MINUTES
of the
FIRST MEETING
of the
NEW MEXICO FINANCE AUTHORITY OVERSIGHT COMMITTEE

June 23, 2017
State Capitol, Room 322
Santa Fe

The first meeting of the New Mexico Finance Authority (NMFA) Oversight Committee for the 2017 interim was called to order by Senator Jacob R. Candelaria, vice chair, on Friday, June 23, 2017, at 9:08 a.m. in Room 322 of the State Capitol in Santa Fe.

Present	**Absent**
Rep. Bill McCamley, Chair	Sen. Joseph Cervantes
Sen. Jacob R. Candelaria, Vice Chair	Rep. Sharon Clahchischilliage
Rep. Alonzo Baldonado	Sen. Ron Griggs
Sen. Craig W. Brandt	Sen. Michael Padilla
Rep. George Dodge, Jr.	Rep. Patricio Ruiloba
Rep. Kelly K. Fajardo	
Rep. Harry Garcia	
Rep. Jimmie C. Hall	
Sen. Richard C. Martinez	
Rep. Jane E. Powdrell-Culbert	
Rep. Debbie A. Rodella	
Sen. Nancy Rodriguez	
Rep. Patricia Roybal Caballero	
Sen. William E. Sharer	
Rep. Linda M. Trujillo	

Advisory Members

Rep. Bealquin Bill Gomez	Rep. Brian Egolf
Sen. Mary Kay Papen	Rep. Patricia A. Lundstrom
Sen. John Pinto	Sen. Clemente Sanchez
Rep. Tomás E. Salazar	Sen. Jeff Steinborn
Rep. Sheryl Williams Stapleton	Rep. Monica Youngblood
Sen. Bill Tallman	
Sen. Pat Woods	

Staff
Jeff Eaton, Staff Economist, Legislative Council Service (LCS)
Diego Jimenez, 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.

Friday, June 23

Mission and Purpose of the NMFA and Board Report

John E. McDermott, board chair, NMFA, gave an overview of the NMFA as follows. The NMFA, a highly effective public-sector bank whose model other states conform to, focuses on infrastructure and economic development projects. It serves small communities that would, without it, face high costs and difficulty in reaching the bond markets to finance their public projects. The NMFA has been improving efficiency in public finance in the state since 1992, and its loan volumes continue to grow. At about $2.2 billion, the NMFA is about the fifth-largest banking institution in the state. Its AAA bond rating allows it to make low-cost loans, and that attribute grows increasingly important as interest rates rise.

Mr. McDermott praised the work of Robert P. Coalter, chief executive officer, NMFA, who introduced members of his staff in the audience: Zach Dillenback, chief lending officer; Michael Vonderheide, director of water resources; John Brooks, director of commercial lending; Oscar Rodriguez, chief financial officer; Michael Zavelle, chief financial strategist; and Bryan Otero, assistant general counsel. Mr. Coalter summarized his professional background, which includes work at the Coca-Cola Company and in Texas state government.

Mr. Coalter continued with an overview of the NMFA as follows. The organization has an 11-member board and focuses on three key project areas: 1) infrastructure and capital equipment; 2) water; and 3) community facilities and economic development. The first category includes the authority's flagship program, the Public Project Revolving Fund (PPRF), and the Local Government Planning Fund and the Colonias Infrastructure Project Fund programs. The second consists of the Drinking Water State Revolving Loan Fund, the Water Project Fund and the Acequia Project Fund programs. The third category includes the Primary Care Capital Fund, the Behavioral Health Capital Fund, the New Markets Tax Credits, the Smart Money Initiative and the Collateral Support Participation programs.

PPRF loans and bonds. As follows, Mr. Dillenback outlined the PPRF program and described the advantages it provides. The program began in 1992. Through it, governmental entities in the state, including municipalities, counties, public schools, special districts, tribes and state agencies, may take out PPRF loans at preferable rates to pay for public projects. The program also features a disadvantaged funding rate for borrowers whose median household income is comparatively low. Each year, a bill is introduced in the legislature to authorize the making of PPRF loans of $1 million or more. Several NMFA loan officers work with potential borrowers to determine their credit needs, debt capacity and borrowing opportunities.

A highlight of the program is its strong credit ratings: AAA by Standard & Poor's and Aa1 by Moody's. The advantage provided by those ratings, low interest rates, carries over to borrowers, whose own credit ratings are in some cases low. The program's high credit ratings are growing increasingly significant, as federal scrutiny within the municipal bond market has begun to intensify. The program is considered to have low investment risk in part because its main revenue stream is 75% of the state's governmental gross receipts tax (GGRT) revenues and because it is associated with restricted reserve funds — two features that weigh heavily in the rating agencies' rating methodologies.

As shown by the graph on page nine of the main handout, activity within the PPRF program — as measured by the number and amount of loans — is rising and is expected to continue to grow. The trend is attributable to a lack of funding alternatives. A chart on page 10 of the handout shows the extent to which entities, by category, utilized the program in fiscal year (FY) 2017. The top three categories, in order, are: municipalities; counties; and public schools. An accompanying handout lists the projects funded with PPRF loans and the corresponding borrowers and loan amounts.

For FY 2018, the NMFA anticipates a relatively sharp uptick in PPRF activity involving public schools. The shift is due to a recent downgrade in the state's credit rating, which results in an increase in the pricing of the general obligation bonds school districts may issue. Consequently, school districts opt for PPRF loan financing over going directly to the market, where they would pay more.

Mr. Zavelle continued the presentation by discussing PPRF bonds as follows.

The last of the bond issues listed on page 12 of the handout, the 2017D series, is a subordinate lien issue and is notable for its relationship to a change the board made recently that received positive attention from Standard & Poor's. The NMFA board identified an underutilized resource, the contingent liquidity account, and used it to establish a new reserve that it incorporated into the subordinate lien. The new reserve acts as a bond credit enhancement for loans to entities that do not have enduring revenue sources and depend on appropriations from the state, entities to which the NMFA was previously reluctant to make PPRF loans. Responding to the change, Standard & Poor's has put out an event notice indicating that it intends to raise the subordinate lien rating to AAA. This is significant because it is very unusual for both a senior and subordinate lien — and even more unusual for a pooled loan fund — to both have that top rating. The event notice will be disseminated widely and is positive news for New Mexico.

PPRF bonds are issued for three purposes only: 1) to reimburse PPRF loans of less than $10 million; 2) to fund PPRF loans of $10 million or more; and 3) to refinance PPRF bonds for cost savings.

The interest rates for PPRF loans are based on different factors. For loans under $10 million, rates are based on true interest cost. For those $10 million and over, rates are based on bond terms, which in turn are based on an index that does not correlate with true interest costs. Each week, the NMFA posts the true interest cost rates.

Many sources are available to repay PPRF bonds. When a bond is closed, revenue from those sources is pledged to repay it, which means that, were there a loan default, the NMFA would have flexibility in managing the default. In any case, the NMFA maintains strong credit standards, and no PPRF loan it has made has ever defaulted.

Though the distribution of GGRT revenue to the program occurs monthly, the NMFA receives the payout only once a year, on June 16. A trustee receives the monthly payments, which lag by two months, and holds them until that date. The lump-sum payout causes a spike in the NMFA's cash holdings; the spike is apparent in the NMFA's end-of-year audit report. Likewise, if the legislature diverts a portion of GGRT revenue to another purpose, as it did recently for FY 2018, the state will not receive the distribution until June 16.

The PPRF bond and loan programs are interlaced, but differ. Disadvantaged funding loans are made with GGRT revenue, not reimbursed by PPRF bonds. Nevertheless, those loans' repayments are pledged to bond repayment. Meanwhile, individual debt service reserve funds, though not pledged to bond repayment, serve as a bond credit enhancement. Given that the program's risk rating would fall below an acceptable level without the GGRT distribution, the GGRT component makes it possible for the NMFA to issue PPRF bonds. Lastly, Internal Revenue Service rules restrict the use of money from PPRF loans, since PPRF bonds are tax-exempt; the NMFA, thus, closely monitors borrowers' uses of loan money.

The bond issuance process is rigorous and extensive. PPRF bonds are sold on both negotiated-sale and competitive-sale bases, and PPRF bond underwriters are selected through a request-for-proposals process. Many external professionals are involved in bond issuance.

Water programs. Mr. Vonderheide gave an overview of the water programs the NMFA administers.

The first, the Local Government Planning Fund program: 1) began in 2002; 2) provides up-front capital for vital water and wastewater project planning; 3) used to have a requirement that the "grant" money be repaid if other funding was received; 4) was broadened by statute twice to allow for more types of plans to qualify; 5) was changed by rule in 2014 to allow for asset management plans to qualify; and 6) includes, for some recipients, a local match requirement.

The second, the Colonias Infrastructure Project Fund program: 1) began in 2010; 2) provides capital for infrastructure in communities designated as colonias; 3) has seen a decrease, to 4.5%, in the allotment of senior severance tax bonding capacity dedicated to it; 4) for the FY 2017 cycle, will receive a $5.2 million allotment to fund 13 projects selected by the Colonias Infrastructure Board and for which agreements have been approved by the NMFA; 5) has had six funding cycles through which 168 projects have been funded at a total cost of $75.5 million; 6) since January 2015, has been administered by the same staff as the Water Project Fund program; and 7) has in common with the Water Project Fund program the improvement in many processes, which has resulted in shorter closing times and faster project completion.

The third, the Drinking Water State Revolving Loan Fund program: 1) began in 1998; 2) is a federal loan program that provides low-cost financing for construction of and improvements to drinking water facilities; 3) is capitalized by federal and state money and loan and interest payments; 4) is administered in partnership with the Department of Environment and its Drinking Water Bureau and Construction Programs Bureau; and 5) has provided for 116 loans totaling more than $182.1 million.

The fourth, the Water Project Fund program: 1) began in 2002; 2) is funded through an annual distribution from the Water Trust Fund and 9% of senior severance tax bonding capacity; 3) provides for grants and low-cost loans for five types of water projects; 4) makes those grants and loans for projects recommended by the Water Trust Board and authorized by the legislature; 5) has recently seen many improvements that reduce the burden on applicants and align it more with the Colonias Infrastructure Project Fund program; and 6) will receive less in funding this year due to the statutory suspension of its severance tax bonding capacity allotment.

The fifth, the Acequia Project Fund program: 1) began in 2004; 2) has been funded with donations from a foundation; 3) provides for planning grants recommended by the Water Trust Board and authorized by the legislature; and 4) has about $25,000 in available funding.

Private lending programs. Mr. Brooks highlighted the NMFA's private lending programs, which foster public-private partnerships and economic development, as follows.

The first, the Primary Care Capital Fund program: 1) began in 1994; 2) is administered in partnership with the Department of Health; 3) provides for loans at a 3% interest rate to nonprofit primary care clinics in rural and medically underserved communities; 4) has a loan forgiveness component tied to services rendered to indigent patients; 5) was initially capitalized by a $5 million General Fund appropriation; and 6) has provided for 19 loans totaling more than $11.5 million.

The second, the Behavioral Health Capital Fund program: 1) is administered in partnership with the Human Services Department; 2) provides for financing for capital needs of certain small, nonprofit behavioral health clinics in rural and medically underserved communities; 3) was capitalized with $2.5 million from cigarette tax revenue bonds; and 4) features the same forgiveness component as the Primary Care Capital Fund program.

The third, the New Markets Tax Credit program: 1) began in 2006; 2) is administered in partnership with New Mexico Community Capital, with which the NMFA created Finance New Mexico, LLC; 3) has received federal tax credit allocations of about $246 million for investment in certain low-income census tracts in non-urban counties; and 4) has an advisory board composed of community leaders from across the state.

Lastly, the Economic Development Revolving Fund: 1) has received state and federal appropriations; 2) provides for loan participation, in which the NMFA buys portions of loans made by local banks through two programs: the Smart Money Initiative and the Collateral Support Participation program; and 3) is intended to stimulate economic development by helping to fill financing gaps and lower borrowers' costs. The Smart Money Initiative began in 2003, has job-creation requirements and provides for loans to for-profit and nonprofit entities. To date, $5.6 million in loans have been made and one $1.6 million loan is expected to soon close under the program. Meanwhile, the Collateral Support Participation program began in 2011, is administered in partnership with the Economic Development Department (EDD) and is designed to increase the flow of capital to small businesses in rural areas. Some of that program's funding was recently diverted to the New Mexico Catalyst Fund and to the EDD.

<u>Questions and Discussion</u>

Tribal infrastructure projects. Mr. Eaton clarified that the annual senior severance tax bonding capacity allocation for tribal infrastructure projects is being reduced. The reduction is intended to increase distributions to the Severance Tax Permanent Fund.

State's utilization of the PPRF. Mr. Dillenback pointed out that the slide showing only one PPRF state project is a narrow snapshot of program activity, and he gave several examples of other previously funded state projects. Mr. Coalter noted that the NMFA also issues bonds for the Department of Transportation (DOT).

Economic Development Revolving Fund. Mr. Brooks explained that the reversions from the Economic Development Revolving Fund to the state, as mentioned in the handout, resulted in part from the former requirement that loans be legislatively authorized. That requirement made it difficult for the NMFA to make loans and use money in the fund. Moreover, in some years, the authorization bill was not enacted, thereby stifling program activity. Mr. Brooks also clarified that: 1) the Smart Money Initiative does not feature income-related requirements; 2) in the program, banks evaluate loan applicants and forward documents to the NMFA, which then conducts an independent analysis; and 3) program loans may be made for new businesses, business expansion or job retention.

Clarification on program attributes. Mr. Coalter clarified that the Collateral Support Participation program was not coming to a close; rather, the New Mexico Catalyst Fund will use some of the program money for venture capital investments and the EDD has plans for the portion of money from the fund diverted to it. Mr. Vonderheide clarified that the Drinking Water State Revolving Loan Fund program is a federal-based program, and the Water Project Fund program is a state-based program. Mr. Dillenback indicated that some PPRF borrowers receive only a portion of their project funding through the PPRF and the rest through capital outlay or some other source. He also said that the GGRT distribution for the PPRF program is about $29 million each year.

Recommendations for initiatives to stimulate economic development. Responding to a committee member's request for suggestions on how the NMFA can help improve efficiency in project completion and economic development in the state, Mr. Coalter named several measures the NMFA has taken to improve its economic development programs, and he indicated that the NMFA is analyzing those programs to identify other barriers to effectiveness and efficiency and areas of potential growth. He said that NMFA staff would bring proposals for program-related improvement to the committee's attention later in the interim. He added that the NMFA, together with the EDD, is exploring innovative economic development initiatives.

Mr. McDermott added to his remarks as follows. The NMFA is focused on ensuring that PPRF loan projects are completed as soon as possible, because that swiftness helps maximize efficiency in resource use. Further, it is important that the NMFA be able to act with the speed and deliberateness that commercial lending requires. The NMFA is exploring opportunities to fill gaps in the capital structure that are not served well by commercial lending in the state, such as it did with the New Mexico Catalyst Fund initiative and will do with the transfer of funding to the EDD, which is intended to boost technology transfer and acceleration. Lastly, an area worth exploring is public-private finance based on ratepayer (versus taxpayer) revenue streams for projects such as broadband, solar power and wind power development.

Water systems. Mr. Coalter agreed with a committee member's comment that the consolidation of small, independent water systems into regional water systems improves efficiency in the delivery of water to users. He also noted that such a model of centralization parallels that of the NMFA, whose work helps satisfy small communities' financing needs.

Accounting of NMFA Loan Programs

Sanjay Bhakta, deputy state auditor, Office of the State Auditor (OSA), introduced Emily Oster, compliance and quality control director, OSA.

Auditing terms; NMFA fund balances. Ms. Oster gave background information as follows. "Fund balance" and "net position", in the nongovernmental world, are referred to as equity. Equity accumulates when revenues exceed expenditures. For entities such as the NMFA that administer loan programs, funds are referred to as "proprietary funds", of which there are three categories: 1) net investment in capital assets; 2) restricted; and 3) unrestricted. The NMFA has a minimal net investment in capital assets. In contrast, it has a substantial amount of money, over $495 million as of June 30, 2016, considered restricted, or subject to limitations on use. Its unrestricted money, meanwhile, amounts to about $9.7 million as of that date.

Deputy State Auditor Bhakta continued as follows with a discussion of findings from a report produced by the OSA on the FY 2016 balances of state funds. New Mexico was one of the first states to produce such a report and has been lauded for its effort. The report is available online. Information on fund balances contained in the report was derived from audited financial statements and was assumed correct.

As the report relates to the NMFA: 1) at over $865 million, infrastructure fund balances represent a large share of total fund balance, and funds in that category consistently carry high balances; 2) the NMFA administers programs whose funds constitute much of that category's fund balance; 3) there might be a good reason for those high balances, but also it might be possible or prudent to increase activity in those funds; 4) the WPF's balance, at over $512 million, continues to increase; 5) the NMFA has some "stagnant" funds, or those whose attributes suggest low activity; this is a potential issue the committee might wish to explore; and 6) the main issue for the NMFA is the high balances in its infrastructure funds. In general, some best practices for reducing excessive fund balances are: 1) take a realistic, not optimistic, approach to lending; 2) design programs to require local involvement; and 3) fund only projects in which local- and state-level priorities align. As relates to the NMFA, the committee might wish to request an aging analysis of the approximately $135 million in the agency's undisbursed loans, or loans approved but not drawn on. Likewise, the legislature might wish to: 1) request that information as it pertains to other state agency funds; 2) implement a requirement for project audits; or 3) increase transparency and accountability by creating a centralized project monitoring process. Other best practices to consider are listed on page eight of the presentation handout.

Questions and Discussion

Stagnant NMFA funds. Deputy State Auditor Bhakta clarified that the data to identify stagnant funds was taken from 2014 through 2016 and that detail on those funds is listed in the report. Mr. Coalter testified that money in the "Primary Care" fund is currently loaned out and that the fund is active. He added that the NMFA is actively scrutinizing certain NMFA funds listed in the report, including the Water and Wastewater Project Grant Fund, in an effort to revert the money in them. He also said that, in some cases, the law would have to change to allow for reversion, and that the NMFA will propose such legislation for the next legislative session. In the case of the "Local Transportation Program" fund, the NMFA is communicating with DOT legal counsel on the matter of the fund's balance.

Project audits. A member commented that legislation to establish a statutory requirement for project audits has been introduced and that, if enacted, the requirement would increase project cost by about 10%. The member proposed the idea of random audits, which would have less fiscal impact. Deputy State Auditor Bhakta agreed with the soundness of the idea and also proposed the idea of limiting the requirement to projects over a certain size.

General reaction to report. Mr. Coalter briefly explained some of the NMFA fund balances cited in the presentation and assured the committee that NMFA staff would comment at a later meeting on the OSA's findings as they relate to the NMFA. Several members articulated the need for more report-related detail to properly understand the findings and identify reasons that some fund balances are high.

2017 Session Legislation Summary

Mr. Coalter summarized as follows NMFA-related bills that were introduced during the 2017 regular session and enacted into law. They are: 1) House Bill (HB) 256, which appropriates $1.8 million from the PPRF to the Drinking Water State Revolving Loan Fund to provide state matching funds for projects approved by the Department of Environment and pursued through the federal Safe Drinking Water Act of 1974; 2) HB 268, which lists projects authorized for PPRF financing; 3) Senate Bill (SB) 43, which helps public bodies by allowing them to delegate authority related to the sale of public securities; and 4) SB 44, which authorizes the funding, through the Water Project Fund program, of projects that have been rigorously reviewed for compliance and readiness. As discussed, a subsequent law suspended the allocation of senior severance tax bonding capacity to the program, thereby cutting off much of the funding for the authorized projects.

Questions and Discussion

Water Project Fund program funding. Mr. Coalter indicated that: 1) the Water Trust Board voted to take the fragment of total water project program funding for 2017 that was not suspended, i.e., the distribution from the Water Trust Fund, and hold it over for use in the next year; 2) the NMFA has sent notifications of the funding situation to concerned entities; and 3) the 2018 application cycle is now beginning, and although new applications are required, applicants from the 2017 cycle may use the same information previously submitted. Mr. Coalter agreed to follow up with a committee member on a specific project on which the member requested information.

Communication of project status to committee. A member recommended that the NMFA, in its reporting to the committee, show a broad view, rather than more limited snapshots, of projects' progression over time. Mr. Coalter noted that NMFA staff will continue to provide aging reports and other information related to project progression.

Water Project Fund and Colonias Infrastructure Project Fund progression. Mr. Coalter said that the several policies affecting the Water Project Fund and Colonias Infrastructure Project Fund programs have been instated in recent years that encourage the hastening of project spending and completion.

Proposed Work Plan and Meeting Schedule

Members discussed the committee's proposed work plan and meeting schedule. Some members suggested the addition of topics to the work plan, the addition of specificity to some topics listed, changes to the meeting locations and visits to particular sites during meetings. The committee adopted the proposed work plan and meeting schedule with the changes suggested.

Adjournment

There being no further business before the committee, the committee adjourned at 11:56 a.m.