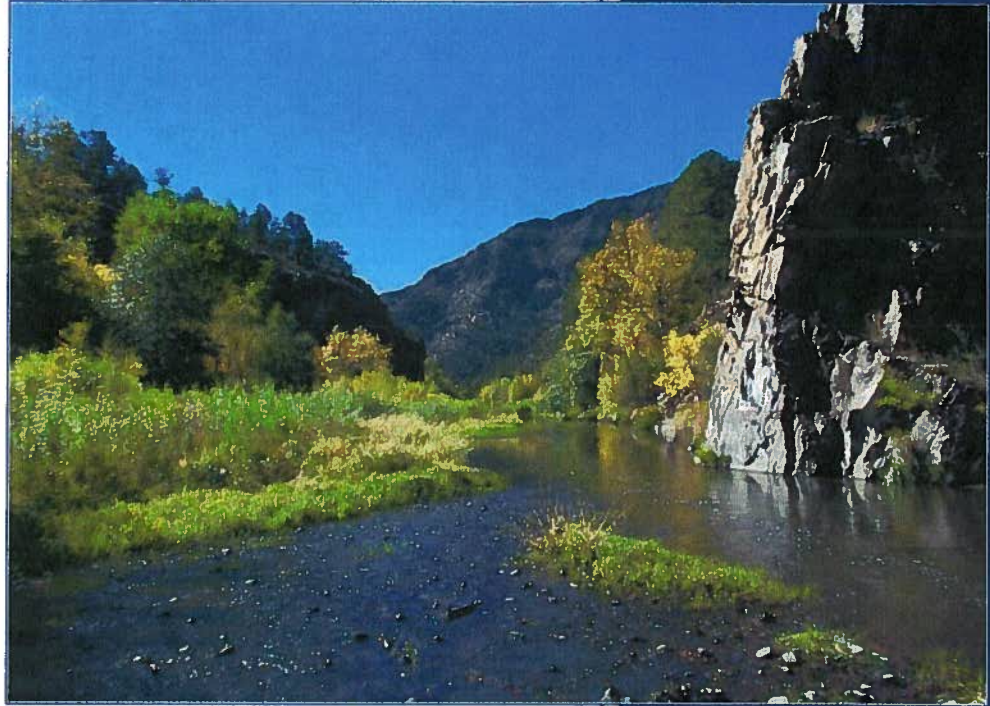


2016



STATUS OF THE NEW MEXICO UNIT FUND

Report to the New Mexico Legislative Finance
Committee



New Mexico Interstate
Stream Commission
November 2016

Status of the New Mexico Unit Fund: Report to the
New Mexico Legislative Finance Committee

New Mexico Interstate Stream Commission

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ABBREVIATIONS AND ACRONYMS

AWSA	Arizona Water Settlements Act of 2004
CAP	Central Arizona Project
CRBPA	Colorado River Basin Project Act of 1968
CUFA	New Mexico Consumptive Use and Forbearance Agreement
EIS	Environmental Impact Statement
FTE	Full-time equivalent
GSFCC	Gila San Francisco Coordinating Committee
ISC	New Mexico Interstate Stream Commission
JPA	Joint Powers Agreement
NEPA	National Environmental Policy Act
NGO	Non-governmental organization
OM&R	Operation, Maintenance & Repair (or Replacement)
ROD	Record of Decision
SWNMSG	Southwest New Mexico Stakeholders Group

EXECUTIVE SUMMARY

The New Mexico Unit Fund (“NM Unit Fund”) is a fund in the New Mexico treasury created by the NM Unit Fund Act, NMSA 1978, § 72-14-45, consisting primarily of deposits from the United States pursuant to the federal Arizona Water Settlements Act of 2004 (“AWSA”). The NM Unit Fund Act requires that the Interstate Stream Commission (“ISC or Commission”) report to the Legislative Finance Committee and the Interim Water and Natural Resources Committee every year by November 15 on the following three items:

- 1) the status of the NM Unit Fund;
- 2) the distribution of money from the NM Unit Fund to implement the purpose of the fund pursuant to the Act; and
- 3) proposed uses and levels of funding projected for the following fiscal year.

The AWSA provides New Mexico with up to an annual average 14,000 acre-feet of water per year from the Gila and San Francisco Rivers above the water decreed to New Mexico by the U.S. Supreme Court in *Arizona v. California*, 376 U.S. 340 (1964). In addition, the AWSA provides \$66 million (adjusted for inflation) for construction of a New Mexico Unit (“NM Unit”) or other water utilization project(s) in the counties of Catron, Grant, Hidalgo, and Luna. A NM Unit is the physical facilities that would be used to develop any of the additional water. Additional funding from the Department of the Interior in an amount up to \$62 million may be available for construction of a NM Unit pursuant to the AWSA.

The \$66 million provided to New Mexico by the AWSA is being deposited in 10 installments, adjusted for inflation, into the NM Unit Fund. New Mexico has received five annual payments of \$9.04 million totaling \$45.2 million. Expenditures to date for AWSA activities total \$6.55 million as of October 31, 2016. The current balance in the fund is \$38.88 million.

The planned FY2017 budget includes:

1. The ISC’s FY2017 operating budget is \$425,300 from the NM Unit Fund that includes 3.5 Full-Time Equivalent (“FTE”) positions and support costs.
2. The ISC’s FY2017 AWSA/Gila Work Plan as approved by the Commission is \$12,116,000.
3. The ISC approved the NM CAP Entity’s FY2017 budget of \$1.33 million, which will be paid from the NM Unit Fund.

In addition, the FY2018 budget will include the following:

1. The ISC’s appropriation request for the operating budget is \$315,000 for 3 FTEs and support costs.
2. The ISC’s Gila/AWSA Work Plan will include engineering; environmental compliance costs; legal services; and Non-NM Unit projects. The specifics of those costs are currently unknown.
3. The NM CAP Entity requested a budget in the amount of \$1.354 million which was approved by the Commission together with the NMISC’s appropriation request for FY2018.

I. INTRODUCTION

During the 2011 Legislative Session, the New Mexico Legislature passed H.B. 301 (“the Act”) creating the NM Unit Fund in the State Treasury. The Act is codified as 2011 NM Laws, Ch. 99, NMSA 1978, § 72-14-45 (2011). The fund consists of money distributed to the State pursuant to Paragraphs (2)(D)(i) and (ii) of Section 403(f) of the Colorado River Basin Project Act of 1968 (“CRBPA”), codified at 43 U.S.C § 1524(f), as amended by Section 107(a) of the AWSA. Pursuant to the Act, the fund can also consist of appropriations, grants, and donations or bequests to the fund.

Income from the fund is credited to the fund. Balances do not revert to the general fund.

Money in the NM Unit Fund is administered by, and appropriated to, the ISC. The Act requires the ISC to report to the Legislative Finance Committee and the Interim Water and Natural Resources Committee every year by November 15 on the following three items:

- 1) the status of the NM Unit Fund;
- 2) the distribution of money from the NM Unit Fund to implement the purpose of the fund pursuant to the Act; and
- 3) proposed uses and levels of funding projected for the following fiscal year.

This report includes these three items. In addition, this report provides a general update on issues and activities arising from the AWSA.

II. BACKGROUND

The federal CRBPA directed the Secretary of the Interior (“Secretary”) to offer to contract with water users in New Mexico for water from the Gila River, its tributaries, and underground water sources in amounts to permit consumptive use of water in New Mexico not to exceed an annual average in any period of ten consecutive years of 18,000 acre-feet over and above consumptive uses provided by Article IV of the Decree of the Supreme Court of the United States in *Arizona v. California*, 376 U.S. 340 (1964).

The federal AWSA amended the CRBPA by directing the Secretary to offer to contract with water users in New Mexico, with the approval of the ISC, or with the State of New Mexico through the ISC, for water from the Gila River, its tributaries and underground water sources in amounts that permit consumptive use not to exceed an annual average of 14,000 acre-feet in any 10-year period. This consumptive use is in addition to New Mexico’s decreed right in *Arizona v. California*.

Should New Mexico divert and consumptively use the additional AWSA water, the Secretary must deliver an equal volume from the Central Arizona Project (“CAP”) to downstream, forbearing Gila River water users in Arizona (sometimes called the exchange water).

The AWSA further provides \$66 million, adjusted for inflation since January 1, 2004, in ten annual payments to the NM Unit Fund beginning with year 2012. Withdrawals from the NM Unit Fund are for the purpose of paying costs of the NM Unit or other water utilization alternatives to meet water supply demands in Catron, Grant, Hidalgo, and Luna Counties as determined by the ISC in consultation with NM CAP Entity.¹ The AWSA mandates that costs associated with planning, environmental compliance, and environmental mitigation and restoration, among others, be paid with withdrawals from the NM Unit Fund.

The AWSA allows an additional amount of \$34 million, adjusted for inflation since January 1, 2004, for construction of the NM Unit provided that certain conditions listed in the AWSA are met. Moreover, if the rate of return on carryover funds in the federal Lower Colorado Basin Development Fund exceeds an average annual rate of four percent for the period beginning with the AWSA’s enactment through the date of initiation of construction of the NM Unit, an additional amount up to \$28 million shall be made available for construction. Thus, a maximum additional \$62 million may be available for construction of the NM Unit. Earnings in the Development Fund to date do not support the additional \$28 million.

¹ The AWSA mandates that the ISC consult with the Southwest New Mexico Water Study Group or its successor. This group was succeeded by the Gila-San Francisco Water Commission. The NM CAP Entity is the successor to the Gila-San Francisco Water Commission.

III. ISC PLANNING, PROJECT SELECTION, AND ADMINISTRATION

The AWSA was signed into law in December 2004. In early 2005, the ISC formed the Gila San Francisco Coordinating Committee (“GSFCC”), in an attempt to build consensus among regional stakeholders. The GSFCC was composed of one representative each from the ISC, the Bureau of Reclamation, the U.S. Fish and Wildlife Service, the Office of the Governor, and the Gila San Francisco Water Commission (representing local governments). The GSFCC convened a Technical Committee composed of representatives from local water users, environmental groups, and state and federal agencies.

The task of the GSFCC’s Technical Committee was to determine the studies necessary to evaluate the environmental effects of potential water withdrawals under the AWSA. After literature reviews, science forums, and initial baseline studies, the Technical Committee agreed on a suite of 13 studies and surveys with a total projected cost of \$945,000. The 2006 Legislature appropriated the full amount of funding, but the appropriation was vetoed.

In 2007, the ISC formed the Southwest New Mexico Stakeholders Group (“SWNMSG”). The task of the SWNMSG was to reach consensus among all stakeholders on a small suite of projects to be funded from AWSA monies. By November 2010, the SWNMSG’s suite consisted of 70 different projects. In February 2011, after a request by the ISC to reach consensus on a much smaller set of projects, the SWNMSG could only reduce the number of projects to 50.

As a consequence of these failed attempts to obtain consensus from local stakeholders, the ISC developed its own process to solicit and evaluate proposals. The ISC, with input from regional stakeholders, initiated a two-tiered evaluation process for selection of projects to be funded from the NM Unit Fund.

During Tier-1 of the process, the ISC received 41 project proposals from stakeholders, which were evaluated by a panel consisting of representatives from the ISC; the New Mexico Department of Game and Fish; the New Mexico Environment Department; the Energy, Minerals, and Natural Resources Department; and the Office of the State Engineer. Twenty proposals met the Tier-1 criteria and passed to the Tier-2 ranking process. On February 29, 2012, the ISC selected 16 of the 20 Tier-2 projects for further assessment, refinement, or combination. In 2013, one proponent withdrew its proposal from consideration.

After extensive evaluation of the 15 proposals’ technical feasibility, legal feasibility, costs, water supply, benefits, and environmental impacts, the ISC voted at its November 24, 2014 meeting to send a written notice to the Secretary that New Mexico intended to build a NM Unit. The Commission also voted to fund eight non-NM Unit projects (with some modifications made by the ISC at its February 26, 2015, meeting), at a total cost of \$9.1 million. Those projects and their respective allocations are listed in Table 1.

Table 1. Non-NM Unit projects as approved by the Commission

No.	Project	Award (\$)
1	Municipal Water Conservation Fund	3,000,000
2	Grant County Water Commission (GCWC) Wellfield and Pipeline*	2,100,000
3	City of Deming Effluent Reuse	1,750,000
4	Gila Basin Irrigation Commission Diversion Structure	1,250,000
5	Catron County Ditches Diversion Structures	500,000
6	Pleasanton East Side Ditch Improvement	200,000
7	Sunset/New Model Ditches Improvement	200,000
8	1892 Luna Irrigation Ditch Association Diversion Structure	100,000

* Subject to the GCWC presenting a business plan, a final project plan and securing a match by Dec 2016

Prior to construction of a NM Unit, an Environmental Impact Statement (“EIS”) must be prepared, in accordance with the National Environmental Policy Act (“NEPA”). The Secretary must issue a Record of Decision, upon the completion of the EIS.

The AWSA directs the U.S. Bureau of Reclamation to be the lead agency for environmental compliance pursuant to NEPA. The AWSA also provides for the State of New Mexico, at its option, to be joint lead agency for environmental compliance. On February 26, 2015, the ISC voted to be joint lead agency and transmitted its intent to the Secretary on February 27, 2015.

The ISC and Reclamation are working together to 1) sign a Memorandum Of Understanding that outlines both agencies’ duties and responsibilities as NEPA joint leads with respect to environmental compliance and the preparation of the EIS for the NM Unit; and 2) execute a Funding Agreement with the NM CAP Entity, as the project proponent, to fund Reclamation’s work on this EIS. After the Funding Agreement and the NEPA MOU are signed, and the ISC has transferred sufficient advance funding to Reclamation, Reclamation will advertise a Request for Proposals, and select a NEPA Contractor to prepare the EIS. Reclamation will also publish in the Federal Register a Notice of Intent to prepare an EIS for the NM Unit, which will officially begin the NEPA process. Reclamation anticipates publishing the NOI in the Winter 2016/2017.

For the purpose of preparing the EIS, the NM Unit needs to be designed to a level sufficient to allow the public and interested parties to make meaningful comments and to determine what physical, socio-economic, and environmental impacts might result from implementation of the NM Unit. On November 24, 2015, the CAP Entity voted to allow the ISC to negotiate, procure and award a contract for up to 30-percent engineering design services for the NM Unit, in coordination with the NM CAP Entity to obtain information that will help the Entity make decisions as it moves forward with this process.

Following the NM CAP Entity’s approval, the ISC hired an engineering firm to work with the NM CAP Entity to develop a conceptual design and identify a Proposed Action. The work was completed and the NM CAP Entity submitted its proposal to Reclamation on July 15, 2016. This same engineering firm will refine the proposed concepts and take this design to the up-to-30-percent level.

In the meantime, the ISC hired a financial adviser to determine an appropriate asset allocation strategy for investment of the NM Unit Fund in the pooled funds offered by the NM State

Investment Council (“SIC”). At its June 22, 2016, meeting, the Commission approved the staff’s recommendations for the NM Unit Fund asset allocation strategy.

At its August 18, 2016 meeting, the Commission delegated the authority to the Director to sign a Joint Powers Agreement between the ISC and the SIC, directing SIC to invest the monies available in the NM Unit Fund. The Joint Powers Agreement was signed by both parties and subsequently approved by the Department of Finance and Administration on September 16, 2016. The ISC Director sent a letter to the SIC, requesting an initial investment of the funds on November 1, 2016, based on the asset allocation and targets shown in Table 2. Monthly transfer of funds in to the SIC will continue until up to \$32 million is fully invested, based on dollar cost averaging investing.

Table 2. Asset allocation and targets

Asset Class	Implementation Choice*	Minimum	Target	Maximum
Large Cap U.S. Equity	Passive	22%	25%	28%
Small/Mid Cap U.S. Equity	Active	6.5%	8%	9.5%
Non-U.S. Developed Equity	Passive	15%	17%	19%
Non-U.S. Emerging Markets Equity	Active	4%	5%	6%
Core (Plus) Fixed Income Bonds	Active	40%	45%	50%

* The two implementation choices are actively or passively managed investment pools. Actively-managed strategies strive to outperform a relevant broad market benchmark, albeit at higher fees, whereas passively-managed strategies seek to meet the return of the relevant broad-market benchmark at substantially lower fees.

IV. NM CAP ENTITY

The AWSA also provides for the creation of the NM CAP Entity, an entity formed or designated by the State of New Mexico, through the ISC, to enter into the NM Unit Agreement with the Secretary. The text of the NM Unit Agreement was drafted in 2004 and attached to the AWSA as an appendix. In addition, the AWSA states that the NM CAP Entity shall own and hold title to the NM Unit. Following construction of the NM Unit, the NM CAP Entity will be responsible for reimbursing the Secretary for operation, maintenance, and repair (“OM&R”) costs attendant to delivery of the exchange water.

The Secretary is authorized to design, build, operate, and maintain the NM Unit. Upon request by the NM CAP Entity, the Secretary shall transfer to the NM CAP Entity those responsibilities, or any combination thereof. In April 2016, the NM CAP Entity requested transfer of the design responsibility from the Secretary to the NM CAP Entity. In early 2015, the ISC staff drafted a Joint Powers Agreement (“JPA”) creating the NM CAP Entity. This draft JPA was distributed to local organizations and governmental agencies for their review and input. Based on their feedback, the JPA was finalized and approved by the ISC at its June 9, 2015 meeting. Thirteen local governments from Southwest New Mexico opted to participate in the NM CAP Entity and passed resolutions to sign the JPA. They are as follows:

1. Upper Gila Irrigation Association
2. Fort West Irrigation Association
3. Gila Farm Irrigation Association
4. Gila Hot Springs Irrigation Association
5. Catron County
6. Grant County
7. Luna County
8. Village of Santa Clara
9. Hidalgo Soil & Water Conservation District
10. Hidalgo County
11. City of Deming
12. San Francisco Soil & Water Conservation District
13. City of Lordsburg

In addition, the ISC signed the JPA as a non-voting member of the NM CAP Entity.

The New Mexico Department of Finance and Administration approved the JPA on July 27, 2015. As soon as it was formed, the NM CAP Entity began negotiations with the Bureau of Reclamation for supplemental terms that the Department of Interior wanted added to the NM Unit Agreement. The negotiations lasted several months. At its September 29, 2015 meeting, the NM CAP Entity voted to sign the NM Unit Agreement. The Secretary of the Interior signed the NM Unit Agreement on November 23, 2015, thus meeting the deadline set by the AWSA.

V. NEW MEXICO UNIT FUND

The NM Unit Fund and NMSA 1978, § 72-14-45 are described in the Introduction, and the descriptions are not repeated here.

STATUS

The most recent annual deposit of \$9.04 million dollars from the United States into the NM Unit Fund occurred in January 2016. This was the fifth such deposit. Deposits from the Bureau of Reclamation to date total \$45.2 million. The total amount expended from the Fund to date is \$6.55 million as of October 31, 2016. The current balance of the Fund is \$38.88 million. The difference accounts for the interest earned on the funds.

DISTRIBUTION OF MONEY TO IMPLEMENT THE PURPOSES OF THE FUND

The expenditures to date of \$6,554,571.36 have been for the purposes of paying the following: FTEs dedicated to AWSA/Gila work; staff support costs; engineering and scientific investigations and reports; website development and maintenance; legal support; facilitators for public meetings, and the NM CAP Entity's budget.

USES AND LEVELS OF FUNDING PROJECTED FOR THE CURRENT FISCAL YEAR

1. ISC Operating Budget: The appropriated FY2017 operating budget for ISC Gila staff is \$425,300 which includes 3.5 FTEs² and support costs.
2. ISC Gila/AWSA Work Plan: The ISC approved the FY2017 Gila/AWSA Work Plan in the amount of \$12,116,000 for the purposes of 30-percent design of the NM Unit, i.e., engineering to help assess the feasibility of the project proposed by the NM CAP Entity on July 15, 2016; NEPA and related services; public outreach services; legal services; and Non-NM Unit projects. The corpus of work can be viewed online at www.nmawsa.org. The largest portion of this request, \$9,100,000, is the funding previously allocated by the Commission for non-NM Unit projects. The full amount has not been budgeted, as some of the ISC's requirements for non-NM Unit projects have not yet been met (e.g., matching funds). The budget requested in this Work Plan does not cover the NEPA Contractor or Reclamation's internal costs. Those costs will be presented for the ISC's approval when the Funding Agreement has been approved by the NM CAP Entity and the ISC.

² Two of those positions are currently filled and it is anticipated that a third position will be filled within the next few months.

3. NM CAP Entity Budget: At present, the NM CAP Entity's expenses are also paid from the NM Unit Fund pursuant to Paragraph V(m) of the JPA. The ISC approved the NM CAP Entity's FY2017 budget of \$1.33 million on April 21, 2016. The NM CAP Entity's budget includes: operational expenses; salary of the executive director; consultants; legal services, and other contractual services.

USES AND LEVELS OF FUNDING PROJECTED FOR THE NEXT UPCOMING FISCAL YEAR 2018

1. The ISC appropriation request from the NM Unit Fund for the Gila Basin operating budget is \$315,000 for 3 FTEs and support costs.
2. The Gila/AWSA Work Plan will include engineering; environmental compliance costs; legal services; and Non-NM Unit projects. The specifics of those costs are currently unknown.
3. The NM CAP Entity's FY2018 budget request in the amount of \$1.354 million was approved by the ISC on July 21, 2016 and submitted with the ISC appropriation request (item 1 above). The NM CAP Entity's budget includes: operational expenses; salary of the executive director; consultants; legal services, and other contractual services.

Therefore, the ISC anticipates FY2017 and FY2018 expenditures to include FTEs and support costs, engineering, federal environmental compliance, the NM CAP Entity's budget, public outreach, legal services, and the funding for the Non-NM Unit projects.

The ISC has received Reclamation's Interim Project Plan, as defined in the Funding Agreement, for the period of January 1, 2017 through September 30, 2017 in the amount of \$4,413,000 to fund Reclamation's planned internal costs and contracts associated with the NEPA process. The Interim Project Plan was approved by the NM CAP Entity on November 2, 2016. However, the Commission has not yet acted on this request.

