STATE OF NEW MEXICO

DEPARTMENT OF FINANCE AND ADMINISTRATION

BOARD OF FINANCE

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DEBT AFFORDABILITY STUDY

February 1, 2021

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Introduction and Scope

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

The core State bonding programs that are the focus of this study include general obligation bonds, severance tax bonds and supplemental severance tax bonds issued by the State Board of Finance, and transportation revenue bonds issued by the Department of Transportation through the New Mexico Finance Authority. These bonding programs, along with general funds appropriated by the State Legislature, are the primary sources of capital investment funding for the State. The study incorporates the bonds issued by the New Mexico Finance Authority (NMFA) on behalf of the Department of Transportation as statewide debt, but does not address debt issuance by State higher educational institutions, the Mortgage Finance Authority, or the regional housing authorities. Finally, the study references the Public Project Revolving Fund of the New Mexico Finance Authority, but does not address the range of NMFA financing activities or other bonds issued by political subdivisions of the State.

The core State long-term bonding programs have projected capacity of $4.7 billion of new money, long-term general obligation and senior severance tax bonds over the next 10 years for State capital projects based upon the policies described herein, as well as a further $3.6 billion of short term “sponge” funding notes for statewide capital projects and public school capital outlay purposes. In aggregate, this level of funding represents a 9.3 percent increase in projected capital capacity over the amounts projected in last year’s annual Debt Affordability Study. The regular issuance of long-term debt in a manner that allocates available long-term debt capacity over a ten-year horizon, in conjunction with the continued use of short-term notes to direct annually available balances in the Severance Tax Bonding Fund to investment in State economic infrastructure and other critical state facilities, has been central to the State long-term capital investment planning for many years.

The projected available debt capacity for the core State bonding programs as described herein is not funded from, and therefore does not place stress on, the State General Fund, and this projected capital capacity is affordable within currently projected levels of the revenue streams that are dedicated to debt repayment. As the increase in projected debt capacity noted above suggests, natural resource production technologies have augmented severance tax revenues, notwithstanding extraordinary volatility in world oil prices in early 2020. Due in large measure to the conservative debt management practices of the State, the key debt ratios did not suffer materially on account of the downturn in State revenues over the past several years, even as new long-term debt was issued. Now, revenue prospects over the near and medium turn are decidedly positive.

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

The State bond ratings are now in the middle tier of the *"double-A"* level, the second highest investment grade rating category, with stable outlooks. These bond ratings continue to benefit from strong debt management attributes, which include rapid debt retirement, moderate debt levels, and debt ratios relative to population and personal income that have shown a downward trend over time. These credit strengths have been balanced against the State's historical dependence on federal employment, low levels of personal income relative to national averages and state peers, and the inherent revenue volatility derived from volatility in oil and natural gas pricing and production levels.

Action by the Governor and state legislature to address the PERA funding situation has ameliorated an historic credit issue facing the state. Moody's Investors Services, which incorporates pension fund liabilities into its credit analysis based upon lower assumed long-term pension fund earnings, has drawn particular attention to the funding of teacher pension funds nationally, where ambiguities in state laws has left open questions with respect to the locus of responsibility for funding shortfalls in those pension systems. In its September 2020 research report on state pension systems, Moody's called out the underfunding of the New Mexico Educational Retirement Board (ERB) as a significant source of financial pressure on the State. The ERB pension issue, and Moody's overall pension methodology are discussed herein, and we provide a comparison of the State debt and liability position to all of the states, utilizing Moody's adjustments to state net pension liabilities.

Core State Bonding Programs

The core State bonding programs that are the focus of this study include general obligation bonds, severance tax bonds and supplemental severance tax bonds issued by the State Board of Finance, and transportation revenue bonds issued by the Department of Transportation through the New Mexico Finance Authority. The State general obligation bonds are secured by the full faith and credit pledge of the State, and are repaid from a dedicated *ad valorem* statewide mill levy. The severance tax and supplemental severance tax bonds are secured by and repaid from revenues deposited into the Severance Tax Bonding Fund, which primarily include taxes on natural resource extraction in the state. The transportation revenue bond program is secured by a pledge of revenues received into the State Road Fund, which are principally derived from gasoline and diesel fuel taxes, motor vehicle registration, and road user fees, plus an additional pledge of certain federal revenues received annually by the Department of Transportation. None of these outstanding core state bonds are payable from General Fund resources.

The following table sets forth the sources of capital funding for the State over the past five years, including the core State bonding programs, the severance tax note program, and pay-as-you-go funding appropriated from the General Fund for capital projects.

Principal Sources of Capital Funding by Fiscal Year (Millions of dollars)						
	2016	2017	2018	2019	2020	Total
General Obligation Bonding Program						
General Obligation Bonds	-	-	$174.3	-	$157.9	$332.2
Subtotal	-	-	174.3	-	157.9	332.2
Severance Tax Bonding Program						
Severance Tax Bonds	$293.1	$51.0	222.5	-	-	566.6
Severance Tax Funding Notes	8.6	38.5	28.9	$74.8	307.2	458.0
Supplemental Severance Tax Bonds	81.0	-	-	-	-	81.0
Supplemental Severance Tax Funding	127.3	120.4	139.2	181.5	254.5	822.9
Subtotal	510.0	209.9	390.6	256.3	561.7	1,928.5
Other Sources						
General Fund	-	-	-	650.8	-	650.8
Transportation Bonds	-	-	-	-	-	-
Subtotal	-	-	-	650.8	-	650.8
Total	**$510.0**	**$209.9**	**$564.9**	**$907.1**	**$719.6**	**$2,911.5**

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

As January 1, 2021, the State had outstanding $421.7 million general obligation bonds, $646.87 million Senior and Supplemental Severance Tax Bonds, and $864.9 million transportation bonds supported by State Road Fund revenues. The State lease appropriation bonds that were previously reviewed as part of this study were refunded in their entirety in November 2018 by bonds issued by the New Mexico Finance Authority. The following table sets forth the State tax-supported debt outstanding as of January 1, 2021.

State Bonds Outstanding as of January 1, 2021 (millions)	
General Obligation Bonds	$421.70
Severance Tax Bonds	$606.50
Supplemental Severance Tax Bonds	$40.37
Transportation Bonds	$864.87
Lease Appropriation	$0.00
	$1,933.44

Review of the State Credit

Ratings on State Bonds

The ratings on the State's bonds represent the assessment by each rating agency of the credit quality of each bond issue, and the State's ability and willingness to repay its debt on a timely basis. The State's general obligation bonds are rated *Aa2* and *AA* by Moody's Investors Service ("Moody's") and Standard & Poor's Ratings Services ("S&P"), respectively. Each of these ratings were downgraded one notch, in June 2018 by Moody's and in September 2018 by S&P, in the face of the downturn in State revenues and the ensuing deterioration in General Fund reserves, as well as growing concerns over unfunded pension liabilities. Notwithstanding the extraordinary challenges created for the State by the coronavirus pandemic and volatility of global oil prices, both rating agencies continue to maintain a stable outlooks on those ratings.

The key credit factors that rating analysts have historically looked to as credit strengths in evaluating New Mexico's general obligation bond ratings include (i) the commitment to maintaining strong General Fund reserve balances and cash liquidity, (ii) the performance and stability of General Fund revenues, (iii) rapid debt retirement and moderate debt levels, and, more recently (iv) the impact of fracking on oil and gas production levels. These credit strengths have been balanced against historically low levels of personal income, the inherent volatility of oil and natural gas-related revenues, a relative lack of economic diversity, and dependence on federal employment. Continuing challenges facing the State bond ratings include (i) ERB and overall challenges with respect to the funding of post-retirement benefits, (ii) the timeliness of financial reporting compared to industry norms, and (iii) continuing healthcare and education funding pressures in the General Fund. The table below sets forth the ratings on outstanding bonds for State bonding programs.

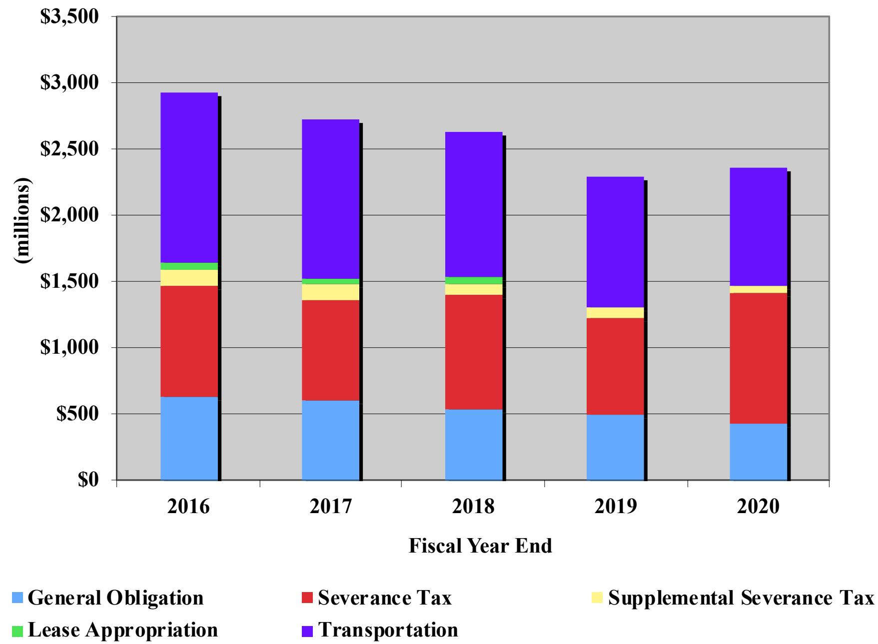
Outstanding State Bond Ratings		
State Board of Finance	**Moody's**	**Standard & Poors**
General Obligation Bonds	Aa2	AA
Severance Tax Bonds	Aa2	AA-
Supplemental Severance Tax Bonds	Aa3	A+
State Transportation Revenue Bonds		
Senior Lien	Aa1	AA+
Subordinate Lien	Aa2	AA
New Mexico Finance Authority		
Senior Lien Public Project Revolving Fund	Aa1	AAA
Subordinate Lien Public Project Revolving Fund	Aa2	AAA

Trends in State Debt Issuance

Trends in debt issuance are an integral factor in evaluating the State's debt levels. The State has made and continues to make substantial investment in basic capital infrastructure, particularly in the areas of transportation, educational facilities, and water supply. As illustrated

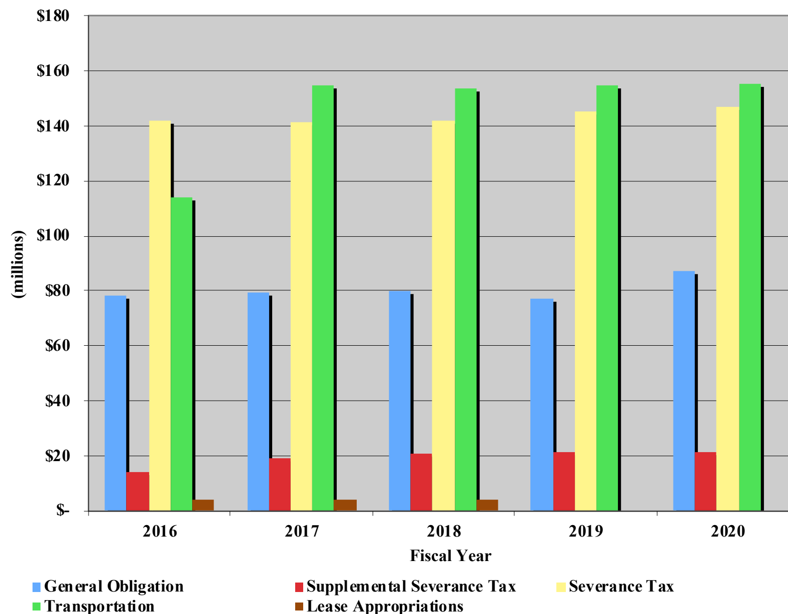
in the following graph, total outstanding tax-supported state debt has declined 19.6 percent over the past five years, from $2.9 billion in 2016 to $2.4 billion in 2020.

Outstanding Tax-Supported Bonds



The State's annual debt service payments on its core bonding programs have in aggregate remained stable over the past five years. Over that time period, aggregate long-term bond debt service rose 17 percent, from $352.1 million in 2016 to $410.7 million in 2020.

Tax Supported Bond Debt Service 2016-2020



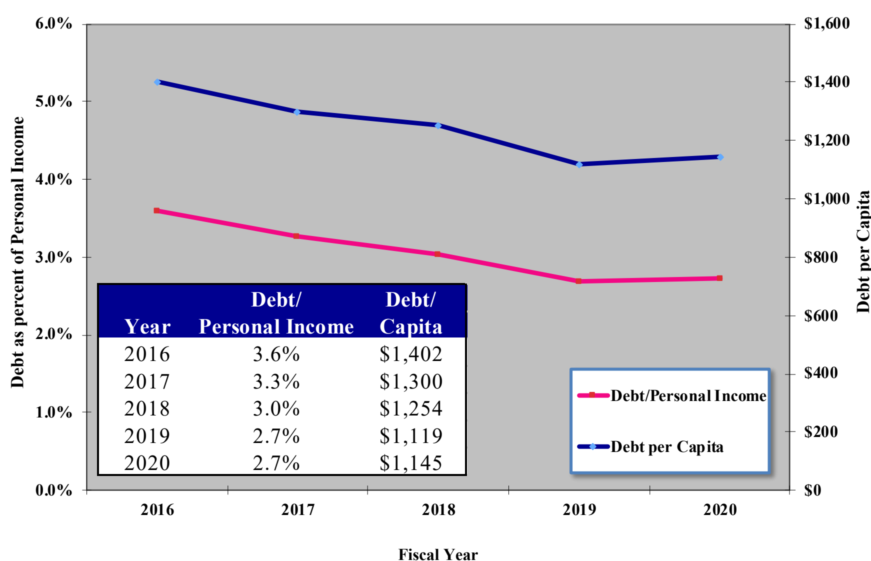
State Debt Ratios

In addition to examining an issuer's total debt position, rating analysts review the issuer's debt ratios and their change over time. Two key debt ratios developed and utilized by the bond rating agencies with respect to the evaluation of the credit quality of the State of New Mexico are Net Tax-Supported Debt to Personal Income and Net Tax-Supported Debt per Capita.

Two other metrics impacting the credit quality of general obligation bonds are the amount of outstanding debt as a percentage of the assessed value of the property that will be taxed to pay for those bonds, and the rate of repayment of the bonds. As of January 1, 2021, State general obligation bonds totaled 0.69 percent of statewide assessed value of property, or approximately three-quarters of the maximum of 1 percent of statewide assessed value permitted by the State Constitution. Another important credit factor is that the public referendum to authorize the issuance of general obligation bonds also provides for the imposition of a mill levy that is solely dedicated to the repayment of those bonds.

With respect to the pace of repayment of outstanding bonds, repayment of 25 percent of the par amount of the bonds in five years and 50 percent of the par amount of the bonds in 10 years is considered the norm for general obligation issuers nationally. Therefore, the State's issuance of bonds with a final maturity of 10 years is substantially more conservative than the norm. The following graph presents the State's tax-supported debt ratios over the past five years, and demonstrates the downward trend in debt per capita and as a percent of personal income.

Key Debt Ratios



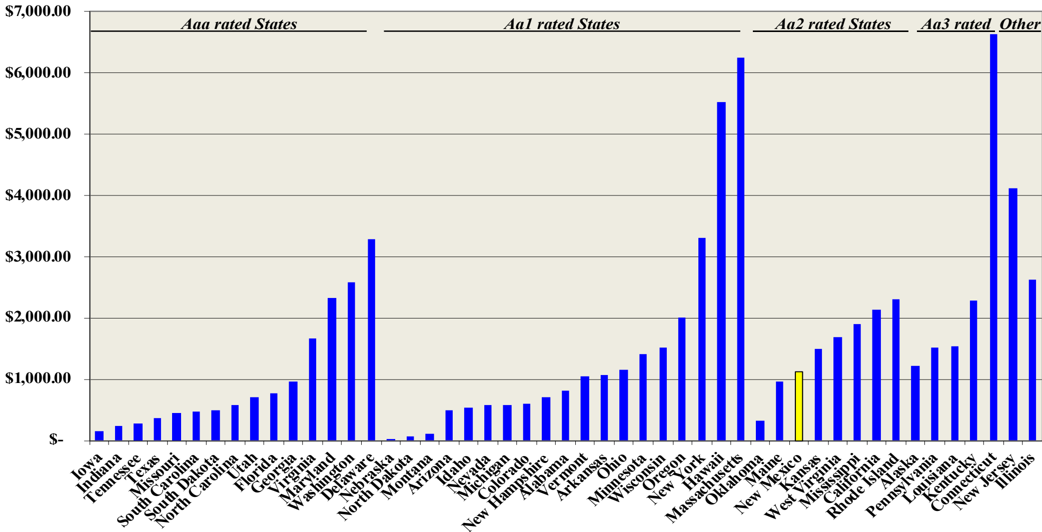
Year	Debt/ Personal Income	Debt/ Capita
2016	3.6%	$1,402
2017	3.3%	$1,300
2018	3.0%	$1,254
2019	2.7%	$1,119
2020	2.7%	$1,145

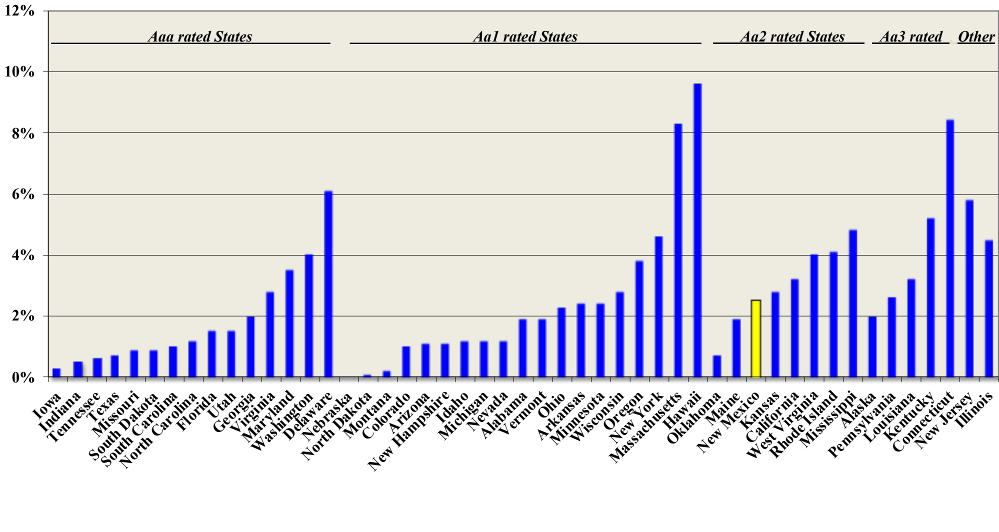
Because the rate of debt repayment is a contributing factor to credit ratings, it is notable that both State general obligation bonds and bonds issued under the Severance Tax Bonding Program are fully retired within 10 years. The five-year retirement rates of the State general obligation, severance tax and supplemental severance tax bonds as of the date of this report are 82.0 percent, 76.2 percent, and 100 percent, respectively. With respect to the transportation

bonds, the five-year retirement rate is 61.4 percent, while 98.0 percent mature within 10 years. Historically, the State debt management practices have provided for the rapid repayment of bonds, which is generally a positive credit consideration.

Comparison of Debt Ratios to Selected Peer Group and National Medians

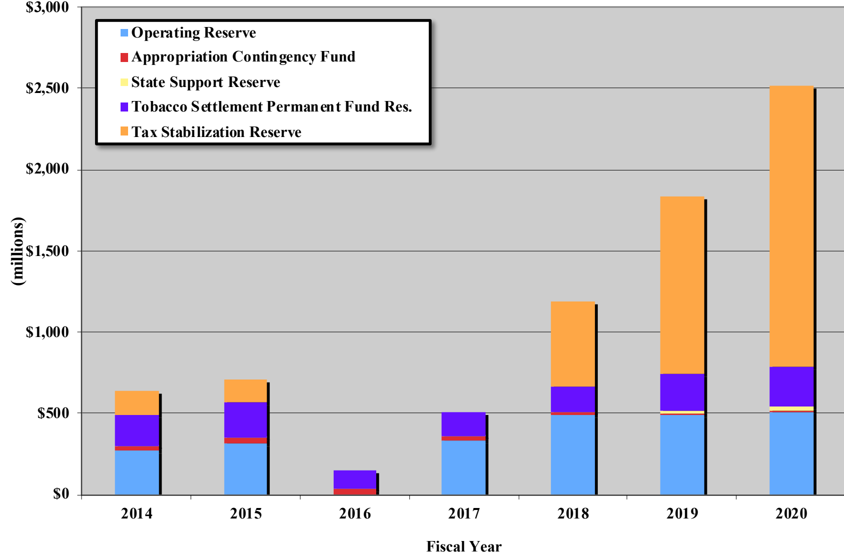
A comparison of key New Mexico debt ratios to those of the rest of the states is useful to place the State's debt position in a national context. For the purposes of benchmarking the State's level of indebtedness, we have provided a comparison with all of the states, sorted by rating category, utilizing data published by Moody's in May 2020. The first graph below presents a comparison of net tax supported debt per capita. The second graph presents a comparison of net tax supported debt to personal income. In both cases, New Mexico is highlighted in yellow. Along both metrics, New Mexico is near the median of the states, being 21st in debt per capita and 24th in debt as a percent of personal income.





General Fund Reserves

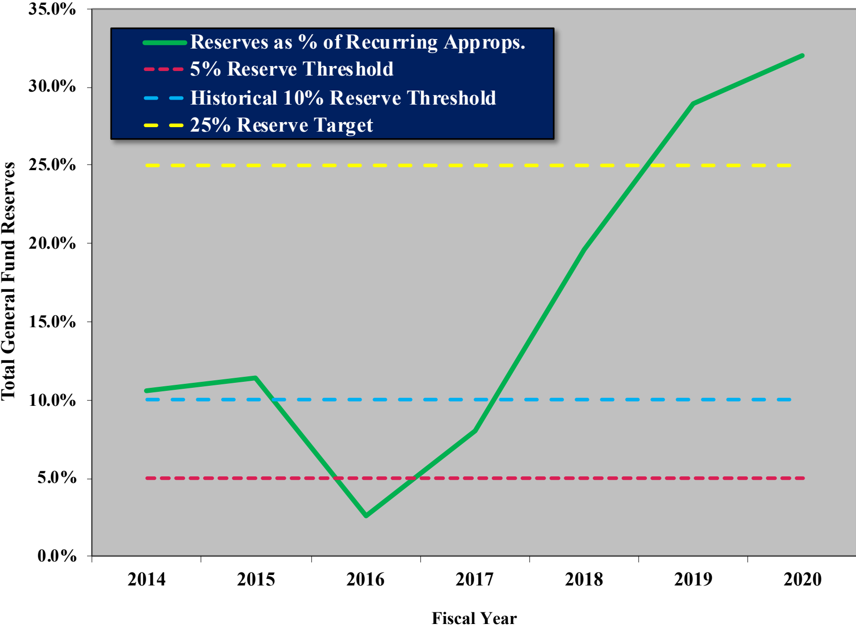
Strong reserve balances in the General Fund have historically underpinned New Mexico's general obligation bond ratings and have offset negative credit attributes, including low personal income levels, the relative lack of economic diversity, and vulnerability to federal budget risk. General Fund balances in New Mexico comprise the General Operating Reserve Fund, the Appropriation Contingency Reserve, the State Support Reserve, the Tobacco Settlement Permanent Fund Reserve, and the Tax Stabilization Reserve, which has been officially designated as a Rainy Day Fund. Each of these funds is legally available for appropriation by the Legislature, though utilization of the Tax Stabilization Reserve requires a super-majority vote. As the graph below illustrates, year-end results for fiscal year 2016 showed a 79.3 percent decline in reserve balances from the prior year level, to $147.7 million. In contrast, the recovery of reserves has been dramatic. Results for fiscal year-end 2020 reserve levels indicate that balances have been restored to slightly over $2.5 billion, the highest level ever.



In 2017, the State established a Rainy Day Fund within the Tax Stabilization Reserve to reduce the impact of volatility in oil and gas revenue on General Fund balances. The Rainy Day Fund legislation requires that annual revenues generated from the Oil and Gas School Tax in excess of the 5-year average for that revenue source be deposited into the Tax Stabilization Reserve Fund. Appropriation of such funds from the Tax Stabilization Reserve require a super majority vote of the Legislature and a declaration from the governor that the appropriation is necessary for public peace, health or safety. The establishment of this trigger mechanism to set aside a portion of natural resource revenues is expected to further strengthen and stabilize State reserves. As of June 30, 2020, the Tax Stabilization Reserve had an ending balance of $1.7 billion.

The following graph presents the General Fund reserves as a percentage of recurring appropriations. The blue dashed line designates the 10 percent State reserve target established

over the years. The yellow dashed line represents the 25 percent target for General Fund reserves established by the Lujan Grisham administration to address concerns over the historical volatility of revenues and reserve levels. Over the past 10 years, the reserve ratio generally remained at or above the 10 percent threshold, until falling below the 5 percent threshold in fiscal year 2016 with the significant decline in energy prices. Since then, with the recovery of oil prices and the significant growth in natural resource production in the state, reserve levels have recovered to well beyond the previous 10 percent policy target. In fiscal year 2017, reserve balances were restored to 8.0 percent, and in fiscal year 2020, total General Fund reserve balances reached 32.0 percent of recurring appropriations.

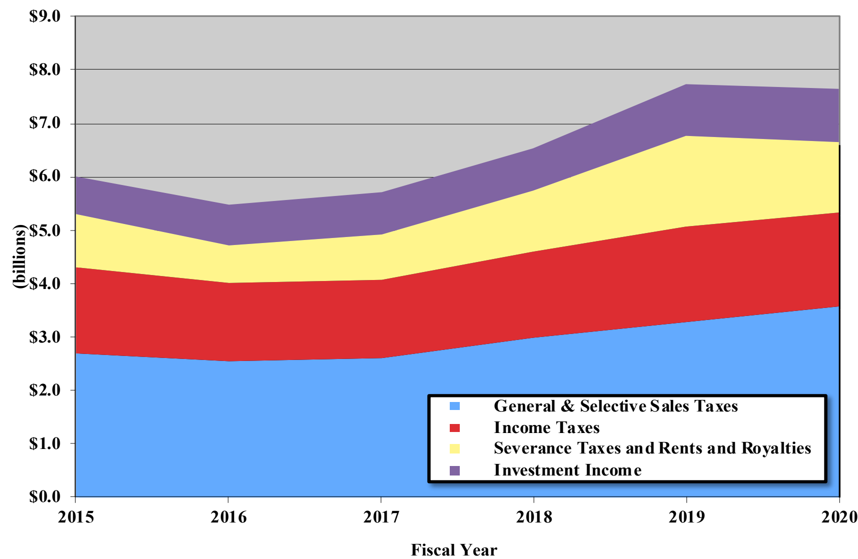


Revenue Volatility

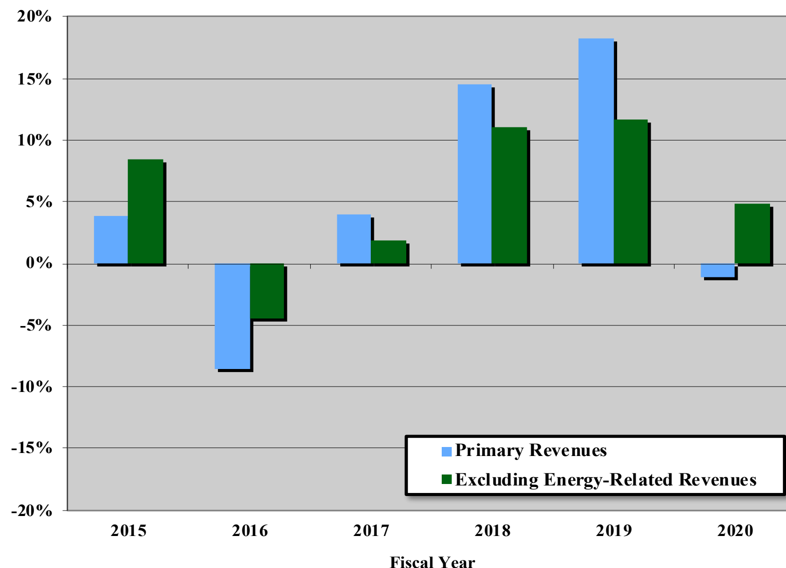
The cyclicality of General Fund revenues has contributed to fluctuations in reserve levels, as highlighted in the discussion about State General Fund Reserves. Trends in primary General Fund revenues, which comprise sales taxes, income taxes, revenues derived from mineral extraction activities, and investment earnings – including contributions from State permanent funds – are evaluated by the rating agencies as they consider fundamental issues of fiscal stability and trends. These revenue trends are illustrated in the next graph.

The normal fluctuation in the General Fund revenues reflecting economic cycles mirror those of peer states with a mix of income and gross receipts taxes. The State's revenue mix reflects these revenues, along with taxes and royalties derived from mineral extraction industries. The extraction industry revenues give the State the posture of being a seller of oil and natural gas, and therefore reflect both volatility in price and production levels over time. Both Moody's and S&P have focused on the historical volatility in General Fund revenues created by the State's mineral taxes and revenues as a negative credit attribute, though for many years

natural resource revenues were seen as a counter-cyclical hedge against volatility in other revenues sensitive to broader economic activity. As the graph below illustrates, while there had been volatility within individual revenue categories in recent years, the aggregate revenue trends remained positive until the downturn in energy prices in 2016, followed by a recovery in revenues the subsequent two years. The dramatic volatility of global oil prices is evident in the dip in aggregate revenues in 2020.



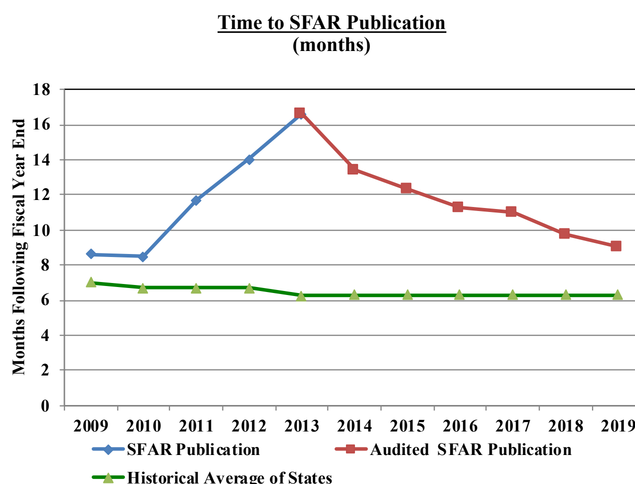
The year-over-year changes in the primary General Fund revenues are presented below. In this case, in contrast to prior periods of volatility in natural resource pricing, the upswing in energy-related revenues reflects, at least in part, the impact of fracking technology on production levels in the state.



Financial Reporting

Delays in the issuance of the State Consolidated Annual Comprehensive Report (SFAR, and previously referred to as the CAFR) have historically been a negative credit factor for the State. On average, state governments issue their audited comprehensive annual financial reports within six to seven months of the end of the fiscal year, with many states publishing their audited SFAR in less than six months. Fiscal year 2013 was the first year the State of New Mexico SFAR was audited. While the shift to an audited SFAR in 2013 caused an increase in the time to release, as the graph below indicates, the practices that have now been established have produced annual reports on an improving timeline.

New Mexico state law impacts the timing of the annual production of the SFAR. Each state agency and political subdivision whose financial information is ultimately rolled up into the SFAR is required to be fully audited. In addition, the audits of those state agencies that are aggregated into the SFAR are not due until as late as December 1st of each year. The audit of the SFAR is completed utilizing a process whereby the opinions of the individual audits are referenced in the SFAR audit, and ensured that previously audited financial information reconciles with the SFAR. Otherwise stated, the financial information for the state is audited twice, annually, at the agency level and again during the SFAR audit process, and those initial agency audits – which comprise the significant financial activity of the State – are completed within six months after year end. The Department of Finance and Administration (DFA) is now working with the State Auditor to find ways to improve the timing of SFAR production by requesting that the Office of the State Auditor be a co-auditor on those audits. Findings will be discussed once the Fiscal Year 2020 SFAR is submitted. The graph below presents the number of months following fiscal year end in which the SFAR was published, with a line comparing the State's performance with the average timing in SFAR production by states across the country.



State Pension Funds and Other Post-Employment Benefit Liabilities

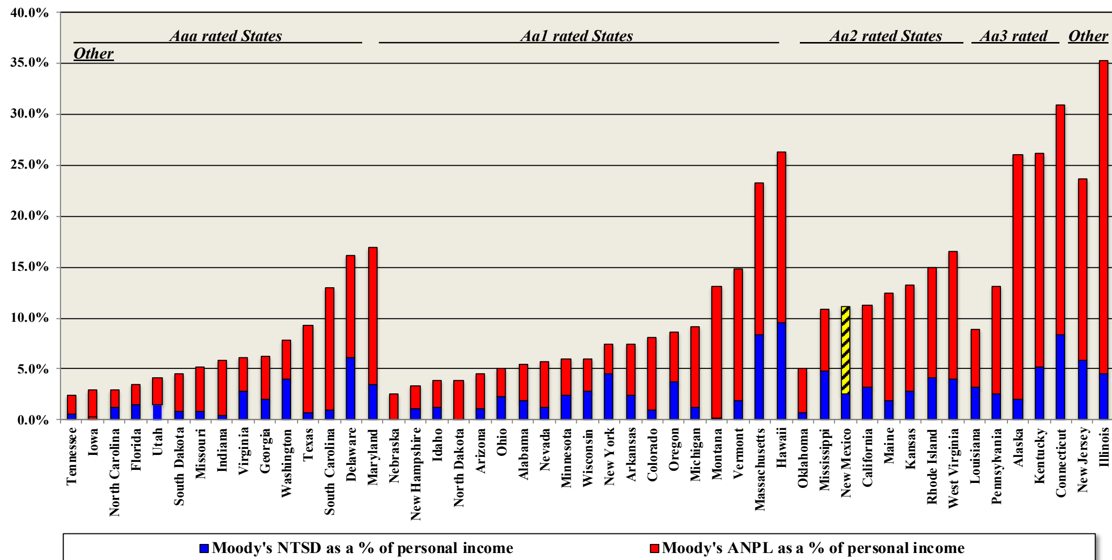
Unfunded pension liabilities, along with projected liabilities for other post-employment benefits, have become a significant focus of attention for both bond rating analysts and the

general public, as unfunded pension liabilities now exceed publicly issued debt as the largest share of the long-term liabilities of most states. In recent years, bond rating agencies have intensified their analytic focus on the legal and economic circumstances of state pension funds, and begun to treat unfunded pension liabilities as long-term liabilities on a par with other forms of outstanding indebtedness.

Moody's has taken the most aggressive stance with respect to its evaluation of pension obligations and has implemented new practices that recognize unfunded pension obligations as long-term obligations comparable to long-term debt. Specifically, Moody's approach comprises three specific analytic steps: (i) allocating cost-sharing plan liabilities to the balance sheets of the underlying obligors, (ii) adjusting an issuer's total actuarial liability to reflect a portfolio yield over time that is somewhat lower than an issuer's actuarial yield assumption – reflecting a discount rate approximating the return on high-grade corporate bonds rather than a mix of bonds and equities – and, (iii) looking at market values of assets without regard to asset-smoothing.

The graph below, based upon data provided by Moody's in its September 2020 report on state pension liabilities, illustrates the impacts of the proposed changes on how pension liabilities are viewed. The graph presents each state's Net Tax Supported Debt as a Percentage of State Personal Income in blue, and then includes each state's Adjusted Net Pension Liabilities as a Percentage of State Personal Income added on in red. As this graph illustrates, for nearly every state, the magnitude of unfunded state pension obligations dwarf state debt obligations. New Mexico's aggregate debt and pension liabilities as calculated by Moody's is 19th among the states.

Peer Comparison:
Adjusted Debt and Pension Liabilities as Percent of Personal Income
Moody's Data September 2020



In 2019, Governor Lujan Grisham created a PERA Solvency Task Force to address the PERA situation. The Task Force made a series of recommendations to address the funding shortfall, with the goal of fully funding the PERA system over a 25-year period. Those recommendations

became the basis of reform legislation that was passed into law during the 2020 legislative session and signed into law by the Governor.

The calculation of aggregate State unfunded pension liabilities, as reflected in the graphic above, does not reflect the significant unfunded liabilities of the Educational Retirement Board. Historically, the characterization of local school district ERB liabilities has been an issue of dispute. While ERB contends that the liabilities belong to the individual school district – as do teacher pension funds in other states – substantially all of local school district operating funds – including funds necessary for the payment of ERB pension obligations – are provided by annual state appropriations.

Moody's is now looking specifically at the treatment of teacher pension funds across the country, and the impact of reframing those liabilities as State obligations in its pension adjustment. The impact of this would be significant. In a 2017 analysis of the impact of ERB on the State, a summary of which is provided below, Moody's both changed the actuarial rate on pension liabilities down from the 7.75% to 3.61–4.44%, and assumed that 667.1% of the ERB liabilities rested with the State. The impact of this was to more than double the State's Net Pension Liability – an updated term reflecting the unfunded actuarial accrued liability. In its September 2020 report on State pension system liabilities, Moody's highlighted the situation with respect to ERB in New Mexico: *"New Mexico's (Aa2 stable) fiscal 2019 ANPL increases to a significant 24.6% of state GDP from 7.6% when including currently unrecognized teacher liabilities."* The PERA Solvency Task Force did not address the underfunded status of the ERB pension system.

Moody's 2017 Pension Adjustment

With and without reframing ERB Liabilities

Moody's 2017 Pension Adjustment			***Plan Total***	***State Share***		***Moody's Adjusted State Share***		
Plan Name	Investment Rate of Return/ Single Equivalent Discount Rate	Reported State Share of Cost-sharing Liabilities	Total Pension Liability= (NPL/funded ratio)	State Total Pension Liability	State Plan Fiduciary Net Position	Discount Rate***	State Share Adjusted Total Pension Liability	State Share Adjusted Net Pension Liability
New Mexico Judicial Retirement Fund	7.75%	100.00%	191,555	191,555	84,933	3.61%	159,308	233,897
Magistrate Retirement Fund	5.61%	100.00%	74,518	74,518	31,038	3.61%	62,225	64,520
Volunteer Firefighters Retirement Fund	7.75%	100.00%	48,936	48,936	61,049	3.61%	136,219	20,402
Educational Employees' Retirement Plan	7.75%	0.34%	18,729,272	56,169	34,589	4.44%	39,187	51,072
Public Employees Retirement Fund	7.75%	52.70%	19,986,039	10,242,651	7,085,866	4.44%	8,487,672	6,189,257
Total			**39,030,319**	**10,613,829**	**7,297,475**		**8,884,611**	**6,559,148**

($000)

Moody's 2017 Pension Adjustment: with ERB Adjusted			***Plan Total***	***State Share***		***Moody's Adjusted State Share: ERB@66.1%***		
Plan Name	Investment Rate of Return/ Single Equivalent Discount Rate	Reported State Share of Cost-sharing Liabilities	Total Pension Liability= (NPL/funded ratio)	State Total Pension Liability	State Plan Fiduciary Net Position	Discount Rate***	State Share Adjusted Total Pension Liability	State Share Adjusted Net Pension Liability
New Mexico Judicial Retirement Fund	7.75%	100.00%	191,555	191,555	84,933	3.61%	318,830	233,897
Magistrate Retirement Fund	5.61%	100.00%	74,518	74,518	31,038	3.61%	95,558	64,520
Volunteer Firefighters Retirement Fund	7.75%	100.00%	48,936	48,936	61,049	3.61%	81,451	20,402
Educational Employees' Retirement Plan	7.75%	0.34%	17,971,135	61,102	39,087	4.44%	17,524,087	9,926,797
Public Employees Retirement Fund	7.75%	52.70%	18,504,990	9,752,130	7,508,165	4.44%	13,697,422	6,189,257
Total			**36,791,134**	**10,128,240**	**7,724,271**		**31,717,347**	**16,434,873**

($000)

** Employer Service Cost= Total Service Cost - Employee Contribution*

*** Duration (Sensitivity to 100 Basis Point Decrease in Discount Rate) = (((TPL+Impact of 1% Decrease in Discount Rate)/TPL -1)*1000*

****** Citi Pension Discount Rate***

Column H-J: Based on column D date

Column K-S: Based on column C date

Projected State Debt Issuance

The table below represents the projected sources and uses of funds from the core State bonding programs as of the date of this report, reflecting the capacity available from each of the core funding sources. This table includes the issuance of long-term general obligation, severance tax, supplemental severance tax and transportation bonds, as well as the current year funding provided from the cash available in the Severance Tax Bonding Fund through the issuance of severance tax and supplemental severance tax notes. Projected debt issuance is based on statutory and constitutional capacity constraints and incorporates estimates of property values and future oil and gas revenues.

Core Bonding Programs: Sources and Uses of Funds (millions)						
Sources of Funds (millions)	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**	**Five-Year**
General Obligation Bonds	$199.4	-	$214.3	-	$214.3	$628.0
Severance Tax Bonds*	368.5	$368.5	368.5	$368.5	368.5	1,842.4
Severance Tax Notes	163.3	161.2	154.1	132.4	112.7	723.8
Additional Severance Tax Notes	-	-	-	-	-	-
Total Senior STBs	***531.8***	***529.7***	***522.6***	***500.8***	***481.2***	***2,566.2***
Supplemental Severance Tax Bonds	-	-	-	-	-	-
Supplemental Severance Tax Notes	232.9	234.3	256.0	265.9	269.2	1,258.3
Total Supplemental STBs	***232.9***	***234.3***	***256.0***	***265.9***	***269.2***	***1,258.3***
Total Sources of Funds	$964.1	$764.0	$992.9	$766.7	$964.7	$4,452.5
Uses of Funds (millions)	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**	**Five-Year**
Projects approved by referendum	$199.4	-	$214.3	-	$214.3	$628.0
New Statewide Capital Projects	428.0	$434.4	428.5	$410.7	394.6	2,096.2
Reassigned STB Projects	0.2	-	-	-	-	0.2
Authorized but Unissued STB Bonds	7.9	-	-	-	-	7.9
Water Projects	47.9	47.7	47.0	45.1	43.3	231.0
Colonias Project Capital	23.9	23.8	23.5	22.5	21.7	115.5
Tribal Projects Capital	23.9	23.8	23.5	22.5	21.7	115.5
K-12 Public School Capital Outlay	207.9	209.3	256.0	265.9	269.2	1,208.3
PED Instructional Materials/Transportation	25.0	25.0	-	-	-	50.0
Total Uses of Funds	$964.1	$764.0	$992.9	$766.7	$964.7	$4,452.5

*Amounts reflect bond funding, not total appropriations.

State Board of Finance Bonding Programs

As presented in the table below, the State Board of Finance currently projects $8.4 billion of new money financing for statewide capital projects over the next 10 years. This amount comprises $1.1 billion of projected general obligation bonding capacity, subject to legislative authorization and voter approval, $4.6 billion of senior severance tax bonds and notes subject to legislative authorization and appropriation, and $2.7 billion of supplemental severance tax notes for education projects designated for funding by the Public School Capital Outlay Council. Projections of severance tax bonding capacity reflect long-term natural resource price and production projections developed by DFA economists and the Consensus Revenue Estimating Group, which includes economists from both the Legislative and Executive branches of New Mexico government. Information utilized in the development of price and production projections includes forecasts by the U.S. Energy Information Administration, IHS Global Insight and Moody's Analytics forecasting services, and NYMEX futures contracts data. Projections of severance tax bonding capacity are revised on a regular basis to reflect State consensus revenue estimates.

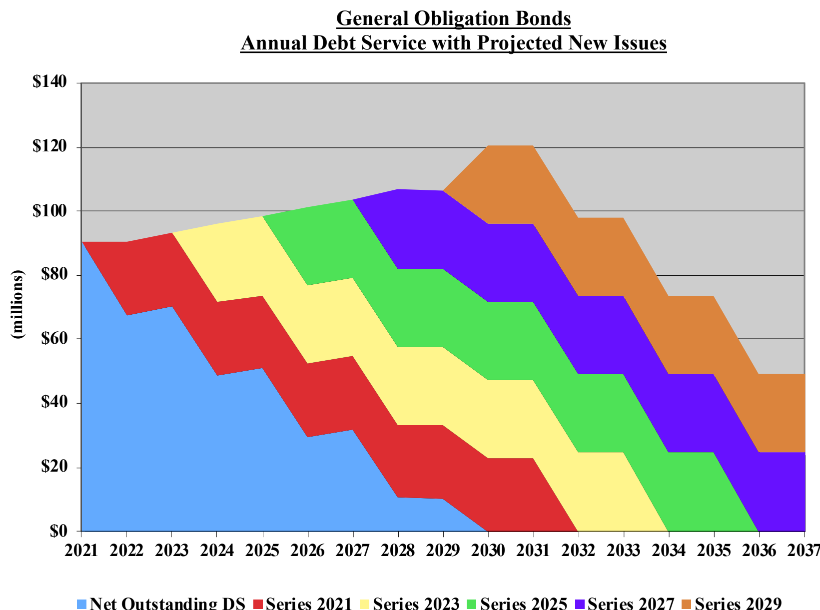
State Board of Finance Projected Bonding Capacity by Fiscal Year (millions of dollars)						
		Severance Tax Bond Program		Supplemental STB Program		
	GO Bonds	Bonds	Notes	Bonds	Notes	Total
2021	$199.4	$368.5	$163.3	--	$232.9	$964.1
2022	-	368.5	161.2	--	234.3	764.0
2023	214.3	368.5	154.1	--	256.0	992.9
2024	-	368.5	132.4	--	265.9	766.7
2025	214.3	368.5	112.7	--	269.2	964.7
2026	-	368.5	93.7	--	273.4	735.6
2027	214.3	368.5	70.1	--	282.5	935.3
2028	-	368.5	43.2	--	282.5	694.2
2029	214.3	368.5	15.7	--	282.5	881.0
2030	-	368.5	0.2	--	291.6	660.3
Total	**$1,056.6**	**$3,684.8**	**$946.7**	**$0.0**	**$2,670.8**	**$8,358.9**

*Amounts reflect bond funding, not total appropriations.

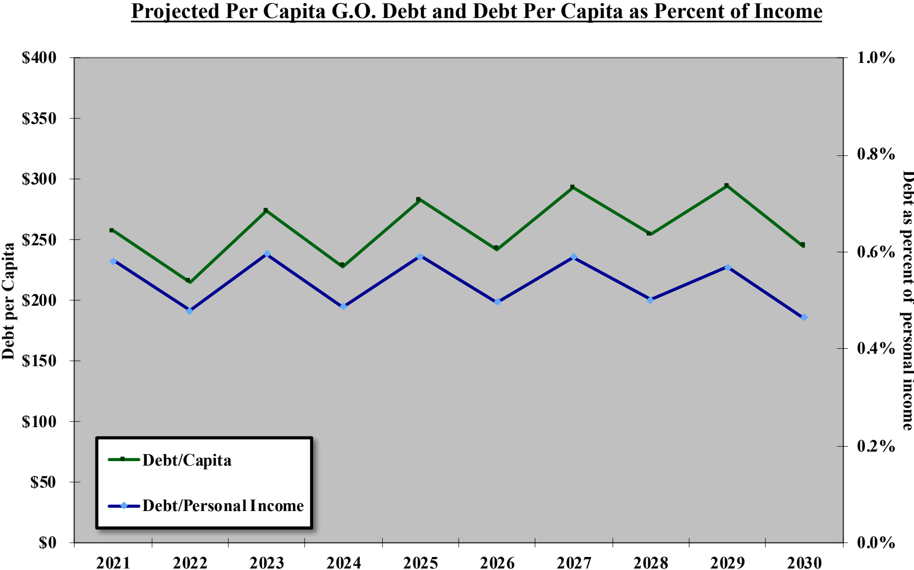
General Obligation Bond Issuance

State general obligation bonds are authorized by the Legislature and placed on the ballot for voter approval on a biennial basis. As a general matter, state general obligation bonds are subject to a debt limit equal to 1 percent of statewide net taxable property value. The debt limit as of the most recent property valuation was $706.5 million, and $421.7 million in general obligation bonds were outstanding as of the date of this report. General obligation bonds are secured by the full faith and credit of the State, and are repaid from a dedicated property tax millage assessment established pursuant to the voter approval of the bonds.

The projected general obligation bond issuance, reflected in the Sources and Uses of Funds table above, reflects the administration policy to limit general obligation bond authorizations to amounts that can be issued while keeping the statewide property tax mill rate flat. The graph below illustrates the debt service profile of outstanding general obligation debt and projected new bond issuance. The debt service profile on currently outstanding general obligation bonds is net of the funds contributed to the debt service account from the economic defeasance of Series 2015 Bonds maturing from 2021-2025.



General obligation bonds are sold with a maximum maturity of 10 years. As illustrated in the following graph, the projected biennial issuance of general obligation bonds sustains a stable level of debt per capita and debt service as a percentage of personal income in the State. For the purposes of this projection of future debt ratios, population growth in the State is projected to remain flat, as it has been, and annual personal income growth in the State is projected to be 2.0 percent.



Severance Tax Bond and Supplemental Severance Tax Bond Issuance

Severance tax bonds are authorized by the Legislature for statewide and local capital projects, with set-asides established by statute of 9 percent of capacity for water projects and 4.5 percent each for tribal and colonias projects. The Legislature has authorized the State Board of Finance to issue supplemental severance tax bonds for public school projects in amounts certified to the Board from time to time by the Public School Capital Outlay Council.

Severance tax bonds and supplemental severance tax bonds are secured by and repaid from pledged revenues received in the Severance Tax Bonding Fund. Historically, under the statutory test governing the issuance of severance tax bonds and supplemental severance tax bonds, severance tax bonds and notes could only be issued to the extent that severance tax bond debt service did not exceed 50 percent of revenues received into the Severance Tax Bonding Fund during the most recently completed fiscal year, and long-term supplemental severance tax bonds could only be issued to the extent that the combined debt service on outstanding severance tax bonds and long-term supplemental severance tax bonds did not exceed 62.5 percent of revenues received into the Severance Tax Bonding Fund during the most recently completed fiscal year. Severance tax notes issued to make cash available for capital projects prior to the semi-annual transfer to the Severance Tax Permanent Fund were subject to the same limitations as severance tax bonds, while supplemental severance tax notes could be issued to

the extent that the severance and supplemental severance tax bond and note debt service did not exceed 95 percent of revenues as defined by the statutory test.

SEVERANCE TAX BONDING FUND REVENUES
Maximum revenues available to pay debt service on *Severance Tax Bonds and Notes:* **47.6% from 2019 onward**
Maximum revenues available to pay debt service on *Supplemental Severance Tax Bonds, and Severance Tax Bonds and Notes:* **60.1% from 2019 onward**
Maximum revenues available to pay debt service on *Supplemental Severance Tax Notes*, and *Supplemental Severance Tax Bonds, and Severance Tax Bonds and Notes:* **89.4% in 2020 decreasing to 86.2% in 2022**
Remaining Revenues at maximum debt service: **9.0% increasing to 13.8% in 2022**

In 2015, the State revised the statutory issuance tests governing the Severance Tax Bonding Program in order to increase revenues to the Severance Tax Permanent Fund. As illustrated in the graphic here, the statutory issuance test for senior severance tax bonds and supplemental severance tax bonds were reduced from from 50% and 62.5% to 47.6 percent and 60.1%, respectively, and the statutory test with respect the issuance of supplemental severance tax notes was reduced from 95% to the current level of 89.4%, with a further decrease to 86.2% in 2022.

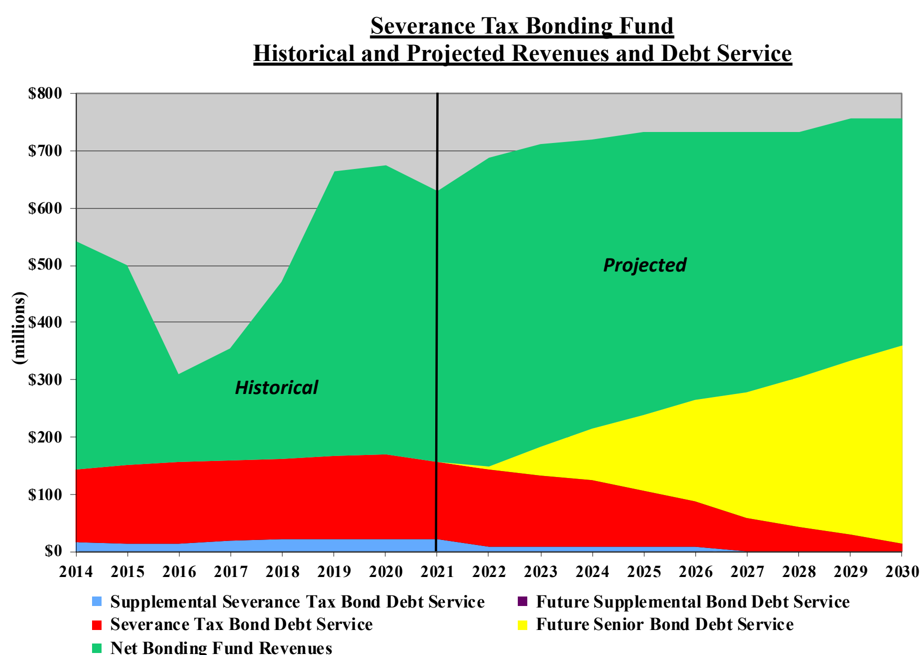
A further amendment was signed into law designed to ensure more stable inflows to the Severance Tax Permanent Fund. Whereas previously the statutory issuance test that limited bonding capacity was calculated on the basis of previous fiscal year revenues, this further change provides that statutory capacity to issue bonds be calcuated on the basis of the lesser of previous fiscal year revenues or estimated current fiscal year revenues. This will have the effect of ensuring that, in years when revenues decline versus the previous fiscal year, revenue for bond issuance will also decline, leaving more money to flow to the Severance Tax Permanent Fund. Similarly, in years when revenues increase, the amount available to the bonding programs will be tied to the prior year's revenue, leaving more money to go to the Severance Tax Permanent Fund.

The statutory issuance tests and State Board of Finance policies constraining the issuance of long-term debt are key attributes of the strong credit quality of the Severance Tax Bonding Program. Central to the analysis of both Moody's and Standard & Poor's is the debt service coverage ratio of current Severance Tax Bonding Fund revenues, excluding interest earnings, relative to maximum annual debt service on outstanding bonds. Both agencies maintain current rating levels based upon the expectation that coverage levels will be maintained well in excess of the minimum 2.10 times coverage reflected in the revised statutory issuance test. The increases in debt service coverage that will be created by the new, more restrictive statutory issuance tests, will enhance debt service coverage and support the strong bond ratings on the Severance Tax Bonding Program.

Annual long-term capacity for severance tax bond issuance is determined by the State Board of Finance, based upon outstanding debt service and projections of future Severance Tax Bonding Fund revenues. As a general matter, annual long-term bonding capacity is calculated as

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

The following graph illustrates the historical and projected revenue and debt service profile of the Severance Tax Bonding Program reflecting the currently projected annual issuance of $368.5 million of new long-term severance tax bonds. It also illustrates the State practice of projecting Severance Tax Bonding Fund revenues based upon flat to declining oil and natural gas prices and production levels over the long term, which has tended to suppress the volume of long-term bond debt service and increase the use of cash funding for capital projects.



	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Gas Price	$2.45	$2.70	$2.65	$2.70	$2.80	$2.80	$2.80	$2.80	$2.80	$2.80
Oil Price	$43.50	$47.00	$48.50	$49.00	$49.50	$49.50	$49.50	$49.50	$49.50	$49.50
Gas Volume	1,830	1,830	1,830	1,830	1,830	1,830	1,830	1,830	1,830	1,830
Oil Volume	370.0	370.0	370.0	370.0	370.0	370.0	370.0	370.0	370.0	370.0

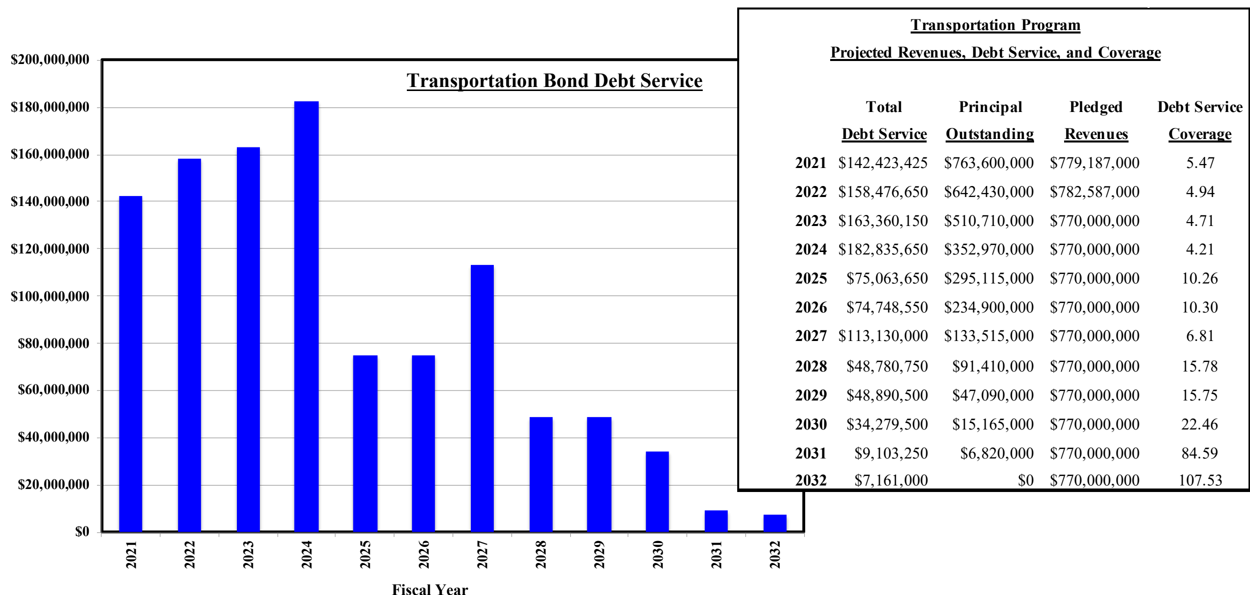
The table below presents the historical and projected debt service coverage for long-term severance tax and supplemental severance tax bonds. The first two columns present the severance tax bond debt service coverage for the outstanding bonds, while the second two columns present historical coverage and projected coverage taking into account future issues. Rating analysts and investors look at the second two columns as a projection of actual coverage in future years, taking into account future bond issuance and revenue projections.

Severance Tax Bonding Program Historical and Projected Debt Service Coverage					
	Coverage with No Future Issues		Coverage with Projected Future Issues		
Fiscal Year	Senior Severance Tax Bonds	Supplemental Bonds	Senior	Supplemental	
2013	3.31	2.83			
2014	4.28	3.81			
2015	3.64	3.30			
2016	2.18	1.98			
2017	2.52	2.22			
2018	3.31	2.90			
2019	4.56	3.98			
2020	4.59	4.01			**Actual**
2021	4.61	4.00	4.61	4.01	**Projected**
2022	5.15	4.82	4.94	4.64	
2023	5.72	5.33	4.12	3.92	
2024	6.22	5.77	3.49	3.34	
2025	7.56	6.91	3.18	3.06	
2026	9.34	8.37	2.87	2.77	
2027	12.34		2.63		
2028	16.81		2.40		
2029	26.58		2.27		
2030	59.85		2.10		

Transportation Bond Program Projected Revenues and Bond Issuance

The New Mexico State Department of Transportation has managed the largest capital investment program in the State over the past decade. The Statewide transportation capital investment program is funded from State and federal revenues in addition to bond proceeds. Bonds issued by the State Department of Transportation through the New Mexico Finance Authority are secured by and repaid from revenues received into the State Road Fund, which are principally derived from gasoline taxes, registration fees and road user fees, as well as certain federal revenues received annually by the State Department of Transportation. As of January 1, 2021, the transportation debt outstanding was $864.9 million.

These tables present annual debt service and the projected level of debt service coverage on outstanding transportation bonds.



Transportation Program
Projected Revenues, Debt Service, and Coverage

	Total Debt Service	Principal Outstanding	Pledged Revenues	Debt Service Coverage
2021	$142,423,425	$763,600,000	$779,187,000	5.47
2022	$158,476,650	$642,430,000	$782,587,000	4.94
2023	$163,360,150	$510,710,000	$770,000,000	4.71
2024	$182,835,650	$352,970,000	$770,000,000	4.21
2025	$75,063,650	$295,115,000	$770,000,000	10.26
2026	$74,748,550	$234,900,000	$770,000,000	10.30
2027	$113,130,000	$133,515,000	$770,000,000	6.81
2028	$48,780,750	$91,410,000	$770,000,000	15.78
2029	$48,890,500	$47,090,000	$770,000,000	15.75
2030	$34,279,500	$15,165,000	$770,000,000	22.46
2031	$9,103,250	$6,820,000	$770,000,000	84.59
2032	$7,161,000	$0	$770,000,000	107.53

Public Project Revolving Fund

The Public Project Revolving Fund ("PPRF") is the central public sector financing program operated by the New Mexico Finance Authority. The PPRF provides market rate loans to disadvantaged communities at a subsidized rate. Debt service on PPRF bonds is funded by repayments on its loan portfolio. The program is funded by various sources of local revenue including net system revenues, property taxes and gross receipts taxes among others, and is further secured by the NMFA's share of the Governmental Gross Receipts Tax.

Because the PPRF obligations are issued to fund loans for local projects and are primarily repaid from local revenues pledged to repay those loans, they have not been treated as State obligations for the purposes of this Debt Affordability Study. As of July 1, 2020, the NMFA had $1.26 billion of PPRF bonds outstanding.

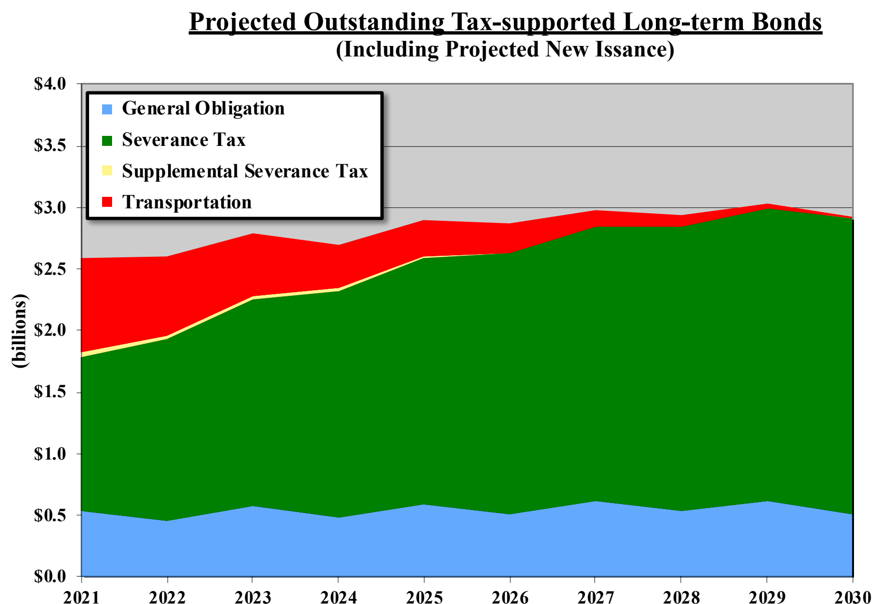
Affordability of Projected State Debt Issuance

The core State bonding programs project bonding capacity for the issuance of $4.7 billion of new money long-term general obligation and severance tax bonds over the next 10 years, as presented above. Each of the core bonding programs is funded by dedicated revenue streams. The dedicated sources of repayment for the general obligation, severance tax and transportation bonding programs are the general obligation bond property tax millage, the Severance Tax Bonding Fund revenues, and the State Road Fund revenues, respectively.

None of these core bonding programs utilize revenues that flow into or would otherwise flow into the General Fund of the State. However, we do note that State Road Fund revenues that secure the transportation bonding program are dedicated to transportation operations as well as bond debt service.

Each of the core state bonding programs provide strong legal protections and the revenue-backed bonds demonstrate strong historical and projected debt service coverage. All long-term debt obligations, however, are repaid from the underlying State economy and rely upon economic stability and expansion to assure that the repayment of debt does not become an increasing burden on the taxpayers of the State.

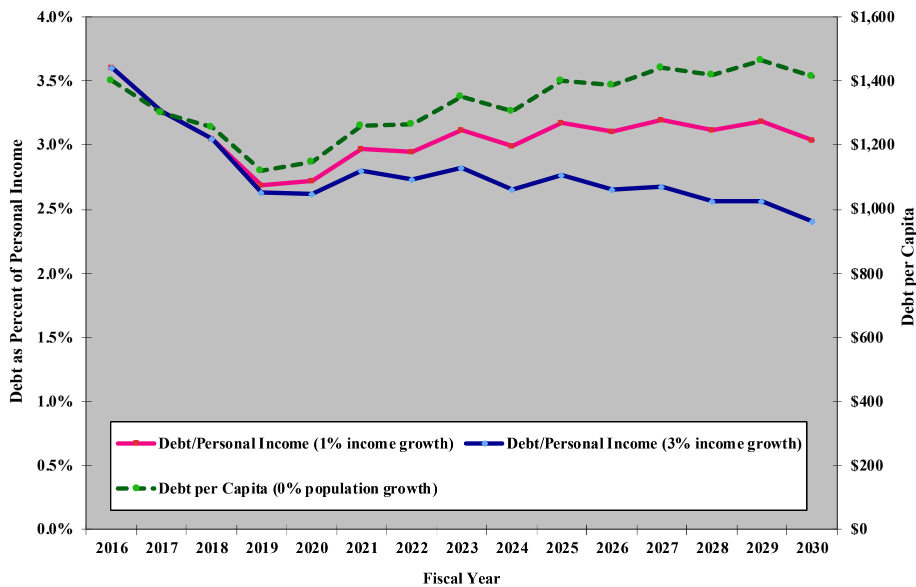
The following graph presents the projected levels of outstanding tax-supported debt, categorized by debt type, over the next 10 years. This includes the issuance of $4.7 billion in new long-term bonds, as described in the course of this study.



The following graph projects the impact of the planned issuance of $4.7 billion of long-term general obligation and severance tax debt on the key debt ratios of the State over the next 10 years. These projected ratios do not include any further issuance of transportation bonds,

which would increase projected debt ratios from the levels shown here. As illustrated, the debt ratios are projected to remain stable over time based upon current debt issuance policies and retirement of outstanding debt. State debt ratios peaked in 2009, when debt per capita reached a high of $1,798 and debt as a percentage of personal income was 5.4 percent. Both measures have declined and stabilized at lower levels over the years since. The projection of Net Tax Supported Debt Per Capita is based upon flat population growth. Two projections are provided for Net Tax Supported Debt as a Percent of Personal Income, the first reflecting a 3.0 percent growth rate reflective of historical State growth, and the second using a lower, 1.0 percent growth rate.

Historical and Projected Debt Ratios



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

As is illustrated in this Debt Affordability Study, the projected debt issuance plans for the core State bonding programs are affordable as measured by projected stability of its key debt ratios over time, and with respect to the revenue streams that are dedicated to debt repayment,

which do not place stress on the State General Fund. The threats to the State's credit ratings will come from the extent to which the severance tax bonding program is leveraged and from the continuing challenges with respect to pension funding and financial reporting.

Capital Project Planning and Prioritization

State and Local Government

New Mexico Department of Finance and Administration works with State agencies and local entities each year to develop an Infrastructure Capital Improvement Plan. This five-year plan identifies and prioritizes capital needs. Under the direction of the General Services Department and the Department of Finance and Administration, State agencies prepare a five-year facilities master plan incorporating preventive and deferred maintenance planning, program justification, and a criteria-based weighting system to determine priority. The objective has been to increase the efficiency in the use of capital outlay funds to meet critical capital outlay needs statewide and reflects the importance of attention to the allocation of scarce resources across myriad statewide capital projects. Executive Order 2013-006 required that local entities demonstrate compliance with the State Audit Act and also budget reporting requirements in order to be awarded capital outlay funds from Severance Tax Bond proceeds. Implementation of this requirement has resulted in a dramatic decrease in the number of local entities found to be out of compliance with the State Audit Act by the Office of the State Auditor.

Transportation

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

Public Schools

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

Higher Education

The New Mexico Higher Education Department is responsible for the review and prioritization of higher education capital projects for all public four-year, two-year, and constitutionally-created special schools. Based upon this review and prioritization, the recommended higher education capital plan is submitted to the Governor and Legislature for funding through the General Obligation Bond and Severance Tax Bonding programs.

Debt Management Policies

State debt management policies and practices are established in statute and policy documents. The primary policies governing the issuance of bonds by the State Board of Finance are set forth below.

Policy Area	***G.O. Bonds***	***Severance Tax Bonds***	***Transportation Bonds***
Bond Life	10-year maximum term.	10-year maximum term.	Bond life may not exceed project design life.
Bond Amortization	Substantially level debt service.	Substantially level debt service.	Substantially level debt service.
Debt Service Coverage	The state constitution establishes a debt limit of 1% of statewide assessed value, essentially providing asset coverage of at least 100 to 1.	Senior and supplemental bonds subject to the terms of the statutory issuance test and the market test, which suggest a minimum coverage level of 2.10x, though actual coverage realized has historically been higher.	Long-term coverage projected at a minimum of 4.00x to 5.00x.
Variable Rate Bond Limits	Not utilized.	Unhedged exposure will not exceed 20% of par outstanding.	Unhedged exposure will not exceed 20% of par outstanding.
Variable Rate Bond Considerations	Not utilized.	Balance interest savings and cashflow risks. Short bond life lessens potential savings.	Balance interest savings, cashflow risk and balance sheet management considerations.
Debt Staging	Traditionally issued as ten-year fixed rate bonds.	Traditionally issued as five- to ten-year fixed rate bonds. Construction financing permitted but has not been utilized.	Construction financing may utilize short-term, variable rate or bond anticipation financing.
Interest Rate Swaps	Not utilized.	Not utilized to date due to short bond life.	Limited to 30% of par outstanding.
Refundings	Debt evaluated on an ongoing basis to identify bond refunding and	Debt evaluated on an ongoing basis to identify bond refunding, and cash and	Debt evaluated on an ongoing basis to identify bond refunding, and cash and economic

	defeasance opportunities.	economic defeasance opportunities.	defeasance opportunities.
Policy Area	***G.O. Bonds***	***Severance Tax Bonds***	***Transportation Bonds***
Cash Financing	General Fund cash contribution to capital program sought annually, with funding based on magnitude of non-recurring and surplus revenues.	Funding notes utilized to direct available cash in Severance Tax Bonding Fund to capital projects each December 31st and June 30th.	Transportation capital primarily funded with bond proceeds, with cash contributions from the Road Fund, the General Fund and federal revenues.
Disclosure	Separate Disclosure Counsel retained to oversee disclosure practices. Annual financial disclosure statement published.	Separate Disclosure Counsel retained to oversee disclosure practices. Annual financial disclosure statement published.	Separate Disclosure Counsel retained to oversee disclosure practices. Annual financial disclosure statement published.

Use of Interest Rate Exchange Agreements

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

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

Conclusions

The State of New Mexico's core debt programs administered by the State Board of Finance are affordable. These programs reflect solid debt management policies and practices, reliable repayment structures, and minimal reliance upon or competition for General Fund dollars.

Over the past several years, the State has weathered significant volatility in global natural resource pricing and in-state production levels, which resulted in the near-elimination of General Fund reserves. True to its history, however, the State worked diligently to restore operating balance and restore strong balances in the General Fund. Now, based upon current projections, the tide has turned and the revenue future is bright. As described herein, each of the core State bonding programs are funded by dedicated revenue streams, including the dedicated general obligation bond millage, the Severance Tax Bonding Fund revenues and the State Road Fund revenues, for the general obligation, severance tax and transportation bonding programs, respectively, and none of these core bonding programs utilize revenues that flow into or would otherwise flow into the General Fund. Each of the programs continue to provide strong legal protections and the revenue-backed bonds demonstrate strong historical and projected debt service coverage.

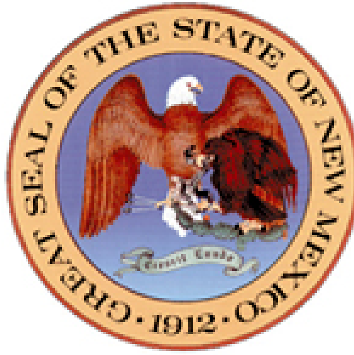
As discussed in detail in this study, the projected capacity to issue $4.7 billion of new long-term general obligation and severance tax bonds over the next 10 years will allow for continued stability in the key debt ratios of the State. As presented herein, the debt ratios are projected to remain stable after taking into account future planned debt issuance.

Global energy markets and political controversy at the national level surrounding fracking will no doubt continue to contribute to volatility in domestic oil and gas pricing in the medium and long term. Revenue volatility in recent years overwhelmed even the strong historical state reserve policies, and highlights the importance of the State's continuing commitment to sustaining strong reserve levels, the importance of the State's historically conservative management practices with respect to the severance tax bonding program, and the importance of funding the newly-created Rainy Day Fund.

The State's determination to strengthen reserve balances to well above the 10 percent level is an important financial management policy objective, reflected in the Lujan Grisham administration establishing a significantly higher target for General Fund reserves. The State's historically strong General Fund reserve balances have underpinned its credit ratings, and these reserves will now be augmented by the establishment of the Rainy Day Fund to capture and retain a portion of the growth in natural resource derived revenues. The State fully expects that actions taken by the Legislature and the Executive over the course of the upcoming legislative session will be closely watched by rating analysts and investors alike to gauge the continuing commitment of the State to sustaining strong reserve levels.

While New Mexico's bond rating outlook is stable at this time, over the medium term, the State bond ratings will continue to be under pressure for reasons noted in this study, notably the underfunding of public employee pension funds, as well as continuing healthcare cost pressures and the timeliness of financial reporting. Other management practices that bond rating analysts continue to focus on that would be viewed as positive credit improvements include (i) granting the Governor executive power to take intra-year budget actions without convening the Legislature, (ii) establishing target levels for state reserves in statute, and (iii) addressing the constraints that impede the timeliness of financial reporting, as discussed in the body of this report, in order to enable the State to achieve benchmarks that have become the norm for its state peers.

Appendix A: State Board of Finance Debt Policies



STATE OF NEW MEXICO
DEPARTMENT OF FINANCE AND ADMINISTRATION
STATE BOARD OF FINANCE

GOVERNOR SUSANA MARTINEZ
PRESIDENT

THOMAS E. CLIFFORD, PhD
CABINET SECRETARY

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DEBT POLICIES

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I. INTRODUCTION

These debt policies have been developed and approved by the New Mexico State Board of Finance (the "Board") to provide for the effective management of the Board's debt programs in a manner consistent with applicable laws, industry standards and the maintenance of the highest credit ratings. It is the intention of the Board to oversee the implementation of these policies on an ongoing basis and to assure transparency in and public understanding of State debt management practices.

II. GOVERNING LAWS AND PRINCIPLES

New Mexico laws establish the Board as the issuer of the State's core bonding programs. These include the General Obligation Bonds, the Senior Severance Tax Bonds, and the Supplemental Severance Tax Bonds.

General Obligation Bonds

General Obligation bonds are a primary source of funds for capital projects statewide. State General Obligation bonds are secured by the full faith and credit of the State and are repaid from a dedicated statewide property tax. Article 9, Section 8 of the New Mexico Constitution limits General Obligation indebtedness to no more than one percent of the assessed valuation of all the property subject to taxation in the state.

In even-numbered years, the New Mexico Legislature authorizes General Obligation Bonds to be voted on in public referendum at the subsequent November general election. General Obligation Bonds that are approved by a majority vote are issued by the Board.

Severance Tax Bonds

The State Severance Tax Bonding Act, Sections 7-27-1 through 7-27-27 NMSA 1978, as amended (the "Severance Tax Bonding Act") authorizes the Board to issue bonds secured by revenues received by the State into the Severance Tax Bonding Fund, and which include Severance Tax Bonds and Supplemental Severance Tax Bonds. Severance and Supplemental Severance Tax Bonds are repaid from revenues deposited into the Severance Tax Bonding Fund, which primarily include taxes on mineral production in the State.

Severance Tax Bonds are used to finance statewide capital projects, and as a general practice are issued in the spring following the Legislative Session to fund projects that have been authorized by the Legislature and approved by the Governor. Supplemental Severance Tax Bonds are used to fund public school projects approved for funding by the Public School Capital Outlay Council. Public sales of Supplemental Severance Tax Bonds have been infrequent in recent years but, when issued, have historically taken place in the fall.

Senior Long-Term Severance Tax Bond Statutory Capacity

The Severance Tax Bonding Act sets forth a Statutory Issuance Test that limits the amount of Severance Tax Bonds that may be issued in any year. Specifically, that test requires that the Board not issue new Severance Tax Bonds unless the debt service obligation in any future year on all outstanding and newly issued Severance Tax Bonds is not more than 50 percent of the deposits into the Severance Tax Bonding Fund for the fiscal year immediately preceding the issuance of new Severance Tax Bonds.

Supplemental (Subordinated) Long-Term Severance Tax Bond Statutory Capacity

The Severance Tax Bonding Act sets forth a Statutory Issuance Test that limits the amount of Supplemental Severance Tax Bonds that may be issued in any year. Specifically, that test requires that the Board not issue new long term Supplemental Severance Tax Bonds unless the debt service obligation in any future year on all outstanding and newly issued long term Senior and Supplemental Severance Tax Bonds is not more than 62.5 percent of the deposits into the Severance Tax Bonding Fund for the fiscal year immediately preceding the issuance of new Supplemental Severance Tax Bonds.

Covenant to Maintain Debt Service Coverage

In addition to the Statutory Issuance Tests, the Board covenants in the Bond Resolutions that secure the Severance Tax and Supplemental Severance Tax Bonds, that the State will use its best efforts to maintain actual annual debt service coverage in every year of at least 2.00x on all Severance Tax Bonds and 1.60x on all Supplemental Severance Tax Bonds.

Short-Term Severance Tax Note Program and Statutory Capacity

In addition to the issuance of long-term Severance Tax and Supplemental Severance Tax Bonds, on or prior to each December 31st and June 30th, the Board issues short-term Severance Tax and Supplemental Severance Tax Notes to enable the State to utilize additional Severance Tax Bonding Fund revenues available on an annual basis for funding authorized capital projects. The purpose of the Severance Tax Note Program is to make funds in the Severance Tax Bonding Fund that are not needed to fund long-term Severance Tax and Supplemental Severance Tax Bonds available for cash funding of capital projects.

Severance Tax and Supplemental Severance Tax Notes are subject to the Statutory Issuance Tests. Severance Tax Notes can be issued in each fiscal year to the extent that total debt service on Severance Tax Bonds and Notes does not exceed 50 percent of the receipts into the Severance Tax Bonding Fund during the prior fiscal year, and Supplemental Severance Tax Notes can be issued in each fiscal year to the extent that total debt service on Severance Tax and Supplemental Severance Tax Bonds and Notes does not exceed 95 percent of the receipts into the Severance Tax Bonding Fund during the prior fiscal year.

In addition to the issuance limitations and other requirements set out by State and Federal laws, the Board policies with respect to the issuance of debt are guided by the principles

of prudence, cost effectiveness and transparency. The purpose of this Debt Policy is to set forth the parameters for the issuance of debt by the Board, and provide guidance and understanding of Board debt management procedures and practices.

III. DEBT POLICIES

Policy 1: Credit Ratings

It is the objective of the Board to achieve and maintain the highest possible credit rating for the State's bonds. The Board will continue a practice of full and timely disclosure of information to the rating agencies and to the investor community, and will comply with all regulations and industry standards with respect to primary and secondary market disclosure (see Policy 14: Financial Disclosure below for more information). The Board will work with the Governor's Office to coordinate annual rating agency and periodic investor meetings in New York or in New Mexico to provide information on policy initiatives and ongoing financial performance and outlook.

The Board, together with the Department of Finance and Administration will continue to work on key areas that have been identified by the rating agencies. These include:

a. Implementing Timely Financial Reporting
b. Creating Policies Regarding the Funding of General Fund Reserves
c. Implementing Multi-Year Financial Planning and Budgeting
d. Monitoring Credit Vulnerabilities to Federal/Sovereign Risk

Policy 2: Capital Planning

Prior to each legislative session, the State Board of Finance provides an estimate of Severance Tax Bond capacity to the legislature. As detailed below, 20 percent of senior Severance Tax Bond capacity is earmarked for water, tribal and colonias projects. Each legislative session, the Legislature considers legislation authorizing specific capital projects to be funded with the remaining 80 percent of senior Severance Tax Bond capacity. Often, negotiation between the Legislative and Executive branches has resulted in the splitting of Severance Tax Bonding capacity between the Governor, who has normally recommended projects addressing statewide infrastructure needs, the House of Representatives, and the Senate. Portions assigned to the House of Representatives and the Senate have sometimes been further split so that each individual legislator has a certain portion to allocate amongst capital projects.

The New Mexico Department of Finance and Administration works with State agencies and local entities each year to develop an Infrastructure Capital Improvement Plan. This five-year plan identifies and prioritizes capital needs and encourages State agencies and local entities to plan for the development of capital improvements to prevent emergency situations and instead allow capital needs to be planned, funded and developed at a pace that sustains State and local activities.

The New Mexico Department of Transportation develops the Statewide Transportation Improvement Program (STIP) annually to allocate capital resources to transportation

purposes. The STIP is a six-year multi-modal transportation preservation and capital improvement program that lists prioritized projects for a three-year funding period and provides information for planning and programming purposes for the subsequent three years. The STIP is a product of the transportation program's planning process involving local and regional governments, Metropolitan Planning Organizations, Regional Planning Organizations, other State and transportation agencies, and the public.

Subject to certification of need by the Water Trust Board, 10 percent of senior Severance Tax Bond capacity is allocated to the Water Trust Fund for water projects statewide. Subject to certification of need by the Tribal Infrastructure Board, 5 percent of senior Severance Tax Bond capacity is allocated to the Tribal Infrastructure Fund for tribal infrastructure improvements. Subject to certification of need by the Colonias Infrastructure Board, 5 percent of senior Severance Tax Bond capacity is allocated to the Colonias Infrastructure Fund for infrastructure improvements in colonias (small rural communities within 150 miles of the U.S. – Mexico border).

The Public School Capital Outlay Council is responsible for implementing a standards-based process for prioritizing and funding public school capital needs throughout the State. All school facilities are ranked in terms of relative need and resources are directed to schools with the greatest needs. Funding for projects is provided annually through the Supplemental Severance Tax Bonding Program.

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

Policy 3: Debt Affordability and Limits

In an effort to assess the affordability of projected debt issuance, the Board shall conduct a debt affordability study on an annual basis. The study provides a review of the State's core bonding programs, including the General Obligation Bonds, the Severance Tax Bonds, the Supplemental Severance Tax Bonds, and the Transportation Revenue Bonds, the long-term debt issuance plans, the impact of debt service costs on the State budget, and the impact of debt issuance trends on key bond rating ratios and related metrics. The study serves as a management tool for State policymakers, provides a basis for assessing history and trajectory of the State's credit position, and compares the State with peer states.

Policy 4: Length of Debt

The State will issue debt in a manner that provides for a fair allocation of costs to current and future beneficiaries and in compliance with applicable federal tax law.

Long-Term Bonds

The State issues General Obligations Bonds and long-term Severance and Supplemental Severance Tax Bonds with a maximum maturity of ten years.

Short-Term Notes
The State issues short-term Severance and Supplemental Severance Tax bonds (as described above in Section II: Governing Laws and Principles) with a maximum maturity of one week.

Policy 5: Debt Structure

The Board structures its long-term bonds so as to minimize the net cost to the State.

General Obligation Bonds are issued with a ten-year term, or other such term as may be provided in the referendum presented to the voters of the State for their approval. Bonds are structured with a level debt service amortization.

As a general practice, both Severance Tax and Supplemental Severance Tax Bonds are sold with a ten-year maximum maturity and a level debt service amortization. The ten-year maximum maturity mirrors the economic life of the underlying oil and gas proven reserves, and is an important factor in the strong bond ratings on the Severance Tax Bonds. In the event the Board issues bonds with a non-level debt service amortization structure, the average life of that bond issue should not exceed the average life of a level debt service amortization structure.

Policy 6: Severance Tax Bonding Capacity

In order to allocate limited bonding capacity for current and future capital needs, the Board determines current year long-term severance tax bonding capacity in a manner that allows for the level allocation of long-term bond issuance over a ten-year horizon. In the event that severance tax bonding capacity calculated in this manner is not fully utilized in a given fiscal year, the Board may determine it is in the best interest of the State to add such unutilized capacity to the following fiscal year.

Policy 7: Variable Rate Debt

While the Board evaluates the cost effectiveness of the use of variable rate debt on an ongoing basis, currently 100 percent of the State's outstanding General Obligation and Severance Tax Bonds are fixed rate obligations. At no time will the use of variable rate debt exceed 20 percent of the par amount of total debt outstanding.

Policy 8: Use of Derivative Products

The Board may consider the use of derivative products, including interest rate swaps, caps and floors when the use of such products provides an economic benefit to the State that outweighs the risks involved or reduces the risk of existing or planned debt. The following additional requirements must be met in the utilization of such debt management tools:

a. The use of these products must be associated with underlying debt issued by the Board and may not be used for speculative purposes;
b. Master swap agreements shall contain terms and conditions as set forth in the International Swaps and Derivatives Association (ISDA) Master Agreement;

c. When considering the use of these products, the Board will utilize its independent financial advisor and bond counsel to ensure that the State is receiving a fair market value for the contract and that the terms of the contract are reasonable and within the limits of the applicable law and this Board of Finance Debt Policy; and
d. At no time will the notional amount of the derivatives being used exceed 20 percent of the par amount of total debt outstanding;
e. Counterparties must be rated at least "AA-" or "Aa3" by Moody's, Standard & Poor's and Fitch, as required by New Mexico Law and Board regulations;
f. Uncollateralized exposure to a single counterparty should not exceed 10 percent of the total par amount of bonds outstanding; and
g. No less than semi-annually, outstanding agreements will be reviewed by the Board's financial advisor with respect to the following issues: (i) projected and cashflow receipts with respect to basis risk exposure, (ii) worst-case scenario analysis assuming counterparty default, (iii) available cash balances and total unhedged exposure to risks under the contracts, (iv) changes in counterparty rating position, and (v) counterparty collateral requirements, if any.

Policy 9: Cash Financing

State funding of capital projects is provided through a combination of proceeds of long-term bonds, proceeds of short-term Severance Tax notes, and cash funding provided through General Fund appropriations. General Fund appropriations may be provided annually, as the Legislature and the Governor allocate General Fund resources through the annual budget process to finance a portion of the State's capital investment plan. Cash financing is provided through the semi-annual issuance of Severance Tax and Supplemental Severance Tax Notes, as discussed above.

During Fiscal Years 2007 through 2011, Statewide capital funding, including transportation and New Mexico Finance Authority programs, totaled $4.3 billion. Of this total, 45.9 percent, or $2.0 billion, was provided through cash appropriations or the Severance Tax Note Program.

Policy 10: Informational Presentations

From time to time, the Board may receive presentations from staff of various State entities to remain informed of items affecting the Board's bonding programs and potential disclosure concerns. The Board may request presentations from, among others:

a. the Public School Facilities Authority to discuss use of Supplemental Severance Tax Bond and Note proceeds;
b. the State Investment Council to discuss performance of the Severance Tax and Land Grant Permanent Funds;
c. the Public Employees Retirement Association, the Educational Retirement Board, and the New Mexico Retiree Health Care Authority to remain informed about actuarial findings related to funds under the management of such entities;

d. the Taxation and Revenue and Energy, Minerals and Natural Resources Departments to discuss trends in tax collections and natural resource production; and
e. the Financial Control Division of the Department of Finance and Administration concerning financial reporting issues.

Policy 11: Refunding Bonds

The Board may advance refund bonds or call outstanding bonds prior to their final maturity from time to time to achieve positive net present value savings to the State. Refunding bonds will only be issued when there is a clear economic benefit to the State, and as a general matter the Board seeks to achieve a net present value savings target of 3 percent or greater when considering the issuance of advance refunding bonds. The State also seeks to refund bonds on a current basis at the time of the issuance of new money bonds when a positive net present value can be achieved. The life of any refunding bonds will not exceed the life of the bonds being refunded. The Board evaluates its outstanding bonds on an ongoing basis to identify bond refunding and cash and economic defeasance opportunities.

Policy 12: Credit Enhancements

The Board regularly considers the use of credit enhancement, primarily through the use of bond insurance, to reduce the net cost of its debt. As a general matter, the Board pre-qualifies its bonds for bond insurance on a bidder-option basis, and the determination of the cost effectiveness of utilizing such insurance is made through the competitive bid process.

Policy 13: Method of Sale

The Board issues its bonds, including current refunding bonds, through a competitive bidding process. The Board sells its bonds through open, online bid platforms and awards the sale of bonds on a lowest true interest cost basis. From time to time, the Board may select an investment banking team for the purpose of the negotiated sale of advance refunding bonds, and may issue advance refunding bonds through a negotiated sale if the Board determines that it is in the best interest of the State.

Policy 14: Investment of Bond Proceeds

Bond proceeds are invested with the State Treasurer in the Tax-Exempt and Taxable Bond Proceeds Investment Pools (collectively "BPIP") as set forth in the State Treasurer's Investment Policy. The investment objectives of the BPIP are to preserve capital, provide liquidity and generate the highest return possible. All investments are in accordance with the State Treasurer's Investment Policy, which is approved by the Board.

The BPIP investment strategy is a two-tiered money market and enhanced cash strategy, which aims to (i) preserve capital and provide liquidity by investing in short-term (0 to 3 year) fixed income securities with high investment grade ratings per the State Treasurer's Investment Policy, and (ii) earn excess returns relative to traditional money market strategies by slightly increasing duration consistent with the timing of the need for funds.

Monthly position reports and quarterly performance reports can be found on the State Treasurer's website at www.nmsto.gov.

Policy 15: Arbitrage Rebate and Tax Compliance

The Board will fully comply with federal arbitrage rebate regulations, while minimizing the cost of arbitrage rebate and compliance. Through its investments in the BPIP, earnings on invested bond proceeds are allocated and tracked by issue, and invested to the maximum benefit of the State, while assuring the availability of funds in accordance with the disbursement requirements of the projects funded with bond proceeds. Rebate calculations are performed annually, with a five-year report prepared for each tax-exempt issue as required under applicable regulations, and a final report upon the final maturity of the bonds. Arbitrage earnings subject to future rebate are segregated for future payment, and recorded as a liability on the financial accounts of the State. The Board provides arbitrage rebate reports to the IRS for each bond issue as required, and makes rebate payments on a timely basis as required by Federal law.

Policy 16: Financial Disclosure

The Board is committed to full and complete financial disclosure, and to full cooperation with rating agencies, institutional and individual investors, State agencies, other levels of government and the general public to share clear, comprehensible and accurate financial information. The Board is committed to meeting secondary disclosure requirements on a timely and comprehensive basis.

It is the Board's policy to provide full and complete disclosure to bondholders and the investment community on a periodic basis as required by the Securities and Exchange Commission (SEC) Disclosure Rule 15c2-12, SEC Antifraud Provision Rule 10b-5 and Municipal Securities Rulemaking Board (MSRB) Rule G-36. Official statements accompanying Board debt issues and continuing disclosure statements will meet or exceed the minimum standards applicable to each debt issue, as promulgated by regulatory bodies and professional organizations, including the SEC, the MSRB and the Governmental Accounting Standards Board (GASB), and follow Generally Accepted Accounting Principles (GAAP).

Policy 17: Expert Advisors

The Board has procured experts to provide financial advisor, bond counsel, disclosure counsel, and arbitrage consulting and compliance services, and will continue to retain qualified experts to provide these services to help remain fully informed of the Board's fiduciary duties, legal issues related to the issuance of bonds, disclosure obligations, arbitrage rebate liabilities, and matters of post-issuance compliance. The Board will seek advice from its staff and advisors related to implementation of the policies herein when necessary.

Approved by the state Board of finance this 20th day of March, 2012.

Stephanie Schardin Clarke, Director