

Rating Action: Moody's assigns Aa1 rating to New Mexico's Severance Tax Bonds, Series 2013A

Global Credit Research - 02 Jun 2013

Outlook is stable; \$818 million parity senior lien bonds outstanding, including current issue

New York, June 02, 2013 --

Moody's Rating

Issue: Severance Tax Bonds, Series 2013A; Rating: Aa1; Sale Amount: \$220,000,000; Expected Sale Date: 06-10-2013; Rating Description: 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 2013A, expected to be issued in the amount of \$220 million. Proceeds of the Series 2013A bonds will be used to fund general government capital projects. Following this issuance, the state will have \$818 million in senior and \$85 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 steeply from fiscal year 2015 to final maturity in 2022.
- * 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.

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 and 2012, 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 MAKE THE RATING GO UP

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

WHAT COULD MAKE THE RATING GO 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.

PRINCIPAL METHODOLOGY USED

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.moodys.com for a copy of this methodology.

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