

— TENTATIVE AND PRELIMINARY DRAFT —
FOR DISCUSSION PURPOSES ONLY

New Mexico Finance Authority
Management's Discussion and Analysis
June 30, 2013

Introduction

This section of the New Mexico Finance Authority's (the "Authority") annual financial statements presents management's discussion and analysis of the Authority's financial position at June 30, 2013 and its financial performance during the fiscal year then ended. This section should be read together with the Authority's financial statements and accompanying notes.

The New Mexico Finance Authority

The Authority was created by the New Mexico State Legislature in 1992 to finance infrastructure projects for the state's counties, cities, school districts and certain departments of the state government. The objective was to provide low-cost financing for borrowers who might not otherwise be able to access the tax-exempt bond market on a cost-effective basis. The 1992 statute created the Public Project Revolving Fund (PPRF) as the vehicle to accomplish this financing objective. As authorized by the statute, the Authority issues tax-exempt PPRF bonds to obtain the funds in which it loans to New Mexico governmental entities. The statute created the Governmental Gross Receipts Tax as a source of funding for Authority operations and to serve as a credit enhancement for the Authority's bonds. Although the legislature has created additional program responsibilities for the Authority, the PPRF remains the core of its activities.

Overview of the Financial Statements

The financial statements have been prepared using the economic resources measurement focus and accrual basis of accounting in accordance with generally accepted accounting principles and include the following three statements:

- ◆ The *Statement of Net Position* presents information on the assets and liabilities of the Authority, with the difference between the assets and the liabilities reported as net position. Over time, increases or decreases in net position serve as a useful indicator of whether the financial position of the funds are improving or deteriorating.
- ◆ The *Statement of Revenues, Expenses and Changes in Net Position* present information reflecting how the net position of the Authority changed during the fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows. Thus, revenues and expenses are reported in the statement for some items that will only result in cash flows in future fiscal periods.
- ◆ The *Statement of Cash Flows* reports the cash flows from operating activities, noncapital financing activities, capital and related financing activities and investing activities, and the resulting impact on cash and cash equivalents for the fiscal year.

As discussed in Note 1, the basic financial statements herein present the financial position, change in financial position and cash flows of the Authority. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. These notes can be found immediately following the financial statements.

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Financial Highlights

- ◆ On August 1, 2012, the criterion for PPRF loans was temporarily amended, placing a lending limit of \$5 million for new loans. The lending protocol was in response to the discovery that the fiscal year 2011 financial statements were falsely represented as audited. The protocol was lifted in March 2013 after the 2011 and 2012 financial statements were audited and approved by the Office of the New Mexico State Auditor. The temporary loan limit impacted activity in several financial areas.
- ◆ The Authority's overall financial position increased slightly in the past year. The key indicator is total net position which increased by \$22.4 million or 5.4%.
- ◆ The Authority's unrestricted cash increased 44.5% or \$35.7 million. Restricted cash increased by 4.1% or \$4.3 million in 2013. Restricted investments increased in 2013 by 4.2% or \$5.3 million.
- ◆ Loans receivable decreased by \$84.3 million or 6.4% in 2013, primarily as a result of diminished loan activity due to the lending protocol in place for seven months during fiscal year 2013.
- ◆ Bonds payable decreased by \$36.7 million or 3.0% in 2013 the result of issuance of \$44.3 million of new bonds, principal payments on outstanding bonds of \$81.4 million, and amortization of bond premium of \$0.4 million.
- ◆ Undisbursed loan proceeds to be provided decreased by \$28.4 million or 38.4% during 2013 indicating reduced loan activity against loan proceeds from borrowers.
- ◆ The Authority's appropriation revenue decreased by \$9.1 million in fiscal year 2013, representing a 21.1% decrease over fiscal year 2012. The decrease reflects a reduction in the Local Transportation Program.
- ◆ The Authority experienced a \$4.0 million or 53.8% decrease in administrative fees revenue from \$7.4 million in 2012 to \$3.4 million in 2013. This drop in revenue was in direct relation to the lending limits that were in place during seven months of the year, as discussed above.
- ◆ Expenses increased 8.0% or from \$105.3 million in 2012 to \$113.8 million in 2013 representing an expected increase of \$8.5 million.
- ◆ Grant revenue and corresponding activity decreased 16.3% or \$6.8 million as the Authority leveled its program grant expenses.
- ◆ No reversions were due to the State General Fund for fiscal year 2013.

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Statement of Net Position

The following presents condensed, combined statements of net position as of June 30, 2013 and 2012, with the dollar and percentage change:

	2013	2012	Net Increase/ (Decrease)	Percentage Increase/ (Decrease)
Assets				
Cash and equivalents				
Unrestricted	\$ 116,073,324	\$ 80,351,262	\$ 35,722,062	44.5%
Restricted	109,965,262	106,424,138	3,541,124	3.3%
Investments – restricted	131,565,455	125,496,887	6,068,568	4.8%
Loans receivable, net of allowance	1,231,232,043	1,315,526,827	(84,294,784)	-6.4%
Intergovernmental receivables	125,274,549	132,180,805	(6,906,256)	-5.2%
Other receivables	10,960,455	11,195,806	(235,351)	-2.1%
Capital assets	220,772	239,589	(18,817)	-7.9%
Other assets	10,284,110	10,878,718	(594,608)	-5.5%
Total assets	<u>\$ 1,735,575,970</u>	<u>\$ 1,782,294,032</u>	<u>\$ (46,718,062)</u>	<u>-2.6%</u>
Liabilities				
Bonds payable, net	\$ 1,180,405,517	\$ 1,217,118,299	\$ (36,712,782)	-3.0%
Undisbursed loan proceeds	45,485,533	73,864,493	(28,378,960)	-38.4%
Advanced loan payments	68,380,111	70,884,890	(2,504,779)	-3.5%
Accounts payable, accrued payroll and compensated absences	831,236	571,388	259,848	45.5%
Other liabilities	4,998,215	6,806,772	(1,808,557)	-26.6%
Total liabilities	<u>1,300,100,612</u>	<u>1,369,245,842</u>	<u>(69,145,230)</u>	<u>-5.0%</u>
Net Position				
Invested in capital assets	220,772	239,589	(18,817)	-7.9%
Restricted for debt service	68,069,252	74,009,248	(5,939,996)	-8.0%
Restricted for program commitments	143,292,282	196,844,296	(53,552,014)	-27.2%
Unrestricted	223,893,052	141,955,057	81,937,995	57.7%
Total net position	<u>435,475,358</u>	<u>413,048,190</u>	<u>22,427,168</u>	<u>5.4%</u>
Total liabilities and net position	<u>\$ 1,735,575,970</u>	<u>\$ 1,782,294,032</u>	<u>\$ (46,718,062)</u>	<u>-2.6%</u>

The Authority's overall financial position increased slightly in the past year. The key indicator is total net position which increased by \$22.4 million or 5.4%.

Assets

Loans receivable decreased by \$84.3 million or 6.4% in 2013. New loans made during the year totaled \$73.7 million; loan payments received were \$155.7 million.

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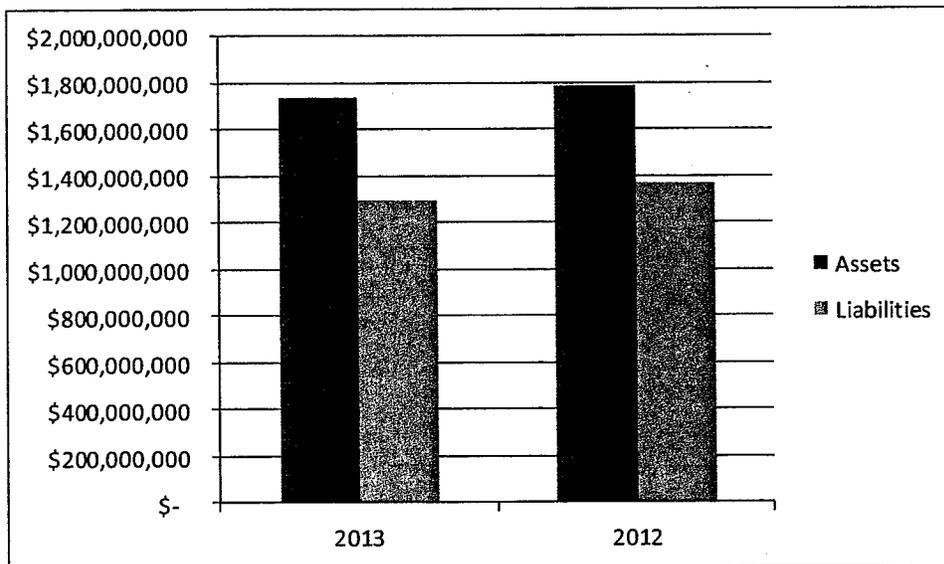
The allowance for loans uncollectible loans increased \$2.3 million due to changes in estimated losses based on the risk evaluations performed by a third party. The number and amount of early loan payoffs decreased significantly from 2012 as interest rates began to stabilize.

Total cash and investments increased 14.5% from \$312.3 million in 2012 to \$357.6 million in 2013 due to the disproportionate number of new loans made and loan payments received compared to debt issued during the year. The majority of the new loans will be reimbursed through the issue of new debt in fiscal year 2014.

Liabilities

Bonds payable decreased by \$36.7 million in 2013 resulting from the issuance of \$44.3 million of new bonds, principal payments on outstanding bonds of \$81.4 million, and amortization of bond premium of \$2.4 million. Undisbursed loan proceeds to be provided decreased by \$28.4 million during 2013 indicating stable draw requests against loan proceeds from borrowers. Advanced loan payments remained fairly constant with a \$2.5 million or 3.5% decrease from 2012.

The following chart indicates ratio of assets to liabilities:



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Statement of Revenue, Expenses and Changes in Net Position

The following table presents the condensed combined statement of revenue, expenses and changes in net position for 2013 and 2012 fiscal years:

	2013	2012	Net Increase/ (Decrease)	Percentage Increase/ (Decrease)
Operating Revenues				
Administrative fees	\$ 3,395,491	\$ 7,352,753	\$ (3,957,262)	-53.8%
Interest on loans	52,942,880	54,459,612	(1,516,732)	-2.8%
Interest on investments	139,403	436,387	(296,984)	-68.1%
Total operating revenues	<u>56,477,774</u>	<u>62,248,752</u>	<u>(5,770,978)</u>	<u>-9.3%</u>
Expenses				
Grants to local governments	\$ 48,828,884	42,063,551	6,765,333	16.1%
Bond issuance costs	752,792	1,272,046	(519,254)	-40.8%
Professional services	3,409,746	2,520,763	888,983	35.3%
Salaries and benefits	3,926,740	3,976,586	(49,846)	-1.3%
Debt service – interest expense	53,026,726	55,005,184	(1,978,458)	-3.6%
Other expense	3,877,739	510,604	3,367,135	659.4%
Total operating expenses	<u>113,822,627</u>	<u>105,348,734</u>	<u>8,473,893</u>	<u>8.0%</u>
Net operating loss	<u>(57,344,853)</u>	<u>(43,099,982)</u>	<u>(14,244,871)</u>	<u>33.1%</u>
Nonoperating Revenues (Expenses)				
Appropriation revenue	34,033,130	43,146,845	(9,113,715)	-21.1%
Grant revenue	48,692,048	41,883,216	6,808,832	16.3%
Reversions and transfers	(2,953,157)	(8,725,047)	5,771,890	-66.2%
	<u>79,772,021</u>	<u>76,305,014</u>	<u>3,467,007</u>	<u>4.5%</u>
Increase in net position	22,427,168	33,205,032	(10,777,864)	-32.5%
Net position, beginning of year	413,048,190	379,843,158	33,205,032	8.7%
Net position, end of year	<u>\$ 435,475,358</u>	<u>\$ 413,048,190</u>	<u>\$ 22,427,168</u>	<u>5.4%</u>

Operating revenue decreased 9.3% to \$5.8 million in 2013. Interest on investments continued to decline, experiencing 68.1% decline in revenues compared to 2012. Appropriation revenue decreased 21.1% while grant revenue increased 16.3%.

Overall operating costs increased 8% due to increased grant expenses of \$6.8 million and a change in estimated loan loss which increased loan losses by \$2.8 million. The estimate change was made based on third party review of the risk of the outstanding direct equity loans and grant expense increasing after a grant activity recovery effort in fiscal years 2011 and 2012.

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Long-Term Debt

The Authority's long-term debt consists of outstanding bond issues related to the various programs administered by the Authority. At the end of fiscal year 2013, the total amount outstanding was \$1.2 billion (excluding the \$1.6 billion in GRIP bonds which are administered by but are not a direct liability of the Authority). More detailed information about the Authority's long-term debt is presented in Note 7 to the financial statements.

During the fiscal year, the Authority issued \$44.3 million in PPRF debt, primarily to directly fund loans and to reimburse the PPRF loan fund for loans already made.

Programs

The Authority accounts for each of its programs separately, each with its own assets, liabilities, net assets, income and expense. The Public Project Revolving Fund is highlighted in the following discussion due to the significance of the program.

Public Project Revolving Fund

The Authority began its existence in 1992 to administer the PPRF. The mission of the PPRF is to make affordable tax-exempt financing for infrastructure projects available to borrowers who could not, on their own, access the bond market on a cost-effective basis. New Mexico's counties, cities and certain departments of state government qualify as entities who can borrow from the PPRF. Departments of state governments and certain not-for-profit entities, including state universities, are also eligible borrowers. Since 1993, the PPRF has made 1,119 loans totaling \$2.4 billion.

The PPRF makes loans of less than \$5 million from its own funds on hand. It then replenishes its cash balance at a later date by "packaging" the loans as collateral and selling tax-exempt bonds. Loans for amounts larger than \$5 million are funded by closing the loans at the same time a reimbursement bond issue closes, thus ensuring a precise matching of loan and bond interest rates.

The PPRF operates, in many respects, in the same manner as a bank or other lending institution. Infrastructure finance agencies similar to the PPRF are often called "bond banks." Financial statements for the PPRF are presented in the following pages in a format similar to that employed by commercial banking organizations.

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Public Project Revolving Fund
Statements of Net Position
June 30

	2013	2012	Net Increase/ (Decrease)	Percentage Increase/ (Decrease)
Assets				
Cash and equivalents				
Unrestricted	\$ 79,007,637	\$ 53,637,734	\$ 25,369,903	47%
Restricted	79,173,378	67,315,479	11,857,899	18%
Restricted investments	130,787,736	125,496,887	5,290,849	4%
Accounts receivable and other	10,367,285	10,494,432	(127,147)	-1%
Loans receivable, net of allowance	1,138,450,511	1,226,886,603	(88,436,092)	-7%
Due from the State of New Mexico	108,025,000	111,305,000	(3,280,000)	-3%
Capital assets	186,696	205,513	(18,817)	-9%
Other assets	22,813,527	26,784,977	(3,971,450)	-15%
Total assets	\$ 1,568,811,770	\$ 1,622,126,625	\$ (53,314,855)	-3%
Liabilities				
Accounts payable and accrued payroll liabilities	\$ 6,202,814	\$ 5,923,640	\$ 279,174	4.7%
Undisbursed loan proceeds	45,423,441	73,787,401	(28,363,960)	-38.4%
Borrowers' debt service and reserve deposits	72,016,499	77,039,173	(5,022,674)	-6.5%
Bonds payable, net	1,165,236,955	1,198,797,118	(33,560,163)	-2.8%
Total liabilities	1,288,879,709	1,355,547,332	(66,667,623)	-4.9%
Net Position				
Invested in capital assets	\$ 186,696	205,513	(18,817)	-9.2%
Restricted for program funds	113,492,695	144,405,478	(30,912,783)	-21.4%
Unrestricted	166,252,670	121,968,302	44,284,368	36.3%
Total net position	279,932,061	266,579,293	13,352,768	5.0%
Total liabilities and net position	\$ 1,568,811,770	\$ 1,622,126,625	\$ (53,314,855)	-3.3%

Loan Volume

	2013	2012	Since Inception
Amount of loans made	\$61.2 million	\$310.0 million	\$2.38 billion
Number of loans made	67	86	1,119
Average loan size	\$0.9 million	\$3.6 million	\$2.1 million

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Public Project Revolving Fund
Statements of Revenue, Expenses and Changes in Net Position
For the Years Ended June 30

	2013	2012	Net Increase/ (Decrease)	Percentage Increase/ (Decrease)
Interest Income				
Loans	\$ 50,708,332	\$ 52,000,267	\$ (1,291,935)	-2.5%
Investments	127,387	276,618	(149,231)	-53.9%
Total interest income	<u>50,835,719</u>	<u>52,276,885</u>	<u>(1,441,166)</u>	<u>-2.8%</u>
Interest Expense				
Bonds	52,317,500	54,039,449	(1,721,949)	-3.2%
Short-term borrowing	94,931	114,479	(19,548)	-17.1%
Total interest expense	<u>52,412,431</u>	<u>54,153,928</u>	<u>(1,741,497)</u>	<u>-3.2%</u>
Net Interest Income (Loss)				
Interest income (loss) less interest expense	(1,576,712)	(1,877,043)	300,331	-16.0%
Less provision for loan losses	292,689	1,633,297	(1,340,608)	-82.1%
Net interest loss after provision for loan losses	<u>(1,284,023)</u>	<u>(243,746)</u>	<u>(1,040,277)</u>	<u>426.8%</u>
Noninterest Income				
Loan administration fees	1,659,473	3,366,234	(1,706,761)	-50.7%
Appropriation revenues	26,585,797	27,405,961	(820,164)	-3.0%
Total noninterest income	<u>28,245,270</u>	<u>30,772,195</u>	<u>(2,526,925)</u>	<u>-8.2%</u>
Noninterest Expense				
Salaries and benefits	2,507,794	2,543,974	(36,180)	-1.4%
Professional services	1,633,231	1,075,421	557,810	51.9%
Bond issuance costs	674,703	1,145,628	(470,925)	-41.1%
Other	1,301,970	1,283,993	17,977	1.4%
Total noninterest expense	<u>6,117,698</u>	<u>6,049,016</u>	<u>68,682</u>	<u>1.1%</u>
Excess of revenues over expenditures	20,843,549	24,479,433	(3,635,884)	-14.9%
Transfers to other funds or agencies	193,951	(754,733)	948,684	-125.7%
Increase (decrease) in net assets	<u>21,037,500</u>	<u>23,724,700</u>	<u>(2,687,200)</u>	<u>-11.3%</u>
Net assets, beginning of year	<u>266,579,293</u>	<u>242,854,593</u>	<u>23,724,700</u>	<u>9.8%</u>
Net assets, end of year	<u>\$ 287,616,793</u>	<u>\$ 266,579,293</u>	<u>\$ 21,037,500</u>	<u>7.9%</u>

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Net Interest Income

As a not-for profit lender, the Authority attempts to pass on to its borrowers the same rates it pays on the bonds it issues to provide the funds it loans. Therefore, in its planning and management processes, the Authority attempts to achieve approximately zero net interest income in the PPRF. In 2013, the PPRF had a net interest loss of \$1.3 million, compared to \$.24 million in 2012. This is a result of market conditions in which \$ 111.2 million in PPRF loans exercised their early call in 2012 and 2013 provisions and the Authority relent those loan repayments at moderately lower interest rates. See Note 14 Contingencies – Loan Prepayment and Bond Call Provisions.

Governmental Gross Receipts Tax

The Governmental Gross Receipts Tax (GGRT) is a tax imposed on the gross receipts of municipalities for services rendered to customers such as water, sewer, and solid waste collection. 75% of GGRT collections are appropriated to the PPRF. The Authority's share of GGRT collections was \$27.8 million in 2013, a \$1.6 million increase from the \$26.2 million received in 2012. The GGRT funds are used as follows:

- ◆ As a credit enhancement for the PPRF bonds. In the event of defaults on loans, GGRT funds can be used to make up for any shortfall in funds available for bond payments.
- ◆ To fund loans to borrowers, especially smaller loans which the Authority may choose to not reimburse in a bond issue.
- ◆ To pay operating expenses of the PPRF.

Other Programs

The PPRF accounts for a large portion of total Authority activity. At June 30, 2013, and for the year then ended, the relationships were as follows:

	<u>PPRF</u>	<u>Total Authority</u>	<u>% PPRF</u>
Total assets	\$1.6 billion	\$1.7 billion	94%
Net assets	\$279.9 million	\$435.5 million	64%
Revenues	\$79.0 million	\$139.2 million	57%

There are 14 other programs administered by the Authority, some of which are loan programs and some of which are grant programs.

A decline occurred in grant volume for the Local Government Transportation Fund because most of the funds were appropriated to the Authority on a one-time basis. Most of the funds have been expended, and the program is in its final stages with expected final disbursements by June 2013.

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Similar to the Local Government Transportation Fund, an increase in the Water and Wastewater Project Grant Fund grant activity reflects the fact that the program is closing out its nonrecurring appropriation received from the state legislature and with final expenditures for projects expected by December 2013.

A for profit limited liability company operated by the Authority has been awarded a total of \$156 million allocation of New Markets Tax Credits by the U.S. Treasury Department. Under this program, the Authority can provide federal income tax credits to incentivize businesses to create jobs and otherwise contribute to the economic development of the state. Prior to 2013, the Authority made two awards totaling \$24 million. During 2013, the Authority has made two additional awards totaling \$23 million. The tax credits have no impact on the financial statements of the Authority beyond the expenses incurred to administer the program and the fees charged to applicants and recipients of the credits, which are minimal.

Contacting the Authority's Financial Management

This financial report is designed to provide citizens, taxpayers, customers, legislators, investors, and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. Substantial additional information is available on the Authority's website at www.nmfa.net. If you have any questions about this report or need additional financial information, contact:

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