

RatingsDirect®

Summary:

Artesia, New Mexico; Sales Tax

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Summary:

Artesia, New Mexico; Sales Tax

Credit Profile

US\$11.67 mil gross rcpt tax rfdg rev bnds ser 2019 due 06/01/2029

Long Term Rating

AA-/Stable

New

Artesia SALESTAX

Long Term Rating

AA-/Stable

Upgraded

Rationale

S&P Global Ratings raised its rating on the city of Artesia, NM.'s gross receipts tax revenue bonds to 'AA-' from 'A+'. S&P Global Ratings also assigned its 'AA-' rating on the city's series 2019 gross receipts tax refunding revenue bonds. The outlook is stable.

We rate the bonds under our "Priority-Lien Tax Revenue Debt" criteria (published Oct. 22, 2018, on RatingsDirect), which factors in both the strength and stability of the pledged revenue, as well as the general credit quality of the municipality where taxes are distributed and collected (the obligor's creditworthiness).

The upgrade of the city's gross receipts tax revenue bonds reflects our application of the "Priority-Lien Tax Revenue Debt" criteria and our assessment of the strong historical coverage level and the 2x additional bonds test (ABT), supporting future coverage. The priority-lien rating on these bonds is not limited by our view of the obligor's creditworthiness.

The series 2019 bonds are secured by gross receipts tax revenues distributed to the city from the state. The bonds feature an ABT that allows the city to issue additional parity debt if pledged revenue from the previous year provides at least 2x maximum annual debt service (MADS) coverage on existing and proposed bonds.

Key credit considerations include:

- The city's very weak-to-weak economic base,
- Our view that nationwide sales taxes have historically demonstrated low volatility, and
- The city's very strong coverage and liquidity.

Economic fundamentals: Very weak to weak

Artesia is in Eddy County, in southeastern New Mexico. The city's per capita income is an adequate 96% of the national level. However, the taxing base is only supported by a population of 12,472. The small taxing boundary population and the lack of a broad and diverse metropolitan area to provide additional employment opportunities combine to provide an increased risk of volatility, and are the basis for our assessment of the economy as very weak to weak.

Coverage and liquidity: Very strong

We view Artesia's coverage and liquidity as very strong. The coverage on the bonds has been historically well above the 2x ABT, with a current MADS coverage of 2.8x strengthening our assessment. Recent sales tax trends and a front-loaded debt service schedule support our view that coverage is expected to remain very strong.

Artesia's sales tax revenues grew significantly from 2016 to 2017, increasing 20%. Officials anticipate sales tax growth will continue as the oil and gas industry remains strong in the area, combined with the growth from Carlsbad stimulating development. Officials report current-year sales tax collections are up an additional 30% from the prior year. Excess revenue not necessary for annual debt service payments can be used for any legal purpose and is relied on for general operating revenues, limiting the incentive to bond down to the ABT. The city may issue the additional authorized parity bonds if the prior year's pledged sales-and-use tax revenues provide a minimum 2x MADS coverage. We expect coverage to remain very strong given revenue growth trends.

Volatility: Low

We assess the volatility of revenues to determine the likelihood of the availability of revenues during different economic cycles. We have two levels of volatility assessment: macro and micro.

On a macro level, we consider sales tax revenues to have a low historical volatility assessment, given that the demand for goods and services taxed are expected to remain relatively stable throughout various economic cycles. Nationwide, these taxes have historically remained relatively stable with notable periods of fluctuation, including during the recession in 2009. Future shifts, if any, in purchasing habits are not expected to weaken economic activity.

On a micro level, using the history of tax collections, we believe historical volatility in sales tax revenues worsens the macro assessment of volatility as low. While pledged collections have fluctuated in the past, based on historical trends, we expect that usage in Artesia will remain relatively stable.

Rating linkage to Artesia

We assess Artesia's general operations because we view overall creditworthiness as a key determinant of an obligor's ability to pay all of its obligations, including bonds secured by a special tax.

We consider Artesia's economy adequate based on income levels and market value. The city has maintained very strong budgetary flexibility and liquidity despite weak financial performance in previous years due to spending down reserves for capital projects. Officials anticipate more limited capital spending, and do not expect to significantly draw on reserves over the next two years. In our view, Artesia's debt and contingent liability profile is weak. We view the moderately high annual fixed costs of debt and a volatile economy leading to weak budgetary performance in the past as limiting the rating.

Outlook

The stable outlook reflects our view of the very strong coverage levels and strong bond provisions, including an ABT of 2x, limiting additional debt issuance. While we view the very weak-to-weak economy to be a limiting factor to the ratings, we consider recent growth and expected development as moderately stabilizing. For these reasons, we do not expect to change the rating during the two-year outlook horizon. However, in line with our criteria, we believe there is

a link between the attributes of the priority-lien pledge and the creditworthiness of the obligor, the city of Artesia. Therefore, in some cases, movement in the priority-lien rating could be dictated or limited by movement in the obligor's creditworthiness.

Upside scenario

All else remaining equal, we could raise the rating if Artesia experiences significant economic expansion and diversification, increasing sales tax revenues and improving coverage levels, accompanied by stability in the city's creditworthiness.

Downside scenario

Conversely, if actual coverage deteriorates on any of the bonds to a level we no longer consider to reflect the current rating, or Artesia's creditworthiness deteriorates, we could lower the rating. We believe any weakening in gross receipts tax revenues would weaken the city's creditworthiness before negatively pressuring coverage levels on the bonds.

Ratings Detail (As Of March 27, 2019)		
Artesia sales tax (BAM)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Upgraded
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<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Upgraded
Many issues are enhanced by bond insurance.		

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