S&P Global
Ratings

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New Mexico; General Obligation

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Credit Profile		
New Mexico GO		
Long Term Rating	AA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'AA' long-term rating on the State of New Mexico's outstanding general obligation (GO) bonds based on the application of its "Methodology For Rating U.S. Governments," published Sept. 9, 2024, on RatingsDirect.
- The outlook is stable.

Security

The state's full faith and credit pledge, including an unlimited ad valorem tax on taxable property, secures the GO bonds. New Mexico annually levies property taxes in amounts sufficient to provide a reasonable cash surplus in excess of the next year's debt service payments on its GO debt to provide protection against delinquent tax payments.

Credit overview

The GO rating reflects the state's historically strong reserves in recent years, which we believe aids them during their times of revenue volatility given their exposure to energy-related tax revenues, as well as a modest debt burden with rapid amortization, but offset by significant pension liabilities, although recent reforms could improve this risk over the long term. The rating further reflects state income levels that are below the national average and population growth that has lagged the nation over the past decade, but an economy that also benefits from a large, stabilizing federal employment presence.

The 'AA' GO rating reflects what we view as New Mexico's:

- Economic concentration in the cyclical oil and gas industry, which has experienced large fluctuations, both up and down, in the past five years, combined with a larger-than-average dependence on federal employment, which we believe provides a stabilizing element;
- Cyclical financial performance that has generally followed trends in the oil and gas industry;
- Reserve levels that are at historical highs, which we believe will help the state navigate revenue uncertainty in the medium term;
- Large permanent funds, earnings of which are available for general fund spending, although the funds themselves are restricted;
- Modest debt burden with rapid amortization and well-managed other postemployment benefits (OPEB) liabilities, but significant pension liabilities that remain sizable relative to those of state peers, although retirement reforms passed in 2020 will moderate these liabilities over time; and
- Institutional framework that supports the state's budgeting and operations, in our view, and demonstrates fiscal transparency through regular reporting of key financial information.

Environmental, social, and governance

Environmental and social factors are a moderately negative consideration in our credit rating analysis for New Mexico. The state is the second-largest crude oil producer in the nation, with energy-related taxes representing an estimated 30% of general fund revenue in fiscal 2024. Concentration in carbon emission-intensive industries could negatively affect financial operations given policy and regulatory efforts to transition to net-zero. Favorably, the state can diversify its revenue sources by raising taxes with a simple majority vote of the legislature, and the state has undertaken efforts to expand job diversification through the solar power industry. In addition, New Mexico has been experiencing recent drought and wildfires. Social factors include that 36% of the state's population is enrolled in Medicaid at present, which ranks as the highest Medicaid enrollment rate in the U.S. as of June 2024. We believe this is indicative of New Mexico's service needs that could challenge budgetary performance, particularly in times of economic stress.

Outlook

The stable outlook reflects our expectations that the state will maintain substantial near-term reserves to help cushion against the next oil and gas downturn, as well as projections of structural balance for the foreseeable future. Our rating anticipates that New Mexico will make efforts to keep reserve balances at strong levels during cyclical upturns to help ride out the inevitable cyclical downturns, as it has done historically.

Downside scenario

We could consider a negative rating action should there be an extended structural imbalance that depletes reserves without a plan for replenishment. Although the state recently took action to improve its retirement systems, potential pressure could recur if actuarial and statutory pension funding requirements diverge again and the state delayed taking action to shore up funding levels.

Upside scenario

If New Mexico's economic metrics improved, including a more diverse economic base that would reduce revenue cyclicality, while the state maintained improved pension funding, we could raise the rating. In addition, if we view the revenue base to be less reliant on volatile energy prices, it could result in a higher rating.

Credit Opinion

Institutional Framework

In our view, New Mexico's strong institutional framework includes a strong balanced budget requirement, legal framework for debt, and the legislative flexibility to raise most revenues or reduce appropriations with a simple majority vote.

The state interprets Article IX, Section 7, of the New Mexico Constitution, which prohibits the state from borrowing more than $200,000 to cover a shortfall in revenue compared with necessary expenses, as a requirement that New Mexico adopt, and that the state maintain, a balanced budget. According to the constitution, only the legislature has broad authority to adjust general fund appropriation levels as necessary to balance the budget, but the executive can directly reduce expenditures for cabinet-level agencies and call a special legislative session if budget amendments are deemed necessary. Although the executive does not have autonomy to unilaterally reduce expenditures without legislative input, the state has demonstrated willingness to make timely cuts to its budgets.

The state has the legal ability to raise revenues with only a simple majority vote of the legislature, which we view as providing revenue flexibility. However, changes to distributions to the general fund from the severance tax permanent fund (STPF) and the land grant permanent fund (LGPF) require a three-fifths vote by the legislature, according to the constitution. The New Mexico Constitution limits the state property tax rate for all operations at 10 mills; however, the state does not currently levy a property tax for operations. The state has historically demonstrated a willingness to increase revenues, but recent strong oil and gas prices have obviated the need for tax increases in recent years. In the 2023 legislative session, the state enacted a gross receipts tax decrease given its significant growth in revenues in recent years.

In 2023, the state enacted Senate Bill 26, which will divert "windfall" severance tax contributions to the STPF and for education purposes, beginning in fiscal 2025. The legislation will direct severance tax revenue above a five-year average plus growth in severance tax revenue above fiscal 2024 levels to be split between education funding and the STPF.

New Mexico is not a voter-initiative state, and although voters have the ability to veto legislation passed through a referendum, the amount of signatures needed to place a measure on the ballot imposes a high threshold. All the state's tax-secured debt has a lien on specific revenues, which provides preferential status.

Management

New Mexico follows what we consider generally strong management practices. During the Great Recession, and in the more recent downturn in the oil and gas industry, the state demonstrated willingness to make timely cuts to its budget, including reducing public and higher education spending and cancelling certain cash-funded capital outlay appropriations from previous surplus years, which enabled transfer of unspent balances from other funds as well as reserves to help meet its budget gaps. Deficits were not carried forward, and budget solutions included recurring revenue increases and appropriation reductions, as well as drawdowns in fund balances.

The consensus revenue forecasting group, representing economists from both the executive and legislative branches, uses independent economic forecasts from various sources including S&P Global Market Intelligence and the University of New Mexico, as well as oil and gas estimates from industry experts. The forecasting group typically prepares revenue forecasts two to four times a year, with regular releases in December and August, and if warranted, during midsession in January or February, but rarely in September or October. The executive conducts monthly reviews of finances throughout the year to track actual budget performance against projections, but it must make broad budget appropriation amendments in cooperation with the legislature. In addition to constitutional maximum GO debt limits and strong statutory additional bonds coverage tests for severance tax bonds, the Board of Finance and the Department of Finance have formal debt management guidelines, including the maximum amortization of debt and recommended savings thresholds for debt refunding.

New Mexico has been increasing its informal combined reserve target in recent years. Although it had historically been targeting 10%, the state raised its target to 20% in fiscal 2020 and now targets 30%. The reserve target is statutory and can be changed by the legislature with each enacted budget.

The state has a tax stabilization reserve that requires a supermajority of the legislature to spend. Legislation passed during the 2020 regular session established the Early Childhood Trust Fund (ECTF) and provided that excess oil and gas emergency school tax revenue is distributed to either the ECTF or the tax stabilization reserve fund, depending on state reserve conditions. If New Mexico's reserve balances for the current fiscal year are equal to or greater than 25% of the aggregate recurring appropriations for the current fiscal year from the general fund, the excess oil and gas emergency school tax revenue shall be distributed to the ECTF. If the reserve balance is less than 25% of the aggregate recurring appropriations for the current fiscal year from the general fund, the excess oil and gas emergency school tax revenue will be distributed to the tax stabilization reserve fund, but limited only to the amount necessary to bring state reserve balances equal to 25% of recurring appropriations from the general fund. Any remaining excess revenue is distributed to the ECTF.

The state received an unqualified financial audit opinion in fiscal 2021, after receiving a qualified audit opinion previously for a number of years. It released its 2021 audit on what we consider to be a timely basis after a period of late audit releases and has been timely ever since.

Economy

New Mexico's economy has historically been based on agriculture, mineral production, and government, although other important industries including high-technology manufacturing, tourism, and call-center businesses are present. New Mexico hosts Intel in Rio Rancho and various other high-tech manufacturers around the Los Alamos and Sandia National Laboratories. Oil and gas production has also shown strong growth since 2016 due to a recovery in oil prices and increased fracking activity in the Permian Basin.

Since the Great Recession, New Mexico has experienced slower population growth than the nation, after having faster growth in the previous decade. State population declined slightly by 0.08% in 2021 and increased 0.35% in 2020, to 2.1 million people. New Mexico's age dependency ratio (which measures nonworking-age population to working-age population) was 68.7% in 2022, a large 4.3 percentage points above that of the U.S., reflecting a growing retiree population attracted to New Mexico's moderate climate and low cost of living.

The state ranks first in the nation in terms of federal spending per dollar of tax paid, indicating the importance of federal dollars, according to S&P Global Market Intelligence. Federal employment is concentrated in New Mexico's three Air Force bases, as well as the White Sands Missile Range, and the Los Alamos and Sandia national laboratories. Other industries include high-tech manufacturing attracted by state tax breaks and proximity to federal labs; tourism; and call-center businesses, which are drawn in part by New Mexico's low business costs.

S&P Global Market Intelligence forecasts real gross state product (GSP) to be slightly below national levels in calendar

2025, at 1.23% compared with 1.66% for the nation. Looking ahead, GSP projections are 1.57% for the state in 2026 and 1.81% in 2027, roughly in line with national GDP projections.

Financial Performance, Reserves, And Liquidity

New Mexico's budgetary performance has historically followed upswings and downturns in the oil and gas industry given the cyclical impacts it has on the state's revenue streams. As a result, the state has historically targeted strong reserves, in our opinion, due to the cyclicality of its revenue streams. Although these reserves have been nearly depleted in previous downturns, New Mexico has a track record of restoring them in growth periods, and estimates to have finished fiscal 2024 with reserves at a high 31.7% of recurring appropriations on a budgetary basis of accounting, or $3.04 billion.

In the current fiscal year (2025), the state's general fund recurring revenue is projected to increase by 0.6%, to $12.84 billion from $12.76 billion. At the same time, recurring appropriations are projected to increase by 6.7%, to $10.2 billion from $9.6 billion. Additionally, including the state's one-time appropriations and revenues, the state is projecting a slight surplus and an increase in reserves. In total, the state is projecting its reserves to increase to $3.6 billion in fiscal 2023 from $3.04 billion, or a strong 34.8% of recurring appropriations.

New Mexico's fiscal 2025 budget recognized about a 10% increase compared with fiscal 2024 levels. Public school funding increased 13.9% compared with fiscal 2024, which will account for 42% of the total general fund budget.

New Mexico's mineral wealth has allowed the state to establish large endowments that generate annual revenue to its general fund and augment its tax revenue. Previous land grants from the federal government for the benefit of public schools and various other public institutions form a land trust totaling 9.0 million surface acres and 13.4 million subsurface acres of land, which earn income from mineral production royalties, leases, and sale proceeds; all land trust income is deposited into the state's LGPF. The LGPF had a fund balance of $28.7 billion as of June 30, 2023, an asset increase of 13.8% over the previous fiscal year. Distributions from the fund to beneficiaries are based on a formula in the state constitution, with 83% of distributions going toward public education, which supports the general fund. Changes to the distributions require a three-fifths legislative vote and a majority vote of the people.

The state's constitution requires New Mexico to deposit severance tax receipts related to natural gas and oil production into the severance tax bonding fund, effectively serving as a dedicated source for funding state capital projects. Remaining deposits are then transferred to the STPF after debt service on related debt, including the state's severance tax and supplemental severance tax long-term bonds. New Mexico has also annually issued short-term severance tax notes as a mechanism to divert severance tax revenues to nonrecurring capital outlay projects before deposit into the STPF. Despite the regular use of the severance tax revenues for capital projects, the STPF fund balance as of June 30, 2023, was $8.3 billion. The state constitution provides for a distribution from the STPF to the general fund for general purposes equal to 4.7% of the fund's previous five-year average market value; New Mexico is unable to appropriate funds from the corpus of the fund.

Debt And Liabilities

We believe New Mexico's debt levels are moderate, with a rapid debt amortization--the result of state policy to issue GO and severance tax debt with no longer than a 10-year maturity--while we believe the state's proportionate share of net OPEB liabilities is also moderate. However, we consider the state's unfunded pension liabilities high, with a very long 59-year amortization period for the state Public Employees Retirement Assn. (PERA) unfunded liability.

Pension and OPEB liabilities

While New Mexico has implemented pension reforms in recent years, our view is that those efforts will take time to reduce the state's pension liabilities and the current liabilities remain an outlier at higher levels in comparison to other U.S. states. New Mexico funds its retirement systems under statutory law, which has sometimes differed from actuarial requirements. As a result, the state carries what we view as high unfunded pension liabilities and had projected a PERA cash flow shortfall before statutory reforms in 2000 improved annual contribution levels.

PERA member and employer contribution rates are established by state statute. Legislation implementing pension reform in 2013 lowered the unfunded liability and slightly improved funded ratios, but the state's statutory funding formula still did not keep pace with actuarial shortfalls.

As a result, New Mexico enacted additional pension reforms in 2019, 2020, and 2021 that increased annual contributions, delayed pension cost-of-living adjustments (COLAs) for three years, and made COLAs after that subject to an investment return trigger. Beginning in fiscal 2021, New Mexico increased state and local government employee and employer pension contribution rates by 0.5%, and will increase them each year for the next four years, for a total increase of 2.0%. A major change included suspending COLAs for three years and replacing them with a noncompounding 2% for all members.

On a GAAP basis, the PERA funded ratio was 67.3% as of fiscal year-end June 30, 2023, the state's most recent audited year, while New Mexico's proportionate share of the PERA net pension liability was $4.3 billion. The separate education retirement system had a 65.2% GAAP funded ratio and a state proportionate share of the net pension liability of $2.3 billion. New Mexico's recent reforms were designed to raise teacher pension employee contributions and reduce COLAs until the system is 100% funded. The state reports that, as of June 30, 2023, on an actuarial basis, PERA had a relatively long amortization period of 53 years. The teachers' pension system has a closed 30-year amortization period beginning June 30, 2019.

In fiscal 2023, New Mexico's portion of all the combined state retirement plans' net pension liability was $6.8 billion, up from $6.2 billion in 2022 but down from $9.6 billion in fiscal 2020, due to the earlier state reforms and the elimination of a prior projected cash depletion date. New Mexico's unfunded pension liability was $3,207 per capita, a level we still consider high. We calculate that the combined actuarial funded ratio for the state's five pension funds--including PERA; the Educational Retirement Board; and the Judicial, Magistrate, and Volunteer Firefighter Fund--based on GASB 67 and 68 GAAP standards as of a June 30, 2023, valuation date, 66.2% compared to 67.1% in 2022, and the three-year average of all the state's pension funds, including the teachers' pension fund, was 68.9%, a funded level we still consider relatively low.

The state's proportionate share (26.8%) of net OPEB liability in fiscal 2023, was $335.4 million, or a low $159 per capita. New Mexico is currently funding 100% of its OPEB actuarially determined annual required contribution, and its OPEB trust fund is 68% funded. The OPEB trust fund held a fiduciary net position of $1.1 billion at June 30, 2023.

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Table 2

New Mexico--key credit metrics				
	2024e	**2023**	**2022**	**2021**
Economy				
State population ('000s)		2,115	2,114	2,116
GSP per capita ($)		52,163	48,877	47,692
GSP per capita % of U.S.		78	74	74
State PCPI ($)		55,328	53,078	50,713
State PCPI % of U.S.		79	80	79
State unemployment rate (%)		3.7	4.1	7.1
Financial performance - S&P Global Ratings adjusted				
Operating fund revenues (mil. $)	13,022	10,890	9,842	7,808
Operating fund expenditures (mil. $)	12,650	10,456	8,686	8,892
Operating result (mil. $)	372	434	1,156	(1,085)
Operating result % of revenues	2.9%	4.0	11.7	-13.9
Reserves and liquidity - S&P Global Ratings adjusted				
Available reserves (mil. $)	3035.00	4,043	3,680	1,570
Available reserves % of operating revenues	23.3%	37.1	37.4	20.1
Debt and liabilities				
Net direct debt cost % of revenues	--	4.5	3.6	2.9
Pension and OPEB cost % of revenues	--	1.5	1.8	1.5
Total current cost % of total government revenues	--	6.1	5.4	4.4
Net direct debt (mil. $)	--	3,286	3,057	2,450
Net direct debt per capita ($)	--	1,554	1,446	1,158
Direct debt 10-year amortization (%)	--	92	92	95
Combined net pension liabilities (mil. $)	--	6,782	6,240	4,681
Net pension liabilities per capita ($)	--	3,207	2,952	2,212
Combined pension plan funded ratio (%)	--	66.2	67.1	73.5

e--Estimated. GSP--Gross state product. PCPI--Per capita personal income. OPEB--Other postemployment benefits.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022