S&P Global
Ratings

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Summary:
Artesia, New Mexico; Sales Tax

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Summary:

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Credit Profile		
US$6.2 mil gross receipts tax rev bnds ser 2018 due 06/01/2033		
Long Term Rating	A+/Stable	New
Artesia SALESTAX		
Long Term Rating	A+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'A+' long-term rating to Artesia, N.M.'s series 2018 gross receipts tax (GRT) revenue bonds with a par of approximately $6.2 million. At the same time, S&P Global Ratings affirmed its 'A+' long-term rating and underlying rating (SPUR) on the city's existing GRT revenue debt. The outlook is stable.

Although the city's economy is concentrated in the volatile oil and gas sector, which led taxable gross receipts within the city to decline by 29.8% in fiscal 2016 as oil prices fell, maximum annual debt service (MADS) coverage on the city's GRT revenue bonds bottomed out at 2.2x in fiscal 2017, which we still consider strong. We calculate that MADS coverage (based on fiscal 2018 pledged revenues) will be 2.3x following the issuance of the series 2018 GRT revenue bonds. Going forward, we expect that rising oil prices will support the city's GRT revenues in the near term, and that declining debt service after fiscal 2020 will lead to rising MADS coverage.

The city's GRT revenue bonds are secured by a first lien on a 1.225% tax on taxable gross receipts within the city, collected by the state and remitted to the city per state law, which represents a portion of the total 5.125% GRT imposed by the state on local gross receipts. We understand that the state can reduce the share of taxable gross receipts within the city that it remits to the city (i.e., the pledged GRT rate), and that it last did so in 1992, but that separate state legislation prohibits it from doing so if the remitted revenues are pledged for debt service. Pledged revenues do not include a separate municipal GRT imposed by the city. The city has about $19.1 million in parity GRT revenue debt outstanding. We understand that the city will use series 2018 bond proceeds to finance street, water, and sanitary sewer and storm drainage infrastructure improvements.

The ratings reflect our view of the city's:

- Strong, 2.3x MADS coverage based on fiscal 2018 pledged revenues, and
- Strong, 2.0x MADS additional bonds test (ABT).

Partially offsetting these strengths, in our view, is the city's economic concentration in the historically volatile oil and gas extraction sector.

Following the 29.8% contraction in taxable gross receipts in fiscal 2016, the city's taxable gross receipts fell by an additional 8.2% in fiscal 2017 but then rebounded by 13.5% in the first 11 months of fiscal 2018 as oil prices increased.

While the city had conservatively budgeted for a 5.2% decline in GRT revenues in fiscal 2019, we understand that actual GRT revenues have outpaced budgeted revenues by about 33% in first three months of the fiscal year. We expect that the city's taxable gross receipts and GRT revenues will continue to increase over the near term as oil prices continue to rise. That said, the city's GRT base remains concentrated in the volatile mining and oil and gas extraction sector, which accounted for 19.8% of total taxable gross receipts in the first 11 months of fiscal 2018. In comparison, retail trade accounted for 22.1% of the total over the same period and construction accounted for 11.4%.

Fiscal 2019 MADS coverage, based on fiscal 2018 pledged revenues (on a cash basis, as provided by the New Mexico Taxation and Revenue Department), is strong, in our view, at 2.3x including debt service on the series 2018 bonds. Pledged revenues currently include "hold harmless" distributions from the state, which compensate municipalities for lost GRT revenues due to 2004 state legislation that removed certain food and medical transactions from the GRT base. However, the state began phasing out these hold harmless distributions in fiscal 2016, and they will be fully phased out by fiscal 2030, although the phase-out legislation states that hold harmless distributions will be maintained if the phase-out would impair a municipality's ability to pay debt service. The phase-out legislation also allows cities to levy up to an additional three-eighths GRT increment to offset the loss of hold harmless distributions; Artesia has opted to levy a two-eighths GRT increment under this provision, but revenues from this local-option levy are not pledged to the GRT revenue bonds' repayment. Assuming the full loss of hold harmless distributions, fiscal 2018 pledged revenues would cover MADS (which occurs in fiscal 2020) by a still-strong 2.2x.

The city's ABT is strong in our view, requiring 2.0x coverage of future MADS by pledged revenue received by the city in the immediately preceding fiscal year. Debt service on the bonds is structured to decline starting in fiscal 2021. We understand that the city currently has no plans to issue additional parity debt.

In fiscal 2017, the most recent audited year, pledged revenues represented 40.7% of total general fund revenues. Artesia's available general fund balance as of fiscal year-end 2017 was $15.8 million, which we consider very strong at 85.1% of adjusted expenditures. The city has historically carried strong year-end fund balances in excess of the state-required minimum.

The city deposits pledged revenues into the fund that pays debt service monthly, and has excess revenues available for general purposes. There will be no initial debt service reserve, but the bond ordinance provides for the funding of a springing reserve of 2.0x MADS if pledged revenues in any fiscal year fall lower than 2.0x MADS. In such a case, the springing reserve is to be funded from excess pledged revenues in 12 roughly equal monthly installments. We view such a reserve as providing limited additional security because it would place additional liquidity demands on the city at a time when coverage would already be stressed.

The city issued a series 2013 GRT bond as a direct-purchase placed with the Bank of Albuquerque. We have reviewed the bond transcripts and do not believe that any provisions of the bond ordinance, sale resolution, or purchase agreement pose a contingent liquidity risk to the city. Acceleration is not a remedy for default under the ordinance. We understand that the city has not issued any direct purchase or private placement debt since the series 2013 bond.

Artesia, with a population 2017 population of about 12,700, is located in southeastern New Mexico, about 240 miles southeast of Albuquerque and between the cities of Roswell and Carlsbad. The area economy is limited and has historically been dominated by oil and gas production, but participates in the farming and dairy industries to a lesser extent. The city is home to a federal law enforcement training center (one of four such centers in the U.S.) that has capacity to train about 1,400 students at a time year-round. Per capita effective buying income and retail sales are good, in our opinion, at 96% and 125% of the national levels in 2017, respectively. Partly due to a local economy rooted in the mining and oil and gas sectors, unemployment rates in the area have historically been lower than the state's overall and comparable to national rates; county unemployment was 4.0% for the year ended July 2018.

Outlook

The stable outlook reflects our expectation that the city will maintain strong debt service coverage, supported by rising oil prices in the near term and a strong ABT. However, we also expect that the city's economy will remain concentrated in oil and gas extraction, resulting in a volatile GRT base. Accordingly, we do not expect to change the ratings within the next two years.

Upside scenario

We could raise the ratings if the city's economy were to diversify significantly while the city maintains debt service coverage at or above current levels.

Downside scenario

We could lower the ratings if a renewed decline in oil prices causes debt service coverage to fall below 2.0x MADS.

Related Research

Special Tax Bonds: U.S. Recovery Underpins The Sector's Stability, Sept. 14, 2015

Ratings Detail (As Of September 25, 2018)		
Artesia sales tax (BAM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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