

Global Credit Research - 17 May 2012

**OUTLOOK IS STABLE; \$709 MILLION OUTSTANDING PARITY SENIOR LIEN DEBT, INCLUDING CURRENT ISSUE**

New York, May 17, 2012 --

Moody's Rating

Issue: Severance Tax Bonds, Series 2012A; Rating: Aa1; Sale Amount: \$70,635,000; Expected Sale Date: 5/21/12; Rating Description: Special Tax: Non-Sales/Non-Transportation

Opinion

Moody's Investors Service has assigned a Aa1 rating to the State of New Mexico's Severance Tax Bonds (senior lien), Series 2012A, expected to be issued in the amount of \$70.6 million. Proceeds of the Series 2012A bonds will be used to fund general government capital projects. Following this issuance, the state will have \$709 million in senior and \$102 million subordinate severance tax bonds outstanding. The subordinate bonds are rated Aa2, and the outlook on both 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 on deposit in and interest earnings of the Bonding Fund. The ratings reflect the volatility of the pledged revenue stream, which consist 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, requirements to maintain 12 months' debt service on deposit in the Bonding Fund, and the rapid payout of outstanding bonds.

**STRENGTHS**

- \* Payout is rapid; bonds are issued with a maximum 10-year maturity, and annual debt service declines rapidly after 2013.
- \* The state has not leveraged revenues to the additional bonds test, resulting in stronger coverage of peak debt service.
- \* 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 for the 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.
- \* Coverage has declined steadily since 2007.
- \* Additional bonds tests are relatively weak 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 a increase in the additional bonds tests.

#### WHAT COULD MOVE THE RATINGS—DOWN

\* Deterioration in coverage as a result of new declines in severance tax revenues, new tax credits, or leveraging tax revenues 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 US Public Finance Special Tax Methodology published in March 2012. Please see the Credit Policy page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

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