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## New Mexico; General Obligation

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# New Mexico; General Obligation

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US\$222.8 mil cap projects GO bnds ser 2009 due 03/01/2019		
Long Term Rating	AA+/Stable	New
New Mexico GO		
Long Term Rating	AA+/Stable	Affirmed

## Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating, and stable outlook, to New Mexico's 2009 general obligation (GO) bonds. At the same time, we affirmed our 'AA+' long-term rating, with a stable outlook, on the state's existing GO debt.

The ratings reflect what we view as the state's:

- Sustained, strong financial performance with general fund reserves above 10% of recurring appropriations in the past five years and projected fiscals 2009 and 2010 despite economic softening and revenue declines;
- Continued relative stability in the economic base despite some recent economic softening; and
- Low debt per capita with very rapid amortization.

The full faith and credit of the state, including an unlimited ad valorem tax on taxable property in New Mexico, secures the bonds. The state will use bond proceeds primarily to fund higher education and school projects as well as various community and health facilities.

In 2008, New Mexico served a population of 1.99 million, which represents growth of 1.3% per year on average in the past five years. The state's employment base comprised primarily jobs in the government sector (23%); trade, transportation, and utilities (18%), business and professional services (13%); and education and health services (12%). Mineral production and extraction as well as tourism are other important components of the state's economy. Kirtland Air Force Base and Sandia National Laboratories in Albuquerque and Los Alamos National Laboratories are among the state's leading employers. Additional leading employers in the state include Presbyterian Healthcare Services, Lovelace Health Systems Inc., Intel Corp. (A+/Stable/A-1+), and University of New Mexico. According to IHS Global Insight Inc., state employment rose only 0.4% in 2008, compared with 1.4% in the previous year due to job losses in the manufacturing, construction, and financial services sectors. Global Insight forecasts a 0.6% and 0.1% decline in total nonfarm employment growth for 2009 and 2010, respectively. The state's taxable assessed value has shown what we consider strong growth in the past five years increasing 9% per year, on average, since 2002 to \$50.4 billion in 2008.

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

As of June 30, 2008, total reserves were:

- \$247.2 million in the operating reserve;
- \$254.4 million in the tax stabilization reserve;

- \$96.6 million in the appropriation contingency fund; and
- \$135.9 million in the tobacco settlement permanent fund reserve.

After a trend of declining reserves in fiscals 2002 and 2003, the state has maintained reserve levels above 10% of appropriations between fiscals 2004 and 2008. In fiscal 2008, total general fund budgetary reserves were \$735 million, or what we view as a strong 13% of recurring appropriations at year-end. General fund recurring receipts increased by 4% to \$6 billion despite reduced income tax revenue, due primarily to growth in severance taxes, investment income, and rents and royalties. The state's fiscal 2009 estimates reflect a 5% decline in total recurring revenue, despite 2.4% growth in sales taxes, due to a 4% decline in income taxes and falling oil and gas prices, which contributed to declines in mineral production taxes and rents and royalties. In early 2009, the legislature addressed a projected \$450 million budget deficit, or 7.5% of the current fiscal year's budget, by cutting recurring spending by \$164 million, cancelling previously authorized capital projects to contribute to reduced nonrecurring spending of \$119 million, and transferring almost \$130 million of state agency funds into the general fund. State officials estimate a \$607 million ending general fund balance in fiscal 2009, or what we consider a still-strong 10.7% of total appropriations.

The fiscal 2010 adopted budget assumes recurring revenue declines of 4.0%, including an assumed 1.8% growth in sales taxes offset by continued declines in rents and royalties and severance taxes. According to the general fund consensus revenue-estimating group, total recurring revenues in fiscal 2010 are estimated to fall another 4.7% compared with fiscal 2009 estimates. Fiscal 2010 revenue forecasts show gross receipts taxes rising by only 0.4% in fiscal 2010, while total income taxes are forecast to decline by 0.1% due primarily to 6.0% declines in corporate income taxes.

The state adopted close to a \$5.5 billion budget in fiscal 2010, which is 8.5% below fiscal 2009 estimated recurring appropriations. The adopted budget addressed a \$576 million budget gap, or 10.5% of budget, primarily through the use of about \$165 million of federal stimulus money for public school operations and \$167 million for Medicaid expenditures. State officials estimate total federal stimulus funding allocated to the state exceeds \$2 billion including general aid of \$544 million for Medicaid, \$260 million for general educational purposes, and \$58 million for general purposes. Therefore, the state has approximately 37%, 70%, and 100% remaining of public education, Medicaid, and general purpose federal stimulus funding, respectively, to use in future fiscal years or for potential additional revenue shortfalls in fiscal 2010. The budget also assumes reduced state agency and higher education spending by \$140 million and use of \$115 million in a one-time transfer from the general fund operating reserve. The budget projects a 10% ending general fund reserve.

Standard & Poor's deems New Mexico's financial management practices "good" under its Financial Management Assessment (FMA) methodology. An FMA of good indicates practices exist in most areas, although not all may be formalized or regularly monitored by governance officials. The state also has recently implemented a new central enterprise accounting system that has contributed to the timely release of the fiscal 2008 comprehensive annual financial report (CAFR) after years of late CAFR filings since fiscal 2002.

After this issuance, the state's total tax-supported debt--including GO, severance tax, and gas tax bonds for the department of transportation--is low in our view, at \$1,558 per capita, and what we see as above-average when compared with other states at 4.6% of personal income. Total GO debt is limited to a maximum of 1% of net taxable value. The state amortizes all GO debt and severance tax debt over a very rapid 10 years. Amortization of principal on all debt is also rapid at 60% within 10 years.

## Outlook

The stable outlook reflects what Standard & Poor's views as New Mexico's proven ability to maintain its strong reserves since fiscal 2004. The outlook also reflects our expectation that revenue consensus forecasts that conservatively project future revenues and the prompt budgetary actions the state took for the fiscals 2009 and 2010 budget years to target 10% general fund reserves could mitigate the current economic softening and revenue declines. Although a portion of the fiscal 2010 budgetary measures include the use of nonrecurring federal stimulus money, like many other states, New Mexico has only budgeted the use of 45% of the available federal stimulus funds for Medicaid, education, and general fund purposes in fiscal 2010, with the remainder of these funds available for future fiscal years or potential further budgetary shortfalls. In addition, the outlook reflects Standard & Poor's expectation that the state will take action to address any potential further budgetary shortfalls.

## Economy

New Mexico's economy has weakened in fiscal 2009, in our opinion, as slowdowns in construction and manufacturing as well as lower oil and gas prices have filtered into the general economy, reducing employment and lowering income taxes. Total private housing starts fell 34%, year-over-year, in each of 2007 and 2008. Although the state has experienced a slowdown in new home construction, the downturn is not as severe as some other states reflected in median home prices that fell by only 1% in 2008, according to Global Insight, compared with declines in home prices of 18.5% across the country according to the S&P Case/Schiller Home Price indices.

According to Global Insight, real personal income rose by 2.2% in 2008 and Global Insight forecasts slower growth of 2.5% in 2009 and 1.0% in 2010. While per capita personal income increased 4% in 2008, per capita income of about \$31,800 still remains below average compared with other states in the nation. A large military population contributes somewhat to depressed per capita income.

The state's economy has historically been based on agriculture, mineral production, and government; however, employment in the expanding professional, educational, and health service sectors, which represented 26% of nonfarm employment in 2008, has contributed to economic diversity. New Mexico possesses significant natural resources; and mineral extraction--natural gas, oil, and coal, in particular--remains a sizable contributor to the state's economic base and fiscal operations. Mining, however, accounted for just about 2% of nonfarm employment in 2008 as gas and oil production have become more capital intensive. Federal, state, and local government accounted for a large 23% of the state's nonfarm employment in 2008. The retail trade, leisure and hospitality, and construction sectors accounted for 11%, 10%, and 7%, respectively, of total nonfarm employment in 2008.

Leading high-tech employers include Intel Corp. (A+/Stable/A-1+) and Sandia National Laboratories, both of which are in the Albuquerque metropolitan statistical area (MSA), and Los Alamos National Laboratories in the Santa Fe MSA. In early 2009, Intel announced another 100-200 layoffs at its Rio Rancho plant, and in February 2009 Eclipse Aviation, a light jet manufacturer in Albuquerque, filed for bankruptcy and suspended all operations laying off all 800 of its employees.

## Finances

New Mexico levies sales taxes, which account for the state's largest source of operating funds; the sales tax generated 39% of general fund recurring revenues in fiscal 2008. The state's broad-based 5% gross receipts tax includes services and the sale of property, which subjects annual revenues to some fluctuations in retail sales, tourism, and other service sector activity. Over time, however, total sales tax collections have demonstrated steady growth, proving less volatile than retail sales activity alone. General and selective sales tax revenue in the general fund remained fairly stable in fiscal 2008, rising by 0.4% between fiscals 2007 and 2008 to \$2.3 billion, compared with 7.8% growth between fiscals 2006 and 2007, due primarily to a weakening economy and declines in construction as well as new tax credits for hospitals, and health care provider deductions adopted by the 2007 legislature.

Total personal and corporate income taxes generated 26% of recurring general fund revenues, or almost \$1.6 billion, in fiscal 2008. Beginning in tax-year 2003, state officials implemented a five-year reduction in the personal income tax rate that reduced the rate to 4.9% for fiscal 2008 from its high of 8.2% in tax year 2002. Despite these rate reductions, personal income tax receipts have continued to grow. However, fiscal 2008 total income tax collections fell by 4.4% due primarily to a 23.0% decline in corporate income taxes as lower oil and gas prices reduce profits for mineral extraction companies, new tax credits were enacted, and a change in the corporate income tax accounting structure resulted in lost quarterly revenue. Concentration exists in corporate income taxes from the mineral extraction industry, which accounted for a large two-thirds of fiscal 2008 payments. Investment income from two large permanent funds and the state treasurer's cash balances also support current fund operations. The two permanent funds are funded from oil and gas royalty and lease payments and severance taxes from mineral extraction. As of June 30, 2008, the market value of assets in the state's land grant permanent fund totaled \$10.1 billion, which represents a decline of 5% over the previous year, while the state's severance tax permanent fund totaled \$4.3 billion, a 9% decline over the previous year. Values in these funds continued to decline through early fiscal 2009 due to market conditions. State officials do not pledge money in the permanent funds to pay debt service on any state bonds; officials, however, do distribute income from the state land grant permanent fund to beneficiary education institutions and the general fund for public school costs. Including interest income from the severance tax permanent fund and cash balances, state officials transferred about \$661 million in investment income, or 11% of fiscal 2008 general fund recurring receipts, into the general fund in fiscal 2008. Additional major revenue sources include mineral rents and royalties (10% of revenues) and mineral production taxes (10%).

The state's audited fiscal 2008 CAFR reflected an \$854 million unreserved general fund balance, or what we consider a strong 14% of general fund revenue, compared with a \$681 million balance, or 12% of revenue, in fiscal 2007 after the state transferred a portion of reserves for capital expenditures in that year. On a government-wide basis, total net assets rose 4% to \$18 billion in fiscal 2008 from \$17.4 billion in fiscal 2007, with unrestricted net assets of about \$744 million representing 13% of total governmental expenditures.

## Financial Management Assessment: 'Good'

New Mexico's financial management practices are considered "good" under Standard & Poor's FMA methodology, indicating practices exist in most areas, although not all may be formalized or regularly monitored by governance officials.

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

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

New Mexico coordinates with individual state agencies and local governments to develop their respective five-year capital plans, which are submitted to the state; state officials identify funding for these prioritized capital needs annually through the legislative appropriation process. In addition to constitutional maximum GO debt limits and a statutory 2x coverage test for severance tax bonds, the board of finance and department of finance and administration have formal debt management guidelines, including the maximum amortization of debt and recommended savings thresholds for debt refunding. In addition to state guidelines, the department of transportation and New Mexico Finance Authority (NMFA) have their own formal debt management policies that guide their use of variable-rate debt and derivatives. The state updates a debt affordability study biennially to review debt plans and their effect on the budget and key debt ratios. Traditionally, the state has not used variable-rate debt for GO debt.

## Debt

Under the New Mexico Constitution, GO debt is limited to 1% of assessed value, preserving what we consider the state's low GO debt level. Additional GO debt is subject to electorate approval. As of fiscal year-end 2008, GO debt totaled about \$384 million, which is below the current 1% net taxable value limit of \$504 million. The total GO debt burden equaled what we consider a low \$193 per capita.

State officials also finance capital projects with severance tax and highway revenue bonds secured by gas taxes and highway user and federal highway revenues. As of fiscal year-end 2008, about \$1.8 billion of gas-tax-supported debt, issued by the NMFA for the state transportation commission, was outstanding, including almost 30% of variable-rate principal. The federal government recently froze federal revenue to the transportation department due to shortcomings in required accounting; federal revenue represents almost 40% of the pledged revenue on the gas tax bonds; however, even after excluding all annual federal pledged revenue, debt service coverage on all senior and subordinate gas tax bonds would still be what we consider strong at about 2.5x. NMFA officials expect the freeze to

be temporary as they work through a solution with the federal government. In early 2008, the authority refunded its series 2004 and 2006 auction-rate bonds with variable-rate demand bonds to lower its interest costs. As part of the refunding, the authority did not alter its interest-rate swap contracts, which were originally entered into to offset its exposure to variable-rate fluctuations. Although Lehman Bros. Derivative Products was a counterparty on one swap with a notional value of \$50 million, the NMFA was able to replace the counterparty with Deutsche Bank (A+/Stable/A-1) under the same terms and at no loss after Lehman Brothers filed for bankruptcy in September 2008. (For a complete discussion of its highway debt rating and debt derivative profile score, please see the latest full report on the NMFA's state transportation refunding bonds, issued for New Mexico State Transportation Commission, published May 20, 2008, on RatingsDirect.) In addition, the state had \$733 million of senior and supplemental severance tax bonds outstanding at fiscal year-end 2008 and \$57 million of debt issued by the NMFA and secured by various taxes, including state gross receipts taxes and cigarette tax revenue. Subsequent to fiscal year-end 2008, in September 2008 Grant County issued \$60 million of lease appropriation bonds for the replacement of the Fort Bayard Medical Center; the state department of health entered into a lease agreement with the county in which lease payments are secured by state appropriations. The state amended the New Mexico Constitution to authorize lease purchase financing for state facilities in 2006. State officials expect to issue additional severance tax bonds at the end of 2009.

The annual debt service payment on GO debt represents what we view as a low 1.3% of general fund expenditures. Total debt service on all debt represents 3.4% of government expenditures less capital outlay. Debt retirement of GO and severance tax bonds is very rapid, with officials retiring 100% of principal over 10 years; other governmental tax-backed bond principal, including gas tax debt, retires at a slower 42% in 10 years.

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

The State Public Employees' Retirement Association and the Educational Retirement Board provide retirement benefits for most state employees and political subdivisions. As of June 30, 2008, the Public Employees' Retirement Fund was 93% funded with an unfunded accrued liability of about \$926 million, no change from its 93% funded ratio in fiscal 2007. The Educational Retirement Fund was 72% funded with an unfunded liability of \$3.7 billion in fiscal 2008, a slight improvement from a 71% funded ratio in fiscal 2007. Market conditions in fiscal 2009 have caused the market value of assets in these funds to drop further.

New Mexico completed a revised actuarial valuation and review of other postemployment benefits (OPEB) for the New Mexico Retiree Health Care Authority as of June 30, 2008. Assuming a 5% discount rate and 30-year amortization, the study estimated the state's total long-term unfunded liability at \$2.9 billion as of June 30, 2008, compared with an unfunded liability estimate of \$4.1 billion as of June 30, 2006. The liability was primarily reduced due to an assumed increase in retiree self-pay rates and including offsets for retiree prescription drug plan federal subsidies. The actuarial report estimates the annual required contribution at \$287 million for fiscal 2008. In 2009, the legislature increased the eligibility requirements to receive retiree health care benefits by increasing the required years of service to 30 years from 25 years. In addition, legislators mandated an increase in the employer and employee contribution to the New Mexico Retiree Health Care Fund to 3.0% from 1.95% over a four-year period. State officials expect to begin addressing the OPEB liability funding in fiscal 2011.

## Related Research

USPF Criteria: "GO Debt," Oct. 12, 2006

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