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New Mexico; Miscellaneous Tax

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Credit Profile		
US\$163.44 mil Severance Tax bonds ser 2007A due 07/01/2017		
<i>Long Term Rating</i>	AA/Stable	New
New Mexico supplemental severance tax bonds (AMBAC)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Upgraded
New Mexico Supplemental Severance Tax		
<i>Long Term Rating</i>	AA-/Stable	Upgraded
New Mexico Supplemental Severance Tax (FSA)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its standard long-term rating and Standard & Poor's underlying rating (SPUR) on New Mexico's subordinate supplemental severance tax debt one notch to 'AA-' from 'A+' due to strong historical and projected debt service coverage (DSC). The outlook remains stable.

Standard & Poor's also assigned its 'AA' standard long-term rating, and stable outlook, to the state's series 2007A severance tax bonds and affirmed its 'AA' standard long-term rating and SPUR, with a stable outlook, on the state's parity severance tax bonds.

The ratings reflect the state's:

- Strong DSC by fiscal 2006 severance tax revenues of 5.7x scheduled senior maximum annual debt service (MADS) and 4.9x total senior and supplemental bond MADS;
- Adequate legal provisions, including an additional bonds test that requires at least 2.0x DSC on the senior bonds and 1.6x DSC on the subordinate long-term supplemental bonds; and
- Rapid debt amortization with all principal being retired by 2017.

These credit strengths are mitigated by:

- The inherent instability associated with natural gas and oil prices and production levels, which account for the bulk of pledged revenues; and
- The state's geographic limitations in serving natural gas markets due to its location.

A lien on money deposited into the severance tax bonding fund, including net tax receipts generated from natural gas and oil and other severed natural resources in New Mexico, secures the severance tax bonds. A second lien on pledged revenues secures the supplemental severance tax bonds. Officials will use series 2007 bond proceeds to finance various New Mexico Legislature-authorized capital projects and refund a portion of parity debt outstanding.

New Mexico levies taxes on a variety of minerals. The primary severance tax revenue generators are natural gas (about 63% of projected fiscal 2007 severance tax receipts) and oil (27%). Officials are projecting these taxes, combined with all other receipts and interest earnings, to total \$463.9 million in fiscal 2007, down by 12.8% from fiscal 2006 based on conservative assumptions. Total actual fiscal 2006 receipts provided 5.7x and 4.9x DSC of scheduled senior and combined MADS, respectively. Total projected fiscal 2007 bonding fund receipts produce

5.00x pro forma MADS coverage on senior bonds and 4.25x MADS on senior and supplemental bonds.

Total annual revenues vary widely due, in large part, to the effect of mineral price fluctuations on severance tax receipts. Total bonding fund receipts ranged between roughly \$246 million in fiscal 2002 and \$532 million in fiscal 2006. Officials estimate annual DSC on senior and supplemental bonds will range from 4x-5x between fiscals 2007-2011.

The historical additional bonds test of 2x DSC for the senior severance tax bonds limits the state's ability to issue parity debt. This test and a "best efforts" pledge to maintain annual deposits equal to 2x DSC are positive credit factors. The additional bonds test for the long-term supplemental severance tax bonds is 1.6x. The state can issue short-term severance tax notes maturing within the fiscal year if previous-year pledged deposits cover total combined debt service of senior, supplemental, and short-term bonds by at least 1.05x.

Severance tax bond proceeds represent a major source of capital project funding for the state. Including the 2007 bonds, the state will have \$530 million outstanding in senior severance tax bonds and \$82 million in supplemental bonds. In general, the debt service schedule is front loaded with final maturity occurring over a rapid 10 years. The state uses senior severance tax bonds to fund legislature-approved capital projects and supplemental severance tax bonds for public school projects. Although the ongoing annual issuance of senior severance tax bonds is likely, state officials do not plan to issue additional supplemental severance tax bonds in the near future.

Outlook

The stable outlook reflects the expectation that despite the state's forecast of declining revenues and additional bond plans, severance tax collections will continue to provide sound DSC during the bonds' relatively short 10-year life. The stable outlook also reflects the expectation that natural gas and oil reserves will continue to be replenished to maintain sufficient production over the bonds' life.

Legal Provisions

The bonds are a special obligation of New Mexico, secured by deposits into the severance tax bonding fund. Such deposits include the net receipts of taxes levied on certain natural resources obtained from the ground in New Mexico and investment earnings on such deposits. On Dec. 31 and June 30 of each fiscal year, management transfers excess money -- defined as amounts in excess of the next two semiannual debt service payments on bonds payable from severance taxes -- into the severance tax permanent fund. Money in the permanent fund is not available to pay debt service. In practice, just before the Dec. 31 and June 30 dates, state officials have historically issued short-term severance tax notes that mature within 24 hours to cash fund capital projects before transferring any surplus into the severance tax permanent fund.

State statute prohibits the state board of finance, which includes the governor, lieutenant governor, and state treasurer, from issuing additional senior long- and short-term severance tax bonds unless it can service total bonds outstanding by no more than 50.0% of the annual deposit into the severance tax bonding fund in the fiscal year preceding issuance and total senior and long-term supplemental severance tax bonds by no more than 62.5% of the annual deposit. In addition, the board covenants that the state will use its best efforts to deposit into the bonding fund severance taxes that, when combined with other money in the fund, will equal at least 200% of principal and interest due in each fiscal year on the senior bonds. State officials can issue short-term supplemental tax notes

maturing within the fiscal year if the state can service total combined bonds outstanding by no more than 95% of the annual deposit into the severance tax bonding fund in the fiscal year preceding issuance.

Mineral Production And Reserves

Natural gas (63% of projected fiscal 2007 bonding fund receipts), oil (27%), and coal (4%) are New Mexico's major severance tax revenue generators. Carbon dioxide, copper, potash, and other minerals account for the balance.

Gas

Over the past two decades, gas producers have replaced most of their production with new discoveries. An important part of the state's long-term production forecast is the assumption that the industry will replace reserves with new discoveries and the further development of existing formations. California is the end-user of the majority of New Mexico-produced gas. Improvements to the pipeline infrastructure, however, allow the state's gas producers to move gas to either western or eastern markets to take advantage of whichever market is more profitable.

Gas reserves were 19,344 billion cubic feet (bcf) at the end of 2005 compared with the 20-year peak of 20,399 bcf in 1992. Annual production increased to 1,646 bcf in 1999 from 1,218 in 1992; and it was in the 1,500 bcf-1,600 bcf range through 2005, at which time it totaled 1,594.

Gas production is concentrated within the 10 leading gas producers, which accounted for 70% of total gas production in 2005. The 10 leaders included Burlington Resources, Conoco Phillips Co., BP America Production Co., and Devon Energy Production. The average sale price of natural gas increased steadily to \$7.46 in fiscal 2006 from \$2.68 in fiscal 2002. New Mexico's estimated gas prices should average \$6.20 and \$6.30 per 1,000 cubic feet in fiscals 2007 and 2008, respectively, before gradually declining to \$5.50 by fiscal 2011. State officials are also projecting natural gas production to decline by 1% annually within the next five years. Due to forecast declines in prices and production, management expects severance tax receipts to decline between 4.5% and 7.5% annually between fiscals 2009 and 2011.

Oil

Although oil production has averaged about 61 million barrels annually over the past decade, 2005 oil reserves were 100 million barrels higher than beginning reserves in 1984 because the industry has replaced most of New Mexico-produced oil over the past 20 years with new discoveries and better extraction technologies. State forecasts have oil production declining by 3% annually. Oil reserves, like gas, also peaked at 757 million barrels in 1992; and they fluctuated between 620 million and 744 million barrels from 1992-2005, ending at 690 million barrels in 2005. In 2005, concentration existed in the 10 leading oil producers, which accounted for 48% of production. The 10 leaders included Chevron USA Inc., Occidental, and Conoco Phillips.

Coal

New Mexico has used the majority of its coal production for electrical power generation in the state, as well as Arizona power stations. Three mines in the San Juan Basin in northern and northwestern New Mexico produce coal. The state's economically recoverable coal resources total 45.8 billion tons.

Ratings Detail (As Of May 8, 2007)		
New Mexico severance tax (AMBAC)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

Ratings Detail (As Of May 8, 2007) (cont.)		
New Mexico severance tax (MBIA)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
New Mexico Severance Tax		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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