



## **Rating Action: MOODY'S ASSIGNS Aa1 RATING TO NEW MEXICO'S SEVERANCE TAX BONDS (SENIOR LIEN) AND AFFIRMS Aa1 AND Aa2 RATINGS ON OUTSTANDING SENIOR AND SUBORDINATE BONDS**

Global Credit Research - 11 Nov 2011

### **STABLE OUTLOOK APPLIES TO \$740 MILLION OUTSTANDING SENIOR AND SUBORDINATE LIEN DEBT, INCLUDING CURRENT ISSUE**

New York, November 11, 2011 -- Moody's Rating

Issue: Severance Tax Bonds Series 2011A-1 ; Rating: Aa1; Sale Amount: \$45,670,000; Expected Sale Date: 11/16/2011; Rating Description: Special Tax Sales

Issue: Severance Tax Bonds Series 2011A-2; Rating: Aa1; Sale Amount: \$76,470,000; Expected Sale Date: 11/16/2011; Rating Description: Special Tax Sales

#### Opinion

Moody's Investors Service has assigned a Aa1 rating to the State of New Mexico's Severance Tax Bonds (senior lien), Series 2011A-1 and Refunding Series 2011A-2, expected to be issued in the amounts of \$45.7 million and \$76.5 million, respectively. At the same time, Moody's has affirmed the Aa1 rating on the State's parity Severance Tax Bonds (senior lien) and the Aa2 rating on the State's Supplemental Severance Tax Bonds (subordinate lien). Proceeds of the Series 2011A-1 bonds will be used to fund general government capital projects. Proceeds of the Refunding Series 2011A-2 bonds will be used to refund outstanding bonds for debt service savings. Following this issuance, the State will have \$740 million in senior and subordinated bonds outstanding. The outlook on the ratings is stable.

#### SUMMARY RATING RATIONALE

Severance taxes are deposited upon receipt in the Bonding Fund. The senior and subordinate bonds are secured by a first and second lien, respectively, on severance taxes and interest earnings of the Bonding Fund. The ratings reflect the volatility of the pledged revenue stream, which consists primarily of taxes on the production of natural gas and oil in the state, offset by coverage levels in excess of the additional bonds test and the rapid payout of outstanding bonds.

#### STRENGTHS

- \* Payout is rapid; bonds are issued with a maximum 10 years maturity, and annual debt service declines rapidly after 2013.
- \* The state has not leveraged revenues to the additional bonds test: with the current offering, peak debt service on senior bonds by fiscal 2011 revenues is 3.06 times; on all bonds is 2.62 times.
- \* Constitutional provisions offset the absence of a reserve fund; the State must maintain 12 months' debt service requirements in the Bonding Fund before excess revenues can be transferred to the Permanent Fund or, via the issuance of short-term notes, utilized for capital spending.
- \* No operating claims compete against pledged revenues; surplus revenues not needed for debt service on the bonds are transferred to the Severance Tax Permanent Fund or used for capital spending.
- \* Near-term outlook for oil production is positive due to high prices and new drilling technologies.

#### CHALLENGES

- \* Pledged severance taxes are volatile due to dominance of oil and gas, and sensitivity to production levels and commodity prices.
- \* Current coverage has declined steadily since 2007.
- \* Relatively weak additional bonds tests compared to similarly rated bonds: 2.0 times coverage for senior bonds and 1.6 times coverage for subordinate bonds.

#### OUTLOOK

The outlook on the Severance Tax Bond ratings is stable, reflecting the growth in pledged revenues in fiscal 2011, the positive near-term outlook for oil production in the state, the rapid payout on the bonds, and the expectation the state will not leverage severance tax beyond current levels.

#### WHAT COULD MOVE THE RATINGS—UP

\* Structural changes that strengthen the program, such as an increase in the additional bonds tests.

#### WHAT COULD MOVE THE RATINGS—DOWN

\* A deterioration in coverage as a result of new declines in severance tax revenues, new tax credits, or leveraging tax revenues in beyond the 3.0 times level seen with the current issuance.

\* Debt policy changes that weaken the program, such as lengthening maturities.

The principal methodology used in this rating was Piercing the G.O. Ceiling published December 2008. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology .

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