THE STATE OF NEW MEXICO

CONTINUING DISCLOSURE

ANNUAL FINANCIAL INFORMATION FILING
FISCAL YEAR 2014

NEW MEXICO
STATE BOARD OF FINANCE

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State Capital Program

State general fund balances and proceeds from General Obligation Bonds, Senior Severance Tax Bonds, Supplemental Severance Tax Bonds and Transportation Bonds are important sources of capital financing for the State. The following table summarizes the capital funding administered by the Board and certain other sources for Fiscal Year 2010 through Fiscal Year 2014.

TABLE 1

Principal Sources of Capital Project Funding
Fiscal Year Ended June 30
(Dollars in millions)

	2010	2011	2012	2013	2014
Proceeds from General Obligation Bonding Program[1]					
General Obligation Bonds	$ --	$ 19.7	$ --	$139.3	$ --
Subtotal	$ --	$ 19.7	$ --	$139.3	$ --
Proceeds from Severance Tax Bonding Program[1]					
Severance Tax Bonds	$ 315.3	$ --	$121.2	$ --	$339.7
Severance Tax Funding Notes[2]	178.5	27.3	76.2	112.0	90.5
Supplemental Severance Tax Bonds	112.9	--	--	--	--
Supplemental Severance Tax Funding Notes[2]	97.0	206.1	148.7	167.8	175.2
Subtotal	$ 703.7	$233.4	$346.1	$279.8	$605.4
Proceeds From Other Sources					
General Fund[3]	$(259.2)	$ --	$ --	$ --	$ --
Transportation Bonds[4]	52.5	--	--	--	70.1
Lease Appropriation Bonds	--	--	--	--	--
Subtotal	$(206.7)	$ --	$ --	$ --	$ 70.1
Total[5]	$ 497.0	$253.1	$346.1	$419.1	$675.5

(1) Dollar amounts from State Board of Finance funding programs reflect net proceeds available for capital expenditure. Amounts vary annually by legislative action and the timing of bond closings.
(2) The Board issues short-term Severance Tax funding notes and Supplemental Severance Tax funding notes to fund authorized projects. The notes are sold to the State Treasurer and retired within the same fiscal year.
(3) In Fiscal Year 2010, due to budgetary constraints, $259.2 million previously appropriated for Capital Project Funding was reappropriated for purposes other than Capital Project Funding.
(4) In July 2008, the New Mexico Finance Authority entered into a $200,000,000 line of credit which was drawn upon for transportation related capital expenditures in Fiscal Years 2009-2011. In Fiscal Year 2011, the New Mexico Finance Authority refunded the line of credit through the issuance of State Transportation Revenue and Refunding Bonds (Senior Lien) Series 2010A-1 and State Transportation Revenue and Refunding Bonds (Subordinate Lien) Series 2010A-2, the proceeds of which are available for transportation related capital expenditures. All subsequent bonds or notes issued by the New Mexico Finance Authority for transportation purposes, with the exception of the State Transportation Highway Infrastructure Fund Revenue Bonds issued March 12, 2014 for $70,110,000, have been either economic refundings of outstanding new money bonds or restructurings of outstanding new money bonds.
(5) Totals may not add due to rounding.

Source: New Mexico State Board of Finance, the Department of Finance and Administration and the New Mexico Finance Authority.

In addition to the General Obligation Bonding Program, the Severance Tax Bonding Program and the Supplemental Severance Tax Bonding Program issued and administered by the Board, there are a number of other sources of funds for capital projects throughout the State. These other sources of funding include surplus general fund appropriations and proceeds of bonds issued by, among others, the New Mexico Finance Authority, the State Transportation Commission and state educational institutions.

The New Mexico Finance Authority (the "Finance Authority") was created by the State legislature in 1992 to assist qualified governmental entities in financing capital equipment and infrastructure projects. The Finance Authority is a state instrumentality governed by a board of directors and is not subject to the direct supervision or control of any other board, bureau, department or agency of the State. In July 2012, the Finance Authority disclosed that what it believed was the audit of its financial statements for the fiscal year ended June 30, 2011 was not completed properly (the "Incomplete Audit"). Upon such discovery, the Finance Authority withdrew the Incomplete Audit. The Finance Authority then initiated an investigation and determined that its former controller had misrepresented the status of the Incomplete Audit and provided financial statements for use by third parties that he falsely represented as "audited." Investigations also were conducted by (i) the Office of the State Auditor and PricewaterhouseCoopers, (ii) the Securities Division of the New Mexico Regulation and Licensing Department and (iii) Hewitt EnnisKnupp. The reports were completed and found no money missing. The United States Securities and Exchange Commission (the "SEC") issued an inquiry to the Finance Authority regarding the Incomplete Audit (the "SEC Inquiry"), to which the Finance Authority timely responded and provided all the requested information. It is unknown whether the SEC will pursue further action. The audit completed by REDW, LLC for the Fiscal Year 2011 agreed with the Finance Authority in its application of accounting principles and did not disclose the presence of any missing funds. The Finance Authority's former controller entered into a plea agreement for forgery and securities fraud. Pursuant to that plea agreement, the former controller received a sentence of 5 years supervised probation. The Finance Authority is implementing recommendations contained in the three published reports. In September 2012, the Finance Authority terminated its Chief Executive Officer and Chief Operating Officer. It has since hired a new Chief Executive Officer, a new Chief Financial Officer, and has restructured its Audit Committee.

General Obligation Bonds

Sections 7 and 8 of Article IX of the State Constitution limit the power of State officials to incur general obligation indebtedness in the following ways:

(a) The State may borrow money not exceeding the sum of two hundred thousand dollars ($200,000) in the aggregate to meet casual deficits or failure in revenue, or for necessary expenses.

(b) Other debt may be contracted by or on behalf of the State only when authorized by law for some specified work or object. Such a law takes effect only after being submitted to the qualified electors of the State and having received a majority of all votes cast thereon at a general election. No debt may be created if the total indebtedness of the State, exclusive of the debts of the territory and several counties thereof assumed by the State, would thereby be made to exceed 1 percent of the assessed valuation of all property subject to taxation in the State, as shown by the last preceding general assessment.

(c) The State may contract debts to suppress insurrection and to provide for the public defense.

Outstanding and Additional Parity General Obligation Bonds

The principal amounts of outstanding General Obligation Bonds, as of December 31, 2014, are shown in Table 2.

TABLE 2

Outstanding General Obligation Bonds

Series	Principal Outstanding
Series 2005	$13,800,000
Series 2007	47,565,000
Series 2009	112,050,000
Series 2011	13,530,000
Series 2013	124,325,000
Total	$311,270,000

Source: New Mexico State Board of Finance.

Future debt payments, by fiscal year, on General Obligation Bonds outstanding, as of December 31, 2014, are shown in Table 3.

TABLE 3

Future General Obligation Bond Debt Service(1)

Fiscal Year	Principal	Interest	Total
2015	$63,635,000	$5,888,124	$69,523,124
2016	51,915,000	8,993,948	60,908,948
2017	54,110,000	6,805,948	60,915,948
2018	38,915,000	4,535,397	43,450,398
2019	40,440,000	3,014,448	43,454,448
2020	16,145,000	1,426,248	17,571,248
2021	16,510,000	1,061,848	17,571,848
2022	14,635,000	688,448	15,323,448
2023	14,965,000	359,160	15,324,160
Total	$311,270,000	$32,773,566	$344,043,566

(1) Figures may not add due to rounding.

Source: New Mexico State Board of Finance.

Voters must approve the issuance of additional General Obligation Bonds, other than for refunding purposes, and the levy of additional *ad valorem* taxes. Any such additional General Obligation Bonds may be issued on a parity with, or subordinate to, all outstanding General Obligation Bonds.

Calculation of 1 Percent Bonding Limitations	
Net taxable value as of December 31, 2013	$56,735,504,632
General obligation bond limitation @ 1 percent of net taxable value	$567,355,046
Total general obligation bonds outstanding as of December 31, 2013	$311,270,000
Ratio of total debt to net taxable value	0.549%

Source: Local Government Division and Fiscal Strategies Group.

Underlying General Obligation Bonds

The following table presents information on county, city, local and public school district debt outstanding as of June 30, 2014. The table does not include debt of special districts or community colleges.

Certain Underlying General Obligation Debt	
Counties	$ 292,080,694
Cities	$ 438,818,780
Schools	$ 2,044,547,000

Source: New Mexico Department of Finance and Administration, Local Government Division and New Mexico Public Education Department.

Severance Tax Bonds

The Severance Tax Bonding Act, Sections 7-27-1 to 7-27-27 NMSA 1978, as amended, permits the State Board of Finance (the "Board") to issue two categories of bonds against Severance Tax Bonding Fund (the "Bonding Fund") revenues: "New Mexico Severance Tax Bonds," referred to herein as "Senior Severance Tax Bonds," and "New Mexico Supplemental Severance Tax Bonds," referred to herein as "Supplemental Severance Tax Bonds." The Board is prohibited by statute from issuing Senior Severance Tax Bonds and short-term Senior Severance Tax Funding Notes unless the aggregate amount of total Senior Severance Tax Bonds and Funding Notes outstanding, after giving effect to the proposed issuance, can be serviced with not more than 50 percent of the annual deposits into the Bonding Fund from the preceding fiscal year. The Board is prohibited by statute from issuing Supplemental Severance Tax Bonds unless the aggregate amount of Senior Severance Tax Bonds and Supplemental Severance Tax Bonds outstanding, after giving effect to the proposed issuance, can be serviced with not more than 62.5 percent of the annual deposits into the Bonding Fund from the preceding fiscal year. In addition, short-term Supplemental Severance Tax Funding Notes may be issued if the debt service on such Supplemental Severance Tax Funding Notes, when added to the debt service previously paid or scheduled to be paid during that fiscal year on Senior and Supplemental Severance Tax Bonds and Funding Notes does not exceed 95 percent of the deposits into the Bonding Fund from the preceding fiscal year. The Senior Severance Tax Bonds and Funding Notes fund a wide variety of capital projects while Supplemental Severance Tax Bonds and Funding Notes are earmarked for capital projects for public education.

The Board has authority to issue Supplemental Severance Tax Bonds for public school projects in amounts certified to the Board from time to time by the Public School Capital Outlay Council of the State. The lien of the pledge of such Supplemental Severance Tax Bonds (including short-term funding notes) is subordinate to any outstanding Senior Severance Tax Bonds.

Section 7-27-8 NMSA 1978 requires that on each December 31 and each June 30 the State Treasurer shall transfer to the Severance Tax Permanent Fund all money in the Bonding Fund except the amount necessary to meet all principal and interest payments on bonds payable from the Bonding Fund on the next two ensuing semiannual payment dates.

In 2014, the Board filed a voluntary material event notice (the "Voluntary Disclosure") with the Municipal Securities Rulemaking Board's Electronic Municipal Market Access ("EMMA") system, available on the Internet at http://emma.msrb.org, in connection with the State's Severance Tax Note, Series 2014S-A and Supplemental Severance Tax Note, Series 2014S-B (collectively, the "2014S Notes"). The Voluntary Disclosure related to the sizing of the 2014S Notes in excess of the amount permitted by State statute as a result of an accounting oversight. This resulted in an underpayment on June 30, 2014 of a corresponding amount from the Severance Tax Bonding Fund to the Severance Tax Permanent Fund. As noted in the Voluntary Disclosure, upon discovering this oversight, in September 2014 Board staff directed the State Treasurer to transfer the required amount from the Severance Tax Bonding Fund to the Severance Tax Permanent Fund to correct the underpayment. The Board subsequently issued additional short-term notes in December 2014 which accounted for the September payment made to the Severance Tax Permanent Fund.

Outstanding and Additional Senior Severance Tax Bonds

The principal amounts of outstanding Senior Severance Tax Bonds, as of December 31, 2014 are shown in Table 4.

TABLE 4

Outstanding Senior Severance Tax Bonds

Severance Tax Bonds, Series 2009A	$84,365,000
Severance Tax Bonds, Series 2010A	86,170,000
Severance Tax Bonds, Refunding Series 2010C	9,915,000
Severance Tax Bonds, Refunding Series 2010D	73,805,000
Severance Tax Bonds, Series 2011A-1	38,215,000
Severance Tax Bonds, Refunding Series 2011A-2	61,905,000
Severance Tax Bonds, Series 2012A	53,840,000
Severance Tax Bonds, Series 2013A	145,575,000
Severance Tax Bonds, Series 2014A	143,770,000
Total	$697,560,000

Source: New Mexico State Board of Finance.

Future payments, by fiscal year, on outstanding Senior Severance Tax Bonds, as of December 31, 2014, are shown in Table 5.

TABLE 5

Future Senior Severance Tax Bond Debt Service[1]

Fiscal Year	Principal	Interest	Total
2015	--	$ 16,794,712	$ 16,794,712
2016	$108,940,000	30,651,038	139,591,038
2017	108,400,000	25,277,538	133,677,538
2018	99,160,000	20,088,538	119,248,538
2019	89,710,000	15,453,038	105,163,038
2020	78,250,000	11,496,725	89,746,725
2021	62,235,000	8,288,431	70,523,431
2022	48,160,000	5,821,250	53,981,250
2023	44,300,000	3,746,400	48,046,400
2024	37,955,000	1,876,375	39,831,375
2025	20,450,000	511,250	20,961,250
Total	$697,560,000	$140,005,293	$837,565,293

(1) Figures may not add due to rounding.

Source: New Mexico State Board of Finance.

Outstanding Supplemental Severance Tax Bonds

The principal amounts of Supplemental Severance Tax Bonds that are outstanding, as of December 31, 2014, are shown in Table 6.

TABLE 6

Outstanding Supplemental Severance Tax Bonds

Supplemental Severance Tax Bonds, Series 2010B	$62,520,000
Total	$62,520,000

Source: New Mexico State Board of Finance.

The future fiscal year debt payments on outstanding Supplemental Severance Tax Bonds, as of December 31, 2014, are shown in Table 7.

TABLE 7

Future Supplemental Severance Tax Bond Debt Service[(1)]

Fiscal Year	Principal	Interest	Total
2015	--	$ 1,506,775	$ 1,506,775
2016	$9,725,000	2,770,425	12,495,425
2017	9,945,000	2,278,675	12,223,675
2018	10,215,000	1,774,675	11,989,675
2019	10,525,000	1,256,175	11,781,175
2020	10,865,000	721,425	11,586,425
2021	11,245,000	224,900	11,469,900
Total	$62,520,000	$10,533,050	$73,053,050

(1) Figures may not add due to rounding.

Source: *New Mexico State Board of Finance.*

Tax Revenue Anticipation Notes

The State has issued, and expects to issue from time to time, Tax Revenue Anticipation Notes ("TRAN"). The TRAN are not general obligations of the State. The purpose of the TRAN is to fund a portion of the State's cash flow needs during the fiscal year in which the TRAN are sold. The State Treasurer's Office has not issued TRAN since Fiscal Year 2011, during which $200,000,000 was issued.

Severance Tax Bonding Fund and Debt Service Requirements

Severance tax receipts contributed 98.1 percent of total revenue to the Bonding Fund in Fiscal Year 2014, with the remainder attributable to interest earnings and reversions. Severance taxes are almost entirely attributable to natural gas, crude oil and coal sales. Natural gas and crude oil together accounted for 97.7 percent of total Fiscal Year 2014 severance tax receipts as shown in Table 8. This percentage is calculated net of Intergovernmental Tax Credits.

TABLE 8

Severance Tax Bonding Fund
Receipts, Disbursements and Transfers
Fiscal Year Ended June 30[(1)(2)]
(Dollars in thousands)

	2010	2011	2012	2013	2014
Beginning Balance	$172,318	$130,346	$161,190	$254,810	$142,806
Receipts:					
Taxes:					
Oil and Gas Severance Tax	$325,761	$350,718	$449,283	$400,959	$518,371
Other Minerals Severance Taxes	24,362	16,009	13,548	13,416	12,297
Total Severance Taxes	$350,123	$366,727	$462,831	$414,375	$530,668
Other Income:					
Interest on Investments	$ 21,610	$ 18,102	$9,941	$ 6,772	$5,844
Bond Proceeds	369	0	4	0	0
Other financing sources	2,131	10,823	7,126	2,777	4,706
Total Other Income	$ 24,111	$ 28,295	$17,072	$ 9,549	$10,551
Total Receipts	$374,234	$395,652	$479,903	$423,923	$541,219
Disbursements:					
Senior Bond Debt Service	$ 96,290	$103,867	$121,367	$127,951	$246,999[(4)]
Senior Short-term Obligations[(3)]	178,594	27,273	76,220	111,999	90,545
Supplemental Bond Debt Service	15,452	19,212	29,300	21,483	28,084[(5)]
Supplemental Short-term Obligations[(3)]	97,001	206,130	148,745	167,832	175,161
Costs of Issuance and Other Charges	1,396	4,838[(6)]	3,034[(7)]	2,774[(8)]	(1,331)[(8)]
Total Disbursements	$388,734	$361,321	$378,665	$432,039	
Transfers:					
To Severance Tax Permanent Fund	$ 27,472	$ 3,488	$7,617	$103,888	$124,996
Total Transfers	$ 27,472	$ 3,488	$7,617	$103,888	$124,996
Ending Balance, June 30	$130,346[(9)]	$161,190[(10)]	$254,810[(11)]	$142,806	$19,571

(1) All receipts, expenditures and balances exclude amounts in rebate accounts retained for potential arbitrage rebates.
(2) Proceeds and expenditures attributable to refunding bonds are excluded from this table because such proceeds and expenditures are reserved for payments on appropriate refunding bonds and are not available for debt service payments on other Severance Tax Bonds.
(3) The Board issues short-term Severance Tax funding notes and Supplemental Severance Tax funding notes to fund the authorized projects. The notes are sold to the State Treasurer and retired within the same fiscal year.
(4) Includes $120.6 million July 1, 2014 principal and interest payment on Severance Tax Bonds that was paid on June 27, 2014.
(5) Includes $12.5 million July 1, 2014 principal and interest payment on Supplemental Severance Tax Bonds that was paid on June 27, 2014.
(6) Includes $2.0 million paid to escrow agent in connection to Series 2010D advance refunding.
(7) Includes $2.2 million paid to the Internal Revenue Service in August 2011 for arbitrage rebate liabilities.
(8) Fiscal Year 2013 includes $2.2 million that was incorrectly debited a second time in July 2012 for the August 2011 arbitrage rebate payment made to the Internal Revenue Service as part of the State Treasurer's Fiscal Year 2012 audit adjustments. Fiscal Year 2014 reflects reversal of this error in November 2013.
(9) The ending balance includes the amount of the transfer to the Severance Tax Permanent Fund, which was made on July 1, 2010 in the amount of $3.5 million.
(10) The ending balance includes the amount of the transfer to the Severance Tax Permanent Fund, which was made on August 3, 2011 in the amount of $7.6 million.
(11) The ending balance includes the amount of the transfer to the Severance Tax Permanent Fund, which was made on July 3, 2012 in the amount of $103.9 million.

Source: New Mexico State Board of Finance based on the Statewide Human Resources, Accounting, and Management Reporting System (the "SHARE System").

Table 9 shows projected coverage ratios for outstanding Severance Tax Bonds based on revenue projections produced by the consensus revenue group on December 8, 2014. In subsequent weeks, oil and natural gas markets have experienced volatility; accordingly, such projections are subject to future review.

TABLE 9

State of New Mexico Severance Tax Bonds
Projected Cash Receipts, Debt Service Requirements and Coverage

Fiscal Year Ending 6/30	Projected STBF Revenues	Scheduled Senior Debt Service[(1)]	Projected Senior Debt Service Coverage	Scheduled Supplemental Debt Service[(1)]	Projected Supplemental Coverage
2015	$469,928,955	$137,411,506	3.42x	$13,986,175	3.10x
2016	451,317,605	139,591,038	3.23x	12,495,425	2.97x
2017	475,397,803	133,677,538	3.56x	12,223,675	3.26x
2018	493,274,576	119,248,538	4.14x	11,989,675	3.76x
2019	484,282,462	105,163,038	4.61x	11,781,175	4.14x
2020	472,228,269	89,746,725	5.26x	11,586,425	4.66x
2021	462,038,025	70,523,431	6.55x	11,469,900	5.64x
2022	450,857,715	53,981,250	8.35x	--	--
2023	440,180,411	48,046,400	9.16x	--	--
2024	429,978,939	39,831,375	10.79x	--	--

(1) Excludes debt service on refunded bonds which will be payable from escrowed securities and severance and supplemental severance tax debt obligations sold to the State Treasurer which are retired within the same fiscal year.

Sources: New Mexico State Board of Finance and Fiscal Strategies Group.

Investments

Funds on deposit in the Bonding Fund are invested by the State Treasurer at the direction and approval of the Board, pursuant to the State Treasurer's Investment Policy ("Investment Policy"), adopted as of May 20, 2014. Investments are made in securities, which are at the time legal investments of the State, and no such investment or deposit shall violate any applicable restrictions imposed by the Code (defined below) and applicable Treasury Regulations relating to the market price and the existence of an established market.

Except for funds deposited into the Rebate Fund for any bond series (defined in the Bond Resolution), net interest earned on the amounts on deposit in the Debt Service Account for those bonds shall be retained therein, and net interest earned on amounts on deposit in the Project Fund for those bonds shall be credited to the Debt Service Account for those bonds and applied to the payment of principal and interest on the bonds next becoming due. Any net loss, after applying any earnings in that account or find to the loss, resulting from any investment shall be charged to the applicable account from which such investment was made.

Severance Tax Collections and Reporting

Operators, purchasers and working interest owners are required to submit monthly reports to the TRD showing the total value, volume and kind of products sold from every production unit each month. Taxes must be paid at the same time and are due 55 days after the month of production. Each production report must be accompanied by a company identification number, which facilitates automated processing of return information. Production and associated tax liability are reported by "production unit" and a designation for a well or group of wells that is assigned by the TRD based on the master operation, property name identification and pool. A suffix is added to the production unit number to designate the specific land type and taxing authority including county, school district, and municipality. During calendar year 2014, the TRD received an average of 595 oil and natural gas returns per month containing an average of 127,886 lines of detailed information about production from different production units.

Complete reporting forms must be mailed or delivered, or their information electronically transmitted, on or before the 25th day of the second month after the calendar month for which the report is required. Taxpayers whose total tax liability for the month (including the oil and gas emergency school tax, the oil and gas conservation tax and the oil and gas ad valorem tax, as well as the oil and gas severance tax) exceeds $25,000 must provide payment by automated clearinghouse or by wire transfer on or before the due date. Taxpayers who fail to report or pay in a timely fashion are assessed interest at the rate established for individuals under Internal Revenue Code Section 6621 computed on a daily basis beginning the day after the due date and continuing until the date the tax is reported or paid. A penalty is assessed when a taxpayer fails to pay any tax or file any report by the due date because of negligence or disregard of rules and regulations. A penalty is charged at a rate of 2 percent per month, up to a maximum of 20 percent of the tax due.

The State maintains an automated database system ("ONGARD" for Oil and Natural Gas Administration and Revenue Database) to monitor production and sales activities of oil and natural gas producers. ONGARD functions include: managing the inventory of lands within the state and tracking all leases to determine whether royalty payments are owed to the State; monitoring all oil and natural gas wells for compliance with unitization agreements and other production-related information; and processing tax and royalty payments due to the State. The integrated database gives the State enhanced capabilities to compare and evaluate production, tax and royalty reports, and to issue automated exception reports.

Severance taxes received by the TRD are deposited into the Oil and Gas Suspense Fund. Using the ONGARD system, the TRD reconciles monthly information reports with the payments received to identify the appropriate amounts to distribute to each tax beneficiary. Oil and gas severance tax amounts that have been reconciled and as to which TRD has determined no substantive risk of protest or litigation is present are then transferred monthly to the Bonding Fund.

TABLE 10

New Mexico Oil, Natural Gas and CO_2 Subject to Taxation
Fiscal Years Ended June 30

	2010	2011	2012	2013	2014
Oil					
Sales Volume (million barrels)	62.9	67.0	79.7	93.8	113.5
Value (millions)	$4,470	$5,547	$7,144	$8,047	$10,795
Average Price (per barrel)	$71.29	$84.20	$89.64	$85.82	95.13
Natural Gas					
Sales Volume (bcf)	1,282	1,224	1,229	1,173	1,186
Value (millions)	$6,657	$6,805	$6,145	$5,127	$6,086
Average Price (per mcf)	$5.20	$5.50	$5.50	$4.37	$5.13
CO_2					
Sales Volume (bcf)	123.4	120.7	113.1	115.8	107.3
Value (millions)	$128.4	$150.0	$149.6	$153.7	$158.1
Average Price (per mcf)	$1.04	$1.24	$1.32	$1.33	$1.47

Source: New Mexico Taxation and Revenue Department, Tax Analysis, Research and Statistics Office (ONGARD, sales month basis as of November 2014).

Severance Taxes on Oil, Natural Gas, and Carbon Dioxide

The State collects taxes on the severance and sale of oil, natural gas and carbon dioxide ("CO_2"). Table 11 summarizes the history of statutory tax rates imposed on natural gas, oil, and CO_2. Tax rates are set by statute, Section 7-29-4 NMSA 1978, and are levied on the volume and/or value of product sold. With the exceptions noted below, tax rates have been imposed on an *ad valorem* basis, with deductions allowed for royalties paid to governments and also for certain expenses of transporting and processing products downstream of the production facility.

TABLE 11

History of Severance Tax Rates on Oil, Natural Gas and Carbon Dioxide

Year of Statutory Change	Natural Gas	Oil	Carbon Dioxide
1959	2.500%	2.500%	–
1974	3.750%	3.750%	–
1977	$0.050/mcf + surtax	$0.450/bbl + surtax	–
1980	$0.087/mcf + surtax	3.750%	–
1987	3.750%	3.750%	3.750%

Source: New Mexico Department of Finance and Administration.

Oil and Natural Gas Incentives

Although the State offers reduced severance tax rates for several categories of production, prices are above the threshold level, so none of these incentives are presently applicable. Table 12 summarizes incentive tax rates applying to various categories of production as of Fiscal Year 2014. Recent declines in oil and natural gas prices have not resulted in these incentives becoming applicable to date. Should prices decline in the future, some of these incentives may become applicable again.

TABLE 12

Oil and Natural Gas Tax Incentive Programs

Incentive Category	Incentive Tax Rate	Threshold Price Below Which Incentive Rate Applies	Qualified Production As a Percent of Fiscal Year 2014 Total
Production Restoration Project	0.0000%[(1)]	$24.00 per barrel[(2)]	0.0% Oil[(4)]
		$24.00 per barrel[(2)]	0.0% Natural Gas[(4)]
Well workover wells	2.4500%	$24.00 per barrel[(2)]	0.0% Oil[(4)]
		$24.00 per barrel[(2)]	0.0% Natural Gas[(4)]
Stripper wells	1.8750%	$ 1.15 per mcf-Gas[(3)]	0.0% Natural Gas[(4)]
		$15.00 per barrel-Oil[(3)]	0.0% Oil[(4)]
	2.8125%	$ 1.35 per mcf-Gas[(3)]	0.0% Natural Gas[(4)]
		$18.00 per barrel-Oil[(2)]	0.0% Oil[(4)]
Enhanced oil recovery	1.8750%	$28.00 per barrel[(2)]	0.0% Oil[(4)]

(1) The incentive rate applies for 10 years after the restoration project is completed. Each year's production is tested against the threshold price.
(2) Twelve-month average price for West Texas Intermediate crude oil as reported on Oil Postings for last day of each month.
(3) Average annual taxable value of natural gas or oil sold in New Mexico during the preceding calendar year.
(4) No oil or natural gas volumes are expected to qualify for these incentives during the period because average taxable value exceeds the threshold levels.

Source: Sections 7-29A and 7-29B NMSA 1978.

Severance Tax on Indian Land

The State can tax non-Indian oil and natural gas production on tribal land, according to United States Supreme Court precedent in *Cotton Petroleum Co. v. State of New Mexico*, 490 U.S. 163, 104 L. Ed. 2d 209, 109 S. Ct. 1968 (1989). The State's authority to impose severance taxes on Indian oil and natural gas production on tribal land was upheld by the United States District Court in New Mexico in *Jicarilla Apache Tribe v. New Mexico Taxation and Revenue Department*, No. USDC 87-922. In 2009, the United States District Court for the District of New Mexico held that the State may not impose severance taxes on non-tribal operators extracting oil and natural gas on the tribal land of the Ute Mountain Ute Tribe. *Ute Mountain Ute Tribe v. Homans,* 775 F. Supp. 2d 1259 (D.N.M. 2009) (Parker, J.). The Tenth Circuit Court of Appeals overturned the district court opinion and held that the State severance taxes are not preempted by federal law because, among other things, the State had asserted sufficient justification for imposing the taxes. *Ute Mountain Ute Tribe v. Rodriguez*, 660 F.3d 1177 (10th Cir. 2011). The Ute Mountain Ute Tribe petitioned for an *en banc* review, which the court denied on September 12, 2011. The United States Supreme Court denied the Ute Mountain Ute Tribe's petition for a *writ of certiorari* on February 21, 2012. *Ute Mountain Ute Tribe v. Padilla*, 132 S.Ct. 1557 (2012).

Information reported on the ONGARD website by TRD based on oil and gas tax return data indicates that natural gas production and crude oil production on Indian land was approximately 3.7 percent and 0.5 percent, respectively, of total statewide production in Fiscal Year 2014. The TRD estimates that oil and natural gas production on Indian land generated $7.9 million in severance tax revenues to the State in the production months corresponding to Fiscal Year 2014. Coal production on Indian land was 18.6 percent of total statewide production in Fiscal Year 2014. No potash, copper or carbon dioxide (CO_2) is produced on Indian land.

Section 7-29C-1 NMSA 1978, enacted by the 1995 Legislature, authorized a credit against state production and property taxes for similar taxes imposed by tribal governments. The credit applies to crude oil and natural gas from new wells drilled on or after July 1, 1995 on land within Indian reservation boundaries on March 1, 1995. The amount of the credit is 75 percent of the lesser of state taxes or tribal taxes imposed. If the applicable tribal taxes were raised after March 1, 1995, then the amount of the State's credit is lowered. The ONGARD website reports that total credits claimed under this provision were about $3.4 million in Fiscal Year 2014. About $1.4 million of these credits were applied against oil and natural gas severance tax liability. The Bonding Fund revenue projection assumes that this amount will grow slowly in the future.

The 2001 Legislature enacted Sections 7-29C-2, 7-9-88.2 and 9-11-12.2 NMSA 1978, which provided a similar 75 percent intergovernmental tax credit against severance tax and severance surtax on coal mined on the Navajo Nation. The TRD reports that this credit reduced Bonding Fund revenue by $1.4 million in Fiscal Year 2014.

Carbon Dioxide

The Bravo Dome CO_2 field encompasses 1.2 million acres in Harding, Union and Quay Counties in the northeastern area of the State. It contains estimated resources of 16.3 trillion cubic feet, of which 7.0 to 10.6 trillion cubic feet are considered economically recoverable. Although the State has long produced limited quantities of liquid and solid CO_2 for use in the food and the engineering industries, the main commercial value of CO_2 deposits is derived from the use of the product in its gaseous form in enhanced oil recovery projects in the Permian Basin of Texas and New Mexico. Future sales ultimately will depend on the CO_2 requirements of such projects and on the State's proportion of the market, which is shared with Colorado's Sheep Mountain and Little Sheep Mountain, McElmo Dome and Doe Creek Fields. Sales of CO_2 were approximately 107.3 bcf in Fiscal Year 2014, a decrease of 7.3 percent from 115.8 bcf during Fiscal Year 2013. The weighted average wellhead price of CO_2 sales for Fiscal Year 2014 was $1.47 per mcf reported at the production facility, an increase of 14 cents from $1.33 per mcf during Fiscal Year 2013. Severance Taxes on CO_2 are levied at the rate of 3.75 percent of taxable sales value. Deductions have ranged from 32.7 percent in Fiscal Year 2006 to 22.9 percent in Fiscal Year 2008. Weighted average deductions were 26.6 percent in Fiscal Year 2014.

History of Severance Tax and Severance Tax Surtax on Coal Production

Severance taxes have been levied on coal production in New Mexico since 1937. Revenues were distributed to the State general fund until adoption of the Severance Tax Bonding Act in 1961. Tax rates were imposed on an ad valorem basis, 0.125 percent of value from 1937 to 1974, and 0.5 percent of value from 1974 to 1977. In 1977, rates were converted to $0.38 per short ton for seam coal and $0.18 per short ton for metallurgical coal. A severance surtax was also imposed. Subsequent rates were to be determined annually by multiplying the severance tax per short ton by the percentage increase in the Consumer Price Index ("CPI") from 1976 to the calendar year just prior to the year in which the surtax rates were to be computed. The base severance tax rate was then increased to the current base rate of $0.57 per ton in 1980. A slightly reduced base rate of $0.55 per ton was provided for underground-mined coal in 1982.

Effective July 1, 1989, the severance surtax was frozen for a period of four years at $0.60 per ton for surface coal and $0.58 per ton for underground coal. When added to the base tax rate, this action had the effect of freezing the total rate at $1.17 per ton for surface coal and $1.13 per ton for underground coal. The surtax freeze was to terminate on July 1, 1993.

In 1990 the Legislature exempted from the surtax coal sold under new contracts entered into on or after July 1, 1990, and before July 1, 1994. The exemption also extended to incremental sales under existing contracts measured by the increase in sales over the annual average established in Fiscal Years 1987 to 1989. In 1992 the exemption was extended to incremental sales under renegotiated contracts.

In 1993 the exemption was extended to July 1, 1994. The annual increase was to be based upon the Producer Price Index ("PPI") for coal instead of the CPI. The surtax formula provides that in no case will the surtax be decreased, so a fall in the PPI for coal will not trigger a drop in the surtax rate. In 1994 the exemption was extended to July 1, 1995. In 1995 it was extended to July 1, 1997. In 1997 it was extended to July 1, 1999.

Pursuant to actions of the 1999 Legislature, currently the following coal is exempt from the surtax: (1) coal sold and delivered pursuant to genuinely new contracts entered into on or after July 1, 1990; (2) coal sold and delivered pursuant to contracts already in effect on July 1, 1990, that exceeds the annualized average calendar year deliveries under the contract during production years 1987, 1988 and 1989 or the highest contract minimum during these three years, whichever is greater, unless the deliveries are reduced due to causes beyond the reasonable control of either party to the contract; (3) if a contract existing on July 1, 1990, and renegotiated after May 20, 1992, requires the purchaser to take annual coal deliveries in excess of the greater of the average calendar year deliveries from 1987-1989 or the highest annual contract minimum from 1987-1989, the surtax does not apply to such excess deliveries for the remaining term of the renegotiated contract. Taxpayers were required to register any contract for the sale of qualified coal with the department prior to taking the exemption.

After a number of years of stable revenues, 2011 marked a significant decrease of coal severance tax from $23.3 million in Fiscal Year 2010 to $15.7 million in Fiscal Year 2011. This decrease was caused by renegotiation of several long term mine-mouth contracts. Coal sold and delivered under the new contracts is exempt from the coal surtax. The resources excise tax collections were $4.7 million in Fiscal Year 2014.

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The table below sets forth data on coal production, pricing and average tax rates for the past five fiscal years.

TABLE 13

Coal Production, Prices, Revenues, and Taxes
Fiscal Years 2010 to 2014

	2010	2011	2012	2013	2014
Production:					
Total Sales Volume (tons)	23,213,759	24,202,247	23,024,642	22,634,537	18,466.917
Surface Mined Surtax Exempt	7,144,637	16,148,057	16,413,332	15,880,674	11,366,169
Surface Mined Non-Exempt	10,019,543	1,768,875	533,727	893,391	832,843
Underground Mined Surtax Exempt	6,049,579	6,285,315	6,077,582	5,860,472	6,267,905
Prices:					
Weighted Average Price per Ton for All Coal	$28.97	$29.55	$33.65	$34.11	$35.47
Sales Revenue:					
Total Sales Revenue	$672,551,118	$715,148,886	$774,782,796	$772,134,654	$654,998,911
Taxes Collected and Intergovernmental Tax Credits (ITC):					
Gross Severance Tax and Severance Surtax Due	$ 23,330,785	$ 15,668,404	$ 13,626,955	$ 13,919,087	$11,483,480
Intergovernmental Tax Credit (ITC)	$ 2,257,604	$ 3,267,415	$ 2,747,567	$ 3,411,207	$1,411,347
Net Severance Tax and Severance Surtax Liability (Net of ITC)	$ 21,073,181	$ 12,400,989	10,879,388	$ 10,507,880	$10,072,106
Effective Taxes (Net of ITC):					
Effective Tax Rate	3.13%	1.73%	1.40%	1.36%	1.54%
Effective Tax per Ton for all Coal (Net of ITC)	$0.91	$0.51	$0.47	$0.46	$0.55

Source: New Mexico Taxation and Revenue Department, Tax Analysis, Research and Statistics Office (the "GenTax System").

Severance Taxes on Other Minerals

Many other minerals and natural resources are taxed in the State upon their severance from the earth or, in some cases, their sale or shipment. Existing tax rates are listed in Table 14. In many cases, flat percentage deductions are allowed to account for certain production costs. The result is that the gross value is a percentage of the "full value." The "full value," in turn, is sometimes based upon published prices rather than actual revenues. Generally, for products with a price at the point of production, value is that price less deductions allowed for actual costs for hoisting, loading, and crushing of up to 50 percent of price. For products that must be processed before sale, deductions are allowed for cost of processing and freight charges to the point of sale. Several exceptions apply, as detailed below.

For potash, the gross value is 40 percent of the posted field or market price, less those actual expenses of hoisting, crushing and loading necessary to place the severed product in marketable form and at a marketable price but allowable deductions may not exceed 50 percent. The gross value for each type of potash and potash product requiring processing or beneficiation (other than sizing) is 33.33 percent of the proceeds realized from the sale of muriate of potash and sulphate of potash magnesia, as standard grades, and 33.33 percent of the value of such products consumed in the production of other potash products, less 50 percent of such reported value as a deduction for expenses of hoisting, loading, crushing, processing, and beneficiation.

Gross values for copper, lead and zinc, gold, and silver are 66.66 percent of specified Comex, London Metal Exchange cash price, London Metal Exchange Final, and London spot, U.S. Equivalent, respectively, as published in *Metals Week*. The gross value for gold is the sales value established from published price date of the quantity of gold recoverable from the concentrate or other product which is sold or is shipped, transmitted or transported out of New Mexico without sale. The gross value for silver is 80 percent of the sales value established from published price date of the quantity of silver recoverable from the concentrate or other product which is sold or is shipped, transmitted or transported out of New Mexico without sale. For molybdenum, gross value is the value of molybdenum contained in concentrates shipped or sold from a mine site, but in no event shall it be less than market value. For copper, lead, zinc, gold, silver and molybdenum, deductions of 50 percent of the sales value are allowed for the expenses of hoisting, loading, crushing, processing and beneficiation, regardless of actual expenses incurred.

For sand and gravel, in the absence of substantial evidence of a different posted field or market price, it is presumed that the gross value is $1.75 per ton. In the absence of evidence of lower deductible expenses the maximum 50 percent deduction will be allowed. In determining taxable value, rent and royalty payments to the federal government or the State government are deductible from gross value.

TABLE 14

Severance Tax Rates on Other Minerals

Mineral Resources	Tax Rate (%)	Gross Value as Percent of Full Value (%)
Potash	2.500	Not fixed
Copper	0.500	16.67
Timber, Pumice, Gypsum, Clay, Fluorspar, Other	0.125	Not fixed
Molybdenum	0.125	50.00
Lead, Zinc	0.125	16.67
Gold	0.200	50.00
Silver	0.200	30.00
Uranium	3.500	50.00 (taxable value as percent of full value)

Source: New Mexico Taxation and Revenue Department, Tax Analysis, Research and Statistics Office.

Severance tax revenue from potash was $1.4 million in Fiscal Year 2014, down from $1.9 million in Fiscal Year 2013. Severance tax revenue from copper, which is limited because of the statutorily defined narrow tax base, was $777,519 in Fiscal Year 2014, up from $747,503 in Fiscal Year 2013 after peaking at $760,288 in Fiscal Year 2008. Weighted average copper prices were $3.21 per pound in Fiscal Year 2014.

GENERAL INFORMATION CONCERNING THE STATE OF NEW MEXICO

The State, admitted as the forty-seventh state on January 6, 1912, is the fifth largest state, containing approximately 121,593 square miles. The estimated 2013 population of the State is 2,085,287. The State has a semiarid subtropical climate with light precipitation. Its climate is characterized by sunshine and bright skies in both winter and summer. Every part of the State receives no less than 70 percent sunshine year-round. Humidity ranges from 30 to 60 percent. Thunderstorms in July and August bring most of the moisture. December to March snowfalls vary from 2 inches (lower Rio Grande Valley) to 300 inches (north central mountains).

Governmental Organization

The Executive Branch of State government consists of a Governor, Lieutenant Governor, Secretary of State, State Auditor, State Treasurer, Attorney General, and Commissioner of Public Lands. These officials are elected to four-year terms beginning January 1 after their election. An elected Executive Branch officer may succeed himself or herself in office once. The primary functions of the Executive Branch are currently carried out by the offices of each elected Executive Branch officeholder, in addition to approximately 22 cabinet departments, each headed by a cabinet secretary appointed by the Governor and approved by the Legislature, and approximately 9 cabinet-level agencies. Elections for all statewide offices were held on November 4, 2014.

The State Board of Finance has seven voting members consisting of the Governor, the Lieutenant Governor, the State Treasurer, and four members appointed by the Governor with the advice and consent of the Senate. No more than two appointed members may be from the same political party. The Department of Finance and Administration (the "DFA") Secretary serves as the Executive Officer of the Board and is a non-voting Board member. The Board, in addition to other powers and duties provided by law, has general supervisory authority over the fiscal affairs of the State and over the safekeeping and depositing of all money and securities belonging to, or in the custody of, the State. The Governor serves as the President of the Board.

The DFA is the principal financial organization of State government and performs through its divisions the duties and functions relating to State and local government financing and general administration. The executive and administrative head of the DFA is the Secretary, who is appointed by the Governor with the advice and consent of the Senate. The Board of Finance is a division of the DFA that provides operational, analytical and administrative support to the Board. The Director of the Board is appointed by the Secretary with the approval of the Board.

The Legislature consists of 112 members and is divided into a Senate and a House of Representatives. Senators are elected for four-year terms and members of the House are elected for two-year terms. The Legislature convenes in regular session annually on the third Tuesday in January. Regular sessions are constitutionally limited in length to 60 calendar days in odd-numbered years and 30 calendar days in even-numbered years. Special sessions of the Legislature may be convened by the Governor. Extraordinary sessions may be convened by the Legislature under certain limited circumstances. Legislators do not receive any salary, but do receive per diem and mileage allowances while in session or performing official State business.

The judicial branch is composed of a statewide system including Magistrate and District Courts, the Court of Appeals and the Supreme Court. The District Courts are the trial courts of record with general jurisdiction.

Pension and Other Retirement Funds and Benefits

Legislative History. As with many other states, the State has experienced funding issues regarding its pension and other retirement funds. As set forth below, the Legislature has acted to reform pension programs and to better ensure the continued viability of the programs.

The Legislature enacted the Educational Retirement Act, Section 22-11-1 et seq. NMSA 1978, the Public Employees Retirement Act, Section 10-11-1 et seq. NMSA 1978, and the Retiree Health Care Act, Sections 10-7C-1 through 10-7C-19, NMSA 1978, which created the retirement plans that cover most employees of the State and its political subdivisions. These retirement plans are managed by the Educational Retirement Board ("ERB"), the Public Employees Retirement Association ("PERA"), and the New Mexico Retiree Health Care Authority ("NMRHCA") and described below. The Legislature establishes all financing provisions of the plans and the provisions are not subject to negotiation. Financing provisions include employee and employer contributions, fund investment provisions and benefit provisions. In 1998, the voters amended the State Constitution, adopting Section 22 of Article XX, which states that upon meeting the minimum service requirements of an applicable retirement plan created by law for employees of the State or any of its political subdivisions or institutions, a member of a plan shall acquire a vested property right with due process protections under the applicable provisions of the New Mexico and United States Constitutions. The amendment also stated that nothing in Section 22 shall be construed to prohibit modifications to retirement plans that enhance or preserve their actuarial soundness.

Recent legislative changes enacted during the 2009, 2010, 2011, 2012 and 2013 legislative sessions also amended various provisions of the Educational Retirement Act, the Public Employees Retirement Act, and the New Mexico Retiree Health Care Act to improve the long-term stability of these funds.

House Bill 573 (Chapter 288, Laws 2009) increased the years in service requirement from 25 years to 30 years for new members who joined the ERB on or after July 1, 2010. Existing ERB members remain under the 25 year service requirement. This law also increased payroll contributions by employers and employees to the New Mexico Retiree Health Care Fund (the "NMRHCF"). House Bill 573 also included training requirements for members of the ERB and PERA boards.

House Bill 631 (Chapter 286, Laws 2009) added a section to the Educational Retirement Act to extend the rule whereby ERB members could retire with full benefits if their combined service and age at retirement met or exceeded 75, to a combined service and age at retirement of 80 for ERB members hired after July 1, 2010.

House Bill 351 (Chapter 287, Laws 2009) increased the employer/employee contribution to the NMRHCF from 1.95 percent to 3 percent for most employers and employees. The contribution increase was slightly higher for employees in an enhanced retirement plan. The increase is being phased-in over a four-year period. Due to the passage of this legislation, the NMRHCA estimates that solvency will be extended from approximately 2018 to 2027.

House Bill 854 (Chapter 124, Laws 2009) modified most employer and employee contributions to the State's retirement funds for Fiscal Years 2010 and 2011, shifting 1.5 percent of the annual contribution rate from employers to employees for those employees with a full-time equivalent annual salary greater than $20,000.

House Bill 628 (Chapter 178, Laws 2011) extended the existing 1.5 percent shift made in House Bill 854 through Fiscal Year 2013 and shifted an additional 1.75 percent of the annual contribution rate from employers to employees for Fiscal Year 2012. The additional 1.75 percent of the annual contribution rate shifted back from the employees back to the employers for Fiscal Year 2013. The 1.5 percent contribution shift from the employers to the employees remains in place through Fiscal Year 2013. House Bill 628 also required an actuarial study by PERA and ERB prior to September 20, 2013 to analyze whether contribution rate changes have had an adverse actuarial effect on the retirement systems.

House Bill 129 (Chapter 6, Laws 2011) required retired members who return to work with an educational employer pursuant to Paragraphs A, B or F of Section 22-11-25.1 NMSA 1978 to pay non-refundable contributions to the Educational Retirement Fund equal to the amount paid by nonretired employees. Employers continue to pay the employers' contributions to the Fund for retired members who return to work under the statute.

Senate Bill 27 (Chapter 225, Laws 2013) significantly amends the Public Employees' Retirement Act by creating a new tier of reduced benefits for new hires. The law reduces the cost of living adjustments for all current and future retirees; delays the application of cost of living adjustments for certain future retirees; suspends the cost of living adjustments for certain return-to-work retirees; provides for an increase in the statutory employee contribution rate of 1.5 percent (subject to certain requirements) for employees earning $20,000 or more in annual salary; provides for an increase in the statutory employer contribution of 0.4 percent beginning in Fiscal Year 2015; increases age and service requirements; lengthens the base average salary calculation amount from three to five years for future employees; increases the vesting period for employees from five to eight years for most members; lowers the annual service credit by 0.5 for most members; and makes several other clarifying and technical changes. The projected actuarial funded ratio in 2043 with changes made by Senate Bill 27 is 108.8 percent.

Senate Bill 115 (Chapter 61, Laws 2013) amends the Educational Retirement Act. The law increases employee contributions for members whose salary exceeds $20,000 per year to 10.1 percent in Fiscal Year 2014 and 10.7 percent beginning in Fiscal Year 2015; keeps in place scheduled increases in employer contribution rates; creates a new tier membership for persons who become members of the ERB fund on or after July 1, 2013; creates certain actuarial limitations on benefits of new tier members; places limitations on future cost of living adjustments ("COLA") for current and future retirees which are tied to the future funded ratios of the plan; and makes certain other clarifying and technical changes. The projected actuarial funded ratio in 2043 with changes made by Senate Bill 115 is 100.7 percent.

Legislative changes enacted during the 2014 legislative session amended sections of the law relating to the judicial and magistrate retirement funds and followed many of the changes implemented in the 2013 legislative session for the public employees' and educational retirement funds.

House Bill 33 (Chapter 35, Laws 2014) amends the Judicial Retirement Act. Among other things, the law suspends for two years and makes adjustments to cost of living increases, adjusts employee and employer contributions, requires mandatory participation in the fund and implements changes to the benefits structure.

House Bill 216 (Chapter 39, Laws 2014) amends the Magistrate Retirement Act. Among other things, the law suspends for two years and makes adjustments to cost of living increases, adjusts employee and employer contributions, requires mandatory participation and implements changes to the benefit structure.

Senate Bill 160 (Chapter 43, Laws 2014) also makes changes to the Magistrate Retirement Act. This law duplicates the changes made in House Bill 216.

Educational Retirement Board-Historic Financial Information. The ERB had 140,008 members as of June 30, 2014, including active, retired, inactive vested and inactive non-vested members. The market value of Educational Retirement Fund (the "Fund") as of September 30, 2014 was $11.18 billion, which was up from a low of $6.0 billion in February 2009. The ERB had net investment gains for the Fiscal Year 2014 of 14.2 percent.

In April 2011, the ERB voted to change its assumed rate of return on the pension fund's investments from 8.0 percent to 7.75 percent. As of June 30, 2014, the actuarial value of assets was $10.7 billion and the unfunded accrued actuarial liability ("UAAL") was $6.3 billion based on the

7.75 percent assumed rate of return. Others changes were made to the ERB's actuarial assumptions in April 2011, the most significant of which included: changing the funding method to traditional individual entry age normal; revising post-retirement mortality to reflect slightly longer life expectancy; changing retirement rates at ages 65 and 69 and with 25 or more years of service; decreasing salary increases for members with 10 or more years of service; and decreasing membership growth assumptions. The combined effect of the changes in actuarial assumptions, including to the assumed investment return rate, increased the UAAL by $426.1 million at that time. In April 2013, the ERB made further changes to its assumptions regarding post-retirement, disabled, and active mortality rates, retirement rates, changes to its service-based termination table and decreases in wage inflation from 4.75 percent to 4.25 percent and in the payroll growth from 3.75 percent to 3.50 percent. These changes reduced the June 30, 2013 UAAL by $81.5 million. The funded ratio on June 30, 2014 was 63.1 percent.

The change in the assumed rate of return was recommended by the ERB's outside actuaries and was made after consultations with the ERB's internal investment staff and its general investment consultant. The ERB will continue to monitor both its investment returns and general market conditions and may again change its assumed rate of return as market conditions and experience warrant.

As of June 30, 2014, the UAAL had an amortization period of 42.1 years based on the 7.75 percent assumed rate of return. The amortization period, also referred to as the funding period, is a calculation based on actuarial models of the period required to amortize the UAAL, assuming ERB's experience exactly follows actuarial assumptions. The calculation is based on current contribution rates which are established by state statute and does not take into account the statutorily scheduled increases in those rates described below.

TABLE 15

Schedule of Statutorily-Mandated Contribution Rates

Fiscal Year	Wage Category	Date Range	Member Rate	Employer Rate	Total
2010	$20k or less	7/1/2009-6/30/2011	7.90%	12.40%	20.30%
2010	Over $20k		9.40%	10.90%	20.30%
2011	$20k or less	7/1/2009-6/30/2011	7.90%	12.40%	20.30%
2011	Over $20k		9.40%	10.90%	20.30%
2012	$20k or less	7/1/2011-6/30/2012	7.90%	12.40%	20.30%
2012	Over $20k		11.15%	9.15%	20.30%
2013	$20k or less	7/1/2012-6/30/2013	7.90%	12.40%	20.30%
2013	Over $20k		9.40%	10.90%	20.30%
2014	$20k or less	7/1/2013-6/30/2014	7.90%	13.15%	21.05%
2014	Over $20k		10.10%	13.15%	23.25%
2015	$20k or less	7/1/2014 - Future	7.90%	13.90%	21.80%
2015	Over $20k		10.70%	13.90%	24.60%

Source: New Mexico Statutes Annotated 1978, Section 22-11-21, as amended.

In addition, New Mexico universities and colleges make an additional contribution of 3 percent of the salary of those employees who elect to participate in the Alternative Retirement Plan ("ARP"), a defined contribution retirement plan available to certain faculty and professional employees, to satisfy the UAAL attributable to participation in the ARP.

The ERB successfully implemented Governmental Accounting Standards Board ("GASB") Statement 67 requirements early with its June 30, 2013 financial statements. GASB Statement 67 requires ERB to report net pension liability ("NPL") which is measured as total pension liability less the amount of the plan's fiduciary net position. GASB 67 replaced GASB 25 which had required ERB to report the annual required contribution of the employer ("ARC") and the percentage of the ARC contributed. ERB meets 100 percent of its statutorily required employer contributions annually. The following table lists the ARC, NPL and the ERB funded ratio for Fiscal Years 2010 through 2014.

TABLE 16

ERB Funded Ratio

Fiscal Year	Annual Required Contribution (GASB 25)	Net Pension Liability (GASB 67)	Funded Ratio
2010	$357,220,043	--	65.7
2011	$377,884,749	--	63.0
2012	$400,461,343	--	60.7
2013	--	$6,276,852,149	60.1
2014	--	$5,705,730,813	63.1

Source: Educational Retirement Board.

The ERB also implemented GASB Statement 68 early with its June 30, 2014 financial statements. GASB 68 requires the plan's participating employers to recognize their pro rata share of NPL on their balance sheets.

In July 2012, the ERB adopted goals of achieving a 95 percent, plus or minus 5 percent, funded ratio by 2040. The amendments to the Educational Retirement Act made through enactment of Senate Bill 115 (Chapter 61, Laws 2013) are intended to assist the ERB in achieving these goals.

ERB pensions are adjusted annually by a COLA beginning on the later of either July 1 of the year in which a member reaches age 65 or July 1 following the year a member retires. SB 115 reduces the amount of the COLA until ERB is 100 percent funded. The amount of the adjustment is determined by the change in the Consumer Price Index ("CPI"), the retiree's pension amount and the retiree's service credit. Pensions cannot be decreased if there is a decrease in the CPI.

In December 2013, the Supreme Court of New Mexico, in *Barlett v. Cameron,* 2014-NMSC-002, rejected the claims of certain retired teachers, professors and other public education employees challenging the state constitutionality of Senate Bill 115 (Chapter 61, Laws 2013) to the extent that it reduces the future amounts that all education retirees might receive as annual COLA. The court held that Article XX Section 22 of the State Constitution did not grant the retirees a right to an annual COLA based on the formula in effect on the date of their retirement. The court held that any future COLA to a retirement benefit is merely a year-to-year expectation that, until paid, does not create a property right under the State Constitution. Once paid, the COLA by statute becomes part of the retirement benefit and a property right subject to those constitutional protections.

In 2010, the ERB changed the manner in which interest was calculated on members' contributions that are subject to refund so that it would be calculated in a manner similar to a savings account. As a result of a programming error, interest was miscalculated on refunds during July and August 2010 leading to overpayment of approximately $1.7 million to 693 individuals. The software was corrected after staff became aware of the error. Subsequently, the ERB undertook steps to recover the overpayments. To date, over $1.2 million has been recovered. The ERB has entered into payment plans with a number of the recipients through which it expects to recover additional funds and is continuing to pursue recovery from others who were overpaid.

The Public Employees Retirement Association-Historic Financial Information. PERA had 49,288 members as of June 30, 2014. As of June 30, 2014, the total market value of PERA Fund was $14.5 billion. The Fiscal Year 2014 PERA total fund investment return was 17.03 percent.

Cavanaugh Macdonald Consulting, LLC completed an actuarial valuation of the PERA Fund, Judicial Retirement Fund, Magistrate Fund, Legislative Division and Volunteer Firefighter Fund as of June 30, 2014. In May 2014, PERA actuaries conducted an experience study, testing actuarial assumptions currently used in its valuations. The PERA Board accepted the actuary's revised assumptions that the assets, benefit values, reserves and computed contribution rates reflect utilization of an inflation rate of 3.0 percent per annum and real rate of return rate of 4.75 percent, reflecting an investment rate of return of 7.75 percent. The Board also adopted reduced wage inflation and payroll growth assumptions of 3.5 percent, each compounded annually, as well as revised retirement and mortality assumptions.

In 2013, the PERA Board lowered the interest rate on members' contributions from 5.25 percent to 2 percent. In 2014, the Board changed the accrual rate for service credit for non-vested members who regularly work part-time.

PERA member and employer contribution rates are established by State statute. In 2013, the Legislature amended the PERA Act, NMSA 1978 1-11-1 et seq. to increase the employer contribution rate of 0.4 percent beginning July 1, 2014, and to increase member contribution rates by 1.5 percent beginning July 1, 2013.

Actuarial information for each fund as of June 30, 2014 is shown in Table 16.

TABLE 17

Summary of State Retirement Funds Managed by PERA
(Dollars in thousands)

	PERA[1]	Judicial	Magistrate	VFF	Legislative
Membership	92,732	285	151	9,129	319
Actuarial Information					
Accrued Liability[2]	$17,784,376	$133,346	$51,140	$ 41,516	$25,833
Actuarial Value of Assets[3]	$13,486,178	$ 85,106	$32,759	$ 57,658	$33,401
Unfunded (Overfunded) Accrued Liability	$ 4,298,198	$ 48,240	$18,380	$ (16,141)	$ (7,568)
Present Value of Statutory Obligations	$20,387,523	$154,002	$55,031	$ 47,718	$29,420

(1) Includes both the state and municipal divisions.
(2) Includes the accrued liability of both the retired and active members.
(3) The valuation of assets is based on an actuarial value of assets whereby gains and losses relative to a 7.75 percent annual return are smoothed in over a four-year period.

Source: Public Employees Retirement Association.

As of June 30, 2014, PERA has an amortization or funding period of 40 years, based on the employer and member contribution rates in effect as of July 1, 2014. Member and employer rates are established pursuant to Section 10-11-1 through 10-11-142 NMSA 1978. The funded ratio (ratio of the actuarial value of assets to accrued actuarial liability) was 75.8 percent as of June 30, 2014 and the UAAL of the PERA Fund has decreased $321.0 million to approximately $4.2 billion. The State's portion of the UAAL of the PERA Fund is 53.1 percent, or $2.3 billion. Prior to 2013 pension reform, the funded ratio was 65.3 percent and the UAAL of the PERA Fund was calculated to be approximately $6.2 billion. The primary cause of the increase in the funded ratio and decrease in accrued actuarial liability is the investment gain from 2014 plan years and passage of SB27 during the 2013 legislative session. On a market value basis, PERA's funded ratio is approximately 81.05% as of June 30, 2014.

The PERA Board's reform proposal (Senate Bill 27) had an immediate impact of reducing the $6.2 billion unfunded liability by $1.55 billion, increased the funded ratio by 6.6 percent and is projected to restore the fund to approximately 100 percent funded status by 2042. Current 30-year projections indicate the PERA Fund will be 100 percent funded in 2031.

In 2014, significant pension reform measures for the Judicial and Magistrate Retirement Funds were passed by the Legislature and signed into law by the Executive. Due to severe underfunding of these Funds, in addition to significant benefit reductions for future and current judges and magistrates, cost-of-living adjustments (COLAs) for retired judges and magistrates were suspended for two consecutive years and future COLAs will only be paid every third year unless the Funds are projected to be 100 percent funded.

In 2014, PERA implemented the new GASB 67 Statement and is preparing to implement the new GASB 68 Statement in 2015. Beginning in early 2015, PERA will work with local governments to allocate net pension liabilities (NLP) at the employer level. Beginning with FY15, GASB 68 requires participating local governments to recognize their pro rata share of NPL on their balance sheets.

GASB Statement 25 requires PERA to report its ARC and the percentage of the ARC contributed. PERA meets 100 percent of its statutorily required employer contributions annually.

The following tables list the funded ratios for each individual PERA fund for Fiscal Years 2010 through 2014.

TABLE 18

Funded Ratio of State Retirement Funds Managed by PERA

Fiscal Year	PERA	Judicial	Magistrate	VFF	Legislative
2010	78.5%	61.2%	65.8%	231.3%	82.9%
2011	70.5	56.0	59.8	173.4	89.2
2012	65.3	51.0	53.2	167.9	91.8
2013	72.9	55.7	58.38	138.16	115.2
2014	75.8	64.2	64.5	139.7	129.3

Source: Public Employee Retirement Association.

New Mexico Retiree Health Care Authority-Historic Financial Information. The RHCA was enacted for the purpose of providing comprehensive group health insurance coverage for persons who have retired from certain public service positions in the State and their eligible dependents. NMRHCA offers both pre Medicare and Medicare plans, as well as dental, vision and life insurance plans to eligible retirees. There were approximately 56,131 enrolled members as of July 2014 and approximately 300 participating public entities.

NMRHCA experienced an investment gain in Fiscal Year 2014 of approximately 17.21 percent, and NMRHCA has been able to add over $125 million to its trust fund over the past four years. NMRHCA's market value as of October 31, 2014 was $381.9 million.

The Retiree Health Care Act provides that the benefits offered to retired public employees may be modified, diminished or extinguished by the Legislature, and that the Act does not create any contract, trust or other rights in public employees to health care benefits.

NMRHCA, the agency that administers the Retiree Health Care Act, has a revenue base comprised of active employee payroll deductions, participating employer contributions, monthly premium contributions of enrolled participants, investment income, and amounts distributed annually from the Taxation Administration Suspense Fund ("TAA Fund"). Employer and employee contribution rates are established in statute as is the amount distributed from the TAA Fund. Respective employer/employee contribution rates were 2 percent and 1 percent of the participating employee's salary for Fiscal Year 2014.

Based on the GASB Statement 43 valuation for Fiscal Year 2014, and assuming that the NMRHCA Fund is an equivalent arrangement to an irrevocable trust and, hence using a discount rate of 5 percent, the UAAL has been calculated to be approximately $3.4 billion. As required by GASB Statement 43, this calculation takes into consideration only current assets of the NMRHCA Fund. The NMRHCA continues to look for additional opportunities to further strengthen the financial standing of the NMRHCA. The NMRHCA Board of Directors has passed a five-year solvency plan to ensure the long term financial stability of the program through a series of targeted benefit reductions and increases to contribution levels from participating employees and their employers. In addition to increased retiree cost sharing through plan design changes, the solvency plan calls for proportionately higher premiums for retirees who retired younger (decreased premium subsidies to pre-Medicare retirees), didn't work or pay into the system as long (increasing years of service required to receive maximum subsidy) and decreased subsidies for family members. Taken as a whole, the plan is projected to extend the life of the NMRHCA's trust fund into 2040.

As recently as 2007, the NMRHCA was projected to be insolvent as early as 2014. However, actions taken by the NMRHCA decreasing subsidy levels, increasing premiums and modifying plan designs, coupled with increases in employer/employee contribution rates have extended the NMRHCA's solvency through 2033.

GASB Statement 43 also requires the NMRHCA to report its ARC and the percentage of the ARC contributed. The following table lists the NMRHCA ARC and percentage of the ARC contributed for Fiscal Years 2010 through 2014.

TABLE 19

NMRHCA Annual Required Contribution

Fiscal Year	Annual Required Contribution	Percentage Contributed
2010	$309,919,743	34.1%
2011	$326,994,988	36.9
2012	$340,074,787	39.8
2013	$353,657,828	38.3
2014	$367,804,141	40.6
2015	$292,656,756	NA

Source: New Mexico Retiree Health Care Authority.

FINANCIAL OVERVIEW

State Auditing and Accounting Systems

The financial affairs of every agency in the State are examined and audited each year by the State Auditor, personnel of the State Auditor's office designated by the State Auditor, or by the independent auditors approved by the State Auditor, as required by Section 12-6-3 NMSA 1978. The audits are conducted in accordance with generally accepted auditing standards. The audit reports include financial statements that are presented in accordance with generally accepted accounting principles.

In July 2006, the State implemented a Statewide Human Resources, Accounting and Management Reporting System ("SHARE System"). The SHARE System, based on commonly used PeopleSoft software, replaced the State's existing central accounting system, central payroll system, personnel system, treasury reconciliation accounting and cashiering system, and 114 additional systems then in place at various State agencies. Since June 2007, the State has officially used SHARE as its book of record.

Following the transition to SHARE, the State Treasurer's audit has contained audit findings of varying severity related to the timeliness of the book to bank reconciliation. This issue stems from certain SHARE system limitations as well as required improvements to statewide accounting processes. In the

2009 Legislative session, an appropriation in the amount of $1.2 million was made to DFA, which has statutory responsibility for completion of the book to bank reconciliation, to address some of these issues. A material weakness finding related to the completion of an accurate and timely book to bank reconciliation was reported in DFA's Fiscal Year 2012 and 2013 annual financial statements.

Because the book to bank reconciliation had not been completed, as of June 30, 2012, the balance sheet of the General Fund Operating Reserve Fund booked a contingent liability for potential loss of $70 million with a corresponding loss provision. The potential loss was reported as a special item on the statement of revenues, appropriations and changes in fund balances, since it was considered to be unusual, and its placement within the financial reporting entity of the State of New Mexico is under the control of management. In June 2012, an independent expert diagnostic report revealed that State General Fund Investment Pool (the "Pool") balances were not reconciled at the business unit/fund level since the inception of SHARE on July 1, 2006. The Fiscal Year 2012 Comprehensive Annual Financial Report ("CAFR") for the State noted that the loss provision could be as high as $100 million. An additional contingent liability of $31.7 million was booked against the General Fund Operating Reserve Fund in Fiscal Year 2013, bringing the total contingent liability for cash reconciliation to $101.7 million.

The Fiscal Year 2013 CAFR, the first audited State CAFR, was submitted to the State Auditor for review in June 2014 and released in November 2014 with a disclaimed opinion. Previous CAFRs were reviewed by an independent auditor. A review of financial statements is a lower standard than an audit of financial statements. The Fiscal Year 2013 audited CAFR identified the following material weaknesses: (1) book-to-bank reconciliation; (2) interagency/interfund transactions; (3) government fund type classifications; (4) budget statements; and (5) internal control over financial reporting. DFA has implemented corrective actions to address each of these findings, some of which have already been completed. The Fiscal Year 2014 CAFR is being prepared and is scheduled to be provided to the State Auditor ahead of the previous year's schedule.

Under the direction of the State Controller/Financial Control Division Director, the Financial Control Division of the New Mexico Department of Finance & Administration (the "DFA/FCD") continues to take aggressive action to address the book-to-bank reconciliation problem. DFA/FCD has undertaken the Cash Management Remediation Project (the "Remediation Project") in partnership with the State Treasurer's Office, the Department of Information Technology, and Deloitte & Touche LLC ("D&T"), a firm with significant experience with PeopleSoft software. The purpose of the Remediation Project is to design and implement the changes necessary to reconcile the Pool in a manner that is complete, accurate, and timely. The Remediation Project will result in changes (some of which have already been implemented) to the SHARE configuration, cash accounting policies and procedures, business practices, and banking structure that will allow for the completion of timely and accurate book to bank reconciliations.

The first phase of the Remediation Project was completed in Fiscal Year 2013 and resulted in the implementation of monthly cash reconciliation of statewide cash activity on a go-forward basis beginning February 1, 2013. Prior to beginning-the second phase of the Remediation Project, DFA received a legislative appropriation to conduct a historical reconciliation of statewide cash from July 1, 2006, the implementation date of SHARE, through January 31, 2013. The work conducted by the State and D&T with respect to the historical reconciliation resulted in fifteen findings, which are documented in D&T's final report. Four findings were corrected during the first phase of the Remediation Project and one was corrected during the historical reconciliation work. An additional eight findings will be addressed during the second phase of the Remediation Project, which began in December 2014 and is expected to be completed in the spring of 2016. The remaining findings will require an assessment of the State's enterprise resource planning and financial system capabilities and a reimplementation of the State's enterprise resource planning system to convert.

The historical reconciliation project has caused DFA/FCD to conclude that it is not possible to reliably determine the dollar amount of adjustments to SHARE State General Fund Investment Pool balances at the State agency level. In light of the fact that DFA/FCD will not be able to determine the final loss provision to be booked from the results of the historical reconciliation, DFA/FCD anticipates using the State agencies' audited balances since they are the most accurate information available.

DFA/FCD has determined that when appropriate adjustments to balances are identified, differences between the agency balances reported in SHARE and the balance of the Pool will be adjusted first against the $101.7 million loss contingency accrued to the State General Fund and then, if necessary, against the State General Fund's General Operating Reserve Fund. Adjustments will not be applied to any prior period of any specific agency.

In September 2014, the DFA wrote to the former outside auditor of the State's General Fund Operating Reserve fund, alleging a material breach of certain of the auditor's contracts with the DFA, in that the auditor failed to identify and/or report that balances had not been reconciled at the agency level after the implementation of the SHARE System. The DFA requested a return of all fees paid to the auditor for compensation for audit and review work in order to avoid litigation. In October 2014, the former auditor responded that it was its belief that all of the pertinent information regarding its audit services may not have been considered, and that the former auditor was gathering information to provide what it considered a more complete perspective. To date, no litigation has been filed in this matter.

State Budgetary and Appropriation Process

All State agencies are required by Section 6-3-19 NMSA 1978 to submit completed budget forms to the DFA Budget Division by September 1 of each year. Guidelines and forms are provided to State agencies in advance of the September 1 deadline. Budget hearings to examine the merits of budget requests are scheduled through the fall and are usually completed by mid-December. The DFA Budget Division presents comprehensive budget recommendations to the Governor, as required by Section 6-3-15(B) NMSA 1978.

The Governor is required by Section 6-3-21 NMSA 1978 to submit a budget for the upcoming fiscal year to the Legislature in early January. The Governor's budget includes the executive recommendations for public education; higher education; State agencies; and historical information on prior expenditures, revenues and revenue projections, among other information. The State budget is contained in a General Appropriation Act, which also may contain proposals for supplemental and deficiency appropriations for the current fiscal year.

Upon passage by the Legislature, the Governor may sign the General Appropriation Act, veto it, veto line items or veto parts of it. After the Governor has signed the General Appropriation Act, the DFA Budget Division approves the agency budgets and monitors the expenditure of the funds beginning on July 1, the first day of the fiscal year.

State Treasurer's Investment Responsibilities

Pursuant to Sections 6-10-10(I) through 6-10-10(O) NMSA 1978, the State Treasurer, with the advice and consent of the State Board of Finance, may invest money not immediately needed for government operations. These investment responsibilities are conducted in accordance with the State Treasurer's Investment Policy (the "Investment Policy") which is adopted by the State Treasurer and approved by the State Board of Finance. The Investment Policy states that in keeping with the office's fiduciary responsibility, all investment decisions made by the State Treasurer will adhere to the following three fundamental principles: safety, liquidity and return. The Investment Policy applies to all financial assets of the State invested by the Treasurer in the exercise of the Treasurer's statutory authority or invested as directed by other agencies which have specific investment authority and for which the Treasurer acts as the investing authority. The State Treasurer is the investing authority for the State's General Fund Investment Pool, the Local Government Investment Pool, Bond Proceeds Investment Pools, the Severance Tax Bonding Fund and bond debt service funds.

In February 2014, working with the Financial Control Division, the Treasurer's Office recommended and implemented 12 new investment accounts for the State Wide Chart of Accounts in order to record all investment accounting activity on a monthly basis versus providing the information on a net basis once a year. This allows for the State Treasurer's investment transaction records to be input into the SHARE system until a $2.9 million dollar appropriation for the configuration of the PeopleSoft Treasury Management Module can be implemented. This module will allow for real time recording of all investment and cash management activity and is scheduled to be implemented once PeopleSoft Financials 9.2 is implemented.

The State Treasurer's Office invested a portion of the general fund and the State Bond Proceeds Investment Pool in the Reserve Primary Fund ("RPF"), a money market fund, in Fiscal Years 2007 and 2008 respectively. On September 15, 2008, the balance of the general fund's RPF investment was $448.7 million, and the balance of the State Bond Proceeds Investment Pool's RPF investment was $311.6 million. On September 16, 2008, the RPF net asset value fell below $1.00 and holdings in the fund were frozen. Since then, RPF has returned approximately $0.9904 per share to shareholders. On the recommendations of the independent public accounting firm performing the Fiscal Year 2011 audit of the State Treasury, the remaining positions in the RPF, $4.33 million of the general fund and $3.01 million of the State Bond Proceeds Investment Pool, were written-down in Fiscal Year 2011. On December 6, 2013, a notice from the Primary Liquidating Fund (Primary Fund-In Liquidation, formerly known as the RPF) indicated that Form 1099-DIV (the "Form") relating to calendar year 2013 was expected to be distributed on or about January 31, 2014. The Form will report a shareholder's proportionate share of each Fund's income and expense. There also may be limitations on deductibility which may reduce or eliminate the ability to deduct such expense items against any taxable income for federal, state or local tax purposes. The State Treasurer's Office has not yet received the final distribution of Primary Fund-In Liquidation Assets for the general fund or the State Bond Proceeds Investment Pool.

According to the Investment Policy, the State Treasurer's Investment Committee is appointed by the State Treasurer and the Board. The Investment Committee is an advisory committee that reviewed investment reporting and any other matters of the State Treasurer's choosing. The Investment Committee consists of five voting members: the State Treasurer or designee; the State Treasurer's Chief Investment Officer, who serves as Investment Committee Chair; the Director of the State Board of Finance or designee; and two additional members. These additional members must be participants in the private investment community or have expert knowledge or professional experience in public finance or public money investing. One member is appointed by the State Treasurer and approved by the Board and one member is appointed by the Board and approved by the State Treasurer.

In addition to the Investment Committee oversight and recommendations, the State Treasurer contracts with an independent investment advisor to provide guidance and advice on investments, market conditions and benchmarks. The investment advisor provides quarterly performance reports on all of the State Treasurer's portfolios and information relating to the economic outlook and market trends.

General Fund

The State derives the majority of its recurring General Fund revenue from four major sources: general and selective sales taxes; income taxes; taxes and royalties on natural resource production; and investment earnings both on its two permanent funds and on cash balances. Effective July 1, 1981, the Legislature repealed the property tax levy for general State operating purposes, and has not reinstated it since that time. However, the New Mexico Constitution authorizes a levy of up to four mills for general State operating purposes and additional levies for the support of State educational, penal and other institutions.

The following table lists audited revenues, expenditures and ending fund balances for Fiscal Years 2011 through 2013, unaudited revenues, expenditures and ending fund balances for Fiscal Year 2014, and projections for results for Fiscal Years 2015 and 2016.

TABLE 20

General Fund Financial Summary
Fiscal Year 2011 – Fiscal Year 2016

(Dollars in thousands)

	Actual 2011	Actual 2012	Actual 2013	Unaudited 2014	Projected 2015	Projected 2016
A. APPROPRIATION ACCOUNT						
Recurring Receipts:						
General and Selective Sales Taxes	$ 2,332,524	$ 2,428,026	$ 2,397,750	$ 2,514,262	$ 2,630,000	$ 2,763,800
Income Taxes	1,290,752	1,431,516	1,508,102	1,451,733	1,520,000	1,555,000
Severance Taxes	423,796	456,402	438,357	557,113	475,500	464,400
License Fees	49,750	49,595	50,011	51,667	51,600	51,800
Investment Income	648,431	662,588	631,786	638,851	693,900	774,200
Rents and Royalties	477,439	595,082	504,263	617,341	579,500	534,500
Miscellaneous Receipts	52,176	45,104	41,272	45,015	46,600	49,900
Tribal Revenue Sharing	65,891	68,189	70,709	67,582	70,000	53,300
Tobacco Settlement	-	-	-	-	-	-
Reversions/Adjustments	67,816	65,885	65,761	96,538	53,000	45,000
Total Recurring Receipts	**5,408,575**	**5,802,385**	**5,708,012**	**6,040,103**	**6,120,100**	**6,291,900**
Total Nonrecurring and Adjustments	**62,536**	**14,683**	**618**	**443**	**-**	**-**
Total Receipts	**$ 5,471,111**	**$ 5,817,068**	**$ 5,708,629**	**$ 6,040,547**	**$ 6,120,100**	**$ 6,291,900**
Recurring Appropriations:						
Legislative	$ 25,549	$ 23,778	$ 27,314	$ 24,495	$ 18,112	
Judicial	194,531	190,591	199,026	207,643	224,146	
General Control	173,711	156,436	160,634	176,216	181,105	
Commerce and Industry/Exam. and Lic.	50,759	43,142	43,890	46,010	50,538	
Agriculture, Energy and Natural Resources	69,299	61,551	62,814	66,424	73,153	
Health, Hospitals and Human Services	1,232,956	1,524,724	1,584,339	1,637,277	1,648,153	
Public Safety	363,110	354,101	367,803	377,493	401,562	
Other Education	26,088	27,590	52,573	68,734	107,092	
Higher Education	766,282	716,565	757,717	796,011	838,607	
Public School Support	2,309,665	2,338,422	2,402,768	2,488,742	2,608,378	
Recurring Appropriations	5,211,950	5,436,899	5,658,878	5,889,044	6,150,845	
Other Recurring Appropriations	-	-	-	-		
Total Recurring Appropriations	**5,211,950**	**5,436,899**	**5,658,878**	**5,889,044**	**6,150,845**	**6,291,900**

		Actual 2011	Actual 2012	Actual 2013	Unaudited 2014	Projected 2015	Projected 2016
	Nonrecurring Appropriations[1]	**18,254**	**77,171**	**68,225**	**36,961**	**23,050**	**0**
	Total Appropriations	**$ 5,230,203**	**$ 5,514,071**	**$ 5,727,103**	**$ 5,926,005**	**$ 6,173,895**	**$ 6,291,900**
	Transfer from/(to) Other Reserve Accounts	(804)	(40,000)				
	TRANSFER FROM/(TO) OPERATING RESERVE	**$ (240,103)**	**$ (262,997)**	**$ 18,474**	**$ (114,542)**	**$ 53,795**	**$ -**
B.	**OPERATING RESERVE**						
	Beginning Balance	**$ 36,236**	**$ 276,688**	**$ 346,945**	**$ 275,606**	**$ 273,040**	**$ 202,245**
	Revenues/Repayments/Reversions	1,366	271	92	-		
	Appropriations:						
	Contingencies	-	(70,000)	(51,700)	(99,000)		
	Other Appropriations and Adjustments	(1,016)	(1,551)	(1,257)	(1,007)	(2,000)	(2,000)
	Total Appropriations[2]	**(1,016)**	**(71,551)**	**(52,957)**	**(100,007)**	**(2,000)**	**(2,000)**
	Transfers:						
	From/(To) General Fund Appropriations Account	240,103	262,997	(18,474)	114,542	(53,795)	-
	To Appropriation Contingency Fund	-	-	-	(17,000)	(15,000)	
	To Tax Stabilization Reserve Fund	-	(121,461)	-	-		
	Total Transfers	**240,103**	**141,536**	**(18,474)**	**97,542**	**(68,795)**	**-**
	Ending Balance[3]	**$ 276,688**	**$ 346,945**	**$ 275,606**	**$ 273,140**	**$ 202,245**	**$ 200,245**
C.	**STATE SUPPORT RESERVE**						
	Beginning Balance	**$ 1,000**	**$ 1,000**	**$ 1,000**	**$ 1,000**	**$ 1,000**	**$ 1,000**
	Transfers From Operating Reserve/ Appropriation Account[4]	-	-	-	-		
	Ending Balance	**$ 1,000**	**$ 1,000**	**$ 1,000**	**$ 1,000**	**$ 1,000**	**$ 1,000**
D.	**APPROPRIATION CONTINGENCY FUND**						
	Beginning Balance, Excluding Education Reform	**$ 29,642**	**$ 5,184**	**$ 29,505**	**$ 16,394**	**$ 18,409**	**$ 16,909**
	Receipts:						
	Reversions	4,317	1,921	15,314	4,240	-	-
	Transfers From General Fund	-	40,000	-	17,000	15,000	-
	Expenditures/Appropriations:[5]						
	Disasters	(28,775)	(17,600)	(28,425)	(19,225)	(16,000)	(16,000)

		Actual 2011	Actual 2012	Actual 2013	Unaudited 2014	Projected 2015	Projected 2016
	Other	-	-	-	-	(500)	-
	Ending Balance, Excluding Education Reform	**$ 5,184**	**$ 29,505**	**$ 16,394**	**$ 18,409**	**$ 16,909**	**$ 909**
	Education Reform:						
	Beginning Balance, Education Reform	**$ 53,047**	**$ 47,047**	**$ 39,047**	**$ 9,047**	**$ 3,047**	**$ 3,047**
	Transfers In	-	-	-	-		
	Expenditures	(6,000)	(8,000)	(30,000)	(6,000)		
	Audit Adjustment	-	-	-	-	-	-
	Ending Balance, Education Reform	**$ 47,047**	**$ 39,047**	**$ 9,047**	**$ 3,047**	**$ 3,047**	**$ 3,047**
	Ending Balance, Appropriation Contingency Fund	**$ 52,231**	**$ 68,552**	**$ 25,441**	**$ 21,456**	**$ 19,956**	**$ 3,956**
E.	**TAX STABILIZATION RESERVE**						
	Beginning Balance	**$ 26,008**	**$ 26,008**	**$ 147,469**	**$ 147,469**	**$ 147,469**	**$ 147,469**
	Transfers In	-	121,461	-	-	-	-
	Transfers Out	-	-	-	-	-	-
	Ending Balance[6]	**$ 26,008**	**$ 147,469**	**$ 147,469**	**$ 147,469**	**$ 147,469**	**$ 147,469**
F.	**TOBACCO SETTLEMENT PERMANENT FUND RESERVE**[7]						
	Beginning Balance	**$ 132,031**	**$ 148,786**	**$ 148,978**	**$ 170,166**	**$ 193,461**	**$ 227,921**
	Transfers In	38,565	39,321	39,303	21,124	39,900	40,100
	Transfers Out	(38,565)	(39,321)	(39,303)	(29,354)	(19,950)	(20,050)
	Gains Losses	16,755	191	21,188	31,526	14,510	17,094
	Ending Balance	**$ 148,786**	**$ 148,978**	**$ 170,166**	**$ 193,461**	**$ 227,921**	**$ 265,065**
G.	**TAXPAYER DIVIDEND FUND**						
	Beginning Balance	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
	Transfers In	-	-	-	-	-	-
	Transfers Out	-	-	-	-	-	-
	Gains/Losses	-	-	-	-	-	-
	Ending Balance	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
H.	**TOTAL RESERVE BALANCES**						
	Beginning Balance	**$ 277,964**	**$ 504,714**	**$ 712,944**	**$ 619,681**	**$ 636,426**	**$ 598,591**
	Ending Balance	**$ 504,714**	**$ 712,944**	**$ 619,681**	**$ 636,526**	**$ 598,591**	**$ 617,735**

	Actual 2011	Actual 2012	Actual 2013	Unaudited 2014	Projected 2015	Projected 2016
Reserves as a Percentage of Current-Year Recurring Appropriations	9.7%	13.1%	11.0%	10.8%	9.7%	9.8%

Note: Detail may not add to column totals due to independent rounding.

NOTES TO GENERAL FUND FINANCIAL SUMMARY:

(1) Appropriation Account, Nonrecurring Appropriations:
FY11 includes the following appropriations from Laws 2010: $1.1 million from Section 5 of the General Appropriation Act of 2010 (2nd Special Session, Chapter 3), $1.5 million for the 2011 redistricting session (Laws 2011, Chapter 1), and $15.6 million from Section 5 and Section 6 of the General Appropriation Act of 2011 (Chapter 179).
FY12 includes the following appropriations from Laws 2008: $50 thousand for capital outlay projects for a Bernalillo county land grant.
FY12 includes the following appropriations from Laws 2011: $0.3 million 2012 election expenses and $0.5 million for Department of Health (Laws 2011, Ch. 179, Sec. 5); $1.5 million for redistricting (Laws 2011, Ch. 1); and $1.3 million for the 2011 1st Special Session (Chapter 1), $0.5 million for Medicaid and SNAP (1st Special Session, Chapter 2), and $4.0 million appropriated for police vehicles (1st Special Session, Chapter 5).
FY12 includes the following appropriations from Laws 2012: $69.1 million from Sections 5 and 6 of the General Appropriation Act of 2012 (Laws 2012, Ch. 19).
FY13 includes the following appropriations from Laws 2012: $2.5 million for supplemental funding for public schools (Laws 2012, Ch. 19, Sec. 5).
FY13 includes the following appropriations from Laws 2013: $65.7 million from Section 5 of the General Appropriation Act of 2013 (Laws 2013, Ch. 227).
FY14 includes the following appropriations from Laws 2014: $37.0 million from Sections 5 and 6 of the General Appropriation Act of 2014 (Laws 2014, Ch. 63).
FY15 includes the following appropriations from Laws 2013: $6.5 million for water litigation on interstate streams (Laws 2013, Ch. 227, Sec. 5, and reauthorized in Laws 2014, Ch. 63, Sec. 5).
FY 15 includes the following appropriations from Laws 2014: $16.6 million from Section 5 of the General Appropriation Act of 2014 (Laws 2014, Ch. 63).

(2) General Fund Operating Reserve Appropriations:
FY11 includes $1.0 million for State Board of Finance Emergency Fund.
FY12 includes $1.6 million for State Board of Finance Emergency Fund and a $70 million contingent liability established in the Fiscal Year 2012 General Fund financial statements for potential charges related to unreconciled cash transactions.
FY13 includes $1.3 million for State Board of Finance Emergency Fund, a $31.7 million contingent liability established in the Fiscal Year 2013 General Fund financial statements for potential charges related to unreconciled cash transactions, and a $20 million contingent appropriation (HB628, Laws 2013) for Special Education Maintenance of Effort funding.
FY14 includes $1.0 million for State Board of Finance Emergency Fund, a $16 million contingent appropriation (HB628, Laws 2013) for Special Education Maintenance of Effort funding, a $73 million contingent liability established in the Fiscal Year 2013 General Fund financial statements for Medicaid receivables, a $10 million contingent liability established in the Fiscal Year 2014 General Fund financial statements for Special Education Maintenance of Effort funding, and a $17 million transfer to the appropriation contingency fund to address reductions in federal funding to New Mexico agencies resulting from federal sequester.
FY15 includes $2.0 million for State Board of Finance Emergency Fund, and a $15 million transfer to the appropriation contingency fund.

(3) Year-ending Balances in the Operating Reserve:
Annually, if the balance in the General Fund Operating Reserve exceeds 8 percent of the previous year's recurring appropriations, the excess over 8 percent is transferred to the Tax Stabilization Reserve.
FY12 includes $121 million transfer from the Operating Reserve to the Tax Stabilization Fund due to the fund balance exceeding 8 percent of the previous year's recurring appropriation.

(4) Appropriation Contingency Fund Appropriations:
FY11 includes the following appropriations/transfers from Laws 2010: $28.8 million for disaster allotments; and $4.0 million for education reform appropriations from the General Appropriation Act of 2010 (2nd Special Session, Chapter 6, Section 5, Item 16).
FY11 includes the following appropriations/transfers from Laws 2011: $2.0 million for emergency support to public schools (Laws 2011, Ch. 179, Sec. 5, Item 23).
FY12 includes the following appropriations/transfers from Laws 2011: $2.5 million for education reform appropriations (Ch. 179, Sec. 5, Item 25).
FY12 includes the following appropriations/transfers from Laws 2012: $17.6 million for disaster allotments; $5.5 million for education reform appropriations (Ch. 19, Sec. 5, Items 33-34); and $40 million transferred from the general fund (Laws 2012, Ch. 19, Sec. 10).
FY13 includes the following appropriations/transfers from Laws 2012: $1.5 million for education reform (Laws 2012, Ch. 19, Sec. 5).
FY13 includes the following appropriations/transfers from Laws 2013: $28.4 million for disaster allotments, and $28.5 million for education reform (Laws 2013, Ch. 227, Sec. 5).

FY14 includes the following appropriations/transfers from Laws 2013: $17 million transfer from the operating reserve to address reductions in federal funding to New Mexico agencies resulting from federal sequester.
FY14 includes the following appropriations/transfers from Laws 2014: $19.2 million for disaster allotments, and $6 million for education reform (Laws 2014, Ch. 63, Sec. 5).
FY15 includes the following appropriations/transfers from Laws 2014; $15 million transfer from the operating reserve (Laws 2014, Ch. 63, Sec. 12) and $0.5 million for preservation of U.S. military bases contingent on federal announcement of base realignment and closure initiative.

(5) Year-ending Balances in the Tax Stabilization Reserve:
Annually, if the balance in the Tax Stabilization Reserve exceeds 6 percent of the previous year's recurring appropriations, the excess over 6 percent is transferred to the Taxpayer's Dividend Fund.
FY12 includes $121.5 million transfer from the Operating Reserve to the Tax Stabilization Fund due to the fund balance exceeding 8 percent of the previous year's recurring appropriation.

(6) Tobacco Settlement Permanent Fund Reserve (established by Laws 2003, Chapter 312).
FY11 – 100 percent of Tobacco Settlement Permanent Fund revenues, equaling $38.6 million, were transferred to the Tobacco Settlement Program Fund for Medicaid, rather than the historical 50 percent transfer (Laws 2010, Chapter 49).
FY12 – 100 percent of Tobacco Settlement Permanent Fund revenues, equaling $39.3 million, were transferred to the Tobacco Settlement Program Fund for Medicaid, rather than the historical 50 percent transfer (Laws 2011, Chapter 3).
FY13 –100 percent of Tobacco Settlement Permanent Fund revenues, equaling $39.0 million, were transferred to the Tobacco Settlement Program Fund for Medicaid, rather than the historical 50 percent transfer (Laws 2011, Chapter 3).
FY14 – Tobacco Settlement Permanent Fund revenues were reduced by approximately $18.4 million as a result of a panel decision that found New Mexico noncompliant in its 2003 enforcement of the Master Settlement Agreement. 50 percent of Tobacco Settlement Permanent Fund revenues, or $10.6 million, were transferred to the Tobacco Settlement Program Fund for Medicaid, 25 percent of Tobacco Settlement Permanent Fund revenues or $5.3 million were transferred to CYFD for early childhood learning initiatives, and 25 percent of Tobacco Settlement Permanent Fund revenues or $5.3 million were transferred to the Legislative Lottery Scholarship Fund to address solvency (Laws 2013, Ch. 228). $8.2 million was appropriated from the Tobacco Settlement Permanent Fund for Medicaid (Laws 2014, Sec. 12).
FY15 – 50 percent of Tobacco Settlement Permanent Fund revenues, or $19.9 million, are estimated to be transferred to the Tobacco Settlement Program Fund for Medicaid pursuant to Section 6-4-9C NMSA 1978.

Review of Results and Projections in the General Fund

Fiscal Year 2012. In Fiscal Year 2012, recurring general fund revenues increased to $5.8 billion. The price of oil averaged $89.64 per barrel and the price of natural gas averaged $5.00 per mcf in Fiscal Year 2012. The Fiscal Year 2012 budget contained approximately $5.4 billion of recurring appropriations. Among the measures taken to balance the budget were decreasing the fire protection fund distribution by $1.3 million, reducing the film tax credit by $23.3 million, shifting an additional 1.75 percent of annual State pension contributions from employer to employees to save $49.7 million, improving the system for payment of unemployment insurance by State agencies resulting in cost savings of $3 million, and implementing government efficiencies to save $2.5 million. General fund reserves were $712.9 million at fiscal year-end after accounting for a $70 million contingent liability established in the Fiscal Year 2012 General Fund financial statements for potential charges related to unreconciled cash transactions. The ending balance represented approximately 13.1 percent of current-year recurring appropriations for Fiscal Year 2012. The Governor expressed goals of maintaining reserves of 10 percent in future fiscal years, and providing for five-year expenditure forecasts to accompany consensus revenue forecasts. During the 2012 regular legislative session, $100.8 million in Fiscal Year 2012 non-recurring appropriations were enacted, including $55 million for Medicaid and personal care option program expenditures, as well as $6 million for the Economic Development Department's job training incentive program.

Fiscal Year 2013. New Mexico's economy stagnated in Fiscal Year 2013. Total General Fund revenues fell by 1.6 percent during this period, however, this level of decline was anticipated by the consensus group, as actual revenue came in as forecast in December 2012. Total recurring revenue was approximately $5.7 billion. Approximately half of the decline in general fund revenue was attributable to lower oil and natural gas prices, a reflection of national and international trends in energy markets and lackluster state lease sales. The price of oil averaged $85.82 per barrel and the price of natural gas averaged $4.40 per mcf in Fiscal Year 2013. Mineral production taxes, bonuses and royalties totaled $943 million in Fiscal Year 2013, a decrease of 9 percent from Fiscal Year 2012. In addition, the federal government sequestered about $21 million in Federal Mineral Leasing (FML) revenues, which were returned to the state in the early half of Fiscal Year 2014 causing a shift in revenue accounting periods.

The state's broad-based taxes grew minimally during Fiscal Year 2013, with the exception of personal income tax collections, which grew by 7.9 percent. This growth rate is partially driven by accelerated payments that were made in anticipation of federal tax changes. Fiscal Year 2013 general sales tax revenue was 1.1 percent below Fiscal Year 2012, primarily due to reduced federal procurement spending. Corporate income tax collections fell 4.9 percent compared to Fiscal Year 2012, apparently a reflection of the sluggish national rate of economic growth. Investment income to the general fund from the state's Permanent Funds also declined in Fiscal Year 2013 due to the constitutionally mandated decrease in the annual distribution from the Land Grant Permanent Fund from 5.8 percent to 5.5 percent in Fiscal Year 2013.

General fund reserves were approximately $651.4 million at the end of Fiscal Year 2013, approximately 11.5 percent of Fiscal Year 2013 recurring appropriations, after accounting for the $31.7 million contingent liability established in the Fiscal Year 2013 General Fund financial statements for potential charges related to unreconciled cash transactions. This balance also includes a $20 million contingent appropriation related to Special Education funding Maintenance of Effort.

Fiscal Year 2014. General Fund revenues rebounded from the Fiscal Year 2013 decline largely as a result of high oil and natural gas revenues. Recurring revenue grew by 5.8 percent in Fiscal Year 2014, reaching $6.04 billion. New Mexico oil prices averaged $95.14 per barrel and the price of natural gas averaged $5.13 per mcf. Strong oil and natural gas production contributed to the revenue increase with oil volume growth of 17 percent and a natural gas volume increase of 1 percent following years of declining production. In Fiscal Year 2014, oil volumes were double the amount produced in Fiscal Year 2009. Mineral production taxes, rents and royalties increased by 24.6 percent over Fiscal Year 2013 to $1.2 billion. General sales taxes, including the gross receipts tax (GRT) and compensating tax, also experienced growth of 5.2 percent. Permanent fund investment income benefited from a larger fund corpus and strong stock market returns. Income tax revenues decreased slightly, reflecting a one-time acceleration of capital gains income in Fiscal Year 2013.

Major changes were made to the corporate income tax in the 2013 legislative session to be phased in over several years. These changes reduce corporate tax rates and allow single sales factor income apportionment for manufacturers. Legislation passed in the 2014 legislative session will allow taxpayers to carry forward net operating losses (NOLs) for 20 years. While "static" estimates have projected a slight decline in revenues in the near term, these measures are likely to encourage new business investment and economic growth, with positive effects on state revenues.

The general fund reserve balance was approximately $636.5 million at the end of Fiscal Year 2014 or 11.0 percent of Fiscal Year 2014 recurring appropriations. Reserves were negatively impacted by a reduction of $73.1 million of federal Medicaid reimbursements. The reserves are also affected by a $20 million reduction in tobacco settlement distributions in Fiscal Year 2014 as a result of a recent arbitration decision that found New Mexico lacking in diligence with regards to non-participating manufacturers to the Master Settlement Agreement. In addition, the State booked a $26 million contingent appropriation related to federal special education funding maintenance of effort requirements. The State believes it has met maintenance of effort requirements, and has appealed the federal ruling, but a full resolution will likely take more than a year.

Fiscal Year 2015. Based on its December 2014 forecast, the consensus revenue group projects Fiscal Year 2015 general fund recurring revenue to increase by 1.3 percent over Fiscal Year 2014. Total recurring revenue is estimated to be approximately $6.1 billion. Revenue growth is hampered by the rapid decline in crude oil prices, which have fallen 40 percent since the end of Fiscal Year 2014. The large decrease in mineral taxes, rents and royalties is expected to be offset by growth in sales and income taxes, as well as the recent strong investment performance of the state's Permanent Funds. Insurance premiums tax revenue is forecast to increase due to the expansion of Medicaid and dissolution of the New Mexico high-risk insurance pool through implementation of the Affordable Care Act. Timing and magnitude of these changes is uncertain.

In the 2014 legislative session, the legislature and executive branch worked together to produce a budget and tax policy changes that will help build a stronger economy while funding essential public services. For the fourth straight year, spending growth was limited to just over 4 percent, a figure that is in line with the long-term growth of state revenue. Prudent spending restraint made it possible to fund targeted public school reforms, healthcare workforce initiatives and economic development funding that will have long-term benefits for the state's economy. Other significant enacted legislation included reforming the judicial and magistrate retirement programs to improve solvency through a balanced approach, and improved targeting of capital outlay funds to meet essential water and wastewater infrastructure needs and stimulate the construction economy. General fund reserves are estimated to be $598.6 million at the end of Fiscal Year 2015, or 9.7 percent of recurring appropriations.

Fiscal Year 2016. The consensus revenue group revised downward the General Fund revenue forecast in December 2014 in response to the sharp decline in oil prices seen in the first half of Fiscal Year 2015. Recurring revenue is expected to grow 2.8 percent in Fiscal Year 2016 to $6.3 billion. Due to weaker oil and natural gas prices and volumes, mineral taxes, rents and royalties are projected to decrease by 5.3 percent to just under $1 billion. General sales taxes are estimated to grow by 5.0 percent, which is consistent with historical trends, while selective sales will benefit from increases in Insurance Premiums tax revenues as a result of changes associated with the Affordable Care Act. Income taxes will continue to grow but at a slower pace due to the phase in of the corporate income tax rate reduction and single sales factor election, and investment income will continue to benefit from a larger fund corpus due to growing contributions and strong stock market gains.

New Mexico faces several challenges heading into the 2015 Legislative Session, not least of which is the reduction in "new money" – or Fiscal Year 2016 revenues less Fiscal Year 2015 recurring appropriations – resulting from the decline in oil prices. Based on the consensus revenue group's December 8, 2014 forecast, new money is projected to be $141 million in Fiscal Year 2016 or 2.3 percent of Fiscal Year 2015 recurring appropriations, which will limit budget growth to less than the 4 percent seen in previous Fiscal Years. In addition, pending a decision from the New Mexico Supreme Court, the General Fund faces a potential $20 million recurring reduction in Gross Receipts Tax revenue due to an appellate court decision that would partially hold local governments harmless for taxpayer refunds and other revenue distribution adjustments. On May 20, 2014, in the *City of Eunice v. N.M. Taxation & Revenue Department*, 2014-NMCA-085, the New Mexico Court of Appeals held that the New Mexico Department of Taxation and Revenue (the "TRD") has authority to seek repayment, or "claw back," excessive transfers of gross receipts taxes to municipalities under Section 7-1-6.15 NMSA 1978 for no more than one year prior to the year in which the error was found, regardless of who is at fault for the erroneous distributions. In *City of Eunice*, the taxpayer filed several amended tax returns asserting that the taxpayer overpaid gross receipts taxes to the TRD based on a mistaken belief that the taxpayer was located within city limits, when the taxpayer was actually located in an unincorporated portion of the county, and therefore did not have to pay the city gross receipts tax. Because individual taxpayers can amend their returns for a period of three years prior, the TRD granted the taxpayer a refund going back from 2012 through 2009, and then sought repayment from the city for the taxpayer's taxes paid to the city. The city objected. The Court of Appeals concluded that, while the taxpayer could reclaim the full amount of overpaid taxes, Section 7-1-6.15 NMSA 1978 limits the TRD to reclaim from the municipality the excess distributions going back only one year from the determination of error. This decision thus leaves the State of New Mexico obligated to refund to taxpayers overpaid gross receipts taxes for three years, but able to recover the excess gross receipts taxes paid to municipalities for only one year. The New Mexico Supreme Court granted review of *City of Eunice* on August 29, 2014.

Moreover, the General Fund risks losing up to $100 million in protests from jobs-credit claim denials following 2013 legislative changes that better targeted the credit thereby reducing General Fund exposure. Finally, the General Fund looks to gain up to $20 million in Tribal Revenue Share receipts if the 2001 Tribal Gaming Compact, which is set to expire at the end of Fiscal Year 2015, is extended.

Recent Education Funding Litigation. Recently two lawsuits were filed challenging the funding of the State's primary and secondary education system. In March 2014, individual plaintiffs in New Mexico District Court in McKinley County brought suit against the State, among others, alleging, among other things, that the State's educational funding formula violates the sufficiency of education and uniform system of public schools provisions of the New Mexico Constitution and asks the court for injunctive relief ordering the State to develop a budget and funding formula that sufficiently, uniformly and equitably funds the public school system. In April 2014, individual plaintiffs in New Mexico District Court in Santa Fe County brought suit against the State, among others, alleging, among other things, that the State has failed to provide a sufficient and uniform system of education in violation of the sufficiency, uniformly, equal protection and due process provisions of the New Mexico Constitution because of an inadequate and arbitrary funding system. The lawsuit asks for a declaratory judgment and injunctive relief requiring the adoption of a school finance system to remedy these violations. Neither lawsuit asks for a specific award of damages. Because these suits have been only recently filed, and because the allegations of violations have not been litigated or proven, the State believes it is premature to assess what effect, if any, these law suits might have on State budget matters.

General Fund Taxes and Revenues

Programs and operations of the State are predominantly funded through a system of 28 major taxes, and a substantial number of minor taxes, administered by the TRD. The Office of the Superintendent of Insurance collects taxes on insurance premiums. The Regulation and Licensing Department collects professional licensing fees and a number of charges for regulating activities and professions in the state. In addition, interest income and earnings from the Land Grant Permanent Fund, the Severance Tax Permanent Fund and cash balances invested by the State Treasurers Office provide important sources of revenue for State purposes. The most important tax and revenue sources, as measured by magnitude of revenue generation, and the application of the monies to certain funds and purposes, are described below.

Gross Receipts and Compensating Taxes

The gross receipts tax is levied on the total amount of money or the value of other consideration received from selling tangible and certain intangible personal property in the State, from leasing property employed in the State, from performing services in the State and from research and development services performed outside the State on products initially used in the State. The tax is remitted by the seller but generally passed on to the purchaser. The compensating tax is imposed generally on property used in the State but purchased elsewhere. Gross receipts and compensating taxes are due on the 25th day of the month following the month in which the transaction occurs.

The general presumption is that all receipts of a person engaging in business are subject to the gross receipts tax, even though there are over 100 specified exemptions and deductions from gross receipts taxation. Exemptions from the gross receipts tax include, but are not limited to, certain receipts of governmental agencies and certain non-profit organizations; receipts from the sale of certain vehicles; occasional sales of property or services; wages; certain agricultural products; and dividends, interest and receipts from natural gas, oil or mineral interests sales or leases. Deductions from the gross receipts tax include, but are not limited to, receipts from various types of sales or leases of tangible personal property or service; receipts from certain sales of property to governmental agencies or to certain non-profit organizations; receipts from certain processing of some agricultural products; receipts from certain publication sales; certain receipts from interstate commerce transactions; and as set forth below, certain food and medical services as of January 1, 2005.

The gross receipts and compensating taxes are together the single largest source of State General Fund revenue. The gross receipts tax is also a significant source of revenue for cities and counties. The gross receipts tax includes the 5.125 percent statewide gross receipts tax levy, plus several city and county local-option gross receipts taxes. The statewide gross receipts tax rate was increased from 5 to 5.125 percent effective July 1, 2010 as a result of action taken during the 2010 special legislative session. Receipts from the statewide gross receipts tax levy, less certain disbursements, are deposited in the State General Fund. The disbursements include 1.225 percent of the taxable gross receipts reported in each incorporated municipality to that municipality. The State Aviation Fund receives a monthly distribution equal to 4.79 percent of the reported value of jet fuel sales, and a statutory monthly distribution which increased from $167,000 to $250,000 in July 2009 as specified in Section 7-1-6.7 (D) NMSA 1978. An additional $530,000 is currently distributed monthly to the New Mexico Finance Authority's State Building Fund Bonding Fund, pursuant to Section 7-1-6.42 NMSA 1978. Pursuant to legislation enacted in 2009, that distribution to the State Building Bonding Fund will increase to $680,000 per month on the later of July 1, 2011 or upon certification that the increased distribution is needed to make debt service payments on bonds issued pursuant to Section 7-1-6.42 for construction of a new executive office building near the State Capitol in Santa Fe. The County Equalization Distribution is made annually from state gross receipts tax revenues; it has averaged $17.9 million over the past five years. After all other distributions, the General Fund share of gross receipts tax collections was 61 percent in Fiscal Year 2014 and is expected to be about 60 percent for subsequent years.

Receipts from the compensating tax, less distributions, are transferred to the state General Fund. Compensating tax distributions include 15 percent to the small cities assistance fund and 10 percent to the small counties assistance fund, and a distribution to municipalities based on the level of their taxable gross receipts. In Fiscal Year 2012, legislation increased the distribution to small cities from 10 percent to 15 percent, increased the minimum distribution to small cities from $35,000 to $90,000, and amended statute to allow for larger distributions to small counties. The distribution changes went into effect in Fiscal Year 2014.

In 2005, the Legislature made a number of changes to the state gross receipts tax laws in Sections 7-1-6.16, 7-1-6.46, 7-1-6.47, 7-9-92 and 7-9-93 NMSA 1978. The credit of 0.5 percent granted to municipalities against the statewide rate was eliminated. The tax on food for off-premise consumption and certain medical services also was eliminated. After the 2005 legislative changes, retailers are required to report receipts from sales of groceries to claim the deduction. The deduction does not apply to receipts of restaurants or sales of prepared foods. The legislation also created a gross receipts tax deduction for some receipts of licensed health care providers (broadly defined) from Medicare Part C and managed health care plans, and health care insurers. This medical deduction was modestly expanded in the 2007 legislative session. The 2005 legislation also provided for payments from the State to reimburse local governments for all lost gross receipts tax revenues due to these deductions. Legislation in 2007 froze the rate, but not the size, of these payments for counties with a population over 48,000, and municipalities with a population greater than 10,000 or greater than average per capita taxable gross receipts. In the 2013 legislative session, a bill was enacted which, among other things, will eliminate these payments to certain larger local governments over a 15 year period beginning in Fiscal Year 2016.

In Fiscal Year 2014, total distributions to the General Fund from gross receipts and compensating taxes increased by 5.2 percent over the previous fiscal year to $2.1 billion, comprising 34.3 percent of recurring General Fund revenue.

Personal Income Tax

The personal income tax is imposed on the net income of every individual resident and upon the net income from business, property, or employment of individual nonresidents. Collections, net of refunds, are deposited in the General Fund. State taxable income is generally equal to federal adjusted gross income less deductions and amounts not taxable by State or federal laws. The State allows deductions for income earned by Indians on reservations, graduated deductions for income earned by taxpayers 65 years or older, and deductions for low- and middle-income taxpayers.

New Mexico's personal income tax structure has changed significantly in recent years, starting in 2003. The Legislature enacted significant personal income tax reductions that reduced the top marginal personal income tax rate from 8.2 percent in 2002 to 4.9 percent by 2008, codified in Section 7-2-7 NMSA 1978. This law combined the Head of Household filers' tax rate with the Married, Joint and Surviving Spouse filers' tax rate, beginning in 2006. Single parents are now taxed at the same rate as married couples. Statutory changes enacted in 2005 also provided low and middle-income tax exemptions, a personal income tax exemption for medical expenses, incentives to encourage business formation in rural areas, and incentives to encourage renewable energy production in the State.

In the 2014 Fiscal Year, total distributions to the General Fund from personal income tax increased by 1.1 percent over the previous fiscal year to $1.3 billion, and generated 20.8 percent of total recurring General Fund revenue.

Current State tax rates are set forth below:

If the taxable income is:	**Married Filing Separate:**	**If the taxable income is:**	**Surviving Spouse, Married Filing Joint and Head of Household**
Not over $4,000	1.7% of taxable income	Not over $8,000	1.7% of taxable income
$4,001 to $8,000	$68.00 plus 3.2% of excess over $4,000	$8,001 to $16,000	$136.00 plus 3.2% of excess over $8,000
$8,001 to $12,000	$196.00 plus 4.7% of excess over $8,000	$16,001 to $24,000	$392.00 plus 4.7% of excess over $16,000
Over $12,000	$384.00 plus 4.9% of excess over $12,000	Over $24,000	$768.00 plus 4.9% of excess over $24,000

If the taxable income is:	**Single Including Trust and Estates:**
Not over $5,500	1.7% of taxable income
$5,501 to $11,000	$93.50 plus 3.2% of excess over $5,500
$11,001 to $16,000	$269.50 plus 4.7% of excess over $11,000
Over $16,000	$504.50 plus 4.9% of excess over $16,000

Corporate Income Tax

The corporate income tax is imposed on the net income of a corporation doing business in the State or deriving any income from property or employment in the State by Section 7-2A-3 NMSA 1978. Collections, net of refunds, are transferred to the General Fund. Corporations are required to file a return on or before the 15th day of the third month following the end of each taxable year at which time corporate income taxes are also due. A corporation is required to make estimated tax payments if the tax, net of credits, is $5,000 or more. Insurance companies do not pay corporate income tax; rather, they pay a tax on insurance premiums. Nonprofit organizations and retirement trust funds do not pay corporate income tax.

Tax rates are established under a graduated table and range from 4.8 percent on the first $500,000 or less of taxable income to 7.6 percent on income in excess of $1,000,000. For the 2014 Fiscal Year, total distributions to the General Fund of net receipts from corporate income taxes are projected to have totaled $196.8 million. This is a decrease of 26.3 percent from the prior fiscal year and generated 3.3 percent of recurring General Fund revenue.

In recent years, a number of credits administered through the corporate income tax system have been enacted. These include: the film production credit, enacted as Section 7-2F-1 NMSA 1978; the real property tax credit, enacted as Section 7-2-18.10 NMSA 1978; the rural jobs tax credit, enacted as Section 7-2E-1 NMSA 1978; the biodiesel production and sale credit, enacted as Section 7-2-18.21 NMSA 1978; the sustainable building tax credit, enacted as Section 7-2-18.19 NMSA 1978; and the renewable energy production tax credit, enacted as Section 7-2A-19 NMSA 1978. The 2011 Legislature placed a cap of

$50 million per year on the film production tax credit, and added a deferred payment process for larger productions. In the first year of enactment, Fiscal Year 2012, film credit refunds totaled $10 million, partly due to the rush to file claims in Fiscal Year 2011 prior to enactment of the cap. In Fiscal Year 2013 and Fiscal Year 2014 claims reached the $50 million cap, and the consensus revenue group expects the film credit cap to be reached in subsequent Fiscal Years.

In the 2013 legislative session, House Bill 641 (Chapter 160) was enacted, which will reduce the State corporate income tax rate over several years to a maximum marginal rate of 5.9 percent. The legislation also allows manufacturers in the State to use sales as a single factor in calculating income tax liability. The Legislation also requires certain corporate taxpayers to adhere to mandatory combined reporting of unitary corporations for tax purposes. During the 2014 legislative session, Senate Bill 106 (Chapter 53) was enacted extending the net operating loss carryforward to 20 years from 5 years in prior law.

Mineral Production Taxes

Mineral production taxes (Resource Excise Tax, Natural Gas Processors Tax, Oil and Gas Conservation Tax, and Oil and Gas Emergency School Tax) are levied on producers and others on the value of severed minerals and material resources from within the State and these taxes are disbursed to the General Fund. The Oil and Gas Emergency School Tax is imposed for the privilege of engaging in the business of severing oil, natural gas, liquid hydrocarbons and carbon dioxide (“CO_2”) from the soil of the State. The Oil and Gas Emergency School Tax is imposed at a rate of 3.15 percent of taxable value of oil and 4 percent of taxable value for natural gas. Taxable value reflects gross sales value less deductions for royalties paid to government entities and for certain processing and transportation expenses. The same definition of taxable value is used for calculation of oil and gas severance tax liability.

In the 2014 Fiscal Year, distributions to the General Fund from Oil and Gas Emergency School Tax receipts totaled $500.7 million. This represents a 31.8 percent increase from the prior fiscal year. Other General Fund taxes on natural resource production totaled $56.4 million. For Fiscal Year 2014, mineral production taxes contributed 9.2 percent of recurring General Fund revenue.

In 2002, the Legislature created the Jicarilla Apache Tribal Capital Improvement Tax Credit, codified in Section 7-31-27 NMSA 1978. This tax credit can reduce the Oil and Gas Emergency School Tax on products severed from wells drilled on the Jicarilla Apache Nation by up to 0.7 percent of the taxable value of production. Proceeds of the tax credit must be used exclusively to fund capital improvement projects on Jicarilla Apache tribal lands, although funds may not be used to finance commercial activity. This credit totaled $1.1 million for Fiscal Year 2014.

In April 2013, the County of Mora, New Mexico, became the first county in the United States to pass an ordinance that bans hydraulic fracturing. The County of San Miguel, New Mexico, had in place a moratorium on hydraulic fracturing since around 2010, and recently, in November 2014, it passed an ordinance that bans hydraulic fracturing entirely in one portion of the county and imposes strict requirements for the practice in another portion. In November 2013, the Independent Petroleum Association of New Mexico trade group and three Mora County property owners sued Mora County in federal district court over the ordinance, in *Vermillion v. Mora County*, 13-CV-01095 CG/GBW. In January 2014, SWEPI Limited Partnership, a subsidiary of Royal Dutch Shell, filed a second lawsuit against Mora County also in federal district court, in *SWEPI v. Mora County*, 14-CV-00035 JB-SCY. These lawsuits challenge the ordinances as violating the residents’ and SWEPI’s rights under the First, Fifth and Fourteenth Amendments to the United States Constitution, their corresponding rights under the New Mexico Constitution, and also challenge the ordinances as invalid under the United States Constitution’s Supremacy Clause.

On January 19, 2015, in *SWEPI v. Mora County*, the Honorable James O. Browning, United States District Judge for the District of New Mexico, invalidated several provisions of the Mora County ordinance which he found to be in conflict with federal law, and therefore in violation of the Supremacy Clause, other provisions he found to violate SWEPI's constitutional rights, and others he found to conflict with New Mexico state law. Because the invalid provisions in the ordinance could not be severed from the ordinance's remaining provisions, Judge Browning invalidated the ordinance entirely. The sister lawsuit, *Vermillion v. Mora County*, remains pending in federal court with a summary judgment motion filed by the plaintiffs against Mora County awaiting a decision. While Judge Browning's invalidation of the Mora County ordinance is not binding on the *Vermillion v. Mora County* decision, it is likely that the two judges from the same federal district court will reach the same conclusion. If the conclusion in *SWEPI v. Mora County* is reached in *Vermillon v. Mora County*, such decisions will re-allow the practice of hydraulic fracturing in Mora County. Such decisions could also likely lead to challenges seeking to invalidate the San Miguel County hydraulic fracturing prohibition and the restrictions that the San Miguel County ordinance put in place on the other portion of the county. The *SWEPI v. Mora County* decision could presumably also dissuade, if not prevent, other counties and municipalities from enacting such bans in the future.

Royalties, Rents and Bonuses

Federal Lands. Under terms of the 1920 Federal Mineral Leasing Act, the State receives 50 percent of all income generated from leasing federal lands located in the State for mineral production. Principal sources of income are royalty payments on oil and natural gas production. Additional income is derived from bonus payments for oil and natural gas leases and royalty payments on production of coal, potash and other minerals. The U.S. Office of Natural Resources Revenue, part of the former Minerals Management Service, collects federal mineral lease income and deducts 2 percent from the State's share for administrative costs. The State receives payments on a monthly basis and makes deposits to the General Fund. In Fiscal Year 2014, total distributions to the General Fund from federal mineral leases totaled $569.9 million. This equals 9.4 percent of recurring General Fund receipts for the fiscal year.

Federal Fiscal Year 2009 appropriations bills implemented a 2 percent administrative fee cut from the federal royalty payments to states. This 2 percent fee was extended each federal fiscal year since 2009, and extended for 10 years in the 2013 Bipartisan Budget Act. Approximately $10.2 million was deducted from the federal mineral leasing payments to the State in Fiscal Year 2012, $9.7 million was deducted in Fiscal Year 2013, and $11.9 million was deducted in Fiscal Year 2014.

In Federal Fiscal Year 2014, federal mineral leasing revenues were sequestered at the rate of 7.2 percent, totaling $42.9 million. These revenues were returned to New Mexico at the beginning of Federal Fiscal Year 2014. The sequestration of these revenues was extended in Federal Fiscal Year 2015 at the rate of 7.3 percent or an estimated $3.0 million per month. These revenues are expected to be returned to the State in Federal Fiscal Year 2016.

State Trust Lands. The Commissioner of Public Lands and the State Land Office manages lands acquired by the State under the federal Fergusson Act and the Enabling Act for New Mexico enacted prior to statehood, as well as under the State Constitution. All income from State trust lands is dedicated to specific institutions; each section of State trust land has a specific named beneficiary institution. As with federal lands, the oil and natural gas industry is the principal source of revenue from State trust lands. Bonus income is also collected in the form of cash payments as a result of competitive bidding for State leases. Rentals and bonus income are distributed to the respective beneficiary institutions. The largest beneficiary group is the State's public school system. Mineral production from State trust lands also generates royalty income which is deposited in the State Land Grant Permanent Fund ("LGPF"). Royalties are imposed on most mineral production values at the rate of 12.5 percent, although there is a provision for rates of up to 20 percent for new leases on developed acreage. LGPF beneficiaries and "State lands" beneficiaries are the same institutions and public schools. In Fiscal Year 2014, distributions to the General Fund from the State Land Office totaled $47.5 million, which equaled 0.8 percent of recurring General Fund receipts for the fiscal year.

Severance Tax Permanent Fund and the Land Grant Permanent Fund

The Severance Tax Permanent Fund ("STPF") was established in the State Treasury in 1973 to receive the residual revenues from the Bonding Fund and serve as an endowment for future capital projects. In 1976, the electorate approved a constitutional amendment giving the STPF constitutional status. In 1982, the electorate approved a second constitutional amendment that removed the discretionary power of the Legislature to appropriate funds from the corpus of the STPF, thereby creating a permanent endowment fund. Distributions from investments of the STPF, however, may be appropriated by the Legislature in the same manner as other general revenues are appropriated. Severance tax receipts have been the primary source of funding for the STPF. The State Investment Council ("SIC") invests the corpus and non-appropriated income of the STPF. The market value of the STPF as of June 30, 2014 was approximately $4.77 billion, an overall asset increase of approximately 14.4 percent from the prior Fiscal Year. Investment performance for the one year period ended June 30, 2014 was 15.75 percent, 0.70 percent below the Fund policy index. Funds on deposit in the STPF are not pledged to and may not be used to pay any Bonds.

The LGPF is designed solely to benefit the public educational system of the State and other specified institutions. The origins of the LGPF are found in the federal Fergusson Act of 1898, which granted two sections of land in every township for the benefit of the public schools in the territories of New Mexico. Also under this Act, specific acreage was granted to individual education, medical and penal institutions in the territory. The initial grant totaled in excess of 5.5 million acres. In 1910, the Enabling Act granted additional lands to various beneficiaries in New Mexico, including the public schools, which received the largest share. This brought the total lands placed in trust for the common school system and other beneficiaries to over 13 million acres. Over the years, some land has been sold (and the proceeds used to increase the corpus of the LGPF), so the current total is nine million surface acres and 13.4 million subsurface acres.

Pursuant to Section 19-1-1 NMSA 1978, the State Land Office is charged with the custody and disposition of the land granted to the State. The Commissioner of Public Lands sells or leases these properties in accordance with the provisions of the appropriate statutes. The SIC invests the corpus and income of the LGPF. As of June 30, 2014, the market value of the LGPF was approximately $14.35 billion, an asset increase of approximately 17.6 percent over the prior fiscal year. Investment performance for the year ended June 30, 2014 was 15.67 percent, and 0.78 percent below the LGPF's policy index. The corpus of the LGPF is constitutionally protected from appropriation and LGPF assets are not pledged to and may not be used to pay debt. The LGPF is also protected by the Federal Enabling Act of 1910.

In November 1996, the State electorate approved a constitutional amendment regarding distributions from both of the State's permanent funds. Distributions are now calculated on a total return basis rather than an income distribution method. In addition, distributions to beneficiaries are now based on a formula under which a statutorily specified percentage of the previous average five-year market value of the fund is distributed.

In September 2003, the State electorate approved a constitutional amendment increasing the rate of annual distribution from the LGPF from the previous 4.7 percent, to a new base distribution of 5 percent of the LGPF's five-year average market value, beginning in Fiscal Year 2005. Certain additional distributions shall be made to implement and maintain educational reforms as provided by law. An additional 0.8 percent was distributed in fiscal years 2005 through 2012 and an additional 0.5 percent will be distributed in fiscal years 2013 through 2016. A three-fifths majority of each house of the Legislature may suspend this additional distribution.

In May 2009 an investigation by the New York Attorney General into placement fees paid in relation to investments made by New York pension funds, led to an indictment of an investment advisor to that fund as well as New Mexico SIC and ERB. The investment advisor later pled guilty to a fraud charge relating to investments made by the New York retirement fund. In connection with that plea, the investment advisor stated that from 2004 to 2009 his business had acted as an advisor to the SIC and the ERB and that, contrary to his fiduciary responsibilities to the SIC and ERB, he ensured recommendations of certain proposed investments pushed on him by politically connected individuals or their associates who stood to benefit financially or politically from the investments, and that the investments were not necessarily in the best interests of the State. To date, no criminal charges have been filed by state or federal investigators in New Mexico. In May 2011, the SIC, filed recovery lawsuits against more than a dozen placement agents, the former State Investment Officer, and other individuals, alleging that these individuals improperly benefited from pay-to-play and kickback schemes involving SIC investments. To date, settlements of more than $29 million have been placed in escrow pending final approval by the courts, or in some cases, delivered to the permanent funds. Additional legal recovery efforts are ongoing. Additional settlements and trials are anticipated in 2015 and 2016.

In response to these and other events and the negative returns suffered by the State's various investment funds during the market turmoil associated with the downturn in the nation's economy in 2008 and 2009, the Board and the Legislative Council Service ("LCS") co-sponsored an Independent Fiduciary and Operational Review of State Investment Policies, Procedures and Practices prepared by Ennis, Knupp & Associates. Inc. (the "Review"). The scope of the work of this Review included, among other things, review and recommendations for appropriate governance and organizational structure, and investment best practices for investing agencies. The findings and recommendations of the Review were reported to the Board at a meeting on January 13, 2010. In order to address certain recommendations of the Review, during the 2010 legislative session the Legislature, among other things, modified the composition of the SIC, clarified the authority of the SIC and the State Investment Officer, provided for the appointment of the State Investment Officer by the SIC and changed the method of appointment of public members of the SIC. Removal of individual investment authorization powers by the Investment Officer alone, and addition of Council Investment, Audit, Governance and legal Committees have greatly improved Council practices and governance procedures. In an October 2013 strategic planning session, the SIC asked the consulting group now known as Hewitt-EnnisKnupp to revisit the SIC's recent efforts to improve the SIC's investment and operational practices, and assist the SIC in its continuing efforts to expand reforms. The SIC later endorsed a 2013 Strategic Planning Summary report and plan produced in conjunction with this effort.

Investment Income

Investment earnings credited to the General Fund are from three primary sources: the LGPF, the Severance Tax Permanent Fund, and cash balances invested by the State Treasurer. A percentage of market value from the LGPF is distributed among the beneficiary institutions and public schools. The allocation received by the public schools, which is approximately 84.2 percent, is deposited in the General Fund. For the 2014 Fiscal Year, $449.4 million of LGPF distributions were transferred to the General Fund for public school purposes. The State distributed $170.5 million of income from the Severance Tax Permanent Fund, all of which was deposited in the General Fund. In the 2014 Fiscal Year, the Treasurer's cash balances produced $19.0 million for the General Fund. Total investment income credited to the General Fund was $638.9 million. This is 10.6 percent of recurring General Fund receipts.

PROPERTY VALUATION AND TAXATION

Property Tax System

With certain limited exceptions, real and personal property owned by individuals or corporations is subject to *ad valorem* taxation (i.e., taxation as a fraction of value rather than on a per unit basis) in the State. County assessors are responsible for appraising most of New Mexico's residential and commercial property. The Appraisal Bureau of the TRD provides technical assistance to county assessors and helps them implement the Property Tax Code (Articles 35 through 38 of Chapter 7 NMSA 1978).

The State Assessed Property Bureau of the TRD, commonly known as the Central Assessment Bureau, is responsible for assessing certain types of property that are not assessed by counties because assessing the property is exceptionally technical or because the property extends across county boundaries. Assessments undertaken by the Central Assessment Bureau, referred to as central valuations, are performed on the following types of properties:

- Railroads;
- Communication systems;
- Pipelines;
- Public utilities;
- Airlines;
- Electric generating plants;
- Construction machinery and equipment, and other personal property of persons engaged in construction that is used in more than one county; and
- Mineral property, excepting oil and natural gas related property.

Property valuations are established as of January 1 of each year (except for certain livestock). Centrally assessed property is verified and certified to local assessors who combine the values with all locally assessed property values. The totals are reported to the Central Assessment Bureau and the DFA, and certified for budgetary use. County treasurers levy the applicable rates against individual properties and are required to mail tax bills for the current tax year no later than November 1. Property taxes are due in two equal installments on November 10 and April 10. Taxes become delinquent on December 10 and May 10 following the two respective due dates. Civil penalties and interest are imposed on delinquent taxes. County treasurers are responsible for collecting property taxes and distributing them to governmental entities that receive them. Major property tax recipients include counties, municipalities, and school districts. In Property Tax Year 2013, 4.7 percent of property tax collections statewide were distributed to the State for payment of principal of and interest on general obligation bonds.

State law provides a mechanism by which, in the event of a dispute with respect to property taxes owed, a taxpayer may make payment under protest. Such monies may not be spent by property tax recipients until the taxpayer's claim has been decided. At that time, the monies are distributed either to the county or the taxpayer, depending on the outcome of the taxpayer's claim. As a result, counties may experience delays in receiving tax revenues or may be required to refund monies already received.

Except for property that by statute is subject to special methods of valuation, assessed value of property is generally its market value as determined by the sales of comparable property subject to certain limitations. Income or cost valuation methods also are used when appropriate. Residential properties are eligible for a $2,000 head of family exemption. A $4,000 veteran exemption may be applied against residential and certain nonresidential property. Honorably discharged members of the armed services are eligible for the veteran exemption. Taxable value is one-third of assessed value, as required by Section 1 of Article VIII of the New Mexico Constitution. Net taxable value, against which rates are imposed, consists of taxable value less exemptions. Maximum property tax rates for operations for various types of local governments are imposed by the Constitution of the State and by governing statutes. See "Property Tax Limitations," below. Different tax rates typically apply to residential and non-residential properties in the same tax jurisdiction due to the state's "yield control" statute (Section 7-37-7.1 NMSA 1978), which is applied separately to residential property.

Oil and natural gas properties and related production equipment are subject to property taxation in the State. The oil and natural gas *ad valorem* production tax is levied and collected by the Oil and Gas Bureau of the TRD on the basis of assessed value deemed the equivalent of 50 percent of the actual price of oil and natural gas received at the production unit multiplied by the volume of oil and natural gas produced, less certain trucking expense deductions and royalties paid to the federal government, the State, or Indian tribes. The oil and natural gas production "equipment *ad valorem* tax" is levied based on assessed value deemed equivalent to 9 percent of the previous calendar year sales value of the product from each production unit. The tax year for oil and natural gas production begins on September 1 based on tax rates that are set on August 31. The oil and natural gas "*ad valorem* production tax" is due by the 25th day of the second month following the month of production. Taxes are collected monthly. The oil and natural gas production "equipment *ad valorem* tax" is due on November 30 based upon assessments issued on or before October 15. The TRD distributes its collections to the county treasurers who further distribute the tax revenues to property tax recipients.

Property Tax Valuation Limitations

The valuation of oil and natural gas production and the assessment of the *ad valorem* production tax are based on the actual value of production on a monthly basis from September 1 to August 31. Oil and natural gas are valued for the calendar year preceding the property tax year, as established in Section 7-32-15 NMSA 1978. For rate setting, the Local Government Division of the DFA may adjust the State levy for changes in oil and natural gas values.

In November 1998, the New Mexico electorate approved an amendment to Section 1 of Article VIII of the State Constitution to authorize the Legislature to limit increases in residential property valuation for property taxes. The limitation may be applied to classes of residential property taxpayers based on owner-occupancy, age or income. The limitations may be authorized statewide or at the option of a local jurisdiction and may include conditions. Any valuation limitations authorized as a local jurisdiction option shall provide for applying statewide or multi-jurisdictional property tax rates to the value of the property as if the valuations increase limitation did not apply. This amendment and related legislation may have an impact on future property taxation increases.

The 2000 Legislature passed and the Governor signed legislation limiting the increase in the value of residential property for property valuation purposes. Section 7-36-21.3 NMSA 1978 provides for a freezing of values for single-family dwellings occupied by certain low-income owners 65 years of age or older. Another law provides that the value of a residential property in any tax year, starting with the year 2001, shall not exceed certain percentage increases based on whether the county where the property is situated has a sales assessment ratio of at least 85 percent, as codified in Section 7-36-21.2 NMSA 1978. Sales assessment ratios are computed annually by the TRD and measure a county's assessment valuations against current sales information. Counties that have at least an 85 percent sales assessment ratio are considered "current and correct" while counties that fall below that threshold are considered not "current and correct." If a property is situated in a current and correct county, the law limits the annual increase to no more than 3 percent (and 6.1 percent over the value two years ago). If a residential property is situated in a county that is not current and correct, the law limits the annual increase to 5 percent. In addition, in such a non-current and correct county, the law limits the aggregate annual increases for all residential properties (excluding net new properties added to the tax rolls) in that county to 3 percent. The annual limitations do not apply to new improvements or to any property that has had a change in ownership, use or zoning during the year.

The 2005 Legislature passed and the Governor signed a bill, codified as Section 7-38-12.1 NMSA 1978 of the Property Tax Code, requiring the disclosure only to the County Assessor of sale prices and other items of value upon the sale of residential real property. This amendment has led to an increase in the assessed value of some residential properties.

The 2008 Legislature passed and the Governor signed legislation amending Section 7-36-15 NMSA 1978 to require county assessors to consider, in determining the market value of residential housing, any decrease in value that would be realized by an owner in the sale of the property because of the effects of any affordable housing subsidy, covenant or encumbrance under a federal, state or local housing program that restricts the future use or resale value of the property, or otherwise prohibits the owner from fully benefiting from any enhanced value of the property.

Several legal challenges were brought in response to the Legislature's enactment of Section 7-36-21.2 NMSA 1978, because of the exception to the annual valuation cap for residential properties which experienced a change in ownership in the previous tax year. This exception resulted in acquisition-value taxation, and also resulted in instances in which the property's valuation based on its fair market value at the time it changed ownership was much greater than its previously-capped valuation, also known as "tax lightning." In these situations, the new property owner faced greatly increased property taxes compared with the previous owner. Several lower courts concluded that the exception therefore violated Article VIII, Section 1 of the New Mexico Constitution by creating an inappropriate classification of taxpayers.

On March 28, 2012, in *Zhao v. Montoya*, 2012-NMCA-056, on certification from the district court for Bernalillo County, the New Mexico Court of Appeals reversed the district courts, and held that the change-of-ownership exception to the valuation cap on residential property values until a change of ownership occurs does not violate the New Mexico Constitution. The Court of Appeals reasoned that, given that the owner-occupancy class consists of persons who became owner-occupants only upon acquisition of the property, the exception applies to a sub-class of the constitutionally permissible owner-occupancy class.

On June 30, 2014, in *Zhao v. Montoya*, 2014-NMSC-025, the New Mexico Supreme Court affirmed in part and reversed in part the Court of Appeals' decision. The New Mexico Supreme Court agreed with the Court of Appeals that the change-of-ownership exception to the valuation cap for residential properties is constitutional, albeit on other grounds. The New Mexico Supreme Court stated that the Court of Appeals' holding based on the taxpayers' classification "creates the impression that ownership alone may equate to owner-occupant." The New Mexico Supreme Court held instead that the change-of-ownership exception to the valuation cap is constitutional because it focuses on the nature of the property, when it was acquired, and not on the classification of the taxpayer, whether the taxpayer is an owner-occupant.

Thus, although the Supreme Court's decision in *Zhao* focused on the constitutionality of the exception to the annual limitations on residential property revaluation, its holding supports that the New Mexico Property Tax Code is constitutional, including the general annual valuation cap. *Zhao* also supports that the Property Tax Code's additional exceptions to the cap for properties which have changed use or which have been subject to a zoning change during the previous year are also constitutional, as they similarly focus on the nature of property, rather than on the taxpayer.

While the Supreme Court declared the change-of-ownership exception to the revaluation limitation constitutional, it remains to be seen whether county assessors around the State who stopped the practice of revaluing properties at their current fair market value upon a change of ownership will re-institute it. If the county assessors re-institute acquisition-value taxation under the exception, it will likely increase property tax revenue going forward, barring any material reduction in residential property values statewide. Any such reduction could result in a diminution of state general obligation bond capacity. Additionally, limitations on assessments could cause an increase to the property tax levied against tax payers necessary to pay debt service on state general obligation bonds.

Table 20 sets forth the aggregate statewide net taxable valuations for the last 10 years.

TABLE 21

Final Net Taxable Valuations
(Dollars in thousands)

Property Tax Year	Residential	Non-Residential	Oil and Gas	Copper	Net Taxable Value
2005	$21,120,378	$12,161,447	$4,643,270	$65,157	$38,910,768
2006	23,016,630	12,605,105	7,259,891	103,402	42,985,028
2007	25,805,629	14,458,192	5,758,696	133,262	47,288,631
2008	27,798,246	15,259,324	7,245,955	160,279	50,463,804
2009	29,455,894	16,383,859	9,033,975	172,481	55,046,209
2010	29,845,647	16,513,415	4,556,355	125,538	51,040,955
2011	30,265,867	16,594,029	5,868,724	117,476	52,846,098
2012	30,794,394	16,639,038	6,938,090	119,440	54,490,962
2013	31,320,905	16,824,354	6,431,256	149,491	54,726,006
2014	31,678,950	17,161,038	7,710,780	184,736	56,735,505

Source: New Mexico Department of Finance and Administration, Local Government Division.

Property Tax Mill Levy Limitations

Section 2 of Article VIII of the New Mexico Constitution states:

Taxes levied upon real or personal property for state revenue shall not exceed four mills annually on each dollar of the assessed valuation thereof except for the support of the educational, penal and charitable institutions of the state, payment of the state debt and interest thereon; and the total annual tax levy upon such property for all state purposes exclusive of necessary levies for the state debt shall not exceed ten mills; provided, however, that taxes levied upon real or personal tangible property for all purposes, except special levies on specific classes of property and except necessary levies for public debt shall not exceed twenty mills annually on each dollar of the assessed valuation thereof, but laws may be passed authorizing additional taxes to be levied outside of such limitation when approved by at least a majority of the qualified electors of the taxing district who paid a property tax therein during the preceding year voting on such proposition.

Currently the State imposes no levy of property taxes except for the payment of State debt.

Statutes establish maximum property tax rates for operating purposes for cities, counties and school districts. The DFA is permitted by statute to set a rate at less than the maximum rate in any tax year. These maximum property tax rates for operating purposes are set forth below:

Maximum Operating Mill Levy Rates

Counties	11.85
Cities	7.65
Schools	0.50
Maximum combined statutory rate	20.00

Source: Section 7-37-7(B) NMSA 1978.

Apart from the allowable operating tax rates above, New Mexico governments may levy additional property taxes as authorized by statute and voter approval for:

- Debt service;
- County hospitals and health care services;
- School district capital improvements;
- Branch and community colleges;
- Vocational schools;
- Flood control districts and authorities;
- Judgments;
- Water and sanitation districts;
- Conservancy districts;
- Public improvement districts;
- Tax increment development districts; and
- Other special districts.

In addition, the Legislature has established certain limits on the increase in property tax revenue that may be realized for county and city operating purposes. The "yield control" formula is activated by property valuation increases resulting from county assessor reappraisal programs. The yield control law limits the increase in operating revenue from existing properties in absence of new rate impositions in any one year over the prior year to the lesser of 5 percent or the percentage increase in the annual price index published by the United States Department of Commerce for State and Local Government Purchases of Goods and Services, plus increases in tax revenues resulting from new construction, improvements to properties and increased taxable value due to annexation.

Production and Property Taxes on Oil and Natural Gas

Current effective production tax rates expressed on ad valorem and unit bases are shown below. The rates were based on data from Fiscal Year 2014 and reflect an average sales price of $95.14 per barrel for oil and $5.13 per thousand cubic feet (mcf) for natural gas. The gross rates presented in the table below show taxes paid as a percentage of gross sales value before subtracting allowable deductions and tax credits. The gross tax per unit is also based on gross sales value. The net tax per unit, however, is also based on taxable value before subtracting allowable deductions and tax credits.

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TABLE 22

Effective Tax Rates applicable for Fiscal Year 2014

	Crude Oil		Natural Gas	
Type of Tax	**Ad Valorem**	**Per Barrel**	**Ad Valorem**	**Per mcf**
Price		$95.14		$5.13
Oil and Gas School Tax	2.79%	$2.65	3.06%	$0.16
Oil and Gas Severance Tax	3.32%	$3.16	2.88%	$0.15
Oil and Gas Conservation Tax (General Fund only)	0.21%	$0.20	0.15%	$0.01
Natural Gas Processors Tax	N/A	N/A	0.27%	$0.01
Oil and Gas Production *ad valorem* Tax	1.00%	$0.95	0.93%	$0.05
Oil and Gas Production Equipment *ad valorem* Tax	0.15%	$0.14	0.26%	$0.01
Total	**7.46%**	**$7.10**	**7.53%**	**$0.39**
Subtotal: State Tax Only (excludes *ad valorem* taxes)	6.32%	$6.01	6.08%	$0.31

Source: New Mexico Department of Finance and Administration.

Production, Sales, and Property Taxes on Coal

Total State production and property taxes on coal totaled approximately $20.4 million in Fiscal Year 2014, down from approximately $23.5 million in Fiscal Year 2013. Coal production, also, decreased from approximately 22.6 million tons in Fiscal Year 2013 to approximately 18.5 million tons in Fiscal Year 2014. Thus, the average effective tax per ton increased from approximately $1.03 in Fiscal Year 2013 to approximately $1.11 per ton for Fiscal Year 2014. With total sales revenue of approximately $665.1 million in Fiscal Year 2014, the average effective tax was 3.11 percent of total sales revenue. This does not include the gross receipts tax. The average burden of production, property, and gross receipts taxes on a ton of coal produced and sold during Fiscal Year 2014 is shown in Table 23.

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TABLE 23

Tax Burden on Coal for Fiscal Year 2014

Type of Tax	Tax per Ton	Effective Tax Rate	Taxes Collected
Severance Tax and Surtax (Net of ITC)	$0.55	1.54%	$ 10,072,106
Resource Excise Tax	$0.26	0.72%	$ 4,704,565
Conservation Tax	$0.06	0.18%	$ 1,188,391
Total Production Taxes	$0.87	2.44%	$ 15,965,062
Property Tax	$0.24	0.67%	$ 4,410,567
Gross Receipts Tax	$2.30	6.48%	$ 42,414,698
Total Production and Non-Production Taxes	$3.41	9.59%	$ 62,790,327

Price per Ton	$35.47
Total Production (Short Tons)	18,466,917
Total Value	$654,998,911

(1) The figures reported in this table come from the New Mexico Taxation and Revenue Department's GenTax System. They reflect only the information contained in all tax returns and amendments filed during Fiscal Year 2013. These figures differ from actual distributions made by the Taxation and Revenue Department's Financial Services Bureau, as the distributions include penalties, interest, and other modifications such as previously unallocated or unidentified receipts. Total production is based on volumes reported on severance tax returns, which differ from the volumes reported on resource excise tax returns.

(2) Property taxes were billed for tax year 2013.

Source: *New Mexico Taxation and Revenue Department, Tax Analysis, Research and Statistics Office (the GenTax System, Financial Services Bureau and Property Tax Division's Central Assessment Unit).*

Statutory rates for the resources excise tax and the conservation tax are effectively reduced by a deduction for Federal, State and Indian royalties. The effective severance tax rate on coal reflects the mix of old and new contract sales and of underground and surface mines. Property tax pertains to both equipment and production values. Fundamental differences in tax bases preclude a true comparison between property taxes and other taxes shown above. However, property taxes are included in this analysis to prevent understating the tax burden.

In addition to production taxes, gross receipts tax is imposed on coal produced and sold within the State. During 2012, the most recent year for which data is available, 63.1 percent of all coal produced in the State was supplied to electric power plants in New Mexico. 94.7 percent of all coal produced in New Mexico is subject to gross receipts tax. The combined state and local tax rate for Fiscal Year 2014 is 6.483 percent of taxable gross receipts.

ADDITIONAL INFORMATION

Additional financial information from government agencies of the State may be obtained online from the State's Sunshine Portal. The information contained in the Sunshine Portal database may change over time. The State Board of Finance assumes no responsibility or liability for the contents of the Sunshine Portal. The State Board of Finance also maintains a website containing general information about the State and its bond programs.