S&P Global Ratings

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Summary:

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

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New Mexico Fin Auth (New Mexico State Transp Comm) sr lien		
Long Term Rating	AA+/Stable	Downgraded

Rationale

S&P Global Ratings has lowered its rating on New Mexico Finance Authority's senior-lien transportation revenue bonds, issued for the New Mexico State Transportation Commission, to 'AA+' from 'AAA'. The outlook is stable.

The downgrade follows the application of our Priority-Lien Tax Revenue Debt criteria published Oct. 22, 2018, which factors in both the strength and stability of the pledged revenues, as well as the general credit quality of New Mexico as issuing obligor. The priority-lien rating on the senior-lien bonds is limited by our view of the state's creditworthiness (general obligation [GO] rating AA/Stable) and is constrained from being raised higher unless we raise our GO rating on the state, despite very strong revenue coverage of debt service. In our view, the transportation revenue bonds do not benefit from limited scope of operations or extraordinary expenditure flexibility of the obligated entity, while we believe pledged revenues have exposure to operating risk of the state.

We are also affirming our 'AA' rating, with a stable outlook, on the subordinate-lien transportation revenue bonds, which reflects our lower stand-alone credit profile assessment (SACP) of the subordinate-lien pledged revenue stream, which as a result is not limited by the 'AA' state GO rating.

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 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. Subordinate-lien bonds have a pledge on the same revenues, after payment of senior bond debt service. Neither lien has a debt service reserve.

We view the strength and stability of the pledged revenues as very strong. 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 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 comprise about half of pledged revenue; and
- Strong current MADS coverage of 6.73x on senior-lien debt service and 4.16x on combined senior- and subordinate-lien debt service, by pledged fiscal 2018 revenue.

Revenue Volatility: Moderately low

Overall, combined state road fund and HIF pledged revenue has experienced some ups and downs over the past nine years, but has increased 5.3% cumulatively during this period. We view the portion of pledged revenue derived from state taxes as more stable than pledged federal revenue.

State derived pledged revenue declined 5.9% from fiscal years 2008-2010, rose 3.4% in 2011, declined 1.3% in 2012, increased 2.0% in 2013, and dropped 0.01% in 2014, before increasing 7.4% cumulatively from fiscal years 2015 to 2017. Combined state pledged revenue totaled $409.1 million in fiscal 2017.

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 24.0% cumulative increase from fiscal years 2011-2015, and a 2.1% cumulative decrease from fiscal years 2015-2017, to $377.0 million. NMDOT earlier projected 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. 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 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.

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.

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

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

Fiscal 2017 total state and federal pledged revenue covered senior-lien MADS by what we view as a very strong 6.73x, and pro forma combined senior- and subordinate-lien MADS 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 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-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 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 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.

Economic fundamentals: Very strong

We view the large statewide economic base of 2.09 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 a rebound in oil and gas production bode well for near-term state economic success after a previous period of weakness.

New Mexico's population growth trend was above that of the U.S. until 2011. In 2014 and 2015, the state's population experienced small declines, before a slight 0.15% increase in 2016 and 0.13% in 2017, to 2.09 million, compared with 0.72% national growth in 2017. Overall, state population increased 4.9% from 2007 to 2017, compared with 8.1% for the U.S. The state's age dependency ratio of nonworking population-to-working age population is also somewhat high at 67.3% in 2017 compared with the nation's 61.8%.

We believe the state economy is likely to generate continued slow growth in pledged transportation revenue. While state population growth 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 gross state 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 22.5% of employment in 2017, compared to 15.5% for the nation. Reflecting New Mexico's energy sector, mining and logging employment represents 2.5% of jobs in the state, up from 2.4% in 2016, but down from 3.4% in 2014, compared with 0.5% for the nation in 2017. The state's professional and business services sector (12.6% of employment) includes jobs at the national laboratories.

Other important economic sectors include agriculture, high-tech manufacturing, tourism (particularly Native American-owned casinos), and call-center businesses are present. Manufacturing accounted for only 3.2% of state employment, compared with 8.5% nationally.

The state's personal income per capita in 2017 represented only 77% of that of the nation, down from 78% in 2016, and 83% in 2009 during boom energy times; it is currently more in line with years before that period. The state's unemployment rate in 2017 was 6.2%, above the national rate of 4.4%.

Linkage to state general creditworthiness

Because the state collects the pledged revenues, we view the rating on the transportation revenue bonds as linked to New Mexico's creditworthiness. Although 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 some uplift, in our opinion, the state's collection and distribution of pledged revenues exposes 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 Sept. 12, 2018.

Outlook

The stable outlook on the senior-lien bonds reflects our stable outlook on the state GO rating, as well as our view of the senior lien's strong debt service coverage ratios and strong ABT. Should we raise or lower the state GO rating or revise our outlook on New Mexico, we would similarly raise or lower our rating on the senior-lien transportation revenue bonds or revise the outlook. The outlook on the senior lien also reflects our expectation that pledged state revenues will remain relatively stable and limited future parity bond issuance 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 for both senior- and subordinate-lien bonds, 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 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 bonds during our two-year 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 the state GO rating below 'AA-'.

Ratings Detail (As Of November 15, 2018)		
New Mexico Fin Auth gas tax		
Long Term Rating	AA/Stable	Affirmed
New Mexico Fin Auth, New Mexico		
New Mexico State Transp Comm, New Mexico		
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

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.