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CREDIT OPINION
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New Mexico (State of)

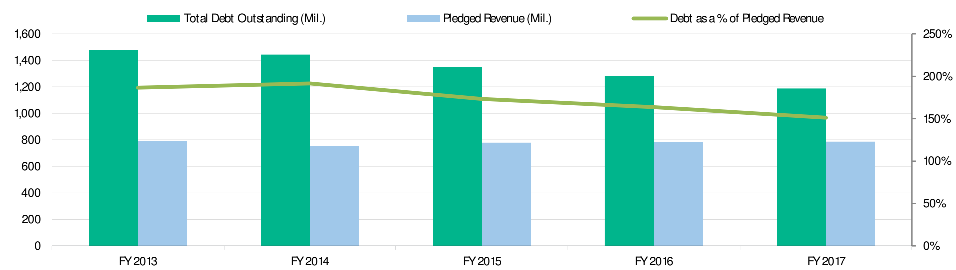
Update to credit analysis--state transportation revenue bonds

Summary

The credit quality of the transportation revenue bonds issued by the State of New Mexico (general obligation bonds Aa1 negative) through the New Mexico Finance Authority benefits from ample coverage of debt service by pledged revenues (which consists of state and federal revenues) and by state revenues alone, rapid payout of outstanding bonds, and the absence of additional borrowing plans, balanced against relatively stagnant state revenues and periodic reauthorization risk for federal revenues. Additional credit strengths include the elimination of significant variable rate and swap exposure at the subordinate level following the planned issuance of the Series 2018A bonds, and strong legal separation between the pledged transportation revenues and the state's general fund.

Pledged revenues include both: (1) state highway revenues, consisting primarily of fuel taxes and various transportation-related fees; and (2) federal highway aid received by the state. The senior lien transportation revenue bonds are rated Aa1, and the subordinate lien transportation revenue bonds are rated Aa2.

Exhibit 1
Transportation debt declining as outstanding bonds mature



Source: NM Department of Transportation annual financial statements; official statements.

Credit strengths

» Ample coverage of peak debt service by total pledged revenues and by state revenues alone.

» Rapid payout of outstanding bonds, and lack of additional borrowing plans.

» Elimination of significant variable rate and swap exposure at the subordinate level following the planned issuance of the Series 2018A bonds.

» Strong legal separation between the pledged transportation revenues and the state's general fund.

Credit challenges

» Relatively stagnant state transportation revenues resulting from economic trend and improving fuel efficiency.

» Periodic reauthorization risk for federal revenues.

Rating outlook

The outlook for New Mexico's transportation revenue bonds is stable reflecting the expectation of a continuation of ample coverage of debt service.

Factors that could lead to an upgrade

» Structural changes that result in a significant and permanent improvement in coverage.

Factors that could lead to a downgrade

» Significant decline in pledged revenues and/or coverage as a result of economic weakness, state of federal legislative changes, or the issuance of additional debt.

Key indicators

Exhibit 2

New Mexico Transp Rev Bonds (Sr & Sub)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Coverage of Maximum Annual Debt Service (x)	4.5x	4.3x	4.4x	4.5x	4.5x
Total Debt Outstanding (Mil.)	1,480	1,443	1,351	1,282	1,188
Pledged Revenue (Mil.)	$794	$754	$779	$784	$786
Total Pledged Revenue Annual Change	1.9%	-5.0%	3.4%	0.6%	0.3%
Debt as a % of Pledged Revenue	186.5%	191.5%	173.3%	163.6%	151.2%
Additional Bonds Test (x) (Sr/Sub)	3.5x/3.0x	3.5x/3.0x	3.5x/3.0x	3.5x/3.0x	3.5x/3.0x

Sources: NM Department of Transportation annual financial statements; official statements.

Profile

New Mexico is the 36th-largest state by population, at 2.1 million. Its state gross domestic product, $97.1 billion, is the 37th-largest. The state's wealth levels are below average, with per capita personal income equal to 77.4% of the US level and a poverty rate among the highest for US states.

The New Mexico Finance Authority is a government instrumentality created by the state legislature to facilitate the financing of state and local public projects.

Detailed credit considerations

Tax Base and Nature of the Pledge

The senior and subordinate lien bonds are secured by first and second liens, respectively, on both: (1) state road and highway revenues and (2) federal highway aid received by the state. In fiscal 2017, approximately 52% of the state road and highway revenues consisted of gasoline and special fuel (diesel) taxes. The balance of the state revenues consisted of weight/distance fees assessed on trucks, registration fees, license fees and other transportation-related fees. State revenues totaled $409 million in 2017. Due to economic trends and improving fuel efficiency, state revenues have been relatively flat. The compound average annual growth in state revenues from 2007 to 2017 was 0.2%.

Federal highway aid consists of all aid received by the state from the federal government for highway construction, improvement and maintenance projects. Federal aid equaled $377 million in fiscal 2017. Federal highway aid has generally increased over time: the compound annual growth rate of federal revenues from 2007 to 2017 was 5.0%. However, federal revenues have been highly variable from year to year and are subject to periodic reauthorization risk.

Debt Service Coverage and Revenue Metrics

Total 2017 state and federal revenues provide 6.73 times coverage of peak debt service on the senior bonds and 4.16 times coverage of peak debt service on the senior and subordinate bonds combined, following the planned refunding. State revenues alone for 2017 provide 3.50 times coverage of peak debt service on the senior bonds and 2.17 times peak debt service on the senior and subordinate bonds combined.

LIQUIDITY

Pledged state and federal revenues provide strong coverage debt service and are legally separate from the state's general fund. A constitutional provision prevents the legislature from reducing or diverting pledged revenues as long as the bonds are outstanding.

Debt and Legal Covenants

DEBT STRUCTURE

Following the planned issuance of the Series 2018A subordinate lien bonds, the state will have approximately $555 million senior lien transportation revenue bonds and approximately $541 million subordinate lien transportation revenue bonds outstanding. Payout is rapid, with 89% of principal scheduled to be repaid by 2026 and all bonds repaid by 2032.

The issuance of additional senior lien bonds is governed by a two-pronged test. Total pledged revenues (state and federal) must provide 3.5 times coverage of peak debt service on the senior lien bonds, and state revenues alone must provide 3.0 times coverage. Additional subordinate lien bonds may be issued if total revenues provide 3.0 times coverage of peak debt service on the senior and subordinate lien bonds combined.

The state has $234.6 million remaining bond capacity under its current program, but has no plans to issue additional debt at this time.

DEBT-RELATED DERIVATIVES

Proceeds of the planned issuance of series 2018A bonds will be used to refund to fixed rate $420 million outstanding variable rate obligations and fund associated swap termination costs. Following this refunding, the state will have no variable rate or swap exposure associated with it transportation revenue bonds.

PENSIONS AND OPEB

Pensions and OPEB are not a major factor in Moody's special tax methodology.

Management and Governance

The state has many governance best practices including a consensus revenue forecasting process, multi-year revenue projections, and timely budget adoption. In addition, in conjunction with the fiscal 2018 budget, the state has established a Rainy Day Fund to capture future growth in oil- and gas-related revenues. While it will likely take some time before the fund builds up any sizable balance, the mechanism should enhance budget discipline in periods of increasing revenue.

At the same time, the state's financial reporting has had numerous weaknesses. Prior to fiscal 2013, the financial statements in New Mexico's Comprehensive Annual Financial Report (CAFR) were not audited. The statements were only “reviewed,” which indicates a substantially lower standard of verification. In addition, the CAFRs have not been released on a timely basis. Prior to fiscal 2007, CAFRs were issued on average 19 months after the end of the fiscal year.

The state has made significant progress in improving its financial reporting. The fiscal year 2013 and 2014 CAFRs were audited, but these audits contained numerous findings related to cash reconciliations and consolidations. The state is committed to a number of initiatives to eliminate the findings and improve the timeliness of its CAFRs. The audited 2015 CAFR was released in early July 2016, 12 months after the end of the fiscal year, and the number of audit findings was substantially reduced. The 2015 audits reflected enough progress on cash reconciliation to allow the state to release the $100 million special reserve it had established to cover any adjustments necessary to resolve the cash discrepancies. Moody's expects that the state will make continued improvement in its financial reporting.

The state does provide timely, audited financial statements for its major agencies and for its statutory General Fund. The statutory General Fund, also known as the "Component Appropriation Accounts" or the "Component Appropriation Funds," is not exactly equivalent to the GAAP-basis General Fund shown in the CAFR. In particular, it excludes certain departmental revenue accounts that are included in the GAAP General Fund. Even so, the two representations of the General Fund have tracked very closely. These agency statements provide sufficient verified information to evaluate the state's financial performance, but the absence of timely, unqualified comprehensive statements remains a credit challenge.

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