

**MINUTES
of the
JOINT MEETING
of the
NEW MEXICO FINANCE AUTHORITY OVERSIGHT COMMITTEE
and the
WATER AND NATURAL RESOURCES COMMITTEE**

**July 1, 2014
Science and Technology Park Rotunda
University of New Mexico
Albuquerque**

The joint meeting of the New Mexico Finance Authority (NMFA) Oversight Committee and the Water and Natural Resources Committee (WNRC) was called to order by Representative George Dodge, Jr., chair, WNRC, on Tuesday, July 1, 2014, at 9:47 a.m. at the Science and Technology Park Rotunda of the University of New Mexico (UNM) in Albuquerque.

Present

Sen. Joseph Cervantes, Chair
Rep. Patricia A. Lundstrom, Vice Chair
Rep. Alonzo Baldonado
Rep. Ernest H. Chavez
Sen. Lee S. Cotter
Rep. Roberto "Bobby" J. Gonzales
Sen. Phil A. Griego
Sen. Ron Griggs
Rep. Jimmie C. Hall
Rep. Yvette Herrell
Rep. Dona G. Irwin
Sen. Michael Padilla
Rep. Jane E. Powdrell-Culbert
Rep. Debbie A. Rodella
Sen. John C. Ryan
Sen. William P. Soules
Rep. James P. White

Absent

Rep. Candy Spence Ezzell
Rep. Henry Kiki Saavedra

Advisory Members

Sen. Jacob R. Candelaria
Rep. Sharon Clahchischilliage
Rep. Anna M. Crook
Rep. Kelly K. Fajardo
Rep. Mary Helen Garcia
Rep. Emily Kane

Sen. Sue Wilson Beffort
Rep. Brian F. Egolf, Jr.
Sen. Stuart Ingle
Sen. Timothy M. Keller
Rep. W. Ken Martinez
Sen. George K. Munoz
Sen. William H. Payne

Sen. Bill B. O'Neill
Sen. Mary Kay Papen
Sen. Nancy Rodriguez
Rep. Edward C. Sandoval
Rep. James R.J. Strickler

Sen. John Pinto
Sen. Clemente Sanchez
Rep. Sheryl Williams Stapleton
Rep. Thomas C. Taylor
Rep. Monica Youngblood

Guest Legislators

Rep. Zachary J. Cook
Rep. Stephanie Garcia Richard
Rep. James E. Smith

Staff

Jon Boller, Legislative Council Service (LCS)
Lisa Sullivan, LCS
Jeret Fleetwood, LCS
Renée Gregorio, LCS
Carolyn Ice, LCS
Tessa Ryan, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Tuesday, July 1

Welcome from UNM

Robert G. Frank, president, UNM, welcomed the committees and described UNM's efforts to graduate more students within four years and to improve the job outlook for graduates. Addressing the first initiative, UNM: adopted a new tuition model that encourages students to take more credit hours in a semester; reduced the number of credit hours required in many programs; and changed its advising process. Addressing the second initiative, UNM recently partnered with the City of Albuquerque and private-sector leaders to sponsor Innovate ABQ, a research district that facilitates entrepreneurship.

Overview of Water Project Fund (WPF) Financing

Marquita D. Russel, chief of programs, NMFA, outlined the statutes and processes that guide how community water projects are funded. Funding sources include: the Public Project Revolving Fund and the Rural Infrastructure Revolving Loan Fund, which sources require a monthly application process; the Drinking Water State Revolving Loan Fund and the Local Government Planning Fund, which sources require a quarterly application process; and the WPF,

the Colonias Infrastructure Project Fund, the Clean Water Administrative Fund and the Tribal Infrastructure Project Fund, which sources require an annual application process.

The largest of these funding sources is the WPF, which was established by the Water Project Finance Act (WPFA) and is administered by the NMFA. The Water Trust Board (WTB) receives applications for grants and loans from the WPF. A project may qualify for funding by meeting statutory requirements and WTB rule-based eligibility and prioritization criteria. A project management team consisting of representatives from seven agencies, each with its own project criteria, comprehensively reviews applications and provides technical advice on project merit, eligibility and fitness for funding. Then, the WTB ranks qualifying projects and selects the highest-ranked ones for legislative approval.

Mr. Boller discussed the legislature's role in WPF financing. Primarily, the legislature authorizes projects recommended by the WTB in a bill introduced each year.

Ms. Russel discussed the project-authorization bill from 2014, Senate Finance Committee Substitute for Senate Conservation Committee Substitute for Senate Bill 112, as amended (veto), (SB 112). SB 112 began with a list of 120 projects. The final version of the bill passed by the legislature listed 64 projects. The 64 projects' value was approximately \$70 million, and approximately \$33 million was available for project funding. Although SB 112 was vetoed, the \$33 million is still available for use because there are legislatively authorized projects from prior years that continue to need financing. That is, in past years, more projects were authorized than money was available to finance them.

Committee members offered comments and questions, and Ms. Russel responded, as follows.

- It seems that the legislature's role in the WTB's process is weak, given that projects can be funded in spite of a veto of the authorization bill — and that, typically, projects get "rubber stamp" approval.
- As shown in a spreadsheet depicting projects and authorizations, one project receiving funding this year received its authorization, which is being treated as ongoing, as long ago as 2005. The authorization language, as quoted in that spreadsheet, is very broad.
- Ms. Russel said that the application process recently changed to allow for a longer application period to help smaller communities. As a result, the project list presented to the legislature is more comprehensive, since further refinement of priorities occurs after the legislative session.
- Ms. Russel said that 10% of senior severance tax bond capacity is earmarked for the WPF, 5% for tribal infrastructure projects and 5% for colonias infrastructure projects. The latter two do not require legislative approval.
- The legislature might wish to have more oversight over tribal and colonias projects.

WTB: A Review of Planning, Spending and Outcomes

Jonas Armstrong, program evaluator, Legislative Finance Committee (LFC), and Jon Courtney, program evaluation manager, LFC, reported on the findings of an analysis of the WPF program that was conducted by the LFC and published in a November 2013 report. They summarized the report's key findings and recommendations and responded to committee members' questions.

The LFC found that: 1) the high proportion of grants to loans offered through the program dilutes the effectiveness of the loan programs; 2) although challenges exist for the fair administration of the WPF, the WTB is correctly funding projects according to policy; 3) the Water Trust Fund (WTF) is in danger of becoming insolvent; and 4) the WTB is implementing new policies to improve the program. Concerning the first finding, the LFC compared New Mexico's mostly-grant program to other states' corresponding programs and discovered that most other states have self-sustaining, revolving loan funds and that New Mexico spends more on grants than all of its neighboring states combined. Concerning the second finding, the LFC found that water project financing programs are not streamlined for applicant ease, that the WTB does not comply with interest rate rules, that the WTB too willingly forgives loan obligations, that the WTB has not delivered a statutorily required annual report to the legislature since 2006 and that more oversight of WTB administration and projects is needed. Concerning the third finding, the LFC found that it is projected that money in the WTF will be depleted by 2033. Lastly, the LFC found that the WTB is taking steps to employ best practices and improve the financial and environmental accountability of public utilities, and that these policies will result in an increased need for assistance to smaller participating entities.

The report contained the following recommendations, which Mr. Armstrong and Mr. Courtney outlined. Pertaining to the WTB: a centralized process for water infrastructure process funding, featuring the use of a uniform-across-agency application process, should be established; loan terms should comply with the law; policies should be implemented faithfully and consistently; and a third party should be contracted to help project recipients with planning and analysis. Pertaining to the legislature: the requirement for a uniform application process should be established; an interagency committee that coordinates all water infrastructure funding programs should be created; and water projects should be funded through the capital outlay process only when other sources of funding are not available.

Committee members offered comments and questions, and the presenters responded, as follows.

- It would help legislators to know of a given requesting entity's pursuit of project funding from other sources and the entity's ability to secure financing for all phases of its project.
- Considering that many communities' tax bases are inadequate to repay loans, the proportion of resources dedicated to grants and to loans is not necessarily

inappropriate. Further, the legislature intended the program to function as a grant program to assist small communities with their water infrastructure needs.

- The WTB should resume presenting its statutorily required report to the legislature.
- Committee members requested: 1) more detail on the options for making the WTF solvent; 2) more detail on the recommendation that the legislature create an interagency committee to coordinate all water infrastructure funding programs; and 3) more detail on the category of mutual domestics in the table on page 10 of the LFC presenters' handout.

WPF Application and Approval Process

A panel consisting of Bill Fulginiti, executive director, New Mexico Municipal League, John Gasparich, former interim chief executive officer (CEO), NMFA, Richard Rose, director of water resources, Water Resources Allocation Program, Office of the State Engineer, Blanca Surgeon, rural development specialist, Rural Community Assistance Corporation New Mexico (RCAC), and Ms. Russel discussed the WPF application and approval process.

Mr. Fulginiti introduced himself as having been a board member of the NMFA and the WTB since those boards' inception. He stressed the importance of a long application period to allow small municipalities, especially, adequate time to undergo the relatively complex application process, and he stressed the importance of the technical review process. Mr. Fulginiti reported that the funding process has become more streamlined since the WTB's formation. He further stated that in the last legislative session, uncertainty about proposed projects could have been mitigated by providing more information to the NMFA Oversight Committee and to the full legislature.

Mr. Gasparich indicated that he is no longer affiliated with any state entity but that he was participating on the panel to be available to respond to questions that he might address in his capacity as former CEO of the NMFA and former member of the WTB. He echoed Mr. Fulginiti's assertion that less misunderstanding would have resulted had the legislature received more information about projects proposed for authorization.

Mr. Rose offered some background about the WPF program and commented on its current state. He noted that in 2002, there was a severe drought that caused many communities to run out of water. A specially created team found that the problem was largely the result of those communities' lacking technical expertise to develop systems to guard against such shortages. Now, with a longer application period and state-provided technical assistance, small communities are more likely to secure funding for their projects and avoid the most dire consequences of a severe drought.

Ms. Surgeon profiled the state's rural water systems, testified on the challenges that many water utilities face and provided some recommendations for legislative response. Small rural systems constitute a vast majority of all drinking water systems in the state. Small systems are generally run by volunteer boards of directors that must navigate a complex web of water project

funding programs and the requirements (depicted in a table that Ms. Surgeon provided) that they impose. In the case of WTB funding, an applicant community must meet a funding-match requirement. If the applicant is unsuccessful in that effort or if it fails to score the minimum number of points associated with all requirements, then it must restart the application process. Further, the RCAC could offer much-needed technical expertise to small communities if it were adequately funded. Ms. Surgeon recommended that the state encourage the development of regional umbrella projects, which achieve an economy of scale with respect to policy and funding. She further recommended that the entities that operate urban water systems be required to help neighboring rural communities with their water systems.

Ms. Russel reviewed a handout illustrating key statistics in the history of the WPF program and describing the evolution of the WTB's processes. Throughout the years, the WTB has adapted its vetting process. The ratio of projects submitted to the legislature to the projects ultimately funded has varied. The recently lengthened application period forestalls the WTB's project rankings, which, in turn, prevents the legislature from receiving a more refined list of project priorities before the end of the interim.

Committee members offered comments and questions, to which the presenters responded, as follows.

- Because of the onerous application process, must small communities be required to start the application process over if they are not initially selected?
- This program was designed to benefit small communities, and many of the rules that have been put in place since the program's inception interfere with that intent.
- Improvements to water project funding could be made by incorporating data and statistics into the analysis and developing mechanisms to help state agencies and rural communities to work together.
- Whether legislative authorizations of water projects are perpetual is debatable, and the possibility of a legal action to challenge the validity of past years' authorizations is being discussed. Deeming authorizations perpetual has the effect of diluting legislative prerogative. A provision in SB 112 would have put an expiration on authorizations. The effect that such an authorization cut-off would have on multi-phase projects that span more than one year should be considered.
- In response to the SB 112 veto message, SB 112 was debated multiple times in committee, and efforts at selecting and funding projects would be less frustrated if the legislative branch had more control over WTB composition. Legislative and executive cooperation in this context is essential to ensuring that worthwhile projects get funded.
- It is important for WTB members to be present at meetings like this to hear the concerns expressed.
- Mr. Rose indicated that there have been attempts throughout the years at making more uniform the requirements of the various water project funding programs. He said that a statutory scheme involving a central agency would be needed to achieve uniformity

on a wider scale. Ms. Russel cited technical problems as a barrier to uniformity; the federal programs, for instance, have different rules, and the various programs have different timing requirements. Compared with other states, she said, New Mexico has a high number of funding sources for its population.

- Ms. Russel said that, occasionally, the WTB, which has the final say in which projects get funded, deviates from the project management team's recommendations.
- A committee member requested more information on the WTB process for project consideration and funding.
- A committee member expressed strong concern about a situation in which the Ancones Mutual Domestic Water and Wastewater Consumers Association (MDWWCA) has tried for two years to implement a project, and, as a result of its initial failure at securing part of that funding, residents have had to haul water for the last year. The association recently learned that the capital outlay portion of funding that it was supposed to receive for the project has been held up by the Department of Finance and Administration (DFA) because of a perceived audit problem under EO 2013-006 and that the next opportunity for a bond sale to finance the project is in December, which the association and the member consider unacceptably late. Ms. Russel testified that the NMFA certified that the Ancones project was compliant with audit requirements imposed by Executive Order (EO) 2013-006. The member asked what safeguards — such as an emergency funding source — could be implemented to prevent such situations.

Capital Outlay for Water Infrastructure Projects and WTB Composition

Tom Clifford, secretary of finance and administration and chair of the WTB, discussed the executive branch's efforts to improve the capital outlay process. He outlined areas seen as strengths, which include state and local cooperation, use of best practices and improvements in education and training, and areas seen as needing improvement. They include staffing, coordination, planning, prioritization and accountability. Secretary Clifford gave an overview of funding sources for capital outlay and noted that EO 2013-006 and the corresponding training by his staff to small communities have improved local governments' compliance with the Audit Act. Secretary Clifford added that \$89 million was appropriated through the 2014 capital outlay bill for water projects throughout the state.

Secretary Clifford also highlighted recent improvements to the WTB's process, responded briefly to the LFC's report on that process and commented on the WTB's composition. Improvements include implementation of a simplified project-interest form that screens for initial eligibility and the expanded window of opportunity for applicants to correct deficiencies that would otherwise disqualify them from consideration for funding. Regarding the 2013 LFC review, Secretary Clifford noted that the WTB carefully analyzes applicants' finances and finds that many are unable to repay loans, which helps to explain the LFC's finding of a high grant-to-loan ratio. He added that staff spends a lot of time preventing the duplication of efforts that applicants of the several funding programs sometimes encounter. Lastly, Secretary Clifford

pointed out that the legislature, in its role of confirming cabinet secretaries and the WTB's public member appointments, helps to determine who holds positions on the WTB.

Debra Hughes, executive director, New Mexico Association of Conservation Districts, introduced herself as a representative for the environmental community and treasurer of the WTB and said that she worked on the original WPFA and served on the first WTB. She expressed disagreement with the LFC report on its point that there should be a larger loan component in WPF program funding. Ms. Hughes concluded by indicating that the board scrutinizes projects to determine funding priority and by acknowledging that it would help the legislature to know what those priorities are.

Ms. Russel reviewed a handout summarizing major WTB-related legislation and outlining WTB composition.

Senator Cervantes thanked the members of the WTB in attendance, who were Brent Van Dyck, WTB representative of the soil and water conservation districts, Robert P. Coalter, CEO, NMFA, Mr. Fulginiti, Secretary Clifford and Ms. Hughes, for their participation. Mr. Van Dyck stressed the importance of protecting water and agriculture and helping small communities overcome the disadvantages that many face in securing funding for water projects.

Committee members directed comments and questions to Secretary Clifford as follows.

- Can the State Board of Finance find money to fund on an emergency basis the Ancones water project (whose status was discussed during the "Water Project Fund Application and Approval Process" presentation)? Secretary Clifford responded that it is possible that the DFA made a mistake and that the issue preventing the issuance of money for the project would be researched. He added that the process for such issuances includes measures to improve accountability.
- A motion was made, and passed without objection, that the following action be taken. The committees will send a letter to the secretary of finance and administration requesting: DFA staff to work with the Ancones MDWWCA to resolve the issue preventing the issuance of money for its project so that money is secured as soon as possible and construction may begin as planned in July; and that the DFA provide a follow-up report on the situation and how situations like it can be prevented.
- EO 2013-006 might be unconstitutional, as the attorney general opined.
- A partisan imbalance in the WTB representation occurs when 14 of the 16 members are executive appointees. Provisions guiding the composition of the State Investment Council (SIC) serve as an example of forming a more balanced oversight body. The legislature's influence through senate confirmation over WTB membership is too minor to prevent the imbalance. In the senate confirmation process, a candidate's worthiness to serve on the WTB is not actively considered.
- There should be an evaluation of colonias' infrastructure needs and a corresponding comprehensive plan to address them. Policymakers should know how much money is

available and how much would be needed to fully address colonias' infrastructure needs.

- The WTB should submit a more refined list of projects to the legislature next year. Secretary Clifford responded that the process to determine readiness to proceed will help cull the list submitted to the legislature, but it is difficult to strike a balance between applicants' and the legislature's needs and wishes. He said the WTB can work on getting the legislature a more refined list. Secretary Clifford also said that a rule change would be required to expand the application and funding cycle.
- Last session, efforts were made to conform the list of projects in SB 112 with the governor's agenda. Yet when asked, the state engineer said that, at the time, there was no list of projects having the governor's support. Such a list did not become available until two days before the end of the session, which was not enough time for the legislature to evaluate and incorporate them into its bill.
- A committee member requested that NMFA staff provide information on which of the governor's projects are part of entities' infrastructure capital improvement plans.
- Small communities should not have to restart the application process after being disqualified. Rather, there should be a period of years in which their applications should be held open. Further, if an entity receives approval contingent on securing a match for a grant, there should be assistance (e.g., a time extension or a supplemental grant) offered if the entity cannot satisfy the contingency.

Federal-State-Local Cooperation in Forest Watershed and Fire Management — The Necessity of Long-Term Forest and Watershed Management Planning

Tony Delfin, New Mexico state forester, James Melonas, New Mexico state liaison, United States Forest Service Southwestern Region (USFS), Laura McCarthy, director of conservation programs, New Mexico Field Office, The Nature Conservancy, Brent Racher, president, New Mexico Forest Industry Association, Kent Reid, director, New Mexico Forest and Watershed Restoration Institute (NMFWRRI), and Nita Taylor, Lincoln County manager, discussed federal, state and local cooperation in forest watershed and fire management efforts.

Mr. Delfin briefly described the role of the state Drought Task Force Watershed Subcommittee (DTFWS) in improving the health of forests and watersheds. The DTFWS developed a plan and funding request for watershed restoration projects on public lands. Mr. Delfin turned the committees' attention to a recent press release from the Office of the Governor that announced \$6.2 million for those projects and indicated that the projects are ready to begin. The larger projects could take up to about two years to complete.

Mr. Reid highlighted the NMFWRRI's responsibilities and purpose, which consist of conducting long-range collaborative planning with other entities to "promote the use of adaptive ecosystem management ... reduce the risk of wildfires, and restore the health of fire-adapted forest and woodland ecosystems" in the region.

Mr. Melonas described three aspects of the USFS's efforts to quickly and sweepingly restore watersheds in New Mexico: science, tools and partnerships. With regard to the first aspect, the Forest Service Rocky Mountain Research Station recently published a report that outlines a comprehensive framework for "improving ecosystem resiliency". Mr. Melonas defined the "tools" as provisions in the 2014 federal farm bill. Lastly, he cited partnerships among the USFS and several public and private entities that will enhance the USFS's efforts.

Ms. Taylor described the effect that five recent wildfires have had on Lincoln County. She discussed the county's response while the fires were burning (establish effective communication systems and collaborate with first responders and partners) and the work required of the county after the fires were extinguished (assess the damage and the impact on the local economy and initiate a process of recovery and cleanup).

Ms. McCarthy described the damage that wildfires, which are occurring on an increasingly large scale, have on the ecosystem and communities' water systems. Fires like the Las Conchas fire of 2011 cause a massive movement of sediment from the mountains into rivers and lakes. That sediment pollutes municipal water supplies to the point that some water utilities have determined that the water is not worth treating. Moreover, a growing body of science is pointing to the condition of watersheds as a factor in the historical declines in stream flow. Ms. McCarthy indicated that the cost of reacting to fires (about \$2,000 per acre) exceeds the cost of preventative forest restoration measures (about \$700 per acre). Immediate action must be taken to restore forests. Ms. McCarthy described some efforts to address the problem. Many public and private entities helping to develop the Rio Grande Water Fund (RGWF) plan have built momentum in the undertaking and that the legislature's support of their efforts is critical.

Mr. Racher underscored the urgency of the situation and the current deficiencies in addressing the matter. He asked for the legislature's help in establishing a long-term funding plan to address wildfire risks and said that related legislation would be proposed in the next session.

Committee members offered comments and questions, and the presenters responded, as follows.

- This work will require the participation of the federal government and bipartisan, bicameral cooperation in the legislature.
- It would be worthwhile to understand what other states and the USFS are doing to address the wildfire issue. Arizona has begun a long-term project to improve forest thinning on a large scale and is exploring innovative ways to control the costs.
- Wildfires demand an immediate response, and New Mexico should take the lead among states in its efforts to address the problem. Those efforts should include training New Mexicans for forest restoration-related jobs. It would be appropriate for the Jobs Council to hear a presentation on the economic development aspects of forest restoration.

- At the request of a committee member, Dale Dekker, architect, Dekker/Perich/Sabatini, who was in the audience, commented on the discussion. Mr. Dekker expressed his enthusiasm about collaborative forest restoration efforts and suggested that the business community is playing a role in tackling the problem.
- At its October meeting, the WNRC should address options to generate revenue for forest restoration. Ms. McCarthy indicated that there have been conversations with the superintendent of insurance about the possibility of imposing a premium tax on homeowners insurance to help offset the cost of restoration efforts. She also said that the RGWF group has designed a model in which downstream water users help to pay the costs of water source protection. The cost during the transition to plan implementation will be about \$30 million per year, including a federal contribution of about \$20 million.
- Efforts at forest restoration would improve if there were fewer government-imposed restrictions on forest thinning; private industry would then be more willing to step in and invest in it. One of the most crucial components of forest restoration will be increasing private investment.

Status of the WTF

Charles Wollman, SIC, provided some history of the WTF and reported on its status. The WTF was statutorily created in 2003. It received an initial \$40 million appropriation in 2007 and another of \$15 million in 2008, but none since then; its current value is \$45 million. Money in the fund is invested according to the terms that guide investment of the land grant permanent funds. Every year, at least \$4 million from the WTF is distributed to the WPF. Unlike other funds managed by the SIC, the WTF has not grown, in spite of the strong aggregate growth of permanent fund assets that has occurred since June 2009. From April 2010 to May 2014, the WTF lost \$304,000. It is predicted that the WTF will be depleted in 2035; but if market performance weakens, then the WTF's life could span as little as 15 more years. The SIC's consultant, having assumed that a targeted return of 7% will be met and having not taken into account inflation, has projected that a \$12 million contribution to the WTF would improve the chances of the fund being maintained; with inflation taken into account, more would be needed. Other options for making the fund solvent include: replenishing the fund annually through a recurring distribution; reducing the amount of annual distribution to the WPF; and basing the distribution on the fund's earnings. The SIC favors the recurring distribution option. Mr. Wollman acknowledged that the option of basing the distribution on earnings would protect the WTF's corpus but make planning difficult.

Committee members suggested other ideas for helping to sustain the fund, including conducting a study to determine a healthy rate of distribution and establishing a funding stream, such as a severance tax on water. In response to a committee member's question, Mr. Wollman indicated that the SIC believes that the fund is managed efficiently.

Adjournment

There being no further business before the NMFA Oversight Committee, its second meeting adjourned at 4:58 p.m.