



THE STATE OF NEW MEXICO

CONTINUING DISCLOSURE

**ANNUAL FINANCIAL INFORMATION FILING
FISCAL YEAR 2016**

**NEW MEXICO
STATE BOARD OF FINANCE**

January 2017

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**THE STATE OF NEW MEXICO CONTINUING DISCLOSURE
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State Capital Program

State general fund balances and proceeds from General Obligation Bonds, Senior Severance Tax Bonds, Supplemental Severance Tax Bonds and Transportation Bonds are important sources of capital financing for the State. The following table summarizes the capital funding administered by the Board and certain other sources for Fiscal Year 2012 through Fiscal Year 2016.

TABLE 1

Principal Sources of Capital Project Funding
Fiscal Year Ended June 30
(Dollars in millions)

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Proceeds from General Obligation Bonding Program⁽¹⁾					
General Obligation Bonds	\$ --	\$ <u>139.3</u>	\$ --	\$ <u>167.0</u>	\$ --
Subtotal	\$ --	\$ <u>139.3</u>	\$ --	\$ <u>167.0</u>	\$ --
Proceeds from Severance Tax Bonding Program⁽¹⁾					
Severance Tax Bonds	\$ <u>121.2</u>	\$ --	\$ <u>339.7</u>	\$ --	\$ <u>293.1</u>
Severance Tax Funding Notes ⁽²⁾	76.2	112.0	90.5	128.2	8.6
Supplemental Severance Tax Bonds	--	--	--	--	81.0
Supplemental Severance Tax Funding Notes ⁽²⁾	<u>148.7</u>	<u>167.8</u>	<u>175.2</u>	<u>214.5</u>	<u>127.3</u>
Subtotal	\$ <u>346.1</u>	\$ <u>279.8</u>	\$ <u>605.4</u>	\$ <u>342.7</u>	\$ <u>510.0</u>
Proceeds From Other Sources					
General Fund	\$ --	\$ --	\$ --	\$ --	\$ --
Transportation Bonds	--	--	70.1	--	--
Lease Appropriation Bonds	--	--	--	--	--
Subtotal	\$ --	\$ --	\$ 70.1	\$ --	\$ --
Total⁽³⁾	<u>\$ <u>346.1</u></u>	<u>\$ <u>419.1</u></u>	<u>\$ <u>675.5</u></u>	<u>\$ <u>509.7</u></u>	<u>\$ <u>510.0</u></u>

⁽¹⁾ Dollar amounts from State Board of Finance funding programs reflect net proceeds available for capital expenditure. Amounts vary annually by legislative action and the timing of bond closings.

⁽²⁾ The Board issues Senior Funding Notes and Supplemental Funding Notes to fund authorized projects. The notes are sold to the State Treasurer and retired within the same fiscal year.

⁽³⁾ Totals may not add due to rounding.

Source: New Mexico State Board of Finance and the New Mexico Finance Authority.

In addition to the General Obligation Bonding Program, the Severance Tax Bonding Program and the Supplemental Severance Tax Bonding Program issued and administered by the Board, there are a number of other sources of funds for capital projects throughout the State. These other sources of funding include surplus general fund appropriations and proceeds of bonds issued by, among others, the New Mexico Finance Authority, the State Transportation Commission and state educational institutions.

The New Mexico Finance Authority (the “Finance Authority”) was created by the State legislature in 1992 to assist qualified governmental entities in financing capital equipment and infrastructure projects. The Finance Authority is a state instrumentality governed by a board of directors and is not subject to the direct supervision or control of any other board, bureau, department or agency of the State.

In July 2012, the Finance Authority disclosed that what it believed was the audit of its financial statements for the fiscal year ended June 30, 2011 was not completed properly (the “Incomplete Audit”). Due to the Incomplete Audit, The Finance Authority was unable to file its audit for the fiscal year ended June 30, 2011 in a manner that was in material compliance with its previous undertakings. Eventually, the audit for fiscal year ended June 20, 2011 was completed and made available, and the Finance Authority filed such audit with the Municipal Securities Rulemaking Board in February 2013 as specified in its disclosure undertakings.

General Obligation Bonds

Sections 7 and 8 of Article IX of the State Constitution limit the power of State officials to incur general obligation indebtedness in the following ways:

- (a) The State may borrow money not exceeding the sum of two hundred thousand dollars (\$200,000) in the aggregate to meet casual deficits or failure in revenue, or for necessary expenses.
- (b) Other debt may be contracted by or on behalf of the State only when authorized by law for some specified work or object. Such a law takes effect only after being submitted to the qualified electors of the State and having received a majority of all votes cast thereon at a general election. No debt may be created if the total indebtedness of the State, exclusive of the debts of the territory and several counties thereof assumed by the State, would thereby be made to exceed 1 percent of the assessed valuation of all property subject to taxation in the State, as shown by the last preceding general assessment.
- (c) The State may contract debts to suppress insurrection and to provide for the public defense.

Outstanding and Additional Parity General Obligation Bonds

The principal amounts of outstanding General Obligation Bonds, as of December 31, 2016, are shown in Table 2.

TABLE 2

Outstanding General Obligation Bonds

<u>Series</u>	<u>Principal Outstanding</u>
Series 2007	\$ 16,635,000
Series 2009	70,480,000
Series 2011	10,015,000
Series 2013	98,590,000
Series 2015	<u>131,035,000</u>
Total	326,755,000

Source: New Mexico State Board of Finance.

Future debt payments, by fiscal year, on General Obligation Bonds outstanding, as of December 31, 2016, are shown in Table 3.

TABLE 3

Future General Obligation Bond Debt Service

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 65,995,000	\$ 6,678,848.75	\$ 72,673,848.75
2018	51,395,000	10,492,897.50	61,887,897.50
2019	53,540,000	8,347,947.50	61,887,947.50
2020	29,900,000	6,104,747.50	36,004,747.50
2021	30,955,000	5,052,597.50	36,007,597.50
2022	29,800,000	3,956,947.50	33,756,947.50
2023	30,890,000	2,869,410.00	33,759,410.00
2024	16,720,000	1,714,000.00	18,434,000.00
2025	17,560,000	878,000.00	18,438,000.00
Total ⁽¹⁾	326,755,000.00	46,095,396.25	372,850,396.25

(1) Figures may not add due to rounding.

Source: New Mexico State Board of Finance.

Voters must approve the issuance of additional General Obligation Bonds, other than for refunding purposes, and the levy of additional *ad valorem* taxes. Any such additional General Obligation Bonds may be issued on a parity with, or subordinate to, all outstanding General Obligation Bonds.

Calculation of 1 Percent Bonding Limitations

Net taxable value as of December 31, 2016.....	\$ 56,922,567,412
General obligation bond limitation @ 1 percent of net taxable value.....	\$ 569,225,674
Total general obligation bonds outstanding as of December 31, 2016.....	\$ 326,755,000
Ratio of total debt to net taxable value.....	.00574

Source: Local Government Division and Fiscal Strategies Group.

Underlying General Obligation Bonds

The following table presents information on county, city, local and public school district debt outstanding as of June 30, 2016. The table does not include debt of special districts or community colleges.

Certain Underlying General Obligation Debt

Counties.....	\$ 337,734,610
Cities	\$ 496,511,343
Schools	\$ 2,171,445,000

Source: New Mexico Department of Finance and Administration, Local Government Division and New Mexico Public Education Department.

Severance Tax Bonds

The Severance Tax Bonding Act, Sections 7-27-1 to 7-27-27 NMSA 1978, as amended, permits the State Board of Finance (the “Board”) to issue two categories of bonds against Severance Tax Bonding Fund (the “Bonding Fund”) revenues: “New Mexico Severance Tax Bonds,” referred to herein as “Senior Severance Tax Bonds,” and “New Mexico Supplemental Severance Tax Bonds,” referred to herein as “Supplemental Severance Tax Bonds.”

The Board is prohibited by statute from issuing Senior Severance Tax Bonds and short-term Senior Severance Tax Funding Notes unless the aggregate amount of total Senior Severance Tax Bonds and Funding Notes outstanding, after giving effect to the proposed issuance, can be serviced with not more than the following percentages of the annual deposits into the Bonding Fund, as determined by the lesser of the deposits during the preceding fiscal year or the deposits during the current fiscal year as estimated by the Board of Finance Division (the “Division”):

- (1) For fiscal year 2017, 48.8 percent;
- (2) For fiscal year 2018, 48.2 percent; and
- (3) For fiscal year 2019 and subsequent fiscal years, 47.6 percent.

The Board is prohibited by statute from issuing Supplemental Severance Tax Bonds with a term that extends beyond the fiscal year in which they are issued unless the aggregate amount of Senior Severance Tax Bonds and Supplemental Severance Tax Bonds outstanding, after giving effect to the proposed issuance, can be serviced with not more than the following percentages of the annual deposits into the Bonding Fund, as determined by the lesser of the deposits during the preceding fiscal year or the deposits during the current fiscal year as estimated by the Division:

- (1) For fiscal year 2017, 61.3 percent;
- (2) For fiscal year 2018, 60.7 percent; and
- (3) For fiscal year 2019 and subsequent fiscal years, 60.1 percent.

In addition, short-term Supplemental Severance Tax Funding Notes may be issued if the debt service on such Supplemental Severance Tax Funding Notes, when added to the debt service previously paid or scheduled to be paid during that fiscal year on Senior and Supplemental Severance Tax Bonds and Funding Notes does not exceed the following percentages of the lesser of the deposits in the Bonding Fund during the preceding fiscal year or the deposits into the Bonding Fund during the current fiscal year as estimated by the Division:

- (1) For fiscal year 2017, 93.8 percent;
- (2) For fiscal year 2018, 93.2 percent;
- (3) For fiscal year 2019, 91 percent;
- (4) For fiscal year 2020, 89.4 percent;
- (5) For fiscal year 2021 87.8 percent; and
- (6) For fiscal year 2022 and subsequent fiscal years, 86.2 percent.

The Senior Severance Tax Bonds and Funding Notes fund a wide variety of capital projects while Supplemental Severance Tax Bonds and Funding Notes are earmarked for capital projects for public education. The Board has authority 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 of the State. During fiscal years 2017 through 2022, certain public school capital expenditures, including text books and school bus transportation, will be funded via the issuance of Supplemental Severance Tax Bonds as certified by the Public Education Department. The lien of the pledge of such Supplemental Severance Tax Bonds (including short-term funding notes) is subordinate to any outstanding Senior Severance Tax Bonds.

Section 7-27-8 NMSA 1978 requires that on each December 31 and each June 30 the State Treasurer shall transfer to the Severance Tax Permanent Fund all money in the Bonding Fund except the amount necessary to meet all principal and interest payments on bonds payable from the Bonding Fund on the next two ensuing semiannual payment dates.

In 2014, the Board filed a voluntary material event notice (the “Voluntary Disclosure”) with the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access (“EMMA”) system, available on the Internet at <http://emma.msrb.org>, in connection with the State’s Severance Tax Note, Series 2014S-A and Supplemental Severance Tax Note, Series 2014S-B (collectively, the “2014S Notes”). The Voluntary Disclosure related to the sizing of the 2014S Notes in excess of the amount permitted by State statute as a result of an accounting oversight. This resulted in an underpayment on June 30, 2014 of a corresponding amount from the Severance Tax Bonding Fund to the Severance Tax Permanent Fund. As noted in the Voluntary Disclosure, upon discovering this oversight, in September 2014 Board staff directed the State Treasurer to transfer the required amount from the Severance Tax Bonding Fund to the Severance Tax Permanent Fund to correct the underpayment. The Board subsequently issued additional short-term notes in December 2014 which accounted for the September payment made to the Severance Tax Permanent Fund.

Outstanding and Additional Senior Severance Tax Bonds

The principal amounts of outstanding Senior Severance Tax Bonds, as of December 31, 2016 are shown in Table 4.

TABLE 4

Outstanding Senior Severance Tax Bonds

Severance Tax Bonds, Series 2009A	\$ 53,125,000
Severance Tax Bonds, Series 2010A	60,200,000
Severance Tax Bonds, Refunding Series 2010D	14,725,000
Severance Tax Bonds, Series 2011A-1	19,745,000
Severance Tax Bonds, Refunding Series 2011A-2	32,460,000
Severance Tax Bonds, Series 2012A	42,325,000
Severance Tax Bonds, Series 2013A	30,205,000
Severance Tax Bonds, Series 2014A	40,055,000
Severance Tax Bonds, Series 2015A	126,195,000
Severance Tax Bonds, Series 2016A	78,750,000
Severance Tax Bonds, Series 2016B	181,395,000
Severance Tax Bonds, Series 2016C	41,925,000
Severance Tax Bonds, Series 2016D	26,725,000
Severance Tax Bonds, Series 2016E	19,090,000
Total	\$766,920,000

Source: New Mexico State Board of Finance.

Future payments, by fiscal year, on outstanding Senior Severance Tax Bonds, as of December 31, 2016, are shown in Table 5.

TABLE 5

Future Senior Severance Tax Bond Debt Service

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Debt Service</u>
2017		16,580,873.33	16,580,873.33
2018	108,960,000	31,820,711.39	140,780,711.39
2019	110,780,000	26,525,978.75	137,305,978.75
2020	102,395,000	21,803,672.50	124,198,672.50
2021	95,660,000	17,708,947.50	113,368,947.50
2022	82,555,000	14,093,173.75	96,648,173.75
2023	77,720,000	10,613,650.00	88,333,650.00
2024	69,895,000	7,298,425.00	77,193,425.00
2025	54,015,000	4,494,625.00	58,509,625.00
2026	38,085,000	2,294,875.00	40,379,875.00
2027	20,865,000	1,342,750.00	22,207,750.00
2028	5,990,000	299,500.00	6,289,500.00
Total⁽¹⁾	766,920,000	154,205,807.22	921,125,807.22

(1) Figures may not add due to rounding.

Source: New Mexico State Board of Finance.

Outstanding Supplemental Severance Tax Bonds

The principal amounts of Supplemental Severance Tax Bonds that are outstanding, as of December 31, 2016, are shown in Table 6.

TABLE 6

Outstanding Supplemental Severance Tax Bonds

Supplemental Severance Tax Bonds, Series 2010B	\$42,850,000
Supplemental Severance Tax Bonds, Series 2015B	66,345,000
Total	\$109,195,000

Source: New Mexico State Board of Finance.

The future fiscal year debt payments on outstanding Supplemental Severance Tax Bonds, as of December 31, 2016, are shown in Table 7.

TABLE 7

Future Supplemental Severance Tax Bond Debt Service

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017		2,673,650	2,673,650
2018	15,515,000	4,959,425	20,474,425
2019	16,995,000	4,146,675	21,141,675
2020	18,145,000	3,268,175	21,413,175
2021	18,175,000	2,416,400	20,591,400
2022	7,285,000	1,836,125	9,121,125
2023	7,660,000	1,462,500	9,122,500
2024	8,055,000	1,069,625	9,124,625
2025	8,465,000	656,625	9,121,625
2026	8,900,000	222,500	9,122,500
Total⁽¹⁾	\$109,195,000	\$22,711,700	\$131,906,700

(1) Figures may not add due to rounding.

Source: New Mexico State Board of Finance.

Tax Revenue Anticipation Notes

The State has issued, and expects to issue from time to time, Tax Revenue Anticipation Notes (“TRAN”). The TRAN are not general obligations of the State. The purpose of the TRAN is to fund a portion of the State’s cash flow needs during the fiscal year in which the TRAN are sold. The State Treasurer’s Office has not issued TRAN since Fiscal Year 2011, during which \$200,000,000 was issued.

Severance Tax Bonding Fund and Debt Service Requirements

Severance tax receipts contributed 96.5 percent of total revenue to the Bonding Fund in Fiscal Year 2016, with the remainder attributable to interest earnings and reversions. Severance taxes are almost entirely attributable to natural gas, crude oil and coal sales. Natural gas and crude oil together accounted for 96.6 percent of total Fiscal Year 2016 severance tax receipts as shown in Table 8. This percentage is calculated net of Intergovernmental Tax Credits.

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TABLE 8**Severance Tax Bonding Fund Receipts, Disbursements and Transfers****(Dollars in thousands)**

	Fiscal Year Ended June 30 ⁽¹⁾⁽²⁾				
	2012	2013	2014	2015	2016
Beginning Balance	\$161,190	\$254,810	\$142,806	\$19,572	\$152,471
Receipts:					
Taxes:					
Oil and Gas Severance Tax	\$449,283	\$400,959	\$518,371	\$474,533	\$289,063
Other Minerals Severance Taxes	13,548	13,416	12,297	11,506	10,102
Total Severance Taxes	<u>\$462,831</u>	<u>\$414,375</u>	<u>\$530,668</u>	<u>\$486,039</u>	<u>\$299,165</u>
Other Income:					
Interest on Investments	\$9,941	\$ 6,772	\$5,844	\$5,035	\$9,292
Bond Proceeds	4	0	0	0	0
Other financing sources	7,126	2,777	4,706	8,435	1,483
Total Other Income	<u>\$17,072</u>	<u>\$ 9,549</u>	<u>\$ 10,552</u>	<u>\$13,470</u>	<u>\$10,775</u>
Total Receipts	\$479,903	\$423,923	\$541,219	\$499,509	\$309,940
Disbursements:					
Senior Bond Debt Service	\$121,367	\$127,951	\$246,999 ⁽⁴⁾	\$16,795	\$142,085
Senior Short-term Obligations ⁽³⁾	76,220	111,999	90,545	128,217	8,615
Supplemental Bond Debt Service	29,300	21,483	28,084 ⁽⁵⁾	1,507	13,842
Supplemental Short-term Obligations ⁽³⁾	148,745	167,832	175,161	214,472	127,290
Costs of Issuance and Other Charges	<u>3,034 ⁽⁶⁾</u>	<u>2,774 ⁽⁷⁾</u>	<u>(1,331) ⁽⁷⁾</u>	<u>639</u>	<u>841</u>
Total Disbursements	\$378,665	\$432,039	\$539,458	\$361,630	\$292,672
Transfers:					
To Severance Tax Permanent Fund	<u>\$7,617</u>	<u>\$103,888</u>	<u>\$124,996</u>	<u>\$4,980</u>	<u>\$8,468</u>
Total Transfers	\$7,617	\$103,888	\$124,996	\$4,980	\$8,468
Ending Balance, June 30	\$254,810 ⁽⁸⁾	\$142,806	\$19,571	\$152,471	\$161,271

⁽¹⁾ All receipts, expenditures and balances exclude amounts in rebate accounts retained for potential arbitrage rebates.

⁽²⁾ Proceeds and expenditures attributable to refunding bonds are excluded from this table because such proceeds and expenditures are reserved for payments on appropriate refunding bonds and are not available for debt service payments on other Severance Tax Bonds.

⁽³⁾ The Board issues short-term Severance Tax Funding Notes and Supplemental Severance Tax Funding Notes to fund the authorized projects. The notes are sold to the State Treasurer and retired within the same fiscal year.

⁽⁴⁾ Includes \$120.6 million July 1, 2014 principal and interest payment on Severance Tax Bonds that was paid on June 27, 2014.

⁽⁵⁾ Includes \$12.5 million July 1, 2014 principal and interest payment on Supplemental Severance Tax Bonds that was paid on June 27, 2014.

⁽⁶⁾ Includes \$2.2 million paid to the Internal Revenue Service in August 2011 for arbitrage rebate liabilities.

⁽⁷⁾ Fiscal Year 2013 includes \$2.2 million that was incorrectly debited a second time in July 2012 for the August 2011 arbitrage rebate payment made to the Internal Revenue Service as part of the State Treasurer's Fiscal Year 2012 audit adjustments. Fiscal Year 2014 reflects reversal of this error in November 2013.

⁽⁸⁾ The ending balance includes the amount of the transfer to the Severance Tax Permanent Fund, which was made on July 3, 2012 in the amount of \$103.9 million.

Source: New Mexico State Board of Finance based on the Statewide Human Resources, Accounting, and Management Reporting System (the "SHARE System").

Crude oil and natural gas prices continued to decline during Fiscal Year 2016, reducing revenue inflows to the Severance Tax Bonding Fund. In addition, expected prices in future years have been reduced, reducing future expected revenue inflows. In response to these changes, severance tax bonding capacity has been reduced. The expected decrease in revenue is not expected to reduce the coverage ratio of debt service below 2x in any future year due to several mitigating factors, including (1) the legal coverage test, which now limits long-term bond issuance to less than 48.8 percent of bonding fund revenue, (2) the historical practice of the State to limit long-term bond issuance with respect to available capacity under such test, and (3) the practice of structuring debt service to decline over time. Rather, most of the impact of lower revenue will be realized in the form of lower amounts available through the State's issuance of very short-term bonds that effectively utilize the revenues on a cash basis.

Table 9 shows projected coverage ratios for outstanding Severance Tax Bonds as of January 15, 2017. The severance tax revenue outlook is prepared by the Department of Finance and Administration (the "DFA") using analysis by the Consensus Revenue Estimating Group, which includes economists from both the Legislative and Executive branches of New Mexico government, as well as forecasts by the U.S. Energy Information Administration, the IHS Global Insight and Moody's Analytics forecasting services, and public information about NYMEX futures contracts. The DFA's December 2016 figures estimated oil prices at \$42.00 per barrel for Fiscal Year 2017, \$47.00 for Fiscal Year 2018, and \$50.00 for Fiscal Year 2019 with slight increases in subsequent fiscal years. The DFA's December 2016 figures estimated natural gas prices at \$2.95 mcf for Fiscal Year 2017, \$3.20 for Fiscal Year 2018 and Fiscal Year 2019 with slight increases in subsequent fiscal years. Global oil and gas prices continue to experience significant market volatility. Accordingly, revenue projections are subject to continuing review.

TABLE 9

**State of New Mexico Severance Tax Bonds Projected Cash Receipts,
Debt Service Requirements and Coverage**

Fiscal Year Ending June 30	Projected STBF Revenues	Scheduled Senior Debt Service⁽¹⁾⁽²⁾	Projected Senior Debt Service Coverage	Scheduled Supplemental Debt Service⁽¹⁾⁽²⁾	Projected Supplemental Coverage
2017	\$291,082,289	\$141,063,473	2.06x	\$19,025,925	1.83x
2018	333,857,032	140,780,711	2.37	20,474,425	2.07
2019	344,799,404	137,305,979	2.51	21,141,675	2.18
2020	351,212,222	124,198,673	2.83	21,413,175	2.41
2021	359,341,617	113,368,948	3.17	20,591,400	2.68
2022	364,266,010	96,648,174	3.77	9,121,125	3.44
2023	364,550,322	88,333,650	4.13	9,122,500	3.74
2024	364,814,957	77,193,425	4.73	9,124,625	4.23
2025	365,060,313	58,509,625	6.24	9,121,625	5.40
2026	365,286,782	40,379,875	9.05	9,122,500	7.38

⁽¹⁾ Excludes debt service on refunded bonds which will be payable from escrowed securities and severance and supplemental severance tax debt obligations sold to the State Treasurer which are retired within the same fiscal year.

⁽²⁾ Fiscal Year 2017 Scheduled Senior Debt Service and Scheduled Supplemental Debt Service are as of June 30, 2016; all other dollar amounts reflect projections as of January 15, 2017.

Sources: New Mexico State Board of Finance and Fiscal Strategies Group.

Investments

Funds on deposit in the Bonding Fund are invested by the State Treasurer at the direction and approval of the Board, pursuant to the State Treasurer's Investment Policy ("Investment Policy"), adopted on May 20, 2014. Investments are made in securities, which are at the time legal investments of the State, and no such investment or deposit shall violate any applicable restrictions imposed by the Tax Code (defined below) and applicable Treasury Regulations relating to the market price and the existence of an established market.

Except for funds deposited into the Rebate Fund for any bond series (defined in the Bond Resolution), net interest earned on the amounts on deposit in the Debt Service Account for those bonds shall be retained therein, and net interest earned on amounts on deposit in the Project Fund for those bonds shall be credited to the Debt Service Account for those bonds and applied to the payment of principal and interest on the bonds next becoming due. Any net loss, after applying any earnings in that account or fund to the loss, resulting from any investment shall be charged to the applicable account from which such investment was made.

Severance Tax Collections and Reporting

Operators, purchasers and working interest owners are required to submit monthly reports to the Taxation and Revenue Department (the "TRD") showing the total value, volume and kind of products sold from every production unit each month. Taxes must be paid at the same time and are due 55 days after the month of production. Each production report must be accompanied by a company identification number, which facilitates automated processing of return information. Production and associated tax liability are reported by "production unit" and a designation for a well or group of wells that is assigned by the TRD based on the master operation, property name identification and pool. A suffix is added to the production unit number to designate the specific land type and taxing authority including county, school district, and municipality. During calendar year 2016, the TRD received an average of 501 oil and natural gas returns per month containing an average of 94,665 lines of reported tax detail from production units in the State.

Complete reporting forms must be mailed or delivered, or their information electronically transmitted, on or before the 25th day of the second month after the calendar month for which the report is required. Taxpayers whose total tax liability for the month (including the oil and gas emergency school tax, the oil and gas conservation tax and the oil and gas ad valorem tax, as well as the oil and gas severance tax) exceeds \$25,000 must provide payment by automated clearinghouse or by wire transfer on or before the due date. Taxpayers who fail to report or pay in a timely fashion are assessed interest at the rate established for individuals under Internal Revenue Code Section 6621 computed on a daily basis beginning the day after the due date and continuing until the date the tax is reported or paid. A penalty is assessed when a taxpayer fails to pay any tax or file any report by the due date because of negligence or disregard of rules and regulations. A penalty is charged at a rate of 2 percent per month, up to a maximum of 20 percent of the tax due.

The State maintains an automated database system ("ONGARD" for Oil and Natural Gas Administration and Revenue Database) to monitor production and sales activities of oil and natural gas producers. ONGARD functions include: managing production related information, which includes maintenance of tax rate information for the taxing authorities, processing of tax returns, payments, and distribution; managing the inventory of lands within the state and tracking all leases to determine whether royalty payments are owed to the State; monitoring all oil and natural gas wells for compliance with unitization/communitization agreements and other production-related information; and processing tax and royalty payments due to the State. The integrated database gives the State enhanced capabilities to

compare and evaluate production, tax and royalty reports, and to issue automated exception reports.

Severance taxes received by the TRD are deposited into the Extraction Tax Suspense Fund. Using the ONGARD system, the TRD reconciles monthly information reports with the payments received to identify the appropriate amounts to distribute to each tax beneficiary. Oil and gas severance tax amounts that have been reconciled and as to which TRD has determined no substantive risk of protest or litigation is present are then transferred monthly to the Bonding Fund. TRD is currently in the process of transitioning ONGARD capabilities to a more modern system.

TABLE 10

New Mexico Oil, Natural Gas and CO₂ Subject to Taxation

	<u>Fiscal Years Ended June 30</u>				
	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
<u>Oil</u>					
Sales Volume (million barrels)	79.7	93.8	113.5	141.4	146.6
Value (millions)	\$7,144	\$8,047	\$10,795	\$8,580	\$5,549
Average Price (per barrel)	\$89.64	\$85.82	\$95.13	\$60.67	\$37.85
<u>Natural Gas</u>					
Sales Volume (bcf)	1,229	1,173	1,186	1,185	1,175
Value (millions)	\$6,145	\$5,177	\$6,086	\$4,436	\$2,820
Average Price (per mcf)	\$5.00	\$4.37	\$5.13	\$3.78	\$2.40
<u>CO₂</u>					
Sales Volume (bcf)	113.1	115.8	107.3	99.6	95.4
Value (millions)	\$149.6	\$153.7	\$158.1	\$123.1	\$86.24
Average Price (per mcf)	\$1.32	\$1.33	\$1.47	\$1.24	\$0.90

Source: New Mexico Taxation and Revenue Department, Tax Analysis, Research and Statistics Office (ONGARD, sales month basis as of December 2016)

Severance Taxes on Oil, Natural Gas, and Carbon Dioxide

The State collects taxes on the severance and sale of oil, natural gas and carbon dioxide (“CO₂”). Table 11 summarizes the history of statutory tax rates imposed on natural gas, oil, and CO₂. Tax rates are set by statute, Section 7-29-4 NMSA 1978, and are levied on the volume and/or value of product sold. With the exceptions noted below, tax rates have been imposed on an *ad valorem* basis, with deductions allowed for royalties paid to governments and also for certain expenses of transporting and processing products downstream of the production facility.

TABLE 11

History of Severance Tax Rates on Oil, Natural Gas and Carbon Dioxide

Year of Statutory Change	Natural Gas	Oil	Carbon Dioxide
1959	2.500%	2.500%	--
1974	3.750%	3.750%	--
1977	\$0.050/mcf + surtax	\$0.450/bbl + surtax	--
1980	\$0.087/mcf + surtax	3.750%	--
1987	3.750%	3.750%	3.750%

Source: New Mexico Department of Finance and Administration.

Oil and Natural Gas Incentives

Although the State offers reduced severance tax rates for several categories of production, prices are above the threshold level, so none of these incentives are presently applicable. Table 12 summarizes incentive tax rates applying to various categories of production as of Fiscal Year 2016. Recent declines in oil and natural gas prices have not resulted in these incentives becoming applicable to date. Should prices decline in the future, some of these incentives may become applicable again.

TABLE 12

Oil and Natural Gas Tax Incentive Programs

Incentive Category	Incentive Tax Rate	Threshold Price Below Which Incentive Rate Applies	Qualified Production as a Percent of Fiscal Year 2016 Total
Production Restoration Project	0.0000% ⁽¹⁾	\$24.00 per barrel ⁽²⁾ \$24.00 per barrel ⁽²⁾	0.0% Oil ⁽⁴⁾ 0.0% Natural Gas ⁽⁴⁾
Well workover wells	2.4500%	\$24.00 per barrel ⁽²⁾ \$24.00 per barrel ⁽²⁾	0.0% Oil ⁽⁴⁾ 0.0% Natural Gas ⁽⁴⁾
Stripper wells	1.8750%	\$1.15 per mcf-Gas ⁽³⁾ \$15.00 per barrel-Oil ⁽³⁾	0.0% Natural Gas ⁽⁴⁾ 0.0% Oil ⁽⁴⁾
	2.8125%	\$1.35 per mcf-Gas ⁽³⁾ \$18.00 per barrel-Oil ⁽²⁾	0.0% Natural Gas ⁽⁴⁾ 0.0% Oil ⁽⁴⁾
	1.8750%	\$28.00 per barrel ⁽²⁾	0.0% Oil ⁽⁴⁾

- (1) The incentive rate applies for 10 years after the restoration project is completed. Each year's production is tested against the threshold price.
- (2) Twelve-month average price for West Texas Intermediate crude oil as reported on Oil Postings for last day of each month.
- (3) Average annual taxable value of natural gas or oil sold in New Mexico during the preceding calendar year.
- (4) No oil or natural gas volumes are expected to qualify for these incentives during the period because average taxable value exceeds the threshold levels.

Source: Sections 7-29A and 7-29B NMSA 1978.

Severance Tax on Indian Land

The State can tax non-Indian oil and natural gas production on tribal land, according to United States Supreme Court precedent in *Cotton Petroleum Company v. State of New Mexico*, 490 U.S. 163, 104 L. Ed. 2d 209, 109 S. Ct. 1968 (1989). The State's authority to impose severance taxes on non-Indian oil and natural gas production on tribal land was upheld by the United States District Court in New Mexico in *Jicarilla Apache Tribe v. New Mexico Taxation and Revenue Department*, No. USDC 87-922. In 2009, the United States District Court for the District of New Mexico held that the State may not impose severance taxes on non-tribal operators extracting oil and natural gas on the tribal land of the Ute Mountain Ute Tribe. *Ute Mountain Ute Tribe v. Homans*, 775 F. Supp. 2d 1259 (D.N.M. 2009) (Parker, J.). The Tenth Circuit Court of Appeals overturned the district court opinion and held that the State severance taxes are not preempted by federal law because, among other things, the State had asserted sufficient justification for imposing the taxes. *Ute Mountain Ute Tribe v. Rodriguez*, 660 F.3d 1177 (10th Cir. 2011). The Ute Mountain Ute Tribe petitioned for an *en banc* review, which the court denied on September 12, 2011. The United States Supreme Court denied the Ute Mountain Ute Tribe's petition for a writ of certiorari on February 21, 2012. *Ute Mountain Ute Tribe v. Padilla*, 132 S.Ct. 1557 (2012).

Information reported on the ONGARD website by TRD based on oil and gas tax return data indicates that natural gas production and crude oil production on Indian land was approximately 3.6 percent and 0.7 percent, respectively, of total statewide production in Fiscal Year 2016. The TRD estimates that oil and natural gas production on Indian land generated \$7.9 million in severance tax revenues to the State in the production months corresponding to Fiscal Year 2016. On December 30, 2014, the Navajo Nation completed the purchase of the Navajo coal mine. As a result, there has not been any production reported to the TRD since such purchase. No potash, copper or carbon dioxide (CO₂) is produced on Indian land.

Section 7-29C-1 NMSA 1978, enacted by the 1995 Legislature, authorized a credit against state production and property taxes for similar taxes imposed by tribal governments. The credit applies to crude oil and natural gas from new wells drilled on or after July 1, 1995 on land within Indian reservation boundaries on March 1, 1995. The amount of the credit is 75 percent of the lesser of state taxes or tribal taxes imposed. If the applicable tribal taxes were raised after March 1, 1995, then the amount of the State's credit is lowered. The ONGARD website reports that total credits claimed under this provision were about \$1.1 million in Fiscal Year 2016. About \$450,000 of these credits were applied against oil and natural gas severance tax liability. The Bonding Fund revenue projection assumes that this amount will grow slowly in the future.

The 2001 Legislature enacted Sections 7-29C-2, 7-9-88.2 and 9-11-12.2 NMSA 1978, which provided a similar 75 percent intergovernmental tax credit against severance tax and severance surtax on coal mined on the Navajo Nation.

Carbon Dioxide

The Bravo Dome CO₂ field encompasses 1.2 million acres in Harding, Union and Quay Counties in the northeastern area of the State. It contains estimated resources of 16.3 trillion cubic feet, of which 7.0 tcf to 10.6 tcf are considered economically recoverable. Although the State has long produced limited quantities of liquid and solid CO₂ for use in the food and the engineering industries, the main commercial value of CO₂ deposits is derived from the use of the product in its gaseous form in enhanced oil recovery projects in the Permian Basin of Texas and New Mexico. Future sales ultimately will depend on the CO₂ requirements of such projects and on the State's proportion of the market, which is shared with Colorado's Sheep Mountain and Little Sheep Mountain, McElmo Dome and Doe Creek Fields. Sales of CO₂ were approximately 95.4 bcf in Fiscal Year 2016, a decrease of 9.2 percent from 105.0 bcf in Fiscal Year 2015. The weighted average wellhead price of CO₂ sales for Fiscal Year 2016 was \$0.90 per mcf reported at the

production facility, a decrease of \$0.32 from \$1.22 per mcf during Fiscal Year 2015. Severance Taxes on CO₂ are levied at the rate of 3.75 percent of taxable sales value. Weighted average deductions were 38.3 percent in Fiscal Year 2016.

History of Severance Tax and Severance Tax Surtax on Coal Production

Severance taxes have been levied on coal production in New Mexico since 1937. Revenues were distributed to the State general fund until adoption of the Severance Tax Bonding Act in 1961. Tax rates were imposed on an ad valorem basis, 0.125 percent of value from 1937 to 1974, and 0.5 percent of value from 1974 to 1977. In 1977, rates were converted to \$0.38 per short ton for seam coal and \$0.18 per short ton for metallurgical coal. A severance surtax was also imposed. Subsequent rates were to be determined annually by multiplying the severance tax per short ton by the percentage increase in the Consumer Price Index (“CPI”) from 1976 to the calendar year just prior to the year in which the surtax rates were to be computed. The base severance tax rate was then increased to the current base rate of \$0.57 per ton in 1980. A slightly reduced base rate of \$0.55 per ton was provided for underground-mined coal in 1982.

Effective July 1, 1989, the severance surtax was frozen for a period of four years at \$0.60 per ton for surface coal and \$0.58 per ton for underground coal. When added to the base tax rate, this action had the effect of freezing the total rate at \$1.17 per ton for surface coal and \$1.13 per ton for underground coal. The surtax freeze was to terminate on July 1, 1993.

In 1990 the Legislature exempted from the surtax coal sold under new contracts entered into on or after July 1, 1990 and before July 1, 1994. The exemption also extended to incremental sales under existing contracts measured by the increase in sales over the annual average established in Fiscal Years 1987 to 1989. In 1992 the exemption was extended to incremental sales under renegotiated contracts.

In 1993 the exemption was extended to July 1, 1994. The annual increase was to be based upon the Producer Price Index (“PPI”) for coal instead of the CPI. The surtax formula provides that in no case will the surtax be decreased, so a fall in the PPI for coal will not trigger a drop in the surtax rate. In 1994 the exemption was extended to July 1, 1995. In 1995 it was extended to July 1, 1997. In 1997 it was extended to July 1, 1999.

Pursuant to actions of the 1999 Legislature, currently the following coal is exempt from the surtax: (1) coal sold and delivered pursuant to genuinely new contracts entered into on or after July 1, 1990; (2) coal sold and delivered pursuant to contracts already in effect on July 1, 1990, that exceeds the annualized average calendar year deliveries under the contract during production years 1987, 1988 and 1989 or the highest contract minimum during these three years, whichever is greater, unless the deliveries are reduced due to causes beyond the reasonable control of either party to the contract; (3) if a contract existing on July 1, 1990 and renegotiated after May 20, 1992 requires the purchaser to take annual coal deliveries in excess of the greater of the average calendar year deliveries from 1987-1989 or the highest annual contract minimum from 1987-1989, the surtax does not apply to such excess deliveries for the remaining term of the renegotiated contract. Taxpayers were required to register any contract for the sale of qualified coal with the department prior to taking the exemption.

After a number of years of stable revenues, 2011 marked a significant decrease of coal severance tax from \$23.3 million in Fiscal Year 2010 to \$15.7 million in Fiscal Year 2011. This decrease was caused by renegotiation of several long term mine-mouth contracts. Coal sold and delivered under the new contracts is exempt from the coal surtax. Revenues continued to fall in Fiscal Year 2016 to a total of \$6.8 million. The sale of the Navajo mine to the tax-exempt Navajo Nation in Fiscal Year 2014 contributed to the decline.

The table below sets forth data on coal production, pricing and average tax rates for the past five fiscal years.

TABLE 13
Coal Production, Prices, Revenues, and Taxes Fiscal Years 2012 to 2016⁽¹⁾

	2012	2013	2014	2015	2016
Production:					
Total Sales Volume (tons)	23,024,642	22,634,537	18,466,917	14,019,573	12,124,191
Surface Mined Surtax Exempt	16,413,332	15,880,674	11,366,169	7,974,724	6,501,537
Surface Mined Non-Exempt	533,727	893,391	832,843	351,397	0
Underground Mined Surtax Exempt	6,077,582	5,860,472	6,267,905	5,693,451	5,622,653
Prices:					
Weighted Average Price per Ton for All Coal	\$33.65	\$34.11	\$35.47	\$38.13	\$33.83
Sales Revenue:					
Total Sales Revenue	\$774,782,796	\$772,134,654	\$654,998,911	\$534,625,847	\$410,140,009
Taxes Collected and Intergovernmental Tax Credits (ITC):					
Gross Severance Tax and Severance					
Surtax Due	\$13,626,955	\$13,919,087	\$11,483,480	\$8,327,076	\$6,798,336
Intergovernmental Tax Credit (ITC)	\$ 2,348,013	\$ 2,298,775	\$ 3,385,576	\$2,408,236	\$1,076,391
Net Severance Tax and Severance					
Surtax Liability (Net of ITC)	\$11,278,942	\$11,620,312	\$8,097,904	\$5,918,840	\$5,721,945
Effective Taxes (Net of ITC):					
Effective Tax Rate	1.46%	1.50%	1.24%	1.11%	1.40%
Effective Tax per Ton for all Coal (Net of ITC)	\$0.49	\$0.51	\$0.44	\$0.42	\$0.47

⁽¹⁾ Totals may not sum due to rounding.

Source: New Mexico Taxation and Revenue Department, Tax Analysis, Research and Statistics Office (the "GenTax System").

Severance Taxes on Other Minerals

Many other minerals and natural resources are taxed in the State upon their severance from the earth or, in some cases, their sale or shipment. Existing tax rates are listed in Table 14. In many cases, flat percentage deductions are allowed to account for certain production costs. The result is that the gross value is a percentage of the "full value." The "full value," in turn, is sometimes based upon published prices rather than actual revenues. Generally, for products with a price at the point of production, value is that price less deductions allowed for actual costs for hoisting, loading, and crushing of up to 50 percent of price. For products that must be processed before sale, deductions are allowed for cost of processing and freight charges to the point of sale. Several exceptions apply, as detailed below.

For potash, the gross value is 40 percent of the posted field or market price, less those actual expenses of hoisting, crushing and loading necessary to place the severed product in marketable form and at a marketable price but allowable deductions may not exceed 50 percent. The gross value for each type of potash and potash product requiring processing or beneficiation (other than sizing) is 33.33 percent of the proceeds realized from the sale of muriate of potash and sulphate of potash magnesia, as standard grades, and 33.33 percent of the value of such products consumed in the production of other potash products, less 50 percent of such reported value as a deduction for expenses of hoisting, loading, crushing, processing, and beneficiation.

Gross values for copper, lead, zinc, gold, and silver are 66.66 percent of specified Comex,

London Metal Exchange cash price, London Metal Exchange Final, and London spot, U.S. Equivalent, respectively, as published in *Metals Week*. The gross value for gold is the sales value established from published price date of the quantity of gold recoverable from the concentrate or other product which is sold or is shipped, transmitted or transported out of New Mexico without sale. The gross value for silver is 80 percent of the sales value established from published price date of the quantity of silver recoverable from the concentrate or other product which is sold or is shipped, transmitted or transported out of New Mexico without sale. For molybdenum, gross value is the value of molybdenum contained in concentrates shipped or sold from a mine site, but in no event shall it be less than market value. For copper, lead, zinc, gold, silver and molybdenum, deductions of 50 percent of the sales value are allowed for the expenses of hoisting, loading, crushing, processing and beneficiation, regardless of actual expenses incurred.

For sand and gravel, in the absence of substantial evidence of a different posted field or market price, it is presumed that the gross value is \$1.75 per ton. In the absence of evidence of lower deductible expenses the maximum 50 percent deduction will be allowed. In determining taxable value, rent and royalty payments to the federal government or the State government are deductible from gross value.

TABLE 14

Severance Tax Rates on Other Minerals

Mineral Resources	Fiscal Year 2015⁽¹⁾ Collections	Fiscal Year 2016⁽¹⁾ Collections	Tax Rate	Gross Value as Percent of Full Value
Potash	\$1,399,122	\$1,058,559	2.500%	not fixed
Copper	916,173	743,290	0.500	16.67%
Timber, Pumice, Gypsum, Clay, Fluorspar, Other	60,779	52,360	0.125	not fixed
Molybdenum ⁽³⁾	0	0	0.125	50.00
Lead, Zinc	Not detailed	Not detailed	0.125	16.67
Gold	16,991	26,931	0.200	50.00
Silver	700	784	0.200	30.00
Uranium	Not detailed	Not detailed	3.500	50.00 ⁽²⁾
Other than Potash, Copper, Molybdenum	Not detailed	Not detailed		

⁽¹⁾ Collections for Fiscal Years 2015 and 2016 are the most recent data available.

⁽²⁾ Taxable Value as a Percentage of Full Value.

⁽³⁾ In June 2014, Chevron Mining closed its Questa molybdenum mine in Taos County, reducing total molybdenum collections to zero in Fiscal Years 2015 and 2016.

Source: *New Mexico Taxation and Revenue Department, Tax Analysis, Research and Statistics Office.*

Severance tax revenue from potash was an estimated \$1.1 million in Fiscal Year 2016, a decrease of approximately 24.4 percent from Fiscal Year 2015. Severance tax revenue from copper, which is limited because of the statutorily defined narrow tax base, was \$743,290 in Fiscal Year 2016, down from \$916,173 in Fiscal Year 2015. The average price of copper was \$2.208 per pound in Fiscal Year 2016.

GENERAL INFORMATION CONCERNING THE STATE OF NEW MEXICO

The State, admitted as the forty-seventh state on January 6, 1912, is the fifth largest state, containing approximately 121,593 square miles. The estimated 2016 population of the State is 2,081,015 according to the United States Census Bureau. The State has a semiarid subtropical climate with light precipitation. Its climate is characterized by sunshine and bright skies in both winter and summer. Every part of the State receives no less than 70 percent sunshine year-round. Humidity ranges from 30 to 60 percent. Thunderstorms in July and August bring most of the moisture. December to March snowfalls vary from 2 inches (lower Rio Grande Valley) to 300 inches (north central mountains).

Governmental Organization

The Executive Branch of State government consists of a Governor, Lieutenant Governor, Secretary of State, State Auditor, State Treasurer, Attorney General, and Commissioner of Public Lands. These officials are elected to four-year terms beginning January 1 after their election. An elected Executive Branch officer may succeed himself or herself in office once. The primary functions of the Executive Branch are currently carried out by the offices of each elected Executive Branch officeholder, in addition to approximately 22 cabinet departments, each headed by a cabinet secretary appointed by the Governor and approved by the Legislature, and approximately 9 cabinet-level agencies. Elections for all statewide offices were held on November 4, 2014.

The State Board of Finance has seven voting members consisting of the Governor, the Lieutenant Governor, the State Treasurer, and four members appointed by the Governor with the advice and consent of the Senate. No more than two appointed members may be from the same political party. The Department of Finance and Administration (the “DFA”) Secretary serves as the Executive Officer of the Board and is a non-voting Board member. The Board, in addition to other powers and duties provided by law, has general supervisory authority over the fiscal affairs of the State and over the safekeeping and depositing of all money and securities belonging to, or in the custody of, the State. The Governor serves as the President of the Board.

The DFA is the principal financial organization of State government and performs through its divisions the duties and functions relating to State and local government financing and general administration. The executive and administrative head of the DFA is the Secretary, who is appointed by the Governor with the advice and consent of the Senate. The Board of Finance is a division of the DFA that provides operational, analytical and administrative support to the Board. The Director of the Board is appointed by the DFA Secretary with the approval of the Board.

The Legislature consists of 112 members and is divided into a Senate and a House of Representatives. Senators are elected for four-year terms and members of the House are elected for two-year terms. The Legislature convenes in regular session annually on the third Tuesday in January. Regular sessions are constitutionally limited in length to 60 calendar days in odd-numbered years and 30 calendar days in even-numbered years. Special sessions of the Legislature may be convened by the Governor. Extraordinary sessions may be convened by the Legislature under certain limited circumstances. Legislators do not receive any salary, but do receive per diem and mileage allowances while in session or performing official State business.

The judicial branch is composed of a statewide system including Magistrate and District Courts, the Court of Appeals and the Supreme Court. The District Courts are the trial courts of record with general jurisdiction.

Pension and Other Retirement Funds and Benefits

Legislative History. The Legislature enacted the Educational Retirement Act, Section 22-11-1 et seq. NMSA 1978, the Public Employees Retirement Act, Section 10-11-1 et seq. NMSA 1978, and the Retiree Health Care Act, Sections 10-7C-1 through 10-7C-19, NMSA 1978, which created the retirement plans that cover most employees of the State and its political subdivisions. These retirement plans are managed by the Educational Retirement Board (“ERB”), the Public Employees Retirement Association (“PERA”), and the New Mexico Retiree Health Care Authority (“NMRHCA”) and described below. The Legislature establishes all financing provisions of the plans and the provisions are not subject to negotiation. Financing provisions include employee and employer contributions, fund investment provisions and

benefit provisions. In 1998, the voters amended the State Constitution, adopting Section 22 of Article XX, which states that upon meeting the minimum service requirements of an applicable retirement plan created by law for employees of the State or any of its political subdivisions or institutions, a member of a plan shall acquire a vested property right with due process protections under the applicable provisions of the New Mexico and United States Constitutions. The amendment also states that nothing in Section 22 shall be construed to prohibit modifications to retirement plans that enhance or preserve their actuarial soundness.

Educational Retirement Board-Historic Financial Information. The ERB had 150,082 members as of June 30, 2016, including active, retired, inactive vested and inactive non-vested members. The market value of Educational Retirement Fund (the “Fund”) as of June 30, 2016 was \$11.5 billion. The ERB had net investment gains for the Fiscal Year 2016 of 3.1 percent. As of August 31, 2016, the market value of the Fund was \$11.7 billion.

As with many other states, the State has experienced funding issues regarding its pension funds. The Legislature has enacted several reforms in recent years to better ensure the continued sustainability of the ERB pension program. In 2009, the Legislature increased the years in service requirement from 25 to 30 years, and extended the rule whereby ERB members could retire with full benefits if their combined service and age at retirement met or exceeded 75 to 80 for new members hired after July 1, 2010. A 2011 change in law required retired members who return to work with an educational employer to pay non-refundable contributions to the Fund equal to the amount paid by non-retired employees. Employers continue to pay the employers’ contributions to the Fund for retired members who return to work. Finally, in 2013, the Legislature increased employee contributions for members whose salary exceeds \$20,000 per year to 10.1 percent in Fiscal Year 2014 and 10.7 percent beginning in Fiscal Year 2015, kept in place scheduled increases in employer contribution rates, created a new tier of membership for persons who become members on or after July 1, 2013, created certain actuarial limitations on benefits of new tier members, and placed limitations on future cost of living adjustments (“COLA”) for current and future retirees which are tied to the future funded ratios of the plan. The projected actuarial funded ratio in 2043 with these changes is 100.7 percent.

In April 2011, the ERB retirement board voted to change its assumed rate of return on the pension fund’s investments from 8.0 percent to 7.75 percent. As of June 30, 2016, the actuarial value of assets was \$11.5 billion and the unfunded accrued actuarial liability (“UAAL”) was \$6.6 billion. Other changes were made to the ERB’s actuarial assumptions in April 2011, the most significant of which included: changing the funding method to traditional individual entry age normal; revising post-retirement mortality to reflect slightly longer life expectancy; changing retirement rates at ages 65 and 69 and with 25 or more years of service; decreasing salary increases for members with 10 or more years of service; and decreasing membership growth assumptions. The combined effect of the changes in actuarial assumptions, including to the assumed investment return rate, increased the UAAL by \$426.1 million at that time. In April 2013, the ERB made further changes to its assumptions regarding post-retirement, disabled, and active mortality rates, retirement rates, changes to its service-based termination table and decreases in wage inflation from 4.75 percent to 4.25 percent and in the payroll growth from 3.75 percent to 3.50 percent. These changes reduced the June 30, 2013 UAAL by \$81.5 million. Finally, in June 2015, the ERB voted to further lower the wage inflation assumption from 4.25 percent to 3.75 percent, to adopt a generational mortality projection to better reflect future longevity improvements, to remove its population growth assumption for projections and to make minor changes to several demographic assumptions.

The 2011 change in the assumed rate of return was recommended by the ERB’s outside actuaries and was made after consultations with the ERB’s internal investment staff and its general investment consultant. The ERB will continue to monitor both its investment returns and general market conditions and may again change its assumed rate of return as market conditions and experience warrant.

As of June 30, 2016, the UAAL had an amortization period of 45.0 years. The amortization period, also referred to as the funding period, is a calculation based on actuarial models of the period required to amortize the UAAL, assuming ERB’s experience exactly follows actuarial assumptions. The calculation is based on current contribution rates which are established by state statute.

TABLE 15

Schedule of Statutorily-Mandated Contribution Rates

<u>Wage Category</u>	<u>Fiscal Year(s)</u>	<u>Date Range</u>	<u>Member Rate</u>	<u>Employer Rate</u>	<u>Total</u>
\$20k or less	2010–2013	07/01/2009–06/30/2013	7.90%	12.40%	20.30%
	2014	07/01/2013–06/30/2014	7.90%	13.15%	21.05%
	2015–Future	07/01/2014–Future	7.90%	13.90%	21.80%
Over \$20k	2010–2011	07/01/2009–06/30/2011	9.40%	10.90%	20.30%
	2012	07/01/2011–06/30/2012	11.15%	9.15%	20.30%
	2013	07/01/2012–06/30/2013	9.40%	10.90%	20.30%
	2014	07/01/2013–06/30/2014	10.10%	13.15%	23.25%
	2015–Future	07/01/2014–Future	10.70%	13.90%	24.60%

Source: New Mexico Statutes Annotated 1978, Section 22-11-21, as amended.

In addition, New Mexico universities and colleges make an additional contribution of 3 percent of the salary of those employees who elect to participate in the Alternative Retirement Plan (“ARP”), a defined contribution retirement plan available to certain faculty and professional employees, to satisfy the UAAL attributable to participation in the ARP.

The ERB implemented Governmental Accounting Standards Board (“GASB”) Statement 67 requirements with its June 30, 2013 financial statements. GASB Statement 67 requires ERB to report net pension liability (“NPL”) which is measured as total pension liability less the amount of the plan’s fiduciary net position. GASB 67 replaced GASB 25 which had required ERB to report the annual required contribution of the employer (“ARC”) and the percentage of the ARC contributed. ERB meets 100 percent of its statutorily required employer contributions annually. The following table lists the ARC, NPL and the ERB funded ratio for Fiscal Years 2011 through 2016.

TABLE 16

Educational Retirement Board Funded Ratio

<u>Fiscal Year</u>	<u>Annual Required Contribution (GASB 25)</u>	<u>Net Pension Liability (GASB 67)</u>	<u>Funded Ratio</u>
2011	\$377,884,749	--	63.0
2012	\$400,461,343	--	60.7
2013	--	\$6,276,852,149	60.1
2014	--	\$5,705,730,813	63.1
2015	--	\$6,477,266,299	63.7
2016	--	\$7,196,433,561	64.2

Source: Educational Retirement Board.

The ERB also implemented GASB Statement 68 early with its June 30, 2014 financial statements. GASB 68 requires the plan’s participating employers to recognize their pro rata share of NPL on their balance sheets.

In July 2012, the ERB adopted goals of achieving a 95 percent, plus or minus 5 percent, funded ratio by 2040. The amendments to the Educational Retirement Act made through enactment of Senate Bill 115 (Chapter 61, Laws 2013) are intended to assist the ERB in achieving these goals.

ERB pensions are adjusted annually by a COLA beginning on the later of either July 1 of the year in which a member reaches age 65 or July 1 following the year a member retires. SB 115 reduces the amount of the COLA until ERB is 100 percent funded. The amount of the adjustment is determined by the change in the Consumer Price Index (“CPI”), the retiree’s pension amount and the retiree’s service credit. Pensions cannot be decreased if there is a decrease in the CPI.

In December 2013, the Supreme Court of New Mexico, in *Barlett v. Cameron*, 2014-NMSC-002, rejected the claims of certain retired teachers, professors and other public education employees challenging the state constitutionality of Senate Bill 115 (Chapter 61, Laws 2013) to the extent that it reduces the future amounts that all education retirees might receive as an annual COLA. The court held that Article XX Section 22 of the State Constitution did not grant the retirees a right to an annual COLA based on the formula in effect on the date of their retirement. The court held that any future COLA to a retirement benefit is merely a year-to-year expectation that, until paid, does not create a property right under the State Constitution. Once paid, the COLA by statute becomes part of the retirement benefit and a property right subject to those constitutional protections.

In 2010, the ERB changed the manner in which interest was calculated on members’ contributions that are subject to refund so that it would be calculated in a manner similar to a savings account. As a result of a programming error, interest was miscalculated on refunds during July and August 2010 leading to overpayment of approximately \$1.7 million to 693 individuals. The software was corrected after staff became aware of the error. Subsequently, the ERB undertook steps to recover the overpayments. To date, over \$1.2 million has been recovered. The ERB has entered into payment plans with a number of the recipients through which it expects to recover additional funds and is continuing to pursue recovery from others who were overpaid.

The Public Employees Retirement Association-Historic Financial Information. PERA had 48,693 active members as of June 30, 2016. As of June 30, 2016, the total market value of PERA Fund was \$15.182 billion. The Fiscal Year 2016 PERA total fund investment return was 0.7 percent. As of October 31, 2016, the total market value of the PERA fund was \$14.209 billion.

The PERA Board performs annual actuarial valuations of the retirement Funds it administers. Cavanaugh Macdonald Consulting, LLC completed an actuarial valuation of the PERA Fund, Judicial Retirement Fund, Magistrate Fund, Legislative Division and Volunteer Firefighter Fund as of June 30, 2016.

In May 2015, PERA actuaries conducted an experience study, testing actuarial assumptions currently used in its valuations. The PERA Board accepted the actuary's revised assumptions that the assets, benefit values, reserves and computed contribution rates reflect utilization of an inflation rate of 3.0 percent per annum and real rate of return rate of 4.75 percent, reflecting an investment rate of return of 7.75 percent. The Board also adopted reduced wage inflation and payroll growth assumptions of 3.5 percent, each compounded annually, as well as revised retirement and mortality assumptions.

In 2016, the PERA Board adopted a select and ultimate rate of return assumption for funding purposes. The change in the assumed rate of return was recommended by the PERA's outside actuaries and was made after consultations with the PERA's internal investment staff and its general investment consultant. The rate is 7.25 percent for the first 10 years (select period) and 7.75 percent for all other years (ultimate). The equivalent blended rate is 7.48 percent and will be used as the discount rate used to measure the total pension liability. The projection of cash flows used to determine the discount rate assumed that future contributions will be made in accordance with statutory rates. On this basis, the pension plan's fiduciary net position together with the expected future contributions are sufficient to provide all projected future benefit payments of current plan members as determined in accordance with GASB Statement No. 67. Therefore, the 7.48 percent assumed long-term expected rate of return on pension plan investments will be applied to all periods of projected benefit payments to determine the total pension liability.

PERA member and employer contribution rates are established by State statute. In 2013, the Legislature amended the PERA Act, NMSA 1978 10-11-1 et seq. to increase the employer contribution rate by 0.4 percent beginning July 1, 2014, and to increase member contribution rates by 1.5 percent beginning July 1, 2013. Actuarial information for each fund as of June 30, 2016 is shown in Table 17.

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TABLE 17

**Summary of State Retirement Funds Managed by
the Public Employees Retirement Association**
(Dollars in thousands)

	<u>PERA</u> ⁽¹⁾	<u>Judicial</u>	<u>Magistrate</u>	<u>VFF</u>	<u>Legislative</u>
Membership	100,974	307	179	9,418	320
<u>Actuarial Information</u>					
Accrued Liability ⁽²⁾	\$19,474,241	\$146,935	\$53,547	\$ 45,256	\$ 27,943
Actuarial Value of Assets ⁽³⁾	\$14,654,814	\$ 90,471	\$33,060	\$ 64,900	\$ 40,451
Unfunded (Overfunded) Accrued Liability	\$ 4,819,427	\$ 56,464	\$20,487	\$ (19,643)	\$(12,508)
Present Value of Statutory Obligations	\$21,951,183	\$163,711	\$57,580	\$ 50,590	\$ 30,496

(1) Includes both the state and municipal divisions.

(2) Includes the accrued liability of both the retired and active members.

(3) The valuation of assets is based on an actuarial value of assets whereby gains and losses relative to a 7.25 annually for the first 10 years and 7.75 thereafter percent annual return are smoothed over a four-year period.

Source: Public Employees Retirement Association.

As of June 30, 2016, PERA has an amortization or funding period of 56 years, based on the employer and member contribution rates in effect as of July 1, 2016. Member and employer rates are established pursuant to Section 10-11-1 through 10-11-142 NMSA 1978. The funded ratio (ratio of the actuarial value of assets to accrued actuarial liability) was 75.3 percent as of June 30, 2016 and the UAAL of the PERA Fund increased \$108 million to approximately \$4.8 billion. The State's portion of the UAAL of the PERA Fund is 52.9 percent, or \$2.5 billion. Prior to 2013 pension reform, the funded ratio was 65.3 percent and the UAAL of the PERA Fund was calculated to be approximately \$6.2 billion. The primary cause of the slight increase in the funded ratio is due to use of pensionable wages and the increase in accrued actuarial liability is reflective of the lower than expected investment return from the 2016 plan years. On a market value basis, PERA's funded ratio is approximately 69.18 percent as of June 30, 2016. Current 30-year projections indicate the PERA Fund will be 76.8 percent funded in 2043.

In 2016, PERA implemented GASB 67 for the third year. PERA will also produce an audited Schedule of Employer Allocations and Pension Amounts in the winter of 2017 to assist its employer participants in implementing GASB 68. GASB 68 requires participating local governments to recognize their pro rata share of net pension liability ("NPL") and other pension elements in the face of their financial statements. The total NPL as of June 30, 2016, for the PERA Fund allocated to its nearly 200 cost sharing employers that participate in the Fund is approximately \$6.2 billion.

In 2015, PERA completed the Schedule of Employer Allocations required by GASB 68 and provided local governments with the allocation percentage necessary to derive an employer's proportionate share of the collective NPL as of June 30, 2014. This information assisted GASB 68 implementers in implementing GASB 68 for the first time in 2015. PERA continues to provide statewide outreach and assistance to local governments to ensure local governments continue to receive pertinent allocation information required by GASB 67 and 68.

Net Pension Liability Table
(GASB 67)

<u>Fund</u>	<u>FY 2014 NPL</u>	<u>FY 2015 NPL</u>	<u>FY 2016 NPL</u>
PERA	\$ 3,319,394,159	\$ 4,260,526,331	\$ 6,159,380,375
Judicial	\$ 41,310,273	\$ 48,049,718	\$ 106,623,028
Magistrate	\$ 21,216,149	\$ 30,348,921	\$ 43,480,544
Volunteer Firefighter	\$ (21,042,172)	\$ (17,625,607)	\$ (12,114,026)

The following table lists the funded ratios for each individual PERA fund for Fiscal Years 2012 through 2016.

TABLE 18

Funded Ratio of State Retirement Funds Managed by the Public Employees Retirement Association

<u>Fiscal Year</u>	<u>PERA</u>	<u>Judicial</u>	<u>Magistrate</u>	<u>VFF</u>	<u>Legislative</u>
2012	65.3	51.0	53.2	167.9	91.8
2013	72.9	55.7	58.38	138.16	115.2
2014	75.8	64.2	64.5	139.7	129.3
2015	74.9	62.5	62.4	140.2	138.5
2016	75.3	61.6	61.7	143.4	144.8

Source: Public Employee Retirement Association.

Recent legislative changes enacted during the 2009 through 2016 legislative sessions also amended various provisions of the Public Employees Retirement act to improve the long-term stability of the fund. House Bill 573 (Chapter 288, Laws 2009) included training requirements for members of the PERA board. House Bill 854 (Chapter 125, Laws 2009) modified employer and employee contributions to the State's retirement funds for Fiscal Years 2010 and 2011, shifting 1.5 percent of the annual contribution rate from employers to employees for those employees with a full-time equivalent salary greater than \$20,000. House Bill 628 (Chapter 178, Laws 2011) extended the existing 1.5 percent shift made in House Bill 854 through Fiscal Year 2013 and shifted an additional 1.75 percent of the annual contribution rate from employers to employees for Fiscal Year 2012. The additional 1.75 percent of the annual contribution rate shifted back from the employees to the employers for Fiscal Year 2013. The 1.5 percent contribution shift from the employers to the employees remained in place through Fiscal Year 2013. House Bill 628 also required an actuarial study by PERA prior to September 20, 2013 to analyze whether contribution rate changes have had an adverse actuarial effect on the retirement systems.

Senate Bill 27 (Chapter 225, Laws 2013) significantly amended the Public Employees' Retirement Act by creating a new tier of reduced benefits for new hires. The law reduces the cost of living adjustments for all current and future retirees; delays the application of cost of living adjustments for certain future retirees; suspends the cost of living adjustments for certain return-to-work retirees; provides for an increase in the statutory employee contribution rate of 1.5 percent (subject to certain requirements) for employees earning \$20,000 or more in annual salary; provided for an increase in the statutory employer contribution of 0.4 percent beginning in Fiscal Year 2015; increased age and service requirements; lengthened the base average salary calculation amount from three to five years for Tier 2 employees; increased the vesting

period for employees from five to eight years for most Tier 2 members; lowered the annual service credit by 0.5 for most members; and makes several other clarifying and technical changes.

Legislative changes enacted during the 2014 legislative session amended sections of the law relating to the judicial and magistrate retirement funds and followed many of the changes implemented in the 2013 legislative session for the public employees' and educational retirement funds.

House Bill 33 (Chapter 35, Laws 2014) amended the Judicial Retirement Act. Among other things, the law suspended for two years and makes adjustments to cost of living increases, adjusted employee and employer contributions, required mandatory participation in the fund and implemented changes to the benefits structure.

House Bill 216 (Chapter 39, Laws 2014) amended the Magistrate Retirement Act. Among other things, the law suspended for two years and makes adjustments to cost of living increases, adjusted employee and employer contributions, required mandatory participation and implemented changes to the benefit structure.

Senate Bill 160 (Chapter 43, Laws 2014) also made changes to the Magistrate Retirement Act. This law duplicated the changes made in House Bill 216.

During the State of New Mexico (52nd Legislature) Second Special Session in 2016, Senate Bill 6 was passed that reduced the State's distribution to the legislative retirement fund from \$200,000 a month to \$75,000 a month. Prior to this legislative change, \$2,400,000 was received as an annual contribution to the legislative fund. As of October 19, 2016, \$900,000 will be the annual amount distributed by the State to the legislative fund. PERA's funded ratio is expected to increase from 75.3 percent to 76.8 percent by 2043, assuming the Plan meets all of its economic and demographic assumptions.

New Mexico Retiree Health Care Authority-Historic Financial Information. The NMRHCA was enacted for the purpose of providing comprehensive group health insurance coverage for persons who have retired from certain public service positions in the State and their eligible dependents. NMRHCA offers both pre Medicare and Medicare plans, as well as nonsubsidized dental, vision and life insurance plans to eligible participants. As of July 2016, there were approximately 60,000 enrolled members and approximately 300 participating public entities.

NMRHCA's long-term investments have begun to struggle as the 1-year rate of return was -0.58 percent as of June 30, 2016 and the 5-year rate of return fell to 5.31 percent. However, an independent allocation analysis of the investment portfolio projects a 7 percent rate of return over the next 5 – 7 year period. In addition, NMRHCA has added over \$198 million to its trust fund over the past six years. NMRHCA's trust fund balance as of June 30, 2016 was \$464.5 million.

The Retiree Health Care Act provides that the benefits offered to retired public employees may be modified, diminished or extinguished by the Legislature, and that the Act does not create any contract, trust or other rights for public employees to health care benefits.

NMRHCA, the agency that administers the Retiree Health Care Act, has a revenue base comprised of active employee payroll deductions, participating employer contributions, monthly premium contributions of enrolled participants, investment income, and amounts distributed annually from the Taxation Administration Suspense Fund ("TAA Fund"). Employer and employee contribution rates are established in statute as is the amount distributed from the TAA Fund. Respective employer/employee contribution rates are 2 percent and 1 percent of the participating employee's salary for Fiscal Years 2016 and 2017.

Based on the GASB Statement 43 valuation for Fiscal Year 2016, and assuming that the NMRHCA Fund is an equivalent arrangement to an irrevocable trust using a discount rate of 5 percent, the UAAL has been calculated to be approximately \$3.8 billion. As required by GASB Statement 43, this calculation takes into consideration only current assets of the NMRHCA Fund. However, beginning in Fiscal Year 2017, NMRHCA will begin reporting under the new standards created under GASB 74, which is replacing GASB 43.

The NMRHCA continues to look for additional opportunities to further strengthen the financial standing of the NMRHCA. The NMRHCA Board of Directors has passed a five-year solvency plan to ensure the long term financial stability of the program through a series of targeted benefit reductions and increases to contribution levels from participating employees and their employers. In addition to increased retiree cost sharing through plan design changes, the solvency plan calls for proportionately higher premiums for retirees who retired younger (decreased premium subsidies to pre-Medicare retirees) or did not work or pay into the system as long (increasing years of service required to receive maximum subsidy) and decreased subsidies for family members. Combined, these actions are expected to further improve the financial condition of the trust fund by increasing revenues and reducing future liabilities.

As of June 30, 2016, the NMRHCA program had a 20-year projected solvency (period of positive fund balance). However, Senate Bill 7 (Chapter 1, Laws 2016) passed during the 2nd Special Session changes the distribution received from the Tax Administration Suspense Fund, reducing projected revenues by a cumulative \$250 million and effectively reducing the solvency period by approximately 3 years. NMRHCA will conduct another solvency study before the end of Fiscal Year 2017 to measure the full impact of the amended law.

Currently, GASB Statement 43 requires the NMRHCA to report its ARC and the percentage of the ARC contributed. The following table lists the NMRHCA ARC and percentage of the ARC contributed for Fiscal Years 2012 through 2016.

TABLE 19

New Mexico Retiree Health Care Authority Annual Required Contribution

<u>Fiscal Year</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
2012	\$340,074,787	39.80
2013	\$353,657,828	38.30
2014	\$367,804,141	40.60
2015	\$292,656,756	53.53
2016	\$303,631,394	52.65

Source: New Mexico Retiree Health Care Authority.

Economic and Demographic Characteristics

New Mexico is the 36th largest state by population and the fifth largest in land area. The population of the State as of the time of the 2010 United States Census was 2,059,179. From 2000 to 2010, the State's population grew 13.2 percent, while the national population grew 9.7 percent.

There are four Metropolitan Statistical Areas ("MSAs") in the State. The Albuquerque MSA is comprised of Bernalillo, Sandoval, Torrance and Valencia Counties; the Las Cruces MSA is comprised of Doña Ana County; the Santa Fe MSA is comprised of Santa Fe County; and the Farmington MSA is

comprised of San Juan County. The following table sets forth information on population growth in New Mexico and nationally.

TABLE 20
Population New Mexico and the United States
2007-2016

Year⁽¹⁾	Population⁽²⁾		Annual Percentage Change	
	New Mexico	United States	New Mexico	United States
2007	1,966,357	301,231,207	--	--
2008	1,984,179	304,093,966	0.9%	1.0%
2009	2,007,315	306,771,529	1.2	0.9
2010	2,059,179	308,745,538	2.6	0.6
2011	2,077,756	311,663,358	0.9	1.0
2012	2,083,784	313,998,379	0.3	0.8
2013	2,085,193	316,204,908	0.1	0.7
2014	2,083,024	318,563,456	(0.1)	0.8
2015	2,080,328	320,896,618	0.0	0.7
2016	2,081,015	323,127,513	0.0	0.7

⁽¹⁾ As of July 1 (except for 2010 data which is as of April 1). Except for 2010 data, population figures are stated as intercensal estimates.

⁽²⁾ All estimates are subject to change.

Source: U.S. Census Bureau, Population Division, 2006-2009 released September 2011; 2010-2016 released December 2016.

Major industries in the State include oil and natural gas production, tourism and retail, healthcare, government and mining. Major federally funded scientific research facilities at Los Alamos, Albuquerque and White Sands are a notable part of the State's economy. Currently, lower global oil prices are negatively impacting mining and industries that serve the mining industry. In 2015, the largest employment sector in the State was government (comprising approximately 19.0 percent of the State's workforce), followed, in order, by health care and social assistance; retail trade; accommodation and food services; and professional, scientific and technical services. For the twelve-month period ended December 31, 2015, total average employment in the State increased by 1.3 percent as compared to the same twelve-month period ending December 31, 2014. The following table sets forth information on employment by industry over the period of 2006 through 2015, the most recent figures available.

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TABLE 21**Total New Mexico Full-time and Part-time Employment by North American Industry Classification System 2006-2015**

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Growth 2014-2015	Growth 2006-2015
Total employment	1,080,732	1,105,413	1,107,869	1,075,660	1,060,716	1,065,291	1,067,757	1,075,867	1,082,277	1,095,949	1.3%	1.4%
Wage and salary employment	868,518	878,592	81,856	849,122	837,320	837,281	839,789	846,896	852,861	859,738	0.8	-1.0
Proprietors employment	212,214	226,821	226,013	226,538	223,396	228,010	227,968	228,971	229,416	236,211	3.0	11.3
Farm proprietors employment	15,255	18,193	18,041	18,270	19,083	20,715	21,436	21,547	21,322	21,311	-0.1	39.7
Nonfarm proprietors employment	196,959	208,628	207,972	208,268	204,313	207,295	206,532	207,424	208,094	214,900	3.3	9.1
Farm employment	22,829	25,804	24,702	25,228	25,630	27,323	28,370	29,218	28,111	28,772	2.4	26.0
Nonfarm employment	1,057,903	1,079,609	1,083,167	1,050,432	1,035,086	1,037,968	1,039,387	1,046,649	1,054,166	1,067,177	1.2	0.9
Private employment	843,571	869,670	869,872	834,214	817,651	824,157	827,488	835,812	844,809	858,620	1.6	1.8
Forestry, fishing and related activities ⁽²⁾	5,131	5,161	5,293	5,287	5,200	5,237	5,138	5,247	5,682	5,884	3.6	14.7
Mining ⁽³⁾	23,632	24,913	28,331	24,467	27,049	28,362	34,232	36,831	38,198	35,898	-6.0	51.9
Utilities	4,211	4,538	4,666	4,873	4,637	4,554	4,583	4,667	4,591	4,573	-0.4	8.6
Construction ⁽⁴⁾	79,756	80,578	77,980	67,247	61,314	59,382	58,032	59,248	59,713	60,555	1.4	-24.1
Manufacturing	42,863	42,818	40,671	36,587	34,587	35,750	35,771	35,469	34,032	34,076	0.1	-20.5
Durable goods manufacturing ⁽⁵⁾	29,961	29,770	28,091	24,485	23,086	23,698	23,217	22,553	21,241	20,935	-1.4	-30.1
Nondurable goods manufacturing ⁽⁶⁾	12,902	13,048	12,580	12,102	11,501	12,052	12,554	12,916	12,791	13,141	2.7	1.9
Wholesale trade	29,430	29,015	28,755	26,698	26,921	26,513	26,486	26,694	27,496	28,567	3.9	-2.9
Retail trade ⁽⁷⁾	116,789	119,034	118,204	114,095	110,475	111,583	111,908	112,808	114,086	115,724	1.4	-0.9
Transportation and warehousing ⁽⁸⁾	25,906	27,435	26,703	24,361	23,430	24,333	25,361	25,505	25,846	26,447	2.3	2.1
Information ⁽⁹⁾	18,451	18,879	18,971	17,497	17,130	16,508	16,473	16,059	15,723	16,006	1.8	-13.3
Finance and insurance ⁽¹⁰⁾	32,407	33,829	34,633	36,035	34,660	35,632	35,138	34,903	34,602	34,612	0.0	6.8
Real estate and rental and leasing ⁽¹¹⁾	39,542	41,944	41,498	39,685	39,500	39,760	38,275	38,513	39,253	40,479	3.1	2.4
Professional, scientific and technical services	74,398	82,057	82,138	80,457	78,439	77,591	76,152	75,940	76,094	77,546	1.9	4.2
Management of companies and enterprises	6,419	6,072	5,908	5,566	5,380	5,491	5,449	5,503	5,632	5,814	3.2	-9.4
Administrative and waste services ⁽¹²⁾	58,480	60,437	60,327	55,868	54,315	54,746	53,440	54,622	54,418	54,184	-0.4	-7.3
Educational services	15,952	15,801	15,988	16,363	16,814	16,280	16,152	16,404	16,716	17,553	5.0	10.0
Health care and social assistance ⁽¹³⁾	107,985	111,857	114,850	118,169	119,533	121,675	123,264	123,782	124,943	129,672	3.8	20.1

Arts, entertainment and recreation ⁽¹⁴⁾	21,943	23,000	23,352	23,308	23,110	23,142	23,722	23,743	24,052	24,885	3.5	13.4
Accommodation and food services ⁽¹⁵⁾	84,498	85,156	84,057	81,759	81,222	82,391	83,232	85,532	88,375	90,601	2.5	7.2
Other services, except public administration ⁽¹⁶⁾	55,778	57,146	57,547	55,892	53,935	55,227	54,680	54,342	55,357	55,544	0.3	-0.4
Government and government enterprises ⁽¹⁷⁾	214,332	209,939	213,295	216,218	217,435	213,811	211,899	210,837	209,357	208,557	-0.4	-2.7

⁽¹⁾ Most recent data available.

⁽²⁾ The “Forestry, fishing and related activities” category includes: forestry and logging; fishing, hunting and trapping; and support activities for agriculture and forestry.

⁽³⁾ The “Mining” category includes: oil and gas extraction; mining (except oil and gas); and support activities for mining.

⁽⁴⁾ The “Construction” category includes: construction of buildings; heavy and civil engineering construction; and specialty trade contractors.

⁽⁵⁾ The “Durable goods manufacturing” category includes: wood product manufacturing; nonmetallic mineral product manufacturing; primary metal manufacturing; fabricated metal product manufacturing; machinery manufacturing; computer and electronic product manufacturing; electrical equipment, appliance, and component manufacturing; motor vehicles, bodies and trailers, and parts manufacturing; other transportation equipment manufacturing; furniture and related product manufacturing; and miscellaneous manufacturing.

⁽⁶⁾ The “Nondurable goods manufacturing” category includes: food manufacturing; beverage and tobacco product manufacturing; textile mills; textile product mills; apparel manufacturing; leather and allied product manufacturing; paper manufacturing; printing and related support activities; petroleum and coal products manufacturing; chemical manufacturing; and plastics and rubber products manufacturing.

⁽⁷⁾ The “Retail trade” category includes: motor vehicle and parts dealers; furniture and home furnishings stores; electronics and appliance stores; building material and garden equipment and supplies dealers; food and beverage stores; health and personal care stores; gasoline stations; clothing and clothing accessories stores; sporting goods, hobby, musical instrument, and book stores; general merchandise stores; miscellaneous store retailers; and nonstore retailers.

⁽⁸⁾ The “Transportation and warehousing” category includes: air transportation; rail transportation; water transportation; truck transportation; transit and ground passenger transportation; pipeline transportation; scenic and sightseeing transportation; support activities for transportation; couriers and messengers; and warehousing and storage.

⁽⁹⁾ The “Information” category includes: publishing industries (except Internet); motion picture and sound recording industries; broadcasting (except Internet); Internet publishing and broadcasting; telecommunications; data processing, hosting, and related services; and other information services.

⁽¹⁰⁾ The “Finance and insurance” category includes: monetary authorities-central bank; credit intermediation and related activities; securities, commodity contracts, and other financial investments and related activities; insurance carriers and related activities; and funds, trusts and other financial vehicles.

⁽¹¹⁾ The “Real estate and rental and leasing” category includes: real estate; rental and leasing services; and lessors of nonfinancial intangible assets (except copyrighted works).

⁽¹²⁾ The “Administrative and waste services” category includes: administrative and support services; and waste management and remediation services.

⁽¹³⁾ The “Health care and social assistance” category includes: ambulatory health care services; hospitals; nursing and residential care facilities; and social assistance.

⁽¹⁴⁾ The “Arts, entertainment and recreation” category includes: performing arts, spectator sports, and related industries; museums, historical sites, and similar institutions; and amusement, gambling and recreation industries.

⁽¹⁵⁾ The “Accommodation and food services” category includes: accommodation; and food services and drinking places.

⁽¹⁶⁾ The “Other services, except public administration” category includes: repair and maintenance; personal and laundry services; religious, grantmaking, civic, professional, and similar organizations; and private households.

⁽¹⁷⁾ The “Government and government enterprises” category includes: federal, civilian; military; and state and local governments.

Source: Regional Economic Information System, Bureau of Economic Analysis, Last Revised: September 2016.

The following tables set forth selected additional economic and demographic data with respect to the State.

TABLE 22

Employment and Labor Force
New Mexico and the United States
2007 – 2016
(numbers in thousands)⁽¹⁾

Year	Civilian Labor Force		Number of Employed		Unemployment Rate		N.M. as % of U.S. Rate
	New Mexico	United States	New Mexico	United States	New Mexico	United States	
2007	934	153,918	899	146,273	3.8%	5.0%	76.0%
2008	945	154,655	902	143,369	4.5	7.3	61.6
2009	940	153,111	869	138,013	7.5	9.9	75.8
2010	936	153,650	860	139,301	8.1	9.3	87.1
2011	930	153,995	860	140,902	7.5	8.5	88.3
2012	929	155,628	863	143,330	7.1	7.9	89.9
2013	924	155,151	859	144,741	7.0	6.7	104.5
2014	921	156,238	859	147,521	6.7	5.6	119.6
2015	920	157,957	859	150,030	6.6	5.0	132.0
2016 ⁽²⁾	929	159,456	867	152,048	6.7	4.6	145.7

⁽¹⁾ Figures rounded to nearest thousand.

⁽²⁾ As of November 2016.

Source: U.S. Department of Labor, Bureau of Labor Statistics, Last Revised: United States as of January 23, 2017.

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TABLE 23

Personal Income
New Mexico and the United States
2007 – 2016

Year	Personal Income (Dollars in thousands)		Annual Percentage Change	
	New Mexico	United States	New Mexico	United States
2007	63,091,733	11,995,419,000	5.9%	5.4%
2008	67,250,834	12,492,705,000	6.6	4.1
2009	66,243,018	12,079,444,000	(1.5)	(3.3)
2010	68,361,950	12,459,613,000	3.2	3.2
2011	72,175,501	13,233,436,000	5.6	6.2
2012	73,822,778	13,904,485,000	2.3	5.1
2013	72,465,608	14,068,960,000	(1.8)	1.2
2014	76,449,091	14,801,624,000	5.5	5.2
2015	79,104,093	15,463,981,000	3.5	4.5
2016 ⁽¹⁾	80,868,664	16,109,167,638	--	--

⁽¹⁾ Estimate through September 30, 2016

Source: U.S. Department of Commerce, Bureau of Economic Analysis, Regional Data. Last Revised: December 2016.

TABLE 24

Per Capita Personal Income
New Mexico and the United States
2007-2016

Year	Per Capita Income			Annual Percentage Change	
	New Mexico	United States	N.M. as a % of U.S.	N.M.	U.S.
2007	31,703	39,821	80	4.4%	4.4%
2008	33,447	41,082	81	5.5	3.2
2009	32,523	39,376	83	(2.8)	(4.2)
2010	33,109	40,277	82	1.8	2.3
2011	34,729	42,453	82	4.9	5.4
2012	35,410	44,267	80	2.0	4.3
2013	34,724	44,462	78	(1.9)	0.4
2014	36,656	46,414	79	5.6	4.4
2015	37,938	48,112	79	3.5	3.7
2016 ⁽¹⁾	38,796	49,681	78	--	--

⁽¹⁾ Estimate through September 30, 2016

Source: U.S. Department of Commerce, Bureau of Economic Analysis, Regional Data. Last Revised: December 2016.

TABLE 25
2005-2015
Wages and Salaries by Industry Sector

NAICS Earnings by Place of Work ⁽¹⁾ Applicable to 2005-2015	New Mexico (Dollars in Thousands)		United States (Dollars in Millions)		Cumulative Annual Percent Change 2005 - 2015		Distribution of 2015 Wages & Salaries	
	2015	2005	2015	2005	N.M.	U.S.	N.M.	U.S.
Farm Wage and Salary	\$ 254,614	\$ 214,760	\$ 26,208	\$ 19,022	18.6%	37.8%	0.7%	0.3%
Non-farm Wage and Salary	37,189,533	28,494,581	7,822,347	5,669,804	30.5	38.0	99.3	99.7
Private Wage and Salary	27,400,659	19,947,786	6,565,357	4,692,227	37.4	39.9	73.2	83.7
Forestry, Fishing, and other related activities	86,059	55,994	17,922	11,627	53.7	54.1	0.2	0.2
Mining	1,937,982	935,624	76,971	40,258	107.1	91.2	5.2	1.0
Utilities	356,438	244,035	57,465	41,906	46.1	37.1	1.0	0.7
Construction	1,969,300	1,891,291	380,306	321,546	4.1	18.3	5.3	4.8
Manufacturing	1,639,421	1,546,191	806,749	710,362	6.0	13.6	4.4	10.3
Wholesale Trade	1,169,660	964,845	440,251	324,775	21.2	35.6	3.1	5.6
Retail Trade	2,717,343	2,250,525	482,275	392,793	20.7	22.8	7.3	6.1
Transportation and Warehousing	1,042,862	793,524	257,382	183,730	31.4	40.1	2.8	3.3
Information	667,209	555,651	266,815	195,273	20.1	36.6	1.8	3.4
Finance and Insurance	1,431,619	1,026,434	609,705	449,051	39.5	35.8	3.8	7.8
Real Estate and Rental and Leasing	396,888	318,719	117,371	87,308	24.5	34.4	1.1	1.5
Professional, Scientific, and Technical Services	4,132,742	2,529,013	788,837	472,985	63.4	66.8	11.0	10.1
Management of Companies and Enterprises	363,469	308,493	260,974	153,601	17.8	69.9	1.0	3.3
Administrative and Waste Services	1,453,297	1,216,718	337,732	232,968	19.4	45.0	3.9	4.3
Educational Services	341,216	264,525	143,799	88,010	29.0	63.4	0.9	1.8
Health Care and Social Assistance	4,737,660	2,944,341	897,590	560,754	60.9	60.1	12.7	11.4
Arts, Entertainment, and Recreation	230,998	161,439	86,511	58,793	43.1	47.1	0.6	1.1
Accommodations and Food Services	1,636,722	1,105,207	290,685	188,308	48.1	54.4	4.4	3.7
Other Services, Except Public Administration	1,089,774	835,217	246,017	178,179	30.5	38.1	2.9	3.1
Government and Government Enterprises	9,788,874	8,546,795	1,256,990	977,577	14.5	28.6	26.1	16.0
Total	<u>\$37,444,147</u>	<u>\$28,709,341</u>	<u>\$7,848,555</u>	<u>\$5,688,826</u>				

⁽¹⁾ The estimates of wage and salary disbursements for 2005-2006 are based on the 2002 North American Industry Classification System (NAICS). The estimates for 2007 forward are based on the 2007 NAICS.

⁽²⁾ All dollar estimates are in current dollars (not adjusted for inflation).

Source: U.S. Department of Commerce, Bureau of Economic Analysis, Last Revised: September 2016.

FINANCIAL OVERVIEW

State Auditing and Accounting Systems

The financial affairs of every agency in the State are examined and audited each year by the State Auditor, personnel of the State Auditor's office designated by the State Auditor, or by the independent auditors approved by the State Auditor, as required by Section 12-6-3, NMSA 1978. The audits are conducted in accordance with generally accepted governmental auditing standards. The audit reports include financial statements that are presented in accordance with generally accepted governmental accounting principles.

In July 2006, the State implemented a Statewide Human Resources, Accounting and Management Reporting System ("SHARE System"). The SHARE System, based on commonly used PeopleSoft software, replaced the State's existing central accounting system, central payroll system, personnel system, treasury reconciliation accounting and cashing system, and 114 additional systems then in place at various State agencies. Since June 2007, the State has officially used SHARE as its book of record.

Following the transition to SHARE, both the State Treasurer's and DFA's audits contained audit findings of varying severity related to the State's book to bank reconciliation process. The findings stemmed from certain system issues and business process gaps resulting from the implementation. A material weakness finding related to the completion of accurate and timely book to bank reconciliations was reported in DFA's Fiscal Year 2012, 2013 and 2014 annual financial statements and a significant deficiency finding related to the book to bank reconciliation process was reported in DFA's Fiscal Year 2015 annual financial statements. In the 2009, 2013, 2014 and 2015 Legislative sessions, appropriations were made to DFA, which has statutory responsibility for completion of the book to bank reconciliation, to address these issues.

In June 2012, an independent diagnostic report commissioned by DFA confirmed that State agency claims on the State General Fund Investment Pool had not been reconciled against the assets managed by the State Treasurer's Office since the inception of SHARE in 2006. This reconciliation is the foundation of the book to bank reconciliation process. It was also recognized that the fundamental business processes and information necessary to perform this basic control were not in place.

Beginning immediately upon discovery of this issue, DFA commenced remediation efforts to redesign business processes, banking structure and SHARE system configuration. Since 2012, DFA has undertaken multiple remediation and reconciliation projects in partnership with the Department of Information Technology, the State Treasurer's Office, and Deloitte Consulting LLC, a firm with significant experience with PeopleSoft software. The purpose of the remediation and reconciliation projects is to design and implement the changes necessary to prepare the State's book to bank reconciliations in a complete, accurate and timely manner. The completed remediation efforts have resulted in changes to SHARE system configurations, cash accounting policies and procedures, business practices, and banking structure that facilitate the completion of timely and accurate book to bank reconciliations. Further remediation efforts and business process enhancements are currently underway.

The first phase of the remediation effort was completed in Fiscal Year 2013 and resulted in the addition of new staff and the implementation of processes that allowed DFA to begin performing monthly book to bank reconciliations of statewide cash activity on a go-forward basis beginning February 1, 2013. In 2014, DFA received a legislative appropriation to conduct a historical reconciliation of statewide cash transactions from July 1, 2006, the implementation date of SHARE, through January 31, 2013. Unfortunately incomplete data sets and the absence of data granularity prevented successful completion

of the historical reconciliation effort. The historical analysis added value to the State by identifying key process improvements needed to reduce reconciliation issues on a go-forward basis.

In an environment of incomplete data, supported by a system with known implementation issues and millions of unreconciled transactions, management concluded that the likelihood of a loss related to the lack of a book to bank reconciliation process was probable. In accordance with the requirements of generally accepted governmental accounting standards related to uncertainty, a contingent liability for a potential loss which ultimately totaled \$100 million was established. The potential loss was reported as a special item in the Fiscal Year 2014 audit of the State's Component Appropriation Funds ("General Fund"), since it was considered to be unusual, and its placement within the financial reporting entity of the State of New Mexico is under the control of management.

In the Fiscal Year 2015 General Fund audit, the State reported that reconciliation procedures performed during the fiscal year provide evidence that the financial assets held in the State General Fund Investment Pool exceed the claims on those assets recorded in the general ledger by approximately 0.1% of the Pool's assets. In the Fiscal Year 2016 General Fund audit the State reported that the monthly reconciliation procedures confirmed the continuing consistency of the book and bank value of financial assets and that there were no material differences. Specifically, the value of bank resources were equivalent to and can cover the face value of all book claims against those assets. Accordingly, the \$100 million contingent liability was released. Book to bank reconciliations have been performed monthly since Fiscal Year 2015 and the DFA finding related to book to bank reconciliation was closed in 2016. The audit finding that had been reported in the State Treasurer's audit report related to the book to bank reconciliation process was deemed to have been resolved and was removed during the State Treasurer's Fiscal Year 2016 audit.

The Fiscal Year 2013 CAFR was the first audited State CAFR, and was submitted to the State Auditor for review in June 2014 and released in November 2014. Previous CAFRs were reviewed by an independent auditor. A review of financial statements provides a lower standard of assurance than an audit of financial statements. The Fiscal Year 2013 audited CAFR received a disclaimed opinion and identified the following material weaknesses: (1) book to bank reconciliation; (2) interagency/interfund transactions; (3) government fund type classifications; (4) budget statements; and (5) internal control over financial reporting.

Many of the same issues identified in the Fiscal Year 2013 CAFR were identified again in Fiscal Year 2014 and prevented the auditor from providing an opinion on all the statements contained within the CAFR. However, while in Fiscal Year 2013 the entire CAFR audit received a disclaimed opinion, for Fiscal Year 2014 the auditor was able to express an unmodified opinion on 40 percent of the total fund level opinion units. Additionally, two of the five Fiscal Year 2013 material weaknesses were resolved, and the ongoing reconciliation of bank transactions to the general ledger, which has been in place since February 2013 as described above, has positioned the State to resolve another long-standing issue. Finally, the 2014 CAFR was released 4 months earlier than the 2013 CAFR, helping to address a serious concern that has been raised by the bond rating agencies.

Over the last three years, accounting and control initiatives to improve financial reporting practices have been undertaken by DFA. The CAFR is considered an important statement about the State's financial condition by the bond rating agencies, federal regulatory bodies and the individuals holding the State's bonds.

Recognizing the importance of timely CAFR issuance to the financial community, the State has procured specialized software to automate CAFR preparation for Fiscal Year 2015. The Legislature and the Executive provided additional funding for Statewide Financial Reporting and Accountability Bureau positions, which enabled more outreach to the numerous entities included in the CAFR and facilitated

improvements in the State's model accounting practices. As a result, the Fiscal Year 2015 CAFR was issued three weeks earlier than the CAFR for Fiscal Year 2014 and the goal is to accelerate the release of the Fiscal Year 2016 CAFR by another two months. In Fiscal Year 2017, completion of individual agency audits will be advanced one month which will expedite the release of the Fiscal Year 2017 CAFR by an equivalent amount of time. In addition to accelerating the CAFR release, the State was able to resolve a number of long standing audit issues, and, as a result, the number of CAFR Opinion Units receiving an unmodified opinions reached an all-time high.

State Budgetary and Appropriation Process

All State agencies are required by Section 6-3-19 NMSA 1978 to submit completed budget forms to the DFA Budget Division by September 1 of each year. Guidelines and forms are provided to State agencies in advance of the September 1 deadline. Budget hearings to examine the merits of budget requests are scheduled through the fall and are usually completed by mid-December. The DFA Budget Division presents comprehensive budget recommendations to the Governor, as required by Section 6-3-15(B) NMSA 1978.

The Governor is required by Section 6-3-21 NMSA 1978 to submit a budget for the upcoming fiscal year to the Legislature in early January. The Governor's budget includes the executive recommendations for public education; higher education; State agencies; and historical information on prior expenditures, revenues and revenue projections, among other information. The State budget is contained in a General Appropriation Act, which also may contain proposals for supplemental and deficiency appropriations for the current fiscal year.

Upon passage by the Legislature, the Governor may sign the General Appropriation Act, veto it, veto line items or veto parts of it. After the Governor has signed the General Appropriation Act, the DFA Budget Division approves the agency budgets and monitors the expenditure of the funds beginning on July 1, the first day of the fiscal year.

State Treasurer's Investment Responsibilities

Pursuant to Sections 6-10-10(I) through 6-10-10(O) NMSA 1978, the State Treasurer, with the advice and consent of the State Board of Finance, may invest money not immediately needed for government operations. These investment responsibilities are conducted in accordance with the State Treasurer's Investment Policy (the "Investment Policy") which is adopted by the State Treasurer and approved by the State Board of Finance. The Investment Policy states that in keeping with the office's fiduciary responsibility, all investment decisions made by the State Treasurer will adhere to the following three fundamental principles: safety, liquidity and return. The Investment Policy applies to all financial assets of the State invested by the Treasurer in the exercise of the Treasurer's statutory authority or invested as directed by other agencies which have specific investment authority and for which the Treasurer acts as the investing authority. The State Treasurer is the investing authority for the State's General Fund Investment Pool, the Local Government Investment Pool, Bond Proceeds Investment Pools, the Severance Tax Bonding Fund and bond debt service funds.

In February 2014, working with the Financial Control Division, the Treasurer's Office recommended and implemented 12 new investment accounts for the Statewide Chart of Accounts in order to record all investment accounting activity on a monthly basis versus providing the information on a net basis once a year. This allows for the State Treasurer's investment transaction records to be input into the SHARE system until a \$2.9 million appropriation for the configuration of the PeopleSoft Treasury Management Module can be implemented. This module will allow for real time recording of all investment and cash management activity and is scheduled to be implemented once PeopleSoft Financials 9.2 is implemented.

The State Treasurer's Office invested a portion of the general fund and the State Bond Proceeds Investment Pool in the Reserve Primary Fund ("RPF"), a money market fund, in Fiscal Years 2007 and 2008 respectively. On September 15, 2008, the balance of the general fund's RPF investment was \$448.7 million, and the balance of the State Bond Proceeds Investment Pool's RPF investment was \$311.6 million. On September 16, 2008, the RPF net asset value fell below \$1.00 and holdings in the fund were frozen. Since then, RPF has returned approximately \$0.9904 per share to shareholders. On the recommendations of the independent public accounting firm performing the Fiscal Year 2011 audit of the State Treasury, the remaining positions in the RPF, \$4.33 million of the general fund and \$3.01 million of the State Bond Proceeds Investment Pool, were written-down in Fiscal Year 2011. Final distributions were made to shareholders in January 2015.

According to the Investment Policy, the State Treasurer's Investment Committee is appointed by the State Treasurer and the Board. The Investment Committee is an advisory committee that reviews investment reporting and any other matters of the State Treasurer's choosing. The Investment Committee consists of five voting members: the State Treasurer or designee; the State Treasurer's Chief Investment Officer, who serves as Investment Committee Chair; the Director of the State Board of Finance or designee; and two additional members. These additional members must be participants in the private investment community or have expert knowledge or professional experience in public finance or public money investing. One member is appointed by the State Treasurer and approved by the Board and one member is appointed by the Board and approved by the State Treasurer.

In addition to the Investment Committee oversight and recommendations, the State Treasurer contracts with an independent investment advisor to provide guidance and advice on investments, market conditions and benchmarks. The investment advisor provides quarterly performance reports on all of the State Treasurer's portfolios and information relating to the economic outlook and market trends.

General Fund

The State derives the majority of its recurring General Fund revenue from four major sources: general and selective sales taxes; income taxes; taxes and royalties on natural resource production; and investment earnings both on its two permanent funds and on cash balances. Effective July 1, 1981, the Legislature repealed the property tax levy for general State operating purposes, and has not reinstated it since that time. However, the New Mexico Constitution authorizes a levy of up to four mills for general State operating purposes and additional levies for the support of State educational, penal and other institutions.

The following table lists audited revenues, expenditures and ending fund balances for Fiscal Years 2012 through 2016 and result projections for Fiscal Year 2017 and 2018.

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TABLE 26**General Fund Financial Summary Fiscal Year 2013 – Fiscal Year 2018**

(Dollars in thousands)

	<u>Actual</u> <u>2013</u>	<u>Actual</u> <u>2014</u>	<u>Actual</u> <u>2015</u>	<u>Actual</u> <u>2016</u>	<u>Projected</u> <u>2017</u>	<u>Projected</u> <u>2018</u>
A. APPROPRIATION ACCOUNT						
Recurring Receipts:						
General and Selective Sales Taxes	\$ 2,397,750	\$ 2,514,262	\$ 2,695,544	\$ 2,553,767	\$ 2,453,800	\$ 2,629,600
Income Taxes	1,508,102	1,451,733	1,594,190	1,445,711	1,401,000	1,446,000
Severance Taxes	438,357	557,113	427,453	279,751	310,600	335,300
License Fees	50,011	51,667	55,875	54,815	55,800	56,900
Investment Income	631,786	638,851	702,493	770,258	740,900	811,000
Rents and Royalties	504,263	617,341	584,419	437,822	475,000	489,000
Miscellaneous Receipts	41,272	45,015	56,153	48,063	61,500	56,700
Tribal Revenue Sharing	70,709	67,582	67,178	64,413	64,200	64,700
Reversions/Adjustments	65,761	96,538	51,455	54,184	37,500	40,000
Total Recurring Receipts	5,708,012	6,040,103	6,234,759	5,708,783	5,600,300	5,929,200
Total Nonrecurring and Adjustments	618	443	1,100	74	(672)	-
Total Receipts	\$ 5,708,629	\$ 6,040,547	\$ 6,235,859	\$ 5,708,858	\$ 5,599,628	\$ 5,929,200
Recurring Appropriations:						
Legislative	\$ 27,314	\$ 24,495	\$ 29,419	\$ 26,035	\$ 18,661	
Judicial	199,026	207,643	218,643	273,949	267,672	
General Control	160,634	176,216	201,436	135,273	123,053	
Commerce and Industry/Exam. and Lic.	43,890	46,010	50,019	53,391	48,543	
Agriculture, Energy and Natural Resources	62,814	66,424	71,920	71,144	64,772	
Health, Hospitals and Human Services	1,584,339	1,637,277	1,641,473	1,655,433	1,652,062	
Public Safety	367,803	377,493	393,903	415,656	426,418	
Other Education	52,573	68,734	106,910	112,902	105,697	
Higher Education	757,717	796,011	838,565	843,428	786,772	
Public School Support	2,402,768	2,498,742	2,608,378	2,623,316	2,580,233	
Recurring Appropriations	5,658,878	5,899,044	6,160,667	6,210,527	6,073,881	5,929,200
Other Recurring Appropriations	-	-	-	-	-	-
Total Recurring Appropriations	5,658,878	5,899,044	6,160,667	6,210,527	6,073,881	5,929,200

Nonrecurring Appropriations ⁽¹⁾		68,225	36,961	114,551	98,308	(53,285)	-
Total Appropriations	\$	5,727,103	\$ 5,936,005	\$ 6,275,218	\$ 6,308,835	\$ 6,020,596	\$ 5,929,200
Transfers from/(to) Other Accounts ⁽²⁾					114,552	313,774	
TRANSFER FROM/(TO) OPERATING RESERVE	\$	18,474	\$ (104,542)	\$ 39,359	\$ 485,425	\$ 107,194	\$ -
<hr/>							
B. OPERATING RESERVE							
Beginning Balance	\$	346,945	\$ 327,306	\$ 274,603	\$ 319,790	\$ 2,000	\$ (107,194)
Revenues/Repayments/Reversions		92	973	0	0		
Appropriations:							
Contingencies			(103,746)	100,000			
Restricted Funds			(36,000)		36,000		
Other Appropriations and Adjustments		(1,257)	(1,471)	(454)	(390)	(2,000)	
Total Appropriations⁽³⁾		(1,257)	(141,217)	99,546	35,610	(2,000)	
Transfers:							
From/(To) General Fund Appropriations Account		(18,474)	104,542	(39,359)	(485,425)	(107,194)	-
From/(To) Appropriation Contingency Fund			(17,000)	(15,000)	(20,000)	-	-
From/(To) Tax Stabilization Reserve Fund					147,469		
From/(To) Other State Funds					4,555		
Total Transfers		(18,474)	87,542	(54,359)	(353,401)	(107,194)	-
Ending Balance⁽⁴⁾	\$	327,306	\$ 274,603	\$ 319,790	\$ 2,000	\$ (107,194)	\$ (107,194)
<hr/>							
		Actual	Actual	Actual	Actual	Projected	Projected
		2013	2014	2015	2016	2017	2018
C. STATE SUPPORT RESERVE							
Beginning Balance	\$	1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000
Transfers From Operating Reserve/ Appropriation Account ⁽⁵⁾		-					
Ending Balance	\$	1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000
<hr/>							
D. APPROPRIATION CONTINGENCY FUND							
Beginning Balance, Excluding Education Reform	\$	29,505	\$ 16,394	\$ 18,409	\$ 28,440	\$ 34,372	\$ 26,122
Receipts:							
Reversions		15,314	4,240	7,709	2,182	8,000	8,000
Transfers From General Fund/Appropriation Contingency Fund		-	17,000	15,000	20,000		
Expenditures/Appropriations: ⁽⁶⁾							
Disasters		(28,425)	(19,225)	(12,625)	(16,250)	(16,000)	(16,000)

Other	-	-	(53)	-	(250)	-
Ending Balance, Excluding Education Reform	\$ 16,394	\$ 18,409	\$ 28,440	\$ 34,372	\$ 26,122	\$ 18,122
Education Reform:						
Beginning Balance, Education Reform	\$ 39,047	\$ 9,047	\$ 3,047	\$ -	\$ -	\$ -
Transfers In	-	-	-	-	-	-
Expenditures	(30,000)	(6,000)	(3,047)			
Ending Balance, Education Reform	\$ 9,047	\$ 3,047	\$ -	\$ -	\$ -	\$ -
Ending Balance, Appropriation Contingency Fund	\$ 25,441	\$ 21,456	\$ 28,440	\$ 34,372	\$ 26,122	\$ 18,122
E. TAX STABILIZATION RESERVE						
Beginning Balance	\$ 147,469	\$ 147,469	\$ 147,469	\$ 147,469	\$ -	\$ -
Transfers In	-	-	-	-	-	-
Transfers Out	-	-	-	(147,469)	-	-
Ending Balance⁽⁷⁾	\$ 147,469	\$ 147,469	\$ 147,469	\$ -	\$ -	\$ -
F. TOBACCO SETTLEMENT PERMANENT FUND RESERVE⁽⁸⁾						
Beginning Balance	\$ 148,978	\$ 170,166	\$ 193,461	\$ 216,362	\$ 110,357	\$ 7,183
Transfers In	39,303	21,124	35,036	39,552	48,000	39,000
Transfers Out	(39,303)	(29,354)	(19,283)	(149,135)	(158,348)	(19,500)
Gains/(Losses)	21,188	31,526	7,147	3,579	7,173	470
Ending Balance	\$ 170,166	\$ 193,461	\$ 216,362	\$ 110,357	\$ 7,183	\$ 27,153
G. TAXPAYER DIVIDEND FUND						
Beginning Balance	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Transfers In	-	-	-	-	-	-
Transfers Out	-	-	-	-	-	-
Gains/Losses	-	-	-	-	-	-
Ending Balance	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
H. TOTAL RESERVE BALANCES						
Beginning Balance	\$ 712,944	\$ 671,382	\$ 637,989	\$ 713,060	\$ 147,729	\$ (72,889)
Ending Balance	\$ 671,382	\$ 637,989	\$ 713,060	\$ 147,729	\$ (72,889)	\$ (60,919)
Reserves as a Percentage of Current-Year Recurring Appropriations	11.9%	10.8%	11.6%	2.4%	-1.2%	-1.0%

Note: Detail may not add to column total due to independent rounding.

NOTES TO GENERAL FUND FINANCIAL SUMMARY:

(1) Appropriation Account, Nonrecurring Appropriations:

FY13 includes the following appropriations from Laws 2012: \$2.5 million for supplemental funding for public schools (Laws 2012, Ch. 19, Sec. 5).

FY13 includes the following appropriations from Laws 2013: \$65.7 million from Section 5 of the General Appropriation Act of 2013 (Laws 2013, Ch. 227).

FY14 includes the following appropriations from Laws 2014: \$37.0 million from Sections 5 and 6 of the General Appropriation Act of 2014 (Laws 2014, Ch. 63).

FY 15 includes the following appropriations from Laws 2014: \$16.6 million from Section 5 of the General Appropriation Act of 2014 (Laws 2014, Ch. 63).

FY15 includes the following appropriations from Laws 2015: \$93.7 million from Sections 5 and 6 of the General Appropriation Act of 2015 (Laws 2015, Ch. 101) and \$4.3 million from the 2015 1st Special Session (Laws 2015, Ch. 1, Sec. 3).

FY16 includes the following appropriations from Laws 2015: \$1.4 million from Section 5 of the General Appropriation Act of 2015 (Laws 2015, Ch. 101) and \$30 million for capital outlay projects (Laws 2015, 1st Special Session, Ch. 3).

FY16 includes the following appropriations from Laws 2016: \$66.9 million from Sections 5 and 6 of the General Appropriation Act of 2016 (Laws 2016, Ch. 11).

FY17 includes the following appropriations from Laws 2016: \$0.4 million from Section 5 of the General Appropriation Act of 2016 (Laws 2016, Ch. 11), \$1.0 million to the SBOF to be disbursed to agencies experiencing hardship as a result of special session budget cuts (Laws 2016, 2nd Special Session, Ch. 6), \$1.5 million for child abuse prevention (Laws 2016, 2nd Special Session, Ch. 3), and \$56.2 million in deauthorized and reverted general fund capital outlay funding (Laws 2016, 2nd Special Session, Ch. 5)

(2) Appropriation Account, Transfers from/(to) Other Accounts:

FY16 includes \$5.5 million transfer from the state government unemployment compensation reserve fund, and \$109.1 million transfer from the tobacco settlement permanent fund.

FY17 includes \$44 million transfer from other state funds, \$8 million in disencumbered balances from prior year general fund appropriations, \$10 million transfer from the New Mexico Finance Authority, \$13 million transfer of unspent balances of prior year taxable bond proceeds, \$33.7 million to restore general fund capital expenditures to be funded through severance tax bond proceeds, \$63.2 million transfer from other state funds, \$15.5 million transfer from the New Mexico Mortgage Finance Authority, \$16.1 million transfer from the Public Education Department, and \$110.4 million from the tobacco settlement permanent fund.

(3) General Fund Operating Reserve:

FY13 includes \$1.3 million for State Board of Finance Emergency Fund appropriation and repayment/reversion.

FY14 includes \$1.5 million for State Board of Finance Emergency Fund appropriation and repayment/reversion, an additional \$30.0 million contingent liability established in the Fiscal Year 2014 General Fund financial statements for potential charges related to unreconciled cash transactions, a \$73.7 million contingent liability established in the Fiscal Year 2014 General Fund financial statements for Medicaid receivables, and a \$17 million transfer to the appropriation contingency fund to address reductions in federal funding to New Mexico agencies resulting from federal sequester. FY14 also includes \$36 million in restricted fund balances for Special Education Maintenance of Effort funding (HB628, Laws 2013).

FY15 includes \$0.5 million for State Board of Finance Emergency Fund appropriation and repayment/reversion, \$15 million transfer to the appropriation contingency fund, and release of the \$100 million contingent liability established in the Fiscal Year 2012 and Fiscal Year 2014 General Fund financial statements.

FY16 includes \$0.4 million for State Board of Finance Emergency Fund appropriation and repayment/reversion, \$20 million transfer to the appropriation contingency fund, \$147.5 million transfer from the tax stabilization reserve, \$1.3 million transfer from other state funds (HB311, Laws 2016), and release of the \$36 million restricted fund balance for Special Education Maintenance of Effort funding (HB311, Laws 2016).

FY17 includes \$2.0 million for the State Board of Finance Emergency Fund appropriation.

(4) Year-ending Balances in the Operating Reserve:

Annually, if the balance in the General Fund Operating Reserve exceeds 8 percent of the previous year's recurring appropriations, the excess over 8 percent is transferred to the Tax Stabilization Reserve.

(5) Appropriation Contingency Fund Appropriations:

FY13 includes the following appropriations/transfers from Laws 2012: \$1.5 million for education reform (Laws 2012, Ch. 19, Sec. 5).

FY13 includes the following appropriations/transfers from Laws 2013: \$28.4 million for disaster allotments, and \$28.5 million for education reform (Laws 2013, Ch. 227, Sec. 5).

FY14 includes the following appropriations/transfers from Laws 2013: \$17 million transfer from the operating reserve to address reductions in federal funding to New Mexico agencies resulting from federal sequester.

FY14 includes the following appropriations/transfers from Laws 2014: \$19.2 million for disaster allotments, and \$6 million for education reform (Laws 2014, Ch. 63, Sec. 5).

FY15 includes the following appropriations/transfers from Laws 2014: \$15 million transfer from the operating reserve (Laws 2014, Ch. 63, Sec. 12), \$12.6 million for disaster allotments, and \$3.1 million for education reform (Laws 2015, Ch. 101, Sec. 5).

FY16 includes the following appropriations/transfers from Laws 2015: \$20 million transfer from the operating reserve (Laws 2015, Ch. 101, Sec. 11), and \$16.3 million for disaster allotments.
FY17 includes the following appropriations/transfers from Laws 2016: \$0.3 million for the relocation of the Bernalillo County child wellness center (Laws 2016, Ch. 11, Sec. 5).

(6) Year-ending Balances in the Tax Stabilization Reserve:

Annually, if the balance in the Tax Stabilization Reserve exceeds 6 percent of the previous year's recurring appropriations, the excess over 6 percent is transferred to the Taxpayer's Dividend Fund.

(7) Tobacco Settlement Permanent Fund Reserve (established by Laws 2003, Chapter 312).

FY13 – 100 percent of Tobacco Settlement Permanent Fund revenues, equaling \$39.3 million, were transferred to the Tobacco Settlement Program Fund for Medicaid, rather than the historical 50 percent transfer (Laws 2011, Chapter 3).

FY14 – Tobacco Settlement Permanent Fund revenues were reduced by approximately \$18.4 million as a result of a panel decision that found New Mexico noncompliant in its 2003 enforcement of the Master Settlement Agreement. 50 percent of Tobacco Settlement Permanent Fund revenues, or \$10.6 million, were transferred to the Tobacco Settlement Program Fund for Medicaid, 25 percent of Tobacco Settlement Permanent Fund revenues or \$5.3 million were transferred to CYFD for early childhood learning initiatives, and 25 percent of Tobacco Settlement Permanent Fund revenues or \$5.3 million were transferred to the Legislative Lottery Scholarship Fund to address solvency (Laws 2013, Ch. 228). \$8.2 million was appropriated from the Tobacco Settlement Permanent Fund for Medicaid (Laws 2014, Ch. 63, Sec. 12).

FY15 – 50 percent of Tobacco Settlement Permanent Fund revenues, or \$19.3 million, were transferred to the Tobacco Settlement Program Fund for Medicaid pursuant to Section 6-4-9C NMSA 1978.

FY16 – 100 percent of Tobacco Settlement Permanent Fund revenues, or \$39.6 million, were transferred to the Tobacco Settlement Program Fund for Medicaid pursuant to Section 6-4-9C NMSA 1978. \$0.5 million was appropriated from the Tobacco Settlement Permanent Fund for Medicaid (Laws 2015, Ch. 101, Sec. 11). \$109.1 million was transferred to the Appropriation Account (Laws 2016, 2nd Special Session, Ch. 4).

FY17 – 100 percent of Tobacco Settlement Permanent Fund revenues, or an estimated \$48 million, are estimated to be transferred to the Tobacco Settlement Program Fund for Medicaid pursuant to Section 6-4-9C NMSA 1978 and Laws 2016, Ch. 12. The estimated settlement distribution was increased by \$9 million due to the State's prevailing in a motion filed to vacate the Partial Arbitration Award issued by the 2003 NPM Adjustment Dispute arbitration panel. An estimated \$110.3 million is expected to be transferred to the Appropriation Account.

Review of Results and Projections in the General Fund

Fiscal Year 2013. New Mexico's economy stagnated in Fiscal Year 2013. Total General Fund revenues fell by 1.6 percent during this period. Total recurring revenue was approximately \$5.7 billion. Approximately half of the decline in general fund revenue was attributable to lower oil and natural gas prices, a reflection of national and international trends in energy markets and lackluster state lease sales. The price of oil averaged \$85.82 per barrel and the price of natural gas averaged \$4.40 per mcf in Fiscal Year 2013. Mineral production taxes, bonuses and royalties totaled \$943 million in Fiscal Year 2013, a decrease of 9 percent from Fiscal Year 2012. In addition, the federal government sequestered about \$21 million in Federal Mineral Leasing (FML) revenues, which were returned to the state in the early half of Fiscal Year 2014 causing a shift in revenue accounting periods.

The state's broad-based taxes grew minimally during Fiscal Year 2013, with the exception of personal income tax collections, which grew by 7.9 percent. This growth rate is partially driven by accelerated payments that were made in anticipation of federal tax changes. Fiscal Year 2013 general sales tax revenue was 1.1 percent below Fiscal Year 2012, primarily due to reduced federal procurement spending. Corporate income tax collections fell 4.9 percent compared to Fiscal Year 2012, a reflection of the sluggish national rate of economic growth. Investment income to the general fund from the state's Permanent Funds also declined in Fiscal Year 2013 due to the constitutionally mandated decrease in the annual distribution from the Land Grant Permanent Fund from 5.8 percent to 5.5 percent in Fiscal Year 2013.

General fund reserves were approximately \$651.4 million at the end of Fiscal Year 2013, approximately 11.5 percent of Fiscal Year 2013 recurring appropriations, after accounting for the \$31.7 million contingent liability established in the Fiscal Year 2013 General Fund financial statements for potential charges related to unreconciled cash transactions. This balance also includes a \$20 million contingent appropriation related to Special Education funding Maintenance of Effort.

Fiscal Year 2014. General Fund revenues rebounded from the Fiscal Year 2013 decline largely as a result of high oil and natural gas revenues. Recurring revenue grew by 5.8 percent in Fiscal Year 2014, reaching \$6.0 billion. New Mexico oil prices averaged \$95.14 per barrel and the price of natural gas averaged \$5.13 per mcf. Strong oil and natural gas production contributed to the revenue increase with oil volume growth of 17 percent and a natural gas volume increase of 1 percent following years of declining production. In Fiscal Year 2014, oil volumes were double the amount produced in Fiscal Year 2009. Mineral production taxes, rents and royalties increased by 24.6 percent over Fiscal Year 2013 to \$1.2 billion. General sales taxes, including the gross receipts tax (GRT) and compensating tax, also experienced growth of 5.2 percent. Permanent fund investment income benefited from a larger fund corpus and strong stock market returns. Income tax revenues decreased slightly, reflecting a one-time acceleration of capital gains income in Fiscal Year 2013.

Major changes were made to the corporate income tax in the 2013 legislative session to be phased in over several years. These changes reduce corporate tax rates and allow single sales factor income apportionment for manufacturers. Legislation passed in the 2014 legislative session will allow taxpayers to carry forward net operating losses (NOLs) for 20 years.

The general fund reserve balance was approximately \$636.5 million at the end of Fiscal Year 2014 or 11.0 percent of Fiscal Year 2014 recurring appropriations. Reserves were negatively impacted by a reduction of \$73.1 million of federal Medicaid reimbursements. The reserves were also affected by a \$20 million reduction in tobacco settlement distributions in Fiscal Year 2014 as a result of a recent

arbitration decision that found New Mexico was lacking in diligence in Fiscal Year 2003 with regards to non-participating manufacturers to the Master Settlement Agreement. In addition, the State booked a \$26 million contingent appropriation related to federal special education funding maintenance of effort requirements. The State believes it has met maintenance of effort requirements, and has appealed the federal ruling, but a full resolution will likely take more than a year. This balance includes the \$100 million contingent liability established for the potential loss related to the book to bank reconciliation.

Fiscal Year 2015. A steep drop in crude oil and natural gas prices during Fiscal Year 2015 sharply reduced the growth rate of General Fund recurring revenue. Whereas non-oil and gas related revenue grew by over 7 percent, total revenue including oil and gas related revenues grew at 2.6 percent to \$6.2 billion, surpassing the previous peak level reached in Fiscal Year 2008. New Mexico oil prices averaged \$60.64 per barrel in Fiscal Year 2015, while New Mexico natural gas prices averaged \$3.78 per mcf. Strong volume growth offset declining energy prices with oil volumes growing 25 percent over Fiscal Year 2014. Natural gas volumes remained unchanged from the prior fiscal year. With strong growth across the retail, construction, wholesale, and service sectors, GRT grew by 5.2 percent. Distributions from the State's Permanent Funds continued to benefit from a larger fund corpus and strong stock market returns, reaching a total of \$685 million or 11 percent of total General Fund revenues. Income tax revenues also grew in Fiscal Year 2015 with 6.8 percent growth for personal income tax and 29.3 percent growth for corporate income tax. General Fund reserves were \$713.1 million or 11.6 percent of recurring appropriations at the end of Fiscal Year 2015. This balance includes release of the \$100 million contingent liability established for the potential loss related to the book to bank reconciliation.

Fiscal Year 2016. Fiscal Year 2016 recurring revenues are estimated to have decreased by 7.9 percent to \$5.7 billion, driven by a decrease of 29.1 percent in oil and natural gas related revenue. New Mexico oil prices averaged \$37.85 per barrel in Fiscal Year 2016, while New Mexico natural gas prices averaged \$2.40 per mcf. Estimated growth of 3.7 percent in oil volumes partially offset declining oil prices, while natural gas volumes decreased by 1.0 percent over Fiscal Year 2015. Results show a significant decline in the State's broad-based gross receipts, compensating, personal income, and corporate income taxes, which were all impacted by ongoing weakness in the oil and natural gas sectors. The decline in revenue was partially affected by the diversion of a large portion of the liquor excise tax to the lottery tuition scholarship program. Offsetting this and other declines, the insurance premiums tax collections increased sharply due to expansion of the Medicaid program.

Since enactment of the Fiscal Year 2016 budget, several downward revisions to the consensus revenue estimate led to budget cuts, fund transfers and necessitated the Legislature reconvening in special session early in Fiscal Year 2017. As a result of the revised forecast, during the 2016 legislative session the legislature enacted a 0.5 percent across-the-board reduction in Fiscal Year 2016 appropriations, with the exception of the Medicaid program and certain other healthcare-related programs. The Legislature also passed House Bill 311, which allowed one-time transfers from various state funds into the general fund, totaling \$40.6 million in Fiscal Year 2016 and \$74.9 million in Fiscal Year 2017. The Fiscal Year 2016 transfer included the \$36 million operating reserve fund balance that had been restricted for supplemental special education maintenance of effort funding.

During the 2016 special legislative session, Senate Bill 2 authorized the transfer of \$109.1 million from the Tobacco Settlement Permanent Fund to the general fund appropriation account to close Fiscal Year 2016 in balance. Also to close Fiscal Year 2016, \$485.4 million was transferred from operating reserves to the general fund appropriation account. After these transfers, reserves ended Fiscal Year 2016 at \$147.7 million, or 2.4 percent of recurring appropriations.

Fiscal Year 2017. According to the December 2016 consensus revenue estimate, Fiscal Year 2017 recurring revenues are estimated to be \$5.6 billion, representing a decrease of 1.9 percent over Fiscal Year

2016. Oil and natural gas related revenue is projected to increase slightly from Fiscal Year 2016 levels. New Mexico oil prices are projected to average \$43.00 per barrel in Fiscal Year 2017, while New Mexico natural gas prices are expected to average \$3.15 per mcf. Oil volumes are projected to decline by 2.5 percent in Fiscal Year 2017 and natural gas volumes are estimated to decline by 2.6 percent. Non-oil and gas related revenue was forecast to decline by 3.6 percent, reflecting a decline of 5.1 percent in general sales tax, growth of 0.3 percent in personal income tax, and 10.2 percent in insurance premiums tax. Corporate income tax revenues are expected to decline by 40.9 percent over the previous fiscal year.

During the 2016 special legislative session, several bills were passed to address Fiscal Year 2017 solvency. In addition to authorizing the transfer of the balance in the Tobacco Settlement Reserve Fund to the appropriation account to cover Fiscal Year 2016 and Fiscal Year 2017 expenditures, Senate Bill 2 also provides for the transfer of balances from various funds to the general fund in a total amount of \$65 million. Senate Bill 4 appropriates \$12.5 million in supplemental severance tax note proceeds for public school capital outlay to allow the same amount of general fund appropriation reduction. Senate Bill 6 provides for reduced Legislative Retirement Fund distributions, narrows the eligible entities allowed to take the health care practitioner gross receipts tax deduction under Section 7-9-94 NMSA 1978, and clarifies and narrows New Mexico's High Wage Jobs Tax Credit, with an estimated benefit to recurring revenues of \$10.2 million. Senate Bill 7 reduces the distribution of insurance premiums tax revenue to the Fire Protection Grant Fund, thereby increasing the reversion to general fund, and reduces general fund distributions to the Retiree Health Care Fund. The legislation is expected to increase Fiscal Year 2017 recurring revenue by \$4.8 million. Senate Bill 8 provides for certain taxable severance tax note and supplemental severance tax note proceeds to be swept to the general fund to restore past general fund capital allotments, resulting in an increase to general fund cash balances of about \$33.7 million and a reduction in appropriation of \$56.2 million. Senate Bill 9 reduces State agency budgets by a recurring \$170.9 million in Fiscal Year 2017. Under this legislation, the majority of state agency budgets are reduced by 5.5 percent, with judicial and legislative cuts of 3.0 percent. The Children Youth and Families Department, Department of Public Safety, and sexual assault services and prevention contracts at the Department of Health will not be subject to cuts. The Legislature also inserted language in Senate Bill 9 that provides for redistributing public school State Equalization Guarantee distributions to special education services if funding is insufficient to meet federal maintenance of effort requirements. Before any actions that may be taken in the 2017 Legislature, Fiscal Year 2017 ending reserves are projected to be -\$61.6 million or -1.2 percent of recurring appropriations.

A combination of economic factors including rising enrollments, a decrease in the federal matching rate for the new adult group (a.k.a, Medicaid expansion), rising drug costs, and insufficient legislative appropriations caused the State to experience a significant funding shortfall in the Medicaid program in Fiscal Years 2016 and 2017. In response to the shortfall, the State is implementing a number of cost-reduction measures, which include reduced reimbursement rates for health care providers and reduced administrative spending for Medicaid managed care organizations ("MCOs"). The State is also considering the imposition of new mandatory payments for some patients. Slightly lower enrollment rates, a delay in the imposition of certain federal fees on insurance companies, including MCOs, and the possibility of additional federal funding for services provided to Native Americans is expected to reduce or eliminate the general fund shortfall for Fiscal Year 2017.

In November 2015, the United States Health and Human Services Office of Inspector General (the "Inspector General") released a report concluding that the State received more than \$16.0 million in unallowable performance bonus payments under the Children's Health Insurance Program Reauthorization Act ("CHIPRA") for Fiscal Years 2009 through 2013. Specifically, the Inspector General determined that the State included ineligible individuals in its enrollment figures for bonus requests to the Centers for Medicare and Medicaid Services ("CMS"), resulting in an overpayment of \$16.0 million by CMS to the State. The Inspector General recommended that the State refund the money to the federal government. In the report, the State stated that it believed its methodology for determining enrollment was correct and that

the bonus payments received were allowable under federal requirements. According to the State, the methodology was delineated in the supporting documentation submitted with each CHIPRA bonus application, and the documentation indicated the specific population groups that were being excluded. CMS approved payments based on this methodology, and at no time did CMS deem the state's methodology to be incorrect or not in compliance with its guidelines. It is expected that the CMS will determine whether to pursue any recovery in connection with the Inspector General's recommendation.

In September 2016, the Office of the State Auditor (the "OSA") released an audit conducted in partnership with the Office of the Superintendent of Insurance (the "OSI") that suggested that insurance firms had been underpaying the premiums tax. It examined the insurance premiums taxes collected between April 2010 and April 2015 and found that within a sample comprising 26 percent of the total collected there was likely underpayment of \$193 million over the five year period. The OSI has disagreed with the audit findings and has called for the repayment of a lower amount, which could be substantially less than the amounts that would be produced by using the OSA methodology.

Education Funding Litigation. Two lawsuits challenging the funding of the State's primary and secondary education system have been pending since 2014. In March 2014, individual plaintiffs in New Mexico District Court in McKinley County reinstated a suit originally brought against the State and others in 1998, alleging, primarily, that the State's educational funding formula violates the sufficiency of education and uniform system of public schools provisions of the New Mexico Constitution. The Plaintiffs in the McKinley County case have asked the court for injunctive relief ordering the State to develop a budget and funding formula that sufficiently, uniformly and equitably funds the public school system. In April 2014, individual plaintiffs in New Mexico District Court in Santa Fe County brought suit against the State, among others, alleging, among other things, that the State has failed to provide a sufficient and uniform system of education in violation of the sufficiency, uniformity, equal protection and due process provisions of the New Mexico Constitution because of an inadequate and arbitrary funding system. The lawsuit asks for a declaratory judgment and injunctive relief requiring the adoption of a school finance system to remedy the alleged violations. Neither lawsuit asks for a specific award of damages. On January 26, 2015, The Honorable Judge Singleton of the First Judicial District Court of Santa Fe County ordered that the two pending lawsuits be consolidated and that venue for the consolidated cases be in the First Judicial District Court of Santa Fe County. Discovery in the consolidated case is still on-going and no specific settlement demands have yet been made. Trial is currently scheduled to begin in late May of 2017 and is expected to conclude sometime in August of 2017. At this time, the State believes that it is premature to assess what effect, if any, this litigation might have on State budget matters.

Oil and Gas Market Volatility and the General Fund

Crude oil and natural gas prices have fallen significantly over the past two years, reducing revenue inflows to the General Fund. According to the Consensus Revenue Estimating Group, over the course of a fiscal year, a \$1.00 change in the price of oil generally results in a \$10 million direct change in the State's General Fund revenue, and a \$0.10 change in the price of natural gas generally results in a \$9 million direct change in the State's General Fund revenue. The State entered Fiscal Year 2016 with reserves equal to 11.6 percent of recurring appropriations. Over the course of the fiscal year, the reserves fell to 2.4 percent, partially as a result of declining energy prices. The Martinez administration has maintained and continues to maintain as a matter of policy a target level of 10 percent to minimize the impact of such price declines. That target has not been met this year. The annual distributions to the State General Fund from the two permanent funds have been increasing significantly in recent years, which helps to offset some of the volatility of revenue from current oil and gas production. Recent upswings in energy prices are expected to alleviate future pressure on reserve balances, though current levels remain far below the 10 percent target.

General Fund Taxes and Revenues

Programs and operations of the State are predominantly funded through a system of 28 major taxes, and a substantial number of minor taxes, administered by the TRD. The Office of the Superintendent of Insurance collects taxes on insurance premiums. The Regulation and Licensing Department collects professional licensing fees and a number of charges for regulating activities and professions in the state. In addition, interest income and earnings from the Land Grant Permanent Fund, the Severance Tax Permanent Fund and cash balances invested by the State Treasurer's Office provide important sources of revenue for State purposes. The most important tax and revenue sources, as measured by magnitude of revenue generation, and the application of the monies to certain funds and purposes, are described below.

Gross Receipts and Compensating Taxes

The gross receipts tax is levied on the total amount of money or the value of other consideration received from selling tangible and certain intangible personal property in the State, from leasing property employed in the State, from performing services in the State and from research and development services performed outside the State on products initially used in the State. The tax is remitted by the seller but generally passed on to the purchaser. The compensating tax is imposed generally on property used in the State but purchased elsewhere. Gross receipts and compensating taxes are due on the 25th day of the month following the month in which the transaction occurs.

The general presumption is that all receipts of a person engaging in business are subject to the gross receipts tax, even though there are over 100 specified exemptions and deductions from gross receipts taxation. Exemptions from the gross receipts tax include, but are not limited to, certain receipts of governmental agencies and certain non-profit organizations; receipts from the sale of certain vehicles; occasional sales of property or services; wages; certain agricultural products; and dividends, interest and receipts from natural gas, oil or mineral interests sales or leases. Deductions from the gross receipts tax include, but are not limited to, receipts from various types of sales or leases of tangible personal property or service; receipts from certain sales of property to governmental agencies or to certain non-profit organizations; receipts from certain processing of some agricultural products; receipts from certain publication sales; certain receipts from interstate commerce transactions; and as set forth below, certain food and medical services as of January 1, 2005.

The gross receipts and compensating taxes are together the single largest source of State General Fund revenue. The gross receipts tax is also a significant source of revenue for cities and counties. The gross receipts tax includes the 5.125 percent statewide gross receipts tax levy, plus city and county local-option gross receipts taxes. The statewide gross receipts tax rate was increased from 5 to 5.125 percent effective July 1, 2010 as a result of action taken during the 2010 special legislative session. Receipts from the statewide gross receipts tax levy, less certain disbursements, are deposited in the State General Fund. The disbursements include 1.225 percent of the taxable gross receipts reported in each incorporated municipality to that municipality. The County Equalization Distribution is made annually from state gross receipts tax revenues; it has averaged \$18.9 million over the past five years. After all other distributions, the General Fund share of gross receipts tax collections was 64 percent in Fiscal Year 2016 and is expected to be about 60 percent for subsequent years.

Receipts from the compensating tax, less distributions, are transferred to the state General Fund. Compensating tax distributions include 15 percent to the small cities assistance fund and 10 percent to the small counties assistance fund, and a distribution to municipalities based on the level of their taxable gross receipts. In Fiscal Year 2012, legislation increased the distribution to small cities from 10 percent to 15 percent, increased the minimum distribution to small cities from \$35,000 to \$90,000, and amended

statute to allow for larger distributions to small counties. The distribution changes went into effect in Fiscal Year 2014.

In 2005, the Legislature made a number of changes to the state gross receipts tax laws in Sections 7-1-6.16, 7-1-6.46, 7-1-6.47, 7-9-92 and 7-9-93 NMSA 1978. The credit of 0.5 percent granted to municipalities against the statewide rate was eliminated. The tax on food for off-premise consumption and certain medical services also was eliminated. After the 2005 legislative changes, retailers are required to report receipts from sales of groceries to claim the deduction. The deduction does not apply to receipts of restaurants or sales of prepared foods. The legislation also created a gross receipts tax deduction for some receipts of licensed health care providers (broadly defined) from Medicare Part C and managed health care plans, and health care insurers. This medical deduction was modestly expanded in the 2007 legislative session. The 2005 legislation also provided for payments from the State to reimburse local governments for all lost gross receipts tax revenues due to these deductions. Legislation in 2007 froze the rate, but not the size, of these payments for counties with a population over 48,000, and municipalities with a population greater than 10,000 or greater than average per capita taxable gross receipts. In the 2013 legislative session, a bill was enacted which, among other things, will eliminate these payments to certain large local governments over a 15 year period beginning in Fiscal Year 2016.

In Fiscal Year 2016, total distributions to the General Fund from gross receipts and compensating taxes decreased by 6.7 percent over the previous fiscal year to \$2.0 billion, comprising 35 percent of recurring General Fund revenue.

Personal Income Tax

The personal income tax is imposed on the net income of every individual resident and upon the net income from business, property, or employment of individual nonresidents. Collections, net of refunds, are deposited in the General Fund. State taxable income is generally equal to federal adjusted gross income less deductions and amounts not taxable by State or federal laws. The State allows deductions for income earned by Indians on reservations, graduated deductions for income earned by taxpayers 65 years or older, and deductions for low- and middle-income taxpayers.

New Mexico's personal income tax structure changed significantly beginning in 2003. The Legislature enacted significant personal income tax reductions that reduced the top marginal personal income tax rate from 8.2 percent in 2002 to 4.9 percent by 2008, codified in Section 7-2-7 NMSA 1978. This law combined the Head of Household filers' tax rate with the Married, Joint and Surviving Spouse filers' tax rate, beginning in 2006. Single parents are now taxed at the same rate as married couples. Statutory changes enacted in 2005 also provided low and middle-income tax exemptions, a personal income tax exemption for medical expenses, incentives to encourage business formation in rural areas, and incentives to encourage renewable energy production in the State.

In the 2016 Fiscal Year, total distributions to the General Fund from personal income tax decreased by 0.9 percent over the previous fiscal year to \$1.3 billion, and generated 23.3 percent of total recurring General Fund revenue.

Current State tax rates are set forth below:

If the taxable income is:	Married Filing Separate:	If the taxable income is:	Surviving Spouse, Married Filing Joint and Head of Household:
Not over \$4,000	1.7% of taxable income	Not over \$8,000	1.7% of taxable income
\$4,001 to \$8,000	\$68.00 plus 3.2% of excess over \$4,000	\$8,001 to \$16,000	\$136.00 plus 3.2% of excess over \$8,000
\$8,001 to \$12,000	\$196.00 plus 4.7% of excess over \$8,000	\$16,001 to \$24,000	\$392.00 plus 4.7% of excess over \$16,000
Over \$12,000	\$384.00 plus 4.9% of excess over \$12,000	Over \$24,000	\$768.00 plus 4.9% of excess over \$24,000

If the taxable income is:	Single Including Trust and Estates:
Not over \$5,500	1.7% of taxable income
\$5,501 to \$11,000	\$93.50 plus 3.2% of excess over \$5,500
\$11,001 to \$16,000	\$269.50 plus 4.7% of excess over \$11,000
Over \$16,000	\$504.50 plus 4.9% of excess over \$16,000

Corporate Income Tax

The corporate income tax is imposed on the net income of a corporation doing business in the State or deriving any income from property or employment in the State by Section 7-2A-3 NMSA 1978. Collections, net of refunds, are transferred to the General Fund. Corporations are required to file a return on or before the 15th day of the third month following the end of each taxable year at which time corporate income taxes are also due. A corporation is required to make estimated tax payments if the tax, net of credits, is \$5,000 or more. Insurance companies do not pay corporate income tax; rather, they pay a tax on insurance premiums. Nonprofit organizations and retirement trust funds do not pay corporate income tax.

For tax year 2015, tax rates are established under a graduated table and range from 4.8 percent on the first \$500,000 or less of taxable income to 6.9 percent on income in excess of \$1,000,000. For the 2016 Fiscal Year, total distributions to the General Fund of net receipts from corporate income taxes totaled \$118.5 million. This is a decrease of 53.4 percent from the prior fiscal year and generated 2.1 percent of recurring General Fund revenue.

In recent years, a number of credits administered through the corporate income tax system have been enacted. These include: the film production credit, enacted as Section 7-2F-1 NMSA 1978; the real property tax credit, enacted as Section 7-2-18.10 NMSA 1978; the rural jobs tax credit, enacted as Section 7-2E-1 NMSA 1978; the biodiesel production and sale credit, enacted as Section 7-2-18.21 NMSA 1978; the sustainable building tax credit, enacted as Section 7-2-18.19 NMSA 1978; and the renewable energy production tax credit, enacted as Section 7-2A-19 NMSA 1978. The 2011 Legislature placed a cap of \$50 million per year on the film production tax credit, and added a deferred payment process for larger productions. In the first year of enactment, Fiscal Year 2012, film credit refunds totaled \$10 million, partly due to the rush to file claims in Fiscal Year 2011 prior to enactment of the cap. The film credit cap has been reached each year since the \$50 million cap was imposed. TRD expects the State to continue to invest \$50 million into the film industry in the foreseeable future. This is for two reasons: (1) the number of applications for this refundable tax credit has been increasing over time, and (2) by statute, if there are less than \$50 million in film credits refunded, the State is required to accelerate payments for taxpayers who have already filed.

In the 2013 legislative session, House Bill 641 (Chapter 160) was enacted, which will reduce the State corporate income tax rate over several years to a maximum marginal rate of 5.9 percent. The legislation also allows manufacturers in the State to use sales as a single factor in calculating income tax liability. The Legislation also requires certain corporate taxpayers to adhere to mandatory combined reporting of unitary corporations for tax purposes. During the 2014 legislative session, Senate Bill 106 (Chapter 53) was enacted extending the net operating loss carryforward to 20 years from 5 years in prior law.

Mineral Production Taxes

Mineral production taxes (Resources Excise Tax, Natural Gas Processors Tax, Oil and Gas Conservation Tax, and Oil and Gas Emergency School Tax) are levied on producers and others on the value of severed minerals and material resources from within the State and these taxes are disbursed to the General Fund. The Oil and Gas Emergency School Tax is imposed for the privilege of engaging in the business of severing oil, natural gas, liquid hydrocarbons and carbon dioxide (“CO₂”) from the soil of the State. The Oil and Gas Emergency School Tax is imposed at a rate of 3.15 percent of taxable value of oil and 4 percent of taxable value for natural gas. Taxable value reflects gross sales value less deductions for royalties paid to government entities and for certain processing and transportation expenses. The same definition of taxable value is used for calculation of oil and gas severance tax liability.

In the 2016 Fiscal Year, distributions to the General Fund from Oil and Gas Emergency School Tax receipts totaled \$236.4 million. This represents a 36.9 percent decrease from the prior fiscal year. Other General Fund taxes on natural resource production totaled \$43.0 million. For Fiscal Year 2016, these mineral production taxes contributed 4.8 percent of recurring General Fund revenue.

In 2002, the Legislature created the Jicarilla Apache Tribal Capital Improvement Tax Credit, codified in Section 7-31-27 NMSA 1978. This tax credit can reduce the Oil and Gas Emergency School Tax on products severed from wells drilled on the Jicarilla Apache Nation by up to 0.7 percent of the taxable value of production. Proceeds of the tax credit must be used exclusively to fund capital improvement projects on Jicarilla Apache tribal lands, although funds may not be used to finance commercial activity. This credit totaled \$400 thousand for Fiscal Year 2016.

Recent Local Law Developments

Over the past few years, several local governments in the State have proposed or adopted laws that could have the effect of limiting natural resource extraction in those jurisdictions. No local government in which a significant extraction of natural resources occurs has enacted laws limiting natural resource extraction.

For example, in 2008, Santa Fe County amended its land development code to address oil and gas exploration, drilling, production, transportation, abandonment and remediation. The provisions of this code, while restrictive, do not ban exploration activities and to date have not been challenged by lawsuit. In April 2013, Mora County, a county in the north central section of the State enacted a self-styled Community Water Rights and Local Self Government Ordinance, which, among other things, states: “It shall be unlawful for any corporation to engage in the extraction of oil, natural gas, or other hydrocarbons within Mora County.” Several lawsuits were filed challenging the validity of this Ordinance. In January 2015, a federal district court declared the Mora County ordinance invalid based on several grounds including violation of the Supremacy Clause and the First Amendment of the U.S. Constitution and preemption by New Mexico oil and gas regulatory statutes. *SWEPI, LP v. Mora County*, 81 F. Supp. 3d 1075 (D.N.M. Jan. 19, 2015). In March 2015, the Mora County Commission voted to repeal the ordinance. Legislation heavily regulating oil and gas development was adopted in November 2014 in San Miguel County, also in the north central section

of the State. Legislation banning hydraulic fracturing was adopted in Las Vegas, a municipality in San Miguel County, by its city council but was not signed and is not enforced by its mayor. Historically, there has been little or no oil and gas production in Santa Fe, Mora or San Miguel counties.

To date, the proposal and enactment of local laws has not had a material effect on the amount of severance tax revenues collected by the State. While future actions by local governments relating to natural resource extraction is not predictable, litigation challenging any restrictive local enactments would be a likely consequence of such actions.

Royalties, Rents and Bonuses

Federal Lands. Under terms of the 1920 Federal Mineral Leasing Act, the State receives 50 percent of all income generated from leasing federal lands located in the State for mineral production. Principal sources of income are royalty payments on oil and natural gas production. Additional income is derived from bonus payments for oil and natural gas leases and royalty payments on production of coal, potash and other minerals. The U.S. Office of Natural Resources Revenue, part of the former Minerals Management Service, collects federal mineral lease income and deducts 2 percent from the State's share for administrative costs. The State receives payments on a monthly basis and makes deposits to the General Fund. In Fiscal Year 2016, total distributions to the General Fund from federal mineral leases totaled \$390.0 million. This equals 6.8 percent of recurring General Fund receipts for the fiscal year.

Federal Fiscal Year 2009 appropriations bills implemented a 2 percent administrative fee cut from the federal royalty payments to states. This 2 percent fee was extended each federal fiscal year since 2009, and extended for 10 years in the 2013 Bipartisan Budget Act. Approximately \$11.9 million was deducted in Fiscal Year 2014, \$11.1 million was deducted in Fiscal Year 2015, and \$8.0 million was deducted in Fiscal Year 2016.

In Federal Fiscal Year 2016, federal mineral leasing revenues were sequestered at the rate of 6.8 percent, totaling \$24.3 million. These revenues were returned to New Mexico at the beginning of Federal Fiscal Year 2017. The sequestration of these revenues continues in Federal Fiscal Year 2017 at the rate of 6.9 percent. These revenues are expected to be returned to the State in Federal Fiscal Year 2018.

State Trust Lands. The Commissioner of Public Lands and the State Land Office manages lands acquired by the State under the federal Fergusson Act and the Enabling Act for New Mexico enacted prior to statehood, as well as under the State Constitution. All income from State trust lands is dedicated to specific institutions; each section of State trust land has a specific named beneficiary institution. As with federal lands, the oil and natural gas industry is the principal source of revenue from State trust lands. Bonus income is also collected in the form of cash payments as a result of competitive bidding for State leases. Rentals and bonus income are distributed to the respective beneficiary institutions. The largest beneficiary group is the State's public school system. Mineral production from State trust lands also generates royalty income which is deposited in the State Land Grant Permanent Fund ("LGPF"). Royalties are imposed on most mineral production values at the rate of 12.5 percent, although there is a provision for rates of up to 20 percent for new leases on developed acreage. LGPF beneficiaries and "State lands" beneficiaries are the same institutions and public schools. In Fiscal Year 2016, distributions to the General Fund from the State Land Office totaled \$47.8 million, which equaled 0.8 percent of recurring General Fund receipts for the fiscal year.

Severance Tax Permanent Fund and the Land Grant Permanent Fund

The Severance Tax Permanent Fund ("STPF") was established in the State Treasury in 1973 to receive the residual revenues from the Bonding Fund and serve as an endowment for the State. In 1976,

the electorate approved a constitutional amendment giving the STPF constitutional status. In 1982, the electorate approved a second constitutional amendment that removed the discretionary power of the Legislature to appropriate funds from the corpus of the STPF, thereby creating a permanent endowment fund. Distributions from investments of the STPF, however, may be appropriated by the Legislature in the same manner as other general revenues are appropriated. Severance tax receipts have been the primary source of funding for the STPF. The State Investment Council (“SIC”) invests the corpus and non-appropriated income of the STPF. The market value of the STPF as of June 30, 2016 was approximately \$4.54 billion, an overall asset decrease of approximately 4.1 percent from the prior fiscal year. Investment performance for the one year period ended June 30, 2016 was 0.44 percent, 0.23 percentage points below the Fund policy index. Funds on deposit in the STPF are not pledged to and may not be used to pay any severance tax debt.

The LGPF is designed solely to benefit the public educational system of the State and other specified institutions. The origins of the LGPF are found in the federal Fergusson Act of 1898, which granted two sections of land in every township for the benefit of the public schools in the territories of New Mexico. Also under this Act, specific acreage was granted to individual education, medical and penal institutions in the territory. The initial grant totaled in excess of 5.5 million acres. In 1910, the Enabling Act granted additional lands to various beneficiaries in New Mexico, including the public schools, which received the largest share. This brought the total lands placed in trust for the common school system and other beneficiaries to over 13 million acres. Over the years, some land has been sold (and the proceeds used to increase the corpus of the LGPF), so the current total is nine million surface acres and 13.4 million subsurface acres.

Pursuant to Section 19-1-1 NMSA 1978, the State Land Office is charged with the custody and disposition of the land granted to the State. The Commissioner of Public Lands sells or leases these properties in accordance with the provisions of the appropriate statutes. The SIC invests the corpus and income of the LGPF. As of June 30, 2016, the market value of the LGPF was approximately \$14.61 billion, an asset decrease of approximately 1.3 percent over the prior fiscal year. Investment performance for the year ended June 30, 2016 was 0.37 percent, and 0.31 percentage points below the LGPF’s policy index, and below its annual target rate of return of 7.0 percent. The Council lowered its annual rate of return target from 7.5 percent to 7.0 percent during fiscal year 2016, in anticipation of a low-return investment environment. The corpus of the LGPF is constitutionally protected from appropriation and LGPF assets are not pledged to and may not be used to pay debt. The LGPF is also protected by the Federal Enabling Act of 1910.

In November 1996, the State electorate approved a constitutional amendment regarding distributions from both of the State’s permanent funds. Distributions are now calculated on a total return basis rather than an income distribution method. In addition, distributions to beneficiaries are now based on a formula under which a statutorily specified percentage of the previous average five-year market value of the fund is distributed.

In September 2003, the State electorate approved a constitutional amendment increasing the rate of annual distribution from the LGPF from the previous 4.7 percent, to a new base distribution of 5.0 percent of the LGPF’s five-year average market value, beginning in Fiscal Year 2005. Certain additional distributions were made to implement and maintain educational reforms as provided by law. An additional 0.8 percent was distributed in fiscal years 2005 through 2012 and an additional 0.5 percent was distributed in fiscal years 2013 through 2016.

In May 2009 an investigation by the New York Attorney General into placement fees paid in relation to investments made by New York pension funds, led to an indictment of an investment advisor to that fund as well as New Mexico SIC and ERB. The investment advisor later pled guilty to a fraud

charge relating to investments made by the New York retirement fund. In connection with that plea, the investment advisor stated that from 2004 to 2009 his business had acted as an advisor to the SIC and the ERB and that, contrary to his fiduciary responsibilities to the SIC and ERB, he ensured recommendations of certain proposed investments pushed on him by politically connected individuals or their associates who stood to benefit financially or politically from the investments, and that the investments were not necessarily in the best interests of the State. No criminal charges were filed by state or federal investigators in New Mexico. In May 2011, the SIC filed recovery lawsuits against more than a dozen placement agents, the former State Investment Officer, and other individuals alleging they improperly benefited from pay-to-play and kickback schemes involving SIC investments. To date, settlements of more than \$38 million have been recovered or placed in escrow pending final approval by the courts, for ultimate return to the permanent funds. Additional legal recovery efforts are ongoing, and additional settlements or court judgments are anticipated in 2017.

In response to these and other events and the negative returns suffered by the State's various investment funds during the market turmoil associated with the downturn in the nation's economy in 2008 and 2009, the Board and the Legislative Council Service ("LCS") co-sponsored an Independent Fiduciary and Operational Review of State Investment Policies, Procedures and Practices prepared by Ennis, Knupp & Associates, Inc. (the "Review"). The scope of the work of this Review included, among other things, review and recommendations for appropriate governance and organizational structure, and investment best practices for the SIC and New Mexico's public employee and state educator pensions (PERA & ERB). The findings and recommendations of the Review were reported to the Board at a meeting on January 13, 2010. In order to address certain recommendations of the Review, during the 2010 legislative session the Legislature, among other things, modified the composition of the SIC, clarified the authority of the SIC and the State Investment Officer, provided for the appointment of the State Investment Officer by the SIC and changed the method of appointment of public members of the SIC. Removal of individual investment authorization powers by the Investment Officer alone, and addition of Council Investment, Audit, Governance and legal Committees have greatly improved Council practices and governance procedures. To date, the Investment Council has adopted or accomplished 77 of the 82 recommendations made by EnnisKnupp in their 2010 Operational Review, with the remainder still being considered for partial or full adoption.

Investment Income

Investment earnings credited to the General Fund are from three primary sources: the LGPF, the STPF, and cash balances invested by the State Treasurer. A percentage of market value from the LGPF is distributed among the beneficiary institutions and public schools. The allocation received by the public schools, which was approximately 84.5 percent in Fiscal Year 2016, is deposited in the General Fund. For the 2016 Fiscal Year, \$555.1 million of LGPF distributions were transferred to the General Fund for public school purposes. Also in Fiscal Year 2016, the State distributed \$193.5 million of income from the Severance Tax Permanent Fund, all of which was deposited in the General Fund. In the 2016 Fiscal Year, the Treasurer's cash balances produced \$21.6 million for the General Fund. Total investment income credited to the General Fund was \$770.3 million. This is 13.5 percent of recurring General Fund receipts.

Ratings

The State's General Obligation Bonds, Severance Tax Bonds (the "Senior Bonds"), and Supplemental Severance Tax Bonds (the "Supplemental Bonds") have received ratings from Moody's Investors Service, Inc. ("Moody's"), and S&P Global Ratings ("S&P"). On May 12, 2016, Moody's downgraded the ratings of the Senior Bonds to Aa2 (from Aa1) and downgraded the ratings of the Supplemental Bonds to Aa3 (from Aa2). On May 12, 2016, S&P downgraded the ratings of the Senior Bonds to AA- (from AA) and downgraded the ratings of the Supplemental Bonds to A+ (from AA-). On

October 25, 2016, Moody's downgraded the rating on the General Obligation Bonds from Aaa to Aa1, with a negative outlook. On November 10, 2016, S&P downgraded the rating on the General Obligation Bonds from AA to AA-, with a negative outlook. Such ratings reflect only the views of the respective organizations. An explanation of the significance of each rating may be obtained from the rating agency furnishing such rating. There is no assurance that such ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely by such rating agencies if, in the judgment of such rating agencies, circumstances so warrant. Any downward revision or withdrawal of either rating can be expected to have an adverse effect on the market price of the bonds.

PROPERTY VALUATION AND TAXATION

Property Tax System

With certain limited exceptions, real and personal property owned by individuals or corporations is subject to *ad valorem* taxation (i.e., taxation as a fraction of value rather than on a per unit basis) in the State. County assessors are responsible for appraising most of New Mexico's residential and commercial property. The Appraisal Bureau of the TRD provides technical assistance to county assessors and helps them implement the Property Tax Code (Articles 35 through 38 of Chapter 7 NMSA 1978).

The State Assessed Property Bureau of the TRD, commonly known as the Central Assessment Bureau, is responsible for assessing certain types of property that are not assessed by counties because assessing the property is exceptionally technical or because the property extends across county boundaries. Assessments undertaken by the Central Assessment Bureau, referred to as central valuations, are performed on the following types of properties:

- Railroads;
- Communication systems;
- Pipelines;
- Public utilities;
- Airlines;
- Electric generating plants;
- Construction machinery and equipment, and other personal property of persons engaged in construction that is used in more than one county; and
- Mineral property, excepting oil and natural gas related property.

Property valuations are established as of January 1 of each year (except for certain livestock). Centrally assessed property is verified and certified to local assessors who combine the values with all locally assessed property values. The totals are reported to the Central Assessment Bureau and the DFA, and certified for budgetary use. County treasurers levy the applicable rates against individual properties and are required to mail tax bills for the current tax year no later than November 1. Property taxes are due in two equal installments on November 10 and April 10. Taxes become delinquent on December 10 and May 10 following the two respective due dates. Civil penalties and interest are imposed on delinquent taxes. County treasurers are responsible for collecting property taxes and distributing them to governmental entities that receive them. Major property tax recipients include counties, municipalities, and school districts. In Property Tax Year 2016, 4.5 percent of property tax collections statewide were distributed to the State for payment of principal of and interest on general obligation bonds.

State law provides a mechanism by which, in the event of a dispute with respect to property taxes owed, a taxpayer may make payment under protest. Such monies may not be spent by property tax recipients until the taxpayer's claim has been decided. At that time, the monies are distributed either to

the county or the taxpayer, depending on the outcome of the taxpayer's claim. As a result, counties may experience delays in receiving tax revenues or may be required to refund monies already received.

Except for property that by statute is subject to special methods of valuation, assessed value of property is generally its market value as determined by the sales of comparable property subject to certain limitations. Income or cost valuation methods also are used when appropriate. Residential properties are eligible for a \$2,000 head of family exemption. A \$4,000 veteran exemption may be applied against residential and certain nonresidential property. Honorably discharged members of the armed services are eligible for the veteran exemption. Taxable value is one-third of assessed value, as required by Section 1 of Article VIII of the New Mexico Constitution. Net taxable value, against which rates are imposed, consists of taxable value less exemptions. Maximum property tax rates for operations for various types of local governments are imposed by the Constitution of the State and by governing statutes. See "Property Tax Limitations," below. Different tax rates typically apply to residential and non-residential properties in the same tax jurisdiction due to the state's "yield control" statute (Section 7-37-7.1 NMSA 1978), which is applied separately to residential property.

Oil and natural gas properties and related production equipment are subject to property taxation in the State. The oil and natural gas *ad valorem* production tax is levied and collected by the Oil and Gas Bureau of the TRD on the basis of assessed value deemed the equivalent of 50 percent of the actual price of oil and natural gas received at the production unit multiplied by the volume of oil and natural gas produced, less certain trucking expense deductions and royalties paid to the federal government, the State, or Indian tribes. The oil and natural gas production "equipment *ad valorem* tax" is levied based on assessed value deemed equivalent to 9 percent of the previous calendar year sales value of the product from each production unit. The tax year for oil and natural gas production begins on September 1 based on tax rates that are set on August 31. The oil and natural gas "*ad valorem* production tax" is due by the 25th day of the second month following the month of production. Taxes are collected monthly. The oil and natural gas production "equipment *ad valorem* tax" is due on November 30 based upon assessments issued on or before October 15. The TRD distributes its collections to the county treasurers who further distribute the tax revenues to property tax recipients.

Property Tax Valuation Limitations

In November 1998, the New Mexico electorate approved an amendment to Section 1 of Article VIII of the State Constitution to authorize the Legislature to limit increases in residential property valuation for property taxes. The limitation may be applied to classes of residential property taxpayers based on owner-occupancy, age or income. The limitations may be authorized statewide or at the option of a local jurisdiction and may include conditions. Any valuation limitations authorized as a local jurisdiction option shall provide for applying statewide or multi-jurisdictional property tax rates to the value of the property as if the valuations increase limitation did not apply. This amendment and related legislation may have an impact on future property taxation increases.

The 2000 Legislature passed and the Governor signed legislation limiting the increase in the value of residential property for property valuation purposes. Section 7-36-21.3 NMSA 1978 provides for a freezing of values for single-family dwellings occupied by certain low-income owners 65 years of age or older. Another law provides that the value of a residential property in any tax year, starting with the year 2001, shall not exceed certain percentage increases based on whether the county where the property is situated has a sales assessment ratio of at least 85 percent, as codified in Section 7-36-21.2 NMSA 1978. Sales assessment ratios are computed annually by the TRD and measure a county's assessment valuations against current sales information. Counties that have at least an 85 percent sales assessment ratio are considered "current and correct" while counties that fall below that threshold are considered not "current and correct." If a property is situated in a current and correct county, the law

limits the annual increase to no more than 3 percent (and 6.1 percent over the value two years ago). If a residential property is situated in a county that is not current and correct, the law limits the annual increase to 5 percent. In addition, in such a non-current and correct county, the law limits the aggregate annual increases for all residential properties (excluding net new properties added to the tax rolls) in that county to 3 percent. The annual limitations do not apply to new improvements or to any property that has had a change in ownership, use or zoning during the year.

The 2005 Legislature passed and the Governor signed a bill, codified as Section 7-38-12.1 NMSA 1978 of the Property Tax Code, requiring the disclosure only to the County Assessor of sale prices and other items of value upon the sale of residential real property. This amendment has led to an increase in the assessed value of some residential properties.

The 2008 Legislature passed and the Governor signed legislation amending Section 7-36-15 NMSA 1978 to require county assessors to consider, in determining the market value of residential housing, any decrease in value that would be realized by an owner in the sale of the property because of the effects of any affordable housing subsidy, covenant or encumbrance under a federal, state or local housing program that restricts the future use or resale value of the property, or otherwise prohibits the owner from fully benefiting from any enhanced value of the property.

Several legal challenges were brought in response to the Legislature's enactment of Section 7-36-NMSA 1978, because of the exception to the annual valuation cap for residential properties which experienced a change in ownership in the previous tax year. This exception resulted in acquisition-value taxation, and also resulted in instances in which the property's valuation based on its fair market value at the time it changed ownership was much greater than its previously-capped valuation, also known as "tax lightning." In these situations, the new property owner faced greatly increased property taxes compared with the previous owner. Several lower courts concluded that the exception therefore violated Article VIII, Section 1 of the New Mexico Constitution by creating an inappropriate classification of taxpayers.

On March 28, 2012, in *Zhao v. Montoya*, 2012-NMCA-056, on certification from the district court for Bernalillo County, the New Mexico Court of Appeals reversed the district courts, and held that the change-of-ownership exception to the valuation cap on residential property values until a change of ownership occurs does not violate the New Mexico Constitution. The Court of Appeals reasoned that, given that the owner-occupancy class consists of persons who became owner-occupants only upon acquisition of the property, the exception applies to a sub-class of the constitutionally permissible owner-occupancy class.

On June 30, 2014, in *Zhao v. Montoya*, 2014-NMSC-025, the New Mexico Supreme Court affirmed in part and reversed in part the Court of Appeals' decision. The New Mexico Supreme Court agreed with the Court of Appeals that the change-of-ownership exception to the valuation cap for residential properties is constitutional, albeit on other grounds. The New Mexico Supreme Court stated that the Court of Appeals' holding based on the taxpayers' classification "creates the impression that ownership alone may equate to owner-occupant." The New Mexico Supreme Court held instead that the change-of-ownership exception to the valuation cap is constitutional because it focuses on the nature of the property, when it was acquired, and not on the classification of the taxpayer, whether the taxpayer is an owner-occupant.

Thus, although the Supreme Court's decision in *Zhao* focused on the constitutionality of the exception to the annual limitations on residential property revaluation, its holding supports the conclusion that the New Mexico Property Tax Code is constitutional, including the general annual valuation cap. *Zhao* also supports that the Property Tax Code's additional exceptions to the cap for properties which have changed use or which have been subject to a zoning change during the previous year are also

constitutional, as they similarly focus on the nature of property, rather than on the taxpayer.

While the Supreme Court declared the change-of-ownership exception to the revaluation limitation constitutional, it remains to be seen whether county assessors around the State who stopped the practice of revaluing properties at their current fair market value upon a change of ownership will re-institute it. If the county assessors re-institute acquisition-value taxation under the exception, it will likely increase property tax revenue going forward, barring any material reduction in residential property values statewide. Any such reduction could result in a diminution of state general obligation bond capacity. Additionally, limitations on assessments could cause an increase to the property tax levied against taxpayers necessary to pay debt service on state general obligation bonds.

Table 27 sets forth the aggregate statewide net taxable valuations for the last 10 years.

TABLE 27

Final Net Taxable Valuations
(Dollars in thousands)

<u>Property Tax Year</u>	<u>Residential</u>	<u>Non-Residential</u>	<u>Oil and Gas</u>	<u>Copper</u>	<u>Net Taxable Value</u>
2007	25,805,629	14,458,192	5,758,696	133,262	47,288,631
2008	27,798,246	15,259,324	7,245,955	160,279	50,463,804
2009	29,455,894	16,383,859	9,033,975	172,481	55,046,209
2010	29,845,647	16,513,415	4,556,355	125,538	51,040,955
2011	30,265,867	16,594,029	5,868,724	117,476	52,846,098
2012	30,794,394	16,639,038	6,938,090	119,440	54,490,962
2013	31,320,905	16,824,354	6,431,256	149,491	54,726,006
2014	31,678,950	17,161,038	7,710,780	184,736	56,735,505
2015	32,396,576	17,720,157	8,463,290	211,459	58,791,482
2016	33,533,677	18,181,319	4,982,793	224,778	56,922,567

Source: New Mexico Department of Finance and Administration, Local Government Division.

Property Tax Mill Levy Limitations

Section 2 of Article VIII of the New Mexico Constitution states:

Taxes levied upon real or personal property for state revenue shall not exceed four mills annually on each dollar of the assessed valuation thereof except for the support of the educational, penal and charitable institutions of the state, payment of the state debt and interest thereon; and the total annual tax levy upon such property for all state purposes exclusive of necessary levies for the state debt shall not exceed ten mills; provided, however, that taxes levied upon real or personal tangible property for all purposes, except special levies on specific classes of property and except necessary levies for public debt shall not exceed twenty mills annually on each dollar of the assessed valuation thereof, but laws may be passed authorizing additional taxes to be levied outside of such limitation when approved by at least a majority of the qualified electors of the taxing district who paid a property tax therein during the preceding year voting on such proposition.

Currently the State imposes no levy of property taxes except for the payment of State debt.

Statutes establish maximum property tax rates for operating purposes for cities, counties and school districts. The DFA is permitted by statute to set a rate at less than the maximum rate in any tax year. These maximum property tax rates for operating purposes are set forth below.

Maximum Operating Mill Levy Rates

Counties	11.85
Cities	7.65
Schools.....	<u>0.50</u>
Maximum combined statutory rate.....	20.00

Source: Section 7-37-7(B) NMSA 1978.

Apart from the allowable operating tax rates above, New Mexico governments may levy additional property taxes as authorized by statute and voter approval for:

- Debt service;
- County hospitals and health care services;
- School district capital improvements;
- Branch and community colleges;
- Vocational schools;
- Flood control districts and authorities;
- Judgments;
- Water and sanitation districts;
- Conservancy districts;
- Public improvement districts;
- Tax increment development districts; and
- Other special districts.

In addition, the Legislature has established certain limits on the increase in property tax revenue that may be realized for county and city operating purposes. The “yield control” formula is activated by property valuation increases resulting from county assessor reappraisal programs. The yield control law limits the increase in operating revenue from existing properties in absence of new rate impositions in any one year over the prior year to the lesser of 5 percent or the percentage increase in the annual price index published by the United States Department of Commerce for State and Local Government Purchases of Goods and Services, plus increases in tax revenues resulting from new construction, improvements to properties and increased taxable value due to annexation.

Production and Property Taxes on Oil and Natural Gas

The valuation of oil and natural gas production and the assessment of the *ad valorem* production tax are based on the actual value of production on a monthly basis from September 1 to August 31. Oil and natural gas are valued for the calendar year preceding the property tax year, as established in Section 7-32-15 NMSA 1978. For rate setting, the Local Government Division of the DFA may adjust the State levy

for changes in oil and natural gas values.

Current effective production tax rates expressed on ad valorem and unit bases are shown below. The rates were based on data from Fiscal Year 2016 and reflect an average sales price of \$37.85 per barrel for oil and \$2.40 per thousand cubic feet (mcf) for natural gas. The gross rates presented in the table below show taxes paid as a percentage of gross sales value before subtracting allowable deductions and tax credits. The gross tax per unit is also based on gross sales value. The net tax per unit, however, is also based on taxable value before subtracting allowable deductions and tax credits.

TABLE 28

Effective Tax Rates Applicable for Fiscal Year 2016

Type of Tax	Crude Oil		Natural Gas	
	Ad Valorem	Per Barrel	Ad Valorem	Per mcf
Price		\$37.85		\$2.40
Oil and Gas School Tax	2.76%	\$1.05	2.68%	\$0.07
Oil and Gas Severance Tax	3.29%	\$1.25	2.53%	\$0.06
Oil and Gas Conservation Tax (General Fund only)	0.17%	\$0.06	0.13%	\$0.00
Natural Gas Processors Tax	N/A	N/A	0.65%	\$0.02
Oil and Gas Production ad valorem Tax	1.07%	\$0.41	0.85%	\$0.02
Oil and Gas Production Equipment ad valorem Tax	0.36%	\$0.14	0.70%	\$0.02
Total	7.64%	\$2.90	7.53%	\$0.18
Subtotal: State Tax Only (excludes ad valorem taxes)	6.22%	\$2.36	5.99%	\$0.15

Source: New Mexico Department of Finance and Administration.

Production, Sales, and Property Taxes on Coal

Total State production and property taxes on coal totaled approximately \$16.9 million in Fiscal Year 2016, down from approximately \$18.3 million in Fiscal Year 2015. Coal production also decreased from approximately 14.0 million tons in Fiscal Year 2015 to 12.1 million tons in Fiscal Year 2016. Thus, the average effective tax per ton increased from approximately \$1.31 in Fiscal Year 2015 to approximately \$1.40 per ton for Fiscal Year 2016. With total sales revenue of approximately \$410.2 million in Fiscal Year 2016, the average effective tax was 4.12 percent of total sales revenue. This does not include the gross receipts tax. The average burden of production, property, and gross receipts taxes on a ton of coal produced and sold during Fiscal Year 2016 is shown in the following table.

TABLE 29**Tax Burden on Coal for Fiscal Year 2016**⁽¹⁾

Type of Tax	Tax per Ton	Effective Tax Rate	Taxes Collected
Severance Tax and Surtax (Net of ITC)	\$0.56	1.66%	\$ 6,798,336
Resource Excise Tax ⁽²⁾	0.26	0.78	3,182,315
Conservation Tax ⁽²⁾	0.07	0.20	806,186
Total Production Taxes	<u>0.89</u>	<u>2.63</u>	<u>10,786,836</u>
Property Tax ⁽³⁾	0.51	1.50	6,132,060
Gross Receipts Tax	0.96	2.84	11,647,905
Total Production and Non-Production Taxes	<u>2.36</u>	<u>6.97</u>	<u>28,566,801</u>
Price per Ton			\$33.83
Total Production (Short Tons)			12,124,191
Total Value			\$410,161,381

⁽¹⁾ The figures reported in this table come from the New Mexico Taxation and Revenue Department's GenTax System. These figures differ from actual distributions made by the Taxation and Revenue Department's Financial Services Bureau, as the distributions include penalties, interest, and other modifications such as previously unallocated or unidentified receipts. Total production is based on volumes reported on severance tax returns, which differ from the volumes reported on resource excise tax returns.

⁽²⁾ Complete Fiscal Year 2016 data was not available and therefore an estimate of the full Fiscal Year is provided.

⁽³⁾ Property tax year began September 1, 2015.

Source: New Mexico Taxation and Revenue Department, Tax Analysis, Research and Statistics Office (the GenTax System, Financial Services Bureau and Property Tax Division's Central Assessment Unit).

Statutory rates for the resources excise tax and the conservation tax are effectively reduced by a deduction for Federal, State and Indian royalties. The effective severance tax rate on coal reflects the mix of old and new contract sales and of underground and surface mines. Property tax pertains to both equipment and production values. Fundamental differences in tax bases preclude a true comparison between property taxes and other taxes shown above. However, property taxes are included in this analysis to prevent understating the tax burden.

In addition to production taxes, gross receipts tax is imposed on coal produced and sold within the State. During 2015, the most recent year for which data is available (Source: U.S. Energy Information Administration), 60.4 percent of all coal produced in the State was supplied to electric power plants in New Mexico. In Fiscal Year 2016, 45.9 percent of all coal produced in New Mexico is subject to gross receipts tax. Part of the decline is due to the sale of the Navajo mine to the Navajo Nation, which is exempt from gross receipts tax. The combined state and local tax rate for Fiscal Year 2016 is 6.72 percent of taxable gross receipts.

ADDITIONAL INFORMATION

Additional financial information from government agencies of the State may be obtained online from the State's Sunshine Portal. The information contained in the Sunshine Portal database may change over time. The State Board of Finance assumes no responsibility or liability for the contents of the Sunshine Portal. The State Board of Finance also maintains a website containing general information about the State and its bond programs.