

June 19, 2009

New Mexico; Miscellaneous Tax

Primary Credit Analyst:

Sussan Corson, New York (1) 212-438-2014; sussan_corson@standardandpoors.com

Secondary Credit Analyst:

Gabriel Petek, CFA, San Francisco (1) 415-371-5042; gabriel_petek@standardandpoors.com

Table Of Contents

Rationale

Outlook

Bond Provisions

Mineral Production And Reserves

Gas

Oil

Coal

Related Research

New Mexico; Miscellaneous Tax

Credit Profile		
US\$218.45 mil severance tax bonds ser 2009A due 07/01/2019		
<i>Long Term Rating</i>	AA/Stable	New
New Mexico severance tax		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
New Mexico supplemental severance tax		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating, and stable outlook, to New Mexico's series 2009A severance tax bonds.

At the same time, Standard & Poor's affirmed its 'AA' long-term rating and underlying rating (SPUR) on the state's parity severance tax bonds and its 'AA-' SPUR on the state's subordinate supplemental severance tax debt. The outlook is stable.

The ratings reflect what we view as New Mexico's:

- Strong debt service coverage (DSC) by fiscal 2008 severance tax revenues of 5.4x scheduled senior maximum annual debt service (MADS) and 4.7x total senior and supplemental bond MADS;
- Adequate bond 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 to be retired by 2019.

Mitigating these credit strengths in our opinion are:

- 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 2009A bond proceeds to refund a portion of debt outstanding and finance various statewide capital projects primarily authorized for 2009, including water, higher education, economic development, and state building projects.

New Mexico levies taxes on a variety of minerals. The primary severance tax revenue generators are natural gas (about 58% of projected fiscal 2009 severance tax receipts) and oil (27%); investment earnings generate 10% of pledged revenue in fiscal 2009. Fiscal 2008 pledged severance taxes totaled \$574 million, up by 12% compared with the previous year. Total actual fiscal 2008 receipts provided 5.4x and 4.7x DSC of pro forma senior and combined MADS, respectively. In fiscal 2009, officials estimate pledged severance tax revenue of about \$525 million, which

would provide 4.9x and 4.3x DSC of senior and combined MADS, respectively.

Total annual revenues rose 18% per year, on average, between fiscals 2003 and 2008; however, revenues vary widely due in large part to the effect of mineral price fluctuations on severance tax receipts. In fiscal 2009, officials estimate pledged revenue to decline by 8%. Based on the Consensus Group projections for fiscal 2010, officials project pledged revenue covers MADS on senior and supplemental bonds by 3.2x and 2.8x, respectively.

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 new money portion of the series 2009 bonds, the state will have about \$650 million outstanding in senior severance tax bonds and \$40 million in supplemental bonds. In general, the debt service schedule is front loaded, with final maturity occurring over a rapid 11 years. The state uses the senior severance tax bonds to fund legislature-approved capital projects and the supplemental severance tax bonds for public school projects. The state annually issues senior severance tax bonds and officials are planning about \$65 million of supplemental severance tax bonds for public school projects at the end of 2009. In addition to long-term senior and supplemental severance tax bonds, the state generally uses overnight short-term senior and supplemental severance tax notes that mature within one day to fund additional authorized capital projects.

Outlook

The stable outlook reflects Standard & Poor's expectation that despite the state's forecast of declining revenues and additional bond plans, severance tax collections will continue to provide strong DSC in the bonds' relatively short 11-year life. The outlook also reflects the expectation that natural gas and oil reserves will continue to be replenished to maintain sufficient production over the bonds' life.

Bond 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. According to the resolution, on Dec. 31 and June 30 of each fiscal year, the state 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 New Mexico 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 (58% of estimated fiscal 2009 severance taxes), 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. The state taxes non-Indian oil and gas production on tribal land, which generated \$13.2 million, or 2.3% of severance tax revenues, in fiscal 2008.

Gas

New Mexico's proved reserves have increased in the past 10 years to 18,397 billion cubic feet (bcf) in 2007 from 16,259 bcf in 1998 as 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 further develop existing formations.

California is the end user of the majority of New Mexico-produced gas. Improvements to the pipeline infrastructure, however, have allowed the state's gas producers to move gas to either the western or eastern markets to take advantage of whichever market is more profitable. The net average sale price of natural gas increased to \$6.76 per thousand cubic feet (mcf) in fiscal 2008 after fluctuating in the past couple of years.

Annual gas production has remained in the 1,400 bcf-1,600 bcf range through 2008, at which time it totaled 1,428 bcf. Gas production is concentrated within the 10 leading gas producers, which accounted for 67% of total gas production in 2008. The 10 leaders continue to include ConocoPhillips Co. (A/Stable/--), Devon Energy Production, and BP America Production Co. (AA/Stable/A-1+). New Mexico's forecasts reflect declining natural gas production by 2%-4% annually in the next five years; state officials also estimate that average gas prices will fall increase to \$4.80 per mcf in fiscal 2010 before increasing to \$7.00 in fiscal 2013. Due to forecast declines in prices and gas sales, management expects gas severance tax receipts to decline 17% in fiscal 2010 before increasing 27% and 9% in fiscal 2011 and fiscal 2012, respectively.

Oil

Oil reserves totaled 735 million barrels at the end of 2007, down from ending reserves of 620 million barrels in 1998. The industry continues to replace much of New Mexico-produced oil with new discoveries and better extraction technologies. Although New Mexico oil production in 2007 totaled 60 million barrels, 2007 ending oil reserves were 30 million barrels higher than beginning reserves. State forecasts have oil production declining by 1% annually in the next five years. Official forecasts reflect declining oil sales and oil prices in fiscal 2010 to result in a 25% decline in oil severance tax receipts before increasing oil prices restore oil severance tax receipts to fiscal 2009 levels by fiscal 2013.

In 2007, concentration existed in the 10 leading oil producers, which accounted for 54% of production. The leading three producers include Chevron USA Inc., Occidental Permian Ltd., and Cog Operating LLC.

Coal

New Mexico has used the majority of its coal production for electrical power generation in the state, as well as for Arizona power stations. The severance tax on surface-mined coal and coal mined underground in fiscal 2009 totaled \$1.40 per ton and \$1.35 per ton, respectively. Sales volume totaled 22.8 million short tons in fiscal 2008 and generating \$17.2 million of severance taxes (3% of pledged revenue), after intergovernmental tax credits for production on Native American reservations.

Related Research

USPF Criteria: "Special Tax Bonds," June 13, 2007

Ratings Detail (As Of June 19, 2009)		
New Mexico severance tax		
<i>Long Term Rating</i>	AA/Stable	Affirmed
New Mexico severance tax bnds ser 2008A-1		
<i>Long Term Rating</i>	AA/Stable	Affirmed
New Mexico supplemental severance tax		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
New Mexico supplemental severance tax bnds rfdg ser 2008A-2		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Copyright © 2009, Standard & Poors, a division of The McGraw-Hill Companies, Inc. (S&P). S&P and/or its third party licensors have exclusive proprietary rights in the data or information provided herein. This data/information may only be used internally for business purposes and shall not be used for any unlawful or unauthorized purposes. Dissemination, distribution or reproduction of this data/information in any form is strictly prohibited except with the prior written permission of S&P. Because of the possibility of human or mechanical error by S&P, its affiliates or its third party licensors, S&P, its affiliates and its third party licensors do not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. S&P GIVES NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates and its third party licensors be liable for any direct, indirect, special or consequential damages in connection with subscribers or others use of the data/information contained herein. Access to the data or information contained herein is subject to termination in the event any agreement with a third-party of information or software is terminated.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1)212.438.7280 or by e-mail to: research_request@standardandpoors.com.