DEBT POLICIES

FEBRUARY 21, 2012
I. INTRODUCTION

These debt policies have been developed and approved by the New Mexico State Board of Finance (the “Board”) to provide for the effective management of the Board’s debt programs in a manner consistent with applicable laws, industry standards and the maintenance of the highest credit ratings. It is the intention of the Board to oversee the implementation of these policies on an ongoing basis and to assure transparency in and public understanding of State debt management practices.

II. GOVERNING LAWS AND PRINCIPLES

New Mexico laws establish the Board as the issuer of the State’s core bonding programs. These include the General Obligation Bonds, the Senior Severance Tax Bonds, and the Supplemental Severance Tax Bonds.

General Obligation Bonds
General Obligation bonds are a primary source of funds for capital projects statewide. State General Obligation bonds are secured by the full faith and credit of the State and are repaid from a dedicated statewide property tax. Article 9, Section 8 of the New Mexico Constitution limits General Obligation indebtedness to no more than one percent of the assessed valuation of all the property subject to taxation in the state.

In even-numbered years, the New Mexico Legislature authorizes General Obligation Bonds to be voted on in public referendum at the subsequent November general election. General Obligation Bonds that are approved by a majority vote are issued by the Board.

Severance Tax Bonds
The State Severance Tax Bonding Act, Sections 7-27-1 through 7-27-27 NMSA 1978, as amended (the “Severance Tax Bonding Act”) authorizes the Board to issue bonds secured by revenues received by the State into the Severance Tax Bonding Fund, and which include Severance Tax Bonds and Supplemental Severance Tax Bonds. Severance and Supplemental Severance Tax Bonds are repaid from revenues deposited into the Severance Tax Bonding Fund, which primarily include taxes on mineral production in the State.

Severance Tax Bonds are used to finance statewide capital projects, and as a general practice are issued in the spring following the Legislative Session to fund projects that have been authorized by the Legislature and approved by the Governor. Supplemental Severance Tax Bonds are used to fund public school projects approved for funding by the Public School Capital Outlay Council. Public sales of Supplemental Severance Tax Bonds have been infrequent in recent years but, when issued, have historically taken place in the fall.
Senior Long-Term Severance Tax Bond Statutory Capacity
The Severance Tax Bonding Act sets forth a Statutory Issuance Test that limits the amount of Severance Tax Bonds that may be issued in any year. Specifically, that test requires that the Board not issue new Severance Tax Bonds unless the debt service obligation in any future year on all outstanding and newly issued Severance Tax Bonds is not more than 50 percent of the deposits into the Severance Tax Bonding Fund for the fiscal year immediately preceding the issuance of new Severance Tax Bonds.

Supplemental (Subordinated) Long-Term Severance Tax Bond Statutory Capacity
The Severance Tax Bonding Act sets forth a Statutory Issuance Test that limits the amount of Supplemental Severance Tax Bonds that may be issued in any year. Specifically, that test requires that the Board not issue new long term Supplemental Severance Tax Bonds unless the debt service obligation in any future year on all outstanding and newly issued long term Senior and Supplemental Severance Tax Bonds is not more than 62.5 percent of the deposits into the Severance Tax Bonding Fund for the fiscal year immediately preceding the issuance of new Supplemental Severance Tax Bonds.

Covenant to Maintain Debt Service Coverage
In addition to the Statutory Issuance Tests, the Board covenants in the Bond Resolutions that secure the Severance Tax and Supplemental Severance Tax Bonds, that the State will use its best efforts to maintain actual annual debt service coverage in every year of at least 2.00x on all Severance Tax Bonds and 1.60x on all Supplemental Severance Tax Bonds.

Short-Term Severance Tax Note Program and Statutory Capacity
In addition to the issuance of long-term Severance Tax and Supplemental Severance Tax Bonds, on or prior to each December 31st and June 30th, the Board issues short-term Severance Tax and Supplemental Severance Tax Notes to enable the State to utilize additional Severance Tax Bonding Fund revenues available on an annual basis for funding authorized capital projects. The purpose of the Severance Tax Note Program is to make funds in the Severance Tax Bonding Fund that are not needed to fund long-term Severance Tax and Supplemental Severance Tax Bonds available for cash funding of capital projects.

Severance Tax and Supplemental Severance Tax Notes are subject to the Statutory Issuance Tests. Severance Tax Notes can be issued in each fiscal year to the extent that total debt service on Severance Tax Bonds and Notes does not exceed 50 percent of the receipts into the Severance Tax Bonding Fund during the prior fiscal year, and Supplemental Severance Tax Notes can be issued in each fiscal year to the extent that total debt service on Severance Tax and Supplemental Severance Tax Bonds and Notes does not exceed 95 percent of the receipts into the Severance Tax Bonding Fund during the prior fiscal year.

In addition to the issuance limitations and other requirements set out by State and Federal laws, the Board policies with respect to the issuance of debt are guided by the principles
of prudence, cost effectiveness and transparency. The purpose of this Debt Policy is to set forth the parameters for the issuance of debt by the Board, and provide guidance and understanding of Board debt management procedures and practices.

III. DEBT POLICIES

Policy 1: Credit Ratings
It is the objective of the Board to achieve and maintain the highest possible credit rating for the State’s bonds. The Board will continue a practice of full and timely disclosure of information to the rating agencies and to the investor community, and will comply with all regulations and industry standards with respect to primary and secondary market disclosure (see Policy 14: Financial Disclosure below for more information). The Board will work with the Governor’s Office to coordinate annual rating agency and periodic investor meetings in New York or in New Mexico to provide information on policy initiatives and ongoing financial performance and outlook.

The Board, together with the Department of Finance and Administration will continue to work on key areas that have been identified by the rating agencies. These include:

a. Implementing Timely Financial Reporting
b. Creating Policies Regarding the Funding of General Fund Reserves
c. Implementing Multi-Year Financial Planning and Budgeting
d. Monitoring Credit Vulnerabilities to Federal/Sovereign Risk

Policy 2: Capital Planning
Prior to each legislative session, the State Board of Finance provides an estimate of Severance Tax Bond capacity to the legislature. As detailed below, 20 percent of senior Severance Tax Bond capacity is earmarked for water, tribal and colonias projects. Each legislative session, the Legislature considers legislation authorizing specific capital projects to be funded with the remaining 80 percent of senior Severance Tax Bond capacity. Often, negotiation between the Legislative and Executive branches has resulted in the splitting of Severance Tax Bonding capacity between the Governor, who has normally recommended projects addressing statewide infrastructure needs, the House of Representatives, and the Senate. Portions assigned to the House of Representatives and the Senate have sometimes been further split so that each individual legislator has a certain portion to allocate amongst capital projects.

The New Mexico Department of Finance and Administration works with State agencies and local entities each year to develop an Infrastructure Capital Improvement Plan. This five-year plan identifies and prioritizes capital needs and encourages State agencies and local entities to plan for the development of capital improvements to prevent emergency situations and instead allow capital needs to be planned, funded and developed at a pace that sustains State and local activities.

The New Mexico Department of Transportation develops the Statewide Transportation Improvement Program (STIP) annually to allocate capital resources to transportation
purposes. The STIP is a six-year multi-modal transportation preservation and capital improvement program that lists prioritized projects for a three-year funding period and provides information for planning and programming purposes for the subsequent three years. The STIP is a product of the transportation program’s planning process involving local and regional governments, Metropolitan Planning Organizations, Regional Planning Organizations, other State and transportation agencies, and the public.

Subject to certification of need by the Water Trust Board, 10 percent of senior Severance Tax Bond capacity is allocated to the Water Trust Fund for water projects statewide. Subject to certification of need by the Tribal Infrastructure Board, 5 percent of senior Severance Tax Bond capacity is allocated to the Tribal Infrastructure Fund for tribal infrastructure improvements. Subject to certification of need by the Colonias Infrastructure Board, 5 percent of senior Severance Tax Bond capacity is allocated to the Colonias Infrastructure Fund for infrastructure improvements in colonias (small rural communities within 150 miles of the U.S. – Mexico border).

The Public School Capital Outlay Council is responsible for implementing a standards-based process for prioritizing and funding public school capital needs throughout the State. All school facilities are ranked in terms of relative need and resources are directed to schools with the greatest needs. Funding for projects is provided annually through the Supplemental Severance Tax Bonding Program.

The New Mexico Higher Education Department is responsible for the review and prioritization of higher education capital projects for all public four-year, two-year, and constitutional special schools. Based upon this review and prioritization, the recommended capital project funding plan is submitted to the Governor and Legislature for funding.

Policy 3: Debt Affordability and Limits
In an effort to assess the affordability of projected debt issuance, the Board shall conduct a debt affordability study on an annual basis. The study provides a review of the State’s core bonding programs, including the General Obligation Bonds, the Severance Tax Bonds, the Supplemental Severance Tax Bonds, and the Transportation Revenue Bonds, the long-term debt issuance plans, the impact of debt service costs on the State budget, and the impact of debt issuance trends on key bond rating ratios and related metrics. The study serves as a management tool for State policymakers, provides a basis for assessing history and trajectory of the State’s credit position, and compares the State with peer states.

Policy 4: Length of Debt
The State will issue debt in a manner that provides for a fair allocation of costs to current and future beneficiaries and in compliance with applicable federal tax law.

Long-Term Bonds
The State issues General Obligations Bonds and long-term Severance and Supplemental Severance Tax Bonds with a maximum maturity of ten years.
Short-Term Notes
The State issues short-term Severance and Supplemental Severance Tax bonds (as described above in Section II: Governing Laws and Principles) with a maximum maturity of one week.

Policy 5: Debt Structure
The Board structures its long-term bonds so as to minimize the net cost to the State.

General Obligation Bonds are issued with a ten-year term, or other such term as may be provided in the referendum presented to the voters of the State for their approval. Bonds are structured with a level debt service amortization.

As a general practice, both Severance Tax and Supplemental Severance Tax Bonds are sold with a ten-year maximum maturity and a level debt service amortization. The ten-year maximum maturity mirrors the economic life of the underlying oil and gas proven reserves, and is an important factor in the strong bond ratings on the Severance Tax Bonds. In the event the Board issues bonds with a non-level debt service amortization structure, the average life of that bond issue should not exceed the average life of a level debt service amortization structure.

Policy 6: Severance Tax Bonding Capacity
In order to allocate limited bonding capacity for current and future capital needs, the Board determines current year long-term severance tax bonding capacity in a manner that allows for the level allocation of long-term bond issuance over a ten-year horizon. In the event that severance tax bonding capacity calculated in this manner is not fully utilized in a given fiscal year, the Board may determine it is in the best interest of the State to add such unutilized capacity to the following fiscal year.

Policy 7: Variable Rate Debt
While the Board evaluates the cost effectiveness of the use of variable rate debt on an ongoing basis, currently 100 percent of the State’s outstanding General Obligation and Severance Tax Bonds are fixed rate obligations. At no time will the use of variable rate debt exceed 20 percent of the par amount of total debt outstanding.

Policy 8: Use of Derivative Products
The Board may consider the use of derivative products, including interest rate swaps, caps and floors when the use of such products provides an economic benefit to the State that outweighs the risks involved or reduces the risk of existing or planned debt. The following additional requirements must be met in the utilization of such debt management tools:

a. The use of these products must be associated with underlying debt issued by the Board and may not be used for speculative purposes;

b. Master swap agreements shall contain terms and conditions as set forth in the International Swaps and Derivatives Association (ISDA) Master Agreement;
c. When considering the use of these products, the Board will utilize its independent financial advisor and bond counsel to ensure that the State is receiving a fair market value for the contract and that the terms of the contract are reasonable and within the limits of the applicable law and this Board of Finance Debt Policy; and

d. At no time will the notional amount of the derivatives being used exceed 20 percent of the par amount of total debt outstanding;

e. Counterparties must be rated at least “AA-” or “Aa3” by Moody’s, Standard & Poor’s and Fitch, as required by New Mexico Law and Board regulations;

f. Uncollateralized exposure to a single counterparty should not exceed 10 percent of the total par amount of bonds outstanding; and

g. No less than semi-annually, outstanding agreements will be reviewed by the Board’s financial advisor with respect to the following issues: (i) projected and cashflow receipts with respect to basis risk exposure, (ii) worst-case scenario analysis assuming counterparty default, (iii) available cash balances and total unhedged exposure to risks under the contracts, (iv) changes in counterparty rating position, and (v) counterparty collateral requirements, if any.

Policy 9: Cash Financing

State funding of capital projects is provided through a combination of proceeds of long-term bonds, proceeds of short-term Severance Tax notes, and cash funding provided through General Fund appropriations. General Fund appropriations may be provided annually, as the Legislature and the Governor allocate General Fund resources through the annual budget process to finance a portion of the State’s capital investment plan. Cash financing is provided through the semi-annual issuance of Severance Tax and Supplemental Severance Tax Notes, as discussed above.

During Fiscal Years 2007 through 2011, Statewide capital funding, including transportation and New Mexico Finance Authority programs, totaled $4.3 billion. Of this total, 45.9 percent, or $2.0 billion, was provided through cash appropriations or the Severance Tax Note Program.

Policy 10: Informational Presentations

From time to time, the Board may receive presentations from staff of various State entities to remain informed of items affecting the Board’s bonding programs and potential disclosure concerns. The Board may request presentations from, among others:

a. the Public School Facilities Authority to discuss use of Supplemental Severance Tax Bond and Note proceeds;

b. the State Investment Council to discuss performance of the Severance Tax and Land Grant Permanent Funds;

c. the Public Employees Retirement Association, the Educational Retirement Board, and the New Mexico Retiree Health Care Authority to remain informed about actuarial findings related to funds under the management of such entities;
d. the Taxation and Revenue and Energy, Minerals and Natural Resources Departments to discuss trends in tax collections and natural resource production; and

e. the Financial Control Division of the Department of Finance and Administration concerning financial reporting issues.

**Policy 11: Refunding Bonds**
The Board may advance refund bonds or call outstanding bonds prior to their final maturity from time to time to achieve positive net present value savings to the State. Refunding bonds will only be issued when there is a clear economic benefit to the State, and as a general matter the Board seeks to achieve a net present value savings target of 3 percent or greater when considering the issuance of advance refunding bonds. The State also seeks to refund bonds on a current basis at the time of the issuance of new money bonds when a positive net present value can be achieved. The life of any refunding bonds will not exceed the life of the bonds being refunded. The Board evaluates its outstanding bonds on an ongoing basis to identify bond refunding and cash and economic defeasance opportunities.

**Policy 12: Credit Enhancements**
The Board regularly considers the use of credit enhancement, primarily through the use of bond insurance, to reduce the net cost of its debt. As a general matter, the Board pre-qualifies its bonds for bond insurance on a bidder-option basis, and the determination of the cost effectiveness of utilizing such insurance is made through the competitive bid process.

**Policy 13: Method of Sale**
The Board issues its bonds, including current refunding bonds, through a competitive bidding process. The Board sells its bonds through open, online bid platforms and awards the sale of bonds on a lowest true interest cost basis. From time to time, the Board may select an investment banking team for the purpose of the negotiated sale of advance refunding bonds, and may issue advance refunding bonds through a negotiated sale if the Board determines that it is in the best interest of the State.

**Policy 14: Investment of Bond Proceeds**
Bond proceeds are invested with the State Treasurer in the Tax-Exempt and Taxable Bond Proceeds Investment Pools (collectively “BPIP”) as set forth in the State Treasurer’s Investment Policy. The investment objectives of the BPIP are to preserve capital, provide liquidity and generate the highest return possible. All investments are in accordance with the State Treasurer’s Investment Policy, which is approved by the Board.

The BPIP investment strategy is a two-tiered money market and enhanced cash strategy, which aims to (i) preserve capital and provide liquidity by investing in short-term (0 to 3 year) fixed income securities with high investment grade ratings per the State Treasurer’s Investment Policy, and (ii) earn excess returns relative to traditional money market strategies by slightly increasing duration consistent with the timing of the need for funds.
Monthly position reports and quarterly performance reports can be found on the State Treasurer’s website at www.nmstoto.gov.

**Policy 15: Arbitrage Rebate and Tax Compliance**
The Board will fully comply with federal arbitrage rebate regulations, while minimizing the cost of arbitrage rebate and compliance. Through its investments in the BPIP, earnings on invested bond proceeds are allocated and tracked by issue, and invested to the maximum benefit of the State, while assuring the availability of funds in accordance with the disbursement requirements of the projects funded with bond proceeds. Rebate calculations are performed annually, with a five-year report prepared for each tax-exempt issue as required under applicable regulations, and a final report upon the final maturity of the bonds. Arbitrage earnings subject to future rebate are segregated for future payment, and recorded as a liability on the financial accounts of the State. The Board provides arbitrage rebate reports to the IRS for each bond issue as required, and makes rebate payments on a timely basis as required by Federal law.

**Policy 16: Financial Disclosure**
The Board is committed to full and complete financial disclosure, and to full cooperation with rating agencies, institutional and individual investors, State agencies, other levels of government and the general public to share clear, comprehensible and accurate financial information. The Board is committed to meeting secondary disclosure requirements on a timely and comprehensive basis.

It is the Board’s policy to provide full and complete disclosure to bondholders and the investment community on a periodic basis as required by the Securities and Exchange Commission (SEC) Disclosure Rule 15c2-12, SEC Antifraud Provision Rule 10b-5 and Municipal Securities Rulemaking Board (MSRB) Rule G-36. Official statements accompanying Board debt issues and continuing disclosure statements will meet or exceed the minimum standards applicable to each debt issue, as promulgated by regulatory bodies and professional organizations, including the SEC, the MSRB and the Governmental Accounting Standards Board (GASB), and follow Generally Accepted Accounting Principles (GAAP).

**Policy 17: Expert Advisors**
The Board has procured experts to provide financial advisor, bond counsel, disclosure counsel, and arbitrage consulting and compliance services, and will continue to retain qualified experts to provide these services to help remain fully informed of the Board’s fiduciary duties, legal issues related to the issuance of bonds, disclosure obligations, arbitrage rebate liabilities, and matters of post-issuance compliance. The Board will seek advice from its staff and advisors related to implementation of the policies herein when necessary.
Approved by the state Board of finance this 20th day of March, 2012.

Stephanie Schardin Clarke, Director