

## New Mexico

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**Credit Profile**

US\$73.745 mil GO bnds rfdg ser 2008A due 03/01/2009-2013

<i>Long Term Rating</i>	AA+/Stable	New
New Mexico GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

**Rationale**

Standard & Poor's Ratings Services assigned its 'AA+' rating to New Mexico's 2008A general obligation (GO) bonds and affirmed its 'AA+' rating on New Mexico's existing GO debt.

The rating reflects the state's:

- Sustained, strong financial performance with general fund reserves above 10% of recurring appropriations over the past four years;
- Stable and gradually diversifying economic base; and
- Moderate total tax-supported debt burden with very rapid amortization.

The full faith and credit of the state including an unlimited ad valorem tax on taxable property in the state secures the bonds. The state will use bond proceeds to refund a portion of existing series 2001 and series 2003 bonds.

In 2007, New Mexico served a population of 1.96 million, maintaining its ranking as 36th most-populated state in the nation. Although New Mexico's dependence on national defense has diminished over the past 10-15 years, related employment remains significant. Kirtland Air Force Base and Sandia National Laboratories in Albuquerque and Los Alamos National Laboratories are among the state's leading employers. Additional leading employers in the state include University of New Mexico, Intel Corp., and a variety of health care providers. Mineral production and extraction, health care, and tourism are other important components of the state's economy. Employment growth of 1.3% slowed in fiscal 2007 compared with 2.9% growth in fiscal 2006; an improved unemployment rate of 3.5% in fiscal 2007, from

4.25% in fiscal 2006, was attributable to slower growth in the labor force. Global Insight Inc. forecasts slower total nonfarm employment growth for fiscals 2008 and 2009 at 0.6% and 0.9%, respectively, as construction and manufacturing employment continues to decline. Global Insight also forecasts job losses in the professional and business service sector as federal budget cutbacks could impact the Sandia and Los Alamos National Laboratories. The state's taxable assessed value has shown strong growth over the past five years increasing 9% per year, on average, since 2002 to \$47.3 billion in 2007.

The state maintains four separate general fund budgetary reserves: operating, appropriation contingency, tax stabilization, and tobacco settlement permanent fund.

As of June 30, 2007, total reserves were:

- \$156.1 million in the operating reserve,
- \$254.4 million in the tax stabilization reserve,
- \$113.6 million in the appropriation contingency fund, and
- \$116.7 million in the tobacco settlement permanent fund reserve.

After a trend of declining reserves in fiscals 2002 and 2003, the state has maintained reserve levels above 10% of appropriations between fiscals 2004 and 2007. In fiscal 2007, total general fund reserves fell to \$642 million, or a still strong 10.7% of total appropriations at year-end compared with 15.0% of total appropriations in fiscal 2006. The planned drawdown in fiscal 2007 general fund reserves resulted primarily from a large amount of nonrecurring appropriations for capital expenditures approved by the legislature. In fiscal 2007, general fund recurring receipts increased by 11% to almost \$5.8 billion due primarily to sales and income tax growth. The state's fiscal 2008 estimates reflect slower growth in sales taxes from the construction slowdown, a 3% decline in income taxes over the previous year, and 11% growth in recurring appropriations to contribute to \$612 million ending general fund balance, or a still strong 10.2% of total appropriations, including \$313 million of nonrecurring appropriations for capital projects. The fiscal 2009 adopted budget assumes recurring revenue growth of 1.6% in fiscal 2009, including slight declines in mineral-related income and 3% sales tax growth. The budget assumes a \$4.8 million surplus to maintain the total general fund reserves at \$624 million, or a strong 10.3% of budget.

Standard & Poor's deems New Mexico's financial management practices "good" under its Financial Management Assessment (FMA) methodology, indicating financial practices are good, well embedded, and likely sustainable.

The state's total tax-supported debt—including GO, severance tax, and gas tax bonds for the department of transportation—was above average compared with other states at \$1,425 per capita and 4.5% of personal income at fiscal year-end 2007. Total GO debt is limited to a maximum of 1% of net taxable value. The state amortizes all GO debt and severance tax debt over a very rapid 10 years.

## ***Outlook***

The stable outlook reflects the state's proven ability to maintain its strong reserves with the expectation that officials will maintain their conservative management practices. The stable outlook also reflects Standard & Poor's expectation that continued employment and personal income growth, as well as high oil and gas prices over the near future, should support income tax and energy-related taxes and fee revenues to the general fund.

### ***Finances: Revenue Growth Slows***

New Mexico levies sales taxes, which account for the state's largest source of operating funds; the sales tax generated 40% of estimated general fund revenues in fiscal 2007. The state's broad-based 5% gross receipts tax includes services and the sale of property, which subjects annual revenues to some fluctuations in retail sales, tourism, and other service sector activity. Retail trade (27%), construction (16%), and business and professional services (12%) were the state's largest sales tax revenue generators in fiscal 2007. Over time, however, total sales tax collections have demonstrated steady growth, proving less volatile than retail sales activity alone.

Sales tax revenue in the general fund grew 7.8% in fiscal 2007 over the previous year to \$2.3 billion. In fiscal 2008, state officials estimate a slower rate of 2.9% sales tax growth over the previous year to \$2.4 billion due to recent declines in construction, new tax credits for hospitals, and health care provider deductions adopted by the 2007 legislature. An exemption of food and health sales in 2005 and efforts to reduce pyramiding in business-to-business transactions have also slowed growth over the past couple of years but have not caused declines.

Total personal and corporate income taxes generate 28% of recurring general fund revenues. Beginning in tax-year 2003, state officials implemented a five-year reduction in the personal income tax rate that reduced the rate to 4.9% for fiscal 2008 from its high of 8.2% in tax year 2002. Despite these rate reductions, audited personal and corporate income tax receipts grew by 6% in fiscal 2006 and 16% in fiscal 2007. In fiscal 2007, increased collections from accrued corporate income taxes of a few large taxpayers in that year contributed to growth. On a budgetary basis, officials estimate total fiscal 2008 personal and corporate income taxes declined by 3% over the previous year due, in part, to a return to more normalized corporate income tax collections after higher back-tax collections in fiscal 2007. Some concentration exists in corporate income taxes from the mineral extraction industry, which accounted for a large 65% of fiscal 2007 payments compared with 50% in fiscal 2006. Investment income from two large permanent funds and the state treasurer's cash balances also support current fund operations. The two permanent funds are funded from oil and gas royalty and lease payments and severance taxes from mineral extraction. As of June 30, 2007, the market value of assets in the state's land grant permanent fund totaled \$10.7 billion while the state's severance tax permanent fund totaled \$4.7 billion. State officials do not pledge money in the permanent funds to pay debt service on any state bonds; officials, however, do distribute income from the state land grant permanent fund to beneficiary education institutions and the general fund for public school costs. Including interest income from the severance tax permanent fund and cash balances, state officials transferred roughly \$602 million, or 10% of fiscal 2007 general fund receipts, into the general fund in fiscal 2007. Additional major revenue sources include mineral rents and royalties (10% of revenues) and severance taxes on primarily natural gas and oil production (8%).

### ***Health Care Costs Continue To Increase***

New Mexico officials estimate health care and welfare appropriations will increase by 13% in fiscal 2008 year-end due to rate increases granted to providers, new substance-abuse initiatives, higher state contributions to the Medicaid program, and changes to Medicaid eligibility. The fiscal 2009 budget projects year-over-year health care costs will increase another 10% with increases in Medicaid coverage and enrollment.

In fiscal 2008, a portion of the health care cost increase is attributed to a new program that increases Medicaid coverage for adults at or below the poverty level; state officials are phasing the program in over two years, and they estimate the incremental cost of the program to the general fund at roughly \$30 million in fiscal 2009.

Gov. Bill Richardson has indicated his intention to call a special session to reexamine a health care initiative that was not approved in the 2008 legislative session. The initiative requires health care coverage for all state residents and provides coverage for eligible uninsured residents; the initiative also establishes a new administrative authority that would review residents' eligibility for the state-subsidized health care. The initiative assumes the federal government's share of Medicaid would fund a large portion of the increased costs. Although the legislature has not approved the initiative and specific cost estimates are not available, preliminary cost estimates for covering all eligible adults and children range from \$375 million in fiscal 2010 to \$1.7 billion in fiscal 2013 with the bulk of the costs associated with the state's adult uninsured population. The state estimates the general fund contribution above current Medicaid costs would range from \$100 million in fiscal 2010 to \$150 million in fiscal 2013. Uninsured residents represent a high 21% of the state's population. (Please see the article titled "Top 10 Reasons Why States Are Central To Health Care Reform Efforts" published on RatingsDirect.)

### ***Financial Management Assessment: 'Good'***

New Mexico's financial management practices are considered "good" under Standard & Poor's FMA methodology, indicating practices are deemed currently good, but not comprehensive.

The state annually generates five-year revenue forecasts based on consensus forecasting among economists for several state agencies, including the legislative finance council; department of finance and administration; and department of transportation, taxation, and revenue. The group meets quarterly to update revenue forecasts for the general fund. Oil and gas revenue assumptions are based on price forecasts from several independent sources, and volumes are based on econometric analysis that uses historical tax returns. Executive officials also expect to begin to generate annual five-year expenditure forecasts by the end of 2008, but these appropriation projections will not be based on consensus forecasting. The executive conducts monthly reviews of finances throughout the year to track actual budget performance against projections. Management must make budget amendments in cooperation with the state legislature, but the executive can directly reduce expenditures for cabinet-level agencies and call a special legislative session if budget amendments are deemed necessary.

Although statutes exist that dictate maximum reserves for certain general fund reserves, no statute exists that dictates minimum general fund reserves. Management, however, has adopted an internal policy that establishes a targeted reserve equal to 10% of recurring appropriations within the general fund based on cash flow requirements. The policy also requires a minimum reserve equal to 5% of appropriations. Officials communicate the reserve targets with the legislature, and the state has maintained reserves above the minimum 5% since fiscal 2001. Furthermore, the treasurer's office has a formal investment policy that is reviewed annually and requires the committee to report on investments to the state board of finance monthly.

New Mexico coordinates with individual state agencies and local governments to develop their respective five-year capital plans, which are submitted to the state; state officials identify funding for these prioritized capital needs annually through the legislative appropriation process. In addition to

constitutional maximum GO debt limits and a statutory 2x coverage test for severance tax bonds, the board of finance and department of finance and administration have formal debt management guidelines, including the maximum amortization of debt and recommended savings thresholds for debt refunding. In addition to state guidelines, the department of transportation and New Mexico Finance Authority have their own formal debt management policies that guide their use of variable-rate debt and derivatives. The state updates a debt affordability study biennially to review debt plans and their effect on the budget and key debt ratios. Traditionally, the state has not used variable-rate debt for GO debt.

### ***Financial Reporting***

Although the state has released component audits for the general fund in a timely matter, the state's comprehensive annual financial reports (CAFRs) have been published more than two years after the end of the fiscal year since fiscal 2002. Officials now expect the fiscal 2006 and fiscal 2007 CAFRs will be published in the next few months and the recent implementation of a new accounting system will contribute to timely CAFRs going forward.

### ***Debt***

Under the New Mexico Constitution, GO debt is limited to 1% of assessed value, preserving the state's low GO debt level. Additional GO debt is subject to electorate approval. As of fiscal year-end 2007, GO debt totaled roughly \$360 million, which is below the 1% net taxable value limit of \$473 million. The total GO debt burden equaled a low \$184 per capita.

State officials also finance capital projects with severance tax and highway revenue bonds secured by gas taxes and highway user and federal highway revenues. As of fiscal year-end 2007, roughly \$1.8 billion of gas-tax-supported debt, issued by New Mexico Finance Authority for the state transportation commission, was outstanding, including roughly 30% of variable-rate bonds. In early 2008, the authority refunded its series 2004 and 2006 auction-rate bonds with variable-rate demand bonds in order to lower its interest costs. As part of the refunding, the authority did not alter its interest-rate swap contracts, which were originally entered into to offset its exposure to variable-rate fluctuations. (For a complete discussion of its highway debt rating and debt derivative profile score, please see the latest report for New Mexico Finance Authority on RatingsDirect.) In addition, the state had \$612 million of senior and supplemental severance tax bonds outstanding at fiscal year-end 2007 and recently issued another \$175 million of senior and supplemental severance tax bonds in May 2008. The state also has about \$60 million of debt issued by the New Mexico Finance Authority and secured by various taxes, including state gross receipts taxes and cigarette tax revenue. Roughly \$9 million of the outstanding cigarette tax bonds were issued in variable-rate mode.

Including all tax-supported debt, the state's total debt burden in fiscal 2007 was above average at \$1,450 per capita and 4.6% of personal income compared with other states. After the current refunding and the additional severance tax debt issuance in fiscal 2008, the state's debt burden totals \$1,520 and 4.8% of personal income. The annual debt service payment on all debt represents a low 5% of general and debt service expenditures. Debt retirement of GO and severance tax bonds is very rapid, with officials retiring 100% of principal over 10 years; the gas tax bond principal retires at a slower 40% in 10 years. State residents will vote on a new \$223 million general obligation

authorization in November 2008 to primarily fund higher education projects, health facilities, and senior citizen projects.

### ***Retirement Funds And Retiree Health Benefits***

The State Public Employees' Retirement Assn. and the Educational Retirement Board provide retirement benefits for most state employees and political subdivisions. As of June 30, 2007, the Public Employees' Retirement Fund was 92.8% funded with an unfunded accrued liability of roughly \$933 million, a slight improvement compared with its 92.1% funded ratio in fiscal 2006. The Educational Retirement Fund was 70.5% funded with an unfunded liability of \$3.6 billion in fiscal 2007 compared with a 68.3% funded ratio in fiscal 2006.

In August 2007, New Mexico completed a revised actuarial valuation and review of other postemployment benefits for the New Mexico Retiree Health Care Authority. Assuming a 5% discount rate and that benefits are paid from similar arrangements to a qualified trust, the study estimated the state's total long-term unfunded liability at \$4.1 billion as of June 30, 2006. The annual required contribution would be \$383 million for fiscal 2007. State officials expect results of an updated actuarial study should be complete by October 2008.

### ***Economy: Employment, Personal Income Growth Slow***

New Mexico's economy has slowed somewhat in fiscal 2008 as residential building permits and construction have declined statewide, but home prices had continued to hold steady through the end of 2007. Residential building permits declined to 9,239 in 2007 from 14,180 in 2005. After 2.0% and 2.8% growth in total nonfarm employment growth in 2005 and 2006, respectively, total nonfarm employment growth slowed to 1.3% in 2007, including a 1.0% decline in manufacturing employment. Global Insight Inc. projects only 0.6% growth in 2008, including a 5.0% decline in manufacturing employment.

Personal income grew another 6.7% in 2007 after average annual growth of 7.6% in the previous three years; Global Insight forecasts slower growth of 4.8% and 3.7% in 2008 and 2009, respectively. While per capita personal income grew 5% in 2007, per capita income of roughly \$31,000 remained below average compared with other states in the nation. A large military population contributes somewhat to depressed per capita income.

The state's economy has historically been based on agriculture, mineral production, and government; however, employment in the expanding professional, educational, and health service sectors, which has grown an average of 4.5% per year and represented 26% of employment in 2007, have contributed to economic diversity. New Mexico possesses significant natural resources; and mineral extraction—natural gas, oil, and coal, in particular—remains a sizable contributor to the state's economic base and fiscal operations. Mining, however, accounted for just about 2% of nonfarm employment in 2007 as gas and oil production have become more capital intensive. Federal, state, and local government accounted for a large 23% of the state's nonfarm employment in 2007. Retail trade, leisure and hospitality, and construction sectors accounted for 11%; 10%; and 7%, respectively, of total nonfarm employment in 2007.

Leading high-tech employers include Intel and Sandia National Laboratories, both of which are in the Albuquerque metropolitan statistical area (MSA), and Los Alamos National Laboratories in the Santa Fe MSA. Los Alamos and Sandia have announced layoffs as a result of federal cutbacks in 2008.

Intel, ending production on an older semiconductor technology, also laid off 1,000 employees at its Rio Rancho plant in 2007. Somewhat offsetting the lost jobs is development in the Albuquerque MSA including Fidelity Investments' construction of a new facility in southeast Albuquerque with plans to eventually employ 1,200. Additionally, Schott Solar broke ground on its planned manufacturing facilities to open in spring of 2009 with 350 employees and plans future expansions to employ up to 1,500. Tesla Motor Co. also plans to begin production of electric cars with an initial 400 employees when it opens in 2009. Other recent development includes the University of New Mexico hospital in the Albuquerque MSA that opened a new six-story wing in June 2007.

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