State Bond Ratings:
History, Current Status, and Outlook

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Presentation Overview

- **Overview of Municipal Bond Ratings**
- **New Mexico State Bond Ratings and History**
- **Review of Recent Downgrades**
- **General Fund Reserve Trends**
- **Debt Ratio Comparison with Peer States**
- **Impact of Pension Obligations on Debt Ratios**
- **Projected Debt Ratios**
- **Key Future Rating Issues**

Overview of Municipal Bond Ratings

Moody's Ratings

Aaa: This is the highest rating Moody's assigns. This is the strongest category of creditworthiness.

Aa: This the next highest tier of Moody's. It implies very strong creditworthiness.

A: This is the third highest tier. It implies above average creditworthiness.

Baa: This is the fourth highest tier and the lowest tier of what is generally considered 'investment grade'.

Standard and Poor's Ratings

AAA: Highest rating. Extremely strong creditworthiness.

AA: Very strong creditworthiness.

A: Strong creditworthiness.

BBB: Adequate creditworthiness. Considered the lowest 'investment-grade' bond rating.

Fitch's Ratings

AAA: Denotes the highest rating. This rating is given to those with the lowest default.

AA: Denotes expectations of very low default risk relative to other issuers or obligations.

A: Denotes expectations of low default risk relative to other issuers or obligations in the same country.

BBB: Denotes a moderate default risk relative to other issuers or obligations in the same country.

Municipal Bond Rating Criteria

- ***Economy***

  Growth, income, employment, education, concentration

- ***Debt Structure***

  Debt burden per capita/income, coverage, pensions, average life

- ***Financial Condition***

  Reserves, budgets, revenues/expenditures, performance history

- ***Demographic Factors***

  Population trends, age, workforce

- ***Management Practices***

  Budgets, accounting practices, legal, transparency

State of New Mexico Bond Ratings

- The State Board of Finance has historically overseen issuance of General Obligation Bonds (GOBs) and Severance Tax Bonds (STBs)
- SBOF staff assisted in the issuance of the Grant County bonds for the Department of Health's new Fort Bayard Medical Center, which are state lease appropriation bonds, and therefore rated based upon the State GOB rating.
- Creation of the State Aid Intercept program in 2003 allows for an upgrade on all qualifying school district bonds by guaranteeing the State will pay debt service in the event of a default, and then subtracting any amount paid from the school district's next monthly school support allotment.
- Other state bonds, such as the NMFA PPRF bonds are ultimately tied to the state bond ratings.

Outstanding State Bond Ratings

State Board of Finance	Moody's	Standard & Poors
General Obligation Bonds	Aa1	AA
Severance Tax Bonds	Aa2	AA-
Supplemental Severance Tax Bonds	Aa3	A+
Lease Appropriation Bonds	Aa2	AA-
State-aid-intercept School Bonds	Aa2	
State Transportation Revenue Bonds		
Senior Lien	Aa1	AAA
Subordinate Lien	Aa2	AA+
New Mexico Finance Authority		
Senior Lien Public Project Revolving Fund	Aa1	AAA
Subordinate Lien Public Project Revolving Fund	Aa2	AA+

General Obligation Bond Rating History

Moody's	Date	Rating	Outlook	Comment
	July 1974	Aa		
	Aug 1981	Aa1		Rating Upgrade
	Feb 1985	Aa		Rating Downgrade
	July 1994	Aa1		Rating Upgrade
	Nov 2003	Aa1	Stable	Outlook Assigned
	Apr 2010	Aaa	Stable	Recalibration Upward
	July 2011	Aaa	Under review	Possible Downgrade/US Budget Issues
	Aug 2011	Aaa	Negative	Linkage to US Budget Issues
	July 2013	Aaa	Stable	Linkage to US Budget Issues
	Sept 2016	Aaa	Under review	Possible Downgrade
	Oct 2016	Aa1	Negative	Rating Downgrade
	June 2017	Aa1	Negative	Status quo, outlook pending August

S&P	Date	Rating	Outlook	Comment
	May 1980	AA		Initial Rating
	Apr 1992	AA	Stable	
	Oct 1993	AA+	Stable	Rating Upgrade
	Feb 1997	AA+	Negative	
	Feb 1999	AA+	Stable	
	Nov 2014	AA+	Negative	
	Nov 2016	AA	Negative	Rating Downgrade
	June 2017	AA	Negative	Status quo

Severance Tax Bond Rating History

Moody's	Date	Senior/Supple. Rating	Outlook	Comment
	1970	Aa		
	1975	Aaa		
	1986	Aa		
	1997	Aa2		Refinement
	2003	Aa2/Aa3	Stable	Initial Supplemental Rating
	May 2010	Aa1/Aa2	Stable	Recalibration
	May 2016	Aa2/Aa3	Negative	Rating Downgrade
	June 2017	Aa2/Aa3	Stable	Outlook Upgrade

S&P	Date	Senior/Supple. Rating	Outlook	Comment
	1998	AA	Stable	
	2000	AA/A+	Stable	Initial Supplemental Rating
	2007	AA/AA-	Stable	Supplemental Upgrade
	May 2016	AA-/A+	Stable	Rating Downgrade
	June 2017	AA-/A+	Stable	

Review of Recent Bond Rating Downgrades

General Obligation Bond Rating Downgrades

- GOB are voter-approved debt paid from a state-wide mill levy, but the GOB rating reflects broader aspects of state financial management and economic situation.
- Valuation of oil and natural gas properties impacts state-wide GOB capacity, as well as local bonds in oil and natural gas producing counties.
- GOB ratings were downgraded in October and November of 2016 by Moody's and S&P, respectively, which each maintain a negative outlook, suggesting risk of continued downgrades.
- Downgrades reflected near-complete depletion of reserve levels.
- General Fund reserve levels have historically been a critical offset to low state wealth factors.
- CAFR release and disclaimed audit raised ongoing issue of financial reporting and disclosure.
- Financial reporting has historically been problematic for GOB ratings – working towards timely release of CAFR and continued progress remediating CAFR audit findings.
- Important to diversify economy to decrease revenue volatility.
- Debt ratios must be controlled through conservative issuance and economic growth.
- Pension and other post employment benefit (OPEB) liabilities factor into rating as well.
- New rainy day fund will become important credit enhancement in coming years.

Review of Recent Bond Rating Downgrades

Severance Tax Bond Rating Downgrades

- STB ratings were downgraded in May 2016 by Moody’s and S&P, though the outlooks on each are now stable.
- Downgrades reflected declines in natural gas and oil pricing and production volumes, and resulting lower debt service coverage compared to historical levels.
- Important to ensure strong revenue coverage through conservative issuance.
- Volatility is inherent credit issue.
- Life of proven oil and natural gas reserves remains important ‘inventory’ factor for credit.

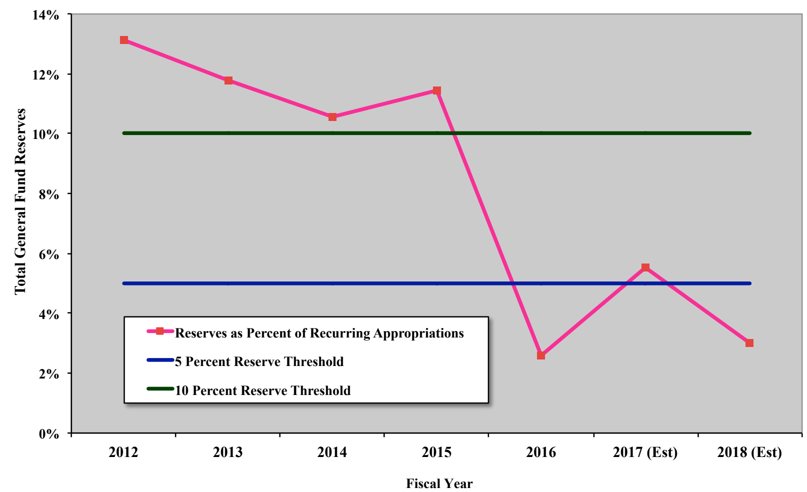
Financial Impact of Bond Rating Downgrades

- Bond ratings affect interest rate paid on bonds, but market assessment of those bonds also comes into play, apart from rating agency assessment.
- A dual 1-notch downgrade, such as occurred at the end of last year, is estimated to cost the State 10-15 basis points in yield (0.10-0.15%).
- Based on a standard 10-year GOB, that translates to between $6,000 to $9,000 per $1 million issued on an NPV basis over the life of the bond. Annually, that’s around $650 to $970 per $1 million.

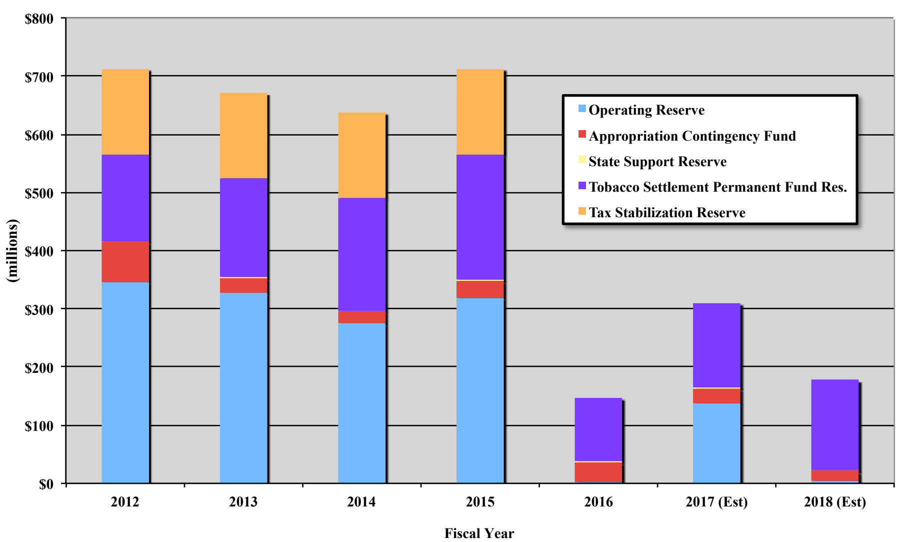
General Fund Reserve Trends

- Operating reserves have been depleted to well below historic threshold of 10% of recurring appropriations.
- Based on tracking, FY17 reserves are expected to end at 5.3%. After accounting for expected FY17 strength, FY18 reserves are projected to end at 3.0%.
- Actions during recent Legislative sessions stabilized rating deterioration. Further action will be needed going forward.
- Creation of rainy day fund with windfall oil and natural gas receipts will lend stability over time.

General Fund Reserves as Percent of Recurring Appropriations



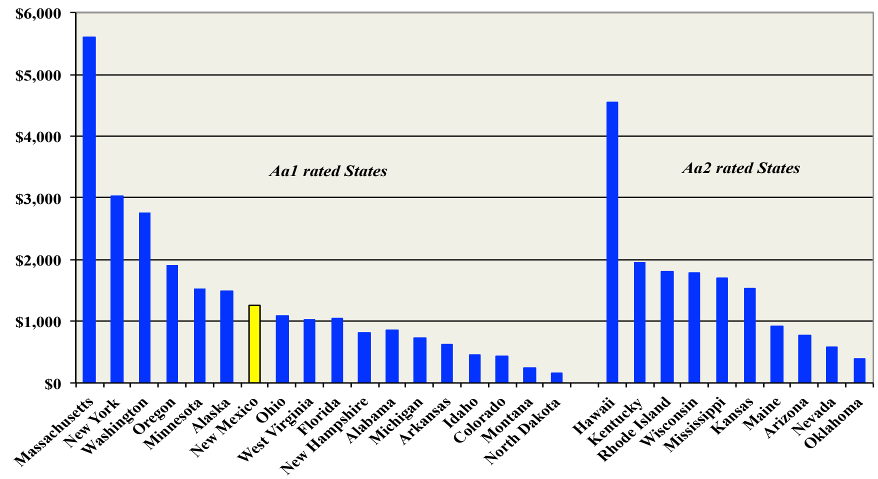
General Fund Reserves FY 2012-2018 (Est)



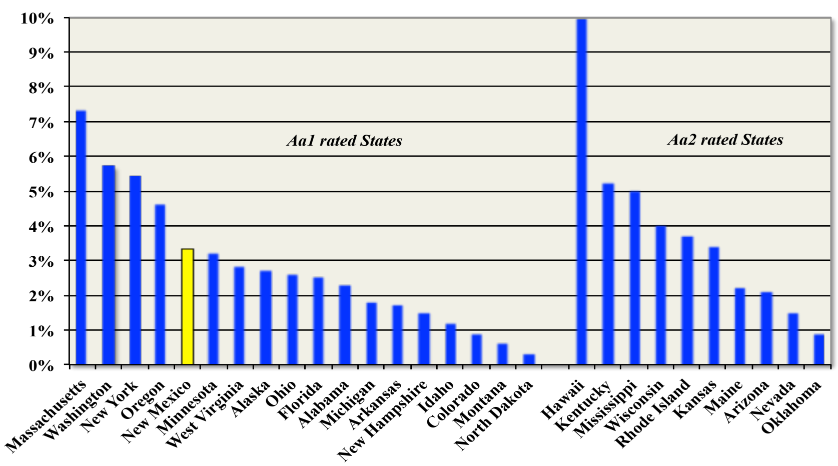
Debt Ratio Comparison with Peer States

- After recent downgrades, New Mexico's debt per capita is average for its peer-rated states.
- Before the downgrades, New Mexico's ratings were "over-rated" relative to peer metrics.

Peer Comparison: Net Tax Supported Debt per Capita

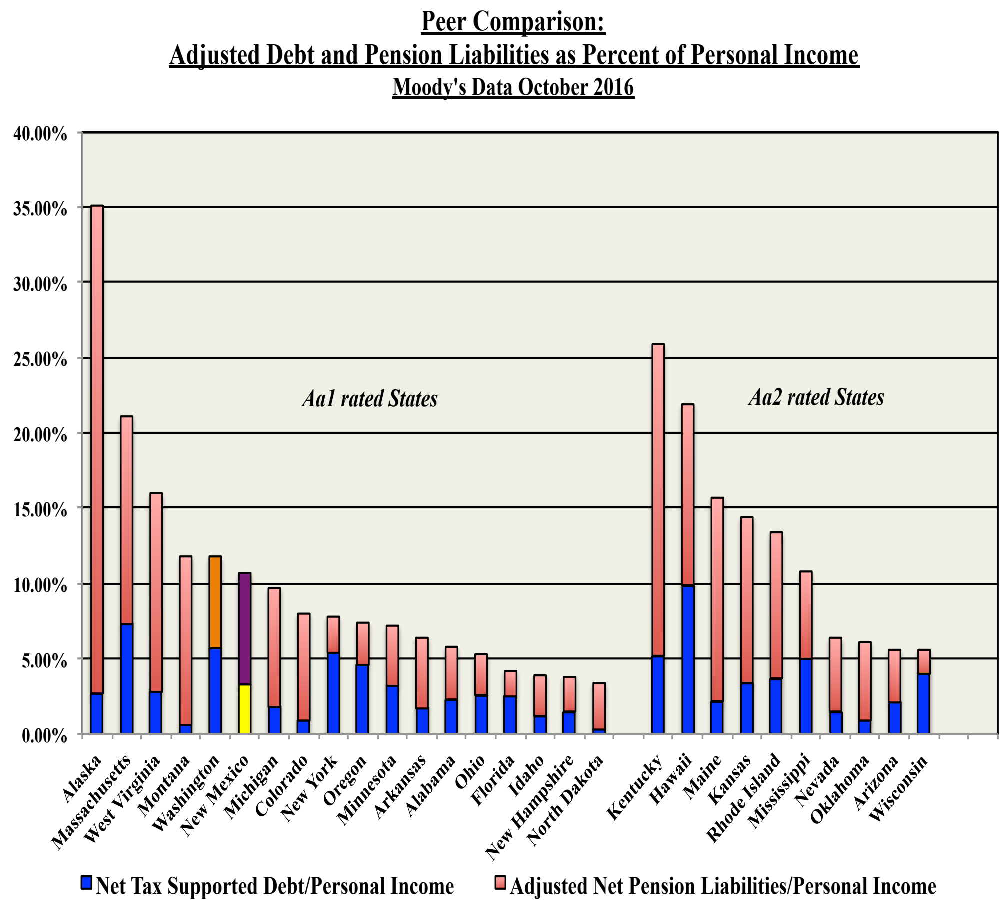


Peer Comparison: Net Tax Supported Debt as Percent of Personal Income



Impact of Pension Obligations on Debt Ratios

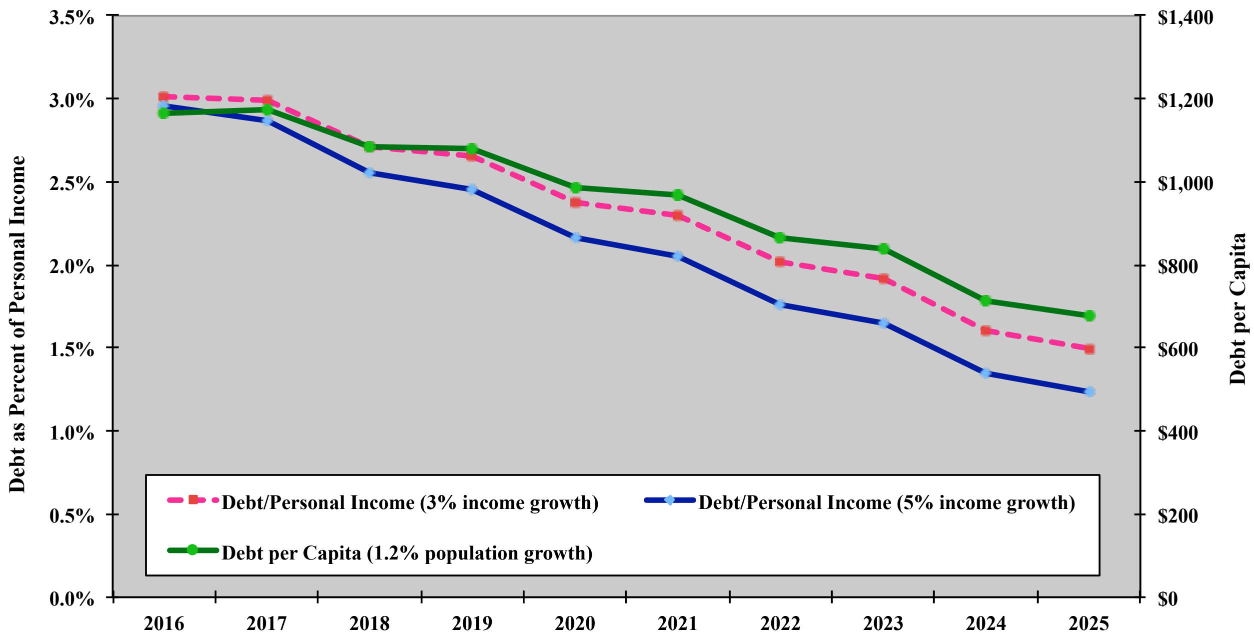
- Actuaries calculate New Mexico pension liabilities based upon a 7.75% "actuarial" investment return rate.
- Moody's recalculates State unfunded pension liabilities based on high-grade bond rate in range of 4.4% to compare liabilities across states. This increases present value of unfunded liabilities.
- "Actuarial" 7.75% rate of return equates to $3.6 billion in unfunded pension liabilities, while Moody's adjusted 4.4% rate of return equates to $10.2 billion unfunded pension liabilities.
- Allocates pension liabilities to each responsible level of government (State, local, schools).
- Net pension liability for New Mexico, which is comparable to long-term debt, is more than twice its outstanding bonded indebtedness.



Projected Debt Ratios Project As Stable Over Time

- Notwithstanding the rating downgrades, projected statewide debt ratios remain stable.
- Debt ratios continue to trend downward.
- Projected ratios indicate affordability of projected capacity from the perspective of debt ratio impacts.

Historical and Projected Debt Ratios



Key Future Bond Rating Issues

- The SBOF's projects the availability for authorization of $2.4 billion of new GOB and senior STB long-term bonds over the next 10 years.
- The projected debt capacity of these core State bonding programs does not materially impact the challenges facing the State General Fund.
- The State's historically strong General Fund reserves were substantially depleted and are now beginning to replenish. Restoring reserve levels toward the target 10% reserve level over the next few years will be essential to stability of GOB ratings.
- The State's GOB debt ratios are within the range of its peer group in the wake of the bond rating downgrades, while they remain above national median levels.
- The STB program has been negatively impacted by natural resource pricing over the past two years, though this has been offset to some extent by an uptick in production activity. The program will continue to be impacted by any future pricing declines.
- Management of pension fund liabilities, and resolving the longstanding issues with respect to the timing and quality of the State CAFR remain key credit issues.