FY21 Appropriation Request Budget Guidelines

NEW MEXICO LEGISLATIVE FINANCE COMMITTEE

I. PURPOSE

The Legislative Finance Committee (LFC) budget guidelines provide analysts with committee directions on performance-based budgeting, the preparation of the budget narrative, the development of FY21 recommendations on recurring appropriations, and priority capital spending and other one-time investments. The guidelines also serve to inform state agencies and the general public about new LFC priorities and approach to budget recommendations for FY21.

II. REVENUE OUTLOOK

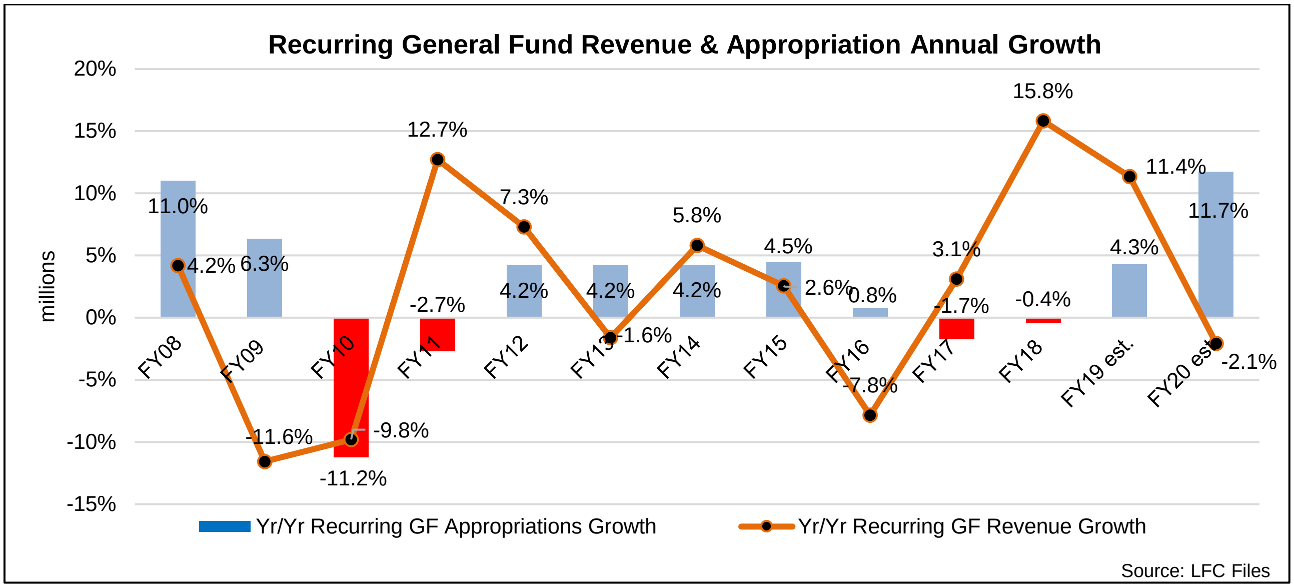
Strength in energy-related revenues led to another year of double-digit revenue growth, with FY19 recurring revenues increasing an estimated 16.2 percent above FY18. Recurring revenues for FY20 are estimated at $7.78 billion, a decrease of $43.6 million, or -0.6 percent, due a one-time payment from a very large federal land lease sale in FY19 that partially inflated the revenue growth. Recurring revenues for FY21 are projected at $7.99 billion, an increase of $304.6 million, or 2.7 percent, from FY20. "New money", defined as projected recurring revenues from the following fiscal year less current year recurring appropriations, is estimated at $907 million for FY20, or 13 percent growth from the FY20 recurring budget level. New Mexico's revenues remain well above the 10-year trend, with revenue volatility increasing due to a strong reliance on the energy industry. Changes in commodity prices or production levels could generate significant positive or negative swings in general fund revenues.

III. FY21 PRIORITY AND APPROACH

General fund revenue growth has strengthened significantly since the financial crisis of the Great Recession and oil price collapse. The committee's goal is to propose a balanced budget with a single digit growth rate. The large FY20 budget increase represented needed catch-up growth for the state after the downturn in oil related revenues beginning in FY16 and to respond to school finance litigation.

Instead of unsustainably high growth levels, the goal is to use a more modest growth rate that improves service levels, increases accountability, and ensures an adequate general fund reserve. In light of the recent bond rating downgrade by Moody's, the Legislature will need to consider issues impacting the state's bond rating, including the large Medicaid caseload, large pension liabilities, except for two counties, an economy that also is lagging the rest of the country, below-average income levels, and weak financial reporting practices.

Education continues to be the state and Legislature's highest priority and biggest fiscal and policy challenge. Other committee priorities include early childhood investment, public health, workforce development, public safety, protection of vulnerable citizens, and increased economic growth, and improving transportation infrastructure.



Overall, the committee will consider modest general fund appropriation growth levels in most state agency budgets. Growth in base general fund appropriations will be considered to improve outcomes for New Mexicans, including evidence-based programs, address changes in public and higher education enrollment, program caseload, workload, waiting lists, and medical and per diem inflationary costs.

In order to fund prioritized programs, the committee will consider targeted cost savings, focusing on duplicated services, non-critical or ineffective initiatives, areas where efficiencies have been created, or where there is no evidence a program is working.

To balance the budget during the economic downturn, nonrecurring revenue was used to support ongoing operations which created a structural deficit. The committee will consider backfilling nonrecurring revenue with general fund revenue in the agency's operating budgets and other measures to reduce future fiscal liabilities. Given continued reliance on volatile revenue sources, the committee will also focus on fiscal stability measures, such as funding large trust funds that could provide a stable source of future revenue to priority areas, including public schools, higher education and early childhood services. The committee will seek to maintain General Fund reserve levels of 20 percent to 30 percent because of increased dependence on energy revenues.

IV. PERFORMANCE AND ACOUNTABILITY

Analysts shall integrate agency performance results into their budget analysis and, whenever possible, align budget recommendations with program achievement. Consideration for continued base funding should be given to those programs that demonstrate positive results, effective design, and strong planning and management. Analysts should follow these guidelines in reviewing agency performance:

- Analysts should recommend new or alternative performance measures, as necessary, to enable policy makers and the public to better gauge program outcomes, conversion of "explanatory" measures to outcome measures, and report results quarterly.

- Agency strategic plans should ensure: 1) the stated mission, goals, and objectives are consistent with statute and state policies; 2) overarching programs are coordinated among divisions and, where applicable, across agencies; 3) programs are consistent with current resources and conditions; and 4) resources are aligned with the agency's strategic direction and performance results.
- Performance targets should be benchmarked for priority programs whenever possible. Suggested resources for benchmarking include federal standards, best-practice standards set by other agencies and states, historical data, and desired results.
- Performance data and results from recent LFC program evaluations should be used to identify ineffective programs or producing marginal results or, conversely, are achieving desired outcomes.

Analysts shall use Results First cost-benefit analysis where available, notably in the areas of public safety, early childhood, child welfare, and behavioral health programs. In select cases, analysts may recommend new performance measures from what DFA approved during the interim for agencies to include in their FY21 budget request.

The committee will also focus on Managing for Results. Performance accountability has matured and agencies need to effectively use performance indicators and tools, such as cost-benefit analysis, to ensure limited resources are used to cut ineffective programs and bolster effective ones.

V. BUDGET GUIDELINES

The following budget guidelines apply to all agencies.

Compensation, FTE, and Vacancy Rates. Even though state employment in New Mexico remains significantly below peak employment levels seen prior to the Great Recession of 2008, out-of-cycle salary increases, targeted salary adjustments, and higher benefit costs have boosted spending on personal services and employee benefits (PS&EB). Also, elevated vacancy rates have resulted in large amounts of PS&EB funding transferred to other areas of the budget.

The State Personnel Office (SPO) continues reporting high employee turnover, particularly in the first year of state service. The difficulty the state faces in retaining employees results from factors including base salary adequacy, working conditions, and private sector demand for workers. In addition to examining salary adequacy, analysts shall review the components of total compensation including insurance, pensions, and other benefits to determine how the state compares to the region and the impact of the benefit package on take-home pay.

The committee will consider targeted compensation increases to address recruitment and retention in critical occupations and general salary increases for all public state employees to offset inflation and increased benefit costs.

Expenditures and Contractual Services. Analysts shall analyze requested expenditures for professional services and other contracts to ensure contracts address legislative priorities, and adhere to performance criteria. Analysts shall use the monthly Contracts Report provided by DFA information in the New Mexico Sunshine Portal and postings on the USD website to analyze an agency's historical use of contractual services. Analysts should note shifts of workload from FTE to contractors and ensure the cost of performing the work is not double funded.

Revenues and Cash Balances. Use of other state funds and federal funds shall be maximized based on grants, awards, agreements, budget adjustment request (BAR) activity, and program history. To reduce the need for revenue from the general fund, cash balances shall be used in the FY21 budget recommendation. Governing statutes shall be reviewed to ensure that if funds are budgeted appropriately and if they can be used for other purposes. Analysts shall scrutinize expenditures where earmarked revenue or federal funds are in decline or potentially unavailable. Analysts shall also examine funds that were swept during recent solvency efforts and the need for replacement of those funds to ensure ongoing effective operations of agencies and programs.

Federal Funds. Federal funds should be leveraged to the extent possible in keeping with the committee's policy priorities to ensure these funds are accurately reflected in the budget recommendation. Analysts are directed to compare information on revenue forms provided in the budget requests with deviations from appropriations, the database provided by the Federal Funds Information for States (FFIS) service, and other sources of information on federal funds. Analysts shall also use historical budget adjustment information to determine if the level of federal funds is accurately reflected in the agency request.

Expansion. Expansions will be limited to committee priorities that are evidence-based, tied to enhanced service delivery, and are appropriate functions of state government. Workload growth is not considered an expansion. Analysts shall avoid financing expansions with nonrecurring revenue. Generally, expansions not identified as a committee priority must be financed within current appropriation levels through reprioritization. All expansions must be tied to enhanced performance and explained in the budget document accordingly. Expansion FTE should be budgeted for a partial year if it is unlikely they will be filled by July 1, 2020.

Maintaining Investments in Technology and Facilities. Recurring annual investments in agency based operating budgets for information technology upgrades and replacement of equipment, and for basic maintenance of state facilities has lagged due to multiple rounds of solvency actions over the past decade. The committee will consider appropriations for recurring information technology and facility maintenance funding for agencies with clearly articulated need and multi-year plans to address any backlogs and future scheduled needs.

Capital Outlay, Building Use Costs, and Space Allocation. Analysts should evaluate capital projects based on whether they will address a risk or hazard to public health and/or safety, support a core government function, and promote operating savings or efficiencies. Other factors to consider include compliance with federal codes and accreditation standards, potential to leverage other funding or resources, and whether the requested funding would complete a fully functional phase of a project and advance long-term economic development. Analysts shall evaluate the effectiveness of agency owned and leased space, including maintenance and renewal costs in future years, space utilization standards adopted by the Capitol Buildings Planning Commission, lease costs, and square feet per employee. Agency infrastructure capital improvement plans must comply with Executive Order 2012-023 (Facility Master Planning Guidelines) and 2013-006 (Uniform Funding Criteria, Grant Management, and Oversight), and analysts should consider progress and outcomes on previous capital outlay appropriations.

Analysts should evaluate if the agency has long-term debt outstanding and if so, the sufficiency of dedicated revenue to make annual debt payments.

Information Technology Requests. With the potential for additional revenues, the state's most critical and other high-priority information technology (IT) projects will be considered for funding. Funding recommendations will be based on conformance with agency priorities, agency and statewide IT plans, the quality of the specific business case, including cost-benefit analysis, and available funding. Agencies must demonstrate potential cost savings and/or efficiencies gained in impacted business processes. Analysts shall consider operating budget implications, such as ongoing maintenance, training, and impacts on operations, when reviewing requests for new or extended IT projects. Staff shall review IT appropriations from previous years and monitor the progress and outcome of ongoing IT projects. Analysts must ensure all IT funding requests are submitted through established protocol (i.e., requests are submitted directly to DFA, LFC, and DoIT using the "C2" budget request form separate from the agency's annual budget request) to ensure these requests receive the appropriate level of analysis prior to approval.

Agency Audit Reports. Analysts shall use the agency's financial audit reports in preparing the FY20 budget recommendation paying close attention to general fund reversions, unreserved/undesignated fund balances, and any long-term outstanding debt. Significant deficiencies and material weaknesses identified in the audit shall be reported to the LFC. Additionally, analysts shall identify significant, long-existing fund balances, barriers to expenditure, and potential reprioritization of accumulated balances.

VI. TAX EXPENDITURES AND TAX REFORM

Significant state and local gross receipt tax rate increases have sparked numerous discussions on tax reform over the last 15 years. Various tax credits, deductions, and exemptions – tax expenditures – have narrowed the tax base, leading to the need for higher rates to maintain equivalent revenue levels. Narrowing of the tax base also often results in inequities in taxation and uneven playing fields for businesses providing the same products or services, and rising rating exacerbates the effects of tax "pyramiding" – the addition of extra layers of taxes when the GRT is applied to each business-to-business transaction at each stage of production. Additionally, the state's strong reliance on the oil and gas industry creates a highly volatile tax structure in which revenues boom and bust along with the energy sector. A tax reform package that broadens the GRT base and lowers rates would help stabilize this revenue and alleviate burdens on taxpayers created by the high rates. The state needs time to digest the recent tax changes, before addressing outstanding issues in the state's tax structure.

VII. OTHER FINANCIAL ISSUES

In addition to agency operating budgets and revenues, analysts should consider other financial issues.

Analysts should evaluate cost-saving initiatives such as administrative cost ratios, payment and delivery system improvement initiatives, appropriateness of various rate structures, changes in federal requirements, client-generated revenue, and consider ways the state can leverage Medicaid dollars for services that improve outcomes, such as Medicaid financed home visiting. Additionally, analysts should evaluate programs initiated or expanded with ACA such as care coordination, pay-for-performance, and Centennial Rewards to ensure cost effectiveness and expected performance outcomes.

Public School Funding Issues. Funding for public schools represents approximately 46 percent of total general fund appropriations – the largest category of state spending in New Mexico. In FY20, the Legislature appropriated $3.25 billion, an increase of $448.2 million, or 16 percent, over the prior year for public education. The Legislature directed large increases to improve school leadership and teacher quality through better pay; expand learning opportunities, particularly for at-risk students, through new formula extended learning program, including K-5 Plus and prekindergarten; and improve efficient and effective oversight and support through targeted Public Education Department increases and initiatives. Recent data show schools making modest improvements in student achievement. However, resolutions for the education sufficiency lawsuits and local schools ability to effectively use the new resources to support improved student achievement remain an ongoing concern. In addition, the Legislature should continue to monitor implementation of educational reforms in response to the Yazzie-Martinez lawsuit requiring practice or administrative changes by local schools, PED and education preparation programs, including ensuring compliance with state and federal law for the Indian Education Act, Bilingual Multicultural Act and use of at-risk student funding.

To build a world-class education system in New Mexico, the committee will again prioritize programs and initiatives that improve school leadership, teacher quality, extended learning opportunities, and accountability. Priorities of the committee for FY21 include ensuring effective and efficient implementation of funding to equitably close the achievement gap, enhancing instructional time, maintaining public education accountability systems, increasing school employee compensation to recruit and retain the highest quality employees, and coordinating access to early childhood programs with significant evidence of improving student outcomes. Aside from using the Public Education Reform fund to implement evidence-based educational interventions, analysts should identify funding flexible approaches to help schools transition to implement extended learning time programs and K-5 Plus, pilot expansion of K-5 Plus to middle and high schools and implement high quality career and technical education.

Child Welfare and Early Childhood Care and Education. Although funding for early childhood initiatives have continued to increase over the previous few years, early childhood programs are under increasing pressure to improve statewide quality standards, which typically increase costs, and coordinate expansion to avoid duplication of services. Priorities for FY21 include targeting existing services to children birth to age 4 and enhanced program accountability through a new Early Childhood Care and Education Department. Additionally, funding must be invested in a deliberate manner so that communities can grow local capacity and infrastructure responsibly. In particular, analysts should examine agency coordination and planning to avoid duplication of service funding for 3 & 4 year olds in preschool settings; and infants and toddlers in home visiting programs. New Mexico continues to struggle in some areas to meet quality early childhood program standards, such as the providers' level of technical skills, education, and stability among caregivers. Investment in workforce development will be necessary to meet continued growth of early childhood services. Priority for funding will be given to early childhood programs that have a demonstrated impact on education, health and child well-being, including through performance reporting and rigorous research of program models.

New Mexico continues to face increased rates of child abuse and neglect, in large part driven by parental substance use disorders, and out-of-home placement of children in foster care and other settings. Analysts should prioritize options for evidence-based child welfare prevention and early intervention services, including those that leverage federal funding such as Medicaid financed home visiting, in addition to workload changes in child protective services.

Behavioral Health. Concerns remain that the state has not fully recovered from disruptions to the behavioral health system which exacerbated existing challenges to access and quality care. Over the interim, the LFC and the Legislative Health and Human Services Interim Committee (LHHS) jointly requested additional information about the Human Services Department's (HSD) efforts to ensure the behavioral health network is sufficient to meet the needs of the state's most vulnerable populations. Working together with HSD, analysts will analyze access, costs and expenditures, outcomes, and services available to best address gaps and improve outcomes with limited resources.

For non-Medicaid behavioral health administered by HSD’s Behavioral Health Services Division, analysts will assess changes as clients move from state-funded services to Medicaid-funded services and determine the best use for any additional savings realized. Additionally, analysts should assess the need for recurring funding to support services that cross systems for individuals with mental health and substance use disorders that also are involved in the criminal justice system or that need housing to alleviate homelessness.

Public Safety. Improved performance management and coordination among the various state and local criminal justice agencies (courts, district attorneys, law enforcement, public defender, counties), combined with effective implementation of evidence-based criminal justice reforms offers New Mexico a path towards improved overall public safety. Effective reforms, including technical parole violation revocation practices, offer potential for taxpayer savings from reduced costs associated with incarceration and repeated incarceration. Analysts should examine opportunities for investments in proven public safety programs and potential savings that can be reinvested further in public safety, including ensuring appropriate prison space is available, and behavioral health efforts.

Medicaid. By the end of FY20, an estimated 840,939 New Mexicans will be enrolled in Medicaid, 262,285 of whom became eligible pursuant to the federal Patient Protection and Affordable Care Act (ACA), which expanded Medicaid eligibility for adults with incomes up to 138 percent of the federal poverty level beginning January 1, 2014. In April, the Human Services Department estimated a FY20 projected shortfall of approximately $2.4 million from the general fund. The outlook for FY21 may include additional funding requests for Medicaid rate and assessment increases, rate adjustments based on more client acuity in certain cohorts, reduced federal funding support for the Children's Health Insurance Program, expanding IT systems and maintenance costs, and expansion of physical and behavioral health services included in Centennial Care 2.0.

Pensions. New Mexico has two pension plans, one for public employees and another for educational employees. Although a reform proposal shoring up the finances of the educational pension system was enacted in 2019, the public employees' pension system continues to be significantly underfunded. The committee will review the work of the Governor's pension solvency task force and determine the necessary steps to put New Mexico's retirement plans on a firm financial footing.

Transportation. Transportation infrastructure, including state and local roads, bridges, airports and distribution hubs, require significant recurring and non-recurring funding increases to meet regular maintenance and improve the system overall. New Mexico's gas tax of 17 cents per gallon was last increased in 1993 and is among the lowest in the region. The Legislature allocated significant non-recurring appropriations for major state road projects, non-recurring increases to the Road Fund for heavy maintenance projects, and increased revenue from the Motor Vehicle excise tax for recurring transfer to the Road fund. While the additional funding will help, road conditions have deteriorated to the point statewide that the department estimates an annual construction and maintenance shortfall of $480 million. Local governments also face significant transportation funding shortfalls; $50 million was appropriated for local road projects in FY20 and local governments submitted over $150 million worth of project requests. The Committee will work to increase revenue earmarked for state and local road needs.