

CREDIT OPINION

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New Mexico Finance Authority

Update to credit analysis

Summary

The [New Mexico Finance Authority](#) (NMFA; Aa1 stable) has a stable credit profile that benefits from very strong governance of the pool which is actively and professionally managed. NMFA's management has strengthened with the recent implementation of a new department to oversee loan credit quality and analysis.

NMFA's senior lien revenue bonds benefit from the high default tolerance due to adequate and steadily improving debt service coverage provided by the sum of legally separate and pledged loan agreement revenues and governmental gross receipt taxes (GGRT). The profile is supported by the pool structure which includes a debt service reserve fund and individual debt service reserves for certain borrowers, as well as bond maturity that matches the final loan payoff. These attributes are weighed against the average credit quality of borrowers in the large, senior lien pool and modest concentration among the five largest borrowers.

The subordinate lien revenue bonds benefit from the inherent credit quality of the subordinate lien pool, with additional strength derived from the automatic availability of excess senior lien cash flow post senior lien debt service repayment, which provides relatively stronger debt service coverage compared to the senior lien pool. Like the senior lien pool, the subordinate lien pool benefits from high default tolerance, as well as a supplemental debt service reserve fund for the pool and individual debt service reserves for certain individual borrowers. These factors moderate the subordinate lien pool's relatively higher concentration among the five largest borrowers and weaker weighted average credit quality.

Credit strengths

- » Strong program and borrower oversight provided by experienced management team
- » Around 50% of loan agreement revenues are subject to intercept, meaning NMFA has first claim on funds
- » Governmental gross receipts tax (GGRT) provide high default tolerance

Credit challenges

- » Both pools include borrowers with below average or speculative credit profiles
- » Both pools have modest concentration in the five largest borrowers

Rating outlook

The stable outlook reflects our expectation that GGRT revenue will remain resilient through periods of economic volatility. GGRT revenue has historically been very stable, including

during the coronavirus pandemic and, in combination with loan agreement revenue, will continue to provide high default tolerance and adequate debt service coverage on both the senior and subordinate lien obligations.

Factors that could lead to an upgrade

- » Significant improvement in the weighted average credit quality of the pool participants
- » Continued growth in GGRT revenue that results in materially stronger debt service coverage

Factors that could lead to a downgrade

- » Material and sustained declines in GGRT collections
- » Deterioration of the default tolerance of the program or erosion of weighted average credit quality of the pool participants

Key indicators

Exhibit 1

NMFA - PPRF Senior Lien Revenue Bonds	
Size and Diversity	
Size of Portfolio	203
% of Borrowers with less than 1% of the pool	39.2%
% of loans to the top 5 borrowers	19.4%
Amount Outstanding	
Total Bonds Outstanding	\$1.1B
Total Loans Outstanding	\$1.3B
Top 5 Participants	Percent of Pool
Rio Rancho (City of), NM	5.0%
New Mexico General Services Department	4.9%
Farmington (City of), NM	3.4%
Las Cruces (City of), NM	3.2%
Farmington (City of), NM (Electric System)	2.9%

Note: Size of portfolio reflects unique borrower pledge combinations
Source: New Mexico Finance Authority; Moody's Investors Service

Exhibit 2

NMFA - PPRF Subordinate Lien Revenue Bonds	
Size and Diversity	
Size of Portfolio	156
% of Borrowers with less than 1% of the pool	32.5%
% of loans to the top 5 borrowers	26.1%
Amount Outstanding	
Total Bonds Outstanding	\$370.8M
Total Loans Outstanding	\$471.0M
Top 5 Participants	Percent of Pool
New Mexico General Services Department	9.2%
Santa Fe (City of), NM	5.5%
Eastern New Mexico University Board of Regents	4.3%
New Mexico General Services Department	3.9%
Jicarilla Apache Nation	3.3%

Note: Size of portfolio reflects unique borrower pledge combinations
Source: New Mexico Finance Authority; Moody's Investors Service

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Profile

The New Mexico Finance Authority is a public body politic and corporate, separate and apart from the State, constituting a governmental instrumentality of the [State of New Mexico](#) (Aa2). The Finance Authority was created in 1992 to coordinate the planning and financing of State and local public projects, to provide for long-term planning and assessment of State and local capital needs and to improve cooperation among the executive and legislative branches of State government and local governments in financing public projects. NMFA is governed by an 11 member board and served by 64 employees.

Detailed credit considerations

Loan portfolio: average credit quality in large portfolio of diverse borrowers

The authority's portfolio is large and is likely to remain stable. We do not expect material changes in the composition of either pool. There is modest concentration in each pool with the five largest borrowers accounting for 19% and 26% of loans outstanding in the senior and subordinate liens, respectively. However, the vast majority of participants represent less than 1% of outstanding loans. Post issuance, the portfolio is expected to consist of 1,087 loans, 748 in the senior pool, valued at \$1.3 billion, and 339 in the subordinate pool, valued at \$471 million.

The senior lien pool has 203 unique borrowers with 287 unique borrower/pledge combinations. The five largest borrowers include the [City of Rio Rancho](#) (Aa2), State of New Mexico General Services Department (state gross receipts tax pledge), the City of Farmington, the [City of Las Cruces](#) (Aa2), and Gadsden Independent School District 16. Pledged revenues consist of general obligation, gross receipt taxes and enterprise revenues. The subordinate lien pool has 187 unique borrowers with 200 unique borrower/pledge combinations. The five largest borrowers include the State of New Mexico General Services Department (appropriation revenue pledge), the City of Santa Fe, Eastern New Mexico University Board of Regents, State of New Mexico General Services Department (state gross receipts tax pledge), and Jicarilla Apache Nation. Pledged revenues consist of general obligation, gross receipt taxes, enterprise revenues, and local special taxes (e.g. cigarette taxes, lodgers' taxes).

Positively, around 50% of revenue in both pools is interceptable (either through Department of Revenue and Taxation or Department of Finance and Administration for school districts), meaning the authority receives funds before the borrower, which mitigates risk of debt service shortfall.

Underlying credit quality and default tolerance: weighted credit quality in each pool is average; GGRT and loan agreement revenues provide high default tolerance

Given the authority's projected cash flows, inclusive of loan agreement revenues and GGRT, default tolerance on both liens is expected to remain high over the near-term. The credit worthiness of the senior lien pool is fairly stable (weighted average is A2), with the top borrowers representing large governments. The subordinate lien pool (weighted average of Baa2) has historically included borrowers with more speculative elements. However, in the past several years, the authority has diversified borrower composition, which improved the credit worthiness of the pool.

The senior lien bonds are secured by borrower repayments, known as loan agreement revenues, and governmental gross receipt taxes (GGRT). NMFA receives 75% of statewide GGRT collections. The majority of GGRT revenues are generated from water, sewer, and refuse collection and disposal services. Since 1996, GGRT has declined only four times, and in each instance, the loss was less than 5%. GGRT is fairly resilient to economic volatility as it is a tax on essential services. We note that this revenue stream is a key credit strength—without GGRT, senior lien default tolerance would decline to around 15.6% from its current 45%. The subordinate lien would decline to 11% from 137.8%. In fiscal 2022, GGRT totaled \$37 million, a 13.2% increase from prior year's \$33 million. Based on projected cash flows, senior lien annual debt service coverage (with fiscal 2022 GGRT) is 1.40 times in fiscal 2023 and increases throughout the life of the bonds. However, we expect future issuances to consume the slack, keeping coverage around 1.40 times.

The subordinate lien bonds benefit from wholly separate and distinct loan agreement revenues used to repay the bonds. The subordinate distinction in this case only applies to the subordinate lien claim on excess cash flow of the senior lien bonds. The claim is automatic and flows to the subordinate lien debt service fund after the senior lien bonds are paid. Based on projected cash flows, including the flow-through excess cash flow of the senior lien bonds, subordinate lien annual debt service coverage is 2.03 times in fiscal 2023 and increases throughout the life of the bonds, though future issuance may consume the slack, we expect coverage will continue to strengthen. Our coverage of the subordinate lien bonds excludes loan revenues from the Jicarilla Apache Nation as outlined

in our methodology. Despite this exclusion, annual debt service coverage remains strong at above 2.0 times. Based on our internal assessment of individual participant credit quality, the weighted average of the senior lien pool is A2. Similarly, the weighted average of the subordinate lien pool is Baa2.

Liquidity

The state has a history of sweeping excess cash reserves (anywhere from \$8 million to \$15 million) from the authority in times of financial stress. This risk is mitigated in that the state can only access available monies after all debt, senior and subordinate, is serviced and all reserves are topped up (as necessary). The authority's receipt of GGRT is protected by statute. The state cannot divert revenues and/or impair the payment of debt. No funds were swept in fiscal 2022. The authority has two primary reserve funds that are cross collateralized and held by trustee for the repayment of senior and subordinate bonds: the common debt service reserve (CDSR, pledged to the senior lien bonds) and supplemental credit reserve fund (SCRF, pledged to the subordinate lien bonds). Both reserves will be funded at roughly the same level upon closing of the Series 2023 bonds and will hold roughly \$38.4 million. The SCRF also serves as a subordinate lien loan reserve fund and short-term borrowing liquidity reserve fund.

NMFA requires certain borrowers to maintain an individual debt service reserve funded at the lesser of the three prong test and held by trustee. These funds are only available for the individual borrower and are not cross collateralized. As such, we do not include these balances in our default tolerance calculations, but we do recognize that they provide additional stability to NMFA's operations. Currently, the senior lien pool has \$33.6 million of internal debt service reserves and the subordinate lien pool has \$31.3 million of internal debt service reserves. The authority also has access to a \$100 million line of credit with [Wells Fargo Bank N.A.](#) (Aa1/P-1) to provide for additional liquidity and short-term borrowing.

Legal framework, covenants and debt structure: provisions provide strong bondholder security

Legal provisions provide strong bondholder security. The PPRF additional bonds test requires that a) the authority deliver a cash flow statement to the Trustee which takes into account the additional indebtedness, b) all prior payments required to be made into the bond fund have been paid in full, c) additional bond proceeds are for refunding or additional loans, grants or to purchase securities (including reserve requirements), and d) no events of default have occurred. Borrowers are required to fund debt service on loans at least five days in advance of when it is due. The trustee covers insufficiencies in any borrower's account with the debt service fund as of five days prior to the due date by transferring available funds in the related agreement reserve account. Borrowers intending to prepay a loan are required to notify the Trustee forty-five days in advance of the prepayment date. The Authority does not allow advance refundings.

Legal security

The bonds are payable solely from the special revenue and funds of the authority pledged under the Indenture including: moneys from the repayment by governmental borrowers of loans made (differentiated between senior and subordinate), certain governmental gross receipts tax revenue, and additional revenue received by the authority that are designated as funds pledged by the indenture. GGRT revenue is collected based on statewide utility usage.

Debt structure

The Authority has \$1.1 billion in outstanding senior lien (inclusive of the current offerings) and \$370.8 million in outstanding subordinate lien bonds. The debt service schedule on both pledges is downward trending in order to layer in future bonds without adversely impacting coverage.

Debt-related derivatives

The authority is not party to any variable rate debt or interest rate derivatives.

Pensions and OPEB

Not applicable.

ESG considerations

Environmental

The NMFA is not directly exposed to environmental risks. Individual borrowers may be exposed, but this should not impair the authority's ability to service its debt: in addition to the two reserves created by indenture, the authority requires borrowers with lower

credit quality (as determined internally by NMFA) to create individual debt service reserves held by trustee, and the authority can intercept roughly 50% of loan revenues, if needed.

Social

The NMFA is not directly exposed to social risks. Individuals borrowers may be exposed, but this should not impair the authority's ability to service its debt: in addition to the two reserves created by indenture, the authority requires borrowers with lower credit quality (as determined internally by NMFA) to create individual debt service reserves held by trustee, and the authority can intercept roughly 50% of loan revenues, if needed.

Governance

The authority's program management and oversight of the PPRF is a strong credit factor incorporated into the credit profile. NMFA is authorized by various state statutes to operate 22 programs; 12 are active. The State used the Authority as the disbursement arm for various economic emergency stimulus and coronavirus response programs. NMFA also runs New Mexico's Local Government Planning Fund, Drinking Water State Revolving Loan Fund, and Water Project Fund along with several private business lending program authorized and funded by the state and issues bonds for the New Mexico Department of Transportation.

The NMFA's lending criteria are strong and the authority does not approve all loan applications. Authority oversight of the program includes the use of credit committees to review loan applications and recommendations are made to approve or deny individual issuers. Additionally, the authority tracks loans and reviews borrowers quarterly, internal loan officers are in frequent contact with borrowers, and the State monitors the monthly fiscal health of communities so challenges can be addressed in a timely manner. The board is composed of 11 members who serve as the governing body of the NMFA. Nine of the 11 members are appointed by the governor.

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