Memorandum

To: Members of the New Mexico Finance Authority Legislative Oversight Committee
From: John Gasparich, Interim Chief Executive Officer
Marquita Russel, Chief of Programs
Date: October 12, 2012
Re: Measuring the Impacts of Any Reallocation of Governmental Gross Receipts Tax

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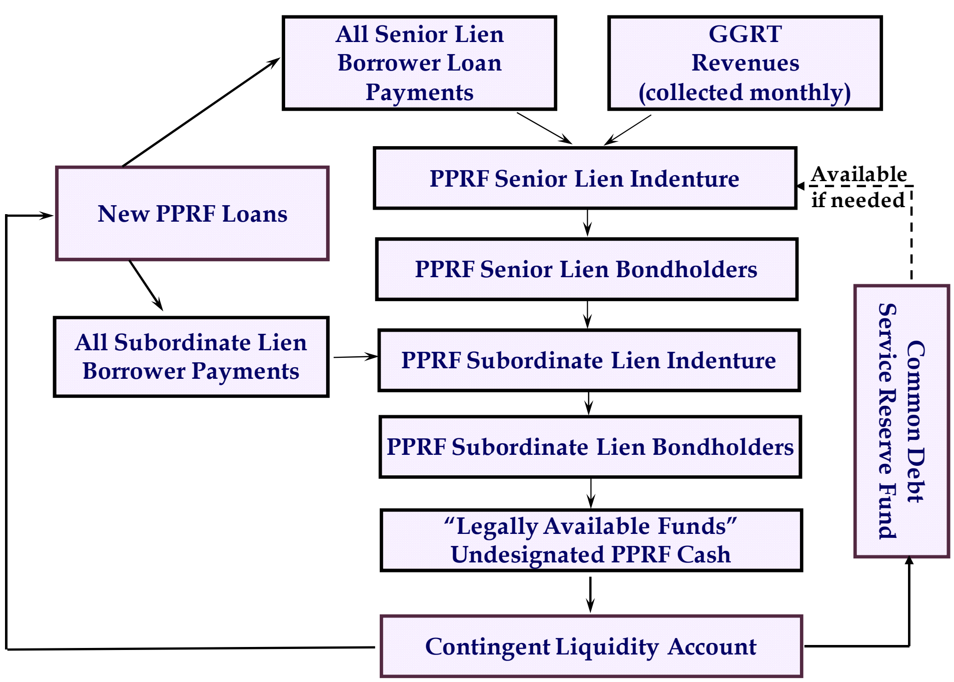
Issue:

Discussion of possible impacts resulting from any reallocation of the Governmental Gross Receipts Tax (GGRT) from NMFA's Public Project Revolving Fund (PPRF).

Background:

By law, the PPRF receives 75% of the State's GGRT, which is levied on government-provided goods and services, such as refuse collection and disposal, sewage services and water sales. Pursuant to the PPRF's bond indentures which date back to the program's first bond issue in 1995, the GGRT is available to pay bondholders should there be insufficient funds from loan repayments. Over time, the indenture has been amended to provide for a Contingent Liquidity Account and a Common Debt Service Reserve Fund which provide additional strength to the PPRF program as they serve as potential sources of bond payments should there be insufficient funds from either GGRT or loan repayments. Currently, the bond indentures provide for the following flow of funds:

PPRF Flow of Funds



The NMFA has been asked to comment on the potential impacts on the PPRF from the potential reallocation of GGRT. Such a reallocation could occur under two scenarios:

Scenario 1: GGRT is no longer distributed to the PPRF; or
Scenario 2: GGRT is appropriated out of the PPRF after bondholders are paid.

There are three issues to consider in determining the impacts of either of scenario:

1) Bondholder lawsuits from the impairment of debt;
2) Additional Bonds Tests; and
3) Ratings Test.

Impairment of Debt

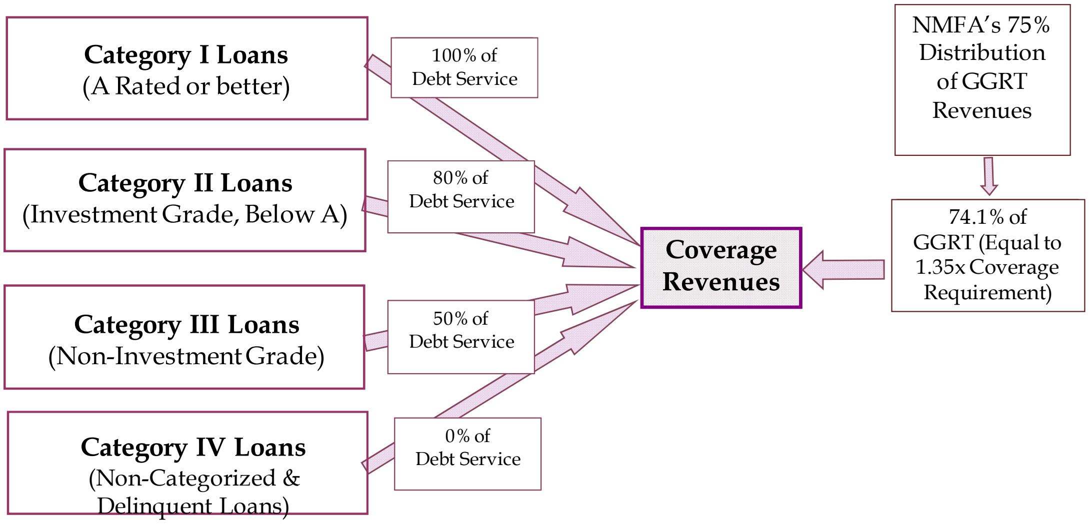
Section 7-1-6.38, the statute that directs the distribution of GGRT, states clearly that the State will not take action to diminish the GGRT while bonds are outstanding. Specifically, "The state pledges to and agrees….that the state will not limit, reduce or alter the distribution of the net receipts attributable to the governmental gross receipts tax to the NMFA… until the bonds or notes together with the interest thereon are fully met and discharged. The NMFA (is) authorized to include this pledge and agreement of the state in any agreement with the holders of the bonds or notes." The bondholders have been pledged, through the PPRF program's General Indenture, 75% of the GGRT collections. The NMFA has included the permitted non-impairment pledge on all PPRF bonds issued under the Indenture.

Further, the Non-Impairment Clause of the New Mexico Constitution, Article II, Section 19, expressly prevents the legislature from taking any action that impairs existing contractual relationships. The NMFA has been able to effectively market its bonds in the municipal bond markets because it represented to the bond purchasers that the State would take no action to impair the contractual relationship. Holders of the $1.165 billion of outstanding PPRF bonds, the oldest of which were issued in 2002 may file suit to prevent any reallocation of GGRT from the PPRF, in order to protect their contractual rights. A violation of that pledge not only impacts the NMFA's current bonds but also adversely impacts the ability of the NMFA, as well as the State and its political subdivisions, from effectively participating in the municipal bond market.

The potential for a lawsuit is greater if the GGRT is no longer pledged to the PPRF. Redirecting GGRT after bondholders get paid may still result in a lawsuit, but the potential is reduced dramatically under this second scenario.

Additional Bonds Test

There are two basic formulas that determine the size of the PPRF program. The first test is the ***Additional Bonds Test*** that is built into the bond indenture. This test was written into the PPRF indenture when NMFA issued its first PPRF bond in 1995. The test requires that the PPRF have one dollar of total discounted revenues for each dollar of debt service on all PPRF bonds outstanding. To help us determine discounted revenue, Moody's Investors Service reviews and categorizes PPRF loans into one of four categories. Depending on the categorization, the PPRF may get credit for 100%, 80% 50% or 0% of the loan repayments from the categorized loan. The PPRF also gets "credit" for approximately 74% of the prior year's GGRT. The total of these two discounted revenues streams must, in every year, be greater than the annual debt service on the existing and proposed bonds in order for the program to issue new bonds. Historically, based on the quality of the PPRF portfolio, the NMFA has received "credit" for more than 90% of the loan repayments received annually.



GGRT Reversion Impact on Additional Bonds Test in Indenture: Without the GGRT, the debt service coverage ratio falls to .866 which means that new bonds cannot be issued and lending would be limited to loan repayments not applied to debt service. If the GGRT is reverted after bonds are issued, the PPRF loses the GGRT flow through which will make it difficult to maintain the 1.0 discounted revenue test. This limited liquidity will result in fewer equity loans and will eliminate Disadvantaged Entity Funding subsidies; lending will likely fall from $200 million per year to $125 million per year.

Ratings Test

The second capacity test is the Ratings Test which basically provides that 100% of the revenues received from annual inflows of GGRT plus 100% of the loan repayments received annually will be sufficient to pay the annual debt service on the existing and proposed bonds with a 1.3 times debt service coverage ratio. This coverage ratio, while not required by the General Indenture, is a level that has allowed the PPRF senior lien program to achieve its current ratings of 'AAA/Aa1' by Standard & Poor's and Moody's, respectively.

GGRT Reversion Impact of Ratings Tests: Without the GGRT, the target ratios fall to 1.12, 1.12. and 1.13 over the next three years. This would result in a decrease in ratings, potentially to the BBB range, and interest costs would increase substantially if bonds could be issued. If the GGRT is reverted after bonds are issued, the PPRF loses the GGRT flow through which will cause the current ratios to fall to 1.2 within the next five years, likely resulting is a drop in ratings as liquidity decreases.

Conclusion:

Even with strong lending policies and a solid track record of quality loans, the Governmental Gross Receipts Tax remains a critical component to the success and capacity of the PPRF. Any action by the Legislature that alters the formula or reduces the amount of GGRT revenues flowing to the PPRF will cause bond market participants to seriously question the commitment of the Legislature and Governor to the program.

New Mexico Finance Authority Quantification of GGRT Reallocation from PPRF

Scenario - NMFA No Longer Receives GGRT

To Issue Bonds	Loan Revenues	Plus	GGRT	Divided By	Bond Debt Service	Equals	Test Ratio	Result
First Test - Indenture Test	Credit at 100%, 80%, 50%, 0% depending on Moody's categorizations	+	Most recent year's GGRT divided by 1.35	/	100% of Annual Debt Service	=	Ratio must at least equal 1.0 every year or bonds cannot be issued. Without GGRT current ratio falls to .866	New bonds cannot be issued. Lending limited to repayments.
Second Test - Ratings Test	Credit for 100% of Loan Revenues	+	Most recent year's GGRT	/	100% of Annual Debt Service	=	Target Ratio is 1.3 in senior lien to maintain ratings. Without GGRT, current ratios fall to 1.12, 1.12, 1.13 next three years.	Ratings would fall, potentially to BBB or A range or lower and interest costs increase substantially if bonds could be issued.

Scenario - Receives GGRT but Flow Through is Reverts to State

To Issue Bonds	Loan Revenues	Plus	GGRT	Divided By	Bond Debt Service	Equals	Test Ratio	Result
First Test - Indenture Test	Credit at 100%, 80%, 50%, 0% depending on Moody's categorizations	+	Most recent year's GGRT divided by 1.35	/	100% of Annual Debt Service	=	Ratio must at least equal 1.0 every year or bonds cannot be issued. With loss of GGRT flow through, keeping ratio at 1.0 is a challenge.	Liquidity and ability to make equity loans decreases. Lending falls from $200M/year to $125M - $150M/year.
Second Test - Ratings Test	Credit for 100% of Loan Revenues	+	Most recent year's GGRT	/	100% of Annual Debt Service	=	Target Ratio is 1.3 in senior lien to maintain ratings. With loss of GGRT flow through, current ratios fall to around 1.2 within 5 years.	Ratings potentially drop to A category within 5 years as liquidity concerns and questions on State commitment to the program drive ratings down.