

New Mexico; Appropriations; General Obligation

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Credit Profile

New Mexico GO

Long Term Rating

AA/Stable

Outlook Revised

Rationale

S&P Global Ratings has revised its outlook on the State of New Mexico's general obligation (GO) bonds outstanding to stable from negative and affirmed its 'AA' rating on the bonds. At the same time, S&P Global Ratings has revised its outlook on the state's annual appropriation-secured debt to stable from negative and affirmed its 'AA-' rating on the debt.

The outlook revision reflects New Mexico's return to structural balance following a significant increase in oil and gas production. The state projects general fund reserves to rise to 34% of recurring appropriations at fiscal year-end 2019 on a budgetary basis, up from 18% at fiscal year-end 2018, and 8% at fiscal year-end 2017. In contrast, after a 2017 special legislative budget session, the state legislative finance committee projected that fiscal 2018 would end with only a 0.4% general fund reserve, despite the use of significant one-time budget measures during the most recent oil and gas downturn. While we expect revenue and reserves to continue to fluctuate based on economic activity, we believe New Mexico will be able to build and retain strong reserves during current prosperous times to help cushion against the next downturn.

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

- Economic concentration in the cyclical oil and gas industry, which is experiencing a strong rebound after a severe downturn, as well as larger-than-average dependence on federal employment;
- Cyclical financial performance and reserve levels that have followed recent trends in the oil and gas industry. Despite midyear budget cutting and the use of one-time budget actions during the oil and gas downturn, budgetary reserves have cycled down from what we viewed as strong in fiscal 2015, to low in fiscal 2016, to minimal in 2018 after a 2017 special legislative session, and to very strong levels projected at fiscal year-end 2019;
- Large permanent funds, whose earnings are available for general fund spending, although the funds themselves are restricted; and
- Moderate debt levels with rapid amortization, but extremely slow amortization of high unfunded pension liabilities under a statutory funding formula.

The state's full faith and credit pledge, 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.

New Mexico's economy is characterized by above-average reliance on federal employment, due to federal laboratories and military bases, as well as by significant oil and gas production. The new federal defense bill and a rebound in oil

and gas production bode well for near-term state economic success after a previous period of weakness.

The state 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 New Mexico'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 in part by New Mexico's low business costs. Oil and gas production has also jumped sharply higher recently, sparked by increased fracking activity in the Permian Basin as oil prices rise.

Nevertheless, state employment growth has been slow. IHS Markit forecasts that New Mexico will not reach pre-recession levels of employment until this year. IHS Markit forecasts 1.4% state employment growth in 2018 and 1.2% in 2019, compared with national growth at 1.7% and 1.5%, respectively. State per capita income was also below average at 77% of that of the nation in 2017, down from 78% in 2016, and 83% in 2009. Although state finances fluctuate significantly with oil and gas activity, direct employment in the mining sector comprises a relatively small 2.5% of state employment, albeit higher than the 0.5% national figure.

Similarly, New Mexico population growth trends were above the U.S. until 2011. In 2014 and 2015 the state's population experienced small declines, before a slight 0.15% increase in 2016 and 0.13% in 2017, to 2.09 million, compared with 0.72% national growth in 2017. Overall, state population increased 4.9% from 2007 to 2017, compared with 8.1% for the U.S. The state's age dependency ratio of nonworking population-to-working age population is also somewhat high at 66.6% in 2016 compared with the nation's 61.3%.

New Mexico had typically targeted general fund reserves of about 10% of recurring expenditures. However, a severe downturn in oil and gas activity after oil prices collapsed left state financial reserves well short of original budgeted amounts, even with midyear budget cuts and significant use of one-time fund transfers. Reserves fell from a strong 11.6% of recurring budgetary operating appropriations at fiscal year-end 2015 to what we consider a low 2.4% at fiscal year-end 2016. The state's revised 2018 budget target after a 2017 special legislative budget session was for only a 2.7% reserve at fiscal year-end 2017 and a 0.4% reserve at fiscal year-end 2018, according to state legislative finance committee projections. Since then, New Mexico has revised its consensus revenue forecast to project substantially higher severance tax and mineral royalty revenue, as much as \$914.3 million extra in fiscal 2019 alone, or about 13% of currently projected 2019 revenue. Fiscal 2017 ended with a \$505.1 million reserve, or 8.3% of recurring appropriations, while the state's August 2018 consensus revenue forecast estimates fiscal 2018 will end with a very strong \$1.1 billion in total reserves, or 18.3%, and fiscal 2019 at \$2.2 billion, or an extremely strong 34.2% of recurring appropriations. A component of 2019 total general fund reserves will be a budget stabilization fund holding an amount equal to 23.4% of recurring appropriations. In 2017, New Mexico statutorily dedicated oil and gas emergency school tax revenue in excess of its previous five-year fiscal annual average to the budget stabilization fund, beginning in fiscal 2019. State legislative finance committee economists recently proposed raising the state's targeted reserve level to 20% of recurring appropriations from 10%, following an in-house stress test, and it remains to be seen how this might be incorporated into the next legislative budget session.

Underpinning the reserve volatility are fluctuations in budgetary revenue, including a 7.4% decline in budgetary general fund revenue in fiscal 2016, and a 3.1% decline in recurring revenue in 2017. The 2017 decline was covered in

part by \$575.7 million in nonrecurring revenue, or an amount greater than 2017 ending reserves. Oil and gas production affects the state's gross receipts tax (GRT) as well as severance tax and federal mineral royalty revenue. (For more information on state oil and gas production and severance tax revenue, please refer to our summary analysis of New Mexico's severance tax bonds, published June 11, 2018, on RatingsDirect.) The state's August consensus revenue forecast assumes a crude oil price of \$56 per barrel in fiscal 2019 and natural gas prices of \$3.10 per 1,000 cubic feet, which we consider reasonable (see "S&P Global Ratings Raises 2018 Brent And WTI Oil Price Assumptions And 2019 Brent Price Assumptions," published May 7, 2018). New Mexico oil prices typically run about 10% below Texas benchmark levels due to higher transportation costs.

Additional budgetary considerations include a recent lower court decision that state funding for local schools has been inadequate. The court did not set a specific monetary remedy, and the current administration is likely to appeal the decision. However, the current governor is term limited and one of the two major candidates running to replace her has indicated an intention to drop any pending appeals. At this point, the timing and financial impact on the state's finance is not fully known.

On a generally accepted auditing principles (GAAP) basis, the state's 2017 comprehensive annual financial report (CAFR) shows a total general fund balance of \$1.3 billion, or a good 9.8% of general fund expenditures and net transfers, after a \$46 million restatement of beginning fund balance, up from 7.5% the year before without restatement. However, the available assigned and unassigned general fund balance in 2017 was only \$14 million, or 0.1%.

Of note is a financial audit opinion disclaimer relating to inconsistent recognition of interagency transactions in New Mexico's fiscal 2017 CAFR. The state had similar auditor findings in fiscal years 2014, 2015, and 2016. The CAFR for the fiscal year ended June 30, 2017, was not publicly released until August 2018, 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 11% of fiscal 2017 general fund revenue on a budgetary basis, which we view as helping to provide revenue stability. At fiscal year-end 2017, the STPF had a fund balance of \$4.9 billion and the LGPF had \$16.5 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 2017—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 \$1,245 per capita and 3.2% of personal income. 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 94% of total tax-backed debt principal retired within 10 years. The state has placed a modest \$165 million GO bond question on the upcoming November ballot, but we believe the state's debt burden will remain relatively stable given limited long-term 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 2017, we calculate the state's share of the combined net pension liability for all its pension plans at \$6.0 billion, up from \$5.5 billion the year before. Unfunded pension liabilities equaled \$2,867 per capita and 7.4% of personal income, levels we consider high. New Mexico's annual pension contribution rates are set by statute, which do not necessarily match actuarial requirements. The state's 2017 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 55 years, using a 7.25% assumed rate of return for the next nine years and a 7.75% rate thereafter, for an equivalent blended rate of 7.51%. The Education Retirement Board (ERB) actuarial report calculated that its unfunded liability would be amortized over 125 years with a 7.25% investment rate of return, or a still extremely long 61 years under an alternate projection incorporating an expected decrease in normal costs, reflecting eligibility for a new pension tier and a potential reduction in cost of living adjustments. At fiscal year-end 2017, the combined pension funded ratio was 62.5% on a Governmental Accounting Standards Board (GASB) accounting basis, down from 65.4% the year before. The three-year average was 66%, which we consider low. Annual pension contributions have typically been below plan service, interest, and amortization costs. We consider the state's \$4.5 billion unfunded other postemployment benefit (OPEB) liabilities to be moderate at about \$2,170 per capita. An OPEB trust fund held \$567.3 million of assets as of June 30, 2017. In 2017, combined state employee and employer contributions covered 50.2% of the actuarial annual required OPEB contribution of \$317.5 million.

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 stable outlook reflects the state's return to structural balance, after a period of imbalance because of the downturn in the oil and gas industry. Our rating anticipates that New Mexico will make efforts to restore reserve balances to strong levels during cyclical upturns in order to help ride out inevitable cyclical downturns, as it has done historically. Although not expected during our two-year outlook horizon, factors that could lead to a downward rating adjustment include a revenue decline significantly larger than forecast, so as to depress reserves to minimal levels for an extended period of time, or a budgeted spend down of reserves to sustained minimal levels. Another potential pressure could occur if the state's statutory pension funding formula proves insufficient to keep GASB pension-funded ratios from declining significantly and New Mexico takes no action to short up funding levels, either through changes in the

statutory pension funding formula or benefit levels. An upward rating adjustment would need improved economic metrics, including a more diverse economic base less subject to cyclicity and higher income levels.

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 Markit 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 Department of Finance and Administration (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. From fiscal years 2004 to 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. However, the 2017 special legislative session proved contentious when the governor successfully vetoed revenue enhancements passed by the legislature and fiscal 2018 reserves were projected to come in at minimal levels. As it turned out, substantial improvements in revenue enabled the state to end fiscal 2018 with good reserve levels without a further legislative session. 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 that of the nation since 2011, with growth of only 0.13% in 2017 and declines of 0.1% in both 2014 and 2015, resulting in a state population of 2.09 million. From 2007-2017, state population increased overall 4.9%, compared with 8.1% for the U.S. New Mexico's age dependency ratio (which measures nonworking-age population to working-age population) was 66.6% in 2016, a large 5.3 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 22.5% of state employment in 2017 compared with 15.5% 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 2.5% of jobs in the state, up from 2.4% in 2016, but down from 3.4% in 2014, compared with 0.5% for the nation in 2017. The state's professional and business services sector (12.6% of employment) includes jobs at the national laboratories. Although the large share of governmental employment had previously created a buffer against sharp cyclical downturns, slow federal budget growth following the last recession created a drag on state employment growth. The new defense bill could potentially increase state military related employment. New Mexico has a sizable military presence with three air force bases and a missile range, as well as two national laboratories. Conversely, at some future point the state also could be vulnerable to cutbacks in defense spending.

The state's personal income per capita in 2017 represents only 77% of that of the nation, down from 78% in 2016, and 83% in 2009 during boom energy times; it is currently more in line with years prior to that period. IHS Markit forecasts annual personal income growth ranging from 3.0%-5.1% from 2018 to 2021, and gross state product (GSP) growth below that of the nation from 2018-2021. GSP per capita of \$46,497 in 2017 was 79% of the national level, up from 78% the year before. In 2017, GSP growth remained below the nation's, but showed an increase unlike the small decline in 2016, probably reflecting oil and gas activity. The state's unemployment rate in 2017 was 6.2%, above the national rate of 4.4%.

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.

However, starting in fiscal 2016, New Mexico struggled to have meaningful reserve levels as midyear revenue shortfalls forestalled budgeted increases in reserves. 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 even after midyear adjustments. Another special session ended with a 0.4% reserve projection for fiscal 2018 and only modestly improved reserves for fiscal 2017. Fortunately for the state, improving revenues produced an actual 8.4% general fund reserve position at fiscal year-end 2017 and an estimated 18.3% reserve at fiscal year-end 2018. A recent August 2018 consensus revenue forecast now projects an ending fiscal 2019 reserve of \$2.2 billion, or a very strong 34.2% of recurring appropriations. We expect it reasonable to assume that the next legislative session might budget use of a portion of such a large reserve. However, state legislative finance committee economists have recently recommended raising the state's targeted reserve level to 20% to cover potential future revenue volatility based on an internal budget stress test.

Although there are no legal minimum reserve levels, statutes do limit some general fund reserves to certain maximum levels. However, New Mexico recently put into statute a provision to place oil and gas emergency school tax revenue above five-year averages into the state's budget stabilization fund, beginning in fiscal 2019.

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 to 2017 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. It reported a \$2.338 billion of state general fund investments pool balance as of May 31, 2018, up 36% from the same period the year before. 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 hold for 55 days before it is distributed.

We believe New Mexico's revenue structure is diverse. We calculate state sales tax for fiscal 2017 accounted for 32% of general fund revenue on a budgetary basis, while personal income taxes represented 21% and combined mineral production-related taxes and federal mineral royalties were 12%. 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%).

In our view, New Mexico budgets typically target structural balance as they are focused on matching recurring revenues to recurring appropriations, although this was not the case in fiscal 2017 when substantial one-time fund transfers and sweeps were used. New Mexico has also adjusted its budget on a timely basis when necessary, such as the midyear cuts in the 2016 and 2017 special legislative sessions. 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 publicly released its audited fiscal 2017 CAFR in August 2018, following release of the 2013 CAFR in November 2014, and the 2014, 2015, and 2016 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. A 2017 restatement increased the total governmental fund position by a positive \$145.4 million, including a \$46 million positive restatement of the general fund position.

We have assigned a score of '1.8' 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 2017--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 \$2.6 billion. This produces tax-supported debt per capita of \$1,245 and 3.2% of state personal income, which we consider moderate. We also view

the debt service carrying charge of 5.4% of state governmental funds expenditures when excluding federal revenue as moderate. We calculate rapid amortization of all tax-supported debt, with 94% 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 2013 lowered the unfunded liability and slightly improved funded ratios. In fiscal 2017, New Mexico's portion of the combined state retirement systems' net pension liability was \$6.0 billion, up from \$5.5 billion in 2016, in part due to a lowered 7.25% investment return assumption for the ERB in 2017. New Mexico's unfunded pension liability per capita was \$2,867 per capita and 7.4% 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, ERB, and the Judicial, Magistrate, and Volunteer Firefighter Fund, was 62.5% in 2017, and the three-year average was 66%, levels we consider relatively low. PERA uses a 7.25% rate of return for the next nine years, and a 7.75% earnings assumption for later years, producing a blended 7.51% rate of return assumption in 2017. The state beat its assumed rate of return for the five years through fiscal 2017 with an average 8.7% return, boosted by its 10.6% one-year annual investment return in 2017. ERB uses a 7.25% return assumption for all future years.

The state uses a statutory retirement system funding formula that does not necessarily match actuarial requirements or amortization of unfunded liabilities. New Mexico's 2017 actuarial valuation calculated that the state funding formula would fully amortize its unfunded PERA liability in an extremely long, in our opinion, 55 years, based on a 7.51% rate of return, and 125 years for the ERB following a reduction of its assumed rate of return in 2017 to 7.25%.

PERA's active-to-inactive participant ratio of 1.30 is not significantly worse than industry means, in our opinion, while ERB's ratio is 1.25. 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 2017 was \$4.5 billion, or about \$2,170 per capita, a level we consider moderate. There is an OPEB trust fund with \$567.3 million as of June 30, 2017. In fiscal 2017, the state funded only 50% of its actuarial annually required OPEB contribution. As part of the state's budget-closing actions, OPEB contributions were reduced in fiscal 2017

On a scale where '1.0' is the strongest score and '4.0' is the weakest, we have assigned a score of '2.6' 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 market value of \$16.3 billion as of June 30, 2017. 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 distribution rate was 5.0% in fiscal 2017, which includes 0.5% for educational reforms.

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 market value of the STPF as of June 30, 2017, was \$4.9 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.

Table 1

New Mexico -- GAAP Financial Data*					
(Mil. \$)	--Fiscal year-end June 30--				
	2017	2016	2015	2014	2013
General fund (GAAP basis)					
General fund revenues	13,404	14,032	13,528	12,467	5,903
General fund expenditures	13,882	14,419	13,255	11,855	1,249
Net transfers and other adjustments	635	(213)	(40)	(421)	(4,686)
Net operating surplus (deficit)	157	(601)	233	612	(31)
Restatement of fund balances	46	(175)	N/A	N/A	N/A
Total general fund balance	1,297	1,094	1,870	1,776	867
Unassigned general fund balance	5	(120)	190	626	770
Available assigned plus unassigned balance	14	(110)	206	636	770
Available balance/general fund expenditures and net transfers (%)	0.1	(0.8)	1.5	5.2	13.0
Total general fund balance/general fund expenditures and net transfers (%)	9.8	7.5	14.1	14.5	14.6
Net operating surplus (deficit)/general fund expenditures and net transfers (%)	1.2	(4.1)	1.8	5.0	(0.5)

*2017-2013 comprehensive annual financial reports have disclaimed auditor opinions. N/A--Not applicable.

Table 2

New Mexico -- General Fund Budgetary Basis Results						
(Mil. \$)	2015	2016	2017	2018P	2019E	2020E
Recurring revenue	6,194.7	5,708.8	5,885.4	6,743.2	7,279.4	7,501.3
Non-recurring revenue	41.2	0.1	575.7	65.5	0.0	0.0
Total revenue	6,235.9	5,708.9	6,461.1	6,808.6	7,279.4	7,501.3
Recurring appropriations	6,161.7	6,210.5	6,103.6	6,073.3	6,332.2	N/A
Non-recurring appropriations	113.5	92.8	26.0	122.1	47.8	N/A
Total appropriations	6,275.2	6,303.3	6,129.6	6,200.9	6,380.1	N/A
Net	(39.3)	(594.4)	331.5	607.7	899.3	N/A
Total general fund reserves	713.1	146.1	505.1	1,112.30	2,164.20	N/A
As % of recurring appropriations	11.6	2.4	8.3	18.3	34.2	N/A
Tax stabilization fund (rainy day fund)	147.5	146.1	0	448.9	1,482.7	1,659.9
As % of recurring appropriations	2.4	2.4	0.0	7.4	23.4	N/A

Source: New Mexico Legislative Finance Committee reports. N/A--Not applicable. P--Preliminary. E--Estimated.

Ratings Detail (As Of September 12, 2018)

Grant Cnty, New Mexico

New Mexico

Grant Cnty (New Mexico) APPROP

Long Term Rating

AA-/Stable

Outlook Revised

Grant Cnty (New Mexico) (Ft. Bayard Proj) APPROP (ASSURED GTY) (SEC MKT)

Unenhanced Rating

AA-(SPUR)/Stable

Outlook Revised

Many issues are enhanced by bond insurance.

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