

New Mexico Finance Authority; Gas Tax

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US\$424.565 mil state transp rfdg rev bnds ser 2018A due 06/15/2030

Long Term Rating AA/Stable New

New Mexico Fin Auth, New Mexico

New Mexico State Transp Comm, New Mexico

New Mexico Fin Auth (New Mexico State Transp Comm) sr lien

Long Term Rating AAA/Stable Affirmed

New Mexico Fin Auth (New Mexico St Transp Comm) Gas Tax

Long Term Rating AA/Stable Affirmed

New Mexico Fin Auth (New Mexico State Transp Comm) GASTAX

Long Term Rating AA/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AA' rating to the New Mexico Finance Authority's (NMFA) state transportation refunding revenue bonds (state transportation commission-subordinate lien), series 2018A, issued for the New Mexico State Transportation Commission. The outlook is stable.

S&P Global Ratings also affirmed its 'AA' rating, and stable outlook, on the NMFA's \$116.3 million outstanding parity subordinate-lien bonds and its 'AAA' and stable outlook to the NMFA's \$555.1 million outstanding senior-lien state transportation revenue debt.

The ratings reflect what we view as:

- A relatively stable trend in pledged state revenues, including nearly all statewide vehicle-related fees and fuel taxes, which provide strong debt service coverage excluding pledged federal revenue;
- Very strong historical and projected debt service coverage by state revenue alone, particularly for the senior bonds, which offsets the lack of debt service reserve funds;
- A very strong additional bonds test of 3.0x on senior-lien maximum annual debt service (MADS) from pledged state revenues and 3.5x from all state and federal pledged revenues, and a subordinate-lien additional bonds test that requires 3.0x combined senior-lien and subordinate-lien MADS coverage from all state and federal pledged revenues; and
- A relatively short 10-year amortization for the senior bonds and no current future bonding plans for either the senior lien or subordinate lien.

In our opinion, these strengths are slightly mitigated for the subordinate-lien bonds by the inclusion of pledged federal funds in their additional bonds test, which we view as a more volatile revenue source than state tax revenue, and the legal ability to issue additional prior lien senior bonds, although the state has no current plans to do so.

The state transportation commission will be refunding all of its outstanding variable-rate debt and terminating related

interest rate swap agreements. All senior and subordinate transportation revenue bonds will consist of fixed rate debt after this refunding. The refunding will result in some present value dissavings as the result of pushing certain principal maturities out by four years, and MADS will rise slightly. The new debt service schedule also will reduce annual debt service in fiscal years 2025 and 2026 in order to accommodate certain anticipated reductions in federal reimbursement payments for debt service in those years.

Pledged revenues include both state-derived, transportation-related tax revenue (52% in fiscal 2017), and a portion of federal transportation funds (48%) received by New Mexico.

The senior bonds have a first lien on pledged revenue prior to the subordinate-lien bonds. Neither senior nor subordinate-lien bonds have debt service reserve funds. Indenture provisions require the regular monthly deposit from pledged revenue to principal and interest accounts for the senior- and subordinate-lien bonds. The monthly receipt of state road fund revenue and strong annual coverage on all bonds somewhat mitigates the lack of debt service reserve funds.

Pledged state tax revenue consists of various taxes and fees required to be paid into the state road fund, and taxes and fees that must be deposited into the highway infrastructure fund (HIF). Pledged federal funds are revenue available to the NMDOT under federal law and not otherwise obligated that are paid into the state road fund. State road fund revenues primarily comprise 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.

Overall, combined state road fund and HIF pledged revenue has experienced some ups and downs over the past nine years, but has grown 5.3% cumulatively during this period. State revenue declined 5.9% between fiscal years 2008-2010, grew 3.4% in 2011, declined 1.3% in 2012, grew 2.0% in 2013, declined 0.01% in 2014, and has increased 7.4% cumulatively between fiscal years 2015-2017. Combined state pledged revenue totaled \$409.1 million in fiscal 2017. The state estimates state derived pledged revenue will grow 3.0% in fiscal 2018.

Pledged federal revenue fluctuates from year to year, including a 24.0% cumulative increase between fiscal years 2011-2015, and a 2.1% decrease between fiscal years 2015-2017, to \$377.0 million. The state estimates pledged federal revenue will decline another 2.9% in fiscal 2018.

Overall combined state and federal pledged revenue has increased each year since fiscal 2011, growing a cumulative 13.9% to \$786.1 million in 2017, after a 0.2% drop in 2011. The state estimates 0.2% growth in fiscal 2018. Fiscal 2017 total state and federal pledged revenue covers senior lien MADS by what we view as a very strong 6.73x, and pro-forma combined senior and subordinate lien MADS after this refunding by a still very strong 4.16x.

The NMDOT has authority to issue approximately \$235 million of additional debt under current legislative authority; however, NMDOT officials report there are no current plans to issue parity new money debt and that issuance of future debt would likely depend on increased tax rates for the pledged revenues. The senior-lien additional bonds test 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 additional bonds test for subordinate-lien bonds requires 3.0x MADS coverage of senior-lien 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 additional bonds test allows for significant leverage against relatively volatile federal revenue.

We believe the state economy is likely to generate continued slow growth in pledged transportation revenue. While state population growth that has been somewhat below that of the nation, including two years of small population losses in 2014 and 2015 during a bust in the state's oil and gas sector, energy prices have now turned around. Although population increased only 0.13% in 2017, nominal state gross product increased 4.13% as the energy sector bounced back. The state also has a relatively large and stabilizing federal employment sector due to the presence of federal laboratories and military bases. Governmental employment was 23% of employment in 2017, compared to 16% for the nation. IHS Markit forecasts continued annual population and gross product growth through 2021, but at levels for each somewhat slower than that for the U.S.

Outlook

The stable outlook reflects our expectation that the relative stability of state revenues and limited future debt needs will continue to provide strong MADS coverage, although pledged federal revenue could fluctuate. Due to the strong current MADS coverage by state-only tax revenues, we do not believe that potential declines in federal funds would necessarily lead to a downgrade; however, concurrent significant softening of pledged state revenues from exempt sales, decreased fuel demand, or other factors could pressure the ratings. Given an additional bonds test 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 bonds in the next two years.

Pledged Revenue

The state imposes gasoline excise taxes, 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 except Oklahoma. 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. The 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 to 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 2008.

Total pledged federal funds have shown some year-to-year volatility, related to federal reimbursement of specific projects, including a 4.6% decrease in fiscal 2011 and a 1.7% decrease in fiscal 2016. Officials believe their future pledged federal funds projections are conservative in that they do not include the potential for new federally funded transportation projects. NM DOT projects a decline in federal revenue in fiscal years 2018 and 2019, as certain federal projects wind down, and then a relatively stable level of federal funding at \$340 million under the federal FAST Act, compared to \$377 million of pledged state federal transportation funds in fiscal 2017. Although future actions of

Congress cannot be predicted, the NMDOT and commission officials expect stable funding for the program on a continuing resolution basis for the foreseeable future based on historical precedence for continued program funding despite past lapses of multiyear authorizations. Aside from the federal highway funding, should general federal funding significantly decline, 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.

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