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DEPARTMENT OF FINANCE AND ADMINISTRATION
BOARD OF FINANCE

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DEBT AFFORDABILITY STUDY

DRAFT DATED
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Introduction and Scope

The New Mexico Department of Finance and Administration, in conjunction with the State Board of Finance and its Financial Advisors, has developed this Debt Affordability Study as a management tool for assessing the affordability of projected debt issuance by the State and monitoring the State's debt capacity. The prudent management of capital for investment in critical State infrastructure is essential for the long-term health of the New Mexico economy and for increasing real incomes and the quality of life for New Mexicans. Properly managed, debt is a critical tool for investing in our schools, addressing essential water needs, improving roads and building our economy.

The core State bonding programs that are the focus of this study include general obligation bonds, severance tax bonds and supplemental severance tax bonds issued by the State Board of Finance, and transportation revenue bonds issued by the Department of Transportation through the New Mexico Finance Authority. The Fort Bayard lease appropriation bonds are also included, as will be any future state lease appropriation bonds that may be issued. These bonding programs, along with periodic general fund revenue surpluses, are the primary sources of capital investment funding for the State. The study does not address debt issuance by State higher educational institutions, the Mortgage Finance Authority, debt programs of the New Mexico Finance Authority beyond the NMFA issuance of bonds on behalf of the Department of Transportation, or the regional housing authorities. The study also does not address bonds and other indebtedness issued by political subdivisions of the State to fund public schools and local government infrastructure.

These core State bonding programs have projected capacity of $3.1 billion of new money long-term general obligation and senior severance tax bonds over the next 10 years for State capital projects based upon the policies described herein. This projected available debt capacity for the core State bonding programs would not be funded from, and therefore would not place stress on the State General Fund, and is affordable within currently projected levels of the revenue streams that are dedicated to debt repayment. The key debt ratios are projected to trend downward over time even as the new debt is issued. The regular issuance of affordable levels of long-term debt as contemplated for investment in State economic infrastructure and other critical state facilities is consistent with the State’s strong bond ratings.

The key debt ratios used in this study to assess the state debt burden are debt per capita and debt as a percentage of personal income, which evaluate the ability to pay and provide a basis for comparing levels of debt use across states and with peers. These ratios, along with the level of financial reserves and trends in State revenues and other financial resources, directly impact the State bond ratings, and the State bond ratings directly determine the State’s cost of capital. Understanding the position of the State relative to its peers will allow the State to monitor its financial and debt positions and provide a framework for benchmarking with respect to debt issuance levels, debt capacity, and levels of new investment.

Since 2008, the budgets of state governments across the country have been under pressure as unsustainably high spending levels have been reduced to conform with sharply lower revenues. While the National Bureau of Economic Research has determined that the recession ended in June 2009, and state revenues have begun to recover from recessionary lows, most states' revenues remain below their pre-recession peak. Therefore, attention to debt affordability and trends in core credit factors is perhaps more important now than at any time in recent history. Credit market access and access to capital at low rates requires that the State sustain its high bond ratings. The prudence of the State in the past with respect to judicious use of debt, recent demonstrated ability to rebuild critically important operating reserve balances, and the thoughtful oversight role of the State Board of Finance are important elements in the strong credit position and market access that the State continues to enjoy.

New Mexico's general obligation bond ratings from both Moody's and Standard & Poor's reflect strong credit attributes that include (i) historically strong General Fund reserves, (ii) solid revenue performance, even during periods of national economic weakness, and (iii) rapid debt retirement and moderate debt levels. These credit strengths have been balanced against historically low levels of personal income, the inherent volatility of oil and natural gas-related revenues, a relative lack of economic diversity, and dependence on federal employment.

This year, the Debt Affordability Study includes a discussion of the impact of unfunded pension liabilities on the credit of the State. Consistent with increased public scrutiny on the condition of state and local public employee pension funds, the bond rating agencies are focusing increased attention on the financial pressures and the impact of funding these significant liabilities with limited governmental resources. Moody's Investors Services has begun the process of incorporating pension fund liabilities into their credit analysis. We have addressed their methodology and provided a preliminary peer comparison of how the State debt position compares to its peer-rated states utilizing Moody's proposed adjustments to include net pension liabilities.

Consistent with recommendations made in previous years in the context of the annual Debt Affordability Study, the State continues to take important steps to improve management practices that underpin the quality of its bond ratings. Over the past two years, the Martinez administration has been successful in stabilizing and rebuilding the State's operating reserve funds to healthy levels. The State's determination to restore its reserve balances toward historical levels is a critically important credit factor.

Debt capacity for core state infrastructure investment is a limited and scarce resource. State decision makers in the Executive Branch and in the Legislature require solid information to understand the alternative sources of debt financing for State purposes, and the implications and opportunity costs of decisions regarding the use of scarce debt resources. This Debt Affordability Study will enable the State to structure its future use of debt in a manner that is consistent with preferred debt policies and cognizant of existing and future resource constraints. It will provide a comparison of the State's debt position to relevant industry standards and assess the impact of new debt issuances on the State's debt position.

This Debt Affordability Study will also provide a tool for evaluating the effect of existing and new debt programs on the State credit position. Debt and debt management is one of the four critical factors assessed in the determination of the State bond ratings, along with economic and demographic factors, financial performance, and management. The study will assist in guiding the development of debt management policies as well as policies regarding the use of other financial products to manage the State's financial position and prospects over time.

Core State Bonding Programs

The core State bonding programs that are the focus of this study include general obligation bonds, severance tax bonds and supplemental severance tax bonds issued by the State Board of Finance, and transportation revenue bonds issued by the Department of Transportation through the New Mexico Finance Authority. The State general obligation bonds are secured by the full faith and credit pledge of the State, and are repaid from a dedicated *ad valorem* statewide property tax. The severance and supplemental severance tax bonds are secured by and repaid from revenues deposited into the Severance Tax Bonding Fund, which primarily include taxes on mineral production in the state. The transportation revenue bond program is secured by a pledge of revenues received into the State Road Fund, which are principally derived from gasoline taxes, registration fees and road user fees, plus an additional pledge of certain federal revenues received annually by the Department of Transportation.

Over the last five years, $2.42 billion of capital funding was derived from the core State bonding programs, which include General Obligation Bonds, Severance Tax Bonds, Supplemental Severance Tax Bonds and Transportation Revenue Bonds.

In September 2008, the State issued its first lease appropriation bonds under a constitutional amendment approved by the voters in 2006, which allows for the State to utilize lease purchase financing for buildings and real property. These bonds were issued to fund the Fort Bayard Medical Center. In conjunction with the issuance of these bonds, the State Board of Finance implemented policies and procedures to integrate lease appropriation financings into the State financial management system. The outstanding lease appropriation bonds are the only core state bonds that are payable from General Fund resources.

The following table sets forth the sources of capital investment funding for the State over the past five years, including the core State bonding programs, the severance tax note program as

Principal Sources of Capital Funding by Fiscal Year
(Millions of dollars)

	2008	2009	2010	2011	2012	Total
General Obligation Bonding Program						
General Obligation Bonds	$0.0	$223.4	$0.0	$19.7	$0.0	$243.1
Subtotal	-	223.4	-	19.7	-	243.1
Severance Tax Bonding Program						
Severance Tax Bonds	$153.6	$0.0	$315.3	$0.0	$121.2	$590.1
Severance Tax Funding Notes	150.9	188.7	178.5	27.3	76.2	621.6
Supplemental Severance Tax Bonds	-	-	112.9	-	-	112.9
Supplemental Severance Tax Funding Notes	222.8	240.8	97.0	206.1	148.7	915.4
Subtotal	527.3	429.5	703.7	233.4	346.1	2,240.1
Other Sources						
General Fund	$123.0	($148.6)	($259.2)	$0.0	$0.0	($284.8)
Transportation Bonds	-	112.3	52.5	-	-	164.8
Lease Appropriation Bonds	-	60.0	-	-	-	60.0
Subtotal	123.0	23.7	(206.7)	-	-	(60.0)
Total	**$650.3**	**$676.6**	**$497.0**	**$253.1**	**$346.1**	**$2,423.1**

Note: Dollar amounts from SBOF bonding programs reflect net proceeds available for capital expenditure.

well as other sources of funding and pay-as-you-go funding from the General Fund. As shown in this table, in 2009 and 2010 the General Fund contribution to capital funding was negative. This reflects the decision to re-appropriate available prior year funds that had been appropriated for capital projects to utilize those funds for current year operating purposes. This decision marked a significant change from prior year practices, when the State appropriated excess general fund revenues, primarily derived from activities related to oil and natural gas production, for direct expenditure for capital purposes.

At the end of fiscal year 2012, the State had $296.9 million of outstanding general obligation bonds and $740.8 million of bonds secured by Severance Taxes Bonding Fund revenues. In addition, the State had $58.9 million of lease appropriation bonds, and $1.6 billion of transportation bonds supported by State Road Fund revenues. The following table sets forth the State tax-supported debt outstanding as of June 30, 2012.

State Debt Outstanding as of June 30, 2012 (millions)	
General Obligation Bonds	$296.89
Severance Tax Bonds	$638.76
Supplemental Severance Tax Bonds	$102.00
Transportation Bonds	$1,635.87
Lease Appropriation	$58.94
	$2,732.46

Review of the State Credit

The State's general obligation bonds are rated *Aaa,* with a "negative" outlook, by Moody's Investors Service ("Moody's") and *AA+,* with a "stable" outlook, by Standard & Poor's Ratings Services ("S&P"). These ratings are the highest ratings offered by Moody's and one notch below the "gilt-edged" triple-A ratings by S&P.

> *New Mexico's general obligation bond ratings are Aaa and AA+ from Moody's and Standard & Poor's, respectively. The negative outlook on the Moody's rating reflects Moody's concern over the high level of federal spending and employment in the State, which could be at risk as the Federal Government addresses its budget issues.*

The ratings on State's bonds represent the assessment by each rating agency of the credit quality of each bond issue, and the State's ability and willingness to repay its debt on a timely basis. Bond ratings directly affect interest rates on State bonds when they are issued. While each series of bonds carries its own credit rates, the general obligation bond rating represents the overall credit rating of the State. In April 2010, Moody's began the recalibration of its municipal bond ratings with the stated objective of "enhancing the comparability of ratings across the Moody's rated universe". The move to a global rating system resulted in an upward shift for 31 state and territory credits, including New Mexico, Indiana, Iowa, Tennessee and Texas advancing to *Aaa*. Moody's cautioned at that time that market participants view the recalibrations not as rating upgrades but as reconfigurations to a different scale.

In July 2011, Moody's changed the outlook on New Mexico's *Aaa* rating from stable to negative. The Moody's action came in response to growing credit concerns regarding the financial pressures facing the federal government, and Moody's view that New Mexico's economic and financial vulnerability to looming cuts in federal funding may ultimately warrant reconsideration of New Mexico's *Aaa* rating.

As it reviews New Mexico's credit against federal risk factors, Moody's analytic focus has been on the following:

- Employment volatility due to U.S. factors;
- Federal employment as a percentage of total state employment;
- Federal procurement contracts as a percentage of state gross domestic product;
- Medicaid as a percentage of total state expenditures;
- Put-able variable rate debt as a percentage of available resources;
- Availability of operating fund balance as a percentage of operating revenue, as an offset to these risk factors.

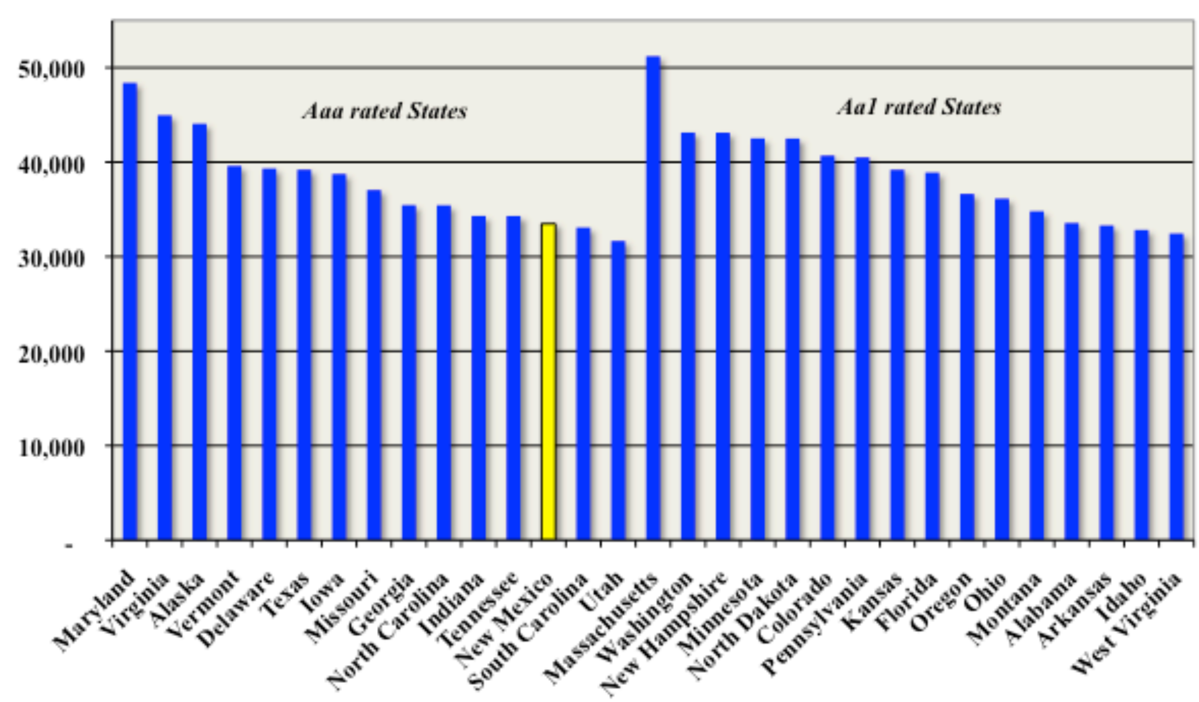
In Moody's assessment of New Mexico against these factors, it concluded that the State's risk exposure is above average with respect to (i) federal employment as a share of total state employment, (ii) above average exposure to put-able variable rate debt (transportation bonds issued by the New Mexico Finance Authority), (iii) above average levels of federal procurement contracts as a percentage of state gross domestic product, and (iv) above average level of Medicaid expenditures as a percentage of total expenditures. Against these negative factors, Moody's noted that the State has historically maintained strong operating fund balances as a percentage of operating revenue.

To date, Moody's has sustained New Mexico's *Aaa* rating. The key credit factors that have supported the State's strong general obligation bond ratings from both Moody's and S&P over the past two decades include (i) strong General Fund reserves, (ii) solid revenue performance, even during periods of national economic weakness, and (iii) rapid debt retirement and moderate, though increasing, debt levels. These credit strengths have been balanced against historically low levels of personal income, the inherent volatility of oil and natural gas-related revenues, a relative lack of economic diversity, and dependence on federal employment. The following table sets forth a comparison of per capita income in New Mexico with other states rated *Aaa* or *Aa1* by Moody's.

New Mexico's strong bond ratings reflect (i) historically strong General Fund reserves, (ii) solid revenue performance, even during periods of national economic weakness, and (iii) rapid debt retirement and moderate, though increasing, debt levels.

New Mexico's per capita income is at the low end of its peer states, reflecting higher poverty factors in the state.

Peer Comparison: Per Capita Income



The rating analysts have historically recommended specific management practices that would strengthen the State credit position, including the development of a debt affordability study as a debt management tool, the implementation of coordinated, multi-year revenue and expenditure planning, and addressing the timeliness of financial reporting. They have also suggested that legislation to mandate minimum reserve levels in the General Fund would provide additional rating strength.

With the implementation of the Statewide Human Resources and Accounting (SHARE) program, and after years of diligent work to improve its performance with respect to financial reporting, the State issued its Comprehensive Annual Financial Report (CAFR) for the fiscal year ending June 30, 2011, in June 2012. The Department of Finance and Administration's Financial Control Division has worked for a number of years to improve the timeliness of financial reporting, and published the CAFR for the fiscal year ending June 30, 2010 in March 2011. Accordingly, it is notable that the most recent CAFR was published in June, or three months later than the prior year. State officials should expect that bond rating analysts will continue to focus on the timeliness of financial reporting and other ongoing issues related to internal financial controls.

Critical to the State bond ratings is continued progress to improve the timeliness of financial reporting and the publication of annual Comprehensive Annual Financial Reports.

The table below sets forth the ratings on outstanding bonds for the core State bonding programs.

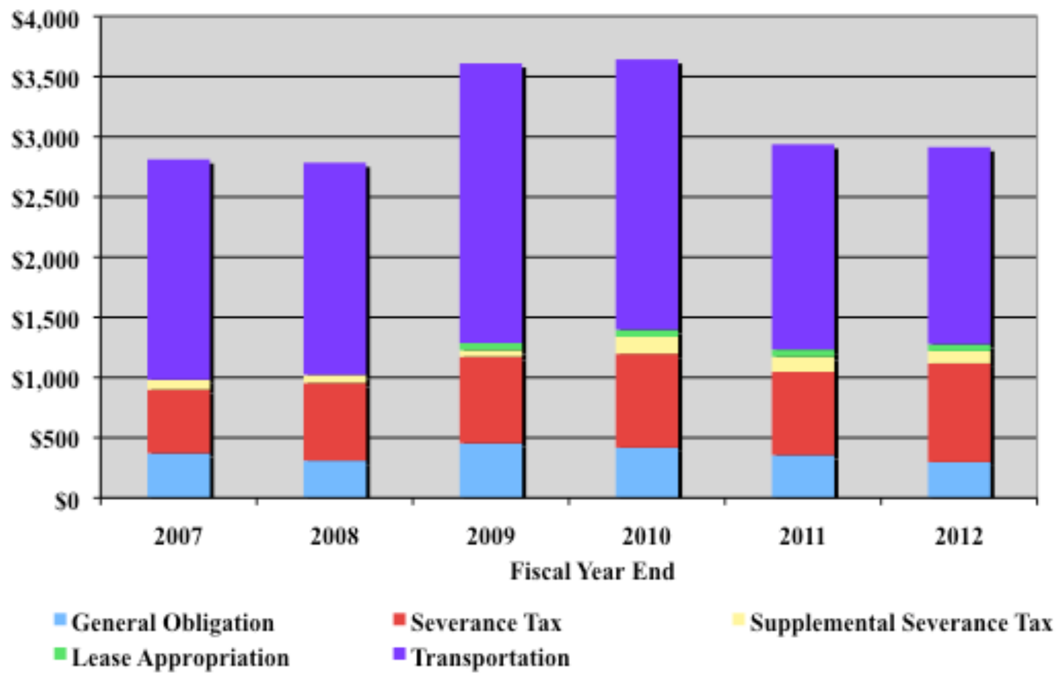
Outstanding State Bond Ratings

	Moody's	Standard & Poors
State Board of Finance		
General Obligation Bonds	Aaa	AA+
Severance Tax Bonds	Aa1	AA
Supplemental Severance Tax Bonds	Aa2	AA-
State Transportation Revenue Bonds		
Senior Lien	Aa1	AA+
Subordinate Lien	Aa2	AA
Adjustible Rate Subordinate Lien	Aaa	AA-
Approved State Lease Appropriation Bonds		
DOH Fort Bayard Project, Grant County	Aa1	AA

Trends in State Debt Issuance

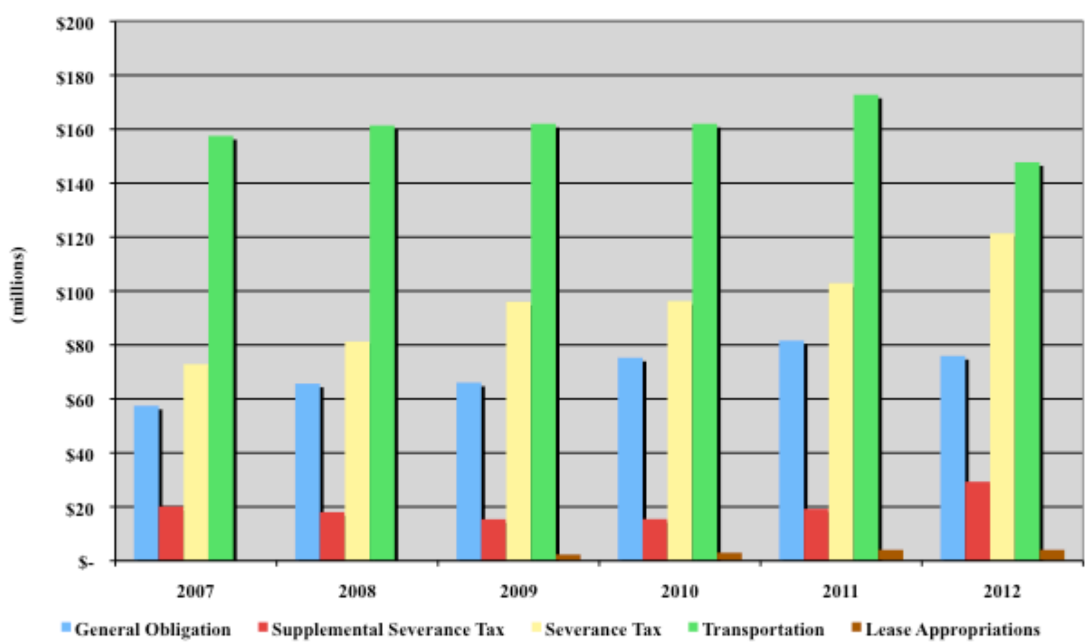
Trends in debt issuance are an integral factor in evaluating the State's debt levels. The State has made and continues to make substantial investment in basic capital infrastructure, particularly in the areas of transportation, educational facilities and water supply. The trends in total outstanding state tax-supported debt are illustrated in the following graph.

Outstanding Tax-Supported Bonds



The State's annual debt service payments have increased over the last five years, rising from approximately $308 million in fiscal year 2007 to approximately $380 million in fiscal year 2012 at an average annual growth rate of approximately 5 percent.

Tax Supported Bond Debt Service 2007-2012



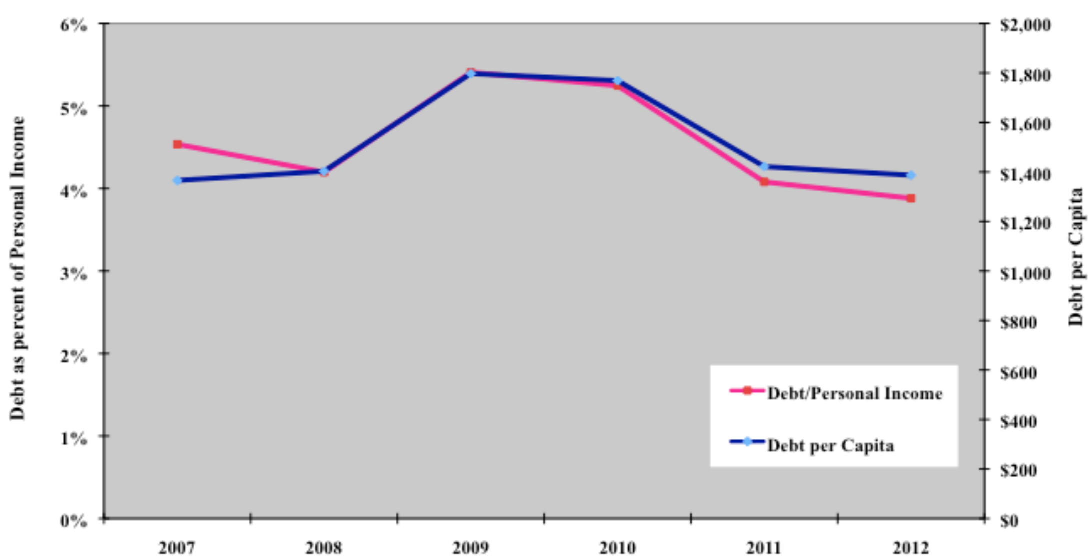
State Debt Ratios

In addition to examining an issuer's total debt position, rating analysts review the issuer's debt ratios and their change over time. The key debt ratios that are evaluated with respect to the credit quality of the State of New Mexico are Net Tax-Supported Debt to Personal Income and Net Tax-Supported Debt per Capita. The debt to personal income ratio provides an indication of the burden a state's indebtedness imposes on the income tax base—the ultimate source of the repayment of state obligations—while debt per capita provides a relative measure of an entity's debt position compared to its peers.

Other credit factors related particularly to the credit quality of general obligation bonds are the amount of outstanding debt as a percentage of the assessed value of the property that will be taxed to pay for the bonds, and the rate of repayment of the bonds. Payment of 25 percent in five years and 50 percent in 10 years is considered average for general obligation issuers nationally. Therefore, the State's issuance of bonds with a final maturity of 10 years is substantially more conservative than the norm. The following graph presents the State's tax-supported debt ratios over the past five years.

State law mandates short debt maturities and rapid debt amortization, both strong, structural debt features that contribute to strong rating and low interest rates.

Key Debt Ratios



As noted above, rating analysts also consider the rate of debt repayment as a credit factor. By law, both State general obligation bonds and bonds issued under the Severance Tax Bonding Program are fully retired within 10 years, and the five-year retirement rates of the State general obligation, severance tax and supplemental severance tax bonds are 81.4 percent, 77.5 percent and 61.6 percent, respectively. With respect to the transportation bonds, the five-year retirement rate is 29.6 percent, while 69.4 percent mature within 10 years. Historically, the State debt management practices have provided for the rapid repayment of bonds, which is generally a positive credit consideration. An opposing view would suggest that the overly rapid bond repayment for the transportation program could be an undue constraint on debt capacity, resulting in the deferral of much needed improvements to the State's transportation infrastructure.

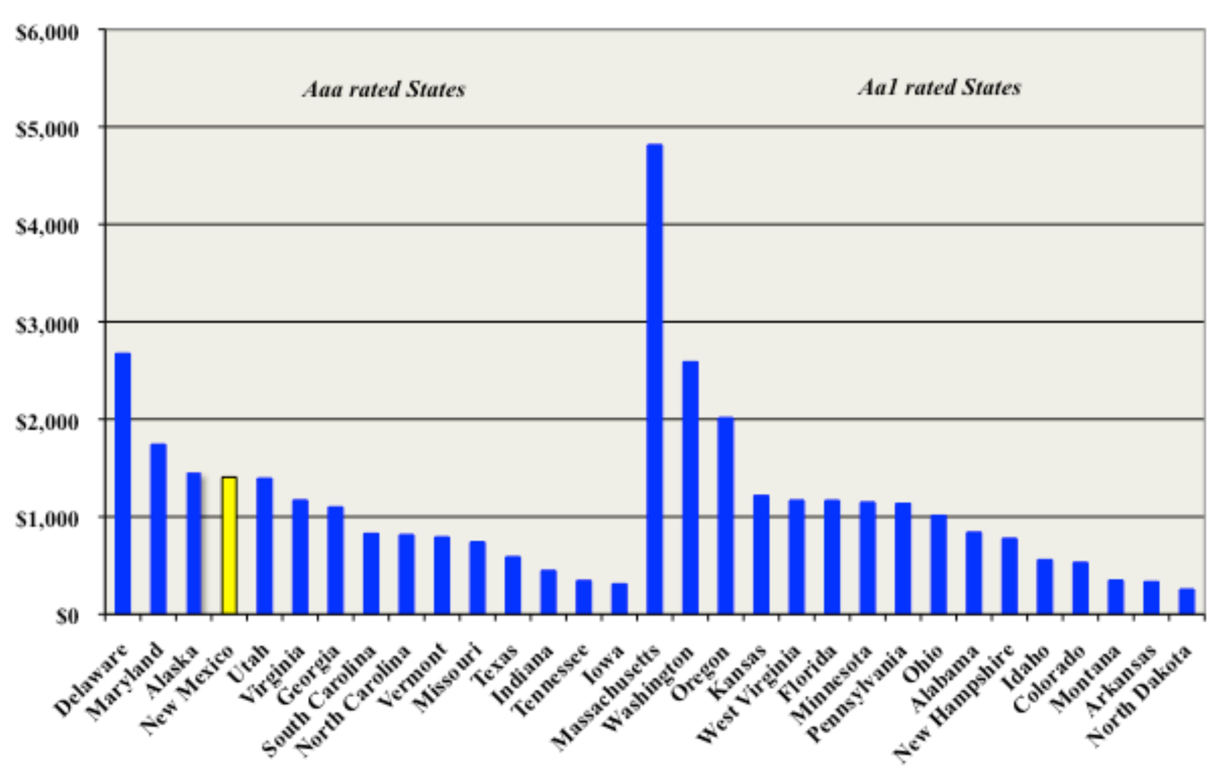
Comparison of Debt Ratios to Selected Peer Group and National Medians

A comparison of key State debt ratios to peer group performance ratios is useful to place the State's debt position in a national context. Both Moody's and S&P publish ratio data on state governments on a regular basis. For the purposes of benchmarking the State's key debt ratios, a comparison with peer states is provided below utilizing data published by Moody's in May 2012. The peer group comprises states that are rated *Aaa* and *Aa1*.

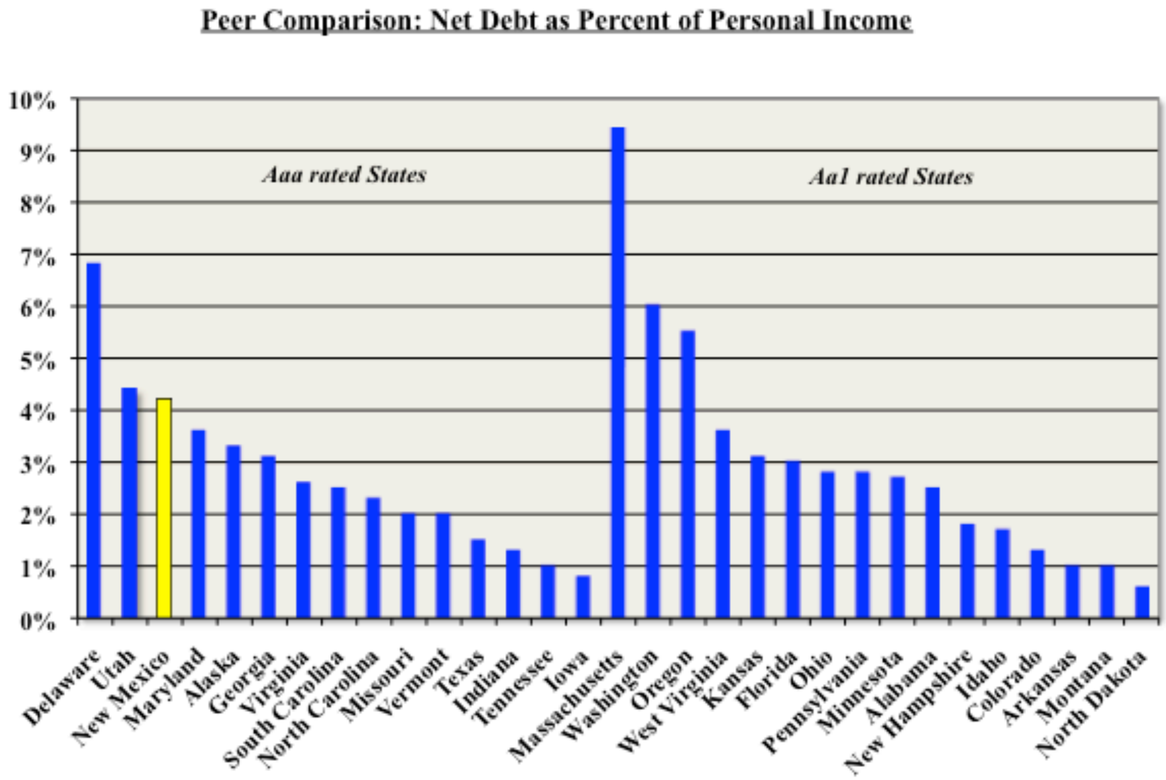
The graph below presents a peer comparison of net debt per capita for states in the two highest rating categories. As is illustrated here, New Mexico has a net debt per capita that is high relative to its peers, exceeded only by Delaware, Maryland and Alaska. New Mexico's high debt per capita is a function of the infrastructure requirements of being one of the largest states in the nation in terms of land area while having a small population base. The large land area combined with the small population base creates disproportionate costs for roads and other infrastructure on a per capita basis relative to its state peers.

Debt ratios are stable, though high compared to peer states relative to both population and personal income, reflecting both the large size of the State relative to population, as well as per capita income.

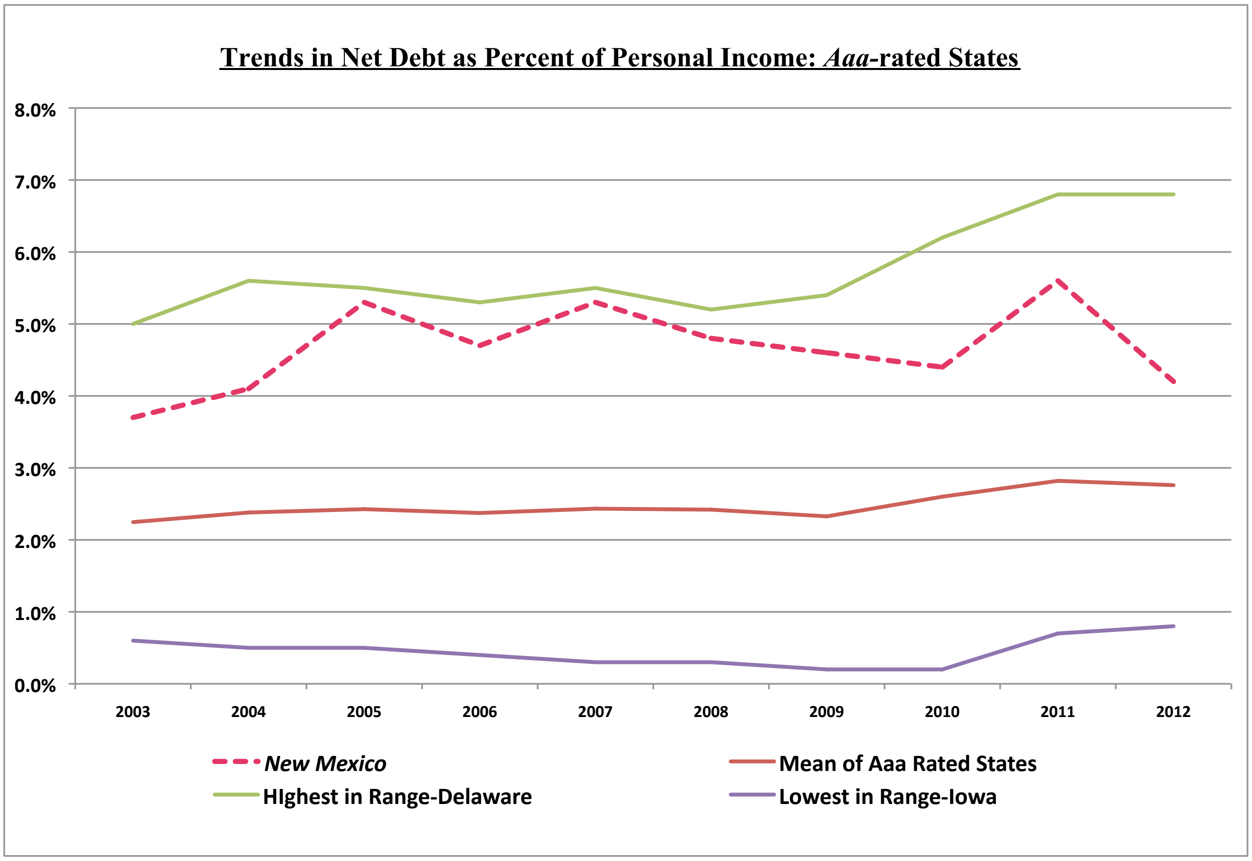
Peer Comparison: Net Debt per Capita



Similarly, the graph below presents the ratio of State net tax-supported debt to personal income in comparison with the same peer group. As illustrated here, New Mexico has a ratio of net tax-supported debt to personal income that again is high relative to its peers.



Finally, the graph on the top of the next page presents the 10-year trend in State debt to personal income and the comparable trends of peer states, based on data provided by Moody's. This graph illustrates the relative stability of State debt over the past decade, and also illustrates the relatively high level of indebtedness relative to the cohort of *Aaa*-rated peer states.



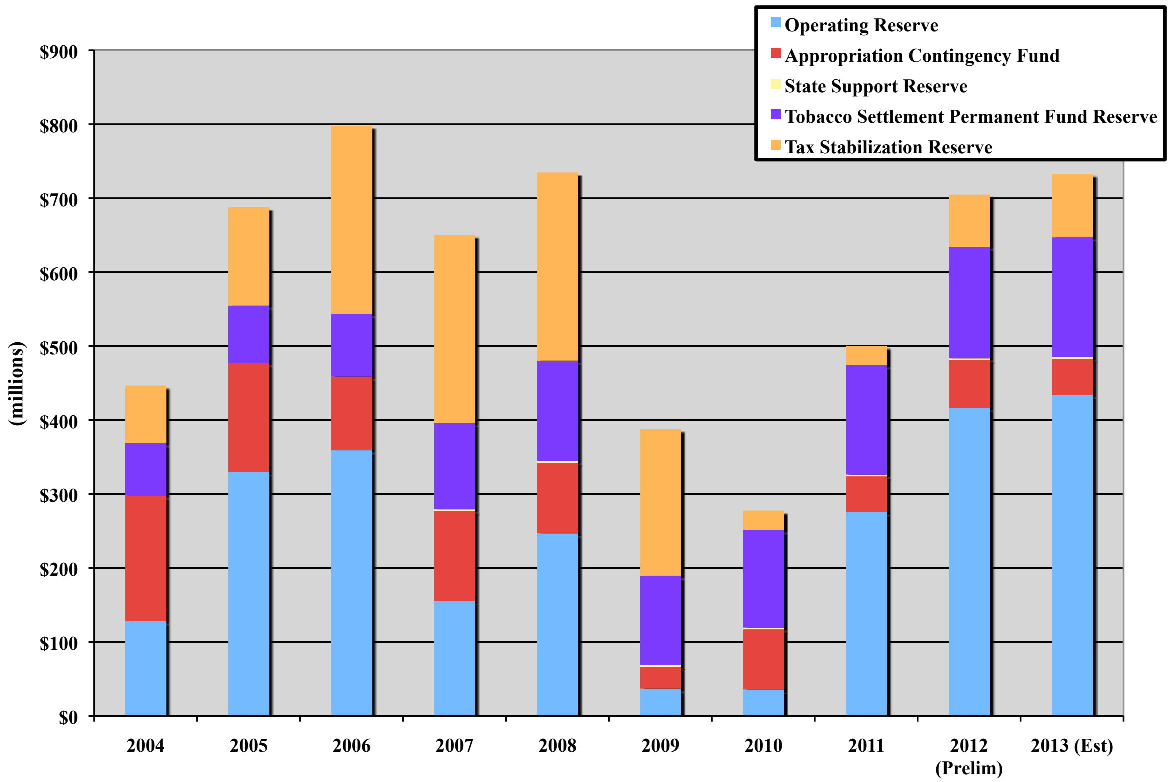
General Fund Reserves

Strong reserve balances in the General Fund have been a credit strength of the State general obligation bond ratings, and are viewed by Moody's as a potential offset against the State's vulnerability to federal risk. When the State bond ratings were upgraded by both Moody's and S&P from *Aa/AA* to the *Aa1/AA+* ratings in the 1993-1994 period, the State economy was strong and General Fund reserves—which at that point were primarily held in the Operating Reserve—were annually 5 to 10 percent of recurring appropriations, reaching a peak of 10.3 percent at the end of fiscal year 1993. Immediately following the two bond rating upgrades, the State reserves fell by nearly 90 percent over a two-year period, and the State added the Risk Reserve to the General Fund to bolster the budgetary reserves. Neither rating agency downgraded the State in the wake of the reserve decline, however S&P put the State on CreditWatch and informed the State that the general obligation bond rating would be lowered if the reserves were not re-established above 5 percent of recurring appropriations and maintained at that level.

General Fund Reserve levels have been critical to the New Mexico bond ratings. Keeping aggregate reserves above five percent and toward 10 percent are key rating metrics for both bond rating agencies.

The following graph presents the components of the General Fund reserve balances, including preliminary results for 2012 and estimated 2013 year-end balances, and illustrates the strong growth over the past 10 years. As illustrated here, reserve balances grew steadily, approaching $800 million, or over 17 percent of recurring revenues in fiscal year 2006. However, the 2008 recession placed considerable strain on the State's reserve funding. By the end of fiscal year 2010, reserve balances were $520 million below 2006 levels, as reserve balances declined to a low of 5.2% of recurring appropriations. Reserves are expected to have ended 2012 at 13.0 percent of recurring appropriations.

General Fund Reserves FY 2004-2013 (Est)



The following graph presents the General Fund reserves as a percentage of recurring appropriations, with a line designating the 5 percent reserve floor established as a credit criteria by S&P and a line designating the 10 percent reserve target established within the Executive Branch. Over the past 10 years, the reserve ratio has fluctuated, but has remained above the 5 percent reserve threshold at all times, and remained above the 10 percent reserve threshold from fiscal years 2004-2008. The restoration of operating reserves balances of 13 percent, shown in the graph above, and below on a percentage basis, has been accomplished by a combination of recovering revenues and deliberate management action to restrain spending growth.

The Martinez administration has met the challenge of restoring General Fund Reserve levels and controlling expenditures in a time of great fiscal challenges for states across the country.

General Fund Reserves as Percent of Recurring Appropriations

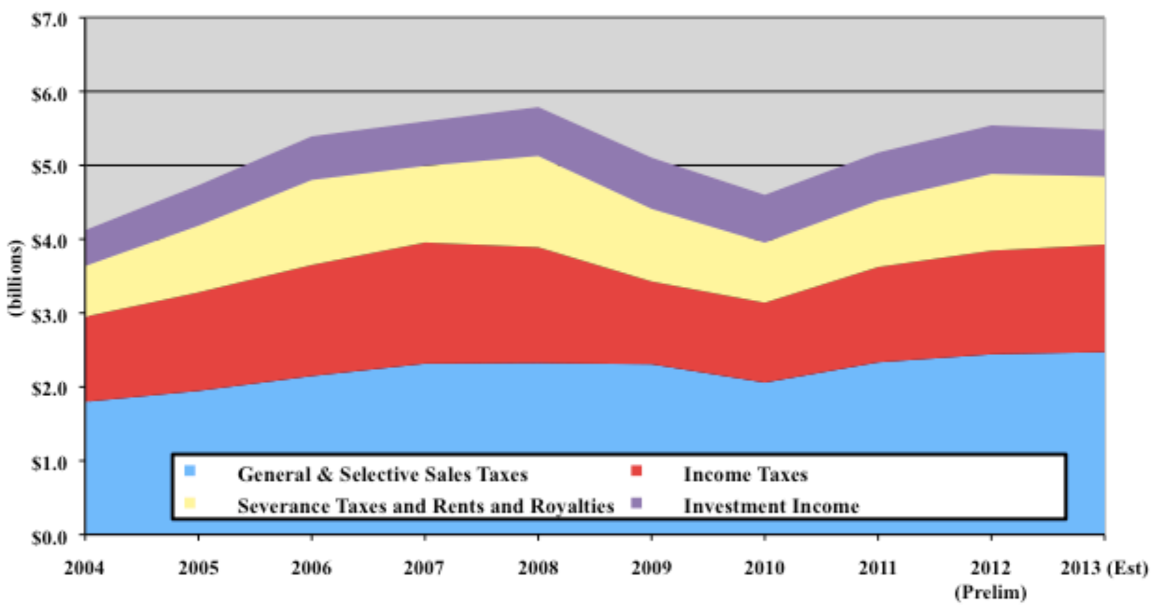
Revenue, Volatility and Forecast Error

While historically strong General Fund reserves have been a credit factor supporting the strong State ratings, historical volatility of General Fund receipts has led to volatility in reserve levels, as illustrated in the two previous graphs. Trends in primary General Fund revenues, which comprise sales taxes, income taxes, revenues derived from mineral extraction activities and investment earnings, including those from State permanent funds, are evaluated by the rating agencies as they consider fundamental issues of fiscal stability and trends, are illustrated in the graph on the following page.

Severance taxes have tended to provide a counter-cyclical benefit to the State revenue mix.

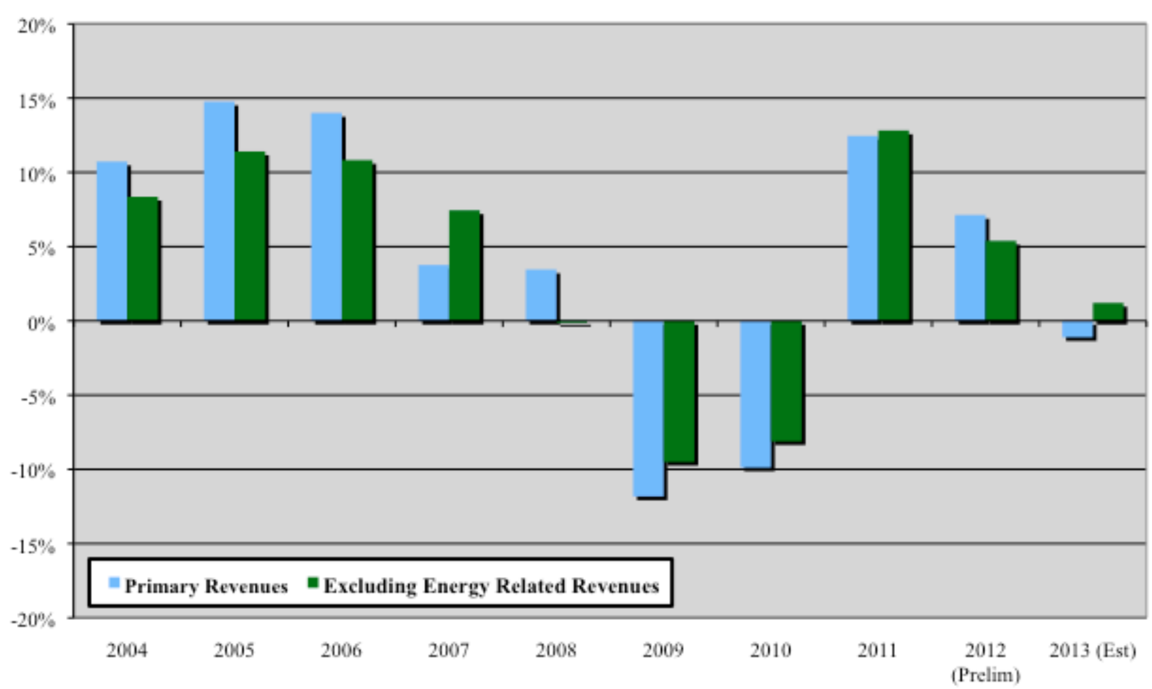
The normal fluctuation in the primary General Fund revenues reflecting economic cycles is exacerbated by the inherent volatility in revenues related to mineral extraction, as these revenues give the State the posture of being a seller of oil and natural gas, and therefore vulnerable to changes in price, and to a lesser extent production, over time. While Moody's has focused on the volatility in General Fund revenues created by the State's mineral taxes and revenues, S&P has noted the counter-cyclic benefits of the revenue diversity, and the strong revenue performance that the State has realized during periods of national economic weakness. In the most recent economic recession, however, each of the State's core revenues has declined in the face of the deep economic downturn. However, the revenue mix continues to benefit the State by demonstrating counter-cyclical attributes and the strength of natural resource-based revenues has balanced the downturn in other core revenue streams through the recent economic downturn. In addition, distributions from the State's two permanent funds, contributing over 10 percent of General Fund revenue, are a stabilizing factor that helps to mitigate the volatility of other revenues.

Primary General Fund Revenues 2004-2013 (Est)

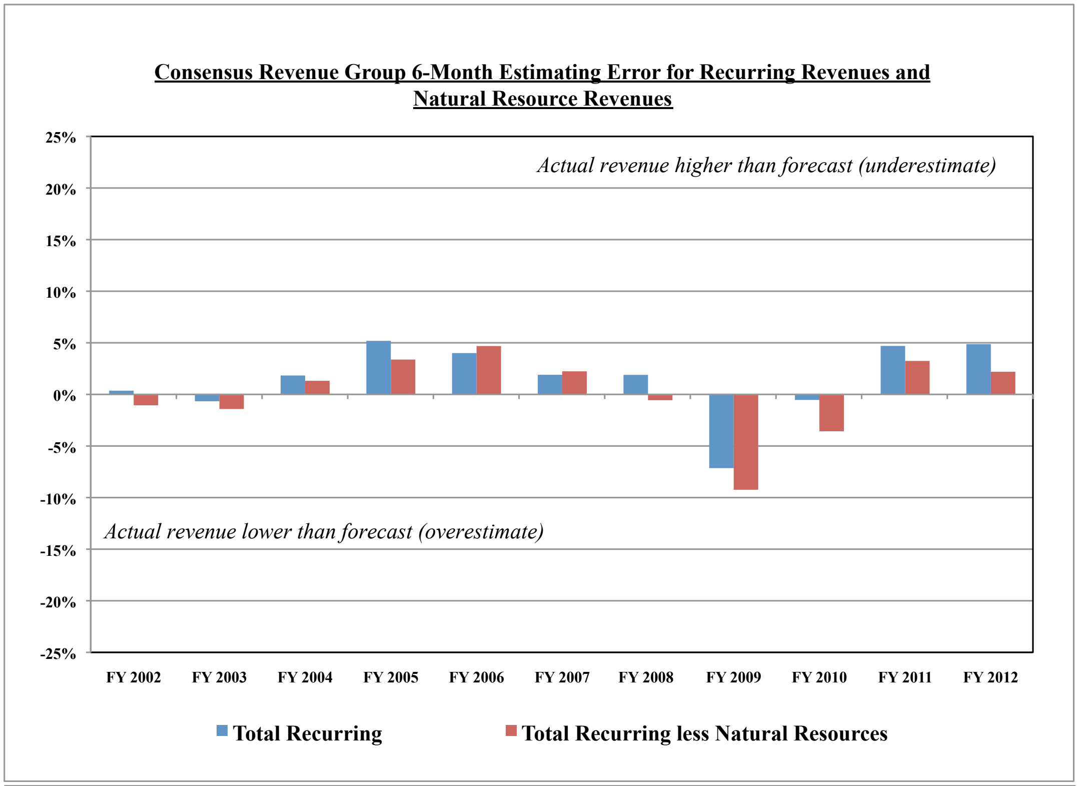


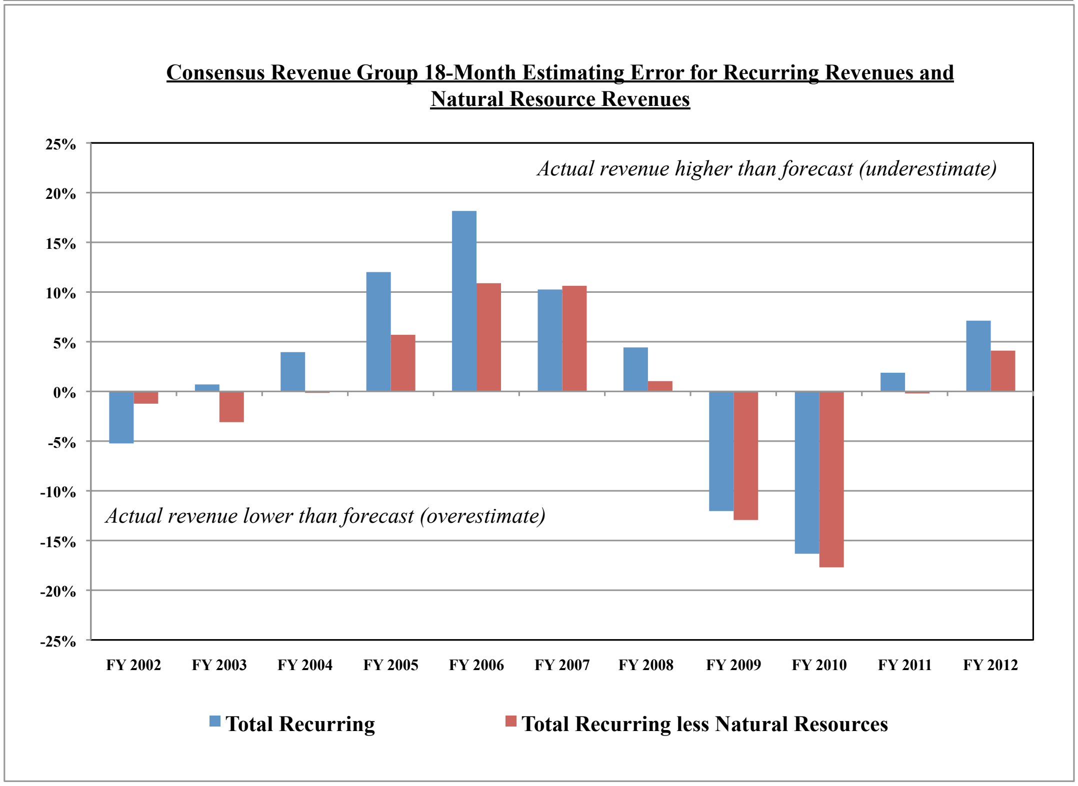
The year-over-year growth in the primary General Fund revenues, which comprise sales taxes, income taxes, revenues derived from mineral extraction activities and investment earnings, including those from State permanent funds, is presented below.

Annual Fluctuation in Primary Revenues



Because of the role of mineral taxes and revenues in the State revenue mix, the State closely tracks the 6-month and 18-month forecast error in State revenue planning. The 18-month estimate represents projections at the time the fiscal year budget is adopted. As illustrated in the following graphs, State revenue estimates as developed through the consensus revenue estimation process have tended to have a pro-cyclical bias that has resulted in core revenues outperforming projections during expansions and underperforming during contractions. Negative error indicates actual revenue receipts fell short of estimate. Positive error indicates actual revenue receipts exceeded the estimate.

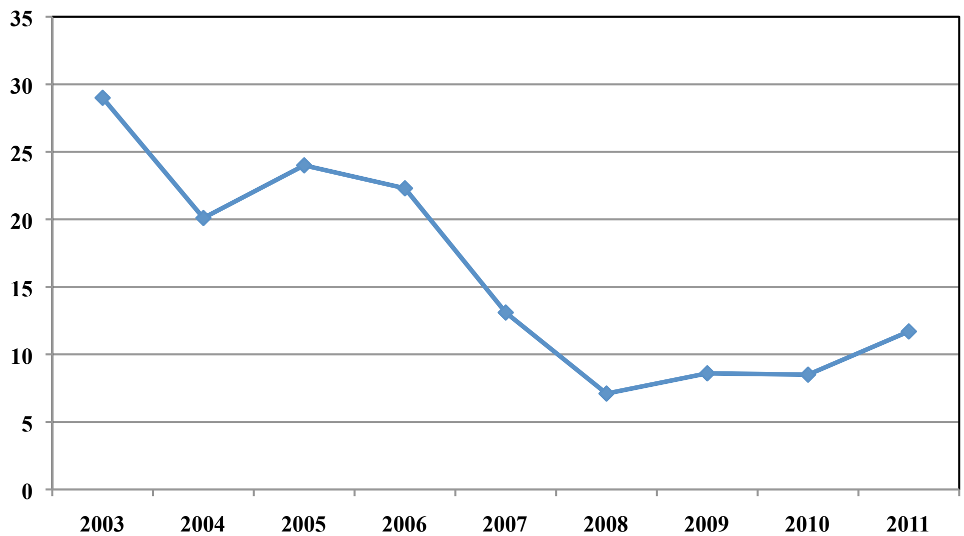




Financial Reporting

Delays in the issuance of the State Comprehensive Annual Financial Report have historically been a negative credit factor for the State. The standard for the issuance of annual financial reports is within six to eight months of the end of the fiscal year, with many states publishing their audited CAFR in less than six months. By comparison, the State has on average issued its CAFR 19 months after the end of the fiscal year, prior to fiscal year 2007. The graph below illustrates the number of months following fiscal year end in which the CAFR was published.

Time until CAFR Publication
(months)



The 2011 CAFR was published on June 20, 2012, approximately three months later than the prior year CAFR. It will be important for the State to make every effort to have its financial reporting practices conform to industry standards as noted above.

State Pension Funds and Other Post-Employment Benefit Liabilities

The financial position of the State pension funds and the projected liabilities for Other Post-Employment Benefits (OPEB) have not traditionally been a focus of this debt affordability study. These liabilities, however, constitute the most significant long-term liabilities of the State, and, as with other states across the country, are only likely to increase as areas of concern for bond rating analysts and bond investors. The bond rating agencies have recently intensified their analytic focus on the legal and economic circumstances of state pension funds, and the long-term consequences of chronically underfunded public pension obligations.

The financial condition of PERA and ERB looms as the next significant rating challenge to the State, as bond raters increasingly look at unfunded pension liabilities as part of the overall state debt burden.

Over the next several years, market losses realized during the economic downturn will continue to be recognized within the context of multi-year smoothing which may have mitigated the impact of adverse market impacts on portfolio market values at the Public Employees Retirement Association (PERA) and the Educational Retirement Board (ERB) over the past several years. Additionally, the dramatic change in the interest rate environment, and the long and sustained decline in bond yields, may ultimately require reconsideration of the yield assumption utilized by the actuaries in valuing State pension and OPEB liabilities. Any ensuing reduction in the actuarial yield assumption would materially increase unfunded pension fund and OPEB liabilities.

This year, Moody's has proposed new procedures that it intends to implement to recognize unfunded pension obligations as obligations comparable to long-term debt. Specifically, with respect to assessing the impact of pension obligations, Moody's proposes three specific analytic steps: (i) allocating cost-sharing plan liabilities to the balance sheets of the underlying obligors, (ii) adjusting an issuer's total actuarial liability to reflect a 5.5 percent portfolio yield over time, approximating the return on high-grade corporate bonds, and (iii) looking at market values of assets without regard to asset-smoothing.

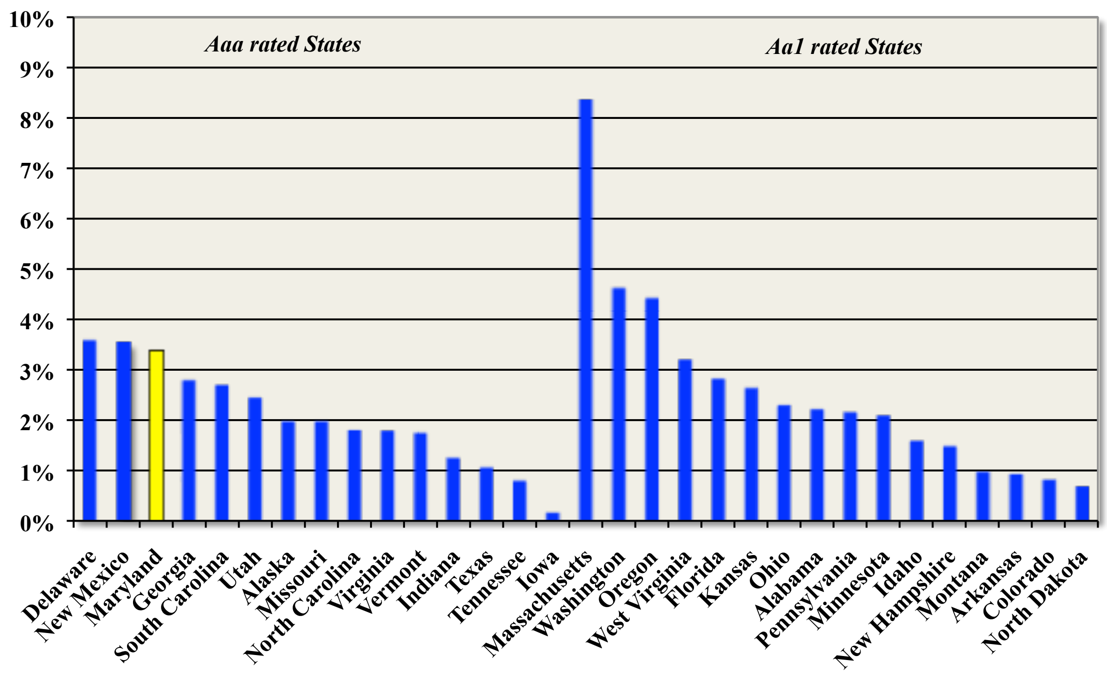
Moody's purpose is to include issuer liabilities that are comparable to debt obligations in its credit review process. Its intention is specifically to draw greater issuer and public attention to these liabilities and to assess those liabilities in light of market returns that may be lower than actuarial expectations. Moody's has provided the State with its preliminary assessment of the impact of its analytic methodology on the present value of New Mexico's pension liabilities, and the impacts are significant. Specific data points from Moody's adjustments are presented below.

Moody's Adjustments to US New Mexico Reported Pension Data

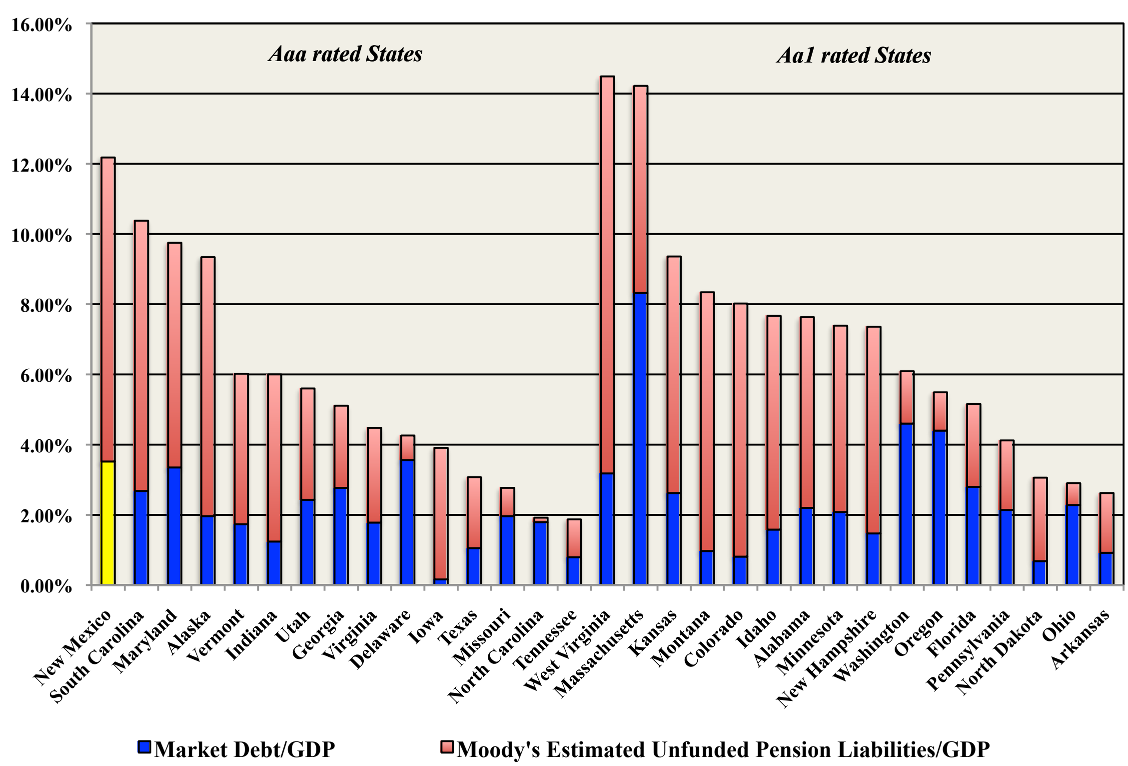
	Total	ERB	PERA
As Reported			
Total Liability	$29,954,961	$14,353,500	$15,601,461
Actuarial Value of Assets	$21,675,013	$9,431,300	$12,243,713
Market Value of Assets	$18,248,991	$8,232,500	$10,016,491
Unfunded Liability	$8,279,948	$4,922,200	$3,357,748
Funded Ratio	72.4%	65.7%	78.5%
Adjusted			
Total Liability	$40,615,855	$19,461,874	$21,153,981
Actuarial Value of Assets	$21,675,013	$9,431,300	$12,243,713
Market Value of Assets	$18,248,991	$8,232,500	$10,016,491
Unfunded Liability	$22,366,864	$11,229,374	$11,137,490
Funded Ratio	44.9%	42.3%	47.4%
Discount Rate	-	5.5%	5.5%
State ENC	$795,165	$285,488	$509,677
Amort. UAAL PMT	$1,951,365	$979,691	$971,674

The graphs on the following page illustrate the impacts of the proposed changes, based upon data provided by Moody's. The first graph presents the Net Debt as a percentage of state GDP prior to the adjustment to include unfunded pension obligations as debt. The second graph, on the top of the next page, presents the same comparison with state unfunded pension obligations included as debt, and shown in red to illustrate the magnitude relative to public market state debt. While Moody's has indicated that it does not anticipate changing the relative rankings of state ratings based upon the inclusion of this data, it is notable that the adjustment to include unfunded pension obligations as debt places New Mexico at the top of the *Aaa* cohort in terms of total adjusted net debt as a percentage of state GDP. However, because New Mexico's primary debt programs do not rely on General Fund revenue, it is questionable whether the revised metric including pension obligations is in fact a better measure of the State's debt affordability.

Peer Comparison: Net Debt as Percent of GDP



Peer Comparison: Adjusted Net Debt as Percent of GDP
Moody's Data



Projected State Debt Issuance

The table below represents the projected sources and uses of funds from the core State bonding programs for State capital investment over the next five years. This table includes the issuance of long-term general obligation, severance tax, supplemental severance tax and transportation bonds, and projected lease appropriation obligations, as well as the current year funding provided from the cash available in the Severance Tax Bonding Fund through the issuance of severance tax and supplemental severance tax notes. Projected debt issuance is based on statutory and constitutional capacity constraints and incorporates estimates of property values and future oil and gas revenues. This table also assumes that the Legislature and the Governor authorize projects up to the total debt capacity projected to be available.

The State projects the capacity to issue $2.85 billion of bonds for capital funding over the next five years. However, $1.4 billion would be from cash flow notes that will not constitute new long-term debt.

Core Bonding Programs:
Sources and Uses of Funds (millions)

Sources of Funds (millions)	FY13	FY14	FY15	FY16	FY17	Five-Year
General Obligation Bonds	-	$155.0	-	$180.0	-	$335.0
Severance Tax Bonds	222.5	222.5	222.5	222.5	222.5	1,112.5
Severance Tax Notes	112.0	94.1	90.7	76.5	60.1	433.4
Total Seniors	***334.5***	***316.6***	***313.2***	***299.0***	***282.6***	***1,545.9***
Supplemental Severance Tax Bonds	-	-	-	-	-	-
Supplemental Severance Tax Notes	179.5	182.8	197.1	203.7	203.1	966.2
Total Supplemental STBs	***179.5***	***182.8***	***197.1***	***203.7***	***203.1***	***966.2***
Total Sources of Funds	$514.0	$654.4	$510.3	$682.7	$485.7	$2,847.1

Uses of Funds (millions)	FY13	FY14	FY15	FY16	FY17	Five-Year
Projects approved by referendum	$0.0	$155.0	$0.0	$180.0	$0.0	$335.0
New Statewide Capital Projects	223.7	253.3	250.6	239.2	226.1	$1,192.8
Authorized but Unissued STB Bonds	43.9	-	-	-	-	$43.9
Water Projects	33.5	31.7	31.3	29.9	28.3	$154.6
Colonias Project Capital	16.7	15.8	15.7	15.0	14.1	$77.3
Tribal Projects Capital	16.7	15.8	15.7	15.0	14.1	$77.3
Education Capital	179.5	182.8	197.1	203.7	203.1	$966.2
Total Uses of Funds	$514.0	$654.4	$510.3	$682.7	$485.7	$2,847.1

State Board of Finance Bonding Programs

As presented in the table below, the State Board of Finance currently projects $5.6 billion of new money financing for statewide capital projects over the next 10 years. This amount comprises $875 million of projected general obligation bonding capacity, with issuances subject to legislative authorization and voter approval, $2.8 billion of severance tax bonds and notes subject to legislative authorization and appropriation, and $2.0 billion of supplemental severance tax notes for education projects designated for funding by the Public School Capital Outlay

Council. Projections of general obligation bonding capacity reflect the current consensus between the Governor and the Legislature regarding the objective of keeping the aggregate general obligation mill levy stable, and overall limitations on constitutionally available capacity reflecting 1.4 percent increase in net taxable values for property tax year 2013 over 2012, and increases projected at 3.4 to 4.0 percent in subsequent years. Projections of severance tax bonding capacity reflect long-term natural resource price and production projections developed by State economists and are revised periodically.

State Board of Finance
Projected Bonding Capacity by Fiscal Year
(millions of dollars)

		Severance Tax Bond Program		Supplemental STB Program		
	GO Bonds	**Bonds**	**Notes**	**Bonds**	**Notes**	**Total**
2013	-	$222.5	112.0	--	179.5	514.0
2014	155.0	$222.5	94.1	--	182.8	654.4
2015	-	$222.5	90.7	--	197.1	510.3
2016	180.0	$222.5	76.5	--	203.7	682.7
2017	-	$222.5	60.1	--	203.1	485.7
2018	180.0	$222.5	47.5	--	200.2	650.2
2019	-	$222.5	33.5	--	197.5	453.5
2020	180.0	$222.5	22.1	--	194.8	619.4
2021	-	$222.5	12.3	--	192.1	426.9
2022	180.0	$222.5	0.1		200.9	603.5
Total	**$875.0**	**$2,225.0**	**$548.9**	**$0.0**	**$1,951.7**	**$5,600.6**

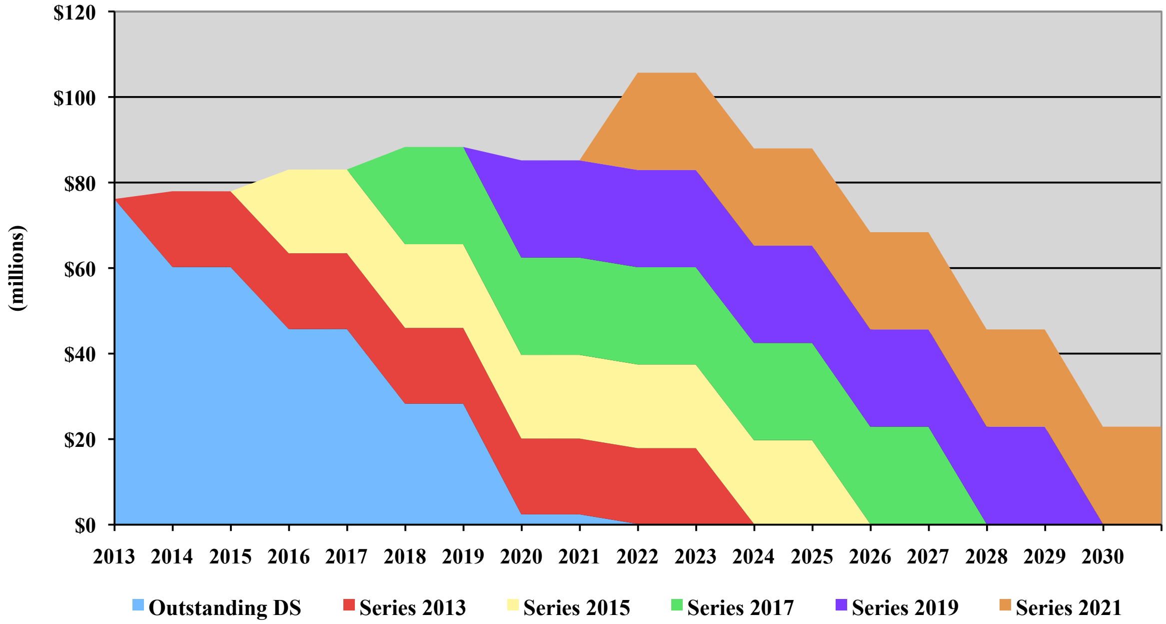
General Obligation Bond Issuance

State general obligation bonds are authorized by the Legislature and placed on the ballot for voter approval on a biennial basis, with $140 million on the ballot for consideration by the voters in November 2012. As a general matter, state General obligation bonds are subject to a debt limit equal to 1 percent of statewide net taxable property value. The debt limit as of the most recent property valuation is approximately $542 million, and $296.9 million in general obligation bonds were outstanding as of the end of fiscal year 2012. General obligation bonds are secured by the full faith and credit of the State and repaid from a dedicated property tax millage assessment established pursuant to the voter approval of the bonds.

General obligation bonding capacity of $875 million over the next decade reflects the current consensus between the Governor and the Legislature regarding the objective of keeping the aggregate general obligation mill levy stable.

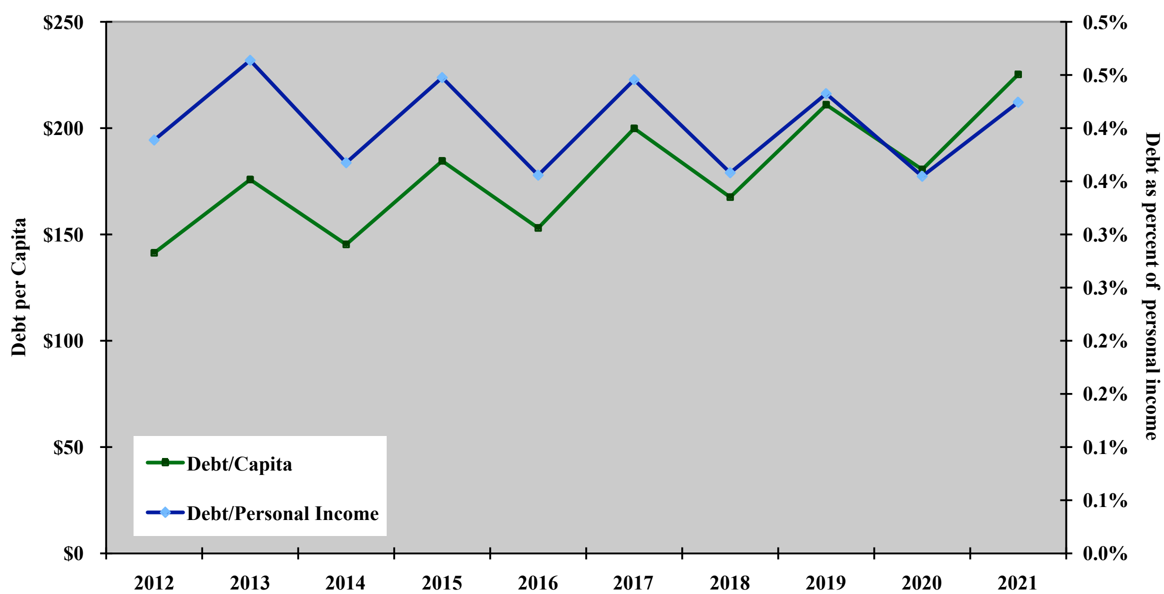
The graph below illustrates the debt service profile of outstanding debt, and the new general obligation bond issues projected in the table above. The abnormal shape of the profile in 2022-2023 is a function of the abnormally low size of the general obligation bond issue approved by voters in fall 2010 and issued in 2011. The potential size of the Series 2013 issuance is also smaller than allowed pursuant to the 1 percent capacity calculation. The Martinez administration and the Legislature limited the general obligation bond authorization to an amount that could be issued while keeping the State's property tax mill rate flat.

General Obligation Bonds
Annual Debt Service with Projected New Issues



General obligation bonds are sold with a maximum maturity of 10 years. As illustrated in the following graph, the projected biennial issuance of general obligation bonds sustains a stable level of debt per capita and a moderately declining level of general obligation debt service as percentage of personal income in the State.

Projected Per Capita G.O. Debt and Debt Per Capita as Percent of Income

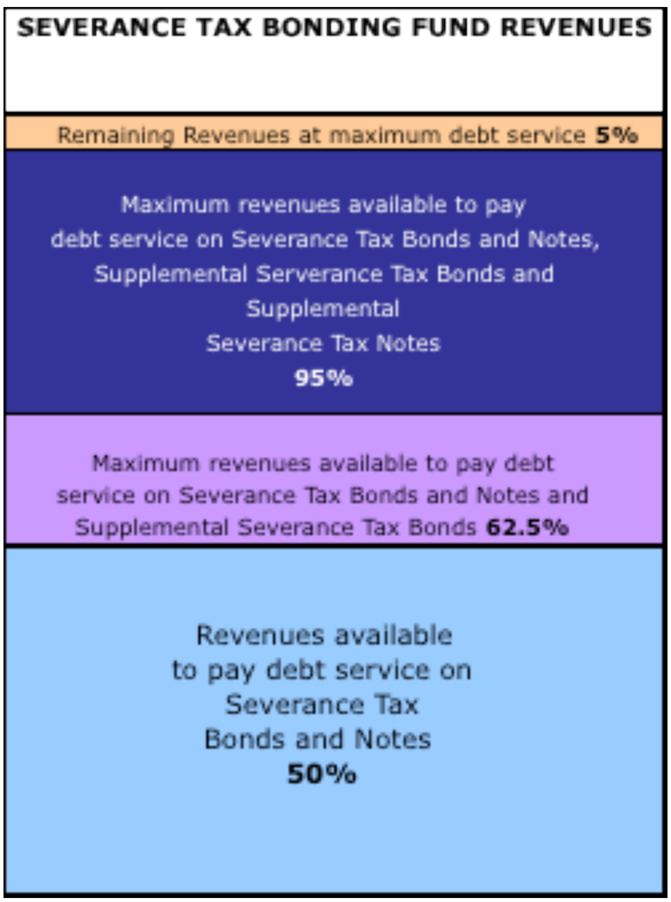


For the purposes of projecting future debt ratios, population growth in the State is projected to continue at an annual rate of 1.7 percent, and projected personal income growth in the State at a continuing annual rate of 4.3 percent. For long-term planning purposes we have utilized a rate that roughly comprises population growth of 1.7 percent, inflation of 3.3 percent and real growth of 1.0 percent.

Severance Tax and Supplemental Severance Tax Bond Issuance

Severance tax bonds are authorized by the Legislature for statewide capital projects. Currently, 10 percent of senior severance tax bonding capacity is set aside for water projects and 5 percent of senior severance tax bonding capacity is set aside for both tribal projects and the colonias projects. The Legislature has authorized the State Board of Finance to issue supplemental severance tax bonds for public school projects in amounts certified to the Board from time to time by the Public School Capital Outlay Council, subject to the annual bonding capacity limitations of the supplemental severance tax bonding program.

Severance tax and supplemental severance tax bonds are secured by a pledge of and repaid from revenues received in the Severance Tax Bonding Fund. Under the statutory test governing the issuance of severance tax and supplemental severance tax bonds, and as illustrated in this chart, severance tax bonds and notes can only be issued to the extent that severance tax bond debt service does not exceed 50 percent of revenues received into the Severance Tax Bonding Fund during the most recent completed fiscal year, and supplemental severance tax bonds can only be issued to the extent that the severance tax bond and supplemental severance tax bond debt service does not exceed 62.5 percent of revenues received into the Severance Tax Bonding Fund during the most recent completed fiscal year. Severance tax notes issued to make cash available in the Severance Tax Bonding Fund prior to the semi-annual transfer to the Severance Tax Permanent Fund available for capital projects are subject to the same test as severance tax bonds. Supplemental severance tax notes can be issued to the extent that the severance tax bond and note, and supplemental severance tax bond and note debt service does not exceed 95 percent of revenues received into the Severance Tax Bonding Fund during the most recent completed fiscal year.



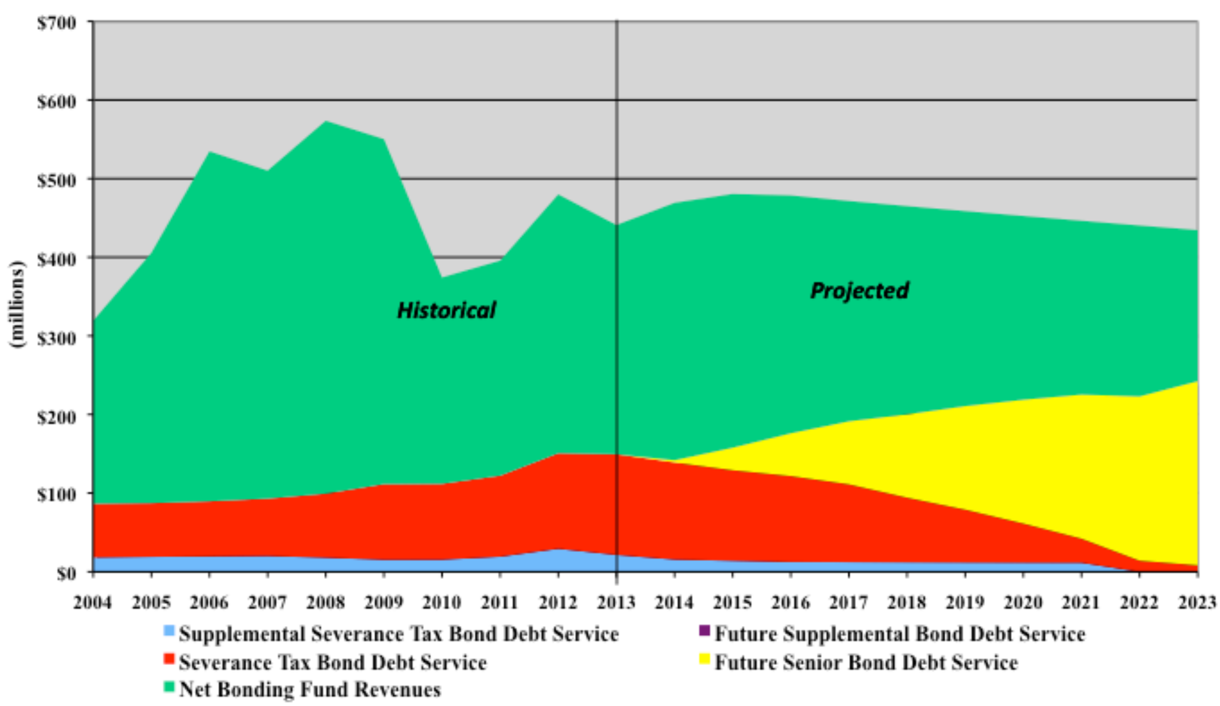
Annual long-term capacity for severance tax bonds is determined by the State Board of Finance, based upon outstanding debt service and projections of future Severance Tax Bonding

Fund revenues. As a general matter, annual long-term bonding capacity is calculated as 10 percent of the long-term debt capacity under the statutory test, and based upon level-debt service bond amortization over a 10-year life. Annual capacity for severance tax and supplemental severance tax notes are similarly calculated based upon long-term revenue forecasts, projections of long-term bond issuance, and the resulting cash flow available on an annual basis to be set aside for capital purposes through note issuance.

Long-standing State policy has allocated total long-term severance tax bonding capacity over a ten-year horizon. With $2.2 billion of long-term capacity, and $2.5 billion of short-term "sponge" capacity, less than half of the Severance Tax Bonding Program comprises the issuance of long-term debt.

The following graph illustrates the historic and projected revenue and debt service profile of the Severance Tax Bonding Program reflecting the projected issuance of $222.5 million of new long-term severance tax bond issues annually, as projected in the table earlier. It also illustrates the State practice of projecting Severance Tax Bonding Fund revenues based upon declining oil and natural gas prices and production levels, which has tended to suppress the volume of long-term financing and debt service and increase the use of cash funding for capital projects.

Severance Tax Bonding Fund
Historical and Projected Revenues and Debt Service



The table below presents the historic and projected debt service coverage for long-term severance tax and supplemental severance tax bonds. The first two columns present the severance tax bond debt service coverage for the outstanding bonds (historical and projected), and the second two columns present historical coverage and projected coverage (assuming future issues).

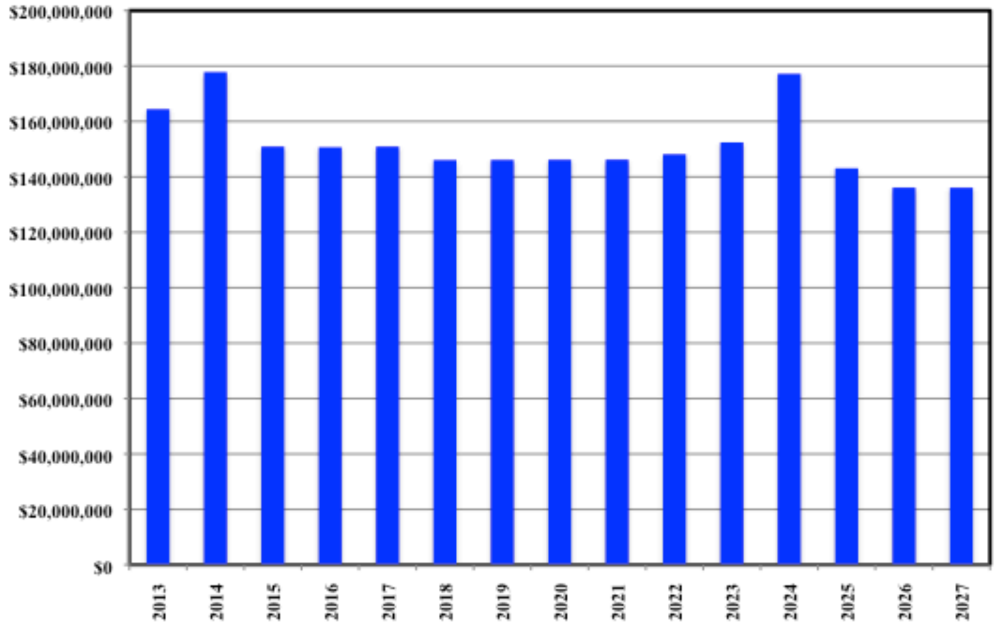
Severance Tax Bonding Program Historical and Projected Debt Service Coverage					
			Coverage with Future Issues		
Fiscal Year	Senior Severance Tax Bonds	Supplemental Bonds	Senior	Supplemental	
2004	4.68	3.69	4.68	3.69	
2005	5.95	4.65	5.95	4.65	
2006	7.65	5.97	7.65	5.97	
2007	7.00	5.48	7.00	5.48	
2008	7.06	5.78	7.06	5.78	
2009	5.73	4.94	5.73	4.94	
2010	3.89	3.35	3.89	3.35	
2011	3.84	3.24	3.84	3.24	
2012	3.95	3.19	3.95	3.19	Actual
2013	3.45	2.95	3.35	2.88	Projected
2014	3.80	3.38	3.17	2.87	
2015	4.18	3.72	2.97	2.74	
2016	4.39	3.93	2.70	2.52	
2017	4.77	4.24	2.49	2.34	
2018	5.66	4.94	2.39	2.25	
2019	6.83	5.81	2.28	2.15	
2020	9.11	7.38	2.20	2.08	
2021	14.60	10.61	2.14	2.03	

Transportation Bond Program Projected Revenues and Bond Issuance

The Department of Transportation has managed the largest capital investment program in the State over the past decade. The Statewide transportation capital investment program is funded from State and federal revenues in addition to bond proceeds. Bonds issued by the Department of Transportation through the New Mexico Finance Authority are secured by and repaid from revenues received into the State Road Fund, which are principally derived from gasoline taxes, registration fees and road user fees, plus an additional pledge of certain federal revenues received annually by the Department of Transportation. As of June 30, 2012, the Transportation debt outstanding was $1.636 billion.

The graph below presents current outstanding transportation bonds. The strong ratings and stable outlook reflect the rating agencies' assessment of long and stable trends in pledged state revenues and very strong historical and projected coverage.

Transportation Bond Debt Service



The table below presents debt outstanding, aggregate debt service on outstanding transportation bonds, and the projected level of debt service coverage from the pledged revenues.

Transportation Program
Projected Revenues, Debt Service, and Coverage

	Total Debt Service	Principal Outstanding	Pledged Revenues	Debt Service Coverage
2013	$164,433,330	$1,547,360,000	$624,010,000	3.79
2014	$177,827,629	$1,440,750,000	$624,010,000	3.51
2015	$150,925,900	$1,356,630,000	$624,010,000	4.13
2016	$150,701,229	$1,268,430,000	$624,010,000	4.14
2017	$150,923,766	$1,175,520,000	$624,010,000	4.13
2018	$146,083,198	$1,083,010,000	$624,010,000	4.27
2019	$146,134,304	$985,880,000	$624,010,000	4.27
2020	$146,169,263	$884,315,000	$624,010,000	4.27
2021	$146,216,388	$777,640,000	$624,010,000	4.27
2022	$148,166,988	$663,695,000	$624,010,000	4.21
2023	$152,434,713	$539,640,000	$624,010,000	4.09
2024	$177,197,466	$385,735,000	$624,010,000	3.52
2025	$143,090,191	$259,080,000	$624,010,000	4.36
2026	$136,096,892	$133,500,000	$624,010,000	4.59
2027	$136,064,884	$0	$624,010,000	4.59

Lease Appropriation Bond Financing

Lease appropriation financing has become one of the central tools for the financing of public facilities in the United States. However, until the approval of a constitutional amendment in 2006, New Mexico was one of very few states whose courts declined to permit lease appropriation financing.

In September 2008, the State completed its first issuance of lease appropriation bonds for a core state facility, the Fort Bayard Medical Center in Grant County, in the amount of $60,000,000. In anticipation of this financing, the Department of Finance and Administration in 2008 established procedures and policies that will govern the issuance of lease appropriation bonds for core state facilities in the future. This policy document is attached hereto as Appendix B.

Affordability of Projected State Debt Issuance

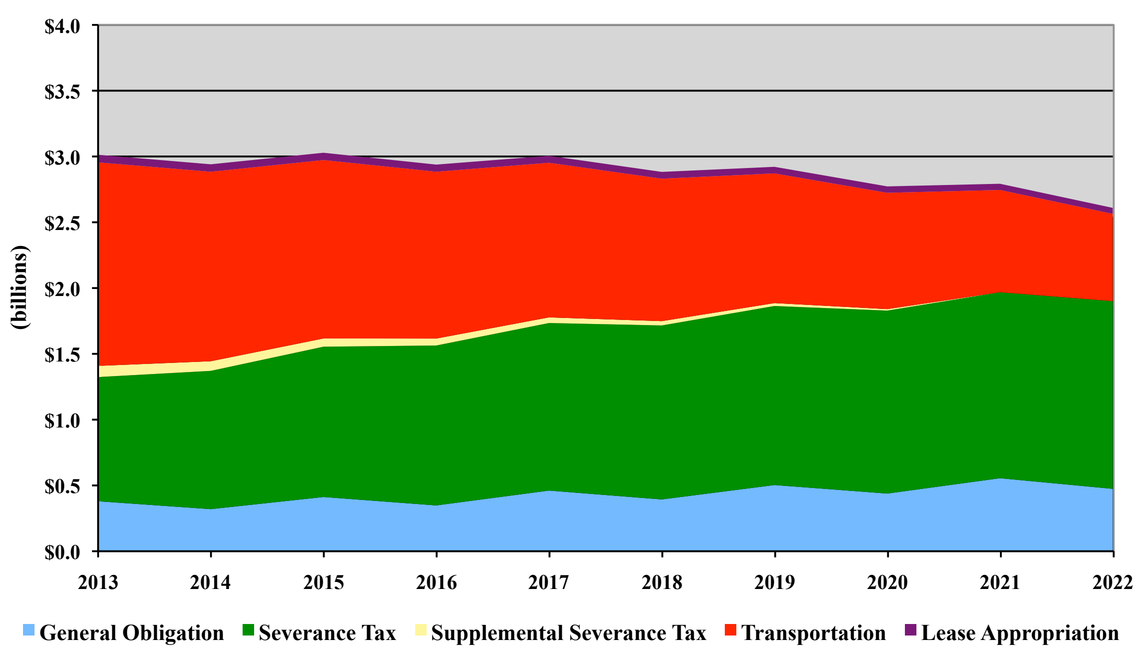
The core State bonding programs project bonding capacity for the issuance of $3.1 billion of new money long-term general obligation and severance tax bonds over the next 10 years. Each of the bonding programs are funded by dedicated revenue streams, including the general obligation bond property tax millage, the Severance Tax Bonding Fund revenues and the State Road Fund revenues, for the general obligation, severance tax and transportation bonding programs, respectively.

The projected $3.1 billion of long-term bonding capacity over the next decade is fully funded by dedicated revenue streams that do not flow into the State General Fund, and accordingly do not place stress on State finances or competing uses of funds.

None of these core bonding programs, with the exception of lease appropriation financing, utilize revenues that flow into or would otherwise flow into the General Fund of the State, although State Road Fund revenues that secure the transportation bonding program are dedicated to transportation operations as well as bond debt service. Each of the programs provide strong legal protections and the revenue-backed bonds demonstrate strong historical and projected debt service coverage. All long-term debt obligations, however, are repaid from the underlying State economy and rely upon economic strength and continued growth to assure that the repayment of debt does not become an increasing burden on the taxpayers of the State.

The following graph presents the projected levels of outstanding tax-supported debt, categorized by debt type, over the next 10 years.

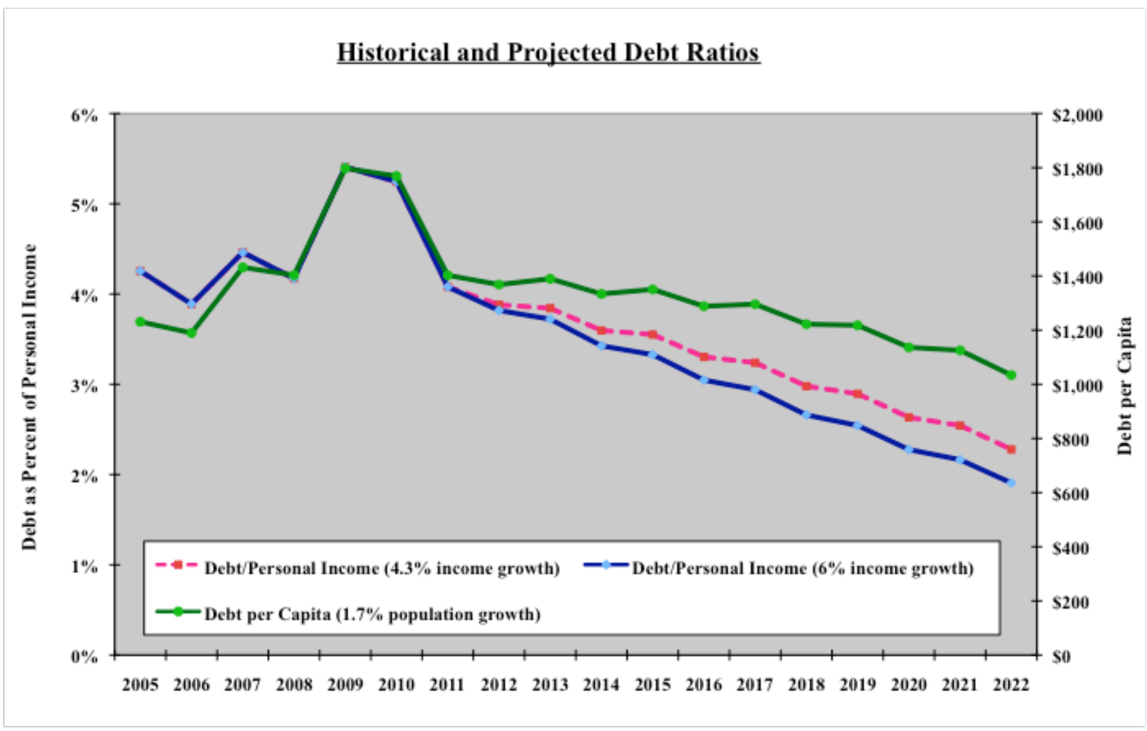
Projected Outstanding Tax-supported Long-term Bonds



The following graph projects the impact of the planned issuance of $3.1 billion of new debt over the next 10 years, and retirement of outstanding debt, on the key debt ratios of the State. These projected ratios do not include any further issuance of transportation bonds, which increase projected debt ratios from the levels shown here. As illustrated, the debt ratios are projected to trend downward from peak levels in 2009 following the large transportation issuance in 2007 and the biennial issuance of general obligation bonds. When debt ratios peaked in 2009, debt per capita reached a high of $1,798 and debt as a percentage of personal income was 5.4 percent; and both are now trending downward.

The projected long-term bonding does not place stress on the State debt levels, as measured by key rating metrics of debt as a percentage of personal income and debt per capita. For the foreseeable future, the State indebtedness as measured by these key credit ratios will remain high relative to peer states, but should trend downward.

As noted earlier, for the purposes of projecting future debt ratios, we have projected population growth in the State at an annual rate of 1.7 percent, and personal income growth at an annual rate of 4.3 percent. Personal income growth over the past two years has been approximately 6 percent, however for long-term planning purposes we have utilized a rate that roughly comprises population growth of 1.7 percent, inflation of 3.3 percent and real growth of 1.0 percent. For comparison purposes, we have added a dotted red line illustrating the projected ratios at a rate of personal income growth closer to national norms.



As is illustrated here, the projected debt issuance plans for the core State bonding programs do not place stress on the State General Fund, and are affordable with respect to the revenue streams that are dedicated to debt repayment. The increase in debt ratios appears to have peaked, and the ratios are projected to decline steadily. These ratios do suggest, however, that for the foreseeable future, the State indebtedness as measured by the key credit ratios will remain high relative to New Mexico's rating peer group, though as economic and population growth continues, State indebtedness as measured by these credit ratios should trend downward.

The inclusion of pension liabilities as long-term obligations of the State will place increasing scrutiny on the funding of those liabilities. It is notable that the pension obligations of the State far exceed the amount of outstanding debt or future contemplated debt that may be issued for funding continued investment in critical state infrastructure. While the change in the calculation of key debt ratios, as Moody's intends, may materially change how the state credit is perceived, it will not change the underlying strength of the State debt structure. The core State debt funding programs are self-supporting from pledged revenue streams, with the exception of lease appropriation debt, and those debt obligations neither compete with pension obligations for limited General Fund resources, nor compete with pension obligations for other public resources. The Constitution of the State of New Mexico sets forth a structural framework that provides for the integrity of the public debt, and that framework is extraordinarily strong, and not affected by other financial challenges the State may face.

The projected ratios for the State indicate that the projected level of debt issuance is strong and should continue to warrant the State's strong bond ratings. The regular updating of this debt affordability analysis, however, should be used as a tool to identify changes in economic or demographic trends, or debt program management, and to consider appropriate changes to its debt policies and bonding plans.

Capital Planning, Debt and Financial Policies

Capital Project Prioritization

New Mexico Department of Finance and Administration works with State agencies and local entities each year to develop an Infrastructure Capital Improvement Plan. This five-year plan identifies and prioritizes capital needs.

The New Mexico Department of Transportation develops the Statewide Transportation Improvement Program (STIP) annually to allocate capital resources to transportation purposes. The STIP is a six-year multi-modal transportation preservation and capital improvement program that lists prioritized projects for a three-year funding period and provides information for planning and programming purposes for the subsequent three years. The STIP is a product of the transportation programs planning process involving local and regional governments, Metropolitan Planning Organizations, Regional Planning Organizations, other state and transportation agencies, and the public.

The Public School Capital Outlay Council is responsible for implementing a standards-based process for prioritizing and funding public school capital needs throughout the state. All school facilities are ranked in terms of relative need and resources are directed to schools with the greatest needs. Funding for projects is provided annually through the supplemental severance tax bonding program.

The New Mexico Higher Education Department is responsible for the review and prioritization of higher education capital projects for all public four-year, two-year, and constitutionally-created special schools. Based upon this review and prioritization, the recommended higher education capital plan is submitted to the Governor and Legislature for funding through the general obligation bond program.

In Executive Order number 2012-023, Governor Susana Martinez directed the General Services Department and the Department of Finance and Administration to collaborate on improving the process by which capital projects for state agencies are identified, prioritized and funded. State agencies will prepare a five-year facilities master plan incorporating preventive and deferred maintenance planning, program justification and a criteria-based weighting system to determine priority. The goal is to increase the efficiency in the use of capital outlay funds in meeting critical capital outlay needs statewide. This improved selection process will be implemented in the upcoming legislative session.

Debt Management Policies

Policy Area	***G.O. Bonds***	***Severance Tax Bonds***	***Transportation Bonds***
Bond Life	10-year maximum term.	10-year maximum term.	Bond life may not exceed project design life.
Bond Amortization	Substantially level debt service.	Substantially level debt service.	Substantially level debt service.
Debt Service Coverage	Not applicable.	Senior and supplemental bonds subject to the terms of the statutory issuance test and the market test.	Long-term coverage projected at 4.50x.
Variable Rate Bond Limits	Not utilized.	Unhedged exposure will not exceed 20% of par outstanding.	Unhedged exposure will not exceed 20% of par outstanding.
Variable Rate Bond Considerations	Not utilized.	Balance interest savings and cashflow risks. Short bond life lessens potential savings.	Balance interest savings, cashflow risk and balance sheet management considerations.
Debt Staging	Traditionally issued as ten-year fixed rate bonds.	Traditionally issued as five to ten-year fixed rate bonds. Construction financing permitted but has not been utilized.	Construction financing may utilize short-term, variable rate or bond anticipation financing.
Interest Rate Swaps	Not utilized.	Not utilized to date due to short bond life.	Limited to 30% of par outstanding.
Refundings	Debt evaluated on an ongoing basis to identify bond refunding, and cash and economic defeasance opportunities.	Debt evaluated on an ongoing basis to identify bond refunding, and cash and economic defeasance opportunities.	Debt evaluated on an ongoing basis to identify bond refunding, and cash and economic defeasance opportunities.
Cash Financing	General Fund cash contribution to capital program sought annually, with funding based on magnitude of non-recurring and surplus revenues.	Funding notes utilized to direct available cash in Severance Tax Bonding Fund to capital projects each December 31st and June 30th.	Transportation capital primarily funding with bond proceeds, with cash contributions from the Road Fund, the General Fund and federal revenues.

Policy Area	***G.O. Bonds***	***Severance Tax Bonds***	***Transportation Bonds***
Disclosure	Separate Disclosure Counsel retained to oversee disclosure practices. Annual financial disclosure statement published.	Separate Disclosure Counsel retained to oversee disclosure practices. Annual financial disclosure statement published.	Separate Disclosure Counsel retained to oversee disclosure practices. Annual financial disclosure statement published.

Use of Interest Rate Exchange Agreements

Interest rate exchange agreements may be used by the State Board of Finance and the Department of Transportation as a debt management tool to reduce interest expense, manage financial risk or to create a risk profile not otherwise achievable through traditional debt or investment instruments. The risk factors to evaluate when considering interest rate exchange agreements include (i) interest rate risk, (ii) termination risk, (iii) counterparty risk, (iv) basis risk, (v) rating considerations, (vi) liquidity risk, and (vii) tax risk. To date, among the core State financing programs, only the Department of Transportation has utilized interest rate exchange agreements to reduce and manage its cost of capital. The benefits of interest rate exchange agreements, particularly with respect to the creation of synthetic fixed rate debt, have not been attractive for issuers whose bonds mature in ten years or less, and accordingly they have not been attractive for use in conjunction with the general obligation or severance tax bonding programs.

Other information on debt management and related policies is provided in Appendix A in the State Board of Finance Debt Policy.

Conclusion

Steady revenues and stable economic growth and diversification underpin the State of New Mexico bonding programs and assure the affordability of its capital improvement program. Each of the core State bonding programs are funded by dedicated revenue streams, including the general obligation bond millage, the Severance Tax Bonding Fund revenues and the State Road Fund revenues, for the general obligation, severance tax and transportation bonding programs, respectively, and none of these core bonding programs utilize revenues that flow into or would otherwise flow into the General Fund. Each of the programs provide strong legal protections and the revenue-backed bonds demonstrate strong historical and projected debt service coverage.

As discussed in detail in this report, the projected capacity to issue $3.1 billion of new general obligation and severance tax secured debt over the next 10 years would not adversely impact the key debt ratios of the State. As presented herein, the debt ratios are projected to trend downward from their 2009 peak after taking into account future planned debt issuance.

The global financial crisis and the ensuing recession have placed considerable stress on state and municipal government credit ratings including the State of New Mexico. Last year, this report emphasized the importance of the new administration meeting the challenge of weighing competing budget demands in a time of continuing economic uncertainty, and placing a priority on stabilizing and rebuilding the State's operating reserve funds. Over the past year, the State has been successful in taking the necessary actions to restore operating reserve levels to healthy levels. The State's determination to restore its reserve balances toward historical levels will be a positive credit factor.

New Mexico's bond ratings will be subject to increased scrutiny as Moody's implements its changes in methodology to include long-term pension obligations as debt of the State. It is important to note, however, that such changes do not reflect credit deterioration, but rather a change in the methodology for considering liabilities that have existed for many years. In addition, New Mexico's credit ratings will continue to be impacted by the continued revenue pressures, slow economic growth, and the state's vulnerability to budget constraints at the federal level.

The State's key debt ratios are at the high end of its peer group and above national median levels, and this will only be exacerbated by Moody's proposed methodology for including unfunded pension liabilities as state debt. The State retires its debt rapidly and funds a significant portion of its annual capital expenditures utilizing cash resources from the State General Fund and from the Severance Tax Bonding Fund. The State's historically strong General Fund reserves are central to its strong credit ratings, and will be particularly important in addressing Moody's concerns regarding vulnerability to federal fiscal issues, as are its transparent policies with respect to investments, debt and derivatives.

The effort to continually improve management practices will be important for maintaining the State's high quality ratings in the face of financial challenges. Such management practices include the state-wide capital improvement programming process as directed by Executive Order number 2012-023, the continued assessment of state credit factors, financial policies, and debt affordability on an annual basis, and the development of five-year expenditure forecasts in parallel with the current long-term revenue estimation process.

The Department of Finance and Administration and the State Board of Finance adopted updated debt policies in February 2012 (see Appendix A). Policies were also issued in 2008 governing the sale of lease appropriation bonds (see Appendix B). The State issued its Comprehensive Annual Financial Report (CAFR) for the fiscal year ending June 30, 2011 CAFR in June 2012. The State now publishes its financial reports in a timely fashion, and within industry standards. This progress in timely reporting represents the culmination of diligent work by the Department of Finance and Administration's Financial Control Division to address long-standing issues with regard to timely financial reporting.