as increases for the Insurance Division; a federal funds increase of \$54.7 because more federal funding is available for the Pipeline Safety Bureau; and a fund balance increase of \$2.9 million to cover additional patient compensation settlements. Commissioner Lyons added the patient compensation fund is a traditional program not affecting the overall PRC operating budget.

Commissioner Lyons stated the PRC is working on building a budget for next year with no general fund monies.

Vice Chairman Varela asked if Think New Mexico has talked with the PRC about suggested changes for restructuring, and Commissioner Lyons stated they have talked and are willing to work with them. Representative Larrañaga asked what Commissioner Lyons thought of reorganizing and making the Insurance Division a separate agency and Commissioner Lyons said he agreed with Think New Mexico, saying it should be an independent agency.

The discussion continued with political hiring and the personnel system, the systemic issues with the State Fire Marshall and Construction Industries, funding for experts, and campaign restrictions.

**Department of Public Safety (790).** Secretary Gorden Eden and State Police Chief Robert Shilling provided an overview of the department and its budget request. Chief Shilling told the committee about the Motor Transportation Division receiving the Federal Highway Association Roadside Safety Award for the department's Smart Roadside Inspection System.

Secretary Eden stated the department came up with a new vision and mission statement, with a new core policy agenda and initiatives, and will collect data on everything.

Secretary Eden outlined many initiatives to improve efficiency throughout the department: combining the K-9 and fleets of State and Motor Transportation Police; reducing the chief's staff; requiring district offices to use data-driven plans to meet the needs of the community; restructuring Special Investigation Division zones; participating with other law enforcement entities to improve policing; exploring opportunities to expand forensic laboratory services and use of technology; streamlining administrative processes such as finance, procurement, and human resource management; and implementing a "transition with honor" program to attract

trained individuals into the officer ranks. The department recently underwent a re-accreditation process. The Bureau of Alcohol, Tobacco and Firearms has partnered with the DPS to expand the Hobbs lab to include fire arms and tool marks, which may help with the funding issue. The State Police has 63 candidates for its next recruit school, with 27 military veterans.

The general fund request is \$3.6 million higher than FY12. The increase includes \$1.7 million for a second recruit school, \$1.3 million for salaries and benefits for 40 graduates, \$178 thousand for salaries and benefits for four dispatchers, \$148 thousand to replace funding meth lab cleanup formerly funded by the federal government, and \$213 thousand for additional costs for forensic services as a result of *Bullcoming v. New Mexico*. The DPS is also requesting a supplemental appropriation of \$587.6 thousand for FY12 fuel and \$250 thousand for data circuits.

Senator Smith asked about the process for dealing with abandoned vehicles on the roadside for 30 days or more and expressed concern about students bringing drugs from Mexico in their backpacks and if the K-9s can be used. Chief Shilling responded that vehicles should not be left more than 72 hours after a sticker is placed on the car, and he will check with the lieutenant in Deming. Chief Shilling informed the committee the use of drug-sniffing dogs at the border must be coordinated with the Border Authority and U.S. Immigration and Custom Enforcement.

Representative Varela asked why federal revenues declined. Secretary Eden stated New Mexico is not in compliance with the Sex Offender Registry Act, so federal dollars are withheld and all justice grants have been decreased. Vice Chairman Varela also asked about the use of the proceeds from the sale of the state aircraft to buy police vehicles. Chief Shilling said that the department received a \$4 million appropriation during the special legislative session but did not know the source of the funds. The money will be spent on vehicles for State Police and Motor Transportations probably on the Ford platform as the Crown Victoria will no longer be produced.

**Energy, Minerals and Natural Resources Department (521).** John Bemis, secretary designee, Energy, Minerals and Natural Resources Department, introduced his staff and stated the department has 500 employees, and a budget of \$60 million to \$70 million a year. Of that, about one third is from general fund, one third is federal funds, and one third is other funds.

Tommy Mutz, State Parks Director, reported state parks offers services for 4.5 million visitors annually. Unlike many state parks across the country, New Mexico has not had any permanent park closures. In FY11, state parks provided more than 730 various outdoor classroom programs for 15 thousand children and more than 900 boating safety classes. Volunteers contributed more than 300 thousand hours to state parks, equaling about 45 FTE.

State Forester Tony Delfin said last year's fires burned more acres in all jurisdictions than any fire season on record. The Forestry Division responded to more than 1 thousand fires on non-federal, non-municipal lands. Federal Emergency Management Agency (FEMA) grants were approved for seven fires, and approximately \$10 million of \$22 million in fire suppression costs will be reimbursed by FEMA and other federal agencies. Mr. Delfin reported he expects exceptional to extreme drought in 2012.

Louise Martinez, division director for the Energy Conservation and Management Division, said among other things, the division provides technical assistance for energy programs across New

Mexico and evaluates tax credit applications and oversees renewable energy programs. Those programs provided for 22 percent reduction in energy consumption, generated \$1.8 million in gross receipts tax revenue, and reduced utility bills by \$400 thousand.

Fernando Martinez, director of EMNRD's Mining and Minerals Division, stated exploration has increased due to high commodity prices the last few years.

Secretary Designee Bemis briefed the committee on oil and gas trends, citing 1,464 permits to drill this year, and a rig count of 79 drill rigs. He noted the activity is mainly in the southeastern part of the state.

In response to Representative Gray regarding the "pit rule" on water discharge by the oil industry, Secretary Designee Bemis stated the judicial body should determine the outcome, adding that changes currently proposed by the New Mexico Oil and Gas Association would not totally eliminate the closed loop system.

In response to Vice Chairman Varela, Jeff Primm, Oil Conservation Division staff, stated that approximately \$25 thousand is budgeted for mainframe costs, and a new information technology person will be hired. Vice Chairman Varela expressed concern that transitioning the ONGARD system off the mainframe could result in inaccurate collection of production numbers. Secretary Designee Bemis said the responsibility for ONGARD is shared with the Land Office and the Taxation and Revenue Department and agreed that an audit process is critical to ensure taxes and royalties are correctly paid.

Representative Larrañaga asked if the EMNRD keeps record of employment growth in mining within the last year. Mr. Martinez stated employment has increased and he would provide him with a report by the end of the year. Finally, the committee briefly discussed a new potash mine in southeastern New Mexico, as well as reclamation of old mines.

**Higher Education Department (950) and Education Trust Board (949).** José Z. Garcia, secretary, Higher Education Department (HED), noted that staff retention is a problem and the new funding formula requirements require departmental reorganization. The HED's priorities for FY12 were working on a new funding formula, pursuant to statute, and bringing stability to the Education Trust Board.

Various departmental staff reported on the HED's initiatives from FY11 and priorities for FY12. Lori Vigil, former HED administrative services division director, discussed the HED's FY13 budget request. Except for lower federal funding for FY13, the department's operating and financial aid requests reflect FY12 budget levels.

Secretary Garcia stated the ETB's legal problems have been resolved and the agency is working on hiring a new director to oversee the fund. Vice Chairmen Varela asked for a report on the ETB's recovery and distribution of settlement funds resulting from the ETB's suit against Openheimer Funds. While the ETB's operating budget audits for FY08, FY09, and FY10 are not complete, David Hadwiger, director for the institutional finance division, reported the ETB's investment fund audits for those years are current and filed with the State Auditor's office.

The department's Human Resources Director Amparo Juarez told the committee said the agency has faced a number of challenges, such as a considerable vacancy factor, so positions were reallocated and reclassified and exempt positions were reduced. Of the agency's 58 positions, 35 are filled, with a 39 percent vacancy rate. Projections for the first three months of 2012 show 49 filled positions with nine vacancies, equaling a 15 percent vacancy rate.

Vice Chairman Varela said assessing the department's FY13 request without the department's complete FY10 audit is difficult. Ricky Bejarano, state controller, reported on conversations with the HED staff and said he expects the FY10 and FY11 audits will be done by December 15, 2011. A representative from the Office of the State Auditor stated the HED is still on the "at risk" list because of its failure to complete a FY10 audit. Vice Chairman Varela stated the importance of the department completing both FY10 and FY11 audits and asked for a report on FY12 finances when the House Appropriations and Finance Committee meets in January 2012.

Vice Chairman Varela asked the secretary about the status of the Santa Fe Community College's (SFCC's) Learning Center and \$20 million in bond funding for the center. Secretary Garcia said his interpretation of the learning center statute is definitive, that the SFCC center cannot only be approved by the department but that it must be approved by the Legislature. He noted that his predecessor approved the center and the bond election. Chairman Smith clarified the learning center authorizing statute allows for the center's operating expenses to be considered by voters, and if this is the same statute that the secretary cites, the center goes to voters but that further legislative action is not necessary.

Karen Kennedy, the director of the financial aid division, reported that financial aid disbursements are down from \$87 million in FY11 to about \$78 million in FY12. Two federal grant and scholarship programs were eliminated, reducing available state-administered aid. Ms. Kennedy stated the college affordability fund has an unaudited balance of \$21 million, though many distributions have not been made and the projected balance is significantly lower. In response to Senator Beffort, Ms. Kennedy said the Western Interstate Commission on Higher Education dental and veterinary school slots at participating western schools receive general fund appropriations and slots at these schools are based on budget projections.

### **Friday, November 18**

The following members were present on Friday, November 18, 2011: Chairman John Arthur Smith, Vice Chairman Luciano "Lucky" Varela, Representatives Don Tripp, William "Bill" J. Gray, James P. White, Nick L. Salazar, Larry A. Larrañaga, and Henry "Kiki" Saavedra; and Senators Pete Campos, Sue Wilson Beffort, Carlos R. Cisneros, Steven Neville. Representatives Donald E. Bratton, Rhonda King, Jim R. Trujillo; and Senators Rod Adair, Phil A. Griego, and Linda Lopez attended as guests.

**Natural Gas Market Outlook.** Marianne Kah, chief economist, planning strategy, Conoco Phillips, briefed the committee on natural gas scenarios. There is a huge debate over when the surplus in North America is going to end. One camp believes it will end around 2030, and another believes prices, at some point, will be restored to a \$6 or \$ 7 per thousand cubic feet level, but not in the near future.

With the sustained surplus view, shale production fully meets U.S. gas demand and sets prices; costs continue to fall because of the learning curve. The United States has not been using hydraulic fracturing combined with horizontal drilling for very long. However, the industry is drilling despite the bad economy. In addition, the Clean Air Act was intended to close old plants, but because of the economy, these plants are not closing.

Under the shorter surplus view, the limited supply of shale gas could prompt costs to rise as production moves away from liquids-rich area and the industry shifts to produce liquids. A belief that North America would see many coal plant closures due to federal environmental regulations is also part of this scenario, with a backlash against renewables and nuclear plants. Ms. Kah added there are people building liquid natural gas export plants because it may be the only way to get oil and gas to the market, despite political risk in permits.

Ms. Kah briefed the committee on different supply and demand situations. When supply and demand are both high, that is called the slow transition to a full cost recovery case. High supply eventually results in high demand, resulting in a price recovery. There is also the long-term disconnect case, where supply continues to stay high without demand growth to absorb it. In this case, the United States remains disconnected from the world market. Ms. Kah stated the people who believe in this case are interested in investing in LNG exports.

The global economic malaise scenario is when both supply and demand are low and there is a prolonged period of low economic growth. The high-demand, low-supply case is called the gas demand overbuild scenario, where many natural gas-fired power plants were built.

Ms. Kah compared the demand across the four scenarios, saying the long-term disconnect scenario is not sustainable for 20 years, as many people think; in the gas demand overbuild case there is federal hydraulic fracturing regulations increasing shale costs and reducing production, which means economically we cannot produce in the United States. New Mexico now allows hydraulic fracturing. Ms. Kah explained the changing electricity generation mix between coal, renewable, nuclear, hydraulics, and natural gas. According to Ms. Kah, today the United States is either in the long-term disconnect scenario, or the global economic malaise scenario.

Demand growth is expected in the industrial sector, with electric power emphasized. Natural gas will gain share in electricity generation. Ms. Kah stated a natural gas, combined cycled power plant is the cheapest to build for consumers, but that is not happening. Government policy is driving wind and solar.

The United States has over 100 years of shale gas supply, with a sharp increase of resource estimates in recent years by combining hydraulic fracturing and horizontal drilling. Ms. Kah briefly talked about coal plants, costs of drilling down to the rock in North America, and “sweet spot” estimations, which some believe to be very big.

Ms. Kah stated the United States does not need LNG, and U.S. natural gas prices are expected to remain disconnected from oil prices. The crude-oil-to-gas ratio will get worse before it gets better. Supportive government policy is needed to capture gas opportunity. Ms. Kah stated realistic tax and fuel-neutral policies need to be in place, and over-regulating hydraulic fracturing is detrimental.

The oil and gas industry in New Mexico provides about 79 thousand jobs, with nearly \$2.2 billion in revenues paid to state and municipalities. New Mexico has 608,857 natural gas customers. Ms. Kah said if prices are being set by the largest and least expensive shale plays, the state's business climate should be one where the regulations do not exceed the costs.

Senator Neville brought up interstate transportation, and Ms. Kah indicated truckers are not supportive because of high fees. Alaska's huge reserve was discussed. Ms. Kah stated ConocoPhillips is interested in a pipeline; however, it would cost \$40 billion, and the lower 48 states do not need it.

Representative White asked about the term "fracking" and Ms. Kah stated the term is used for what people do not like about oil and gas drilling. If the vertical well is not put in properly, methane can get into the water aquifer, which is true for any well.

**State Treasurer (394).** James B. Lewis, State Treasurer, testified that his FY13 budget request is flat and includes \$122 thousand in other state funds local government investments, which generates \$400 thousand annually for the general fund.

Budget reductions over the past five years amounted to a 20 percent decrease, or almost \$1 million. Office relocation occurred six months ago, which reduced rent costs by \$153 thousand. The office also reverted \$98 thousand for FY11.

Currently the STO has invested \$294 million in capital project bonds issued by state and local governments over the past year. Its portfolio includes securities issued by five school districts, one county, the New Mexico Finance Authority, and state bonds and notes. The treasurer also noted the state is currently in an investment environment with historically low investment returns.

The STO is working on improving a cash forecasting model which tracks major agency daily cash receipts and disbursements and is working with agencies to ensure deposits are made and entered in share. It is working with the DFA to address issues of large negative fund balances carried by some agencies. Agencies must draw down reimbursable funds more frequently from federally funded programs.

The STO is working on proposed legislation for 2012 to update public fund statutes and definitions to reflect current business practice and industry standards. It is also drafting an administrative rule to direct agencies on cash management procedures and draw downs.

Vice Chairman Varela asked if the STO and the DFA secretary received a letter on overdrawn accounts and what action has been taken. He wanted to know whether the office has been able to work with the DFA to eliminate this problem. Mr. Lewis replied that the STO meets on a regular basis with the DFA and has been meeting with agencies that have negative fund balances.

Vice Chairman Varela then asked whether the STO has been able to determine whether the general fund has had a negative cash balance. Mr. Lewis replied that the Treasurer's Office reconciles cash from the bank to the books. Sometimes the general fund temporarily borrows from non-general fund accounts and vice-versa so it comes out a wash (this has been happening for years and years).

Representative Larrañaga asked what the Legislature can do to discourage negative fund balances. He sees a need to change the statute to tie with current business practices. Mr. Lewis mentioned the STO has tried follow-up meetings with agencies to talk about the issues but that the agencies were not “following up” and did not draw down other funds in a timely fashion.

### **Staff Reports**

Educational Retirement Board (352). The ERB is requesting a budget of 38.1 million or 5 percent, a decline from FY12 of 40.2 million. The ERB has 58 FTE and wants to increase its FTE to 63. The ERB also requests an expansion of \$408 thousand, included in the budget.

Jan Goodwin, interim executive director, talked about reaching 8 percent target on investment returns and the five-year return number was 5.5 percent. Compared with other top pension plans, New Mexico was in the top 21<sup>st</sup> percent.

Ms. Goodwin stated that in April the board lowered the long-term investment report to 7.75 percent, and as of September 30, 2011, total assets were \$8.7 billion. It was a difficult quarter and the S&P was down 14 percent and the ERB was down 8 percent. As of October 31, 2011, the PERA was up 4.5 percent and was at \$9.1 billion.

In response to Vice Chairman Varela, Ms. Goodwin stated the ERB has gone on a listening tour all across the state, with interesting responses. The ERB has three new proposals from membership.

Public Employees Retirement Association (366). The PERA is requesting a budget of 35.4 million, an increase from FY12 of 29.7 million, a jump of 19 percent. The PERA has for 76 authorized FTE, but currently has 75 filled because one position was lost a position due to reclassifying. The PERA has also requested an expansion of \$170 thousand. That number is included in the budget. It is also looking to increase its FTE to 77.

Retiree Health Care Authority (343). Anne Hanika-Ortiz, LFC analyst, introduced the RHCA staff to the committee and gave a high-level overview of the FY13 request that included member demographics and agency mission. Wayne Probst, director, RHCA, provided a general overview on the budget request. The RHCA is requesting \$263 million, 9 percent over FY12. The request includes an increase of \$23 million for health benefits and an expansion of \$50 thousand for investment services.

Due to significant plan changes since 2007, the plan now is solvent through 2027 with a \$205 million fund balance and \$3.3 billion unfunded liability for future benefits. The board has adopted a five-year sustainability plan beginning in 2012 that balances cost increases among the three stakeholders. The request includes \$2.9 million for program support, flat with FY12 except for a \$50 thousand expansion request for an investment consultant. The request includes \$257.2 million for health benefits, a 9.8 percent increase over FY12. Plan upward pressures include a growth in membership projected to be 6 percent and increased medical costs of 8 percent. Downward pressures include movement of members to higher deductible options.

Mark Tyndall, deputy director, RHCA, talked about the impact of a flat budget on the agency’s mission. To achieve a “flat” budget, the plan would have to increase cost-sharing with retirees,

that would not necessarily reduce overall healthcare spending. Representative Varela asked for more detail on the investment advisory services provided by the State Investment Council. Mr. Probst stated the reason for the expansion is to hire an investment advisor because the SIC has stated it will not provide that benefit within the current fee structure. Various members commented on proposed plan design changes for the future. Mr. Probst stated the board is looking into various scenarios that would limit retiree healthcare benefits based on age and service. The RHCA does not need legislative approval to adopt changes to the plan.

**Accountability in Government Act (AGA) Activity.** The FY11 Accountability in Government Act (AGA) report card summary was presented to the committee. The summary noted that solvency spending reductions of approximately 10 percent over the last three fiscal years resulted in some unmet needs and a higher level of performance outcomes would be more desirable. Performance outcomes indicate a need to address deteriorating roads, dismal grade school reading and math proficiency, low graduation rates, lengthy waiting lists, etc. A number of efficiency measures indicate slower processing times, longer wait times, and increased caseloads and backlogs are noted throughout the state. However, most agencies requested flat budgets indicating a need for more data-driven decision making. Performance outcomes indicate the need for more action plans and strategic planning that improve outcomes.

### **Miscellaneous Business**

#### *Actions Items*

*Approval of Minutes.* **Senator Cisneros moved to approve the October 2011 meeting minutes, seconded by Representative White. The motion carried.**

*FY12 Contract Approval.* Director Abbey requested contract approval for Dr. Lou Baca, Danielle Wilson, Marty Daly, and Gary Chabot for work as analysts during the 30-day session. **Vice Chairman Varela moved to approve the contracts, seconded by Representative Saavedra. The motion carried.**

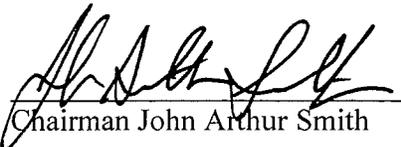
*Approval of Subcommittee Reports.* **Senator Cisneros moved to approve the October 2011 Subcommittee Reports, seconded by Representative Larrañaga. The motion carried.**

### **Information Items**

Director Abbey briefed the committee about the FY11 LFC financial audit, saying the LFC received an unqualified audit opinion. Director Abbey briefly discussed the *October 2011 BAR Report*, FY12 LFC budget status, and the *Full-Time Employees by Agency* report.

Deputy Secretary Sallee proposed evaluating community colleges, specifically looking at Central New Mexico Community College and Doña Aña Community College.

With no further business, the committee adjourned at 11:24 a.m.

  
Chairman John Arthur Smith

  
Vice Chairman Luciano "Lucky" Varela

