

New Mexico; Miscellaneous Tax

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Credit Profile		
US\$76.47 mil State Sev Tax rfdg bnds ser 2011A-2 due 07/01/2018		
Long Term Rating	AA/Stable	New
US\$45.67 mil State Sev Tax bnds ser 2011A-1 due 07/01/2021		
Long Term Rating	AA/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating to New Mexico's series 2011A-1 severance tax bonds and series 2011A-2 refunding severance tax bonds. At the same time, Standard & Poor's affirmed its 'AA' long-term and underlying ratings on the state's \$597.8 million parity senior severance tax bonds outstanding, and its 'AA-' rating on the state's \$102.0 million subordinate supplemental severance tax bonds outstanding. The outlook on the bonds is stable.

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

- Strong 2.81x senior-lien maximum annual debt service (MADS) coverage by fiscal 2011 severance tax revenues, and 2.41x total senior and supplemental bond MADS;
- Good additional bonds test (ABT) requiring at least 2.00x debt service coverage (DSC) to issue additional senior-lien bonds, and 1.60x DSC to issue additional subordinate long-term supplemental bonds; and
- A declining debt service schedule and rapid debt amortization, with all principal to be retired by 2021.

Mitigating these credit strengths are:

- A large, in our opinion, 32% decline in severance tax receipts in fiscal 2010, and what we view as 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.

We understand that the proceeds of the series 2011A-1 bonds will be used to fund various state capital improvements, while the series 2011A-2 bonds will advance refund a portion of the series 2008A-1 bonds outstanding.

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 senior severance tax bonds. The supplemental severance tax bonds are secured

New Mexico levies taxes on a variety of minerals. The primary severance tax revenue generators are natural gas (about 46% of the state's projected fiscal 2012 severance tax receipts), oil (48%), and coal (5%). Fiscal 2011 severance taxes alone produced 2.95x senior lien MADS coverage in fiscal 2011. In addition, the state realized \$18.1 million of investment earnings in its bond fund in fiscal 2011. Using total pledged 2011 revenues as the state calculates coverage, including refunding proceeds, other financing sources, and interest earnings, would bring senior-lien MADS coverage to 3.06x.

Fiscal 2010 pledged severance tax revenue declined 32% to \$350 million, primarily the result of lower natural gas production and prices. Severance tax revenue increased 4.7% in fiscal 2011. New "fracking" technology has increased domestic natural gas and oil production. However, New Mexico believes this has caused uneven effects between the two commodities. State oil prices align more closely with international oil prices, since oil is a more transportable commodity, while natural gas prices depend more on domestic supply and demand, in addition to nearby competition from Texas production. The result is that oil prices have not fallen as much as natural gas prices, and with the new technology, increases in oil production have offset the decline in prices to produce relatively stable oil severance tax receipts. Currently, the state projects stabilized and slowly increasing oil and gas prices in the next few years. Not including interest or other earnings, we calculate that the state's fiscal 2012 forecast of severance tax revenues alone will cover senior-lien MADS 3.06x and combined senior- and subordinate-lien MADS 2.62x.

DSC will also improve as debt is retired. Senior-lien annual debt service declines to \$91.1 million by 2017 from \$130.3 million in 2013, and entirely matures in 2021. Subordinate-lien debt service also declines and also entirely matures in 2021. Additional parity debt would need additional state legislative authorization. Although it is uncertain exactly how much might be authorized in the coming spring legislative session, up to \$250 million of additional debt could be authorized based on preliminary discussions. New Mexico has typically sold additional severance tax debt annually.

The historical ABT 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, in Standard & Poor's opinion. The ABT for the long-term supplemental severance tax bonds is 1.6x. New Mexico can also 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. The state typically issues these notes with a maturity of five days or fewer to the state treasurer to make funds available for capital projects.

The state generally uses short-term senior and supplemental severance tax notes that mature within one day to fund additional authorized capital projects.

Outlook

The stable outlook reflects our expectation that, despite possible future bonding, DSC will remain strong in the next two years as the result of strong ABTs and a declining debt service schedule. We also expect natural gas and oil reserves will continue to be replenished to maintain sufficient production over the bonds' life and that severance tax collections will continue to provide good MADS coverage during the bonds' relatively short 10-year life, despite the decline in revenues in fiscal 2010. Should MADS coverage begin to approach the ABTs, a downward adjustment of the rating or outlook is possible. The volatility of the pledged revenue stream somewhat limits upward movement of the rating.

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 semi-annual 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 Dec. 31 and June 30, 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% 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 New Mexico 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 (46% of projected fiscal 2012 severance taxes), oil (48%), and coal (5%) 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. In fiscal 2009, a U.S. district court ruled that the state could not impose severance taxes on non-Indian operators extracting oil and natural gas on Ute Mountain-Ute Tribe tribal land. The ruling is under appeal. According to the New Mexico Tax and Revenue Department, nontribal oil and gas production on native American land statewide, net of tax credits, generated a minor \$8.1 million of overall revenues in fiscal 2011.

New Mexico's forecasts reflect natural gas volume production declining by 4.5% in fiscal 2011, 3.3% in 2012, and 3.1% per year between 2013-2015; state officials also estimate that average gas prices will decrease from \$5.15 mcf in 2011 to \$5.35 in 2012, and then increase gradually to \$6.25 by 2015. The state forecasts that the interplay between declining production and rising prices would produce increases in natural gas severance tax receipts between 2012-2014, followed by moderate declines, to a level in 2016 that would still be 4.1% above 2012's forecasted level of revenues.

State forecasts have oil sales increasing at 4.0% in 2012, followed by decreases of 1.6% in 2013, 1.4% in 2014, and 1.0% in 2015. Official forecasts reflect \$82.00 average price per barrel in 2012 compared with \$84.20 in 2011, and prices to rise to \$84.00 in 2013, \$84.50 in 2014, \$85.00 in 2015, and \$85.00 in 2016. The state projects oil severance tax revenues would stay relatively stable at about \$191 million-\$193 million through 2015, and then fall to \$188 million in 2016.

The severance tax on surface-mined coal and coal-mined underground in fiscal 2011 totaled \$1.13 and \$1.09, respectively, compared with \$1.02 and 99 cents per metric ton, respectively, in fiscal 2010. Sales volume fell 15% in fiscal 2010 to generate \$23 million of net severance taxes. (See table for severance tax bond coverage.)

New Mexico Severance Tax Bond Coverage						
(Mil. \$)	--Fiscal year ended June 30--					State projection
	2007	2008	2009	2010	2011	2012
Pledged severance tax receipts*	452.9	511.8	516.3	350.1	366.7	398.5
% change	N/A	13.0	0.9	(32.2)	4.7	8.7
Coverage of senior lien MADS	3.5	3.9	4.0	2.7	2.8	3.1
Coverage of combined senior and subordinate MADS	3.0	3.4	3.4	2.3	2.4	2.6

*Does not include bond fund investment earnings or certain other nontax bond fund receipts. MADS--Maximum annual debt service. N/A--Not applicable.

Related Criteria And Research

USPF Criteria: Special Tax Bonds, June 13, 2007

Ratings Detail (As Of November 11, 2011)		
New Mexico severance tax		
<i>Long Term Rating</i>	AA/Stable	Affirmed
New Mexico severance tax		
<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
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
Many issues are enhanced by bond insurance.		

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