MINUTES OF THE

NEW MEXICO STATE BOARD OF FINANCE

SPECIAL MEETING

Santa Fe, New Mexico

April 30, 2012

A Special Meeting of the New Mexico State Board of Finance was called to order on this date at 9:10 a.m. in the Governor’s Cabinet Room, Fourth Floor, State Capitol Building, Santa Fe, New Mexico.

1. ROLL CALL: QUORUM PRESENT

Members Present:
The Hon. Susana Martinez, President
The Hon. John Sanchez, Lt. Governor [arriving at 10:05 a.m.]
The Hon. James B. Lewis, State Treasurer
Mr. Robert J. Aragon, Public Member
Mr. Michael Brasher, Public Member
Mr. John Gasparich, Public Member, Secretary
Mr. Sam Spencer, Public Member

Members Excused:
None.

Legal Counsel Present:
Mr. Zack Shandler, Attorney General’s Office

Staff Present:
Dr. Thomas E. Clifford, Secretary, Department of Finance & Administration
Ms. Stephanie Schardin Clarke, Director, State Board of Finance

Others Present:
[See sign-in sheets.]

2. APPROVAL OF AGENDA

NEXT REGULAR MEETING: MAY 21, 2012, 9:00 AM

The Agenda was reprioritized.
Treasurer Lewis moved approval of the Agenda, as amended. Mr. Brasher seconded the motion, which passed 6-0 by voice vote.

3. **APPROVAL OF MINUTES: March 20, 2012 (Regular Meeting)**

Mr. Gasparich moved approval of the March 20 Minutes, as submitted. Mr. Brasher seconded the motion, which passed 6-0 by voice vote.

**STATE TREASURER’S OFFICE**

Presenters: James B. Lewis, State Treasurer; Linda Montoya Roseborough, Chief Investment Officer

4. **Monthly Investment Reports for Month-ended February 29, 2012**

Ms. Roseborough presented the February Investment Review, with the following highlights:

--- Equity Markets continued their upward momentum in February as leaders in the Eurozone delivered a rescue plan for Greece that had general buy-in from all the affected parties.

--- The US economy continues to show signs of economic growth.

--- Employment numbers were positive, with over 200,000 non-farm jobs created during the month.

--- The Dow Jones Industrial Average touched 13,000 during the shortened month of February, a level not seen since the dark days of 2008. February continued January’s strong numbers in the equity marketplace.

--- Internationally, markets experienced a continued strong rally in February as positive global economic data coincided with a resolution to the difficult Greek debt issues and significant liquidity injected into the European banking system from the ECB.

--- In the domestic fixed-income markets, longer-term government bonds were volatile. The benchmark 30-year bond ended the month at 3.08 percent.

--- Closer to home, the municipal market had an extremely strong month, with considerable tightening versus relative benchmark securities. New Mexico tax-exempt bond issuance was light for the month.

--- Federal Reserve Chair Bernanke spoke to Congress at the end of the month and the Federal Reserve minutes showed continued worries about demand; a continued bias towards “easy money”; and a cautionary view towards any potential QE3. The Fed reiterated its stance to low rates through 2014.
Oil prices have remained high, acting as a further drag on the domestic economy.

General Fund balances remained positive, with our projected nadir reached during the end of March.

Over our maturity sector, we have seen continued improvement in rate levels, with increases in the 3-5 year area. The curve has remained steep allowing for roll-down in the various portfolios.

General obligation bond principal and interest was paid on outstanding debt on March 1.

The portfolios all reported positive balances on a mark-to-market basis. Lower rates and a steep yield curve have contributed to these levels.

Unrealized gains in the General Fund were $7.2 million; in the Bond Proceeds Funds, $4.8 million; and gains in the LGIP and Severance Tax Bonding Fund were flat.

Investment Earnings were $1.1 million in the General Funds; $947,000 in the Bond Proceeds Funds; $214,000 in the LGIP; and $34,000 in the Severance Tax Bonding Fund.

During February, STO maintained Average Daily Collected Balances at the fiscal agent bank of approximately $130 million. This balance earned a soft-dollar credit against processing fees assessed by the bank.

The past month has seen a dramatic change in investor sentiment. The first quarter of the year is proving to be one of the strongest starts in the equity marketplace, with levels exceeding 13,000 on the DJIA.

A relatively strong employment number dramatically changed investor sentiment as investors began to perceive that the stock market seems “cheap” on a relative basis.

The on-again, off-again situation in Greece was finally resolved. Investors took large haircuts on their Greek debt holdings, but a worst-case expectation for Greek default was averted. Investors remain cautious that the situation with the weaker Euro countries will be resolved, but the removal of an inevitable Greek default, aided by a flood of liquidity, gave investors confidence.

Case-Schiller housing numbers showed continued weakness in the US housing market as the previously mentioned backlog of foreclosures will soon move to the market thanks to the global settlement with the larger banks.

A significant divergence in the energy sector has emerged in recent weeks, with oil prices heading higher and natural gas prices lower. At the pump and in the wallet, the price of gas rose dramatically, further reminding consumers that the economy is not completely on the mend. Unfortunately for New Mexico, natural gas prices trended lower due to increased prices.
efficiency of extraction combined with a reduction in demand due to the unseasonably warm winter months in the country.

-- STO continues to expect anemic growth throughout the year with a bias toward slightly higher rates as the year progresses, and into 2013. STO believes the curve will continue to remain positively sloped with Theta-based strategies continuing to outperform the general marketplace.

Investment update

-- Given the backup in rates and the significant change in investor sentiment given the domestic fixed income securities market and STO’s portfolio positioning at the longer end of its permitted investment maturity spectrum, STO continues to monitor its strategy.

-- When one steps back from the day-to-day minutiae of the market, we are still confronted by a couple of recurring economic themes: (a) while the economy seems to be doing better, it is not on a strong growth tear; (b) the European situation may be somewhat resolved for the time being; (c) China is showing additional signs of weakness; (d) our housing market is far from showing signs of a robust recovery; and (e) we still have a significant amount of unemployed, underemployed and disillusioned workers. All these factors allow us to think that the economy is in for a long slog and unfortunately a period of low rates for some time to come.

-- Absent strong growth STO feels that this economic affliction will be with us for some time to come. STO also believes that future increases in rates will be well telegraphed and that the market will show signs of strength in anticipation of real growth.

-- In the past, STO has articulated what it expects the methods of potential Fed tightening will be and still holds to that conviction and sees no compelling reason to change strategy at this time.

Investment Policy Compliance Review

-- During February, there were no transaction variances that posed compliance issues.

-- All trade information was entered correctly in STO’s internal systems and in the systems used by the custody bank.

-- All transactions for the month settled successfully. There were no price discrepancies.

-- There were no interfund transactions in February.

Portfolio summary

-- The General Fund portfolios closed the month of December at $1.48 billion. Average collected balance at the fiscal agent bank was $30 million for the month.
95 percent of the General Fund Core portfolio is invested in fixed income securities; 35 percent in Treasury securities; 58 percent in Agency Securities; 2 percent in TLGP Securities backed by the FDIC; 7 percent in New Mexico Municipal Bonds; 2 percent in Corporate Bonds, and the balance in cash.

27 percent of the portfolio is invested in securities that mature in one year; 28 percent in securities that mature in 1-2 years; 27 percent in 2-4 years and 18 percent in securities that mature within 5 years.

The General Fund held positions in 94 securities.

Responding to a request from Dr. Clifford, Ms. Roseborough agreed to present a report at the May meeting on how STO has established targets for the different components of the portfolio, and how performance is evaluated relative to a benchmark.

Dr. Clifford commented that the $1.48 billion balance in the General Fund is good news, as it is several hundred million dollars higher than it was at this time last year and to some extent reflects that revenues are coming in ahead of forecasts.

Presenter: Stephanie Scharadin Clarke, Director

7. Approval of State Board of Finance’s Appointment of State Treasurer’s Investment Committee Private Sector Member

Ms. Clarke stated that the Board of Finance wishes to reappoint Paul Cassidy of RBC to the State Treasurer’s Investment Committee through April 2014. Mr. Cassidy has served on the Committee since the position was created in 2006. As SBOF representative on the STIC, she finds that Mr. Cassidy gives good and timely advice to the Treasurer and his staff, and asks tough questions.

Mr. Aragon moved to reappoint Mr. Cassidy. Treasurer Lewis seconded the motion, which passed 6-0 by voice vote.

SEVERANCE TAX BONDS

8. Presentations on Fund Solvency

Presenters: Jan Goodwin, Executive Director; Bob Jacksha, Chief Investment Officer; Rick Scroggins, Deputy Director

(A) Educational Retirement Board

Ms. Goodwin made a slide presentation, with the following highlights:
-- ERB is a defined benefit plan, i.e., when a person retires, they know what their monthly income will be. It is a function of their years of service, the multiplier (.0235) and their final average salary (five highest consecutive fiscal years of salary). A COLA is provided to members when they turn 65, or on July 1 of the year following the effective retirement date. On average, the COLA has been 2 percent and is capped at 4 percent.

-- Examples of retirement percentage rates: 25 years x .0235=58.75 percent; 30 years x .0235=70.5 percent; 35 years x .0235=82.25 percent.

-- There is no cap on the income replacement rate. For many years, it has been said the reason behind this is because state public employees’ salaries have been low, so the tradeoff has been low salary while working, and financial security at retirement.

-- Although there have been many pension plans in the U.S. where the employee pays no contribution and the employer pays the full amount, ERB members have always paid a significant amount of the total contribution. With the contribution swap in place, many ERB members are paying a higher contribution rate than their employer.

Responding to Governor Martinez, Ms. Goodwin said a member who earns more than $20,000 pays 11.15 percent and the employer pays 9.15 percent. Because the state reserve funds hit the level that they needed to in January, on July 1 people who earn more than $20,000 a year will be paying 9.4 percent and the employer will pay 10.9 percent.

-- In 2005, the Legislature raised the employer and employee contribution rates, and all of the ERB Board-endorsed legislation in the last couple of years has called for higher contribution rates, but only for the employee.

Governor Martinez asked where New Mexico ranks nationwide in state contributions, and Ms. Goodwin responded that New Mexico ranks fairly high because the benefit is fairly high; and the employee contribution is one of the highest nationally.

-- As of June 30, 2011, the ERB had an unfunded liability of $5.7 billion and an unfunded ratio of 63 percent. With the current contribution rates, the ERB will never be able to pay the unfunded liability, reflected in the infinite amortization period. Under GASB, a state should be able to pay its unfunded liability in 30 years. GASB does not have a standard for funded ratio.

-- In April 2012, upon the advice of its actuaries and general investment consultants, the ERB Board lowered the long-term earnings rate assumption from 8 percent to 7.75 percent. Although the ERB’s 20- and 25-year earnings history reflects that it met the 8 percent target, future earnings assumptions were less optimistic.

Mr. Aragon asked Ms. Goodwin how much a teacher who started working in 1982 and retired after 30 years would contribute to the Fund over that period of time if their annual salary at retirement were $50,000, and assuming their salary in 1982 was $14,000 to $18,000.
Ms. Goodwin said she would estimate the contribution would be about $75,000 over that time, and the employer match would have been a bit higher — perhaps $85,000. As with most pension plans, however, when the member is ultimately receiving the benefit, between 60 percent and 75 percent of the monthly benefit is interest earnings on the contributions.

Mr. Aragon calculated that, based on the total of $160,000 contributed, at $35,000 a year it would take less than six years for the person to receive the entire amount back.

Ms. Goodwin agreed and said the additional amounts received beginning in year seven would be investment earnings on the contributions made over the 30-year employment period of the employee in question. She added that one of the premises of a defined benefit plan is for a regular influx of new members and new contributions.

Mr. Aragon commented that promoting an investment plan and promising returns based on contributions from new investors is illegal in the private sector. He said the premise that it is morally right for politicians to obligate future generations of unborn voters in this way is “morally and ethically repugnant to those who have some kind of moral fiber.”

Mr. Aragon suggested that the defined benefit plan be eliminated by the Legislature and replaced with a defined contribution system because New Mexico taxpayers can no longer afford to foot the bill. He said there is a gross inequity between the public sector, with guaranteed retirement benefits, and the private sector, where such benefits do not exist and where people are suffering financially.

Continuing with her presentation, Ms. Goodwin stated that, in September 2011, the ERB Board, after receiving feedback from stakeholders and legislators, developed funding goals of 80 percent by 2030 and 95 percent (plus or minus 5 percent) by 2040.

Ms. Goodwin stated that Board members and staff went on a three-week listening tour to towns and cities around the state to present plan design change scenarios, and developed a survey for members to provide input on the scenarios. She said the framework established by the Board included: shared responsibility among members, retirees and employers; intergenerational equity; long-term sustainability; preservation of the defined benefit plan; and maintaining a similar benefit structure over time.

Ms. Goodwin explained that the ERB Board wanted to preserve the defined benefit plan because defined benefit plans have a number of advantages over defined contribution plans and end up being less expensive in providing the same amount of benefit — they typically have better investment performance and are able to pool longevity risk.

Ms. Goodwin stated that the ERB Board adopted a plan design proposal in November 2011 that was consistent with the funding goals it had adopted in September. Highlights included:

--- Maintain 87.5 percent of current COLA benefit for all current and future retirees.
-- Minimum retirement age of 55 for members who would not be eligible to retire within 10 years of the proposal’s adoption. [ERB projects approximately 10,000 members will benefit from 10-year grandfather period.]

-- Increase in employee contribution from 7.90 to 9.90 percent.

-- This design proposal would mean solvency would be at 78 percent by 2030 and 96.3 percent by 2040.

Ms. Goodwin stated that the Investments and Pensions Oversight Committee endorsed the Board’s solvency proposal in December 2011, and the ERB drafted a bill that was presented at the 2012 Legislature. However, SB 150, the final version of the bill, did not pass. She said the ERB is now working with a new proposal that it will review with the stakeholders and members, receive input, and present to the Investments and Pensions Oversight Committee.

Dr. Clifford observed that, while there have been regular increases in contributions over time (slide 3), the funded ratio has fallen, and he didn’t think all of that could be blamed on investment performance – contributions are now more than 20 percent of payroll, and balancing the fund on the basis of increasing contributions is not working. He said that was essentially what the ERB had proposed to the Legislature, and there wasn’t a serious effort to revisit the benefit formulas. He agreed with Mr. Aragon – there may be advantages to defined benefit over defined contribution, “but if it’s an unfunded plan, then it’s an unfunded plan. So certainly before we talk about any other benefits, we’ve got to get the plan onto a funded basis, and that’s the plan we have to evaluate.” He said he would echo his comments to PERA as well – the issues are materially the same.

Responding to Dr. Clifford, Ms. Goodwin stated that a significant portion of the improvement in the plan design comes from the COLA reduction. She said the next most important component was the increase in the contributions from the employees, and, thirdly, the minimum retirement age.

Ms. Goodwin further explained that, based on the bill passed in the 2005 Legislature, which increased the employee and employer contributions, the total employee contribution would have hit the goal by FY 2009; however, because of the state’s fiscal issues, there have been a number of delays in the employer contributions.

Responding to Mr. Gasparich, Ms. Goodwin said Article 20, Section 22 of the NM Constitution says that the vested benefit becomes a property right for the member; however, it also states that any changes can be made to the plan that would either enhance or preserve solvency of the fund. She noted that this provision has not been interpreted by the courts, so she could not say whether it could be applied to a defined contribution plan.

Governor Martinez asked if there is any language in the Constitution that would permit a wholesale change from a defined benefit plan to a defined contribution plan, even if it were only
to affect those not yet vested, and Ms. Goodwin responded that the Constitution is silent on that issue.

Ms. Goodwin added that, because of the last decade in the stock market, many states that have gone from defined benefit to defined contribution plans have retraced their steps and returned to defined benefit plans. Until 10 or 15 years ago, defined benefit plans were the main benefit with private employers; however, IRS code prohibits employee contributions in the private sector.

Responding to concerns expressed by Governor Martinez about the 63 percent funded ratio, Ms. Goodwin stated that SB 150, had it been adopted by the Legislature this year, would have assured the long-term sustainability of the plan, and would not have required drastic changes.

Governor Martinez said she thought adding a retirement age, when there hasn’t been one before, would be drastic. Ms. Goodwin responded that, although the ERB does not have a minimum retirement age for employees who retire with 25 or 30 years, the ERB has two other retirement eligibilities that do have retirement ages. She said “65 and 5” has a hard minimum retirement age, and the Rule of 75 (combination of age and service) has significant reductions in benefit if a member retires younger than age 60. She commented that ERB’s retirees in recent years have average retirement age of 60+. For people who retired under the 25 years of service eligibility, the average years of service this past year totaled 29.5, and their average age of retirement was 58.4. She said two-thirds of the group who retired last year had an average retirement age of 62.

Governor Martinez asked Ms. Goodwin how much money the ERB has recovered after overpaying retirees.

Ms. Goodwin responded that the people who received the interest overpayments were those who either terminated employment and took benefits, died while working and their beneficiaries received payment, or died shortly after retirement. She said the total amount paid out was $1.7 million, and the ERB has recovered approximately half. She stated that the ERB Board approved a litigation strategy at its last meeting.

Mr. Brasher asked if the funding source for the employer comes directly out of university level instruction general funds, and at the public school level out of the school funding formula – in other words, these are funds that would otherwise go toward classroom instruction.

Ms. Goodwin responded that this was correct; however, the state general fund appropriations for these institutions are not their sole revenue source; for example, substantial federal monies come in, and for higher education institutions there is tuition.

Ms. Goodwin confirmed that teachers received a significant increase in salary around 2005 with the Tier 3 licensure.
Responding to Mr. Brasher, Ms. Goodwin stated that, when she asked the actuaries why the ERB funded ratio was at 63 percent despite the fact that it had been meeting the 8 percent investment target for an extended period of time, she was told that the 2008-2009 worldwide financial market disintegration happened when the Fund was at a high level; on the flip side, liabilities have been increasing more quickly because salary increases were higher than expected over a long period of time. Partly as a result, some members retired earlier than expected; on average members were living longer than expected; and even though the salaries had been rising, the higher level of contributions had not been in place long enough to make a difference.

Mr. Aragon noted that the NM Constitution does not mention a defined benefit system so therefore it is not required.

Mr. Aragon stated that children are the intended beneficiaries of the public school system, and money has been taken from public schools in order to fund the employer contributions, the employer being the State of New Mexico.

Responding to points raised by Mr. Aragon, Ms. Goodwin said the components that go into the decision of how the state spends its money involves a dialogue with legislators, the Governor and the Governor’s administration; and she could not say that increasing employer contribution rates takes money away from classroom instruction because the state general fund is a very large pot of money and can be used for many different purposes. She also noted that the educational appropriations over time have been increasing.

Mr. Aragon stated that the current pension system is broken “almost beyond repair.”

Dr. Clifford expressed concern about the assumption over the long term of a 7.75 percent investment return. He said his concern also extended to PERA. He noted the explanation offered by the ERB actuaries, as related by Ms. Goodwin, that the Fund was meeting the 8 percent target but then there was the disintegration in the world economic picture. He asked Board financial advisor David Paul to comment on how the financial industry views the 7.75 percent return assumption.

Mr. Paul stated that many state constitutions were crafted in the 1840s to allow states, many of which were bankrupt, to resume access to capital with a very narrow set of borrowing criteria. The constitutions had two parallel sets of rules: the state could only incur debt obligations that burdened taxpayers based on very strict threshold tests, which in New Mexico was based on the vote of the people. The constitutions also protected pensions, and the current contribution from the member and funder of the system were deemed that year to be sufficient to fully fund the future benefit that was earned in that year, so there was no presumption that future taxpayers would be on the hook for funding that. The cash-funded or bond-funded defined benefit plan was the norm, and the change from that system to something funded on an actuarial model changed the risk profile of those systems – everything was fine as long as the actuarial return mirrored the returns in the marketplace. He said the 7.5 or 8 percent return one tended to see was developed as a balanced portfolio return between long-term history returns on equities of 12 percent and bonds of 6 percent.
Mr. Paul said that, while 20- to 30-year histories reflect that those returns were met, over the last 10 years they have not. If the world has changed as much as people think it has, the question is whether a 7.75 or 8 percent return is a rationale that suggests the 12 percent equity return and 6 percent bond return blend is still viable. Across the country, this is the dominant issue affecting public finances of state and local governments. He said the state of Illinois is on the edge of insolvency, as is its pension system, and the rating agencies are grappling with how to deal with this. He added, “In our view, going from 8 percent to 7.75 percent is not grappling with the question of whether there has been a fundamental change.”

Mr. Paul stated that all of the assumptions being made, and changes suggested in the plan design, are premised on a world where a 7.5 to 8 percent yield is realized. If one looks long term and says that, hypothetically speaking, bonds are going to be 3-4 percent and equities 8 percent, with a blended return of 5 percent, that destroys the economics of all of these systems. He said this tension goes back to the question raised by Mr. Aragon, which is that risk and financial obligation is being transferred to taxpayers, which wasn’t contemplated when these constitutional structures were created.

Mr. Paul said that, in short, the reduction to a 7.75 percent return assumption does not address the fundamental changes that people need to be dealing with.

Dr. Clifford noted that some of the State Investment Council fund managers are addressing this issue by moving their portfolios into riskier areas such as hedge funds and other alternative investments. Although that strategy has performed well in some time periods, he did not think it fiduciarily prudent to take on more risk to chase these return targets. He said a prudent fiduciary would adopt reasonable and achievable targets.

Presenter: Kurt Weber, Interim Executive Director; Gerald Chavez, PERA Board Chair

(B) Public Employees Retirement Association

Mr. Weber stated that PERA’s assets declined by $6.0 billion during the worldwide financial market meltdown of 2008-09; and although the PERA fund’s assets have increased since the downturn, PERA has an unfunded liability of $5 billion. He said significant but reasonable changes to the benefit structure across all membership groups will be necessary – without changes to the benefits, the unfunded liability will grow to $26 billion by 2041.

Mr. Weber stated that, as of June 2011, the PERA’s funded status was 70.5 percent.

Mr. Weber stated that the PERA Board is considering four major changes to reach 100 percent funded status by 2041:

1. Tier II – prospective members and non-vested members hired 7/01/2010 and later:

   -- 0.5 percent pension factor reduction for all retirement plans;
-- Increase service credit and age requirements for retirement eligibility;
-- 5-year final average salary;
-- Longer vesting period (8-10 years); and
-- 2 percent COLA at retirement.

2. Pension factor reduction – current, vested employees

-- Reduce the pension factor for all active employees by 0.5 percent going forward.
-- All service credit earned before the changes become law would be credited at the rate earned. Future service credit would be calculated at 0.5 percent lower with a 2 percent COLA at retirement.
-- Increase the pension maximum as a percentage of final average salary from 80 percent to 90 percent of salary. This would allow members to work longer to earn a higher benefit.

3 COLA reduction

-- COLA for future years of retirement would be calculated at 2 percent, affecting all members.

4. Contribution increase

-- A contribution increase of 2 percent to be shared by employee and employer would be applied to all retirement plans (PERA has 31 plans).

Mr. Weber stated that the current employee contribution rate is 10.67 percent and the employer contribution rate is 13.34 percent, consistent with the statutory 24 percent contribution requirement. With the reversal of the 1.5 percent, the rates would be 15 percent and 9 percent respectively.

Mr. Weber summarized the impact:

-- Reducing the COLA will result in an immediate $1.4 billion, or approximately 30 percent reduction in the unfunded liability.

-- All actions taken together would result in PERA being approximately 110 percent funded by 2041.

-- Even if all the changes under consideration are enacted, the benefit provided by PERA will still provide current and future retirees with a sound, secure retirement future.

-- The longer the changes are delayed, the more drastic the changes will need to be in the future.
Mr. Aragon asked Mr. Weber if PERA has run a model of a defined contribution plan, and Mr. Weber responded that it has not. He commented that only 10-15 percent of people can manage their assets to achieve a meaningful retirement, based on what has happened with 401K plans, which leads to the concern that under a defined contribution plan, people may be returning to government asking for assistance. He said he believes that a defined benefit plan is the appropriate structure as long as the benefits are reasonable and properly funded.

Mr. Aragon questioned how Mr. Weber could draw that conclusion and Mr. Weber responded that, based on the literature and experience of other pension plans, there is no evidence that the average person can retire based on their own management of those assets. He said other options, such as cash balance plans, have been tried and tested and have not worked well in the public or private sector.

Mr. Aragon suggested that “taxpayer” be substituted in PERA’s slide presentation for “employer,” since that is more accurate.

Responding to Mr. Gasparich, Mr. Weber stated that PERA is moving ahead on schedule to present its plan to the Investments and Pensions Oversight Committee in October.

Mr. Gasparich said there will be many new faces in the next Legislature, and encouraged PERA to contact them as part of the process.

Lt. Governor Sanchez said he hoped the new Legislature would have the courage to look at the long-term exposure and liabilities that the state has in order to preserve its economic viability, which will mean making significant structural changes to the pension plans.

PERA Board Chair Gerald Chavez commented that this has been an emotional issue – as PERA pursues its outreach efforts with the members, and explains to them that it will be reducing their benefits after many years of enhancing benefits, not a single group has expressed a willingness to do any belt tightening. He said PERA continues to seek consensus. He added that it is very tough to propose changes to legislators, too, who are among the beneficiaries.

Presenter: Wayne Propst, Executive Director
(C) Retiree Health Care Authority

Mr. Propst presented an overview, with the following highlights:

- 32,000 retirees and their families (50,000 total members) rely on NMRHCA for their health insurance. FY 2012 budget of $240 million.

  - 40 percent are under 65 (PPO options with $300 to $800 deductibles and $3,000 to $4,000 out of pocket maximums

  - 60 percent are over 65 (Medicare Supplement and Medicare Advantage Plans)
- NMRHCA pays about 50 percent of the costs with the membership paying the other 50 percent through annually updated premiums

- Dental, Vision and Life Insurance Plans are offered on a 100 percent retiree pay basis.

-- NMRHCA was established by the Retiree Health Care Act in July 1990 with no initial appropriation

-- NMRHCA began paying benefits in January 1991 with statutory limitations to premium increases until 2008

-- NMRHCA was not pre-funded in a similar manner as PERA and ERB. It was never intended to be pre-funded. It is a pay-as-you-go system. Unlike both PERA and ERB, NMRHCA does not have to request legislative approval of benefit changes, and has made significant changes over the last four years; however, the Board does not have the authority to change the employer-employee contribution.

-- In 2007, NMRHCA was projected to exhaust its fund balance by 2014. The first GASB evaluation indicated that the state had a $4.1 billion unfunded liability.

-- NMRHCA Board of Directors and Legislative efforts increased the period of positive fund balance to 2027 by:

- Significantly reducing subsidies (retirees pay more of the total premium)

- Significantly reducing plan benefits (retirees pay more when they access care through higher deductibles and coinsurance maximums)

- Increasing contributions from active employees and employers

Mr. Propst stated that the NMRHCA expects the retiree population to grow by 4 percent going forward. He said a significant challenge the NMRHCA faces, as do other such retirement systems in the U.S., is the rate of medical inflation, which has grown by at least 8 percent annually. To properly fund the benefit, the agency has to take that into account.

Mr. Propst said the NMRHCA Board is currently prioritizing additional changes to program that may result in a further 8 -10 percent reduction of the unfunded liability and further extension of solvency period. These changes will be considered at the Board’s July meeting.

Mr. Propst stated that the NMRHCA’s GASB 45 unfunded liability projection has dropped from $4.1 billion in 2007 to $3.3 billion. He noted that GASB takes into account all future and current liabilities but does not include contributions; however, the NMRHCA benefit is not
protected by the NM Constitution and is in statute, which is very clear in stating that the benefit may be “extinguished” by an act of the Legislature and Executive at any time. He commented that essentially GASB is requiring the NMRHCA to book a liability into the future that the state has already said it doesn’t accept a liability for.

Mr. Propst noted that the state of Texas has begun to push back on how GASB requires liability to be calculated and applied to a retiree health care system, including some legislation that they introduced and passed in their last session. He said the NMRHCA should be able to calculate what the benefit will cost next year so the premiums and benefits match.

Responding to Dr. Clifford, Mr. Propst said the general fund contribution each year is about 25 percent of the agency’s $200 million operating budget, or $50 million.

Dr. Clifford commented that there is a $325 million obligation the state is incurring compared to a current contribution of $50 million a year – he thought this was an important message that the GASB formula is trying to send. He said he found the tone of Mr. Propst’s remarks to be troubling, because the state would have to substantially increase its commitment, and he didn’t think that should be viewed as “something the Legislature might turn its back on in the future.”

Dr. Clifford said he appreciated Mr. Propst’s comments that the NMRHCA is taking steps in the right direction, but he thought the approach to that should be aggressive.

Mr. Propst responded that the NMRHCA Board agrees that it needs to be aggressive, which is why in some instances retirees have seen their costs go up 50 percent in the last four years, since he became Director, and have seen deductibles and out-of-pocket maximums triple in that time. He said the Board has also taken steps to reduce the unfunded liability by $800 million and realizes it needs to do even more; but with respect to GASB, taking a snapshot of Retiree Health Care today and projecting that will be the same picture in 30 or 50 years is unrealistic and distorts the picture. He said the NMRHCA plan is more like a defined contribution plan than a defined benefit plan because the benefits change and will continue to change.

Mr. Gasparich asked if he understood correctly that the NMRHCA’s under-65 beneficiaries are the most heavily subsidized group, and Mr. Propst said that is correct, because until then they are not receiving Medicare benefits. He said this group comprises 40 percent of the agency’s population and 60 percent of its costs. He said the NMRHCA Board is looking at ways to encourage people to work longer, and is also considering a minimum retirement age.

Mr. Gasparich asked how NMRHCA benefits will be affected by the Affordable Care Act, and Mr. Propst said there will not be much impact because the Act targets people who do not have health insurance. He said the hope is that the Act will begin to bend the 8 percent annual cost curve down.
STATE TREASURER’S OFFICE (Cont’d)

Presenter: Janet Pacheco-Morton

5. **Presentation of Fiscal Year 2011 State Treasurer’s Audit**

Lt. Governor Sanchez reported that, in December 2011, the Board appointed him and Member Sam Spencer to serve as the STO Audit Subcommittee:

-- On January 5, 2012, he and Mr. Spencer convened the subcommittee and met with Clifton Gunderson and STO staff to review the 2011 findings.

-- The audit indicated one material weakness (STO failed to report impairment of investments held by fiduciary funds) and five control deficiencies.

-- In the control deficiencies category, the subcommittee pressed the auditors and STO staff for some answers regarding the daily auto reconciliation process.

-- STO staff indicated an unreconciled balance of over $1.1 billion (book to bank).

-- It was unclear why the deficiency was downgraded by the independent audit, since it appeared to be an ongoing problem.

-- STO staff indicated that the primary responsibility of reconciling the balance belonged to DFA.

-- In response, Mr. Spencer, Ms. Clarke and Lt. Governor Sanchez’s staff met with DFA Secretary Clifford and State Controller Ricky Bejarano on January 10, 2012 to further discuss the reconciliation issue.

-- DFA confirmed the existence of the problem and indicated that resolution would take a collaborative effort by STO and DFA.

Lt. Governor Sanchez thanked STO and DFA for their time and willingness to discuss potential solutions to the problem and he said he looked forward to hearing a progress report.

Ms. Pacheco-Morton was present with Deputy State Treasurer Mark Valdes; State Chief Investment Officer Linda Montoya Roseborough; State Cash Manager Sam Collins; and Cash Management Division staff member Victor Vigil.

Ms. Pacheco-Morton noted the following highlights:

-- The State Treasurer’s Office received an unqualified opinion.
-- The financial statements were free of material misstatements and were fairly presented in accordance with Generally Accepted Accounting Principles.

-- The State Treasurer’s Office was in compliance with all Governmental Accounting and Auditing Standards.

Ms. Pacheco-Morton said GASB Statement No. 54 (Fund Balance Reporting and Governmental Fund Type Definitions) was implemented at state and local government entities in FY 2011. Prior to GASB 54, there were two primary categories of fund balance: reserved and unreserved, which are basically restricted and unrestricted categories. GASB 54 expanded the number of categories to five in which fund balances must be reported. She said this was not a major issue for STO inasmuch as they have a very small amount of unrestricted funds and the remainder of the funds are restricted for debt service.

Ms. Pacheco-Morton stated that there were two significant accounting estimates:

-- Fair value of investments. These are the investment trust funds held on behalf of the state and local governments. At the end of FY 2011, the amount totaled $3.5 billion.

-- Compensated absences. The current portion is due to be paid out in the next fiscal year and totaled $190,000 at the end of FY 2011.

Ms. Pacheco-Morton said two significant adjustments were made:

-- $203.8 million to correct TRAN fund activity. The amount was posted in reverse, an unintentional error.

-- $2.2 million to accrue liability for arbitrage rebate payable as of 6-30-11. Accruals are typically made in the course of an audit, so this is not unusual.

Other points of interest:

-- There were no disagreements with management. Management was very forthcoming during the course of the audit and always willing to supply the necessary information.

-- There was no consultation with other independent auditors.

-- No difficulties were discussed prior to retention on either side.

Ms. Pacheco-Morton discussed FY 2011 findings:

-- Material Weakness: 2011-02 reporting of impairment of investments held by fiduciary funds (new finding). In 2008, STO had some investments with the Reserve Primary Fund that were impaired, but actual losses that would be realized from those investments were not known at the time, and therefore nothing was booked. From 2008 to 2010, STO was able to recover 99+
percent of their investment in that fund. The remaining (less than 1 percent) totaled about $3.2 million, which is the actual loss, and that was known as of August 2011. At that time, STO knew the amount and could have booked it and informed their participants in the pool. The nature of this finding is that they did not inform the participants. This finding is not expected to repeat itself.

- Significant Deficiency: None.

- Control Deficiencies:
  - 2007:04: Reconciliation process requires manual intervention (repeated from prior year).

- Over the years, this has been downgraded from a material weakness to a significant deficiency, then to a control deficiency. There are two reasons: 1) there have been significant improvements made to the process over time; and 2) a change in thought process for the auditors. This is the book to bank reconciliation for the entire state, so it does not have a financial impact on STO’s financial statements, because STO reports cash in investments at fair market value at their bank balances.

- This process is currently being performed primarily by DFA, but with some input from STO.

- The auditors looked at the book to bank reconciliation in the current year and found that the outstanding items are growing and that there are several outstanding items from 2008, 2009 and 2010.

- A book to bank reconciliation should be performed on a monthly basis; however, it is being done quarterly. The recommendation is that STO collaborate with DFA to review and clear the unidentified items; and as the process is improved, to move the quarterly reconciliation process to a monthly process.

  Dr. Clifford said he sees this as a major problem for the state and was surprised to see it downgraded in this audit.

  Mr. Collins stated that the process has continued to improve. When SHARE was implemented in 2006, there was a significant problem with the reconciliation process, and there were 10 types of reconciling deficiencies listed in the audit, and that number has been reduced to three. He said the problems cannot be fully eliminated, however, until changes are made in the system and business processes.

  Treasurer Lewis stated that, when he became State Treasurer in 2007, STO had been doing reconciliations on a daily basis and was depositing all state monies in the Treasury in accordance with statute and receipting the agencies. He said STO was unable to report balances to the agencies after the SHARE system was implemented, and STO was unable to obtain legislative
funding for SHARE. He said a legislative committee was meeting on a daily basis to address the problem of daily reconciliation, but for the past two years he has heard nothing further.

Treasurer Lewis stated that he shares Dr. Clifford’s concerns and he and his staff have called these issues to the attention of the auditors, since these are in violation of state statute.

Responding to Governor Martinez, Ms. Pacheco-Morton stated that the 10 reconciliation processes were initially called material weaknesses in the first year of the audit because there was no reconciliation process at all in 2007. She said each process would be considered a material weakness on its own were this audit done for the state as a whole; however, because this is an issue for STO, and does not impact STO’s books, the auditors see this as a compliance issue as opposed to a financial statement issue. In terms of compliance, she said she is aware that there are statutes that allude to STO performing book to bank reconciliations or keeping just and true cash balances. She said the reconciled numbers are not required to be reported by STO according to GAAP, although individual state agencies are required to report them.

Governor Martinez questioned how non-compliance with state statute could not be considered a material weakness, and Ms. Pacheco-Morton responded that this is literally correct because it would not lead to a material misstatement on STO’s books.

Dr. Clifford asked where this appears, then, if it does not appear on STO’s books, and Ms. Pacheco-Morton responded that this is the issue the auditors have had since 2007 – there is no place to put it. She said the state’s CAFR is not audited, so it would not be in that report necessarily. She said the auditors put it in their report because years ago STO did report a book to bank reconciliation and the public still expects it. She said the auditors see this as a fiduciary issue that should be in the audit report.

Treasurer Lewis asked Cash Management Division staff member Victor Vigil to elaborate.

Mr. Vigil responded that STO used to be a third party independent agency that provided cash balances to independent auditors. With the implementation of SHARE, they lost control over that because they gave up the third party system and now rely on SHARE to provide legitimate cash balances for state agencies as well as the state’s overall cash system. When the system was implemented, a lot of business and systematic issues had to be worked on, and they have been working on them ever since.

Mr. Vigil stated that, two years ago, STO, in collaboration with DFA, underwent its “Streamlined Banking Project,” which narrowed the 10 issues down to three. He said the project involved taking a systematic look at SHARE, and they were able to clean up a lot of those functional issues.

Mr. Vigil said he can assure the Board that STO reconciles activity in the bank on a daily basis, and has created functionality so it can have a clean picture. He said the problem resides in the overall book to bank activity, as those transactions haven’t been clearly identified and may be listed in the wrong “bucket” in the general ledger system.
With respect to the non-compliance with statute, Mr. Vigil said STO has tried to work with legislators to make the necessary changes. He said STO looks forward to working with DFA and correcting any problems that remain.

Responding to a question from Mr. Aragon, who expressed concern that the state does not know how much money it has, Mr. Collins said STO compares the balance in the bank to the balances on the general ledger, and they are within 1 percent of each other. He said that was not clear when the Audit Committee met – they saw a reconciliation that had a $1 billion negative balance, but it has since been refined. He said he can assure the Board that, if all the fund balances are added up, the total is very close to the balance in the Treasury.

Ms. Pacheco-Morton continued with her report on reconciliation issues (under Control Deficiencies):

- 2007-08: Cash overdrafts (repeated from prior year).

  -- Over the course of the year, there were four occasions where there were overdrafts in the bank. This relates to ACH transactions made by state agencies that did not notify STO in sufficient time to transfer the funds to cover the transactions. While there are no bank charges, it does affect the average cash balances in the bank and the interest assessed on the cash balances.

Responding to the Governor, Mr. Collins said the funds are invested in an overnight repo, and STO is required to make the investment at 9:30 a.m. He said STO is working with the state agencies to address the issue and is also asking the fiscal agent bank to allow the overnight investment to take place later in the day.

- 2009-06: Reporting additions and deductions to fiduciary funds (repeated from prior year)

  -- This is related primarily to how the breakdown of ins and outs to the fiduciary funds are reported in the financial statements. In total, they currently don’t have the required breakout for amortization of bond premiums and discounts on some of the investments, which is a required disclosure.

- 2011-02: Reconciliation of investment income from QED to JP Morgan (new)

  -- QED is the investment accounting software used by STO. There is no reconciliation on an accrual basis, but there is reconciliation on a cash basis, but that conversion has to take place at year end for reporting purposes. The auditors recommend that, during the course of the year, STO track on an accrual basis.

- 2011-03: Inadequate collateralization of repurchase agreement accounts (new)
Repurchase agreements have to be collateralized in the state of New Mexico at 102 percent. During the test work, the auditors found that, although STO has indicated to the bank that they would like investments to be collateralized at 102 percent, they were actually collateralized at slightly under 102 percent.

Responding to Dr. Clifford, Ms. Roseborough said STO is working with QED to facilitate the reconciliation. She said part of this is historical, as STO did not have access to SHARE and was under the impression they would have a feed into the SHARE system to report this information. She said that did not happen, but STO continued to use QED. At some point, she said the cash keys for the QED system were not turned on. She said STO does not know why that happened, but the result was STO was not analyzing its cash positions within investments. A few months ago, she said STO worked with QED and had the cash keys turned on, and they are able to have all cash for all investments redirected properly. In addition, she said STO will be implementing SERVS, which is the industry standard.

Presenter: Ricky Bejarano, State Controller; David Holmes, SHARE Manager

6. Presentation on SHARE Reconciliation Issues and Outlook

Mr. Bejarano said he would first address questions asked in the previous agenda item.

Mr. Bejarano stated that the CAFR (comprehensive annual financial report) is essentially a roll-up process, where all agency financial information is rolled up into one consolidated report. He said this report has not been audited for years; it is simply “reviewed,” and a review does not provide the high level of assurance that an audit does, because it has fewer procedures and a lower standard. He stated that this year’s CAFR can be found on the DFA website and is due to be published on May 1.

Mr. Bejarano said the state didn’t have a full CAFR until about 10 years ago, and while it comes up for discussion during legislative sessions, it doesn’t receive the attention it should get. He said the reality is that, while the state spends millions of dollars on individual agency audits, those individual audits receive virtually no attention, and it is the CAFR that Wall Street and other outside third parties look for.

Mr. Bejarano said the goal of his office is to have an audited CAFR for 2014, understanding that major issues will be identified given that this will be the State of New Mexico’s first audited CAFR.

With respect to STO’s reconciliation issues, Mr. Bejarano explained that, on the book to bank side, there are 32 buckets of thousands of transactions in the SHARE system totaling billions of dollars. Early on in SHARE, agencies were allowed access within the cash module – which ended with the streamlined banking project, where they could go in and “plug” numbers if they weren’t balancing, which does not give him much comfort. He said Mr. Collins’ statement that the difference between the bank balance and general ledger is now only 1 percent does not
give him much comfort either, given that this is 1 percent of billions of dollars. He stressed that he meant no disrespect to STO – this is just a point of disagreement.

Mr. Bejarano stated that, while streamlined banking has come a long way, one of the problems currently is the ACH component, which represents 70 percent of the dollars that the state pays. This piece is not working properly yet, but will be part of the next phase of the streamlined banking project.

Mr. Bejarano discussed actions that the state has taken to address the reconciliation issue and other issues:

-- DFA is using monies from the Financial Control Division’s operating budget to hire Deloitte to independently scope this problem and determine what needs to be done. An RFP will be issued when Deloitte completes the work. The Legislature appropriated $200,000 (available July 1) for this contract. It may not be enough to address the full scope of the work.

-- Since implementation of SHARE, the Financial Control Division has essentially become a SHARE division. The Financial Control Division has identified IT people and others with PeopleSoft knowledge to work with the SHARE people so that the Financial Control Division can return to its intended role as accountants for the state – auditing data, issuing financial statements, etc.

-- DFA is having a legal analysis done of statutes, which are outdated and cannot meet today’s needs. While the temptation is to do it piecemeal, it has to be a consolidated effort among all agencies.

Mr. Bejarano commented that the PeopleSoft platform works – it is all in the training and implementation – and in his opinion the state should not be looking at other platforms; it would amount to reinventing the wheel because state employees are familiar with this platform.

Mr. Holmes reported on his progress since he took over the job as SHARE manager about six or seven weeks ago as well as issues around SHARE.

-- In the first two weeks, he reprioritized goals.

-- SHARE is about six to seven years old and is running on its original hardware. There haven’t been any real updates to it since the day it was implemented. This is water under the bridge – the state needs to move ahead by getting the necessary upgrades. He has shared a roadmap with the leadership team.

-- SHARE will be re-platformed to the newer technologies, giving it much greater capacity to test and bring additional functionality online. Once complete, the upgrade to the PeopleSoft financials product will be installed (from 8.8 to 9.2). This will be especially valuable to STO’s cash management issues and DFA.
The next step will be the HCM (Human Capital Management system) upgrade.

Streamlined Banking was very helpful but needs an upgrade, and he is working with DFA and STO on getting the necessary budget for it.

Mr. Bejarano stressed the importance of training.

Treasurer Lewis said STO looks forward to working with Mr. Holmes and Mr. Bejarano and he was pleased to see that a legal analysis was being done of the existing statutes and that there would be training. When the interfacing begins, he said he would very much like to know what the general ledger system and deal module will or will not do, because STO has never received any money from the Legislature – whenever they bring up the issue with legislators, the money is always appropriated to DFA. He commented that he has always wondered how the books can be reconciled if the Treasurer’s Office is not involved – in 2006, STO spent weeks working with the custodial bank trying to identify balances in the accounts.

Mr. Gasparich asked Mr. Bejarano what the FY 2014 CAFR audit, given his remarks about the number of issues that would be identified, would do to the state’s bond rating. Mr. Bejarano responded that the state is going to have to “face the music at some point, and better sooner than later.” He added that, as money gets tighter in the future if the economy does not improve, the question will come up about why the CAFR has only heretofore received a review.

**EMERGENCY FUNDING REQUESTS**

**Presenter: Kathy Romero, Secretary/Treasurer**

22. North San Isidro Mutual Domestic Water Consumers Association – Requests Appearance to Address Past Due Emergency Water Loan and Possible Extension or Conversion to Grant ($99,850)

Ms. Romero stated that Sen. Phil Griego has asked her to apologize on his behalf for not being present today, as he is on the campaign trail.

Ms. Romero said North San Isidro serves 110 people through 45 connections, 27 of which are active and 18 inactive. She said they instituted an “inactive rate” in an effort to increase their revenues -- active rates are $22 and inactive rates are $11 -- and the result was that five members turned their memberships over to the Association, and there is concern that this trend will continue.

Ms. Romero stated that the Association works with members who are behind in their payments, but some people are having difficulty with that. She said the Association is paying the Board of Finance at $50/month. Their annual membership meeting is scheduled in June, at which time the Association will propose a rate increase.

Ms. Romero asked the Board to convert this loan to a grant.
Ms. Clarke discussed the history of this $100,000 loan, which was approved by the Board in 2004 or 2005. For several years, Board staff unsuccessfully tried to get Association representatives to appear before the Board to explain why they were in default, and in January 2012 Association representatives did come before the Board. At that time, the Association asked the Board to either extend the repayment terms or convert the loan to a grant, and Ms. Clarke had expressed concern to the Board at that time about a possible lack of internal controls because at the time it was very difficult to get information from them, and Association Board Chairman Sandoval had agreed that it was also difficult for him to get financial information for reporting purposes.

Ms. Clarke said the Board asked the Association to provide a report on their internal control structure to Board staff and return to the Board. She said the report received back describes that their treasurer’s report consists of the current balance as of the last bank statement; deposit records; and payments made during the month. Ms. Clarke said she requested samples, but they were unable to provide them. She said the treasurer’s report lacks a summation of delinquent payments, which would be helpful.

Ms. Clarke noted that, in 2011, the Board approved an emergency funding policy. Section 5 of the policy discusses the criteria the Board will consider when considering requests to forgive or extend emergency loans. In any request of this nature, the Board would consider whether there is demonstration of significant efforts to repay as much of the loan as possible, including but not limited to exhaustion of all other revenue sources; whether any portion of the loan will be repaid by the scheduled repayment date; type of public entity making the request, with priority given to requests by general funded state agencies; timeliness in informing the Board about the inability to make repayment; and the public entity’s past compliance with requirements to submit quarterly reports to the Board [not relevant in this instance].

Ms. Clarke said this is purely a policy decision for the Board, and staff does not necessarily have a recommendation.

Responding to Mr. Aragon, Ms. Romero said area residents live below the poverty line; in 2006, an income survey of the community residents (required when they received USDA assistance) showed an average annual income of $18,000 to $22,000. She said the Association has determined that increasing the rate for the active members from $22 to $25 would not pose a hardship.

Mr. Aragon asked what happens to people who simply cancel their accounts in terms of getting water, and Ms. Romero responded that the five members who did this drilled their own wells.

Lt. Governor Sanchez asked what the demographic is of the Association members, and Ms. Romero responded that the majority are older people and 60 to 70 percent are retired, in her estimation. She said young people leave the community to find jobs.
Ms. Romero said Sen. Griego is working with Rick Martinez at New Mexico Finance Authority. She stated that Sen. Griego was unsuccessful in passing legislation in the last session to help the Association.

Responding to the Governor, Ms. Romero said the $100,000 loan was to drill a second well. She said the Association had received $300,000 in federal monies to cover the cost of drilling the first well, storage tank and distribution (meters, fire hydrants, etc.), but the pump failed. When they tried to pull the pump out to repair it, it became stuck in the well shaft and couldn’t be retrieved.

Ms. Clarke added that the driller of the first well declared bankruptcy so legal remedies could not be pursued. She said the Association is making payments on the federal loan.

Governor Martinez asked Ms. Romero if there was ever an attempt to get capital outlay monies to avoid borrowing money, and Ms. Romero responded that the village had been out of water with several months at that point and was having water trucked in by the National Guard. Based on discussions with officials, it was determined that they had an emergency and needed to proceed at that level.

Responding to Dr. Clifford, Ms. Romero said the Association has applied to the Clean Water State Revolving Fund every year and has not received any money. Even if it did receive funding, she was not sure it could be used to repay the Board.

Responding to Mr. Brasher, Ms. Clarke said she was not on Board staff at the time, but would assume the Board was thinking the Association would get a legislative appropriation to repay the loan. She said she would also assume the Board realized there was no way an entity this size would be able to repay a $100,000 loan and that it would have to be converted to a grant if the Association was unsuccessful in getting a legislative appropriation.

Mr. Spencer said he thought the Board should consider converting this loan to a grant provided the Association can provide the financial information that is supposed to be included in their treasurer’s report.

Mr. Spencer moved to convert this loan to a grant contingent upon Director receipt of evidence that the resources of the Association are insufficient to make payment; and that three months of bank statements be provided within two weeks. Mr. Brasher seconded the motion, which passed 7-0 by voice vote.
SEVERANCE TAX BONDS (Cont’d)
Presenters: David Buchholtz and Jill Sweeney, Disclosure Counsel, Brownstein Hyatt Farber Schreck; Robbie Heyman and Rachel S. King, Bond Counsel, Sutin, Thayer & Browne
9. Approval of Notice of Bond Sale Including Form of Preliminary Official Statement, and Bond Resolution, Severance Tax Bond Series 2012

Mr. Buchholtz stated that, as the Board heard this morning, some disclosure problems can be quite thorny, but it is useful and important to be able to discuss the good, bad and difficult.

Mr. Buchholtz stated that the primary disclosure here is not only about the bond issue itself, but about the revenues that the state collects from the severance of natural resources from the ground. He said one of the challenges in this disclosure is to have accurate and timely information about the collection of those revenues; and as many have read in the press, natural gas prices, one of the main sources of repayment for these bonds, are unusually low. He said staff has been working with the LFC and DFA. He stated that there is disclosure from a variety of natural resource activity from the state.

Mr. Buchholtz said the document appendix includes information on the state’s pension funds, the state’s accounting system, and SHARE. He said a due diligence session will be held later this week to review the information and materials received. He stated that the posting of the notice is scheduled on May 8, giving Board members time to review the disclosure memorandum and raise any concerns.

Ms. Sweeney assured the Board that counsel is meeting with the pension funds, Taxation & Revenue, DFA and Energy & Minerals to be sure the information therein is accurate and up to date. She said the information will be as up to date as possible at the time of the posting.

Mr. Aragon asked how the Board can reconcile a disclosure statement that contemplates the unfunded portion of the state’s pension obligations. He cited the case of Orange County public officials who were subject to liability for failure to disclose.

Mr. Buchholtz responded that one of the reasons the pension funds were asked to report today was because of concerns expressed by the Board at previous meetings on these issues, so this could be part of the disclosure document and because disclosure is an ongoing process. He said this bond issue, however, involves payment of Severance Tax obligations from natural resources, although this doesn’t mean the bondholder wouldn’t be interested in other things. He said disclosure documents over the years have always included information about unfunded liability, however.

Mr. Buchholtz explained that disclosure is a matter of honesty and not debilitation – so if disclosure counsel is convinced that the disclosure they make is accurate, which includes the amount of unfunded liability, investment strategies, projected returns, etc., there will be a much
higher level of security on the part of the Board members that they have looked at the question and treated it appropriately.

Mr. Buchholtz stated that counsel has made studies over the years with regard to questions about the Risk Management program of the state, and believes it provides adequate coverage.

Treasurer Lewis asked for comments on what impact the GASB rules, which are still being formulated, will have on the state’s bond rating.

Board financial advisor David Paul, of Fiscal Strategies Group, responded that the rating agencies have been struggling with this for quite a while. He said the discussion this morning was very important in terms of the fundamental credit issues facing the state: pension funds; financial disclosure and timeliness; and what will happen to New Mexico financially where the pricing of oil and natural gas deviates permanently because of the plethora of supplies coming on line. He said the rating agencies haven’t resolved whether to include unfunded pension obligations and debt calculations they do of the states – they are either in a point of confusion or, arguably, in a state of denial over this situation.

Mr. Paul stated that, unlike many other states, both of New Mexico’s bonding programs bring with them dedicated revenue streams, so in neither case is the state’s debt program competing with the general fund for scarce resources.

Mr. Heyman added that the Official Statement includes the State Treasurer’s audit because it covers the Severance Tax Bonding Fund. For general obligation bonds, the Official Statement includes the state’s general fund audit.

Dr. Clifford noted that the forecast for the state’s natural gas revenues was done in December 2011, and he thought it would make sense to do a new forecast.

Ms. Sweeney responded that, in discussion with Ms. Clarke and Ms. Burrows, it was her understanding that the focus is to be on current natural gas prices rather than a forecast.

Dr. Clifford stated that, to the extent natural gas has fallen, oil has risen; and in this fund, oil now makes up half the revenue. He said he thought it important to look at the whole picture.

Mr. Buchholtz agreed with Dr. Clifford that this should be considered.

Dr. Clifford also questioned why the state does not have its own forecast for this program rather than using the CREG Report, and Ms. Sweeney responded that the state is moving in this direction.

Mr. Heyman reviewed the resolution, reflecting a proposed maximum size of $70.6 million (versus the $100+ million of new projects authorized by the Legislature) because a significant number of entities have indicated they are not ready to accept the money.
Ms. King stated that $43,268,000 worth of projects were signed into law and are not ready. She said these include $30 million for Paseo del Norte-related projects; $8 million for a state IT project; $5 million for a substance abuse treatment facility in Los Lunas; a couple of smaller projects with start dates of 2013 and 2014; and $100,000 for a fire truck that was already purchased. She said the project list is still undergoing final vetting, so there may be additional projects that are not fundable for other reasons.

Ms. Clarke added that the Paseo del Norte projects are on hold because a local match is required, and whether or not that is available won’t be known until the November election. She said those projects could potentially be funded in the Board’s December sponge note sale.

Mr. Heyman stated that this proposal limits the maximum interest rate to 6 percent, and provides for the state not to be able to make any optional redemption prior to maturity, which is based on the financial advisor’s analysis of what the market would best accept from the state and what would produce the best result for the state.

Mr. Gasparich moved for approval. Mr. Brasher seconded the motion, which passed 7-0 by voice vote.

GENERAL SERVICES DEPARTMENT
Presenter: Charles Gara, Director, Property Control Division


Mr. Gara reported financials for the Capitol Buildings Repair Fund, with a beginning balance as of February 1 of $16,971,512. After cash receipts and cash disbursements, the ending balance at February 29 was $17,187,702. Subtracting encumbrances, the uncommitted cash balance as of February 29 was $1,723,342. Year to date revenues total $3,695,883.

Mr. Gara stated that, of the 180 projects listed in the February Project Nothing Drops report, 95 percent are on budget and on schedule. He said the total budget for these projects exceeds $274 million.

Mr. Gara said there were no emergency declarations in February.

11. Property Control Division – Requests Approval of Contract with Donner Plumbing & Heating for HVAC Upgrades at Central New Mexico Correctional Facility ($1,777,369.10)

Mr. Gara requested approval of a contract with Donner Plumbing & Heating, Inc. of Albuquerque for heating, ventilating and air conditioning upgrades at CNMCF, located in Los Lunas, HVAC systems at the CNMCF housing units are past their useful life expectancy; and without the HVAC replacement, the facility’s existing HVAC equipment will continue to fail

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and will not make it through another heating and cooling season. He said this project will replace 
the system at Housing Unit #2, and this will be the first of a series of projects at this facility.

Responding to Mr. Aragon, Ms. Clarke stated that this contract was awarded to the lowest 
qualified bidder.

**Mr. Brasher moved for approval. Mr. Spencer seconded the motion, which passed 7-0 
by voice vote.**

12. **Property Control Division – Requests Approval of Contract with Yearout 
Mechanical, Inc. for HVAC Upgrades at Southern New Mexico Correctional 
Facility ($4,069,017.75)**

Mr. Gara requested approval of a contract with Yearout Mechanical, Inc. of Albuquerque, for 
HVAC upgrades at Southern New Mexico Correctional Facility in Las Cruces. He stated that this 
project will address Housing Units #4 and #5 and will complete the HVAC work at this facility.

**Mr. Brasher moved for approval. Lt. Governor Sanchez seconded the motion, which 
passed 7-0 by voice vote.**

13. **General Services Department, Property Control Division – Requests 
Approval of Fourth Amendment to Agreement to Purchase and Trade 
Real Property to and from Paseo Nuevo, Ltd. Co. (Purchaser conveys 
$5,948,226.80 and Real Property worth $1,938,855.60)**

Mr. Gara stated that this is for the property at Las Soleras, which has been identified as the 
site location for the Health & Human Services “super complex.”

Mr. Gara said this fourth amendment will extend the due diligence period in that certain 
conditions precedent to the closing of the agreement have not been met. He said one condition, 
which is that final approval for a New Mexico Rail Runner train station at I-25/Las Soleras be 
received from the Department of Transportation and Federal Highway Administration, has not 
been completed.

Mr. Gara also stated that the $4 million in funding to acquire the land was reauthorized in 
this year’s Legislature to the Manuel Lujan Building renovation project with the understanding 
that, when this project does go forward, the Legislature would reauthorize the money for the 
acquisition.

Ms. Clarke said the meat of this amendment is an extension to the period where the state can 
review the transaction and terminate the agreement without cause. Currently, the state’s option to 
terminate would expire on May 15, 2012, and the amendment would extend that period to May 
15, 2013.
Mr. Aragon asked if terminating this agreement would mean the Rail Runner stop would not go in.

Ms. Clarke responded that the Board has already approved the agreement and amendments 1, 2 and 3, so approving this amendment would just preserve the state’s flexibility to terminate without cause. If May 15 comes and goes without this amendment, she believes the developer could argue that the state is locked in.

**Board legal counsel Zack Shandler stated that, if the Board chooses to approve this amendment, staff recommends that it be contingent upon the same contingencies as found with the approval of the initial approval from November 2010, as well as contingent upon all necessary funding becoming available for the state, including issuance of a Bond Anticipation Note and/or capital funds appropriated.**

Ms. Clarke stated that the second part of the contingency is that typically the Board would not approve a purchase and sale agreement unless the state had in its resources all of the funding necessary to close the transaction. At the time in November 2010 when the original purchase and sale agreement was approved, the state had all of that available – the NMFA had committed to issuing a $1.9 million Bond Anticipation Note, and there was a $4 million Severance Tax Bond appropriation, but which Mr. Gara indicated was reauthorized to a different purpose. She said any Board approval of this amendment should therefore be made contingent upon that funding becoming available again.

Responding to the Governor, Mr. Gara stated that, if the Board does not approve this amendment, the state would either have to obligate itself (which it does not have the funds to do) or else terminate the agreement, so in his view it would have to do the latter. He said there would be no consequences as a result.

**Mr. Aragon moved to not approve the extension. Mr. Brasher seconded the motion.**

Mr. Gara commented that this property, in his opinion, remains a viable alternative for this project or other state projects down the line, simply because of the lack of larger land masses in the city of Santa Fe. He said GSD looked at the DOT site on Cerrillos Road at the LFC’s direction, and met with DOT; however, the issue is the state would have to build new headquarters for DOT before building the HHS complex. In addition, a parking structure would have to be built for the site. This would extend the HHS project many years into the future when HHS is currently sitting in leased facilities while the DOT property is owned by the state and the state isn’t paying a third party landlord to rent it. He said having the Las Soleras land available for future projects is therefore beneficial to the state.

Mr. Gara asked the Board to grant additional time for GSD to look at the Las Soleras land and consider how the state might use it.
Ms. Clarke said the Board could approve a different version of the fourth amendment if it wished; for instance, it could extend it another month, giving it time to address the matter at the May meeting.

Mr. Aragon stated that the Rail Runner is an “albatross” around the state’s neck and he opposed any approval of it. Further, if a door is opened for government to expand, it will expand, and government is already too large.

Lt. Governor Sanchez said he philosophically supports Mr. Aragon’s position but feels the Board should give Mr. Gara and staff some additional time for review.

Mr. Gara described GSD’s plans for moving state agencies out of leased space and into state-owned buildings. He said that, while there is a serious economic downturn right now in the real estate market, rental rates will go back up, and right now the state is leasing 600,000 square feet of space in Santa Fe and almost a million square feet in Albuquerque. He added that it would be preferable to buy buildings, given the cheap prices in the real estate market right now, than to continue leasing space.

Responding to Governor Martinez’s concerns that approving this purchase has to include the Rail Runner stop, and Mr. Gara responded that the state can choose to remove it as a condition precedent to the closing on the land. He said he believed it was included in the agreement for the state’s protection, because the seller, not the state, is currently paying for the stop. The seller would pay for the infrastructure necessary to put the stop in.

Mr. Gara asked for a six month extension. He said he would also want time to look at ways to transport people from existing Rail Runner stops to the Las Soleras site if there is no stop there.

**Lt. Governor Sanchez moved to amend the motion to extend this item for six months to November 15, 2012 and that it is not to include any additions or improvements for the Rail Runner stop; and that this be subject to receipt of the final version of the amendment signed by both parties.**

The amendment was accepted as friendly.

Mr. Gara said the only remaining issue is that the Board may need to extend the agreement again after the six months to get past the 2013 Legislative session to try to get the funding back.

Mr. Gara asked if the motion was saying that there would be no Rail Runner stop.

Ms. Clarke noted that the developer is supposed to pay for the improvements to pay for the Rail Runner stop. She said it was not clear to her whether the Board doesn’t want the stop because it would cost the state more money overall.
Mr. Aragon stated that there should be no stop because the state would still have to service it, so it is still an expense.

Mr. Gasparich said he thought there should be compensation back to the state if the seller is being relieved of the obligation to build a Rail Runner stop.

**The motion passed 7-0 by voice vote.**

[Break.]

[Treasurer Lewis stepped away from the proceedings.]

**PROPERTY DISPOSITIONS**

14. **WITHDRAWN.**

Presenter: Jody Balch, Deputy Superintendent of Operations

15. **Clovis Municipal School District – Requests Approval of Sale of Real Property to ZBO Corporation ($415,000)**

Mr. Balch requested approval for the sale of 40 acres of land that the Clovis Municipal School District bought in 1966. He said the land has served no purpose to the District since that time, but he believes it was purchased to build a new high school. The property is landlocked, with a private school on one side and housing on the other three sides. There are two elementary schools within three-quarters of a mile of this lot, and a new middle school is now under construction.

Mr. Balch said the proceeds would go into an account for the future purchase of land for other schools. He noted that the last two schools constructed by the District have been on donated land.

**Mr. Aragon moved for approval. Mr. Brasher seconded the motion, which passed 6-0 by voice vote.**

16. **WITHDRAWN.**

Presenters: Dr. Katharine W. Winograd, President; Katherine Ulibarri, Vice President of Finance; Charlotte Gensler, Purchasing and Material Management Director

17. **Central New Mexico Community College – Requests Approval of Lease of Real Property with CTS Corporation ($667,218.75 annual)**

Dr. Winograd stated that, in January 2010, Central New Mexico Community College purchased a piece of property that had gone into foreclosure, and part of the purchase was a lease agreement with CTS, a technology manufacturing company that is attached to that property. In
November 2011, CTS approached CNM and said they had been asked to move to Tucson. She said CNM was very concerned about that because they see themselves as an economic development engine and want to retain manufacturing jobs in the area. She said CNM worked with their local economic development people to come up with a plan that would reduce CTS’s rent to a rate consistent with area manufacturing rents.

Dr. Winograd asked the Board to grant approval of a lease extension by five years and decrease the lease payments from $7.50 per square foot to $6.875 per square foot.

Responding to Lt. Governor Sanchez, Dr. Winograd stated that CTS employs about 200 people and brings in substantial revenue to Albuquerque and the state. She noted that the individual who runs CTS is from New Mexico and wants to stay here, but they were under pressure from their larger company to move to Tucson. She said the five-year extension includes an option that would allow CTS to extend the lease term again. She stated that CTS has agreed to stay at the Albuquerque location at least for the duration of the five-year extension for this reduced rent.

Dr. Winograd also stated that CNM is helping with training for CTS. She said most are technician level jobs, and CTS offers internships for CNM students.

Mr. Aragon moved for approval. Mr. Brasher seconded the motion, which passed 6-0 by voice vote.

Presenter: Gary Esslinger, Treasurer Manager

18. Elephant Butte Irrigation District – Requests Approval to Sell 0.48 Acres of Real Property to Mr. Paul Vescovo ($40,372.95)

Mr. Esslinger requested approval to sell 0.48 acres of real property to Paul Vescovo in exchange for $40,372.95 in pipe and materials. Mr. Vescovo is a local businessman who wants to gain access to his property through the canal bank, and this arrangement would be a “win-win situation” for both Mr. Vescovo and the Elephant Butte Irrigation District.

Lt. Governor Sanchez moved for approval. Mr. Brasher seconded the motion, which passed 6-0 by voice vote.

19. WITHDRAWN.

Presenters: Tommie Herrell, Commissioner

20. Otero County – Requests Approval of Lease of Real Property to AIR Cadmos Energy I Corp to Install and Operate a Solar Panel Electrical Generation Facility ($12,500 annually first 12 years, $37,500 annually for remainder of lease)

Mr. Herrell introduced Oswaldo Galarza, CEO of AIR Cadmos I Energy Corporation, and head of the developer-engineer team.
Mr. Herrell requested approval of a 25-year lease of 25 acres of real property at the Otero County Prison Facility and the Otero County Processing Facility with Air Cadmos Energy I. The 25 acres is currently being used as a drainage field for the County's solid wastewater facility.

Mr. Herrell said the lease agreement includes the construction, installation and operation of an electricity grid-connected photovoltaic, solar power plant to provide a portion of electrical service needs of the two County facilities and to transmit and sell electricity to third parties. The rent will be set at $12,500 per year for the first 12 years, after which Air Cadmos will pay the County $37,500 per year until the end of the 25-year agreement. He said Otero County would then become owner of the solar facility. The prison facility will also be paid off at approximately the same time. He stated that the County's goal is to generate income and therefore become self-sufficient.

Responding to Mr. Gasparich, Mr. Herrell said the prison facility has been operated by MTC, a Utah-based corporation, since 2002. The facility was constructed with bonds through the New Mexico Finance Authority, and the County will be asking to the Board in the future to approve a refinancing at a substantially lower interest rate that would ultimately save the County $15 million and accelerate the payoff schedule from 20 years to 11 years.

Mr. Herrell stated that, when MTC took over the prison facility, it had 640 beds, and that has grown to 1,245 beds at the current time. He added that, in 2008, a 1,045 bed ICE facility unit was constructed on County property, and that is operated by the US. Marshal Service under contract with the County.

Responding to Lt. Governor Sanchez, Mr. Herrell stated that this lease arrangement will cost the County nothing, and AIR Cadmos will be solely responsible for the operation and maintenance of the generating facility at its cost, and will bear all risk of loss with respect to the facility. He said AIR Cadmos has obtained private financing for the facility.

Mr. Galarza clarified that there will be a cost to the County, but after the 25-year agreement ends.

Mr. Herrell stated that another provision in the lease is that there will be 75 percent efficiency at the end of the 25 years – this is in accordance with electrical industry standards.

Responding to Dr. Clifford, Ms. Clarke said the appraisal received by Board staff indicates that the current appraised value of the 25 acres is $12,000 per year – so the lease would start out at $12,500 per year, just above fair market value. Board staff does not have the report back from the Property Tax Division signing off that the appraisal is reasonable, so any approval today would be contingent upon receipt of that report.

Responding to Mr. Brasher, Mr. Galarza said they will be generating 1.8 million kWh of electricity. He said the cost of electricity will be 3 cents lower than what the Otero County
Electric Coop is charging. Mr. Herrell added that the cost will not escalate over the term of the lease.

Responding to questions from Mr. Brasher about the lifecycle of the equipment, Mr. Galarza said there are existing solar panels that are more than 35 years old and are still generating the amount of electricity they were designed for. He said existing technology means production of electricity is reduced 5 to 7 percent over a 10 year period, and they are very comfortable with the terms in the lease that say production will be at 75 percent efficiency after 25 years.

Dr. Clifford asked Mr. Galarza if he has developed other facilities, and Mr. Galarza responded that he has personally developed facilities in Arizona and Texas, mainly in connection with jails.

Dr. Clifford said he had noted from reading the questions and answers between the Board and developer that the term of the lease would be extended if MTC purchased less than the agreed-upon amount of power, and asked for an explanation.

Mr. Galarza explained that the facility is currently consuming about 5 Mgs of electricity, and AIR Cadmos would only be building 1 Mg, or 25 percent of the consumption of the power. If someday the facility has a dramatic drop in the number of inmates, which they do not think will happen, somebody has to purchase the energy to cover the debt of the facility.

Dr. Clifford stated that the bond refunding transaction mentioned by Mr. Herrell was brought to the NMFA, which had a number of concerns about the suggested refunding. He said NMFA staff did not recommend approval at that time, even though there are apparently substantial savings that the County would realize through the refunding. He said one of the concerns raised by NMFA staff was that the prison population has been falling rather quickly over the last few years, and they were concerned that the prison lease payments, which are based on the prison population, may not be supported in the future. He said he believes Mr. Galarza is saying that this does not pose a problem in the sense that the PPA is for far less than their total usage today, but it sounds like the prison itself may not be viable in the future.

Mr. Herrell responded that the County is in negotiations with NMFA and with the state to move prisoners to that facility. Recently, the numbers have dropped, but as of last Thursday the facility was completely full. He said the County is on contract with the U.S. Marshal Service on a per diem basis and the population constantly fluctuates. He said the U.S. Marshal Service has assured the County that there will be an increase in population in the facility. He stated that the County is well aware of the potential problem, which is one reason why they are seeking the refinancing, since it will substantially reduce the County’s costs.

[Treasurer Lewis rejoined the proceedings.]

Lt. Governor Sanchez moved for approval. Mr. Gasparich seconded the motion.
Board legal counsel Zack Shandler said staff recommends that any approval be contingent upon Director’s receipt of the report of concurrence by the Property Tax Division of the Taxation & Revenue Department; and receipt of final version of lease, including all exhibits, signed by the parties.

Staff’s recommendations were accepted as a friendly amendment.

Mr. Brasher asked what would happen if the federal government decided to move everyone out of the facility, and Mr. Galarza responded that if there is no jail, then there is no customer to buy the electricity, and AIR Cadmos would have to remove the equipment.

Mr. Aragon said that isn’t what the lease says. He said paragraph 9b (Term) states that “the term for all of the equipment will be extended one year for every year of the lease in which less than 1700 MWh of electricity are purchased from the Generating Facility under the PPA.” He said he wasn’t sure that it didn’t obligate the County for an additional year.

Dr. Clifford noted that paragraph 23 (Termination Right) states that the lessee has the right to terminate the lease upon termination of the PPA prior to the end of the term, which essentially states that the landlord has no right to the improvements.

Mr. Aragon said he couldn’t “connect the dots” between the two paragraphs and stated that the language appears to be ambiguous and creates the question of “enforcement of whose rights are whose.”

**Mr. Aragon moved to table this item. [Motion was not seconded.]**

In addressing the two paragraphs under discussion, Dr. Clifford noted that the County’s benefits under the lease are actually conditional upon the behavior of AIR Cadmos and MTC. – so the County is being somewhat exposed to transactions between third parties that it doesn’t have influence over.

Governor Martinez recommended deferring this for a month to allow an additional legal review.

In discussing staff’s approach to this item, Ms. Clarke said staff reviewed this document for legal sufficiency. Beyond that, it tried to have demonstrated in writing, before the meeting, that the County understands any of the risks involved and is willing to accept those risks as a business decision. She said a final version of the lease arrived at her office on Friday, and at that point staff became comfortable that the language in the lease was consistent with the County’s understanding of how it should work. She commented that the Board seems to feel there is a disconnect between what is in the lease and how the Board is being told the lease should work.

**Mr. Aragon moved to table this item, with direction to staff to work with the County Commission to make this more consistent with what is clearly articulated as the intent of the parties. Mr. Brasher seconded the motion, which passed 7-0 by voice vote.**
EMERGENCY FUND BALANCES
Presenter: Stephanie Schardin Clarke, Director
21. **Emergency Balances – April 2012**

Operating Reserve Fund $1,191,814.39
Emergency Water Fund $118,400.00

Ms. Clarke reported these balances.

EMERGENCY FUNDING REQUESTS
Presenter: Burt Rubinowitz, Board Chairman
23. **Timberon Water & Sanitation District – Requests Extension of Emergency Loan Repayment Schedule or Conversion to Grant ($40,000)**

Mr. Rubinowitz stated that, on January 13, 2012, the Timberon Water & Sanitation District emerged from receivership that was imposed by the District Court, and at that time regained control of the District. Since then, TWSD has made significant progress toward stabilizing the financial conditions of the District, and is applying for a rate increase from the Public Regulation Commission but they would still have a projected shortfall of approximately $26,000 for the coming fiscal year.

Based on the shortfall problem, Mr. Rubinowitz said TWSD is asking the Board to extend the term of the $40,000 loan or convert it to a grant, and that the first payment become due on December 31, 2013. He explained that this would give the District an opportunity to have six months of activity, following advice notice to the PRC, to replace the $26,000 it would lose in the first fiscal year.

Ms. Clarke stated that, at the time this $40,000 loan was initially requested in December 2010, the District’s ability to repay the loan was unknown because PRC approval of an emergency rate increase was pending. At the time of the December 2010 Board meeting, the Board placed a paid-in-full due date on June 30, 2012 and it was contemplated that, after the rate schedule was settled, the District would come back to the Board to request a payment plan. She said she thought the request was reasonable and not unexpected.

Ms. Clarke asked Mr. Rubinowitz how many years are contemplated to repay the loan, and Mr. Rubinowitz responded 10 years, at $4,000 per year, payable on December 31 of each year.

Responding to Governo Martinez, Mr. Rubinowitz said the PRC granted the emergency interim rate increase contingent upon filing of permanent rates by September 30, 2011. In the 18 months the District was in receivership, the receivers did no work at all in applying for the
permanent rates. The board took over on January 13 and this week will be filing an advice notice for a permanent rate increase with the PRC. He said the District is filing under a provision for water systems with under 1,500 connections, which permits them to get a rate increase without a hearing provided the increase is under 50 percent; hence, the reason for the $26,000 shortfall.

Governor Martinez asked if the District would be able to pay the $40,000 back on an accelerated payment schedule based on increased revenues from the permanent rate increase, and Mr. Rubinowitz responded that they could because they would have an opportunity before December 2013 to have an additional rate increase. He said they could raise the rates sufficiently to pay the loan off in a shorter period of time and still remain under the 50 percent rule.

Mr. Rubinowitz said they could probably pay the loan off in five years provided they received PRC approval of a second rate increase.

Ms. Clarke suggested that the Board today could approve repayment of $8,000 per year over a five year period; and if the rate increase isn’t approved, the District could come back and request repayment over 10 years.

Mr. Aragon so moved. Mr. Gasparich seconded the motion, which passed 7-0 by voice vote.

Presenter: Judge Barbara J. Vigil, Chief Judge

24. First Judicial District Court – Requests Approval of Emergency Funding to Purchase Security Equipment, Furniture, Fixtures and Related Technological Infrastructure for the New Judicial Courthouse ($1,043,172)

Judge Vigil was present with court administrator Stephen Pacheco and staff attorney Alisa Lauer. Also present was Arthur Pepin, Administrative Office of the Courts; Stephen Ross, Santa Fe County Attorney; Joseph Gutierrez, County of Santa Fe business and financial manager; and court financial manager Kathleen Vigil. Judge Vigil also recognized New Mexico State Representative Luciano “Lucky” Varela and New Mexico State Senator Nancy Rodriguez.

Judge Vigil requested an emergency loan or grant in the amount of $1,043,172 to purchase security equipment, furniture, fixtures and related technology necessary for the court to occupy the new Steve Herrera Judicial Complex upon its completion in December. If the court is unable to obtain the necessary funding, it will be unable to move into the $60 million, 103,000 square foot courthouse when it is completed.

Judge Vigil said the First District Court serves over 200,000 residents and an average of 700 people walk in their front doors every day. She said the eight district judges currently preside over 10,000 cases; and by being located in the State Capitol, the First District Court is often the venue selected for many lawsuits that arise from the activities of state government.

Judge Vigil said the existing building was constructed in 1939 as a junior high school, and in 1979 it was renovated to house the District Court. She stated that the building design lacks in
basic security features essential to a modern-day courthouse. Ten years ago, after a number of very serious security incidents associated with the obsolescence of the building, the Santa Fe County Commission began to address the need for a new courthouse to address, among other things, security issues and public parking concerns.

Judge Vigil stated that, in November 2006, a $25 million general obligation bond was approved by the voters; and in 2008, a $30 million revenue bond was also issued, which delegated a 1/16 percent increment of gross receipts tax revenue to fund the bond. She stated that, without the additional funding being received months in advance of the expected move at the end of 2012, the court would not be able to meet the move-in goal and the new building would remain vacant until they were able to secure the necessary funding following the 2013 legislative session – in other words, the court could not wait until the next legislative session to secure the requested funding for priorities 1 and 2 in their request.

Judge Vigil stated that continuing to operate the current facility would continue to expose judges, lawyers, court staff and the public to safety and security risks that galvanized the community to support the construction of the new facility in the first place. In the current facility, inmates are escorted through the offices of administrative assistants, and public hallways, to get to the courtrooms, and there have been multiple inmate escapes and attempted escapes due to the nature of the building. She said the public would also continue to be exposed to other deficiencies of the courthouse. Just this month, the roof started leaking in the middle of a jury trial in Judge Singleton’s courtroom. The proceedings had to be halted; and because there was no other space available for the proceedings, the decision was made to continue with the trial after people and file boxes were moved to another part of the room. She stated that, in another courtroom, computers had to be moved to avoid damage from a leaky roof, and on other occasions judges have had to move out of their chambers because of leaks. Last winter, the clerk’s office flooded and thousands of files, equipment and furnishings had to be moved, and staff were relocated until water could be extracted from the offices and the mold remediated.

Judge Vigil stated that any precipitation at all outside means wastebaskets have to be placed in the second floor hallway to capture the water.

Judge Vigil said the cost and risk to leaving the new building vacant would be enormous; Santa Fe County would have to continue to insure, heat and maintain the building while it remained vacant, and would be required to provide security to avoid the endangerment that a huge vacant building poses to the health and safety of the community. The risk of vandalism would also rise; and system warranties for the heating and cooling equipment would also begin without the necessary usage to test such systems, and Santa Fe County would lose the opportunity to use the existing building. Furthermore, she said the likely exploitation of the uncertainty made visible by this scenario would test the security of governments and the administration of justice.

Judge Vigil said all of the existing furniture is dilapidated because it is over 30 years old, and the cost to move it would be $200,000, in excess of the value of the items moved, and would include having to shut down court operations for two weeks to make the move.
Judge Vigil said this request is being made based on the historical and legal obligation that state courthouses be furnished and equipped through state monies. She cited Section 34-6-24 NMSA provides that “from the funds of each judicial district, furniture, equipment, books and supplies shall be provided for the operation of each district court within the judicial district.” For this reason, she said there is a legal obligation to request funds for these necessary items from state resources.

Judge Vigil said the First District Court has carefully examined its budget for FY 2013; and based upon current projections, they would be able to contribute less than $10,000 of available resources for the requested items. Likewise, the Administrative Office of the Courts has closely examined its current year budget and determined that there are not adequate resources that can be made available to shift over to meet the needs of the First District Court for the following reasons:

-- The funding received by AOC for the needs of other courts are specifically appropriated to those other needs, and it would therefore be impermissible to access such resources for the First District Court;

-- The use of other monies received by the AOC would violate the precedence and expectations of other courts across New Mexico in a unified budget process of the judiciary; and

-- The increase in the AOC budget received for this year for technology and equipment for those other courts did not incorporate the First Judicial District Court’s needs for furniture and equipment.

Judge Vigil said the First District Court has also approached the County for assistance, and has carefully examined the bond language to determine whether it would permit the County to fund furnishings and fixtures. The County General Obligation Bonds did contain language authorizing the purchase of furnishings; however, those revenues have long since been exhausted on construction. She said construction costs also rose due to the remediation and cleanup as a result of gas contamination of the site. She noted that the County has funded the advanced wiring for security and technology systems. Judge Vigil said the County’s position is that the cost of construction is its primary obligation to the court, and has declined their request for additional resources to meet the court’s needs.

In conclusion, Judge Vigil stated that she has provided a list of priorities and asked that the Board either lend or grant this request so that priority items 1 and 2 can be purchased during the 2012 calendar year and allow the relocation to the new courthouse in a timely manner.

Ms. Clarke explained that the electronic agenda contains an IT priority request and a furnishings priority request, each broken down into first, second and third priorities. She said the first and second priority items from the two lists total $1,043,172, which includes 8 percent overage for installation and delivery.
Mr. Gasparich noted that there is $1,191,814 in the Operating Reserve Fund and the Board may receive other emergency funding requests before the end of the fiscal year.

Responding to Dr. Clifford, Ms. Clarke said the Board’s funding for emergencies is appropriated through Section 4 of the General Appropriation Act, which has to be expended in FY 2012, which means that goods and services must be received by June 30. The Financial Control Division has advised her that, if the Board were to approve a grant, the term “expended” applies, and any equipment, furnishings and items purchased with a grant would have to be received by June 30 to be expended. However, in terms of the loan, she was advised that the term “expended” doesn’t really have a reasonable application; and so, with a loan, there is more flexibility to purchase and receive goods after fiscal year’s end and still be in conformance with the General Appropriation Act.

Mr. Aragon stated that he recently visited the courthouse, and agreed that it is a “mess.” He said staff was very helpful to him, and commended Judge Vigil on the ability of the employees there to maintain their professionalism. He commented that people tend to forget that the courts are the cornerstone of the judiciary system and therefore should be funded at all times, but it is a function of government that people don’t think about until they suddenly need it.

Mr. Aragon said he thought this request “extremely modest,” but the $1.19 million balance in the Emergency Operating Reserve Fund poses a problem. While his fellow Board members share the same sentiment, which is that they want to help, last year in June a tragedy struck that ate up the entire fund. He said the concern is that there are two months left to address such unforeseen events.

Mr. Aragon noted that the Board adopted a debt policy at the last meeting on how to fund requests of this type, e.g., should it be done with bonds that encumber the state for 10 years on something that might last 3 years. He said this approach is too costly for the taxpayers and is almost always done for political gain, and he supported the Governor’s vetoing of various projects for that reason.

Mr. Aragon stated that he felt this request should be funded 100 percent, but unfortunately it was before the Board about six weeks too soon, and granting this request with perhaps half of the available balance in a “cut and paste way” would be doing a disservice to the Court.

Dr. Clifford said DFA and staff have reviewed the statute carefully and have met with the Judge on the issue of who is responsible for what – and DFA’s interpretation of the statute differs, because even though it uses the word “furniture,” it uses it in a phrase that refers to the court’s operations. He said DFA’s understanding is that the state is responsible for funding the operations of the court, which is done every year in the budget process by funding the Administrative Office of the Courts. He noted that furniture is typically included in the state’s capital outlay funding for construction, and the general obligation bond sold by the County for the courthouse specified that furniture would be purchased with that funding.
Dr. Clifford said DFA did a quick review of the County’s budget, and it is their impression that the 1/16th gross receipts tax earmarked in part for this purpose is raising significantly more revenue this year than what was budgeted. He said he would encourage Judge Vigil to work with the County to see if additional funding is available from that for this purpose.

Governor Martinez noted that the $25 million general obligation bond approved by the voters was to “construct, equip, design, improve and furnish” a district courthouse and related parking facilities. She said she understood a gas station on site made it impossible to begin building because of contamination, and that it was recommended to the County not to purchase the property because it would be building a two-story underground parking facility.

Judge Vigil clarified that the project began in about 2005 and the County, after considering various sites, chose the existing site not knowing there was contamination there. As construction began in 2009, the County discovered that gas stations located in surrounding areas, not on the site itself, had leaked gas that infiltrated the site and created the contamination. She said there was never a gas station on the site, and she thought the County took the admirable position of taking the responsibility of cleaning up the site so it could be used. She said the gas stations in the surrounding area were there from the 1920s through the 1950s, when there were no regulations around that, so there was no one specifically responsible for the contamination. She said she and her colleagues feel that the courthouse should remain in the downtown area “as a representation of our community.”

Governor Martinez said her concern is that $14 million of the $25 million was used for the remediation, which wasn’t what the voters approved. Even the Environment Department tried to step in to do the appropriate testing and drilling, and the County refused and decided to do the test wells on their own. She said the final report found that the site was “horribly contaminated with high levels of toxic chemicals.” She questioned whether the taxpayers understood that $14 million would be paid for this, plus an additional $600,000 to the contractor “for doing zero work for two years” while the remediation took place. In addition, there is another $3 million from the 1/16 percent tax increment that could be directed towards a courthouse.

Governor Martinez stated that she understood that the security cameras would cost about $70,000 and that was to come out of a projected Court general fund budget surplus (for FY 2012) of about $167,000. She said she would point out that the budget increase for the Judiciary was the greatest increase of any other state agency, at 4.4 percent, while the state budget as a whole had a 4 percent increase, and the AOC also received $1 million during the last legislative session for security equipment.

Governor Martinez expressed concern that the County would go against the recommendations of the State Environment Department and also ignore the wishes of the voting public that approved this $25 million general obligation bond. She said the problem could have been addressed in another way.
Judge Vigil responded that Governor Martinez has made several incorrect assumptions. She said it is the state’s responsibility and not a county’s responsibility to purchase furniture, books and equipment for courthouses in New Mexico.

Governor Martinez responded that the bond language called for furniture, and that’s what the voters approved, and Judge Vigil said that was correct, but the money has been spent on construction and remediation. She said the situation is that there is a $60 million project at this point, and the remediation amount was $8 million, and there were savings due to the delay in construction on the interest of the bonds. She said the building will be completed in December, and she asked for the necessary funding so the courthouse can be occupied at that time in order to serve the public.

Judge Vigil said the Court was not intimately involved in the County’s remediation decision or in the County’s debate with the Environment Department, and was not at this meeting to blame anyone or point fingers about decisions made. She agreed that the project has overrun the budget because of the remediation work, but she personally felt it was the right decision to make under the circumstances.

Judge Vigil also clarified that the analyst’s projection of any amounts that would revert back in the Court’s budget was not $167,000; rather, the Court would be able to revert approximately $5,000.

Governor Martinez read from budget analyst Josefina Roberts’ memorandum dated March 30, 2012, stating that “based on her budget projection as of March 26, 2012, the Court may have a general fund budget surplus of about $167,766 at the end of fiscal year 2012.”

Judge Vigil stated that the amount was incorrect.

Ms. Clarke said there was later discussion between court executive officer Stephen Pacheco and Ms. Roberts, and the last she heard was that they concluded there was about $100,000 of balance remaining, but there is a BAR for $50,000 outstanding; so the amount truly available for reversion is either $50,000 or $100,000, depending on whether the BAR is approved. She said the BAR is to allow for tapes to be digitized for recordkeeping of court transcripts.

Governor Martinez asked why wouldn’t the Court put off digitizing tapes so it could put up the security cameras.

Judge Vigil responded that the Court has so many tapes that need to be digitized that it would cost a significant amount to move them to the new facility. She said the Court expected that the security cameras and security equipment would be paid for through the legislative capital outlay request.

Governor Martinez agreed with Dr. Clifford that the state pays for operations. She said her veto was based on that, along with the substantial 4.4 percent increase to the Judiciary, and the fact that the County made decisions that were very costly and that it is the County’s
responsibility to pay for what is left. She said the project was supposed to cost $38.5 million, not $60 million.

Judge Vigil said she did not think it would be prudent for the taxpayers to leave a $60 million building vacant. She said the courts have been very frugal and have been working with limited resources for many years despite an increasingly large caseload.

Lt. Governor Sanchez asked Judge Vigil how the Court would repay this loan, assuming the loan were made, and Judge Vigil responded that they would submit for funding on the first day of the next legislative session.

Lt. Governor Sanchez asked how much the Board might receive in emergency funds for the next fiscal year.

Mr. Gasparich responded that he believed it would be $1.75 million.

Lt. Governor Sanchez asked if the Court’s request could technically be considered an emergency.

Ms. Clarke responded that, based on Section 6-1-2 NMSA, an emergency has to be an unforeseen occurrence that severely affects the quality of government services, requiring immediate expenditure that is not within the available resources of the state agency, and that cannot reasonably await appropriation at the next legislative session.

Ms. Clarke said the biggest legal question in complying with these criteria is whether this is truly an unforeseen occurrence. It has always been her understanding that this pool of money is intended to be used for items that could not have been appropriated at the last session and cannot wait for the next session – it is not intended to circumvent the appropriation process. She added that it is somewhat difficult to justify it being an unforeseen occurrence given that it was so well known that it was in the capital outlay bill, although proponents of the request argue that the veto itself was the unforeseen occurrence. She said she personally feels that action by the legislature and then the veto are all part of the appropriation process and part of the legislative process. She said it was hard for her to come to terms with this being an unforeseen occurrence, but certainly one could argue otherwise.

Lt. Governor Sanchez asked what would happen to the existing old courthouse, and Judge Vigil responded that the County plans to renovate it and use it for offices.

Lt. Governor Sanchez wondered if there are other sources of money from the County, as well as proceeds for the lease or sale of the old courthouse, that could be applied here. In addition, the 1/16 percent of gross receipts tax is ongoing and could also be used.

Mr. Brasher noted that the AOC has committed funds for security purposes at other facilities across the state, and given how important the First Judicial District Court is, that could be a potential funding source as well.
Mr. Brasher said the County should find the $1+ million and cover this expense. He said there are small communities with no other source of funding at all that approach the Board for emergency loans, which causes him to hesitate about lending the court money even in the next fiscal year, given the size of its request.

Mr. Aragon asked AOC Executive Director Arthur Pepin how much the AOC has left in their budget, and Mr. Pepin responded that the reversion in FY 2011 was $53,000, or 0.11 percent, and the Judiciary as a whole reverted .02 percent, or $350,845, which was in 24 different budgets. He said he has four operating budgets and cannot transfer money from one to the other.

Mr. Aragon expressed concern about the County’s “cavalier attitude that it has done all it’s going to do.” He said the County Manager should be at the table arguing the case for the Court, not Judge Vigil.

Lt. Governor Sanchez said this is a conundrum because it is not clear which entity is responsible here. He suggested the Board consider granting the Court half of the money and leave the rest up to the County.

Mr. Aragon suggested that a subcommittee of the Board meet with the County Manager and others to have questions answered and solve this dilemma.

Mr. Aragon moved that the Chair appoint a subcommittee to engage in discussion with the AOC, Santa Fe County Manager and/or the County Commission designee, and any legislative representatives, and to report back to the Board at the June meeting.

Mr. Brasher seconded the motion.

Mr. Gasparich said he personally had no problem using Emergency Fund money for this purpose before the end of the year rather than reverting it back, but regardless of what the Board does, it will not meet the full need, and the County and possibly the AOC, as well as any reversion in the First District Court, are other possible funding sources. Additionally, perhaps the Local Government Division may want to step in with ideas. By the June meeting, Dr. Clifford and his staff should have a good idea of how the Board can proceed.

The motion passed 7-0 by voice vote.
ADDITIONAL EMERGENCY FUNDING REQUEST
Presenter: Lloyd Ayliffe, Manager

31. Lybrook Mutual Domestic Water Consumers Association – Requests Emergency Funding to Repair and Upgrade Domestic Water System ($50,000)

Mr. Ayliffe stated that the Lybrook Water Association has been in existence for over 30 years and over this time has been able to operate and maintain the water system from their own revenues and reserves. He stated that they are now facing the following issues:

-- One pump has failed due to age, another due to a power surge, and the third pump failed down hole.

-- Due to the age of the infrastructure, the piping has failed on seven different occasions, costing $3,000 to $5,000 in material and labor each time, for a total cost of $28,000.

-- With the ongoing operational and maintenance cost, the Association has not been able to replace the emergency reserve fund.

Mr. Ayliffe stated that the community of 300 residents, which has a 100-student school, has no water at this time. He asked the Board to lend or grant the Association $50,000.

Ms. Clarke said she feels this is a justified emergency. She said she understands the Association has received verbal quotes on the pump replacement and that it will cost $18,000. She said additional electrical work would also prevent future power surges such as the one that caused the previous pump failure.

Ms. Clarke asked that approval of any funding be contingent upon receipt of written quotes.

Ms. Clarke said the Board has received positive recommendations from the State Environment Department and Office of the State Engineer. She said she received a bank statement from the Association reflecting an account balance of $400 as of the end of March, confirming that the Association does not have the funds.

Ms. Clarke stated that the materials received by the Board demonstrate that the Association has prudently managed their infrastructure needs over the years.

Mr. Spencer moved to approve a loan of $50,000. Mr. Aragon seconded the motion.

Responding to Dr. Clifford, Mr. Ayliffe stated that revenue from users is about $3,500 to $4,000 a month. After expenses and operating costs, they have $300 to $500 left each month, and this does not include any preventative maintenance work, etc. He said current rates are $30 a
month for the base rate and $3.50 for the first thousand gallons, and progressing depending on the amount used.

Dr. Clifford commented that this amounts to about $50 a month for 6,000 gallons of usage. He said the rate is about twice the state average.

Mr. Ayliffe stated that the Association would be able to pay the loan back in annual payments of $2,000 for 25 years.

Ms. Clarke stated that this loan would be made pursuant to Section 3-27-9, which pertains to emergency water loans. The resolution states that an emergency exists, requiring this expenditure for adequate and safe drinking water; that the Association has a population of less than 5,000 which uses a drinking water supply in common; therefore, the Board approves a loan in the amount of up to $50,000 out of the FY 12 Emergency Water Fund to the Lybrook Mutual Domestic Water Consumers Association to be used to repair its water pump and make associated infrastructure improvements. Such funding will be contingent upon Director review of quotes justifying the actual cost of work to be completed. The loan shall bear no interest and shall be repaid in annual payments of $2,000 for a period of 25 years, with the first payment due on January 1, 2013 and on every January 1 thereafter for 25 years.

The motion passed 7-0 by voice vote.

STAFF ITEMS
Presenter: Ms. Stephanie Schardin Clarke, Director

25. Final Award and Approval of Contract for Arbitrage Consulting & Compliance Services

Ms. Clarke stated that staff recommends approval, subject to execution by the Contracts Review Bureau of the Department of Finance and Administration, of a contract with AMTEC for arbitrage consulting and compliance services. Based on the results of an RFP issued on January 17, 2012, the Board tentatively awarded the contract to AMTEC on March 15, 2012. At that time, the Board authorized staff to negotiate a contract with AMTEC, and that contract is before the Board for approval today.

Treasurer Lewis moved for approval. Mr. Spencer seconded the motion, which passed 7-0 by voice vote.

26. Recommendation of Selection of Contractor to Perform Bond Counsel Services

Ms. Clarke reported that the State Board of Finance issued a Request for Proposals for Bond Counsel Services on February 7, 2012. Responsive proposals were received on March 9, 2012.
from three firms: Brownstein Hyatt Farber Schreck, Kutak Rock, and Sutin Thayer & Browne. The Evaluation Committee carefully reviewed and evaluated these proposals based on the criteria and weights set out in the RFP and assigned the following total scores (out of a possible 1,000 points):

- Brownstein Hyatt Farber Schreck: 955.7
- Kutak Rock: 714.5
- Sutin Thayer & Browne: 966.7

Ms. Clarke stated that the Evaluation Committee recommends selection of Sutin Thayer & Browne to begin negotiations of an agreement with staff for bond counsel services.

Ms. Clarke reminded the Board about confidentiality requirements associated with competitive sealed proposals prior to final award.

**Mr. Brasher moved for approval. Mr. Gasparich seconded the motion, which passed 7-0 by voice vote.**

27. **Recommendation of Selection of Contractor to Perform Disclosure Counsel Services**

Ms. Clarke reported that the State Board of Finance issued a Request for Proposals for Disclosure Counsel Services on February 7, 2012. Responsive proposals were received on March 9, 2012 from six firms: Ballard Spahr, Brownstein Hyatt Farber Schreck, Hogan Lovells, Kutak Rock, Modrall Sperling, and Sutin Thayer & Browne. The Evaluation Committee carefully reviewed and evaluated these proposals based on the criteria and weights set out in the RFP and assigned the following total scores:

- Ballard Spahr: 715.4
- Brownstein Hyatt Farber Schreck: 843.9
- Hogan Lovells: 749.0
- Kutak Rock: 691.3
- Modrall Sperling: 827.2
- Sutin Thayer & Browne: 824.0

Ms. Clarke said the Evaluation Committee recommends selection of Brownstein Hyatt Farber Schreck to begin negotiations of an agreement with staff for disclosure counsel services.

Ms. Clarke reminded the Board about confidentiality requirements associated with competitive sealed proposals prior to final award.

**Mr. Brasher moved for approval. Mr. Spencer seconded the motion, which passed 7-0 by voice vote.**
28. **Board of Finance Dashboard Report**

Ms. Clarke stated that the Dashboard Report has been updated to reflect April activity.

29. **Fiscal Agent/Custodial Bank Fees**

Ms. Clarke stated that fiscal agent billings are in line with historic averages, but are reduced significantly because the State Treasurer is holding higher balances at the fiscal agent bank to earn soft-dollar earnings credits. She said custody bank fees are also in line with historic averages.

30. **Joint Powers Agreement**

The Joint Powers Agreement report was read into the record.

**ADJOURNMENT**

Its business completed, the State Board of Finance adjourned the meeting at 6:15 p.m.

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**Susana Martinez, President**

5-21-12

**Date**

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**John Gasparich, Secretary**

5/21/12

**Date**