

**STANDARD
& POOR'S**

One Market
Steuart Tower, 15th Floor
San Francisco, CA 94105-1000
tel 415 371-5000
reference no.: 1164505

April 8, 2011

State of New Mexico
Office of the Secretary
181 Bataan Memorial Building
Santa Fe, NM 87501
Attention: Ms. Duffy Rodriguez, Deputy Secretary

Re: ***US\$19,970,000 State of New Mexico, New Mexico, Capital Projects General Obligation Bonds, Series 2011, dated: Date of Delivery, due: March 1, 2021***

Dear Ms. Rodriguez:

Pursuant to your request for a Standard & Poor's rating on the above-referenced obligations, we have reviewed the information submitted to us and, subject to the enclosed *Terms and Conditions*, have assigned a rating of "AA+". Standard & Poor's views the outlook for this rating as stable. A copy of the rationale supporting the rating is enclosed.

The rating is not investment, financial, or other advice and you should not and cannot rely upon the rating as such. The rating is based on information supplied to us by you or by your agents but does not represent an audit. We undertake no duty of due diligence or independent verification of any information. The assignment of a rating does not create a fiduciary relationship between us and you or between us and other recipients of the rating. We have not consented to and will not consent to being named an "expert" under the applicable securities laws, including without limitation, Section 7 of the Securities Act of 1933. The rating is not a "market rating" nor is it a recommendation to buy, hold, or sell the obligations.

This letter constitutes Standard & Poor's permission to you to disseminate the above-assigned rating to interested parties. Standard & Poor's reserves the right to inform its own clients, subscribers, and the public of the rating.

Standard & Poor's relies on the issuer/obligor and its counsel, accountants, and other experts for the accuracy and completeness of the information submitted in connection with the rating. This rating is based on financial information and documents we received prior to the issuance of this letter. Standard & Poor's assumes that the documents you have provided to us are final. If any subsequent changes were made in the final documents, you must notify us of such changes by sending us the revised final documents with the changes clearly marked.

To maintain the rating, Standard & Poor's must receive all relevant financial information as soon as such information is available. Placing us on a distribution list for this information would facilitate the process. You must promptly notify us of all material changes in the financial

Ms. Duffy Rodriguez

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April 8, 2011

information and the documents. Standard & Poor's may change, suspend, withdraw, or place on CreditWatch the rating as a result of changes in, or unavailability of, such information. Standard & Poor's reserves the right to request additional information if necessary to maintain the rating.

Please send all information to:

Standard & Poor's Ratings Services
Public Finance Department
55 Water Street
New York, NY 10041-0003

Standard & Poor's is pleased to be of service to you. For more information on Standard & Poor's, please visit our website at www.standardandpoors.com. If we can be of help in any other way, please call or contact us at nypublicfinance@standardandpoors.com. Thank you for choosing Standard & Poor's and we look forward to working with you again.

Sincerely yours,

Standard & Poor's Ratings Services
a Standard & Poor's Financial Services LLC business

A handwritten signature in cursive script that reads "Standard + Poor's". The signature is written in dark ink and includes a small flourish at the end of the word "Poor's".

tw

enclosures

cc: Mr. David Paul
Ms. Stephanie Schardin-Clarke

**STANDARD
& POOR'S**

One Market
Steuart Tower, 15th Floor
San Francisco, CA 94105-1000
tel 415 371-5000
reference no.: 3776001

April 8, 2011

State of New Mexico
Office of the Secretary
181 Bataan Memorial Building
Santa Fe, NM 87501
Attention: Ms. Duffy Rodriguez, Deputy Secretary

Re: *State of New Mexico, New Mexico, General Obligation Bonds*

Dear Ms. Rodriguez:

Standard & Poor's has reviewed the rating on the above-referenced obligations. After such review, we have affirmed the "AA+" rating and stable outlook. A copy of the rationale supporting the rating and outlook is enclosed.

The rating is not investment, financial, or other advice and you should not and cannot rely upon the rating as such. The rating is based on information supplied to us by you or by your agents but does not represent an audit. We undertake no duty of due diligence or independent verification of any information. The assignment of a rating does not create a fiduciary relationship between us and you or between us and other recipients of the rating. We have not consented to and will not consent to being named an "expert" under the applicable securities laws, including without limitation, Section 7 of the Securities Act of 1933. The rating is not a "market rating" nor is it a recommendation to buy, hold, or sell the obligations.

This letter constitutes Standard & Poor's permission to you to disseminate the above-assigned rating to interested parties. Standard & Poor's reserves the right to inform its own clients, subscribers, and the public of the rating.

Standard & Poor's relies on the issuer/obligor and its counsel, accountants, and other experts for the accuracy and completeness of the information submitted in connection with the rating. To maintain the rating, Standard & Poor's must receive all relevant financial information as soon as such information is available. Placing us on a distribution list for this information would facilitate the process. You must promptly notify us of all material changes in the financial information and the documents. Standard & Poor's may change, suspend, withdraw, or place on CreditWatch the rating as a result of changes in, or unavailability of, such information. Standard & Poor's reserves the right to request additional information if necessary to maintain the rating.

Ms. Duffy Rodriguez
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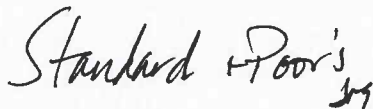
Please send all information to:

Standard & Poor's Ratings Services
Public Finance Department
55 Water Street
New York, NY 10041-0003

If you have any questions, or if we can be of help in any other way, please feel free to call or contact us at nypublicfinance@standardandpoors.com. For more information on Standard & Poor's, please visit our website at www.standardandpoors.com. We appreciate the opportunity to work with you and we look forward to working with you again.

Sincerely yours,

Standard & Poor's Ratings Services
a Standard & Poor's Financial Services LLC business

A handwritten signature in black ink that reads "Standard & Poor's" with a stylized flourish at the end.

tw

enclosure

cc: Ms. Stephanie Schardin-Clarke, Interim Director
State of New Mexico

STANDARD & POOR'S

Standard & Poor's Ratings Services Terms and Conditions Applicable To Public Finance Ratings

You understand and agree that:

General. The ratings and other views of Standard & Poor's Ratings Services ("Ratings Services") are statements of opinion and not statements of fact. A rating is not a recommendation to purchase, hold, or sell any securities nor does it comment on market price, marketability, investor preference or suitability of any security. While Ratings Services bases its ratings and other views on information provided by issuers and their agents and advisors, and other information from sources it believes to be reliable, Ratings Services does not perform an audit, and undertakes no duty of due diligence or independent verification, of any information it receives. Such information and Ratings Services' opinions should not be relied upon in making any investment decision. Ratings Services does not act as a "fiduciary" or an investment advisor. Ratings Services neither recommends nor will recommend how an issuer can or should achieve a particular rating outcome nor provides or will provide consulting, advisory, financial or structuring advice.

All Rating Actions in Ratings Services' Sole Discretion. Ratings Services may assign, raise, lower, suspend, place on CreditWatch, or withdraw a rating, and assign or revise an Outlook, at any time, in Ratings Services' sole discretion. Ratings Services may take any of the foregoing actions notwithstanding any request for a confidential or private rating or a withdrawal of a rating, or termination of this Agreement. Ratings Services will not convert a public rating to a confidential or private rating, or a private rating to a confidential rating.

Publication. Ratings Services reserves the right to use, publish, disseminate, or license others to use, publish or disseminate the rating provided hereunder and any analytical reports, including the rationale for the rating, unless you specifically request in connection with the initial rating that the rating be assigned and maintained on a confidential or private basis. If, however, a confidential or private rating or the existence of a confidential or private rating subsequently becomes public through disclosure other than by an act of Ratings Services or its affiliates, Ratings Services reserves the right to treat the rating as a public rating, including, without limitation, publishing the rating and any related analytical reports. Any analytical reports published by Ratings Services are not issued by or on behalf of you or at your request. Notwithstanding anything to the contrary herein, Ratings Services reserves the right to use, publish, disseminate or license others to use, publish or disseminate analytical reports with respect to public ratings that have been withdrawn, regardless of the reason for such withdrawal. Ratings Services may publish explanations of Ratings Services' ratings criteria from time to time and nothing in this Agreement shall be construed as limiting Ratings Services' ability to modify or refine its ratings criteria at any time as Ratings Services deems appropriate.

Information to be Provided by You. For so long as this agreement is in effect, in connection with the rating provided hereunder, you warrant that you will provide, or cause to be provided, as promptly as practicable, to Ratings Services all information requested by Ratings Services in accordance with its applicable published ratings criteria. The rating, and the maintenance of the rating, may be affected by Ratings Services' opinion of the information received from you or your agents or advisors. You further warrant that all information provided to Ratings Services by you or your agents or advisors regarding the rating or, if applicable, surveillance of the rating, as of the date such information is provided, (i) contains no untrue statement of material fact and does not omit a material fact necessary in order to make such information, in light of the circumstances in which it was provided, not misleading and (ii) does not infringe or violate the intellectual property rights of a third party. A material breach of the warranties in this paragraph shall constitute a material breach of this Agreement.

Confidential Information. For purposes of this Agreement, "Confidential Information" shall mean verbal or written information that you or your agents or advisors have provided to Ratings Services and, in a specific and particularized manner, have marked or otherwise indicated in writing (either prior to or promptly following such disclosure) that such

information is “Proprietary and Confidential.” Notwithstanding the foregoing, information disclosed by you or your agents or advisors to Ratings Services shall not be deemed to be Confidential Information, and Ratings Services shall have no obligation to treat such information as Confidential Information, if such information (i) was known by Ratings Services or its affiliates at the time of such disclosure and was not known by Ratings Services to be subject to a prohibition on disclosure, (ii) was known to the public at the time of such disclosure, (iii) becomes known to the public (other than by an act of Ratings Services or its affiliates) subsequent to such disclosure, (iv) is disclosed to Ratings Services or its affiliates by a third party subsequent to such disclosure and Ratings Services reasonably believes that such third party’s disclosure to Ratings Services or its affiliates was not prohibited, (v) is developed independently by Ratings Services or its affiliates without reference to the Confidential Information, (vi) is approved in writing by you for public disclosure, or (vii) is required by law or regulation to be disclosed by Ratings Services or its affiliates. Ratings Services acknowledges that it is aware that U.S. and state securities laws impose restrictions on trading in securities when in possession of material, non-public information and has adopted securities trading policies to that effect.

Ratings Services’ Use of Information. Except as otherwise provided herein, Ratings Services shall not disclose Confidential Information to third parties. Ratings Services may (i) use Confidential Information to assign, raise, lower, suspend, place on CreditWatch, or withdraw a rating, and assign or revise an Outlook, and (ii) share Confidential Information with its affiliates engaged in the ratings business who are bound by appropriate confidentiality obligations; in each case, subject to the restrictions contained herein, Ratings Services and such affiliates may publish information derived from Confidential Information. Ratings Services may also use, and share Confidential Information with any of its affiliates or agents engaged in the ratings or other financial services businesses who are bound by appropriate confidentiality obligations (“Relevant Affiliates and Agents”), for modelling, benchmarking and research purposes; in each case, subject to the restrictions herein, Ratings Services and such affiliates may publish information derived from Confidential Information. With respect to structured finance ratings not maintained on a confidential or private basis, Ratings Services may publish data aggregated from Confidential Information, excluding data that is specific to and identifies individual debtors (“Relevant Data”), and share such Confidential Information with any of its Relevant Affiliates and Agents for general market dissemination of Relevant Data; you confirm that, to the best of your knowledge, such publication would not breach any confidentiality obligations you may have toward third parties. Ratings Services will comply with all applicable U.S. and state laws, rules and regulations protecting personally-identifiable information and the privacy rights of individuals. Ratings Services acknowledges that you may be entitled to seek specific performance and injunctive or other equitable relief as a remedy for Ratings Services’ disclosure of Confidential Information in violation of this Agreement. Ratings Services and its affiliates reserve the right to use, publish, disseminate, or license others to use, publish or disseminate any non-Confidential Information provided by you, your agents or advisors.

Ratings Services Not an Expert, Underwriter or Seller under Securities Laws. Ratings Services has not consented to and will not consent to being named an “expert” or any similar designation under any applicable securities laws or other regulatory guidance, rules or recommendations, including without limitation, Section 7 of the U.S. Securities Act of 1933. Ratings Services is not an “underwriter” or “seller” as those terms are defined under applicable securities laws or other regulatory guidance, rules or recommendations, including without limitation Sections 11 and 12(a)(2) of the U.S. Securities Act of 1933. Rating Services has not performed the role or tasks associated with an “underwriter” or “seller” under the United States federal securities laws or other regulatory guidance, rules or recommendations in connection with this engagement.

Office of Foreign Assets Control. As of the date of this Agreement, (a) neither you nor the issuer (if you are not the issuer) or any of your or the issuer’s subsidiaries, or any director or corporate officer of any of the foregoing entities, is the subject of any U.S. sanctions administered by the Office of Foreign Assets Control of the U.S. Department of the Treasury (“OFAC Sanctions”), (b) neither you nor the issuer (if you are not the issuer) is 50% or more owned or controlled, directly or indirectly, by any person or entity (“parent”) that is the subject of OFAC Sanctions, and (c) to the best of your knowledge, no entity 50% or more owned or controlled by a direct or indirect parent of you or the issuer (if you are not the issuer) is the subject of OFAC sanctions. For so long as this agreement is in effect, you will promptly notify Ratings Services if any of these circumstances change.

Ratings Services’ Use of Confidential and Private Ratings. Ratings Services may use confidential and private ratings in its analysis of the debt issued by collateralized debt obligation (CDO) and other investment vehicles. Ratings Services may disclose a confidential or private rating as a confidential credit estimate or assessment to the managers of CDO and similar investment vehicles. Ratings Services may permit CDO managers to use and disseminate credit estimates or

assessments on a limited basis and subject to various restrictions; however, Ratings Services cannot control any such use or dissemination.

Entire Agreement. Nothing in this Agreement shall prevent Ratings Services from acting in accordance with applicable laws, regulations and Ratings Services' policies as published from time to time. Subject to the prior sentence, this Agreement, including any amendment made in accordance with provisions hereof, constitutes the complete and entire agreement between the parties on all matters regarding the rating provided hereunder. The terms of this Agreement supersede any other terms and conditions relating to information provided to Ratings Services by you or your agents and advisors hereunder, including without limitation, terms and conditions found on, or applicable to, websites or other means through which you or your agents and advisors make such information available to Ratings Services, regardless if such terms and conditions are entered into before or after the date of this Agreement. Such terms and conditions shall be null and void as to Ratings Services.

Limitation on Damages. Ratings Services does not and cannot guarantee the accuracy, completeness, or timeliness of the information relied on in connection with a rating or the results obtained from the use of such information. RATINGS SERVICES GIVES NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. Ratings Services, its affiliates or third party providers, or any of their officers, directors, shareholders, employees or agents shall not be liable to you, your affiliates or any person asserting claims on your behalf, directly or indirectly, for any inaccuracies, errors, or omissions, in each case regardless of cause, actions, damages (consequential, special, indirect, incidental, punitive, compensatory, exemplary or otherwise), claims, liabilities, costs, expenses, legal fees or losses (including, without limitation, lost income or lost profits and opportunity costs) in any way arising out of or relating to the rating provided hereunder or the related analytic services even if advised of the possibility of such damages or other amounts except to the extent such damages or other amounts are finally determined by a court of competent jurisdiction in a proceeding in which you and Ratings Services are parties to result from gross negligence or willful misconduct of Ratings Services. In furtherance and not in limitation of the foregoing, Ratings Services will not be liable to you, your affiliates or any person asserting claims on your behalf in respect of any decisions alleged to be made by any person based on anything that may be perceived as advice or recommendations. In the event that Ratings Services is nevertheless held liable to you, your affiliates, or any person asserting claims on your behalf for monetary damages under this Agreement, in no event shall Ratings Services be liable in an aggregate amount in excess of seven times the aggregate fees paid to Ratings Services for the rating giving rise to the cause of action, up to a maximum of US\$5,000,000 except to the extent such monetary damages directly result from Ratings Services' intentional wrongdoing or willful misconduct. The provisions of this paragraph shall apply regardless of the form of action, damage, claim, liability, cost, expense, or loss, whether in contract, statute, tort (including, without limitation, negligence), or otherwise. Neither party waives any protections, privileges, or defenses it may have under law, including but not limited to, the First Amendment of the Constitution of the United States of America.

Termination of Agreement. This Agreement may be terminated by either party at any time upon written notice to the other party. Except where expressly limited to the term of this Agreement, these Terms and Conditions shall survive the termination of this Agreement.

No Third-Party Beneficiaries. Nothing in this Agreement, or the rating when issued, is intended or should be construed as creating any rights on behalf of any third parties, including, without limitation, any recipient of the rating. No person is intended as a third party beneficiary of this Agreement or of the rating when issued.

Binding Effect. This Agreement shall be binding on, and inure to the benefit of, the parties hereto and their successors and assigns.

Severability. In the event that any term or provision of this Agreement shall be held to be invalid, void, or unenforceable, then the remainder of this Agreement shall not be affected, impaired, or invalidated, and each such term and provision shall be valid and enforceable to the fullest extent permitted by law.

Amendments. This Agreement may not be amended or superseded except by a writing that specifically refers to this Agreement and is executed manually or electronically by authorized representatives of both parties.

Governing law. You irrevocably agree that this Agreement and the rating letter, for purposes of any claim against Rating Services that may be asserted by you, your affiliates or any person asserting claims on your behalf, shall be governed by the internal laws of the State of New York. You irrevocably agree that, for purposes of any claim against Rating Services that may be asserted by you, your affiliates or any person asserting claims on your behalf in any dispute arising out of or relating to this Agreement, the state courts of New York located in the County of New York or the U.S. federal court for the Southern District of New York shall be the exclusive forums for such disputes and the parties hereby consent to the personal jurisdiction of such courts. For purposes of any claim against you that Rating Services may assert in any dispute arising out of or relating to the Agreement, neither party waives its right to contest the applicable governing law or the appropriate forum, including in connection with any assertion of sovereign immunity.

New Mexico; General Obligation

Primary Credit Analyst:

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

Secondary Contact:

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

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New Mexico; General Obligation

Credit Profile		
US\$19.97 mil cap Projs GO bnds ser 2011 due 03/01/2021		
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 2011 capital projects general obligation (GO) bonds. At the same time, Standard & Poor's affirmed its 'AA+' long-term rating, with a stable outlook, on the GO debt outstanding.

Under our new state criteria methodology, published Jan. 3, 2011, the state's overall score was '1.9', which we associate with a 'AA' indicative credit level. As our criteria indicates, the final state rating can be within one notch of the indicative credit level, based on the state's position relative to all other states.

Standard & Poor's 'AA+' GO rating on New Mexico is warranted, in our view, given the existence of two permanent funds the state maintains with activity related to the its mineral assets and which serve as endowments of more than \$13 billion. Although the corpus of the funds is not accessible pursuant to the state's constitution, the funds generate interest income for New Mexico's general and public education needs, which lends additional strength to the credit.

We also base the 'AA+' rating on what we view as New Mexico's very strong government and budget management framework that includes a strong legal framework for debt, balanced budget requirements, and the legislative flexibility to raise most revenues or reduce appropriations with a simple majority vote. Demonstrated timely adjustments to cure budgetary imbalances caused by declining revenue in the past two years adds further strength. We believe that the strength of New Mexico's budget management and government framework has allowed it to maintain budget balance and reserve levels that are consistent with a 'AA+' rated state.

In addition to the strengths above, the rating also reflects what we consider New Mexico's:

- Good reserve levels;
- Relative revenue diversity; and
- Moderate debt per capita with rapid amortization.

These strengths are somewhat mitigated by our view of New Mexico's weak pension funding levels.

The full faith and credit of the state, including an unlimited ad valorem tax on taxable property, secures the bonds. New Mexico annually levies property taxes sufficient to meet the next three debt service payments on its GO debt, which provides protection against delinquent tax payments. Standard & Poor's understands that the state will use bond proceeds primarily to fund public school projects and equipment as well as senior citizen and library facilities. The voters defeated a measure on the November 2010 ballot to include \$155 million of bonds for higher education capital projects.

New Mexico's economy has historically been based on agriculture, mineral production, and government; however, employment in the professional and financial sectors had been expanding before 2009, which has contributed to economic diversity. The state's economy has weakened since fiscal 2008 in line with the national slowdown; lower oil and natural gas prices have also filtered into the general economy resulting in reduced employment and lower income taxes. State unemployment was 8.4% in 2010, up compared with 7.2% in 2008, but remaining below the 9.6% national average.

Taxable value, which totaled \$51 billion in 2010, declined 7% compared with 2009 levels and could fall further based on changes to residential property assessments. Although potential further declines in taxable value could reduce New Mexico's GO bonding capacity, the unlimited ad valorem tax pledge requires property tax rates for the state's GO debt to rise to offset any value declines. Officials attribute the decline in 2010 primarily to lower oil and gas valuations and a recent court ruling that required a retroactive reassessment of residential property value in Bernalillo County. Proposed legislation that would have conformed residential property assessments statewide did not pass in the 2010 legislative session; however, similar proposals in future sessions, if successful, could result in further declines for statewide assessed value (AV). Since Bernalillo County's taxable value represents about 30% of state levels, officials estimate a large portion of the impact has already been incorporated into current statewide taxable value. Also, a February 2011 court ruling in Dona Ana County could reduce residential property values in that county and consequently total future state taxable value; total taxable value in Dona Ana County represents 7.5% of state taxable value.

The state's reserve levels remain good, in our opinion, despite draws on strong general fund reserves in the past couple of years due primarily to declining revenue. On a budgetary basis, New Mexico's budgetary general fund reserves (which include the operating, appropriation contingency, tax stabilization, and tobacco settlement permanent funds) totaled \$282 million, or what we consider a good 5.3% of recurring appropriations at fiscal year-end 2010 compared with a strong 13.0% of total appropriations in fiscal 2008. Officials project total receipts to decline 1.0% in fiscal 2011, which could contribute to another slight decline in the fund balance to a projected \$265 million or 5.1% of recurring appropriations, including projected ongoing expenditure controls to stabilize the balance at the administration's 5.0% minimum target.

Officials project budgetary reserves at fiscal year-end 2011 will comprise:

- \$39 million in the operating reserve;
- \$56 million in the appropriation contingency fund (including \$37 million of funds designated for education reform);
- \$26 million in the tax stabilization reserve; and
- \$143 million in the tobacco settlement permanent fund reserve.

The fiscal 2012 state budget represents a 4% increase in recurring appropriations compared with estimates for fiscal 2011, due primarily to higher general fund support for Medicaid after the loss of American Recovery and Reinvestment Act (ARRA) funding. The state's consensus forecast projects fiscal 2012 recurring receipts to rise \$250 million, or 5.0%, compared with the fiscal 2011 adjusted estimates, driven by a projected 4.0% increase in gross receipts tax (GRT) and a 3.8% increase in personal income tax collections. The fiscal 2012 state budget addresses an identified budget gap that exceeds \$400 million due, in part, to the expiration of ARRA funding, and provides for a 5.4% budgetary reserve. Forecasted fiscal 2012 revenue growth covers about half of the shortfall, while savings from shifting employer retirement contribution costs for certain plans to the employee as well as a transfer

of tobacco settlement revenue for Medicaid costs and tax increases on the film industry cover the majority of the remaining shortfall.

Standard & Poor's deems New Mexico's financial management practices "good" under its Financial Management Assessment (FMA) methodology. An FMA of good indicates financial practices are good, well embedded, and likely sustainable.

After this issuance, the state's total tax-supported debt--including GO, severance tax, gas tax bonds for the department of transportation (less 40% support from federal revenue), and various state tax-secured debt and loans included in the New Mexico Finance Authority's (NMFA) public project revolving fund--is what we consider moderate at \$1,277 per capita and 3.8% of personal income. Total GO debt is limited to a maximum of 1% of net taxable value and GO debt issuance requires a majority vote of the electorate. New Mexico's total GO debt outstanding, including the series 2011 bonds, will represent 0.7% of taxable value. Pursuant to its debt policy, the state amortizes all GO debt and severance tax debt over a very rapid 10 years. Amortization of principal on all governmental tax-supported debt, including state loans in NMFA's public project revolving fund, is rapid with 70% of principal retired within 10 years.

Outlook

The stable outlook reflects our expectation that New Mexico will continue to proactively manage budget adjustments and maintain good reserve levels, despite recent drawdowns. The outlook also reflects what we view as the strong government framework that provides the state with relative flexibility to adjust revenues and appropriations. Should stagnant revenue growth or continued revenue declines and rising program costs in the absence of federal stimulus dollars weaken the state's resolve to continue to adjust its budget toward structural balance, we could lower the rating. The high pension liabilities and low pension funding levels along with average to below-average economic indicators limit upward rating movement at this time.

Government Framework

New Mexico is not a voter initiative state and although voters have the ability to veto legislation passed through a referendum, the amount of signatures needed to place a measure on the ballot imposes a high threshold. All of New Mexico's tax-secured debt, except for a lease appropriation bond secured by state appropriations to the Department of Health, has a lien on specific revenues, which provides preferential status. Other than changes to distributions to the general fund from the severance tax fund and the land grant fund (which requires a three-fifths vote by the legislature as per the constitution) other taxes or revenues can be increased with only a majority vote of the legislature, providing revenue flexibility. Although New Mexico constitution limits the state property tax rate for all operations at 10 mills, the state does not levy a property tax for operations. New Mexico has demonstrated its willingness to increase revenue as evidenced most recently in fiscal 2011 when it raised the statewide GRT and cigarette tax rates and eliminated a state income tax deduction to generate additional revenue. Statutes provide for a portion of certain state taxes to be shared with local governments, although tax revenue is shared based on local sales and activity and the legislature can change the distribution rate or the tax base on which taxes are levied with a majority vote.

The state interprets Article IX section 7 of New Mexico's constitution, which prohibits it from borrowing more than

\$200,000 to cover a shortfall in revenue compared with necessary expenses, as a requirement that the state adopt and maintain a balanced budget. According to the constitution, only the legislature has broad authority to adjust general fund appropriation levels as necessary to balance the budget, but the executive can directly reduce expenditures for cabinet-level agencies and call a special legislative session if budget amendments are deemed necessary. In the 2010 General Appropriations Act passed for fiscal 2011, the legislature gave the executive the authority to make proportionate cuts to allocations across agencies to offset revenue declines without reconvening the legislature.

On a four-point scale where '1.0' is the strongest and '4.0' is the weakest, we have assigned a score of '1.0' to New Mexico's governmental framework.

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 might be formalized or regularly monitored by governance officials.

The executive conducts monthly reviews of finances throughout the year to track actual budget performance against projections. Management must make broad budget appropriation amendments in cooperation with the state legislature, but in the current year, the legislature granted the executive the authority to reduce allotments as necessary to offset declining revenues. The state treasurer's office invests general fund money according to a formal investment policy that is reviewed annually; the policy requires the state treasurer to prepare and submit a report on investment holdings and returns 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; annually, officials identify funding for these prioritized capital needs 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 the department of finance and administration have formal debt management guidelines, including the maximum amortization of debt and recommended savings thresholds for debt refunding. The state updates a debt affordability study annually to review debt plans and their effect on the budget and key debt ratios. Traditionally, New Mexico has not used variable-rate debt for GO or severance tax debt. In addition to state guidelines, the department of transportation and the NMFA have their own formal debt management policies that guide their use of variable-rate debt and derivatives.

New Mexico follows what we consider generally strong budget management practices. Between fiscals 2004 and 2008, operating surpluses due to revenue growth were used for nonrecurring capital outlay and building budgetary reserves to strong levels. In the past few years of revenue declines, the state has demonstrated its willingness to make timely cuts to its budget, including reducing public and higher education spending, although it has avoided larger cuts to education programs due to its receipt of ARRA funding since 2009. In the past few years, the state has cancelled cash-funded capital outlay appropriations from previous surplus years and transferred unspent balances from other funds as well as reserves to help meet its budget gaps. Deficits have not been carried forward and recent budget solutions have also included revenue increases and appropriation reductions. Once the state's budget is adopted annually, any changes to budget appropriation levels must be made by the New Mexico legislature; however, the executive called a legislative special session in October 2009 to address revenue shortfalls for fiscal 2010 within two months of the August 2009 consensus revenue forecasts. In addition, in 2010 the legislature gave

the executive branch the broad authority to proportionately reduce allotments in the fiscal 2011 general fund budget, recognizing the need for quick action in the event of a budget shortfall. The consensus revenue forecasting group typically prepares revenue forecasts four times a year: in December (before the January legislative session), February, August, and October. The legislative finance committee posts monthly revenue reports tracking actual collections against forecasts. The executive also tracks actual budget performance against projections monthly.

We have assigned a score of '1.5' to New Mexico's financial management framework, where '1.0' is the strongest score and '4.0' is the weakest.

Economy

New Mexico's population grew steadily at an average annual rate of 1.2% between 2000 and 2009 to 2 million, which ranks the state 36th in population in the nation. Its cumulative population growth of 10.5% was slightly higher than the nation's growth of 9.1% in this period. With an age-to-population dependency ratio of 62.3, the state's dependent population base is only slightly above the nation's ratio of 59.2. The state's four metropolitan statistical areas are Albuquerque, Santa Fe, Las Cruces, and Farmington, although the majority of the state's geographical area is undeveloped and thinly populated. In the past decade, New Mexico has emphasized investment in infrastructure and transportation including a commuter rail line between Belen and Santa Fe that began service in 2008. It has previously extended tax credits for the solar and film industries, which has attracted businesses primarily to the Albuquerque area, although it is unclear whether reducing the state's film production tax incentive in 2012 could dampen future investment in the industry. The Sandia and Los Alamos national labs serve as major research anchors in New Mexico and provide high-skilled employment opportunities. We view per capita personal income of \$33,212 in 2009 (84% of the nation's) as below average. Real gross state product (GSP) growth did not keep up with growth for the nation between 2005 and 2007 but, given slower growth rates in previous years, rose 1% more than the nation's in 2008 and in 2009 suffered a 0.5% lower decline than that of the nation. Real GSP per capita of \$37,000 represents 81% of the nation's.

The state possesses significant natural resources, and mineral extraction--natural gas, oil, and coal, in particular--remains a sizable contributor to its economic base and fiscal operations. Mining, however, accounted for just 2.4% of nonfarm employment in 2010 as natural gas and oil production have become more capital intensive. New Mexico's economy depends more heavily on government employment than most other states with 25% of nonfarm employment in government compared with 17% for the nation in 2010. The state's next largest employment sectors include professional business services, education and health services, and transportation trade and utilities, which represent 12%, 15%, and 17% of nonfarm employment in the state, respectively, and are in line with national levels. New Mexico's manufacturing employment in 2010 represented only 3.6% of employment compared with the nation's 8.9%, and has declined steadily in the past decade.

We have assigned a score of '2.4' to New Mexico's economy, where '1.0' is the strongest score and '4.0' is the weakest.

Budgetary Performance

The state's GFR comprises primarily gross receipts and other sales taxes (43% of recurring GFR) and income taxes (25%). New Mexico's general fund also receives revenue subject to fluctuations in oil and natural gas prices,

including mineral production taxes (7%), rents and royalties (8%), and interest income from its severance tax and land grant permanent funds that collect mineral severance taxes, mineral production royalties, and land sale proceeds. Interest income from the two permanent fund distributions and state cash balances represent 12.5% of recurring GFR. New Mexico's gross receipts and sales taxes are levied on a broad base including most goods and services in the state.

New Mexico 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 four times a year to update revenue forecasts for the general fund. The governor indicated in her proposed budget her intent to establish long-term expenditure forecasting in addition to the revenue forecasts. We understand officials will be working to implement these changes in the near term. Oil and natural gas revenue assumptions are based on price forecasts from several independent sources, and volumes are based on econometric analysis that uses historical tax returns. Despite declines in recurring revenue in the past three years, the consensus forecast released in December 2010 projects recurring revenue to increase 7.6% by fiscal year-end 2011 due primarily to an estimated 8.8% and 17.9% annual growth in sales and income taxes, respectively. The estimated growth includes an increase to the state GRT and cigarette taxes as well as additional estimated revenue from changes to state and local income and sales tax deductions. According to the April 2011 fiscal report by the legislative finance committee, total actual fiscal 2011 receipts through January 2011 reflect 6.3% growth in the same period in fiscal 2010, which is slightly below the revenue forecast for the full year; the majority of the growth is due to better sales tax and corporate income tax collections.

The state's general fund cost structure is driven by public education and health and human services, including New Mexico's share of Medicaid costs. Overall Medicaid spending has been increasing due to rising health care costs and growing enrollments. In the past three years, the state has transferred annual revenue to aid in Medicaid costs from the tobacco settlement permanent fund reserve. More than \$1 billion of ARRA funding in the past three years has also helped to support the general fund's share of education and Medicaid costs. With the expiration of ARRA funding, general fund appropriations to education and Medicaid will increase in fiscal 2012. For fiscal 2010, excluding the ARRA funding and cancelled cash-funded capital outlay projects, New Mexico primarily relied on budget cuts and reserve transfers to cover 47% and 24%, respectively. In fiscal 2011, outside of ARRA funding, the state increased GRT rates and cigarette tax rates and changed income tax deductions to bring in more revenue. The 2011 budget also included shifts of pension contribution costs to employees and cuts to higher education funding; the higher education funding cuts were offset, in part, by higher tuition rates. In fiscal 2011, to maintain budget balance the executive also reduced appropriations by 3.2% across the board to bring total estimated expenditures at year-end to \$5.2 billion from the adopted \$5.35 billion.

Although statutes exist that dictate maximum reserves for certain general fund reserves, no statute exists that requires a minimum level of 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 and a minimum reserve equal to 5% of appropriations. Officials communicate the reserve targets with the legislature, and the state has maintained budgetary reserves above the minimum 5% in fiscals 2001 through 2010. Current estimates for fiscal year-end 2011 reflect ending reserves of 5.1% of recurring appropriations.

New Mexico can borrow up to 50% of pooled cash collected for local governments in the state; this amount is held in a tax suspense fund for 55 days before it is distributed. Current cash flows reflect about \$350 million in the suspense account as of December 2010. The state operates on a consolidated cash basis; actual combined general

fund cash balances invested by the treasurer, including unspent state agency cash and suspense account funds, totaled \$1.3 billion as of Jan. 31, 2011.

According to officials, the typical low points for general fund cash are in March and in November or December of each year. The state did not issue tax and revenue anticipation notes (TRANs) in fiscals 2009 or 2010; however, in the past it had regularly issued TRANs twice a year and most recently issued \$200 million of TRANs in mid-2010. New Mexico is implementing a cash forecasting model to project short- and long-term cash flow requirements for the state.

We have assigned a score of '1.8' to New Mexico's budgetary performance, where '1.0' is the strongest score and '4.0' is the weakest.

Debt And Liability Profile

Debt

Under the New Mexico Constitution, GO debt is limited to 1% of AV and additional GO debt is subject to electorate approval. As of fiscal year-end 2010, GO debt totaled about \$399 million, or 0.78% of 2010 taxable value. In addition to GO debt, the state finances capital projects with severance tax bonds secured by a first-lien on taxes levied on producers that extract minerals and natural resources within the state; the severance taxes, net of debt service, are deposited in the state's Severance Tax Permanent Fund, which generates interest income for the general fund. New Mexico had \$965 million in senior and supplemental severance tax bonds outstanding at fiscal year-end 2010. It also annually issues short-term supplemental severance tax notes, which are purchased by the state treasurer as a mechanism to fund capital projects with severance tax revenue; however, these notes mature within the fiscal year and are not included in the state's debt ratios. The NMFA issues highway revenue bonds secured by a combination of gas taxes, and highway user and federal highway revenues for the state transportation commission; federal revenue represents almost 40% of the pledged revenue on the gas tax bonds and the gas tax revenue does not flow through the general fund. As of fiscal year-end 2010, about \$1.7 billion of gas-tax-supported debt was outstanding, including almost 30% of variable-rate principal. Total gas tax revenue in fiscal 2010 covered total gas tax maximum annual debt service (MADS) by more than 3x; state gas tax and highway revenues alone covered total gas tax by 1.9x MADS. In our debt calculations for the state, we reduce the total gas tax principal by 40% to account for the federal revenue support. NMFA has entered into interest-rate swap contracts with various counterparties to offset its exposure to variable-rate fluctuations. (For a complete discussion of the NMFA 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 Aug. 18, 2010, on RatingsDirect on the Global Credit Portal.)

In fiscal 2010, there was \$60 million of lease revenue debt outstanding related to a lease agreement between the state department of health and Grant County in which lease payments are secured by state appropriations pursuant to a New Mexico constitutional amendment in 2006 that authorized lease purchase financing for state facilities. In addition, at fiscal year-end 2010, New Mexico had about \$140 million of loan principal outstanding issued through NMFA's public project revolving fund and secured by various taxes, including state governmental GRT, and cigarette tax revenue.

Excluding 40% of gas tax debt supported by federal revenue, tax-supported debt represents \$1,277 per capita and 3.8% of personal income, which we consider moderate. Total tax-supported debt service on all New Mexico debt,

less federal revenue support, represents 5.2% of general and debt service expenditures. As a general practice, the state issues severance tax bonds and GO bonds with a 10-year maximum maturity and level debt service. Debt retirement of governmental tax-backed bond principal, including gas tax debt and state loans in the NMFA public project revolving fund, is rapid in our opinion with 70% of principal retired over 10 years.

Retirement Funds And Retiree Health Benefits

We consider the state's aggregated pension funded ratio of 75% for all of New Mexico's retirement systems to be below average, ranking 24th in the nation. The state sponsors five public employee defined benefit retirement plans: in order of size of unfunded actuarial accrued liability (UAAL) include the Educational Employees Retirement System (EERS), the Public Employee Retirement System (PERS), the Judicial Retirement System (JRS), the Magistrate Retirement System (MRS), and the Volunteer Firefighters Retirement Fund (VFRS). The VFRS was overfunded by \$26.9 million at fiscal year-end 2010. The total UAAL for New Mexico's pension plans in fiscal 2010 was more than \$8 billion, which equals about \$4,000 per capita and 12% of personal income, which we consider weak. All funds use an 8% assumed rate of return and 30-year amortization.

The two largest retirement plans, the State Public Employees' Retirement Association (PERA) and the Educational Retirement Board (ERB), provide retirement benefits for most of the state employees and political subdivisions. As of June 30, 2010, the EERS was only 66% funded with a \$4.9 billion UAAL compared with fiscal 2008 when it was 72% funded. The PERS was 81% funded with an UAAL of about \$3.4 billion. New Mexico has funded contribution rates determined by previous statutes. However, since rates are not linked to the actuarial valuation of the fund, it has not funded its annual required contribution (ARC) to the ERS since 2003 and only funded 87.7% of the ARC in fiscal 2010. This underfunding of the ARC in addition to declining market value of assets has contributed to deteriorating funding ratios for the ERS fund in particular. The other funds have a longer trend of funding their ARCs, although the PERS, MRS, and JRS also did not fund their ARCs in fiscal 2009. For fiscal 2011, the state shifted 1.5% of retirement contribution costs to the employee from the employer for the PERA and ERB administered plans although the total contribution cost did not change from statutorily required rates. The fiscal 2012 budget shifts an additional 1.75% of these costs to the employee.

New Mexico completed an actuarial valuation and review of other postemployment benefits (OPEB) for the New Mexico Retiree Health Care Authority as of June 30, 2010. 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. The actuarial report estimates the ARC at \$298 million for fiscal 2010; however, the state funded only 21% of the OPEB ARC.

On a scale where '1.0' is the strongest score and '4.0' is the weakest, we have assigned a score of '2.6' to New Mexico's debt and liability profile.

New Mexico's Permanent Funds

The state's mineral wealth has allowed it to establish large endowments that generate annual revenue to its general fund and augment its tax revenue. Previous land grants from the federal government for the benefit of public schools and various other public institutions form a land trust totaling 9 million surface and 13 million sub-surface acres of land, which earns income from mineral production royalties, leases and sale proceeds; all land trust income is deposited into the state's land grant permanent fund (LGPF). The LGPF had a market value of \$8.8 billion as of

June 30, 2010. Distributions from the fund to beneficiaries are based on a formula in the state constitution with 83% of distributions going toward public education, which supports the general fund. Changes to the distributions require a three-fifths legislative vote and a majority vote of the people. The distribution was last changed in fiscal 2005 after voters approved increasing distributions to 5.8% from 4.7% of the fund's previous five-year average market value through fiscal 2012; the distribution rate falls to 5.5% between fiscals 2013 and 2016 before it returns to a 5.0% distribution thereafter. Distributions are made as long as the average five-year market value remains above \$5.8 billion. The fund experienced a 25% loss in market value between fiscals 2007 and 2009 before rebounding by 11% in fiscal 2010

New Mexico constitution requires the state to deposit severance tax receipts related to natural gas and oil production into the Severance Tax Permanent Fund (STPF), which was intended to serve as an endowment for state capital projects. Deposits to the fund are made after debt service on related debt, including the state's severance tax and supplemental severance tax long-term bonds. New Mexico has also annually issued short-term severance tax notes as a mechanism to divert severance tax revenues to nonrecurring capital outlay projects before deposit into the STPF. Despite the regular use of the severance tax revenues for capital projects, annual contributions to the fund averaged \$60 million in the past five years and the market value of the STPF at fiscal year-end 2010 increased an annual 12% compared with the previous year to \$3.4 billion. The state constitution provides for a distribution from the STPF to the general fund for general purposes equal to 4.7% of the fund's previous five-year average market value; New Mexico is unable to appropriate funds from the corpus of the fund.

The state investment officer is responsible for investing the assets of New Mexico's permanent funds under the direction of the state investment council (SIC), which is made up of the governor, the state treasurer, the commissioner of public lands, the secretary of finance, a state university representative, and six public members appointed by the legislature and governor. After an advisor to the SIC pled guilty in 2009 to fraud charges for recommending politically motivated investments to the SIC and ERB, in 2010 the legislature changed the SIC's composition and the method of appointment for public members to the SIC pursuant to a legislative review of the state investment policies and practices.

Related Criteria And Research

USPF Criteria: GO Debt, Oct. 12, 2006

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