

New Issue

This Official Statement has been prepared by the State Board of Finance to provide information on the \$162,840,000 State of New Mexico Severance Tax Bonds, Series 2007A (the "Bonds"). Selected information is presented on this cover page for the convenience of the user. To make an informed decision, a prospective investor should read the entire Official Statement. Certain capitalized terms used in the cover page and elsewhere in this Official Statement have the meanings given in the Official Statement.

\$162,840,000
THE STATE OF NEW MEXICO
SEVERANCE TAX BONDS, SERIES 2007A

Dated: Delivery Date

Due: July 1, as shown below



<i>Insured Bonds Ratings</i>	"Aaa" Moody's Investors Service, Inc. "AAA" Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc.
<i>Uninsured Bonds Ratings</i>	"Aa2" Moody's Investors Service, Inc. "AA" Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc.
<i>Bond Insurance</i>	The scheduled payment of principal and interest on the 2010, 2011, 2012 and 2013 maturities of the Bonds (the "Insured Bonds") will be guaranteed under an insurance policy to be issued concurrently with the delivery of the Insured Bonds by MBIA Insurance Corporation.
<i>Tax Exemption</i>	In the opinion of Brownstein Hyatt Farber Schreck, P.C., Bond Counsel, under existing laws, regulations, rulings and judicial decisions, and assuming, among other matters, the accuracy of certain representations and continuing compliance with certain covenants, interest on the Bonds is excludable from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, such interest is taken into account in determining adjusted current earnings for the purpose of computing the alternative minimum tax on certain corporations. Bond Counsel is further of the opinion that interest on the Bonds is exempt from State of New Mexico personal income taxes. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. See "TAX MATTERS."
<i>Redemption</i>	The Bonds maturing on or after July 1, 2013 are subject to optional redemption by the State in whole or in part on any date on or after July 1, 2012 at par plus accrued interest.
<i>Sources of Payment</i>	The Bonds are special limited obligations of the State payable primarily from, and secured by, taxes levied upon certain natural resource products severed and saved from the soil of the State deposited into the Severance Tax Bonding Fund.
<i>Priority</i>	The Bonds are being issued under the authority of the State of New Mexico Severance Tax Bonding Act and will be on a parity with Severance Tax Bonds now or hereafter outstanding and senior to Supplemental Severance Tax Bonds now or hereafter outstanding.
<i>Purposes</i>	Net proceeds of the Series 2007A Bonds are being used to finance certain capital projects authorized by the State Legislature, and for the refunding of the July 1, 2008 and 2009 maturities of the State of New Mexico Severance Tax Bonds, Refunding Series 2001A, and the July 1, 2008 maturity of the State of New Mexico Severance Tax Bonds, Series 2002A.
<i>Interest Payment Dates</i>	January 1 and July 1, commencing January 1, 2008.
<i>Closing/Settlement</i>	On or about June 28, 2007.
<i>Denominations</i>	\$5,000
<i>Book-Entry System</i>	The Depository Trust Company
<i>Registrar/Paying Agent</i>	State Treasurer of New Mexico
<i>Bond Counsel</i>	Brownstein Hyatt Farber Schreck, P.C.
<i>Disclosure Counsel</i>	Sutin, Thayer & Browne A Professional Corporation
<i>Issuer Contact</i>	State Board of Finance; Olivia Padilla-Jackson, Director; 505-827-4980; olivia.padilla-jackson@state.nm.us

Dated: May 15, 2007

<u>CUSIP</u> ¹	<u>Year (July 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Yield at Issuance</u> ²	<u>Price at Issuance</u> ²	<u>Initial Call Date</u>	<u>Price</u>
647310 D81	2008	\$34,205,000	5.0%	3.71%	101.264	Not callable	
647310 D99	2009	15,965,000	5.0	3.65	102.591	Not callable	
647310 E23	2010	12,035,000	5.0	3.70	103.668	Not callable	
647310 E31	2011	12,635,000	5.0	3.75	104.611	Not callable	
647310 E49	2012	13,265,000	4.0	3.72	101.268	Not callable	
647310 E56	2013	13,800,000	4.0	3.90	100.450	7/1/2012	100%
647310 E64	2014	14,350,000	4.0	3.96	100.179	7/1/2012	100%
647310 E72	2015	14,925,000	4.0	3.98	100.089	7/1/2012	100%
647310 E80	2016	15,520,000	4.0	4.01	99.924	7/1/2012	100%
647310 E98	2017	16,140,000	4.0	4.05	99.591	7/1/2012	100%

¹ The State takes no responsibility for the accuracy of CUSIP numbers, which are included solely for the convenience of owners of the Bonds.

² This information not provided by the State.

ELECTED STATE OFFICIALS

BILL RICHARDSON
Governor

MARY HERRERA
Secretary of State

DIANE D. DENISH
Lieutenant Governor

JAMES B. LEWIS
State Treasurer

HECTOR H. BALDERAS
State Auditor

GARY K. KING
Attorney General

PATRICK H. LYONS
Commissioner of Public Lands

Public Regulation Commissioners:

JASON A. MARKS
District I

DAVID W. KING
District II

BEN R. LUJAN
District III

CAROL K. SLOAN
District IV

SANDY R. JONES
District V

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Ex Officio Members

GOVERNOR BILL RICHARDSON
President

LT. GOVERNOR
DIANE D. DENISH
Member

STATE TREASURER
JAMES B. LEWIS
Member

Appointed Members

JOHN LOEHR
Member

KIM SANCHEZ RAEI
Secretary

MARIA GRIEGO-RABY
Member

ROBERTA COOPER RAMO
Member

KATHERINE B. MILLER
Executive Officer

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Olivia Padilla-Jackson, Director

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Albuquerque, New Mexico

DISCLOSURE COUNSEL
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A Professional Corporation
Albuquerque, New Mexico

FINANCIAL ADVISORS
Fiscal Strategies Group, Inc.
Swarthmore, Pennsylvania
Public Resources Advisory Group
Los Angeles, California

No dealer, broker, salesperson or other person has been authorized to give any information or to make any representation other than those contained in this Official Statement and, if given or made, such information or representation must not be relied upon. This Official Statement does not constitute an offer to sell or solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person, in any jurisdiction in which it is unlawful to make such an offer, solicitation or sale. The information and expressions of opinion herein are subject to change without notice. Neither the delivery of this Official Statement nor any sales hereunder shall under any circumstances create any implication that there has been no change in the affairs of the State of New Mexico or in the imposition and collection of severance taxes since the date hereof.

This Official Statement contains statements relating to the State's receipt of future revenues that are "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. When used in this Official Statement, the words "estimate", "intend", "expect" and similar expressions are intended to identify forward-looking statements. Such statements are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof.

The issuer is the author of this Official Statement and is responsible for its accuracy and completeness. The Underwriters are not the authors of the Official Statement. In accordance with their responsibilities under federal securities laws, the Underwriters are required to review the information in this Official Statement and must have a reasonable basis for their belief in the accuracy and completeness of the Official Statement. Both the Preliminary Official Statement and the Official Statement are "deemed final" by the Board for purposes of Rule 15c2-12 of the Securities and Exchange Commission.

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**SUMMARY OF INFORMATION
SEVERANCE TAX BONDS, SERIES 2007A**

The following material represents a summary of information concerning the Bonds and the security therefor set forth in this Official Statement and is qualified in its entirety by the detailed information herein. Purchasers of the Bonds should review the entire Official Statement before making an investment decision.

Dated:	Delivery Date.
Interest Payment:	Interest is payable semi-annually on January 1 and July 1, commencing on January 1, 2008.
Principal Payment:	The Bonds mature in serial installments as set forth on the inside cover page of this Official Statement.
Redemption:	The Bonds maturing on and after July 1, 2013 are subject to optional redemption in whole or in part on any date on or after July 1, 2012, at par plus accrued interest.
Registration:	The Bonds are being issued solely in book-entry form in the denomination of \$5,000 or any integral multiple thereof. The Bonds are being registered to Cede & Co., as nominee of The Depository Trust Company, New York, New York, which will act as depository.
Legal Opinion:	The Bonds are offered when, as and if issued, subject to the approval of legality by Brownstein Hyatt Farber Schreck, P.C., Bond Counsel.
Security:	The Bonds constitute special limited obligations of the State of New Mexico and will be payable solely from deposits to and revenues of the Severance Tax Bonding Fund, consisting primarily of receipts from certain taxes levied on certain natural resource products severed and saved from the soil of the State of New Mexico as more fully described herein. Payment of principal and interest on the 2010, 2011, 2012 and 2013 maturities of the Bonds will be guaranteed by a financial guaranty insurance policy issued by MBIA Insurance Corporation. See "BOND INSURANCE" herein.
Additional Parity Bonds:	The State Board of Finance is prohibited by statute from issuing parity Severance Tax Bonds unless the aggregate amount of parity Severance Tax Bonds outstanding, including the bonds to be issued, can be serviced with not more than 50 percent of the annual deposits into the Severance Tax Bonding Fund, as determined by the deposits during the fiscal year preceding the issuance of the Bonds.

**Summary of Projected and Historical Coverage in Severance Tax Bonding Fund
Fiscal Year Ended June 30**

(Dollars in thousands)

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Projected Bonding Fund Receipts	\$463,888	\$460,975	\$433,661	\$414,642	\$398,160
Senior Bond Debt Service ⁽¹⁾⁽²⁾	\$ 72,886	\$ 81,282	\$ 92,672	\$ 75,363	\$ 69,177
Senior Bond Debt Service Coverage Ratio	6.36x	5.67x	4.68x	5.50x	5.76x
Supplemental Bond Debt Service ⁽²⁾	\$ 20,119	\$ 18,020	\$ 15,899	\$ 15,599	\$ 15,590
Supplemental Bond Debt Service Coverage Ratio	4.99x	4.64x	3.99x	4.56x	4.70x
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Bonding Fund Receipts	\$246,046	\$257,157	\$319,337	\$405,541	\$532,386
Senior Bond Debt Service ⁽²⁾	\$ 72,893	\$ 67,994	\$ 68,270	\$ 68,204	\$ 69,902
Senior Bond Debt Service Coverage Ratio	3.38x	3.78x	4.68x	5.95x	7.62x
Supplemental Bond Debt Service ⁽²⁾	\$ 4,026	\$ 12,757	\$ 18,230	\$ 19,008	\$ 19,646
Supplemental Bond Debt Service Coverage Ratio	3.20x	3.18x	3.69x	4.65x	5.95x

⁽¹⁾ Includes debt service on the Bonds and gives effect to the refunding of the July 1, 2008 and 2009 maturities of the State's Severance Tax Bonds, Refunding Series 2001A and the July 1, 2008 maturity of the State's Severance Tax Bonds, Series 2002A.

⁽²⁾ Excludes debt service on refunded bonds which will be paid from escrowed securities and severance tax debt obligations sold to the State Treasurer which are retired within the same fiscal year.

\$162,840,000
STATE OF NEW MEXICO
SEVERANCE TAX BONDS, SERIES 2007A

INTRODUCTION

The purpose of this Official Statement, including the cover page, the Summary of Information, and the Appendices hereto, is to furnish information regarding the issuance of the Severance Tax Bonds, Series 2007A in the principal amount of \$162,840,000 (the “Bonds”), the State of New Mexico (the “State”), and the State Board of Finance (the “Board”).

The Bonds are being issued under authority of the State Severance Tax Bonding Act, Sections 7-27-1 through 7-27-27 NMSA 1978 as amended (the “Severance Tax Bonding Act”) and pursuant to a resolution of the Board adopted on May 15, 2007 (the “Bond Resolution”).

This Official Statement contains summaries of the terms of the Bonds, certain fiscal matters of the State, and the Severance Taxes (defined below) imposed by the State. The descriptions included in this Official Statement do not purport to be comprehensive or definitive, and such summaries and descriptions are qualified in their entirety by reference to such laws, and the definitive forms of documents, exhibits or appendices where applicable.

Requests for additional information about the State, the Severance Taxes, or requests for copies of any document or statute referred to in this Official Statement, may be directed to:

Contact:	State Board of Finance Attn: Olivia Padilla-Jackson, Director
Phone:	505-827-4980
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THE SEVERANCE TAX BONDS

General Terms

The Bonds are dated their date of delivery, bear interest until the principal amount thereof is paid, and mature as set forth on the inside cover page hereof. Interest on the Bonds is payable on January 1 and July 1, commencing on January 1, 2008. The Bonds are being issued solely in book-entry form in denominations of \$5,000 or integral multiples thereof. The Bonds are being registered in the name of Cede & Co., as nominee of The Depository Trust Company (“DTC”), New York, New York, which will act as depository for the Bonds. The Bonds are subject to transfer and exchange as set forth in the Bond Resolution.

Redemption of Bonds

The Bonds maturing on or after July 1, 2013 will be subject to prior redemption at the option of the Board in whole or in part on any date on or after July 1, 2012 at a redemption price equal to 100 percent of the principal amount redeemed plus accrued interest on the principal amount redeemed to the date of redemption.

If less than all of the outstanding Bonds of a particular maturity are to be redeemed, the selection of Bonds or portions of Bonds to be redeemed, in amounts of \$5,000 or any integral multiple thereof, shall be made by lot within that maturity by the State Treasurer, as Registrar/Paying Agent, in such manner as the Registrar/Paying Agent may determine. If less than the full amount of any Bond is to be redeemed, then, upon surrender of such Bond by the owner to the Registrar/Paying Agent for payment of the redemption price, the Registrar/Paying Agent shall deliver to such owner, without charge, a new Bond or Bonds of any authorized denomination or denominations in an aggregate principal amount equal to the unmatured and unredeemed portion of, and with the same interest rate and maturity date as, the Bond surrendered.

The Board shall give the Registrar/Paying Agent notice that Bonds will be called for redemption not less than thirty (30) nor more than forty-five (45) days prior to the redemption date. The Board will give, or cause to be given, notice of redemption to the owners of Bonds to be called for redemption by sending a copy of such notice by registered or certified first-class postage prepaid mail not less than thirty (30) nor more than forty-five (45) days prior to the redemption date to the registered owner of each Bond, or portion of a Bond, to be redeemed at the address shown as of the fifth day prior to the mailing of notice on the registration books kept by the Registrar/Paying Agent. So long as a book-entry system is used for determining beneficial ownership of the Bonds, such notice of redemption will be given to DTC or any successor securities depository, or its nominee, as registered owner of the Bonds. Such notice shall be sent to DTC by a secure means as set forth in the letter of representation from the Board and the Registrar/Paying Agent to DTC or as otherwise agreed to with DTC from time to time (the "Letter of Representation") in a timely manner designed to assure that such notice is in DTC's possession at the time set forth in the Letter of Representation.

In addition, if the Bonds are not being held by DTC, notice of redemption shall be published at least once, not less than thirty (30) days nor more than sixty (60) days prior to the date of redemption, in a newspaper published and of general circulation in the State. Neither the Board's failure to give such notice to the Registrar/Paying Agent, nor the failure to publish such notice, shall affect the validity of the proceedings for the redemption of any Bonds for which prior notice was given by mail as set forth in this paragraph. All notices shall specify the maturity dates and the numbers of the Bonds to be redeemed (if less than all are to be redeemed) the amount of such Bond to be redeemed (if less than the full amount of any Bond is to be redeemed), the date fixed for redemption, the redemption price to be paid and shall further state that on such redemption date there will become and be due and payable upon each Bond to be redeemed at the office of the Registrar/Paying Agent the unpaid principal amount of such Bond, or the portion of such Bond so redeemed, plus accrued interest on such principal amount to the redemption date and that from and after such date interest will cease to accrue on such principal amount. The notice of redemption shall also include additional provisions required by the Letter of Representation. Notice having been given in the manner provided, the Bond or Bonds called for redemption shall become due and payable on the redemption date designated and if an amount of money sufficient to redeem all Bonds or portions of Bonds called for redemption is on deposit with the Registrar/Paying Agent on the redemption date, the Bonds or portions of Bonds to be redeemed shall no longer be deemed to be outstanding and shall cease to bear interest from and after such redemption date. Upon presentation of any Bond redeemed at the office of the Registrar/Paying Agent, the redemption price of such Bond or Bonds shall be paid as set forth in the Bond Resolution.

Security for the Bonds

The Bonds are special limited obligations of the State secured by and payable solely from, on a parity basis to Severance Tax Bonds ("Severance Tax Bonds") now or hereafter outstanding and on a prior lien basis to Supplemental Severance Tax Bonds (defined below) now or hereafter outstanding, deposits to the Severance Tax Bonding Fund (the "Bonding Fund") into which are deposited, pursuant to the Severance Tax Bonding Act, the net receipts from taxes levied in accordance with the Severance Tax Act, Sections 7-26-1 et seq., NMSA 1978 as amended (the "Severance Tax Act"), and the Oil and Gas

Severance Tax Act, Sections 7-32-1 et seq., NMSA 1978 as amended (the “Oil and Gas Severance Tax Act”), upon certain natural resource products severed and saved from the soil of the State (“Severance Taxes”), investment earnings on such deposits and on unused bond proceeds in certain accounts, and such other moneys as the Legislature in its sole discretion may from time to time determine. On June 30 and December 31 of each year the excess money in the Bonding Fund over the amount necessary to meet all principal and interest payments on all outstanding Severance Tax Bonds and all outstanding Supplemental Severance Tax Bonds on the next two ensuing semiannual payment dates must be transferred to the Severance Tax Permanent Fund.

Once moneys are so transferred, they no longer may be used to pay, or to secure payment of, principal of, premium, if any, or interest on any Severance Tax Bonds or Supplemental Severance Tax Bonds (defined below). Severance Tax Bonds are not general obligations of the State and the State is prohibited by law from using the proceeds of property taxes as a source of payment of revenue bonds, including Severance Tax Bonds. The State Treasurer keeps separate accounts for all money collected as Severance Taxes, and is directed by State statute to pay Severance Tax Bonds from moneys on deposit in the Bonding Fund. The Bond Resolution provides for the creation of a separate Debt Service Account within the Bonding Fund for the payment of principal and interest on the Bonds.

The Board is prohibited by statute from issuing Severance Tax Bonds unless the aggregate amount of total Severance Tax Bonds outstanding, including the Severance Tax Bonds proposed to be issued, can be serviced with not more than 50 percent of the annual deposits into the Bonding Fund, as determined by the deposits made in the fiscal year immediately preceding the issuance of the proposed Severance Tax Bonds. The total aggregate principal amount of outstanding Severance Tax Bonds issued by the State does not now, nor will such amount upon the issuance of the Bonds, exceed any applicable limit prescribed by the Constitution or laws of the State.

The Severance Tax Bonding Act requires the Legislature to provide for the continued assessment, levy, collection and deposit into the Bonding Fund of Severance Taxes which, together with such other moneys as may be deposited into the Bonding Fund, will be sufficient to produce an amount at least equal to annual debt service on all outstanding Severance Tax Bonds and Supplemental Severance Tax Bonds.

In addition, the Board covenants in the Bond Resolution that the State will use its best efforts to collect and deposit in the Bonding Fund sufficient income from Severance Taxes so that, when combined with other moneys deposited in the Bonding Fund, the amount deposited annually in the Bonding Fund will equal at least 200 percent of the amount of the principal and interest scheduled to be due in each fiscal year on all Severance Tax Bonds. However, the Board does not have the power to levy or impose Severance Taxes, and no assurance exists that the 200 percent requirement will be met.

The Severance Tax Bonding Act also permits the Board to issue Supplemental Severance Tax Bonds (“Supplemental Severance Tax Bonds”) also payable from amounts in the Bonding Fund, but subject to the prior payment of Severance Tax Bonds. The Bonds, all currently outstanding Severance Tax Bonds, and any Severance Tax Bonds issued on a parity with the Bonds will have a pledge and lien senior to any Supplemental Severance Tax Bonds now outstanding or hereafter issued.

USE OF PROCEEDS

The Bonds are being issued to fund public capital projects authorized by the State Legislature, and to fund an escrow account pursuant to an Escrow Agreement among the State, the State Treasurer and Wells Fargo Bank, N.A. that will provide for the refunding on July 30, 2007 of the July 1, 2008 and July 1, 2009 maturities of the State’s Severance Tax Bonds, Refunding Series 2001A, and the July 1, 2008 maturity of the State’s Severance Tax Bonds, Series 2002A (the “Current Refunded Bonds”). Bond proceeds deposited in the project accounts or used for the redemption of the Current Refunded Bonds are

not available for the payment of debt service on the Bonds except to the extent that upon completion or abandonment of the project or expiration of a statutorily created reversionary period (which may be extended by the Legislature) for the project, amounts remaining in the project account for that project must be transferred to the Bonding Fund, and become available to pay debt service on the Bonds until transferred to the Severance Tax Permanent Fund. Costs incurred in the issuance of the Bonds (other than the underwriters' discount and bond insurance premium) are payable from the Bonding Fund, not from proceeds of the Bonds.

The following table sets forth the sources and uses of funds to be available in connection with the sale of the Bonds:

SOURCES:

Par Amount of Bonds	\$162,840,000.00
Transfers from Debt Service Funds of Current Refunded Bonds	690,300.00
Original Issue Premium	<u>2,061,510.15</u>
TOTAL SOURCES	<u>\$165,591,810.15</u>

USES:

Deposit to Capital Projects Account	\$136,371,000.12
Deposit to Escrow for Redemption of the Current Refunded Bonds	28,895,100.00
Underwriters' Discount	264,610.03
Bond Insurance Premium	<u>61,100.00</u>
TOTAL USES:	<u>\$165,591,810.15</u>

SUMMARY OF CURRENT REFUNDED BONDS

Refunding Series 2001A

Severance Tax Bonds, Refunding Series 2001A

<u>Maturity</u> <u>July 1</u>	<u>Interest</u> <u>Rate</u>	<u>Principal</u> <u>Refunded</u>	<u>CUSIP</u> <u>Number¹</u>	<u>Redemption</u> <u>Date</u>
2008	5.00%	\$16,660,000	647310 WD9	7/30/07
2009	5.00%	<u>4,620,000</u>	647310 WE7	7/30/07
		\$21,280,000		

Series 2002A

Severance Tax Bonds, Series 2002A

<u>Maturity</u> <u>July 1</u>	<u>Interest</u> <u>Rate</u>	<u>Principal</u> <u>Refunded</u>	<u>CUSIP</u> <u>Number¹</u>	<u>Redemption</u> <u>Date</u>
2008	5.00%	\$6,800,000	647310 WL1	7/30/07

¹ The State takes no responsibility for the accuracy of CUSIP numbers, which are included solely for the convenience of owners of the Current Refunded Bonds.

SEVERANCE TAX BONDING FUND AND DEBT SERVICE REQUIREMENTS

Severance taxes have been collected by the State since the adoption of the Severance Tax Act in 1937. Since 1959, certain Severance Tax receipts and certain other moneys determined by the Legislature have been deposited into the Bonding Fund and used, in part, to retire bond issues which have funded a variety of capital improvements in the State.

Pursuant to the provisions of the Severance Tax Act and the Oil and Gas Severance Tax Act, severance tax receipts, including penalties and interest, and such other moneys as the Legislature in its sole discretion may from time to time determine (including interest earnings on moneys in the Bonding Fund and the project accounts and reversions from project accounts in the Bonding Fund), are deposited into the Bonding Fund. As of the date of this Official Statement other moneys including interest earnings on moneys in the Bonding Fund, reversions from project accounts in the Bonding Fund, prepayments and tax settlements have been so deposited. See the table entitled “SEVERANCE TAX BONDING FUND RECEIPTS, DISBURSEMENTS AND TRANSFERS” herein. The moneys in the Bonding Fund are pledged for the payment of principal of, premium, if any, and interest on Severance Tax Bonds and Supplemental Severance Tax Bonds, and there are no other liens or encumbrances of any nature on or against (i) the Bonding Fund, or (ii) the net revenues derived from Severance Taxes which are required to be credited to the Bonding Fund.

Severance taxation is determined by State statute. For a description of the various Severance Tax rates and methods of their calculation, see “SEVERANCE TAX REVENUE” below.

Investments

Funds on deposit in the Bonding Fund, including the Debt Service Account and the Project Fund (established according to the Bond Resolution), are invested by the State Treasurer at the direction and approval of the Board, pursuant to the State Treasurer’s Investment Policy (“Investment Policy”). For a description of the Investment Policy, see “APPENDIX A.” 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 (defined in the Bond Resolution), interest earned on the amounts on deposit in the Debt Service Account shall be retained therein, and interest earned on amounts on deposit in the Project Fund shall be credited to the Debt Service Account and applied to the payment of principal of and interest on the Bonds next becoming due. Any loss resulting from any such investment shall be charged to the applicable account from which such investment was made.

Issuance of Severance Tax Bonds

The Severance Tax Bonding Act authorizes the issuance and sale of Severance Tax Bonds and Supplemental Severance Tax Bonds payable from the net receipts from taxes levied upon certain natural resource products severed and saved from the soil (“Severance Taxes”) in accordance with the provisions of, and as described in, the Severance Tax Bonding Act.

Severance Taxes are collected on a monthly basis by the New Mexico Taxation and Revenue Department (the “Tax Department”) and deposited in the Extraction Taxes Suspense Fund within the general fund of the State. On or around the 25th day of the month following the collection of the Severance Taxes, those tax revenues are released from the Suspense Account and deposited in the Bonding Fund.

On December 31 and June 30 of each fiscal year, excess funds in the Bonding Fund are transferred into the Severance Tax Permanent Fund. Excess funds are defined as funds in excess of the

next two semi-annual payments of debt service on Severance Tax Bonds and Supplemental Severance Tax Bonds. **Balances in the Severance Tax Permanent Fund are not pledged as security for the Bonds.**

In addition to the sale of long-term Severance Tax Bonds and Supplemental Severance Tax Bonds, the State issues short-term severance tax and supplemental severance tax funding notes from time to time to utilize excess capacity available in the Bonding Fund, and to make those funds available for capital projects of the State. These short-term obligations generally have a maturity of five days or less, mature in the fiscal year in which they are issued and are purchased by the State Treasurer.

State Capital Program

Proceeds from surplus State general fund balances, General Obligation Bonds, Severance Tax Bonds, Supplemental Severance Tax Bonds and Transportation Bonds are an important source of capital financing for the State. The following table summarizes the capital funding administered by the Board and certain other sources for fiscal year 2002 through fiscal year 2006 and for fiscal year 2007 year to date through March 31, 2007.

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

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u> (As of March 31)
Proceeds from General Obligation Bonding Program						
General Obligation Bonds	\$ 0.0	\$ 134.4	\$ 0.0	\$ 121.7	\$ 0.0	\$ 142.8
Subtotal	\$ 0.0	\$ 134.4	\$ 0.0	\$ 121.7	\$ 0.0	\$ 142.8
Proceeds from Severance Tax Bonding Program						
Severance Tax Bonds	\$ 69.5	\$ 76.6	\$ 74.5	\$ 87.6	\$ 136.1	\$ 0.0
Severance Tax Funding Notes ⁽¹⁾	103.1	56.4	63.7	87.8	102.1	24.4
Supplemental Severance Tax Bonds	65.0	45.0	10.0	10.0	0.0	0.0
Supplemental Severance Tax Funding Notes ⁽¹⁾	<u>35.1</u>	<u>111.8</u>	<u>151.9</u>	<u>213.3</u>	<u>193.6</u>	<u>145.8</u>
Subtotal	\$ 272.7	\$ 289.8	\$ 300.1	\$ 398.7	\$ 431.9	\$ 170.2
Proceeds From Other Sources						
General Fund ⁽²⁾	\$ 76.0	\$ 36.9	\$ 183.4	\$ 238.6	\$ 454.6	\$ 548.4
Transportation Bonds ⁽³⁾	<u>165.0</u>	<u>16.0</u>	<u>743.6</u>	<u>0.0</u>	<u>0.0</u>	<u>459.4</u>
Subtotal	\$ 241.0	\$ 52.9	\$ 927.0	\$ 238.6	\$ 454.6	\$ 1,007.8
Total	\$ 513.7	\$ 477.1	\$ 1,227.1	\$ 759.0	\$ 886.5	\$ 1,320.8

⁽¹⁾ The Board, in order to take advantage of Severance Tax Bonding Fund revenue that would otherwise be transferred to the Severance Tax Permanent Fund, issues Funding Notes to the State Treasurer (which are retired within the same Fiscal Year with such revenue) to fund authorized projects.

⁽²⁾ \$3,600,000 of the appropriation made in Fiscal Year 2002 was not available until Fiscal Year 2003.

⁽³⁾ On May 20, 2004, the New Mexico Finance Authority issued \$700,000,000 of new money bonds secured by a pledge of, and payable from, funds on deposit in the State Road Fund and the Highway Infrastructure Fund. On October 19, 2006, the New Mexico Finance Authority issued \$450,400,000 of new money bonds secured by a pledge of, and payable from, funds on deposit in the State Road Fund and the Highway Infrastructure Fund.

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 statewide capital projects. These other sources of funding include surplus general fund balances, special appropriations and proceeds of bonds issued by, among others, the New Mexico Finance Authority, the State Transportation Commission and state educational institutions.

Outstanding and Additional Severance Tax Bonds

The Bonds will be secured on a parity with the following Severance Tax Bonds anticipated to be outstanding upon the issuance of the Bonds (exclusive of those Severance Tax Bonds additionally secured by escrowed securities).

Principal Outstanding on Parity Severance Tax Bonds Upon the Delivery of the Bonds⁽¹⁾

Severance Tax Bonds, Refunding Series 2001A	\$ 42,835,000 ⁽²⁾
Severance Tax Bonds, Series 2002A	13,275,000 ⁽²⁾
Severance Tax Bonds, Series 2003A	55,380,000
Severance Tax Bonds, Series 2004A	58,495,000
Severance Tax Bonds, Series 2005A	80,950,000
Severance Tax Bonds, Refunding Series 2005B-1	37,040,000
Severance Tax Bonds, Series 2006A	<u>135,000,000</u>
Total	\$422,975,000

⁽¹⁾ As of July 1, 2007, an aggregate of \$60,935,000 of principal on the bonds in this table will be due and payable, and no longer outstanding.

⁽²⁾ The balances remaining of these bonds after July 1, 2007 are being currently refunded by a portion of the proceeds of the Bonds.

Additional parity bonds may be issued in the future if all outstanding Severance Tax Bonds, including the proposed bonds, can be serviced with not more than 50 percent of the annual deposits into the Bonding Fund as determined by the deposits during the fiscal year preceding the date of issuance of such Severance Tax Bonds. Following the issuance of the Bonds, Severance Tax Bonds in the amount of approximately \$200,863,510 remain authorized for issuance in the fiscal year ending June 30, 2007, but are unissued, a portion of which are expected to be funded with the proceeds of a Severance Tax Funding Notes to be issued by the end of June 2007. Included in this unissued amount is \$33,000,000 authorized pursuant to Chapter 111, Laws 2006, as amended by Chapter 42, Laws 2007, for the purpose of planning, designing, constructing, furnishing, and equipping the Southwest Regional Spaceport to be located in Sierra County, New Mexico. The issuance of Severance Tax Bonds for this purpose is subject generally to a number of conditions including the certification of sufficient development of the spaceport project.

Outstanding and Additional Supplemental Severance Tax Bonds

Supplemental Severance Tax Bonds were authorized pursuant to an amendment to the Severance Tax Bonding Act enacted in May 1999. Long-term Supplemental Severance Tax Bonds may be issued if all outstanding Severance Tax Bonds and Supplemental Severance Tax Bonds, including the proposed bonds, can be serviced with not more than 62.5 percent of the annual deposits into the Bonding Fund as determined by the deposits during the fiscal year preceding the date of issuance of such Supplemental Severance Tax Bonds. In addition, short-term supplemental severance tax funding notes may be issued in a fiscal year 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 Severance Tax Bonds and Supplemental Severance Tax Bonds and severance tax funding notes and supplemental severance tax funding notes does not exceed 95 percent of the deposits into the Bonding Fund during the preceding year. The Legislature has authorized the Board 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 Severance Tax Bonds.

The Bonds will be issued with a lien senior to the Supplemental Severance Tax Bonds, set forth in the table below, anticipated to be outstanding upon the delivery of the Bonds.

**Principal Outstanding on Supplemental Severance Tax Bonds
upon the Delivery of the Bonds⁽¹⁾**

Supplemental Severance Tax Bonds, Series 2000C	\$ 2,015,000
Supplemental Severance Tax Bonds, Series 2002A	13,335,000
Supplemental Severance Tax Bonds, Series 2002B	29,580,000
Supplemental Severance Tax Bonds, Series 2003B	7,545,000
Supplemental Severance Tax Bonds, Series 2004B	8,240,000
Supplemental Severance Tax Bonds, Refunding Series 2005B-2	<u>21,095,000</u>
Total	\$81,810,000

⁽¹⁾ As of July 1, 2007, an aggregate of \$14,765,000 of principal on the bonds in this table will be due and payable, and no longer outstanding.

The following tables set forth actual and projected results for the Severance Tax Bonding Fund including receipts, disbursements, debt service requirements, transfers and projected debt service coverage ratios.

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Severance Tax Bonding Fund
Receipts, Disbursements and Transfers
Fiscal Year Ended June 30⁽¹⁾⁽²⁾⁽³⁾
(Dollars in thousands)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Beginning Balance	\$80,749	\$8,258	\$10,184	\$27,175	\$103,909
Receipts:					
Oil & Gas Severance Tax	\$206,552	\$218,411	\$287,320	\$372,943	\$477,139
Other Minerals Severance Taxes	<u>23,954</u>	<u>19,232</u>	<u>18,273</u>	<u>18,637</u>	<u>20,198</u>
Total Severance Taxes	\$230,506	\$237,642	\$305,594	\$391,581	\$497,336
Other Income:					
Interest on Investments	\$11,007	\$5,526	\$5,475	\$10,994	\$25,284
Bond Proceeds	-	-	-	-	-
Other financial sources	<u>4,531</u>	<u>13,988</u>	<u>8,268</u>	<u>2,975</u>	<u>9,766</u>
Subtotal	\$15,539	\$19,514	\$13,743	\$13,969	\$35,050
Total Receipts	<u>\$246,045</u>	<u>\$257,157</u>	<u>\$319,337</u>	<u>\$405,549</u>	<u>\$532,386</u>
Disbursements:					
Senior Bond Debt Service ⁽⁴⁾⁽⁵⁾⁽⁶⁾⁽⁷⁾	\$132,510	\$71,425	\$67,590	\$ 7,551	\$132,594
Senior Short-term Obligations ⁽⁸⁾	103,077	54,026	63,657	87,793	102,158
Supplemental Bond Debt Service ⁽⁴⁾⁽⁵⁾⁽⁶⁾⁽⁷⁾	14,947	17,569	18,215	3,290	38,011
Supplemental Short-term Obligations ⁽⁸⁾	35,077	111,752	151,859	213,345	193,577
Fiscal Charges	<u>890</u>	<u>459</u>	<u>618</u>	<u>518</u>	<u>738</u>
Total Disbursements	\$286,501	\$255,230	\$301,940	\$312,497	\$467,076
Transfers:					
To Severance Tax Permanent Fund	<u>\$32,035</u>	<u>\$0</u>	<u>\$406</u>	<u>\$16,318</u>	<u>\$12,372</u>
Total transfers	\$32,035	\$0	\$406	\$16,318	\$12,372
Ending Balance, June 30	\$8,258 ⁽⁴⁾	\$10,184 ⁽⁵⁾	\$27,175 ⁽⁶⁾	\$103,909	\$156,847 ⁽⁷⁾

⁽¹⁾ All receipts, expenditures and balances exclude amounts in rebate accounts retained for potential arbitrage rebates.

⁽²⁾ Balances exclude loan receivable from Department of Labor. Loan repayment amounts are included as other income received.

⁽³⁾ Proceeds and expenditures attributable to refunding bonds are excludable from this table because these amounts are reserved for payment to the escrow agent and are not available for debt service payments.

⁽⁴⁾ Includes payment of \$71.5 million of debt service due 7/1/02 on senior and supplemental bonds that was paid on 6/29/02. Ending balance would have been \$79.8 million if this payment was not made during the period.

⁽⁵⁾ Includes payment of \$77.4 million of debt service due 7/1/03 on senior and supplemental bonds that was paid on 6/19/03. Ending balance would have been \$87.6 million if this payment was not made during the period.

⁽⁶⁾ Includes payment of \$77.43 million of debt service due 7/1/04 on senior and supplemental bonds that was paid on 6/29/04. Ending balance would have been \$104.5 million if this payment was not made during the period.

⁽⁷⁾ Includes payment of \$81.6 million of debt service due 7/1/06 on senior and supplemental bonds that was paid on 6/28/06. Ending balance would have been \$238.4 million if this payment was not made during the period. The ending balance includes the amount of the transfer to the Severance Tax Permanent Fund, which was made on July 12, 2006 in the amount of \$123,217,260.81 and additional transfer of \$22,254,808.30 made on December 11, 2006.

⁽⁸⁾ The Board, in order to take advantage of Bonding Fund revenues that would otherwise be transferred to the Severance Tax Permanent Fund, issues short-term Severance Tax funding notes and Supplemental Severance Tax funding notes to the State Treasurer which are retired within the same fiscal year with such revenue to fund authorized projects.

Source: State Board of Finance based on the Comprehensive Financial Reporting Accounting System.

Severance Tax Bonding Fund Projected Receipts
Fiscal Year Ending June 30⁽¹⁾
(Dollars in thousands)

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Severance Tax Bonding Fund Receipts					
Natural Gas	\$292,648	\$293,686	\$271,622	\$259,162	\$246,959
Oil	122,768	119,054	115,546	110,202	106,955
CO2	900	900	900	900	900
Oil & Gas Advanced payments, etc.	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Subtotal-Oil & Gas Severance Tax	\$416,316	\$413,640	\$388,069	\$370,264	\$354,813
Coal	\$ 18,254	\$ 18,254	\$ 18,254	\$ 18,254	\$ 18,254
Other Minerals	<u>1,516</u>	<u>1,457</u>	<u>1,422</u>	<u>1,397</u>	<u>1,397</u>
Subtotal-Other Severance Tax	\$ 19,770	\$ 19,711	\$ 19,676	\$ 19,651	\$ 19,651
Investment Earnings	\$ 22,061	\$ 21,919	\$ 20,564	\$ 19,620	\$ 18,802
Other Income	<u>\$ 5,742</u>	<u>\$ 5,705</u>	<u>\$ 5,353</u>	<u>\$ 5,107</u>	<u>\$ 4,894</u>
Total Receipts	\$463,888	\$460,975	\$433,661	\$414,642	\$398,160
Scheduled Senior Debt Service⁽²⁾	\$ 72,886	\$ 81,282	\$ 92,672	\$ 75,363	\$ 69,177
Senior Bond Debt Service Coverage	6.36x	5.67x	4.68x	5.50x	5.76x
Scheduled Supplemental Debt Service⁽²⁾	\$ 20,119	\$ 18,020	\$ 15,899	\$ 15,599	\$ 15,590
Supplemental Bond Debt Service Coverage	4.99x	4.64x	3.99x	4.56x	4.70x

⁽¹⁾ Columns may not total due to rounding.

⁽²⁾ Includes debt service on the Bonds. Excludes debt service on refunded bonds which will be payable from escrowed securities and severance tax debt obligations sold to the State Treasurer which are retired within the same fiscal year.

Source: NM Department of Finance and Administration and Fiscal Strategies Group.

See also, "NATURAL GAS PRODUCTION AND SEVERANCE TAX REVENUE -- Projections of Severance Tax Revenues from Natural Gas", "OIL PRODUCTION AND SEVERANCE TAX REVENUE -- Projections of Severance Tax Revenues from Oil", and "COAL PRODUCTION AND SEVERANCE TAX REVENUE -- Projections of Severance Tax Revenue from Coal" herein.

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**State of New Mexico Severance Tax Bonds
Projected 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
2007	\$463,888,152	\$72,885,573	6.36x	\$20,118,842	4.99x
2008	460,975,134	81,282,467	5.67x	18,020,276	4.64x
2009	433,661,260	92,671,800	4.68x	15,899,233	3.99x
2010	414,642,230	75,362,713	5.50x	15,598,983	4.56x
2011	398,160,003	69,176,719	5.76x	15,589,920	4.70x
2012	349,335,346	69,356,888	5.04x	15,568,239	4.11x
2013	344,263,590	69,722,163	4.94x	8,122,849	4.42x
2014	339,208,036	61,841,800	5.49x	2,463,283	5.27x
2015	334,365,305	52,653,619	6.35x	1,178,750	6.21x
2016	329,538,775	44,147,250	7.46x		
2017	324,744,650	33,173,438	9.79x		
2018	320,147,146	16,462,800	19.45x		

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

Source: NM Department of Finance and Administration and Fiscal Strategies Group.

See also, the table entitled “SEVERANCE TAX BONDING FUND PROJECTED RECEIPTS” herein.

SEVERANCE TAX REVENUE

The minerals extracted from the State that contribute the largest portion of Severance Tax revenues are natural gas, oil and coal. Severance Tax collections on these three mineral resources produced over 93 percent of total fiscal year 2006 Severance Tax Bonding Fund tax collections. Severance Taxes from natural gas and oil together represent approximately 89.6 percent of total fiscal year 2006 Bonding Fund tax receipts.

The State’s Energy, Minerals, and Natural Resources Department (“EMNRD”) records and generates data on mineral resources in the State. EMNRD produces annual reports on the State’s mineral resources. The Tax Department compiles reports of taxable volume, value, deductions and tax receipts by commodity and land type. Annual production estimates and projections of Severance Tax receipts are made by the Department of Finance and Administration (“DFA”) in cooperation with the Tax Department. See “APPENDIX C: FORM OF ATTORNEY GENERAL’S NO LITIGATION LETTER” for a discussion of pending litigation and other proceedings concerning the collection of Severance Taxes.

Severance Tax Collections and Reporting

Operators, purchasers or working interest owners are required to submit monthly reports to the Tax Department showing the total value, volume and kind of products sold from each production unit during the 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 is reported by “production unit,” a designation for a well or group of wells that is assigned by the Tax Department based on the master operator, property name identification and pool. A suffix is added to the production unit number to designate the specific land type and taxing authority—including counties, school districts and municipalities. The Tax Department receives approximately 750 oil and gas returns per month. These returns contain an average of approximately 75,000 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 twenty-fifth 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 a rate of 1.25 percent per month 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 a month, up to a maximum of 10 percent of the tax due.

The State maintains an automated database system (Oil and Natural Gas Administration and Revenue Database or “ONGARD”) to monitor transactions with 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 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 tax amounts received by the Tax Department are deposited into the Extraction Taxes Suspense Fund. Using the ONGARD system, the Tax Department 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 are then transferred, once a month, to the Bonding Fund.

Severance Tax on Indian Land

The United States Supreme Court has ruled that the state can tax non-Indian oil and gas production on tribal land (Cotton Petroleum Co. v. State of New Mexico, 490 US 163, 104 L. Ed. 2d 209, 109 S. Ct. 1968 (1989)). The authority of the state to impose severance taxes on Indian oil and gas production on tribal land was upheld by the United States District Court in New Mexico (Jicarilla Apache Tribe v. New Mexico Taxation and Revenue Department, No. USDC 87-922). The Taxation and Revenue Department reports that natural gas production and crude oil production on Indian land was approximately 3.7% and 0.8%, respectively, of total taxable statewide production in 2006. The Tax Department estimates that coal production on Indian land ranges from 40 to 45 percent of total statewide production from year to year. No potash or copper is produced on Indian land.

The Laws of 1995, Chapter 171 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% 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 Tax Department estimates that total credits claimed under this provision were about \$4.65 million in 2006. About \$2.3 million of these credits were applied against oil and gas severance tax liability. The Bonding Fund revenue projection assumes that this amount will grow slowly in the future.

Laws 2001, Chapter 134, provides a similar 75 percent intergovernmental tax credit against severance tax and severance surtax on coal mined on the Navajo Nation. The Taxation and Revenue Department reports that this credit reduced Severance Tax Bonding Fund revenue by \$6.9 million in fiscal year 2006. Laws 2002, Chapter 15, created the Jicarilla Apache Tribal Capital Improvement Tax Credit, but this credit does not apply against the severance tax revenues due on the same production, and therefore does not affect revenue pledged to the Bonds.

NATURAL GAS PRODUCTION AND SEVERANCE TAX REVENUE

Natural Gas Reserves and Well Completions

The chart on the following page presents the U.S. Energy Information Administration (“EIA”) estimates of natural gas “proved reserves” in New Mexico over the years 1984 to 2005. Proved reserves are estimates of recoverable volumes under existing economic and operating conditions. They represent the narrowest measurement of energy resources. Each year the EIA updates its estimates to reflect new information, new discoveries and the production during the year. Increases due to revisions and new discoveries usually offset some or all of the decline due to current production.

New Mexico’s proved natural gas reserves were estimated to be 19,344 billion cubic feet (bcf) at the end of calendar year 2005, up from 18,747 bcf at the end of calendar year 1995, a decade earlier. Reserves increased by about 597 bcf during the period, and production was about 16,044 bcf. Additions through new discoveries and revised estimates have offset 103.7 percent of the production during the decade. The current reserve estimate represents a New Mexico reserve-to-current-production ratio of 12.14.

New Mexico’s proved natural gas reserves increased in the early 1990’s due to exploration and development in coal seams that was triggered by the federal income tax credit (Section 29 of the Internal Revenue Code). The credit is currently worth more than \$1.00 per thousand cubic feet (mcf) of production and grows with inflation. The credit is no longer available for production occurring after 2002. Production from coal seam formations now accounts for approximately one-third of total statewide natural gas production.

The “proven reserves-to-production” ratio is a measure analogous to inventory-to-production for manufacturers. It represents the known resources that could be developed at today’s prices. As is the case for other industries, oil and gas producers have to balance their need for adequate inventories with the cost of exploring and developing the reserves. Although they have maintained higher ratios at times in the past, the industry has targeted lower ratios in recent years as a cost savings measure.

Over the last two decades, gas producers have replaced most of their production with new discoveries. As a result, reserves of natural gas at the end of calendar year 2005 were 7,906 bcf above the level at the beginning of 1985, although 27,619 bcf had been produced in the period. Replacement of reserves by new discoveries and further development of existing formations is a key component of the State’s long-term production forecast. New discoveries are expected to offset much of future production. As a result, annual production is expected to decline only gradually. Over time, technology has advanced the discovery of new reserves and the production capability for reserves. The reserves to current production ratio has stabilized between 10.1 and 12.1 over the last ten years.

New Mexico Natural Gas Reserves⁽¹⁾
(Gas numbers in billion cubic feet)

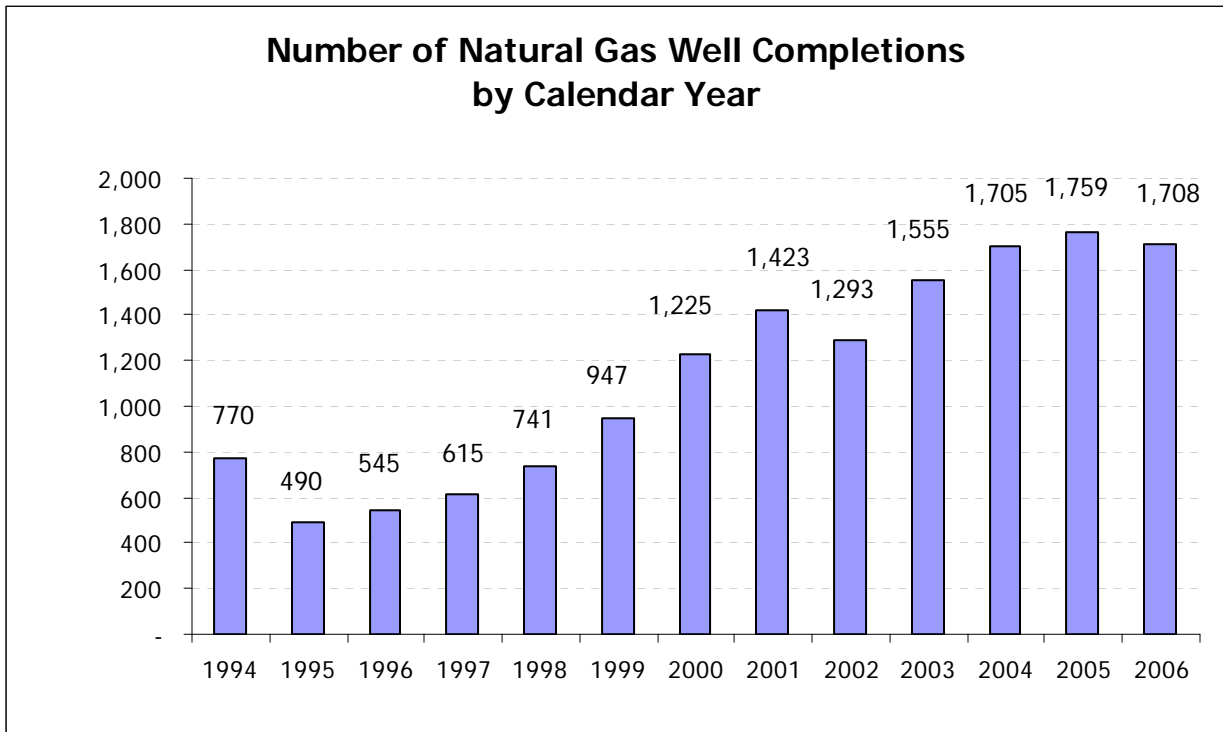
Year	<u>Beginning Reserves</u>	<u>Net Additions/ Adjustments</u>	<u>Estimated Production</u>	<u>Ending Reserves</u>
1984	12,371	573	917	12,027
1985	12,027	307	896	11,438
1986	11,438	1,779	677	12,540
1987	12,540	871	790	12,621
1988	12,621	6,655	793	18,483
1989	18,483	(1,067)	819	16,597
1990	16,597	2,883	951	18,529
1991	18,529	2,309	1,080	19,758
1992	19,758	1,859	1,218	20,399
1993	20,399	959	1,419	19,939
1994	19,939	98	1,449	18,588
1995	18,588	1,642	1,483	18,747
1996	18,747	708	1,530	17,925
1997	17,925	430	1,655	16,700
1998	16,700	1,114	1,555	16,259
1999	16,259	2,137	1,646	16,750
2000	16,750	3,382	1,623	18,509
2001	18,509	1,699	1,649	18,559
2002	18,559	1,528	1,634	18,453
2003	18,453	1,299	1,526	18,226
2004	18,226	3,093	1,632	19,687
2005	19,687	1,251	1,594	19,344

⁽¹⁾ As measured by wet after lease separation. Wet after lease separation represents the volume of natural gas that is marketable after exclusion of pentanes, hydrocarbons and nonhydrocarbons. The presence of these chemicals renders gas unmarketable.

Source: EIA.

Drilling activity in New Mexico has subsided somewhat following a boom in 1990 and 1991 that was stimulated by the deadline for the federal coal seam tax credit. The collapse of oil prices in 1998 caused sharp cutbacks in drilling for both oil and gas wells. The subsequent recovery of prices for both oil and gas has spurred a sharp increase in drilling activity. The drilling rig count in the State has more than tripled since 1995 in response to higher oil and natural gas prices.

In early August 1999, a joint venture between Sonat Raton and PennzEnergy Corporation announced plans for an extensive development program in the Raton Basin in northeastern New Mexico. Since 2000, production from the Raton Basin has yielded 80 million mcf. Production in fiscal year 2006 was 25.7 million mcf. Natural gas prices from production in the Raton Basin are higher than natural gas prices from production in the San Juan Basin because the Raton Basin has better pipeline access to potential markets.



Source: NM Energy, Minerals and Natural Resources Department.

Natural Gas Markets

Between 1986 and 2002, total U.S. consumption of natural gas had grown in all but one year, reaching 23.0 trillion cubic feet (tcf) in calendar year 2002. Since then, total consumption declined to 22.3 tcf in calendar year 2003, 22.4 tcf in 2004, 22.2 tcf in 2005 and 21.9 tcf in 2006. Consistently higher prices over the past several years have resulted in a decrease in demand for natural gas as users switched to alternative petroleum-based products or were priced out of the market. According to the EIA, during the period 1986 through 2003, domestic production increased steadily from less than 17 tcf in 1986 to 19.1 tcf in calendar year 2003. Since 2003, domestic production has decreased by three percent to 18.48 tcf in calendar year 2006. Declining production in mature provinces such as West Texas has been offset by sharp production increases from coal-bed methane formations and deepwater Gulf of Mexico deposits. The growing gap between domestic production and domestic consumption has been met by sharply growing imports, from 0.75 tcf in 1986 to 3.4 tcf in calendar year 2006.

The balance between supply and demand has shifted periodically during the 1990's, depending on the availability of pipeline capacity for expanded imports, as well as the usual weather-related conditions. Average wellhead prices were relatively stable from 1988 through 1992, but have fluctuated since 1993. New Mexico producers have generally received a lower price at the wellhead due to the longer distance from the dominant east coast markets than the competing product from Texas and Louisiana, and the resulting higher transportation costs. National average wellhead prices and average New Mexico wellhead prices for 1997 through 2006 are presented in the following table.

**Average Wellhead Price by Calendar year
(\$ per thousand cubic feet)**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
National Average Wellhead Price	\$2.32	\$1.96	\$2.19	\$3.68	\$4.00	\$2.95	\$4.88	\$5.49	\$7.51	\$7.33
New Mexico Producers	\$1.76	\$1.76	\$2.11	\$3.43	\$3.89	\$2.68	\$3.60	\$4.68	\$5.80	\$6.38
NM as a percentage of National Average	76%	90%	96%	93%	97%	91%	74%	85%	77%	87%

Source: National average prices: EIA, "Monthly natural gas prices" selected issues. New Mexico average prices: DFA calculations based on severance tax return data.

New Mexico's producers have benefited from higher wellhead prices since 1996. Economic growth in California, the end-use market for a majority of gas produced in the State, has caused prices received in the San Juan Basin to increase relative to eastern markets. Additions to pipeline infrastructure have enabled the State's producers to move gas east or west to the more profitable market. The result has been improved New Mexico wellhead prices compared to the national average.

Natural Gas Production

Total natural gas production in New Mexico increased sharply in the early 1990's due to increased coal seam production in the San Juan Basin. This production was stimulated by federal income tax credits that expired at the end of calendar year 2002. Coal seam gas production now accounts for approximately one-third of total statewide production. After rising steadily through the 1990s, total statewide production began to decline in 2002, falling below 1,600 bcf in fiscal years 2003 through 2006. Total revenue doubled in fiscal year 2001 as shortages caused gas prices to spike to unprecedented levels during the winter of 2000-2001. Since that time, revenue continues to rise as the price of natural gas has once again increased sharply, reaching \$7.46 in fiscal year 2006. Taxable production volume, sales revenue and average price per thousand cubic feet for fiscal years 1997 through 2006 are presented in the following table.

**Natural Gas Subject to Taxation
Production, Revenues and Average Price
Fiscal Years 1997-2006**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Sales Volume (bcf)	1,543	1,609	1,615	1,625	1,627	1,614	1,570	1,534	1,560	1,510
Sales Revenues (millions)	\$3,290	\$3,343	\$2,722	\$4,004	\$8,105	\$4,318	\$5,652	\$7,179	\$9,029	\$11,265
Average Price per mcf	\$2.13	\$2.08	\$1.69	\$2.46	\$4.98	\$2.68	\$3.60	\$4.68	\$5.79	\$7.46

Source: NM Taxation and Revenue Department and Fiscal Strategies Group.

The following table sets forth the production levels of the State's largest gas producers in calendar year 2005.

Ten Largest Natural Gas Producers in New Mexico and 2005 Production

	Billion Cubic Feet
Burlington Resources	360
Conoco Phillips Company	233
BP America Production Co.	104
Devon Energy Production Co.	103
Yates Petroleum	64
Energen Resources Corp.	46
XTO Energy Inc.	45
Williams Production Co.	43
Chevron USA Inc.	40
Marathon Oil Company	31

Source: NM Energy, Minerals and Natural Resources Department, Oil Conservation Division.

Severance Taxes on Natural Gas

Severance taxes are levied by statute on the sale or transport out of state of natural gas produced in the State. State taxation of minerals production for the general fund began as early as 1933. The Severance Tax Bonding Act, enacted in 1961, earmarked a portion of the existing severance tax to pay debt service on severance tax bonds, with remaining revenues going to the general fund. The severance tax at that time was 2.5 percent of the marketable sales value, with deductions allowed for royalties to governments and for certain processing and transportation expenses. Beginning in 1973, the Severance Tax Permanent Fund was created, receiving excess severance tax revenues not required for debt service payments.

The tax rate was increased to 3.75 percent of value in 1974. Beginning in 1977, the tax rate was converted to a per unit basis, \$0.05 per mcf of gas, with a deduction allowed for royalties to governments. A surtax was added, equal to the base tax rate times the percentage increase in the Consumer Price Index (CPI) from the base year. This surtax rate was updated annually. The base tax rate was increased to \$0.087 per mcf in 1980, and the surtax provision continued to apply.

By July 1, 1986 the surtax had reached \$0.076 and the total tax rate was \$0.163 per mcf. With the sharp decline in wellhead natural gas prices in 1986, the effective severance tax rate was over 8.0 percent of gross sales value. The combined effective tax rate on gas production, including general fund taxes, was over 11.0 percent, significantly higher than in neighboring gas-producing states. The 1987 Legislature responded to declining prices by converting the tax to 3.75 percent of value on a phased in basis. Beginning July 1, 1990, the new tax rate applied to all production.

The 1995 Legislature authorized reduced severance tax rates for certain categories of production. A 10-year exemption from Severance Taxes was provided for production from previously non-producing wells ("restoration"). A 50 percent rate reduction was provided for incremental production from a qualifying work over project ("recompletion"). Qualified volumes are expected to grow slowly over time.

In response to sharply lower oil prices and declining production of oil and associated natural gas, the 1999 Legislature adopted new severance tax incentives for production from recompletion wells and stripper wells. Instead of a 50 percent rate reduction (from 3.75 percent to 1.875 percent) for only the *incremental* production from recompletion wells, a tax rate of 2.45 percent was applied to *all* production from qualified wells. This provision had a minimal effect on severance tax collections, as the higher incentive tax rate offsets the increase in eligible volumes.

For stripper well production, the 1999 legislation introduced a sliding scale of applicable tax rates, depending on the prevailing taxable value of products. For natural gas, a stripper well is defined as one having average daily production of less than 60,000 cubic feet per day. For oil wells, the threshold is 10 barrels per day.

The following table summarizes incentive tax rates applied to various categories of oil and gas production in New Mexico as of fiscal year 2006. However, due to the rise in oil and gas prices, most of these incentive programs are not currently in effect. Should prices decline in the future, some of these incentives again will be applicable.

Oil and Gas Tax Incentive Programs

<u>Incentive Category</u>	<u>Incentive Tax Rate</u>	<u>Threshold price below which incentive rate applies</u>	<u>Qualified production as a percent of fiscal year 2006 total</u>
Restoration wells	0.0%	\$24.00 per barrel ⁽¹⁾	0.0% Natural Gas ⁽³⁾ 0.0% Oil ⁽³⁾
Recompletion wells	2.45%	\$24.00 per barrel ⁽¹⁾	0.0% Natural Gas ⁽³⁾ 0.0% Oil ⁽³⁾
Stripper wells	1.875%	\$1.15 per mcf-Gas ⁽²⁾ \$15.00 per barrel-Oil ⁽²⁾	0.0% Natural Gas ⁽³⁾ 0.0% Oil ⁽³⁾
	2.8125%	\$1.35 per mcf-Gas ⁽²⁾ \$18.00 per barrel-Oil ⁽²⁾	0.0% Natural Gas ⁽³⁾ 0.0% Oil ⁽³⁾
Enhanced oil recovery	1.875%	\$28.00 per barrel ⁽¹⁾	0.0% Oil

⁽¹⁾ Twelve month average price for West Texas Intermediate crude oil as reported on Oil Postings for last day of each month.

⁽²⁾ Average annual taxable value of natural gas or oil sold in New Mexico during the preceding calendar year.

⁽³⁾ No oil or natural gas volumes are expected to qualify for these incentives during fiscal year 2005 because average taxable value exceeds the threshold levels.

Source: NM Department of Finance and Administration.

Projections of Severance Tax Revenues from Natural Gas

Natural gas production in the State is expected to decline by an average 1 percent to 2 percent per year in the future. Most of the wells in the State have been producing for a prolonged period, and the loss of pressure in gas formations will lead to declines in per well production that will be partially offset by new drilling. New gas development in the Raton Basin could result in an increase in future gas production in the State.

The natural gas price outlook is based on analysis of national markets by Petroleum Industry Research Associates (“PIRA”) and the New Mexico consensus revenue estimating group, which is composed of economists from the executive and legislative branches of New Mexico state government. Natural gas prices rose to levels that were unprecedented during the winter of 2000-2001. Supplies failed to keep up with increasing demand and inventories reached record low levels. After falling back to lower levels, in response to the economic recession and slower economic growth, prices rose again in anticipation of the war with Iraq. The 2005 hurricane season and resulting damage of the natural gas infrastructure in the Gulf of Mexico caused prices to increase to historically high levels. Volatility in oil producing countries such as Iran and Nigeria has also influenced natural gas prices upward. The result is higher natural gas prices for the foreseeable future.

Almost all new power plant capacity being planned at the present time is gas-fired. Environmental concerns with coal power make gas a preferred option. In addition, deregulation of electric power markets places a premium on “distributed generation” – power generation facilities that are closer to end use markets than traditional, central-station facilities. Under likely scenarios, PIRA sees the potential for natural gas demand to increase by 50 percent over the next 10 to 15 years. Given relatively limited options for domestic supply, and even assuming increases in imports, the result should be strong upward pressure on natural gas prices in the long term.

The average price received by New Mexico producers doubled from 42.46 in fiscal year 2000 to \$4.98 in fiscal year 2001. While prices decreased in fiscal year 2002 to \$2.68, they have increased steadily since that time, reaching a record high of \$7.46 in fiscal year 2006. Based on the long-term outlook for natural gas demand projected by PIRA, the price received by New Mexico producers is expected to decline to \$6.20 in fiscal year 2007.

The severance tax base for natural gas is defined as the wellhead value less deductions for the expense of transporting and processing their product to the first point of sale. In addition, deductions are allowed for royalties paid to governmental entities (federal, state and tribal). The combined value of all deductions has averaged about 20 percent of gross wellhead sales value in recent years. Thus, estimated taxable value is about 20 percent lower than the sales prices reported in the following table.

**New Mexico Gas Volume, Price and Severance Tax Projections
Fiscal Years Ending June 30**

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Natural gas sales (bcf)	1,535	1,520	1,505	1,490	1,475
Average sales price (\$/mcf)	\$6.20	\$6.30	\$5.90	\$5.70	\$5.50
Severance Taxes on Gas (in thousands)	\$292,648	\$293,686	\$271,622	\$259,162	\$246,959

Source: NM Department of Finance and Administration and Fiscal Strategies Group.

OIL PRODUCTION AND SEVERANCE TAX REVENUE

Oil Reserves and Production

The chart below presents the EIA’s estimate of oil “proven reserves” from 1984 to 2005. Proven reserves are estimates of recoverable barrels under existing economic and operating conditions. As oil prices rise, proven reserves increase. They represent the narrowest measurement of the country’s energy resources. Each year the EIA updates its estimates to reflect new information, new discoveries and production during the year. Increases due to revisions and new discoveries usually offset some or all of the decline due to current production. The EIA reports on proven reserves of crude oil in the State on the basis of company surveys. Current New Mexico reserves represent approximately 11.15 years of production.

The “proven reserves-to-production” ratio is a measure analogous to inventory-to-production for manufacturers. It represents the known resources that could be developed at today’s prices. As is the case for other industries, oil producers have to balance their need for adequate inventories with the cost of exploring and developing the reserves. Although they have maintained higher ratios at times in the past, the industry has targeted lower ratios in recent years as a cost savings measure.

Oil reserves at the end of calendar year 2005 were 110 million barrels higher than at the beginning of calendar year 1984. The increases in the reserves are believed to have come from acquisitions and from better extraction technologies. In addition, the current price environment makes high-cost wells more economically feasible. The New Mexico Taxation and Revenue Department is forecasting an annual decline of three percent for oil production and one percent for natural gas production.

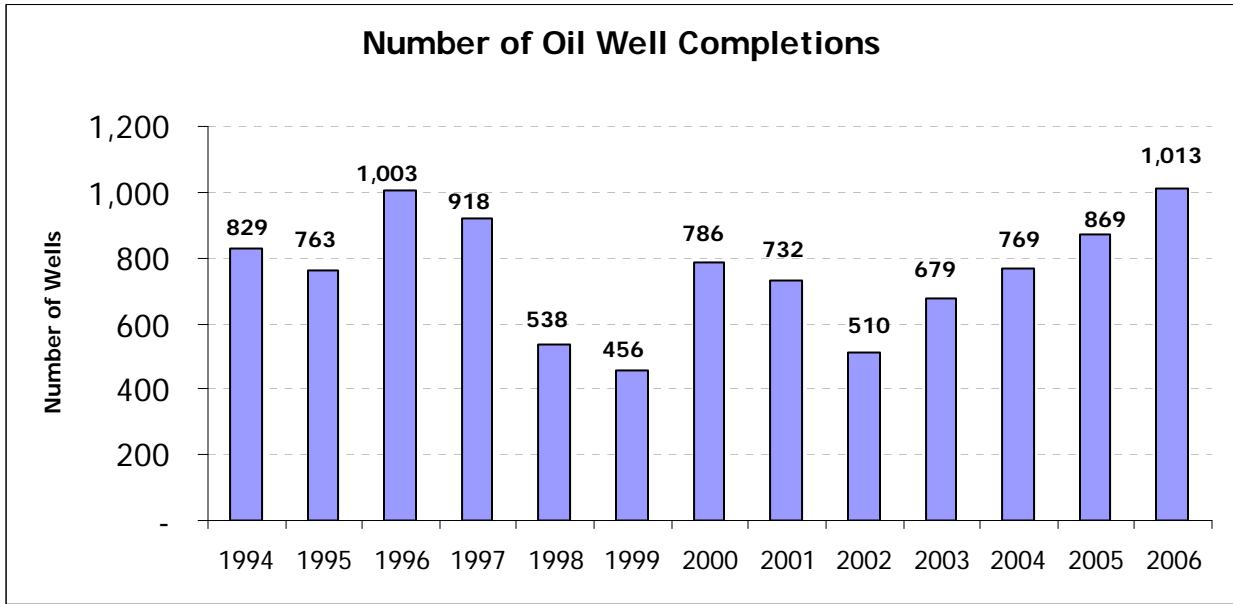
**New Mexico Oil Reserves
Crude Oil⁽¹⁾**

<u>Year</u>	<u>Beginning Reserves</u>	<u>Additions/ Adjustments</u>	<u>Estimated Production</u>	<u>Ending Reserves</u>
1984	580	156	76	660
1985	660	104	76	688
1986	688	29	73	644
1987	644	79	69	654
1988	654	71	64	661
1989	661	68	64	665
1990	665	83	61	687
1991	687	99	65	721
1992	721	100	64	757
1993	757	14	64	707
1994	707	74	63	718
1995	718	80	66	732
1996	732	82	70	744
1997	744	54	63	735
1998	735	-56	59	620
1999	620	159	61	718
2000	718	58	57	719
2001	719	58	62	715
2002	715	59	64	710
2003	710	26	59	677
2004	677	52	60	669
2005	669	79	58	690

⁽¹⁾ Barrels in millions.

Source: U.S. Energy Information Administration and NM Taxation and Revenue Department.

Potential new development of oil resources is indicated by exploration and drilling activity. Secondary or tertiary recovery projects (water or carbon dioxide injection) typically require new development wells. The following chart presents oil well completions during the period 1994 through 2006.



Source: NM Energy, Minerals and Natural Resources Department.

Oil Production

Oil production in the State reached its highest level in 1969 at 129.2 million barrels. After declining during the 1980's, a period of dramatically lower oil prices, production had stabilized around 70 million barrels per year during most of the 1990's and has fluctuated between 62 and 69 million barrels per year in the past five years. Application of three-dimensional seismic technology has been very successful in New Mexico, enabling production from shallower depths in older, mature fields. The following table sets forth the production levels of the largest oil producers in the State in calendar year 2005.

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Ten Largest Oil Producers in New Mexico and 2005 Production
Millions of Barrels

	<u>Millions of barrels</u>
Chevron USA. Inc.	5.6
Occidental Permian	4.1
Conoco Phillips Company	4.0
Marbob Energy	3.4
Devon Energy Production Co.	2.9
Yates Petroleum	2.6
Chesapeake Operating, Inc.	2.2
Mack Energy Corp.	2.0
Pogo Production Co.	1.8
Amerada Hess Corp.	1.6

Source: NM Energy, Minerals and Natural Resources Department, Oil Conservation Division.

Severance Taxes are levied on oil on the basis of sales value at the time of either sale or transportation from the State. Oil production and oil sales are related but are not directly proportional because of stockpiling and price fluctuations from period to period. Estimates of oil sales occurring in the last ten fiscal years are presented in the following table.

	Oil Subject to Taxation									
	Production, Revenues and Average Price									
	<u>Fiscal Years 1997-2006</u>									
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Sales Volume (bbls in millions)	75.4	73.5	66.0	67.3	70.3	69.0	68.5	66.5	63.5	61.96
Sales Revenues (billions)	\$1,590	\$1,238	\$0,740	\$1,485	\$2,018	\$1,521	\$1,904	\$2,126	\$2,794	\$3,651
Average Price per Barrel	\$21.09	\$16.84	\$11.21	\$22.07	\$28.71	\$22.04	\$27.80	\$31.97	\$44.00	\$58.92

Source: NM Department of Finance and Administration and Fiscal Strategies Group.

Severance Taxes on Oil

Severance taxes are levied by statute on the sale or transport out of state of oil produced in the State. The severance tax rate on oil was increased to 3.75 percent of sales value in 1974. Beginning in 1977, the rate was converted to \$0.45 per barrel, with a surtax indexed to the CPI. In 1980, the tax rate was converted back to 3.75 percent of value.

In 1992, the Legislature provided a 50 percent reduction of the severance tax rate applied to oil produced through enhanced recovery methods. Enhanced methods include carbon dioxide miscible fluid displacement, water flood, pressure maintenance and thermal methods. The reduced rate applies to all production from an enhanced recovery project following certification of a positive production response by EMNRD's Oil Conservation Division.

The 1995 Legislature authorized reduced severance tax rates for certain categories of production. A 10-year exemption from Severance Tax was provided for production from previously non-producing wells ("restoration"). A 50 percent rate reduction was provided for incremental production from a qualifying work over project ("recompletion"). During fiscal year 1999, 100,000 barrels of oil had qualified for the restoration tax exemption. During the same period, 500,000 barrels of oil had qualified for the recompletion rate reduction. Combined, these volumes represent less than 1.0 percent of annual production of oil. Qualified volumes are expected to grow slowly over time. The 1999 Legislature expanded the incentive program for recompletion wells and created a new incentive for stripper wells.

Projections of Severance Tax Revenues from Oil

Volume of production: The natural rate of production decline from an oil field, absent application of enhanced recovery methods (“EOR”) or additional drilling for exploration and development, is usually estimated at 10 percent per year. During most of the 1990’s, producers prevented a decline in total production by a combination of new well drilling, well maintenance activity and EOR investment. Oil producers responded to higher world oil prices by increasing output in fiscal year 2001. Since then, output has declined by 1 percent to 2 percent and is expected to continue to decline at this rate. The current West Texas Intermediary price per barrel is \$60.55⁽¹⁾. In spite of high prices, oil production continues to decline.

Prices: Average annual oil prices received by New Mexico producers have fluctuated from a low of \$11.21 to a high of \$59.00 over the past decade. A dramatic cycle in crude oil prices was initiated in the fall of 1997, when the OPEC cartel announced its intention to increase production quotas. Coincident with a worldwide economic slowdown, the announcement led to a drop of about 50 percent in world crude oil prices. A new agreement to reduce production levels was reached by the cartel during the spring of 1999. The OPEC action and the dramatic rise in the domestic price for natural gas led to a spike in oil prices in 2001. Since that time, prices abated as world economic growth slowed, and then rose again in anticipation of potential production shortfalls related to the war in Iraq and other potential instability in oil-producing countries. A long-term downward trend in production levels is expected, with prices stabilizing, as set forth in the table below. For New Mexico producers, a price of \$61.00 is expected for fiscal year 2007 and is expected to decline to \$60.00 beginning in fiscal year 2010 and the rest of the forecast period.

**New Mexico Oil Volume, Price, and Severance Tax Projections
Fiscal Years Ending June 30**

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Oil sales (million barrels)	59.5	57.7	56.0	54.3	52.7
Average price (\$/barrel)	\$61.00	\$61.00	\$61.00	\$60.00	\$60.00
Severance Taxes on Oil (in thousands)	\$122,768	\$119,054	\$115,546	\$110,202	\$106,955

Source: NM Department of Finance and Administration and Fiscal Strategies Group.

COAL PRODUCTION AND SEVERANCE TAX REVENUE

Coal Reserves and Production

Coal mining is currently based in the San Juan Basin in the northern and northwestern regions of the State, which accounts for all of the State’s coal production. The State Institute of Mining and Technology, Bureau of Mines and Mineral Resources (“IMT”) estimates that approximately 11 billion tons of strippable resources and approximately 28.4 billion tons of deep resources exist as reserves in the San Juan Basin. Total economically recoverable coal resources in the State are reported at approximately 45.8 billion tons. These estimates have been revised downward substantially since 1994 as a result of a thorough review of reserves by IMT. The quality of coal located in the State ranges from high-heat content bituminous coal to lower rank sub-bituminous coal. Coal found in the State is generally low in sulfur content, with wide variations in ash and moisture content. The demand for coal is largely a derived demand, depending heavily on the electrical power market. The power market in the western U.S., in turn, depends heavily upon economic conditions in California and upon regulatory actions taken in that

⁽¹⁾ As of April 16, 2007.

market. The forecast assumes no resurrection of an earlier proposal to impose environmental penalties in California on the use of electricity from coal-fired power plants. Such penalties would likely affect the level of sales of New Mexico coal.

Wholesale electricity prices in the western U.S. increased to unprecedented levels during the winter of 2000-2001. New generating capacity had not kept pace with increasing demand over the latter part of the 1990s, leading to reserve margins that fell below 10 percent. In addition, natural gas prices rose to unprecedented levels, which dramatically increased the cost of marginal electricity supplies. Wholesale prices remained high through the early spring, but fell back into their historical range in the summer of 2001 as the slowing economy and mild weather reduced demand. Natural gas prices have fallen by more than 50 percent, reducing fuel costs for electricity generators.

In spite of higher coal prices, a positive production response has not occurred. Total coal sales are expected to decline gradually in the forecast due to increased competition and environmental concerns. An increasing portion of total sales is expected to be eligible for the surtax exemption.

Severance Taxes on Coal

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 ton plus a surtax indexed to the CPI. The base 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. The current surtax rate is \$0.61 per ton, and \$0.59 for underground-mined coal, resulting in current combined rates for coal subject to severance surtax of \$1.18 for surface-mined coal and \$1.14 for underground-mined coal.

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 (only a very small portion of coal production comes from underground mines). Originally the surtax freeze was to have terminated on July 1, 1993. However, the 1993 Legislature extended the freeze until July 1, 1994, after which time the surtax is adjusted in accordance with the increase in the Producer Price Index ("PPI") for coal. 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. The surtax rate for fiscal year 1995 increased \$0.01 to \$0.61 per ton for surface coal and \$0.59 per ton for underground coal. The surtax rate for fiscal year 2007 will be \$0.73 per ton for surface coal and \$0.71 per ton for underground coal.

The 1990 Legislature suspended the surtax until July 1, 2009, for coal sold under new contracts entered into on or after July 1, 1990, and before July 1, 1994. The provision also extends to incremental sales under existing contracts measured by the increase in sales over the annual average established in fiscal years 1987-1989. The 1992 Legislature extended the surtax exemption to incremental sales under renegotiated contracts. Subsequent Legislatures extended the period for new contracts to qualify for the extension to June 30, 1999.

The 1999 Legislature reexamined coal severance taxes in the light of deregulation of the electric power market. Increased competition in power markets makes it harder for utilities to pass on the cost of high production taxes on coal used in generation. A study of New Mexico's coal taxes by economists at the Tax Department and the DFA indicated that New Mexico's taxes were among the highest in the

region.⁽¹⁾ In view of these facts, the 1999 Legislature and Governor acted to repeal the sunset of the severance surtax exemption. Thus, as existing contracts expire which are currently subject to the surtax, any subsequent contracts will be exempt from the surtax. Although a total of \$9.6 million in severance surtax was collected in fiscal year 2006, the impacts of the new statute are expected to be small, as most contracts subject to the surtax do not expire for a number of years. The full impact of the provision will not be felt until all existing contracts expire, in about 10 years.

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

Coal Production, Pricing and Tax Rates						
Fiscal Years 2001-2006						
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u> *	<u>2005</u>	<u>2006</u>
Total Sales Volume (short tons)	27,131,704	26,589,634	26,704,979	25,584,920	26,555,045	26,566,669
Surface Mined Surtax Exempt Volume	10,318,045	10,405,420	10,918,338	10,104,895	6,207,544	6,455,233
Surface Mined Non-Exempt Volume	15,705,560	14,715,458	13,626,804	14,066,790	13,434,239	13,140,540
Underground Non-Exempt Volume	1,108,099	1,468,656	2,159,837	1,512,643	6,913,261	6,970,895
Total Sales Revenue	\$548,233,652	\$528,324,790	\$611,561,557	\$583,588,317	\$659,066,157	\$659,678,864
Average Price Per Ton	\$20	\$20	\$22	\$23	\$25	\$26
Total Intergovernmental Tax Credits	NA	\$4,154,255	\$6,180,464	\$6,965,252	\$6,463,061	\$6,927,776
Estimated Net Severance Tax Liability	\$25,677,079	\$20,761,702	\$18,712,346	\$17,161,561	\$16,729,934	\$17,142,780
Average Tax Rate (dollars per ton)	\$0.95	\$0.78	\$0.67	\$0.67	\$0.63	\$0.65

* Total Volumes for 2004 are actual; Exempt and Non-Exempt Volumes are estimates from previous years' trends.

Source: NM Taxation and Revenue Department.

⁽¹⁾ "Taxation of Coal Production in Western States" by Kelly O'Donnell, N.M. Taxation and Revenue Department and Dr. Thomas Clifford, N.M. Department of Finance and Administration, presentation to the Revenue Stabilization and Tax Policy Committee, November, 1998.

Projections of Severance Tax Revenue from Coal

Coal Severance Tax projections were prepared by the DFA, based on an analysis of the demand for State coal for in-State electric power generation and for out-of-state uses (primarily power production as well). Usually 13 to 15 million tons per year of New Mexico coal production are burned at the Four Corners and at the San Juan generating stations. The sources for these operations are three mines in San Juan County; Navajo Mine feeds the Four Corners Station, while La Plata and San Juan Mines provide coal for San Juan Station. Most of the production from these mines is subject to the severance tax and the severance surtax. Severance tax collections are offset by the Intergovernmental Tax Credit for production on Indian lands that offset severance tax collections on coal by an estimated \$6.93 million in fiscal year 2006.

The McKinley Mine in the county of the same name, owned by the Pittsburg & Midway Mining Co. (Chevron) supplies coal to Arizona power stations. Output from the McKinley Mine was 5.67 million tons in fiscal year 2006, an increase from 5.57 million tons in fiscal year 2005 and 5.4 million tons in fiscal year 2004, and 5.5 million tons in 2003, but a decline from 6.1 million tons in fiscal year 2002, with the declining output due to competition from other electricity sources. Surtax non-exempt sales comprise almost 66% percent of their sales.

The Lee Ranch Mine, also in McKinley County, ships coal in varying quantities to Arizona power stations. Total production at Lee Ranch was 4.92 million tons in fiscal year 2006, down from 5.09 million tons in fiscal year 2005, 6.8 million tons in fiscal year 2004 and 6.7 million tons in fiscal year 2003. Surtax-exempt sales account for approximately 48% of sales.

BHP Billiton Company (including the San Juan Coal Company subsidiary) produced 16.0 million tons in fiscal year 2006, up from 8.98 million tons in fiscal year 2005, 8.2 million tons in fiscal year 2004, 15.3 in fiscal year 2003 and 14.3 in fiscal year 2002. About 33.3 percent of the total are surtax-exempt. In addition, about 20.0 percent of the total—3.0 million tons—is now being produced using underground “long-wall” mining techniques. The San Juan Coal Company implemented the technology in 2001 in order to increase productivity and prolong the life of the mine. Three companies have expressed interest in constructing power plants in the Four Corners region over the next several years. Additional generating capacity in the area is likely to result in increased demand for coal in the Four Corners region. Coal production generated in other states or on Indian land would limit the potential increase in severance tax revenues.

OTHER MINERAL PRODUCTION AND SEVERANCE TAXES

Carbon Dioxide

The Bravo Dome carbon dioxide (“CO₂”) field, encompassing 1.2 million acres in Harding, Union and Quay Counties in the northeastern area of the State, contains estimated resources of 16.3 trillion cubic feet, of which 7.0 to 10.6 trillion cubic feet are considered recoverable. Although the State has long produced limited quantities of liquid and solid CO₂ for use in the food and engineering industries, the main commercial value of carbon dioxide deposits is derived from 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 CO₂ 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 CO₂ are expected to remain near 125 bcf per year. The wellhead value of CO₂ sales currently is approximately \$0.35 per mcf reported at the production facility, and is expected to remain stable over the forecast period. Severance taxes on CO₂ are levied at the rate of 3.75 percent of sales value.

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 in the following table. In many cases, flat percentage deductions are allowed to account for certain production costs. The result is that the taxable value is a percentage of the “full” value. The “full value”, in turn, is sometimes based upon published prices rather than actual revenues.

Severance Tax Rates and Taxable Values on Other Minerals

<u>Mineral Resources</u>	<u>Tax Rates</u>	<u>Taxable Value as Percent of Full Value</u>
Potash	2.500%	16.67%
Copper	0.500%	16.67% ⁽¹⁾
Timber, Pumice, Gypsum, Sand, Gravel, Clay, Fluorspar, Other	0.125%	100.00% ⁽²⁾
Molybdenum	0.125%	50.00%
Lead, Zinc	0.125%	16.67% ⁽¹⁾
Gold	0.200%	50.00% ⁽¹⁾
Silver	0.200%	30.00% ⁽¹⁾
Uranium	3.500%	50.00%

⁽¹⁾ Value based upon the indicated percentage of specified Comex, LME or London spot prices published in Metals Week.

⁽²⁾ 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, which must be processed before sale, deductions are allowed for cost of processing and freight charges to the point of sale.

Source: NM Energy Minerals and Natural Resources Department.

Tax revenue from potash was about \$778,289 in fiscal year 2006. Severance tax revenue from copper is limited because of the statutorily defined narrow tax base. Revenue from copper peaked at \$593,000 in fiscal year 1996, a result of the combination of high prices and strong production, but most recent revenues were \$474,809 in fiscal year 2006. Copper prices have rebounded due to strong world demand, particularly in China. Prices increased \$1/lb in fiscal year 2006, to \$2.41/lb. Prices for 2007 are expected to be in the \$3.20 to \$3.50 range and remain in the high \$2 to low \$3 range through 2011.

TAXATION OF ENERGY MINERALS NOT PLEDGED

Rates for various property and production taxes on New Mexico minerals are summarized below. As discussed in prior sections of this Official Statement, proceeds from the Severance Tax and the Oil and Gas Severance Tax are pledged via the Bonding Fund to payment of interest, premium and principal of the Bonds. **Proceeds of other taxes shown below are not pledged to the payment of principal, premium, if any, or interest on Severance Tax Bonds.**

Production and Property Taxes on Oil and Gas

Current effective production and property tax rates expressed on *ad valorem* and unit bases are shown below. The rates were based on data from fiscal year 2006 and reflect an average sales price of \$58.92 per barrel for oil and \$7.46 per thousand cubic feet (mcf) for natural gas. The effective rates presented in the table below show taxes paid as a percentage of gross sales value before subtracting allowable deductions.

**Effective Production and Property Tax Rates on Oil and Gas
Fiscal Year 2006**

<u>Type of Tax</u>	Crude Oil			Natural Gas		
	<u>Statutory</u> <u>Rate</u>	<u>Ad</u> <u>Valorem</u>	<u>Per</u> <u>Barrel</u>	<u>Statutory</u> <u>Rate</u>	<u>Ad</u> <u>Valorem</u>	<u>Per</u> <u>mcf</u>
Price			\$58.92			\$7.46
Oil and Gas Emergency School Tax	3.15%	2.87%	\$1.69	3.15%	3.33%	\$0.25
Oil and Gas Severance Tax	3.75%	3.41%	\$2.01	3.75%	3.13%	\$0.23
Oil and Gas Conservation Tax	0.19%	0.17%	\$0.10	0.19%	0.16%	\$0.01
Natural Gas Processors Tax	N/A	N/A	N/A	\$0.011	0.23%	\$0.02
Oil and Gas Production ad valorem Tax	2.10%	1.05%	\$0.62	2.10%	0.87%	\$0.06
Oil and Gas Production Equipment ad valorem Tax	2.10%	0.13%	\$0.08	2.10%	0.13%	\$0.01
Total		7.64%	\$4.50		7.86%	\$0.58
Subtotal – State tax only, excludes ad valorem taxes		6.46%	\$3.81		6.86%	\$0.51

Source: NM Taxation and Revenue Department.

The School Tax rate of 3.15 percent imposed on natural gas was raised to 4.00 percent effective July 1, 1993, pursuant to Laws 1993, Chapter 360. This action was taken partially to compensate for the large decreases in revenues due to the 1987 tax changes for natural gas. Further, it was believed that the tax increase was tolerable to industry because of relatively higher prices. The School Tax rate imposed on crude oil continues to be 3.15 percent.

Statutory rates on Oil for the School Tax (3.15 percent), the oil and gas severance tax (3.75 percent) and the conservation tax (0.19 percent) are effectively reduced by deductions allowed for trucking costs and for Federal, State and Indian royalties. Statutory rates on natural gas for the school tax (4.00 percent), the oil and gas severance tax (3.75 percent), and the conservation tax (0.19 percent) are effectively reduced by deductions for Federal, State and Indian royalties and by deductions for transportation and processing tariffs upstream of the sales location. The *ad valorem* taxes are imposed in lieu of property taxes on reserves and lease equipment, and local rates vary in accordance with jurisdiction.

The 2005 Legislature amended current severance tax laws to include helium and hydrocarbon gases in the definition of products subject to the oil and gas severance tax, the oil and gas conservation tax, the oil and gas school emergency tax and the oil and gas production equipment *ad valorem* tax. The Department is not aware of any wells currently producing commercial helium in the State. However, according to a study by the New Mexico Bureau of Geology and Mineral Resources,⁽¹⁾ the State has produced commercial volumes of helium in the recent past. If the historical production volumes are reached in the future, increased taxes on helium and new hydrocarbon gases could generate as much as \$1.3 million in revenue for the Severance Tax Bonding Fund.

⁽¹⁾ "Helium in New Mexico: Geologic Distribution and Exploration Possibilities," Ronald F. Broadhead and Lewis Gillard, N.M. Bureau of Geology and Mineral Resources.

Production Taxes on Coal

Total State production taxes on coal amounted to nearly \$48.5 million in fiscal year 2006. Total coal production was just under 25.6 million tons in that year. Thus, the average effective tax per ton was approximately \$1.82. With total sales revenue of over \$695.6 million, the average effective tax was 6.97 percent of total sales revenue. The breakout of the effective tax and the total amount collected for each tax is shown in the following table.

Tax Burden		
<u>Type of Tax</u>	<u>Tax Burden</u> <u>Effective Rate</u>	<u>Amount</u>
Severance Tax & Surtax	\$.65 per ton	\$17,142,780
Resources Excise Tax	.20 per ton	5,217,591
Conservation Tax	.05 per ton	1,321,790
Property Tax	.23 per ton	6,208,294
Gross Receipts Tax	<u>.70 per ton</u>	<u>18,574,000</u>
Total	\$1.82 per ton	\$48,464,456
Price per Ton		\$26.19
Total Production		25,566,669
Total Value		\$695,678,864

Source: NM Taxation and Revenue Department.

Statutory rates for the Resources Excise 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 pertained 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. Currently, approximately 65.0 percent of all coal produced in the State is subject to gross receipts tax, even though a substantial portion is shipped out of the State for ultimate consumption. The combined state and local tax rate is 6.97 percent of value. To convert taxes per unit of output to tax rates per dollar of sales, the taxes shown above may be divided by the average price per ton of coal in Fiscal Year 2006, which was approximately \$26.19.

Excluding Gross Receipts Tax $\$1.12/\$26.19 = 4.30\%$

Including Gross Receipts Tax $\$1.82/\$26.19 = 6.97\%$

BOOK-ENTRY-ONLY SYSTEM

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the State believes to be reliable, but the State takes no responsibility for the accuracy thereof.

The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of such issue of the Bonds, each in the aggregate principal amount of such issue, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, FICC and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations provided details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the State as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions and dividend payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, or the State, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the State. Under such circumstances, in the event that a successor depository is not obtained, Bond certificates are required to be printed and delivered.

The State may decide to discontinue use of the system of book-entry only transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered to DTC.

THE STATE WILL NOT HAVE ANY RESPONSIBILITY OR OBLIGATION TO THE DTC PARTICIPANTS OR BENEFICIAL OWNERS.

SO LONG AS CEDE & CO., AS NOMINEE OF DTC, IS THE REGISTERED OWNER OF THE BONDS, REFERENCES HEREIN TO THE BONDHOLDERS OF THE BONDS WILL MEAN CEDE & CO., AND WILL NOT MEAN THE BENEFICIAL OWNERS OF THE BONDS.

When reference is made to any action which is required or permitted to be taken by the Beneficial Owners, such reference only relates to those permitted to act by statute, regulation or otherwise on behalf of such Beneficial Owners for such purposes. When notices are given, they are to be sent to DTC, and the State does not have responsibility for distributing such notices to the Beneficial Owners.

The State does not have any responsibility or obligation to the DTC Participants or the Beneficial Owners with respect to (a) the accuracy of any records maintained by DTC or any DTC Participant; (b) the payment by DTC or any DTC Participant of any amount due to any Beneficial Owner in respect of the principal of and premium, if any, and interest on the Bonds; (c) the selection of the Beneficial Owners to receive payment in the event of any partial redemption of the Bonds; (d) any consent given or other action taken by DTC, or its nominee, Cede & Co., as Bond Owner; or (e) the distribution by DTC to DTC Participants or Beneficial Owners of any notices received by DTC as registered owner of the Bonds.

SUMMARY OF CERTAIN PROVISIONS OF THE BOND RESOLUTION

The following summarizes certain provisions of the Bond Resolution. This summary does not purport to be complete and reference is made to the Bond Resolution for a full and complete statement of its provisions.

Covenants

So long as any Bonds are outstanding, the State and the Board have covenanted and agreed with the owners of Bonds that: (a) the State will use its best efforts to collect and deposit in the Bonding Fund proceeds from Severance Taxes as set forth in the Severance Tax Bonding Act which, when combined with other amounts the State Legislature, in its sole discretion, may from time to time deposit in the Bonding Fund, will equal at least two hundred (200) percent of the amount of the principal of and interest scheduled to be due in each fiscal year of the State on the Severance Tax Bonds, including the Bonds; (b) the State will promptly pay the principal of and the interest on the Bonds, at the places, on the dates and in the manner specified in the Bond Resolution and in the Bonds; (c) the State will keep proper books of record and account, separate and apart from all other records and accounts, showing complete and correct entries of all transactions relating to Severance Taxes, the Bonding Fund and each project account; (d) any registered owner or Beneficial Owner of any of the Bonds or any duly authorized agent of such registered owner or Beneficial Owner, shall have the right, at all reasonable times, to inspect all records, accounts and data relating to the Bonds, the collection of Severance Taxes and the Bonding Fund; provided, however, that pursuant to Section 6-14-10E NMSA 1978, records with regard to the ownership of or pledges of the Bonds are not subject to inspection or copying; (e) the State will prepare annual statements or audits of collections and disbursements of Severance Taxes in sufficient detail to show compliance with requirements of the Bond Resolution and the State will furnish a copy of such audit to any owner of Bonds upon written request therefor; (f) in order to prevent any accumulation of claims for interest after maturity, the State will not directly or indirectly extend or assent to the extension of time for the payment of interest on any of the Bonds; (g) the State will make no use of the proceeds of the Bonds or any funds reasonably expected to be used to pay the Bonds which will cause the Bonds to be arbitrage bonds within the meaning of Section 148 of the Internal Revenue Code of 1986, as amended (the "Code") which would result in the loss of the exclusion from gross income for federal income tax purposes of the interest on the Bonds; (h) the State will take or cause to be taken such actions which may be required of it for the interest on the Bonds to be and remain excluded from gross income for federal income tax purposes; and (i) the State will not take or permit to be taken any actions which would adversely affect that exclusion, and the State or persons acting for it, will, if necessary to maintain such exclusion, among other acts of compliance, (1) apply, or cause to be applied, the proceeds of the Bonds to the purpose of the borrowing, (2) restrict the yield on investment-type property acquired with those proceeds, (3) make timely rebate payments to the federal government in accordance with Section 148 of the Code and the Bond Resolution, (4) maintain books and records and make calculations and reports, and (5) refrain from certain uses of proceeds, all in such manner and to the extent necessary to assure such exclusion of that interest under the Code.

Defeasance

If the State shall pay all of the outstanding Bonds, or shall cause them to be paid and discharged in accordance with the next paragraph of this section, or if all payments of principal of and interest on the Bonds, due or to become due, shall otherwise be paid to the owners of the outstanding Bonds, then the Bond Resolution shall cease to be effective and become null and void (except for those provisions surviving in accordance with the last paragraph of this section), and the covenants, agreements and obligations of the Board and the State under the Bond Resolution shall be released, discharged and satisfied.

All or any part of the Bonds shall be deemed to have been paid and discharged if: (1) the Registrar/Paying Agent shall, in advance of any payment to the owners of the outstanding Bonds, have received sufficient moneys for the payment in full of the principal of and interest on the Bonds, or part thereof, or (2) there shall have been placed in trust for the payment of the Bonds and irrevocably committed to such payment, non-callable Defeasance Obligations (defined below) which are certified by an independent public accounting firm of national reputation to be of such maturities or redemption dates and interest payment dates, and scheduled to bear such interest, as will be sufficient, together with any

moneys on deposit with the Registrar/Paying Agent available to pay principal of and interest on the Bonds, without further investment or reinvestment of either the principal amount or the interest earnings on such Defeasance Obligations (which earnings are to be held likewise in trust and so committed, except as provided herein), for the payment in full of all principal of and interest on the Bonds, or part of the Bonds, deemed to have been paid, at their maturity.

As used in the Bond Resolution, “Defeasance Obligations” means, as permitted by law:

(i) direct obligations of, or obligations the full and timely payment of the principal of and interest on which is unconditionally guaranteed by, or obligations issued by or backed by the full faith and credit of corporations sponsored by, the United States of America;

(ii) obligations issued or guaranteed as to full and timely payment of principal and interest by any agency or person controlled by and acting as an instrumentality of the United States of America, pursuant to authority granted by the Congress of the United States of America; and

(iii) obligations described in Section 103(a) of the Code (a) provisions for the payment of the principal of, premium, if any, and interest on which (1) shall have been made by the irrevocable deposit, with a bank or trust company acting as a trustee or escrow agent for holders of such obligations, of non-callable securities described in clauses (i) and (ii) above, the maturing principal of and interest on which, when due and payable, without further investment or reinvestment, will provide sufficient moneys to pay when due the principal of and interest on such obligations, and (2) which securities described in clause (i) and (ii) are not available to satisfy year any other claim, including any claim of such trustee or escrow agent or of any person claiming through such trustee or escrow agent or to whom such trustee or escrow agent may be obligated, including claims in the event of the insolvency of such trustee or escrow agent or proceedings arising out of such insolvency or (b) rated by either Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc. or Moody’s Investors Service, Inc., or similar rating agency in its highest rating category (without regard to any refinement or gradation by numerical modifier or otherwise).

Any moneys held in trust in accordance with the defeasance provisions of the Bond Resolution may be invested only in non-callable Defeasance Obligations having maturity dates, or having redemption dates which, at the option of the holder of such Obligations, shall not be later than the date or dates at which moneys will be required for the purposes described above. Within fifteen (15) days after any Bonds are deemed to be paid and discharged, a written notice of such deemed payment and discharge shall be given to each registered owner of Bonds as shown on the registration books kept by the Registrar/Paying Agent on the date on which such Bonds are deemed paid and discharged. Such notice shall state the numbers of the Bonds deemed paid and discharged or state that all Bonds are deemed paid and discharged and set forth a description of the obligations held.

Notwithstanding that Bonds may be deemed to have been paid, any provisions of the Bond Resolution which relate to the maturity of Bonds, interest payments and dates thereof, exchange, transfer and registration of Bonds, replacement of mutilated, destroyed, lost or stolen Bonds, the safekeeping and cancellation of Bonds, nonpresentment of Bonds, and the duties of the Registrar/Paying Agent in connection with all of the foregoing, shall remain in effect and be binding upon the State and the Registrar/Paying Agent until final payment of all Bonds notwithstanding the release and discharge of the Bond Resolution. Notwithstanding any provision of the Bond Resolution to the contrary, any provisions of the Bond Resolution which relate to the exclusion of interest from gross income for federal tax purposes shall remain in effect and be binding upon the State and the Registrar/Paying Agent.

Amendment of Bond Resolution

The Bond Resolution may be amended or supplemented from time to time without the consent of or notice to the holders of the Bonds for any of the following purposes: (a) to cure any ambiguity, omission, formal defect or inconsistency; or (b) to make any change that, in the judgment of the Board, in reliance upon an opinion of counsel, does not have a material adverse effect on the rights of the owners of any Bonds; or (c) to achieve compliance with any applicable federal securities or tax laws or to ensure the exclusion of interest on the Bonds from the gross income of the owners of the Bonds for federal income tax purposes.

Except as provided above, the Bond Resolution may only be amended or supplemented by resolution adopted by the Board in accordance with applicable law, with or without receipt by the State of any additional consideration, but with the written consent of the owners of a majority in principal amount of the Bonds then outstanding; provided, however, that no such resolution shall have the effect of permitting: (i) an extension of the maturity of any Bond; or (ii) a reduction in the principal amount of, the rate of interest on, or the redemption premium on any Bond; or (iii) a reduction of the principal amount of Bonds required for consent to such amendatory or supplemental resolution; or (iv) the establishment of priorities as between Bonds issued and outstanding under the provisions of the Bond Resolution; or (v) the modification of, or otherwise affecting, the rights of the owners of less than all of the Bonds then outstanding.

Remedies of Holders of Bonds

The registered owners, or Beneficial Owners, of not less than 25 percent in aggregate principal amount of the Bonds then outstanding may bring an action to protect the rights of the registered owners and Beneficial Owners of Bonds under the Bond Resolution in any court of competent jurisdiction, for the specific performance of any covenant or agreement contained in the Bond Resolution or to enjoin any act or thing which may be unlawful or in violation of any right of any owner of the Bonds. All such proceedings at law or in equity shall be instituted, had and maintained for the equal benefit of all owners of the Bonds then outstanding. The failure of any registered owner or owners or Beneficial Owner or Beneficial Owners of Bonds to so proceed shall not relieve the State or the Board of any obligation to perform any duty under the Bond Resolution. Each right or privilege of such owner and Beneficial Owner is in addition and cumulative to any other right or privilege, and the exercise of any right or privilege by or on behalf of any registered owner or Beneficial Owner shall not be deemed a waiver of any other right or privilege.

Payment of Principal and Interest

The Bonds and the interest accruing on the Bonds shall be payable and collectible out of the Bonding Fund, which is pledged for such payment as provided in the Severance Tax Bonding Act. Interest on the Bonds shall be payable by check or draft mailed to their registered owners, as shown on the registration books for the Bonds maintained by the Registrar/Paying Agent at the address appearing in such books at the close of business on the fifteenth (15th) day of the calendar month next preceding each applicable interest payment date (the "Record Date") or in such other manner as may be agreed upon by the Registrar/Paying Agent and the registered owner of a Bond. Interest which is not timely paid or duly provided for shall cease to be payable to the owners of the Bonds (or of one or more predecessor Bonds) as of the Record Date, but shall be payable to the registered owners of the Bonds (or of one or more predecessor Bonds) at the close of business on a special record date (the "Special Record Date") for the payment of that overdue interest to be fixed by the Registrar/Paying Agent. The Special Record Date shall be fixed by the Registrar/Paying Agent whenever moneys become available for payment of the overdue interest, and notice of the Special Record Date shall be given to owners of Bonds not less than ten (10) days prior to such date. The principal of the Bonds is payable upon presentation and surrender of the Bonds without deduction for exchange or collection charges at the office of the Registrar/Paying

Agent. Principal of and interest on the Bonds are payable in lawful money of the United States of America.

While registered in the name of DTC or its nominee, payments of principal of and interest on the Bonds shall be made to DTC or its nominee as set forth in the Letter of Representation between DTC and the State.

TRANSCRIPT AND LEGAL OPINIONS

The Board will furnish an official transcript of proceedings of the authorization and issuance of the Bonds.

Legal matters incident to the issuance of the Bonds and the exclusion from gross income for Federal and State of New Mexico income tax purposes of interest on the Bonds (see “TAX MATTERS” below and the form of opinion of Bond Counsel attached hereto as Appendix D) are subject to the approving legal opinion of Brownstein Hyatt Farber Schreck, P.C., Bond Counsel to the State (“Bond Counsel”). Certain legal matters will be passed upon for the State of New Mexico by Sutin, Thayer & Browne A Professional Corporation, Disclosure Counsel. Certain legal matters will be passed upon for the State of New Mexico by the Office of the Attorney General of the State of New Mexico.

TAX MATTERS

The Internal Revenue Code of 1986 (the “Code”) imposes certain requirements that must be met subsequent to the issuance and delivery of the Bonds for interest thereon to be excluded from gross income for Federal income tax purposes. Noncompliance with such requirements could cause the interest on the Bonds to be included in gross income for Federal income tax purposes retroactive to the date of issue of the Bonds. The issuer has covenanted to comply with the applicable requirements of the Code in order to maintain the exclusion of the interest on the Bonds from gross income for Federal income tax purposes.

In the opinion of Brownstein Hyatt Farber Schreck, P.C., Bond Counsel, under existing law and assuming compliance with the aforementioned covenant, interest on the Bonds is excluded from gross income for Federal income tax purposes. Bond Counsel is also of the opinion that the Bonds are not “specified private activity bonds” within the meaning of Section 57(a)(5) of the Code and, therefore, the interest on the Bonds will not be treated as a preference item for purposes of computing the alternative minimum tax imposed by Section 55 of the Code. Interest on the Bonds owned by corporations will, however, be taken into account in determining the alternative minimum tax imposed by Section 55 of the Code on 75 percent of the excess of adjusted current earnings over alternative minimum taxable income (determined without regard to this adjustment and the alternative tax net operating loss deduction).

In rendering its opinion, Bond Counsel will rely on, and will assume the accuracy of, certain representations and certifications, and compliance with certain covenants of the issuer. Bond Counsel will not independently verify the accuracy of the certifications and representations made by the issuer. In addition, Bond Counsel has not been engaged, and will not undertake, to monitor the issuer’s compliance with the covenants or to inform any person as to whether the covenants are being complied with; nor has Bond Counsel undertaken to determine or to inform any person as to whether any actions taken or not taken, or events occurring or not occurring, after the date of the issuance of the Bonds may affect the federal tax-exempt status of the interest on the Bonds.

Bond Counsel is further of the opinion that the difference between the principal amount of the Bonds maturing on July 1, 2016 and July 1, 2017 (the “Discount Bonds”) and the initial offering price to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers) at which price a substantial amount of such Discount Bonds of the same

maturity was sold constitutes original issue discount which is excluded from gross income for Federal income tax purposes to the same extent as interest on the Bonds. Further, such original issue discount accrues actuarially on a constant interest rate basis over the term of each Discount Bond and the basis of each Discount Bond acquired at such initial offering price by an initial purchaser thereof will be increased by the amount of such accrued original issue discount. The accrual of original issue discount may be taken into account as an increase in the amount of tax-exempt income for purposes of determining various other tax consequences of owning the Bonds, even though there will not be a corresponding cash payment. Owners of the Discount Bonds are advised that they should consult with their own advisors with respect to the state and local tax consequences of owning such Discount Bonds.

Bond Counsel is also of the opinion that the difference between the principal amount of the Bonds maturing on July 1, 2008 through July 1, 2015 (collectively, the "Premium Bonds") and the initial offering price to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers) at which price a substantial amount of such Premium Bonds of the same maturity was sold constitutes to an initial purchaser amortizable bond premium which is not deductible from gross income for Federal income tax purposes. The amount of amortizable bond premium for a taxable year is determined actuarially on a constant interest basis over the term of each Premium Bond. For purposes of determining gain or loss on the sale or other disposition of a Premium Bond, an initial purchaser who acquires such obligation in the initial offering to the public at the initial offering price is required to decrease such purchaser's adjusted basis in such Premium Bond annually by the amount of amortizable bond premium for the taxable year. The amortization of bond premium may be taken into account as a reduction in the amount of tax-exempt income for purposes of determining various other tax consequences of owning the Bonds. Owners of the Premium Bonds are advised that they should consult with their own advisors with respect to the state and local tax consequences of owning such Premium Bonds.

Bond Counsel has not undertaken to advise in the future whether any events after the date of issuance of the Bonds may affect the tax status of interest on the Bonds. No assurance can be given that future legislation, or amendments to the Code, if enacted into law, will not contain provisions which could directly or indirectly reduce the benefit of the exclusion of the interest on the Bonds from gross income for Federal income tax purposes. Furthermore, Bond Counsel expresses no opinion as to any Federal, State or local tax law consequences with respect to the Bonds, or the interest thereon, if any action is taken with respect to the Bonds or the proceeds thereof upon the advice or approval of bond counsel other than Bond Counsel.

Although Bond Counsel has rendered an opinion that interest on the Bonds is excluded from gross income for Federal income tax purposes, a Beneficial Owner's Federal, State or local tax liability may otherwise be affected by the ownership or disposition of the Bonds. The nature and extent of these other tax consequences will depend upon the Beneficial Owner's other items of income or deduction. Without limiting the generality of the foregoing, prospective purchasers of the Bonds should be aware that (i) Section 265 of the Code denies a deduction for interest on indebtedness incurred or continued to purchase or carry the Bonds, (ii) with respect to insurance companies subject to the tax imposed by Section 831 of the Code, Section 832(b)(5)(B)(i) reduces the deduction for loss reserves by 15 percent of the sum of certain items, including interest on the Bonds, (iii) interest on the Bonds earned by certain foreign corporations doing business in the United States could be subject to a branch profits tax imposed by Section 884 of the Code, (iv) passive investment income, including interest on the Bonds, may be subject to Federal income taxation under Section 1375 of the Code for Subchapter S corporations that have Subchapter C earnings and profits at the close of the taxable year if greater than 25% of the gross receipts of such Subchapter S corporation is passive investment income and (v) Section 86 of the Code requires recipients of certain Social Security and certain Railroad Retirement benefits to take into account, in determining the taxability of such benefits, receipts or accruals of interest on the Bonds. Bond Counsel has expressed no opinion regarding any such other tax consequences.

Unless separately engaged, Bond Counsel is not obligated to defend the issuer or the Beneficial Owners regarding the tax-exempt status of the Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the issuer and their appointed counsel, including the Beneficial Owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of the IRS positions with which the issuer legitimately disagrees, may not be practicable. Any action of the IRS, including but not limited to selection of the Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the Bonds, and may cause the issuer or the Beneficial Owners to incur significant expense.

Bond Counsel is also of the opinion that interest on the Bonds is exempt from State of New Mexico personal income taxes as described herein.

A copy of the proposed form of opinion of Bond Counsel is attached hereto as Appendix D.

The foregoing is not intended to be an exhaustive discussion of collateral tax consequences arising from receipt of interest on the Bonds. Prospective purchasers or owners should consult their tax advisors with respect to collateral tax consequences, including without limitation the calculations of alternative minimum tax, environmental tax or foreign branch profits tax liability, inclusion of Social Security or other retirement payments in taxable income and the state and local tax rules in New Mexico and other states.

LITIGATION

At the time of the original delivery of the Bonds, the Board will deliver a no-litigation certificate to the effect that no litigation or administrative action or proceeding is pending, or, to the knowledge of the appropriate State officials, threatened, restraining or enjoining, or seeking to restrain or enjoin, the issuance and delivery of the Bonds, the effectiveness of the legislation authorizing the issuance of the Bonds, the levying or collecting of any taxes for the payment of the debt service on the Bonds (other than those cases described in Appendix C, which proceedings are not, in the opinion of the State Attorney General, reasonably expected to have a material effect on the bondholders), or contesting or questioning the proceedings and authority under which the Bonds have been authorized and are to be issued, sold, executed or delivered, or the validity of the Bonds.

The State is a party to various legal proceedings seeking damages or injunctive relief and generally incidental to its operations which proceedings are unrelated to the Bonds, and to the security therefor. The ultimate disposition of such proceedings is not presently determinable. Such proceedings are not, in the opinion of the State Attorney General, reasonably expected to have a material adverse effect on the Bonds or the security for the payment of the Bonds for the following reason: Severance Taxes are the primary source of payment for the Bonds which are limited obligations of the State. See Appendix C for a summary of litigation and administrative action or proceedings that impact Severance Taxes.

FINANCIAL ADVISORS

The Board has retained Fiscal Strategies Group, Inc., as Financial Advisor in connection with the preparation of this Official Statement and with respect to the issuance of the Bonds. Fiscal Strategies Group, Inc. has contracted with Public Resources Advisory Group (together with Fiscal Strategies Group, Inc., the "Financial Advisors") in connection with the preparation of this Official Statement and with respect to the issuance of the Bonds. The Financial Advisors are not obligated to undertake, and have not undertaken to make, an independent verification or to assume responsibility for the accuracy, completeness, or fairness of the information contained in this Official Statement nor the information,

covenants and representations contained in any of the Bond documentation with respect to the federal income tax status of the Bonds. The Financial Advisors are independent advisory firms and are not engaged in the business of underwriting, trading or distributing municipal securities or other public securities. The financial advisory fee for services performed with respect to the Bonds is contingent upon the issuance and delivery of the Bonds but is payable from the Severance Tax Bonding Fund.

BOND INSURANCE

The MBIA Insurance Corporation Insurance Policy

The following information has been furnished by MBIA Insurance Corporation (“MBIA”) for use in this Official Statement. Reference is made to Appendix F for a specimen of MBIA’s policy (the “Policy”). The Policy insures only the 2010, 2011, 2012 and 2013 maturities of the Bonds (the “Insured Bonds”).

MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the Policy and MBIA set forth under the heading “BOND INSURANCE.” Additionally, MBIA makes no representation regarding the Insured Bonds or the advisability of investing in the Insured Bonds.

The Policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the State to the Paying Agent or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Insured Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the Policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless MBIA elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner of the Insured Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law (a “Preference”).

The Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Insured Bonds. The Policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of Insured Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. The Policy also does not insure against nonpayment of principal of or interest on the Insured Bonds resulting from the insolvency, negligence or any other act or omission of the Paying Agent or any other paying agent for the Insured Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Paying Agent or any owner of an Insured Bond the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such Insured Bonds or presentment of such other proof of ownership of the

Insured Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the Insured Bonds as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the Insured Bonds in any legal proceeding related to payment of insured amounts on the Insured Bonds, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Paying Agent payment of the insured amounts due on such Insured Bonds, less any amount held by the Paying Agent for the payment of such insured amounts and legally available therefor.

MBIA Insurance Corporation

MBIA Insurance Corporation (“MBIA”) is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company (the “Company”). The Company is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in and subject to regulation under the laws of all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA, either directly or through subsidiaries, is licensed to do business in the Republic of France, the United Kingdom and the Kingdom of Spain and is subject to regulation under the laws of those jurisdictions.

The principal executive offices of MBIA are located at 113 King Street, Armonk, New York 10504 and the main telephone number at that address is (914) 273-4545.

Regulation

As a financial guaranty insurance company licensed to do business in the State of New York, MBIA is subject to the New York Insurance Law which, among other things, prescribes minimum capital requirements and contingency reserves against liabilities for MBIA, limits the classes and concentrations of investments that are made by MBIA and requires the approval of policy rates and forms that are employed by MBIA. State law also regulates the amount of both the aggregate and individual risks that may be insured by MBIA, the payment of dividends by MBIA, changes in control with respect to MBIA and transactions among MBIA and its affiliates.

The Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

Financial Strength Ratings of MBIA

Moody’s Investors Service, Inc. rates the financial strength of MBIA “Aaa.”

Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc. rates the financial strength of MBIA “AAA.”

Fitch Ratings rates the financial strength of MBIA “AAA.”

Each rating of MBIA should be evaluated independently. The ratings reflect the respective rating agency’s current assessment of the creditworthiness of MBIA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the Insured Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the

Insured Bonds MBIA does not guaranty the market price of the Insured Bonds nor does it guaranty that the ratings on the Insured Bonds will not be revised or withdrawn.

MBIA Financial Information

As of December 31, 2005, MBIA had admitted assets of \$11.0 billion (audited), total liabilities of \$7.2 billion (audited), and total capital and surplus of \$3.8 billion (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of December 31, 2006, MBIA had admitted assets of \$10.9 billion (unaudited), total liabilities of \$6.9 billion (unaudited), and total capital and surplus of \$4.0 billion (unaudited), each as determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

For further information concerning MBIA, see the consolidated financial statements of MBIA and its subsidiaries as of December 31, 2006 and December 31, 2005 and for each of the three years in the period ended December 31, 2006, prepared in accordance with generally accepted accounting principles, included in the Annual Report on Form 10-K of the Company for the year ended December 31, 2006 and the consolidated financial statements of MBIA and its subsidiaries as of December 31, 2006, which are hereby incorporated by reference into this Official Statement and shall be deemed to be a part hereof.

Copies of the statutory financial statements filed by MBIA with the State of New York Insurance Department are available over the Internet at the Company's web site at <http://www.mbia.com> and at no cost, upon request to MBIA at its principal executive offices.

Incorporation of Certain Documents by Reference

The following document filed by the Company with the Securities and Exchange Commission (the "SEC") is incorporated by reference into this Official Statement:

- (1) The Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Any documents, including any financial statements of MBIA and its subsidiaries that are included therein or attached as exhibits thereto, filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of the Company's most recent Quarterly Report on Form 10-Q or Annual Report on Form 10-K, and prior to the termination of the offering of the Insured Bonds offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof from the respective dates of filing such documents. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the Company's SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2006, and (2) the Company's Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006 are available (i) over the Internet at the SEC's web site at <http://www.sec.gov>; (ii) at the SEC's public reference room in Washington D.C.; (iii) over the Internet at the Company's web site at <http://www.mbia.com>; and (iv) at no cost, upon request to MBIA at its principal executive offices.

RATINGS

It is expected that, upon issuance, the Insured Bonds will receive a rating of “Aaa” from Moody’s Investors Service, Inc. (“Moody’s”) and a rating of “AAA” from Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc. (“S&P”) with the understanding that upon delivery of the Insured Bonds, a policy insuring the payment when due of the principal of and interest on the Insured Bonds will be issued by MBIA.

All of the Bonds have received underlying ratings from Moody’s and S&P as set forth on the cover of this Official Statement.

Such ratings reflect only the views of the respective organizations. An explanation of the significance of each rating may be obtained from the rating agency furnishing such rating. There is no assurance that such ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely by such rating agencies if, in the judgment of such rating agencies, circumstances so warrant. Any downward revision or withdrawal of either rating can be expected to have an adverse effect on the market price of the Bonds.

CONTINUING DISCLOSURE UNDERTAKING

The Board will agree, by means of a Continuing Disclosure Undertaking (the substantial form of which appears in Appendix E) to be delivered to the purchaser of the Bonds at closing, for the benefit of owners of the Bonds to provide certain Annual Financial Information relating to the State by no later than 210 days after the end of each fiscal year of the State, commencing with the fiscal year ending June 30, 2007, and to provide notices of occurrence of certain enumerated events, if material. The Board will further agree in the Continuing Disclosure Undertaking that if its audited financial statements are not provided as part of the Annual Financial Information, the Board will provide such audited statements when available. The Annual Financial Information and audited financial statements (when available) will be filed by the Board with each Nationally Recognized Municipal Securities Information Repository and with any New Mexico State Information Depository. The notices of material events will be filed by the Board with the Municipal Securities Rulemaking Board and with any New Mexico State Information Depository. In the event of a failure of the Board to comply with any provision of the Continuing Disclosure Undertaking, any owner of Bonds (including beneficial owners of the Bonds) may seek specific performance by court order from a State court in Santa Fe County, New Mexico.

The Continuing Disclosure Undertaking is being executed by the Board to assist in complying with Rule 15c2-12(b)(5) promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 (the “Rule”). The Continuing Disclosure Undertaking will be in effect from and after the issuance and delivery of the Bonds and shall extend to the earliest of: (i) the date the principal and interest on the Bonds is paid or deemed paid; (ii) the date the Board is no longer an “obligated person” with respect to the Bonds within the meaning of the Rule; and (iii) the date on which those portions of the Rule which require the Continuing Disclosure Undertaking are held invalid or repealed.

Except as set forth in the succeeding sentences, the State has never failed to comply in all material respects with any previous undertakings with regard to SEC Rule 15c2-12(b)(5) to provide annual reports or notices of material events. Continuing disclosure undertakings previously entered into by the Board in relation to the State’s Capital Projects General Obligation Bonds and Severance Tax Bonds called for it to file Audited Financial Statements of the State as part of the Board’s annual financial information disclosures, or when available if the financial statements had not been finally audited by the time that it was required to make the annual financial disclosures. Due to the investigation by federal authorities of potentially criminal activity by the two prior elected State Treasurers, and the seizure of financial information from the State Treasurer’s Office to further that investigation, preparation and

auditing of the Audited Financial Statements of the State for the Fiscal Year ended June 30, 2005 was substantially delayed, and the Audited Financial Statements were not available until August 22, 2006. The State filed the Audited Financial Statements on October 31, 2006, and, on that date, the State notified the MSRB of the filing. The Board believes that it is now in compliance with all its continuing disclosure undertakings.

GOVERNOR'S FINANCE COUNCIL

The Governor's Finance Council was re-established pursuant to Executive Order No. 2006-066 on December 1, 2006, to develop an overall strategy for issuing long-term debt obligations and making investments to improve the New Mexico economy and to coordinate and integrate infrastructure development and the capital outlay processes. The Executive Order designates, among other state officials, the Director of the Board and a Board Member as selected by the Governor as members of the Governor's Finance Council.

MISCELLANEOUS

The foregoing summaries, descriptions and references do not purport to be comprehensive or definitive, and such summaries, descriptions and references are qualified in their entirety by reference to each statute, document, exhibit or other materials summarized or described. The instruments and other materials referred to in this Official Statement may be examined, or copies thereof will be furnished in reasonable amounts, upon written request to the NM State Board of Finance, 131 South Capitol Street, Bataan Memorial Building, Room 181, Santa Fe, New Mexico 87501, or by telephone at (505) 827-4980.

Statements made in this Official Statement involving matters of opinion, forecasts or estimates, whether or not expressly so stated, are intended as such and not as representations of fact. The Appendices are integral parts of this Official Statement and must be read with all other parts of this Official Statement.

This Official Statement has been authorized and issued by the Board.

STATE BOARD OF FINANCE
OF THE STATE OF NEW MEXICO

By /s/ Bill Richardson
President

APPENDIX A

GENERAL INFORMATION CONCERNING THE STATE OF NEW MEXICO

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 State's climate is characterized by sunshine and warm, bright skies in both winter and summer. Every part of the State receives no less than 70 percent sunshine year-round. Humidity ranges from 60 percent (mornings) to 30 percent (afternoons). Evenings are crisp and cool in all seasons because of low humidity.

The State has a semiarid subtropical climate with light precipitation. 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). The State is an experience in comfortable living with its clean air, blue skies and fair weather.

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 who are elected to four-year terms beginning the 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 20 cabinet departments, each headed by a cabinet secretary appointed by the Governor and approved by the Legislature.

The Board has seven 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 such appointed members may be from the same political party. 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 Department of Finance and Administration ("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, and who also serves as Executive Officer 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, members of the House 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 sixty calendar days in odd-numbered years and thirty calendar days in even-numbered years. In addition, special sessions of the Legislature may be convened by the Governor, and under certain limited circumstances, extraordinary sessions may be convened by the Legislature. Legislators receive no 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 court is the trial court of record with general jurisdiction.

Pension Funds

Two retirement plans, covering most of the employees of the State and its political subdivisions, have been established by State statute. These retirement plans are described below. All financing of the plans, including employer and employee contributions and fund investment provisions, as well as all benefit provisions, are established by the Legislature and are not subject to negotiation.

Educational Retirement Board

Total Educational Retirement Board ("ERB") membership as of June 30, 2006 was officially reported as 120,318. The annual actuarial valuation of the Educational Retirement Fund of the State was conducted and reported as of June 30, 2006 by Gabriel Roeder, Smith & Co. Accrued assets at fair value on June 30, 2006 were \$8.219 billion and the unfunded liability was \$3.622 billion. The funded ratio (the ratio of the actuarial value of assets to the actuarial accrued liability) decreased from last year. The funded ratio at June 30, 2005 was 70.4%, and at June 30, 2006 was 68.3%.

As of June 30, 2006, ERB's unfunded actuarial liability (UAAL) had an amortization period of infinity. This is the same as the prior year's funding period. The amortization period, also referred to as the funding period, is the number of years expected to be required to completely amortize the UAAL, assuming that ERB's experience exactly follows the actuarial assumptions.

Member and employer contribution rates are established by statute. Section 22-11-21 NMSA 1978 was amended in 2005 to increase the employer contribution rate by 75 basis points (0.75%) each of the seven years beginning July 1, 2005, and increase member contribution rates by 7.50 basis points (0.075%) for each of the four years beginning July 1, 2005. As of July 1, 2006, the employer contribution rate is 10.15% and the member contribution rate is 7.75%. The member rate will reach its ultimate level of 7.90% in FY 2009, and the employer rate will reach its ultimate level of 13.90% in FY 2012.

As indicated above, as of June 30, 2006, ERB has an infinite funding period. Therefore, if the employer contribution rate (10.15% as of July 1, 2006) and member contribution rate (7.75% as of July 1, 2006) were to remain in place, and all actuarial assumptions are exactly realized, including an 8.00% investment return on the actuarial value of assets, then the UAAL will never achieve complete amortization. The employer contribution in Fiscal Year 2006 that would have been required in order to amortize the UAAL over 30 years was 14.51%. As mentioned above, under current law, the employer and member rates will increase to 13.90% and 7.90%, respectively. However, GASB 25 does not permit the consideration of contribution rates not yet in effect, so an infinite funding period must be reported.

Over the course of seven years ending June 30, 2012, assuming the fund continues to earn an 8% investment return, overall contributions to the system will increase from 16.25 percent of salaries (as it was for Fiscal Year 2005) to 21.8 percent of salaries and the funding period will be reduced to less than 10 years by the early 2020s.

The Public Employees Retirement Association

Gabriel, Roeder, Smith & Co. completed an actuarial valuation of the Public Employees Retirement Fund (PERA), Judicial Retirement Fund, Magistrate Fund, Legislative Division and Volunteer Firefighter Fund (VFF) as of June 30, 2006. The Public Employees Retirement Board accepted the actuary's conclusions that the assets, benefit values, reserves and computed contribution rates reflect utilization of an inflation rate of 5 percent per annum, compounded annually, and other risk assumption changes including salary increases for longevity and merit, the real rate of return on investments,

mortality, active member withdrawals, disability and retirement rates to allow for expected future experience. Actuarial information, for each fund, as of June 30, 2006, is shown below.

Summary of Certain State Retirement Funds
(Dollars in thousands)

	<u>PERA</u> ⁽¹⁾	<u>Judicial</u>	<u>Magistrate</u>	<u>VFF</u>	<u>Legislative</u>
Membership	77,349	226	111	6,147	258
Actuarial Information					
Accrued Liability ⁽²⁾	\$11,781,722	\$ 95,216	\$33,362	\$23,743	\$19,434
Value of Assets	\$10,850,217	\$ 74,003	\$33,694	\$39,512	\$13,678
Unfunded (Overfunded)					
Accrued Liability	\$ 931,505	\$ 21,213	\$ (332)	\$(15,769)	\$ 5,756
Present Value of Statutory Obligations	\$15,065,365	\$124,324	\$42,446	\$40,834	\$21,246

⁽¹⁾ Includes both the state and municipal divisions.

⁽²⁾ Includes the accrued liability of both the retired and active members.

New Mexico Retiree Health Care Authority

In addition to the pension funds described above, the Retiree Health Care Act was enacted by Laws 1990, Chapter 6, Sections 1-16, codified as Sections 10-7C-1 through 10-7C-19 NMSA 1978, for the purpose of providing comprehensive group health insurance coverage for persons who have retired from certain public service in the State and eligible dependents. 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 it does not create any contract, trust or other rights in public employees to health care benefits.

The New Mexico Retiree Health Care Authority (the “NMRHCA”), the agency which administers the Retiree Health Care Act, has a fund base comprised of active employee payroll deductions, participating employer contributions, monthly premium contributions of enrolled participants, investment income, and an amount provided annually from the Taxation and Revenue Suspense Fund. Employer and employee contribution rates are established by statute. Such contribution rates are currently 1.3% and 0.65% of the participating employee's salary, respectively. These rates combined, as well as other sources of revenue, are significantly less than what is necessary to fund the normal cost and amortization of the UAAL over a 30-year period. The Legislature is required by statute to review and adjust the employer and employee contribution rates and the distribution from the Taxation and Revenue Suspense Fund at the first session of the Legislature following July 1, 2010 in order to ensure the actuarial soundness of the benefits provided under the Retiree Health Care Act.

Total NMRHCA membership as of June 30, 2006 was reported as 36,268. Accrued assets at fair value on June 30, 2005 were \$167,399,635, and on June 30, 2006 were \$180,289,837.

The annual actuarial valuation under GASB 43 and the UAAL have been calculated for the fiscal year ended June 30, 2006. NMRHCA's UAAL is approximately \$5.0 billion based on a discount rate of 3.5% and giving no effect to the actuarial value of its assets. The State will be studying the results of the actuarial report and will address the issues raised by it. Because total revenues for the NMRHCA's largest sponsor are over \$100 million per year, the NMRHCA must comply with GASB 43 for fiscal years beginning after December 15, 2005.

Laws 2002, Chapter 75, Section 2 and Laws 2002, Chapter 382, Section 2, codified as Section 10-7C-17 NMSA 1978, also created the senior prescription drug program in the NMRHCA. Laws 2006, Chapter 26, amended Sections 10-7C-17 through 19 NMSA 1978, extending the program to all New Mexicans regardless of age.

Severance Tax Permanent Fund and the Land Grant Permanent Fund

The Severance Tax Permanent Fund was established in the State Treasury in 1973 to receive the residual revenues from the Severance Tax Bonding Fund and serve as an endowment for future capital projects. In the General Election of 1976, the electorate approved a constitutional amendment giving the Severance Tax Permanent Fund constitutional status. In the General Election of 1982, the electorate approved a second constitutional amendment which removed the discretionary power of the Legislature to appropriate funds from the corpus of the Severance Tax Permanent Fund. Distributions from investments of the Fund, 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 Severance Tax Permanent Fund. The State Investment Officer under the direction of the State Investment Council invests the corpus and income of the Severance Tax Permanent Fund. The market value of the Severance Tax Permanent Fund as of June 30, 2006 was approximately \$4.2 billion, an increase of approximately 6.5 percent from the prior year. **Money on deposit in the Severance Tax Permanent Fund is not pledged to and may not be used to pay Severance Tax Bonds.**

The New Mexico State Land Grant Permanent Fund (“LGPF”) is designed solely to benefit the educational system of the State and other specified institutions. The origins of the LGPF are found in the 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, with the latter receiving 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), bringing the current total to 9.0 million surface acres and 12.8 million subsurface acres.

The State Land Office is charged with the custody and disposition of the land granted to the State. Through the Commissioner of Public Lands these properties granted to the State are sold and/or leased in accordance with the provisions of the appropriate statutes. The State Investment Officer under the direction of the State Investment Council invests the corpus and income of the LGPF. As of June 30, 2006, the market value of the LGPF was approximately \$9.1 billion, an increase of approximately 10.3 percent from the prior year. **The corpus of the LGPF is constitutionally protected from appropriation and amounts on deposit therein are not pledged to and may not be used to pay the Bonds.** The LGPF is also protected by the Federal Enabling Act of 1910.

In November 1996, the electorate of New Mexico approved a constitutional amendment regarding distributions from the State’s permanent funds. Distributions are now based on a total return basis rather than an income distribution method. Distributions to beneficiaries are based on a formula under which 4.7 percent of the previous average five-year market value of the fund is distributed.

In September 2003, the electorate of the State of New Mexico approved a constitutional amendment increasing the rate of distribution from the LGPF from 4.7 percent to 5.0 percent of the average fiscal year market value of the LGPF 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 will be 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 members elected to each house of the legislature may suspend this additional distribution.

Financial Process; Procedures

State Auditing and Accounting Systems. By statute, the financial affairs of every agency in the State are thoroughly 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. The audits are conducted in accordance with generally accepted auditing standards. The audit reports include financial statements which are presented in accordance with generally accepted accounting principles. In July of 2006, the State implemented a Statewide Human Resources, Accounting and Management Reporting System (the "SHARE System"). The SHARE System replaced the State's existing Central Accounting System, central payroll system, personnel system, treasury warrant accounting reporting system and 114 additional systems currently in place at various state agencies. The State is currently in the process of making adjustments to the SHARE System to ensure it meets the State's accounting needs.

State Budgetary and Appropriation Process. All State agencies are required to submit their budget requests to the Budget Division of the DFA by September 1 of each year following guidelines and forms provided in advance for this purpose. Budget hearings are scheduled for the purpose of examining the merits of budget requests through the fall and are usually completed by mid-December. Statutes require the Budget Division to present comprehensive budget recommendations to the Governor annually by January 2.

By statute, the Governor is required to submit a budget for the upcoming fiscal year to the Legislature by the twenty-fifth legislative day (in mid-February). The Governor's budget includes the executive recommendations for higher education, public education and State agencies as well as historical information on prior expenditures and revenues and revenue projections, among other information. The State budget is contained in a General Appropriation Act, which may also contain supplemental and deficiency appropriations for the then 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 Budget Division of the DFA 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 Practices

By statute the State Treasurer is responsible for the investment of the operating and capital funds. These responsibilities are conducted in accordance with the State Treasurer's Investment Policy (the "Investment Policy") adopted by the State Treasurer and approved by the Board. 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 governs the investment activities of the State Treasurer. This policy applies to all financial assets of the State invested by the Treasurer in the exercise of his 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 public money includes the State's general fund, the Local Government Investment Pool, bond funds, bond debt service funds and other special funds with respect to which the State Treasurer is the investing authority.

According to the Investment Policy, the Investment Committee has the specific purpose and responsibility of establishing, maintaining and administering the Investment Policy. The Investment Committee consists of five (5) voting members: the State Treasurer, or designee, who serves as Chairman; the Treasurer's Chief Investment Officer (with the State Cash Manager as an alternate); the Director of the Board or designee; and two members that are participants in the private investment community or have expert knowledge or professional experience in the subject of public finance or public fund investing, of which one member will be appointed by the State Treasurer and approved by the Board and one member will be appointed by the Board and approved by the State Treasurer.

The Investment Committee is charged with the following responsibilities:

- Reviewing the Investment policy, no less than annually, and recommending, if advisable, modifications in the Investment Policy from time to time;
- Assessing, no less than annually, the utility and efficacy of established internal controls as loss prevention measures with respect to the investment portfolio;
- Determining, no less than annually, whether legislation affecting the investment activities of the State Treasurer should be recommended;
- Recommending investment procedures that may be useful or required in maintaining currency with public finance market practices;
- Deliberating such topics as: economic outlook, portfolio diversification and maturity structure, potential risks, the target rate of return on the investment portfolio;
- Identifying potential violations of and suggesting remedial actions to achieve conformity with the Investment Policy;
- Recommending, no less than annually, action on depositories, custodians, broker/dealers and investment managers and advisors; and
- Assessing whether the Investment Policy is being properly implemented by the individuals and entities involved in the administration and management of investment activities.

In an effort to continue to strengthen the Investment Policy, in the first half of 2006, the State Treasurer and the Board have revised the Investment Policy in a process that included public comment. The revisions and additions to the Investment Policy increase transparency and oversight, ensure better operating procedures in the State Treasurer's Office, and incorporate legislative changes. Some of these changes include: a requirement to use electronic trading; a requirement to attain a credit quality rating for the Local Government Investment Pool from a national rating agency; a provision that the investment consultants used by the State Treasurer establish performance benchmarks for the State Treasurer's Office and report performance relative to that benchmark; various technical clarifications to reporting requirements and trading activity; requirements for the State Treasurer to adopt an employee code of conduct policy, a campaign contributions policy, and a whistleblower policy applicable to the public officers and employees subject to the State Treasurer's policies and supervision; and a requirement for the State Treasurer and employees involved in the investment process to refrain from personal business activity that may impair their ability to make impartial investment decisions. The most recent revisions to the Investment Policy were approved by the State Board of Finance at its meeting on January 16, 2007. The State Treasurer's Office is operating under this new Investment Policy.

On October 26, 2005, following indictment on multiple charges of extortion, money laundering and conspiracy related to his time in office, then-New Mexico State Treasurer Robert Vigil resigned. On September 30, 2006 he was convicted of one count of attempted extortion and acquitted on 23 other charges related to his time in office. The previous State Treasurer had pleaded guilty to extortion for actions he took as State Treasurer. An Interim State Treasurer, Douglas Minge Brown, was appointed by the Governor on November 3, 2005. On November 7, 2006, James B. Lewis was elected State Treasurer. The Interim State Treasurer served until James B. Lewis took the oath of office on December 15, 2006. Following the indictment of Robert Vigil, the State engaged the law firm of Hogan and Hartson, LLP and Deloitte Financial Advisory Services L.L.P. to conduct a special audit of the State Treasurer's Office. The special audit found a significant number of internal control weaknesses and deficiencies in the operations of the State Treasurer's Office; however, the special audit did not find that the integrity of funds held at the State Treasurer's Office had been compromised. The special audit recommended a slate of legislative, rulemaking and control enhancements designed to ensure that the funds held by the State Treasurer's Office are prudently invested and safely handled. The State Treasurer's Office has undertaken to implement the recommendations of the special audit and has implemented a detailed corrective action plan of the type necessary to establish an effective internal control management program.

Economic and Demographic Characteristics

New Mexico is the 36th largest state by population and the fifth largest in land area. The population of the State as of the time of the official 2000 United States Census was 1,819,046. In the 1990's, the State was the 12th fastest growing state, as the population increased 20.1 percent from the 1990 population of 1,515,069. Over the same period of time, the national population grew 13.2 percent.

Most of this population growth is occurring in or near the larger cities. There are four Metropolitan Statistical Areas (MSAs) in the State. The Albuquerque MSA is comprised of Bernalillo, Sandoval, Torrance and Valencia Counties; the Las Cruces MSA is comprised of Doña Ana County; the Santa Fe MSA is comprised of Santa Fe County; and the Farmington MSA is comprised of San Juan County. The fastest growing counties in the state are Sandoval, Doña Ana, Bernalillo, San Juan, Luna and Lincoln. The following table sets forth information on population growth in New Mexico and nationally over the past decade.

Population New Mexico and the United States 1997-2006				
Year	Population		Annual Percentage Change	
	New Mexico	United States	New Mexico	United States
1997	1,774,839	272,646,925	1.3%	1.2%
1998	1,793,484	275,854,104	1.1%	1.2%
1999	1,808,082	279,040,168	0.8%	1.2%
2000	1,821,656	282,216,952	0.7%	1.1%
2001	1,832,783	285,226,284	0.6%	1.0%
2002	1,855,353	288,125,973	1.2%	1.0%
2003	1,877,598	290,796,023	1.2%	0.9%
2004	1,900,620	293,638,158	1.2%	1.0%
2005	1,925,985	296,507,061	1.3%	1.0%
2006	1,954,599	299,398,484	1.5%	1.0%

Source: Population Division, U.S. Census Bureau, December 2006.

Major industries in the State are energy resources, semi-conductor manufacturing, tourism, services, arts and crafts, agriculture-agribusiness, government, and mining. Major federally funded scientific research facilities at Los Alamos, Albuquerque and White Sands are also a notable part of the State's economy. The following table sets forth information on employment by industry over the period 1980-2005.

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Total Full-time and Part-time Employment by Industry

	1980	1990	2000	2001⁽¹⁾	2005⁽¹⁾	1980-1990	Growth 1990-2000	2001-2005⁽¹⁾
Total employment	598,199	767,139	972,954	977,815	1,064,351	28.2%	26.8%	8.8%
Wage and salary employment	513,306	635,725	789,690	801,610	856,406	23.8%	24.2%	6.8%
Proprietors employment	84,893	131,414	183,264	176,205	207,945	54.5%	39.7%	18.0%
Farm proprietors employment	13,400	13,600	14,985	17,470	17,157	1.5%	10.2%	-1.8%
Nonfarm proprietors employment	71,493	117,814	168,279	158,735	190,788	64.8%	42.8%	20.2%
By Industry								
Farm employment	22,191	19,766	21,760	24,091	24,685	-10.9%	10.1%	2.5%
Nonfarm employment	576,008	747,373	951,194	953,724	1,039,666	29.8%	27.3%	9.0%
Private employment	428,156	568,085	748,804	748,250	820,099	32.7%	31.8%	9.6%
Agricultural services, forestry, fishing and other	4,358	8,414	13,548	7,019	7,224	93.1%	61.0%	2.9%
Mining	31,152	20,489	19,323	19,469	21,024	-34.2%	-5.7%	7.9%
Oil and gas extraction	15,116	14,068	14,425	6,447	6,751	-6.9%	2.5%	4.7%
Mining and support activities for mining ⁽²⁾	16,036	6,421	4,898	13,022	14,273	149.7%	23.7%	9.6%
Construction	38,873	40,606	59,895	63,144	73,164	4.5%	47.5%	15.9%
General building contractors	11,933	11,858	16,710	18,050	19,396	-0.6%	40.9%	7.5%
Heavy construction contractors	8,287	6,729	8,720	10,365	10,171	-18.8%	29.4%	-1.9%
Special trade contractors	18,653	22,019	34,465	34,729	43,597	18.0%	56.5%	25.5%
Manufacturing ⁽³⁾	35,963	47,732	48,788	49,913	46,003	32.7%	2.2%	-7.8%
Durable goods	21,583	32,500	33,275	32,671	29,113	50.6%	2.4%	-10.9%
Nondurable goods ⁽⁴⁾	14,380	15,232	15,513	17,242	16,890	5.9%	1.8%	-2.0%
Transportation and public utilities ⁽⁵⁾	30,732	34,130	43,350	39,423	37,458	11.1%	27.0%	-5.0%
Wholesale trade	22,733	27,896	33,751	27,970	28,566	22.6%	21.1%	2.1%
Retail trade ⁽⁶⁾	98,075	134,482	172,516	175,525	183,919	37.1%	28.3%	4.8%
Finance, insurance, and real estate ⁽⁷⁾	37,945	46,955	62,905	60,113	69,993	23.7%	34.0%	16.4%
Services ⁽⁸⁾	128,325	207,381	294,728	308,674	338,935	61.6%	42.1%	9.8%
Government and government enterprises	147,852	179,288	202,390	205,474	219,567	21.3%	63.1%	6.9%
Federal, civilian	29,963	31,621	30,205	28,785	30,099	5.5%	-4.5%	4.6%
Military	21,794	22,552	17,167	17,106	16,258	3.5%	-23.9%	-5.0%
State and local	96,095	125,115	155,018	159,583	173,210	30.2%	23.9%	8.5%
State governmental	42,560	55,722	64,654	65,503	69,786	30.9%	16.0%	6.5%
Local government	53,535	69,393	90,364	94,080	103,424	29.6%	30.2%	9.9%

⁽¹⁾ Prior to 2001, the U.S. Department of Commerce employed the Standard Industrial Classification ("SIC") system for industry specific data covered in its economic research and analysis of non-agricultural wage and salary employment information. In 2001, the U.S. Department of Commerce adopted a revised and expanded industry classification system, the North American Industry Classification System ("NAICS"). Consequently, 2001 and 2005 employment by industry data is not comparable with employment by industry data for the years 2000, 1990 and 1980. NAICS Industry groups and subgroups in the 2001 and 2005 data have been combined or extracted to approximate the SIC Industry groups listed for the years before 2001.

⁽²⁾ The SIC subgroups, "Metal Mining", "Coal Mining" and "Nonmetallic Minerals, except fuels" were combined to approximate the NAICS category "Mining and Support Activities for Mining".

⁽³⁾ The NAICS "Information" subcategories, "Publishing industries, except Internet" and "Internet Publishing and broadcasting" and the NAICS "Manufacturing" category have been combined to approximate the former SIC "Manufacturing" group.

⁽⁴⁾ The NAICS "Information" subcategories, "Publishing industries, except Internet" and "Internet Publishing and broadcasting" and the NAICS "Manufacturing – Nondurable Goods" category have been combined to approximate the SIC "Manufacturing – Nondurable Goods" subcategory.

⁽⁵⁾ The NAICS categories of "Utilities" and "Transportation and Warehousing" and the NAICS "Information" subcategories of "Broadcasting, except Internet" and "Telecommunications" have been combined to approximate the SIC "Transportation and Public Utilities" category.

⁽⁶⁾ The NAICS "Accommodation and Food Services" subcategory of "Food Services and Drinking Places" has been added to the NAICS "Retail Trade" category to approximate the SIC "Retail Trade" category.

⁽⁷⁾ The NAICS categories of "Finance and Insurance" and "Real Estate and Rental and Leasing" have been combined to approximate the SIC category of "Finance, Insurance and Real Estate".

⁽⁸⁾ The NAICS categories of "Professional and Technical Services", "Management of Companies and Enterprises", "Administrative and Waste Services", "Educational Services", "Health Care and Social Assistance", "Arts, Entertainment and Recreation", "Other Services, except Public Administration", and the subcategories, "Accommodation and Food Services – Accommodation", "Information – Motion Picture and Sound Recording Industries", "Information – ISPs, Search Portals, and Data Processing", "Information – Other Information Services" have been combined to approximate the SIC category "Services".

Source: U.S. Department of Commerce, Bureau of Economic Analysis, March 2007.

The following tables set forth selected additional economic and demographic data with respect to the State.

**Employment and Labor Force
New Mexico and the United States
1997-2006**

<u>Year</u>	<u>Civilian Labor Force</u> (000)		<u>Number of Employed</u> (000)		<u>Unemployment Rate</u>		<u>N.M. as % of U.S. Rate</u>
	<u>New Mexico</u> ⁽¹⁾	<u>United States</u> ⁽¹⁾	<u>New Mexico</u> ⁽¹⁾	<u>United States</u>	<u>New Mexico</u>	<u>United States</u>	
1997	823	136,297	769	129,558	6.6%	5.0%	133%
1998	836	137,673	784	131,464	6.2%	4.5%	139%
1999	840	139,368	793	133,488	5.6%	4.2%	133%
2000	851	142,583	809	136,891	5.0%	4.0%	127%
2001	862	143,734	819	136,934	4.9%	4.7%	104%
2002	875	144,863	828	136,485	5.5%	5.8%	95%
2003	893	146,510	841	137,736	5.9%	6.0%	99%
2004	912	149,401	860	139,252	5.7%	5.5%	103%
2005	915	149,320	867	141,730	5.3%	5.1%	104%
2006	935	151,428	896	144,427	4.2%	4.6%	91%

⁽¹⁾ Figures rounded to nearest thousand.

Source: U.S. Department of Labor, Bureau of Labor Statistics, March 2007.

**Personal Income
New Mexico and the United States
1997-2006**

<u>Year</u>	<u>Personal Income (000)</u>		<u>Annual Percentage Change</u>	
	<u>New Mexico</u>	<u>United States</u>	<u>New Mexico</u>	<u>United States</u>
1997	\$34,960,814	\$6,907,332,000	4.8%	6.1%
1998	37,045,765	7,415,709,000	6.0%	7.4%
1999	38,045,599	7,796,137,000	2.7%	5.1%
2000	40,318,443	8,422,074,000	8.8%	8.0%
2001	44,138,165	8,716,992,000	9.5%	3.5%
2002	44,986,517	8,872,871,000	1.9%	1.8%
2003	46,650,275	9,150,320,000	3.7%	3.1%
2004	50,707,317	9,716,351,000	8.7%	6.2%
2005	53,714,363	10,220,942,000	5.9%	5.2%
2006 ⁽¹⁾	57,998,275	10,860,916,880	8.0%	6.3%

⁽¹⁾ Preliminary estimate.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, March 2007.

**Per Capita Personal Income
New Mexico and the United States
1997-2006**

<u>Year</u>	<u>Per Capita Income</u>		<u>N.M. as a % of U.S.</u>	<u>Annual Percentage Change</u>	
	<u>New Mexico</u>	<u>United States</u>		<u>N.M.</u>	<u>U.S.</u>
1997	\$19,698	\$25,334	78%	3.5%	4.8%
1998	20,656	26,883	77%	4.9%	6.1%
1999	21,042	27,939	75%	1.9%	3.9%
2000	22,133	29,843	74%	5.2%	6.8%
2001	24,083	30,562	79%	8.8%	2.4%
2002	24,247	30,795	79%	0.7%	0.8%
2003	24,846	31,466	79%	2.5%	2.2%
2004	26,679	33,090	81%	7.4%	5.2%
2005	27,889	34,471	81%	4.5%	4.2%
2006 ⁽¹⁾	29,673	36,276	82%	6.4%	5.2%

⁽¹⁾ Preliminary estimate.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, March 2007.

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Wages and Salaries by Industry Sector 1990, 2000, 2001 and 2005

	New Mexico (Dollars in thousands)				United States (Dollars in millions)				Percent Change 2001 – 2005 ⁽¹⁾		Distribution of 2005 Wages & Salaries ⁽¹⁾	
	2005 ⁽¹⁾	2001 ⁽¹⁾	2000	1990	2005 ⁽¹⁾	2001 ⁽¹⁾	2000	1990	N.M.	U.S.	N.M.	U.S.
Farm Total	252,352	176,072	179,521	95,849	21,404	17,920	16,781	11,767	43.3%	19.4%	0.9%	0.4%
Non-Farm												
Private												
Agricultural Services, Forestry, Fishing	84,932	72,008	143,971	62,663	17,836	15,968	30,886	15,164	17.9%	11.7%	0.3%	0.3%
Mining	924,039	726,676	671,919	507,585	40,605	32,132	31,219	26,655	27.2%	26.4%	3.3%	0.7%
Construction	1,864,210	1,481,698	1,306,228	577,016	318,815	271,681	256,807	140,468	25.8%	17.3%	6.6%	5.6%
Manufacturing ⁽²⁾	1,633,154	1,669,853	1,656,465	980,349	763,810	773,184	830,026	561,384	-2.2%	-1.2%	5.8%	13.5%
Transportation & Public Utilities ⁽³⁾	1,294,999	1,239,195	1,351,378	884,830	361,463	295,851	313,333	179,390	4.5%	22.2%	4.6%	6.4%
Wholesale Trade	952,118	834,834	950,471	552,522	322,972	283,974	332,549	189,402	14.0%	13.7%	3.4%	5.7%
Retail Trade ⁽⁴⁾	3,020,117	2,564,031	2,434,023	1,316,067	525,241	463,539	449,642	264,791	17.8%	13.3%	10.7%	9.3%
Finance, Insurance & Real Estate ⁽⁵⁾	1,308,467	1,060,638	1,027,385	543,814	535,578	444,684	431,911	207,758	23.4%	20.4%	4.6%	9.5%
Services ⁽⁶⁾	8,547,983	7,693,954	5,916,169	2,945,866	1,845,272	1,535,895	1,382,404	644,429	11.1%	20.1%	30.4%	32.6%
Total Private	19,635,730	16,283,154	15,458,009	8,370,712	4,674,424	4,116,908	4,058,777	2,229,441	20.6%	13.5%	69.7%	82.6%
Government												
Federal, Civilian	1,707,762	1,366,112	1,280,241	917,118	166,905	134,679	135,011	99,598	25.0%	23.9%	6.1%	2.9%
Military	678,213	495,168	477,480	440,596	80,074	54,970	50,520	46,332	37.0%	45.7%	2.4%	1.4%
State & Local	5,881,523	4,700,434	4,374,109	2,472,762	716,475	615,467	572,880	356,505	25.1%	16.4%	20.9%	12.7%
Total Government	8,267,498	6,561,714	6,131,830	3,830,476	963,454	805,116	758,411	502,435	26.0%	19.7%	29.4%	17.0%
Non-Farm Total:	27,903,228	22,844,868	21,589,839	12,201,188	5,637,878	4,922,024	4,817,188	2,731,876	22.1%	14.5%	99.1%	99.6%
Total	28,155,580	23,020,940	21,769,360	12,297,037	5,659,282	4,939,944	4,833,969	2,743,643	22.3%	14.6%	100.0%	100.0%

⁽¹⁾ Prior to 2001, the U.S. Department of Commerce employed the Standard Industrial Classification (“SIC”) system for industry specific data covered in its economic research and analysis of non-agricultural wage and salary employment information. In 2001, the U.S. Department of Commerce adopted a revised and expanded industry classification system, the North American Industry Classification System (“NAICS”). Consequently, 2001 and 2005 employment by industry data is not comparable with employment by industry data for the years 2000, 1990 and 1980. NAICS Industry groups and subgroups in the 2001 and 2005 data have been combined or extracted to approximate the SIC Industry groups listed for the years before 2001.

⁽²⁾ The NAICS “Information” subcategories, “Publishing industries, except Internet” and “Internet Publishing and broadcasting” and the NAICS “Manufacturing” category have been combined to approximate the former SIC “Manufacturing” group.

⁽³⁾ The NAICS categories of “Utilities” and “Transportation and Warehousing” and the NAICS “Information” subcategories of “Broadcasting, except Internet” and “Telecommunications” have been combined to approximate the SIC “Transportation and Public Utilities” category.

⁽⁴⁾ The NAICS “Accommodation and Food Services” subcategory of “Food Services and Drinking Places” has been added to the NAICS “Retail Trade” category to approximate the SIC “Retail Trade” category.

⁽⁵⁾ The NAICS categories of “Finance and Insurance” and “Real Estate and Rental and Leasing” have been combined to approximate the SIC category of “Finance, Insurance and Real Estate”.

⁽⁶⁾ The NAICS categories of “Professional and Technical Services”, “Management of Companies and Enterprises”, “Administrative and Waste Services”, “Educational Services”, “Health Care and Social Assistance”, “Arts, Entertainment and Recreation”, “Other Services, except Public Administration”, and the subcategories, “Accommodation and Food Services – Accommodation”, “Information – Motion Picture and Sound Recording Industries”, “Information – ISPs, Search Portals, and Data Processing”, “Information – Other Information Services” have been combined to approximate the SIC category “Services”.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, March 2007.

APPENDIX B

**STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER
FINANCIAL STATEMENTS FOR THE
FISCAL YEAR ENDED JUNE 30, 2006**

STATE OF NEW MEXICO
OFFICE OF THE
STATE TREASURER
Financial Statements
for the Year Ended
June 30, 2006,
and Independent
Auditors' Report

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

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STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

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Year Ended June 30, 2006

Office of the State Treasurer

Douglas Minge Brown, State Treasurer

Scott W. Stovall, Deputy State Treasurer

Mark S. Valdes, Asst. State Treasurer

State Treasurer's Investment Committee

Douglas Minge Brown, Chairman

Scott Stovall, Vice-chairman

Steve Borlin, Member

Paul Cassidy, Member

Olivia Padilla Jackson, State Board of Finance Member



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INDEPENDENT AUDITORS' REPORT

Honorable Bill Richardson, Governor
 State Board of Finance
 Honorable Douglas Minge Brown, State Treasurer
 Honorable Domingo P. Martinez, CGFM, State Auditor
 Santa Fe, New Mexico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the State of New Mexico, Office of the State Treasurer (State Treasurer), as of and for the year ended June 30, 2006, which collectively comprise the State Treasurer's basic financial statements as listed in the table of contents. We have also audited Schedules 2 through 5 and Schedules 8 through 9 and Schedule 6 – Summary of Long Term Debt Obligations, as listed in the table of contents and included in the financial statements as supplementary information as of and for the year ended June 30, 2006. These financial statements are the responsibility of the State Treasurer's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the State Treasurer are intended to present the financial position and the changes in financial position and its budgetary comparisons of only that portion of the governmental activities, each major fund and the aggregate remaining fund information of the State of New Mexico that is attributable to the transactions of the State Treasurer. They do not purport to, and do not, present fairly the financial position of the entire State of New Mexico as of June 30, 2006, and the changes in financial position and its budgetary comparisons for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Honorable Bill Richardson, Governor
State Board of Finance
Honorable Douglas Minge Brown, State Treasurer
Honorable Domingo P. Martinez, CGFM, State Auditor
Santa Fe, New Mexico

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the State Treasurer as of and for the year ended June 30, 2006, and the respective changes in financial position thereof, and the respective budgetary comparison for the general fund for the year then ended, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, Schedules 2 through 5 and Schedules 8 through 9 and Schedule 6 – Summary of Long Term Debt Obligations referred to above, present fairly, in all material respects, the respective financial and fiduciary funds of the State Treasurer and the long-term debt obligations of the State of New Mexico as of and for the year ended June 30, 2006, and the respective changes in financial position, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 8, 2006, on our consideration of the State Treasurer's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 4 through 11 is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming opinions on the financial statements that collectively comprise the State Treasurer's basic financial statements. Schedules 1 and 10, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Schedules 1 and 10, as listed in the table of contents, have been subjected to the auditing procedures applied in the audit of the basic financial statements and in our opinion are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Meyners + Company, LLC
December 8, 2006

**STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER**

Management's Discussion and Analysis



The State of New Mexico Office of the State Treasurer's (State Treasurer) Management's Discussion and Analysis (MD&A) is designed to assist the reader in focusing on significant financial issues, provide an overview of the State Treasurer's financial activity, identify changes in the State Treasurer's financial position (ability to address future year challenges), identify any material deviations from the financial plan, and identify any fund issues of concern.

The MD&A is designed to focus on the past year's activities, resulting changes and currently known facts; please read it in conjunction with the transmittal letter at the front of this report and the State Treasurer's financial statements and notes which follow this section.

Financial Highlights

- The General Fund's main revenue was appropriations, which amounted to 99% of all revenue.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the State Treasurer's basic financial statements. The State Treasurer's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-Wide Financial Statements

The government-wide financial statements are designed to provide a broad overview of the State Treasurer's finances, in a manner similar to a private sector business. The statement of net assets presents information on all of the State Treasurer's assets and liabilities, the difference between the two being reported as net assets.

The statement of activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal year periods (e.g., uncollected taxes and earned but unused vacation leave).



Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources segregated for specific activities or objectives. The State Treasurer, like other state and local government entities, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the State Treasurer can be divided into two categories: governmental funds and fiduciary funds.

Governmental Funds:

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The State Treasurer maintains four individual governmental funds. Information is presented separately in the governmental fund balance sheet and statement of revenues, expenditures, and changes in fund balances for the General Fund, the Bond Issuance Fund, General Obligation Bond Fund, and Severance Tax Bond Fund, all of which are considered to be major funds. The General Obligation and Severance Tax Bond funds combine into a single, aggregated presentation of the activity of each individual bond issue. Individual bond transaction data of these governmental funds is provided in the form of combining statements elsewhere in this report.

The State Treasurer adopts an annual operating budget for its General Fund. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with this budget.



Fund Financial Statements - continued

Fiduciary Funds:

Fiduciary funds are used to account for resources held for the benefit of parties outside the State Treasurer. Fiduciary funds are not reflected in the government-wide financial statement because the resources of those funds are not available to support the State Treasurer's own programs.

Fiduciary funds provide the same type of information as the government-wide financial statements, only in more detail. The fiduciary fund financial statements provide separate information for the Short-term Investment Pool, Consolidated Investment Pool, and State Funds Investment Pool. The State Treasurer's fiduciary funds account for cash, securities, and other investments identified and held in custody on behalf of local and state government agencies, and are separately identified by the types of State and local agencies for which the funds are held. The Short-term Investment Pool accounts for the Local Government Investment Pool (LGIP), the Consolidated Investment Pool accounts for funds held in custody for both State and local government agencies, and the State Funds Investment Pool accounts for funds identified and held in custody on behalf of State agencies.

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to a user's full understanding of the data provided in the government-wide and fund financial statements, and begin on page 22 of this report.

Other Information

The combining statements referred to earlier in connection with the General Obligation and Severance Tax Bond funds are presented immediately following the notes to the financial statements. Combining statements, schedules of capital assets, and schedules of long-term debt can be found beginning on page 62 of this report. Fiduciary schedules begin on page 77.

Required Supplementary Information (Other than MD&A)

In addition to the basic statements and accompanying notes, this report also presents certain required supplementary information concerning the State Treasurer's progress in funding its obligation to provide pension benefits to its employees.

**STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER**

Management's Discussion and Analysis - continued



Government-wide Financial Analysis

Net Assets: Table A-1 summarizes the State Treasurer's net assets for the fiscal year ending June 30, 2006. Total State Treasurer net assets for fiscal year 2006 are \$331,876,351. However, most of those net assets are restricted as to the purposes for which they can be used.

**Table A-1
The State Treasurer's Net Assets**

	Total	
	2006	2005
Assets:		
Cash, cash equivalents and repurchase agreements	\$ 289,469,620	153,041,655
Due from other agencies	39,385,885	36,638,001
Accrued interest and other receivables	1,595,197	43,319
Investment in NM Business Development Corp.	1,359,766	1,357,139
Capital assets, net	65,883	97,725
Total assets	\$ 331,876,351	191,177,839
Current liabilities:		
Accounts payable and other	\$ 132,823,251	12,729,873
Compensated absences, amounts due in one year	95,980	100,000
Compensated absences, amounts due beyond one year	-	1,251
Total liabilities	132,919,231	12,831,124
Net assets:		
Invested in capital assets	65,883	97,725
Restricted	199,253,120	178,421,080
Unrestricted	(361,883)	(172,090)
Total net assets	198,957,120	178,346,715
Total liabilities and net assets	\$ 331,876,351	191,177,839

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the State Treasurer, assets exceeded liabilities by \$198,957,120 at the close of the most recent fiscal year.

**STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER**

Management's Discussion and Analysis - continued



Government-wide Financial Analysis - continued

Net Assets - continued: By far the largest portion of the State Treasurer's net assets reflects amounts to be provided to satisfy its General Obligation and Severance Tax Bond obligations. It is the responsibility of the State Treasurer to record and administer debt on behalf of the agencies and departments of the State of New Mexico. The proceeds of bond issues authorized by the State Board of Finance are transferred to various State agencies in the form of grants. The State Treasurer anticipates the future tax revenues generated will be adequate to service the debt obligations.

An additional portion of the State Treasurer's net assets, \$199,253,120, represents resources that are subject to external restrictions on their use.

Changes in Net Assets: Governmental activities increased the State Treasurer's net assets in the governmental financial statements by \$20,548,026. Key elements of this increase are shown in Table A-2.

**Table A-2
Changes in the State Treasurer's Net Assets**

	<u>Total</u>	
	<u>2006</u>	<u>2005</u>
Revenues:		
Federal funds	\$ (8,936)	(13,883)
State appropriation	(3,822,500)	(3,426,400)
Interest income	(40,120,599)	(16,259,668)
Total revenues	<u>(43,952,035)</u>	<u>(19,699,951)</u>
Expenses:		
Current:		
Personnel services and employee benefits	2,502,020	2,480,492
Operating costs	918,122	963,432
Contractual services	185,622	232,063
Debt Service:		
Interest on long-term debt	59,237,511	51,349,828
Debt service activity	387,019,669	389,032,224
Other charges	2,709,501	4,116,899
Non-operating (revenue) and expense	(429,168,436)	(439,914,466)
Total expenses	<u>23,404,009</u>	<u>8,260,472</u>

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Management's Discussion and Analysis - continued

Government-wide Financial Analysis - continued

Table A-2 - continued
Changes in the State Treasurer's Net Assets

	Total	
	2006	Restated 2005
Change in net assets	\$ 20,548,026	24,284,436
Net assets, beginning, restated	178,409,094	154,124,658
Net assets, ending	\$ 198,957,120	178,409,094

Financial Analysis of the Government's Funds

As noted earlier, the State Treasurer uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the State Treasurer governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the State Treasurer's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At the end of the current fiscal year, the State Treasurer's governmental funds reported combined ending fund balances of \$198,987,217, an increase of \$20,754,598 in comparison with the prior year. The primary reason for the significant increase in the overall change in net assets is the increase in severance tax receipts of \$98,734,435 due to the increase in the price of oil and natural gas. The increase was used for debt service payments or retained for future debt service payments after \$123,217,261 reverted to the permanent fund.

The fund balance of the State Treasurer general fund decreased by \$14,786 during the current fiscal year.

**STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER**

Management's Discussion and Analysis - continued



General Fund Budgetary Highlights

Differences between the original budget and the final amended budget are briefly summarized as follows:

- \$375,200 in increases for personnel costs, contractual services and operating costs.

There were no significant variances between final budget amounts and actual budget results for the General Fund. The General Fund actual expenditures were less than the final budgeted amounts by less than one percent. The only significant variances between final budget amounts and actual budget results for the General Fund were for contractual services, which were 50 percent less than actual expenditures.

Capital Assets and Debt Administration

Capital Assets. The State Treasurer's investment in capital assets for its governmental activities as of June 30, 2006, amounts to \$65,883, net of accumulated depreciation. This investment in capital assets includes equipment.

Additional information on the State Treasurer's capital assets can be found in Note 4 of this report.

GASB #34 requires the recording and depreciation of infrastructure assets such as roads, bridges, traffic signals, etc. The State Treasurer does not own any infrastructure assets.

Long-Term Debt. At the end of the current fiscal year, the State Treasurer was responsible for administering debt service payments on total bonded debt outstanding of \$1,009,378,786, all of which is secured by pledged tax revenues. More detailed information about the State Treasurer's long-term debt is presented in Note 5 to the financial statements and Schedule 6.

	<u>Total</u>	
	<u>2006</u>	<u>2005</u>
General Obligation Bonds	\$ 325,707,588	318,055,000
Severance Tax Bonds	<u>683,671,198</u>	<u>512,180,000</u>
Total principal balances	\$ <u>1,009,378,786</u>	<u>830,235,000</u>



Economic Factors and Next Year's Budgets and Rates

- Additional resources were added to improve the investment function. A portfolio manager was added to manage the new bond proceeds portfolio. Additionally, a new financial analyst will be added to provide analytical and accounting support. A new electronic trading platform (Trade Web) was initiated to allow transparent, competitive investment trades. The Local Government Investment Pool received its maiden rating (AAAm) from Standard & Poors. These additional resources greatly benefited the investment function of the State Treasurer.
- The State Treasurer contracted for a higher level of legal services to assist with investment and other internal policy updates, provide legal counsel for various personnel lawsuits and grievance hearings, and draft proposed legislation and other miscellaneous legal advice.
- Added resources to implement numerous recommendations included in the forensic audit prepared by Deloitte.
- Initiated personnel, system and facility, and security recommendations made by the Office of the Chief Information Officer.
- Reduced IT budget based on decommissioning of TRACS and recognized staffing efficiencies in banking operations due to SHARE implementation.

These factors were considered in preparing the State Treasurer's budget for FY2007.

Contacting the State Treasurer's Financial Management

This financial report is designed to provide a general overview of the State Treasurer's finances for those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to

Douglas Minge Brown, State Treasurer
Office of the State Treasurer
P.O. Box 608
Santa Fe, New Mexico 87504-0608

FINANCIAL STATEMENTS

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Statement of Net Assets



AS OF JUNE 30, 2006

		Governmental Activities
ASSETS		
Cash and cash equivalents	\$	961,405
Repurchase agreements		288,508,215
Due from other agencies		39,385,885
Accrued interest receivable		1,594,736
Other receivables		461
Investment in New Mexico Business Development Corporation		1,359,766
Capital assets, net of accumulated depreciation (Note 4):		
Equipment		65,883
TOTAL ASSETS	\$	331,876,351
LIABILITIES AND NET ASSETS		
Accounts payable and other current liabilities	\$	593,859
Due to State General Fund		848,428
Due to Severance Tax Permanent Fund		123,217,261
Due to other agencies		8,163,703
Non-current liabilities:		
Due within one year		95,980
Due in more than one year		-
TOTAL LIABILITIES		132,919,231
NET ASSETS:		
Invested in capital assets		65,883
Restricted for:		
Debt service		195,338,689
Debt service-arbitrage		2,554,665
New Mexico Business Development Corporation		1,359,766
Unrestricted		(361,883)
TOTAL NET ASSETS		198,957,120
TOTAL LIABILITIES AND NET ASSETS	\$	331,876,351

See Notes to Financial Statements.

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Statement of Activities



YEAR ENDED JUNE 30, 2006

Functions/Programs	Expenses	Program Revenue	Net (Expenses) Revenue and Changes in Net Assets Primary Government
PRIMARY GOVERNMENT:			
GOVERNMENTAL ACTIVITIES:			
Personnel services and employee benefits	\$ 2,502,020	8,936	(2,493,084)
Operating costs	918,122	-	(918,122)
Interest on long-term debt	59,237,511	-	(59,237,511)
Contractual services	185,622	-	(185,622)
Other charges	<u>2,709,501</u>	<u>-</u>	<u>(2,709,501)</u>
TOTAL GOVERNMENTAL ACTIVITIES	65,552,776	8,936	(65,543,840)
GENERAL REVENUES:			
State general fund appropriations			3,822,500
State property tax levy			48,079,757
Severance taxes			498,602,285
Other taxes			765,706
Capital projects, reversions in			5,204,979
Severance tax permanent fund, reversions out			(123,217,261)
Miscellaneous			(267,030)
UNRESTRICTED INVESTMENT EARNINGS			40,120,599
BOND ACTIVITY:			
Bond proceeds			980,698,375
Bond premiums			14,383,373
Bond principal payments			(963,964,337)
Bond appropriations expense			(431,832,807)
TRANSFER FROM OTHER STATE AGENCY			<u>13,695,727</u>
TOTAL GENERAL REVENUES AND TRANSFERS			<u>86,091,866</u>
CHANGE IN NET ASSETS			20,548,026
NET ASSETS, BEGINNING			178,346,715
PRIOR PERIOD ADJUSTMENTS			<u>62,379</u>
NET ASSETS, BEGINNING, restated			<u>178,409,094</u>
NET ASSETS, ENDING			\$ <u>198,957,120</u>

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Balance Sheet - Governmental Funds

AS OF JUNE 30, 2006

	Major Funds							Total Governmental Funds
	General Fund	NM Business Development Corp. Fund	Bond Insurance Fund	General Obligation Bond Fund	Severance Tax Bond Fund	Tax & Revenue Anticipation Notes	Gaming Suspense Fund	
ASSETS:								
Cash and cash equivalents	\$ 380,127	-	-	-	-	-	581,278	961,405
Repurchase agreements	-	-	-	46,049,693	234,458,522	8,000,000	-	288,508,215
Investment in NM Business Development Corp.	-	1,359,766	-	-	-	-	-	1,359,766
Other receivables	461	-	-	2,444,281	36,941,604	-	-	461
Due from other agencies	-	-	-	17,792	1,576,944	-	-	39,385,885
Interest receivable	-	-	-	-	-	-	-	1,594,736
TOTAL ASSETS	\$ 380,588	1,359,766	-	48,511,766	272,977,070	8,000,000	581,278	331,810,468
LIABILITIES AND FUND BALANCES:								
LIABILITIES								
Accounts payable	\$ 102,904	-	-	-	214,518	180,278	-	497,760
Due to Severance Tax Permanent Fund	-	-	-	-	123,217,261	-	-	123,217,261
Due to other agencies	-	-	-	-	163,703	8,000,000	-	8,163,703
Due to State General Fund	267,150	-	-	-	-	-	581,278	848,428
Accrued payroll	96,099	-	-	-	-	-	-	96,099
Other payables	-	-	-	-	-	-	-	-
TOTAL LIABILITIES	466,219	-	-	-	123,595,482	8,180,278	581,278	192,829,251
FUND BALANCES:								
Reserved for:								
New Mexico Business Development Corp.	-	1,359,766	-	47,131,980	148,206,709	-	-	1,359,766
Debt service	-	-	-	1,379,786	1,174,879	-	-	195,398,689
Arbitrage	-	-	-	-	-	-	-	2,534,665
Unreserved, reported in general fund	(85,625)	-	-	-	-	-	-	(85,625)
Unreserved, reported in:								
Taxation & Revenue Anticipation Notes	-	-	-	-	-	(180,278)	-	(180,278)
TOTAL FUND BALANCES	(85,625)	1,359,766	-	48,511,766	149,381,588	(180,278)	-	198,987,217
TOTAL LIABILITIES AND FUND BALANCES	\$ 380,588	1,359,766	-	48,511,766	272,977,070	8,000,000	581,278	331,810,468

See Notes to Financial Statements.

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Reconciliation of the Balance Sheet to the
Statement of Net Assets - Governmental Funds



YEAR ENDED JUNE 30, 2006

Total Fund Balance - Governmental Funds
(Governmental Fund Balance Sheet) \$ 198,987,217

Amounts reported for governmental activities in the Statement of
Net Assets are different because:

Capital assets used in governmental activities are not current financial
resources and, therefore, are not reported in this fund financial
statement, but are reported in the governmental activities of the
Statement of Net Assets. 65,883

Some liabilities (compensated absences) are not due and payable
in the current period and are not included in the fund financial
statement, but are included in the governmental activities
of the Statement of Net Assets. (95,980)

Net assets of governmental activities (Statement of Net Assets) \$ 198,957,120

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER
Statement of Revenues, Expenditures and Changes
in Fund Balances - Governmental Funds

	Major Funds							Total Governmental Funds
	General Fund	Not Revenues Development Corp. Fund	Road Business Fund	General Obligation Bond Fund	Revenue Tax Bond Fund	Tax & Revenue Anticipation Notes	Quasi- Sovereign Fund	
REVENUES								
Federal funds	8,036	-	-	-	-	-	-	8,036
State general fund appropriations	3,447,300	-	-	-	-	-	-	3,447,300
Special appropriations	375,200	-	-	-	-	-	-	375,200
Other income	120	-	-	-	-	-	-	120
Interest income	-	2,627	-	-	-	-	-	2,627
Interest income - debt service	-	-	-	6,923,172	31,893,306	-	-	38,816,478
Interest income - savings	-	-	-	666,132	646,360	-	-	1,312,492
TOTAL REVENUES	3,831,556	2,627	7,588,304	7,588,304	32,539,666	-	-	43,962,155
EXPENDITURES:								
Current								
Personnel services and employee benefits	2,502,031	-	-	-	-	-	-	2,502,031
Operating costs	185,022	-	-	-	-	-	-	185,022
Contractual services	881,581	-	-	-	-	-	-	881,581
Other administrative expenditures	-	-	-	-	-	-	-	-
Debt service	-	-	-	57,483,280	389,614,432	876,154,166	-	1,023,251,878
Principal and interest on long-term debt	-	-	-	4,250	1,794,471	624,718	-	2,709,501
Arbitrage	-	-	346,002	-	-	-	-	346,002
Other charge	9,969	-	-	-	-	-	-	9,969
Capital outlay	3,572,182	-	346,002	57,437,500	361,446,903	576,778,944	-	1,022,480,531
TOTAL EXPENDITURES	262,314	3,627	(346,002)	(49,244,196)	(648,819,285)	(576,778,944)	-	(968,538,386)
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(267,150)	-	7,930,306	7,588,304	32,539,666	-	-	39,791,126
OTHER FINANCING SOURCES (USES)								
Revenues	-	-	-	-	-	-	-	-
Revenue taxes	-	-	-	-	498,602,285	-	-	498,602,285
State property tax levy	-	-	-	48,079,787	-	-	-	48,079,787
Bond proceeds	-	-	490,698,375	-	-	550,000,000	-	1,040,700,750
Bond premiums (discount)	-	-	1,480,444	-	-	12,902,939	-	14,383,383
Other taxes	-	-	-	-	-	-	-	-
Capital projects, revenues in	-	-	768,706	-	-	-	-	768,706
Payments to other agency	-	-	792,694	-	4,472,386	-	-	5,265,080
Miscellaneous other sources	-	-	-	-	-	-	-	-
Severance tax (permission fund), revenues not transferred to	-	-	-	-	(128,217,261)	-	-	(128,217,261)
Transfer to other agency	-	-	(431,852,807)	-	-	13,693,722	-	(418,159,085)
TOTAL OTHER FINANCING SOURCES (USES)	(267,150)	-	(346,002)	(49,244,196)	379,857,402	13,693,722	-	1,006,112,984
NET CHANGE IN FUND BALANCES	(14,796)	2,627	7,588,304	(41,655,892)	32,539,666	(418,159,085)	-	20,574,598
FUND BALANCES, June 30, 2005	(70,839)	1,387,139	(48,794,061)	(11,156)	128,269,879	(180,278)	-	178,360,240
PLUS PERIOD ADJUSTMENTS	(70,839)	1,387,139	(48,794,061)	(11,156)	128,269,879	(180,278)	-	178,360,240
FUND BALANCES, June 30, 2006	(85,635)	1,389,766	(56,388,365)	(58,811,766)	140,381,588	(180,278)	-	198,987,212

See Note to Financial Statements.

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Reconciliation of the Statement of Revenues, Expenditures,
and Changes in Fund Balances - Governmental Funds
to the Statement of Activities - Governmental Funds

YEAR ENDED JUNE 30, 2006

Net Changes in Fund Balances - Total Governmental Funds
(Statement of Revenues, Expenditures, and Changes in Fund Balances) \$ 20,574,598

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds report outlays for capital assets as expenditures because such outlays use current financial resources. In contrast, the Statement of Activities reports only a portion of the outlay as expense. The outlay is allocated over the assets' estimated useful lives as depreciation expense for the period.

This is the amount by which depreciation of \$41,811 exceeded capital outlay of \$9,969 in the current period: (31,842)

Some expenses reported in the statement of activities do not require the use of current financial resources, and these are not reported as expenditures in governmental funds: 5,271

Rounding (1)

Change in net assets of governmental activities \$ 20,548,026

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Statement of Revenues and Expenditures -
Major Governmental Funds -
Budget and Actual (Non-GAAP Basis)

YEAR ENDED JUNE 30, 2005

	GENERAL FUND			
	Budgeted Amounts		Actual Amounts (Budgetary Basis)	Variance From Final Budget Positive (Negative)
	Original	Final		
REVENUES:				
State General Fund appropriation	\$ 3,408,300	3,447,900	3,447,300	-
Special appropriation	39,000	375,200	375,200	-
Other grants	25,400	25,400	8,936	(16,464)
Other	-	-	120	120
TOTAL REVENUES	\$ 3,472,700	3,847,900	3,831,556	(16,344)
EXPENDITURES:				
Current:				
Personnel services and benefits	\$ 2,540,600	2,553,600	2,502,020	51,580
Contractual services	174,600	441,900	224,772	217,128
Operating costs	757,500	852,400	852,400	-
TOTAL EXPENDITURES	3,472,700	3,847,900	3,579,192	268,708
OTHER FINANCING SOURCES (USES):				
Transfers in	-	-	-	-
Transfers out	-	-	-	-
TOTAL OTHER FINANCING SOURCES (USES)	-	-	-	-
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES AND OTHER FUNDING SOURCES (USES)	\$ -	-	252,364	252,364

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Statement of Fiduciary Net Assets

AS OF JUNE 30, 2006

	<u>Investment Trust Fund</u>
ASSETS:	
Cash and investments:	
Certificates of Deposit	\$ 255,350,000
Commercial Paper	191,653,910
U.S. Government securities	2,218,721,438
Corporate Bonds	4,992,600
Municipal Bonds	37,000,000
Repurchase agreements	<u>2,104,326,583</u>
Total cash and investments	4,812,044,531
Other assets:	
Accrued interest receivable	<u>13,618,667</u>
TOTAL ASSETS	\$ <u>4,825,663,198</u>
LIABILITIES:	
Bank overdraft	\$ <u>(394,180,837)</u>
TOTAL LIABILITIES	(394,180,837)
NET ASSETS HELD IN TRUST	<u>5,219,844,035</u>
TOTAL LIABILITIES AND NET ASSETS HELD IN TRUST	\$ <u>4,825,663,198</u>

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Statement of Changes in Fiduciary Net Assets

AS OF JUNE 30, 2006

	<u>Investment Trust Fund</u>
INVESTMENT INCOME	\$ 224,951,933
EXPENSES:	
Management fees	_____(384,000)
NET INVESTMENT INCOME	224,567,933
NET PROCEEDS OF DEPOSITS (WITHDRAWALS)	42,700,515
NET ASSETS, HELD IN TRUST FOR POOL PARTICIPANTS, JUNE 30, 2005	<u>4,558,394,750</u>
NET ASSETS, HELD IN TRUST FOR POOL PARTICIPANTS, JUNE 30, 2006	\$ <u>4,825,663,198</u>



NATURE OF ORGANIZATION

The Office of the State Treasurer (State Treasurer) has existed continuously since 1851 (Laws 1851-1852). The Legislative Assembly of the Territory of New Mexico passed an act to establish and regulate the Treasury Department of the Territory of New Mexico. This act established the office of territorial Treasurer and designed the duties of Treasurer. The Office of the State Treasurer is established by the New Mexico Constitution, Article V, Section 1, which provides in part:

"The executive department shall consist of a governor, lieutenant governor, secretary of state, state auditor, state treasurer, attorney general, and commissioner of public lands, who shall, unless otherwise provided in the constitution of New Mexico, be elected for the term of four years beginning on the first day of January next after their election. The governor and lieutenant governor shall be elected jointly by the casting by each voter of a single vote applicable to both offices."

Statutory powers and duties of the State Treasurer are contained in numerous articles of the New Mexico Statutes Annotated. Principal statutory provisions related to the New Mexico State Treasurer's Investment Fund are listed below:

- (1) Sections 8-6-1 through 8-6-7 NMSA 1978 (1983 Repl.), as amended. Section 8-6-3 NMSA 1978 (1983 Repl.) provides that the State Treasurer shall receive and keep all monies of the state, except when otherwise provided, shall disburse the public money upon lawful warrants and shall keep a just, true and comprehensive account of all monies received and disbursed.
- (2) Section 6-1-13 NMSA 1978 (1978 Repl.) provides that the State Treasurer shall authorize all state agency deposit accounts and shall establish conditions and reports appropriate to the accounts.
- (3) Section 6-8-2 NMSA 1978 (1988 Repl.) provides that the State Treasurer shall be a member of the State Investment Council. Section 6-8-6 NMSA 1978 (1988 Repl.) states that the State Treasurer shall maintain custody of the state permanent fund.
- (4) Sections 6-10-11 (G), (H), and (I) NMSA 1978 (1988 Supp.) empower the State Treasurer, with the advice and consent of the State Board of Finance, to invest money held in demand deposits and not immediately needed for the operation of state government in certain specified securities or investments.
- (5) Section 12-6-4 NMSA 1978 provides that the cost of the annual audit of the State Treasurer shall be borne by special appropriations to the State Board of Finance. The cost of the audit and other expenses paid in behalf to the New Mexico State Treasurer's Investment Fund not material to the combined financial statements are not reflected in the accompanying financial statements.

NATURE OF ORGANIZATION – continued

- (6) Section 6-124-2 NMSA 1978 is to ensure an orderly and uninterrupted flow of money to the general fund by anticipating the receipt of taxes and other state revenue.
- (7) Section 61-10-10.1 Short-term investment fund created; distribution of earnings; report of investment.
- a. There is created in the state treasury the 'short-term investment fund'. The fund shall consist of all deposits from governmental entities and Indian tribes or pueblos that are placed in the custody of the State Treasurer for short-term investment purposes pursuant to this section. The State Treasurer shall maintain a separate account for each governmental entity and Indian tribe or pueblo having deposits in the fund.
 - b. If any local public body is unable to receive payment on public money at the rate of interest as set forth in Section 6-10-36 NMSA 1978 from financial institutions within the geographic boundaries of the governmental unit, then a local public finance official having money of that local public body in his custody required for expenditure within thirty days or less may, with the consent of the appropriate local board of finance, if any, remit some or all of such money to the state treasurer, bank, savings and loan association or credit union for deposit for the purpose of short-term investment as allowed by this section.
 - c. Before any local funds are invested or reinvested for the purpose of short-term investment pursuant to this section, the local public body finance official shall notify and make sure funds are made available to banks, savings and loan associations and credit unions located within the geographical boundaries of their respective governmental unit, subject to the limitation on credit union accounts. To be eligible for such funds, the financial institution shall pay to the local public body the rate established by the State Treasurer pursuant to a policy adopted by the State Board of Finance for such short-term investments.
 - d. The local public body finance official shall specify the length of time each deposit shall be in the short-term investment fund, but in any event the deposit shall not be made for more than thirty days. The State Treasurer through the use of the state fiscal agent shall separately track each such deposit and shall make such information available to the public upon written request.
 - e. The State Treasurer shall invest the fund as provided for state funds under Section 6-10-10 NMSA 1978 and may elect to have the short-term investment fund consolidated for investment purposes with the state funds under the control of the State Treasurer, provided that accurate and detailed accounting records are maintained for the account of each participating entity and Indian tribe or pueblo and that a proportionate amount of interest earned is credited to each of



NATURE OF ORGANIZATION – continued

the separate government accounts. The fund shall be invested to achieve its objective, which is to realize the maximum return consistent with safe and prudent management.

- f. At the end of each month, all interest earned from investment of the short-term investment fund shall be distributed by the State Treasurer to the contributing entities and Indian tribes or pueblos in amounts directly proportionate to the respective amounts deposited in the fund and the length of time the amounts in the fund were invested. No fees or transfer expenses shall be charged to the participating entities and Indian tribes or pueblos for investment in the short-term investment fund.

The State Treasurer is responsible for making the State of New Mexico's debt service and interest payments on general obligation and severance tax bonds and maintaining the related accounting records. The proceeds from the issuance of these general obligation and severance tax bonds and the related debt are maintained in agency funds at the Department of Finance and Administration (DFA) and are not part of this audit. Those funds are included in the DFA's financial statements. The debt service activity, including the ending balances for the general obligation and severance tax bonds and the amortization of bond premiums, discounts and issuance costs, are included in the Supplementary Information section of this report and the statewide Comprehensive Annual Financial Report (CAFR).

Certain investments owned and administered by the Department of Highway and Transportation are purchased through the State Treasurer's Office. The fair value and other gratuitous information related to these investments are not included in the financial statements of the Investment Trust Fund.

The State Treasurer's Office operates several investment pools which collectively represent the cash and investments held at the State Treasurer's Office. These pools represent amounts being held and invested for state agencies and for local governments. They have been identified as: 1) state funds investment pool, 2) short-term investment pool, and 3) consolidated investment pool.

Oversight by the State Board of Finance

The State Board of Finance (Board) by statute is comprised of the State of New Mexico governor, lieutenant governor, state treasurer and four members from the general public, and each is a voting member of the Board.

The Board has the responsibility for the issuance of the general obligation and severance tax bonds and for the investment and distribution of the proceeds from such bonds. In that regard, the Board approves the issuance of all such bonds, and provides information for bond prospectuses in order to ensure compliance with financial disclosure requirements and to present information concerning bond issues in a meaningful



NATURE OF ORGANIZATION – continued

Oversight by the State Board of Finance - continued

and informative format. Debt Service Funds are maintained by the State Treasurer for Bonds issued by the Board. The State Treasurer does not report the corresponding debt. The debt is reported on the statement of the Board. The details of the debt are reported in the supplementary and additional information sections in this report.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

◆ ***Financial Reporting Entity***

The State Treasurer is a department of the State of New Mexico. The financial statements and notes to the financial statements include all funds for which the State Treasurer is responsible. These financial statements only present activity related to the State Treasurer's Office. The State Treasurer receives funding from state and federal sources and must comply with the requirements of these funding source entities. However, the State Treasurer is not included in any other governmental 'reporting entity' as defined by GASB pronouncements, since the State Treasurer is elected by the public and has decision making authority, the power to designate management, and the ability to significantly influence operations and have primary financial accountability for fiscal matters. In addition, there are no component units as defined in GASB Statement 14 which are included in the State Treasurer's reporting entity.

◆ ***Government-wide and Fund Financial Statements***

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the government. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.



1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

◆ ***Government-wide and Fund Financial Statements - continued***

Separate financial statements are provided for governmental funds and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

◆ ***Measurement Focus, Basis of Accounting, and Financial Statement Presentation***

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are billed.

Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The government reports the following major governmental funds:

The *General Fund* is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued**

◆ **Measurement Focus, Basis of Accounting, and Financial Statement Presentation – continued**

The government reports the following Debt Service Funds:

The *New Mexico Business Development Corporation Fund* was established to account for the State's investment in the New Mexico Business Development Corporation Bank. The authority for the creation of the fund was Sections 53-7-18 through 53-7-46 NMSA 1978.

The *Bond Issuance Fund* was established to account for the issuance and related issuance costs of severance tax and general obligation bond issues. The corresponding debt is accounted for in each specific *General Obligation Bond Fund* and *Severance Tax Bond Fund*. The corresponding debt is accounted for on the books of the Board.

The *General Obligation Bond Funds* are to account for payment of principal and interest on general obligation bonds. Financing sources are provided through the collection of property tax levies by other state agencies.

The *Severance Tax Bond Funds* are to account for tax receipts levied by other state agencies upon natural resource products, severed and saved from the lands of the State of New Mexico, and to account for payment of principal and interest on severance tax bonds.

The *Taxation and Revenue Fund* was established to account for the transactions related to the issuance of Taxation and Revenue Notes.

The *Gaming Suspense Fund* was established to collect monies owed to the state from gaming establishments.

Additionally, the government reports the following fiduciary funds:

The *Short-Term Investment Pool* accounts for cash, securities and other investments identified and held in custody only for the Local Government Investment Pool (LGIP).

The *Consolidated Investment Pool* accounts for cash, short-term securities and other investments held in custody for both state and local government agencies.

The *State Funds Investment Pool* accounts for cash, securities and other investments, identified and held in custody only for state agencies.



1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued**

◆ **Measurement Focus, Basis of Accounting, and Financial Statement Presentation – continued**

Amounts reported as *program revenues* include: 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

The effect of interfund activity has been eliminated from the government-wide financial statements.

◆ **Deposits and Investments**

The State Treasurer's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

State statutes authorize the State Treasurer to invest in, subject to various restrictions, U.S. government obligations, commercial paper, corporate bonds, asset backed obligations, repurchase agreements, certificates of deposit, securities lending transactions, variable rate notes, tax-exempt securities, and money market mutual funds.

◆ **Receivables and Payables**

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either 'due to/from other funds' (i.e., the current portion of interfund loans) or 'advances to/from other funds' (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as 'due to/from other funds.'

Advances between funds, as reported in the fund financial statements, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

All receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. In the government-wide and governmental fund financial statements, delinquent property taxes are not recorded as revenue until received.



1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

◆ **Capital Assets**

Capital assets, which include equipment, are reported in the applicable governmental columns in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 (amount not rounded) and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. Information Technology Equipment including software is being capitalized and included in furniture, fixtures and equipment in accordance with NMAC 2.20.1.9 C (5) and *AICPA Statement of Position 98-1*.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Equipment of the State Treasurer is depreciated using the straight line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Office equipment	5
Computer equipment	5

◆ **Compensated Absences**

Employees are entitled to accumulate annual leave at the rate based on appointment date and length of continuous service. A maximum of 240 hours of such accumulated annual leave may be carried forward after the pay period beginning in December and ending in January. When employees terminate, they are compensated for accumulated unpaid annual leave as of the date of termination, up to a maximum of 240 hours.

Employees are entitled to accumulate sick leave at the rate of 3.69 hours per pay period. There is no limit to the amount of sick leave which an employee may accumulate. State agencies are allowed to pay fifty (50) percent of each employee's hourly rate for accumulated sick leave over 600 hours up to 120 hours. Payment may be made only once per fiscal year at an employee-specified pay period in either January or July.



1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued**

◆ **Long-term Obligations**

In the government-wide financial statements, long-term debt and other long-term obligations are not reported as liabilities in the applicable governmental activities. The State Treasurer is not the issuer of the debt, nor is it ultimately responsible for the debt. The details of the long-term debt are reported in the Supplementary Information section of the financial statements as Schedule 6. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method, and are reported as Supplementary Information in Schedule 6 of the financial statements. Bonds payable are reported net of the applicable bond premium or discount in Schedule 6.

The State Treasurer reports the debt service activity of the State of New Mexico in its fund financial statements. Governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources, while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Since the State Treasurer reports the debt service activity in its fund financial statements, but does not report the related liabilities in the governmental activities, the Office reports the debt service activity of the State of New Mexico in its government-wide financial statements under general revenues and program expenses as follows:

Bond Proceeds. To report the proceeds received from bonds issued by the State Board of Finance.

Bond Premiums. To report premiums on bonds issued by the State Board of Finance.

Bond Principal Payments. To report principal payments on long-term debt made by the State Treasurer on debt issued by the State Board of Finance.

Bond Appropriations Expense. To report bond proceeds transferred to the DFA State Board of Finance for the agencies to draw the down as needed.

Debt Issuance Costs. Debt issuance costs are reported as other charges and included in program expenses.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

◆ ***Fiduciary Net Assets***

The combining statement of changes in fiduciary net assets reports the deposits and withdrawals made by the participants in the Investment Trust Funds as 'net deposits and withdrawals'. These amounts are reported as net, rather than gross, due to the volume of transactions completed during a fiscal period.

◆ ***Fund Equity***

In the fund financial statements, governmental funds report reservations of fund balance that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

◆ ***Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

◆ ***Restricted Resources***

When the Office of the State Treasurer has both restricted and unrestricted resources available to finance a particular program, it is the Government's policy to use restricted resources before unrestricted resources. Net assets are restricted by the bond indenture for debt service. Restricted resources include special appropriations limited to use as described in Laws 2004, C 114, S9, and severance taxes limited to use for the debt service obligations of the State of New Mexico.

2. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

◆ ***Budgets and Budgetary Accounting***

The State Treasurer follows these procedures in establishing the budgetary data reflected in the financial statements:

1. By September 1, the State Treasurer prepares a budget appropriation request by category to be presented to the next legislature.
2. The appropriation request is submitted to the Department of Finance and Administration's Budget Division (DFA) and to the Legislative Finance Committee (LFC).
3. DFA makes recommendations and adjustments to the appropriation request which become the Governor's proposal to the Legislature.



2. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY - continued

◆ *Budgets and Budgetary Accounting – continued*

4. LFC holds hearings on the appropriation request, also submitting recommendations and adjustments before presentation to the Legislature.
5. Both DFA's and LFC's recommended appropriation proposals are presented to the Legislature for approval of the final budget plan.
6. Budgetary control is exercised at the category level of the State Treasurer as a whole and changes are approved by the DFA.
7. Formal budgetary integration is employed as a management control device during the year for the General Fund.
8. The General Appropriations Act of 2004 established the modified accrual basis of accounting as the budgetary basis of accounting for the State of New Mexico beginning July 1, 2004. Accordingly, future budgets will be prepared using the modified accrual basis of accounting.
9. The State Treasurer's budget for the fiscal year ending June 30, 2006 was amended in a legally permissible manner by reallocating line item category totals as the need arose during the fiscal year. Individual amendments were not material in relation to the original budget.

The New Mexico Business Development Corporation Special Revenue Fund and the Bond Issuance Fund are not budgeted. Debt Service funds are budgeted over the life of their respective bond issues and not on an annual basis.

3. DEPOSITS AND INVESTMENTS

◆ *Fiscal Agent Bank*

The State Board of Finance and Bank of America in Albuquerque (Bank) entered into an agreement whereby the Bank would provide banking services as Fiscal Agent for the State of New Mexico through April 3, 2006, with the option to renew for two additional years at the option of the State Board of Finance, not to extend beyond April 12, 2010.

◆ *Correspondent Bank*

The State Board of Finance and Northern Trust entered into an agreement whereby BTC would provide banking services as Correspondent Bank for the State of New Mexico through January 31, 2008, with the option to renew for two additional years at the option of the State Board of Finance.



3. DEPOSITS AND INVESTMENTS - continued

◆ Investment Trust Fund

Cash on deposit represents the demand deposit account with the fiscal agent bank. Current year transactions reflect all banking activity for the fiscal year as well as the activity of investments purchased and disposed of during the fiscal year.

The State Treasurer does not hold cash in the office vault. All amounts deposited with the State Treasurer are subsequently redeposited in the fiscal agent account or invested in certificates of deposit, treasury securities or overnight repurchase agreements.

The State Treasurer invests all public monies held in excess of the minimum compensating balance maintained with the fiscal agent bank in accordance with an investment policy approved by the State Board of Finance.

The Treasurer's Investment Trust Fund has implemented GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments*. This statement requires certain investments as defined in GASB Statement No. 31 to be valued at fair value. Fair value is based on quoted market prices as of the valuation date. The change in fair value is recognized as a component of investment income in the current year.

The State Treasurer invests excess cash balances on behalf of certain earmarked funds of state agencies identified by state statute and local governments. Interest earnings are distributed based on average outstanding cash balances for local governments and the state agencies where interest is allowed to be earned. All other interest earnings are transferred to the State General Fund.

The State Treasurer deposits public monies with New Mexico financial institutions in denominations which generally are in excess of the \$100,000 in insurance coverage provided by federal agencies. Accordingly, the State Treasurer requires that depository financial institutions provide additional collateral for such investments. The collateral generally is in the form of marketable debt securities and is required in amounts ranging from 50% to 102% of the par value of the investment dependent upon the institution's operating results and capital. Collateral for the fiscal agent account is required in amounts equal to 50% of the average investment balance.

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Notes to Financial Statements - continued

3. DEPOSITS AND INVESTMENTS - continued

◆ Investment Trust Fund – continued

At June 30, 2006, collateral pledged to public money deposits was as follows:

	<u>Fiscal Agent Account</u>	<u>Certificates of Deposit</u>
Cash in bank	\$ (48,308,513)	255,350,000
Less FDIC insurance coverage	-	(1,000,000)
Total unsecured public funds	<u>\$ (48,308,513)</u>	<u>254,350,000</u>
Collateral requirement (50% of uninsured public funds)	\$ -	127,175,000
Collateral pledged:		
US Government securities	<u>37,752,587</u>	<u>165,185,264</u>
(Over) under collateralized	<u>\$ 37,752,587</u>	<u>38,010,264</u>

The book balance in the Fiscal Agent Account was a deficit of \$394,180,837 at June 30, 2006. See Schedule 10 for detail of pledged collateral.

◆ Brokered Transactions

The State Treasurer initiated purchase trades with the following brokers during the year ended June 30, 2006:

<u>Broker Name</u>	<u>Number of Transactions</u>
Merrill Lynch	106
Citigroup	79
Morgan Stanley	57
Bank of America	47
Goldman Sachs	41
Wachovia Securities	20
LPL Financial	20
UBS	5



3. DEPOSITS AND INVESTMENTS - continued

◆ *Brokered Transactions - continued*

<u>Broker Name</u>	<u>Number of Transactions</u>
Avests, Inc.	4
Raymond James	4
Bear Stearns	3
RBS	1
Sutter Securities	1
Capital Markets	1
Southwest	1

◆ *Direct Transactions*

The State Treasurer made the following direct purchases:

<u>Security</u>	<u>Number of Transactions</u>
CS First Boston	22
Lehman Brothers	18
Ants Abbey	5
AIG	5
Caylon	4
San Paolo	4
Intessa	4
Prudential	3
Natexis	2
HSBC	2
Dexia	2
Union Banc	2
La Salle	1
Royal Bank	1

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Notes to Financial Statements - continued



3. DEPOSITS AND INVESTMENTS - continued

◆ **Investment Balances**

The fair value of investments administered by the State Treasurer at June 30, 2006 follows:

	<u>Amortized Cost</u>	<u>Carrying Amount Fair Value</u>
U.S. Government Securities	\$ 2,189,980,781	2,218,721,438
Corporate Bonds	5,125,744	4,992,600
Commercial Paper	191,653,910	191,653,910
Flex Repurchase Agreements	<u>2,392,834,798</u>	<u>2,392,834,798</u>
	<u>\$ 4,779,595,233</u>	<u>4,808,202,746</u>

The fair value of investments administered by the State Treasurer at June 30, 2006 follows:

	<u>Amortized Cost</u>	<u>Carrying Amount Fair Value</u>
U.S. Government Securities	\$ 2,189,980,781	2,218,721,438
Corporate Bonds	5,125,744	4,992,600
Commercial Paper	191,653,910	191,653,910
Flex Repurchase Agreements	<u>2,392,834,798</u>	<u>2,392,834,798</u>
	<u>\$ 4,779,595,233</u>	<u>4,808,202,746</u>

The fair value includes repurchase agreements of \$288,508,215 of debt service funds reported in the Statement of Net Assets – Governmental Activities and Governmental Funds Activity for general obligation funds and severance tax bond funds. The remaining \$4,519,694,531 represents the investment portion of the investment trust fund reported in the Statement of Fiduciary Net Assets.

The State Treasurer also administers an investment of \$1,359,766 in New Mexico Business Development Corporation bonds on behalf of the State of New Mexico. The original bond investment of \$2,528,332 was called in October, 1991 (Note 11). This investment is reflected in the New Mexico Business Development Corporation Special Revenue Fund.

◆ **Local Government Investment Pool**

Cities, counties, and other non-state agencies invest monies in the State Treasurer external investment pool (Local Government Investment Pool). The investments are recorded at fair value based on quoted market prices as of the valuation date in the financial statements; however, the individual



3. DEPOSITS AND INVESTMENTS - continued

◆ **Local Government Investment Pool - continued**

participant balances remain at their carrying cost. At June 30, 2006, the Local Government Investment Pool carrying cost approximated the fair value.

The State Treasurer Local Government Investment Pool is not SEC registered. Section 6-10-10 1, NMSA 1978, empowers the State Treasurer, with the advice and consent of the State Board of Finance, to invest money held in the short-term investment fund in securities that are issued by the United States government or by its departments or agencies, and are either direct obligations of the United States or are backed by the full faith and credit of the United States government, or are agencies sponsored by the United States government. The Local Government Investment Pool investments are monitored by the same investment committee and the same policies and procedures that apply to all other state investments. The pool does not have unit shares. Per Section 6-10-10.1F, NMSA 1978, at the end of each month all interest earned is distributed by the State Treasurer to the contributing entities in amounts directly proportionate to the respective amounts deposited in the fund and the length of time the amounts were invested. Participation in the local government investment pool is voluntary.

◆ **Investment Guidelines and Limitations**

The investment policy is a comprehensive guide governing the investment functions of the New Mexico State Treasurer with respect to all financial assets of the State of New Mexico invested by the State Treasurer in the exercise of his authority and for which the State Treasurer acts as the investing authority. These assets include, as examples only, the State General Fund, the Local Government Investment Pool, bond proceeds, bond debt service funds, and those pension and permanent funds and other special funds with respect to which the State Treasurer is the investing authority.

The investment policy and the public finance investment decisions of the State Treasurer must serve and satisfy several fiduciary, fiscal and financial obligations. In making these decisions and in resolving any conflict or competing considerations that may arise from time to time among these obligations, the State Treasurer will observe the following priority:

1. Preservation of Principal – to ensure the performance of basic governmental functions, clearly the highest priority must be accorded to the preservation and protection of capital or the principal of the funds and other assets to be invested;
2. Maintenance of Liquidity – similarly, the next level of priority must be accorded to maintaining sufficient liquidity to ensure the immediate availability of public funds to satisfy the reasonably anticipated, continuing operational requirements of State Government; and



3. DEPOSITS AND INVESTMENTS - continued

◆ *Investment Guidelines and Limitations - continued*

3. Maximum Return – to serve the legislative policy of revenue enhancement, third priority will be accorded to maximizing investment yield, through budgetary and economic cycles, consistent with the higher priority accorded to the security and liquidity of principal.

The standard of prudence to be applied in the investment of State assets shall be the “Prudent Person” rule that specifies that: “Investments shall be made with the judgment and care, under circumstances then prevailing, that persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.”

The State Treasurer or his designees, acting in accordance with this policy and any other written procedures pertaining to the administration and management of State assets and exercising due diligence, shall be relieved of personal responsibility, if any, for credit risk or market price changes of a particular security, provided that deviations from expectations are timely noted and appropriate action is taken to control and prevent further adverse developments.

◆ *Investments Permitted by Policy*

The scope of investment authority of the State Treasurer is defined by law. The applicable investment statutes, principally Sections 6-10-10, 6-10-25, 6-10-26, 6-10-37, 6-10-44 and 6-1410,1, NMSA 1978, as well as Article VIII, Section 4 of the New Mexico Constitution, specify particular types of investments that may be made by the State Treasurer, and they establish certain prerequisites, limitations and other requirements relating to such investments. Moreover, the State Treasurer, in his discretion, may further limit or restrict such investments.

In this regard, the State Treasurer has determined that only the following statutorily authorized investments may presently be made, and these investments shall be subject to such further limitations or restrictions as follows:

1. U.S. Government Obligations – Securities, including discount notes, that are issued by the United States government or by its agencies or instrumentalities and that are either direct obligations of the United States or are backed by the full faith and credit of the United States government or agencies sponsored by the United States government. Investments shall be limited to a maximum maturity of three (3) years at time of purchase, except securities for any advanced refunding escrow with a duration of more than three years.



3. DEPOSITS AND INVESTMENTS - continued

◆ Investments Permitted by Policy – continued

2. Commercial Paper – Unsecured obligations with a maturity up to 270 days at time of purchase issued by corporations organized and operating with the United States. The commercial paper shall have short-term credit ratings of A-1, P-1 or equivalent or better by two national rating services. If the rating declines below A-1, P-1, then the Investment Committee will meet to evaluate a course of action.
3. Corporate Bonds – Debt instruments issued by a corporation organized and operating in the United States with a maturity not exceeding three (3) years at time of purchase and at the time of purchase rated A or its equivalent or better by Standard & Poor's and/or Moody's. If the rating declines below BBB+ or Baa1, then the Investment Committee will meet to evaluate a course of action.
4. Asset-Backed Obligations – Debt instruments which are backed by defined cash flows or receivables with a final maturity not exceeding three (3) years at time of purchase and rated AAA, or its equivalent by Standard & Poor's and/or Moody's. If the rating declines below AAA, then the Investment Committee will meet to evaluate a course of action.
5. Repurchase Agreements – Contracts for the present purchase and resale at a specified time in the future of specific securities at specified prices at a price differential representing the interest income to be earned by the state. No such contract shall be invested in unless the contract is fully secured by deliverable obligations of the United States or other securities backed by the United States having a market value of at least one hundred two percent of the amount of the contract. Repurchase agreements and flexible repurchase agreements shall be limited to a maximum maturity of one (1) year, but flexible repurchase agreements, in which bond proceeds are invested, may have a maximum maturity of three (3) years. Repurchase agreements for the Local Government Investment Pool shall be limited to the maximum maturity allowed by law, although any underlying U.S. government obligations may have maturities extending beyond the term of such repurchase agreements. Subject to these conditions and the prior approval of the State Board of Finance with respect to the custodial undertaking agreement, tri-party repurchase agreements are proper investments under this policy.
6. Bank, Savings and Loan Association or Credit Union Deposits – Deposits are allowed in certified and designated New Mexico financial institutions whose deposits are insured by an agency of the United States. All deposits will comply with the Interest Rate and Collateral Policies adopted by the State Board of Finance. Deposits shall be limited to a maximum maturity of three (3) years. A deposit in any credit union shall be limited to the amount insured by an agency of the United States.



3. DEPOSITS AND INVESTMENTS - continued

◆ ***Investments Permitted by Policy – continued***

7. **Securities Lending** – Following State Board of Finance approval of the terms and conditions under which securities lending may occur and including but not limited to specifics with respect to credit and collateral requirements, the State Treasurer may also invest in contracts for the temporary exchange of state-owned securities for the use of broker-dealers, banks or other recognized institutional investors in securities for a specified fee rate. No such contract shall be invested in unless the contract is fully secured by exchange of an irrevocable letter of credit running to the state, cash or equivalent collateral of at least one hundred two percent of the market value of the securities plus accrued interest temporarily exchanged. Securities lending agreements shall be limited to a maximum maturity of one (1) year. No securities lending activity occurred during the year ended June 30, 2006.
8. **Variable Rate Notes** – Variable rate notes (VRN) may be United States government obligations, commercial paper, corporate bonds or repurchase agreements. The use of VRNs is considered to be prudent in the management of the portfolio within certain maturity, indexing and concentration restrictions.
9. **Tax Exempt Securities** – Pursuant to 6-14-10.1, the State Treasurer or designee may also invest in tax exempt securities that at time of purchase are rated in any of the three highest major rating categories by one or more national rating agencies and have a final maturity of up to three years. If the rating declines below A, then the Investment Committee will meet to evaluate a course of action.
10. **Mutual Funds** – Shares of an open-end money market mutual fund, registered under the Federal Investment Company Act of 1940 and managing total assets of at least one billion dollars (\$1,000,000,000), that invests in United States fixed income securities or debt instruments specified in Subsections I, J and N of Section 6-10-10 NMSA 1978, provided that the investments made by the State Treasurer in any particular money market mutual fund are less than 5 percent of the assets of the investment company. In addition, the State Treasurer may act as the investing authority for those agencies which have independent statutory authority to invest. The State Treasurer shall act in a manner consistent with each agency's guidelines and directives.

◆ ***Unauthorized Investments/Investment Actions***

Except as otherwise provided by law, the State Treasurer will not borrow funds for the sole purpose of investing those funds at a higher yield. The State Treasurer is not authorized by law to invest or as a matter of policy has determined not to invest in securities, assets, investment agreements or instruments except as specifically permitted in this Investment Policy. Accordingly, as examples only, the following securities, assets, investment agreements or instruments are presently impermissible:



3. DEPOSITS AND INVESTMENTS - continued

◆ **Unauthorized Investments/Investment Actions - continued**

1. Common or preferred stock
2. Exchange traded future contracts
3. Inverse floaters
4. Whole-loan mortgage obligations
5. Interest only and principal only as they relate to asset-backed obligations
6. Currency swaps
7. Range notes and index amortizing notes
8. Reverse repurchase agreements
9. Short sales

◆ **Custodial Credit Risk**

Custodial credit risk is the risk that the State Treasurer will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of an outside party if the counter party fails. Investment securities are exposed to risk if the securities are uninsured, are not registered in the name of State Treasurer and are held by either the counterparty of the counterparty's trust department of agent but not in State Treasurer's name.

The State Treasurer's Investment Policy for safekeeping and custody states that all investment securities purchased by the State, held as collateral on repurchase agreements or held as collateral on securities lending arrangements shall be held in third-party safekeeping at a fiduciary qualified to act in this capacity. All securities held for the State account will be held free and clear of any lien and all transactions will be conducted in compliance with Section 6-10-10(P) NMSA 1978, which requires contemporaneous transfer and same day settlement. On a monthly basis, the custodian will provide reports which list all transactions that occurred during the month and all securities held for the State at month-end, including the book and market value of holdings. The Fiscal agent and representatives of the custodian responsible for, or in any manner involved with, the safekeeping and custody process of the State shall be bonded in such a fashion as to protect from losses from malfeasance and misfeasance.

All investment and collateral securities were held by the State Treasurer or its Custodian in the name of the State Treasurer. As of June 30, 2006, the State Treasurer's bank balances were not exposed to custodial credit risk.

◆ **Credit Risk**

The State Treasurer's fixed income portfolio investment policy sets credit quality rating guidelines and benchmark indices for each of its sub-asset classes and/or as outlined in each portfolio manager contract. The quality rating of investments in fixed income securities as described by nationally recognized statistical rating organizations (Standard and Poors) at June 30, 2006, are as follows:

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Notes to Financial Statements - continued

3. DEPOSITS AND INVESTMENTS - continued

◆ *Credit Risk - continued*

Quality Rating	Fair Value	Percentage of Portfolio
AAA:	\$ 953,567,705	
U.S. Government Agency Obligations	953,567,705	
A-1+:	161,674,910	3.36%
Commercial Paper	161,674,910	3.36%
A-1:	29,979,000	0.62%
Commercial Paper	29,979,000	0.62%
BB:	4,992,600	.10%
Corporate Bonds	4,992,600	.10%
Not rated and other:	3,657,988,529	76.09%
Flex Overnight Pool	1,937,000,000	40.29%
Short-term Government Bonds and Notes	1,265,153,733	26.32%
Flex Repurchase Agreements	455,834,798	9.48%
Grand Total	\$ 4,808,202,746	100.00%

◆ *Concentration of Credit Risk*

Concentration of credit risk is the risk of loss that may arise in the event of default by a single issuer. It is the policy of the State to diversify its investment portfolios. Assets shall be diversified to reduce the risk of loss resulting from an over-concentration of assets in a specific maturity, a specific issuer or a specific class of securities. The following diversification limitations shall be imposed on the portfolio:

1. Investment maturities will be staggered to avoid undue concentration of assets in a specific maturity sector and to reflect cash flow requirements.
2. Investment in callable instruments is permitted for the State General Fund, but the amount invested in callable instruments should not exceed the range of twenty to twenty-five percent (20% to 25%) of the total amount invested from the State General Fund. Investment in callable investments is prohibited for Tax and Revenue Anticipation Note proceeds (and any other liquidity vehicle), the Local Government Investment Pool, bond-proceeds, bond debt service funds, and such pension and permanent fund monies with respect to which the State Treasurer is the investing authority.

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Notes to Financial Statements - continued

3. DEPOSITS AND INVESTMENTS - continued

◆ **Concentration of Credit Risk - continued**

3. The maximum level of CD deposits for the entire portfolio shall be \$300 million with not more than \$30 million in any single financial institution. The State Board of Finance urges banks to loan this money out in their respective local communities to spur economic development.
4. Investments in commercial paper, corporate bonds and asset-backed obligations shall not exceed 40 percent of assets of a fund. Investments in corporate bonds shall not exceed 10 percent of a fund; provided that investments in commercial paper or bonds of any single corporation shall not exceed \$30 million; provided that investments in corporate bonds of a single corporation shall not exceed \$10 million.
5. Investments purchased with Tax Revenue Anticipation Note proceeds will be excluded from State General Fund investments for the purpose of determining investment allocation limits.

Investments greater than five percent with a single issuer include the following:

Quality Rating	Fair Value	Percentage of Portfolio
US Government Agency Obligations:	\$ 953,567,705	19.83%
Federal Home Loan Bank	563,013,005	11.72%
U.S. Government Agency Obligations	335,856,800	6.99%
FNMA	54,697,900	1.12%
Other issuers:		
Flex Repurchase Agreements:	455,834,797	9.48%
Cantor Fitzgerald	181,005,224	3.76%
Morgan Stanley	153,858,452	3.20%
Citibank/Citicorp	120,971,122	2.52%
Flex Overnight Pool	1,937,000,000	40.29%
Corporate Bonds	4,992,600	0.10%
Commercial Paper	191,653,910	3.99%
Short-term Government Bonds and Notes	1,265,153,733	26.31%
Grand Total	\$ 4,808,202,746	100.00%



3. DEPOSITS AND INVESTMENTS - continued

◆ Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investments. The State Treasurer recognizes that any portfolio of marketable investment securities is subject to interest rate risk. The State Treasurer, in an attempt to limit the possibility of loss due to interest rate fluctuations, will attempt to match investments with anticipated cash requirements. The State Treasurer or designee shall give particular emphasis to the following factors when selecting a specific security for inclusion in the portfolio:

1. **Relative Yield to Maturity:** Comparison of return available from alternative investment media for comparable maturity dates.
2. **Marketability:** Analysis of relative marketability of alternate investments in case of forced sale and/or possibility of future trades.
3. **Intermarket Yield Analysis:** Analysis of the spread relationship between sectors of the market (e.g., Treasury Bonds or Bills versus Agency Bonds or Discount Notes), to take advantage of aberrations in yield differentials.
4. **Yield Curve Analysis:** Analysis of the slope of the yield curve to determine the most attractive maturities for earning maximum return with minimal risk.
5. **General Economic and Interest Rate Outlook:** Review and analysis of current literature on interest rate projections to assist in timing transactions and selecting appropriate maturities.

Maturities on investment are as follows:

Quality Rating	Maturities		
	Fair Value	Less Than 1 Year	1 - 5 Years
AAA: U.S. Government Agency Obligations	\$ 953,567,705	830,515,550	123,052,155
A-1+: Commercial Paper	161,674,910	161,674,910	-
A-1: Commercial Paper	29,979,000	29,979,000	-

STATE OF NEW MEXICO
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Notes to Financial Statements - continued



3. **DEPOSITS AND INVESTMENTS - continued**

◆ **Interest Rate Risk - continued**

Quality Rating	Fair Value	Maturities	
		Less Than 1 Year	1 - 5 Years
BB:	\$ 4,992,600	4,992,600	-
Corporate Bonds	4,992,600	4,992,600	-
Not rated and other:	3,657,988,529	3,544,465,787	113,522,742
Flex Overnight Pool	1,937,000,000	1,937,000,000	-
Short-term Government Bonds and Notes	1,265,153,733	1,265,153,733	-
Flex Repurchase Agreements	455,834,798	342,312,056	113,522,742
Grand Total	\$ 4,808,202,746	4,571,627,849	236,574,897

◆ **Foreign Currency Risk**

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The State Treasurer's investment policy does not have a specific policy on foreign currency risk. However, the listing of permissible investments includes descriptions on the limitations related to each investment type.

All holdings at June 30, 2006, were denominated in United States Dollars.

◆ **Securities Collateral**

Securities collateral relates to Flex Repurchase Agreements. At June 30, 2006, investments in repurchase agreements were \$2,392,834,798. Collateral required by State statute at June 30, 2006 was \$2,440,691,491. The investments in repurchase agreements were collateralized by US Government Mortgage Backed Securities valued at \$2,515,156,560, held at Northern Trust Company in California, in the Office's name.

The State's Investment Policy states that no such contract shall be invested in unless the contract is fully secured by deliverable obligations of the United States or other securities backed by the United States having a market value of at least one hundred two percent (102%) of the amount of the contract. The State's collateral requirements follow:

1. The market value of the collateral including accrued interest must be equal to 102% of the amount of cash transferred by the State to the dealer bank or security firm under the repo plus accrued interest. If the value of securities held as collateral slips below 102% of the value of the cash transferred, then additional cash and/or acceptable securities must be delivered to the third party custodian sufficient to cure any deficiency; and

STATE OF NEW MEXICO
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Notes to Financial Statements - continued

3. DEPOSITS AND INVESTMENTS - continued

◆ **Securities Collateral - continued**

2. For repurchase agreements with terms to maturity of greater than one (1) day, the State will value the collateral securities continuously and require that, if additional collateral is required, then that collateral must be delivered within one business day. If a collateral deficiency is not corrected within this time frame, the collateral securities will be liquidated; and
3. The collateral on all repurchase agreements will have a maturity date that exceeds the term of the repurchase agreement. If the maturity date of the collateral is significantly longer than that of the repurchase agreement, then the collateral rate must be higher than 102% to compensate for market risk.

Credit ratings on collateral securities are as follows:

Quality Rating	Fair Value	Percentage of Portfolio
AAA:	\$ 2,515,156,560	100.00%
US Government Agency Obligations	1,242,922,706	49.42%
US Treasury Notes	<u>1,272,233,854</u>	50.58%
Grand Total	\$ 2,515,156,560	100.00%

Concentrations of risk on collateral are as follows:

Quality Rating	Fair Value	Percentage of Portfolio
US Government Agency Obligations:	\$ 2,515,156,560	100.00%
US Government Agency Obligations	1,242,922,706	49.42%
US Treasury Notes	<u>1,272,233,854</u>	50.58%
Grand Total	\$ 2,515,156,560	100.00%

**STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER**

Notes to Financial Statements - continued



3. DEPOSITS AND INVESTMENTS - continued

◆ **Securities Collateral - continued**

Maturities on collateral are as follows:

Quality Rating	Fair Value	Maturities		
		1-10 Years	11-20 Years	1 - 5 Years
AAA:	\$ 2,515,156,560	1,272,233,854	101,528,618	1,141,394,088
US Government Mortgage Backed Securities	1,242,922,706	-	101,528,618	1,141,394,088
US Treasury Notes	<u>1,272,233,854</u>	<u>1,272,233,854</u>	-	-
Grand Total	\$ 2,515,156,560	1,272,233,854	101,528,618	1,141,394,088

4. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006, was as follows:

<u>Enterprise Funds</u>	<u>Balance June 30, 2005</u>	<u>Additions</u>	<u>Adjustments/ Deletions</u>	<u>Balance June 30, 2006</u>
Governmental activities:				
Depreciable assets:				
Equipment	\$ 306,659	9,969	(38,342)	278,286
Less accumulated depreciation	<u>(208,934)</u>	<u>(41,811)</u>	<u>(38,342)</u>	<u>212,403</u>
Total	\$ <u>97,725</u>	<u>(31,842)</u>	<u>-</u>	<u>65,883</u>

Depreciation expense was charged to functions/programs of the State Treasurer's Office as follows:

Governmental activities:	
General government	\$ <u>41,811</u>

STATE OF NEW MEXICO
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Notes to Financial Statements - continued



5. **LONG-TERM OBLIGATIONS**

◆ **Compensated Absences**

As in prior years, the general fund is used to liquidate compensated absences. Following are the changes in compensated absences for the year ended December 31, 2006:

	<u>Balance</u>			<u>Balance</u>	<u>Amounts Due</u>
	<u>June 30, 2005</u>	<u>Increase</u>	<u>(Decrease)</u>	<u>June 30, 2006</u>	<u>Within</u>
					<u>One Year</u>
Compensated absences	\$ <u>101,251</u>	<u>125,463</u>	<u>(130,734)</u>	<u>95,980</u>	<u>95,980</u>

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

State Treasurer's Investment Trust Fund - Balance Sheet



6. *CONDENSED FINANCIAL STATEMENTS*

Condensed financial statements of the Investment Trust Fund, inclusive of external and internal participants for the fiscal year ended June 30, 2006, are as follows:

ASSETS

Investments	\$ 4,812,044,531
Interest receivable	<u>13,618,667</u>

TOTAL ASSETS \$ **4,825,663,198**

LIABILITY

Cash overdraft	\$ (394,180,837)
----------------	------------------

NET ASSETS

External Participant account balances	713,297,552
Other Internal Participant account balances:	
Primary government	4,514,938,971
Undistributed reserves and unrealized gains (losses)	<u>(8,392,488)</u>

TOTAL LIABILITIES AND NET ASSETS \$ **4,825,663,198**

INVESTMENT INCOME

At June 30, 2006, the State Treasurer's investment income earnings were as follows:

Local Governmental Investment Pool	\$ 31,867,057
Consolidated Investment Pool	95,567,244
State Funds Investment Pool	97,517,632
Unrealized loss	<u>-</u>
	\$ <u>224,951,933</u>

7. APPROPRIATIONS

The State Treasurer received the following appropriations for the year ended June 30, 2006:

<u>General Fund</u>	
General appropriation, (General Appropriation Act)	\$ 3,447,300
Special appropriation	<u>375,200</u>
Total appropriations	\$ <u>3,822,500</u>

The State Treasurer's Office received a special appropriation, Law 2006, Chapter 109, Section 6, to fund compensation for FY2006.

8. COLLATERAL IN TRUST

The State Treasurer holds a variety of different types of collateral, government guaranteed loans and mortgages, certificates of deposit, surety bonds, etc., for certain state agencies, which are not included in the financial statements.

9. DUE TO SEVERANCE TAX PERMANENT FUND AND REVERSIONS

The State Treasurer is required by statute (Section 7-27-8 NMSA 1978, 1986 Repl.) to transfer to the Severance Tax Permanent Fund, all monies in the Severance Tax Bonding Fund, except the amount necessary to meet principal and interest payments on bonds payable of the next two ensuing semi-annual payment dates. A balance of \$123,217,261 remains in the Severance Tax Bonding Fund, payable to the Severance Tax Permanent Fund that was transferred in July 2006.

10. ARBITRAGE ON TAX EXEMPT BONDS

Prior to the Tax Reform Act (TRA) of 1986, state and local governments had up to three years to use the proceeds from tax exempt bonds issued by them before arbitrage on such proceeds had to be paid to the Treasury Department. Arbitrage, as defined, is the excess interest earned by a state or local government on proceeds from the sale of its bonds over interest paid to bond holders.

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Notes to Financial Statements - continued



10. ARBITRAGE ON TAX EXEMPT BONDS - continued

TRA 1986 required rebate of such arbitrage to the Treasury Department on governmental bonds issued after August 31, 1986, and on private activity bonds issued after December 31, 1984, when the proceeds were held for six months or longer. These rebates must be calculated annually and paid at the end of every fifth year until the bonds are retired.

The Revenue Reconciliation Act of 1989 amended the six-month rule. For bonds issued after December 19, 1989, the rebate requirement does not apply if: 1) all of the gross proceeds of the issue, other than the reserve fund, are spent within the six-month period following the date of issue, and 2) the rebate requirement is satisfied for the reserve fund after the six month period. The term gross proceeds for purposes of the rule include both the sale proceeds received from the bond purchase on the issue date and investment earnings on such proceeds during the six-month period. Gross proceeds deposited in a reserve fund or bona fide debt service fund, however, are not subject to the expenditure requirement.

The following is a schedule of bond issues, along with the bond year ends and arbitrage rebate due dates. The State Treasurer's Office has had the first arbitrage computation for the bonds, completed as indicated:

	First Computation Date	First Payment Due to IRS	First Computation of Arbitrage Completed
General Obligation Capital Projects Bonds Series 1999	9/1/2004	10/1/2004	X
General Obligation Bonds Series 2001	3/21/2006	5/20/2006	X
General Obligation Bonds Refunding Series 2001A	9/1/2004	10/1/2004	X
General Obligation Bonds Refunding Series 2001B	9/1/2006	10/1/2006	X
General Obligation Bonds Series 2003	3/18/2008	5/17/2008	
General Obligation Bonds Refunding Series 2003B	4/16/2008	6/15/2008	
General Obligation Bonds Series 2005	3/1/2010	4/30/2010	
Severance Tax Bonds Series 1993B	7/1/1998	8/1/1998	X
Severance Tax Bonds Series 1994B	7/1/1999	8/1/1999	X
Severance Tax Bonds Series 1995A	7/1/2000	8/1/2000	X
Severance Tax Bonds Series 1995B	7/1/2000	8/1/2000	X
Severance Tax Bonds Series 1996A	12/20/2001	2/20/2002	X
Severance Tax Refunding Bonds Series 1997A	7/1/2001	8/1/2002	X
Severance Tax Refunding Bonds Series 1998A	7/1/2003	8/1/2003	X

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Notes to Financial Statements - continued



10. ARBITRAGE ON TAX EXEMPT BONDS - continued

	Bond Year-End of First Rebate Computation	First Arbitrage Rebate Due Date	First Computation of Arbitrage Completed
Severance Tax Bonds Series 1999B	7/1/2004	8/1/2004	X
Severance Tax Bonds Series 1999A Supplemental	11/17/2004	1/17/2005	X
Severance Tax Bonds Series 2000	7/1/2005	8/1/2005	X
Severance Tax Bonds 2000C Supplemental	11/16/2005	1/16/2006	X
Severance Tax Bonds Refunding Series 2001A	12/20/2006	2/20/2007	
Severance Tax Bonds Series 2002A Supplemental	1/16/2007	3/16/2007	
Severance Tax Bonds Series 2002A	6/19/2007	8/18/2007	
Severance Tax Bonds Series 2002B Supplemental	11/14/2007	1/13/2008	
Severance Tax Bonds Series 2003A	6/27/2008	8/26/2008	
Severance Tax Bonds Series 2003B Supplemental	10/14/2008	12/13/2008	
Severance Tax Bonds Series 2004A	6/15/2009	8/14/2009	
Severance Tax Bonds Series 2004B Supplemental	11/17/2009	1/16/2010	
Severance Tax Bonds Series 2005A	6/15/2010	8/14/2010	
Severance Tax Bonds Series 2005B-1 Refunding	6/28/2010	8/27/2010	
Severance Tax Bonds Series 2005B-2 Supplemental	6/28/2010	8/27/2010	
Severance Tax Bonds Series 2006A	6/20/2011	8/16/2011	
Enhanced 911 Revenue Bonds Series 2000	9/12/2005	10/12/2005	X

Interest earnings on invested bond proceeds through June 30, 2006 did not exceed the interest costs of the bonds. Such amounts would have been included as a reservation of fund balance in the accompanying financial statements. Amounts due the Internal Revenue Service which are known and measurable are recorded as a liability - accrued arbitrage interest payable in the accompanying financial statements.

11. NEW MEXICO BUSINESS DEVELOPMENT CORPORATION (BDC)

In 1991, the State Treasurer called in the original investment of \$2,528,332 in bonds, issued by the BDC to protect the state's share of BDC's assets. This action forced a liquidation of BDC, and the remaining assets of BDC were turned over to a trustee, Wells Fargo Bank (formerly Norwest Bank), on behalf of the State Treasurer on October 1, 1991, pursuant to the terms of the Realization of Assets

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Notes to Financial Statements - continued

11. NEW MEXICO BUSINESS DEVELOPMENT CORPORATION (BDC) - continued

Agreement.' Payment of interest on the remaining outstanding debt ceased as of the call date. Accordingly, no interest income is being accrued in the accompanying financial statements. There are outstanding accounts receivable for BDC; however, since the collectibility is not known, the accounts receivable or corresponding bad debt has not been recognized. The balance at June 30, 2006 is the fair market value at that date.

12. TRANSFERS

◆ **Bond Proceeds**

The Bond Issuance Fund transferred the net proceeds of the Revenue Bonds and Severance Tax Bonds to the Department of Finance and Administration (DFA). The proceeds were distributed as follows, and the proceeds are accounted for in DFA's June 30, 2006 financial statements:

CAS Number		Transfer From Amount	Transfer To Amount
	Bond Issuance Fund:	\$ 431,832,807	-
963	Series 2006A Supplemental	-	136,134,432
410	Series 2006S-A	-	85,310,095
410	Series 2006S-B	-	38,195,000
410	Series 2005S-F	-	155,359,230
410	Series 2005S-E	-	<u>16,834,050</u>
	Total	\$ <u>431,832,807</u>	<u>431,832,807</u>

◆ **Interfund Transfers**

Interfund transfers are completed to move revenue from Fund 410, Severance Tax Bonding Fund, to the specific Debt Service funds per bond resolutions. The debt on Sponge Notes (noted with S in description) is paid directly from Fund 410.

	Fund	Transfer From	Transfer To
Debt Service:			
Severance Tax Bonding Fund	410	\$ 77,028,246	-
Severance Tax Bond - 2006A Debt Service	963	-	3,185,000
Severance Tax Bond - 2005B2 Debt Service	571	-	1,035,000

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Notes to Financial Statements - continued

12. TRANSFERS - continued

◆ Interfund Transfers - continued

	Fund	Transfer From	Transfer To
Severance Tax Bond - 1998A Rebate	486	\$ -	-
Severance Tax Bond - 2004A Debt Service	492	-	6,600,000
Severance Tax Bond - 1999A Debt Service	184	-	2,013,959
Severance Tax Bond - 2000 Rebate	391	1,288,713	-
Severance Tax Bond - 2004B Debt Service	183	-	850,000
Severance Tax Bond - 2005B1 Debt Service	388	-	1,760,000
Severance Tax Bond - 2005A Debt Service	412	-	18,500,000
Severance Tax Bond - 2000C Debt Service	405	-	1,800,000
Severance Tax Bond - 2001A Debt Service	408	-	21,400,000
Severance Tax Bond - 2002A Debt Service	699	-	5,800,000
Severance Tax Bond - 2002 Supplemental Debt Service	095	-	6,068,000
Severance Tax Bond - 2002B Supplemental Debt Service	390	-	1,100,000
Severance Tax Bond - 2003A Debt Service	884	-	7,200,000
Severance Tax Bond - 2003B Debt Service	484	-	1,005,000
Total		\$ 78,316,959	78,316,959

CAS #	Transfer From:					Total
		031 CO 2003 Debt Service	414 CO 2001 Debt Service	418 CO 2003B Ref Debt Service	482 CO 2001B Refunding	
031	CO 2003 Debt Service	\$ -	-	-	3,776,347	3,776,347
414	CO 2001 Series Debt Service	-	-	3,081,765	-	3,081,765
418	CO 2003B Ref Debt Service	2,361,555	-	-	-	2,361,555
482	CO 2001B Refunding	-	1,657,595	-	-	1,657,595
	DFA	707,594	-	25,000	-	732,594
Total		\$ 3,069,149	1,657,595	3,106,765	3,776,347	11,609,856

12. TRANSFERS - continued

\$13,695,727 was transferred from DFA to the Tran Debt Service for the purpose of paying interest on the Tax and Revenue Anticipation Notes.

13. EMPLOYEE RETIREMENT PLAN – STATE OF NEW MEXICO

◆ **Plan Description**

Substantially all of the State Treasurer's full-time employees participate in a public employee retirement system authorized under the Public Employees Retirement Act (Chapter 10, Article 11 NMSA 1978). The Public Employees Retirement Association (PERA) is the administrator of the plan, which is a cost-sharing multiple-employer defined benefit retirement plan. The plan provides for retirement, disability benefits, survivor benefits and cost-of-living adjustments to plan members and beneficiaries. PERA issues a separate, publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to PERA, P.O. Box 2123, Santa Fe, New Mexico 87504-2123.

◆ **Funding Policy**

Plan members are required to contribute 7.42% of their gross salary. The Office is required to contribute 16.59% depending upon the division of the gross covered salary. The contribution requirements of plan members and the State Treasurer are established under Chapter 10, Article 11 NMSA 1978. The requirements may be amended by acts of the legislature. The Office's contributions to PERA for the years ending June 30, 2006, 2005, and 2004, were \$292,265, \$408,129 and \$374,200, respectively, equal to the amount of the required contributions for each year.

14. POST EMPLOYEMENT BENEFITS – RETIREE HEALTH CARE ACT CONTRIBUTIONS

The Retiree Health Care Act (Act) (Chapter 10, Article 7C NMSA 1978) provides comprehensive core group health insurance for persons who have retired from certain public service in New Mexico. The Retiree Health Care Authority is the administrator of the plan. The purpose is to provide eligible retirees, their spouses, dependents and surviving spouses and dependents with health insurance consisting of a plan, or optional plans, of benefits that can be purchased by funds flowing into the Retiree Health Care Fund and by co-payments or out-of-pocket payments of eligible retirees.

Monies flow to the Retiree Health Care Fund on a pay-as-you-go basis from eligible employers and eligible retirees. Eligible employers are institutions of higher education, school districts, or other entities participating in the Public School Insurance Authority and state agencies, state courts, magistrate courts, municipalities or counties which are affiliated under or covered by the Educational



14. POST EMPLOYEMENT BENEFITS – RETIREE HEALTH CARE ACT CONTRIBUTIONS
- continued

Retirement Act, Public Employees Retirement Act, Volunteer Firefighters Retirement Act, Judicial Retirement Act or the Magistrate Retirement Act.

Eligible retirees are: (1) retirees who made contributions to the fund for at least five years prior to retirement and whose eligible employer during that period of time made contributions as a participant in the Retiree Health Care Act on the person's behalf unless that person retires before the employer's NMRHCA effective date, in which event the time period for contributions shall become the period of time between the employer's effective date and the date of retirement, and (2) retirees defined by the Act who retired prior to July 1, 1990 and former legislators who served at least two years.

◆ **Fund Contributions**

Each participating employer makes contributions to the fund in the amount of 1.3 percent of each participating employee's annual salary. Each participating employee contributes to the fund an employee contribution equal to .65 percent of the employee's salary. Each participating retiree pays a monthly premium for the medical plus basic life plan and an additional participation fee of five dollars (\$5.00) if the eligible participant retired prior to the employer's NMRHCA effective date or is a former legislator. Participants may also enroll in optional plans of coverage.

Contributions from participating employers and employees become the property of the Retiree Health Care Fund and are not refundable under any circumstances, including termination of employment or termination of the participating employer's operation or participation in the Retiree Health Care Act. The employer, employee and retiree contributions are required to be remitted to the Retiree Health Care Authority on a monthly basis.

The Retiree Health Care Authority issues a separate, publicly available audited financial report that includes post employment benefit expenditures of premiums and claims paid, participant contributions (employer, employee and retiree) and net expenditures for the fiscal year. The report also includes the approximate number of retirees participating in the plan. That report may be obtained by writing to the Albuquerque State Government Center, 4308 Carlisle Blvd. NE, Suite 104, Albuquerque, NM 87109.

For the fiscal year ended June 30, 2006, the State Treasurer remitted \$22,297 in employer contributions and \$11,149 in employee contributions to the Retiree Health Care Authority.

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Notes to Financial Statements - continued

15. DEFICIT FUND BALANCE

As of June 30, 2006, the State Treasurer reported a deficit fund balance of \$85,625 in its general fund. The primary cause of the deficit fund balance was accrued payroll for \$96,099 that was paid for in FY07. The Taxation and Revenue Fund had a deficit of \$180,278. The \$180,278 related to cost of issuance for a note that was issued July 7, 2006.

16. RISK MANAGEMENT

The State Treasurer is exposed to various risks of loss for which the State Treasurer carries insurance (auto; employee fidelity bond; general liability; civil rights and foreign jurisdiction; money and securities; property; and workers' compensation) with the State of New Mexico Risk Management Division. Public employee fidelity bonding coverage is self-insured by the State of New Mexico. The current policy year is July 1, 2005 to June 30, 2006. The limit of coverage is \$5,000,000, with \$1,000 deductible per occurrence. All State Treasurer employees are covered by this bond.

17. REVERSION TO THE STATE GENERAL FUND

Under State Statute 6-5-10 NMSA, 1978, all unreserved, undesignated fund balances in reverting funds and accounts as reflected in the central accounting system as of June 30, as adjusted, shall revert to the General Fund within forty-five days of release of the audit report for that fiscal year.

The amount expected to revert to the State General Fund as of June 30, 2006 is \$848,428, which relates to the fiscal year ended June 30, 2006.

Amounts reverted to the State General Fund during 2006 were as follows:

		<u>Appropriation</u>	<u>Reversion</u>
Reversion to State General Fund FY05	\$	<u>3,379,300</u>	<u>4,255</u>

18. SUBSEQUENT EVENTS

◆ *State Treasurer*

On September 16, 2005, the Federal Bureau of Investigation took then State Treasurer Robert Vigil into custody as a result of an investigation regarding alleged kickbacks received by Mr. Vigil from certain investment brokers. Mr. Vigil was subsequently indicted by a federal grand jury on charges of extortion and racketeering, and resigned as State Treasurer on October 26, 2005.

On September 30, 2006, Mr. Vigil was acquitted on 23 counts of extortion and racketeering, and found guilty of one count of attempted extortion by a federal jury. The conviction does not affect the financial position of the State Treasurer's Office for the year ended June 30, 2006.

Mr. James Lewis was elected to the Office of the State Treasurer by public election on November 7, 2006, and will begin his term on December 15, 2006.

◆ *Local Government Investment Pool (LGIP)*

On August 10, 2006, the LGIP was rated by Standard & Poors rating service and received an AAAM rating.

19. SHORT-TERM DEBT – TAXATION AND REVENUE ANTICIPATION NOTES

The State Treasurer issues six month, fixed-rate tax and revenue anticipation notes to provide short-term cash to carry on the State of New Mexico operations until tax revenues are received in June. Repayment of the notes comes from tax payments received in the year.

Short-term debt activity for the year ended June 30, 2006 was as follows:

	<u>Balance</u> <u>July 1, 2005</u>	<u>Issued</u>	<u>Redeemed</u>	<u>Issuance</u> <u>Cost</u>	<u>Balance</u> <u>June 30, 2006</u>
Tax and Revenue					
Anticipation Notes	\$ _____	550,000,000	550,000,000	(180,278)	(180,278)

The issuance cost represents services rendered in FY06 related to tax and revenue anticipation notes that were issued July 7, 2006.

STATE OF NEW MEXICO
OFFICE OF THE STATE TREASURER

Notes to Financial Statements - continued



20. PRIOR PERIOD ADJUSTMENTS

The following prior period adjustments were recorded as of June 30, 2006:

Fund Balance	Amount	Purpose
640 GO Debt Service	\$11,156	An accrual to Due from State Agency was erroneously recorded. This entry decreased the fund balance by \$11,156.
884 STB Debt Service	\$73,535	An accrual to Due to State Agency was erroneously recorded. This entry increased the fund balance by \$73,535.

APPENDIX C

FORM OF ATTORNEY GENERAL'S NO LITIGATION LETTER

[date]

State Board of Finance
State of New Mexico
Bataan Memorial Bldg. St. 181
Santa Fe, NM 87501

Brownstein Hyatt Farber
Schreck, P.C.
201 Third St. NW, St. 1700
Albuquerque, NM 87102

Sutin, Thayer & Browne
A Professional Corporation
PO Box 1945
Albuquerque, NM 87103

Re: \$162,840,000 State of New Mexico Severance Tax Bonds, Series 2007A

Ladies and Gentlemen:

This letter will serve as our certificate of litigation affecting New Mexico Severance Taxes.

In 2001, the Department began assessing a number of taxpayers for additional taxes based upon the taxpayers' under-valuation of carbon dioxide and natural gas. A number of taxpayers have paid assessments under these programs, filed for refunds, and initiated litigation against the Department. A carbon dioxide case that was dismissed by the district court in May, 2006 for inactivity was reopened by the district court in July, 2006. The district court has denied the Department's motion for reconsideration of a summary judgment granted against it in that case. The case has been set for mediation and if it is not resolved there, the Department anticipates appealing once final judgment is entered. The assessment paid in that case is in suspense, as described below. Another two carbon dioxide cases are pending in district court following the taxpayers' payments of assessments, which payments are also in suspense, as described below. A natural gas refund case remains pending in district court, and the assessment paid remains in suspense. In the other remaining natural gas refund case, the taxpayer filed a protest case and did not pay the assessment; the parties have agreed to settle and are negotiating a closing agreement. The refund suit filed in district court against the Department by a taxpayer who owns natural gas in New Mexico which challenges the imposition of severance taxes on its activities remains pending, with a trial date set in this fall. The taxes paid are not in suspense.

Finally, at any given time, a number of protests/refund claims are pending at the administrative level.

Re: Severance Tax Bonds, Series 2007A

[date]

Page 2

As of June 15, 2001, payments on severance tax assessments issued by the Department, including any on undervaluation assessments made after that date, typically are held in a suspense fund until the Department Secretary determines that there is no substantial risk of protest or other litigation. See NMSA 1978, § 7-1-6.20(B) (2001).

While we are unable to predict with reasonable certainty the outcome of pending litigation and administrative proceedings, they would not, in our opinion, reasonably be expected to have a material effect on the bondholders.

This office is not aware of any other pending or threatened litigation that would affect the severance tax of the state or the authority of the state to issue these severance tax bonds.

Sincerely,

Assistant Attorney General

APPENDIX D

**FORM OF OPINION OF BOND COUNSEL
SEVERANCE TAX BONDS, SERIES 2007A**

June 28, 2007

State Board of Finance
State of New Mexico
Santa Fe, New Mexico

RE: \$162,840,000 State of New Mexico Severance Tax Bonds, Series 2007A

Ladies and Gentlemen:

We have examined the transcript of proceedings (the "Transcript") relating to the issuance of \$162,840,000 State of New Mexico Severance Tax Bonds, Series 2007A (the "Bonds"), dated June 28, 2007, and being a series of bonds in registered form maturing on July 1, 2008, and serially thereafter on July 1 of each year through 2017.

We have also examined the provisions of the Constitution and laws of the State of New Mexico (the "State") under authority of which the Bonds were issued, the resolution authorizing the issuance and sale of the Bonds (the "Bond Legislation") adopted by the State Board of Finance (the "Board") on May 15, 2007, as amended, an executed Bond of the first maturity, and the Tax Certificate of the State (the "Tax Certificate"). We have also made such further inquiries and investigations and have examined such further documents and matters as we have considered necessary in rendering this opinion.

Certain agreements, requirements and procedures contained or referred to in the Bond Legislation, the Tax Certificate and other relevant documents may be changed and certain actions (including, without limitation, the defeasance of Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. No opinion is expressed herein as to any Bond or the interest thereon with respect to any such change or action taken or omitted upon the advice or approval of counsel other than ourselves.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Our engagement with respect to the Bonds has concluded with their issuance, and we disclaim any obligation to update this letter. Furthermore, we have assumed compliance with the covenants and agreements contained in the Bond Legislation and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Bond Legislation and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against the State of New Mexico. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum or waiver provisions contained in the documents described herein. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express herein no opinion relating thereto.

Based on our examination, we are of the opinion that, under the law existing on the date of this opinion:

1. The Bonds constitute valid and binding special obligations of the State in accordance with the terms and provisions thereof.

2. The Bonds are payable solely from, and such payment is secured by a pledge (but not an exclusive pledge) of, the money on deposit in the Severance Tax Bonding Fund (defined in the Bond Legislation), consisting of the net receipts from taxes levied upon certain natural resource products severed and saved from the soil of the State and such other moneys as the State Legislature may, in its sole discretion, from time to time determine to deposit in the Severance Tax Bonding Fund, certain interest earnings on moneys on deposit in the bond accounts and such proceeds of the Bonds as may from time to time be deposited in the Severance Tax Bonding Fund as a result of statutorily required reversions or otherwise. Under the Bond Legislation, the Board may also issue additional obligations on a parity with the Bonds on the terms and conditions of the Bond Legislation. The owners of the Bonds have no right to have ad valorem taxes levied by the State for the payment of principal of or interest on the Bonds and the Bonds do not represent or constitute a debt or pledge of, or a charge against, the general credit of the State.

3. The Bond Legislation is valid and binding on the Board, is enforceable in accordance with its terms and creates the pledge which it purports to create.

4. The interest on the Bonds is excludable from gross income for federal income tax purposes under Section 103(a) of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, such interest is taken into account in determining adjusted current earnings for the purpose of computing the alternative minimum tax on certain corporations. We express no opinion regarding other federal income tax consequences caused by the receipt or accrual of interest on or ownership of the Bonds.

5. The interest on the Bonds is exempt from income taxes imposed directly thereon by the State.

Very truly yours,

APPENDIX E

**FORM OF
CONTINUING DISCLOSURE UNDERTAKING**

CONTINUING DISCLOSURE UNDERTAKING

This Continuing Disclosure Undertaking (the “Disclosure Undertaking”) is executed and delivered by the State Board of Finance (“Board”) of the State of New Mexico (the “State”) on behalf of the State in connection with the issuance by the State of \$162,840,000 Severance Tax Bonds, Series 2007A (the “Bonds”). The Bonds are being issued pursuant to a Bond Resolution adopted by the Board on May 15, 2007 (the “Resolution”).

BACKGROUND

1. The Bonds are being issued to finance capital projects approved by the State Legislature and to refund certain maturities of the State’s outstanding severance tax bonds.

2. In order to allow the underwriters of the Bonds to comply with Rule 15c2-12 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, § 240.15c2-12) to the date hereof, the State is required to make certain continuing disclosure undertakings for the benefit of owners (including beneficial owners) of the Bonds.

3. This Disclosure Undertaking is intended to satisfy the requirements of said Rule 15c2-12, as in effect on the date hereof.

STATE COVENANTS AND AGREEMENTS

Section 1. Definitions.

(a) “Annual Financial Information” means the financial information or operating data with respect to the State, delivered at least annually pursuant to Section 2(a) and 2(b) hereof, of the type set forth in the sections of the final Official Statement identified on Exhibit A hereto. Annual Financial Information includes Audited Financial Statements.

(b) “Audited Financial Statements” means the annual financial statements for the State, prepared in accordance with generally accepted accounting principles, as in effect from time to time, audited by a firm of certified public accountants.

(c) “Event Information” means the information delivered pursuant to Section 2(d) hereof.

(d) “MSRB” means the Municipal Securities Rulemaking Board. The current address of the MSRB is 1900 Duke Street, Suite 600, Alexandria, Virginia, 22314, phone (703) 797-6600, fax (703) 797-6700.

(e) “National Repository” shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. Currently, the following are National Repositories:

Bloomberg Municipal Repository
100 Business Park Drive
Skillman, New Jersey 08558
Phone: (609) 279-3225
Fax: (609) 279-5962
Email: Munis@Bloomberg.com
Web: www.bloomberg.com/markets/rates/municontacts.html

DPC Data Inc.
One Executive Drive
Fort Lee, New Jersey 07024
Phone: (201) 346-0701
Fax: (201) 947-0107
Email: nrmsir@dpcdata.com
Web: www.dpcdata.com

FT Interactive Data
Attn: NRMSIR
100 William Street, 15th Floor
New York, New York 10038
Phone: (212) 771-6999; (800) 689-8466
Fax: (212) 771-7390
Email: NRMSIR@interactivedata.com
Web: www.ftid.com

Standard & Poor's Securities Evaluations, Inc.
55 Water Street
45th Floor
New York, New York 10041
Phone: (212) 438-4595
Fax: (212) 438-3975
Email: nrmsir_repository@sandp.com
Web: www.jjkenny.com/jjkenny/pser_descrip_data_rep.html

(f) "Official Statement" means the Official Statement dated May 15, 2007 delivered in connection with the original issue and sale of the Bonds.

(g) "Repository" means (i) each NRMSIR and (ii) any SID.

(h) "Rule" means Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, § 240.15c2-12), as the same may be amended.

(i) "SEC" means the Securities and Exchange Commission.

(j) "SID" means any State Information Depository operated or designated by the State that receives information from all issuers within the State. As of the date of this Disclosure Undertaking, no SID exists for the State.

Section 2. Provision of Annual Information and Reporting of Event Information.

(a) Commencing with the fiscal year ending June 30, 2007 and annually while the Bonds remain outstanding, the State agrees to provide or cause to be provided the Annual Financial Information to each Repository annually.

(b) Such Annual Financial Information shall be provided not later than 210 days after the end of each fiscal year for the State (i.e., each June 30). If the Audited Financial Statements are not available by the time the other Annual Financial Information must be provided, unaudited financial statements shall be provided as part of the Annual Financial Information. If not provided as a part of the Annual Financial Information, the Audited Financial Statements will be provided when available.

(c) The State may provide Annual Financial Information by specific reference to other documents, including information reports and official statements relating to other debt issues of the State, which have been submitted to each Repository; provided, however, that if the document so referenced is a final official statement within the meaning of the Rule, such final official statement must also be available from the MSRB.

(d) At any time the Bonds are outstanding, the State shall provide, in a timely manner, to the MSRB and any SID notice of any of the following events with respect to the Bonds, if material (provided, that any event under clauses (viii), (ix) or (xi) will always be deemed to be material):

- i. Principal and interest payment delinquencies;
- ii. Non-payment related defaults;
- iii. Unscheduled draws on debt service reserves reflecting financial difficulties;
- iv. Unscheduled draws on credit enhancements reflecting financial difficulties;
- v. Substitution of credit or liquidity providers, or their failure to perform;
- vi. Adverse tax opinions or events affecting the tax-exempt status of the security;
- vii. Modifications to rights of security holders;
- viii. Bond calls, other than mandatory sinking fund redemption;
- ix. Defeasances;
- x. Release, substitution or sale of any property securing repayment of the securities;
and
- xi. Rating changes.

(e) At any time the Bonds are outstanding, the State shall provide, in a timely manner, to the MSRB and any SID notice of any failure of the State to timely provide the Annual Financial Information as specified in Sections 2(a) and 2(b) hereof.

(f) Any filing under this Disclosure Undertaking may be made by transmitting such filing to the Texas Municipal Advisory Council (the "MAC") as provided at <http://www.disclosureusa.org>

unless the United States Securities and Exchange Commission has withdrawn the interpretive advice in its letter to the MAC dated September 7, 2004.

Section 3. Method of Transmission. Subject to technical and economic feasibility, the State shall employ such methods of electronic or physical information transmission as is requested or recommended by the Repositories or the MSRB unless otherwise required by law.

Section 4. Enforcement. The obligations of the State hereunder shall be for the benefit of the owners (including the beneficial owners) of the Bonds. The owner or beneficial owner of any Bonds is authorized to take action to seek specific performance by court order to compel the State to comply with its obligations under this Disclosure Undertaking, which action shall be the exclusive remedy available to it or any other owners or beneficial owners of the Bonds. Any such action shall be brought only in a State court of competent jurisdiction in Santa Fe County, New Mexico. Breach of the obligations of the State hereunder shall not constitute an event of default under the Resolution and none of the rights and remedies provided by the Resolution shall be available to the owners (including the beneficial owners) of the Bonds.

Section 5. Additional Information. Nothing in the Disclosure Undertaking shall be deemed to prevent the State from disseminating any other information, using the means of dissemination set forth in this Disclosure Undertaking or any other means of communication, or including any other annual information or notice of occurrence of an event which is not Event Information, in addition to that which is required by this Disclosure Undertaking; provided that the State shall not be required to do so. If the State chooses to include any annual information or notice of occurrence of an event in addition to that which is specifically required by this Disclosure Undertaking, the State shall have no obligation under this Disclosure Undertaking to update such information or include it in any future annual filing or Event Information filing.

Section 6. Term. This Disclosure Undertaking shall be in effect from and after the issuance and delivery of the Bonds and shall extend to the earliest of (i) the date all principal and interest on the Bonds shall have been paid or legally defeased pursuant to the terms of the Resolution; (ii) the date that the State shall no longer constitute an “obligated person” with respect to the Bonds within the meaning of the Rule; or (iii) the date on which those portions of the Rule which require this Disclosure Undertaking are determined to be invalid by a court of competent jurisdiction in a non-appealable action, have been repealed retroactively or otherwise do not apply to the Bonds.

Section 7. Amendments and Waivers. Notwithstanding any other provision of this Disclosure Undertaking, the State may amend this Disclosure Undertaking from time to time, and any provision of this Disclosure Undertaking may be waived, without the consent of the owners or beneficial owners of the Bonds upon the State’s receipt of an opinion of counsel experienced in federal securities laws to the effect that such amendment or waiver will not adversely affect compliance with the Rule. Any Annual Financial Information containing amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided. If an amendment changes the accounting principles to be followed in preparing financial statements, the Annual Financial Information and Audited Financial Statements for the year in which the change is made will present a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles. The State shall provide notice of any such amendment or waiver to each Repository.

Section 8. Beneficiaries. This Disclosure Undertaking shall inure solely to the benefit of the State and the owners (including beneficial owners) from time to time of the Bonds, and shall create no rights in any other person or entity.

Section 9. Governing Law. This Disclosure Undertaking shall be governed by the laws of the State.

Date: _____, 2007

STATE BOARD OF FINANCE

By _____
President

By _____
Secretary

EXHIBIT A

Portions Of The Official Statement
Containing The Type Of Information
To Be Included as Annual Financial Information

1. SEVERANCE TAX BONDING FUND AND DEBT SERVICE REQUIREMENTS
 - Investments
 - Issuance of Severance Tax Bonds
 - State Capital Program
 - Outstanding and Additional Severance Tax Bonds
 - Outstanding and Additional Supplemental Severance Tax Bonds
 - Table entitled “Severance Tax Bonding Fund Receipts, Disbursements and Transfers”
 - Table entitled “State of New Mexico Severance Tax Bonds - Projected Receipts, Debt Service Requirements and Coverage”
 - Fiscal Year and Scheduled Debt Service columns
2. SEVERANCE TAX REVENUE
 - All
3. NATURAL GAS PRODUCTION AND SEVERANCE TAX REVENUE
 - Natural Gas Production
 - Data for chart entitled: “Natural Gas Subject to Taxation: Production, Revenues and Average Price”
 - Severance Taxes on Natural Gas
 - All
4. OIL PRODUCTION AND SEVERANCE TAX REVENUE
 - Oil Production
 - Data for chart entitled: “Oil Subject to Taxation: Production, Revenues and Average Price”
 - Severance Taxes on Oil
 - All
5. COAL PRODUCTION AND SEVERANCE TAX REVENUE
 - Severance Taxes on Coal
 - Data for chart entitled: “Coal Production, Pricing and Tax Rates”
 - Projections of Severance Tax Revenue from Coal
 - All
6. OTHER MINERAL PRODUCTION AND SEVERANCE TAXES
 - Any statements therein relating to the severance tax collected and tax rates
7. TAXATION OF ENERGY MINERALS NOT PLEDGED
 - All
8. APPENDIX A - GENERAL INFORMATION CONCERNING THE STATE OF NEW MEXICO
 - All
9. STATE OF NEW MEXICO FINANCIAL STATEMENTS (Audited)

APPENDIX F

SPECIMEN BOND INSURANCE POLICY

FINANCIAL GUARANTY INSURANCE POLICY

**MBIA Insurance Corporation
Armonk, New York 10504**

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless the Insurer elects, in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]
[LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Insurer, or any designee of the Insurer for such purpose. The term owner shall not include the Insurer or any party whose agreement with the Insurer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

MBIA Insurance Corporation

President

Assistant Secretary

SPECIMEN