S&P Global
Ratings

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Summary:

New Mexico State Transportation Commission
New Mexico Finance Authority; Gas Tax

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Credit Profile		
US$69.9 mil state transp rfdg rev bnds (sr ln) (New Mexico State Transp Comm) ser 2020A due 06/15/2025		
Long Term Rating	AA+/Negative	New
New Mexico Fin Auth, New Mexico		
New Mexico State Transp Comm, New Mexico		
New Mexico Fin Auth (New Mexico State Transp Comm) Gas Tax		
Long Term Rating	AA+/Negative	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' rating to the New Mexico Finance Authority's (NMFA) state transportation refunding revenue bonds (state transportation commission senior lien), series 2020A, issued for the New Mexico State Transportation Commission. The outlook is negative.

At the same time, we affirmed our 'AA' rating on the subordinate-lien transportation revenue bonds, which reflects our lower stand-alone credit profile (SACP) assessment of the subordinate-lien pledged revenue stream. The outlook on the subordinate-lien revenue bonds is stable.

The outlook on the senior-lien revenue bonds reflects the negative outlook on the state's general obligation (GO) bonds and the application of our priority-lien criteria (published Oct. 22, 2018, on RatingsDirect), which limits the transportation revenue bonds to no more than one notch above the GO rating. Should we lower our rating on the state, we could similarly downgrade the senior-lien transportation revenue bonds; if we revise the outlook on the state GO rating back to stable, we could similarly revise our highway revenue bond rating outlook to stable.

Credit overview

With the fourth quarter of the 2020 in sight, the initial blow to the state's economy following the pandemic-induced recession is giving way to signs of a recovery, but the lingering uncertainty of the path of the novel virus continues to cloud the outlook and lean to the downside, in our view. Despite recessionary headwinds accelerating in second quarter of the year, total pledged revenues ended fiscal year 2020 marginally down 0.3% (June 30, 2020), although they were forecast to slide 4% in fiscal year 2021. Pledged revenues are forecast to revert to positive territory in 2022 with 7.5% growth. The state's pledged revenue forecast aligns with its broader consensus general fund revenue outlook of continued economic weakness through fiscal year 2021 with a gradual recovery in fiscal year 2021. While we anticipate the current situation will remain fluid, the state's and commission's active management will remain a key credit consideration in addressing developments on the ground and the subsequent second-order effects as they materialize.

The senior-lien transportation revenue bonds are secured by a first-lien pledge of various taxes and fees required to be paid into the state road fund, certain federal transportation revenue, and taxes and fees that must be deposited into the highway infrastructure fund (HIF). Pledged federal funds are revenue available to the New Mexico Department of Transportation (NMDOT) under federal law and not otherwise obligated, which are paid into the state road fund. State road fund revenues primarily include gasoline, special fuel, and weight and distance taxes, as well as motor vehicle registration fees. State HIF revenues include leased vehicle gross receipts taxes and tire recycling fees. Subordinate-lien bonds have a pledge on the same revenues, after payment of senior bond debt service. Neither lien has a debt service reserve.

Key considerations in our assessment of the credit quality of the pledged revenues include:

- A very strong statewide economic base of 2.1 million people generating the pledged revenues;
- Low volatility of pledged state-generated revenues, including a history of New Mexico increasing motor fuel tax rates and fees, although we view pledged federal revenue as somewhat more volatile;
- Anticipated continued strong debt service coverage (DSC), despite recent economic pressures, based on lack of current state debt issuance plans and a strong senior-lien additional bonds test (ABT) of 3.0x maximum annual debt service (MADS) by pledged state taxes alone, and 3.5x by combined state taxes and pledged federal revenue; the subordinate-lien ABT is also good, requiring 3.0x combined senior and subordinate MADS coverage by combined state and federal revenue, although it is weakened somewhat by the inclusion of federal revenues, which make up about half of pledged revenue; and
- Strong current MADS coverage of 7.12x on senior-lien debt service (2022) and 4.66x on combined senior- and subordinate-lien debt service, by pledged fiscal 2020 revenue (preliminary final).

Environmental, social, and governance factors

In our view, environmental, social, and governance (ESG) factors align with those of the state. For more information on the state's general credit characteristics, please refer to our last full analysis on New Mexico, published on May 19, 2020, on RatingsDirect.

Negative Outlook (senior lien), Stable Outlook (subordinate lien)

The negative outlook on the senior-lien bonds reflects our negative outlook on the state GO rating, as well as our view of the senior and subordinate lien's DSC ratios and ABTs.

The outlook reflects our expectation that pledged state revenues, while anticipated to decline in fiscal year 2021, will nevertheless provide strong MADS coverage and gradually strengthen over time. Due to the strong current MADS coverage by state-only tax revenues for both senior- and subordinate-lien bonds, a decline in federal funds would not necessarily alter our view of overall credit quality.

Return to stable scenario (senior-lien)

A revision of our rating or outlook on New Mexico would similarly result in a revision of our rating or outlook on the senior-lien transportation revenue bonds.

Downside scenario

Material declines of pledged state revenues beyond current baseline assumptions could pressure the senior- and subordinate-lien ratings. Given an ABT that allows the subordinate lien to leverage what we believe are more volatile federal revenues, we don't expect to raise the rating on the subordinate-lien within our outlook horizon.

We would not lower the rating on the subordinate-lien bonds as a result of our establishment of a one-notch limitation above the state's general creditworthiness for the transportation revenue bonds unless we lowered our state GO rating below 'AA-'.

Credit Opinion

Revenue volatility: Moderately low

Overall, combined state road fund (SRF) and HIF pledged revenue has experienced some ups and downs over the past ten years, but has increased 18% cumulatively during this period. From 2011-2020, state-derived pledged revenue growth has ranged from a peak of 7.2% (2019) to a trough of 2.2% in 2020, with a compound annual growth rate of 1.7%. We view the portion of pledged revenue derived from state taxes as more stable than pledged federal revenue.

The lowest point of fiscal year 2020, SRF collections, which make up the majority of state derived revenue, was in April with collections down 31.5% relative to same month a year prior. SRF collections subsequently grew in May but were again down 24.7% compared to a year prior but rebounded in June, growing 7.4% over June of fiscal year 2019.

Combined state pledged revenue totaled slightly over $448 million in fiscal year 2020 (preliminary final). After a forecasted decline of state-derived pledged revenue of 7.5% in fiscal year 2021, revenues revert back to growth of 14.9% and 3% in fiscal years 2022 and 2023, respectively. The outsized bump in growth is 2022 is largely due to the SRF receiving a greater share of motor vehicle excise taxes beginning July 1, 2021. Absent the change, state-derived revenue growth in 2022 would be a more modest 6%, followed by 2.8% growth, assuming flat growth of $5.5 million forecasted in 2021.

Total pledged federal funds have shown some year-to-year volatility related to federal reimbursement of specific projects, including a 4.6% one-year decrease in fiscal 2011, followed by a 24% cumulative increase from fiscal years 2011-2015, and a 2.1% cumulative decrease from fiscal years 2015-2017, and subsequently growing a cumulative 7.3% from 2017-2020. For planning purposes, NMDOT has assumed federal revenues will remain flat at 2020 levels, although subject to changes in federal funding. To-date a new surface transportation bill has not been approved by Congress, with the existing legislation (Fixing America's Surface Transportation Act) expiring at the end of September. Although we cannot predict future actions of Congress, for the foreseeable future, the NMDOT and commission officials expect stable funding for the program on a continuing resolution basis based on historical precedence for such continued program funding despite past lapses of multiyear authorizations. Aside from the federal highway funding, should general federal funding shrink significantly, we believe state revenues could also see some declines at the same time due to the state economy's significant military and federal research components.

Our macro volatility assessment begins with an assessment of the historical volatility of the economic activity being taxed, and includes an analysis of societal, demographic, political, and other factors that could affect these activities.

Based on the variance of national economic activity that we believe most closely represents the taxing base over multiple economic cycles, it is used to inform our opinion on expectations of future volatility.

Coverage and liquidity: Senior bonds very strong; subordinate bonds strong

The state has historically maintained very strong DSC levels on both the senior- and subordinate-lien debt.

Based on fiscal year 2020 (preliminary final) figures, total state and federal pledged revenue covered senior-lien MADS by what we view as a very strong 7.12x, and pro forma combined senior- and subordinate-lien MADS by a still very strong 4.66x. Estimated total pledged revenues for 2021 would provide 6.83x and 4.48x, senior and combined MADS coverage, respectively.

NMDOT has authority to issue approximately $235 million of additional debt under current legislative authority, although effective June 26, 2020, an authorized issuance of $75 million (from existing authorized but unissued debt) cannot be issued until July 1, 2022.

The senior-lien ABT requires that state revenues in any 12 consecutive months of the preceding 18 months total 3.0x MADS, and all pledged revenues total 3.5x MADS on all closed-lien obligations and proposed senior-lien bonds outstanding. The ABT for subordinate-lien bonds requires 3.0x MADS coverage of senior- and subordinate-lien bonds outstanding from all pledged revenues. Given the relatively even mix between federal and state pledged revenue, we believe the subordinate-lien ABT allows for significant leverage against the potentially more volatile federal revenue.

The state imposes gasoline excise taxes, which are the largest contributor to pledged state revenues, at a fixed 17 cents per gallon, a rate that has not been increased for some time and is the lowest for any Western state. State law permits the tax exemption of up to 60 million gallons of gas sales outside of Native American reservations per year from two registered Native American wholesale distributors. NMDOT has entered into gas tax-sharing agreements with both distributors, extended in 2014 for a 10-year period, that officials believe have mitigated the effect of any off-reservation sales on the state road fund and have helped reduce volatility in New Mexico's gas tax revenue after exemptions. We understand the agreements allow either party to terminate with 12 months' notice. Certain distributors can also sell retail gasoline on reservations free of the tax, but taxable gasoline distribution has represented a relatively stable 92%-93% of total gasoline distribution since 2010.

Economic fundamentals: Very strong

We view the large statewide economic base of nearly 2.1 million people that generates pledged state-derived tax revenues as strong, despite a somewhat above-average reliance on federal employment, due to federal laboratories and military bases, and on oil and gas production. Increased federal defense spending and, until recently, a rebound in oil and gas production due to fracking activity in the Permian Basis, helped boost the state economy in recent years after a previous period of weakness.

Since the Great Recession, the state has experienced slower population growth than the nation, after having faster growth in the previous decade. The state population grew only 0.20% in 2019 and 0.05% in 2018, and had slight declines in both 2014 and 2015, resulting in a 2019 state population of 2.097 million. From 2009-2019, the state population increased overall 2.9%, compared with 7.0% for the U.S. New Mexico's age dependency ratio (which measures nonworking-age population to working-age population) was 68.1% in 2018, a large 5.6 percentage points above that of the U.S., reflecting a growing retiree population attracted to the state's moderate climate and low cost of living.

The state's relatively large federal employment sector due to the presence of federal laboratories and military bases provides a backdrop of economic stability. The state ranks first in the nation in terms of federal spending per dollar of tax paid, indicating the importance of federal dollars. Federal employment is concentrated in New Mexico's three air force bases, as well as the White Sands Missile Range, and the Los Alamos and Sandia national laboratories. Other industries include high-technology manufacturing attracted by state tax breaks and proximity to federal labs, tourism, and call-center businesses, which are drawn in part by New Mexico's low business costs. Governmental sector employment was higher than the national average at 22.0% of state employment in 2019 compared with 15.0% nationally; governmental employment does not include additional military employment at the state's military bases.

IHS Markit forecasts the state's gross state product (GSP) will contract 4.6% by year's end, marginally better than the U.S. level of a 4.8% contraction, and subsequently rebound with growth of 1.7% and 3.4% in 2021 and 2022, respectively. Long term, we believe the state--like the nation as a whole--will have to contend with certain structural factors--evolving productivity developments, lower labor-force participation, and shifting trade dynamics, and now the potential lasting negative imprint of the pandemic.

Linkage to state general creditworthiness

Given that the state collects the pledged revenues, we view the rating on the transportation revenue bonds as linked to New Mexico's creditworthiness. Although the state constitution restricts transportation-related revenues to transportation-related purposes, these can be purposes other than specifically repayment of debt. In our establishment of a one-notch upward limitation on the transportation revenue bond rating compared to the state GO rating, we factored into our analysis our view that the state provides critical public services. While we consider that statutory and bond covenant restrictions on the use of highway transportation revenues as providing a degree of uplift, in our opinion, the state's collection and distribution of pledged revenues expose the revenues to operating risk. For this reason, under our priority-lien criteria, we consider the linkage between the priority-lien pledge and the State of New Mexico close.

For more information on our State of New Mexico GO rating, please refer to our most recent GO rationale, published May 19, 2020.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of September 22, 2020)		
New Mexico Fin Auth, New Mexico		
New Mexico State Transp Comm, New Mexico		
New Mexico Fin Auth (New Mexico State Transp Comm) Gas Tax		
Long Term Rating	AA/Stable	Affirmed
New Mexico Fin Auth (New Mexico State Transp Comm) Gas Tax		

Ratings Detail (As Of September 22, 2020) (cont.)		
Long Term Rating	AA/Stable	Affirmed
New Mexico Fin Auth (New Mexico State Transp Comm) Gas Tax		
Long Term Rating	AA/Stable	Affirmed

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.