

RatingsDirect®

New Mexico; Appropriations; General Obligation

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Credit Profile

US\$153.96 mil GO rfdg bnds ser 2017B dtd 08/22/2017 due 09/01/2027

Long Term Rating AA/Negative New

US\$153.6 mil capital projects GO bnds ser 2017A dtd 08/22/2017 due 09/01/2027

Long Term Rating AA/Negative New

Rationale

S&P Global Ratings has assigned its 'AA' rating and negative outlook to the State of New Mexico's \$153.6 million capital projects general obligation (GO) bonds, series 2017A, and \$153.96 million GO bonds, refunding series 2017B. At the same time, S&P Global Ratings affirmed its 'AA' rating, with a negative outlook, on New Mexico's GO bonds outstanding and 'AA-' rating on state annual appropriation-secured debt.

The 'AA' GO rating reflects what we consider New Mexico's:

- Economy that is somewhat reliant on the cyclical oil and gas industry, which appears to be experiencing a modest rebound after a severe downturn, as well as relatively more stable federal employment;
- Recent structural imbalances and timely state action to restore positive reserves, albeit with significant one-time budget items in fiscal 2017;
- Adequate reserves, although declined from levels we previously considered high, as a result of falling oil and gas prices. Recent revenue trends could lead to an improved fund balance above what has been budgeted for fiscal 2018;
- Emphasis on structural budget balance measures;
- Large permanent funds, whose earnings are available for general fund spending, although the corpus is restricted; and
- Moderate debt levels with rapid amortization.

The state's full faith and credit, including an unlimited ad valorem tax on taxable property, secures the bonds. New Mexico annually levies property taxes in amounts sufficient to provide a reasonable cash surplus in excess of the next year's debt service payments on its GO debt, in order to provide protection against delinquent tax payments.

The state's economy is characterized by above-average reliance on federal employment, due to federal laboratories and military bases, as well as by oil and gas production. New Mexico ranks first in the nation in terms of federal spending per dollar of tax paid, indicating the importance of federal dollars. Federal employment is concentrated in the state's three air force bases, as well as the White Sands Missile Range and Los Alamos and Sandia federal research centers. Other state industries include high-tech manufacturing attracted by state tax breaks and proximity to federal labs, tourism, and call-center businesses, which are drawn partly by New Mexico's low business costs. The state has still not reached pre-recession levels of employment as a result of slow growth. IHS Markit is forecasting 1.1% state employment growth in 2017 and 1.0% in 2018, compared nationally with 1.5% and 1.2%, respectively. State per capita income is also below average at 78% of the nation.

New Mexico population growth trends were above the U.S. until 2011. In 2014 and 2015 the state's population experienced negative trends, but increased a slight 0.03% in 2016, to 2.08 million, compared with 0.70% growth nationally. It grew 6.0% between 2006 and 2016 compared with 6.3% for the U.S. The proportion of the population of nonworking age is also somewhat high at 66.1% in 2016 compared with that of the nation at 60.7%. Prolonged declines in oil and gas prices could continue to depress the state's energy sector and revenue to the general fund. Although direct employment in the mining sector comprises a relatively small 2.4% of state employment, it represents a larger share of employment than the 0.5% national figure.

Weakness in oil and gas-related revenue led to extended budget wrangling this year, requiring a special legislative session after the governor vetoed tax increases and a substantial portion of state spending. The final enacted budget, signed before the start of the 2018 fiscal year, is based on a December 2016 revenue forecast, which the state now believes to be overly conservative due to a recent rise in revenue collection, which, in part reflects a modest improvement in oil and gas production.

The enacted fiscal 2018 state budget anticipates a \$132 million drawdown in state reserves, or 2.2% of budgeted general fund recurring appropriations. This would leave the state with reserves of \$178.3 million, or what we see as an adequate 2.9% of continuing appropriations on a budgetary basis of accounting, but a substantial decline from a year-end reserve equal to 11.6% of recurring appropriations as recently as fiscal 2015. Until fiscal 2016, the state had generally targeted reserve levels near 10%. The state believes the next updated revenue forecast in August 2017 is likely to result in improved fiscal 2018 forecast revenues that would carry forward into improved reserves in 2018. The state believes the updated August forecast will likely reduce the December forecast \$48/barrel of oil assumption incorporated in the budget, but the lost revenue would be more than offset by increased volume. New Mexico oil prices typically run about 10% below Texas benchmark levels due to higher transportation costs.

We believe the volatility of oil and gas prices and production makes accurate revenue forecasting difficult. Energy price declines contributed to a drawdown in general fund reserves to 2.4% of recurring appropriations at the end of fiscal 2016. New Mexico initially enacted a fiscal 2017 budget assuming fiscal year-end reserves equal to 9.6% of recurring appropriations, but a subsequent revenue downturn necessitated a September 2016 special legislative session that implemented substantial one-time budget-balancing items, which still left the state with forecast year-end reserves of only 1.0%. After the collecting improved revenue through April, the state now estimates fiscal 2017 ended with 5.1% reserves, but this incorporates \$532 million of one-time general fund budget-balancing items, or a substantial 8.7% of fiscal 2017 recurring appropriations.

Declines against budgeted levels have been attributed to federal mineral leasing and the state's gross receipts tax (GRT). The state department of finance and administration (DFA) estimated after adoption of the original fiscal 2017 budget that revenue directly related to oil and gas production was projected to be about 12.5% of general fund revenue. (For more information on state oil and gas production, please refer to the full analysis on New Mexico's severance tax bonds, published July 11, 2017, on RatingsDirect.)

Additional budgetary considerations include an ongoing lawsuit on the adequacy of school funding that could potentially require the state to contribute significantly more to education in future years.

The state has enacted a statute that directed excess oil and gas revenue above a five-year average to a budget stabilization reserve, beginning in fiscal 2020. Use of the stabilization reserve, unless changed by succeeding statute, would require a two-thirds legislative supermajority. We believe such a reserve, when fully funded and added to during good economic times, may add some stability to the state's revenue flexibility, but at this point it is too early to gauge the state's discipline regarding its use from a credit perspective.

On a generally accepted auditing principles (GAAP) basis, the state's 2016 comprehensive annual financial report (CAFR) shows a total general fund balance of \$1.1 billion, or 7.5% of general fund expenditures and net transfers after a \$175 million restatement of beginning fund balance, down from 14.1% the year before without restatement. The available assigned and unassigned general fund balance in 2016 was negative \$120 million, or negative 0.8%, down from 1.5% of combined expenditures and net transfers before restatement.

Of note is a financial audit opinion disclaimer relating to inconsistent recognition of interagency transactions in the state's fiscal 2016 CAFR. The state had similar auditor findings in fiscal years 2014 and 2015. The 2016 CAFR for the fiscal year ended June 30, 2016, was released in July 2017, which we view as delayed. New Mexico attributes the delay to statute, which requires a financial and compliance audit to be performed on every agency; CAFR production commences after completion of these audits, which are due at the end of the calendar year.

Constitutional provisions funnel certain oil and gas receipts into the state's permanent funds and somewhat help insulate the general fund from falling energy prices. New Mexico uses annual receipts from an oil and gas severance tax for capital and severance bond debt service expenditures and deposits surplus severance tax revenue into the severance tax permanent fund (STPF). The state also deposits mineral production royalties, leases, and land sale proceeds into the land grant permanent fund (LGPF). Distributions from each of the permanent funds to the general fund are constitutionally limited to 4.7% and 5.0%, respectively. Investment income from the funds in the past couple of years has been sufficient to cover these distributions. Distributions to the general fund of interest earnings from the state's two permanent funds contributed a combined 13% of fiscal 2016 general fund revenue, which we view as helping to provide revenue stability. At fiscal year-end 2016, the market value of the STPF was \$4.5 billion and of the LGPF \$14.6 billion.

S&P Global Ratings 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.

The state's total tax-supported debt outstanding in fiscal 2016—including GO, severance tax, gas tax bonds for the department of transportation, 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 \$1,350 per capita and 3.5% of personal income. We calculate that this new GO debt and \$80 million of severance tax debt selling at about the same time would add about \$114 of debt per capita. Amortization of principal on all governmental tax-supported debt, including transportation debt, appropriation-secured debt, and state loans in NMFA's public project revolving fund, is rapid with about 93% of total tax-backed debt principal retired within 10 years. We believe the state's debt burden will remain relatively stable given limited GO and severance tax debt issuance plans and rapid amortization. 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.

Pursuant to its debt policy, the state amortizes all GO debt and severance tax debt over what we view as a very rapid 10 years.

In fiscal 2016, we calculate the state's share of the combined net pension liability for all its pension plans at \$5.5 billion. Unfunded pension liabilities equaled \$2,636 per capita and 6.8% of personal income, levels we consider high. New Mexico's annual pension contributions are set by statute, which do not necessarily match actuarial requirements. The state's 2016 actuarial report of its main pension plan, the Public Employees Retirement Association (PERA) calculated that the state funding formula would be sufficient to amortize the unfunded liability over 56 years, using a 7.25% assumed rate of return for the first 10 years and a 7.75% rate thereafter, for an equivalent blended rate of 7.48%. At fiscal year-end 2016, the combined pension funded ratio was 65.4% on a Governmental Accounting Standards Board (GASB) accounting basis, down from 70.6% the year before, in part because of the lower assumed rate of return. The three-year average was 70%, which we consider low. Annual pension contributions have typically been below plan service, interest, and amortization costs. We consider the state's \$3.8 billion unfunded other postemployment benefit (OPEB) liabilities to be moderate at about \$1,828 per capita. An OPEB trust fund held \$464.5 million of assets as of June 30, 2016. The fiscal 2015 OPEB actuarially annual required contribution was about \$304 million, of which 53% was funded. However, recent budget adjustments will reduce fiscal 2017 contributions to the OPEB trust fund.

Under our State Ratings Methodology, we have assigned New Mexico a total score of '2.0' on a four-point scale whereby '1.0' is the strongest and '4.0' is the weakest.

Outlook

The negative outlook reflects the state's structural imbalance in fiscal 2017, its budgeted small structural imbalance in fiscal 2018, and its budgeted 2.9% year-end reserve for fiscal year-end 2018, which we believe may be small relative to the state's recent revenue swings. Although our rating anticipates that New Mexico will adjust its budget to maintain structural balance, as it has done historically, the negative outlook reflects the possibility the rating could be further pressured if continued slow economic growth, declining energy prices, and cost pressures significantly reduced revenue during the remaining year of our two-year outlook horizon. Factors that could lead to a downgrade include revenue decline significantly larger than forecast, without timely budget adjustment, reliance on significant one-time or uncertain revenue sources, or if pension funding requirements significantly increased and materially added to fixed cost pressure. If revenues fall and the state has difficulty responding in a structurally balanced manner, we could lower our GO rating. However, if the state's revenue continues to brighten along recent monthly trends, and the state ends fiscal 2018 with near-structural balance and good reserves near fiscal year-end 2017 levels, as the state believes is likely, we could revise our outlook to stable.

Governmental Framework

In our view, New Mexico's strong government framework 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.

The state interprets Article IX, section 7, of the New Mexico Constitution, which prohibits the state from borrowing more than \$200,000 to cover a shortfall in revenue compared with necessary expenses, as a requirement that New Mexico 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.

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 require 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 in our opinion.

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 implemented tax cuts on certain business inputs in the previous few years to reduce heavy sales tax burdens (and eliminate so-called pyramiding); however, the state has also demonstrated its willingness to increase revenue as evidenced by slight revenue enhancements in the September 2016 special legislative session for fiscal 2017, and in fiscal 2011 when it raised the statewide GRT and cigarette tax rates and eliminated a state income tax deduction to generate additional revenue, although legislatively proposed tax increases in fiscal 2018 were successfully vetoed by the governor. 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.

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

New Mexico's financial management practices are considered "good" under S&P Global Ratings' FMA methodology, indicating practices exist in most areas, although not all might be formalized or regularly monitored by governance officials.

The consensus revenue forecasting group, representing economists from both the executive and legislative branches, uses independent economic forecasts from various sources, including among others, IHS Global Insight and the University of New Mexico, as well as oil and gas estimates from industry experts to produce a consensus revenue forecast two to four times a year. The executive conducts monthly reviews of finances throughout the year to track actual budget performance against projections, but it must make broad budget appropriation amendments in cooperation with the state legislature. 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 strong statutory additional bonds coverage tests for severance tax bonds, the board of finance and the DFA 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, although the executive does not have the autonomy to unilaterally reduce expenditures without legislative input. Between fiscal years 2004 and 2008, operating surpluses due to revenue growth were used for nonrecurring capital outlay and building budgetary reserves to strong levels. During the last recession, the state demonstrated willingness to make timely cuts to its budget, including reducing public and higher education spending and cancelling certain cash-funded capital outlay appropriations from previous surplus years, which enabled transfer of unspent balances from other funds as well as reserves to help meet its budget gaps. Deficits were not carried forward and budget solutions included recurring 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 and legislative sessions are relatively short, ranging from 30 to 60 days depending on the year. Despite these limitations, the state demonstrated timely midyear budget adjustments to maintain balance in the September 2016 special legislative session, when the state made substantial appropriation reductions, and in October 2009 when the executive called a legislative special session 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. Subsequent budgets passed by the legislature have allowed the governor to implement midyear cuts, but the governor has vetoed this provision in favor, as we understand it, of calling a special legislative session when needed, as opposed to using across the board cuts. The consensus revenue forecasting group typically prepares revenue forecasts two to four times a year: with regular releases in December (before the January legislative session) and August, and if warranted during mid-session in January or February and rarely in September or 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 '2.0' to New Mexico's financial management framework, on a scale where '1.0' is the strongest score and '4.0' is the weakest.

Economy

Although state population growth has been historically strong compared with that of the nation, a lagged recovery and

federal sequestration have contributed to slower state annual population growth than the nation since 2011, with growth of only 0.03% in 2016 and declines of 0.1% in both 2014 and 2015, resulting in a state population of 2.08 million. From 2006-2016 state population increased overall 6.0%, compared with 6.3% for the U.S. New Mexico's age dependency ratio (which measures working-age population to total population) was 66.1% in 2015, a large 5.4 percentage points above that of the U.S., reflecting a growing retiree population attracted to the state's moderate climate and low cost of living.

New Mexico's economy has historically been based on agriculture, mineral production, and government, although other important industries include high-tech manufacturing, tourism (particularly Native American-owned casinos), and call-center businesses are present. New Mexico hosts Intel in Rio Rancho and various other high-technology manufacturers around the national labs. The area around Farmington is heavy in gas production with traditional vertical drilling and the southeastern part of the state encompasses oil drilling in the Permian Basin. Governmental sector employment was 23.0% of state employment in 2016 compared with 15.7% nationally; and a smaller proportion in manufacturing, 3.2% compared with 8.5% nationally. Reflecting the state's energy sector, mining and logging employment represents 2.4% of jobs in the state, down from 3.4% in 2014, compared with 0.5% for the nation in 2016. The state's professional and business services sector (12.2% of employment) includes jobs at the national laboratories. Although the large share of governmental employment has previously created a buffer against sharp cyclical downturns, slow federal budget growth has slowed the state's economic recovery since the recession. New Mexico has a sizable military presence with three air force bases and a missile range, as well as two national laboratories and the state could be vulnerable to cutbacks in defense spending.

The state's personal income per capita in 2016 represents only 78% of that of the nation, and although it has declined since 2008 when it was 83% of the nation during boom energy times, it is currently more in line with years previous to that period. IHS Markit forecasts annual personal income growth ranging from 3.7%-5.5% between 2017 and 2020, and gross state product (GSP) growth below that of the nation from 2017-2020. GSP per capita of \$44,832 in 2016 was 78% of the national level. In 2016, GSP growth was well below the nation's, likely reflecting the oil and gas slowdown, after a period of below-average state growth. The state's unemployment rate in 2016 was 6.7%, above the national rate of 4.9%.

New Mexico'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. We believe that relatively low taxes, recent changes to the tax structure, good transportation infrastructure, and affordable costs, as well as the spin-off of scientific research from the Sandia and Los Alamos national labs, contribute to a favorable climate for business growth.

We have assigned a score of '2.8' to New Mexico's economy, on a scale where '1.0' is the strongest score and '4.0' is the weakest.

Budgetary Performance

The state does not have a formal reserve target, but historically had an informal budget target of at least a 10% budgetary basis general fund reserve level as a percent of recurring general fund appropriations at the time a budget is

enacted. Also, on an informal basis, New Mexico historically considered a projection of a 5% or lower fiscal year-end reserve at the close of a current fiscal year to be the basis for considering midyear budgetary actions to maintain a reserve of at least 5%, which it met in fiscal years 2001-2015 on a budgetary basis of accounting. State officials originally budgeted for \$490.9 million in general fund reserves at fiscal year-end 2016, or 7.9% of recurring appropriations, but final budgetary reserves were \$147.8 million, or 2.4% of recurring appropriations. The original fiscal 2017 budget projected a \$595.4 million fiscal year-end balance, or 9.6% of recurring appropriations, but declining revenues caused the state to convene a special legislative session, after which it forecast a 1.0% reserve. Incorporating a recent uptick in monthly revenue through April, New Mexico now anticipates a \$310.8 million general fund reserve at fiscal end 2017 (5.1% of recurring appropriations), including \$532 million of one-time budget items. It is budgeting a \$132 million drawdown in reserves in fiscal 2018, to bring them to \$178.3 million, or 2.9%. New Mexico considers it likely that revenue projections will be revised in August so as to eliminate the need to dip into the reserve in fiscal 2018.

Although there are not legal minimum reserve levels, statutes do limit some general fund reserves to certain maximum levels.

The governor's budget recommendations and enacted budgets use revenue estimates from a consensus forecast. New Mexico semiannually generates five-year revenue forecasts based on consensus forecasting among economists for several state agencies, including the legislative finance committee; the DFA; the department of transportation; and the department of taxation and revenue. The group meets up to four times a year to update revenue forecasts for the general fund. 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.

The state's audited CAFRs for fiscal years 2013, 2014, 2015, and 2016 received disclaimed audit opinions pertaining to inconsistency in applying accounting policy between various state entities, making the consolidation of governmental funds reporting difficult. We understand the state has an ability to interfund borrow across one consolidated cash pool within the fiscal year, which has provided sufficient liquidity for operations, and New Mexico has not issued external cash flow notes for liquidity since 2010. The state reports \$1.1 billion of general fund cash and investments at fiscal year-end 2016, or 7.5% of general fund expenditures and net transfers on a GAAP basis. Providing additional liquidity is a tax suspense fund from which New Mexico can borrow up to 50% of pooled cash collected for local governments in the state and held 55 days before it is distributed.

We believe New Mexico's revenue structure is diverse. We calculate state sales tax for fiscal 2016 accounted for 35% of general fund revenue on a budgetary basis, while personal income taxes represented 23%, and mineral production-related taxes were 5%. The state's general fund cost structure is driven by public education, which comprises 42% of fiscal 2016 general fund recurring appropriations; Medicaid (15%); other health, hospitals, and human services (12%); and higher education (14%). The original enacted 2017 budget gave small increases in Medicaid and education funding, but had a slight reduction in overall appropriations after cuts in state agency funding. Medicaid spending has been increasing due to rising health care costs and growing enrollments, although the state's expansion of Medicaid under the federal Affordable Care Act has lowered Medicaid costs to the general fund in the past couple of years.

In our view, New Mexico budgets typically target structural balance as they are focused on matching recurring revenues to recurring appropriations, although potential revenue shortfalls during the current fiscal year could bring down general fund balances. New Mexico has also adjusted its budget on a timely basis when necessary, such as the midyear cuts in the 2016 special legislative session, and significant midyear adjustments made in fiscal 2017. The state last increased GRT and cigarette tax rates and changed income tax deductions to bring in more revenue in fiscal 2011. In that same fiscal year, pension contribution costs were shifted to employees and appropriations were reduced by 3.2% across the board to restore structural balance.

After some delay, the state released its audited fiscal 2016 CAFR in July 2017, following release of the 2013 CAFR in November 2014, and the 2014 and 2015 CAFRs in July of the following year. The independent auditor did not express an opinion on the financial statement or the state's position overall due to several findings of material weakness in New Mexico's accounting processes and internal controls. Material weaknesses cited included specific accounting policies and procedures leading to inconsistent recognition of interagency transactions. In 2016, the previous fiscal 2015 governmental activities net position was restated across governmentwide funds by negative \$34 million, and total governmental funds by negative \$160 million.

We have assigned a score of '2.0' to New Mexico's budgetary performance, on a scale where '1.0' is the strongest score and '4.0' is the weakest.

Debt And Liability Profile

We believe New Mexico's debt levels are moderate, with a rapid debt amortization, the result of state policy to issue GO and severance tax debt with no longer than a 10-year maturity. However, we consider the state's unfunded pension liabilities high.

We calculate the state's tax-supported debt burden as moderate. Tax-supported debt at the end of fiscal 2016—including GO debt, appropriation debt, transportation revenue debt, and other tax-supported loans in the NMFA public project revolving fund secured by various taxes and fees—totaled about \$2.8 billion. This produces tax-supported debt per capita of \$1,350 and 3.5% of state personal income, which we consider moderate. We also view the debt service carrying charge of 4.1% of state governmental funds expenditures when excluding federal revenue as moderate. We calculate rapid amortization of all tax-supported debt, with 93% of principal retired in 10 years.

Under the New Mexico Constitution, GO debt is limited to 1% of assessed value and additional GO debt is subject to electorate approval. 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 STPF, which generates interest income for the general fund. 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 do not show up in the state's year-end 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. The authority has entered into interest-rate swap contracts with various counterparties to offset its exposure to

variable-rate fluctuations. New Mexico also has loans outstanding with the NMFA's public project revolving fund and secured by various taxes and fees, including state governmental GRT and cigarette tax revenue.

Legislation implementing pension reform in 2011 lowered the unfunded liability and slightly improved funded ratios. In fiscal 2016, the state portion of the combined state retirement systems' net pension liability was \$5.5 billion, up from \$4.3 billion following a lowered 7.48% blended assumed rate of investment return. New Mexico's unfunded pension liability per capita was \$2,636 per capita and 6.8% of personal income, levels we consider high. We calculate that the combined actuarial funded ratio for the state's five pension funds based on GASB Statement 67 and 68 GAAP standards, including PERA, Education Retirement Board (ERB), and the Judicial, Magistrate, and Volunteer Firefighter Fund, was 65.4% in 2016, and the three-year average was 70%, levels we consider relatively low. The state used a 7.75% assumed rate of investment return for its 2015 actuarial calculations, which we consider somewhat high, but moved to a blended return assumption in 2016. The state assumes a 7.25% assumed return for 10 years, and a 7.75% earnings assumption for later years, producing a blended 7.48% rate of return assumption. The state beat its assumed rate of return for the five years through fiscal 2015, but we calculate it fell below its new blended return assumption in the five-year average ending in fiscal 2016 with an actual five-year rate of return of 6.18%, based on lower investment returns in fiscal 2016.

The state uses a statutory retirement system funding formula that does not necessarily match actuarial requirements or amortization of unfunded liabilities. New Mexico's 2016 actuarial valuation calculated that the state funding formula would fully amortize its unfunded PERA liability in a long, in our opinion, 56 years, based on a 7.48% rate of return, and 45 years for the ERB.

PERA's active to inactive participant ratio of 1.38 is not significantly worse than industry means, in our opinion, while ERB's ratio is 1.31. We believe that PERA's actuarial valuation mortality tables do not use the most recent generational studies, and could raise liabilities if updated.

Unfunded OPEB for retiree health care as of fiscal year-end 2016 was \$3.8 billion, or about \$1,828 per capita, a level we consider moderate. There is an OPEB trust fund with \$464.5 million as of June 30, 2016. In fiscal 2016, the state funded only 53% of its actuarial annually required OPEB contribution. OPEB contributions are expected to be reduced in fiscal 2017 and beyond as part of the state's recent budget closing actions.

On a scale where '1.0' is the strongest score and '4.0' is the weakest, we have assigned a score of '2.4' 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 New Mexico's 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 acres and 13 million subsurface acres of land, which earns income from mineral production royalties, leases, and sale proceeds; all land trust income is deposited into the state's LGPF. The LGPF had a net asset value of \$14.7 billion as of June 30, 2016. 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 current distribution rate is 5.0% in fiscal 2017, which includes 0.5% for educational reforms and assumes the fund has at least \$5.8 billion in previous five-year average market value. If market value falls below that level, the distribution rate would be 5.0%. The distribution rate also returns to 5.0% after fiscal 2016. In November 2014, the voters approved a measure that requires at least \$10 billion in the LGPF's previous five-year average market value to maintain the higher 5.5% distribution rate through fiscal 2016. The amendment also allows the state investment council to invest more than 15% of the LGPF in international securities and to the LGPF in accordance with its standard for managing other funds. Legislative proposals in recent years to increase the distribution to 7% for early childhood education programs have not passed to date.

New Mexico Constitution requires the state to deposit severance tax receipts related to natural gas and oil production into the severance tax bonding fund, effectively serving as a dedicated source for funding state capital projects. Remaining deposits are then transferred to the STPF 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, the net asset value of the STPF as of June 30, 2016, was \$4.6 billion. However, legislation passed in 2015 has reduced the amount that can be used for debt service, thereby increasing inflows to the permanent fund. 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.

New Mexico GAAP Financial Data

(Mil. \$)	--Fiscal year-end June 30--					
	2016	2015	2014	2013	2012	2011
General fund (GAAP basis)						
General fund revenues	14,032	13,528	12,467	5,903	5,056	5,528
General fund expenditures	14,419	13,255	11,855	1,249	1,235	1,097
Net transfers and other adjustments	(213)	(40)	(421)	(4,686)	(4,526)	(4,198)
Net operating surplus (deficit)	(601)	233	612	(31)	196	233
Restatement of fund balances	(175)	N/A	N/A	N/A	N/A	N/A
Total general fund balance	1,094	1,870	1,776	867	816	621
Unassigned general fund balance	(120)	190	626	770	605	311
Available assigned plus unassigned balance	(110)	206	636	770	605	318
Available balance/general fund expenditures and net transfers (%)	(0.8)	1.5	5.2	13.0	10.5	6.0
Total general fund balance/general fund expenditures and net transfers (%)	7.5	14.1	14.5	14.6	14.2	11.7
Net operating surplus (deficit)/general fund expenditures and net transfers (%)	(4.1)	1.8	5.0	(0.5)	3.4	4.4

N/A--Not applicable.

Ratings Detail (As Of July 12, 2017)

New Mexico GO		
Long Term Rating	AA/Negative	Affirmed

Ratings Detail (As Of July 12, 2017) (cont.)

Grant Cnty, New Mexico

New Mexico

Grant Cnty (New Mexico) lease approp (Ft. Bayard Proj) ser 2008 (ASSURED GTY) (SEC MKT)

<i>Unenhanced Rating</i>	AA-(SPUR)/Negative	Affirmed
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Grant Cnty (New Mexico) APPROP

<i>Long Term Rating</i>	AA-/Negative	Affirmed
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Many issues are enhanced by bond insurance.

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