



NEW MEXICO
LEGISLATIVE
FINANCE
COMMITTEE

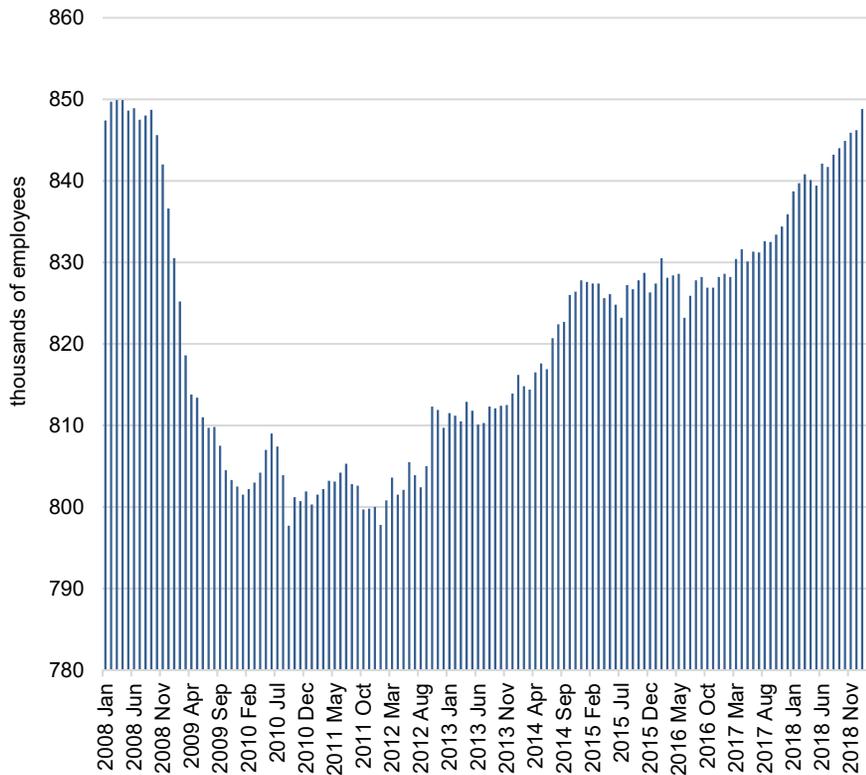
Post-Session Fiscal Report

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Presented to the
New Mexico Tax Research Institute
May 2, 2019

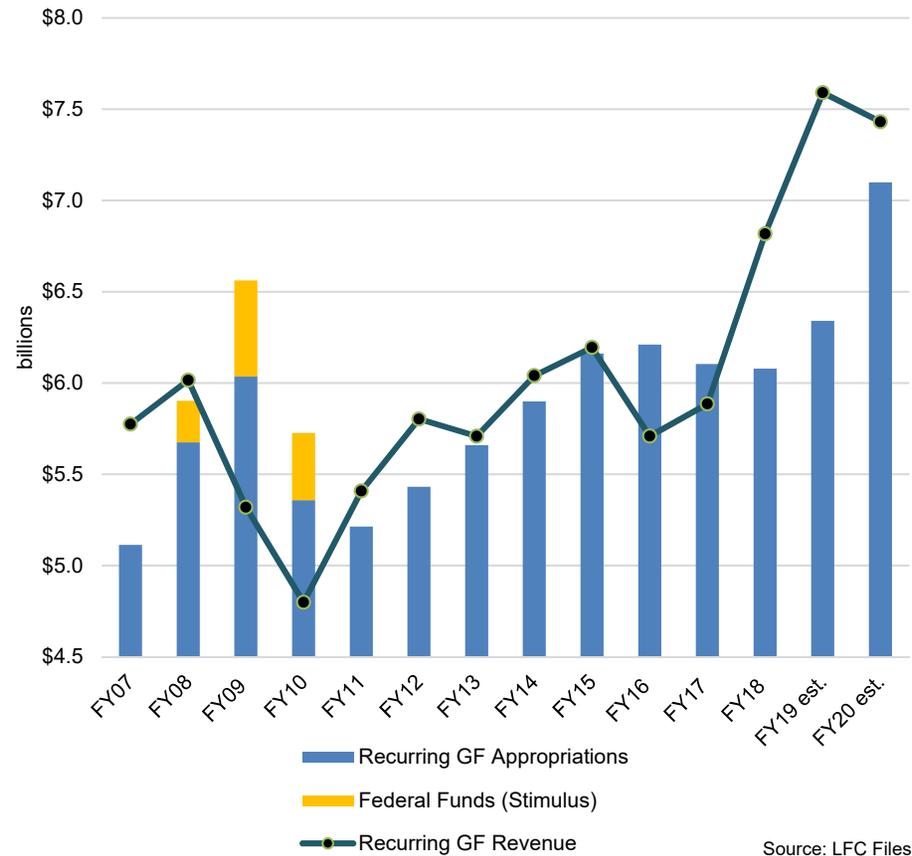
Lost decade of job and revenue growth, but growth rates are rising quickly. Jobs levels are nearing pre-recession employment peak.

Lost Decade: New Mexico Monthly Employment Levels



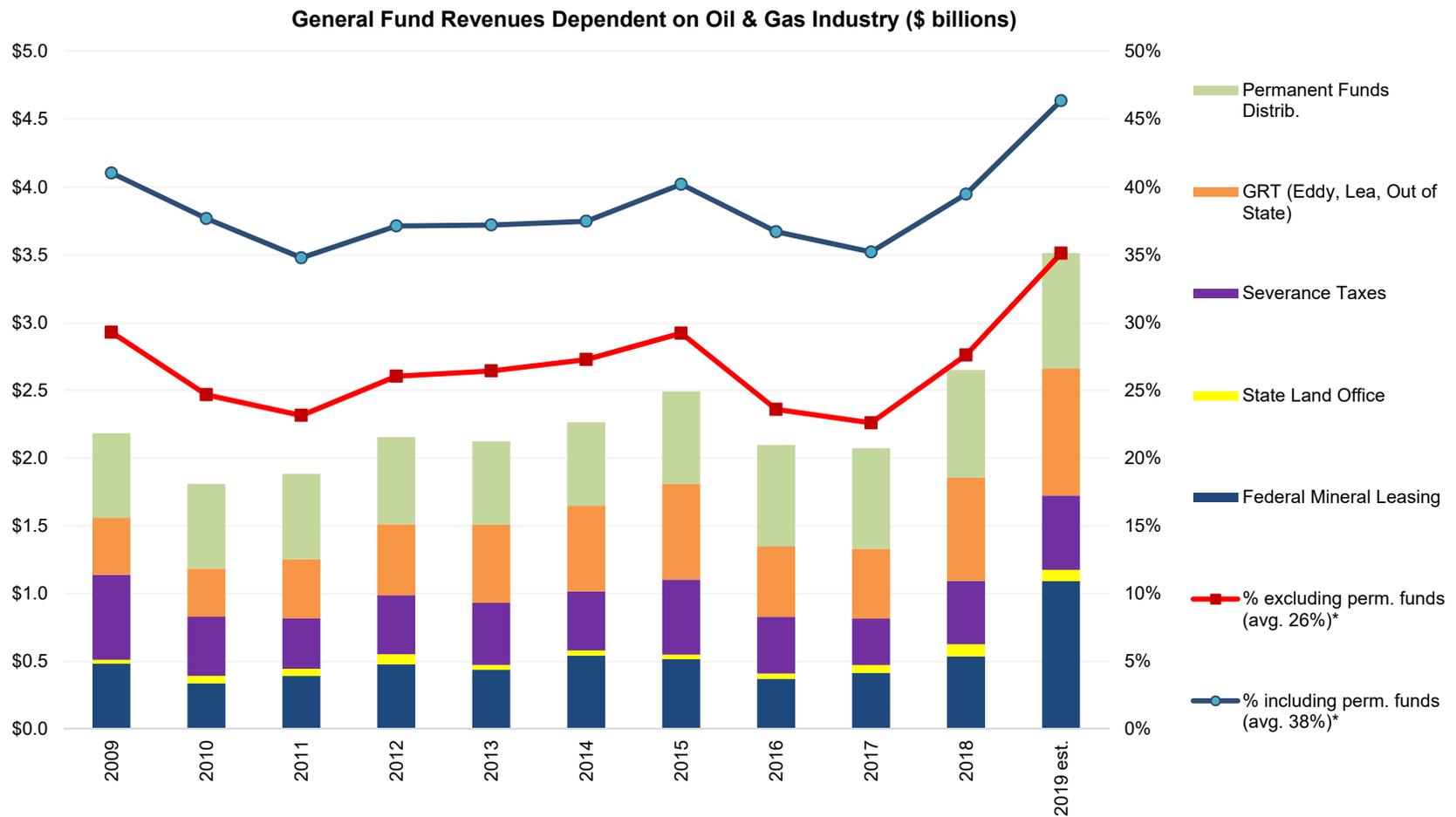
Source: Bureau of Labor Statistics (CES data)

Recurring General Fund Revenues & Appropriations
(including Great Recession federal stimulus offset)



Source: LFC Files

Growing dependence on direct revenues from the oil and gas industry: increased from 26 percent average to 35 percent in FY19

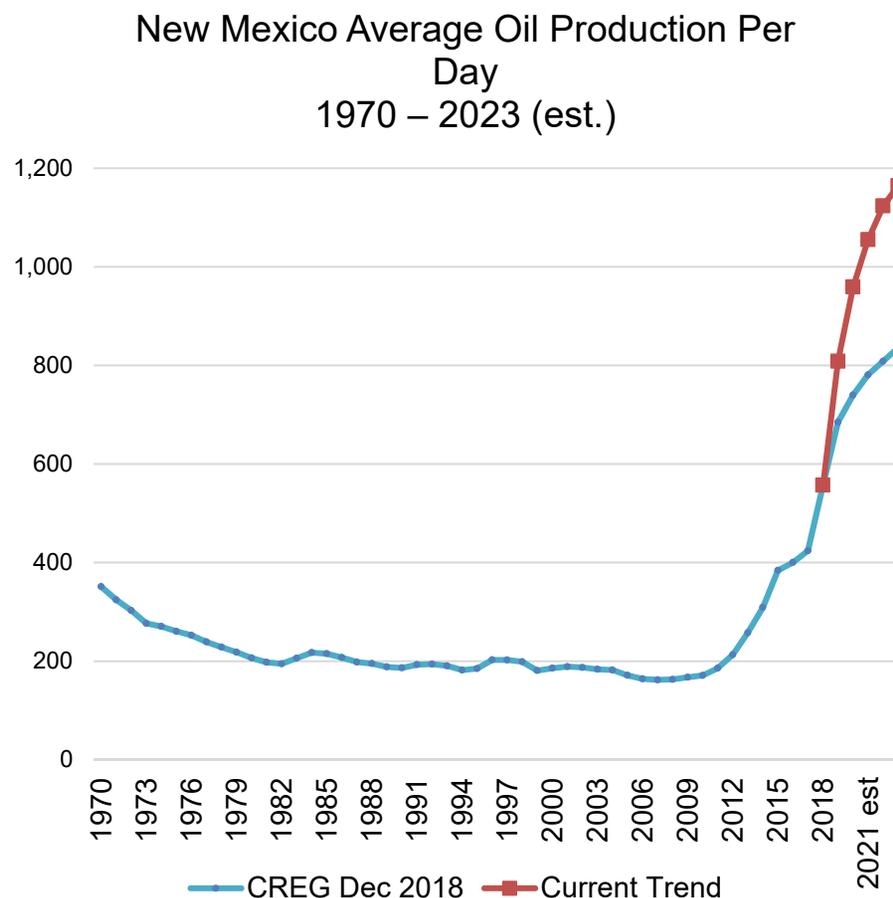


* Average from FY09 – FY18

Source: LFC Files

Current trends in oil production are surpassing the previous estimates

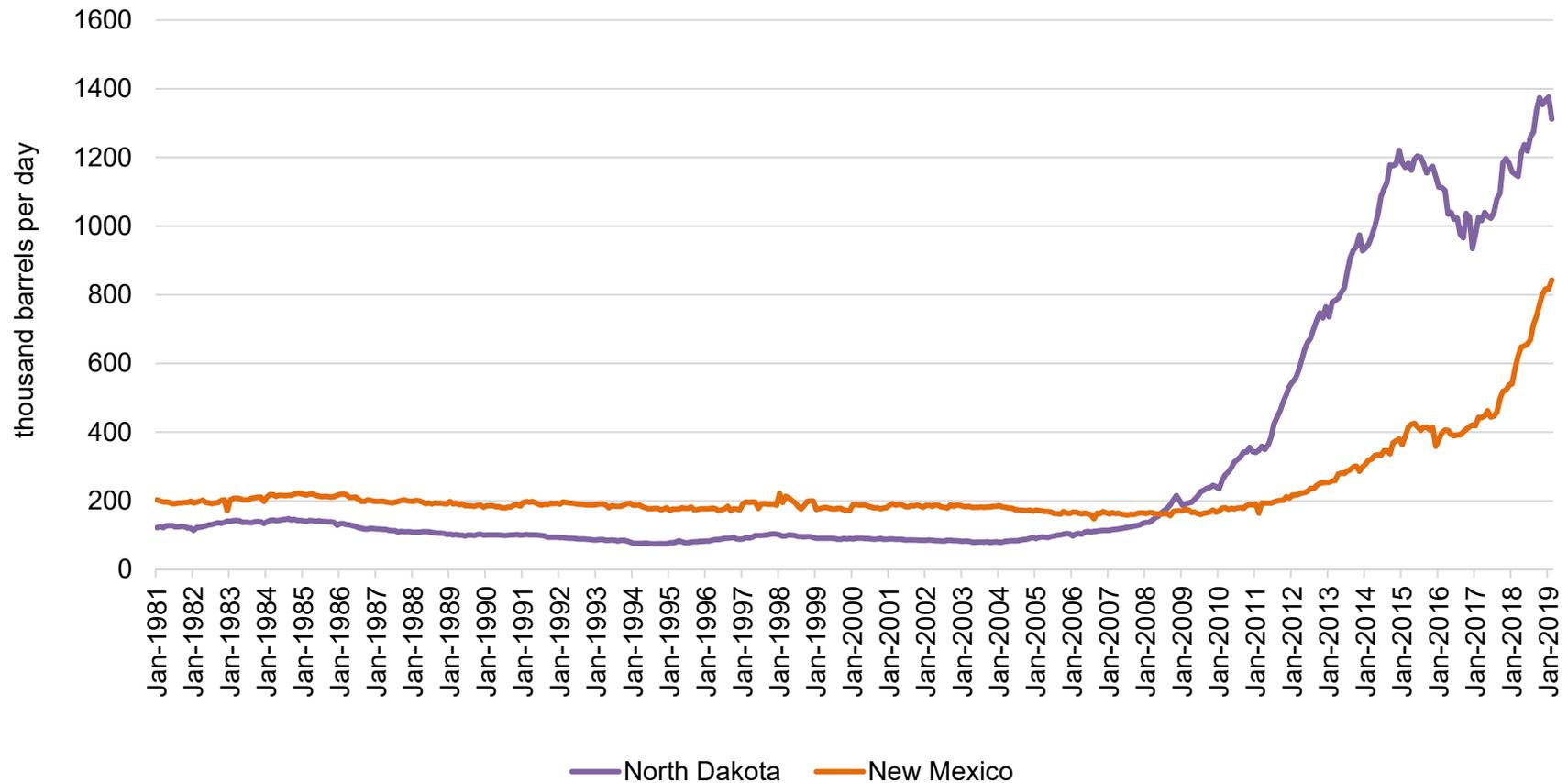
- Average oil production in FY18 was 557 thousand barrels per day
- Average oil production for the first quarter of 2019 was about 810 thousand barrels per day
- Compound annual growth rate of about 20 percent from 2012 to 2019
 - Unclear when production will level off
- Macroeconomic forecasts project Permian basin production to double in the next 5 years
 - Could mean annual NM production of over 400 million barrels by 2023



Source: OCD, LFC Files

Where is New Mexico oil production heading?

North Dakota and New Mexico Oil Production
(January 1981 to February 2019)



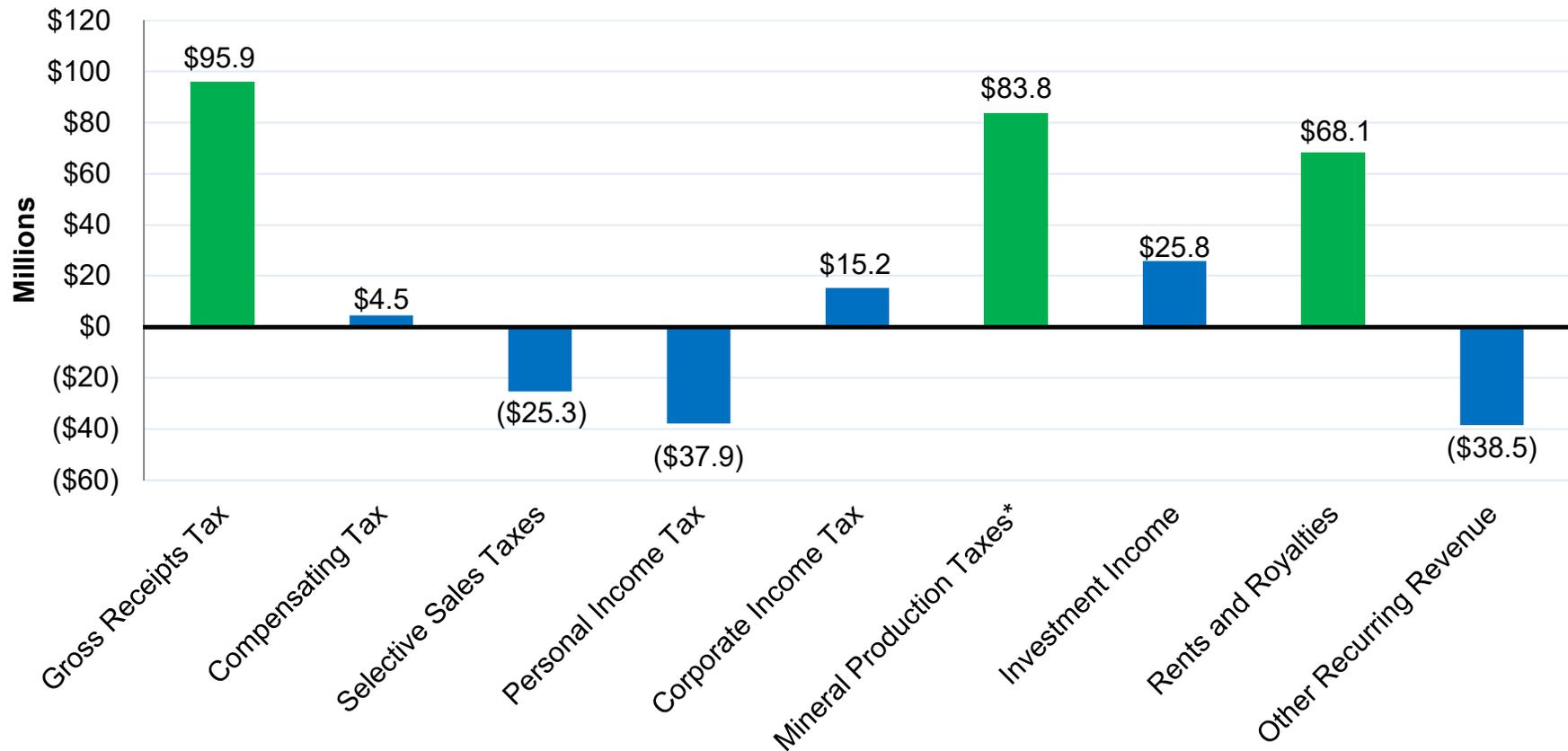
Source: Energy Information Administration

What do changes in production prices mean for New Mexico?

- Based on 2019 direct oil and gas revenues (production taxes and federal royalties),
 - A \$1 change in the annual average NM price of oil has about an \$18 million impact on the general fund
 - A \$0.10 change in the annual average NM price of natural gas has about a \$10 million impact on the general fund
 - Each additional million barrels of oil generates about \$3 million for the general fund
 - NM is currently on track to produce about 290 million barrels in FY19, 40 million barrels above the December 2018 projection
 - Each additional 10 billion cubic feet of natural gas generates about \$2 million for the general fund

FY19 oil and gas related revenues are tracking above the forecast

FY19 Revenue Tracking vs. Forecast



* Includes Oil and Gas Emergency School Tax revenues going to general fund and to tax stabilization reserve

Source: DFA General Fund Report, LFC Files

HEADING INTO THE 2019 SESSION...



Last year, Moody's Investor Service flagged the state's challenges...**downgraded bond rating**

- State general obligation bond rating downgraded twice in last two years. Moody's report flags pressing issues.
 - Fiscal stability
 - Educational outcomes: early childhood to higher education completion rates
 - Medicaid growth: crowding out effect on state responsibilities
 - Total compensation & pension solvency: pay falling behind and benefits cost increasing
 - Tax reform: gross receipts tax rates high with narrowing taxpaying base

New Mexico needed to take 100 buckets to 3 fires



From a fiscal point of view, the legislature needed to focus these pressing issues

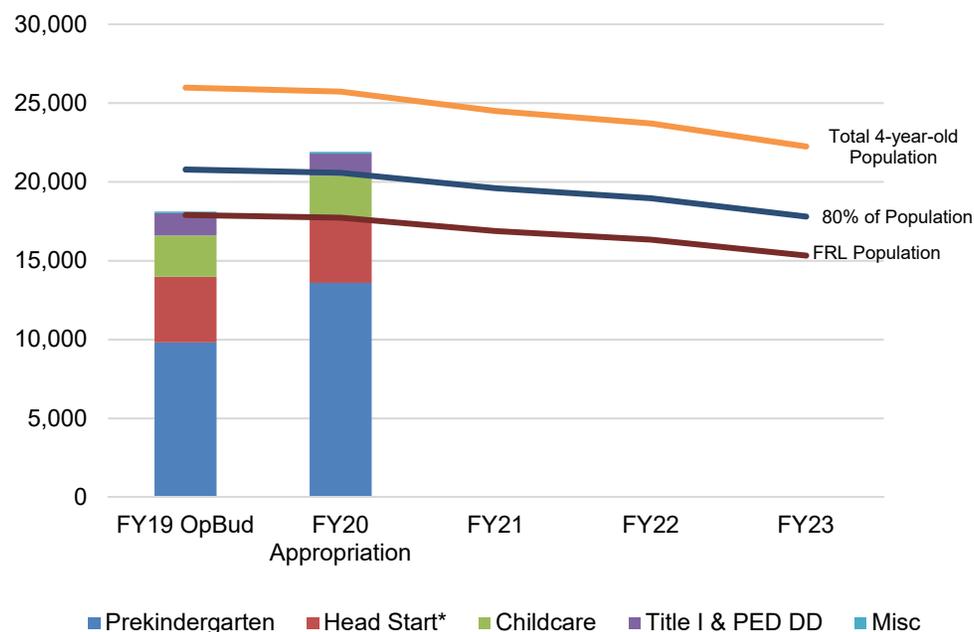
Legislative Focus: Public Education

- Recurring budget of \$3.2 billion for FY20, an unprecedented \$448 million (or 16 percent) increase from the prior year
- Companion legislation significantly responding to Martinez and Yazzie v. New Mexico sufficiency lawsuit
 - Funding for at-risk students, extended learning time (longer school day and school year), bilingual and multicultural education, and rural schools
 - Six percent raises for all school staff and minimum salary increases for teachers and principals
 - Funding for school buses, instructional materials, and professional development
 - Funding to help teacher loan repayment, support adult basic education, and expand career technical education
- LFC studies show evidence these programs improve student outcomes and will be game changers over time

Legislative Focus: Early Childhood Education

- Over \$438 million for early childhood programs, a \$125 million (or 40 percent) increase from the prior year
- Excluding the extended school year K-5 Plus initiative, early childhood programs still up \$36 million (or 12.6 percent)
- Over 80 percent of 4-year-olds are funded for early childhood education and care services
- Legislation establishing a new early childhood education and care department

New Mexico 4-Year-Old Service Capacity: Care and Education



Source: LFC Files, DOH

Notes: Represents funded slots not accounting for children enrolled in multiple services or seasonality. Children accessing more than one service is <1,100.

*Includes American Indian Head State Programs (slots)=685

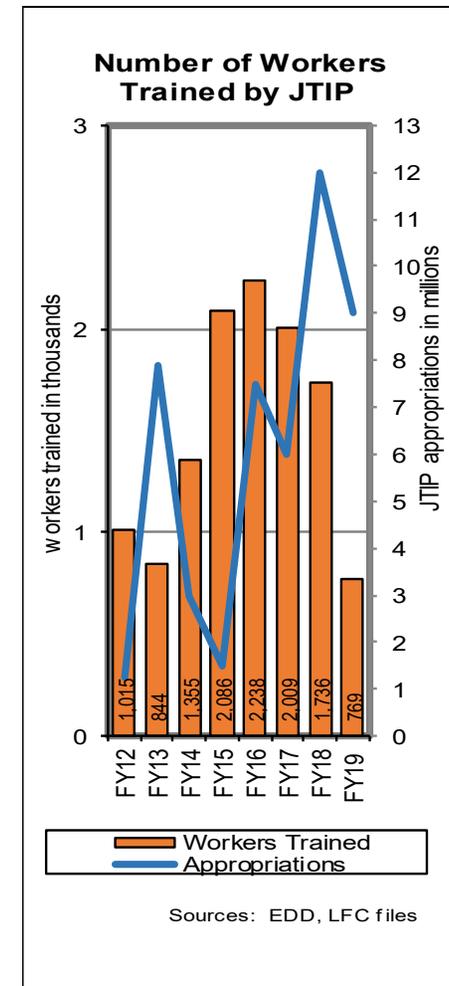
+Estimated from free and reduced-fee lunch (FRL) participation rates in New Mexico public schools (185 percent of federal poverty level)

Misc = City of Albuquerque and City of Santa Fe funded slots

FY20 appropriation is prior to governor action on HB2

Legislative Focus: Economic Development

- **Job Training Incentive Program (JTIP)**
 - JTIP grants subsidize wages for employees, with certain restrictions and job requirements
 - JTIP has supported the creation of over 46 thousand jobs since its creation
 - Operating budget increased to \$5 million
 - Special appropriation of \$5 million
- **Local Economic Development Act (LEDA)**
 - Authorizes state reimbursement to qualifying local governments for certain infrastructure developments
 - The program has created about 3,850 jobs since FY16 at costs ranging \$6,000 to \$30,000 per job
 - GAA added \$60 million in LEDA funding, with a contingency for \$15 million more if revenues exceed the forecast
- **Outdoor Recreation Division**
 - Created by SB462; intended to increase outdoor based economic development, tourism and ecotourism
 - Economic Development Department received a \$200 thousand appropriation to establish the new division in FY20



Robust Increases for Many Other Priorities

- CYFD Child Protective Services: +\$4 million (8.2%)
- Tourism and marketing: +\$3 million (26%)
- Oil Conservation Division: +\$800 thousand (16%)
- State Parks: +\$500 thousand (7%)
- Developmental Disabilities Waiver: +\$20 million (13%)
- Corrections Transitional Living: +\$2.2 million
- Higher Education Department, Center for Technical Excellence: +\$1 million
- State Employee Compensation: +4%

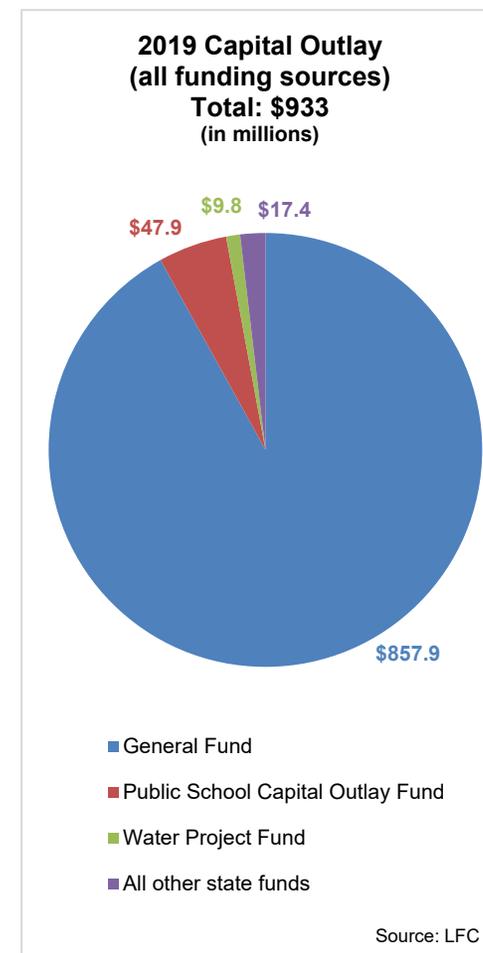
Legislative Focus: Increasing Fiscal Stability

- Projected 21% reserves in FY19 and 20% in FY20
- Backfilling other state funds and fund balances (e.g. Tobacco Settlement Permanent Fund, State Support Reserve, etc.)
- Strengthening the “Rainy Day Fund”
 - Follow-up to 2017 legislation to manage oil and gas revenue volatility and build a true rainy day fund
 - HB393 allowed interest earnings to accumulate in the fund & transferred fund management to State Investment Council for premium returns
 - SB401 transfers federal mineral leasing (oil and gas royalties and bonuses) revenues in excess of the 5-year average to the rainy day fund
- Even with 12 percent growth in recurring appropriations, the session ended with a \$332 million FY20 recurring budget surplus

Legislative Focus: Infrastructure

2019 Capital Outlay

- Appropriations total \$933 million for 1,570 projects
- Significant revenues allowed the use of general fund rather than severance tax bonds
- Projects funded include:
 - \$34 million for Impact Aid school districts for teacher housing and to build above statewide adequacy standards
 - \$33 million for the Department of Public Safety’s evidence and crime lab facility
 - \$29.3 million for the Children, Youth and Families Department’s Child Wellness Center
 - \$20 million for renewable energy, energy storage, and energy efficiency system infrastructure improvements at state-owned buildings statewide
 - \$16 million for correctional facilities statewide
 - \$15 million for public safety radio and communications equipment and infrastructure
 - \$10 million for rural broadband infrastructure
 - \$9 million for Department of Health facilities statewide
 - \$5 million for repairs to state agency buildings statewide
 - \$4.5 million museums and historic sites statewide
 - \$4.3 million for a student dormitory and cafeteria for the New Mexico School for the Arts



Capital Outlay Concerns

- While \$385 million of general and other state funds for “statewide” projects were reviewed and vetted by LFC and DFA, many did not go through a defined project selection procedure
- State agencies currently oversee 1,608 outstanding capital outlay projects with balances of \$639.9 million; the significant increase in the number of projects may exceed project management capacity at management and oversight agencies
 - GSD’s Facilities Management Division oversees most state agency projects; currently, two of the division’s seven project manager positions are vacant
 - PED will oversee 267 new projects at traditional public schools and charter schools; PED’s capital outlay bureau only has two FTE
 - DFA’s Local Government Division will oversee 461 new projects for local governments statewide; seven of that division’s 41 positions are vacant
- Efforts to increase capital outlay transparency, including publicizing how elected officials choose to allocate capital funding, were unsuccessful
- Rising construction costs pose a risk to project completion

Road Funding – Another Game Changer

- Significant additional recurring and nonrecurring funding for local governments, state-funded construction projects, and major investment projects
 - Again, concerns about capacity of road-building industry when the United States is at full employment
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| <ul style="list-style-type: none">➤ Nonrecurring (GAA Section 9)<ul style="list-style-type: none">– \$250 million in statewide projects– \$89 million for prioritized statewide transportation improvement program (STIP) project. Additional \$11 million if revenues exceed the forecast– \$50 million to new local government transportation project fund (includes up to \$5 million for construction of a relief route on U.S. 285 in Carlsbad) | <ul style="list-style-type: none">➤ Recurring<ul style="list-style-type: none">– HB6 increased motor vehicle excise tax (MVX) from 3 percent to 4 percentFY20-FY21: the additional MVX revenues sent to DOT to mitigate emergency road conditions in district 2 (Southeast NM)Beginning FY22: the additional MVX revenues plus \$26 million of existing MVX revenues to be split equally between state road fund and local government road fund |
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Legislative Focus: Tax Policy

- Virtually no net change in general fund tax revenues in FY20 and FY21
- Enacted hospital tax reform to bring nonprofit and government hospitals into the tax base
- Enacted internet tax reform to bring remote sales (including third-party platforms) into the tax base and apply local GRT increments
- Likely personal income tax increase to 5.9 percent of taxable income over \$315 thousand for joint filers (\$210 thousand for single filers)
 - Effective in FY21, contingent on FY20 revenues being no more than 5 percent above FY19 revenues
- Significant boost to local government revenues beginning in FY22, adding \$111 million recurring to local operating funds, not including the additional \$40 million for local road funds
 - Largest revenue gains from applying local GRT increments to internet sales, applying local increments to the compensating tax, and hospital GRT revenues

Legislative Focus: Tax Policy

- Revenue gains of the omnibus tax bill (HB6) offset by increase in film credit
 - Film credit changes estimated to cost over \$500 million to the general fund over the next five years (in addition to the \$250 million that would have been paid out under the existing cap)
 - Likely the most significant state investment ever in a single industry for economic development, despite evidence of about a 40 cent return on the dollar
- Significant tax reform initiatives left undone (e.g. broadening the GRT base and eliminating certain tax expenditures, lowering GRT rates, addressing tax pyramiding issues, etc.)
- Net effect of all 2019 revenue legislation is a recurring general fund loss of about \$50 million in FY22 and beyond.

Fiscal Outlook

- FY19 year-to-date revenues running significantly ahead of the forecast
- Oil production soaring
 - About 80 percent of all FY19 revenue growth due to oil and gas activity
 - Stress tests of the December 2018 consensus forecast showed FY20 revenues could come in \$1.3 billion above or below projections depending on oil prices and production activity
- Recession outlook
 - Recession signals in the bond markets: recent inversion in the yield curve, meaning very short rates rose above longer 10-year note rates
 - U.S. gross domestic product forecasts transition from above-trend growth in 2018-2019 to below-trend growth in 2020.

Expenditures

- Continued pressure to increase spending on many fronts, notably
 - Public Schools
 - Early Childhood
 - Medicaid
- With U.S. at full employment and N.M. nearing employment peaks, can the state find workers to increase government services and complete construction projects?
- Unfinished Issues
 - Unfunded pension liability
 - Selecting and managing capital outlay projects
 - Gross receipts tax pyramiding, high rates, and narrowing base
 - Fiscal stabilization
 - Worth looking at a state like North Dakota