MINUTES
of the
FOURTH MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

October 13-14, 2016
Room 322, State Capitol
Santa Fe

The fourth meeting of the Revenue Stabilization and Tax Policy Committee was called to order by Representative Jason C. Harper, chair, on October 13, 2016 at 10:05 a.m. in Room 322 of the State Capitol.

Present
Rep. Jason C. Harper, Chair
Sen. Carlos R. Cisneros, Vice Chair
Sen. Ted Barela (10/13)
Sen. Lee S. Cotter
Rep. Antonio Maestas
Rep. Rod Montoya
Sen. George K. Munoz (10/13)
Rep. Debbie A. Rodella
Sen. Clemente Sanchez
Rep. James R.J. Strickler
Rep. Carl Trujillo
Rep. Jim R. Trujillo
Sen. Peter Wirth (10/13)

Absent
Rep. David M. Gallegos
Rep. Tim D. Lewis
Sen. Mark Moores
Sen. William E. Sharer
Sen. John Arthur Smith

Designees
Rep. Randal S. Crowder
Rep. Bill McCamley
Sen. Nancy Rodriguez
Sen. James P. White
Sen. Pat Woods

Rep. David E. Adkins
Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Sharon Clahchischilliage
Rep. Brian Egolf
Rep. Miguel P. Garcia
Rep. Stephanie Garcia Richard
Rep. Bealquin Bill Gomez
Sen. Stuart Ingle
Rep. Conrad James
Sen. Gay G. Kernan
Rep. Idalia Lechuga-Tena
Rep. Javier Martínez
Rep. Tomás E. Salazar
Sen. John M. Sapien

Rep. Jeff Steinborn
Rep. James G. Townsend

(Attendance dates are noted for members not present for the entire meeting.)

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Jeff Eaton, Research and Fiscal Policy Analyst, LCS
Ric Gaudet, Researcher, LCS
Tessa Ryan, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

Handouts
Handouts and other written testimony are in the meeting file.

Thursday, October 13

Approval of Minutes
On a motion made and seconded, the minutes from the September meeting were adopted without objection.

Capital Outlay Overview and Discussion
Stephanie Schardin Clarke, deputy cabinet secretary, Department of Finance and Administration (DFA), Rick Lopez, division director, Local Government Division (LGD), DFA, Linda M. Kehoe, principal analyst, Legislative Finance Committee (LFC), William Fulginiti, executive director, New Mexico Municipal League (NMML), and Steve Kopelman, executive director, New Mexico Association of Counties (NMAC), gave a joint presentation on the state's capital outlay system and on efforts to reform it.

Ms. Kehoe introduced the panel and gave background for the presentation. A group of system administrators has been meeting regularly to discuss problems with, and recommend improvements to, the capital outlay system. The group has concluded that, considering the large amount of unspent, earmarked capital outlay money, the system falls short of its potential to improve health, safety and economic development. Some of the group's recommendations have been implemented. As part of its efforts, the group has conducted surveys of city and county officials. Cognizant of the widespread resistance to legislative reform of the system and the need to preserve the legislature's power of appropriation, the group has explored administrative changes to streamline and improve the system.

The capital outlay system; issues. Mr. Lopez summarized the capital outlay system and described some of its salient issues. The system is intended to: improve health, safety and quality of life; create and retain jobs; and provide other critical government services. It is estimated that $2.6 billion will be spent in the next five years on state and local capital outlay projects, but flaws in the system compromise the state's ability to achieve the highest possible return on that investment. Too often, funding is directed at low-priority projects that are insufficiently funded and unready to begin. As a result, hundreds of millions of dollars in bond proceeds earmarked for projects sit idle.

The capital outlay funding process is convoluted. It involves many steps related to planning, requesting, vetting, authorizing, procuring, reimbursing and fiscal exchange.

Several of the entities that play a role in administering the capital outlay system operate within the DFA. Generally, the department's role in this context is to promote accountability in the system's use of public money by ensuring compliance with applicable state and federal laws and policies. Often, issues in project funding arise while the DFA is performing its role in the project funding process. Frequently, issues are attributable to breakdowns in communication between a local administrator and a state agency. Those wishing to resolve such an issue are encouraged to contact Mr. Lopez or Ms. Schardin Clarke.

Municipal perspective. Mr. Fulginiti reported the results of a survey of municipal representatives and articulated the NMML's perspectives on the capital outlay system. The system is cumbersome. Local representatives frequently have to submit the same information on different forms to more than one agency. This duplication could be cured by instituting a universal form. Meanwhile, the four-year time frame in which project money must be spent is too restrictive: instead of the period beginning when the authorization bill is signed, it should begin when the state approves the grant for a project. There is also a need for providing written guidelines or a checklist for completing necessary documentation to local officials. The turnover in local offices often compounds the problems stemming from these flaws in the system.

County perspective. Mr. Kopelman reported the results of the survey that the NMAC conducted of its members and on the NMAC's perspectives on the capital outlay system. The survey results were virtually identical to those of the NMML's survey. In sum, the system: 1) is cumbersome — time-consuming and difficult — particularly for small counties; 2) allows for partial funding of projects for which full funding is unavailable or too difficult to secure; 3) allows for nonprofit or quasi-governmental agencies to propose, and get legislative authorization for, projects that require local government participation but that local governments do not agree beforehand to take on; and 4) demands much in these cases from the local governments, which often lack the resources and expertise to fulfill their responsibilities in this context.

Communication and cooperation among those who otherwise operate independently of one another could mitigate some of the system's problems, including many that could be solved without legislative action. Many problems could be further tempered by: 1) instituting a uniform, comprehensive, project database for agency use; 2) prioritizing projects with the highest needs; 3) requiring local government preapproval of a project proposed by an external entity and involving that government; 4) taking into account project time lines in developing grant agreements; 5) educating legislators annually on the process; 6) encouraging legislators from the same regions to collaborate with their local officials to address capital outlay concerns and needs; and 7) involving councils of governments (COGs) more in the process.

State agency perspective. Ms. Schardin Clarke spoke about problems with, and suggested improvements to, the capital outlay system. She also spoke about recent administrative changes and steps legislators can take to improve the system.

The system could be improved by reducing the proliferation of authorized projects. The multitude of projects dilutes spending efficiency since each project, regardless of its size, carries fixed costs. Graphs on page 18 of the presentation handout illustrate the dilution: the 2016 median project cost is $85,000, and of the 680 projects outstanding in that period, 427 cost less than $100,000.

Potential improvements to the system include: 1) prioritizing critical infrastructure over nonessential projects; 2) coordinating project funding streams; 3) streamlining and standardizing forms; 4) limiting projects for nonprofit organizations, which heavily consume legal resources and for which the cost of bonds rises by one-third; and 5) ensuring that projects are ready to begin when they are authorized.

Steps that have been taken to improve the system include the following: 1) the State Board of Finance (SBOF) has moved to a web-based, streamlined questionnaire to aid local government grantees and state reviewers; 2) the governor issued Executive Order 2013-006, which improved compliance with the Audit Act; 3) the SBOF began publishing on its website a list of authorized, but unissued, projects; 4) agreements for projects with potential anti-donation issues are formed only after those issues are resolved; 5) the deadline for completed bond questionnaires has been moved to before the governor's bill-signing deadline; 6) the LGD managed to generate 2016 grant agreements more quickly than in the past; and 7) the DFA plans to survey grantor agencies on their practices, identify those that are most effective and prescribe a best-practice standard.

Steps that can be taken to potentially improve the system include the following: 1) creating a capital outlay planning council to increase prioritization and reduce proliferation and piecemeal funding; 2) as individual legislators, considering the priorities identified in local infrastructure capital improvement plans (ICIPs); 3) as legislators from a region, collaborating to fully fund large, region-wide, critical projects; 4) ensuring that a funded asset's useful life exceeds the average maturity period of the state's long-term bonds; 5) establishing a minimum project size of $50,000 for all but the most critical projects; 6) avoiding funding privately operated projects unless necessary; 7) instituting unwavering time-related requirements; 8) limiting the number of outstanding projects associated with a given local entity; 9) except for critical projects, requiring matching funding from local governments; and 10) requesting that the LCS work with the DFA on project data sharing. Concerning the last step, which seems like low-hanging fruit, the DFA has consulted with the LCS, which in turn is seeking related guidance from legislative leaders.

Ms. Kehoe added that the proposed collaborative database would not reveal sponsor names, but would help expedite the process, prevent capital outlay money from sitting idle and prevent project de-authorizations. She enumerated the criteria applied in recently identifying projects to de-authorize for budget solvency and closed by underscoring the value of educating legislators and others on the capital outlay system.

Questions and Discussion

Term definition. Ms. Kehoe clarified that, as used in the presentation: "critical" refers to projects that, for example, treat wastewater; bring buildings into compliance with federal disability law; repair cracked sidewalks, leaky roofs or roads; relate to health and safety concerns; or prevent tunnels from collapse; and "nonessential" projects satisfy wants, not needs. Ms. Schardin Clarke clarified that the need to ensure that projects are "ready when authorized" refers to the bond-sale prerequisite that a project be certified in writing as ready to begin within a certain time frame and be one for which 85% of its cost can be spent within three years. She said that delays often arise despite such certification.

Project eligibility; Anti-Donation Clause; nonprofit entities; local government fiscal agents. Members expressed their concerns about the limitation on funding for projects that benefit nonprofit entities: 1) each administration, it seems, interprets the Constitution of New Mexico's Anti-Donation Clause differently and for its political advantage; but the capital outlay system should not be politicized — rather, it should impartially meet legitimate infrastructure needs; 2) often, local governments do not wish to act as fiscal agents for nonprofit entity-sponsored projects; in those cases, perhaps a central agency like the LGD could perform that function; 3) in some cases, nonprofit entities that perform functions otherwise assumed by the government or that the government is unwilling to assume ought to benefit more equally from the system; and 4) COGs can be helpful in acting as fiscal agents for certain projects. Lastly, a member asked whether any local government is charging a fee for acting as a fiscal agent.

The presenters responded as follows. Ms. Kehoe said that: 1) the Public School Facilities Authority and the Facilities Management Division of the General Services Department charge fees for acting as fiscal agents; 2) previously, some local governments charged administrative fees to nonprofit entity recipients, but the practice ceased because of concerns about fee ranges and accountability and because those governments often indirectly benefit from the project grants; 3) previously, nonprofit entities received more capital outlay benefits because more General Fund money, which is not subject to bond-sale tax laws, was available for capital expenditures and because some of that nonprofit entity work fell within Anti-Donation Clause exceptions; and 4) recently, some nonprofit entities benefiting from project grants received a letter from the SBOF notifying them that they were out of compliance with grant agreements; many of those entities can reach compliance by reporting statistics on their services. Ms.

Schardin Clarke said that capital outlay improvements to buildings occupied by nonprofit entities are allowed if the buildings are publicly owned and if the owners lease them at fair-market value. Mr. Lopez said that: 1) under Executive Order 2013-006, grantees out of compliance with the Audit Act must have a local government act as the fiscal agent for a project; 2) the DFA has worked with COGs in their role as fiscal agents; and 3) those relationships are improving, but they have room to grow.

Project size; system efficiency; acequia projects. Responding to the suggestion that funding be concentrated in larger-scale projects and projects identified as priorities in ICIPs, members commented that: 1) recent low-capacity trends, combined with the valid policy of equalizing the division of funding among legislators, lead to the proliferation of small-scale projects; 2) legislators not knowing ICIP-listed priorities and the general lack of communication among the entities with a role in the process also influence project selection; 3) the situation can at times be averted when lobbyists for local governments coordinate project selection with legislators; 4) many worthwhile projects can be funded for less than $50,000; 5) not all worthwhile projects are listed as priorities in ICIPs; and 6) it is better to fully fund a small project than to insufficiently fund a large project.

Members criticized the system for presenting difficulty in securing funding for acequias, a difficulty made worse by the governor's having vetoed all acequia projects in the most recent capital outlay authorization bill. A member characterized the vetoes as politically motivated and retaliatory and contended that the action mostly hurt the people who would have benefited from the projects, not legislators. Another member pointed out that the prerequisite for an engineering study, which acequias often cannot afford, is an impediment to their getting project funding and that the planning grants available to pay for such a study are sometimes unavailing.

In response, Ms. Kehoe reported that: 1) the governor categorically vetoed all projects under a certain amount, which included every acequia project; 2) ICIP-listed projects are reported at LFC hearings each December; 3) the DFA puts instructions on accessing those lists in legislators' mailboxes on the first day of session; 4) she maintains copies of ICIP descriptions; 5) one reason legislators generally do not select ICIP priority projects is that their individual allotments usually fall short of those projects' costs; 6) in the 1970s, the only local projects funded were critical projects; and 7) local projects reduce the resources available for state projects, which serve more people.

Recent project de-authorizations. A member requested a list of projects de-authorized during the special session and the corresponding reasons for their de-authorization. Mr. Lopez stressed the importance of working collaboratively to avoid such "sweeps", and he said that the governor, when considering vetoes, often considers whether a given project is listed in an ICIP. He remarked that long-term, critical, infrastructure-oriented projects should be favored and said that staff strictly follows the rule-based guidelines for funding. Ms. Kehoe stated that projects in the de-authorization bill are being reviewed for readiness to proceed. Projects not ready to proceed would call for a line-item veto.

Proposed project-vetting body. Responding to the idea of creating a statewide capital outlay committee or board, members commented that such a body would probably: 1) favor funding for Albuquerque and Santa Fe projects; 2) be a costly, extra layer of bureaucracy; 3) like the Water Trust Board and Colonias Infrastructure Board, usurp some of the legislature's appropriation power; and 4) not solve the problem of earmarked, but idle, funding. Another member added that: 1) a legislative attempt was made to add staff to facilitate the process, but that effort failed; 2) policymakers should focus not on the question of the size of government, but rather its effectiveness; and 3) the governor, it seems, is trying to shrink government.

In response, Ms. Schardin Clarke pointed out that: 1) to allay the first concern about the suggestion of creating a project-vetting body, the legislature could enact safeguards for equity; 2) the legislature could further protect funding equity by modeling the capital outlay system on the public school capital outlay system, which incorporates surveys and ranking; 3) New Mexico has a funding-scarcity problem; 4) the move to per-legislator allocations improved equity but made the system less workable; 5) the budget process is sensible because most of the work is accomplished through committees that would make recommendations to the full legislative body, which would not dilute the legislature's appropriation power; and 6) under the proposal for a project-vetting body, staff would review projects and provide relevant information to that body, which would then make recommendations to the legislature.

Information sharing for efficiency; other proposed system changes. Responding to the suggestion that agencies collaborate more to streamline the system for the sake of project applicants and grantees, members expressed support for greater agency collaboration and for the use of a standardized form.

Members articulated the following additional suggestions for improving the system: 1) produce a one-page sheet listing steps in the process for reference by applicants; 2) impose a match requirement, particularly for projects for which other funding channels are reasonably available; 3) exempt from the requirement small entities that cannot afford such funding; 4) differentiate between large and small entities in establishing funding criteria and require a greater match from large entities; 5) include in the application a prompt for applicants to list other funding sources secured, validate that information and share it with legislators; 6) require that applicants ready their proposed projects before the legislature is approached with the request to fund them; however, applicants face many up-front costs in readying projects; and 7) to avoid the problem of excessive enrichment, require local governments to disclose, and then inform the appropriate legislators of, projects pursued by the governments through the state-funded project channel.

In response, Ms. Kehoe said that a multi-agency-produced guidelines sheet, as described in the first comment above, already exists; Mr. Lopez added that it could be modified to include anti-donation rules.

Special Session LFC Summary; New LFC Economist

Summaries of legislation passed in the special session were distributed to the committee, and Representative Harper recognized the new LFC economist, Dawn Iglesias, who was in the audience.

Job Trends and Status of the Unemployment Compensation Fund

Celina C. Bussey, secretary of workforce solutions, gave an update as follows on the state's economy and its unemployment insurance system.

New Mexico's economy. Statewide, as of August: 1) the unemployment rate was 6.6%; 2) the year-over-year non-farm job growth was .2%; 3) 1,800 jobs were added; 4) also in that period, employment increased by 10,400 jobs in private service-providing industries and decreased by 8,700 jobs in goods-producing industries; 5) the job loss was concentrated in industries connected to energy extraction, and the job gain was concentrated in education, health services and the leisure and hospitality industries; and 6) on the whole, the breakdown of employment by sector has not changed much since 2011.

Unemployment insurance. Concerning the state's unemployment insurance system: 1) approximately 11,000 individuals are certifying for benefits each week; 2) about 950 claims are filed each week; 3) the weekly claims rate tends not to fluctuate; 4) the rate of exhaustion of benefits is 38.4%, the seventeenth-highest in the nation; 5) New Mexico's previous rankings among all states for that measure were even higher, but the current measure places it low in a rank among states in the region, in part due to concerted efforts of the Workforce Solutions Department (WSD) to pursue re-employment strategies; 6) the average duration of benefits is 17.3 weeks, the thirteenth-highest in the nation — a figure the WSD will soon strive to reduce; 7) over the past 12 months, $188.5 million has been paid in benefits; 8) the WSD's initiatives to improve the re-employment rate include an active engagement with, and the empowerment of, workforce centers to pursue re-employment strategies, such as one-on-one case management and improved work-search planning; and 9) these efforts are paying off.

Unemployment Trust Fund. The health of the Unemployment Trust Fund is improving, and employer rates are decreasing. The approximately $377.6 million in the fund falls slightly below the fund's ideal balance of between $400 million and $440 million, a level believed sufficient to withstand an economic downturn. If the fund is depleted, the state would have to turn to borrowing money or selling bonds to make up the difference between its payment obligations and the fund's balance.

Meanwhile, to maintain fund health, a "reserve factor" is determined and used in the calculation of unemployment insurance taxes owed by employers. If the fund balance is low, the reserve factor — and, in turn, taxes — increase. Calendar year 2017's reserve factor, which will be reported in notices to employers, is 2.5264, a decrease from the 4.0 reserve factor used to calculate rates in calendar years 2015 and 2016, the period during which the fund hit an all-time low of $20 million. Constituents of legislators who receive the notices and have questions about them are encouraged to contact the WSD.

Questions and Discussion

Employment data. Secretary Bussey commented that: 1) unemployment reports distinguish farm employment from non-farm employment to present information not influenced by seasonal trends; 2) in general, agriculture-related employment in New Mexico is strong; 3) the agricultural industry has, in the past 10 years, experienced changes caused by automation; and 4) variable weather patterns have also affected the industry. Secretary Bussey agreed to provide the number of unemployed people represented by the state's 6.6% unemployment rate.

Benefit determination. Secretary Bussey clarified that: 1) in a given case, a computation based on work history determines a claimant's allowable duration of benefits; 2) the rate-of-exhaustion figure indicates that 38.4% of claimants collect unemployment benefits for their individual maximum duration; 3) an applicant is ineligible for benefits if the applicant drove the separation from employment; and 4) when an employee is laid off from one position but offered a different position, the determination of whether that employee is eligible for benefits hinges on factors that include the degree of change in location, work conditions and work shift of the new job. Secretary Bussey agreed to provide the number of applicants deemed ineligible for benefits.

Employer rates; practices affecting experience in the program. Secretary Bussey clarified that: 1) the reserve factor is calculated based on many factors; 2) the rate cap results in a system in which some employers subsidize others; 3) most employers are not subsidized; 4) subsidized employers are not concentrated in any particular industry classification, business size or location; 5) federal law requires that the system, which is an insurance program, provide for subsidization; 6) the cap was raised in 2013 for "high-risk" employers; 7) the legislature can further raise the cap; and 8) a relatively small number of employers pay an excess claims premium.

Secretary Bussey went on to explain that: 1) to avoid classification as "high-risk", an employer should be selective in hiring and proactive in responding to employee misbehavior; 2) the WSD considers potential liability of all of an applicant's employers during the previous 18 months; 3) the determination of liability is based on whether the reason for separation was voluntary or for cause; 4) to help avoid a determination of liability, an employer should always respond completely and timely to related, department-initiated inquiries, which solicit the reason for separation and evidence of that reason; 5) in making the determination of liability, the WSD impartially rules on the two parties' testimony and evidence; 6) each party has a right of appeal within the WSD and to the courts; 7) those appeals, while potentially cumbersome, afford due-process protections; and 8) an employer receives an inquiry-based notice only if its former employee applies for benefits. Responding to a member's suggestion that, to accommodate their needs, employers submit quarterly reports to the department, Secretary Bussey said that she would consider ways to improve the collection of related information from employers, but she also noted that the cost to the department of handling that volume of paperwork, considering the relatively small number of applicants, would probably outweigh the benefit of the approach.

Chronic unemployment. Responding to a member's question about whether the unemployment insurance system promotes unemployment, Secretary Bussey remarked on the importance of keeping people employed for as long as possible, saying that long-term unemployment can be devastating. She expressed the desire to institute policies that promote the value of work, in cooperation with other benefits-providing agencies.

New Mexico's Economic Base — A Study Performed by the Office of Policy Analysis at Arrowhead Center

Jim Peach, Ph.D., regents professor, Department of Economics, Applied Statistics and International Business, New Mexico State University (NMSU), read from a prepared statement reflecting his personal perspectives. The statement was distributed to the committee and is summarized as follows.

New Mexico's under-performing economy. Compared with other states, New Mexico's economy has performed poorly for long-term, structural reasons unrelated to the downturn in oil and gas prices. In the period starting in December 2007, the beginning of the national recession, to August 2016, New Mexico ranked forty-ninth among states for positive change in non-farm employment. In the period from June 2009, when national recovery from the recession began, to August 2016, it ranked forty-eighth among states in that measure. During the first period, the state lost 21,600 jobs. It is unlikely that the state will have made up that loss by the point marking a decade after the recession began.

That outcome, however, is not inevitable. If the state's job-growth rate since the beginning of the national recession were 1% — a plausible and, relative to the state's own past performance, low rate — the current fiscal crisis could have been averted. Were jobs added at that rate, fiscal year (FY) 2016 and FY 2017 gross receipts tax (GRT) and personal income tax (PIT) revenues would have been substantially higher and expenditures lower.

Other economic indicators point to trouble in the state's economy. New Mexico's unemployment rate is considerably higher than that of the nation and neighboring states, and its real gross domestic product recently decreased. And for the first time in five decades, the state's population is decreasing.

Analyzing the state's current economic structure and potential economic growth. It is important, given these troubling economic trends, to analyze the state's economic structure and its industry-specific potential for growth. The legislature's interim Jobs Council has made one such attempt: the council has striven to identify economic-base industries and define the need for economic-base jobs.

One way of conducting such an analysis is through an economic-base study. NMSU's Arrowhead Center has, for several years, conducted such studies for the state and subdivisions of the state. In general, an economic-base study can be used as a tool to guide local economic development activities, direct officials in their efforts to attract firms to a local area and improve local businesses' understanding of their local and export product markets.

Economic-base studies rely on the theory that a local economy has "basic" and "non-basic" industries, i.e., those that bring jobs and income into the local economy and those that do not, and that basic industries promote economic growth. Commonly, a local economy's basic activity is identified by determining its location quotient, or the proportion of a given industry's local employment to that industry's employment in the state or nation. The location quotient tells the relative importance of that industry, in a measure of employment, to the local economy. Economic-base studies often go on to identify an export-base employment multiplier. That figure is calculated by dividing the total employment of a given location to the location's total, basic-industry employment.

NMSU's most recent economic-base study for New Mexico shows that in 2014, the state's basic industries, or those whose location quotient exceeded 1.0 were: 1) mining; 2) utilities; 3) agriculture and related industries — forestry, fishing and related activities; 4) accommodation and food services; 5) federal government, including military and civilian jobs; and 6) state government. For several reasons, it is important that when using the results of such a study to guide policymaking, one should consider factors that undermine the results' integrity.

Often, policymakers — including, recently, those in New Mexico — use the results of economic-base studies to target industry clusters in economic development plans. But the state's most recent strategic plan, developed by the Economic Development Department (EDD), does not. Rather, it focuses on supporting businesses and creating a favorable business climate. Regardless of a state's economic development strategy, economic-base studies and other economic analyses can aid policymakers in their efforts to improve the economy.

Looking forward. Restoring New Mexico's economy would require a substantial amount of work and investment and changes to law. If that work is not undertaken and those investments and changes are not made, the state's economic troubles will worsen.

<u>Questions and Discussion</u>

Future economic outlook; steps toward improvement. Responding to a member's question about the state's economic future — specifically, its ability to function and to promote the economy — considering the conditions that forced a special session and the measures taken during that session to shore up revenue for solvency, Dr. Peach remarked that: 1) it appears that FY 2018 revenue will be flat; 2) a rise in oil and gas prices, which is possible, would boost those revenues; 3) the continued in-state production of oil and gas is probable, given the advances in related technology and investments already made; 4) factors such as international events affecting oil markets, possible cutbacks in global production and the exhaustion of stored oil will influence oil prices; 5) it appears that further drops in GRT revenue levels are improbable; 6) the state's long-term dependence on the volatile stream of revenue from oil and gas production is deleterious; 7) copper and coal mining activity is not likely to resume to prior levels, but uranium mining might; 8) long-term, structural problems afflict the national economy, too; and 9) to alleviate some of its current fiscal problems, the state should address its basic tax structure and, when oil and gas prices are high, make investments in infrastructure and education. When asked by a member what New Mexico would look like if it had taken those steps beginning in 1980, Dr. Peach responded that without the Richardson-era tax cuts and changes to the GRT, the state would have a steadier revenue stream.

Taxation and investments. Dr. Peach noted that relatively high taxes and burdensome regulation have not driven energy producers from the state, and he noted that California, an example of a non-low-tax state, has had robust non-farm employment largely because of its strong labor force. He further recommended that New Mexico: 1) reduce its reliance on the oil and gas industry for General Fund revenue; 2) prepare its youth for the labor force; and 3) strive to make its K-12 education and workforce training programs as good as or better than those of surrounding states.

Energy sector slump; population loss. Responding to a member's statements that high energy taxes and a restrictive regulatory regime have exacerbated the dramatic job loss and economic collapse in energy-sector-dependent San Juan County, Dr. Peach noted that cause for optimism lies in the fact that the county's workforce is highly skilled and that, though the county is experiencing an out-migration, many who leave will return after oil and gas prices rebound. He said also that: 1) the recent statewide population loss is due in part to the state of the economy and to the death rate outpacing the birth rate; 2) to attract those who have left, the state should repair its economy; and 3) it is not necessarily regrettable when a New Mexican leaves the state to fill an esteemed professional role.

Public and private sector cooperation. Dr. Peach disputed the notion that the private sector necessarily performs more efficiently than the public sector and pointed out that some of the greatest historical accomplishments, such as the construction of canals and railroads and many technological innovations, were either borne of public-private partnerships or were publicly funded.

Proposal to Tax All Contractors Equally That Operate National Laboratories

Andrea Romero, executive director, Regional Coalition of LANL Communities, described her organization and argued for the elimination of a GRT exemption as follows.

The Regional Coalition of LANL Communities. The Regional Coalition of LANL Communities consists of nine entities, including cities, towns, counties and pueblos, that surround Los Alamos National Laboratory (LANL). The coalition is a nonpartisan organization founded in 2011 to advocate for its members' interests in the context of national decisions relating to LANL. Specifically, the coalition focuses on the topics of regional economic development and site employment, environmental remediation and adequate funding for LANL.

Requested changes to law. The coalition asks the legislature to consider eliminating the GRT exemption for nonprofit entities insofar as it applies to contractors that manage and operate the national laboratories. As shown in tables in the presentation handout, the state has collected from those contractors many millions of dollars in GRT revenue in at least the past 10 years. Recently, that amount, combined with the amount collected by laboratory-area local governments, has approximated $200 million each year.

With the upcoming selection of a new contractor to manage and operate the laboratories, the coalition is concerned about the prospect that the selected contractor will qualify as a nonprofit entity under current law and, thus, have no GRT obligation on the sales of its services to the United States. Were that the case, the communities surrounding LANL and Sandia National Laboratories (SNL) would, along with the state, suffer a loss of revenue otherwise used to improve infrastructure and provide services that benefit the laboratories.

Page two of the handout lists several options for amending the existing law to ensure that in both the near and long term, regardless of whether the contractor selected to manage and operate the laboratories is a for-profit or nonprofit entity, the revenues from those laboratories' activities that the state and certain local governments have come to depend on will continue without interruption.

Questions and Discussion

Prospect of a contract award to a nonprofit organization. Ms. Romero testified that: 1) the National Security Agency (NSA) has assured the coalition that the state's law, even as that law might be changed, will be complied with; and 2) the coalition has been tracking acquisitions in other states and noticing the growing trend, which fuels the coalition's concern in this context, of contract awards to nonprofit entities. Ms. Romero summarized certain trends observed in the NSA's recent contracting practices in other states.

Prospect of amending the GRT exemption for nonprofit entities. Ms. Romero indicated that the coalition is currently exploring different options for potential statutory change.

A member expressed concern about making such a narrow exception to the GRT exemption at issue. Janet Peacock, a legislative contractor who was in the audience, amplified the member's concern. She cautioned that singling out national laboratories in this way might invite a federal challenge to the law and pointed out that other institutions — such as nonprofit hospitals — for which the exemption would presumably continue, also resemble for-profit businesses. Several members expressed worry about a potential action in this context resulting in the loss of the national laboratories in the state.

Representative Harper raised the possibility that under tax reform measures the committee is considering, the GRT exemption for nonprofit organizations be eliminated altogether or be changed to incorporate income-based, graduated tiers of exemption.

Status Update of the Committee: GRT and Property Tax

Representative Harper outlined his ideas for enacting GRT- and property-tax-reforming measures, details of which are in a handout distributed to the committee, as follows.

Under the proposed plan, the law would: 1) be enacted in 2017; 2) take effect on January 1, 2018; 3) temporarily bar local governments from adjusting their sales tax rates; 4) for its first year in effect: set new state, municipal and county sales tax rates (to be determined using estimated data) with a revenue-neutral result; expand the sales tax base; require that any revenue in excess of a revenue-neutral baseline amount be deposited into a tax stabilization fund; and require that money in that fund be distributed to certain local governments with low revenue levels; 5) for its second year in effect, provide for sales tax rate adjustments to more precisely generate revenue at target levels; and 6) for its third year in effect, transfer excess revenues from the tax stabilization fund and remove the temporary moratorium on local government adjustments to sales tax rates.

Questions and Discussion

Proposed plan. Representative Harper clarified that under the proposed plan: 1) the rate would be determined using information stored in a database, which was presented at the last meeting, and be based on a very broad base; 2) the LFC, Taxation and Revenue Department (TRD) and DFA will help develop the rate-setting methodology; 3) local governments' hold harmless enacted tax increments would not factor into the rate-setting calculation; 4) the new, re-branded sales tax would be imposed on sellers, include services in its base and include a use tax component; 5) local governments would be allowed to spend revenue from the tax as they wish; 6) the first year's revenue-neutral baseline amount would be based on the highest of the past three years' GRT revenue levels; 7) the goals of the reform are to normalize and simplify the sales tax and to encourage business development and fairness; and 8) the repeals of selected exemptions, deductions and credits would take effect at the beginning of tax years. Representative Harper indicated that he is talking with the governor's staff about the proposal but has not yet received executive endorsement of it.

Members commented on: 1) the value of some exemptions, deductions and credits in making the state more competitive in attracting outside capital and businesses to the state; and 2) the probability that, once the plan is fully implemented and the sales tax "reset", lobbyists would begin appealing for new tax incentives.

Recess

The committee recessed at 4:45 p.m.

<u>Friday, October 14</u>

The committee reconvened at 9:15 a.m. on Friday, October 14, with Representative Harper chairing the meeting.

The Cost and Benefits of a Next Generation Energy Company

Sayuri Yamada, director of New Mexico governmental affairs, Public Service Company of New Mexico (PNM), and Matthew Jaramillo, federal and state government affairs, PNM, discussed as follows PNM and some of its contributions to the state, some consumer protection-related concerns of PNM and a recent regulatory rate case to which PNM was a party.

Overview of PNM; contributions to the state. For about 100 years, PNM has provided electricity in New Mexico; it is one of the state's top state and local taxpayers. It has spent millions of dollars in investments in, and has charitably served, the state. Those activities have benefited small businesses, the solar power industry, local communities, nonprofit entities and low-income families. Each year, PNM sponsors a volunteer fair in which its employees offer different types of assistance to low-income residents.

PNM works toward the goals of transmitting power more reliably, improving meter technology and increasing its investments. The company was instrumental in attracting Facebook to New Mexico and in enacting a special economic development rate for electric service. It is working on replacing its meters with "smart" meters, which feature advanced capabilities.

Another of PNM's goals is to provide more clean energy. PNM has invested in more than one million solar panels, has 15 solar sites across the state and is working with partners to improve battery storage to make solar power generation more advantageous. More than 7,400 customers that use private solar systems are part of the PNM system, and it is projected that 2016 will mark a dramatic spike in the amount of solar power generated in the state. Federal and state tax subsidies drove much of that recent increase.

Consumer protection concerns. Although PNM is generally supportive of the trend toward clean energy power generation, the company is concerned about some of the practices engaged in by out-of-state companies exploiting the trend and tainting the reputation of the utility industry. Some of these companies are misleading people, many of whom are on low or fixed incomes, in the companies' efforts to finance, lease or sell private solar energy systems. Specifically, company representatives show prospective customers electric utility bills along with quotes for solar power that falsely depict the differences in the costs of each type of power. In truth, when considering all of the costs of each choice, the difference between them is only marginally significant. To respond to this deceptive practice, PNM has been working with other stakeholders to develop and promote a legislative initiative to require certain disclosures, impose a grace period during which such contracts could be rescinded and implement other consumer protection measures.

Another consumer-related issue resides in the sale or lease of solar panels to homeowners who later wish to sell their solar-panel-enhanced homes. Often, the contractual obligations that homeowners assume in these transactions put undesirable encumbrances on the homes or reduce the homes' marketability. In this context, too, PNM would like there to be requirements that help inform potential solar energy system buyers.

A third issue associated with the increased prevalence of solar energy system sales relates to hazardous meter installation practices potentially causing explosions, damage to humans or damage to property. PNM wishes to promote legislation to standardize the interconnection process and otherwise promote safety in this context.

Regulatory rate review final order. PNM is displeased with the result of a recent rate case, whose final order the Public Regulation Commission (PRC) issued on September 28. The order will decrease the amount of PNM investments that PNM may recover through customer assessments. Tables on page three of the presentation handout enumerate the costs of key investments and the recoverable portions of those investments. The order will potentially discourage PNM from making new investments, which help promote economic development.

Questions and Discussion

On questioning, Carlos Lucero, government affairs manager, PNM, and Anthony Bueno, senior technical account manager, PNM, who were in the audience, the presenters and the committee addressed the following topics.

Solar energy system sales and leases. Members expressed support for consumer protection in solar energy system transactions, particularly considering the current and anticipated growth in that industry. A member noted that these issues also affect real estate agents. Mr. Jaramillo stated that there is model legislation to address related issues; he also said that PNM would pursue a policy that does not impede buyers from acquiring such systems but, rather, helps them make informed decisions. Ms. Yamada added that PNM would also pursue provisions that allow the attorney general to prosecute offenders or create a civil right of action.

Hazardous meter installation practices. Mr. Bueno clarified that the illustration on page 11 of the handout shows an illegal, disconnected production meter on a functioning solar energy system. The setup creates a safety hazard and an offset on the bill, he said.

Rate case. Mr. Jaramillo cited as the PRC's reasons for denying PNM's cost recovery on its investments in balanced draft technology (pollution control equipment) that: 1) the equipment was an imprudent investment; and 2) such recovery would burden customers. He noted that PNM purchased the equipment to comply with an environmental law mandate. Ms. Yamada added that: 1) the PRC approved the federal Environmental Protection Agency's (EPA's) promulgated regulation as a way to curtail emissions from PNM's San Juan Generating Station; 2) PNM made the purchase three years before the rate case at what was believed to be fair market value; and 3) in rate cases such as this, strictures on communications between PNM and the PRC limit PNM's ability to plead its case.

Several members articulated the challenge inherent in PNM's having to comply with the EPA's regulatory mandate, on the one hand, and the limitation on recovery of costs associated with mandate compliance, on the other. They further commented that: 1) the circumstance seems unfair; 2) the widespread desire for inexpensive, reliable and low-carbon-emission electricity transmission cannot be easily satisfied when rulings like this discourage PNM investments, stymie the company's planning efforts and interfere with its ability to promote power stability and to expand quickly; and 3) that the stability and ability to expand are important for economic development.

Economic development rate. Ms. Yamada explained that the relatively newly implemented economic development utility rate provision in state law will help attract businesses to the state, thereby spreading out the fixed costs among PNM customers. The provision, she said, helped attract Facebook and entice other companies considering locating here.

PRC reorganization. Some members expressed support for the idea of reorganizing the PRC, through a constitutional amendment, from an elected to an appointed body. They remarked that: 1) in its current form, the PRC is politically influenced; and 2) it should instead make decisions based not on underlying bias but, rather, on scientific objectivity. It was recommended that such a re-formed commission include legislative appointees and treat fairly both its utilities and its consumers.

Annual Report — Laboratory Partnership with Small Business Tax Credit

Genaro Montoya, program leader, New Mexico Small Business Assistance (SBA) Program, SNL, reported as follows on the laboratory partnership with small business tax credit.

The SBA Program, funding for which is made available through GRT credits claimed by the laboratories, is a catalyst for the transfer of cutting-edge technologies developed at the laboratories to fill small businesses' needs. The credits provide up to $2.4 million per laboratory each year to support small business projects in urban and rural areas. The TRD primarily administers the program, and the EDD offers advice on improving program operations.

Each year, an outside party conducts economic impact and customer satisfaction surveys and otherwise analyzes the program. Those analyses show that in the period from the program's inception in 2000 through 2015, the program has: 1) assisted 2,495 small businesses — 65% of which are in rural New Mexico — in all 33 counties; 2) provided $48.5 million in assistance to those businesses; 3) created or retained 5,734 jobs; 4) resulted in other cost savings and increased revenues for businesses; and 5) had other positive economic effects. For 2016, it is estimated that $4.5 million to $4.8 million will be used by the program to help over 300 small businesses in 28 to 30 counties.

The 2015 annual report, copies of which were distributed to the committee, features more statistics on the program and highlights some examples of successful projects.

Mariann Johnston, communications director, Richard P. Feynman Center for Innovation, LANL, outlined the program's strategies and focus as follows. The program strives to: 1) expand the types of businesses that receive program assistance and expand to more underserved rural counties; and 2) continue to help the state grow its economy. The program's focus industries are: agriculture; oil and gas; mining; renewable energy; manufacturing; and high technology.

Ms. Johnston highlighted some of the businesses served and the technologies applied in their businesses in 2015.

Eugene C. Hudson, chief executive officer, Emerging Technology Ventures, Inc., testified on the help he received through the program to expand his unmanned vehicles business, which is headquartered in Alamogordo. The company partnered with SNL to develop smart battery management technology and a resulting product. That product assesses the health of an unmanned vehicle's battery pack before and during the vehicle's mission. The partnership has helped create high-paying full-time jobs for a relatively small investment.

Mr. Montoya and Ms. Johnston commented that the program allows for the leveraging of resources and involves the participation of several of the state's higher education institutions.

Questions and Discussion

Value of deduction. Mr. Montoya indicated that the SBA Program is not asking for any additional benefit from the state. A member noted that the committee is considering tax reform that would do away with many — but not all — GRT exemptions, deductions and credits. The member argued that, because of its effectiveness and its value in helping people and small businesses, this credit should not be among those eliminated under that reform.

Annual Report — Locomotive Fuel Gross Receipts and Compensating Tax Deductions

Demesia Padilla, secretary of taxation and revenue, noted that the report on the locomotive fuel deductions is statutorily required.

Hector Dorbecker, senior economist, TRD, and Ndem Tazifor, economist, EDD, presented the following information on the locomotive fuels deduction for FY 2016. The deduction, which can be taken against the compensating tax and the GRT, was reported by Union Pacific Railroad (UP) as providing $9.5 million in compensating tax relief and no GRT relief. BNSF Railway reported $4.6 million in GRT relief and $1.9 million in compensating tax relief. A TRD PIT analyst estimated (using a conservative 3% rate) that the construction jobs resulting from those companies' presence in the state generated $1.7 million in PIT revenue; from permanent jobs, it generated $1.2 million. That analysis is continually being refined.

Questions and Discussion

Rail fuel vending. The committee discussed the topic of where UP and BNSF buy fuel for their trains that run through the state.

Value of deduction. Some members praised the economic success experienced recently in the Santa Teresa region, stimulated in part by the enactment of the locomotive fuel deduction. Others raised the possibility that the railroads would have made the capital investments they did without the deduction. Ivan Jaime, director of public affairs, UP, commented that before UP's partnership with New Mexico, it had two tracks and no jobs in the state. Now, the railroad employs about 435 people in the state and has invested about $550 million in infrastructure, and it directs a lot of freight traffic through New Mexico. He added that many UP employees who work in New Mexico but who live in El Paso would move to New Mexico if not for housing shortages. John Thompson, lobbyist for BNSF, commented that the railroad, which buys millions of dollars of fuel from New Mexico vendors, would not be buying it without the deduction; he agreed to provide the names of those vendors.

Secretary Padilla noted that the law providing for the deduction does not require claimants to hire local contractors in building the requisite infrastructure.

Economic development promotion; project idea. A member suggested that to grow its economy, New Mexico identify and promote its advantages — such as its proximity to Mexico and its intersection between train routes — as compared with other states. The member argued for the creation, possibly using Local Economic Development Act funding, of an industrial transloading facility in Bernalillo County. Such a facility, the member suggested, could be located at the end of a one-mile spur, connect to truck-freight corridors and freight rail lines, help transport to market goods manufactured in the state and benefit the entire state.

Economic Benefits of the GRT for Nonathletic Special Events

Scott Breckner, director, special events, NMSU, reported as follows on the GRT deduction for nonathletic special events. The deduction was enacted in 2007 and was extended in 2012. It is scheduled to sunset on June 30, 2017. NMSU requests that the legislature extend the deduction through June 30, 2022. If it does not, there will be drastic reductions in NMSU's concert business; its student employment, internships and scholarships; tax revenues; New Mexicans' quality of life; and revenue for area businesses. Conversely, if the legislature does extend the deduction, its benefits, including the economic boost corresponding to ticket sales made to Texas residents, which constitute about one-third of all sales, will continue. These circumstances result from the hosting by nearby University of Texas at El Paso of comparable events whose revenues are tax exempt.

Ricardo Rel, senior director, NMSU Government Affairs, who was in the audience, testified that the deduction does not affect General Fund revenue levels but, rather, the amount of money accruing to the recipients of the governmental GRT. He added that the annual amount in tax revenue resulting from the events and their associated effects, approximately $344,000, exceeds the approximately $80,000 per year in tax that would have been paid on NMSU's nonathletic event ticket sales, had those sales occurred.

There were no questions or comments from members.

Economic Benefits of the Renewable Energy Production Tax Credit and Cost-Saving Opportunities from Reforming the Credit

Ward Marshall, director of business development, Pattern Energy Group LP, Jim Shandalov, executive director, NextEra Energy Resources, LLC, and Kari Smith, director of business development and regulatory affairs, SunPower Corporation, presented on the proposed extension of a modified renewable energy production tax credit. Each presenter read from prepared statements, which were distributed to the committee and are summarized as follows.

NextEra Energy Resources testimony. Extending the renewable energy production tax credit will economically benefit the state despite the state's current fiscal challenges. The credit was created in 2002. Since then, it has attracted renewable energy-related investment to rural parts of the state, made the state competitive in the market for that investment and financially enriched school districts.

If extended, the credit should be modified to continue to attract renewable energy-related investment. Specifically, the credit limit should be reduced to more closely align with market conditions, which have changed since 2007, when the statute providing for the credit was last amended. The credit should also be modified to reduce the backlog of applicants for it. Lastly, the credit should gradually phase out. These changes would increase the value of the credit to the state.

Pattern Energy Development testimony. Pattern Energy, which develops and constructs renewable energy and transmission projects, including three wind projects in Curry County that were initiated because of the credit, also supports the reforms as outlined in the NextEra Energy Resources testimony.

Extending the credit is important for New Mexico because of the credit's potential to increase renewable energy-related investment and grow the state's economy. A recent economic impact analysis found that the value of the credit outweighs its costs by eight to one. Renewable energy projects create economic value in the form of landowner royalties and major investments in infrastructure.

Furthermore, New Mexico is poised to become a leading exporter of renewable energy, and the continuation of the credit will promote that outcome. New Mexico has an advantage over other states because of its excellent wind resource. Its disadvantage, on the other hand, lies in its location: it is relatively far from active markets, and the transmission wheeling costs associated with projects in the state are comparatively high. Meanwhile, a sharp future increase in renewable-energy demand from California will increase competition among companies hoping to capitalize on that demand and, thus, will reduce the cost of that energy. Continuing the credit would help New Mexico stay competitive in that race.

If extended, the credit would have major long-term effects on the state's economy. It does not exist to increase renewable energy companies' profit margins but, rather, to bring those companies' projects to the state, where they otherwise would not be.

SunPower Corporation testimony. SunPower Corporation, which is a solar manufacturer and systems developer that has several projects in the state, also supports the continuation, with modifications, of a renewable energy production tax credit. The company's projects enrich the state through state land lease payments, payments to counties and school districts and job creation.

Reducing the credit now is feasible and smart and would allow the state to capture the economic benefits from solar projects on the credit waiting list. Without the credit, new projects might not materialize. The prospect for new projects is especially great given the strong interest by many commercial and industrial customers to locate in renewable energy-supportive states and to meet corporate sustainability goals.

Questions and Discussion

Nonrenewable energy industry; movement toward renewable energy production. A member expressed concern about: 1) the rapid rate at which traditional energy sources are being replaced by renewable energy sources; 2) energy storage issues associated with renewable energy production and corresponding power supply disruptions; 3) the policy preference for renewable energy activity over coal mining activity; 4) the renewable energy industry's heavy reliance on government subsidies; and 5) the disadvantages faced by the coal industry, which not only does not receive subsidies but must pay severance taxes.

Mr. Ward commented that it is prudent for states to rely on a wide array of energy sources and that the tax credit, if extended, can mean the difference between a company deciding to invest in infrastructure in New Mexico or not.

Adjournment

There being no further business before the committee, the committee adjourned at 12:30 p.m.