Legislative Finance Committee
State Capitol Building, Room 307
Santa Fe, New Mexico
July 21, 22, 23, 2010

Wednesday, July 21

The following members were present on Wednesday, July 21: Chairman Luciano "Lucky" Varela, Vice-Chairman John Arthur Smith, Representatives Donald E. Bratton, Rhonda S. King, Don Tripp, Edward C. Sandoval, Jeannette O. Wallace, Nick L. Salazar, and Henry "Kiki" Saavedra; and Senators Clint Harden (for Sue Wilson Beffort), Carroll Leavell, John M. Sapien, Howie Morales (for Mary Kay Papen), Pete Campos, Carlos Cisneros, and Stuart Ingle. Representatives Bernadette Sanchez, Dennis Kintigh, Brian Egolf and Antonio Lujan attended as guests.

Preliminary FY10 General Fund Revenue Reports and Revised Revenue Estimates for FY11 and FY12 and General Fund Financial Summary. Katherine Miller, secretary, Department of Finance and Administration (DFA), noted the revenue forecast does not include actual revenues for May or June 2010. The national and state economies experienced weaker recoveries than most analysts expected. GDP is expected to grow by 3.1 percent in 2010 and 2.7 percent in 2011. Inflation is expected to remain low – 1.5 percent in 2010 and 1.4 percent in 2011, as commodity prices correct downwards and wage growth remains weak. Although the unemployment rate is expected to improve, it is likely to remain high for the next couple of years at 9.7 percent in 2010 and 9.2 percent in 2011, respectively.

Analysts are uncertain whether the economy is clearly on the rebound or whether a "double-dip" recession is in the offing. The $787 billion federal fiscal stimulus package continued to roll out; New Mexico is expected to receive $3.7 billion in American Reinvestment and Recovery Act (ARRA) funds. Although recurring revenues are likely to rebound slowly, the state has prepared for continued slow growth in revenue and will take additional measures as necessary to control spending in FY11.

Through its FY11 operating budget instructions and guidance on the "50 percent rule" the governor and DFA have been preparing agencies for the possibility of reduced revenue estimates for FY11. All agencies were asked to prepare for a potential three percent to five percent budget reduction mid-year. While the final numbers for FY10 are not in yet, July revenue estimates show there is a small net shortfall in revenues and the need to use authorized reserves to close FY10. Revenues and authorized transfers will be insufficient to meet general fund appropriations for FY11. The Governor will allocate $20 million of ARRA state fiscal stabilization funds to FY10 and will reduce FY11 allotments pursuant to the provision of Section 14 of the General Appropriations Act of 2010. In addition, there is also substantial concern whether Congress and the President will actually extend by two quarters the FMAP (Medicaid match) bonus provision of the ARRA before the fall election. These funds were included in balancing the FY11 state budget. If Congress fails to extend the enhanced FMAP, New Mexico's general fund budget shortfall for Medicaid is estimated to be $160 million, and the overall reduction in the program is $614 million when coupled with the loss of federal funds. Also under consideration by Congress are proposals to step down the enhanced FMAP, which would result in a lesser general fund budget shortfall for Medicaid of $56 million. If the Human Services Department (HSD), is required to implement reductions to the Medicaid program, the department would have to consider eliminating programs in their entirety or pursuant to requirements of ARRA maintenance of effort and recent health reform legislation, the state would consider declaring a "budget deficit" for the state and requesting permission from the U.S. Department of Health and Human Services to allow a change in the eligibility threshold for adults and possibly children.

The national economy shows mixed signs of a weak recovery from the recession with some signs that subsequent growth may continue to be weak with possible setbacks, although output has shown two quarters of growth and some months of job gains as U.S. employment turns around. Before employment turned around, the national unemployment rate peaked above 10 percent.

The July IHS Global Insight forecast reflected national job losses in each of the 26 months preceding their June forecast with negative GDP growth for four consecutive quarters. Consumer price growth is expected to remain low with consumer demand too weak to support large increases. Changes to the national economic outlook are minimal for the most recent IHS Global Insight forecasts for U.S. real GDP and inflation. As national consumer spending and sentiment grow, yet remain weak, the trend of personal savings rates has fallen after a dramatic rebound.

While HIS Global Insight reports job gains nationally have begun to occur in the second quarter of 2010, UNM's Bureau of Business and Economic Research (BBER) reports job losses in New Mexico through that same quarter. This job weakness in New Mexico is reflected in substantial reductions in expected general fund revenues from recent years and slow growth through FY14. The recession, causing the national unemployment rate to peak at more than ten percent is now causing secondary problems in the credit and housing markets. Because of the depth of the recession, jobs and general fund revenues will take several years to achieve the peak levels of FY08. This revenue forecast does not indicate that there will be sufficient revenue in FY12 to make up for the loss of ARRA funding. Based on recent data, job growth has slowed in New Mexico from over three percent in mid-2006 to negative 1.5 percent as of preliminary May 2010 reports. The preliminary U.S. average growth for the May 2009-May 2010 period was a negative 0.4 percent; New Mexico ranked 44th among all states in job growth for this period. New Mexico's preliminary May 2010 unemployment rate was 8.4 percent, up 1.6 percent year-over-year, but down 0.3 percent from the prior month. The national preliminary May 2010 unemployment rate was 9.7 percent, up 0.3 percent year-over-year and down 0.2 percent from the prior month. BBER reported in its state review that the economy is losing fewer jobs, with all sectors other than educational services and health care showing substantial improvement in the first quarter of 2010.

Duffy Rodriguez, secretary designate, Taxation and Revenue Department (TRD), reported the FY10 general fund recurring revenues are expected to be $32.5 million less than estimated in the December forecast and total revenues will be $43.5 million less; a small net shortfall of less than one percent. Strong mineral tax revenues will somewhat offset weak sales and income taxes. While FY10 revenues have not closed further adjustments should not create problems and the fiscal year can be closed within available transfer authority.

The total revenue outlook has changed substantially from December 2009. The FY11 budget forecast expects near-term weakness in natural gas-related revenues, followed by slowly growing natural gas prices and moderate growth in gross receipts, personal income, corporate income, motor vehicle excise taxes and investment income. Ms. Rodriguez noted gross receipts and compensating taxes are the largest source of general fund revenue generating over one-third of total recurring revenue. In FY09, these taxes fell by 1.1 percent year-over-year. The momentum in taxable gross receipts deteriorated rapidly in calendar year 2009. The rate of decline began to slow last winter and continued to slow throughout calendar year 2010, but has yet to see sustained positive overall growth. In FY10, the overall gross receipts and compensating tax collections are expected to drop by

10.7 percent from FY09, the largest drop in decades; this is 12 percent below the FY08 peak level.

In FY07, the construction sector was one of the biggest drivers of growth. In FY08, it contributed to the slowing of growth and in FY09, it became a significant drag on the economy helping to pull reserves lower year-over-year for the first time in decades. In FY10, year-to-date construction fell by over 30 percent year-over-year, an unprecedented drop. The contraction of the construction sector is changing the composition of the gross receipts revenue base making up almost one-sixth of total gross receipts in the past; in recent years, it has contributed as little as one-twelfth. Revenue growth is expected to return, albeit slowly during FY11. The base level is expected to grow by 2.6 percent and will be augmented by the recently enacted one-eighth percent rate increase. Overall revenue growth is therefore expected to grow by 5.7 percent. More robust growth is expected to return in FY12 to 6.1 percent and 6.2 percent in FY13 and begin to moderate slightly in FY14 to 5.6 percent and level off to 5 percent in FY15. Even with the recently passed tax increase, gross receipts tax revenue is not expected to surpass its FY08 levels until FY13.

Personal income tax comprises approximately 20 percent of general fund recurring revenues. The recession has negatively affected personal income tax revenues in a variety of ways including the slowing of personal income growth, reduced capital gains and higher unemployment levels. Since the December 2009 forecast, the economy has continued to weaken, further reducing personal income tax revenues. Projected FY10 revenues are now 22 percent below FY08 peak levels; however the decline has been partially offset by revenue enhancements passed during the 2010 special legislative session. Forecasted FY11 personal income tax revenues prior to legislative changes are eight percent above expected FY10 revenues.

In December 2009, corporate income tax revenue estimates were $160 million in FY10 and $200 million in FY11. While final figures for FY10 are still unavailable, revenues are expected to be roughly $120 million or 25 percent below the December forecast. The FY11 July estimate for corporate income tax revenues is $175.5 million suggesting that corporate income taxes, in absence of legislation, will grow 30 percent between FY10 and FY11. This result is consistent with forecasts for corporate profits, federal corporate income taxes and other indicators produced by IHS Global Insight and the Congressional Budget Office. Similar reasoning suggests corporate income taxes will total $230 million in FY12.

Selective excise taxes, particularly the motor vehicle excise tax are sensitive measures of consumer sentiment. These taxes are expected to decline by 1.2 percent in FY10, primarily due to large declines in the Fire Protection Fund, motor vehicle excise and gaming revenues, only partially offset by a large increase in insurance revenues. For FY11, insurance revenues are expected to continue to grow while motor vehicle excise and gaming revenues will also grow, but from the lower FY10 base. The recession nationally, as well as in New Mexico has strongly affected the automotive industry. Revenue peaked in FY07 and $131.3 million; however are expected to fall to $91.8 million in FY10, declining almost $39 million or 30 percent in only three years.

Oil and Gas taxes and royalties are expected to decline in their percentage contribution to the general fund from FY10 to FY15. In FY10, oil and gas revenues made up 16.8 percent of the general fund's revenue; they are expected to contribute only 14.6 percent by FY15. Since the December 2009 forecast oil and natural gas prices have only slightly changed. The price of natural gas is estimated at $5.12 per mcf in FY10 and expected to rise incrementally to $7.00 per mcf by FY15. Oil prices are estimated to be $71.35 per barrel for FY10 and expected to increase gradually to $90 per barrel by FY15. The estimates for both oil and gas volumes were adjusted from the December forecast. New Mexico producers continue to receive a premium against daily spot process; however processing and gathering costs continue to be higher on average in New Mexico than reported in prior years-particularly in the San Juan basin. The long-term prospect for natural gas is a gradual decrease in volumes produced and reported. Volumes peaked at an excess of 1,600 bcf (billion cubic feet); however future total production volumes are expected to decline to less than 1,100 bcf by FY15. New Mexico now has three horizontal rigs drilling in the San Juan basin. This new technology largely replaced conventional vertical and directional drilling in the Marcellus and Barnett oil shale plays making significant inroads in the discovery of new production will in the more mature fields of the San Juan and Permian basins.

Secretary Miller continued and said over the last six years reversions have averaged $41 million per year to the general fund and $5 million to the appropriation contingency fund; however the usual pattern has been for agencies to wait until after their agency audit is completed to remit the amount of reversion calculated by the auditors. On average, 27 percent of reversions from any particular fiscal year are remitted and booked by September 30 of the fiscal year following the allotment. Approximately 57 percent of reversions are remitted with a one-year lag as agencies remit reversions pursuant to completed audits. Because of the need to balance the FY09 budget, a year-ending effort by DFA staff to accelerate the timing of reversions generated approximately $26.1 million for the general fund over levels estimated in August 2009. Additional amounts of revenue were scored as recurring because of the difficulty of determining whether a particular reversion is recurring or nonrecurring, timely or delinquent. Regular reversions for FY10 are estimated at $36 million based on a survey recently conducted by the budget division staff of large executive agencies and programs.

For the agencies whose budget reductions were vetoed in Laws 2009, Chapter 5, first special session, but for which the governor ordered a reduction of expenditures in executive order 2009-044, the administration established within each affected state agency's operating fund, a liability to the general fund and a corresponding expenditure. The savings expected from the executive order total $87.6 million with $8.6 million coming from five furlough days taken by executive employees. By the end of September, these liabilities will be discharged upon the reversion of these savings to the general fund. Another component of the FY10 solvency package includes Laws 2010, Chapter 105, entitled Capital Outlay Reversions for Solvency. Upon gubernatorial action on the bill, DFA estimated it would provide $141.1 million in nonrecurring transfers to the general fund; however valid commitments and expenditures made prior to the effective date of the legislation and other provisions of the bill lowered the transfers by $11.1 million to $130 million.

Amounts shown as transfer from tax stabilization reserve and transfer from appropriation contingency fund have been calculated to account for the transfer authority granted by legislation enacted in the October 2009 special session and the General Appropriation Act (GAA) of 2010.

The general fund financial summary is based on this current revenue estimates updated for legislation and shows the amount of the reduction required by Section 14 of the GAA of 2010. Section 14 requires the governor to proportionately reduce general fund allotments to certain entities receiving general fund appropriations. These include legislative agencies named in certain sections of House Bill 1 of the regular 2010 session, and except for the Human Services Department's (HSD) Medicaid programs and the Department of Health's (DOH) developmentally disabled services programs, agencies named in Section 4 of House Bill 2 of the second special session in 2010. After the governor's commitment to use $20 million of ARRA/state fiscal stabilization fund dollars is applied, the reductions mandated by Section 14 translate to 3.2 percent across all remaining entities or $150.3 million.

The FY11 estimate for tobacco settlement revenues was lowered by $4.6 million to $40 million based on actual receipts for the program received in April 2010. Receipts for FY10 were $7.9 million less than FY09. As a result, the forecast was rebased and adjusted down. The Legislature temporarily distributed 100 percent of the annual payment to the tobacco settlement program fund to fund health-related programs including Medicaid. The FY11 appropriation for the program fund totals $44.6 million, 10.3 percent more than the revenue estimate. DFA will require the affected agencies to reduce their budgets pursuant to section 3(F) of the GAA of 2010 to keep spending within available resources. FY10 tobacco settlement revenues were $4 million less than appropriations, requiring the affected agencies to reduce their budgets from this source by 7.9 percent and DFA to claw back previous allotted amounts.

Downside risks to the forecast include the recent poor performance of European economies due partially to debt problems of Greece and Spain. Because they are members of the European Union, they are unable to pursue an independent monetary policy or devalue their currencies. One result is that the U.S. has once again become a safe haven with the value of the dollar rising relative to the Euro. Another result is instability of financial markets and potential impacts on many economic variables, including consumption and investment. The energy revenue forecast also contains a number of risks. The mineral extraction industry has been using horizontal drilling rigs and chemical fracturing to engage in extraction from oil shale. These new technologies are only slowly being adopted and adapted in New Mexico. On the positive side, there is considerable recent strength in consumer spending and many other factors suggest the "double-dip" recession is unlikely to occur. These include improved conditions in the housing sector, recent rises in industrial productions, and economic growth in China is continuing.

Tom Clifford, chief economist, LFC, reported the new forecast results in a shortfall between total revenue and total appropriations of $194.7 million in FY10 and $203.5 million in FY11. The annual percentage change in total revenues is forecast at 7.3 percent in FY11 in part due to new revenue legislation. When new legislation is excluded, underlying revenue growth is estimated at $165 million, or 3.4 percent. Total revenue growth is expected to average 4 percent to 5 percent per year in FY12 through FY15. Starting in FY12, other revenues were revised down by $37 million, primarily because of the uncertainty over whether the federal government will reinstate the estate tax credit for state taxes.

Mr. Clifford provided an overview general fund summary including an estimate of the "sanding" required under the GAA which leaves a reserve of 3.7 percent. He also presented an FY12 budget "new money" scenario that starts with the same level of appropriations as the sanded FY11 budget, and also assumed the need to replace $350 million of temporary federal funding used to reduce general fund appropriations for FY11.In addition, the need to fund temporary one-time savings assumed in the FY11 budget would add $42 million to the budget. These assumptions would yield a deficit of $170 million between the FY12 revenue and the assumed appropriation level. Also assumed in this scenario are legislative actions to continue several temporary provisions in the FY11 budget -- such as increased employee contributions to retirement programs – that save approximately $90 million of general fund appropriations. FY11 appropriations after the sanding are at a level of 13 percent below their peak level in FY09. Mr. Clifford provided an update of the LFC's monthly revenue tracking report, which is pointing to a decline of $40 million for FY10; however not all figures have been finalized. The national economic indicators show a sharp decline in employment and payroll, as well and low inflation figures. Natural gas volumes are down 7.5 percent from FY09.

Brent Earnest, senior fiscal analyst, LFC, provided an update on Medicaid and FMAP extensions. Congress passed an extension of the unemployment insurance; however it did not include an extension of the enhanced FMAP rate. If a step-down version is enacted, New Mexico would need an additional $47 to $60 million. Without additional state funds, Medicaid would be reduced $700 to $800 million, or $220 million with the step-down version. Medicaid has a projected shortfall of $23 million for FY11. Mr. Earnest suggested reducing agency's budgets by an additional one percent and re-appropriating funds to Medicaid, as well as looking for additional funds in cash balances and capital outlay. Mr. Earnest noted the Medicaid program has been planning for cost containment and reduced provider rates by three percent and tightened benefits. Benefits have not been eliminated and eligibility has not been changed due to preclusion from the federal government.

In response to Chairman Varela, Ms. Rodriguez said a $200 million shortfall was anticipated for FY10; however it has been adjusted to $35 million. Daily deposits and monthly distribution reports have a lag due to modified accrual. An accrued FY10 final number will be available by the end of September and additional FY10 revenue will continue. Books are closed on an accrual estimate. Secretary Miller noted the audit and audit adjustments are based on actuals. Vice-Chairman Smith clarified the $200 million shortfall was anticipated for the FY11 budget, not the FY10 budget; however the FY11 budget is now estimated at a shortfall of $160 million. Vice Chairman Smith suggested given the situation, the governor may want to reanalyze stimulus fund commitments and put them in a direction more beneficial to sustain the state in the short-term rather than build a monument in the future. Representative Bratton added that appropriate reductions have to be made based on the revised revenue projections.

Senator Harden asked about federal tax movement that may be hitting New Mexico citizens and businesses and the effect on revenue projections. Mr. Clifford said the national forecasting service has a method of estimating the federal budget balance and shows a diminishing federal deficit going forward requiring revenue increases.

Chairman Varela asked if other reserve funds have been considered to make up the shortfall. Secretary Miller said there is capacity of $70 million in senior and $30 million in supplemental of sponge for FY11; however there was not any legislation passed to authorize its use. It could be passed in January and issued in the June timeframe.

Performance and Status Report for the Behavioral Health Collaborative. Alicia Smith, Alicia Smith and Associates, provided an overview and the timeline on the directed corrective action plan for Optum Health based on concerns raised by the provider community, the Legislature, and members of the collaborative. A number of issues were identified, including providers were not able to register clients into the system accurately and claims not being paid on time. Because the system changed dramatically, there were issues about whether the providers were accurately trained, prepared and ready to understand the new system. The remediation for some issues laid out steps in the directed corrective action plan. Expedited payments were made to providers keeping them solvent and able to continue providing services. OptumHealth also relaxed edits in their automated claims processing system making it easier for claims to be paid. The directive corrective action plan required OptumHealth to engage with an independent auditor (Hewitt) to audit its claims processing system. OptumHealth is also required to form a provider council to advise and begin to participate in addressing concerns directly.

Ms. Smith said performance measures are monitored on a weekly and monthly basis, including:

- the number of claims processed each month
- percent of claims paid
- percent of billed dollars
- percent of inappropriate denials

- percent of claims auto-adjudicated
- turnaround time by week
- reconciliation results
- fund burn rate
- independent audit

The claims reconciliation process has begun for providers who received expedited payments. To date, 139 providers received letters and reports about reconciliation. Linda Roebuck-Homer, CEO, Behavioral Health Purchasing Collaborative, reported a letter of agreement was done with OptumHealth in June clarifying issues within the directive plan of correction. Because of the timeliness, there is concern that the providers need to be made whole under general fund. Language indicates if money is reverted, OptumHealth would still be financially liable to pay providers for services.

Ms. Smith said the monitoring of claims processing and denials will continue, as well as monitoring the completion of the reconciliation process, completing the return of standard edits, continuing to refine the service registration process, continuing to refine and make the provider council permanent, improve the ability to make sure funds are disbursed to the correct provider with the correct rate of expenditures, and continue monitoring provider complaints.

Ms. Roebuck-Homer continued with an overview of the behavioral health collaborative and identified 17 members on the collaborative. Five agencies provide funding to the contract with OptumHealth. There are 18 local collaborative including three Native American collaboratives to better ensure Native voice.

The collaborative consolidated services including the agreement that HSD's behavioral health services division (BHSD) will manage the office of substance abuse prevention. The collaborative has also taken on a more active role with the Compulsive Gambling Council and is providing pre-admissions screening and resident review (RASRR).

Ms. Roebuck-Homer said the role of the statewide entity is to manage the contracts with providers and provide financial clinical services and monitor performance. Accomplishments include building comprehensive systems of care for children, youth and adults, increase effectiveness and efficiency, increase accountability and increase consumer and family voice. Ms. Roebuck-Homer noted the 2009 annual report is posted on the website.

Forty-one core service agencies were established across the. Core services agencies create a clinical home for a targeted high-needs population. Ms. Roebuck-Homer noted that only core service agencies will provide comprehensive community support services; however consumers can still go to the provider of their choice for other services. Over 5,000 individuals receive community support; 93 percent are seen by a core service agency. The other seven percent need to make a transition in January.

The collaborative monitors quality of care through metrics of individual progress. The collaborative is also working with the Consortium for Behavioral Health Research and Training to monitor performance. Funding from the five departments has been consolidated across 16 funding streams. Between FY07 and FY09 Medicaid funding was maximized by $9.9 million by converting claims from other funding streams. Other services have been added allowing for more funding to be transferred to Medicaid and freeing up general fund dollars at other agencies. Oversight and contract management has been strengthened. The collaborative competitively brought in $33 million in grants since it was formed.

Directions and issues for the future include workforce development; there is a shortage of behavioral health providers. In health care reform, behavioral health is an essential service that has parity with physical health care. The collaborative is developing a comprehensive behavioral health strategic plan to be completed by November. The collaborative is also working on integration of primary care and behavioral health, strengthening language with prevention programs, focusing on early intervention, continuing focus on returning veterans and services.

In response to Senator Sanchez, Ms. Roebuck-Homer said behavioral health was protected from Medicaid cuts although it received the standard three percent reduction across all providers, ten percent for residential care, and 1.8 percent to the Behavioral Health Services Division providers. Secretary Falls added that cuts were looked at based upon current budget. The latest projections indicate cuts are minimal. In addition, an evaluation was conducted to determine which providers have medical loss ratio not going to direct services.

Senator Morales said in speaking with local providers they have expressed frustration with billing and payments. Ms. Smith responded there have been problems with misdirected claims. Senator Morales asked why the service registration system is being used for a payment system. Ms. Smith said the service registration was initially designed to capture important demographic information to manage the contract and it was also designed to alert the system that a particular client was being treated by a particular provider or diagnosis; however it does not work that way. Senator Morales asked if there was consideration to extend the 60-day reconciliation process to alleviate burden to providers. Ms. Smith said the 60-day process is a goal; however it is understood that a 60-day window is not sufficient because of the complexity. The monitors have made offers to work with providers and OptumHealth to quickly resolve issues.

Public comment:
Larry Martinez, Presbyterian Medical Services, representing six core agencies, testified there is insufficient infrastructure and encouraged that other provider operations be strengthened through sub-contracting and expansion. The agencies will honor consumer choice when selecting providers.

Patsy Romero, Romero and Associations, Inc., testified in opposition to the core service agency implementation. There are considerable issues the collaborative has not taken into consideration.

Shannon Freedle, Team Builders Counseling Services, current designee as a children's core service agency in six local collaboratives, testified there was pre-qualifying criteria established in the core service agency designation process including having physical presence for at least three years prior and provision of comprehensive community support services. The process was open assuming pre-qualifying criteria was met. Local collaborative are set according to judicial districts.

Regina Roanhorse, representing a family member, testified there is a need to raise revenue to keep Medicaid fully funded.

Capital Outlay Funding Quarterly Report and Review of Selected Projects. **Capital Outlay Funding Quarterly Report and Review of Selected Projects.** Linda Kehoe, principal analyst, presented the quarterly report for all outstanding capital outlay projects as of June 15, 2010, including projects that were funded for $1 million or greater. Through the efforts of the Department of Finance and Administration (DFA), the Legislative Council Service (LCS), and LFC staff 2,796 projects totaling $321.3 million were voided or expended; $156 million were voided with passage of

Senate Bill 182 while an additional $165.1 million was expended during the last six months. Following the voids, swaps, expenditures and reversions approximately $1 billion still remains outstanding for 2,084 projects. The current balance does not include $180 million set to revert on June 30, 2010. It also does not include $175 million authorized by the Legislature in 2010 for four general obligation bonding requiring voter approval in November. Of the $1 billion that remains outstanding, 1,524 projects totaling $209 million are projects sponsored by individual legislators and initiatives requested by the governor. There are an additional 560 projects totaling $820 million authorized for statewide projects. It is expected that the 27 percent not expended in 2005 and most of 2006 will revert and close by the end of July. The majority of funds sit between the 2008 and 2009.

LFC staff track projects $1 million or greater. The data, such as expenditures, milestones achieved and milestones projected for the next quarter are provided by state agencies and local entities overseeing the projects. To date, LFC staff track 57 percent of all outstanding balances. There are currently 284 projects totaling $557 million. State agency input has significantly improved the movement and the spending of funds; 30 projects totaling $146.4 million have been closed and were not subject to the December 2009 freeze.

There will be no general fund available for capital outlay in FY11. However, during the interim LFC staff will continue to perform site visits, meet with major agencies and higher education officials, work with DFA to review state and local infrastructure capital improvement plans, work with the Property Control Division to make sure estimates for completing projects are accurate, as well as applying LFC guidelines to assess and prioritize capitol needs. Additionally, LFC staff will closely monitor funds from severance tax bond (STB) capacity to ensure projects are starting on a timely basis and are expended in compliance with statutory requirements and IRS code compliance. LFC staff will also continue to closely monitor all general fund projects in the event general fund is needed for solvency. With the passage of Senate Bill 279 in 2010, severance tax bond capacity will decrease by ten percent as of January 2012. Legislation passed during the 2010 session allows 5 percent for deposit into the tribal infrastructure project fund and While the tribal infrastructure board has developed a good process for reviewing applications, making allocations, and providing accountability, LFC staff feels it is critical that similar guidelines be developed for the allocation of Colonias funds.

Jeannae Leger and Kyle Burns, fiscal analysts, LFC, provided a current status of four major ongoing capital outlay projects; the Lordsburg Port of Entry, the Las Cruces State Police District Office, the New Mexico State Veterans' Home Alzheimer's and Skilled Nursing Units, and the Albuquerque Incubator also known as WESST Corp. The capital staff performed site visits and received information from state and local entities and grantees to determine the status of projects and reasons for delays.

The Lordsburg Port of Entry, district four head quarters serves Catron, Grant, Hildago and Luna counties. The district is one of five ports that operate twenty-four hours a day, seven days a week. It is under the administration of the Motor Transportation Police Division. The port of entry monitors traffic entering New Mexico via Interstate 10. Between 2005 and 2009, the Legislature appropriated $11.5 million in general fund and severance tax bonds to construct a permanent 9,000 square foot facility. Construction of the facility commenced in January 2010. As of July 1, the project is more than 65 percent complete and is on schedule to be completed by October 2010. Although the project is under construction, the Property Control Division (PCD) and the Department of Transportation (DOT) are currently working to resolve an issue with the east bound on and off ramps. The original project plan did not include needed improvements to the ramps providing access to the port of entry.

The weight of commercial vehicles has caused wear and tear to the ramps and requires complete re-pavement. DOT has made 16 temporary fixes totaling $23,000 over the last two years. A memorandum of understanding between PCD and DOT to re-pave the two ramps is currently under negotiation. The estimated cost to re-pave the ramps totals $527,417.

The current Las Cruces State Police district office was constructed in 1973 on a small piece of land leased from the New Mexico State University (NMSU). The facility was constructed to house 12 officers, but currently houses 26 employees. In addition to the 26 employees located in the district office, there are an additional 30 to 45 officers serving the area and are housed in leased space throughout Las Cruces. In 2006, $10,000 was appropriated to begin the planning for a new district office. To date, $6.1 million has been appropriated to support the project. The design began based on the design of the Gallup district office with certain modifications to fit the needs of the Las Cruces area. LFC staff visited the proposed site which was located on a major drainage system and lacked the necessary infrastructure for the project. An alternative site was identified in March 2009. The selected land site is property owned by the Bureau of Land Management (BLN) that will be transferred to the state for $2,000 once construction of the facility is complete. Delays in the land purchasing agreement were caused by turnover in staff at BLN and the slow progress of the architect completing the utility site plan. Preliminary approval was granted by BLN to move forward with construction once the site plan was approved in May 2010. In the Spring 2009, the PCD informed LFC staff of concerns regarding connectivity to communication towers used for public safety. PCD was informed by the Department of Information Technology (DoIT) that a new communication tower was needed to communicate with existing infrastructure located at the current district office. DoIT was not involved in the initial planning process which led to insufficient amounts budgeted for information technology infrastructure. The funds for tower connectivity were appropriated in 2010. The project may require addition funds to provide additional furniture, fixtures and equipment for officers previously housed in leased space. Costs will not be determined until the project construction is complete.

Ms. Leger continued with the New Mexico Veterans' Home located in Truth or Consequences. The Veterans' Home serves honorably discharged veterans, spouses, and gold star parents. According to the programming documents the state's Alzheimer's population is expected to increase by 39 percent between 2010 and 2025; the current facility is unable to meet the projected increase. The facility currently operates at 97 percent with a wait list of over 15 patients for the Alzheimer's unit alone. To date the Legislature has authorized $8.3 million in cigarette tax revenue and STB for phase one of the project. The U.S. Department Veterans' Affairs funds up to 65 percent of construction costs only for state extended care facilities; the state must provide an additional 35 percent match. The administrator of the New Mexico Veterans' Hospital applied for a $15 million grant for the Department of Veteran Affairs to match the state's $8.3 million. The Veterans' Home is currently number 12 for funding in the next federal fiscal year. Announcements of awards are expected to be made in August 2010. New information from the Department of Health (DOH) shows approximately $6 million is needed to cover soft costs. DOH has included this request in the agency's infrastructure improvement plan for 2012. Programming for the project is complete; the design began in June and construction documents are expected to be complete by early 2011. If all funding is secured for the project, construction may begin as early as early as the Spring 2011.

Mr. Burns said the West Enterprise Center is located near down town Albuquerque and is a 37,000 square foot business incubator that opened in January 2009. The center is operated by the Women's Economic Self-Sufficiency Team (WESST), a non-profit. WESST Corp is a statewide economic development organization committed to growing New Mexico's economy by cultivating entrepreneurship. Their main objective is to provide support to young businesses during the vulnerable start up period by providing coaching and mentoring services and discounted infrastructure services. The facility is currently operating at 70 percent capacity and occupied by various types of entities. The center received $4.5 million is state appropriations between 2006 and 2008. In addition to state funding, WESST received a total of $5.8 million from local, federal, and private resources. Although the project is fully constructed with the exception of 6500 square feet of shell space, the city of Albuquerque has only been reimbursed for expenditures authorized by 2006 state funding. Reimbursement requested by DFA between May 2008 and November 2009 was denied due to anti-donation issues. To resolve the anti-donation issue and ensure fair market value of the center, DFA recommended funds be awarded to WESST Corp under conditions required by LEDA, the local economic development act. WESST Corp is working with the city of Albuquerque to complete the required application for qualifying as an entity under LEDA. The city is reviewing WESST Corp's application and if approved, they may go before the Albuquerque Development Commission for approval hearing on August 18 allowing Albuquerque to complete its grant agreement and seek reimbursement. Ms. Kehoe added the DFA legal counsel inserted a new clause in grant agreements allowing cancellation of agreements at call by DFA. Most local governmental entities contacted do not have an issue with the clause; however the city of Albuquerque did have an issue and already had $9 million in obligation that would be at risk if they did not sign grant agreements.

In response to Chairman Varela, Ms. Kehoe said projects are tracked in the event funds need to be reauthorized for state facilities or help with solvency issues. DFA is also making sure projects revert and will monitor them for available balances that do not expire June 30.

Population Projections for State Prisons and Alternative Sentencing Options. Population Projections for State Prisons and Alternative Sentencing Options. Tony Ortiz, executive director, New Mexico Sentencing Commission (NMSC), reported the population forecast report was produced for the first time this year by the NMSC. In the early part of the decade there were steady increases; however beginning in 2006 through 2009 there was a decline. Recently, there has been a slight upward trend in the male population. Compared to four years ago, there are 140 fewer inmates in New Mexico prisons.

There is reason to believe that efforts such as the DWI drug courts and mental health courts have the consequence of diverting people from getting further into the system, as well as other programs such as pre-prosecution diversion used by district attorney offices. Efforts undertaken by the New Mexico Corrections Department (NMCD) have also had a positive effect on the population. NMCD has been aggressive in finding alternative ways to deal with technical parole violators. There are a number of offenders that are unable to or do not want to serve their parole in the community and prefer incarceration. The total population of inmates in adult county detention facilities exceeds the population in the state prison system.

Based upon the forecast and the data provided by NMCD, the next two to four years the population in N.M. will remain relatively stable with small growth into the future. The recent growth is almost exclusively in the male population. New admissions remain flat or are declining with the exception of violent offenders. Violent offenders receive longer sentences pursuant to legislation enacted in 1999. NMSC has a subcommittee to address sentencing issues including trial court judges, prosecutors, members of the criminal defense bar, and representatives from the Public Defender Department (PDD).

According to Mr. Ortiz, statistics from the U.S. Bureau of Justice indicate that prison population increases 70 percent in the first six months of a year. House Bill 807 enacted in 2009, provided for a system of meritorious deductions for jail inmates similar to a program that has been in place in the state system for 11 years. Parole officers carry heavy caseloads and provide an incentive for people under supervision to reduce the amount of time they are on parole by complying with terms and conditions.

The criminal justice system struggles with the full integration of computer systems that operate between law enforcement, the PDD, prosecutors, courts and jails. The Justice Information Sharing Council has a consolidated offender query system in place consisting of 5,000 subscribers bringing together databases from the courts, NMCD, and the sex offender registry. It also supplies information on outstanding warrants and weapons charges. The system allows criminal justice professionals to retrieve juvenile information that is not allowed by statue to be posted on a public access website and provides domestic violence case information, which federal law does not allowed to be posted on a public access website. The system costs less than $125,000 annually to administer and maintain.

BEN BAUR, district public defender, PDD, Santa Fe, testified it is in everybody's interest to identify the most appropriate and cost-effective punishment for responding to those accused of committing crimes. Often mental health or substance abuse issues lead to non-violent criminal activity. Rather than incarceration alternative sentencing that addresses the underlying issues achieves appropriate and cost-effective punishment. For example, mental health and drug treatment courts administered by district and magistrate courts have proven effective at reducing recidivism.

Lemuel Martinez, 13th District Attorney, testified district attorneys have a responsibility to enforce the law and are in favor of treatment in lieu of incarceration.

Representative Saavedra stated the Legislature does not have control over judiciary committees. Mr. Ortiz said the United States far exceeds any other country rates of incarceration and it is a great expense to the federal and state governments. Mr. Ortiz added that that it may be help to consider asking if we are locking people up because we fear them or because we're frustrated with them.

Thursday, July 22

The following members were present on Thursday, July 22: Chairman Luciano "Lucky" Varela, Vice-Chairman John Arthur Smith, Representatives Donald E. Bratton, Rhonda S. King, Don Tripp, Edward C. Sandoval, Jeannette O. Wallace, Nick L. Salazar, and Henry "Kiki" Saavedra; and Senators Clint Harden (for Sue Wilson Beffort), Carroll Leavell, John M. Sapien, Mary Kay Papen, Pete Campos, Carlos Cisneros, and Stuart Ingle. Representatives Brian Egolf, Antonio Lujan, Danice Picraux and Senator Howie Morales attended as guests.

Tax Policy Issues in New Mexico.

The GRT, Pyramiding and Economic Activity. Richard Anklam, president and executive director, New Mexico Tax Research Institute, provided a description of pyramiding and said it is a common problem in state transaction taxes like the gross receipts tax (GRT) and occurs on sales made by businesses to other businesses. Economists have argued for years that ideally the GRT should be applied only to final consumption and not to business inputs. Intuitively it seems clear that a broad tax base which is often a desirable policy will result in greater pyramiding of tax. Pyramiding is very rate sensitive and the problem is much worse with the higher rates because the rate applies to each transaction. Pyramiding on services is a bigger problem for small businesses because they often purchase business services rather than using in-house providers. Pyramiding places a heavier tax burden on businesses and individuals making a lot of purchases from in-state vendors creating incentives to buy from out-of-state vendors. The likelihood is high that most of the ultimate burden is borne by in-state households, a hidden tax with regressive implications. In-state companies face a direct impact on their bottom line reducing their ability to invest and add laborers and compete with out-of-state businesses. The tax becomes less transparent and is embedded in the price of goods and services.

The GRT is a business privilege tax imposed on sellers. As of July 1, the state tax rate is 5.125 percent plus local option taxes averaging 2 percent. The state shares approximately 25 percent of its revenue with municipalities. The compensating tax or use tax is the tax buyers pay on purchases from out-of-state sellers. It also mirrors the 5.125 percent tax rate. There are no local options and is not imposed on services and there is a statutory prohibition from collecting compensating tax from individuals. Pyramiding is another implication of any broad tax base. New Mexico pyramids more because it taxes more services and non-service business inputs relative to most other states.

Removing pyramiding from the GRT would require more tax suspension mechanisms. Pyramiding is seen as a problem not just by the economists who prefer a theoretically sound, adequate and efficient system, but also by businesses who percieve that the tax on their purchases adds to their costs. It makes them less competitive and in the end causes them to lose business. In addition, taxing business inputs hides the tax in business costs which will ultimately be borne by the consumer.

Sales of services are becoming a greater portion of the economy as compared with transactions involving tangible products creating issues in the efficient administration of the GRT system including jurisdictional issues, difficulties in defining the inputs, and competitiveness problems.

One-third to half of the GRT revenue comes from pyramiding and thus a comprehensive solution is very expensive to address. Possible solutions and recommendations to limit pyramiding include:

- holding down the GRT tax rate
- avoiding exemptions targeted at consumer purchases
- limiting the use of tax incentives
- focusing on final sales and excluding intermediate sales
- creating an anti-pyramiding credit
- splitting the GRT into two taxes – retail sales tax and business privilege tax

Tom Clifford, chief economist, LFC, said revenue needs to be adequate to fund government services by having a broad tax base generating a large amount of revenue at a relatively low rate. However, it creates problems for efficiency and equity. General sales taxes constitute over 40 percent of all tax collections in New Mexico, whereas in the average state they are somewhere in the 20 to 25 percent range. New Mexico has a much lower collection of property taxes (10 to 15 percent) as opposed to 30 percent in the average state structure. The individual income tax burden is significantly lower than most states and is made up in the other tax category which includes oil and gas production taxes. Mr. Clifford noted the largest one percent of firms contribute over half of the GRT base; two-thirds of businesses contribute 3 percent. About half the states exempt equipment used in manufacturing, New Mexico does not. New Mexico taxes a much broader spectrum of services than most states. Few deductions are allowed for sales to businesses.

Chairman Varela asked how much is actually paid by an individual providing a product and how much is absorbed by the consumer. Mr. Clifford said the usual assumption is when a tax is imposed on sales the burden of taxation is shifted forward to the buyer. However, that does not take into account how it will affect the buyer's behavior. There are economic consequences for both the seller and the buyer. Mr. Anklam added a lot of the tax is passed forward to households creating concern for regressivity in the tax system. Chairman Varela asked if deductions and exemptions should be eliminated in order to eliminate pyramiding while maintaining the broad tax. Mr. Clifford suggested tradeoffs in order to supplement the tax base. Mr. Anklam added that another point to consider is reducing a significant portion of pyramiding in the base, allowing room for the rate to resemble other states.

Senator Sapien asked what the down side would be for going to a sale tax base rather than a GRT base. Mr. Clifford said local revenues would be a large conceptual issue. Economically it is a more efficient system. Also, the retail base is much smaller than the FRT base, so revenue would have to be made up somehow.

Vice Chairman Smith asked what type of problem would be created if local governments were given the authority to tax non-profits. Mr. Clifford said the thrust would be to get states to standardize tax systems more comprehensively to allow multi-state vendors to comply voluntarily or through congressional action. If local governments are allowed to define their tax base they would migrate away from a standardized tax system. Mr. Anklam added that giving them authority would also add administrative complications.

Issues and Alternatives for Corporate Income Tax. Helen Hecht, tax counsel, Federation of Tax Administrators, reported the corporate income tax affects a particular industry or business depending on a number of variables including where else that business is located and the business results it gets from its operations. Many corporations operate in more than one state. These multi-state corporations cannot be taxed by any one state on 100 percent of their income. States are free within very broad limits to adopt apportionment to determine the portion of income earned by the corporation from activities within each state. Because of the manner of apportionment there is no uniformity and there is possibility a business will pay tax on more than 100 percent of its income or more commonly, less than 100 percent of its income. New Mexico uses a three-factor formula for almost all businesses with a few exceptions. The formula looks at payroll, property, and the sales of the business.

Businesses operating as corporations do not operate as single entities; they operate as corporate groups and have shared ownership or common ownership of entities. At the federal level, companies who are part of a corporate group will file on a consolidated basis. Inter-company transactions are eliminated or ignored for purposes of computing income of the consolidated group. Approximately 22 states allow or require corporations that are members of a corporate group to file separately. Approximately 24 states require combined filing. Allowing separate filing may permit aggressive tax planning to take place.

State courts determined distortion occurs when a structure or transaction resulting in tax savings have no economic reality. State cures for distortion include: 1) The unitary combined filing method which operates like the consolidated filing method in that all inter-company transactions are eliminated; 2) The add-back statute targets inter-company transactions, but does not affect other legitimate transactions; 3) The Uniform Division of Income for Tax Purposes Act (UDITPA) Section 18 Powers adopted by a majority of states, including New Mexico provides power for the tax department in a jurisdiction; 4) The assertion of Economic Nexus allows tax on a royalty company; 5) The Sham transaction doctrine ignores transactions that do not have economic substance. Transfer pricing rules like add back statutes is not a cure; however is used to make sure legitimate inter-company transactions are priced the same as third-party transactions. New Mexico has UDITPA Section 18 authority and Economic Nexus powers. As a result of these powers, New Mexico has been able to settle and collect taxes in cases where royalty companies and other similar tax planning structures have been used. There are drawbacks to the use of UDITPA Section 18 authority. It is generally applied on a case-by-case basis. Often, limited authority is implied creating business risk. Both add-back statutes and mandatory combined filing have the advantage of taking away some uncertainty and risk. Additional considerations for mandatory combined filing eliminate inter-company transactions. States are not allowed to require consolidated filing the same way the federal government does. In addition to ownership factors states have to show corporations are engaged in a unitary business. The Legislature will need to address other issues by statute or regulation governing companies and corporations from separate filing to combined filing.

There are a number of variations in statutory add-back provisions. It is important for New Mexico to retain its section 18 authority even if it adopts another method of addressing distortion. Add-back provisions are narrower and are targeted at the problem impacting fewer businesses in the state. Mandatory combined filing is much broader and disruptive during the transition period.

Mr. Clifford said New Mexico has a graduated rate structure. The taxable income definition is from federal tax law and applies to C-corporations. Some provisions increase the tax base while others reduce the tax base. The tax rate is relatively high compared to other states and is above the national average; however the franchise tax is low. Most western states require combined reporting with the exception of New Mexico, Oklahoma, and Oregon. Most states also allow the federal consolidated option. Most states have gone to an apportionment formula applying extra weight to sales. Mr. Clifford noted the federal tax plummeted in 2009 by 85 percent; New Mexico's tax is going down 65 to 70 percent over a two-year period. Approximately 20,000 companies pay corporate income tax. There are approximately 100,000 businesses operating in New Mexico. The corporate income tax may be a discouragement to investment in the state impacting economic development.

Senator Wirth asked if the tax department under its authority can go beyond an individual company and put in place a regulatory overlay that applies to a group of corporations. Ms. Hecht said the tax department enacted specific apportionment formulas for specific industries.

Tax System Progressivity. Gerry Bradley, research director, Fiscal Policy Project, NM Voices for Children, presented three types of tax incidence models and their descriptions:

- Representative Taxpayer
- Computable General Equilibrium (CGE)
- Tax Incidence

In 2002, New Mexico ranked 21st for regressivity. A tax incidence model for New Mexico would allow an objective look at the state's tax system in terms of the income distribution. It would also allow the state to assess the regressivity-progressivity of proposed tax increases and decreases and determine how much of a tax would be exported to other states.

Mr. Clifford added the equity principle of good tax policy adopted by the LFC advocates fairness to taxpayers with different incomes. The tax burden should be crafted to people's ability to pay. In New Mexico, 29 percent of households make less than $25,000 per year compared to the U.S. average figure of 23 percent. Statistically, it is difficult to measure household's total financial resources because data is not readily available. The economic theory is imprecise on how these taxes get shifted. Incidence studies have to be reviewed carefully using different assumptions and showing impacts on results. An adverse selection could take place because of the mobility of households across state lines. It is important to consider the impacts of spending, as well as taxes.

<u>Health Insurance Benefit Plans for New Mexico Public Employees: Options for Controlling Costs.</u> Cristy Edwards, deputy director, Public Schools Insurance Authority (PSIA), reported in the year 2000, there were 150,000 members participating in the interagency benefits advisory committee (IBAC) with claim cost totaling $360 million. Currently, there are over 200,000 members with an FY11 budget which includes insurance premiums, ASO fees, and claim costs total over $940 million. The majority of plans offered by the IBAC are self-funded except for the Medicare supplement plan administered by the Retiree Health Care Authority (RHCA). In a recent announcement, the IBAC collectively selected one prescription drug management company effective July 1, 2010.

In a recent polling and satisfaction survey, PSIA member satisfaction decreased from 89 percent to 65 percent for IBAC participants with overall IBAC satisfaction dropping from 88 percent to 75 percent. Vera Dallas, director, Employee Benefits, Albuquerque Public Schools (APS), added that APS did not conduct an internal satisfaction and relied on research and polling through the IBAC. Mark Tyndall, deputy director, Retiree Health Care Authority (RHCA), said RHCA's assessment was also through IBAC research and polling and RHCA was forced to re-evaluate the types of plans offered resulting in member satisfaction dropping from 87 percent to 82 percent. A cost-sharing measure was introduced making the retiree responsible for the Medicare part B deductible only, effective January 2010. Nancy Bearce, bureau chief, Employee Benefits, Risk Management Division (RMD), General Services Department (GSD), reported they also suffered a reduction in satisfaction primarily as a result of plan design changes that were made in order to keep premiums flat. RMD is entering into its third year of flat premiums; however there are moderate co-pay changes, as well as increased deductibles. Chairman Varela said policy makers need to make sure actions taken by the IBAC will not adversely affect the most vulnerable.

Ms. Edwards described in-network benefits comparisons, the prescription drug coverage, the employer contribution comparison, and IBAC medical rates comparison. NMPSIA along with other members of the IBAC take an active role in provider negotiations. The IBAC also relies on contracted vendors for case management and utilization management.

Ms. Dallas said APS implemented plan design changes resulting in a savings of $1.3 million. Plan design changes include:

- benefit program enhancements
- increased employer contributions to 80 percent for employees earning less than $29,000 per year
- wellness benefits including a health risk assessment incentive
- implementation of prescription drug mail order pilot program resulting in the generic field rate of 78 percent
- $5.6 million in reserve fund balance to reduce projected increases
- a 5 percent increase in medical contribution rates effective January 1, 2010

Cost management strategies for plan year 2011 include:

- biometric screening for employee and spouse generating a savings of $600,000
- an increase for specialist visit co-pays to $35 generating a savings of $375,000
- an increase for emergency room and urgent care co-pays
- an increase in COBRA rates to the relative value saving $1.1 million
- using $4.9 million of reserve fund balance to reduce the projected increases

- premiums will not be raised for 2011

Mr. Tyndall continued and said RHCA was set to become insolvent in 2014. However, with the help of the Legislature, and changes to plan designs made by the RHCA board, it extended solvency to 2025. Without the subsidy associated with Medicare being the primary payer, 60 percent of costs are spent on pre-Medicare retirees even though they only represent 40 percent of membership. As a result, the plan with $100 deductible and $1,000 out-of-pocket maximum was eliminated. However, RHCA kept the zero dollar co-pay for all wellness and preventive services, as well as other first dollar coverages not subject to the deductible. More than half of pre-Medicare members incurred $250 or less of out-of-pocket expenses in the last year. In addition, cost sharing was introduced to the Medicare supplement plan to achieve a flat cost savings and avoid fraud, waste, and abuse. Slight changes were made to the prescription benefit resulting in an increase of generic utilization for recurring savings of $9 million. Beginning in July 2010, members will be offered health risk assessments. Results of the assessments will feed into disease management programs and other integrated clinical programs administered by medical plans. Members will be provided the opportunity to receive biometric screenings at all informational and enrollment meetings, as well as flu shots and other vaccines. The RHCA board has also taken a number of responsible steps including lowering the amount of subsidy paid to pre-Medicare retirees. The solvency study assumes premiums will be raised by 8 percent every year for both pre-Medicare and post-Medicare retirees. Mr. Tyndall noted the federal health care reform includes an early retiree reassurance program providing for potential reimbursements up to $18 million. Medicare is also picking up a larger portion of routine and preventive services. It is possible RHCA will consider rate actions for biometric screenings in accordance with retiree's healthy or unhealthy behavior.

Ms. Bearce said get well New Mexico was initiated in FY04 with a variety of wellness programs and health risk assessments. Employees were offered money off deductibles to complete health risk assessments. RMD also have a four-year pricing strategy locking in rates for FY09 and FY10 on medical, dental, and vision. One of the successes for RMD was making a concerted effort in 2004 to market plans to local public bodies and enrollment went up 60 percent due to due to aggressive marketing over the last four years. Currently, there are over 100 local public bodies participating I RMD's plan.

In response to Chairman Varela, Mr. Tyndall said out of $1 billion spent out of the IBAC, $900 million is directly related to medical costs and less than 10 percent is in administrative costs. Chairman Varela asked if the IBAC collaborates with the Human Services Department (HSD) to develop cost containment for Medicaid and Medicare. Katie Falls, secretary, Human Services Department (HSD) added that with health care reform will help to leverage dollars.

In response to Representative Sandoval, Ms. Dallas said charter school employees are not covered under APS health plans; they are covered under the Public Schools Insurance Authority.

Senator Sapien asked about insurance benefits for dependents up to age 26. Ms. Bearce said coverage is currently offered for dependents up to age 25 and will be extended to age 26 under health care reform beginning July 1, 2011. Ms. Edwards responded that NMPSIA's board reviewed the possibility; however decided not to expand its liability with the current financial environment. Ms. Dallas responded that APS will offer the extension beginning January 1, 2011. Mr. Tyndall responded the RHCA board voted to approve the extension of dependent benefits up to the age of 26 effective July 1, 2010.

The New Mexico Medical Insurance Pool and Health Insurance Alliance: Tax Credits and

Role in a Health Insurance Exchange. Katie Falls, secretary, Human Services Department (HSD), reported that the governor by executive order created a Health Care Reform Leadership Team consisting of nine state agencies and to develop a strategic plan to implement federal health care reforms. Each agency identified the impact of the federal reforms on each agency and the people they serve. Recommendations from the plan include:

- expanding the leadership team
- creating an office of health care reform
- receiving tribal consultation
- developing an analysis for the next legislative session

Secretary Falls noted as part of the federal reform plan, $37 million will be available to New Mexico to serve approximately 1,000 individuals over the next three years in a temporary federal high-risk pool. Beginning in 2014, the state will be operating a health insurance exchange unless it is determined that the federal government will operate the exchange. The law allows HSD and the exchange to make Medicaid eligibility determinations and appropriate tax and premium subsidies. It is required to have one application for both tax subsidies and the Medicaid program and everybody has to be screened for Medicaid first before purchasing off the exchange. Planning grants in the amount of $1 million will be available to each state beginning in the fall.

Mike Nunez, executive director, Health Insurance Alliance, reported the alliance collects premiums and withholds funds for administrative expenses, as well as broker expenses. The alliance began in 1995 as a second option to take care of HIPPA eligibles and small groups. The alliance is part of 18 chambers of commerce around the state, community core organizations, the Department of Insurance, the New Mexico Insurance Pool, and Medicaid. From 2008 to 2009, 17 percent of members dropped their coverage, most likely due to the recession. Currently, the alliance is a third-party administrator receiving applications, working with brokers, and make sure people are placed into the correct market. Pricing is set by the average state indexing rates. Eligibility is determined according to a plan of operations set by the Legislature and the federal government.

Michelle Lujan-Grisham, deputy director, New Mexico Medical Insurance Pool (the Pool), reported the Pool was created in 1987 to provide efficient, affordable, and comprehensive health insurance for people who are denied adequate health insurance and are considered uninsurable. The Legislature authorized a Low Income Premium Program (LIPP) that pays a portion of the insurance premium for certain policy holders based on income. The Pool is administered by Blue Cross and Blue Shield of New Mexico and currently serves more than 8,000 individuals. The Pool collects premiums from policy holders and receives a limited amount of federal revenue the remaining portion is covered by assessments to insurers providing health insurance in New Mexico. All insurers are required to be members of the Pool including not-for-profit health care plans and health maintenance organizations (HMO). The Pool projects expenditures of $90 million in 2009 with only $19 million supported by premiums. To offset rising assessments, the Legislature authorized a tax credit to offset the taxes carriers pay. As losses increase, the Pool assigns larger assessments resulting in larger tax credit offsets. In 2009 the tax credit was projected at $38.4 million and is expected to grow to $62.6 million in 2011. Ms. Lujan-Grisham provided an overview of the federal temporary high risk pool. Secretary Falls added that in 2014 there is a lot of additional money that will come to the state to implement reforms. The state has to make sure it is taking advantage of every dollar available in terms of planning, grants, and funding.

Friday, July 23

The following members were present on Friday, July 23: Chairman Luciano "Lucky" Varela, Vice-

Chairman John Arthur Smith, Representatives Donald E. Bratton, Rhonda S. King, Don Tripp, Edward C. Sandoval, Jeannette O. Wallace, Nick L. Salazar, and Henry "Kiki" Saavedra; and Sue Wilson Beffort, Carroll Leavell, John M. Sapien, Mary Kay Papen, Pete Campos, and Carlos Cisneros. Representatives James Roger Madalena and Rick Miera attended as guests.

Chairman Varela stated based on the latest revenues estimates; there are serious funding problems for FY11 and looking worse for FY12. The Legislature and the governor gave the direction to streamline government, look for efficiencies, and minimize the impact on all government. Vice Chairman Smith said close to $200 million more revenue was projected; however revenues are estimated to be $160 million weaker. An additional 3.2 reduction is required to make up the impact. Chairman Varela added that adjustments for the current fiscal year will be addressed by the Legislature in the next legislative session.

Program Evaluation of State and Local Charter Schools. David Craig, program evaluator, LFC, presented a *Program Evaluation of New Mexico Charter Schools*, and began by saying charter schools are public schools the state contracts with for five years to provide innovative education practices, improve student achievement, provide choices in education, and encourage parental and community involvement. After the first five years schools can submit a renewal application for another five year contract. Charter schools have grown from four schools in 1995 to 72 in FY10. Charter schools received $116 million in FY10. Mr. Craig presented key findings and recommendations including the following:

- Charter schools generate more state funds per student because of favorable adjustments under the funding formula. On average, charter school students generate a higher program cost (26 percent) per student than traditional public schools.
    - Charter schools generated approximately $24.1 million in small school size adjustment in FY10. Under the funding formula, schools with enrollment less than 400 are eligible to receive size adjustments commonly called the small school size adjustment. In 1977, the Legislature prohibited size adjustments for special programs, including but not limited to, vocational and alternative education. It is not clear that the purpose of size adjustment in the funding formula is to act as a subsidy for the diseconomies of scale that special programs at charter schools produce. LFC staff recommends changing statute to exempt charter schools from size adjustments because they are special programs.
    - Charter schools generated $7.5 million in growth funding in FY10. Charter schools and school districts have to grow enrollment by one percent to qualify for growth adjustments. However, on average charter schools only have to grow by two enrollment figures to qualify for growth adjustment. The funding formula scales carry over balances for charter school and districts based upon size. LFC staff recommends the Legislature consider a similar approach for charter schools.
    - In 2009, the Legislature passed legislation to hold charter school harmless for the teacher training and experience index (an adjustment based upon a calculation of years of experience and educational attainment of teachers in a school or district and a multiplier under the formula). Forty-six schools took advantage of the save harmless provision in FY10 generating an extra $3.1 million.
    - Because of charter school's initial start-up year, current year funding is received for students enrolled in a new school because prior year funding is unavailable. A majority of new students are from traditional public schools where they were funded on the prior year count; new charter students are funded twice by the state by an estimated $6.5 million.

  - Charter schools diluted the unit value by $38.85 with the amount of small school size adjustments and $13.43 through program growth units in FY10. Mr. Craig noted that eliminating the impacts due to size and growth adjustments and the T&E index save harmless provision would increase education funding $34.7 million statewide.
- Measures of student performance show charter school students have similar levels of performance as traditional public schools. Charter schools identified education programs they felt were innovative. Most of these education programs were not completely new innovations to the education landscape, but may be innovations new to New Mexico.
- Site visits revealed improper expenditures, questionable discretionary spending, and real or potential conflicts of interest. Improper expenditures included not adhering to the procurement code for attaining three quotes or improper sole sourcing. There were also political donations to former state legislators and athletic teams violating the anti-donation clause. Expenditures also showed many instances where tax obligations or other payables were neglected and fines were incurred. Governance reforms to disclose and prevent conflicts of interest are necessary because some administrators have relationships that could be construed as conflicts of interest. Administrators who found the school are responsible for selecting their initial governing body which sets their salary and approves family hiring. Some founders, administrators and business managers contract with their charter schools for additional services. These arrangements have the potential for a conflict of interest and business arrangements that do not follow the procurement code cannot guarantee the state is getting the best price.
- The current process by which schools become chartered is not rigorous enough to ensure quality schools open, academic and financial monitoring of schools needs improvement and the renewal process does not contain objective performance measures to minimize subjectivity in renewal decisions. Statements of need and budget proposals in applications lack supporting documentation. Administrative guidance and regulations for lease agreements are also needed. Charter documents also need improved performance measurements to allow nonrenewal of poorly performing charter schools.
- Until the state can rectify these issues with the approval process, and ensure only quality charter schools open and starts closing poor performing schools, charter authorizes should not approve new applications for charter schools. LFC staff recommends non-approval or nonrenewal of charter schools that are unable to demonstrate competence with *each* area of the application, instead of the current process that looks at start-up and renewal applications as a whole. The state should consider an RFP process allowing state and districts to solicit applications that target a specific need for the authorizer.

Charles Sallee, program evaluator manager, LFC, added that while at the federal level, the new administration looks favorably on charter schools, they look favorably on high quality charter schools. Given the amount of state investment of over $116 million a year in operation funds, it is incumbent upon the state to put in a more rigorous application process for charter schools that have strong programmatic planning, as well as strong business planning. Charter schools should be held accountable for delivered outcomes and impact to school districts should be considered as well. Small school size adjustment funding accounts for as much as 45 percent of some charter school's overall formula funding. School districts also receive small school size adjustment funding, but this does not have as big of an impact on overall finances. School districts also receive small school district size adjustment totaling $18 million statewide. Of the 89 school districts, 72 received a size adjustment ranging from $21,000 to almost $570,000. Districts are primarily generating formula funding based on the students served, as well as student needs. Charter schools are relying heavily as a group for favorable adjustments built into the funding formula. Overall, the different formula components for charter schools dilute the amount of funds available for all students statewide by almost $35 million in FY10.

Dr. Susanna Murphy, secretary designate, Public Education Department (PED), responded that PED has become better at implementing charter schools and replicating their best practices. PED firmly believes that quality authorizing practices create quality charter schools following the standard by the National Association of Charter School Authorizers. In 2007, the Public Education Commission began authorizing charter schools. LFC staff based most recommendations on information from past practices of local district authorizers. The report exaggerates the disparity existing between charter schools and school districts. The resulting recommendations could lead to unintended and dire consequences for charter schools. Recommendations will make it harder for charter schools to succeed both financially and programmatically. The recommendation for the Public Education Commission to not process new charter applications is contrary to state law. Several of the LFC findings are self-correcting issues. Charters use a district's T&E only in their first year; the following year they use their own. The report fails to mention that double-funding benefits the districts, not the charter schools. By PED policy, charter schools unlike districts do not qualify for supplemental emergency. New Mexico has long recognized the unique needs of small schools. Allowances in the formula are critical to the continued viability of charters and small districts. For small school size, charters are limited by an enrollment cap that is not applied to districts. The percentage of total revenue charter schools receive is less than the percentage of total enrollments served. Growth units for charter schools are necessary as charters expand rapidly when grades are phased in. Increase in student populations requires increase in staffing, materials, equipment, and infrastructure. Any administrative costs can represent a large proportion of total expenditures than for a school district. Charter schools must operate and perform all duties of a district so that administrators serve as the superintendent and the principal.

School districts must hold their locally authorized charter schools to the same high standards of accountability sought by the state. Local charter school governing bodies have the same responsibility specific to issues around audits, business officials, fiscal controls, and lack of training on financial management. PED staff is currently serving on the Legislative Education Study Committee (LESC) finance workgroup to evaluate the adequacy and effectiveness of New Mexico's laws and regulations relating to public school finance. Much of the LFC's concerns regarding financial accountability will be addressed by the workgroup. Local districts can and should act when their charter schools evidence lack accountability with public funds. The state needs time to implement new legislation and findings by the LESC workgroup. Until then, it is too soon to declare that charter schools represent a high risk of improper use to state funds. PED is further concerned that the findings may be anecdotal in nature and not representative of charter schools across the state.

New Mexico is not unique in the area of capital facilities for charter schools. Nationally, charter schools have had a difficult time securing appropriate facilities. Charter applicants have no resources to pay for a market study. The Public Education Commission made an opening of a charter school conditional upon demonstration that a facility receives a certificate for e-occupancy. Since the inception of the PED's charter school division, the requirement for schools to be in facilities that meet educational occupancy standards has been enforced consistently.

CREDO reports found that nationally by a charter's third-year, students perform higher than non-charter students in both reading and math. In New Mexico, CREDO found student academic performance in charter schools is improving over time. Substantial progress was made with special education students in both reading and math. Improvements were larger than seen is traditional public schools. Nearly all remaining student subgroups at charter schools made at least some progress in math from 2006 to 2007 including Hispanics, Native Americans, students in poverty, and English language learners.

PED believes that the market for charter schools is best determined by students on waiting lists. Budgets should be consistent with actual expenses when approved. Community input hearings are required in law. Charter schools must select their students by lottery and New Mexico's open enrollment law allows any student to choose to apply for enrollment in any school. Charter schools proposed budgets are in their applications and provide the best estimates of revenues and expenditures. Estimates are not in final approved budget format. Budgets for charter schools are made and adjusted based on the actual number of students who are admitted.

PED is supportive of statutory language allowing for improved performance measures for charter schools. The charter schools division has required for the past two years that applications for initial and renewal charters have "smart goals." PED recognizes the need for substantial monitoring of all schools and has instituted a rigorous monitoring process for state charters. Local districts are using the model as well. Self reporting is a first step in monitoring process. A monitoring report is conducted annually on state chartered charter schools. PED has also instituted processes regarding potential conflicts of interest in charter school governing bodies and inconsistent or unlawful admission requirements. All charter school governing bodies authorized by the state must approve and submit conflict of interest policy outlining action to be taken when a potential conflict of interest arises. State charters must submit an admission enrollment policy detailing the lottery selection process utilized for selecting students.

Ms. Murphy said she is committed to working with the Legislature, the Public Education Commission, and local school districts to ensure charter schools meet the public's expectations for high accountability results. Ms. Murphy said she remains concerned about addressing the complexities of the funding formula in isolation and the unintended consequences for all New Mexico public school children. Charter schools offer students and parents the critical choice and provide best practices that will improve learning for both students in charter and traditional schools.

Dr. Don Duran, assistant secretary, Charter Schools Division, Public Education Department (PED), added that charter schools are quality choices for parents. Charter public schools were developed from a belief deep rooted in American democracy that empowers families and gives educators a chance to create effective schools. Parents, teachers, and students are asking for more quality choice. Authorizers have a responsibility to the public to maintain high standards, protect students and public interests, and preserve school autonomy. With legislative support and PED efforts and the leadership of CSD, efforts must continue to improve the monitoring process. The LFC report did not recognize the efforts of state chartered charter schools, the charter schools division, and the Public Education Commission.

Public comment:
Dr. Lisa Grover, CEO, New Mexico Coalition for Charter Schools, testified she represents 91 percent of charter schools and is a prior high school bilingual teacher. The 16 charter schools did not have an opportunity to review the report in its final version. However, there has been opportunity for each charter school to respond to its specific section. Dr. Grover noted charter schools are outperforming in math. The 2010 CREDO report shows that in one year, charter schools have significantly made up the gap between 2009 and 2010. Charter schools in New Mexico receive in and around $500 less per student. Ms. Groger requested an opportunity to address the Committee after the final report is read in full.

Shelly Cherrin, administrator, Alice King Community School, Albuquerque, testified that they also did not have an opportunity to respond to the final report. Members of the governing council are concerned that statements are not accurately reported; many responses were misinterpreted. There were negative comments regarding charter schools in general. The report was written with a lack of understanding and expertise.

Chairman Varela stated the evaluation report was not intended to be all encompassing of charter schools. Mr. Sallee said the project was looking at charter school issues statewide authorized by the Public Education Commission or local school districts. It involves publicly available data about charter schools and public school districts statewide. LFC staff selected a sample of charter schools to get a better understanding of the unique and different challenges they face. The selection criteria were explained and staff initially considered whether or not to provide a summary page of each charter school visited. After reviewing documentation and other information, LFC staff elected not to provide separate reports for the 16 charter schools because the report focuses on overall charter schools overall. All 16 charter schools, as well as the PED were offered an opportunity to review a draft report in its entirety. Charter schools that participated in the project were made aware once the report was released, it could be reviewed in detail for additional responses.

Mike May, director, Amy Biehl High School, Albuquerque, asked how the effect of venture capital investment is assessed during difficult times. Mr. May also asked if the schools are performing similar at best to traditional schools, why are parents and families continuing to line up to attend. The innovation list by Amy Biehl High School was not included in the report.

Mark Gurzan, parent, Media Arts Collaborative Charter School, Albuquerque, testified that funds were based on absolute findings rather than relative findings. Mr. Gurzan also suggested receiving response from parents regarding performance.

Christopher Lopez, board president, Las Montañas High School, Las Cruces, testified there are concerns with inaccuracies and misrepresentations within the report. Las Montañas was the only school to meet AYP in its second year of existence and graduated 27 students in its third year.

Grace Phillips, president, Turquoise Trail Charter School Governance Council, testified Turquoise Trail is the oldest charter school in the state largely serving its community. Sixty-six percent of the student body qualifies for free or reduced lunch. The school offers full-time art, music, physical education, computer, innovative programs, and ongoing professional development for staff.

Joe Guillen, executive director, New Mexico School Boards Association, testified quality schools are favored, both public and charter. However, given the state of the economy and the nature of results from the report, it does not make sense school boards across New Mexico to be closing schools and on the other hand developing new charter schools. At a recent retreat of board presidents, 75 percent of the presidents indicated support of a moratorium on new charter schools.

Tom Sullivan, executive director, New Mexico School Superintendents Association, testified rather than engaging about a philosophical debate about parental choice, the value of competition and the educational arena, or the desire to pursue alternative creative models of successful practices, we should focus on financial issues. We should look exclusively at whether the charter movement is a more fiscally responsible practice. Traditional alternative schools within local districts do not receive additional funding.

In response to Chairman Varela, Ms. Murphy said PED is working on a three percent reduction in total funds. Stephen Burrell, Director of the Finance and Analysis Bureau, PED, added a 3.2 percent reduction on the SEG totals $71 million statewide. Chairman Varela said the Legislature is considering alternatives to reductions for the current year and FY12 to minimize the impact to education and health care primarily, and all government. Representative Sandoval suggested imposing a moratorium on adding new charter schools. Ms. Murphy said the PED does not have the authority to place a moratorium on charter schools; legislation would have to be changed. Mr. Duran added that under the law there are only four reasons for denying an application.

Vice Chairman Smith asked about late payments to the retirement fund. Mr. Burrell said procedures are being developed to give charter schools more guidance. Ms. Murphy added that if revocation of a charter needs to occur because of fiscal irresponsibility, PED will move forward.

In response to Senator Sapien, Mr. Duran said PED provides staff to the PEC only when it comes to the renewal and initial application. New Mexico is one of the few states in the union that allows a charter school authorized by another entity to change authorization. PED recommended to the Public Education Commission not to renew a charter if they are academically or financially not able to continue.

In response to Representative Tripp, Mr. Duran said the responsibility of oversight in the law is up to the authorizer. Under the law, revocation could be appealed to the secretary of education.

Senator Papen asked how charter schools provide services for children with special needs. Mr. Craig said most charter schools contract out for special education services, including writing IEP's, as well as providing educational assistance for direct services. Special education service delivery is managed at the school site level. Senator Papen asked if a charter school is in a small community if it is required to hire a teacher to serve children with special needs. Mr. Craig said rural schools often have in-house special education directors; however during site visits these directors expressed concerns with service delivery levels.

Chairman Varela said LFC staff will provide a follow-up to the evaluation. Corrections to the report should be submitted to LFC staff and PED. The evaluation will be the basis for developing legislation in January, as well as looking at regulations at PED.

Miscellaneous Business

Action Items

Approval of LFC Minutes – June 2010. **Senator Cisneros moved to approve the June 2010 minutes, seconded by Representative Sandoval. Motion carried.**

Approval of FY11 Contracts. Director Abbey recommended three contracts in excess of $5,000 for approval. Contracts include: Ralph Vincent, Helen Gaussoin, and the University of New Mexico, Economic Forecasting. **Representative Saavedrea moved to approve the recommended contracts, seconded by Representative Sandoval. Motion carried.**

Information Items

Chairman Varela asked Committee members to review the draft LFC budget guidelines to be approved at the August meeting in Taos.

Information Items

Director Abbey directed members to the ARRA Status Report, the June 2010 Cash Balance Report, the June 2010 BAR Report, the FY11 LFC Budget Status, the Full-Time Employees by Agency Report, the Exempt Employees by Agency, and the LFC Program Evaluation Status Report to review at their own free time.

With no further business, the committee adjourned at approximately 12:20 p.m.

Chairman

8/17/010
Date