

**RATING ACTION COMMENTARY**

**Fitch Downgrades Santa Fe, NM IDR, GO, and GRT Bonds to 'AA' on Criteria Change; Outlook Stable**

Wed 18 Sep, 2024 - 3:16 PM ET

Fitch Ratings - Austin - 18 Sep 2024: Fitch Ratings has downgraded the following ratings of Santa Fe, NM to 'AA' from 'AA+' due to criteria changes:

- Long-Term Issuer Default Rating (IDR);
- Outstanding general obligation (GO) bonds;
- Outstanding gross receipts tax (GRT) revenue bonds;
- Outstanding subordinate lien GRT revenue bonds.

The Rating Outlook is Stable. The ratings have been removed from Under Criteria Observation.

**RATING ACTIONS**

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕
Santa Fe (NM) [General Government]	LT IDR AA Rating Outlook Stable	Downgrade AA+ Rating Outlook Stable
Santa Fe (NM) /General Obligation - Unlimited Tax/1 LT	LT AA Rating Outlook Stable	Downgrade AA+ Rating Outlook Stable
Santa Fe (NM) /Special Tax Obligations - Subordinate Lien/2 LT	LT AA Rating Outlook Stable	Downgrade AA+ Rating Outlook Stable
Santa Fe (NM) /Special Tax Obligations/1 LT	LT AA Rating Outlook Stable	Downgrade AA+ Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

The downgrade of the IDR, GO, GRT, and subordinate lien GRT ratings to 'AA' from 'AA+' reflects the implementation of Fitch's new U.S. Public Finance Local Government Rating Criteria. The IDR, which serves as the cap for the security ratings, incorporates the city's financial resilience assessment of 'aaa' based on a 'high midrange' level of budgetary flexibility and

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The IDR also incorporates a -1 notch Additional Analytical Factor (pension contributions) reflecting the city's underfunding of its actuarially determined pension contributions and the prolonged amortization periods for two of its three pension plans, recognizing that the city participates in a cost-sharing multiple-employer plan, contribution levels are established by state statute, and require legislative action to adjust their levels.

The 'AA' rating on the senior lien GRT revenue bonds factors in the structure's ample resilience to revenue declines and strong additional bonds test (ABT) provisions, which are balanced against slow revenue growth prospects notwithstanding recent post-pandemic surges. The GRT revenue bond rating is capped at the city's IDR as Fitch does not assume that the pledged GRTs would be protected from the operating risk of the city in the event of a city bankruptcy.

The 'AA' rating on the subordinate lien GRT revenue bonds highlights the structure's ample resilience to revenue declines and strong ABT provisions, which are balanced against the prospects for slow revenue growth notwithstanding recent post-pandemic surges. The GRT revenue bond rating is capped at the city's IDR as Fitch likewise does not assume the pledged GRTs would be protected from the operating risk of the city in the event of a city bankruptcy. Because the debt service cushion and legal protections are not materially weaker for the subordinate lien compared to the senior lien, Fitch does not make a rating distinction between the two liens.

## **RATING SENSITIVITIES**

### **Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade**

For the IDR and GO ratings:

--Sustained declines in available general fund reserves to below 10% of spending, which would reduce the city's financial resilience assessment to below 'aaa';

--A sustained 25% increase in the long-term liability burden assuming current levels of personal income and governmental resources;

--Weakened underlying demographic and economic performance including, but not limited, to rising unemployment relative to the nation average or lower resident income relative to the Fitch portfolio median.

### **Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade**

For the GRT dedicated tax bonds:

--Large and sustained GRT revenue declines or greater than expected leverage that reduces maximum annual debt service (MADS) coverage to below 1.5x;

--Negative rating action on the IDR.

### **Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade**

For the IDR and GO ratings:

--A sustained 50% decrease in the long-term liability burden assuming current levels of personal income and governmental resources;

--Legislative changes that provide for full funding of actuarially determined contributions to the city's three pension plans and a reduction in the amortization period to 30 years or lower for the municipal police and fire fighter plans.

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--Positive rating action on the IDR concurrent with maintenance of MADS coverage of 1.7x or higher.

## SECURITY

The GO bonds are payable from an annual unlimited property tax levy. The senior lien GRT revenue bonds are payable from pledged revenues comprised of the 1.225% state shared, 0.5% municipal and 0.0625% infrastructure gross receipts taxes. The subordinate lien GRT revenue bonds are payable from a subordinate lien on the aforementioned pledged revenues.

## FITCH'S LOCAL GOVERNMENT RATING MODEL

The Local Government Rating Model generates Model Implied Ratings, which communicate the issuer's credit quality relative to Fitch's local government rating portfolio. (The Model Implied Rating will be the Issuer Default Rating except in certain circumstances explained in the applicable criteria.) The Model Implied Rating is expressed via a numerical value calibrated to Fitch's long-term rating scale that ranges from 10.0 or higher (AAA), 9.0 (AA+), 8.0 (AA), and so forth down to 1.0 (BBB- and below).

Model Implied Ratings reflect the combination of issuer-specific metrics and assessments to generate a Metric Profile and a structured framework to account for Additional Analytical Factors not captured in the Metric Profile that can either mitigate or exacerbate credit risks. Additional Analytical Factors are reflected in notching from the Metric Profile and are capped at +/-3 notches.

## RATINGS HEADROOM & POSITIONING

Santa Fe Model Implied Rating: 'AA' (Numerical Value: 8.33)

-- Metric Profile: 'AA+' (Numerical Value: 9.33)

-- Net Additional Analytical Factor Notching: -1.0

Individual Additional Analytical Notching Factors:

-- Pension Contributions: -1.0

Santa Fe's Model Implied Rating is 'AA'. The associated numerical value of 8.33 is at the lower end of the 8.0 to 9.0 range for its current 'AA' rating.

## KEY RATING DRIVERS

### FINANCIAL PROFILE

#### Financial Resilience - 'aaa'

Santa Fe's financial resilience is driven by the combination of its 'High' revenue control assessment and 'Midrange' expenditure control assessment, culminating in a 'High Midrange' budgetary flexibility assessment.

-- Revenue control assessment: High

-- Expenditure control assessment: Midrange

-- Budgetary flexibility assessment: High Midrange

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-- Five-year low fund balance to expenditure ratio: 27.7% (2023)

### Revenue Volatility - 'Weak'

Santa Fe's weakest historic three-year revenue performance has a modest negative impact on the Model Implied Rating.

The revenue volatility metric is an estimate of potential revenue volatility based on the issuer's historical experience relative to the median for the Fitch-rated local government portfolio. The metric helps to differentiate issuers by the scale of revenue loss that would have to be addressed through revenue raising, cost controls or utilization of reserves through economic cycles.

-- Lowest three-year revenue performance (based on revenues dating back to 2005): 9.8% decrease for the three-year period ending fiscal 2011

-- Median issuer decline: -4.5% (2023)

## DEMOGRAPHIC AND ECONOMIC STRENGTH

### Population Trend - 'Weak'

Based on the median of 10-year annual percentage change in population, Santa Fe's population trend is assessed as 'Weak'.

Population trend: 0.5% Analyst Input (29th percentile) (vs. 0.6% 2022 median of 10-year annual percentage change in population)

### Unemployment, Educational Attainment and MHI Level - 'Midrange'

The overall strength of Santa Fe's demographic and economic level indicators (unemployment rate, educational attainment, median household income [MHI]) in 2023 are assessed as 'Midrange' on a composite basis, performing at the 54th percentile of Fitch's local government rating portfolio. This is due to very high education attainment levels offsetting midrange median-issuer indexed adjusted MHI and unemployment rate.

-- Unemployment rate as a percentage of national rate: 105.7% Analyst Input (40th percentile) (vs. 91.7% 2023), relative to the national rate of 3.6%

-- Percent of population with a bachelor's degree or higher: 44.0% (2022) (81st percentile)

-- MHI as a percent of the portfolio median: 93.7% (2022) (40th percentile)

### Economic Concentration and Population Size - 'Strongest'

Santa Fe's population in 2022 was of sufficient size and the economy was sufficiently diversified to qualify for Fitch's highest overall size/diversification category.

The composite metric acts asymmetrically, with most issuers (above the 15th percentile for each metric) sufficiently diversified to minimize risks associated with small population and economic concentration. Downward effects of the metric on the Metric Profile are most pronounced for the least economically diverse issuers (in the 5th percentile for the metric or lower). The economic concentration percentage shown below is defined as the sum of the absolute deviation of the percentage of personal income by major economic sectors relative to the U.S. distribution.

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**Analyst Inputs to the Model**

Analyst inputs to the model reflect metric adjustments to account for historical data anomalies, forward-looking performance shifts, or non-recurring events that may otherwise skew the time series.

The analyst input reflects the use of an average of the unemployment rate for 2019-2023. County medians for New Mexico were used in place of Santa Fe County data for two employment sectors that was not available.

**LONG-TERM LIABILITY BURDEN****Long-Term Liability Burden - 'Strong'**

Santa Fe's carrying costs to governmental expenditures has improved while liabilities to personal income remain midrange and liabilities to governmental revenue remain moderately strong. The long-term liability composite metric in 2023 is at the 61st percentile, indicating a somewhat lower liability burden relative to the Fitch's local government rating portfolio.

-- Liabilities to personal income: 4.9% Analyst Input (54th percentile) (vs. 5.2% 2023 Actual)

-- Liabilities to governmental revenue: 132.4% Analyst Input (72nd percentile) (vs. 138.0% 2023 Actual)

-- Carrying costs to governmental expenditures: 13.5% (2023) (60th percentile)

Long-Term Liability Burden Additional Analytical Factors and Notching: -1.0 notch (for Pension Contributions)

The -1 notch additional analytical factor reflects the fact that the city's statutory pension contributions have been materially below the actuarially determined contribution (ADC) levels for its three New Mexico Public Employee Retirement Association (PERA) plans. Fitch estimates that the city's statutory contributions, as mandated by PERA, have averaged approximately 72% of annual ADC since fiscal 2019, leading to prolonged amortization periods for the municipal police (61 years) and municipal firefighter (infinite) plans.

**Analyst Inputs to the Model**

Analyst inputs to the model reflect metric adjustments to account for historical data anomalies, forward-looking performance shifts, or non-recurring events that may otherwise skew the time series.

The analyst input reflects the amortization of GO and GRT debt scheduled in fiscal 2024.

**DEDICATED TAX SECURITY**

The senior lien GRT revenue bonds are payable from pledged revenues comprised of the 1.225% state shared, 0.5% municipal and 0.0625% infrastructure GRTs.

**DEDICATED TAX KEY RATING DRIVERS**

Fitch expects long-term pledged GRT revenue growth will approximate the rate of inflation based on current and anticipated trends of economic expansion, balanced against the inherent volatility of the city's tourism sector.

Modest debt plans and strong ABT provisions lead Fitch to expect GRT coverage will experience ample resilience to future revenue declines relative to expected revenue volatility through economic cycles.

The rating on the senior lien GRT revenue bonds is capped at the city's IDR. The dedicated taxes pledged to the bonds do not

The bonds are payable from a subordinate lien on pledged revenues comprised of the 1.225% state shared, 0.5% municipal and 0.0625% infrastructure GRTs.

### DEDICATED TAX KEY RATING DRIVERS

Fitch expects long-term pledged GRT revenue growth will approximate the rate of inflation based on current and anticipated trends of solid economic expansion, balanced against the inherent volatility of the city's tourism sector.

Modest debt plans and strong ABT provisions lead Fitch to expect GRT coverage will experience ample resilience to revenue declines relative to expected moderate revenue volatility through economic cycles.

The rating on the subordinate lien GRT revenue bonds is capped at the city's IDR. The dedicated taxes pledged to the bonds do not meet the requirements set out in Fitch criteria for treatment as "pledged special revenue" under section 902(2) of the bankruptcy code and are not otherwise insulated from the operating risk of the city.

### PROFILE

Santa Fe serves as the county seat and state capital and is located in north central New Mexico. The local economy is anchored by the large state government presence and tourism. The estimated 2023 population totals 89,167, a 31% increase from 2010, driven in part by annexation of unincorporated lands surrounding the city.

In addition to the large state government presence, other important sectors include tourism and recreation, retail trade, health care and some industrial activity. Wealth indices for the city are above state averages but moderately below the U.S. average. Assessed Value (AV) has grown moderately in the last few years and ongoing development is expected to maintain the current trajectory.

Strong building activity is evident in both residential and commercial sectors. Multi-family projects comprise the majority of recent residential development either approved or under construction, which totals over 4,575 units. Single-family homes that have been approved or under construction total 528 units.

The city's largest employers include the state of New Mexico and other public entities. The largest private employer is Christus St. Vincent Hospital. Netflix's purchase of a large movie studio in nearby Albuquerque has served to boost Santa Fe's TV and film industry. Los Alamos National Laboratory, located 30 miles away, is expanding with 2,500 employees in 2025, likely benefitting the city's population and economic base. The facility's workforce is expected to expand by a total of 5,000 to 8,000 over the next five years.

### REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

### ESG CONSIDERATIONS

Santa Fe (NM) [General Government] has an ESG Relevance Score of '4' for Data Quality and Transparency due to a history of late audits, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors. Significant recent improvements in the performance of the accounting department, if sustained, may lead to a score of '3' pending the timely publication of future financial audits.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on

**Jose Acosta**

Senior Director

Primary Rating Analyst

+1 512 215 3726

jose.acosta@fitchratings.com

Fitch Ratings, Inc.

2600 Via Fortuna, Suite 330 Austin, TX 78746

**Omid Rahmani**

Associate Director

Secondary Rating Analyst

+1 512 215 3734

omid.rahmani@fitchratings.com

**Michael D'Arcy**

Director

Committee Chairperson

+1 212 908 0662

michael.darcy@fitchratings.com

**MEDIA CONTACTS****Sandro Scenga**

New York

+1 212 908 0278

sandro.scenga@thefitchgroup.com

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**APPLICABLE CRITERIA**[U.S. Public Finance Local Government Rating Criteria \(pub. 02 Apr 2024\) \(including rating assumption sensitivity\)](#)**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.1.0 (1)

U.S. Local Government Rating Model, v1.2.0 (1)

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